



Nigerian Cement Sector

Sector Report

Still room for strategic selection

- In line with the capacity expansion in Nigeria, the stage for competition has become far wider with price likely to be the new play. In this report, we update our views on the Nigerian cement sector with a more sanguine outlook on consumption following the industry wide volume growth over H1 18 and the more convincing growth in government capital expenditure (capex) – with a multiplier impact on private consumption. Thus, we forecast volume growth of 16% to 21.6 million tons (Previous: +14.7% to 21.3 million tons) in 2018. Over the next five years, we estimate a more aggressive capex implementation by the FGN and even a more faster infrastructure development across the federating units, which necessitated our five-year compounded annual volume growth of 9%.
- Accompanying our optimistic volume growth in the sector is a robust gross margin expansion and EBITDA growth over the same period. Our sense of margin and EBITDA expansion is anchored on the improved energy and cost efficiency across the sector. For context, after deviating from average of 43% (between FY 13-15) to 32% in FY 16, the energy diversification and price increase across the sector supported a 610bps expansion in gross margin to 37% in FY 17. On operational efficiency, despite the average higher cost per tonne (+41% YoY to ₦27,380) across the industry in 2017, sector EBITDA to sales still expanded 372bps YoY to 37.6%. In the years ahead, we expect increased utilisation of locally produced coal and better efficient utilisation of the diversified energy sources to have more compelling impact on margins.

Company	Rating	TP (₦)	ETR
DANGCEM	BUY	278.54	39.3%
LAFARGE	BUY	29.96	30.3%
CCNN	NEUTRAL	28.47	13.9%

DANGCEM

Valuation Metrics	FY 17	FY 18E	FY 19E
P/E (x)	19.2	18.5	13.9
EPS (₦)	12.0	15.0	19.9
EV/EBITDA (x)	10.7	11.2	9.0
EBITDA Margin	48.2%	48.5%	52.0%
EV/IC	3.54	3.84	3.65
ROCE	17.5%	20.7%	25.6%

Lafarge

Valuation Metrics	FY 17	FY 18E	FY 19E
P/E (x)	-7.23	-26.21	17.42
EPS (₦)	-6.2	-1.1	1.7
EV/EBITDA (x)	16.2	8.6	8.7
EBITDA Margin	10.1%	15.1%	17.3%
EV/IC	1.10	1.07	1.24
ROCE	-8.4%	-2.4%	5.0%

CCNN

Valuation Metrics	FY 17	FY 18E	FY 19E
P/E (x)	3.7	26.8	16.1
EPS (₦)	2.6	1.0	1.7
EV/EBITDA (x)	1.9	17.1	9.8
EBITDA Margin	24.9%	9.8%	9.0%
EV/IC	0.63	1.38	1.22
ROCE	23.4%	9.7%	8.9%

Analyst(s)

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- We believe that our coverage cement companies are trading cheaper on respective FY 19E valuation basis with PE and EV/EBITDA of 15.8x and 9.1x relative to Bloomberg averages of 18.7x and 9.0x for Middle East and African peers. However, within our coverage companies, we prefer DANGCEM as we believe it is attractively priced and presents a higher upside potential relative to peers. Beyond valuation, DANGCEM offers the best opportunity to play the cement sector in Nigeria, given its reducing revenue concentration, defensive earnings quality, ability to determine industry margin and, limited risks to forecast and earnings surprise.

Housing deficit; a goldmine for cementitious volumes

- Going by recent publication by the Center for Affordable Housing Finance in Africa (CAHF), housing production in Nigeria is at approximately 100,000 units per year compared to minimum 1,000,000 units needed yearly to bridge the estimated 17 million housing deficit by 2033 at current annual population growth rate of 3.5% with the cost estimated at nearly ₦6 trillion (US\$16 billion).
- To address the housing deficit, the FGN embarked on several initiatives of which is the Family Home Fund (FHF) that is expected to facilitate the supply of 500,000 homes by 2023 specifically for low income earners. Also, the government in conjunction with World Bank adopted a Housing Finance Development Program (HFDP) with a total commitment cost of \$300 million which necessitated the establishment of the mortgage refinance company, setting up of mortgage guarantee products targeted at lower income borrowers, demystification of mortgage with the creation of housing microfinance, and Technical Assistance which will include provision of operational support to NMRC including assistance for bond issuance, mortgage lender training, mortgage consumer protections and financial literacy, housing market information, and impact evaluation of the mortgage market.
- Going by the above, we estimate that the drive to bridge the current housing deficit alone even just by 20% of the required annual minimum could unlock 25 million tons (mt) of cement consumption annually over the next five years. Beyond government initiatives to drive increased annual housing units per year, we also expect the increasing infrastructure spend on road constructions and expansions and deepening of dams to further spur increased cement consumption.

- Further buttressing our optimistic outlook for the sector is the relatively low cement consumption per capita, the nation’s export potential with ongoing construction of export terminals by major players and the likelihood of increased attention by the FGN to road cement construction. Also, after two consecutive years of contraction (FY 16: 6.6% and FY 17: 2.5%) in the real estate and construction sector, we are positive of a reversal to growth over 2018 – albeit at a marginal rate as we expect completion of ongoing constructions over 2019, especially real estate. Beyond 2019, our expectation is more inclined with the ERGP which estimates 5.4% average annual growth for the construction and real estate sector over 2017 – 2020, but with a slight twist as we expect this to be more plausible over 2020 and 2025 which we believe will be largely driven by both private real estate development and public construction spend.

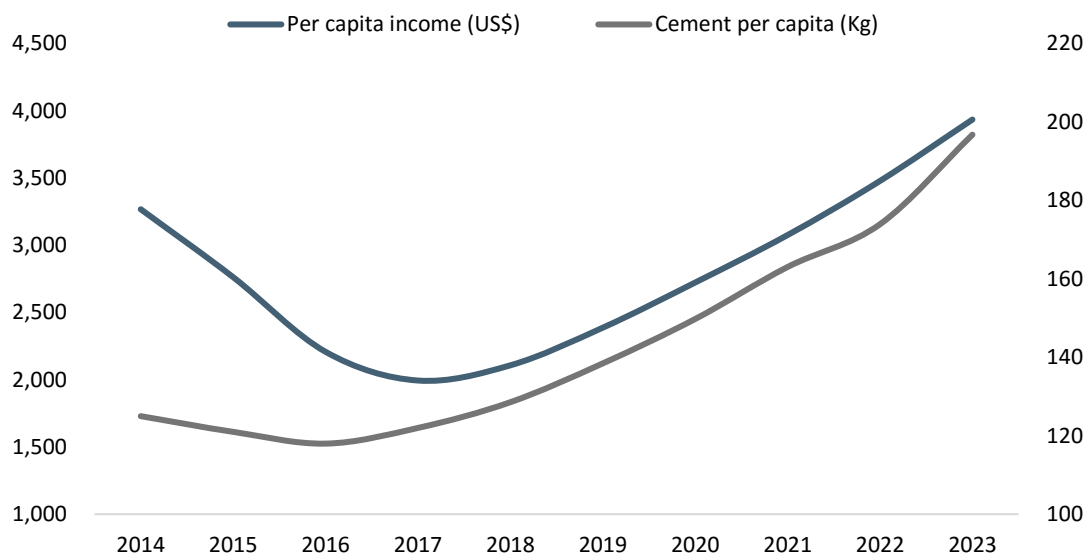
Table 1: Cement per capita consumption (kg) and per capita income ratio

	Cement per capita (Kg)	Per capita income (US\$)	CPC/PCI Multiplier
Ethiopia	82	873	0.09
Sierra Leone	82	491	0.17
Tanzania	88	1,034	0.09
Zambia	101	1,480	0.07
Cameroun	111	1,401	0.08
Bangladesh	120	1,602	0.07
Nigeria	122	1,994	0.06
Kenya	124	1,702	0.07
Mauritania	134	1,318	0.10
Pakistan	170	1,541	0.11
India	200	1,983	0.10
Ghana	202	1,663	0.12
Senegal	222	1,038	0.21
South Africa	234	6,180	0.04
Congo	349	1,958	0.18

Source: DANGCEM Reporting, Global Cement Report, IMF, ARM Research

- We posit that the relatively low cement consumption per capita in Nigeria relative to per capita income suggests a large room for volume growth in the medium to long term. Using our adjusted volume per capita/per capita income multiplier methodology, we estimate cement consumption per capita growth of 8% per annum over the next five years, to reach 189kg by 2023. Over 2018, we expect cement consumption per capita and cement volume growth of 5.7% YoY and 16% YoY to 129kg and 21.6mt respectively.

