

**Dangote Cement Plc | Earnings Report**

12 months ended 31<sup>st</sup> December, 2015

**Looking beyond record top-line performance (₦154.09 - SELL)**

- Dangote Cement Plc. (Dangcem) reported strong growth (+26% YoY) in revenues to ₦491 billion for 12 months ended December 2015 (9M 15: +18% YoY to ₦365 billion). Although PBT was 2% lower YoY at ₦188 billion (9M 15: +8% to ₦167 billion), PAT came in 14% higher YoY at ₦181 billion, buoyed by lower effective tax rate of 3.7% (vs. 14% in FY 14).
- Dangcem proposed a record dividend of ₦8.00 which implies a payout ratio of 74% (FY 14: 64%).

**Aggressive pricing strategy drives record quarterly sales**

- Cascading to quarterly results, Dangcem's Q4 15 revenues surged 55% YoY to ₦126 billion, largely in line with our forecast and represents the company's strongest quarterly revenue performance till date. Q4 15 sales was boosted by a surge in group volumes (+68% YoY to 6 million tons) which offset the lower realizable prices of ₦21,033/ton (-8%YoY). In Nigeria, a cut back in factory gate prices (-18% QoQ, -4% YoY)<sup>1</sup> stimulated a sharp recovery in volumes to 4 million tons (+34% QoQ, +31% YoY) helping Dangote cement increase market share by 6pps to 68%.

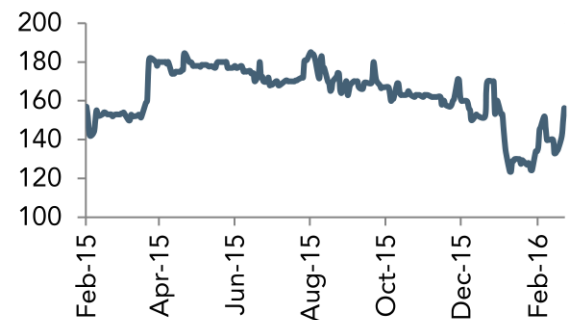
Income Statement Data			
	2015 - 12M'm	2014 - 12M'm	%chg
<b>Revenue</b>	491,725	391,639	26%
<b>PBT</b>	188,294	184,689	-2%
<b>Tax</b>	6,971	25,188	-72%
<b>PAT</b>	181,323	159,501	14%

Balance Sheet Data			
	2015-Dec 'm	2014-Dec 'm	%chg
<b>Inventory</b>	53,118	42,687	24%
<b>Receivables</b>	11,544	9,803	18%
<b>Cash</b>	40,792	20,593	98%
<b>Payables</b>	127,597	94,308	35%
<b>Net Assets</b>	644,720	591,885	9%

Stock Data	
<b>Price</b>	₦168.00
<b>2 week range</b>	₦122.90 - ₦188.68
<b>Market Cap. (N'b)</b>	2,863
<b>1-month Avg. Vol</b>	673,329
<b>Curr. PE</b>	15.5x
<b>Bloomberg Ticker</b>	DANGCEM:NL
<b>Reuters Ticker</b>	DANGCEM.LG

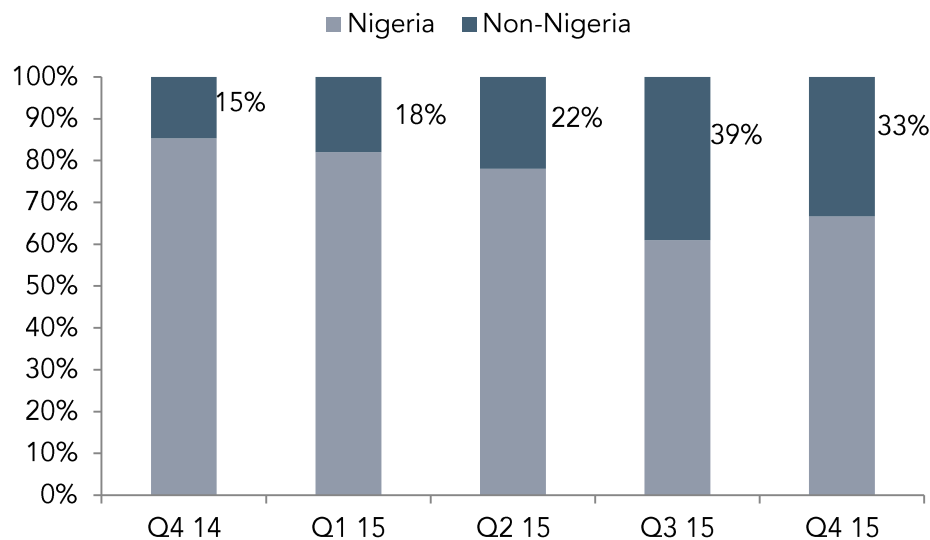
**Dangote Cement Plc- Share Price Trend**

