Homeboyz Entertainment Plc

December 21st 2020

Homeboyz Entertainment Plc ("HEL") has listed in the GEMS segment of the NSE. We valued the company using DCF and EV/EBITDA and obtained a fair value of **KES 4.29.** The company's value has been negatively affected by government restrictions during the COVID-19 pandemic.

Key Highlights:

- **Diversified sources of income:** HEL'S revenue comes from different sources. This reduces the companies reliance on a single business unit and cushions the business against market volatility. The gross margins in the individual business segments range between 20% to 63%, with the Soundtrack business segment (the group's main source of revenue) recording the highest margins.

  The company is likely to continue to use strategic partnerships to increase the groups revenue.

- **New business model to stabilize revenue:** Homeboyz's revenue has historically been erratic as the company has typically relied on contracts that are signed annually. The group is now focusing on signing long-term contracts derived from strategic partnerships with stakeholders in the sports industry, public sector and development partners and finally the e-commerce sector.

- **Huge potential in the E-sports segment:** Homeboyz has partnered with the eSports Kenya Federation to scale up the eSports scene in Kenya. This will give the company a first mover advantage in the rapidly expanding market. Global revenues for E-sport are expected to touch $1.1bn this year while in South Africa, the industry is expected to grow at a CAGR of 24.7%.

- **Investment risks**: The company faces a number of risk which include: erratic top line growth due to the company's dependence on one-year contracts that are not always renewed, high operating cost which has reduced the company's efficiency, changes in customer preference, and the possibility of the introduction of disruptive technology which could affect the company's profitability. There's also the risk of an investment in an unprofitable venture as the management team actively seeks to increase revenue by investing in new business streams which have not always been successful.

COMPANY OVERVIEW

Homeboyz is a media and entertainment company that was founded in 1992.

1992

Inception of Homeboyz DJ's by a couple of music lovers.

2008

Partnered with Warner Bros in the creation of the popular game Pamoja Mtaani whose original intent was to increase HIV/AIDS awareness in the entire continent of Africa.

2009

Bought a bottled water company at a cost of KES 100,000,000 and pumped in additional money in re-branding and marketing of the firm's H2O water through H2O beverages.

2010

- Launch of a 52- episode series in BBC's pre-school channel CBeebies and the Disney Channel co-produced by Homeboyz and Tiger Aspect (UK).
- Homeboyz foundation was founded.

2011

Company divested the water business.

2016

Partnered with Publicis Groupe to enable Homeboyz transform into an integrated marketing and communications agency.

2019

Homeboyz joins Ibuka program.

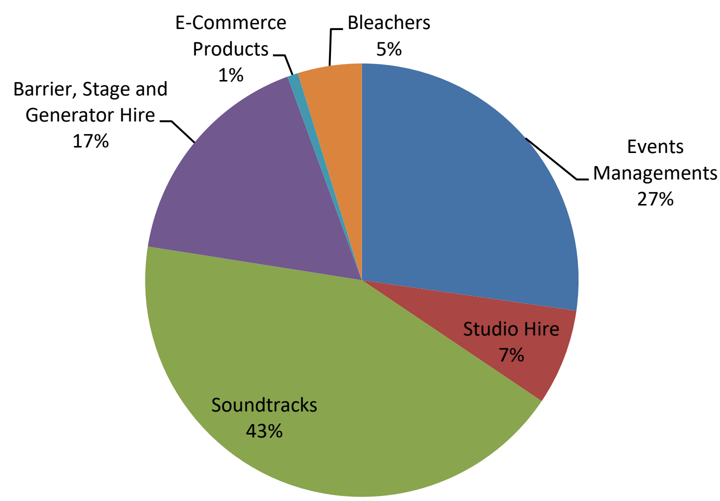
2020

Homeboyz is listed on the NSE.

INVESTMENT DRIVERS

- **Diversified sources of income:** HEL'S revenue comes from different sources. This reduces the companies reliance on a single business unit and cushions the business against market volatility.

