




# PADENGA HOLDINGS LIMITED

*An FBC Securities Pvt Limited Coverage*



*A cut above the rest .....*



## Rating: STRONG BUY

## Initiation of Coverage

As on 27<sup>th</sup> April 2014

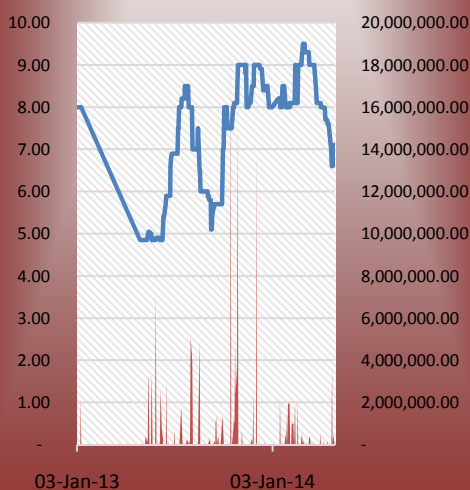
Current Price	7.1c
Target Price	12.45c
Expected Capital Gain	75.3%
Expected Div Yield	3.7%
Expected Total Return	79.0%

### Key Metrics

Ticker	PHL.zw
Share Price	7.1c
Shares Outstanding	541,593,440
Market Capitalisation	\$38.5m
P/E	6.61x
P/B	1.24x
EV/EBITDA	5.15x
EV	\$40.6m

### Share Price Performance

Padenga 52 week Price vs Volumes



## Investment Summary

Set to change course.....

FBC Securities initiates coverage of Padenga with a **Strong Buy recommendation** and a **Low risk rating**.

Despite the exigency to infer an indisputable rating due to tough economic nexus presented by the declining economy, we believe Padenga is currently under appreciated and depicts an **undemanding** valuation in the market. In our view, this is likely to change over the course of the year for a number of reasons:

- Increasing profitability and higher earnings visibility should support convergence to Fair Market value in the immediate short term. A double increase in cash and cash equivalents to ~\$8.2m justifies the ability to support planned CAPEX by the group from internal resources, giving a platform for the company to reduce its debt.
- Most importantly, the business model is unique and enjoys a desirable level of immunity from local economic apprehension. Point in case, being Padenga's strong export orientation across its product lines and established networks and synergies within the crocodile leather market. Subsequently, Padenga locally enjoys a unique competitive advantage that enhances its Industry competitiveness.
- Serving the luxury end of premium brands which has remained relatively inelastic to global consumer demand trends, the crocodile farmer is assured of sustainable demand for the foreseeable future.

Trading at PER, EV/EBITDA and PEGR of 6.37X, 4.38X and 0.23 respectively against emerging market averages of 22.34X, 6.5X and 0.85 times respectively, Padenga is trading at a discount to emerging market Textile industry comparables. Combining this with a static (no growth) discounted cash flow valuation of US10.2 cents/ share (144% of current value) and no current price portion attributable to (PVGO) Present value of growth opportunities against industry average of 20% and factoring in the current Price / Net Asset Value (P/NAV) of 1.26x against industry average above 1.5X; Padenga is currently underweighted by the market. Using a combination of comparable multiples (PER, EV/EBITDA, PEG) and Free cash flows to Equity DCF valuation models we introduce a 12-month target price of US12.45 Cents to FY 2014, an upside potential of 75.3%.

### Key forecasts and Ratios

	Dec-13	est Dec-14	est Dec-15	est Dec-16	est Dec-17
Revenue (\$m)	25.20	31.50	36.20	42.70	53.00
EBITDA(\$m)	10.50	16.40	18.50	21.80	26.80
Net Income(\$m)	6.10	9.90	11.50	13.70	17.00
RoA(%)	11.8	16.4	15.7	16.0	17.4
RoE(%)	26.3	24.8	23.8	24.2	26.2
EPS US Cents	1.07	1.76	2.12	2.53	3.14

..... a pedestal for diversified revenue streams has become an apparent dynamic.....

..... use of advanced technology on production allows the room for the least combination factors of production to sustain margins and also to improve the bottom line.....

## Investment Positives

- **Diversification of Revenue Streams Portal for Improved Bottom Line:** Following the conclusion of a 50% stake acquisition in American Based Lone Star Alligator Farms LLC in Texas; an Alligator farming business, a pedestal for diversified revenue streams has become an apparent dynamic. Albeit the initiative has not yet fully benefited the group's bottom line as the project is still in its infancy, the USA alligator business poses immense growth potential accompanied by wider margins. Padenga is set to drive expansion from this front by exploiting the production efficiencies in the US operating environment. We have forecasted the company's revenue to grow at a CAGR of ~20.8% over FY2014-17.
- **Adoption of the least cost combination of factors of production turns to benefit the bottom line:** Apart from the objective to diversify revenue streams and also to service new markets in which the group was unable to establish a foothold in historical times, the Alligator business turns to be a cost neutraliser to the overall business model as the use of advanced technology on production allows room for the a least cost combination of factors of production to sustain margins and also to improve the bottom line. It only takes a 3 person labour force to generate production capacity of 20,000 skins targeted for 2014, compared to the traditional Nile Operation(Zimbabwe) which is labour intensive.
- **High earnings business:** Despite being punished by the market, company multiples ascertain a high earnings business with respect to the comparables of the emerging market peers average. Turning to the EV/EBITDA multiple, at EV/EBITDA of 4.33x, hypothetically, the payback period of the business in the event of any purchase of the company is 4.3 years. Relative to the emerging market EV/EBITDA average of 6x, the company exhibits high growth opportunities not yet realised, igniting a possible market correction in the short-medium term.
- **Strong Balance Sheet:** Padenga has a strong Balance Sheet and is able to meet long-term funding requirements through internally generated operating cash flows without resorting to engage financial institutions for borrowings. The company holding on to ~\$10.3m cash under the review period, would complement efforts to take advantage of projects with positive NPV without increasing the interest burden for the group and eroding Return on Equity.
- **Dominant market player:** Padenga indisputably is amongst the emerging market players in the crocodile business space in Southern Africa. While the crocodile business is mainly for foreign markets, and crocodile meat is mainly for the export market, increasing campaigns and advertising for the crocodile meat (reversal of the wrong traditional perception that the crocodile meat is poisonous) in the local market is set to benefit the group in consonant with its market position as the crocodile meat is cheap at

## Investment Positives Cond'

~\$2.5/kg vs. \$5.5/kg and \$4.5/kg for beef and pork. At record campaigns through the local meat distributors have started to pay dividend as uptake for crocodile meat has started to pick up.

