

EABL INITIATION OF COVERAGE:

A Giant of an opportunity.

- » **We initiate our coverage of EABL with a BUY on EABL:** With **NSE 20** and **NASI** at all time lows, gaps have opened up for active investment. In our opinion, investment sentiments sour beyond positions supported by fundamentals. As the **NSE** echoes the global decline in equities, opportunities to attain positions in perennial strong earning performers on the cheap is on the rise. The market currents is heavily underrating **EABL**, pricing the counter at **KES 199.75** close to its **52-week** low of **KES 160**. The low valuation, **36%** below our current Target Price of **KES 246.65**, provides a great opportunity for investors to overweight their exposure to EABL at historical lows.
- » **The market is underestimating the new trajectory of earnings after a successful Management refocus on innovation and value:** Management has successfully implemented a raft of changes to revitalize their offering since the disappointing FY17 and FY18 EPS performance. The management seem to have hit on strategies that rides the intricacies and the complexity of the developing alcohol market in Kenya and the region at large by innovating and bolstering their value offering. Innovation around premium brands and beers is bringing the attention from the millennial consumers who seem want to differentiate themselves from the mainstream consumer. Investment in new capacity in Kisumu we also believe holds the key in continuing to make the Senator Keg more competitive in the face of the dominance of Alternative brews.
- » **The recovery of the regional disposable income will be crucial for EABL's revenue growth:** We see revenue growth in FY19 growing at around 4.1%, slightly below the FY18 revenue growth of 4.6%. Increased demand caused by an increase in disposable income in the medium term should stabilize revenue growth in the next four years. The stable growth in revenue combined with a focus on cost mitigation should continue to help bring EPS back to double digits.
- » **Leverage and the regulatory arena remains a concern:** The tax, leverage and regulatory environment, however, continue to pose a threat to our valuation. Alcohol consumption is seen by the conservative regional governments as a prime target for tax and other forms of regulation meant to curb its consumption. We have added a 1% premium to our Equity Risk Premium to reflect this risk but we advise investors to continue to watch for any developments in the region to manage the risks

July 18, 2019

EABL

Rating: **BUY**Target Price **264.65**Current Price **199.25**Upside **36%**Dividend Yield(ntm) **4%**Forecast Total Return **40%**52- Week trading range **268 to 160**

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GLOBAL ALCOHOL MARKET

- » **Global alcoholic beverage Market is projected to grow to \$1.7Bn by 2025:** A report by the Allied Market Research Company estimated that the global alcoholic beverages market was valued at \$1.4 trillion in 2017 and is expected to expand to 1.7 trillion by 2025, recording a CAGR of 2% from 2018 to 2025. Europe currently dominates in the consumption of Alcohol but the Asia-Pacific region, as the fastest growing region, currently holds the key to future global consumption.
- » **Spirits is the most popular but Beer remains the key segment that currently drives the global consumption.** The bulging global young-adult demographic, growing global disposable income and consumer shifts to the premium/super premium segment. Economic growth, health concerns and industry innovation is driving a new kind of consumer, the millennial, towards the premium end of the market. The changing consumer preferences has seen the market gradually increase in the amount the typical consumer is willing to pay in exchange in exchange for use of quality ingredients and healthier innovative products.
- » **AB-Inbev remains global king.** As per the latest annual Forbes 2000 list Anheuser-Busch Inbev (AB-Inbev) was ranked as the largest alcoholic beverage company globally followed by Diageo and Heineken. The rankings are based on a combined metric that takes into account the company's global performance in terms of sales, profits, assets and market value.

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Table 1: 2018 ALCOHOLIC BEVERAGE COMPANIES- GLOBAL RANKINGS

Rank	Company	Sales (\$ Bn)	Profits (\$ Bn)	Assets (\$ Bn)	Market Value (\$ Bn)
1.	Anheuser-Busch Inbev	56.4	7.9	248.6	184.3
2.	Diageo	15.7	4.1	40.7	89.4
3.	Heineken	24.7	1.1	51.2	28.5
4.	Pernod Ricard	10.2	1.8	35.8	43.6
5.	Kweichow Moutai	8.5	4.4	21.4	142.4
6.	Asahi Group Holdings	19.4	1.4	29	25.3
7.	Kirin Holdings	16.6	2.2	21.1	25.5
8.	Constellation Brands	7.6	2.3	20.5	41.6
9.	Molson Coors Brewing	10.9	1.5	30.2	13.1
10.	Wuliangye Yibin	4.4	1.7	12.7	47.2

Source: Forbes AIB Capital

Key Consumption Drivers

- » **The prevalence of alcohol consumption is declining but per capita consumption is increasing:** The World Health Organization (WHO) estimates that alcohol consumers totaled 2.3 billion people- c.31% of the world's population as of 2016. The prevalence of alcohol consumers was particularly high in the Americas, Europe and Western Pacific, where consumers accounted for more than half of the respective countries' populations. The global percentage of drinkers has however decreased in most regions albeit trends of increasing consumption per capita. The global consumption of alcohol per capita expanded to 6.4 liters in 2016 from 5.5 liters in 2005. WHO projects that global per capita consumption rates will rise to 7 liters by 2025, mainly fueled by increased consumption in the Americas, South-East Asia and the Western Pacific.
- » **Globally, the beverage of choice is spirits accounting for 44.8% of the market.** Beer is the second most consumed alcoholic beverage followed by wines and alternative beverages, accounting for 34.3%, 11.7% and 9.3% of global consumption respectively. Consumption of these products is however threatened by illicit brews which constitute 26% of all alcohol consumed worldwide. However, the prevalence of unrecorded alcohol is as high as 46.5% in Africa..

Empirical Drivers of Consumption

The Global status report on alcohol and health found 3 key factors to be the drivers of alcohol consumption. These include age, gender and economic wealth.

- » **Age:** Empirical evidence shows that the prevalence of alcohol consumers generally peaks in young consumers around 20-24 years. Further, drinkers in that age group are often heavy drinkers, with the prevalence of heavy drinkers higher in the same age group in comparison to the combined population.
- » **Gender:** Males dominate the alcohol market both in terms of amount consumed and frequency of consumption. Global statistics show that men are almost twice as likely to be drinkers and they drink close to three times as much as women. Further, men are also almost 7 times more likely to be heavy drinkers in comparison to women. Close to 54.6% of women worldwide are lifetime abstainers. In Africa the proportion of female life time abstainers is as high as 70%.
- » **Economic Wealth.** As per the latest annual Forbes 2000 list Anheuser-Busch Inbev (AB-Inbev) was ranked as the largest alcoholic beverage company globally followed by Diageo and Heineken. The rankings are based on a combined metric that takes into account the company's global performance in terms of sales, profits, assets and market value.

