



Rating	<b>NEUTRAL</b>
Price	₦253.00
FVE	<b>₦256.85</b>
52-week range	₦158.99 - 290.00
Market Cap. (₦'tn)	3.749
1-month Avg. Vol	1,166,124
Curr. P.E	21.9x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2016 A</b>	3.10	2.97	1.77	3.12
<b>2017 A</b>	4.14	4.31	2.88	0.65
<b>2018 F</b>	4.29	4.12	3.16	3.01

#### DANGCEM.NL - Share Price Trend



#### Analyst(s)

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## Dangote Cement Plc. (DANGCEM.NL)

### Stock Report

#### *Weaker Growth, Higher Valuation, Turning Cautious!*

- In this report, we transfer coverage of Dangote Cement (DANGCEM) to **Oluwasegun Akinwale**.
- DANGCEM posted another impressive performance to overshadow the historic fit achieved in 2016. Much of the strong performance mirrored margin improvement in Nigerian operations, a reflection of price-induced revenue growth as well as cost-effective energy mix. Also, non-Nigerian operations recorded volume growth on the back of higher demand in Tanzania, Senegal, Cameroun, Ethiopia, and Zambia. Consequently, the company reported a cumulative FY 17 EPS (₦11.99) that is 1.4x and 1.1x those of FY 16 (restated) and FY 15 respectively. However, over Q4 17, the company's EPS was 79% lower YoY at ₦0.65 following a surprise provision for unapproved tax incentives at the Ibese 3&4 and Obajana line which pushed the quarter's effective tax to 84%.
- Going into 2018, we remain broadly positive on DANGCEM and expect the company to sustain earnings growth, albeit at a much slower pace than 2017. Specifically, we see volume induced revenue growth and lower energy as key drivers of earnings in FY 18, relative to the price-induced growth story in prior year. On pricing, we believe with Nigeria gross margin now ahead of the pre-crisis level of ~61.8%, the argument for leaving prices at currently elevated levels to compensate for cost pressures will fall apart. And on energy, we look for a stable energy source over 2018

with locally mined coal now gaining more prominence and the streamlining of energy source in the non-Nigerian operation, especially with the installation of a gas genset in Tanzania. Consequently, the impact of lower energy cost is expected to moderate the waning effect of price hikes on margin which we expect to print at 57% (2017: 56%). Overall, we project EPS of ₦14.52 (+21% YoY). That said, while we think earnings growth story is compelling, it looks expensive from a valuation standpoint. Accordingly, we maintain our **NEUTRAL** recommendation with a FVE of **₦256.85** (previously: ₦282). DANGCEM trades at 2018 EV/EBITDA of 10.4x which is at a premium to EMEA peers of 10.5x.

### *Improved Margins but growth momentum cools off*

- Going by the breakdown, much of the margin expansion in 2017 stemmed from higher prices in the Nigerian business (+56% YoY to ₦45,595/tonne) which more than made up for weaker volumes (-15.9% YoY to 12.7MT)<sup>1</sup>. On the other hand, non-Nigerian volumes growth (+8.4% YoY to 9.3MT) was supported by Tanzania, Senegal, Cameroun, Ethiopia, and Zambia with revenue in the Non-Nigerian region rising 22.8% to ₦258 billion and accounting for 31% of the group's revenue. Consequent on the price-inspired momentum in Nigeria, and volume-led growth in Non-Nigerian, the group's revenue printed 31% higher YoY at ₦805 billion – missing our estimate by only 1.1%.
- Further down, input cost was subdued, rising 8% YoY to ₦351 billion. Much of the containment in input cost mirrored improved energy efficiency. According to management, Obajana and Ibese reported lower usage of LPFO in the period to 2% and 1% of total energy respectively (2016: 29% and 16%), with local coal and gas usage assuming greater prominence. The foregoing, alongside price-induced revenue growth drove gross margin in Nigerian operations to 71% - above pre-crisis level of 61.8%. However, non-Nigerian operations faced margin pressure in the period, reflective of energy challenges, particularly in Tanzania, where the company reported high usage of expensive diesel. Consequently, the group's gross margin printed at 56%, below pre-crisis shock levels of 61% with gross profit tracking higher by 56% YoY to ₦454 billion.
- The foregoing translated to a strong growth of 60% YoY to ₦289 billion at the PBT level. However, PAT rose at a much slower pace of 43% YoY owing to an unexpected surge in tax provisions to ₦58 billion which pushed FY 17 tax provision to ₦85 billion, representing an

