IJG

Securities (Pty) Ltd.

Member of the NSX

NAMIBIA BREWERIES LIMITED

1H17 Results Review

May 2017

Namibia Breweries Ltd

1H17 Results Review

Target Price (c)	3095
Current Price (c)	3350

Year End 30 June	2014	2015	2016	F2017	F2018
Revenue (N$m)	2,317	2,434	2,426	2,638	2,744
Operating Profit	451	507	541	550	579
HEPS (c)	1.59	1.87	1.86	1.99	1.93
HEPU growth (%)	(10.5)	17.6	(0.7)	7.2	(3.3)
PE	10.3	10.9	13.7	16.8	17.4
DPS (c)	68	74	80	84	88
DY	4.2	3.6	3.1	2.5	2.6
EV/EBITDA	12.3	11.00	10.8	10.2	8.1

Recommendation	SELL
NSX Code	NBS
Market Cap (N$m)	6918.7
Shares in Issue (m)	206.5
Free float (%)	41
P/B (x)	6.6
52 week high	3364
52 week low	2394
Expected Total Return (%)	-6.4

Source: BVN, IJG

1H17 Results

Namibia Breweries (NBS) released results for the six months ended 31 December 2016. The results reflect resilient operational performance in a tough economic environment. Revenue was up 13.6% y/y and operating profit increased by 6.5% y/y. Basic EPS decreased 45.0% y/y to 46.5c, due to the losses in the associate, while HEPS increased by 3.2% from 109.9c to 113.4c. Interim dividends increased by 5.0% to 42 cps.

Sales and Volumes

Total revenue for the half year increased by 13.6% from the previous period. The higher revenue figure was largely a product of price increases in the Namibian market and increased volumes in the South African Market. Namibian beer volumes increased by only 0.2% y/y while South African export volumes increased by 33.1%.

Heineken South Africa

Namibia Breweries' associate, Heineken South Africa continues to deliver operating losses. Equity accounted losses from ongoing operations of N$83.4 million were recorded, higher than our expectations. Additionally, fair value adjustments to Plant, Property, and Equipment, impairments of assets and recognition of liabilities resulted in further equity losses of N$68 million. According to management these were once off adjustments as a result of the restructuring of South African operations.

However, the strong growth in revenues generated from South African exports is a promising sign of the progress that is being made to gain market share and boost volumes in that market. Sales to their largest customer, and associate, Heineken South Africa increased by 49.8% to N$455.0 million in 1H17. Namibia Breweries definitely seem to be making inroads in the South African premium beer market. Management currently indicate that they have roughly half of the South African premium beer market share, which makes up about 16% of total volumes

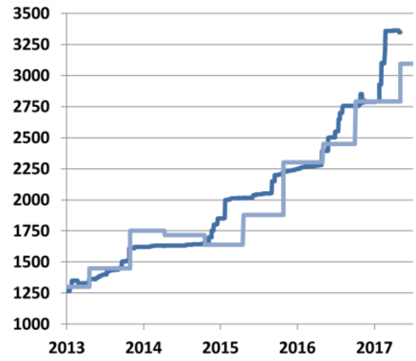
Export Markets

Total beer volumes sold to export markets increased by 7.7% while soft drink volumes were in line with previous periods. Furthermore, Tanzania and Zambia continue to show double digit growth while volumes in Botswana and Mozambique have declined from the previous period.

Valuation

We value NBS using a combination of an EV/EBITDA multiple and discounted cash flow analysis on a 50/50 weighting. The first five years are explicitly modelled and thereafter a terminal value is used. We use an exit multiple of 9.5x based on the average EV/EBITDA multiple for smaller Africanbreweries, a required rate of return on equity of 13.7%, based on a risk-free rate of 10.7% and an equity risk premium of 3.0%, and a long-term sustainable growth rate of free cash flows of 8.0%. Based on these assumptions and our forecasted cash flows for NBS, we have set a target price of N$30.95. As a result of the target price being substantially below the current price, **we change our recommendation to SELL.**

NBS Share Price vs Target Price



Dividends

Notice is hereby given that an interim dividend of 42 cents per ordinary share was declared for the period ended 31 December 2016.

