Emerging African Markets > Equity Research

20 October2014

Namibia Breweries Ltd	Target Price (c)	1640
FY14 Results – Results Review	Current Price (c)	1642

Year End 30 June	2012	2013	2014	F2015	F2016
Revenue (N$m)	2,160	2,383	2,316	2,392	2,461
Operating Profit	494	500	451	425	414
HEPS (c)	149	178	159	158	160
HEPU growth (%)	7.9	18.9	-10.5	-0.13	3.7
PE	15.3	9.3	16.5	14.2	14.7
DPS (c)	54	62	68	68	72
DY	3.3	3.8	4.1	4.1	4.4
EV/EBITDA	6.6	5.6	5.9	6.8	6.2

Recommendation	HOLD
NSX Code	NBS
Market Cap (N$m)	3,391
Shares in Issue (m)	207
Free float (%)	50
P/B (x)	3.2
52 week high	1660
52 week low	1511
Expected Total Return (%)	3.9

Source: NBS, IJG

FY14 Results

Namibia Breweries (NBS) released results for the year ended 30 June 2014. The full year results reflect disappointing operational performance with operating profit down 9.7% y/y. Basic EPS rose 181.9% y/y to 99.5c, coming of a low base after the N$188m impairment to its investment in DHN Drinks (Pty) Ltd last year that resulted in a decrease in earnings per share in FY13. HEPS, however, is down 10.5% from 177.8c to 159.1c. The board declared a final dividend of 34cps, taking the total dividend for the year to 68cps,up 9.7% on last year, with last day to trade cum 21 November 2014.

Sales and Volumes

Although NBSmanaged to increase local sales volumes, revenue fell by 2.8% y/y to N$2,316.9bn,with the contraction stemming from the migration of production volumes to South Africa.Total sales of goods, however, are down 3.0% y/y while royalty income rose 2.9%.Locally,sales volumes growth was seen across the board, led by Tafel Lager. Ready to drink (RTD)and soft drink sales recorded double digit growth compared to last year, confirming the market's positive uptake of the Vigo soft drink.

SAB MILLER

Despite the strong macro environment, we are concerned about the possible impact the SAB Okahandja Brewery might have on NBS. SABMiller Namibia started production at its 260 000 hectolitre brewery in Okahandja during September this year. The introduction of the returnable format by Castle Brewing will change the competitive landscape of the Namibian brewing industry. SAB targets a medium term market share of 30% in Namibia.

DHN Drinks JV

The equity loss from the JV increased to N$120.0m in FY14, with the increase attributed to a fiercely competitive environment in South Africa and higher cost of goods sold per unit due to unfavourable production levels and mix. Although the DHN Drinks JV still shows a loss, taking into account royalties and production margins that NBL earn through selling to DHN Drinks directly from their Namibian brewery, NBL continue to make positive returns from the ongoing operations in South Africa. The volatility in the line item emphasises its unpredictable nature and uncertainty going forward.

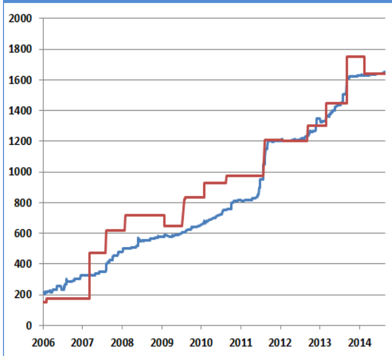
Valuation

We value NBS using the dividend discount model, with the required rate of return of 11.5%, based on a risk free rate of 8.22% (GC24), equity risk premium of 4.09% and a beta of 0.8, and a long-term sustainable growth rate of 7.5%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N$15.70 per share.

Using a justified PE multiple of 12.8x, however, we forecast a target price for NBS of N$16.40 per share. This implies anexpected total return of 3.9% over the next twelve months, largely supported by dividend payments. We are concerned as to the effect SAB will have on the company's market share going forward as well as the losses being carried as a result of the JV, however we do not expect the stock to trade significantly lower than current levels over the next 12 months given the illiquidity of the stock and the possibility that once sold shares may be difficult to rebuy in future, therefore we keep our recommendation on a **HOLD**.

