Dangote Cement Plc

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Unimpressive Operating Performance: Dangote Cement Remains a Buy for Long-Term Investors

INVESTMENT SUMMARY

The total sales volume reported by Dangote Cement in the first half of 2019 declined marginally and this reflected on the top-line as revenue fell by 3.05% to ₦467.73 billion (vs. ₦482.44 billion in the first half of 2018). Due to Presidential/National Assembly election delay in Nigeria in February 2019, increased competition from new capacity in Nigeria and operational and economic challenges in key territories such as Ethiopia and South Africa, total cement volumes sold fell marginally by 0.60%. Out of the company's cement capacity of 45.55 million tonnes per annum across Africa, a total of 12.28 million tonnes was produced in H1'19 (vs. 12.36 million tonnes in H1'18). Overall, the group manufacturing costs fell by 2.24% to ₦193.17 billion in H1'19 (vs. ₦197.60 billion in H1'18), as a result of lower volume recorded in Nigeria, South Africa and Ghana. Mainly as a result of 33.46% increase in haulage expenses, total selling and distribution expenses rose significantly by 29.22% to ₦80.31 billion in H1'19 (vs. ₦62.15 billion in H1'18). Consequently, EBITDA fell by 11.41% to ₦217.94 billion in H1'19, from ₦246.01billion in H1'18.

The non-operating performance was relatively stable, as net finance costs increased marginally by 0.19% to ₦15.01 billion (vs. ₦14.98 billion in H1'18). With unimpressive operating performance and relatively stable non-operating performance, profit before tax fell by 16.20% to ₦155.49 billion (vs. ₦185.54 billion in H1'18). On the back of tax exemptions on three production lines in Nigeria, the company made a lower provision of ₦36.24 billion for tax (vs. ₦72.37 billion in H1'18). Consequently, profit after tax increased by 5.37% to ₦119.24 billion (vs. ₦113.16 billion in H1'18). However, the company's 12-month trailing EPS rose to ₦23.26, from ₦12.18 recorded in the previous period. We downgrade our target price per share to ₦214.44 (Previous Target Price: ₦215.73) and also maintain a **BUY** recommendation on the company shares.

Fig. 1: Quarterly results highlights

	2Q2019	1Q2019	2Q2018	Q/q Δ	Y/y Δ
Revenue (₦'mn)	227,573	240,157	240,323	-5.24%	-5.31%
Op. Profit (₦'mn)	82,114	87,845	96,730	-6.52%	-15.11%
Net profit (₦'mn)	58,986	60,254	41,041	-2.10%	43.72%

Source: NSE, Bloomberg, PAC Research

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Price:	
- Current	**₦166.00**
- Target	**₦214.44**
Recommendation:	**BUY**

** As at Wednesday August 21, 2019*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-12.49%/-24.55%
52-week range	₦161.00- ₦240.00
30-day Average vol.	1,438,332
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	2,828.72
EPS (₦) - 12months trailing	23.26
DPS (₦) - FY2018	16.00

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'19	H1'18
Gross profit margin	58.70%	59.04%
Net profit margin	25.49%	23.46%
Equity multiplier	1.99x	2.38x
Asset turnover	0.28x	0.28x

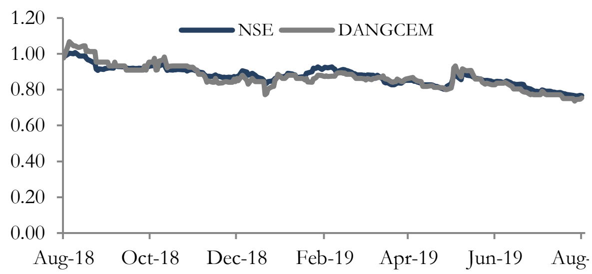
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019E	FY2020F
P/E	13.85x	7.25x	11.62x	10.37x
P/B	3.62x	2.87x	2.74x	2.69x
Div Yield (%)	6.33	9.64	7.53	8.43
Pay-out Ratio	87.60%	69.85%	87.53%	87.49%
EV/EBITDA	7.85x	6.91x	6.64x	6.18x
Ev/Revenue	3.78	3.34	3.20	3.05
Sales Per Share	47.27	52.89	54.21	56.92
P/S Ratio	3.51	3.14	3.06	2.92

