White Gold Regains its Glitter....

28th November 2005

Cottco

Agriculture

Based on Interims End to September '05

- The group produced a solid performance for its first half to September underpinned by a significant reduction in finance costs versus the prior comparable period.

- There was a significant reduction in the national crop from 331,000 tonnes to 198,000 tonnes due to drought in the 2005/06 season; with Cottco's market share also declining from 55% to 40% due at a delayed start to buying by the company as Cottco sought clarification from RBZ on the cotton producer price and subsequent subsidy which was introduced.

- Turnover rose by a sub-inflationary 92% to Z$809,519 billion; attributable to the low cropping volume which in turn delayed exports. At present group has exported 50% of its crop.

- Interest costs stood at Z$44,899 billion declining 57% on prior period, reflecting the group's use of offshore and concessionary financing. Total borrowings at HY1 '05 were Z$1,291.6 trillion of which 85% were based offshore bringing average cost of borrowing to a manageable 7%.

- **HY2 '06 earnings should record significant growth on prior year.** More than 85% of export receipts should be garnered in second half. Cottco will realise full value for these with the new inter-bank rate hovering at around Z$60,000 reflecting a +900% increase on the exchange rate at start of the year. Group has successfully managed their debt position, which should in effect realise interest income for FY '06 compared to interest costs of Z$206 billion for FY '05.

Recommendation:

BUY **Z$4,000**

Key Data	
Market Cap (Z$m)	3,064,760
(U$m)	33,605
Implied OM Rate Z$91,199.67:1US$	
Inter-Bank Rate Z$64,500: 1US$	
Shares in Issue (000's)	766,190
Year High	Z$5,000
Year Low	Z$170
Rolling EPS	Z$109.44
Ann. P/E	36.5x
Sector P/E	22.9x
Forward P/E	**2.02x**
NAV per share	Z$468.08
NAV Multiple	8.55x
Operating Cash Flow Per Share	Z$716.26
EV/Operating Profit	13.01x
Price/Sales	1.35
Dividend	-
Dividend Yield	-

Key Ratios & Efficiencies	
Operating Margins	23.9%
Net Op. Margins	15.4%
ROA	8%
ROE	51%
ROCE	75%
Gearing	217%

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Nature of Business

The Cotton Company of Zimbabwe is the largest ginner and marketer of cotton in Southern Africa. The group is involved along the entire cotton production process, from assistance to its out growers in terms of inputs, cotton ginning, to marketing lint on global markets. The group has 7 ginneries, two of which, Cotpro International and Motmate Designs, are wholly owned subsidiaries with EPZ status.

The group has a 75% stake in Scottco, a local spinning mill, which produces yarn for the export market. The group also retains a 42% stake in exchange–listed regional seed producer Seedco.

The group's foreign operations are located in Mozambique and Uganda.

SWOT Analysis

Strengths	**Weaknesses**
➢ Local market leader in cotton, despite drop in market share in past season to 40%; traditionally procure 55% to 60% of the national crop. ➢ Cotton has traditionally been farmed by small-scale communal farmers who have been little affected by land altercations of last few years. ➢ Group covers entire spectrum of cotton industry. ➢ Group exports most of its production in the form of lint. Zimbabwean lint is rated highly, and therefore attracts a premium on the world market.	➢ The group is considerably geared, although the average cost of borrowings has been reduced with access to concessionary financing & offshore financing. ➢ As with all agricultural concerns, its fortunes are tied to the weather. ➢ Highly seasonal earnings cycle; traditionally 80% of earnings in HY2.
Opportunities	**Threats**
➢ The recent devaluation of the exchange rate should see value of exports production increase significantly. ➢ Increasing use of offshore funding should help group contain interest costs. ➢ The group has made available enough seed to ensure a potential record crop of 400,000 tonnes for 2005/06 season. ➢ Seedco's earnings for HY1 '06 should contribute massively to the group's bottom line.	➢ Prone to political risk, and thus expropriation risk which has reduced somewhat due to government's 'keenness' to revive agriculture. ➢ Group's Mozambique and Ugandan operations currently loss-making and group is already undertaken to exit the Ugandan market. ➢ Lack of inputs for unsupported farmers.

Operational Review

Segmental Review Z$billions	Turnover HY1 '05	% growth		PBT HY1 '05	% growth		PBT Margin HY1 '05	HY1 '04
Ginneries	606.2	85%	75%	114.8	676%	77%	19%	5%
Spinning	64.6	160%	8%	32	321%	22%	50%	31%
Regional Op.	47.4	276%	6%	-10.7	-2575%	-7%	-23%	-3%
Seed	91.3	61%	11%	12.7	-70%	13%	14%	33%
TOTAL	**809.5**		**100%**	**148.8**		**100%**	**15%**	

NB Seedco's results fully consolidated.

