

Dangote Sugar Refinery Plc.

Strong test in 2018; SELL

Update: We revise estimates for DANGSUGAR following 2017FY results and call with management. Key change to our model estimates is the downward revision of volume and margin, and consequently, earnings. On net, we revise revenue estimate 5% lower, and EBITDA, EBIT, and net profit estimates by 9% average. Compared to 2017FY, our 2018E EBITDA (7%) and EBIT (4%) estimates are higher while net profit is lower (adjusting for the FX gain recorded in Q4-17) by 11%. The stock's TP on our revised estimates is NGN17.97 (previously NGN19.03); SELL rating maintained. On our revised estimates, DANGSUGAR trades on one-year (2018E) forward P/E and EV/EBITDA multiples of 7.4x and 4.0x respectively, consistent with both its five-year historical averages of 7.9x and 4.4x, and the 7.4x and 4.6x Middle Eastern peer averages.

Flattish revenue in 2018E: Our marginal revenue growth forecast of 0.5% is on freight revenue (+18% y/y), which has continued to grow – 18% in 2017FY and 26% average in the last five years – although accounting for barely 2% of gross revenue. We revise sugar revenue growth forecast lower to 0.2%, from 5%, given conservative outlook on sales volume and price, than we previously had. On the recent call, management reiterated some of the volume concerns – although which it expects to improve this year – we had highlighted in previous notes, notably the activities of smugglers and the poor condition of the factory road. On price, we retain our NGN14,000/bag estimate for 2018E (-11% y/y), consistent with the rate management said it is currently able to achieve (vs. NGN17,010/bag same period in 2017). DANGSUGAR's average selling price was lowered 9% q/q to NGN13,509/bag in Q4-17 (on our calculation), despite 4% q/q increase in per tonne cost, confirming pressure on market share. Selling price was reduced by cumulative 22% between Q2 and Q4 2017.

Margin revised lower: By our estimate, DANGSUGAR's per tonne production cost increased 4% in Q4-17, after successive declines between Q1-Q3. The higher cost, combined with lower selling price, produced a gross margin of 23%, below both the 32% rate achieved between Q2-Q3, and our 30% estimate. We have revised our gross margin estimate for 2018E 112 bps lower to 26%. Our estimate remains above the 25% margin achieved in 2017FY, and DANGSUGAR's five-year historical average of 24%. We reiterate that the downside risks to DANGSUGAR's gross margin are (1) deeper cut in selling prices and (2) gas supply disruption, while the upside risks include (1) better energy mix and stronger exchange rate, (2) stable outlook of global raw sugar prices, and (3) positive mix from growing contribution of higher margin Savannah.

A step-up in capex: Capex increased to NGN9.8 billion in 2017FY, the biggest in three years. No specific guidance was given for spending in 2018 and beyond, but management reiterated that funding for its BIP will be 20% equity (and noted that this portion can be increased) and the balance via borrowings. It guided to (1) the completion of the first phase of the BIP, comprising the establishment of 1 million sugar metric tonnes capacity in three locations – (Nasarawa 600,000, Adamawa 250,000, and Taraba 150,000) – in 2022 and (2) capital raising for the project in Q4-18.

SELL

Target Price (NGN)	17.97
Current Price (NGN)	22.00
Implied Return (%)	-18.33
Expected Dividend Yield (%)	7.09
Expected Total Return (%)	-11.24

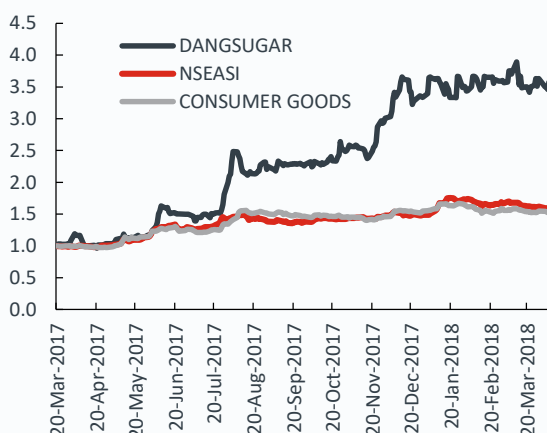
Company Data

NSE Code	DANGSUGAR
Bloomberg Code	DANGSUGAR:NL
Reuters Code	DANGSUGAR.LG
Sector	CONSUMER GOODS
Market Cap. (NGN'bn)	264.00
Free Float (%)	26.90

Ratios	Q4-2017	Q4-2016	2017FY
Gross margin	22.98%	7.32%	24.94%
Opex margin	5.26%	4.20%	3.66%
EBITDA margin	23.52%	8.32%	23.94%
EBIT margin	18.23%	3.83%	21.48%
PAT margin	32.05%	7.86%	19.46%
RoAE**	29.33%	21.97%	21.97%
EPS (NGN)	0.63	0.35	3.32

**12 months

Price movement (DANGSUGAR vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros research

Summary of 2017FY Results.

