Kenya Oil and Gas Sector Overview

Initiation of coverage

EQUITY RESEARCH

15 February 2012

Recommendation:

KenolKobil- BUY

Total Kenya- SELL

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We initiate coverage for KenolKobil with a BUY recommendation (fair value KES 17.2; 66.8% upside) while we rate Total Kenya on a SELL (fair value KES 15.3; 10.2% downside). Whereas the two oil marketers operate in the same sector, they differ particularly when it comes to geographical scope and extent of business lines. KenolKobil operates in 9 countries while Total Kenya revenues and assets are predominantly in Kenya. The other key difference is in the trading desk operations which KenolKobil is active on bulk products. On infrastructure, KenolKobil is active in developing its own storage facilities, ahead of its downstream competitors in the region.

We think that overall profitability for the sector will improve despite concerns about introduction of price controls in Kenya as the pricing formula (introduced 14 months ago) included margins which had historically been enjoyed by oil marketers anyway. We see better performing companies diversifying into non regulated product lines. The discovery of oil and other energy resources in the region is likely to be positive for some product lines, but negative for others. Near term outlook for margins remains uncertain, with Totals performance likely to be negatively impacted by financing costs (Total acquired Chevron's assets in 2009 through debt). Storage and distribution infrastructure is now a key source of competitive advantage with state controlled infrastructure proving inadequate and inefficient.

Price controls exposes weaknesses in less diversified players. We note that price controls have actually been positive for the industry, with the average unit contribution per litre being higher by almost 20% under price controlled regulations (by our estimates). We see the impact of price controls being more on Total Kenya rather than KenolKobil due to improved brand building activities by the latter. Smaller players, particularly independents have also found it difficult to operate in the Kenyan market under price controls due to thinner margins in the retail end compared to wholesale. We note that both listed downstream oil marketers are relatively well diversified with segments such as fuel oil, LPG aviation and commercial increasingly accounting for a higher share of profits. We are however concerned at the volatility in profitability of these segments as experienced over the years.

Oil infrastructure control is now crucial in the industry. East Africa suffers from inadequate infrastructure for refining, storage and moving product (pipeline). Most of the successful downstream oil marketers have had to supplement state controlled infrastructure with alternative options. KenolKobil has purchased/leased additional storage capacities to enhance its flexibility- and the impact of this action can be partly attributed to the success of the group.

New energy sources could impact certain lines of business. The exploitation of different energy resources could have a substantial impact in opportunities available in downstream activities particularly by lowering product costs- which could potentially lead to margin expansion (processing of crude oil from the region and supplying it regionally could have this impact). We believe the listed oil marketers will have limited participation in potential upstream activities in the near term though. In some cases, the exploitation of alternative energies such as coal in Kenya could for example limit use of fuel oil for electricity generation in the country.

Discovery of oil related resources a key game changer for the energy sector

Where the resources are located…

The search for reliable energy sources has crystallized into greater exploration effort being put into the largely underexplored East African region. This process has intensified with Uganda's discovery of an estimated 2.5bn barrels of oil in the Albertine Graben region. Tanzania has discovered about 10tcf gas deposits in four areas - Songo Songo island off the eastern coast, in nearby West Songo Songo, Mnazi Bay in southeastern Tanzania and Mkuranga near Dar es Salaam. Ethiopia has proven reserves of gas in the Ogaden region. South Sudan has over 6bn barrels in proven reserves, with a potential exports of around 260,000bpd. Rwanda is exploring ways to tap the 2tcf of methane gas and 10tcf of carbon dioxide in Lake Kivu. Somalia is thought to have reserves of oil but exploration has remained limited due to instability in the country-but there are signs of entrants starting to participate actively-Africa Oil now drilling in Puntland. Offshore Mozambique, Anadarko has discovered 20-30tcf of natural gas, raising interest in Kenya's offshore blocks. Kenya is focusing on geothermal power in the Rift Valley as well as commercially viable coal deposits in the Mui basin. Africa Oil and Tullow have also commenced a drilling campaign in Nothern Kenya near Lake Turkana; an area which shares many geological attributes with the Lake Albert Rift Basin in Uganda where Tullow has made a large discovery.