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

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Revenue declines by 3.05% due to lower cement volumes in Nigeria: Dangote Cement recorded a lower cement volume in the first half of 2019 as it declined marginally by 0.65% to 12.28 million tonne (vs. 12.36 million tonne in the first half of 2018). As a result, revenue declined by 3.05% to ₦467.73 billion in H1’19 (vs. ₦482.44 billion in H1’18). The decline in both the revenue and total cement volumes can be mainly attributed to lower sales in Nigeria during the period. Due to election delay in February and increased competition in the industry, total cement volume in Nigeria fell by 2.69% to 7.60 million tonnes in H1’18 (vs. 7.81 million tonnes in H1’18) and this translated to a lower revenue of ₦328.29 billion in H1’19, compared with ₦344.10 billion reported in the corresponding period of the previous year. The average realised price on Nigerian sales was about ₦43,224.00 per tonnes ($120.00) in the half year of 2019, compared with average realised price of ₦44,059.00 per tonne in the corresponding period of previous year. However, Pan-African cement volumes increased by 2.63% to 4.69 million tonnes in H1’19 (vs. 4.57 million tonnes in H1’18) due to increased volumes in Tanzania. The higher volumes in Tanzania were partially offset by the decreased volumes in South Africa, Ghana and Ethiopia, driven by the socio-economic and power generating challenges. The higher volume in Pan-African operation reflected on the revenue which increased marginally by 1.01% to ₦140.09 billion in H1’19 (vs. ₦138.69 billion in H1’18).

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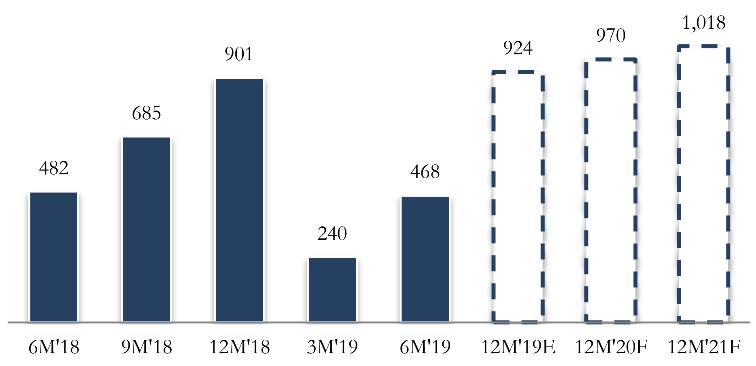
Fig. 6: Revenue – 6M’18-12M’21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Group manufacturing costs falls by 2.24% year-on-year as a result of lower cement volumes in Nigeria, South Africa and Ghana: The overall manufacturing cost declined by 2.24% to ₦193.17 billion in the half year of 2019 (vs. ₦197.56 billion in the corresponding period of the previous year), mainly as a result of lower cement volumes in Nigeria, South Africa and Ghana. Manufacturing costs in Nigeria decreased by 1.60% to ₦93.60 billion (vs. ₦95.20 billion in H1’18) while Pan-African manufacturing costs fell by 2.80% to ₦99.50 billion in H1’19 (vs. ₦102.40 billion in H1’18).

In general, administrative expenses was relatively flat at ₦24.98 billion (vs. ₦24.71 billion in H1'18) while selling and distributions expenses increased significantly by 29.22% to ₦80.31 billion in H1'19 (vs. ₦62.15 billion in H1'18). The increase in the selling and distribution expenses can be mainly attributed to higher haulage expenses, particularly in Nigeria during the period. Although Nigerian cement volumes fell by 2.80%, there was an increase in the size of the company's truck fleet as well as the proportion of sales distributed by the trucks to the customers, as opposed to sales by self-collection.

