



NAMIBIA BREWERIES LIMITED
1H15 Results Review
APRIL 2015

Namibia Breweries Ltd	Target Price (c)	1880
1H15 Results Review	Current Price (c)	2015

Year End 30 June	2012	2013	2014	F2015	F2016	Recommendation	SELL
Revenue (N\$m)	2,160	2,383	2,316	2,328	2,369	NSX Code	NBS
Operating Profit	494	500	451	460	446	Market Cap (N\$m)	3,391
HEPS (c)	149	178	159	168	167	Shares in Issue (m)	207
HEPU growth (%)	7.9	18.9	-10.5	5.96	-0.71	Free float (%)	50
PE	18.7	11.3	20.3	18.2	16.9	P/B (x)	3.5
DPS (c)	54	62	68	71	72	52 week high	2016
DY	2.7	3.1	3.4	3.5	3.6	52 week low	1631
EV/EBITDA	6.6	5.6	5.9	6.4	6.6	Expected Total Return (%)	-2.7

Source: BVN, IJG

1H15 Results

Namibia Breweries (NBS) released results for the first half of the year ended 31 December 2014. The interim results reflect a stable operational performance with operating profit up 6.3% y/y, with the migration of RTD volumes forming a drag on revenues. Basic EPS fell 25.2% y/y to 61.7c, after an impairment of N\$87.6m to its investment in DHN Drinks (Pty) Ltd was recorded. HEPS, however, is up 5.6% from 98.7c to 104.2c. The board declared an interim dividend of 37cps, up 8.8% on the same period last year, with last day to trade cum 17 April 2015.

Local Sales and Volumes

Although NBS managed to increase local sales volumes, revenue fell by 0.8% y/y to N\$1.434bn, with the contraction stemming from the decrease in RTD volumes produced and sold to DHN Drinks in South Africa. Total sales of goods, however, are down 1.0% y/y while royalty income rose 8.2%. Locally, sales volumes continued to increase, up 5.0% y/y, led by Tafel Lager and Windhoek Draught. According to management, demand continues to move from Windhoek Lager to Tafel Lager and Windhoek Draught and this portfolio shift was achieved without losing overall market share. As the RTDs are lower margin business, the drop in RTD volumes did, however, lead to an increase in the operating margin and cushioned the blow on the bottom line.

Revenue per Category	1H14	1H15	y/y % Δ
Beer	1,218,307	1,243,561	2.1%
Softs	72,638	78,872	8.6%
RTDs	59,378	17,242	-71.0%
Other	3,558	3,755	5.5%
Total	1,353,881	1,343,430	-0.8%

Export Markets

In South Africa, total volumes produced by NBS and sold to the DHN Drinks joint venture (JV), its largest single customer, decreased. This resulted in the value of sales to DHN decreasing by 6.1%. Total beer volumes exported to Tanzania and Zambia increased compared to the previous year, thus showing good growth in volumes albeit from a low base. Volumes sold to Mozambique, however, slowed down with brand competition challenges, while growth in Botswana has been impacted by the increase in alcohol levy. Export sales declined as a percentage of total sales of goods, falling to 42.9% from 50.0% a year ago. This means that local sales now outweigh exports thus increasing the company's exposure to the local market.

Export Sales	1H14	1H15	y/y % Δ
DHN Drinks	573,615	538,661	-6.1%
Heineken SA	54,285	19,813	-63.5%
Diageo SA	30,069	-	-100.0%
Total	657,969	558,474	-15.1%

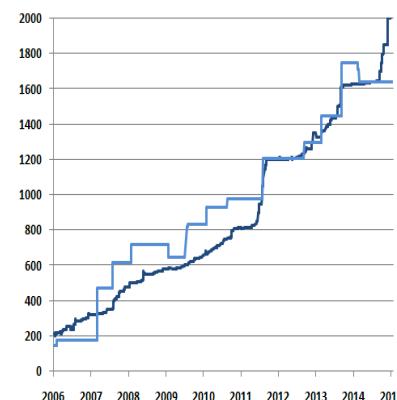
DHN Drinks JV

The equity loss from the JV increased to N\$87.7m in 1H15 from N\$34.7m in 1H14, with the increase attributed to a fiercely competitive environment in South Africa.

Valuation

We value NBS using the dividend discount model, with the required rate of return of 13.0%, based on a risk free rate of 8.51% (GC24), equity risk premium of 4.5% and a beta of 1.0, and a long-term sustainable growth rate of 9.5%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N\$16.67 per share.

Using a justified PE multiple of 14.0x, however, we forecast a target price for NBS of N\$18.80 per share. This implies an expected total return of -2.7% over the next twelve months, as we are concerned as to the effect SAB will have on the company's market share going forward as well as the losses being carried as a result of the JV, therefore we change our **HOLD** recommendation to a **SELL**.

