

Revenue recovers but cost pressures remain

Dangote Sugar in its recently released 9M 2019 financials reported a marginal y/y growth in Revenue to N117.4bn in 9M 2019 from N116.8bn in 9M 2018. However, on a q/q basis, Revenue dipped 12.2% q/q to N37.1bn in Q3 2019 from N42.2bn in Q2 2019. We note Revenue in Q3 2019 came in higher than Q3 2018 Revenue by 13.4% y/y. Meanwhile, Net Income declined 12.0% y/y to N14.7bn for 9M 2019 while declining 6.2% q/q to N3.7bn for Q3 2019.

We have revised our Revenue estimate and consequently profit lines upward given recovery in volumes on the back of reduction in influx of smuggled sugar as well as recovered market share following price increase by key competitor, Golden Penny (Flourmills). However, we note that cost pressures stemming from higher raw sugar price as well as increasing freight costs due to the Apapa wharf gridlock remains a source of concern. Thus, despite an upward revision of our key profit lines, they remain lower than 2018 numbers.

We raise our target price for Dangote Sugar to N13.87/s from N13.27/s previously while we maintain our Hold recommendation on the stock given. We note that investors' interest in the stock has improved over the past few months given attractive dividend yield as well as news of the border closure. We are however less optimistic given the uncertainty around the timeline for the border closure. We arrive at our target price using a combination of the DCF and relative valuations in a ratio of 60:40.

Dangote Sugar in its recently released 9M 2019 financials reported a marginal 0.6% y/y rise in Revenue to N117.4bn in 9M 2019 from N116.8bn in 9M 2018. However, on a q/q basis, Revenue dipped 12.2% q/q to N37.1bn in Q3 2019 from N42.2bn in Q2 2019. However, we note Revenue in Q3 2019 came in higher than Q3 2018 Revenue by 13.4% y/y which suggests the possibility that the company may be feeling the positive impact of the border closure which has limited entry of smuggled sugar.

Across business segments, sales of the 50kg bag category grew 0.9% y/y to N111.2bn while Revenue from retail sugar was up 2.7% y/y to N3.3bn. On the other hand, Revenues from molasses and freight services were down 26.8% y/y and 7.3% y/y. Furthermore, we compared business segment growth in Q3 2019 with the same period in 2018. We observed strong Q3 2019 y/y recovery in the 50kg bag category (up 15.4% y/y) and Retail sales (up 7.3% y/y). The strong rebound reflects reduction in the influx of smuggled sugar.

Cost of Sales (adjusted for depreciation) was up 2.4% y/y to N85.4bn for 9M 2019 from N83.3bn in 9M 2018. The y/y increase in Cost of Sales reflects the mild pressure on raw sugar prices in the first nine months of the year (our benchmark raw sugar price is up 2.2% y/y). This is notably evident in the 4.6% y/y increase in raw material costs. On a q/q basis, Cost of Sales fell by 13.3%, higher than the 12.2% q/q decline in revenue. The decline in Cost of Sales reflects lower volumes as well as softer q/q raw sugar price (Q3 2019 vs Q2 2019). Against this backdrop, Gross Profit fell 4.1% y/y to N32.1bn in 9M 2019 from N33.4bn in 9M 2018. On a q/q basis, Gross Profit was down

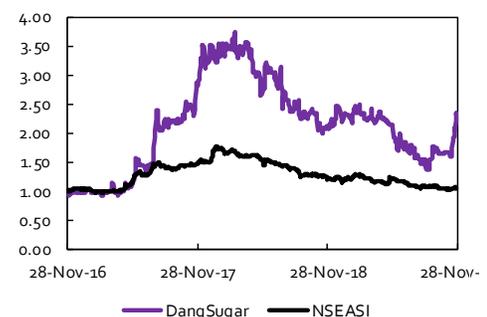
Recommendation	Hold
Target Price	13.87
Closing Price	13.80

