

Dangote Sugar Earnings Review Q1 2020

Stock rating: BUY
Target Price: N17.95/s
Closing Price: N14.55/s

Company Information	
TTM P/B (x)	1.6x
TTM P/E (x)	8.2x
EV/EBITDA (x)	2.0x
Dividend Yield	7.5%
Free Float	26.9%
Market Cap (N'bn)	179.4

Q1 2020: Negative surprise in opex pressures operating performance

- Revenue surges by 24.9% y/y on price and volume growth
- Gross margin weakens by 6.3ppts on increase cost pressures
- Profit before tax declines 11.1% on jump in FX loss
- Earnings per share prints at N0.53/s

Synchronised growth in volume and price drives healthy revenue growth

Dangote Sugar reported a 24.9% y/y increase in Revenue to N47.6bn in Q1 2020 from N38.1bn in Q1 2019. On a q/q basis, Revenue grew 9.1% from N43.7bn in Q4 2019. The growth in Revenue was driven by double digit growth in volume sold which was up by 19.5% y/y to 189,724 tonnes as well as further price increments by the company. We note that the Federal Government has maintained closure of land borders through which smuggled sugar finds its way into the Nigerian market. Thus, Dangote sugar has witnessed a recovery in demand while its ability to raise prices has been strengthened following significant reduction in the presence of smuggled sugar in the Nigerian market. Across product segments, the 50kg SKU (+28.5% y/y) and retail sizes (+0.3% y/y) recorded growth while Freight Income (-67.5% y/y) and Molasses Revenue (-26.2% y/y) plunged.

Elevated cost pressure weighs on margin

Gross margin weakened by 6.3ppts y/y to 26.7% in Q1 2020 although, Gross Profit eked out a marginal 1.0% y/y growth to N12.7bn in Q1 2020 from N12.6bn in Q1 2019. The pressure on margins was due to faster growth in Cost of Sales relative to Revenue. Cost of Sales surged 36.6% y/y to N34.9bn in Q1 2020 from N25.6bn in Q1 2019. The growth in Cost of Sales was faster than both Revenue growth as well as sales volume growth. This was due to; higher import duty on raw sugar importation (from 5% to 10%), recent VAT increase (from 5% to 7.5%) and upward pressure from naira devaluation in Q1. However, we note that margins recovered from Q4 2019 levels which is an indication of the superior pricing power the company now holds.

Double-digit climb in Opex drags on operating performance

Operating expenses climbed higher by 13.8% y/y to N2.0bn in Q1 2020 from N1.8bn in Q1 2019 driven by increases in both Selling & Distribution expenses (+4.6% y/y to N0.2bn) as well as Administrative expenses (+14.9% y/y to N1.8bn). We note that Administrative Expenses has been under pressure since Q4 2018 due to sustained increase in personnel cost. The growth in Opex outpaced marginal Gross profit growth and as a result, Operating Profit declined 1.0% y/y to N10.7bn in Q1 2020. Nevertheless, a 10.1% y/y increase in Other Income and decline in Fair value loss on biological asset saw EBIT print higher by a modest 3.0% y/y to N10.7bn.

FX loss weighs on Finance cost...as Pre-Tax Profit dips

The company recorded a 60.5% y/y decline in Finance Income to N0.1bn in Q1 2020 from N0.3bn in Q1 2019. In addition, Finance Cost surged 3,165.9% to N1.4bn in Q1 2020 from N0.04bn in Q1 2019. Consequently, the company booked Net Finance Cost of N1.3bn as against Net Finance Income of N0.3bn in Q1 2019. The surge in Finance Cost was driven by the FX loss of N1.3bn recorded in Q1 2020 due to the devaluation of the Naira in Q1 2020. Meanwhile, the company recorded a decline in Finance Income despite the surge in Cash & Cash Equivalent balances evidencing the pressure on the yield environment. Against this backdrop, Pre-Tax profit dipped 11.1% y/y to N9.5bn in Q1 2020 from N10.7bn in Q1 2019. On a q/q basis, Pre-Tax Profit was up by 38.8%.

