

August, 2015

Dangote Sugar Plc - Current Market Price (N6.01)

We rate the counter NEUTRAL

Despite a 3.06% y/y increase in Sales, half year post-tax profits declined 7.66% y/y on pressures from rising finance costs and a significant dip in income from non-core business activities.

Depressed market conditions constrain sales growth.....

Dangote Sugar Plc reported revenue growth of 3.06% y/y to N51.12billion, compared with N49.60billion in the same period of last year. In Q2 2015 alone, revenue came in at N28.65billion, an increase of 20.83% y/y and 27.56% q/q.

DSR is Nigeria's largest producer of household and commercial sugar with a refining capacity of 1.44 million tonnes, catering to a population of c.165 million consumers through a network of distributors. The company's refinery at Apapa imports raw sugar from Brazil and refines it into white, Vitamin A fortified sugar suitable for household and industrial uses. DSR has managed to overcome major operational challenges within the review period - from gas supply disruptions to its refinery in Apapa, to currency devaluation and the problem of insurgency in parts of North-Eastern Nigeria.

COGS/revenue ratio which measures a firm's cost effectiveness from its production perspective increased to 75.15% in Half-year 2015, from 73.87% in the same period of 2014. This led to a decline in gross margin as the firm converted a lower proportion of its revenue to gross profit. Hence, gross profit decreased to N12.70billion in half year 2015 from N12.96billion in the same period of 2014. Gross margin therefore declined to 24.85% from 26.13% in 2014.

Key Ratios

	HY'15	HY'14	Change
Gross Margin	24.85%	26.13%	1.28%
Net Margin	12.35%	13.78%	1.43%
Equity Multiplier	1.90x	1.90x	0.00x
Asset Turnover	0.51x	0.56x	0.05x
Debt /Equity	0.14x	0.01x	0.13x
EPS (Kobo)	0.53	0.56	5.4%

Source: NSE, Planet Capital Research

Valuation

	FY'14	FY'15(E)
P/S	0.80x	0.76x
P/E	6.68x	6.06x
PEG	0.94x	0.96x
P/B	1.30x	1.27x
ROE	19.48%	20.95%
ROA	12.29%	10.77%
Div Yield	6.02%	6.66%

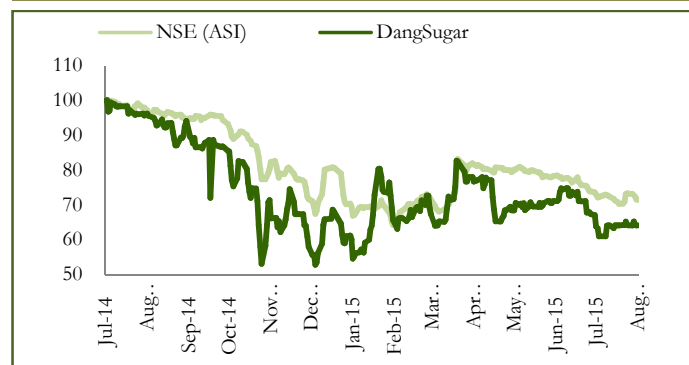
Source: NSE, Planet Capital Research

Stock Data

Ticker Symbol	DangSugar
Year end	December
52-week range	N4.94 - N9.10
Price Mov't YtD	(5.34%)
Average daily vol./val	1.28mn/N7.76mn
Outstanding Share (Mn)	12,000
Market Cap.(N'm)	73,200
EPS (6Months)	53k
DPS	40k

