

# Lafarge Africa Plc.

## Ignore the Debt Conversion; Focus on Fundamentals!

In announcing its 9M-16 result, the management of LAFARGE informed investors/analysts that the company, as at July, 1st 2016, converted shareholders' loan for an amount of USD493 million (out of USD510 million) to an equity instrument, on which the repayment (including interest at an average 6% p.a) is discretionary. The summary of this renegotiation (permissible under IAS 32) is that it removes volatility on the income statement by (1) significantly reducing losses from currency depreciation to only those emanating from outstanding third party USD borrowings and (2) charging interest expenses accruing from the loan to retained earnings.

Going forward, while acknowledging the impact of the debt conversion as par the summary above (recall that forex losses from sizeable USD loans -- accounting for about 60% of gross loans -- contributed significantly to the post tax loss the company reported over 9M-16), we choose to focus more on the (1) impact of higher cement price on margins, beginning from this quarter; (2) somewhat stable, but still expensive energy supply; and (3) on-boarding of 2.5MTs UNICEM's Line II at Mfamosing. We believe these have more direct link with the company's operations and in determining earnings over next year. We expect LAFARGE to return to profitable operation in 2017 and forecast PAT of N11.2 billion. The assumptions driving this forecast are (1) 5% volume growth; (2) higher average cement prices in Nigeria; (3) significantly lower forex losses; and (4) reduction in finance charges.

Notwithstanding the expected return to profitable operation next year, we think fundamentally, WAPCO's earnings recovery (to pre consolidation levels) has some miles to cover. Key risk is that the current high price of cement (N41,000/tonne price) - which is imperative to a quick and strong earnings recovery -- is not sustainable. Even in terms of volume, growth expectation (from the newly commissioned plant) is doused by the weak national consumption outlook (short term) and especially, the expected fierce competition from DANGCEM.

Our hunch is that DANGCEM -- the market leader -- might cut prices next year (in the second half), considering (1) the company's potentially lower production costs from conversion to cheaper fuel and (2) the need to protect its market share, particularly in the East which is exposed to threat from the on-boarding of UNICEM's Line II. Noting that LAFARGE lacks the capacity to counter aggressive competition, lower prices should slow down the pace of earnings recovery, more so that the elevated industry production costs (forex and energy especially) experienced over 2016 is unlikely to moderate materially in 2017. Notably, LAFARGE's energy diversification investments in key markets in Nigeria began way behind competition, and the results on earnings, in our view, are not expected (given pressure on cash flow, amid weak forex outlook) up until 2018/2019.

The performance of the South African subsidiary has been unimpressive. Down 64% as at 9M-16, the group's EBITDA from the subsidiary in Africa's second largest economy has fallen consistently in each of the three years since consolidation. Outlook remains weak, in light of intense competition and weak infrastructure investments faced in that market. We think the price increase implemented in July will be reversed in 2017.

Besides pricing and volume challenges, LAFARGE still has sizeable debt profile. Despite the above noted debt conversion (totaling N150 billion) to equity, the balance of gross borrowings as at 9M-16 was N133 billion (vs. N148 billion in 2015FY). In our view, while the huge loan book suggests that interest expenses will remain high over the next two years, combined with imminent forex losses on the outstanding USD85 million external borrowings (should they not be restructured), potentially constitute risks to earnings.

Following the revision to our forecasts, we have increased 2017 TP to N60.10 (from N50.38) and upgrade recommendation to BUY (from HOLD) due to the 31% correction in the company's share price since we last updated. At current price, the stock is trading on a forward PE and EV/EBITDA of 14.8x and 6.7x, at 33% and 13% premium respectively to Bloomberg's SSA comparables. While acknowledging the risks to earnings recovery in the short term, we think LAFARGE's shares have faced intense pressure and expect the market price to rise to our 2017 TP on relatively (compared to 2016) better performance.

