

Guinness Nigeria Plc. (GUINNESS)

Stock Report

Rating	OVERWEIGHT
Price	₦65.00
FVE	₦77.31
52-week range	₦61.5-₦110
Market Cap. (₦bn)	142.4
1-month Avg. Vol	362,453
Curr. PE	18.23

Quarterly EPS	Q1	Q2	Q3	Q4
2017 A	-1.46	-1.62	1.40	2.96
2018 A	0.02	0.95	1.35	0.74
2019 A (E*)	0.38	0.80	0.85*	1.18*

GUINNESS:NL - Share Price Trend



Analyst(s)

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6M 2019 Initial View: [Heightened competition bites earnings](#)

Guinness Nigeria Plc: A differentiation play

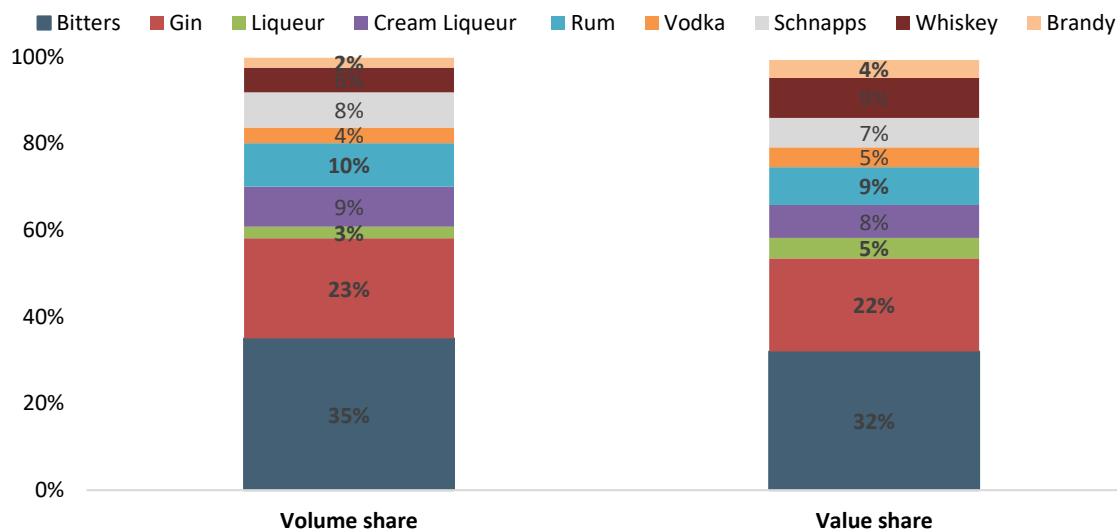
- Following the release of the FH1 19 earnings, we paid a visit to the Guinness brewing plant in Ogba Lagos where we engaged the management of Guinness Nigeria Plc to understand the drivers of earnings over its half-year 2019¹ and get insight into the outlook of the firm over the rest of the year.
- No doubt, the ongoing contest for market share in the brewery sector has started taking a toll on margins for major sector players. This largely accounts for lackluster earnings performance of Nigerian Breweries (NB) and Guinness over the past few quarters. However, beaming our lights on the sector, we noticed flashes of differentiation which points towards a soft landing for Guinness compared to NB. To buttress, while the industry rivalry is expected to drive an 88bps plunge in FY 18E gross margin for NB, the wider portfolio mixes of Guinness which harbors Spirits provides a partial cover for Guinness gross margin (FY 19E: -31bps YoY to 33.7%). More so, reflecting lower finance cost for Guinness after recent deleveraging on FCY debt using proceeds from rights issue, we see improved profitability for the brewer. Hence, whilst we have a SELL rating on NB, we see upside opportunity (19% upside) for investors in Guinness with FVE of **₦77.31** which translates to an **OVERWEIGHT** rating on the stock. On our numbers, GUINNESS currently trades at a P/E of 18.23x relative to 26.08x and 24.5x for NB and Bloomberg MENA peers respectively.

¹ Financial Year 2019 is from July 2018 – June 2019.

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- **Industry competition bites topline:** As expected, following the ongoing bout for market share in the Brewery sector, Guinness revenue contracted (-3.9% YoY to ₦67.7 billion) over the period largely on the back of slower growth in Lager and Ready to drink (RTD) volumes. In fact, the milder plunge in revenues reflects increased participation in APNADs (Adult premium nonalcoholic drinks) and spirits (mainstream and premium) whose contribution to revenue increased to 18% from 15% as at FY 18. For clarity, management stated that excluding lager, overall volumes grew ~4% but fell 13% with lager inclusive. In its spirits segment, Bitters and Gin were the biggest contributors to revenue with a combined volume and revenue share of 58.1% and 53.5% respectively.
 - **Lower finance expense provides respite:** In addition, Guinness Nigeria Plc enjoyed the benefits of a deleveraged balance sheet over the first half of its 2019 financial year (July – December 2018), with EPS expanding 23% YoY to ₦2.58 billion. For clarity, while operating performance remained pressured by the ongoing industry competition, the improved earnings largely stemmed from a sharp drop in finance cost (-67.9% YoY to ₦1.54 billion) following the reduction of its foreign currency denominated loans² with proceeds of its ₦40 billion rights issue in its 2018 fiscal year. Still on its FCY debt with its parent company—Diageo, management hinted that the remaining balance of \$9.2 million attracts an interest rate of 7.5% which is still favorable compared to prevailing market rate in the domestic scene (YTD average bond yields: ~15.2%).
 - **Cost pressure persist:** In addition to the slower growth in volumes over the period, Guinness faced input cost pressure over the period. Although management linked this to pass through from inflationary pressures and Lower fixed cost absorption rate, we think higher barley prices (11% YoY) over the period also played a major role in driving the expansion in input cost to 69.8% from 66% last year.
 - **Spirits to the rescue in 2019:** Going into the second half of its 2019 financial year (January – June 2019), Guinness will have to contend with slower beer volumes due to intense industry competition. Baring that in mind, in a bid to cushion margin loss from lower beer and RTD volumes, management guided to increasing spirits contribution to overall revenue from 18% in FH1 19 to 30% over the medium term. To affirm its commitments towards expanding its spirits portfolio, Guinness recently launched three new products in the spirits category – Johnnie walker 18, White walker Whisky and Baileys delight.

