IJG

Securities (Pty) Ltd.
Member of the NSX

NAMIBIA BREWERIES LIMITED
FY16 Results Review
OCTOBER 2016

Namibia Breweries Ltd

FY16 Results Review

Target Price (c)	2790
Current Price (c)	2850

Year End 30 June	2014	2015	2016	F2017	F2018
Revenue (N$m)	2,317	2,434	2,426	2,454	2,513
Operating Profit	451	507	541	550	555
HEPS (c)	159.1	187.1	185.7	180.8	176.2
HEPU growth (%)	-10.5	17.6	-0.7	-2.6	-2.5
PE	22.2	11.8	15.3	15.8	16.2
DPS (c)	68	74	80	83	86
DY	3.1	3.3	2.8	2.9	3.0
EV/EBITDA	12.3	11.0.	10.7	9.1	8.3

Recommendation	HOLD
NSX Code	NBS
Market Cap (N$m)	5886.1
Shares in Issue (m)	206.5
Free float (%)	41
P/B (x)	4.7
52 week high	2850
52 week low	2202
Expected Total Return (%)	0.8

Source: BVN, IJG

FY16 Results

Namibia Breweries (NBS) released results for the year ended 30 June 2016. The full year results reflect a stable operational performance with operating profit up 6.7% y/y. Basic EPS increased 43.8% y/y to 180.3c and HEPS decreased 0.75% from 187.1c to 185.7c.

The large increase in basic EPS was largely attributable to the write back of a deferred tax asset in the new associate. The board declared a final dividend of 40 cps, taking the total dividend for the year to 80cps, up 8.1% on last year.

Heineken South Africa

NBS now holds a 25% stake in Heineken South Africa which is a merger of DHN Drinks and the Sedibeng Brewery. Heineken International now holds a direct stake of 75% in Heineken South Africa.

Sales and Volumes

Total revenue for the 2016 financial year decreased by 0.3% from the previous period. The lower revenue figure was largely a product of the contractual migration of production volumes from Windhoek to the Sedibeng brewery in Johannesburg.

Export Markets

Due to the volume migration, exports to south Africa decreased by 41.7%. Total beer volumes sold to export markets (excluding South Africa) declined by 5% in comparison with the prior reporting year. African export sales showed mixed results. While Zambia and Mozambique detracted from overall performance, Tanzanian volumes doubled for the third consecutive year, and still show further promise.

International sales volumes (ex-Africa), made up primarily of the UK, Germany and Australia, remained flat year on year.

Local Procurement

Local procurement made up 38% percent of commodity inputs and the group is continuously increasing their support to local procurement partners. Locally, 1800 tons of barley was produced in the financial year, and used exclusively to produce King Lager.

Deferred Tax Asset

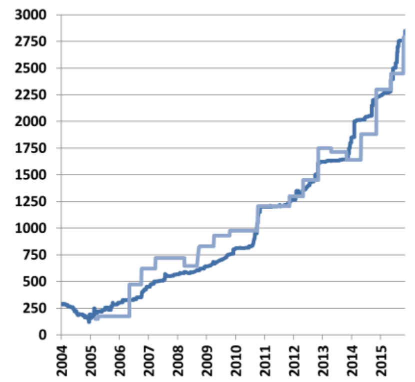
A deferred tax asset of R89.2 million was recognised in the books of NBS, being their share of the Heineken South Africa accumulated losses, now deemed recoverable. The recognition of this asset has translated into a profit per share of 43.2c.

Valuation

Using a EBITDA multiple method, assuming an exit multiple of 9.50x and discounted cash flow analysis on a 50/50 weighting, we set a target price of 2790cps. Based on the 28.5% appreciation in price over the last year, we believe the current price of the security has become somewhat demanding.

Based on our target price and estimated dividend, we expect a one year total return of 0.8%. While this is a below-cash return, the nature of the Namibian investment environment, characterised by an undersupply of investable assets, particularly in the equity space, and the illiquidity that results, means that the sale of the security may make its repurchase challenging. We thus continue to recommend a HOLD on this security, with the expectation of improved earnings in the future.

NBS Share Price vs Target Price



Dividends

Notice is hereby given that a final dividend of 40 cents per ordinary share was declared for the period ended 30 June 2016.

- Last day to trade cum dividend was 14 October 2016
- First day to trade ex-dividend was 17 October 2016
- Payment date: 11 November 2016

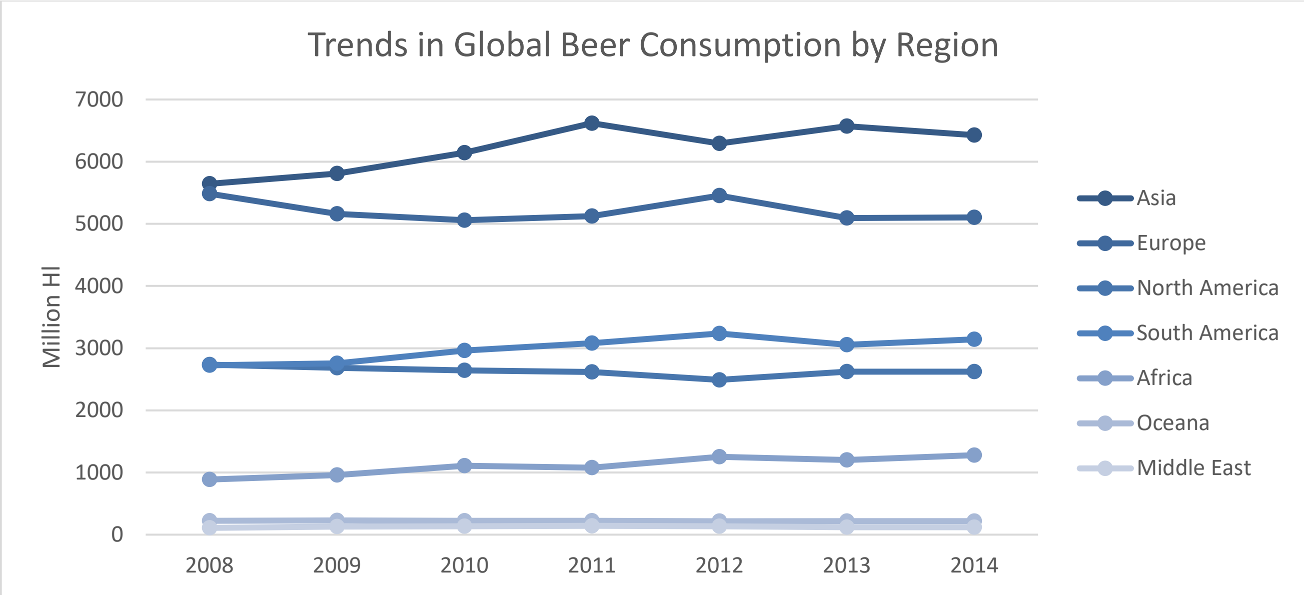
Analyst

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

Key Points

- NBS entered 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% in June 2015.
- The new structure has NBS owning 25% of DHN Drinks and 25% of Sedibeng Brewery and Heineken international owning 75% percent of both entities. DHN Drinks and Sedibeng Brewery were subsequently combined and renamed Heineken South Africa.
- Revenues decreased by 0.3% from the previous period, largely due to the contractual migration of production volumes from Windhoek to the Sedibeng Brewery in Johannesburg.
- Volumes of 320,000 hectolitres were migrated in FY16, this bring the cumulative migration figure to 560,000 hectolitres since FY14, concluding the contractual migration. Any further transfers will be at the discretion of management and will likely be dependent on the availability of water locally.
- Operating margin improved significantly due to lower input costs, while operating profits increased by 6.7%.
- Sedibeng brewery is making headway in achieving full capacity, we estimate they will run at full production within the next five years.
- Latest wholesale pricing reveals that SAB are gaining competitiveness, and appear to be aiming to undercut NBS on pricing. Castle Lager is now the cheapest lager in both the dumpy and quart sizes in the Namibian market.
- In line with worldwide health trends and the growth of the Lite beer category, NBS has launched Tafel Lite which has 27% less carbohydrates than Tafel Lager. This product is expected to compete with Castle Lite, however it remains to be proven.
- Water remains a concern, however NBS has made a lot of headway in water efficiency and have added to its own ability to supply a portion of its own needs, having drilled two boreholes on their premises. They are currently 28% self-sufficient.
- According to management, local barley is taking off, although the industry is still in its infancy. Quality is in line with international standards and a local malting plant may be a possibility in a few years' time.

