

Fig1: Key Statistics

Bloomberg Ticker	KNOC KN
Reuters Ticker	KOCL.NR
Current price (KES)	12.05
Fair value	15.80
Total issued shares ('000)	1,471,761
Free Float (%)	30.60%
Market Cap (KES '000)	17,734,723
Av daily traded T.O (KES)	6,389,449
Av daily traded vol	625,554
52 Week range	8.90 -12.30
1yr return	36.62%
6M return	22.96%
3M return	21.11%
Year end	Dec

Source: Company filings and DB estimates

Fig2: Key Forecasts

Key Forecasts	2011A	2012F	2013F
Gross Profit	12,333	16,016	18,418
% Growth	62.34%	29.86%	15.00%
Gross Profit margin (%)	5.54%	6.00%	6.00%
EBITDA	6,307	8,875	9,319
% Growth	44.58%	40.73%	5.00%
EBITDA Margin (%)	2.84%	3.10%	3.10%
EBITDA to Interest Coverage	4.46	4.43	4.43
PBT	4,934	5,606	6,446
% Growth	73.96%	13.61%	15.00%
PBT margin (%)	2.22%	2.10%	2.10%

Source: Company filings and DB estimates

Fig3: KenolKobil Vs NSE 20 share index



Source: Bloomberg

KenolKobil.....Rallying growth through regional expansion and business diversification

We initiate coverage on KenolKobil with a **BUY** recommendation based on a fair value of **KES 15.80**, representing a 31% upside potential on the current market price. Our investment case is informed by the company's expansion strategy in Sub-Saharan Africa where we project a 3 year CARG of 14.9% in revenues as well as strong growth in the EBITDA margin (FY 2013F: 3.10%), occasioned by increased operating efficiencies. We believe KenolKobil has strategically positioned itself by increasing its capacity on the midstream and downstream segments that will enable it to tap into new business lines particularly with the discovery of oil reserves in the East African region. KenolKobil has a trailing P/E of KES 5.5x, which is below 6.1x industry average and 9.3x African comparables average and P/B Value of 1.5x. Its ROE of 28.10% is higher compared to the 10.67% sector average.

• Volume growth and geographical diversification approach to propagate growth

We estimate revenues to grow by 20% y/y in FY 2012F on account of increased sales. We believe the company will maintain its volume growth approach across its regional markets. Currently it has operations in over eight African countries. The Kenyan market constitutes a significant proportion of this although the company has a long term focus to diversify geographically in the face of underlying sector risks. In FY2011, out of the 3 million M³ in total sales, Kenya contributed 1.058 million M³. Consequently, KenolKobil has moved away from the 'country contribution' approach to its group business and has adopted the 'business-line contribution' approach with more focus on certain niche business lines.

• Business diversification to drive long term profitability

The potentially lucrative commercial real estate business plan will cement the company's balance sheet besides improving the net profit margins, where we project a 3 year CARG of 15.0%. KenolKobil has outlined a CapEx programme of USD 50Mn (USD 10Mn in Kenya and USD 40Mn in both Ethiopia and Rwanda) for non-fuel business expansion, which will be financed partly from its operations and the rest from a strategic partner, according to Business Daily. Additionally, the strategic partner will provide technical expertise on the project, which is expected to be complete by 2015, thus reducing the risk exposure from the fuel business.

• Growth prospects in alternate revenue

We note strong growth in the African trading desk (73% y/y to 1.5 million M³), which we believe will continue to drive the company sales. In 2011, KenolKobil opened two Trading Desks, one in Dar es Salaam and the other in Harare (Ex Beira port), as a result of which KenolKobil's operating costs exposure has been reduced via bulk purchasing. We believe the company will continue to strengthen its operations across the territories.

• Downstream positioning

In line with its storage capacity expansion, KenolKobil acquired 4,000 cubic metres of storage capacity in Lubumbashi from World Oil Congo SPRL. This acquisition was to strategically position KenolKobil to capitalize on Democratic Republic of Congo's mining industry. It expects mining firms to be among its largest clients once it starts selling fuel products and lubricants at wholesale and retail levels. Lubumbashi has an annual demand of fuel exceeding 360,000 tonnes a year.

