

# Dangote Sugar Refinery Plc.

## Update After Speaking with Management

The management of Dangote Sugar Refinery Plc (DANGSUGAR) hosted earnings call with analysts last week to discuss the company's performance in 2016, update on recent developments, and provide guidance for 2017. Our key takeaways are as follows:

**Margin target is quite ambitious.** On the earnings call, management said it plans to achieve 20% gross margin in 2017F, 646 bps ahead of 2016's 13.5%. The margin guidance is also well-ahead of the record-low 7.3% achieved in Q4-16 (wherein realized per tonne selling price reached record high), which was attributed to both the increase in the international price of raw sugar and the sharp slippage of the Naira exchange rate at the alternative markets. In defence of the margin guidance, the management said it (1) is purchasing forex at a relatively lower average rate (compared to Q4-2016, *but not the entire 2016*) and (2) expects higher output from Savannah where margins are higher. Management said the soon-to-be-released Q1-17 results show that margins are already returning to "normal".

But we note that part of the gain from reduced FX cost has been offset by the N20,000 per tonne reduction of selling price last quarter. And while mindful of the success achieved thus far in the FX environment, we think it is too early to expect that the average NGN/USD rate will be lower this year, compared to 2016. Besides, energy cost (per tonne cost in Q4-16 was highest in recent history) remains substantial, with the usage ratio for gas to LPFO (at 50:50, against the preferable 80:20) still unfavourable. When asked about the gas supply outlook, to our ears, the answer provided by management was not encouraging. In addition, we think the expected support from Savannah, where output is still about 2% of Group's total, is overrated.

**Forex condition has improved.** Management said on the call that it is currently sourcing forex at a relatively lower average rate compared to Q4-16. Although most of its requirements are still met outside of the central bank's window -- to cater to pressing obligations before the forward contracts are settled -- management said the pressure on the company's operations has subsided, following the significant appreciation of the NGN in the alternative markets since the third week of February. But when we asked, management confirmed that its internally adopted blended exchange rate (around which it prepared its 2017 budget) is N350-N400.

From a broader perspective, we would expect continued improvement in the forex condition -- recall that the reverse significantly constrained purchasing power in 2016 -- to support recovery (albeit cautiously) in aggregate demand for confectionaries and beverage products with high sugar input requirements.

**Volume returning to normal level.** Following the price increase after Q3-16, we had forecasted DANGSUGAR's sales volume to fall by 20% q/q to 143K tonnes in Q4-16. Indeed, sales fell during the period (where management revealed that a lot of its customers reduced production by as much as 50% due to higher sugar prices), but the realized volume (164K tonnes) was higher than

# HOLD

Target Price (N)	7.31
Current Price (N)	6.12
Implied Return (%)	19.36

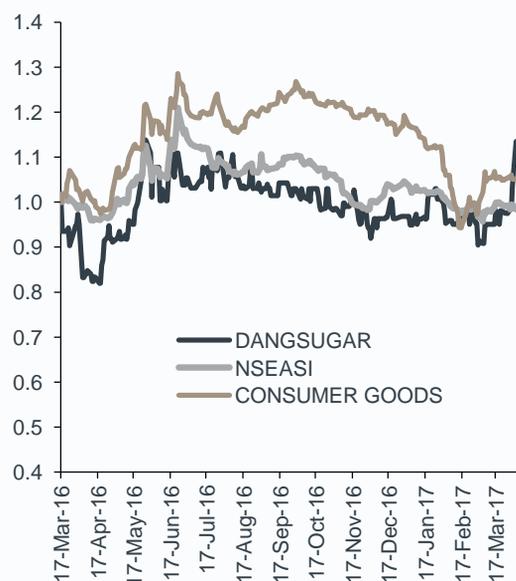
## Company Data

NSE Code	DANGSUGAR
Bloomberg Code	DANGSUGAR:NL
Reuters Code	DANGSUGAR.LG
Sector	CONSUMER GOODS
Market Cap. (N'bn)	73.44
Free Float (%)	26.90

Ratios	Q4-2016	Q4-2015	2016FY
Gross margin	7.32%	7.00%	13.54%
Opex margin	4.20%	8.21%	4.08%
EBIT margin	3.83%	2.67%	9.90%
PAT margin	7.86%	7.85%	8.48%
RoAE	21.97*	20.79%*	23.24%
EPS (N)	0.36	0.18	1.20

\*Trailing

## Price movement (DANGSUGAR vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros research

we expected. However, management claims to have seen encouraging demand during Q1-17 (we sense above Q4-16), aided by the price reduction (referred to above) -- which was implemented in March, by the way. It said focus this year will be on growing market share, and plans to overcome major distribution challenges with additional warehouses closer to key markets. The improved security situation in the North is also considered a major opportunity for renewed cross-border trades.