We remain, however, concerned about the NBS business going forward, as we expect the increased competition in the local market to drive margin compression and sales-volume reductions for the business. Additionally, the losses experienced within the JV, and the migrating of local production to the Sedibeng Brewery are concerning, in that royalties from production at Sedibeng are significantly lower than lost revenues due to this migration, and this volume migration appears inadequate to notably reduce the JV loss, or make the JV profitable.

Share Price (c)



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Revenue

Namibia Breweries reported revenue of N$2.316bn in FY14, down 2.8% compared to FY13. The decrease inrevenue is attributed to a 3.0% decrease in sales of goods to N$2.244bn, which was mainly due the migration of production volumes to South Africa. Royalties however, increased slightly, up 2.9% to N$72.5mcontributing only 3.1% to total revenue, nonetheless,up from 3.0% last year.

Segmental Revenue

	FY13	FY14	y/y % Δ	FY13 Contribution	FY14 Contribution
Beer	2,044,668	2,105,731	**3.0%**	85.8%	**90.9%**
Softs	108,586	121,247	**11.7%**	4.6%	**5.2%**
RTDs	220,199	82,808	**-62.4%**	9.2%	**3.6%**
Other	9,931	7,146	**-28.0%**	0.4%	**0.3%**

Source: NBS

From a segmental perspective, beer continues to be the most significant contributor. In FY14, beer revenue grew 3.0%, contributing 90.9% of overall revenue. Soft drinksperformed handsomely over the period, increasing 11.7% and contributed 5.2% to revenue, slightly more than the 4.6% in FY13. Revenue from RTD's however, declined 62.4% and contributed less to overall revenue, with 3.6% of revenue attributed to RTDs. The decline in RTD revenue is attributed to a transfer of volumes to Sedibeng Breweries in South Africa.

Export Sales

	FY13	FY14	y/y % Δ
DHN Drinks	1,250,549	885,128	**-29.2%**
Heineken SA	87,115	108,078	**24.1%**
Diageo SA	71,172	36,870	**-48.2%**
Diageo GBP	8,739	-	**-100.0%**
Export Sales	**1,417,575**	**1,030,076**	

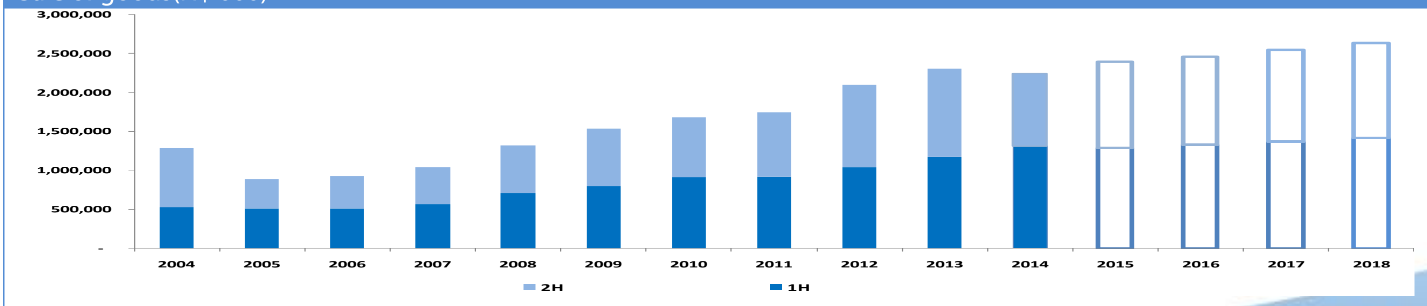
Source: NBS

Locally, beers sales continued to perform exceptionally well, with Tafel Lager outperforming within the beer portfolio. Windhoek Draught sales did well, contributing significantlyto the overall growth in volumes, while Windhoek Lagercontinuedto decline, due to migration to Tafel Lager, on the back of the lower price.The RTD range and soft drink sales have seen double digit growth in the local market compared to the prior year with Vigo having rooted itself in the premium soft drink market.

In South Africa, total volumes produced by NBS and sold to theDHN Drinks joint venture (JV) decreased, with total beer and RTD volumes down 24% and 87% respectively, which according to managementis in line with the volume migration plan. The migration of volumes to the Sedibeng Breweryin South Africa resulted in the value of sales decreasing 27.3% for NBS.