NBS Share Price**Dividends**

Notice is hereby given that an interim dividend of 37 cents per ordinary share was declared on 20 March 2015 for the period ended 31 December 2014.

• Last day to trade cum dividend:
17 April 2015

• First day to trade ex-dividend:
20 April 2015

• Payment date:
8 May 2015

Analyst

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Revenue

Namibia Breweries reported revenue of N\$1.343bn in 1H15, down 0.8% compared to 1H14. The decrease in revenue is attributed to a 1.0% decrease in sales of goods to N\$1.301bn, which was mainly due the migration of production volumes to South Africa. Royalties however, increased 8.2% to N\$41.7m contributing only 3.1% to total revenue, nonetheless, up from 2.8% for the same period last year.

Segmental Revenue					
	1H14	1H15	y/y % Δ	1H14 Contribution	1H15 Contribution
Beer	1,218,307	1,243,561	2.1%	90.0%	92.6%
Softs	72,638	78,872	8.6%	5.4%	5.9%
RTDs	59,378	17,242	-71.0%	4.4%	1.3%
Other	3,558	3,755	5.5%	0.3%	0.3%
Total	1,353,881	1,343,430	-0.8%	100%	100%

Source: NBS

From a segmental perspective, beer continues to be the most significant contributor, making up 92.6% of total revenue. In 1H15, beer revenue grew 2.1% which was mainly driven by local beer consumption. Soft drinks performed handsomely over the period, increasing 8.6% and contributed 5.9% to revenue, slightly more than the 5.4% in 1H14. Revenue from RTD's, however, declined 71.0% and contributed less to overall revenue, with 1.3% of revenue attributed to RTDs. The decline in RTD revenue is on the back of a transfer of volumes to Sedibeng Brewery in South Africa.

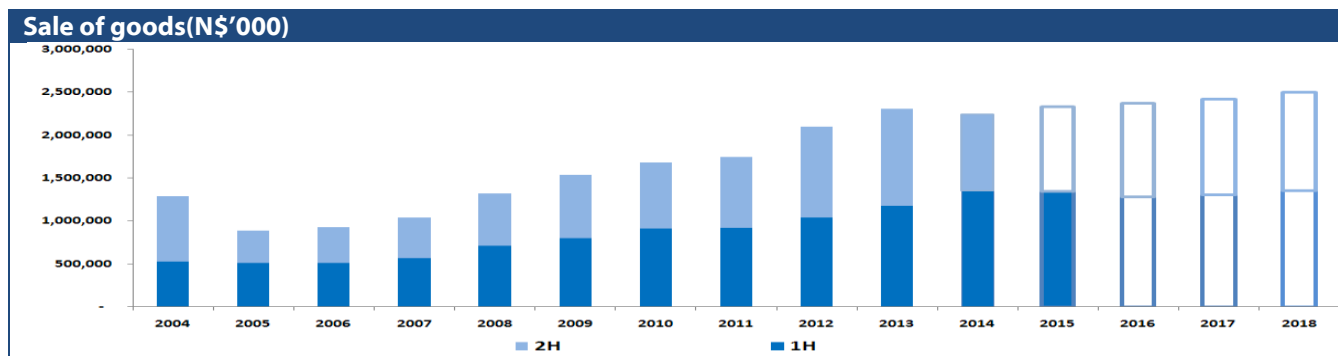
Locally, beers sales continued to perform well, increasing 5.0% y/y, with Tafel Lager outperforming within the beer portfolio. Windhoek Draught sales did well, contributing significantly to the overall growth in volumes, while Windhoek Lager continued to decline, due to migration to Tafel Lager and Windhoek Draught. The RTD range and soft drink sales saw double digit growth in the local market compared to the prior year with Vigo having rooted itself in the premium soft drink market.

South Africa Export Sales			
	1H14	1H15	y/y % Δ
DHN Drinks	573,615	538,661	-6.1%
Heineken SA	54,285	19,813	-63.5%
Diageo SA	30,069	-	-100.0%
Export Sales	657,969	558,474	-15.1%

Source: NBS

Total volumes produced by NBS and sold to the DHN Drinks joint venture (JV) in South Africa decreased, which according to management is in line with the volume migration plan. The value of export sales to South Africa decreased 15.1% or N\$99.5m, largely on account of the migration of volumes to the Sedibeng Brewery in South Africa. Most of the migration was from the RTD products, which in value terms, decreased by 71.0% or N\$42.1m for NBS. Export sales continued to decline as a percentage of total sales of goods as production was moved from the local plant to the Sedibeng Brewery. Export sales to South Africa were recorded at 42.9% of total sales, down from 50.0% a year ago.

