



Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

Opportunity Knocks

Tanzania Breweries Limited: MEDIUM-TERM BUY

- We maintain our **medium-term BUY** recommendation on TBL. Our stance on the company is a bullish medium term view on one of the highest potential growth markets in terms of alcohol beverage demand in the region.
- Our conviction is backed by:
 - Moderate growth in per capita GDP driving the growth potential of the local alcohol beverage industry
 - Undervaluation of the shares – TBL is trading at an PER trailing of 8.3x compared to EABL's PER of 16.3x – implying that it TBL is grossly undervalued, relative to other regional players in the industry at its current trading price of Tshs. 2,020/=
- TBL's strong operating performance are not reflected in the current price. Over the last five years, TBL has more than doubled its sales and net income from Tshs. 315 bn and Tshs. 64bn respectively in FY07 to c.Tshs. 636bn and Tshs.122bn in FY11. However in the same period, shares rose only by 18% from Tshs. 1,540 in FY07 to Tshs. 2,020 31 October 2011 pushing the year-end PER trailing up to 8.3x in FY11 vs. 7.6x in FY07, i.e. 9% up. In our view, the current low valuation fails to capture the company's operating fundamentals and potential.
- Despite the strengthening of the local competition and the tougher economic environment, we believe TBL is well positioned to benefit from the growing demand, and, along with an improvement in its debt position, expect to continue to post robust operating growth.

Catalyst for the share price

- We expect the main catalyst to be the sale by EABL of its 20% shareholding that is occurring November 2011. The local market constraints will likely continue to weigh negatively on TBL's share price, but we anticipate a rerating once EABL completes the disposal of its stake, as it should highlight the significant mismatch between the company's current share price and its impressive operating performance.
- We view downside risk emanating from EABL termination of the brewing and distribution agreement with TBL and EABL's corporate action and the which creates uncertain for TBL in the medium term. EABL's also purchased 51% in Serengeti Breweries Ltd (SBL) which creates an increased competition and this reduces TBL's market share in the alcohol beverage industry in Tanzania.

31 October 2011
Equity Research
Tanzania Breweries Ltd

Research Analyst
Moremi Marwa

+255 22 2112807
+255 782 007 785
moremi@tanzaniasecurities.co.tz

Share Statistics

Price as at 31 October (Tshs)	2,020
Target price (Tshs.)	2,060
Shares on offer (mn)	59.985
Issued shares (mn)	295
Free float (%)	28
Market cap (Tshs bn)	595
Market cap (US\$ mn)	355
PER (Trailing)	8.34x
ROE	62.12
52-week price range	1,780-2,040
Last dividend reported (interim)	60
Financial year end	31March
Avg daily trdg volume, Tshs.	11 Mn

(Sources : TSL Analysis, Bloomberg, Dar es Salaam Stock Exchange)

Share Price Performance (Tshs.)





Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

Risks to our scenario

- The main risks to our scenario are the price at which the transaction is finalised, and the type of buyers involved in the sale, as in our view the fewer foreigners the transaction is opened to, the less interest there will be in the stock. The competitive power of EABL (via its subsidiary Serengeti Breweries Ltd) in the local market, higher than expected demand (impact on capex increasing funding needs) and a tougher economic environment could also substantially affect our stance on the stock.

Investment Case

- TBL has delivered an impressive performance over the last five years. From FY07 to FY11, net sales and net profit grew at CAGRs of c.19% and c.17% respectively, while the share price moved from a low of Tshs. 1,540 in 2007 to Tshs. 2,020 as of 31 October 2011.
- We believe that TBL is currently trading at a deep discount compared to its competitor EABL at 49%. TBL is currently trading at PER 8.3x compared to EABL's 16.3x. Discounting the current price by country and market risks should place TBL at a price range of between Tshs. 2,750 and Tshs. 3,630.

FY11 Financial Performance

- Sales revenue grew by c.20% in 2011 -- mainly attributed to growth in the market share, strong performance of TBL's wine and spirit business as well as annual price increases. Also the increased brand and market focus, with Castle Lager, Castle Lite and Ndovu Special Malt significantly outperforming its premium segments: Kilimanjaro Premium Lager and Safari Lager contributed to the growth in sales performance.
- The Mbeya Brewery which was commissioned in November 2009 and started packaging products in December 2010 has improved the distribution of TBL beers in Southern highlands regions and reduced transport costs of the products from Dar es Salaam. The commissioning of line 5 in the Dar es Salaam plant has also increased production and supply/sales in the Coastal regions.
- TBL has been exposed to some risks associated with tougher economic environment in Tanzania, which has put pressure on its operating costs (c.21% over the past five years and c.17%, 2011). These difficulties dampened the company's performance in FY11. The Shilling depreciated against major currencies resulting into increased cost pressure on imported materials, while the significant rise in oil prices and unreliable power supply also adversely affected fuel and energy costs. However, improved production and distribution efficiencies allowed operating profit to end 26% ahead of FY11.

