Dangote Sugar Refinery Plc

Nigeria | Equities | Consumer Goods | August 4, 2015 PAC RESEARCH

Rising finance cost impacts earnings

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Price:

- Current	**₦6.01***
- Target	**₦9.93**
Recommendation:	**BUY**

** As at Tuesday August 04, 2015*

1H2015 revenue increases by 3.1% y/y while sales quantity declines by 12.5% y/y. In the first half year to June 2015, Dangote Sugar Refinery posted revenue of ₦51.12billion, up by 3.1% compared with ₦49.60billion in the corresponding period of the preceding year. The increase in revenue was a result of 18.6% increase in the average prices of 50kg industrial sugar to ₦6,741 in the period, compared with average prices of ₦5,685 in the previous period. On the contrary, the company's sales quantity declined by 12.5% to 368,026 metric tonnes (mt) against 420,822mt in 2014, similarly production quantity declined by 13.2% y/y to 367,693mt compared with 423,608mt in the previous year. The decline in production and sales quantity in the review period was due to general slowdown in economic activities in the first quarter of the year, resulting from declining prices of crude oil and the uncertainty that pervaded the nation over the 2015 general elections. Also, weakening consumer demand and security challenges in the north-eastern region of Nigeria were among the reasons for the decline in production and sales volume in the period.

On a quarterly basis, the company's revenue of ₦28.60billion in the second quarter of the review period increased by 27.0% and 20.6% against ₦22.52billion and ₦23.72billion respectively in 1Q2015 and 2Q2014. Similarly, the latest quarter's revenue is higher than our estimate of ₦23.24billion and 8-quarter average of ₦24.26billion by 23.0% and 17.9% accordingly. On a geographical basis, Dangote Sugar generated revenue of ₦13.88billion and N20.68billion from Lagos and Northern region respectively which represented 27.2% and 40.5% of total revenue in the period. Also, revenue of ₦13.35billion and N3.20billion were generated from the Western region and the Eastern region in that order, which accounts for 26.1% and 6.3% of total revenue in the period. However, in our view, the improvement in revenue in the second quarter was a result of strong demand on the back of successful outcome of the election.

Fig. 1: Quarterly results highlights

	2Q2015	1Q2015	2Q2014	Q/q Δ	Y/y Δ
Revenue (₦'mn)	28,598	22,522	23,716	+26.98%	+20.59%
Operating profit (₦'mn)	6,199	8,957	4,347	-30.79%	+42.60%
Net profit (₦'mn)	3,938	2,374	3,077	+65.88%	+27.98%

Source: NSE, PAC Research

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-5.51%/-34.78%
52-week range	₦4.94 - ₦9.20
Average daily vol./val.	3,164,254 /₦21.698mn
Shares Outstanding (₦'mn)	12,000
Market Cap. (₦'mn)	72,000 ($300.0mn)
EPS, ₦- 12months trailing	0.93
DPS, ₦- FY2014	0.40
FCF, ₦- FY2014	0.27

Source: NSE, Company's Annual Reports, PAC Research

Fig. 3: Key ratios

	1H2015	1H2014
Gross profit margin	24.85%	26.13%
Net profit margin	12.35%	13.78%
Equity multiplier	1.90x	1.90x
Asset turnover	0.96x	1.10x

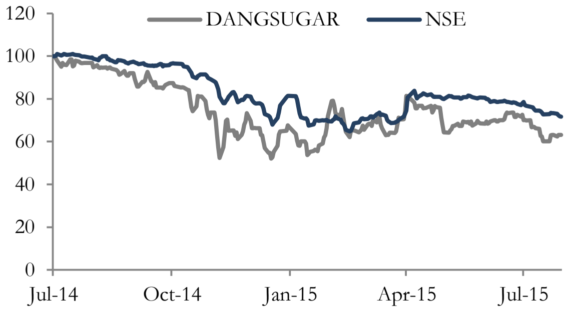
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2014	FY2015E	FY2016F	FY2017F
P/Sales	0.76x	0.77x	0.76x	0.75x
P/E	6.19x	5.32x	5.40x	5.95x
PEG	0.88	0.33	n/a	n/a
EV/EBITDA	3.82x	3.13x	3.17x	3.44x
P/B	1.40x	1.30x	1.22x	1.13x
ROE	22.63%	24.54%	22.66%	18.98%
ROA	12.54%	13.88%	13.25%	11.71%
Div. Yield	6.67%	8.33%	8.33%	10.00%

