Company Name:
TRANSCENTURY LTD

Bloomberg Ticker:	Country of Domicile:	Sector:	Recommendation:
TCL KN	Kenya	Investments	Buy **(+28.7% ETR)**

Resetting to sustainable course!
(A re-rate from **ACCUMULATE** to **BUY**; YE15 PT at **KES 22.50**)

We re-rate our coverage on TCL with a BUY recommendation based on a fair value estimate of KES 22.50, an ER of 26.4% from the current market price of KES 17.80. Our investment case is informed by affirmative business outlook across all business segments. The company has outlined a strong pipeline of projects despite the issued profit warning for FY14. We forecast a 4-year CAGR of 15.8% in PBT to KES 1.5b in FY17e and a notable growth in PBT margin (FY17e: 8.4%), elicited by a constricted growth in OpEx as well as the declining finance costs to FY17e. The stock is trading at an undemanding rating compared to its regional peers and has underperformed the market by 49.7% (1 yr) as shown by the Stock Relative Strength (SRS) chart. The company trades on a forward P/E, P/B and EV/EBITDA of 13.7x, 0.38x and 5.3x respectively compared to its regional peers that trade at an average PE, P/B and EV/EBITDA of 46.78x, 1.7x and 59.7x respectively (Appendix 1).

Sustainable blended EBITDA margin: We forecast a sustained EBITDA margin of 14.4% in FY15e though below the management forecasts of 18%. We see this improvement emanating from 1) the revenue growth on key business segments (where we estimate 37.1% y-o-y growth in FY15e revenues to KES 12.8billion); 2) from stringent cost management resulting especially from the renewed business focus. Nonetheless, we note the long lived project cycle in its engineering division which could pressurize EBITDA margins given that the payment is due after certain stages of project completion and a bullet payment upon overall project completion.

Curving a niche: Product specialization augments its competitive edge. Through its subsidiary, Kewberg, the company manufacture and sell specialized cables with customer specific adaptation, design capabilities and full technical back-up service to companies in industries such as petrochemicals, mining, industrial, construction and domestic building. In addition, it's engineering division (through Civicon), has well equipped and large transport division which can ferry large tanks i.e in the brewing industry. Again, fitting and maintenance of these tanks requires expertise in which the company has a competitive advantage.

Infrastructural development: We have analysed the markets in which TCL operates and have identified a huge growth potential in the infrastructural development division. This division is a continuation of RVR concession model with an IRR target of at least 25%. Civicon (62% owned by TCL) along with its partners, Ormat Technologies and Symbion Power signed a 25-Year Power Purchase and Steam Supply Agreements with Kenya Power for the 35 MW Menengai geothermal project in Kenya. The regional Oil & Gas and Mining discoveries open numerous opportunities for infrastructure development and engineering services across sub-Saharan Africa. In a consortium with local investors, Civicon also plans to develop approx. 50MW renewable energy Wind firm in Limuru worth USD 130M with ground breaking set for Q1:15. TCL has also been shortlisted for the Kitui coal mining contract in the Mui basin. All these projects bode well for the company where we have estimated a 4-year CAGR of 11.7% in blended revenues to KES 18.4b in FY17e.

The Dark Continent: The historical low electrification levels portray a significant potential in power division, with most of the Sub-Saharan countries reporting access of less than 25% of the population and per capita consumption of less than 200 kWh, compared to European Union's 3,500 kWh or even South Africa's 4,146.5 kWh. TCL through its subsidiary, E.A Cables (which reported 13% decline in FY14 PBT to KES 507.5m) is counting on increased demand for its products in the region where governments and utility firms have outlined huge CapEx on power generation, transmission and distribution. For instance, Kenya and Tanzania have purposed to construct a high-voltage power line connecting the two nations, part of efforts to meet growing demand for electricity and deepen integration of their economies. The two countries will build approximately 510 km of 400 kilovolt (kV) power lines and several substations to allow them trade in power. Both Kenya and Tanzania have outlined plans to double their power generation capacity by the year 2018 while Uganda is keen on capacity upgrade which bodes well for the Group's growth moment outlook.

