



NAMIBIA BREWERIES LIMITED
1H16 Results Review
APRIL 2016

Namibia Breweries Ltd	Target Price (c)	2450
1H16 Results Review	Current Price (c)	2393

Year End 30 June	2013	2014	2015	F2016	F2017	Recommendation	HOLD
Revenue (N\$m)	2,383	2,316	2,434	2,536	2,609	NSX Code	NBS
Operating Profit	500	451	506	552	569	Market Cap (N\$m)	4,711
HEPS (c)	178	159	187	193	202	Shares in Issue (m)	207
HEPU growth (%)	18.9	-10.5	17.6	3.0	5.0	Free float (%)	50
PE	12.8	22.9	12.2	11.8	11.3	P/B (x)	2.7
DPS (c)	62	68	74	80	85	52 week high	2281
DY	2.7	3.0	3.2	3.5	3.7	52 week low	2015
EV/EBITDA	11.1	12.3	11.0	10.1	10.0	Expected Total Return (%)	5.3

Source: BVN, IJG

1H16 Results

Namibia Breweries (NBS) released results for the first half of the 2016 financial year ended 31 December 2015. Sales of goods for the period decreased 3.5% or N\$45.1 million to N\$1.306 billion compared to 1H15, mainly due to production volume migrated to South Africa, however, royalty income received by NBS only increased by N\$7.9 million. What is promising though, is the fact that the loss from the JV has more than halved from N\$87.7 million in 1H15 to N\$40.8 million. Operating profit rose 5.4% y/y as raw materials & consumables and railage & transport were reduced by 18.9% and 17.3% respectively on the back of lower volumes being produced locally. Basic EPS increased 37.9% y/y to 84.4c and HEPS is up 6.3% from 104.2c to 110.8c. The board of directors declared an interim dividend of 40cps, up 8.1% on the 37cps last year, increasing the pay-out ratio from 35.5% to 36.1%.

Local Sales and Volumes

NBS managed to increase local sales volumes with new products being launched and the acquisition of Aquasplash from Namibia Dairies during the period, however, export sales declined with the migration of production to Sedibeng Brewery. Locally, sales volumes continued to increase on the back of beer sales, which was led by Tafel Lager and Windhoek Draught. RTDs decreased 17.0% on the comparable period and given the fact that RTDs are generally a lower margin business than the core, beer, business, the migration of RTD volumes to South Africa lead to an increase in the operating margin and cushioned the blow on the bottom line.

Revenue per Category	1H15	1H16	y/y % Δ
Beer	1,243,561	1,200,194	-3.5%
Softs	78,872	77,232	-2.1%
RTDs	17,242	14,304	-17.0%
Water	-	8,845	-
Other	3,755	5,580	48.6%
Total	1,343,430	1,306,155	-2.8%

Export Markets

Total volumes produced by NBS and sold to Heineken SA and DHN Drinks, its largest single customer, decreased significantly, down 91.4% and 43.6% respectively, while no sales are further made to Diageo since the restructuring. This resulted in the value of export sales to South Africa to decrease 45.3%.

Export Sales	1H15	1H16	y/y % Δ
DHN Drinks	538,661,000	303,731,000	-43.6%
Heineken SA	19,813,000	1,695,000	-91.4%
Diageo SA	-	-	-
Total	558,474,000	305,426,000	-45.3%

Export sales to South Africa declined as a percentage of total sales of goods, falling to 23.4% from 41.6% a year ago. This was due to the continuous migration of volumes from Namibia to Sedibeng in South Africa. This means that the local market once again gains greater importance to the company from a revenue and profit perspective.

Total export volumes sold, excluding South Africa, contributes about 5% of total volumes sold. According to management China and Mozambique remain a challenge, however Zimbabwe and Swaziland's volume contributions continued to grow. Slow economic growth and devaluation of currencies continue to put pressure on volumes in Zambia, while Tanzania's volume growth remained stable compared to 1H15. Total beer and soft drinks volumes sold to export markets decreased by 21.0% and 46.0% respectively compared to 1H15.

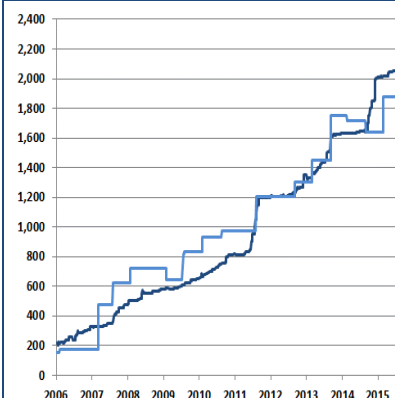
Sedibeng Brewery

On 1 December 2015 NBS acquired 25% of the issued share capital of Sedibeng Brewing (Pty) Ltd and an additional 9.5% of the issued share capital of DHN Drinks (Pty) Ltd from Diageo Highlands Holdings. The total investment amounted to N\$592.3 million, which was financed out of operations and by way of medium term loans from Standard Bank and RMB. This will need to be repaid over the next 5 years, with NBS enjoying a payment holiday of one year. The loan will be partially amortised over the period, with a balloon payment at the end of the loan period. Interest bearing loans and borrowings increased from N\$13.8 million at the end of FY15 to N\$613.3 million at the end of 1H16, increasing the gearing ratio from 12% to 54%.

Valuation

We use a dividend discount model to assess the intrinsic value of the company. Our required rate of return, of 13.2%, is based on a risk free rate of 9.3%, equity risk premium of 2.7%, a beta of 1.0, and a long-term sustainable growth rate of 9%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N\$17.04 per share.

However, we forecast **FY16 earnings of 192.6 cents per share** and calculate a **target price of N\$24.50 per share** based on a **justified PE ratio of 12.7x**. This implies an expected total return of 5.3% over the next twelve months. Generally, we are notably more optimistic as to the future of the company following the restructuring of the JV and after NBS gained a share of the Sedibeng Brewery, which was critical to the JV's success from an NBS perspective. We remain cautious as to the effect SAB will have on the company's market share domestically going forward, as well as the impact of the potential water challenges the company may experience in FY17 and FY18. Therefore, we maintain our recommendation on **HOLD**.

NBS Share Price vs Target Price**Dividends**

Notice is hereby given that a final dividend of 37 cents per ordinary share was declared for the period ended 30 June 2015.

