



## Dangote Sugar Refinery Plc. (DANGSUGAR.NL)

### Stock Report

### *Losing competitiveness to border sneak*

|                    |                |
|--------------------|----------------|
| Rating             | <b>NEUTRAL</b> |
| Price              | ₦15.50         |
| FVE                | ₦17.01         |
| 52-week range      | ₦9.13-₦23.95   |
| Market Cap. (₦'bn) | 186            |
| 1-month Avg. Vol   | 4,557,773      |
| Curr. PE           | 5.2x           |

| Quarterly EPS      | Q1   | Q2   | Q3    | Q4    |
|--------------------|------|------|-------|-------|
| <b>2016 A</b>      | 0.28 | 0.34 | 0.23  | 0.36  |
| <b>2017 A</b>      | 0.40 | 1.03 | 0.78  | 1.10  |
| <b>2018 A (E*)</b> | 0.45 | 0.62 | 0.48* | 0.66* |

### DANGSUGAR:NL - Share Price Trend



### Analyst(s)

**Feyisike Ilemore**

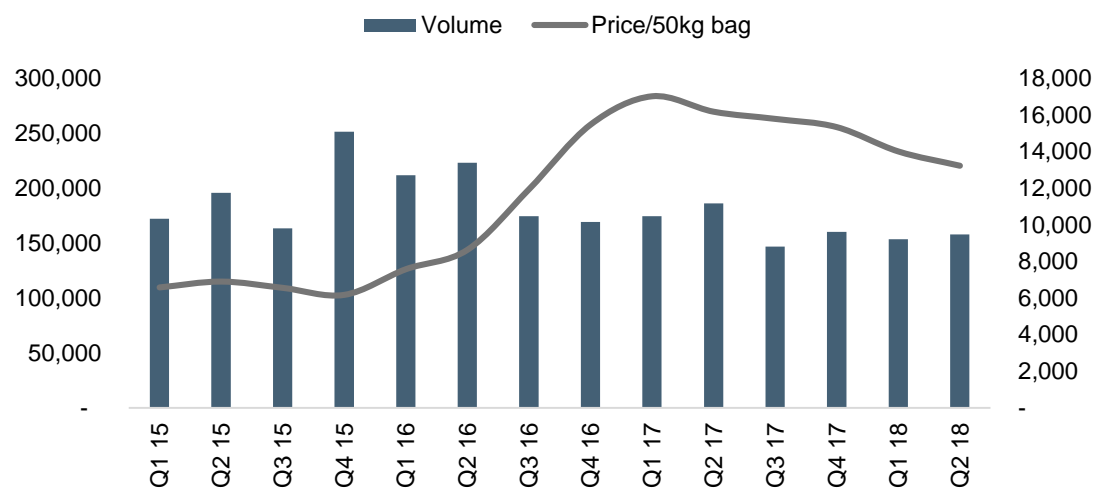
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- Dangote Sugar Refinery (DSR) earnings in first half 2018 result declined 25.6% YoY to ₦12.7 billion (ARM forecast: ₦12.1 billion) and translating to an EPS of ₦1.07 (vs. ₦1.43 in H1 17). Expectedly, the slump in earnings in H1 18 stemmed from lower revenue (-29.2% YoY to ₦84.1 billion) induced by weaker sales volume as well as price rollbacks on its refined sugar product. Precisely, despite lower per ton refined sugar price (-18.3% YoY to ₦264,000) over H1 18, sales volume declined 13.7% YoY to 311KMT owing to incessant smuggling of sugar which impacted on DSR's market share.
- Going forward, we believe the trajectory of DSR's earnings is highly dependent on development around sugar smuggling activities within the country. In playing its part to curb the activity and drive volume growth, management of DSR explained that the company is in partnership with regulatory authorities and others in the sugar industry to stem the influx of poor quality unlicensed sugar into country. Though a positive move, we think the action will be slow and thus do not foresee an abatement in the interim. Consequent to this as well as slight underperformance of Q2 revenue to our estimate, we cut our FY 18 volume forecast by 2% and estimate 2018 full-year sales volume to touch a five year low of 636KMT. This coupled with our price forecast of ₦256,000/ton translates to a FY 18 revenue of ₦167 billion (-18.3% YoY) and after-tax earnings of ₦27.5 billion (-31% YoY). The foregoing combined with increases to operating expenses leads to an 8% cut in our FVE estimate to ₦17.01/share. A sooner than expected successful

curtailment of smuggled sugar is an upside potential to sales volume, revenue, and earnings.