Government's 40% local sourcing rule: We note that about 40% of the cabling materials are sold to retail through their own distribution shops. The remainder is sold to utilities companies and project developers. The government passed a legislation requiring that 40% of the cabling materials required for any government project worth less than KES 1 billion should be sourced locally which is good for their business. Since the directive was issued, the factory utilization rate has since more than doubled from 25% in 2013 noting low material importation on government projects. In addition, the company has partnered with Jamii Bora Bank to help finance electricity materials LPOs for amounts not exceeding KES 1m extended to women, youth and the disabled.

Expansion: E.A Cables intends to put up a new medium voltage cable manufacturing plant by March 2017 which would require more funding (possibly debt financing). The company intends to open its modernized plant by H1:15. They have 500 tons/month of copper crush, and their closest competitor (Doshi Group) manages 100 tons/month. This capacity portend well for the group to further its presence in the regional market. The demand in Tanzania is much smaller at 50 tons/month.

Product pricing: Given low copper prices at the London Metal Exchange (LME), the company's product pricing has remained relatively stable in order to cushion its earnings from any unforeseen shocks. Copper is the main raw material in making power cables and the rest is PVC which is sourced locally or imported from India.

Current P/E and EBITDA multiples not the holy grail of our valuation: TCL shares are currently trading on an undemanding rating compared to its peers, which underpins our TP of KES 22.50, representing 26.4% upside from the current levels of KES 17.80. We maintain a bullish stand on TCL with the envisioned group focus on power, engineering and infrastructural development. Although the company's earnings have been deteriorating, we are optimistic of improved performance in FY15e, where we forecast an improved EBITDA margin of 14.4% from forecasted 1.8% in FY14e. The company offers a unique opportunity to invest in the power sector, fast growing oil and gas exploration, minerals and infrastructural development across the sub-Saharan Africa (SSA).

Financials and valuation metrics (Dec YE): KES m

KES m	2013A	2014E	2015E	2016E	2017E
Turnover	11,808	9,326	12,784	15,022	18,371
PBT	859	(1,021)	868	1,101	1,546
PBT margin	7.3%	(10.9%)	6.8%	7.3%	8.4%
EPS	1.06	(3.67)	1.30	1.35	2.01
EPS growth (y/y)	(36.0%)	(445.3%)	135.4%	3.6%	49.0%
P/E (x)	16.74	-	13.69	13.21	8.86
P/B (x)	0.37	0.40	0.38	0.37	0.34
EV/EBIT (x)	6.34	-	9.85	7.35	5.91
Dividend yield	2.3%	0.0%	2.3%	2.3%	2.3%
ROaA (%)	1.3%	(4.5%)	1.6%	2.1%	2.9%
ROaE (%)	5.8%	(22.0%)	8.5%	7.2%	7.6%

Source: Company filings, OMS Research estimates

Target price (KES)	22.50
New Rating	**Buy**
Old Rating	Accumulate
Current price (KES)	17.80
ER (12 months)	26.4%
Div yield (%)	2.3%
ETR (12 months)	28.7%
PER at CP(Y1)	13.7x
Implied PER (YI)	17.3x
Sector PER	13.3x
Price/Book	0.4
Issued shares (m)	280
Free Float %	44.07%
6m ADVT (KES m)	6.1607
Market cap (KES bn)	6.3
Net debt (KES bn)	3.4
Enterprise Value (KES bn)	9.7
Year end	Dec

*ER - Expected share return
*ETR – Expected total return

USD. Mn	2013A	2014E	2015E	2016E	2017E
Turnover	129	102	139	163	200
EBITDA	25	2	20	25	29
EBIT	17	(6)	11	14	18
PBT	9	(11)	9	12	17
EPS	0.01	(0.04)	0.01	0.01	0.02

