Bidvest Namibia

1H14 Result Review – Catch of the day

24 March 2014

BidC – The future looks bright

The BidCom companies managed to grow revenues, and almost all businesses within the commercial portfolio showed improvements in trading profit margins. BidCom accounted for 23.0% of trading profits, up from 17.0% in 2012. Increased sales initiatives and effective implementation of turnaround strategies by the Industrial and commercial products divisions allow for a positive outlook, supported by higher trading profits in the Freight and logistics division, stemming from the continuation of the oil and gas exploration opportunities and spin-offs from the expansion of the Walvis-bay harbour is expected to be significant once construction starts.

Valuation and Recommendation

The stock is currently trading on a FY14 yield of 5.8% based on full year dividends of 74cps at an assumed 52% payout ratio. This compares favourably to its average of 4.8% since listing.

The positive economic environment bodes well for the revenue growth in the commercial businesses, and despite weaker selling prices of horse-mackerel, a weaker local currency and a healthy fishing resource provides support for revenue growth off a low base in the fishing division, justifying FY15 growth in revenue of 12.0% and trading profit margin starting to widen from the low in 2014. The growth HEPS should further benefit from the lower corporate tax rate.

Cost of equity is calculated at 12.8%, given the risk free rate of 8.59% and a 3.45% equity risk premium with a beta of 1 and country risk premium of 0.71%.

That said, we have adjusted our earnings forecast and target price following a detailed analysis of the first half results. We forecast FY15 earnings of N$1.65 per share and calculate a target price of N$14.00 per share based on a justified PE ratio of 8.5 times. Based on this the 12m total return is 16.2%, sufficing our required rate of return of 12.8%, we therefore change our HOLD recommendation to a BUY.
Operational performance

Revenue

BVN managed to grow revenues by 9.0% y/y to N$1.7bn, mainly attributed to growth in the majority of the commercial businesses, while performance by the fishing division was rather sluggish. Revenue composition was weighted towards the fishing division, contributing 40.9% towards revenue, down from the 44.7% contribution in 1H13. Food and distribution ended up adding 37.7% to the revenue pie, up from 33.5% contributed during the previous comparative period.

Source: BVN, IJG

Trading Profit

Trading profit shrunk by 11.6% y/y to total N$221.5m. As usual, the fishing division supplied the largest chunk of trading profit, coming in at N$170.0m or 76.8%. This figure is 19.6% lower than the N$211.4m seen in 1H13, despite the division’s individual revenue falling by only 0.1% y/y, reflecting depressed margins resulting from the quota rental fees – 1H14 trading profit margin fell to 24.5% from 30.4% reported in 1H13. Food and Distribution contributed 9.6% of total trading profit. Food and Distribution trading profit rose 27.0% y/y to report a trading profit of N$21.4m, despite a drop in poultry sales. Freight and Logistics had a 7.9% share of trading profit, up from 5.9%, as project activity in the oil and gas industry supported the Freight division.

Earnings and dividends

Despite the difficult trading environment the fishing division finds itself in, EPS and HEPS increased to 55.4cps, up 2.0% and 2.2% respectively. An interim cash dividend of 24cps was declared, up 4.3% from what the dividend declared in 1H13, as the company increased the payout ratio to 43% from 42% before.

Cash position

The cash generated by operations increased by 44.2% to N$249.8m, with the decrease in operating profit being more than offset by a significantly smaller investment in working capital, N$4m compared to N$115m working capital outflow previously. The smaller working capital investment was on account of lower payables offsetting the increase in receivables. Although not much changed from a year ago, the final cash position increased by 13.6% or N$95.2m to N$792.8m during the interim period with the firm increasing reserves.
Segmental Highlights and Outlook

