Dangote Cement Plc

Nigeria | Equities | Industrial Goods | April 3, 2018 — PAC RESEARCH

Improved Product Pricing Boosts Earnings

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Price:	
- Current	₦260.00
- Target	₦262.87
Recommendation:	HOLD

** As at Thursday March 29, 2018*

INVESTMENT SUMMARY

Dangote Cement Plc reported a stellar performance in its FY'17 audited account. The company reported 30.97% rise in revenue to ₦805.58 billion in FY'17 (vs. ₦615.10 billion in FY'16). The increase in the revenue was driven by higher product price in Nigeria and increased volume in Pan Africa operations (i.e. other African nations except Nigeria). For the period, the company's cement capacity stays at 45.55 million tonnes per annum, however cement production volumes dropped to 21.91 million tonnes in FY'17 against 23.57 million tonnes reported in FY'16, representing a drop of 7.04%. Production cost of sales rose by 8.48% to ₦351.29 billion in FY'17 (vs. ₦323.82 billion recorded in FY'16). The increase in the production cost of sales is attributed to the increased volume in Pan African operations, particularly in Ethiopia, Zambia, Cameroon, Sierra Leone and Congo. Due to reduced sales volume in Nigeria, manufacturing costs of sales reduced by 11.00% to ₦158.60 billion in FY'17 from ₦178.10 billion in FY'16. However, we are impressed with the company's ability to reduce the cost margins as gross profit grew faster than revenue, having grown by 55.96% to ₦454.29 billion in FY'17 (vs. ₦291.29 billion in FY'16).

With proper management of cost, increased price of cement in Nigeria and improved volume in Pan Africa segments, profit before tax increased by 60.06% to ₦289.59 billion in FY'17 (vs. ₦180.93 billion in FY'16). However, provision for tax weigh on improved performance of the company as the provision for tax increased by 124.17% to ₦85.34 billion in FY'17 (vs. ₦38.07 billion in FY'16). As a result, profit after tax increased to ₦204.25 billion in FY'17 from ₦142.86 billion in FY'16, representing an increase of 42.97%. As usual, the company rewarded shareholders with improved dividend as dividend per share increased by 23.53% to ₦10.50 in FY'17 (vs. ₦8.50 in FY'16)

Based on the recent figures of the company, we recommend a **HOLD** on the stock with a target price of ₦262.87

Fig. 1: Quarterly results highlights

	4Q2017	3Q2017	4Q2016	Q/q Δ	Y/y Δ
Revenue (₦'mn)	202,007	190,899	173,011	+5.82%	+16.76%
Operating Profit (₦'mn)	71,121	69,641	60,186	+2.13%	+18.17%
Net profit (₦'mn)	11,112	49,092	9,337	-77.36%	+19.01%

Source: NSE, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	+13.04%/+57.58%
52-week range	₦158.99 - ₦290.00
30-day Average vol.	915,214
Shares Outstanding ('mn)	17,040.51
Market Cap. (₦bn)	4,430.532
EPS (₦) - 12months trailing	11.99
DPS (₦) - FY2017	10.50

Source: NSE, Bloomberg, PAC Research

Fig. 3: Key ratios

	FY'17	FY'16
Gross profit margin	56.39%	47.36%
Net profit margin	25.35%	23.23%
Equity multiplier	2.13x	2.11x
Asset turnover	0.25x	0.23x

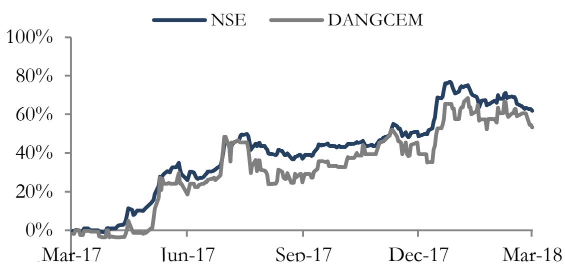
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018F	FY2019F
P/E	31.01x	21.69x	18.44x	15.99x
P/B	6.11x	5.67x	5.34x	4.35x
Div Yield (%)	3.27	4.04	4.42	4.81
Payout Ratio	101.39%	87.60%	81.56%	76.89%
EV/EBITDA	19.04x	12.16x	11.50x	10.42x
Ev/Revenue	7.62	5.77	4.99	4.23
Sales Per Share	36.10	47.27	57.20	69.79
P/S Ratio	7.20	5.50	4.55	3.73

