Delta Full Year Ended 31 March 2017 Analysis

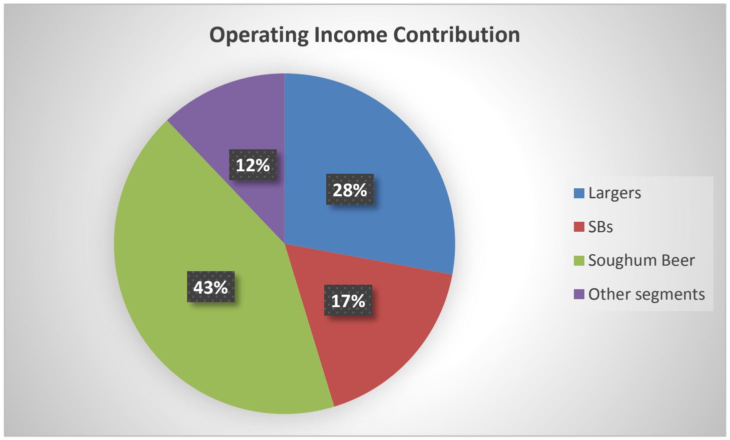
Market Data			
Current Share Price(Usc)			**88.75**
Shares in Issue			**1,243,404,124.00**
Market cap(US$)			**1,103,521,160.05**
YOY high(Usc)			**92**
YOY Low(Usc)			**80**
EPS			**5.7**
Final dividend			**2.45**
Total Dividend Payout			**96%**
P/E			**15.57**
Income Statement	**FY2017**	**FY 2016**	**% Change**
	US$'000	**US$'000**	
Revenue	482,968	538,198	**-10.3%**
Operating profit	82,044	96,072	**-14.6%**
Profit After tax	69,885	80,089	**-12.7%**
Operating margin	17%	18%	**-4.8%**
Net Profit margin	14%	15%	**-2.8%**
Financial Position			
Total Assets	704,089	696,238	**1.1%**
Total Liabilites	200,227	208,339	**-3.9%**
Attributable Equity	503,862	487,899	**3.3%**
Cashflows and Ratios			
Cashflows from Operations	108,343	137,463.00	**-21.2%**
ROE	13.87%	16.42%	**-15.5%**
ROA	9.93%	11.50%	**-13.7%**
Current Assets to CLs	1.95	3.13	**-37.7%**
Total asset turnover	0.69	0.77	**-11.3%**
Debt to Assets	8.5%	9.3%	**-8.7%**
CFO/Net Income	1.55	1.72	**-9.7%**

Delta Revenues Down 10%, PAT Down 13%

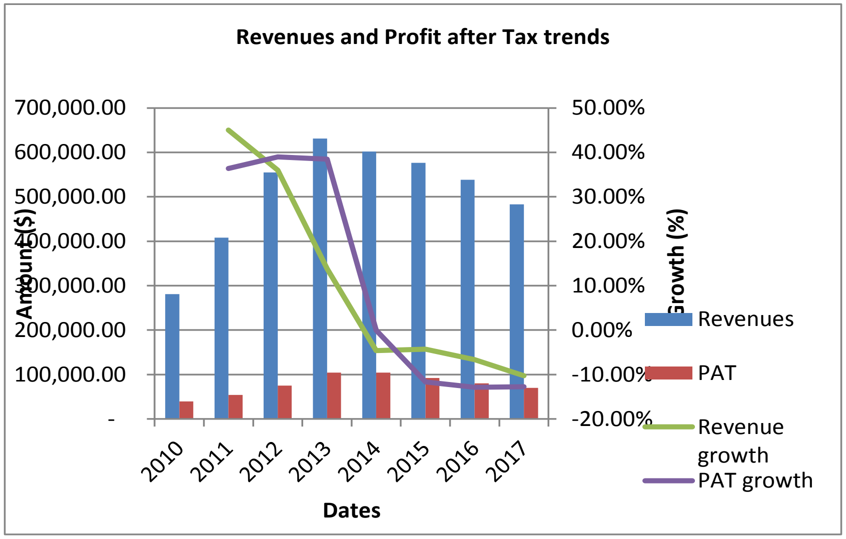
Delta revenues took a 10% knock to $483 million as the depressed economic environment compounded by cash shortages continued to strain the consumer creating a bias towards lower value products. Larger beer volumes were down 7%, Sparkling beverages were down 11% whilst Sorghum beer volumes were down 3%. Sorghum beer which has become a significant earnings supporter was affected by inaccessibility of some markets due to rain damaged roads. Revenues took a heavier knock in the last half of the financial year which coincided with the beginning of the country's cash crisis. The table below indicates that the decline in revenues is higher than the decline in volumes as lower valued products have become significant contributors to volumes.

