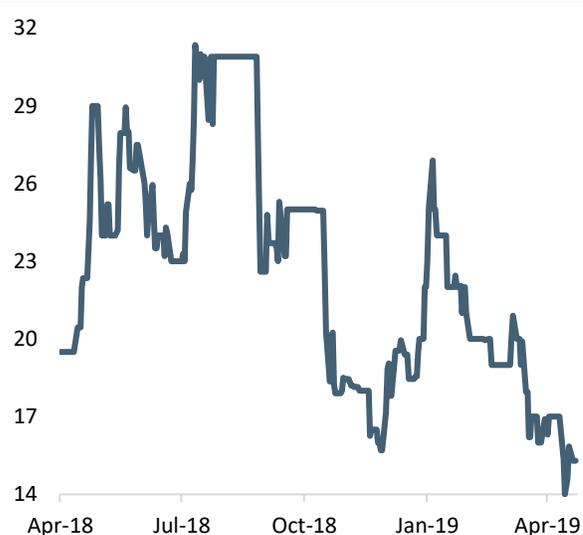


Rating	<b>BUY</b>
Price	₦15.30
FVE	<b>₦22.87</b>
52-week range	₦14.40 – ₦32.00
Market Cap. (N'bn)	201.096
1-month Avg. Vol	335,722
Current PE	13.82x

### CCNN.NL - Share Price Trend



### Analyst(s)

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## CCNN Plc (CCNN.NL)

### Stock Report

#### Expanding volumes, any upside for gross margin?

- In our last report on the enlarged Cement Company of Northern Nigeria Plc (CCNN) following the release of its Q1 2019 result (See report: *Solid volume, diluted EPS, pricey valuation*), we noted that despite the strong volume growth and the expanding market share in the North, the pass through to earnings per share remain clouded. While we see increasing volume growth on the horizon, with our forecast<sup>1</sup> average capacity utilization of 88% and domestic market share of 5.6% by FY 2023 (excluding the additional capacity 3 million tons as guided by management) from 3.1% in 2018, we believe a lot more efficiency needs to be achieved on the new plant as regards energy cost for the top line growth to have a meaningful impact on shareholders given the sizeable dilution that accompanied the merger.
- However, reflecting our upbeat expectation on volumes and the recent ₦3,000 per tonne increase by the sector leader, we expect better margins in the coming quarters. Further into our forecast horizon, we see increased efficiency on the new plant translating to improvement in margins with average estimate of 48% (Prior estimate: 43%). Irrespective, we note that when compared to DANGCEM (58%), our modelled CCNN's gross profit margin is much lower. During our discussion with management of BUA/CCNN in the past week, they guided to a dedicated approach to scale up efficiency on the new plant to achieve a more telling impact on EPS. Particularly, they guided to reducing the cost of transporting coal from Kogi, which is approximately 50% of the actual cost of the coal.

- While we maintain our view on the trajectory of margin over our forecast horizon, we delineate a scenario on how targeted approach to reducing energy cost (which currently accounts for 54% of total production costs) could translate to improved earnings to shareholder. We ruled out any significant increase in price ahead of the market leader, given that price remain the major competitive play for CCNN in the North.
- **Room for margin expansion....** Despite the push in volumes and increase in revenue per ton, CCNN's FY19E gross margin (although expanding) is still much lower than DANGCEM's<sup>2</sup> of 58%, with the major differential stemming from energy cost. For context, over Q1 2019 DANGCEM's production cost per ton printed at ₦15,695, with CCNN's much higher at ₦22,329. Further breakdown showed energy cost for DANGCEM accounted for 32% (₦5,096) of production cost compared CCNN's of 54% (₦12,151).

During our recent meeting, management harped on putting measures to drive energy cost much lower by acquiring its own fleet for the transportation of locally sourced coal from Kogi (which constitutes 70% of the total coal used), as against the current model of outsourcing the haulage service. This is expected to drive energy cost lower by half and could implicitly reduce production cost per tonne by 25%. That said, we flexed our model for the best possible valuation of CCNN by estimating different energy costs per ton which implied varying levels of gross margins based on our current volumes and price projections. In our working model, we conservatively assume energy cost per ton of ₦12,000 which does not incorporate savings from the new transportation model.

**Table 1: Scenario analysis**

	Energy cost per tonne	Cost per tonne	Gross margin	EPS	ROA	FVE	2019 P/E
<b>Scenario A</b>	6,000	16,308	62%	1.70	6%	36.02	21.18
<b>Scenario B</b>	9,000	19,308	55%	1.43	5%	29.45	20.65
<b>Scenario C</b>	12,000	22,308	48%	1.15	4%	22.87	19.88
<b>5-yr avg.<sup>3</sup></b>	13,684	22,858	32%	1.46	10%	NA	6.67
<b>Dangcem</b>	<b>5,096</b>	<b>15,695</b>	<b>59%</b>	<b>14.14</b>	<b>23%</b>	<b>248.14</b>	<b>15.96</b>

