

Dangote Cement Plc. (DANGCEM.NL)

Stock Report

Competition caps earnings growth

- In this report, we transfer coverage of Dangote Cement Plc (DANGCEM) to **Janet Ogunkoya**.
- DANGCEM posted an impressive growth in EPS by 91% YoY to ₦22.9 (missing our estimate of ₦13.52) over 2018. The deviation from our estimate stemmed largely from the long-awaited tax credit (₦89.52 billion) which included reversal of tax provisions (₦134 billion) made on the Obajana 4 and Ibese 3 & 4 lines for 2015 – 2017, as well as a tax charge of ₦44 billion based on a 15% effective tax rate for 2018 (inclusive of an extension of the additional two-year pioneer tax credit which is pending approval). However, we reckon that core earnings dragged over 2018 with PBT increasing modestly by 4% YoY to ₦300.81 billion, which was in line with our estimate of ₦303.21 billion.
- Going into 2019, we maintain our optimism on DANGCEM and expect the company to sustain earnings growth, albeit at a still slower pace. Specifically, we expect PBT to expand modestly by 6% YoY and a steep decline in EPS by 32% YoY to ₦15.6 (reflecting the high base of 2018 due to the reversal of prior year tax benefits); excluding the impact of the tax reversals in 2018, forecasted 2019 EPS will grow 3% YoY. The slower growth in our forecast PBT stemmed from i) downward revision of our 2019 and 2020 volume growth to 10% and 6% to 25.96mt and 27.55mt respectively; ii) downward adjustment to revenue per ton, with average price for the group estimated at ₦35,790 per ton (lower by 3.1% YoY) largely driven by price erosion in Nigeria and the rest of Africa as competition intensifies; and (iii) reduction in our

Rating	STRONG BUY
Price	₦194.00
FVE	₦248.14
52-week range	₦170.00 – 268.90
Market Cap. (₦'tn)	3.306
1-month Avg. Vol	1,811,739
Curr. P.E	8.47x

Quarterly EPS	Q1	Q2	Q3	Q4
2017A	3.3	3.2	2.6	2.9
2018A	4.2	2.4	2.6	13.6
2019F	5.3	3.4	3.3	3.5

DANGCEM.NL - Share Price Trend



Analyst(s)

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gross margin estimates to 57.8% from 58.3%. The impact of our adjustments culminated in a cut of our FVE on DANGCEM to ₦248.14 (Previous: ₦253.03). DANGCEM trades at 2019 EV/EBITDA of 9.8x which is at a discount to MEA peers of 12.74x. Accordingly, we maintain our STRONG BUY recommendation on the stock.

- ***Competition dwarf volume growth in near term.*** The downward revision of our forecast volume growth over 2019 of 10% YoY (prior estimate: 12% YoY) is driven largely by expectation of slower growth in Nigeria and moderation of our bullish expectation in the rest of Africa. In Nigeria, we model a 6.8% and 9% YoY growth in sales volume to 15.2mt and 16.6mt over FY 19 and 20 respectively, as we believe the increased competition and slower growth in demand will limit the upside for volumes in 2019. Elsewhere in the rest of Africa, while we believe the recently commissioned gas genset in Tanzania and dissipated civil unrest in Ethiopia will support volumes going into the year, the graduated competition in Cameroun (with the entrance of a new competitor), South Africa and capacity max-out in Senegal suggests slower volume growth over our forecast period. Although, management guided to the completion of the clinker export terminals to other West African countries in Q3 2019, we await further details before incorporating the gains in our model. Overall, we forecast 14.8% and 2% YoY growth in Pan-African volumes to 10.8mt and 11mt over FY 19 and 20 respectively. Overall, we expect group volumes to expand 10% and 6% YoY in 2019 and 2020 to 25.9mt and 27.6mt respectively.
- ***Prices to be pressured by increased competition.*** On prices, reflecting the growing competition in the domestic market which resulted in ~2% price erosion over H2 2018, we expect a further moderation in price going into 2019 with our supply-demand model suggesting an additional 3% decline in price to ₦42,302/tonne in 2019 and an extension into 2020 with 2.5% price erosion. Overall, revenue in Nigeria is projected to be 3.6% (9% YoY in 2018) higher in 2019 to ₦642 billion. For the rest of Africa, prices across markets are likely to be pressured going into 2019 following entrants of new players and competitive products across some major markets – specifically in Cameroun, South Africa and regulatory actions in Tanzania – which we believe will drive average price lower by 3.1% YoY (excluding the impact of currency movement). Overall, we project revenue growth in the rest of Africa of 11.2% YoY to ₦316 billion. Cumulatively, we project 6% YoY growth in group revenue in FY 19 and 20 to ₦957 billion and ₦1.1 trillion respectively.
- ***Slower increase in COGS salvages margins.*** On cost, with complete installation of the gas generating set in Tanzania in 2018, we expect a much meaningful improvement in cost of sales over 2019. Specifically, we see a decline in energy cost per tonne (5% YoY), materials consumed (4% YoY) and overall cash cost per tonne (4% YoY) over 2019. However, following the increase in volume our modelled decline in cost per tonne by 4.2% YoY to ₦15,564 translates to an increase in cost of sales by 5% YoY to ₦404 billion (previous ₦403 billion), which should sustain gross margin at 57.8% (+34bps YoY) – gross profit to rise 7% YoY to ₦554 billion (previous: ₦565 billion).