NBS indicated that other export markets have showed a mixed performance, noting increased competition within the SADC markets. Total beer volumes sold to export markets were up by 4% whereas RTD volumes were down by 36% compared to FY13. The company has decided to go a more focused route, decreasing their target markets from 13 to 4. The four markets are Botswana, Mozambique, Tanzania and Zambia, with the rest being regarded as trading markets. Volumes exported to the Tanzania and Mozambique increased compared to the previous year, thus showing good growth in volumes albeit from a low base.

Sale of goods(N$'000)



Source: NBS

Pricing

Over the past year, we have witnessed that Castle Brewing Namibia has been setting higher prices and NBS has been following these increases. Our latestpricelist, effective 17 March this year, once again showed NBS followingCastle Brewing Namibia on price increases. Prices are usually adjusted again in October, but so far there has been no suchadjustment made by Castle Brewing Namibia, except for charges on return bottles which was set at 87 cents on a returnable that effected prices and the price for crates are N$9.57. This is after production started at the Castle brewery in Okahandja, as Castle now offers the return option. NBS however, made a few strategic price changes to their portfolio.

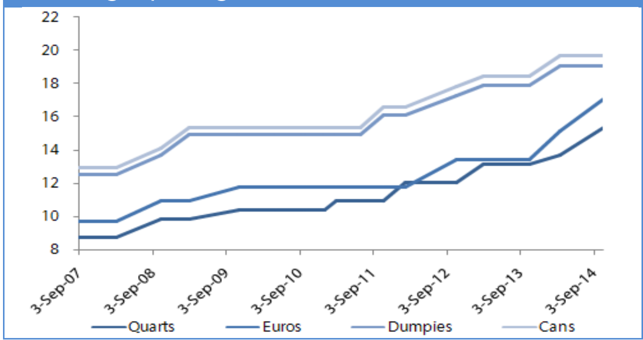
In October the only price increase seen within the NBS product offeringwasfor the Tafel Lager Euro, up 12.7%, the Tafel Lager Quart, up 12.0%and the Windhoek Draught Quart, up 7.7%. Interesting to note is that the recommended selling price of Quarts for Windhoek Lager, Windhoek Draught and Tafel Lager arenow the same, at N$14.00 per unit. This follows the migration away from Windhoek Larger to the previously cheaper TafelLager.The strategic pricing of the brands in the main stream segment of the market, together with the Windhoek Brand marketing, one canexpect to see Windhoek volumes stabilise after the decline seen in volumes due to this migration to Tafel Lager.

	Windhoek Lager		Tafel Lager		Black Label & Castle Lager	
	N$// October 2014	y/y % change	N$// October 2014	y/y % change	N$// October 2014	y/y % change
Quarts	15.36	0.0%	15.36	12.0%	17.27	7.2%
Euro	17.05	0.0%	17.05	12.7%		
Dumpies	21.76	0.0%	19.10	0.0%	22.08	0.0%

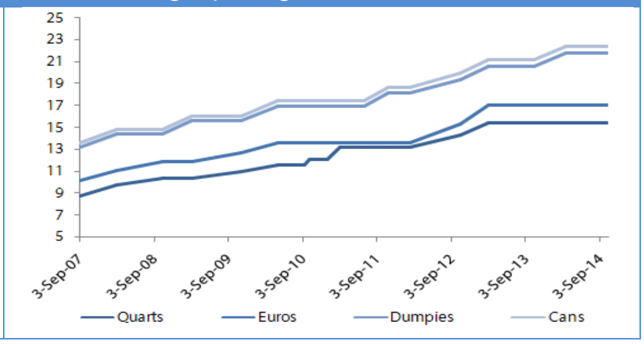
Source: CBN pricing list, NBS pricing list, IJG Research

After the recent increase, Castle Lager/Black Label is now more expensive than theWindhoek Lagercomparable ranges. The SAB products are also considerably more expensive than the Tafel Lager counterparts.Given the sensitivity of the mainstream segment of the Namibian beer market, one can expect to see Tafel Lager continue to outperform Windhoek Lager and Castle Lager/Black Label over the near-term, however whether this will remain the case when the Castel Brewery is fully operational and looking to capture market share, remains to be seen.