The mainstay of the group, the **ginneries,** experienced a relatively poor increase in turnover, reflective of the delayed start to buying of cotton crop and subsequent delayed start to ginning. However, the SBU did record a significant 676% increase in PBT on the back of a depreciating Zimbabwean dollar, lower producer price of cotton due to a subsidy afforded to cotton farmers for past season by the RBZ, as well as lower interest costs. Accordingly margins improved 280% to 19%. **Regional operations** (Mozambique & Uganda) continued to struggle despite increases in turnover in line with inflation, simply as function of the exchange rate depreciation. Both entities made losses to the half year. Management is presently in the process of disinvesting from Uganda, while prohibitive legislation in Mozambique, may well see group exit in near future. The **spinning** division performed admirably recording a 321% increase in PBT, which was accompanied by a 61% improvement in pre-tax margins. The **seed** division in the form of Seedco experienced a predictably poor first half due to poor winter wheat sales. The group traditionally conducts the vast majority of sales in HY2.

Short term Borrowings	Z$billions	Cost of Finance
Local Currency Loans	191	7.94%
Offshore	663.6	6.34%
Regional Operations	437	7.49%
	1291.6	**6.97%**

A factor behind the solid performance by Cottco has been management's ability to structure the group's seasonal borrowing.

The table above highlights the group's reliance on offshore borrowings which directly offset the exported crop and have a degree of predictability in terms of interest costs. The local currency denominated loans consist largely of concessionary financing availed by the RBZ. Regional operations loans consist mainly of Seedco's regional operational requirements.

International Lint Prices
Cotton Futures (Weekly) CT, NYBOT $0.50 a lb

Source; www.tradingcharts.com

2004 saw a rapid decline in international lint prices precipitated by over supply in the world markets. The strong demand emanating from China has seen the decline arrested somewhat, and for much of 2005 lint prices have been a steady upward trend. Indications are that the world supply and demand conditions are effectively in equilibrium and sudden price movements appear unlikely.

Earnings Forecast

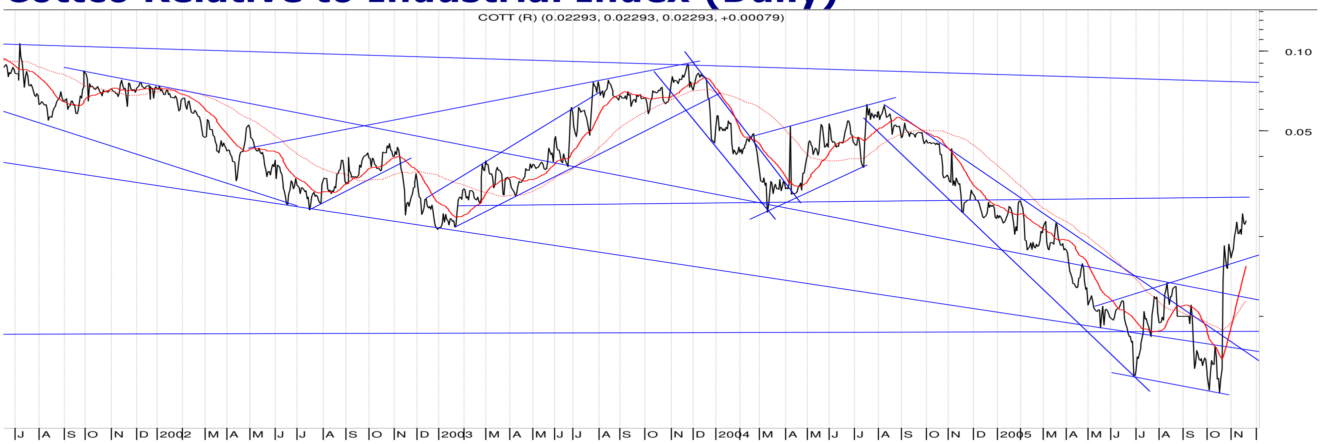
Z$000's	**2003**	**2004**	**2005**	**2006**
Turnover	**26,440,932**	**278,200,954**	**1,159,502,000**	**4,698,212,127**
Operating Profit	14,897,647	149,403,813	237,709,000	2,349,106,064
Interest	902,174	(32,908,176)	(206,203,000)	32,095,881
Pre-tax Profit	**15,799,821**	**116,495,637**	**31,506,000**	**2,381,201,945**
Tax	(2,288,524)	(20,203,007)	1,998,000	(642,924,525)
Income after tax	13,511,297	96,292,630	33,504,000	1,738,277,420
Minority Interest	(226,995)	(1,752,175)	(3,928,000)	(212,611,425)
Attributable Earnings	**13,284,302**	**94,540,455**	**29,576,000**	**1,525,665,995**
EPS	$17.67	$125.72	$38.60	**$1,991.24**
Target Price				**$13,938.66**
Forward PER				**1.76x**
No. of shares (000's)	752,000	752,000	766,190	766,190
Turnover Growth	67%	952%	317%	305%
Operating margin	56%	54%	21%	50%
Net Profit Margin	50%	34%	3%	32%
PBT Margin	60%	42%	3%	51%
Eps growth	464.8%	611.7%	(69.3%)	5058.5%

