



DANGOTE SUGAR REFINERY-FY'09 & Q1'10

Equity|Nigeria|Food and Beverages

Vetiva Research

07 June 2010

Upbeat Earnings Expectation

We have placed an **"Accumulate"** recommendation on Dangote Sugar Refinery Plc (Dangsugar), following the company's improved performance relative to the previous year's, as well as the improved outlook for raw sugar prices, which are currently on the decline. Our Fair Value range is ₦22.74 - ₦26.57.

- In February 2010, global raw sugar prices commenced a decline, due to robust harvests from key sugar producing countries. The decline is expected to be sustained by the increased supply envisaged for 2010/2011.
- Although the results released were dampened by the effect of high prices of raw sugar, which persisted for most of 2009; we project Sales growth of 5% (₦86.52 billion - FY 2010) and Earnings growth of 35% (₦17.82 billion - FY 2010).
- We expect the increase in domestic and industrial demand for refined sugar locally to further boost Revenue growth relative to the previous year.
- Investment in backward integration further goes to improve the company's long term prospects.
- The major risk to our valuation is the possibility of an upward trend in global raw sugar prices, following reports of increasing sugar demand in Russia, one of the world's largest sugar importers and a 15% reduction in sugar import tax in Russia to encourage raw sugar imports, and tackle rising prices.

Event

Dangsugar simultaneously released its FY'09 and Q1'10 results on Wednesday, 30th June 2010. The FY'09 result shows a YoY increase of 2.14% (Actual - ₦82.40 billion) in Turnover which was above expectation of ₦71.79 billion, while Profit After Tax declined by 39.71% (Actual - ₦3.97 billion) relative to the commensurate period last year, and was much below our expectation of ₦17.02 billion.

Its Q1'10 performance shows significant growth in Turnover of 19.26% to ₦22.79 billion, while Profit After Tax fell by 5.29% to ₦3.97 billion. The company proposed a dividend of ₦1.00 per Share for the financial year ended December 2009. This implies a dividend yield of 4.80% and an impressive payout ratio of 91% relative to 66% in the previous year.

Results (N'Millions)	FY'09	FY'08	% Change	FY Forecast	FY% of FY Forecast
Turnover	82,395	80,671	2.1%	71,797	115%
PBT	19,586	30,151	-35.0%	27,283	72%
Tax	6,401	8,280	-22.7%	(7,296)	-88%
PAT	13,185	21,871	-39.7%	17,023	77%

Results (N'Millions)	Q1 '10	Q1 '09	% Change	FY Forecast	Q1% of FY Forecast
Turnover	22,787	19,107	19.3%	86,515	26%
PBT	5,839	5,591	4.4%	25,462	23%
Tax	1,868	1,397	33.7%	(7,639)	-24%
PAT	3,971	4,193	-5.3%	17,823	22%

Source: Vetiva Research, NSE

Fair Value Range
₦22.74 - ₦26.57

Stock Data

Current Price (₦): 20.85
Trailing EPS (₦): 1.08
Trailing PE: 19.30

Symbol: DSR
Industry: Food & Beverages
Share Vs Ind. Group: Accumulate
Ind. Group Vs Market: Overweight

Net Assets (₦): 3.80
Price/Book (x): 5.52
ROAA (%): 19.27
ROAE (%): 35.52

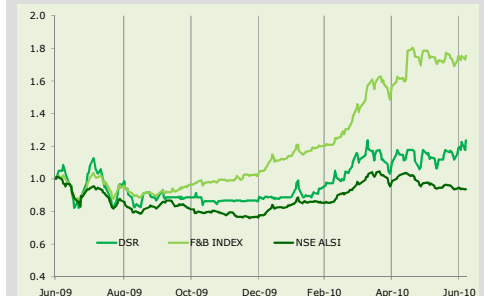
Shares Outstanding (mn): 12,000
Year High (₦): 20.97
Year Low (₦): 14.90

Share Price Performance

30 Days (%): 16.50
90 Days (%): 31.14
52 weeks (%): 17.94

DSR VS F&B SECTOR VS NSE ALSI (YTD)

