

**Dangote Cement Plc. | Earnings Report**

9 months ended 30<sup>th</sup> September, 2016

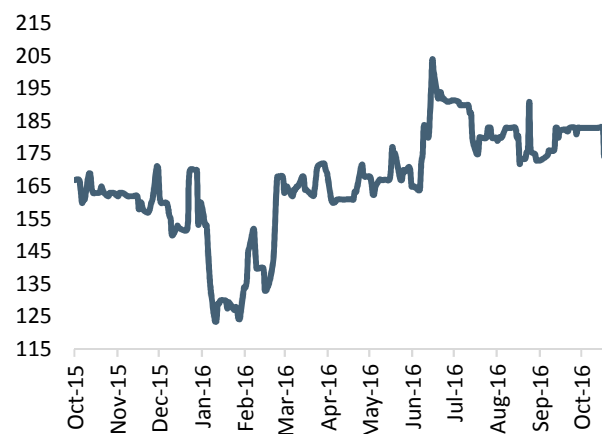
**Earnings wilt under tough operating conditions**
**(₦172.87 - UNDERWEIGHT)**

- Over Q3 16, underlying operating performance remained significantly in line with sustained weakness observed since the first half of 2016 as pressures from higher energy and materials cost nullified gains from foreign exchange and tax credit. Specifically, despite recorded ₦11.6 billion FX gains and ₦6.3 billion tax credits in the quarter, PAT plunged 17% YoY to ₦30 billion—relative to ₦36 billion in our Q3 16E.

**Non-Nigerian gains sustain top-line momentum**

- In the review quarter, Dangcem reported 22% YoY increase in revenue to ₦149.9 billion—6% ahead of our Q3 16E—following a 10% YoY rise in cement output to 5.4MT and 11% YoY increase in mean cement prices to ₦27,868/tonne across the group. Looking across broad regional categories, contributions from non-Nigerian operations was again the main trigger for group revenue increase over Q3 16. Specifically, revenue from non-Nigerian operations rose 65% YoY to ₦59 billion vs. 4% YoY growth in Nigerian operations to ₦91 billion. The stronger growth outside Nigeria reflects continued ramp up in cement production in foreign markets (+17% YoY to 2.2MT) and higher prices (+41% YoY to ₦26,300/tonne).

| Income Statement Data                   |                  |             |      |
|---|------------------|-------------|------|
|   | 2016 – 9M'm      | 2015 – 9M'm | %chg |
| Revenue                                 | 442,092          | 365,450     | 21%  |
| PBT                                     | 148,716          | 166,914     | -11% |
| Tax                                     | (15,195)         | (8,921)     | 70%  |
| PAT                                     | 133,521          | 157,993     | -15% |
|   |                  |             |      |
| Balance Sheet Data                      |                  |             |      |
|   | 2016-Sep'm       | 2015-Dec 'm | %chg |
| Inventory                               | 83,627           | 53,118      | 54%  |
| Receivables                             | 35,699           | 11,544      | 209% |
| Cash                                    | 86,872           | 40,792      | 113% |
| Payables                                | 241,723          | 127,597     | 89%  |
| Net Assets                              | 748,426          | 644,720     | 16%  |
|   |                  |             |      |
| Stock Data                              |                  |             |      |
| Price                                   | ₦175.00          |             |      |
| 52 week range                           | ₦122.90– ₦203.96 |             |      |
| Market Cap. (N'b)                       | 2,982            |             |      |
| 1-month Avg. Vol                        | 358,942          |             |      |
| Curr. PE                                | 22.3x            |             |      |
| Bloomberg Ticker                        | DANGCEM:NL       |             |      |
| Reuters Ticker                          | DANGCEM.LG       |             |      |
| Dangote Cement Plc. - Share Price Trend |                  |             |      |