	Change in Volumes	Change in Revenues
Larger Beer	-7%	-8%
SBs	-3%	-6%
Sorghum Beer	-11%	-15%
Total	-6%	-10%

Source: Delta FY 2017 Financials



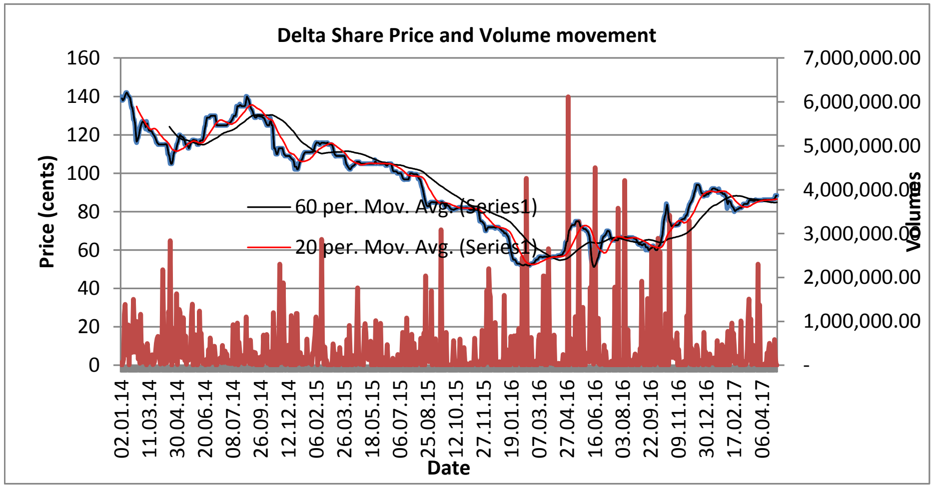
The Pie Chart on the other hand shows that Sorghum Beer contributed 43% to operating profits followed by Largers at 28% whilst SBs contributed 17%. Operating profit was down 15% due to fixed cost effects and the delay in the commissioning of the Kwekwe and Masvingo breweries thereby leading to high freighting costs. Operating margins and net profit margins remained strong and were down 5% and 3% respectively. PAT was down 13% whilst Cash flow from operations took a 21% knock due to lower profitability levels and current liabilities that remain incessantly high arising from delays in making foreign payments. Quality of earnings remained quite robust at 1.55 whilst debt levels remain quite low due to the benefits of high cash levels. Net cash after interest bearing debt stood at $113 million which is inclusive of unremitted dividends of about $28 million and $20 million of foreign payments that are still to be processed. Final dividend was declared at 2.45cents bring the total dividend this financial year at 5.45 cents which is 96% of current EPS. This high payout is a result of reduced CAPEX needs and the fact that management believes that the business will remain profitable despite the current challenges.



Source: Delta Financial Results

The graph indicates a general negative trend in both the revenue and profit after tax growth since 2012. However there is also an indication that there is no significant worsening in these trends especially for PAT growth.

