

Dangote Sugar Refinery Plc.

Recommendation Upgraded to BUY

We upgrade recommendation on DANGSUGAR to BUY (previously HOLD), with 2017 TP of N8.31. The company's dominance in the sugar industry -- more so considering that unofficial imports have been significantly constrained by FX scarcity -- has allowed management to boldly respond to cost pressures via price increases (70% recovery over 2016F to N213, 899/tonne). Despite the downward revision following the below expected performance in Q3, we still look for 2016F net profit growth of 25% (previously 37%).

While demand is set to ease by 28% in 2017 (with price per tonne now at N342, 000 ex-VAT), the decline will be more than compensated for by significantly higher average price, suggesting potential growth in topline (we estimate 15%). Except for material deceleration in costs, especially given the adverse impact on Q3-16 margins, it is unlikely that prices would be reduced, at least in the first half of next year. The management of DANGSUGAR's sister company, also in the business of manufacturing and which has raised selling prices recently, said that emphasis in 2017 will be on margins via reduction of energy costs and by retaining the higher prices.

Our volume forecast is based on expected decline in national consumption. Corporate demand (accounting for 30% of DANGSUGAR's sales) will be affected by (1) weak volumes, as they seek to pass on costs to consumers and (2) the substitution of sugar with relatively cheaper glucose. Management, however, expects that the deficit in the domestic market will be met by potential growth in cross-border demand.

Costs are likely to peak at 2016 levels, though risk is to the upside. Key risks are unresolved FX issues and high energy costs. DANGSUGAR's management stated recently that it purchases about 70% of its total FX requirements from unofficial sources (at between N450-N470/USD, against the CBN's N305/USD) owing to lingering shortages. On energy, the currently high LPFO substitution is unlikely to improve materially, given the unrelenting attacks on gas pipelines.

Overall, we forecast 34% net profit growth in 2017. Risks to the forecast are (1) lower than expected sales volume, or price reduction, or both and (2) significant cost inflation. DANGSUGAR's stock is up 4% YtD, and is trading on a forward PE of 5.2x, at 40% and 63% discount to Bloomberg's SSA and Nigerian comparables.

Income Statement (N'bn)	30-Sep-16	30-Sep-15	Q3:16	Q3:16 y/y	Q3:16 q/q
Revenue	115.3	73.0	44.8	104.2%	18.3%
Cost of Sales	96.3	54.3	39.7	150.3%	29.3%
Gross profit	19.0	18.8	5.1	-16.2%	-28.9%
OPEX	4.6	3.9	1.9	51.0%	62.2%
Other income	0.4	0.2	0.2	52.3%	707.3%
Investment income	0.3	0.0	0.2	7591.3%	52.0%
Financial charges	0.4	0.9	0.1	-79.2%	-20.9%
Profit before tax	15.3	14.2	4.2	-5.9%	-31.1%
Taxation	5.2	4.9	1.4	2.1%	-28.6%
PAT Owners of the Company	10.2	9.4	2.8	-8.9%	-32.1%

BUY

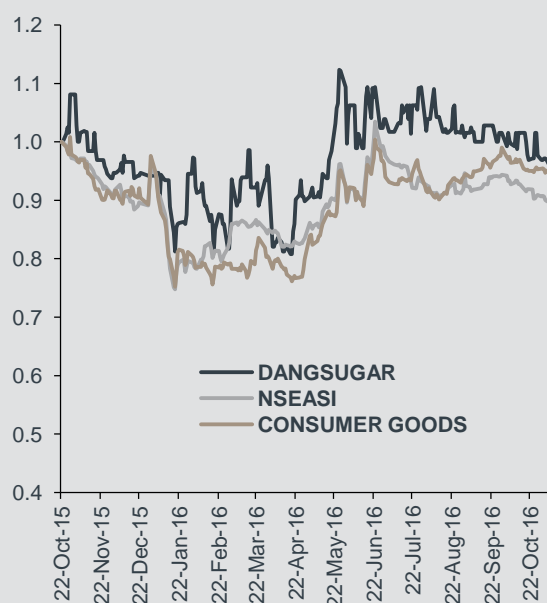
Target Price (N)	8.31
Current Price (N)	6.30
Implied Return (%)	31.86

Company Data

NSE Code	DANGSUGAR
Bloomberg Code	DANGSUGAR:NL
Reuters Code	DANGSUG.LG
Sector	CONSUMER GOODS
Market Cap. (N'bn)	75.60
Free Float (%)	26.90

Ratios	9M-16	9M-15	2016FY
Gross margin	16.49%	25.69%	16.93%
Opex margin	4.03%	5.35%	5.28%
EBIT margin	12.77%	20.68%	12.98%
PBT margin	13.29%	19.47%	12.86%
PAT margin	8.78%	12.78%	8.74%
EPS (N)	0.84	0.78	1.20

Price movement (DANGSUGAR vs. Benchmark Indices)



Financial Statement (N'billion).

