Dangote Cement Plc

Nigeria | Equities | Industrial Goods | March 6, 2020 — PAC RESEARCH

Low Growth Across Key Markets amidst Rising Competition

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Price:	
- Current	**₦170.00**
- Target	**₦178.06**
Recommendation:	**HOLD**

** As at Thursday March 5, 2020*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+19.72%/-13.71%
52-week range	₦136.00 - ₦215.00
30-day Average vol.	1,150,719
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	2,896.89
EPS (₦) - 12months trailing	11.79
DPS (₦) - FY2019	16.00

Source: NSE, Bloomberg, PAC Research

INVESTMENT SUMMARY

The 2019 full year audited report released by Dangote Cement Plc showed a slow-down in top line as revenue fell marginally by 1.06% to ₦891.67 billion (vs. ₦901.21 billion in 2018). This is in line with our projection as the revenue figure is 1.58% lower than our forecast of ₦905.72 billion for the FY'19F. The decline in revenue was driven by reduced net prices in both Nigeria and Pan-African operations (i.e. other African nations except Nigeria) as result of high level of discounts. Of the company's cement capacity of 45.55 million tonnes per annum across Africa, a total of 23.57 million tonnes was produced in FY'19 (vs. 23.54 million tonnes produced in FY'18). However, as a result of reduced volume in Ghana, South Africa and Cameroon, the group manufacturing costs fell marginally by 0.87% to ₦379.99 billion in FY'19 (vs. ₦383.31 billion in FY'18). Due to high haulage cost in Nigeria, selling & distribution expenses rose by 17.32% to ₦160.65 billion (vs. ₦136.92 billion in FY'18) and this resulted in lower EBITDA of ₦395.36 billion in FY'19 (vs. ₦435.26 billion in FY'18).

In addition to unimpressive operating performance during the period, FX losses from Pan African operations contributed to the total performance of the group as profit before tax fell by 16.73% to ₦250.48 billion (vs. ₦300.81 billion in FY'18). However, the company continued to benefit from tax exemptions on three major production lines and this resulted in low effective tax rate of 19.94% in 2019. Consequently, profit after tax fell significantly by 48.63% to ₦200.52 billion (vs. ₦390.33 billion FY'18) and this translated to EPS of ₦11.79 in 2019 (2018: ₦22.83). However, the company magnanimously proposed a final dividend of ₦16.00 per share (vs. ₦16.00 DPS in FY'18). With the unimpressive result and expectation of strong competition in the cement industry, we downgrade our target price and recommendation to ₦178.06 per share (Previous Target Price: ₦202.84) and **HOLD** respectively.

Fig. 1: Quarterly results highlights

	4Q2019	3Q2019	4Q2018	Q/q Δ	Y/y Δ
Revenue (₦'mn)	211,880	212,061	215,923	-0.09%	-1.87%
Op. Profit (₦'mn)	67,479	60,986	71,838	+10.65%	-6.07%
Net profit (₦'mn)	46,171	35,110	232,048	+31.50%	-80.10%

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'19	FY'18
Gross profit margin	57.38%	57.47%
Net profit margin	22.49%	43.31%
Equity multiplier	1.94x	1.72x
Asset turnover	0.51x	0.53x

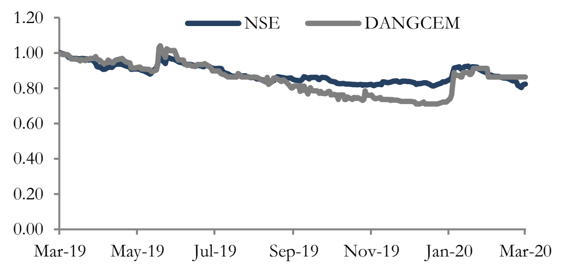
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020F	FY2021F
P/E	7.42	14.45x	13.35x	12.69x
P/B	2.94x	3.23x	3.09x	2.94x
Div Yield (%)	9.41	9.41	7.35	7.65
Pay-out Ratio	69.85%	135.97%	98.19%	97.01%
EV/EBITDA	7.07x	7.94x	7.58x	7.25x
Ev/Revenue	3.41	3.52	3.39	3.24
Sales Per Share	52.89	52.33	54.94	57.69
P/S Ratio	3.21	3.25	3.09	2.95

