Dangote Cement Plc

PAC Holdings
| A PROPRIETARY INVESTMENT COMPANY |

Nigeria | Equities | Industrial Goods | July 26, 2018 — PAC RESEARCH

Foreign Exchange Loss and Higher Tax Provision Weigh on Impressive Performance

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INVESTMENT SUMMARY

The H1'18 report released by Dangote Cement Plc shows impressive performance in the core operating activities of the company as revenue rose by 16.91% to ₦482.44 billion (vs. ₦412.68 billion in H1'17). The improvement in the revenue came from increased sales volumes in Nigeria and better per-tonne prices when Pan-African revenue (i.e. other African nations except Nigeria) was converted to Naira. From the company's cement capacity of 45.55 million tonnes per annum across Africa, a total of 12.36 million tonnes was produced in H1'18 (vs. 11.51 million in H1'17). In the first half year of 2018, production cost of sales increased by 11.29% to ₦197.60 billion (vs. ₦177.55 billion recorded in H1'17), this was driven by increased production volumes in Nigeria as well as the foreign exchange impact when converting Pan-African costs from local currency to Naira. However, we are enthralled with the company's ability to reduce the cost margins to 40.96% in H1'18 from 43.02% recorded in H1'17. Gross profit improved by 21.14% to ₦284.84 billion in H1'18 (vs. ₦235.13 billion in H1'17).

Foreign exchange loss of ₦11.51 billion in Q2'18 (vs. FX Gain of 10.85 billion in Q2'17), largely from Pan-African operations that use the CFA as the functional currency, almost pose a threat to profitability. Profit before tax increased by 19.25% to ₦185.54 billion in H1'18 (vs. ₦155.58 billion recorded in H1'17). However, high provision for tax completely weighed on improved performance of the company as the provision for tax increased by 57.79% to ₦72.37 billion in H1'18 (vs. ₦45.87 billion in H1'17). Profit after tax increased to ₦113.16 billion in H1'18 from ₦109.71 billion published in H1'17, representing an increase of 3.15%. Impressively, 12-month trailing EPS increased by 39.25% to ₦12.19 from ₦8.75 recorded in the previous period.

Based on the recent figures released by the company, we downgrade our target price per share to ₦217.12 and as a result, we maintain our **HOLD** rating on the stock.

Fig. 1: Quarterly results highlights

	2Q2018	1Q2018	2Q2017	Q/q Δ	Y/y Δ
Revenue (₦'mn)	240,323	242,116	204,510	-0.74%	+17.51%
Op. Profit (₦'mn)	96,730	103,787	80,250	-6.80%	+20.54%
Net profit (₦'mn)	41,041	72,123	53,847	-43.10%	-23.78%

Source: NSE, Bloomberg, PAC Research

Price:	
- Current	**₦235.00**
- Target	**₦217.12**
Recommendation:	**HOLD**

** As at Wednesday July 25, 2018*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+2.17%/+0.64%
52-week range	₦200.00 - ₦290.00
30-day Average vol.	1,134,442
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	4,004.519
EPS (₦) - 12months trailing	12.19
DPS (₦) - FY2017	10.50

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'18	H1'17
Gross profit margin	59.04%	56.98%
Net profit margin	23.46%	26.59%
Equity multiplier	2.38x	1.99x
Asset turnover	0.28x	0.25x

Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018E	FY2019E
P/E	28.03x	19.61x	17.44x	13.99x
P/B	5.52x	5.13x	5.38x	5.29x
Div Yield (%)	3.62	4.47	4.89	5.32
Pay-out Ratio	101.39%	87.60%	85.33%	74.44%
EV/EBITDA	16.6x	10.90x	9.21x	7.97x
Ev/Revenue	6.93	5.24	4.46	3.83
Sales Per Share	36.10	47.27	57.02	66.38
P/S Ratio	6.51	4.97	4.19	3.54

Source: NSE, PAC Research

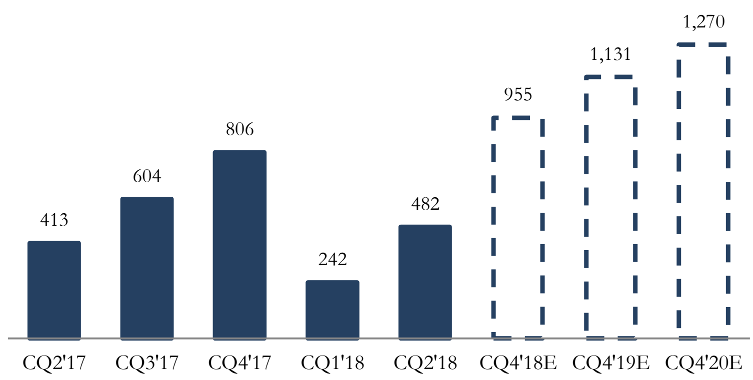
Fig. 5: DANGCEM vs NSE, 52-wk Movement (Rebased)

