

Dangote Sugar Refinery Plc. | Earnings Report

6 months ended 30th June, 2016

Interest savings on debt pay-down saves the day
(OVERWEIGHT: ₦7.90)

- Dangote Sugar Refinery Plc. (DSR) released its unaudited H1 2016 wherein revenue climbed 37.9% YoY to ₦70.5 billion while PBT and PAT rose 13.8% YoY and 16.9% YoY to ₦11.2 billion and ₦7.4 billion respectively. Focusing on the Q2, despite FX induced input cost pressures, which offset strong top-line growth, interest savings following DSR's complete liquidation of its debt drove modest improvement in earnings.

Improved financial efficiency support earnings

- Given challenges on the macroeconomic front, declining purchasing power of consumers and rising input costs, companies across the FMCG's space are focusing on financial and operational efficiency. In this light, DSR paid down its outstanding ₦2 billion loan which drove finance charges 32% YoY lower to ₦139 million over Q2 16. The lower interest expense combined with a strong rise in interest income (twenty nine fold YoY higher to ₦119 million) drove net finance costs 90% lower YoY. Robust interest income reflects six-fold YoY expansion in cash balances to ₦24.3 billion.
- Furthermore, DSR also pushed harder on cost optimization with OPEX growth tracking slower than revenues resulting in a 12bps cutback in opex-sales ratio.

Income Statement Data (₦'million)

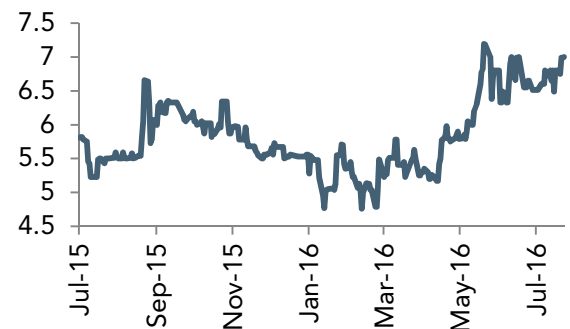
| | 2016 – 6M | 2015 – 6M | %chg |
|----------------|-----------|-----------|-------|
| Revenue | 70,472 | 51,120 | 37.9% |
| PBT | 11,156 | 9,802 | 13.8% |
| Tax | 3,774 | 3,490 | 8.1% |
| PAT | 7,381 | 6,312 | 16.9% |

Balance Sheet Data (₦'million)

| | 2016-Jun | 2015-Dec | %chg |
|--------------------|----------|----------|--------|
| Inventory | 15,138 | 15,548 | -2.6% |
| Receivables | 10,789 | 14,704 | -26.6% |
| Cash | 24,347 | 8,993 | 170.7% |
| Payables | 37,031 | 28,092 | 31.8% |
| Net Assets | 59,530 | 58,149 | 2.4% |

Stock Data

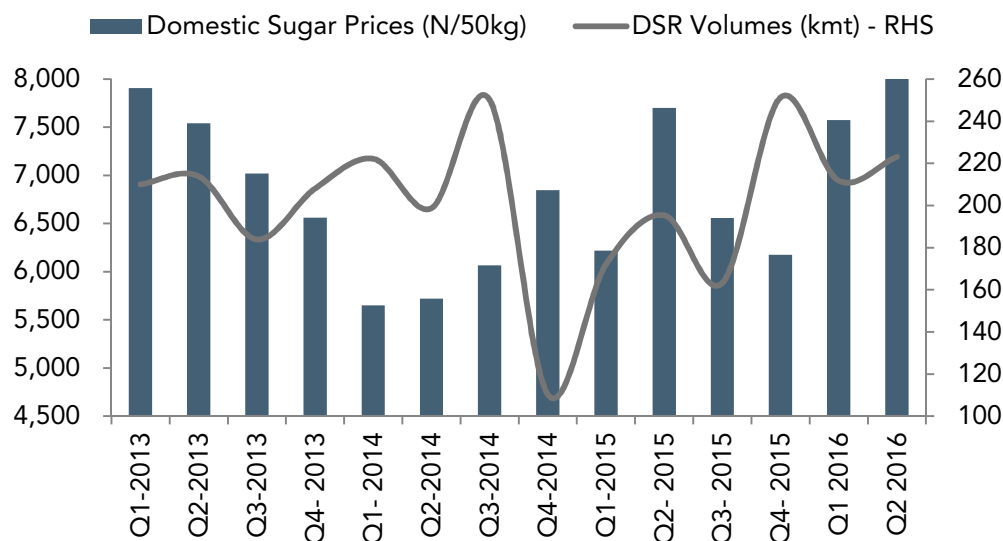
| | |
|--------------------------|---------------|
| Price | ₦7.00 |
| 52 week range | ₦4.76 - ₦7.19 |
| Market Cap. (N'm) | 84,000 |
| 1-month Avg. Vol | 1,308,318 |
| Curr. PE | 6.9x |
| Bloomberg Ticker | DANGSUGA:NL |

