EDISON

Zambeef Products

Full-year results

External factors in H114 obscure progress

Food and agriculture

Zambeef continues to make progress towards becoming one of the largest food producers focusing on sub-Saharan Africa rather than only Zambia. This progress was slowed down by several adverse externally-driven effects that blighted H114 performance, resulting in a small pre-tax loss (after adjusting for unrealised forex losses) for the full year. Noting improved H2 profitability as the adverse effects have passed, we expect a return to pre-tax profit in FY15, although at lower levels than our previous estimates. We retain our valuation range of 17-37p.

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	EPS* (c)	P/E (x)	Yield (%)
09/13	300.4	24.4	4.2	1.1	18.4	N/A
09/14	279.5	21.3	(3.6)	(1.7)	N/A	N/A
09/15e	333.6	22.4	3.9	0.8	25.3	N/A
09/16e	376.5	23.5	5.5	1.3	15.5	N/A

Note: *PBT and EPS are normalised (fd), excluding intangible amortisation, impairments, and share-based payments. All translation losses are included.

Progress made towards long-term objectives

Management has made significant investment in facilities during FY14. These are intended to give the capacity to become a major food supplier to the sub-Saharan region and to improve efficiencies, thus increasing competitiveness and offsetting the impact of depreciation in the Zambian kwacha on input costs. Recent investments include almost trebling milk processing capacity, raising stock feed capacity by 50%, increasing in-house soya bean crushing capacity, modifying broiler hen housing to support more intensive rearing techniques and developing a new dairy cattle feeding shed to help generate higher milk yields. Strategic partnerships remain a key element of long-term development. The enhancements to chicken production and processing were carried out with partner RCL Foods. Expansion in West Africa was underpinned by partner Shoprite's own programme of opening new stores in Nigeria and Ghana.

External factors during H1 affect FY14 outcome

Volume growth in the core cold chain food product divisions was offset during H114 by a weakening kwacha, a sharp drop in global soya bean prices and an outbreak of African Swine Fever, resulting in $3.2m adjusted pre-tax losses during the period. The external environment improved during H2. This supported margin growth in the core divisions, generating $2.9m adjusted pre-tax profit during the period. This H2 result underpins confidence in a return to profitability in FY15, provided that the US dollar/kwacha exchange rate remains stable.

Valuation: Profit growth needed to drive value

Our valuation, which is unchanged, is based on a DCF calculation and gives a range of 17-37p. To progress up this range, Zambeef will need to demonstrate it is able to improve product margins despite a weaker kwacha and an intense competitive environment.

15 December 2014

Price	**12.63p**
Market cap	**£31m**
	ZMW5.88:$; $1.60/£
Net debt (US$m) at Sept 2014	118.5
Shares in issue	248.0m
Free float	67%
Code	ZAM
Primary exchange	AIM
Secondary exchange	Lusaka

Share price performance

%	1m	3m	12m
Abs	(13.7)	(38.8)	(63.9)
Rel (local)	(10.0)	(34.5)	(63.3)
52-week high/low		45.0p	12.6p

Business description

Zambeef Products is a producer, distributor and retailer of beef, pork, chicken, eggs, milk, dairy products, edible oils, stock feed, flour and bread. It also carries out row cropping, leather and shoe manufacture, has operations in West Africa and is developing a palm oil plantation.