Graph1: Revenue composition



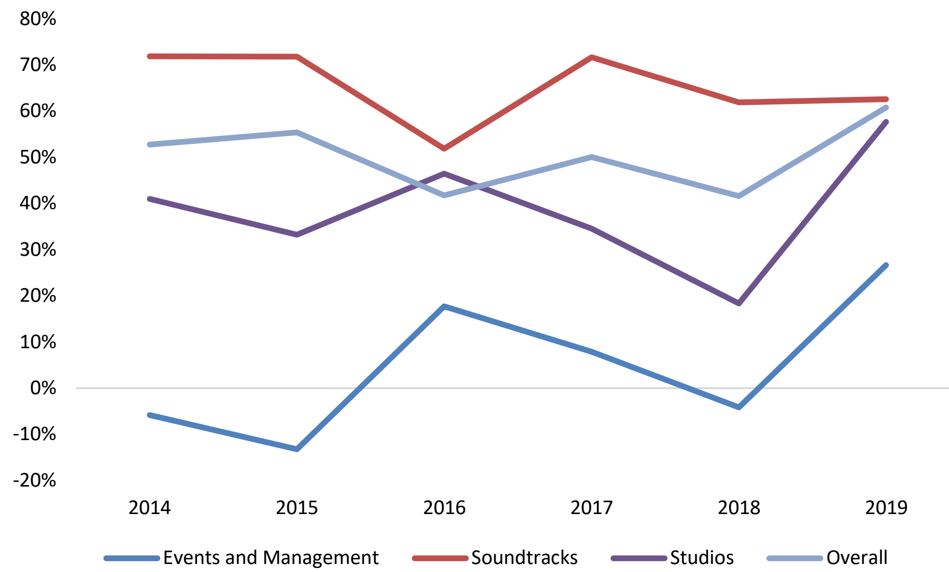
- **A new business model that aims to stabilize revenue:** Homeboyz's revenue has historically been erratic as the company has typically relied on contracts that are signed annually. The group is now focusing on signing long-term contracts derived from strategic partnerships with stakeholders in the sports industry, public sector, development sector, and the e-commerce sector. The aim is to lock in revenue over a long period of time (three to ten years).

  Homeboyz has been able to secure a number of lucrative contracts for major sporting events such as the Magical Kenya Open, World (Safari) Rally, Kenya Rugby League, E-sports League and Athletics Kenya. It has also signed a three-year MoU with the Kenya National Chamber of Commerce and Industry (KNCCI) that will see to the piloting of SME incubation hubs in all the KNCCI 47 County chapters.

  This new model will mainly buoy the events management business segment.

- **High margin business:** The overall gross margin currently stands at 63%. The Soundtracks business segment (this is mainly about suppling sound at an event) has been the group's main source of revenue and has the highest margins (at 63% in 2019). The barriers to entry in this segment are also relatively higher than that in other segments.

Graph 2: Gross margins



As the event management business continues to grow, supported by long-term contracts, the overall gross margin is likely to decline to 50%.

- **Huge potential in the E-sports segment:** Homeboyz has partnered with the eSports Kenya Federation to scale up the eSports scene in Kenya. This will give the company a first mover advantage in rapidly expanding global market.
  According to NewZoo, a market intelligence firm, global revenues for E-sport are expected to touch $1.1bn this year. In Africa, it is most prominent in South Africa. If Kenya follows South Africa's trend of a 24.7% CAGR, then Homeboyz could greatly benefit from the growth.