**Scaled down backward integration projects.** Management said it faced difficulty acquiring lands in targeted areas of Katsina, Kebbi, and Taraba states, owing to disputes with local communities and state governments. As such, it has scaled down the production it aims to achieve from the entire backward integration programme to 1.5MTs (vs. 2MTs) across six factories (from eight previously targeted), with 6 years (previously 10 years) overall delivery timeline, counting from 2017. In the interim, implementation will focus on the projects in Adamawa (Savannah) and Nasarawa.

Note that the mention of 2MTs comes to us as a surprise, given that reference had always been made in previous calls/presentations to the target of 1.5MTs. Also, we are in wait-and-see mode regarding the delivery timeline for the BIP, as management seems to retain a 10-year target with every passing year.

**Seeming change in capital raising plan.** Based on our understanding, DANGSUGAR will be raising less than the USD 100 million it guided to in 2016. Although it did not provide a revised estimate during the call, management said it may not be requiring as much additional capital as previously proposed, in line with the decision to scale down backward integration projects. In addition, management had stated in previous calls that 80% of the previously proposed capital raise will be funded through borrowing from the money market, using instruments such as commercial papers. But from the latest call, it appears focus has shifted to the central bank for the debt financing, where it looks to borrow at lower interest rates.

**View of Competitors.** We asked management whom it considers its biggest competitor between BUA Sugar and Golden Sugar. Our understanding from the response is that BUA is a competitor in the North (and also supplies sugar to the East) while Golden Sugar -- focused mainly on the corporate end of the market -- is a competitor in the West (mainly Lagos). DANGSUGAR has a better regional presence, with 49% of its revenue generated from Lagos, 36% from the North and the balance from the West (ex Lagos) and East. The management considers the two competitors to be of equal strength, as they both share the same refining capacity (700k tones/annum) and operate within the same quota (700K tonnes vs. DANGSUGAR's 960K tonnes) allocated to them by the sugar council.

**We reviewed our estimates.** After the call, we made the following changes (against previous estimates) for 2017F: (1) -20% sales volume, from -28%, (2) reduction of gross margin to 14.7%, from 18.9%, and (3) downward review of EBITDA to N28.2 billion, from N32.5 billion, and PBT to N25.9 billion, against N28.4 billion previously forecasted. **Notwithstanding the downward revisions, the latest estimates of revenue (+21%), EBITDA (+31%), and PBT (+31%) remain well-ahead of 2016's realized. But at a TP of N7.31 (previously N8.31), 19.4% ahead of current market value, we lower rating on the stock to HOLD (previously BUY).**

