

Report Date: September 7, 2007.

Valuation Price: N101.29

Recommendation: BUY

Discount to Valuation Price: 13.25 per cent

EXECUTIVE SUMMARY AND INVESTMENT RATIONALE

- Julius Berger Nigeria Plc is a construction giant with close to four decades of operations in Nigeria and was quoted on the Nigerian Stock Exchange (NSE) in 1979. It is an associate company of **Bilfinger Berger AG, Germany**, which holds 49.87 per cent of its equity capital. Its foreign transactions are monitored by **Bilfinger Berger AG**. This includes its stocks, importation of its machinery and payment of foreign suppliers. The company's core activities span planning, design, construction and maintenance of civil engineering and building works. It also acts as the sponsor company in the execution of certain joint-venture contracts.
- Lately, Julius Berger re-designed its business strategy by diversifying its operations into four business units with a view to improving performance and returns to all stakeholders. The company has subsisting contract agreements to build more Mega Fuel Stations in the country and is also strategically favoured to win additional Floating Filling Stations in the Niger Delta. Julius Berger also can also leverage on its competitive advantage in rail track construction to bid for the federal government contract for the linking of Lagos and Kano by rail. Riding on its unrivalled and long-standing goodwill in the industry with proven integrity and expertise, we believe the company is well positioned to sustain its business drives in winning more 'big-ticket' projects in the key industries of the economy both from governments, private sectors and multinationals.
- Risks attached to our analysis are the exposure of the company to key economic drivers and policy focus of the government at all levels. Hence, it is worthy of note that Julius Berger's business processes and fortunes are highly vulnerable to economic vagaries.
- Julius Berger financial results for the **FYE December 2006** showed the impact of its recent business restructuring on their performance. The company grew its turnover by 42.7 per cent

from N39.84bn in 2005 to N56.87bn in the financial year ended December 31, 2006. Its EPS rose from N2.09 to N3.73. The company's recently released results for the third quarter 2007 revealed a turnover growth of 27.6 per cent from N38.90bn to N49.65bn, while after-tax profit increased from N708.5m to N995.0m, implying a growth rate of 40.4 per cent.

- We project turnover and after-tax profit of N73.93bn and N1.74bn respectively for the year ending December 31, 2007, premised on growth rates of 30.0 per cent and 55.2 per cent in that order. This implies a forecast EPS of N5.29 for the year ending December 2007.
- **Based on our analysis, we recommend the stock for BUY especially for value investors with medium to long term investment horizons.**

Global Construction Industry & The Nigerian Experience:

The construction sector contributes some 7 per cent of the GDP in most OECD countries and up to 12 to 14 per cent in Japan and Korea (Gann, 2000), while in developing countries (according to Dharwadker, 1979) investments in construction projects could be as high as 50-60 per cent of national budgets. The sector is a very important component of a nation's economy. The sector is investment-led and therefore susceptible to economic cycles as it suffers badly during the recessions and experiences an upturn, particularly in response to government infrastructure investment programmes such as capacity building in health, education, mortgage, transport, oil and gas and other private sector activities. Government accounts for over 50 per cent of the demand for the construction industry's output.

In the 1980s, the Nigeria construction industry was a dominant contributor to the nation's GDP, accounting for about 70 per cent of the GDP. This made the industry very strategic to Nigeria's development efforts. Unfortunately, however, the industry has been bedevilled by a combination of low demand and consistent low productivity and poor performance over the years. This has reduced its contribution to the national economy to a mere 1per cent of the GDP in 2002 (AfDB/OECD, 2004). The industry is made up of both organised formal and unorganised informal sectors. **The formal sector comprises foreign and indigenous companies, which are classified into small, medium and large scale according to their level of capitalisation and annual turnover.** The few large firms (mostly foreign), which constitute just about 5per cent of the total number of contractors in the formal sector, control about 95per cent of the construction market, giving the small firms just about 5per cent share of the market.

A major challenge facing the participants in this industry, especially the organised formal sector is the growing quantum of receivables from their major clients, the government and a number of multinational private firms.