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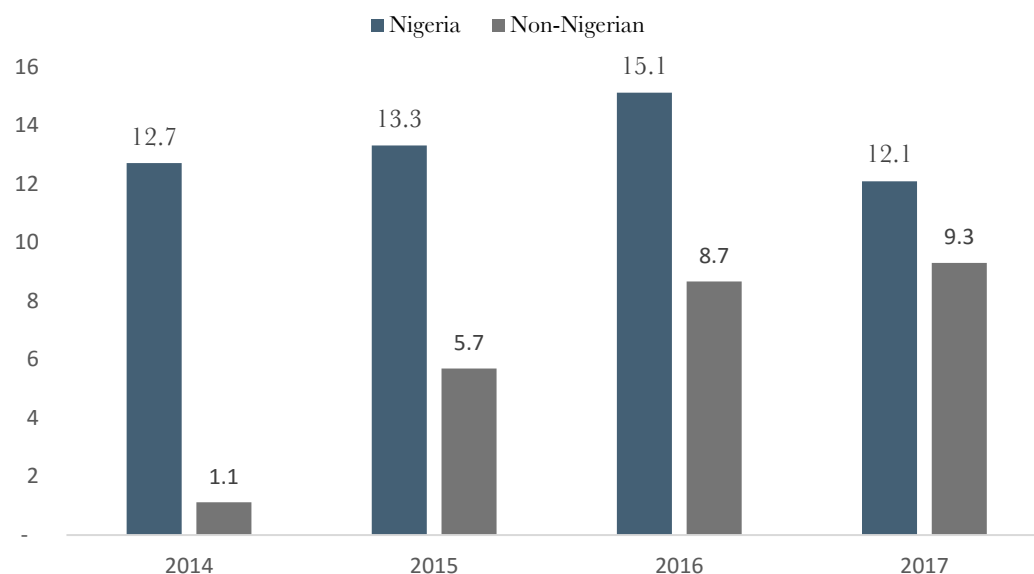
<sup>1</sup> While Nigerian business maintained the same contribution of 68% of total group revenue (before intercompany adjustments) in FY 17, its volume attribution contracted 610bps YoY to 58%.

effective tax rate of 29% versus 21% in FY 16. On the tax provision, management submitted that the earlier tax benefits of ₦28 billion and ₦44 billion taken in 2015 and 2016 respectively on the Ibese 3&4 and Obajana line 4 assumed that it qualified for a pioneer status incentive. However, given the delay on the approval of the status by Nigerian Investment Promotion Commission (NIPC), management decided to make a total provision of ₦134 billion (with ₦71 billion treated through prior year reserves) for the year and at the same time reversed previous benefits booked in 2016.

### ***Price correction to stimulate Nigerian volumes in 2018***

- Going into 2018, with Nigerian gross margin having exceeded pre-crisis level of ~61.8% (71% in FY 17), the argument for leaving prices at currently elevated levels to compensate for cost pressures will fall apart. But, we expect the price correction to be gradual, as the sustainability of current gains are considered. In view of this, we now adopt per ton Nigerian cement price of ₦42,590 (-7% YoY) on average over 2018 which should stimulate volume growth (+9.4% YoY to 13.9MT) with related revenue expected to print at ₦590 billion (7% YoY).
- For the non-Nigerian operations, the company's drive to ramp up sales in Tanzania, Congo, and South Africa guides to volume growth in the regions. Specifically, in South Africa, there are ongoing discussions to extend the tariffs on imported cement to other import destinations like China which bodes well for volumes if implemented. In Senegal, Ethiopia, Zambia, Cameroun, Ghana, and Sierra Leone, we expect the currently lower pricing in Q4 17 (compare to the average selling prices in Q3 17) to support volume growth. Overall, we project non-Nigerian volumes and mean price at 11.1MT and ₦28,790/ton respectively with related revenue of ₦298 billion. In all, we now look for FY 18 group revenue of ₦889 billion (+10.4% YoY).

