

National Foods Holdings Limited

Buy

Bloomberg	NTFD.ZH
Reuters	NTFD.ZI
ZSE	NTFD.ZW
Price:	300.00c
52 Wk High:	315.00c
52 Wk Low:	195.00c
20 Day VWAP:	312.07
P/E:	12.23
D/Y:	2.92%
PBV:	2.79
EV/EBITDA:	8.31
Issued Shares:	68.4mn
Market Cap:	\$205.2mn

We are initiating coverage of National Foods, a leading food manufacturing and processing and packaging company in Zimbabwe. The company which has a distribution network encompassing more than twenty nine depots across Zimbabwe which is its primary market, a strong management team, a solid balance sheet as well as leading positions in its markets, is expected to benefit from the fundamental market growth drivers both of structural and secular nature and continue to outpace its rivals. This assertion is premised on the group's early realignment of operations in the post dollarization period.

While the dynamics of food processing altered immensely since the early 2000's when Zimbabwe embarked on a land redistribution exercise, the current trend post dollarization has shown a gradual increase in agricultural production which simultaneously improves processing levels. Aggregate agricultural production for the 2013/14 season is forecasted to grow by 23% to 1,456,000 metric tonnes with maize being one of the major drivers.

Natfoods has over the years invested heavily in retooling of milling plants and is therefore strategically positioned to exploit excesses as they readily have the capacity. The rebound in agriculture which is a major supplier of raw materials as well as a source of economic growth will spur production as well as attainment of firmer margins as more volumes will be driven at constant capacity. However the introduction of local maize floor price regime of \$390 will invariably strain margins growth. The company also enjoys a competitive advantage in its milling market where competitors have largely failed to recapitalize post dollarization leaving the company to aggressively gain more market share.

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The company's intensified marketing and rebranding exercise augurs well with popular brands Red Seal and Gloria will in turn assist in spurring sales growth against less known imported brands. National Foods is also correctly positioned given a more defensive product mix, as consumers continue down-trading with a clear shift towards essentials such as staples in the face of contracting economic activity. The company's low end product placement makes a convenient investment case for Natfoods given the country's low level of consumption and discrete expenditure patterns.

After an above par performance in the full year to June we expect Natfoods to remain on a buoyant path growing earning consistently as the factors that drove growth still prevail. Natfoods has defensive characteristics and considering the stage of the current economic cycle Zimbabwe is in, the status quo presents an opportunity for the company to consolidate its position as well as grow shareholder value through expansion and capacity ramping ahead of a much anticipated economic turnaround. The stock is currently trading a fairly discounted PE and EV/EBITDA multiples relative to other food processing and packaging groups in the region and thus we initiate coverage with **BUY** rating on the group.

Financials Highlights:

		Year Ended 30-Jun-10	Year ended 30-Jun-11	Year ended 30-Jun-12	Year ended 30-Jun-13	Year ended 30-Jun-14
Consolidated Stmt of Comprehensive Income		\$0	\$0	\$0	\$0	\$0
Revenue		160,818	201,170	244,063	309,320	343,518
Profit from operating activities		1,429	7,032	11,053	17,439	22,621
Profit Before Tax		869	7,304	10,708	16,249	21,745
Profit for the year		-1,410	5,097	7,904	10,135	16,783
Total Assets		78,638	81,986	88,517	114,144	120,089
Total Equity and Liabilities		78,638	81,986	88,517	114,144	120,089
Net Cash inflow/(outflows) from operations		-6,110	4,109	12,911	-18,408	25,324
Financing activities		8,259	-6,333	-5,692	17,371	-23,454
Net Change cash & cash equivalents		4,801	-3,196	4,466	-4,248	1,345
Profitability						
Operating margin	%	1%	3%	5%	6%	7%
Return on total assets	%	2%	9%	13%	18%	19%
Return on equity	%	8%	13%	18%	28%	28%
Growth						
Increase in revenue	%	103%	25%	16%	26%	11%
Increase in operating profit	%	-81%	392%	57%	67%	23%
Productivity						
Asset turnover	times	2	3	3	3	3
Solvency and liquidity						
Current ratio	times	1.36	1.56	1.72	1.66	2.09
Interest cover	times	1.19	12.76	32.03	15.5	25.83
Net debt to shareholders' funds	%	11%	3%	Nil	27%	Nil
Total liabilities to shareholders' funds	%	101%	88%	77%	88%	63%
Employee statistics						
Number of employees	ave	1,601	924	918	966	954
Revenue per employee*	US\$	100,449	217,716	265,864	320,207	360,082
Operating profit per employee	US\$	893	7,611	12,040	22,820	23,712
Share performance						
Number of shares issued	000's	68,379	68,399	68,400	68,400	68,400
Weighted average shares in issue	000's	68,379	68,399	68,399	68,400	68,400
Basic earnings per share	US cents	4.24	7.27	11.55	20.38	24.54
Diluted earnings per share	US cents	4.24	7.27	11.55	20.38	24.54
Dividend per share	US cents	-	0.7	2.75	6	8.18
Dividend cover	times	-	4.74	4.19	3.4	3
Dividend yield	%	-	1%	2%	2%	4%
Price earnings ratio	times	21.23	13.07	9.7	12.02	8.76
Net asset value per share	US cents	57.08	63.75	73.12	88.93	107.47
Market capitalisation	\$'000	61,541	64,979	76,608	167,580	147,060
Market price per share						
High	US cents	135	101	125	270	250
Low	US cents	85	81	80	140	195
Price - year end	US cents	90	95	112	245	215

