

Guinness Nigeria Plc.

Q3-18: Further weakening margin; opex and finance cost to the rescue

Update: GUINNESS reported 40% y/y increase in Q3-18 net profit (EPS: -4% y/y), coming off better-than-expected revenue growth, and relatively lower operating expenses and finance charges. Both masked a disappointing gross margin, which has now weakened for four quarters in a row. Compared to consensus, the reported net profit was head by 131%, and beat our estimate by 47%.

Estimates and valuation changes: Following the Q3 and 9M-18 results, we raise our 2018E EPS estimate to NGN3.85 (previously NGN2.98), and for 2019E and 2020E to NGN4.71 (previously NGN4.30) and NGN5.14 (previously NGN5.12) respectively. The assumptions driving the single-digit increase in our 2019-2020E EPS estimates are the (1) increase in revenue growth forecast to 9% average (previously c.8% average) and (2) 400 bps downward revision of opex-to-revenue ratio estimate, offsetting the (3) 300 bps downward revision of gross margin estimate. On our revised estimates, and with valuation rolled-forward to 2019E, we have a TP of NGN73.75/share (previously NGN68.59/share) and maintain SELL rating. The stock is trading on 2019F P/E and EV/EBITDA multiples of 21.8x and 8.6x respectively, which compares with SSA peers (20.6x and 9.5x respectively) – though we acknowledge that GUINNESS' multiples are at considerable discounts relative to 5-year historical average (excluding 2016).

Revenue has impressed consistently: Q3-18 revenue grew 15% y/y and beat our estimate and consensus' by 4%. Consistently for three quarters, GUINNESS has reported revenue growth that exceeded both our estimate and that of the market. Whilst noting the impact of pricing, we are aware that volume has also contributed to the impressive revenue performance thus far, thanks especially to Guinness stout, mainstream spirits, and Dubic lager. Going forward, the recovering macro and consumer environment – we have observed the gradually reducing on-the-shelf prices of consumer products across major outlets – bodes well for the beer market from volume view point, leaving GUINNESS and NB to now seek unique strategies to deal with the challenge of competition from the encroachment of INTREW's brands in their territories.

We are better off conservative on gross margin expectation: Both we and consensus have been consistently disappointed by the outcome of GUINNESS' gross margin since the surprise surge to record 55% in Q3-17 (although now restated to 42%). The latest gross margin contraction (-922 bps y/y and 32 bps q/q) is even more worrying, when the (1) marked softening in the prices of local sorghum (especially in February and March), barley (-11% YtD and -6% y/y in Q1-18) and maize (-16% y/y), and importantly, (2) the stability of the naira, are taken into consideration. Consequently, we have revised gross margin estimate for 2018E to c.33% (previously 34%) and for 2019-2020E to 34% (previously 37%), more so, that the outlook for drinks' prices generally is now to the downside.

Opex to support EBIT margin: DIAGEO (GUINNESS' parent company) has been emphasizing on its efficiency programs in Nigeria, the impact of which – in our view – has reflected more on GUINNESS' operating expenses, than on production costs. On 9M-18 run-rate, we expect opex will be lower by 14% in 2018E, bringing the average growth from 2016FY to -6%, compared to +9% between 2011-2015FY. Opex-to-revenue ratio has equally been on the decline, from 37% in 2016FY to 31% in 2017Y, and 23% in 2018E, on our estimate. From 8% in 2017FY, we estimate EBIT margin to increase to 10% in 2018E, and average c.11% over 2019-2020E.

Balance sheet: Outstanding borrowings as at end-March was NGN16.8 billion, comprising mainly of related party loans (48%) and letter of credit (42%), which we believe are quite cheap and have impacted little on finance costs thus far. Management had said it would retain some USD loans after the equity capital raise of last year. Capex as at 9M-18 was NGN8.4 billion, and at the run-rate, should equal 8% of revenue (same as for the last three years) by the end of the year.