Tshs. mn	FY12f	FY11
Sales	712,491	635,863
PBT	182,609	173,183
PAT	122,780	121,695
EPS (Tshs)	416	387



Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

Tanzania Securities Ltd's view on TBL's FY12 earnings

With the economic challenges and the increased competition, overall, we expect the company to not maintain its historical double-digit growth in net profits in FY12, we anticipate the company to post about y-o-y c.5% increase on net profit to c.Tshs. 128bn vs. c.Tshs. 122bn in FY11. However, given the IMF's positive forecasts for per capita GDP and the low per capita alcohol beverage consumption in Tanzania, we expect beverage volume growth to keep pushing up TBL's sales, despite: (1) the potential inflationary pressure in the short term and (2) the growing competition in the medium to long term. Taking into account these two parameters, we estimate TBL's total volume to increase by 10%.

TBL should be able to achieve this growth despite economic odds that are anticipated to put pressure on production and operating costs and also the results brought by the divestiture of the EABL shares in TBL and its acquisition of 51% in SBL. Postive achievement are expected, thanks to: (1) the recent investment related to the commissioning the Mbeya brewery plant; (2) commissioning of line 5 in the Dar es Salaam plant; (3) quality products; (4) customer retention and (5) the increased market share. The increase in sales is expected to emanate from increased demand, market focus as well as aggressive penetration into the southern highlands region following the commissioning of the Mbeya brewery which is anticipated to significantly reduce distribution costs in the region.

TBL: Undervalued by the market

TBL's valuation has decreased continuously since end of FY02, falling by 68% in the period, from a 14.5x PER to 8.3x PER at 31 October 2011. Breaking down those numbers, its EPS increased by 252% from Tshs. 110 to Tshs. 387 in FY11 while in contrast the share price increased just by 26%, from Tshs. 1,600 to Tshs. 2,020.

Impressive Performance. Neither the company's past performance nor the business outlook provide room for doubt in our view over the stock's mispricing. Our analysis of the last five years confirms that TBL has consistently achieved a good operating performance underpinned by strong financial fundamentals. The main P&L lines recorded double digit CAGRs over the past five years (FY07-11): (1) Total revenue: 19% (2) reported EBIT: 17% (3) PBT: 16%.

The company has more than doubled its sales and net earnings in five years, which is comparable to the performance achieved by the best known stocks in the Sub-Saharan Africa (SSA) brewers industry, i.e. Nigerian Breweries (NB), Guinness Nigeria (GN) and EABL Kenya.

Tshs. bn	FY07	FY08	FY09	FY10	FY11	CAGR
Revenue	314.9	383.2	464.2	527.8	635.9	19%
Costs	219.3	274.0	349.0	394.0	462.7	21%
PBT	95.6	109.2	115.2	133.8	173.2	16%
Net income	63.9	74.2	80.8	92.3	121.7	17%
Net Assets	109.4	123.3	156.9	201.2	317.3	30%
EPS (Tshs.)	209	242	262	297	387	17%

Source: TSL estimates, TBL Financials



Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

As can be seen the table below, TBL's operating earnings growth stood in the high teens over the past five years, close to Guinness Nigeria, as well as EABL.

	NB	GN	EABL	TBL
Total revenue	18.3%	18.4%	13.3%	18.1%
EBITDA	19.4%	14.8%	na	14.6%
EBIT	22.0%	14.5%	8.5%	15.5%
Net Earnings	29.7%	23.1%	8.5%	14.7%

Source: Company annual reports, TSL estimates

Despite challenges brought by 2008/09, TBL has continued to grow its net profits, unlike EABL, which struggled to maintain its EPS growth in recent years. This strong performance could be explained by the resilience of TBL's business model and its dominant position within the high growth potential alcohol beverage market.