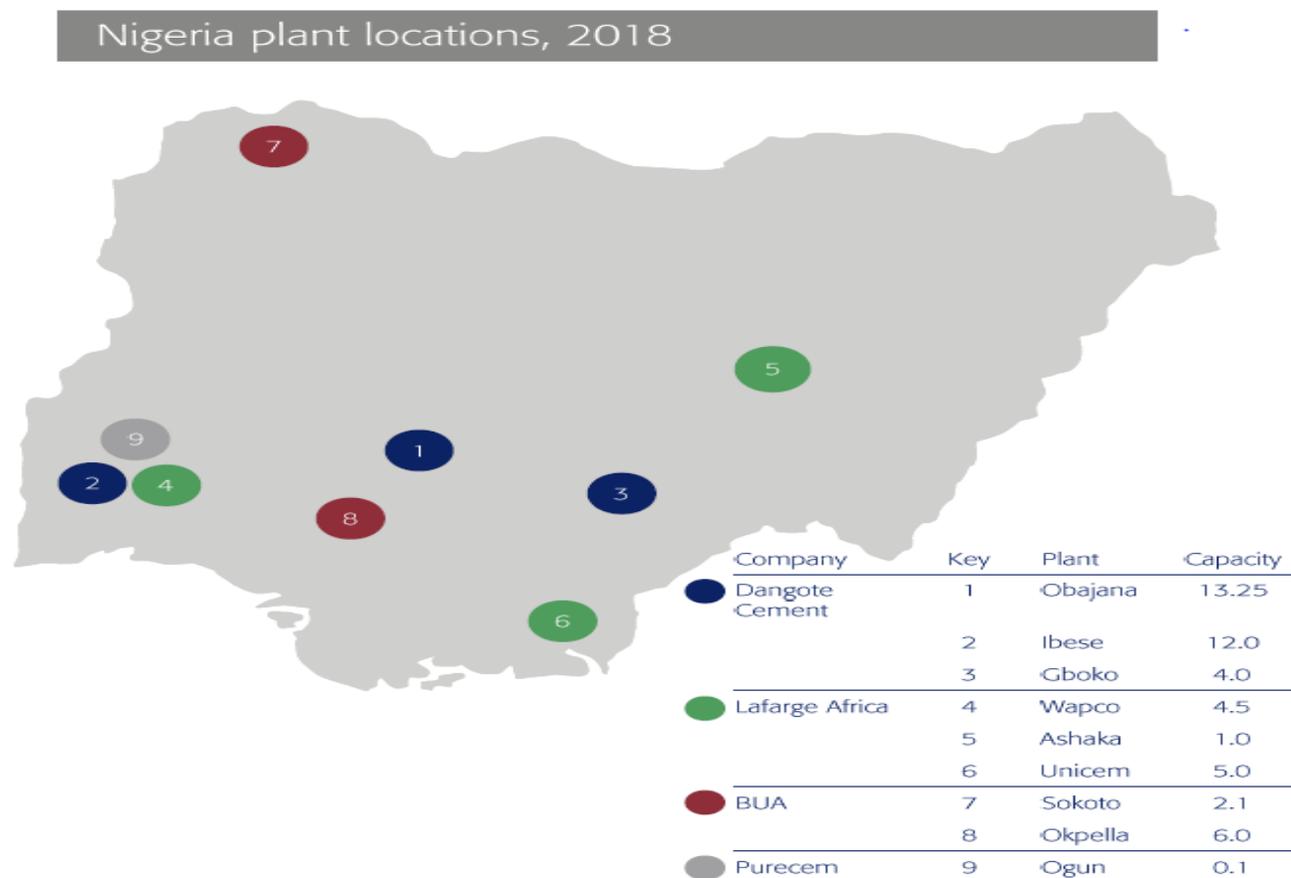
Source: ARM Research

- **Upbeat volume expectation.** That said, we estimate a 79% utilisation rate over 2019 (Q1 18: 82%), which implies volume of 1.6mt – 1.4mt domestic consumption and 206,303 in exports to neighbouring countries. Our optimism on CCNN's volumes hinges on the favourable siting in the North West and proximity to neighbouring countries – particularly Niger, Mali, Burkina Faso. Further boosting our optimism on volumes was the jump in prepayments made by customers which increased from ₦2 billion in FY 18 to ₦8.3 billion in Q1 19.

<sup>2</sup> Group gross margin.

<sup>3</sup> 2013-2017

**Figure 1: Cement plant locations in Nigeria as at 2018**



Source: Dangote Cement Plc presentation

- Expanded margins on the horizon.** On price, with the ₦150/50kg bag (₦3,000/ton, excluding any discounts) price increase in April by the market leader and management confirming adoption of same, we raised our per ton estimate higher to ₦42,770 over 2019. This combined with projection of a lower production cost per ton to ₦22,308 in 2019 (2018: ₦23,590, 2017: ₦25,310) – reflecting the improved energy mix from coal-powered plant – we now project a higher gross margin of 48% over 2019 compared to our previous estimate of 42% and FY 18’s margin of 45%.
- We assume a lower opex to sales ratio of 19% over 2019 (2018: 21%), which implies an increase in opex by 91% YoY to ₦11.5 billion. Specifically, we expect increase selling and distribution expenses to increase to ₦4.8 billion, driven by the increased volumes sold, while we estimate increase in administrative expenses to ₦7.1 billion in 2019 with the technical and management fees to Damnaz Cement contributing the most to the increase. According to management, the payment to Damnaz constitutes proportion of total revenue for technical services rendered to CCNN. Despite the increase in opex, EBIT remains strong at ₦21 billion, with the related margin surging 617 bps YoY to 31% in 2019.