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

Group revenue falls by 1.06% due to higher level of discounts and low growth environment across key markets: In line with our projection, Dangote Cement Plc reported a slow-down in its top-line as revenue fell by 1.06% to ₦891.67 billion in FY'19 (vs. ₦901.21 billion reported in FY'18). The reduction in revenue was mainly driven by reduced average net prices in both Nigeria and Pan-Africa. The lower average net prices showed the level of intense competition in the Nigerian market and low growth environment across key markets.

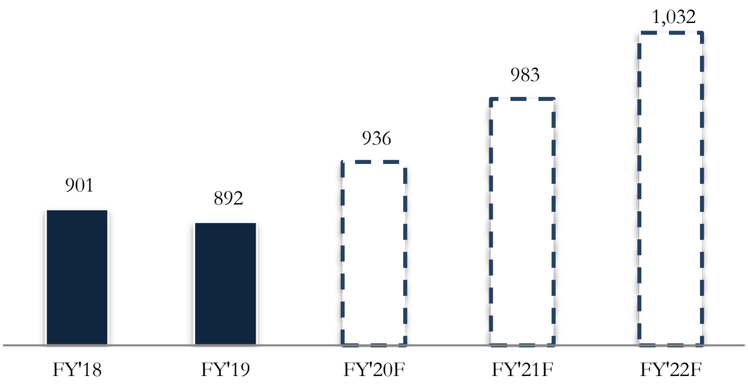
Although, total cement volume sold within Nigeria increased by 1.90% to 13.67 million tonnes in 2019 (when compared with 13.41 million tonnes recorded in 2018), net revenue per tonne in Nigeria declined by 0.90% to ₦43,221 in 2019 (vs. ₦43,610 in 2018) due to sales promotion activities. In addition to the lower average net prices in the Nigerian market, total exports of cement declined significantly by 41.00% to 0.45 million tonnes as a result of border closure by the Federal Government of Nigeria during the period. Consequently, total revenue for Nigerian operations fell by 1.30% to ₦610.25 billion in 2019, from ₦618.30 billion reported in 2018.

…total exports of cement declined significantly by 41.00% to 0.45 million tonnes as a result of border closure by the Federal Government of Nigeria during the period.

For Pan-African operations, total cement volumes increased marginally by 0.82% to 9.45 million tonnes in FY'19 (vs. 9.37 million tonnes in FY'18) due to higher volume sales recorded in Tanzania, Sierra Leone, Senegal and Congo. As a result of increase in government infrastructure spending and increase in cement demand from the Southern region, total cement volume in Tanzania increased by 94% to 1.2 million tonnes in 2019. Having removed import duties on bagged cement to support building activities in Sierra Leone, infrastructure investment and building projects commenced in 2019 and this contributed to a significant increase of 116.00% growth recorded in cement sales in the country. Higher exportation of cement, especially to Mali, led to 8.40% increase of cement sales in Senegal. However, Ethiopia's volumes dropped by 4.00% to 2 million tonnes owing to shortages of limestone due to a major issue with quarry equipment and reduction in government spending. Other countries that recorded negative growth during the period are Ghana, South Africa and Zambia. Consequently, Revenue from Pan-African operations fell marginally by 0.19% to ₦282.71 billion in 2019 (vs. ₦283.26 billion reported in 2018).

Of the total group revenue, Nigerian operations contributed 68.40% in 2019 (2018: 68.61%) while Pan-African operations contributed 31.71% in 2019 (2018: 31.43%).