- **Enjoys desirable immunity from local economic apprehension:** The business model is unique and enjoys a desirable level of immunity from local economic apprehension. Being export oriented with the main product lines sold to the foreign market and 80% of inputs sourced from South Africa, Padenga enjoys a unique competitive advantage that enhances its Industry competitiveness. Serving the luxury end of premium brands which has remained relatively inelastic to global consumer demand trends, the crocodile farmer is assured of sustainable demand for the foreseeable future.
- **Exploiting organisational and operational economies of scale:** With exciting developments in USA including: Commissioned skinning plant in Delcambre Louisiana Texas, Commissioned meat processing plant in Winnie, Natural captive breeder project with capacity to produce 20 000 hatchlings per annum, group synergies are set to open room for the Exploitation of organisational and operational economies of scale.
- **Static and Present Value from Growth Opportunities (PVGO) Test model shows suppressed pricing at current levels:** Assuming a constant growth in earnings in the ensuing years, we have calculated Static Value per share of US10.2 cents , representing 144% of the current price of 7.1 cents before factoring in PVGO, the intrinsic Static Value shows that Padenga is already undervalued. At current pricing the PVGO is unaccounted for. BY mere rule of thumb that the Static Value has to be at least 60% of Share price and PVGO at most 40%, Padenga is indisputably **undervalued** as even the current earnings capacity is not fully reflected in current pricing.

## Investment Negatives

- **Exposure to supply side shocks of raw inputs:** We are apprehensive about the supply sustainability of nutritious concentrates from South Africa as 80% of feed raw materials are coming from South Africa. Industrial action in the labour market in South Africa is expected to have negative impact on industrial activity igniting supply side shocks for nutritious raw materials portal for Padenga's business flow.
- **Deteriorating economic fundamentals threatens fair value convergence:** While Zimbabwean economic fundamentals are diminishing, positive relationship between equities' performance and economic repute cannot be over-emphasised. Re-pricing to a fair value of Padenga is subject to economic constrains at a time when the economy is bleeding. Equity Market activity has been significantly affected as Investors play in alternative capital market products and investments.
- **Concentration on a Single Buyer:** The production flow ends with a single buyer Hermes, which absorbs all of Padenga's current capacity. Limited distribution as evidenced by the concentration on the single customer limits bargaining muscle which in turn limit the upward price adjustment.

*.....The business model is unique and enjoys a desirable level of immunity from local economic apprehension.....*

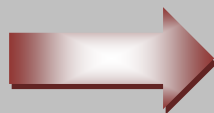
*.....room for the Exploitation of organisational and operational economies of scale.....*

*.....Padenga is indisputably undervalued as it places significant value on current earnings profile.....*

SWOT Analysis

- *Strong Branded products in the local and international environment.....*
- *High cost structures undermine international comparative advantage and competitiveness.....*
- *Potential for market growth in the local frontiers especially at a time when the consumption of croc meat products is still at infancy level.....*
- *Increasing competition from the international environment wherein state of the art technology has become an apparent advantage.*

<b>Strengths</b>	<ul style="list-style-type: none"> <li>▪ Strong Branded Products.</li> <li>▪ Product range diversity.</li> <li>▪ Group synergies</li> <li>▪ Services Niche Market.</li> <li>▪ Strong Research and Development backed by strong operating cash flows.</li> <li>▪ Vertical integration strategies.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>▪ High cost structures undermine international comparative advantage and competitiveness.</li> <li>▪ Limited distribution channels with concentration on Single Buyer.</li> <li>▪ Traditional formulas that are labour intensive.</li> <li>▪ Sale of unfinished commodity product with limited value addition.</li> </ul>
<b>Opportunities</b>	<ul style="list-style-type: none"> <li>▪ Potential for market growth in the local frontiers especially at a time when the consumption aggregates of crocodile meat products are still at infancy levels.</li> <li>▪ Strategic synergies through Padenga-Texas guarantees a strong market penetration and growth into International Markets.</li> <li>▪ New Product development.</li> <li>▪ Being located on Lake Kariba confers significant opportunity to expand into additional forms of farming.</li> </ul>
<b>Threats</b>	<ul style="list-style-type: none"> <li>▪ Stunted global economic trends as well as declining disposable incomes in the domestic economy inhibits capacity.</li> <li>▪ Increasing competition from the international environment wherein state of the art technology has become an apparent advantage.</li> <li>▪ External Supply side shocks e.g. Electricity, labour cost demands, rising cost structures</li> <li>▪ Vulnerability of Biological assets to disease outbreak</li> </ul>



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Corporate Profile

CORPORATE PROFILE

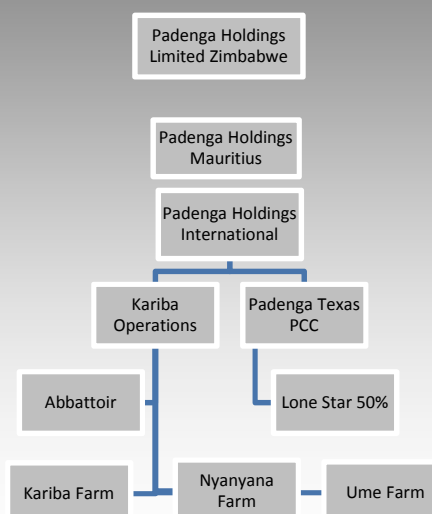
Business Overview:

Padenga is a company that is principally involved in the production, processing and sale of Nile crocodile products and Alligator products. By definition, Nile crocodile (*Crocodylus niloticus*) is an African crocodile and the second largest extant reptile in the world, after the saltwater crocodile. This type of crocodile is widespread throughout Sub-Saharan Africa wherein Padenga is the dominant market player. The business has been in operation since 1965, however, before it attained the new name “Padenga Holdings Limited” in recent times, marking it the oldest crocodile producer in the national boundaries. Prior to the consolidation of the business operations and the incorporation of a stand-alone entity in 2010 by way of a dividend in specie from the Inncor Group, Padenga Holdings Limited operations were conducted as the Niloticus Division Inncor Africa Limited.

**Business Units:** Padenga operates four stand-alone business units, comprising Kariba Crocodile Farm, Nyanyana Crocodile farm, Ume Crocodile farm and the Abattoir located on the Kariba Farm. The four business entities are managed as separate business entities each with independent profit centre, and each with a dedicated management team, reporting to the Company’s Executives. The Farms are structured in such a way that they have similar size, same labour force stock numbers and management systems for easy and clear comparison, producing premium quality skins and meat for export to Europe and Asia. Producing larger size and premium quality of skins ensures that the company will remain an important part of the supply chain that will benefit from growth in the luxury branded goods market. The abattoir provides slaughter services to the three farms. To keep in track with vertical integration to benefit from technological economies of scale and also to attain product diversity, the group recently concluded a 50% stake acquisition in American Based Lone Star Alligator Farms LLC in Texas. This introduced the company to a new line of business with Alligators being the core business.

.....operates three farms on the shores of Lake Kariba in Zimbabwe, producing premium quality skins and meat for export to Europe and Asia.....

