

13 September 2018

Lafarge Africa Plc.

The product of a painful restructuring, lest we forget

In June 2014, Lafarge Group announced the combination of its businesses in Nigeria and South Africa to create a leading Sub-Saharan Africa building materials platform. LafargeHolcim was formed a year after – and became the majority shareholder in LAFARGE – as a result of the successful merger between two global cement giants. Overall, we saw a transformation of the cement industry at the global level, that could potentially change the dynamics of the Nigerian cement market from one dominated by Dangote Industries Limited (DIL) through Dangote Cement Plc (DANGCEM) – as is currently happening in the brewery industry.

Looking back, WAPCO was actually better-off alone. The 2013 proforma financials show that WAPCO's standalone EBITDA margin of 37% was a lot bigger than the combined entity's 27% EBITDA margin. And more instructively, WAPCO's PBT margin was 28% in 2013 while ASHAKACEM's and UNICEM's were 13% and 5% respectively.

Shareholders have been on the losing end since the restructuring. We estimate that the M&A resulted in the dilution of the share of minority shareholders' stake in the old WAPCO to 22% currently (our estimate), from 40% pre-merger level. From an earnings perspective, it is instructive noting that since the NGN9.4/s last reported by WAPCO in 2013FY, EPS has been on a consistent slide under LAFARGE to negative NGN6.4 in 2017FY, eroded by high restructuring and financing costs. The experience has been worse for shareholders when viewed with respect to share price performance.

The causes of LAFARGE's dwindling earnings are diverse and largely result from the business combination. Operating costs have increased significantly following the M&A at a four-year CAGR of 20%, faster than revenue CAGR of c.10%. From NGN21.5 billion in 2013FY, the total debt reported by LAFARGE increased to NGN287.6 billion in 2017FY, with finance costs increasing accordingly. Besides, earnings have also been beset of efficiency issues in recent years, and revenues have not been supportive.

Desperate measures have been taken under the desperate situation. This includes (1) the diversion of priority from ASHAKACEM's capacity expansion plan, (2) back and forth moves with the USD shareholder loans, and (3) capital raises resulting in further dilution of minority shareholding.

The Nigerian cement market outlook is not too fantastic in the short to medium term. At -3% average annual rate, the cement market has grown less between 2014-2017 compared to the years preceding, and economic growth is forecast to be much slower. Worse for LAFARGE, DANGCEM has raised the barrier of survival for competitors in the market with the group's investments of the last decade, and BUA Group is also positioning strategically. Ultimately, LAFARGE needs to stabilize production across its plants and restore market share back to competitive levels.

We update on LAFARGE following H1-18 result, with HOLD recommendation. The recently announced rights issue is incorporated into our valuation, as we believe it is already being factored in by investors. We also roll forward our estimates and valuation by one year, as we believe investors are already trading on 2019E multiples. On our DCF-derived TP of NGN27.22, the stock offers 18% potential upside – and expected total return of 25% after incorporating 2018E dividend yield of 6.5%. The stock has lost 21% since the H1-18 result release and rights issue (RI) announcement, not surprisingly faster than the (1) broader market (-11%) and (2) fellow cement companies (DANGCEM: -11%, CCNN: +8%) have dipped.

HOLD

Target Price (NGN)	27.22
Current Price (NGN)	23.00
Implied Return (%)	18.35
Expected Dividend Yield (%)	6.52
Expected Total Return	24.87

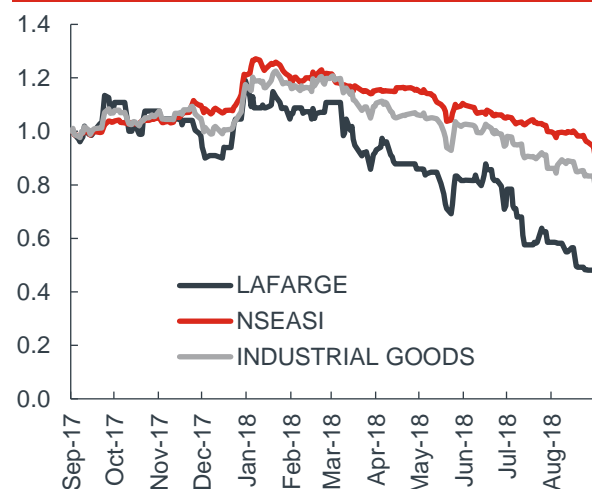
Company Data

NSE Code	WAPCO
Bloomberg Code	WAPCO:NL
Reuters Code	WAPCO. LG
Sector	INDUSTRIAL GOODS
Market Cap. (NGN' bn)	289.45
Free Float (%)	17.83

Ratios	Q2-2018	Q2-2017	2017FY
Gross margin	25.67%	32.04%	16.97%
Opex margin	13.42%	13.90%	15.14%
EBITDA margin	19.16%	27.21%	10.11%
EBIT margin	12.35%	20.03%	2.64%
PAT margin	-2.33%	19.82%	-11.57%
EPS (NGN)	-0.22	2.76	-6.37

*Trailing 12m

Price movement (LAFARGE vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

13 September 2018

Financial Statements (NGN billion).

