

Growth in Adversity....

8th September 2006

Innscor Africa

Conglomerate-Agro-Processing, Retail & Distribution, Fast-Foods, & Manufacturing

Based on the Finals to 30th June 2006

- Innscor produced a solid set for FY06 to the end of June 2006, underpinned by enhanced margins from replacement pricing in period which saw a resurgence in inflation, as well as real growth in the group's agro-processing division.
- Turnover for the period rose by 796% on the prior period to Z\$19,467 billion ahead of average Y-o-Y inflation of 675%. EBITDA increased by 1,680% to Z\$8,163 billion attributable to a doubling in operating margins from 20.3% in FY05 to 41.3% at FY06.
- Healthy cash generation in the period (cash generated from operations up 1,385% to Z\$2,278 billion) & comparatively high interest rates in group's H206 enabled a rise in interest income of 986% to Z\$624,629 million. Equity accounted earnings emanating largely from the group's share in National Foods profits rose by 945% to Z\$1,310 billion. Overall net profits rose 1,992% to Z\$8,097 billion accompanied by an increase in net margins to 31.3% (FY05: 17.8%).
- Sectorally the agro-processing division (Colcom & Niloticus) was the star-performer enhanced by a fair value adjustment of livestock (representing 24% of EPS), turnover & PBT rose 1,556% and 1,792% respectively. Sector contributions to PBT were as follows Agro-Processing 47.9%, manufacturing 22.2%, retail & distribution 16.1%, fast food 4.4% and corporate 9.4%.
- The balance sheet remains strong and liquid; the current ratio stands at 2.38x, while net gearing remains at -16%. Net cash resources were Z\$1,061 billion, while stock was valued at Z\$4 billion.
- Going forward we expect the group to continue to outperform inflation; local retail operations may suffer from continued pressure on disposable income & product availability. However continued real growth in Niloticus coupled to changes in exchange rate should buoy earnings.

Recommendation:

BUY Z\$300
(US\$0.30)

Key Data

| | |
|-----------------------------------|-------------------|
| Reuters Code | <u>INN.ZI</u> |
| Market Cap (Z\$m) | 158,520 |
| (U\$m) | 160.008 |
| Implied OM Rate Z\$990.7.89:1US\$ | |
| Inter-Bank Rate Z\$250: 1US\$ | |
| Ave. Daily Turnover | Z\$30.037m |
| YTD | US\$65,045 |
| Shares in Issue | |
| (000's) | 528,400 |
| Mkt Weighting | 7.12% |
| Year High | Z\$325 |
| Year Low | Z\$6 |
| EPS | Z\$11.54 |
| P/E | 26x |
| P/E (+1) | 2.26x |
| Large-Cap | |
| Sector P/E | 51.85x |
| NAV per share | Z\$12.43 |
| NAV Multiple | 24.1x |
| Op. Cash Flow | |
| Per Share | Z\$4.31 |
| EV/Operating | |
| Profit | 19.6x |
| Price/Sales | 8.14 |
| Total Dividend | Z\$1.10 |
| Dividend Yield | 0.4% |

Key Ratios & Efficiencies

| | |
|-------------------|------|
| Operating Margins | 41% |
| Net Margins | 31% |
| ROA | 43% |
| ROE | 93% |
| ROCE | 87% |
| Gearing | -16% |