SOURCE: NATIONAL FOODS/EFE

Snap Shot:

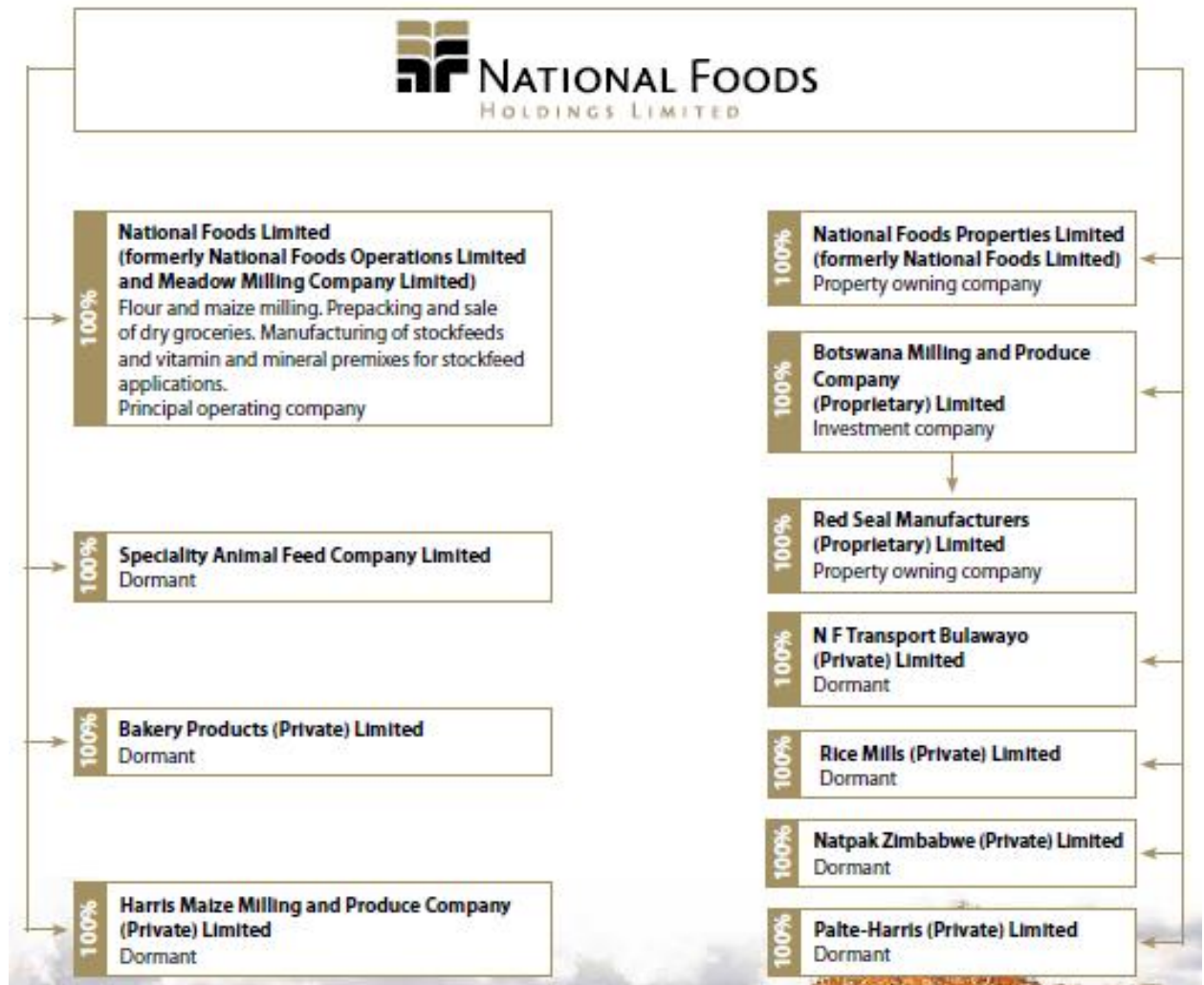
National Foods has over ninety years of milling experience and is a dominant feature in the history of milling in Zimbabwe. On establishment in 1920, the company's main focus was on milling. Today the company provides the resources, technology and manpower necessary to feed millions of people.