- Last day to trade cum dividend was 7 April
- First day to trade ex-dividend was 10 April 2017
- Payment date: 19 May 2017

Analyst

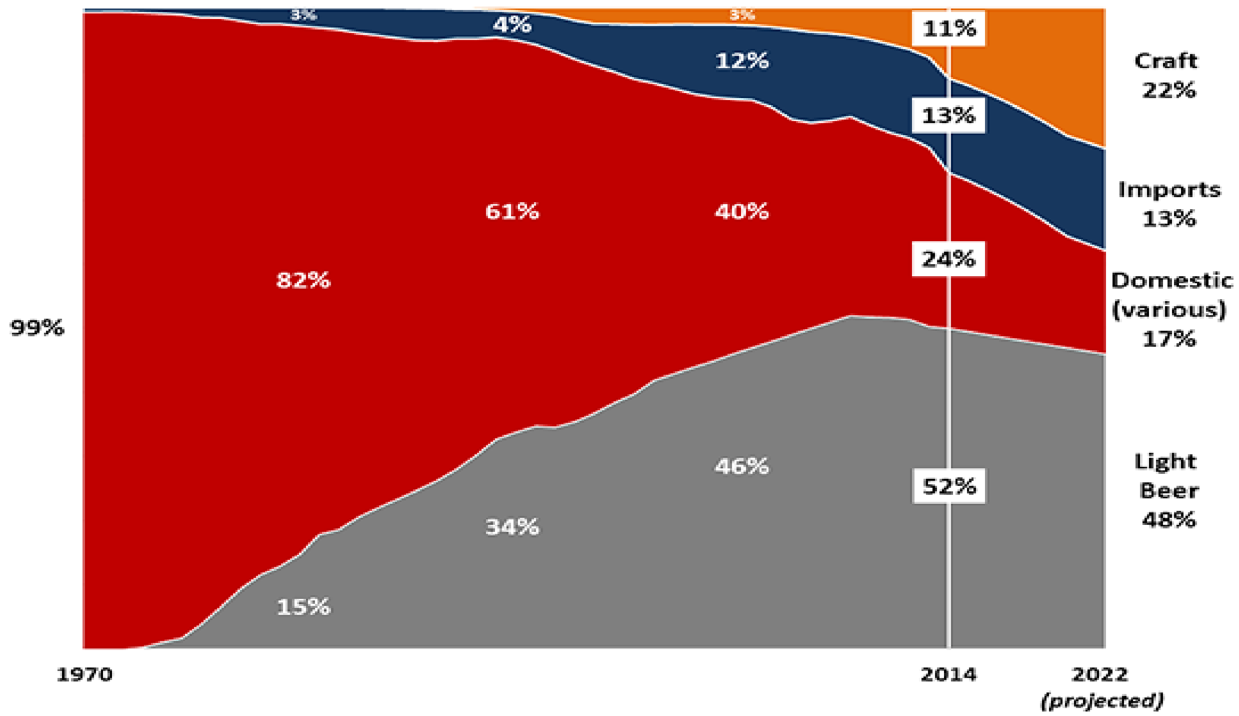
Dylan van Wyk
+264 61 383 521
dylan@ijg.net

Global Trends

2016 was a tough year overall in global beer markets. AB-Inbev, the world's leading global brewer, reported a 2% decline in total beer volumes, after taking into account their purchase of SABMiller. U.S. production volumes have been flat between 2007 and 2015, while other key markets such as Germany, France and the UK, fell by roughly 10% over the same period. The per capita consumption by Germans, who are some of the world's biggest lovers of beer, has dropped by one-third since 1976. The reason for these declines include changing demographics due to ageing populations and the substitution to different beverages such as wines, ciders as well as more health-conscious alternatives.

In addition to slowing volumes, there has been increased competitive pressures, especially in the premium and super premium (craft) segments. These segments show the greatest growth and command higher price premiums, which have made margins in these products very attractive. Furthermore, economies of scale are less important for these products as the fact that they are not mass produced gives them their defining quality. This opens the market for all types of small market entrants.

Data from the US Brewers association displays the growth in craft brews in the US market quite well and shows the expectations of large growth in the segment over the next few years. The data also shows the large part of the market, roughly half, is made up of light beers. This highlights the shifting of consumer preferences away from mainstream beers.