Source: NSE, PAC Research

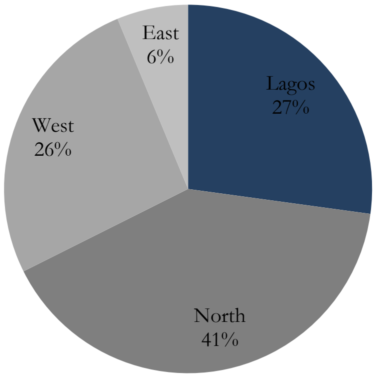
Fig. 5: DANGSUGAR vs. NSE, 52-wk movement (rebased)



Source: Bloomberg, PAC Research

Please read the Important Disclosures at the end of this report.

Fig. 6: Quarterly revenue (₦'billion)



Source: NSE, PAC Research

Lower prices of raw sugar fails to impact input costs. For the review period, Dangote Sugar recorded cost of sales (COS) of ₦38.42billion, up by 4.8% compared with ₦36.64billion in the previous year. The disproportionate increase in revenue and COS resulted in a higher COS/revenue ratio of 75.2% relative to 73.9% in 2014. In addition, the disruption in gas supply in the Apapa plant led to the use of low pour fuel oil to power plants which is more expensive than gas. Also, the unfavourable exchange rate regime in the period was another reason for the disproportionate increase of the input costs. On a quarterly basis, the company's COS of ₦21.42billion in 2Q2015 was up by 26.0% and 19.3%, compared with ₦17.00billion and ₦17.95billion respectively in 1Q2015 and 2Q2014. On the contrary, the latest quarter's COS/revenue ratio of 74.9% is lower than 75.5% and 75.7% in the first quarter to March 2015 and 2Q2014 respectively; it is also lower than 8-quarter average of 75.7%. Therefore, gross profit declined by 2.0% to ₦12.70billion against ₦12.96billion in the corresponding period of 2014, and gross profit margin fell to 24.9% relative to 26.1% in the previous period.

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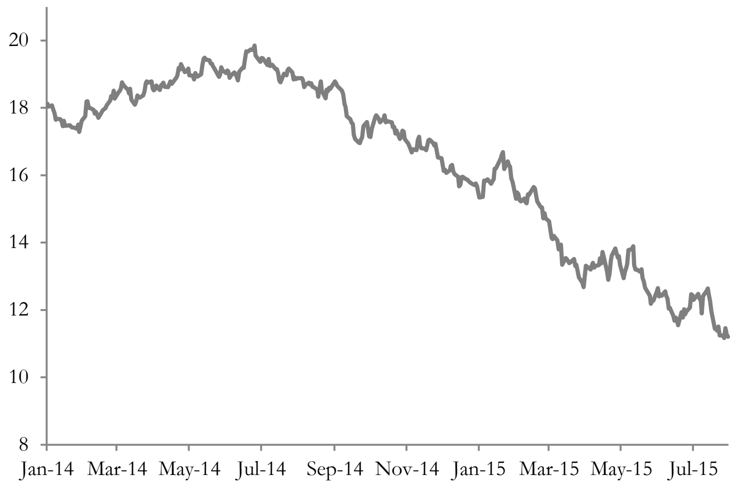
In the review period, the average prices of raw sugar in the global commodity market declined by 25.4% to US$13.58¢/lb compared with US$18.58¢/lb in the previous period **(fig.7)**. Global production of raw sugar is expected to increase slowly in 2014/15 by 0.4% after a decline of 1.5% in the previous year. The expected marginal production cut in China and Thailand will be offset by production increase in India, which will be consequent to incentives granted to sugar farmers in the country. Moreover, estimated consumption growth of 2.3% in 2014/15 sugar year is expected to be sustained by low prices of sugar and expected consumption increase in China and Africa. Although, demand is projected to be lower in the United States yet it will not be strong enough to erode the effects of rise in consumption in Africa and China. The Economic Intelligence Unit (EIU) estimated a decline of 20.6% in the average prices of raw sugar in 2015 to US$13.9¢/lb against US$17.0¢/lb in the prior period. Similarly, EIU projected average prices of U$S13.5¢/lb and US$13.75¢/lb in the third quarter and the fourth quarter of 2015. From the foregoing, the estimated lower average prices of raw sugar in the global commodity market in the quarters ahead is expected to impact positively on gross profit margins of the company.

