

Dangote Sugar Refinery Plc.

Continued weak volume and higher opex offset resilient gross margin

Update: We update on DANGSUGAR following the recent Q2-18 result, wherein revenue and net profit came behind Q2-17s at strong double-digits. Compared to our estimates, both revenue and net profit were lower by 14% and 13% respectively. Stronger gross margin minimized the effect of still-weak volume and higher-than-expected opex, in what would have been a more disappointing quarter. We now expect 2018FY net profit will be lower by 31% vs. 2017FY (-20% previously), whilst noting possible upside from (1) continued resilient margin over H2-18 (even in the traditionally weak Q4) and (2) strong reduction of opex from the current surprisingly high level (Q2-18 figure highest since Q4-16).

Further revision of volume estimate: At 312Kts in H1-18, DANGSUGAR's sales volume is lower by 14% vs. H1-17. The difficult Apapa traffic condition remains a challenge, but more importantly, competition from smugglers importing fortified sugar (accounting for over 60% of DANGSUGAR's sales volume) is apparently on the rise, amidst (1) globally soft raw sugar prices (-26% Ytd and -41% in 52 weeks), (2) relatively high domestic prices (+66% compared to two years ago), and (3) stable FX. DANGSUGAR's sales volume are typically lower during the wet season in Q3, and sales in Q4-18 are unlikely to beat H1 run-rate under the prevailing market conditions. Consequently, we have revised our 2018 volume estimate lower to 609Kts (previously 691Kts), representing c.-8% vs. 2017FY.

Resilient margin: At 30.3%, the gross margin achieved in Q2 is slightly above the 29.5% we estimated. We believe margin was boosted by a further reduction of per tonne sugar cost (6% q/q) and marginal increase (2% q/q) in selling price. We increase gross margin estimate for 2018 slightly higher to 27% (previously 26%), while reiterating (1) better energy mix, (2) stable exchange rate, (3) stable outlook of global raw sugar prices, and (4) positive mix from growing contribution (4% of total sales volume, from 2% previously) of high margin Savannah, as tailwinds supporting our view.

We estimate 2018FY EBITDA and net profit will be lower by 16% and 31% respectively. Our EBITDA estimate reflects both our view on low revenue (-20% vs. 2017FY) and the increase in opex estimate to NGN8 billion (6.5% vs. 2017FY), following the surprise print in Q2. We do not see the price increase mentioned above resetting revenue in H2, given the little size (basically to support revenue in Q3), amidst possible reversal in Q4. In addition to the aforementioned, our estimate of wider net profit decline adjusts for the huge (one-off) FX gain recorded in Q4-17.

Valuation: We revise target price lower to NGN16.27 (previously NGN17.42), with a HOLD rating. DANGSUGAR's stock has lost 20% since we updated on Q1-18 result (with SELL rating). On our estimates, the stock is trading at forward (2018E) P/E and EBITDA multiples of 7.43x and 4.03x respectively, almost in line with its five-year historical averages, but below the Middle East peer averages of 13.2x and 8.6x respectively.

Risks: These include (1) higher pressure on volume, which may (2) prompt drastic price discounting, and (3) possibly pressure margins lower.

HOLD

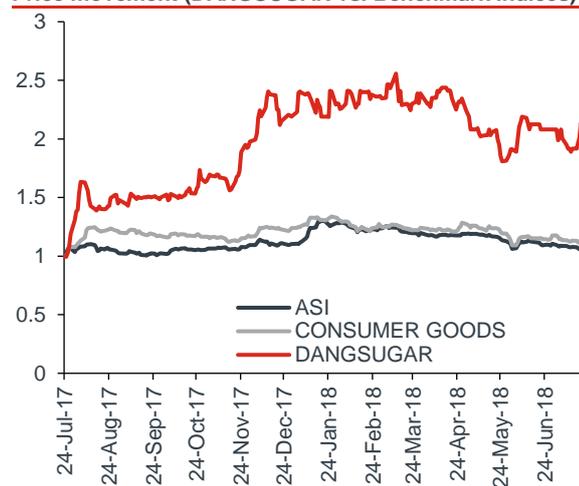
Target Price (NGN)	16.27
Current Price (NGN)	17.00
Implied Return (%)	-4.30
Expected Dividend Yield (%)	7.12
Expected Total Return (%)	2.82

Company Data

NSE Code	DANGSUGAR
Bloomberg Code	DANGSUGAR:NL
Reuters Code	DANGSUGAR.LG
Sector	CONSUMER GOODS
Market Cap. (NGN' bn)	204.00
Free Float (%)	26.90

Ratios	Q2-2018	Q2-2017	2017FY
Gross margin	30.30%	13.17%	24.94%
Opex margin	5.33%	3.30%	3.66%
EBITDA margin	28.75%	11.47%	23.94%
EBIT margin	25.44%	9.99%	21.48%
PAT margin	17.32%	7.99%	19.46%
RoAE**	39.60%	33.46%	21.97%
EPS (NGN)	0.62	1.03	3.32

Price movement (DANGSUGAR vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

Financial Statement (NGN'billion).

