Overstretched valuation eclipses growth potential

United Capital
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Equity Research | Earnings Update

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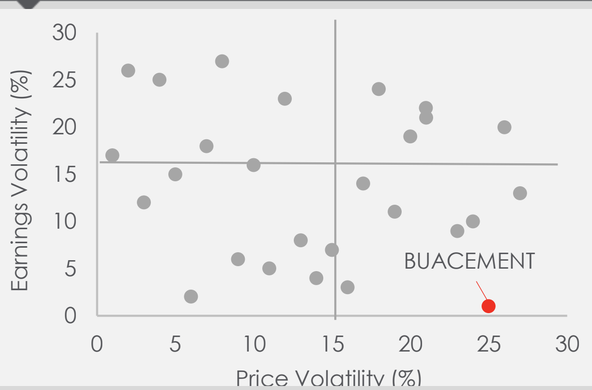
Risk Rating: High

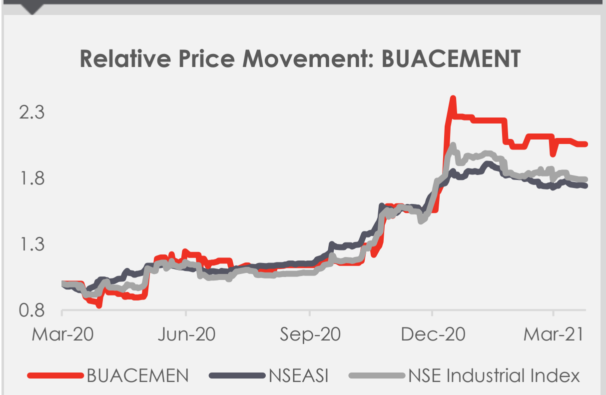


Note: Refer to appendix for complete description of risk rating

Key Data

Last Price (₦)	72.70
Last Price ($)	0.18
52 week High/Low (₦)	85.00/ 29.40
1M Price Change (%)	-2.7
3M Price Change (%)	-9.0
6M Price Change (%)	77.8
YTD Change (%)	-6.0
Beta	1.02
Market Capitalization (₦'bn)	2,461.9
Market Capitalization ($'mn)	6,029.4
Shares Outstanding. (Units'bn)	33.9
Float (%)	35.2
Dividend Yield (%)	2.8

Price Performance Chart



Sources: Bloomberg, United Capital Research

Stock Rating	Target Price	Expected Return
SELL	**Old: N59.1** **New: N42.2**	**-41.9%**

Recently, BUA Cement Plc ("BUACEMENT") filed its audited FY-2020 results. Despite substantial cost pressures, the cement maker saw a 19.1% and 19.4% y/y increase in PBT and PAT, respectively, to N78.9bn and N72.3bn. This was primarily driven by volume growth (+13.3% y/y), which supported topline (+19.3% y/y), and lower Net financing expenses (-28.3% y/y) over the period. We review the FY earnings and adjust our expectations for FY-2021 below.

Revenue: Resilient output amid harsh operating environment

In the period under review, BUACEMENT's revenue surged (+19.3% y/y) to N209.4bn in FY-2020, on the back of a 13.3% y/y growth in sales volumes to 5.1Mt. and a 5.3% increase in Revenue per tonne to N41,116/tonne. Sales within Nigeria made up 99.3% of Revenue (vs 97.1% in FY-2019) as exports fell by 71.8% amid the pandemic's effect on regional trade. The strong performance was aided by strategies to increase market presence and distribution capacities. Furthermore, a rebound in construction activity following the lifting of pandemic-related lockdowns in late Q2-2020 and a comparatively quiet rainy season in Q3-2020, bolstered volume growth, as observed with industry peers. Notably, the cement maker maintained the highest level of capacity utilization (compared to peers) at 63.8% . However, we highlight that two (2) major customers accounted for 23.9% of Revenue from cement sales (vs 26.5% in 2019), with each contributing more than 10% of total revenue.

Profitability: Margins give-in to inflationary and FX pressures

BUACEMENT saw faster growth in Cost of Sales (+22.4% y/y to N114.0bn), owing to higher energy costs (+18.6% y/y to N43.1bn), which remains a persistent concern, and Raw materials cost (+81.2% y/y to N21.3bn) amid inflationary pressures and increased production. The rise in energy costs was mostly reflective of the impact of Naira devaluation on gas supply contracts, an industry-wide issue . This pressured Gross Margin 138bps lower y/y to 45.6%. Similarly, Operating expenses grew 21.2% y/y to N13.5bn as EBIT margin shrank by 153bps

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to 39.2%.

However, Net finance cost declined by 42.7% y/y to N3.0bn due to an increase in Finance income (+447.5% y/y to N859.6mn), and a decrease in Finance cost (-28.3% y/y to N3.8bn) despite a significant increase in debt . Recall that the group registered a N200.0bn Bond program in 2020. Notably, the bulk of the first tranche (N115.0bn) of the bond issuance was used to refinance existing debt at a much lower funding cost, leveraging the low yield environment in 2020. Summarily, PBT and PAT increased by 19.1% and 19.4% y/y, respectively, to N78.9bn and N72.3bn. Thus, BUACEMENT's Net profit margin for the year settled at 34.5%, (vs DANGCEM's 36.1% and WAPCO's 15.7%), Return on equity at 19.2% (vs DANGCEM's 31.0% and WAPCO's 14.9%) and Return on assets at 9.4% (vs DANGCEM's 13.7% and WAPCO's 6.1%).

