

**Cement Company of Northern Nigeria Plc. | Earnings Report**

3 months ended 31<sup>st</sup> March, 2016

**Improved prices to taper earnings pressure (₦10.12 - BUY)**
**Increasing market competition drives revenue compression**

- Cement Company of Northern Nigeria Plc. (CCNN) released unaudited results for 3 months ended 31<sup>st</sup> March, 2016. Revenues declined for the seventh consecutive quarter to ₦3.6 billion (-20% YoY but +6% relative to our Q1 16E), with a more modest decline in input costs driving a sharp drop (-62% YoY) in PBT and PAT to ₦357 million and ₦243 million respectively.
- The decline in sales reflects significantly depressed prices (-25% YoY to ~₦24,688) as cement volumes rebounded (+5% YoY by our estimates) in the period. We note that CCNN which, had hitherto enjoyed above market cement pricing (~10% higher) due to its geographical location, was forced to cut prices in Q4 15 following the influx of cheaper cement after Dangote effected an 18% price cut in September 2015. Indeed, to preserve market share, the company doubled discounts on sales to ~10% in Q1 16.
- For input costs, the modest decline to ₦2.8 billion (-5% YoY) primarily reflects lower energy cost (~45% of input costs). In Q1 16, CCNN's energy costs declined 31% YoY to ₦1.3 billion reflecting savings on LFPO—its key source of energy—whose prices declined (-16% YoY) in tandem with down-leg in crude oil prices. Consequently, gross profits halved to ₦807 million with related margins

**Income Statement Data**

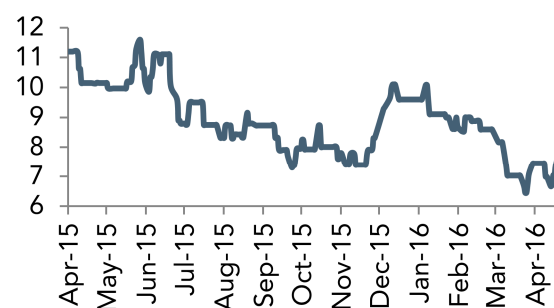
	2016 – 3M'm	2015 – 3M'm	% chg
<b>Revenue</b>	3,570	4,435	-20%
<b>PBT</b>	357	929	-62%
<b>Tax</b>	114	297	-62%
<b>PAT</b>	243	632	-62%

**Balance Sheet Data**

	2016-Mar 'm	2014-Dec 'm	%chg
<b>Inventory</b>	5,044	5,497	-8.2%
<b>Receivables</b>	1,143	508	125%
<b>Cash</b>	1,450	1,019	42%
<b>Payables</b>	3,981	3,587	11%
<b>Net Assets</b>	10,387	10,145	2%

**Stock Data**

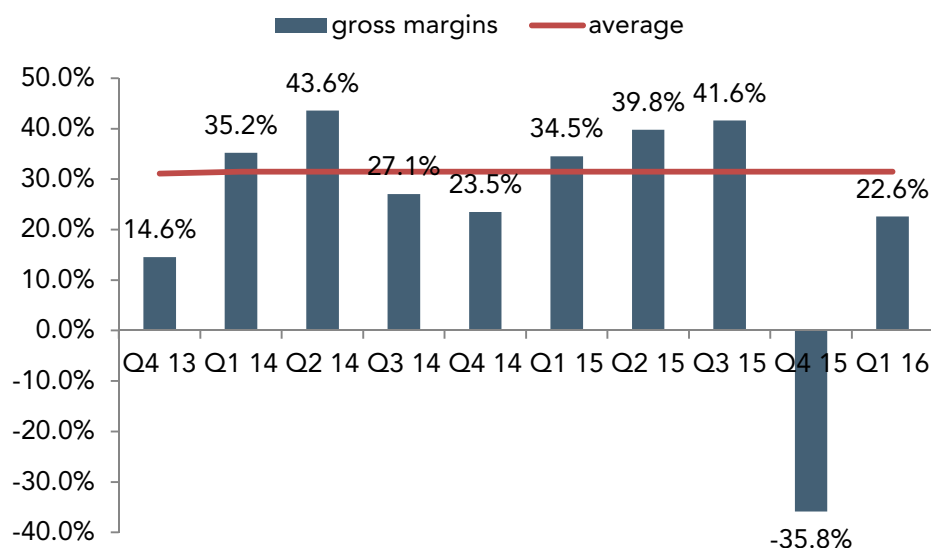
<b>Price</b>	₦7.86
<b>52 week range</b>	₦7.31 – ₦13.23
<b>Market Cap. (N'm)</b>	10.267
<b>1-month Avg. Vol</b>	175468
<b>Curr. PE</b>	8.5x
<b>Bloomberg Ticker</b>	CCNN:NL
<b>Reuters Ticker</b>	CCNN.LG

