Dangote Cement Plc

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Depreciation of Currencies Weighs on Impressive Operating Performance in H1-2022

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INVESTMENT SUMMARY

Dangote Cement maintained impressive top-line in the first half of 2022, despite the setback recorded in cement production volume across Africa. Owing to the rising inflation, higher interest rate and energy supply disruptions, production volume of the Group fell by 7.01% to 14.21 million tonnes in H1'22 (vs. 15.28 million tonnes reported in H1'21). However, Dangote Cement benefited from higher cement price in various countries in the first half of 2022. The increase in cement price outweighed the setback recorded in production volume during the period. Consequently, the Group revenue rose by 17.01% to ₦808.04 billion in H1'22 (vs. ₦690.55 billion in H1'21). Meanwhile, inflationary pressure continued to bite hard on the manufacturing costs as it increased by 16.79% to ₦322.46 billion in H1'22 (vs. ₦276.12 billion in H1'21), despite the lower cement volumes during the period. Also, the total selling, distribution and administrative expenses grew by 43.22% to ₦169.41 billion in H1'22 (vs. ₦118.28 billion in H1'21), due to inflationary pressure and foreign currencies conversion to naira. Despite the higher operating expenses, the operating profit improved by 5.27% to ₦318.12 billion in H1'22 (vs. ₦302.20 billion in H1'21).

Due to the depreciation in the CFA and Ghana Cede during the period, net finance cost of the Group increased significantly by 154.17% to ₦53.23 billion in H1'22 (vs. ₦20.94 billion in H1'21). The setback in the non-operating activities weighed on impressive operating performance as profit before tax fell by 5.82% to ₦264.89 billion in H1'22 (vs. ₦281.25 billion in H1'21). A higher provision of ₦92.79 billion was made for tax in H1'22 (H1'21: ₦89.62 billion). Consequently, the net profit fell by 10.19% to ₦172.10 billion in H1'22 (vs. ₦191.63 billion in H1'21), resulting in a 12-month trailing earnings per share of ₦20.24. With the recent performance, supply chain disruption, current inflationary pressure, among others, we downgrade the target price per share to ₦310.60 (previous target price per share: ₦324.66) but upgrade to a **BUY** recommendation.

Fig. 1: Quarterly results highlights

	2Q2022	1Q2021	2Q2021	Q/q Δ	Y/y Δ
Revenue (₦'mn)	394,856	413,181	357,894	-4.44%	+10.33%
Op. Profit (₦'mn)	135,318	182,803	150,453	-25.98%	-10.06%
Net profit (₦'mn)	66,253	105,851	101,920	-37.41%	-35.00%

Source: NGX, Bloomberg, PAC Research

Price:	
- Current	**₦258.80**
- Target	**₦310.60**
Recommendation:	**BUY**

** As at Friday August 12, 2022*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+0.70%/+7.83%
52-week range	₦237.60 - ₦300.00
30-day Average vol.	278,214
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	4,515.73
EPS (₦) – 12 months trailing	20.24
DPS (₦) - FY2021	20.00

Source: NGX, Bloomberg, PAC Research

Fig. 3: Key ratios

	H1'22	H1'21
Gross profit margin	60.09%	60.01%
Net profit margin	21.30%	27.75%
Equity multiplier	2.88x	2.58x
Asset turnover	0.36x	0.33x

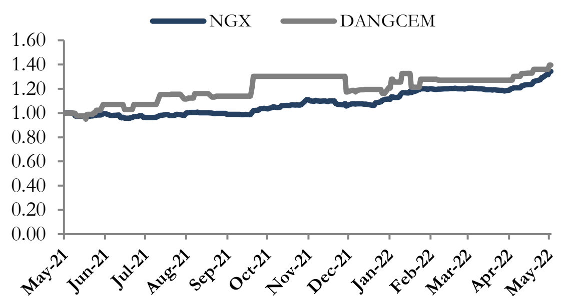
Source: NGX, PAC Research

Fig. 4: Valuations

	FY2020	FY2021	FY2022F	FY2023F
P/E	15.97x	12.10x	11.95	10.70x
P/B	4.95x	4.48x	4.53x	4.12x
Div Yield (%)	6.18	7.73	8.11	8.89
Pay-out Ratio	98.76%	93.52%	96.95%	95.12%
EV/EBITDA	10.20x	6.95x	6.33x	5.74x
Ev/Revenue	4.70	3.44	3.02	2.77
Sales Per Share	60.69	81.20	94.19	103.61
P/S Ratio	4.26	3.19	2.75	2.50

