

DANGOTE CEMENT PLC



... Energy Disruptions Induce Deteriorating Margins

March 27, 2023



Earnings Note

Event

Dangote Cement Plc's ('The Group') margins came under pressure in FY 2022 amid sales volume decline. But effective price increases offset the negative volume performance. Revenue grew by 17% year-on-year to N1.62trn – composed of a 5% volume decline and a 23% average price increase.

Dull Sales Across Two Broad Markets

In the Nigerian market, sales volume declined by 4% YoY, attributed to energy disruptions that affected production, evidenced by a 200-basis points reduction in the Nigerian production capacity to 51% in FY 2022 (FY 2021: 53%). However, average price per tonne increased by 27% YoY and that helped to deliver a 21% YoY revenue growth in the Nigerian market. We note that the 2022 fiscal year was the third consecutive year of a double-digit revenue growth in the Nigerian market, with higher prices being the driver of revenue performance in the last two fiscal years. We believe that the Group's market leadership status and overall solid industry fundamentals enabled it to enjoy significant pricing power.

In the Pan-American, the trend was similar as sales volume declined by 8% YoY, catalysed by lower production due to extended plant maintenance and repair activities. Meanwhile, revenue grew by 4% YoY. The Group also raised prices across its Pan-African markets. On the average, product prices increased by 14% YoY.

	Nigerian Market			Pan-African Market		
	FY 2022	FY 2021	Growth	FY 2022	FY 2021	Growth
Sales volume (Mta)	17.84	18.61	-4%	9.98	10.86	-8%
Average price per tonne	N67,567	N53,379	27%	N41,566	N36,586	14%
Revenue (N'mn)	1,205,401	993,399	21%	414,830	397,329	4%
EBITDA margin	54.70%	61.40%	-670 bps	15.60%	22.40%	-680 bps

Source: Company Accounts, WSTC Research

Margins Shrink on the Back of Inflationary Pressures

Occasioned by higher distribution costs, the Group's EBITDA margin dipped. In the Nigerian market, EBTIDA margin declined by c.600 basis points to 55% in FY 2022 (FY 2021: 61%). The reason was because of higher diesel costs incurred in powering delivery trucks during the fiscal year. In the Pan-African market, EBITDA margin also declined by c.600 basis points to 16% (FY 2021: 22%). Higher coal and diesel prices were the reasons for the margin decline.

Overall, the Group's EBITDA grew by 3% YoY to N706.04bn from N683.59bn in FY 2021. Meanwhile, the Group's EBITDA margin declined by 500 basis points to 44% in FY 2022 (FY 2021: 49%). Besides the higher distribution costs incurred, we also link the EBITDA margin decline to the impact of operating leverage in the business. Fixed costs remained constant while volume declined. Therefore, in our view, the less absorption of fixed costs impacted margins.

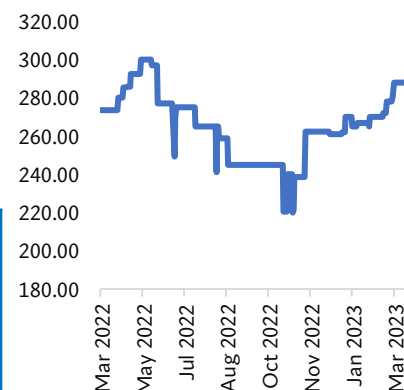
BUY

Fair Value Estimate:
N349.84

Total Return: +29%

Current price (N)	288.00
Shares Outstanding (mn)	17,000
Market Cap (N'mn)	4,896,000
52-week high (N)	300.00
52-week low (N)	220.00
Trailing EPS (N)	22.49
Forward EPS (N)	28.42
Forward PE (X)	10.13
Justified PE Multiple (X)	12.31

Price Movement



Stock Data	FY 2021	FY 2022	FY 2023F
P/E	13.43x	12.81x	10.13x
P/BV	4.98x	4.54x	4.01x
PBT Margin	39%	32%	34%
PAT Margin	26%	24%	25%
RoE	39%	37%	44%
Dividend Yield	7%	7%	8%

Analysts

Abdulrauf Bello

a.bello@wstc.com.ng

Isaac Osaro

i.osaro@wstc.com.ng

Oluwadamilola Pase

o.pase@wstc.com.ng

Operating profit remained flat at N585.65bn in FY 2022 from N582.83bn in FY 2021; but operating profit margin declined to 36% in FY 2022 (FY 2021: 42%).