Diageo

Diageo is one of the largest adult beverage companies, recording profits upward of 3Bn in its latest financial year. In Africa, the multinational has a presence in East Africa, Nigeria, South Africa and other regional markets, though the East African region contributes the lion's share of net sales in Africa. Net sales in the African region are fueled by beer sales despite Diageo's core competency being in the spirits segment. Mainstream and premium brands have the highest contributions to net sales in the African market followed by value brands. Diageo's key brands in the African space include Guinness, Malta Guinness, Johnnie Walker, Smirnoff, Tusker, Senator and Satzenbrau. The Satzenbrau and Senator beer brands are key drivers of top line growth for Diageo in Africa recording growth of 34% and 17% in net sales as of Diageo's latest financial year. Diageo, operates in East Africa through EABL, having acquired a majority stake (50.03%) in the company.

Table 2: EABL'S MAJOR SHAREHOLDING

Principal Shareholders	Stake
Diageo Kenya Ltd	42.82%
Diageo Holding Netherlands B.V	4.60%
Guinness Overseas Ltd.	2.61%
Total	50.03%

Source: EABL FY18 financials. AIB Capital

Africa & EABL's Market

- » **Africa's growing young adult population point to a crucial future demographic tailwinds:** With demographics of the more advanced countries shifting in favor of an older generation, beverage giants such as Diageo, AB-Inbev, Heineken and Castle are seeking African markets to ride the demographic dividend. Further, consumption preferences of the more advanced counties are leaning more and more towards spirits leaving multinational brewers to seek new markets for their produce..
- » **Africa's consumption trends also make the continent attractive to multinationals.** The average per capita consumption in Africa as of 2016 stood at 6.3 liters, significantly higher than the global average of 5.5 liters. Consumption in EABL's key markets was even higher, averaging at 7.8 liters of pure alcohol. WHO however forecasts that consumption is likely to moderate to about 7.5 liters in 2020 through to 2025..

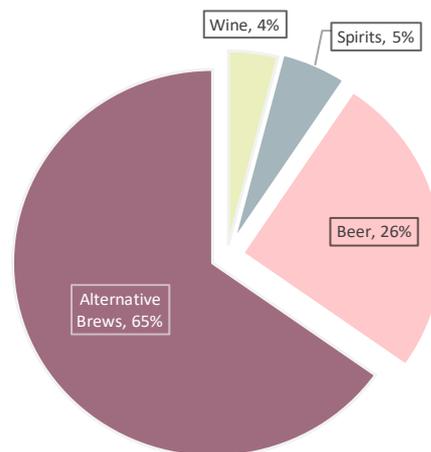
Table 3: Total Alcohol Per Capita Consumption (liters of pure alcohol)

Country	Estimated	Projections	
	2016	2020	2025
Kenya	3.4	2.7	3.1
Uganda	9.5	9.8	10.3
Tanzania	9.4	9.6	9.9
Rwanda	9.0	8.4	7.6
Burundi	7.5	7.0	6.6
Average	7.8	7.5	7.5

Source:WHO. AIB Capital

- » **Alternative brews still rules the roost.** In the general African region, the adult beverage of preference is alternative brews claiming 65.1% of the alcoholic drinks sector followed by beer and spirits at 25.5% and 5.3% respectively. Wine is the least preferred alcoholic drink claiming a mere 4% of the market. A similar trend is replicated across EABL's markets.

Graph 1: Africa - Alcohol Consumption by Product



Source:WHO. AIB Capital

- » **The beer segment in Africa is buckling the global trend.** The growth in the beer segment has been robust in Africa albeit declining global trends, with the beer consumption going up by 4% between 2012 and 2014 recording and projected to grow by 5% between 2015 and 2020. Within the East African market, there has been a shift away from premium beer brands into the value brands. Key players in the segment including AB-InBev have reported that their growth is rooted in the lower end of the market where the incumbent has been the informal brewers and traditional brews.

- » **Africa's young population can support the above global growth in consumption of Alcohol:** The region is predominantly young with 62.3% of the Eastern African population estimated to be less than 24 years of age. The latter is in comparison to global statistics where the same age group accounts for 59.4% of population. The age group between 15 and 24 (the peak drinking age) formed about 20.4% of the population and is expected to increase marginally to 20.6% in 2020, slightly above the world averages of 19.3% and 19.2% in 2015 and 2020 respectively. Further, the region's demography is slightly skewed towards women, who on average drink less, with men constituting 49.6% of the population.

Table 4: GLOBAL DEMOGRAPHY GLOBAL & PROJECTIONS

Region	Year	0Yrs - 24Yrs	15Yrs - 24Yrs	25Yrs +
World	2015	42.3%	16.2%	57.7%
	2020	40.9%	15.4%	59.1%
	2025	39.8%	15.2%	60.2%
Africa	2015	60.3%	19.3%	39.7%
	2020	59.4%	19.2%	40.6%
	2025	58.4%	19.4%	41.6%
Eastern Africa	2015	63.8%	20.4%	36.2%
	2020	62.3%	20.6%	37.7%
	2025	60.5%	20.5%	39.5%

Source:UN. AIB Capital

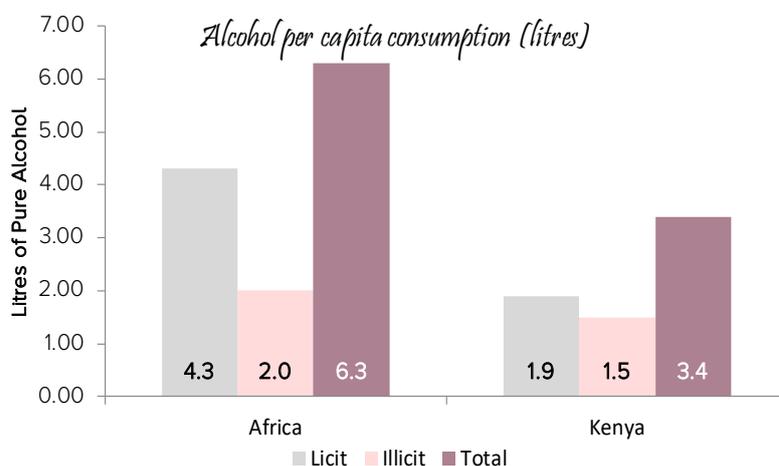
Table 5: REGIONAL POPULATION PROJECTIONS

