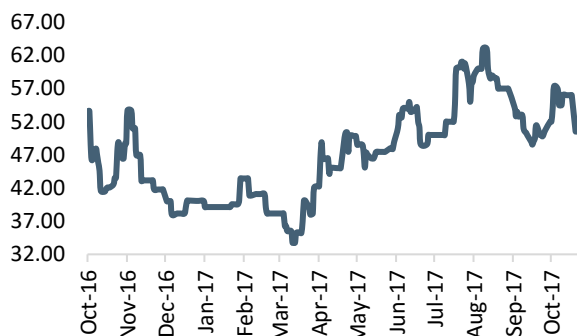




Rating	<b>SELL</b>
Price	₦50.54
FVE	<b>₦48.45</b>
52-week range	₦33.75 – ₦63.00
Market Cap. (N'bn)	277
1-month Avg. Vol	1,420,755
Curr. PE	5.0x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2015 A</b>	1.16	3.93	1.07	N/A
<b>2016 A</b>	N/A	N/A	N/A	9.94
<b>2017A(E*)</b>	0.94	2.67	N/A	1.73*

#### WAPCO.NL - Share Price Trend



#### Analyst(s)

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## Lafarge Africa Plc. (WAPCO.NL)

### Stock Report

#### Surprise loss unsteadies wave of recovery

- Amidst rebounding earnings across other cement names, Lafarge reported a shock ₦18 billion loss in Q3 17. For context, the current loss was more than double that of Q3 16, a period in which the business' energy flexibility efforts were still at infancy, energy set-backs were more evident and prices reasonably lower. With this loss, our EPS target of ₦5.30, which based on H1 17's performance (EPS: ₦3.61) looked very realistic, is also now a tall order. In this report therefore, we analyse the drivers of the company's current loss, re-evaluate our expectation for 2017, and provide guidance for the coming year.
- Negative one-offs drag Lafarge back into red.** Going by provided breakdowns, the company's current loss was driven by a combination of higher admin expense (+73% YoY to ₦13.8 billion), surge in other losses & net finance cost, and reversal to tax charge (₦1.7 billion). Although the company expectedly grew gross profits by over four-folds YoY to ₦13 billion (gross margin: +14pps YoY to 20%), the pressure from higher admin expense drove it to an operating loss of ₦383 million in Q3 17. Even though this operating loss was markedly narrower than that reported in the corresponding quarter of 2016 (i.e. ₦5 billion), it represented a shock return to the red zone after only three quarters of positive operating performance. According to management, pressures on operating expense was driven by one-off costs associated with Ashaka delisting, restructuring and ERP implementation, and system stabilization project & inventory write-offs in South Africa. Put together, these one-off items dragged Lafarge's Q3 17 operating expense higher by ₦2.3 billion.

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- More pertinent though was the four-fold YoY jump in other operating loss to ₦9.3 billion which management linked to foreign exchange losses arising from the conversion of its \$220 million debt (formerly part of quasi equity) into naira using exchange rate of ₦385/\$, and FX liabilities on operating cost settling differences. In a related development, the implied rise in debt levels (more than double YoY to ₦267 billion) cascaded to strong pressures at the net finance cost level (over two-fold higher YoY to ₦7.4 billion). Elsewhere, management opted to delay draw-down on its over ₦40 billion tax asset related to UNICEM until processes associated with the consolidation are fully finalized. In view of this, the company reported tax charge of ₦1.7 billion (vs. ₦3.0 billion tax credit in the corresponding period of 2016) with the concoction of the aforementioned pressures driving an after-tax loss of ₦18 billion in Q3 17.
  - ***Shock Q3 loss to soil an otherwise impressive 2017.*** In line with current run rate of Nigerian cement volume (-17% YoY to 3.4MT), we raise our forecast Nigerian volumes by 6% to 4.68 MT (-10% YoY). In addition to this, we adopt weighted average Nigerian cement price of ₦43,634/ton (vs. ₦43,323 previously), which is at par with that of industry leader—DANGCEM. In view of these, we now project Nigerian cement revenue at ₦204 billion (vs. ₦192 billion in prior forecast). In South Africa, business environment is expected to remain challenging with higher prices likely to continue discouraging customer patronage in cyclical sectors such as cement even as growth remains fragile. Thus, our expectation for 28% YoY contraction in South African cement volumes to 1.6MT is left intact. However, having reviewed our target South African non-cement revenue 32% higher to ₦33 billion in line with 9M 17 performance, we now forecast overall group revenue 32% higher YoY at ₦290 billion (vs. ₦266 billion previously).
  - In addition, despite management's claim of improved energy flexibility, we are of the view that cost pressures subsisted over 9M 17. For evidence, in spite of the largely ubiquitous drop in output across segments of the business, input cost still rose 9% YoY to ₦55 billion in Q3 17 as was the case in H1 17. We have therefore reviewed our FY 17 cost to sales assumption to 74% (vs. 70% previously). Notwithstanding, strong pass-through from top-line should still drive gross profit 86% higher YoY to ₦75 billion (vs. ₦83 billion in prior forecast). Elsewhere, we have increased our OPEX target to ₦40 billion (vs. ₦36 billion previously) to reflect current run rate as well as factored in FX-related one-off cost from Q3 17. In addition to this, we now expect the company to report tax charge of ₦1.4 billion (vs. ₦155 million over 9M 17 and ₦1.7 billion over Q3) going by the recent return to tax payment. This, as well as other adjustments, should drive 2017 PAT to ₦10.4 billion (vs. ₦16.9 billion in 2016). ***However, we note that the company still has potential tax writebacks in excess of ₦40 billion that***
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*is related to the UNICEM business. A deployment of some or all of these potential writebacks could substantially inflate Q4 and FY 17 earnings as was the case in 2016.*

