Emerging African Markets > Equity Research

10 April 2014

Namibia Breweries Ltd	Target Price (c)	1715
1H14 Results – High base in the making	Current Price (c)	1630

Year End 30 June	2011	2012	2013	F2014	F2015
Revenue (N$m)	1,797	2,160	2,383	2,703	2,730
Operating Profit	453	494	500	561	541
HEPS (c)	1.386	1.495	1.778	2.076	2.020
HEPU growth (%)	32.2	7.9	18.9	16.7	-2.6
PE	15.9	15.2	9.2	10.6	10.6
DPS (c)	49	54	62	68	72
DY	3.0	3.3	3.8	4.2	4.4
EV/EBITDA	7.6	6.6	5.6	5.3	5.4

Source: NBS, IJG

Recommendation	HOLD
NSX Code	NBS
Market Cap (N$m)	3,368
Shares in Issue (m)	207
Free float (%)	50
P/B (x)	3.4
52 week high	1632
52 week low	1328
Expected Total Return (%)	9.7

1H14 Results – Operationally Strong

The interim results reflect a strong operational performance with operating profit up 17.3% y/y. Basic EPS rose 40.5% y/y to 82.5c, whileHEPS were up 18.9% from 83.0c to 98.7c. The board declared an interim dividend of 34cps increasing its dividend for 1H13 by 9.7%.

NBS managed to grow revenue by 10.9% y/y to N$1.35bn, with growth stemming from sales of goods, which is up 11.6% y/y while royalty income fell 8.6%.Locally,double digits sales growth was seen,with beer sales volumes up 11%, while in South Africa,total volumes produced by NBS and sold to theDHN Drinks joint venture (JV)increased 7% compared to 1H13, however the value of sales actually decreased 3.7%, implying pricing pressure in SA.

Operating Margin – High base created

In FY14 we expect to see further expansion in the operating margin as the continuing surge in local revenue (higher margin business) more than offsets the negative impact of a weakening exchange rate and rising raw material prices.

However, in the medium term we turn more negative on NBS operating margins and profits. The strong increases in local revenue had a leverage effect through to operating profits on the back of higher selling prices in the local market. We are however concerned of the inverse effect that might come through when increased competition puts pressure on local revenue and ultimately operating margins.

NBS operating margin was at 20.98% as at FY13, the highest it has been since 2005 and we forecast that margins will keep up in FY14 after which we expect it to mean revert and go below the 20% level in the medium term as we are seeing a high base currently in the making.

Valuation

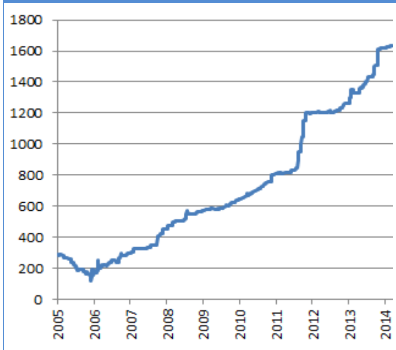
We value NBS using the dividend discount model, with the required rate of return based on an expected market return of 12.8%, justified by inflation expectations of 6.1% and forecasted economic growth of 2.45% in SA, according to Bloomberg. The required rate of return is 11.8%, based on a risk free rate of 9.01% (GC24), equity risk premium of 3.49% and a beta of 0.8.

Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N$14.40 per share.

We do however forecast a target price for NBS of N$17.15 per share, based on a justified PE multiple of 11.1x, with an implied expected total return of 9.7% over the next twelve months; and therefore we recommend a HOLD on the stock.

Fundamentally Namibia Breweries offers attractive value which could justify a buy recommendation on the stock; however, the potential downside risk (price and free cash flow dilution) to the DHN/Sedibeng deal and the upcoming change in the competitive landscape are creating a cause of concern.

Share Price (c)



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Revenue

NBS reported revenue of N$1.354bn in 1H14, up 10.9% compared to 1H13. The increase in revenue is attributed to an 11.6% increase in sales of goods to N$1.315bn, contributing 97.1% to total growth. Royalties however, declined 8.6% to N$36.6mcontributing only 2.8% to total revenue, down from 3.5% last year.

