

19 October 2018

Lafarge Africa Plc.

Journey to profit in 2019 – more ground to cover!

Update: LAFARGE published 9M-18 results this week, with higher-than-expected after tax loss in Q3-18. We have increased our loss after tax estimate for 2018E to NGN9.12 billion (from NGN4 billion) to adjust for the miss in Q3, and as we look for lower net profit in Q4 than previously expected. **We believe the group will deliver its first profit in two years in 2019E, wherein we expect finance charges will be some way lower compared to 2018E.** But that aside, the short-term outlook for both Nigeria and the South Africa cement markets is conservative from the view point of economic activities. And while the ongoing restructuring/turnaround activities across the group appear to be yielding little results, the associated costs remain elevated, with continued negative pass-through to margins and profitability.

Volume growth in 2019; eyes on turnaround programme and Ghana: Economic activities do not appear likely to improve significantly in Nigeria and South Africa (SA) in 2019, from 2018. And we believe it was for this reason that LAFARGE's management was cautionary about its cement demand growth expectation¹ in both markets during the recent conference call. Management however noted that the ongoing turnaround programmes will provide the group some room to improve on volume and close the gaps – which has existed in recent years – with the markets. Volume is also expected to gain support from Ghana – where management said the result from test exports from Nigeria was positive – with a target 80% utilization rate from the 670kmts grinding station billed to commence production next month.

Price, restructuring costs, and margins: Management guided to a price erosion trend that started in Nigeria in Q3 (-c.6% y/y). **Management expects price to stabilize in the market from the seasonally strong dry season (between Q4-18 and April 2019), but noted that price movement will be positively correlated with state of the economy.** Management said it increased price in SA by 14% q/q in Q3, with a stable outlook.

SAP and restructuring costs accruing from Nigeria (+38% in 9M-18) are expected to start reducing as SAP go live from January 2019. In SA where there are still some grounds to cover, the costs will probably remain elevated. Overall, we expect cost reduction from the entire restructuring/turnaround activities to be more impactful on margins from 2020E.

Rights issue (RI), debt restructuring, FX risk: From the timeline provided by management, we expect to see the impact of the approved RI on both earnings and balance sheet from 2019E. **Both the substitution of expensive short-term debts with equity and the restructuring of USD loans** (from USD308 million to USD293 million, maturity extended to 7.5 years, and with 2-year moratorium on both interest and principal effective September 2018) **should moderate finance cost.** That said, we believe the outstanding USD debt is underlined by FX risk in a possibly volatile 2019 environment.

Strong price upside, but with a caution: On our DCF-derived TP of NGN27.05/s, LAFARGE's stock offers 29% potential upside – and expected total return of 36% after incorporating 2018E dividend yield of 7%. However, we maintain HOLD rating. **The group has consistently disappointed with its ability to grow revenue and maintain stable margin, amidst a highly leveraged balance sheet (with high FX risk).**

HOLD

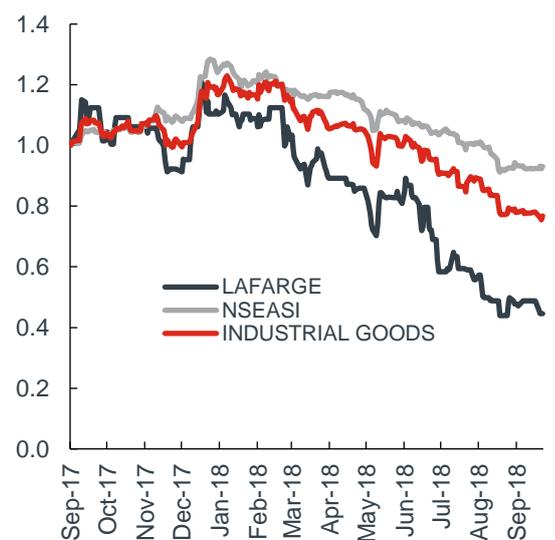
Target Price (NGN)	27.05
Current Price (NGN)	21.00
Implied Return (%)	28.81
Expected Dividend Yield (%)	7.14
Expected Total Return	35.95