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



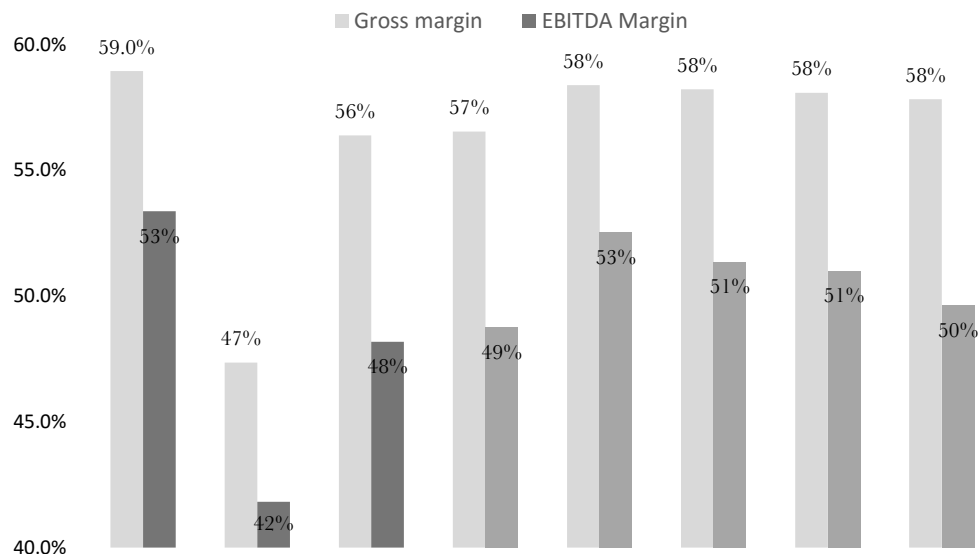
Source: Company's Financials, ARM Research

### *Improved energy mix to sustain margin*

- On cost, expected currency and energy stability over 2018 guides to further moderation in cost of sales. In addition, for Tanzania, management guides to the delivery of gas gensets in Q2 18 which should reduce the plant's usage of expensive diesel. Accordingly, we expect input cost to print at ₦386 billion (+10% YoY) which should sustain gross margin at 57% (+1pps YoY) – gross profit to rise 11% YoY to ₦502 billion. Further down, we expect the company to achieve efficiency in terms of its distribution to other countries, however our forecast of higher volumes speaks to increased distribution expense going into the year. Thus, we expect a slower increase in operating expense (+7% YoY in FY 18 vs. 30% YoY in FY 17), which should drive a 158bps YoY expansion in operating margin to 39% (vs. 38% in FY 17). Consequently, we expect an expansion in Nigeria and non-Nigeria EBITDA margin to 67% and 16%<sup>2</sup> (vs. 65% and 14% in FY 17) respectively, with overall group EBITDA margin 58pps higher YoY to 49%.

<sup>2</sup> Before central costs and eliminations of N5 billion.