...the history

National Foods has a long history stretching back to early last century, when two separate families, the Palte family and the Harris family, started separate businesses, which eventually came together as one. Joseph Palte started his company, J. Palte & Co in 1908 in Bulawayo, where he traded as Miller and Merchants. When he died in 1934, his son, Jack, took over the business. He expanded it in 1952, when Tiger Oats became major shareholders. Meanwhile in 1915 Mark Harris established Mark Harris Manufacturing in what was then Salisbury, using the trade name Atlas. In 1920 he sold his shares to the British South Africa Company (now Anglo American Corporation). The same year C. Harris & Co., which was later renamed Harris Brothers, was established in Bulawayo. It was then that the brand name Red Seal was born. The Gloria brand name was also born. In 1924 Mark Harris Manufacturing was renamed Rhodesian Milling and Manufacturing Company. In 1956 the Rhodesian Milling and Manufacturing Company purchased Harris Brothers. However, the Red Seal brand was taken over by Harris Maize Milling and Produce Company, a company founded the same year by three sons of C. Harris, the founder of Harris Brothers. In 1964 Harris Maize Milling and Produce Company merged with J. Palte & Co. to form Palte Harris. In 1970 Palte Harris went public as Palte Harris Industrial Holdings. In 1975 the Rhodesian Milling and Manufacturing Company merged with Palte Harris to form National Foods, bringing together the Gloria and Red Seal brands. The company has grown to become one of the largest manufacturers and marketers of food products in Zimbabwe and the Southern African region.

Today the group's principal operating company for the holding company is National Foods Limited, which is incorporated in and operates throughout Zimbabwe via a system of factories, depots and agencies.

Group Structure:



SOURCE: NATIONAL FOODS

Group Structure Explained

National Foods Limited is a diversified conglomerate, which has grown to be arguably the largest manufacturer and marketer of food products in Zimbabwe whose operations were established in 1920. Its main activities comprise the milling of flour and maize, manufacture of stock feeds and edible oils, and the packaging and sale of other general household goods. National Foods Holdings Limited dispenses its operations through several subsidiaries, including wholly owned National Foods Operations Limited, National Foods Properties Limited, Bakery Products (Private) Limited, Harris Maize Milling and Produce Company (Private) Limited, Rice Mills (Private) Limited, Natpak Zimbabwe (Private) Limited, NF Transport Bulawayo (Private) Limited, Palte-Harris (Private) Limited and Speciality Animal Feed Company Limited, among others.

