



Initial View

6 months ended 30th June, 2015**Recommendation: NEUTRAL (₦6.74)**

- Dangote Sugar Refinery Plc (DSR) released unaudited results for 6 months ending 30th June 2015 wherein revenues rose 3.1% YoY to ₦51.1 billion while PBT and PAT were 4.5% and 7.7% lower YoY at ₦9.8 billion and ₦6.3 billion respectively.

Price hikes offset volume weakness to power top-line growth

- In response to the sizable naira weakness over 2015, DSR hiked refined sugar prices (+20.7% YoY to ₦6,900/50kg) over Q2 15 in a bid to pass-on higher raw material import costs. The price increases offset continued weak volumes (-3.4% YoY) resulting in revenues quickening 20.6% YoY to ₦28.6 billion (Q2E: ₦25.4 billion) – highest in 15 quarters. In addition to subdued consumer demand over period, DSR links volume pressures to distribution challenges caused by sizable traffic gridlock at the Apapa ports over the period when fuel haulage trucks blockaded the ports.

Income Statement Data

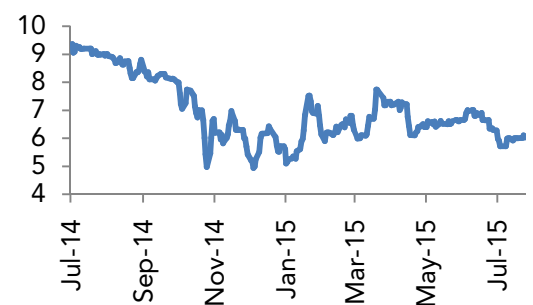
	2015 – 6M'm	2014 – 6M'm	%chg
Revenue	51,120	49,601	3%
PBT	9,802	10,263	-4%
Tax	3,490	3,428	2%
PAT	6,312	6,836	-8%

Balance Sheet Data

	2015-Jun 'm	2014-Dec 'm	%chg
Inventory	19,540	15,099	29%
Receivables	17,584	14,013	25%
Cash	4,035	6,202	-35%
Payables	29,786	25,227	18%
Net Assets	52,926	51,414	3%

Stock Data

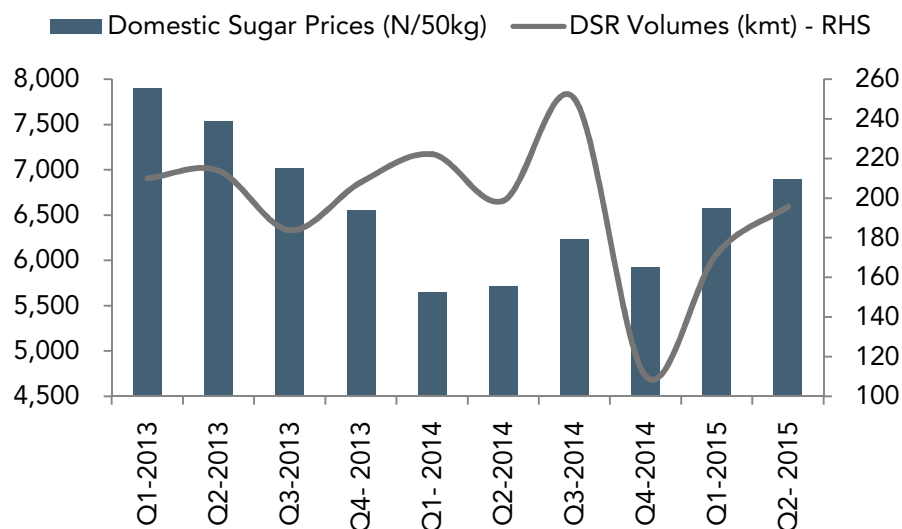
Price	₦6.00
52 week range	₦4.70 – ₦9.05
Market Cap. (₦'m)	72,240
1-month Avg. Vol	1,312,864
Curr. PE	6.74x
Bloomberg Ticker	DANGSUGA:NL
Reuters Ticker	DANGSUG.LG

Dangote Sugar Plc- Share Price Trend**Analyst(s)**

Usman Olubajo

usman-olubajo.ajibola@arm.com.ng

Figure 1: Domestic Refined Sugar Prices and DSR volumes



Source: DSR, NSDC, ARM Research

Price hikes and tamer input costs help offset devaluation pressures

- A second order impact of the price hikes was that together with extended benign patterns in raw sugar prices (-31% YoY, -11% QoQ), helped offset naira weakness over the period leading Q2 15 COGS to track slower than revenues (+19.3% YoY to ₦21.4 billion). Consequently, gross profit climbed 24.4% YoY to ₦7.2 billion with gross margin rising 80bps 25.1%.
- Q2 15 opex fell 28.5% YoY to ₦932 million (opex-sales ratio: -2.2pps YoY to 3.3%) as negative selling and distribution expenses—possibly reflecting over accruals in Q1 15—more than offset 32.4% YoY rise in admin costs to ₦1.24 billion—largely underpinned by DSR booking management fees in Q2 15 (Q2 14: Nil). Consequently, EBIT surged 39.8% YoY to ₦6.3 billion with corresponding margin 3pps higher YoY to 21.9%.

