

## FINANCIAL MARKETS REVIEW FOR THE FOUR MONTHS TO APRIL 2014

### **Economic Outlook**

Zimbabwe is experiencing a slowdown in economic activity as growth estimates for 2013 was revised downwards from 6% to 3.4%. GDP growth forecast for 2014 is 6.1% according to the Ministry of Finance although it is likely that this figure will be revised downwards, given the performance of the economy in the first quarter. The growth is based on the Zimbabwe Agenda for Sustainable Socio Economic Transformation (ZIMASSET) programme which seeks to initiate the development of the economy over the next 5 years. The new policy is hinged on the utilization of the country's vast resources to secure funding for injection into key sectors and restore the economy. Mineral exports account for over 60% of the total export revenues of the country. This means that other sectors such as Agriculture are no longer contributing much to National GDP although Tobacco remains a key contributor to export revenues. There is a serious liquidity challenge due to lack of external support and a very low savings base. Year on year inflation has declined with March 2014 inflation dropping 0.42% to -0.91% from February's figure of 0.49%. The country has recorded negative inflation for 2 months and if it records a third consecutive month of negative inflation, the economy will be in a deflation. The Reserve Bank of Zimbabwe Deputy Governor recently announced that if the country enters into deflation, it does not have the instruments to come out of it. The country is still highly indebted and has been working with the International Monetary Fund (IMF) under the Staff Monitored Programme which seeks to help implement a policy framework that will revive the economy. Interest rates have remained high due to limited lines of credit and high country risk. Banks have been lending to various sectors but financials reflect an increase in nonperforming loans and accumulation

of low quality assets. Most companies are now carrying a heavy debt burden due to high borrowing costs.

Industry analysis shows that the economy is still operating below sustainable capacity levels with other industries operating below 40% capacity level. Some of the challenges being faced by the country include energy constraints, dilapidated infrastructure, low credit rating, obsolete equipment among others.

## **Zimbabwe Financial Market Review**

### **Money Market**

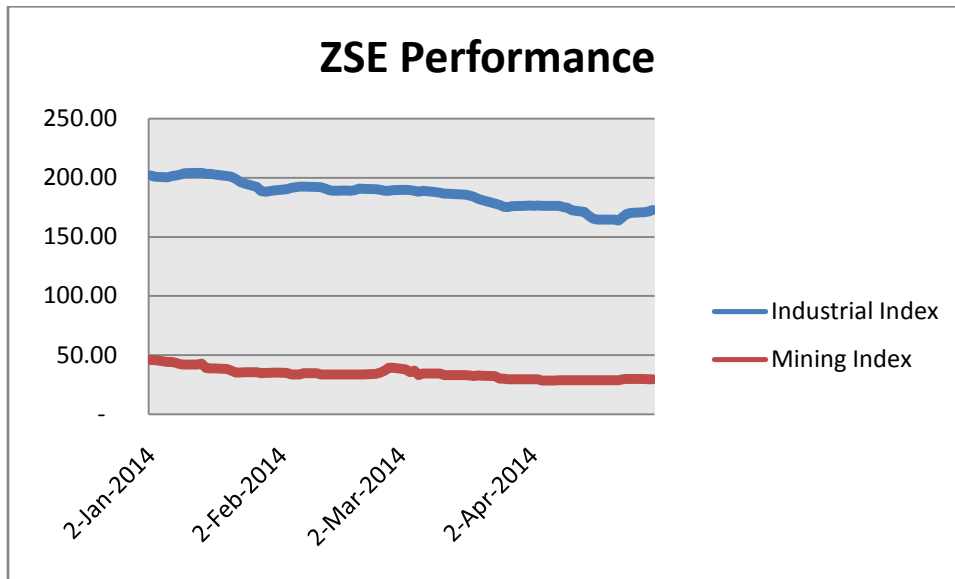
The market is still segmented with tier 1 banks not willing to commit funds to risky assets. The middle and lower tier banks are the ones that have been lending out to low quality borrowers leading to accumulation of low quality assets on their loan books. Total banking sector deposits have remained stagnant, an indication of limited activity and lack of liquidity in the economy.