Source: NSE, PAC Research

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

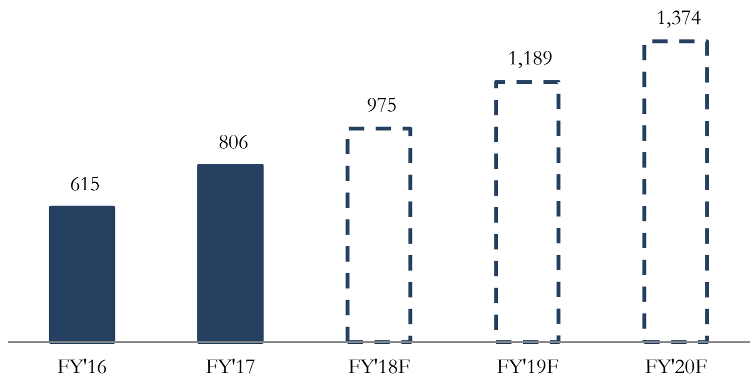


Source: Bloomberg, PAC Research

Improved product pricing in Nigeria and increased volumes in Pan African operations lift revenue: Dangote Cement consistently posts a significant YoY growth in revenue over the years. Revenue in FY'17 increased by 30.97% to ₦805.58 billion (vs ₦615.10 billion in FY'16), driven by increased revenue per tonne in Nigeria and increased volumes in Pan Africa segments. Though cement volumes in Nigeria operations dropped by 15.89% to 12.72 million tonnes in FY'17 (vs. 15.13 million tonnes in FY'16), improved pricing drove Nigerian revenue up by 29.62% to ₦552.36 billion in FY'17 from ₦426.13 billion in FY'16. Total volume in Pan Africa segments increased by 8.40% to 9.36 million tonnes in FY'17 (vs. 8.64 million tonnes in FY'16), boosted by increased volumes in Cameroon, Ethiopia, Tanzania, Zambia and Senegal. As a result, revenue in Pan African segment increased by 32.52% to ₦258.44 billion in FY'17 (vs. ₦195.03 billion in FY'16).

Revenue in FY'17 increased by 30.97% to ₦805.58 billion (vs ₦615.10 billion in FY'16), driven by increased revenue per tonne in Nigeria and increased volume in Pan Africa segments.

Fig. 6: Grosss Earnings - FY'16-FY'20F (Billion NGN)



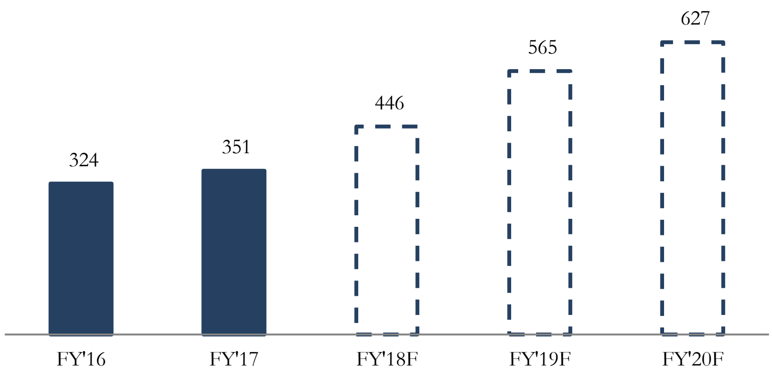
Source: NSE, PAC Research

Production cost of sales increases by 8.48% YoY, resulting from increased volume in Pan Africa operations: In full year 2017, cost of sales grew by 8.48% to ₦351.29 billion (vs. ₦323.82 billion in FY'16). The growth in production cost of sales can be attributed to the increased production volume in Ethiopia, Zambia and Cameroon, as well as maiden operations in Sierra Leone and Congo. In addition to increased production volume in Pan Africa operations, exchange rate also contributed to the increased production cost in Pan Africa as exchange rate stood at ₦331/$1 at the end of 2017 (vs. ₦304/$1 in 2016). Exchange rate effects contributed about ₦35.00 billion to increase in production cost in other African nations. Though, production cost of sales in Nigeria reduced by 11.00% to ₦158.60 billion in FY'17 (vs. ₦178.10 billion in FY'16) as a result of reduced sales volume and improved fuel mix, the increase in production cost of sales in Pan Africa outweigh the decrease in production cost of sales in Nigeria.

