

**Dangote Cement Plc. | Earnings Report**

6 months ended 30<sup>th</sup> June, 2016

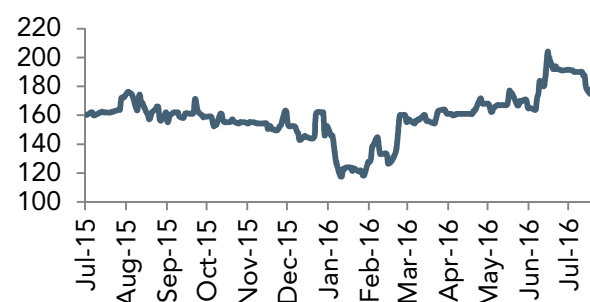
**Net FX gains mask weaker operating performance (₦161.48 - SELL)**

- Dangote Cement Plc. (Dangcem) released its unaudited Q2 16 result wherein pre-tax earnings rose 20% YoY to ₦70 billion well ahead of our ₦19 billion estimates. However, PAT was 5% lower YoY at ₦50 billion following a 19pps rise in effective tax rates to 28% drove.

**FX translation gains flatter earnings...**

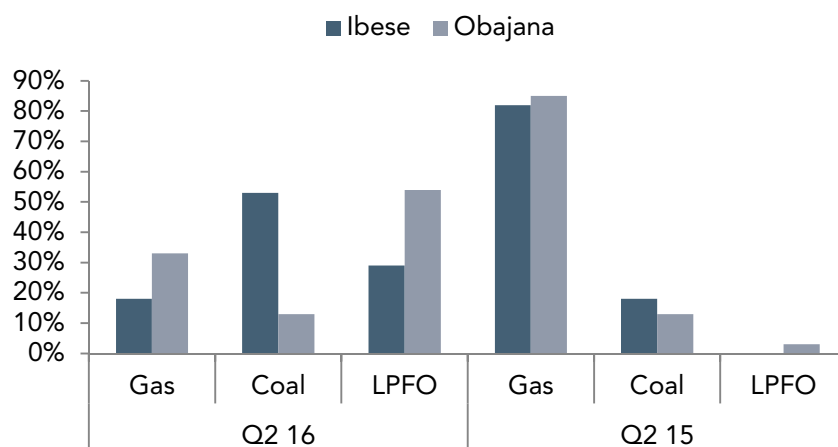
- In contrast to peer Lafarge, whose net short dollar position drove sizable FX losses in the aftermath of the 42% naira depreciation, Dangcem's net long dollar position translated to net FX gains of ₦38billion which masked weak operating performance. Adjusting for the exchange rate impact, pre-tax earnings slides 46% YoY to ₦32 billion with related margins shrinking 24.9pps to 21% (vs. +40bps to 46.4% prior to adjustment).
- Focusing on core operating performance, we note that significantly higher costs underpinned weak underlying earnings performance in Q2 16. Specifically, although group revenue rose 19% YoY to ₦152 billion following strong growth in West & Central Africa (over two-fold YoY to ₦26 billion) and South & East Africa (+85% YoY to ₦16 billion), a combination of higher input and distribution cost eroded top-line gains. According to management, input cost pressures (+73% YoY to ₦77 billion) was underpinned by prolonged gas shortage across Nigeria which forced the company to rely on the

Income Statement Data			
	2016 – 6M'm	2015 – 6M'm	%chg
Revenue	292,191	242,215	21%
PBT	124,890	128,726	-3.0%
Tax	21,470	6,918	210%
PAT	103,420	121,808	-15%
Balance Sheet Data			
	2016-Jun'm	2015-Dec 'm	%chg
Inventory	67,806	53,118	28%
Receivables	19,916	11,544	73%
Cash	49,058	40,792	20%
Payables	228,885	127,597	79%
Net Assets	680,236	644,720	6.0%
Stock Data			
Price	₦180.00		
2 week range	₦122.90 – ₦203.96		
Market Cap. (N'b)	3,067		
1-month Avg. Vol	791,310		
Curr. PE	29.7x		
Bloomberg Ticker	DANGCEM:NL		
Reuters Ticker	DANGCEM.LG		
Dangote Cement Plc. - Share Price Trend			


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more expensive back-up—LPFO.<sup>1</sup>

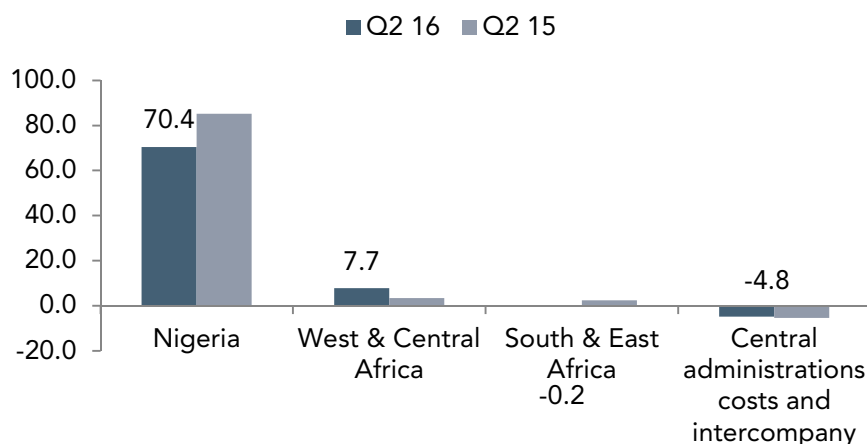
**Figure 1: Energy mix across plants**



Source: Company results, ARM Research

- In addition to this, a ramp up of distribution expenses outside of Nigeria also drove significant pressures over Q2 16. Notably, high selling and distribution expenses swung South and East Africa operations into loss at the EBITDA level with overall Q2 16 operating profit also tumbling 35%YoY to ₦34 billion and related margins contracting 23pps YoY to 27.6% (Gross margins: -16pps YoY to 49.2%).