Source: Company filings, OMS Research

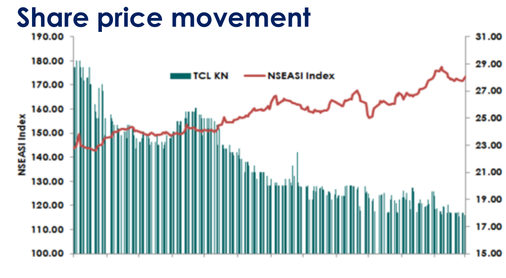
Fair Value Matrix - FY2015e

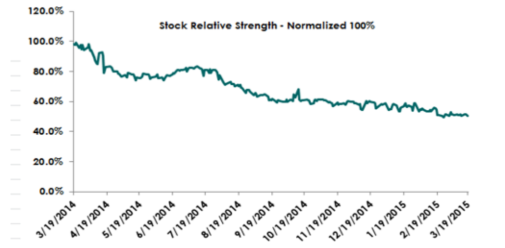
	EPS	PE (x)		
	(KES)	16.8	17.3	17.8
Bear case	1.1	18.49	19.04	19.59
Base case	1.3	21.85	22.50	23.15
Bull case	1.5	25.21	25.96	26.71

Source: Company filings, OMS Research

Company Summary:
TCL is a holding company operating through three main divisions across the power, engineering and infrastructure space for the region. It has operating companies such as EA Cables, Tanelec, Kewberg, Civicon and Avery, which are in its Power Infrastructure, and Engineering divisions. It's Infrastructural division sources and invests in projects.

Share price movement





Source: NSE, OMS Research

20th March, 2015

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A re-rate from **ACCUMULATE** to **BUY**; YE15 PT at **KES 22.50**

Target (2015)	Scenario
Bull Case *(KES 26.71)*	*Our bull case scenario will be informed by impressive GDP growth (above 6%), stable currency and low inflation levels (below 6%). Donor funding on infrastructural developments and huge budget allocations towards development expenditure will contribute positively to our PT.*
Base Case *(KES 22.50)*	*Our base case scenario is informed by low electrification rate (below 25% in SSA). Numerous opportunities along regional oil& gas as well as mineral finds continue to drive the company's topline growth.*
Bear Case *(KES 18.49)*	*We however remain cautious on the convertible debt, may the conversion option be exercised before Mar-2016. In addition, subsidiaries underperformances remain a derail on our PT.*

Our key concerns

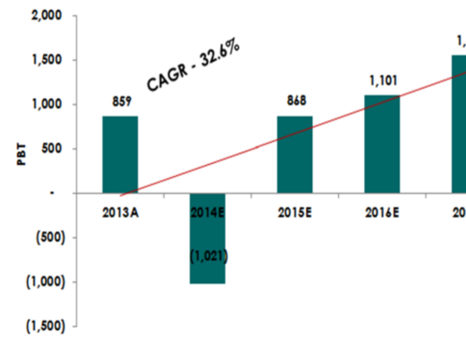
As at FY13a, the fair value of the 34% stake was KES 4.79b inclusive of KES 308.8m fair value gain

RVR exit nets approx. KES 1b loss: The exit of the 34% RVR stake in Q1:14 netted approx. KES 1b fair value book loss, which will be mirrored in FY14 financials as highlighted in the issued profit warning. From the initial CapEx of KES 668m (acquiring 20% stake in RVR) deployed in Dec-06, TCL invested an additional KES 581m in 2010, KES 740m in 2012 and KES 924m in 2013, bringing the total stake in RVR to 34%. As at FY13a, the fair value of the 34% stake was KES 4.79b inclusive of KES 308.8m fair value gain, hence the KES 3.8bn (USD 43.7m) realized from the sale of its stake in RVR was below the fair value of the investment prompting a KES 1bn loss. From the concession model the management learnt that 1) they would want to have a controlling stake and not minority shareholders 2) they would not want a concession model with high fixed overheads.

Competition and dumping: The Company continues to face heightened competition from the influx of cheap imports from China and India. There has been massive dumping of electrical materials for the last two years from Egypt due to political unrest. These products are dumbed at cost which makes them retail cheaply in the market. However the company continues to establish strong business relations with key stakeholders especially developers in order to mitigate this dumping risk.

Counterfeit products: Counterfeiting has also been a major risk for the company. The company engaged in a series of brand awareness campaigns like the "Wire si Wire" brand awareness campaign; aimed at creating awareness to customers about their products as well as product coding in order to fight counterfeit products out of the market. The company has also reduced pricing spreads on all distributors to ensure little variation in pricing.