Refineries under consideration…

Whereas the Kenya Petroleum Refinery Limited (KPRL) has been relied on for products into the East African region, this could change once Uganda constructs its own refinery, which is much more Central to landlocked countries around Central Africa. KPRL is looking to turn into a merchant refinery in April 2012 which means that it will import, process and sell its own crude. But for it to be competitive, it will have to invest at least an additional USD 1bn, or get tax concessions to survive in a free market. South Sudan is also considering its own refinery instead of exporting the raw product.

Pipelines under consideration…

The Kenyan Lamu Port-Southern Sudan-Ethiopia Transport (Lapsset) corridor involves a pipeline to be owned by South Sudan, with the entire project covering road, rail and the main port estimated to cost upwards of USD 22bn. The project targets landlocked South Sudan and Ethiopia. Total has also previously alluded to setting up a pipeline to link South Sudan and Uganda and then proceed to the Kenyan coast, which could potentially undermine the Lapsset project which has taken long to take off the ground. South Sudan and Ethiopia have also signed a memorandum of understanding on a planned pipeline to pass through to Djibouti.

Kenya plans to construct a new finished product pipeline to replace the existing 14-inch finished product pipeline linking Mombasa to Nairobi which has outlived its 30-year lifespan. The new pipeline is expected to suit the projected demand to 2044 and would cost USD 300m. Kenya Pipeline Company's network runs from Mombasa to the town of Nakuru in the west of the country, and then branches to Eldoret and Kisumu. Kenya hopes to extend the pipeline past Eldoret and possibly into Uganda. Kenya could lose out on the Uganda crude transport through its existing pipeline if Tanzania succeeds in a 1,220km pipeline from Dar es salaam (Indian Ocean) to Mwanza on Lake Victoria, with suggestions to extend it to Uganda via Lake Victoria.

Tanzania is also seeking a USD 1.06bn loan to build a natural gas pipeline from Mtwara region in the southern part of the country to Dar es Salaam. Another pipeline to move the gas from Dar es Salaam to the Kenyan port city of Mombasa is also being considered at a cost of up to USD 630m. Kenya is an important gas market and an LNG facility is to be constructed there at a cost of USD 500m.

Storage capacity under consideration…

State-run National Oil Corporation of Kenya has been considering plans to develop a strategic national petroleum reserve. The reserve will hold about 1bn litres - equivalent to 90 days consumption - and help ease disruptions in the supply chain. The cost of building up the reserve is however estimated at over USD 1bn. Kenya has no strategic reserves and relies solely on oil marketers' 21-day oil reserves required under industry regulations.

Key upstream players in Kenya

In February 2011, Tullow completed the farm-in to blocks 10A, 10BA, 10BB, 12A and 13T in Kenya and the South Omo block in Ethiopia. Tullow now operates all six blocks covering an area of around 100,000 sq km in the Turkana Rift Basin where similar geological characteristics to the Lake Albert Rift Basin in Uganda have been identified. In March 2011, Tullow farmed into the L8 block offshore Kenya for a 15% equity position with an option to increase to 20%. In Block 10BB, all existing 2D seismic data has been interpreted and a prospect has been selected for drilling. Africa Oil and Tullow have started a drilling campaign in Kenya which will see two wells drilled in Nothern Kenya and another drilled at the Kenyan coast.

In September 2011, Total Group announced an acquisition, through its Total E&P Kenya B.V.(not listed, upstream), of a 40% interest in five offshore exploration blocks in the Lamu- on which it subsequently received approval. Total acquired a 20% stake from Anadarko Kenya Company, which will continue to be the operator with a 50% interest in the permits; a 5% stake from Cove Energy, which will maintain a 10% interest and a 15% stake from Dynamic Global Advisors, which sold its entire interest. The area, covering more than 30,500 square kilometers of exploration blocks is located offshore the Lamu Archipelago in water depths of between 100 and 3,000 metres. A 3,500 square kilometres 3D seismic survey is currently underway. If the results are satisfactory, one or more exploration wells will be drilled. Total was mainly attracted to the exploration project given recent discoveries in offshore Mozambique and Tanzania. We believe the recent farm in by some of the larger and skilled operators will see more effort being made in drilling wells in the country, which would increase the chances of a find.