From a segmental perspective, beer continues to be the most significant contributor. In 1H14, beer revenue grew 18.4%, contributing 90.0% of overall revenue. Soft drinksperformed handsomely over the period, increasing 23.4% and contributed 5.4% to revenue, slightly more than the 4.8% in 1H13. Revenue from RTD's however, declined 54.4% and contributed less to overall revenue, with 4.4% of revenueattributed to RTDs. The decline in RTD revenue is attributed to a transfer of volumes to Sedibeng Breweries.

Segmental Revenue

	1H14	1H13	y/y % Δ	1H14 Contribution	1H13 Contribution
Beer	1,218,307	1,029,125	18.4%	90.0%	84.3%
Softs	72,638	58,884	23.4%	5.4%	4.8%
RTDs	59,378	130,245	-54.4%	4.4%	10.7%
Other	3,558	2,275	56.4%	0.3%	0.2%

Source: NBS

Locally, beers sales continued to perform exceptionally well, with Tafel Lager out performing within the beer portfolio. Beer volumes are reportedly up 11% compared to the previous year. Windhoek Draught sales did well and contributed to the overall growth in volumes, while Windhoek Lager, continuedto decline.Growth in Softs and RTD's volumes only increased marginally when compared to last year.

In South Africa, total volumes produced by NBS and sold to the DHN Drinks joint venture (JV) increased 7% compared to 1H13, however the value of sales actually decreased 3.7%, implying continuing price pressure in SA. According to management, total beer, including the Windhoek trade mark saw a slight decline in the period, while the RTD portfolio was the main driver of growth in volumes.Although the DHN Drinks JV still shows a loss, taking into account royalties and production margins that NBL earn through selling to DHN Drinks, NBL continue to make positive returns from the ongoing operations in South Africa.

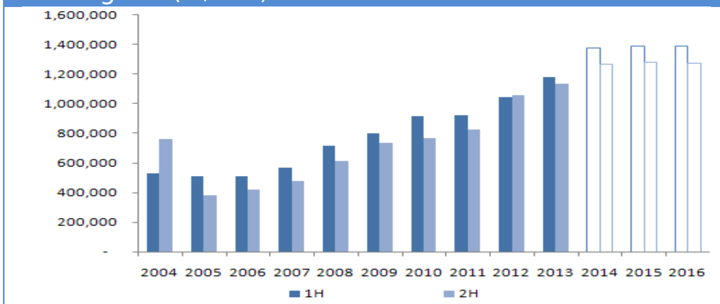
NBS indicated that other export markets have showed a mixed performance, noting increased competition within the SADC markets. The company has decided to go a more focused route, decreasing their target markets from 13 to 4. The four markets are Botswana, Mozambique, Tanzania and Zambia, with the rest being regarded as trading markets. Volumes exported to the Tanzania and Mozambique increased compared to the previous year, thus showing good growth in volumes albeit from a low base.

Export sales

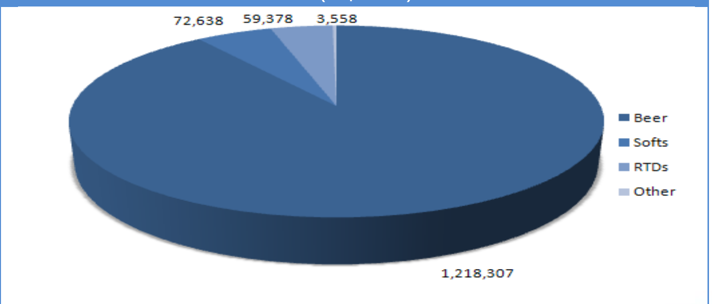
	1H14	1H13	y/y % Δ
DHN Drinks	573,615	595,817	-3.7%
Heineken SA	54,285	49,109	10.5%
Diageo SA	30,069	40,843	-26.4%
Diageo GBP	0	6,078	-100.0%

Source: NBS

Sale of goods(N$'000)



1H14Revenue breakdown (N$'000)



Source: NBS

Pricing

We noticed an interesting trend that Castle Brewing Namibia has been setting higher prices and NBS has been following the increases and as we have expected, given the pricing list effective as of 17 March, NBS once again followed Castle Brewing Namibia on price increases.