<table>
<thead>
<tr>
<th>Segment analysis</th>
<th>Revenue FY13</th>
<th>Revenue 1H13</th>
<th>Revenue change 1H13</th>
<th>Trading Profit FY13</th>
<th>Trading Profit 1H13</th>
<th>Trading Profit change 1H13</th>
<th>Trading Profit Margin FY13</th>
<th>Trading Profit Margin 1H13</th>
<th>Trading Profit Margin change 1H13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fishing</td>
<td>1,589,450</td>
<td>695,418</td>
<td>-594,032</td>
<td>528,469</td>
<td>211,437</td>
<td>-317,032</td>
<td>33.2%</td>
<td>30.4%</td>
<td>24.5%</td>
</tr>
<tr>
<td>Freight and Logistics</td>
<td>325,153</td>
<td>128,745</td>
<td>-208,408</td>
<td>36,658</td>
<td>14,763</td>
<td>-21,895</td>
<td>11.3%</td>
<td>11.3%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Food and Distribution</td>
<td>1,026,776</td>
<td>521,507</td>
<td>-505,269</td>
<td>28,445</td>
<td>16,806</td>
<td>-11,639</td>
<td>2.8%</td>
<td>3.2%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Services</td>
<td>113,173</td>
<td>60,952</td>
<td>-52,221</td>
<td>10,627</td>
<td>6,133</td>
<td>-4,494</td>
<td>9.4%</td>
<td>10.1%</td>
<td>16.7%</td>
</tr>
<tr>
<td>Industrial and Commercial Products</td>
<td>295,309</td>
<td>147,944</td>
<td>-147,365</td>
<td>11,414</td>
<td>6,480</td>
<td>-4,934</td>
<td>3.9%</td>
<td>4.4%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Corporate Services</td>
<td>5,116</td>
<td>1,896</td>
<td>-3,220</td>
<td>(14,116)</td>
<td>(5,043)</td>
<td>9,073</td>
<td>3.5%</td>
<td>4.4%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Total</td>
<td>3,354,987</td>
<td>1,556,402</td>
<td>1,868,544</td>
<td>601,497</td>
<td>250,556</td>
<td>350,941</td>
<td>350,941</td>
<td>350,941</td>
<td>42.5%</td>
</tr>
</tbody>
</table>

Source: BVN, IJG

BidFish

At 76.8% of trading profit, although down from 84.4% in 1H13, this division remains the backbone of the firm. As such, the challenging operating environment prevalent during 1H14 resulted in the subdued first half performance for the whole group.

Segmental revenue fell by 0.1% to total N$694.7m from N$695.4m reported for 1H13, on account of the softer price for horse-mackerel in the market, while the trading profit generated by the division fell 19.6% y/y from N$211.4m in 1H13 to N$170.0m for the reporting period, showing margin contraction from 30.4% in 1H13 to total 24.5% in 1H14. The reduced margins come as a result of higher cost of securing quota indirectly and the profits of the Trachurus joint venture declined as the entire quota had to be purchased. The fishing segment was put further under pressure through a standstill in the Angolan operations and softer selling prices, this was however partially offset by a weakening Namibian dollar. Horse mackerel is the main driver of the fishing business, and as such, is examined in more detail.

Total Allowable Catches (TAC) is set by the Ministry of Fisheries and Marine Resources at the start of every calendar year (CY) and the bulk of the TACs are then allocated for that year; where the ministry usually keeps a portion of the TACs in reserve, to be allocated as the year progresses. As such, the concession holders do not know exactly how much they will be allocated once the year starts, putting a spanner in the works for planning purposes as it does not give enough information to plan for smoothing out allocated TAC throughout the year.

The TAC announced by the Ministry of Fisheries and Marine Resources for CY14 has remained unchanged at 350,000 tons, and BVN’s slice of the pie including both direct allocation and indirect acquisition of TACs relatively in line with last year. Note that the full CY14 TAC allocation is yet to be announced and at the moment there is still 102,200t in reserve. However, BVN managed to secure a substantial percentage of the reserve allocation in CY13, effectively securing 44.0% of quota allocation directly. This compares direct quota allocation of 38.3% in CY12 and 47.6% in CY11.

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Quota Allocation</td>
<td>78,799</td>
<td>54,985</td>
<td>64,095</td>
<td>66,018</td>
</tr>
<tr>
<td>% of total BVN TAC</td>
<td>47.5%</td>
<td>38.3%</td>
<td>44.0%</td>
<td>44.4%</td>
</tr>
<tr>
<td>Indirect Quota acquired</td>
<td>86,674</td>
<td>88,580</td>
<td>81,537</td>
<td>82,732</td>
</tr>
<tr>
<td>% of total BVN TAC</td>
<td>52.4%</td>
<td>61.7%</td>
<td>56.0%</td>
<td>55.5%</td>
</tr>
<tr>
<td><strong>BVN Total TAC</strong></td>
<td><strong>165,473</strong></td>
<td><strong>143,565</strong></td>
<td><strong>145,633</strong></td>
<td><strong>148,750</strong></td>
</tr>
<tr>
<td>Total TAC</td>
<td>310,000</td>
<td>320,000</td>
<td>350,000</td>
<td>350,000</td>
</tr>
<tr>
<td>% of total TAC</td>
<td>55.4%</td>
<td>44.9%</td>
<td>41.6%</td>
<td>42.5%</td>
</tr>
</tbody>
</table>