Source: Bloomberg, Planet Capital Research

Share Price Movement - 52wks

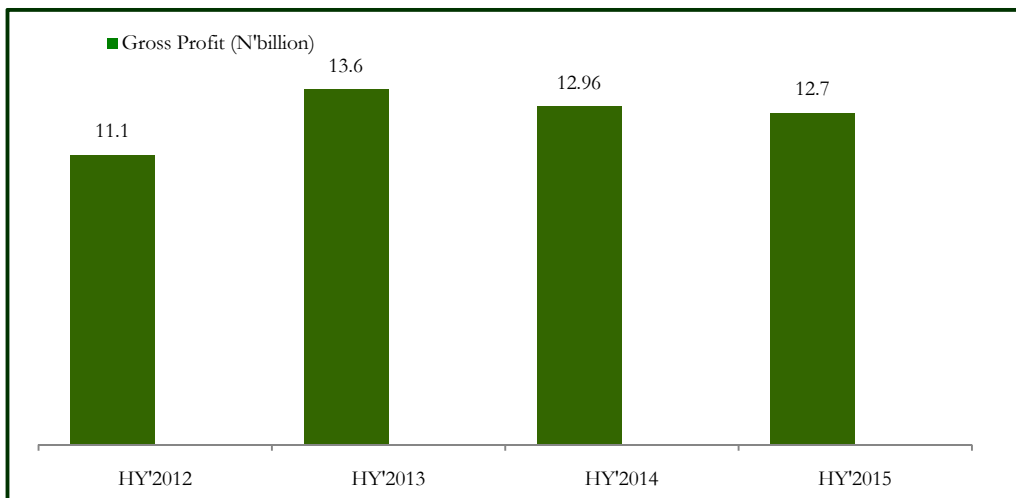


The fall in global price of raw sugar softened the negative impact of Naira devaluation on the company's input costs.

Also, Management was able to offset the higher input cost by raising the selling price, passing on some of the costs to consumers as the company hiked sugar prices by 20.6 percent.

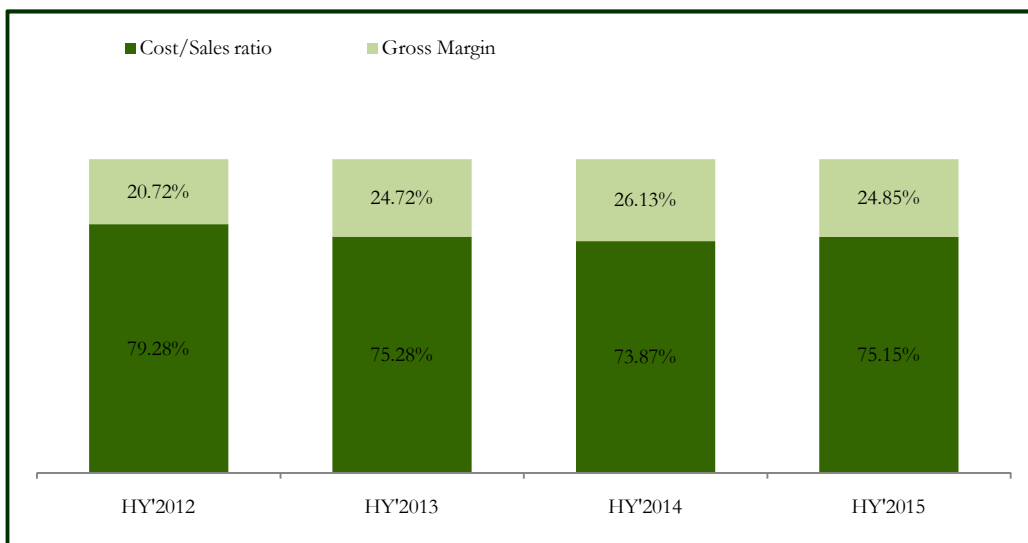
DSR has seen an increase in locally refined sugar production, underpinned by ongoing rehabilitation and expansion of its subsidiary, savannah sugar. We expect the company to enjoy synergy from locally grown sugarcane thereby reducing input costs which will impact positively on profit margins going forward.