Statement of Comprehensive Income (NGN'mn)						Profitability Ratios					
	2015a	2016a	2017a	2018e	2019e		2015a	2016a	2017a	2018e	2019e
Turnover	267,234	219,714	299,153	328,688	343,935	Gross profit margin	30.9%	18.5%	17.0%	23.0%	23.1%
Cost of sales	(184,589)	(179,052)	(248,394)	(253,090)	(264,486)	EBITDA margin	25.8%	16.8%	8.5%	16.3%	16.3%
Gross profit	82,645	40,662	50,760	75,598	79,449	Operating profit margin	14.2%	5.7%	2.6%	8.1%	8.1%
Gross opex	(31,509)	(27,093)	(45,280)	(50,079)	(52,746)	PBT margin	11.0%	-10.4%	-11.4%	-1.4%	2.3%
Other operating income/(expenses)	(13,096)	(1,129)	2,406	1,183	1,135	Net profit margin	10.2%	7.8%	-11.5%	-1.2%	1.9%
Operating profit	38,041	12,440	7,886	26,702	27,838	RoAE	15.4%	8.1%	-16.9%	-2.6%	3.6%
Interest income	1,953	3,675	1,439	1,583	1,665	RoAA	6.3%	3.6%	-6.4%	-0.7%	1.2%
Interest expenses	(10,702)	(38,921)	(43,217)	(32,844)	(21,750)	RoACE	8.7%	4.9%	-8.4%	-0.9%	1.5%
Share of net loss from associate	(5)	(13)	(140)	-	-						
Profit before tax	29,287	(22,819)	(34,032)	(4,558)	7,753	Liquidity Ratios					
Taxation	(2,124)	39,989	(281)	684	(1,163)	Working capital (NGN'mn)	-20,478	-85,040	-189,551	-192,220	-128,622
Profit for the year - continued	27,163	17,170	(34,314)	(3,875)	6,590	Current ratio	0.8x	0.5x	0.4x	0.4x	0.5x
						Quick ratio	0.4x	0.3x	0.3x	0.2x	0.3x
						Cash ratio	0.2x	0.1x	0.1x	0.1x	0.1x
Financial Position (NGN'mn)						Efficiency Ratios					
	2015a	2016a	2017a	2018e	2019e		2015a	2016a	2017a	2018e	2019e
Property, plant and equipment	364,397	390,241	393,652	393,031	412,721	Fixed assets turnover	0.7x	0.6x	0.8x	0.8x	0.8x
Intangible assets	1,549	1,563	2,634	3,376	3,545	Current assets turnover	3.6x	2.4x	2.0x	2.7x	2.7x
Investment in subsidiaries	-	-	-	-	-	Total assets turnover	0.6x	0.4x	0.5x	0.6x	0.6x
Investment in Associate	27	90	-	-	-	Inventory turnover	5.7x	4.6x	4.8x	4.3x	4.4x
Other long term investment	297	10,215	22,386	23,626	24,810	Receivables turnover	12.9x	14.0x	17.2x	12.9x	12.9x
Deferred tax asset	-	7,641	7,952	10,373	10,893	Payables turnover	2.6x	1.9x	2.2x	2.2x	2.4x
Long term receivables	9,975	-	-	-	-	Days inventory outstanding	64	80	76	85	84
Assets classified as held for sale/cash	2,188	-	-	-	-	Days collection outstanding	28	26	21	28	28
Total non current assets	378,434	409,749	426,624	430,406	451,969	Days payable outstanding	148	233	166	172	143
Inventories	33,027	44,981	58,266	59,089	62,049	Cash conversion cycle	-56	-128	-69	-59	-31
Trade and other receivables	21,590	9,766	25,110	25,927	27,226						
Current tax receivable	2,138	487	918	800	840	Solvency Ratios					
Cash and cash equivalents	16,493	19,441	50,415	19,792	20,784	Debt-to-capital ratio	0.5x	0.3x	0.6x	0.7x	0.5x
Current assets	73,249	91,624	151,104	122,660	128,805	Net debt/EBITDA	1.9x	2.9x	9.3x	4.8x	3.6x
TOTAL ASSETS	451,683	501,374	577,727	553,066	580,773	Net debt-to-equity ratio	0.7x	0.4x	1.5x	1.8x	0.9x
Trade and other payables	75,012	114,457	113,000	119,438	103,305	Interest coverage	3.6x	0.3x	0.2x	0.8x	1.3x
Provisions	1,864	1,177	1,166	856	740						
Financial liabilities	12,823	59,483	218,913	191,431	150,652	Investment Ratios					
Deferred revenue	235	235	111	113	97	Earnings per share (NGN)	6.0	3.3	-6.2	-0.4	0.5
Dividend payable	3,406	-	-	-	-	Dividend per share (NGN)	3.0	1.1	2.4	1.5	1.5
Current tax payable	387	1,312	3,252	2,865	2,478	Dividend Payout	50%	34%	-38%	-336%	287%
Total current liabilities	93,726	176,664	340,654	314,879	257,426	Dividend yield	3.1%	2.5%	5.3%	6.5%	6.5%
Financial liabilities	135,465	68,222	68,715	83,834	70,911						
Retirement benefits obligation	7,542	3,780	4,917	5,090	4,402	PE	16.23x	13.54x	-7.2x	-51.5x	43.9x
Deferred tax	32,937	-	1,463	-	-	EV/EBITDA	8.3x	9.2x	19.0x	8.5x	8.7x
Provisions	2,577	2,201	3,472	3,708	3,207						
Deferred revenue	2,134	1,555	1,518	1,488	1,287						
Liabilities associated with assets held for sale	1,150	-	-	4,654	20,546						
Total non-current liabilities	181,805	75,757	80,086	98,773	100,354						
TOTAL LIABILITIES	275,531	252,421	420,741	413,652	357,780						
Share capital	2,277	2,740	2,788	4,337	6,293						
Share premium	186,420	217,528	222,272	351,097	439,140						
Retained earnings	100,993	102,843	160,258	143,373	136,952						
Foreign currency translation reserve	(10,157)	(8,660)	9,936	9,291	9,291						
Other reserves arising on business combination	(162,185)	(256,900)	(368,683)	(368,683)	(368,683)						
Non-controlling interest	58,803	191,401	-	-	-						
TOTAL EQUITY	176,152	248,953	156,987	139,414	222,993						