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Nature of Business

| Agro-Processing | Manufacturing | Retail & Distribution | Fast Foods (QSR) |
|---|--|--|--|
| <p>Colcom Holdings – (77% owned) meat (pigs & cattle) processor-ZSE listed- Mkt Cap Z\$18,911 billion (US\$19,089 million) Livestock incl ostriches, cattle (4,000) & pigs (21,000)</p> | <p>National Foods – (37% owned) leading local food processor & miller-ZSE listed. Tiger Brands of SA also have a 26% stake. Mkt Cap Z\$25,256 billion (US\$25,493 million) Capacities; wheat 33,000 tonnes a month; maize 55,000 tonnes a month</p> | <p>SPAR Distribution– Supports 50 SPAR member stores and 31 Savemor stores. Also group owns SPAR corporate stores in Zimbabwe (5 stores) and Zambia (3 stores).</p> | <p>QSRs (Fast Food) - brands operated under include Nando’s, Chicken Inn, Bakers Inn & Pizza Inn. Rolled out across 9 African countries including Ghana, Kenya, Zambia, & Malawi. Company owned and franchised stores. Mobil On the Run – convenience stores, rights to sites to all Mobil filling stations across much of Africa.</p> |
| <p>Crocodile Ranching (Niloticus) – Primarily involved in the sale of crocodile skins- one of the largest operations in Southern Africa. FY06 saw sales of 49,294 skins.</p> | <p>Plant Bakeries – major local supplier of bread. 230,000 loaves a day.</p> | <p>TV Sales & Hire - Electronic consumer goods</p> | |
| | <p>Appliance Manufacturing – manufacturer of fridges through the Capri brand. Iris Biscuits – confectionary Zapnax- corn-based snacks</p> | <p>Others; Medilink (Zimbabwe, Malawi, & Zambia), Kodak Photo Marketing, The River Club (Zambia)</p> | |

SWOT Analysis

Strengths

- History of delivering solid returns in keeping with its blue-chip status.
- Diversified earnings base; operates agro-processing, retail distribution and manufacturing in the economy, and contributes a sizable portion of GDP.
- National Foods remains one of the largest food processors in Southern Africa ex-South Africa. Despite low capitalisation the company has significant intrinsic value.
- Group does enjoy a regional presence covering East, Southern, & West Africa.
- Solid balance sheet evidenced by a net gearing of -16%; cash balances at FY06 amounted to Z\$1,374 billion.
- Sound management who have continued to grow the business in an essentially hostile environment.

Opportunities

- Group's crocodile concern Niloticus continues to register real volume growth skin sales for FY06 amounted to 49,294, targeting 54,000 skins for FY07.
- Appliance division set to resume exports with 800 units set to be exported to Zambia.
- Group continues to expand its retail operations in Zambia with a 5th corporate store under construction.
- The group's emphasis regionally is to set up fully third party franchised QSRs namely in Nigeria, Angola, Mozambique, Uganda & Malawi.
- Zambian and Kenyan operations are now posting profits.

Weaknesses

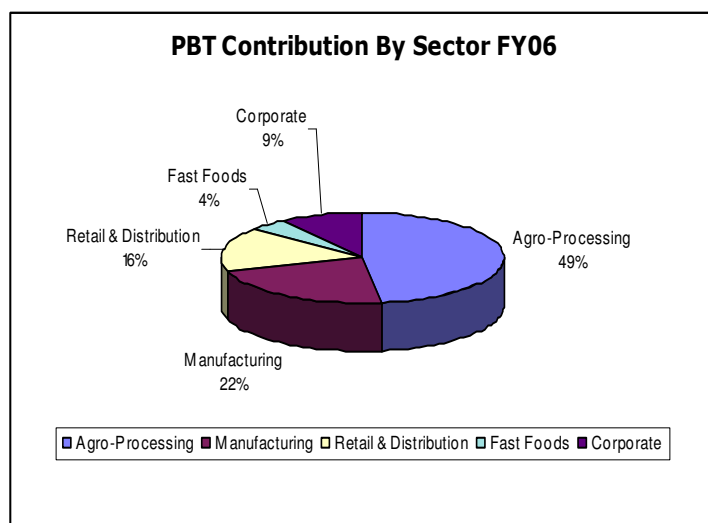
- The group's business is inextricably linked to the fortunes of the Zimbabwean consumer; an example being the group's QSRs, whose contribution to PBT down to 4.4% from 35% historically, also attributable to growth in other areas of the business.
- The group remains a net importer despite improved contribution from exporting concerns Niloticus and to a certain extent Colcom.
- Perceived lack of focus emanating from the diversified nature of group's businesses.
- Group's foreign entities continue to struggle due to a lack of critical mass, although steps are being taken to counter the problem.

Threats

- The deteriorating economic environment associated declining disposable incomes, falling GDP, and hyperinflation will continue to affect volumes in its retail concerns.
- While continued foreign currency shortages will continue to inhibit the product range at retail outlets.
- As with all companies in the country, exposed to erratic economic policy; principal threats lie in the reintroduction of widespread price controls and changes in the foreign exchange retention by the RBZ.