Pre-Tax Profit



Source: Company filings, OMS Research

Business environment: We note the deterioration of earnings for the last two years which resulted mainly due to challenging business environment and changes in business strategy. In FY13a, EPS declined by 36.0%y/y to KES 1.06/share due to project delays. We expect the aftermath effects along with the KES 1b RVR stake exit loss to exacerbate the company's FY14e financial performance, where we forecast 112.6% decline in EPS. Nonetheless, the shifting focus to more specialized projects augur well for the group, where we forecast improved EBIT margin of 12.2% in FY15e and a 4-year CAGR of 32.6% to FY17e in PBT.

Low fuel prices to slow down the E&P activities: We note the heightened worries of possible future slowdown in Exploration & Production activities driven by the current drop in the global oil and other mineral resource prices. In recent years, the U.S. has tripled its shale gas extraction rate from about 5% to 15% while Saudi Arabia has opted to maintain its production capacity amid falling crude oil prices a move which may witness a prolonged slump in international oil prices.

Bond conversion: Though we are hopeful of reduced finance costs as from FY16e, we remain cautiously optimistic given the possibility of additional 97.04m shares (25.7% dilution) being created from the conversion, though this is factored in our model. Nonetheless, we believe that the company may still consider a debt option to fund its infrastructural projects. As part of equity, the proceeds from the sale of RVR stake has been committed in the 35MW Menengai geothermal project.

Valuation methodology

Our KES 22.50 price target is derived using a DCF model over the 2014-2017E period. Our model is based on long-term growth of 5.5% and a discount rate (cost of equity) assumption of 17.68%. Our DCF model makes use of a WACC of 14.85%. Our WACC is driven by a beta of 0.786 and a risk free rate of 12.6%. Other components driving our WACC include an equity risk premium of 6.5% and an after tax cost of debt of 7.1%.

KES m (12m to Dec)	FY13A	FY14E	FY15E	FY16E	FY17E	Terminal value
EBIT	1,535	(589)	988	1,324	1,646	
Add: Depreciation & Amortization	723	758	848	941	1,048	
EBITDA	2,258	168	1,836	2,265	2,694	
Less: Net Interest	(676)	(432)	(120)	(223)	(100)	
Less notional tax	(232)	306	(260)	(330)	(464)	
Less Capex	(634)	(1,122)	(1,122)	(1,142)	(1,304)	
Less Net Working Cap change	1,534	(2,952)	581	594	478	
Free cashflow	2,250	(4,030)	915	1,163	1,304	
FCFF	2,926	(3,599)	1,035	1,387	1,404	15,842
Discount Period		0.01	1.01	2.01	3.01	3.01
Discount factor @ WACC		1.00	0.87	0.76	0.66	0.66
Present value of free cash flow		(3,596)	901	1,051	926	10,450

Value of operations	9,731
Add/(less) net debt	3,425
Market Capitalization	6,305
No of shares	280
Per share value	**22.50**
Current price	17.80
Upside/downside	26.4%

Sensitivity analysis

Fair value | Cost of equity and long term growth rate						
		Cost of equity				
		15.7%	16.7%	17.7%	18.7%	19.7%
	3.5%	21.87	18.37	15.34	12.71	10.39
	4.5%	26.40	22.17	18.57	15.48	12.80
Long term growth	5.5%	32.09	26.86	**22.50**	18.81	15.64
	6.5%	39.45	32.78	27.36	22.86	19.06
	7.5%	49.36	40.51	33.54	27.90	23.25

Financial summary

Transcentury Financials (Dec YE): KES m

Income Statement	2013A	2014E	2015E	2016E	2017E
Turnover	11,808	9,326	12,784	15,022	18,371
% change	(12.5%)	(21.0%)	37.1%	17.5%	22.3%
EBITDA	2,258	168	1,836	2,265	2,694
EBITDA margin (%)	19.1%	1.8%	14.4%	15.1%	14.7%
Depreciation & Amortization	(723)	(758)	(848)	(941)	(1,048)
EBIT	1,535	(589)	988	1,324	1,646
EBIT margin (%)	13.0%	(6.3%)	7.7%	8.8%	9.0%
Profit Before Tax	859	(1,021)	868	1,101	1,546
PBT Margin	7.3%	(10.9%)	6.8%	7.3%	8.4%
Taxation	(232)	306	(260)	(330)	(464)
Net Profit (Before XO items)	626	(715)	607	770	1,082
Minority Interest	(335)	(314)	(243)	(262)	(325)
Net Profit	291	(1,029)	364	508	758
Net profit Margin (%)	2.5%	(11.0%)	2.9%	3.4%	4.1%