Padenga Group Structure



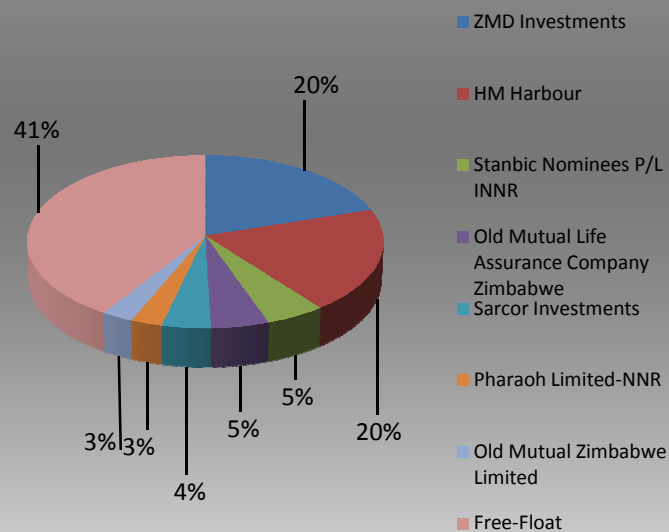
Company overview contd'

..... On 1 August, Padenga purchased by way of a Purchase and Sale Agreement the entire assets and liabilities of Niloticus Division from Innscor.....

Company History:

The whole story of Padenga commenced with the establishment of Kariba Crocodile Farm in 1965 on the shores of Lake Kariba and turns out to be the first crocodile producing venture in the country. Ume Crocodile Farm was added to the Kariba operations in 1973. In 1993, a company which later formed an integral part of Innscor purchased the entire crocodile business from Art Corporation. The operations were formally incorporated as part of Innscor in 1998 and have been reported by Innscor as Niloticus since then. On the 27<sup>th</sup> of July 2010, Padenga was incorporated as a wholly-owned subsidiary of Innscor. On 1 August, Padenga purchased by way of a Purchase and Sale Agreement the entire assets and liabilities of Niloticus Division from Innscor.

Top Shareholders



Source: Corpserve Transfer Secretaries/ZSE



.....Comprised of Competent and qualified senior management team....

### Management Team

- Padenga is comprised of competent and highly professional executive management team. With some of the executive members accounting for considerable shareholding in the company, we are convinced that future growth and profitability of the company is a priority to management as it is to Shareholders, and that would complement our calculated price upward re-rating.
- However, a free-float of 41% in shareholding structure ought to be reduced to avoid compromise of fair value adjustments. We recommend that the company should consider a share buy-back exercise to reduce on free-float.

Name	Designation
Gary Sharp	Chief Executive Officer
Oliver Kamundimu	Chief Finance Officer
Michael Fowler	Executive Director
Charles Boddy	Operations Executive
Jimmyson Kazangarare	General Manager KCF
Prince Chapenyama	General Manager NCF
Pierre Steyn	General Manager UCF
Jeremiah Hunzwi	Abattoir Manager

Source: Company Reports

## Key Markets

..... Padenga skins are predominantly meant for export market with Asia and Europe being the major markets.....

- Padenga skins are predominantly meant for export market with Asia and Europe being the major markets. Despite depressed economic activity in Asia, Asia emerged the dominant customer for crocodile meat. Skins are sold to well-known skin tanneries who in-turn onward sell to luxury brand houses such as Hermes, Cartier, Louis Vuitton and Prada more manufacturing of high value leather accessories and clothing. The market for crocodile leather, known in the trade as the “Classic” skin market, includes the market for alligator, Nile, and porous or saltwater crocodile skin. Other types include siamensi, novaguinea and caiman but they do not have the same attraction for the market. The classic skin market is segmented according to quality and size, with a significant premium attaching to larger skins of a high quality.
- Alligator skin dominates the world trade in terms of volumes but mainly services the watchband market with limited numbers of large skins produced suitable for handbags and leather apparel. The Nile skin occupies the second position, predominantly from Zimbabwe, South Africa and Zambia. The skins are grown larger than Alligator skins basically for manufacturing of handbags, accessories and leather apparel.



The Threat of new entrants into the Industry is probable and likely, given the low capital requirements in the form of both Biological and physical Assets.

Further improvement in quality by competition both locally and regionally could provide the client with alternatives.

Rivalry among existing firms is low as quality issues trim the top end of the skin supplier list. High demand for premium quality skins expands the demand base relative to supply

Buyers' power is considerable as all of Padenga's premium skins are consumed by a single tannery which is one of 4 tanneries out of 8 for premium skins owned by a single holding company.

The business model is process and labour intensive utilizing a semi-skilled labour force, operating in an environment with over 80% unemployment gives leverage to Padenga. Feeding supplements are sourced from South Africa as well as in the local market.

**Crocodile Industry Developments .....**

..... Padenga's investment into Alligator could not have come at a more probable time. Strong demand for product will see the product differentiation coming in strongly on alligator skins due to its skin characteristics vs the Nile .....- **Alligator growth still imminent**

With Padenga already eyeing the captive breeder project in Louisiana following hurricane disasters positions the Group for sustained growth in the market as they will not have to rely solely on the wild life ration....

For wild life conservationist Padenga's captive breeder project could give mother nature time to recover on lost populations whilst the populist business of Alligator farming Thrives in Louisiana.....**Padenga Capex investments are indeed well directed for future growth and earnings capacity**

Niloticus business will continue to thrive in the luxury goods market due to its skin texture and characteristics which remain desirable – The fusing in of the two breeds (Alligator and Niloticus), for Padenga will translate

- into eased cashflows due to the shorter breeding to culling period of the alligator
- Cost containment as overall business production will expand at a faster rate than costs – due to efficiencies especially in alligator ranching
- Whilst Niloticus skin prices will consistently lock in value against the slightly more susceptible and volatile pricing associated with Alligator...

While some agricultural producers are facing tough times, Florida alligator farmers are cashing in on reptile chic — the growing worldwide demand for alligator skins on everything from belts and boots to \$10,000 designer handbags.

"The market for high-end alligator leather products is very strong right now, and farmers are getting top dollar for their gator skins," said Perran Ross, a wildlife ecologist with UF's Institute of Food and Agricultural Sciences. "Florida alligator farming has had its ups and downs in recent years, but it's definitely a good time for those who are already established in the business."

Louisiana is the nation's leading producer, harvesting about 300,000 alligators every year compared to 60,000 in Florida, but Hurricanes Katrina and Rita damaged alligator egg production in Louisiana. As a result, luxury-goods manufacturers in the United States and Europe need to secure future supplies of alligator skins, which is helping Florida farmers who can provide high-quality products.....<http://www.research.ufl.edu/publications/explore/>

The current international trade involves over 1 million crocodylian skins per year, exported legally from about 30 countries. CITES trade records from the [UNEP World Conservation Monitoring Centre \(WCMC\)](http://www.unep.org/wcmc/), and trends in crocodylian skin trade are regularly summarized (eg Caldwell 2007, 2010; see Suggested Reading).