Rebased 30/06/2009



Source: NSE, Vetiva Research

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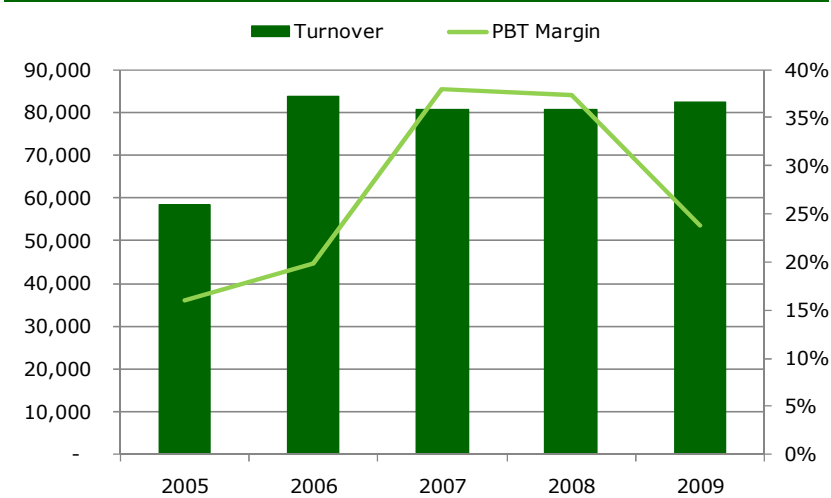
DANGOTE SUGAR REFINERY PLC FY'09 & Q1'10

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Performance Review

- Marginal and Significant Growth in Turnover for FY'09 and Q1'10 respectively.** In FY'09 Turnover grew slightly by 2.14%, which was higher than the negative growth anticipated. According to the company, it was able to transfer some of the costs to the final consumers as it increased refined sugar prices in the course of the period under review by c.80% to compensate for the c.100% increase in price of raw sugar in the course of the year. Q1'10 Turnover figure also shows impressive growth relative to previous quarters (the first double-digit Turnover growth in 3 years), which could be attributed to increased volumes due to a slight decrease in the price of refined sugar within the period.
- Worsening Profitability Profile.** Full Year profitability profile continued to decline, as we saw margins drop quite substantially on a Year-on-Year basis to 23.77% (PBT) and 16.00% (PAT) from 37.38% and 27.11% in FY'08. In Q1'10, profitability margins also declined on a Year-on-Year basis to 25.62% and 17.43% from 29.26% and 21.94% respectively. However, on quarter-on-quarter basis, Q1'10 profitability margins improved from 16.23% (PAT) and 5.62% (PBT) in Q4'09.

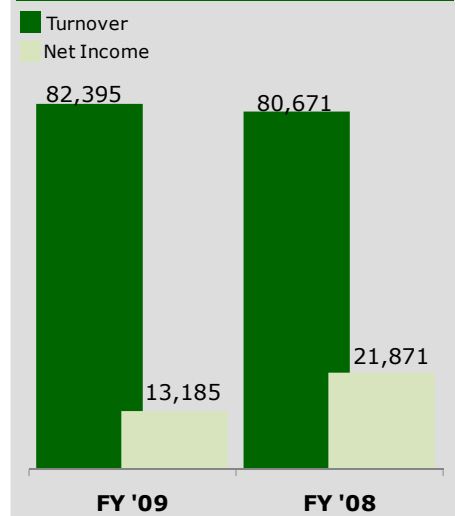
2005 – 2009 TURNOVER VS. PBT MARGIN



Source: Company Financials; Vetiva Research

- Impressive Growth recorded in Q1'10 Turnover did not reflect in profitability.** Despite the impressive Turnover growth of 19.26%, the growth in Earnings before tax remained flat at 4.44% which could be majorly attributed to high cost of inputs. Although we note that raw sugar prices commenced a decline in February 2010 (from USc.28.94/lb in January to USc.\$21.36/lb in March), the prices were still high compared to the same period in 2009 (Jan'09 - USc.\$13.09/lb; Mar'09 - USc.\$13.83/lb). This translates to 54% increase in cost from Q1'09 to Q1'10, which severely impacted profitability in the period.

TURNOVER AND NET INCOME



Source: NSE; Vetiva Research



DANGOTE SUGAR REFINERY PLC FY'09 & Q1'10

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Forecast (N'mn)	2008A	YoY%	2009A	YoY%	2010E	YoY%	2011E	YoY%	2012E
Turnover	80,671	2%	82,395	5%	86,515	7%	92,571	8%	99,976
PBT	30,151	-35%	19,586	30%	25,462	35%	34,311	18%	40,349
Tax	(8,280)	-23%	(6,401)	19%	(7,639)	35%	(10,293)	18%	(12,105)
PAT	21,871	-40%	13,185	35%	17,823	35%	24,018	18%	28,244
Absolute Dividend	14,400	-17%	12,000	13%	13,500	4%	14,000	7%	15,000
Earnings p/share (N)	1.82	-40%	1.10	35%	1.49	35%	2.00	18%	2.35
Dividend p/share (N)	1.20	-17%	1.00	13%	1.13	4%	1.17	7%	1.25
Net Asset p/ share (N)	2.72	28%	3.47	3%	3.57	0%	3.58	3%	3.67
P/E (x)	11.44	66%	18.98	-26%	14.04	-26%	10.42	-15%	8.86