Dangote Sugar of Nigeria Plc- Share Price Trend

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Currency and gas supply woes impale gross margins

- The cost improvement helped mask underlying challenges during the period. First, the renewed insurgency in the Niger Delta, which led to gas supply disruptions and factory down-time resulted in DSR switching to more expensive LPFO to fire its plant over the period. In addition, FX shortages, which culminated in CBN's liberalization of the interbank FX market and subsequent 43% naira depreciation led to higher costs on imported raw materials. Assisted by higher raw sugar prices (+36.2% YoY), DSR reported a 43.4% YoY increase in COGS to N30.7 billion. The input cost pressure more than offset strong top-line growth (+32.4% YoY to ₦37.9 billion) over the period resulting in 6pps YoY contraction in gross margin to 18.9%. The sturdy turnover emanated from increased refined sugar prices (+12% YoY to ₦8,631/50kg bag) as DSR pass-through some of the input cost pressures to consumers and higher volume growth (+14.2% YoY). Upswing in volumes reflected increased demand for domestically refined sugar, as difficulty in sourcing FX inhibits smuggling activities, in addition to the atypical sugar demand in the Ramadhan season.

Figure 1: Trend in refined sugar prices and volumes

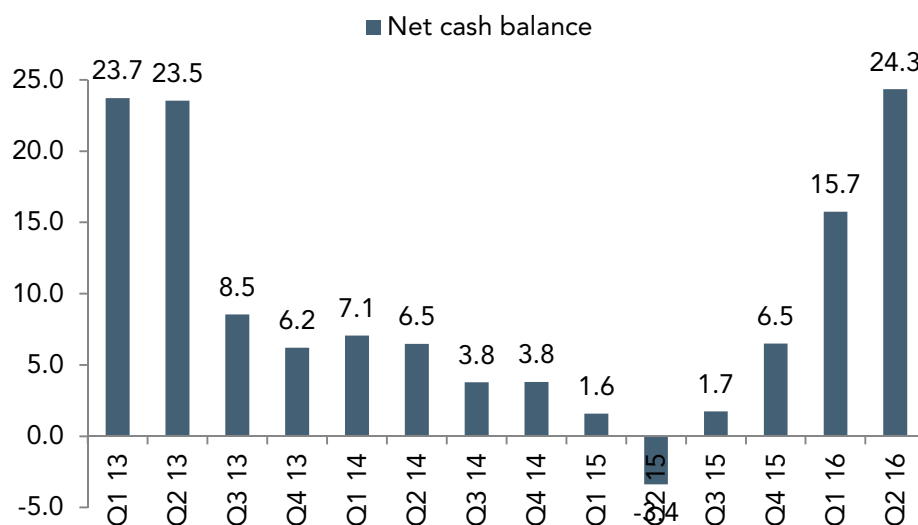


Source: Company presentation, ARM Research

Sizable cash balance and cost containment buoy earnings outlook

- Going forward, naira worries and higher raw sugar prices point to sustained input cost pressure. The foregoing provides pretext for DSR to raise prices, which together with positive volume momentum underpins our expectation for higher turnover. (FY 16E: +33.7% YoY to ₦135.1 billion). Nonetheless, given pressured consumer spending, we do not see DSR fully transmitting the aforementioned input costs to consumers. Thus we project gross margin compression of 88bps YoY over FY 2016. However, amidst DSR's sizable cash balance of ₦24.3 billion and full repayment of its debt, rising yield levels following CBN's tight monetary policy stance should support strong finance income over the remaining two quarters of the year. Thus, we revise our 2016E net finance expense projection lower to ₦45 million (previous estimate: ₦632 million). In addition, increased management focus on cost control informs our expectation for muted rise in OPEX (2016E: +8.7% YoY) relative to revenue (+33.7% YoY). On balance, we expect lower net finance costs and subdued growth in OPEX to sustain earnings upswing. Overall, largely reflecting outperformance of earnings relative to our forecasts in Q2 16, and rising net cash balance, we now project 2016E PAT growth of 21.7% YoY to ₦14.0 billion (vs. earlier estimate of ₦12 billion).

Figure 2: Trend in net cash balance (₦' billion)



Source: Company financials, ARM Research

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- DSR trades at a current P/E of 6.9x vs. 14.9x for Bloomberg Middle East & Africa peers. The stock has gained 16.1% YTD (Food: -1.74% YTD, NGSE: -2.21%) with last trading price of ₦7.00 at a 13% discount to our FVE of (₦7.90) which translates to an **OVERWEIGHT** rating.
 - **Conference call to hold on Thursday, 4 August 2016, at 4:00pm Lagos time.**

