

**Operating efficiency revamps earnings**
**(SELL: ₦57.60)**

- Guinness Nigeria Plc (Guinness) released its audited FY 17 results, which revealed a post-tax profit of ₦1.9 billion (FY 16: ₦2.0 billion loss). The marked turnaround in performance majorly stemmed from belt tightening measures and price-induced growth in top-line.
- In view of this the improved performance, Guinness raised its dividend per share by 28% YoY to ₦0.64, which translate to a dividend yield of 0.7% based on current pricing.
- Going into FY18, we expect Guinness' margins to remain at subdued levels as depressed real income levels drives further dominance of value beers in top-line. That said, the combined effect of a relatively stable NGN outlook, which limits scope for further FX losses, price induced growth to top-line as well as continued cost containment bodes well for earnings recovery from the low base of 2017. Irrespective, owing the dilutive impact of its planned rights<sup>1</sup> (46% of current shares outstanding), we reiterate our SELL rating on the company's stock.

**Income Statement Data**

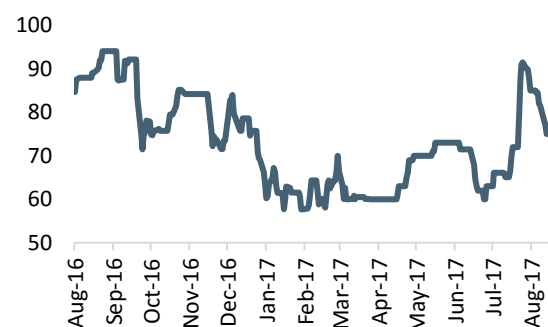
	2017 -FY	2016 -FY	%chg
<b>Revenue</b>	125,919	101,973	23.5%
<b>PBT</b>	2,662	2,347	N/A
<b>Tax</b>	738	331	N/A
<b>PAT</b>	1,924	2,016	N/A

**Balance Sheet Data**

	2017-Jun 'm	2016-Jun 'm	%chg
<b>Inventory</b>	23,094	13,021	76.9%
<b>Receivables</b>	24,199	29,004	-16.6%
<b>Cash</b>	9,933	5,845	69%
<b>Payables</b>	43,052	37,530	14.7%
<b>Net Assets</b>	42,943	41,661	2.97%

**Stock Data**

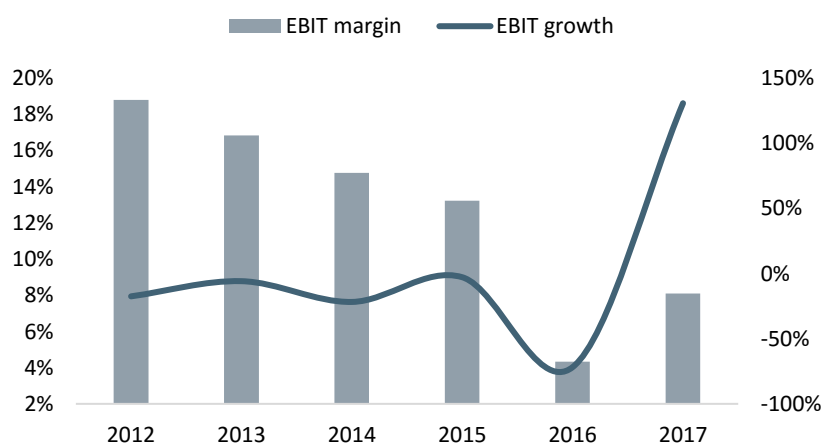
<b>Price</b>	₦96.33
<b>52-week range</b>	₦57.66 - ₦96.33
<b>Market Cap. (N'm)</b>	145,062
<b>1-month Avg. Vol</b>	1,128,641
<b>Curr. PE</b>	75.4x
<b>Bloomberg Ticker</b>	GUINNESS:NL

**Guinness Nigeria Plc- Share Price Trend**

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<sup>1</sup> The closure date for the rights was on the 30<sup>th</sup> of August, 2017.