National Foods Limited

This is the group's principal operating company that dispenses its operations through a system of factories, depots and agencies across the breadth and length of Zimbabwe. Operations include flour and maize milling, prepacking

and sale of dry groceries as well as manufacturing of stock feeds and vitamin and mineral premixes for stock feed applications. The company has 11 factories of which 8 were operational as at financial year end 2014. The group has twenty nine strategically located depots to allow for good brand exposure and the establishment of a relationship with small traders and farmers and of these depots twenty depots are connected on a “real-time” basis to the central processing system

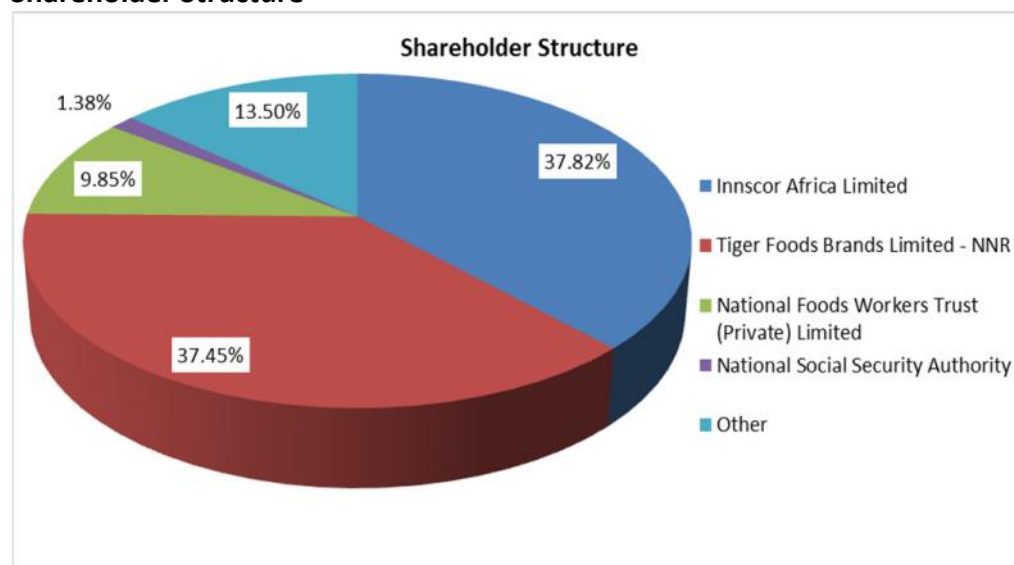
National Foods Properties Limited

This is the wholly owned entity that manages the group’s vast property portfolio from which the group’s operations are dispensed. As at 30 June 2014 the net lettable area of properties stood at 105,000 square metres, of which 77% was occupied by National Foods, whilst 12% was leased to third parties and 11% was vacant. \$1,4m of property is categorised as held for resale.

Botswana Milling and Produce Company

This entity is an investment holding company with its main investment being in Red Seal Manufacturers (Proprietary) Limited which is a property owning company.

Shareholder Structure



SOURCE: NATIONAL FOODS.

National Foods has a solid shareholder structure anchored by two major FMCG conglomerates Innscor Africa Limited and Tiger Brands of South Africa, who offer both technical and financial support to guarantee sustainable growth. This leaves the group with a free float of circa 15% which makes the group a fairly tightly held stock which could easily trade at a premium on the market due to its exclusivity.

Financial Review:

In its most recent financial results the Group posted revenue growth of 11% on an 8% increase in volumes sold relative to the previous financial year. Volumes for the year amounted to 538,000mt representing 48% capacity utilisation. Group margin grew slightly to 23%. Profit before tax achieved over the period amounted to \$21,7m up 26%, inclusive of a non-recurring \$1.5m from disposal of property. PAT increased by 20% to \$16,8m and headline earnings of \$15,4m being 17% higher than the prior year. Capital expenditure in the same financial year amounted to \$3,6m on completed while a further \$3,2m of approved capital expenditure projects will roll over into the next financial year.

Operations Review

National foods' operations are categorised mainly by the product lines namely Flour milling, Maize Milling, Stock Feeds, FMCG and Properties. We review the recent performances from each of the subcategories:

Flour Milling

In FY 2014 the division's results indicated a subdued performance where revenues came down 1% despite a 2% uplift in volumes over the prior year on the back of a lower realisation per ton of wheat sold. Profitability declined 13% as the group sacrificed margins against in a sector dominated by imports both at raw material level and final product. Plans are afoot to upgrade the mills to desired standards with the first stage of the scope of the work required having been completed and benefits are expected to accrue in the next three years. The division ended FY14 with sufficient wheat of the correct quality and at satisfactory prices for its target final product. Its strategic thrust will be on achieving operational efficiencies in order to sustainably compete with regional competitors.