NBS indicated that other export markets have showed a mixed performance, noting increased competition within the SADC markets. Total beer volumes exported to Tanzania and Zambia increased compared to the previous year, thus showing good growth in volumes albeit from a low base. Volumes sold to Mozambique, however, slowed down with brand competition challenges, while growth in Botswana has been impacted by the increase in alcohol levy. The alcohol levy in Botswana was further increased in January this year, by 10%, taking it to 55%, resulting in a spike in the price of alcohol with immediate effect.



Source: NBS

Pricing

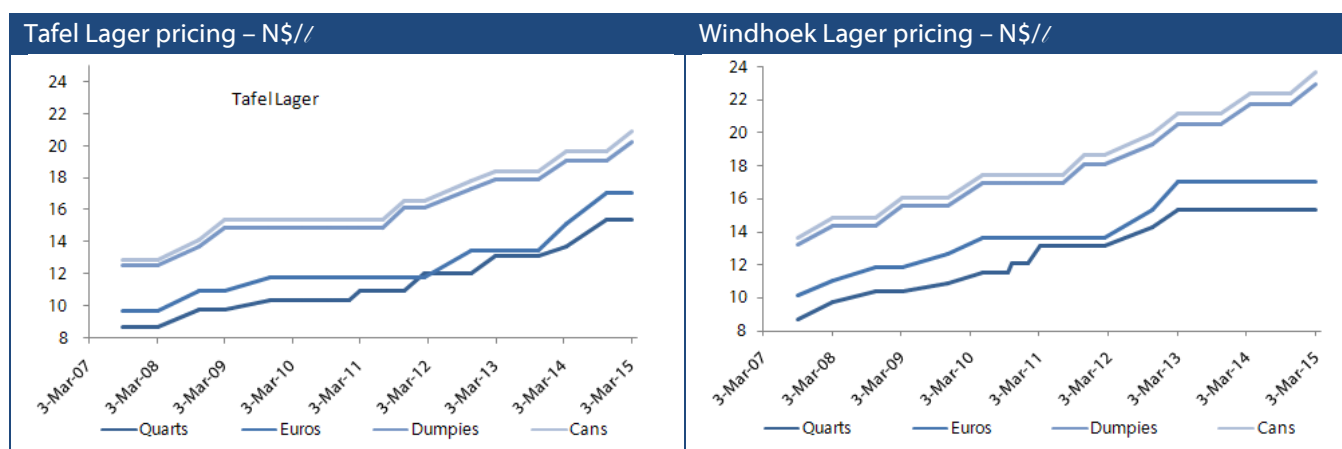
Over the past few years, we have witnessed that Castle Brewing Namibia has been setting higher prices and NBS has been following these increases. According to our latest price list, effective 3 March this year, NBS once again followed Castle Brewing Namibia on price increases with regards to Dumpies. In March the strongest price increase seen within the NBS product offering was for the Tafel Lager Cans and Dumpies, up 6.3%, followed by the Windhoek Lager Dumpies and Cans at 5.6%. This is after SAB increased the price of Black Label and Castle Lager Dumpies by 8.1%. Interesting to note was that NBS left the prices of the Tafel Lager and Windhoek Lager Quartz unchanged, while the price of the Black Label and Castle Quarts was decreased by 0.5%.

In October last year the price of Tafel Lager Euro was increased 12.7%, the Tafel Lager Quart, up 12.0% and the Windhoek Draught Quart, up 7.7%. Interesting to note is that the recommended selling price of Quarts for Windhoek Lager, Windhoek Draught and Tafel Lager are now the same, at N\$14.00 per unit. This follows the migration away from Windhoek Lager to the previously cheaper Tafel Lager. The strategic pricing of the brands in the main stream segment of the market, together with the Windhoek Brand marketing, one can expect to see Windhoek volumes stabilise after the decline seen in volumes due to this migration to Tafel Lager.

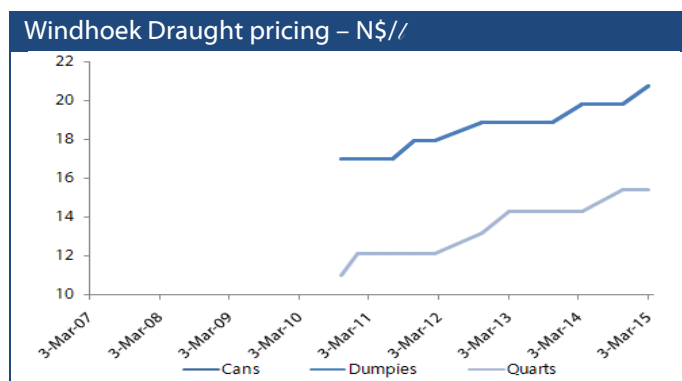
After the recent changes, Castle Lager/Black Label is still more expensive than the Windhoek Lager and Tafel Lager comparable ranges. Given the sensitivity of the mainstream segment of the Namibian beer market, one can expect to see Tafel Lager and Windhoek Lager continue to outperform Castle Lager/Black Label over the near-term, however whether this will remain the case when the Castel Brewery is fully operational and looking to capture market share, remains to be seen.

