

Report Date: July 25, 2008

An Excerpt



Equity Research Report

Nigerian Aviation Handling Company (NAHCo) Plc.

Investment Rationale:

- NAHCo's post- privatization growth momentum in top line has been rather unimpressive averaging about 6 percent annually.
- Our assumed compounded annual growth rates (CAGR) projections consistent with the past and most recent performance coupled with sector prospects, suggest that growth outlook does not support current pricing of the stock.
- Competitive pressures look likely to erode NAHCo's monopoly status in the aviation ground handling business as current reforms are luring ground handling companies into the country
- Due to the high degree of sensitivity of the aviation industry to policy changes, NAHCo's model could be negatively impacted by unexpected negative government regulations.
- Without leveraging its capital base structure, the dilutive effect of the company's capital raising exercise and bonus issues in 2005 and 2006 respectively is expected to persist for the next 3 years; having failed to grow its earnings by a factor proportionate to its new equity base.

Business Summary

The Nigerian Aviation Handling Company was incorporated in 1979 under the Nigeria Enterprise Promotion Decree. The federal government through the Federal Airport Authority of Nigeria (FAAN) originally owned about 60 percent controlling shares in the company while foreign airline

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operators owned the remaining 40 percent. The company was privatized in 2005 and listed on the Nigerian Stock Exchange in 2006.

NAHCO controls over 75 percent of the aviation ground handling market in Nigeria, offering ground support services covering aircrafts handling, passenger/baggage handling, cargo handling and mail handling to a majority of about 40 airlines operating in the country. The company is a member of the International Alliance of Aviation Handlers.

Table of Key Investment Statistics

Key Metrics/Multiples	NAHCo	Peer Average
Trailing EPS (N)	0.66	0.59
Trailing PE(x)	29.06	30.64
Forward PE (x)	41.62	31.99
Earnings Yield (%)	3.44	3.27
Shares Outstanding (m)	984.38	809.19
Shareholders Fund (N'bn)	1.22	1.46
Market Cap	N19.01bn (US\$162.49m)	N14.07bn (US\$126.00m)
BVPS (N)	2.27	2.10
Turnover per share	5.48	4.60
ROE (%)	35.00%	31.45%
ROA (%)	12.05%	14.01%
PB Ratio (x)	8.53	8.52
Price to sales (x)	3.96	4.31
Cost to turnover (x)	0.41	0.51
Volatility Index (Beta)	1.10	0.71

Analysis of Financials

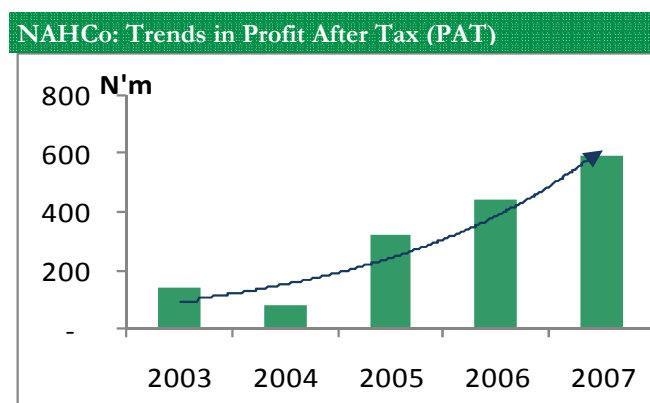
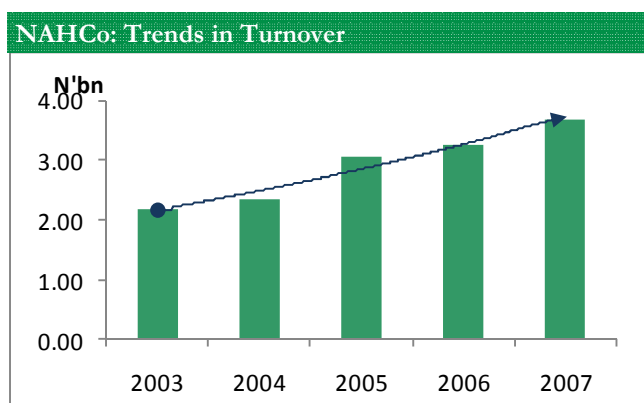
Trends in Turnover and Earnings Growths

NAHCo has maintained a positive turnover growth trend in the last five years. The company grew

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its top line from N2.17bn in 2003 to N3.7bn in 2007, translating into a CAGR of 13.9 percent. Turnover growth path peaked in 2005 at 30.2 percent. This is regarded as an outlier which is directly connected to the successful divestment of government ownership. Subsequently, growth speed slowed down and the company was only able to achieve a 12.8 percent turnover growth in 2007 as against 17.0 percent forecast for the period.