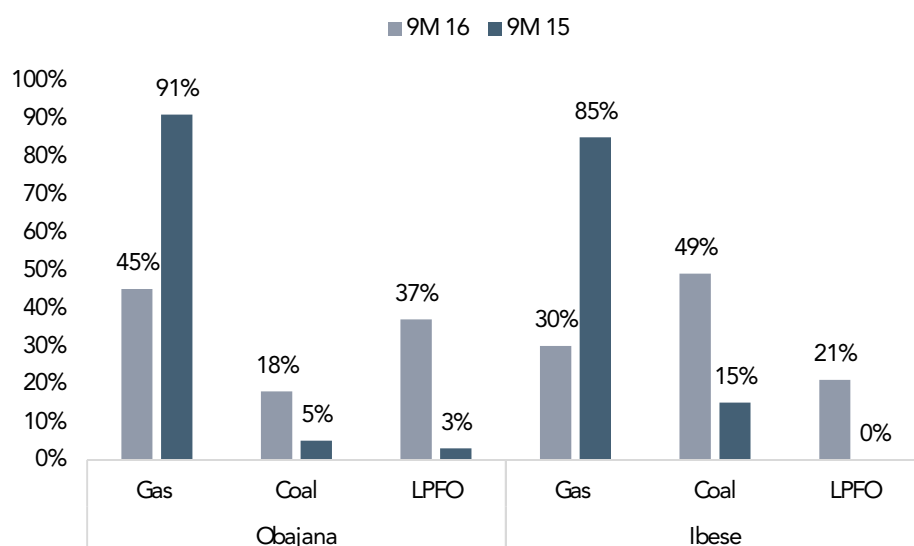

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In Nigeria, following a 47% price hike in August, volume growth slowed from average of 39% YoY in the first two quarters of 2016 to 6% YoY in Q3 2016 suggesting negative demand response to the latest price increase. Specifically, in view of the price increase, the company's 11-month volume growth streak was bucked in September 2016 with cement volumes coming in 7% lower YoY.

### Energy headaches and NGN depreciation drive margin compression

- That said, impact of strong group revenue was more than offset by sharp cost pressures in Nigeria, which largely underpinned the 71% YoY surge in group input cost to ₦92 billion in Q3 16 with related margin plunging 18pps YoY to 38%. Breakdowns provided reveal that these input cost pressures largely stemmed from sharp increases in cost of energy (over two-fold YoY to ₦36 billion) and materials consumed (+64% YoY to ₦25 billion). On energy, Dangcem was hit by the double whammy of higher gas prices, following continued NGN depreciation<sup>1</sup>, and persisting gas supply issues which provoked a fallback on more expensive back-up (LPFO) in the review period.

**Figure 1: Energy mix across plants**



Source: Company results, ARM Research

<sup>1</sup> Gas supply contracts are priced in dollars

- Further compounding pressures on Q3 16 performance, Dangcem reported a sharp rise in operating expense (+81% YoY to ₦36 billion), which reflected significant increases in haulage expenses (+92% YoY to ₦15 billion), depreciation (more than double YoY to ₦6 billion), as well as salaries and related staff cost (+40% YoY to ₦2 billion). The uptick in haulage costs stem from Dangcem's cement exports to Ghana, Niger and Togo following the recent acquisition of over 1,000 distribution trucks. Elsewhere, we link the pressures from higher salaries and related staff cost to translation impact on compensation of foreign expatriates. Thus, aided by significant pressures from gross level, operating profits plunged 52% YoY to ₦24 billion with related margins at 16% (vs. 41% in the corresponding quarter of 2015).
- On a slightly positive note, net interest expense declined 96% YoY to ₦498 million (-66% QoQ) following an over eight-fold YoY jump in finance income to ₦12 billion, 97% of which constitutes foreign exchange gains as the company continued to benefit from its net long dollar position amidst naira declines. Hence, having also reported tax credit of ₦6.3 billion (vs. tax charge of ₦2 billion in the corresponding quarter of 2015), Dangcem recorded a milder 17% YoY contraction in PAT to ₦30 billion.

