Dangote Cement Plc

PAC Holdings | A PROPRIETARY INVESTMENT COMPANY |

Nigeria | Equities | Industrial Goods | March 8, 2019 — PAC RESEARCH

Tax Exemptions and Higher Volumes Impact Outstanding Earnings Figures

Oluwole Adeyeye
oluwole.adeyeye@panafricancapitalholdings.com

Price:	
- Current	**₦195.00**
- Target	**₦247.29**
Recommendation:	**BUY**

** As at Thursday March 7, 2019*

INVESTMENT SUMMARY

The 2018 full year audited report released by Dangote Cement Plc showed an impressive performance in top line as revenue increased by 11.87% to ₦901.21 billion (vs. ₦805.58 billion in 2017). This is in line with our projection as the revenue figure is 0.60% higher than our forecast of ₦895.81 billion for the FY'18F. The upsurge in revenue was driven by increased volumes in Nigeria and a 9.5% increase in revenue per tonnes in Pan-African operations (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 23.54 million tonnes was produced in FY'18 (vs. 21.92 million tonnes produced in FY'17). However, due to exchange rate impact as well as input price adjustments in Pan-African operations and increased volume in Nigeria, group manufacturing costs increased by 9.12% to ₦383.31 billion in FY'18 (vs. ₦351.29 billion in FY'17). Impressively, the group EBITDA (which is 1.80% lower than our projection) increased by 12.14% to ₦435.26 billion (vs. ₦388.15 billion in FY'17).

Due to the unimpressive performance of non-operating activities of the company, profit before tax struggled to increase by 3.87% to ₦300.81 billion (vs. ₦289.59 billion in FY'17). However, the company benefited from tax exemptions on three major production lines in Nigeria and as a result, tax credit of ₦89.52 billion was recorded in FY'17. Consequently, profit after tax increased by 91.10% to ₦390.33 billion (vs. ₦204.25 billion FY'17). The company's 12-month trailing EPS soared to ₦22.83, from ₦11.65 recorded in the previous period. Therefore, the company proposed a final dividend of ₦16.00 per share (vs. ₦10.50 DPS in FY'17). With this impressive result and progressive outlook from the management, we upgrade our target price per share to ₦247.29 (Previous Target Price: ₦239.94) and also maintain a **BUY** recommendation on the company shares.

Fig. 1: Quarterly results highlights

	4Q2018	3Q2018	4Q2017	Q/q Δ	Y/y Δ
Revenue (₦'mn)	215,923	202,851	202,007	+6.44%	+6.89%
Op. Profit (₦'mn)	71,838	66,343	71,069	+8.28%	+1.08%
Net profit (₦'mn)	232,048	45,113	50,126	+414.37%	+362.93%

Source: NSE, Bloomberg, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+2.79%/-29.09%
52-week range	₦170.00- ₦290.00
30-day Average vol.	1,613,440
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	3,322.90
EPS (₦) - 12months trailing	22.83
DPS (₦) - FY2018	16.00

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'18	FY'17
Gross profit margin	57.47%	56.39%
Net profit margin	43.31%	25.35%
Equity multiplier	1.72x	2.13x
Asset turnover	0.53x	0.48x

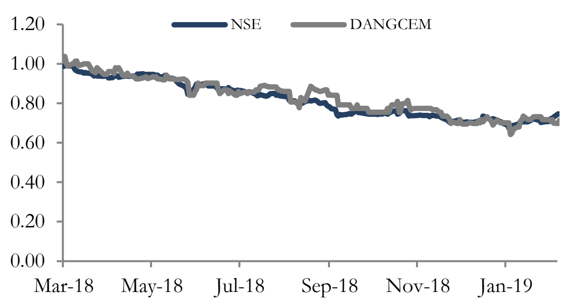
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019F	FY2020F
P/E	16.27	8.51x	11.78x	10.63x
P/B	4.25x	3.37x	3.42x	3.34x
Div Yield (%)	5.38	8.21	6.67	7.18
Pay-out Ratio	87.60%	69.85%	78.52%	76.29%
EV/EBITDA	9.13x	8.05x	7.11x	6.51x
Ev/Revenue	4.40	3.89	3.47	3.11
Sales Per Share	47.27	52.89	59.50	66.93
P/S Ratio	4.12	3.69	3.82	2.91

