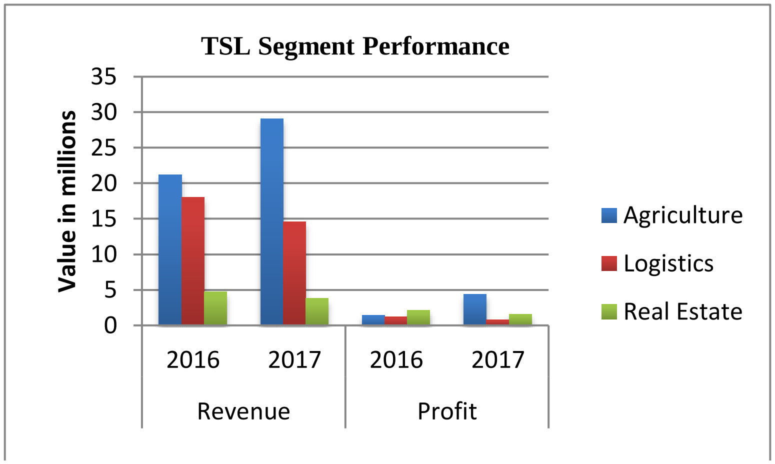
TSL Financial Year Ended 31 October 2017 Analysis

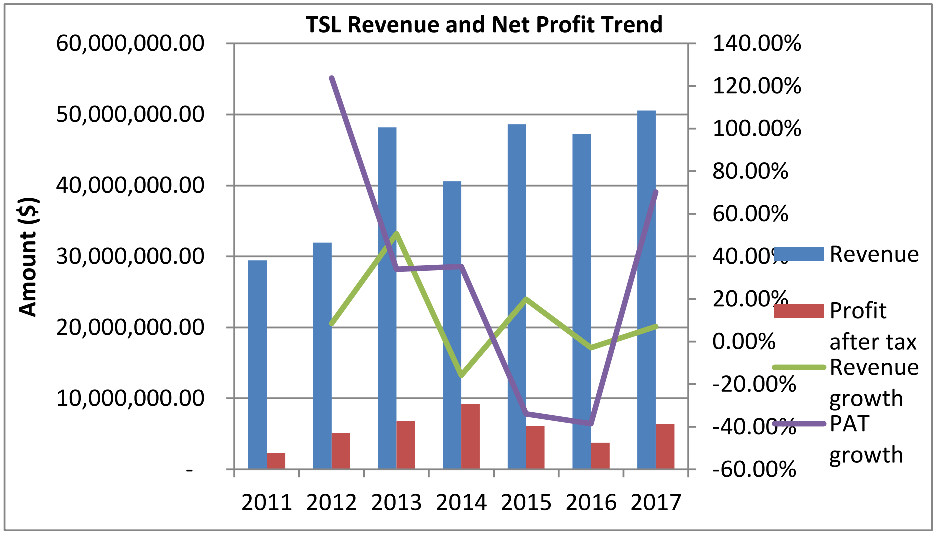
Market Data			
Share Price(USc)			45
Fair Price (USc)			37
Recommendation			SELL
Shares in Issue			357,102,445.00
Market cap(US$)			160,696,100.25
YOY high(Usc)			55
YOY Low(Usc)			18
YTD			22.10%
EPS			1.20
Dividend			0.45
Annualised dividend yield			1.00%
Income Statement	**FY 2017 '000'**	**FY2016 '000'**	**% Change**
Revenue	50,555,093.00	47,235,811.00	7.0%
Operating profit	7,002,016.00	5,633,884.00	24.3%
Profit After tax	4,843,250.00	2,771,551.00	74.7%
Operating margin	13.9%	11.9%	16.1%
Net Profit margin	9.6%	5.9%	63.3%
Financial Position			
Total Assets	107,213,458.00	99,360,024.00	7.9%
Total Liabilites	24,552,501.00	24,227,287.00	1.3%
Attributable Equity	82,660,957.00	75,132,737.00	10.0%
Cashflows and Ratios			
CFs from Operations	3,585,752.00	5,314,172.00	-32.5%
CFs from Investing	(3,799,314.00)	(1,530,388.00)	148.3%
CFO/Net Profit	0.74	1.92	-61.4%
ROE	5.9%	3.7%	58.8%
Total asset turnover	0.47	0.48	-0.8%
Debt to Total Assets	23%	24%	-6.1%

TSL Revenues Up 7%, PAT Up 75%

TSL revenues grew by 7% to $50.6million supported largely by the agriculture cluster, whose revenue increased by 37% to $29.1million. The tobacco sales floor retained its dominant position in the auctioning of the independent crop whilst volumes handled for merchants increased significantly. The new business model at Propak hessian began to bear fruit with volume uptake of hessian going up by 11%. The favorable rainy season also bolstered growth in agricultural trading and commodity production. The logistics cluster saw revenues decrease by 23% to $14.6million. This subdued performance was due indirectly to foreign currency shortages and also low volumes of goods transported within the country and across the border. Real estate revenues took a 19% knock to $3.8million due to a high level of voids, margin compression and increase in unoccupied industrial property. Efficient cost management led to an even bigger growth in operating profit of 24% to $7 million and a substantial growth in PAT of 75%. Contributing to the PAT growth was a change in accounting standards affecting biological standards. However, the growth still remains substantial at 50% if this effect of standards is removed. The chart below indicates the revenue and profit composition of the various segments.