#### **Price increase arrive too late for FY 16 earnings redemption**

- Overall, sustained surge in energy prices have forced Dangcem to completely abandon its low pricing strategy in Nigeria—cascading to the ₦600 increase in ex-factory prices of 50kg bag of cement in August. In our view, given its status as price leader in the Nigerian cement space, Dangcem stands in poll position to benefit from this price increase in relative terms, which informs a 24% upward revision to our target cement price for 2016 to ₦29,053/MT. That said, as in Q3 16, we see greater scope for temperance in volume growth in Q4 16 as the combination of weaker disposable income and dour macro tapestry combine to leave cement consumers price sensitive. Consequently, we lower our estimates for Dangcem's 2016 Nigerian cement volumes to 15MT (vs. 15.7MT in previous 2016 estimates, and 11.9MT over 9M 16). Irrespective, we expect the price increase to be net positive for Nigerian revenues (+12% YoY to ₦436 billion). For the non-Nigerian leg, our volume estimate of 9.6MT remains firmly in line with current run rate (+73% YoY to

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6.5MT). However, given observed changes in naira prices in the review period, we adjust average non-Nigeria prices higher by 36% to ₦26,960/tonne. Our overall top-line adjustments cascade to 91% YoY jump in non-Nigerian revenues to ₦217 billion with group revenues now expected to come in 33% higher YoY at ₦653 billion (vs. ₦564 billion in previous forecast).

- Following the extended gas supply shortages over 9M 15, we have also revised our 2016 input cost 39% higher to ₦374 billion (+85% YoY). Thus, we expect gross profits to contract 4% YoY to ₦279 billion with related margin at 43% (vs. -7pps YoY to 53% previously predicted) over FY 16. In addition, with operating expenses having almost outpaced our expectations, we review our target 2016 OPEX higher by 32% to ₦124 billion (+44% YoY) to account for sustained rise in selling and distribution expense. This should leave EBIT 22% lower YoY at ₦161 billion (vs. ₦203 billion in previous forecast).
  - On other fronts, Dangcem's net long position which has already resulted in cumulative FX gain over 9M 16 should provide slight reprieve for earnings. Specifically, in addition to ₦6.3 billion tax write back in Q3 16, the company has reported a cumulative ₦54 billion FX gain over 9M 16. This should pare 2016 PAT (₦162 billion) declines to 11% YoY with related margin at 25% (vs. 37% in 2015). Farther out though, Dangcem's abandonment of its low-price strategy leads to upward adjustments to our price forecasts beyond 2016 (+6% YoY). In addition, recent completion of repair works on damaged oil installations should result in improved gas supplies over 2017, which, supported by ramp up of alternative energy sources, drives margin improvement over our forecast horizon relative to the depressed 2016 levels. The expected recovery in earnings informs upgrade to our FVE (+8% to **₦172.87**).
  - Dangcem currently trades at 2016E EV/EBITDA of **14.9x** (forward: 8.8x) vs. Bloomberg peer average of 8.4x (forward: 8.9x). We place an **UNDERWEIGHT** rating (previous SELL) on the stock.
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## Summary of Results and Forecasts

