IJG Securities (Pty) Ltd.
Member of the NSX

NAMIBIA BREWERIES LIMITED
FY15 Results Review
OCTOBER 2015

Namibia Breweries Ltd

FY15 Results Review

Target Price (c)	2300
Current Price (c)	2216

Year End 30 June	2013	2014	2015	F2016	F2017
Revenue (N$m)	2,383	2,316	2,434	2,536	2,609
Operating Profit	500	451	506	552	569
HEPS (c)	178	159	187	197	202
HEPU growth (%)	18.9	-10.5	17.6	5.3	2.7
PE	12.5	22.2	11.8	11.3	10.9
DPS (c)	62	68	74	80	85
DY	2.8	3.1	3.3	3.6	3.9
EV/EBITDA	11.1	12.3	11.0	10.1	10.0

Recommendation	HOLD
NSX Code	NBS
Market Cap (N$m)	4,568
Shares in Issue (m)	207
Free float (%)	50
P/B (x)	2.8
52 week high	2216
52 week low	1642
Expected Total Return (%)	7.5

Source: BVN, IJG

FY15 Results

Namibia Breweries (NBS) released results for the year ended 30 June 2015. The full year results reflect a stable operational performance with operating profit up 12.2% y/y. Basic EPS increased 26.0% y/y to 125.4c and HEPS is up 17.6% from 159.1c to 187.1c. The board declared a final dividend of 37cps, taking the total dividend for the year to 74cps, up 8.8% on last year.

Sales and Volumes

NBS managed to increase local sales volumes, however, export sales declined with the migration of ready to drink (RTD) production to Sedibeng Brewery. Revenue increased by 5.1% y/y to N$2.434 billion, with total sales of goods up by 5.0% y/y, while royalty income rose 9.0%. Locally, sales volumes continued to increase on the back of beer sales, which was led by Tafel Lager and Windhoek Draught. As RTDs are generally a lower margin business than the core, beer, business, the drop in RTD volumes lead to an increase in the operating margin and cushioned the blow on the bottom line.

Revenue per Category	FY14	FY15	y/y % Δ
Beer	2,105,731	2,266,443	7.6%
Softs	121,247	133,911	10.4%
RTDs	82,808	29,146	-64.8%
Other	7,146	4,677	-34.6%
Total	**2,316,932**	**2,434,77**	**5.1%**

Export Markets

Volumes produced by NBS and sold to the DHN Drinks joint venture (JV) in South Africa increased slightly in FY15, however the total value of export sales to South Africa, including products sold to Heineken and Diageo, decreased by 8.9% or N$91.8 million, largely on account of the migration of production volumes to the Sedibeng Brewery in South Africa. According to management, this is in line with the volume migration plan, together with the fact that Diageo is selling out of the JV. Most of the migration was from the RTD products, which in value terms decreased by N$53.7 million or 64.8% for NBS. Export sales continued to decline as a percentage of total sales of goods, as production was moved from the local plant to the Sedibeng Brewery. Export sales to South Africa were recorded at 39.8% of total sales, down from 45.9% a year ago.

Export Sales	FY14	FY15	y/y % Δ
DHN Drinks	885,128	912,228	3.1%
Heineken SA	108,078	26,089	-75.9%
Diageo SA	36,870	-	-100%
Total	**1,030,076**	**938,317**	**-8.9%**

DHN Drinks JV

The equity loss from the JV increased to N$127.5 million in FY15, from N$120.3 million in FY14, with the increase attributed to a fiercely competitive environment in South Africa and timing differences relating to marketing and operational spend.

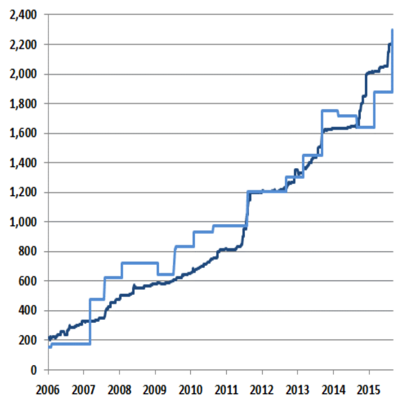
On 27 July 2015, NBS entered into an agreement to acquire 25% of the issued share capital of Sedibeng Brewing (Pty) Ltd and an additional 9.5% of the issued share capital of DHN Drinks (Pty) Ltd from Diageo Highlands Holdings. The total estimated investment required is N$570.0 million, which according to the company will be "financed out of operations and by way of a medium term loan to the amount of N$200.0 million".

Valuation

We use a dividend discount model to assess the intrinsic value of the company. Our required rate of return, of 14.1%, is based on a risk free rate of 8.41%, equity risk premium of 4.5%, a beta of 1.0, and a long-term sustainable growth rate of 10%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N$18.45 per share.

Using a justified PE multiple of 12.0x, however, we set a **target price for NBS of N$23.00** per share. This implies an expected total return of 7.5% 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 FY16 and FY17. Nevertheless, we change our **SELL** recommendation to **HOLD**, based on the company's improved outlook following developments with the JV.