Next event

AGM	22 December 2014

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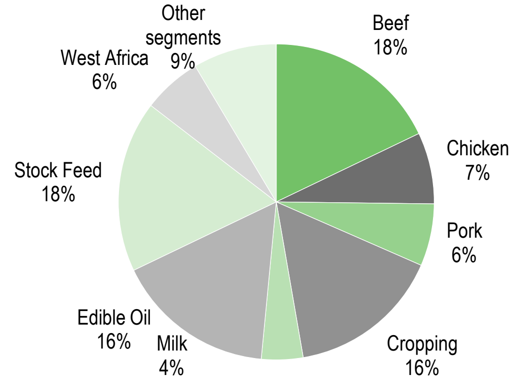
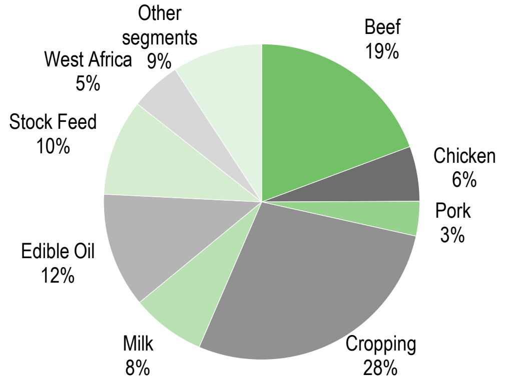
Divisional performance

Exhibit 1: Analysis of FY14 revenues by segment



Source: Zambeef Products

Exhibit 2: Analysis of FY14 gross profit by segment



Source: Zambeef Products

Our discussion focuses on those segments that experienced the greatest movement in year-on-year profit. The Milk and Dairy, West Africa and Chicken and Egg divisions showed a substantial increase, whereas the Edible oils, Cropping, Stock feed and Beef divisions a substantial decrease. Pork reported increased profits year-on-year, but growth was held back by external factors in H114.

Exhibit 3: Segmental analysis FY13 and FY14

	Revenues ($m)			Segmental contribution ($m)		
	FY13	FY14	Change (%)	FY13	FY14	Change (%)
Beef	61.0	58.8	(4)	19.6	18.2	(7)
Chicken (excluding egg)	25.4	24.1	(5)	5.1	5.3	5
Pork	21.7	20.9	(4)	2.5	3.3	36
Cropping	78.2	51.6	(34)	29.1	26.4	(9)
Milk	11.6	14.0	21	5.0	7.2	44
Edible oils	69.8	53.9	(23)	19.2	11.1	(42)
Stock feed	49.8	57.7	16	11.1	9.3	(16)
West Africa	16.1	19.8	23	3.8	4.9	29
Other	30.3	28.1	(7)	8.7	8.7	(1)
Total	363.9	328.9	(10)	104.1	94.4	(9)
Intra-group sales	(63.5)	(49.5)				
Group total	300.4	279.5				

Source: Zambeef Products

Milk and Dairy: Segmental revenues rose by ZMW21.0m (34%) to ZMW82.4m and profit by ZMW15.7m (60%) to ZMW42.0m year-on-year. The volume of milk produced by the group's own beasts rose by 8% to 6.5m litres through a combination of better milk yields, helped in part by a new feeding shed, and by a larger number of lactating cows. Following the commissioning of the new milk processing plant in November 2013, capacity increased from 25,000 litres/day to 65,000 litres, enabling Zambeef to target supply growth more aggressively. The volume of milk sourced from third parties more than doubled to 2.4m litres. The new plant also supports the production of a greater number of higher-margin value-added products, helping to improve divisional profit margin. Divisional profit (in US$) was 22% higher in H2 than H1. Our estimates model continued strong growth in the volumes of third-party milk processed, underpinning further profit growth going forwards.

West Africa: Segmental revenues rose by ZMW30.8m (36%) to ZMW116.2m and profit by ZMW8.6m (43%) to ZMW28.7m year-on-year. This was driven largely by the continued roll-out of stores by Zambeef's partner, Shoprite. During the year Shoprite opened four new stores in Nigeria and one in Ghana. This brings the total of outlets in West Africa to 11 Shoprite stores in Nigeria and four in Ghana, and six self-operated outlets in Nigera. Our model assumes further portfolio expansion. Shoprite expects to open three new stores in Nigeria and two in Ghana during FY15.

