



# MERISTEM EQUITY REPORT

## Report Date: January 5, 2007.

### BENUE CEMENT COMPANY (PLC)

#### **WORLD CEMENT INDUSTRY FORECASTS TO 2010:**

Global demand for cement is expected to grow by 4.7 percent annually to 2.8 billion metric tons in 2010. China, which is the largest market for cement in the world, will register the biggest gains in terms of the total amount of cement sold. Other developing parts of the Asia/Pacific region and Eastern Europe, as well as a number of nations in the Africa/Middle-East and Latin America regions, will also record above-average cement market gains, fueled by a robust construction outlook. Vietnam, Thailand, the Ukraine, Turkey and Indonesia will record some of the strongest increases in percentage terms. Market advances will be less robust in the developed areas of the US, Japan and Western Europe, with maintenance and repair construction accounting for much of the growth in cement demand through 2010. However, a pickup in construction spending in Germany and Japan following an extended period of decline will help bolster overall developed world market growth.

#### **NIGERIA CEMENT INDUSTRY: AN OVERVIEW**

The Nigerian Cement industry today comprises four (4) major cement firms with other new players emerging with strong strategic moves to capture the market. The Industry was dominated by **West African Portland Cement (WAPCO)** and **Ashakacem Plc** with a combined market share of about 87% of local production in 1999 and lost grip to 75% in

2005 as a result of new entrants into the market. Notwithstanding, WAPCO currently leads the market with a market share of about 51% of the aggregate local production (measured in terms of turnover of all players at the end of December 2005). Competition is often restricted to regions and as such, producers' marketing efforts tend to be regionalized. Similarly, as a result of relatively high transportation cost involved in moving cement to the company's regional area of dominance, cheap imports will continue to pose a threats until the company can significantly reduce production cost.

However, the existing profit-taking in the industry has attracted some major industrial players which may pose a threat to **WAPCO** and **Ashakacem** in the long run. By the year-end 2005, BCC increased its stake to 8% of the overall market share through its pricing and expansion strategies. It is expected therefore that though the industry is capital intensive, the increasing availability of venture capital by financial institutions and the abnormal profits enjoyed in the industry would be a major attraction for a profit seeking aggressive entrepreneur to penetrate this market. This is already being witnessed with the establishment of **Obajana Cement** and take-over of controlling interest in **Benue Cement Company (BCC)** by **Dangote Industries Limited (DIL)**.

Recently, in September 2006, Nigerian International Bank Limited, NIB (a subsidiary of Citigroup) and eight other banks signed an agreement to syndicate a N26 billion or \$205 million multi-tranche project facility for United Cement Company of Nigeria Limited (UNICEM) for the construction of a green-field cement plant located about 30km north east of Calabar, Cross River State.

## **INDUSTRY OUTLOOK:**

Prior to 2004/2005, the Nigeria cement industry's potential had been constrained by a host of macro-economic factors such as: **high cost of borrowing and interest expenses, increasing energy costs and overheads, uncompetitive pricing differential with imported cement, volatility in exchange rates to mention a few**. However, the sub-sector witnessed an appreciable growth in level of demand in the year 2005 as the total national output soared by 10% to approximately 9.1 million metric tones in 2005. Meanwhile, the Federal Government's ban on cement is but a significant victory to the

industry. As of 2004 more than 70% of the Nigeria's cement was imported while the Other 30% was locally produced. The supply gap of 70% to be made up by local industry presents good opportunities for companies within the sector. BCC has been able to boost its output and therefore profitability and the good news is the supply gap is yet to be closed. Local cement demand is expected to rise and this has led to renewed interest in the stock on the floor of the Nigerian Stock Exchange (NSE).

However, the import-driven demand is expected to dwindle in the years ahead as the existing production capacity of 3.0 million is expected to rise by over 400 percent to about 15 million metric tones in 2007. Invariably, the level of competition in the sector is expected to increase as Nigeria is transiting from an import-oriented nation to producer-exporter nation.

Undoubtedly, this improvement will subsequently reduce pressure on the naira and boost stability in the foreign exchange (**forex**) market. It is expected that Nigeria will make some savings in forex annually as from 2007. This will be largely attributable to the increase in capacity of the existing factories and the commencement of operations of the Obajana factory, which is the largest single factory in Africa.

The completion of WAPCO's flagship's Plant at Ewekoro in August 2005 as well as its third - phase programme for the refurbishment of its Shagamu Plant in 2006, will also increase the market output frontier while DIL is pushing the industry output through **BCC** and Obajana. Lafarge SA is also planning to increase its investment on not less than \$100m in the coming years. In the same vein, CCNN is also warming up to the market through rights issue in order to contribute to bridging the supply gap in the industry.