Between 2001 and 2005, international trade averaged 1.2 million skins per year, comprised of 44% classic skins and 56% caiman skins. Between 2006 and 2008, international trade averaged 1.44 million skins (42% classic, 58% caiman). However, trade decreased from a high in 2006 (1.81 million skins), largely due to increased numbers of caiman skins, to pre-2006 levels in 2007 and 2008. More recently, the Global Financial Crisis (2009-2010) resulted in reduced demand for crocodile products generally, although the market for the very highest quality products remained strong. In terms of volume, the main species in international trade (and main producer countries) are *C. niloticus* (Africa), *C. siamensis* (Thailand, Vietnam, Cambodia), *C. porosus* (Australia, Papua New Guinea, Indonesia, Malaysia, Singapore, Thailand), *C. novaeguineae* (Papua New Guinea, Indonesia), *C. acutus* (Colombia, Honduras), *C. moreletii* (Mexico), *C. crocodilus* (Colombia, Bolivia), *C. yacare* (Brazil, Argentina, Bolivia, Paraguay), *C. latirostris* (Argentina) and *A. mississippiensis* (USA).....  
<http://www.iucnscg.org/pages/Farming-and-the-Crocodile-Industry.html>

Louisiana and Florida continue to dominate the industry. The 2011 value of farmed alligator production in Louisiana was estimated at \$38.5 million, up from \$28.7 million in 2010 (LSU Ag Center 2012). Meanwhile, the net sales of alligator hides and meat in Florida fell from a high of almost \$7 million in 2008 to \$2.6 million in 2010

While the number of U.S. farms selling alligator hides has declined, the number of hides sold each year generally increased until exhibiting a steep decline in 2010 and 2011 as a result of low prices and reduced stocking rates in 2008. While the worldwide economic recession was largely to blame for this downturn, some industry observers also cite consolidation within the tanning sector as a downward influence on prices to producers. In either case, the luxury item status of alligator hide products makes them particularly susceptible to market volatility when economic downturns occur.....[http://www.agmrc.org/commodities\\_\\_products](http://www.agmrc.org/commodities__products)

## Breeding



- Breeding usually takes place during the dry season though the exact timing varies with location.

In Zimbabwe and at Padenga mating season is between May-August with egg laying season being Sept – Dec

- The nest is a hole, up to 50 centimetres deep, dug by the female into a sandy bank, several meters from the water.
- Padenga has 5000 breeders at a ratio of 1:7 male to female

## Incubation



Eggs are collected and checked every day at Padenga's breeding Pens. The age of the egg is determined by the bold line around the egg.

- Eggs are collected, examined and packed for incubation . – which is all a very precise and delicate process as temperatures, humidity and air circulation have to be kept well regulated.
- Sex in the Nile crocodile is determined by the temperature at which the eggs are incubated, with females produced below 31 degrees Celsius, and males at above 31 to 34 degrees Celsius.
- Padenga's incubator breeding temperature on average is 32 degrees Celsius - which could be strategy on Padenga's part to rear more males than females.
- The average incubation period is 80 days.

## Hatching



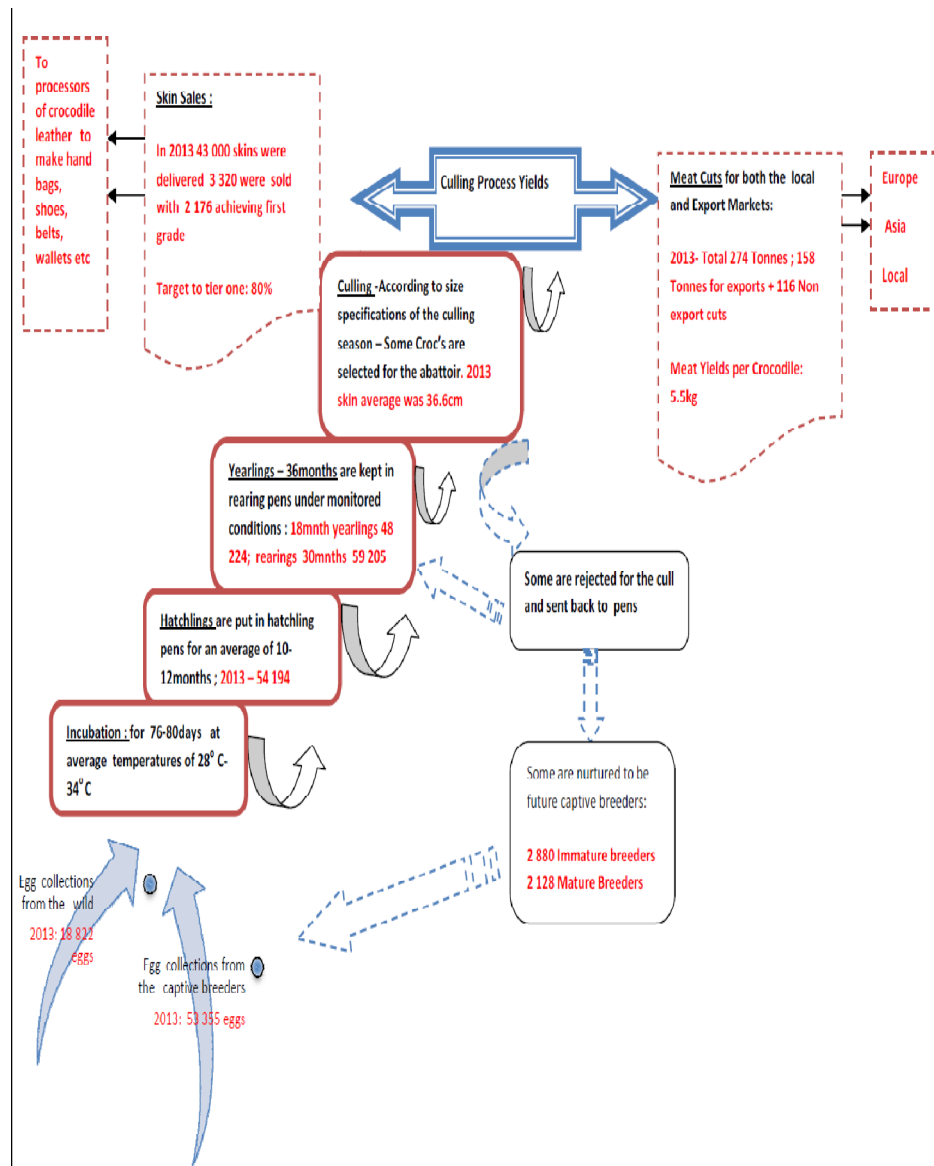
Padenga currently has the capacity to hatch 100 000 eggs.

2013 utilization level achieved was at 72 177 with 55 238 hatchlings being taken to pens.

Hatchlings weigh 72 grams and are 29 cm in length. –Padenga Yields average 90% vs International standards of 80%

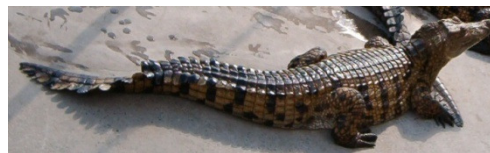
After 24hrs the hatchlings are transferred to Hatchling Farms for the next 10mths- 12mths.

## Operation Flow Chart



Source : FBC Securities Research

## Yearlings – Rearing's (3 years)



grow to about 4.6 cm per month.