• Last day to trade cum dividend was 23 October 2015

• First day to trade ex-dividend was 26 October 2015

• Payment date: 13 November 2015

Analyst

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Key Points

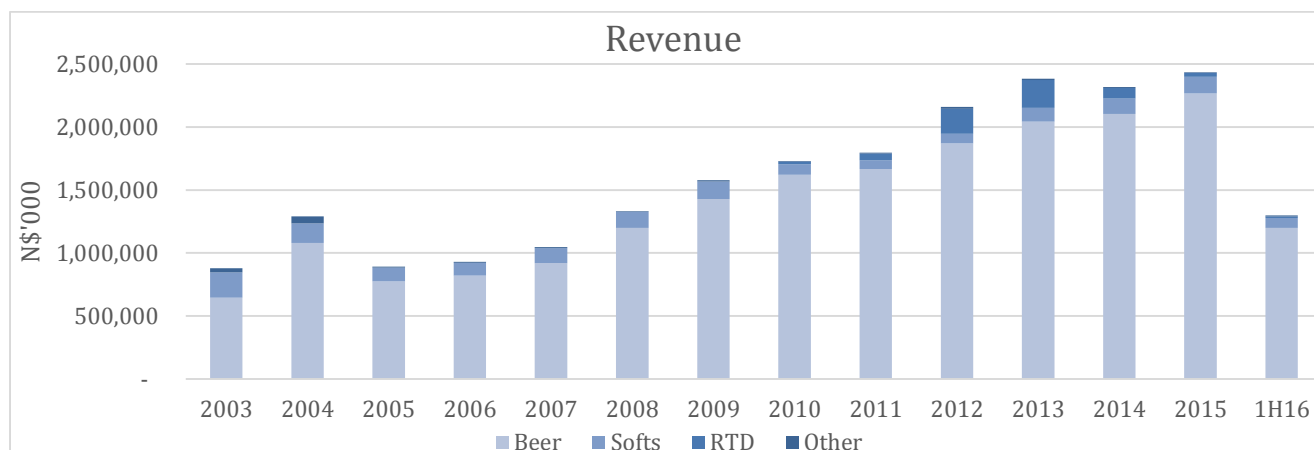
- On 1 December 2015, Heineken, Diageo plc and The Ohlthaver & List Group of Companies, the controlling shareholder of NBS, have completed the restructuring of their respective joint venture operations in South Africa and Namibia.
- Gaining a share of the Sedibeng Brewery was critical to the JV's success from an NBS perspective and after the announcement of the deal, our optimism as to the JV improved significantly.
- As NBS now owns a share in the brewery, the company will share in the profit or loss made by the brewery itself, rather than simply absorb a share of the losses from the marketing and distribution JV. As NBS and Heineken now both have ownership in the brewery and marketing venture, interest are aligned, or in the favour of NBS, for the first time with regards to the entity in which profits from SA based operations are made.
- While we believe the JV transaction will be highly beneficial to the company in the long term, the financing of the deal does add pressure on the short-term finances of NBS, with significantly higher leverage.
- The poor rainfall seasons over the last three years resulted in the lack of water inflows into the key national dams that supply the central region with water, mean that the City of Windhoek may experience a water crisis in near future. Should water shortages result in restrictions on use in Windhoek, NBS is likely to experience challenges with regards to beer production at the local plant.
- Management is implementing different opportunities to save water and has indicated that the company's water shortage mitigation plan includes the drilling of additional boreholes and investing in a water reclamation and pre-treatment plant. The City of Windhoek has requested NBS to save up to 30% of water usage. However, with the planned initiatives, the company should achieve 70% self-sufficiency by mid-2016.
- Together with the water savings plans, NBS has a volume migration plan in place, to move more production volumes to the Sedibeng Brewery in South Africa if faced with a water crisis.



Operational Performance

Total Revenue

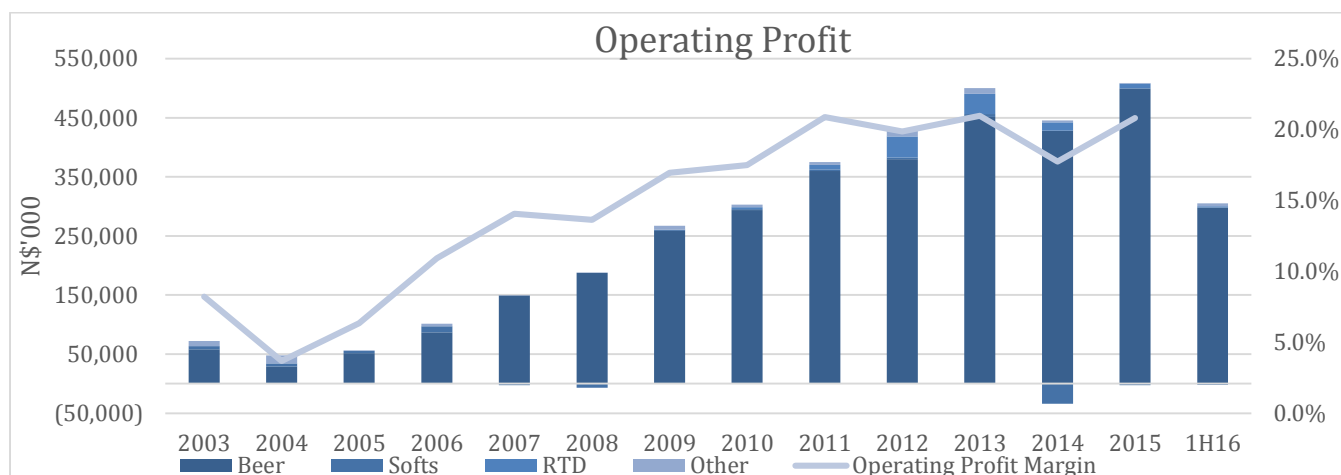
Namibia Breweries reported revenue of N\$1.306 billion in 1H16, down 2.8% compared to 1H15. The decrease in revenue is attributed to a 3.5% or N\$45.1 million decrease in sale of goods totalling N\$1.256 billion, mainly due to production volume migrated to the Sedibeng Brewery in South Africa. The decrease in revenue was slightly offset by royalty income received by NBS, which increased by 19.1% year on year to N\$49.7 million. Royalties only contributed 3.8% to total revenue, nonetheless, up from 3.1% in corresponding period.



Source: NBS

Operating Profits

NBS managed to increase operating profit during the first half of the year to N\$307.5 million, up 5.4% from N\$291.6 in 1H15. The operating margin widened 184 basis points from 21.7% in 1H15 to 23.5% in 1H16 and compares to profit margin of 20.8% for FY15. The better performance is a function of a decrease in operating expenses as raw material costs, consumables and transport costs were reduced significantly with the migration of volumes from the local plant to the Sedibeng Brewery in South Africa, sharing the low margins that the export business has been running on. Performance was offset to some extent by the weaker local currency.



Source: NBS

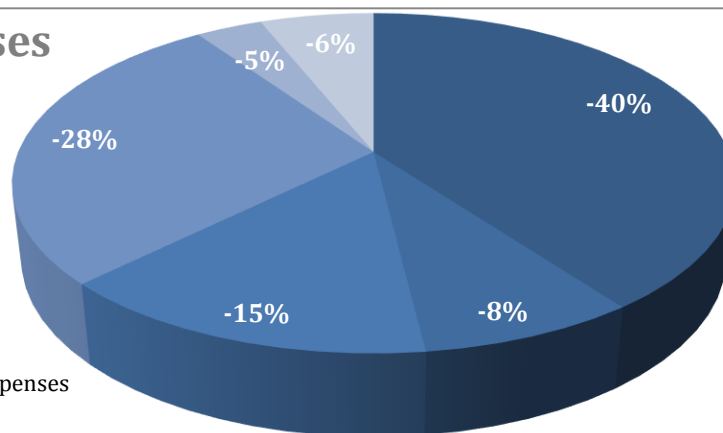
Operational Expenses

Total operating expenses shrunk 5.1% from N\$1.052 billion in 1H15 to below the billion dollar mark in the current reporting period. Raw materials and consumables, which contributed 39.8% of total operating expenses, decreased by almost N\$100 million or 18.9% year on year to N\$397.8 million as lower volumes were produced locally. However, due to the weaker Namibian Dollar against the Euro, the cost of importing raw materials, such as barley and malt, resulted in a drag on margins. Railage and transport costs also decreased as less products, which had to be transported to South Africa, were produced locally. The production of these products were moved to the Sedibeng Brewery in South Africa. On the other hand, employment costs, contributing 14.6% of total costs, increased by 9.7% and administration and marketing expenses, contributing 27.7%, increased 12.8%, while repairs and maintenance increased 16.8% from last year, but only contributes 3.6% of total operating expenses.



Operating Expenses

- Raw materials and consumables
- Railage and transport
- Employment Costs
- Administration and Marketing expenses
- Repairs and Maintenance
- Depreciation