Figure 1: Historical and Forecast Nigeria Cement per capita (kg)



Source: ARM Research *unless otherwise stated

Tactical price adjustment or product diversification

- After a rebound of Nigeria gross margin to 71% in FY 17 for DANGCEM, we had expected a gradual price correction during the year by the industry price setter. Despite the ₦50 per 50kg bag price increase effected by DANGCEM in April, we are still optimistic of slight adjustment to price over the rest of 2018, albeit tactical. Our view of tactical adjustment to price is buttressed by the recent introduction of Falcon Cement (32.5 grade) by DANGCEM in the Northern region at a ₦50 per 50kg bag discount to 3X (42.5 grade), a move we believe will extend to other parts of the country before the end of H1 2019. The introduction of Falcon cement is to complement the 3X and diversify product base to better position for competition with Lafarge cement 32.5 grade cement (popularly called Lafarge Classic). On the other end of the competition is the recent price reduction (which we understand took effect in August) by BUA Cement. While DANGCEM had hitherto maintained a lower price compared to both BUA Sokoto (CCNN) and BUA Okpella, BUA lowered pricing in the North Central by ₦100 per 50kg bag in August, effectively bringing the price ₦50 lower than DANGCEM 3X of ₦2,400 per 50kg bag and closer to Lafarge Supaset.
- Although, we are yet to receive information of a retaliatory price cut by DANGCEM, our sense is that this development signals a move towards a tactical adjustment of prices which we believe will take a full and more noticeable effect in 2019. Over the rest of 2018, our view

on pricing is tilted more towards stability, as we expect a slight downward adjustment to average prices of 1.2% YoY to ₦43,769.

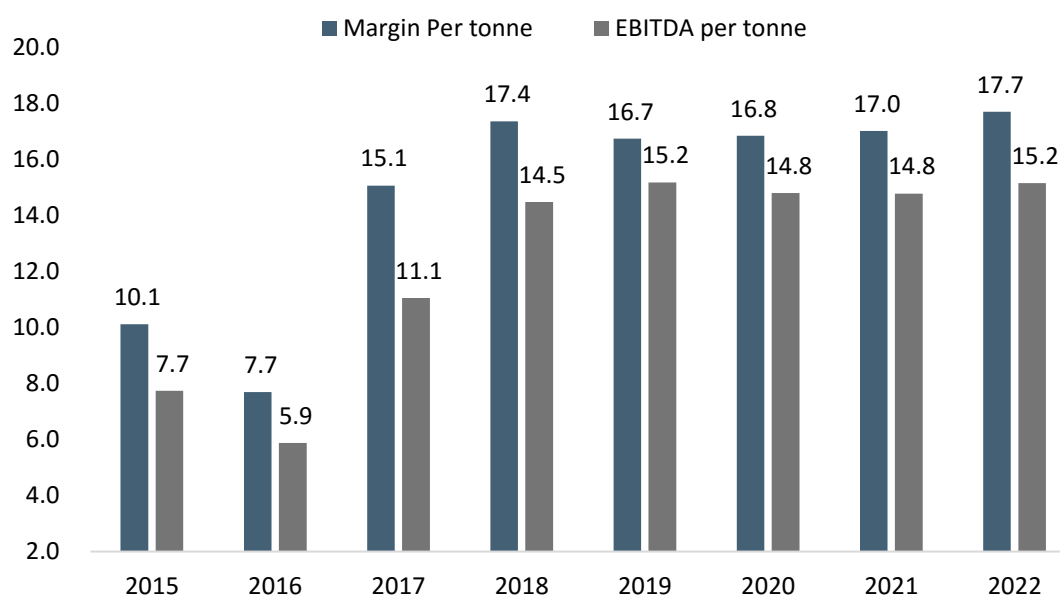
- Beyond 2018, we see a more rapid adjustment in prices as the current market penetration with superior products starts to have impact on margins. For context, market survey revealed that players in the industry are now bagging products with higher grades than estimated on the bags. That is, bagging a 42.5 grade cement as 32.5 grade at a flat price in order to penetrate market with a more superior quality. While this is unsustainable, as our estimate reveals that producing a 42.5 grade cement uses 7% more clinker content than in 32.5 grade, we expect the competition to revert to prices and thus forecast between 6% - 14% annual adjustment to prices over 2019 - 2022.

Energy efficiency to support price competition

- Although cost pressure subsided over 2017 following the diversification of energy mix by DANGCEM and Lafarge, the use of imported coal and low efficiency in the operation of the newly diversified alternatives still kept energy cost in 2017 (mean level of 27%) ahead of the level in 2015 (22.2%). Over H1 17, DANGCEM successfully improved its energy mix at Obajana and Ibese plants, with the proportion of LPFO in energy mix down to 4% and 2% (vs. 36% and 26% in H1 16) respectively, and further moderating to 2% and 1% by FY 17. For Lafarge, by FY 17 its energy mix was well diversified across gas (62% vs. 66% in FY 16), coal (19% vs. 22% in FY 16), Petcoke (7% vs. nil in FY 16), alternative fuel (9% vs. 4% in FY 16) and the proportion of expensive LPFO reduced to 3% (vs. 8% in FY 16). On the other hand, CCNN was unable to improve its energy source – as that would require the plant to be shut down for upward of 3 months – and remained largely dependent on expensive LPFO and related haulage cost further compounding the pressure with energy cost representing 58% (vs. 53% in FY 16) of total cash cost in 2017.
- In the years ahead, we expect increased utilisation of locally produced coal and better efficient utilisation of the diversified energy sources to have impact on margins as our five-year forecast volume growth is accompanied by robust gross margin expansion and EBITDA growth over the same period. For context, after deviating from average of 43% (between FY 13-15) to 32% in FY 16, the energy diversification and price increase across the sector supported a 610bps expansion in gross margin to 37% in FY 17. On operational efficiency, despite the average higher cost per tonne (+41% YoY to ₦27,380) across the

industry in 2017, sector EBITDA to sales still expanded 372bps YoY to 37.6%. Thus, we expect average gross margin of 42.2% and EBITDA of 36.9% over our forecast horizon.

Figure 2: Historical and forecast per ton margins (₦'000)



Source: ARM Research *unless otherwise stated

The scapegoat in a price competition

- Given the changing industry fundamentals and the leg room for competition, we carried out a sensitivity analysis on our coverage companies to assess the impact of a potential price erosion. We used average base price of ₦43,769 and worked our price sensitivity around same. Specifically, we find that in the event of a 12% change in price over FY19E-20E, DANGCEM's EPS is likely to decline by 26% on average. For CCNN, we expect a 32% average EPS contraction over the same period. Finally, we believe that Lafarge is the most exposed, as our sensitivity reveals that in the event of a 12% price cut, average EPS could decline by 36% over the same period.
- Accordingly, despite our optimistic view on volumes growth over the forecast period, the key risk to our estimate remains the likely price competition given the possible additions to capacity from BUA and DANGCEM.