Source: NGX, PAC Research

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



Source: Bloomberg, PAC Research

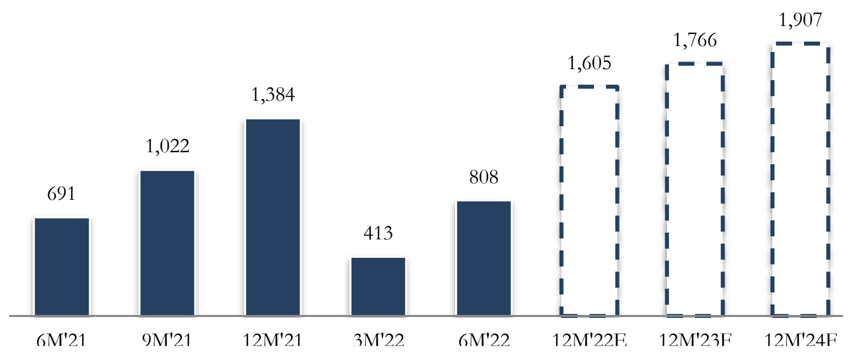
…freight costs substantially elevated and caused volatility in the landing cost of cement and clinker in Cameroon, Ghana, and Sierra Leone.

Group revenue rises by 17.01%, mainly driven by higher prices: In the first half of 2022, Nigeria witnessed energy supply challenges which resulted in lower production volume of 9.34 million tonnes during the period – a 5.34% lower than the 9.87 million tonnes reported in the first half of 2021. Also, Pan-African operations (other Africa countries, except Nigeria) faced supply chain disruption (triggered by the ongoing war between Russia and Ukraine) in the first half of 2022. This was intensified by a shut down in Congo plant (for over 2 months) owing to maintenance and repairs, in addition to the extended power plant maintenance in Senegal. Also, freight costs substantially elevated and caused volatility in the landing cost of cement and clinker in Cameroon, Ghana, and Sierra Leone. As a result of the global supply chain disruption and plant maintenance, the Pan-African cement volume fell by 11.02% to 4.86 million tonnes in the first half of 2022 (vs. 5.47 million in the first half of 2021). The energy supply challenges in Nigeria and supply chain challenges and plant maintenance in Pan-African operations resulted in Group's cement production volume of 14.21 million tonnes in the first half of 2022, which is 7.01% lower than the 15.28 million tonnes in the first half of 2021.

Despite the significant fall in cement production volume in Nigeria and other African countries, the revenue of the Group increased by 17.01% to ₦808.04 billion in H1'22 (vs. ₦690.55 billion in H1'21). The increase in the revenue is mainly attributed to the increase in cement price in Nigeria, which offset the setback recorded in production volume during the period. Specifically, revenue from Nigerian operations increased by 26.07% to ₦622.98 billion in H1'22 (H1'21: ₦494.14 billion), while revenue from Pan-African operations fell by 6.77% to ₦185.06 billion in H1'22 (H1'21: ₦198.50 billion).

In coming quarters, we do not expect significant increase in cement production volume in Pan-African operations as the global supply chain disruption still remains a major challenge. Although, the energy supply challenges has been resolved in Nigeria, the current raining season may result in slow cement demand. Nevertheless, we assume continuous improvement in revenue in coming quarters as we expect the company to benefit from the higher cement price in Nigeria.

