Dangote Cement Plc

PAC Holdings
RC254413
| A PROPRIETARY INVESTMENT COMPANY |

Higher Tax provision Impacts Impressive Operating Performance

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Price:	
- Current	**₦204.90**
- Target	**₦239.94**
Recommendation:	**BUY**

** As at Friday November 2, 2018*

INVESTMENT SUMMARY

Dangote Cement Plc reported another impressive performance in its core operating activities in the nine-month to September 2018 reports as revenue increased by 13.54% to ₦685.29 billion (vs. ₦603.58 billion in nine-month to September 2017). The improvement in the revenue can be attributed to increase in the group volume, mainly driven by increased volume in Nigerian operation while the total volume in Pan-African operations (i.e. other African nations except Nigeria) remained flat. From the company's cement capacity of 45.55 million tonnes per annum across Africa, a total of 17.77 million tonnes was produced in 9M'18 (vs. 16.51 million tonnes produced in 9M'17). During the period, production cost of sales rose by 10.71% to ₦287.68 billion (vs. ₦259.85 billion in 9M'17). The increase in manufacturing costs was driven by increased production volumes in Nigeria, as well as foreign exchange impact when converting Pan-African costs from local currency to Naira. Impressively, the company reduced the cost margins to 41.98% in 9M'18, from 43.05% reported in 9M'17. Consequently, gross profit of the company improved by 15.68% to ₦397.61 billion in 9M'18 (vs. ₦343.72 billion in 9M'17).

The company's profit before tax increased by 12.35% to ₦247.36 billion in 9M'18 (vs. ₦220.18 billion in 9M'17). However, high provision for tax continues to weigh on performance as the company made a provision of ₦89.09 billion for tax in 9M'18 (vs. ₦66.06 billion in 9M'17). As a result, profit after tax increased by 2.70% to ₦158.28 billion in 9M'18 (vs. ₦154.12 billion 9M'17). We are impressed with company's 12-month trailing EPS as it increased to ₦12.23, from ₦9.59 recorded in the previous period. However, the management confirmed that they are expecting pioneer tax certificate from the government in few weeks to enable the company enjoy tax concession. As a result, we upgrade our target price per share to ₦239.94 (Previous Target Price: ₦217.12) and we also upgrade our recommendation to a **BUY** on the company shares.

Fig. 1: Quarterly results highlights

	3Q2018	2Q2018	3Q2017	Q/q Δ	Y/y Δ
Revenue (₦'mn)	202,851	240,323	190,899	-15.59%	+6.26%
Op. Profit (₦'mn)	66,343	96,730	69,641	-31.41%	-4.74%
Net profit (₦'mn)	45,113	41,041	44,409	+9.92%	+1.59%

Source: NSE, Bloomberg, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-10.91%/-8.53%
52-week range	₦199.90 - ₦290.00
30-day Average vol.	946,364
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	3,459.22
EPS (₦) - 12months trailing	12.23
DPS (₦) - FY2017	10.50

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	9M'18	9M'17
Gross profit margin	58.02%	56.95%
Net profit margin	23.10%	25.53%
Equity multiplier	2.17x	1.90x
Asset turnover	0.40x	0.37x

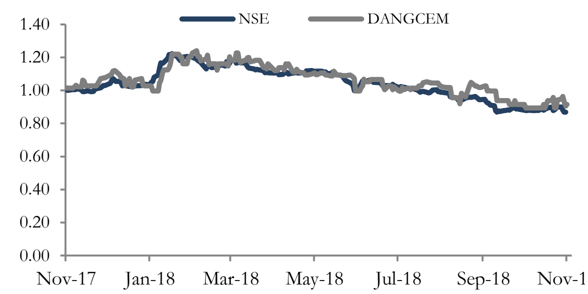
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018E	FY2019E
P/E	24.44	17.09x	14.30x	11.61x
P/B	4.81x	4.47x	4.43x	4.40x
Div Yield (%)	4.15	5.12	5.61	6.10
Pay-out Ratio	101.39%	87.60%	80.26%	70.10%
EV/EBITDA	14.60x	9.57x	8.36x	7.26x
Ev/Revenue	6.09	4.61	4.14	6.37
Sales Per Share	36.10	47.27	52.57	59.40
P/S Ratio	5.68	4.33	3.90	3.45