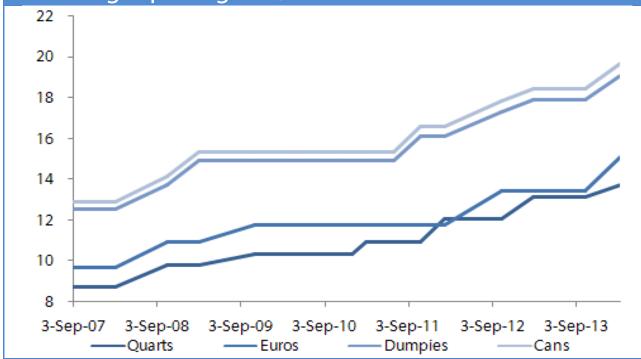
In March the strongest price increase seen within the NBS product offeringwas for the Tafel Lager Euro, up 12.5%, followed by the Tafel Lager Dumpies and Cans at 6.7%. Interesting to note was that NBS also increased prices of the Tafel Lager Quartz by 4.2%, while leaving the price of Quartz and Dumpies under the Windhoek brand unchanged. The strategic pricing of the brands, together with the Windhoek Brand marketing launch, one should expect to see Windhoek volumes to stabilise as opposed to the current decline.

	Windhoek Lager		Tafel Lager		Black Label & Castle Lager	
	March 2014	y/y % change	March 2014	y/y % change	March 2014	y/y % change
Quarts	15.36	0.0%	13.72	4.2%	16.11	7.84%
Euro	17.05	0.0%	15.13	12.5%		
Dumpies	21.76	5.9%	19.10	6.7%	22.08	8.10%

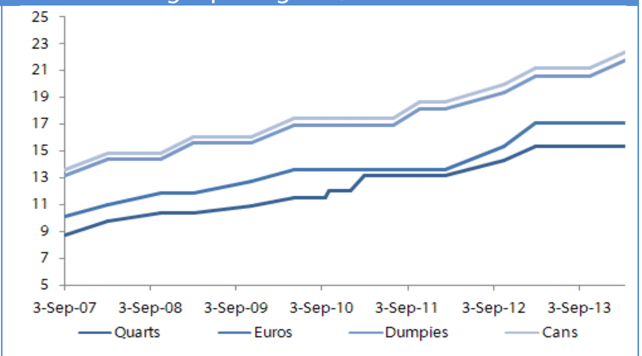
Source: CBN pricing list, NBS pricing list, IJG Research

After the recent increase, Castle Lager/Black Label is now more expensive than theWindhoek Lagercomparable ranges. The SAB products are also considerably more expensive than the Tafel Lager counterparts.Given the sensitivity of the mainstream segment of the Namibian beer market, one can expect to see Tafel Lager continue to outperform Windhoek Lager and Castle Lager/Black Label, but will this be the case once the Castle Brewery is up and running?

