Dangote Cement Plc

Nigeria | Equities | Industrial Goods | November 24, 2020 PAC

Strong Recovery After a Challenging Second Quarter

INVESTMENT SUMMARY

Dangote Cement witnessed a strong recovery in the demand for cement across Africa after a reduction of cement sales in the second quarter of 2020, due to the lockdown of economic activities and restriction of movement in various countries. In the nine-month to September 2020, revenue increased by 12.01% to ₦761.44 billion (vs. ₦679.79 billion in nine-month to September 2019), driven by higher cement volumes in Nigeria and Pan-Africa (i.e. other African nations except Nigeria). Of the company's cement capacity of 45.55 million tonnes per annum across Africa, a total of 19.21 million tonnes was produced in 9M'20 (vs. 18.02 million tonnes in 9M'19). Nigeria, Ethiopia, Senegal, Cameroon, Sierra Leone, South Africa and Congo contributed to the higher cement volumes recorded during the period. Overall, production cost of sales increased by 9.49% to ₦317.54 billion in 9M'20 (vs. ₦290.02 billion in 9M'19), as a result of an increase in the Nigerian manufacturing costs. Administrative expense rose by 4.15% to ₦39.95 billion (vs. ₦38.36 billion in 9M'19), while selling and distribution expenses fell by 2.07% to ₦119.46 billion in 9M'20 (vs. ₦121.98 billion in 9M'19). Consequently, the group's EBITDA increased by 17.08% to ₦355.02 billion in 9M'20 (vs. ₦303.22 billion in 9M'19).

Due to higher interest earning cash balances in Ethiopia, exchange gain in Nigeria and lower average effective interest rate on borrowings, net finance loss fell significantly by 52.76% to ₦15.97 billion in 9M'20 (vs. ₦33.80 billion net financial loss in 9M'19). With the impressive operating and non-operating performance, profit before tax rose by 37.58% to ₦271.96 billion in 9M'20 (vs. ₦197.68 billion in 9M'19). The company made a provision of ₦63.28 billion for tax in 9M'20 (vs. ₦43.33 billion in 9M'19). Consequently, profit after tax improved significantly by 35.20% to ₦208.69 billion in 9M'20 (vs. ₦154.35 billion in 9M'19). With the impressive performance in 9M'20, we upgrade the target price per share to ₦206.47 (Previous Target Price: ₦173.18), but downgrade to a **HOLD** recommendation.

Fig. 1: Quarterly results highlights

	3Q2020	2Q2020	3Q2019	Q/q Δ	Y/y Δ
Revenue (₦'mn)	284,592	227,670	212,061	+25.00%	+34.20%
Op. Profit (₦'mn)	114,449	81,700	60,986	+40.08%	+87.66%
Net profit (₦'mn)	82,542	65,551	35,110	+25.92%	+135.10%

Source: NSE, Bloomberg, PAC Research

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Price:	
- Current	**₦199.80**
- Target	**₦206.47**
Recommendation:	**HOLD**

** As at Tuesday November 24, 2020*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+40.70%/+38.37%
52-week range	₦116.00- ₦201.90
30-day Average vol.	1,961,776
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	3,404.69
EPS (₦) - 12months trailing	14.96
DPS (₦) - FY2019	16.00

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	9M'20	9M'19
Gross profit margin	58.30%	57.34%
Net profit margin	27.41%	22.71%
Equity multiplier	2.26x	1.92x
Asset turnover	0.41x	0.41x

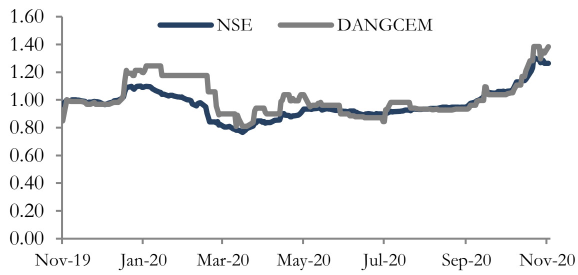
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020E	FY2021F
P/E	8.72x	16.98x	13.03x	12.55x
P/B	3.45x	3.79x	4.14x	4.14x
Div Yield (%)	8.01	8.01	6.76	7.26
Pay-out Ratio	69.85%	135.97%	88.02%	91.08%
EV/EBITDA	8.23x	9.23x	7.71x	7.35x
Ev/Revenue	3.98	4.09	3.64	3.48
Sales Per Share	52.89	52.33	59.65	62.63
P/S Ratio	3.78	3.82	3.35	3.19