Source: NBS

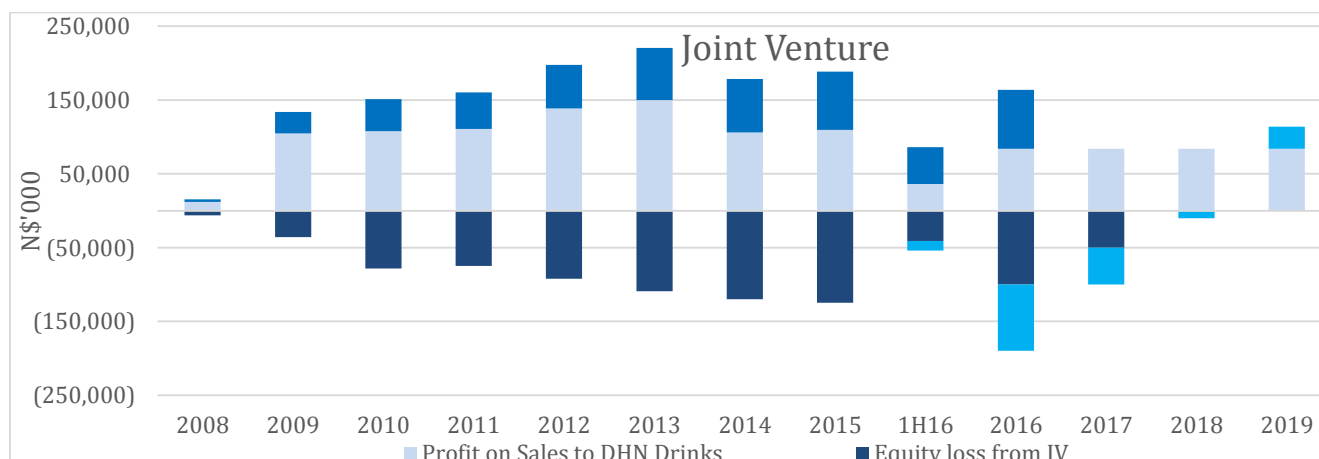
Equity loss from associate and JV

Volumes produced by NBS at the local plant and sold to the DHN Drinks joint venture (JV) in South Africa decreased in 1H16, down 43.6% compared to 1H15. This decrease was largely on account of volume migration, with these volumes now being produced directly at Sedibeng Brewery, rather than being produced in Namibia and transported to South Africa. According to management, this is in line with the volume migration plan, together with the fact that Diageo has sold out of the JV. Management indicated that according to the JV's agreement, migration of volumes to the Sedibeng Brewery has reached the desired level and comes to an end by FY16. Therefore, we should not see the NBS sales to the JV decrease any further beyond FY16.

However, as the restructuring of the joint venture between Heineken, Diageo and O&L have been completed, NBS now holds a 25% stake in DHN Drinks and a 25% stake in the Sedibeng Brewery with Heineken holding a 75% stake in both entities. Therefore, NBS now shares in 25% of profits and/or losses from the JV and the Sedibeng Brewery going forward. NBS reported a N\$40.8 million equity loss from the JV and a N\$13.2 million equity loss from the associate as at the end of 1H16, with the equity loss from associate only accounted for in the financials for one month given the fact that the deal was completed on 1 December 2015.

The equity loss from the JV decreased significantly from N\$87.7 million in 1H15, to N\$40.8 million as at 1H16, down 53.4%. Although the JV still shows a loss, taking into account royalties and production margins that NBS earn through selling to the JV directly from their Namibian brewery, NBS continue to make positive returns from the ongoing operations in South Africa. According to management, the impact of the acquisition resulted in a 37.0% reduction in losses attributable to the associate with Sedibeng contributing N\$21 million in profit.

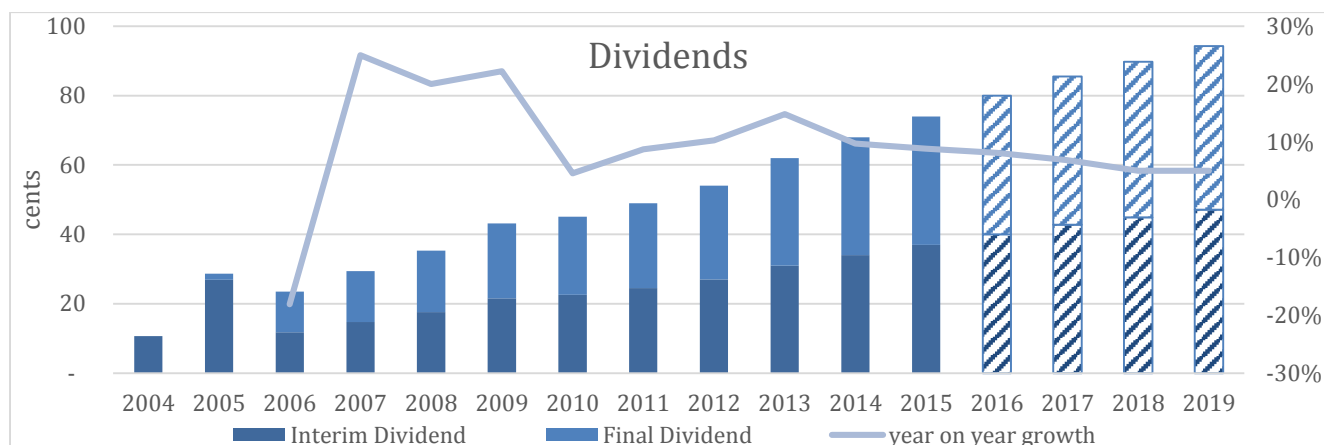
As a result of this acquisition, NBS is expected to achieve synergies and streamline costs as the focus is now primarily on beer, rather than spirits as was the case in the previous structure. At the results presentation, management indicated that the JV is expected to start breaking even within the next six months. However, in our forecasts, we incorporated a breakeven point for the JV by the end of FY17 as we believe the profit from the sales of products to the JV will not be sufficient to offset the equity loss from associate and JV given the decrease in volumes produced locally and the potential costs required for the transition to the new JV business. We do, however, estimate the JV to reflect profits as of FY19 when the JV achieved synergies and streamlined the cost structures.



Source: NBS

Earnings and Dividends

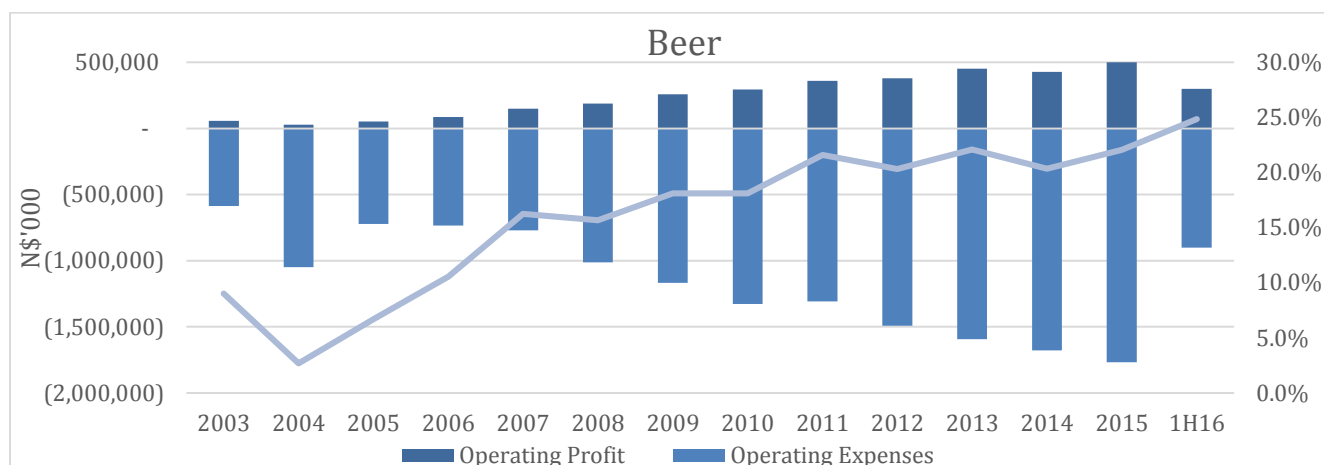
The interim results reflect a stable operational performance with operating profit up 5.4% year on year to N\$307.5 million, while profit for the year increased notably, up 37.1% to N\$174.6 million as the equity loss on the JV decreased by 53.4%. Basic EPS rose 37.9% year on year to 84.4 cents, while HEPS is up 6.3% from 104.2 cents in 1H15 to 110.8 cents. The board of directors declared an interim dividend of 40 cents per share, up 8.1% on the corresponding period in 2015, with last day to trade cum dividend 22 April 2016 and payment date 13 May 2016. Going forward we expect dividends of 80 cents per share in FY16 and increasing to 85 and 90 cents per share for FY17 and FY18, respectively. Our dividend forecast is a function of net profit adjusted for the equity loss from the JV. Given the developments regarding a shareholding in the Sedibeng brewery, we expect to see the JV losses decreasing significantly over the next two years, which should provide increased support for the NBS bottom line.



