NAMIBIA BREWERIES LIMITED
1H18 Results Review
April 2018

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Namibia Breweries Ltd

1H18 Results Review

Target Price (c)	***3550***
Current Price (c)	4500

Year End 30 June	2016	2017	F2018	F2019	F2020
Revenue (N$m)	2,426	2,708	2,635	2,850	3,075
Operating Profit	541	611	566	618	663
HEPS (c)	186	230	186	201	218
HEPU growth (%)	(0.7)	24	-19	8.4	8.6
PE	13.7	16.4	24.2	22.4	20.6
DPS (c)	80	84	92	100	116
DY	3.1	2.2	2.0	2.2	2.6
EV/EBITDA	10.8	13.8	12.4	10.4	9.1

Recommendation	SELL
NSX Code	NBS
Market Cap (N$m)	9,294
Shares in Issue (m)	206.5
Free float (%)	51
P/B (x)	6.6
52 week high	4501
52 week low	3330
Expected Total Return (%)	-19.1

Source: NBS, IJG

1H18 Results

Namibia Breweries (NBS) released interim results for the period ended 31 December 2017. The financial results have surprised to the upside with the associate's operations (Sedibeng Brewery) posting a smaller loss than expected. Revenue for the period was down 3.0% y/y while operating profit increased by 5.8% y/y. Basic EPS **increased** by 150.2% y/y to 116.3cps (1H17: 46.5cps), due to the reduced losses in the associate, while HEPS **increased** by 8.5% from 113.4cps to 123.0cps. A dividend of 46cps was declared.

Sales and Volumes

The drop in revenue stems from a decrease in volumes in all markets. Namibian volumes dropped by 1.8%, South African volumes decreased by 22.9%, and export volumes decreased by 1.8%. Overall beer volumes dropped by 7.7%. The royalties component of revenue increased by 7.8% which indicates that the amount of NBS products sold in South Africa increased despite volumes exported to SA decreasing. The results presentation pointed out that the Sedibeng brewery produced 4.4m hectolitres and management indicated that this is up by approximately 1m hectolitres.

Equity Loss from Associate

The associate, Heineken South Africa (HSA), seems to be reaching a turning point with the loss from associate decreasing from N$138.2m in 1H17 to N$13.8m in 1H18. The increased volumes out of Sedibeng have resulted in scale efficiency gains and NBS management indicated at the results presentation that HSA is ahead of their earlier estimates for breakeven. The net profit breakeven point is still expected to be in FY19.

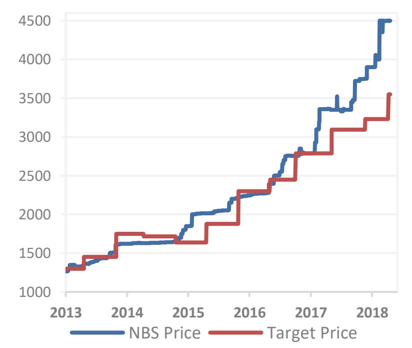
Operating Margin

Operating profits improved by 5.8% in 1H18 despite the decrease in revenues. Operating expenses decreased by 5.4% largely due to a 21.3% decrease in administration and marketing expenses. Railage and transport expenses decreased by 8.6% and raw materials and consumables costs were down 4.1%, both as a result of volume decreases. Employment costs increased by 7.1% y/y. The operating margin thus expanded further to 23.9%.

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 11x based on an adjusted average EV/EBITDA multiple for smaller African breweries, a required rate of return on equity of 13.88%, based on a risk-free rate of 9.88% and an equity risk premium of 4.0%, 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$35.50. As our target price is 21% below the current price, **we maintain our SELL recommendation.**

NBS Share Price vs Target Price



Dividends

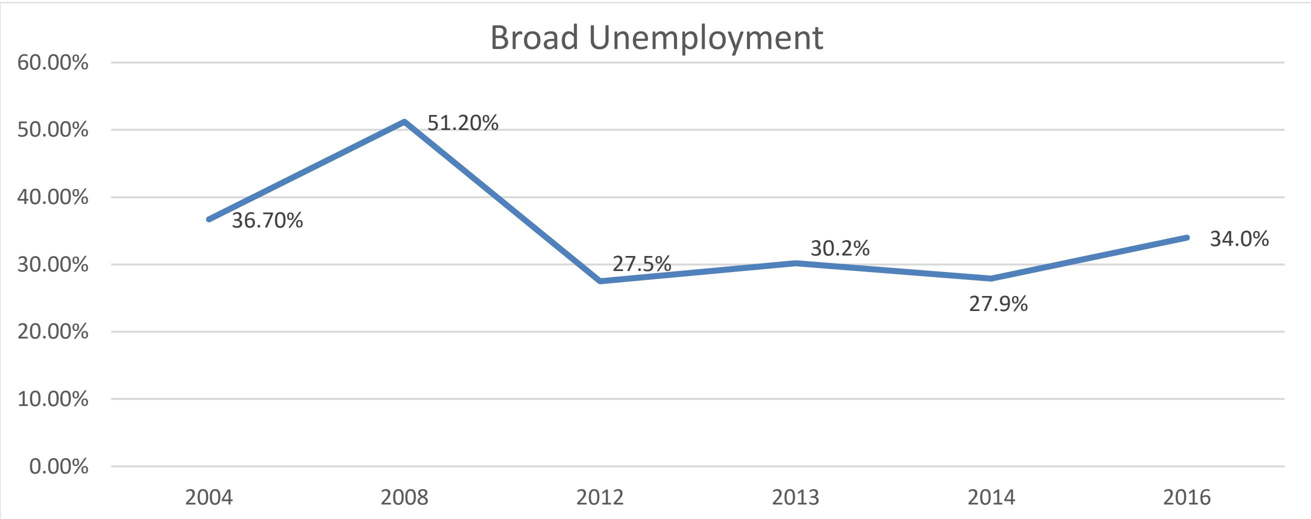
An interim dividend of 46 cents per ordinary share was declared for the period ended 31 December 2017.