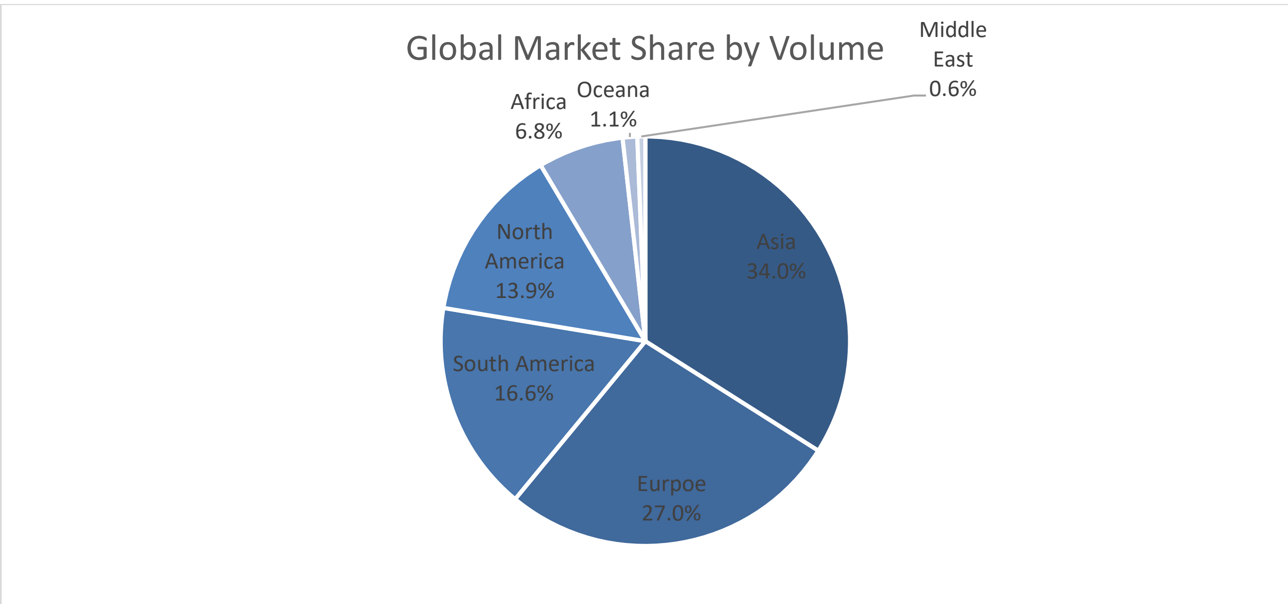
Global Trends



Source: Kirin Group

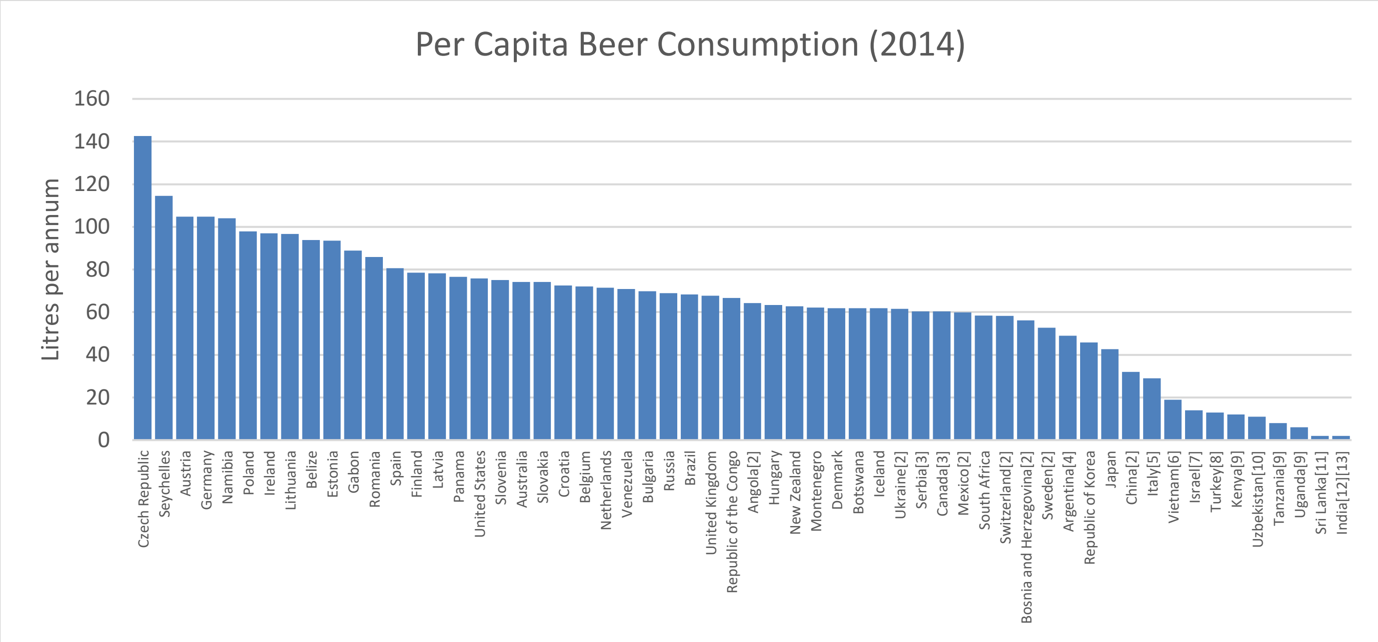
Growth in global beer volumes has stagnated somewhat over the last few years. The North America and European markets are largely saturated and South America, Asia and Africa remain the new growth frontiers. This hunt for growing markets is largely what drove the merger between AB Inbev and SABMiller.

Although Africa still makes up a small part of global volumes, at only 6.8%, it remains the fastest growing market. The last six years displayed growth of 6.3%. Estimates by Canadian research group points to compound annual volume growth in Africa of 5% from 2016 to 2020. This is in comparison to only 3% in Asia over the same period.



Source: Kirin Group

When looking at beer consumption per capita, Namibia breweries is in a privileged position. Research by the Kirin group shows that of the 58 countries surveyed, Namibia has the third highest beer consumption per capita, of 97.8 litres per annum, following only the Czech Republic and Austria. South Africa clocks in at number 41 at 58.4 litres per person. Over time it appears that South African consumption per capita has been slowly decreasing, from 61.8 litres in 2009 to 58.4 litres in 2014.

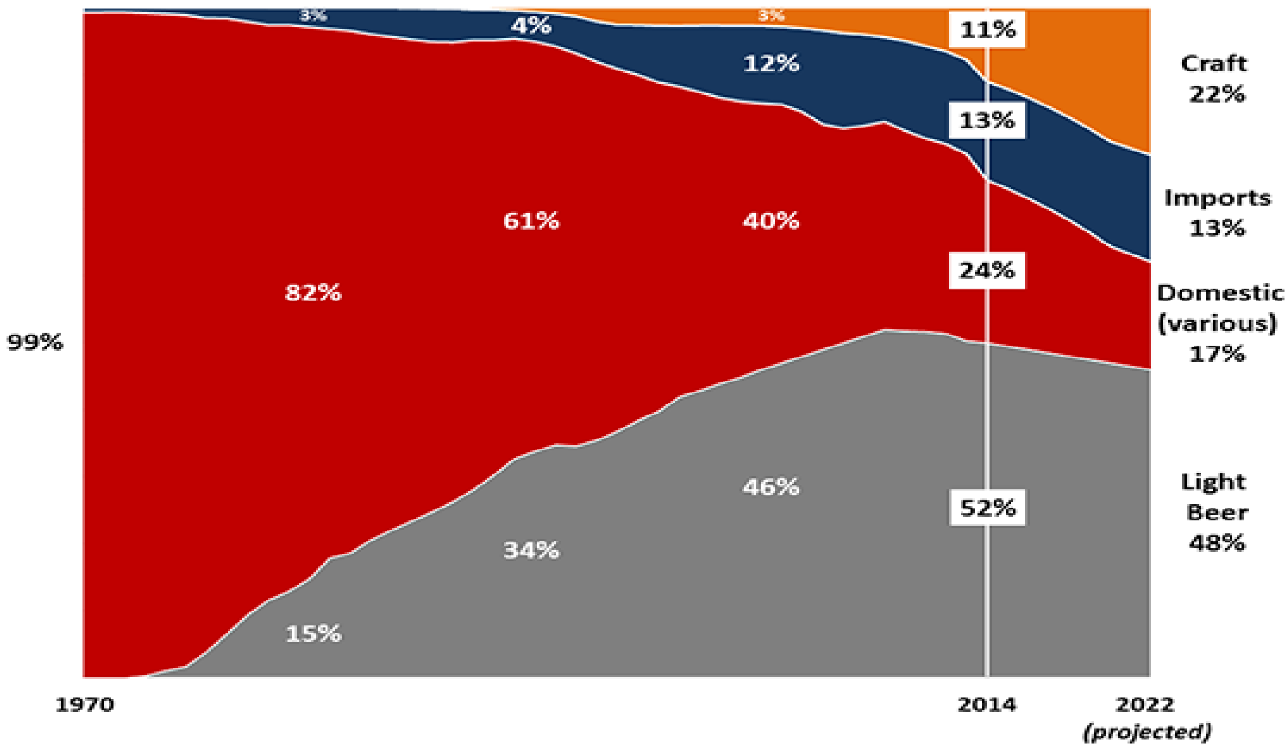


Source: Kirin Group

Craft beer has become one of the most attractive growth segments in beer. Craft offerings are artisanal products that often support local communities and provide an authentic experience through premium ingredients, unique flavours and small-batch quality. Commercial brewers are entering this category by investing in craft-style brands or acquiring craft breweries.

Craft and craft-style beer is estimated to be close to 5% of total beer volume in South Africa with double-digit growth rates expected. According to research done by Goldman Sachs on 'The Rise of Craft', the millennial generation, who represent the largest age cohort in the world, are more experimental, seek bolder flavours, and have a high propensity to favour consumption of goods that are perceived to be more 'authentic'. During the year NBL entered into a partnership with Stellenbrau, a Stellenbosch-based craft brewer, thereby strengthening NBL's association with a craft-style beer positioning.

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.



Source Brewers Association

NBS's own consumer research indicated that consumers want choice, and brand loyalty appears to be fading. Consumers are also affected by the perceived appearance of their beverage choices which therefore has to be relevant to their lifestyle. Taste appears to be becoming less important; status, or aspiration, has become a more important factor in choosing a beverage.