Fig. 6: Revenue - FY'18 - FY'22F (Billion NGN)



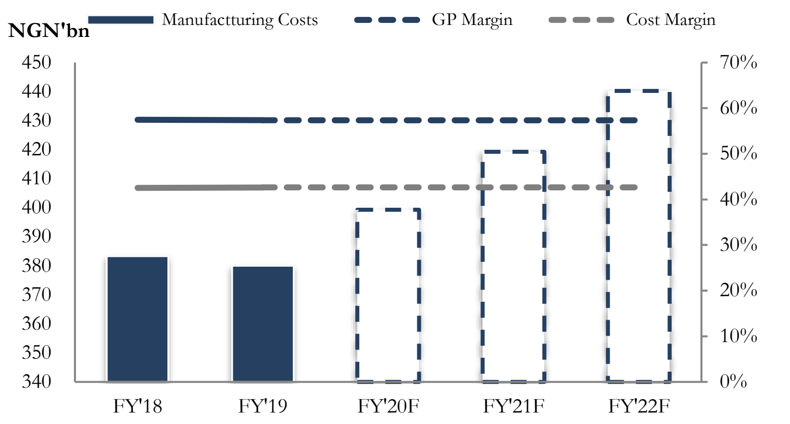
Source: NSE, Bloomberg, PAC Research

Manufacturing costs remains relatively flat as lower cost of sales in Pan African operations offsets higher cost of sales in Nigerian operation: Pan-African operations' manufacturing cost decreased by 6.60% to ₦199.00 billion in 2019 (vs. ₦213.30 billion reported in 2018) as result of reduced cement volumes, notably in Ghana, South Africa and Cameroon during the period. The reduction in manufacturing costs of Pan-African operations was partially offset by the increase in Nigerian manufacturing costs and increased production costs in Tanzania, Congo and Sierra Leone as a result of higher cement sales during the period. Manufacturing costs in Nigeria increased by 6.28% to ₦181.00 in 2019 (vs. ₦170.3 billion in 2018), due to general inflation and foreign exchange impacts on USD denominated expenses. Consequently, the group manufacturing costs remained relatively flat at ₦379.99 billion in 2019 (vs. ₦383.31 billion recorded in 2018). This also reflected on cost-to-revenue ratios as it remained almost flat at 42.62% in 2019 (2018: 42.53%). Specifically, material consumed was the highest contributor to the total manufacturing costs as it contributed 32.33% to total manufacturing costs in 2019 (2018: 34.84%), closely followed by fuel & power consumption which contributed 30.85% to total manufacturing cost (2018: 31.98%).

The reduction in manufacturing costs of Pan-African operations was partially offset by the increase in Nigerian manufacturing costs and increased production costs in Tanzania, Congo and Sierra Leone as a result of higher cement sales during the period.

However, total administration and selling costs increased by 13.40% to ₦214.77 billion in 2019 (vs. ₦189.42 billion reported in 2018), mostly as a result of higher distribution costs in Nigeria and Pan-Africa. Although, the total volumes sold in Nigeria remained flat, the proportion delivered by the trucks increased and this led to higher haulage costs in Nigeria as it increased by 24.69% to ₦70.70 billion in 2019 (vs. ₦56.70 billion in 2018). The trend was the same in Pan-Africa as higher proportion of the sales volume was delivered by trucks and this led to higher haulage costs of ₦36.5 billion in 2019, when compared to haulage costs of ₦31.3 billion in 2018. In addition, various promotion schemes were deployed by the company in Nigeria which drove the increase in advertising and promotion costs.