- Last day to trade: 6 April 2018
- Payment date: 11 May 2018

Macro Environment

The Namibian macro environment remains challenging. The preliminary national accounts release in March pointed to a contraction of 0.8% in real GDP in 2017. This follows growth of 0.7% in 2016, a far cry from the >5% real GDP growth Namibia had become accustomed to between 2010 and 2015. The last two years have also been characterised by rising unemployment, due in large part to the drought affecting subsistence farming activities prior to the good rainy season of 2017. A construction bust followed the drought adding construction industry jobs to the list of unemployed, although there is little hard data on this at present.

The food and beverages industry is generally accepted to be a non-cyclical sector of the economy, less affected by economic downturns. The decrease in NBS Namibian beer volumes over the last year, 3% in FY17, and expectations for similar in FY18, compares unfavourably with the mild contraction in GDP. However, this performance is less poor than the rise in unemployment would suggest, even before accounting for the increase in competition.



Source: NSA

The Namibian macro environment viewed from an employment perspective is less than encouraging in our view. Government has been a major source of employment in Namibia and the fiscal difficulties experienced over the last two years have resulted in an effective freezing of new positions. Thus, Namibia's largest employer will not be directly adding jobs to the economy. That said, the Namibian government has announced an expansionary budget for 2018/19 and beyond, aiming to drive infrastructure investment which could see many of the jobs lost in the construction industry return. We expect more moderate gains in employment though, as government seeks to avoid making the same pro-cyclical policy mistakes as before.

The above discussion mutes our expectations of NBS volume growth stemming from the Namibian market. South Africa and the Heineken South Africa (HSA) venture is thus where the growth opportunities lie.

The South African macro picture is more optimistic than our view on the domestic economy. Real GDP growth has been weak since the global financial crisis. Unemployment has been steadily rising, and real GDP per capita is more or less at 2008 levels. A low base combined with a new political regime could see a South African growth revival. While this is far from determined we believe that the short- and medium-term picture in South Africa has improved somewhat. Whether the "Ramaphoria" will last will depend on the policy direction taken by the ANC going forward, but for now we lean towards the optimistic.

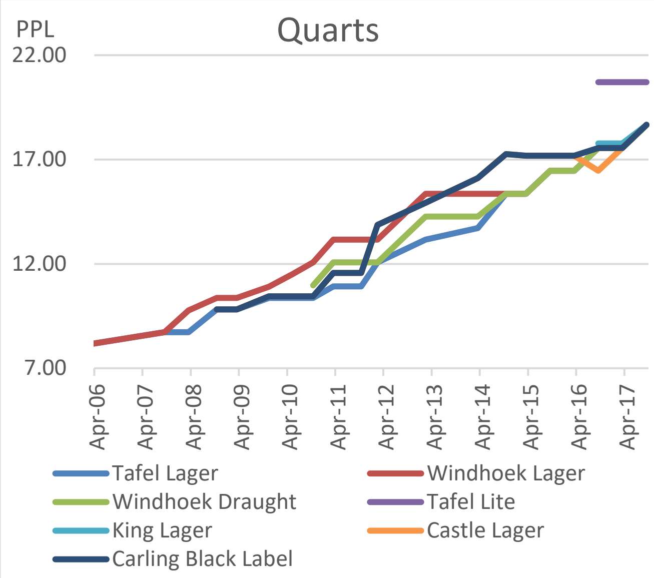
The NBS/Heineken product offerings are clustered in the premium segment of the South African market, in contrast to the mainstream offerings making up the bulk of the Namibian volumes. The premium segment has been growing rapidly as noted in our 2017 full year review. A South African growth story could see this segment of the market continue to grow at an elevated pace over the medium term. The environment in our view is thus conducive to further growth in HSA volumes.