Gross Profit trend



Source: Bloomberg, Planet Capital Research

CoGS/Revenue Ratio and Gross Margin

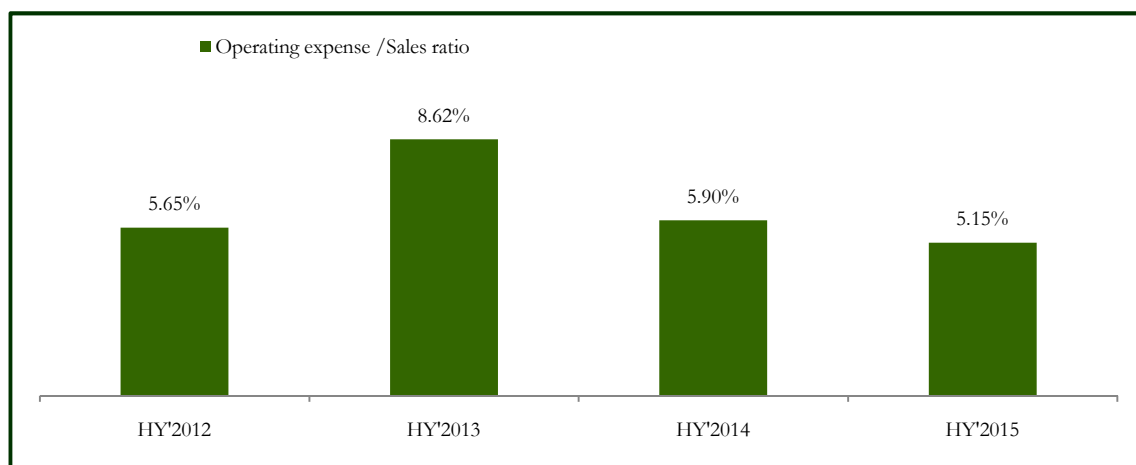


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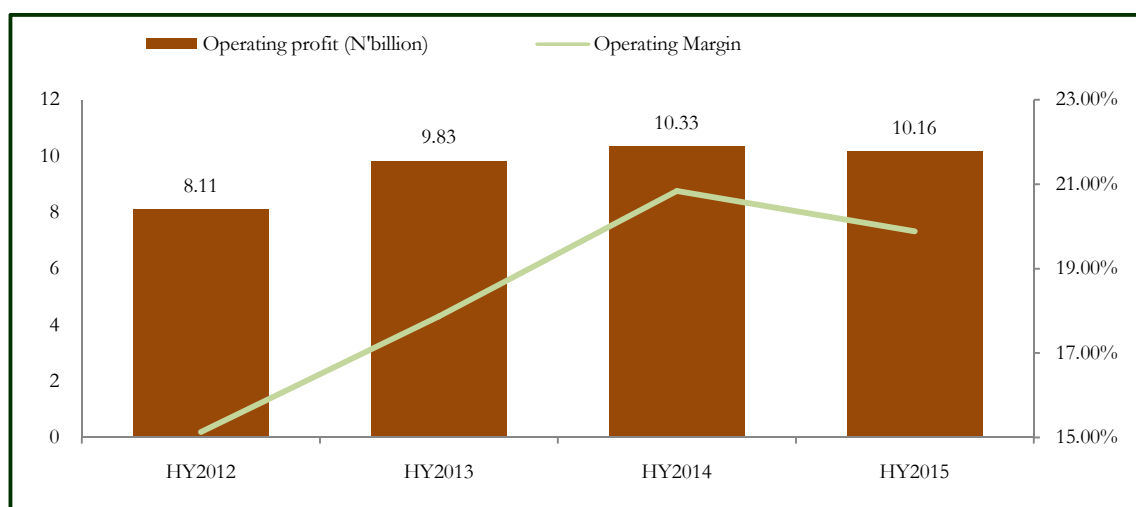
Bloomberg, Planet Capital Research

Operating expense moderated by 10.02% y/y to N2.63billion from N2.92 billion in HY 2014 and 45.16% q/q to N930million from N1.7billion in Q1 2015. Operating expense/revenue ratio recorded a slight decrease of 0.75% y/y. The drop in opex was from lower selling, distribution and administrative costs.

Income realized from non-core business activities (other income) declined by 69.31% y/y to N93.46million for the review period from N304.55million in HY 2014, though QoQ, other income was reported to be (N42.54million) for Q2 2015, down from N136million in the previous quarter. Total operating income for DSR came in at N10.16billion, a marginal decline of 1.80 percent from N10.33billion for the corresponding period of 2014. Consequently, operating margin declined to 19.88% from 20.48% in HY 2014.