The Rise and Rise of Lite Beer

The new health conscious consumer is always on the lookout for the least harmful alternative to enjoy their vices. The trend in healthy, low calorie beers had a resurgence of late and the breed of healthy beers aims to keep the kilos down without forfeiting flavour.

It is important to make a distinction between Light and Lite beer. *Light* beer has been brewed to be lower in alcohol, lower in calories, or lower in both (depending on the brand), while *Lite* beer has only been brewed to remove carbohydrates (but usually have the same alcohol content). In other words, if it has half the calories, you can have twice as much.

Lite beer is by no means a new concept, it was invented in 1967 by American biochemist Joseph Owades, who had the idea of finding an enzyme that could break the side-branching chains of starch, which could allow yeast to digest all the starch and produce a beer with no residual carbohydrates and lower calories.

Owades introduced the first "lite beer" in 1967, named Gablinger’s Diet Beer, using his newly discovered process. It was a complete failure, but its many successors, starting with Miller Lite became successful in the American beer marketplace.

Until recently, Namibians have only had mainstream access to Castle Lite, which was released a few years ago. Now we have two new beers to choose from, Tafel Lite and Amstel Lite. Here is how they stack up.

	Tafel Lite	Amstel Lite	Castle Lite
Alcohol by Volume	4.0%	4.0%	4.0%
Calories/ 100ml	27	27	30
Volume	330ml/660ml	330ml/440ml	340ml/440ml
Recommended Selling Price (N$)	10.00/17.00	10.50/11.00	9.24/11.00 (RSA)
Beer Advocate Rating	Not Rated	2.4/5.0	1.7/5.0

We suspect that some consumers will prefer to move to the new, more healthy alternatives, instead of choosing the normal Tafel or Amstel brands, but suspect that the cannibalisation effect will be minimal. Instead, the lite beer product attracts a different type of consumer, women. Instead of offering rich, hoppy, heavy beers, the introduction lighter or flavored beers is more appealing to the both the female consumer and people who generally prefer a lighter, less filing beverage.

Pricing and Competition

Price changes by Namibia Breweries and SABMiller Namibia are usually released twice a year, around March/April and September/October. Namibia Breweries were first out of the gate with price increases, while SAB waited until middle October to announce their pricing.

According to the latest wholesale pricing, effective 5 September 2016, the price of Windhoek and Tafel Lager Quarts increased by 6.7%, the Windhoek and Tafel Lager Euros by 9.5%, while the price of Windhoek and Tafel Lager Dumpies were increased by 5.3% and 5.9% respectively.

In a surprising move, SAB cut the prices of Castle Quarts by 4.2% and Castle Dumpies by a staggering 12.8%. This makes castle the cheapest mainstream option in both the 750ml and 330ml space in Namibia. Black Label Quart prices increased by just 2.2%, to match Windhoek and Tafel prices and Black Label Dumpies prices were kept unchanged.

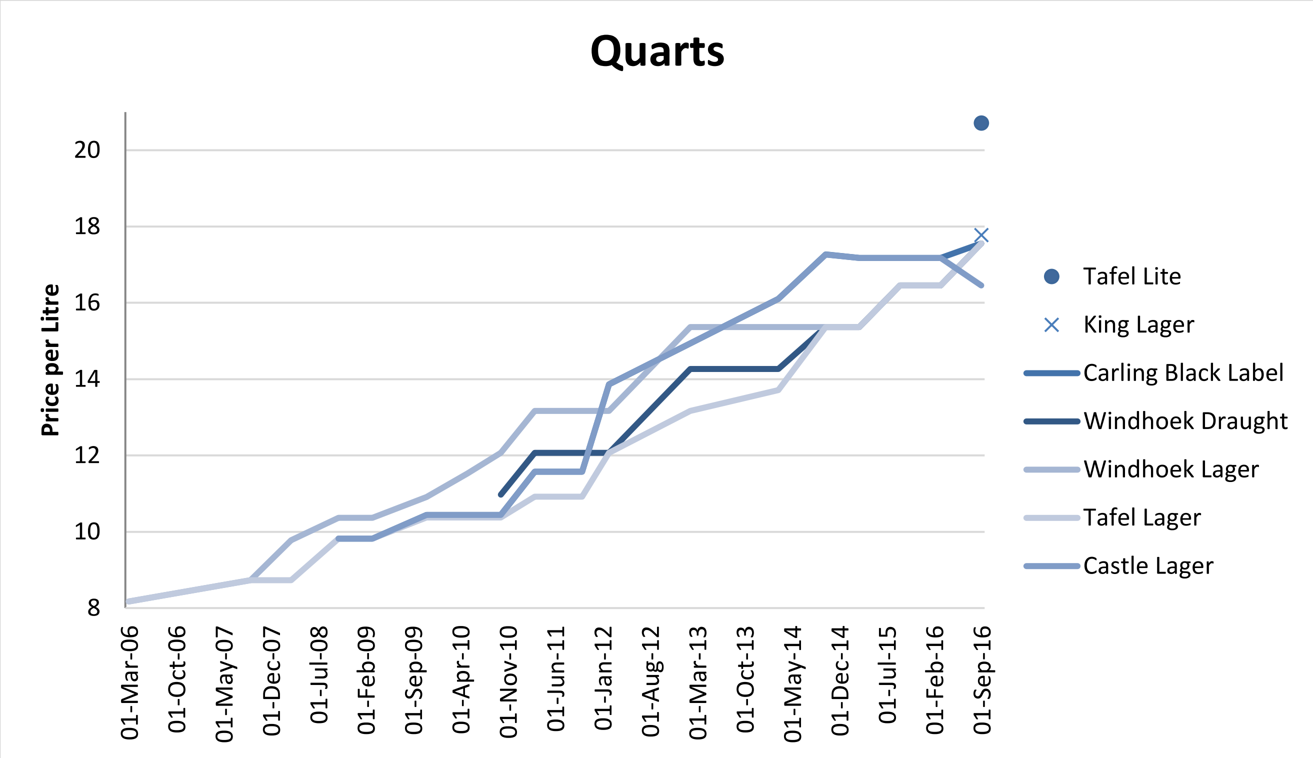
This seems to be SAB throwing down the gauntlet, making a compelling value agreement for the consumer to switch to Castle. Since the mainstream market is regarded as price sensitive, the significant discount is likely to attract volumes and eat into NBS's market share.

	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	17.56	6.7%	17.56	6.7%	17.56	2.2%	16.46	-4.2%
Euro	19.61	9.5%	19.61	9.5%	-	0.0%	-	0.0%
Dumpies	24.91	5.3%	22.14	5.9%	23.88	0.0%	20.83	-12.8%

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

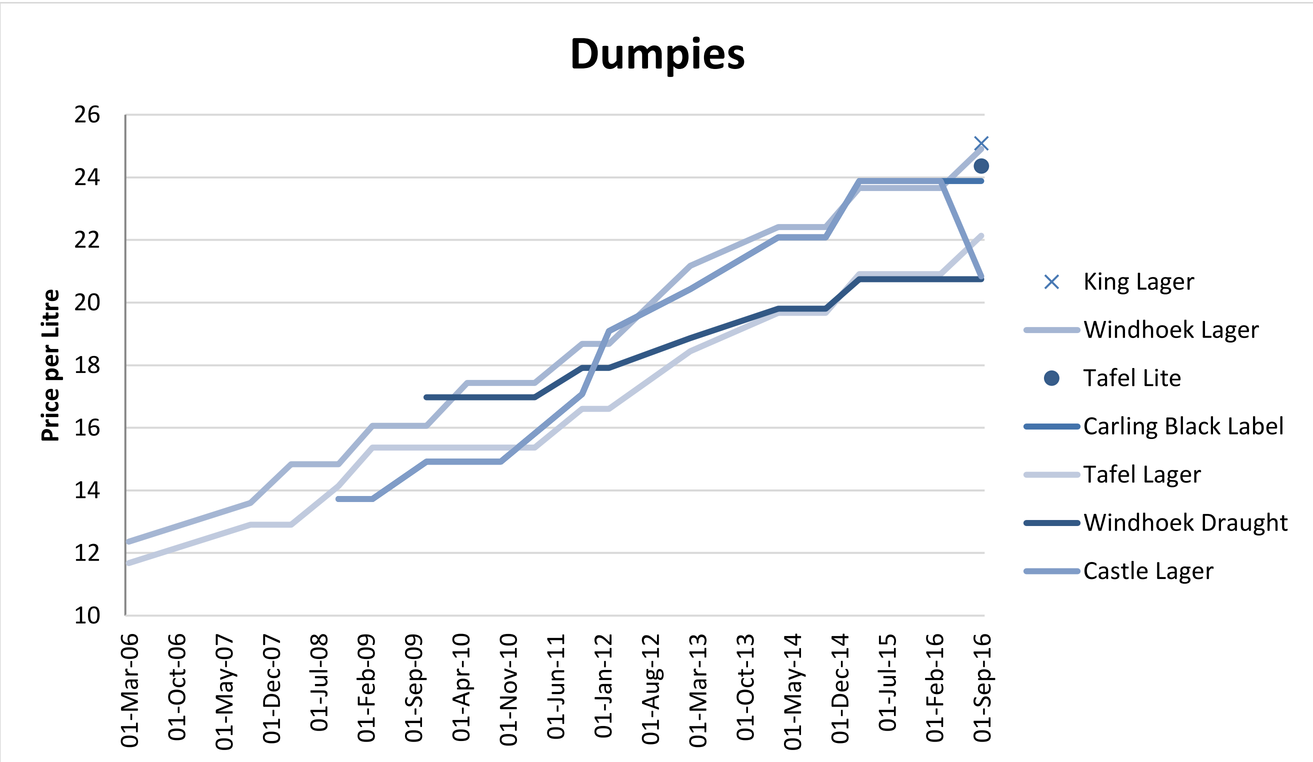
The launch of the two new brands, King Lager and Tafel Lite, were done at odd price points when compared to the complementary and competitor products in the market. King Larger quarts (750ml) are priced slightly higher than the other brands per litre, while the Tafel Lite (660ml) is priced significantly higher per litre (and per unit).