Fig. 8: Manufacturing Costs - FY'18 - FY'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

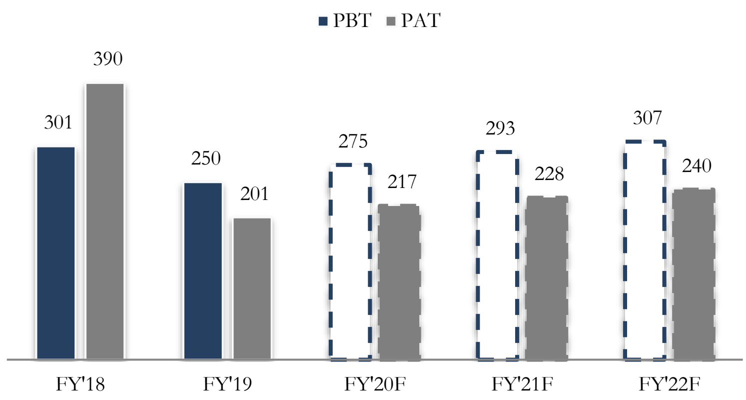
Non-operating activities contributes to the poor operating performance as profit before tax falls significantly by 16.73%: During the period under review, non-operating activities of the company contributed significantly to overall performance of the company as finance costs rose by 49.78% to ₦57.67 billion in FY'19 (vs. ₦49.78 billion in FY'18), mainly as a result of exchange loss during the period. Although, the average interest rate on funds borrowed declined to 10.87% per annum for 2019 (2018: 11.14% per annum), the Group recorded unrealised exchange losses from Pan-Africa operations that use the 'FCFA', Sierra Leonean 'Leone' and the Ghana 'Cedi'. This led to an exchange loss of ₦13.48 billion in 2019 (vs. exchange loss of ₦8.11 billion in 2018). In addition, finance income fell by 32.79% to ₦7.61 billion in 2019 (2018: ₦11.46 billion), mainly as a result of reduced interest earning cash balances in Nigeria.

Although, the average interest rate on funds borrowed declined to 10.87% per annum for 2019 (2018: 11.14% per annum), the Group recorded unrealised exchange losses from Pan-Africa operations…

With poor performance, which reflected on high operating expenses and non-operating activities of the company, profit before tax fell significantly by 16.73% to ₦250.48 billion in 2019 (vs. ₦390.33 billion reported in 2018). Meanwhile, the company continued to benefit from tax exemptions, particularly on Ibese production lines 3 & 4 and Obajana production line 4 as effective tax rate was 19.90% in 2019. As a result, the company made a provision of ₦49.96 billion in 2019 (vs. a tax credit of ₦89.52 billion in 2018). Consequently, profit after tax fell significantly by 48.63% to ₦200.52 billion (vs. ₦390.33 billion in 2018) and this translated to EPS of ₦11.79 in 2019 (2018: ₦22.83). However, investors should not be carried away by the profit after tax achieved by the company in 2018 as this was as a result of combination of tax exemptions in the previous year and reversed tax provision. Prior to 2018, the company made a tax provision on profits 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.

Approval was obtained in December 2018 and the provision was reversed in the same year.

Fig. 9: Profit before Tax and Profit after Tax – FY'18 - FY'22F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Balance sheet remains strong; Directors recommend dividend of ₦16.00 per share: In the review period, the company increased total non-current assets by 5.45% to ₦1.33 trillion, from ₦1.27 trillion reported in 2018. This was mainly driven by more investment in property, plant and equipment. The group invested additional ₦35.00 billion to the property, plant and equipment in Nigeria and Pan-African operation. As a result, total assets increased by 2.77% to ₦1.74 trillion in 2019 (vs. ₦1.69 trillion in 2018). However, total liabilities increased by 19.15% to ₦843.41 billion in FY'19 (vs. ₦707.85 billion in FY'18) as a result of higher trade & other payables, higher financial liabilities and deferred tax liabilities. Consequently, the net assets of the company declined by 8.99% to ₦897.94 billion in FY'19, from ₦986.61 billion recorded in FY'18 and this translated to a net asset per share of ₦52.69 (vs. ₦57.90 in FY'18).

