

May 28th 2010

Scangroup Stock analysis

Company Profile

Special points of interest:

- * Sustainable Growth rate 13%
- * Market Share 62%
- * EPS Growth 14% CAGR
- * Return on Equity 18%
- * Return on Assets 10%
- * P/E Ratio 18.09
- * Return Index 213.1
- * Share Price KShs 32.00
- * EPS KShs. 1.81
- * DPS KShs. 0.50

Based in Nairobi, Kenya, Scangroup is East Africa's largest communications service group. The company currently offers full services in Kenya, Tanzania, and Uganda, and currently has media purchasing offices across eleven African countries. The company is listed on The Nairobi Stock Exchange since 2006. The company is structured as a Holding company offering Advertising and communication services in a Horizontal model with autonomous units which allow the company to handle diverse clients while avoiding potential conflict of interest. Scangroups operations are based in East Africa with Kenya generating 76 per cent, Tanzania 14 per cent and Uganda 10 per cent as well as a presence in a swathe of sub Saharan Africa markets including Ethiopia, Zimbabwe, Malawi, Angola, Gabon, Democratic Republic of Congo and Mauritius. Scangroup boasts media planning and buying capability in a total of 32 countries across Africa.

Scangroup has been pursuing a strategic expansion policy through horizontal partnerships and takeovers which have seen the company forge strategic relationships. The acquisition strategy was incorporated in Scangroup's IPO plan by reservation of 5 million shares with the company's target being to become an African Multinational company.

Since listing on the NSE in 2006 Scangroup has had impressive success in implementing the horizontal expansion strategy through various acquisitions and affiliations which have positioned Scangroup as the leading media advertising company in East Africa. Below is a brief chronological summary of the events since listing on the NSE.

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2006:

Scangroup listed on the NSE and soon after acquired FCB Tanzania giving them their first Telcom account i.e. Vodacom Tanzania.

2007:

Scangroup acquired Redsky which brought both the Safaricom Kenya and Telcom Uganda accounts into the fold.

Scangroup ventured into research by entering into a joint venture with Millward Brown East Africa which is an affiliate of WPP international.

Scangroup put in place an employee mentorship program so as to strengthen the quality of the workforce.

2008

Scangroup introduced an ESOP program as a reward and incentive system for employees. Scangroup sold a 27.5% stake to WPP who also got 2 seats on the Scangroup BOD this deal effectively altered the company's corporate structure with the introduction of a 2nd anchor shareholder it also enhanced Scangroup by:

- Providing a succession plan for stability and continuity
- Created a platform for further affiliation with WPP operating companies for increased technical support.
- Provided an ideal platform for continental expansion.

Scangroup failed to secure an entrance into the Nigerian market. Scangroups business remained robust despite the post election upheavals in Kenya and global financial crisis.

2009:

Scangroup entered into a joint venture with Hill & Knowlton, another WPP affiliate company to provide Public Relation services.

• advertising agencies

- Lowe Scanad Kenya, Uganda and Tanzania, (EABL, Equity)
- FCB Tanzania (Vodacom)
- Thompson Kenya,
- Grey East Africa,
- McCann Erickson Kenya
- RedSky; (Safaricom)
- Ogilvy (Zain & Essar)
- JWT

• Media Planning & Buying

- Media Initiative East Africa,
- Mediacom
- Universal McCann;

• public relations companies

- Scanad Public Relations,
- Hill & Knowlton

• event management & experiential marketing

- Roundtrip

• marketing research

- Millward Brown.

2010

With the landing of undersea fibreoptic cable on Kenyan shores Scangroup launched Squad Media an integrated Digital Marketing Agency in a Joint venture between Scangroup, leading Indian digital marketing and technology businesses Smile Interactive Technology Group and Quasar, part of WPP Digital.

Scangroup entered into a joint venture with Smollan group of south Africa to provide field marketing, Brand activation and market intelligence services across East Africa

Scangroup has announced the creation of a pan-African joint venture with Ogilvy and Mather (worldwide) another affiliate of WPP. The deal which is to be sealed via a share swap agreement with Scangroup acquiring 50% of O&M's sub sahara interests is subject to regulatory and shareholder approval and has already drawn the ire of Scangroups competitors who fear that Scangroup may flout monopoly regulations. However Scangroup has held that the partners will continue to compete independently of each other and that the target is to spread their footprint across Africa.