Lower effective tax rate eases pressure on Net Income

Dangote Sugar recorded a 1.5ppts y/y decrease in Effective Tax Rate, thus lower Pre-Tax Profit and Effective Tax Rate pushed Tax Expense lower by 15.1% y/y. This helped to ease the pressure on Net Income which however declined 9.0% y/y to N6.4bn in Q1 2020 from N7.0bn in Q1 2019. On a q/q basis, Net Income fell 16.8% largely because of the Tax credit recorded in Q4 2019. Earnings per share in Q1 2020 printed at N0.53/s compared to N0.59/s in Q1 2019.

Outlook: Long term prospects improve...Forecasts revised upwards

Sustained recovery in Revenue albeit at a slower pace

Revenue outlook for Dangote Sugar has improved significantly following the success the Federal government has recorded in limiting influx of smuggled products including Sugar via the land borders. This has filtered into strong recovery in volumes sold as well as ability to raise prices back to previous levels. Nevertheless, the impact of the Coronavirus outbreak puts a dent on expectations. In Q2, the lockdown measures limited activities of the Industrial operators. We expect demand from Industrial customers to dip in Q2. In addition, with social gatherings remaining banned, we expect demand from confectionery producers to decline. Nevertheless, with the economy being reopened gradually, we anticipate recovery in demand in Q3 and Q4 albeit at a slower pace. Against this backdrop, we forecast an 8.0% increase in volume sold as well as a 5.0% increase in price. Overall, we project a 12.3% y/y increase in Revenue to N180.9bn in FY 2020e with other business units (Freight & Molasses sales) expected to underperform.

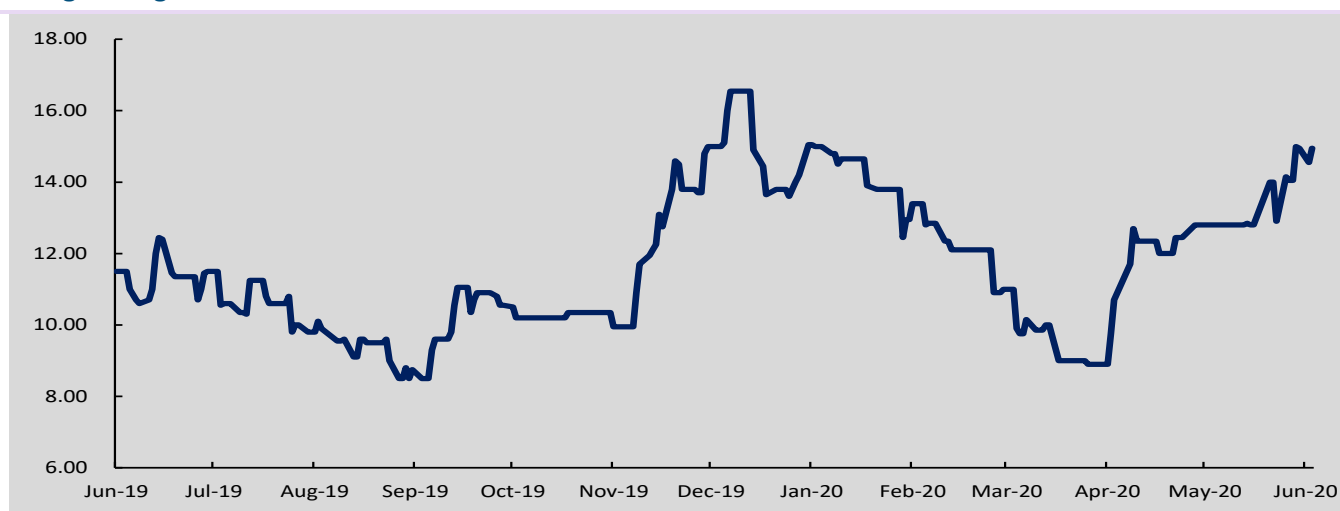
Cost pressures remain elevated...FX loss another pressure point

Dangote Sugar faces mounting cost pressures. Devaluation of the naira makes it more expensive for the company to import raw sugar in naira terms while import duties on such imports have climbed to 10% from 5% previously. Another layer of pressure is the increase in VAT to 7.5%. With all these pressure points in focus, we project a 13.5% y/y climb in Cost of Sales which would see Gross Margin weaken. Furthermore, Opex continues to climb higher evidenced by the double digit growth in Q1 2020. We expect this to place pressure on Operating performance. Nevertheless, we project a modest 7.4% y/y growth in Operating Profit. However, we are concerned about the quantum of FX loss booked by the company in Q1, thus, we expect Finance Cost to be a significant pressure point for the rest of the financial year. Overall, we forecast a 4.4% y/y decline in Net Income to N21.4bn in FY 2020e while we project EPS would settle at N1.78/s.

