

Dangote Sugar Refinery Plc. (Dangsuga.NL)

Stock Report

Sustained cost Efficiency to salvage lost sales

- Amidst pressures from smuggled low-priced sugar and the Apapa gridlock, Dangote Sugar's Q1 2019 numbers came in strong with the company reporting gross margin expansion of 800bps YoY to 33%. The expansion emanated largely from faster decline in raw material cost which more than offset the decline in revenue over the same period. Further supported by moderation in its operation expenses, PAT over Q1 19 grew 32.7 % YoY to ₦7.0 billion.

- Volume declined much slower than estimate.** Over Q1 19, sales declined by 7.3% YoY to ₦38.1 billion (coming higher than our estimate of ₦36.1 billion) despite volume increasing 4% YoY. The revenue decline clearly reveals the telling impact of unlicensed sugar, which has led to downward adjustment in local sugar prices – 50kg bag price came down by 11% YoY to ₦14,400 over 2018. Notwithstanding the revenue decline, we believe the growth in volume (+4% YoY) is positive as it implies that some level of progress in moving its refined sugar out of the port to its consumers. Recall over 2018, the Apapa gridlock was a major challenge for the company, as the unavailability of trucks required to move out its refined sugar from the factory led to slowdown in production.

- Cost savings, amidst decline in sugar prices drives margin expansion.** Compared to the growth in volume, Dang Sugar posted a much stronger decline in cost (-17.2% YoY to ₦25.6 billion) emanating from lower raw material cost (-21% YoY) as global raw sugar prices continues to trend lower. Accordingly, gross margin expanded to 33% (+800bps YoY). That said, coupled with a 9% moderation in its operation expenses, EBIT printed at ₦10.8 billion (+29.7% YoY) with related margin at 28%.

Rating	OVERWEIGHT
Price	₦14.05
FVE	₦15.67
52-week range	₦12.45 - ₦21.10
Market Cap. (₦'bn)	168,600
1-month Avg. Vol	778,418
Curr. PE	7.05x

Quarterly EPS	Q1	Q2	Q3	Q4
2017 A	0.40	1.03	0.78	1.10
2018 A	0.45	0.62	0.34	0.44
2019 (E*)	0.58	0.53*	0.37*	0.32*

DANGSUGA: NL - Share Price Trend



Analyst(s)

Olamide Adeboboye
olamide.adeboboye@arm.com.ng

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- For the rest of the year, we do not see a change to the current operating environment, as the government continues to drag its feet in battling the smuggling activities – that said, we leave our sales estimate for the full year at ₦134.9 billion (-10% YoY). However, management guided to some key projects that are expected to further increase cost optimization. Firstly, management further emphasized its resolve to adopt alternative routes of evacuating refined sugar from the refinery to limit exposure to the gridlock on the Apapa axis. Secondly, they plan to complete refinery efficiency projects in a bid to maximize cost savings benefit. Thirdly, construction of additional storage facility for finished products in the refinery to optimize production cycle hampered by unavailability of trucks due to the traffic gridlock.
 - With the second and third relating largely to production activities, we see further moderation in production cost in the near term. However, with the absence of key timelines to deliver the respective projects, we expect the implementation of the refinery optimization project to be completed in the course of the year with construction of the additional storage facility expected for delivery in the first half of 2020. Accordingly, we have revised our cost estimate downwards with cost to sales ratio at 72.5% (previously 74.5%), which translates to gross profit of ₦37.1 billion, with related margin at 27.5% (+145bps YoY).
 - Although management guided to the adoption of more efficient means of distributing goods to customers in the course of the year. Given that the gridlock on the Apapa axis still persists, we do not see any improvement in its selling and distribution spend. As a result, we leave our FY 19E OPEX to sales unchanged at 4.5%. Coupled with our expectation of lower net finance income, we estimate FY 19 PAT of ₦21.1 billion (-4.0% YoY) with EPS printing at ₦1.76.
 - Coalescing the above adjustments, we raised our FVE slightly higher to ₦15.67 (previously: ₦14.11). Nonetheless, we retain our **OVERWEIGHT** recommendation. Dangote sugar currently trades at a FY 19E P/E of 9.1x, compared to Bloomberg MENA peer average of 17.1x.
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Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦' m) *	2017A	2018A	2019F	2020F	2021F
Revenue	204,422	150,373	134,853	138,223	147,879
COGS	153,434	110,688	97,768	100,212	106,473
Gross Profit	50,988	39,685	37,084	38,011	41,406
Operating Cost	7,482	7,772	7,036	7,212	7,716
Operating Profit	43,506	32,115	30,048	30,799	33,690
Interest Income	7,501	4,027	4,301	4,103	1,886
Interest Expense	278	293	248	261	274
PBT	53,599	34,601	31,778	32,866	36,640
Tax	13,815	12,625	11,122	11,503	12,824
PAT	39,784	21,976	20,656	21,363	23,816
Balance Sheet (₦ '000) *					
Fixed Assets	59,414	64,256	62,395	63,475	62,335
Stocks	47,656	37,676	24,442	25,053	26,618
Trade debtors	35,437	41,330	17,531	20,733	22,182
Liabilities					
Trade Creditors	75,653	54,498	43,996	40,085	42,589
Non-current Liabilities	6,680	6,736	5,310	5,310	5,310
Total liabilities	102,345	76,141	65,864	62,038	64,632
Shareholders' fund	92,736	98,975	112,580	122,621	133,814
Key Ratios	2017A	2018A	2019F	2020F	2021F
Gross Margin	25%	26%	28%	28%	28%
EBIT Margin	25%	21%	22%	22%	23%
PBT Margin	26%	23%	24%	24%	25%
Net Margin	19%	15%	15%	15%	16%
EPS	3.32	1.83	1.72	1.78	1.98
P/E	5.34	9.66	10.28	9.94	8.92
EV/EBITDA	4.12	4.01	3.26	3.11	2.57
ROA	20.30%	12.49%	12.18%	12.15%	12.56%
ROE	42.90%	22.20%	18.35%	17.42%	17.80%

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
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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