<b>5-YEAR CEMENT INDUSTRY MARKET TURNOVER HISTORY</b>						
<b>Year</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>Symbol</b>	<b>(N'bn)</b>	<b>(N'bn)</b>	<b>(N'bn)</b>	<b>(N'bn)</b>	<b>(N'bn)</b>	<b>(N'bn)</b>
<b>ASHAKACEM</b>	15.815	12.567	10.199	8.742	8.649	7.22
<b>WAPCO</b>	26.626	22.096	13.73	13.263	13.41	11.994
<b>CCNN</b>	5.92	5.53	3.306	1.914	0.574	0.538
<b>BCC</b>	4.005	0	0.391	0.583	1.115	0.791
<b>TOTAL(N'bn)</b>	<b>52.366</b>	<b>40.193</b>	<b>27.626</b>	<b>24.502</b>	<b>23.748</b>	<b>20.543</b>

## TRENDS IN CEMENT INDUSTRY MARKET SHARE BY TURNOVER

Year	2005	2004	2003	2002	2001	2000
ASHAKACEM	30.2%	31.3%	36.9%	35.7%	36.4%	35.1%
WAPCO	50.8%	55.0%	49.7%	54.1%	56.5%	58.4%
CCNN	11.3%	13.8%	12.0%	7.8%	2.4%	2.6%
BCC	7.6%	0.0%	1.4%	2.4%	4.7%	3.9%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

### **BUSINESS SUMMARY:**

Benue Cement Company (BCC) was incorporated July 16,1975 with its main base in Tse-Kucha, Benue State. The company was a result of the current growth and expansion of the nation in the mid to late 1970s due to the oil windfall the nation was experiencing. This led to a lot of development projects which needed cement for there completion. The Company's main investors were the **Federal Government, Benue State Government and other state Agencies which accounted for over 65% of the company's shareholding.**

BCC manufactures and retails Portland cement under the patented "**Lion brand**". The company commissioned its plant in 1980 with an installed capacity of 900,000 metric tones. In its initial years of operation the company performed favorably with high profitability, however the company succumbed to disenabling factors such as rising fuel costs, erratic power supply & competitively priced imported cement. All these coupled with the high cost of maintaining its plant led to steady declines in the company's fortunes. Till the turnaround year of 2005.

### **ANALYSIS OF FINANCIALS:**

#### **LIQUIDITY:**

BCC has been hit by liquidity problems for the past few years. This is evident by the analysis of the company's liquidity ratios. Its **current ratio** ranged from 0.42 in 2001 to almost 0.09 in 2005. The **quick ratio** was worse with a range of 0.078 in 2001 to 0.048 in 2005, while the **cash ratio** was abysmal with an average less than 0.01 for the five years under review. This

means the company's current assets could not cover current liabilities and this increased as the years progressed. The most frightening factor was cash flow with a constant negative cash flow from operations for all the years covered. The company's only resolve was to fund its operations through loans and advances. The loans and advances almost became the company's Achilles heel as the company faced harsh operating environment and thus could not increase profitability. In essence, turnover and profitability dropped while interest charges skyrocketed as the company had to borrow more and more funds to stay afloat. It even reached a point in which the company would borrow to service already existing loans.

#### **DEBT/LEVERAGE POSITION:**

The Company urgently needed to go public. The new core investor Dangote Industries Limited (DIL) was able to renegotiate better credit terms with the company's main creditors as well as secure a waiver on some loans and advances. DIL has also made cash injection into the company thereby reducing its negative shareholders' funds. As at the year ended 2005 the company's liquidity position was still a bit dire, however one can be optimistic that this will not be the position in the coming years due to the involvement of DIL. **DIL** as a core investor in BCC in 2004 with 35.39% ownership inherited a debt of N1.5 billion. When taking over, one line was burnt with half of capacity of production thereby pushing up the debt to N6.5 billion. DIL carried out total overhaul of BCC with the assistance of experts from the technical consultants, Associated Cement Companies (ACC) of India.

With respect to solvency, the company is in a bad position as it recorded negative values for **shareholders funds** for more than five years. This was constantly made worse by the company's lack of profitability, as the net losses after tax experienced each year (**N1.07b in 2001, N2.14b in 2002, N0.72b in 2003, N0.91b in 2004**) only exasperated the negative shareholding position. The company did experience a turnaround in fortunes in 2005 in which after tax profit increased from a negative position of N912m to a profit after tax of N2.24b therefore a net increase of N3.36b in profit after tax.