	Windhoek Lager			Tafel Lager			Black Label & Castle Lager	
	N\$/l October 2014	y/y % change		N\$/l October 2014	y/y % change		N\$/l October 2014	y/y % change
Quarts	15.36	0.0%		15.36	0.0%		17.18	-0.5%
Euro	17.05	0.0%		17.05	0.0%			
Dumpies	22.97	5.6%		20.29	6.3%		22.88	8.1%

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

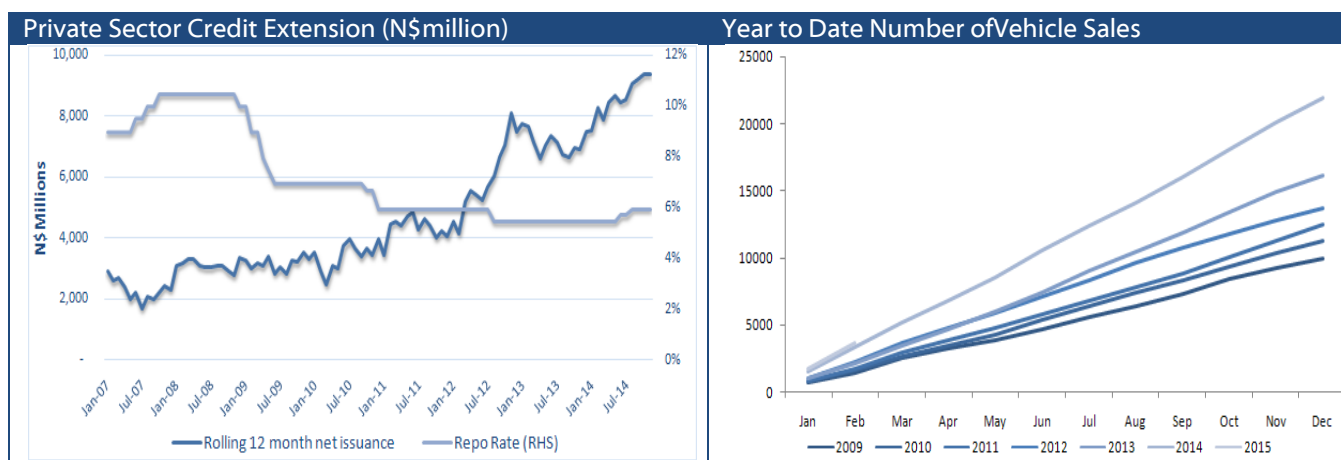


Source: NBS pricing list



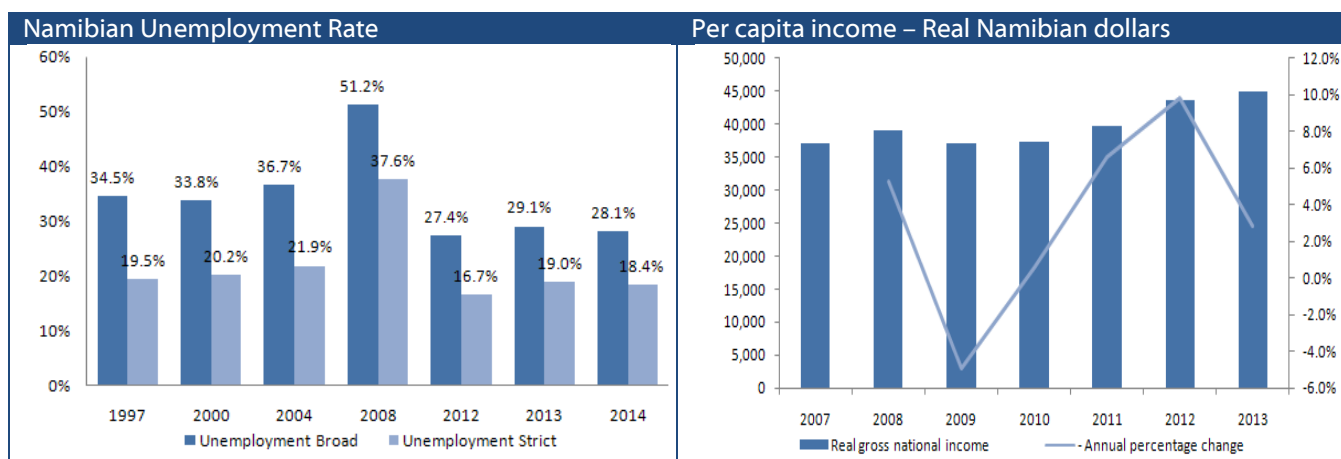
Macro Environment

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 relatively low tax rates and low interest rates together with the very supportive government budget.



