Delta Full Year Ended 31 March 2018 Analysis

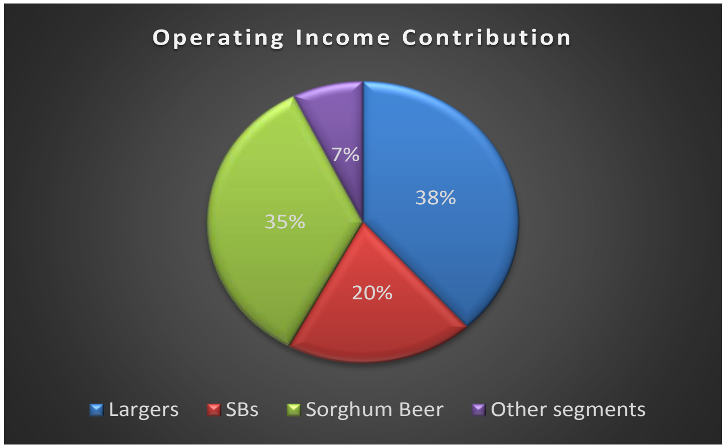
Market Data	
Current Share Price(Usc)	**202**
Shares in Issue	**1,257,365,601.00**
Market cap(US$)	**2,539,878,514.02**
Fair Price	**194**
Recommendation	**SELL**
YOY high(Usc)	**202.38**
YOY Low(Usc)	**155**
EPS	**7.22**
Final dividend	**2.7**
Total Dividend Payout	**100%**
P/E	**27.98**

Income Statement	FY2018	FY 2017	% Change
	US$'000	**US$'000**	
Revenue	572,227	482,968	**18.5%**
Operating profit	104,715	82,044	**27.6%**
Profit After tax	88,508	69,885	**26.6%**
Operating margin	18%	17%	**7.7%**
Net Profit margin	15%	14%	**6.9%**
Financial Position			
Total Assets	837,400	704,089	**18.9%**
Total Liabilites	335,194	228,422	**46.7%**
Attributable Equity	496,779	475,667	**4.4%**
Cashflows and Ratios			
Cashflows from Operations	221,481	132,939.00	**66.6%**
ROE	17.82%	14.69%	**21.3%**
ROA	10.57%	9.93%	**6.5%**
Current Assets to CLs	1.68	1.64	**2.1%**
Total asset turnover	0.68	0.69	**-0.4%**
Debt to Assets	5.1%	8.5%	**-40.1%**
CFO/Net Income	2.50	1.90	**31.5%**

Revenue Up 18%, PAT Up 27% bolstered by strong demand

Delta recorded an impressive 18% growth in revenues to $572 mln as buoyant consumer demand led to a substantial increase in volumes across all segments particularly in the last half of its financial year. Larger beer volumes and revenues rose by 27% which is the first positive growth since 2013. Further supporting larger beer revenues was a 2% increase in its premium segment contribution. Revenues from Sparkling Beverages and Sorghum Beer were up 15% and 13% respectively. Demand over the year ended was driven by improved disposable incomes from the command agriculture programme, improved mining output and a generally positive social political environment. Adding just a 1% increase in revenues was the recently acquired National Breweries Zambia where Delta has a 70% interest. The table and chart below indicates the change in revenues and operating profit and the contribution to operating profit of the different segments.