Income Statement (N'bn)	2015a	2016a	2017a	2018e	2019e
Turnover	101.06	169.72	204.42	163.99	213.93
Cost of Sales	-80.33	-146.74	-153.43	-119.67	-155.77
Gross profit	20.73	22.99	50.99	44.32	58.17
Operating expenses	-6.21	-6.93	-7.48	-7.97	-8.38
Other income	1.33	0.75	0.40	0.46	0.46
Operating profit	15.85	16.81	43.91	36.80	50.25
Investment income	0.01	0.60	3.36	2.58	3.17
Fair value adjustments	1.35	2.50	2.47	1.13	1.39
Interest expenses	-0.66	-0.30	3.86	-0.14	-0.14
Profit before tax	16.55	19.61	53.60	40.37	54.68
Tax expense	-5.01	-5.22	-13.82	-12.92	-17.50
Profit after tax	11.54	14.40	39.78	27.45	37.18

Financial Position (N'bn)	2015a	2016a	2017a	2018e	2019e
PPE	54.80	54.80	59.41	69.61	85.77
Other assets	0.00	0.00	0.00	0.05	0.06
Biological assets	1.55	-	-	-	-
Investment property	-	-	-	-	-
Deferred tax assets	2.97	10.10	7.17	7.39	9.11
Intangible assets	0.14	0.01	0.00	0.00	0.00
Total Non-current assets	59.46	64.92	66.59	77.06	94.94
Inventories	15.55	47.41	47.66	31.37	38.66
Biological assets	1.89	3.01	2.81	1.28	1.58
Trade and other receivables	14.70	17.73	20.91	29.35	36.16
Other assets	1.17	9.43	14.88	21.49	26.48
Held for sale investment in subsidiary	0.86	-	0.87	0.90	1.10
Bank/cash balances	8.99	35.02	41.37	31.47	38.78
Total current assets	43.17	112.60	128.49	115.87	142.76
Total assets	102.62	177.52	195.08	192.92	237.70
Current tax liabilities	5.54	6.60	17.72	22.54	27.87
Retirement benefit obligation	1.08	1.03	0.98	0.90	1.30
Trade and other payables	28.09	88.28	75.65	62.25	76.94
Borrowings	2.50	2.04	0.07	0.07	0.07
Other liabilities	2.11	2.81	1.24	0.70	0.87
Total current liabilities	39.33	100.75	95.66	86.47	107.04
Borrowings	-	-	1.47	5.60	7.36
Deferred tax liabilities	5.15	11.48	5.21	7.06	8.82
Employees' gratuities/provisions	-	-	-	-	-
Total non-current liabilities	5.15	11.48	6.68	7.06	8.82
Total Liabilities	44.48	112.23	102.34	93.74	115.86
EQUITY	58.15	66.15	92.74	99.19	121.84

Source: Company Accounts, Cordros Research estimates

Profitability Ratios	2015a	2016a	2017a	2018e	2019e
Gross profit margin	20.5%	13.5%	24.9%	27.0%	27.2%
EBITDA margin	21.1%	14.2%	25.1%	26.3%	27.3%
Operating profit margin	15.7%	9.9%	21.5%	22.4%	23.5%
PBT margin	16.4%	11.6%	26.2%	24.6%	25.6%
Net profit margin	11.4%	8.5%	19.5%	16.7%	17.4%
RoAE	21.1%	23.2%	50.1%	28.6%	33.6%
RoAA	11.8%	10.3%	21.4%	14.1%	17.3%

Liquidity Ratios	2015a	2016a	2017a	2018e	2019e
Working capital (NGN'bn)	3.8	11.8	32.8	29.4	35.7
Current ratio	1.1x	1.1x	1.3x	1.3x	1.3x
Quick ratio	0.7x	0.6x	0.8x	1.0x	1.0x
Cash ratio	0.2x	0.3x	0.4x	0.4x	0.4x

Efficiency Ratios	2015a	2016a	2017a	2018e	2019e
Fixed assets turnover	1.8x	3.1x	3.4x	2.4x	2.5x
Current assets turnover	2.3x	1.5x	1.6x	1.4x	1.5x
Total assets turnover	1.0x	1.0x	1.0x	0.9x	0.9x
Inventory turnover	0.2x	0.1x	0.1x	0.1x	0.1x
Receivables turnover	0.2x	0.1x	0.1x	0.1x	0.1x
Payables turnover	0.3x	0.2x	0.1x	0.2x	0.1x
Days inventory outstanding	61	33	32	41	31
Days collection/sales outstanding	72	43	36	45	34
Days payable outstanding	128	220	180	190	180
Cash conversion cycle	6	-143	-112	-104	-115

Investment Ratios	2015a	2016a	2017a	2018e	2019e
Earnings per share (NGN)	0.97	1.20	3.31	2.3	3.1
Dividend per share (NGN)	0.50	0.60	1.75	1.2	1.6
Payout	51.8%	50.0%	52.9%	52.9%	52.9%
Dividend yield	8.3%	9.8%	8.8%	7.1%	9.6%

P/E	6.24x	5.10x	6.05x	7.43x	5.49x
EV/EBITDA	3.09x	1.67x	3.89x	4.03x	2.85x

Disclosures.

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