Maize Milling

FY 14 results were exceptional for the division on the back of significant improvements in volumes sold that surged 19% this year compared to the previous year which combined with a 13% increase in average realisation per ton, to see revenue rise 33%.

Stock feeds

The unit experienced 3% uplift in revenues on the back of a 6% increase in volumes though the company acknowledges the proliferation of competition as a real threat citing the opening of three new plants by major competitors. All-in manufacturing cost was down 3% on the previous year the downward trend in maize and soya prices toward the end of the reporting period allowed further cost and price reductions.

FMCG

The unit's product range includes of rice, salt, small grains, pasta and spreads. Volumes sold in FY14 were 22% higher than previous year whilst baked beans' volumes were down 31%. In March of FY14 the group resumed sales of Red Seal and Better Buy cooking oil which is produced for us under license by a local manufacturer these products have been well received to see them sit at a market share of 18% by June.

Properties

One property was sold in FY14 as the group continues to dispose non-core or ageing assets and realign the balance sheet appropriately. Presently the division manages a net lettable area of 105,000 sqm.

National Foods' Markets

National Foods has enjoyed the success from adapting early to the post dollarization era relative to one of their next notable competitors by size. Presently the group's brands are a dominant feature in the FMCG and stock feed spaces; however each of their different product categories faces varying dynamics.

Milling

The milling space in Zimbabwe has traditionally been dominated by four major players listed in the table below above however some of the players have found the going tough post the dollarization period and National foods enjoyed the first move advantage to kick start operations in the multicurrency environment. Only recently has one of their closest competitors Blue Ribbon gotten funding and resumed operations at a notable scale.

Company name	Products	Export destinations
Blue Ribbon	Wheat flour Biscuits Maize-meal Salt Sugar beans, Rice	Zambia, Malawi, Botswana, South Africa, DRC
National Foods	Flour cooking oil maize meal rice	Malawi, South Africa, Zambia, DRC, Namibia Botswana, Mozambique
Victoria Foods	Wheat flour Snacks Rice Salt	Botswana, Malawi Burundi, DRC Zambia
Grain Marketing Board	Millet Sorghum Sunflower Ground nuts Soya beans	Malawi Botswana DRC Zambia Mozambique South Africa

SOURCE: ZIMTRADE

The market dynamics that National Foods faces varies however by product depending on the raw material source and procurement as well as available regulatory control framework in terms raw materials and final products. Capital expenditure is forecast at \$8.3m mainly in the flour business unit in order to consolidate its growth by improving efficiencies.

Flour:

Flour milling is one of the group's major lines but in recent times they have had to sacrifice margins thus operating at lower realisations per ton to at least retain market share. With Zimbabwe producing less than 10% of its estimated 400,000 metric tons wheat the farms National Foods relies on imports of wheat to run its mills. Their main competition presently is from imports as bakers are permitted to import duty free flour of any quality and origin while spot traders of flour also compete with them during periods of international price volatility by importing flour into Zimbabwe whereas National Foods is committed to a five month pipeline of pre-priced wheat and hence must compromise margin in order to respond to short-term price movements. The group contracted 5000 growers and is expecting 25 000 tonnes from the wheat scheme.

Maize:

Maize Milling enjoyed a resounding business growth over the years since dollarization as first move advantage to recapitalise and rejigger operations gave them a clear cut market leadership. Their Red Seal and Pearlenta brands have clearly dominated the shop floor spaces with competition coming from the proliferation of many new smaller players in the same space. The recent decent maize harvest in Zimbabwe and expected improvements going forward are expected to ease the procurement burden via imports however the controlled grain price offers a challenge on millers' margins. Natfoods maize procurement price is up 3% as a result of the controlled grain price.