Macroeconomic Headwinds Induce Significant FX Losses

On the back of monetary policy normalisation by the United States Federal Reserve, the US Dollar appreciated significantly against emerging market currencies. As a result, the Group recorded significant foreign exchange losses – particularly in its Pan-African market. FX losses increased by 515% YoY, shaving off N53.93bn from operating profit. Also, net finance cost increased by 3% YoY to N36.53bn – the finance cost increase of 34% YoY to N75.24bn was partly offset by an 86% YoY increase in finance income of N38.72bn.

RoE Weakens, But Remains Strong

The combined impact of higher operating costs (distribution expenses) and non-operating costs (FX losses and finance costs) dampened profitability, as profit before tax declined by 3% year-on-year to N524.00bn. However, a lower effective tax rate in FY 2022 (27% versus 32% in FY 2021) ensured a more optically pleasing bottomline, as profit after tax grew by 5% year-on-year to N382.31bn.

Return on equity (RoE) stood relatively strong at 37% in FY 2022. Although 200 basis points decline from a 39% RoE in FY 2021, the figure was comfortably above our estimated cost of equity of 23%. The breakdown of RoE showed that a decline in net margin accounted for the RoE reduction in FY 2022. Asset turnover improved to 0.65x (FY 2021: 0.63x), while financial leverage increased slightly to 2.43x (FY 2021: 2.35x). Therefore, the lower net margin due to cost pressures resulted in the RoE decline in FY 2022.

Supply Chain Disruptions Weigh Negatively on Cash Flows

Net operating cash flow declined by 35% YoY to N387.84bn, resulting from increased working capital funding. For instance, inventory and prepayments grew by 43% respectively.

Free Cash Flow (FCFF) stood at N321.90bn in FY 2022, a decline of 22% YoY from N410.90bn in FY 2021. In the same trend, Free Cash Flow to Equity (FCFE) declined by 11% YoY to N321.00bn from N360.51bn in FY 2021.

FY 2022 Financial Performance

Income Statement (N'mn)	FY 2022	FY 2021	Growth (%)
Revenue	1,618,323	1,383,637	17%
Cost of sales	(662,890)	(551,019)	20%
Gross profit	955,433	832,618	15%
Other income	5,333	6,221	-14%
Operating income	960,766	838,839	15%
General and administrative expense	(79,879)	(64,349)	24%
Selling and distribution expense	(295,234)	(191,658)	54%
Operating expense	(375,113)	(256,007)	47%
Operating profit	585,653	582,832	0%
Non-operating profit	(61,651)	(44,466)	39%
Finance income	38,715	20,765	86%
Finance cost	(75,242)	(56,326)	34%
FX loss	(53,929)	(8,766)	515%
Other gains / (losses)	27,823	(615)	4,624%
Impairment of financial assets	223	(341)	-165%
Share of associate profit	759	817	-7%
Profit before tax	524,002	538,366	-3%
Taxation	(141,691)	(173,927)	-19%
Profit/Loss for the year	382,311	364,439	5%
Balance Sheet (N'mn)	FY 2022	FY 2021	Growth (%)
Assets			
PP & E	1,527,293	1,472,859	4%
Inventory	239,563	167,205	43%
Receivables	45,490	47,469	-4%
Prepayments	447,149	311,722	43%
Cash	283,843	339,843	-16%
Others	72,317	52,921	37%
Total Assets	2,615,655	2,392,019	9%
Liabilities			
Loans & Borrowings	735,646	588,161	25%
Payables	334,899	371,224	-10%
Others	466,163	448,965	4%
Total Liabilities	1,536,708	1,408,350	9%
Net Assets	1,078,947	983,669	10%

Source: Company Accounts, WSTC Research

Outlook

We expect the energy disruptions that negatively affected volumes in FY 2022 to normalise in FY 2023. We also expect the Group to conclude its plant maintenance in the Pan-African market and resume production in the affected plants. Hence, we project a 4% volume growth in the Nigerian market while we project a 7% volume growth in the Pan-African market. Overall, we are estimating a total volume growth of 5% in FY 2023 for the Group.

Despite a low single-digit volume growth that we are projecting, we estimate a 19% revenue growth for FY 2023. This is due to our projection of a 14% price increase. Our opinion is that the Group will make additional price increases to protect margins.