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

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Group Revenue increases by 11.87%, driven by increased volume in Nigeria and higher revenue per tonne in Pan-African operation

In line with our projection, Dangote Cement Plc reported improved performance in its top-line as revenue increase by 11.87% to ₦901.21 billion in FY'18 (vs. ₦805.58 billion reported in FY'17). However, the actual figure for revenue is slightly above our projection of ₦895.81 billion for the full year 2018. The development in revenue is driven mainly by increased volumes in Nigeria and a 9.5% increase in revenues per tonne in Pan-African operation. Despite the heavy rains and flooding in September, cement volumes sold in Nigeria operations increased by 11.43% to 14.18 million tonnes in 2018 (vs. 12.72 million tonnes in 2017), with revenue from Nigerian operations rising by 11.94% to ₦618.30 billion (vs. ₦552.36 billion in 2017). Sales to domestic customers in Nigeria improved by 11.7% to 13.4 million tonnes in 2018 (vs. 12.0 million tonnes sold in 2017), with the remaining 0.77 million tonnes exported to other countries.

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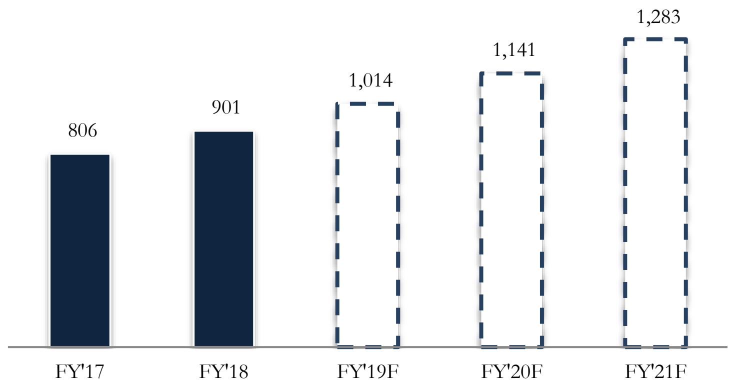
For Pan-African operations, total cement volumes remained approximately constant at 9.370 million tonnes in FY'18 (vs. 9.365 million tonnes in FY'17). During the period, Ghana, Ethiopia and Tanzania recorded lower volumes and the lower volumes in these countries was offset by higher volumes in Senegal and Zambia. However, the increased revenue per tonne in Pan-African operations can be mainly attributed to depreciation of Naira which drove higher Naira values when revenue was converted into Naira, as well as price adjustments in some countries.

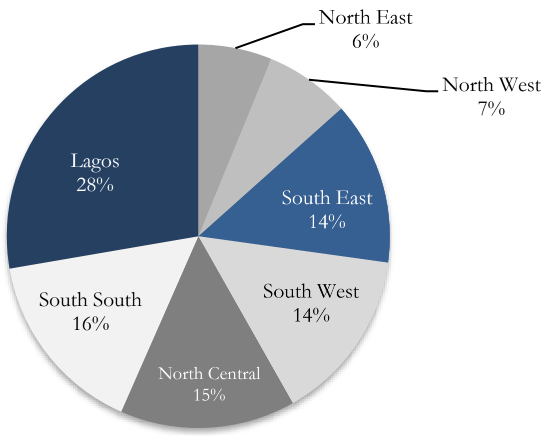
Of the total group revenue, Nigerian operations contributed 68.6% while Pan-African operations contributed 31.4%. In Nigeria, Lagos state remains the highest Dangote Cement consumption region with 27.7% sales, followed by South-South region and North-Central with 15.7% and 14.8% sales respectively.