Balance sheet	2013A	2014E	2015E	2016E	2017E
Non-current assets	15,056	10,628	10,902	11,103	11,359
Current assets	8,784	11,452	12,945	13,622	15,830
Total assets	23,840	22,080	23,847	24,725	27,189
Shareholders' equity	13,218	12,299	12,741	13,344	14,316
Non-current liabilities	4,715	4,715	4,715	4,715	4,715
Current liabilities	5,907	5,066	6,390	6,667	8,158
Total equity & liabilities	23,840	22,080	23,847	24,725	27,190

Per share data	2013A	2014E	2015E	2016E	2017E
Ave. shares ranking (m)	274	280	280	377	377
EPS	1.06	(3.67)	1.30	1.35	2.01
CFPS	(0.26)	9.95	2.53	2.51	4.09
Free cash flow per share	(4.88)	23.05	(1.47)	(0.51)	0.63
Net dividend (KES)	0.40	-	0.40	0.40	0.40
Payout ratio (%)	37.62%	-	30.76%	29.68%	19.92%
NAVPS (KES)	48.25	44.89	46.51	48.71	52.26

Valuation	2013A	2014E	2015E	2016E	2017E
Price to earnings	16.74	(4.85)	13.69	13.21	8.86
Price to book value	0.37	0.40	0.38	0.37	0.34
price to free cash flow	(3.65)	0.77	(12.11)	(34.80)	28.10
EV / Turnover	0.82	1.04	0.76	0.65	0.53
EV / EBITDA	4.31	57.84	5.30	4.30	3.61
EV / EBIT	6.34	(16.51)	9.85	7.35	5.91
EV / CE	(139.25)	3.49	13.71	10.26	6.31
Free cash flow yield	(27%)	129%	(8%)	(3%)	4%
Dividend yield	2.25%	0.00%	2.25%	2.25%	2.25%
ROaA (%)	1.28%	(4.48%)	1.59%	2.09%	2.92%
ROaE (%)	5.77%	(21.97%)	8.48%	7.23%	7.61%

Cash flow statement	2013A	2014E	2015E	2016E	2017E
Operating profit before working capital	2,083	168	1,836	2,265	2,694
Changes in working capital	(1,534)	2,952	(581)	(594)	(478)
Operating cash flow	549	3,120	1,254	1,671	2,216
Net interest paid	-	(432)	(120)	(223)	(100)
Income tax paid	(419)	306	(260)	(330)	(464)
Net operating cash flow	(70)	2,788	710	949	1,543
Net cash invested	(1,266)	3,672	(1,122)	(1,142)	(1,304)
Free cash flow	(1,336)	6,460	(412)	(193)	239
Borrowings	1,043	-	-	(4,813)	-
Additional capital	-	-	-	4,813	-
Net cash from financing	1,266	-	-	-	-
Movement in cash and cash equivalents	(69)	6,460	(412)	(193)	239
Beginning Cash	(60)	(130)	6,330	5,918	5,725
Change in Cash	(130)	6,330	5,918	5,725	5,964

