Dangote Cement Plc

DUNN LOREN MERRIFIELD

Update: Our visit to Dangote Cement's Ethiopia plant

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Price:	
- Current	**₦172.0***
- Target	**₦208.68**
Recommendation:	**BUY**

** As at Thursday, July 02, 2015*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-14.09%/-28.83%
52-week range	₦141.90- ₦250
Average daily vol./val.	778,589/₦133.72m
Shares Outstanding (mn)	17,040
Market Cap. (₦'mn)	2,930,967($17,446mn)
EPS, ₦- 12months trailing	9.36
DPS, ₦- FY2014	6.00
FCF, ₦- FY2014	0.00

Source: Bloomberg, NSE, DLM Research

Fig. 3: Key ratios

	1Q' 2015	1Q'2014
Gross profit margin	65.14%	65.30%
Net profit margin	59.81%	45.98%
Equity multiplier	1.61x	1.66x
Asset turnover	0.11x	0.11x

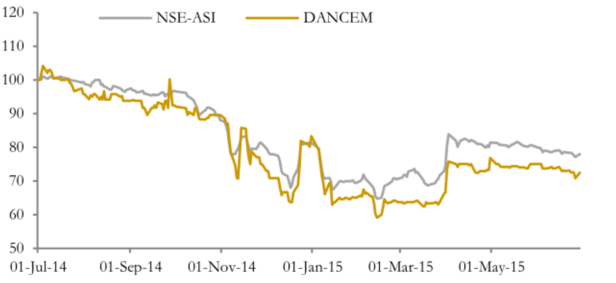
Source: Company report, NSE, DLM Research

Fig. 4: Valuations

	FY2014	FY2015E	FY2016F	FY2017F
P/Sales	7.48x	6.24x	5.42x	4.84x
P/E	18.38x	14.76x	14.16x	12.66x
PEG	0.00	0.00	0.00	0.00
EV/Sales	8.00x	6.45x	5.60x	4.98x
P/B	4.79x	3.99x	3.82x	3.67x
ROE	26.05%	27.02%	26.96%	28.97%
ROA	16.20%	18.10%	17.81%	19.03%
Div. Yield	3.49%	4.07 %	4.07%	4.07%

Source: Company annual report, DLM Research

Fig. 5: Dangote Cement vs. NSE, 52-wk movement (rebased)



Source: NSE, DLM

Key highlights

While the Dangote Cement brand is facing stiff competition in Nigeria, our perception is that it is approaching a "hero" status in Ethiopia. Having only started operations in April 2015, the company has taken over as the market leader of the cement sector in Ethiopia. By our estimates, we expect sales volume of 1.1mt with average daily sales of 5,500tons for 2015.

- Clearly, while there has been an increase in cement production in Ethiopia in the last five years, the market is not saturated with its cement deficit of 3.1million metric tonnes per annum (mmtpa). Supportive of this is the infrastructural investment plan of the Ethiopia government. This erases the general belief that the entrance of Habesha Cement with production capacity of 1.4mmtpa which is expected to start production in 2016 will create a cement glut.

- At present, Dangote Cement has set standard of cement production for other producers to follow. The fact that the company is planning to add an additional 2.5mmtpa to the existing plant makes us believe it is positioning its brand and products for sustained market leadership in the years ahead. In our opinion, this is achievable given Dangote Cement's economies of scale versus the relatively weak competition. For example, most of its competitors are still running on old and weak plants with an average age of 32 years.

- Given it current market dominance, we have come to the conclusion that the Ethiopia market will over time be one of the group's largest markets. The fact that the company can source most of its raw materials locally with kilometres from the factory makes Ethiopia a good investment ground for the company.

- While sales in other Africa operation has picked up, we anticipate that the Nigeria operation will be a drag on the group's performance for H1'15, given the notable weak macro story and shut-down in gas supply which paralysed operations during the most part of the period. Although, we are optimistic the shortfall will be offset from the expected improvement in sales from other Africa operations.

- The company could be in Ethiopia for more than 100 years given its 100 years mining license issued for Limestone mining. Limestone, which is the company's largest raw materials, is being transported via conveyor belt from the mines to the factory, which saves transport cost.

- **While the Nigeria operation has been the major driver of the group's earnings, in the near term, we expect over 35% contribution from other Africa operations.**

- **While we have considered the on-going pan-African expansion drive to push up the company's valuation, investors' are most likely to find a more rewarding outcome by considering the expectations of economic returns from the investment and assets.**

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The Ethiopia macro story.

