

### EQUITY RESEARCH

7 March 2012

Recommendation: **BUY**

Updated fair value: **KES 17.00**

Previous fair value: KES 17.23

#### Operating performance

	FY11A	FY12E	FY13F
EPS (KES)	2.03	2.34	2.54
% growth	68.3	15.4	8.3
DPS (KES)	1.00	1.15	1.25
Dividend payout	44.9%	45.0%	45.0%
NAV (KES)	6.26	7.89	9.35
PE (x)	5.42	4.69	4.33
PB (x)	1.76	1.39	1.18

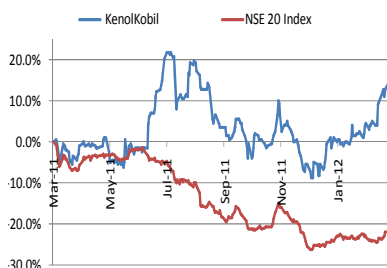
Source: Company financials,

#### Trading data

Price (KES)		11.20
Market cap	KES m	18,052
	USD m	217
Avg. daily value traded (3 months)	KES m	2.9
	USDk	35
Bloomberg		KNOC KN
Free float		30.6%

Source: Company financials

#### Share price graph



Source: Nairobi Stock Exchange

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### A year of two halves

KenolKobil delivered a fully diluted FY11 EPS of 2.03 (+56.1% y/y) on restated 2010 profits which were 7.8% higher than the previous numbers. 2010 profits were restated due to a change in the calculation of fixed assets to historical values from revaluation- which had an impact of decreasing depreciation by KES 139m. The FY11 performance was 2.2% weaker than our estimates. The 2H11 was particularly weaker than our estimates with 4% gross margin vs 8.1% in 1H11, operating margin was at 2% vs 5.4% as net profit margin came at 0.8% vs 2.6%. Overall, revenue climbed 118.8% y/y on the back of higher product prices (+43%) and volumes (+52%), particularly in 2H11. Gross margins declined y/y from 7.5% to 5.5% due to higher participation in the low margins trading business. Exchange losses came in at KES 1.2bn, up 79.8% y/y. The company made an additional exchange related loss of KES 1.5bn on outstanding hedges by year end, an item which was dealt with separately under comprehensive income. Overall, EBITDA was up 83.5% y/y. Interest expenses surged 159.6% y/y to KES 1.4bn due to higher borrowings and generally higher interest rates during the year. The company declared a final dividend of KES 0.43 per share (in addition to an interim of KES 0.57 DPS), a 20% underperformance on our estimates, with management sticking with a 40-45% dividend payout regime.

**Valuation & forecast update.** We retain our BUY recommendation. We revise our fair value downwards (-1.3%) to KES 17.00 – 53.8% above current share price. Based on our FY12 forecast EPS and NAV, KenolKobil currently trades at 4.7x PE and 1.4x PB. We have trimmed our dividend payout to between 40-45% as per management guidance, and in line with additional investments (We expect CAPEX of around USD 15m).

**Business outlook.** We see KenolKobil as well positioned to perform reasonably well in 2012 in view of additional focus on storage/terminal hospitality, non-regulated fuel lines particularly LPG and trading. Our main concerns lie on Aviation (where African airlines have formed a joint fuel purchase program), exchange losses (currencies dealt with are positively correlated, as well as additional losses from hedges taken in 2011 which will crystallize in 2012). Although details are sketchy, we like the biofuel distribution agreement signed by the oil marketer on moving blended petrol. We also see investments made in storage in the region in 2011 starting to bear fruit in 2012 (in addition to the ongoing CAPEX). Volatility in oil prices remains a concern for us with a lot depending on management strength to take positions in the physical markets. We are not particularly worried by regulation.