Tafel Lager pricing – N$//

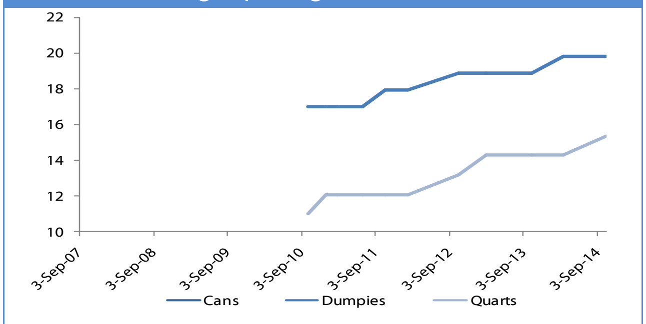


Windhoek Lager pricing – N$//



Source: NBS pricing list

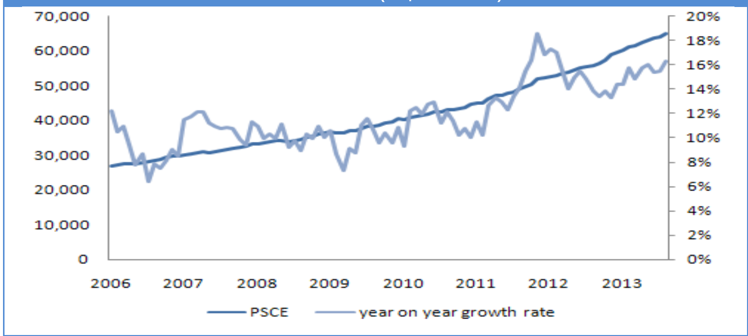
Windhoek Draught pricing – N$//



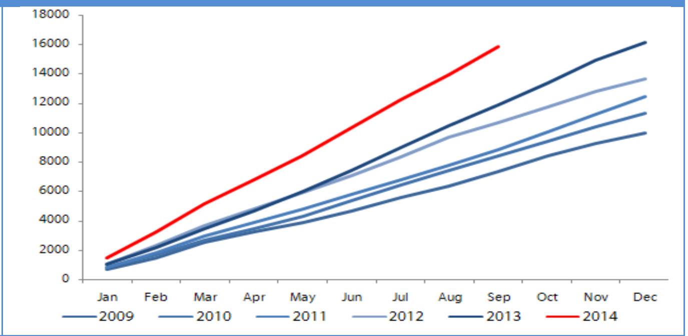
Macro Environment

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

Private Sector Credit Extension (N$million)



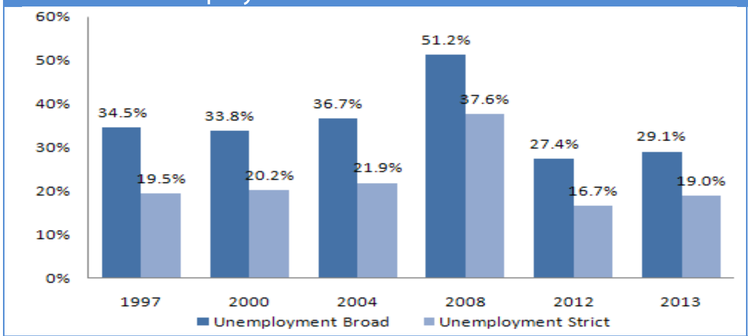
Year to Date Number ofVehicle Sales



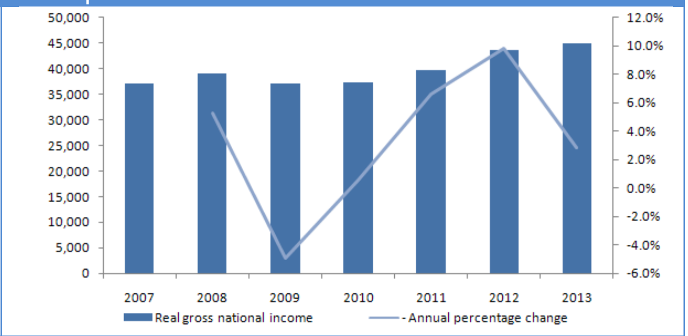
Source: NSA

Looking forward, the macro environment remains bullish, with favourable monetary and fiscal policies fuelling growth in disposable income and resultantly, domestic demand. Government policies have been very focused on creating jobs and improving income equality, with results starting to show in the unemployment rate and distribution of income.

