Dangote Sugar Refinery Plc

DUNN LOREN MERRIFIELD

Nigeria | Equities | Consumer Goods | August 13, 2014 — DLM RESEARCH

Benefitting from lower sugar prices in the global market

Sales volume declines by 1.1% y/y. In the six months period to June 2014, Dangote Sugar reported sales revenue of ₦49.60billion, down by 9.9% compared with ₦55.03billion in the corresponding period of 2013. The decline in revenue in the period was partly a result of 12.0% reduction in the selling prices of 50kg refined sugar to an average of ₦5,685.00 from an average of ₦6,460.00 in 2013 and a marginal shortfall in sales volume. However, the period's revenue is lower than our estimate of ₦50.99billion by 2.7%. Also, the company's refined sugar production declined by 9.6% to 423,608 million tonnes against 468,432 million tonnes in 2013. The shortfall in production was consequent to the disruption in gas supply to the Apapa plant during the period and maintenance service carried out in the same plant in the month of May.

Similarly, quantity sold dropped to 420,862 million tonnes i.e. a decline of 1.1% compared with 425,441 million tonnes in the previous year. On a geographical basis, Dangote Sugar recorded revenue of ₦21.38billion in Lagos, down by 10.6% compared with ₦23.90billion in the previous year; the region's revenue accounts for 43.1% of the total revenue in the period. Also, the revenue of ₦21.19billion generated from the Northern region translates to 42.7% of the period's total revenue, however the revenue declined by 8.9% y/y. Similarly, the revenue of ₦5.40billion and ₦1.63billion were recorded from the Western and the Eastern part of Nigeria, down by 10.6% y/y and 10.5% y/y accordingly and translates to 10.9% and 3.3% of the total revenue.

On a quarterly basis, the company's sales revenue of ₦23.72billion in 2Q2014 is lower than ₦25.88billion and ₦27.39billion in 1Q2014 and 2Q2013 respectively by 8.4% and 13.4%. Also, the latest quarter's revenue is below our estimate of ₦25.11billion by 5.5%, and below 8-quarters average of ₦25.67billion by 7.6%.

Fig. 1: Quarterly results highlights

	2Q2014	1Q2014	2Q2013	Q/q Δ	Y/y Δ
Revenue (₦'mn)	23,716	25,885	27,390	-8.38%	-13.41%
Operating profit (₦'mn)	4,347	5,564	3,956	-21.87%	9.88%
Net profit (₦'mn)	1,820	3,758	2,538	-51.57%	-28.29%

Source: NSE, DLM Research

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Price:

- Current	**₦8.99***
- Target	**₦12.86**
Recommendation:	**BUY**

** As at Wednesday, August 13, 2014*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-23.50%/-18.93%
52-week range	₦8.77 - ₦12.27
Average daily vol./val.	3,294,371 /₦35.918mn
Shares Outstanding (₦'mn)	12,000
Market Cap. (₦'mn)	107,400 ($671.2mn)
EPS, ₦- 12months trailing	1.11
DPS, ₦- FY2013	0.60
FCF, ₦- FY2013	-0.76

Source: Bloomberg, Company's Annual Reports, DLM Research

Fig. 3: Key ratios

	1H2014	1H2013
Gross profit margin	26.13%	28.03%
Net profit margin	13.78%	12.74%
Equity multiplier	1.90x	1.86x
Asset turnover	2.08x	2.24x

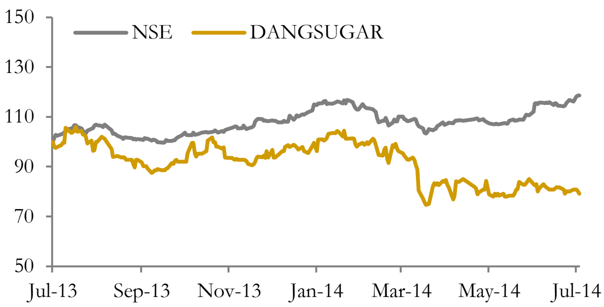
Source: NSE, DLM Research

Fig. 4: Valuations

	FY2013	FY2014E	FY2015F	FY2016F
P/Sales	1.01x	1.05x	1.04x	1.02x
P/E	10.00x	7.98x	7.87x	7.60x
PEG	0.22	0.32	7.87	1.90
EV/Sales	0.94x	0.98x	0.96x	0.96x
P/B	2.01x	1.89x	1.80x	1.69x
ROE	20.06%	23.72%	22.89%	22.18%
ROA	12.39%	14.55%	14.07%	13.81%
Div. Yield	6.67%	6.67%	7.78%	10.00%