Source: NSE, PAC Research

Fig. 5: DANGCEM vs NSE, 52-wk Movement (Rebased)



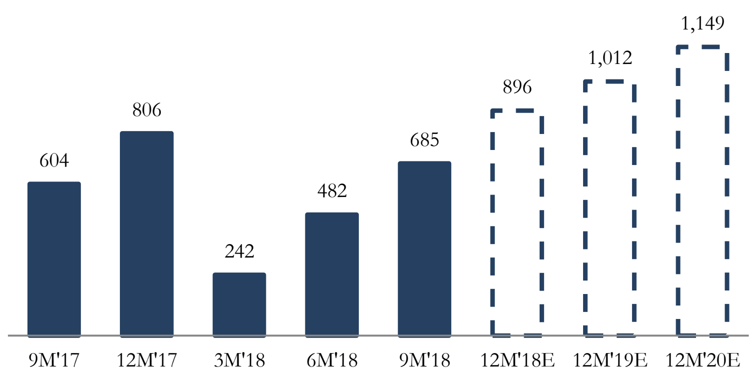
Source: Bloomberg, PAC Research

Revenue increased by 13.54% YoY, driven by high volume in Nigeria operation and foreign exchange gains

The company reported an impressive performance in its top-line as revenue increase by 13.54% to ₦685.29 billion in 9M'18, from ₦685.29 billion in 9M'17. The improvement in revenue can be attributed to the improved group volumes, particularly from Nigerian operation and better per-tonne prices in Pan-African operations, mainly as a result of foreign exchange gains when converting the sales from local currencies into Naira. Sales volume in Nigeria increased by 11.7% to 10.76 million tonnes in 9M'18 (vs. 9.63 million tonnes reported in 9M'17), due to strong market growth in August 2018. However, Nigerian sales were partly affected by serious flooding in September 2018. Meanwhile, sales volume in Pan-African operations was almost flat at 7.03 million tonnes in 9M'18 (9M'17: 7.02 million tonnes), due to production shutdown in Tanzania, disruption in Ethiopia and lower sales in Ghana. The development in sales volume in Nigeria reflected in its revenue as it increased by 13.3% to ₦471.33 billion in 9M'18 (vs. ₦416.11 billion achieved in 9M'17). In addition, revenue in Pan-African operations increased by 11.7% to ₦214.31 billion in 9M'18 (vs. ₦191.85 billion in 9M'17). Although, the sales volume in Pan-African operations remains flat, the better per-tonne prices when Pan-African revenue is converted to Naira led to improvement in the top-line. The average per-tonne price for Pan-African operations increased from ₦27,322 to ₦30,502, mainly as a result of changes in the exchange rate.

Although, the sales volume in Pan-African operations remains flat, the better per-tonne prices when Pan-African revenue is converted to Naira led to improvement in the top-line.

Fig. 6: Revenue - 9M'17-12M'20E (Billion NGN)



Source: NSE, Bloomberg, PAC Research

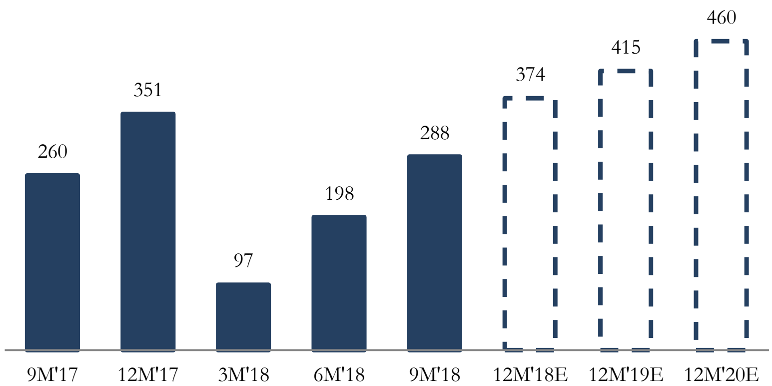
Manufacturing costs increased by 10.71% YoY, due to increased volumes in Nigeria and FX impact on Pan African operations

During the period under review, the manufacturing costs rose by 10.71% to ₦287.68 billion (vs. ₦259.85 billion in 9M'17). The rise in manufacturing costs can be attributed to increased production volumes in Nigeria as well as the foreign exchange impact when converting Pan-African costs from local currencies to Naira.

