

4th May 2011



Sector

Industrial & Allied

Market Price

KES 130.00

Bloomberg

CBIL KN

Bloomberg code

NICB KN

Reuters

CARB NR

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Introduction

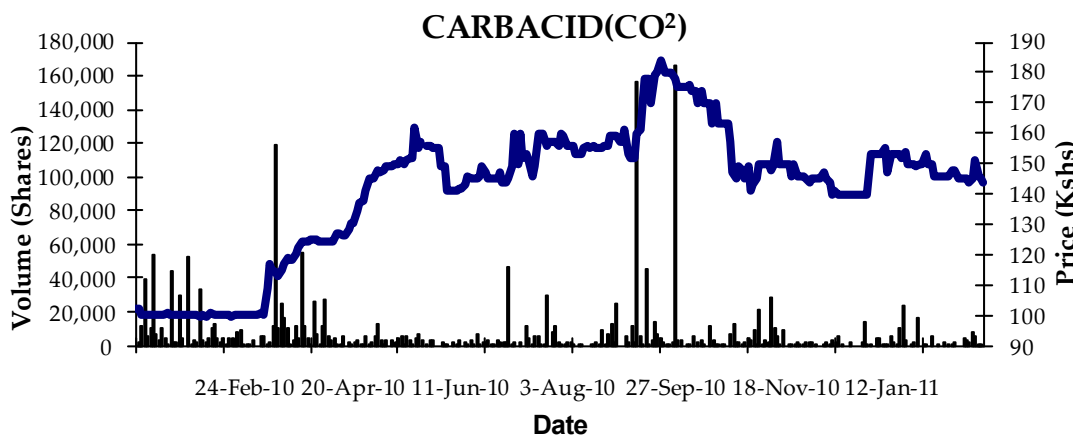
We are pleased to present you with our research note on Carbacid Investments Limited (CIL). In the note we present the investment thesis for CIL and in our opinion CIL presents itself as an attractive opportunity for investors in the Nairobi Stock Exchange because of the following reasons:

1. Cash Rich: We have reviewed excess cash held by the business in form of bank deposits and non-core investments which we have estimated at KES 505 million translating to excess cash per share of close to KES 18. The lack of debt and the company continuously generating healthy Cash From Operations (CFO) which is mostly deployed to financial assets presents an opportunity for dividend income investors. This cash situation has contributed to CIL's low liquidity in the market as most investors are holding onto the share for dividend income.

2. Margins: CIL shows a clear flow through accrued revenues to actual net cash flows due to its low cost structure and minimal working capital requirements. It reported Net margins of 50% in 2010.

3. Monopoly: CIL through its subsidiary Carbacid (CO2) Ltd controls close to 95% of the East African liquid Carbon dioxide market with little or no competition.

Healthy Net Margins



Low liquidity with trades below 20,000 shares. Price has been stable at the KES 140 to KES 150 range

Source:NSE price data

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Table 1:Top 5 Shareholders

| Name | Holding |
|--------------|---------|
| Rasimu Ltd | 20.89% |
| Mrs. Patel | 15.00% |
| Mr. Patel | 10.93% |
| Leverton Ltd | 9.36% |
| Kivuli Ltd | 5.83% |

Source:Company filings

Table 2 :Directors

| |
|-------------------|
| Hon. M. Wanjigi |
| Mr. R..A Shepherd |
| Mr. B. Patel |
| Mr. M.K.R Shah |

Source:Company filings

Table 3 : Management Team

| | |
|--------------|-----------------------------|
| Mr. Bhaduri | General Manager |
| Ms. Manji | Finance Manager |
| Mr. Maigacho | Mine Admins |
| Mr. Awori | Logistics & Procur- ment |
| Mr. Gitau | Sales & Marketing |