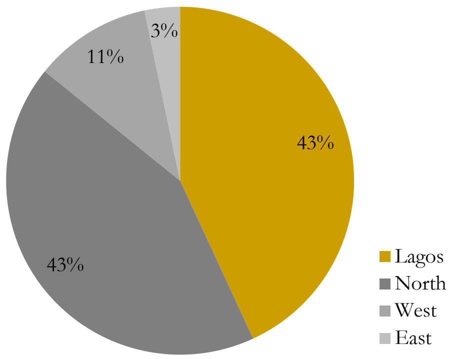
Source: Bloomberg, DLM Research

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



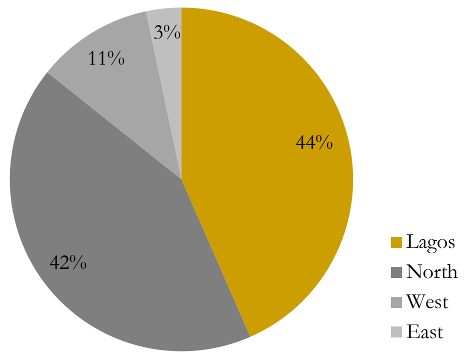
Source: Bloomberg

Fig. 7: Regional sales revenue – 1H2014



Source: NSE, DLM Research

Fig. 8: Regional sales revenue – 1H2013



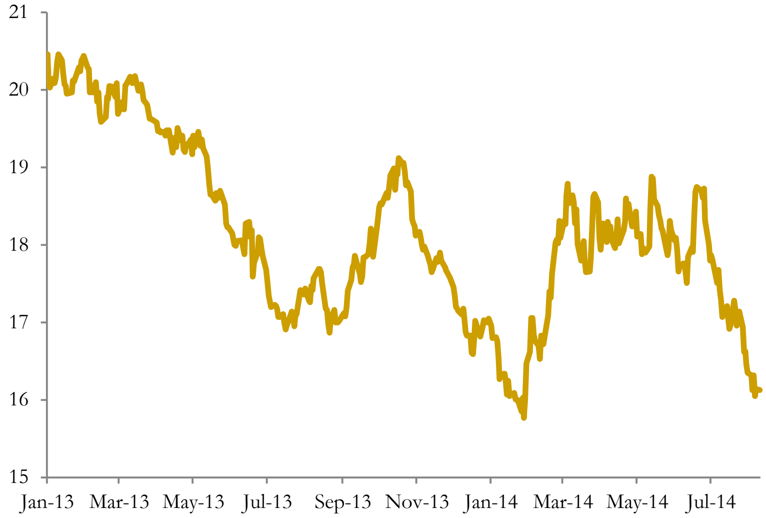
Source: NSE, DLM Research

Decline in the prices of raw sugar depresses input costs. For the review period, Dangote Sugar's cost of sales (COS) of ₦36.64billion declined by 7.5% compared with ₦39.61billion in the previous year. The higher y/y decline in revenue relative to COS resulted in a higher COS/revenue ratio of 73.9% relative to 72.0% in the corresponding period of 2013. The decline in the COS was subsequent to the fall in the average prices of raw sugar in the global market by 8.6% to 17.73 US cent/lb compared with 19.39 US cents/lb in 2013.

Moreover, we are of the view that the prices of raw sugar will fall further in the months ahead in the global commodities market, this is on the back of increased availability due to early cane crushing in Brazil and the positive effects of incentives granted to sugar producers in India. Hence, the input costs of the company is expected to fall further relative to sales revenue in the quarters ahead. On a quarterly basis, the company recorded COS of ₦17.94billion in the latest quarter, down by 4.0% and 5.3% compared with ₦18.70billion and ₦18.95billion in 1Q2014 and 2Q2013 respectively. Also, 2Q2014's COS is lower than 8-quarters average of ₦19.42billion by 7.6%.

