

Disappointing Result in a Challenging Operating Environment

INVESTMENT SUMMARY

Nigerian Breweries Plc released its H1'18 unaudited report which shows a lower than expected figure in the top line as revenue declined by 4.34% to ₦183.69 billion (vs. ₦192.02 billion in H1'17). However, due to the newly introduced excise duty regime by the federal government of Nigeria in June 2018, revenue further depleted to ₦172.66 billion in the first half year of 2018, as ₦11.03 billion was taken for excise duty expense. The company attributed the decline in the top line to the new excise duty regime and higher rate of beer introduced by the Federal Government, which impacted on affordability in the period under review. During the first half of 2018, the cost of sales reduced by 2.62% to ₦96.58 billion (vs. ₦99.18 billion recorded in the first half of 2017) but cost of sales to revenue remains a major concern as it increased to 55.94% in H1'18 from 54.80% reported in H1'17. The company was able to monitor its marketing and distribution expenses as it reduced by 0.99% to ₦34.55 billion in H1'18 (vs. ₦34.90 billion in H1'17). On the other hand, administrative expenses increased to ₦10.34 billion in H1'18 (vs. ₦9.41 billion in H1'17), representing an increase of 9.95%. Profit before tax reduced by 19.11% to ₦27.55 billion in H1'18 (vs. ₦34.06 billion in H1'17). A provision of ₦9.11 billion was made for tax in H1'18 (H1'17: ₦10.31 billion) and as a result, profit after tax decreased by 22.38% to ₦18.43 billion in H1'18, from ₦23.75 billion reported in H1'17.

The lower than expected result is reflected on 12-month trailing EPS as it reduced by 16.22% to ₦3.47 from ₦4.14 recorded in the previous period. Based on the recent figures released by the company and challenging operating environment, we downgrade our target price per share to ₦96.34 and as a result, we maintain our **HOLD** rating on the stock.

Fig. 1: Quarterly results highlights

	2Q2018	1Q2018	2Q2017	Q/q Δ	Y/y Δ
Net Revenue (₦mn)	89,693	82,966	89,721	+8.11%	-0.03%
Operating profit (₦mn)	13,952	17,664	20,116	-21.01%	-30.64%
Net profit (₦mn)	8,321	10,204	12,317	-19.33%	-33.18%

Source: Bloomberg, PAC Research

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Price:

- Current	₦103.00
- Target	₦96.34
Recommendation:	HOLD

* As at Friday August 10, 2018

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-43.09%/-23.65%
52-week range	₦193.00- ₦99.00
30-day Average vol.	3,123,213
Shares Outstanding (mn)	7,996.90
Market Cap. (₦bn)	823.68
EPS, ₦- 12months trailing	3.47
DPS, ₦- FY2017	4.13

Source: NSE, Company's Annual Reports, PAC Research

Fig. 3: Key ratios

	H1'18	H1'17
Gross profit margin	44.06%	45.20%
Net profit margin	10.68%	13.12%
Equity multiplier	2.16x	2.19x
Asset turnover	0.47x	0.46x

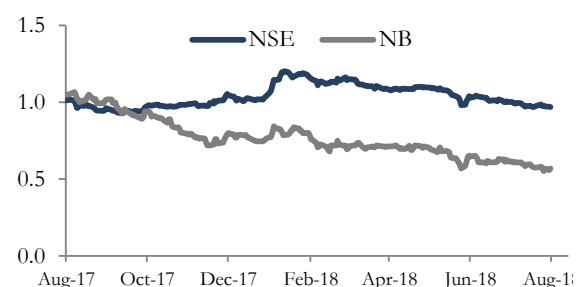
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018F	FY2019F
P/Sales	2.60x	2.39x	2.33x	2.17x
P/E	28.74x	24.92x	22.39x	19.87x
PEG	-1.14x	1.63x	1.98x	1.57x
EV/EBITDA	40.68x	33.40x	29.04x	25.42x
P/B	4.92x	4.62x	4.37x	4.85x
ROE	17.13%	18.54%	20.33%	22.44%
ROA	7.74%	8.65%	9.42%	10.33%
Div. Yield	3.48%	4.01%	4.37%	4.85%

Source: NSE, PAC Research

Fig. 5: NB vs NSE, 52-wk Movement (Rebased)



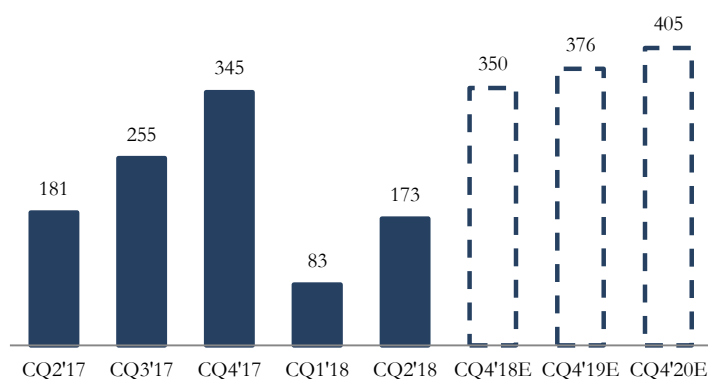
Source: Bloomberg, PAC Research

Newly introduced excise duty weigh on company's performance; net revenue down by 4.60% YoY