Table 1: South Africa E-sports market

ZAR (Mn)	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2018-23
E-sports media rights revenue	0.4	0.7	1.5	3.4	5.9	8.7	12.3	16	21	24	32%
E-sports streaming advertising revenue	1.7	3.3	5.7	11	16	21	25	30	34	38	20%
E-sports sponsorship revenue	1.7	2.7	5.6	11	17	23	29	36	43	52	26%
E-sports consumer ticket sales revenue	0	0	0.1	0.4	0.9	2.1	3.4	5	6.5	8.2	56%
E-sports consumer contribution revenue	1.5	2.4	3.2	5.1	6.5	8	9.8	12	14	15	19%
Total	5.3	9.1	16	31	46	63	80	99	118	138	25%
YOY growth(%)		72%	77%	92%	48%	38%	27%	25%	19%	17%	

Source: PWC's Entertainment and media outlook: 2019-2023, An African Perspective

- **Low customer concentration risk:** The company has a wide portfolio of clients. Some of their clients include Warner Bros, Disney, Rockefeller Foundation, UN, Microsoft, Google, BBC, Tiger Aspect (UK), Endemol, American Embassy, British Embassy, Samsung, and LG amongst many others.

- **Opportunities to increase revenue in E-commerce:** Homeboyz is on course to launch among many other e-commerce products a video-on-demand platform (HBTV) that will showcase local content produced by Homeboyz including Kenya Premier League, Kenya Rugby League, Kenya e-Sports League and the Kenya Motor Cross.

- **Strategic partnerships:** The company continuously seeks partnerships with strategic players in a bid to drive revenue. Its partnership with Publicis Groupe, one of the world's largest communications agencies, has enabled Homeboyz to tap Publicis' global footprint, knowledge base and best practices. This partnership has seen Homeboyz undertake several communications and public relations mandates with global brands such as Microsoft, Samsung, Google and LG amongst many others.

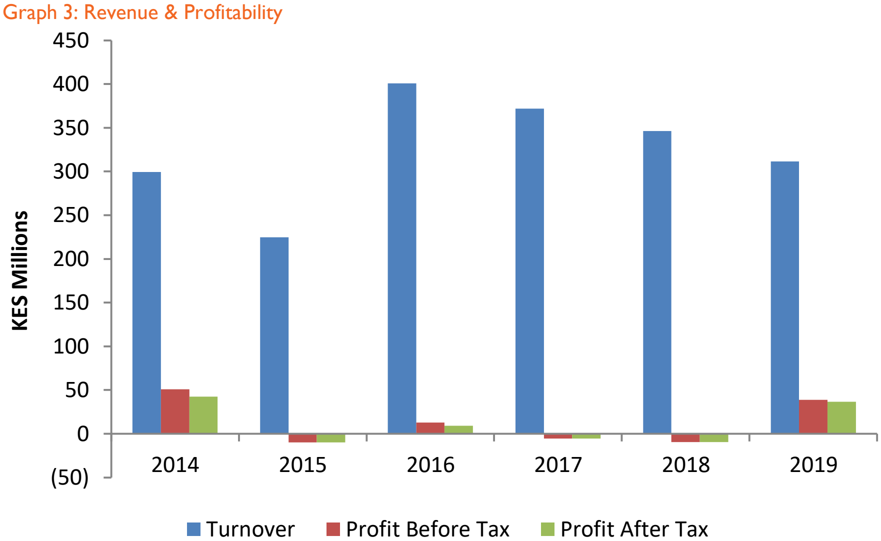
- **Strong brand and millennial appeal:** Homeboyz is a household name and its social and broadcast platforms has increased its appeal to the youth. The company is likely to ride on this as it markets and launches its products.

- **World class equipment and infrastructure:** Homeboyz prides itself as being one of the best providers of sound and video equipment in Kenya. Its on ground transport, backup power and storage facilities and infrastructure complement it product offering.

INVESTMENT RISKS

- **Erratic revenue and profitability growth**: Homeboyz has historically depended on revenue from one-year contracts that have are not always renewed. Although the company has currently increased the tenure of the contracts, a number of its businesses will still have to be renewed on an annual basis.

Graph 3: Revenue & Profitability



- **COVID-19 Pandemic:** The company's revenue is likely to be greatly affected as a number of events were cancelled in 2020. It is likely that the effects of the pandemic may continue to be felt in FY21.