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

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Key Points

- On 27 July 2015, NBS entered into an agreement to acquire a 25% stake in the Sedibeng Brewery and to take its stake in DHN Drinks to 25%, by buying a further 9.5%.

- 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 rime 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 may put pressure on the short-term finances of NBS.

- Despite the positives, we remain concerned about the possible impact the SAB brewery in Okahandja will have on NBS, given the current high market share enjoyed by NBS, and the high margin nature of the Namibian beer market relative to the SA based market.

- The introduction of the returnable format by Castle Brewing will change the competitive landscape of the Namibian brewing industry, especially in the main stream segment of the market as the consumer in this target group is price sensitive.

- The poor rainfall seasons over the last two 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 FY16 and FY17. 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.

- 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.

Revenue

Namibia Breweries reported revenue of N$2.434 billion in FY15, up 5.1% compared to FY14. The increase in revenue is attributed to a 5.0% rise in sales of goods to N$2.355 billion, as Namibian beer volumes continued to increase, despite export volumes declining. Royalties increased by 9.0% to N$79.1 million contributing only 3.2% to total revenue, nonetheless, up from 3.1% for last year.

Revenue per Category	FY14	FY15	y/y % Δ	FY14 Contribution	FY 15 Contribution
Beer	2,105,731	2,266,443	7.6%	90.9%	93.1%
Softs	121,247	133,911	10.4%	5.2%	5.5%
RTDs	82,808	29,146	-64.8%	3.6%	1.2%
Other	7,146	4,677	-34.6%	0.3%	0.2%
Total	**2,316,932**	**2,434,177**	5.1%	100%	100%

Source: NBS

From a segmental perspective, beer continues to be the most significant contributor to revenue, making up 93.1% of total revenue. In FY15, beer revenue grew 7.6%, which was mainly driven by local beer sales. Soft drinks performed well over the period, increasing 10.4% and contributed 5.5% to revenue, slightly more than the 5.2% in FY14. Revenue from RTD's, however, declined 64.8% and contributed less to overall revenue than in FY14, with 1.2% 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.

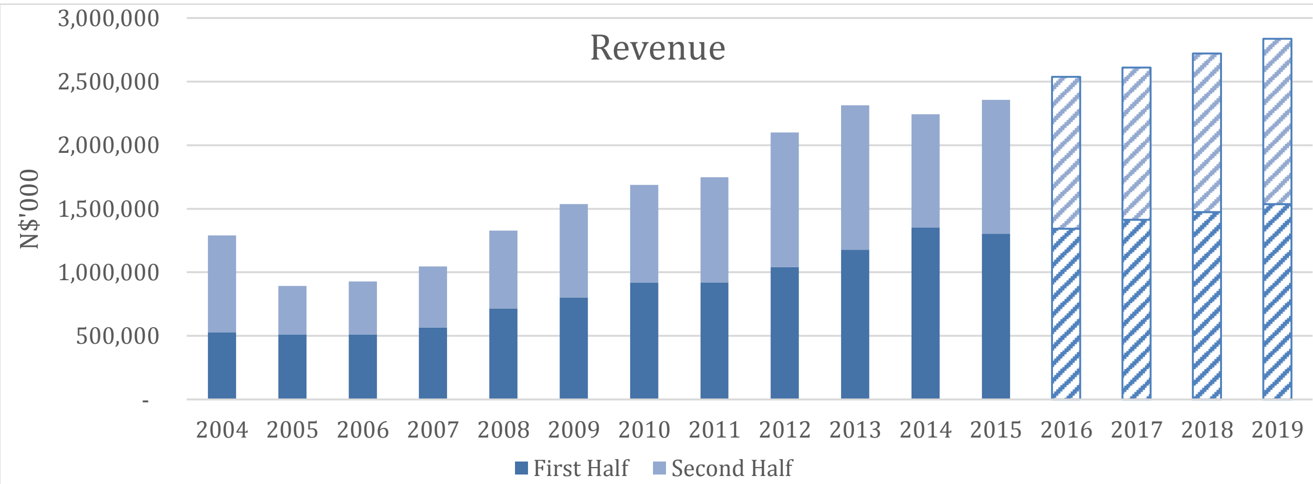
Locally, beers sales continued to perform well, with Tafel Lager outperforming within the beer portfolio. Windhoek Draught sales also increased, contributing significantly to the overall growth in volumes, while Windhoek Lager continued to decline, due to consumer migration to Tafel Lager and Windhoek Draught. The RTD range and soft drink sales saw double digit growth in the local market compared to the prior year with Vigo having rooted itself in the premium soft drink market, with a third variant that was released during the year.

South Africa Export Sales	FY14	FY15	y/y % Δ
DHN Drinks	885,128,000	912,228,000	3.1%
Heineken SA	108,078,000	26,089,000	-75.9%
Diageo SA	36,870,000	-	-100.0%
Export Sales	**1,030,076,000**	**938,317,000**	-8.9%

Source: NBS

Volumes produced by NBS and sold to the DHN Drinks joint venture (JV) in South Africa increased slightly in FY15, however the total value of export sales to South Africa, including products sold to Heineken and Diageo decreased 8.9% or N$91.8 million, largely on account of the migration of production volumes to the Sedibeng Brewery in South Africa, which according to management is in line with the volume migration plan, together with the fact that Diageo is selling out of the JV. Most of the migration was from the RTD products, which in value terms, decreased by N$53.7 million or 64.8% for NBS. Export sales continued to decline as a percentage of total sales of goods, as production was moved from the local plant to the Sedibeng Brewery. Export sales to South Africa were recorded at 39.8% of total sales, down from 45.9% a year ago.