Source: NSE, PAC Research

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

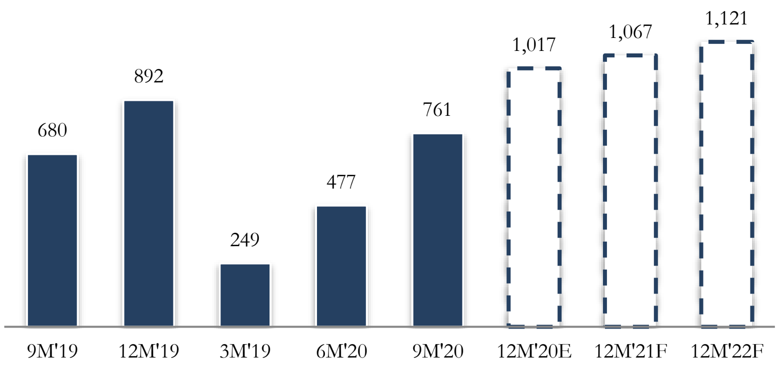


Source: Bloomberg, PAC Research

Dangote Cement witnessed strong appetite for real estate investment and infrastructure spending – including more concrete roads, especially in Nigeria, in the third quarter of 2020.

Mainly as result of higher cement demand across Africa, Revenue improves by 12.01% (year on year): The lockdown of economic activities and restriction of movements (which were imposed by the governments to contain the widespread of coronavirus) in most African countries adversely affected the demand for cement in the second quarter of 2020. However, most countries either lifted the lockdown or gradually eased the lockdown of economic activities in the third quarter and this positively impacted the demand for cement. Dangote Cement witnessed strong appetite for real estate investment and infrastructure spending – including more concrete roads, especially in Nigeria, in the third quarter of 2020. Consequently, cement volume across Africa increased by 6.60% to 19.21 million tonnes in 9M'20 (vs. 18.02 million tonnes in 9M'19). Total cement volumes in Nigeria increased by 10.20% to 11.92 million tonnes (9M'19: 10.82 million tonnes). With the improved cement demand in Ethiopia, Senegal, Cameroon, Sierra Leone, South Africa and Congo, cement volumes in Pan-African operations increased by 3.70% to 7.47 million tonnes in 9M'20 (9M'19: 7.20 million tonnes). In addition, the net revenue per tonnes in Nigeria increased by 3.90% to ₦44,943 in 9M'20, compared to ₦43,258 in 9M'19. The increase in the cement volume across board and higher prices, especially in Nigeria reflected on top-line as the group's revenue increased by 12.01% to ₦761.44 billion in nine-month to September 2020 (vs. ₦679.79 billion in nine-month to September 2019). Nigeria remains a major market for Dangote Cement as it contributed 70.03% to total revenue in 9M'20 (vs. 68.83% contribution to revenue in 9M'19).

Fig. 6: Revenue – 9M'19-12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Group manufacturing costs rise by 9.49% year-on-year due to higher energy costs in Nigeria: The manufacturing costs of the Group increased by 9.49% to ₦317.54 billion in nine-month to September 2020 (vs. ₦290.02 billion incurred in nine-month to September 2019), mainly driven by higher energy costs in Nigeria. The higher energy costs in Nigeria could be attributed to increased production volumes and higher prices for gas which is pegged to the US Dollar and this translated to higher manufacturing cost of ₦161.70 billion in 9M'20 (vs ₦140.40 billion in 9M'19).

Although, the Group's manufacturing costs increased by 9.49%, the company's cost-to-sales ratio fell to 41.70% in 9M'20, from 42.66% in 9M'19.

Mainly as a result of salary increments and improved corporate social responsibility during the period under review, the administrative expenses increased by 4.15% to ₦39.95 billion (vs. ₦38.36 billion in 9M'19). In addition, the Nigerian operations increased its selling and distribution costs by 7.90% to ₦89.30 billion in 9M'20 (vs ₦82.80 billion in 9M'19), due to various promotion schemes which drove the increase in advertising and promotion costs. However, rise in selling and distribution costs in Nigeria was offset by the decline in the selling and distribution costs in Pan-African operations, due to reduced haulage costs in Tanzania and Zambia and reduced depreciation charges in Ethiopia, as some of the trucks approach the end of their useful lives. Consequently, the Groups selling & distribution expenses fell by 2.07% to ₦119.46 billion in 9M'20 (vs. ₦121.98 billion in 9M'19).