Notwithstanding higher finance expense, operating profit gains filtered through

- In tandem with a surge in ST borrowings (YoY: +24x, QoQ: 3x to ₦7.4 billion), finance costs rose nearly three-fold YoY to ₦203 million. Management links higher

borrowings to financing working capital needs at its Savannah sugar plantation. Assisted by 97% YoY contraction in finance income to ₦7 million, the elevated finance charges swung DSR from net finance income of ₦147 million in Q2 14 to net finance expense of ₦196 million in Q2 15.

- Largely reflecting pass-through from operating profit (aided by 59% YoY contraction in other expense to ₦50 million), PBT and PAT climbed 33.6% and 28% YoY to ₦6 billion and ₦3.9 billion respectively with corresponding margins rising 2pps and 80bps YoY to 21% and 13.8% respectively.

Price hikes hold positive connotations for fundamental outlook,... but CEO departure raises some concerns

- Relative to our expectations, Q2 results positively surprised largely reflecting the impact of the refined sugar price hikes, a development we did not foresee due to the weak macro environment. Whilst the prospect of a demand pull back exists, the price increase, if sustained, should buoy DSR's top-line over the rest of 2015. By extension, we see the combination of price hikes and bearish raw sugar price outlook as providing an offsetting effect to naira weakness creating scope for gross margin expansion. These gains should more than offset expansionary impact of recent surge in borrowings on finance costs to drive earnings growth. Beyond the broadly positive fundamental issues, the announcement of departure of CEO Graham Clark, after 23 months at the helm, comes as a surprise to us as DSR recruited him, from Africa's largest sugar producer (Illovo Sugar), to lead their push to develop sugar estates across Nigeria in their ambitious goal to produce 2 million tonnes of raw sugar by 2020 under its 'Sugar for Nigeria' plan (Nigeria currently produces 70kt of raw sugar as at FY 2014—USDA). Parsing through commentary accompanying the release, Clark's departure stems from differing views with DSR's board over growth strategies, a development which, in our views, raises some concern over progress on the plan. DSR trades at a current P/E of 7.51x vs. 11.19x for Bloomberg regional peers with its last trading price at a 12% discount to our FVE (~~₦6.74~~) which translates to a **NEUTRAL**.
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Summary of forecasts

Quarterly Forecasts	Q1 2015A	Q2 2015A	Q3 2015E	Q4 2015E	
Revenue	22,522	28,599	25,625	24,712	
Cost of Goods Sold	17,002	21,416	19,731	19,028	
Gross Profit	5,521	7,182	5,894	5,684	
Operating Cost	1,700	932	1,409	1,359	
Operating Profit	3,820	6,250	4,484	4,325	
Other Income	136	(50)	53	53	
Pre-tax Profit	3,798	6,004	4,358	4,198	
Tax	1,424	2,006	1,395	1,343	
Post-tax Profit	2,374	3,938	2,963	2,855	
Income Statement ('000)	2014A	2015E	2016F	2017F	2018F
Revenue	94,855	101,457	112,903	118,856	124,573
Cost of Goods Sold	76,227	77,177	89,193	93,896	98,413
Gross Profit	18,628	24,280	23,710	24,960	26,160
Operating Cost	9,232	5,127	6,774	7,131	7,474
Operating Profit	9,396	19,153	16,935	17,828	18,686
Finance expense	106	782	910	950	994
Pre-tax Profit	14,642	18,562	16,376	17,289	18,185
Tax	3,637	6,228	5,240	5,532	5,819
Post-tax Profit	11,004	12,334	11,136	11,756	12,366
Balance Sheet ('000)					
Assets	2014A	2015E	2016F	2017F	2018F
Fixed Assets	50,473	50,103	49,982	49,799	52,044
Stocks	15,099	13,709	16,055	17,840	17,714
Trade debtors	14,013	20,946	23,710	24,960	26,160
Cash and other bank balances	6,202	6,934	8,925	12,230	15,267
Total Asset	92,801	98,705	105,686	111,843	118,120
Liabilities					
Trade Creditors	25,227	22,579	24,974	26,291	27,556
Long Term Liabilities	4,611	6,283	6,414	6,552	6,698
Total liabilities	41,388	42,394	44,909	46,365	47,775
Shareholders' fund	51,414	56,332	60,776	65,479	70,425
Key Ratios	2014A	2015E	2016F	2017F	2018F
EPS	0.92	1.03	0.93	0.98	1.03
BVPS	4.28	4.69	5.06	5.46	5.87
DPS	0.40	0.61	0.56	0.59	0.62
P/E	6.21	5.86	6.49	6.14	5.84
EV/EBITDA	7.28	3.81	4.19	3.79	3.45
ROA	20%	12%	11%	11%	11%
ROE	21%	22%	19%	19%	18%

Source: Company financials, ARM Estimates

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 to 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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