SELL

Target Price (NGN)	73.75
Current Price (NGN)	103.00
Implied Return (%)	-28.40

Company Data

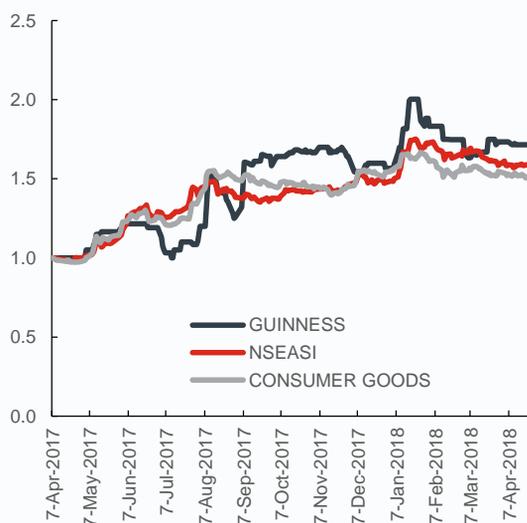
NSE Code	GUINNESS
Bloomberg Code	GUINNESS:NL
Reuters Code	GUINNES.LG
Sector	CONSUMER GOODS
Market Cap. (NGN'bn)	225.61
Free Float (%)	37.40

Ratios	Q3-18	Q3-17	2017FY
Gross margin	33.19%	42.40%*	38.37%
Opex margin	22.14%	28.97%**	30.95%
EBITDA margin	17.93%	21.29%	15.23%
EBIT margin	11.54%	14.08%	8.09%
PAT margin	8.47%	6.95%	1.53%
EPS (NGN)	1.35	1.40	1.28

*Reported LY was 54.71%

**Reported LY was 41.28%

Price movement (GUINNESS vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros research

Summary of Quarterly Results.

Income Statement (NGN'bn)	9M-18	9M-17*	Q3-18	y/y	q/q	Q2-18	Q1-18	Q4-17	Q3-17
Turnover	105.48	89.87	34.93	15.0%	-14.1%	40.65	29.90	36.05	30.38
Cost of sales	-69.90	-58.62	-23.34	69.6%	-13.7%	-27.03	-19.53	-19.90	-13.76
Gross profit	35.59	31.25	11.59	-30.3%	-14.9%	13.62	10.37	16.14	16.62
Operating expenses	-25.36	-27.62	-7.73	-38.3%	-20.5%	-9.73	-7.89	-10.43	-12.54
Other Operating Income/Expenses	0.45	0.57	0.17	-11.2%	67.3%	0.10	0.17	0.28	0.20
EBIT	10.68	4.19	4.03	-5.8%	0.8%	4.00	2.65	5.99	4.28
Interest Expenses	-4.99	-8.67	-0.20	-92.1%	-78.9%	-0.96	-3.84	-1.10	-2.56
Interest income	2.21	2.02	0.52	7.9%	13.4%	0.46	1.23	0.24	0.48
Profit before tax	7.89	-2.46	4.35	97.9%	24.3%	3.50	0.04	5.13	2.20
Taxation	-2.80	-0.09	-1.39	1527.1%	-1.3%	-1.41	0.00	-0.65	-0.09
Profit after tax	5.09	-2.56	2.96	40.0%	41.6%	2.09	0.04	4.48	2.11

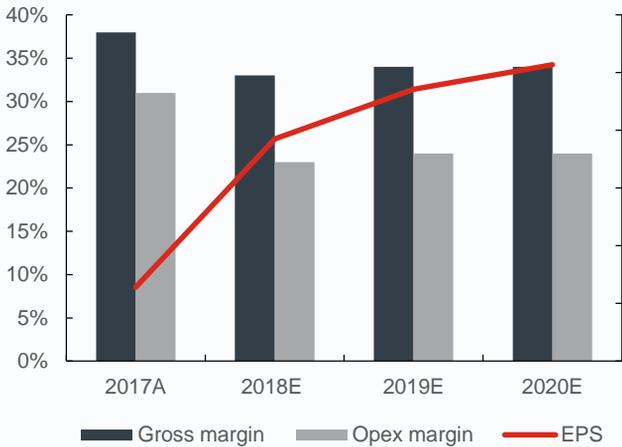
Ratios	9M-18	9M-17*	Q3-18	Q2-18	Q1-18	Q4-17	Q3-17
Gross profit margin	34%	34.8%	33.2%	33.5%	34.7%	44.8%	54.7%
EBITDA margin	16%	12.0%	17.9%	15.4%	16.3%	23.3%	21.3%
EBIT margin	10%	4.7%	11.5%	9.8%	8.9%	16.6%	14.1%
PAT margin	5%	-2.8%	8.5%	5.1%	0.1%	12.4%	7.0%
EPS (NGN)	2.32	-1.70	1.35	0.95	0.02	2.97	1.40