In addition, our analysis revealed that 2Q2014's COS/revenue ratio of 75.7% is higher than 72.2% and 69.2% in 1Q2014 and 2Q2013 respectively, but almost equal to 8-quarters average of 75.6%. Therefore, gross profit which is a function of unit selling price, sales volume and input costs declined by 16.0% to ₦12.96billion in the review period against ₦15.43billion in 2013, resulting in a lower gross profit margin of 26.1% relative to 28.0% in the corresponding period of the previous year.

Fig. 6: Prices of raw sugar (US cents/lb.)



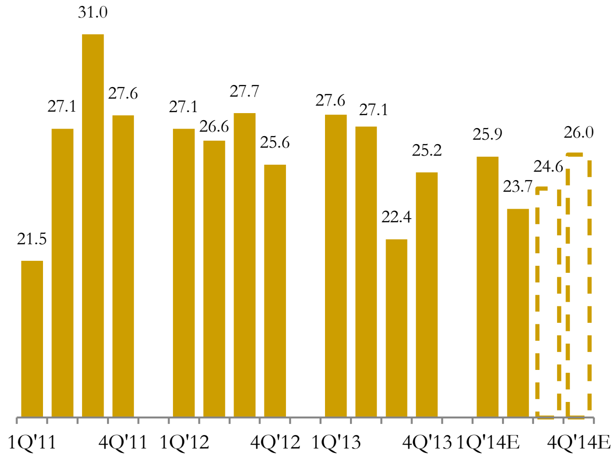
Source: Bloomberg, DLM Research

Operating expenses declines significantly due to reduction in promotional activities. During the review period, Dangote Sugar reported operating expenses of ₦2.92billion, i.e. a decline of 55.5% compared with ₦6.57billion in 2013. The decline in the operating expenses was a result of 65.4% y/y drop in selling and distribution costs to ₦631million compared with ₦1.82billion in 2013, which was consequent to the reduction in promotional activities in the period. Similarly, administrative expenses stood at ₦2.29billion in the review period, down by 51.7% compared with ₦4.74billion in the previous year which was subsequent to the suspension of management fees in the period and a 33.7% y/y decline in salaries and other staff related costs. The higher y/y decline in operating expenses relative to revenue resulted in a lower operating expenses/revenue ratio of 5.9% relative to 11.9% in 2013.

On a quarterly basis, the company's operating expenses of ₦1.30billion in the latest quarter is lower than ₦1.62billion recorded in 1Q2014 by 19.8%, this translates to operating expenses/revenue ratio of 5.5% and 6.3% respectively. Overall, total cost declined by 14.3% to ₦39.57billion against ₦46.18billion in the previous year. The higher y/y decline in the total cost relative to revenue resulted in a lower total cost/revenue ratio of 79.8% in 1H2014 relative to 83.9% in 2013. Therefore, operating profit moved up by 2.8% to ₦10.12billion in the period compared with ₦9.84billion in the corresponding period of the previous year while operating profit margin stood at 20.4% relative to 17.9% in 2013. Consequently, net profit declined by 2.5% to ₦6.83billion compared with ₦7.01billion in 2013 and net profit margin improved to 13.7% relative to 12.7% in the previous year.

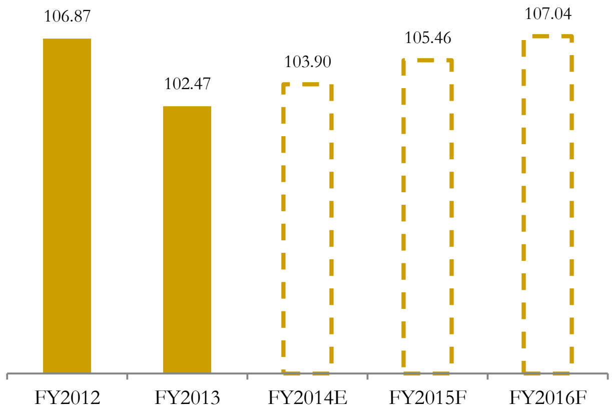
"On a quarterly basis, the company's operating expenses of ₦1.30billion in the latest quarter is lower than ₦1.62billion recorded in 1Q2014 by 19.8%, this translates to operating expenses/revenue ratio of 5.5% and 6.3% respectively."