Kenya Petroleum Industry Overview

Kenya imports approximately 60,000 barrels of crude per day (2.1 billion litres per year) which is refined by the country's only refinery in Mombasa. The other 40% is imported as finished product from other areas, mostly by sea from the Middle East. After the crude oil has landed, the importer has to pay a refining fee to Kenya Petroleum Refineries Limited (KPRL) for processing the crude to final products. The current average processing fee is USD 2.4/bbl (approx. KES 1.20 per litre). The refinery also uses 5% of the crude oil as fuel and loss in its operations, which is recovered in the pricing mechanism. We estimate that the requirement to use the KPRL refinery adds about 3/- per litre in additional costs to the end consumer.

KPRL is keen on expansion with a plan to convert into a merchant refinery. This would mean it would import, process and sell crude products to marketers by July this year. The Kipevu Oil Storage Facility (KOSF), a government owned import tank farm for refined products, is managed/operated by Kenya Pipeline Company (KPC). The charge for using KOSF is USD 3.0/M³ plus VAT (KES 0.28 per litre.)

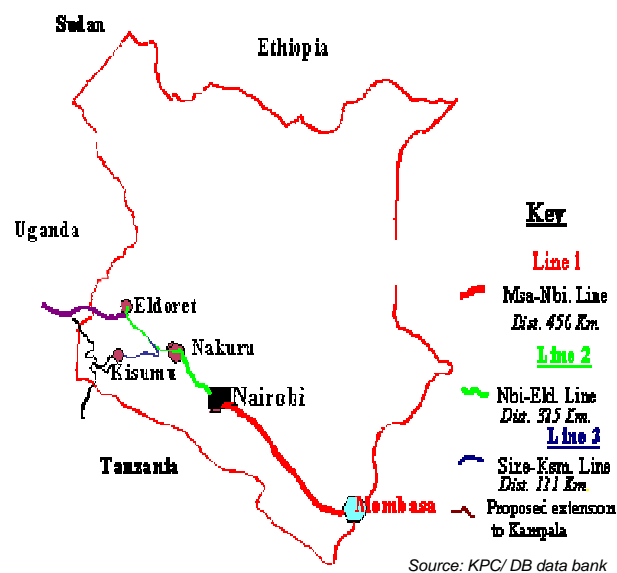
After crude oil makes it through the KPRL refinery, or crude product makes it through port, the majority is transported to Nairobi, either through pipeline or overland by truck. The main pipeline (8inch width) from Mombasa has a pumping capacity of approximately 440M³/hour, which is not enough to meet Kenya's demand. The charge for transportation from Mombasa to Nairobi is KES 1.53 per litre plus VAT. The Transport and Storage agreement between KPC and oil marketing companies provides for a maximum operational loss allowance of 0.25% volume. Through the Lamu Port - South Sudan – Ethiopia Transport corridor (LAPSSET), the Southern Sudan government agreed to construct a new pipeline that is expected to meet Kenyan projected demand by year 2044.

The KES 1.6 trillion project - which targets landlocked South Sudan and Ethiopia - will cover road, railway and a port in Lamu. This will decongest the port of Mombasa and ease the transportation and piping of the petroleum products. We expect this will occasion a price reprieve on the petroleum products. The Kenya pipeline network runs from Mombasa to Nakuru, and then branches to Eldoret and Kisumu. However, Kenya plans to extend the pipeline to Uganda. As a result of storage capacity issues, the pipeline often does not have enough capacity to meet demand.

However, National Oil Corporation of Kenya (NOCK) is in the process of developing a strategic national petroleum reserve with an equivalent of 3-month reserve, which will ease supply disruption exposure within the sector at an estimated cost of over USD 1Bn.

We believe that the oil marketers' reliance on truck transportation which is costly and inefficient will continue in the medium term. A truck can only accommodate 35M³ per trip, which can take more than 48 hours. KenolKobil fully utilizes its pumping capacity with KPC when it can, although the demand outweighs the pumping capacity. When crude product reaches Nairobi, the majority is consumed there. The rest is shipped through pipeline or truck to depots in Kisumu, Nakuru, Eldoret, or other areas. The Kenyan petroleum sales for the year 2011 amounted to 4,569,402 metric tons with Gas oil, Jet A-1, premium gasoline and fuel oils accounting for 39%, 20%, 16% and 14% respectively.

