



Rating	SELL
Price	₦39.05
FVE	₦34.71
52-week range	₦33.10 – ₦63.40
Market Cap. (₦bn)	316.14
1-month Avg. Vol	755,962
Curr. PE	N/A

Quarterly EPS	Q1	Q2	Q3	Q4
2017 A	0.94	2.67	-	-
2018 E (A*)	-	0.65	-	1.44

WAPCO.NL - Share Price Trend



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Lafarge Africa Plc. (WAPCO.NL)

Stock Report

Still Overpriced Despite Earnings Recovery

- We expect Lafarge Africa Plc (Lafarge) to demonstrate improvement in fundamentals, mainly from higher volumes, energy savings and lower finance cost. Basically, with FX issues effectively addressed in the near term, we expect gains from higher volumes (a fallout of improving domestic cement consumption in Nigeria) and energy savings should have more telling impact on earnings in 2018. On volumes, we estimate a Nigeria cement consumption of ~4.7MT (+5% YoY). On energy, we look for a stable energy source over 2018 with gas and coal gaining more prominence in Nigeria and ongoing turnaround plan in South Africa. Consequently, we have adopted a conservative cost to sales ratio of 77% which translates to 6ppts expansion in gross profit margin to 23%. Overall, we project EPS and DPS of ₦0.65 and ₦1.15 respectively for 2018.
- However, this is eclipsed by its excessive valuation, in our view. We downgrade the stock to a **SELL** (previously: NEUTRAL) as we revise our FVE lower to ₦34.71 (prior: ₦48.45). Lafarge trades at 2018 EV/EBITDA and P/E of 9.7x and 53.3x compare to Bloomberg EMEA peers of 9.2x and 16x respectively.

Cost pressures drive a second-rate first quarter

- Largely lagging the industry, Lafarge recorded a slight moderation in group revenue (0.82% YoY to ₦80.6 billion) in Q1 18, driven by decline in Nigeria's sales as the

elevated price was unable to support the decline in volumes. Going by breakdown, after recording a 15.8% YoY decline in volumes in FY 17, Lafarge continues to shed market share with volume contracting by 5.25 YoY to 1.3mt. As such, despite a 2.3% YoY increase in price to ₦44,328, revenue in Nigeria contracted 3.0% YoY to ₦57.8 billion in Q1 18. In South Africa, operations benefitted from higher prices and slight improvement in volumes (+2.6% YoY), with revenue rising 5.2% YoY to ₦23.0 billion.

- Notwithstanding the group's volume decline, input cost remained elevated (+3.7% YoY to ₦62.6 billion) with cost to sales expanding 338bps YoY to 78%. Going by provided breakdown, management's claim of improved energy flexibility, with relative availability of gas and improved use of alternative energy across Ewekoro I and II as well as in Ashaka, yielded some results. However, a surprise jump in other variable costs (+49.2% YoY to ₦37 billion) and production costs (+26.8% YoY to ₦9.6 billion) continues to be a major drag on cost even as material and consumables continues to exact pressure on cost, with the impact reflecting on the contraction in gross profit margin to 22% (vs. 26% in Q1 17).
- Elsewhere, operating profit was down 50.2% YoY to ₦6.2 billion in Q1 18, following a sharp jump in operating expenses (+41% YoY to ₦11.8 billion), with large chunk of the pressure emanating from higher administrative costs (+47.6% YoY to ₦10.3 million). Going by provided details of admin expense, the pressure was driven by a combination of wages & salaries, consultancy fee, office & general expenses and technical service fees. In a related development, the rise in debt levels (more than doubled YoY to ₦250 billion in Q1 17) cascaded to strong pressures at the net finance cost level (+84.7% YoY to ₦9.5 billion). With the concoction of the aforementioned pressures, the company reported a before tax loss of ₦3 billion (versus PAT of ₦9.4 billion in Q1 17) with the absence of a tax surprise leaving the company at a net loss of ₦2.0 billion.

Base effect from current one-offs to magnify 2018 earnings

- Going forward, we expect ex-factory gate prices to remain at current elevated levels with a marginal upward adjustment over the year to average ₦44,328/ton as the company continue to access the impact of price increases on margin and in line with that of industry leader – Dangcem¹. On the volume end, we believe Lafarge would struggle to gain market share during the year, which is already reflective in the 5% decline in volume in Q1 18. However,

¹ Please see our report "[Dangote Cement Plc. – Weaker Growth, Higher Valuation, Turning Cautious!](#)"

given our outlook of increased consumption over 2018, we look for a 4.9% YoY growth in Nigeria output to ~4.7mt. Accordingly, we expect Nigerian revenue to print at ₦217 billion (vs. ₦205 billion in 2017). 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 1.9MT (+8% YoY) and ₦101 billion (+6.9% YoY). At the group level therefore, we see scope for sales in excess of ₦318 billion in 2018E.