The first quarter of 2014 saw the government through the central bank and the treasury floating Treasury Bills. The Reserve Bank of Zimbabwe (RBZ) recently floated Treasury Bills (TBs) worth US\$103 mln meant to clear part of Government's US\$1.35 bln debt assumed from the Central Bank. The bills have 3-5 year tenure at a rate of 2% p.a and have prescribed asset status and are exempted from tax. The TBs were targeted at dealing with two components of FCA balances relating to what the banks had with the Central Bank and towards tobacco retentions.

### **The Zimbabwe Stock Exchange's Performance**

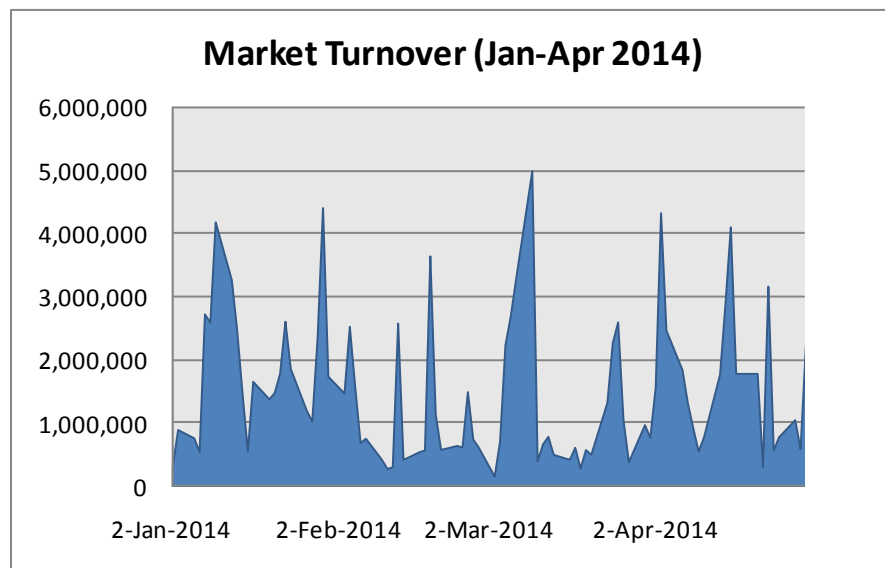
The Industrial Index lost 14.45% during the first 4 months of the year whilst the Mining Index lost a significant 35.27%. Most mining companies are struggling to recapitalize operations in this capital intensive sector. Figure 1 below shows the performance of the ZSE since the beginning of the year.

**Figure 1: ZSE Performance First Four Months to April 2014**



Both the Industrial Index and the Mining Index have recorded negative returns in the first four months to April 2014. There has been increased volatility in the equities market with heavyweight counters leading the stock market movement. The chart below shows the daily value of trades in Q1.

**Figure 2: Daily Market Turnover**



The average daily value of trades has averaged US\$1.51 mln with foreign investors contributing most of the trades. This figure was 7% below the average daily value of trades of US\$1.62 mln over the same period in 2013. Total market turnover for the four months to April 2014 was US\$124.9 mln, a 1.2% decline from US\$126.5 mln over the first four months of 2013. There were more foreign inflows than outflows for the 4 months to April 2014. Foreign inflows amounted to US\$115.55 mln against US\$93.32 mln over the same period last year. Foreign outflows increased to US\$74.51 mln.

We feel that the stock market is going to remain subdued in the short to medium term as liquidity conditions remain tight. The recent underperformance by the equities market has made some companies cheap thereby creating buying opportunities at these levels. Some investors are still taking positions in the equities market as seen by the increased flow of trades especially from foreign investors in the first quarter.