Long term outlook improves...BUY rating recommended

We have a target price of N17.30/s for Dangote Sugar which represents an 15.7% upside to Tuesday's closing price of N14.95/s with a Buy recommendation on the stock. Our Buy recommendation is informed on the improved long-term prospects of the company. With competition from smuggled sugar now subdued, we expect positive growth to be restored and this reflects in the upward revisions across our forecasts over 2020e – 2024e. In addition, the stock trades at a PE multiple of 8.2x which is a discount to our peer average of 12.9x despite superior ROE and long-term earnings growth prospects.

Dangote Sugar 1-Year Price Movement



Source: Bloomberg, FSDH Research

Dangote Sugar Plc Earnings Highlight Q1 2020

N'm	Q1 2020	Q1 2019	y/y	Q1 2020	Q4 2019	q/q
Revenue	47,643	38,146	24.9%	47,643	43,661	9.1%
Cost of Sales	(34,922)	(25,557)	36.6%	(34,922)	(34,395)	1.5%
Gross Profit	12,721	12,589	1.0%	12,721	9,266	37.3%
Selling & Distribution Expenses	(187)	(178)	4.6%	(187)	(207)	-9.8%
Administrative Expenses	(1,819)	(1,584)	14.9%	(1,819)	(2,185)	-16.7%
Operating Profit	10,715	10,826	-1.0%	10,715	6,875	55.9%
Other Income/(Expenses)	32	29	10.1%	32	484	-93.3%
Impairment Gains/(Losses)	-	-	n/a	-	(332)	-100.0%
Fair Value Adjustment	(9)	(427)	-98.0%	(9)	130	-106.7%
EBIT	10,739	10,429	3.0%	10,739	7,157	50.1%
Finance Income	124	314	-60.5%	124	126	-1.8%
Finance Cost	(1,353)	(41)	3165.9%	(1,353)	(431)	213.9%
Net Finance Income/(Cost)	(1,229)	273	-550.8%	(1,229)	(305)	303.3%
Profit before Tax	9,510	10,702	-11.1%	9,510	6,852	38.8%
Income (Tax)/Credit	(3,137)	(3,697)	-15.1%	(3,137)	807	-488.9%
Profit for the period	6,372	7,004	-9.0%	6,372	7,659	-16.8%

Other Key Inputs	Q1 2020	Q1 2019	y/y	Q1 2020	Q4 2019	q/q
Basic Earnings Per Share (N/s)	0.53	0.59	-9.4%	0.53	0.63	-16.0%
EBITDA (N'm)	12,189	11,127	9.5%	12,189	9,755	25.0%

Margins	Q1 2020	Q1 2019	y/y	Q1 2020	Q4 2019	q/q
Gross Margin	26.7%	33.0%	-6.3ppts	26.7%	21.2%	5.5ppts
EBITDA Margin	25.6%	29.2%	-3.6ppts	25.6%	22.3%	3.2ppts
Operating Margin	22.5%	28.4%	-5.9ppts	22.5%	15.7%	6.7ppts
Net Margin	13.4%	18.4%	-5.0ppts	13.4%	17.5%	-4.2ppts
Basic Outstanding Share	12,000	12,000		12,000	12,000	
Depreciation & Amortisation	1,450	698		1,450	2,598	