From the strategic expansion discussed above Scangroup has since listing on the NSE managed to create a formidable presence in East Africa with constituent companies and partnerships ensuring the company handles some of the most lucrative accounts especially in the big ad spending rapid growth telcom sector as well as some of the top companies in the region.

Major client accounts Scangroup has handled in its portfolio

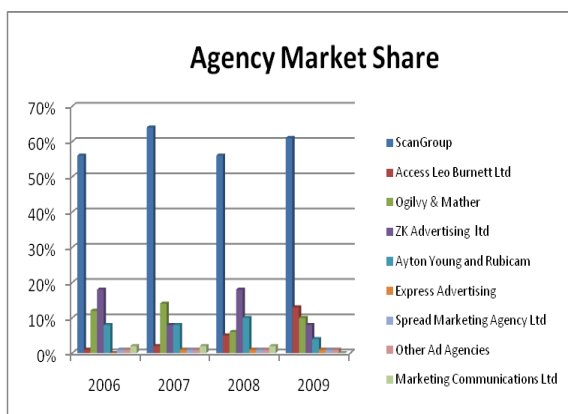
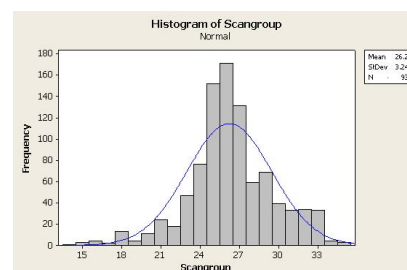
- Duracoat
- Haco industries
- Uniliver
- Coca Cola
- General Motors
- Standard Group Limited
- LongHorn Publishers
- Kenya Commercial Bank
- Kenya Airways
- Safaricom
- Nation media Group
- East African Breweries
- Pfizer
- Minute maid

Industry profile

The Media and advertising industry in the East African region has been characterized by exponential growth with the increase of FM radio stations, TV stations, Billboard advertising, Internet connectivity, Mobile phone coverage and event hosting i.e. concerts,

Athletics events, conferences and expo's. all these are measured in terms of advertising exposure by volume this has increased by a compounded Average Growth rate measure of 9.63% over the last 4 years Broadcast and digital media have recorded increased growth with Radio advertising being the media of choice due to mass coverage with an increase of CAGR of 9.97% while TV advertising has recorded the highest growth at CAGR of 10.91% as advertisers see more value emanating from them while print media has declined over the last 3 years. Going forward there is expectation that there will be a remarkable shift towards digital advertising as internet connectivity becomes more available particularly on the mobile telecommunication devices.

Year	total Spots	Radio	TV	Print
2006	1,360,401.00	1,120,941	193,676	37,939
2007	1,622,690.00	1,350,388	223,289	41,881
2008	1,714,026.00	1,434,755	227,710	37,882
2009	1,792,589.00	1,490,891	264,226	34,998
CAGR	9.63%	9.97%	10.91%	-2.65%

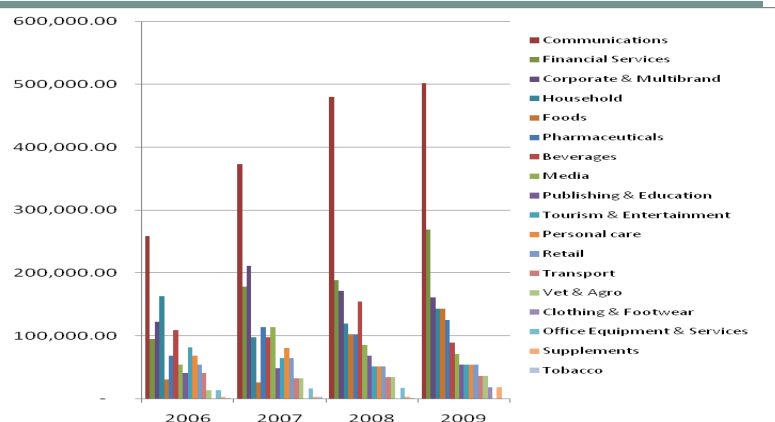


Agency Market Share

With 61% market share in 2009 and an average market share of 59% with a CAGR of 2.89% Scangroup is the dominant player in the industry and a partnership with Ogilvy and Mather would raise the market share by another 10% to 71% which has brought other industry players up in arms citing monopoly regulations. However the companies maintain that they will not merge their operations but will continue to compete with each other in a loose horizontal structure under the same holding company.