Pork: Segmental revenues rose by ZMW7.6m (7%) to ZMW123.1m while profit rose by ZMW6.6m (51%) to ZMW19.6m year-on-year. Profit growth was held back by an outbreak of African Swine Flu in Zambia, which lasted from November 2013 to February 2014. Zambeef's own beasts were not affected by the outbreak, but the government imposed restrictions on the sale of pork products and movements of pigs during the outbreak significantly affected divisional performance during H114. Once the restrictions were lifted there was significant improvement in demand for pork products. Margin development was held back by higher prices for feed and for spices, both of which are denominated in US$. Our model expects improved demand to continue into FY15, which will benefit from a full year of sales from the division.

Chicken and Egg: Segmental revenues grew by ZMW14.2m (9%) to ZMW173.9m and profit by ZMW7.3m (20%) to ZMW43.2m year-on-year. The volume of broiler birds produced increased by 21% to 6.2 million, the volume of eggs by 15% to 46 million. This volume growth was driven by investment in the broiler houses to support more intensive rearing techniques recommended by strategic partner Rainbow Chicken. However, average sales prices in kwacha were lower because of increased competition and the 9% growth in kwacha-denominated revenues was entirely offset by currency devaluation. Rainbow has also advised on the introduction of value-added product ranges such as the launch of individual quick frozen portions. This product development was underpinned by investment in a new Gyro Freezer, which was commissioned in January 2014. Profits for the Chicken and Egg divisions were respectively 12.2% and 21.5% higher in H2 than H1.

Edible oils: Segmental revenues fell by ZMW53.8m (15%) to ZMW316.7m and profit reduced by ZMW36.8m (36%) to ZMW65.1m year-on-year. The global price of soya beans fell by around US$100/t between the 2013 and 2014 buying seasons. Until August 2014, Zambeef processed beans purchased at the higher price while the sales price of soya meal and edible oil was falling and the cost of fuel for crushing, denominated in US$, was rising. This unfortunate combination put pressure on margins, a situation exacerbated by competition from unregulated imported edible oil. The lower output prices also made it economically unviable to crush beans at third-party facilities, which contributed to a 32% drop in the volume of beans crushed to 58,747Mt. An additional factor contributing to the volume reduction was a programme to upgrade the capacity of the crushing plant from 8,500Mt/month to 100,000 Mtpa, which began in August 2014. We expect segmental performance to improve during FY15 as a result of increased in-house crush capacity and lower bean purchase prices.

Cropping: Segmental revenues dropped by ZMW111.5m (27%) to ZMW303.6m while profits were flat year-on-year at ZMW155.3m. Both soya bean and wheat yields were higher than in FY13, producing an aggregate of around 120,000t of maize, soya beans, barley and wheat. However, while global wheat prices were stable, global soya bean prices fell by around $100/t to $500/t. At the same time input costs, primarily fertiliser and fuel, which are denominated in US$, were rising, squeezing margins. Input prices rose significantly during H114 because of the rapid devaluation of the kwacha. Our estimates show revenues increasing during FY15 and FY16, reflecting higher yields but a further reduction in segmental profit during FY15 because of continued pressure on margins.

Stock feed: Segmental revenues increased by ZMW75.1m (28%) to ZMW339.3m but profit declined by ZMW4.4m (7%) year-on-year to ZMW54.7m. Volume output grew by 33% to 118,885Mt following the commissioning of a second pelleting line in May 2014. However, gross margins were depressed because of the time lag in passing on increased input prices, mainly for maize and soya meal, which are denominated in US$, on to customers who typically pay in Zambian kwacha. Our estimates show revenues rising during FY15, reflecting a full year of production from the second pelleting line and a modest improvement in divisional margin now that the kwacha has stabilised.

Beef: Segmental revenues grew by ZMW21.9m (7%) to ZMW345.8m and profit by ZMW3.0m (3%) to ZMW107.2m. The total number of cattle slaughtered rose by 17% to 59,000. At the beginning of the financial year, volumes had not fully recovered after the alleged contamination of certain imported products episode, so high levels of promoting activity were used during Q214 to stimulate sales. This policy was successful, but adversely affected average pricing and margins. Margins recovered strongly during H2. Our estimates model further growth in the number of cattle slaughtered and stable pricing and margins resulting in a substantial improvement in divisional performance.