Operational Review

| | Z\$millions | | | US\$000 | |
|----------------------------------|--------------|-------------|--------------|------------------|------------------|
| | Turnover (%) | PBT (%) | PBT | Contribution (%) | PBT |
| Agro-Processing | 1556 | 1792 | 3,482 | 48% | 29,337.24 |
| Manufacturing | 779 | 1183 | 1,614 | 22% | 13,596.80 |
| Retail & Distribution | 679 | 1277 | 1,170 | 16% | 9,860.74 |
| Fast Foods | 640 | 838 | 320 | 4% | 2,694.86 |
| Corporate | | | 683 | 9% | 5,757.20 |
| | 796 | 1507 | 7,270 | | 61,246.84 |



The **Agro-Processing** Division was the star performer for the group, with turnover & PBT growing by 1,556 & 1,792% respectively. The division contributed just under 50% of the group's PBT. The crocodile concern, **Nilioticus**, registered a 38% increase in skin sales to 49,294 with average US\$ prices up 9% to above US\$157 a skin. Skin sizes were up 1.9% while the % of 1st grade skins rose to 91%. ZSE-listed **Colcom** experienced a 3% increase in pig kills to 86,694 animals.

Local sales of Colcom declined by 13%, with a significant decline being experienced in the group's 4th quarter, however this was partially offset by a 5% increase in exports. The period under review saw an increase in the cattle herd from 2,300 to 4,000. Fair value adjustments on livestock amounted to Z\$448 million for Colcom. The **Manufacturing** Division had a mixed year with **bread** sales declining 34% on the prior period. This was attributable to the fact that the prior year saw the enforcement of price controls which buoyed demand. **Iris Biscuits** experienced a 152% increase in volumes albeit off a low base, while snack foods saw a decline in volumes of 8%. Fridge sales under Appliances declined by 34%, however the group has just resumed exports, with 800 units being exported to Zambia. **National Foods** had a predictably poor performance in terms of capacity utilisation and subsequently sales volumes, due to unavailability of foreign exchange for the importation of grain, as well as a poor harvest in the prior season. For H106, group recorded an 872% increase in turnover to Z\$6,738 billion; operating margins doubled to 41%, and overall net profits rose by 1,410% to Z\$1,587 billion.

In the **Retail & Distribution** Sector, the group's Distribution unit, **Distribution Group Africa (DGA)** experienced a 26% decline in volumes. This was attributable to declining disposable incomes thus making the products increasingly expensive especially in the face of a depreciating local currency. **TV Sales & Hire** which had removed credit sales had a 42% decline in volumes. Spar Distribution Centre's volumes (down 18%) were affected by increased grey imports into the country. The group's corporate stores all registered positive increases in volumes. Regional distribution operations in Zambia & Malawi exhibited solid top-line growth now amounting to US\$28.7 million for the period under review.

Fast Foods performance continued to be hindered by constrained disposable incomes, with customer counts down 18% in Harare, and 22% in Bulawayo and Gweru. Turning to the group's regional QSR's, countries in which group is fully third party franchising operations include Mozambique, Nigeria, Angola, Uganda and Malawi. Overall regional fast food operations broke even relative to a loss in the prior period.