² 60% of FCY loans was refinanced using proceeds from Rights Issue

Figure 1: Breakdown of volume and revenue share in the spirits segment



Source: Company FH19 Presentation, ARM Research

- Less scope for beer price increases:** Whilst our expectation for increased spirit contribution provides some respite for topline going forward, we remain less sanguine of any notable growth in net revenue over the near term. Especially, given that the second phase of excise duty hike took effect in January 2019, we do not see Guinness passing on the excise duty cost to customers ahead of other industry players. Our view is hinged on possible reluctance by International Breweries to take a price increase given its strategy to gain market share, particularly to increase its fixed cost absorption rate at the Shagamu plant. Hence, we cut FY 19E net revenues by 1% to ₦144.3 billion while we leave our COGs estimate unchanged at ₦95.7 billion. As a result, we envisage gross profit of ₦48.62 billion over FY 19E which remain little unchanged from the ₦48.63 billion recorded last year. As a result our gross margin expectation of 33.7% for FY 19E is broadly flat from 34% recorded in the prior year.
- Efficiency drive to preserve margins:** To further preserve EBIT margin, management guided to maintaining its cost cutting in line with H1 19 wherein operating expense declined 7.3% YoY—from a drop in selling and distribution expense. As a result, we cut operating expense by 3% to ₦36.4 billion, with related OPEX to sales ratio of 25.2% (FY 18: 25.1%) and FY 19F EBIT margin of 9.1% (FY 18: 9.4%). Over our forecast horizon, our EBIT margin remains broadly in line with 5-year historical average of 10%. Elsewhere, with interest income tracking ahead of our estimate (~84%) we raise our FY 19E finance income upward by 25% to ₦1.05 billion. This alongside tamer finance expense translates to our expectation of a softer net interest expense of ₦1.3 billion in FY 19E (vs ₦3.4 billion in FY 18).

- Incorporating these changes, we expect FY 19 earnings to print at ₦8.4 billion which translates to an EPS of ₦3.81, representing a 24% growth in earnings. Consequently, we raise our FVE by 4% to ₦77.31 (19% upside) which translates to an **OVERWEIGHT** rating on the stock. On our numbers, GUINNESS currently trades at a P/E of 18.23x relative to 26.08x and 24.5x for NB and Bloomberg MENA peers respectively.

Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦' m)	2017A	2018A	2019E	2020F	2021F
Revenue	125,920	142,976	144,274	149,213	156,448
COGS	77,605	94,350	95,654	98,481	101,691
Gross Profit	48,315	48,625	48,620	50,732	54,757
Operating Cost	38,976	35,908	36,357	38,348	40,207
Operating Profit	10,186	13,386	13,190	13,340	15,549
Interest Income	2,253	2,201	1,053	452	509
Interest Expense	9,778	5,645	2,308	2,951	3,378
PBT	2,662	9,943	11,935	10,841	12,680
Tax	738	3,226	3,581	3,252	3,804
PAT	1,924	6,718	8,355	7,589	8,876
Balance Sheet (₦ '000)					
Fixed Assets	87,325	97,602	98,665	98,859	99,202
Stocks	57,227	54,610	54,390	62,037	69,330
Trade debtors	24,199	24,766	24,527	25,366	26,596
Cash & other bank balances	51,351	15,139	22,083	27,381	28,959
Total Assets	146,038	153,255	154,098	161,939	169,575
Trade Creditors	43,053	31,176	28,696	29,544	30,507
Non-current Liabilities	39,376	22,820	23,631	24,524	25,506
Total liabilities	103,095	65,667	62,875	66,386	68,958
Shareholders' fund	42,943	87,588	91,222	95,553	100,617
Key Ratios					
	2017A	2018A	2019E	2020F	2021F
Gross Margin	38%	34%	34%	34%	35%
EBIT Margin	8%	9%	9%	9%	10%
PBT Margin	2%	7%	8%	7%	8%
Net Margin	2%	5%	6%	5%	6%
EPS	1.28	3.07	3.81	3.46	4.05
P/E	50.88	21.19	17.04	18.76	16.04
EV/EBITDA	6.22	9.04	6.29	5.67	4.91
ROA	1.4%	4.5%	5.4%	4.8%	5%
ROE	5%	7.9%	9.2%	8.1%	9%

Source: ARM Research *unless otherwise stated

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% – 20 %	NEUTRAL	5% – 20 %
NEUTRAL	0% – 10 %	SELL	<5%
UNDERWEIGHT	-5% – 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
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