Namibian Unemployment Rate



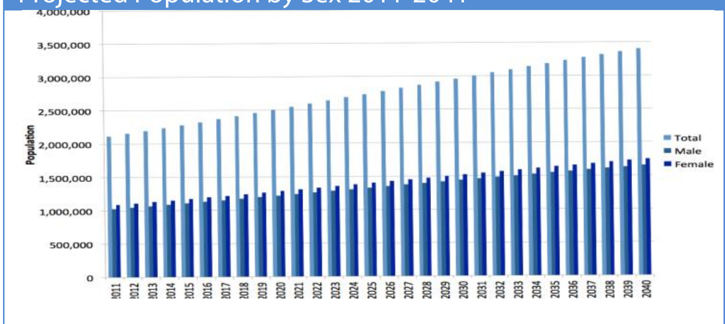
Per capita income – Real Namibian dollars



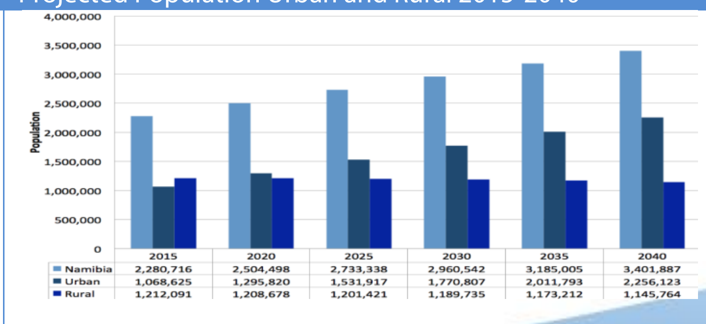
Source: NSA

Growth in the Namibian population alongside per capita beer consumption are key underlying factors in our forecast of local revenue. According to the 2013 Labour Force Survey, released by the Namibia Statistics Agency (NSA), the Namibian population was recorded at 2.1m people and in the recent Population Projections Statement, the NSA forecasted the Namibian population to grow to 3.4m by 2041, a growth rate of about 1.7% per annum. In our valuation of NBS we factored in a slightly more conservative future population growth rate of 1.4%. Also, the Namibian unemployment rate is currently at 29.6%, although it is up from 27.4% in 2012, it is still substantially lower than 51.2% in 2008. The lower unemployment rate is very positive for national income, with real gross national income growing 11.4% and 4.2% in 2012 and 2013, respectively. This will be positive for the per capita consumption rate of beer in Namibia which will in turn drive local volumes and enhance group margins.