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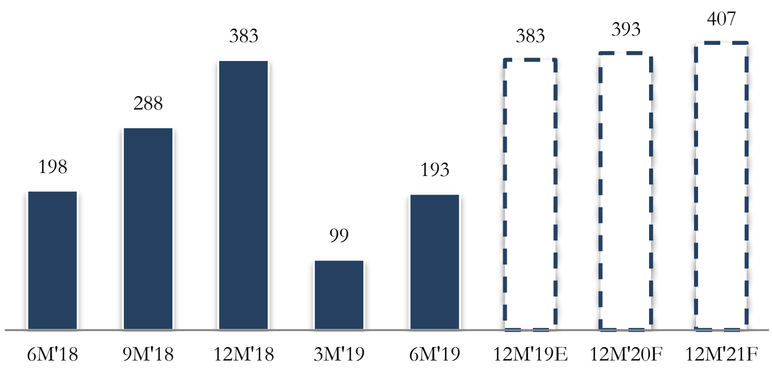
Fig. 7: Manufacturing Costs – 6M'18-12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Tax exemption benefit offsets the unimpressive operating performance as profit after tax rises by 5.37%: During the period under review, Dangote Cement recorded a stable performance in non-operating activities of the company as net finance costs was relatively flat at ₦15.01 billion in H1'19, compared with ₦14.98 recorded in the corresponding period of the previous year. Mainly as a result of unimpressive operating performance of the company during the period, profit before tax fell significantly by 16.20% to ₦155.49 billion (vs. ₦185.34 billion in H1'18).

However, Nigerian operations continued to benefit from tax exemption on Ibese Production Line 3 & 4 and Obajana Production Line 4, which was granted in the fourth quarter of 2018. These lines, according to the company, are entitled to additional two-year extension of tax exemptions and this resulted in reduced tax effective rate (ETR) of 19.00% in H1'19 (vs. 32.00% ETR in H1'18). The ETR of 19.00% in H1'19 was attributed to the mix of production lines that were out tax exemptions and the lines that are still entitled to tax exemption under the Pioneer Status Incentive. on the basis of tax exemptions on the three major operation lines, the company made a lower provision of ₦36.25 billion for tax (vs. ₦72.37 billion in H1'18) and as a result, profit after tax increased by 5.37% to ₦119.24 billion in H1'19 (vs. ₦113.16 billion in H1'18).

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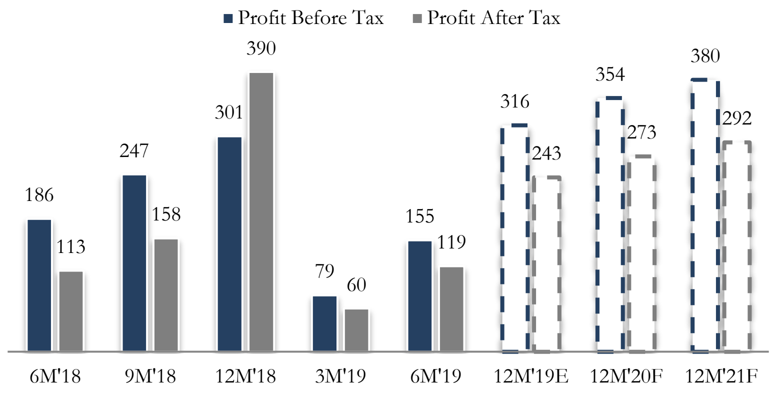
Fig. 8: Profit before Tax and Profit after Tax – 6M'18-12M'21F (Billion NGN)



Source: NSE, Bloomberg, PAC Research

Dangote Cement maintains a strong balance sheet; impressive historical dividend payment to continue in FY'19: The balance sheet position of the company remains solid, reflected in lower liabilities during the period. Total liabilities of the company declined significantly by 17.60% to ₦0.83 trillion in H1'19 (vs. ₦1.00 trillion in H1'18), due to significant reduction in deferred tax liabilities, lower financial liabilities, reduced current tax payables, trades and other payables. As a result of lower bank & cash balances, reduced inventories and lower prepayments & other current assets, total assets of the company decreased by 4.21% to ₦1.66 trillion in H1'19 (vs. ₦1.73 trillion in H1'18.