- Yearlings - 1- 2 years grow to about 25-28 cm. The rate of growth slows down as crocodiles get bigger. During the first two years the crocodiles

- Rearing for the Nile Crocodiles is done outdoors until crocodiles have reached slaughter size which is normally 1.5 metres in length and at an age of 36 months. Crocodiles are reared under ideal conditions of temperature and humidity

Cleaned skins are salted and stored in a chiller until dispatched.

### The Abattoir



Crocodiles are slaughtered in a registered export crocodile abattoir. The Padenga Abattoir is registered with the Ministry of Agriculture under

the Veterinary Technical Services Department which is the regulatory authority for all meat export facilities within Zimbabwe. These certifications are done annually after inspections to validate compliance to the Produce Export Regulations of 1984 and the Public Health regulations of 1995.

### Slaughtering- culling



Crocodiles to be slaughtered are identified against export grade requirements

The carcass is cut to facilitate drainage of blood and it is washed in potable water to remove blood

The rinsed carcass is transferred to an appropriately chilled room to complete the drainage process by hanging.

### Skinning and Boning

The skin is carefully and safely removed from the carcass to customer and enterprise specifications and productivity requirements, and transferred to the appropriate container



**Meat** is carefully and safely removed from the carcass according to customer and enterprise specifications and productivity requirements. Cuts of meat to be identified

by name are placed in the appropriate container and remaining meat is removed from the skeleton.

Meat is packed, frozen and stored

Identification and traceability of product is maintained according to the enterprise food safety standards.

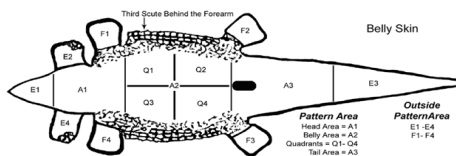


**Skin** is flensed to remove all remaining meat from the skin.

Nile Crocodile information table

Characteristic		Male	Female
Adult body weight	kg	400-500 (max. 900)	150-300 (max. 600)
Hatchling body weight	g		100-110
Adult body length	m	4.0-5.5 (max. 6.1)	3.0-4.0 (max. 5.0)
Hatchling body length	cm		25-30
Total body length (snout to tail end)	cm	109-141	106-138
Age of sexual maturity	years	10-12 (at 3 m body length)	10-12 (at 2-2.25 m body length)
Age of social maturity (1st mating)	years	15-20	10-12
Incubation period	days		90
1st hatchlings born at age	years		11-13
Egg dimensions: length:	cm		7.0-8.0
width:	cm		3.5-4.0
mass:	g		100-120
Number of eggs per clutch	number		25-90 (avg. 45)
Hatchling interval	months		12
Mating season			May-Aug
Egg-laying season			Sep-Dec
Hatchling season			Dec-Mar
Hatchling dispersal age	months		3
Independent at age	months		24 (at 1.2 m body length)
Gender ratio: entire population (natural)		1	1.5
Mating ratio: adults (natural)		4	1
(production)		1	8
Hatchling birth ratio: (temperature dependent)		At incubation of: 30.5 - 34.8 °C	At incubation of: 28 - 31.7 & 34.5 - 36 °C
Maximum lifespan: (natural)	years	70-100	70-100
(in captivity)	years	40-60	40-60
Social order			Gregarious groups (floats)
Home range	km <sup>2</sup>	Undefined	Undefined
Territory range	ha	Varies (2 - 1800)	None
Weekly food consumption (adults)	kg	5-8	4-5
Annual population growth			2%

### Crocodile Skin Grading



Crocodile skins will be graded to the following requirements and are classified as: **Grade #1; Grade #2; Grade #3; Culls**

### Crocodile Skin Quality Requirements :

Each grade will be based upon the following in order of priority:

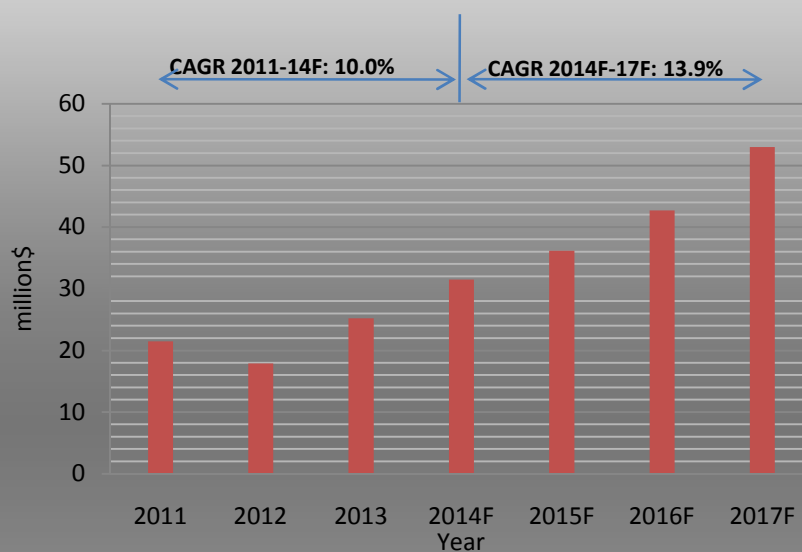
1. Scars, scratches, scale slip, subcutaneous blemishes, cuts and holes.
2. Size
3. Condition or preservation of the skin
4. Shape of skin
5. Proficiency of skinning and fleshing.

## Padenga's Financial Profile

### STRONG REVENUE GROWTH

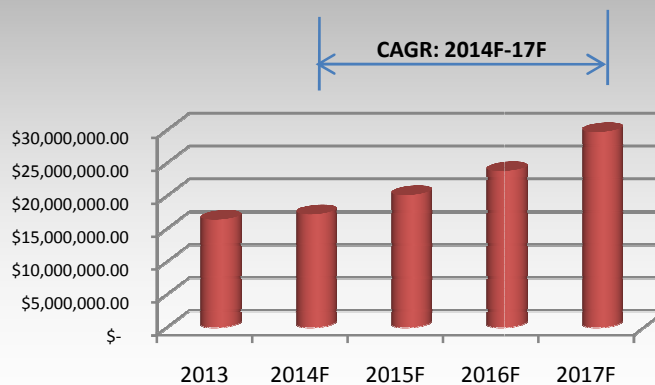
.....Recorded an impressive growth in revenues since 2011, growing at a CAGR of 5.4% in the period between FY2011-13.....

- Padenga recorded an impressive growth in revenues since 2011, growing at a CAGR of 5.4% in the period between FY2011-13. In the period under review, using normalised expenses, the group grew revenue by 41% from US\$17.9m in FY12 to US\$25.2m in FY13 aback improved skin quantities and quality. We have forecasted revenues to grow by a CAGR of 20.43% in the period between FY13-17 due to price hike linked to continued emphasis on improved skin quality and size as management reckoned that large and quality skins sell at a premium of 25%.



Source: Company Reports and own estimates

- Operating Costs Profile:** We have forecasted operating costs to increase marginally to ~\$17.2m from \$16.4m stirred by efforts to enhance skin quality and to increase output to 50 000 premium quality skins.