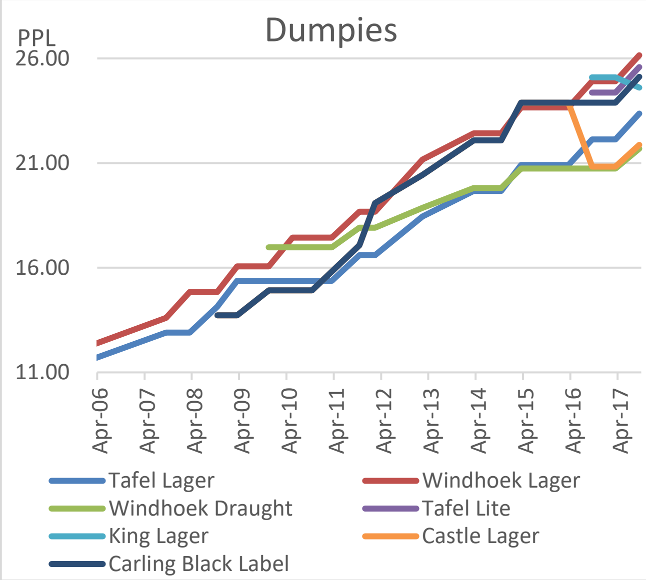
Pricing and Competition

	Windhoek Lager		**Tafel Lager**		**Black Label**		**Castle Lager**	
	N$/l	y/y % change	N$/l	y/y % change	N$/l	y/y % change	N$/l	y/y % change
Quarts	18.65	6.3%	18.65	6.3%	18.67	6.3%	18.67	6.3%
Euros	20.46	4.3%	20.46	4.4%	-	0.0%	-	0.0%
Dumpies	26.15	5.0%	23.36	5.6%	25.12	5.2%	21.88	5.0%

Wholesale pricing of NBS products remains largely unchanged as at the time of this report. Our FY17 report highlighted that the wholesale prices of NBS and ABI products are relatively consistent with a number of exceptions. Castle Lager dumpies were cheaper than Tafel Lager dumpies, while Windhoek Draught dumpies were cheaper on a per litre basis but packaged in 440ml bottles. We speculated that the Castle Brewery was producing near enough capacity to not compete aggressively on price.

In the 1H18 results presentation NBS management stated that the volume declines in the local market were due to a shift away from beer as well as a weak economy rather than market-share losses to the competition. The market is becoming less clear cut with craft beers and malt beverages encroaching on the traditional beer space, clouding the competitive landscape somewhat. While NBS competes in different market segments and has a variety of products, it is in the mainstream market that they do most of their business domestically (Tafel Lager). This market will be less influenced by beer alternatives than the premium market in South Africa where HSA is active. For this reason, the volume decline in Namibia is more likely a factor of the economic downturn (increase in unemployment), with encroachment of alternative products playing a marginal role.





These figures remain unchanged from the FY17 report

Heineken South Africa

The below excerpt from IJG's FY17 Results Review has proven telling with substantial volume increases coming from The Sedibeng Plant. During the results presentation NBS management previewed the HSA results which pointed to volume production of 4.4m hectolitres for the period ended 31 December 2017. Management further indicated that this was approximately 1m hectolitres more than the prior period. It is unclear whether the HSA volumes will be made public again in the future.

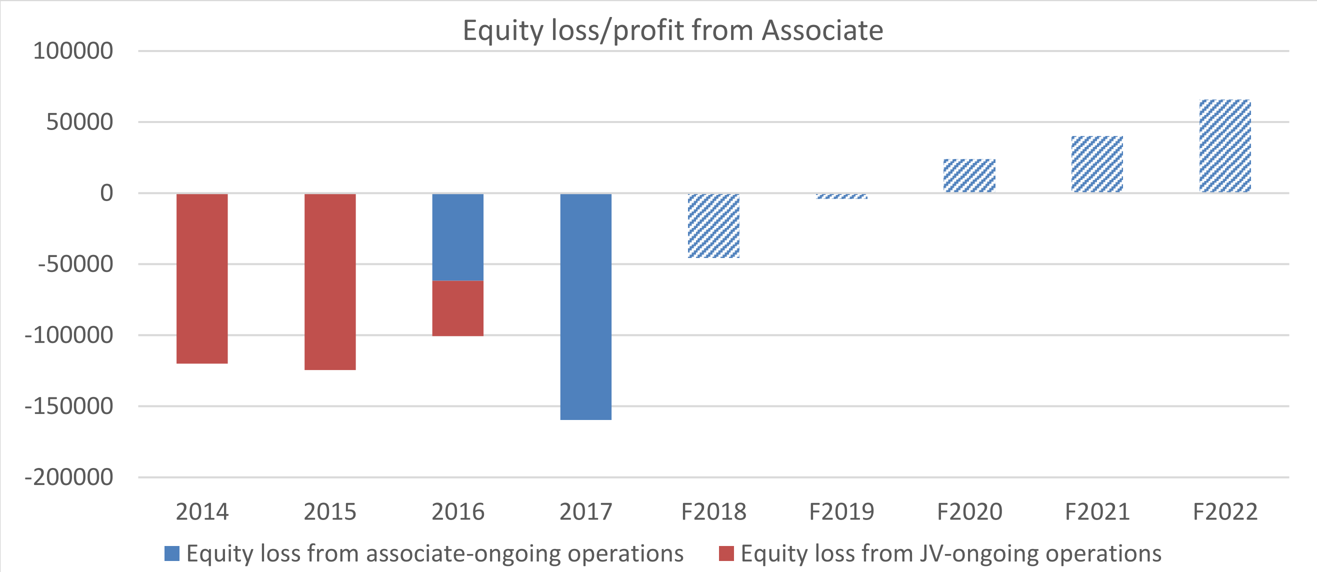
The restructuring of the JV was a step in the right direction for Heineken and NBS as the Brandhouse distribution channel favoured Diageo and the distribution of spirits. Heineken South Africa is now free to focus on gaining efficiencies at the Sedibeng Brewery as well as growing the footprint of the products produced by the brewery. Thus, the sales and distribution operations should be more focussed on Heineken and NBS products than before.

