# Company Update: Lafarge Africa Plc

## Coronavirus: a spanner in the works for Lafarge?

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***Khalil Woli***
khali.woli@cardinalstone.com
**(Oil & Gas and Cement Analyst)**

***Philip Anegbe (Team Lead)***
philip.anegbe@cardinalstone.com

*The transformational story of Lafarge Africa Plc (WAPCO) was largely about its handling of endogenous challenges of seeking resolutions to the margin-dilutive South African operation and a huge FX debt in FY'19. With the spread of coronavirus in Nigeria, the business faces a test of its resistance to exogenous shocks in the current year. These shocks are likely to rein in demand for cement and harm cash flows in 2020. Thus, even though we retain a bullish medium-to-long term view on the company, we reduce our Target Price to N19.06 (vs. N23.50 previously) to reflect potential difficulties in FY'20 and FY'21. Along with the sector, the business is likely to fully recover from the current impasse in, at least, two years.*

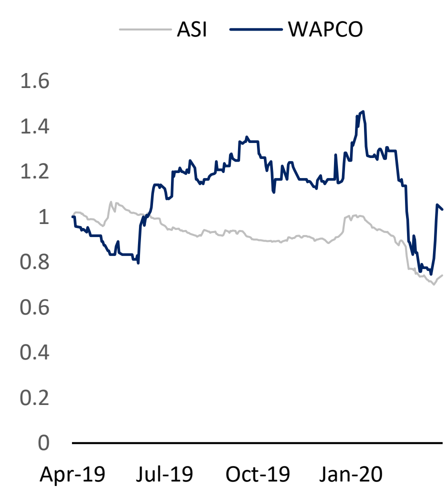
**BUY** | **TP: ₦19.06**

| Stock Data | |
|---|---|
| Bloomberg Ticker: | WAPCO:NL |
| Market Price* (₦) | 12.40 |
| Shares Outs (Mn) | 16,107.8 |
| Market cap (₦'Bn) | 199.7 |

| Price Performance | WAPCO | NSE |
|---|---|---|
| 12-month (%) | 3.3 | -25.8 |
| 3-month (%) | -17.3 | -25.3 |
| YTD (%) | -19.0 | -18.5 |

| Valuation | 2019A | 2020E | 2021F |
|---|---|---|---|
| P/E (x) | 1.7 | 14.6 | 18.0 |
| EV/EBITDA (x) | 5.0 | 6.1 | 6.7 |
| Div. Yield (%) | 8.1 | 5.5 | 4.5 |

**1-year price performance (rebased)**

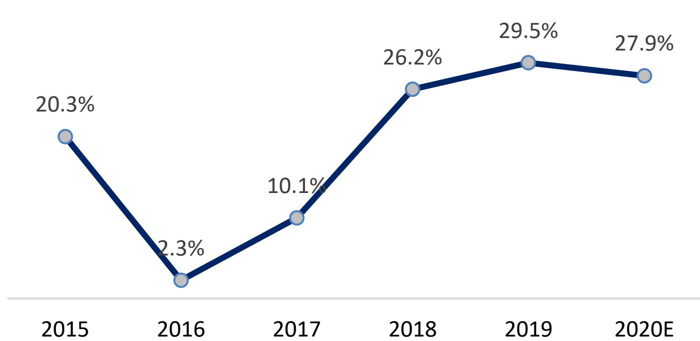



### All roads may lead to a plunge in volume in FY'20

As noted in an earlier report Dangote Cement Plc: Hammered but not out, our base case expectation is that the Nigerian cement sector would decline by 16.0% YoY to 18.2MT in FY'20. We expect Lafarge to slightly underperform the sector with a 17.6% YoY contraction in cement output to c.4.1MT, owing to the intensifying competition from BUA Cement across Lafarge's support hubs in the Northern and Southern zones of the country. *More concerning for us, however, is whether competitors would respond with price actions to prevent a free fall of output in the current year*. A possible Lafarge reaction to such price actions, amidst growing competition, is likely to adversely affect revenue in FY'20. On expectation that local cement prices remain flat (base case), Lafarge's FY'20 revenue is likely to decline by 17.6% YoY to N175.5 billion and by a further 4.3% to N168.0 billion in FY'21 estimates. However, we expect a resurgence afterwards in line with the cyclicality of the company, with revenue likely to grow by an average of 8.8% between FY'22E and FY'24E.

**Cost savings strategy couldn't have come at a better time**. Following the implementation of cost cutting measures across power; energy; and general administrative expenses, the company reported 21.9% YoY plunge in operating expenses in FY'19. In FY'20, we believe this cost-saving measures could slightly taper the potentially huge impact of lower cement volumes on margins. We, however, note that the ongoing crisis is likely to delay the commissioning of Ashaka's captive power plant project, which was expected to reduce cost in the North East.