With the robust balance sheet, the company took money from the reserve to match the dividend paid last year. The directors recommended a dividend of ₦16.00 per share in 2019 (2018: ₦16.00) for approval at the Annual General Meeting scheduled for 15th June 2020 at the Eko Hotel & Suite. If approved, the dividend will be paid electronically on the 16th of June 2020 to shareholders whose names appear in the Register of Members as at May 25 2020 and who have completed the e-dividend registration and mandate the registrar to pay their dividends directly into their bank account

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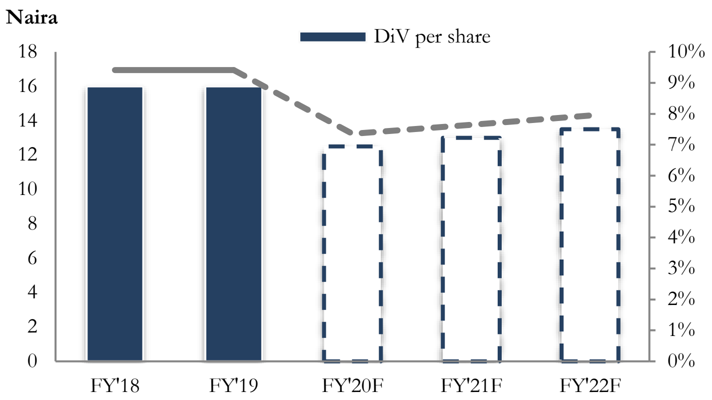
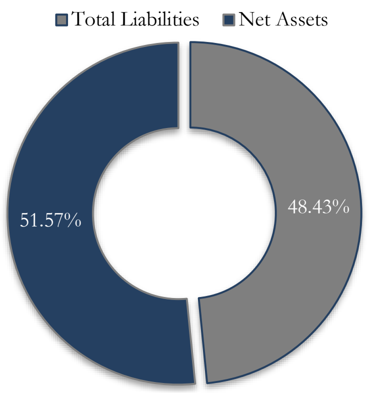
Fig. 10: Dividend Per Share and Dividend Yield (FY'18 - FY'22F)



Source: NSE, PAC Research

Fig. 11: Total Liabilities Vs Net Asset in FY'19



Source: NSE, Bloomberg, PAC Research

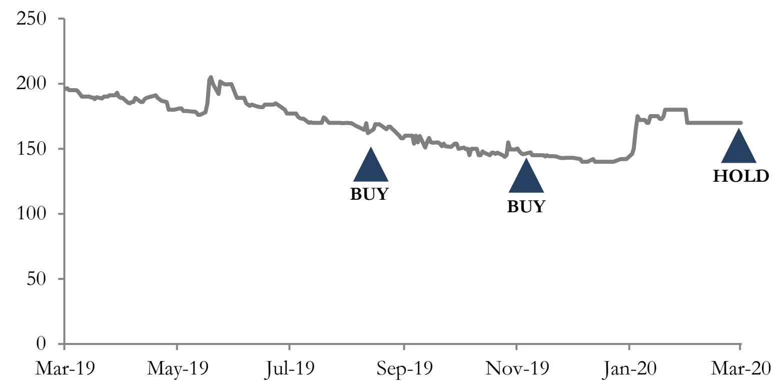
Valuation

Our valuation puts the target price of the stock at ₦178.06, representing an increase of 4.74%, from the current price of ₦170.00. 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, increased competition and the performance of the company in the cement industry.

Our valuation puts the target price of the stock at N178.06, representing an increase of 4.74%, from the current price of N170.00

Fig. 12: Share Price History (Naira)