Although the quart market is likely not the main outlet for Tafel Lite, the significant premium makes it unlikely to gain much foothold in this market. The slight premium for King lager is also makes one question whether consumers are willing to pay more for a "home grown" product.



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

A similar scenario appears in the Dumpies space. The 12.8% price cut in Castle Lager displays SAB's intentions quite clearly. The Black Label price also looks to undercut Windhoek and King Lager brands. The new pricing is certain to change the competitive landscape of the Namibian market, but Namibia breweries will have to wait until March next year to react.



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

After celebrating the two-year anniversary of their 260,000 hectolitre Okahandja brewery, SAB seems to have found their footing and are ready to compete. This change in strategic direction comes just as the merger between SABMiller and ABInbev was concluded in early October.

Although the Okahandja brewery is relatively small and does not enjoy significant economies of scale, the brewery offers an attractive entry point into the fast-growing Namibian market which does not require transporting the product over large distances. To some extent, SAB has mirrored what Namibia Breweries are doing in Sedibeng.

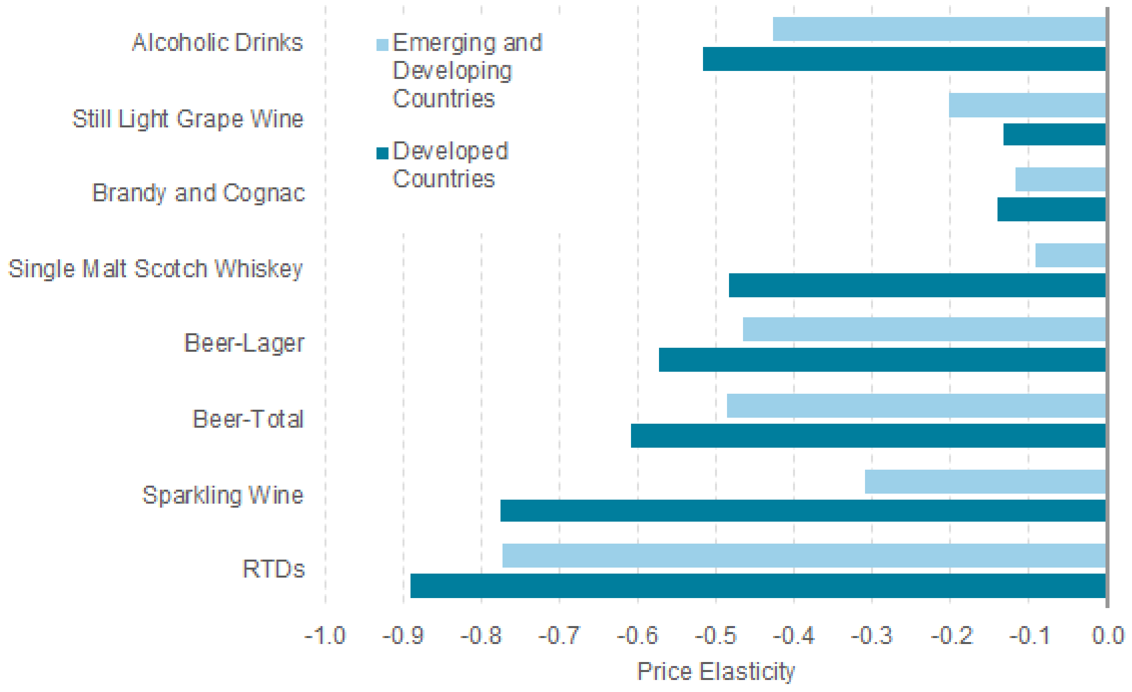
This is likely to be a thorn in NBS's side. If NBS makes too much waves in South Africa, they might face repercussions in their home market. NBS currently generates all its profits in Namibia, and a price war would likely damage the high margins both companies enjoy. This will likely have larger consequences for NBS and the local Castle brewery than the deep pocketed SAB, who would be much better prepared financially to wage such a battle.

According to NBS's management they currently have a Namibian market share of about 84% and they estimate the size of the Namibian market at roughly 1.3 million hectolitres. By inference this would leave SAB with a maximum of the remaining 16% or 208,000 hectolitres, somewhat short of the 260,000 hectolitre capacity of the Okahandja plant. SAB claim they are targeting 30% of the Namibian market over the medium term, this might be the start of that attempt.

SAB followed a similar strategy of price leadership in Nigeria, where it completes mainly with Heineken. The strategy paid off; SAB's Hero, a local beer sold mostly in rural areas around the capital and priced slightly below rivals, performed well. This shows the changing trend in the Nigerian market (and possibly the African market as a whole) where the so-called economy beers are taking market share from the mid-priced beers.

In 2015, Economy lagers were the largest segment in that market for the first time, which comprised 32% of total sales and 49% of total volume. Heineken's premium beer sales in the region dropped by 0.8% while the overall mid-priced lagers market decreased by 9%.

Just how much of an impact the relative price changes might have on the volumes are difficult to say, but a rough estimate can be made using historical price elasticities. Price elasticity of demand is a measure used in economics to show the responsiveness, or elasticity, of the quantity demanded of a good or service to a change in its price, ceteris paribus. More precisely, what percentage change in quantity demanded can be expected in response to a one percent change in price.



Source: Euromonitor International's Industry Demand Model

As can be seen in the figure above, nearly all alcohol is relatively inelastic, i.e. a 1% increase in price lead to a less than 1% decline in quantity consumed. Furthermore, emerging markets are less sensitive to price changes than developed markets.

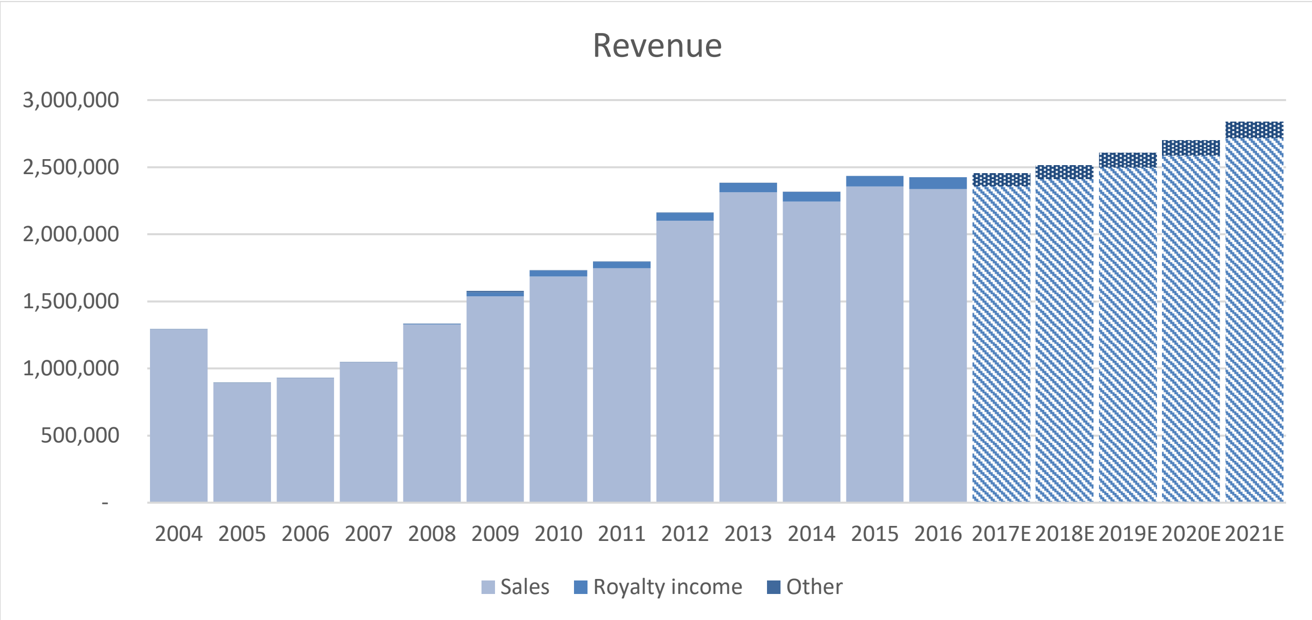
The South African National treasury conducted a study (Van Walbeek & Blecher) in 2002 where it found the price elasticity of demand for various alcohol groups. The results were as follows: Normal beer -0.40, light beer -0.46, low price wine -1.08, medium price wine -0.84, high price wine -0.42 and spirits -0.75. Unfortunately estimates of cross price elasticities are difficult to come by and even amongst the studies that have estimated cross price elasticities, no consistent picture emerges.

Thus, using very simplified, back of the envelope calculations, based only on the substitution effect of price changes, we can assume the 12.8% cut in Castle Lager dumpies price will results in a 5% increase in volumes, while the 5.3% increase in Tafel prices will lead to a 2% decrease.