- Looking through its second quarter standalone result revealed lingering pressure on revenue which largely impacted on earnings, as EPS dipped 39.7% YoY to ₦0.62 (ARM forecast: ₦0.56). For context, revenue declined 27.4% YoY to ₦42.9 billion weighed by a 15.3% decline in sales volume to 158KMT as the smuggling of cheaper unlicensed sugar into Nigeria continues to take its toll on the company’s market share, particularly retail consumers – which accounts for 50% of the market and trends to ~60% during the Ramadan. To retain competitive market share, management has been rolling back prices with current per ton price at ₦263,000 (vs. ₦280,000 in Q1 18 and ₦323,000 in Q2 17). Despite this, sales volume remained downbeat even in the face of the Ramadan season which ordinarily should drive increased consumption of its refined sugar.
- For us, the reason for the slow recovery in volume might not be far from the fact that DSR’s refined sugar price remains at a 10% premium to that of smuggled sugar. In fact, management had earlier guided that further price cuts to levels of smuggled sugar isn’t favorable for its operations considering that the company pays duties and levies on imported raw sugar which is circumvented by the smugglers of unlicensed sugar. Elsewhere, we believe the unrelenting gridlock in Apapa<sup>1</sup> imposed an additional pressure on sales volume.

**Figure 1: Trend in DSR Quarterly Volume and Price**



Source: Company Report

<sup>1</sup> Location of its 1.44 million MT refined sugar plant

- Over Q2 18, raw material cost<sup>2</sup> (-43.8% YoY to ₦21.9 billion) eased further hinged on the free fall of global raw sugar prices (Q2 18: -21.3% YoY) – owing to oversupply of the commodity in international markets, alongside sustained FX liquidity. The pass-through from the slump in raw material cost largely drove cost of sales to drop 25.4% YoY to ₦29.9 billion given that the raw material sub-component accounts for a large chunk<sup>3</sup> of total input costs. Also, the company’s input cost benefitted from improved efficiencies in energy utilization. Irrespective, cost reduction was outshone by revenue slump, resulting in a gross margin contraction of 191bps YoY to 30.3%. Irrespective, Q2 18 margin of 30.3% is impressive when compared to 25% and 23% recorded in Q1 18 and Q4 17 respectively.
- A major surprise was operating expenses which more than doubled that of Q2 17 to ₦2.3 billion (-16.2% deviation from forecast) incited by higher admin expense (+12.7% to ₦1.6 billion). Owing to this, OPEX to sales ratio spiked to 5.3% (vs. 2.4% in Q2 17) with attendant impact on EBIT margin (-481bps to 25%). Overall, despite higher finance income (+17.7% YoY to ₦808 million) and lower interest expense (-83.1% YoY to ₦50.9 million), earnings slumped 39.7% to ₦7.4 billion.

***Sales volume on track to touch its lowest level in five years***

- Going forward, we believe the trajectory of DSR’s earnings is highly dependent on the development around sugar smuggling activities within the country. In playing its part to curb the illegal activity and drive volume growth, management explained that the company is in partnership with regulatory authorities and others in the sugar industry to stem the influx of poor quality unlicensed sugar into country. Though a positive move, we think the process will be slow and thus do not foresee an abatement in the interim. Consequent to this as well as slight underperformance of our revenue estimate, we cut our FY 18 volume forecast by 2% and estimate sales volume to touch a five year low of 636KMT (FY 17: 667KMT). This combined with our per ton price forecast of ₦256,000 (-14% YoY) translates to a FY 18 revenue of ₦167 billion (-18.3% YoY), slightly lower than our previous estimate of ₦170 billion. A sooner than expected successful curtailment of smuggled sugar is an upside potential to sales volume and revenue.
- To capture our expectation of further declines in the price of raw sugar price and sustained improved FX liquidity, we have lowered our cost of sales forecast by 3.8% YoY to ₦122 billion, translating to a 20.5% YoY decline from FY 17. Specifically, global raw sugar prices

<sup>2</sup> Dangote Sugar major input is raw sugar of which 98% of what it requires is imported

<sup>3</sup> Accounts for ~70% of total input costs

have touched a three year low of \$11.89/pound with prospects of a further drop in price owing to supply overhang of the commodity in global markets which should subsist throughout 2018. Thus, our revenue and cost projections translate to a FY 18 gross margin of 27%, 206bps higher than 24.9% in FY 17.