Strategic exits and disposals

Zambeef has evolved into a highly vertically integrated organisation to secure the key inputs (stock feed and animals) to its core cold chain food processing businesses. As the economy in Zambia has progressed, it is no longer necessary for Zambeef to be so highly integrated. Earlier this year management flagged that it was considering exiting non-core businesses. During H214 it closed its low-margin bakery operation, which was part of the Milling division.

In early December, management announced it was in preliminary discussions regarding the potential sale of its Zamanita subsidiary. Zamanita crushes soya beans, some of which are grown on Zambeef's own farm, producing edible oil and soya meal. The edible oil is sold to consumers, complementing the cold chain food products sold through its retail network. The soya meal is a key component of the feed produced by the Stock Feed division, providing essential protein. The business was acquired in January 2008 to provide security of soya meal supply. However, it is highly capital intensive compared with the core cold chain food operations and the margins achievable are substantially lower because of competition from cheap imports. We will adjust our estimates to reflect the potential disposal once the transaction has completed.

Valuation

An analysis of prospective multiples for Zambeef's listed peers shows that the shares are currently trading on prospective multiples, which are broadly in line with the sample mean. This suggests that if margins remain at the levels given in our estimates, which are substantially lower than the margins achieved by its peers, the shares are at least fairly priced.

Exhibit 4: Prospective multiple of listed peers

Company	Market cap (£m)	Year1 EV/EBITDA (x)	Year 2 EV/EBITDA (x)	Year 1 P/E ratio (x)	Year 2 P/E ratio (x)	Year 1 EBIT margin (%)	Year 2 EBIT margin (%)
Astral Foods	407	-	-	10.6	9.6	8.1	8.2
Flour Mills of Nigeria	433	3.8	3.3	16.7	12.3	6.6	7.0
Innscor Africa	208	4.2	3.9	10.9	9.1	5.1	5.8
Nestle Nigeria	2,365	18.7	15.9	27.0	23.3	21.4	22.0
RCL Foods/South Africa	901	-	-	21.0	14.6	4.6	5.6
Seed Co	143	9.2	8.3	11.9	10.1	19.4	21.0
Unilever Nigeria	470	0.6	0.5	32.8	24.3	9.1	10.7
UAC of Nigeria	293	6.1	5.2	14.9	11.9	17.0	17.5
Mean		7.1	6.2	18.2	14.4		
Zambeef Products	**31**	**7.7**	**7.2**	**25.9**	**16.0**	**3.2**	**3.1**

Source: Edison Investment Research. Note: Prices as at 2 December.

However, management is confident that the programme of investment to improve the efficiency of operations, eg new broiler sheds and greater milk processing capacity, will result in substantially improved margins in the longer term. Our DCF model (WACC and terminal growth below) takes a highly prudent approach to the potential for margin improvement, looking for only 3.0pp EBIT margin growth between 2015e and 2021e. This gives a valuation range of 17-37p, the same level as our October update. To progress up this range, Zambeef will need to demonstrate it is able to improve product margins despite a weaker kwacha and relatively stiff competition. We note that the shares are trading at a discount to net asset value, which was 53p/share at the end of FY14, indicating potential for upside to our current valuation if management succeeds in its strategy of extracting more value from the asset base.