*Price as at 28 Nov

Key data

Year to December, Nbn	2018	2019e	2020e	2021e
Sales	150.4	154.4	158.7	161.6
EBITDA	37.2	34.6	35.5	36.2
Net Profits	22.0	19.4	21.3	21.5
EPS, N	1.85	1.63	1.79	1.80
PE Ratio	7.5x	8.5x	7.7x	7.7x
EV/EBITDA	3.4x	4.2x	4.1x	4.0x
Dividend yield	8.3%	7.2%	7.9%	8.0%
Market cap.	N162.6bn (US\$448.0m)			
Free float	26.9%			
Bloomberg	DANGSUGA NL			
Reuters	DANGSUG.LG			

Three-year graph



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8.6% to N9.0bn in Q3 2019 from N9.9bn in Q1 2019. Gross margin was 27.3% in gM 2019, 1.3ppts lower than the 28.6% reported for gM 2018

Dangote Sugar, gM 2019, Nm

Nm, except where mentioned otherwise	gM'19	gM'18	y/y	Q3'19	Q2'19	q/q
Revenue	117,425	116,756	0.6%	37,061	42,218	-12.2%
Cost of Sales (Ex-Dep)	(85,350)	(83,327)	2.4%	(28,017)	(32,321)	-13.3%
Gross Profit	32,074	33,429	-4.1%	9,044	9,896	-8.6%
Selling and Distribution Expenses (Ex-Dep)	(607.0)	(1,076)	-43.6%	(210)	(219)	-4.2%
Administrative Expenses (Ex-Dep)	(5,332)	(4,809)	10.9%	(2,015)	(1,792)	12.5%
Impairment gains/(losses) on financial assets	-	-	n/a	-	-	n/a
EBITDA	26,135	27,543	-5.1%	6,819	7,886	-13.5%
Depreciation and Amortization	(3,354)	(3,598)	-6.8%	(1,242)	(1,509)	-17.7%
Operating profit	22,781	23,945	-4.9%	5,578	6,377	-12.5%
Other Income	122	341	-64.2%	45	47	-3.9%
Investment Income	594	2,162	-72.5%	6	274	-98.0%
Change in value of biological assets	(443)	(79)	463.2%	327	(343)	-195.3%
EBIT	23,054	26,370	-12.6%	5,956	6,355	-6.3%
Net Finance Cost	(85)	(163)	-47.7%	(19)	(24)	-20.2%
Profit before tax	22,968	26,207	-12.4%	5,936	6,331	-6.2%
Tax expense	(8,266)	(9,498)	-13.0%	(2,210)	(2,359)	-6.3%
Net Profit	14,703	16,710	-12.0%	3,726	3,972	-6.2%
Earnings per share	1.24	1.41	-12.1%	0.31	0.34	-6.2%
Margins:	gM'19	gM'18	y/y	Q3'19	Q2'19	q/q
Gross margin	27.3%	28.6%	-1.3ppts	24.4%	23.4%	1.0ppts
EBITDA Margin	22.3%	23.6%	-1.3ppts	18.4%	18.7%	-0.3ppts
PBT Margin	19.6%	22.4%	-2.9ppts	16.0%	15.0%	1.0ppts
Net margin	12.5%	14.3%	-1.8ppts	10.1%	9.4%	0.6ppts

Source: Company, CSL Research.

Operating Expenses (adjusted for depreciation) grew marginally, up 0.9% y/y to N5.9bn for gM 2019 driven by a 10.9% y/y growth in Administrative Expenses (excluding depreciation) to N5.3bn. On the other hand, Selling & Distribution Expenses was down 43.6% y/y to N607.0m. On the back of lower Gross Profit, EBITDA declined 5.1% y/y to N26.1bn in gM 2019 from N27.5bn in gM 2018. EBITDA margin for gM 2019 was lower by 1.3ppts y/y to 22.3%.

EBIT fell 12.6% y/y to N23.1bn in gM 2019 from N26.4bn in gM 2018 on the back of lower Other Income (down 64.2% y/y to N122.1m) and lower Investment Income (down 72.5% y/y to N593.7m) booked by the company for the period. We note the huge slide in Investment Income which was due to the decline in the company's short-term deposits (down 91.5% y/y to N1.4bn) with financial institutions.