Source: Company accounts, Cordros Research estimates

Contents.

The product of a painful restructuring, lest we forget..... 1

Financial Statements (NGN billion). 2

The M&A. 4

Attention-seeking issues..... 5

Desperate measures in desperate situation. 8

The Nigerian cement market. 9

Lafarge Africa Plc – HOLD; TP. NGN27.22/s. 10

Disclosures..... 11

13 September 2018

The M&A.

It all started in June 2014 when Lafarge Group announced the combination of its businesses in Nigeria and South Africa to create a leading Sub-Saharan Africa building materials platform. What followed between then and 2017 was the transfer of the Group's shares in its businesses in Nigeria – United Cement Company of Nigeria Plc (UNICEM), Ashaka Cement Plc (ASHAKACEM), and Atlas Cement Company Limited (ATLAS) – and South Africa – Lafarge South Africa Holdings (Pty) Limited (LSAH) – to Lafarge Cement WAPCO Nigeria Plc – renamed as Lafarge Africa Plc (LAFARGE) – for share and cash considerations. Through the combination, LAFARGE has a current installed cement capacity of 14Mts from six plants, in addition to strong market position in aggregates, ready mix concrete, and fly ash.

LafargeHolcim was formed in 2015 – and became the majority shareholder in LAFARGE – as a result of the successful merger between two global cement giants; Lafarge (headquartered in France) and Holcim (headquartered in Switzerland). At the time of the M&A, the merged entities had cement production capacity of 374Mts, located in 90 countries, and across 5 continents. **Overall, we saw a transformation of the cement industry at the global level, that could potentially change the dynamics of the Nigerian cement market from one dominated by Dangote Industries Limited (DIL) through Dangote Cement Plc (DANGCEM) – as is currently happening in the brewery industry.**

Looking back, WAPCO was actually better-off alone

As a standalone, WAPCO's five-year revenue CAGR was 18% in 2013 while its EBITDA margin of c.38% (from 23% in 2009) on 4.5Mts capacity compared well with DANGCEM's 59% on c.14Mts capacity. RoAE was 35% in 2013, from 12% in 2009, while per share dividend (NGN3.30 in 2013FY) CAGR was 41% over the period. On the balance sheet, borrowings reached record-highs in 2010 (NGN46.6 billion) and 2011 (NGN53.8 billion) following the more-than two-fold expansion of cement production capacity to 4.5Mts. However, debt reduced progressively to NGN21.5 billion in 2013, the highlight being the repayment of both syndicated Naira loans worth NGN9 billion (14 months ahead) and all foreign currency denominated facilities worth USD34 million. Net debt-to-equity ratio and interest cover were respectively c.42% and c.5x in 2013.

ASHAKACEM's five-year revenue CAGR was 5% in 2013 on 1Mts capacity while EBITDA margin was 16.5% (five-year average was c.22%). Same year, RoAE was 6% (from 7.3% in 2009), with per share dividend of NGN0.42 (same amount paid from 2011-2013), from nil payment between 2007 and 2009. The company's operation was debt-free.

The full financials of the other consolidated entities were not available at the time of the business combination. However, the 2013 proforma financials show that WAPCO's standalone EBITDA margin of 37% was a lot bigger than the combined entity's 27% EBITDA margin. And more instructively, WAPCO's PBT margin was 28% in 2013 while ASHAKACEM's and UNICEM's were 13% and 5% respectively. Only LSAH's was better at 41%.

