IMARA INVESTING IN AFRICA

Securities

Choppies Enterprises Ltd

Half Year Results to 31 December 2015

Still growing further…

Equity Research

Botswana

13 May 2016

Retail

BLOOMBERG: Choppies: BG			
Current price (BWP)			4.10
Current price (USD)			0.37
Target price (BWP)			3.75
Upside/Downside			-9.33%
12 month High/Low (BWP)			5.50;3.85
Liquidity			
Market Cap (BWPm)			5,295.76
Market Cap (USDm)			480.86
Shares (m)			1,291.63
Free Float			100%
Income Statement (BWP'm)	**H1 16**	**H1 15**	**%ch**
Revenue	3,530.67	3,008.48	17.36%
Gross profit	713.81	644.01	10.84%
EBIT	141.12	140.58	0.38%
PBT	133.47	129.44	3.11%
Net profit	104.10	103.25	0.82%
EPS (thebe)	8.08	8.57	-5.72%
DPS (thebe)*	4.88	4.51	8.20%
NAV/share(thebe)	114.51	77.72	47.34%
Balance Sheet (BWP'm)	**H1 16**	FY 15	
Non current assets	1,446.49	1,269.31	13.96%
Current assets	1,204.51	1,149.38	4.80%
Total assets	2,651.00	2,418.70	9.60%
Non current liabilities	331.93	312.43	6.24%
Current liabilities	840.06	654.73	28.31%
Equity	1,479.02	1,451.54	1.89%
Ratios and Margins			
Gross profit Margin (%)	20.22%	21.41%	
Operating profit margin (%)	4.00%	4.67%	
PBT margin (%)	3.78%	4.30%	
Net profit margin (%)	2.95%	3.43%	
Inventory Turnover (x)	8.39	9.04	
LT Debt/ Equity (%)	22.44%	21.52%	
Current ratio (x)	1.43	1.76	
RoaE (%)*	16.57%	21.21%	
RoaA (%)*	8.26%	9.02%	
PER (x)*	26.73	30.10	
PBV (x)	3.58	5.66	
Dividend Yield (%)*	1.10%	0.95%	
Dividend cover (x)	1.66	1.90	

**last 12 months*

Choppies released satisfactory results for the six months ended 31 December 2015 as reflected by a moderate 0.82% increase in net profit and a 5.72% decrease in EPS to 8.08 thebe. The company continued to grow at a robust pace, having opened a total of 18 stores during the half year (Botswana: 5, South Africa: 4, Zimbabwe: 8, Zambia: 1), bringing overall store count at H1 16 to 147, covering an aggregate floor space of 214,052m² - up 22.19% from 177,031m² at H1 15. Currently, Choppies operates 172 stores and 10 distribution centres in 5 countries. Choppies' on-going aggressive growth strategy saw high cash flows used to fund expansion and as a result, the company maintained its low yield dividend policy – no interim dividend was declared, thus its dividend yield remained flat at a modest 1.10%.

Income Statement: The opening of new stores during H1 16 and declining inflation levels across all markets aided the 17.36% growth in Choppies' top line to BWP 3.5bn (H1 15: BWP 3.0bn). Despite the aforementioned decline in inflation levels which would imply cheaper expenses for the company, cost of goods sold grew ahead by 19.13% to BWP 2.8bn (H1 15: BWP 2.4bn) leading to the GPM contracting by 1.19pp to 20.22%. Opex grew by 17.93% to BWP 606.1m (H1 15: BWP 514.0m), underpinned by a 23.28% increase in administration expenses to BWP 491.5m with the high rate of growth mainly attributable to the addition of the 18 stores during H1 16; electricity (+28.97% to BWP 44.8m), rent (+19.12% to BWP 85.4m), and staff costs (+21.18% to BWP 230.4m). Execution costs associated with establishing infrastructure such as distribution centres, ERP systems and marketing of new stores further eroded earnings and EBIT margins slightly declined by 0.52pp to 3.78% (H1 15: 4.30%).

Interest expenses shrunk by 4.97% to BWP 11.6m on the back of a 26.93% decrease in total borrowings and the bank overdraft, while interest received increased 3.7x to BWP 3.9m and this supported a 3.11% increase in PBT to BWP 133.5m. With the effective tax charge increasing to 22.00% from 20.23% in the comparative period, PAT improved marginally by 0.82% to BWP 104.1m.

Balance Sheet: Total assets grew by 9.60% to BWP 2.7bn (FY 15: BWP 2.4bn), driven by a 25.90% increase in inventory to BWP 674.4m from BWP 535.7m at FY 15, and a 17.28% rise in plant and equipment to BWP 875.0m reflecting the ongoing expansion. Choppies registered BWP 147.1m in net cash inflows from operating activities and a 22.51% decrease in cash flows used in investment activities, while cash from financing activities fell by 98.22% to BWP 8.9m (FY 15: BWP 501.9m). The company reported a 27.58% decrease in cash overall to BWP 249.0m (FY 15: BWP 343.8m) decline in.

The group increased its gearing during the period under review and this was reflected in the 48.07% rise in net debt to BWP 923.0m (FY 15: BWP 623.3m), while equity funding rose by a marginal 1.89% to BWP 1.5bn during H1 16. Given the capital raise from the secondary listing on the JSE which increased equity funding by 62.07% to BWP 1.5bn at FY 15 vs. BWP 912.6m at H1 15, annualised RoaE decreased to 16.57% at H1 16 vs. 21.21% at H1 15. Despite a 56.32% decrease in the bank overdraft, the 53.46% increase in trade and other payables to BWP 695.4m (FY 15: BWP 453.1m) underpinned a 28.31% rise in current liabilities to BWP 840.1m.