The increase in production from the Sedibeng plant is largely attributable to improved marketing, sales and distribution (MSD) since the divorce from Diageo. Having a dedicated team incentivised to distribute HSA products is paying off. Packaging of products is another area where gains have been made. Attempts to diverge from popular packaging sizes were unsuccessful in the past and a renewed emphasis was put on consumer preferences.

The Heineken and Strongbow brands posted strong performance, while the management presentation indicated that both Tafel and Windhoek volumes posted solid growth. The increase in royalty income of 7.8% for the period emphasises this. Thus, while volumes sold to South Africa declined by 23.1%, the total volume of NBS products sold in SA increased, indicating strong production of NBS products from Sedibeng.

The increase in volumes (total) produced at Sedibeng is the most important highlight of this set of results. The fact that this brewery is reaching a level of production volumes where scale efficiencies start driving margin growth should mean that the operational breakeven and net profit timelines for HSA, as indicated in our FY17 Results Review, are on track or possibly ahead of schedule. Management expected operational breakeven in FY18 (HSA yearend is 31 December) and a possible small net profit at HSA in FY19. While we did partially factor in the possibility of this guidance proving accurate when establishing our TP last year, we tempered our expectations based on prior guidance being inaccurate. The latest results are thus above our expectations and the upward adjustment in our forecasts for the associate contribution is the major driver of our revised TP.

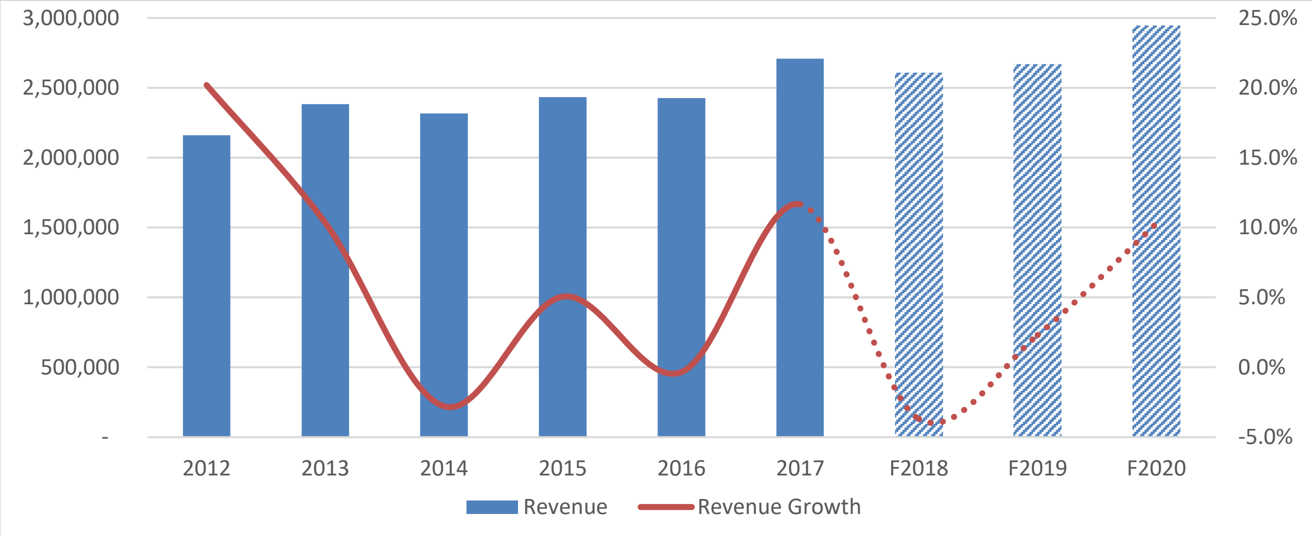
HSA is subject to the same cyclicality as NBS in that line efficiencies are greater during the June to December period. This means that the equity loss from associate is likely to be quite a bit larger than double the amount in the financials for 1H18. We thus expect this amount to be approximately N$45m, down from N$159.7m recorded in FY17.