Exhibit 5: DCF analysis

		WACC				
		10.00%	10.50%	11.00%	11.50%	12.00%
Terminal growth rate	1.0%	30.6p	26.7p	23.1p	19.9p	17.0p
	2.0%	34.6p	30.0p	26.0p	22.4p	19.1p
	2.5%	37.0p	32.0p	27.6p	23.8p	20.4p

Source: Edison Investment Research

Financials

Earnings

In kwacha terms, group revenues rose by 3% year-on-year to ZMW1,643.3m. However, as the ZMW depreciated against the US$ by 17.9%, (most of which took place during H1), in dollar terms group revenues reduced by 7% year-on-year to $279.5m. This was in line with our estimate of $284.2. Volume growth in the Milk and Dairy, Chicken and Egg and Beef divisions was offset by a weak kwacha, a sharp drop in global soya bean prices, an outbreak of African Swine Fever and aggressive promotional activity to stimulate demand in the Beef division. Total divisional profit margin (gross profit margin) was broadly stable at 34%.

Administration costs were tightly controlled. Excluding depreciation, these rose by only 2% year-on-year in Kwacha, compared with the annual inflation rate estimated at around 8%. Interest costs grew by $0.9m to $8.6m as management switched from dollar-denominated debt to more expensive kwacha-denominated debt to reduce forex exposure. Excluding unrealised foreign exchange losses of $3.3m but including realised foreign exchange losses of $2.5m, the pre-tax result shifted from a $6.0m profit to $0.3m loss. As in FY13, when management decided to suspend dividend payments in the light of lower level of profit, no dividend will be paid.

The main external factors that adversely affected H1, ie a 15% depreciation in the kwacha compared with the US$, a sharp year-on-year drop in global soya bean prices, an outbreak of African Swine Fever and aggressive discounting to stimulate beef sales, did not affect H2, although pricing pressure remains. After adjusting for unrealised foreign exchange differences, H1 posted a $3.2m pre-tax loss, while H2 generated a $2.9m profit. This H2 result underpins our confidence in a return to profitability in FY15, provided that the US dollar/kwacha exchange rate remains stable.

Exhibit 6: Revisions to estimates

	EPS (c)			PBT (US$m)			EBITDA (US$m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2015e	2.3	0.8	(57)	7.6	3.9	(49)	28.4	22.4	(21)
2016e	-	1.3	-	-	5.5	-	-	23.5	-

Source: Edison Investment Research

We modify our FY15 estimates to take a more prudent view of margin development in the Edible Oils division. Noting continued pricing pressure, we now assume that divisional margins will remain at FY14 levels throughout the forecast period, despite productivity gains from substantially increased crush volumes. We look for 19% group revenue growth to $333.6m generating $3.9m pre-tax profit. These assume that the relative stability of the Kwacha noted during H214 continues. We take a prudent approach to dividend payments, assuming that management will retain cash for capital investment rather than dividends until the return to profitability is assured.

Cash flow

Zambeef generated $15.2m cash at operating level. Although operating profit was lower than FY13, stock levels fell by $16.8m, helped by low commodity prices. After deducting $8.6m on finance costs, $10.3m (net) on capital investment and $2.6m on the immature palm oil plantation, net debt increased by $4.3m to $118.5m.

Management expects around $14m expenditure on capital investment during FY15, with the majority of this allocated to completing the ZamHatch project and routine replacement of plant and machinery used in the Cropping division. We assume that capex will reduce to $10.5m in FY16 once these major programmes are complete. On this basis we expect net debt to rise to $123.7m at the end of FY15 and to begin falling from FY16 onwards as the enhanced production facilities deliver increased volumes of output at higher levels of efficiency. This excludes any cash realised from the proposed Zamanita disposal.

Balance sheet

Management's long-term goal of reducing gearing has been effectively put on hold while the investments in capacity and efficiency necessary for long-term growth are carried out. Gearing increased from 46% at end FY13 to 56% FY14. Excluding any cash realised from the proposed Zamanita disposal, gearing is expected to rise to 58% at end FY15 before starting to come down at the end of FY16 (55%). Interest cover is relatively low at 1.3x during FY14 compared with 1.9x in FY13. This reflects management's decision to switch from dollar-denominated debt to more expensive kwacha debt to reduce forex exposure. Excluding any reduction in debt arising from the proposed Zamanita disposal, interest cover is expected to improve, rising to 1.6x in FY15e and 1.9x in FY16e.

