

Lafarge Africa Plc.

Finally!!!

Lafarge Africa Plc (LAFARGE) stated in a press release today, that a resolution to raise the sum of N140 billion by way of a Rights Issue (RI), will be presented to its shareholders at the upcoming Annual General Meeting (AGM).

The Rights Issue ...

It was stated in the press release that the RI will be offered at such price, time, and on such other terms as the directors of the company may deem fit. The amount to be raised, if applied to LAFARGE's last traded price of N49.60, equates to new 2.8 billion ordinary shares that would be offered to existing shareholders of the company. This potentially increases the overall outstanding shares of LAFARGE to 8.3 billion (from 5.5 billion). However, considering the minimum period it takes (about three months) to conclude a capital raise via Rights Issue, using the stock's current market price to estimate the potential additional shares resulting from the offer may not be a fair representation.

... Is Long Coming

In the notice of the AGM, it was stated that the Directors of LAFARGE will seek shareholders authorization to apply any shareholder loan due to any person, towards payment for any shares subscribed for by such person under the RI. As at the end of Q1-2017, LAFARGE had shareholder loan worth USD581 million (N164 billion using the company's 2016FY average NGN/USD of N283). The facility was disbursed by Lafarge Holcim -- its parent company -- through various subsidiaries. Lafarge Holcim holds cumulative stake of 73% in the local subsidiary.

Recall that in July 2016, following significant unrealized FX losses in the first half, the management of LAFARGE converted its shareholder loan worth USD493 million to quasi-equity, allowing for (1) the elimination of the volatility impact of the USD borrowing on the income statement and (2) the repayment of the principal and the interests to be at the sole discretion of LAFARGE, according to the negotiation. **Since then, the management of LAFARGE had been asked on several occasions on the possibility of fully converting the parent debt to equity, and on each occasion (including during the latest Q1-17 conference call with analysts), the response was not in the affirmative.**

Given its 73% stake in LAFARGE, we estimate the parent company's share of the N140 billion to be N101.9 billion. Pending further details, we assume that the balance of the Rights proceed from the minority shareholders will also be applied towards the repayment of the USD debt. Altogether, we look for a net outstanding parent loan of N24.6 billion after the exercise, which LAFARGE will either (1) continue to recognize as quasi-equity or (2) completely eliminate, by raising debt capital using the N40 billion outstanding from last year's N100 billion bond programme for which the company obtained regulatory approval. **We understand that the plan is to fully pay back the parent USD borrowings, but if that is the case, we wonder why LAFARGE is not raising capital sufficient to achieve this purpose once and for all.**

Let Go of It

While the additional share issue risks diluting (should some existing shareholders reject their Rights) per share dividend and share holding, we view the RI as crucial for LAFARGE, given the company's leveraged balance sheet, where we estimate normalized net debt to EBITDA (ND/EBITDA) to be around 6.7x as at end-2016FY. **If successful, we assume the RI would be earnings accretive from 2018F, wherein we look for (1) improvement in interest cover (from 0.89x in 2016FY to 4.2x) and (2) a decline in ND/EBITDA to around 0.7x.** Importantly, the debt repayment more reasonably addresses LAFARGE's underlying FX risk, and allows management focus on profitable operations going forward.

BUY

Target Price (N)	80.56
Current Price (N)	49.60
Implied Return (%)	63.85

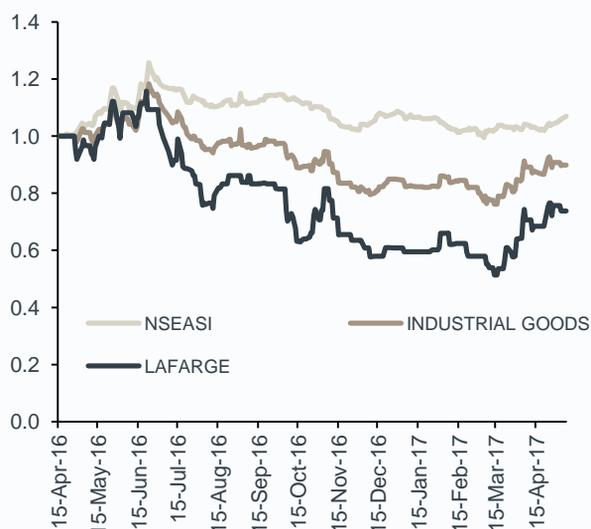
Company Data

NSE Code	WAPCO
Bloomberg Code	WAPCO:NL
Reuters Code	WAPCO.LG
Sector	INDUSTRIAL GOODS
Market Cap. (N'bn)	271.84
Free Float (%)	27.19