Segmental Analysis: The Botswana segment maintained its position as the largest contributor to the top line - accounting for 64.44% of total revenue. Revenue in the group's mainstay grew by 14.78% to BWP 2.3bn partly attributable to the opening of 5 stores. Although macroeconomic pressures continued to weigh on the spending power of consumers in Zimbabwe and deflationary trends manifested through the strengthening USD, the segment achieved the largest revenue growth rate of 48.86% to BWP 587.3m partly due to the translation effects of the strong USD.

Although South Africa registered revenue growth of 8.20% to BWP 674.5m, despite a decrease in footfall (H1 16: 9.0m vs H1 15: 10.0m) - it recorded the lowest rate across all segments, partly attributable to challenging trading conditions in mining towns - which stemmed from prevailing strikes and workers leaving the mining belt due to industry job losses. 22 out of the 40 Choppies stores in South Africa are in mining towns. Operations in Zambia commenced on 25 November 2015 with a distribution centre and $1,192m^2$ store in Lusaka being opened and the store generated BWP 5.5m in revenue.

An aggressive pricing and promotions strategy and start-up costs for the 8 new stores opened in Zimbabwe during the period under review further eroded the country's profitability as it registered an EBITDA margin of 2.40% (H1 15: 3.82%). Botswana continued to record the highest EBITDA margin of 9.41%, 57bps higher than the corresponding period's 8.84%, while rising power cuts which resulted in higher cost pressures impacted South Africa's profitability negatively, thus producing a negative EBITDA margin of - 1.98% (H1 15: 2.24%). Although the South African segment's average basket size increased from 54 to 55 items y-o-y and retail floor space increased by 29% to 76,451sqm (H1 15: 59,271sqm), the sharp devaluation of the rand during H1 16 put pressure on the conversion of rand – based sales into pula (01/06/15: BWP 1.00 – ZAR 1.19 vs. 31/12/15: BWP 1.00 – ZAR 1.36), which further weighed down earnings generated from operations in South Africa.

Botswana's pre-tax profit margin rose by 110bps to 7.58% (H1 15: 6.48%), while Zimbabwe's declined by 0.92pp to 0.16% (H1 15: 1.96%). South Africa's negative pre- tax profit margin also worsened to 5.94% at H1 16 vs. -1.29%at H1 15 and Zambia also recorded a pre-tax loss, with an expected negative margin of 29.71% as the store recorded revenues for 1 month vs. start up costs incurred in the opening of the store.

Outlook: Choppies continues to invest heavily in new stores which is undeniably assisting the group to grow its top-line in the double digits, but this does expose the company to execution risks. A total of 18 stores were opened in H1 16 and an additional 21 stores were acquired in South Africa on 01 March 2016, taking the total to 168 – leaving the company well positioned to achieve its target of over 200 stores in around 6 countries by FY 16. Choppies extended its presence in its home market with the opening of 5 stores in H1 16, and the addition of a 79^{th} local store on 4 March 2016, further strengthening its position as the leading supermarket/grocery retailer in Botswana with a dominant market share of *c*.36% of the formal grocery retail channel. Management asserts that a further 2 stores are expected to open before the end of the current year in Botswana.

Although the market size in Botswana is limited owing to its small population (just over 2.0m), while Botswana's overall retail market is increasingly getting saturated in terms of players and market share due to the mushrooming of many malls (5 opened in the past 3 years), the expansion is justified as the local retail market has been efficient and is characterised by high volume sales due to a relatively high GDP per capita. The expected recovery of the local economy should boost disposable incomes and thus spending in the sector, which could inherently yield higher revenue inflows for the company.

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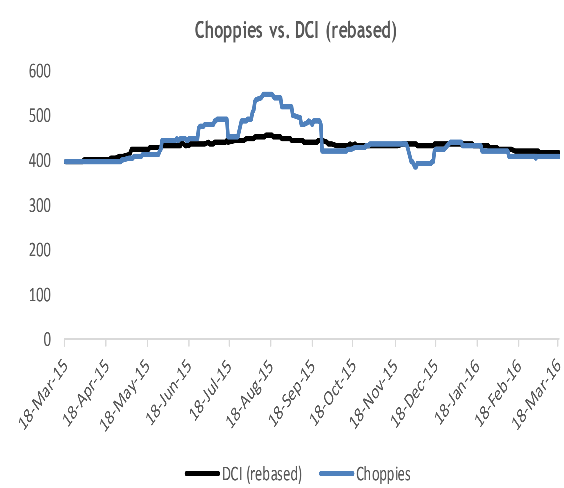
A deal was concluded in Kenya whereby 10 stores will be acquired – the process commenced on 13 February 2016 with the takeover of the first store in Kisumu and to date, a further 4 stores have been taken over. Moreover, the 21 retail stores which were acquired in South Africa on 01 March 2016 broadened Choppies' SA footprint to 61 stores. The acquired stores which are currently operating under the brand '*Jwayelani*' in Kwa-Zulu Natal and Eastern Cape, generated revenues of ZAR 1.0bn in the year to August 2015 with a gross profit margin of 20.37% and a PBT margin of 2.84%. An additional 10 stores are to be acquired in Zambia during FY 16. The aforementioned acquisitions create a strong platform for potential earnings growth and could translate into higher economies of scale which would strengthen Choppies' core competitive advantage of low pricing on goods.

The counter is currently trading at a PER of 26.73x and a Price to Sales of 1.5x, which are above its peer average in Sub-Saharan Africa. Using the relative valuation method, we arrive at a target price of BWP 3.75, which represents a 9.33% downside. Accordingly, we recommend a **HOLD** call on the stock.



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