Source: NSA

Looking forward, the macro environment remains bullish, 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 equality, with results starting to show in the unemployment rate and distribution of income.

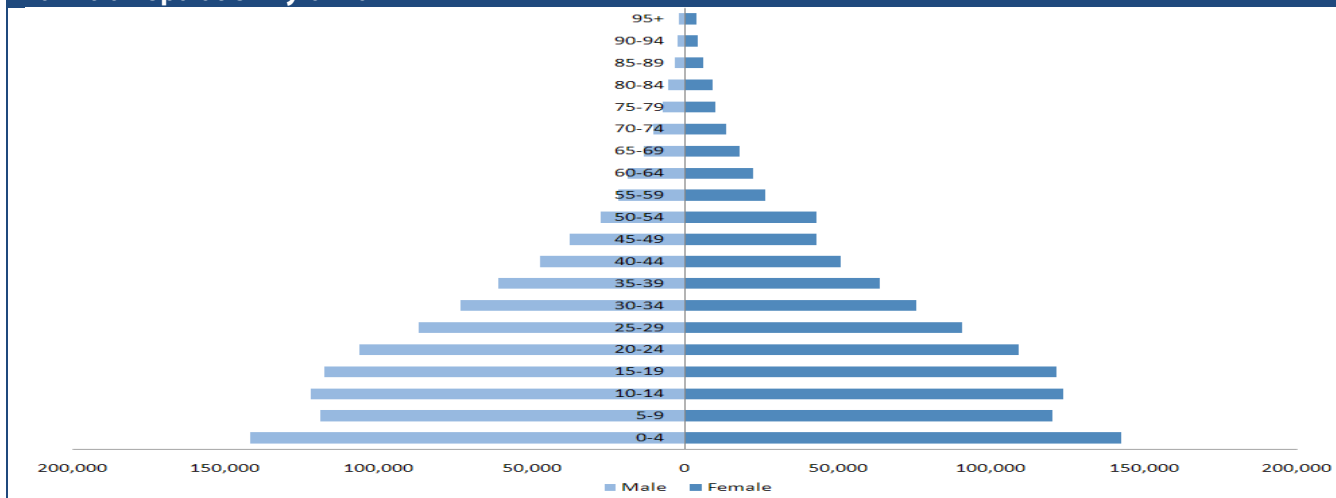


Source: NSA

Growth in the Namibian population alongside per capita beer consumption are key underlying factors in our forecast of local revenue. According to the 2014 Labour Force Survey, released by the Namibia Statistics Agency (NSA), the Namibian population was recorded at 2,247,124 people and in the latest Population Projections Statement, the NSA forecasted the Namibian population to grow to 3.4m by 2041, a growth rate of about 1.7% per annum. In our valuation of NBS we factored in a slightly more conservative future population growth rate of 1.4%. Also, the Namibian unemployment rate is currently at 28.1%, down from 29.1% in 2013. 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. This 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 implications on strategies of breweries. A younger population pyramid gives an indication for future consumption of beer and with a bulge of children and teenagers set to become adults in the near future, growth in aggregate beer demand can be expected to increase on the back of the increase in consumer numbers.

Namibia Population Pyramid



Source: NSA

SABMiller Castle Brewing

Despite the strong macro environment, we are concerned about the possible impact the SAB Okahandja Brewery will have on NBS. SABMiller Namibia started production at its 260,000 hectolitre brewery in September last year, with its inaugural brew being Carling Black Label. The company started with non-returnable glass bottles, which are now being converted into returnable bottles and cardboard packaging previously used has been replaced with plastic crates to be used at the brewery. In IJG's view the introduction of the returnable format by Castle Brewing will change the competitive landscape of the Namibian brewing industry, especially in the main stream segment of the market as the consumer in this target group is price sensitive.

At the latest results presentation, NBS management indicated that NBS still enjoy 87.0% of the local market share, while SAB targets a medium term market share of 30% in Namibia.