Pipeline route

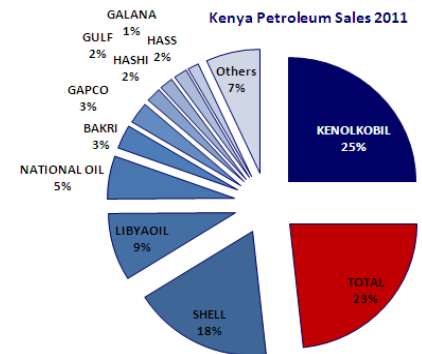


Kenya Oil Company Limited

Kenya Oil Company Limited (KenolKobil) is an oil marketing company in Kenya. Profit is generated through selling crude oil products to the end consumer. In Kenya, 60% of the products are purchased through the country’s refinery in Mombasa and sold to the end consumer in Kenya or surrounding countries. The other 40% of products are purchased from international refineries and sold to the local market. KenolKobil’s major subsidiaries are in Burundi, Rwanda, Uganda, Ethiopia, Tanzania, Zambia, Zimbabwe, Mozambique and Democratic Republic of Congo. It also has trading zones in Sudan, Namibia and Malawi. In Kenya, KenolKobil sales volume amounted to 1.058Mn M3, which is 35% of the total sales volume. The group has 20 terminals from which it supplies network of stations.

KenolKobil service stations and the market share

Country	No.of Stations	Mkt share
Kenya	156	25%
Ethiopia	65	6%
Uganda	64	10%
Rwanda	46	32%
Tanzania	27	11%
Zambia	25	11%
Burundi	17	15%

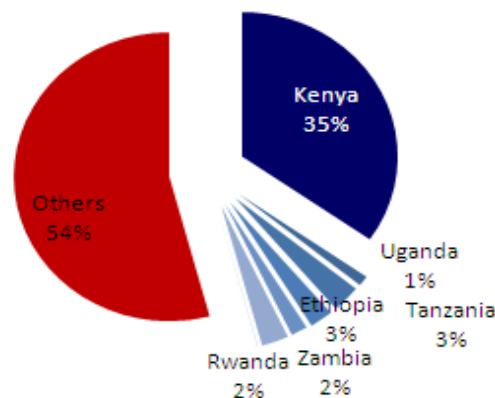


Source: Company data, PIEA

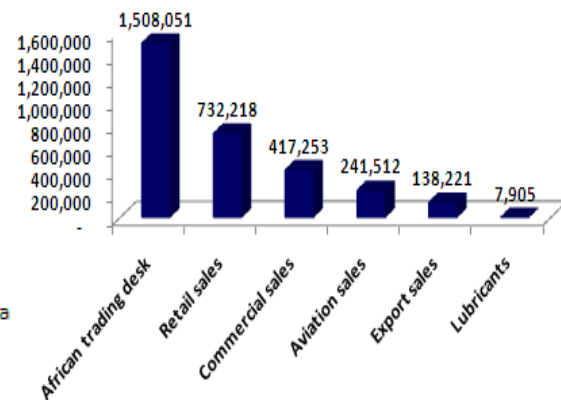
KenolKobil has 401 service stations in the region with a target of 413 service stations by the end of this year. It plans to add 4 service stations each in Tanzania and Zambia and 5 service stations in Ethiopia. The Group has a significant market share in Rwanda and remains focused on intensifying its operations in Democratic Republic of Congo.

Sales volume by country and business lines (M³)

Sales volume in M3 by country 2011



Volume sales by business lines (M3)



Source: Company data

KenolKobil sales volume in Kenya amounted to 1.058 million M³, which is 35% of the total sales volume. In the 2nd Half 2011, KenolKobil opened two Trading Desks, one in Dar es Salaam and the other in Harare (Ex Beira port). The Company’s long term strategy remains to develop and strengthen operations along this business segment. Focus on trading, aviation and commercial customers will also reduce risk exposure on foreign exchange volatility as the volumes are sold in USD.