Fig. 6: Revenue – 6M'21 - 12M'24F (Billion NGN)



Source: NGX, Bloomberg, PAC Research

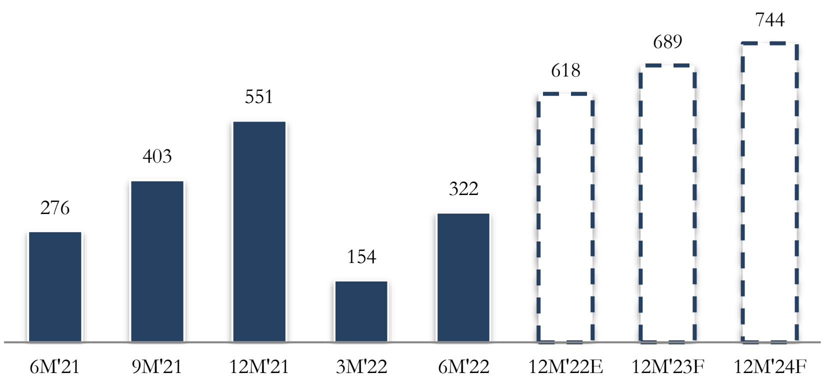
Inflationary Pressure weighs on Group manufacturing costs: Despite the lower cement production volume in the first half of 2022, the manufacturing costs of the group increased by 16.79% to ₦322.46 billion (vs. ₦276.12 billion in the first half of 2021). The increase in the group manufacturing costs is mainly attributed to the inflationary pressure, which reflected in plant maintenance cost and rising energy costs. The increase in Nigeria's manufacturing costs was mainly driven by increased plant maintenance cost, rising energy costs and increase in price of gas which is pegged to the US dollar. The Nigerian Naira depreciated by ₦10.00 to ₦421/1US$ at the end of H1'22 (vs. ₦411/1US$ at the end of H1'21).

The increase in Nigeria's manufacturing costs was mainly driven by increased plant maintenance cost, rising energy costs and increase in price of gas which is pegged to the US dollar.

Breaking the Group's manufacturing costs down, fuel & power consumed, which constituted about 40% of the total manufacturing costs, increased by 31.30% to ₦129.96 billion in H1'22 (H1'21: ₦98.98 billion) due to increasing energy costs especially AGO (diesel) and coal. Also, materials consumed cost, which constituted about 30% of the overall manufacturing cost, rose by 3.23% to ₦97.01 billion in H1'22 (H1'21: ₦93.97 billion), mainly driven by the inflationary pressures in various African countries during the period.

Mainly as a result of significant rise in the price of diesel, which resulted in 65.3% increase in haulage expenses, the total selling and administrative expenses increased by 43.22% to ₦169.41 billion in H1'22 (vs. ₦118.28 billion in H1'21). The company also attributed the part of the increase in the total administrative expenses to inflationary pressure and foreign currency conversion to naira during the period. Although, we do not expect significant increase in the production volume of the group in third quarter due to the raining season which may reduce construction and building activities, however, the rising inflation and depreciation of currencies in various African countries are expected to drive up the manufacturing costs, selling and administrative expenses in second half of 2022.

Fig. 7: Manufacturing Costs – 6M'21 – 12M'24F (Billion NGN)



