

UPDATES ON DANGOTE SUGAR REFINERY PLC

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EXECUTIVE SUMMARY AND INVESTMENT RATIONALE

- Dangote Sugar Refinery Plc is a market leader in the Nigerian Sugar industry with operations spanning over 7 years. The company imports and refines raw sugar using an in-house developed technology to refine and package fortified and unfortified Vitamin A white sugar. Dangote Sugar has an installed capacity of 1.44million metric tons of a world class facility designed by Tate & Lyle (the largest sugar refiner in Europe), for the production of refined sugar in Nigeria.
- The company currently operates at near 75 per cent of its installed capacity and controls about 70 per cent of the Nigerian sugar market (by sales revenue). Concerted strategic efforts are being made to grow revenue base by expansion to North and West African regions. This strategic move will expectedly enhance optimization of installed capacity and subsequently increase current production frontier by about 79 per cent in the next couple of years to 2.5M metric tons p.a.
- Dangote Sugar has recorded impressive performance in the last 3 quarters of 2007 with an average growth of 75.9 per cent and 35.1 per cent in profit before tax (PBT) and profit after tax (PAT), despite the consistent dip in sales revenue by an average of 4 per cent during the same period. Current trend in performance suggests the need for the company to grow its industrial clientele base as well as its retail domestic market in order to sustain and possibly surpass its market share.

- Our forecasts for the year ended December 31, 2007 put sales revenue and PAT at N84.80bn and N24.04bn. This implies a earnings per share of N2.40 for the FYE December 31, 2007 and assuming a payout ratio of 70 per cent, we project a cumulative dividend per share of N1.68k. This suggests that the management can still cough out a final dividend 48k/Share.
- Key risk attached to our analysis and valuation is the new major competitor, BUA Group of companies, the owners of BUA Sugar Refinery with an installed capacity of about 720,000 metric tons p.a, which is scheduled to commence operations by April 2008. Similarly, Dangote Sugar is also highly exposed to changes in regulations ranging from protectionist policy of prohibitive tariff on imports to NAFDAC's regulation on Vitamin A fortification.
- Our valuation suggests that the stock trades at a fair price. However, we only anticipate a strong rally provided the management declares a generous scrip issue in addition to the final dividend.

Nigeria's Consumers Purchasing Power and 2008 Federal Government Budget:

In the past 4 years, the Nigerian economy has witnessed a wave of policy reforms aimed at bolstering the purchasing power of the ordinary Nigerians. An assessment of the patterns of cost of living, x-rayed by the **Composite Consumer Price Index (CCPI)** which is an indirect but veritable yardstick for tracking the changes in consumer purchasing power, revealed a downward bound in growth rate relative to historical trend. The average annual growth rate of the CCPI at 1985 base price for both baskets of *All Items* and *Food Items*, though oscillatory, has perched in the threshold of 16 per cent since 2000. This average approximately halved the figure for the period 1995 to 1999 which stood at 31per cent. A feasible explanation for this relatively low growth in CCPI is underlined by the CBN's contractionary monetary policy focus anchored on "single-digit inflation targeting" which saw the y-o-y inflation rate nose-dived to **6.6 per cent** at the end of 2007.

As growing CCPI chomps into consumers' purchasing power, the 2008 Federal Budget, built on Medium Term Fiscal Framework though with an overall deficit of 2.7per cent of projected GDP for 2008, is expected to provide palliative measures to cushion this effect just as built-in mechanisms look likely to increase consumers' nominal income. The 2008 Federal Budget, proclaimed by the President as **“budget for the ordinary Nigerians”**, apportioned N110 bn (representing 5 per cent) to poverty alleviation in consonance with the Paris Club Debt relief accord and the pursuit of the Millennium Development Goals (MDGs). This, coupled with the track record of 7 per cent GDP growth rate and the 2008 projection of 11per cent, will further impact positively on the GDP per capita which surged appreciably from abysmal US\$400 at the turn of the century to over US\$1000 by the end of 2007.

Impliedly, if this marked macro-economic performance is sustained, with falling CCPI growth rate, corporate players in the Food Sector are on good stead to rake impressive top and bottom lines resulting from burgeoning effective domestic demand.