Net profit margin for the year was 34.5%, (vs DANGCEM's 36.1% and WAPCO's 15.7%)

Net debt climbs to N269.3bn, 71.6% of equity

As noted above, BUACEMENT took to the debt markets in the year under review, taking advantage of the lower interest rate climate in a bid to finance its working capital needs, expansion plans, and refinance related party debt. The Company issued a N115.0bn local bond in Dec-2020, with a 7-year tenor and a coupon rate of 7.5%. Net financial debt for the full year totaled N269.3bn, representing 71.6% of equity (vs 5.9% in FY-2019). Consequently, Leverage Ratio climbed to 2.0x. Our Dupont Analysis of BUACEMENT's Return on Equity (ROE) indicates that the increased leverage made for a higher ROE (19.2% vs 16.7% in FY-2019) amid a marginal 1bps expansion in Net Margin (34.5%) and lower Asset Turnover (0.27x vs 0.37x in FY-2019). Relatedly, proceeds from the bond issuance reflected in BUACEMENT's cash position (+694.4% to N123.8bn).

Outlook and Valuation: Overstretched valuation undermines growth potential

For 2021E, we expect BUACEMENT to pick up from its strong FY-2020 debut, with volumes driving revenue, supported later in the year by its 3Mt plant in Sokoto, which is expected to be operational this year. On costs, we struggle to see improvement in cost efficiency for the full year, given persistent inflation and BUACEMENT's long-term gas contracts, which are highly susceptible to FX risk. The cement maker is also likely to maintain its marketing efforts to drive volumes, pressuring OPEX. Furthermore, we anticipate additional debt financing, beginning with the second tranche of its N200.0bn bond program, for the funding of its additional 9Mt capacity tabled for completion in 2023, and higher tax charges, due to pioneer status expiry on its OBU lines. Accordingly, we expect higher financing costs and tax charges.

Consequently, we expect a 15.5% increase in Revenue to N241.9bn, driven by a 10.1% volume growth to 5.6Mt. and a slight moderation in EBITDA margin to 46.0%. In all, we forecast a 8.9% y/y and 6.9% y/y growth in PBT and PAT, respectively to N85.9bn and N77.3bn. Additionally, we expect a BUA to maintain its dividend payout strategy and forecast a N2.2/s dividend for the fiscal year.

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We acknowledge the cement maker's growth potential by virtue of its expansion strategy, volume growth, headroom for price increases and healthy margins. However, we consider the ticker highly overvalued at current price. BUACEMENT trades at an EV/EBITDA ratio of 26.1x (vs DANGCEM 8.5x and WAPCO's 4.4x) and PE ratio of 34.9x, a massive premium over the domestic peer average (12.1x ex. BUACEMENT). Following our forecast updates and adjustments for the higher rate environment, we set a target price of N42.2/s and reiterate a SELL recommendation due to the 41.9% downside on the stock.

BUACEMENT trades at a massive premium over domestic peers

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Financial Highlights (N'Mn)

Headlines	FY-2020	FY-2019	Change
Revenue	**209,443**	**175,518**	19.3%
Cost of sales	-113,965	-93,075	22.4%
Gross profit	95,479	82,443	15.8%
Other Income	376	50	647.3%
Operating expenses	-15,188	-22,361	-32.1%
Impairement Writeback/(Charge)	1,356	3,758	-63.9%
Finance Income	860	157	447.5%
Finance Costs	**-3,961**	**-5,349**	-26.0%
Profit/Loss Before Tax	78,873	66,225	19.1%
Taxation	**-6,529**	**-5,614**	16.3%
Profit/Loss After Tax	**72,344**	**60,610**	19.4%
	FY-2020	FY 2018	
Cash and bank balances	123,821	15,587	694.4%
Trade & Other Receivables	83,308	2,619	3081.0%
Trade & Other Payables	23,869	36,342	-34.3%
Total borrowings	156,098	21,424	628.6%
Net Assets	**375,955**	**363,697**	3.4%
Total Assets	**766,303**	**470,567**	**62.8%**
Gross Margin	45.6%	47.0%	**-1.4%**
Net Margin	34.5%	34.5%	**0.0%**
Cost to Sales	54.4%	53.0%	**1.4%**
Leverage Ratio (Debt/Equity)	41.5%	5.9%	**35.6%**
Price (N)	73.5		
EPS (N)	2.1		
BVPS (N)	11.1		
P/E (x)	34.4		
P/BV(x)	6.6		
ROAE	19.6%		
Proposed Final Dividend	2.1		
Dividend Yield	2.8%		
Qualification Date	9-Jul-21		
Closure Date	12-Jul-21 - 16-Jul-21		
Payment Date	23-Jul-21		

Sources: Company Financials, United Capital Research

Disclosure Appendix

Investment Rating Criteria and Disclosure

United Capital Research adopts a 3-tier recommendation system for assets under our coverage: Buy, Hold and Sell. These generic ratings are defined below;

Buy: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%). We consider this as the minimum return that may deserve our holding of a risk asset, like equity.

Hold: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

Sell: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

NR*: Please note that in addition to our three rating heads, we indicate stocks that we do not rate with NR; meaning Not-Rated. We may not rate a stock due to investment banking relationships, other sources of conflict of interests and other reasons which may from time to time prevent us from issuing a rating on the shares (or other instruments) of a company.

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High: High probability of an imminent systematic risk or/and unsystematic risk

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Low: Low probability of an imminent systematic risk or/and unsystematic risk

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Flour Mills of Nigeria Plc	h
Forte Oil Plc	g
International Breweries Plc	a,h
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Total Nigeria Plc	h
UAC of Nigeria Plc	h
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