Fig. 6: Revenue - FY'17-FY'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Fig. 7: Dangote Cement Sales by Regions in Nigeria - 2018



Source: NSE, Bloomberg, PAC Research

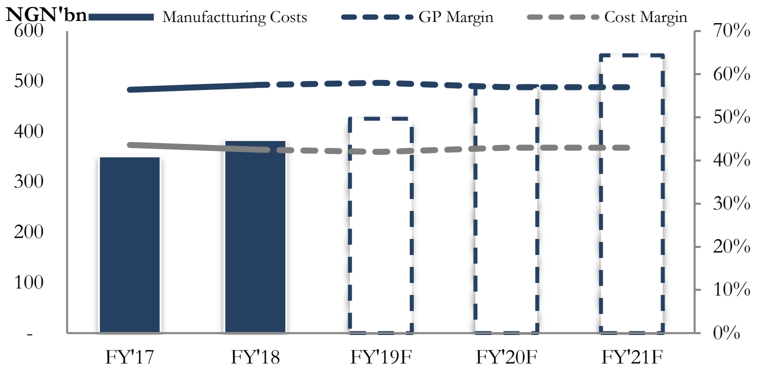
Higher production cost of sales due to increased volumes in Nigeria and exchange rate impacts on Pan African operations

In 2018, group manufacturing costs increased by 9.12% to ₦383.31 billion (vs. ₦351.29 billion recorded in 2017). The upsurge in group manufacturing cost can be mainly attributed to increased volumes in Nigeria and foreign exchange impact when converting Pan-African costs from local currencies to Naira. Manufacturing costs in Nigeria increased by 7.4% to ₦170.3 billion in FY'18, from ₦158.6 billion recorded in FY'17. Although, Pan-African volume remained approximately constant, manufacturing costs increased by 10.6% to ₦213.0 billion in FY'18 (vs. ₦192.7 billion in FY'17), mainly as a result of exchange rate impacts as well as input price adjustment. Nigerian Naira declined by 7.80% in value as it was traded at ₦359/$1 at the end of 2018, compared to ₦331/$ at the end of 2017. Generally, the increase in total manufacturing costs can be ascribed to higher material consumption, increased fuel & power consumption and high plant maintenance cost. However, we are worried with the costs of fuel and power consumed as it remains the highest contributor to the manufacturing costs. Fuel & power consumption contributed 34.84% to total manufacturing cost (FY'17: 31.76%) while material consumption contributed 31.98% to total manufacturing cost in FY'18 (FY'17: 31.75%).

Nigerian Naira declined by 7.80% in value as it was traded at ₦359/$1 at the end of 2018, compared to ₦331/$ at the end of 2017.

Total administration and selling costs rose by 22.0% to ₦189.43 billion in 2018 (vs. ₦155.30 billion reported in 2017), mostly as a result of higher sales and associated distribution costs in Nigeria. Haulage expenses in Nigeria rose by 21.94% to ₦56.7 billion (vs. ₦46.5 billion in FY'17) while haulage expenses in Pan-African operations increased by ₦3.2 billion in FY'18.

Fig. 8: Manufacturing Costs - FY'17-FY'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

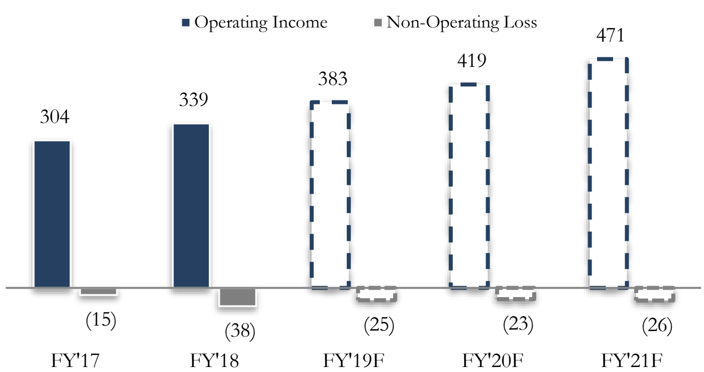
Non-operating activities of the company threatens profitability as profit before tax rises by 3.87%.