Region	Year	0Yrs - 24Yrs	15Yrs - 24Yrs	25Yrs +
Kenya	2015	61.5%	20.1%	38.5%
	2020	59.6%	20.5%	40.4%
	2025	57.4%	20.6%	42.6%
Rwanda	2015	59.8%	19.0%	40.2%
	2020	58.6%	19.6%	41.4%
	2025	56.5%	20.3%	43.5%
South Sudan	2015	62.4%	20.4%	37.6%
	2015	61.2%	20.3%	38.8%
	2020	59.7%	20.0%	40.3%
	2025	68.6%	20.4%	31.4%
Uganda	2015	67.4%	20.7%	32.6%
	2020	66.0%	20.9%	34.0%
	2025	64.6%	19.4%	35.4%
Tanzania	2015	63.9%	19.7%	36.1%
	2020	63.0%	20.1%	37.0%
	2025	63.0%	37.0%	20.1%

Source:UN. AIB Capital

COUNTRY PROFILE I: Kenya

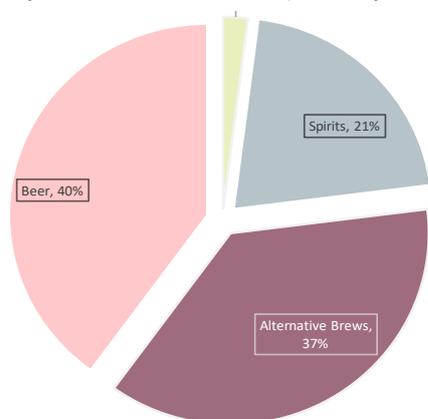
- » **Consumption of alcohol in Kenya still relatively below the African average:** In Kenya the consumption in pure liters of alcohol averaged 3.4L in 2016. This was far below the 6.3L average consumed across Africa. Consumption projections estimate that alcohol consumption is bound to moderate to 2.7L per capita by 2020 before picking up to 3.1L in 2025. Of the consumed amount, 44% is in the form illicit brews. This is well above the African average of 31.7%. Illicit brews continue to plague the formal alcohol markets particularly in the value segments since the markets are heavily price sensitive.



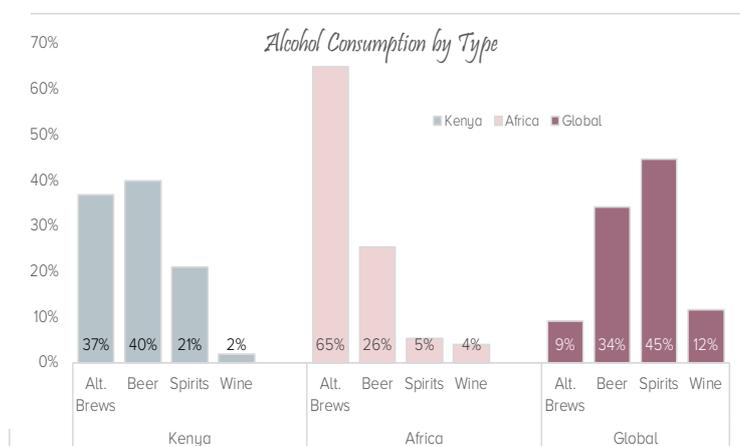
Source:WHO. AIB Capital

Unlike the rest of Africa, the beverage of choice is beers claiming a market share of 40% whereas wine is least preferred claiming only 2% of the alcoholic beverage market.

Graph 2: Kenya - Alcohol Consumption by Product



Source:WHO. AIB Capital



Source:WHO. AIB Capital

- » **The drinking population in Kenya is estimated at about 23.9%** of the country's population and almost half of drinkers are considered heavy drinkers (46%). In line with global trends, drinking peaks between the ages of 15 and 19 years with 59.1% of the age group classified as heavy drinkers.
- » **Diversified alcohol palate in Kenya necessitates a diversified EABL offering:** EABL operates through Kenya Breweries Limited (KBL) in Kenya, where the company is the dominant player in the market with an overall market share of 71.5%. As is EABL's strategy, the company offers a variety of products targeting various price points.

Table 6: KENYA - THE KEY BRANDS

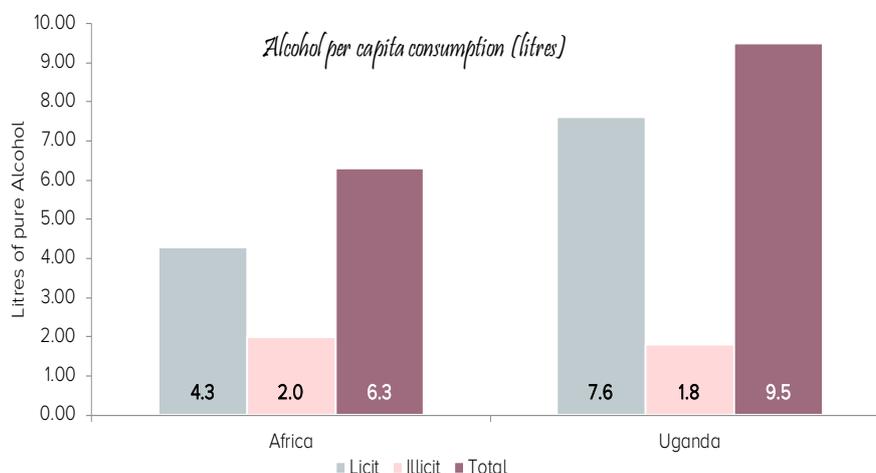
Segment	Premium Brands	Mainstream Brands	Value Brands	Innovation Brands
Beer	Tusker Lite Guinness WhiteCap	Tusker Lager	Senator	Tusker Cider
Spirits	Johnnie Walker	Smirnoff	Kenya Cane Chrome	Kenya Cane Citrus & Coconut

Source:EABL. AIB Capital

- » **HY19 Net Sales in Kenya were up 12%:** In EABL’s latest half year results, Kenya’s net sales were up 12% from -4% recorded in the corresponding period last year. Growth in Kenya was mainly driven by the scotch and Senator brands which grew by 37% and 35% respectively. On the other hand, net sales of bottled beer remained relatively flat during the review period. The subdued performance was as a result of the increased excise duty by Kshs.5.20. EABL passed the tax to their consumers coupled with a slight margin that netted off the negative effects of increased prices on volumes.

