9M 2019: Dangote Cement

Nigeria | Cement | **Dangote Cement**

20 November 2019

Equities

Feeling the heat of a slowing Nigerian market

Dangote Cement 9M 2019 Revenue declined 0.7% y/y to N679.8bn (annualised; N906.4bn), coming below our FY 2019 forecast of N933.1bn. The decline in Revenue was largely due to subdued performance from its Nigerian operations. The weak topline performance coupled with an increase in Operating Expenses (+22% y/y) and FX loss led to a decline in Pre-tax Profit (down 20.1% y/y to N197.7bn).

Since the start of the year, Dangote cement has struggled to deliver strong top line performance owing largely to weak demand in a low growth, yet competitive Nigerian market. This, alongside unfavorable weather conditions forced the company to embark on sales promotional activities to boost sales volumes. There was a pickup in sales volumes in Q3 (up 9.4% y/y), making us forecast an improvement in sales volumes for the rest of the year driven by the ongoing sales promotions, expectations of favorable weather conditions and improved CAPEX spending from the fiscal authority.

Nonetheless, we have made slight changes to our estimates and the overall impact is a reduction in our target price to N224.4/s from N248.7/s previously. We however maintain our Buy recommendation. At current levels, we believe Dangote Cement is steeply discounted, trading at FY 2019e EV/EBITDA of 6.40x compared to its EM peers average of 10.12x and its 5-year average of 8.05x. We arrived at our target price using a blend of DCF valuation and Relative valuation in the ratio 60:40.

Dangote Cement 9M 2019, Nm

Nm, except mentioned otherwise	9M'19	9M'18	y/y	Q3'19	Q2'19	q/q
Sales	679,791	685,290	-0.8%	212,061	227,573	-6.8%
Cost of Sales (Ex-Dep)	(241,109)	(239,729)	0.6%	(80,476)	(77,475)	3.9%
Gross Profit	**438,682**	**445,561**	-1.5%	**131,585**	**150,098**	**-12.3%**
Other Income	2,048	4,516	-54.7%	820	691	18.7%
Selling and Distribution Expenses	(103,888)	(79,336)	30.9%	(35,355)	(34,414)	2.7%
Administrative Expenses	(33,619)	(33,444)	0.5%	(11,771)	(10,192)	15.5%
EBITDA	**303,223**	**337,297**	**-10.1%**	**85,279**	**106,183**	**-19.7%**
Depreciation and Amortization	71,741	70,437	1.9%	24,293	24,069	0.9%
EBIT	**231,482**	**266,860**	**-13.3%**	**60,986**	**82,114**	**-25.7%**
Net Finance Income/ (Cost)	(33,802)	(19,496)	73.4%	(18,794)	(5,586)	236.4%
Profit before tax	**197,680**	**247,364**	**-20.1%**	**42,192**	**76,528**	**-44.9%**
Share of profit from Associate	0	0	N/A	0	0	N/A
Tax expense	(43,330)	(89,087)	-51.4%	(7,082)	(17,542)	-59.6%
Net Profit	**154,350**	**158,277**	**-2.5%**	**35,110**	**58,986**	**-40.5%**
Net income attributable to equity holders	155,107	157,710	-1.7%	35,607	59,186	-39.8%
Diluted EPS	9.10	9.25	-1.7%	2.09	3.47	-39.8%

Margins:	9M'19	9M'18	y/y	Q3'19	Q2'19	q/q
Gross margin	64.5%	65.0%	-0.5ppts	62.1%	66.0%	-3.9ppts
EBITDA Margin	44.6%	49.2%	-4.6ppts	40.2%	46.7%	-6.4ppts
PBT Margin	29.1%	36.1%	-7.0ppts	19.9%	33.6%	-13.7ppts
Net margin	22.7%	23.1%	-0.4ppts	16.6%	25.9%	-9.4ppts

Source: Company, CSL Research.