Earnings Forecast FY06- Z\$

| Z\$ | 2003 | 2004 | 2005 | 2006 | 2007F |
|------------------------------|-------------------|--------------------|----------------------|-----------------------|------------------------|
| Net turnover | 78,650,854 | 574,631,000 | 2,172,896,000 | 19,467,055,000 | 253,071,715,000 |
| Operating income | 24,196,928 | 115,711,000 | 438,274,000 | 8,046,225,000 | 108,820,837,450 |
| Interest | (653,101) | 23,887,000 | 57,540,000 | 624,629,000 | 939,000,000 |
| Equity Acc. Earnings | 551,446 | 29,057,000 | 125,291,000 | 1,309,764,000 | 14,407,404,000 |
| Pretax Profit | 24,095,273 | 168,655,000 | 621,105,000 | 9,980,618,000 | 124,167,241,450 |
| Taxation | (6,470,405) | (42,966,000) | (156,001,000) | (2,710,239,000) | (38,491,844,850) |
| Minority Interest | (2,992,903) | (17,694,000) | (78,066,000) | (1,172,940,000) | (12,902,340,000) |
| Attributable earnings | 14,631,965 | 107,995,000 | 387,038,000 | 6,097,439,000 | 72,773,056,601 |
| EPS | \$0.03 | \$0.21 | \$0.73 | \$11.54 | \$137.72 |
| Target Price | | | | | \$2,479.02 |
| Forward P/E | | | | | 2.2 |
| DPS | | | \$0.08 | \$1.10 | \$13.77 |
| Cover | | | 9.0 | 10.5 | 10.0 |
| Shares in issue '000s | 493,100 | 506,200 | 527,800 | 528,400 | 528,400 |
| Ratios | | | | | |
| Turnover growth | 327.6% | 630.6% | 278.1% | 795.9% | 1200.0% |
| Operating margin | 30.8% | 20.1% | 20.2% | 41.3% | 43.0% |
| Net Profit margin | 18.6% | 18.8% | 17.8% | 31.3% | 28.8% |
| Interest Cover | 37.0 | (4.8) | (7.6) | (12.9) | (115.9) |
| Pretax margin | 30.6% | 29.4% | 28.6% | 51.3% | 49.1% |
| Tax Rate | 26.9% | 25.5% | 25.1% | 27.2% | 31.0% |
| EPS Growth | 698.0% | 619.0% | 243.7% | 1473.6% | 1093.5% |
| DPS Growth | 1011.1% | 340.0% | (99.6%) | 1250.1% | 1152.0% |

Earnings Forecast-US\$

| | | | | | |
|------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Ave.US\$ Rate Implied Rate | 0.752 | 2.951 | 10.212 | 118.7 | 1000 |
| US\$ | 2003 | 2004 | 2005 | 2006 | 2007F |
| Net turnover | 104,588,902 | 194,724,161 | 212,778,692 | 164,002,148 | 253,071,715 |
| Operating income | 32,176,766 | 39,210,776 | 42,917,548 | 67,786,226 | 108,820,837 |
| Interest | (868,485) | 8,094,544 | 5,634,548 | 5,262,249 | 939,000 |
| Equity Acc. Earnings | 733,306 | 9,846,493 | 12,268,997 | 11,034,238 | 14,407,404 |
| Pretax Profit | 32,041,586 | 57,151,813 | 60,821,093 | 84,082,713 | 124,167,241 |
| Taxation | (8,604,262) | (14,559,810) | (15,276,244) | (22,832,679) | (38,491,845) |
| Minority Interest | (3,979,924) | (5,995,934) | (7,644,536) | (9,881,550) | (12,902,340) |
| Attributable earnings | 19,457,400 | 36,596,069 | 37,900,313 | 51,368,484 | 72,773,057 |
| EPS | \$0.04 | \$0.07 | \$0.07 | \$0.10 | \$0.14 |
| Target Price | | | | | \$0.44 |
| P/E | | | | | 2.2 |