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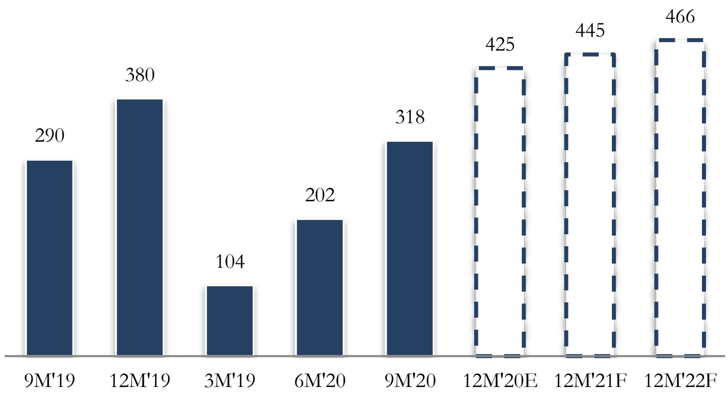
Fig. 7: Manufacturing Costs – 9M'19-12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

With impressive operating and non-operating performance, profit before tax rises by 37.58% year-on-year: In addition to impressive operating performance during the period, the company benefited from the lower yield environment in Nigeria, interest earning cash balances in Ethiopia and devaluation, which impacted non-operating activities positively. The average effective interest rate on borrowings was 9.57% in 9M'20, compared to 10.48% in 9M'19. Also, there was higher interest earning cash balances in Ethiopia which translated to improved interest income for Dangote Cement. In addition, the Nigerian Naira was devalued to ₦386/1$ in 9M'20 (9M'19: ₦365/1$) and this resulted in net exchange gains from inter-group assets and liabilities that do not eliminate in full on consolidation in the Nigerian operations. Consequently, net finance costs fell significantly by 52.76% to ₦15.97 billion in the nine-month to September 2020 (vs. ₦33.80 billon in the nine-month to September 2019).

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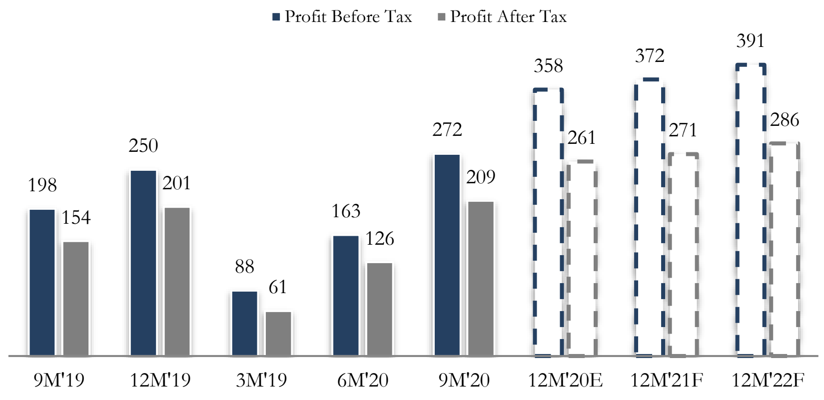
The impressive performance in operating and non-operating activities of Dangote Cement reflected on the profitability of the company as profit before tax improved significantly by 37.58% to ₦271.96 billion in the nine-month to September 2020 (vs. ₦197.68 billion reported in the nine-month to September 2019).

However, the company made a provision of ₦63.28 billion for tax in 9M'20 (vs. ₦43.33 billion in 9M'19). Although, the company benefited from tax exemption (arising from the Pioneer Status Incentive scheme for Ibese Lines 3 & 4 and Obajana Line 4) which ended in February 2020, the Group's effective tax rate increased to 23.27% in 9M'20 (9M'19: 21.92%), mainly due to intercompany exchange gains reported in Other Comprehensive income for the Group and Pan-African subsidiaries making losses that reduced the Group's profit without direct tax benefits for those losses. Consequently, profit after tax for the period increased by 35.20% to ₦208.69 billion in 9M'20 (vs. ₦154.35 billion reported in 9M'19).