Revenue

Total revenue for the 2016 financial year decreased by 0.3% from the previous period. The lower revenue figure was largely a product of the contractual migration of production volumes from Windhoek to the Sedibeng brewery in Johannesburg.

The production of 320,000 hectolitres of beer was migrated in FY16, bringing the cumulative migration figure to 560,000 hectolitres since 2014. As a result, total volumes produced in Namibia decreased by 9% y/y and export revenue to South Africa fell by 41.7% y/y. This has concluded the contractual volume migration and any further transfers will be at the discretion of management. Based on the increase in competition, we have forecasted relatively muted top line revenue growth over the next few years of only 1.1% in FY17, 2.4% in FY18 and 3.7% in FY19.



Source: NBS, IJG

Royalties on Namibia Breweries products produced in South Africa, which make up 3.7% of total revenue, amounted to N$ 88.6 million and showed sound growth of 12%.

Revenue per Category	FY15	FY16	y/y % Δ	FY15 Contribution	FY 16 Contribution
Beer	2,266,443	2,240,987	-1.1%	93.1%	92.4%
Other	167,734	184,989	10.3%	6.9%	7.6%
Total	**2,434,177**	**2,425,976**	-0.3%	100.0%	100.0%

Source: NBS

From a segmental perspective, beer still makes up the core of the portfolio, contributing to 92.4% of total revenue.

Revenue from beer fell 1.1% y/y, due to the migration of production. However, local beer volumes displayed solid growth of 8.0% y/y, driven largely by Tafel Lager, which surpassed the one million hectolitre sales mark. The other category, on an aggregated basis, displayed strong growth of 10.3% y/y. Sales in the ready-to-drink category decreased compared with the prior year, however, the soft drink category maintained its double-digit growth.

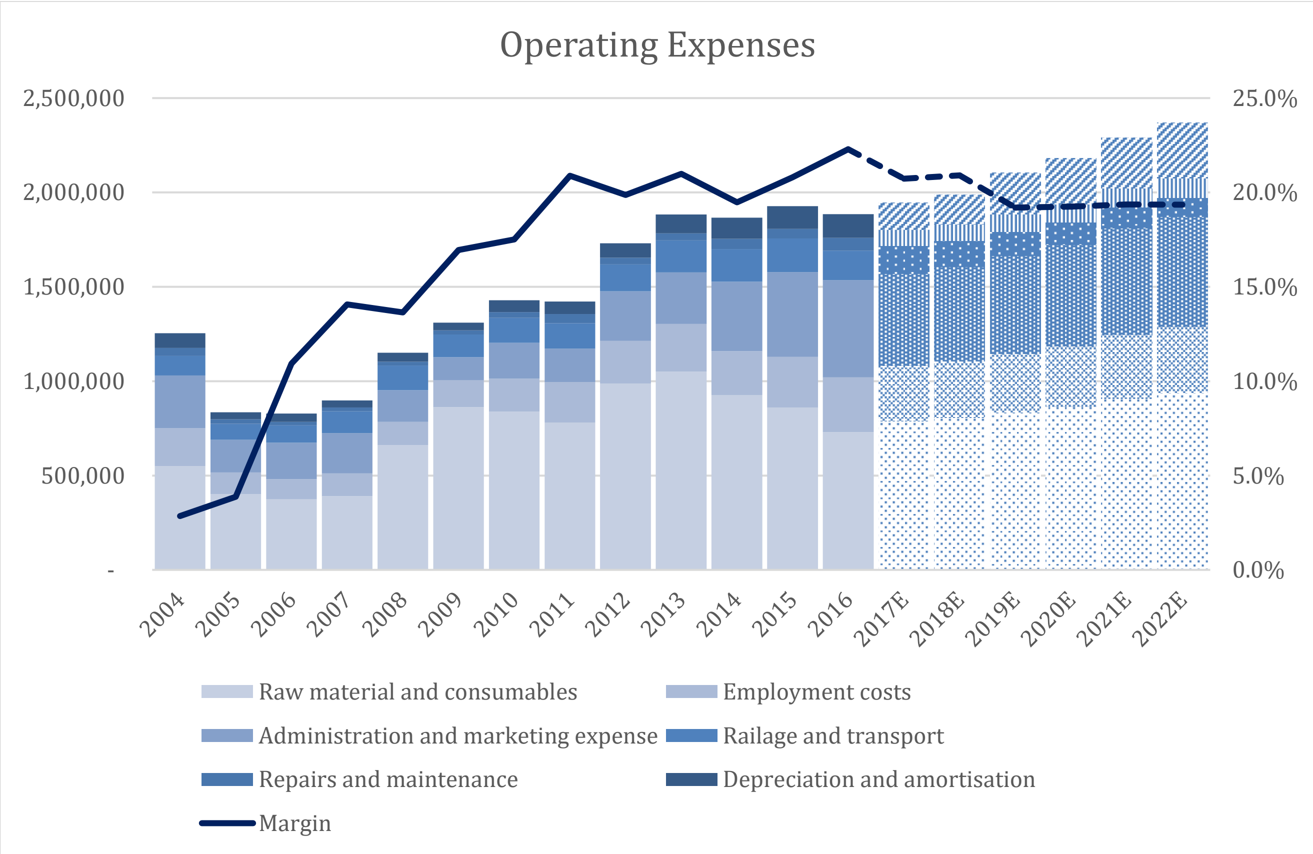
Geographical Revenue Splits	FY15	FY16	y/y % Δ
Namibia	1,400,293	1,755,510	25.4%
South Africa	912,228	531,864	-41.7%
Rest of the World	121,656	138,511	13.9%
Total	**2,434,177**	**2,425,885**	-0.3%

Source: NBS

Total beer volumes sold to export markets (excluding South Africa) declined by 5% in comparison with the prior reporting year. African export sales showed mixed results. While Zambia and Mozambique detracted from overall performance, Tanzanian volumes doubled for the third consecutive year, and according to management still shows potential for further growth. International sales volumes (ex-Africa), made up primarily of the UK Germany and Australia, remained flat year on year.

Operating Profits

Operating profit increased by 6.7% as the operating margin widened by 1.48%, largely due to favourable movements in raw material and packaging material prices. Packaging material costs were also reduced due to increased packaging efficiencies, which reduced material wastage by 0.5%.



Source: NBS, IJG

Raw material costs decreased by 15.1% y/y due to lower volumes being produced and favourable price movements in packaging, barley and hops. 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. The Group hedges these foreign purchases in order to manage its foreign currency exposure. Forward exchange contracts are entered into in order to manage the Group’s exposure to fluctuations in foreign currency exchange rates.

Local procurement made up 38% percent of commodity inputs and the group is continuously increasing their support to local procurement partners to mitigate foreign exchange exposure. Locally produced barley of approximately 1800 tons was harvested in the last financial year, but this was not malted, and used exclusively for King Lager.

Local Barley and Malting Plant

In 2015 NBS concluded a tripartite agreement with the Ministry of Agriculture, Water and Forestry, as well as the Agricultural Business Development Agency. This followed several years of trials to establish a commercial barley growing venture. Testing revealed that local barley was of excellent quality and matches the high standards of the barley that NBS imports from its international suppliers. Local prices are determined by global demand and supply and a quality grading scale.

The barley is grown as part of Government's green scheme, which encourage the development of irrigation-based agronomic production in Namibia. The green schemes increase the contribution of agriculture to the country's GDP and simultaneously achieve social development and upliftment of communities located within suitable irrigation areas. Barley is grown as a winter crop and does not hinder local food production. So far, 257 hectares of barley have been planted at Ndonga Linena, 90km east of Rundu and 120 hectares at Shadikongoro, 200 km east of Rundu.

The fields are planted and the silos are ready.

Since commencement of the barley trials almost five years ago, NBS has invested in excess of N$5 million into the barley project for trial planning, execution, seeds, laboratory and brewing trials, as well as shipments and transport. NBS expects to be able to create about 4000 jobs and aim to have 12,000 hectares under irrigation for barley productions over a ten-year timeframe.

Plans for a local malting plant have been proposed, but local barley production is still in its infancy and volumes produced are still only around 1,800 tons. Estimates are that a malting plant will be viable when the project reaches its target 15,000 tons of barley per annum

Unfortunately, the Namibian climate does not support the cultivation of hops, which will continue to be imported.

Employment costs increased by 7.8% y/y, while administration and marketing costs increased by 15.0% y/y. Administration and marketing now represent larger portions of total operating expenses, increasing from 23.3% to 27.4%. Cost were largely driven by the new marketing initiatives including the King Lager and the McKane mixology campaigns.

Repairs and maintenance remain a small but quickly accelerating part of expenses. Although repairs only make up 3.6% of total operating expenses the year on year increase of 33.9% or N$ 17.7 million is troubling. Due to the technical expertise required most of the repairs and maintenance services are imported, and therefore subject to the exchange rate. Namibia breweries aim to expand their local capabilities to do as much internal line maintenance as possible.

An emphasis has been placed on improving operating efficiencies at the Namibia plant, and this is set to support margins over the long term. Transport costs should be a main contributor to savings, as round-trip efficiency between Namibia and South Africa is maximised. A 16% improvement in efficiency has already been achieved using a new truck stacking mechanism for pallets containing empty returnable bottles.