Source: Bloomberg, PAC Research

Increased volumes in Nigeria and better per-tonne prices in Pan-African operation lift revenue: An impressive result released by Dangote Cement in H1'18 shows an increase of 16.91% in revenue as it rose to ₦482.44 billion from ₦412.68 billion recorded in H1'17. The development in revenue was driven by increased sales volume in Nigeria and better per-tonne prices when Pan-African revenue is converted to Naira. As a result of strong market recovery, sales volume in Nigerian operation increased by 13.04% to 7.81 million tonnes in H1'18 from 6.85 million tonnes recorded in H1'17. This development improved Nigeria's revenue by 18.09% to ₦344.10 billion in H1'18 (vs. ₦291.40 billion achieved in H1'17). On the other hand, sales volumes across Pan-African operations declined by 4.00% to 4.56 million tonnes in H1'18 (vs. 4.75 million tonnes in H1'17) due to civil unrest in Ethiopia and reduction in production in Tanzania. Despite the reduction in volume, revenue in Pan-African operations improved by 11.44% to ₦138.68 billion in H1'18 (vs. ₦124.45 billion reported in H1'17), mainly as a results of foreign exchange gains when converting the sales from local currencies to Naira.

As a result of strong market recovery, sales volume in Nigerian operation increased by 13.04% to 7.81 million tonnes in H1'18 from 6.85 million tonnes recorded in H1'17.

Fig. 6: Revenue – Cum. Quarters CQ2'17-CQ4'20E (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Manufacturing costs rose by 11.29% YoY as a result of increased volumes in Nigeria and FX impact on Pan African operations:
Due to increased production volumes in Nigeria and foreign exchange impact when converting Pan-African costs from local currencies to Naira in second quarter of 2018, manufacturing costs grew by 11.29% to ₦197.60 billion in H1'18, from ₦177.55 billion recorded in H1'17. The average exchange rate in H1'18 was ₦338/$1 (vs. ₦308/$1 in H1'17) and as a result, exchange rate effect pushed up the total cost in Pan-African operations by ₦8.4 billion.

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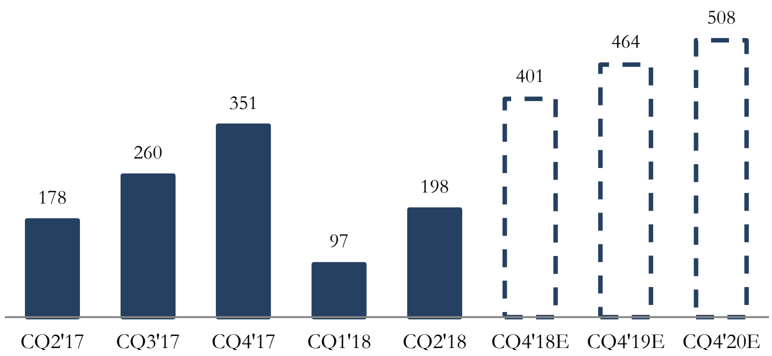
In Nigeria, manufacturing costs increased by 14.00% to ₦95.20 billion in H1'18, from ₦83.50 billion reported in H1'17.

The percentage increase in manufacturing costs in Nigeria is reflected in the 13.90% increase in total volume sold in Nigeria in half year of 2018 (H1'18: 7.81 million tonnes vs H1'17: 6.85 million tonnes).

Overall, fuel and power consumption remains the largest contributor to manufacturing cost of sales as it contributed 33.95% in H1'18 (vs. H1'17: 33.15%), closely followed by material consumed which contributed 31.28% to production cost of sales in H1'18 (H1'17: 32.49%).

