

22 March 2016

Lafarge Africa Plc | Earnings Report

12 months ended 31st December, 2015

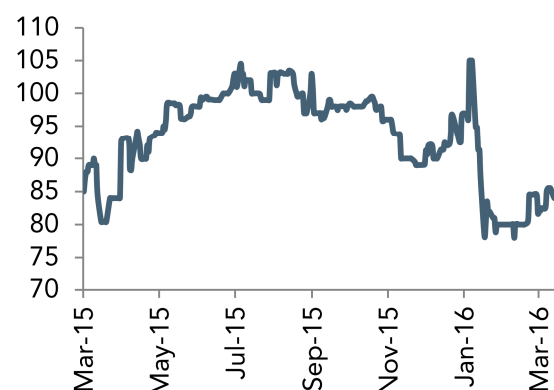
Intensifying competition to weigh on earnings (₦81.02 - SELL)

- Lafarge Africa Plc. (Lafarge) reported its FY 2015 results, which consolidates contribution from UNICEM. In the same vein, the company also restated FY 2014 financial statements.
- Based on the consolidated numbers, FY 15 revenues rose 2.5% YoY to ₦267 billion while PBT and PAT were 27% and 19% lower YoY at ₦30 billion and ₦27 billion respectively.
- Lafarge proposed a dividend of ₦3.00 which implies dividend yield of 3.6% (FY 14: 3.6%) as at last closing price.

Revenues decline on lower prices

- Cascading to quarterly results, Q4 15 group revenues declined **11% YoY to ₦52 billion**, mainly driven by contraction in revenue **in Nigeria (-15% YoY to ₦35 billion)** which offset higher sales in South Africa (+7% YoY). We believe pressures on the Nigerian front was driven by cut back in cement prices **(-15% YoY)** across Ashaka, Wapco, and UNICEM, in response to 18% price cut effected by industry leader (Dangcem). On the volume front, overall output in Nigerian was **flat YoY** at **~1.5MT** (our estimate) as the **11% YoY** growth in joint production volume from Wapco and Ashaka to ~1.1MT offset sharp volume drop at UNICEM **(-35% YoY)**. According to management, sharp volume declines at UNICEM was underpinned by production downtime

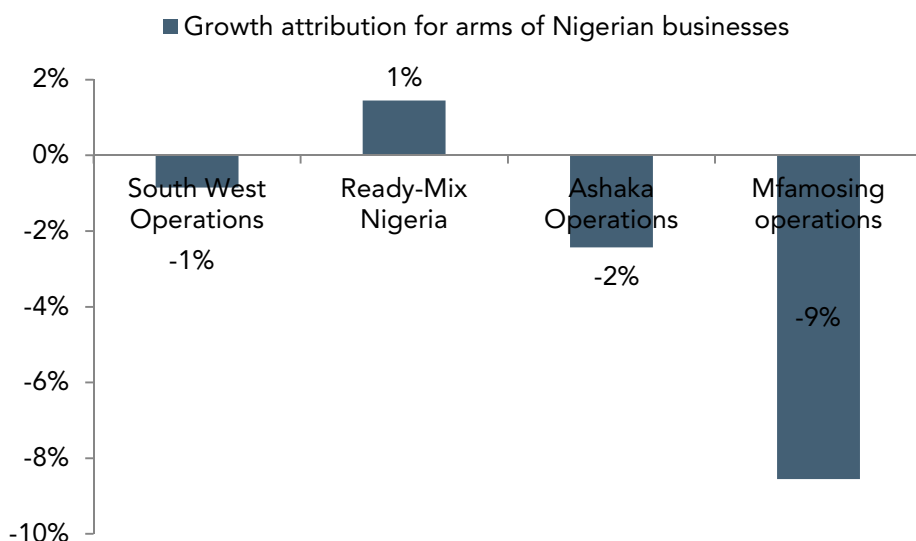
Income Statement Data			
	2015 – 12M'm	2014 – 12M'm	%chg
Revenue	267,234	260,810	2.5%
PBT	29,532	40,358	-26.8%
Tax	2,277	6,538	-65.2%
PAT	27,255	33,820	-19.4%
Balance Sheet Data			
	2015-Dec 'm	2014-Dec 'm	%chg
Inventory	33,027	31,545	5%
Receivables	23,474	19,830	18%
Cash	16,493	20,330	-19%
Payables	76,847	67,463	14%
Net Assets	176,152	175,580	0.3%
Stock Data			
Price	₦82.61		
2 week range	₦78.00 – ₦105.00		
Market Cap. (N'b)	2,863		
1-month Avg. Vol	164,634		
Curr. PE	14.2x		
Bloomberg Ticker	WAPCO:NL		
Reuters Ticker	WAPCO:LG		
Lafarge Africa Plc- Share Price Trend			


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due to power challenges that allowed competition encroach into UNICEM's market share in Q4 2015.

- On the South African end, revenue growth was supported by **23% YoY** surge in cement volumes which offset contraction in cement prices (**-16% YoY** ~~₦14,944~~). We believe this volume growth from South Africa is also reflective of aggressive marketing campaign embarked upon by management in November 2015.

Figure 1: Attribution of FY 15 Nigerian revenue growth



Source: Company information, ARM Research

Heavy restructuring cost and FX loss on UNICEM dollar loans drive Q4 15 loss

- Although the unavailability of 9M 15 consolidated numbers makes quarter analysis challenging, management attributed the 3.3pps YoY surge in operating margins to 4.8% in Q4 15 to savings from renegotiations of gas contracts, improved biofuel usage in its energy mix, as well as reduced employment cost—following staff rightsizing and streamlining of compensation packages.
- However, one-off redundancy/restructuring cost of ~~₦2.3~~ billion (vs. null in 2014)—owing to the company's staff rightsizing—as well as FX losses on financing UNICEM dollar loans of ~~₦3.3~~ billion (vs. null in 2014) over Q4 15 swung Lafarge into a loss of ~~₦3~~ billion in the quarter. Interestingly, relative to the newly consolidated Q4 14 numbers, Q4 15 loss is nearly double YoY.