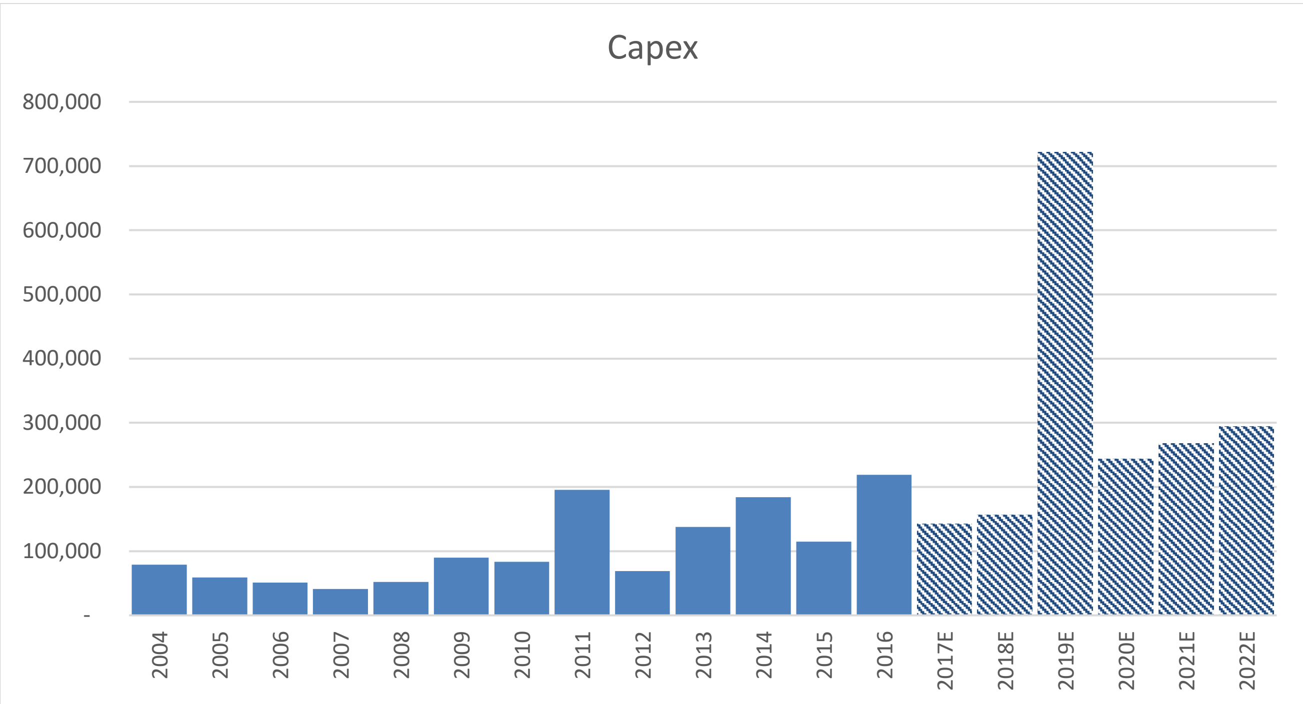
Capital Expenditure

Over the past 13 years, NBS spent an average of N$105.8 million on expanding property plant and equipment annually. During the FY16 year management invested approximately N$100.0 million above its normal capital expenditure 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.

NBS commenced with the testing phase of the biomass boiler in the last weeks of June 2016. The boiler, which was imported from Austria, is set to replace 80% of the 3,600 tons of heavy furnace oil NBS annually uses. The project, which is founded on NBS's commitment to renewable energy, was costed based on assumptions related to variables such as the exchange rate, international oil prices and interest rates, which have since shifted significantly. This results in a longer repayment period, but still offers cost and environmental savings on an annual basis. Based on the current price of USD 275 a ton and a current exchange rate of ZAR13.75/USD, this amounts to approximately N$ 10.9 million of annual savings in furnace oil.

Management indicated that the company plans maintain capex at the level of depreciation during FY16, as any new investment in the local plant will be heavily dependent on the water situation. Management also expressed the need to invest in a new packaging line within the next five years. Components of the current line are nearing 30 years of age, and the current packaging line is running close to capacity. This represents a huge investment and estimates of cost run anywhere from N$500 million to N$1 billion.

The decision whether the expansion plan will be implemented or whether capital would be better applied elsewhere will be taken in the FY17 financial year. For the purposes of our analysis we have assumed an investment of 500 million in FY19. We have assumed this will be financed by a medium term note at an interest rate of Jibar + 2%.



Source: NBS, IJG

Water

Poor rainfall over the last three years have resulted in a severe water shortage. The Omatako, Von Bach and Swakoppoort dams form the 'three-dam' system, which is the main supplier for Namibia's central area (including Windhoek). The last significant inflow to these dams was five years ago.

According to inspections of the three dams conducted by NamWater and the Ministry of Agriculture, Water and Forestry, the situation is dire. As at the end of September dam levels are critically low. Von Bach is at 17.9% capacity, while the Swakoppoort is at 7.9%, and the Omatako dam is virtually dry.

In May 2016, NamWater, as the national bulk supplier of water to the City of Windhoek, announced an increase from 30% to 40% in required water savings, based on the predicted average annual demand. That target has not nearly been met.

Source: City of Windhoek

NBS is the biggest industrial consumer of water in Windhoek and will be hard hit if more aggressive water restrictions are implemented. Based on the severity of the possible restrictions they may have to migrate some or all their local production to Johannesburg.

The company reported that it used on average 4.4 hectolitre of water to produce one hectolitre of each final product. According to our estimates, they produced about 1.6 million hectolitres of beer annually, requiring about 7.0 million hectolitres of water each year. The excess 3.4 hectolitre that is not used in the final product is not wasted, the majority is reclaimed and transferred into the city's effluent system, where a percentage of it gets recycled.

As an intermediate solution to the water crisis, NBS obtained licences to drill two boreholes on its premises from the city's Department of Water Affairs. These proved to be well vested with underground water, and the drilling of two more boreholes is in process. These boreholes are separate from the aquifer supplying the city with water. NBS needs to apply for abstraction permits from the Ministry of Agriculture, Water and Forestry as per the Water Resources Management Act of 2004. These permits are valid for two years. As an added control, NBS report their water usage from these boreholes to the Ministry every three months.

Water reduction of 40 to 50% has been achieved in the production process over the last four years., Collectively, these initiatives have achieved 28% self-sufficiency at the last year end. NBS's future water saving initiatives include reclamation in the brewing and packaging plants, which is set to reduce water consumption by 25%. Additionally, ,a water pre-treatment plant was installed. Together with future reclamation saving, will bring the litres of water used to produce a litre of beverage to approximately 3.5 litres, further increasing self-sufficiency.

According to management, Namibia breweries were considering the construction their own effluent treatment plant. However, based on talks with the city's Department of Water this would have been counterproductive. Seemingly the effluent from the brewery effectively acts as a diluent to effluent of Windhoek's other industries, making Windhoek's recycled water easier and more cost effective to treat.

We are confident that the measures taken by Namibia breweries will allow them to continue operations in Windhoek. In the event of a prolonged water crisis, volumes can be migrated, but this is not our base case scenario.

Sedibeng Breweries and DHN Drinks

Following the transaction announced in 2015, DHN Drinks' beer and spirits portfolio was split, with Diageo taking full ownership of the spirits portfolio and Brandhouse. NBS now holds a 25% stake in DHN Drinks and a 25% stake in Sedibeng with Heineken holding a 75% stake in both entities. Subsequently, DHN Drinks and Sedibeng Brewery were merged into DHN Drinks which was renamed to Heineken South Africa Limited.

Gaining a stake in the Brewery is seen as a key factor for Namibia Breweries' success in the South Africa. The South African beer market is expected to grow by approximately 1.5% per annum from its current size of 30 million hectolitres to an estimated potential of 35 million hectolitres by 2024. This presents great prospects for Namibia Breweries who are actively targeting market share in the region. The decision to split from Diageo also allows the beer partners to focus solely on beer, which we also view as a positive for Namibia breweries.

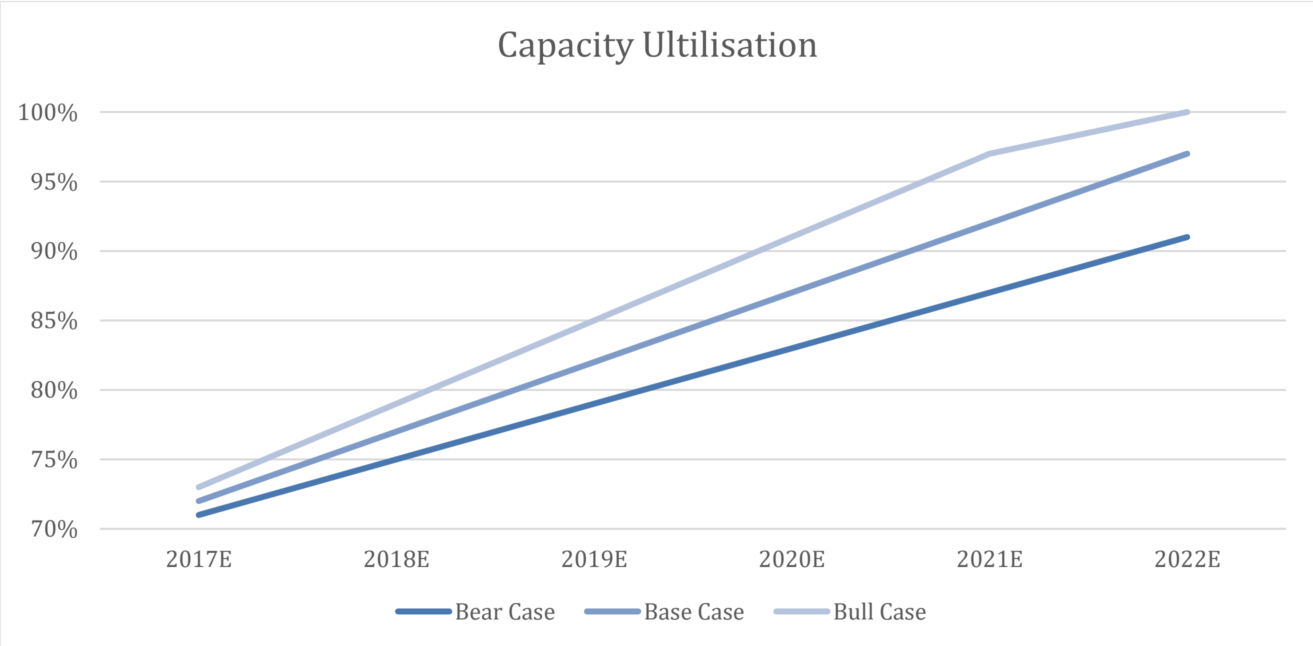
As a result of this acquisition, NBS is expected to achieve synergies and streamline costs. From here on a large part of the South African export volumes will be produced in Johannesburg, eliminating the excessive transport costs.