Source: NBS, IJG Securities

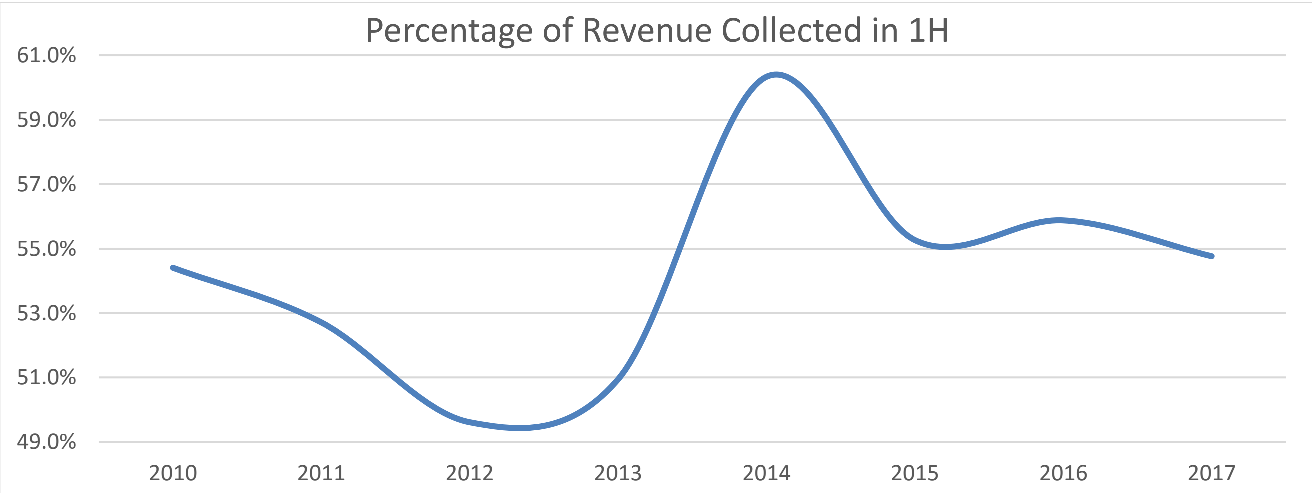
Revenue and Volumes

The operating environment in Namibia remained challenging, continuing with this theme from the FY17 Results Review. Namibian volumes dropped by 1.8% with export volumes dropping by the same. Overall beer volumes decreased by 7.7% and revenue decreased by 3.0%. Volumes produced for export to South Africa fell by 23.1%, but, as noted elsewhere in this report, this is due to volumes migrated to the Sedibeng brewery in the current period that were produced in Namibia in FY17. Thus, most of the spike in export volumes to South Africa in the 1H17 (33.1%) results have been produced by the Sedibeng Brewery in 1H18. Management confirmed this last point, indicating that the greater than expected demand for NBS products in SA last year led to the sharp increase in exports from Namibia. NBS management expect further exports above the 450,000hl contractual exports in 2H18 (for logistical efficiency as packaging materials are imported) which should result in a smaller decline in volumes exported to SA in the FY18 results.



Source: NBS, IJG Securities

The 2H18 revenue is generally lower than 1H as illustrated in the below chart. This is due to seasonally higher sales over the December holiday period. NBS management have indicated that this will once again be the case as December demand in both Namibia and SA was strong. The anticipated increase in export volumes to SA is likely to result in 2H revenue contributing approximately 45% to FY18 by our calculations. Revenue for the year is thus expected to come in below that of 2017 although the bottom line performance should improve due to smaller losses from the associate.