### Cost containment buoys operating performance

- Going through the finer details, cost containment measures were central to Guinness' earnings rebound as management reined in OPEX (+2.9% YoY to ₦39 billion) by reducing staff headcount (-29% YoY to 951) and kept S&D cost (+2% YoY) in check. According to Guinness management, the company's marketing efforts were only focused on the Satzenbrau and mainstream spirits launches. Against this backdrop, OPEX-sales ratio fell 6pps YoY to a three-year low of 37% over the financial year.
- Supporting the operational efficiency is the strong top-line, which rose at its fastest pace in eight years (+23.5% YoY) to a record high of N125.9 billion. The upsurge in turnover largely reflected price hikes as the company, in a bid to pass-on inflationary pressures to consumers, raised prices of its products (+30%-35% YoY across most of its portfolio). As in prior years, consumer downtrading from premium and mainstream products remained prevalent with management attributing most of top-line growth to higher sales of value brands, with Satzenbrau (+61% YoY) and Dubic Malt leading the top-line improvement. Consequently, Guinness reported a more than two-fold YoY growth in EBIT to ₦10.2 billion with related margin expanding 3.8pps YoY to 8.1%.

**Figure 1: Historical operating margin**

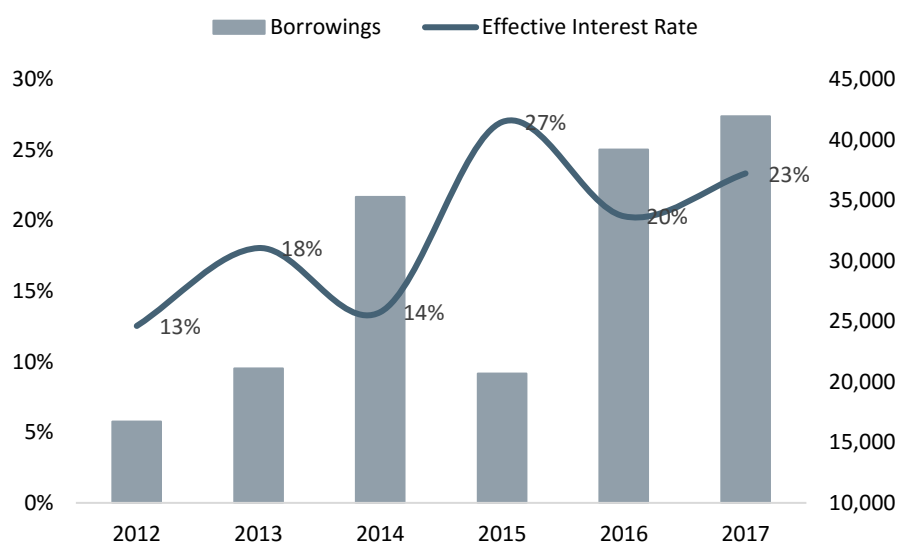


Source: Company financials, ARM Research

### Earnings defy subsisting cost pressures

- Despite the impressive operating performance, there were noteworthy pressures. First was the elevated input cost. Over FY 17, Guinness reported a 29% YoY—faster than revenue growth—rise in COGS to ₦77.6 billion. Sifting the breakdown provided, we isolate the upsurge in COGS to elevated raw material cost (+43% YoY to ₦53.4 billion) following uptrend in the cost of key domestic inputs (YoY: Sorghum: +109%, Refined sugar: +99.5%) as well as impact of naira weakness (FY 17 mean FX rate: -37%% YoY to ₦322.24/\$) on imports. Second was the higher finance cost which tracked movement in borrowings (+7% YoY to ₦41.9billion) and interest rate in the domestic environment. Particularly, reflecting CBN's ongoing monetary tightening which has pushed the naira yield curve 9.6pps higher YoY to 20.7%, the effective interest rate on Guinness' debt climbed 300bps. Nevertheless, gains from cost control as well as revenue growth drove a rebound in PAT to ₦1.9 billion (FY 16 loss after tax: ₦2 billion).

Figure 2: Historical effective interest rate and borrowings(₦'000)



Source: Company financials, ARM Research

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### *Potential share dilution leaves SELL rating unchanged*