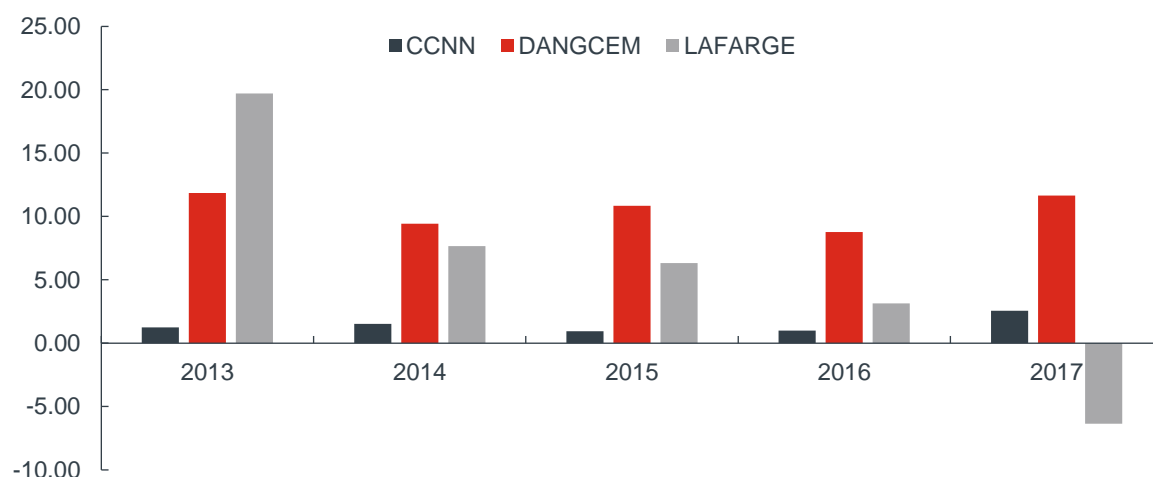
Shareholders have been on the losing end since the restructuring

The business combination took the form of shares exchange and cash payments. Overall, we estimate that WAPCO (currently LAFARGE) issued 2.57 billion shares and paid NGN77.1 billion to both Lafarge Group and minority shareholders of the acquired companies under the transaction. The implication of this, is the dilution of the share of minority shareholders' stake in the old WAPCO to 22% currently (our estimate), from 40% pre-merger level.

From an earnings perspective, it is instructive noting that since the NGN9.4/s last reported by WAPCO in 2013FY, EPS has been on a consistent slide under LAFARGE to negative NGN6.4 in 2017FY, eroded by high restructuring and financing costs. In hindsight, ASHAKACEM's shareholders (EPS was NGN1.26 in 2013) that migrated to the new entity have not fared better. Meanwhile elsewhere, DANGCEM's EPS of NGN11.65 in 2017FY, is almost unchanged vs. 2013FY (NGN11.85), despite the dilutive impact of the loss-making Pan Africa operation. And despite suffering from capacity constraints, CCNN's EPS grew from NGN1.13 to NGN2.57 over the same period.

13 September 2018

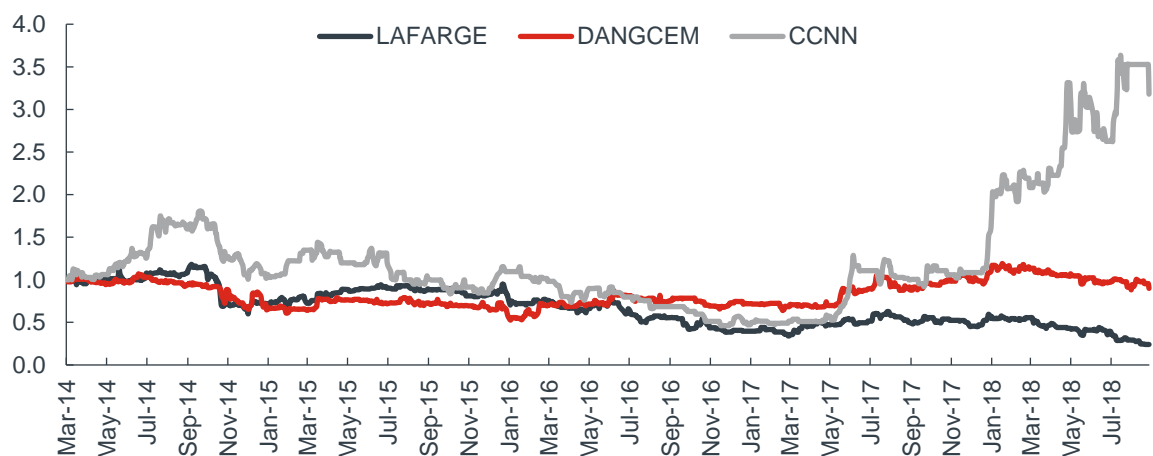
Figure 1: Historical EPS of listed cement companies



Source: Company accounts, Cordros Research

The experience has been worse for shareholders when viewed with respect to share price performance. The price of WAPCO's stock has fallen from NGN112.50/s in June 2014 when the M&A was announced, to NGN23.00/s at the close of business today. Within the same period, the price of DANGCEM's stock has lost only 8% to NGN210.00/s and CCNN's has increased by 169% to NGN27.85/s.

Figure 2: Share price trend of listed cement companies



Source: NSE, Bloomberg, Cordros Research

Attention-seeking issues.