COUNTRY PROFILE II: Uganda

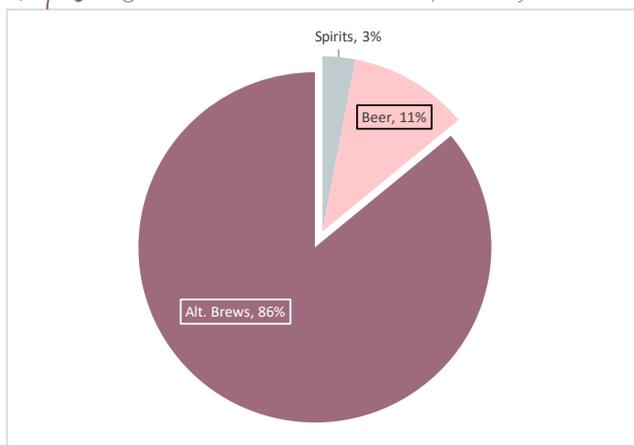
- » **Ugandan remain the biggest consumer of alcohol in East Africa:** Data from the World Bank shows that as of 2016, Uganda had the highest alcohol consumption per capita in East Africa at 9.5 liters per capita. The Ugandan market is dominated by value offerings with 68% of the alcohol markets being illicit brews mostly packaged in sachets. The latter is reflective of the price sensitivity of alcohol in the Ugandan market.



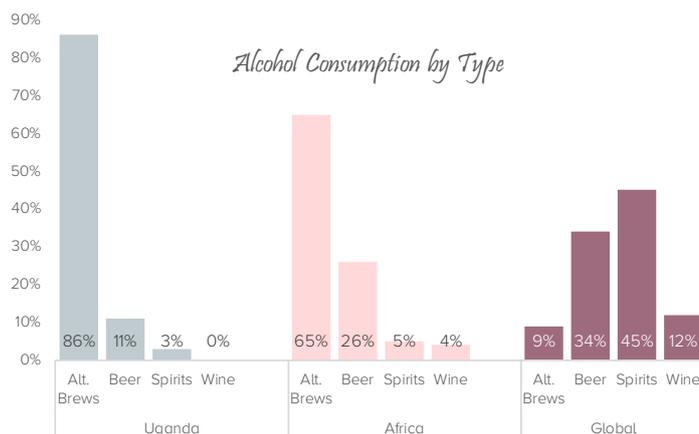
Source:WHO. AIB Capital

- » **Ugandan remain the biggest consumer of alcohol in East Africa:** Data from the World Bank shows that as of 2016, Uganda had the highest alcohol consumption per capita in East Africa at 9.5 liters per capita. The Ugandan market is dominated by value offerings with 68% of the alcohol markets being illicit brews mostly packaged in sachets. The latter is reflective of the price sensitivity of alcohol in the Ugandan market.
- » **Uganda still have a preference for Alternative brews with 86% of alcohol consumed:** The market heavily prefers local brews such as Ajon, Omuramba and Kweete with beers and spirits only accounting for 11% and 3% respectively.

Graph 3: Uganda - Alcohol Consumption by Product



Source:WHO. AIB Capital



Source:WHO. AIB Capital

- » **Innovation Brands leading the EABL charge in Uganda:** EABL's Ugandan arm, Uganda Breweries Limited (UBL) was once the dominant player in the Ugandan market with a market share of c. 90%. However, fierce competition from AB-Inbev's Nile Breweries in recent years has led to a dissipating market share. Demand for the company's flagship brand, Bell, has been abating as the younger generations fail to match the previous generations' uptake of the product (volume growth of the beer in 1H18 stood at 3%). To remedy the situation, UBL introduced innovation beers in 2016. Among them was the Ngule beer brand which was well received by the market. The innovation beer was created through collaborative efforts of UBL and the Buganda kingdom. The beer was a success claiming a market share of 7%, a few months after its introduction. The beer's success has been underpinned by the sense of ownership it inspires among the Buganda people having been created for and commercialized by the Buganda kingdom.

Table 6: UGANDA -THE KEY BRANDS

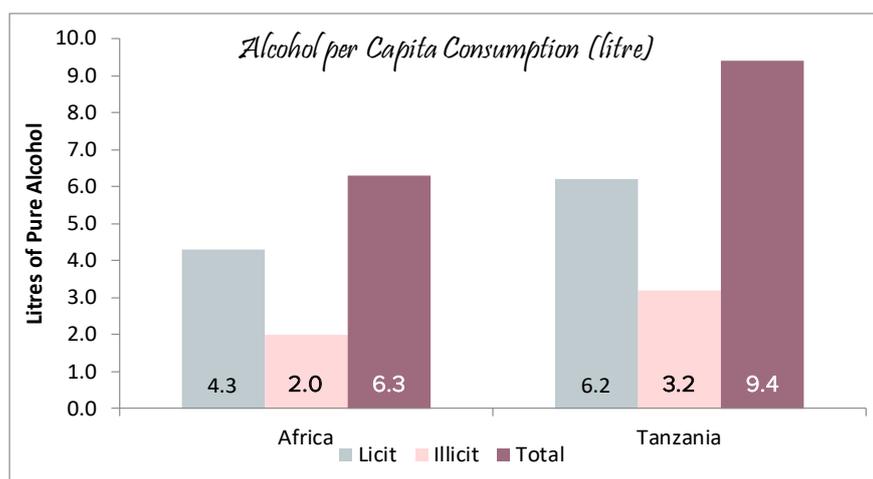
Segment	Premium Brands	Mainstream Brands	Value Brands	Innovation Brands
Beer	Guinness	Bell Lager Tusker Malt	Senator	Ngule
Spirits		Uganda Waragi		Uganda Waragi- Coconut & Citrus

Source: EABL. AIB Capital

- » **EABL's Ugandan market posted a HY19 bounce back:** The Ugandan market registered strong Net Sales Value performance in 1H19, growing at 12% compared to a decline of -0.3% last year. Growth in this market was catapulted by premium beers (Guinness and Tusker Lite) which grew by 21% in net sales. Spirits also delivered strong growth in net sales of 16%.

