Crown Paints – Rights Issue

- Over the past few years, Crown Paints has seen steady growth in both its top and bottom lines. Revenue has grown at a CAGR of 6% between 2015 and 2019, from KES.6.7Bn to KES.8.6Bn. This rise has mainly been driven by regional expansion, a digital transformation strategy to improve service delivery and introduction of new products to meet the ever-changing market needs which have all been well received by the overall market.
- The firm has also enjoyed steady after tax profits within the period, with after tax profits rising from KES.30.7Mn in FY15 to KES.317Mn in FY19.
- In October 2020, Crown paints announced plans for a rights issue that seeks to raise KES.711Mn which as per management, would help the company invest in its loss-making subsidiaries, help strengthen its balance sheet to give it advantages in a highly competitive market and finally help the firm diversify its revenue base.
- The Company intends to issue 71.1Mn new ordinary shares at par value of KES.5 each and a rights issue price of KES 10 per new ordinary share.
- The news came amidst the backdrop of a KES.653Mn impairment of amounts invested in its subsidiaries, primarily in Uganda and Tanzania which have raked in cumulative losses of a staggering KES.1Bn since inception.
- The subsidiaries, which have struggled to show profitability to date, rely on the parent company for the provision of working capital and their ability to continue as a going concern depends entirely on the continued support they receive from the parent company.
- This situation has seen the firm extend loans to the subsidiaries in 2018 amounting to KES.908Mn which it later had to convert into equity due to difficulty experienced by these units to pay off the loans.
- In FY19, management announced that turnaround efforts had commenced with the Rwanda subsidiary on the path to recovery with Uganda and Tanzania expected to catch up in 2021. The results of these turnaround efforts have seemingly begun to bear fruit with the firm announcing a 765% jump in HY21 profits, growing from KES.29Mn to KES.252.8Mn YOY.

Forward Outlook

- **While the rights issue will help the firm beef up finances within its subsidiaries, and help mitigate the challenges posed by the ongoing Covid-19 pandemic, it will significantly dilute present shareholders.**
- The company's proposed rights issue price of KES.10 per share is deeply discounted compared to the firm's current share price of KES.40 (As at 26th May), meaning that shareholders who do not participate will see their holdings diluted significantly.
- Further, the company is proposing to change its Articles of Association to allow majority shareholders or other outside investors to take up additional stakes in the cash call without first making an offer to all the existing investors which seemingly gives precedent to majority shareholders over minority shareholders.

- We would advise all prospective Crown shareholders as well as present shareholders to take advantage of the discounted right issue pricing to profit from the firm's regional expansion efforts as well as avoid dilution which will be substantial for those who do not buy into the rights issue.