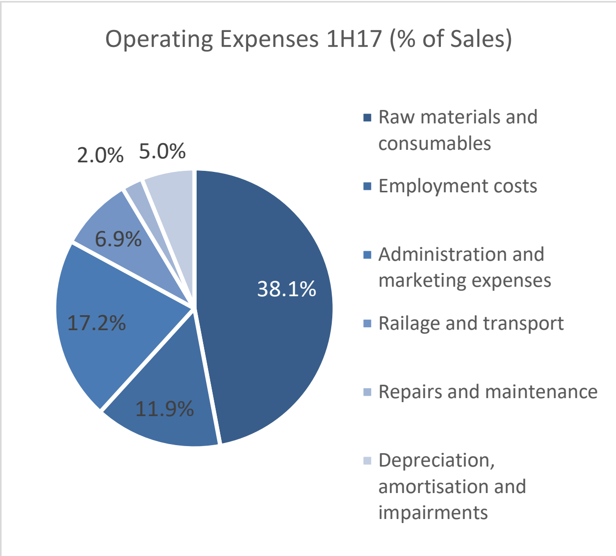


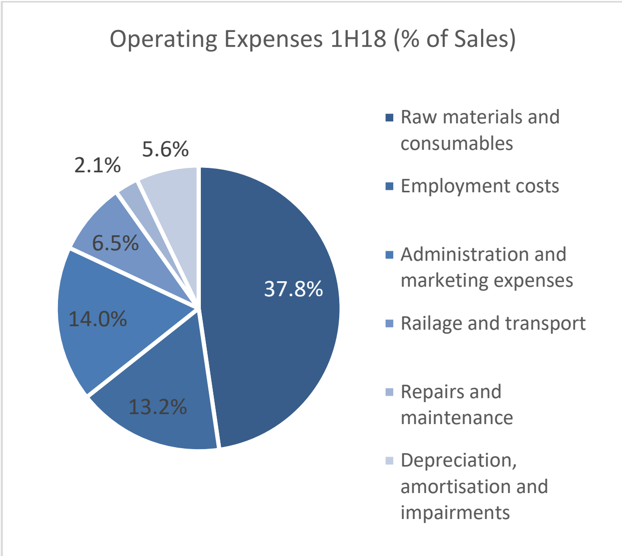
Source: NBS, IJG

NBS management pointed out that while much of the last 12-months growth in HSA volumes has been as a result of Heineken beer volumes, demand for NBS products have increased as well. Demand in the premium segment of the SA market thus seems to have posted strong growth and Heineken and NBS are capitalising on this through HSA. The most recent set of ABI results point to weak volume growth in SA (0.9% in FY19), although the company recorded margin expansion.

Operational Performance

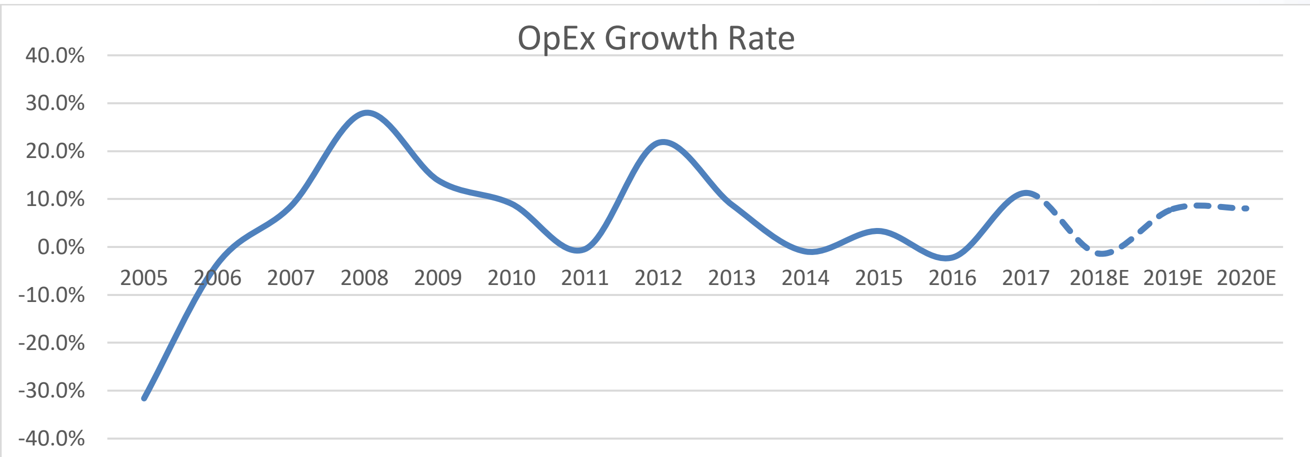
Operating profit increased by 5.8% when compared to 1H17. Operating performance has improved by 217bp in 1H18, after accounting for royalty income. This improvement reflects a large decrease in the administration and marketing line-item. This is likely one of the benefits of the South African associate as marketing expenses can be shared to some extent. This line-item has been improving slightly in the full year results as well, although not to the same extent seen in 1H18. Whether or not the investment in the associate will have a long-term effect on the admin and marketing expense is uncertain but we do see some benefits coming from the sharing of some costs.