Income Statement (NGN'bn)	31-Dec-17	31-Dec-16	y/y	Q4:17	Q4:17 y/y	Q4:17 q/q	Q3:17	Q2:17	Q1:17	Q4:16
Revenue	204.42	169.72	20.4%	41.39	-24.0%	-6.7%	44.35	59.15	59.53	54.47
Cost of Sales	153.43	146.74	4.6%	31.88	-36.9%	7.1%	29.77	40.10	51.69	50.48
Gross profit	50.99	22.99	121.8%	9.51	138.6%	-34.8%	14.59	19.05	7.84	3.99
OPEX	7.48	6.93	8.0%	2.18	-4.8%	14.5%	1.90	1.44	1.97	2.29
Other income	0.40	0.75	-46.3%	0.21	-45.4%	227.2%	0.06	0.05	0.07	0.38
EBIT	43.91	16.81	161.2%	7.55	261.9%	-40.8%	12.75	17.67	5.95	2.09
Investment income	3.36	0.60	459.3%	1.00	239.5%	40.6%	0.71	0.69	0.97	0.29
Fair value adjustments	2.47	2.50	-1.5%	1.52	-16.6%	127.9%	0.67	0.16	0.12	1.82
Financial charges	-3.86	0.30	-1390.5%	-4.29	4348.6%	-3507.2%	0.13	0.30	0.00	-0.10
Profit before tax	53.60	19.61	173.3%	14.35	234.0%	2.5%	14.00	18.21	7.04	4.30
Taxation	13.82	5.22	164.7%	1.08	6338.9%	-76.3%	4.58	5.87	2.28	0.02
Profit after tax	39.78	14.40	176.4%	13.26	210.0%	40.8%	9.42	12.34	4.76	4.28

Ratios	31-Dec-17	31-Dec-16	Q4:17	Q3:17	Q2:17	Q1:17	Q4:16
Gross margin	24.94%	13.54%	22.98%	32.88%	32.21%	13.17%	7.32%
OPEX margin	3.66%	4.08%	5.26%	4.29%	2.43%	3.30%	4.20%
EBITDA margin	23.94%	12.70%	23.52%	31.11%	31.41%	11.47%	8.32%
EBIT margin	21.48%	9.90%	18.23%	28.74%	29.87%	9.99%	3.83%
PBT margin	26.22%	11.56%	34.66%	31.56%	30.79%	11.83%	7.89%
PAT margin	19.46%	8.48%	32.05%	21.23%	20.87%	7.99%	7.86%
CoGS	75.06%	86.46%	77.02%	67.12%	67.79%	86.83%	92.68%
Tax rate	25.78%	26.61%	7.55%	32.72%	32.23%	32.43%	0.39%
EPS (N)	3.32	1.20	0.63	0.79	1.03	0.40	0.35

Source: Company Accounts, Cordros Research

Financial Statement (NGN'billion).