NAHCo transited from a profit after tax (PAT) of N139m in 2003 to N590m in 2007. This represents a 5-Year CAGR of 43.5 percent in PAT. This growth pattern is tracked by the upward trajectory of earnings per share (EPS) until 2006 when the company's EPS bowed to the dilutive effect of new equity issues of 125 million shares resulting from the dual effect of bonus and public offer. EPS nosedived from 106k 1n 2005 to 79k in 2007.

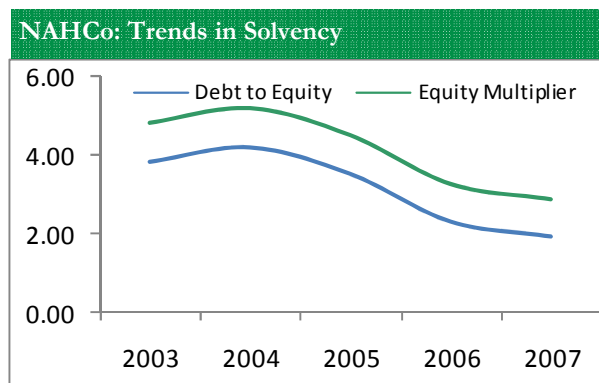
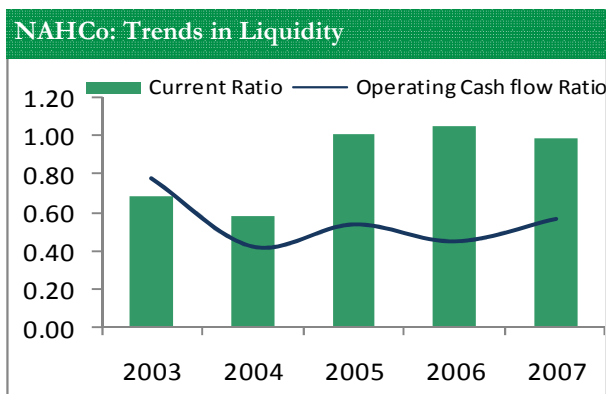
Liquidity and Solvency

In terms of liquidity, NAHCo has maintained a significant improvement as shown in the upbeat recorded in its *current ratio* which moved from 0.69x in 2003 to 0.99x in 2007. This implies that the company's readily available assets cover 99 percent of current liabilities. However, there has been observable deterioration in the quality of net cash generated from operations. This is decipherable from the *downward trend of operating cash flow ratio (OCF)* which nosedived from 0.78 x in 2003 to 0.57 x in 2007. This suggests a weakening strength in the company's cash

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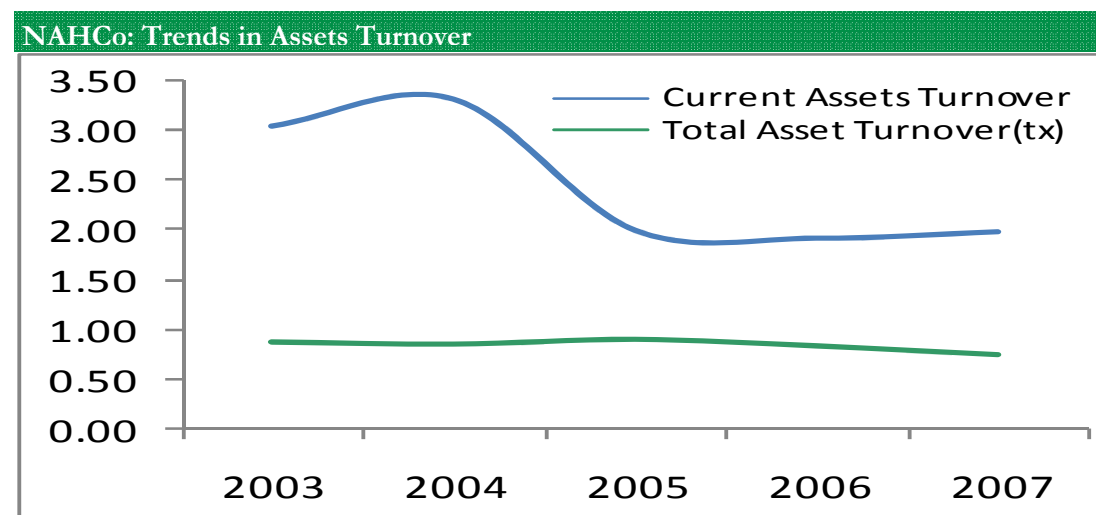
generating operations in covering its current liabilities. However, 2007 FYE suggests a rebound in coming year with operating cash ratio trending up from 0.45x to 0.57x.



