Kingdom Securities

East African Portland Cement PLC

Holding Life Together

Company Performance Summary

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Kenya Construction Industry Performance

Kenya construction industry continues to experience rapid growths due to rising population, adoption of urbanization and government initiatives including affordable housing.

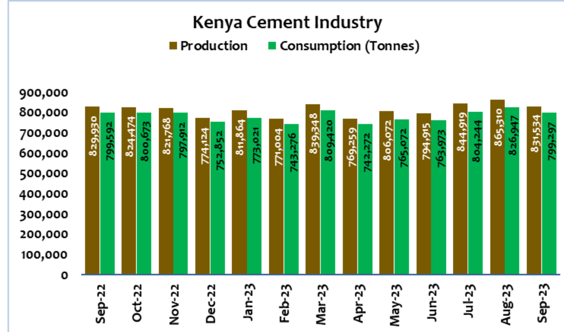
In the twelve months ending September 2023, the cement consumption rose 5.9% year on year (y-y) to stand at 2.43Mn metric tonnes according to the official GDP statistics of Q3 2023.

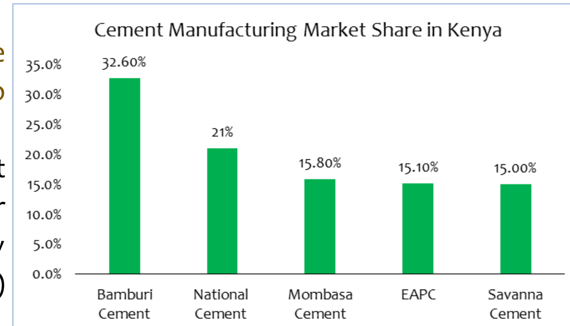
The onset of the construction of affordable housing is expected to push the cement consumption and revenues of the company higher in the coming days.

Credit advanced to the construction sector grew to 3.7% y-y to KES 141.7Bn (the government financial year ending June 2023) while growing faster at 8.6% to KES 149.6Bn in the third quarter of 2023.

For a long time, East African Portland Cement plc (EAPC), a cement manufacturer and distributor, held a market share of 25% (2nd position after Bamburi Cement plc) before it was dislodged by Mombasa Cement on liquidity constraints, and National Cement after acquiring ARM Africa Plc (ARM Cement) which used take the third position on its brand of Rhino Cement.

We issue a HOLD recommendation on the company's share price following the ongoing measures that are likely to bring it out of its loss position if implemented well. Its book value per share is 213.49.





Recommendation:	Hold
Bloomberg Ticker:	EAPC
Share Statistics	
Current Price (KES)	8.00
3-Month Average Price (av)	8.35
6 Month Av.	7.44
52 Week Av.	6.98
Δ% 6-months	61.5%
Δ% y-y	9.3%
52 Week High – Low (KES)	9.34 - 5.32
Issued shares Mn	90.00
Market Cap (KES Mn)	720.00
Market Cap (USD Mn)	4.49
P/E	(1.33)
BVPS	213.49
PB	0.04
EPS	(6.02)

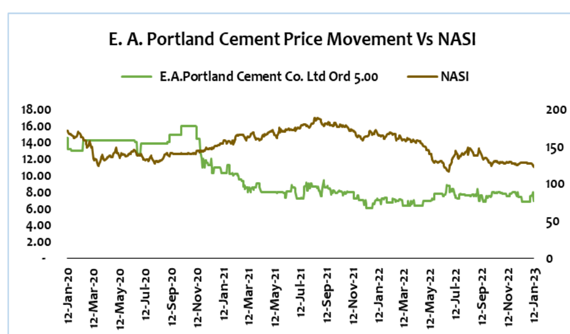
East African Portland Cement Financial Performance

EAPC posted a loss before tax of KES 1,352.12Mn in its full year (FY) ending 30th June 2023 from a profit before tax of KES 529.20Mn of FY-2022. This follows higher landing costs of coal and clinker and elevated thermal energy costs which contribute about 30% of EAPC's cost of sales. The cost of replacing a fault kiln shell plant and elevated forex costs on a weak local currency that all outweighed the gains of the new plant efficiency. Replacing the kiln costed KES 500.00Mn.

Profit after tax (PAT) sunk 350.5% to a loss of KES 1,356.47Mn from KES 541.59Mn reported same time in 2022.

During the period, the company faces a myriad of challenges including low working capital on delayed realization of land sale proceeds, non-operational situation during the kiln shell replacement and stiff price competition from its peers that had seen its market share decline from 21.0% to a third position of 15.1%.

- In 2023, company's revenues jumped 37.8% y-y from KES 2.14Bn to KES 2.95Bn on efficiency from the new kiln shell despite operating for nine months. This follows a three-month slow production, during the period of installation.