There is more good news on the Ethiopia economic growth front. The country is sub-Saharan Africa's fifth biggest economy. Just as the Nigeria economy largely depends on oil, the Ethiopia economy is largely dependent on Agriculture accounting for ~43% of GDP growth. Although, the service sector have seen some growth in the recent past. The county's major exports are coffee and gold. The country's economic growth is principally attributed to accelerated government projects aimed at achieving its Millennium Development Goals (MDGs) as the country aims at achieving a middle-income status by 2025.

Between 2013 and 2014, the GDP growth of Ethiopia was ~10.6%, above that of Kenya with 4.8%, and Rwanda with 7.9%. Ethiopia's transformational plan is to strengthen the manufacturing sector as the country is emerging as a manufacturing hub in the region especially with respect to agro processing, textiles, leather products and cement which is seen as a key growth driver.

One of the major economic objectives of the Government of Ethiopia is pursuing a policy of maximizing revenue of live animal and meat exports. The government's Growth and Transformation Program (GTP), launched in 2010-2011, has established annual export goals of 111,000 metric tons of meat and 2,000,000 live animals by 2015.

Dangote Cement: Ethiopia Plant Overview.

The plant was built at a cost of $500million located near Muger town, 87kilometres from Addis Ababa in West shoa zone. The plant has a production capacity of 5,000 tons/day and 2.5mmtpa.while its crushers for minerals such as limestone, coal and gypsum have a capacity of 1,400tons, 200tons and 200tonnes each per hour. The plant has 2 cement mills with 150tonnes capacity per hour and 6 packers with 120tonnes capacity per hour per line. At present, the plant is producing 60% 32.5-grade cement and 40% 42.5-grade cement.

The plant has two conveyor belts covering a distance of 5km from the crusher with capacity of 1600tonnes per hour while the Clinker has storage capacity of 80,000 tonnes

"The plant has production capacity of 5000 tons/day and 2.5mtpa covering 134.2 land Hectares with Altitude of 2600M above Sea Level.

Mining.

Limestone - Dangote Cement has been granted limestone mining licence for 375Ha. Clay and Gypsum mines licences have also been granted for 265Ha and 151.8Ha and mining has commenced. Mining licence for Basalt, Silica Sand and Pumice have equally been granted, while mining is under progress. The composition of cement is: Limestone 85%; Gypsum 5%; Clay 5% and; Silica Sand 5%.

Sources of raw materials

We note that virtually all of Dangote Cement's raw materials are sourced locally in Ethiopia, with the exception of coal. The company imports coal for clinker and packaging bags from South Africa and Egypt respectively.

Power supply.

The company derives its power supply (40mw) from the national grid which the plant runs strictly on, although, only the kiln runs on coal. The company has a 132KV transmission line which is dedicated for the plant.

Current products.

At the moment, the company manufactures two cement types i.e.

1. OPC-42.5. This is a high grade cement use for heavy construction work such as dams and bridges. Government is the major demand driver as a result of improved infrastructure development.

2. PPC-32.5. Used for block-making, plastering, flooring, and light structural works. The major demand drivers are the public.

Distribution, sales and price.

Based on our observation, the company currently has five major distributors in Ethiopia. While the company has purchased and expecting the supply of

640 trucks to aid distribution, current distribution is done by individual distributors. The company currently has an average daily sales level of 5,500tons. It is currently loading about 170 trucks daily –800bags per truck. Prices of cement are relatively the same but vary from region to region depending on distance to the factory. Dangote Cement currently produces the highest quality of cement in Ethiopia and this has boosted demand for its products.

"The company have average daily sales of 5500tons. It currently loading about 170 trucks daily –800bags per truck.

Export opportunities.

We note that the company is looking to expand distribution to countries with joint border with Ethiopia such as; Djibouti, Somalia, Eritrea, Kenya and South Sudan

Competitors;

The company has four major competitors with an average plant age of 32 years with the following production capacity: Derba 5,000 tons/day; Mugher 4,000tons/day; Moseba 3,500 tons/day; National Cement 3,500 tons/day. There are others 17 smaller producers with production capacity of 250-400 tons/ day. These are relatively old plants creating gas emission above the regulatory limit of 50mg while Dangote Cement's gas emission currently stands at ~30mg, which is far below the regulatory limit. As a result of the large gas emission by these smaller competitors, the government is considering stopping their operations since they cannot compete with cement quality and modern equipment. This will open up more opportunities for Dangote Cement in Ethiopia.

The market.

The industry has a total installed capacity of 11.8mmtpa and annual production of 8.7mmtpa. The industry is facing several challenges such as production cost, inadequate transport service and unavailability of locally produced packaging materials. Real estate development and the construction boom that started in 2008 are the major demand drivers. This prompted the Ethiopian government to invite local and foreign investors to invest in the cement industry. The average cement production capacity utilization rate is ~65%.