Fig. 8: Profit before Tax and Profit after Tax – 9M'19-12M'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Balance sheet position remains strong and solid; historical dividend payment to continue in FY'20: During the period under review, the balance sheet position of Dangote Cement remains healthy, which reflected on the improved total assets as it increased by 12.45% to ₦1.85 trillion (vs. ₦1.64 trillion in Q3'19), mainly as a result of improvement in property, plant and equipment. The property, plant and equipment rose by 5.81% to ₦1.26 trillion in the third quarter of 2020 (vs ₦1.19 trillion in the corresponding quarter of the previous year). Addition to property, plant and equipment was ₦107.40 billion, of which ₦93.00 billion was spent in Nigeria and ₦14.40 billion in Pan-Africa operations. However, the total liabilities increased significantly by 30.86% to ₦1.03 trillion in 9M'20, from ₦787.58 billion reported in 9M'19. The increase in total liabilities of the company was mainly attributed to a 46.13% increase in the current liabilities which was driven by current income tax charge, trade payables and amounts owed to related parties for trucks and the exchange impact (depreciation of Naira from ₦365/1$ to ₦386/1$ in nine-month to September 2020). Consequently, the net assets of the company fell by 4.47% to ₦818.28 billion in the third quarter of 2020 (vs. ₦856.58 billion in the third quarter of 2019), and this translated to a net asset per share of ₦48.02 (vs. ₦50.27 in Q3'19). With the impressive performance in the nine-month to September 2020 and strong balance sheet position, the company may pay, at least, a dividend of ₦13.50 per share in FY'20.

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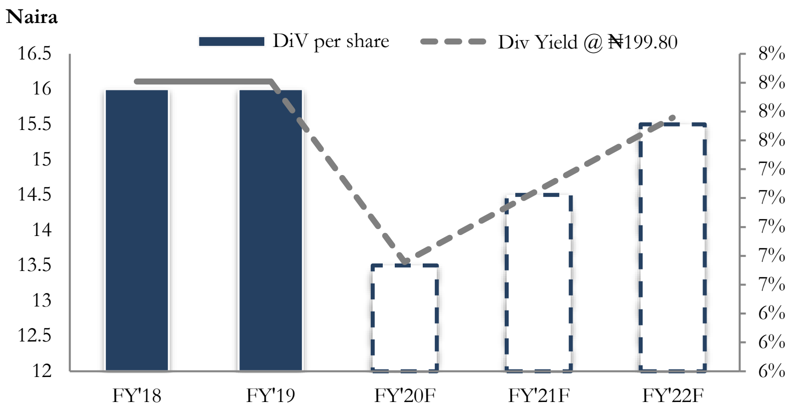
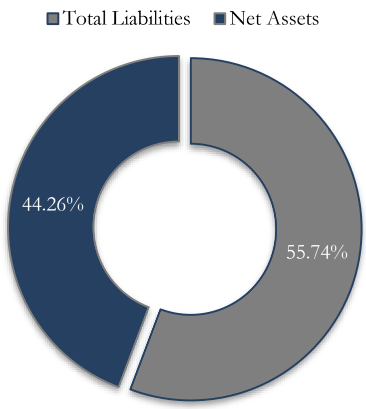
Fig. 9: Dividend Per Share and Dividend Yield (FY'18-FY'22F)



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in 9M'20



Source: NSE, Bloomberg, PAC Research

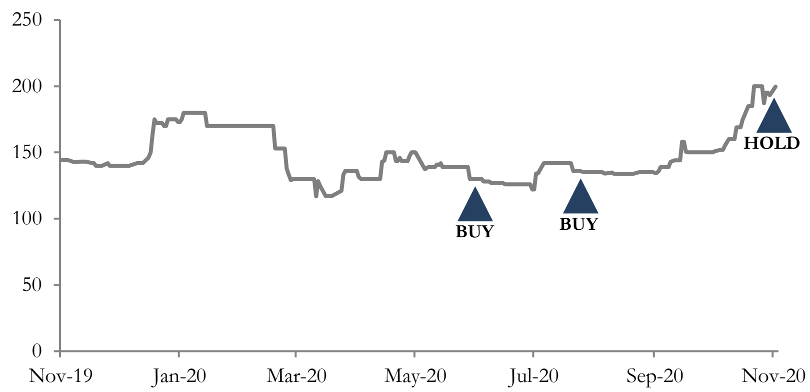
Valuation

Our valuation puts the target price of the stock at ₦206.47, representing an increase of 3.34%, from the current price of ₦199.80. In arriving at the target price, we employed Discounted Cash flow Valuation methodology. Consequently, we downgrade to a **HOLD** 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 strong recovery in the cement market, and the outlook of the management.

Our valuation puts the target price of the stock at N206.47, representing an increase of 3.34%, from the current price of N199.80.