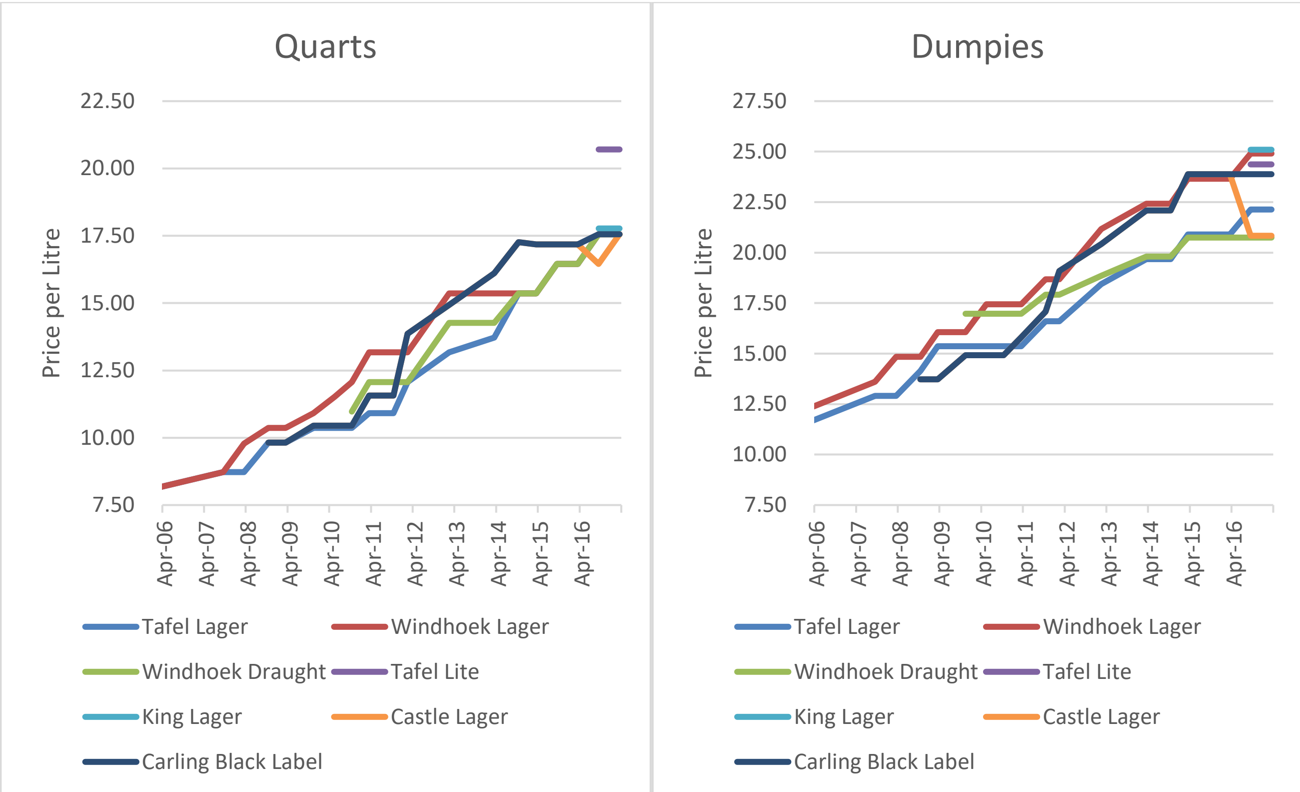
Source US Brewers Association

To some extent the declines in developed markets have been offset by growth in emerging markets. Africa remains one of the biggest growth opportunities for brewers as nearly 65 million people are due to reach the legal drinking age in the next five years. Although Africa still makes up a small part of global volumes, at only 6.8%, it is the fastest growing market. The last six years displayed compound annual growth of 6.3%. Estimates by the Canadean research group points to compound annual volume growth in Africa of 5% from now to 2020. This is in comparison to only 3% in Asia over the same period.

However, economic headwinds in African markets have been an obstacle in achieving this growth, especially in the last two to three years. AB Inbev reported a 5% decline in beer volumes in South Africa in 2016 as a result of currency and commodity headwinds which led to macroeconomic weakness and a sizable price increases. Nevertheless, they added that premium brands, which include Castle Lite and Flying fish, continued to deliver solid volume growth. Namibia has also displayed lackluster growth in volumes with Namibia breweries only showing a 0.2% y/y increase in beer volumes in the review period.

Pricing and Competition

Price changes by Namibia Breweries and SABMiller Namibia are usually released twice a year, around March/April and September/October. This year, there have been very little changes as Namibia breweries have kept their September pricing unchanged, whereas SAB have made a few changes effective 17 April. Most of the changes were increases in the price of 500ml cans, however the 750ml quarts have also reverted back to their old price.