Tafel Lager pricing – N$/l



Windhoek Lager pricing – N$/l



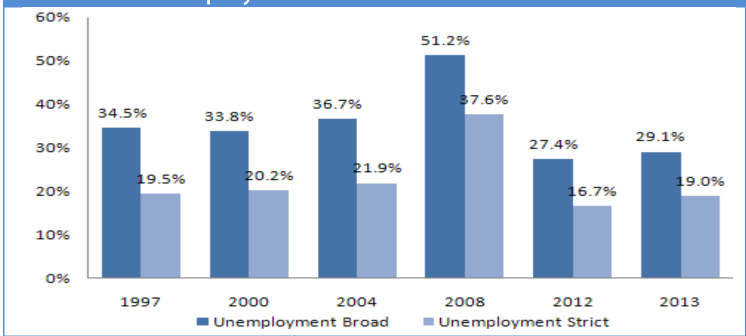
Source: NBS pricing list

Revenue Forecast

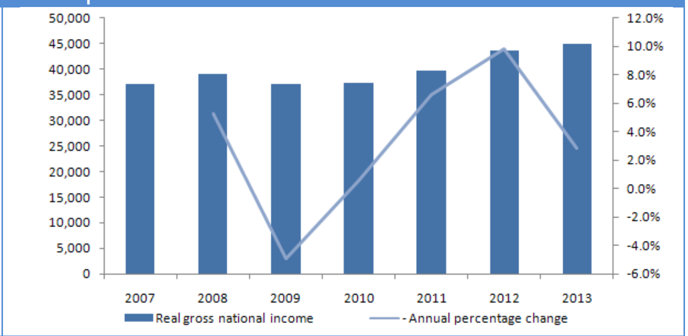
We are of the opinion that revenue growth for NBS is a function of strong growth witnessed in domestic household consumption, as is signalled by demand indicators such as new vehicle sales and private sector credit extension. This was most likely fuelled by the recent tax breaks and the very supportive government budget.

Looking forward, the macro environment bodes well, with favourable monetary and fiscal policies fuelling growth in disposable income and resultantly, domestic demand. Government policies have been very focused on creating jobs and improving income inequality, with results starting to show in the unemployment rate and income per capita.

Namibian Unemployment Rate



Per capita income – Real Namibian dollars

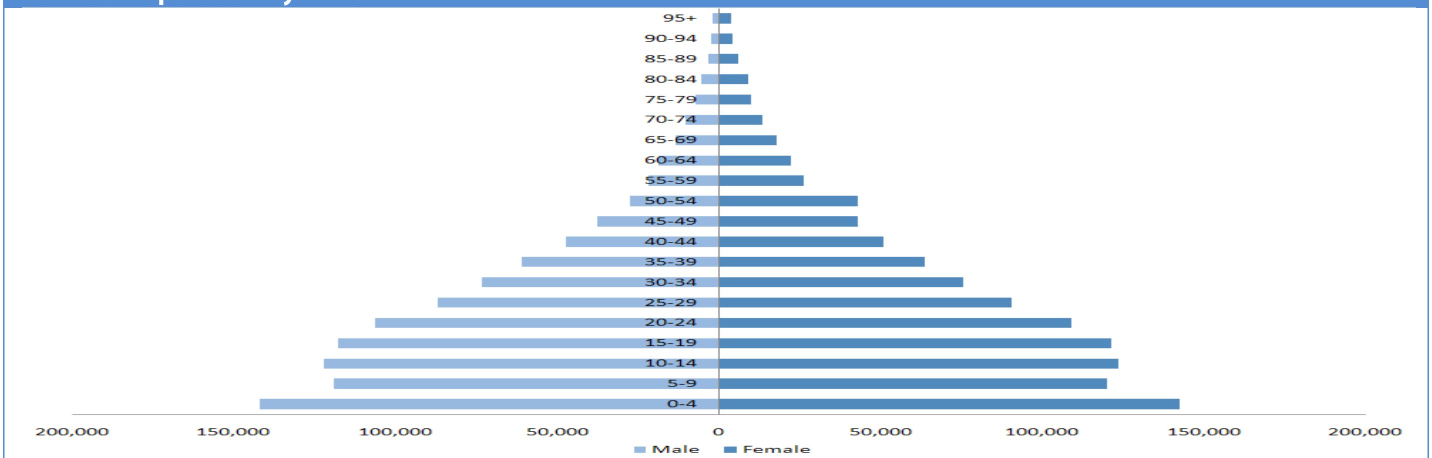


Source: NSA

Growth in the Namibian population alongside per capita beer consumption are key underlying factors in our forecast of local revenue. According to the 2013Labour Force Survey released by the Namibia Statistics Agency (NSA), the Namibian population was recorded at 2.1m people and in our valuation of NBS we factored in a future population growth rate of 1.4%. Also, the Namibian unemployment rate is currently at 29.6%, although it is up from 27.4% in 2012, it is still substantially lower than 51.2% in 2008. The lower unemployment rate is very positive for national income, with real gross national income growing 11.4% and 4.2% in 2012 and 2013, respectively that will be positive for the per capita consumption rate of beer in Namibia which will in turn drive local volumes and enhance group margins.