Portfolio Analysis

Beer

From a segmental perspective, beer continues to be the most significant contributor to revenue, making up 91.1% of total revenue in 1H16, slightly down from 1H15. This was largely due to the recently acquisition of Aquasplash with sales of water taking up some space. Another reason for this decrease was that in 1H16, beer revenue fell 3.5%, which was mainly due production volume moved to the Sedibeng Brewery. Locally, beers sales continued to perform well, increasing by 8.0% year on year with Tafel Lager outperforming within the beer portfolio as it remains the biggest mainstream brand in Namibia. Tafel lager contributes 51.0% of total beer volume. According to management, the Windhoek draught and Windhoek Lager sales, contributing significantly to the overall growth in volumes. The launch of new products, such as King Lager and additions made to Craft Beer portfolio complimented volume growth.



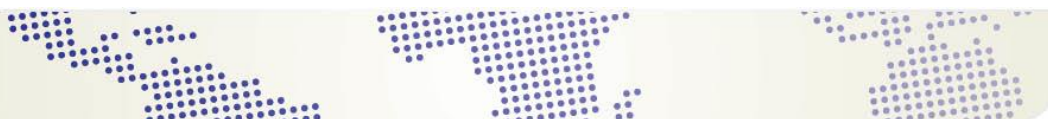
King Lager

During the period under review, NBS introduced its latest innovation, King Lager, to the portfolio of beer brands. King Lager is the Namibia's first beer brand that contains locally-grown barley. The barley used to produce King Lager is harvested at Otavifontein and Shadikongoro farm in the far north of Namibia.

Following the extensive barley trials to explore the establishment of a local barley industry, NBS announced the conclusion of a smart partnership with the Ministry of Agriculture, Water and Forestry as well as AgriBusDev, to grow barley at the Green-schemes in Namibia. According to management, this initiative and partnership which is aimed at adding value to Namibia in support of the 'Growth at Home' strategy in particular will create a local barley supply chain in Namibia that benefits each member of the chain, as well as the Government and the community as a whole.

The idea behind King Lager is to create a market for locally produced barley and encourage more farmers to plant barley. NBS buys from approved suppliers and supports the farmers with the knowledge gained during the trials. NBS currently imports 40,000 tons of malted barley per annum, mainly from Europe. The company aims to harvest at least 12,000 ha of barley per annum within the next ten years. It needs to be noted that NBS imports malted barley as a key ingredient for its current beer brands, while King Lager is made with un-malted barley. According to management, the viability of establishing a new malting plant only makes sense once the goal of harvesting 12,000 hectares of barley have been reached.

At this stage King Lager is only available to the Namibian market and an extensive marketing campaign has been launched to establish the brand locally before exploring opportunities for the brand outside Namibia. The King Lager has an Alcohol By Volume (ABV) of 5.5%, and is intended as a Black Label counterpart. Management noted that it has had not had a cannibalism effect on its own portfolio of beer. Since commencement of the barley trials almost five years ago, NBS has so far invested more than N\$5 million in the barley project for trial planning, execution, seeds, laboratory and brewing trials, as well as shipments and logistics. This amount excludes the product innovation work that has gone into developing the new brand.



Amstel Lite

As part of the premium portfolio, NBS added Amstel Lite to its team when it was officially launched in Namibia on 13 July 2015. At 4% ABV, the Amstel Lite is lower in alcohol and calories than Amstel Lager.

However, SAB Miller, manufacturer of Castle Lite, had complained to the Advertising Standards of Authority of South Africa (ASA) that the silver and green that Brandhouse Beverages, local manufacturers of Amstel Lager, used for its Amstel Lite cans was almost identical to the signature combination in the Castle Lite packaging. SAB also complained that Brandhouse had used the word "Lite" rather than "Light" prominently below the logo.

The ASA agreed with SAB. It found that, as a result of SAB's extensive and consistent usage of its get-up, it had acquired "advertising goodwill" in the packaging, specifically its six-pack shrink wrapping and its can. It held that SAB's advertising goodwill had been diminished and exploited, and that clause 8 of section II of the ASA Code had been contravened. The ASA ruled that the Amstel Lite packaging had to be removed within three weeks.

After the ruling, Brandhouse lodged an appeal to the Advertising Industry Tribunal (AIT). But, in order to ensure that the order that it remove its packaging was suspended, it also approached the ASA's highest appeal authority, the Final Appeals Committee (FAC), for an order suspending the order of the Directorate pending the appeal to the AIT. Judge Ngoepe of the FAC concluded that the FAC did not have the authority to make such a ruling. So, Brandhouse approached the Gauteng High Court, where Judge Bertelsmann ruled that the FAC did have the power to grant a suspension of the ASA's ruling pending the appeal to the AIT and Judge Bertelsmann himself ordered such a suspension.

The decision of the AIT has now been handed down and the appeal related to specific issues only. These included whether the Amstel Lite shrink wrapping and can contravene the ASA Code. The AIT said that Brandhouse had admitted that it had designed the Amstel Lite packaging with Castle Lite in mind, but that it had sought to distinguish the product from the market leader. The AIT felt that Brandhouse had succeeded in its quest, certainly insofar as the can was concerned. The AIT pointed, for example, to the fact that the companies used different fonts and colours for the word "Lite". But, most importantly, the Castle Lite can had a blue-coloured temperature indicator around the top of it, something that Amstel Lite does not have.

The AIT did however point out that both the Castle Lite and the Amstel Lite wrappings is very similar as both are predominantly silver. The wrap covers the bottles and the actual product can only be seen from the side. Placed side-by-side, it is highly likely that a reasonable consumer would be confused between the two products given the fact that, the distinctive blue temperature indicator on the Castle Lite bottle is, because of its positioning, naturally covered by the wrapping..

This meant that Brandhouse did not have to make any changes to the design of Amstel Lite bottle or can, however, it was required to withdraw the shrink wrapping.



Craft Beer

Camelthorn

NBS officially started producing the Camelthorn Weizen beer in June 2014, after the Namibian Competition Commission approved the takeover of struggling start-up micro brewer, Camelthorn Brewing, in January 2014. The approval was without conditions as the merger is not likely to give rise to anti-competitive concerns in view of the significance of NBS in the Namibian beer market. The Commission also considered the fact that Camelthorn was facing financial difficulty, and based on the evaluation of it being determined a failed undertaking, it resolved to approve the merger without conditions.

While Camelthorn Weizen is also brewed according to the strict Reinheitsgebot brewing standards, it differs from the current NBS beers as it is not a lager beer, because it contains wheat and malt. Camelthorn Weizen is Namibia's first locally brewed, premium weiss beer, with an ABV of 4.5 %.The weiss beer is available in bars on tap as well as in 330ml bottles.

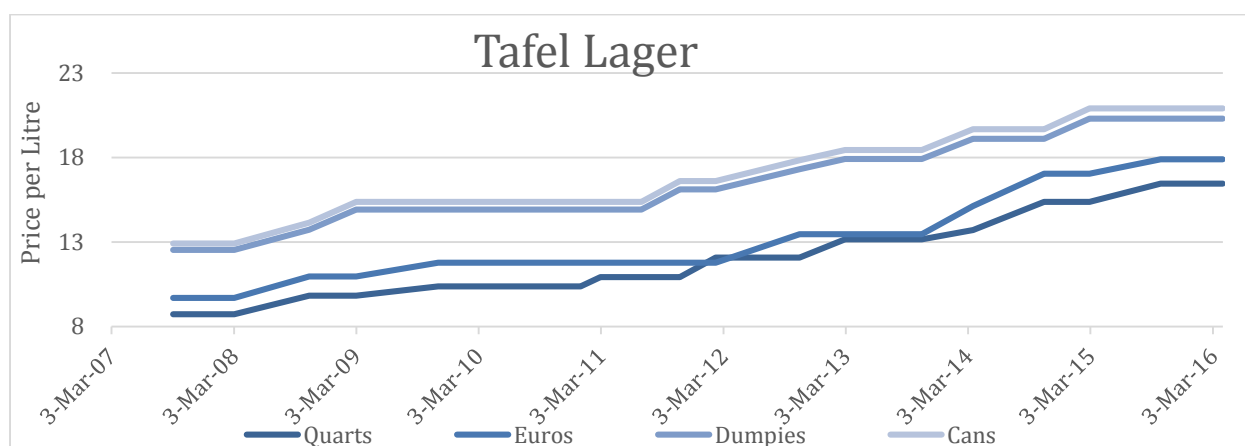
Stellenbrau

NBS expanded its craft beer portfolio during the period under review by adding two of Stellenbrau's products. Stellenbrau's Craven Craft Lager and Jonkers Weiss, with an ABV of 4,5%, is now also brewed by Namibia Breweries in Windhoek. In our view, to capture growth above the generic growth in the beer market, especially in the Namibian market, the introduction of new products, such as King Lager and Stellenbrau, is crucial.