Source: NGX, Bloomberg, PAC Research

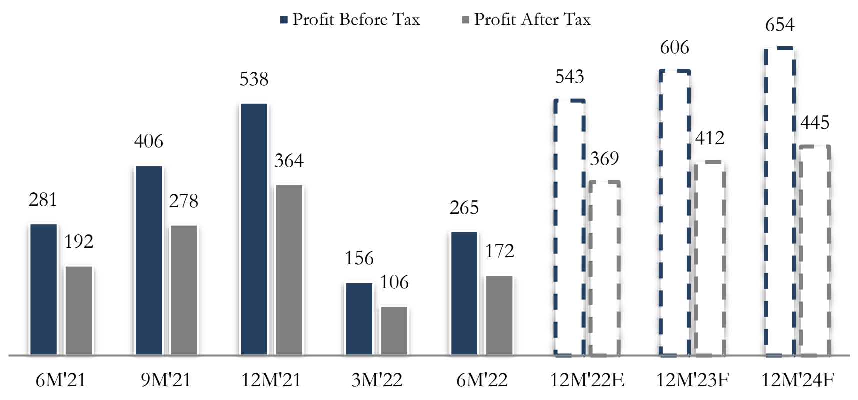
A setback in non-operating activities weighs on impressive operating performance as profit before tax fell by 5.82% year-on-year: In the first half of 2022, the net finance cost of the Group increased significantly by 154.17% to ₦53.23 billion in H1'22 (vs. ₦20.94 billion in H1'21), mainly driven by higher exchange loss.

The Group recorded exchange loss of ₦40.66 billion in H1’22, which is 722.35% higher the exchange loss of ₦4.94 billion reported in H1’21. The significant increase in the exchange loss is attributed to the depreciation in CFA and Ghana Cede.

The setback recorded in the non-operating activities weighed on the profitability of the Group as profit before tax declined by 5.82% to ₦264.89 billion H1’22 (vs. ₦281.25 billion recorded in H1’21). The company made a higher provision of ₦92.79 billion for tax in H1’22 (H1’21: ₦89.62 billion), mainly driven by Nigeria’s income tax of 30% and education tax. Consequently, profit after tax declined by 10.19% to ₦172.10 billion in H1’22 (vs. ₦191.63 billion reported in H1’21), which resulted in basic/diluted earnings per share (EPS) of ₦10.10 in H1’22 (H1’21: ₦11.21).

The company made a higher provision of ₦92.79 billion for tax in H1’22 (H1’21: ₦86.62 billion), mainly driven by Nigeria’s income tax of 30% and education tax.

Fig. 8: Profit before Tax and Profit after Tax – 6M’21 -12M’24F (Billion NGN)



Source: NGX, Bloomberg, PAC Research

Balance sheet remains healthy in Q2’22; Expectation of impressive historical dividend payment in FY’22: Dangote Cement maintained impressive financial position in the second quarter of 2022 as the total assets improved by 7.84% to ₦2.24 trillion (vs. ₦2.07 trillion recorded in the second quarter of 2021), mainly driven by improvement recorded in current assets. The current assets improved by 27.70% to ₦0.79 trillion in Q2’22 (vs. ₦0.62 trillion reported in Q2’21) due to 37.41% growth in inventories, 27.19% rise in prepayments and other current assets and 28.19% increase in bank and cash balances. Meanwhile the non-current assets of the company fell slightly by 0.54% to ₦1.45 trillion in Q2’22 (vs. ₦1.46 trillion reported in Q2’21) due to less aggressive investment cycle and the impact of exchange differences during the period. Additional investment in property, plant and equipment was ₦38.9 billion during the period, of which ₦25.6 billion was spent in Nigeria and ₦13.3 billion in Pan-African operations.

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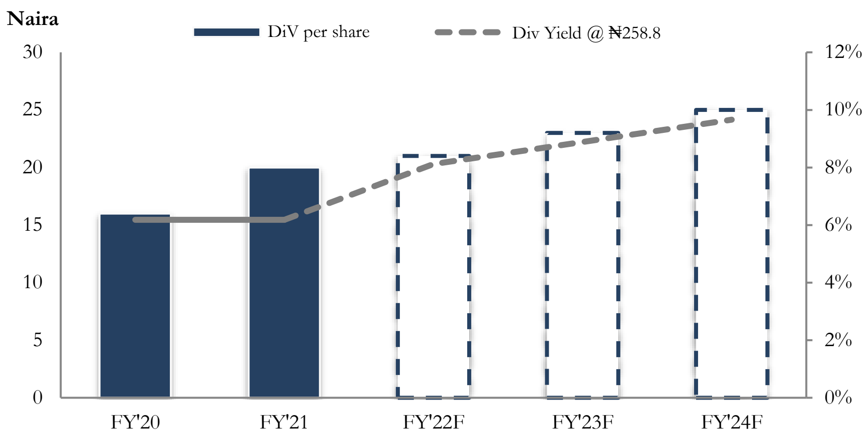
However, the total liabilities of the group increased significantly by 15.11% to ₦1.46 trillion in Q2’22 (vs. ₦1.27 trillion in Q2’21) as a result of higher current tax payables, financial liabilities, among others. The increase in the total liabilities outweighed the improvement in the total assets of the company during the period. Consequently, the net assets fell by 3.62% to ₦0.78 trillion in Q2’22 (vs. ₦0.81 trillion reported in Q2’21), which resulted in a net asset per share of ₦45.53 (vs. ₦47.24 in Q2’21).

