

Dangote Sugar Refinery Plc. (DSR.NL)

Initial View

Lower provisioning, rising cost

- Yesterday, Dangote Sugar Refinery (DSR) released its second quarter 2019 result wherein it reported 46.6% YoY decline in earnings to ₦4.0 billion, with related EPS at ₦0.33. The pressure on the bottom-line emanated largely from increased input cost (+12.6% YoY) as revenue fell slightly by 1.7% YoY. Factoring the Q2 19 numbers, EPS over H1 19 dropped by 14% YoY to ₦11.0 billion (EPS: ₦0.91).
- ***Amidst flattish receipts, costs tilt upwards:*** With sustained competition from smuggled sugar, DSR's revenue declined slightly by 1.7% YoY to ₦42.2 billion, due to volume-induced decline in sale of its 50kg bag. Surprisingly cost jumped by 12.6% to ₦33.7 billion, reflecting a 20% jump in raw materials cost – despite a meagre 3% YoY increase in global raw sugar prices. Though increase in custom duties' conversion rate which took effect in the second week of June comes to mind as plausible driver, but we saw no hint of these changes in cost for other food producers. Therefore, we would have to seek clarity from the company. On that backdrop, gross margin dipped sharply to 20.2% (Q2 18: 30.3%).
- Though operating expense and net finance expense declined over the period, compressed gross margin resulted in 40.6% YoY decline in operating profit to ₦6.4 billion. To clarify, OPEX declined by 6.2% YoY to ₦2.1 billion driven by a 50.4% YoY decline in selling and distribution expenses while net finance expense printed at ₦24.3 million (-52% YoY).
- Overall, DSR operating performance over the second half was very disappointing as we expected cost savings from lower raw sugar prices to tame the impact of competition from smuggled sugar over 2019. Therefore, we would have to seek clarity from management and guidance on cost over the rest of the year. That said, on our cost savings assumptions, we currently have a FVE of ₦15.67, which translates to a **BUY** rating from last closing price. DSR trades at a 2019 P/E of 5.2x relative to 16.9x for MENA peers.

Summary of Results and Forecast

	Q2 19	YoY growth	QoQ growth	H1 19	H1 18	YoY growth
Revenue	42,218	-1.7%	10.7%	64	77	-4.4%
Cost of sales	33,692	12.6%	31.8%	49	81	-2.5%
Gross profit	8,526	-34.5%	-32.3%	14	96	-9.4%
Operating expenses	2,149	-6.2%	-14.5%	11	31	-7.6%
Operating profit	6,377	-40.5%	-41%	03	65	-9.8%
Net interest expense	24	-67.0%	-8%	22	82	-67.0%
PBT	6,331	-45.0%	-41%	32	05	-14.4%
PAT	3,972	-46.6%	-43%	76	17	-13.7%
	Q2 19	Q2 18	Change(pps)	H1 19	H1 18	Change(pps)
Gross margin	20.2%	30.3%	-10.1%	26.3%	27.7%	-1.4%
EBIT margin	15.1%	25.0%	-9.9%	21.4%	22.7%	-1.3%
PBT margin	15.0%	26.8%	-11.8%	21.2%	23.7%	-2.5%
PAT margin	9.4%	17.3%	-7.9%	13.7%	15.1%	-1.5%
Effective tax rates	37.3%	35.4%	1.9%	35.6%	36.1%	-0.6%

Source: Company Financials, ARM Research

ARM ratings and recommendations

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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	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
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