During the period under review, non-operating activities of the company threatened the profitability of the company as finance income declined by 68.48% to ₦11.32 billion in FY'18 (vs. ₦35.93 billion in FY'17). Interest income increased by 23.9% to ₦11.23 billion in 2018 (2017: ₦9.14 billion), mainly as a result of higher average cash balances and improved interest rates in Nigeria and Ethiopia. However, the company recorded a net exchange loss of ₦8.11 billion in 2018, compared to net exchange gain of ₦26.79 billion reported in 2017. Though, Nigerian operations benefited from exchange gain as a result of Naira devaluation, the exchange gain was outweighed mainly by the exchange losses from Pan-African operations that use the CFA currency, as well as Sierra Leone and Ghana.

However, interest expenses declined by 20.94% to ₦41.67 billion in 2018 (vs. ₦52.71 billion reported in 2017) and as a result, net finance loss increased by 129.10% to ₦38.46 billion (vs. ₦16.79 billion in 2017). The unimpressive figure from non-operating activities reflected on profitability of the company as profit before tax struggled to rise by 3.87% to ₦300.81 billion in 2018, from ₦289.59 billion reported in 2017.

Though, Nigerian operations benefited from exchange gain as a result of Naira devaluation, the exchange gain was outweighed mainly by the exchange losses from Pan-African operations…

Fig. 9: Operating Income and Non-Operating Loss - FY'17-FY'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Profit after tax increased by 91.10%, boosted by impressive operating performance and tax exemption

Dangote Cement Plc recorded impressive performance in its core operating activities as it increased by 11.34% to ₦338.70 billion in 2018 (vs. ₦304.21 billion reported in 2017). In addition to the impressive operating performance, the company also benefited from much awaited tax exemptions on its major lines of operations. It should be recalled that in full year 2017, the company made a tax provision on profit earned from Ibese production lines 3 & 4 and Obajana production line 4 on the basis that they were yet to obtain approval for tax exemptions under the Pioneer Status Incentive. However, approval from Nigeria Investment Promotion Commission (NIPC) was obtained in 2018 and the provision of ₦133.7 billion was reversed resulting in the tax credit of ₦89.52 billion in 2018 (2017 tax provision: ₦85.34 billion). As a result, the group's profit after tax for the year increased significantly by 91.10% to ₦390.33 billion (vs. ₦204.25 billion reported in 2017). This translated to higher earnings per share of ₦22.83 in FY'18 (vs. ₦11.65 in FY'17).

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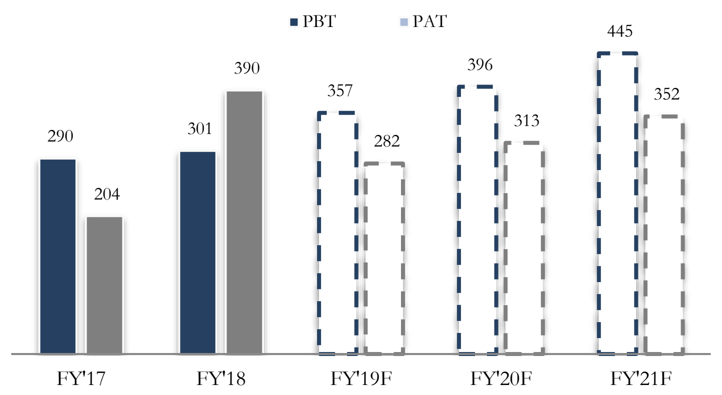
Fig. 10: Profit before Tax and Profit after Tax – FY'17-FY'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Balance sheet remains strong; Directors recommends improved dividend of ₦16.00 per share