Source: NBS, SAB Namibia, IJG

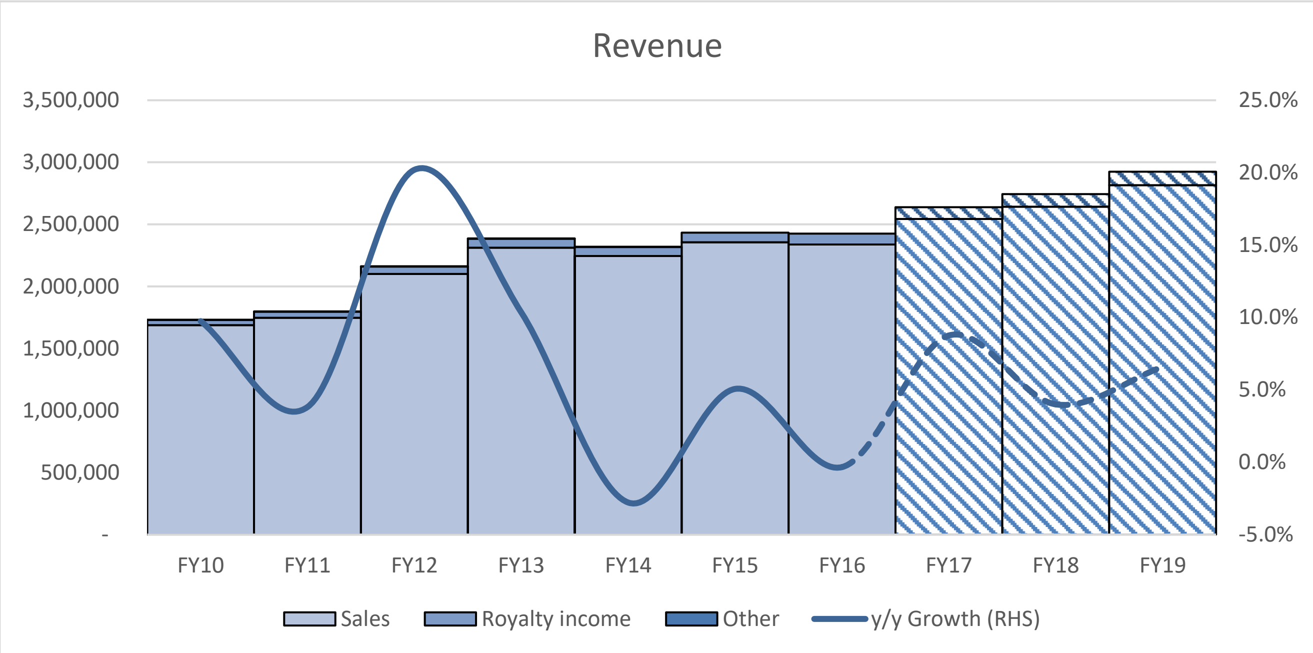
Namibia breweries have indicated that they currently have a market share of around 80%, which is a decline from the 84% market share they stated six months ago. By inference this would leave SAB with a maximum of the remaining 20% or 260,000 hectolitres, which is the capacity of the Okahandja plant. SAB claim they are targeting 30% of the Namibian market over the medium term, and seem to be moving in that direction.

We are of the opinion that the sharp decreases in price announced by SAB Namibia in combination with a more aggressive distribution strategy led to the lost market share. Management also indicated that their strongest competition is from the Castle and Black Label brands. Going forward it is difficult to say if SAB Namibia will succeed in their goal of cornering 30%

of the market. We believe that NBL should be able to defend the current market share due to their well-established local brands and superior distribution networks.

Revenue

Despite a tough operating environment in both Namibia and South Africa, revenue was not impeded and grew by 13.6% from N$1.31 billion in 1H16 to N$1.48 billion 1H17. This performance was on the back of strong growth in exports to South Africa which increased by 33.1% y/y. Total Namibian volumes grew by 1.1% while exports to other countries increased by 7.2%.



Source: NBS, IJG

Beer volumes in Namibia displayed lacklustre growth of 0.2%, which is due to a combination of the loss of market share and a low growth environment. However, the strong growth in revenues generated from South African exports is a promising sign of the progress that is being made to gain market share and boost volumes in that region. Sales to their largest customer, and associate, Heineken South Africa increased by 49.8% to N$455.0 million in 1H17.These volumes are on top of those which have been migrated to Sedibeng. Royalties from Heineken South Africa increased by 8.3% to N$53.8 million.