Overview of the Nigerian Sugar Industry

Broad economic classification of industrial production in Nigeria places the manufacturing of sugar in the Sugar-Cocoa Confectionary sub sector of the economy. Despite its strategic position as one of the most viable agro-allied industries in the world, the sugar industry in Nigeria has remained one neglected sector of the economy. The industry has failed to induce growth and development with increasing demand for the commodity which existing industrial players can not satisfy.

The poor condition of the Sugar industry in Nigeria is a reflection of the woeful state of the agricultural sector which has since suffered neglect leaving it in doldrums for over 4 decades. The myriad of problems facing the industry include inadequate technical knowledge, extensive areas of under production and low milling capacity. Together with cocoa confectionary, the manufacturing capacity utilization of sugar in Nigeria has fallen below 40 per cent from 1984 till date thereby mirroring the persistent capacity underutilization in the Nigerian industrial

sector.

Although the government has taken conscious steps at liberalizing the market and boosting domestic production by privatizing erstwhile government owned sugar-producing corporations, industry analysis shows a high degree of concentration as the sector is dominated by few firms who are consistently striving to meet the growing annual consumption in the domestic economy. Worse still, the four newly privatized companies currently produce at 30 per cent capacity. Domestic Sugar production is a meager 100,000 metric tons representing just 3.56 per cent of annual demand of over 1.2million tons. This means that a substantial portion of raw sugar is imported just as over 90 per cent of total sugar consumed is refined in the country.

The foregoing reveals that the industry has survived on refining with little production of raw sugar. Regrettably, the major players: **Dangote Sugar and lately, BUA Sugar refinery** seem not to be making conscious efforts at boosting the domestic production of raw sugar as most efforts are geared towards refining. This may not be unconnected with the requisite quantum of capital outlay amongst others. Therefore looking ahead, it appears it will take quite some time for the country to attain self sufficiency in sugar production.

Dangote Sugar Refinery Plc:

Business Model:

Dangote Sugar is a prime company in the business of refining raw white sugar and marketing/distribution for domestic consumption and industrial needs. The company's shares were listed on The NSE on March 8, 2007 at N18/share following the divestment of 25 per cent holdings of The Dangote Group (Dangote Industries Limited) via an initial public offering (IPO) of 10billion shares in November/December 2007. The company's installed capacity is close to 1.44million metric tons p.a with about 75 per cent current capacity utilisation. Dangote Sugar imports raw sugar from Brazil, refines and fortifies it with Vitamin A, in compliance with NAFDAC regulations, into white sugar for domestic and industrial

consumption.

The company has two categories of customers- Super industrial users who are largely blue chip Nigerian companies which account for about 18 per cent of its sales revenue. These include Nestle Nigeria Plc, Cadbury Nigeria Plc, Seven-Up Bottling Company Plc and Nigerian Bottling Company Plc (NBC). The other group is the distributors who service the retail end of the market (i.e. household and micro industrial users). This group trades in wholesale white sugar and responsible for near 82 per cent of Dangote Sugar's sales revenue.

This presupposes that the company is highly exposed to swings in consumers' purchasing power and tastes given the skewness in its income base. Therefore, it is expected that the management of Dangote Sugar will exploit its distinctive strategic competitive advantage in the local and international markets as one of the sugar refiners in the world that produce Vitamin A fortified white Sugar not only to sustain and grow its share of local market but also to capture the near markets in African sub-Sahara region. This is expected to also guarantee the optimization of the excess capacity of 25 per cent.

Recent Developments and Latest Quarterlies:

Dangote Sugar's quarterly results in 2007 indicate a consistent dips in sales revenue by an average of 4 per cent against the performance records of corresponding quarters of prior year. Except for the Q-1 2007 when a marginal growth of 0.8 per cent in sales revenue was recorded, the other 2 subsequent quarters showed 3.4 per cent and 4.2 per cent declines relative to the similar quarters in 2006. On the other hand, despite the dips in sales, the company has maintained a good operating performance trend over the past three quarters. Average gross and net margins stand at 28 per cent and 37 per cent respectively, higher than 19 per cent recorded in the corresponding quarters of prior year when the firm was under pioneer status with no income tax burden.