**CCNN of Nigeria Plc. - Share Price Trend**

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shrinking for the second consecutive quarter (-11.9pps YoY to 22.6%). Crucially, excluding the cheaper energy costs, the impact of lower cement prices on margins would have been more visible as gross profit would have dropped 85% YoY to ₦219 million, implying 28.5pps slump in related margins to 6%.

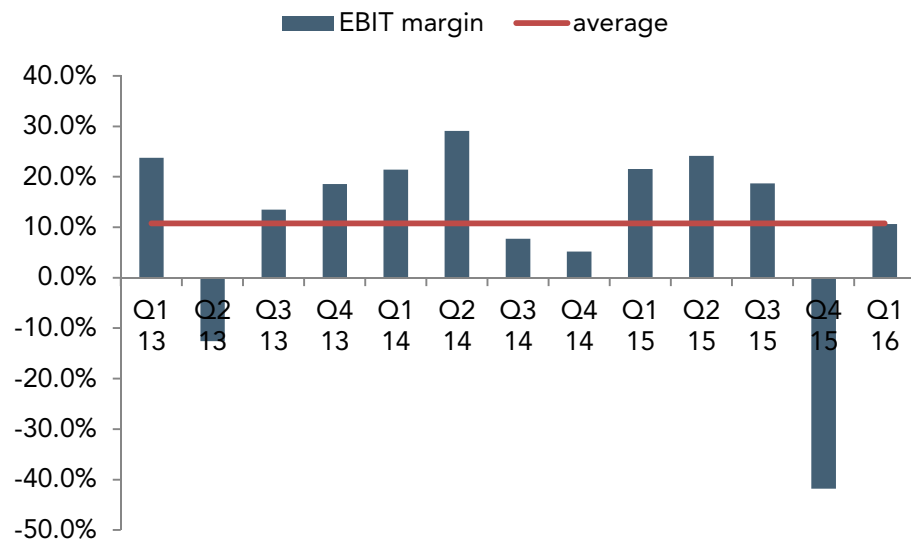
- Unsurprisingly, despite 26% YoY decline in operating cost to ₦427 million, operating profits was also weak at ₦379 million (vs. Q1 15: ₦955 million), with related margins contracting for the second consecutive quarter to 10.6% (-10.9pps YoY). The price induced pressures ultimately filtered into bottom-line with PBT and PAT declining to ₦357 million and ₦243 million implying margins of 10% (-11pps YoY) and 6.8% (-7.5pps YoY) respectively.

**Figure 1: Historical gross margins**



Source: Company financials, ARM Research

**Figure 2: Movements in operating margins**



Source: Company financials, ARM Research

### Earnings pressure to taper on higher prices

- Overall, whilst negative price movement underpinned weaker Q1 16 performance for CCNN, it appears the impact of weaker prices is set to lessen in the coming periods. Specifically, going by our recent engagement with management of cement companies after the 13% price increase in March, cement prices in Nigeria look set to remain relatively high in coming periods as cement businesses remain open to allowing prices reflect impact of long-dragging energy shocks or significant naira devaluation. Thus, with energy shortage still posing short term pressures for industry price setter—Dangcem—and repair works at Trans Forcados gas infrastructure dragging considerably longer than expected, we forecast cement prices to remain around current levels (i.e. ~₦30, 800 per ton) over the rest of the year. This should cascade to a rebound in CCNN's top-line to ₦13.8 billion (+6% YoY) in 2016E. However, whilst we expect implementation of FGN's infrastructure spend on transport, housing, and works to further trigger increases in cement consumption in the domestic market over our forecast horizon, 2016-2020, CCNN's limited plant size should place restraint on potential revenue upside going forward (2016-2010 CAGR: 3.9%).