**Management on the lookout for a strategic partner.** Despite making the disclosure, management provided minimal guidance with regards to plans of bringing a new investor onboard. In our view, we would think it would be positive for investors if the strategic partner is a multinational oil company, or investor with adequate capital to sustain continued business expansion. We see the following options as possible; joint venture; creation of additional shares, sale by majority shareholder.

**Price performance.** Over the past twelve months, KenolKobil (+10.7%) has outperformed our NSE 20 Index (-20.0%). YTD, foreign investors have been net buyers of the stock (USD 0.6m) but most of the price movement has been local investor driven. We think the final DPS declared (KES 0.43) led to the share price pullback despite the strong results. The final dividend was 24.6% lower than the interim dividend, with the total dividend for the year underperforming our estimate by 20%.



### Summary Financials

Income Statement KESm	FY10	FY10*	FY11	%chg	1H11	2H11	h/h
Net sales	101,761	101,650	222,441	118.8%	83,313	139,127	67.0%
Gross Profit	7,708	7,597	12,333	62.3%	6,742	5,591	-17.1%
<i>Gross margin</i>	7.6%	7.5%	5.5%		8.1%	4.0%	
EBITDA	4,011	4,010	7,462	86.1%			
Depreciation and amortisation	343	205	226	10.6%			
<b>Operating profit</b>	<b>3,667</b>	<b>3,806</b>	<b>7,236</b>	<b>90.1%</b>	<b>4,510</b>	<b>2,726</b>	<b>-39.5%</b>
<i>Operating margin</i>	3.6%	3.7%	3.3%		5.4%	2.0%	
Exchange losses	573	573	1,155	101.6%	870	285	-67.2%
Interest expense	544	544	1,413	159.6%	469	944	101.4%
Interest income	147	147	263	79.2%	47	215	354.6%
share of associate profit	1	1	3	241.2%			
<b>Profit before tax</b>	<b>2,698</b>	<b>2,836</b>	<b>4,934</b>	<b>74.0%</b>	<b>3,218</b>	<b>1,712</b>	<b>-46.8%</b>
Income tax	921	921	1,660	80.2%	1,061	596	-43.9%
<i>Tax rate</i>	34.1%	32.5%	33.6%		33.0%	34.8%	
<b>Net profit</b>	<b>1,777</b>	<b>1,915</b>	<b>3,274</b>	<b>71.0%</b>	<b>2,157</b>	<b>1,117</b>	<b>-48.2%</b>
Net profit margin	1.7%	1.9%	1.5%		2.6%	0.8%	
Year end shares (m)	1,472	1,472	1,612	9.5%			
EPS (KES)	1.21	1.30	2.03	56.1%			
DPS (KES)	0.52	0.52	1.00	92.3%			

Source: Company data, Standard Investment Bank estimates, \*restated for asset accounting change; revaluation to historical

Balance Sheet (KESm)	FY09	FY09*	FY10*	FY11
Net tangible assets	4,512	2,840	2,935	3,778
Net intangible assets	1,606	1,472	1,424	2,050
Total noncurrent assets	6,118	4,311	4,359	5,828
Current assets	21,364	21,446	23,880	36,874
Term deposits+cash & cash equiv.	3,806	3,678	2,133	3,272
<b>Total Assets</b>	<b>31,289</b>	<b>29,435</b>	<b>30,373</b>	<b>45,974</b>
Total liabilities	19,834	19,471	19,165	34,324
Shareholder equity	11,455	9,964	11,208	11,650
<b>Total equity and liabilities</b>	<b>31,289</b>	<b>29,435</b>	<b>30,373</b>	<b>45,974</b>

Source: Company data, Standard Investment Bank estimates, \*restated for asset accounting change; revaluation to historical



### Valuation:

Our fair value is derived using discounted cash flows based on 5 year estimates. A fair value of KES 17.00 suggests that KenolKobil is undervalued based on DCF. We assume a weighted average cost of capital of 13.7% and a terminal growth rate of 5.5%. Currently, we see three distinct businesses lines 1) downstream oil distribution 2) Trading operations 3) Real estate which includes storage and hospitality arrangements. We see significant element of hidden value in the real estate assets which would only be apparent in case of M&A.