Fig. 11: Share Price History (Naira)



Source: NSE, PAC Research

Fig. 12: Statement of Profit or Loss, N'mn

	2018	2019	2020E	2021F
Revenue	901,213	891,671	1,016,505	1,067,330
Change		*-1.06%*	*14.00%*	*5.00%*
Cost of Sales	(383,311)	(379,989)	(424,899)	(445,077)
Change		*-0.87%*	*11.82%*	*4.75%*
Gross Profit	517,902	511,682	591,606	622,253
Change		*-1.20%*	*15.62%*	*5.18%*
SG&A	(189,426)	(214,769)	(213,466)	(224,139)
Change		*13.38%*	*-0.61%*	*5.00%*
Other Income	10,222	2,980	4,574	4,803
Change		*-70.85%*	*53.50%*	*5.00%*
Operating profit	338,698	299,893	382,714	402,917
Change		*-11.46%*	*27.62%*	*5.28%*
Finance Income	11,323	7,610	23,380	21,347
Change		*-32.79%*	*207.22%*	*-8.70%*
Finance Cost	(49,778)	(57,673)	(48,792)	(53,367)
Change		*15.86%*	*-15.40%*	*9.38%*
Profit Before Taxation	300,806	250,479	358,013	371,644
Change		*-16.73%*	*42.93%*	*3.81%*
Taxation	89,519	(49,958)	(96,664)	(100,344)
Change		*-155.81%*	*93.49%*	*3.81%*
Profit After Taxation	390,325	200,521	261,350	271,300
Change		*-48.63%*	*30.34%*	*3.81%*

Fig. 13: Statement of Financial Position, N'mn

	2018	2019	2020E	2021F
Fixed Assets	1,171,864	1,206,749	1,260,466	1,280,796
Intangible assets	5,969	3,663	4,879	5,123
Deffered tax assets	40,622	44,768	30,495	32,020
Inventories	106,998	114,806	106,733	112,070
Trade and other recievables	44,468	30,001	40,660	42,693
Bank and Cash Balances	166,896	123,903	182,971	192,119
Total current assets	428,838	406,736	506,728	532,598
Total Assets	1,694,463	1,741,351	1,892,427	1,944,889
Trade and other payables	230,970	284,739	345,612	362,892
Current tax payable	9,223	49,932	56,924	59,770
Financial debt	220,128	260,631	325,282	341,546
Other current liabilities	35,185	34,083	55,908	58,703
Total current liabilities	495,506	630,794	785,352	824,619
Deferred tax liabilities	83,350	93,841	116,898	122,743
Net Assets	986,613	897,937	823,166	822,164

Fig. 14: Profitability Ratio

	2018	2019	2020E	2021F
Return on Equity	39.56%	22.33%	31.75%	33.00%
Return on Assets	23.04%	11.52%	13.81%	13.95%
Gross margin	57.47%	57.38%	58.20%	58.30%
EBITDA margin	48.30%	44.34%	47.22%	47.32%
PBT margin	33.38%	28.09%	35.22%	34.82%
Net Profit Margin	43.31%	22.49%	25.71%	25.42%

Fig. 15: Asset Utilization

	2018	2019	2020E	2021F
cash/sales	0.19	0.14	0.18	0.18
Sales to inventory (x)	8.42	7.77	9.52	9.52
Sales to total assets (x)	0.53	0.51	0.54	0.55
Sales to total fixed assets	0.77	0.74	0.81	0.83
Equity multiplier	1.72	1.94	2.30	2.37
fixed asset turnover	1.30	1.35	1.24	1.20

Fig. 16: Liquidity Ratios

	2018	2019	2020E	2021E
Quick ratio	0.65	0.46	0.51	0.51
Current ratio	0.87	0.64	0.65	0.65
Cash ratio	0.34	0.20	0.23	0.23
Interest Coverage	6.04	4.34	7.34	6.96
Operating Cash Flow Ratio	1.81	1.45	1.18	1.03
Debt/net income	0.78	1.77	1.69	1.71
Debt/operating cashflow	0.34	0.39	0.48	0.55
Debt to asset	0.42	0.48	0.57	0.58
Total liabilities/equities	0.72	0.94	1.30	1.37
Inventory turnover	8.58	7.94	9.12	9.76
Inventory turnover days	41.97	45.33	39.46	36.90
Account payable days	216.92	269.76	292.82	293.53

Fig. 17: Shareholders' Investment Ratios

	2018	2019	2020E	2021F
EPS (₦)	22.91	11.77	15.34	15.92
DPS (₦)	16.00	16.00	13.50	14.50
NAVPS (₦)	57.90	52.69	48.31	48.25
Earnings yield (%)	11.46	5.89	7.68	7.97

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

IMPORTANT DISCLOSURES

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