Fig. 7: Prices of raw sugar (US₵)



Source: NSE, PAC Research

Operating costs declined on the back of reduction in selling and distribution cost. Dangote Sugar recorded operating expenses of ₦2.63billion in the period, down by 10.0% compared with ₦2.93billion in the previous year. The decline was a result of 56.8% reduction in selling and distribution cost to ₦273million compared with N632million in 2014, although administrative expenses moved up by 2.8% to ₦2.36billion against ₦2.29billion in the previous year. The decline resulted in a lower operating expenses/revenue ratio of 5.1% relative to 5.9% in the previous year. Overall, total costs moved up by 3.7% to ₦41.05billion compared with ₦39.57billion in 2014 and total costs/revenue ratio increased to 80.3% relative to 79.8% in the preceding year. Consequently, operating profit improved marginally by 0.4% y/y to ₦10.16billion compared with ₦10.12billion while operating profit margin declined to 19.9% relative to 20.4% in the corresponding period of 2014.

Worthy of note is the increase in interest expenses by 382.7% to ₦362million against ₦75million in the previous period which was a result of additional short-term borrowings incurred in the review period. Short-term borrowings stood at ₦7.09billion by the end of the first half of 2015 compared with ₦299million in the corresponding period of the previous year. Therefore, net profit declined by 7.7% y/y to ₦6.31billion compared with ₦6.84billion in the previous period.

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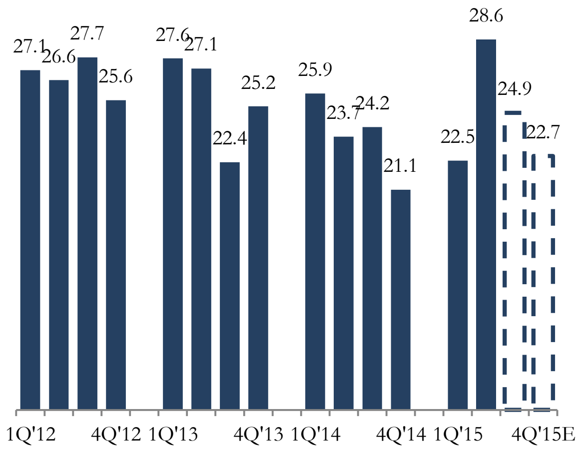
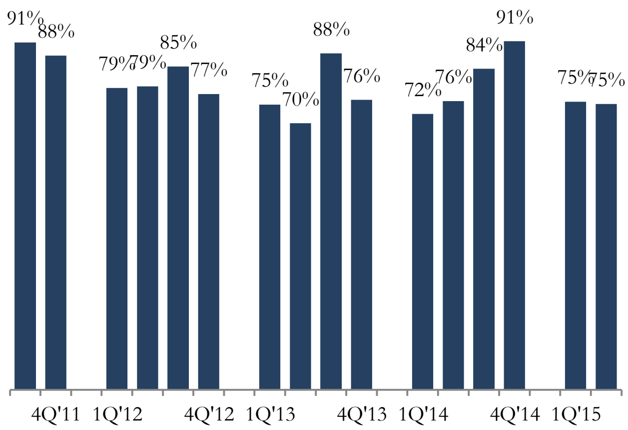
Fig. 8: Quarterly revenue (₦'billion)



