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Celebrated Cuisine
La Fontaine Restaurant

Sweet Enough.....

15th June 2006

ZSR Corporation

Food Processing, Manufacturing, & Transport

Based on results to March 2006

- The period under review saw turnover increase by 464% to Z\$7 trillion from Z\$1,4 trillion in the prior year. Key contributors included; Food business (incl. sugar & value-added sugar products) (Z\$2 trillion), wholesale (Z\$4.5 trillion), packaging (Z\$651 billion) and other businesses (Z\$22 billion). However domestic sugar production fell 33% to 99,570 tonnes (exports to Botswana & Namibia: 27,666 tonnes, down 17% from last year) due to erratic supplies of raw materials such as coal, but this was compensated by the removal of price controls on sugar.
- The group's PBIT recorded a huge increase of 1614% of Z\$1.2 trillion compared to the prior year of Z\$71 billion, as a result of a 206% increase in operating margins to 15.9%. Key contributors included the wholesale division (up 3492% to Z\$319.8 billion) and the food (sugar) division (up 1775% to Z\$392.2 billion).
- Earnings attributable to shareholders saw a sharp increase of 2,908% to Z\$1.13 trillion. Net margins increased slightly by 12.1% from the prior year to 14.9% reflecting net interest income of Z\$312.7 billion compared to an interest expense of Z\$16.9 billion in FY05.
- The group's total assets grew by 1966% to an amount of Z\$8 trillion. This was mainly attributable to the revaluation of the group's assets. The balance sheet still remains strong with a net gearing of -16%, and current ratio of 1.58 times
- The upcoming period will continue to be a difficult one with current economic constraints. The focus for the group will be to ensure raw material supply security. Management is forecasting a 20% increase in sugar production for FY07. Coal remains a huge concern, given Hwange's present inability to deliver.

Recommendation:

Accumulate Z\$22,000

Key Data

Reuters Code	ZSRZ.ZI
Market Cap (Z\$m)	8,382,000
(U\$m)	33.748
Implied OM Rate Z\$248,655.37:1US\$	
Bank Rate \$101,195:1US\$	
Shares in Issue	
(000's)	381,000
Mkt Weighting	1.45%
Year High	Z\$22,000
Year Low	Z\$400
EPS	Z\$2,674
PER	8.2x
PER (+1)	1.23x
Large Cap	
Sector P/E	12.5x
NAV per share	Z\$12,365.42
PBV	1.78x
Operating Cash	
Flow Per Share	Z\$3,032
EV/Operating	
Profit	6.26x
Price/Sales	1.10
Dividend	Z\$758
Dividend Yield	3%

Key Ratios & Efficiencies

Gross Op. Margins	15.9%
Net Op. Margins	14.9%
ROA	14%
ROE	24%
ROCE	16%
Gearing	-16%

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Nature of Business

Food Division	Retail/Wholesale	Transport	Packaging
<p>Consists of 2 refineries located in Bulawayo and Harare. Total production capacity 250,000 tonnes a year. Major producer of refined sugar.</p> <p>Country Choice Foods-manufacture of value-added sugar products.</p>	<p>REDSTAR HOLDINGS- ZSE LISTED-(retain 70% ownership) Mkt Cap; Z\$2,713 trillion (US\$8,848 million)</p> <p>Redstar Wholesalers-39 outlets country-wide(96.74% owned by Redstar Wholesalers)</p> <p>Advance Wholesalers-3 outlets.</p> <p>Spar- 1 distribution centre, 2 Spar/savemor corporate stores, & service 39 franchised Spar/service stores.</p> <p>One of the 2 largest wholesalers in the country.</p> <p>Retail-1,598 sq. m.</p> <p>Wholesale- 63,014 sq.m.</p>	<p>Bluestar Transport- fleet complement of 52 haulage trucks.</p> <p>ZSR Transport- based in South Africa (fleet complement 2 haulage trucks)</p>	<p>Polyfilm Plastics- manufacturer of plastic related products.</p> <p>Highfield Bag- manufacture of polywoven bags. Total production capacity 6,600 tonnes per annum.</p> <p>Other SBUs- Grant Chemicals, Marathon Tyres, Arthur Garden Engineering</p> <p>Property- 80 properties under 4 holding companies, wholesalers occupy 33 commercial properties.</p> <p>Regional-Botswana-own 33.3% of leading packager & distributor of sugar.</p>

SWOT Analysis

Strengths

- Diversified conglomerate, thus diversifying risks associated with different sectors of the economy.
- Group exports to Botswana and Namibia.
- Solid Balance sheet; highlighted by a net gearing of -16%.
- Transport business in South Africa should see an increase in foreign currency.
- The group is 75% self-sufficient in its foreign currency requirements.