Operating Profits

In 1H15 operating profit increased by 6.3% to N\$291.6m, from N\$274.2m last year. The operating margin widened 150bps from 20.3% to 21.7% in 1H15. The better performance is a function of a decrease in operating expenses as raw material costs, consumables, employment and transport costs was reduced significantly with the migration of volumes from the local plant to the Sedibeng Brewery in South Africa. Performance was offset to some extent by the weaker local currency, together with no price increases during the 1H15.

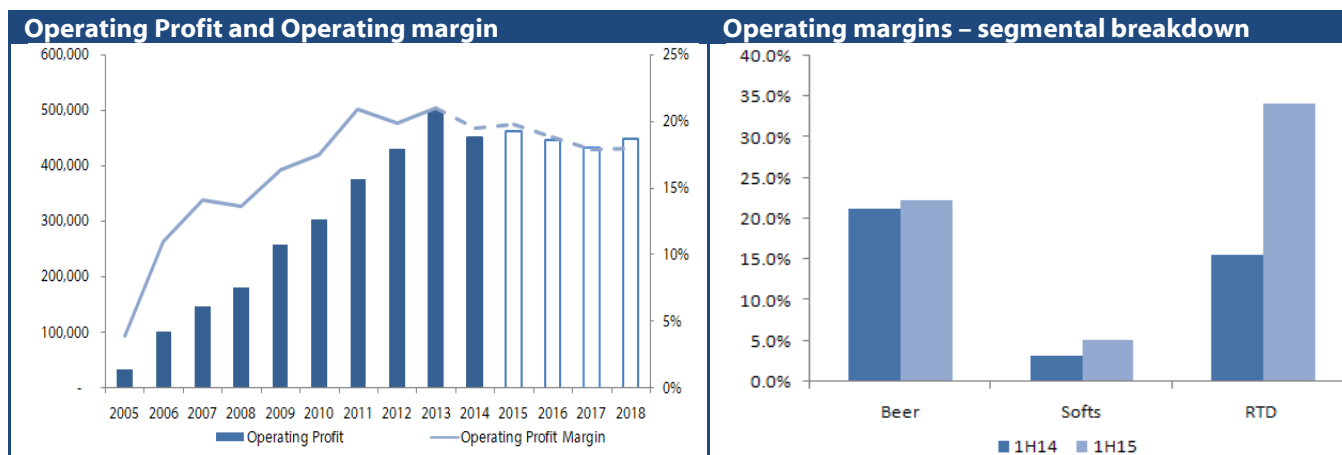
Raw materials and consumables, which contribute almost half of total operating expenses, decreased 13.5% as lower volumes were produced locally, but the weaker Namibian Dollar against the Euro, the cost of importing raw materials, such as malt, resulted in a drag on margins. Employment costs, contributing 12.6%, decreased marginally and administration and marketing expenses, contributing 23.3%, increased 25.7% with the launch of the new marketing campaigns.

1H15	Revenue	Operating Expenses	Operating Profit	Operating Margin
Beer	1,243,561	(965,486)	278,075	22.4%
Softs	78,872	(74,868)	4,004	5.1%
RTD	17,242	(11,352)	5,890	34.2%
Other	3,755	(91)	3,664	97.6%
Total	1,343,430	(1,051,797)	291,633	21.7%

The beer segment's operating margin increased by 110bps to 22.4%, and the profit margin of the soft drinks segment grew to 5.1% from 3.1%. The RTDs operating margin widened significantly, to 34.2%, from 15.7%. The migration in RTD volumes to the Sedibeng Brewery led to the increase in the operating margin and this cushioned the blow on the bottom line. Interesting to note is that while the revenue from the RTDs decreased 71.0%, the operating profit only fell 36.6%, indicating that the exported RTDs were previously sold at very low margins.