PERFORMANCE ANALYSIS:

Turnover Growth:

Julius Berger recorded a 5-year compounded annual growth rate (CAGR) of 21.06 per cent in its turnover which increased from N26.48bn to N56.87bn between 2002 and 2006. Turnover grew by 42.7 per cent from 2005 to 2006, as it rose from N39.84bn to N56.87bn. On a relative basis, **Julius Berger's** turnover growth performance is superior to that of its close peer, **Cappa & D' Alberto**, over similar period. **Cappa & D' Alberto's** turnover grew by 19.3 per cent, from N4.41bn in 2005 to N5.26bn. Its 5-year CAGR was 18.2 per cent as the turnover grew from N2.69bn to N5.26bn between 2002 and 2006.

Trends in Profitability:

Julius Berger operates a cyclical business with wide variations in volume of business and earnings, based on the dictates of the economy. While these wide variations are supposed to be fully mirrored in the gross margin and other performance indicators, the peculiarities of accounting for construction contracts smoothen the effects, thus retaining the gross margin figures within the range of 10.4 per cent and 15.8 per cent in the last 5 years. The gross margin initially declined gradually from 12.8 per cent in 2002 to 10.4 per cent in 2004, but due to improvement in the management of site and other direct contract costs it climbed successively from 10.4 per cent in 2004 to 15.8 per cent in 2006. Similar trend is also observed in its operating margin which initially declined steadily from 3.7 per cent in 2002 to 1.3 per cent in 2004 before it inched up from 1.3 per cent in 2004 to 6.0 per cent in 2006. This performance is however below that recorded by **Cappa & D' Alberto over same period**. **Cappa & D'Alberto** gross margin improved from 13.7 per cent in 2004 to 17.0 per cent in 2006 while its operating margin rose from 4.3 per cent in 2005 to 6.7 per cent in 2006.

Julius Berger grew its after-tax profit from N379.4m in 2002 to N1.12bn in 2006, thus translating to a 5-year compounded annual growth rate of 31.1 per cent. However, following the recent restructuring efforts in core operations and business units, the company achieved an unprecedented growth in profits in 2006 financial year when it posted an after-tax profit of N1.12bn representing 78.5 per cent

growth when compared with N626.9m posted in 2005. Likewise on relative basis, this performance is commendable in the light of the profit growth achieved by **Cappa & D' Alberto** which experienced a decline of 35.2 per cent in its after-tax profit from N197.4m in 2005 to N127.9m in 2006. However, except for 2006, **Cappa & D' Alberto** has a better profit growth record than **Julius Berger** over the past five years. While the former recorded a 5-year CAGR in after-tax profit of 49.7 per cent, Julius Berger achieved 31.1 per cent growth.

Julius Berger's return on equity (ROE), which averaged 19.8 per cent over the last five financial years, initially declined from 19.8 per cent in 2002 to 15.0 per cent in 2004 and then rose significantly to 27.2 per cent in 2006. Similar trend is replicated in the company's return on asset (ROA) which initially declined from 3.5 per cent in 2002 to 2.4 per cent in 2003, then increased successively to 4.0 per cent in 2006. While **Julius Berger's** ROE for 2006 financial year (27.2 per cent) is more than twice that of **Cappa & D' Alberto** (which is 12.1 per cent), its ROA of 4.0 per cent for the same financial year is a far cry from 12.8 per cent achieved by **Cappa & D' Alberto**.

Liquidity, Efficiency and Solvency:

Julius Berger's current ratio, with a 5-year average of 0.82 times, has been trending downwards over the past five years. The ratio which was 0.90 times in 2002 declined consecutively to 0.52 times in 2006, meaning that as the end of 2006 financial year, the company's total current assets cover only 52 per cent of its total current liabilities. Similarly, trend in the company's acid-test ratio over similar period portends deteriorating liquidity position. The acid-test ratio which stood at 0.83 times in 2002 declined continually to 0.41 times in 2006, meaning that Julius Berger's readily realizable short-term assets now cover only 41 per cent of its total short-term liabilities. The company's current and acid-test ratios are far below the current and acid-test ratios of Cappa & D' Alberto, which stand at 1.3 times and 1.2 times respectively as at the end of 2006 financial year end.