Per Sector Advertising breakdown

The most advertising spend was recorded in the communications sector as competition for market share rages with new entrants in the industry despite a slight slowdown during the 2008/2009 financial crisis. The financial sector recorded marginal growth fuelled by the emergence of mobile money transfer services. Most other sectors saw advertisement spend cuts during the financial crisis period but with acceleration in economic growth in 2010 these should see significant recovery.



Company	Scangroup Ltd	
% ROE	18%	
% ROA	10%	
Div Cover	362%	
2009 Quick Ratio	2.07	
Debt/ Equity Ratio	0.0	
Gross Margin Ratio	8%	
Net Profit Margin Ratio	5%	
Financial Leverage	1.75	
Sustainable Growth Rate	13%	
EPS 2009	1.81	
His. EPS	1.26	
P/E Ratio	18.09	
Div. Yield	1.53%	
NAV	1,658,139	
PBV	10.67	
Shares Issued	220,689,655	
Par Value (Kshs)	1.00	
Mkt Cap (Kshs. Bn)	7,227,586,201	
Profit Before Tax 000	2,009	544,100.00
	2,008	436,755
Profits After Tax 000	2,009	401,148
	2,008	315,789
Gross Sales 000	2,009	5,920,012
	2,008	5,789,716
Net Sales 000	2,009	5,920,012
	2,008	5,789,716
Share Holders Funds 000	2009	2,353,840
	2008	2,081,082
	2007	603,661
Goodwill 000	2009	83,548
	2008	83,548
2009 Liabilities 000	2009	1,555,306
	2008	1,690,428
2009 Assets 000	2009	3,213,445
	2008	3,593,824
Debt 000	2009	11,620
	2008	4,065
Total Assets	2009	3,933,148
	2008	3,773,957
	2007	1,753,635
Retention Ratio	2009	72%
Dividend Per Share	2009	Kshs 0.50
	2008	Kshs 0.75
	2007	Kshs 0.90
	2006	Kshs 0.83
	Earnings Per Share	%
2009	Kshs	1.81
	Kshs	1.79
	Kshs	1.49
	Kshs	1.23

Financial Performance

In 2009 Scangroup recorded a 25% rise in pretax profit for 2009 from a year earlier to 544.1 million shillings. Scangroups `revenues rose 13% to KShs. 1.62 billion from KShs. 1.44 billion shillings previously, with billings inching up 2% to 5.92 billion shillings from 5.79 billion shillings. The financial period ending 2009 was characterized by an economic slowdown due primarily from the combined effects of the global credit crunch and the aftermath of the post election violence. The prevailing circumstances were reflected in the financial performance of Scangroup as billings recorded flattened growth of 2% compared to 58% in 2007 and 21% in 2008. The same effect was evident in revenue growth which stood at 13% compared to 39% in 2007 and 29% in 2008. However Scangroup made a prudent move to invest in government securities as a risk mitigation measure earning KShs. 92 Million in the process an increase of 546% from the 14.2 interest income earned in the company's initial foray into fixed income investment. Scangroups EBITDA also recorded flattened growth of 1% in 2009 after 27% growth in the 2 preceding financial periods, however the EBITDA CAGR for the period 2005 – 2009 was an impressive 17%. During the 4 year period since listing on the NSE the Profit attributable to equity shareholders has grown consistently recording 27% in 2007 29% in 2008 and 30% in 2009 to return a CAGR of 28.82%. This growth was accomplished despite dilution due to additional issue of common equity as the weighted average Number of shares grew from listing 160 million to 220 million shares in 2009 an increase of 43.54% over the 4 year period. EPS also grew at a CAGR of 14.37% while the company's PBT margin declined from 33.75% in 2005 to 33.52% in 2009 a CAGR (decline) of -0.17% it is worth noting that in 2008 this stood at a CAGR of -3.42% which is an indication of increasing efficiency over time.