## BUY

Target Price (N)	60.10
Current Price (N)	44.10
Implied Return (%)	36.27

### Company Data

NSE Code	WAPCO
Bloomberg Code	WAPCO:NL
Reuters Code	WAPCO.LG
Sector	INDUSTRIAL GOODS
Market Cap. (N'bn)	247.10
Free Float (%)	34.97

Ratios	9M-16	9M-15	2017FY
Gross margin	11.25%	33.37%	13.48%
Opex margin	12.55%	10.39%	13.00%
EBIT margin	-20.47%	19.21%	-14.29%
PAT margin	-23.22%	15.06%	-19.42%
RoAE	-20.34%	19.44%	-21.95%
EPS (N)	-6.45	6.96	-7.67

### Price movement (WAPCO vs. Benchmark Indices)



# Financial Statement (N'bn).

Statement of Comprehensive Income (N'000)						Profitability Ratios					
	2014a	2015a	2016f	2017f	2018f		2014a	2015a	2016f	2017f	2018f
Turnover	260.8	228.2	216.3	276.9	293.3	Gross profit margin	31.8%	32.4%	13.5%	24.0%	24.1%
Cost of sales	(177.8)	(154.4)	(187.2)	(210.5)	(222.6)	EBITDA margin	21.1%	26.0%	7.3%	18.1%	18.2%
Gross profit	83.0	73.8	29.2	66.5	70.7	Operating profit margin	18.5%	21.7%	-14.3%	9.7%	11.1%
Gross opex	(29.1)	(22.8)	(28.1)	(34.6)	(37.0)	PBT margin	15.5%	12.8%	-21.7%	4.7%	7.3%
Other operating income/(expenses)	(5.7)	(1.4)	(1.1)	(1.1)	(1.1)	Net profit margin	13.0%	11.8%	-19.4%	4.0%	6.2%
Operating profit	48.3	49.6	(30.9)	26.9	32.7	RoAE	19.5%	15.4%	-22.0%	5.4%	8.7%
Interest income	3.3	2.6	1.4	1.9	2.0	RoAA	9.5%	6.2%	-8.7%	2.1%	3.4%
Interest expenses	(11.3)	(11.2)	(17.5)	(15.6)	(13.1)	RoACE	13.6%	8.7%	-12.7%	3.3%	5.5%
Share of net loss from associate	-	-	-	-	-						
Profit before tax	40.4	29.3	(47.0)	13.1	21.5	Liquidity Ratios					
Taxation	(6.5)	(2.3)	5.0	(2.0)	(3.2)	Working capital (N'm)	-3,506	-15,511	-55,781	-54,893	-58,394
<b>Profit for the year - continued</b>	<b>33.8</b>	<b>27.0</b>	<b>(42.0)</b>	<b>11.2</b>	<b>18.3</b>	Current ratio	1.0x	0.8x	0.6x	0.7x	0.7x
						Quick ratio	0.5x	0.5x	0.4x	0.4x	0.4x
						Cash ratio	0.3x	0.2x	0.1x	0.1x	0.1x
Financial Position (N'000)						Efficiency Ratios					
	2014a	2015a	2016f	2017f	2018f		2014a	2015a	2016f	2017f	2018f
Property, plant and equipment	331.3	364.4	402.8	415.4	434.8	Fixed assets turnover	0.8x	0.6x	0.5x	0.7x	0.7x
Intangible assets	2.2	1.5	3.1	3.3	3.5	Current assets turnover	3.6x	3.1x	2.1x	2.5x	2.5x
Investment in subsidiaries	-	-	-	-	-	Total assets turnover	0.6x	0.5x	0.4x	0.5x	0.5x
Investment in Associate	0.0	0.0	0.1	0.2	0.2	Inventory turnover	6.7x	4.8x	4.8x	4.5x	4.6x
Other long term investment	0.0	0.0	0.0	0.1	0.1	Receivables turnover	16.0x	10.5x	7.1x	7.2x	7.3x
Deferred tax asset	0.3	0.4	0.8	0.9	0.9	Payables turnover	3.2x	2.1x	2.0x	1.9x	1.9x