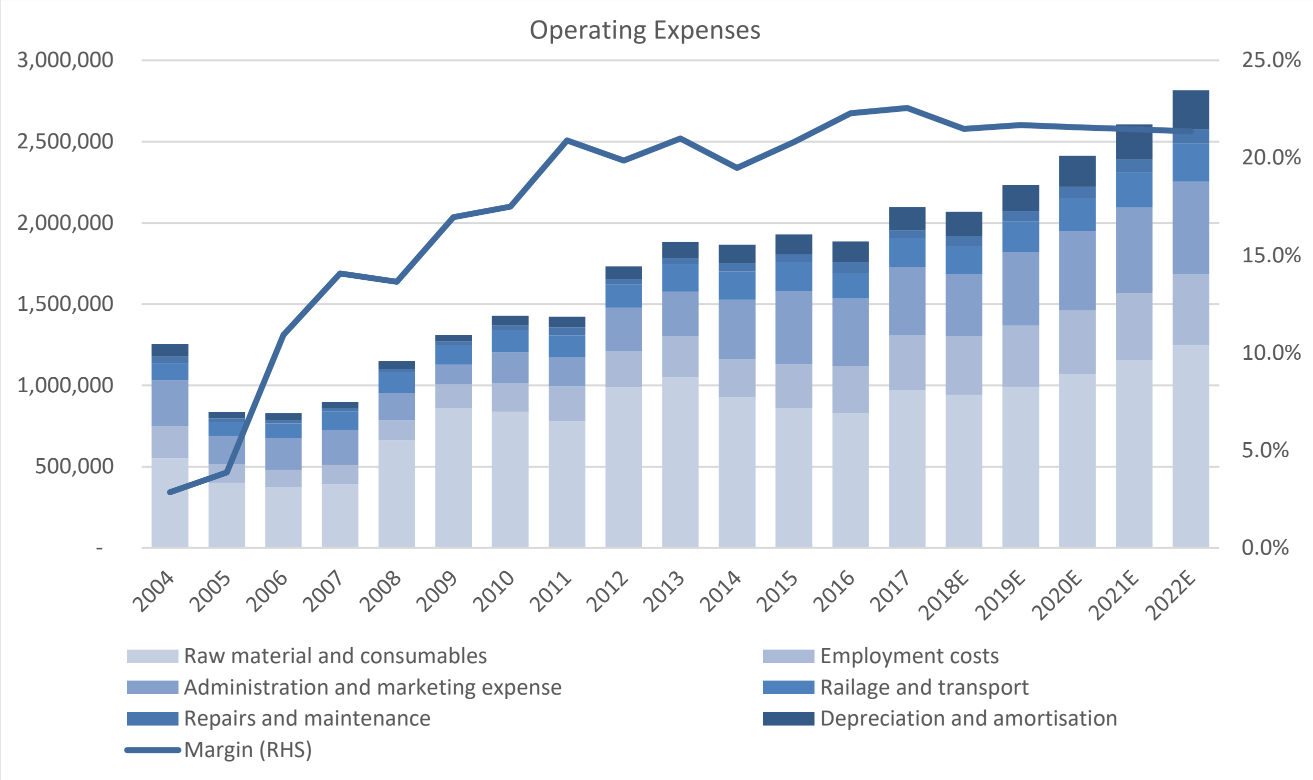


Source: NBS, IJG Securities

The transfer pricing agreement between NBS and HSA (previously with DHN) has come to an end at the end of March this year. A new agreement was reached with HSA with a reduction in margin for NBS, and management have stated that this will dilute operating profit for the group. This is effectively a price per bottle decrease on the volumes exported to SA. Management estimate that the new pricing agreement will have a 1% to 3% impact on forecasted operating profits for FY18. This translates to a 4% to 12% impact on operating profits over a 12-month period dependent on the volumes exported to South Africa. Accordingly, we have updated our FY18 operating profit expectations with the assumption of a 2% impact on operating profit due to the new agreement.

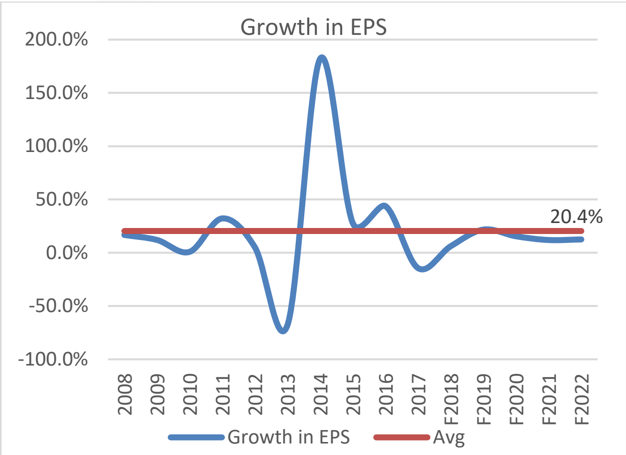


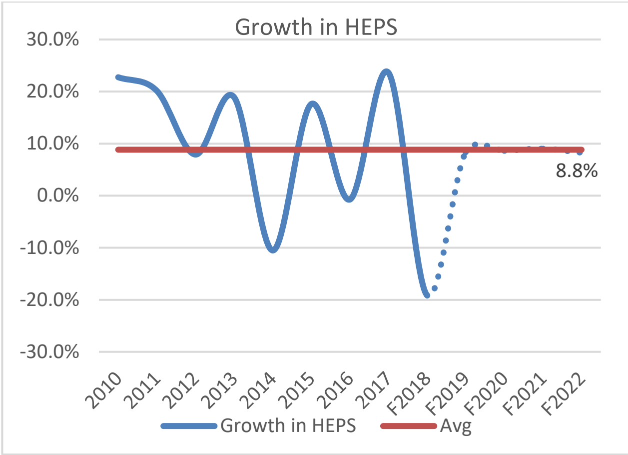
Source: NBS, IJG Securities



Source: NBS, IJG Securities

Valuation





Source: NBS, IJG Securities

We continue to 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 11x based on the average EV/EBITDA multiple for smaller breweries in Africa (see comparison below, previous multiple was 9.5x), a required rate of return on equity of 13.88%, based on a risk-free rate of 9.88% and an equity risk premium of 4.0% 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$35.50.