Fig. 9: Quarterly sales revenue (₦'billion)



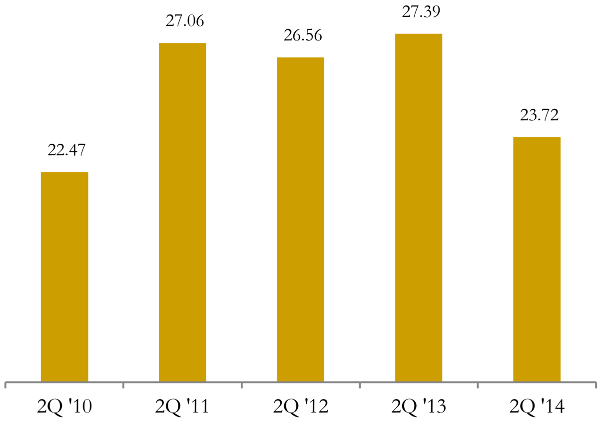
Source: NSE, DLM Research

Fig. 10: Annual sales revenue (₦'billion)



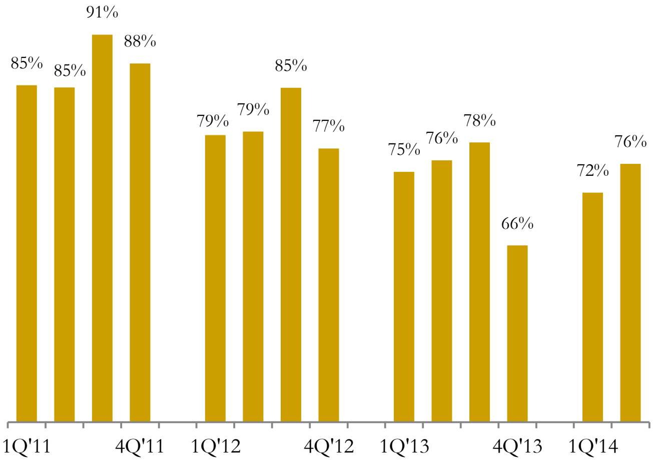
Source: Bloomberg, DLM Research

Fig. 11: 2Q (Second) quarter sales revenue (₦'billion)