Source: Company Accounts, Cordros Research estimates

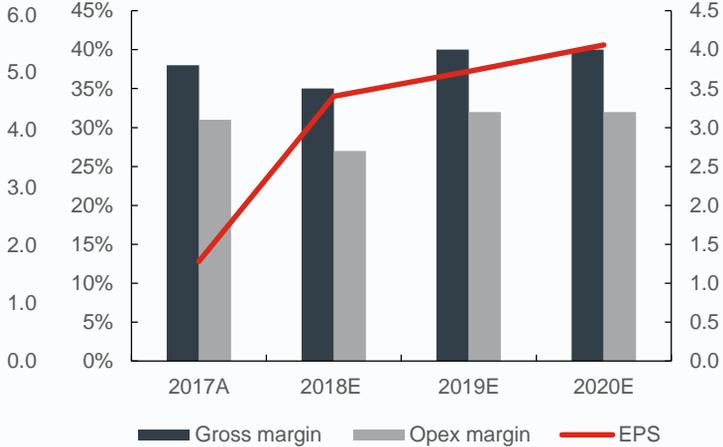
Sensitivity Analysis.

Sensitivity of EPS and valuation to gross and opex margins

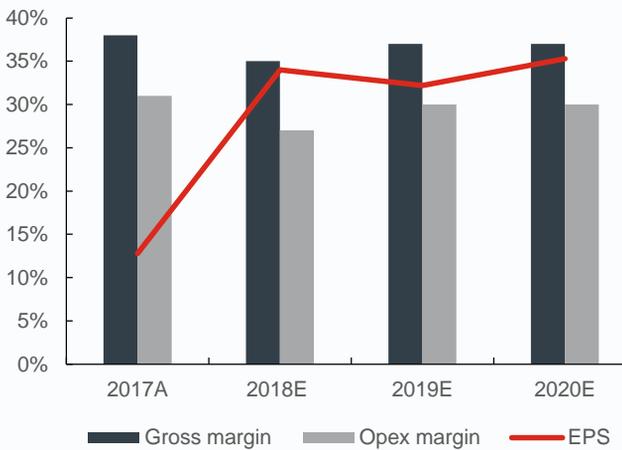
Target price = NGN73.75/share



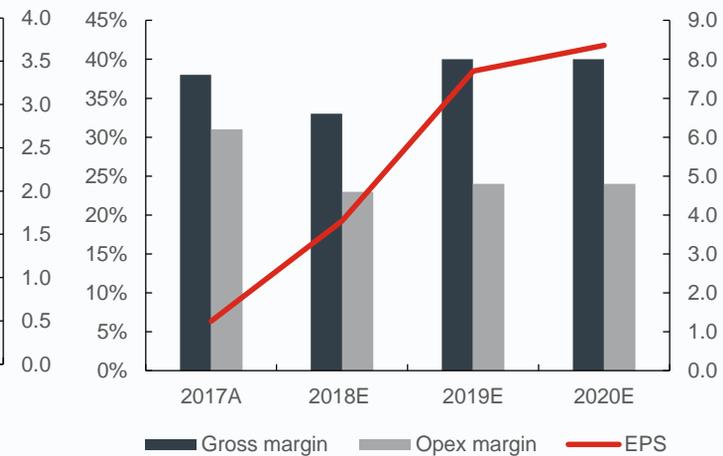
Target price = NGN63.93/share



Target price = NGN59.13/share



Target price = NGN102.76/share



Source: Company Accounts, Cordros Research estimates

Financial Statement (NGN'billion).