NBS indicated that other export markets showed a mixed performance in FY15, noting increased competition within the SADC markets. Total beer volumes exported to Tanzania and Zambia increased compared to the previous year, albeit both from a low base. Volumes sold to Mozambique, however, slowed down with brand competition challenges, while growth in Botswana has been impacted by the increase in alcohol levy. The alcohol levy in Botswana was increased further in January this year, by 10 percentage points, taking it to 55%, resulting in a spike in the price of alcohol with immediate effect.

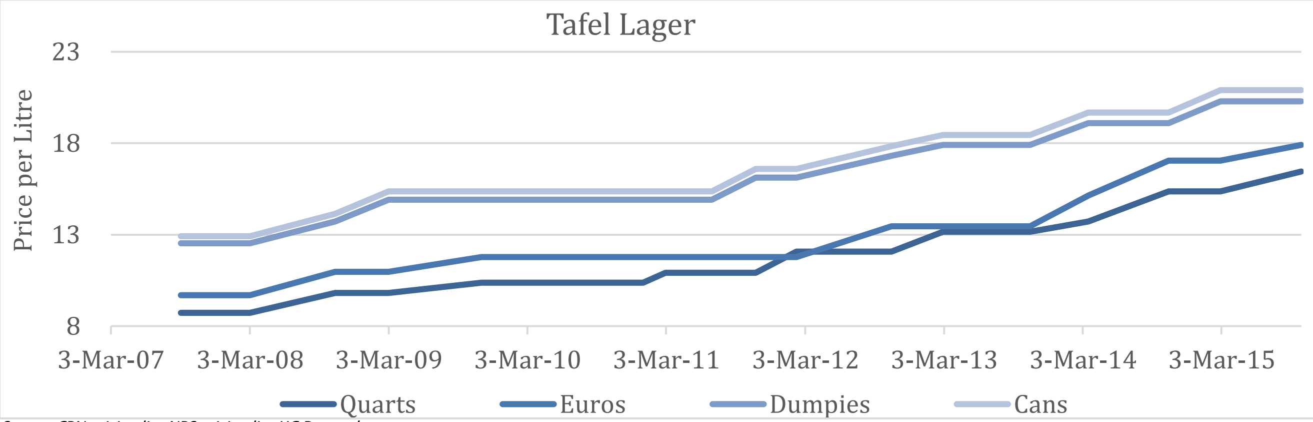


Source: NBS

Pricing and Competition

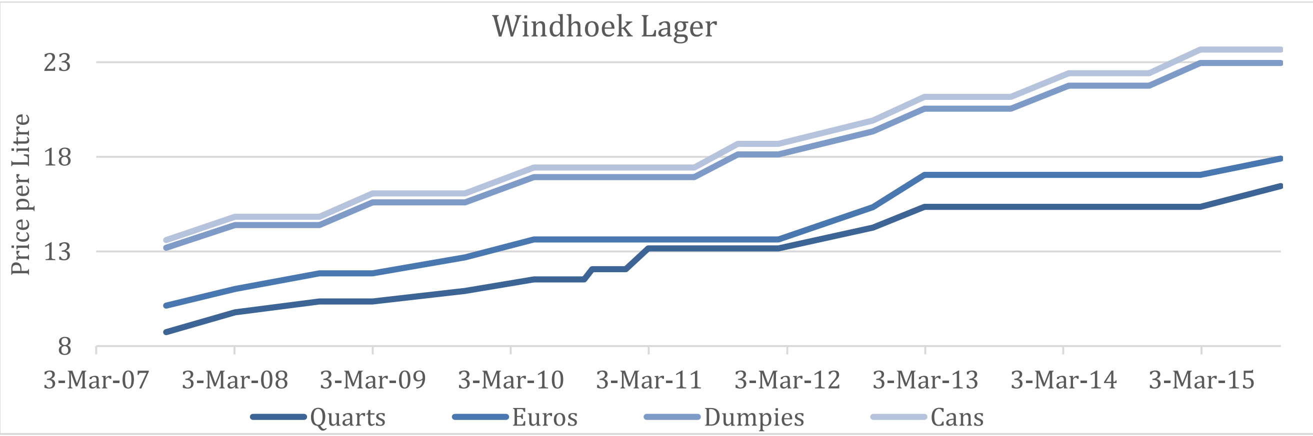
Price changes by Namibia Breweries and SABMiller Namibia are usually released twice a year, effective March and October. Over the past few years, we have witnessed that Castle Brewing Namibia has been setting higher prices and NBS has been following these increases, as was the case for March this year, however, it seems NBS has taken lead this time round with no indication of price changes from Castle Brewing Namibia in October 2015, while NBS increased prices as normal.