Opportunities

- Separate listing of wholesale business under Red Star Holdings although the group retains 70% in the retailer; would enable management to better focus on other businesses.
- Total relaxation of price controls would further enhance profitability in the local sugar business. Currently sugar remains a price monitored product.
- Management anticipates a 20% rise in sugar production in the upcoming period to 173,000 tonnes.
- ZSR Transport in SA continues to grow with the addition of 2 new trucks in the period under review.

Weaknesses

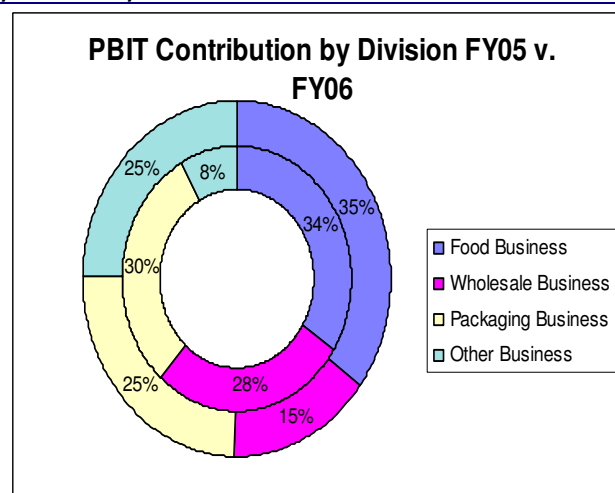
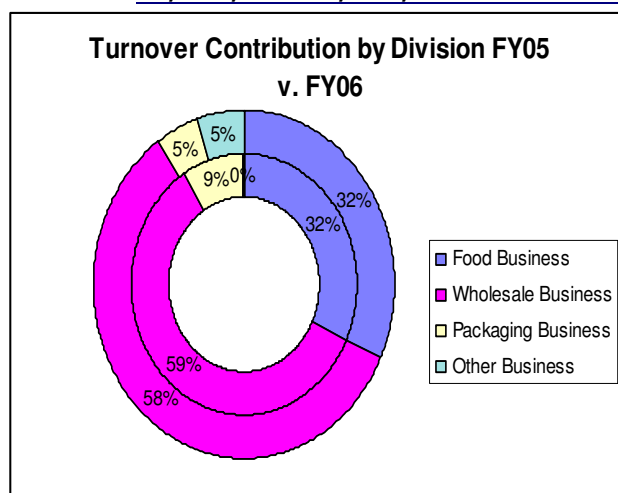
- Reliance of raw sugar from third parties namely Triangle and Hippo, and thus fortunes linked to agriculture.
- The packaging business is dependant on importing raw materials.
- Bluestar Transport incurred a Z\$2 billion loss due to high operating costs as well as fuel shortages.

Threats

- Non-availability of foreign currency, reducing variety of produce on offer in wholesale division.
- Consumer resistance to price increases thus potentially having an adverse impact on volumes.
- Intermittent supplies of raw materials, causing disruptions to production.
- Uncertainty regarding foreign exchange policy will mean group unlikely to realise the full value of their exports.
- Local coal supplies unreliable therefore need to import from South Africa and Botswana.

Operational Review

Z\$millions	Turnover			PBIT			Operating Margin		
	FY06	FY05	% change	FY06	FY05	% change	FY06	FY05	% change
Food Business	2,442,284	432,119	465%	392,217	20,917	1775%	16%	5%	220%
Wholesale	4,534,661	792,300	472%	319,313	8,903	3492%	7%	1%	600%
Packaging	651,630	65,894	889%	349,463	14,801	2261%	54%	23%	145%
Other Business	22,332	66,657	-66%	94,050	14,581	545%	421%	22%	1814%
	7,650,907	1,356,970		1,155,048	59,202				



Outer ring represents 2005, while inner ring represents 2006.

Turnover for the **food business** which comprises of Gold Star Sugars and Country Choice Foods increased by 465% from the prior year despite the 33% decrease in sugar volumes (inadequate raw sugar supplies). While PBIT increased by 1775% on the back of margin expansion which was attributable to the removal of price controls on sugar, the year under review effectively saw the wholesale price of sugar increase by +1000%. The wholesale business which comprises of **Red Star Holdings** contributed the most to the group in terms of turnover (59.3%), an amount of Z\$4,5 trillion. The **packaging business** saw a decline in its volumes attributable to dependency on imported raw materials, although it contributed 29% to the group's operating profit, an increase from the prior year. The **other businesses** which comprise of Arthur Engineering, Marathon tyres, Blue star transport and ZSR transport (S.A) and property contributed 5% to operating profit. The transport business' loss was a result of fuel and spare parts shortages. The year under review saw the group's **properties** revalued to Z\$2.9 trillion.