**Figure 2: EBITDA contribution by region (₦' billion)**



Source: Company financials, ARM Research

<sup>1</sup> LPFO was 3X more expensive than gas in the review period

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### Core operations to remain weak over 2016

- Overall, although the huge currency gains does provide some earnings buffer for Dangcem over 2016, we remain cautious on the business' core operating performance. In Nigeria, for instance, prices are set to remain depressed over Q3 16 with management given only little weight to probability of price increase in Q4 16 at the earliest. To this effect, we have reviewed our average Nigerian prices 11% lower to ₦25,734/tonne (-12% YoY). However, current run rate of volume growth (+39% YoY to 8.8MT) suggests our target volume estimate of 14.6MT for Nigeria may be slightly pessimistic. Thus, we have also increased our Nigerian volume growth target to 15.7MT (+18% YoY) with net impact of the top-line adjustments cascading to a 4% YoY rise in our target Nigerian cement revenues to ₦404 billion (vs. +9% YoY to ₦424 billion in previous estimate). At the other end, our 2016 volume and price estimates for non-Nigerian operations remain largely in line with current run-rate, so we have left our 2016 non-Nigerian revenue target unchanged at ₦160 billion. Thus, reflecting adjustments to Nigerian estimates, we now expect 2016 group revenue to increase 15% YoY to ₦564 billion (vs. +19% YoY to ₦585 billion in previous estimates).
  - For costs, we still expect COGS to rise 33% YoY to ₦269 billion (H1 16: +65% YoY to ₦139 billion) as delays in completing repair works at the damaged Trans Forcados pipeline suggest present gas challenges are likely to linger for most of the year. That said, pass-through effect from our top-line adjustments now leave our operating profit estimate 2% lower YoY at ₦203 billion (vs. +8% YoY to ₦224 billion in previous forecast).
  - Having incorporated the ₦38 billion net FX gains over Q2 16, we now expect Dangcem to report net finance income of ₦14 billion over FY 16 (vs. net finance charge of ₦24 billion previously) and PBT of ₦217 billion (vs. PBT of ₦200 billion in previous forecast). However, management recently guided to effective tax rate of ~17% for 2016 following the expiration of tax concession in some Nigerian plants—implying 11pps and 13pps increases from our estimate and 2015 actual
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respectively.<sup>2</sup> Thus, on raising 2016 effective tax rate to match management's guidance, our forecast 2016 PAT declines 4% to ₦180 billion (-1% YoY).

- Net the impact of these adjustments, our FVE is now 3% lower at **₦161.48**, which currently stands at a 10% discount to the stock's last market price. Dangcem trades at current EV/EBITDA of **12.6x** relative to 9.1x for Bloomberg EMEA peers. We downgrade our recommendation on the stock to **SELL** (vs. NEUTRAL in previous communication).

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<sup>2</sup> The increase in non-pioneer profits and the application of the Commencement Rule on production lines out of tax holidays in Nigeria resulted in increased tax charges and effective rates. The effective tax rate was 10% for the Nigerian operations and 17.2% for the Group.

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QUARTERLY					
Income Statement (N'000,000)*	Q1 2016A	Q2 2016A	Q3 2016F	Q4 2016F	
Turnover	140,521	151,670	141,005	130,823	
COGS	62,204	76,983	67,258	62,587	
Gross Profit	78,317	74,687	73,746	68,235	
Operating Costs	22,409	33,901	24,125	16,066	
Operating Profit	56,130	41,912	50,749	54,206	
Net Finance costs	-1,591	28,439	-7,084	-5,595	
Profit Before Taxation	54,539	70,351	43,665	48,611	
Taxation	1760	19710	7384	8065	
Profit After Taxation	52,779	50,641	36,281	40,546	
ANNUAL					
Income Statement (N'000,000)*	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Revenue	491,725	564,018	651,195	801,247	946,780
COGS	201,808	269,032	280,014	320,499	369,244
Gross Profit	289,917	294,986	371,181	480,748	577,536
Operating Cost	86,046	96,501	81,399	76,118	75,742
Operating Profit	207,822	202,997	294,992	411,040	509,368
Interest income	34,819	31,883	30,693	33,306	31,552
Interest expense	54,347	55,720	39,265	29,523	21,627
PBT	188,294	217,166	286,419	414,822	519,292
Tax	6,971	36,918	48,691	70,520	88,280
PAT	181,323	180,247	237,728	344,302	431,012
Balance Sheet (N'000,000)*					
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	16.92	17.02	12.90	8.91	7.12
EV/EBITDA	12.51	12.62	9.22	6.83	5.56
ROA	17%	16%	20%	28%	33%
ROE	29%	27%	33%	43%	48%
Net Margins	37%	32%	37%	43%	46%
EPS	10.64	10.58	13.95	20.20	25.29
EV/EBITDA	12.51	12.62	9.22	6.83	5.56
P/B	4.76	4.44	4.07	4	3
Dividend yield	4.4%	4.3%	5.7%	8.3%	10.4%

## 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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