

Rating	<b>OVERWEIGHT</b>
Price	₦235.00
FVE	<b>₦278.54</b>
52-week range	₦200.00 - 290.00
Market Cap. (₦'tn)	4.022
1-month Avg. Vol	2,391,998
Curr. P.E	24.1x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2016A</b>	3.10	2.97	1.77	3.12
<b>2017A</b>	4.14	4.31	2.88	0.65
<b>2018A (*F)</b>	4.23	2.41	3.55*	3.72*

#### DANGCEM.NL - Share Price Trend



#### Analyst(s)

**Oluwasegun Akinwale**

[Oluwasegun.akinwale@arm.com.ng](mailto:Oluwasegun.akinwale@arm.com.ng)

## Dangote Cement Plc. (DANGCEM.NL)

### Stock Report

#### Results Miss but Outlook Still Promising

- Dangote Cement (DANGCEM) released Q2 18 result showing a steep decline of 23.8% YoY in EPS to ₦2.41 (missing our estimate of ₦4.27). Largely, the variance between expected and actual stemmed from net foreign exchange loss of ₦15 billion and higher than expected tax provision for the year of ₦36 billion - which resulted in effective tax rate of 46.8% in the review period (vs. 33.5% in Q1 18 and 31.2% in Q2 17).
- Going forward, we reiterate our positive outlook on DANGCEM and expect the company to sustain earnings growth over 2018, at a faster pace than our earlier estimate as we are now more positive on the writeback of the tax provisions booked thus far. On tax, management further expressed confidence on the possibility of a reversal of the cumulative excess tax provision made since Q4 17 on Ibese 3&4 and Obajana line 4. More clearly, management stated that over Q2 18, every related documentation had been filed and inspection done by NIPC, however, a final confirmation which was needed to make the move didn't come in time. Accordingly, we have lowered our effective tax for the year to 24% to reflect a possible reversal of the cumulative tax booked, which informed our PAT estimate of ₦254.9 billion and translates to 8.4% increase in our FVE to **₦278.54**. However, on a highly conservative note, adopting a worst-case scenario which assumed no reversal of the previous provisions with an effective tax rate estimate of 42% in 2018, resulted in a slight moderation to our 2018E PAT of ₦195 billion which translates to a 2.8% cut to our FVE to **₦249.71**.

### Sensitivity Analysis of EPS and FVE

Effective Tax rate	24%	30%	42%	48%
EPS (₦)	15.0	13.8	11.4	10.2
<b>FVE (₦)</b>	<b>278.54</b>	<b>269.2</b>	<b>249.71</b>	<b>233.7</b>