Source: Vetiva Research, NSE

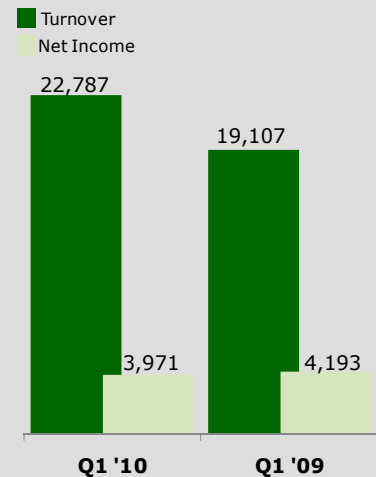
Metrics	7-Up	DSR	NBC	FMN	Nestle
Current Price	47.00	20.85	31.45	68.02	355.00
EPS	3.09	1.08	1.58	6.83	16.32
PE	15.21	19.31	19.91	9.96	21.75
DPS	1.50	1.00	0.50	0.50	12.55
DY (%)	3.19%	4.80%	1.59%	0.74%	3.54%
Payout Ratio	50.27%	91.01%	8.26%	21.95%	84.73%
ROE	20.11%	35.52%	30.66%	11.77%	99.96%
ROA	5.48%	19.27%	13.39%	3.16%	26.65%
Outstanding Shares(mn)	512	12,000	1,309	1,708	661

Source: Vetiva Research, NSE

- We also note an increase in the tax rate within both periods.** The Federal Inland Revenue Service (FIRS) became stricter in the taxation of companies, in a bid to scale up Government revenue. Hence, there were less waivers as some of the laws and regulations were revised to help in achieving revenue targets for the Government. This trend of increased tax rate has been observed across companies in 2009/10.
- We recommend an "Accumulate" on Dangsugar at current price,** with a Fair Value range of ₦22.74 - ₦26.57 and which gives a midpoint of ₦24.65 translating a potential upside of 17.97% relative to its current price of ₦20.85. The Company's Trailing EPS stands at ₦1.08, and is trading at a PE multiple of 19.30x, relative to a sector PE multiple of 14.35x and Market PE multiple of 16.05x.
- Our projection is that** Sales growth surpasses the previous year by 5% which implies Turnover of ₦86.52 billion for FY 2010 and also that PAT grows by 35% giving us a PAT figure of ₦17.82 billion. Our Turnover and PAT forecast for Q2'10 stands at ₦42.68 billion and ₦7.89 billion. This is majorly on the back of reduced cost of production as well as increased demand in the economy in general. We are aware of the different challenges faced by most companies in the previous year in regards to access to credits and the general drag in demand, we have begun witnessed the beginning of a reversal of fortunes. We expect the economy to continue on the path of recovery thereby positively impacting the real sector.

TURNOVER AND NET INCOME

Naira Millions



Source: NSE; Vetiva Research



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Investment Thesis

Dangsugar is the largest sugar refinery by production capacity in sub-Saharan Africa and the second largest refinery in the world with a capacity of 1.4MT per annum. It imports raw sugar from Brazil, refines it and markets majorly to the Nigerian market. The company has plans to enter into other African markets; it has begun exporting to Ghana and plans are underway to extend its outreach to other regions of Africa. Its plant is strategically located at the Apapa port in order not incur additional cost for transporting imported raw sugar. Our valuation is underpinned by the following factors;