Earnings compression to subsist in 2016

- Overall, although significant reduction in operating expenses was enough to dampen impact of weaker topline, Lafarge's Q4 15 performance was marred by FX losses as well as one-off redundancy/restructuring cost.
 - Importantly, we have revised our models to incorporate UNICEM's numbers and lower prices. Specifically, we now have cumulative capacity of 11.5MTPA (vs. 9MTPA in pre-consolidation numbers) and average factory gate prices in Nigeria to ₦22,000 per ton (23% lower than prior estimate) and ₦14,944 per ton (30% lower than prior estimate) in South Africa. We expect the lower prices to stimulate demand in both markets and therefore expect volumes to rise by 8% and 10% YoY in Nigeria and South Africa, respectively. Nevertheless, with output unlikely to offset lower prices, we expect cement revenues to be 18% and 23% lower YoY in Nigeria and South Africa, respectively. Overall, we expect group revenue of ₦241 billion in 2016E (-10% YoY).
 - We expect a quicker drop in input cost (-11% YoY) to ₦165 billion in 2016E, reflecting savings on energy cost in the Nigerian business. Specifically, Lafarge has communicated plans to ramp-up usage of bio fuel at its Sagamu plant and Ewekoro 2 which cumulatively account for nearly 27% of total capacity. However, reflecting significantly lower prices, our estimate for 2016E gross profit is 8% lower YoY at ₦76 billion, with related margins of 32% (vs. 31% in 2015)
 - Given significant reduction in staff cost towards the end of 2015, we expect operating cost to be 10% lower YoY at ₦28 billion with operating profit of coming in at ₦42 billion (+10% YoY). This implies 3pps YoY increase in related margins to 18% in our estimate.
 - For finance charges, which primarily drove Q4 15 loss, management noted its intent to refinance its dollar denominated loans (~\$250million) in naira. Nonetheless, with no clear timeline for the refinancing of the FX loans which management links to current difficulty associated with sourcing dollar locally we expect interest charges on UNICEM loan obligation to significantly pressure earnings for most of 2016. In any case, with naira interest rate still relatively
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higher, there is unlikely to be immediate interest rate saving on refinancing for the company. Nonetheless, refinancing should take away the impact of foreign currency volatility going forward. Consequently, we expect group finance expense to rise 11% YoY to ₦12 billion in 2016E. This implies ~2% YoY contraction in net income to ₦26 billion in 2016E.

- Farther out, we expect ramp up in production volumes in Nigeria—in view of FGN’s commitment to increase capex and infrastructure spend over the next few years—to slightly offset the impact of tamer prices and underpin gradual revenue growth claw back for the business (5 year revenue CAGR: +5.2%). Importantly, we also expect the company to achieve significant variable and fixed cost savings on the back of benefits from combined raw material sourcing and a more tempered staff cost. Beyond this, continued improvements in energy mix, especially with Ewekoro 2 (~50% of Wapco operation) set to commence biofuel substitution in the latter half of 2016, and management’s resolve to refinance UNICEM’s dollar denominated loans, should increase scope for eventual rebound in the company’s EPS over the next 5 years. Thus, we expect EPS to rise by CAGR of 20.3% over the next 5 years (vs. +18.5% in pre-consolidation estimates).

Net adjustment to model drives FVE compression

- Overall, net adjustments to model drove **18%** decline in our FVE to **₦81.02** vs. last trading price of ~~₦82.61~~. Lafarge trades at 2016 EV/EBITDA of **10.9x** relative to 8.6x for Bloomberg EMEA peers. Thus, we downgrade our recommendation on the stock to **SELL** (vs. NEUTRAL in previous communication).
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Summary of Results and Forecasts

ANNUAL					
Income Statement(₹ billion)	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Revenue	267	241	243	249	280
COGS	185	165	165	170	190
Gross Profit	83	76	78	80	89
Operating Cost	31	28	30	31	35
Operating Profit	39	42	41	43	48
Interest income	2	2	3	8	19
Interest expense	11	12	14	16	20
PBT	30	31	30	35	47
Tax	2	5	5	6	8
PAT	27	27	25	30	40
Balance Sheet (₹ billion)	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Fixed Assets	FY 2014A	FY 2015F	FY 2016F	FY 2017F	FY 2018F
Stocks	364	366	367	368	370
Trade debtors	33	23	25	29	27
Cash and other bank balances	23	21	22	22	25
Total Assets	16	133	247	388	509
Liabilities	453	547	664	810	933
Trade Creditors					
Non-current Liabilities	77	71	81	81	89
Total liabilities	187	274	367	497	590
Shareholders' fund	277	354	457	588	689
Fixed Assets	176	255	269	285	306
Key Ratios	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
P/E	13.81	14.15	14.91	12.72	9.43
EV/EBITDA	13.18	10.98	10.74	10.13	8.31
ROA	6%	5%	4%	4%	5%
ROE	15%	12%	10%	11%	13%
Net Margins	10%	11%	10%	12%	14%
EPS	5.98	5.84	5.54	6.49	8.76
P/E	13.81	14.15	14.91	12.72	9.43
EV/EBITDA	13.18	10.98	10.74	10.13	8.31
ROA	6%	5%	4%	4%	5%

Source: ARM Research

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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