Source: NSE, PAC Research

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

	2018	2019	2020F	2021F
Revenue	901,213	891,671	936,255	983,067
Change		*-1.06%*	*5.00%*	*5.00%*
Cost of Sales	(383,311)	(379,989)	(399,313)	(419,278)
Change		*-0.87%*	*5.09%*	*5.00%*
Gross Profit	517,902	511,682	536,942	563,789
Change		*-1.20%*	*4.94%*	*5.00%*
SG&A	(189,426)	(214,769)	(224,701)	(235,936)
Change		*13.38%*	*4.62%*	*5.00%*
Other Income	10,222	2,980	6,647	6,980
Change		*-70.85%*	*123.07%*	*5.00%*
Operating profit	338,698	299,893	318,888	334,833
Change		*-11.46%*	*6.33%*	*5.00%*
Finance Income	11,323	7,610	6,554	6,390
Change		*-32.79%*	*-13.88%*	*-2.50%*
Finance Cost	(49,778)	(57,673)	(51,494)	(49,153)
Change		*15.86%*	*-10.71%*	*-4.55%*
Profit Before Taxation	300,806	250,479	274,603	292,757
Change		*-16.73%*	*9.63%*	*6.61%*
Taxation	89,519	(49,958)	(57,667)	(64,407)
Change		*-155.81%*	*15.43%*	*11.69%*
Profit After Taxation	390,325	200,521	216,937	228,351
Change		*-48.63%*	*8.19%*	*5.26%*

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

	2018	2019	2020F	2021F
Fixed Assets	1,171,864	1,206,749	1,254,581	1,317,310
Intangible assets	5,969	3,663	5,805	6,095
Deffered tax assets	40,622	44,768	45,876	48,170
Inventories	106,998	114,806	116,096	121,900
Trade and other recievables	44,468	30,001	37,450	39,323
Bank and Cash Balances	166,896	123,903	130,139	136,646
Total current assets	428,838	406,736	419,268	440,232
Total Assets	1,694,463	1,741,351	1,793,750	1,883,107
Trade and other payables	230,970	284,739	290,239	304,751
Current tax payable	9,223	49,932	30,990	32,540
Financial debt	220,128	260,631	271,514	285,090
Other current liabilities	35,185	34,083	35,578	37,357
Total current liabilities	495,506	630,794	629,818	661,309
Deferred tax liabilities	83,350	93,841	83,327	86,510
Net Assets	986,613	897,937	936,984	984,485

Fig. 15: Profitability Ratio

	2018	2019	2020F	2021F
Return on Equity	39.56%	22.33%	23.15%	23.19%
Return on Assets	23.04%	11.52%	12.09%	12.13%
Gross margin	57.47%	57.38%	57.35%	57.35%
EBITDA margin	48.30%	44.34%	44.63%	44.63%
PBT margin	33.38%	28.09%	29.33%	29.78%
Net Profit Margin	43.31%	22.49%	23.17%	23.23%

Fig. 16: Asset Utilization

	2018	2019	2020F	2021F
cash/sales	0.19	0.14	0.14	0.14
Sales to inventory (x)	8.42	7.77	8.06	8.06
Sales to total assets (x)	0.53	0.51	0.52	0.52
Sales to total fixed assets	0.77	0.74	0.75	0.75
Equity multiplier	1.72	1.94	1.91	1.91
fixed asset turnover	1.30	1.35	1.34	1.34

Fig. 17: Liquidity Ratios

	2018	2019	2020F	2021F
Quick ratio	0.65	0.46	0.48	0.48
Current ratio	0.87	0.64	0.67	0.67
Cash ratio	0.34	0.20	0.21	0.21
Interest Coverage	6.04	4.34	5.33	5.96
Operating Cash Flow Ratio	1.81	1.45	1.43	1.43
Debt/net income	0.78	1.77	1.64	1.63
Debt/operating cashflow	0.34	0.39	0.39	0.39
Debt to asset	0.42	0.48	0.48	0.48
Total liabilities/equities	0.72	0.94	0.91	0.91
Inventory turnover	8.58	7.94	8.11	8.26
Inventory turnover days	41.97	45.33	44.39	43.58
Account payable days	216.92	269.76	261.66	261.66

Fig. 18: Shareholders' Investment Ratios

	2018	2019	2020F	2021F
EPS (₦)	22.91	11.77	12.73	13.40
DPS (₦)	16.00	16.00	12.50	13.00
NAVPS (₦)	57.90	52.69	54.99	57.77
Earnings yield (%)	13.47	6.92	7.49	7.88

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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