During the period under review, revenue declined by 4.34% to ₦183.69 billion (vs ₦192.02 billion in H1'17). However, with the introduction of excise duty by the federal government in June 2018, net revenue of ₦172.66 billion was realised in H1'18 (vs. ₦180.98 billion in H1'17), as ₦11.03 billion was booked for excise duty in H1'18 (H1'17: ₦11.04 billion). The company reported that the new excise duty regime and higher rate of beer introduced by the Federal Government in June 2018 further impacted on affordability in the period under review. In addition, we believe that high competitive environment contributed a lot to the decline in total volume sales in the first half of 2018 as the consumers find it easy to switch over to other related products with affordable prices within the industry.

The company reported that the new excise duty regime and higher rate of beer introduced by the Federal Government in June 2018 further impacted on affordability in the period under review

Fig. 6: Net Revenue – Cum. Quarters - CQ2'17-CQ4'20E (Billion NGN)



Source: NSE, PAC Research

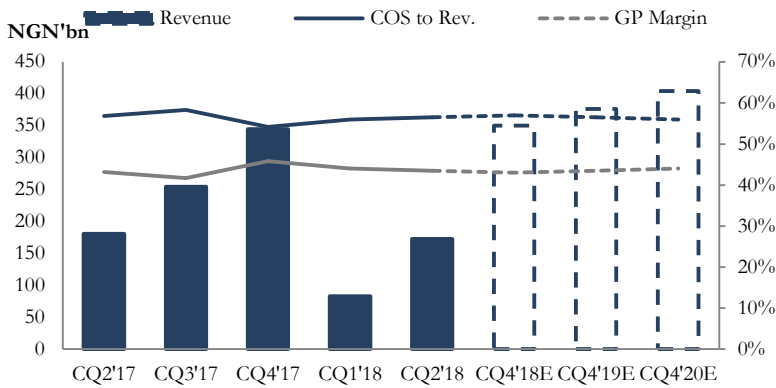
High cost of raw materials and consumables weigh on cost of sales as gross profit declines

Though cost of sales reduced by 2.62% to ₦96.58 billion in H1'18 (vs. ₦99.18 billion in H1'17), sales-to-cost ratio increased to 55.94% in the first half of 2018, from 54.80% achieved in the first half of 2017. However, high cost of raw materials and consumables remains a major challenge in the operating activities of the company. Raw materials and consumables contributed 64.60% to the total cost of sales in H1'18 (vs. 63.00% in H1'17). Cost of raw materials and consumables declined to ₦62.39 billion in the period under review, from ₦62.48 billion reported in the first half of 2017 and this represents a marginal decline of 0.14%.

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Consequently, gross profit declined by 7.00% to ₦76.08 billion in H1'18, from ₦81.80 billion recorded in H1'17.

Fig. 7: Revenue, COS to Rev. and GP Margin - CQ2'17-CQ4'20E



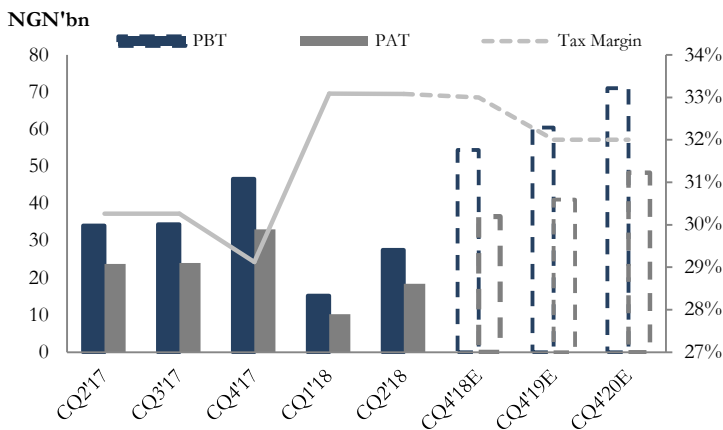
Source: NSE, PAC Research

Insignificant effect of reduced net finance cost on bottom-line as PAT declines by 22.38% YoY

In the first half of 2018, finance income increased by 153.43% to ₦219.72 million (vs. ₦86.70 million in H1'17) while finance costs reduced by 19.80% to ₦4.29 billion (vs. ₦5.35 billion in H1'17). As a result, net finance costs reduced by 22.65% to ₦4.07 billion in H1'18 (vs. ₦5.26 billion reported in H1'17). The reduction in net finance cost did not have any significant effect on the profitability of the company as profit before tax declined by 19.11% to ₦27.55 billion in the first half of 2018 (vs. ₦34.06 billion reported in H1'17). A provision of ₦9.11 billion was made for tax (vs. ₦10.31 billion in first half of 2017) and as a result, profit after tax reduced by 22.56% to ₦18.43 billion in H1'18 (vs. ₦23.75 billion in H1'17)

The reduction in net finance cost did not have any significant effect on the profitability of the company as profit before tax declined by 19.11% to ₦27.55 billion in the first half of 2018)...