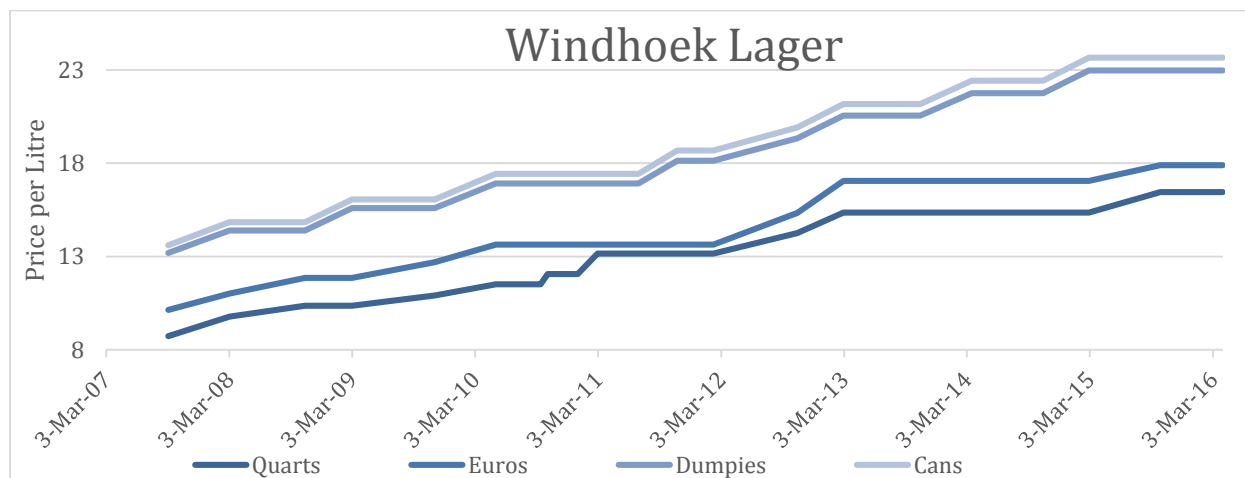
Beer Pricing and Competition

Price changes by Namibia Breweries and SABMiller Namibia are usually released twice a year, effective March and October. Over the past few years, we have witnessed that Castle Brewing Namibia has been setting higher prices and NBS has been following these increases, however, NBS took the lead during 1H16 with no price changes from Castle Brewing Namibia in October 2015. According to our latest price list, effective 1 October 2015, the price of Tafel Lager Euros was increased by 5.0%, the Tafel Lager Quarts, by 7.1%. As at the end of March this year, new price lists have not been released by NBS nor Castle Brewing Namibia.



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

The price of Windhoek Lager Euros was also increased by 5.0%, the Windhoek Lager Quarts, by 7.1%, while the price of Windhoek Lager Dumpies and Cans were increased in March last year by 5.6%. Interesting to note is that the recommended selling price of Quarts for Windhoek Lager, Windhoek Draught and Tafel Lager are the same as of March last year, with the price increased to N\$16.46 per litre in October 2015 from N\$14.00 per litre in March. This follows the consumer migration away from Windhoek Lager to the previously cheaper Tafel Lager.



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

The strategic pricing of the brands in the main stream segment of the market, together with the Windhoek Brand marketing, management noted that Windhoek volumes stabilised after the decline in volumes seen due to this migration to Tafel Lager.

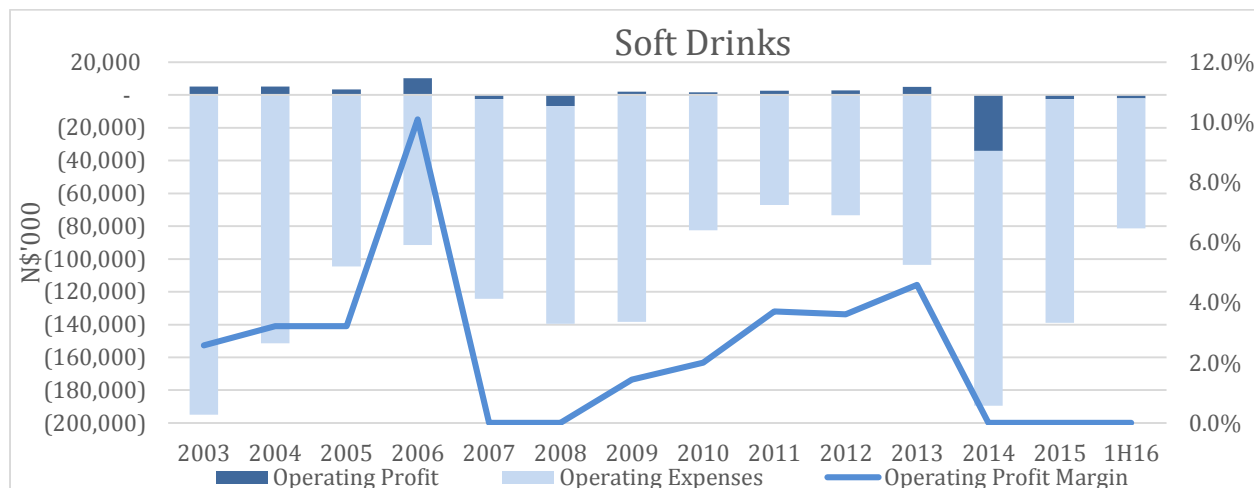
Castle Lager and Black Label are still more expensive than the Windhoek Lager and Tafel Lager comparable ranges. Given the price sensitivity of the mainstream segment of the Namibian beer market, one can expect to see Tafel Lager and Windhoek Lager continue to outperform Castle Lager and Black Label over the near-term, however whether this will remain the case long term remains to be seen. Given the fact that Anheuser-Busch InBev has reached a final agreement for the £71 billion takeover of SABMiller, one might see that with aligning of strategies between AB Inbev and SAB, Castel Brewery might be more aggressive in an attempt to capture market share in Namibia. On the other hand, the brewery in Okahandja might not be able to meet profit targets if prices are lowered given the high fixed costs already incurred and the relatively small size of the brewery. Moreover, the company is likely to be cautious when it comes to destroying the local profit pool by starting a price war. The AB Inbev and SAB deal is expected to be completed in the second half of 2016. 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.

	Windhoek Lager		Tafel Lager		Black Label & Castle Lager	
	N\$ per litre	% change	N\$ per litre	% change	N\$ per litre	% change
Quarts	16.46	0.0%	16.46	0.0%	17.18	0.0%
Euro	17.90	0.0%	17.90	0.0%		
Dumpies	20.29	0.0%	22.97	0.0%	23.88	0.0%

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

Soft Drinks

Soft drinks delivered a poor performance over the period under review, with revenue down 2.1% as export sales of soft drinks fell 46.0% year on year. Soft drinks contributed 5.9% to total revenue, unchanged from 1H15. The poor performance of this segment resulted in an operational loss of N\$2.1 million, down 152.2% from a profit of N\$4.0 million reported for 1H15. Soft drink sales saw double digit growth in the local market compared to the prior 1H15 with Vigo having rooted itself in the premium soft drink market, with a third variant of Vigo that was released during 1H16. NBS extended Mckane's current offering by adding Lemonade to the mix with some design changes to Soda Water and Tonic Water products.



Source: NBS

Ready To Drink

Revenue from the ready to drink products or RTD's, declined 17.0% and contributed less to overall revenue than in 1H15, with 1.1% of total revenue attributed to RTDs. The decline in RTD revenue is on the back of a transfer of volumes to Sedibeng Brewery in South Africa. Operating profit from the RTD range decreased 58.4% to N\$2.5 million and contributed less than 1% to total operating profit. The profit margin of RTD's also fell significantly to 17.1% in 1H16, down from 34.2% in 1H15 and compares to 27.9% for FY15.