Source: Bloomberg, Planet Capital Research



Source: Bloomberg, Planet Capital Research

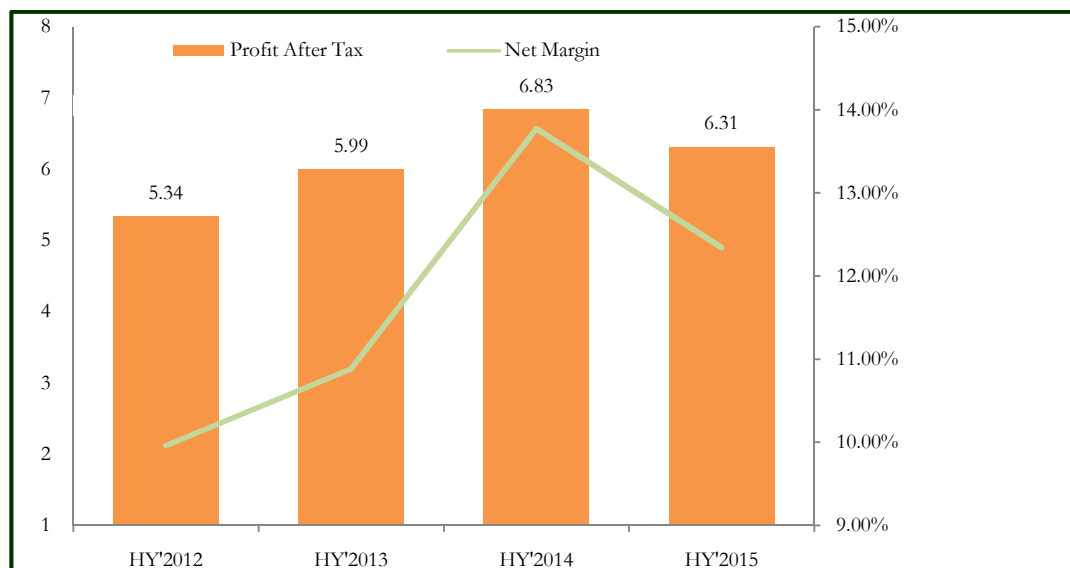
The group's after tax profit dropped by 7.66% y/y to N6.31billion, a feed through from higher finance costs (up 382.78%) to N361.65million. Rising finance costs were from loans used to fund the ongoing backward integration project (Savanah Sugar and Greenfield development of 23,000 acres of sugarcane plantation in Taraba state). As a result, net margins dipped by 1.43% to 12.35% from 13.78% in HY 2014.

However, PAT was up QoQ by 65.88 percent to N3.93billion for Q2 2015 and 27.93% higher y/y from N3.07billion in Q2 2014. Overall, lower raw sugar prices and the impact on CoS in addition to the 20.6 percent increase in sugar prices supported the company's bottom line.

Half year performance

	HY 2015	HY 2014	Change
Revenue (N'million)	51,120.28	49,601.13	3.06%
EBIT (N'million)	10,163.89	10,338.05	-1.68%
PAT (N'million)	6,311.92	6,835.26	-7.66%