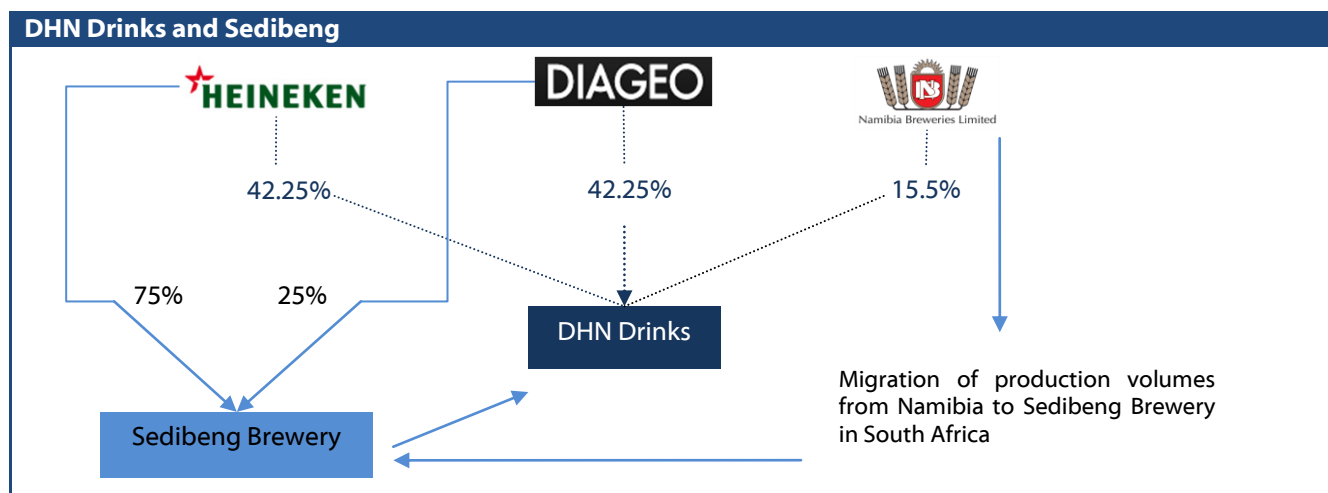
NBS operating margin widened slightly to 21.7% in 1H15, from 21.5% in 1H14. This was a result of lower operating expenses offsetting the decrease in revenue. However, looking forward, we turn more negative in the medium term on NBS operating margins and profits. The strong increases seen over the last few years 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.



Source: NBS, IJG

DHN Drinks JV

The DHN Drinks joint venture between Heineken, Diageo and Namibia Breweries was formed in 2008 as part of a cost sharing, marketing and distribution joint-venture under Brandhouse Beverages formed in 2004. The purpose of the partnership was to keep marketing and distribution costs as low as possible through creating economies of scale, in order to compete with other major players in the market, notably SAB Miller.



Heineken and Diageo both own 42.25% in the DHN Drinks Joint Venture while NBS has the remaining 15.5% share. The JV was formed for the purpose of distributing products which are supplied by these three companies, produced at the NBS Brewery in Windhoek or by the Sedibeng Brewery in South Africa, which is owned by Heineken and Diageo, of which ownership is split 75% and 25% respectively. The JV buys product from the two breweries on a cost-plus basis, which product is then distributed within the South African market. Thus, should the supplying breweries supply at a cost-plus basis above the retail price, or should the JV's marketing and distribution costs push the unit cost above the retail price, the JV will experience losses.

In the past, the JV has been loss making due to the fact that the cost of production has exceeded the sales price for many of the products sold. The reasons for this vary between the two breweries. On the one hand, the size of the NBS Windhoek plant is insufficient to achieve the economies of scale required to compete in a market the size of that of South Africa, while on the other hand, the Sedibeng plant is not operating at full capacity, meaning that it too does not have the economies of scale required to produce below the market price and thus for the JV to make profits.

As such, the JV members have decided to move production volumes away from the relatively expensive NBS plant to the cheaper Sedibeng plant, in order to provide the latter with the economies of scale required for the JV to be profitable. This move, however, means that Diageo and Heineken benefit from increased volume production and lower average costs at the Sedibeng plant, as well as (potentially) profits in the JV, while NBS has lower production volumes and a (relatively small) share of profits from the JV. In addition, NBS receives a royalty for their products (primarily the Windhoek range – Larger, Lite and Draft) that are produced at Sedibeng, but this is relatively small in comparison to the revenue received from the (foregone) production of these beverages at the local plant.

The JV has been a mixed failure and success. On the one hand it has assisted NBS to get a foothold in the SA market, while historic production volumes at the local plant have also been favorable due to the JV. The JV itself, has, however, remained loss making. However, going forward this may well change, as production is migrated to the Sedibeng plant. The JV may become profitable, but it is unlikely that the JV's increased profitability will come close to offsetting this loss in revenue for NBS as production is moved away from Namibia. The reality is that the money is to be made in the provision of beverages to the JV, rather than from the JV to the public.

Both Windhoek and Heineken are now greater than 1 million hectolitre brands, while the focus of Diageo and Heineken appears to be a shift in production to Guinness and believes that DHN Drinks can do more with both the Guinness and Heineken brands, but the investment required to achieve this will have to be carried by all three partners, not just the two brand owners. This situation may contribute to the JV agreement not being renewed in 2017.