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- Further down, reflecting the surge in haulage expense over 2018 and expectation of mild depreciation of the naira over 2019, we raised operating cost estimate higher to ₦207 billion (previous: ₦144 billion), driven largely by the 10% YoY jump in marketing and distribution cost, a fallout of the higher haulage cost (+10% YoY) – a component that accounts for ~65% of total S&D. Overall, we expect a decline in Nigeria EBITDA to 62% from 64% in 2018, and 18bps YoY decline in non-Nigeria EBITDA to 17.1%, with overall group EBITDA margin now expected to contract 132bps YoY to 47%.
 - ***Absent FX loss to drive net finance cost lower.*** While noting the surprise outing in net finance cost (+129% YoY) in 2018, following a net forex loss of ₦8.1 billion compared to a gain of ₦26.8 billion in 2018, with our outlook suggesting a broadly flat movement in the naira over 2019, we see lower scope for any material FX loss/gain over the year and estimate 19% YoY decline in finance cost to ₦45 billion, which overlaid on 13% YoY increase in finance income of ₦12.8 billion, translates to net finance cost of ₦32.6 billion (lower by 15% YoY).
 - Coalescing the foregoing translates to growth in pre-tax earnings by 6% (2018: +4% YoY) to ₦319 billion in 2019. With the settlement of prior year's tax reversals over 2018, we do not expect surprise on taxes over 2019 and estimate effective tax rate of 17% – reflecting the remaining one year of the two-year extension on the pioneer tax status – equating to a ₦54 billion tax charge for 2019. This translates to a decline in PAT by 32% YoY to ₦265 billion (2018: ₦390 billion) and EPS to ₦15.6 (2018: ₦22.9). DANGCEM trades at 2019 EV/EBITDA of 9.8x which is at a discount to MEA peers of 12.74x. Accordingly, we maintain our **STRONG BUY** recommendation on the stock.

Summary of Results and Forecasts

ANNUAL					
Income Statement (₦'m) *	2018A	2019F	2020F	2021F	2022F
Volume (Million tonnes)					
Nigeria	14.20	15.17	16.55	17.18	17.8
Rest of Africa	9.40	10.80	11.00	11.49	11.95
	23.60	25.97	27.55	28.66	29.75
Nigeria Price (N'000)	43.6	42.3	41.2	42.1	42.5
Rest of Africa Average Price (N'000)	30.2	29.3	30.2	29.8	29.2
Revenue					
Nigeria	618,301	641,611	682,591	722,536	756,317
Rest of Africa	283,262	316,187	331,824	342,264	348,938
Intercompany	350	-	-	-	-
	901,213	957,798	1,014,415	1,064,799	1,105,255
COGS	383,311	404,139	432,024	450,839	462,830
Gross Profit	517,902	553,659	582,391	613,961	642,425
Operating Cost	189,426	207,503	219,240	230,134	240,864
Operating Profit	338,698	351,778	369,617	391,132	409,670
Finance Income	11,323	12,784	13,061	12,885	19,654
Finance expense	49,778	45,426	45,919	45,134	47,194
PBT	300,806	319,135	336,759	358,884	382,130
Tax	89,519	54,135	84,190	89,721	95,532
PAT	390,325	265,001	252,569	269,163	286,597
Balance Sheet (₦ 'm) *	2018A	2019F	2020F	2021F	2022F
Fixed Assets	1,265,625	1,360,216	1,398,477	1,429,279	1,449,411
Stocks	106,998	110,414	117,600	122,271	125,060
Trade debtors	44,468	45,974	45,573	50,495	51,707
Cash and other bank balances	166,896	120,156	159,961	262,698	397,559
Total Assets	1,694,463	1,758,373	1,848,891	1,996,854	2,159,434
Trade Creditors	230,970	262,690	280,383	292,143	299,451
Non-current Liabilities	212,344	216,963	222,590	229,346	237,372
Total liabilities	707,850	736,238	771,437	813,606	862,913
Shareholders' fund	986,613	1,022,135	1,077,454	1,183,248	1,296,521
Key Ratios	2018A	2019F	2020F	2021F	2022F
P/E (x)	8.0	15.8	16.5	15.5	14.6
EV/EBITDA (x)	7.6	9.9	9.4	8.7	8.1
ROA	23%	15%	14%	14%	14%
ROE	44%	26%	24%	24%	23%
Net Margins	43%	28%	25%	25%	26%
EPS (N)	22.9	15.6	14.8	15.8	16.8
EBIT margins	38%	37%	36%	37%	37%
PBT margins	33%	33%	33%	34%	35%
Effective Tax rates	-30%	17%	25%	25%	25%
Debt to Equity	35%	32%	30%	29%	29%
Debt to Assets	20%	19%	18%	17%	17%
Interest coverage (X)	6.8	7.7	8.0	8.7	8.7
BVPS (₦)	57.9	60.0	63.2	69.4	76.1

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	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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