Sedibeng Brewery

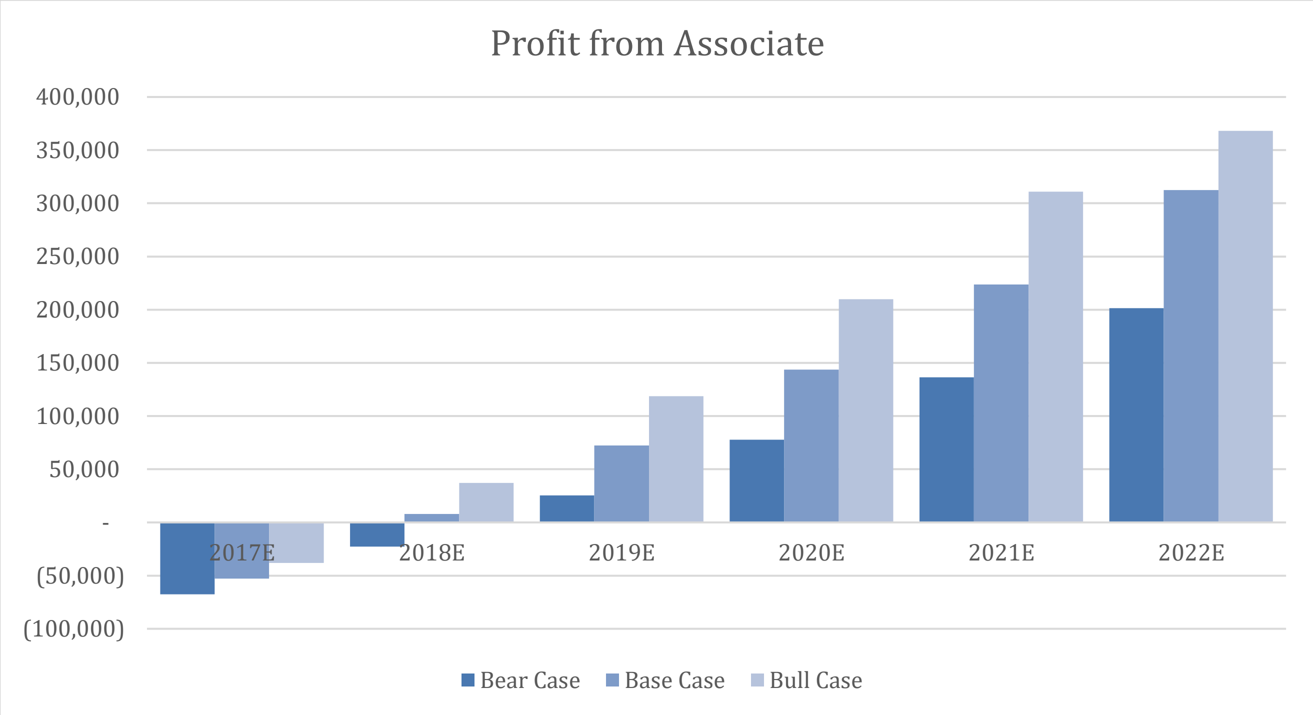
The Sedibeng Brewery has a capacity of 4.5 million hectolitres and management indicated that the brewery is currently operating at approximately 67% capacity and intend to reach the 100% mark over the medium term. They mentioned their satisfaction with Sedibeng's management's ability to continuously 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.

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 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, breakeven levels of profit in FY18 and then increasing profitability thereafter, based heavily on management's guidance. The South African market is likely to be a large source of growth for the business for the foreseeable future.

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 225,000 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 in presented below:



Source: IJG Research



Source: IJG Research

Scenario	Incremental Annual Volume (hl)	Target Price
Bear Case	180,000	24.64
Base Case	**225,000**	**27.90**
Bull Case	270,000	30.69

Source: IJG Research

Deferred Tax Asset

In 2013, the Group recognized a full write-down of its portion (15.5%) of the deferred tax asset in Heineken South Africa Limited (formerly known as DHN Drinks), amounting to N$188.1 million. During the current year, after the restructuring, the Directors consider that at year end a portion of the N$1.6 billion assessed loss in Heineken South Africa Limited is recoverable. They have therefore written back an amount of N$89.2 million, being its share of the deferred tax asset included in the Heineken South Africa (Proprietary) Limited accounts. This implies that about 80% of the accumulated loss, or N$ 1.28 billion, of taxable profits will be generated by the associate in the future.

This writeback was a large contributor to the increase in profit attributable to ordinary shareholders of 43.8%. This line item contributed 43.2c to basic EPS of 180.3c or 24.0% of earnings. This is troubling since these profits are non-cash in nature and based on management's estimates of the future profitability of the associate. Excluding this once off item, EPS increased by only 9.4%.

According to management, the associate is expected to still show losses in FY2017, breakeven in FY2018 and will only start being profitable thereafter. The outlook for the associate will be assessed annually. If it becomes evident that the associate will not be able to generate sufficient taxable profits to realize the asset, the asset will be deemed impaired and will likely be written back down to the recoverable amount, as was done in 2013.

If we assume that the asset is completely written off in FY17, our target price decreases by 1.3% to 2755c. Based on our forecasts we expect that this scenario is unlikely, but remains a risk, should the outlook for Heineken South Africa deteriorate significantly.

IAS12 – Recognition of Deferred Tax Assets

Deferred tax assets generally arise where tax relief is provided after an expense is deducted for accounting purposes. A company may incur tax losses and be able to "carry forward" losses to reduce taxable income in future years.

Determining whether to recognize such assets on the balance sheet and, if so, at what point and at what value can be complex. But the general principles are outlined below.

Deferred tax assets arising from available tax losses are recognized only if the entity has sufficient taxable temporary differences or there is convincing evidence that sufficient taxable profit will be available to utilize the asset to offset the tax expense in future periods.

Significant judgement is involved in determining a deferred tax asset. Entities may therefore look forward a number of future accounting periods to determine whether they will have sufficient taxable profit to justify recognition of a deferred tax asset.

In these circumstances, there is no specific restriction on how many years the entity may look forward, unless there is a date at which the availability of the tax losses expires. The uncertainties of the future mean that the evidence supporting profits in later periods will generally not be as convincing as that for earlier periods, but there is no rule for how many years in the future can be taken into account.

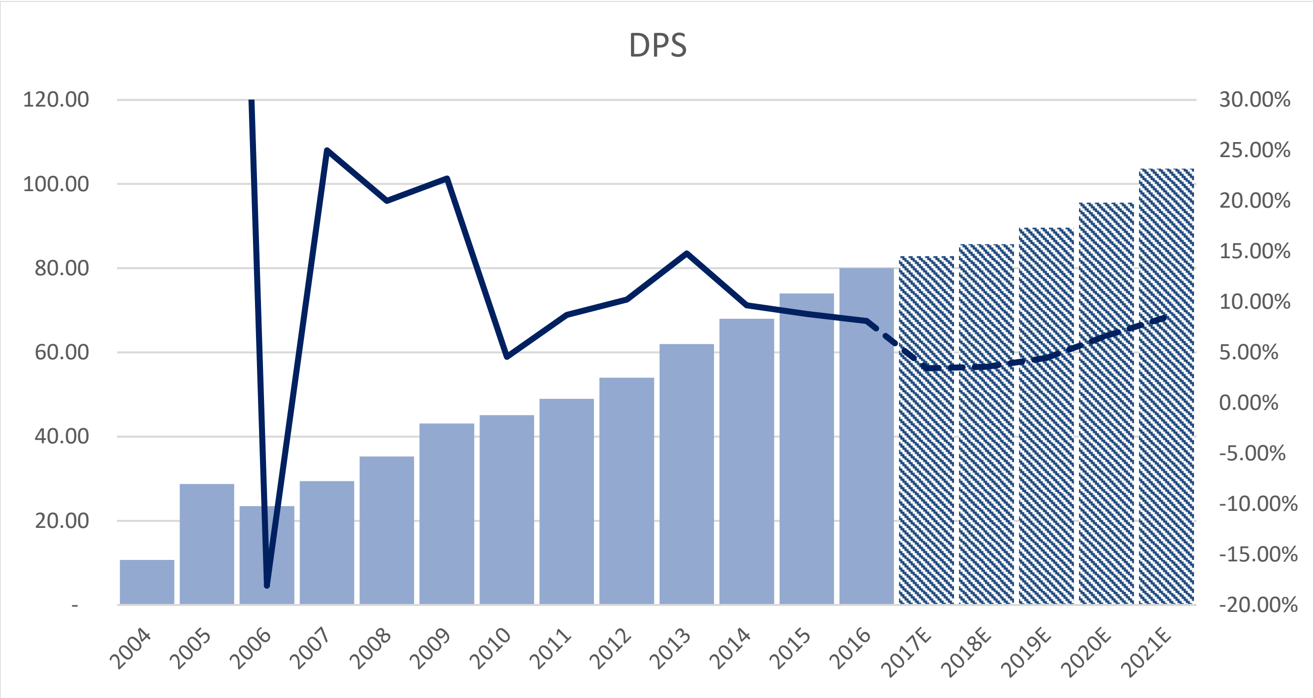
The facts and circumstances of the situation in question will determine the appropriate period. The unavailability of detailed profit forecasts is not necessarily a bar to assuming that profits for later years will be available to support a deferred tax asset. If there are detailed forecasts showing profits for the next three years, it may be unlikely that profits would reduce to nil in year four. The key issue is that the profits are probable and that there is convincing evidence to that effect.