- **Global raw sugar prices trending downwards.** In February 2010, raw sugar commenced a decline from a 30-year high and has been trending downwards since then, losing about 22% Year-to-Date. This descent is mainly due to the deluge of supply in the global raw sugar market as a result of bumper harvest from major producers of raw sugar. Furthermore, is the fact that most farmers in other non-sugar producing nations also found the soaring prices attractive relative to the cost of production and therefore embarked on the cultivation of raw sugar.
- **Increasing Domestic and Industrial Demand.** There has been an increase in aggregate demand relative to the prior year, (which was characterized by an economic slowdown) as the economy is on a recovery path and is likely to strengthen further. Furthermore is the spate of packaged drinks (soft/sparkling drinks) and fast food businesses most of which will continue to prop up the demand for sugar especially on an industrial scale.
- **Low sugar consumption rate.** Nigeria has one of the lowest sugar consumption rate per capita of about 7.5kg/capita, compared to other African countries. Algeria has sugar consumption per capita of about 35kg/capita, South Africa's sugar consumption per capita is 23.0kg/capita and ECOWAS has an average of 9.1kg/capita.
- **Capacity Expansion underway.** Dangsugar plans to extend its current capacity of 1.4MT to 2.5MT per annum, which would make it the largest sugar refinery in the world. In addition, the company is also in the process of completing its plant in Algeria which will further increase its total capacity.
- **Favorable Government Policies.** In Nigeria, there's an import levy of 35% on refined sugar in order to discourage imports and support development of local production, while raw sugar levy is only 5%. This has helped to curb the influx of imported refined sugar in the country thereby giving Dangote sugar a more competitive edge. Furthermore, the Nigerian Government as well as some other African countries, has mandated Vitamin A fortification of sugar which is in favour of Dangote sugar being one of the few companies that possess technology for Vitamin A fortification on the continent.



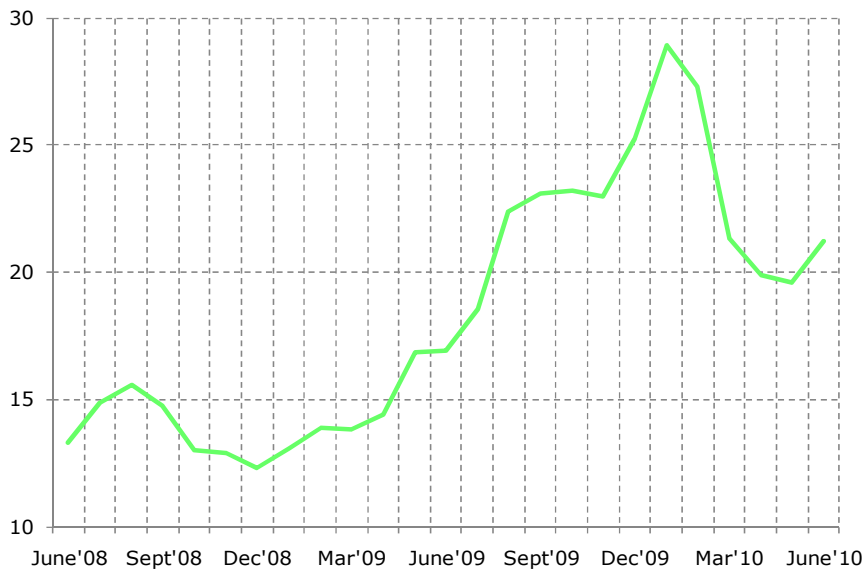
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Risks

- Even though we have highlighted our expectations of a continuous decline in share prices, we note the possibility that sugar prices may increase again. This is majorly based on increasing demand for sugar in Russia, where prices rose 13 percent in June, and where the government recently lowered sugar import tariff by 15% to encourage increased importation. Based on this speculation, sugar prices rose (for the first time in 2010) last month by 8.42%.
- We also note that Dangsugar’s local market is almost mature and any significant growth would majorly be dependent on exports. Also there are regulatory risks that could limit expansion to some potential markets in the African region. Hence, there is need for consistent and increased innovation to aggressively drive and develop new sales.
- Energy costs remains significant; the company makes use of gas to power its plants. The price of gas has been increased in recent times and a sustained increase might offset gains we expect to be made from reduce input costs

RAW SUGAR PRICE MOVEMENT (2008-2010) Cent per Pound



Source: United States Dept of Agric; Vetiva Research

Valuation

In valuing DSR, we applied the Discounted Cash Flow Method. We have assumed a Cost of Equity of 16.00%, which is composed of a Risk Free Rate of 11.50%, Risk Premium of 6%, Beta of 0.80 (DSR is 100% equity financed) and a Terminal Growth Rate of 4.50%. Using the Sensitivity Analysis to vary the Discount Factor and Growth Rate, we derived a Fair Value range of **₦22.74 – ₦26.57**.

We expect the stock to trade within this range in Normal Market conditions.