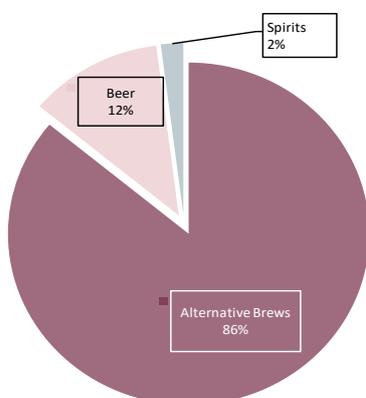
COUNTRY PROFILE III: Tanzania

- » **Total alcohol consumption in Tanzania averaged 9.4 liters of pure alcohol per capita in 2016** a marginal decrease from 9.7 liters in 2010. During the period, consumption of commercially produced alcohol contracted whereas consumption of illicit brews remained stable at 3.2 liters per capita or 51.6% of consumed alcohol.
- » **Male drinkers dominated the alcohol market, consuming an average of 16 liters per capita** as opposed to women who consumed a mere 2.9 liters. In the regulated space, the alcoholic beverages of choice are local brews, capturing 86% of the market. Commercially produced beer is less preferred to local brews claiming a 12% share followed by spirits and wine that make up 2% and 1% respectively.

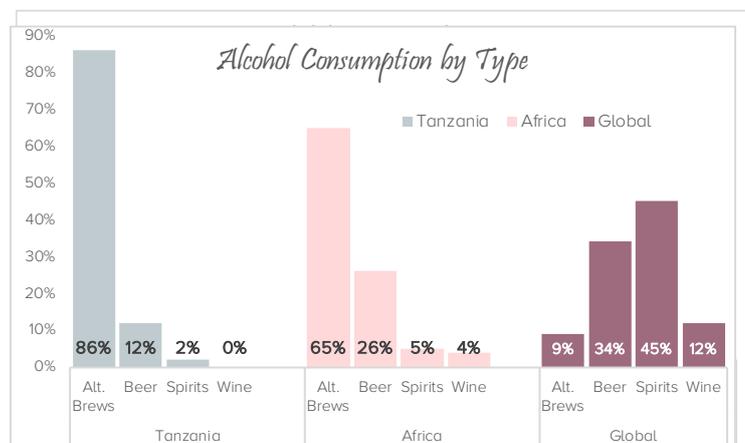


Source:WHO. AIB Capital

Graph 4: Tanzania - Alcohol Consumption by



Source:WHO. AIB Capital



Source:WHO. AIB Capital

- » **EABL operates through Serengeti Breweries Limited (SBL) in Tanzania:** SBL controls 15% of beer volumes in Tanzania placing the subsidiary as the second largest beer manufacturer in the country, after AB-Inbev's Tanzania Breweries Limited (TBL) which is the market leader holding 75% of the market. Tanzania's flagship brand is the Konyagi liquor owned by Breweries Limited. In 2017, EABL opted to convert all its outstanding loans to its Tanzanian arm into equity thereby increasing its effective stake from 51% to 72.5%. A total of 4.3Bn was written off.

COMPANY SPECIFIC: East African Breweries Limited

Background Information:

East African Breweries Ltd. (EABL) is a holding company based in Kenya with a significant stake in a number of beverage manufacturing, marketing and distributing companies across East Africa. The adult beverage manufacturer segments its subsidiaries into 4 main functional areas; beer manufacturing, spirit manufacturing, raw material sourcing and distribution companies.

Table 6: EABL Group

Segment	Country	Company	Stake
1. Beer manufacturing	Kenya	Kenya Breweries Limited (KBL)	100%
	Uganda	Uganda Breweries Limited (UBL)	98%
	Tanzania	Serengeti Breweries Limited (SBL)	72.5%
2. Spirits manufacturing	Kenya	UDV Kenya	46%
	Kenya	International Distillers Kenya Ltd.	100%
	Kenya	Gilbeys East Africa	100%
	Kenya	Kenya Distillers Ltd.	100%
	Uganda	International Distillers Uganda Ltd.	100%
3. Raw material sourcing	Kenya	East African Maltings Ltd.	100%
	Uganda	East African Maltings Uganda Ltd.	100%
4. Distribution	Regional Markets	EABL International Ltd	100%
	Kenya	Kenya Liquor Distributors Ltd.	100%
	Kenya	Harp Distributors	100%

Source: EABL, AIB Capital

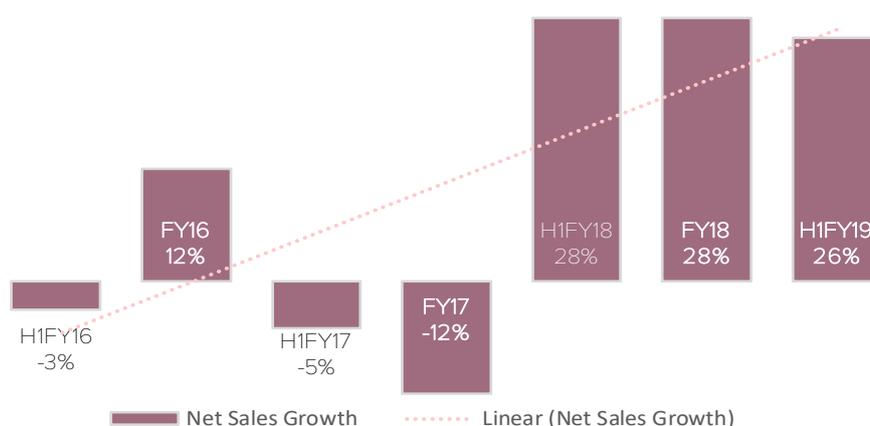
The company's presence is particularly strong in Kenya, Uganda and Tanzania, with the Kenyan market being the largest contributor to revenue