cash flow	FY12E	FY13F	FY14F	FY15F	FY16F	
	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	
Operating profit	7,501,155	7,917,852	8,350,971	8,804,630	9,279,680	
Add: depreciation & amortization	409,973	440,973	475,273	509,573	543,873	
Less: working capital changes	-1,188,682	-339,252	-1,757,640	-1,884,138	-2,017,944	
Less: CAPEX	-1,209,973	-1,240,973	-1,175,273	-1,209,573	-1,243,873	
Less: Cash Tax	-1,914,883	-2,074,637	-2,243,426	-2,418,436	-2,599,761	
Free cash flow	3,597,590	4,703,962	3,649,905	3,802,055	3,961,974	51,086,595
Discount period	0.82	1.82	2.82	3.82	4.82	
Discount factor @ WACC	0.90	0.79	0.70	0.61	0.54	0.54
Present value of free cash flow	3,238,847	3,725,212	2,542,595	2,329,821	2,134,871	27,527,511
Value of operations	41,498,857					
add: net cash	14,103,502					
add: net non operating assets						
Equity value	27,395,355					
no. of shares	1,611,761					
<b>Fair value (KES/share)</b>						<b>17.00</b>

Source: Company data, Standard Investment Bank estimates

### Valuation drivers and recommendation

#### SUMMARY DCF

Risk free rate	9.0%
Beta	1.3
Cost of equity	18.0%
Cost of debt	12.5%
Tax rate (%)	30.0%
After tax cost of debt	8.8%
Gearing	51%
WACC	13.7%
Terminal growth rate	5.5%
<b>Fair value (KES per share)</b>	<b>17.00</b>
<b>Current share price</b>	<b>11.20</b>
<b>Recommendation</b>	<b>BUY</b>

Source: Company data, Standard Investment Bank estimates

### Fair Value Sensitivity

		Long term GDP Growth estimate						
		2.50%	3.50%	4.50%	5.50%	6.50%	7.50%	8.50%
WACC	10.7%	19.42	22.25	26.01	31.22	38.91	51.45	75.47
	11.7%	16.43	18.58	21.32	24.95	29.98	37.42	49.53
	12.7%	14.03	15.70	17.77	20.42	23.93	28.79	35.98
	13.7%	12.06	13.38	14.99	17.00	19.56	22.95	27.65
	14.7%	10.41	11.48	12.76	14.32	16.25	18.73	22.01
	15.7%	9.01	9.89	10.92	12.16	13.67	15.54	17.94
	16.7%	7.81	8.54	9.39	10.39	11.58	13.04	14.86



### Key Ratios

	2009A	2010A	2011A	2012F	2013F	2014F
EPS	0.88	1.21	2.03	2.34	2.54	2.75
% change	-88.8	37.2	68.3	15.4	8.3	8.1
DPS	0.32	0.52	1.00	1.15	1.25	1.50
% change	-7.1	60.0	92.0	15.6	8.3	20.2
Dividend yield (gross)	3.2%	5.2%	8.3%	9.6%	10.4%	12.5%
Payout ratio	37.0%	43.1%	44.9%	45.0%	45.0%	50.0%
Tangible NAV	6.69	7.57	6.26	7.89	9.35	10.89
PE	11.37	8.28	5.42	4.69	4.33	4.01
P/BV	1.49	1.32	1.76	1.39	1.18	1.01
EV/net sales	0.17	0.25	0.15	0.14	0.14	0.13
EV/EBITDA	5.53	5.78	4.60	4.26	4.11	3.83
Total sales/assets	309%	316%	484%	469%	454%	453%