Consequently, the net assets of the company increased by 14.20% to ₦0.83 trillion in the half year of 2019 (vs. ₦0.73 trillion achieved in the half year of 2018) and this translated to a net asset per share of ₦48.78 (vs. ₦42.71 in H1'18). With a solid balance sheet position and expectation of improved revenue in the coming quarters, we presume the company to pay at least a dividend of ₦12.50 per share in the full year of 2019.

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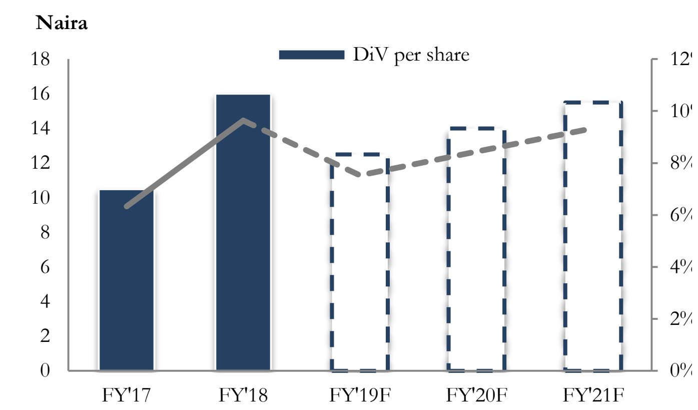
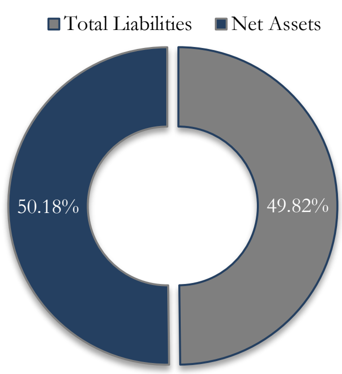
Fig. 9: Dividend Per Share and Dividend Yield (FY'17-FY'21F)



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in H1'19



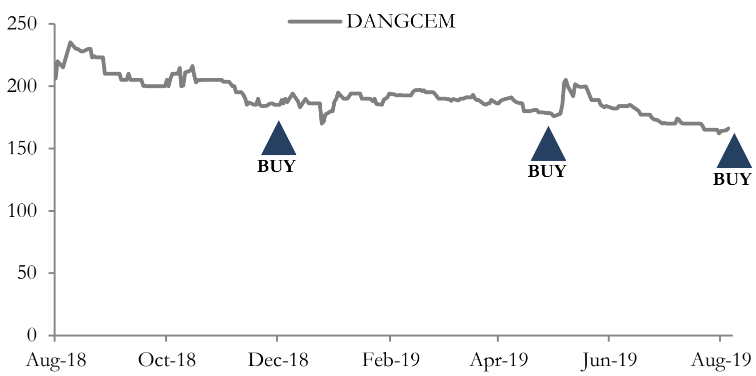
Source: NSE, Bloomberg, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦214.44, representing an increase of 29.18%, from the current price of ₦166.00. 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, higher cement prices and the performance of the company in the cement industry.

Our valuation puts the target price of the stock at N214.44, representing an increase of 29.18%, from the current price of N166.00.

Fig. 11: Share Price History (Naira)