- Elsewhere, we expect the improvement in energy flexibility to persist over 2018 with fuel and power cost contribution to cost of sales expected to decline (FY 18: -16.4% YoY vs 18.1% in FY 17) to ₦40.2 billion. However, the pressure point for cost of sales remains rising cost of raw material & consumables, production, maintenance and distribution activities. Also, with the ongoing turnaround plan in South Africa, we do not rule out the possibility of another impairment charge on redundant equipment. Accordingly, we have adopted a conservative cost to sales ratio of 77% (83% in FY 17) which translates to a slight moderation in cost of sales to ₦244 billion and a 7% YoY decline in cost per tonne to ₦36,000. Thus, we expect a 44% YoY increase in gross profit to ₦73 billion (gross margin: +6pps YoY to 23%). Furthermore, we review our FY 18 OPEX to ₦42 billion in tune with current realities to leave our implied FY 18E EBIT at ₦34.1 billion (vs. ₦7.9 billion in FY 17) barring any negative surprise in form one-off administrative charges from the ongoing turnaround in South Africa.
- On borrowings and finance cost, management recently received shareholders' approval for ₦100 billion capital raise with focus on refinancing existing FCY borrowings and general business spend. However, given management access to cheaper FCY borrowings (currently estimated at \$442 million as at FY 17), we do not expect any significant decline in its FCY obligations especially with management focus on revamping the South African operation. As such, while 68% of total debt stock (₦250 billion as at Q1 18) are due for maturity during the year, we believe management will rollover a large chunk of it with an extension of its maturity profile to fund its capex plan and working capital needs. For context, management guided to a capex plan of ₦19.2 billion for the Ashaka coal power plant, South West alternative fuel project, Mfamosing crusher and Ashaka debottlenecking. On balance, we expect the company's net debt position to print at ₦241 billion by year end. On impact, we do not expect any sizeable loss on its FCY positions with the relative stability of the naira and thus, hold out for 26%YoY decline in finance cost over 2018, which pushed our overall net finance cost for the year to ₦28 billion (vs. ₦42 billion in FY 17).

- Thus, with FX issues effectively addressed in the near term, gains from higher prices and energy savings should have significant impact on earnings in 2018. We therefore forecast PAT at **¥5.7 billion** barring any positive surprise in form of tax writeback. This should translate to EPS and DPS of **¥0.65** and **¥1.15** respectively for 2018.
- Lafarge trades at 2018 EV/EBITDA and P/E of 9.7x and 53.3x which compared to Bloomberg EMEA peers of 9.2x and 16x respectively. In view of our recent adjustments, we now have FVE of **¥34.71** (vs. **¥48.45** in previous communication), which implies a **SELL** recommendation by our rating scale.

Summary of Results and Forecasts

ANNUAL					
Income Statement (¥'m) *	2016A	2017A	2018F	2019F	2020F
Revenue	219,714	299,153	318,066	330,086	363,366
COGS	179,052	248,394	244,911	249,021	275,261
Gross Profit	40,662	50,759	73,155	81,065	88,105
Operating Cost	29,138	46,944	41,931	40,655	40,729
Operating Profit	12,440	7,885	34,051	44,122	51,034
Finance expense	3,675	43,217	31,741	26,127	22,827
PBT	-22,819	-34,033	6,404	22,221	31,961
Tax	-39,717	569	751	2,606	3,748
PAT	16,899	-34,602	5,653	19,615	28,213
Balance Sheet (¥'m) *					
Fixed Assets	390,241	393,652	387,710	377,431	376,996
Stocks	44,981	58,266	51,563	54,489	62,975
Trade debtors	9,766	25,110	23,240	23,873	24,870
Cash & other bank balances	19,441	50,414	30,193	45,502	53,400
Total Assets	501,373	577,727	546,581	560,353	586,159
Trade Creditors	114,457	113,000	115,717	123,450	141,924
Non-current Liabilities	75,758	80,085	148,366	134,964	125,942
Total liabilities	252,422	420,740	378,069	384,440	399,967
Shareholders' fund	248,953	156,987	143,055	150,581	169,308
Key Ratios					
P/E	12.6	-11.3	53.3	15.3	10.7
EV/EBITDA	11.3	20.8	9.7	7.7	6.7
ROA	3.5%	-6.4%	1.0%	3.5%	4.9%
ROE	8.0%	-17.0%	3.8%	13.4%	17.6%
Net Margins	7.7%	-11.6%	1.8%	5.9%	7.8%
EPS	3.1	-4.0	0.7	2.3	3.3
EBIT margins	5.7%	2.6%	10.7%	13.4%	14.0%
PBT margins	-10.4%	-11.4%	2.0%	6.7%	8.8%
Effective Tax rates	174.1%	-1.7%	11.7%	11.7%	11.7%
Debt to Equity	51.3%	183.2%	168.7%	155.2%	131.6%
Interest coverage	3.4	0.2	1.1	1.7	2.2
BVPS	45.4	28.2	25.7	17.4	19.5

Source: ARM Research *unless otherwise stated

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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