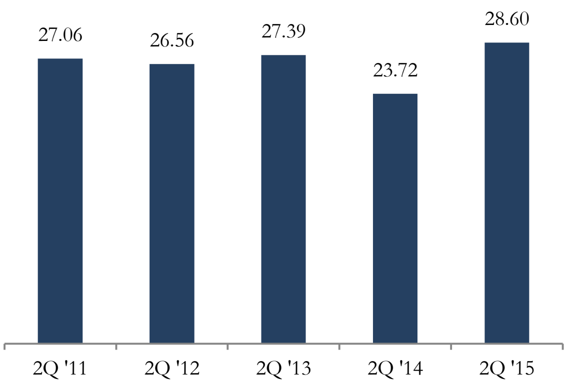
Source: NSE, PAC Research

Fig. 9: Quarterly COS/revenue ratio



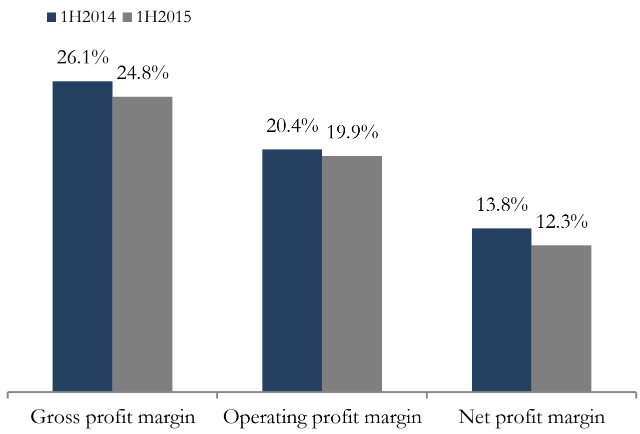
Source: NSE, PAC Research

Fig. 10: Second quarter revenue (₦'billion)



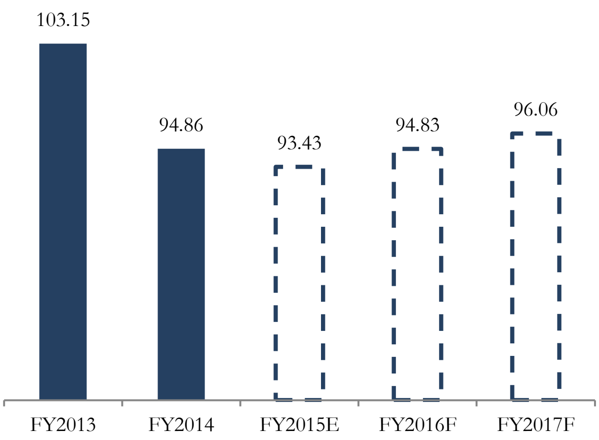
Source: NSE, PAC Research

Fig. 11: Quarterly operating expenses/revenue ratio



Source: NSE, PAC Research

Fig. 12: Annual sales revenue (₦'billion)



Source: NSE, PAC Research

Dangote Sugar outperformed the broad market in the review period. In the review period, Dangote Sugar recorded negative returns of 5.5% compared with negative returns of 12.2% by the equity market as measured by the All Share index. On the contrary, the company under-performed the equity index in 1H2014 with returns of -21.4% against +1.9% recorded by the market in the same period. Similarly, the company recorded returns of -34.8% in 52-week against -27.7% recorded by the broad market.

Valuation

Our revised valuation puts the target price of the stock of Dangote Sugar Refinery Plc at ₦9.93. In arriving at the target price, we employed multiples of price/earnings, price/sales, price/book, and EV/sales. We also employed the discounted cashflow valuation methodology. Consequently, we maintain our BUY recommendation on the stock of the company.

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Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the challenging operating environment in Nigeria, insecurity challenges in the northern part of the country, demographic factor of Nigeria, the strength of consumer spending and the intensity of competition in the market.

Fig. 13: Statement of Profit or Loss, ₦'mn

	FY2014	FY2015E	FY2016F	FY2017F
Revenue	94,855	93,428	94,829	96,062
Change		*-1.50%*	*1.50%*	*1.30%*
Cost of sales	76,227	70,071	72,070	73,968
Change		*-8.08%*	*2.85%*	*2.63%*
Gross profit	18,628	23,357	22,759	22,094
Change		*25.93%*	*-2.56%*	*-2.92%*
Operating expenses	8,600	8,782	9,198	9,606
Change		*2.12%*	*4.74%*	*4.43%*
Other operating income	5,066	4,559	5,243	4,457
Change		*-10.00%*	*15.00%*	*-15.00%*
Operating profit	15,094	19,134	18,804	16,945
Change		*26.77%*	*-1.73%*	*-9.89%*
Interest income	285	311	348	435
Change		*9.00%*	*12.00%*	*25.00%*
Interest expenses	106	101	103	92
Change		*-5.00%*	*20.00%*	*-10.00%*
Profit before tax	15,273	19,344	19,049	17,287
Change		*29.66%*	*-1.52%*	*-9.25%*
Income tax expenses	3,637	5,803	5,715	5,186
Change		*59.56%*	*-1.52%*	*-9.25%*
Profit for the year	11,636	13,541	13,334	12,101
Change		*16.37%*	*-1.52%*	*-9.25%*