Figure 3: DANGCEM price/EPS sensitivity analysis

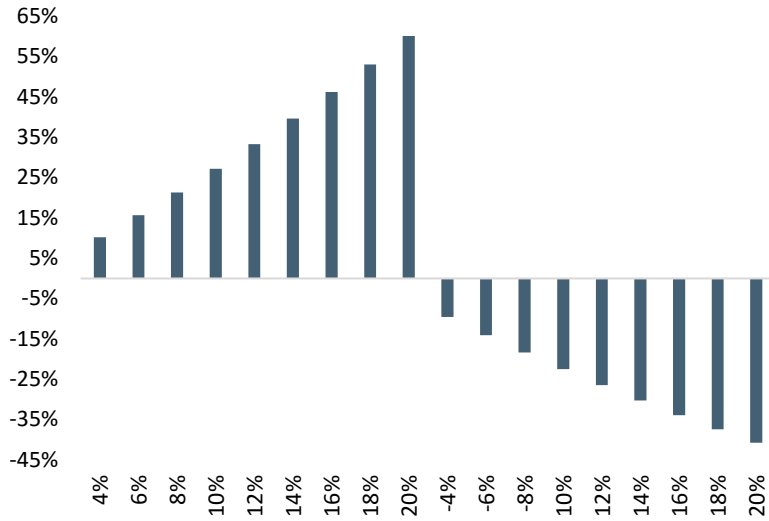
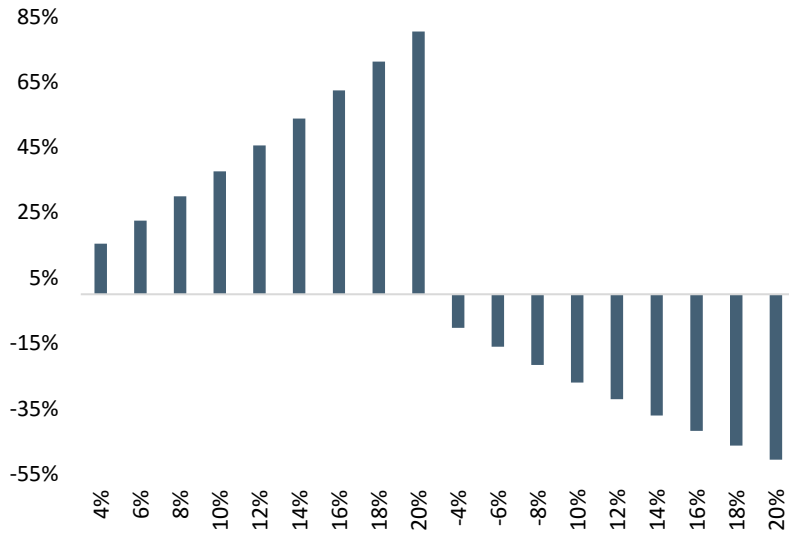


Figure 4: Lafarge price/EPS sensitivity analysis



Figure 5: CCNN price/EPS sensitivity analysis



Sector Valuation and recommendation

- Across our universe, we have rolled forward our valuation, which informed adjustment to our coverage FVE. The adjustment to our estimates assumes an improving macroeconomic situation, higher cementitious public sector capex and more noticeable implementation of government's social housing programmes, the confluence of which we believe will be supportive of cement consumption by both private and public-sector.
- We believe that our coverage cement companies are trading cheaper on respective FY19E valuation basis with PE and EV/EBITDA of 15.8x and 9.1x relative to Bloomberg averages

of 18.7x and 9.0x for Middle East and African peers. However, within our coverage companies, we prefer DANGCEM as we believe it is attractively priced and presents a higher upside potential relative to peers. Beyond valuation, DANGCEM offers the best opportunity to play the cement sector in Nigeria, given its reducing revenue concentration, defensive earnings qualities, ability to determine industry margin and, limited risks to forecast and earnings surprise.

Table 2: ARM Research coverage valuation

Stock	TP (₦)	Rating	PE (x)			EPS (₦)			EV/EBITDA (x)			ROE			EBITDA Margin			ROCE		
			2017A	2018E	2019E	2017A	2018E	2019E	2017A	2018E	2019E	2017A	2018E	2019E	2017A	2018E	2019E	2017A	2018E	2019E
DANGCEM	278.54	BUY	19.2	18.5	13.9	12.0	15.0	19.9	10.7	11.2	9.0	25.9%	32.2%	40.7%	48.2%	48.5%	52.0%	17.5%	20.7%	25.6%
Lafarge	29.96	BUY	0.0	0.0	17.4	-6.2	-1.1	1.7	16.2	8.6	8.7	-17.0%	-5.5%	9.7%	10.1%	15.1%	17.3%	-8.4%	-2.4%	5.0%
CCNN	28.47	NEUTRAL	3.7	26.8	16.1	2.6	1.0	1.7	1.9	17.1	9.8	24.9%	9.8%	9.0%	24.9%	9.8%	9.0%	23.4%	9.7%	8.9%
Average			7.6	15.1	15.8	2.8	5.0	7.8	9.6	12.3	9.1	11.2%	12.2%	19.8%	27.7%	24.5%	26.1%	10.8%	9.3%	13.2%

CCNN Plc. – Still optimistic on near-term upside

We maintain our FVE of ₦28.47 on CCNN, using our most stringent additional shares of 4.8 billion through the equity merger of CCNN with Kalambaina Cement Company Limited. Recall, management guided that the merger consideration is based on 100,000 shares of Kalambaina for 19,811,372 shares of CCNN (1:198) using the 30-day volume weighted average (VWAP) closing price of ₦25.99 as at 22 June 2018. Although, additional details on the number of shares to be issued by CCNN or outstanding shares of Kalambaina is yet to be disclosed, we adopted a net asset merger approach, using the construction cost of \$350 million (₦126 billion using exchange rate of ₦360/1\$) on the announced VWAP. However, we note that a significant upside abounds if a lower exchange rate is used, as the Chairman of CCNN clearly stated that CBN provided most of the forex used for the importation of equipment. CCNN currently trades on FY19 EV/EBITDA of 9.8x, a significant discount to peer average of 14.3x. At a 12.5% upside from current share price of ₦25.3, we have a **NEUTRAL** rating on the stock.

Volume consolidation ahead of merger

- CCNN's H1 18 result was quite impressive wherein revenue and EPS expanded 41% and 152% YoY respectively, ahead of our estimates (+21% and +116% YoY growth). EPS printed at ₦2.07 (H1 18E: ₦1.77, H1 17: ₦0.82). The performance stemmed largely from higher than expected jump in volumes and a significant improvement in gross margin. On volumes, while we had expected the integration of sales from the new plant from Q3, we believe some of the volumes sold from the new plant were incorporated into the Q2 figures. For context, our estimated volume over H1 18 of 284,454 tons suggests that remaining expected production from the plant for H2 cannot exceed 215,546 tons to sum up to the expected annual capacity of the plant. However, using our H2 17 and H2 16 estimate of 264,496 and 263,808 tons respectively, we believe it is unusual for the plant alone to have produced so much in H1 18.

On cost, despite the reported surprising jump in volume, CCNN gross margin expanded 965bps YoY to 45.2% over H1 18 compared to 3-year average of 33.6%. The surprises on volume and cost of sales justify our view that the sales over H1 18 must have incorporated production from the new plant, as our market survey in the north now suggests that BUA Sokoto (CCNN) is now pushing volumes as far as Plateau state, which had never been the case before the commissioning of the plant.

Long-term outlook remains buoyant

- We maintain our optimism on CCNN in the medium to long term as we believe the company is well positioned to compete for market share in the North (especially the North West). Given the significant room for gross margin expansion from the installation of a coal power plant in the new plant, we expect the company to be able to accommodate any price cut to drive volumes.
- Post consolidation of assets from the two plants and running on full course alongside improved energy mix with the adoption of coal on the new plant and conversion of the 500K ton plant to same, we estimate average gross margin of 44% (FY 17; 39%). Further down, we look out for EBITDA CAGR of 21%, which compares favourably to 14% CAGR over FY13- FY 17 and an average annual EPS growth of 25% over our forecast horizon.