Measures of *solvency* and *debt management* revealed appreciable improvement. *Equity multiplier* fell precipitously from 4.8x in 2003 to 2.9x in 2007. This indicates a significant reduction in financial leverage of about 50% as the company adjusted its capital structure by replacing part of its debt capital with equity.

Asset Management and Efficiency

NAHCo has maintained a stable level of efficiency in its asset utilization. This is reflected in the straight path of *total assets turnover ratio* which averaged 0.83 x in the past 5 years. This means that the company has been generating sales of 83 kobo for every naira of its asset base. Assets use efficiency is more commendable among the fixed assets class as the *current asset turnover* plunged from 3.04 x in 2003 to 1.98 x in 2007. This may suggest that the company is less efficient in the deployment of its liquid assets.



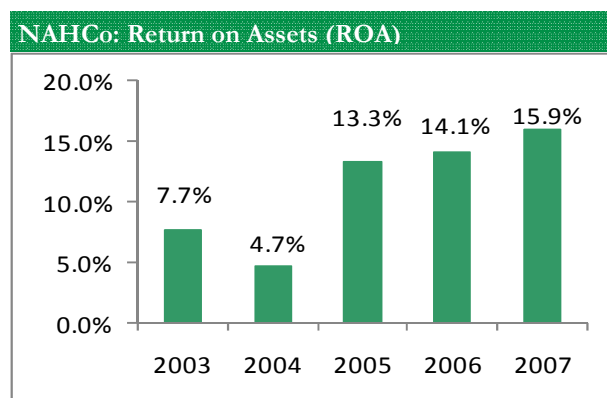
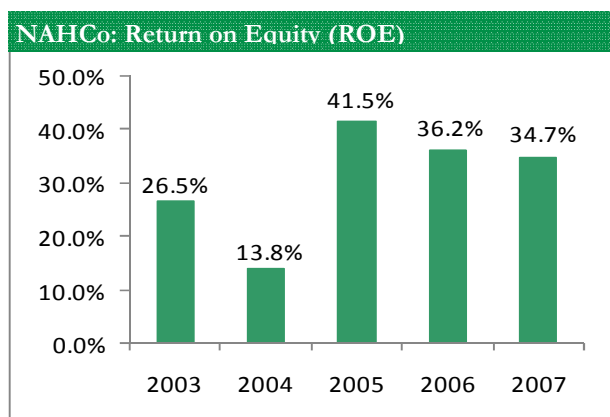
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Though operational costs thread a narrow growth path of 15 percent CAGR, the company has demonstrated an impressive cost efficiency as *Operating Expenses to Sales (Opex-to-Sales)* ratio plummeted from 37 percent in 2003 to 24 percent in 2007. This is largely connected with government divestment as administrative expenses make up a disproportionately large part of operating expenses.

DuPont Analysis of Profitability

NAHCo's record of 5 year average *return on equity (ROE)* of 31 percent shows a declining trend from 2003 to 2007. Despite *rising margins*, ROE dipped slightly from 36.19 percent in 2006 to 34.71 percent in 2007. Near constancy of asset turnover ratios and falling asset leverage have occurred side-by-side with a declining trend in ROE despite increased margins in the last 3 financial years. We believe that NAHCo's profitability can be improved if the company pays closer attention to its degree of asset leverage.



A closer examination reveals that suboptimal combination of reserves and total assets employed is a contributory factor to worsening asset leverage. With respect to *return on total assets*, NAHCo has shown appreciable rise averaging 14 percent over a period of 5 years. This is accounted for by rising *pre-tax margin*.