According to our latest price list, effective 1 October this year, the price of Tafel Lager Euros was increased by 5.0%, the Tafel Lager Quarts, by 7.1%, while the price of Tafel Lager Dumpies and Cans were increased in March this year by 6.3%.



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 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 this 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 Larger to the previously cheaper Tafel Lager.



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

The strategic pricing of the brands in the main stream segment of the market, together with the Windhoek Brand marketing, one can expect to see Windhoek volumes stabilise after the decline in volumes seen due to this migration to Tafel Lager.

After the recent changes, 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, with the Castel Brewery is looking to capture market share, remains to be seen. 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.

	Windhoek Lager		Tafel Lager		Black Label & Castle Lager	
	N$/l	y/y % change	N$/l	y/y % change	N$/l	y/y % change
Quarts	16.46	7.1%	16.46	7.1%	17.18	0.0%
Euro	17.90	5.0%	17.90	5.0%		
Dumpies	20.29	0.0%	22.97	0.0%	23.88	0.0%

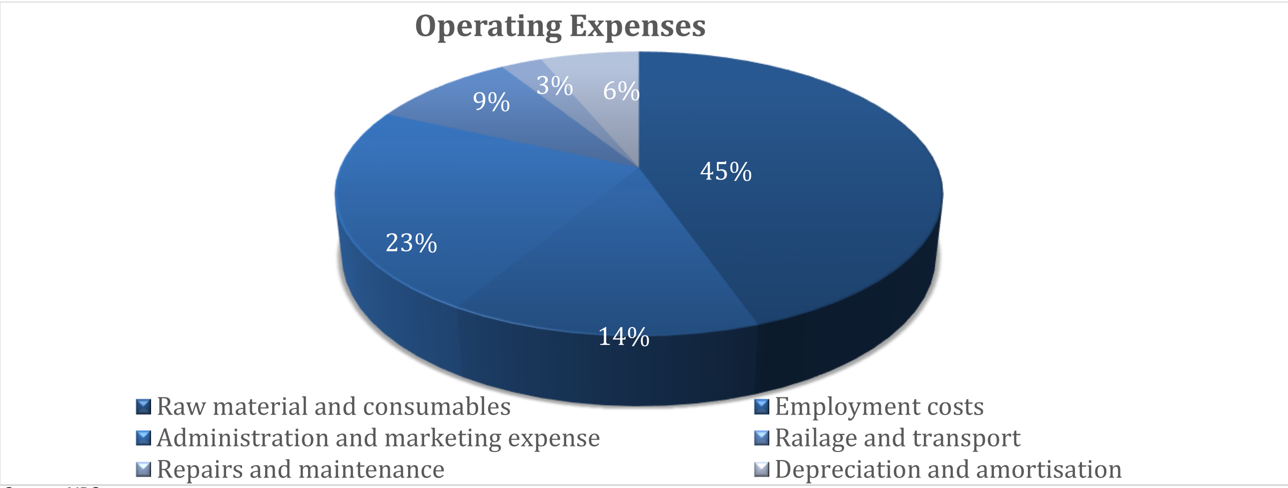
Source: CBN pricing list, NBS pricing list, IJG Research

SABMiller Namibia started production at its 260,000 hectolitre brewery in September last year. The company started with non-returnable glass bottles, which are now being converted into returnable bottles. Cardboard packaging previously used has been replaced with plastic crates to be used at the brewery. In IJG's view, the introduction of the returnable format by Castle Brewing will change the competitive landscape of the Namibian brewing industry, especially in the main stream segment of the market as the consumer in this target group is price sensitive.

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

Operating Profits

In FY15 operating profit increased by 12.2% to N$506.5 million, up from N$451.3 last year. The operating margin widened 130 basis points from 19.5% in FY14 to 20.8% in FY15. The better performance is a function of a decrease in operating expenses as raw material costs, consumables and transport costs was reduced significantly with the migration of volumes from the local plant to the Sedibeng Brewery in South Africa. Performance was offset to some extent by the weaker local currency, together with no price increases during the 1H15.



Source: NBS

Raw materials and consumables, which contribute almost half of total operating expenses, decreased 7.2% 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. 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 as from FY16. 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.