Lower Tax Expense (down 13.0% y/y to N6.1bn) and Net Finance Cost (down 47.7% y/y to N85.2m) cushioned the decline in Net Income. Nonetheless, Net Income was down 12.0% y/y to N14.7bn in gM 2019 from N16.7bn in gM 2018. Earnings per Share (EPS) stood at N1.24/s for gM 2019 compared with N1.41/s in gM 2018.

Outlook: Revenue outlook turns positive in the short term, but cost remains sticky point

Q3 Revenue performance indicates to us that the company may be benefiting from reduction in the influx of smuggled sugar resulting from the border closure. Thus, we anticipate strong recovery in core business units across the B2B segment and B2C channels. Furthermore, we note that that key competitor Golden Penny (Flourmills) raised prices to its B2B customers within the year. Consequently, we observed q/q decline in Sugar Revenue in the period of June - September 2019 for FMN. Meanwhile, Dangote Sugar reported a rebound in Revenue within the same period which signals recovery of market share in Q3 after Q2's weakness. Consequently, we raised our 2019e Revenue forecast by 8.7% to N154.4bn which implies a 2.7% y/y increase over 2018's N150.4bn.

High raw sugar price in 2019 continues to place pressure on raw material cost thus impacting Cost of Sales. Raw material cost as a % of Revenue in 9M 2019 was 56.4% compared with 54.2% in 9M 2018. Furthermore, Freight costs continues to place more pressure, up 9.0%/y/y as gridlock within the Apapa wharf area continues to impact movement of raw materials. We factored this in our model previously, however these pressures have proven slightly worse than we expected. Thus, we revise our modelled 2019e cost margin up by 0.5ppts to 72.5% while adjusting our long-term cost margin forecast higher by 1.3ppts. However, we raise our Gross Profit forecast for 2019e to N42.5bn on the back of projected stronger growth in Revenue. Despite the higher Gross Profit revision, we note it is still a 4.8% decline from 2018 Revenue.

Dangote Sugar, Changes in Forecast, Nm

	Previous forecast	New Forecast	Change
Sales 2019e, Nm	142,077	154,447	8.7%
Sales 2020e, Nm	135,830	158,695	16.8%
Sales 2021e, Nm	131,298	161,612	23.1%
Gross Profits 2019e, Nm	39,781	42,473	6.8%
Gross Profits 2020e, Nm	39,391	43,641	10.8%
Gross Profits 2021e, Nm	38,076	44,443	16.7%
EBITDA 2019e, Nm	33,104	34,565	4.4%
EBITDA 2020e, Nm	33,007	35,548	7.7%
EBITDA 2021e, Nm	31,905	36,201	13.5%
Net Profits 2019e, Nm	19,164	19,457	1.5%
Net Profits 2020e, Nm	20,517	21,375	4.2%
Net Profits 2021e, Nm	19,705	21,567	9.5%
Earnings per Share 2019e, N	1.61	1.63	1.6%
Earnings per Share 2020e, N	1.72	1.79	4.3%
Earnings per Share 2021e, N	1.65	1.81	9.5%

Source: CSL Research

Across Opex lines, we projected Dangote Sugar will be tight on costs as pressure on Revenue and Production costs weigh on profits. However, we observed the company's Opex to sales ratio stood at 5.1% (Prior modelled rate – 4.7%) driven by negative surprise in administrative cost despite lower employee costs. Consequently, we adjust our modelled Opex to sales ratio to reflect 9M run rate. Thus, we forecast a

5.7% y/y growth in Opex to N7.9bn. Despite the upward revision in Opex, we raise our EBITDA forecast to N34.6bn for 2019e on the back of higher Gross profit. Nevertheless, it still implies a 7.0% dip from 2018's N37.2bn.