Above trend suggests two possibilities. Firstly, decline in local demand for Sugar which

invariably impacted on the performance of Dangote Sugar. Secondly, a possible loss of market share to competitors who produce locally or import from abroad. Industry report argues that industrial usage accounts for almost 35 percent of the total sugar consumption in Nigeria while soft drink production alone accounts for about half of total industrial usage. It is therefore logical to conclude that competitors are already eating into Dangote Sugar's share of the 18 per cent of industrial users not to talk of the other group.

Performance Updates:

Dangote Sugar's results for the FYE ended December 31, 2006 indicated a marginal deviation from forecasts as contained in the IPO prospectus. Actual turnover and EBITDA for the FYE December 2006 were N83.77bn and N17.55bn against forecasts of N85.81bn and N19.73bn respectively. This implies marginal short fall of 2.4 per cent and 5.3 per cent in that order. Though the cause of this was not explicitly highlighted by the management in its annual report and accounts for the financial year ended December 31, 2006, one could probably attribute this to the decline/marginal growth in sales activity of its key industrial clientele base such as **Cadbury, 7Up, NBC and Nestle** who constitute over 18 per cent of its annual revenue base and who are also considered as loyal and consistent customers. The general/retail consumers though constitute about 82 per cent of its annual sales revenue are shared amongst other major and fringe contenders- refiners and importers.

A similar trend is replicated in 2007 period results. The company has consistently posted an average of N20bn quarter-on-quarter sales revenue while average Gross and net margins have steadily remained at 28 per cent and 37 per cent over the period against 19 per cent in the corresponding quarters of 2006 when it enjoyed income tax holiday. The results indicate that Dangote Sugar has established a trend in its operating expenses which makes room for costs efficient management in relation to activity level. The Q-3 2007 results show marginal rise in gross and net margins to 38.4 per cent and 28.8 per cent.

However, we anticipate some improvement in sales revenue in the last quarter of 2007 as

Dangote Sugar's key industrial customers such as NESTLE, NBC, CADBURY increase capacity and improve sales activity drive coupled with the annual jump in consumption habit during the last quarter of the year, especially during festivities when household demands hop significantly. We project sales revenue of N86.86bn and profit After Tax (PAT) of N23.80bn for the year ended December 31, 2007. Consequently, we anticipate that gross and net margins will inch up to near 38 per cent and 28 per cent respectively.

Industry Prospects, Future Plans and Strategies:

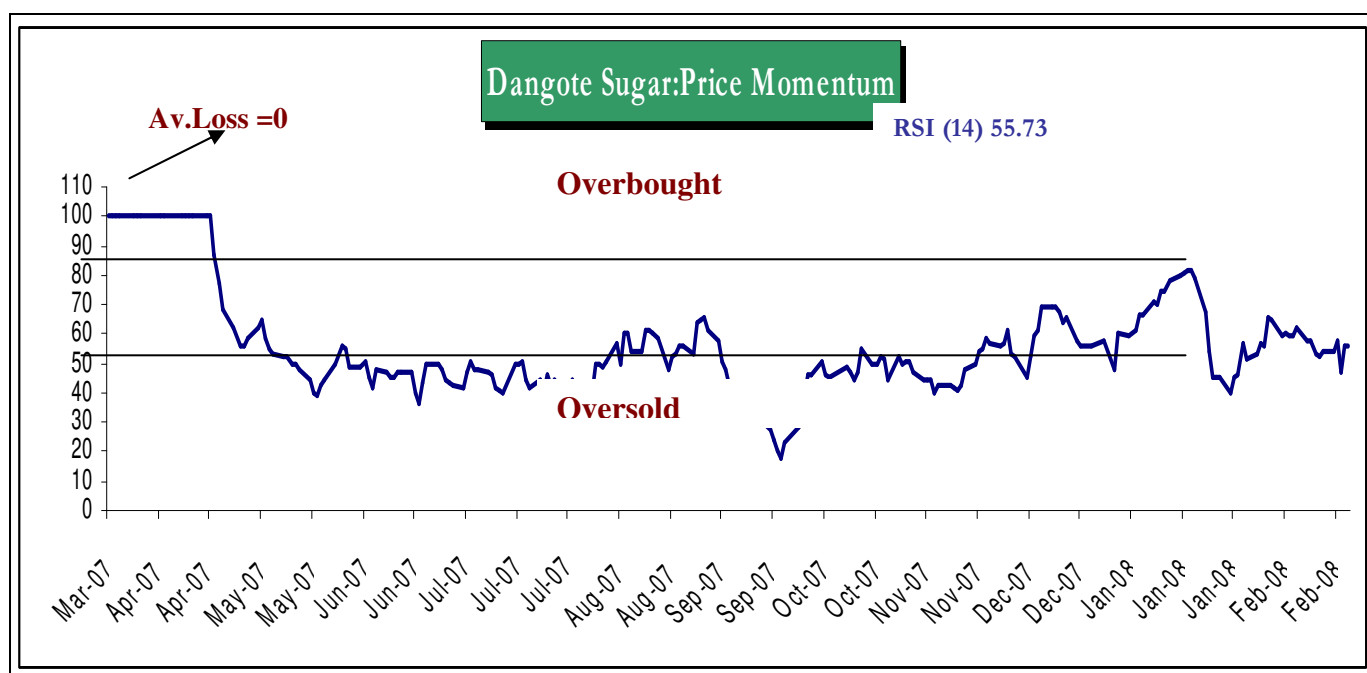
Sugar Industry in Nigeria is largely import dominated as obtained in other key industries such as Cement due to its capital intensity and technology required. This results in a huge gap between local demand and supply. Bulk of Nigeria's sugar imports, both raw and refined, come from Brazil, the EU and Guatemala. Sugar is in high demand by industrial firms as a vital raw material in the manufacture of beverages, food and pharmaceuticals among others. But over the years, imported sugar remained the major source of sugar in Nigeria.

In its strategic drive to sustain existing market and gain control of neighbouring markets in the West Coast, Dangote Sugar has embarked on an aggressive expansion drive in the West and North African Markets. It recently commenced the first shipment of its 1500 metric tonnes sugar to Ghana and is also on the verge of initiating sugar refining at its 1-million metric tonne capacity sugar refinery in Algeria. This export drive is intended to optimally utilise the 1.44 million metric tonnes per annum installed capacity of the company. Besides, the management also plans to grow the existing refining capacity by about 79 per cent to 2.5m MT in 2009 and already pursuing inorganic growth strategy by acquisition of Savannah Sugar Company Limited, currently owned by Dangote Industries Limited, to boost local sugar production and reduce cost of importation of raw sugar. Not only these, the management has also identified the need to broaden its clientele base and introduction of new packaging line for retail customers all with a view to maximising the local market opportunities. Dangote Sugar also plans to acquire vessels to improve freight cost and working capital management.

Frantic efforts are being made towards sustaining its corporate culture of rewarding investor with above average returns. It is exploring the opportunities in virgin markets in this region with a view to taking the advantages available by the ECOWAS free trade zone as well as maximise the opportunities available to company in sub Saharan Africa over the ban on exportation of sugar to the region, by European Union.