Summary of Results and Forecasts

ANNUAL					
Income Statement (₹ million)	2016A	2017A	2018F	2019F	2020F
Volume (000' tonnes)	488.5	467.7	635.0	1,040.0	1,100
Price (N'000)	28.8	41.9	41.8	41.3	41.1
Revenue	14,088	19,588	26,524	42,952	45,210
COGS	10,151	11,983	14,566	24,817	25,901
Gross Profit	3,936	7,605	11,958	18,135	19,309
Operating Cost	2,268	3,482	3,766	4,338	4,792
Operating Profit	1,807	4,227	8,456	14,226	14,969
Finance Income	133	108	120	114	117
Finance expense	199	132	140	220	248
PBT	1,741	4,203	8,436	14,121	14,839
Tax	487	979	2,149	3,656	3,814
PAT	1,254	3,224	6,287	10,465	11,025
Balance Sheet (₹ million)					
Fixed Assets	10,530	12,325	134,995	130,661	126,193
Stocks	5,246	6,516	6,607	11,339	12,369
Trade debtors	1,790	2,674	1,857	3,135	2,496
Cash & other bank balances	2,463	3,134	12,340	23,645	37,534
Total Assets	2,463	3,134	12,340	23,645	37,534
Trade Creditors	4,901	6,101	4,612	7,319	5,966
Non-current Liabilities	3,035	3,071	3,497	4,485	4,485
Total liabilities	8,537	10,237	10,167	14,341	13,587
Shareholders' fund	11,493	14,412	146,162	155,729	165,916
Key Ratios					
P/E	5.0	3.7	26.9	16.2	15.4
EV/EBITDA	2.1	1.9	17.1	9.8	8.5
ROA	6.7%	14.4%	6.9%	6.4%	6.3%
ROE	11.6%	24.9%	9.8%	9.0%	9.1%
Net Margins	8.9%	16.5%	23.7%	24.4%	24.4%
EPS	1.0	2.6	1.0	1.7	1.8
EBIT margins	12.8%	21.6%	31.9%	33.1%	33.1%
PBT margins	12.4%	21.5%	31.8%	32.9%	32.8%
Effective Tax rates	28.0%	23.3%	25.5%	25.9%	25.7%
Debt to Equity	9.7%	5.3%	1.2%	1.6%	2.0%
Debt to Assets	5.6%	3.1%	0.9%	1.1%	1.4%
Interest coverage	9.1	32.0	60.2	64.7	60.5
BVPS	9.1	11.5	18.6	19.4	20.3

Dangote Cement Plc. – Valuation justifies a BUY rating

We maintain our FVE on DANGCEM at ₦278.54 and retain a BUY rating as our volume outlook remains sanguine following expectation of clinker exports to West African countries from 2019 and improved cement consumption in Nigeria over the next five years as capex spend by government across levels gain traction. We believe DANGCEM presents an attractive entry point in the cement sector in Nigeria and a quality name among Sub-Saharan Africa (SSA) peers, given its strong and diversified margins, balanced funding structure and exposure to growth markets in Africa. DANGCEM trades at 2019 EV/EBITDA of 9.0x which is at a premium to MEA peers of 8.9x. Accordingly, we maintain our **BUY** recommendation on the stock.

Volume outlook remains chubby

- As at August 2018, DANGCEM volume update revealed that the company already cleared 16mt of cement (65% of our FY 18 volume estimate) – 9.8mt in Nigeria and 6.2mt for the rest of Africa – at a relatively flat price. For the rest of the year, while we factored in the relatively slow volume in Q3, we believe the company is set to match or outperform our volume estimate of 24mt – additional 8.4mt with 4.9mt in Nigeria and 3.5mt for the rest of Africa.
- Beyond 2018, with the clinker export terminal guided for delivery by Q4 18, we are optimistic of a robust volume in 2019 (+19% YoY to 29 mt) and an average growth of 9.2% over 2022. Notably, our Pan-African volume estimate in the years ahead is buoyed by stronger performance in Ethiopia, Senegal, Cameroon and Tanzania.

... all eyes on Tanzania

- Finally, DANGCEM Tanzanian operation signed an agreement with Tanzania Petroleum Development Corporation (TPDC) in August to provide the much-needed cheaper energy for its recently commissioned gas genset. Recall, while volume at the factory grew by 25% YoY in FY 17, the factory's reliance on diesel resulted in EBITDA losses. Also, as at H1 18, overall Pan-African sales was impacted by the significant contraction in sales volume at the Mtwara plant due to plant maintenance and shutdowns pending the commissioning of gas turbines. With the installation of a 132meter distance natural gas pipeline and a secured supply gas agreement with the government, we are highly optimistic of a rebound in operation with a trickling impact on EBITDA.

Strong room for earnings growth abounds

- Over our forecast period, we estimate EBITDA CAGR of 11.4% over FY18E - FY22E, a moderation from 14% CAGR over FY13 - FY17. We believe Nigeria's contribution to group EBITDA will remain elevated, with our forecast average EBITDA margin of 66%¹. However, we see room for growth for the rest of Africa and thus expect average EBITDA margin of 18% (FY 17: 15%) which we believe will result from improved energy mix across markets and the substitution of local production for imported clinkers. In FY 18E, we maintain our Nigeria and non-Nigeria EBITDA margin of 67% and 16% respectively, with overall group EBITDA margin now expected to expand slower by 27bps YoY (previous: 58pps) to 48.5%.
- Over our forecast period, we factored in the likelihood of a reversal to the historical pioneer adjusted effective cash tax as management stated that every related documentation had been filed and inspection done by NIPC over Q2 18, however, a final confirmation which was needed to make the move didn't come in time. Accordingly, we have adopted a lower effective tax of 24% in FY 18E, which informed our PAT estimate of ₦254.9 billion and translates to FVE of ₦278.54. However, on a highly conservative note, adopting a worst-case scenario which assumed no reversal of the previous provisions with an effective tax rate estimate of 42% in 2018 resulted in a slight moderation to our 2018E PAT of ₦195 billion which translates to FVE of ₦249.71. Beyond 2018, we forecast average EPS CAGR of 16% over FY19E - FY22E as gains from Pan-African operation have a better trickling down impact on earnings.

Table 2: Scenario analysis showing the impact of higher effective tax rate on EPS

	FY 18E	FY 19E	FY 20E	FY 21E	FY 22E
Working tax rate	24%	23%	24%	25%	22%
EPS Forecast	15.0	19.9	21.0	23.2	27.5
EPS at 30% tax rate	13.8	18.1	19.3	21.5	24.5
EPS at 35% tax rate	12.8	16.8	17.9	20.0	22.7
EPS at 40% tax rate	11.8	15.5	16.5	18.4	20.9
EPS at 45% tax rate	10.8	14.2	15.1	16.8	19.1
EPS at 50% tax rate	9.8	12.9	13.8	15.2	17.3

¹ Before intercompany and central cost

Summary of Results and Forecasts

ANNUAL					
Income Statement (N'm) *	2016A	2017A	2018F	2019F	2020F
Volume (Million tonnes)					
Nigeria	15.1	12.1	14.7	16.1	17.9
Rest of Africa	8.5	9.5	9.7	12.9	13.7
	23.6	21.6	24.4	29.1	31.7
Nigeria Price (N'000)	28.2	45.6	44.2	42.4	41.2
Rest of Africa Average Price (N'000)	26.2	29.7	29.0	30.2	31.1
Revenue					
Nigeria	426,223	552,434	649,371	684,930	738,271
Rest of Africa	195,027	258,400	267,987	371,984	406,641
Intercompany	6,147	5,251	-	-	-
	615,103	805,582	917,358	1,056,914	1,144,912
COGS	323,816	351,290	379,531	438,897	476,945
Gross Profit	291,287	454,292	537,827	618,017	667,967
Operating Cost	119,336	155,297	183,472	160,183	189,978
Operating Profit	182,493	304,208	360,777	463,119	482,569
Finance Income	43,817	35,926	34,419	42,653	61,153
Finance expense	45,381	52,711	59,679	64,878	72,875
PBT	180,929	289,590	335,517	440,894	470,847
Tax	38,071	85,342	80,524	101,406	113,003
PAT	142,858	204,248	254,993	339,488	357,844
Balance Sheet (N'm) *					
Fixed Assets	1,155,711	1,192,140	1,236,860	1,267,157	1,291,498
Stocks	82,903	94,594	89,439	110,945	125,224
Trade debtors	26,279	30,155	39,469	35,483	39,168
Cash and other bank balances	115,693	168,387	239,296	277,020	339,013
Total Assets	1,527,908	1,665,883	1,781,463	1,884,878	2,006,415
Trade Creditors	268,966	270,721	258,081	304,172	339,091
Non-current Liabilities	218,316	364,047	393,362	407,185	375,999
Total liabilities	730,563	884,523	980,829	1,018,301	1,052,331
Shareholders' fund	797,345	781,360	800,634	866,578	954,085
Key Ratios	2016A	2017A	2018F	2019F	2020F
P/E (x)	20.8	19.2	18.6	14.0	13.2
EV/EBITDA (x)	12.5	10.7	11.2	9.0	8.5
ROA	11%	13%	15%	19%	18%
ROE	20%	26%	32%	41%	39%
Net Margins	23%	25%	28%	32%	31%
EPS (N)	8.4	12.0	15.0	19.9	21.0
EBIT margins	30%	38%	39%	44%	42%
PBT margins	29%	36%	37%	42%	41%
Effective Tax rates	21%	29%	24%	23%	24%
Debt to Equity	46.8%	49.6%	62.0%	56.3%	51.0%
Debt to Assets	24.4%	23.3%	27.9%	25.9%	24.2%
Interest coverage (X)	4.0	5.8	6.0	7.1	6.6
BVPS (N)	46.8	45.9	47.0	50.9	56.0