Debt position: TBL has been relying on debt to run and most of its expansion activities over the years, this being amplified in the high investment period which started in FY09. From FY10, TBL benefited from the support from its parent company (SaMiller), but also short-term borrowings granted by local banks and the medium-term note that the company issued last year. However, thanks to the decrease in capex needs since FY11, the debt situation has broadly improved.

How much is TBL shares worth?

To answer this question, we build our scenario using two methods : (1) based on TBL's current share price ; (2) the acquisition of SBL by EABL as a reference

- First approach : TBL's enterprise value

We summarise in the table below the calculation of TBL's enterprise value.

	Tshs. mn	US\$ mn
Market cap as of 31 October	595,754	340
Net Debt of FY11	79,600	45
Tax obligations	35,504	20
LT provisions	274	0.15
Total EV	480,375	275

Source: TSL estimates, Company Annual Reports

We view this estimate as the lowest value which TBL is worth.

- Second approach: SBL's acquisition by EABL as a reference point

In October 2010, Diageo disclosed that EABL (its subsidiary), had acquired a 51% stake in SBL for a total amount of US\$ 60.4mn, implying an enterprise value of SBL of around US\$ 118 mn. Given that this value corresponds to an entity representing 15% of the Tanzanian alcohol beverage market (before the addition of EABL's volumes in the Tanzania market), we estimate TBL's market value at c. Tshs. 1,155bn (US\$ 718mn) as shown in the table below:

	Tshs. mn	US\$ mn
SBL EV (15%* market share)	188,800	108
Estimated EV of entity owning 100% market share	1,258,667	720
TBL's implied EV (with 70% market share)	881,067	505
Implied price per share	2,985	1.71
Implied PER	10.1x	

Source: TSL estimates, TBL financials & Dar es Salaam stock exchange



Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

The second approach calculation puts TBL's PE at 10.1x which is almost 22% higher than the PE derived from our floor valuation. Both lack of liquidity and the limitation placed on foreign investors' participation on the Dar es Salaam Stock Exchange (DSE) could explain the difference.

TSL's view on the two valuations The second approach derives a value for TBL of more than twice that given by the first approach. Before choosing our central scenario, the main question is: which of these three approaches reflects the value an investor would be actually be willing to pay to acquire TBL's stake?. To respond to this question, we have examined the existing and potential competitor and compare to TBL.

In the anticipated public offering of the TBL's shares, Tanzanian will be given priority, followed by East Africans and then other investors. As EABL is the most traded stock in the brewing industry, it looks the best regional peer for our comparison exercise. All other peers are either not listed or publish very little information on their operations to enable a proper analysis.

Market data	Tanzania	Kenya
Local market share	c.70%	c.95%
Estimated population	42mn	41mn
Beer per capita consumption	5	8
FY11f per capita GDP (Tshs)	883,200	1,400,000
2011f GDP growth	6%	4%
2012f-2015f GDP growth	7.2%	6.7%

TBL vs. EABL

Operating data (in Tshs. mn)	TBL (2011)	EABL (2011f)
Sales	635,863	724,800
EBIT	186,432	213,731
EBIT margin	35.6%	29.3%
Net income	121,695	133,381
EPS (Tshs)	242	171
PER	8.3x	16.3x

Source: TSL estimates, TBL financials, NSE & DSE

Assuming that EABL generates the bulk of its revenue and earnings from Kenya and TBL generates over 98% of its profits from Tanzania, our comparison leaves no room for doubt that TBL is deeply undervalued. As mentioned previously, the lack of liquidity and the foreign investors limitation on the DSE could explain the discount in TBL's valuation, but, in our view, a difference of four times (TBL's October 2011 PER is 8.3x vs EABL's at 16.3x) is not justified. The Kenyan and Tanzanian markets are quite similar in terms of population, but the potential growth in beer demand is higher in Tanzania given its lower per capita consumption, i.e. c.3 litres below Kenya.