| QUARTERLY                        |           |           |           |           |           |
|----------------------------------|-----------|-----------|-----------|-----------|-----------|
| Income Statement<br>(N'million)* | Q1 2016A  | Q2 2016A  | Q3 2016A  | Q4 2016F  |           |
| Turnover                         | 140,521   | 151,670   | 149,901   | 210,842   |           |
| COGS                             | 62,204    | 76,983    | 92,497    | 142,447   |           |
| Gross Profit                     | 78,317    | 74,687    | 57,404    | 68,395    |           |
| Operating Costs                  | 22,409    | 33,901    | 35,695    | 32,052    |           |
| Operating Profit                 | 56,130    | 41,912    | 24,324    | 38,909    |           |
| Net Finance costs                | (1,591)   | (14,287)  | (12,137)  | (7,875)   |           |
| Net FX Gains                     |           | 42,726    | 11,639    |           |           |
| Profit Before Taxation           | 54,539    | 70,351    | 23,826    | 31,033    |           |
| Taxation                         | 1760      | 19710     | (6,275)   | 2780      |           |
| Profit After Taxation            | 52,779    | 50,641    | 30,101    | 28,254    |           |
|                                  |           |           |           |           |           |
|                                  |           |           |           |           |           |
| ANNUAL                           |           |           |           |           |           |
| Income Statement<br>(N'million)* | FY 2015A  | FY 2016F  | FY 2017F  | FY 2018F  | FY 2019F  |
| Revenue                          | 491,725   | 652,934   | 663,616   | 815,324   | 962,182   |
| COGS                             | 201,808   | 374,131   | 285,355   | 326,130   | 375,251   |
| Gross Profit                     | 289,917   | 278,803   | 378,261   | 489,194   | 586,931   |
| Operating Cost                   | 86,046    | 124,057   | 82,952    | 77,456    | 76,975    |
| Operating Profit                 | 207,822   | 161,275   | 300,618   | 418,261   | 517,654   |
| Interest income                  | 34,819    | 2,277     | 30,693    | 38,296    | 41,972    |
| Net interest expense             | 54,347    | 38,168    | 47,737    | 47,007    | 33,331    |
| Net FX Gains                     |           | 54,365    |           |           |           |
| PBT                              | 188,294   | 179,749   | 283,574   | 409,550   | 526,294   |
| Tax                              | 6,971     | 17,975    | 36,865    | 53,242    | 68,418    |
| PAT                              | 181,323   | 161,775   | 246,709   | 356,309   | 457,876   |
| Balance Sheet<br>(N'million)*    |           |           |           |           |           |
| Assets                           |           |           |           |           |           |
| Cash & Short term funds          | 917,212   | 975,701   | 1,026,887 | 1,084,434 | 1,141,365 |
| Net Loans                        | 53,118    | 72,639    | 64,403    | 64,100    | 88,619    |
| Fixed Assets                     | 11,544    | 11,280    | 14,326    | 19,230    | 23,670    |
| LT investment                    | 40,792    | 26,492    | (13,846)  | (27,406)  | (31,275)  |
| Other Assets                     | 1,110,943 | 1,187,186 | 1,191,153 | 1,260,251 | 1,359,008 |
| Total Assets                     |           |           |           |           |           |
| Liabilities                      | 127,597   | 185,632   | 168,008   | 192,299   | 221,547   |
| Deposits                         | 265,525   | 251,051   | 224,069   | 189,286   | 152,689   |
| Borrowings                       | 466,223   | 495,601   | 437,759   | 417,339   | 404,033   |
| Total liabilities                | 644,720   | 691,584   | 753,394   | 842,912   | 954,975   |
| Shareholders' fund               | 917,212   | 975,701   | 1,026,887 | 1,084,434 | 1,141,365 |
|                                  |           |           |           |           |           |
|                                  |           |           |           |           |           |
| Key Ratios                       | FY 2015A  | FY 2016F  | FY 2017F  | FY 2018F  | FY 2019F  |
| P/E                              | 16.45     | 18.43     | 12.09     | 8.37      | 6.51      |
| EV/EBITDA                        | 12.18     | 14.96     | 8.75      | 6.36      | 4.96      |
| ROA                              | 17%       | 13%       | 17%       | 24%       | 28%       |
| ROE                              | 29%       | 24%       | 32%       | 39%       | 41%       |
| Net Margins                      | 37%       | 25%       | 37%       | 44%       | 48%       |
| EPS                              | 10.64     | 9.49      | 14.48     | 20.91     | 26.87     |
| P/B                              | 4.63      | 4.15      | 3.58      | 2.99      | 2.44      |
| Dividend yield                   | 3.4%      | 2.9%      | 4.5%      | 6.5%      | 7.8%      |

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

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