Recommendation	**Buy**
Target Price	**N224.4**
Closing Price	**N144.9**

*Price as at 19 November

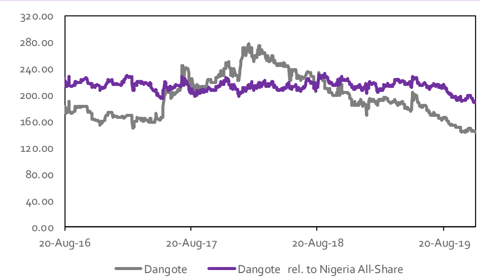
Key data

Year to December, N'bn

	2017	2018	2019e	2020e
Sales	805.6	901.2	922.3	962.1
EBITDA	382.9	435.2	418.5	441.6
EBIT	304.2	338.7	322.9	342.8
PBT	289.6	300.8	277.1	293.4
Net Profits	204.2	390.3	235.6	249.4
EPS, N	12.0	22.9	13.8	14.6
EV/EBITDA	6.9	6.1	6.4	5.9
PE	12.1	6.3	10.5	9.9
Dividend Yield	7.2%	11.0%	6.7%	7.1%

Market cap.	N2.45trn (US$6.76bn)
Free float	14.7%
Bloomberg	DANGCEM NL
Reuters	DANGCEM.LG

Three-year graph



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Faltering demand in Nigerian Operations pressures Group Revenue

Dangote Cement's 9M 2019 Revenue declined 0.8% y/y to N679.8bn owing to weaker than expected Revenue (down 0.7% y/y to N467.9bn) from its Nigerian operations (accounting for 69% of group Revenue as at 9M 2019) amidst the flattish Revenue (down 0.5% y/y to N213.2bn) from its Pan African operations (accounting for 31% of group Revenue).

On a quarterly basis, Group Revenue declined 6.8% q/q-again this was largely due to weaker Revenue from Nigerian operations (down 12% q/q in Q3) which masked the growth in Revenue (5% q/q) from Pan African operations. Management however noted that its promotional activities reversed five months (Feb to June) of negative growth and drove strong double-digit increase in Nigerian volumes in Q3, despite the heavy downpour in the period. Management further disclosed that September sales were impacted by the closure of Nigeria's borders, which depressed export sales. Notably, improved sales volumes in Q3 enabled a turnaround of Nigerian volumes (including export sales) in achieving a marginal growth of 0.6% y/y in 9M 2019 from the negative growth of 2.8% as of H1 2019.

Promotional activities, better weather conditions to buoy Q4 sales volumes in Nigerian Operations

Based on our expectations of a continuation of the ongoing sales promotional activities by the firm, favorable weather conditions (as the harmattan season kicks off) coupled with the increased CAPEX spending as the government accelerates budgetary allocations for infrastructure projects (in line with historical trends), we believe sales volumes in Nigeria will show improvement in Q4. Additionally, we expect the route to market strategy of the firm evident in the increase in Haulage costs (up 26% y/y as at 9M) to support volume growth. We forecast volumes to improve in Q4 2019e by +19% q/q. Notwithstanding, we have reduced our FY 2019 estimate for volume growth given the weaker than expected performance in 9M 2019- we now project a 3% y/y volume growth (Previously; 7%) in Nigerian operations (excluding exports) to 14.0MT (Previously; 14.35MT).

Lower realized net prices mask growth in Pan African sales volumes

Sales volumes for its Pan-African Operations grew 1.7% y/y to 7.1MT in 9M 2019. Revenue however declined marginally by 0.5% y/y to N213.2bn, owing to the fall in the currencies of some African countries which led to reduced net prices following sales conversion to Naira. The soft growth in sales volumes was also caused by depressed economic conditions, power constraints as well as competition in South Africa, Cameroon and Ethiopia. The weaknesses in these regions outweighed the strong growth in sales volumes recorded in Tanzania (up 106% y/y to 842kt), Sierra Leone (up 108% y/y to 173kt), Senegal (up 7.9% y/y to 1.1MT), Congo (up 12% y/y to 173kt) and Zambia (up 1.6% y/y to 780kt). We expect further growth in these countries, supported by increased infrastructure spending by their various governments coupled with the competitive pricing implemented by the company.

Based on management guidance, we think the challenges in South Africa (weak infrastructure spending and a depressed market), Cameroon (continuous security challenges in the North West and South West regions, resulting in reduced activity) and Ethiopia (larger government projects constrained by a lack of foreign currency), will remain in the short to medium term. Overall, we project Pan-African volumes to grow by 1.3% y/y (lower than 9M run rate of 1.7% y/y) to 9.5MT in 2019e from 9.4MT in 2018.

We forecast Group sales of 24.2MT in 2019e, translating to a growth of 3% over 2018. Accordingly, we estimate Group Revenue to grow by 2% y/y (previous forecast; 3%) to N922.3bn in 2019e.