Fig. 7: Production Cost of Sales Cum. Quarters CQ2'17-CQ4'20E (Billion NGN)



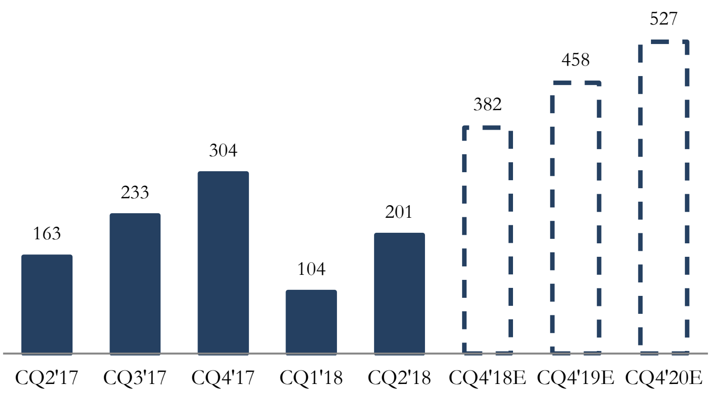
Source: NSE, Bloomberg, PAC Research

With proper management of operating expenses, operating profit strengthened by 22.64% YoY:

During the half year of 2018, gross profit of the company witnessed an upsurge of 21.14% to ₦284.84 billion from ₦235.13 billion recorded in the half year of 2017. Administrative expenses increased by 17.97% to ₦24.71 billion in H1'18 (vs. ₦20.95 billion in H1'17) while selling and distribution expenses increased to ₦62.15 billion in H1'18 from ₦51.89 billion in H1'17, representing an increase of 19.77%. In general, total selling and administrative expenses rose by 19.25% to ₦86.86 billion in H1'18, from ₦72.84 billion reported in H1'17. However, the increase in total selling and administrative expenses resulted from the exchange rate impact in converting Pan-African costs and the increased volumes in Nigeria. Pan-African administrative and selling costs rose by ₦6.70 billion as a result of exchange rate which was at ₦338/$1 during H1'18 (vs. ₦308/$1 in H1'17) while the administrative and distribution costs in Nigeria increased by ₦7.3 billion, mainly due to the increased volumes. As a result, profit from operating activities increased by 22.64% to ₦200.52 billion in H1'18 (vs. ₦163.50 billion recorded in H1'17). However, total operating expenses margin slightly increased to 18.00% in H1'18 (vs. 17.65% recorded in H1'17) while operating profit margin increased to 41.56% in H1'18 (vs. 39.62% reported in H1'17).

…profit from operating activities increased by 22.64% to ₦200.52 billion in H1'18 (vs. ₦163.50 billion recorded in H1'17)

Fig. 8: Operating Profit - Cumulative Quarters CQ2'17- CQ4'20E (Billion NGN)

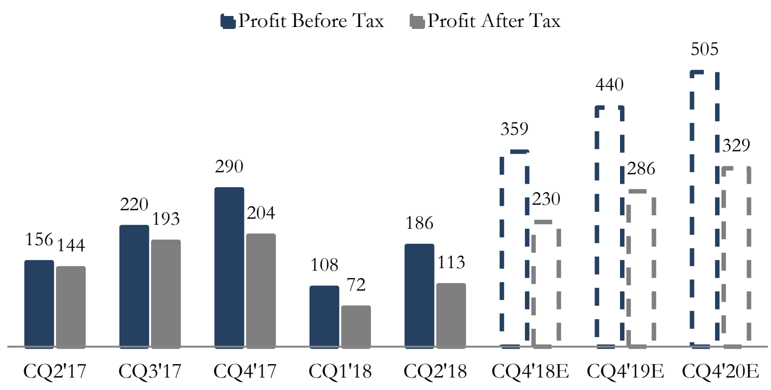


Source: NSE, Bloomberg, PAC Research

Bottom line increased by 3.15% YoY as FX loss and higher tax provision weighed on impressive performance: Impressive performance of the company was made insignificant by the deterioration of finance income which dropped by 78.25% to ₦3.59 billion in H1'18 from ₦16.49 billion reported in H1'17. The unimpressive performance of the finance income can be attributed to exchange losses in Pan-African operations. Though depreciation of Naira to ₦338/$1 in H1'18 (vs. ₦308/$1 in H1'17) resulted in exchange gains in Nigerian operations, the exchange gains were outweighed by the exchange losses in Pan-African operations that use the CFA as the functional currency, resulting in a net exchange loss of ₦2.96 billion in H1'18 (vs. net exchange gain of ₦11.21 in H1'17). With the finance costs of ₦18.56 billion in H1'18 (vs. ₦24.40 billion in H1'17), net finance cost of ₦14.98 billion was realised in H1'18 (vs. ₦7.92 billion achieved in H1'17). Profit before tax increased by 19.25% to ₦185.54 billion in H1'18 from ₦155.58 billion reported in H1'17. Meanwhile, the company made adequate provision for tax in the half year of 2018 as tax holiday it used to enjoy in previous years has elapsed. The company made a provision of ₦72.37 billion for tax in H1'18 from ₦45.87 billion (revised from ₦11.54 billion) in H1'17, representing an increase of 57.79%. The effects of exchange loss and higher tax provision weighed on profit after tax as it managed to increase by 3.15% to ₦113.16 billion in H1'18 (vs. ₦109.71 billion published in H1'17).

