INNSCOR 6 MONTHS ENDED 31 DECEMBER 2016 REPORT

Market Data			
Current Share Price(USc)			**45**
Target Price			**42.9**
Recommendation			**HOLD**
Shares in Issue			**541,593,440.00**
Market cap(US$)			**243,717,048.00**
YOY high			**48.25**
YOY Low			**44**
Interim Dividend(USc)			**0.70**
EPS			**2.32**
Payout ratio			**30%**
Income Statement	**HY2016**	**HY 2015**	**% Change**
Revenue	311,075,696.00	300,614,956.00	**3.5%**
EBITDA	31,327,712.00	27,437,245.00	**14.2%**
Profit After tax	18,398,704.00	15,889,155.00	**15.8%**
Operating margin	10.1%	9.1%	**10.3%**
Net Profit margin	5.9%	5.3%	**11.9%**
Financial Position			
Total Assets	468,083,726.00	453,060,615.00	**3.3%**
Total Liabilites	191,034,669.00	188,778,586.00	**1.2%**
Equity	277,049,057.00	264,282,029.00	**4.8%**
Cashflows and Ratios			
Cashflows from Operations	11,619,833.00	22,470,800.00	**-48.3%**
Asset Turnover	0.66	0.66	**0.2%**
Liquidity Ratio	1.35	1.30	**4.1%**
Debt to Equity	0.24	0.24	**2.3%**
CFO/Net Income	0.63	1.41	**-55.3%**
Receivables/Revenue	32%	22%	**43.0%**
No. of days of receivables	115.97	81.12	**43.0%**

Innscor Revenues Up 3.5%, PAT Up 16%

Innscor once again posted an impressive set of results recording a 3.5% growth in revenues to $311 million driven by a reasonable volume performance from most of its operations. The various restructuring programmes implemented over the past resulted in reduced operating expenditure leading to an even bigger growth in EBITDA of 14%. Income from associates that is Probrands and Profeeds grew by 92% to $3.38 million thereby contributing 14% to Profit Before Tax. Operating and net profit margins where higher by 10% and 12% to 10% and 6% respectively. However, Innscor's quality of earnings as reflected by the CFO/Net Profit ratio took a significant knock of 55% to 0.63 from the previous 1.41. A ratio that is less than one is a serious indicator of earnings that are not backed by cash. This was a result of a significant increase in receivables which led to a growth of 43% in the receivables to revenue ratio and in the number of days of sales outstanding from 81 days to around 116 days. This is an indication of revenues that have a rising proportion of credit sales, poor debtor collection and possible aggressive selling tactics by Innscor. Basic EPS was 30% higher at 2.32cents and an interim dividend of 0.7 cents was declared, giving a payout of 20%.

Below is the performance of the various segments that now make up Innscor Africa Limited;

BAKERY OPERATIONS

- Bread volumes recorded a marginal growth and the relaunch of the operation's pie products saw volumes surging by 169%.
- Revenues increased by 4%.
- Factory efficiencies improved dollar margins and the business showed a pleasing growth in profitability.

NATIONAL FOODS

- Volumes were similar to the comparative period with flour and rice categories growing by 16% and 54% respectively. The performance from the maize division was however quite disappointing with a volume decline of 28% being recorded as competition from government subsidies (relief programme) crowded out the business.
- Revenues declined by 4% due to lower average selling prices.
- Operating Profit was 18% lower whilst Profit before tax recorded a lower drop of 5% due to profits from National Food's associate, Pure Oil industries which recorded a 138% increase in revenues.

COLCOM

- Core product volumes were grew by 23% due to its increased investment in its own pig production facilities which led to an 8% growth in revenues.
- A combination of flat Gross margins and low expenses led to a 7%growth in operating profit.
- A loss in fair value of biological assets however led to a 6% decline in Profit before tax to $3.6 million.

IRVINES

- Although sales of Irvines three main product lines were higher, gross margins were severely impacted by an increase in raw material costs which led to a 38% decline in operating profit.

CAPRI

- Volumes increased by 61% driven by export volumes whilst revenues grew by 42%. Growth in both cases was coming from a low base.