Energy resources impact on oil marketers

The Indian Ocean East Coast region has been a net importer of oil and gas resources but already, this appears likely to change significantly within the next ten years. Already Kenya imports gas from Tanzania and there are plans to construct a pipeline to Kenya from Tanzania. The refining plans being considered by resource rich neighbors suggests a significant increase in intra-regional trade in coming years in relations to oil- particularly if Kenya does not find its own resource. We see downstream players with their own infrastructure being able to tap into opportunities regardless of where the oil comes from in the region- and likely to enjoy better margins generally.

Downstream oil marketers in Kenya, key risks

The main players in downstream operations in Kenya as of September 2011 are Total Kenya (23.7%), KenolKobil (23.4%), Shell (17.8%) and. Libya Oil (10%). We see the key risks in the industry as lying in inventory as well as financing. Financing costs, especially with regards to exchange losses is particularly acute for KenolKobil whereas long term borrowing costs appear to affect Total Kenya to a much higher proportion. KenolKobil operates in around 8 currencies with the KES, UGX and TZS suffering substantial exchange losses in 1H11. Inventory in the oil industry accounts for a big proportion of assets, in many cases, substantially higher than equity so its accuracy is important for the health of the entire group (a risk acute for KenolKobil due to its trading operations). We are also concerned about our ability to forecast margins accurately for the sector, particularly for companies involved in trading business- which can involve significant swings in margins and volumes for different products.

EQUITY RESEARCH

15 February 2012

Recommendation: BUY

Operating performance

	FY11A	FY12E	FY13F
EPS (KES)	2.27	2.09	2.03
% growth	*88.4*	*-8.0*	*-2.9*
DPS (KES)	1.25	1.25	1.42
Dividend payout	55.0%	60.0%	70.0%
NAV (KES)	8.17	9.79	10.52
PE (x)	4.40	4.78	4.93
PB (x)	1.22	1.02	0.95

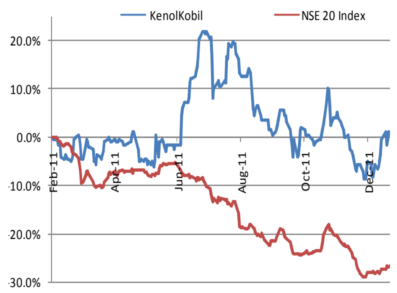
Source: Company financials,

Trading data

Price (KES)		10.25
Market cap	KES m	16,118
	USD m	197
Avg.daily value traded	KES m	2.3
(3 months)	USDk	28
Bloomberg		KNOC KN
Free float		30.6%

Source: Company financials

Share price graph



Source: Nairobi Stock Exchange

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We initiate coverage of KenolKobil with a BUY recommendation on a fair value of 17.2. We expect the company to deliver an 88.4%y/y performance for FY11 but a slightly weaker performance in FY12. KenolKobil has become a key player in Africa's midstream and downstream oil distribution business, particularly serving the Indian Ocean coast, East and Southern Africa. We like the geographical expansion outside of Kenya and the diversity of its business lines particularly the African Trading desk which has managed to reduce the cost per unit of the group through bulk procurement. As the only large independent player, we also see potential interest from suitors for the oil marketer by multinational oil companies, private equity firms or commodity traders looking at growth into sub-Saharan Africa.

Why is KenolKobil thriving? KenolKobil has an expansive investment portfolio spanning Eastern, Central and Southern Africa (the Group consists of subsidiaries in Kenya, Uganda, Tanzania, Rwanda, Zambia, Ethiopia, Burundi, Mozambique, Zimbabwe and more recently, the Democratic Republic of Congo). The downstream oil marketer is also well diversified with segments such as fuel oil, aviation, LPG and commercial which are now accounting for a greater proportion of profits. With regards to price controlled markets, KenolKobil operates in ten sub-Saharan Africa countries, four of which have an element of price controls in the retail segment. We think KenolKobil's experience in working under price controlled environments in markets such as Rwanda, Zambia and Ethiopia made it easier for the company to adopt when it was introduced in Kenya. In 1H11, fuel oil accounted for about 20% of pretax profits for KenolKobil- coming way ahead of retail/reseller segment at 14% (which accounted for 55% of revenue) which demonstrates the fruits of the diversification strategy. KenolKobil has also developed an African Trading Desk (involved in large scale procurement and selling of Petroleum products)- one of the few in the region.