Increased spending on sales and promotional activities pressures margins

Cost of Sales (adjusted for depreciation) increased marginally, up 0.6% y/y and 3.9% q/q, supported by lower material cost and energy cost. However, Gross Margin declined by 50 bps to 64.5% in 9M 2019. We have retained our forecast of Gross Margin of 65% in 2019e.

Despite the muted growth in Cost of Sales, a surge in Selling and Distribution Expenses (+30.9% y/y to N103.9bn) pressured EBITDA (declined 10.1% y/y to N302.3bn). Similarly, EBITDA margin declined 4.6ppts to 44.6% in 9M 2019 (vs 46.6% in H1 2019 and 49.2% in 9M 2018). The surge in Selling & Distribution Expenses (adjusted for depreciation) was driven by the increase in Haulage costs (+26% y/y to N80.6bn in 9M 2019) and Advertisement and Promotion cost (+215% y/y to N7.9bn). Management attributed the increase in both cost items to efforts in strengthening consumer loyalty through sales promotions and the pursuit of its route to market strategy, particularly in Nigeria. Although Nigerian volumes have remained broadly constant, management noted that there has been an increase in the proportion of sales distributed by truck to its customers, as opposed to sales by self-collection. However, management kept a lid on Administrative Expenses, as it remained stable (+0.5% y/y). Overall, OPEX grew 22% y/y to N137.5bn in 9M 2019. Similarly, OPEX/Sales ratio increased to N0.20 in 9M 2019 from N0.16 in 9M 2018, implying that the firm spent more in generating N1 of Revenue.

In line with management guidance, we expect OPEX to increase marginally in Q4 compared to Q3 (up 5.6% q/q) as many of the one-off costs incurred in Q3 will not be incurred in Q4. Accordingly, we project OPEX growth of 11% y/y in in 2019e. We have also reduced our 2019e EBITDA marginally to 45% from 46% previously.

Finance Cost rises on FX loss; leverage position still healthy

Net Finance Cost grew 73.4% y/y to N33.8 bn in 9M 2019, owing largely to the surge in Finance Cost (up 32% y/y to N39.8bn) amidst the decline in Finance Income (down 30% y/y to N5.9bn in 9M 2019). The decline in Finance Income was due to the reduction in Cash Balances (down to N91.8bn in 9M 2019 from N166.9bn in FY 2018), owing largely to dividend payment. The rise in Finance Cost was due to a foreign exchange loss of N11bn which according to management was due to exchange loss in Pan-Africa mainly driven by the depreciation of the Ghanaian cedi, the CFA franc and the Sierra Leonean Leone. Additionally, the relative stability of the Naira in 9M 2019, resulted in lower exchange gains that were outweighed by exchange losses in Pan-African operations, thereby creating a net exchange loss in 9M 2019. Notably, the firm obtained loans amounting to N321.8bn as at 9M 2019 following the issuance of commercial papers and made repayments totalling N284.9bn, resulting in a net addition of N36.9bn. The gearing ratio of Dangote Cement remains healthy at 0.46x as at 9M 2019 (FY 2018; 0.35x). Going forward, we expect Finance cost to remain slightly elevated, hence we estimate Finance Cost of N53.4bn in 2019e (FY 2018; N49.8bn).

Slower Momentum in earnings underpins downward revisions to forecast

Pre-tax Profit declined by 20.1% y/y to N197.7bn in 9M 2019. Supported by the lower effective tax rate of 22% in 9M 2019 (vs 36% in 9M 2018), Profit after tax sowed a smaller decline, down 2.5% y/y to N154.4bn in 9M 2019. Consequently, Earnings per share came to N9.10/s in 9M 2019 compared to N9.25/s in 9M 2018.

We highlight that the lower effective tax rate in 9M 2019 was due to the approval by Nigerian Investment Promotion Council (NIPC) of the two-year Pioneer Status Incentive (PSI) extension made by Dangote Cement on Ibese production lines 3 & 4 and Obajana production line 4. In prior years, the firm had made provisions for tax charge on profits that resulted in a 28% effective tax rate in Nigeria. Following the approval of the PSC extension, the effective tax rate for Nigeria stood at 17% for 9M 2019. We recall that the firm reported a tax credit of N89.52bn in FY 2018, which supported the PAT growth of 91.1% y/y to N390.33bn. Consequently, the firm declared a DPS of N16, translating to a payout ratio of 70%. We anticipate a similar payout ratio in FY 2019, hence we forecast DPS of N9.7, based on our FY 2019e EPS of N13.8

Following the downward revisions to our volume forecasts for Nigeria (-3%) amidst our expectation of slightly weaker margins due to price discounting measures adopted by the firm to boost sales volumes, we have cut our FY 2019 Revenue forecast for the Group (-1.2%). Consequently, we have revised down our FY 2019e Profit before tax estimate to N277.1bn (Previously; N299.6bn). Our revised PAT forecast translates to an EPS of N13.8 (Previous estimate; N13.2).