Source:Company filings

**Controls over 95% of the
East African CO₂ market**

Brief Company Profile

- Carbacid Investments Ltd (CIL) is a Kenyan based investment holding company incorporated in 1961 and listed at the Nairobi Stock Exchange (NSE) in 1972.
- CIL has a main subsidiary Carbacid (Co₂) Limited (“Carbacid”) whose main business is the sale of high purity carbon dioxide as well as other gas mixtures to the East African market. It is also engaged in prospecting and exploration of new natural carbon dioxide deposits in the region.
- Carbacid processes natural carbon dioxide mined from its mine located at the Kereita Forest (discovered in 1933). The plant produces high purity carbon dioxide used mainly for filling cylinders and production of dry ice blocks. It maintains a gas filling plant in Nairobi.
- Increasing regional and local demand resulted in the recent KES 450 million investment in a new plant in the Rift Valley as a means of increasing capacity and distribution footprint.
- Some of Carbacid’s main products and services are:
 - Bulk food grade liquid Carbon dioxide;
 - Bulk Industrial grade liquid Carbon dioxide;
 - Compressed Carbon dioxide Cylinders;
 - Dry ice pellets;
 - Industrial gas cylinders;
 - High purity compressed gas cylinders;
 - Mixed compressed gas cylinders.

Some of their services:

- Cylinder validation;
 - Dry ice blast cleaning;
 - Carbon dioxide Pest Control;
 - Bulk storage and pipeline installation supply;
 - Carbon dioxide Greenhouse enrichment.
- Carbacid’s main customers fall within the beverage market both in the alcoholic and non-alcoholic segments with East African Breweries and Coca Cola bottlers being some of their larger clients within the region. Carbacid controls 95% of the East African Carbon dioxide market.
 - Carbacid maintains its own truck distribution network that covers the entire East Africa region (including Rwanda and Burundi) for the distribution of liquid carbon dioxide. For small scale use, Carbacid supplies its products in cylinders using third parties.

2010 Financial Performance Highlights

Turnover grew by 12%.

- Turnover increased from KES 552.08 million in the year ended 31st July 2009 to KES 620.08 million for the year ended 31st July 2010 representing a growth of close to 12% .

Operating Profit Margins of 46%

- Operating Profit grew to KES 285.36 from KES 265.14 over the same period with operating profit margins of 46% in 2010.

Net Income Margins improved to 50%

- Other income predominantly interest income and fair value gains in equity investments grew to KES 152.68 million from KES 101.89 million in July 2009.

- PBT also increased from KES 367.02 million in the year ended 31st July 2009 to KES. 438.04 million for the year ended 31st July 2010 presenting a Net Income margin of 50%.

- Dividend payout in July 2010 totaled to KES 181.23 million up from KES 113.267 million paid in 2009.

Table 5: Statistics

| Descriptive Statistics 2010 | |
|---|------------|
| Item | CARBACID |
| Max | 184.00 |
| Min | 99.50 |
| Median | 145.00 |
| StdDev | 23.26 |
| DPS | 5.00 |
| Avg Return | 48.04% |
| NASI Return | 36.54% |
| NSE20 Return | 36.50% |
| βNASI | 0.0088 |
| βNSE20 | 0.0096 |
| NB: Descriptive statistics, Returns and Betas are computed from Jan-Dec 2010 | |
| Market Statistics | |
| Issued Shares | 33,980,265 |
| Mkt Cap. KShs Mn | 4,893 |
| EPS | 9.05 |
| DPS | 5.00 |
| P/E | 15.91 |
| Dividend Yield | 3.47% |
| Sector PE | 15.15 |
| NB: computations are based on closing price as at 18th Feb 2011 | |

Source:NSE/NICS research

Table 4: P & L

| KES M | 2009 | 2010 | Change % |
|------------------|--------|--------|----------|
| Revenue | 552.08 | 620.08 | 12 |
| Operating Profit | 265.15 | 285.36 | 8 |
| PBT | 367.02 | 438.04 | 19 |
| PAT | 256.38 | 307.39 | 20 |

Source:Company Annual Reports

Share Price performance

- The Carbacid share price outperformed both NSE20 and NASI market indices in 2010 by 11.5%
- Due to its high cash reserves Carbacid has consistently been placed in the top quartile of high dividend payers listed at the NSE.
- The stock is relatively illiquid due to investors reluctance to part with the high dividend yielding stock.

Key Investment Themes

Market Share of close to 95%

- **Monopoly:** Carbacid is the leading player in the beverage quality carbon dioxide market in the East African region supplying both the Alcoholic beverage and non-Alcoholic carbonated soft drink market. Carbacid currently has a market share of more than 95% in the regional carbon dioxide market.

Value of Carbon dioxide mine not carried in Financial Statement

- **Accounting Treatment:** the main revenue generating asset (the carbon dioxide mine) is carried as an operating lease and as at July 2010 was valued at KES 21.36 million which we believe does not represent the fair value of the mine as it has not factored the value of the carbon dioxide deposits.