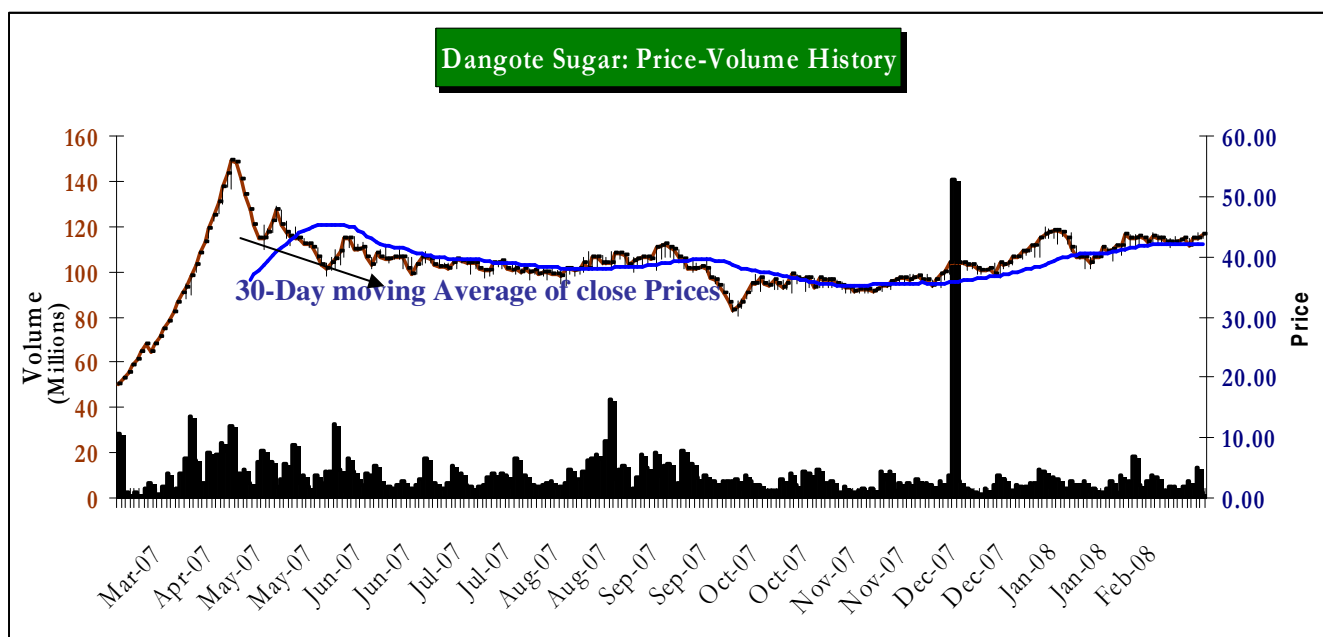
Technical Analysis of Share Performance:

The technical behaviour of Dangote Sugar’s price in the stock market shows rare divergences and strong price momentum even as it looks set to attain a new high. Within the first 28 trading days of its listing on the DOL of the NSE, the stock showed robust consistency in daily price appreciation recording an average capital appreciation of 4.09 per cent. Thus, the Relative Strength Index (RSI), riding on a mean loss of zero, stood firm at the maximum 100 for four weeks thereby sending the stock to an all-time high of **N55.60** on April 23, 2007.



As the stock lingered in this overbought territory, bearish signals were sent across the market. Soon, market trend was intercepted and the initial resistance was broken. Unfortunately, series of down closes occurred as it took the stock about a month to attain its first support level. Afterwards, short periods of rallying and range trading characterized the stock until it

overstepped its bounds reaching a low of **N31** which sent it to the oversold region as the RSI crossed the 30 point benchmark.



Not long after, a BUY signal was generated as the RSI crossed the **30** point line in an upward direction. The strong price momentum continued to rally the stock and it once again inched to the overbought region but stayed there longer than it did in its first period of consistent rally. The stock is currently trading above the **30-day moving average**. So, there are strong indications that it is on an upward trend.

Peer Performance Key Statistics:

FOOD AND BEVERAGES PEER PERFORMANCE REVIEW						
	Avg.	DANGOTE SUGAR	FLOURMILLS	7UP	NESTLE	NBC
Shares Outstanding (bn)	2.81	10.00	1.55	0.51	0.66	1.31
Mkt. Capt. (N'bn)	183.22	466.00	161.55	26.14	173.39	88.99
Market Price as at March 7, 2007	109.38	44.40	105.89	51.00	275.62	70.00
Shareholders Fund -(N'bn)*	14.94	27.98	15.21	5.06	6.36	20.09
Trailing EPS (N)	4.01	2.16	4.76	2.34	9.94	0.84
Last Paid DPS (N)	2.35	1.15	0.85	1.25	8.20	0.30
ROE*	41.2%	59.54%	30.68%	23.05%	88.99%	3.81%
ROA*	18.3%	42.71%	9.15%	7.02%	29.93%	2.94%
Book Value Per Share (BVPS) N*	11.12	2.80	13.06	12.35	12.04	15.35