## Stock Picks

### BAT Share Data

<b>Current Price</b>	985 cents
<b>Price to Earnings</b>	54.72x
<b>Price to Earnings (adjusted)</b>	18.24x
<b>Target Price</b>	1272 cents
<b>Upside</b>	29%
<b>52 week High</b>	1475 cents
<b>52 week low</b>	360 cents
<b>Shares in issue</b>	20,633,517
<b>Market Capitalization</b>	US\$203 mln

**BAT Income Statement for the Year Ended 31 December 2013**

British American Tobacco (BATZ)	FY 2013 US\$ 000	FY 2012 US\$ 000	Change
<b>Revenue</b>	<b>44,597</b>	<b>51,853</b>	<b>-14%</b>
Cost of sales	(14,474)	(21,962)	-34%
<b>Gross Profit</b>	<b>30,123</b>	<b>29,891</b>	<b>1%</b>
<b>Operating Profit</b>	<b>9,815</b>	<b>17,612</b>	<b>-44%</b>
Adjusted Operating Profit	17,278	17,612	-1.8%
Profit Before Tax	9,545	16,878	-43%
<b>Profit for the year</b>	<b>3,773</b>	<b>12,262</b>	<b>-69%</b>
Earnings Per Share	18 cents	71 cents	-74%

BAT recorded a 14% decline in revenues to US\$44.6 mln due to a 17% drop in local cigarette sales volume (1.3 bln sticks). The discontinuation of Cut Rag exports last year also contributed to the reduction in revenue. This was done to allow management to focus on the business of building the cigarette portfolio. Price increases offset the lower sales. Cost reduction by the Group saw gross profit increasing by US\$0.2 mln to US\$30.1 mln. Profit reduced to US\$9.8 mln primarily as a result of share based payment expense of US\$10.9 mln. This was the value of shares and dividends awarded to employees in compliance with the Indigenization and Economic Empowerment legislation. This is a non recurring expense and when adjusted the business was very profitable. Total assets declined 9% to US\$30.5 mln due to liquidation of inventories. Trade receivables dropped from US\$7.3 mln to US\$4.7 mln resulting in an equal increase in cash from US\$3.5 mln to US\$7.3 mln. The company recorded an operating cash inflow of US\$17.7 mln compared to US\$9.2 mln in FY2012 following the liquidation of stock. Net cash generated from operations (US\$17.7 mln) outperformed reported profit. The company declared a dividend of 18 cents per share.

## Recommendation

We still see value in BAT and believe that the company will be able to increase its margins going forward. The company trades at a PER of 54x and an adjusted PER of 18.24x. We forecast EPS of between 61 cents and 65 cents for FY214 for the company. Using adjusted earnings (for non recurring items) and our forecast for FY2014, we reach at a relative valuation of 1272 cents for BAT. This gives an upside potential of 29% on the current trading price. BAT has a market share of 75% and is investing in its brands. Although the current environment points to lower volumes in terms of products, we expect the increase in price to add to the difference in sales figures given that their product is price inelastic. We rate BAT as a **BUY** at current levels.

## Econet Wireless Limited

### Econet Share Data

<b>Current Price</b>	<b>66 cents</b>
<b>Price to Earnings</b>	<b>8.25x</b>
<b>Target Price</b>	<b>78.48 cents</b>
<b>Upside</b>	<b>19%</b>
<b>52 week High</b>	<b>77 cents</b>
<b>52 week low</b>	<b>44.5 cents</b>
<b>Shares in issue</b>	<b>1,640,021,430</b>
<b>Market Capitalization</b>	<b>US\$1.08 bln</b>

**Econet Wireless Income Statement for the Year Ended 28 February 2014**

<b>Econet Wireless</b>	<b>FY 2014</b>	<b>FY 2013</b>	<b>Change</b>
	<b>US\$ 000</b>	<b>US\$ 000</b>	
<b>Revenue</b>	<b>752,678</b>	<b>695,791</b>	<b>8%</b>
EBITDA	332,174	302,413	10%
<b>Profit from operations</b>	<b>230,450</b>	<b>230,850</b>	<b>0.2%</b>
Profit Before Tax	194,009	204,903	-5%
Tax	(74,612)	(64,965)	10%
<b>Profit after tax</b>	<b>119,397</b>	<b>139,938</b>	<b>-15%</b>
Other comprehensive income	(106)	(774)	-86%
<b>Attributable Profit</b>	<b>119,291</b>	<b>139,938</b>	<b>-15%</b>
<b>Earnings Per Share</b>	<b>8 cents</b>	<b>9 cents</b>	<b>-11%</b>