The carrying amount of deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized. Any such reduction is subsequently reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Dividends

Our dividend forecast is a function of net profit adjusted for the equity profits and losses from the associate. We have also considered management's adoption of a progressive dividend policy which aims to grow or maintain the dividend each year.

Given the developments regarding the new structure of the Sedibeng brewery and distribution network, we expect to see smaller losses from the associate in FY17 and break even in FY18, but are optimistic regarding profitability thereafter. Thus, we forecast dividends of 83c and 86c for FY17 and FY18 respectively.



Source: NBS, IJG

Valuation

We value NBS based on exit EV/EBITDA multiple in five years' time of 9.5x and discounted cash flow analysis on a 50/50 weighting. The first five years are explicitly modelled and thereafter a terminal value is used. Our required rate of return on equity, of 14.1%, is based on a risk free rate of 10.1%, equity risk premium of 5.4%, and a beta of 0.74. The weighted average costs of capital was calculated as 13.7% and a long-term sustainable growth of free cash flows was estimated to be 7.9%. Based on these assumptions and our forecasted cash flows for NBS, we have set a target price of 27.90.

Below are the current EBITDA multiples of Namibia Breweries African and European peers

AFRICA	COUNTRY	EV/EBITDA
East African Breweries Ltd	Kenya	8.9
Nigerian Breweries Plc	Nigeria	12.1
Societe Des Brasseries	Morocco	8.4
Tanzania Breweries Ltd	Tanzania	8.2
AVERAGE		**9.4**
EUROPE	**COUNTRY**	**EV/EBITDA**
Anheuser-Busch Inbev	Belgium	13.2
Carlsberg	Denmark	9.7
Harboes Bryggeri	Denmark	4.8
Heineken	Netherlands	11.4
Olvi Oyj	Finland	9.6
Royal Unibrew	Denmark	14.2
Shepherd Neame Ltd	Britain	10.7
AVERAGE		**10.5**

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. However, the share has appreciated by 28.5% in price over the last year, and the current price of the security has become somewhat stretched.

Based on our target price and estimated dividend, we expect a one year total return of 0.8%. While this is a below-cash return, the nature of the Namibian investment environment, characterised by an undersupply of investable assets, particularly in the equity space, and the illiquidity that results, means that the sale of the security may make its repurchase challenging. Furthermore, the proposed changes to Regulation 28 requiring 50% of pension assets to be held locally will likely further fuel demand. We thus continue to recommend a **HOLD** on this security, with the expectation of improved earnings in the future.

Summary of Financials

Income Statement

N$'000	2014	2015	2016	2017E	2018E	2019E
Revenue	2,316,932	2,434,177	2,425,885	2,453,573	2,512,796	2,605,743
Operating expenses	(1,865,601)	(1,927,663)	(1,885,211)	(1,903,314)	(1,957,414)	(2,074,317)
Operating Profit	**451,331**	**506,514**	**540,674**	**550,259**	**555,382**	**531,426**
Finance Costs	(14,932)	(8,847)	(39,412)	(40,829)	(46,454)	(93,926)
Finance Income	12,338	22,000	18,315	14,883	18,476	14,043
Equity loss from JV-ongoing operations	(120,002)	(124,593)	(38,917)			
Equity loss from associate-ongoing operations			(61,759)	(52,887)	7,880	72,212
Equity loss from JV-deferred tax asset write back (/down)	-	-	89,212	-	-	-
Profit before income tax	**328,735**	**395,074**	**508,113**	**471,426**	**535,284**	**523,756**
Income Tax Expense	(122,867)	(136,092)	(135,643)	(150,856)	(171,291)	(167,602)
Profit attributable to ordinary shareholders	205,868	258,982	372,470	320,570	363,993	356,154
Shares in issue	206,529,000	206,529,000	206,529,000	206,529,000	206,529,000	206,529,000
Earnings per share (c)						
Basic EPS	0.995	1.254	1.803	1.552	1.762	1.724
HEPS	1.591	1.871	1.857	1.808	1.762	1.724
	-10.52%	17.60%	-0.75%	-2.62%	-2.53%	-2.15%
Dividend per share (c)						
Interim	34	37	40	41	43	45
Final	34	37	40	42	43	45
Total	68	74	80	83	86	90

Balance Sheet

N$'000	2014	2015	2016	2017E	2018E	2019E
ASSETS						
Non-current assets						
Property, plant & equipment	874,932	871,133	983,365	983,365	1,140,236	1,640,236
Intangible assets	11,494	16,747	25,515	25,515	25,515	25,515
Investment in JV	-	28,325	-	-	-	
Investment In Associates			610,526	557,639	565,519	637,731
Available for sale securities	14	15	15	15	15	15
	886,440	916,220	1,619,421	1,566,534	1,731,285	2,303,497
Current Assets						
Inventories	209,571	226,607	268,138	271,198	277,744	288,018
Trade and other receivables	383,322	325,603	384,215	388,600	393,036	397,522
Cash and cash equivalents	55,941	264,219	198,443	246,344	187,243	327,653
Other	5,925	4,500	-			
	654,759	820,929	850,796	906,143	858,023	1,013,193
Total Assets	1,541,199	1,737,149	2,470,217	2,472,677	2,589,308	3,316,690
EQUITY AND LIABILITIES						
Equity						
Share capital	1,024	1,024	1,024	1,024	1,024	1,024
Retained earnings	930,606	1,043,078	1,256,521	1,406,199	1,593,177	1,755,618
Foreign currency translation reserve	(126)	(3)	249			
	931,630	1,044,099	1,257,794	1,407,223	1,594,201	1,756,642
Non-current liabilities						
Interest bearing loans and borrowings	8,786	13,821	479,739	350,000	210,031	767,663
Post-employment medical aid and severance pay benefit plan	18,046	19,630	19,295	20,453	21,680	22,981
Deferred taxation liability	185,588	187,644	193,654	190,000	190,000	190,000
	212,420	221,095	692,688	560,453	421,711	980,644
Current liabilities						
Interest bearing loans and borrowings	105,822	105,711	44,383	29,203	92,178	92,706
Trade and other payables	289,576	363,368	469,440	474,798	480,217	485,698
Derivative financial instruments	680	300	4,959	-	-	-
Income tax payable	1,071	2,576	953	1,000	1,000	1,000
	397,149	471,955	519,735	505,001	573,395	579,405
Total Equity and Liabilities	1,541,199	1,737,149	2,470,217	2,472,677	2,589,307	3,316,690

IJG Holdings

Group Chairman	Group Managing Director	Group Financial Manager
Mathews Hamutenya	Mark Späth	Helena Amutenya
Tel: +264 (61) 256699	Tel: +264 (61) 383 510	Tel: +264 (61) 383 517
mathews@millennium-invest.com	mark@ijg.net	helena@ijg.net

IJG Securities

Managing Director	Sales and Research	Equity & Fixed Income Dealing
Romé Mostert	Rowland Brown	Lyndon Sauls
Tel: +264 (61) 383 520	Tel: +264 (61) 383 513	Tel: +264 (61) 383 514
rome@ijg.net	rowland@ijg.net	lyndon@ijg.net
Money Market & Administration	Jan-Hendrik Conradie	Leon Maloney
Tashiya Shekutamba	Tel: +264 (61) 383 523	Tel: +264 (61) 383 512
Tel: +264 (61) 383 511	janhendrik@ijg.net	leon@ijg.net
tashiya@ijg.net		
	Eric van Zyl	
	Tel: +264 (61) 383 530	
	eric@ijg.net	
	Dylan van Wyk	
	Tel: +264 (61) 383 521	
	dylan@ijg.net	

IJG Capital

Managing Director	Portfolio Manager	Business Analyst
Herbert Maier	Jakob de Klerk	Mirko Maier
Tel: +264 (61) 383 522	Tel: +264 (61) 383 517	Tel: +264 (61) 383 500
herbert@ijg.net	jakob@ijg.net	mirko@ijg.net

IJG Advisory

Director	Business Analyst
Jolyon Irwin	Jason Hailonga
Tel: +264 (61) 383 500	Tel: +264 (61) 383 529
jolyon@ijg.net	jason@ijg.net