Trailing Earnings Yield	3.75%	4.86%	4.50%	4.59%	3.61%	1.20%
Trailing Price/Earnings (P/E)	35.11	20.56	22.22	21.78	27.73	83.28
Price to Book Value*	11.00	16.66	7.96	4.13	21.81	4.43
Trailing Price To Sales	2.70	5.48	1.50	0.96	4.14	1.44
Trailing Sales Per Share	49.40	8.10	70.44	53.27	66.65	48.52
Trailing Sales(N'bn)	65.04	80.96	109.40	27.30	44.03	63.50
Trailing Profit After Tax (N'bn)	7.32	21.60	7.40	1.20	5.30	1.10

*Based on 2006 year end result

Valuation:

We adopted a wide range of valuation methodologies in arriving at a fair value for **DANGOTE SUGAR REFINERY PLC**. We employed Discounted Cash flow (DCF) model and relative valuation metrics such as the Price- Earnings (P/E), Price/Sales (P/S) and Price/Book Value (P/BV). Thereafter, we attached weights to the output of these methodologies based on our analysts' judgment and the peculiar circumstances of the company. However, we attached a greater weight to the output of DCF model.

We discounted the estimated equity free cash flow of the company using the company's cost of equity, applying a risk free rate of 10.75 per cent, a security beta of 0.95 and a risk premium of 7 per cent. In our final analysis, our fair value for DANGOTE SUGAR is N44.87k.

DANGOTE SUGAR REFINERY PLC

Key Statistics For 2006 FYE & Q3 Ended September 2007.

<i>Sector -Food/Beverages & Tobacco</i>		<i>NSE ticker – Dangosugar</i>	
Valuation Metrics		Trading Information	
Market Capitalisation (Nbn)	46.00	Volatility - Beta	0.95
Trailing P/E ratio	21.26	52-Week Change	
Price/Sales	7.41	52-Week High (April 19, 2007) (Ngn)	56.00
Projected Growth Rate (%)	10	52-Week Low (March 03, 2007) (Ngn)	18.90
Financial Highlights Share statistics		Trailing Market Price (Mar 05, 2008) (Ngn)	46.00
Fiscal Year End	31 Dec	Dansugar 52-Week Return	127.1%
	Q3- Sept	NSE ASI returns 52-Week Return	52.9%
Most Recent Quarter (mrq)	2007	Share statistics	
Profitability		Average Volume Traded (1 month) (million)	9.31
Return on Capital Employed (ROCE) %	59.1%	Average Volume Traded (5 days) (million)	12.64
Return on Equity (ROE) %	59.5%	Shares outstanding (billion)	10.00
Return on Assets (ROA) %	42.7%	Earnings, Dividend and Bonus Updates	
Per Share Statistics:			1.20
Sales Per Share (Ngn)	6.20	Latest Dividend Per Share (Ngn)	(Interim)
Book Value Per Share (Ngn)	2.80	Dividend Cover (times)	1.45
Trailing Earnings Per Share (Ngn)	2.16	Trailing Earnings Yield (%)	4.70
	1.20	Payout Ratio (%) FYE 2006	72
Latest Dividend Per Share (Ngn)	(Interim)	Balance Sheet as at year ended Dec 2006	
Financial Soundness/Liquidity Metrics		Shareholders Fund (Nbn)	27.98
Current Ratio	2.29:1	Total Assets (Nbn)	38.99
Acid Test Ratio	1.98:1	Total Liabilities (Ngn)	11.02
Operating Cash Flow to Net Income	51.0%	Income Statement Sept Q3- 2007	
Income Statement Sept Q3- 2007			
Revenue (Nbn)	62.05		
Operating Profit (Nm)**	17.55		
Profit Before Tax (Nm)	23.81		
Profit After Tax (Nm)	17.85		
Total Expenses (Nm)**	3.10		
** As at Dec 2006 FYE			

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