Ethiopia's cement per capita consumption is 62kg in 2014 compared to global average of 500kg and 765 kg for sub-Saharan Africa. The major cement markets are geographically concentrated around Addis Ababa. The Ministry of Industry has stopped issuing license to new operation with the view of avoiding market saturation and price war.

Overview of operations

Operations	Capacity (mt)	Operating	Expected
Obajana- Nigeria	13.25	13.25	
Ibese- Nigeria	12	12	
Gboko- Nigeria	4	4	
Pout -Senegal	1.5	1.5	
Duala-Cameroon	1.5	1.5	
Tema-Ghana	1	1	
Tema-Ghana	1.5		1.5
Abidjan- Ivory Cost	1.5		1.5
Madingou- Rep of Congo	1.5		1.5
Monrovia- Liberia	0.75		0.75
FreeTown- Sierra Leone	0.7		0.7
Aganang- South Africa	1.8	1.8	
Delmas-South Africa	1.5	1.5	
Ndola- Zambia	1.5	1.5	
Mugher- Ethiopia	2.5	2.5	
Kenya	1.5		1.5
Mtwara- Tanzania	3		3
Total	51	40.55	10.45

Expected sales volume for FY'15 (mmt)	2015	2016	2017	2018
Nigeria	11,000	11,500	11,550	11,500
Other Africa operations	4,603	5,000	5,800	6,000
Total	15,603	16,500	17,350	17,500
Exp. Average price/tone	29,000	29,000	28,000	28,000
Exp. Revenue from cement sales (₦'bn)	452,487,000	478,500,000	485,800,000	490,000,000

Fig. 26: Statement of Profit or Loss, ₦'mn

	FY2014	FY2015E	FY2016F	FY2017F
Turnover	391,639	469,967	540,462	605,317
Change %		20.00%	15.00%	12.00%
Cost of Sales	(143,058)	(176,238)	(205,375)	(230,021)
Change %		23.19%	16.53%	12.00%
Gross Profit	248,581	293,729	335,086	375,297
Change %		18.16%	14.08%	12.00%
SG&A	(65,088)	(84,594)	(102,688)	(111,984)
Change %		29.97%	21.39%	9.05%
EBITDA	219,759	251,432	281,040	323,845
Change %		14.41%	11.78%	15.23%
Core operating Profit	183,493	209,135	232,399	263,313
Change %		13.97%	11.12%	13.30%
Other Operating Income	3,609	5,170	6,486	6,658
EBIT	187,102	214,305	238,884	269,971
Change %		14.54%	11.47%	13.01%
Profit Before Taxation	184,689	228,205	237,835	266,116
Change %		23.56%	4.22%	11.89%
Income tax expenses	(25,187)	(29,667)	(30,919)	(34,595)
Profit After Taxation	159,502	198,538	206,917	231,521
Change %		24.47%	4.22%	11.89%

Source: Company's annual reports, DLM Research

Fig.27: Statement of Financial Position (N,m)

	FY2014	FY2015E	FY2016F	FY2017F
Non-current assets:				
Fixed Assets	747,793	778,465	798,465	808,465
Other non-current assets	99,823	122,191	140,520	157,382
Total noncurrent assets	847,616	900,656	938,985	965,847
Current assets:				
Inventories	42,688	32,350	37,699	42,223
Trade Debtors	15,640	18,026	17,769	19,901
Prepayment	58,183	70,495	81,069	90,798
Bank and Cash Balances	20,593	70,495	81,069	90,798
Other current assets	-	4,700	5,405	7,264
Total current assets	137,104	196,066	223,011	250,983
Total Assets	984,720	1,096,723	1,161,996	1,216,830
Current Liabilities:				
Overdraft	856	856	856	856
Trade payable	100,930	125,539	146,295	163,850
Short term loan	110,640	60,434	60,434	60,434
Other current liabilities	21,371	29,138	33,509	37,530
	233,797	215,967	241,094	262,670
Non-current Liabilities				
Long term loans	110,640	110,640	115,640	115,640
Other noncurrent Liabilities	27,944	35,248	37,832	39,346
	138,584	145,888	153,472	154,986
Total Liabilities	372,381	361,855	394,566	417,656
Shareholders' equity	612,339	734,868	767,430	799,175

Source: Company's annual reports, DLM Research

Fig. 28: Profitability & return

	FY2014	FY2015E	FY2016F	FY2017F
Gross profit margin	63.47%	62.50%	62.00%	62.00%
Operating profit margin	47.77%	45.60%	44.20%	44.60%
Net profit margin	40.73%	42.25%	38.29%	38.25%
ROCE	24.92%	24.33%	25.94%	28.29%
ROE	26.05%	27.02%	26.96%	28.97%
ROA	16.20%	18.10%	17.81%	19.03%