Income Statement	2015a	2016a	2017a	2018e	2019e	2020e	Profitability Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Turnover	118.50	101.97	125.92	145.74	160.31	172.83	Gross profit margin	47.17%	41.00%	38.37%	32.70%	34.00%	34.01%
Cost of sales	-62.60	-60.16	-77.60	-98.08	-105.81	-114.05	EBITDA margin	22.79%	13.08%	15.23%	16.48%	16.70%	16.81%
Gross profit	55.89	41.81	48.32	47.66	54.51	58.78	Operating profit margin	13.22%	4.33%	8.09%	10.18%	10.40%	10.51%
Operating expenses	-40.95	-37.90	-38.98	-33.41	-38.47	-41.31	PBT margin	9.11%	-2.30%	2.11%	8.49%	9.47%	9.57%
Other income/expenses	0.72	0.50	0.85	0.58	0.64	0.69	Net profit margin	6.58%	-1.98%	1.53%	5.78%	6.44%	6.51%
Operating profit/loss	15.67	4.42	10.19	14.84	16.67	18.16	RoAE	16.69%	-4.48%	4.55%	12.76%	11.23%	11.60%
Interest expenses	-5.58	-7.95	-9.78	-5.25	-1.60	-1.73	RoAA	6.12%	-1.56%	1.36%	5.43%	6.02%	6.10%
Interest income	0.71	1.19	2.25	2.78	0.11	0.11							
Profit before tax	10.80	-2.35	2.66	12.38	15.17	16.55	Liquidity Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Taxation	-3.00	0.33	-0.74	-3.95	-4.86	-5.30	Working capital (NGN'bn)	-12.59	-19.24	-6.49	14.40	12.90	12.26
Profit after tax	7.79	-2.02	1.92	8.43	10.32	11.25	Current ratio	0.73x	0.71x	0.90x	1.28x	1.22x	1.19x
							Quick ratio	0.49x	0.52x	0.54x	0.77x	0.73x	0.72x
							Cash ratio	0.13x	0.05x	0.10x	0.23x	0.22x	0.22x
Financial Position	2015a	2016a	2017a	2018e	2019e	2020e	Debt Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Property, plant and equipment	87.75	87.23	87.32	93.16	101.33	108.04	Net debt/EBITDA	0.6x	2.7x	1.8x	0.2x	0.1x	0.1x
Intangible assets	0.94	1.71	1.36	1.13	1.23	1.32	Interest cover	2.8x	0.6x	1.0x	2.8x	10.4x	10.5x
Prepayments	0.01	0.18	0.12	0.10	0.11	0.11	Debt/equity	42.80%	94.02%	97.62%	18.78%	17.73%	16.83%
Other receivables	0.02	-	0.00	-	-	-							
Total non-current assets	88.74	89.12	88.81	94.39	102.67	109.47	Efficiency Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Inventories	10.75	13.02	23.09	26.30	28.61	30.50	Fixed assets turnover	1.35x	1.17x	1.44x	1.56x	1.58x	1.60x
Trade and other receivables	15.50	26.51	22.97	26.60	28.94	30.85	Current assets turnover	3.54x	2.13x	2.20x	2.20x	2.22x	2.25x
Prepayments	1.45	2.49	1.23	1.33	1.44	1.54	Total assets turnover	0.97x	0.74x	0.86x	0.89x	0.90x	0.91x
Cash and cash equivalents	5.80	3.62	6.59	12.11	13.17	14.04	Inventory turnover	5.17x	5.06x	4.30x	3.97x	3.85x	3.86x
Total current assets	33.51	47.87	57.23	66.33	72.16	76.93	Receivables turnover	6.83x	4.85x	5.09x	5.88x	5.77x	5.78x
Total assets	122.25	136.99	146.04	164.22	178.63	190.45	Payables turnover	2.01x	1.74x	1.93x	2.46x	2.72x	2.67x
Loans and borrowings	12.25	14.03	24.89	8.09	8.09	8.09	Days inventory outstanding	71	72	85	92	95	95
Non current financial liabilities	-	-	-	-	-	-	Days collection/sales outstanding	53	75	72	62	63	63
Employee benefits	2.21	1.25	0.98	1.01	1.13	1.22	Days payable outstanding	90	161	108	99	100	99
Deferred tax liabilities	13.34	12.94	13.51	13.95	15.65	16.91	Cash conversion cycle	34	-14	49	55	58	59
Total non-current liabilities	27.80	28.22	39.38	23.05	24.87	26.22							
Bank overdraft	1.47	2.94	7.54	1.52	1.52	1.52	Investment Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Current tax liabilities	2.28	0.59	0.15	2.62	2.94	3.17	Earnings per share (N)	5.18	-1.34	1.28	3.85	4.71	5.14
Dividend Payable	3.90	3.86	3.48	4.03	6.57	8.45	Dividend per share (N)	3.20	0.50	0.64	2.31	2.83	3.08
Loans and borrowings	6.97	22.20	9.50	7.15	7.15	7.15	Payout	62%	-37%	50%	60%	60%	60%
Trade and other payables	31.48	37.53	43.05	36.61	41.08	44.38	Dividend yield	2.66%	0.60%	0.98%	2.24%	2.74%	2.99%
Total current liabilities	46.10	67.11	63.72	51.93	59.26	64.67							
Total liabilities	73.91	95.33	103.10	74.98	84.13	90.89	PE	23.3x	-62.0x	50.9x	26.8x	21.9x	20.0x
Net Assets	48.34	41.66	42.94	89.24	94.50	99.56	EV/EBITDA	7.3x	12.0x	6.9x	9.6x	8.6x	7.9x

Source: Company Accounts, Cordros Research

Disclosures.

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