Technical Analysis



The graph indicates a general decline in the Delta share price from the 2014 levels of around $1.40. Since then the share took a serious plunge in 2016 due to the economy's recessionary effects but has since made a sizeable recovery from the last quarter of 2016 as was the case with most blue chips during that period. Although a small weakness in the share price was observed in the first two months of 2017, the counter has once again recovered to the current prices despite the weakness that continues to be observed in company performance. Both the short and the long term moving averages are currently moving in unison and as such there is currently no indication of either an emerging up or down trend. We expect the share price to continue to be supported by the need to hedge against current monetary developments inspite of a depressed performance as Delta remains one of ZSE's core stocks and its challenges are being experienced economy wide.

Investment case

- The Group continues to record strong cash flows with its balance sheet currently indicating a net cash balance of $113million. This has kept interest bearing obligations at low levels and as such the Group boasts of strong solvency ratios and financial strength.
- Delta is a very high cash generating business which has enabled it to maintain an attractive dividend payout policy despite a decline in earnings.

- Delta has managed to maintain very high market shares in the various beverage categories despite the existence of grey imports.
- Operating and net profit margins remain strong at 17% and 14% respectively.
- Delta's product diversification enables it to capture all classes of consumers. Its low cost products like sorghum beer and other cheaper clear beer beverages are currently supporting revenues and profitability and are capturing part of the lost market share from Largers.
- It is a highly liquid counter.
- It's a bell weather stock whose product demand is highly inelastic despite the competitive pressures from imports and the depressed economic environment.
- It has an experienced management team whose strategies have managed to keep the counter in its top position on the ZSE.

Investment Concerns

- Although Delta's products are highly inelastic, the depressed environment and the current cash shortages are taking a serious toll on the consumer resulting in a persistent decline in volumes.
- The unrelenting competition from cheap grey imports continues to prey on Delta's market share thereby leading Delta to resort to price cuts to defend its market share as consumers have become more price conscious.
- The intention by The Coca-Cola Company to terminate its Bottler's agreement with Delta and Schweppes leaves a lot of uncertainty as to how the outcome of the negotiations will impact on shareholder value.
- Persistent negative growth in revenues and earnings is eroding shareholder value.
- The country has one of the highest prices for key raw materials such as maize and barley in the region which keeps the costs of manufacturing elevated for Delta.
- The unrelenting operating environment is slowly seeking to eclipse the significance of Delta's mainstream's products like Lagers and SBs leaving it to slowly depend on low value products like Sorghum beer.
- The very high dividend payout indicates that the company has reached maturity and has limited growth opportunities.
- Delays in external payments are impacting the sourcing of critical raw materials which led to the delays in the commissioning of the Masvingo and Kwekwe plants.

Valuation and Recommendation

Going into the 2018 financial year, we expect a continued decline in revenues and profits as has been the trend in the past 6 years. However this decline is expected to be slightly lower due to positive volume growth that is expected from Sorghum beer after the commissioning of the Kwekwe and the Masvingo plants. These plants will ensure wider and cheaper distribution of the product. We expect the company to also garner an improvement in product demand given the forecasted positive economic growth for 2017. This demand may not be very significant given the current cash shortages and the high levels of unemployment prevailing. We therefore forecast an 8% decline in revenues in 2018 and a slight improvement in margins due to expected focus on managing costs. This leads us to an 8% decline in EPS to 5.22 cents/share. We use the Relative Approach in our valuation where valuation matrices of regional peers were considered. The following bench marks were used: Regional TTM P/E of 15.9x against Delta's 15.6x, Regional TTM P/BV of 2.6x against Delta's 2.2x, Regional P/S TTM of 2.1x against Delta's 2.3x. The regional benchmarks were adjusted for differences in fundamentals. A combination of all the TTM benchmarks was used and applied on the forecasted forward EPS of 5.22c which gave us a 1 year forward price of 92cents/ share which is 3.4% higher than the current price of 88.75 cents. We therefore give a **HOLD** recommendation.