

Lafarge Africa Plc. (WAPCO.NL)

Rating	BUY
Price	₦12.60
FVE	₦19.41
52-week range	₦8.95 - ₦17.60
Market Cap. (₦bn)	204.60
1-month Avg. Vol	4,530,368
Curr. PE	23.69

Stock report

Covid-19 weighs on top line outlook

Earlier this week, Lafarge Africa Plc (WAPCO) released its FY 19 result which showed growth in PAT by 91% YoY to ₦15 billion. At the crux of the company's performance during the year was the plunge in finance cost (-51% YoY), as expensive debts were taken off the company's books following the sale of LSAH¹ and the maturity of the first tranche of its bond. Further on the positive, we noted a decline in the admin cost (-29% YoY) thanks to improved terms on the technical fee agreement² with the parent company, which drove the fees down by 39% YoY. However, we found the company's Q4 19 performance disappointing. The quarter's performance was littered with low sales (despite an increase in promotional activities), increased promotional expenses, depressed margins and a higher tax charge. As a result, the company suffered an operating and after-tax loss of ₦569 million and ₦5 billion in the quarter, respectively. Away from the income statement, we noted the improvement in Lafarge's cash flow in FY 19, with CFO and FCF growing 2.9x and 30x from FY 19 to ₦80 billion and ₦57 billion, respectively. WAPCO declared dividend of ₦1 which translates to a yield of 8% on current pricing.

WAPCO.NL - Share Price Trend



Analyst

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- **Going forward, we have revised our expectation on earnings lower**, especially for 2020. Our major adjustment was the revenue line, in light of the economic shut down that followed the COVID-19 outbreak. It is worth stating that while this is bound to affect the topline of all the cement players at this time and it is more so for Lafarge, given its concentrated markets and factory in the west which have particularly been hit by the economic shutdown. Thus, we forecast decline in volumes by 6% YoY to 4.6MT with a capacity utilization rate of 45% (vs 48% last year). Bulk of the decline is expected to occur over the first half. On the other hand, we see little room for any maneuvering in prices this year, especially after the rebates and promotional activities in Q4 19 failed to yield an increase in market share (unlike DANGCEM). Overall, we expect revenue will be drop by 8% YoY to ₦196 billion in 2020.

¹ As consideration for the sale of LSAH, \$317 million (N114 billion) owed to related parties was paid off. This reduced the company's debt to capital ratio to 66% from 16%.

² The technical fee agreement will be changed from 3% of revenue to 6% of EBITDA

- ***On the cost leg***, after upheld fixed production costs (particularly depreciation³) threw COGS a curve in Q4 19, we are not optimistic of a recovery in margins in 2020. The high depreciation charge is expected to leave the COGS line relatively high at ₦147 billion (-4% YoY), marking a slower decline in cost than revenue and 114 bps decline in gross margin to 25%. Thus, we project COGS per tonne will print higher in 2020 at ₦32,810 (vs 2019: ₦32,020). This is particularly disappointing, as we had expected Lafarge Africa to deliver much stronger margins after the sale of LSAH. Nonetheless, Lafarge's margins remain better than it had pre-LSAH sale.
- ***The lower finance cost will continue to support earnings through 2020***, especially through the first half of the year (high base effect). We project finance cost will drop by 28% YoY to ₦14.5 billion. However, this will be insufficient to make up for the drop in top line and the cost pressure.
- ***Overall, we project drop in PBT by 29% YoY to N13 billion***. Lafarge is expected to enjoy the last year of the pioneer tax benefits on its Mfamosing line in 2020. This will keep effective tax rate down at 15% (vs statutory 30%). Thus, we estimate a decline in PAT by 30% to N11 billion, translating to an EPS of ₦0.73 (2019: ₦0.96). Besides the adjustments to our earnings estimates, we reduced the risk-free rate in our valuation lower to 12% from 15% and increased our risk premium to 6.5% (previously 6%). Based on the foregoing, we have revised our FVE on WAPCO lower to ₦19.41 from ₦23.59, which still translates to a BUY rating based on current market pricing. This translates to 86% upside from current pricing of ₦12.65 which has dropped 17% YtD.