Projected Population by Sex 2011-2041

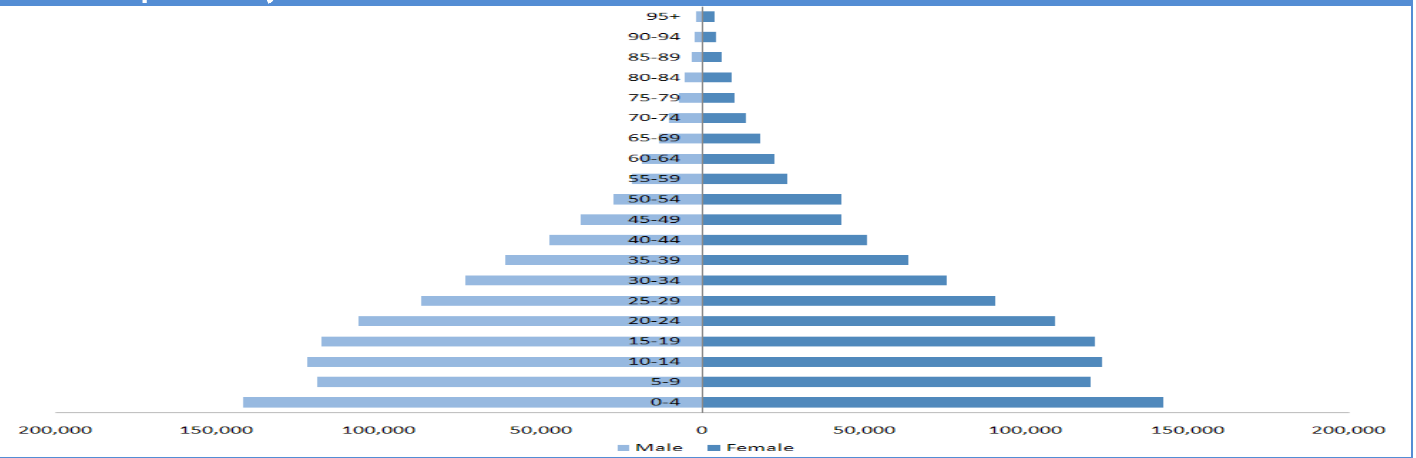


Projected Population Urban and Rural 2015-2040



The shape of the population pyramid also gives us an indication of demand for products and it has major implicationson strategies of breweries. A younger population pyramid gives an indication for future consumption of beer and with a bulge of children and teenagers set to become adults in the near future, growth in aggregate beer demand can be expected to increase on the back of the increase in consumer numbers.

Namibia Population Pyramid



Source: NSA

SABMiller Castle Brewing

Despite the strong macro environment, we are concerned about the possible impact the SAB Okahandja Brewery willhave on NBS. SABMiller Namibia started production at its 260,000 hectolitre brewery in Okahandja during September this year, with its inaugural brewbeing Carling Black Label. The company started with non-returnable glass bottles, which are now being converted into returnable bottles and cardboard packaging previously used has been replaced with plastic crates to be used at the brewery.In IJG's view the introduction of the returnable format by Castle Brewing will change the competitive landscape of the Namibian brewing industry. SAB targets a medium term market share of 30% in Namibia.

Operating Profits

In FY14 operating profit decreased by 9.7% to N$451.1m from N$500.1m last year, and the operating margin contracted150bps from 21.0% in FY13 to 19.5% in FY14. The subdued performance is a function of the weaker local currency, volume migration to South Africa, and the migration to lower cost products together with no price increases.

Raw materials and consumables which contributes almost half of total operating expenses decreased 11.8% as lower volumes was produced locally, but with the Namibian Dollar that weakened 11.0% against the Euro, the cost to import raw materials, such as malt, resulted in a drag on margins. Employment costs contributing12.4%, decreased marginally and administration and marketing expenses contributing 19.7% increased 34.7% on the back of the launch of the new marketing campaign.

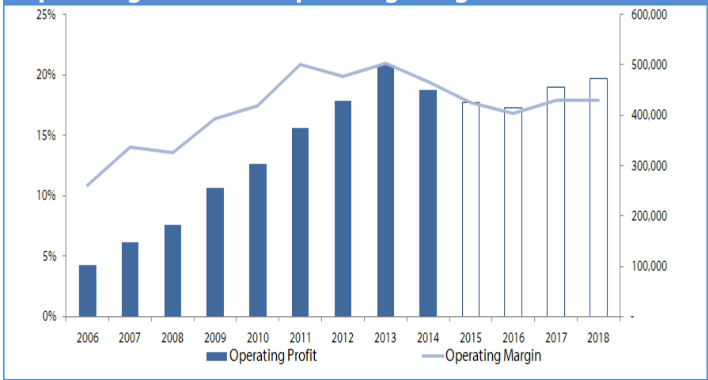
2014	Revenue	Operating Expenses	Operating Profit	Operating Margin
Beer	2,105,731	(1,677,423)	428,308	20.3%
Softs	121,247	(115,315)	5,932	4.9%
RTD	82,808	(68,732)	14,076	17.0%
Other	7,146	(4,131)	3,015	42.2%
Total	2,316,932	(1,865,601)	451,331	19.5%

The beer segment's operating margin decreased slightly by 170bps to 20.0% while RTDs operating margin widened significantly by 200bps to 17.0%, while the operating profit of the soft drinksgrew to 4.9% from 4.6%.