Lafarge Africa Plc. – Dilutive, but still a better bet

We raise our LAFARGE FVE by 7% to ₦29.93 (from ₦27.94) as we now expect the moratorium on the extended parent company's loan to have more telling impact on earnings between FY19 and 20. Also, given the company's guidance to a possible sale of the South African operation as soon as the business turns profitable, we expect a speedy implementation of the ongoing turnaround activity at the plant, which necessitated circa 1.2% reduction in our forecast cost to sales ratio to average 74.7% over FY19-20 (prior average of 75.6%) and a positive contribution to EBITDA in the years ahead. The cumulative impacts of this adjustments more than outweighed the dilution from additional ₦90 billion rights issue. Accordingly, we now have a **BUY** rating on the stock. While the current 38% discount to peers on FY19 EV/EBITDA of 8.7x seem justified, we expect this gap to narrow in the months ahead.

Rights Issue positive for short term loan refinancing

- The shareholders of Lafarge recently approved the proposed rights issue and the related party transactions by management at its recently concluded extra-ordinary general meeting. Concisely, management guided that the rights issue will be used to refinance short term borrowings and working capital needs. On the short-term borrowings, ₦40 billion of the proceeds of the issue will be used to finance obligation with FBN and ₦20 billion to refinance the company's CP programme. On another part, the company will reduce its parent company's obligation by \$22.2 million (₦7.9 billion) via an equity conversion from the rights issue. Accordingly, we estimate net proceed from right issue of ₦21.6 billion. Also, with the first tranche (₦26.4 billion) of the ₦60 billion bond issued in 2016 due for maturity in Q1 2019, we expect the company to issue additional ₦10 billion CP which combined with excess of the proceeds from the rights issue should be sufficient to cover the repayment.

Dilutive, but still a better bet

- To estimate the dilutive impact of the rights issue after a 3.1 billion dilution to shares outstanding in 2017, we adopted a 3-month VWAP of ₦29.93. Applying that on the proposed ₦90 billion, we estimate additional shares of 3.0 billion which should take total shares outstanding to 11.7 billion. Overlaying this on our forecast PAT, we estimate average EPS dilution of ₦1.70 over our forecast period. However, we believe the dilution is better than another year (or more) of loss due to elevated finance expense.

Long term earnings growth still compelling

- Over 2018, we maintain our energy cost estimate of ₦40.2 billion (with FY 18 energy expense to costs of 16.4% vs 18.1% in FY 17) and adopted a conservative cost to sales ratio of 77% (76% in H1 18 and 83% in FY 17) which translates to cost of sales to ₦254 billion and a 3% YoY decline in cost per tonne to ₦37,480. Thus, we expect a 49% YoY increase in gross profit to ₦76 billion (gross margin: +6pps YoY to 23%). Also, we estimate FY 18E EBITDA margin expansion of 500bps to 15% barring any negative surprise in form of one-off administrative charges from the ongoing turnaround in South Africa.
- Over FY 19E – 20E, we forecast EBITDA CAGR of 11%, which compares favourably to negative 21% over FY13 - FY17 anchored largely on improved energy mix at Ashaka with the planned installation of coal power plant, turnaround initiatives in South Africa, alternative fuel project in SW Nigeria, and debottlenecking at Ashaka. Accordingly, we forecast an average group EBITDA margins of 17% over FY19E - FY22E (FY 17: 10%) as we expect a return to positive EBITDA in South Africa over the period.
- We expect positive earnings from FY 19E and forecast average EPS growth of 12% over FY 19E – FY 22E. Particularly in FY 18E, we forecast a loss after tax of ₦9.9 billion, a moderation from a loss after tax of ₦34.6 billion in FY 17.

Summary of Results and Forecasts

ANNUAL					
Income Statement (N' million)	2016A	2017A	2018F	2019F	2020F
Volume (Million tonnes)					
Nigeria Volume	5.3	4.5	5.1	5.3	5.7
South Africa	2.0	1.7	1.5	1.7	1.8
	7.3	6.2	6.6	7.0	7.5
Nigeria Price (N'000)	28.1	44.0	45.3	43.5	42.2
LSAH Price (N'000)	17.0	35.6	36.3	37.7	38.9
Revenue					
Nigeria	152,486	204,493	239,790	239,756	254,511
LSAH	67,235	94,675	89,439	98,425	104,537
	219,714	299,153	329,230	338,181	359,048
COGS	179,052	248,394	253,507	255,128	266,951
Gross Profit	40,662	50,759	75,723	83,053	92,097
Operating Cost	29,138	46,944	51,502	47,985	52,684
Operating Profit	12,440	7,885	27,146	38,871	43,028
Finance Income	3,675	1,439	1,746	1,048	761
Finance expense	3,675	29,741	33,383	16,490	14,110
PBT	-22,819	-34,033	-11,396	22,320	29,995
Tax	-39,717	569	-1,481	2,232	3,599
PAT	16,899	-34,602	-9,914	20,088	26,395
Balance Sheet (N' million)					
Fixed Assets	390,241	393,652	380,474	379,301	380,077
Stocks	44,981	58,266	53,373	55,825	61,074
Trade debtors	9,766	25,110	24,055	24,458	24,575
Cash and other bank balances	19,441	50,414	25,644	42,866	49,902
Total Assets	501,373	577,727	536,532	561,713	582,608
Trade Creditors	114,457	113,000	119,778	126,477	137,639
Non-current Liabilities	75,758	80,085	163,247	176,203	179,524
Total liabilities	252,422	420,740	331,775	353,640	371,838
Shareholders' fund	248,953	156,987	204,757	208,073	210,770
Key Ratios	2016A	2017A	2018F	2019F	2020F
P/E (x)	12.6	-7.2	-26.2	17.4	13.3
EV/EBITDA (x)	11.3	16.2	8.6	8.7	8.0
ROA	3.5%	-6.4%	-1.8%	3.7%	4.6%
ROE	8.0%	-17.0%	-5.5%	9.7%	12.6%
Net Margins	7.7%	-11.6%	-3.0%	5.9%	7.4%
EPS (N)	3.1	-6.2	-1.1	1.7	2.3
EBIT margins	5.7%	2.6%	8.2%	11.5%	12.0%
PBT margins	-10.4%	-11.4%	-3.5%	6.6%	8.4%
Effective Tax rates	174.1%	-1.7%	13.0%	10.0%	12.0%
Debt to Equity	51.3%	183.2%	93.7%	96.9%	95.9%
Debt to Assets	25.5%	49.8%	35.8%	35.9%	34.7%
Interest coverage (X)	3.4	0.3	0.8	2.4	3.0
BVPS (N)	45.4	28.2	23.6	17.8	18.0