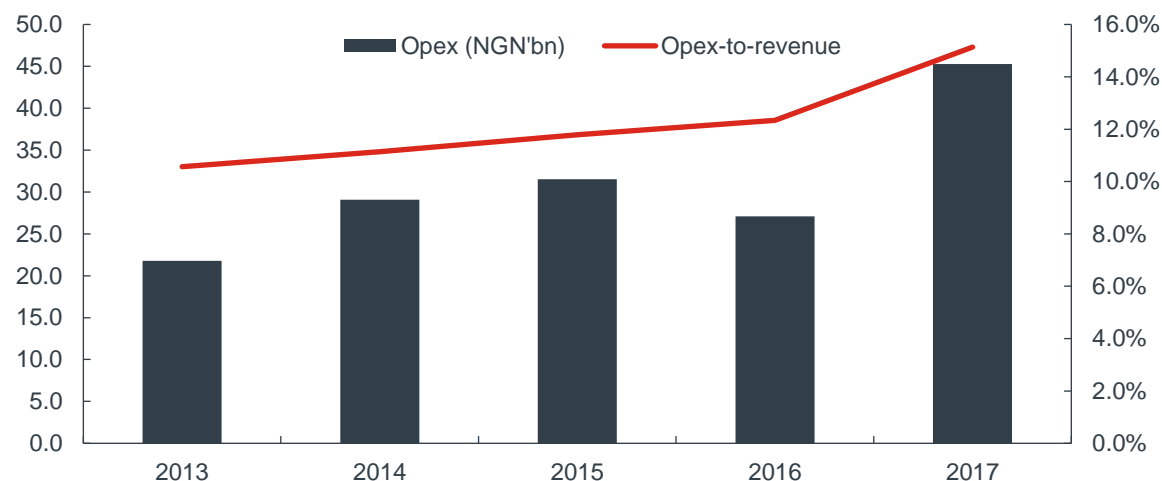
The causes of LAFARGE's dwindling earnings are diverse and largely result from the business combination. We discuss them in detail below.

High operating costs

LAFARGE's operating costs have increased significantly following the M&A. While this is not unexpected, especially amidst the FX induced spike in inflation, concern is that at a four-year CAGR of 20%, operating costs have been growing at a faster rate than revenue CAGR of c.10%. It is instructive to note that restructuring costs incurred yearly since the M&A have almost doubled from NGN2.79 billion in 2014FY to NGN5.2 billion in 2017FY.

13 September 2018

Figure 3: LAFARGE – OPEX and margins



Source: Company accounts, Cordros Research estimates

In relative terms, the ratio of operating expenses to revenue has increased consistently from 11.1% in 2014FY to 15.1% in 2017FY. Prior to the M&A, WAPCO's opex margin had dropped significantly from a historical average of 13% to 7% in both 2012 and 2013. LAFARGE's management said in 2016 that a number of cost reduction measures were being put in place, including the rationalization of expat personnel and the launch of an ERP programme in 2017 to streamline internal processes after the merger. While we expect these measures will eventually yield positive results, we are also mindful of time, given that costs are yet to show any sign of improvement (opex was up 25% y/y in H1-2018, vs. revenue of +5% y/y).

High financing costs

From NGN21.5 billion before the M&A in 2013FY, the total debt reported by LAFARGE increased to NGN121.1 billion shortly after the M&A in 2014FY, and then to NGN287.6 billion in 2017FY after the full consolidation. Debt-to-equity ratio has increased from 54.6% to 69%, and then to 183% over the above stated period. Recall that ASHAKACEM's operation was debt-free, so by implication, UNICEM (especially) and LSAH led the group into the debt overhang situation. For context, by the acquisition of UNICEM, LAFARGE inherited USD507 million shareholder loans, along with USD88 million of third party FCY debt. In Naira terms, this represents about 74% of the disclosed gross debt in 2017FY.

Figure 4: LAFARGE - Debt metrics

Debt metrics	2013	2014	2015	2016	2017
Gross debt (NGN'bn)	28.28	121.14	148.29	127.71	287.63
Financing cost (NGN'bn)	4.62	11.27	10.70	38.92	43.22
Interest cover	14.5x	4.3x	3.6x	0.3x	0.2x
Debt to equity	0.2x	0.7x	0.8x	0.5x	1.8x
Net debt to equity	0.0x	0.6x	0.7x	0.4x	1.5x

Source: Company accounts, Cordros Research estimates

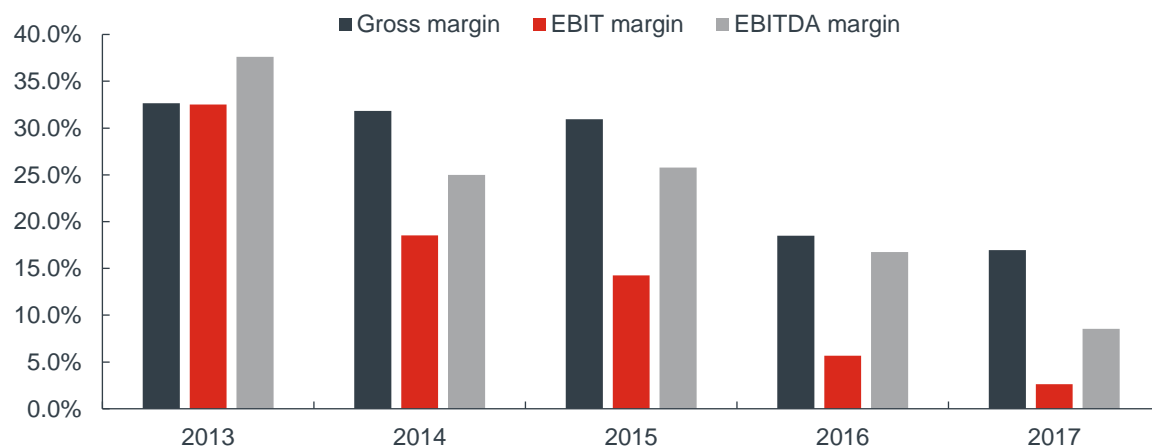
As a result, financing costs have increased nine folds, from NGN4.6 billion in 2013FY to NGN43.2 billion in 2017FY, while exposing the group to high currency and liquidity risks. Annualized, the H1-18 finance cost of NGN24 billion is c.10% ahead vs. 2017FY.