Exhibit 7: Financial summary

US$m	2013	2014	2015e	2016e
Year-end September	**IFRS**	**IFRS**	**IFRS**	**IFRS**
PROFIT & LOSS				
Revenue	300.4	279.5	333.6	376.5
Cost of sales and gain on biological assets	(196.3)	(185.1)	(225.3)	(254.8)
Gross Profit	104.1	94.4	108.3	121.7
EBITDA	24.4	21.3	22.4	23.5
Operating Profit (before amort and except)	14.9	10.8	10.6	11.6
Exceptional items	(0.1)	0.0	0.0	0.0
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0
Share based payments	0.0	0.0	0.0	0.0
Reported Operating Profit	14.9	10.8	10.6	11.6
Net Interest	(7.7)	(8.6)	(6.7)	(6.1)
Foreign exchange gain/(loss)	(3.0)	(5.8)	0.0	0.0
Profit Before Tax (norm)	4.2	(3.6)	3.9	5.5
Profit Before Tax (FRS 3)	4.1	(3.6)	3.9	5.5
Tax and minorities	(1.5)	(0.6)	(2.0)	(2.4)
Net income (norm)	2.7	(4.2)	1.9	3.1
Net income (FRS 3)	2.6	(4.2)	1.9	3.1
Average Number of Shares Outstanding (m)	248.0	248.0	248.0	248.0
EPS - normalised (USc)	1.1	(1.7)	0.8	1.3
EPS - normalised and fully diluted (USc)	1.1	(1.7)	0.8	1.3
EPS - (IFRS) (USc)	1.0	(1.7)	0.8	1.3
Dividend per share (p)	0.00	0.00	0.00	0.00
Gross Margin (%)	34.7	33.8	32.5	32.3
EBITDA Margin (%)	8.1	7.6	6.7	6.3
Operating Margin (before GW and except) (%)	5.0	3.9	3.2	3.1
BALANCE SHEET				
Fixed Assets	280.3	257.2	259.3	257.9
Intangible Assets	3.0	2.5	2.5	2.5
Tangible Assets	274.3	246.3	248.4	247.0
Deferred tax assets and investment in associate	3.1	8.4	8.4	8.4
Current Assets	142.7	126.0	129.6	137.6
Stocks	88.9	70.9	81.2	86.1
Debtors	11.6	19.5	23.3	26.3
Cash	20.1	10.5	0.0	0.2
Other	22.0	25.1	25.1	25.1
Current Liabilities	(99.9)	(105.6)	(116.6)	(127.1)
Creditors	(30.2)	(35.3)	(42.9)	(48.5)
Short term borrowings	(69.7)	(70.3)	(73.7)	(78.6)
Long Term Liabilities	(68.7)	(63.4)	(54.2)	(45.6)
Long term borrowings	(64.6)	(58.7)	(50.0)	(41.4)
Other long term liabilities	(4.1)	(4.7)	(4.2)	(4.2)
Net Assets including minority interest	254.3	214.2	218.1	222.8
CASH FLOW				
Operating Cash Flow	22.2	15.2	16.0	21.3
Net Interest	(7.7)	(8.6)	(6.7)	(6.1)
Tax	(1.7)	(1.4)	(0.6)	(0.8)
Capex and expenditure on plantations	(13.7)	(12.9)	(14.0)	(10.5)
Acquisitions/disposals	14.3	(4.1)	0.0	0.0
Equity financing	0.0	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Net Cash Flow	13.4	(11.8)	(5.3)	3.9
Opening net debt/(cash)	128.4	114.2	118.5	123.7
Foreign Exchange Effect	(3.7)	(2.0)	0.0	0.0
Other	(4.5)	(9.5)	0.0	0.0)
Closing net debt/(cash)	114.2	118.5	123.7	119.8

Source: Company accounts, Edison Investment Research

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