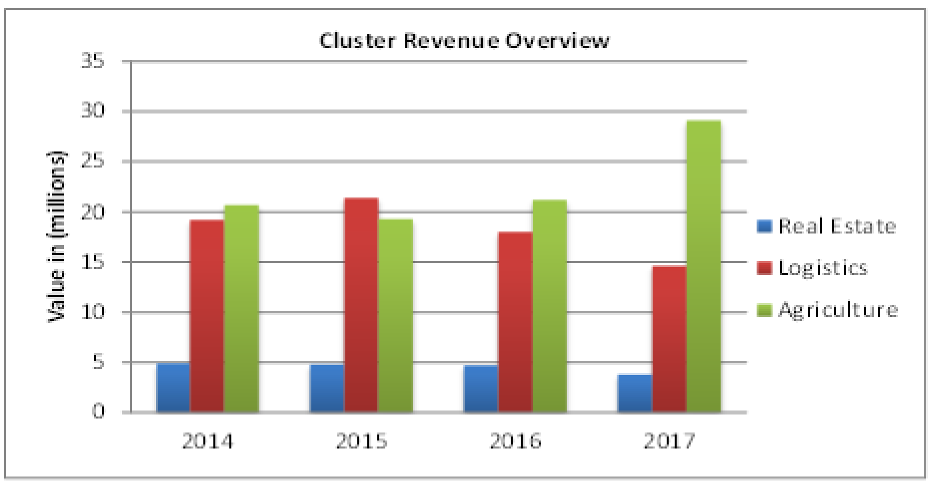


From the chart above we can observe that although revenue contribution from logistics comes much higher than real estate, the business is not as profitable and records profits that are even lower than real estate. Basic EPS was 1.2 cents and a final dividend of 0.45 cents was declared leading to a payout of 37% and a current dividend yield of 1%. Cash generated from operations decreased by 48% to $3.58million leading to a CFO/Net Profit ratio of 0.74. This decline was mostly due to a substantial build up in inventory to cushion the business from the foreign currency shortages.

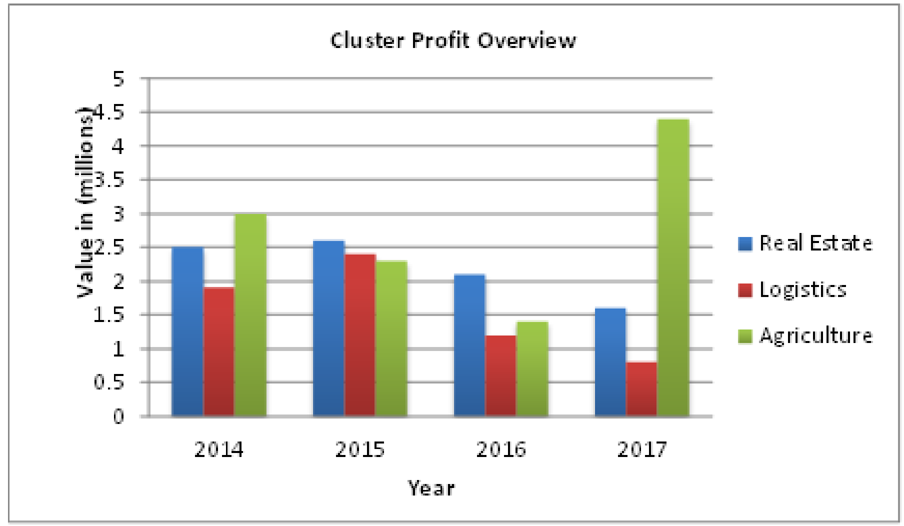


Source: TSL Financials

The graph indicates sustantial volatility and a general negative profit and revenue trend from 2011 to 2016 and a subsequent substantial recovery in the 2017 results. The next graphs indicate the cluster performances from 2014 to 2017.