Key Multiples

Key Multiples	2011A	2012F	2013F	2014F
EPS (KES)	2.22	2.67	3.07	3.37
DPS	1.00	1.00	1.00	1.00
EV/EBITDA	3.69	2.81	2.44	2.22
EV/Sales	0.13	0.11	0.10	0.09
PE (x)	5.42	4.52	3.93	3.57
P/B (x)	1.52	1.25	0.99	0.83
P/S (x)	0.08	0.07	0.06	0.05
Div Yield (%)	8.30%	8.30%	8.30%	8.30%
ROaA (%)	8.58%	7.76%	7.72%	7.69%
ROaE (%)	28.64%	30.42%	28.14%	25.24%

Source: Company filings, DB estimates

Financial condition – Financially fit

In FY2011 results, KenolKobil showed a 73.8%/y jump in pre-tax earnings to KES 4.9Bn. The board of directors also recommended a final dividend of KES 0.43 per share. Below are some highlights from the results:

- The net revenues increased by 118.8%/y to KES 222.4Bn in FY2011 driven by a 55%/y growth in volumes to 3.1Mn cubic meters in FY2011. The cost of sales went up by 123.4% to KES 210.1Bn in FY2011. This was mainly driven by an increase in volumes sold as well as the volatility of the currencies. The gross profit increased by 62.3% to KES 12.3Bn in FY2011.
- The distribution cost increased by 15.3% to KES 1.2Bn, as a result of increased distribution networks as the company opened terminals in Tanzania, Burundi, Uganda and Democratic Republic of Congo. The administration expenses rose by 49.2% to KES 3.9Bn, necessitated by the business expansion across various markets in Africa.
- The expansion in FY2011 was facilitated by the acquisition of terminals in Tanzania, Burundi, Uganda, Democratic Republic of Congo and the acquisition of Phoenix assets in Uganda. In addition, KenolKobil built new storage facilities in Lusaka and Bujumbura.
- The net foreign exchange losses were up by 101.6% from KES 573Mn in FY2010 to KES 1.2Bn in FY2011 caused by foreign exchange volatility during the period.

FY2011 financial results in summary

Income Statement (KES'000)	Dec-11	Dec-10	% Change
Net sales	222,440,715	101,649,560	118.83%
Cost of Sales	210,107,493	94,052,548	123.39%
Gross Profit	12,333,222	7,597,012	62.34%
EBITDA	6,306,618	3,440,338	83.31%
D&A	226,321	204,540	10.65%
Interest Income	262,883	146,697	79.20%
Interest Expense	1,412,563	544,195	159.57%
PBT	4,933,783	2,839,228	73.77%
PAT	3,273,831	1,918,045	70.69%
EPS - Diluted	2.21	1.20	84.17%
DPS	1.00	0.52	92.31%

Source: Company filings

Valuation

To derive our fair value estimate for KenolKobil, we have used 3 year Discounted Cash Flow valuation model. Our discount rate (cost of equity) assumption of 19% was derived using a Risk Free Rate of 13.5%, Market Risk Premium of 7%, a Beta of 0.85x, and a long term sustainable growth rate of 4.0%.

Our DCF model discounts Free Cash Flows over a 4 year period and our estimated Free Cash Flows were discounted using the Weighted Average Cost of Capital (WACC). A cost of debt of 12.0% and a tax rate of 30.0% was used. Our resulting target price is KES 15.80/share.

DCF Valuation

Enterprise Value	29,531,160
Net debt/(cash)	6,273,539
Market Capitalization	23,257,621
Shares Outstanding ('000)	1,471,761
Implied Share Price	15.80
Current Share Price	12.05
Upside	31%

Key Value Drivers

- ✓ The top-line Margin levels will improve on increased volume sales. Regional expansions augur well towards this approach thus reducing geographical risks.
- ✓ Growth capacity in alternate segment - Business line diversification will increase non-fuel income thus improve bottom-line contribution.
- ✓ Growth capacity in alternate revenue – growth in African trading desk will strengthen EBITDA growth though increased sales volumes and reduced costs exposure on bulk purchases.
- ✓ With positive cash flows, the company still remains well positioned to expand its presence further in new markets. Management expects strong revenue contribution from subsidiaries.
- ✓ The ongoing regional infrastructure development along with the KenolKobil's storage facilities enhancement will improve the company's operating efficiencies.
- ✓ KenolKobil could benefit from KES 5.2 billion (not factored in our valuation) held in dispute between the company and Kenya Pipeline Company (KPC) over unfair allocation of storage capacity.