In the medium term, we expect the Group to leverage its market leadership status to grow volumes and prices. In February 2023, the management signed an agreement with China Sinoma Engineering to construct a green field plant (Itori cement plant) with an expected completion date in 2025. The new plant will add 6mn tonnes and take the Nigerian capacity to 41.25mn tonnes.

We forecast an earnings per share (EPS) forecast of N28.42 in FY 2023, which effectively implies a forward price-to-earnings (P/E) multiple of 10.13x – a 22% price discount to our justified P/E multiple of 12.31x. The implied forward P/E multiple is also a 31% discount to its historical average P/E multiple of 13.26x. Thus, we recommend a BUY.

Financial Projections

Income statement (NGN mn)	FY 2021	FY 2022	FY 2023F	FY 2024F	FY 2025F	FY 2026F	FY 2027F	FY 2028F
Revenue	1,383,637	1,618,323	1,929,270	2,115,322	2,576,791	2,724,838	2,860,581	2,981,810
EBITDA	683,598	706,043	857,430	953,922	1,162,981	1,241,211	1,306,846	1,369,354
EBIT	582,832	585,653	712,735	790,621	964,055	1,035,967	1,089,949	1,142,412
Profit before taxation (PBT)	538,366	524,002	653,404	744,669	943,817	1,014,293	1,075,883	1,125,355
Net profit (PAT)	364,439	382,311	483,201	550,693	697,966	750,084	795,630	832,216
EPS (₦)	21.44	22.49	28.42	32.39	41.06	44.12	46.80	48.95
DPS (₦)	20.00	20.00	22.00	31.42	40.65	43.68	46.33	48.46
Balance sheet (NGN mn)	FY 2021	FY 2022	FY 2023F	FY 2024F	FY 2025F	FY 2026F	FY 2027F	FY 2028F
Other current assets	533,199	739,618	825,909	873,069	1,072,893	1,083,973	1,137,604	1,185,500
Non-current assets	1,518,977	1,592,194	1,582,548	1,636,067	1,839,636	1,840,390	1,839,753	1,838,236
Total assets	2,392,019	2,615,655	2,687,600	2,980,117	3,389,949	3,577,574	3,785,616	3,915,819
Current liabilities	1,076,483	1,021,685	1,004,183	1,079,711	1,264,042	1,366,350	1,503,271	1,569,704
Non-current liabilities	331,867	515,023	461,269	501,562	563,270	589,490	607,563	626,791
Total liabilities	1,408,350	1,536,708	1,465,452	1,581,273	1,827,312	1,955,840	2,110,834	2,196,496
Shareholders' equity	983,669	1,078,947	1,222,148	1,398,844	1,562,637	1,621,735	1,674,782	1,719,324
Cash flow statement (NGN mn)	FY 2021	FY 2022	FY 2023F	FY 2024F	FY 2025F	FY 2026F	FY 2027F	FY 2028F
Cash from operating activities	596,709	387,835	530,151	800,081	897,607	1,101,024	1,108,117	1,093,961
Cash from investing activities	(126,869)	(126,822)	(93,200)	(169,648)	(347,778)	(149,400)	(151,590)	(157,681)
Cash from financing activities	(332,222)	(373,779)	(441,650)	(438,596)	(543,391)	(775,831)	(801,479)	(852,456)
Net increase/ (decrease) in cash	137,618	(112,766)	(4,700)	191,838	6,438	175,792	155,048	83,824
Free cash flow	412,133	321,996	395,102	583,261	495,112	895,026	891,857	868,536
Ratio analysis	FY 2021	FY 2022	FY 2023F	FY 2024F	FY 2025F	FY 2026F	FY 2027F	FY 2028F
EBITDA margin	49%	44%	44%	45%	45%	46%	46%	46%
Operating margin	42%	36%	37%	37%	37%	38%	38%	38%
RoE	39%	37%	42%	42%	47%	47%	48%	49%
RoA	17%	15%	18%	19%	22%	22%	22%	22%
Dividend payout ratio	93%	89%	77%	97%	99%	99%	99%	99%

Source: Company Accounts, WSTC Research

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- Hold Rating: estimated change in price is between -10% and 20% of current market price.
- Sell Rating: estimated change in price is $\leq -10\%$ of current market price.

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WSTC Securities Limited has its registered office at 2, Maitama Sule Street, South-West Ikoyi, Lagos, Nigeria.

Email: research@wstc.com.ng

Website: www.wstc.com.ng

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