Income Statement							Profitability Ratios						
	2014a	2015a	2016a	2017a	2018e	2019e		2014a	2015a	2016a	2017a	2018e	2019e
Turnover	94.86	101.06	169.72	204.42	205.50	217.66	Gross profit margin	19.6%	20.5%	13.5%	24.9%	25.8%	25.9%
Cost of Sales	-76.23	-80.33	-146.74	-153.43	-152.57	-161.24	EBITDA margin	19.8%	21.1%	14.2%	25.1%	26.8%	27.0%
Gross profit	18.63	20.73	22.99	50.99	52.93	56.42	Operating profit margin	15.9%	15.7%	9.9%	21.5%	22.2%	22.3%
Operating expenses	-8.60	-6.21	-6.93	-7.48	-7.63	-8.21	PBT margin	16.1%	16.4%	11.6%	26.2%	25.3%	25.6%
Other income	5.07	1.33	0.75	0.40	0.40	0.41	Net profit margin	12.3%	11.4%	8.5%	19.5%	17.2%	17.4%
Operating profit	15.09	15.85	16.81	43.91	45.70	48.62	RoAE	23.7%	21.1%	23.2%	50.1%	35.4%	32.5%
Investment income	0.29	0.01	0.60	3.36	3.75	4.20	RoAA	13.2%	11.8%	10.3%	21.4%	17.2%	16.5%
Fair value adjustments	-	1.35	2.50	2.47	2.74	3.06							
Interest expenses	-0.11	-0.66	-0.30	3.86	-0.14	-0.14	Liquidity Ratios						
Profit before tax	15.27	16.55	19.61	53.60	52.05	55.74	Working capital (NGN'bn)	1.5	3.8	11.8	32.8	40.4	51.3
Tax expense	-3.64	-5.01	-5.22	-13.82	-16.66	-17.84	Current ratio	1.0x	1.1x	1.1x	1.3x	1.4x	1.5x
Profit after tax	11.64	11.54	14.40	39.78	35.39	37.90	Quick ratio	0.6x	0.7x	0.6x	0.8x	0.9x	0.9x
							Cash ratio	0.2x	0.2x	0.3x	0.4x	0.4x	0.5x
Financial Position							Efficiency Ratios						
	2014a	2015a	2016a	2017a	2018e	2019e		2014a	2015a	2016a	2017a	2018e	2019e
PPE	50.47	54.80	54.80	59.41	65.88	73.66	Fixed assets turnover	1.88x	1.84x	3.10x	3.44x	3.12x	2.96x
Other assets	0.19	0.00	0.00	0.00	0.00	0.00	Current assets turnover	2.48x	2.34x	1.51x	1.59x	1.44x	1.37x
Biological assets	1.12	1.55	-	-	-	-	Total assets turnover	1.02x	0.98x	0.96x	1.05x	0.95x	0.90x
Investment property	-	-	-	-	-	-	Inventory turnover	0.2x	0.2x	0.1x	0.1x	0.1x	0.1x
Deferred tax assets	2.49	2.97	10.10	7.17	7.95	8.89	Receivables turnover	0.2x	0.2x	0.1x	0.1x	0.1x	0.1x
Intangible assets	0.26	0.14	0.01	0.00	0.00	0.00	Payables turnover	0.3x	0.3x	0.2x	0.1x	0.1x	0.1x
Total Non-current assets	54.54	59.46	64.92	66.59	73.84	82.56	Days inventory outstanding	60	61	33	32	32	30
Inventories	15.10	15.55	47.41	47.66	52.84	59.08	Days collection/sales outstanding	75	72	43	36	36	34
Biological assets	0.68	1.89	3.01	2.81	3.11	3.48	Days payable outstanding	121	128	220	180	193	193
Trade and other receivables	14.01	14.70	17.73	20.91	23.18	25.92	Cash conversion cycle	14	6	-143	-112	-125	-129
Other assets	1.41	1.17	9.43	14.88	16.50	18.45							
Held for sale investment in subsidiary	0.86	0.86	-	0.87	0.96	1.08	Investment Ratios						
Bank/cash balances	6.20	8.99	35.02	41.37	45.87	51.28	Earnings per share (NGN)	0.97	0.97	1.20	3.31	2.9	3.2
Total current assets	38.26	43.17	112.60	128.49	142.47	159.29	Dividend per share (NGN)	0.40	0.50	0.60	1.75	1.6	1.7
Total assets	92.80	102.62	177.52	195.08	216.31	241.84	Payout	41.2%	51.8%	50.0%	52.9%	52.9%	52.9%
Current tax liabilities	5.94	5.54	6.60	17.72	18.90	20.00	Dividend yield	4.5%	8.3%	9.8%	8.8%	7.1%	7.6%
Retirement benefit obligation	1.53	1.08	1.03	0.98	1.05	1.11							
Trade and other payables	25.23	28.09	88.28	75.65	80.71	85.41	P/E	9.22x	6.24x	5.10x	6.05x	7.46x	6.97x
Borrowings	2.39	2.50	2.04	0.07	0.07	0.07	EV/EBITDA	5.39x	3.09x	1.67x	3.89x	3.99x	3.65x
Other liabilities	1.70	2.11	2.81	1.24	1.32	1.40							
Total current liabilities	36.78	39.33	100.75	95.66	102.05	107.99							
Borrowings	-	-	-	1.47	5.66	6.08							
Deferred tax liabilities	4.61	5.15	11.48	5.21	7.13	7.55							
Employees' gratuities/provisions	-	-	-	-	-	-							
Total non-current liabilities	4.61	5.15	11.48	6.68	7.13	7.55							
Total Liabilities	41.39	44.48	112.23	102.34	109.18	115.54							
EQUITY	51.41	58.15	66.15	92.74	107.13	126.30							

Source: Company Accounts, Cordros Research

Disclosures.

Analyst:

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

Analyst's Certification and Disclaimer

The research analyst(s) whose name(s) appear(s) on the cover of this report certifies (y) that:

- (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers;
- (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report; and
- (3) all analysis made by the analyst(s) were in good faith and the views expressed reflect their opinion, without undue influence or any intervention.

Rating Summary & Definitions

Cordros Capital uses the following rating system:

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.

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

Important Disclosure

This document has been issued and approved by Cordros Capital (Cordros) and is based on information from various sources that we believe are reliable. However, no representation is made that it is accurate or complete. While reasonable care has been taken in preparing this document, no responsibility or liability is accepted for errors or fact or for any opinion expressed herein. This document is for information purposes only. It does not constitute any offer or solicitation to any person to enter into any trading transaction.

Investments discussed in this report may not be suitable for all investors. This report is provided solely for the information of Cordros clients who are then expected to make their own investment decisions. Cordros conducts designated investment business with market counter parties and customers and this document is directed only to such persons. Cordros accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is for private circulation only and may not be reproduced, distributed or published by any recipient for any purpose without prior express consent of Cordros. Users of this report should bear in mind that investments can fluctuate in price and value. Past performance is not necessarily a guide to future performance.

Cordros and/or a connected company may or may not have a relationship with any of the entities mentioned in this document for which it has received or may receive in the future fees or other compensation. Cordros is regulated by the Securities and Exchange Commission to conduct investment business in Nigeria.