- We have also revised our OPEX forecast upward by 14.5% to ₦7.7 billion (+18.3% YoY) to capture the surprise increase in Q2 18. Net impact of the foregoing translates to a 2018E PAT of ₦27.5 billion (-31% YoY), representing an EPS of ₦2.29. Accordingly, we expect the company to pay a DPS of ₦1.21 which translates to a dividend yield of 6.8% based on current pricing.
- On our numbers, Dangote Sugar trades at a forward P/E of 7.7x vs. 15.5x for MENA peers. The stock has lost 22.5% YTD (NGSE: -4.96%) with last trading price of ₦15.50 at a 9.0% discount to our FVE of ₦17.01 which translates to a **NEUTRAL** rating.
- **H1 18 Earnings conference call to hold today at 3:00pm Lagos time.**

## Summary of Results and Forecasts - Naira (₦)

| ANNUAL                     |         |         |         |         |         |
|----------------------------|---------|---------|---------|---------|---------|
| Income Statement (₦' m) *  | 2016A   | 2017A   | 2018E   | 2019E   | 2020E   |
| Revenue                    | 169,725 | 204,422 | 167,079 | 156,276 | 160,353 |
| COGS                       | 146,736 | 153,434 | 121,967 | 116,457 | 120,264 |
| Gross Profit               | 22,989  | 50,988  | 45,111  | 39,819  | 40,088  |
| Operating Cost             | 6,929   | 7,482   | 8,855   | 8,673   | 9,140   |
| Operating Profit           | 10,307  | 14,266  | 16,059  | 43,506  | 36,256  |
| Interest Income            | 601     | 7,501   | 3,514   | 3,326   | 3,554   |
| Interest Expense           | 299     | 278     | 236     | 248     | 261     |
| PBT                        | 19,614  | 53,599  | 40,369  | 35,004  | 35,043  |
| Tax                        | 5,218   | 13,815  | 12,918  | 11,201  | 11,214  |
| PAT                        | 14,396  | 39,784  | 27,451  | 23,803  | 23,830  |
| Balance Sheet (₦ '000) *   |         |         |         |         |         |
| Fixed Assets               | 54,803  | 59,414  | 65,858  | 72,407  | 75,326  |
| Stocks                     | 47,409  | 47,656  | 45,128  | 38,431  | 36,079  |
| Trade debtors              | 17,734  | 20,907  | 20,049  | 18,753  | 19,242  |
| Cash & other bank balances | 35,020  | 41,368  | 41,771  | 47,088  | 53,302  |
| Total Assets               | 178,382 | 195,080 | 198,543 | 202,415 | 209,686 |
| Liabilities                |         |         |         |         |         |
| Trade Creditors            | 88,278  | 75,653  | 65,862  | 58,228  | 54,119  |
| Non-current Liabilities    | 11,475  | 6,680   | 5,213   | 5,213   | 5,213   |
| Total liabilities          | 112,230 | 102,345 | 92,631  | 85,078  | 81,053  |
| Shareholders' fund         | 66,152  | 92,736  | 105,912 | 117,337 | 128,633 |
| Key Ratios                 | 2016A   | 2017A   | 2018E   | 2019E   | 2020E   |
| Gross Margin               | 13.5%   | 24.9%   | 27.0%   | 25.5%   | 25.0%   |
| EBIT Margin                | 6.1%    | 7.0%    | 9.6%    | 27.8%   | 22.6%   |
| PBT Margin                 | 11.6%   | 26.2%   | 24.2%   | 22.4%   | 21.8%   |
| Net Margin                 | 8.5%    | 19.5%   | 16.4%   | 15.2%   | 14.8%   |
| EPS                        | 1.20    | 3.32    | 2.29    | 1.98    | 1.98    |
| P/E                        | 14.75   | 5.34    | 7.74    | 8.93    | 8.92    |
| EV/EBITDA                  | 1.51    | 4.12    | 4.82    | 5.26    | 5.02    |
| ROA                        | 8.1%    | 20.4%   | 13.8%   | 11.8%   | 11.4%   |
| ROE                        | 21.8%   | 42.9%   | 26.0%   | 20.4%   | 18.6%   |

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  |
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