Source: NSE, Planet Capital Research



Source: NSE, Planet Capital Research

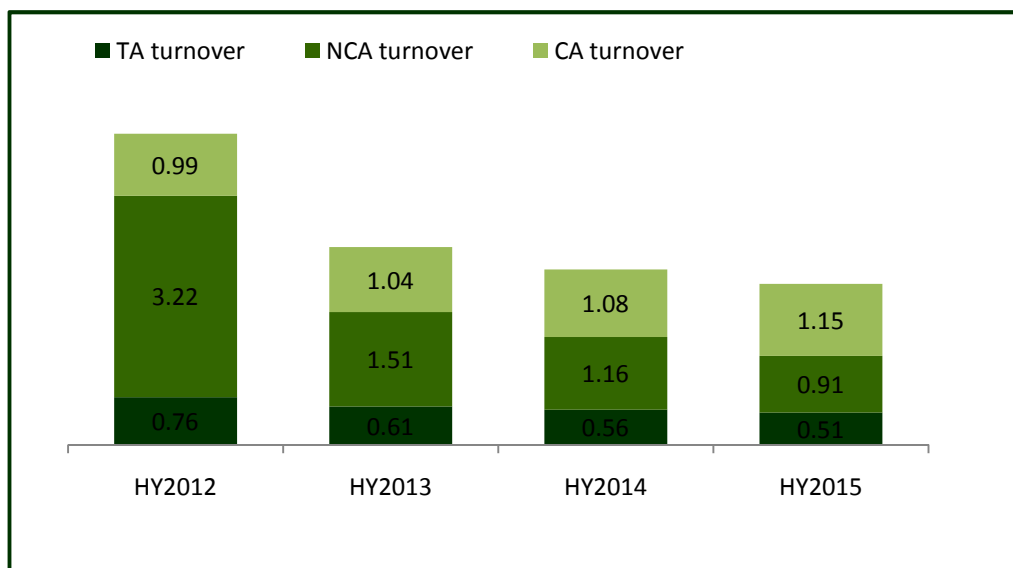
Balance Sheet Analysis

There was a significant increase in the debt levels during the review period. Debt to equity ratio rose to 0.14x in HY2015 from 0.04x as at FY2014 but remains below peer average of 3.26x. The uptick in debt to equity ratio was due to a 210.92% Year-to-date rise in borrowings from N2.38billion in FY2014 to N7.4billion in HY2015 which was used to finance on-going projects. Total debt to assets ratio therefore rose to 0.07x in HY 2015 from 0.03x in FY 2014 compared to industry average of 0.39x.

The company's total assets to liabilities ratio which measures solvency declined to 2.11x in HY2015 from 2.24x in FY2014 which is higher than the industry peer average of 1.37x . Estimated fixed asset turnover lessened to 1.72x in HY2015 from 1.74x in FY2014. Also, current asset turnover ratio decreased to 2.17x during the review period from 2.48x in FY2104. Overall, total-asset turnover ratio declined to 0.96x in HY2015 from 1.02x in FY2014. A higher ratio implies that the company is using its assets more efficiently.

Inventory turnover of 4.47x is lower than 5.05x calculated for FY 2014. DSR experienced inventory build-up as sales dwindled during the period. While Days inventory outstanding increased 81.65 days from 72.30days in FY2014.

Receivables turnover ratio increased to 6.82x from 5.70x in FY2014, showing that the company's extension of credit and collection of accounts receivable improved. However, trade payable turnover increased to 3.06x from 3.02x in FY2014. Days receivables outstanding (DRO) declined to 53.50 days from 64.04 days in FY2014. While, days payable outstanding remained steady at 119.42 days compared to 120.79days in FY2014.



Source: NSE, Planet Capital Research

Valuation

In arriving at a fair value for the company, we employed three valuation methods: The Discounted Dividend Model (DDM), Free Cash Flow to Equity (FCFE) and Price Multiples. We calculated the Gordon's sustainable growth rate to be 11.63% using ROE of 20.30% and earnings retention rate of 59%.

We noticed that the company has low level of interest bearing debt and high proportion of equity in its capital structure as at HY 2015. We therefore adopted the Capital Asset Pricing Model (CAPM) to estimate cost of equity using a risk free rate of 18% and beta of 1.4.

We expect higher growth of 11.63% due to the ongoing backward integration projects while a stable growth of 9.63% will be maintained long term. The Dividend Discount Model generated a fair value of N4.79 per share.

Cost of Equity	
$K_e = R_f + \beta (R_m - R_f)$	19.03%
$R_f =$ Risk free rate	15.54%
$R_m =$ Return on market	18.00%
$R_m - R_f =$ market risk premium	2.46%
$\beta =$ Beta coefficient	1.42

Free Cash Flow to Equity (FCFE) measures how much cash is available to the holders of ordinary shares after all operational expenses such as interests and principal are paid and after necessary investments in net working capital and fixed assets are achieved. Using same growth rate as stated above, the FCFE model generated a fair value of N5.82.

Using the Price Multiples method, we arrived at a fair value of N11.55 per share. Applying an equal weight to DDM, FCFE and price multiples, we arrived at a Target price of **N7.00** per share. At the current price of N6.01, this gives an upside potential of 16.47 percent. We rate the counter neutral at this point but a buy can be initiated when the stock slips below N5.50. YtD, DSR shares have returned -5.35% compared to market return of -10.24%.

Profit & Loss (N'Mn)