Ratios	Q1-17	Q1-16	2016FY
Gross margin	25.70%	214.84%	18.51%
Opex margin	10.27%	12.33%	13.99%
EBIT margin	16.47%	-0.34%	-5.00%
PBT margin	11.62%	-4.24%	-10.39%
RoAE	10.82*	10.33*	7.95%
EPS (N)	0.93	-0.19	3.15

*Trailing 12m

Price movement (WAPCO vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

Latest Result

Lafarge Africa Plc (LAFARGE) announced Q1-17 PAT of N5.2 billion (vs. -N1.9 billion in Q1-16), driven by (1) 55% y/y increase in revenue, (2) comparatively higher gross margin, and (3) higher investment and other incomes. The PAT, however, was behind consensus, owing to higher effective tax rate.

The strong start to the year notwithstanding, the low point of the result was the 1247 bps q/q contraction of margin, which contradicted management's claim that it continues to witness savings from (1) energy efficiency, via increasing substitution of alternative fuel and (2) de-correlation of FX, via local sourcing and energy diversification. **Although not communicated during the analysts' call, management claimed the Q4-16 GM was driven higher by one-offs, relating to accounting treatment of gas contracts and some other costing.**

That said, LAFARGE's latest result, excluding the surprises, was consistent with the performance in Q4-16, and in line with consensus expectation of an improvement in the company's performance following the tough operating environment in 2016. Management retained its 0-2% demand growth, and flat to declining outlook, for both the Nigerian and South African markets respectively. **We retain BUY recommendation on the stock. Our estimates (under review) have not factored in the RI and the Q1-17 result.**

Financial Statement (N'billion).