In Nigeria, manufacturing costs increased by 6.1% to ₦129.3 billion in 9M'18, from ₦121.8 billion reported in 9M'17 and this was in line with the increased volume sold during the period. In Pan-African operation, manufacturing costs increased by 14.7% to ₦158.4 billion in 9M'18 (vs. ₦138.05 billion recorded in 9M'17), due to foreign exchange impact. The average exchange rate during the period was ₦344/$1, compared to an average of ₦314/$1 in the corresponding previous period. Overall, material consumption and fuel & power consumption remains the largest contributor to manufacturing cost of sales as they contributed 32.15% (vs. 9M'17: 33.71%) and 32.46% (vs. 9M'17: 32.70%) respectively.

The average exchange rate during the period was ₦344/$1, compared to an average of ₦314/$1 in the corresponding previous period.

Fig. 7: Production Cost of Sales - 9M'17-12M'20E (Billion NGN)



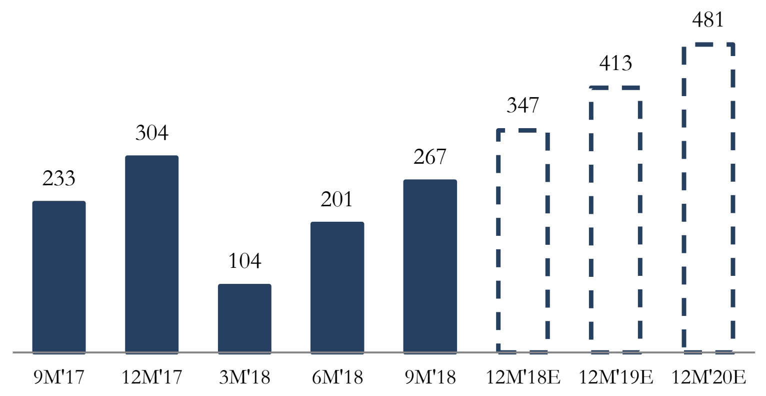
Source: NSE, Bloomberg, PAC Research

Improved gross profit and proper operating expenses management lift operating profit

In nine-month to September 2018, gross profit of the company strengthened by 15.68% to ₦397.61 billion, from ₦343.72 billion reported in the nine-month to September 2017. Administrative expenses increased by 16.65% to ₦38.11 billion in 9M'18 (vs. ₦32.67 billion in 9M'17) while selling and distribution expenses increased by 20.20% to ₦97.15 billion in 9M'18 (vs. ₦80.82 billion in 9M'17). However, the increase in total selling and administrative expenses resulted from increased volumes in Nigeria and exchange rate impact in converting Pan-African costs. Associated selling & distribution costs in Nigerian operation increased by 25.2% to ₦63.4 billion in 9M'18 (vs. ₦50.6 billion in 9M'17). Pan-African administrative and selling costs rose by 11.8 to ₦33.7 billion in 9M'18 (vs. ₦30.2 billion in 9M'17), due to exchange rate, which average ₦344/$1 in 9M'18 (vs. ₦314/$1 in 9M'17) Consequently, operating profit increased by 14.46% to ₦266.86 billion in 9M'18 (vs. ₦233.14 billion in 9M'17).