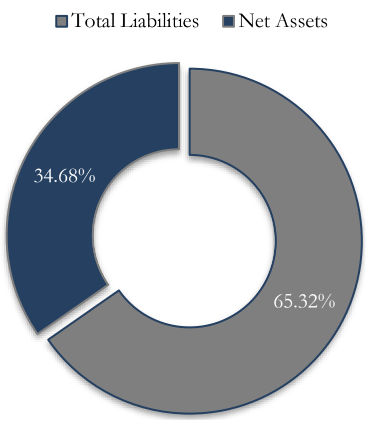
We maintain that the anticipation of improved operating performance (to be mainly driven by high cement price) is expected to raise bottom-line in coming quarters. Hence, expectation of impressive dividend payment in the full year of 2022.

Fig. 9: Dividend Per Share and Dividend Yield (FY'20-FY'24F)



Source: NGX, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in Q2'22



Source: NGX, Bloomberg, PAC Research

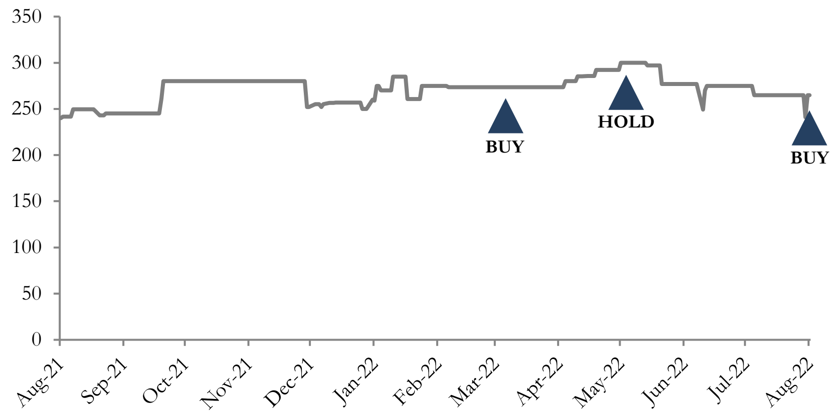
Valuation

Our valuation puts the target price of the stock at ₦310.60, representing an increase of 19.18%, from the current price of ₦258.80. In arriving at the target price, we employed Discounted Cash Flow (DCF) valuation model and residual income valuation methodology. Consequently, we upgrade to 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, the current cement price/volume and the outlook of the management.

Our valuation puts the target price of the stock at ₦310.60, representing an increase of 19.18%, from the current price of ₦258.80.

Fig. 11: Share Price History (Naira)



