EQUITY RESEARCH

SOUTH AFRICA

Industrials: Food producers

Libstar Holdings Limited (JSE: LBR)

Initiation of coverage

17/09/2020

Well positioned in both Private Labels & Branded Products…

Key drivers - product innovation, customer relationships, acquisitions…

We initiate coverage on Libstar with a BUY recommendation mainly due to its positioning in the SA market, being the largest producer of private label (PLs) products (43% of revenue) whilst also deriving c.32% of revenue from Libstar brands. PLs are expected to outgrow traditional branded products over the medium term; however, branded products should still achieve higher margins. These two scenarios both bode well for Libstar's organic growth and should be complemented by its inherent acquisitive strategy since inception in 2005.

Global private label market share has increased significantly over the period 2015-2019, particularly in the UK and Europe. Whilst private label market share growth in the US market has expanded at a slower rate compared to the UK and Europe, popularity for these products has improved over the same period**. A similar consumer sentiment has emerged in the SA market in which private labels market share reached 21.4% in 2019, showing a consistent growth pattern in recent years.** Private labels have outperformed branded products over the same period, with the trend expected to continue over the medium term. The advent of Strategic Private Label and Dealer-Owned Brands (DOBs); has seen enhancements in product quality and innovation driving growth of the private label market.

Over the period FY14-FY19; companies with a higher exposure to PLs have achieved high growth in revenue whilst those mostly focused on branded products have maintained higher EBIT margins but with subdued top-line growth. Categories in Libstar & RFG closely resemble each other with high revenue growth but lower EBIT margins; reflective of aggressive growth strategies which have included acquisitions but with exposure to PLs; have had lower margins than branded products. Whilst branded products have accumulated loyalty, they can be purchased virtually anywhere in the formal and informal markets. However, some PLs and DOBs are only found exclusively at specific retailers.

For Libstar, Perishables and Groceries should continue to account for the bulk of revenue and EBITDA over the medium term. Whilst these two categories experienced negative growth during H1-FY20, we anticipate a recovery in H2 supported by level 1 economic activity, coinciding with the period in which the group traditionally experiences stronger growth. As indicated below, the group's 3 channels to market will be critical in achieving growth going forward;

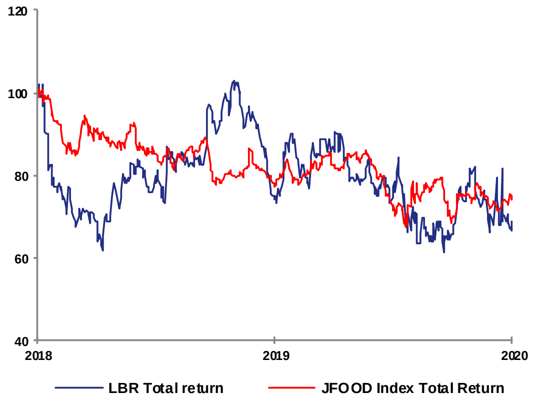
- We expect the ***Retail and Wholesale channel*** to continue doing well whilst Food Service should recover as the economy reopens. Trends in *private labels* bode well for Libstar as the largest producer in this space, complemented by its positioning in *branded products*.
- **The Food service channel** should recover in H2-FY20 with the resumption of economic activity within the QSR sector, which should support key categories such as Perishables and Groceries.
- ***Exports*** will always be a critical channel for Libstar in reaching global markets mainly through Cape Herb & Spice and even though the expected weaker Rand supports growth, supply chain logistical challenges will remain a risk.
- ***Industrial & Contract Manufacturing*** may be impeded by sluggish economic growth in SA even though enhanced production capacities remain a core focus for Libstar.

Forecasts: For FY20e we expect slower revenue growth of 2.1% to R10.10bn (53.4% being derived in H2-FY20) and 4.3% growth in FY21e to R10.53bn. We estimate a lower normalised EBITDA margin of 10.1% for FY20e with normalised EBITDA of R1.02bn; this implies a 13.4% decline from normalised EBITDA of R1.17bn in FY19. We note that even though H2-FY20 should be better than H1-FY20, FY20e will likely result in subdued performance compared to FY19 mainly due to Covid-19, which added further to an SA economy already under pressure. For FY21e we estimate a normalised EBITDA margin of 10.7% with EBITDA of R1.13bn. Consequently, for FY20e we anticipate lower normalised HEPS of 77.2cps and an improvement in FY21e to 85.8cps. We forecast DPS of 23.3cps in FY20e and 25.9cps in FY21e.

Valuation & Recommendation: We used an intrinsic asset valuation approach applying a DCF valuation on the 5yr forecast for the Free Cash Flows to the Firm and derived a 12-month target price of **R8.04**. This resulted in a 25.0% expected total return (dividends inclusive) and a **BUY** recommendation. Our relative valuation derived an average Global EM EV/EBITDA of 10.1x and an average of 6.7x amongst SA Food Producers whilst we derived an EV/EBITDA of 5.6x for Libstar. On this basis, Libstar is at a 44.2% discount relative to the Global EM peers and at a 16.7% discount to the SA peers.

RECOMMENDATION:	**BUY**
12m TP (ZAR)	**8.04**
Upside	22.1%
Fwd DY	2.9%
12month expected return	**25.0%**
Market capitalisation (Rbn)	4,012
No. of shares (m)	609
Float	34%

(Rm) (Continuing operations)	FY2019	FY2020e	FY2021e
Revenue	9,893	10,097	10,529
Adj.EBITDA	1,174	1,016	1,126
Adj.EBITDA Margin (%)	11.9%	10.1%	10.7%
Adj.HEPS (ZARc)	82.7	77.2	85.8
DPS (ZARc)	25.0	23.3	25.9
P/E	9.2	10.4	9.4
DY	3.3%	2.9%	3.2%
ROIC	7.6%	6.4%	7.1%
ROIC tangible net capital	20.7%	15.3%	18.9%



Shareholders:
APEF Pacific Mauriti 41.46%
Public Investment Corporation 13.49%
Coronation Fund Managers 2.87%
SANLAM Limited 2.71%

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