Source: Company data, Standard Investment Bank estimates



### Earnings model- 2009A-2014F

Income Statement (KESm)	2009A	2010A	2011A	2012F	2013F	2014F
Sales	96,693	101,761	222,441	240,236	249,845	259,839
COGS and operating costs	(93,645)	(97,398)	(214,979)	(232,325)	(241,487)	(251,013)
EBITDA	3,048	4,363	7,462	7,911	8,359	8,826
Depreciation	(661)	(695)	(226)	(410)	(441)	(475)
EBIT	2,387	3,667	7,236	7,501	7,918	8,351
Net interest (cost)/income	(319)	(397)	(1,150)	(1,810)	(1,752)	(1,683)
Earnings before tax	1,933	2,698	4,934	5,692	6,166	6,668
Net profit	1,295	1,777	3,274	3,777	4,092	4,425

Balance Sheet (KESm)	2009A	2010A	2011A	2012F	2013F	2014F
Net tangible assets	4,512	4,595	4,269	5,069	5,869	6,569
Net intangible assets	1,606	1,560	1,560	1,560	1,560	1,560
Total noncurrent assets	6,118	6,155	5,828	6,628	7,428	8,128
Current assets	21,364	23,929	36,874	39,869	41,463	43,120
Term deposits+cash & cash equiv.	3,806	2,133	3,272	4,700	6,153	6,170
<b>Total Assets</b>	<b>31,289</b>	<b>32,217</b>	<b>45,974</b>	<b>51,198</b>	<b>55,044</b>	<b>57,418</b>
Total liabilities	19,834	19,511	34,324	36,914	38,410	38,312
Shareholder equity	11,455	12,706	11,650	14,284	16,634	19,106
<b>Total equity and liabilities</b>	<b>31,289</b>	<b>32,217</b>	<b>45,974</b>	<b>51,198</b>	<b>55,044</b>	<b>57,418</b>
Net capital invested	161	896	1,572	1,210	1,241	1,175

Cash Flow (KESm)	2009A	2010A	2011A	2012F	2013F	2014F
Cashflow from operations	2,582	3,885	6,808	7,911	8,359	8,826
Change in net working capital	1,567	-13,583	-7,933	-5,722	-4,893	-5,036
Cash flow from operations	4,150	-9,699	-1,125	2,189	3,466	3,791
Cash flow from investing	-161	-896	-1,572	-1,210	-1,241	-1,175
cash flow from financing	-2,795	9,012	3,550	-334	-1,015	-2,601
Free cash flow	1,194	-1,582	853	645	1,210	14
Cash and cash equivalent at end	3,678	2,133	3,272	3,917	5,127	5,142

Source: Company data, Standard Investment Bank estimates



### Ratio and analysis

Growth and Margins	2009A	2010A	2011A	2012F	2013F	2014F
Gross margin	6.2%	7.6%	5.5%	5.4%	5.4%	5.4%
EBITDA margin	3.2%	4.3%	3.4%	3.3%	3.3%	3.4%
EBIT/operating margin	2.5%	3.6%	3.3%	3.1%	3.2%	3.2%
Net profit margin	1.3%	1.7%	1.5%	1.6%	1.6%	1.7%
Net sales growth	-28.1%	5.2%	118.6%	8.0%	4.0%	4.0%
Net profit growth	12.0%	37.2%	84.3%	15.4%	8.3%	8.1%

Ratios	2009A	2010A	2011A	2012F	2013F	2014F
Net debt/equity	27.2%	52.0%	61.9%	58.0%	55.1%	50.9%
Depreciation rate	-4.1%	-4.6%	5.0%	5.0%	4.9%	4.9%
ROE (Average)	11.0%	12.7%	20.7%	27.2%	25.4%	23.8%
ROCE (Average)	24.9%	23.9%	41.1%	50.8%	45.4%	41.9%
ROA	4.1%	5.5%	7.1%	7.4%	7.4%	7.7%
Asset turnover	309.0%	315.9%	483.8%	469.2%	453.9%	452.5%

Source: Company data, Standard Investment Bank estimates



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