Efforts by Diageo to increase volumes of Guinness and Heineken brands are, however, more likely to positively serve the two major players in the JV, and not NBS to the same extent – the benefits from increased output at the Sedibeng Brewery will be disproportionately felt (positively) by the two owners of the plant, rather than by the owners of the JV. As NBS was not able to secure a share in the Sedibeng Brewery, any increase in costs incurred by the JV will simply have a negative impact on NBS, in order to benefit the other shareholders. As NBS has a minor shareholding, they may be unable to ensure that this does not happen, which means they may decide not to extend their JV agreement when it comes to an end in 2017.

Whether or not the expansion of the two brands will actually be implemented or that NBS will agree to continue with the JV is uncertain. If NBS continues with the JV, distribution of NBL products should not be affected, however, extra investment would have to be made by NBS. If NBS withdraws from the JV, the company is responsible for its own distribution and production of NBL products would no longer take place at Sedibeng Brewery. Given that they now have a foothold in SA, they may be able to continue to service the SA market on their own, however, their production, marketing and distribution costs would spike, which may well make them uncompetitive (in a highly competitive market).

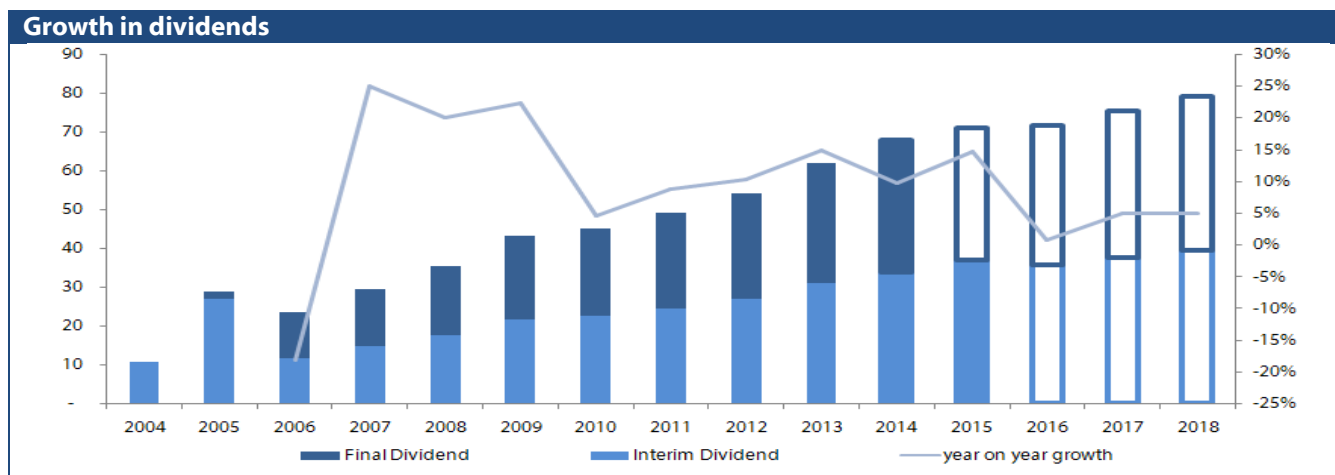
The JV is likely to become less beneficial to NBS as volumes continue to be migrated to SA, and the JV remains borderline-profitable. However, the loss of market share in South Africa is a very real threat, which threat is likely to ensure that NBS takes great caution when making the decision. That said, the management is stuck very much between a rock, a hard place, as the SAB entrance into the local returnable market may see market share loss and margin compression, while the JV dynamics in South Africa are unlikely to well serve NBS and volume migration to Sedibeng will negatively impact NBS's top line.

Gaining a share of Sedibeng was critical to the JV's success from an NBL perspective in our view, and after that deal fell through, our optimism as to the JV declined significantly.



Dividends

The interim results reflect a stable operational performance with operating profit up 6.3% y/y, with the move in RTD volumes forming a drag on performance. Basic EPS fell 25.2% y/y to 61.7c, after an impairment of N\$87.6m to its investment in DHN Drinks (Pty) Ltd was recorded. HEPS, however, is up 5.6% from 98.7c to 104.2c. The board declared an interim dividend of 37cps, up 8.8% on the same period last year, with last day to trade cum 17 April 2015. Our dividend forecast is a function of net profit adjusted for the equity loss from the JV.



Valuation

We value NBS using the dividend discount model, with the required rate of return of 13.0%, based on a risk free rate of 8.51% (GC24), equity risk premium of 4.5% and a beta of 1.0, and a long-term sustainable growth rate of 9.5%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N\$16.67 per share.

Using a justified PE multiple of 14.0x, however, we forecast a target price for NBS of N\$18.80 per share. This implies an expected total return of -2.7% over the next twelve months, as we are concerned as to the effect SAB will have on the company's market share going forward as well as the losses being carried as a result of the JV, therefore we change our **HOLD** recommendation to a **SELL**.

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