Revenue	1H16	1H17	% Change
Beer	1,200,194	1,367,436	13.9%
Other	105,961	115,748	9.2%
Total	**1,306,155**	**1,483,184**	**13.6%**

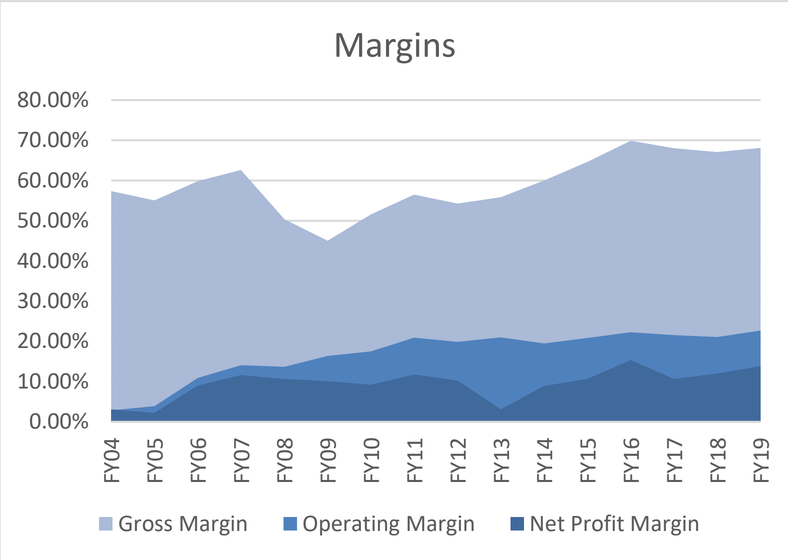
Source: NBS, IJG

Total beer volumes sold to export markets increased by 7.7% while soft drink volumes were in line with previous periods. Tanzania and Zambia continue to show double digit growth while volumes in Botswana and Mozambique have declined from the previous period.

Given the positive signs emanating from the strong increases in volumes from South Africa, we have revised our revenue outlook to reflect the positive contributions in revenue emanating from increased exports to and royalties from the South

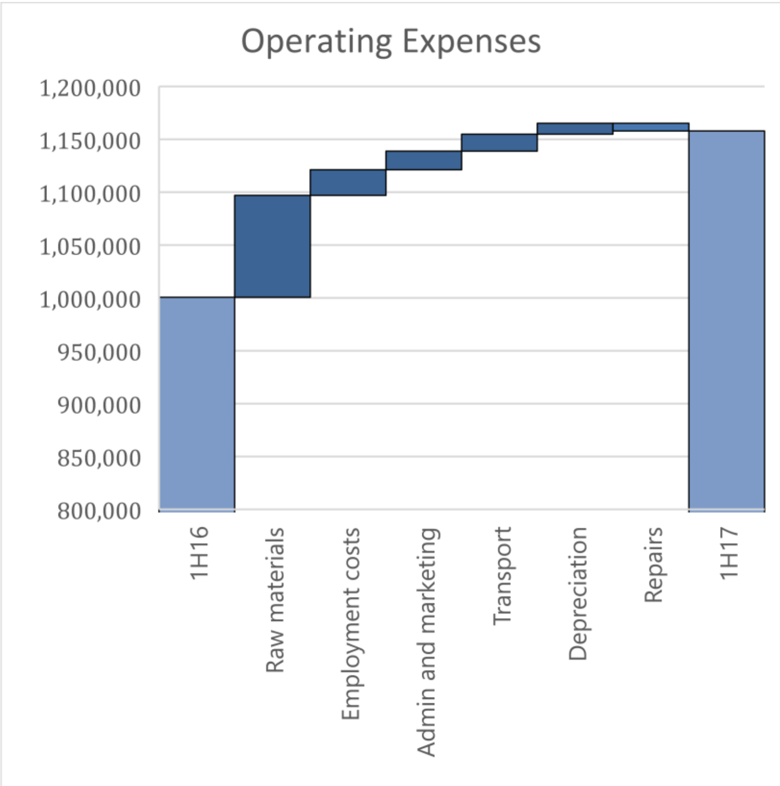
African associate. Thus, we expect revenues to increase by a compound annual growth rate of 6.4% over the next three years.

Operational Performance



Operating expenses grew by 15.7%, which was largely a factor of higher raw material costs due to higher production volumes. The increases in operating expenses were roughly in line with increased revenue, thus the operating margin remained stable at 21.9%. From 2009 to 2016 margins have been steadily improving, as efficiencies were gained in the production and packaging lines. There has also been an improvement in the gross profit margin as volumes have been migrated to South Africa, which decreases raw material and consumable costs and boosts the top line through royalty income.