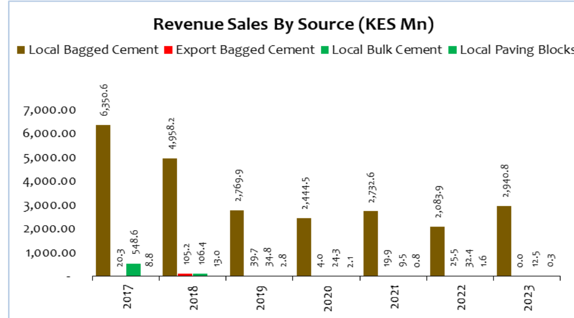
- We forecast the revenues to improve in FY 2024 to above KES 3.90Bn, which on account of the refurbished plant. This is after return to full capacity from 50% and below resulting to the losses witnessed as from 2020 while declaring job redundancy.

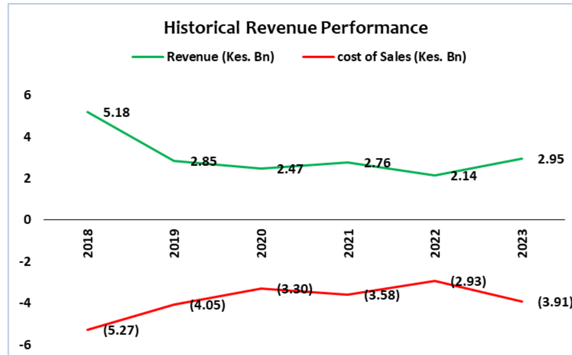
- The cement manufacturer's profits were slowed down by higher cost of sales which went up 33.6% from KES 2.93Bn to KES 3.91Bn on what the management attributed to higher input costs especially its imports on a 19.3% strengthening of the US dollar (pricing currency for imports) and elevates energy costs.

- Total energy costs jumped 90.6% y-y from KES 730.59MN to KES 1,392.24Bn to contribute over 30% of the company's cost of production.

- Employee costs grew at normal rate of 8.0% to KES 487.29Mn. However, the company has significant employees' unpaid salary litigation of KES 1.5Bn and unpaid bills and supplies of KES 496Mn as of 30th June 2023 which if paid before the realization of the projected funds will negatively impact cashflows.

The weakening local currency continue to pose a great challenge especially in the importation of iron and steel which is a key raw material in the cement industry.





Revenue +37.8% y-y

Cost of Sales +33.6% y-y

Power costs +167.1% y-y

Staff Costs +15.4% y-y

Admin and Establishment expense +13.6% y-y

PBT -355.5% y-y

PAT –350.5% y-y

Shareholder's Funds –11.0% y-y

Total Assets - 8.6% y-y

Balance Sheet

The listed counter's total assets shrunk 8.6% y-y of KES 3.07Bn from KES 35.85Bn to KES 32.78Bn on account of sale of land properties to settle its bank obligations. The total value of its properties declined by 8.1% from KES 33.77Bn to KES 31.02Bn.

Total borrowings fell 49.0% y-y from KES 3.80Bn to KES 1.94Bn after the company made a loan payment of KES 2.23Bn resulting to completion of KCB Bank loan facility by way of a land transfer. The total amount of the loan settled was KES 1.8Bn.

EAPC concluded the transfer of LE 8784/654 to KCB Bank to retire its outstanding debt with the lender.

After clearing the bank loan, the company remained with a Japanese debt (JICA) of KES 1,942.95Mn (Initial value was JPY 7.67Bn) taken over the national government. which is being serviced bi-annually by the government, March and September.

Further, the Group's board proposed to extract value from its balance sheet by liquidating its non-core assets such its land occupied by squatters.

Land Disposal

To support its working capital, the board hastened the realization of funds from sell of lands LR8784/144, 8784/145 and 8784/653 (a total of 909 acres previously occupied by squatters), the board approved regularization plan for formalizing its land tittles.

In the plan, EAPC said priority will be given to the locals in the purchase the above 909 acres valued at KES 5 billion within a period of three years.

EAPC also subdivided 1000 acres of LR 10424 into 50-acre plots which are on sale with expected total proceeds of KES 5 billion.

Outlook

The company is set to start realizing better returns after restructuring its balance sheet if the management utilizes well the expected funds.

Following the return to 100% capacity in operations, the Group's managements foresee a recapture of its market share to above 20% of about 1.9 million tonnes per year. This will push revenues to levels of above KES 3.90Bn as explained above.

The recovery of the cement maker remains a key concern to the government with several measures being taken to revitalize the company including partnering in the provision of affordable housing.

Selling idle land to modernize the cement plant and millers will increase its productivity that will result in better pricing and make share expansion.

Profit and Loss Statement Historical Summary						
Date	2018	2019	2020	2021	2022	2023
Revenue	5,182.72	2,847.27	2,474.90	2,762.75	2,143.28	2,953.57
cost of Sales	(5,272.61)	(4,052.56)	(3,300.35)	(3,583.28)	(2,925.51)	(3,909.86)
Gross Profit	**(89.89)**	**(1,205.28)**	**(825.45)**	**(820.53)**	**(782.23)**	**(956.28)**
Other Income	398.24	1,691.49	198.86	108.66	74.17	78.94
Admin & selling Exp.	(3,199.80)	(1,798.74)	(1,859.45)	(888.40)	(743.72)	(844.67)
Operating Loss	(3,479.30)	(2,062.38)	(3,128.54)	(3,212.37)	(1,839.94)	(1,926.03)
Profit/Loss before Tax	**7,041.73**	**(2,961.90)**	**(2,798.61)**	**1,735.94**	**529.20**	**(1,352.12)**
Tax Expense/Credit	811.54	(399.99)	29.26	151.64	12.39	(4.35)