The growth in production cost of sales can be attributed to the increased production volume in Ethiopia, Zambia and Cameroon, as well as maiden operations in Sierra Leone and Congo

Overall, materials consumed and fuel and power consumed constituted larger part of the cost of production in FY'17 as they contributed 31.76% (FY'16: 26.93%) and 31.67% (FY'16: 34.67%) respectively.

Fig. 7: Production Cost of Sales (Billion NGN)



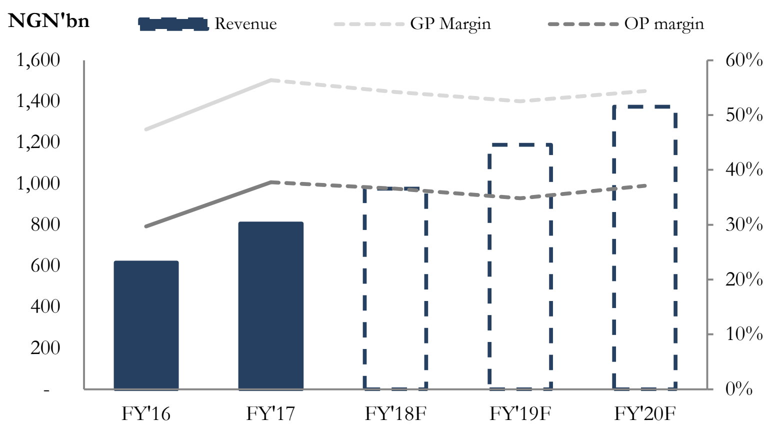
Source: NSE, PAC Research

Operating profit margin improved as the company monitored its operating expenses:

During the period, gross profit increased by 55.96% to ₦454.29 billion in FY'17 (vs. ₦291.29 billion in FY'16). Administrative expenses increased by 23.76% to ₦45.38 billion in FY'17 from ₦36.67 billion in FY'17 while selling and distribution expenses increased to ₦109.92 billion in FY'17 from ₦82.67 billion in FY'16, representing an increase of 32.96%. The increase in total selling and administrative expenses resulted from higher sales and associated cost in Pan Africa operations and increase export sales from Nigeria. As a result, profit from operating activities increased by 66.70% to ₦304.21 billion in FY'17 (vs. ₦182.49 billion recorded in FY'16). However, total operating expenses margin slightly reduced to 19.28% in FY'17 from 19.40% recorded in FY'16 while operating profit margin increased to 37.76% FY'17 from 29.67% reported in FY'16.

The increase in total selling and administrative expenses resulted from higher sales and associated cost in Pan Africa operations and increase export sales from Nigeria.

Fig. 8: Revenue, Gross Profit Margin and Operating Profit Margin (FY'16-FY'20F)

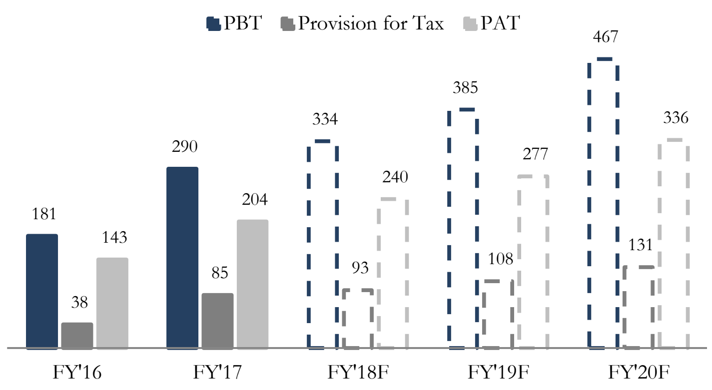


Source: NSE, PAC Research

Tax Provision almost poses a threat to bottom line as the company seek new tax relief approval: During the review period, profit before tax increased by 60.06% to ₦289.59 billion in FY'17 (vs. ₦180.93 billion reported in FY'16). However, tax provision weighed on strong performance of the company as the company made a provision of ₦85.34 billion for tax in FY'17 from ₦38.07 billion (revised from ₦5.70 billion) in FY'16, representing an increase of 124.17%. The increase in tax provision was triggered by the operations in Ibese production lines 3 & 4 and Obajana production line 4 as the approval for tax relief, which the company is entitled to under Pioneer Status Incentive (PSI), is still pending. However, the directors made a provision against the Pioneer tax relief as the company continues to pursue the approval with the Nigerian Investment Promotion Commission (NIPC). If the NIPC approves the applications the tax benefit in FY'17 would be ₦62.2 billion (FY'16: ₦43.8 billion). Overall, the strong operating performance of the company lifted the profit after tax as it increased by 42.97% to ₦204.25 billion in FY'17 (vs. ₦142.86 billion recorded in FY'16).