Potential asset against KPC. Enforcement and crystallization of the award arising from the dispute with Kenya Pipeline Company over unfair allocation of storage capacity is still outstanding- with KPC disputing the KES 5.2bn award. Whereas the dispute has been protracted, KenolKobil could benefit from a potential asset which has not been factored in our valuation.

Robust FY11 results guidance, reiterated in November 2011. 1H11 net sales rose 38.1% to KES 83.3bn largely on higher prices as well as improved throughput (volume up 18%). The company declared an interim dividend of KES 0.57 per share as net profits climbed 82.9%y/y to KES 2.2bn. At the current dividend payout rate, KenolKobil appears poised to more than double its dividend over the previous year. The robust performance was primarily as a result of improved gross margins which rose from 7.1% to 8.1%. KenolKobil has given guidance of USD 36m for FY11, up over 80% on the previous year. Overall, the company benefitted from holding higher inventory at the close of 2010, which was then sold at improved prices in the 1H11. Having reiterated its profit guidance in December 2011, it is likely that a combination of better margins and higher volumes from both Kenya and the regional markets will have delivered the growth despite currency volatility in 4Q11.

Valuation:

Our fair value is derived using discounted cash flows based on 5 year estimates. A fair value of KES 17.23 suggests that KenolKobil is undervalued based on DCF. We assume a weighted average cost of capital of 15.0% and a terminal growth rate of 5.5%.

The business could potentially be also valued into three distinct businesses; storage; trading and oil distribution. We also see some element of hidden value in the real estate assets. The company has kept the value of its assets on a historical cost basis but replacement cost/market value could yield a much higher valuation in case of a takeover or partner being brought on board.

cash flow	**FY11E Dec-11**	**FY12F Dec-12**	**FY13F Dec-13**	**FY14F Dec-14**	**FY15F Dec-15**	
Operating profit	6,220,924	5,818,154	5,734,309	5,862,698	5,914,681	
Add: depreciation & amortization	721,861	741,861	753,661	773,261	792,861	
Less: working capital changes	3,311,611	-724,569	-1,677,058	-1,241,553	-1,464,515	
Less: CAPEX	-769,973	-789,973	-801,773	-821,373	-840,973	
Less: Cash Tax	-1,434,455	-1,319,281	-1,280,426	-1,339,414	-1,401,839	
Free cash flow	8,049,968	3,726,192	2,728,714	3,233,619	3,000,214	33,344,521
Weighted cost of capital (%)	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
Discount period	-0.13	0.88	1.88	2.88	3.88	
Discount factor @ WACC	1.02	0.88	0.77	0.67	0.58	0.58
Present value of free cash flow	8,192,948	3,296,671	2,099,417	2,163,517	1,745,638	19,401,099
Value of operations	36,899,289					
add: net cash	11,544,584					
add: net non operating assets						
Equity value	25,354,705					
no. of shares	1,471,761					
Fair value (KES/share)	**17.23**					

Source: Company data, Standard Investment Bank estimates

SUMMARY DCF	
Risk free rate	9.0%
Beta	1.3
Cost of equity	17.8%
Cost of debt	12.5%
Tax rate (%)	30.0%
After tax cost of debt	8.8%
Gearing	40%
WACC	15.0%
Terminal growth rate	5.5%
Fair value (KES per share)	**17.23**
Current share price	**10.25**
Recommendation	**BUY**

Source: Company data, Standard Investment Bank estimates

Fair Value Sensitivity

Long term GDP Growth estimate

WACC	**2.50%**	**3.50%**	**4.50%**	**5.50%**	**6.50%**	**7.50%**	**8.50%**
12.0%	18.59	20.41	22.72	**25.75**	29.88	35.84	45.22
13.0%	16.68	18.12	19.90	**22.15**	25.10	29.12	34.94
14.0%	15.10	16.26	17.67	**19.40**	21.60	24.47	28.40
15.0%	**13.78**	**14.73**	**15.86**	**17.23**	**18.92**	**21.06**	**23.87**
16.0%	12.65	13.44	14.37	**15.47**	16.80	18.45	20.55
17.0%	11.68	12.34	13.11	**14.01**	15.09	16.39	18.00
18.0%	10.83	11.39	12.04	**12.79**	13.68	14.73	16.00