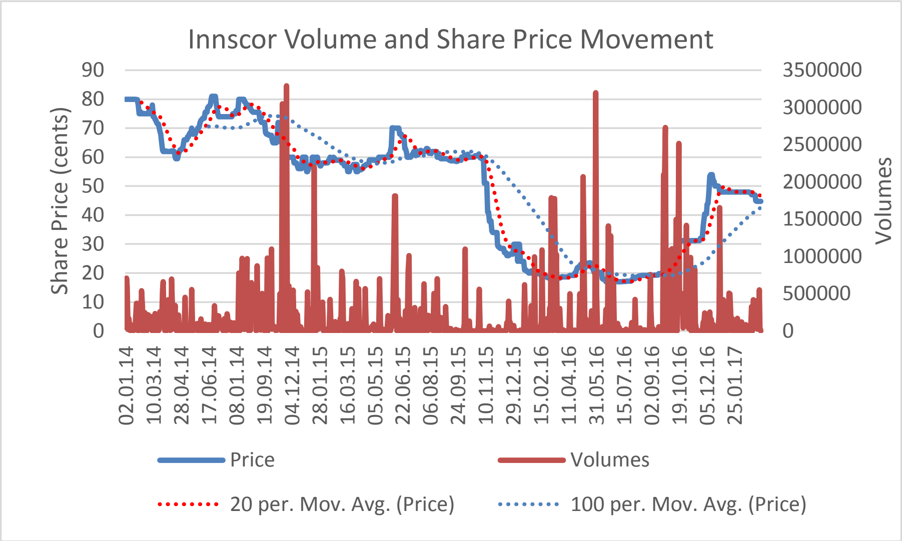
NATPAK

- Volumes grew by 24% and revenues by 20%. Margins narrowed however hereby leading to a 7% growth in operating profit.

PROFEEDS

- The group has a non-controlling interest. A 7% decrease in feed volumes led to a 5% decrease in revenues. Operating profit was however 7% higher due to lower operating expenditure.

Technical Analysis



The graph indicates that Innscor has made a very sharp recovery after its share price adjusted to the unbundling of Simbisa and Axia in late 2015 and early 2016 respectively. The significant recovery that was witnessed in the last quarter of 2016 was mostly induced by the bond note risk aversion rally on the ZSE. Unlike most listed counters, volumes traded for Innscor have remained quite strong signaling high liquidity and investor interest in the counter. However the short term moving average is currently showing signs of wanting to converge with the long term moving average which could be a sign of an emerging down trend. The recent results however indicate resilience in performance as Innscor remains one of the few companies to continue to show positive growth in the top and bottom line (albeit with questionable quality of earnings). We therefore believe that the emerging down trend will not persist long enough to result in a significant decline in share price.

Investment case

- The company recorded an unexpectedly good performance and managed to rise above the current challenges facing the economy such as delays in making foreign payments and depressed economic activity.
- The Group has laid strong foundations for sustainable earnings. Current financial performance indicates fruits of the various strategic measures

taken by management to lower operating expenses, sell non performing entities, improve efficiencies and strengthen group synergies.

- The results indicate a 14% growth in operating profits due to a substantial reduction in operating expenses whilst capital investments in bakery operations, Colcom and Capri have contributed to significant improvements in volumes and revenues.
- Investments in associates such as Profeeds and Probrands and National Food's interest in Pure Oil Industries have become important contributors to Profit Before Tax. Associates contributed 14% to PBT in Innscor and 18% to National Foods' PBT.
- Innscor's subsidiary National Foods has been a significant beneficiary to government's efforts to support local companies through SI 64. This instrument has led to a substantial growth in flour, rice and oil produced volumes.
- Innscor and its subsidiaries Colcom and National Foods pay a regular dividend.
- Innscor attracts a high trading interest on the ZSE and is therefore quite liquid.

Investment concerns

- The Group continues to face challenges related to delays in making foreign payments for its raw materials and even for capital projects. This is also increasing the company's operating costs as there have been penalties imposed by suppliers and more expensive credit terms.
- The low level of aggregate demand and the delays in making foreign payments pose a threat to continued good performance.
- The current quality of earnings as indicated by the CFO/Net Income ratio indicates a significant deterioration and earnings that are largely not supported by cash. A continued trend of this nature brings sustainability of earnings in great question as the Group could be aggressively engaging in aggressive sales or revenue recognition

Valuation and Recommendation

Going forward into the second half of Innscor's 2017 financial year, we expect continued positive growth in both revenues and profit. As was highlighted earlier, we believe that Innscor has made the necessary strategic decisions and investments to ensure sustainable growth in earnings. Our forecasts are however quite conservative given the unpredictable operating environment that the company operates in. We expect National foods to derive much support from the predicted good harvest in the current agriculture season. We believe that this will reduce competition from drought induced government subsidies of maize that affected maize volumes in the current results. We anticipate continued volume support from SI 64 although growth should taper off to moderate levels. Colcom is expected to continue to derive volume growth from its increased pig production efficiencies. Low levels of disposable incomes should however keep the current sales mix oriented towards low value products. A positive performance is also expected from the Baking Operations, Natpak and the associate companies due to improved efficiencies in those operations. We therefore forecast a moderate 1% growth in revenues in the second half, a 0.5% improvement in the EBIT margin from its 5 year historical average of 7%. An 8% growth in equity accounted earnings is expected from S1 64 support. This gives us a forecasted 6.5% revenue growth in 2017 and a 24% growth in After tax profit. Relative valuation with the use of historical averages was used in our valuation given the lack of comparable companies in the local market. We forecast a forward P/E of 9.5x against an average of 6.4x, a forward P/BV of 0.84x against an average of 0.83x and a forward P/S of 0.4x against an average of 0.5x. We therefore forecast a 6 months forward fair price of 42.9 cents which is 5% below the current price of 45cents. We therefore give a **HOLD** recommendation given Innscor's strong prospects going forward.