Source: NBS

Water

NBS started trading in the mainstream water category through the acquisition of Aquasplash from Namibia Dairies (Pty) Ltd, which is owned by Ohlthaver and List Group, during this period. Revenue generated by the water segment of the portfolio, totalled N\$8.8 million in 1H16, with an accompanying operating profit of N\$4.3 million, contributing 0.7% and 1.4% of total revenue and operating profit, respectively. The operating profit margin reported for this segment was 48.6% in 1H16.

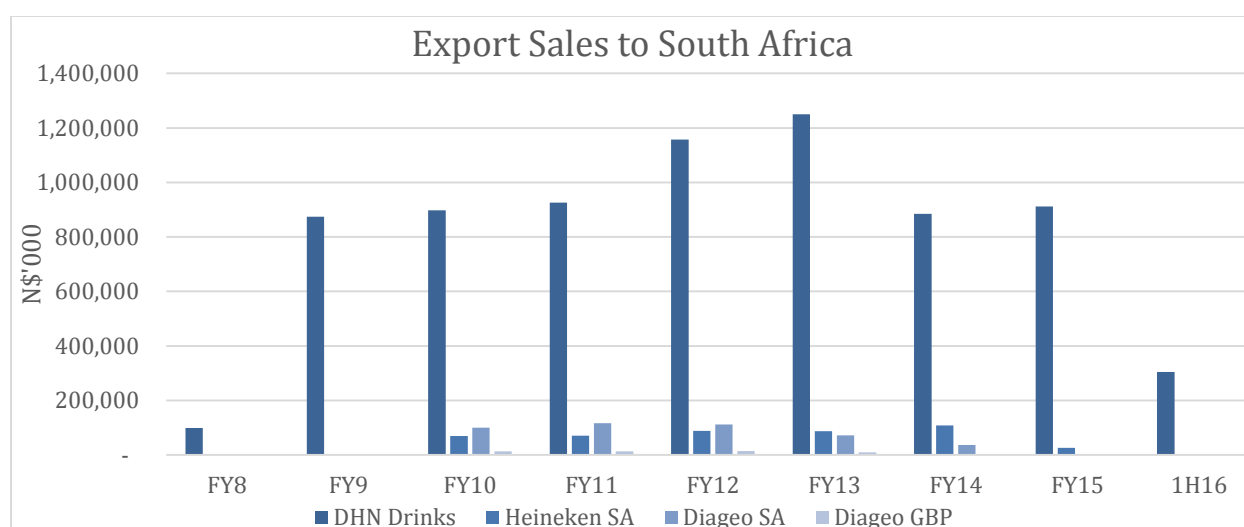


Export Markets

South Africa Export Sales	1H15	1H16	y/y % Δ
DHN Drinks	538,661,000	303,731,000	-43.6%
Heineken SA	19,813,000	1,695,000	-91.4%
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Export Sales	558,474,000	305,426,000	-45.3%

Source: NBS

Volumes produced by NBS at the local plant and sold to the DHN Drinks joint venture and Heineken SA decreased 45.3% or N\$250.0 million when compared to 1H15. This decrease was largely on account of volume migration, with these volumes now being produced directly at Sedibeng Brewery, rather than being produced in Namibia and transported to South Africa. According to management, this is in line with the volume migration plan, together with the fact that Diageo has sold out of the JV. Management indicated that according to the JV's agreement, migration of volumes to the Sedibeng Brewery has reached the desired level and comes to an end by FY16. Therefore, we should not see the export sales to South Africa decrease any further beyond FY16. Export sales to South Africa 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 23.4% of total sales, down from 41.6% a year ago.



Source: NBS

Export sales, excluding South Africa, make up approximately 5.0% of total sales. NBS indicated that other export markets showed a mixed performance in 1H16, noting increased competition within the SADC markets. Total beer volumes exported to Tanzania increased compared to the previous year, with volumes doubled year on year for the third consecutive year. Issues regarding illegal cross-border trading of NBS products to Tanzania have also been addressed to a large extent. Volumes sold to Mozambique, however, slowed down with brand competition challenges, while growth in Botswana managed to halt the decline in volumes through pack renovation and competitive pricing which was implemented during the period under review. Zambia remains a challenge given the slow economic growth and devaluation of the Zambian Kwacha.



Sedibeng Breweries and DHN Drinks JV

The Deal

On 1 December 2015, Heineken, Diageo plc and The Ohlthaver & List Group of Companies, the controlling shareholder of NBS, have completed the restructuring of their respective joint venture operations in South Africa and Namibia. The closing of the transaction follows the fulfilment of all conditions precedent as agreed on 28 July 2015, when the intention to restructure the joint ventures was announced.

In South Africa, NBS now holds a 25% stake in DHN Drinks (Pty) Limited ("DHN") and a 25% stake in Sedibeng (Pty) Limited ("Sedibeng") with Heineken holding a 75% stake in both entities. In Namibia, Heineken now indirectly holds a 29.9% stake in NBS. As part of the restructuring, Diageo sold its 15% indirect shareholding in NBS to Heineken, increasing Heineken's indirect ownership to 29.9%. O&L still owns its 30.1% indirect stake with the balance being owned by local shareholders. Further, Diageo acquired the remaining shares it did not already own in Brandhouse Beverages (Pty) Ltd (brandhouse), the beer and spirits sales and marketing joint venture in South Africa. Brandhouse was the 50/50 distribution and cost sharing joint venture between Diageo and DHN Drinks (Pty) Limited (DHN). DHN is the entity which holds the licenses for the combined beer, RTD and cider portfolio. %.

NBS paid a total net cash consideration of N\$592.3 million to Diageo for the equity and debt positions it acquired in Sedibeng and DHN. Diageo received a total net cash consideration of N\$2.5 billion after Heineken paid a total net cash consideration of approximately N\$1.9 billion to Diageo for the equity and debt positions it acquired in Sedibeng, DHN and NBL.

With effect from 31 December 2015, Sedibeng Brewery (Pty) Ltd sold and transferred its operations as a going concern to DHN Drinks (Pty) Ltd in exchange for the assumption by DHN Drinks (Pty) Ltd of the Sedibeng Brewery (Pty) Ltd liabilities. Sedibeng Brewery (Pty) Ltd distributed the issued shares to Namibia Breweries Limited in proportion to their existing 25% shareholding. The transaction is a non-adjusting post year end event, having been confirmed after the financial year end, but before the financial statements were authorized to be issued. The resulting effects have not been adjusted in the statement of comprehensive income and statement of financial position presented.

