

# High operating leverage undermines capital restructuring gains

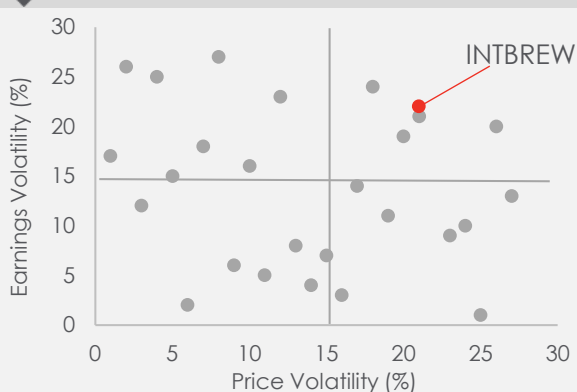
30th April, 2021

Research Analyst:

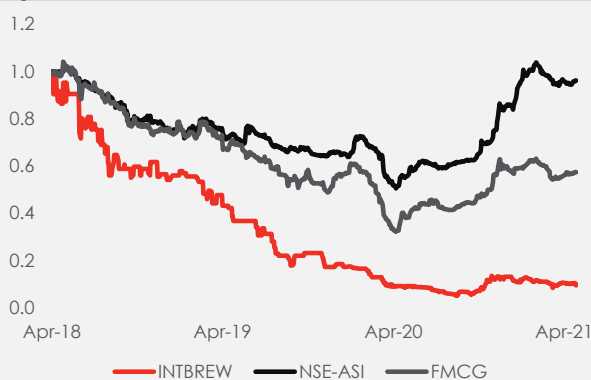
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**Risk Rating: High****Key Data**

Last Price (₦)	5.20
Last Price (\$)	0.01
52 week High/Low (₦)	7.74/ 2.70
1M Price Change (%)	-8.8
3M Price Change (%)	-13.3
6M Price Change (%)	-29.4
YTD Change (%)	-12.6
Beta	0.81
Market Capitalization (₦'bn)	139.7
Market Capitalization (\$'m)	368.6
Shares Outstanding. (Units'm)	26,862.07
Float (%)	98.3
Dividend Yield (%)	N/A

**Price Performance Chart**

Sources: Bloomberg, United Capital Research

**Stock Rating**  
**HOLD**
**Target Price**  
**Old: N4.75**  
**New: N5.88**
**Expected Return**  
**13.1%**

Recently, International Breweries Plc (INTBREW) published its audited FY-2020 financial result. According to the report, Revenue rose by 3.4% y/y to N136.8bn, as strong Revenue recovery in H2-2020 pulled Revenue numbers higher, reflecting the impacted of reduced restrictions on on-trade channels and social activities. Nevertheless, huge operating leverage continues to weigh on the company's performance denting improvement in capital structure. Overall, the company's Loss before and after-tax reduced to N20.2bn and N12.1bn respectively in FY-2020. Below, we review the company's performance and provide our expectations for the year.

**Rebound in H2-2020 revenue supports Revenue growth:** INTBREW's FY-2020 Revenue performance was a tale of two halves. Earlier in H1-2020, INTBREW's Revenue had declined 11.7% y/y as covid-linked pressures pushed beer volumes lower, particularly in Q2-2020. However, gradual easing of restrictions on movement and social gatherings resuscitated demand as Revenue grew 19.5% y/y in H2-2020. Overall, the company recorded Revenue growth of 3.4% y/y to N136.8bn in FY-2020 from N132.4bn in FY-2019.

**Surprise decline in Cost of Sales:** Elsewhere, Cost of Sales surprisingly declined, down 0.8% y/y to N106.3bn in FY-2020 from N107.1bn in FY-2019. The decline in Cost of Sales was broadly supported by a 5.6% y/y decline in cost of raw materials, a positive surprise considering the impact of devaluation on Naira cost of imported barley as well as inflationary pressures on key materials like Packaging materials, Cassava etc. Following the decline in Cost of Sales (compared to growth in Revenue), Gross margin strengthened, climbing 330bps y/y to 22.3% in FY-2020. Similarly, Gross profit grew 20.9% y/y to N30.5bn in FY-2020 from N25.2bn in FY-2019.

**Limited commercial activities curtails Opex:** In FY-2020, the outbreak of the covid-19 pandemic limited the ability of many corporates to engage in usual commercial promotions. This applied to INTBREW who was unable to organize several of its annual commercial promotional

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activities. This reflects in the 23.7% y/y decline in Advertising & Promotion expenses. Overall, this supported the 20.7% y/y decline in Marketing & Promotion expenses to N12.7bn in FY-2020 from N16.0bn in FY-2019. On the other hand, Administrative expenses grew 6.7% y/y to N27.9bn in FY-2020. Overall, core Opex declined by 3.7% y/y.

On a negative note, the company recorded Other Losses of N14.4bn (vs N1.7bn in FY-2019). The surge in Other Losses was driven by Net foreign exchange loss of N10.0bn as well as Loss on disposal of PPE worth N4.4bn in FY-2020. In addition, INTBREW booked Impairment charges worth N1.4bn. This weighed on Operating performance as the company recorded 10.5% y/y increase in Operating loss, printing at N23.2bn in FY-2020 from N21.0bn in FY-2019.