Chart Pack 1

Figure 6: Cement sector GDP and Nigeria real GDP

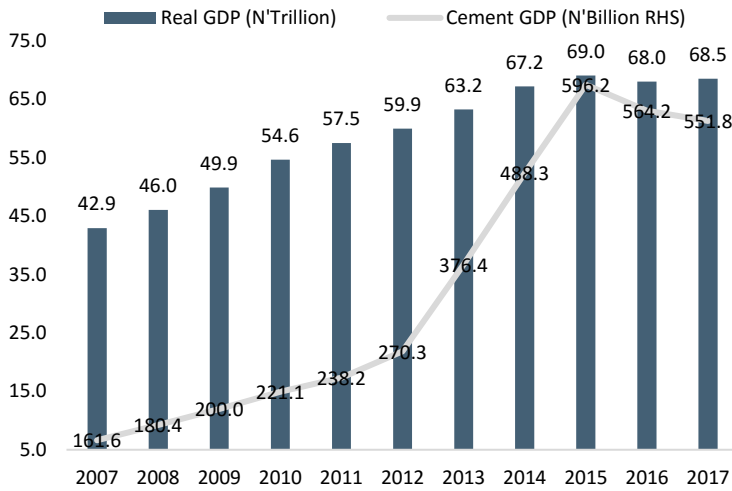


Figure 7: Cement consumption growth vs. GDP growth y/y

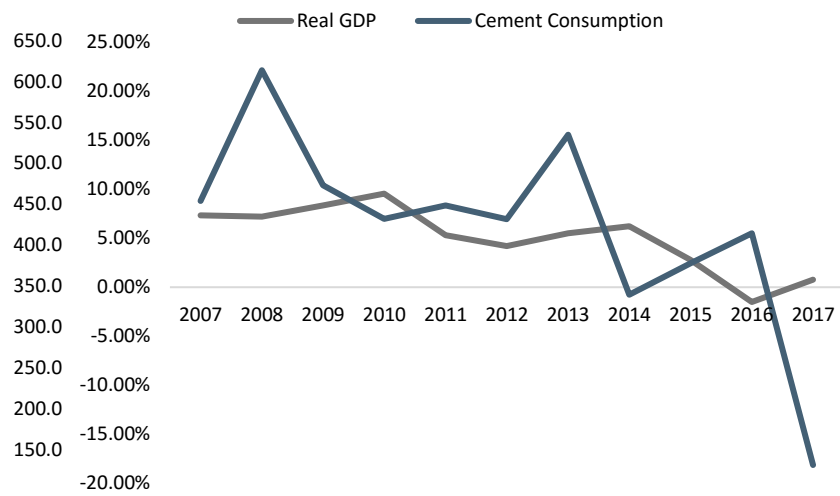


Figure 8: Trend in production vs. consumption

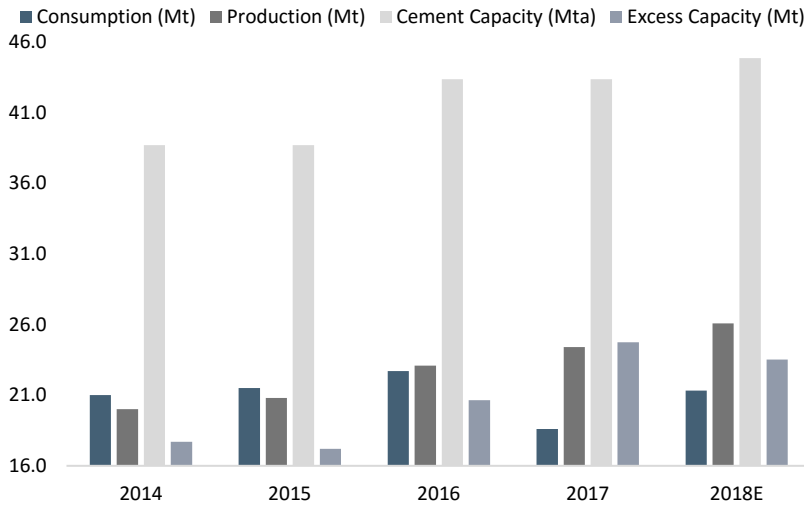


Figure 9: Nigeria Cement Imports vs. local production

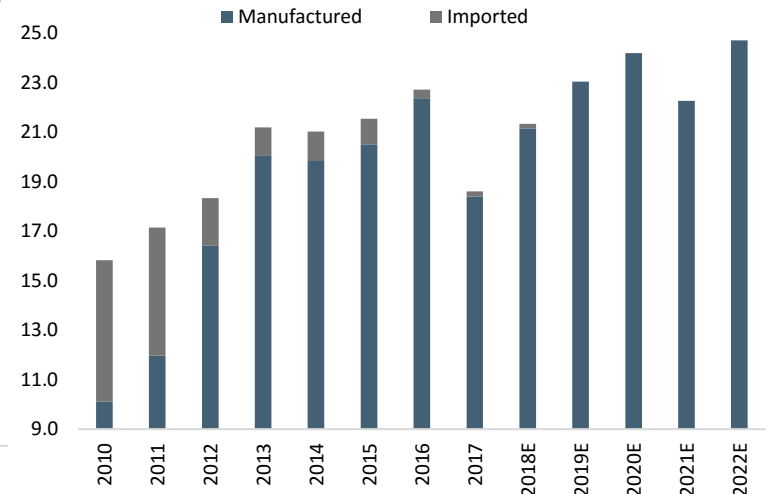


Figure 10: Trend in cement consumption volumes and YoY growth

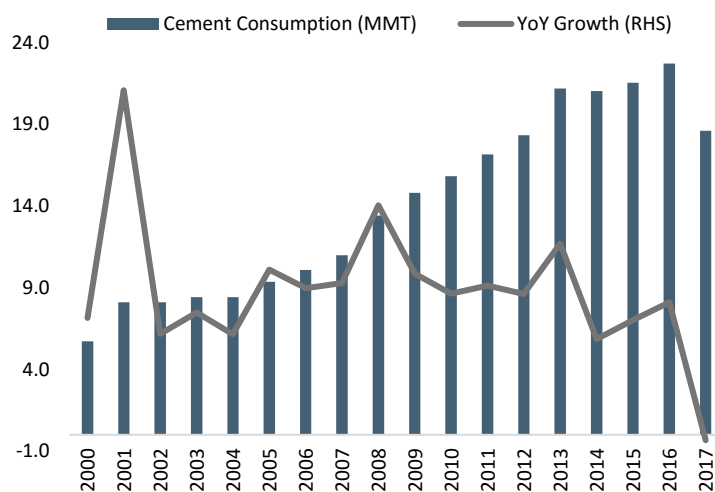
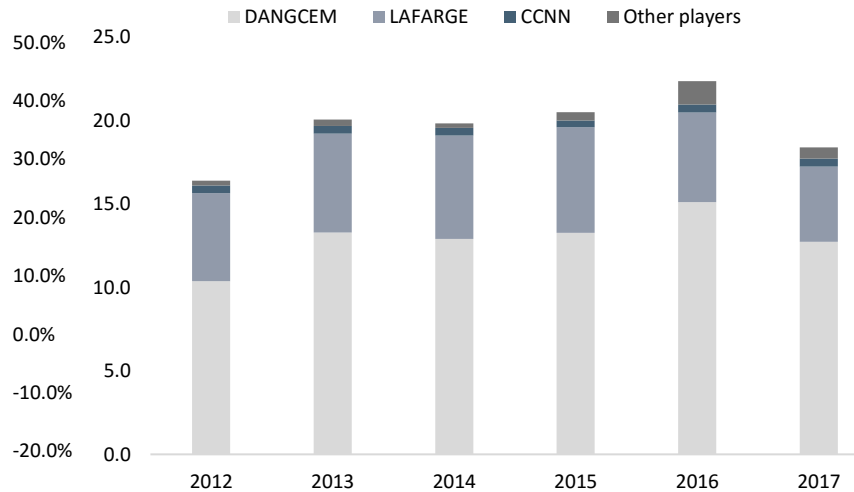