Dangote Sugar Refinery - Summary of Results and Forecasts - Naira (N=million)*

| QUARTERLY | | | | | |
|----------------------------|----------------|----------------|----------------|----------------|----------------|
| Income Statement (N'mln)* | Q1 2016A | Q2 2016A | Q3 2016F | Q4 2016F | |
| Sales | 32,617 | 37,855 | 30,568 | 34,088 | |
| Cogs | 32,617 | 37,855 | 30,568 | 34,088 | |
| Gross profit | 25,848 | 30,706 | 24,607 | 27,441 | |
| Operating cost | 6,770 | 7,149 | 5,961 | 6,647 | |
| Operating profit | 1,523 | 1,190 | 1,345 | 2,693 | |
| Net finance costs | 5,247 | 5,959 | 4,616 | 3,954 | |
| Profit before taxation | 86 | 31 | 81 | 1,032 | |
| Tax | 5,113 | 6,043 | 4,752 | 5,045 | |
| Profit after taxation | 1,774 | 2,000 | 1,521 | 1,614 | |
| ANNUAL | | | | | |
| Income Statement (N'mln) | FY 2015A | FY 2016E | FY 2017F | FY 2018F | FY 2019F |
| Sales | 101,058 | 135,128 | 140,430 | 147,126 | 154,950 |
| COGS | 80,329 | 108,601 | 109,536 | 114,758 | 120,861 |
| Gross profit | 20,728 | 26,526 | 30,895 | 32,368 | 34,089 |
| Operating cost | 6,209 | 6,751 | 8,426 | 8,828 | 9,297 |
| Operating profit | 14,519 | 19,775 | 14,519 | 14,666 | 22,469 |
| Interest expense | 12 | 405 | 23 | 23 | 20 |
| Interest income | 665 | 451 | 693 | 728 | 764 |
| PBT | 16,548 | 20,953 | 23,203 | 24,307 | 25,598 |
| Tax | 5,013 | 6,909 | 7,425 | 7,778 | 8,191 |
| PAT | 11,535 | 14,044 | 15,778 | 16,528 | 17,407 |
| Balance Sheet (N'mln) | FY 2015A | FY 2016E | FY 2017F | FY 2018F | FY 2019F |
| Assets | | | | | |
| Fixed Assets | 54,800 | 62,000 | 71,836 | 80,658 | 89,379 |
| Stocks | 15,548 | 16,616 | 20,812 | 21,804 | 24,172 |
| Trade debtors | 14,704 | 16,295 | 21,065 | 23,540 | 24,792 |
| Cash& Bank balance | 8,993 | 6,244 | 6,055 | 7,401 | 9,879 |
| Total Assets | 102,625 | 109,736 | 128,348 | 141,983 | 156,803 |
| Liabilities | | | | | |
| Trade Creditors | 28,092 | 29,734 | 37,242 | 39,018 | 41,093 |
| Long term liabilities | 5,150 | 5,150 | 5,150 | 5,150 | 5,150 |
| Total liabilities | 44,476 | 46,122 | 53,756 | 55,663 | 57,876 |
| Shareholders' fund | 58,149 | 63,614 | 74,591 | 86,320 | 98,926 |
| Key Ratios | FY 2015A | FY 2016E | FY 2017F | FY 2018F | FY 2019F |
| Valuation multiples | | | | | |
| EPS | 0.96 | 1.17 | 1.31 | 1.38 | 1.45 |
| DPS | 0.50 | 0.45 | 0.69 | 0.73 | 0.76 |
| P/E | 8.18 | 5.98 | 5.08 | 4.83 | 4.54 |
| P/B | 1.24 | 1.32 | 1.13 | 0.97 | 0.85 |
| EV/EBITDA | 3.58 | 3.42 | 3.02 | 2.70 | 2.44 |
| ROA | 11.8% | 12.8% | 13.3% | 12.2% | 11.7% |
| ROE | 20.8% | 22.1% | 22.8% | 20.1% | 18.5% |
| Debt/Equity | 4.3% | 3.9% | 3.5% | 3.2% | 2.9% |
| Gross margin | 20.5% | 19.6% | 22.0% | 22.0% | 22.0% |
| EBIT margin | 14.4% | 14.6% | 10.3% | 10.0% | 14.5% |
| PBT margin | 16.4% | 15.5% | 16.5% | 16.5% | 16.5% |
| PAT Margin | 11.4% | 10.4% | 11.2% | 11.2% | 11.2% |

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 |
| STRONG BUY | >20% | BUY | >20% |
| OVERWEIGHT | 10% — 20 % | NEUTRAL | 5% — 20 % |
| NEUTRAL | 0% — 10 % | SELL | <5% |
| UNDERWEIGHT | -5% — 0% | | |
| SELL | <-5% | | |

| RECOMMENDATION KEY | |
|--------------------|--|
| Rating | Recommendation |
| BUY | Accumulate security to a substantial extent constrained only by portfolio diversification considerations |
| OVERWEIGHT | Accumulate security to an extent moderated by cognizance of its benchmark weight |
| NEUTRAL | Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject reasonable portfolio constraints |
| UNDERWEIGHT | Minimise exposure to security taking cognizance of its index weighting |
| SELL | Sell-off security completely from portfolio |

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