Impressive performance of the company was made insignificant by the deterioration of finance income which dropped by 78.25% to ₦3.59 billion in H1'18 from ₦16.49 billion reported in H1'17

Fig. 9: Profit before Tax and Profit after Tax – CQ2'17- CQ4'20E (Billion NGN)



Source: NSE, Bloomberg, PAC Research

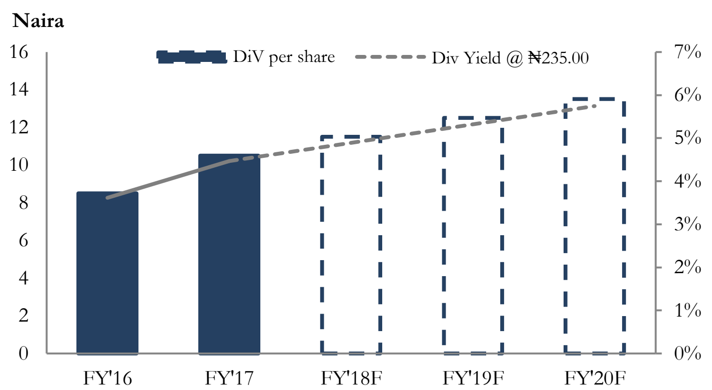
Strong balance sheet of the company guaranties dividend payment to shareholders in FY'18:

In the first half of 2018, the company improved its current assets by 34.48% to ₦486.02 billion (vs. ₦361.41 billion recorded in H1'17) while total non-current assets declined by 2.61% to ₦1.24 trillion in H1'18 (vs. ₦1.28 trillion reported in H1'17). The decrease in non-current assets was mainly driven by the decline in fixed assets (H1'18: ₦1.17 trillion vs. H1'17: ₦1.19 trillion) due to higher depreciation as many of the company's plants that were under construction reached full completion. The massive improvement achieved in total current assets outweighed the decline in non-current assets and as a result, total asset increased by 5.57% to ₦1.73 trillion in H1'18 (vs. ₦1.64 trillion in H1'17). Also, total liabilities increased by 22.83% to ₦1.00 trillion in H1'18 (vs. ₦815.29 billion reported in H1'17).

Consequently, the net assets of the company declined by 11.53% to ₦727.87 billion in H1'18 from ₦822.69 billion reported in H1'17 while the NAPS of the company reduced to ₦42.71 in H1'18 from ₦48.28 in H1'17.

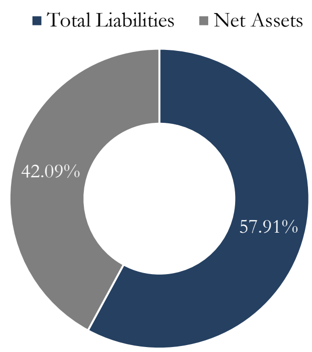
The decrease in non-current assets was mainly driven by the decline in fixed assets (H1'18: ₦1.17 trillion vs H1'17: ₦1.19 trillion) due to higher depreciation…

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



Source: NSE, PAC Research

Fig. 11: Total Liabilities Vs Net Asset in H1'18



Source: NSE, Bloomberg, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦217.12 representing a decline of 7.61% from the current price of ₦235.00. In arriving at the target price, we employed Discounted Cash flow Valuation methodology and Retained Earnings Model. Consequently, we maintained 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 and the performance of the company in the cement industry

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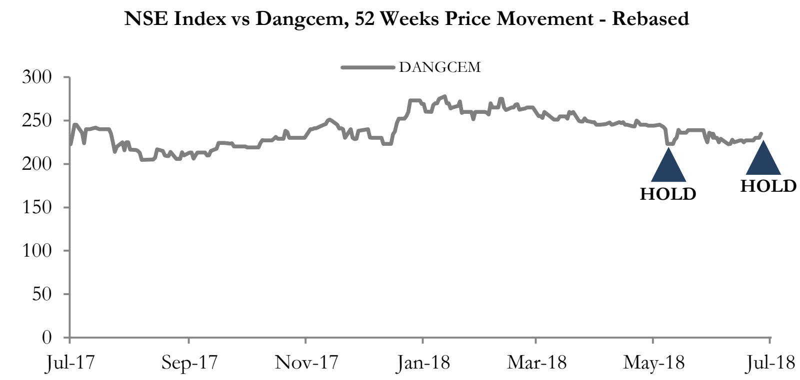
Fig. 12: Share Price History