The increase in tax provision was triggered by the operations in Ibese production lines 3 & 4 and Obajana production line 4 as the approval for tax relief, which the company is entitled to under Pioneer Status Incentive (PSI), is still pending

Fig. 9: Profit bef. Tax, Prov. for Tax and Profit after Tax (Billion NGN) (FY'16-FY'20F)



Source: NSE, PAC Research

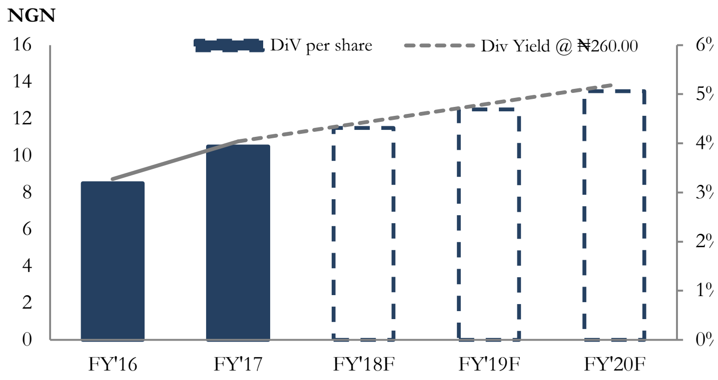
The company rewarded the shareholders with improved dividend as balance sheet remains strong:

The company recommended a dividend of ₦10.50 per share in FY'17 (vs. ₦8.50 in FY'16) and this represents an increase of 23.53% from the preceding year. This will result in a total dividend payment of ₦178.9 billion in FY'17 (vs. ₦144.8 billion in FY'16) and this represents a payout ratio of 87.60% in 2017 (2016: 101.39%). During the period the company increased its total assets by 8.95% to ₦1.67 trillion in FY'17 from ₦1.53 trillion in FY'16 while total liabilities increased by 10.07% to ₦884.52 billion in FY'17 (vs. ₦803.58 billion reported in FY'16).

The company recommended a dividend of ₦10.50 per share in FY'17 (vs. ₦8.50 in FY'16) and this represents an increase of 23.53% from the preceding year.

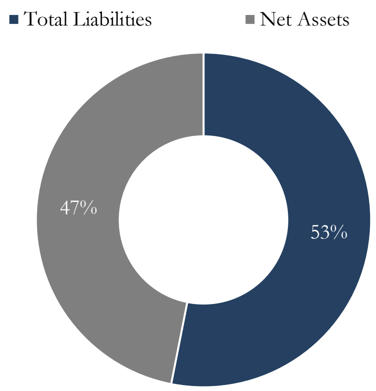
Consequently, the company increased its net asset by 7.70% to ₦781.36 billion in FY'17 from ₦725.53 billion in FY'16.

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



Source: NSE, PAC Research

Fig. 11: Total Liabilities Vs Net Asset in FY'17



Source: NSE, PAC Research

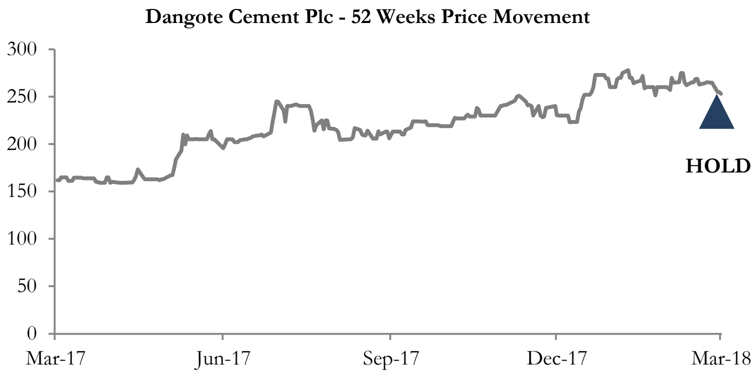
Valuation

Our valuation puts the target price of the stock at ₦262.87 representing an increase of 1.10% from the current price of ₦260.00. In arriving at the target price, we employed Discounted Cashflow 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

Our valuation puts the target price of the stock at N262.87 representing an increase of 1.10% from the current price of N260.00.