New Joint Venture

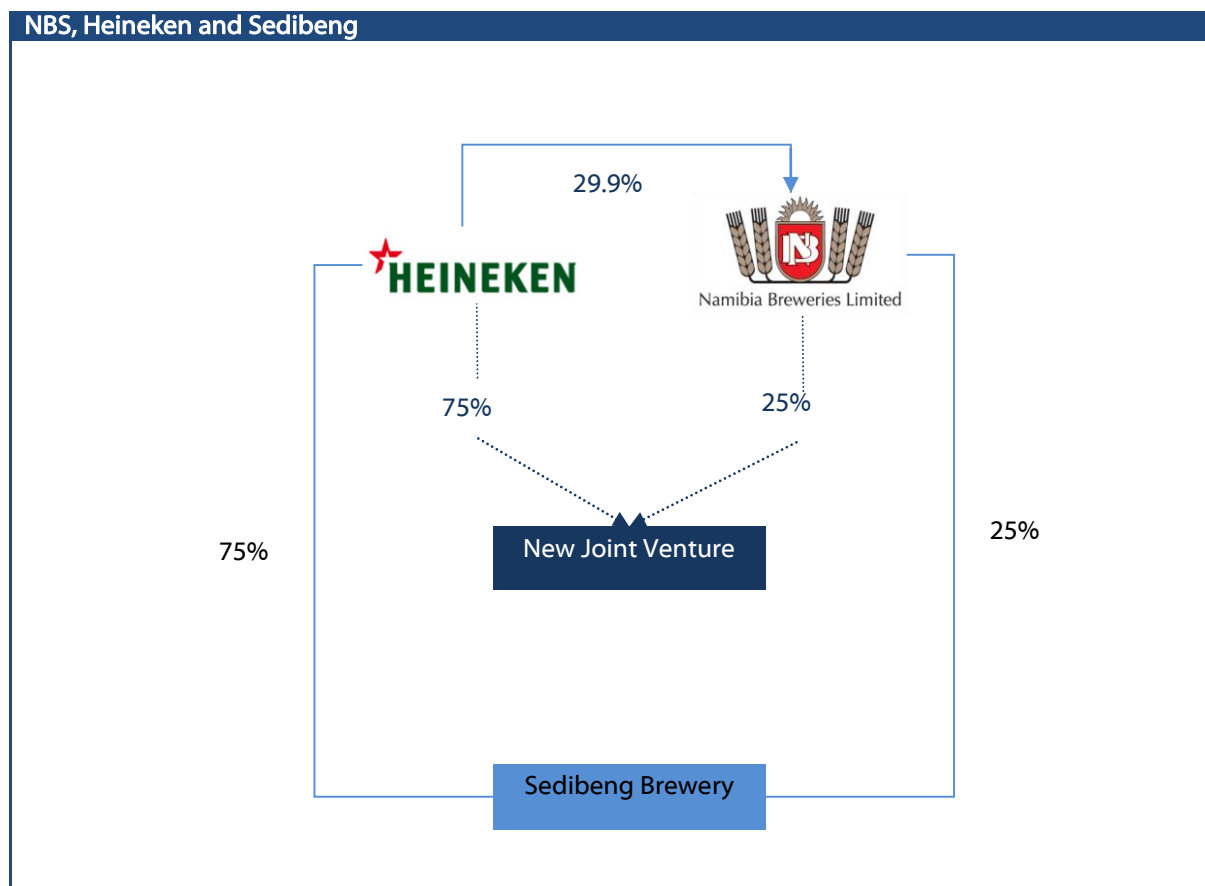
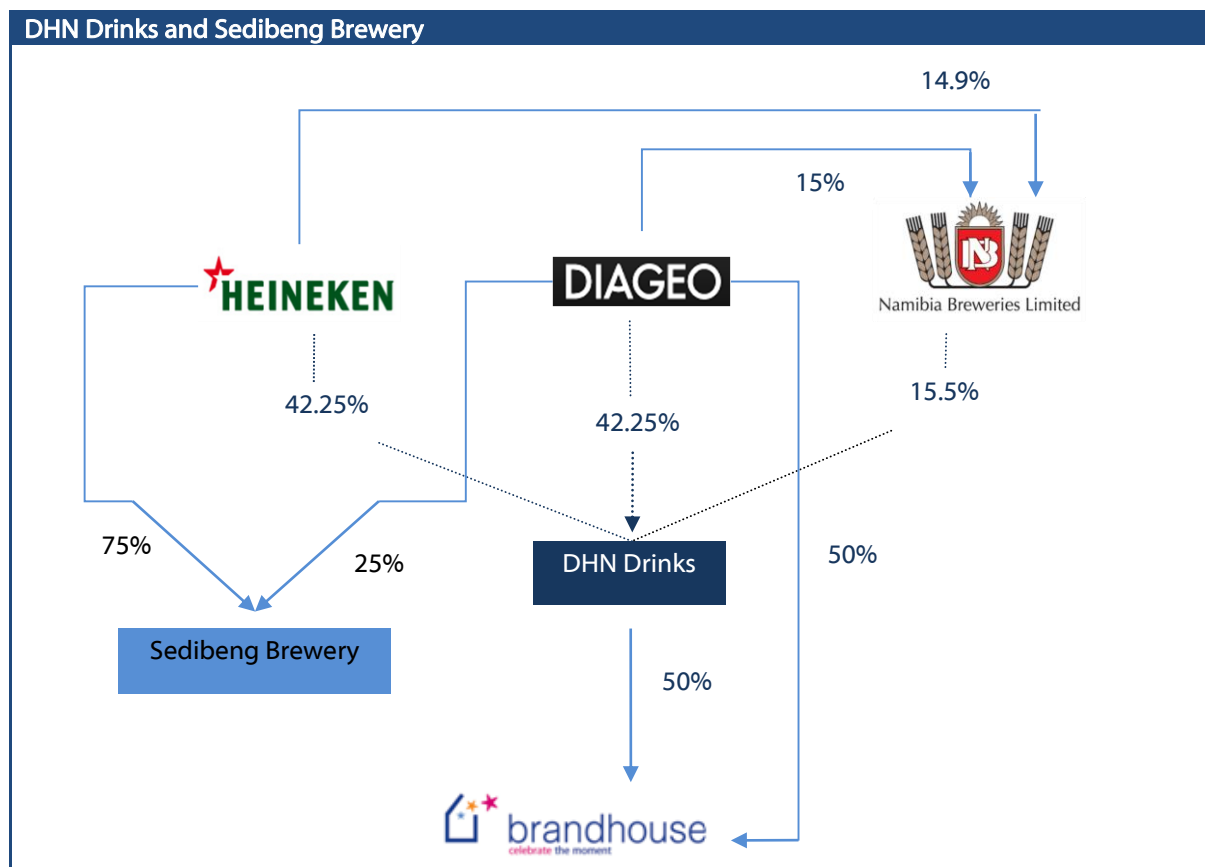
The new NBS and Heineken joint venture in South Africa now focuses on developing the beer portfolio and provides NBS with increased commercial control of its key brands in South Africa. As a result of the transaction and new agreement, the existing joint venture with regards to brandhouse, DHN and the Sedibeng Brewery has been dissolved. During the transition period, brandhouse will continue to operate as normal, and a transition agreement is in place between the three parties to ensure business continuity until Heineken and NBS complete the establishment of a new marketing, sales and distribution business in South Africa.

The Sedibeng facility is built on an 83 hectares site comprising the brewery, production plant and a warehouse managed by brandhouse. The construction began in May 2008, with an initial capacity of three million hectoliters. The brewery was expanded to further increase capacity to 5 million hectolitres. Management indicated that the Sedibeng Brewery is currently operating at approximately 65-70% capacity, which will be increased to 100% in the medium term to achieve the maximum economies of scale, reducing unit costs of production. As we have mentioned in previous reports, gaining a share of the Sedibeng Brewery was critical to the JV's success from an NBL perspective and after the finalisation of the deal, our optimism as to the JV improved significantly.

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, as no glass bottles are manufactured in Namibia, bottles need to be transported to the Windhoek plant from South Africa, only to be filled and then transported back to 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. As NBS now owns a share in the Brewery, this move means that NBS and Heineken benefit from increased volume production and lower average costs at the Sedibeng plant, as well as potential profits in the JV. 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 is expected to change, as production is migrated to the Sedibeng plant. Management indicated that the increased profitability will come close to offsetting this loss in revenue for NBS by FY16 and show positive cash flows as of FY17. 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.