Source: NSE, PAC Research

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

	2016	2017	2018E	2019E
Revenue	615,103	805,582	954,615	1,131,218
Change		*30.97%*	*18.50%*	*18.50%*
Cost of Sales	(323,816)	(351,290)	(400,938)	(463,800)
Change		*8.48%*	*14.13%*	*15.68%*
Gross Profit	291,287	454,292	553,677	667,419
Change		*55.96%*	*21.88%*	*20.54%*
SG&A	(119,336)	(155,297)	(176,604)	(214,931)
Change		*30.13%*	*13.72%*	*21.70%*
Other Income	10,542	5,213	4,773	5,430
Change		*-50.55%*	*-8.44%*	*13.76%*
Operating profit	182,493	304,208	381,846	457,917
Change		*66.70%*	*25.52%*	*19.92%*
Finance Income	43,817	35,926	21,956	33,937
Change		*-18.01%*	*-38.89%*	*54.57%*
Finance Cost	(45,381)	(52,711)	(44,949)	(51,624)
Change		*16.15%*	*-14.73%*	*14.85%*
Profit Before Taxation	180,929	289,590	358,853	440,229
Change		*60.06%*	*23.92%*	*22.68%*
Taxation	(38,071)	(85,342)	(129,187)	(154,080)
Change		*124.17%*	*51.38%*	*19.27%*
Profit After Taxation	142,858	204,248	229,666	286,149
Change		*42.97%*	*12.44%*	*24.59%*

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

	2016	2017	2018E	2019E
Fixed Assets	1,155,711	1,192,140	1,193,268	1,289,589
Intangible assets	4,145	6,355	6,433	7,623
Deffered tax assets	51,306	30,625	46,585	55,203
Inventories	82,903	94,594	103,289	122,398
Trade and other recievables	26,279	30,155	40,784	48,329
Bank and Cash Balances	115,693	168,387	171,831	186,651
Total current assets	303,164	410,299	459,110	521,760
Total Assets	1,529,104	1,665,883	1,735,831	1,909,017
Trade and other payables	268,966	270,721	276,838	305,429
Current tax payable	18,220	63,901	74,460	88,235
Financial debt	220,300	144,783	210,015	248,868
Other current liabilities	18,307	41,071	41,526	49,208
Total current liabilities	525,793	520,476	602,839	691,740
Deferred tax liabilities	103,162	116,898	162,284	192,307
Net Assets	725,528	781,360	744,293	756,669

Fig. 15: Profitability Ratio

	2016	2017	2018E	2019E
Return on Equity	19.69%	26.14%	30.86%	37.82%
Return on Assets	9.34%	12.26%	13.23%	14.99%
Gross margin	47.36%	56.39%	58.00%	59.00%
EBITDA margin	41.73%	48.11%	48.50%	47.98%
PBT margin	29.41%	35.95%	37.59%	38.92%
Net Profit Margin	23.23%	25.35%	24.06%	25.30%

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	0.55	0.59
Sales to total fixed assets	0.53	0.68	0.80	0.88
Equity multiplier	2.11	2.13	2.33	2.52
fixed asset turnover	1.88	1.48	1.25	1.14

Fig. 17: Liquidity Ratios

	2016	2017	2018E	2019E
Quick ratio	0.42	0.61	0.59	0.58
Current ratio	0.58	0.79	0.76	0.75
Cash ratio	0.22	0.32	0.29	0.27
Interest Coverage	3.99	5.49	7.98	8.53
Operating Cash Flow Ratio	1.22	1.44	1.35	1.18
Debt/net income	2.26	1.28	1.62	1.54
Debt/operating cashflow	0.50	0.35	0.46	0.54
Debt to asset	0.53	0.53	0.57	0.60
Total liabilities/equities	1.11	1.13	1.33	1.52
Inventory turnover	5.45	5.45	3.62	3.21
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	13.48	16.79
DPS (₦)	8.50	10.50	11.50	12.50
NAVPS (₦)	42.58	45.85	43.68	44.40
Earnings yield (%)	3.57%	5.10%	5.74%	7.15%

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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