Efficiency issues

Asides from high operating and financing costs, LAFARGE's earnings have also been beset of efficiency issues in recent years. For context, from 39.3% in the standalone period of 2013FY, gross margin has declined

13 September 2018

consistently, reaching 17% in 2017FY. While acknowledging the structural challenges – FX devaluation and gas supply shortages – that have pressured margins industry-wide in the last three years, LAFARGE's faster pace of margin compression, compared to the industry, is evident of tactical gaps on the part of management.

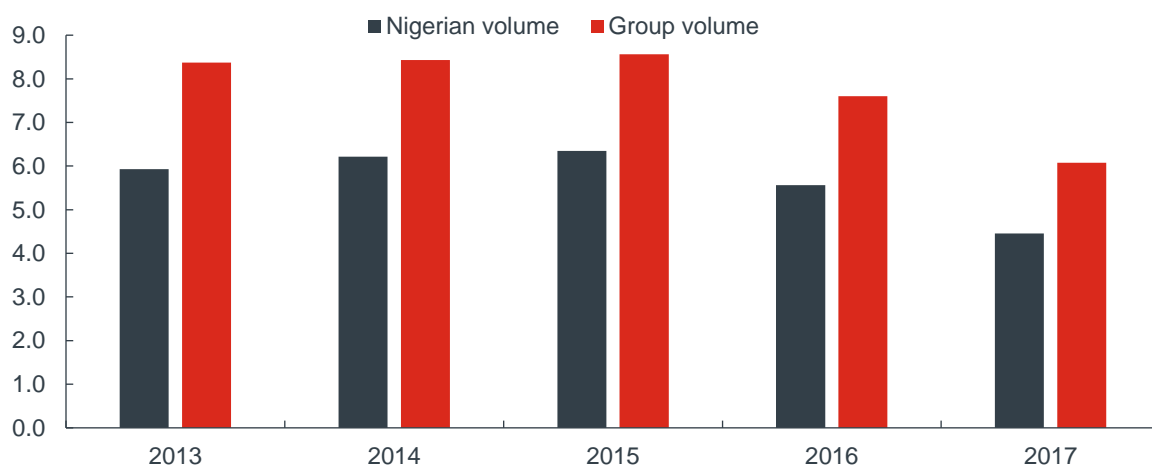
Figure 5: LAFARGE – Margins (%)

Source: Company accounts, Cordros Research estimates

In Nigeria, LAFARGE's margins have had to contend with competitive pressure (the local business is a price taker), production challenges, and unfavorable fuel mix owing to limited efficient alternatives to gas, with higher correlation to the USD. Meanwhile, South African margins are constrained by (1) high costs of operating with a relatively old and inefficient plant, (2) low cement pricing due to weak demand, (3) competitive pressures, and (4) negative product mix.

Unimpressive revenue performance

LAFARGE's revenues have not supported earnings under the current condition of higher fixed costs and weakened gross margins. The group's four-year revenue CAGR (2014-2017) of 10% is below CoGS, opex, and finance costs respective 4-year CAGRs of 16%, 20%, and 75%. Volume performance has not been encouraging. We estimate the group achieved 6.1Mts volume in 2017FY, 27% below the 8.4Mts we estimate was achieved in 2013FY.

Figure 6: LAFARGE – Volumes (Mts)

Source: Company accounts, Cordros Research estimates

13 September 2018

Beyond the group's control, we note that the Nigerian cement market (contributing 70% of group revenue) has experienced flat to negative growth in the last four years - compared to average 10% annual growth in the years preceding 2014 – owing to limited infrastructural and corporate investments. Sales in South Africa have also been challenging, amidst weak infrastructure demand and intense competition.

Looking inward however, volumes have been negatively impacted mainly by production challenges within the group. In Nigeria where reliance on gas for kiln energy is very high, disruption to gas supply has often resulted in missed cement volume targets. The group has also blamed recent volume problems on (1) flooding, (2) logistical challenges, and (3) mining and extraction difficulty owing to limited access to explosives. Besides, we are aware of the strong pressure on market share in the South West from the aggressive retail penetration strategy of the market leader - DANGCEM. In South Africa, industrial issues and kiln shut downs have had the most negative impact on volume.

Desperate measures in desperate situation.

Priority has shifted from ASHAKACEM's capacity expansion plan

The expansion of ASHAKACEM capacity was supposed to be a major product of the business combination. Management had announced in early 2014, the plan to add an additional 3Mts – including a debottlenecking – to the existing 1Mts capacity over a three-year period (ending 2017 or 2018). A groundbreaking ceremony, in commemoration of the project, was held in April 2014.