Source: Company Reports and Own estimates

.....The discord in Revenue and Profit growth was largely attributable to the extra US\$4.367 in costs unmatched by revenues, done to realign reporting periods to designed culling patterns.....

- Operating profit for the period was at US\$5.75 million while PAT was at US\$4.92 million against Operating profit of US\$5.38 million and PAT of US\$4.61 million in prior period. The discord in Revenue and Profit growth is largely attributable to the extra US\$4.367 in costs unmatched by revenues, done to realign reporting periods to designed culling patterns; adjusted EBITDA and PAT would have been US\$8.4 million and US\$8.3 million respectively.

#### Nile Operations (Zimbabwe)

- Price Premium on quality attained (first grade skins up from 84% to 92%) as well as improved volumes (in line with target at 43 thousand) sustained a 29% increase in turnover to US\$23.1 mil from US\$17.9 in the prior year. The 8% room for quality improvement translates into realizable value of up to US\$1.2 million (25% premium on price). With supply target of 50 thousand premium quality skins there is a 16.3% upside potential in volumes at first grade quality of above 91%.
- The Nile crocodile division still forms the greatest chunk of Padenga's portfolio with revenue contribution of 83% of the total US\$26.95 million. Focus going forth will be on achieving target production of fifty thousand skins at first grade quality. **Prospects.** *Target 80% onward sale to the 1<sup>st</sup> tier market; Seek upwards price adjustments basing on improved skin quality ;Strategic reduction of costs through borrowing transferable technologies and techniques from USA and reducing crocodile growing period by ending culling in October.*

#### Alligator (USA) operations

- The use of technology has seen the least cost combination of production factors to sustain higher margins, with a 3 person labour force generating production capacity of 20 000 targeted for 2014. Total skins produced for the year were 24% lower than last time as 2400 alligators were carried into 2014 in efforts to increase the skin size and fetch a higher price. Production volumes were up 375% to 19 309 hatchlings in bans.
- Exciting developments in USA include: Commissioned skinning plant in Delcambre Louisiana Texas, Commissioned meat processing plant in Winnie, Natural captive breeder project with capacity to produce 20 000 hatchlings per annum.
- Prospects include:** *More than double Alligator skin production and increase skin size to medium size, Increase throughput in skinning and meat processing plant, Increase breeder heads through increased domestic egg production, and Improve skin quality to first grade and size to medium sized skins that fetch higher prices*

## Padenga: Valuation-Discounted Cash Flow

### DISCOUNTED FREE CASH FLOW TO THE FIRM

Valuation Date 29 April 2014  
 Next Reporting Date 31 Dec 2014

### MODEL PARAMETERS

Capital Structure: -Debt 34%  
 -Equity 66%  
 Risk Free Rate 6.0%  
 Beta 0.84  
 Growth in Free Cash flows 2.5%  
 Equity Risk Premium 16%  
 Country Risk Premium 0.5%  
 Cost of Equity 19.9%  
 Cost of debt 16%  
 WACC 17.2%

### TERMINAL GROWTH

Long term growth GDP growth rate 3.5%  
 Long term Inflation growth rate 2.5%

### DISCOUNTED CASH FLOW MODEL (\$m)

	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17
Sales	25.2	31.50	36.20	42.70	53.0
EBIT	9.0	14.30	16.30	19.20	23.60
Income Taxes	2.1	3.40	3.90	4.70	5.80
Amortization and Depreciation	1.5	2.10	2.20	2.60	3.20
Intrest Payments	0.8	1.00	0.90	0.80	0.80
Gross Operating Cashflows	7.8	12.30	13.90	16.50	20.40
(+) /- Change in Net Working capital		(0.20)	-0.30	(0.30)	(0.30)
Investments in Fixed Assets		3.50	4.20	3.80	4.30
Net Borrowings					
Free Cash flow to Equity (FCFE)		8.60	9.50	12.50	15.80
Free Cash flow to Firm (FCFF)		9.30	10.20	13.10	16.40
Present values FCFE: Equity		8.60	9.50	12.50	15.80
Present values FCFE: Firm		9.30	10.20	13.10	16.40
Total Present Values: Equity Pespective		64.40			
Total Present Values: Firm Wide Pespective		67.50			
Terminal Value FCFE: Equity		42.60			
Terminal Value FCFE: Firm		58.00			
Value of Operating Business		107.00	125.50		
(+) Cash and Csh Equivalents		11.10	11.10		
(-) Financial debt		14.30	14.30		
Fair Market value of the firm		103.80	122.30		
Number of Outstanding shares		541,593,440	541,593,440		
Fair Value per share (US Cents)		19.17	22.59		

KE (Cost of Equ	Terminal Growth (FCF)				
	1.0%	2.0%	2.5%	4.0%	5.0%
13.8%	19.42	20.53	21.16	23.38	25.25
15.8%	15.33	15.99	16.35	17.6	18.6
17.2%	13.18	13.65	13.91	14.78	15.45
18.2%	12.06	12.45	12.66	13.36	13.89
19.2%	11.04	11.36	11.53	12.1	12.53



## Padenga: Valuation –Relative

	P/E (+1)	PEG Ratio (+1)	P/NAV	EV/EBITDA
EMERGING MARKETS AVERAGE	22.34	0.85	1.50	6.50
PADENGA HOLDINGS LIMITED	4.04	0.14	1.05	4.33

VALUATION	P/E	PE/G	P/NAV	EV/EBITDA
FAIR VALUE PER SHARE	39.28	42.78	10.11	12.59
UPSIDE POTENTIAL	453.27%	502%	42.3%	77.3%
WEIGHTING	25%	25%	25%	25%
FAIR MARKET VALUE PER SHARE-WEIGHTED	26.19			
Weighted Upside Potential	269%			

- In the interest of fair value determination, our peer group pool is composed of Emerging market Crocodile Products based companies operating in markets that exhibit stable macroeconomic fundamentals which are a proxy for fairly valued markets. Peer group technique yielded a weighted fair market value of US26.19 cents, implying an upside potential of 269% on current price of US7.1 cents.

## Padenga: Valuation-Weighted Average Fair Value

Incorporating new information with regards the Crocodile Industry and Market dynamics that have been brought to our attention we updated our Valuation incorporating the following Valuation Dynamics

Discounted Free Cash Flow Model (DCF Model);

- PER relative multiple;
- P/NAV multiple;
- PEG Ration as well,
- EV/EBITDA multiple.