Stock feed

The stock feed market has been growing particularly in the small livestock space, (Chickens) but so too has been the proliferation of new players in the sector who have been setting up plants to partake of the emerging markets. Non-governmental organisation support to small scale livestock farmers has offered new markets for the company and in FY 2014 the group was awarded a tender to supply 14,200mt to the FAO for their beef support programme which was fulfilled on time

FMCG

National Foods' fast moving consumer products have enjoyed a notable presence with market share as high as 45% on some of the products like the salt line.

SWOT Analysis

STRENGTHS

Market leader : the company's deliberate strategy to recapitalise operations earlier than competitors, enabled it to munch into peers market share and assume the **prime position** in that respective industry as a market leader.

Wide distribution channel: the company has a competitive advantage over most of its peers in terms wider distribution across its primary market. Its operational depots span the breadth of Zimbabwe and this ensures timeous and strategic delivery of products especially in remote areas which have proved to be the linchpin of the company sales growth giving the company invariable leverage against its peers and the competing cheaper imports which now floods most urban centres but not readily available in remote areas.

Defensive characteristics: the stock's defensive characteristics give it an edge given the current downturn in the economy. Natfoods has already exhibited this defensive tendency in the current stock market downturn

Shareholders: the company's major shareholders Natfoods and Tiger brands create not only synergistic opportunities in creating a ready market in Innscor's instance while Tiger Brands can distribute and market its produce through Natfoods and the facilitations of procurement of key raw materials such as wheat. All these channels create value for Natfoods and of course a return to the shareholders

Limited free float: Natfoods is one of the few counters with limited free float as the two major shareholders hold 75%. Pension funds and other asset managers equally claim a share in the limited free float. This is a push factor for the price as market forces work in favour of limited supply in strengthening the price

WEAKNESS

Synergies: synergies do not always work in favour of the recipient. Possible endeavors that might result in cost minimization or sales maximization are sacrificed to satisfy relations.

The company's susceptibility to the parent makes it prone to downward shocks in the later similar to the current trend where the lagging company's fast foods unit's bakery has been losing market share a move which constraints flour sales.

OPPORTUNITIES

Agriculture rebound: The rebounding agricultural sector creates clear opportunities for a strong sustainable growth for the country. Controls in maize imports also reduce the competition from the attendant imports. Zimbabwe's projected maize annual maize demand at an estimated 1.7m tones gives scope for the company which is currently processing a combined 0.55m tonnes of maize and wheat in the main.

Capacity utilisation: At only 50% capacity utilisation the company is poised for growth without overburdening the shareholders to increase capacity.

Regional orientation: The group's thrust to create a regional oriented business diversified from Zimbabwe will give Natfoods a chance to re-enter regional markets and grow its business. Previously the company exported into the region in countries like Malawi, South Africa and Zambia.