Key Forecast Changes

	Previous forecast	New Forecast	Change
Sales 2019e, Nm	933,091	922,278	-1.2%
Sales 2020e, Nm	1,005,171	962,076	-4.3%
Sales 2021e, Nm	1,087,352	1,002,927	-7.8%
EBITDA 2019e, Nm	433,037	418,488	-3.4%
EBITDA 2020e, Nm	474,795	441,600	-7.0%
EBITDA 2021e, Nm	521,090	465,065	-10.8%
Net Profits 2019e, Nm	295,005	276,958	-6.1%
Net Profits 2020e, Nm	326,152	293,200	-10.1%
Net Profits 2021e, Nm	368,181	317,022	-13.9%
Earnings per Share 2019e, N	13.16	13.81	5.0%
Earnings per Share 2020e, N	14.55	14.63	0.5%
Earnings per Share 2021e, N	16.42	14.14	-13.9%
Nigeria Volumes 2019e	14.3	14.0	-2.7%
Nigeria Volumes 2020e	15.8	14.7	-7.0%
Nigeria Volumes 2021e	17.4	15.4	-11.4%
Pan African Volumes 2019e	8.9	9.5	6.8%
Pan African Volumes 2020e	9.1	9.7	6.2%
Pan African Volumes 2021e	9.4	10.0	7.0%
Group Volumes 2019e	23.2	24.2	4.0%
Group Volumes 2020e	24.9	25.1	0.7%
Group Volumes 2021e	26.8	26.2	-2.3%

Source: CSL Research.

Valuation; BUY rating maintained

We have made slight revisions over our forecast years (2019e-2022e) and the overall impact is a reduction in our target price to N224.4/s from N248.7/s previously. We however maintain our Buy recommendation. At current levels, we believe Dangote Cement is steeply discounted, trading at FY 2019e EV/EBITDA of 6.40x compared to its EM peers average of 10.12x and its 5-year average of 8.05x. We arrived at our target price using a blend of DCF valuation and Relative valuation in the ratio 60:40.

Dangote Cement forecasts, Nm

Dangote Cement

Dec year-end; N million (except where stated)

Income statement	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Turnover	615,103	805,582	901,213	933,091	1,005,171	1,087,352	1,205,043
Gross profit (ex depreciation)	**342,532**	**517,246**	**590,324**	**610,514**	**666,219**	**727,819**	**826,023**
Total opex	(170,581)	(218,251)	(261,848)	(275,569)	(297,529)	(320,860)	(346,194)
Other income	10,542	5,213	10,222	3,067	3,097	3,128	3,160
EBIT	**182,493**	**304,208**	**338,698**	**338,012**	**371,787**	**410,087**	**482,989**
EBITDA	257,243	388,147	435,261	433,037	474,795	521,090	602,498
Net interest	(1,564)	(16,785)	(38,455)	(38,363)	(38,085)	(37,219)	(36,302)
PBT	**180,929**	**289,590**	**300,806**	**299,649**	**333,702**	**372,868**	**446,687**
Taxation	5,695	(85,342)	89,519	(71,916)	(80,089)	(89,488)	(107,205)
Merger Fee	-	-	-	-	-	-	1
Profit after tax	**186,624**	**204,248**	**390,325**	**227,733**	**253,614**	**283,380**	**339,483**