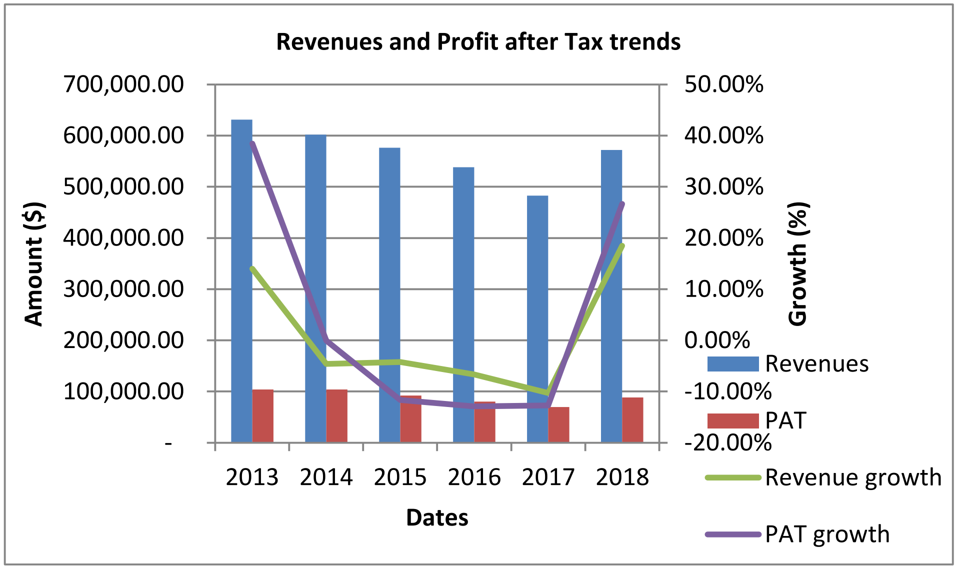
	Change in Revenues	Change in Operating Profit
Larger Beer	Up 27%	Up 76%
SBs	Up 15%	Up 43%
Sorghum Beer	Up 13%	Up 4%



Source: Delta FY 2018 Presentation

The operating profit increase at 28% to $105mln was much higher than revenue growth due to a deliberate focus on cost control and leveraging on economies of scale. As can be seen from the chart above, Largers recorded the largest contribution to operating income of 38% followed closely by Sparkling Beverages at 35%. Operating and net profit margins were also stronger at 18% and 15% respectively. Profits from its associates also recorded substantial growth of 136% to $4.3mln leading. Ultimately PAT was up 27% to $88.5mln with an EPS of 7.22c. The company practically paid out all of its EPS throughout the year with four separate dividend payments, the final dividend being 2.7c. Management indicates that this 100% dividend payout policy is likely to continue granted there is no change in the prevailing foreign currency shortage situation.

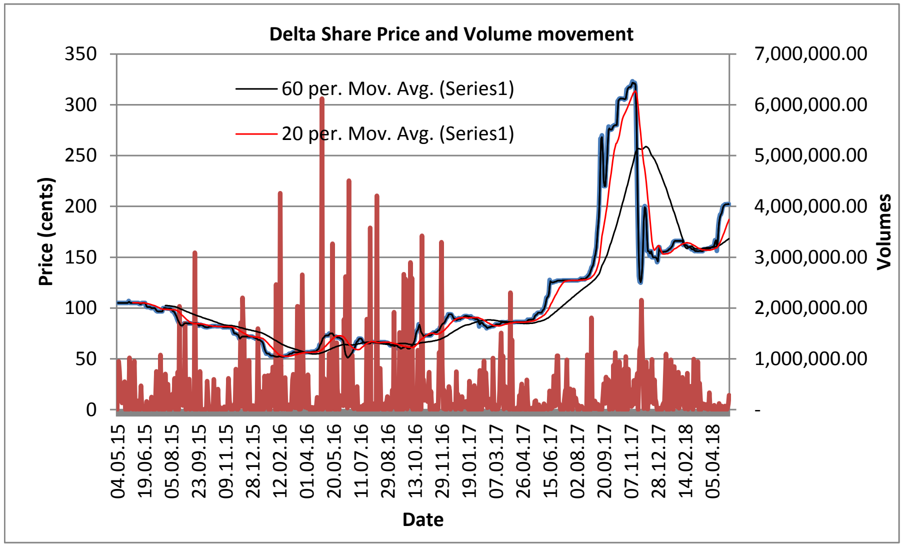
Total assets grew by 66% largely due to the addition of the Zambian subsidiary while total liabilities recorded a substantial 47% growth due to the delays in remitting payments to creditors. Included in the liabilities are dividend payables of $59 million and $159 million credit payables from $88 million in 2017. Cash flow from operations was up 67% leading to a 32% growth in the CFO/ Net Income ratio. Contributing to this increase was the substantial growth in liabilities due to delays in making foreign payments.