Key Ratios

	2008A	2009A	2010A	2011F	2012F	2013F
EPS	0.78	0.88	1.21	2.27	2.09	2.03
% change	-36.9	12.0	37.2	88.4	-8.0	-2.9
DPS	0.35	0.32	0.52	1.25	1.25	1.42
% change		-7.1	60.0	140.5	0.3	13.2
Dividend yield (gross)	7.0%	3.2%	5.2%	11.4%	12.5%	14.2%
Payout ratio	44.6%	37.0%	43.1%	55.0%	60.0%	70.0%
Tangible NAV	62.39	6.69	7.57	8.17	9.79	10.52
PE	6.37	11.37	8.28	4.40	4.78	4.93
P/BV	0.80	1.49	1.32	1.22	1.02	0.95
EV/net sales	0.08	0.17	0.31	0.20	0.17	0.15
EV/EBITDA	2.44	5.53	7.34	4.38	4.40	4.12
Total sales/assets	485%	309%	316%	567%	564%	553%

Source: Company data, Standard Investment Bank estimates

Earnings model- 2008A-2013F

Income Statement (KESm)	2008A	2009A	2010A	2011F	2012F	2013F
Sales	134,518	96,693	101,761	152,641	166,074	184,010
COGS and operating costs	(130,359)	(93,645)	(97,398)	(145,698)	(159,514)	(177,522)
EBITDA	4,159	3,048	4,363	6,943	6,560	6,488
Depreciation	(718)	(661)	(695)	(722)	(742)	(754)
EBIT	3,442	2,387	3,667	6,221	5,818	5,734
Net interest (cost)/income	(582)	(319)	(397)	(1,439)	(1,421)	(1,466)
Earnings before tax	1,880	1,933	2,698	4,782	4,398	4,268
Net profit	1,155	1,295	1,777	3,347	3,078	2,988

Balance Sheet (KESm)	2008A	2009A	2010A	2011F	2012F	2013F
Net tangible assets	4,864	4,512	4,595	4,995	5,395	5,795
Net intangible assets	1,734	1,606	1,560	1,560	1,560	1,560
Total noncurrent assets	6,597	6,118	6,155	6,555	6,955	7,355
Current assets	18,674	21,364	23,929	23,882	26,108	29,012
Term deposits+cash & cash equiv.	2,438	3,806	2,133	-3,537	-3,593	-3,088
Total Assets	**27,709**	**31,289**	**32,217**	**26,900**	**29,470**	**33,279**
Total liabilities	16,793	19,834	19,511	12,165	13,500	16,241
Shareholder equity	10,916	11,455	12,706	14,735	15,971	17,038
Total equity and liabilities	**27,709**	**31,289**	**32,217**	**26,900**	**29,470**	**33,279**
Net capital invested	878	161	896	1,122	1,142	1,154

Cash Flow (KESm)	2008A	2009A	2010A	2011F	2012F	2013F
Cashflow from operations	3,275	2,582	3,885	6,943	6,560	6,488
Change in net working capital	-2,175	1,567	-13,583	3,542	-3,866	-4,246
Cash flow from operations	1,101	4,150	-9,699	10,485	2,694	2,242
Cash flow from investing	-878	-161	-896	-1,122	-1,142	-1,154
cash flow from financing	-40	-2,795	9,012	-4,422	-1,442	-2,098
Free cash flow	183	1,194	-1,582	4,941	111	-1,010
Cash and cash equivalent at end	2,438	3,678	2,133	7,074	7,185	6,176

Source: Company data, Standard Investment Bank estimates

Ratio and analysis

Growth and Margins	2008A	2009A	2010A	2011F	2012F	2013F
Gross margin	5.7%	6.2%	7.6%	7.1%	6.1%	5.5%
EBITDA margin	3.1%	3.2%	4.3%	4.5%	4.0%	3.5%
EBIT/operating margin	2.6%	2.5%	3.6%	4.1%	3.5%	3.1%
Net profit margin	0.9%	1.3%	1.7%	2.2%	1.9%	1.6%
Net sales growth	160.6%	-28.1%	5.2%	50.0%	8.8%	10.8%
Net profit growth	-36.9%	12.0%	37.2%	88.4%	-8.0%	-2.9%