### Valuation Summary

	Padenga	Peer Group Average	Upside Potential	Target Price/ Fair Value	Weighting	Price Portion
PE (Emerging Markets)	4.04	22.34	↑	453%	39.28	10%
PEG (Emerging Markets)	0.14	0.85	↑	502%	42.78	10%
P/NAV (Local Market)	1.05	1.50	↑	42%	10.11	25%
EV/EBITDA (Emerging Market)	4.33	6.50	↑	50%	10.67	25%
DCF Model (FCFE)			↑	170.0%	19.17	30%
<i>Market Specific Risk Discount</i>	<b>35%</b>					
Target Price (US Cents)	<b>12.45</b>					
Upside Potential	<b>75.30%</b>					

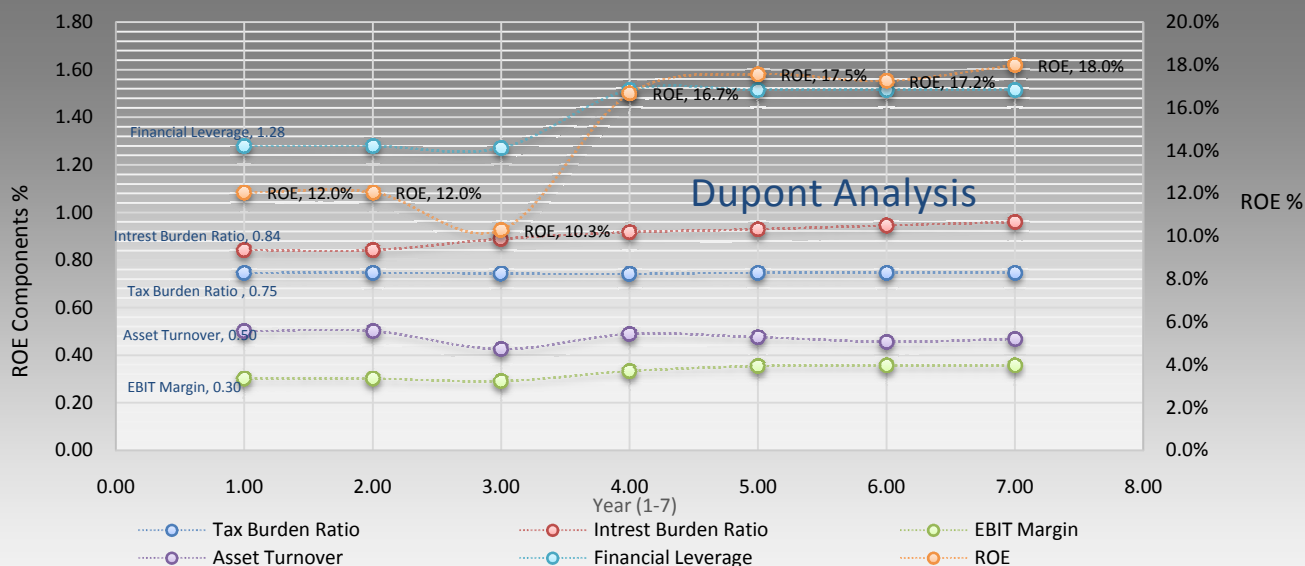
- Overall, in attaining a leading fair value, we have given a 30% weighting to the Discounted Cash Flow model in light of the conviction that the analysts have with regards its information content and depth and that the projections specific to the company's top line are feasible in the respective years attributed to the company's sustainable business model. Furthermore, the model has more information value as it does not focus only on current single year earnings profile that is 2012, but also caters for future growth opportunities for the firm and the industry in the ensuing years.
- For a comprehensive all incorporating valuation, 70% weighting was given to the relative valuation methodologies; P/NAV (local market), EV/EBITDA, PEG (Emerging market) and PER (Emerging markets) in the split of 25%, 25%, 10% and 10% respectively. Having done that, the final fair value per share for Padenga was calculated at **US12.45 cents**, implying an upside potential of **75.3%** on the current price.

## Static Valuation and Present Value from Growth

	Price Portion	Weighting
Static Value per share (US Cents)	10.2	144%
PVGO (US Cents)	-3.1	-44%
Conclusion	<b>Under or Fairly Valued</b>	
<i>Rule of thumb: Static Value has to be at least 60% of Share Price and PVGO at most 40% for a conservative Valuation</i>		

- To enhance justification of our valuation of Padenga we further modelled a Static and Present Value from Growth Opportunities model(PVGO). Turning on the PVGO methodology, the Static no growth valuation reflects undervaluation as the current earnings profile (without growth) is not fully reflected in current price: current earnings warrant 144% of the current price is determined by the current earnings profile, The present value of Future Growth Opportunities is not incorporated in the current price despite the encouraging prospects brought about by the sustainable Business Model and Developments in the Alligator Business( At current pricing PVGO has negative weighting of -44% against standard benchmark of 40%. The going concern status and High earnings sustainability capacity convinced us to maintain our **Strong BUY** recommendation.

## DuPont Analysis



- Increased financial leverage which consequently shouldered a higher interest burden ratio as the group utilised cheaper facilities supported an increase in ROE. This however was slightly offset by a reduction in asset turnover as inventory levels increased to absorb shocks in input source markets. An improved EBIT margin from improved margins also supported growth in ROE.

## Key Risks to Our Valuation

- **Sensitivity and susceptibility of biological Assets to disease outbreak:** Biological Assets are prone to disease outbreak from both human interaction and feed inputs or the natural environment, despite the rigorous counter measures adopted by the crocodile farmer, there still remains credible potential for disease outbreak that could compromise skin quality and in turn revenues
- **High labour intensity exposes the process flow to the risk of Human error on the Nile crocodile Operation:** The Model relies heavily on human intervention at various stages of the process flow with most of the activities done manually with little sophistication in the form of automation. This scenario exposes Padenga to losses arising from human error at the various stages of the process flow, e.g Incubation, breeding, culling and or skinning. Grading is very sensitive skin quality, the highest degree of precision is required to ensure intended skin quality as a single mark could render the skin of lower quality.
- **Concentrated demand for premium quality skins limits the seller's bargaining power:** There are 8 tanneries that buy premium crocodile skins and 4 of which are controlled by a single holding company, Padenga sells all its skins to a single tanner in which case market switching cost can be high due to the positioning that is required to capture and service a particular niche market. Price adjustments are heavily subject to the discretion of the single buyer.
- **Local operating environment risks:** Escalating apprehension in the local environment as economic fundamentals continue trending southwards coupled with the potential for labour market unrests could disrupt operations due to external factors within the local environment while intensified political efforts and tensions with the international community particularly the United States could compromise foreign relationships and operations.
- **Increase in Working Capital management related costs:** Inventory holding costs are set to increase as Padenga seeks to evade stock outs stemming from labour market action and related supply disruptions. As South Africa embarks on political processes (Elections in May)and given the recent labour market unrest that has been precedent its prudent to stock more feeds than the usual Inventory holding levels as lead time may increase with disruptions in key source markets.