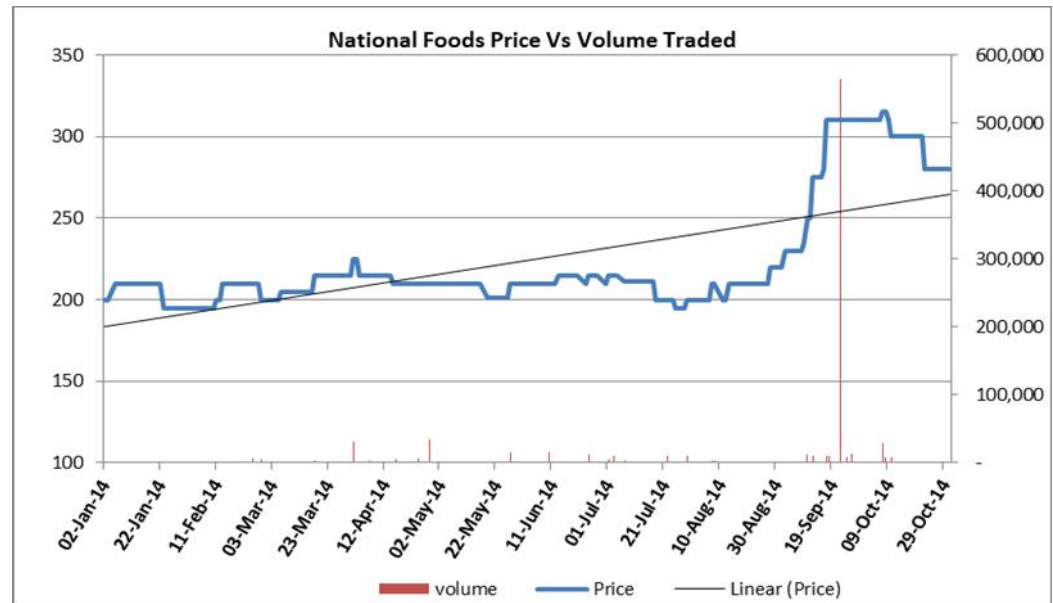
THREATS

Cheap imports: the market has been flooded with imports of sorts. Trade data shows that 75% of the imports are consumptive and mainly food items. Most of these imports are cheap in relative terms yet of usually inferior quality. Controls to curb some of the illegal imports have been less effective leading to the influx.

Re-emerging local competition: blue ribbon which was formerly an anchor player in the industry is reported to be finalising recapitalisation of operations to the tune of \$40m. This will see increased competition and possible loss of market share.

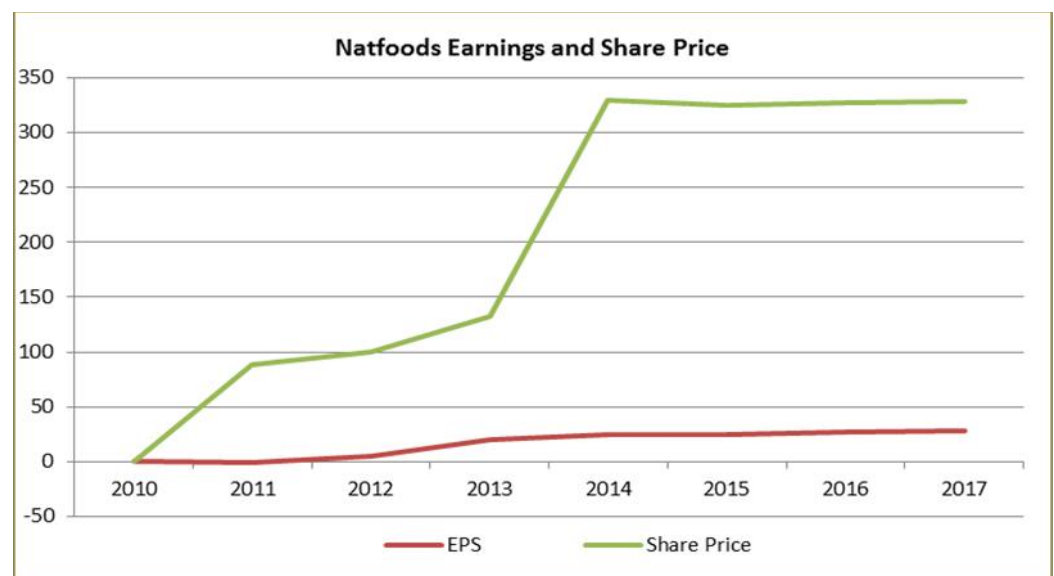
Economic downturn: the continued downturn of the economy will likely result in loss of sales and increased pressure on margins which in the long run will dampen the prospects of the company just like any other operating in Zimbabwe presently. However the defensive nature of the stock makes the stock stable and a worthy investment ahead of the general market.

National Foods Trading Patterns



SOURCE: ZSE/EFE SECURITIES

National Foods has been a fairly consistent performer for the greater part of the year with price fairing fairly stable but spiked in the later part of Q3 after the group posted a solid performance for the year and peaked at 305c. lately however the slow down on the ZSE saw the price shed off some of the gains but the group is well set on an upwards trajectory.



SOURCE: EFE SECURITIES

The 5 year EPS to share price trend depicted above shows that the earnings and price have moved in a parallel trend with a relative slower growth in EPS in 2013 and 2014 compared to the growth in the price. This might indicate increased appeal in the stock as the general economy was confirmed to be in a possible recession after a trending upwards from 2009. Investors realised a treasure trove based on earnings in Natfoods where they could equally seek

umbrage. The improvement in EPS in 2013 was also stellar as it surpassed 80%. Going forward we believe as shown in the trends at the latter part a more stable relationships in the two variables will emerge.