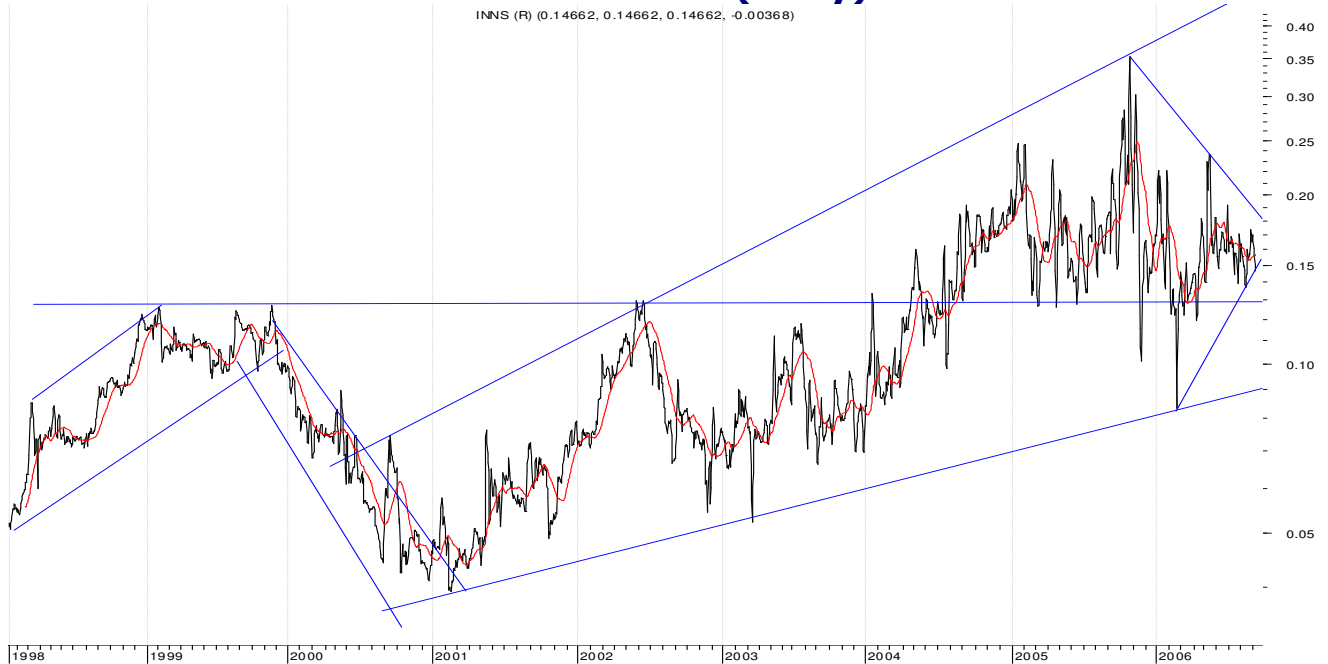
Recommendation

Innscor's latest set of results is a testament to management's ability in gauging and adapting to the hostile environment. The diversified nature of the group's interests has ensured that the group's defensive characteristics have shone through while proactive management has seen the group continue to invest in acquisitions as well as invest in growing areas of the business. Going forward, we expect the agro-processing division to perform ahead of inflation aided by fair value adjustments on its livestock. While retail concerns will continue to be hampered by deteriorating disposable incomes coupled with product supply constraints. The group remains poised to take advantage of any recovery in the economy. Given the relative low risk associated with Innscor, along with its undemanding valuations we recommend investors **BUY** the stock.

Estimated US\$ Intrinsic Value

| | |
|--|----------------------|
| National Foods (34% stake)- PS Factor 1 | |
| Annual Capacity (Wheat) Tonnes | 396,000 |
| Regional Price per tonne (US\$) | 320 |
| Implied Value | 126,720,000 |
| Annual Capacity (Maize) Tonnes | 660,000 |
| Regional Price per tonne (US\$) | 140.00 |
| Implied Value | 92,400,000.0 |
| Total (34%) | 74,500,800.00 |
| Niloticus (crocodiles) | |
| Sales | 49,294 |
| Price per skin US\$ | 157 |
| Sales | 7,739,158 |
| P/S Factor | 1.8 |
| Implied US\$ Value | 13,930,484.40 |
| Colcom Mkt Cap (US\$) | 19,089,089.72 |
| Foreign Sales; Fast Foods & Retail & Distribution | |
| Sales US\$ | 39,000,000.00 |
| US\$ P/S Factor | 1.8 |
| Implied Value | 70,200,000.00 |
| Local Sales; Fast Foods & Retail & Distribution | |
| Local Sales Z\$ | 10,000,000,000 |
| US\$ Value | 84,245,998 |
| US\$ PS Factor | 0.8 |
| Implied Value | 67,396,798.65 |
| Bread Sales – PS Factor 1 | |
| Capacity Annual | 114,550,000 |
| Average Price | 0.85 |
| Implied Value | 97,367,500.00 |
| Total Value | 342,484,672 |
| Value Per Share | 0.65 |
| Present Price per share 08/09/06 | 0.30 |

Technical Analysis Innscore Relative to Industrial Index (Daily)



- **Primary six year bullish trend remains intact; currently testing short term support.**

Innscore Relative to Implied Old Mutual Rate (Daily) – US\$0.30



- **Three successive lower high points to a bearish outlook on the security; key support lies at US\$0.15**

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 based on technical analysis may contradict with fundamental recommendations.

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