Source: BVN, Ministry of Fisheries and Marine Resources, IJG
A factor that boosted fishing revenues came in the form of a strong US$ exchange rate, that averaged N$10.01 over the period, up a substantial 18.5% from N$8.45 averaged in 1H13. This resulted in a net positive impact of N$56.3m in the fishing division, but was offset by decreasing horse-mackerel prices amounting to an estimated N$75.0m. Along with the softer fish prices, the amount paid to secure additional quota has also risen, from N$1,500 at 1H12; to N$1,850 at FY12; to the latest figure of N$2,800 at FY13. We do not foresee the quota rental fees increasing by much more, as currently, the quota rental fees for the Mauritania resource amounts to about N$3,200 and forms a ceiling for attracting ships that would have operated off the North-west African country otherwise.

We estimate average exchange rate over 2H14 of about N$10.90, up notably from the FY13 average rate of N$9.80. Thus, the weaker N$ is expected to remain the silver lining for this division, amidst cloudy conditions that prevail.

BVN’s outlook for the fishing division is described by management as set to remain challenging in the medium term, where they are positive about the long-run prospects, however, we foresee the market price for horse-mackerel continue to be a reason for concern. The Nigerian Government plans to further reduce fish imports by 25% per annum via quota, or by significantly increasing duties on the commodity, so as to reduce imports, but with present local production at 600,000 tons from the sea and inland lakes, farmed catfish production in excess of 200,000 tons and imports above 700,000 tons per year, total available fish is only 1.5 million tons, whilst demand exceeds 2.2 or more million tons. Thus there remains a significant shortfall in Nigeria, but at the same time less demand for Namibian horse-mackerel due to restrictions, resulting in prices likely to fall.

On the other hand, prospect for the pilchard operations are positive. The Ministry of Fisheries and Marine Resources announced the TAC for pilchards are 30,000 tons for 2014 of which 5,000t remain in reserve, up from 25,000t last year. The higher TAC for pilchard together with strong market prices for the pelagic industry allows for a positive outlook for the sub-division.

BidFish Trading Profits (N$m)

Source: BVN, IJG
BidCom

The BidCom companies managed to grow revenues, and almost all businesses within the commercial portfolio showed improvements in trading profit margins.

Increased sales initiatives and effective implementations of turnaround strategies by the Industrial and Commercial Products divisions during the reporting period explains the 15.6% increase in revenue to N$170.9m. Although the trading profit margin shrunk to 4.1% from 4.4% reported for 1H13, trading profit for the period came in at N$7.0m, up 8.9% y/y. Management advises that most of the companies in these segments are performing well, with the exception of Kolok and Voltex as they are facing fierce competition and changing trends in the industry. Services however, reported a trading profit of N$4.9m, down 20.6% y/y while trading profit margin widened from 10.1% reported in 1H13 to 16.7% as at 1H14.

In the case of Freight and Logistics, trading profit added a significant 18.7% y/y to N$17.5m for FY13 after revenue rose by 21.8% y/y to N$156.8m. However, the trading profit margin shrunk somewhat from 11.5% reported for 1H13 to the current figure of 11.2%. Management advises that investments made in oil and gas has paid off and the Manica business in this segment is expected to support trading profits with the continuation of the oil and gas exploration opportunities and spin-offs from the expansion of the Walvis-bay harbour is expected to be significant once construction starts.

Lastly, Food and distribution reported revenue of N$639.2m and an accompanying trading profit of N$21.4m, resulting in a trading profit margin of 3.3%, up from 3.2% in the comparable six months. T&C’s overall performance was above expectations despite significantly lower sales volumes of poultry products as a result of price pressure caused by the import restriction for the infant industry protection. Quantitative import restrictions imposed on dairy products also affected milk and yogurt sales negatively, in addition to cheese products shortfalls experienced in South Africa.

Valuation and Recommendation

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