Raw material costs made up 43% of operating costs and increased by 24.2% to N$494.1 million. Malted barley, a key ingredient of nearly all the beer brands, is the largest cost element and nearly 30,000 tons are imported annually. In the absence of local malting facilities, Namibia Breweries imports all of its malted barley and hops from suppliers in Europe. Unmalted barley produced in Namibia is used exclusively for King Lager. This project delivered 1426 tons of barley in 2016, with 1250 tons being of good quality. Estimates are that a malting plant will be viable when the project reaches its target 15,000 tons of barley per annum.



Admin and marketing expenses make up the second largest cost item and this increased by 6.3% y/y to N$295.8 million in 1H17. This category makes up 26% of operating costs. Employments costs increased by 16.8% y/y while transport and railage costs were up 19.6%.

The only cost savings that were achieved was in the repairs and maintenance category, which decreased by 20.8% y/y to N$28.1 million. This may indicate that the company is making headway in gaining the technical expertise to do repairs and maintenance in house, as they have been dependent on experts from Europe due to the intricacies of the plant.

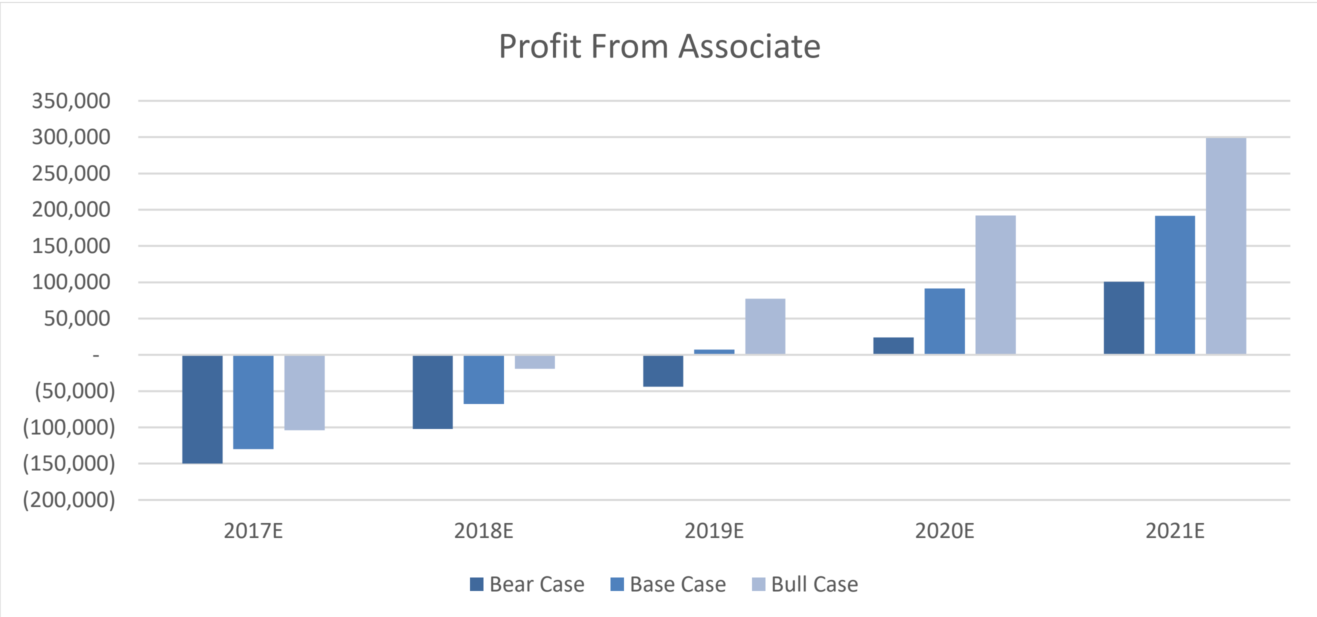
South African Operations

According to Namibia Breweries' management, they and their associate currently hold roughly 50% of the premium beer market in South Africa, which in turn comprises around 16% of the total beer market of 30.7 million hectolitre market. Due to fast growing market share and constraints in the Sedibeng production lines, the Namibian plant has been requested to produce export volumes over and above the migrated 450,000 hectolitres, which has resulted in the higher South Africa export numbers.