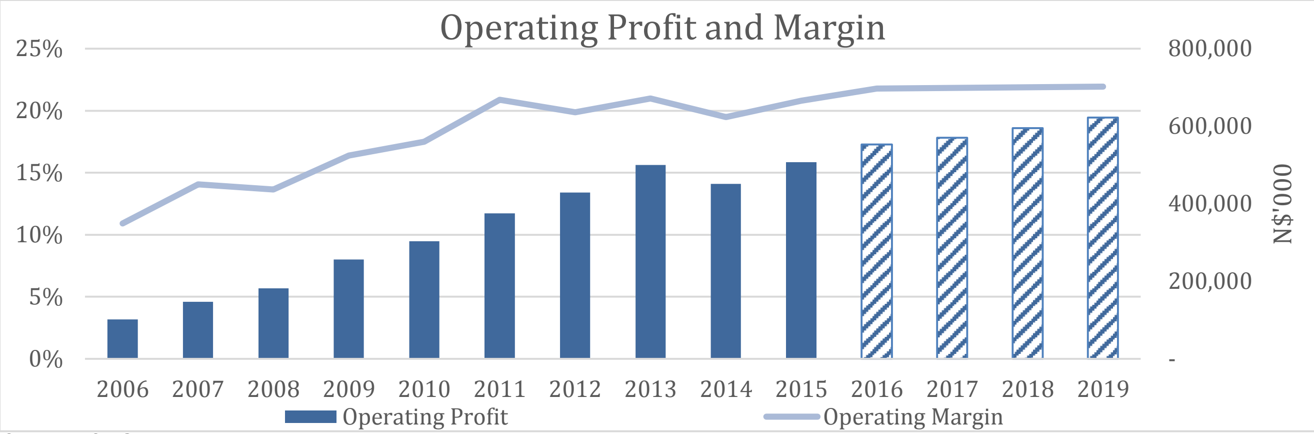
Employment costs, contributing 13.9% of total costs, increased by 16.0% and administration and marketing expenses, contributing 23.3%, increased 22.1% with the launch of the Windhoek Lager marketing campaigns earlier in the year.

Revenue per Category	Revenue	Operating Expenses	Operating Profit	Operating Margin
Beer	2,266,443	(1,766,701)	499,742	22.0%
Softs	133,911	(136,461)	(2,550)	-1.9%
RTDs	29,146	(21,006)	8,140	27.9%
Other	4,677	(3,495)	1,182	25.3%
Total	**2,434,177**	**(1,927,663)**	**506,514**	20.8%

Source: NBS

The beer segment's operating margin increased by 170 basis points to 22.0%, while the soft drinks segment made a loss of N$2.5 million in FY15. The RTDs operating margin widened significantly, to 27.9%, from 17.0% last year. The migration in RTD volumes to the Sedibeng Brewery led to the increase in the operating margin and this cushioned the blow on the bottom line as the RTDs are low margin business. Interesting to note is that while the revenue from the RTDs decreased 64.8%, the operating profit only fell 42.2%, indicating that the exported RTDs were previously sold at very low margins.

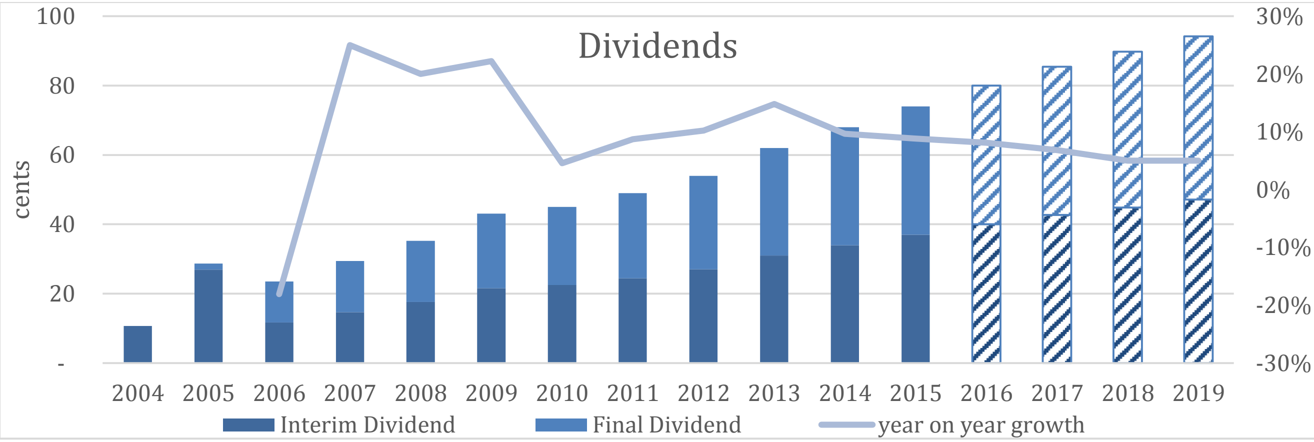
NBS operating margin widened to 20.8% in FY15, from 19.5% in FY14. This was a result of revenues increasing more relative to operating expenses. The strong increases seen over the last few years in local revenue had a leverage effect through to operating profits on the back of higher selling prices in the local market, and thus higher margins.