Fig. 12: Share Price History



Source: NSE, PAC Research

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

	2016	*2017*	*2018F*	*2019F*
Revenue	615,103	805,582	974,754	1,189,200
Change		30.97%	21.00%	22.00%
Cost of Sales	(323,816)	(351,290)	(446,077)	(564,989)
Change		8.48%	26.98%	26.66%
Gross Profit	291,287	454,292	528,677	624,211
Change		55.96%	16.37%	18.07%
SG&A	(119,336)	(155,297)	(189,112)	(230,716)
Change		30.13%	21.77%	22.00%
Other Income	10,542	5,213	16,706	20,381
Change		-50.55%	220.47%	22.00%
Operating profit	182,493	304,208	356,272	413,876
Change		66.70%	17.11%	16.17%
Finance Income	43,817	35,926	46,886	68,974
Change		-18.01%	30.51%	47.11%
Finance Cost	(45,381)	(52,711)	(69,442)	(98,078)
Change		16.15%	31.74%	41.24%
Profit Before Taxation	180,929	289,590	333,715	384,772
Change		60.06%	15.24%	15.30%
Taxation	(38,071)	(85,342)	(93,440)	(107,736)
Change		124.17%	9.49%	15.30%
Profit After Taxation	142,858	204,248	240,275	277,036
Change		42.97%	17.64%	15.30%

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

	2016	2017	2018F	2019F
Fixed Assets	1,155,711	1,192,140	1,462,131	1,807,584
Intangible assets	4,145	6,355	6,569	8,014
Investments in associates	1,582	3,749	3,412	4,162
Finance lease receivables		6,614	6,614	6,614
Deffered tax assets	51,306	30,625	47,568	58,033
Prepayments for PPP	13,196	16,101	20,912	25,512
Inventories	82,903	94,594	105,468	128,671
Trade and other rec.	26,279	30,155	41,644	50,806
Prep. & other cur. assets	78,280	115,496	131,845	160,851
Bank and Cash Balances	115,693	168,387	175,456	196,218
Total Assets	1,529,104	1,665,883	2,001,633	2,446,484
Trade and other payables	268,966	270,721	311,921	368,652
Current tax payable	18,220	63,901	53,124	59,460
Financial debt	220,300	144,783	331,416	380,544
Deferred tax liabilities	103,162	116,898	152,452	142,704
financial liabilities	152,475	242,894	272,931	416,220
LT prov. & other charges	3,344	3,416	5,299	6,465
Deferred revenue	1,072	839	1,699	2,073
long term payables	17,730	-	28,097	34,278
Total Liabilities	803,576	884,523	1,171,244	1,427,848
Net Assets	725,528	781,360	830,389	1,018,636

Fig. 15: Profitability Ratio

	2016	2017	2018F	2019F
Return on Equity	19.69%	26.14%	28.94%	27.20%
Return on Assets	9.34%	12.26%	12.00%	11.32%
Gross margin	47.36%	56.39%	54.24%	52.49%
EBITDA margin	40.02%	47.47%	43.34%	40.59%
PBT margin	29.41%	35.95%	34.24%	32.36%
Net Profit Margin	23.23%	25.35%	24.65%	23.30%

Fig. 16: Asset Utilisation

	2016	2017	2018F	2019F
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	0.49	0.49
Sales to total fixed assets	0.53	0.68	0.67	0.66
Equity multiplier	2.11	2.13	2.41	2.40
fixed asset turnover	1.88	1.48	1.50	1.52

Fig. 17: Liquidity Ratios

	2016	2017	2018F	2019F
Quick ratio	0.42	0.61	0.47	0.47
Current ratio	0.58	0.79	0.62	0.62
Cash ratio	0.22	0.32	0.24	0.23
Interest Coverage	3.99	5.49	4.81	3.92
Operating Cash Flow Ratio	0.00	1.44	1.12	1.04
Debt/net income	2.26	1.28	2.01	1.89
Debt/operating cashflow	0.50	0.35	0.59	0.59
Debt to asset	0.53	0.53	0.59	0.58
Debt to equity	1.11	1.13	1.41	1.40
Total liabilities/equities	1.11	1.13	1.41	1.40
Inventory turnover	5.45	5.45	3.75	3.46
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	2018F	2019F
EPS (₦)	8.38	11.99	14.10	16.26
DPS (₦)	8.50	10.50	11.50	12.50
NAVPS (₦)	42.58	45.85	48.73	59.78
Earnings yield (%)	3.22%	4.61%	5.42%	6.25%

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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