‘Lion’s’ Share Oversubscribed

It certainly was a pleasant surprise for the Colombo Stock Market when the initial public offer (IPO) of Lion Brewery Ceylon Ltd., (TLBCL), was oversubscribed on day one of its official opening.

This was despite Jardine Fleming, the lead underwriter saying, an investment in TLBCL is only expected to yield dividends in the year 1999. This is due to the fact that the company is expected to begin operations only during the latter part of 1998-no dividends are forecast for that year and dividends for 1999 are estimated at only Rs 2/- per share.

TLBCL is the new subsidiary company established by The Ceylon Brewery Limited (TCBL), Sri Lanka’s leading manufacturer of beers. The new company was incorporated on March 05, 1996 as, a public limited liability company, under the Companies Act No. 17 of 1982.

To the Colombo Stock market which is in the doldrums with investors fighting shy of putting their money in shares, the over subscription of TLBCL was indeed a shot in the arm. Small time investors in the recent past have placed their trust more on guild-edged treasury bills with interest rates which could go up to 21 percent rather than in Colombo’s uncertain stock.

TLBCL is expected to raise Rs 250 million through this IPO to part fund the investment in its new state-of-the-art brewery in Biyagama, a project costing Rs

1.5 billion, funded by equity investments of Rs 1 billion and a loan capital of Rs 0.5 billion. The IPO represents 25 per cent of the equity investment in the project. The balance equity investments were made by the parent company, the Ceylon Brewery Ltd. (50.4 %) and Carlsberg Brewery Malaysia Berhad (24.6 %).

Out of the Rs 480 million worth of applications received, over 40 percent were from large foreign investors looking for growth opportunities in Sri Lanka. Sixty six percent of the issue has been taken up by the existing shareholders of The Ceylon Brewery who were entitled to a preferential allotment. Only the balance 34 per cent of the issue, amounting to just over 4.16 million shares, is available for allotment to the other members of the general public.

TA Research, a leading stock market analyst, talking about the risk factors involved in the beer industry in Sri Lanka said, “the main risk factor in the beer industry is the direction of excise duty. revision. Having resorted to a downward revision in excise duty, the government enjoyed an increase in revenue. However, the underneath reason for resorting to a cut in excise tariff was to reduce the social repercussion by making hard liquor unattractive. As the empirical evidence suggest high price elasticity of the product, the company profitability will be inextricably pegged to the excise duty direction of the government.”

Also, TLBCL will be incurring a management fee of 2.5% on net sales to Carsons Management Services (Pvt) Limited who is the managing company of TLBCL. In addition, 40% of the company’s cost of production is exposed to foreign currency, thus the company will be facing a forex risk specially in the light of the depreciating Sri Lankan rupee, analysts said.

Contrary to all these signals the above figures show that the shareholders of TLBCL and the general public have shown immense confidence in the ‘Lion share.

As the sole producer of Lion Lager, Sri Lanka’s leading beer brand, TLBCL will have a head start and be in a strong position to benefit from favourable industry trends fueled by lower prices and changing drinking habits. At the IPO price of Rs 20/-, the stock is trading at 4.32 X FY99 earnings per share (EPS). In view of the company’s expected sound fundamentals and strong earnings growth, TLBCL offers excellent exposure to one of the fastest growing beer markets in the region, says the lead underwriter, Jardine Fleming.

According to the TLBCL prospectus, the project will have an initial installed capacity of 30 million litres per annum and has been designed in such a manner that the initial capacity could be expanded to a final installed capacity of 180 million litres in six phases. The transition from phase I to phase II can be done at a short notice.

The company is of the opinion that the future outlook for the beer industry in Sri Lanka is positive, especially in view of the excise tax reforms initiated by the Government. With the product now becoming more affordable, volume growth is expected to be mainly driven by currently low per capita beer consumption.

The industry's future potential is therefore tremendous. TLBCL regards its new brewery as a competitive tool, a facility which will enable the company to secure premium quality standards, production efficiency and low unit costs through economies of scale.

The Board of Investment has granted TLBCL various infentives under the Large Development Projects Scheme, in view of the size of the investment of Rs 1.5 billion i.e. Tax exemption of 12 years commencing from the date of commencement of business; exemption from custom duty and turnover tax on plant and machinery; dividends declared out of tax exempt profits during the tax holiday and one year thereafter, exemptions from income tax to shareholders; share allotments or transfers to residents or non-residents outside Sri Lanka not subject to tax levies; capital investments by non-resident shareholders; the returns thereon, as well as any proceeds accruing to them upon liquidation, transferable and not subject to exchange control or other like restrictions.

Lion's only local competitor is McCallum, producer of Three Coin beer, which had a 22% market share in 1995, while competition from imported beer is fast diminishing because of high import duties. As TLBCL is the only brewery with confirmed plans to expand capacity, it is likely to dominate the local beer industry. Jardine Fleming also forecasts a market share of 57.5% in FY, '98 and 71.3% in FY, 99, based on their conservative output forecast of 17.5m litres in FY,'99.

Despite the popular belief among local investors that treasury bills are a better investment, Jardine Fleming says that investing in stock is good for those looking for exposure in the long term i.e. 4 to 5 years, especially considering Sri Lanka does not have a long term bond market. A spokesman said "TLBCL is a sound investment. With a forecasted PE of 4.32 in 1999, we expect a re-rating and therefore a capital gain. There is no comparison between this share and the TB (Treasury Bills) which is a fixed income earner."

Looking back at past years many IPOs such as Lanka Lubricants, CDIC, Connaisance etc. have failed miserably in the market and the question among investors, stock brokers and analysts was "what was the right combination to make an IPO work in these market conditions"? The answer may lie in this statement made in a company communique of TLBCL "We believe that this is a very clear indication that local companies have the ability to mobilise substantial quantities of foreign investment given a profitable project with sound fundamentals, a realistic policy framework, favourable industry condition and corporates with a workable strategy, strong management and right technology."

by Dilki Wijesuriya