The Group recorded an 8% increase in revenue to US\$752 mln for the year ended February 2014. There were 800,000 new subscribers although the company recorded a marginal decline in voice revenue due to competition as other players reduced their tariffs. Ecocash revenue was up 307% to US\$33.4 mln, contributing 5% of the Group's total revenue. Data revenue increased by 62% to US\$72.4 mln, contributing 10% of total revenue. EBITDA rose 10% to US\$332 mln faster than revenue growth as margins improved from 43% to 44%. Profit from operations was stable at US\$230 mln although margins declined from 33% to 31% following an increase in depreciation, impairments and amortization. In our view, the impairments were due to changes in the banking division's book. Finance costs rose 29% to US\$37 mln although we expect this increment to be a once off event as finance costs are expected to align with the 13% cost on the company's debt obligations. Operating costs increased by 11% with employee benefits contributing most of the increase. Net profit margin declined from 20% to 16%. The Group recorded an 86% increase in cash generated from operations to US\$401 mln. Broadband and overlay services (Ecocash, Ecoschool, Ecofarmer) are the new growth areas for the Group given the decrease in voice revenue

contribution. Econet's market share dropped from 70% to 66% due to competitive tariffs being charged by other service providers.

### **Recommendation**

Econet trades at a PER of 8.25x against a peer average of 14x. We feel that the Group's profitability will improve going forward given that the banking division's loan book clean up had a negative impact on the Group during the period under review. The significant growth in overlay services provides Econet with diversification on its revenue streams with expectations of further growth in revenue contribution in future. Ecocash's growth is driven by strong agency network and strategic alliances with banking partners. MPESA in Kenya contributed 9% of revenue in 2010 and in 2013, the contribution had increased to 18%. We expect Ecocash to follow a similar growth path given the number of already registered users on Econet. We expect the increase in non voice services to more than offset the decline in voice revenue. We forecast marginal increase in revenue for FY15 for the Group given the current economic environment. Efficiency and cost containment will help drive profitability and we forecast an EPS of 8.72 cents. Using the earnings multiplier, we arrive at a valuation of 78.48 cents giving an upside potential of 19% from the current price. We rate Econet as a long term **BUY**.



## Delta Corporation

### Delta Share Data

<b>Current Price</b>	<b>118 cents</b>
<b>Price to Earnings</b>	<b>13.8x</b>
<b>Target Price</b>	<b>161.59 cents</b>
<b>Upside</b>	<b>37%</b>
<b>52 week High</b>	<b>157 cents</b>
<b>52 week low</b>	<b>104.9 cents</b>
<b>Shares in issue</b>	<b>1,241,564,715</b>
<b>Market Capitalization</b>	<b>US\$1.47 bln</b>

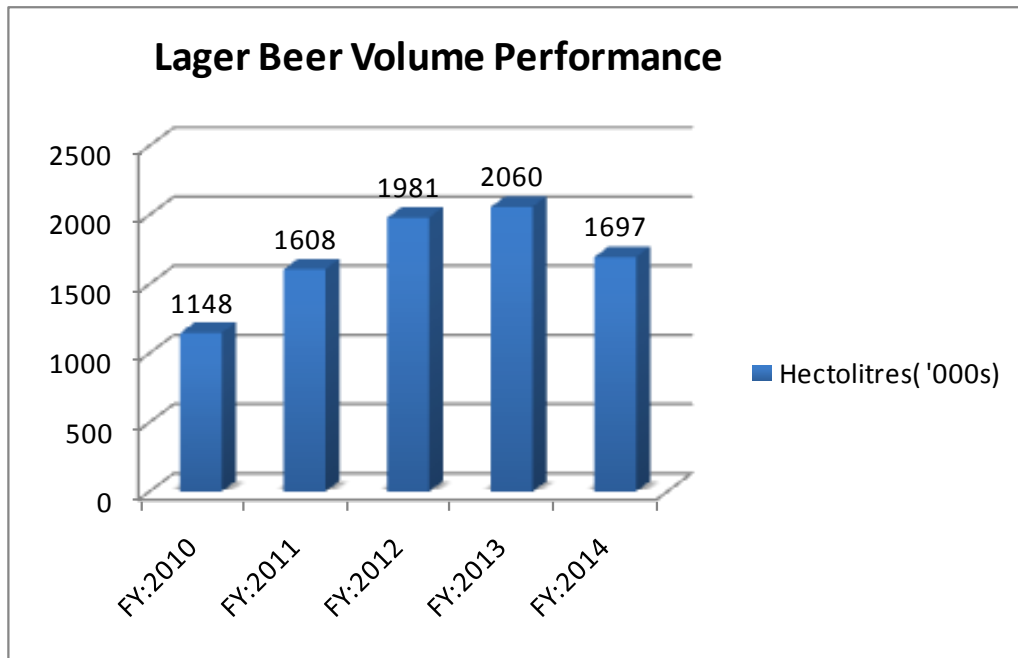
### Delta Corporation Income Statement for the Year Ended 31 March 2014