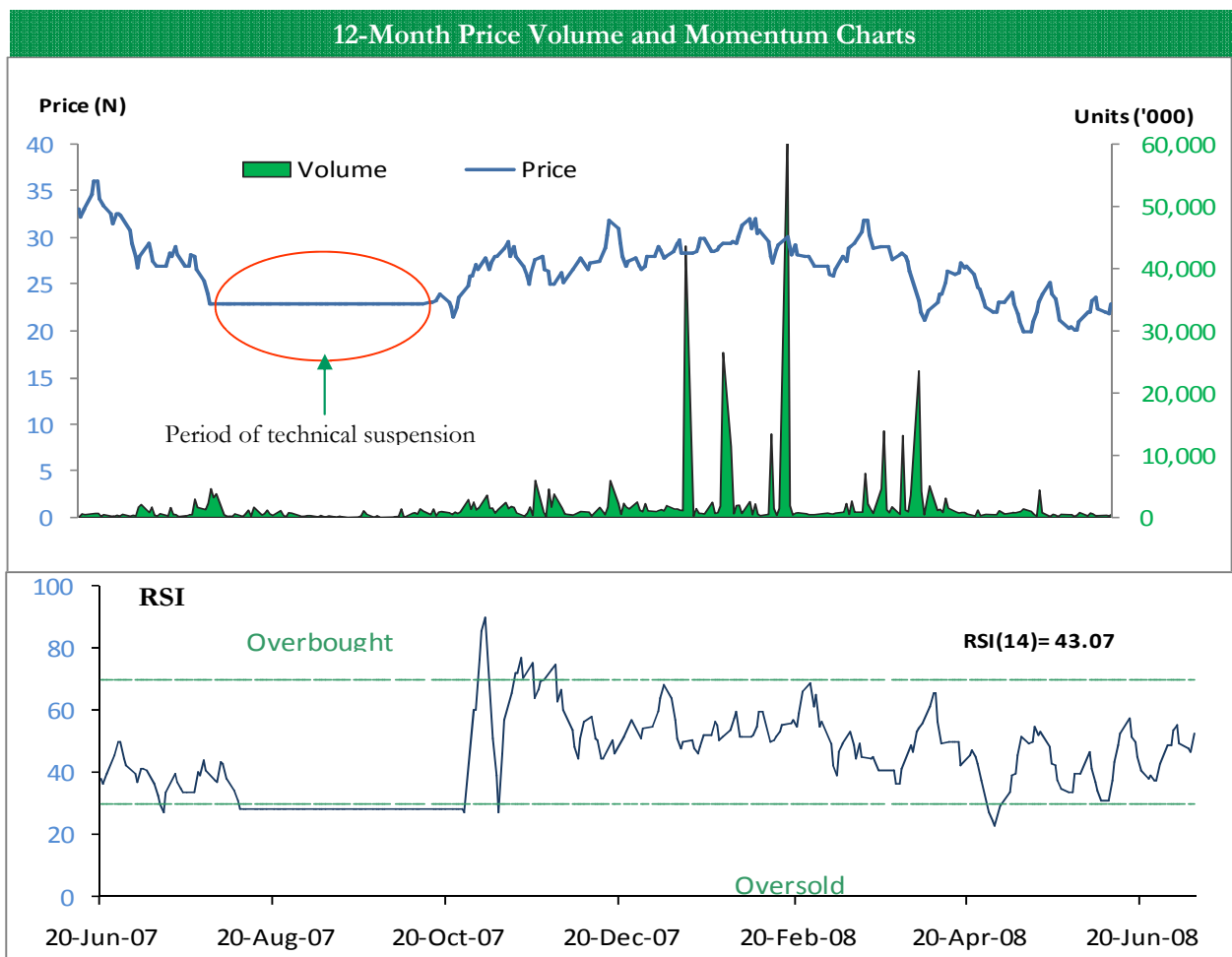
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Stock Price Trajectories and Returns

The historical price path of NAHCO has shown a track record of swings with an above-market volatility of 1.10. With an all time high of N70.05k on 11th May, 2007, the stock has been through the downward pressure of bearish momentum culminating in a 52- and 6 months returns of -29.08 percent and -23.08 percent as against corresponding market returns of 6.52 percent and -6.84 percent respectively.

Our momentum analysis using Relative Strength Index (RSI (14)) shows that NAHCo's price momentum exhibits extreme readings around the overbought region between October 2007 and February 2008. This is largely attributable to the impressive upbeat witnessed in the market during that period. Subsequently, however, the high volatility of NAHCo came to bear in explaining its downward trajectory resulting in extreme readings around the oversold region.