Source: NBS, IJG

Dividends

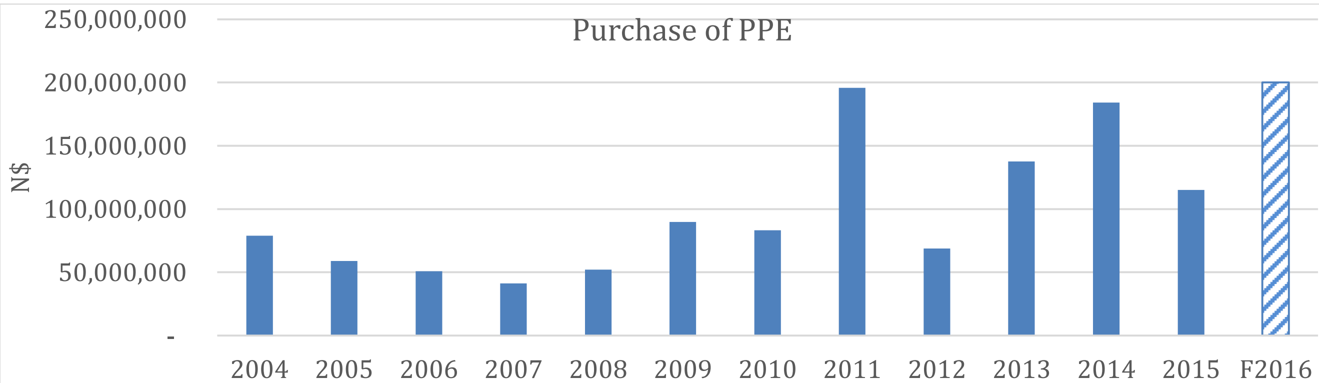
The full year results reflect a stable operational performance with operating profit up 12.2% y/y. Basic EPS rose 26.0% y/y to 125.4 cents and HEPS is up 17.6% from 159.1 cents to 187.1 cents. This strong growth, however, was at least in part attributable to a low base created in FY14, when HEPS fell 10.5%. The board declared a final dividend of 37 cents per share, taking the total dividend to 74 cents for the year, up 8.8% on last year, with last day to trade cum 23 October 2015. 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.



Source: NBS, IJG

Capital Expenditure

Over the past 12 years, NBS spent an average of N$96.4 million on expanding property plant and equipment annually. Management indicated that the company plans to invest approximately N$100.0 million above its normal capital expenditure during FY16 on several projects at the local plant, which include a new boiler, water and electricity saving projects and new labelling machinery for the plastic labels on the Windhoek brands.



Source: NBS, IJG

Sedibeng Breweries and DHN Drinks JV

The Deal

On 27 July 2015, NBS entered into an agreement to acquire a 25% stake in the Sedibeng Brewery and further its stake in DHN Drinks to 25%, by adding another 9.5% to its current holding. This came about after Heineken, Diageo plc and The Ohlthaver & List (O&L) Group of Companies, the majority shareholder of Namibia Breweries Limited, decided to restructure their respective joint venture operations in South Africa and Namibia.

Brandhouse Beverages (Pty) Ltd (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 of Heineken, Diageo and NBS. Heineken and Diageo each owned a 42.25% stake in DHN with NBS owning the remaining 15.5%.

Under the agreement, Diageo will sell its 42.25% stake in DHN to NBS and Heineken on the same terms so it will thereby increase Heineken's stake from 42.25% to 75% and NBS's holdings from 15.5% to 25%. NBS will also buy the 25% stake that Diageo owns in the 4.5 million hector liter Sedibeng Brewery in South Africa, while Heineken will retain its existing 75% stake in the brewery.

As part of the restructuring, Diageo will sell its 15% indirect shareholding in NBS to Heineken, increasing Heinekens indirect ownership to 29.9%. O&L will hold on to its 30.1% indirect stake with the balance being owned by local shareholders. Further, Diageo will acquire the remaining shares it does not already own in brandhouse, the beer and spirits sales and marketing joint venture in South Africa, which will become a wholly-owned subsidiary of Diageo

Diageo will receive a total net cash consideration of N$2.5 billion while Heineken will pay a total net cash consideration of approximately N$1.9 billion to Diageo for the equity and debt positions it acquires in Sedibeng, DHN and NBL and Diageo. Completion of the transaction is expected in 1Q16 and is subject to customary regulatory approvals.

New Joint Venture

The new NBS and Heineken joint venture in South Africa will focus 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, which is subject to regulatory approval, the existing joint venture with regards to brandhouse, DHN and the Sedibeng Brewery will be dissolved ahead of the previously agreed termination date, April 2018. 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 4 million hectolitres by September 2010. Management indicated that the Sedibeng Brewery is currently operating at 60% capacity, which will be increased to 100% in the medium term to achieve the maximum economies of scale, reducing unit costs of production.