Fig. 62: Statement of Financial Position, ₦'mn

	FY2014	FY2015E	FY2016F	FY2017F
Non-Current Assets				
Property, plant & equipment	50,473	58,044	63,268	67,697
Other non-current assets	1,575	1,811	2,047	1,842
Investments	2,489	2,240	2,419	2,056
Total non-current assets	54,537	62,095	67,734	71,595
Current Assets				
Inventories	15,099	14,495	14,060	13,638
Trade & other receivables	14,013	12,892	11,603	11,255
Other assets	2,950	3,216	2,990	3,319
Cash & cash equivalents	6,202	4,857	4,241	3,565
Total Current assets	38,264	34,460	32,894	31,777
Total assets	92,801	97,555	100,628	103,373
Equity	51,414	55,184	58,852	63,753
Non-Current Liabilities				
Deferred tax	4,611	4,703	5,221	5,429
Employee benefits	1,528	1,574	1,479	1,583
Total non-current fin. liab.	6,139	6,277	6,700	7,012
Current Liabilities				
Trade & other payables	25,227	25,984	24,944	23,198
Short-term borrowings	2,385	2,504	2,579	2,476
Other liabilities	1,700	1,802	1,838	1,746
Current tax liabilities	5,936	5,803	5,715	5,186
Total current liabilities	35,248	36,093	35,077	32,607

Fig. 14: Profitability & return

	FY2014	FY2015E	FY2016F	FY2017F
Gross profit margin	19.64%	25.00%	24.00%	23.00%
Operating profit margin	15.91%	20.48%	19.83%	17.64%
Net profit margin	12.27%	14.49%	14.06%	12.60%
ROCE	29.36%	34.67%	31.95%	26.85%
ROE	22.63%	24.54%	22.66%	18.98%
ROA	12.54%	13.88%	13.25%	11.71%

Source: Company's Annual Reports, PAC Research

Fig. 15: DuPont Analysis

	FY2014	FY2015E	FY2016F	FY2017F
Total assets turnover	1.84x	1.69x	1.61x	1.51x
Operating profit margin	15.91%	20.48%	19.83%	17.64%
Equity multiplier	1.80x	1.77x	1.71x	1.62x
ROCE	29.36%	34.67%	31.95%	26.85%

Fig. 16: Efficiency ratios

	FY2014	FY2015E	FY2016F	FY2017F
Fixed assets turnover	1.74x	1.50x	1.40x	1.34x
Current assets turnover	2.48x	2.63x	2.88x	3.02x
Total assets turnover	1.84x	1.69x	1.61x	1.51x
Inventory turnover	5.66x	4.74x	5.05x	5.34x
Receivables turnover	11.68x	12.12x	11.85x	11.83x
Payables turnover	6.88x	9.08x	8.82x	8.69x
Days inventory outstanding	64	77	72	68
Days collection outstanding	31	30	31	31
Days payable outstanding	53	40	41	42
Operating cycle (days)	43	67	62	57

Fig. 17: Liquidity ratios

	FY2014	FY2015E	FY2016F	FY2017F
Working capital (₦'millions)	3,016	-634	-2,182	-829
Current ratio	1.09	0.94	0.93	0.93
Quick ratio	0.71	0.98	0.94	0.97
Cash ratio	0.18	0.13	0.12	0.11

Fig. 18: Long-term solvency & stability ratios

	FY2014	FY2015E	FY2016F	FY2017F
Gearing	0.00%	0.00%	0.00%	0.00%
Equity multiplier	1.80x	1.77x	1.71x	1.62x
Total debt-to-equity	0.80x	0.77x	0.71x	0.62x
Total debt-to-assets	44.60%	43.43%	41.52%	38.33%
Proprietary	55.40%	56.57%	58.48%	61.67%
Interest coverage	142.40x	190.01x	183.07x	183.30x
Cash coverage	146.19x	158.50x	144.51x	141.30x

Fig. 19: Shareholders' investment ratios

	FY2014	FY2015E	FY2016F	FY2017F
EPS, ₦	0.97	1.13	1.11	1.01
DPS, ₦	0.40	0.50	0.50	0.60
Payout	41.25%	44.31%	45.00%	59.50%
FCFPS, ₦	0.27	0.89	0.80	0.84

Source: Company's Annual Reports, PAC 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.

Our recommendation tends 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 variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, 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

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