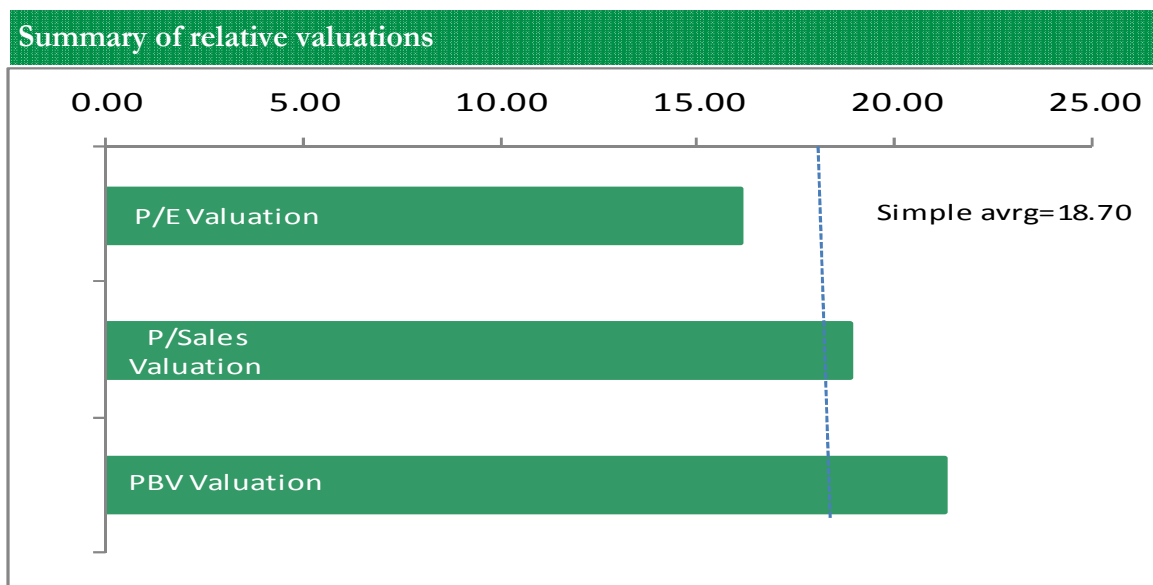


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Valuation: Methodologies and Summary

In the valuation of NAHCo, we employed different valuation methodologies. Based on comparable price multiples (PE ratio, P/Sales and P/BV) and our 12-month earnings, sales and net asset forecasts of 70k, 484k and 215k respectively, the 3 relative valuation methodologies yielded a simple average of N18.70k.



Discounted Cash Flow Valuations

Further, we deployed the Discounted Cash Flow Models with a two-stage **Discounted Dividend**, **Residual Income** and **Free Cash Flow (FCF)** variants. We believe that our DCF assumptions are moderate. Our models employ a terminal growth rate of 7 percent (in line with long run economic growth rate) and CAPM-derived **cost of equity of 14.66 percent**. The input parameters for CAPM include 10.75 percent risk free rate on long term FG Bond, risk premium of 6.00 percent and an industry beta of 0.71 (as the company's beta of 1.1 seems too high and unrepresentative of the behaviour of the stock and the nature of the company's business).

Based on DCF models, current pricing of NAHCo will be justified by a terminal growth rate of 13.00 percent. This justified growth rate in our fair opinion is unsustainable in the long

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run.

Given the sensitivity of the adopted DCF models to terminal growth rate, we subjected these models to varying growth rates. The output of our sensitivity analysis reveals a lower price band of N7.22k at 5 percent terminal growth rate and an upper price band of N24.51k at 10 percent terminal growth rate.

Sensitivity Analysis of DCF Models

Models	Growth rates					
	5%	6%	7%	8%	9%	10%
DDM	7.22	7.89	8.75	9.85	11.36	13.5
FCF MODEL	8.25	9.13	10.24	11.69	13.65	16.46
RI MODEL	14.68	15.73	17.06	18.8	24.51	24.51

Summary and Recommendation

Premised on the above analysis, coupled with appropriate consideration of comparable pricings, our **fair value for NAHCo gives N16.40k**. This implies that the current price is at a 22.0 percent **premium to valuation** and the **downside potential stands at 18.0 percent**.

We therefore place a **SELL** recommendation on NAHCo in the short term horizon as the stock is currently trading above its fair value while we maintain a **HOLD** recommendation for medium to long term investors.

For the comprehensive report detailing company-specific analysis, visit www.meristemng.com