**Figure 1: EBITDA margin trend (2015 -2020E)**

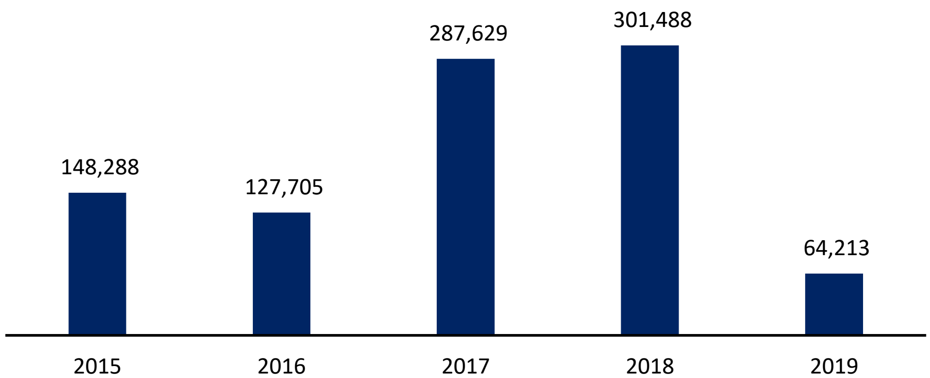



Source: Company financials; CardinalStone Research

### Topline weakness may offset benefits of strategic deleveraging in FY'20

In our view, Lafarge's improved balance sheet creates scope for (i) limited exposure to exchange rate volatility (ii) reduced finance expense and (iii) acquisition of additional debt for new CAPEX, if needed. We recall that the firm settled its erstwhile foreign denominated loan of $338.3 million in 2019 ($315 million principal repayment and $23.3 million accrued interest). In addition to reducing interest expense (-41.3% YoY to N11.8 billion in FY'20E), the decision on the FX obligation may have yielded another fruit by protecting the firm from the foreign exchange losses that would have arisen from the recent naira devaluation. That said, the knock-on effect of weaker top-line is likely to drive earnings lower by 11.8% YoY to N13.7 billion despite a low effective tax rate expectation of 13.3%[1].

**Figure 2: Loans and borrowings (FY'15 -FY'19; N'million)**




Source: Company financials; CardinalStone Research

**On the cashflow front**, we expect CFO to be negatively impacted by the projected contraction in operating performance and a forecast weakness in working capital. Working capital weakness is likely to be driven by inventory buildup due to crisis-induced demand slowdown. In view of the expected pressures, we forecast a 56.4% YoY decline in CFO to 35.0 billion in FY'20E. Ultimately, closing cash balance is likely to contract by N10.8 billion YoY in FY'20, despite expectations of lower CAPEX spend during the year.

### Valuation

Notwithstanding the current shock, we believe Lafarge remains a compelling proposition in the medium-to-long term due to its recent restructurings. Notably, the company's cash flow position is likely to recover strongly in FY'22 alongside expected pick up in domestic macro. The stock is trading on a FY'20E EV/EBITDA of 6.2x compared to 9.1x for Bloomberg EMEA peers. We have a Target Price of N19.06 and a **BUY** recommendation on the stock.

[1] Pioneer tax status on Mfamosing line 2 to expire in December 2020, but there is scope for extension

| Financial metrics | (N'Mn) | | | (US$'Mn) | | |
|---|---|---|---|---|---|---|
| | 2019A | 2020E | 2021F | 2019A | 2020E | 2021F |
| Volumes (kt) | 4.9 | 4.1 | 3.9 | 4.9 | 4.1 | 3.9 |
| Revenue | 212,999 | 175,457 | 167,978 | 561 | 462 | 442 |
| **EBITDA** | 62,876 | 50,808 | 46,845 | 165 | 134 | 123 |
| EBT | 17,892 | 15,790 | 13,084 | 47 | 42 | 34 |
| PAT | 15,518 | 13,694 | 11,122 | 41 | 36 | 29 |
| EBITDA Margin | 29.5% | 29.0% | 27.9% | 29.5% | 29.0% | 27.9% |
| EBT Margin | 8.4% | 9.0% | 7.8% | 8.4% | 9.0% | 7.8% |
| Net Profit Margin | 7.3% | 7.8% | 6.6% | 7.3% | 7.8% | 6.6% |
| Return on Average Assets | 3.0% | 2.8% | 2.3% | 3.0% | 2.8% | 2.3% |
| Return on Average Equity | 6.5% | 3.9% | 3.1% | 6.5% | 3.9% | 3.1% |

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|---|---|
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