However, the increase in total selling and administrative expenses resulted from increased volumes in Nigeria and exchange rate impact in converting Pan-African costs

Fig. 8: Operating Profit - 9M'17-12M'20E (Billion NGN)



Source: NSE, Bloomberg, PAC Research

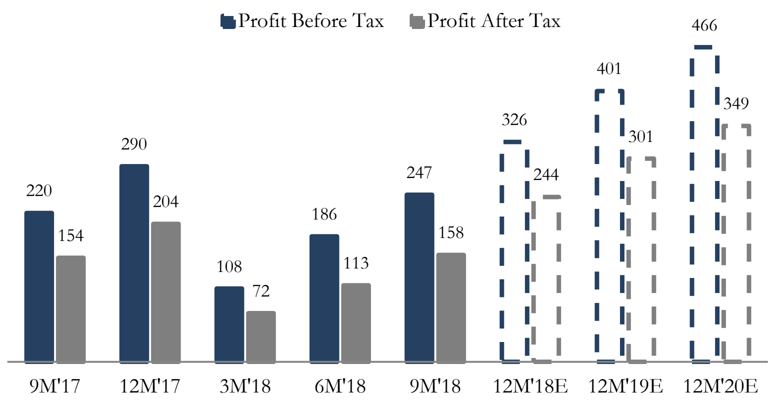
Profitability strengthened by higher volume in Nigeria and improved average prices when converting Pan-African sales to Naira

The impressive performance of the company in its operating activities dominated the unimpressive performance from non-operating activities which came from finance income and finance cost. Finance income dropped by 60.61% to ₦10.62 billion in 9M'18 (vs. ₦26.96 billion reported in 9M'17) while finance costs increased by 24.56% to ₦30.12 billion in 9M'18 (vs. ₦39.92 billion in 9M'17). The unimpressive performance of the finance income can be attributed to significant exchange losses in Pan-African operations. With higher volume in Nigeria and improved average prices in Pan-African operation, when converting from local currencies to Naira, profit before tax rose by 12.35% to ₦247.36 billion in 9M'18 (vs. ₦220.18 billion reported in 9M'17).

With higher volume in Nigeria and improved average prices in Pan-African operation, when converting from local currencies to Naira, profit before tax rose by 12.35% to ₦247.36 billion

However, the company made adequate provision for tax in the 9M'18 as the company await the pioneer tax certificate from the government to enable her enjoy tax concession. A provision of ₦89.09 billion was made for tax in 9M'18, representing an increase of 34.86% (9M'17: ₦66.06 billion). Although the effective tax rate for Nigerian operations was 28.4% during the first nine months of 2018, the group's effective tax rate was higher at 36.0% mainly because of start-up subsidiaries making losses that reduced the group's profit without any tax benefits for those losses. The effects of higher tax provision weighed on bottom-line as profit after tax struggled to improve by 2.70% to ₦158.28 billion in 9M'18, from ₦158.28 billion published in FY'17. However, we are impressed with the company's 12-month trailing EPS as it increased to ₦12.23, from ₦9.59 recorded in the previous period.

Fig. 9: Profit before Tax and Profit after Tax - 9M'17-12M'20E (Billion NGN)