Peer Comparables across the continent

Name	Country	EPS - Gr (%)	P/E	P/BV	EV/EBITDA
KenolKobil Ltd.	Kenya	83.47	5.50	1.50	3.69
Sasol Ltd.	South Africa	23.58	8.44	2.12	-
Total Cote D'Ivoire SA	Cote D'Ivoire	-43.08	14.95	2.01	-
Shell Cote D'Ivoire SA	Cote D'Ivoire	-75.28	17.91	2.68	-
Total Nigeria Plc	Nigeria	75.90	5.12	-	-
Chevron Oil Nigeria Plc	Nigeria	0.10	0.06	-	-
Oando Plc	Nigeria	9.85	3.01	0.64	-
Mauritius Oil Refineries Ltd.	Mauritius	-20.61	13.79	-	-
Total Kenya Ltd.	Kenya	89.44	4.50	0.45	-
Mobil Nigeria Plc	Nigeria	-	11.21	-	-
Total Petroleum Ghana Ltd.	Ghana	6.78	16.47	6.14	19.05
Ghana Oil Co. Ltd.	Ghana	25.82	9.78	-	7.15
Average		16.00	9.23	2.24	10.27

Source: Bloomberg

KenolKobil is trading at a trailing P/E and P/B ratios of 5.5x and 1.5x compared to its African peer comparables average of 9.3x and 2.2x respectively. Its ROE of 28.10% is higher compared to the 10.67% sector average

Projected financial statements

Income Statement (KES' 000)	2011A	2012F	2013F	2014F
Sales	222,440,715	266,928,858	306,968,187	337,665,005
Gross profit	12,333,222	16,015,731	18,418,091	20,259,900
EBITDA	6,306,618	8,274,795	9,516,014	10,467,615
Net finance cost	1,149,680	1,601,573	1,841,809	2,025,990
Profit before income tax	4,933,783	5,605,506	6,446,332	7,090,965
Taxation	(1,659,952)	(1,681,652)	(1,933,900)	(2,127,290)
Net profit	3,273,831	3,923,854	4,512,432	4,963,676

Balance Sheet (KES' 000)	2011A	2012F	2013F	2014F
Fixed assets	5,828,442	6,362,300	6,976,236	7,651,566
Current assets	40,145,862	48,772,526	54,760,492	59,743,179
Total assets	45,974,304	55,134,826	61,736,728	67,394,745
Current liabilities	32,794,177	39,458,453	42,283,804	44,449,906
Non-Current liabilities	1,529,666	1,529,666	1,529,666	1,529,666
Shareholders' funds	11,650,461	14,146,707	17,923,259	21,415,173
Total equity & Liabilities	45,974,304	55,134,826	61,736,728	67,394,745

Cash flow statement (KES '000)	2011A	2012F	2013F	2014F
Operating Cash flow	(851,521)	7,560,650	2,425,487	3,772,975
Net cash invested	(1,174,432)	(1,601,573)	(1,841,809)	(2,025,990)
Free Cash flow	(2,025,953)	5,959,077	583,678	1,746,985
Free Cash flow to the firm	(1,088,576)	7,199,015	2,009,607	3,315,507
Net financing cash flow	3,549,511	(1,427,608)	(735,881)	(1,471,761)
Net cash flow for the year	1,523,558	4,531,469	(152,202)	275,224

Ratio Analysis

Liquidity/Leverage	2011A	2012F	2013F	2014F
Current Ratio	1.22	1.49	1.39	1.41
Quick Ratio	0.49	0.59	0.60	0.62
Inventory to Working Capital	0.97	1.15	1.15	1.15
Total debt/Total Capital	1.62	1.34	1.05	0.88
Total debt/Total Assets	0.41	0.34	0.31	0.28
Cash equivalents/Current Assets	0.08	0.16	0.14	0.13

Fixed Charge Coverage	2011A	2012F	2013F	2014F
Net debt/EBITDA	2.48	1.34	1.18	1.05

Risks

The following company specific factors could prevent the share price from reaching our target price: (i) an election crisis in Kenya; (ii) continued inflationary and currency volatility; (iii) price caps imposed by the Energy Regulatory Commission (iv) a global economic recession, which could lead to a correction in energy prices and global demand; (v) restrictive regulations on fuel pricing especially in Ethiopia and (vi) product dumping in Uganda, creating unhealthy competition within the country. If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. However, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

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