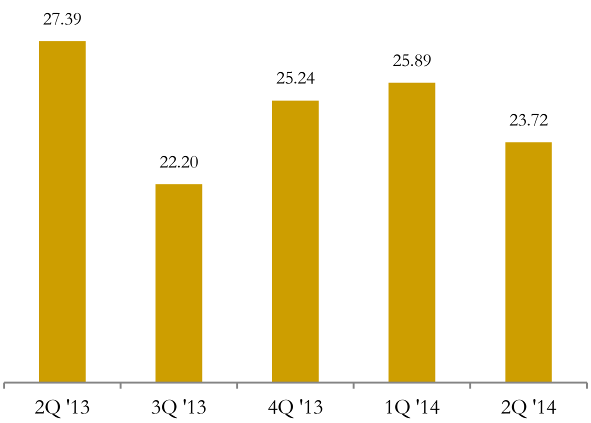
Source: NSE, DLM Research

Fig. 12: Quarterly COS/revenue ratio



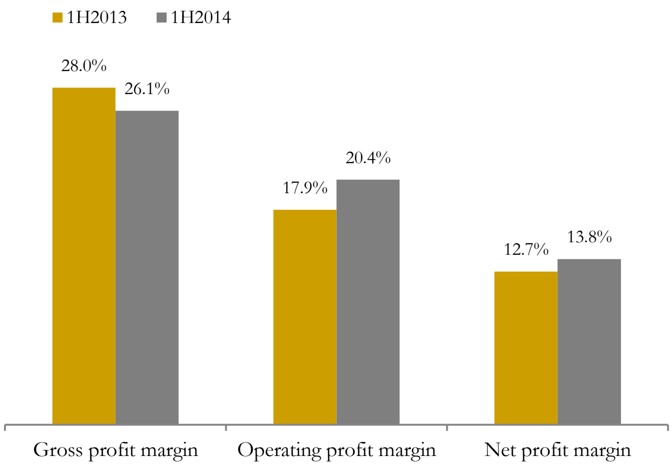
Source: NSE, DLM Research

Fig. 13: Quarterly sales revenue (₦'billion)



Source: NSE, DLM Research

Fig. 14: Profit margins



Source: NSE, DLM Research

Our Valuation puts the revised target price of the stock of Dangote Sugar Plc at ₦12.86. In arriving at the target price, we employed multiples of price/earnings, price/sales, price/book, and EV/sales. We also employed the DDM valuation methodology.

Consequently, we maintained our BUY recommendation on the stock of the company.

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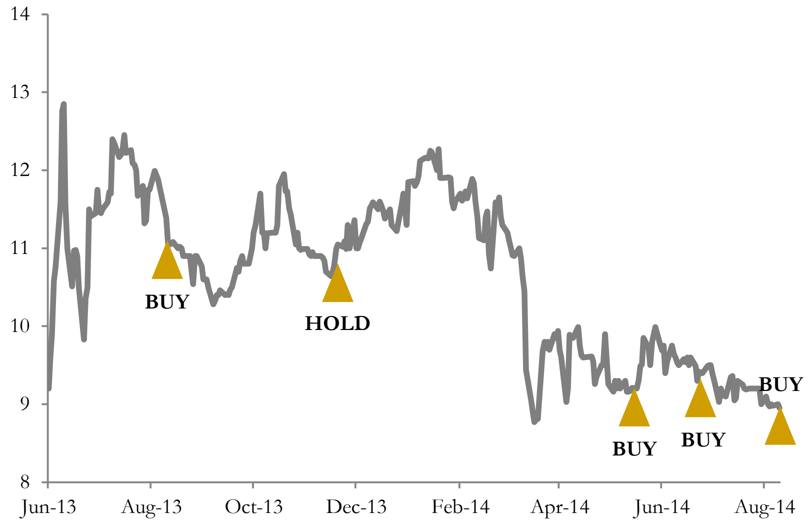
Fig. 15: Share price – our recommendation history



Source: Bloomberg, DLM Research

Our revised valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the challenging operating environment in Nigeria, our outlook on the movement in the prices of commodities in the global market - especially the price of raw sugar - the strength of consumer spending, demographic factor of the country, and the intensity of competition in the market.

Fig. 16: Statement of Profit or Loss, ₦'mn

	FY2013	FY2014E	FY2015F	FY2016F
Sales revenue	102,467	103,902	105,460	107,042
Change		*1.40%*	*1.50%*	*1.50%*
Cost of sales	75,497	75,848	76,986	77,605
Change		*0.47%*	*1.5%*	*0.80%*
Gross profit	26,970	28,053	28,474	29,437
Change		*4.02%*	*1.50%*	*3.38%*
Other operating income	2,258	1,468	1,732	1,472
Change		*-35.00%*	*18.00%*	*-15.00%*
Operating expenses	10,620	10,806	10,968	11,132
Change		*1.75%*	*1.50%*	*1.50%*
Operating profit	18,608	18,715	19,238	19,776
Change		*0.58%*	*2.79%*	*2.80%*
Interest income	1,492	1,626	1,821	2,277
Change		*9.00%*	*12.00%*	*25.00%*
Profit before tax	20,100	20,342	21,060	22,053
change		*1.20%*	*3.53%*	*4.72%*
Income tax expense	6,562	6,611	6,844	7,167
change		*0.75%*	*3.53%*	*4.72%*
Profit for the year	13,538	13,731	14,215	14,886
change		*14.42%*	*3.53%*	*4.72%*