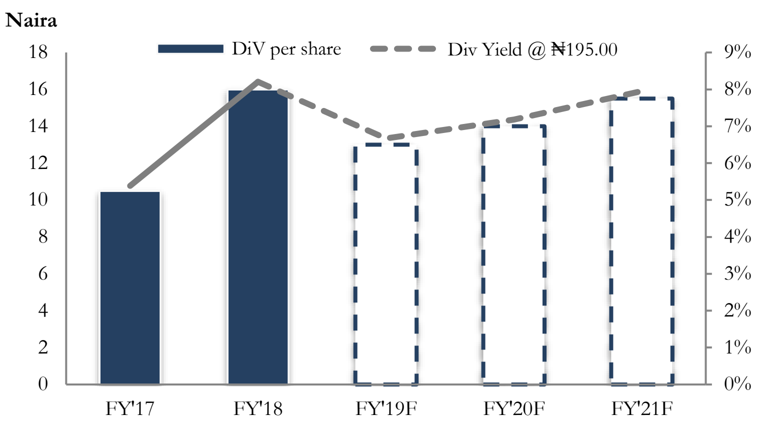
In the review period, the company increased total non-current assets by 0.80% to ₦1.27 trillion, from ₦1.26 trillion reported in 2017. This was mainly as a result of increase in deferred tax assets following the approval of tax exemption as well as payments of fixed assets under construction. The group added ₦61.6 billion and ₦27.0 billion to the property, plant and equipment in Nigeria and Pan-African operation respectively. As a result, total assets increased by 1.72% to ₦1.69 trillion in 2017 (vs. ₦1.67 trillion in 2017).

Total liabilities declined by 19.97% to ₦707.85 billion in FY'18 (vs. ₦884.52 billion in FY'17) as reversal of tax provision resulted in decrease in both current and non-current liabilities. Consequently, the net assets of the company increased by 26.27% to ₦986.61 billion in FY'18, from ₦781.36 billion recorded in FY'17 while net asset per share also improved to ₦57.90 (vs. ₦45.85 billion in FY'17).

With the robust balance sheet and improved profit after tax, the directors recommended an increased dividend of ₦16.00 per share (2017: ₦10.50) for approval at the Annual General Meeting scheduled for 17th June 2019. The proposed dividend is 52.4% higher than that of 2017 and this result in a total dividend payment of ₦272.6 billion in 2018 (2017: ₦178.9 billion).

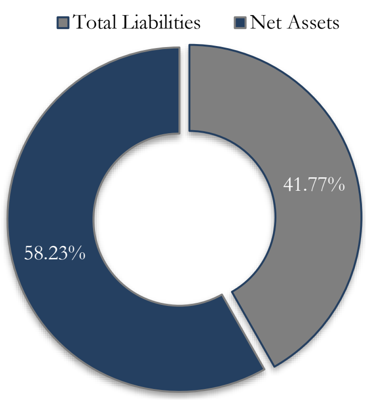
With the robust balance sheet and improved profit after tax, the directors recommended an increased dividend of ₦16.00 per share (2017: ₦10.50) …

Fig. 11: Dividend Per Share and Dividend Yield (FY'17-FY'21F)



Source: NSE, PAC Research

Fig. 12: Total Liabilities Vs Net Asset in FY'18



Source: NSE, Bloomberg, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦247.29 representing an increase of 26.81%, from the current price of ₦195.00. 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 and the performance of the company in the cement industry.

Our valuation puts the target price of the stock at N247.29 representing an increase of 26.81%, from the current price of N195.00

Fig. 13: Share Price History (Naira)

Source: NSE, PAC Research

Fig. 14: Statement of Profit or Loss, N'mn

	2017	2018	2019F	2020F
Revenue	805,582	901,213	1,013,865	1,140,598
Change		*11.87%*	*12.50%*	*12.50%*
Cost of Sales	(351,290)	(383,311)	(425,823)	(490,457)
Change		*9.12%*	*11.09%*	*15.18%*
Gross Profit	291,287	454,292	517,902	588,041
Change		*55.96%*	*14.00%*	*13.54%*
SG&A	(155,297)	(189,426)	(212,912)	(239,526)
Change		*21.98%*	*12.40%*	*12.50%*
Other Income	5,213	10,222	7,401	8,326
Change		*96.09%*	*-27.60%*	*12.50%*
Operating profit	304,208	338,698	382,531	418,942
Change		*11.34%*	*12.94%*	*9.52%*
Finance Income	35,926	11,323	20,784	23,382
Change		*-68.48%*	*83.56%*	*12.50%*
Finance Cost	(52,711)	(49,778)	(46,179)	(46,485)
Change		*-5.56%*	*-7.23%*	*0.66%*
Profit Before Taxation	289,590	300,806	357,137	395,839
Change		*3.87%*	*18.73%*	*10.84%*
Taxation	(85,342)	89,519	(74,999)	(83,126)
Change		*-204.89%*	*-183.78%*	*10.84%*
Profit After Taxation	204,248	390,325	282,138	312,713
Change		*91.10%*	*-27.72%*	*10.84%*