Till date, the plant still operates with 1Mts capacity, with addition of about 0.5Mts in the near term only likely to be through debottlenecking. It is not unlikely that the incident of insurgents' invasion of the facility in 2014 may have prompted management to reconsider the case for the investment. More fundamentally, the lack of progress with the project may not be unconnected with the group's challenging financial condition. We believe priority is being given to (1) sweating the recent investment in Mfamosing and (2) repayment of the outstanding shareholder loans. Uncertainty around the future of the ASHAKACEM's expansion project is high, given little to no mention by management in recent discussions. Group capex has reduced significantly to NGN15 billion in 2017FY, from a record spend of NGN60 billion in 2015FY (2016FY: NGN41 billion).

Back and forth with USD shareholder loans

LAFARGE announced in 2016, the conversion of USD493 million (and subsequently USD507 million) shareholder loans (from the LafargeHolcim group) to quasi-equity instruments. The objective was to limit P&L volatility, after the USD debt had resulted to the recognition of NGN28.6 billion as revaluation losses in H1-16. The equity instrument was expected to bear average interest rate of 6%, payable at the company's discretion. Furthermore, in December 2016, Lafarge Africa refinanced UNICEM's local bank debt with USD88.4 million additional shareholder loan from the LafargeHolcim group, increasing the shareholder loan & quasi-equity to USD595 million.

In Q3-2017, following approval for a rights issue, USD220 million of the shareholder loan was refinanced at "better terms" and removed from quasi-equity to the balance sheet. The implication was the increase in finance cost from NGN17 billion as at 9M-17 to NGN43.2 billion by the end of the year (Q4-17 alone was NGN25.9 billion). We estimate that LAFARGE's balance sheet is currently exposed to about USD308 million of shareholder loans (and possibly more), albeit hedged through Non-Deliverable FX Futures.

No rights issue; ok rights issue; then another rights issue

The Board approved rights issue (RI) to raise NGN131.65 billion in June 2017. The RI was undertaken to refinance the USD287 million quasi-equity loan from the LafargeHolcim group and finance working capital and the expansion of operations. In our note of 08 May 2017 "*Lafarge Africa Plc Rights Issue: Finally!*", we did mention that "the management of LAFARGE had been asked on several occasions on the possibility of fully converting the parent company debt to equity, and on each occasion, the response was not in the affirmative". Anyways, on the positive, the USD loans the company is exposed to has reduced by 48% through the rights, technically (i.e taking all loans into consideration) improving net-debt-to-equity ratio to 1.8x as at H1-18 (2017FY: 2.2x).

Surprisingly on the H1-18 results call, management revealed the plan to refinance existing debt, involving (1) a reduction of the existing USD308 million shareholder loans to USD293 million and (2) rights issue of NGN90 billion to refinance short term naira denominated borrowings. At today's price of NGN23.00, we estimate that

13 September 2018

the proposed rights, if successful, should result in 3.9 billion new shares, increasing LAFARGE's outstanding shares to 12.6 billion by Q1-2019e (2014FY: 4.4 billion).

The Nigerian cement market.

Not too fantastic short-to-medium growth outlook . . .

The Nigerian cement market is currently the largest in Sub-Sahara Africa (SSA), with 40.3Mts production capacity and 18Mts annual consumption. Macro fundamentals are improving following challenging years and the government "appears" bullish on capital expenditure. The country's huge housing and road infrastructure gap, with a population growing at c.3% rate per annum, presents a stable demand point for cement consumption. Instructively, the cement sector is strongly protected by the government (through friendly tax policies and import ban), operators are few, and price competition is significantly less fierce (there have more price increases than cuts, in the last ten years) compared to what is obtainable in other markets.

The above narrative is supportive of LAFARGE's outlook in the long-term. However, we are concerned about the short-to-medium term growth outlook of the cement markets in Nigeria and South Africa. At -3% average annual rate, the Nigerian cement market has grown less between 2014-2017, compared to the preceding years. Private consumption capacity is weighed by the country's significantly deteriorated economic condition, with over 130% currency devaluation severely denting purchasing power, amidst high unemployment rate. The IMF forecasts the economy to grow at a much slower rate of 2% average over the next three years, a pace we do not expect will support sustainable double-digit growth in annual cement consumption. **At less than 10-15% sustainable growth rate, we think the Nigerian cement market will be anything short of a "survival of the fittest" situation.**

. . . with increasing competition

DANGCEM has raised the barrier of survival for competitors in the Nigerian market with the group's investments of the last decade. Its Nigerian cement capacity is currently about 1.5x national consumption, and still expanding – expected to reach 38Mts by 2024. DANGCEM's plants have the advantage of location, plus the most expanded distribution facilities to support route-to-market. Present and future competitors, including LAFARGE, will have to deal with the aforementioned, including the fact that the group is the lowest cost producer – supported by scale, relatively newer plants, and investments into securing energy efficiency – and an established price setter.

BUA Group is also positioning strategically. The group recently announced the commissioning of a new 1.5Mts capacity in Sokoto (North West of Nigeria) through CCNN (which operated for decades with 0.5Mts), increasing its total capacity in the region to 2Mts. Combined with the 3Mts capacity plant in Obu, Edo State, BUA group now has a combined installed cement capacity of 5Mts, representing 11% of the sector (2017: 8%). The expanded capacity in Sokoto brings significant scale advantage to the group, and (1) is a welcome fortification against DANGCEM and, for the sake of this piece, (2) has reduced, in our view, the previously envisaged investment case for LAFARGE's Northern play through the ASHAKACEM expansion plan. We also view the Obu plant, strategically positioned to serve beyond Edo State, as potentially disruptive of LAFARGE's (leveraging UNICEM's expanded capacity) South Eastern market play aspirations.