### *Impressive volume growth swamped by tax worries*

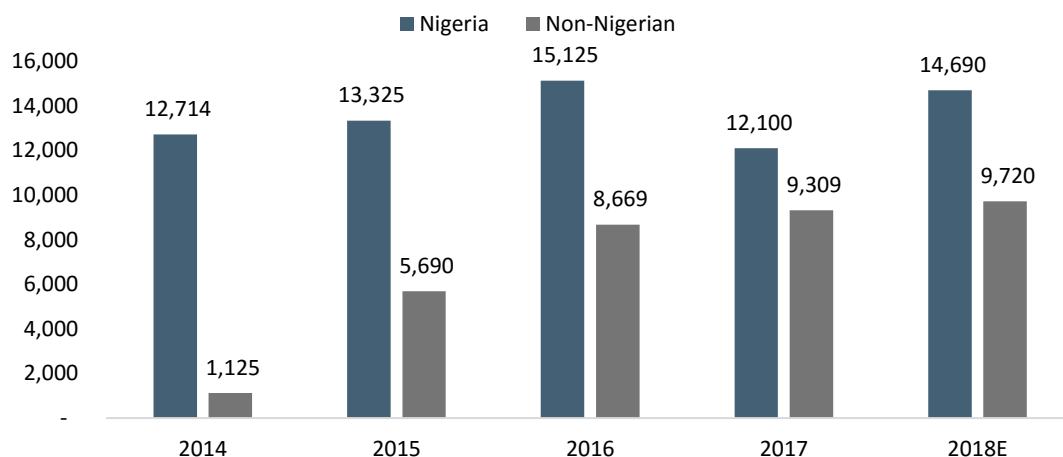
- Going by the breakdown of Q2 performance, Nigerian business recorded buoyant volume growth of 24.5% YoY to 3.8MT, the impact of which more than neutered the lower price (-1.7% YoY to ₦44,311/tonne) to drive growth in Nigerian revenue by 22.4% YoY to ₦170.2 billion. For the non-Nigerian business, despite the persisting volume contraction (3% YoY to 2.3MT), the relatively higher prices (10% YoY to ₦30,149/tonne) pushed sales from the region higher by 6.7% YoY to ₦70.1 billion. The volume decline in non-Nigerian business resulted from still weaker sales in Tanzania, cutback in exports to Ghana and the impact of the civil unrest in Ethiopia. Consequent on the improvement in volumes in Nigeria, as well as pass-through from still high per tonne price (group average: +4.5% YoY to ₦38,970/tonne), group revenue remained solid, rising 17.5% YoY (after a solid outing in Q1 18 of 16.3% YoY) to ₦240 billion – 3.5% higher than our estimate of ₦232 billion.
- Still on the positives, over the review quarter, the company's cost per tonne moderated 68bps YoY to ₦16,255/tonne following decline in material consumed per tonne (2.9% YoY ₦5,357) which more than subdued the 3.4% YoY growth in energy consumed per tonne to ₦5,672. Overall, cost of sales rose at a much slower pace than revenue (+11.7% YoY to ₦100.2 billion, 1.2% variation from our estimate). As a result, gross profit was 22% higher YoY with related margin expanding 220bps YoY 58.3% (forecast: 56.3%).
- Elsewhere, still reflecting the impact of the currency movements across Africa, the company booked ₦11.5 billion net FX loss. For context, while the Nigeria business booked a net FX gain of ₦9.5 billion, the Pan African business recorded a loss of ₦24 billion due to weakness of the weaknesses of currency across the region, especially the CFA franc which took a hit from the depreciation of the Euro (€). Consequently, group net foreign exchange loss printed at ₦15.4 billion in Q2 18, which drove net finance cost of ₦19.6 billion (8x YoY), despite moderation in finance charges (-37% YoY to ₦8.1 billion).
- On tax, recap management guided to the possibility of finalising the necessary requirements for the approval of the extension of the pioneer tax incentive on the Ibese 3&4 and Obajana line 4 over Q2 18, which had informed our expected 20.7% effective tax rate over the period. However, due to delays in finalising the process with the approval still pending with Nigeria

Investment Promotion Council (NIPC), the company made full provision with the effective tax rate far exceeding our expectation at 46.8% with related tax expense rising 47.8% YoY to ₦36 billion which significantly pressured PAT to ₦41.0 billion (lower 23% YoY).

### *Volume shaping the story in 2018*

- Going forward, we are more sanguine on volumes over 2018 and have raised our volume expectation for the year by 5.7% to 14.7 MT. Looking through the Q2 18 numbers, despite the seasonality impact in the quarter, volumes declined by 3.2% relative to 18.2% in Q2 17, suggesting a strong pick up. On pricing, we expect price level in Nigerian to remain flat over Q3 18, with a slight moderation over Q4 18. We now adopt per ton Nigerian cement price of ₦44,210 (3.8% higher than previous estimate) on average over 2018 with related revenue expected to print at ₦649 billion (prior: ₦590 billion). For the non-Nigerian operations, reflecting the lull in sales in Ethiopia, Ghana, South Africa, Tanzania and Senegal over H2 18, we have lowered our volume projection to 9.7MT (previous: 11.1MT) and adopted average price of ₦29,040/ton (87bps higher than previous estimate) to reflect the higher currency translation of ₦338/\$1 (previous ₦331/\$1) which informed our non-Nigerian revenue of ₦267.9 billion (12.4% lower than previous). In all, we now look for FY 18 group revenue of ₦917 billion (₦889 billion previous).