The Sedibeng Brewery has a capacity of 4.5 million hectolitres and management indicated that the brewery is intended to reach full capacity over the medium term. They mentioned their satisfaction with Sedibeng's management's ability to continuously find innovative ways of increasing efficiency. The efforts to get the Sedibeng operation producing at full capacity, thus realizing potential economies of scale, is being spearheaded by general manager by Guy Duringer and managing director Ruud Van den Eijnden, long term Heineken employees. This process is critical to unlocking the investment's value.

Details on the South African operation are limited at present, as financial information regarding the cost structures and future volumes is limited. We have thus assumed that full capacity will be reached over a five-year to six year horizon. Given the high level of fixed cost associated with the brewery and the time it is expected to take to ramp up production, we expect to see a loss in FY17 and FY18, breakeven levels of profit in FY19 and then increasing profitability thereafter. This is based heavily on management's guidance. The South African operation will become a very large part of the business and will make up nearly half of NBS's volumes once running at full capacity. However, increases in the volumes produced at the Sedibeng plant is dependent on the market share obtained in South Africa.

Our target price is quite sensitive to the rate at which the Sedibeng brewery increases production volume. Our base case scenario is that Sedibeng can add an average of 275,000 hectolitres per annum until it reaches full capacity. By our calculations there is quite a bit of upside should volumes produced and sold increase faster than expected. Our sensitivity of our target price based on volume increases is presented below:



Scenario	Incremental Annual Volume (hl)	Target Price
Bear Case	225,000	26.92
Base Case	**275,000**	**30.95**
Bull Case	325,000	33.24

Source: IJG

One example of how Namibia breweries is increasing awareness of its brands in South Africa has been the sponsoring of local sports. Tafel Lager has secured the sponsorship for the Griquas Rugby Union, which will run for a term of three years and includes the attainment of the team and stadium naming rights, as well as "pouring rights" in the stadium. The team will be known as the Tafel Lager Griquas and the stadium as Tafel Lager Park. This will be a great advertisement and create brand awareness in South Africa for Tafel Lager, which was previously overshadowed by Windhoek Lager in South Africa.

However, competition in the premium beer segment remains a concern. After the completion of the merger between AB InBev and SABMiller in October 2016, the world's biggest brewer doesn't seem to have any plans to reduce its presence in any of the 31 African markets in which it now operates. They have also announced their plans to bring global beer brands such as Budweiser, Stella Artois and Corona to African markets.

Furthermore, they have plans to start brewing these brands in South Africa. Within the next 12 months. AB InBev plans to invest between R2.0 billion and R2.6 billion on two new production lines in South Africa. At present, the South African market share of Stella Artois and Corona amounts to less than 1%. Sales in Europe have started to see a pickup after concentrated marketing efforts, with Stella Artois and Corona posting sales growth of 21% and 18% respectively.

Given the numerous options already available in the premium beer market space, it is unclear if this will have a meaningful impact on Namibia breweries sales, but will certainly increase competition in the premium space. As a matter of interest AB Inbev has announced that they will not only be bringing global beers to Africa, but will be taking African beers abroad. They plan to sell packs of eight African beer brands outside the continent, including Castle, Kilimanjaro of Tanzania and Nigeria's Hero to the US, China, UK and Australia.

Impairment of Assets and Recognition of Liabilities of the Associate

According to the group's financial statements, on 31 December 2015 the Group's associate, Heineken South Africa Limited, fair valued the assets and liabilities on the amalgamation of Sedibeng Brewery Limited's operations into Heineken South Africa Limited.

This consisted of a N$709 million fair value adjustment to property, plant and equipment, which will be depreciated over 15 years, and a N$274 million impairment of other assets and recognition of liabilities. The net N$435 million was recorded as a bargain purchase by the associate.

In terms of the Group's accounting policy on IFRS 3, business combinations under common control are recorded at cost and not fair value. Therefore the Group has not accounted for the bargain purchase recorded by Heineken South Africa Limited.

Instead only the recognition of the impairment of assets and recognition of liabilities was recognised. The 25% share of the impairments and liabilities amounted to N$68.5 million or roughly 33cps. No further details were provided regarding this line item.

Valuation

We value NBS using a combination of an EV/EBITDA multiple and discounted cash flow analysis on a 50/50 weighting. The first five years are explicitly modelled and thereafter a terminal value is used. We use an exit multiple of 9.5x based on the average EV/EBITDA multiple for smaller breweries in Africa, a required rate of return on equity of 13.7%, based on a risk-free rate of 10.7% and an equity risk premium of 3.0% and a long-term sustainable growth rate of free cash flows of 8.0%. Based on these assumptions and our forecasted cash flows for NBS, we have set a target price of N$30.95.