In our view, any investor prepared to buy EABL at its current valuation would find TBL more than attractive at a 8.3x PER, and would still be interested in the stock at about 10x PER. We summarise below three key points that strengthen our view:

- We expect EABL and TBL to have similar ROEs in FY11 at c.34%
- TBL's operating margin is well above EABL's, at 36% vs 29%
- In FY10, TBL's dividend yield was almost twice EABL's, at c.8% vs 4.1%

EABL current PER	16.3x
Discounting for country risk	0.2%
EABL PER after discounting for country risk	15.9x

7 Floor IPS Building • Samora Avenue/ Azikwe Street • P.O. Box 9821 • Dar es Salaam • Tanzania

T: +255 22 2112807 • F: +255 22 2112809 • M: +255 718 799 997 • Email : info@tanzaniasecurities.co.tz • Website: www.tanzaniasecurities.co.tz



Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

Market illiquidity discount	60%
EABL PER after country and illiquidity risks discount	9.6x
Normalized earnings based on 3 years (Tshs. Mn)	112,308
TBL's Estimated EV (Tshs. Mn)	1,071,418
Implied price per share (Tshs.)	3,630

The only limitation to our call would be the restriction of the public offering to the Tanzanian market, but as long as it is open to East African investors (and potentially foreigners), we are confident that the company can reach a 10x PE valuation, which is still 40% below EABL's trading multiple.

TSL central scenario is that TBL value is currently at Tshs. 746bn equivalent to Tshs. 2,700 per share.

The central scenario we choose is the combination of the two approaches described above, weighted according to two ratios that sum to 100%. Given that we judge the second scenario as being closer to reality, we decided to give a 65% weight to the second scenario and 35% to the first scenario.

TSL scenario vs other approaches

In Tshs. mn)	1 st Approach	TSL's central scenario	2 nd approach
TBL's EV	421,392	746,405	1,071,418

Source: TSL estimates & analysis, Dar es Salaam stock exchange

We assess the enterprise value of TBL's share at c.Tshs. 746bn. The implied PE is 6.8x, which is 48% above the current PE on the DSE, but 85% below relative multiple valuation approach.

FY11f and FY12f dividends at risk

The company has had a c.69% dividend payout ratio on average over the last four years (except FY11 where the company did not declare dividends), which corresponds to a c.10% dividend yield over the same period. Despite the low visibility on the company's investment programme, we anticipate the return of dividends from this year. At this stage, the company hasn't disclosed any dividend policy, but, having SABMiller as main shareholder should, in our view, incentivise TBL to allocate efficiently its cash at bank between its funding needs and shareholders remuneration. Our dividend estimates set a payout ratio of at least a 60% on average for the FY12-16f period, which is below the 69% ratio we highlighted earlier (FY07-10).

TBL dividend payout to shareholders

	FY07	FY08	FY09	FY10	FY11	FY12f
EPS (Tshs.)	209	242	262	297	387	416
DPS (Tshs.)	200	200	150	150	NIL	208
PE Ratio	7.56	7.52	6.64	6.06	4.70	4.81
Dividend Yield	13.0%	11.0%	9.0%	8.3%	NIL	10.4%
Payout Ratio	92%	80%	55%	48%	NIL	50%

We expect the group's net cash position to stand at c.Tshs. 53.8bn at the end of FY12, i.e. c.1.6bn higher than the previous year. Starting from a lower level of cash available, the TBL is expected not to face higher financial needs than usual given the investments actions that were made from FY09. Even if the TBL's overall financing needs are manageable, we do think that the temptation to lower the dividend payout ratio or not to declare dividends like last year is a risk investors have to factor in.



Tanzania Securities Limited

Stock Brokers | Investment Advisers | Fund Managers

MEMBER OF THE DAR ES SALAAM STOCK EXCHANGE

Analyst' stock ratings are defined as follows:

Outperform/Buy: The stock is of good value, is currently underpriced and have strong fundamentals

Neutral/Hold: The stock is correctly valued with little upside or downside pricing

Underperform/Sell: The stock is currently overpriced, its total return is expected to underperform; it has weak fundamentals and challenging operating environment

Important Disclosures

Tanzania Securities Ltd policy is to update research reports/notes as it deems appropriate, based on developments with the subject company, the sector or the market that may have a material impact on the research views or opinions stated herein. Tanzania Securities Ltd's policy is only to publish research notes that are impartial, independent, clear, fair and not misleading.

The Research Analyst identified in this research report certify, with respect to the companies or securities analyzed, that: (1) the views expressed in this report accurately reflect his personal views about all of the subject companies and securities and (2) no part of his compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Note: This document does not constitute an offer, or solicitation of an offer, for the sale or purchase of any security. Whist every care has been taken in preparing this document, no representation, warranty or undertaking (expressed or implied) is given and no responsibility or liability is accepted by Tanzania Securities Ltd or any employee of Tanzania Securities Ltd as to the accuracy of the information contained and opinions expressed herein.