**Analyst(s)**

**Philip Anege**  
[philip.anege@arm.com.ng](mailto:philip.anege@arm.com.ng)

<sup>1</sup> Dangote Cement Plc. reportedly reduced prices on more than two occasions over H2 15

- Outside Nigeria, the company’s adoption of a similar pricing strategy to increase market penetration as well as increasing capacity utilization at new plants commissioned in earlier quarters (i.e. in Zambia, Ethiopia, and Senegal) underpinned an almost four-fold jump in non-Nigeria volumes to 2million tons in the period.
- Overall, non-Nigerian revenues jumped four-folds YoY to ₦32 billion while revenue from Nigeria was 27% higher YoY at ₦94 billion.

**Figure 1: Historical composition of group volume (%)**



Source: Company information, ARM Research

### Higher cost crimps profit margins

- Q4 15 COGS rose significantly faster than revenues (+94% YoY to ₦63 billion), leaving gross profits only 29% higher YoY at ₦63 billion with related margins contracting 10pps YoY to 50%. Input cost pressures in the quarter were partly driven by significant increases in material costs (nearly three-fold YoY increase to ₦18 billion), and fuel & power which more than doubled YoY to ₦21 billion. In addition, margin compression reflects impact of price cuts over H2 15. Furthermore, with nearly 55% of total cash input cost in Nigeria exposed to

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foreign currency changes, we believe occasional delays in the receipt of FX allocations from the apex bank forced the company to rely on more expensive non-official sources. We believe this contributed to gross margin pressures in the period.

- In line with our expectation, OPEX pressures subsisted over Q4 15 (+90% YoY to ₦29 billion) mainly due to continued ramp-up of non-Nigerian expenses to support sales. Furthermore, management noted that between 60% and 70% of the group's OPEX components are exposed to FX fluctuations, with some salaries and expatriate emolument mentioned in prior communications. Consequently, Q4 15 operating profit was flat at ₦34 billion with related margins contracting sharply to 27.2% (Q4 14: 42.3%)
- Compounding the pressure was a reported net finance cost of ₦13 billion in Q4 15 (vs. net finance income of ₦6 billion in corresponding period of 2014) which drove PBT 47% lower YoY to ₦21 billion with related margin at 16.9% (Q4 14: 49.6%). Adducing drivers for the high net finance charge, we note that the impact of 88% YoY plunge in finance income to ₦3 billion more than offset the effect of ~20% decline in finance expense in the period. Importantly, we note that foreign exchange gains account for 95% of the company's finance income in the period.
- However, a tax credit of ~₦2 billion (vs. tax charge of ₦12 billion in corresponding period of 2014) pared earnings decline to -19% YoY (PBT: ₦23 billion) with corresponding margins 16.9pps lower YoY at 18.5%. According to management, lower taxes reflect greater production from newer production lines within and outside Nigeria that still enjoy tax holidays.

### **Net adjustments to model drive FVE compression**

- Despite strong top-line growth, Dangcem's Q4 15 earnings performance was scarred by high cost (input and opex) as well as net finance charges. That said, what is clear from the result is that Dangcem's pricing strategy enhanced market share, with possibly negative implication for other players. Over 2016, we expect undercutting competition to remain at the heart of Dangcem strategy with management guiding to even stronger volumes growth in the first two months of
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Q1 2016. Citing the extended run of the dynamic of lower price stimulus on volumes and FGN's planned doubling of capital expenditure per the 2016 budget, management guided to ~20% YoY volume (FY 2015: +3%) growth in Nigeria to 16MT over FY 16.

- However, we are not as optimistic on two grounds. Firstly, our checks with some major cement distributors in Nigeria, particularly in the South West and South East regions of the country, revealed more aggressive price response from competitors coming into 2016 that could slightly tilt market share dynamics. Secondly, given delays in the passage of 2016 appropriation bill, we believe that the impact of higher FGN capex would only begin to trickle in in the latter part of 2016. Consequently, we expect volume in Nigeria to grow only 13% YoY to 15MT over 2016.
- Away from Nigeria, Dangcem's other African operations look set to continue their positive top-line growth over 2016—especially in view of the impending commissioning of the group's 1.5 MTPA Congo plant in 2016 and a continued ramp-up of capacity utilization in other markets. Thus, we look for ~68% YoY volume growth from non-Nigeria operations to ~9.6MT in 2016. Combined, our assumptions across Nigeria and Non-Nigeria drive our 2016 forecast for ~29% YoY increase in group volumes to 24.2MT. However, with average prices expected to be 18% lower YoY at ₦21,094 per ton, we forecast group revenue of ₦519 billion (+6% YoY) by YE 2016.