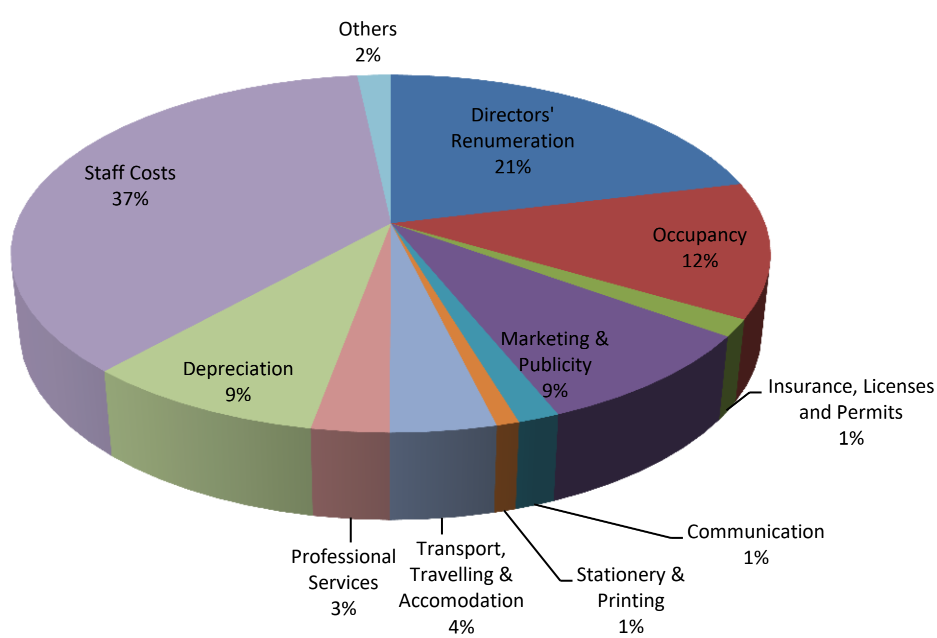
- **Change in cusumer preference:** Consumers have been shying away from live events mainly due to on demand streaming and most recently, the COVID-19 pandemic. This is likely to reduce demand for a number of their services.

- **Disruptive technological changes:** Players in this industry have been affected by changes in technology. Although Homeboyz is currently at the forefront of industry innovations, there is the risk that new innovations may negatively affect the company. For instance technology that reduces the cost of equipment may lower barriers to entry thus affecting the company's profitability.

- **Investment in unsuccessful ventures:** The management team actively seeks to increase revenue by investing in new business streams. A number of past ventures have been unsuccessful such as an investment in a bottled water company. The DJ agency and academy were also closed as the profitability of these businesses reduced.

- **High operating costs:** The company has a high cost to income ratio (average of 94%). Management plans to reduce its staff costs by decreasing the number of permanent workers and hiring on a contract basis based on demand but more need to be done to improve efficiency.

Graph 4: Operating cost



VALUATION

We use a Discounted cash flow (DCF) and EV/EBITDA to calculate Homeboyz Entertainment's fair value of **KES 4.29**.

	Fair Value	Weight	Weighted value
DCF	**2.55**	**60%**	**1.53**
EV/EBITDA	**6.90**	**40%**	**2.76**
			4.29

Discounted Cash Flow (DFC)

Using DCF we obtain a fair value of KES 2.55.

Our key assumptions are:

- Risk free rate (10 year government bond): 11.7%
- Risk premium: 5%
- Beta:1.3
- Cost of equity: 18.2%
- Terminal growth rate: 6.0%

	2020E	2021E	2022E	Terminal Value
EBITDA	-9,910,971	75,271,296	104,579,259	
Tax		-18,229,016	-26,358,244	
Changes in working capital	37,400,433	-19,030,098	-47,674,649	
CAPEX		-12,459,395	-25,620,928	
FCFE	27,489,461	25,552,787	4,925,439	
Period	0.057534247	1.057534247	2.05753425	
Discount factor	0.99	0.85	0.72	
Discounted Cash flow	27,243,069	21,655,338	3,569,509	47,723,629
Discounted horizon cash flows	52,467,917			
Discounted terminal value	34,585,740			
Net debt	73,858,508			
Value of equity	160,912,164			
Number of issued shares (m)	63,200,000			
Fair value (KES)	**2.55**			

EV/EBITDA

For the EV/EBITDA method, we use a an EV to EBITDA exit multiple of 4.78x (30% discount to the sector multiple of 6.83x) on our 2022 EBITDA estimate. We then discount the two-year EV using the WACC to arrive at present value EV. We obtain a fair value of **KES 6.90**.