Ratios	2008A	2009A	2010A	2011F	2012F	2013F
Net debt/equity	37.7%	27.2%	52.0%	42.0%	40.9%	39.0%
Depreciation rate	-0.2%	-4.1%	-4.6%	5.0%	5.0%	4.9%
ROE (Average)	18.8%	11.0%	12.7%	18.7%	20.9%	18.4%
ROCE (Average)	34.1%	24.9%	23.9%	34.4%	37.7%	33.7%
ROA	4.2%	4.1%	5.5%	12.4%	10.4%	9.0%
Asset turnover	485.5%	309.0%	315.9%	567.4%	563.5%	552.9%

Source: Company data, Standard Investment Bank estimates

STANDARD INVESTMENT BANK

Total Kenya Overview

Initiation of coverage

EQUITY RESEARCH

15 February 2012

Recommendation: SELL

Operating performance

	FY11A	FY12E	FY13F
EPS (KES)	0.47	0.76	1.34
% growth	*-84.6*	*60.7*	*76.0*
DPS (KES)	0.36	0.57	1.00
Dividend payout	75.0%	75.0%	75.0%
NAV (KES)	32.56	32.97	33.74
PE (x)	33.78	21.02	11.94
PB (x)	0.49	0.49	0.47

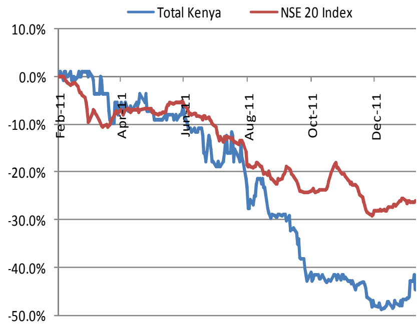
Source: Company financials,

Trading data

Price (KES)		16.95
Market cap	KES m	5,075
	USD m	62
Avg.daily value traded	KES m	0.1
(3 months)	USDk	2
Bloomberg		TKNL KN
Free float		12.7%

Source: Company financials

Share price graph



Source: Nairobi Stock Exchange

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Standard Investment Bank Research is also available to our clients on:
Bloomberg: SIBX <GO>

We initiate coverage of Total Kenya with a SELL recommendation (fair value KES 15.3; 10.2% downside). Total Kenya issued a profit warning, attributing high cost of financing, a weaker KES, price controls and higher operating costs as the main reason for the expected weak performance for FY11. For FY11, we forecast EPS decline of 84.6% to KES 0.47. Against our FY11 forecasts, Total trades at a forward PE of 35.9x. We expect payout to remain within the 75%-80% range with the main driver of dividends being earnings growth.

Profit warning for FY11. Total Kenya issued a profit warning, attributing high cost of financing, a weaker KES, price controls and higher operating costs as the main reason for the expected weak performance for FY11. Finance costs have increased with rising interest rates in Kenya. Total's main borrowings were used to finance working capital as well as medium term loans used to purchase assets of what was previously Chevron Kenya Ltd. In its FY10 earnings (period ending 31 December 2010), Total posted an 89.9% y/y jump in PAT- partly due to a gain on disposal of assets. We think price controls have had a limited impact on the dismal performance for the oil marketer since the gross margins have remained largely unchanged.

The only multinational in Kenya for the long term. Kenya's downstream market has seen the exit of multinationals, the most recent one being Shell, Chevron and Mobil. Most have attributed thin margins and stiff competition for the exit. Total is keen to maintain its downstream operations given recent additional investments. Total has been present in Kenya - one of its longest established host countries in Africa -since 1955 via Total Kenya, headquartered in Nairobi. Total is now the marginal market leader, ahead of KenolKobil, since its acquisition of Chevron's assets in 2009. Total Kenya conducts all of the Group's marketing operations, which include general retail and lubricant, LPG and aviation fuel distribution operations, via a network of 165 service stations. We estimate the company has one of the highest throughput per station in Kenya.