So, LAFARGE needs to stabilize production across its plants and restore market share back to competitive levels

In Nigeria – where the group's share of sector sales (using only DANGCEM, LAFARGE, and CCNN sales volumes) fell to 25% in 2017, from 32% in 2015 – energy supply challenges must be completely resolved by ramping up on diversification to alternative fuels. We are also of the view that the group needs to immensely improve on its distribution model, as feedbacks from distributors on the ease and time of receiving orders from factory – compared to DANGCEM – have not been particularly encouraging. In South Africa, a definite resolution of the industrial/labour related challenges – which affected volumes for most part of 2017FY – at the Lichtenburg plant is necessary to stabilize production volumes and market share in a highly competitive market.

13 September 2018

Lafarge Africa Plc – HOLD; TP. NGN27.22/s.

Update: We update on LAFARGE following H1-18 result, with HOLD recommendation. The recently announced rights issue is incorporated into our valuation, as we believe it is already being factored in by investors. We also roll forward our estimates and valuation by one year, as we believe investors are already trading on 2019E multiples. On our DCF-derived TP of NGN27.22, the stock offers 18% potential upside – and expected total return of 25% after incorporating 2018E dividend yield of 6.5%. The stock has lost 21% since the H1-18 result release and RI announcement, not surprisingly faster than the (1) broader market (-11%) and (2) fellow cement companies (DANGCEM: -11%, CCNN: +8%) have dipped.

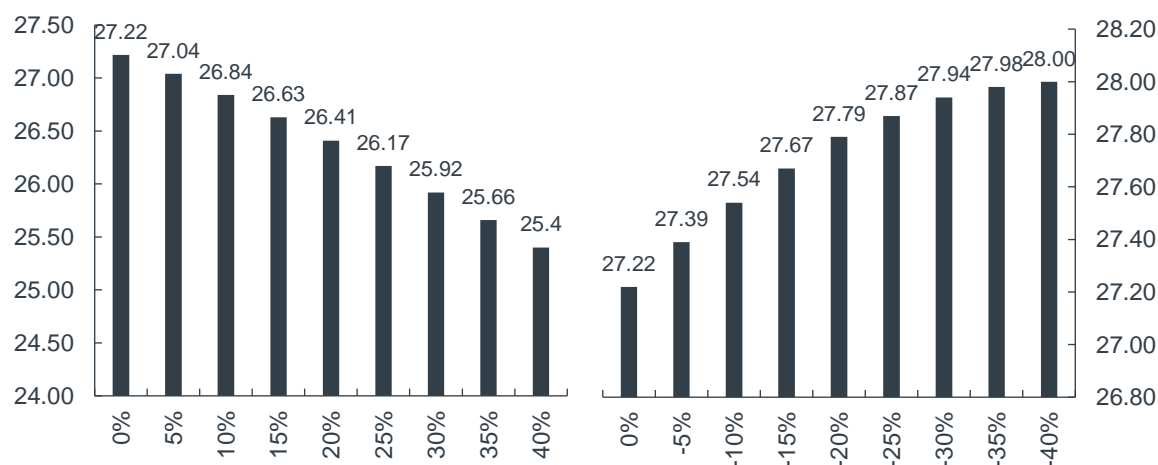
A net loss in 2018E: We see LAFARGE closing 2018E with a net loss. From our estimates, profit can be achieved only through better-than-expected revenue performance, strong gross margin recovery, and significant opex and finance cost savings, which we do not see coming through in the second half – opex and finance cost savings especially. We forecast NGN3.87 billion net loss in 2018E. We acknowledge that our revenue and gross margin estimates are conservative, as such, actual net loss may turn out lower. Both the group's seemingly recovered Nigerian sales volume, and the sharp q/q expansion of gross margin in Q2-18 are instructive. However, we believe we are rightly conservative particularly vis-à-vis gross margin, given the observed volatility of this line in recent quarters, and also considering the typically low print in Q3.

Right issue assumption: Our rights assumption is based on current market price of NGN23.00, potentially delivering additional 3.9 billion shares on the proposed NGN90 billion issue. At 12.6 billion units, the post-rights shares we used in our valuation are higher than the current issued shares by 45%. We also assumed the rights could be issued at up to 15% discount or premium to current market price, both implying 13.5 billion (+56%) or 12.3 billion (+41%) post-rights shares respectively, with varying impact on our TP estimates (see sensitivity analysis in figure 7). In our view, the latter is more likely, with no respite to the current bearish equities market condition in-sight. Given the timing of the RI – management has guided to possible completion of the issue in Q4-18 – we expect to see the impact on both earnings and balance sheet from 2019E, where we forecast finance charges will be lower by 38% vs. 2018E and net-debt-equity ratio of 0.9x (2018E: 1.8x).

Catalysts: Stronger-than-expected volume-driven Nigerian revenue and gross margin.

Risks: (1) Continued negative SA EBITDA (management guided that this would be positive, albeit little, from H2) and (2) operational issues in South East Nigeria amidst the heavy rainfalls.

Figure 7: Sensitivity analysis – rights issue impact on TP



Source: Cordros Research estimates

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.