- **Base effect from current one-offs to flatter 2018 earnings.** Going into 2018, we adjust our mean Nigerian cement price significantly higher to ₦40,000/ton (vs. ₦29,008/ton previously) in line with that of industry leader—Dangcem<sup>1</sup>. In view of the upward revision in price, we have adjusted our forecast Nigerian cement volumes lower to 5.3MT (vs. 8.7MT in previous forecast). The duo should drive 2018E Nigerian revenue to ₦214 billion (vs. ₦253 billion previously). Elsewhere, we look to see a more substantial recovery in South Africa in 2018, with the attendant impact informing our cement volume and revenue forecast of 2.3MT (+49% YoY) and ₦98 billion (+30% YoY). At the group level therefore, we see scope for sales in excess of ₦324 billion in 2018E (vs. ₦337 billion previously).
- In addition, although gains from energy flexibility have scarcely impacted 2017 performance, we look for improvement on this front in 2018 and therefore stick to a slightly lower cost to sales ratio of 70%. Thus, we expect a 29% YoY increase in gross profit to ₦97 billion (gross margin: +4pps YoY to 30%). Furthermore, we review our FY 18 OPEX to ₦45 billion in tune with current realities to leave our implied FY 18E PAT at ₦29 billion (vs. ₦10.4 billion in FY 17E) barring any positive surprise in form of tax writeback.
- Importantly, we have already reviewed our models to reflect impact of the forthcoming ₦131 billion rights issue offered to shareholders at ₦42.5 per share. As oft noted, the rights issue is principally targeted at converting the company's outstanding \$287 million quasi equity owned by parent—Lafarge Holcim—to ordinary shares. Given that the parent owns ~72.6% of Lafarge Africa, the proportion of the potential rights due to it is expected to be worth around ₦95.6 billion with the balance ₦36.07 billion set to be allocated to minority stakeholders. This, alongside the forthcoming ₦24 billion commercial paper borrowing, implies a rise in cash balance of ~₦60 billion that could be used to slightly palliate pressures from working capital (**9M 17 negative working capital: ₦171 billion**) and expensive overdraft (₦35 billion as at 9M 17). On balance, we expect the company's net debt position to print at ₦219 billion by year end (vs. ₦245 billion as at 9M 17).
- In view of our recent adjustments, we now have a FVE of **₦48.45** (vs. ₦49.51 in previous communication). Lafarge trades at 2017E EV/EBITDA of **8.0x** vs 8.5x for Bloomberg

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<sup>1</sup> Please see our report “Dangote Cement Plc. – Don’t lose much sleep over 2018”

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EMEA peers. We retain a **SELL** rating on the stock and re-emphasize that the implied dilution from the rights has been factored into our model.

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

ANNUAL					
Income Statement (₦' m) *	FY 2015A	FY 2016A	FY 2017F	FY 2018F	FY 2019F
Revenue	267,234	219,714	290,042	324,062	407,565
COGS	184,703	179,052	214,631	226,844	285,296
Gross Profit	82,531	40,662	75,411	97,219	122,270
Operating Cost	30,885	30,735	40,026	44,721	46,870
Operating Profit	38,303	9,927	35,385	52,498	75,400
Finance Income	2,183	3,675	5,523	6,258	4,845
Finance expense	11,211	3,675	22,069	23,851	24,089
PBT	29,275	(22,819)	11,751	34,905	56,155
Tax	2,277	(39,717)	1,368	5,585	8,985
PAT	26,998	16,899	10,383	29,320	47,170
Balance Sheet (₦ 'm) *					
Assets					
Fixed Assets	364,397	390,489	360,795	372,643	387,361
Stocks	33,027	44,531	51,511	54,442	68,471
Trade debtors	23,474	25,801	49,307	55,091	69,286
Cash & bank balances	16,493	19,265	8,421	4,075	6,916
Total Assets	453,012	502,491	471,599	487,814	533,597
Liabilities					
Trade Creditors	76,847	100,808	105,169	108,885	134,089
Non-current Liabilities	187,473	77,551	147,413	150,588	155,962
Total liabilities	276,861	253,538	276,861	276,861	276,861
Shareholders' fund	176,152	248,953	161,978	171,361	186,455
Key Ratios					
P/E	9.4	16.3	26.6	9.4	5.9
ROA	6.2%	3.5%	2.1%	6.1%	9.2%
ROE	15.4%	8.0%	5.1%	17.6%	26.4%
Gross margin	30.9%	18.5%	26.0%	30.0%	30.0%
EBIT margin	14.3%	4.5%	12.2%	16.2%	18.5%
PBT margin	11.0%	N/A	4.0%	11.0%	14.0%
Net margin	10.1%	7.7%	3.6%	9.0%	11.6%
EPS	5.4	3.1	1.9	5.4	8.6
Debt to equity	84.2%	51.2%	91.6%	87.4%	81.1%
Current ratio	0.8	0.6	1.4	1.44	1.5

Source: ARM Research \*unless otherwise stated

Ratings, Disclosure & Disclaimer – [Click here](#)