**Figure 1: Volume trend in Nigeria and Non-Nigeria (MT)**

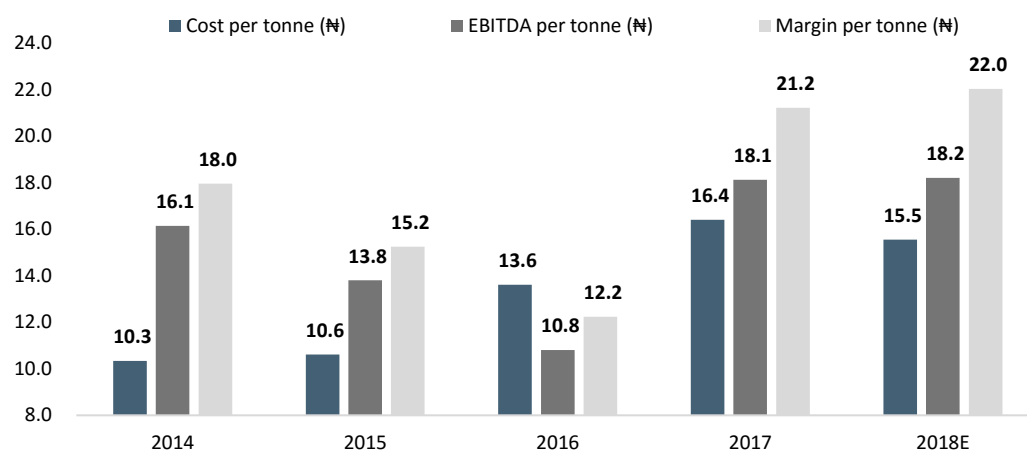


Source: Company's Financials, ARM Research

- On cost, with management guiding to a complete installation of gas generating set in Tanzania in August, we expect a much meaningful improvement in cost over H2 18, with our cost of sales estimated now revised lower to ₦379 billion (previous ₦386 billion) which

should sustain gross margin at 58.6% (+220bps YoY) – gross profit to rise 18% YoY (previous: 11% YoY) to ₦538 billion.

**Figure 2: Trend in cost, EBITDA and Margin per tonne (000'N)**



Source: Company's Financials, ARM Research

- Further down, we raised our opex for the rest of 2018, driven largely by the sizeable jump in sales and distribution cost over H1 18 (+19.8% YoY) a fallout of the higher per tonne haulage cost (12.45 YoY to ₦3,378) – a component that accounts for 68% of total S&D. This should lead to higher opex of ₦183 billion (previous: ₦162 billion), which should drive a 157bps YoY expansion in operating margin to 39% (vs. 38% in FY 17). Overall, we maintained our Nigeria and non-Nigeria EBITDA margin of 67% and 16%<sup>1</sup> respectively, with overall group EBITDA margin now expected to expand slower by 27bps YoY (previous: 58pps) to 48.5%.
- On tax, management further expressed confidence on the possibility of a reversal of the cumulative excess tax provision made since Q4 17 on Ibese 3&4 and Obajana line 4. More clearly, management stated that over Q2 18 every related documentation had been filed and inspection done by NIPC, however, a final confirmation which was needed to make the move didn't come in time. Accordingly, we have lowered our effective tax for the year to reflect a possible reversal of the cumulative tax booked, which informed our PAT estimate of ₦254.9 billion and translates to 8.4% increase in our FVE to **₦278.54**. However, on a highly conservative note, adopting a worst-case scenario which assumed no reversal of the previous provisions with an effective tax rate estimate of 42% in 2018 resulted in a slight moderation to our 2018E PAT of ₦195 billion which translates to a 2.8% cut to our FVE to **₦249.71**.

<sup>1</sup> Before central costs and eliminations of N5 billion.

- DANGCEM trades at 2018 EV/EBITDA of 10.5x which is at a premium to EMEA peers of 9.4x. Accordingly, we maintain our **NEUTRAL** recommendation on the stock.