Long term receivables	6.2	10.0	0.1	0.2	0.2	Days inventory outstanding	55	76	76	80	79
Assets classified as held for sale	-	-	-	-	-	Days collection outstanding	23	35	51	50	50
<b>Total non current assets</b>	<b>343.7</b>	<b>379.1</b>	<b>406.9</b>	<b>420.1</b>	<b>439.8</b>	Days payable outstanding	139	182	210	199	201
Inventories	31.5	33.0	45.3	47.3	49.6	Cash conversion cycle	-61	-71	-82	-69	-72
Trade and other receivables	19.8	23.5	37.4	39.1	40.9						
Current tax receivable	0.5	0.9	2.6	2.7	2.9	Solvency Ratios					
Cash and cash equivalents	20.3	16.5	17.7	23.3	24.3	Debt-to-capital ratio	0.4x	0.5x	0.4x	0.4x	0.4x
<b>Current assets</b>	<b>72.2</b>	<b>73.9</b>	<b>102.9</b>	<b>112.5</b>	<b>117.7</b>	Net debt-to-equity ratio	45.8x	57.9x	40.7x	38.2x	34.8x
<b>TOTAL ASSETS</b>	<b>415.9</b>	<b>453.0</b>	<b>509.8</b>	<b>532.5</b>	<b>557.4</b>	Interest coverage	4.3x	4.4x	-1.8x	1.7x	2.5x
Trade and other payables	67.5	76.8	107.6	115.0	122.7						
Provisions	1.3	1.9	1.5	1.6	1.7	Investment Ratios					
Financial liabilities	5.1	5.3	33.0	32.9	32.7	Earnings per share (N)	7.7	5.9	-7.7	2.0	3.3
Deferred revenue	0.2	0.2	0.0	0.1	0.1	Dividend per share (N)	3.6	3.0	0.0	1.0	1.7
Current tax payable	1.6	1.3	1.7	1.8	2.0	Dividend Payout	47%	51%	0%	50%	50%
<b>Total current liabilities</b>	<b>75.7</b>	<b>89.4</b>	<b>158.7</b>	<b>167.4</b>	<b>176.1</b>	Dividend yield	4.5%	3.1%	0.0%	2.3%	3.8%
Financial liabilities	116.0	142.9	96.2	95.0	87.1						
Retirement benefits obligation	9.0	1.5	4.8	5.1	5.5						
Deferred tax	34.2	33.4	34.0	36.3	38.7						
Provisions	3.1	3.2	4.5	4.8	5.1						
Deferred revenue	2.4	2.1	0.7	0.8	0.9						
Liabilities associated with assets held for sale	-	4.4	4.3	14.5	32.0						
<b>Total non-current liabilities</b>	<b>164.6</b>	<b>187.5</b>	<b>144.5</b>	<b>156.5</b>	<b>169.4</b>						
<b>TOTAL LIABILITIES</b>	<b>240.4</b>	<b>276.9</b>	<b>303.2</b>	<b>323.9</b>	<b>345.4</b>						
Share capital	2.2	2.3	2.7	2.7	2.7						
Share premium	174.0	186.4	217.6	217.6	217.6						
Retained earnings	87.2	101.0	41.3	43.3	46.7						
Foreign currency translation reserve	(1.3)	(10.2)	2.5	2.5	2.5						
Other reserves arising on business combination	(161.7)	(162.2)	(77.6)	(77.6)	(77.6)						
Non-controlling interest	75.2	58.8	20.0	20.0	20.0						
<b>TOTAL EQUITY</b>	<b>175.6</b>	<b>176.2</b>	<b>206.6</b>	<b>208.6</b>	<b>212.0</b>						

Source: Company Accounts, Cordros Research

# Disclosures

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