Total Kenya 1H11 EPS down 73.6% to KES 0.46. Total Kenya announced disappointing 1H11 net profits with EPS declining 73.6% to KES 0.46. Sales inched 14.7%y/y, largely as a result of higher oil prices as the company lost market share to 22.6% from 27.6% a year earlier mainly as a result of lower diesel consumption for emergency power generation. The company grew sales in other segments such as retail network, aviation, lubricants and bitumen. Gross profits declined 23.0%y/y to KES 2.0bn on the back of price controls which impacted their margins. As a result, net profits declined 73.6% to KES 79.7m. Included in net profits, was a gain of KES 200m from the sale of assets- which was part of an earlier agreement with the monopolies commission when the oil marketer acquired Chevron assets in Kenya which was exiting. The company has also been struggling to improve its working capital position and financing costs remain high, although declining- down 27.1% to KES 396.0m y/y.

Valuation:

Our fair value is derived using discounted cash flows based on 5 year estimates. A fair value of KES 15.26 suggests that Total Kenya is overvalued based on DCF. We assume a weighted average cost of capital of 16.5% and a terminal growth rate of 5.5%. The future estimates appear quite uncertain especially since Total Kenya relies on Kenya for the bulk of its revenues and it doesn't appear that there is going to be any strategic changes in the near term. We think a rights issue or further asset sales to pay down the medium debt would be positive for the business valuation.

Operating profit	1,471	1,509	1,861	1,963	2,053	
Add: Depreciation	921	921	921	921	921	
Less: Working Capital Inv	-2,725	-1,191	-1,304	-1,438	-1,593	
Less: Capex	383	383	383	383	383	
Less: Notional Cash Tax	-61	-97	-171	-170	-157	
Free cash flow	-11	1,525	1,690	1,659	1,607	15,406
Beta	1.17	1.17	1.17	1.17	1.17	1.17
Debt/(debt + equity) (%)	18%	18%	18%	18%	18%	18.1%
Weighted cost of capital (%)	15.7%	15.7%	15.7%	15.7%	15.7%	16.5%
Discount period	-0.11	0.89	1.89	2.89	3.89	
Discount factor @ WACC	1.02	0.88	0.76	0.66	0.57	0.57
Present value of free cash flow	-11	1,339	1,283	1,089	912	8,740
Value of operations	13,352					
add: net cash	-8,795					
add: net nonoperating assets						
Equity value	4,557					
no. of shares	299					
Fair value (KES/share)	**15.26**					

Source: Company data, Standard Investment Bank estimates

SUMMARY DCF	
Risk free rate	9.0%
Beta	1.2
Cost of equity	17.2%
Cost of debt	12.5%
Tax rate (%)	30.0%
After tax cost of debt	8.8%
Gearing	18%
WACC	16.5%
Terminal growth rate	5.5%
Fair value (KES per share)	**15.26**
Current share price	**16.95**
Recommendation	**SELL**

Source: Company data, Standard Investment Bank estimates

Fair Value Sensitivity

	Long term GDP Growth estimate						
WACC	**2.50%**	**3.50%**	**4.50%**	**5.50%**	**6.50%**	**7.50%**	**8.50%**
13.5%	14.43	17.58	21.43	**26.23**	32.41	40.65	52.18
14.5%	12.06	14.71	17.88	**21.76**	26.61	32.85	41.16
15.5%	10.06	12.32	14.99	**18.19**	22.10	27.00	33.28
16.5%	**8.34**	**10.29**	**12.57**	**15.26**	**18.49**	**22.44**	**27.38**
17.5%	6.85	8.56	10.53	**12.83**	15.54	18.80	22.78
18.5%	5.55	7.05	8.78	**10.76**	13.08	15.82	19.11
19.5%	4.40	5.74	7.26	**8.99**	11.00	13.33	16.10

Key Ratios

	2008A	2009A	2010A	2011E	2012F	2013F
EPS	2.36	1.62	3.07	0.47	0.76	1.34
% change	-46.6	-31.4	89.9	-84.6	60.7	76.0
DPS	1.49	1.49	2.56	0.36	0.57	1.00
% change	-	0.0	71.6	-86.1	60.7	76.0
Dividend yield (gross)	4.98%	4.98%	16.02%	2.22%	3.57%	6.28%
Payout ratio	63.36%	92.42%	83.53%	75.00%	75.00%	75.00%
NAV	28.66	30.02	32.09	32.56	32.97	33.74
PE	12.72	18.56	5.21	33.78	21.02	11.94
P/BV	1.05	1.00	0.50	0.49	0.49	0.47
EV/net sales	0.22	0.69	0.21	0.20	0.19	0.18
EV/EBITDA	5.76	13.16	3.97	7.08	7.41	6.84
Total sales/assets	307%	104%	212%	224%	230%	237%