Earnings Forecast

Z\$000's	2004	2005	2006	2007F
Turnover	456,341,000	1,423,646,000	7,650,907,000	65,032,709,500
Operating income	58,701,000	80,358,000	1,216,332,000	8,454,252,235
Interest	(6,206,000)	(16,614,000)	312,694,000	1,407,123,000
Pretax Profit	52,339,000	54,041,000	1,529,026,000	9,861,375,235
Taxation	(16,962,000)	(16,236,000)	(391,837,000)	(2,465,343,809)
Minority interest	(1,944,000)	(930,000)	(119,619,000)	(598,095,000)
Profit after tax	33,433,000	36,875,000	1,017,570,000	6,797,936,426

EPS	\$88.04	\$98.03	\$2,670.79	\$17,842.35
Target Price				\$160,581.18
Forward PER				1.23x
DPS	\$22.17	\$32.50	\$758.00	\$5,097.82
Cover	4.0	-	3.5	3.5
Shares in issue '000s	379,750	379,750	381,796	381,796

Ratios	1.816515221			
Turnover growth	841.9%	212.0%	437.4%	750.0%
Operating margin	12.8%	5.6%	15.9%	13.0%
Net Profit margin	7.3%	2.6%	13.3%	10.5%
Pretax margin	11.5%	3.8%	20.0%	15.2%
EPS Growth	584.5%	10.3%	2650.5%	568.1%

Recommendation

ZSR's performance for the FY06 confirms the group's recovery from a period in which the group's wholesale business inhibited depressed margins in a declining inflationary environment as well as price controls on sugar products. Reflecting the overall state of the economy volumes were depressed across the group's major business units. Constraints on the pricing of sugar by the authorities will be a major factor in deciding future profitability of the sugar business. In addition to this, uncertainty regarding the exchange rate will impact the viability of sugar exports. The group's diversified portfolio should stand in good stead to weather the turbulent environment; we thus recommend investors **accumulate** the stock.

Combined ZSR US\$ Valuation

Sugar Business (weighted replacement/ PS valuation)	US\$92,257,813
Plastics Business (weighted replacement/ PS valuation)	US\$18,919,859
Transport Fleet	US\$520,000
Property	US\$33,799,534
Redstar Market Cap 26/06/06	US\$8,848,526

TOTAL	US\$154,345,732
No. of shares	381,796,000
Value per Share	US\$0.40
Price 15-06-06	US\$0.09

Supplementary Information

Replacement Values of Main Operating Assets		US\$
Sugar Refineries		\$70,000,000.00
Plastics Plant		\$15,000,000.00
Transport Fleet		\$ 520,000.00
Total		\$85,520,000.00
Number of shares		381,796,000
Operational Replacement Value a Share		\$ 0.23
Price 15-06-06		0.09
Not incl Properties (80 units)		

Sugar Division Price/Sales Regional US\$ Valuation	
Tonnes (70% capacity utilisation)	175,000
Average Price Regionally US\$ per tonne	698
Value US\$	122,150,000
Implied Price/Sales Factor	1.25
Implied Value of Sugar SBU US\$	114,515,625
EPS US\$	\$0.30

ZSR Property Valuation	
Open Market Value at 31/03/06	Z\$2,900,000,000,000
Implied OM US\$ Rate at 31/03/06	156,000
Open Market Value at 31/03/06 (US\$)	US\$18,589,743.59
Average Discount to replacement value	55%
Implied Replacement Value	US\$33,799,533.80

Sugar Division Price/Sales Regional US\$ Valuation	
Tonnes (80% capacity utilisation)	5,280
Average Price US\$ per tonne	2,746.48
Value US\$	14,501,408
Implied Price/Sales Factor (Average Manufacturing Sector P/S)	2.1
Implied Discounted Country Risk Value of Plastics SBU US\$	22,839,718
Assumptions	
Price per kg Z\$195,000	
Average Implied OM Rate Z\$71,000 to 1US\$	

Technical Analysis ZSR relative to Industrial Index (Daily)



- **Breaking through two year bearish resistance level, which if sustained will enhance the positive outlook on the security.**

ZSR Relative to Implied OM Rate-US\$0.08



- **Funnelling into an apex; support lies at US\$0.06, while key resistance lies at just below US\$0.10**

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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