Income Statement (N'bn)						Profitability Ratios					
	2014a	2015a	2016f	2017f	2018f		2014a	2015a	2016f	2017f	2018f
Turnover	94.86	101.06	164.76	189.62	193.57	Gross profit margin	19.6%	20.5%	16.9%	18.9%	18.7%
Cost of Sales	-76.23	-80.33	-136.86	-153.81	-157.33	EBITDA margin	19.8%	19.5%	15.1%	17.1%	17.0%
Gross profit	18.63	20.73	27.90	35.81	36.24	Operating profit margin	15.9%	15.7%	13.0%	15.0%	14.8%
Operating expenses	-8.60	-6.21	-8.71	-10.12	-10.44	PBT margin	16.1%	16.4%	12.9%	15.0%	14.8%
Investment income	0.29	0.01	0.32	0.37	0.37	Net profit margin	12.3%	11.4%	8.7%	10.2%	10.1%
Other income	5.07	1.33	2.19	2.77	2.93	RoAE	23.7%	21.1%	23.1%	26.6%	23.5%
Interest expenses	-0.11	-0.66	-0.51	-0.44	-0.38	RoAA	13.2%	11.8%	12.3%	13.0%	11.6%
Profit before tax	15.27	16.55	21.19	28.38	28.71						
Tax expense	-3.64	(5.01)	(6.78)	(9.08)	(9.19)	Liquidity Ratios					
Profit after tax	11.64	11.54	14.41	19.30	19.52	Working capital (N'bn)	1.5	4.9	10.5	8.8	13.0
						Current ratio	1.0x	1.1x	1.2x	1.1x	1.2x
						Quick ratio	0.6x	0.7x	0.7x	0.7x	0.7x
						Cash ratio	0.2x	0.2x	0.3x	0.3x	0.3x
Financial Position (N'bn)						Efficiency Ratios					
	2014a	2015a	2016f	2017f	2018f		2014a	2015a	2016f	2017f	2018f
PPE	50.47	54.80	58.99	74.53	78.90	Fixed assets turnover	0.5x	0.5x	0.4x	0.4x	0.4x
Other assets	0.19	0.00	-	-	-	Current assets turnover	0.4x	0.4x	0.4x	0.5x	0.5x
Biological assets	1.12	1.55	-	-	-	Total assets turnover	1.0x	1.0x	0.8x	0.9x	0.9x
Investment property	-	-	1.00	2.00	3.00	Inventory turnover	0.2x	0.2x	0.1x	0.1x	0.1x
Deferred tax assets	2.49	2.97	3.19	4.03	4.27	Receivables turnover	0.2x	0.2x	0.1x	0.1x	0.1x
Intangible assets	0.26	0.14	0.14	0.18	0.19	Payables turnover	0.3x	0.3x	0.2x	0.1x	0.1x
Total Non-current assets	54.54	59.46	62.91	79.48	84.14	Days inventory outstanding	60	61	36	32	31
Inventories	15.10	15.55	25.62	32.38	34.27	Days collection/sales outstanding	75	72	44	39	38
Biological assets	0.68	1.89	2.62	3.32	3.51	Days payable outstanding	121	67	53	60	62
Trade debtors/other debtors	14.01	14.70	20.05	25.33	26.82	Cash conversion cycle	14	67	27	10	7
Other assets	1.41	1.17	0.56	0.70	0.73						
Held for sale investment in subsidiary	0.86	0.86	0.93	1.16	1.22	Investment Ratios					
Bank/cash balances	6.20	8.99	19.11	22.52	22.13	Earnings per share (N)	1.0	1.0	1.2	1.6	1.6
Total current assets	38.26	43.17	68.90	85.41	88.69	Dividend per share (N)	0.4	0.5	0.6	0.8	0.8
Total assets	92.80	102.62	131.81	164.89	172.83	Payout	41.3%	52.0%	52.0%	52.0%	52.0%
Trade and other payables	25.23	14.70	20.05	25.33	26.82	Dividend yield	4.5%	8.3%	9.2%	12.3%	12.4%
Retirement benefit obligation	1.53	1.08	1.11	1.48	1.45						
Current tax liabilities	5.94	5.54	6.07	8.13	8.07						
Borrowings	2.39	2.50	3.29	2.84	2.46						
Other liabilities	1.70	2.11	0.13	0.17	0.17						
Total current liabilities	36.78	38.25	58.38	76.64	75.66						
Deferred taxation	4.61	5.15	5.70	8.34	7.80						
Borrowings	-	-	-	-	-						
Employees' gratuities/provisions	-	-	-	-	-						
Total non-current liabilities	4.61	6.23	6.81	9.82	9.26						
Total Liabilities	41.39	44.48	65.20	86.47	84.92						
EQUITY	51.41	58.15	66.61	78.42	87.91						

Source: Company Accounts, Cordros Research

Disclosures

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