EBITDA (2022F)	104,579,259
Exit Multiple (x)	4.78
Enterprise Value in 2022	500,139,849
Discount factor	0.7
Present value of EV	362455817.6
Net Debt	73,858,508
Implied Market cap	436,314,325
no. of shares (m)	63,200,000
Fair Value per share (KES)	**6.90**

FINANCIAL STATEMENTS

Income Statement	2016	2017	2018	2019	2020F	2021F	2022F
Turnover	400,808,357	371,840,791	346,456,406	311,516,155	119,808,259	379,740,681	456,090,986
Cost of Services	(233,447,667)	(185,592,367)	(202,360,035)	(122,073,166)	(63,498,377)	(201,262,561)	(241,728,223)
Gross Profit	**167,360,690**	**186,248,424**	**144,096,371**	**189,442,989**	**56,309,882**	**178,478,120**	**214,362,764**
Administrative Costs	(153,439,482)	(191,527,097)	(149,978,572)	(147,135,444)	(77,180,241)	(114,297,067)	(122,853,224)
Additional Staff							
Depreciation	17,002,632	35,145,074	14,336,059	12,929,630	10,959,389	11,090,244	13,069,720
EBITDA	**30,923,840**	**29,866,401**	**8,453,858**	**55,237,175**	**(9,910,971)**	**75,271,296**	**104,579,259**
Finance Costs	(1,128,013)	(310,121)	(3,807,084)	(3,399,109)	(898,562)	(3,417,666)	(3,648,728)
Depreciation	(17,002,632)	(35,145,074)	(14,336,059)	(12,929,630)	(10,959,389)	(11,090,244)	(13,069,720)
Profit Before Tax	**12,793,195**	**(5,588,794)**	**(9,689,285)**	**38,908,436**	**(21,768,922)**	**60,763,387**	**87,860,812**
Income Tax	(3,844,189)	0	0	(2,332,940)	-	(18,229,016)	(26,358,244)
Profit After Tax	**8,949,006**	**(5,588,794)**	**(9,689,285)**	**36,575,496**	**(21,768,922)**	**42,534,371**	**61,502,568**

Balance Sheet	2016	2017	2018	2019	2020F	2021F	2022F
Assets							
Non-Current Assets							
Property and equipment	43,719,356	86,433,986	82,650,538	76,345,908	65,386,519	66,755,671	79,306,879
Deferred tax asset - net	6,839,609	6,839,609	0	0	0	0	0
Total Non - Current Assets	50,558,965	93,273,595	82,650,538	76,345,908	65,386,519	66,755,671	79,306,879
Current Assets							
Trade and other receivables	32,153,262	23,023,878	27,306,344	56,942,195	29,541,762	31,211,563	62,478,217
Tax Asset							
Cash in hand and at bank	21,456,265	3,479,238	1,046,991	13,168,326	79,558,508	76,699,224	111,091,173
Total Current Assets	53,609,527	26,503,116	28,353,335	70,110,521	109,100,270	107,910,787	173,569,391
Total Assets	**104,168,492**	**119,776,711**	**111,003,873**	**146,456,429**	**174,486,789**	**174,666,458**	**252,876,270**
Equity & Liabilities							
Equity							
Share Capital	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
Equity Injection					60,000,000		0
Retained Earnings	1,643,491	(1,616,920)	(16,696,960)	19,878,536	(1,890,386)	40,643,985	102,146,553
Total Equity	**21,643,491**	**18,383,080**	**3,303,040**	**39,878,536**	**78,109,614**	**60,643,985**	**122,146,553**
Liabilities							
Non-Current Liabilities							
Debt	0	0		11,600,718	5,700,000	5,985,000	6,284,250
Hire Purchase and Long Term Provisions	0	25,679,162	29,673,844	21,054,345	26,754,345	26,754,345	26,754,345
Total Non - Current liabilities	**0**	**25,679,162**	**29,673,844**	**32,655,063**	**32,454,345**	**32,739,345**	**33,038,595**
Current Liabilities							
Trade and other payables	80,664,761	82,348,308	82,178,928	74,247,535	64,247,535	81,607,833	98,015,827
Short-Term Borrowings							
Directors Account	0	0	6,428,576	10,000,000	10,000,000	10,000,000	10,000,000
Corporation Tax	1,860,240	(6,633,840)	(10,580,515)	(10,324,705)	(10,324,705)	(10,324,705)	(10,324,705)
Total Current Liabilities	**82,525,001**	**75,714,468**	**78,026,989**	**73,922,830**	**63,922,830**	**81,283,128**	**97,691,122**
Total Equity & Liability	**104,168,492**	**119,776,710**	**111,003,873**	**146,456,429**	**174,486,789**	**174,666,458**	**252,876,270**