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- Overall, we estimate PBT of ₱19.9 billion, while based on a slightly slower effective tax rate of 24% (2018: 25%), PAT should print at ₱15.1 billion. This translates to EPS of ₱1.21 in 2019 compared to ₱0.44 in 2018, while we estimate dividend per share of ₱0.98 in 2019 (2018: ~~₱0.44~~) based a pay-out ratio of 85% (2018: 92%). **That said, we note that possible upside for earnings lies in CCNN obtaining the approval for pioneer tax status from NIPC** (which is currently ongoing) by the end of the year, as proposed by management. However, given the uncertainties surrounding pioneer tax applications (like it did in DANGCEM), we await further assurances before incorporating this to our model.
  - The above adjustments raised our FVE to ₱22.87 (previous estimate of ₱17.31) which translates to **BUY** on our rating. However, on a relative basis, we note that despite the increased FY 19E EPS, the stock is trading at a premium when compared to our FY 19 P/E of 19.9x when compared to DANGCEM of 15.96x.
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## Summary of Results and Forecast

ANNUAL							
Income Statement (₹ million)	2017A	2018A	2019F	2020F	2021F	2022F	2023F
Volume (000' tons)	467.7	742.2	1,587.0	1,700.0	1,800.0	1,860.0	1,900.0
Price (N'000)	42.0	42.7	42.8	42.6	42.4	42.2	42.0
Revenue	19,588	31,722	67,881	72,363	76,248	78,408	79,707
COGS	11,840	17,511	35,402	37,597	39,415	40,675	41,094
Gross Profit	7,749	14,211	32,479	34,766	36,833	37,734	38,612
Operating Cost	3,369	6,580	12,558	13,242	13,801	14,035	14,108
Operating Profit	4,483	7,875	20,023	21,668	23,223	23,934	24,783
Finance Income	108	138	158	192	226	270	321
Finance expense	199	388	420	287	347	0	372
PBT	4,203	7,592	19,894	21,513	23,077	23,762	24,592
Tax	979	1,860	4,775	5,206	5,631	5,846	6,099
PAT	3,224	5,731	15,119	16,307	17,446	17,917	18,493
Balance Sheet (₹ million)							
Fixed Assets	12,325	219,573	226,376	234,704	243,355	252,665	262,212
Stocks	6,516	12,642	24,931	25,064	27,466	28,019	28,104
Trade debtors	2,674	4,044	8,643	9,226	9,709	9,997	10,149
Cash & other bank balances	3,134	596	3,236	10,125	7,599	4,815	1,744
Total Assets	24,649	347,746	374,077	390,011	399,019	406,387	413,100
Trade Creditors	6,101	8,861	17,736	19,075	19,896	20,515	20,773
Non-current Liabilities	3,071	2,705	3,050	2,974	3,126	3,149	3,227
Total liabilities	10,236	14,259	27,143	32,027	36,441	40,301	43,644
Shareholders' fund	14,412	333,488	346,934	358,642	363,306	366,835	370,232
Key Ratios							
P/E	3.7	45.8	23.6	21.8	20.4	19.9	19.3
EV/EBITDA	1.9	25.7	15.0	13.8	13.1	12.9	12.7
ROA	14.4%	3.1%	4.2%	4.3%	4.4%	4.4%	4.5%
ROE	24.9%	3.3%	4.4%	4.6%	4.8%	4.9%	5.0%
Net Margins	16.5%	18.1%	22.3%	22.5%	22.9%	22.9%	23.2%
EPS	2.6	0.4	1.2	1.2	1.3	1.4	1.4
Gross margins	39.6%	44.8%	47.8%	48.0%	48.3%	48.1%	48.4%
EBIT margins	22.9%	24.8%	29.5%	29.9%	30.5%	30.5%	31.1%
PBT margins	21.5%	23.9%	29.3%	29.7%	30.3%	30.3%	30.9%
Effective Tax rates	23.3%	24.5%	24.0%	24.2%	24.4%	24.6%	24.8%
Debt to Equity	5.35%	0.16%	0.16%	0.17%	0.20%	0.23%	0.27%
Debt to Assets	3.13%	0.15%	0.15%	0.16%	0.18%	0.20%	0.24%
Interest coverage	11.5	18.7	69.7	62.5	62.4	54.2	48.3
BVPS	11.5	25.4	26.4	27.3	27.6	27.9	28.2

Source: ARM Research \*unless otherwise stated

## ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
<b>UNDERWEIGHT</b>	Minimize exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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