The shape of the population pyramid also gives us an indication of demand for products and it has major implicationson strategies of breweries. A younger population pyramid is great for future consumption of beer and with a bulge of teenagers set to become adults over the next decade and underpin growth in aggregate beer demand, as is the case for Namibia in the graph below.

Namibia Population Pyramid



Source: NSA

Despite the strong macro environment, we are concerned about the possible impact the SAB Okahandja Brewery might have on NBS. According to the Castle Brewing management team construction works are still on target with commissioning of production targeted for third quarter of calendaryear 2014. In IJG's view the introduction of the returnable format by Castle Brewing will change the competitive landscape of the Namibian brewing industry. SAB targets a medium term market share of 30% in Namibia.

We forecast NBS revenue to grow by 11.0% in FY14, which is intact with growth of 10.3% in FY13. We are however concerned about growth in the medium term after a number of rounds of significant ahead of inflation price increases and considering the probable negative impact when SAB commission brewing at its Okahandja Brewery.

Operating Profits

In 1H14 operating profit increased by 17.3% to N$274.2m on the back of growth in revenues and a wider operating margin. The operating margin improved110bps from 19.2% in 1H13 to 20.3% in 1H14and is in our view a function of increased sales to the Namibian market as is evident in the drop in export revenue as a percentage of total revenue to 48.6% from 56.7% in the 1H13.This increase in Namibian sales, for which the unit profit margin is relatively large, more than offset the switch in preference from premium products to the more mainstream Tafel brand.

The main cost drivers were raw materials and consumables at 52.5%, employment costs contributing12.1%, and administration and marketing expenses 18.1%, which increased 20.9% on the back of the launch of the new marketing campaign.

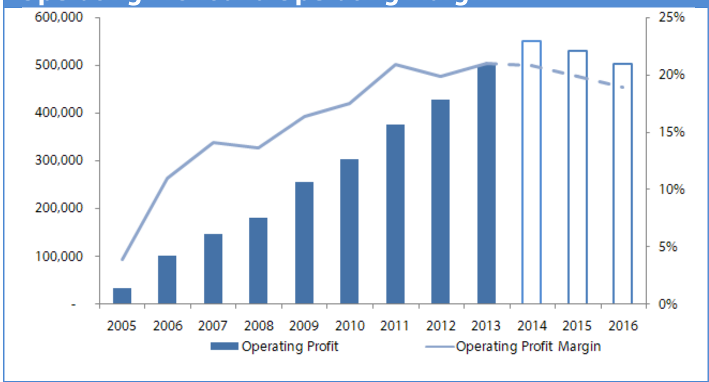
The beer segment's operating margin increased slightly by 30bps to 21.3% and RTDs operating margin widened significantly by 660bps to 15.7%, while the operating profit of the Soft drink segment narrowedto 3.1% from 6.5%.

In FY14 we expect to see further expansion in the operating margin as the continuing surge in local revenue (higher margin business) more than offsets the negative impact of a weakening exchange rate and rising raw material prices.

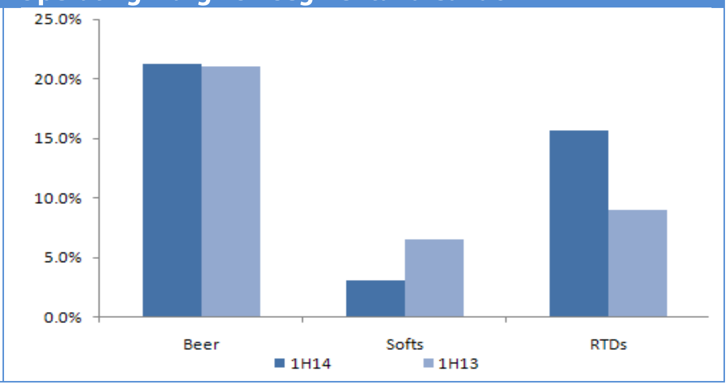
In the medium term we turn more negative on NBS operating margins and profits. The strong increases in local revenue had a leverage effect through to operating profits on the back of higher selling prices in the local market. We are however concerned of the inverse effect that might come through when increased competition puts pressure on local revenue ultimately operating margins.