Source: Company's annual reports, DLM Research

Fig. 29: DuPont Analysis

	FY2014	FY2015E	FY2016F	FY2017F
Total assets turnover	0.40x	0.43x	0.47x	0.50x
Net income margin	40.73%	42.25%	38.29%	38.25%
Equity multiplier	1.61x	1.49x	1.51x	1.52x
ROE	26.23%	27.03%	27.17%	29.07%

Fig. 30: Efficiency ratios

	FY2014	FY2015E	FY2016F	FY2017F
Fixed assets turnover	0.52x	0.60x	0.68x	0.75x
Current assets turnover	2.86x	2.40x	2.42x	2.41x
Total assets turnover	0.40x	0.43x	0.47x	0.50x
Inventory turnover	2.03x	2.35x	5.45x	5.45x
Receivables turnover	25.04x	26.07x	30.42x	30.42x
Payables turnover	1.42x	1.40x	1.40x	1.40x
Days inventory outstanding	108.91	67	67	67
Days collection outstanding	14	14	12	12
Days payable outstanding	257	260	260	260
Operating cycle (days)	0.00	0.00	0.00	0.00

Source: Company's annual reports, DLM Research

Fig. 31: Liquidity ratios

	FY2014	FY2015E	FY2016F	FY2017F
Working capital (₦'mn)	(96.70)	(19,901)	(18,083)	(11,687)
Current ratio	0.59	0.91	0.92	0.96
Quick ratio	0.40	0.76	0.77	0.79
Cash ratio	0.09	0.33	0.34	0.35

Source: Company's annual reports, DLM Research

Fig. 32: Long-term solvency & stability ratios

	FY2014	FY2015E	FY2016F	FY2017F
Gearing	0.00%	0.00%	0.00%	0.00%
Equity multiplier	1.61x	1.49x	1.51x	1.52x
Total debt-to-equity	0.36x	0.23x	0.23x	0.22x
Total debt-to-assets	22%	16%	15%	14%
Proprietary	62%	67.01%	66.04%	65.68%
Interest coverage	0.00x	0.00x	0.00x	0.00x
Cash coverage	0.00x	0.00x	0.00x	0.00x

Source: Company's annual reports, DLM Research

Fig. 33: Shareholders' investment ratios

	FY2014	FY2015E	FY2016F	FY2017F
EPS, ₦	9.36	11.65	12.14	13.59
DPS, ₦	6.00	7.00	7.00	7.00
Pay-out	64.10%	60.08%	57.65%	51.52%
FCFPS, ₦	0.00	0.00	0.00	0.00

Source: Company's annual reports, DLM Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management. This equity research report qualifies as an initiation research report on the company whose stock has been analysed, hence the level and depth of details documented herein. Further updates on this company, or its stock, or both, will be communicated to investors via brief research notes or earnings-flash emails, as occasion demands.

Our recommendation is slightly biased towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials. The investment rank or grade given to a company is an alphabet which falls in the set {A+, A, B, C+, C, D, E, F}, where

- Grade A+ means the company has done excellently well on all fronts that form the basis of our consideration, and has a strongly positive performance outlook.
- Grade A means the company's performance is of high quality, but can be made better. Outlook for the company is positive.
- Grade B means the company performed marginally above average, at least relative to its peers, but faltered on some fronts. Outlook is weakly positive.
- Grade C+ means the company's performance is exactly average; outlook is neither positive nor negative.
- Grades C and D indicate that dwindling performance is the company's fate at the current time. Outlook for the company is mildly negative.
- Grades E and F mean the company is headed for towards jeopardy, which might impair its ability to continue as a going concern. Outlook for the company in this case is alarmingly negative.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profitability margins, growth, economic profitability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to <30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

Source: Company Financials, DLM Research

In our analysis, we distinguish between fair value and price target. Fair value is our opinion of the actual fundamental worth of a stock, irrespective of what the market thinks of the stock or what investors are willing to pay for it. Value investors purchase stocks way below their fair values, while income investors might purchase stocks at their fair values at the very maximum.

Price target, on the other hand, is the estimated price we opine the stock will trade in the near to medium term. It is the price that, if realized, could result in the best investment returns, given prevailing market conditions. It gives an idea of the price other investors might be willing to pay for a stock regardless of its actual worth. We employ fair value, price target or both to determine a stock's upside or downside potential.

A BUY recommendation directly means what it says; purchase the stock according to your wallet and appetite for risk. A SELL recommendation prompts investors to exit their positions in the stock, as the analyst believes the stock is not worth investors' time and capital commitment. A HOLD recommendation generally tells investors to do nothing; if you have not bought the stock, do not buy it and if you have bought it, do not sell it.

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