**Capital restructuring exercise bears fruit:** Following completion of the N164.4bn right issue in Dec-2019, the company used the proceeds from the issuance to pay down some of its loans in 2020. As a result, Total Borrowings declined 58.0% y/y to N110.7bn at the end of FY-2020 compared to N263.6bn as at FY-2019. The decline in borrowings fed into lower Finance cost, declining 79.1% y/y to N3.2bn in FY-2020 from N15.2bn in FY-2019. The right issue proceeds also bolstered the company's cash position (Cash & Cash Equivalents grew 113.3% y/y) amidst improved working capital management. As a result, Finance income surged to N1.5bn in FY-2020 compared to just N1.8m in FY-2019. Overall, Net Interest expense fell 89.0% y/y to N1.7bn in FY-2020 from N15.2bn in FY-2019.

Following the steep decline in Net Interest expense, Loss before Tax and Loss after Tax fell 31.2% y/y and 55.5% y/y respectively to N24.9bn and N12.4bn in FY-2020, from N36.2bn and N27.8bn in FY-2019.

**Valuation & Outlook:** Looking ahead, we anticipate a strong rebound in Revenue in FY-2021 driven by improved volumes and pricing power. Based on our supply chain sources, INTBREW announced price increment across its products which took effect in Mar-2021. Thus, we expect Revenue growth to come in strongly in FY-2021. We estimate Revenue growth of 28.4% y/y for FY-2021e. However, we expect cost pressures to crystallise in FY-2021 after a positive surprise in FY-2020. The impact of devaluation on the Naira cost of imported barley amidst rising cost of the commodity coupled with sustained inflationary pressures on locally sourced materials will ramp cost pressures. Lastly, we remain concerned by the company's high operating leverage (compared to peers) due to huge Opex and Depreciation expense. Thus, while we project a decline in Operating loss and After-tax losses, we do not see the company turning profitable in FY-2021.

Following upward revisions to our Sales forecast and lower Loss estimates, we raise our target price on INTBREW to N5.88/s from N4.75/s which implies an upside potential of 13.1% to current price of N5.20/s. Thus, we raise our rating on the stock to a **HOLD**.

...we revise our year-end Target Price to **N5.88/share with a HOLD rating on the stock.**

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### Financial Highlights (N'Mn)

#### Earnings Flash | International Breweries Plc FY-2020 Audited Result

Financial Highlights (N'Mn)			
Headlines	FY - 2020	FY- 2019	Change
<b>Revenue</b>	<b>136,791</b>	<b>132,352</b>	3.4%
Cost of Sales	-106,316	-107,144	-0.8%
<b>Gross Income</b>	<b>30,475</b>	<b>25,207</b>	<b>20.9%</b>
Other Income/Expense	-11,650	-2,388	387.8%
Net Impairment Charge of Financial Assets	-1,446	-1,667	-13.2%
Operating Expense	-40,575	-42,137	-3.7%
<b>Operating Profit</b>	<b>-23,196</b>	<b>-20,985</b>	<b>10.5%</b>
Finance Income	1,502	2	84477.9%
Finance Costs	-3,179	-15,184	-79.1%
<b>Profit Before Tax</b>	<b>-24,873</b>	<b>-36,167</b>	-31.2%
Taxation	12,508	8,376	49.3%
<b>Profit After Tax</b>	<b>-12,365</b>	<b>-27,791</b>	-55.5%
	<b>FY - 2020</b>	<b>FY - 2019</b>	
Cash and Cash Equivalents	33,477	31,806	5.3%
<b>Trade &amp; Other Receivables</b>	<b>15,790</b>	<b>27,803</b>	<b>-43.2%</b>
<b>Trade &amp; Other Payables</b>	<b>101,608</b>	<b>88,187</b>	<b>15.2%</b>
<b>Total Debt</b>	<b>112,400</b>	<b>264,882</b>	<b>-57.6%</b>
<b>Total Assets</b>	<b>372,646</b>	<b>365,147</b>	<b>2.1%</b>
Net Assets	151,734	7,464	1933.0%
Gross Margin	22.3%	19.0%	<b>3.2%</b>
Cost to Sales	77.7%	81.0%	<b>-3.2%</b>
Net Margin	-9.0%	-21.0%	<b>12.0%</b>
Leverage (Debt/Equity)	74.1%	3548.9%	<b>-3474.9%</b>
Leverage (Net Debt/Equity)	52.0%	3122.8%	<b>-3070.8%</b>
Price(N)	5.2		
12M EPS(N)	NM		
BVPS(N)	5.6		
12M P/E (x)	NM		
P/BV (x)	0.9		
12M ROAE	NM		

Sources: Company Financials, United Capital Research

## Disclosure Appendix

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United Capital Research adopts a 3-tier recommendation system for assets under our coverage: Buy, Hold and Sell. These generic ratings are defined below:

**Buy:** Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%). We consider this as the minimum return that may deserve our holding of a risk asset, like equity.

**Hold:** Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

**Sell:** Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

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Company	Disclosure
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Fidelity Bank Plc	h
Flour Mills of Nigeria Plc	h
Forte Oil Plc	g
International Breweries Plc	a,h
Nigerian Breweries Plc	h
PZ Nigeria Plc	h
Stanbic IBTC Plc	g
Total Nigeria Plc	h
UAC of Nigeria Plc	h
Zenith Nigeria Plc	a

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