Following reduction in short term bank deposits which was used to increase inventories, we forecast the company's Investment Income will continue to slide which will be compounded by a moderating yield environment. Thus, we reduce our forecast for Investment Income to No.8bn for 2019e while we maintain Interest Expense at No.2bn implying a 73.7% y/y decline in Net Finance Income. As a result, our Pre-Tax Profit forecast of N29.9bn is a 13.6% y/y decline from 2018's N34.6bn. Overall, we raise our Net Income forecast by a marginal 1.5% to N19.5bn while our 2019e EPS forecast comes to N1.63/s.

Valuation: Fairly priced; HOLD recommendation maintained

Our slight changes to our forecasts result in a marginal uptick in our target price to N13.87/s from our previously communicated N13.27/s. Our target price of N13.87/s implies a modest 0.5% upside potential to Thursday's closing price of N13.80/s. Consequently, we maintain our HOLD recommendation on the stock. Our valuation combines a mix of DCF analysis and relative valuation. Our relative valuation relies on a blend of CSL EM Sugar peers and the company's 5-year EV/EBITDA historical average. The DCF valuation has the greater weighting over relative valuation in a 60:40 proportion.

Dangote Sugar Refinery

Dangote Sugar

December year-end; Nm (unless otherwise stated)

Income Statement	2017	2018	2019E	2020E	2021E	2022E
Revenues	204,422	150,373	154,447	158,695	161,612	164,821
Cost of Sales*	(149,195)	(105,738)	(111,974)	(115,054)	(117,168)	(119,495)
Gross Profit	55,227	44,635	42,473	43,641	44,443	45,326
Operating Expenses (Opex)*	(6,688)	(7,480)	(7,908)	(8,093)	(8,242)	(8,406)
EBITDA	48,539	37,155	34,565	35,548	36,201	36,920
Depreciation and Amortisation	(5,033)	(5,241)	(5,422)	(5,976)	(6,542)	(7,118)
Other Income	402	569	154	159	162	165
EBIT	43,907	32,483	29,298	29,730	29,821	29,966
PBT	53,599	34,601	29,887	30,435	30,656	30,955
Taxation	(13,815)	(12,625)	(10,460)	(9,131)	(9,197)	(9,286)
Net Profits	39,784	21,976	19,426	21,305	21,459	21,668
Minority interest	98	(193)	(154)	(159)	(162)	(165)
EPS, N	3.31	1.85	1.63	1.79	1.80	1.82
DPS, N	1.75	1.15	1.00	1.09	1.10	1.11
Payout ratio	53%	62%	61%	61%	61%	61%
Dividend sum	21,000	13,800	11,944	13,093	13,189	13,318
Number of shares outstanding, m	12,000	12,000	12,000	12,000	12,000	12,000

*Cost of Sales and Opex adjusted for Depreciation and Amortisation

Balance Sheet	2017	2018	2019E	2020E	2021E	2022E
Fixed Assets	59,414	64,256	69,647	74,779	79,551	83,970
Investments	-	-	-	-	-	-
Intangible Assets	3	0	-	-	-	-
Deferred Tax Asset	7,173	7,173	7,173	7,173	7,173	7,173
Other Assets	3	12	12	12	12	12
Non-Current Assets	66,593	71,441	76,832	81,964	86,736	91,155
Inventories	47,656	37,676	35,922	37,460	38,317	39,049
Trade & Other Receivables	20,907	41,330	41,151	42,274	43,241	44,068
Biological Assets	2,807	1,841	1,841	1,841	1,841	1,841
Assets Held for Sale	869	869	869	869	869	869
Cash and Cash Equivalents	41,368	21,582	20,273	22,568	25,173	28,283
Other Assets	14,882	378	378	378	378	378
Current Assets	128,488	103,676	100,434	105,390	109,819	114,489
Total Assets	195,080	175,117	177,266	187,355	196,555	205,644
Trade & Other Payables	75,653	75,653	54,498	48,985	51,081	52,250
Bank Overdraft	-	-	-	-	-	-
Short-term Debt	71	71	45	219	239	261
Current Tax Liabilities	17,717	12,373	12,373	12,373	12,373	12,373
Retirement Benefit Obligation	984	970	970	970	970	970
Other Liabilities	1,239	1,520	1,520	1,520	1,520	1,520
Total current liabilities	95,665	90,587	69,406	64,068	66,183	67,374
Non-current liabilities	6,680	6,736	6,741	6,502	6,241	5,957
Total Liabilities	102,345	97,323	76,147	70,569	72,425	73,331
Share Capital	6,000	6,000	6,000	6,000	6,000	6,000
Share Premium	6,321	6,321	6,321	6,321	6,321	6,321
capital Reserve	-	-	-	-	-	-
Retained Earnings	80,578	87,010	94,492	102,704	110,975	119,325
Minority Interest (MI)	(163)	(356)	(356)	(356)	(356)	(356)
Shareholders' funds	92,736	98,975	106,457	114,669	122,939	131,289