- Going into FY 2018, we expect top-line to continue to benefit from price hikes as management remain resolute in passing on input cost pressures to consumers. However, given the potential impact of price increases on the already weak consumer discretionary income, we see scope for volume contraction. Overall, we project a slower rise (9% YoY to ₦137.3 billion) in FY 18 sales, relative to the prior year.
  - On cost, subsisting supply shocks (higher transport cost, and flood in key agricultural regions) should drive cost of local raw materials higher. This should trump impact of naira gains on the cost of imported inputs (imports-COGS ratio: 25% over 2017). Against this backdrop, we expect an 8% YoY rise in COGS to drive gross profit to ₦53.6 billion (+11% YoY).
  - Elsewhere, though Guinness has an outstanding net short FCY position on dollar-denominated loans of \$95 million from parent Diageo (\$22 million utilized as at FY 17), planned repayment of the foreign debt and expected stability in FX market dampens prospect for FX loss. As a result, we estimate a 69% YoY contraction in borrowing cost to ₦3.0 billion.
  - Akin to FY 17, we expect Guinness to maintain its ongoing stance of reining S&D in line with management guidance which should result in modest OPEX growth (FY 18E: +4.6% YoY to ₦40.8 billion). Net impact of our adjustments translates to PBT and PAT of ₦12.6 billion (+3.7x YoY) and ₦8.7 billion (+3.6x YoY) respectively over FY 18E.
  - Despite the upbeat earnings outlook, Guinness' plan of raising ₦39.7 billion capital through rights should raise the company's shares outstanding to 2.2 billion shares (+46% from current levels). Given the significant interest trailing the rights, which closed on the 30<sup>th</sup> of August, we are of the view that the rights would have been fully subscribed and have therefore factored it into our model. Against this backdrop, our FY 18 EPS for the company would print at ₦3.94 (excluding dilution: ₦5.8). On current pricing, Guinness trades at a forward
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P/E of 24.4x (excluding dilution: 16.5x) vs 22.13x for its Bloomberg MEA peers. We retain our **SELL** rating on the stock with a **FVE of ~~N~~57.6**

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## Summary of Results and Forecasts (₹ million)

QUARTERLY					
Income Statement (₹mln)*	FO1 2018E	FO2 2018E	FO3 2018E	FO4 2018E	
Sales	29,853	37,956	32,887	36,621	
COGS	17,189	23,848	20,252	22,474	
Gross profit	12,664	14,108	12,635	14,147	
Operating cost	10,242	11,484	9,453	9,898	
Operating profit	2,599	2,865	3,381	4,503	
Net finance cost	217	296	244	313	
<b>Profit before taxation</b>	2,381	2,570	3,137	4,191	
Tax	792	1,077	889	1,139	
<b>Profit after taxation</b>	1,590	1,492	2,248	3,051	
<b>Earnings per share</b>	1.06	0.99	1.49	2.03	
ANNUAL					
Income Statement (₹mln)	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
Sales	118,496	101,973	125,920	137,318	140,508
COGS	62,604	60,163	77,605	83,764	82,900
Gross profit	55,892	41,810	48,315	53,554	57,608
Operating cost	40,947	37,895	38,976	40,783	42,152
Operating profit	15,667	4,416	10,186	13,642	16,359
Finance Income	705	1,185	2,253	1,972	836
Finance Expense	5,578	7,948	9,778	3,041	1,126
<b>PBT</b>	10,795	2,347	2,662	12,572	16,068
Tax	3,000	331	738	3,897	4,820
<b>PAT</b>	7,795	2,016	3,400	8,675	11,248
Earnings per share	5.18	(1.34)	1.28	3.94	5.11
Dividend per share	3.20	0.50	0.53	1.69	2.20
Balance Sheet (₹mln)	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
<b>Assets</b>					
Fixed assets	87,754	87,233	87,325	91,112	92,483
Inventories	10,751	13,021	23,094	25,129	24,870
Trade debtors	16,956	29,004	24,199	28,837	29,085
Cash and other bank balances	5,805	5,845	9,933	3,995	8,297
<b>Total Assets</b>	122,247	136,992	146,038	150,560	156,222
<b>Liabilities</b>					
Trade Creditors	31,482	37,530	43,053	47,662	47,170
Long Term Liabilities	27,805	28,222	39,376	17,473	17,772
<b>Total liabilities</b>	73,905	95,332	103,095	85,120	84,365
<b>Shareholders' fund</b>	48,341	41,661	42,943	65,695	72,112
Key Ratios	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
Gross margin	47%	41%	38%	39%	41%
Operating margin	13%	4%	8%	10%	12%
PBT margin	9%	-2%	2%	9%	11%
Net margin	7%	-2%	2%	6%	8%
P/E	16.88	N/A	68.41	22.16	17.09
EV/EBITDA	8.22	14.25	8.08	9.47	5.15
ROA	6%	-2%	1%	6%	7%
ROE	17%	-4%	5%	16%	16%

Source: ARM Research

## 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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimise exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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