<b>Delta Corporation</b>	<b>FY 2014</b>	<b>FY 2013</b>	<b>Change</b>
	<b>US\$ 000</b>	<b>US\$ 000</b>	
<b>Revenue</b>	<b>625,517</b>	<b>631,276</b>	<b>-1%</b>
<b>Operating Income</b>	<b>134,184</b>	<b>134,989</b>	<b>-1%</b>
Net Finance Expense	3,763	(574)	
Share of associates profit	2,283	2,458	-7%
<b>Profit Before Tax</b>	<b>140,230</b>	<b>136,873</b>	<b>2%</b>
Taxation	(33,037)	(32,750)	1%
<b>Total comprehensive income</b>	<b>107,193</b>	<b>104,123</b>	<b>3%</b>
Earnings Per Share	8.55 cents	8.49 cents	1%

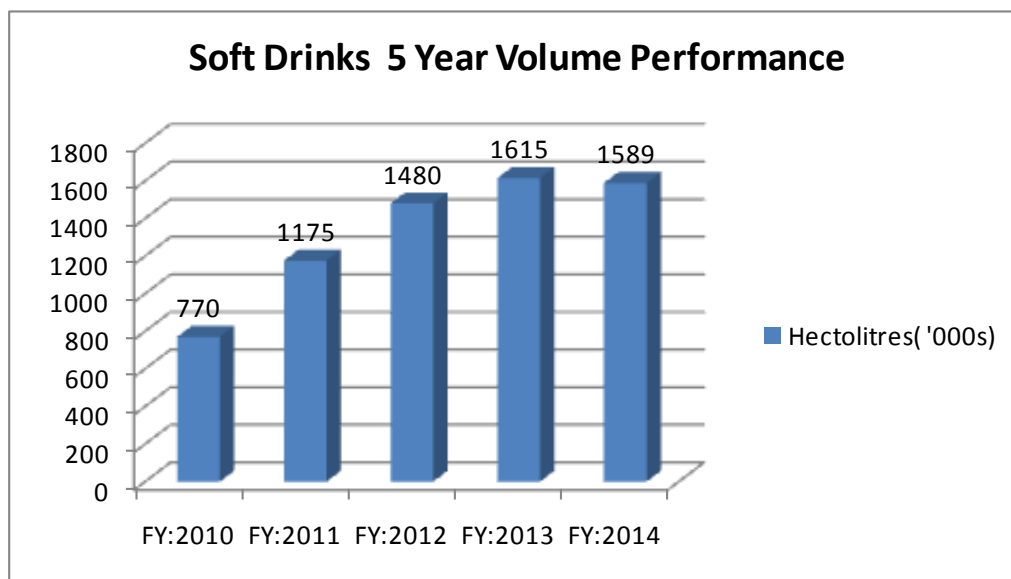
The beverages group recorded a marginal decline in revenue from US\$631.3 mln in FY2013 to US\$625.5 mln in FY2014. This was due to a slowdown in consumer spending especially in the second half as liquidity challenges prevailed. Full year volumes were flat. Volumes for lager beer dropped by 18% whilst sparkling beverages volumes declined by 2%. Sorghum beer volumes, driven by the new Chibuku Super product rose by 12%. Alternative beverage (Maheu) volumes grew

by 33%. Premium beer category contribution was up to 21% from 19% the previous period. The table below shows lager beer 5 year volume performance:

**Figure 3: lager beer 5 year volume performance**



Consumers switched to more affordable beer as the economic condition worsened leading to low disposable income. Sparkling beverages volumes growth have stabilized over the past 3 financial periods as shown in figure 4 below:

**Figure 4: Soft Drinks 5 Year Volume Performance**

Operating income decreased slightly by 1% to US\$134.2 mln. Earnings before interest, tax, depreciation and amortization increased by 2% to US\$165.3 mln. This led to an improvement in EBITDA margins from 25.65 to 26.4%. This was due to an improved product mix and improved supply chain management. Profit for the period rose 3% from US\$104.1 mln to US\$107.2 mln. Total assets grew by 10% to US\$619.9 mln as the company did further investments to maintain and expand operation. The company recorded CAPEX of US\$66.2 mln during the period. The cashflow position of the Group was strong although there was a 3.9% decrease in net cash generated from operations (US\$128.8 mln vs US\$134.1 mln). The decline was due to an increase in working capital and reduced operating income. Earnings per share were 8.55 cents, up 0.7% from the prior period. A final dividend of 2.25 cents was declared bring the total dividend to 3.55 cents which is a 4% increase from 2013.

**SWOT analysis**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>➤ Continuous investment in strong brands</li> <li>➤ Distribution channels</li> <li>➤ Cashflow generating capacity</li> <li>➤ Huge market share</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>➤ Retail pricing on beer still an issue</li> <li>➤ Volumes growth recorded in low margin sorghum beer</li> <li>➤ Premium beer contribution minimal</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>➤ Small players going out of business</li> <li>➤ Duty on imports making imported products less competitive</li> <li>➤ Technological advances</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>➤ Low disposable income</li> <li>➤ Utility challenges especially water supply in Harare</li> <li>➤ Excise duty remains an impediment to volume growth</li> <li>➤ Supply chain challenges</li> </ul>

**Recommendation**

Although the operating environment is expected to remain tough in the foreseeable future, we expect Delta to continue to dominate the industry and post good financial results. This will be backed by its ability to maintain competitive prices for its products and at the same time improve its product mix. We expect further improvement in productivity as the company continues to invest in PPE. CAPEX for FY2015 is expected to be between US\$50 mln and US\$60 mln indicating further investment activities by the company especially for sorghum beer plant. At a PER of 13.8x, Delta remains relatively cheap compared to peer average of 18x. Using a comparative valuation and adjusting for the difference in growth rates, we arrive at a value of 161.59 cents for Delta. We maintain our **BUY** rating for Delta.

**Conclusion**

At a time when the equities market has underperformed other benchmarks, investors need to diversify their portfolios by investing in asset classes that have low correlation with the equities market. Other sectors also provide investors with great opportunities and an assessment of each sector will help in making decisions on where to invest in that particular sector. The Mining and Property sectors offer

attractive investment opportunities and we continue to watch developments in these sectors. However, the Mining sector currently has challenges due to high operational costs, depressed commodity prices and the undercapitalization of most mining companies. Property developments have lagged behind and some old properties have not been refurbished due to lack of funding.

Due to the perceived high country risk, low industry capitalization levels, high default risk levels, poor performance of the stock market and limited availability of investment vehicles, the money market will continue to offer a stable return in the foreseeable future. However, it is important to maintain a weighting in equities as opportunities exist in some companies. The equities market offers attractive potential returns in the long term. We will slowly move out of stocks that we feel do not have any upside potential in the foreseeable future. We will hold on to blue chip counters most of which have the ability to generate enough cash flows to finance their working capital needs and expand their operations. Active trading is also required to grow portfolios as the volatility on the ZSE gives us opportunities to buy/sell at different levels.

#### **Explanation of Recommendations**

<b>Trading Buy:</b>	implies gains within the short term.
<b>Buy:</b>	expect out-performance in short and medium term.
<b>Accumulate:</b>	expect out-performance in medium to long term.
<b>Reduce:</b>	Bearish short term outlook also implies taking profit.
<b>Sell:</b>	Bearish short and long term outlook on security

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