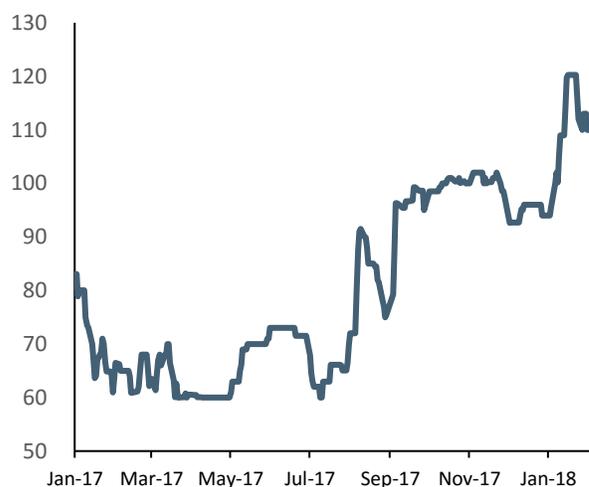




Rating	SELL
Price	₦110.00
FVE	₦80.67
52-week range	₦57.56-120.25
Market Cap. (₦'bn)	275
1-month Avg. Vol	132,870
Curr. PE	41.69x

Quarterly EPS	Q1	Q2	Q3	Q4
2016 A	0.24	0.54	0.20	1.91
2017 A	1.46	1.62	1.40	2.96
2018A(E*)	0.02	0.84	0.56*	0.90*

GUINNESS:NL - Share Price Trend



Analyst(s)

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Guinness Nigeria (Guinness.NL)

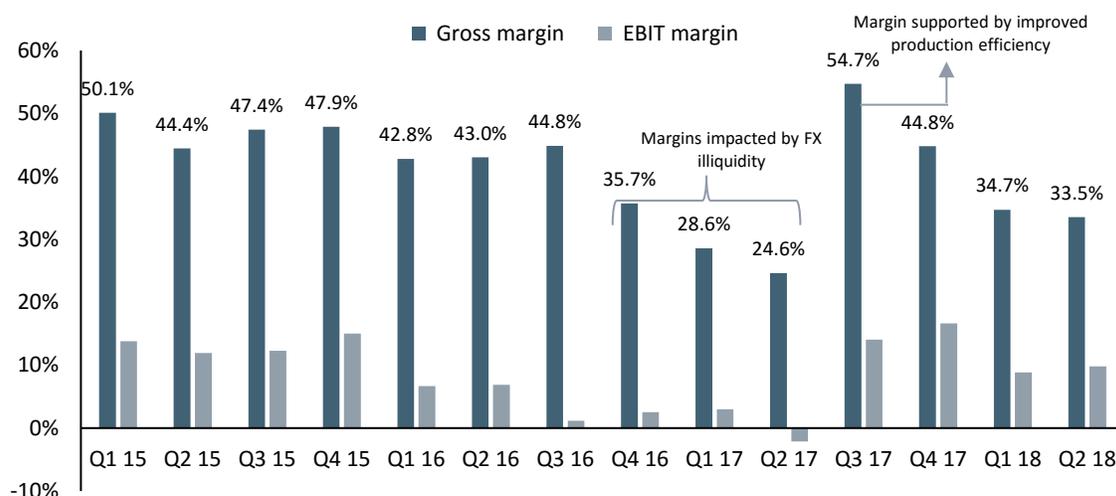
Company Note

Lacking Catalyst! has it all been priced in?

- Guinness Nigeria (Guinness) earnings has shown remarkable turnaround. In the six-months ending December 2017, profit after tax printed at ₦2.1 billion versus ₦4.7 billion losses in the corresponding period of 2017. Much of the turnaround stemmed from the weighty decline in FX losses and finance charges. In addition, there was some positive surprise from input costs in the period which drove an expansion in gross margin (+787bps YoY to 34.7%). For context, despite the increase in Barley and Sorghum prices (28.4% and 4.5% YoY respectively), input cost rose at a more subdued pace (+6.0% YoY to ₦46 billion). The subdued pressure from input cost, which is slower than revenue growth (+18.6% YoY) largely reflected recent right sizing of its brewery workforce and energy optimization as well as improving efficiency across production lines. On the revenue side of things, volumes growth was the key driver as volume contribution to sales growth increased to 75% from 66% in full-year 2017. This was underpinned by increased demand for its value malt, **dubic malt**. Also, there was increased participation in spirits (mainstream and premium) which contributed 15% to FH1 18 revenue, higher than 13% as at FY 17. On the other side, price-induced revenue growth cooled off over the period as prices across product lines were flat. Consequently, price contribution to revenue slowed to 25% in FH1 18 from 33% as at FY 17 and underpinned the slow pace of revenue growth.
- For the rest of the year, management explained that they have begun to see a moderation in volume growth for its mainstream and affordable beer brands following high demand build over 2017

when volumes were strong particularly for their popular affordable brand (Sätzenbrau). Also, we see the possibility of a further drop in price contribution to revenue as the benefits of low pricing base fades off entering FH2 18.