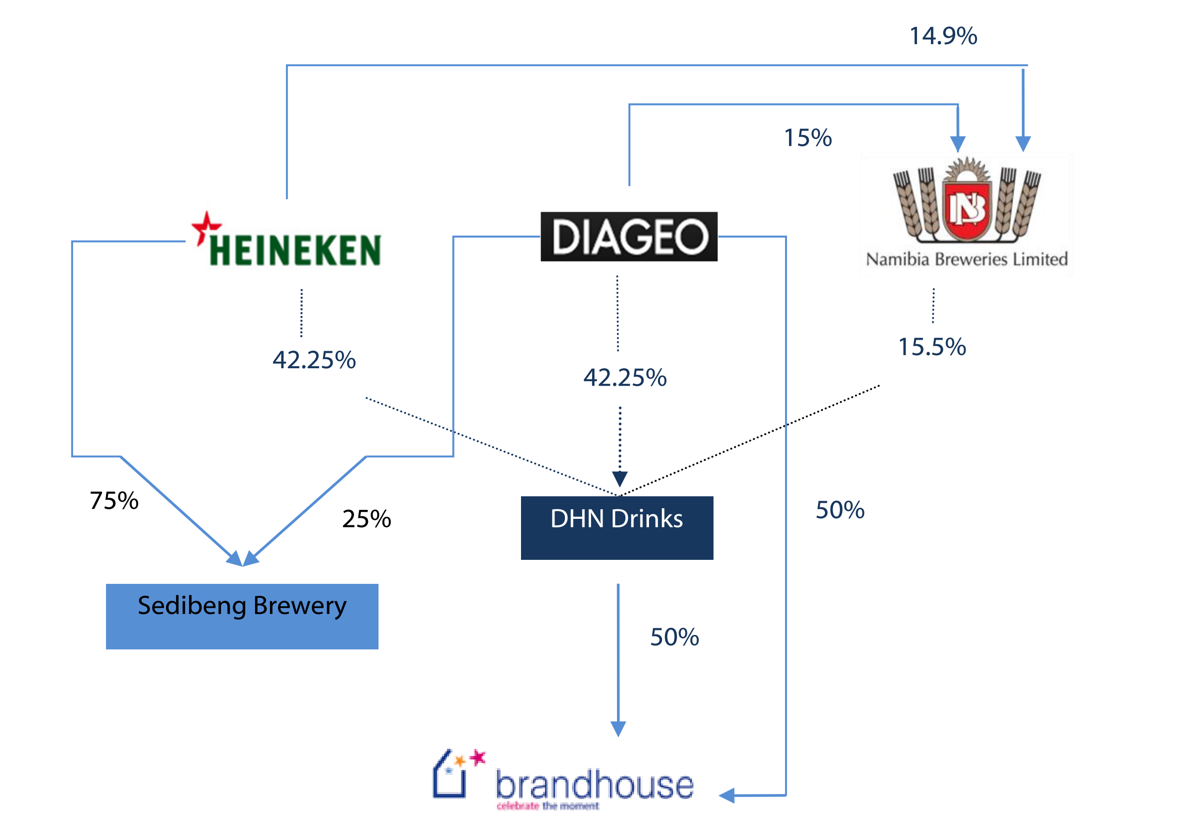
As we have mentioned in previous reports, gaining a share of the Sedibeng Brewery was critical to the JV's success from an NBL perspective and after the announcement of the deal, our optimism as to the JV improved significantly.

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. One 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.

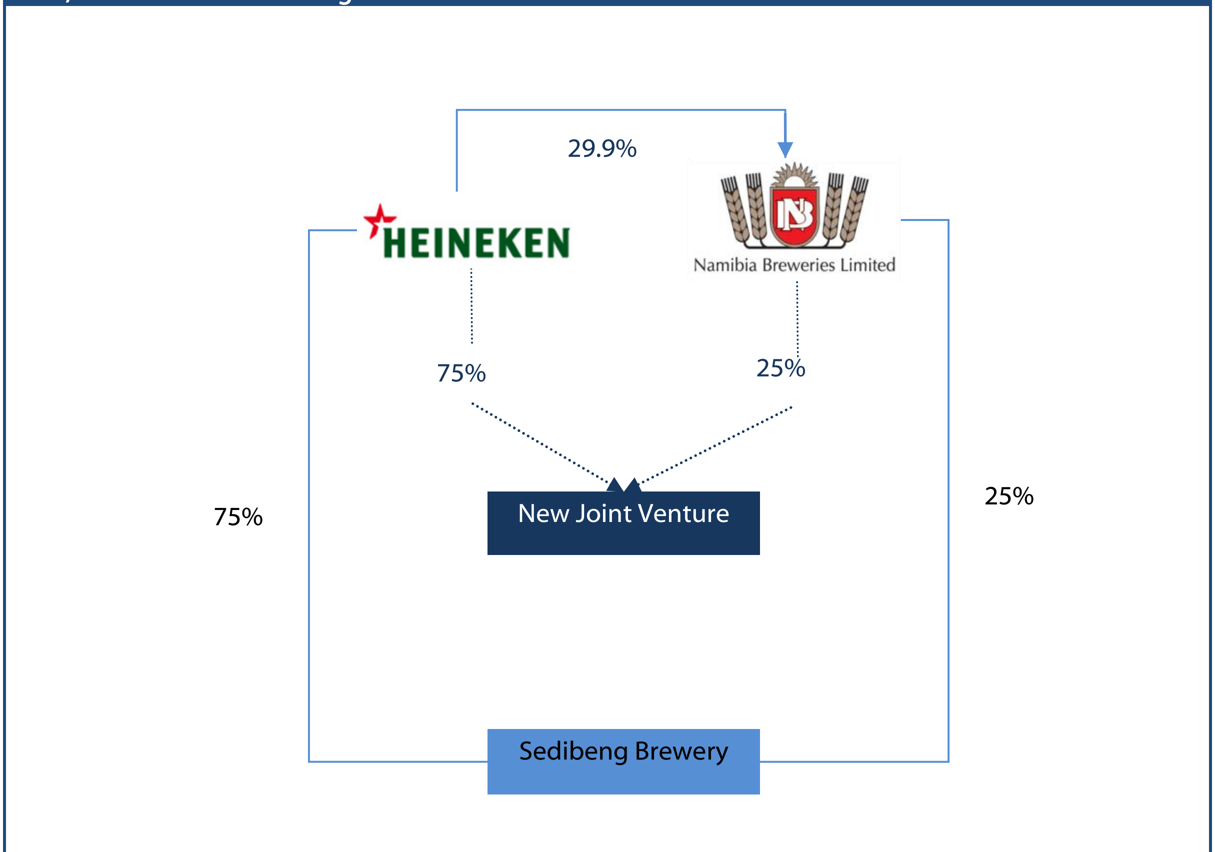
The JV has been a mixed failure and success. On the one hand it has assisted NBS to get a foothold in the SA market, while historic production volumes at the local plant have also been favorable due to the JV. The JV itself, has, however, remained loss making. However, going forward this is expected 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.