Company Data

NSE Code	WAPCO
Bloomberg Code	WAPCO:NL
Reuters Code	WAPCO: LG
Sector	INDUSTRIAL GOODS
Market Cap. (NGN' bn)	182.14
Free Float (%)	17.83

Ratios	Q3-2018	Q3-2017	2017FY
Gross margin	23.79%	19.56%	16.97%
Opex margin	19.94%	20.11%	15.14%
EBITDA margin	18.26%	9.74%	19.27%
EBIT margin	3.88%	-14.12%	2.64%
PAT margin	-8.99%	-27.31%	-11.57%
EPS (NGN)	-0.75	-3.60	-6.37

Price movement (LAFARGE vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

¹ The entire Nigeria cement market is forecast to grow 3-6% in Q4-18 according to management, and likely, at same low single-digit rate next year. Forecasts coming from South Africa is for flat demand.

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Financial Statements (NGN million).

Income Statement (NGN'mn)	2016a	2017a	2018e	2019e	2020e	Profitability Ratios	2016a	2017a	2018e	2019e	2020e
Turnover	219,714	299,153	325,482	340,690	349,829	Gross profit margin	18.51%	16.97%	23.50%	23.60%	23.70%
Cost of sales	(179,052)	(248,394)	(248,994)	(260,287)	(266,919)	EBITDA margin	16.76%	8.54%	16.68%	16.75%	16.85%
Gross profit	40,662	50,760	76,488	80,403	82,909	Operating profit margin	5.66%	2.64%	8.42%	8.39%	8.40%
Gross opex	(27,093)	(45,280)	(50,242)	(52,930)	(54,700)	PBT margin	-10.39%	-11.38%	-3.96%	2.08%	3.35%
Other operating income/(expenses)	(1,129)	2,406	1,172	1,124	1,189	Net profit margin	7.81%	-11.47%	-2.80%	1.77%	2.85%
Operating profit	12,440	7,886	27,418	28,597	29,399	RoAE	8.08%	-16.91%	-6.27%	3.43%	4.69%
Interest income	3,675	1,439	1,825	1,920	1,980	RoAA	3.60%	-6.36%	-1.59%	1.03%	1.64%
Interest expenses	(38,921)	(43,217)	(42,133)	(23,433)	(19,647)	RoACE	4.90%	-8.36%	-2.11%	1.42%	2.41%
Share of net loss from associate	(13)	(140)	-	-	-						
Profit before tax	(22,819)	(34,032)	(12,890)	7,084	11,733	Liquidity Ratios	2016a	2017a	2018e	2019e	2020e
Taxation	39,989	(281)	3,769	(1,063)	(1,760)	Working capital (NGN'm)	-85,040	-189,551	-106,993	-43,251	-38,737
Profit for the year - continued	17,170	(34,314)	(9,121)	6,021	9,973	Current ratio	0.52x	0.44x	0.54x	0.75x	0.78x
						Quick ratio	0.26x	0.27x	0.27x	0.38x	0.39x
						Cash ratio	0.11x	0.15x	0.08x	0.11x	0.11x
Financial Position (NGN'mn)	2016a	2017a	2018e	2019e	2020e	Efficiency Ratios	2016a	2017a	2018e	2019e	2020e
Property, plant and equipment	390,241	393,652	402,705	423,073	436,027	Fixed assets turnover	0.56x	0.76x	0.81x	0.81x	0.80x
Intangible assets	1,563	2,634	6,318	6,637	6,841	Current assets turnover	2.40x	1.98x	2.61x	2.60x	2.59x
Investment in subsidiaries	-	-	-	-	-	Total assets turnover	0.44x	0.52x	0.57x	0.57x	0.57x
Investment in Associate	90	-	-	-	-	Inventory turnover	4.59x	4.81x	4.16x	4.14x	4.08x
Other long-term investment	10,215	22,386	22,249	23,374	24,090	Receivables turnover	14.01x	17.16x	11.64x	10.78x	10.64x
Deferred tax asset	7,641	7,952	12,864	13,515	13,928	Payables turnover	1.89x	2.18x	2.14x	2.33x	2.47x