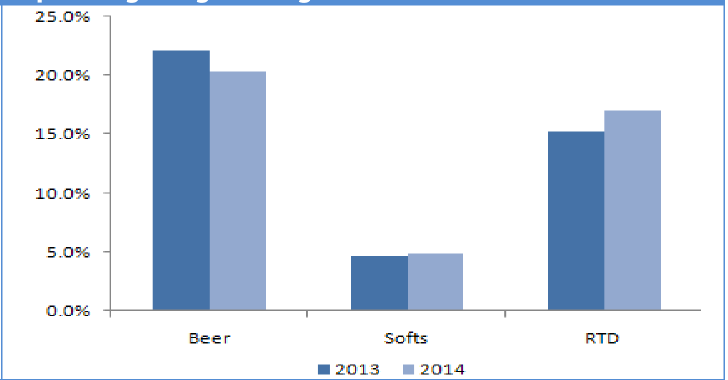
In the medium term we turn more negative on NBS operating margins and profits. The strong increases in local revenue had a leverage effect through to operating profits on the back of higher selling prices in the local market. We are however concerned of the inverse effect that might come through when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

NBS operating margin was at 20.98% as at FY13, the highest it has been since 2005. Margins mean revertedbelow 20% as we expectedand we forecastmargins to remain below the 20% level in the medium term as they arecoming of ahigh base.

Operating Profit and Operating margin



Operating margins – segmental breakdown



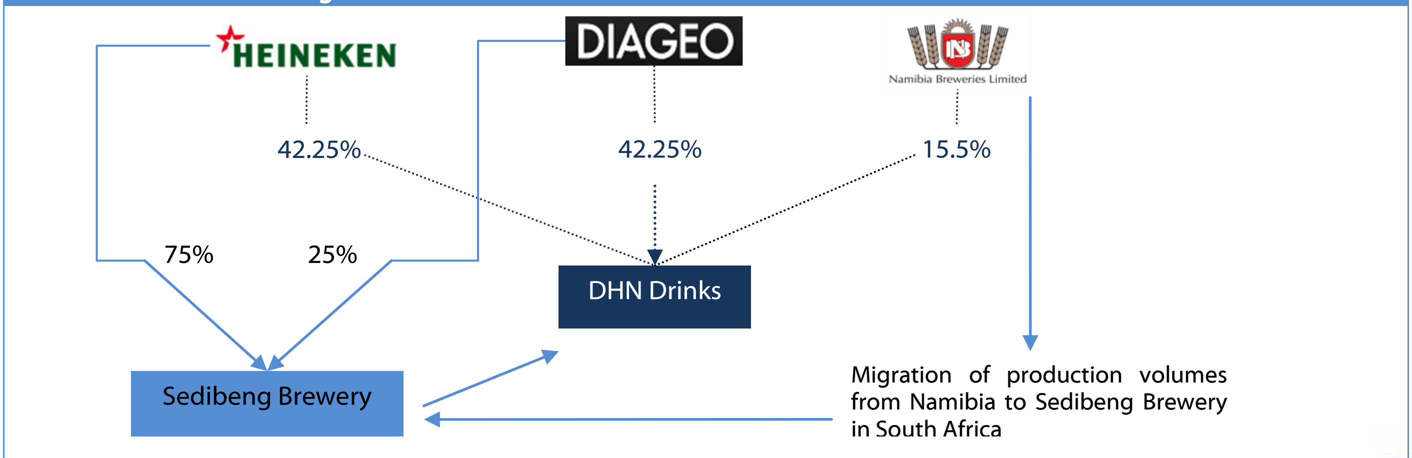
Source: NBS, IJG

DHN Drinks JV

Heineken and Diageo both own 42.25% in the DHN Drinks Joint Venture while NBS has the remaining 15.5% share. The JV was formed for the purpose of distributing products which are supplied by these three companies, produced at the NBS Brewery in Windhoek or by the Sedibeng Brewery, which is owned by Heineken and Diageo, of which ownership is split 75% and 25% respectively. The JV buys product from the two breweries on a cost-plus basis, which product is then distributed within the South African market. Thus, should the supplying breweries supply at a cost-plus basis above the retail price, or should the JV's marketing and distribution costs push the unit cost above the retail price, the JV will experience losses. Due to low volumes being produced at the Sedibeng Brewery, the unit cost of production remains relatively high, thus causing the JV to experience losses. As such NBS has migrated some of its production volumes away from the local brewery, to Sedibeng in an effort to address this challenge.This migration of volumes to from NBS to South Africa resulted in a 29.2% decrease in sales to the DHN Drinks JV from the local brewery.