Debt and Finance Costs Implications

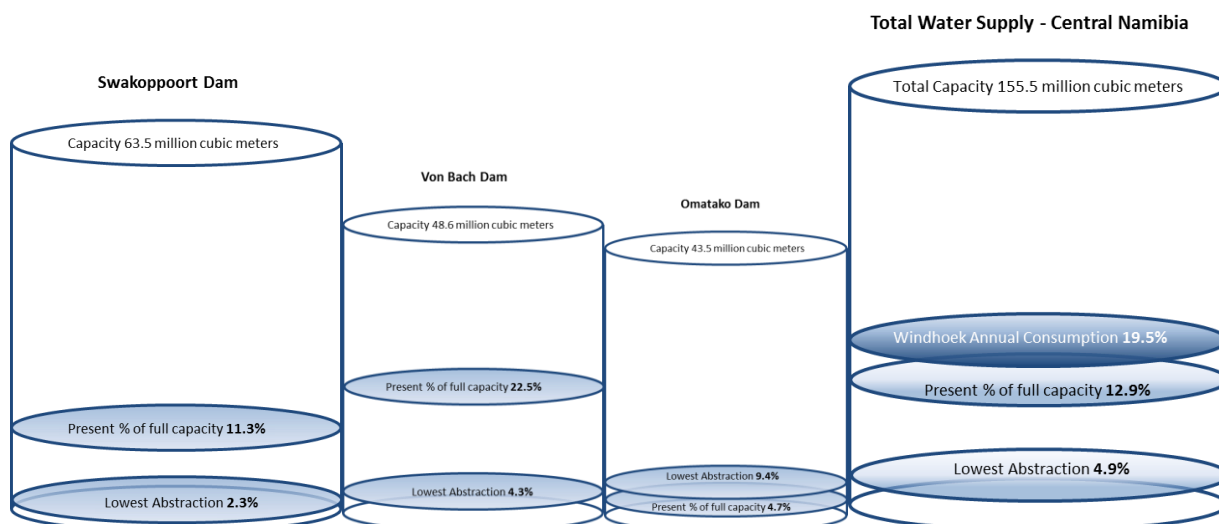
The total consideration paid by NBS to Diageo for shares in Sedibeng and DHN totaled N\$592.3 million, which was previously estimated R610.0 million. NBS raised N\$498.0 million to partly fund operational expenditure and partly fund the acquisition of additional 9.5% in DHN Drinks and 25% in Sedibeng Brewery, resulting in a significant increase in interest bearing borrowings. NBS also utilized available cash (including working capital) to fund a large portion of the deal, while putting in place a loan facility with Standard Bank should the company require working capital for operations. This will ensure that NBS is only paying interest on funds as and when used, rather than on a full loan with working capital reserves sitting idle.

With the unsecured medium term loan of N\$198.7 million and the secured medium term loan amount of N\$400.0 million, interest bearing loans and borrowings increased from N\$8.5 million at the end of 1H15 to N\$613.3 million at the end of 1H16. This meant that the financial leverage for NBS increased significantly, with gearing ratio up from 12% to 54%. RMB funded the N\$400.0 million secured medium term loan with cost of funding of Jibar plus 1.5%. This will result in an estimated increase in costs, through funding charges, of approximately N\$30.0 million annually, however, this excludes the Standard Bank facility. The estimated impact of the increased financial costs on the NBS bottom line show that profits after tax will be roughly 1.0% lower in FY16 and 4.5% lower in FY17. Non-the-less, the deal could potentially unlock significant value with economies of scale presented by the brewery.



Water Restrictions and Water Saving

Poor rainfall seasons over the past three years resulted in limited water inflows into the key national dams that supply the central region of Namibia with water, which means the City of Windhoek runs the risk that the dams may run dry in the fairly near future. Current forecasts suggest that without inflows, by September 2016 all of the key dams providing water to Windhoek will have run dry. According to NamWater, the level of the three dams supplying the central areas with water was between 4% and 22% mid-April 2016.



Source: IJG, NamWater

The Omatako Dam is already below its lowest abstraction level, while the Von Bach Dam outside Okahandja currently holds 10.9 million cubic metres of water, of which only 8.8 million cubic metres can be used before it reaches lowest abstraction level. The Swakoppoort Dam has 7.2 million cubic metres of water, of which 5.7 million cubic metres are usable. Thus, the total water capacity currently stands at 20.1 million cubic meters of which only 12.5 million cubic meters can be used before reaching the lowest abstraction level. Total annual water demand in the central region is approximately 32 million cubic metres, of which 27 million cubic meters are in Windhoek. After September this year, the City of Windhoek and NamWater will only be able to supply about 30% of the required water demand from boreholes, the reclamation plant and the canal from the northern region, should the dams run dry.

NamWater announced on 18 February 2016, that water supply to Windhoek will be cut by 20% in an attempt to postpone dams running dry in September this year to April 2017. Cabinet has also approved a water tariff increase of 10% during the current financial year. NamWater has given no indication as to when the implementation date for the hike will be. Although the decision to increase the tariff was made in March, the minister of communication and technology, Mr Tjekero Tweya, only made announcement on Monday, 11 April 2016. NamWater is only required to give a months' notice before any hike is implemented.

Water shortages and restrictions in Windhoek will directly affect economic activity in Namibia, impacting water dependent industries, such as NBS. The company reported that it uses on average four hectolitres of water to produce one hectolitre of each final product. According to our estimates, they produced about 1.6 million hectolitres of beer per annum, which means that it requires about 6.4 million hectolitres for the year. The firm said if water restrictions are implemented in Namibia, it would have a severe impact on the company as they are heavily reliant on water supply to produce their products.

However, ahead of the possible water crisis in the central areas of the country, management is implementing different opportunities to save water and has indicated that the company's water shortage mitigation plan includes the drilling of additional boreholes and investing in a water reclamation and pre-treatment plant. The City of Windhoek has requested NBS to save up to 30% of water usage. However, with the planned initiatives, the company should achieve 70% self-sufficiency by mid-2016. One on-site borehole has already been drilled, with another one planned near the production site. Management highlighted that these boreholes are not on the main aquifer of Windhoek. The water reclamation plant is expected to be completed by the end of FY16.

Together with the water savings plans, NBS has a volume migration plan in place, to move more production volumes to the Sedibeng Brewery in South Africa if faced with a water crisis. According to management, even though NBS already produce some beer for the South African market, it does not meet the demand of NBS products in South Africa. At the moment products are exported to South Africa, which are produced at the local plant.



NBS produces 1.6 million hectolitres of beer per annum at the Windhoek Brewery, with the total Namibian beer market at approximately 1.3 million hectolitres of which NBS has a market share of 87%. Therefore, approximately 470,000 hectolitres of beer produced locally are exported to South Africa. Given the availability of production capacity at the Sedibeng Brewery, the first 470,000 hectolitres production moved to South Africa will have a minimal cost implication, in fact, with the economies of scale achievable at Sedibeng, this move could prove to be profitable as production costs will be lower than at the Namibian plant, given the size of the Sedibeng Brewery. Transport costs will also be reduced significantly as empty bottles no longer need to be transported to Namibia and then finished products back to South Africa.

Both the water saving strategies and volume migration will come at a cost, however management feels that it would be unethical to continue to produce beer locally, while a large portion of the population is under water restrictions. Therefore, given a scenario where the country is faced with water restrictions, we assume that NBS will move all its production volumes to South Africa. We believe that this will have a serious impact on revenue and cost. As NBS has a 25% stake in the Sedibeng Brewery, it shares in 25% of all revenues and costs, however, the profit made from products produced in Namibia and sold to DHN Drinks and other export markets will then have to be shared with Heineken, while there will still be costs incurred to maintain the plant in Windhoek.

We estimated that revenues will decrease between 20% and 25% during FY17 and a further 35% to 40% in FY18. Given volume migration, we have estimated that NBS will only be able to cut operating expenses by 55%, with fixed costs on the other hand, having to be incurred regardless of production volumes in a short-run shutdown situation at the local plant. Variable costs, such as raw materials, administration and marketing costs could be cut significantly or shared with the Sedibeng Brewery, however, employment costs would be difficult to reduce unless large numbers of employees are laid off, which holds significant social consequences for the employees and NBS. We estimated that FY16 operating profits would decrease slightly as NBS is able to reduce most of the costs effectively, however, we believe that operating profit for FY17 would decrease between 30% and 35%.

Given the fact that the City of Windhoek will be able to supply water to Windhoek until the next rainfall season, we have not factored in a water crisis as our base case scenario, however, both the water savings strategies and the volume migration will come at a cost and we will change our valuation if a water crisis plays out.

Valuation

We use a dividend discount model to assess the intrinsic value of the company. Our required rate of return, of 13.2%, is based on a risk free rate of 9.3%, equity risk premium of 2.7%, a beta of 1.0, and a long-term sustainable growth rate of 9%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N\$17.04 per share.

However, we forecast **FY16 earnings of 192.6 cents per share** and calculate a **target price of N\$24.50 per share** based on a **justified PE ratio of 12.7x**. This implies an expected total return of 5.3% over the next twelve months. Generally, we are notably more optimistic as to the future of the company following the restructuring of the JV and after NBS gained a share of the Sedibeng Brewery, which was critical to the JV's success from an NBS perspective. We remain cautious as to the effect SAB will have on the company's market share domestically going forward, as well as the impact of the potential water challenges the company may experience in FY17 and FY18. Therefore, we maintain our recommendation on **HOLD**.



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