Recommendation

The basis of Cottco's recovery has been the floating of the exchange rate, a more affordable debt structure, and a cheaper producer price due to the implementation of a subsidy in the prior season. The upcoming season, weather permitting, has the potential to yield a record national crop which could see the group at least double its cotton intake. The lack of a subsidy in forthcoming season may well restrict the group's ability to recover market share to 55%, it is therefore imperative that a fair value exchange rate be sustained to ensure the continued organic growth of the company. An added boon will be the potential performance of Seedco, which will be fully consolidated into Cottco's accounts. The counter, despite its recent gains, is still due a further rerating and thus recommend it as a **BUY**.

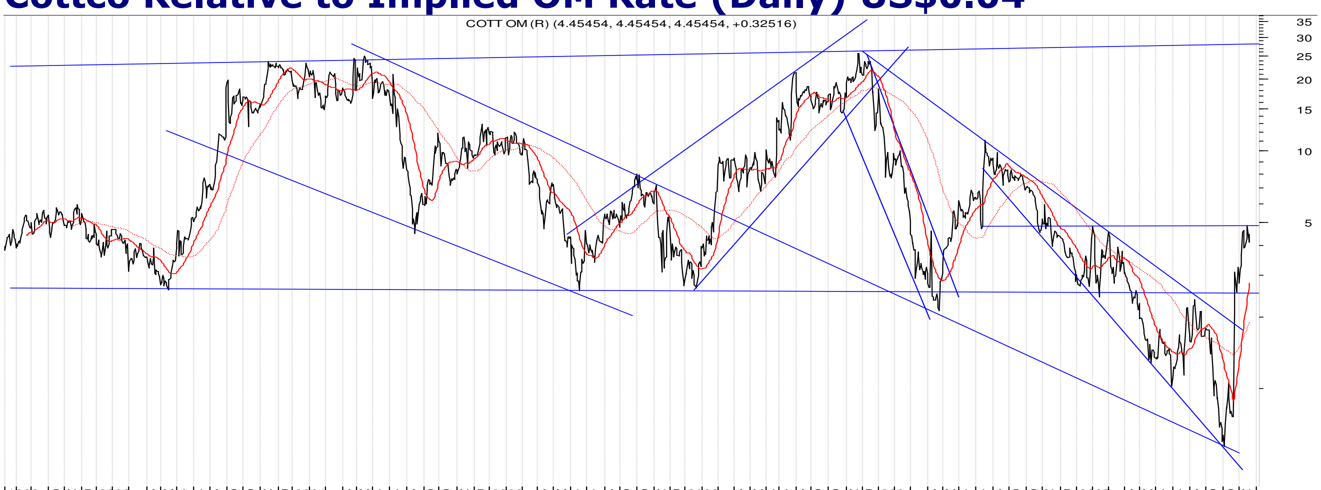
Technical Analysis

Cottco Relative to Industrial Index (Daily)



- **Following a recent dip below 8 year support the security has flagged up through two long term resistance lines to create technical buy signals.**

Cottco Relative to Implied OM Rate (Daily) US$0.04



- **Has rebounded back into medium term broad trading channel in recent weeks.**
- **Longer-term resistance lies at US$0.23.**

Key:

Black Line-	**Security**
Red Line-	**30 Day Moving Average**
Dotted Red Line-	**90 Day Moving Average**
Blue Lines-	**Trendlines**

Explanation of Recommendations

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

Comments and Recommendations are based on technical analysis may contradict with fundamental recommendations.