Fig. 8: PBT, PAT and Tax Margin - CQ2'17-CQ4'20E



Source: NSE, PAC Research

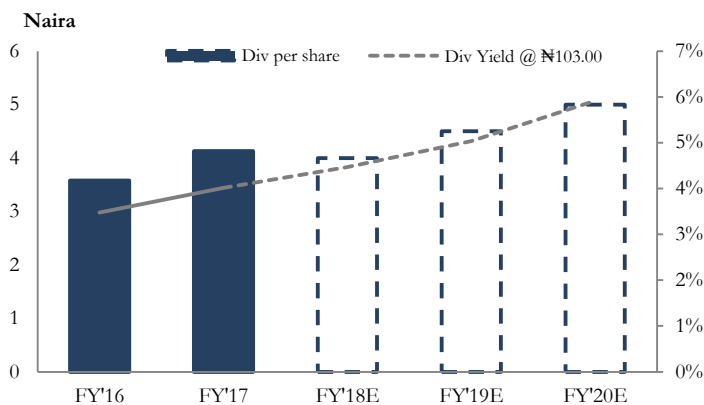
Balance sheet remains strong; lower dividend payment is expected in FY'18

During the period, the company's total assets decreased by 4.99% to ₦369.80 billion (vs. ₦389.21 billion in H1'17) while total liabilities reduced by 6.12% to ₦198.31 billion H1'18 (vs. ₦211.24 billion in H1'17). Consequently, net assets declined by 3.64% to ₦171.49 billion in first half of 2018, from ₦177.96 billion achieved in the first half of 2017. Net Assets Per Shares (NAPS) of the company reduced by 3.64% to ₦21.45 in H1'18 (vs. ₦22.26 realised in H1'17).

With this strong balance sheet position of the company, we do not expect the company to pay higher dividend in full year of 2018 as the 12-month trailing EPS remains at ₦3.47 in first half of 2018 (vs. ₦4.14 recorded in the first half of 2017).

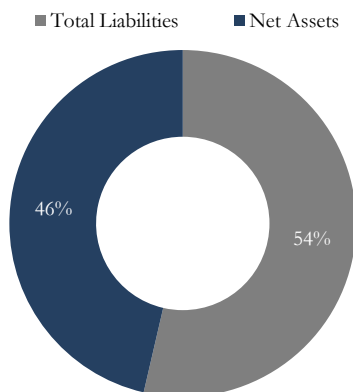
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Fig. 9: Dividend Per Share and Dividend Yield - CQ2'17-CQ4'20E



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in H1'18



Source: NSE, PAC Research

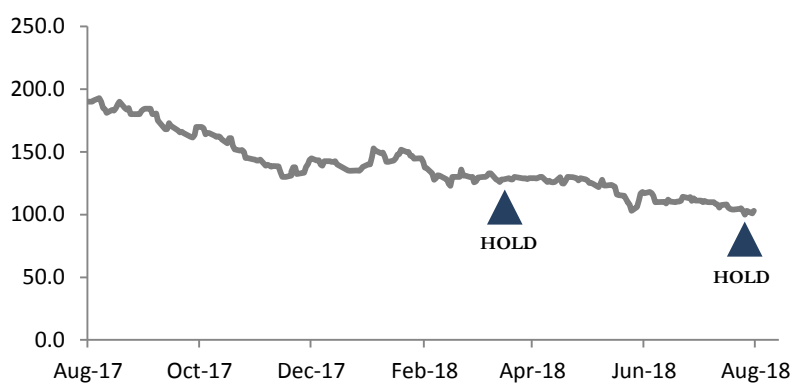
Valuation

Our valuation puts the target price of the stock at ₦96.34 and this shows that the stock is overvalued by 6.47% at current price of ₦103.00. In arriving at the target price, we employed discounted cashflow valuation methodology. Consequently, we maintained **HOLD** recommendation on the stock of the company.

Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company, the challenging operating environment in Nigeria, increased competition within the industry and a cautious outlook from the management.