Cashflow Statement	2016	2017	2018	2019	2020F	2021F	2022F
Profit /loss for the year before Tax	12,793,195	(5,588,794)	(9,689,285)	38,908,436	(21,768,922)	60,763,387	87,860,812
Adjustments for:							
Depreciation of PPE	17,002,632	35,145,074	14,336,059	12,929,630	10,959,389	11,090,244	13,069,720
Gain on Disposal		(545,534)					
WHT Deducted	273,131	(8,494,080)	(3,946,675)				
Prior Year Adjustment		2,328,384	1,448,853				
Tax paid				(2,332,940)	0	(18,229,016)	(26,358,244)
Operating Profit before Working Capital changes	**30,068,958**	**22,845,050**	**2,148,952**	**49,505,126**	**(10,809,533)**	**53,624,614**	**74,572,288**
Changes in:							
Trade and other receivables	(8,307,905)	9,129,384	(4,282,467)	(29,635,851)	27,400,433	(1,669,800)	(31,266,654)
Trade and other payables	7,594,958	1,683,548	(169,380)	(7,675,582)	(10,000,000)	17,360,298	16,407,994
Net cash generated/used in operating activities	**29,356,011**	**33,657,982**	**(2,302,895)**	**12,193,693**	**6,590,899**	**69,315,112**	**59,713,628**
Cash flows from investing activities							
Purchase of Fixed Assets	(4,147,657)	(78,070,169)	(10,552,612)	(6,625,000)	0	(12,459,395)	(25,620,928)
Dsiposal of Fixed Assets		756,000	0	0			
Net cash used in investing activities	**(4,147,657)**	**(77,314,169)**	**(10,552,612)**	**(6,625,000)**	**0**	**(12,459,395)**	**(25,620,928)**
Cash flows from financing activities							
Long term borrowings	(13,137,906)	25,679,162	3,994,682	(8,619,499)	5,700,000	0	0
Directors Account			6,428,576	3,571,424	0	0	0
Debt				11,600,718	(5,900,718)	285,000	299,250
Short term borrowings	(1,994,535)						
Equity Capital					60,000,000	-60,000,000	0
Net cash used in financing activities	**(15,132,441)**	**25,679,162**	**10,423,258**	**6,552,643**	**59,799,282**	**(59,715,000)**	**299,250**
Net Change in Cash	**10,075,913**	**(17,977,025)**	**(2,432,249)**	**12,121,336**	**66,390,181**	**(2,859,284)**	**34,391,950**
Cash at Beginning	11,380,351	21,456,264	3,479,239	1,046,990	13,168,326	79,558,508	76,699,224
Cash at End	**21,456,264**	**3,479,239**	**1,046,990**	**13,168,326**	**79,558,508**	**76,699,224**	**111,091,173**

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