Source: Company data, Standard Investment Bank estimates

Earnings model- 2008A-2013F

Income Statement (KESm)	2008A	2009A	2010A	2011E	2012F	2013F
Sales	44,561	32,677	64,362	86,245	95,732	106,071
COGS and operating costs	(42,862)	(30,972)	(61,041)	(83,853)	(93,301)	(103,288)
EBITDA	1,698	1,705	3,321	2,392	2,430	2,783
Depreciation	272	324	324	269	269	269
Amortisation	34	72	652	652	652	652
EBIT	1,393	1,309	2,344	1,471	1,509	1,861
Net interest (cost)/income	(365)	(526)	(954)	(1,269)	(1,184)	(1,290)
Earnings before tax	1,031	734	1,388	202	325	571
Net profit	704	483	916	141	227	400

Balance Sheet (KESm)	2008A	2009A	2010A	2011E	2012F	2013F
Net tangible assets	2,024	3,444	9,642	9,911	9,911	9,911
Net intangible assets	740	7,339	619	619	619	619
Total noncurrent assets	2,763	10,783	10,261	10,530	10,530	10,530
Current assets	10,215	20,236	19,736	26,502	29,368	32,452
Term deposits+cash & cash equiv.	1,549	510	379	1,458	1,644	1,831
Total Assets	**14,527**	**31,528**	**30,376**	**38,490**	**41,543**	**44,814**
Total liabilities	9,509	22,566	20,796	28,769	31,700	34,742
Shareholder equity	5,018	8,962	9,580	9,721	9,842	10,072
Total equity and liabilities	**14,527**	**31,528**	**30,376**	**38,490**	**41,543**	**44,814**
Net capital invested	297	10,755	407	921	921	921

Cash Flow (KESm)	2008A	2009A	2010A	2011E	2012F	2013F
Cashflow from operations	1,701	1,655	3,237	2,392	2,430	2,783
Change in net working capital	-2,519	-1,804	1,821	-4,054	-2,473	-2,765
Cash flow from operations	-818	-149	5,058	-1,662	-42	17
Cash flow from investing	-297	-10,755	-407	-921	-921	-921
cash flow from financing	-434	7,979	-1,001	-765	-106	-170
Free cash flow	-1,550	-2,924	3,650	-3,349	-1,070	-1,074
Cash and cash equivalent at end	-3,493	-8,673	-5,023	-8,372	-9,442	-10,516

Source: Company data, Standard Investment Bank estimates

Ratio and analysis

Growth and Margins	2008A	2009A	2010A	2011E	2012F	2013F
Gross margin	6.5%	8.6%	8.3%	6.2%	6.0%	6.1%
EBITDA margin	3.8%	5.2%	5.2%	2.8%	2.5%	2.6%
EBIT/operating margin	3.1%	4.0%	3.6%	1.7%	1.6%	1.8%
Net profit margin	1.6%	1.5%	1.4%	0.2%	0.2%	0.4%
Net sales growth	28.2%	-26.7%	97.0%	34.0%	11.0%	10.8%
Net profit growth	-46.6%	-31.4%	89.9%	-84.6%	60.7%	76.0%

Ratios	2008A	2009A	2010A	2011E	2012F	2013F
Net debt/equity	12.4%	37.3%	48.9%	57.4%	59.3%	60.8%
Depreciation rate	37.2%	-1.2%	-9.8%	5.0%	5.0%	5.0%
ROE (Average)	20.7%	8.5%	7.5%	5.5%	1.9%	3.1%
ROCE (Average)	28.1%	15.0%	14.2%	14.8%	11.4%	12.7%
ROA	4.8%	1.5%	3.0%	0.4%	0.5%	0.9%
Asset turnover	306.8%	103.6%	211.9%	224.1%	230.4%	236.7%

Source: Company data, Standard Investment Bank estimates

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