Source: NSE, PAC Research

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

	2017	2018	2019E	2020F
Revenue	805,582	901,213	923,743	969,930
Change		*11.87%*	*2.50%*	*5.00%*
Cost of Sales	(351,290)	(383,311)	(383,353)	(392,822)
Change		*9.12%*	*0.01%*	*2.47%*
Gross Profit	291,287	454,292	517,902	540,390
Change		*55.96%*	*14.00%*	*4.34%*
SG&A	(155,297)	(189,426)	(203,224)	(211,445)
Change		*21.98%*	*7.28%*	*4.05%*
Other Income	5,213	10,222	10,161	10,669
Change		*96.09%*	*-0.60%*	*5.00%*
Operating profit	304,208	338,698	347,327	376,333
Change		*11.34%*	*2.55%*	*8.35%*
Finance Income	35,926	11,323	9,237	11,639
Change		*-68.48%*	*-18.42%*	*26.00%*
Finance Cost	(52,711)	(49,778)	(40,529)	(33,858)
Change		*-5.56%*	*-18.58%*	*-16.46%*
Profit Before Taxation	289,590	300,806	316,035	354,115
Change		*3.87%*	*5.06%*	*12.05%*
Taxation	(85,342)	89,519	(72,688)	(81,446)
Change		*-204.89%*	*-181.20%*	*12.05%*
Profit After Taxation	204,248	390,325	243,347	272,668
Change		*91.10%*	*-37.66%*	*12.05%*

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

	2017	2018	2019E	2020F
Fixed Assets	1,192,140	1,171,864	1,163,917	1,183,315
Intangible assets	6,355	5,969	6,225	6,536
Deffered tax assets	30,625	40,622	39,721	41,707
Inventories	94,594	106,998	106,230	111,542
Trade and other recievables	30,155	44,468	36,950	38,797
Bank and Cash Balances	168,387	166,896	152,418	155,189
Total current assets	303,164	428,838	436,575	453,554
Total Assets	1,665,883	1,694,463	1,702,287	1,742,162
Trade and other payables	270,721	230,970	230,936	237,633
Current tax payable	63,901	9,223	23,094	24,248
Financial debt	144,783	220,128	202,854	212,997
Other current liabilities	41,071	35,185	40,183	42,192
Total current liabilities	520,476	495,506	497,990	517,943
Deferred tax liabilities	116,898	83,350	83,137	86,324
Net Assets	781,360	986,613	1,033,866	1,052,057

Fig. 14: Profitability Ratio

	2017	2018	2019E	2020F
Return on Equity	26.14%	39.56%	23.54%	25.92%
Return on Assets	12.26%	23.04%	14.30%	15.65%
Gross margin	56.39%	57.47%	58.50%	59.50%
EBITDA margin	48.18%	48.30%	48.17%	49.37%
PBT margin	35.95%	33.38%	34.21%	36.51%
Net Profit Margin	25.35%	43.31%	26.34%	28.11%

Fig. 15: Asset Utilization

	2017	2018	2019E	2020F
cash/sales	0.21	0.19	0.17	0.16
Sales to inventory (x)	8.52	8.42	8.70	8.70
Sales to total assets (x)	0.48	0.53	0.54	0.56
Sales to total fixed assets	0.68	0.77	0.79	0.82
Equity multiplier	2.13	1.72	1.65	1.66
fixed asset turnover	1.48	1.30	1.26	1.22

Fig. 16: Liquidity Ratios

	2016	2017	2018E	2019E
Quick ratio	0.61	0.65	0.66	0.66
Current ratio	0.79	0.87	0.88	0.88
Cash ratio	0.32	0.34	0.31	0.30
Interest Coverage	5.49	6.04	7.80	10.46
Operating Cash Flow Ratio	1.44	1.81	2.04	2.06
Debt/net income	1.28	0.78	1.18	1.10
Debt/operating cashflow	0.35	0.34	0.28	0.28
Debt to asset	0.53	0.42	0.39	0.40
Total liabilities/equities	1.13	0.72	0.65	0.66
Inventory turnover	5.45	3.57	2.95	2.88
Inventory turnover days	67.00	67.00	67.00	67.00
Account payable days	211.00	211.00	211.00	211.00

Fig. 17: Shareholders' Investment Ratios

	2017	2018	2019E	2020F
EPS (₦)	11.99	22.91	14.28	16.00
DPS (₦)	10.50	16.00	12.50	14.00
NAVPS (₦)	45.85	57.90	60.67	61.74
Earnings yield (%)	7.22%	13.80%	8.60%	9.64%

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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