NBS operating margin was at 20.98% as at FY13, the highest it has been since 2005. NBS operating margins are also very strong when compared to other African breweries. For this reason we forecast that margins will keep up in FY14 after which we expect it to mean revert and go below the 20% level in the medium term as we are seeing a high base being created.

Operating Profit and Operating margin



Operating margins – segmental breakdown



Source: NBS, IJG

DHN Drinks JV

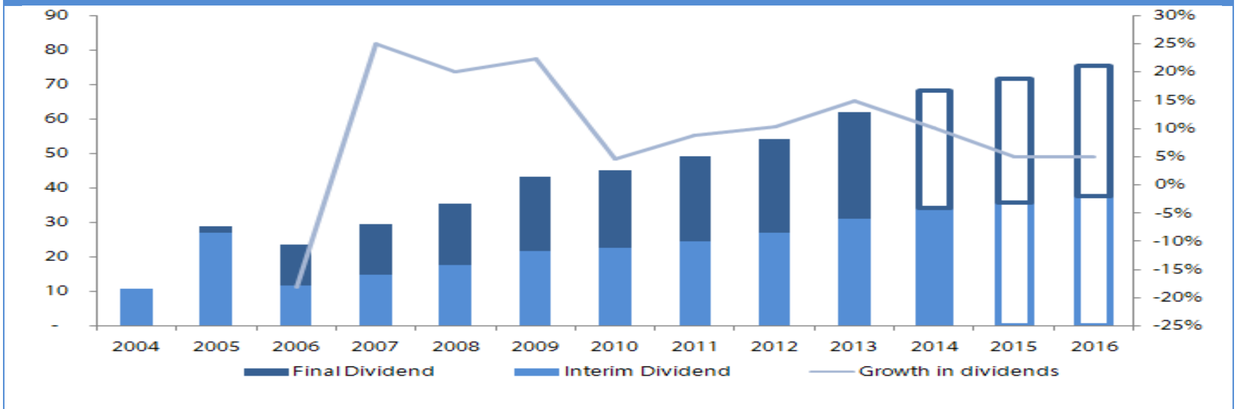
The equity loss from the JV decreased by 31.4% or N$15.9m, to N$34.6m, contributing positively to the bottom line. We look forward to future developments on this front and management guidance on what contributed to the relative improvement.

Namibia Breweries is currently trading under a cautionary announcement that states that the company is continuing discussions with regards to a proposed transaction which involves a restructuring of the existing arrangements between Diageo, Heineken and NBS in SA. Through this transaction, DHN Drinks intend to acquire 100% of the issued share capital of Sedibeng Brewery. We anticipate that DHN will require shareholder funding for this proposed transaction and as a result NBS will simultaneously need to raise additional financing to fund the proposed acquisition. The on-going and extended negotiations is concerning as we do not have much insight to the dynamics of the deal, non the less, this deal could unlock significant value, but to the detriment of free cash flows and ultimately lead to shareholder dilution.

Dividends

The half year results reflect a strong operational performance with operating profit up 17.3% y/y. Basic EPS rose 40.5% y/y to 82.5c, while HEPS were up 18.9% from 83.0c to 98.7c. The board declared an interim dividend of 34cps increasing its dividend for 1H13 by 9.7%, with last day to trade cum 11 April 2014. Our dividend forecast is a function of net profit adjusted for the equity loss from the JV. Dividends declared as a percentage of adjusted net profit has stabilised at 36% in FY12 and FY13. We forecast dividends of 72cps in FY14, 71cps in FY15 and 75cps in FY16.

Growth in dividends



Source: NBS, IJG

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Fundamentally Namibia Breweries offers attractive value which could justify a buy recommendation on the stock; however, the potential downside risk (price and free cash flow dilution) to the DHN/Sedibeng deal and the upcoming change in the competitive landscape are creating a cause of concern.

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