On input cost, management noted that Dangcem completed substitution of imported coal for the 3x more expensive back-up LPFO in Q4 15. Historically, LPFO have accounted for about 24% and 18% of energy mix at Obajana and Ibese respectively, suggesting significant savings on energy cost with the substitution. Thus the completion of this substitution, as well as Dangcem's increasing economies of scale in purchase of raw materials and reliance on dollar returns/repayments from non-Nigerian arms, should taper input cost growth to 13% YoY in 2016 (vs. 41% YoY in 2015). However, knock-on effect of lower prices should extend gross margins pressures over 2016 (-3pps YoY to 56%).

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Furthermore, we expect OPEX pressures to subsist in the near term as the business ramps up further investments to support maiden market entry away from Nigeria and occasional sourcing of FX from non-official sources due to delays in CBN FX allocation.

- Thus, while we expect net finance charges to narrow slightly in 2016—given dovish interest rate outlook and management’s gradual scale down on debt, knock-on effect of overall cost pressures should leave PBT only marginally higher at ₦190 billion by 2016 YE (vs. ₦188 billion in 2015) with related margins contracting 2pps YoY to 37%. Moreover, management recently hinted at a higher effective tax rate for 2016, given expiration of tax concessionary status in a line in Ibese come 2016. We believe this would aggravate earnings pressure in 2016. In all, we expect after tax profit to come in flat at ₦180 billion in 2016.
  - The net impact of our recent adjustments resulted in 13% reduction in our FVE to **₦154.09**, which represents a weighted average of relative and discounted cash flow valuation methodologies. Our current FVE also implies an 8% downside from the stock’s last market price. Importantly, we find Dangcem slightly expensive on a relative valuation basis, given our estimated 2016 EV/EBITDA of **11.4x** relative to **10.0x** for Bloomberg EMEA peers. We downgrade our rating on the stock to a **SELL** (vs. **NEUTRAL** in previous communication).
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## Summary of Results and Forecasts

ANNUAL					
Income Statement	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Revenue	491,725	519,117	608,194	747,228	880,134
COGS	201,808	228,411	261,523	298,891	343,252
Gross Profit	289,917	290,705	346,670	448,337	536,882
Operating Cost	86,046	88,250	85,147	93,403	107,376
Operating Profit	207,822	212,838	273,687	369,878	447,108
Interest income	34,819	7,288	5,064	5,620	2,359
Interest expense	54,347	30,153	25,832	20,502	15,019
PBT	188,294	189,973	252,919	354,995	434,448
Tax	6,971	9,499	15,175	28,400	52,134
PAT	181,323	180,474	237,744	326,596	382,314
Balance Sheet ('000,000)	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Assets	FY 2014A	FY 2015F	FY 2016F	FY 2017F	FY 2018F
Fixed Assets	917,212	966,591	1,011,022	1,061,434	1,111,104
Stocks	53,118	61,671	60,150	59,778	82,381
Trade debtors	11,544	10,382	13,380	17,933	22,003
Cash and other bank balances	40,792	25,322	887	(10,141)	(18,346)
Total Assets	1,110,943	1,159,202	1,180,091	1,242,686	1,326,108
Liabilities					
Trade Creditors	127,597	157,604	156,914	179,335	205,951
Long Term Liabilities	265,525	251,037	224,039	189,226	152,586
Total liabilities	466,223	467,559	426,634	404,314	388,335
Shareholders' fund	644,720	691,643	753,457	838,372	937,773
Key Ratios	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Gross margin	59.0%	56%	57%	60%	61%
Operating margin	42.0%	41.0%	45.0%	50.0%	51.0%
Net margin	37.0%	35.0%	39.0%	44.0%	43.0%
EPS	10.64	10.59	13.95	19.17	22.44
P/E	15.79	15.86	12.04	8.77	7.49
P/B	4.44	4.14	3.80	3.00	3.80
EV/EBITDA	11.73	11.40	9.16	6.99	5.82
ROA	17.0%	16.0%	20.0%	2.07%	30.0%
ROE	29.8%	26.6%	31.8%	40.0%	42.1%

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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