Cash Flow Statement	2017	2018	2019E	2020E	2021E	2022E
Operating Cash Flow	25,927	3,770	20,679	26,011	26,510	27,238
Investing Cash Flow	(6,344)	(8,231)	(10,000)	(10,206)	(10,306)	(10,406)
Financing Cash Flow	(13,200)	(15,325)	(11,987)	(13,510)	(13,600)	(13,722)
Free Cash Flow	32,016	16,177	(6,996)	9,868	14,903	15,197

Source: Company, CSL estimates

Dangote Sugar Refinery

Profitability Ratios	2017	2018	2019E	2020E	2021E	2022E
Gross Profit Margin	27.0%	29.7%	27.5%	27.5%	27.5%	27.5%
EBITDA Margin	23.7%	24.7%	22.4%	22.4%	22.4%	22.4%
Operating Profit Margin	21.3%	21.4%	18.9%	18.6%	18.4%	18.1%
PBT Margin	26.2%	23.0%	19.4%	19.2%	19.0%	18.8%
Net Profit Margin	19.5%	14.6%	12.6%	13.4%	13.3%	13.1%
ROAA	21.7%	11.9%	11.0%	11.7%	11.2%	10.8%
ROCE	49.2%	22.6%	18.7%	19.0%	17.9%	16.9%
ROAE	50.1%	22.9%	18.9%	19.3%	18.1%	17.0%
Dividend Yield	12.7%	8.3%	7.2%	7.9%	8.0%	8.0%
Opex/Sales	3.3%	5.0%	5.1%	5.1%	5.1%	5.1%
Activity Ratios	2017	2018	2019E	2020E	2021E	2022E
Total Asset Turnover	1.1x	0.8x	0.9x	0.9x	0.8x	0.8x
Fixed Asset Turnover	3.6x	2.4x	2.3x	2.2x	2.1x	2.0x
Current Asset Turnover	1.7x	1.3x	1.5x	1.5x	1.5x	1.5x
Inventory Turnover	3.1x	2.8x	3.0x	3.0x	3.0x	4.0x
Cash Turnover	5.4x	4.8x	7.4x	7.4x	6.8x	6.2x
Liquidity Ratios	2017	2018	2019E	2020E	2021E	2022E
Current Ratio	1.1x	1.3x	1.5x	1.6x	1.6x	1.6x
Quick Ratio	0.7x	0.9x	1.0x	1.0x	1.0x	1.1x
Cash Ratio	0.4x	0.4x	0.3x	0.3x	0.3x	0.4x
Solvency Ratios	2017	2018	2019E	2020E	2021E	2022E
Net Debt-to-Equity Ratio	-51%	-43%	-20%	-17%	-18%	-20%
Debt-to-Capital Ratio	2%	2%	1%	2%	1%	1%
Debt-to-Equity Ratio	2%	2%	1%	2%	1%	1%
Debt-to-Assets Ratio	1%	1%	1%	1%	1%	1%
Financial Leverage Ratio	2.6x	2.1x	1.8x	1.7x	1.6x	1.6x
Valuation Multiples	2017	2018	2019E	2020E	2021E	2022E
EV / Sales	0.6x	0.8x	0.9x	0.9x	0.9x	0.9x
EV / EBITDA	2.7x	3.4x	4.2x	4.1x	4.0x	3.8x
EV / EBIT	3.0x	3.8x	5.0x	4.9x	4.8x	4.7x
EV / CE	4.0x	2.4x	1.8x	1.7x	1.5x	1.4x
Price to Earnings	4.2x	7.5x	8.5x	7.7x	7.7x	7.6x
Price to Book Value	1.8x	1.7x	1.6x	1.4x	1.3x	1.3x
Free Cash Flow Yield	19%	10%	-4%	6%	9%	9%
Earnings Yield	24%	13%	12%	13%	13%	13%
Y/y growth	2017	2018	2019E	2020E	2021E	2022E
Revenues	20.4%	-26.4%	2.7%	2.8%	1.8%	2.0%
Gross Profit	104.3%	-19.2%	-4.8%	2.8%	1.8%	2.0%
Marketing & Distribution Expenses	-11.0%	-13.6%	-17.9%	18.6%	1.8%	2.0%
Administrative Expenses	14.9%	17.0%	9.3%	0.5%	1.8%	2.0%
EBITDA	131.9%	-23.5%	-7.0%	2.8%	1.8%	2.0%
EBIT	160.6%	-25.6%	-10.4%	1.5%	0.3%	0.5%
PBT	173.3%	-35.4%	-13.6%	1.8%	0.7%	1.0%
Net Profits	176.4%	-44.8%	-11.6%	9.7%	0.7%	1.0%
EPS	3.31	1.85	1.63	1.79	1.80	1.82
DPS	1.75	1.15	1.00	1.09	1.10	1.11