Balance sheet	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Fixed assets	1,159,856	1,198,495	1,177,833	1,213,620	1,246,495	1,271,601	1,296,893
Other non-current asests	64,888	57,089	87,792	88,199	88,610	88,981	89,356
Total non-current assets	**1,224,744**	**1,255,584**	**1,265,625**	**1,301,819**	**1,335,105**	**1,360,582**	**1,386,249**
Stocks	82,903	94,594	106,998	104,285	106,793	113,278	114,225
Trade debtors	26,279	30,155	44,468	40,278	43,538	49,229	52,923
Other debtors & prepayment	78,280	115,496	101,883	115,039	123,925	137,036	155,170
Due from related companies	-	1,608	2,380	1,442	2,072	2,264	2,285
Short term deposits	-	-	-	-	-	-	1
Cash	115,693	168,387	166,896	166,896	170,000	200,000	200,000
Current assets	**303,164**	**410,299**	**428,838**	**427,940**	**446,327**	**501,807**	**524,603**
Total assets	**1,527,908**	**1,665,883**	**1,694,463**	**1,729,759**	**1,781,432**	**1,862,389**	**1,910,852**
Deferred taxation	43,695	116,898	83,350	84,184	85,025	85,876	86,734
Long term loans	152,475	242,894	125,725	123,771	124,748	124,259	124,504
Other	22,146	4,255	3,269	6,058	7,430	8,816	56,877
Non-current liabilities	**218,316**	**364,047**	**212,344**	**214,012**	**217,203**	**218,951**	**268,115**
Bank overdrafts	-	-	-	-	-	-	-
Trade creditors	83,164	78,561	86,265	88,377	92,864	98,502	103,841
Other creditors	185,802	192,160	144,705	186,618	201,034	217,470	241,009
Dues to related companies	-	-	-	-	-	-	-
Short term debts	220,300	144,783	220,128	216,706	218,417	217,562	217,990
Taxation	18,220	63,901	9,223	6,619	5,605	5,674	5,818
Other	18,307	41,071	35,185	35,889	36,606	37,339	38,085
Current Liabilities	**525,793**	**520,476**	**495,506**	**534,209**	**554,526**	**576,547**	**606,743**
Share capital	8,520	8,520	8,520	8,520	8,520	8,520	8,520
Share premium	42,430	42,430	42,430	42,430	42,430	42,430	42,430
Other reserve	-	-	-	-	-	-	-
Revenue reserve	759,320	717,780	924,177	1,005,762	1,149,090	1,286,805	1,448,859
Non controlling interest	(12,925)	12,630	11,486	16,451	21,979	28,157	35,558
Total shareholders' funds	**797,345**	**781,360**	**986,613**	**1,073,163**	**1,222,019**	**1,365,912**	**1,535,367**

VALUATION	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Price to earnings	15.3x	14.0x	7.3x	12.6x	11.3x	10.1x	8.4x
Dividend yield	4.8%	5.1%	6.3%	9.5%	4.9%	5.9%	7.1%
EV / Sales	7.4x	5.7x	5.1x	4.9x	4.5x	4.2x	3.8x
EV / EBITDA	17.8x	11.8x	10.5x	10.6x	9.6x	8.8x	7.6x
EV / EBIT	25.1x	15.0x	13.5x	13.5x	12.3x	11.2x	9.5x
Price to book value	3.6x	3.7x	2.9x	2.7x	2.3x	2.1x	1.9x

Profitability ratios	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Gross margin	55.7%	64.2%	65.5%	65.4%	66.3%	66.9%	68.5%
EBIT margin	29.7%	37.8%	37.6%	36.2%	37.0%	37.7%	40.1%
EBITDA margin	41.8%	48.2%	48.3%	46.4%	47.2%	47.9%	50.0%
PBT margin	29.4%	35.9%	33.4%	32.1%	33.2%	34.3%	37.1%
Net profit margin	30.3%	25.4%	43.3%	24.4%	25.2%	26.1%	28.2%
ROA av.	14.1%	12.8%	23.2%	13.3%	14.4%	15.6%	18.0%
ROCE av.	15.9%	17.5%	29.3%	16.1%	16.2%	16.6%	18.1%
ROE av.	25.9%	25.9%	44.2%	22.1%	22.1%	21.9%	23.4%
Dividend yield	4.8%	5.1%	6.3%	9.5%	4.9%	5.9%	7.1%

Source: Company, CSL estimates

Analyst Certification

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Important disclosures

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	BUY	HOLD	SELL	Not Rated	Total
Coverage universe	17	10	5	3	33
% distribution	49%	29%	14%	9%	
Investment banking clients	0	1	1	0	2
% distribution	0%	50%	50%	0%	

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Buy: The analyst expects the stock to outperform the Benchmark over the next 12 months or the stated investment horizon.

Hold: The analyst expects the stock to perform in line with the Benchmark over the next 12 months or the stated investment horizon.

Sell: The analyst expects the stock to underperform the Benchmark over the next 12 months or the stated investment horizon.

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Benchmark: The benchmark is the trailing three-year average yield of the 12 month T-Bill plus one standard deviation rounded to the nearest percent.

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	Buy	Hold	Sell	Not Rated	Total
	0	0	1	0	1
% distribution	0%	0%	100%	0%	

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