**Similarly, the shareholders funds has also improved from a deficit of N3.56 billion to N1.35 billion deficit in 2005 .**

#### **OPERATING EFFICIENCY:**

The **efficiency ratios** of BCC do not paint a pretty picture. The company has high **average**

**days for receivables** of 90 days in 2001 and constantly increased to 245 days in 2005 while account payables outstanding declined from 808 days in 2001 to 627 days in 2005. This presented a serious scenario especially when compared to its rival WAPCO which has average days in receivables of 110days and account payable Outstanding of 115. The risk exists that the company is boosting revenue by increasing credit given to its customers. One can also infer that the company has been using its suppliers as a source of much needed funding for its operations in prior years. The company also has low asset turnover ratios ranging from 0.23 xs to 0.20 xs in 2001 to 2005 respectively which would suggest that the company is selling more than its assets can effectively cover. This however is being resolved as the company is currently investing in upgrades and expansion and also investing in its operations. **The operating expenses (OPEX) increased from N402.8m in 2004 to N654.3m in 2005 and consequently upon increase in activities, interest payable and similar charges decreased to N194.2m from N535.2m in the previous year. The results for 2005 demonstrate very clearly the benefits of the major restructuring efforts undertaken in the last 24 months by the company. The improved sales volume, cost reduction and other re-organization efforts led to significant increase in operating profit compared with the negative position recorded in the last five years. Bank interest expense and similar charges were significantly reduced as a result of the rights issue and re-investments.**

### **THE STRATEGIC TURNAROUND IN FORTUNES**

In year 2000 the Federal Government sold its stake in BCC to Dangote industries Limited. The transaction was officially completed in 2004 and Dangote Industries Limited took full control of BCC in May 2004. DIL has concentrated mainly on reducing the debt burden of the company by paying off term loans and also mitigating against the rising interest charges by renegotiating credit terms. In 2004 the company successfully completed a rights issue of 4 for 1, the proceeds for which were used to offset both loans and interest charges. This led to a reduction in interest payments from N5.35bn in 2004 to N1.94bn in 2005.

The company witnessed its first positive earnings per share (EPS) of 453k in 2005 and the excess profit after tax was used to offset some of the negative shareholders funds. BCC has invested heavily over the past two years (2004 to mid 2006) in plants and machinery

## QUARTERLY RESULTS/ PROJECTIONS:

Turnover for the period was N4.50bn with a projected full year value of N7.02bn while it recorded a PAT of N3.04bn against the full year projection of N4.65b. The company's profitability is expected to rise in the coming years and it is expected that if profitability rises at its current pace the company will be able to pay dividend in 2007. This was further enhanced by the company's Managing Director who maintained the company is poised to pay a dividend of N6.50 per share at the end of the 2007 financial year for the first time in the past 12 years. **In the projection for 2007, the company targeted N30.78 bn and pre-tax profit of N19.38 bn while it plans to dole out N15.87 bn to shareholders representing 100% payout.**

### TRENDS IN QUARTERLY PERFORMANCE: WAPCO, ASHAKACEM, BCC & CCNN 2006& 2005

#### TURNOVER HISTORY

##### Turnover (N'billion)

Year	2006-Q3	2005-Q3	CHANGE	2006-Q2	2005-Q2	CHANGE	2006-Q1	2005-Q1	CHANGE
WAPCO	29.4	18.1	62.07%	18.64	11.66	59.86%	8.36	5.35	56.26%
ASHAKACEM	n/a	n/a		9.00	7.65	17.65%	n/a	n/a	
BCC	4.50	2.75	63.60%	2.65	1.73	53.45%	n/a	n/a	
CCNN	4.880	4.893	-0.27%	3.324	2.997	10.91%	1.488	1.615	-7.86%

#### EARNINGS HISTORY

##### Profit After Tax (PAT) (N'b)

Year	2006-Q3	2005-Q3	CHANGE	2006-Q2	2005-Q2	CHANGE	2006-Q1	2005-Q1	CHANGE
WAPCO	8.7	0.943	822.59%	5.11	0.23	2148.90%	1.96	-0.90	317.78%
ASHAKACEM	n/a	n/a		2.41	2.44	-1.23%	n/a	n/a	
BCC	3.04	1.18	158.20%	2.07	0.41	410.86%	n/a	n/a	
CCNN	-0.224	0.542	-141.31%	0.070	0.258	-72.99%	0.217	0.321	-32.50%

## **VALUATION:**

In determining an appropriate price for BCC PLC, we have considered a forward looking valuation approach given the fact that the historical data may not be reflective of the company's future prospects. Without losing sight of the entire past however, we considered the relative valuation approach of Price to Sales ratio, P/B, and P/E ratio.

**We are of the opinion that the forecast EPS for 2006 may not be significantly different from the trailing EPS of 1.66 as deduced from the company's recent Q3 results.**

Our DCF valuation using a Free Cash Flow approach puts a value of BCC at N57.18 while the P/S attaches a value of N10.86. The P/E valuation metric was based on both the industry and the company.

We estimated a significant leap in turnover growth in 2007 given the assumption that the projected output would be realized at the minimum level of 75%. We also assumed that competition would affect growth by 2008 and as a result both growth and expected return on equity would decline as the industry moves to competitive equilibrium.

**Adjusting appropriately different values from the approaches employed, we are convinced that BCC is currently trading at a discount of about 32.9% given its price of N37.56 as at the end of the year.**

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