Figure 1: Gross and EBIT margin trend in the last 14 quarters



Source: ARM Research

- Sizeable decline in FX losses and interest expense bolster earnings:** Guinness' balance sheet as at FH1 18 revealed a further decline in the company's aggregate debt position (-75% YoY to ₦12.5 billion) consistent with management plan to pay down its borrowings using proceeds (₦39.7 billion) from the recently concluded equity capital raise. Consequent to this, the company's gearing ratio improved to 15% from 137% in FH1 17. Specifically, on the Diageo loan, management explained that they have paid down 59% of the loan amounting to ₦15 billion with the balance currently at ₦8.1 billion. The improved debt position reflected in its financial performance as interest expense moderated by 36.2% YoY to ₦1.9 billion despite the high interest rate environment of 2017 while FX losses moderated by 8.1% YoY and 73.9% QoQ, reflecting the company's limited exposure to dollar denominated liabilities as well as currency stability. The mix of improved gross margin and reduction in finance expense underpinned FH1 18 earnings of ₦2.1 billion (versus a loss of ₦4.4 billion in FH1 17).
- Absence of favorable comparable guides to weaker earnings in FH2 18 relative to FH2 17:** Going into the second half of 2018, Guinness Nigeria would be entering a more normalized period where favourable comparable would fade out both on revenue and COGS legs which should reveal a weakening in gross margin. Interestingly, following the implementation of the productivity measures mentioned above, gross margin has contracted

consistently over the last three quarters (from 54.7% in FQ3 17 to 33.5% in FQ2 18) suggesting subsisting input cost pressures which should take center stage in FH2 18. As stated earlier, we suspect these pressures are stemming from barley and sorghum as these commodities are currently in a deficit position which informed their bullish pricing. Thus, we now project FY 18 COGS at 23.2% YoY (FH1 18 run rate +6% YoY) to ₦95.6 billion. Also, on the revenue leg, we do not foresee sizeable price increases in FH2 18 and expect volumes to majorly drive revenue growth in FH2 18. Management guides to moderated growth in its second half given the high base of volume growth for its beer brands. While we have retained our FH2 18 estimate, we raise our FY 18E to ₦144 billion to capture the outperformance in FH1 18 revenue relative to our estimate. Overall, gross margin for FY 18 is estimated at 33.8% (FY 17: 38.4%).

- With the reduction in Guinness' debt position, plan to repay the balance of Diageo loan, optimistic outlook on currency and the currently low interest rate environment of 2018, we expect finance expense to trend downwards in FH2 18. As such, we estimate FY 18 finance expense at ₦6.4 billion which translates to a 35% YoY decline from FY 17 (₦9.8 billion). Management guides to further borrowing in the future but expects it to be appropriate for an efficient capital structure.
 - ***FVE is raised but still not attractive:*** With the above all in, we expect FY 18 earnings to print at ₦5.8 billion which translates to an EPS of ₦2.64, representing a 106% YoY increase over ₦1.28 in FY 17. We highlight that our double-fold increase is because of the low base of FY 17 where Guinness reported losses in two quarters. Consequently, we raise our **FVE by 22% to ₦80.67** but maintain our SELL rating on the back of rich valuation and lack of new share price catalyst. The strong earnings growth in FY 18-19 could increase investors' interest in the near term but a catalyst to propel strong earnings growth beyond 2019F is still not in our view.
 - Guinness has rallied over the last one year and on our 2018 numbers currently trades at a P/E of 41.7x relative to 30.4x average for Bloomberg MENA peers. In our view, the stock is expensive and thus we retain our **SELL** recommendation on the stock.
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Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦'m) *	2016A	2017A	2018E	2019F	2020F
Revenue	101,973	125,920	144,323	154,603	164,554
COGS	(60,163)	(77,605)	(95,614)	(102,038)	(105,315)
Gross Profit	41,810	48,315	48,709	52,565	59,240
Operating Cost	(37,895)	(38,976)	(37,235)	(37,878)	(39,493)
Operating Profit	4,416	10,186	12,123	15,586	20,665
Finance Income	1,185	2,253	3,155	2,350	3,004
Finance expense	(7,948)	(9,778)	(6,387)	(3,754)	(3,850)
PBT	(2,347)	2,662	8,892	14,181	19,820
Tax	331	(738)	(3,112)	(4,254)	(5,946)
PAT	(2,016)	1,924	5,780	9,927	13,874
Balance Sheet (₦ '000) *					
Fixed Assets	87,233	87,325	86,178	83,320	80,333
Stocks	13,021	23,094	28,684	30,611	30,541
Trade debtors	29,004	24,199	30,308	32,003	33,734
Cash and other bank balances	5,845	9,933	29,234	37,526	48,902
Total Assets	136,992	146,038	175,891	184,947	194,996
Liabilities					
Trade Creditors	37,530	43,053	54,404	58,060	58,976
Non-current Liabilities	28,222	39,376	17,473	17,772	18,100
Total liabilities	95,332	103,095	91,863	95,254	97,388
Shareholders' fund	41,661	42,943	85,069	90,733	98,649
Key Ratios					
	2016A	2017A	2018E	2019F	2020F
Gross Margin	41%	38%	34%	34%	36%
EBIT Margin	4%	8%	8%	10%	13%
PBT Margin	N/M	2%	6%	9%	12%
Net Margin	N/M	2%	4%	6%	8%
EPS	N/M	1.28	2.31	3.97	5.55
P/E	N/M	86.11	47.58	27.70	19.82
P/B	3.98	3.86	3.23	3.03	2.79
EV/EBITDA	14.25	9.85	19.03	9.99	7.80
ROA	-2%	1%	4%	6%	7%
ROE	-4%	5%	9%	11%	15%

Source: ARM Research *unless otherwise stated

Ratings, Disclosure & Disclaimer – [Click here](#)