**Figure 2: Trend in Gross and EBITDA margin**



Source: Company's Financials ARM Research

- The pace of increase in DANGCEM's borrowing slowed to +4% YoY (vs. 46% in FY 16) in FY 17 to ₦372 billion, with a total of ₦236 billion (₦76 billion in 2018) expected for maturity between 2018 and 2019 – with the parent company related loans accounting for 84% of the maturing obligations. Accordingly, management has guided to refinance the maturing obligations with a naira denominated bond of ₦300 billion (expected to be issued in a tranche of ₦50 billion to take advantage of pricing). Also, to support its refinancing and fund its estimated capex of \$350 million, the company is issuing a Eurobond of \$500 million.
- On impact, given that most of the parent company's loans were provided at MPR+1, with overall weighted average cost estimated at 13.9% in 2017, and management guiding to a possible 200bps decline in the yield environment (from current levels of ~14.27%) before opening the bond program, we expect the refinancing of the loans to be at a discount (100bps) – with estimated weighted average cost of 13.1%. Given our expectation of a cut in MPR over H2 18, with the related impact on the yield environment, we look at the company issuing the bond over H2 18 and thus we still hold out for slight increase in finance cost over H1 18, which pushed our overall cost for the year to ₦53 billion.
- On tax, while management has guided to a possible approval of the pending pioneer tax incentive on Ibese 3&4 and Obajana line 4 – which could drive a reversal of the sizeable provision in 2017 – we are very much cautious given the current political landscape and thus

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expect effective tax rate to play around 25% (vs. 29% in 2017). On balance, we now look for 2018E PAT of ₦247 billion (+21% YoY).

- Coalescing these changes translates to a 10% decline in our FVE to ₦256.85. DANGCEM trades at 2018 EV/EBITDA of 10.4x which is at a premium to EMEA peers of 10.5x. Accordingly, we maintain our **NEUTRAL** recommendation on the stock with a FVE of **₦256.85**. (previously: ₦282)

## Summary of Results

ANNUAL					
Income Statement (N'm) *	2016A	2017A	2018F	2019F	2020F
Revenue	615,103	805,582	889,276	1,037,750	1,106,624
COGS	323,816	351,290	386,435	431,741	462,196
Gross Profit	291,287	454,292	502,841	606,009	644,428
Operating Cost	119,336	155,297	158,291	152,089	173,428
Operating Profit	182,493	304,208	349,886	458,071	474,320
Finance Income	43,817	35,926	34,419	42,653	67,754
Finance expense	45,381	52,711	53,207	58,617	67,164
PBT	180,929	289,590	331,097	442,106	474,910
Tax	38,071	85,342	83,622	55,158	52,304
PAT	142,858	204,248	247,476	386,949	422,606
Balance Sheet (N 'm) *					
Fixed Assets	1,155,711	1,192,140	1,253,920	1,321,194	1,400,061
Stocks	82,903	94,594	100,187	110,834	123,473
Trade debtors	26,279	30,155	31,313	33,489	36,176
Cash & other bank balances	115,693	168,387	170,567	308,254	473,739
Total Assets	1,527,908	1,665,883	1,721,904	1,964,199	2,238,082
Trade Creditors	268,966	270,721	258,409	298,399	327,590
Non-current Liabilities	218,316	364,047	406,069	465,287	542,303
Total liabilities	730,563	884,523	885,276	1,013,441	1,141,366
Shareholders' fund	797,345	781,360	836,628	950,758	1,096,716
Key Ratios					
P/E	30.1	21.0	17.4	11.1	10.2
EV/EBITDA	17.7	11.6	10.4	8.2	7.8
ROA	11%	13%	15%	21%	20%
ROE	20%	26%	30%	42%	40%
Net Margins	23%	25%	28%	37%	38%
EPS	8.4	12.0	14.5	22.7	24.8
EBIT margins	30%	38%	39%	44%	43%
PBT margins	29%	36%	37%	43%	43%
Effective Tax rates	21%	29%	25%	12%	11%
Debt to Equity	46.8%	49.6%	46.8%	50.3%	52.4%
Debt to Assets	24.4%	23.3%	23.3%	24.9%	26.2%
Interest coverage	4.0	5.8	6.6	7.8	7.1
BVPS	46.8	45.9	50.2	57.0	65.7

Source: ARM Research \*unless otherwise stated  
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