The equity loss from the JV increased to N$120.0m in FY14, with the increase attributed to a fiercely competitive environment in South Africa and higher cost of goods sold per unit due to unfavorable production levels and mix.Although the DHN Drinks JV still shows a loss, taking into account royalties and production margins that NBL earn through selling to DHN Drinks, NBL continue to make positive returns from the ongoing operations in South Africa.However, the volatility in the line item emphasises its unpredictable nature and uncertainty going forward.

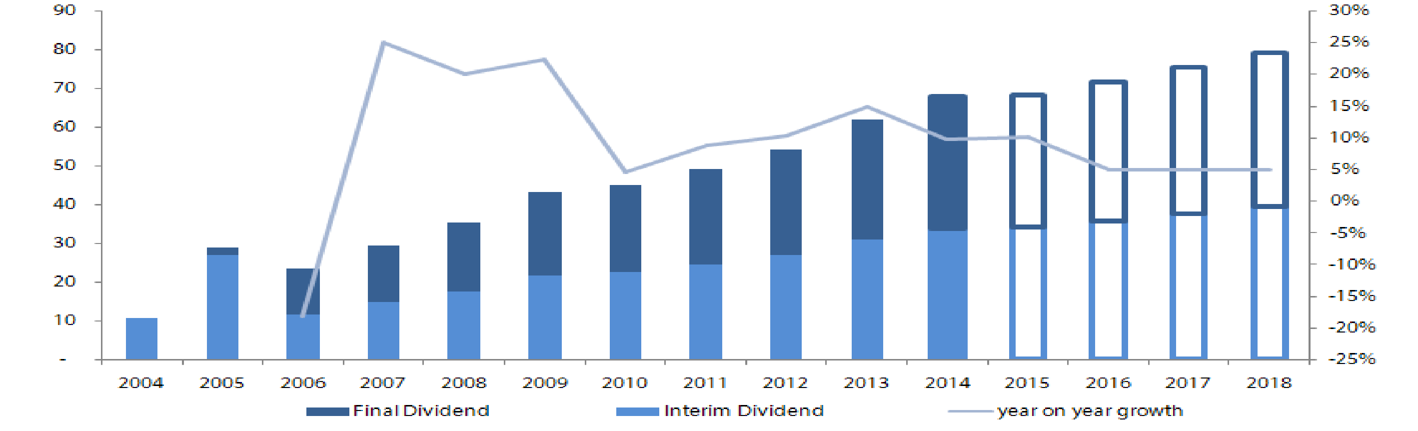
DHN Drinks and Sedibeng



Dividends

The full year results reflect disappointing operational performance with operating profit down 9.7% y/y. Basic EPS rose 181.9% y/y to 99.5c, coming of a low base after the N$188m impairment to its investment in DHN Drinks (Pty) Ltd last year that resulted in a decrease in earnings per share in FY13. HEPS, however, is down 10.5% from 177.8c to 159.1c. The board declared a final dividend of 34cps, taking the total dividend for the year to 68cps,up 9.7% on last year, with last day to trade cum 21 November 2014. We forecast dividends to remain unchanged at 68cps in FY15, 71cps in FY16 and 75cps in FY17.

Growth in dividends



Source: NBS, IJG

Valuation

We value NBS using the dividend discount model, with the required rate of return of 11.5%, based on a risk free rate of 8.22% (GC24), equity risk premium of 4.09% and a beta of 0.8, and a long-term sustainable growth rate of 7.5%

Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N$15.70 per share. Using a justified PE multiple of 12.8x, however, we forecast a target price for NBS of N$16.40 per share. This implies an expected total return of 3.9% over the next twelve months, largely supported by dividend payments. We are concerned as to the effect SAB will have on the company's market share going forward as well as the losses being carried as a result of the JV, however we do not expect the stock to trade significantly lower than current levels over the next 12 months given the illiquidity of the stock and the possibility that once sold units may be difficult to rebuy in future, therefore keep our recommendation on a HOLD.

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