Financial position: Scangroups financial position remained strong as is evident from the company's balance sheet Non Current assets grew 5.87% in the year ended 31st Dec 2009 from KShs. 180.133 Mn to KShs 190.706 Mn, however an inclusion of the government securities element increases this to KShs. 719.7 Mn translating to 107% growth. It is our view that these government securities are not expected to be a permanent feature in Scangroups balance sheet and therefore the latter figure would be a distortion of the true non current asset growth. Furthermore government securities are relatively liquid and therefore we treat them as liquid assets by adding them to the cash and bank balance to reveal a liquid asset position of KShs. 1.206 Bn compared to KShs. 1.111 Bn in 2008 an increase of 8.56%. over the 5 year period non current liabilities grew by CAGR of 85% while current liabilities grew by CAGR of 18.83% while assets grew by a CAGR of 40.08%. however a vertical common size analysis of the balance sheet reveals that current assets have been at an average of 92.24% of total assets over the period compared to non current assets average of 7.76% although the non current assets have been growing at a CAGR of 48%. further analysis reveals that current liabilities have averaged 57.6% compared to total assets with a negative CAGR of -15.17 while non current liabilities have been held at a very low level of .14% of total assets during the 5 year period with borrowings having grown by a CAGR of 32.14% during the period in question. revenue reserves have grown consistently by 18.64% while the share premium account has seen CAGR of 65.94% KShs 55Mn to 1.3 Bn in 2009. share capital and revenue reserves have grown by 147% and 762% respectively over the 5 years translating to a CAGR of 10.13% and 66.18 respectively over the 5 years with total assets having grown by 385% or a CAGR of 40.08% compared to current liability growth of 199% at a CAGR of 18.83%. as we have already seen non current liabilities make up an insignificant %age of the capital structure to warrant any comparison. A look at the Investor ratios reveals that Scangroup is currently operating at healthy margins with ROE of 18.17% and ROA of 10.41% and a dividend cover of 3.62. the company remains at a very liquid position of 2.07 times while the debt equity ratio of 0.0049 indicates that Scangroup has not used much leverage to finance growth while the company shows a financial leverage of 1.75 which is way below dangerous levels.

The Kenyan equities market has undergone some major transformation since late 2008 leading to the notion of a (1) Pre-Safaricom IPO era and a Post-Safaricom IPO era, (2) a post-2007 Political era and (3) a post-Safaricom IPO stockbroker problematic era (a number have either changed ownership or folded).

Pre-Safaricom IPO era – 2006, 2007 and 2008 were a ‘bull’ period for equities during which a number of IPOs and Rights Issues were successfully over-subscribed. The largest IPO being Safaricom (Kshs 50 Billion) and the largest Rights Issue (Kshs 5.5 Billion subscription) being KCB. Safaricom was heavily oversubscribed with the following conclusions - 800,000+ Kenyan Institutional Investors (**KIIs**), Kenyan Wealthy Investors (**KWIs**) and Kenyan Retail Investors (**KRIs**) can invest Kshs 50 Billion+ while less than 100 foreign institutional investors (**FIIs**) can also invest Kshs 50 Billion+. KCB Rights Issue 2008 proved that 100,000 Kenyan investors and some FIIs can participate in a rights issue for Kshs 8 Billion worth of shares. Note that both Safaricom and KCB were **after** the December 2007 election fiasco and **before** the global financial crisis. The equities turnover in 2008 closed at Kshs 97.5 Billion; up 9% from Kshs 88.62 Billion in 2007, a 6% drop from Kshs 95 Billion in 2006. The no of equities transactions in 2008 closed at 890,542 deals, down 9% from 973,548 deals in 2007, a 63% jump from 598,301 deals in 2006. Kenyan investors were the dominant investors in 2006 and 2007 but began to drop noticeably in 2008.