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INCOME STATEMENT (N'Mill)	2007	2008	2009	2010F	2011F	2012F
Income						
Turnover	80,649	80,671	82,395	86,515	92,571	99,976
Cost of Sales	(48,184)	(49,790)	-	(55,625)	(53,776)	(54,852)
Gross Profit	32,465	30,881	-	30,889	38,795	45,125
Distribution & Administrative Expenses	(3,208)	(3,588)	-	(5,364)	(5,091)	(5,499)
Core operating profit	29,258	27,294	-	25,525.549	33,703.4	39,626.231
Other income	1,405	2,877	-	-	674	793
EBIT	30,663	30,170	-	25,526	34,377	40,419
Interest Expense & Similar charges	(2)	(19)	-	(64)	(67)	(70)
Profit from operations	30,661	30,151	-	25,462	34,311	40,349
Profit before taxation	30,661	30,151	19,586	25,462	34,311	40,349
Taxation	(9,182)	(8,280)	(6,401)	(7,639)	(10,293)	(12,105)
PAT	21,479	21,871	13,185	17,823	24,018	28,244
BALANCE SHEET (N'Mn)						
Assets Employed						
Fixed Assets	14,036	13,756	-	18,017	18,378	18,745
Investments	-	874	-	-	-	-
Current Assets						
Stocks	4,098	9,257	-	11,975	14,258	15,258
Debtors & Prepayments	8,450	14,438	-	15,247	18,111	18,995
Amount Due Holding company	3,553	-	-	6,746	8,126	5,626
Cash and bank balances	19,987	19,847	-	28,294	24,257	26,168
Total Assets	50,124	58,172	-	81,500	83,130	84,793
Due within one year	21,818	24,249	-	37,459	38,600	39,847
Due After one year	(2,350)	(1,295)	-	(1,200)	(1,569)	(900)
Capital and Reserves						
Share capital	5,000	6,000	-	6,000	6,000	6,000
Deposit 4 Shares	-	-	-	-	-	-
Share premium	6,321	6,321	-	6,321	6,321	6,321
General Reserve	14,636	20,307	-	30,521	30,641	31,726
Shareholders' Equity	25,956	32,627	41,612	42,842	42,962	44,047
RATIOS						
GROWTH RATES						
Turnover growth	-4%	0%	2%	5%	7%	8%
Growth in Core Operating profit	72%	-7%	7%	-13%	32%	18%
Growth in PBT	75%	-2%	-1%	-15%	35%	18%
Growth in PAT	84%	-2%	4%	-19%	35%	18%
	29%	2%	-40%	35%	35%	18%
PROFITABILITY						
Return on Equity	80%	75%	36%	42%	56%	65%
Return on Assets	48%	40%	19%	22%	29%	34%
Return on Invested Capital	91%	58%	43%	15%	15%	0%
Growth rate (g)	17%	26%	3%	10%	23%	30%
MARGINS						
EBIT/Sales	38%	37%	36%	30%	37%	40%
Gross Profit Margin	40%	38%	41%	36%	42%	45%
Pretax Income/Sales	38%	37%	38%	29%	37%	40%
Net Profit Margin	27%	27%	16%	21%	26%	28%



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INVESTMENT RECOMMENDATIONS

Vetiva uses a 5-tier recommendation system for stocks under coverage: Buy, Accumulate, Neutral, Reduce and Sell.

Buy/Overweight \geq +25% expected absolute price performance

Accumulate +10% to +25% expected absolute price performance

Neutral/Hold +/-10% range expected absolute price performance

Reduce -10% to -20% expected absolute price performance

Sell/Underweight \geq -20% expected absolute price performance

Definition of Ratings

Buy/Overweight recommendation refers to stocks that are highly undervalued but with strong fundamentals and where potential return in excess of or equal to **25%** is expected to be realized between the current price and analysts' target price.

Accumulate recommendation refers to stocks that are undervalued but with good fundamentals and where potential return of between **10%** and **25%** is expected to be realized between the current price and analysts' target price.

Neutral/Hold recommendation refers to stocks that are correctly valued with little upside or downside where potential return of between **+/- 10%** is expected to be realized between current price and analysts' target price.

Reduce recommendation refers to stocks that are overvalued but with good or weakening fundamentals and where potential return of between **-10%** and **-20%** is expected to be realized between current price and analysts' target price.

Sell/Underweight recommendation refers to stocks that are highly overvalued but with weak fundamentals and where potential return in excess of or equal to **-20%** is expected to be realized between current price and analysts' target price.,



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