Source: Company, CSL estimates

Analyst Certification

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Important disclosures

Ratings and Target Price History

Dangote Sugar Refinery

Date	Price (N)	Old Target (N)	New Price Target (N)	Old recommendation	New recommendation
10-May-13	7.9	8.6	8.6	Hold	Hold
27-Jul-13	11.7	8.6	7.1	Hold	Sell
29-Oct-13	11.7	8.6	7.1	Hold	Sell
29-Jul-13	11.7	7.1	7.1	Sell	Sell
15-Jan-14	12.2	7.1	7.6	Sell	Sell
30-Apr-14	9.5	7.6	UR	Sell	UR
2-Sep-14	7.6	UR	UR	UR	UR
10-Jul-15	6.4	UR	4.8	UR	Sell
26-Oct-17	14.6	4.8	18.4	Sell	Buy
15-Jan-18	21.8	18.4	20.3	Buy	Hold
30-Mar-18	21.8	20.3	25.6	Hold	Buy
24-Jul-18	16.9	25.6	21.3	Buy	Buy
31-Oct-18	14.3	21.3	21.1	Buy	Buy
13-May-19	13.8	21.1	14.5	Buy	Hold
13-May-19	9.9	14.5	13.3	Hold	Hold
29-Nov-19	13.8	13.3	13.9	Hold	Hold

CSL Research Ratings Distribution

	BUY	HOLD	SELL	Not Rated	Total
Coverage universe	16	11	3	3	33
% distribution	48%	33%	9%	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.
- Price targets:** Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings fall short of estimates.
- Asset allocation:** Asset allocation is the responsibility of the strategy team. The recommended weight (Buy, Hold and Sell) for equities, cash and fixed income instruments is based on a number of metrics and does not relate to a particular size change in one variable.

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- C. FCMB Bank UK or the Group is a market maker in the publicly traded equity securities of the company.
- D. FCMB Bank UK or the Group beneficially owns 1% or more of the equity securities of the company.
- E. FCMB Bank UK or the Group beneficially holds a significant interest of the debt of the company.
- F. FCMB Bank UK or the Group has been lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of securities of the company.
- G. The company is a client of the investment banking division of the Group.
- H. FCMB Bank UK or the Group has lead managed or co-lead managed a public offering of the securities of the company within the last 12 months.
- I. FCMB Bank UK or the Group has received compensation for investment banking services from the company within the last 12 months.
- J. FCMB Bank UK or the Group expects to receive, or intends to seek, compensation for investment banking services from the company during the next 3 months.

Companies from which FCMB Bank UK or the Group's investment banking division has received compensation in the last 12 months

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

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