Fig. 15: Statement of Financial Position, N'mn

	2017	2018	2019F	2020F
Fixed Assets	1,192,140	1,171,864	1,186,222	1,254,657
Intangible assets	6,355	5,969	6,832	7,686
Deffered tax assets	30,625	40,622	40,555	45,624
Inventories	94,594	106,998	109,700	123,413
Trade and other recievables	30,155	44,468	43,315	48,730
Bank and Cash Balances	168,387	166,896	167,288	182,496
Total current assets	303,164	428,838	454,756	494,492
Total Assets	1,665,883	1,694,463	1,737,054	1,856,408
Trade and other payables	270,721	230,970	233,189	262,337
Current tax payable	63,901	9,223	25,347	28,515
Financial debt	144,783	220,128	222,645	250,475
Other current liabilities	41,071	35,185	44,103	49,616
Total current liabilities	520,476	495,506	525,283	590,944
Deferred tax liabilities	116,898	83,350	94,289	106,076
Net Assets	781,360	986,613	970,471	994,002

Fig. 16: Profitability Ratio

	2017	2018	2019F	2020F
Return on Equity	26.14%	39.56%	29.07%	31.46%
Return on Assets	12.26%	23.04%	16.24%	16.85%
Gross margin	56.39%	57.47%	58.00%	57.00%
EBITDA margin	48.18%	48.30%	48.80%	47.80%
PBT margin	35.95%	33.38%	35.23%	34.70%
Net Profit Margin	25.35%	43.31%	27.83%	27.42%

Fig. 17: Asset Utilization

	2017	2018	2019F	2020F
cash/sales	0.21	0.19	0.17	0.16
Sales to inventory (x)	8.52	8.42	9.24	9.24
Sales to total assets (x)	0.48	0.53	0.58	0.61
Sales to total fixed assets	0.68	0.77	0.85	0.91
Equity multiplier	2.13	1.72	1.79	1.87
fixed asset turnover	1.48	1.30	1.17	1.10

Fig. 18: Liquidity Ratios

	2016	2017	2018E	2019E
Quick ratio	0.61	0.65	0.66	0.63
Current ratio	0.79	0.87	0.87	0.84
Cash ratio	0.32	0.34	0.32	0.31
Interest Coverage	5.49	6.04	7.73	8.52
Operating Cash Flow Ratio	1.44	1.81	1.99	1.77
Debt/net income	1.28	0.78	1.12	1.14
Debt/operating cashflow	0.35	0.34	0.30	0.34
Debt to asset	0.53	0.42	0.44	0.46
Total liabilities/equities	1.13	0.72	0.79	0.87
Inventory turnover	5.45	3.57	3.09	0.00
Inventory turnover days	67.00	67.00	67.00	0.00
Account payable days	211.00	211.00	211.00	0.00

Fig. 19: Shareholders' Investment Ratios

	2017	2018	2019F	2020F
EPS (₦)	11.65	22.83	16.56	18.35
DPS (₦)	10.50	16.00	13.00	14.00
NAVPS (₦)	45.85	57.90	56.95	58.33
Earnings yield (%)	6.15%	11.75%	8.49%	9.41%

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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PanAfrican Capital Holdings Ltd
8A, Elsie Femi Pearse Street
Victoria Island
Lagos, Nigeria
Tel: +234 (1) 2716899, 2718630
www.panafricancapitalholdings.com