Net Margins close to 50%

- **High Margins:** rental income from cryogenic storage tanks to key customers presents a high margin business line for Carbacid. The tanks have long useful life compared to their depreciable life thus locking in most of their prime clients.

Over 30% of Balance sheet in near cash investments

- **Cash Cow:** Carbacid currently has over 30% of its total assets in investments which are non-core with an estimated excess cash as at July 2010 of KES 506 million.
- **History & track record:** Carbacid has been in existence for 50 years and has extensive market experience.
- **Emerging Markets:** the emergence of regional trading bloc's including the East African Community and COMESA present sources of increased demand.
- **Ungearred Balance Sheet:** Carbacid's balance sheet contains virtually no debt which indicates a very low risk entity.

Most players use a hybrid supply schemes

Industry Overview

The industry comprises of gas manufacturers, who then sell the gases in compressed, liquid or solid form. The overall industry may be divided into:

Table 6: Supply

| Supply method | |
|--------------------------------|--|
| Tonnage supply scheme market | Composed of large volume suppliers who supply via direct gas pipelines from an on-site production facility |
| Merchant or Bulk liquid market | Suppliers make use of cryogenic tanks situated on customer sites where the tanks are filled with gas on a need basis |
| Cylinder Gas Deliveries | Small scale supply through the use of gas cylinder deliveries |

Source:Internet

- Industrial carbon dioxide is produced mainly from the processes listed below:
 - Directly from natural carbon dioxide springs, where it is produced by the action of acidified water on limestone or dolomite.
 - As a by-product of hydrogen production plants, where methane is converted to CO₂;
 - From combustion of fossil fuels and wood;
 - As a by-product of fermentation of sugar in the brewing of beer, whisky and other alcoholic beverages;
 - From thermal decomposition of limestone, in the manufacture of lime.

Carbon dioxide (CO₂) consumer market

- The Carbon Dioxide market largely consists of carbonated soft drink producers. Regional bottlers particularly in Uganda and Rwanda are largely dependent on Carbacid for their Carbon dioxide needs.
- Carbon dioxide is usually considered a by-product of most industrial processes to be recycled as an input to other processes that makes use of it as a raw material.
- Carbon dioxide quality acts as the main differentiator as not all Carbon dioxide is regarded as safe for use with food products. This has acted as a barrier to entry for ordinary industries into the Carbon dioxide market.
- East African Breweries recycles most of its carbon dioxide and buys the rest from Carbacid whose carbon dioxide is noted as food & beverage quality.

The main barriers to entry are quality and natural source of CO₂

Financials Review

1. Balance Sheet Review

Table 7: Balance Sheet

| KES M | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|---------------|---------------|-----------------|-----------------|-----------------|-----------------|
| Operating Current Assets | 86.91 | 113.62 | 115.83 | 162.12 | 202.15 | 204.17 |
| Non Interest Bearing Current Liabilities | 37.60 | 31.33 | 39.88 | 38.31 | 66.55 | 66.56 |
| Operating Working Capital | 49.31 | 82.28 | 75.96 | 123.81 | 135.60 | 137.61 |
| Net PPE | 524.24 | 499.40 | 473.11 | 563.42 | 582.66 | 780.65 |
| Carbon Dioxide Mine | 23.71 | 23.24 | 22.77 | 22.30 | 21.83 | 21.36 |
| Operating Assets | 597.25 | 604.92 | 571.83 | 709.52 | 740.08 | 939.61 |
| Excess Cash | 361.10 | 390.25 | 481.20 | 461.71 | 569.75 | 505.99 |
| Total | 958.36 | 995.17 | 1,053.03 | 1,171.23 | 1,309.83 | 1,445.61 |
| Financed By | | | | | | |
| Equity | 815.86 | 860.47 | 925.08 | 1,024.48 | 1,167.59 | 1,293.76 |
| Deferred Tax | 142.50 | 134.70 | 127.95 | 146.75 | 142.24 | 151.85 |
| Total Investor Funds | 958.36 | 995.17 | 1,053.03 | 1,171.23 | 1,309.83 | 1,445.61 |

Source: Company filings

Zero debt Balance sheet 100% cash financed

Carbon Dioxide Mine currently is the smallest asset

- Operating Assets have grown from KES 597.25 million to KES 939.61 million largely financed by Cash.
- Carbon Dioxide asset carried as an operating lease annually amortized
- Cash and marketable securities of KES 505.99 million against a total assets of KES 1,445.61 million.