A review of Julius Berger's cash flows however revealed an improved liquidity between 2005 and 2006. The company's operating cash flow-to-net income ratio, a measure of the extent to which net income generates cash for a business, initially declined from 1.63 times in 2004 to 0.08 times in 2005 and then rose to 0.44 times in 2006. Similarly, the company's operating cash flow-to-current liabilities ratio increased from 0.09 times in 2004 to 0.15 times in 2006, while its cash operating cycle, which indicates the average number of days it takes a company to turn its acquired inputs into actual cash inflows

through sale of its output, declined from 367 days in 2004 to 161 days in 2006, thus implying that Julius Berger is tying up less capital in its processes. The improving trend in Julius Berger's cash flows is corroborated by trends in its average receivables' days and average payables' days.

Julius Berger's average receivables' days declined from 344 days in 2004 to 137 days in 2006, meaning that it is reducing the level of finance it provides to its clients. Also, with the trend in its average payable days which rose consecutively from 15 days in 2002 to 45.8 days in 2006, Julius Berger has secured more confidence from its suppliers and thus enjoyed more finance from them. **However, one impediment to Julius Berger's Liquidity is the growing level of its investments in inventory, as revealed by the trend in average inventory holding period, which rose consecutively from 16 days in 2002 to 69 days in 2006.**

Conversely, there are indications of deterioration in the company's efficiency in the use of assets. The company's total asset turnover declined in succession from 0.77 times in 2004 to 0.64 times in 2006, meaning that the extent of revenue generated from the use of its assets diminished over the two-year period.

In terms of long-term solvency, Julius Berger remains a very stable company. The company has no fixed-interest, long-term debt in its capital structure. The company's total debt-to-total asset ratio has been quite stable at 95 per cent over the past five years. On the other hand, total debt-to-equity ratio exhibited a rising trend as it rose in succession from 1388 per cent in 2002 to 2055 per cent in 2006. Nevertheless, the company's debts, save its short-term loans and bank overdraft, are mainly made up of interest-free liabilities, thus it has low interest payments obligations. The company's **Earnings Before Interest and Tax (EBIT)** covers its interest obligations. Though with a declining trend, the company's interest cover averaged of 3.73 times between 2002 and 2006.

Value to Investors:

Julius Berger's Earnings Per share (EPS) rose from N1.67 to N3.73 between 2002 and 2006, thus translating to a 5-year CAGR of 22 per cent. Over similar period, **Cappa & D' Alberto** recorded a CAGR of 25.7 per cent in EPS having jumped from N0.26 in 2002 to N0.65 in 2006. **Julius Berger's** earnings yield exhibited a declining trend between 2004 and 2006. The company's earnings yield dropped successively from 9.97 per cent in 2004 to 7.96 per cent in 2006. **Cappa & D' Alberto** also