Post-Safaricom IPO era - 2009 saw poor equity traded volumes at Kshs 38.16 Billion, a 61% drop from Kshs 97.5 Billion reported in 2008 and no IPO on the Nairobi Stock Exchange. The no of equities transactions in 2009 closed at 402,169 deals, down 40% from 890,542 deals reported in 2008. All Kenyan investors noticeably exited the equities market as FIIs ended up dominating secondary trading. 2009 was the year of bonds for KIIs and KWIs. The ground-breaking KenGen Bond of Kshs 25 Billion was a major success and so were the various GOK infrastructure bonds and other regular bonds. Currently KCB, KPLC and TPS have all announced rights issues. GOK continue with bond issues every month but with interest rates declining substantially especially in short term securities with 91 day T-Bill at 3.998% as at 20th May 2010, 182 Day T-Bill at 4.599% a situation we expect will prompt fund managers to shift to fixed income secondary markets and equity in search of better yields and returns. The secondary market turnover in March witnessed a surge in Turnover to record KShs 47.39 Billion in Turnover compared to KShs 10.6 Billion in 2009 but there was a let up in April with KShs 30.21 Billion compared to 12.5 in 2009 and as at 25th of May Turnover stood at KShs 36 Billion compared to KShs 25.39 Billion in 2009 with average transaction value at KShs 893,809 compared to an average transaction value of KShs 779,638 in May 2009. **FIIs dominated trading** in January and February but KIIs appear to be coming in strong between March and May 2010. The numbers of transactions declined from 47,397 in March to 43,238 in April but are expected to remain steady in May as KRIs trickle back to the market. Kenya is experiencing sub-4% 91 day interest rates while GDP growth of more than 4.5% is projected for 2010

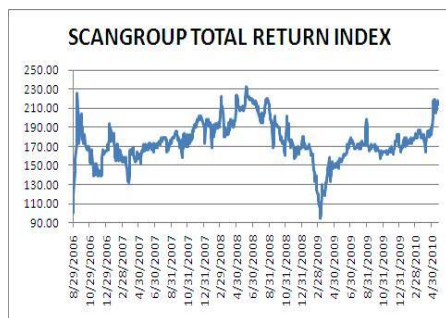
Scangroup Stock performance:

Scangroup shares began trading at the NSE on 29th August 2006 at a share price of 15 KShs and a historic P/E ratio of 10.88times, EPS of 0.96 NAV of 1.58 and an offer price to book value of 6.61 times. At the time of listing forecast EPS was 1.05 and forecast DPS stood at 0.79. over the years a return index of Scangroup indicates that that from a base value of 100 points at the time of listing and on the assumption that all dividends are reinvested the investor would have made a 113% gain on their investment with a low of 95.2 i.e. a value loss of -4.8% and a high of 232.14 i.e. a 132.14% gain on their initial investment with a standard deviation of 21.71.

Technical analysis: The price of Scangroup shares has been relatively stable since listing having hit a minimum price of 14.25 in march 2009 at the bottom of the post financial crisis bear market and an all time high of 34.75 in June 2008 coinciding with the peak of the NSE 20 index. The correlation between the Scangroup stock and the NSE 20 share index and the NASI is 34.4% and 84.3% respectively indicating that positive movement in both indices will see corresponding positive movements in the Scangroup share. The overall all time trend of the Scangroup share price has been relatively volatile with a slight upward trend at a mean of KShs 26.22 and support levels being experienced at around KShs. 24. On a six month technical analysis the stock has been on a steep upward trend with support levels at KShs 24.50 and KShs 26.00 respectively. During the period the stock reached a high of KShs 32.25 but seems poised to attain

higher highs on the back of the prevailing economic recovery and bullish stint at the NSE. Positive Market sentiment towards the Scangroup stock has been rekindled following a string of successful and profitable partnerships and joint ventures that have reversed the perceived failure to successfully enter the west African markets in 2008.

Conclusions and recommendations: With the current decline in lending rates, controlled inflation levels, increasing remittances from the Diaspora, unprecedented levels of entry by foreign investors into the stock market and expected economic recovery in 2010. The macroeconomic indicators point to a reversal of the flight to capital experienced in 2009 and a mass return to the equities segment on the NSE. This will be spurred by increased borrowing as banks lower their lending rates thus increasing investment and most probably rekindling the levels of advertising spend that suffered from cost cutting measures by most industries in order to weather the economic decline in 2008 and 2009. The entry of new mobile services providers, fiberoptic cable and advanced internet connectivity, switch over to digital TV media spectrum, the world cup, constitutional referendum and 2012 general elections all point towards a boom period for advertising and event management firms. Scangroup projects strong growth potential with 72% in retentions and a sustainable growth rate of 13% and 18% ROE which leads to the conclusion that for Medium to long term investors it is a **Strong Buy and Hold stock**



$$RI_t = RI_{t-1} * \frac{PI_t}{RI_{t-1}} \left[1 + \frac{DY_t}{100} * \frac{1}{N} \right]$$