Source: Company Financials, FSDH Research

FSDH Forecast

Nm (unless otherwise stated)								
Income Statement	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Revenues	204,422	150,373	161,086	180,948	208,681	231,999	250,766	265,986
Cost of Sales	(153,434)	(110,688)	(122,801)	(139,330)	(160,684)	(178,639)	(193,089)	(204,809)
Gross Profit	50,988	39,685	38,285	41,618	47,997	53,360	57,676	61,177
Operating Expenses	(7,482)	(7,772)	(8,629)	(9,771)	(11,269)	(12,528)	(13,541)	(14,363)
Operating Profit	43,506	31,914	29,656	31,847	36,728	40,832	44,135	46,814
Other Income/(Loss)	402	569	606	633	730	812	878	931
EBIT	43,907	32,483	30,262	32,480	37,458	41,644	45,012	47,744
Fair Value Adjustments	2,468	(325)	(313)	-	-	-	-	-
Impairment Gains/Losses on Fin Assets	0	201	(332)	-	-	-	-	-
Net Finance (cost)/ income	7,223	2,242	204	(1,935)	(91)	(7)	19	1
PBT	53,599	34,601	29,820	30,545	37,367	41,636	45,032	47,746
Taxation	(13,815)	(12,625)	(7,459)	(9,164)	(11,210)	(12,491)	(13,510)	(14,324)
Net Profits	39,784	21,976	22,361	21,382	26,157	29,145	31,522	33,422
EPS, N	3.31	1.85	1.87	1.78	2.18	2.43	2.62	2.78
DPS, N	1.75	1.15	1.15	1.15	1.30	1.44	1.55	1.66
Dividend Sum	21,000	13,800	13,800	13,777	15,548	17,324	18,580	19,866

Balance Sheet	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Property, Plant & Equipment	59,414	64,256	82,997	93,888	106,479	120,191	134,452	148,814
Deferred Tax Assets	7,173	7,173	10,440	10,440	10,440	10,440	10,440	10,440
Intangible Assets	3	0	-	-	-	-	-	-
Other Assets	3	12	-	-	-	-	-	-
Non-Current Assets	66,593	71,441	93,438	104,328	116,920	130,632	144,893	159,255
Inventories	47,656	37,676	38,864	44,586	41,778	37,514	40,549	38,914
Biological Assets	2,807	1,841	2,069	2,069	2,069	2,069	2,069	2,069
Trade & Other Receivables	20,907	41,330	33,779	30,761	29,215	31,320	35,107	31,918
Cash in Bank & ST Deposits	41,368	21,582	24,612	13,837	15,485	18,561	15,976	17,031
Other Assets	14,882	378	76	76	76	76	76	76
Asset Held for Sale	869	869	869	869	869	869	869	869
Current Assets	128,488	103,676	100,268	92,197	89,491	90,408	94,646	90,876
Total Assets	195,080	175,117	193,706	196,525	206,411	221,040	239,539	250,131
LIABILITIES								
Deferred Tax Liabilities	5,213	5,310	5,020	5,020	5,020	5,020	5,020	5,020
Lease Liabilities	-	-	1,710	1,668	1,645	1,606	1,546	1,531
LT Loans and borrowings	1,467	1,426	1,300	1,256	1,238	1,209	1,164	1,153
Total Non-Current Liabilities	6,680	6,736	8,030	7,944	7,903	7,835	7,729	7,704
Lease Liabilities	-	-	612	610	601	587	565	560
Trade & Other Payables	75,653	54,498	63,224	58,519	57,846	60,737	66,423	63,491
ST Loans & Borrowings	71	45	45	54	53	52	50	49
Taxation	17,717	12,373	11,117	11,117	11,117	11,117	11,117	11,117
Retirement Benefit Obligation	984	970	980	980	980	980	980	980
Other Liabilities	1,239	1,520	1,561	1,561	1,561	1,561	1,561	1,561
Total Current Liabilities	95,665	69,406	77,539	72,841	72,159	75,035	80,696	77,758
Share Capital	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000
Share Premium	6,321	6,321	6,321	6,321	6,321	6,321	6,321	6,321
Revaluation Reserve	-	-	-	-	-	-	-	-
Revenue Earnings	80,578	87,010	96,259	103,842	114,425	126,217	139,128	152,650
	92,898	99,331	108,580	116,163	126,746	138,538	151,449	164,971
Minority Interest	(163)	(356)	(443)	(421)	(395)	(366)	(334)	(301)
Shareholders' Funds	92,736	98,975	108,137	115,741	126,350	138,172	151,114	164,670
Total equity and liabilities	195,080	175,117	193,706	196,526	206,413	221,041	239,540	250,133

Cash Flow	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Operating Cash Flow	25,927	3,770	38,355	23,112	38,205	43,691	41,182	47,549
Investing Cash Flow	(6,344)	(8,231)	(21,053)	(17,518)	(20,428)	(22,689)	(24,558)	(26,103)
Financing Cash Flow	(13,200)	(15,325)	(14,272)	(16,368)	(16,129)	(17,926)	(19,208)	(20,391)
Free Cash Flow	50,256	37,842	(8,388)	19,663	10,272	10,774	18,791	17,524

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