Our valuation puts the target price of the stock at ₦96.34 and this shows that the stock is overvalued by 6.47% at current price of ₦103.00

Fig. 11: Share Price History



Source: NSE, PAC Research

Fig. 12: Statement of Profit or Loss, N'mn

	2016	2017A	2018F	2019F
Revenue	313,743	344,563	350,076	376,331
<i>Change</i>		9.82%	1.60%	7.50%
Cost of sales	178,219	201,013	197,793	214,509
<i>Change</i>		12.79%	-1.60%	8.45%
Gross profit	135,525	143,549	152,283	161,822
<i>Change</i>		5.92%	6.08%	6.26%
Other income	616	2,219	700	753
<i>Change</i>		260.36%	-68.44%	7.50%
Marketing & Distr. Exp.	61,312	66,899	68,265	69,621
<i>Change</i>		9.11%	2.04%	1.99%
Administrative expenses	21,925	21,748	21,705	23,333
<i>Change</i>		-0.81%	-0.20%	7.50%
Results from op. activities	52,903	57,121	63,014	69,621
<i>Change</i>		7.97%	10.32%	10.49%
Net Finance costs	13,229	10,491	8,577	9,182
<i>Change</i>		-20.69%	-18.25%	7.06%
Profit Before Taxation	39,675	46,630	54,437	60,439
<i>Change</i>		17.53%	16.74%	11.03%
Taxation	11,258	13,581	17,964	19,340
<i>Change</i>		20.64%	32.27%	7.66%
Profit After Taxation	28,417	33,049	36,473	41,098
<i>Change</i>		16.30%	10.36%	12.68%

Fig. 13: Statement of Financial Position, N'mn

	2016	2017A	2018F	2019F
PPE	191,182	195,230	199,543	210,745
Intangible assets	99,478	98,277	96,271	101,609
Investments	150	150	175	188
Other receivables	623	552	630	753
Prepayments	1,154	526	525	564
Inventories	31,245	42,729	43,409	37,633
Trade and other rec.	19,974	20,384	22,755	20,698
Cash and bank Bal.	12,156	15,867	16,121	17,330
Total Assets	367,146	382,228	387,359	398,046
current tax liabilities	19,024	19,606	19,920	21,414
Dividend payable	12,676	8,029	8,752	9,408
Trade and Other pa.	111,184	127,947	128,828	129,834
Loans and Borrowings	17,000	8,000	10,502	11,290
Employee benefits	10,101	13,210	13,421	14,428
Deferred tax liab.	29,877	26,667	26,081	28,037
Total liabilities	201,233	203,930	207,982	214,925
Net Assets	165,914	178,298	179,377	183,121

Fig. 14: Profitability Ratio

	2016	2017A	2018F	2019F
Gross profit margin	43.20%	41.66%	43.50%	43.00%
Net Profit Margin	9.06%	9.59%	10.42%	10.92%
operating profit margin	-4.35%	-3.09%	-2.50%	-2.50%
Return on Equity	17.13%	18.54%	20.35%	22.44%
Return on Assets	17.13%	18.54%	20.33%	22.44%
Return on Assets	7.74%	8.65%	9.42%	10.33%
ROCE	23.73%	25.26%	27.47%	29.39%

Fig. 15: Asset Utilisation

	2016	2017	2018F	2019F
cash/.sales	0.04	0.05	0.05	0.05
Sales to inventory (x)	10.04	8.06	8.06	10.00
Sales to total assets (x)	0.85	0.90	0.90	0.95
sales/EBITDA	15.52	14.10	12.42	11.70
Sales to total fixed assets	1.64	1.76	1.75	1.79
Equity multiplier	2.21	2.14	2.16	2.17

Fig. 16: Liquidity Ratios

	2016	2017	2018F	2019F
Quick ratio	0.30	0.29	0.30	0.29
Current ratio	0.52	0.56	0.57	0.52
Cash ratio	0.08	0.10	0.10	0.11
Interest Coverage	2.91	4.37	6.22	6.42
Op. Cash Flow Ratio	0.37	0.37	0.40	0.43
Debt/net income	0.63	0.26	0.30	0.29
Debt/operating profit	0.34	0.15	0.17	0.17
Debt to asset	0.05	0.02	0.03	0.03
Debt to equity	0.11	0.05	0.06	0.06
Total liabilities/equity	1.21	1.14	1.16	1.17
Total liab./ Total Assets	0.55	0.53	0.54	0.54
Inventory turnover	3.73	2.72	2.30	2.65
Inventory days	122.18	67.16	73.90	68.95
Account rec. days	23.24	21.59	23.73	20.08

Fig. 17: Shareholders' Investment Ratios

	2016	2017	2018F	2019F
Earnings per share	3.58	4.13	4.60	5.18
DiV per share	3.58	4.13	4.00	4.50
NAVPS	20.92	22.30	22.62	23.10
Earnings yield	3.48%	4.01%	4.47%	5.03%
FCFPS	9.09	9.01	9.10	9.19

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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