Balance Sheet						
	2018	2019	2020	2021	2022	2023
Investment properties	27,184.75	23,794.90	24,909.68	25,271.72	27,372.45	25,909.70
Plant, Property & equipment	8,033.97	7,475.70	6,931.32	6,867.26	6,397.41	5,111.09
Inventories	1,248.66	1,131.47	1,112.17	1,084.31	924.08	873.60
Total Assets	37,603.55	36,541.11	35,176.89	34,641.11	35,849.47	32,780.93
Total Equity	24,808.75	21,519.98	18,753.14	21,012.12	21,581.29	19,214.26
Borrowings	5,806.32	6,776.29	7,523.60	3,679.42	3,807.50	1,942.95
Trade and other payables	1,010.58	5,527.79	7,248.20	9,361.56	9,793.97	10,953.24

Ratios	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
ROA	31.7%	-15.6%	-14.8%	9.0%	2.5%	-7.1%
ROE	20.9%	-9.2%	-7.9%	5.4%	1.5%	-4.1%
Gross Margin Ratio	-1.7%	-42.3%	-33.4%	-29.7%	-36.5%	-32.4%
Operating Profit Margin	135.9%	-104.0%	-113.1%	62.8%	24.7%	-45.8%

Valuation

EAPC has a total of 90 million shares floated at the NSE market and is the only counter with few floated shares in comparison to its peers.

Trading at a price of KES 8.00 per share, the company's annual average price stands at KES 6.98 with a high and low of KES 9.34 and KES 5.32 per share for the same period respectively.

The company's book value per share (BVPS) stands at 213.49 signaling an undervalued market position of its share price. We obtain the book value per share by dividing the company's shareholders' value and the floated shares. The rest of the valuation formulae could not apply following the negative cashflows.

EAPC Enterprise Value (KES Mn)	
Issued Shares (Million)	90
Market capitalization	720.00
Outstanding Debt	1942.945
Cash and cash equivalents	80.281
Enterprise Value	2,582.66

Assuming revenue for FY-2023-24 grows by half the rate seen in 2022/23, at 18% in the next 2-years and 9.0% in the third year, we expect EAPC's revenues to resemble that in the following table. These projections are based on the expected rise in cement consumption fueled by the affordable housing and the resumption of full capacity production.

Income Statement Forecast						
Item	2021	2022	2023	2024F	2025F	2026F
Revenue (Kes. Bn)	2,762.75	2,143.28	2,953.57	3,511.89	4,175.75	4,570.42
cost of Sales (Kes. Bn)	(3,583.28)	(2,925.51)	(3,909.86)	(2,932.39)	(3,079.01)	(3,232.96)
Gross Profit (Kes. Bn)	**(820.53)**	**(782.23)**	**(956.28)**	**579.50**	**1,096.74**	**1,337.46**
Administration and selling Expenses	(888.40)	(743.72)	(844.67)	(633.50)	(601.82)	(571.73)
Loss from Operating Activities	(3,212.37)	(1,839.94)	(1,926.03)	(171.18)	427.27	741.44
Profit/Loss before Tax (Kes. Mn)	**1,735.94**	**630.05**	**(1,352.12)**	**415.62**	**1,112.68**	**1,540.26**
Tax Expense/Credit	151.64	12.39	(4.35)	47.24	51.73	26.75
Profit/Loss after Tax	**1,887.58**	**642.44**	**(1,356.47)**	**462.85**	**1,164.41**	**1,567.01**
EPS	20.97	15.07	(6.02)	5.14	12.94	17.41

However, despite a better outlook for the company's financial performance, we remain skeptical on issuing a buy recommendation and issue a HOLD recommendation based on the following reasons:

- H2-2023 revenue declined 2.8% from KES 1.50Bn to KES 1.46Bn despite the above full production resumption to full capacity which was expected lead a better H2-2023 financials.
- The cost of sales jumped 22.4% from KES 1.76Bn to KES 2.15Bn even after the kiln replacement happening in the first quarter of the financial year 2022/23.

END

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Analysts' stock ratings are defined as follows:

- **Buy** – A buy rating reflects 1) An analyst has a bullish conviction on a stock 2) A 30% or greater expected return.
- **Accumulate** – An accumulate rating reflects 1) An analyst has a lesser bullish conviction on a stock 2) Expected return fallsbetween 10% and 30%.
- **Hold** – A hold rating reflects 1) An analyst has a neutral conviction (lack of bullish or bearish conviction) on a stock 2)Expected return falls within the range of 5% to 10%.
- **Speculative Buy** – A speculative buy rating reflects 1) An analyst has a bullish conviction accompanied by a substantiallyhigher than normal risk 2) Expected return falls above 10%.
- **Sell** – A sell rating reflects 1) An analyst has a bearish conviction on a stock 2) Expected return falls below 5%.

*Expected Return (ER) represents the sum total of both capital appreciation and the dividend yield.

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