Figure 11: Share of Nigeria domestic cement production



Source: ARM Research *unless otherwise stated

Chart Pack 2

Figure 12: Trend in capacity utilization in the cement industry

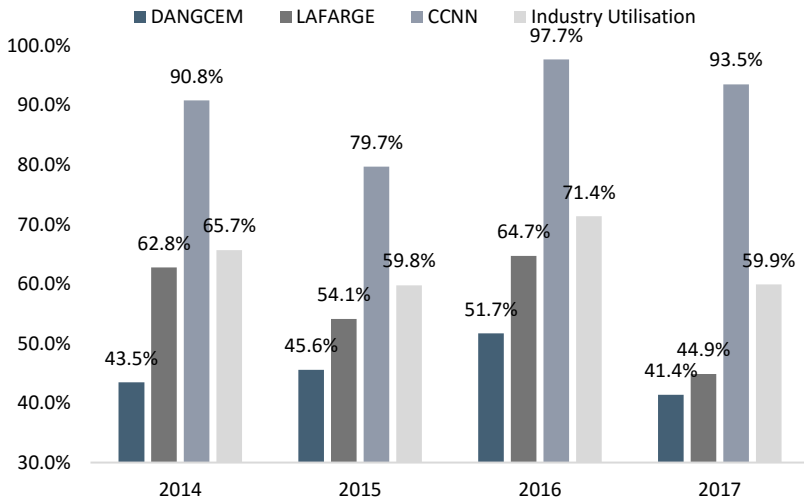


Figure 13: Average annual cement price adjustment

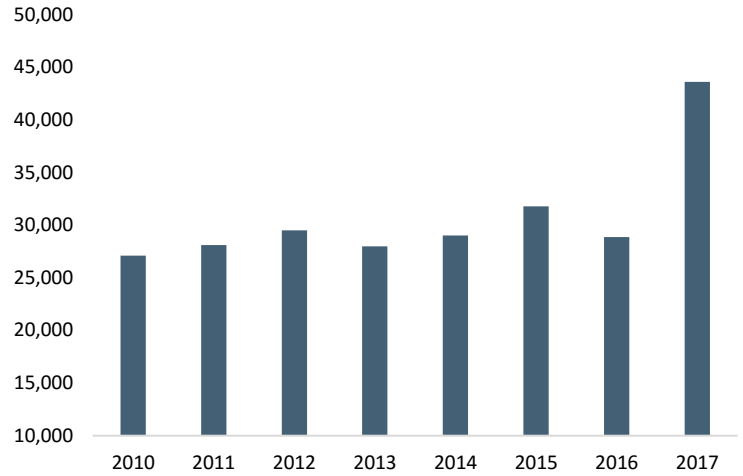


Figure 14: Quarterly trend in local cement price

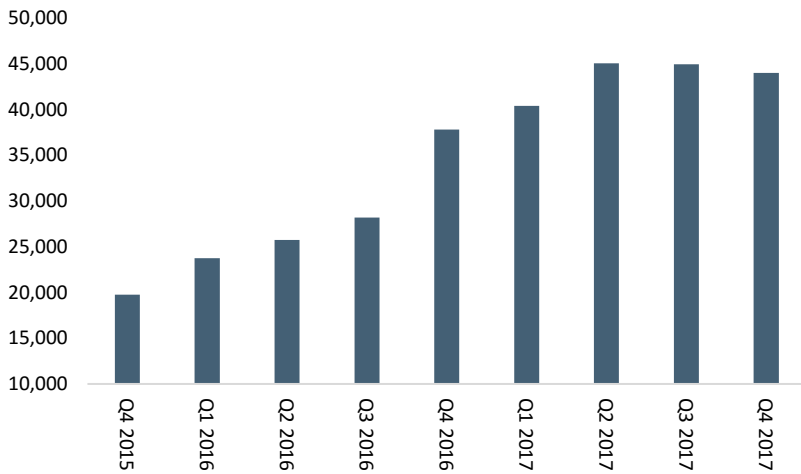


Figure 15: Revenue growth across coverage

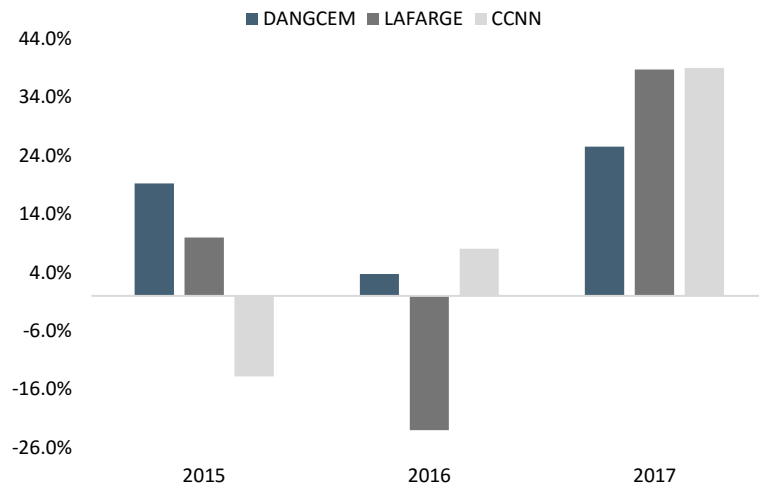


Figure 16: Changes in energy mix across sector

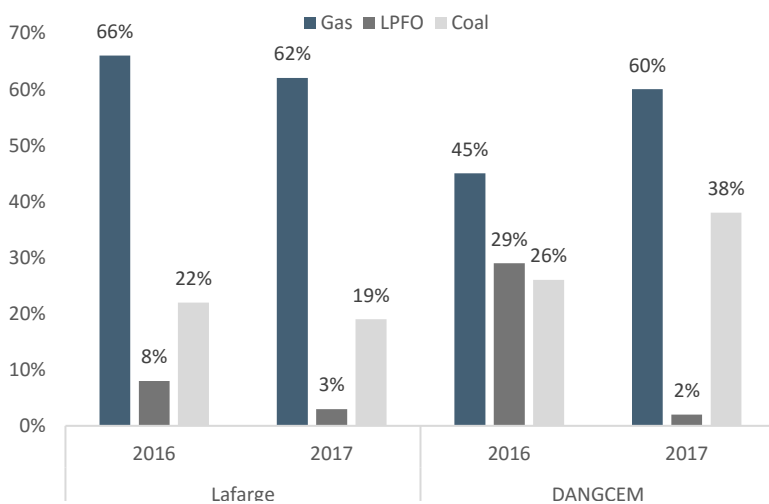


Figure 17: Coverage universe energy expense to cash cost

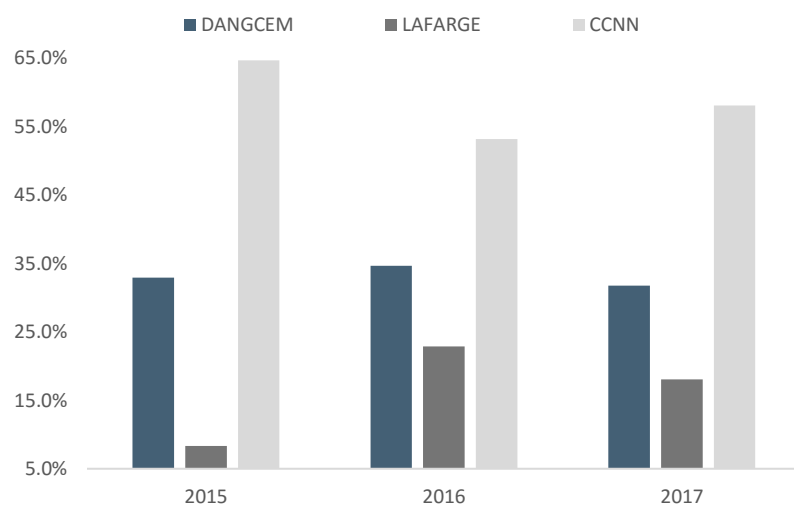


Chart Pack 3

Figure 18: Coverage trend in cost per tonne (N'000)