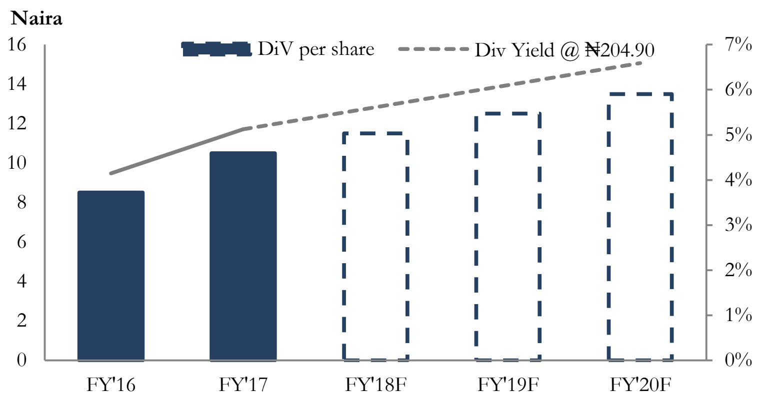
Source: NSE, Bloomberg, PAC Research

Balance sheet remains solid: Improved dividend payment is expected in FY'18

During the nine-month to September 2018, total current assets of the company increased by 18.20% to ₦431.11 billion (vs. ₦364.72 billion reported in nine-month to September 2017) while total non-current assets diminished by 1.28% to ₦1.26 trillion in 9M'18 (vs. ₦1.28 trillion reported in 9M'17). The decrease in non-current assets was mainly driven by the decline in fixed assets (9M'18: ₦1.18 trillion vs. 9M'17: ₦1.20 trillion). However, all the variables under current assets improved, except prepayment and other current assets. The improvement achieved in total current assets overshadowed the decline in non-current assets and as a result, total assets rose by 3.04% to ₦1.70 trillion in 9M'18 (vs. ₦1.65 trillion in 9M'17). Meanwhile, total liabilities increased by 16.84% to ₦913.31 billion in 9M'18 (vs. ₦781.69 billion reported in 9M'17). As a result, the net assets of the company declined by 9.45% to ₦782.28 billion in 9M'18, from ₦863.87 billion reported in 9M'17 while the Net Asset Value Per Share of the company reduced to ₦45.91 in 9M'18(vs. ₦50.70 in 9M'17).

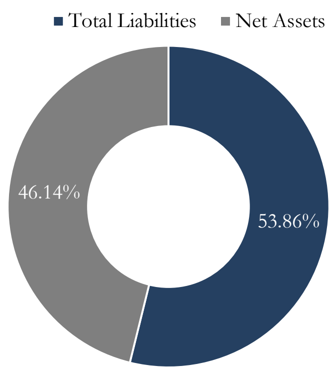
The improvement achieved in total current assets overshadowed the decline in non-current assets and as a result, total assets rose by 3.04% to ₦1.70 trillion in 9M'18…

Fig. 10: Dividend Per Share and Dividend Yield (FY'16-FY'20F)



Source: NSE, PAC Research

Fig. 11: Total Liabilities Vs Net Asset in 9M'18



Source: NSE, Bloomberg, PAC Research

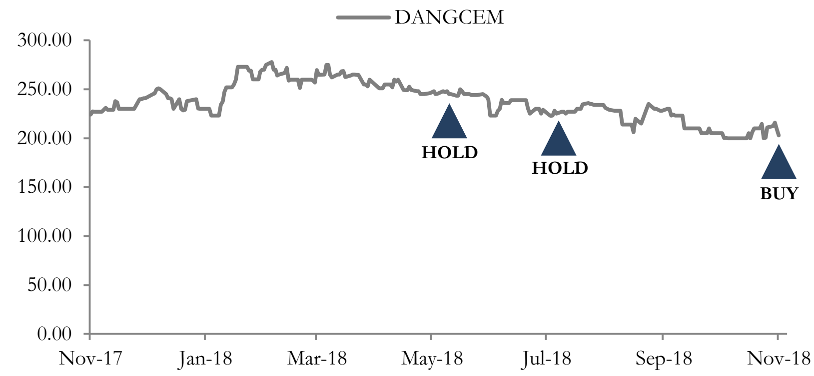
Valuation

Our valuation puts the target price of the stock at ₦239.94 representing a decline of 17.10%, from the current price of ₦204.90. In arriving at the target price, we employed Discounted Cash flow Valuation methodology. Consequently, we maintained a **BUY** recommendation on the stock of the company.

Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company, the performance of the company in the cement industry and expectation of tax concession.

Our valuation puts the target price of the stock at N239.94 representing a decline of 17.10%, from the current price of N204.90.