## Summary of Results

ANNUAL					
Income Statement (N'm) *	2016A	2017A	2018F	2019F	2020F
Revenue	615,103	805,582	917,358	1,061,220	1,159,647
COGS	323,816	351,290	379,531	440,685	483,083
Gross Profit	291,287	454,292	537,827	620,535	676,564
Operating Cost	119,336	155,297	183,472	160,835	192,423
Operating Profit	182,493	304,208	360,777	465,006	488,780
Finance Income	43,817	35,926	34,419	42,653	61,153
Finance expense	45,381	52,711	59,679	64,878	72,875
PBT	180,929	289,590	335,517	442,781	477,058
Tax	38,071	85,342	80,524	101,840	114,494
PAT	142,858	204,248	254,993	340,941	362,564
Balance Sheet (N 'm) *					
Fixed Assets	1,155,711	1,192,140	1,236,860	1,267,630	1,293,412
Stocks	82,903	94,594	89,439	111,397	126,836
Trade debtors	26,279	30,155	39,469	35,628	39,672
Cash & other bank balances	115,693	168,387	239,296	276,912	338,804
Total Assets	1,527,908	1,665,883	1,781,463	1,886,409	2,012,254
Trade Creditors	268,966	270,721	258,081	305,411	343,456
Non-current Liabilities	218,316	364,047	393,362	407,185	376,003
Total liabilities	730,563	884,523	980,829	1,019,541	1,056,699
Shareholders' fund	797,345	781,360	800,634	866,868	955,555
Key Ratios	2016A	2017A	2018F	2019F	2020F
P/E	20.8	19.2	18.6	13.9	13.1
EV/EBITDA	12.5	10.7	11.3	9.0	8.5
ROA	11%	13%	15%	19%	19%
ROE	20%	26%	32%	40%	39%
Net Margins	23%	25%	28%	32%	31%
EPS	8.4	12.0	15.0	20.0	21.3
EBIT margins	30%	38%	39%	44%	42%
PBT margins	29%	36%	37%	42%	41%
Effective Tax rates	21%	29%	24%	23%	24%
Debt to Equity	46.8%	49.6%	60.6%	54.9%	49.7%
Debt to Assets	24.4%	23.3%	27.9%	25.8%	24.2%
Interest coverage	4.0	5.8	6.0	7.2	6.7
BVPS	46.8	45.9	48.1	52.1	57.4

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

---

Copyright © 2018 ARM Securities Limited (“ARMS”).

All rights reserved. Unauthorized use, reproduction, distribution, or disclosure of this document is strictly prohibited.

This material has been issued by ARM Securities Limited, a member of the Asset and Resource Management (“ARM”) Group, and a Company regulated by the Nigerian Securities & Exchange Commission. The analyst(s) primarily responsible for preparing this research report, in whole or in part, certifies that with respect to each security or issuer covered; all the views expressed accurately reflect his/her personal views about the subject securities and issuers and no part of his/her compensation was, is, or will be, directly or indirectly, related to the inclusion of specific recommendations or views in the report.

This research report is based on information from sources that ARMS and its analysts believe to be reliable. Neither ARMS nor any of its research analysts, nor any member of the ARM Group, gives any representation or warranty, express or implied, or undertaking of any kind or assumes responsibility or liability of any kind with respect to the accuracy or completeness of the information set out in this report or any third party’s use (or the results of such use) of such information. This report is provided solely for informational purposes and is not to be construed as providing advice, recommendations, or endorsements of any kind whatsoever. The investments and strategies discussed here may not be suitable for all investors; counsel of investment advisor should be obtained with regard to such investments and or strategies. This research report is not a replacement for advice from an accountant, lawyer, personal finance advisor or other category of investment advisor. The investments discussed in this report may oscillate in price or value. Opinions and information provided are made as of the date of the report issue and are subject to change without notice. This research report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Reference herein to any specific security or financial instrument does not necessarily constitute or imply its endorsement or recommendation by ARMS, its directors, officers, employees, or designated agents. Members of ARM may act as broker, advisor, or lender, or make a market in any investments or issuers referenced in this report. Further information on any of the securities discussed herein may be obtained upon request to ARMS. By accepting this document, you agree to be bound by the foregoing limitations.