# Financial Statement (N'million).

Income Statement	2014a	2015a	2016a	2017f	2018f	Profitability Ratios	2014a	2015a	2016a	2017f	2018f
Turnover	94.86	101.06	169.72	204.63	208.52	Gross profit margin	19.6%	20.5%	13.5%	14.7%	14.6%
Cost of Sales	-76.23	-80.33	-146.74	-174.48	-178.14	EBITDA margin	19.8%	19.5%	12.1%	13.8%	13.6%
Gross profit	18.63	20.73	22.99	30.15	30.38	Operating profit margin	15.9%	15.7%	12.1%	11.0%	10.7%
Operating expenses	-8.60	-6.21	-6.93	-8.47	-8.74	PBT margin	16.1%	16.4%	11.6%	12.7%	12.5%
Investment income	0.29	0.01	0.60	0.83	0.89	Net profit margin	12.3%	11.4%	8.5%	8.6%	8.5%
Other income	5.07	1.33	0.75	0.75	0.75	RoAE	23.7%	21.1%	23.3%	23.5%	20.2%
Interest expenses	-0.11	-0.66	-0.30	-0.18	-0.18	RoAA	13.2%	11.8%	10.4%	9.3%	8.5%
Profit before tax	15.27	16.55	19.72	25.92	26.16						
Tax expense	-3.64	(5.01)	(5.22)	(8.29)	(8.37)						
<b>Profit after tax</b>	<b>11.64</b>	<b>11.54</b>	<b>14.50</b>	<b>17.62</b>	<b>17.79</b>						
Financial Position	2014a	2015a	2016a	2017f	2018f	Liquidity Ratios	2014a	2015a	2016a	2017f	2018f
PPE	50.47	54.80	54.80	61.94	66.71	Working capital (N'bn)	1.5	3.8	11.8	22.6	26.4
Other assets	0.19	0.00	0.00	0.00	0.00	Current ratio	1.0x	1.1x	1.1x	1.2x	1.2x
Biological assets	1.12	1.55	-	-	-	Quick ratio	0.6x	0.7x	0.6x	0.7x	0.7x
Deferred tax assets	2.49	2.97	10.10	11.42	12.30	Cash ratio	0.2x	0.2x	0.3x	0.4x	0.4x
Intangible assets	0.26	0.14	0.01	0.01	0.02						
<b>Total Non-current assets</b>	<b>54.54</b>	<b>59.46</b>	<b>64.92</b>	<b>73.37</b>	<b>79.02</b>	Efficiency Ratios	2014a	2015a	2016a	2017f	2018f
Inventories	15.10	15.55	47.41	53.58	57.71	Fixed assets turnover	0.5x	0.5x	0.3x	0.3x	0.3x
Biological assets	0.68	1.89	3.01	3.40	3.66	Current assets turnover	0.4x	0.4x	0.7x	0.6x	0.7x
Trade debtors/other debtors	14.01	14.70	17.73	20.04	21.59	Total assets turnover	1.0x	1.0x	1.0x	1.0x	1.0x
Other assets	1.41	1.17	9.43	10.65	11.47	Inventory turnover	0.2x	0.2x	0.1x	0.1x	0.1x
Held for sale investment in subsidiary	0.86	0.86	0.00	0.00	0.00	Receivables turnover	0.2x	0.2x	0.1x	0.1x	0.1x
Bank/cash balances	6.20	8.99	35.02	39.58	42.63	Payables turnover	0.3x	0.3x	0.2x	0.1x	0.1x
<b>Total current assets</b>	<b>38.26</b>	<b>43.17</b>	<b>112.60</b>	<b>127.25</b>	<b>137.06</b>	Days inventory outstanding	60	61	33	28	28
<b>Total assets</b>	<b>92.80</b>	<b>102.62</b>	<b>177.52</b>	<b>200.62</b>	<b>216.08</b>	Days collection/sales outstanding	75	72	43	36	35
Trade and other payables	25.23	28.09	88.28	91.79	97.17	Days payable outstanding	121	128	220	192	199
Retirement benefit obligation	1.53	1.08	1.03	1.07	1.13	Cash conversion cycle	14	6	-143	-128	-136
Current tax liabilities	5.94	5.54	6.60	6.86	7.26						
Borrowings	2.39	2.50	2.04	2.04	2.04	Investment Ratios	2014a	2015a	2016a	2017f	2018f
Other liabilities	1.70	2.11	2.81	2.92	3.09	Earnings per share (N)	1.0	1.0	1.2	1.5	1.5
<b>Total current liabilities</b>	<b>36.78</b>	<b>39.33</b>	<b>100.75</b>	<b>104.68</b>	<b>110.70</b>	Dividend per share (N)	0.4	0.5	0.6	0.8	0.8
Deferred taxation	4.61	5.15	11.48	11.93	12.63	Payout	41.3%	52.0%	49.7%	52.0%	52.0%
<b>Total non-current liabilities</b>	<b>4.61</b>	<b>5.15</b>	<b>11.48</b>	<b>11.93</b>	<b>12.63</b>	Dividend yield	4.5%	8.3%	9.8%	12.5%	12.6%
<b>Total Liabilities</b>	<b>41.39</b>	<b>44.48</b>	<b>112.23</b>	<b>116.69</b>	<b>123.53</b>						
<b>EQUITY</b>	<b>51.41</b>	<b>58.15</b>	<b>66.15</b>	<b>83.93</b>	<b>92.55</b>						

Source: Company Accounts, Cordros Research

# Disclosures

**Analyst:**

**Christian Orajekwe** (*christian.orajekwe@cordros.com*)

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