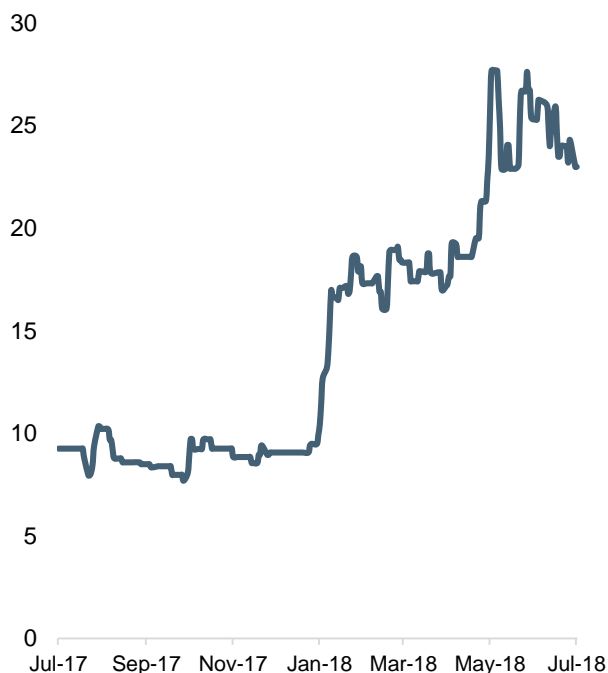


Price	₦23.00
FVE	Under Review
52-week range	₦8.00 – ₦30.45
Market Cap. (₦'bn)	28.90
1-month Avg. Vol	467,919
Current PE	7.6x

CCNN.NL - Share Price Trend



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CCNN Plc (Sokoto Cement)

Equity Commentary

One game before the Finals

- Our constructive view on Cement Company of Northern Nigeria (CCNN) just got clearer and now move to the finals – full information – following management’s notice of a merger of CCNN and Kalambaina Cement Company Limited (Kalambaina). To recall, we published a report in May 2018, wherein we noted our optimistic view on CCNN on the back of capacity expansion by BUA in Sokoto (*See report: [A case for optimism...stay tactical](#)*) of 1.5MT to complement CCNN’s current existing plant of 500KT which now operates just about full capacity (98%). Considering that the new plant is fully-owned by BUA (CCNN’s parent company), we accessed the possible structure on how the plant would be integrated into CCNN, which we assumed three scenarios: (1) a debt related structure (finance lease); (2) contract manufacturing services (operating lease); and (3) consolidation of BUA cement plants into a single entity as well as our TP on the scenarios.
- Putting more clarity to our scenarios, management of CCNN announced a merger of CCNN and Kalambaina – a wholly owned subsidiary of BUA wherein the new cement plant (1.5MT) in Sokoto sits. The consideration for the merger is based on 100,000 shares of Kalambaina for 19,811,372 shares of CCNN (1:198) using the 30-day volume weighted average (VWAP) closing price of ₦25.99. Additional details on the number of shares to be issued by CCNN or outstanding shares of Kalambaina is yet to be disclosed. We await more information

post AGM on the 26th of July 2018. ([Click here for AGM details](#)).

- We are playing one more scenario analysis on CCNN, focusing on the dilutive impact of the additional shares to be issued by CCNN for the acquisition of the asset which is estimated at \$350 million, based on discussion with management of BUA.

Table 1: Key details of the existing and new plant

Description	Old Plant	New Plant
Cement Plant Name	CCNN	Kalambaina plant
Capacity (Tonnes)	500,000	1,500,000
Location	Sokoto	Sokoto
Energy use	LFPO	Coal
Ownership Structure	CCNN	BUA

- We valued the plant of \$350 million using prevailing exchange rate of ₦360/\$ (Scenario 1) and average exchange rate over the 3-year construction period of ₦251/\$ (Scenario 2) which translates to asset value of ₦126 billion and ₦87.9 billion respectively. Juxtaposing the asset value to the 30-day VWAP of ₦25.99 translates to additional shares of 4.84 billion and 3.38 billion units accordingly. Consequently, outstanding shares should come to 6.10 billion and 4.64 billion units for Scenario 1 and 2 in that order.

Table 2: Impact of an asset value conversion

Description	Scenario 1	Scenario 2
New Capacity (MT)	1.5	1.5
Estimate Cost (\$'Million)	350	350
Exchange Rate (₦/\$)	360	251
Estimate Cost (₦' Billion)	126.00	87.85
VWAP (₦)	25.99	25.99
Estimated Shares Issued (Billion)	4,848	3,380
Current Shares Outstanding (Billion)	1,256	1,256
Total shares outstanding After Conversion (Billion)	6,104	4,636
EPS (₦) 2018	0.97	1.38
FVE (₦)	28.47	34.68

- Secondly, we assumed an increase in current shares outstanding by the multiple of the increase in plant size of 3x plus a 20% premium to account for the differences in market value of the assets and the installation of a coal power plant (Scenario 3). This implies CCNN will issue additional shares of 4.52 billion with total outstanding of 5.78 billion.

- Our model is Under Review pending full information from management.

Table 3: Combined entity estimated performance

	2018	2019	2020	2021	2022
Current Capacity (MT)	2.00	2.00	2.00	2.00	2.00
Utilization	30.3%	52.0%	55.0%	59.0%	64.0%
Cement Production	0.61	1.04	1.10	1.18	1.28
Financial Highlight (₦mn)					
Revenue	25,273	42,952	45,210	48,498	52,288
Cost of sales	11,878	20,617	21,701	23,764	24,052
Depreciation	2,100	4,200	4,200	4,200	4,200
PAT	5,916	10,465	11,025	11,774	14,212
FCFF	8,051	18,212	16,976	17,375	19,144

- While we believe cement production in Kalambaina started in May, with our discussion with dealers in Sokoto suggesting that delivery time has significantly improved, we do not expect a consolidation of such production in CCNN's soon to be released Q2 numbers with revenue expected solely from CCNN 500KT plant. Our discussion with dealers in Sokoto suggests that delivery time has significantly improved. Over Q2, we estimate 18.3% YoY (-8.85 QoQ) increase in volume to 117k tonnes, overlaid on per tonne ex-factory price of ₦41,980 translates to revenue of ₦4.93 billion (+18.5% YoY and -8.6% QoQ).
- On cost, despite shutdown in operation at the Kaduna refinery and higher LPFO price (fallout of the increase in crude oil prices) over most part of Q1 2018, cost to sales ratio still contracted 204bps QoQ to 58.0%, helped largely by the relative exchange rate stability. Accordingly, with our estimate of lower volume over Q2 18 and slightly improved activity at Port Harcourt refinery, we expect lower FX exposure relative to Q1. As such, we estimate input cost to print at ₦2.72 billion (-1.7% YoY and -13.3% QoQ) which should sustain gross margin at 44.9% (vs. 33.6% in Q2 17) – gross profit to rise 58.6% YoY to ₦2.21 billion. Further down, we expect the company to achieve efficiency in terms of its distribution, with a slower increase in operating expense (+8.2% YoY vs. +53.2% YoY in Q2 17), which should support expansion in operating margin to 30% (vs. 17.3% in Q2 17). Coalescing the above positives, we therefore forecast PAT at ₦1.15 billion (+122.4% YoY) which translates to EPS of ₦0.91 using existing shares outstanding.

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
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	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
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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