Statement of Comprehensive Income						Profitability Ratios					
	2014a	2015a	2016a	2017f	2018f		2014a	2015a	2016a	2017f	2018f
Turnover	260,810	267,234	219,714	275,954	287,307	Gross profit margin	31.8%	30.9%	18.5%	30.0%	30.1%
Cost of sales	(177,783)	(184,589)	(179,052)	(193,168)	(200,827)	EBITDA margin	25.0%	25.8%	13.5%	23.3%	23.4%
Gross profit	83,028	82,645	40,662	82,786	86,479	Operating profit margin	19.1%	19.8%	6.3%	16.6%	16.6%
Gross opex	(29,061)	(31,509)	(30,735)	(35,874)	(37,637)	PBT margin	15.5%	11.0%	-10.4%	11.0%	12.3%
Other operating income/(expenses)	(5,676)	(13,096)	(20,905)	(1,104)	(1,034)	Net prof it margin	13.0%	10.2%	7.7%	9.3%	10.5%
Operating profit	49,875	52,838	13,769	45,808	47,808	RoAE	19.5%	15.4%	8.0%	9.9%	10.9%
Interest income	3,334	1,953	3,676	1,695	1,770	RoAA	9.5%	6.3%	3.5%	4.9%	5.3%
Interest expenses	(11,266)	(10,702)	(15,504)	(16,701)	(14,000)	RoACE	13.6%	8.7%	4.8%	6.5%	7.4%
Share of net loss from associate	-	(5)	(13)	-	-						
Profit before tax	40,358	29,287	(22,819)	30,343	35,472	Liquidity Ratios					
Taxation	(6,538)	(2,124)	39,717	(4,551)	(5,321)	Working capital (N/m)	-3,506	-20,478	-77,644	-84,665	-81,091
Profit for the year - continued	33,820	27,163	16,899	25,792	30,151	Current ratio	1.0x	0.8x	0.6x	0.6x	0.6x
						Quick ratio	0.5x	0.4x	0.3x	0.3x	0.3x
						Cash ratio	0.3x	0.2x	0.1x	0.1x	0.1x
Financial Position						Efficiency Ratios					
	2014a	2015a	2016a	2017f	2018f		2014a	2015a	2016a	2017f	2018f
Property, plant and equipment	331,257	364,397	390,489	428,891	448,425	Fixed assets turnover	0.8x	0.7x	0.6x	0.6x	0.6x
Intangible assets	2,197	1,549	1,563	1,717	1,801	Current assets turnover	3.6x	3.6x	2.2x	2.6x	2.5x
Investment in Associate	43	27	90	98	109	Total assets turnover	0.6x	0.6x	0.4x	0.5x	0.5x
Other long term investment	8	6	6	7	13	Inventory turnover	6.7x	5.7x	4.6x	4.1x	4.0x
Deferred tax asset	295	-	7,641	8,392	8,780	Receivables turnover	16.0x	12.9x	9.3x	10.2x	9.9x
Long term receivables	6,248	9,975	-	-	-	Payables turnover	3.2x	2.6x	2.0x	1.8x	1.8x
Total non current assets	343,732	378,434	404,147	443,893	464,144	Days inventory outstanding	55	64	79	88	91
Inventories	31,545	33,027	44,531	48,910	51,143	Days collection outstanding	23	28	39	36	37
Trade and other receivables	19,830	21,590	25,801	28,339	29,635	Days payable outstanding	139	148	205	210	214
Current tax receivable	509	2,138	8,746	9,606	10,050	Cash conversion cycle	-61	-56	-87	-86	-87
Cash and cash equivalents	20,330	16,493	19,265	21,160	22,065						
Current assets	72,214	73,249	98,344	108,015	112,893	Solvency Ratios					
TOTAL ASSETS	415,947	451,683	502,491	551,908	577,037	Debt-to-capital ratio	0.4x	0.5x	0.3x	0.3x	0.3x
Trade and other payables	67,463	75,012	100,808	111,361	117,901	Net debt-to-equity ratio	45.8x	57.9x	39.5x	43.5x	36.6x
Provisions	1,334	1,864	1,177	1,300	1,379	Interest coverage	4.4x	4.9x	0.9x	2.7x	3.4x
Financial liabilities	5,134	12,823	59,483	63,980	57,714						
Deferred revenue	235	235	235	259	277	Investment Ratios					
Current tax payable	1,554	387	825	911	967	Earnings per share (N)	7.7	6.0	3.1	4.7	5.5
Total current liabilities	75,720	93,726	175,987	192,680	193,983	Dividend per share (N)	3.6	3.0	1.1	2.4	2.8
Financial liabilities	116,002	135,465	68,047	76,434	64,747	Dividend Payout	47%	50%	34%	50%	50%
Retirement benefits obligation	8,979	7,542	3,780	4,176	4,424	Dividend yield	4.5%	3.1%	2.4%	5.3%	6.2%
Deferred tax	34,173	32,937	-	-	-						
Provisions	3,125	2,577	2,448	2,705	2,866						
Deferred revenue	2,368	2,134	1,555	1,717	1,821						
Liabilities associated with assets held for sale	-	1,150	1,721	2,366	28,678						
Total non-current liabilities	164,647	181,805	77,551	87,398	102,537						
TOTAL LIABILITIES	240,367	275,531	253,538	280,078	296,520						
Share capital	2,202	2,277	2,740	2,740	2,740						
Share premium	173,998	186,420	217,528	217,609	217,609						
Retained earnings	87,206	100,993	102,843	114,479	123,165						
Foreign currency translation reserve	(1,341)	(10,157)	(8,660)	2,501	2,501						
Other reserves arising on business combination	(161,690)	(162,185)	(256,900)	(256,900)	(256,900)						
Non-controlling interest	75,204	58,803	191,401	191,401	191,401						
TOTAL EQUITY	175,580	176,152	248,953	271,830	280,517						

Source: Company Accounts, Cordros Research

Disclosures

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BUY (OVERWEIGHT) - Over the next twelve months, we expect the stock to return at least 20% above the current market price.

HOLD (NEUTRAL) - Over the next twelve months, we expect the stock to range between <-10% and <+20% from the current market price.

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