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- Despite improvements in energy cost in the last quarter due to fall in LPFO prices (Q1 16: -16% YoY), our target cost to sales ratio is now only 3pps lower at 68% in 2016E as recent changes in oil prices and frequent production disruption in Kaduna refinery suggest that gains from falling LPFO prices may be short-lived. Thus, our target input cost for 2016 is only 4% lower at ₦9.4 billion (2016E: +4% YoY; CAGR: +3.7% over 2016-2020). Hence, whilst knock-on effect of stronger top-line should see gross profits rise (+12% YoY) to ₦4.4 billion in 2016E relative to ₦4 billion in previous forecasts, we are less sanguine on gross profit growth potential going forward (2016-2020 CAGR: 4.4%) as the initial impact of current price increase peters out.
  - Leaving our assumptions for operating expense unchanged, our input cost adjustments should translate to FY 2016 EPS of ₦0.79 (vs. ₦0.54 in previous estimate). Farther out, we expect EPS to slightly increase as fresh government spending triggers increases in cement consumption, implying EPS CAGR of 2% over 2016-2020 (vs. -1% over 2010-2015 period).
  - CCNN trades at current 2016E EV/EBITDA and P/B of **3.0x** and **0.9x** relative to 7.6x and 1.2x for Bloomberg EMEA peers—a discount we believe is justified by the company's small size and constrained EPS growth potential which have underpinned investors' aversion to the stock. That said, with our current FVE of **₦10.12** (vs. ₦9.90 in previous communication) now 29% higher than the stock's last market price, we believe the market may have also overreacted to CCNN's fundamental constraints given heightened investor sensitivity following declining oil prices and domestic business activities since Q4 14. Thus, our new FVE implies an upgrade in recommendation to **BUY** (vs. NEUTRAL in previous communication).
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## Summary of Results and Forecasts

QUARTERLY					
Income Statement (R'mln)*	Q1 2016A	Q2 2016F	Q3 2016F	Q4 2016F	
Turnover	3,570	4,016	3,047	3,216	
COGS	2,763	2,731	2,072	1,851	
Gross Profit	807	1,285	975	1,364	
Operating Costs	427	879	879	846	
Operating Profit	379	365	365	351	
Net Finance Charges	37	13	13	-19	
PBT	357	354	354	352	
Taxation	114	106	106	98	
PAT	243	248	248	253	
ANNUAL					
Income Statement (R'mln)	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Revenue	13,038	13,848	14,630	14,965	15,321
COGS	9,080	9,417	10,241	10,326	10,571
Gross Profit	3,958	4,431	4,389	4,639	4,749
Operating Cost	2,136	3,033	2,780	2,993	3,217
Operating Profit	1,889	1,461	1,675	1,713	1,601
Interest income	123	142	238	420	447
Interest expense	462	186	146	177	187
PBT	1,550	1,417	1,767	1,957	1,861
Tax	348	425	530	587	558
PAT	1,201	992	1,237	1,370	1,303
Balance Sheet (R'mln)					
	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
<b>Assets</b>					
Cash & Short term funds	7,347	7,427	7,538	7,639	7,742
Net Loans	4,540	4,818	5,058	5,046	5,412
Fixed Assets	652	692	850	860	915
LT investment	4,394	4,755	4,939	5,219	5,383
Other Assets	17,202	17,978	18,677	19,059	19,896
<b>Total Assets</b>					
Liabilities	3,360	3,736	3,868	3,661	3,558
Deposits	1,985	2,045	2,131	2,263	2,386
Borrowings	6,818	7,314	7,592	7,580	7,667
<b>Total liabilities</b>	<b>10,384</b>	<b>10,665</b>	<b>11,085</b>	<b>11,479</b>	<b>11,850</b>
Shareholders' fund	7,347	7,427	7,538	7,639	7,742
Key Ratios					
	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
P/E	8.2	10.0	8.0	7.2	7.6
EV/EBITDA	2.7	3.0	2.7	2.5	2.6
ROA	7%	6%	7%	7%	7%
ROE	12%	9%	11%	12%	11%
Net Margins	9%	7%	8%	9%	9%
EPS	1.0	0.8	1.0	1.1	1.0
P/B	1.0	0.9	0.9	0.9	0.8

Source: ARM Research

### 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 reasonable portfolio constraints
<b>UNDERWEIGHT</b>	Minimise exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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