Investment Drivers and Risks

Key Value Drivers

- » **Kisumu Brewery opens up opportunities for EABL:** EABL recently undertook a KES 14Bn CAPEX project to revamp its Kisumu brewery with a targeted initial capacity of 1Mn HL. The brewery sits on 55 acres and is in close proximity to Lake Victoria, allowing for easy access to the large amount of water required in alcohol production. The plant will exclusively produce Senator Beer. As a result, we expect increased volumes of the Senator brand going forward. The plant's strategic positioning poses opportunities for growth as it will enable EABL to penetrate new markets in western Kenya and other regional markets. The brewery is in close proximity to the Kisumu port giving the brewer access to the Ugandan market where the brand is also sold in the 50L kegs as well as 500ml bottles. The plant is anticipated to begin commercial production 6 months prior to the planned date thereby saving the company KES 1Bn in project costs. The company will therefore book an accounting income of 1Bn as an over provision in 2H19.
- » **The Senator value brand will continue to underpin growth:** In FY17, senator accounted for c.25% of EABL's beer volume. We anticipate that the product mix will continue to shift in favor of the product line as from FY19 owing to the commissioning of the Kisumu brewery. The increase in volumes will help EABL penetrate the value segment and capture some market share from illicit brews. Earnings from the brand are also likely to recover from FY18 where EABL took a KES 1.7Bn hit associated with production cuts of the beer and a 20% excise-led price increase which depressed demand (**EABL FY18 report**). Going forward it is likely that government taxation on Senator Keg will remain mute due to its relative high price elasticity. Price increases significantly affect Senator's net sales and depress taxable revenue; thereby making tax increases an unlikely course of action for the government. Further, Senator's increasing importance to the product mix, raises concerns over margin erosion. We see Senator brand will continue to enjoy the current tax remission of 80% since management has stated that it will continue to source raw materials, such as sorghum, locally for the foreseeable future.
- » **Tanzania revival remains crucial for growth in the medium term:** The Tanzanian market which had previously weighed on EABL's earnings has been at the forefront of growth in the company's latest fillings. Net sales expanded by 28% and 26% in FY18 and H1FY19 respectively from a decline of 12% in FY17.

Net Sales - Tanzania

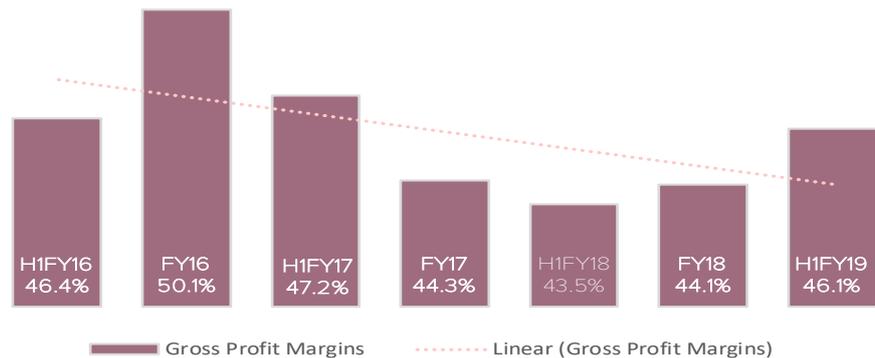


Source: EABL, AIB Capital

Management has attributed the turnaround in its Tanzanian business to an elaborate marketing and repackaging strategy using the Serengeti lite brand. The ban of sachet spirits also had a positive spillover effect into the beer markets. Value consumers were under-served after the abolition of sachets and these consumers flocked into the beer market, effectuating growth in the segment.

- » **The Premium & Reserve segment hold the key to margin enhancement:** In 1HY19, EABL's gross margin improved by 2.7% to 46.1% driven by a 54% growth in reserve spirits as well as efficiency and cost cutting measures. This was however a drop from 47.2% registered in 1H17. Growth in 1H17 was fuelled by the product mix that favored spirits (which have a higher margin) as opposed to beers.

Gross Profit Margin - Group



Source: EABL, AIB Capital

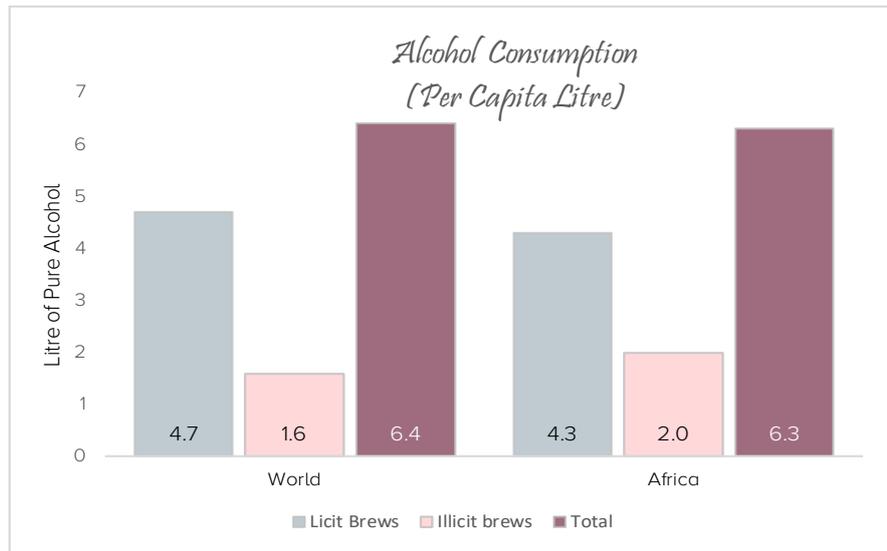
Premium and reserve brands are fundamental to the group's future success given that there is a small but growing segment of wealthy and discerning consumers in East Africa. The marketing and selling of premium and reserve brands will likely to continue boosting the group's margins. The premium & reserve brands sales are, however, likely to be concentrated in Kenya, where EABL's enjoys the lion's share of the premium spirit market. Knight Frank's wealth report details that there are currently 9,482-dollar millionaires in Kenya and 125 individuals worth more than Kshs.3Bn. This presents a small but high margin market for the company.

- » **The double edge sword of Diageo's "Premium" strategy will also help diversify revenue streams and expand margins:** The 'Premium' strategy the group is currently undertaking is straight out of Diageo's play book as it seeks to capture a wider market for its portfolio. Although the strategy yielded significant margin expansion in its latest half year results, premium offerings may suffer in the Tanzanian and Ugandan markets owing to the countries' unique proclivities to local brews. Local brews account for more than 80% of the alcohol markets in those countries and rival players like AB-Inbev have capitalized on those trends, partnered with local brewers.