	2011	2012	2013	2014	2015(E)
Revenue	107,218.64	106,868.05	103,153.74	94,855.20	96,374.35
Changes	19.16%	-0.33%	-3.48%	-8.04%	1.60%
Cost of Sales	93,620.92	85,756.86	78,555.26	76,227.19	78,002.55
Changes	30.13%	-8.40%	-8.40%	-2.96%	2.33%
Gross Profit	13,597.72	21,111.19	24,598.47	18,628.01	18,371.80
Changes	-24.60%	55.26%	16.52%	-24.27%	-1.38%
Operating Expense	3,145.81	6,878.80	12,145.73	8,600.06	7,374.68
Changes	-8.38%	118.67%	76.57%	-29.19%	-14.25%
Investment Income	370.63	1,314.65	1,491.64	285.59	262.59
Changes	N/A	254.70%	13.46%	-80.85%	-8.06%
Other income	98.69	784.63	2,258.02	5,066.05	4,920.50
Changes	-93.63%	695.05%	187.78%	124.36%	-2.87%
EBIT	10,921.23	16,331.68	16,202.40	15,379.60	16,180.21
Changes	67.63%	49.54%	-0.79%	-5.08%	5.21%
Finance Cost	347.00	0.00	67.16	106.44	393.18
Changes	-82.17%	-100.00%	N/A	58.48%	269.38%
PBT	10,921.23	16,331.68	16,265.16	15,273.15	15,787.03
Changes	-32.36%	49.54%	-0.41%	-6.10%	3.36%
Tax	3,517.63	5,535.26	5,419.23	3,637.37	3,699.81
PAT	7,403.60	10,796.42	10,845.93	11,635.78	12,087.22
Changes	-34.38%	45.83%	0.46%	7.28%	3.88%
EPS	0.62	0.90	0.90	0.97	1.01

Statement of Financial Position

	2011	2012	2013	2014	2015(E)
Assets					
Cash and Cash equivalent	6,096.04	24,963.44	7,864.79	6,202.48	4,034.73
Inventories	27,947.07	14,030.30	11,097.89	15,098.89	19,797.60
Account Receivables	21,379.36	24,844.65	19,273.53	14,012.84	14,237.26
Total CA	55,630.82	64,280.58	39,858.49	37,328.21	41,421.63
Total NCA	17,183.89	18,770.86	46,029.10	54,537.44	67,691.99
Total Assets	72,814.71	83,051.44	85,887.59	91,865.65	109,113.62

Liabilities & Equity

	2011	2012	2013	2014	2015(E)
Account Payable	26,389.08	27,112.28	23,073.81	25,226.99	25,814.53
Borrowings	0.00	0.00	921.15	2,385.05	7,402.83
Total Current Liabilities	29,928.08	32,520.85	31,055.17	36,776.26	44,081.82
Total NCL	3,752.93	4,261.44	6,101.03	4,611.31	4,676.36
Total Equity	39,133.71	46,269.16	53,817.51	58,789.22	57,694.88
Total Lia. & Equity	72,814.72	83,051.45	90,973.71	100,176.79	106,453.06

Activity Ratios

	2011	2012	2013	2014	2015(E)
Inventory turnover (x)	3.35	6.11	7.08	5.05	4.47
Receivables turnover(x)	7.84	4.62	4.68	5.70	6.82
Payables turnover(x)	3.55	3.16	3.40	3.02	3.05
Days inventory outstanding	108.96	59.72	51.57	72.3	81.64
Days Sales Outstanding	46.56	79.00	77.99	64.04	53.49
Days Payables Outstanding	102.82	115.51	107.35	120.86	119.42

Leverage and Solvency Ratios

	2011	2012	2013	2014	2015(E)
Equity Multiplier(x)	1.66	1.83	1.69	1.59	1.89
Debt -to-equity	0	0	0.02	0.04	0.13
Total debt-to-assets(x)	0	0	0.01	0.03	0.07
Total asset-to-Liability(x)	2.16	2.26	2.58	2.24	2.33
Interest coverage (x)	0	0	241.24	144.49	41.15

Efficiency Ratios

	2011	2012	2013	2014	2015(E)
Fixed assets turnover(x)	6.24	5.69	2.24	1.74	1.58
Current assets turnover(x)	1.93	1.66	2.59	2.48	1.42
Total assets turnover(x)	1.47	1.29	1.20	1.02	0.88
Equity turnover(x)	2.64	2.50	2.06	1.69	1.67

Outlook

Nigeria's growing population and the proliferation of eateries around the country coupled with increased demand for sugar in the Food, manufacturing and consumer goods sectors is likely to have a positive impact on the local sugar industry with total market demand currently at 1.5million MT. With a 1.4million MT per annum installed capacity, DSR remains ahead of close peers like BUA sugar refinery with a 720,000 MT per annum installed capacity. The company's current strategy is to end the importation of raw sugar and sell more than one and a half million tonnes of locally produced sugar in Nigeria and neighbouring countries.

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