Fig. 17: Statement of Financial Position, ₦'mn

	FY2013	FY2014E	FY2015F	FY2016F
Non-Current Assets				
Property, plant & equipment	26,250	35,438	42,525	49,754
Other non-current assets	367	459	596	537
Investments	3,215	3,858	3,935	3,345
Total non-current assets	29,832	39,754	47,056	53,636
Current Assets				
Inventories	11,098	9,988	9,689	9,398
Trade & other receivables	38,318	35,253	33,842	32,489
Cash & cash equivalents	7,865	8,020	6,966	7,381
Total Current assets	57,281	53,261	50,497	49,268
Total assets	87,113	93,015	97,554	102,904
Equity	53,818	57,083	59,991	64,077
Non-Current Liabilities				
Deferred taxation	4,360	4,447	4,936	5,134
Employees benefits	1,356	1,397	1,313	1,405
Total non-current fin. liab.	5,716	5,844	6,249	6,539
Current Liabilities				
Trade & other payables	22,841	23,526	24,703	25,444
Current tax liabilities	4,738	6,562	6,611	6,844
Total current liabilities	27,579	30,088	31,314	32,288
Total equity and liabilities	87,113	93,015	97,554	102,903

Fig. 18: Profitability & return

	FY2013	FY2014E	FY2015F	FY2016F
Gross profit margin	26.32%	27.00%	27.00%	27.50%
Operating profit margin	18.16%	18.01%	18.24%	18.48%
Net profit margin	13.21%	13.22%	13.48%	13.91%
ROCE	34.58%	32.79%	32.07%	30.86%
ROE	25.16%	24.05%	23.70%	23.23%
ROA	15.54%	14.79%	14.57%	14.47%

Source: Company's annual reports, DLM Research

Fig. 19: DuPont Analysis

	FY2013	FY2014E	FY2015F	FY2016F
Total assets turnover	1.90x	1.82x	1.76x	1.67x
Operating profit margin	18.16%	18.01%	18.24%	18.48%
Equity multiplier	1.62x	1.63x	1.63x	1.61x
ROCE	34.58%	32.79%	32.07%	30.86%

Fig. 20: Efficiency ratios

	FY2013	FY2014E	FY2015F	FY2016F
Fixed assets turnover	3.43x	2.61x	2.24x	2.00x
Current assets turnover	1.79x	1.95x	2.09x	2.17x
Total assets turnover	1.90x	1.82x	1.76x	1.67x
Inventory turnover	6.01x	7.19x	7.83x	8.13x
Receivables turnover	13.37x	13.25x	12.95x	12.96x
Payables turnover	3.93x	4.75x	4.59x	4.44x
Days inventory outstanding	61	51	47	45
Days collection outstanding	27	28	28	28
Days payable outstanding	93	77	80	82
Operating cycle (days)	-5	1	-5	-9

Fig. 21: Liquidity ratios

	FY2013	FY2014E	FY2015F	FY2016F
Working capital (₦'mn)	29,702	23,173	19,183	6,180
Current ratio	2.08	1.77	1.61	1.14
Quick ratio	1.67	1.44	1.30	0.93
Cash ratio	0.29	0.27	0.22	0.17

Fig. 22: Long-term solvency & stability ratios

	FY2013	FY2014E	FY2015F	FY2016F
Gearing	0.00%	0.00%	0.00%	0.00%
Equity multiplier	1.62x	1.63x	1.63x	1.61x
Total debt-to-equity	0.62x	0.63x	0.63%	0.77x
Total debt-to-assets	38.22%	38.63%	38.50%	48.23%
Proprietary	61.78%	61.37%	61.50%	62.27%
Interest coverage	0.00x	0.00x	0.00x	0.00x
Cash coverage	0.00x	0.00x	0.00x	0.00x

Fig. 23: Shareholders' investment ratios

	FY2013	FY2014E	FY2015F	FY2016F
EPS, ₦	1.13	1.14	1.18	1.24
DPS, ₦	0.60	0.60	0.70	0.90
Payout	53.18%	52.44%	59.09%	72.55%
FCFPS, ₦	-0.76	-0.50	-0.50	-0.53

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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