Source: Bloomberg, PAC Research

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

	2020	2021	2022E	2023F
Revenue	1,034,196	1,383,637	1,605,019	1,765,521
Change		*33.79%*	*55.19%*	*10.00%*
Cost of Sales	(437,970)	(551,019)	(617,932)	(688,553)
Change		*25.81%*	*41.09%*	*11.43%*
Gross Profit	596,226	832,618	987,087	1,076,968
Change		*39.65%*	*65.56%*	*9.11%*
SG&A	(214,058)	(256,007)	(337,054)	(353,104)
Change		*19.60%*	*57.46%*	*4.76%*
Other Income	4,754	6,221	3,531	3,884
Change		*30.86%*	*-25.72%*	*10.00%*
Operating profit	386,734	582,491	653,564	727,748
Change		*50.62%*	*69.00%*	*11.35%*
Finance Income	29,814	20,765	41,730	45,904
Change		*-30.35%*	*39.97%*	*10.00%*
Finance Cost	(43,988)	(65,707)	(152,477)	(167,724)
Change		*49.37%*	*246.63%*	*10.00%*
Profit Before Taxation	373,310	538,366	542,817	605,927
Change		*44.21%*	*45.41%*	*11.63%*
Taxation	(97,242)	(173,927)	(173,702)	(193,897)
Change		*78.86%*	*78.63%*	*11.63%*
Profit After Taxation	276,068	364,439	369,116	412,030
Change		*32.01%*	*33.70%*	*11.63%*

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

	2020	2021	2022E	2023F
Property, Plant & Equip.	1,390,687	1,472,859	1,492,668	1,641,934
Intangible assets	4,554	5,122	7,223	7,945
Deffered tax assets	11,708	5,163	6,420	7,062
Inventories	108,270	167,205	208,652	229,518
Trade and other recievables	35,194	47,469	56,176	61,793
Bank and Cash Balances	145,835	339,843	353,104	388,415
Total current assets	550,138	873,042	1,038,929	1,142,822
Total Assets	2,022,451	2,392,019	2,586,327	2,844,960
Trade and other payables	349,388	371,224	393,230	432,553
Current tax payable	59,781	153,385	176,552	194,207
Financial debt	335,011	401,393	465,455	512,001
Other current liabilities	83,460	148,294	160,502	176,552
Total current liabilities	829,817	1,076,483	1,199,110	1,319,021
Deferred tax liabilities	122,980	135,003	160,502	176,552
Net Assets	890,970	983,669	972,802	1,070,082

Fig. 14: Profitability Ratio

	2020	2021	2022E	2023F
Return on Equity	30.99%	37.05%	37.94%	38.50%
Return on Assets	13.65%	15.24%	14.27%	14.48%
Gross margin	57.65%	60.18%	61.50%	61.00%
EBITDA margin	46.12%	49.44%	47.75%	48.25%
PBT margin	36.10%	38.91%	33.82%	34.32%
Net Profit Margin	26.69%	26.34%	23.00%	23.34%

Fig. 15: Asset Utilization

	2020	2021	2022E	2023F
cash/sales	0.14	0.25	0.22	0.22
Sales to inventory (x)	9.55	8.28	7.69	7.69
Sales to total assets (x)	0.51	0.58	0.62	0.62
Sales to total fixed assets	0.74	0.94	1.08	1.08
Equity multiplier	2.27	2.43	2.66	2.66
fixed asset turnover	1.34	1.06	0.93	0.93

Fig. 16: Liquidity Ratios

	2020	2021	2022E	2023F
Quick ratio	0.53	0.66	0.69	0.69
Current ratio	0.66	0.81	0.87	0.87
Cash ratio	0.18	0.32	0.29	0.29
Interest Coverage	8.49	8.19	3.56	3.61
Operating Cash Flow Ratio	1.09	0.85	0.83	0.75
Debt/net income	1.66	1.47	1.70	1.67
Debt/operating cashflow	0.51	0.59	0.63	0.69
Debt to asset	0.56	0.59	0.62	0.62
Total liabilities/equities	1.27	1.43	1.66	1.66
Inventory turnover	9.45	8.21	10.93	8.06
Inventory turnover days	38.11	43.83	32.95	44.67
Account payable days	287.19	242.53	229.09	226.15

Fig. 17: Shareholders' Investment Ratios

	2020	2021	2022E	2023F
EPS (₦)	11.77	16.20	21.66	24.18
DPS (₦)	16.00	16.00	21.00	23.00
NAVPS (₦)	52.69	52.29	57.09	62.80
Earnings yield (%)	4.55	6.26	8.37	9.34

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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