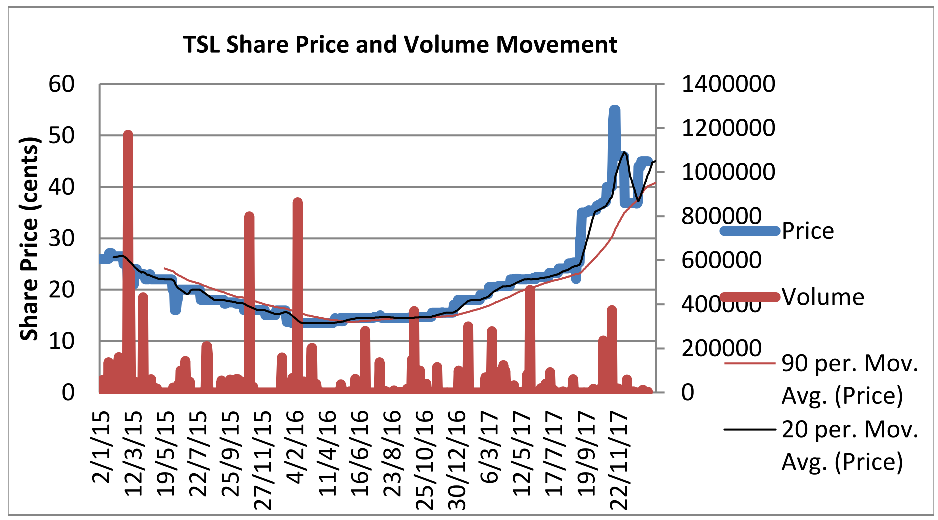
Source: TSL Financials



Source: TSL Financials

The agriculture cluster has been the key revenue driver followed closely by logistics. On the profitability side, the picture becomes more balanced. Out of the four years under review, agriculture had the highest profits in two out of the four years whilst real estate has also been profitable in two out of the four years.

Technical Analysis



Source: Platinum Research

The graph indicates that the TSL share price had been on a general uptrend until the last quarter of 2017 where it took a slight knock subsequent to the political changes in that period. It is quite notable though that the TSL price trend has remained quite resilient unlike most ZSE listed counters that have had a nose-dive since then. This is indicated by its Beta which stands at around 0.04. The recent technicals indicate that the short term moving average is slightly above but still threateningly close to the long term average which is a sign of the current weakness in the counter's price. We expect this weakness to persist as the counter also gradually declines in line with most listed counters. However, this decline is not expected to be significant as the counter is tightly held and has a strong investment case, which is given below.

Investment case

- TSL's Tobacco Sales Floors have retained a dominant position in the auctioning of the independent crop with a market share of over 60%. As such, the company is a key beneficiary from the various initiatives by the government to support tobacco production such as the 12.5% export incentive, the increase from $28 million to $70 million of the tobacco input finance facility and the Diaspora Tobacco Financing Bonds.
- In spite of the volatility in revenue and profits, TSL has recorded a Compound Average Growth Rates (CAGR) of 9% for revenues and 18.7% for PAT from 2011 to 2017.
- The agriculture segment, which is the key revenue generator, continued to record a strong performance. The same is expected going forward given that the company is expected to expand its banana fields by 25 hectares with the view of exporting part of the crop.
- A strong growth in the hessian leasing business is also expected as demand has been strengthened by the growing business from merchants.
- The diversity in Group operations allows it to be well positioned to benefit from the expected growth in economic activity following the new political dispensation. In addition to its current portfolio, the Group is currently engaged in the development of a major commercial and industrial complex at its Vorsterman's property.
- The Tobacco Industry and Marketing Board (TIMB) is optimistic that farmers will produce a high quality crop in the 2017/18 despite the recent dry spell as the weight of the crop tends to decrease when there is too much water.
- TSL is a tightly held counter. This factor has generally lowered the beta of the company making it relatively insensitive to the general market movements.
- Improved performance is expected from the logistics business as the company has signed new contracts with shipping lines.
- The company pays a regular dividend.
- It has invested into robust irrigation systems hence there is low risk that its commodity production business will be affected by the erratic rains in the

Investment Concerns

- Foreign currency shortages continue to be a big concern particularly to the logistics business as this is adversely affecting the volume of cargo that is moving across borders. This further worsens the business case for Logistics, which has not been preforming too well over the years.
- The logistics and real estate (warehouses) clusters have a business model that is designed to thrive under high production and cross border trading activities. Industry capacity levels are bordering around 50% whilst trading levels remain at depressed levels hence the steady decline in earnings from both clusters since 2015.
- The synergistic benefits of their logistics and real estate clusters increase the correlations of the returns from these assets thus limiting the diversity benefits to the Group.
- Historical performance indicates too much volatility in the revenue and net income numbers, which reduces predictability of future cash flows.
- The changing weather patterns pose a significant threat to the tobacco crop.

Valuation and Recommendation

Going into 2018, with the growing financial support of tobacco, internal growth efforts and the strong prospects of economic recovery in the country we expected continued positive growth in both revenues and profits. We considered the Relative Method and the Discounted Cash flow method in our valuation. TSL has a Trailing Twelve Month (TTM) P/E of 37.5x against an industry average of 31.7x, a TTM of 3.2x against an average of 3x and a TTM of 1.9x against an average of 2.2x. As such, two out of the three ratios indicate that the counter is currently overvalued. The DCF approach indicates a fair value of 30cents, a further indication that the counter is currently overvalued. Giving an equal weight to both approaches, we came up with a fair value of 37 cents which is 17.5% below the last trading price of 45 cents. We therefore give a **SELL** recommendation with a view to buy on weakness as the counter has strong fundamental prospects.