Long term receivables	-	-	-	-	-	Days inventory outstanding	80	76	88	88	90
Assets classified as held for sale/cash	-	-	-	-	-	Days collection outstanding	26	21	31	34	34
Total non-current assets	409,749	426,624	444,135	466,599	480,886	Days payable outstanding	233	166	175	146	153
Inventories	44,981	58,266	61,371	64,475	66,449	Cash conversion cycle	-128	-69	-56	-24	-29
Trade and other receivables	9,766	25,110	30,819	32,378	33,369	Solvency Ratios	2016a	2017a	2018e	2019e	2020e
Current tax receivable	487	918	924	971	1,001	Debt-to-capital ratio	0.34x	0.65x	0.68x	0.50x	0.47x
Cash and cash equivalents	19,441	50,415	18,254	19,177	19,764	Net debt/EBITDA	2.94x	9.29x	4.90x	3.44x	2.85x
Current assets	91,624	151,104	124,609	130,911	134,920	Net debt-to-equity ratio	0.43x	1.51x	1.98x	0.90x	0.81x
TOTAL ASSETS	501,374	577,727	568,744	597,510	615,806	Interest coverage	0.32x	0.18x	0.65x	1.22x	1.50x
Trade and other payables	114,457	113,000	119,345	104,448	111,918	Investment Ratios	2016a	2017a	2018e	2019e	2020e
Provisions	1,177	1,166	858	751	805	Earnings per share (NGN)	3.26	-6.24	-1.05	0.48	0.79
Financial liabilities	59,483	218,913	107,099	65,201	56,901	Dividend per share (NGN)	1.09	2.37	1.50	1.50	1.50
Deferred revenue	235	111	116	102	109	Dividend Payout	33.52%	-37.92%	-142.64%	313.55%	189.31%
Dividend payable	-	-	-	-	-	Dividend yield	2.48%	5.27%	7.14%	7.14%	7.14%
Current tax payable	1,312	3,252	3,502	3,065	3,284	PE	13.54x	-7.2x	-20.0x	43.9x	26.5x
Total current liabilities	176,664	340,654	231,601	174,163	173,656	EV/EBITDA	9.2x	19.0x	8.3x	8.1x	7.3x
Financial liabilities	68,222	68,715	177,407	149,993	130,900						
Retirement benefits obligation	3,780	4,917	5,472	4,789	5,131						
Deferred tax	-	1,463	-	-	-						
Provisions	2,201	3,472	3,966	3,471	3,719						
Deferred revenue	1,555	1,518	1,509	1,321	1,415						
Liabilities associated with assets held for sale	-	-	14,622	46,596	92,712						
Total non-current liabilities	75,757	80,086	202,975	206,169	233,878						
TOTAL LIABILITIES	252,421	420,741	434,577	380,332	407,534						
Share capital	2,740	2,788	4,337	6,293	6,293						
Share premium	217,528	222,272	351,097	439,140	439,140						
Retained earnings	102,843	160,258	138,126	131,138	122,231						
Foreign currency translation reserve	(8,660)	9,936	9,291	9,291	9,291						
Other reserves arising on business combination	(256,900)	(368,683)	(368,683)	(368,683)	(368,683)						
Non-controlling interest	191,401	-	-	-	-						
TOTAL EQUITY	248,953	156,987	134,167	217,178	208,272						

Source: Company Accounts, Cordros Research estimates

Disclosures.

Analyst:

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

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SELL (UNDERWEIGHT) - Over the next twelve months, we expect the stock to be more than 10% below the current market price.

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