The South African operation remains the biggest driver of future upside, and overall, we are quite positive on management’s ability to increase market share and production over the forecast period. The last six months has indeed indicated that there is demand for Namibian beers in South Africa and efforts to expand market share seem to be paying off. However, the current price of the security has become somewhat stretched beyond our calculated intrinsic value.

Based on our target price and estimated dividend of 42cps, we expect a one year total return of -6.4%. However, for this return to be realised, the price must obviously return to the intrinsic value. Based on the nature of the Namibian investment environment, characterised by an undersupply of investable assets in the equity space, we do not see expect this to happen. Furthermore, Namibia breweries has been one of the shares which has cult following of dedicated buyers which have supported the price over the last few years. However, given the fact that the price exceeds even our bullish scenario target price, **we change our recommendation to SELL.**

Summary of Income Statement

N$'000	2014	2015	2016	2017E	2018E	2019E
Revenue	2,316,932	2,434,177	2,425,885	2,638,157	2,743,504	2,924,103
Operating expenses	(1,865,601)	(1,927,663)	(1,885,211)	(2,068,786)	(2,164,240)	(2,260,429)
Operating Profit	**451,331**	**506,514**	**540,674**	**569,371**	**579,264**	**663,673**
Finance Costs	(14,932)	(8,847)	(39,412)	(40,829)	(46,454)	(93,926)
Finance Income	12,338	22,000	18,315	14,883	20,207	16,966
Equity loss from JV-ongoing operations	(120,002)	(124,593)	(38,917)			
Equity loss from associate-ongoing operations			(61,759)	(130,051)	(67,604)	7,219
Equity loss from JV-deferred tax asset write back (/down)	-	-	89,212	-	-	-
Profit before income tax	**328,735**	**395,074**	**508,113**	**413,374**	**485,413**	**593,932**
Income Tax Expense	(122,867)	(136,092)	(135,643)	(132,280)	(155,332)	(190,058)
Profit attributable to ordinary shareholders	205,868	258,982	372,470	281,095	330,081	403,874
Shares in issue ('000)	206,529	206,529	206,529	206,529	206,529	206,529
Earnings per share (c)						
Basic EPS	0.995	1.254	1.803	1.361	1.598	1.956
HEPS	1.591	1.871	1.857	1.99	1.93	1.96
	-10.52%	17.60%	-0.75%	7.20%	-3.27%	1.56%
Dividend per share (c)						
Interim	34	37	40	42	44	46
Final	34	37	40	42	44	46
Total	68	74	80	84	88	93

TEAM NAMIBIA MEMBER

IJG Holdings

Group Chairman
Mathews Hamutenya
Tel: +264 (61) 256 699
mathews@millennium-invest.com

Group Managing Director
Mark Späth
Tel: +264 (61) 383 510
mark@ijg.net

Group Financial Manager
Helena Shikongo
Tel: +264 (61) 383 528
helena@ijg.net

IJG Securities

Managing Director
Lyndon Sauls
Tel: +264 (61) 383 514
lyndon@ijg.net

Sales and Research
Eric van Zyl
Tel: +264 (61) 383 530
eric@ijg.net

Equity & Fixed Income Dealing
Leon Maloney
Tel: +264 (61) 383 512
leon@ijg.net

Settlements & Administration
Annetjie Diergaardt
Tel: +264 (61) 383 515
anne@ijg.net

Dylan van Wyk
Tel: +264 (61) 383 521
dylan@ijg.net

IJG Wealth Management

Managing Director
René Olivier
Tel: +264 (61) 383 522
rene@ijg.net

Portfolio Manager
Jan-Hendrik Conradie
Tel: +264 (61) 383 523
janhendrik@ijg.net

Money Market & Administration
Tashiya Shekutamba
Tel: +264 (61) 383 511
tashiya@ijg.net

IJG Capital

Managing Director
Herbert Maier
Tel: +264 (61) 383 522
herbert@ijg.net

Portfolio Manager
Jakob de Klerk
Tel: +264 (61) 383 517
jakob@ijg.net

Business Analyst
Mirko Maier
Tel: +264 (61) 383 500
mirko@ijg.net

IJG Advisory

Director
Jolyon Irwin
Tel: +264 (61) 383 500
jolyon@ijg.net

Business Analyst
Jason Hailonga
Tel: +264 (61) 383 529
jason@ijg.net