## Padenga: Financial Forecasts

### Income statement

	Dec-13	est Dec-14	est Dec-15	est Dec-16	est Dec-17
Total Revenue (Sales)	\$ 25,180,171.00	\$ 31,475,213.75	\$ 36,196,495.81	\$ 42,711,865.06	\$ 52,962,712.67
Total Expenses	\$ 16,374,225.00	\$ 17,192,936.25	\$ 20,099,361.19	\$ 23,754,906.92	\$ 29,689,744.77
EBITDA	\$ 10,491,740.00	\$ 16,389,520.00	\$ 18,520,463.50	\$ 21,816,486.21	\$ 26,818,782.71
Other Income	\$ 1,685,794.00	\$ 2,107,242.50	\$ 2,423,328.88	\$ 2,859,528.07	\$ 3,545,814.81
Depreciation and Amortization	\$ 1,535,557.00	\$ 2,073,001.95	\$ 2,207,363.19	\$ 2,604,688.56	\$ 3,229,813.82
EBIT	\$ 8,956,183.00	\$ 14,316,518.05	\$ 16,313,100.31	\$ 19,211,797.65	\$ 23,588,968.90
Interest Charge	\$ 750,459.00	\$ 975,596.70	\$ 926,816.87	\$ 848,769.13	\$ 770,721.39
EBT	\$ 8,205,724.00	\$ 13,340,921.35	\$ 15,386,283.45	\$ 18,363,028.52	\$ 22,818,247.50
Tax expense p	\$ 2,127,689.00	\$ 3,396,598.58	\$ 3,917,347.77	\$ 4,675,227.06	\$ 5,809,525.81
Net Income	\$ 6,078,035.00	\$ 9,944,322.77	\$ 11,468,935.68	\$ 13,687,801.46	\$ 17,008,721.69
EPS US Cents	1.07	1.76	2.12	2.53	3.14

### Balance Sheet

	Dec-13	est Dec-14	est Dec-15	est Dec-16	est Dec-17
Assets	\$ 55,239,019.00	\$ 66,286,822.80	\$ 79,544,187.36	\$ 91,475,815.46	\$ 105,197,187.78
Fixed Assets	\$ 17,436,827.00	\$ 20,924,192.40	\$ 25,109,030.88	\$ 28,875,385.51	\$ 33,206,693.34
Current Assets	\$ 37,802,192.00	\$ 45,362,630.40	\$ 54,435,156.48	\$ 62,600,429.95	\$ 71,990,494.44
Total Assets	\$ 55,239,019.00	\$ 66,286,822.80	\$ 79,544,187.36	\$ 91,475,815.46	\$ 105,197,187.78
Equity and Liabilities					
Capital and Reserves	\$ 36,490,448.00	\$ 43,788,537.60	\$ 52,546,245.12	\$ 60,428,181.89	\$ 69,492,409.17
Non Current liabilities	\$ 5,521,886.00	\$ 6,626,263.20	\$ 7,951,515.84	\$ 9,144,243.22	\$ 10,515,879.70
Current liabilities	\$ 13,226,686.00	\$ 15,872,023.20	\$ 19,046,427.84	\$ 21,903,392.02	\$ 25,188,900.82
Total Liabilities	\$ 18,748,571.00	\$ 22,498,286.40	\$ 26,997,943.68	\$ 31,047,635.23	\$ 35,704,780.52
Total equity and Liabilities	\$ 55,239,019.00	\$ 66,286,824.00	\$ 79,544,188.80	\$ 91,475,817.12	\$ 105,197,189.69

## Ratio Analysis

		est	est	est	est	est
	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18
EBITDA Margin	35.6%	45.5%	45.1%	45.0%	44.5%	45.6%
Pretax Margin (EBIT) Margin	32.6%	42.4%	42.5%	43.0%	43.1%	44.4%
Net profit margin	24.1%	31.6%	31.7%	32.0%	32.1%	33.1%
Return on Assets	11.8%	16.4%	15.7%	16.0%	17.3%	17.4%
Return on Equity	26.3%	24.8%	23.8%	24.2%	26.2%	26.3%
Return on Total Capital	19.5%	27.0%	25.4%	25.2%	26.4%	25.8%
Earnings per Share (US Cents)	1.07	1.76	2.12	2.53	3.14	3.63
Book Value per Share	0.10	0.12	0.15	0.17	0.19	0.22
Working Capital Turnover	1.31	1.16	1.12	1.12	1.21	1.18
Fixed Assets Turnover	1.19	1.64	1.57	1.58	1.71	1.66
Total assets Turnover	0.49	0.52	0.50	0.50	0.54	0.52
Current Ratio	2.86	2.86	2.86	2.86	2.86	2.86
Debt to assets ratio	0.21	0.22	0.22	0.24	0.26	0.27
Debt to Equity	0.32	0.33	0.34	0.36	0.39	0.42
Debt to Capital	0.28	0.28	0.29	0.31	0.34	0.36
Financial Leverage Ratio	<b>1.51</b>	<b>1.51</b>	<b>1.51</b>	<b>1.51</b>	<b>1.51</b>	<b>1.51</b>
Intrest Coverage	11.93	14.67	17.60	22.63	30.61	39.03
P/Earnings	6.61	4.04	3.35	2.81	2.26	1.96
PEG Ratio	0.00	14.11	11.71	9.82	7.90	6.84

## Padenga : Earnings Quality Test-Accruals

	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
Net Operating Assets	\$ 19,806,047.00	\$ 29,899,657.00	\$ 309,631.00	\$ 14,662,807.00	\$ 18,387,536.24	\$ 22,861,349.26	\$ 25,592,557.02
Accruals Component		\$ 10,093,610.00	\$ (29,590,026.00)	\$ 14,353,176.00	\$ 3,724,729.24	\$ 4,473,813.02	\$ 2,731,207.76
Accruals Ratio		41%	-196%	192%	23%	22%	11%

*NB\* Increasing Accruals ratio indicates a deterioration in the quality of earnings from one period to the next.*

- Despite the suppressed book value of physical Assets, Padenga has not revalued its Assets, its revenue recognition is not aggressive and accruals based earnings form a small fraction of earnings, showcasing good quality earnings that can be sustained into the foreseeable future. In the ensuing years we project the accruals component of earnings moderating to sustainable levels averaging 19% with the increasing quality and size of skins that sell at 25% premium.

## Relevance of Padenga in Luxury branded goods

- High end luxury goods and accessories markets have since pre historic times always found their place in societies and economies and still form a large part of today's global economy and society. The Market for Expensive luxury goods like clothing and Art will always be there and in most cases tends to be immune or inelastic to general economic slowdown. Padenga has its place among the service and product providers to the luxury end markets and will remain a crucial part of the supply chain in luxury branded goods for the foreseeable future.

## In Conclusion

- The business model is supported by sustainable demand with capacity to absorb Padenga's products at full capacity. Demand for luxury branded goods is expected to more than double within the next decade. With sales for the company confined to a single buyer, efforts to expand output will be fully complimented by existing capacity.
- Immunity to local economic apprehension: This positions the company outside the spectrum of companies whose fortunes are tied to the local economic environment thereby increasing desirability relative to other local listed companies thus facilitating convergence to fair market valuation.
- The present value of growth opportunity in the case of Padenga is significant; higher margins in the alligator business present opportunities for wider margins for the group going forward as expansion in that front requires minimum capital while at the same time bearing higher yields.

As its name resounds, ' Padenga,' surely the Group is indeed placed at a high level.

**The End**

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