Forecasts and Valuation

National Foods has ridden on its aforementioned first move advantage in the multicurrency system coupled with its savvy procurement moves that has ensured consistent supplies of raw materials even from off shore when harvests were poor in Zimbabwe. Growth going forward for the group is likely to be dictated by growth and developments in the national economy and possibly the group coming up with new products to tap into new markets, of course not forgetting the possibility of the re-emergence of the seemingly dormant competitors like Victoria Foods as seen in the recent re-entry of Blue Ribbon onto the market. We have opted for earnings multiples based valuation models for national foods as we consider the return power of a company to be the single most important factor to the ultimate investor - Shareholders. A DCF would have been ideal, but it risks prejudicing the company's value as free cash-flows in the short term would be very difficult to estimate in Zimbabwe's illiquid economy. As such, it would not be a good proxy of value.

Exogenous factors to consider

Bull Case

- Foreign Direct Investments improve on thawing relations with funders
- The realignment of wages continues hence disposable incomes improve
- Import duties and tariffs on basic commodities are reintroduced
- Banks increase credit facilities for the retail industry.

Base Case

- The local political environment remains uncertain, though peaceful.
- Hence, it will remain difficult to mobilize long-term investments.
- A quick solution is not found for civil servant salary improvements.
- Import duties and tariffs remain suspended on basic commodities
- The financial sector remains under capitalized, hampering prospects of significant credit facilities for retail expenditure.

Bear Case

- The local political environment fails to improve, relapsing in the process thereby discouraging FDI
- Disposable incomes remain low as the economy remains in the doldrums.
- The financial sector fails to recover, resulting in the collapse of some players hampering the re-introduction of credit facilities for the retail sector

Valuation summary

	<i>Actual</i> 2013	<i>Actual</i> 2014	<i>Forecast</i> 2015	<i>Forecast</i> 2016	<i>Forecast</i> 2017
	T-1	T	T+1	T+2	T+3
Sales	309,320,000	343,518,000	368,251,296	393,292,384	420,036,266
Y-O-Y Change	n/a	11	7	7	7
Net Profit	13,939,000	16,783,000	17,248,255	18,421,136	19,673,773
Y-O-Y Change	270.94	20.40	2.77	6.80	6.80
Operating Margin	6.0%	6.6%	6.6%	6.6%	6.6%
Net Margin	4.5%	4.9%	4.7%	4.7%	4.7%
EPS	0.20	24.54	25.22	26.93	28.76
PE	4.56	12.43	11.30	10.58	9.91
DPS	2.75	6.00	6.30	8.98	9.59
NAVPS	0.89	1.07	1.25	1.44	1.65
Earnings Yield	0.07%	8.61%	8.85%	9.45%	10.09%
Dividend Yield	0.96%	2.11%	2.21%	3.15%	3.36%
P/BV	3.20	2.65	2.27	1.97	1.73
ROE	23%	23%	20%	19%	17%
ROA	20%	21%	26%	26%	26%
ROCE	20%	28%	21%	20%	19%
Enterprise Value	178,480,370.80	206,396,307.80	194,028,307.80	194,256,307.80	194,427,307.80
EV/EBITDA	8.76	8.31	7.34	6.88	6.44
Mkt cap:Total Assets	2.86	2.40	2.96	2.77	2.60

SOURCE: EFE SECURITIES

We applied an 8% growth factor to revenue for the full year to 2015 which follows a declining trend from the immediate 2 years. We believe GP and Operating margins will remain almost constant at 23% and 7% respectively against pressure from lower average realisation per tonne and slightly increased cost of sales. Revenue, EBITDA and PAT will therefore come in at \$368.3m, \$25.23m and \$17.2m respectively. This implies an EPS of 25.22c which is 3% up on the prior period. With these forecast we arrived at PE+1 of 11.3x which compares even more favourably against a moderated industry average PER of 16%, we value Natfoods at 403c which implying a potential upside of 34.5% on the current price.

The group remains a dominant player in the food processing and packaging space with strong brand equity in the market offering. The ongoing Innscor inspired restructuring offers opportunities for the group to rejigger and realign operations in National Foods for even better returns going forward prompting us to initiate coverage of the group with a **BUY** rating.

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