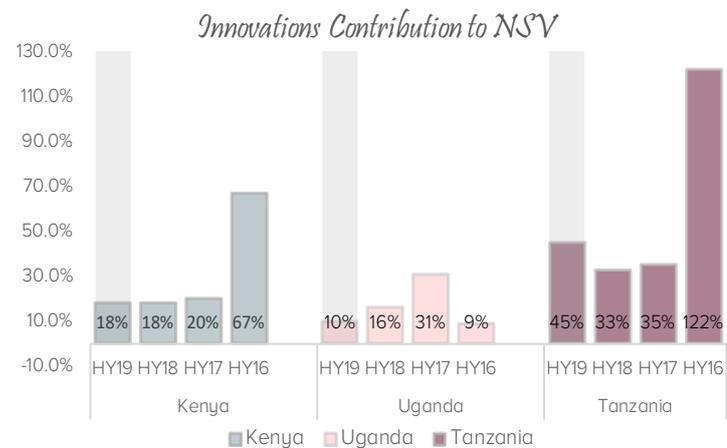
Source: EABL, AIB Capital

- » **Crackdown against counterfeits and illicit brews:** Illicit brews continue to plague the adult beverage markets globally and more so in Africa. WHO estimates the informal alcohol markets in Sub-Saharan Africa to be three to five times the value of formal alcohol markets. As revenues of premium beer begin to flatten, alcohol producers are shifting more towards the value end of the markets attempting to recruit consumers of illicit brews into the formal markets. The governments' war against counterfeits and illicit products is likely to weed out EABL's competitors in the informal segments, thereby increasing government revenue and allowing for fair competition within the value segments. The stringent clearance at the Kenyan ports is however likely to delay the clearance of licit products



Source: WHO, AIB Capital

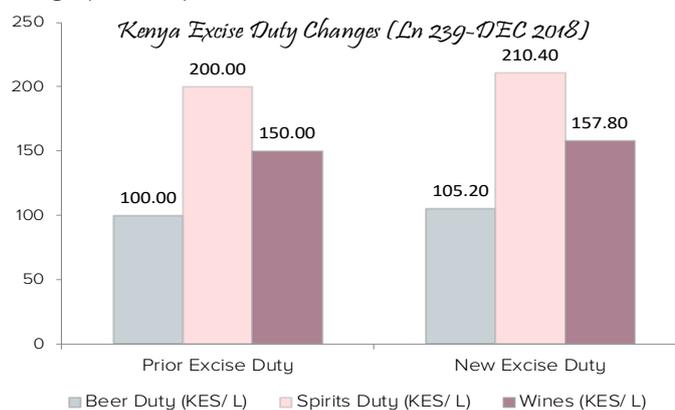
- » **Innovation Brands:** The contribution of innovation brands to net sales value grew by 20% in the period from July to December last year. EABL maintains a strong focus on innovation and adapting to consumer tastes in order to appeal to the c.1Mn youth that reach drinking age each year. The company uses a market based model tailoring its products to its particular markets as well as the young demographic in its markets. Judging by the success of innovation brands in the past, our view is that innovation brands will continue to be pertinent to earnings as well as market expansion.



Source: EABL, AIB Capital

Key Investment Risks

- » **The Tax Environment:** EABL is the second largest contributor to government revenue in Kenya (1% GDP). The company has previously been subject to drastic tax increases to abridge fiscal deficit. However, the intensity of latter trend is unlikely to abate since the imposition of these taxes has historically suppressed volumes and consequently taxable revenue especially around the price elastic value market segment in the region. Investors should expect that in the coming fiscal years, that tax rates in the region would be revised upward to narrow bulging fiscal deficit. Governments are likely to continue targeting the popular “sin tax” basket of goods, making EABL’s entire portfolio a ripe target. Any upward tax revisions of will likely be skewed the group’s premium and reserve brands as opposed to the price sensitive value offerings (Senator).



In Tanzania, the Tanzania Revenue Authority has effectuated the Electronic Tax System (ETS). The switch from the paper system to an electronic system is expected to increase transparency and reduce tax evasion. With the system, TRA is able to track goods from the factories to their final destination and even determine in advance, the duty to be paid. The enforcement of the system means that manufactures now need to incur an additional cost of \$10 for every 1000 units of production to cater for the installation and maintenance of the system.

- » **Ban of Sachet Alcohol in Uganda:** The Ugandan sachet ban is also likely to improve margins since the low value offerings will no longer drag margins. However, volumes of the mainstream spirits (Waragi and Bond 7), which have previously driven earnings, are likely to be negatively affected, thus posing a risk to earnings.
- » **Kisumu Brewery debt:** The construction of the Kisumu brewery was a significant investment for EABL. The project was initially estimated to be worth Kshs.15Bn- 12.5 of which was to be finance with debt. The listed company had initially taken out the loan with its parent company Diageo but later refinanced the amount with local banks for tax purposes. The company’s gearing ratio currently stands at 70.22% from 66.85% in 2017. The increased debt taken to finance the brewery also increases the company’s currency risk since 60% of the loan is denominated in euros and only 40% is in Kenyan shilling. However, management has taken steps to mitigate this risk with a change of the Euro debt under a dynamic hedge. on short term only to manage risk and costs-long term expensive pegged to expectations of the future. 5-7 years maturity.
- » **Increased Competition Outside Kenya-AB-Inbev:** TAB-Inbev’s African subsidiaries are EABL’s largest threats in Uganda and Tanzania. The beverage manufacturing giant controls 75% of the Tanzanian market through Tanzania Breweries Limited and 60% in Ugandan market through Nile Breweries Limited. TBL’s \$100Mn brewery compared SBL’s 3 production plants with a cumulative capacity of 1.5Mn HL, expandable to 1.8Mn HL..

Income Statement

Income Statement (KES OOO)	2016	2017	2018	2019F	2020F	2021F
Revenue	64,322,220	70,247,065	73,456,832	76,491,407	79,736,657	82,934,243
Cost of sales	(28,950,488)	(36,074,661)	(37,891,637)	(36,009,057)	(37,637,587)	(38,853,804)
Gross profit	35,371,732	34,172,404	35,565,195	40,482,351	42,099,070	44,080,439
Selling costs	(6,058,859)	(5,375,078)	(6,423,767)	(6,582,385)	(6,861,651)	(7,136,816)
Administrative expenses	(8,607,612)	(7,860,901)	(8,115,660)	(8,462,413)	(8,790,169)	(9,130,705)
EBITDA	20,705,261	20,936,425	21,025,768	25,437,553	26,447,250	27,812,918
Less Depreciation & amortization	(3,449,620)	(3,430,320)	(3,579,956)	(4,313,525)	(4,745,709)	(5,195,217)
less restructuring costs	(108,921)	-	-	-	-	-
EBIT	17,146,720	17,506,105	17,445,812	21,124,028	21,701,541	22,617,701
Other (expenses/incomes)	(262,539)	(1,025,056)	(2,344,884)	(2,086,908)	(2,175,448)	(2,262,688)
Finance income	280,738	81,686	81,949	-	-	-
Finance cost	(3,545,979)	(3,255,402)	(3,441,067)	(3,353,598)	(3,353,598)	(2,706,098)
Profit before tax	13,618,940	13,307,333	11,741,810	15,683,521	16,172,494	17,648,914
Tax	(5,597,555)	(4,792,765)	(4,486,255)	(4,705,056)	(4,851,748)	(5,294,674)
Profit for the year	8,021,385	8,514,568	7,255,555	10,978,465	11,320,746	12,354,240