The upsides to our estimates would lie in (1) getting approval for a 2-year extension on the pioneer tax credit from NIPC beyond 2020 and (2) should the planned capex on the Ashaka power plants and de-bottle necking. WAPCO's forward P/E prints at 17x, a premium to Bloomberg MEA peer average of 13.2x.

³ About 93% of depreciation charge was recognized in direct cost, thus the implementation of IFRS 16 which necessitated an increase in depreciation charge on newly recognized Rights of Use assets was the major driver of the 4% increase in COGS, despite the decline in sales (-2%) in 2019, and the 454 bps plunge in gross margins over FY 19.

Summary of Results and Forecasts

ANNUAL							
Income Statement (N'million)	2018*	2019	2020E	2021E	2022E	2023E	2024E
Production capacity (Million tonnes)	10.2	10.2	10.2	10.2	10.2	10.2	10.2
Utilisation rate	47%	48%	45%	48%	50%	52%	55%
Volume (Million tonnes)	4.83	4.90	4.59	4.90	5.10	5.30	5.61
Price (N'000)	45.11	43.43	43.65	43.87	44.09	43.87	43.65
Revenue	217,813	212,999	200,358	214,783	224,851	232,676	244,869
COGS	150,701	157,047	150,014	156,352	162,484	167,418	175,609
Gross Profit	67,112	55,952	50,343	58,432	62,367	65,258	69,261
Operating Cost	28,776	22,655	23,899	24,094	25,907	26,359	27,869
Operating Profit (EBIT)	38,528	34,910	26,382	34,158	36,331	38,735	41,234
Net finance cost	-40,038	-17,018	-12,473	-10,366	-7,631	-7,514	-5,951
PBT	-1,510	17,892	13,909	23,792	28,700	31,221	35,283
Tax	9,607	(2,374)	(2,086)	(5,948)	(7,175)	(7,805)	-8,821
PAT	8,097	15,518	11,822	17,844	21,525	23,416	26,462
Balance Sheet (N'million)	2018**	2019	2020E	2021E	2022E	2023E	2024E
Property, plant and equipment	394,489	369,797	363,012	358,150	354,558	351,991	351,991
Non-Current Assets	447,376	422,106	416,927	412,855	410,440	408,776	408,776
Current Assets	12,551	27,104	25,918	13,651	23,764	29,377	36,215
Total Assets	540,737	497,152	501,229	488,482	493,180	502,012	511,290
Borrowings	266,207	64,185	60,976	40,416	38,395	36,475	34,652
Non-Current Liabilities	193,546	67,826	65,193	45,181	43,680	42,254	40,899
Current Liabilities	212,650	84,412	88,758	92,454	94,348	99,922	105,263
Equity	134,541	344,914	347,278	350,847	355,152	359,835	365,128
Key Ratios							
P/E	13.39	14.53	17.24	11.42	9.47	8.70	7.7
EV/EBITDA	5.9	4.0	4.4	3.7	3.4	3.2	3.0
ROA	1.6%	3.0%	3.2%	3.3%	3.3%	3.2%	3.2%
ROE	6.0%	6.5%	3.4%	5.1%	6.1%	6.5%	7.3%
Gross margin	30.8%	26.3%	25.1%	27.2%	27.7%	28.0%	28.3%
Net Margin	3.7%	7.3%	5.9%	8.3%	9.6%	10.1%	10.8%
EPS	0.93	0.96	0.73	1.11	1.34	1.45	1.64
EBIT margins	17.7%	16.4%	13.2%	15.9%	16.2%	16.6%	16.8%
Effective Tax rates	N/A	13.3%	15.0%	25.0%	25.0%	25.0%	25.0%
Debt to Capital	66.4%	15.7%	14.9%	10.3%	9.8%	9.2%	8.7%
Interest coverage	0.96	2.05	2.12	3.30	4.76	5.15	6.9
BVPS	62.34	30.86	31.12	30.33	30.62	31.17	31.7

*The 2018 income statement is for Lafarge Africa, excluding LSAH

** The 2018 balance sheet figures include LSAH business

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