The cash flow forecasts used in the target price calculation assume that operating breakeven at Sedibeng has been achieved and that a small net profit is achieved in FY19 (HSA year end 31 December), as per management guidance. HSA volume production is higher than we assumed they would be and the loss from associate will be much smaller than in FY17.

Upside scenarios to our target price include further market-share gains in South Africa and with that efficiency gains at Sedibeng. This may be possible given that AB Inbev probably does not command the patriotism that SAB used to. Our forecasts are now more aligned with those of management due to the production surprise at Sedibeng. As our target price is 21.0% below the current share price we maintain our **SELL recommendation** on **NBS**.

Bloomberg Peer Review							
	3Yr Growth in Dividends	Dividend Yield	P/E	P/B	P/S	ROE	EV/EBITDA
Societe de Limonaderies et Brasseries	(9.27)	3.91	6.10	1.61	0.88	29.14	3.76
Sechaba Breweries Holdings Ltd	(21.44)	3.09	12.78	4.79	11.69		11.82
Capevin Holdings Ltd	0.20	2.95	17.58	2.58		12.15	
Distell Group Ltd	3.58	2.88	19.32	2.61	1.24	12.70	12.10
Guinness Nigeria PLC	(40.44)	0.63	19.32	2.72	1.35	14.64	8.74
Societe Des Brasseries du Maroc	9.84	4.30	22.11	5.37	3.67	26.22	12.47
Societe Frigorifique et Brasserie de Tunis SA	13.62	2.72	22.45	5.56	4.06	24.97	11.68
Namibia Breweries Ltd	**7.42**	**1.96**	**24.20**	**6.61**	**3.53**	**24.35**	**12.40**
Phoenix Beverages Ltd	6.96	1.72	24.59	2.61	1.46	11.05	15.58
Tanzania Breweries Ltd	11.87	2.41	27.10	6.44	4.31	24.40	
Societe Brasseries du Cameroun	(45.84)	0.77	29.04	2.88	1.25	9.72	
Zambian Breweries PLC		2.92	29.11	3.09	1.89	11.05	7.87
Nigerian Breweries PLC	(4.56)	3.28	30.37	5.65	2.91	19.21	10.94
Delta Corp Ltd/Zimbabwe	7.72	2.75	31.63	4.37	4.58	14.09	
East African Breweries Ltd	10.89	2.96	32.21	21.71	3.04		11.21
International Breweries PLC			52.88	12.03	4.46	24.57	
Mean	(3.53)	2.62	25.05	5.66	3.35	18.45	10.78
Median	5.27	2.88	24.39	4.58	3.04	16.92	11.68
	positive	negative	positive	negative	negative	positive	negative

Summary of Income Statement

N$'000	2015	2016	2017	2018E	2019E	2020E
Revenue	2 434 177	2 425 885	2 708 978	2 634 532	2 850 323	3 075 439
Operating expenses	(1 927 663)	(1 885 211)	(2 097 965)	(2 068 560)	(2 232 519)	(2 412 099)
Operating Profit	**506 514**	**540 674**	**611 013**	**565 972**	**617 805**	**663 340**
Finance Costs	(8 847)	(39 412)	(50 923)	(46 454)	(37 676)	(24 188)
Finance Income	22 000	18 315	18 304	22 931	28 983	35 711
Equity loss from JV-ongoing operations	(124 593)	(38 917)	-			
Equity loss from associate-ongoing operations		(61 759)	(159 742)	(45 337)	(3 815)	23 940
Equity loss from JV-deferred tax asset write back (/down)	-	89 212	4 025	-	-	-
Profit before income tax	**395 074**	**508 113**	**422 677**	**497 112**	**605 297**	**698 803**
Income Tax Expense	(136 092)	(135 643)	(104 249)	(159 076)	(193 695)	(223 617)
Profit attributable to ordinary shareholders	**258 982**	**372 470**	**318 428**	**338 036**	**411 602**	**475 186**
Shares in issue (‘000)	206 529	206 529	206 529	206 529	206 529	206 529
Earnings per share (c)						
Basic EPS	125	180	154	164	199	230
HEPS	187	186	230	186	201	218
Dividend per share (c)						
Interim	37	40	42	46	50	58
Final	37	40	42	46	50	58
Total	74	80	84	92	100	116

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