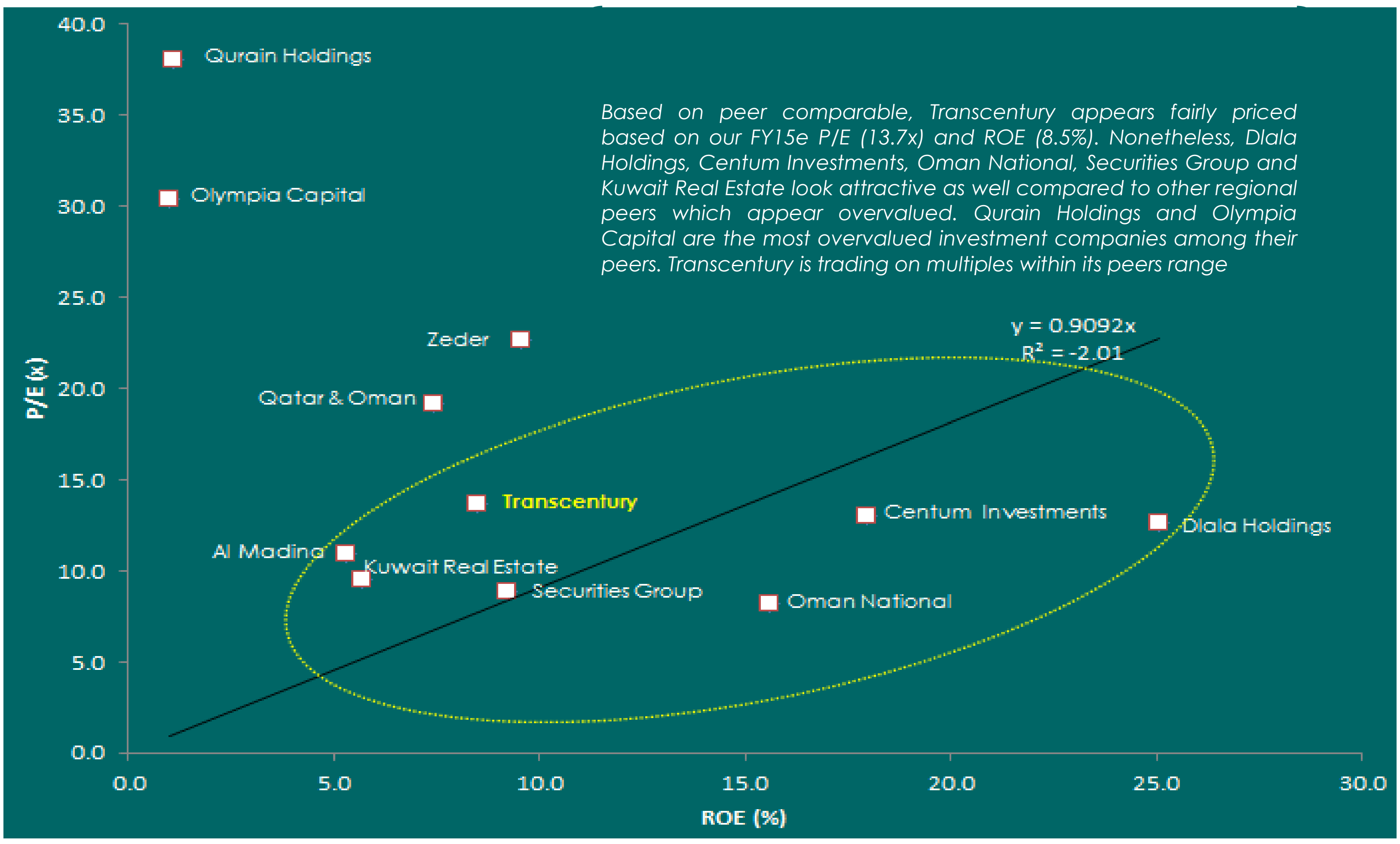
Profitability ratios	2013A	2014E	2015E	2016E	2017E
Gross Margin	30.1%	29.0%	30.0%	30.0%	30.0%
EBITDA Margin	19.1%	1.8%	14.4%	15.1%	14.7%
EBIT Margin	13.0%	(6.3%)	7.7%	8.8%	9.0%
Pretax Margin	7.3%	(10.9%)	6.8%	7.3%	8.4%
Net Income Margin	2.5%	(11.0%)	2.9%	3.4%	4.1%
ROCE av.	1.6%	(6.0%)	2.1%	2.8%	4.0%
ROCE / WACC (x)	10.9%	-	14.1%	19.0%	26.8%
Opex / Turnover	21.2%	22.0%	20.0%	19.0%	19.0%

Activity ratios	2013E	2014E	2015E	2016E	2017E
Inventory turnover	5.26	4.71	6.25	5.83	5.97
Days of Inventory on hand	69	77	58	63	61
Receivables turnover	1.90	1.83	3.11	2.93	2.96
Days of sales outstanding	192	199	117	125	123
Payables turnover	2.22	2.11	2.64	2.51	2.54
No. of payable days	165	173	138	145	144
Cash conversion cycle	97	103	38	42	40
Working capital turnover	4.10	1.46	1.95	2.16	2.39
Fixed asset turnover	0.78	0.88	1.17	1.35	1.62
Capital employed turnover	0.66	0.55	0.73	0.83	0.97
Total asset turnover	0.50	0.42	0.54	0.61	0.68