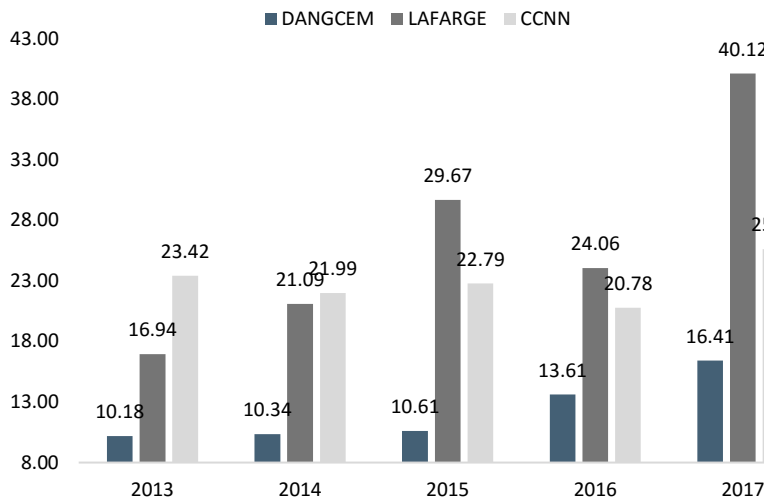


Figure 19: Trend in cement coverage gross profit margin

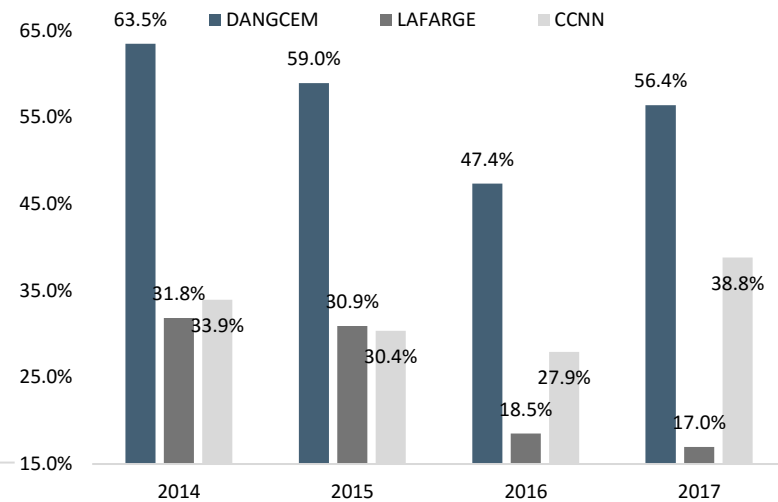


Figure 20: EBITDA position across coverage

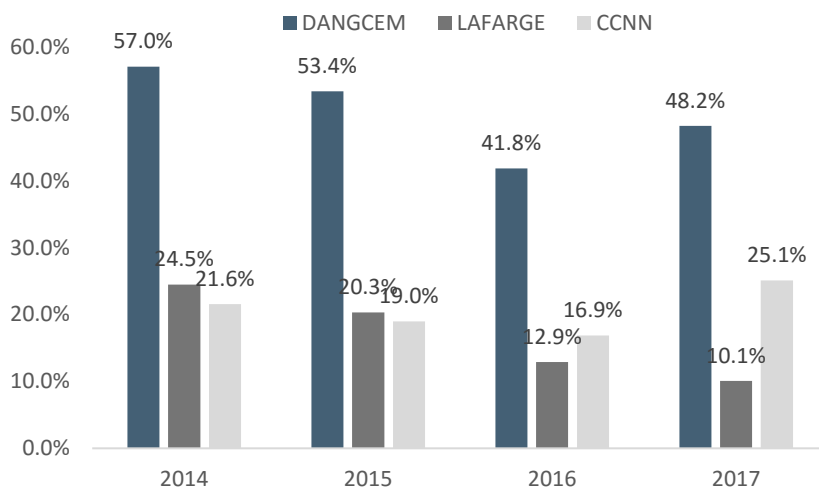


Figure 21: EBIT position across coverage

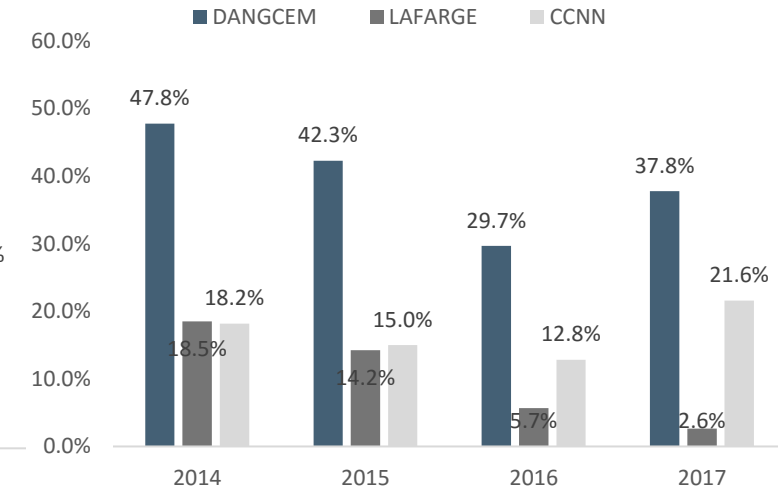


Figure 22: Coverage PBT margin trend

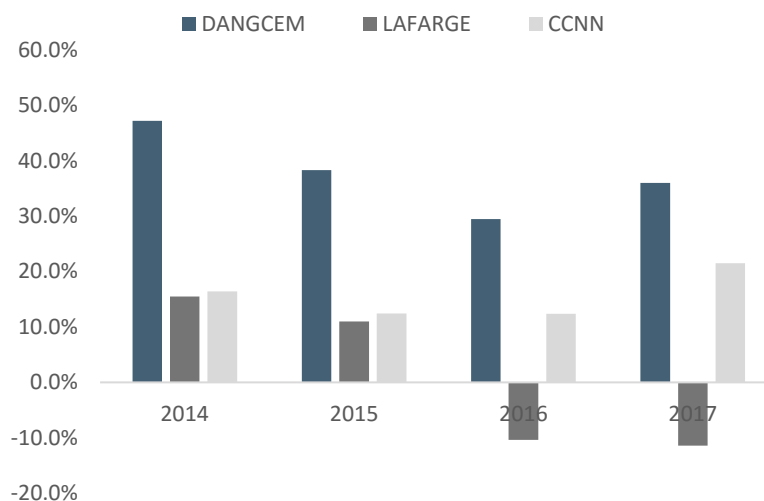
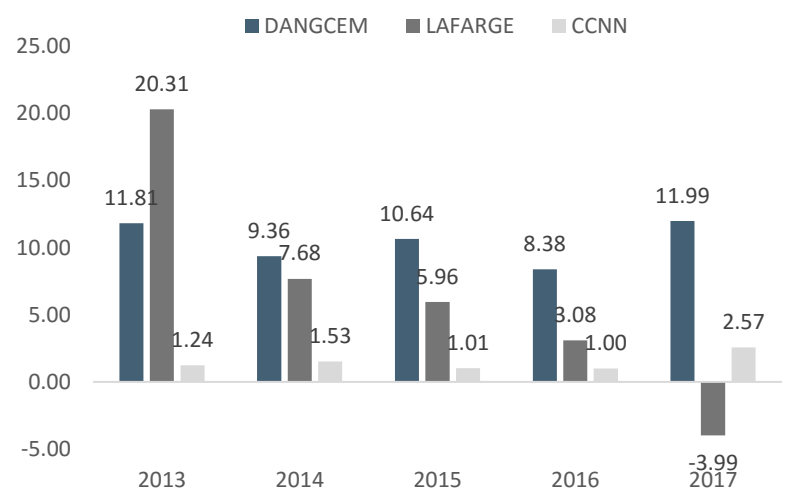


Figure 23: After tax earnings per share across coverage



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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