Fig. 12: Share Price History



Source: NSE, PAC Research

Fig. 13: Statement of Profit or Loss, N'mn

	2016	2017	2018E	2019E
Revenue	615,103	805,582	895,807	1,012,262
Change		*30.97%*	*11.20%*	*13.00%*
Cost of Sales	(323,816)	(351,290)	(374,447)	(415,027)
Change		*8.48%*	*6.59%*	*10.84%*
Gross Profit	291,287	454,292	521,360	597,235
Change		*55.96%*	*14.76%*	*14.55%*
SG&A	(119,336)	(155,297)	(180,953)	(192,330)
Change		*30.13%*	*16.52%*	*6.29%*
Other Income	10,542	5,213	6,539	8,098
Change		*-50.55%*	*25.44%*	*23.84%*
Operating profit	182,493	304,208	346,946	413,003
Change		*66.70%*	*14.05%*	*19.04%*
Finance Income	43,817	35,926	20,604	30,368
Change		*-18.01%*	*-42.65%*	*47.39%*
Finance Cost	(45,381)	(52,711)	(42,015)	(42,406)
Change		*16.15%*	*-20.29%*	*0.93%*
Profit Before Taxation	180,929	289,590	325,534	400,965
Change		*60.06%*	*12.41%*	*23.17%*
Taxation	(38,071)	(85,342)	(81,384)	(100,241)
Change		*124.17%*	*-4.64%*	*23.17%*
Profit After Taxation	142,858	204,248	244,151	300,723
Change		*42.97%*	*19.54%*	*23.17%*

Fig. 14: Statement of Financial Position, N'mn

	2016	2017	2018E	2019E
Fixed Assets	1,155,711	1,192,140	1,164,549	1,153,979
Intangible assets	4,145	6,355	6,037	6,821
Deffered tax assets	51,306	30,625	43,715	49,398
Inventories	82,903	94,594	96,926	109,527
Trade and other recievables	26,279	30,155	38,272	43,247
Bank and Cash Balances	115,693	168,387	161,245	167,023
Total current assets	303,164	410,299	430,827	466,893
Total Assets	1,529,104	1,665,883	1,674,096	1,708,965
Trade and other payables	268,966	270,721	241,868	232,820
Current tax payable	18,220	63,901	69,873	78,956
Financial debt	220,300	144,783	197,078	192,330
Other current liabilities	18,307	41,071	38,968	44,033
Total current liabilities	525,793	520,476	547,786	548,140
Deferred tax liabilities	103,162	116,898	152,287	156,901
Net Assets	725,528	781,360	788,430	794,205

Fig. 15: Profitability Ratio

	2016	2017	2018E	2019E
Return on Equity	19.69%	26.14%	30.97%	37.86%
Return on Assets	9.34%	12.26%	14.58%	17.60%
Gross margin	47.36%	56.39%	58.20%	59.00%
EBITDA margin	41.73%	48.11%	49.48%	50.60%
PBT margin	29.41%	35.95%	36.34%	39.61%
Net Profit Margin	23.23%	25.35%	27.25%	29.71%

Fig. 16: Asset Utilization

	2016	2017	2018E	2019E
cash/sales	0.19	0.21	0.18	0.17
Sales to inventory (x)	7.42	8.52	9.24	9.24
Sales to total assets (x)	0.40	0.48	0.54	0.59
Sales to total fixed assets	0.53	0.68	0.77	0.88
Equity multiplier	2.11	2.13	2.12	2.15
fixed asset turnover	1.88	1.48	1.30	1.14

Fig. 17: Liquidity Ratios

	2016	2017	2018E	2019E
Quick ratio	0.42	0.61	0.61	0.65
Current ratio	0.58	0.79	0.79	0.85
Cash ratio	0.22	0.32	0.29	0.30
Interest Coverage	3.99	5.49	7.75	9.46
Operating Cash Flow Ratio	1.22	1.44	1.51	1.60
Debt/net income	2.26	1.28	1.43	1.16
Debt/operating cashflow	0.50	0.35	0.42	0.40
Debt to asset	0.53	0.53	0.53	0.54
Total liabilities/equities	1.11	1.13	1.12	1.15
Inventory turnover	5.45	5.45	3.54	3.06
Inventory turnover days	67.00	67.00	67.00	67.00
Account payable days	211.00	211.00	211.00	211.00

Fig. 18: Shareholders' Investment Ratios

	2016	2017	2018E	2019E
EPS (₦)	8.38	11.99	14.33	17.65
DPS (₦)	8.50	10.50	11.50	12.50
NAVPS (₦)	42.58	45.85	46.27	46.61
Earnings yield (%)	4.09%	5.85%	6.99%	8.61%

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top-down and bottom-up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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