2. Income Statement Review

Table 8: Abridged P&L

| KES M | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------|--------|--------|--------|--------|--------|--------|
| Turnover | 271.69 | 318.98 | 369.66 | 387.12 | 552.85 | 620.08 |
| Gross Profit | 208.66 | 231.23 | 237.13 | 285.16 | 366.24 | 407.09 |
| EBITDA | 164.3 | 189.09 | 234.71 | 249.83 | 318.36 | 359.98 |
| PBT | 158.65 | 179.21 | 226.8 | 241.94 | 367.03 | 438.04 |
| PAT | 113.35 | 126.72 | 155.23 | 166.76 | 256.38 | 307.39 |

Source: Company filings

- Turnover has grown by a CAGR of 18% from 2005 with profitability growing at a CAGR of 22%.
- Net Income Margins of close to 50%.

Annual Cash generation can support firms investment activities

3. Cash Flow Statement Review

Table 9: Abridged Cash Flow

| KES M | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|----------------------------|--------|--------|--------|---------|---------|---------|
| CFO | 114.5 | 119.89 | 184.83 | 143.75 | 306.16 | 283.17 |
| CFI | 24.39 | 38.62 | -20.23 | -68.39 | 21.49 | -411.78 |
| Dividend Paid | -51.01 | -82.12 | -90.61 | -113.27 | -113.27 | -181.23 |
| Net Change | 87.88 | 76.39 | 73.69 | -37.91 | 214.38 | -309.84 |
| Closing Cash & Equivalents | 265.96 | 342.35 | 416.03 | 377.85 | 532.6 | 211.94 |

Source: Company filings

- Annual Cash from Operations (CFO) can adequately support investment activities as shown in 2007 to 2009.
- The huge negative investment cash flows in 2010 is due to investment activities in the capital markets which is non core and was largely financed from reserves.
- Dividend payout made from Cash from Operations.

4. Dividend and Cash Analysis

Table 10: Asset Analysis

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|------|------|------|------|------|------|
| Cash & Marketable securities to Current Assets | 84% | 81% | 84% | 77% | 77% | 76% |
| Cash & Marketable securities to Total Assets | 38% | 40% | 46% | 40% | 43% | 36% |
| Dividend to CFO | 45% | 68% | 49% | 79% | 37% | 64% |

Source: NIC Research

Close to 30% of assets in near cash

- Dividend payout supported by cash from operations.
- Near Cash investments have been more than 30% of assets.

Ratio Analysis

1. Statement of Comprehensive Income Ratio Analysis

Table 11: P&L Ratios

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------------|------|------|------|------|------|------|
| Sales Growth | 27% | 17% | 16% | 5% | 43% | 12% |
| Gross Margin | 77% | 72% | 74% | 74% | 66% | 66% |
| EBITA Margin | 48% | 49% | 54% | 55% | 52% | 51% |
| Net Income Margin | 42% | 40% | 42% | 43% | 46% | 50% |

Source: NICS Research

- Sales have grown at double digit with Gross Margins declining to 66% but stable.
- EBITA Margins have been above 50% from 2007.
- Net Income Margins have improved to 50%.

2. Statement of Financial Position Ratio Analysis

Table 12: B/S Ratios

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------------|-------|-------|-------|-------|-------|-------|
| Asset Turnover | 0.28x | 0.32x | 0.35x | 0.34x | 0.43x | 0.43x |
| Return on Assets | 12% | 13% | 15% | 14% | 20% | 21% |
| Financial Leverage | 1.22 | 1.19 | 1.18 | 1.18 | 1.18 | 1.17 |

Source: NICS Research

- Asset Turnover have improved to 0.43x .
- Return on Assets have improved to 21% from the lows of 12%.
- The use of Equity has increased shown by the decline in financial leverage.

3. Other Ratio Analysis

Table 13: Investment Returns

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|------|------|------|------|------|------|------|
| ROE | 14% | 15% | 17% | 17% | 23% | 25% |
| ROIC | 15% | 18% | 22% | 25% | 29% | 30% |

Source: NICS Research

- Return on Equity and Return on Investors Capital have improved and currently above 20% implying positive economic profits for investors.