Balance sheet

Balance Sheet (KES OOO)	2016	2017	2018	2019F	2020F	2021F
Equity attributed to owners..	11,283,415	12,385,573	5,680,945	12,310,150	19,281,635	27,286,616
Non-controlling interest	(416,169)	(397,403)	5,971,091	5,971,091	5,971,091	5,971,091
Total Equity	10,867,246	11,988,170	11,652,036	18,281,241	25,252,726	33,257,707
Deferred tax liabilities	1,303,190	5,095,988	3,264,233	3,264,233	3,264,233	3,264,233
Borrowings	21,473,594	27,488,274	30,546,789	30,474,500	25,474,484	25,145,486
Non-Current Liabilities (NCL)	22,909,537	32,694,428	33,811,022	33,738,733	28,738,717	28,409,719
TOTAL EQUITY & NCL	33,776,783	44,682,598	45,463,058	52,019,974	53,991,443	61,667,426
Property, plant & equipment	35,606,808	37,317,446	45,363,844	49,141,436	52,829,720	56,406,553
Intangible assets-Software	422,611	562,815	441,597	410,926	379,065	345,969
Intangible assets-Goodwill	3,577,191	2,839,319	2,712,564	2,712,564	2,712,564	2,712,564
Intangible aseets-Brand	563,005	482,562	459,394	459,394	459,394	459,394
Prepaid operating leases rentals	10,309	14,992	7,351	7,011	6,671	6,331
Other investments	10,000	10,000	10,000	10,000	10,000	10,000
Deferred tax assets	-	3,304,578	726,114	726,114	726,114	726,114
Non Current assets	40,189,924	44,531,712	49,720,864	53,467,445	57,123,528	60,666,925
Current Assets	21,556,281	22,134,600	21,525,962	24,335,283	23,586,959	28,646,431
TOTAL ASSETS	61,746,205	66,666,312	71,246,826	77,802,728	80,710,487	89,313,356
Current Liabilities	27,969,422	21,983,714	25,783,768	25,782,754	26,719,028	27,645,914
Net assets	33,776,783	44,682,598	45,463,058	52,019,974	53,991,460	61,667,442

EABL Valuation Assumptions	
Variable	Assumed
Rfr (10-yr T-bond)	12.250%
Equity Risk Premium	4.5%
Regulatory Risk Premium	0.5%
Leverage Risk Premium	0.5%
Adjusted Beta	0.63
Cost of Equity (Based on CAPM)	15.6%
Cost of Debt	12.0%
Equity/Debt Ratio	37.5%
Terminal Growth	6.0%
Exit P/E	20
Tax Rate	30.0%
WACC	10.4%
No of Shares	788,296
Valuation Day	8-Jul-19
Share Price	195

1.0 Discounted Cashflows (DCF) 'KES 000'	30-Jun-20	30-Jun-21	30-Jun-22	30-Jun-23	30-Jun-24
EBIT	21,124,028	21,701,541	22,617,701	23,021,041	23,213,325
EBIT(1-TAX)	14,786,820	15,191,078	15,832,391	16,114,728	16,249,327
Add Depreciation & Amortization*(Tax)	4,313,525	4,745,709	5,195,217	5,661,845	6,145,419
Less Investment in working capital	(4,518,303)	3,179,050	(4,518,303)	(1,325,369)	446,274
Less Capex	(8,209,144)	(8,557,153)	(8,900,205)	(9,239,157)	(9,574,662)

FCFF	6,372,897	14,558,684	7,609,099	11,212,048	13,266,358
Terminal value					322,546,049

Time(T)	0.96	1.96	2.96	3.96	4.96
PV Period	0.910	0.825	0.747	0.677	0.613
PV Cash flow	5,799,662	12,005,411	5,685,613	7,591,334	205,968,926
Cummulative PV	237,050,945				
Add Cash	3,588,370				
Less Debt	(31,066,701)				
Equity value	209,572,614				
Number of shares	788,296				
Value per share (DCF)	265.86				

2.0 Residual income	30-Jun-20	30-Jun-21	30-Jun-22	30-Jun-23	30-Jun-24
Net income	10,978,464	11,320,745	12,354,239	12,590,122	13,509,427
Total Equity	18,281,241	25,252,726	33,257,707	41,498,569	50,658,737
Cost of equity	15.59%				
Equity Charge	(2,849,131)	(3,935,637)	(5,183,214)	(6,467,552)	(7,895,164)

Residual Income	8,129,332	7,385,107	7,171,026	6,122,570	5,614,263
Exit price					270,188,535

Period	0.96	1.96	2.96	3.96	4.96
PV Period	0.910	0.825	0.747	0.677	0.613
PV Cash flow	7,398,108	6,089,921	5,358,278	4,145,404	169,162,321
Cumulative pv	192,154,032				
Number of shares	788,296				
Value per share (Residual Income)	243.76				

3.0 Relative Valuation

3.1 P/E

SSA Industry Medium P/E	19.73
FY 2020 EPS	13.88
Fair Value	273.95

3.2 EV/EBITDA

SSA Industry EV/EBITDA multiple	10.21
FY 2020 EBITDA	25,437,553
Enterprise Value	259,796,271
Less Debt	(31,066,701)
Add Cash	3,588,370
Implied Market Capitalization	232,317,940
No of Shares	788,296
Fair Value	294.71

Value Per Share (Relative Valuation)	284.33
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4.0 Valuation

Methodology	Fair Value Estimates	Weighting	Weighted Average
Discounted Cash Flows (DCF)	265.86	33.33%	88.62
Residual Value	243.76	33.33%	81.25
Relative Valuation (P/E, EV/EBITDA)	284.33	33.33%	94.78
Target Price			264.65

5.0 Recommendation:

Current Share Price	195.00
Upside/(Downside)	36%
Dividend Yield	4%
Total Return	40%
Recommendation	Buy

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