Liquidity ratios	2013A	2014E	2015E	2016E	2017E
Current ratio	1.49	2.26	2.03	2.04	1.94
Quick ratio	1.23	2.01	1.78	1.74	1.66
Cash ratio	0.06	1.35	1.00	0.93	0.79
Debt -to-equity ratio	2.16	2.65	2.48	0.63	0.59
Debt-to capital ratio	0.63	0.65	0.63	0.34	0.32
Financial leverage	4.59	5.30	5.39	2.57	2.64

- *Financial leverage to improve in FY16e after the debt conversion.*

Peer comparable



Source: Bloomberg, OMS Research

Appendix 1:

	Country	Mkt Cap (KES b)	Price (KES)	P/E (x)	P/B (x)	EV/EBITDA (x)	Dvd Yld (%)	FCF Yld (%)	ROA (%)	ROE (%)
TRANSCENTURY LTD	**Kenya**	**4,989**	**17.80**	**16.74**	**0.37**	**4.31**	**2.25**	**-27.39**	**1.28**	**5.77**
CENTUM INVESTMENT CO LTD	Kenya	39,261	59.00	13.00	1.96	-	-	-	12.44	17.95
ZEDER INVESTMENTS LTD	South Africa	84,520	58.58	22.67	2.11	-	0.06	-	4.85	9.54
SAUDI ADVANCED INDUSTRIES	Saudi Arabia	24,550	568.71	66.35	1.28	101.41	-	0.33	1.71	1.82
DLALA HOLDING	Qatar	21,310	960.62	12.63	2.86	11.39	-	(44.51)	6.75	25.06
KUWAIT REAL ESTATE CO KSC	Kuwait	20,845	23.01	9.52	0.54	22.56	-	(35.98)	3.46	5.67
AL-AHSA DEVELOPMENT CO.	Saudi Arabia	18,760	383.15	-	1.56	-	-	-	(5.45)	(5.94)
OTZAR HITYASHVUTH HAYEHUDIM	Israel	17,392	167,460.90	298.57	0.70	349.43	-	-	0.23	0.25
OMAN NATIONAL INVESTMENT CO	Oman	16,574	95.65	8.16	1.05	-	-	10.73	6.65	15.58
QATAR & OMAN INVESTMENT CO	Qatar	12,572	399.42	19.20	1.37	17.87	-	(3.66)	7.17	7.45
UNION INVESTMENT CORP	Jordan	9,734	194.93	-	2.21	13.27	-	-	(0.55)	(2.25)
SECURITIES GROUP CO	Kuwait	7,982	31.29	8.86	0.44	-	-	29.98	4.12	9.19
OSOOL ESB SECURITIES BROKERA	Egypt	5,787	72.39	99.73	11.46	-	-	(1.80)	5.83	10.66
EKTTITAB HOLDING CO S.A.K.C	Kuwait	3,956	12.42	-	0.45	-	-	2.16	(4.74)	(5.95)
AL MADINA INVESTMENT CO	Oman	3,267	15.78	10.96	0.56	12.42	6.89	(5.19)	4.07	5.29
QURAIN HOLDING CO	Iraq	1,227	4.14	38.03	0.43	-	-	(8.41)	0.78	1.08
OLYMPIA CAPITAL HOLDINGS LTD	Kenya	240	6.00	30.44	0.30	4.92	-	(6.45)	0.45	1.00
Average				**46.78**	**1.74**	**59.73**	**3.07**	**(7.52)**	**2.88**	**6.01**

- *Calculations are based on reported actual numbers (i.e no forecasts)*

Source: Bloomberg, OMS Research

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Buy: FV between 20% and 30% above CSP
Accumulate: FV between 10% and 20% above CSP
Hold: FV between -10% and 10% around CSP
Lighten: FV between 10% and 20% below CSP
Sell: FV more than 20% below CSP