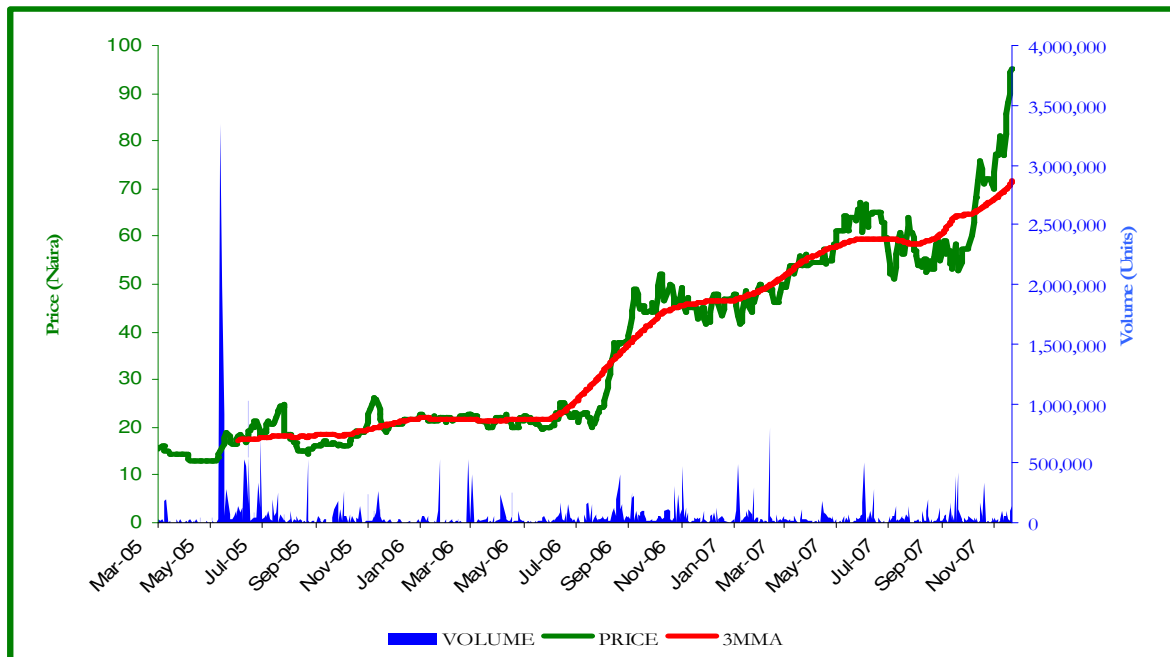
experienced similar trend in its earnings yield, which dropped significantly from 17.7 per cent in 2004 to 7.2 per cent in 2006. Conversely, Julius Berger's dividend yield climbed in succession from 0.75 per cent in 2002 to 3.41 per cent in 2005 and then declined to 1.92 per cent in 2006.

Julius Berger's 5-year average dividend payout stands at 19 per cent, with the highest of 33.5 per cent and the lowest of 0.75 per cent recorded in 2005 and 2003 financial years respectively. The company only paid a bonus once (1 for 3, 2004 FY) in the last 5 financial years. On the other hand, **Cappa & D' Alberto's** dividend yield has been relatively stable at 3.3 per cent over the past 5 years and its 5-year average pay-out ratio stands at 22.4 per cent. **Cappa & D' Alberto**, like **JBerger**, also paid bonus once (1 for 1, 2004 FY) in the last 5 financial years.

Technical Analysis for Julius Berger:

Julius Berger recorded an average trading price of N17.22 in 2005 recording a High/Low of N26.08 / N13.00 on the 16th of November, 2005 and 15th of April, 2005. With an opening price of N16.40, the stock recorded an appreciation of 32.6 per cent at the end of the year 2005. In 2006, the stock maintained an average trading price of N30.35 with its High/Low of N 52.15/ N 19.50 recorded on the 17th of October 2006 and 30th of May 2006 respectively. The capital appreciation recorded for the year 2006 was 115.4 per cent

3-YEAR PRICE-VOLUME CHART



The stock witnessed a sharp bullish run after the end of the second quarter of 2006, moving from a support level of N20.52 to a resistance level of N52.15. From the beginning of 2007 till date, the bullish trend of Julius Berger has continued, with the share price hitting an all-time High of N95.01 on the November 30, 2007. Its all-time low this year is N41.50. Capital appreciation from the beginning of the year to date is 87.9 per cent.

Average deal volume for Julius Berger stands at 152,828 units, 49,737 units and 46,051.94 units for 2005, 2006 and 2007 which signifies a higher liquidity risk for the stock. With a security beta 0.21, it is however, less volatile than the market.

Valuation:

In our valuation of Julius Berger, a number of valuation metrics, such as Price-to-Book value method, Price-to-sales method, Price-to-Earnings method, and Discounted Free Cash Flow valuation method (**Discount Rate:**11.95 per cent and **Risk Premium:**10 per cent), were used. After applying appropriate weights with a bias for Free Cash Flow valuation method, we arrived at a fair value of N101.29, implying that the stock is trading at a discount of 13.12 per cent to valuation.

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