DHN Drinks and Sedibeng Brewery



Source: IJG

NBS, Heineken and Sedibeng



Source: IJG

Deal implications

The total consideration payable by NBS to Diageo for shares in Sedibeng and DHN was previously estimated R610.0 million, however, after discussions with management, they indicated that the deal will cost NBS closer to N$570.0 million. According to the company this will be "financed out of operations and by way of a medium term loan to the amount of N$200.0 million". Looking at the cash position of NBS, the net cash flows generated from operations, improved significantly from N$265.9 million in FY14 to N$466.3 million in FY15, with the cash position on the balance sheet reported at N$264.2 million, up significantly from N$55.9 million in FY14. NBS plans to utilize current 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 medium term loan amount of N$200.0 million, the debt to equity ratio will increase to 30%, which imply higher financial leverage for NBS, but not to the same extent as previously anticipated. RMB will fund the N$200.0 million medium term loan with cost of funding of Jibar plus 1.5% to 2.5%[1]. This will result in an estimated increase in costs, through funding charges, of approximately N$15.0 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, however we cannot form a clear cut investment opinion about the proposed transaction at this stage, as we will need more insight to the timing and dynamics of the deal and the Sedibeng Brewery operations. What is more certain, however, is that this deal could unlock significant value with economies of scale presented by the brewery.

[1] Management was unwilling to divulge the exact rate at the time of writing.

BOX Article: Potential Water Crisis

Poor rainfall seasons over the past two 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 1.2% and 36% at the end of September 2015.

The Omatako Dam is already empty, while the Von Bach Dam outside Okahandja currently holds 16 million cubic metres of water, of which only 14.2 million cubic metres can be used before it reaches its 'dead storage level'. The Swakoppoort Dam has 17.0 million cubic metres of water, of which 15.7 million cubic metres are usable. Total annual water demand in the central region is approximately 31.8 million cubic metres, of which 25.6 million cubic meters are in Windhoek. After September next 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. If the dams do not receive sufficient inflows, severe restrictions need to be enforced.

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 the company as they are heavily reliant on water supply to produce their products.

However, ahead of a possible water crisis in the central areas of the country, management is exploring different opportunities to save water and has indicated that the company at this stage has ongoing projects that are aimed at creating water-saving opportunities which forms part of the total budgeted expansion plan for property, plant and equipment in 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 be shared with Heineken, while there will still be costs incurred to maintain the plant in Windhoek.

As the first half of FY16 ends in December and the rainfall season ends in March/April next year, we have assumed that if a water crisis unfolds, the effect will be seen mostly in the FY17 results as no water restrictions have been implemented so far.

We estimated that revenues will decrease between 20% and 25% during FY16 and a further 35% to 40% in FY17. 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 unpredictability and the fact that the rainfall season is still ahead of us, 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.

Income Statement – Water Crisis Scenario

N$'000	2013	2014	2015	F2016	F2017
Revenue	**2,383,384**	**2,316,932**	**2,434,177**	**1,902,389**	**1,174,458**
Operating expenses	**(1,883,295)**	**(1,865,601)**	**(1,927,663)**	**(1,403,433)**	**(858,755)**
Raw material and consumables	1,051,378	927,394	860,587	430,294	215,147
Employment costs	251,202	231,702	268,714	268,714	134,357
Administration and marketing expense	273,057	367,681	448,969	336,727	112,242
Railage and transport	170,349	174,065	177,930	222,413	266,895
Repairs and maintenance	37,021	52,994	50,572	25,286	10,114
Depreciation and amortisation	100,288	111,765	120,891	120,000	120,000
Operating Profit	**500,089**	**451,331**	**506,514**	**498,956**	**315,703**

Source: NBS, IJG

Valuation

We use a dividend discount model to assess the intrinsic value of the company. Our required rate of return, of 14.1%, is based on a risk free rate of 8.41%, equity risk premium of 4.5%, a beta of 1.0, and a long-term sustainable growth rate of 10%. Based on these assumptions and our forecasted dividends for NBS, we value the company at an intrinsic value of N$18.45 per share.

Using a justified PE multiple of 12.0x, however, we set a **target price for NBS of N$23.00** per share. This implies an expected total return of 7.5% 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 FY16 and FY17. Nevertheless, we change our **SELL** recommendation to **HOLD**, based on the company's improved outlook following developments with the JV.

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