Source: Delta Financial Results

The graph indicates the importance of the current results in Delta's operating history in the past 5 years as it points to the first signs of recovery in growth since the peaks recorded in 2013. It can also be observed that the increase recorded in both revenues and profit after tax in FY17 managed to reverse the declines in 2016 and 2017.

Technical Analysis



The graph indicates a recent recovery in the price of the counter after the massive drop towards the end of 2017 due to the market self-correcting after the market rally in that year. This price improvement has mainly been driven by the impressive financial performance in the reported results. As such, the short term moving average is currently above the long term average due to the recent price recovery. However, the strength of this trend in the short term may be threatened by the raw material shortages that are threatening the production levels of the company.

Investment case

- The revenue and profit after tax trend indicates that the latest results have managed to reverse the declines witnessed in both 2016 and 2017. This demonstrates how quickly Delta operations can recover on positive consumption growth. As the country is currently poised for economic recovery and increased investor interest the resultant growth in consumer spending should further propel company performance and add much value to shareholders.
- The Group continues to record strong cash flows with its balance sheet currently indicating a net cash balance of $54 million. This has kept interest bearing obligations at low levels and as such the Group boasts of strong solvency ratios and financial strength. This has also continued to improve the quality of earnings as is indicated by the CFO/Net Income ratio.

- The Group's cash generating capacity has enabled it to pay a very consistent dividend each year. Due to the current foreign currency challenges management has resolved to maintain a 100% payout dividend until this situation is resolved.
- Delta has managed to maintain a very high market share in the various beverage categories despite the existence of grey imports.
- Operating and net profit margins remain strong at 18% and 15% respectively.
- The contribution of the Group towards the fiscus is quite substantial. Management indicates that in 2017 it paid taxes valued at $141 million excluding import duties. They have also invested $45 million towards Savings Bonds to support on lending to exporting business. This strategic importance goes some way in ensuring that the Group is also prioritized in foreign currency allocations.
- Delta's product diversification enables it to capture all classes of consumers.
- 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

- The greatest challenge that the Group is currently facing are the supply gaps particularly for Sparkling Beverages and Sorghum Beer where delays in foreign currency remittances have been affecting supply of concentrate for SBs and packaging material for Sorghum. The same challenges have been affecting all Delta's associates that is Afdis, Schweppes and Nampak. The Group requires about $65 to $70 million a year.
- The unrelenting competition from cheap grey imports continues to prey on Delta's market share. The company has had to continuously defend its market shares through competitive prices hence the slow growth in margins.
- The intention by The Coca-Cola Company to terminate its Bottler's agreement with Delta and Schweppes continues to leave uncertainty as to how the outcome of the negotiations will impact on shareholder value. However there appears to be no threat the license could be abruptly cancelled.
- 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 recently acquired 70% interest in National Breweries Zambia is currently recording losses and it could be a while before the company starts realizing positive returns from the investment as the Zambian market has many players and the market is quite price sensitive.

Valuation and Recommendation

Going forward, we expect the coming months to be challenging to the Group due to the prevailing foreign currency challenges. Barring that, demand is expected to continue to be stronger with much support coming from growing government participation in agriculture, improving mining activity from small scale miners and election spend. In addition, the prospects of the economy are presently quite stronger that in the same period last year due to the change in the political environment and the current dispensation's agenda to re-engage with the international community. In our valuation, we considered that the likely increase in disposable incomes over the next few years given the growing investor interest in the country will have a great bearing on expected investor spending and on Delta's operations. We used the Dividend Discount model and came out with a fair value of 194c per share which is 4% lower than the current price of 202c. We therefore consider that the current price may not hold much longer given the supply side challenges that Group may face in the short term. We therefore give a **SELL** recommendation.