



### BCC/DCP Merger Update

#### ...Worth the bargain!

In this report, we assess the key terms of the deal offer to Benue Cement Company (BCC) shareholders, further to the proposed merger with Dangote Cement Plc (DCP):

**Key facts of the merger.** BCC's shareholders would receive **1 DCP share** in exchange for **every two held in BCC**. In line with the terms of the merger, 494,019,668 DCP ordinary shares of 50 kobo each would be issued to the minority shareholders of BCC; increasing DCP's number of shares outstanding to 15,494,019,668 from its current 15,000,000,000 shares. As stated in the Scheme of Merger document, the "effective date" of the merger is the date on which the court sanctions the merger scheme, following the holding of separate court ordered meetings by DCP and BCC<sup>1</sup>. BCC shares would be placed on full suspension two days after the "effective date" and subsequently delisted. The indicative date for listing DCP shares on the NSE is 05 November 2010. Other indicative timelines of the merger are shown in the side table.

**The merger presents the opportunity to be co-owners** of an emerging cement giant on the African continent. Upon the completion of Obajana's 3<sup>rd</sup> and 4<sup>th</sup> cement lines and the Ibese plant (scheduled for completion February 2011), Dangote Cement would boast of an annual capacity of c.19 million tonnes, and would emerge as the largest cement producer in Africa. The key advantage to BCC minority shareholders in this regard, is the robust revenue growth expected from the enlarged Dangote Cement entity starting from 2011 when the new plants would become operational. The Table below shows analysis of gains to BCC shareholders based on forecast earnings and dividends provided in Scheme of Merger document.

Item	Value in BCC (2 BCC shares)	Value in DCP (1 DCP share)	Value Accretion /Dilution
<b>2010 EPS</b>	₦5.26 *2= ₦10.52	₦7.67	(₦2.85)
<b>2010 DPS</b>	₦3.95 *2= ₦7.90	₦5.75	(₦2.15)
<b>2011 EPS</b>	₦7.36 *2= ₦14.72	₦15.98	₦1.26
<b>2011 DPS</b>	₦5.52 *2= ₦11.04	₦11.98	₦0.94
<b>2012 EPS</b>	₦6.60 *2= ₦13.20	₦20.77	₦7.57
<b>2012 DPS</b>	₦4.95 *2= ₦9.90	₦15.57	₦5.67

Source: Scheme Document

**Better placed to compete.** A key investment case for the cement industry in Nigeria over the last 2 decades has been a strong, continuously growing and yet unsatisfied demand base. A combined strategy of imports and local production has repeatedly proved insufficient over the years. Further to this, a total of 3 Greenfield and Brownfield cement plants have sprung up over the last two years, having an estimated combined capacity of 10.3 million MT, with another estimated 13.2 million MT from 3 new plants expected to come on stream in the next one year.

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#### Merger Information

Qualification Date:	30 Aug. 2010
Effective Date:	20 Oct. 2010
Terminal Date:	21 Oct. 2010
Suspension of BCC shares:	22 Oct. 2010
Listing of DCP Shares:	05 Nov. 2010

Per Share BCC Valuation:	₦67.50
Per Share DCP Valuation:	₦135.00

#### Shares Outstanding (Mn)

Benue Cement Company Plc:	3,915
Dangote Cement Plc:	15,000
DCP (post merger):	15,494

#### BCC- Ownership Structure

Dangote Cement Plc (%):	74.77
Others (%):	25.23

#### DCP- Ownership Structure

Dangote Industries (%):	99.14
Others (%):	0.86

#### Post Merger Ownership Structure

Dangote Industries (%):	95.90
Scheme Shareholders (%):	3.19
Others (%):	0.83

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<sup>1</sup> The court- ordered meetings are scheduled for 28 September 2010.



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Consequently, the existing supply gap is increasingly being narrowed and competition amongst key players especially in the major markets has become more intense. Whilst in the past the key word has been "Location! Location! Location! (i.e. proximity to raw material source and market), we believe the focus will shift to "economies of scale" and "efficiency" in the nearest term. And on this basis, BCC shareholders record another plus. The scale and efficiency gains that will accrue to Dangote Cement in an increasingly competitive market, will outweigh those to BCC as a standalone entity with its current 2.8 million tonnes, as it will eventually be unable to compete aggressively on volume growth, leaving the prospects of revenue upside to pricing which would at best remain constant in face of rising cement supply in the industry.

**We believe the expected 75% dividend policy** (detailed in the Scheme of Merger) for the post merger entity makes the deal even more attractive, given that BCC only paid dividend in 2009 over the last five years. Relative to BCC's 54.5% dividend payout in 2009, BCC shareholders can get an additional 20.5% uplift in dividend payout post merger. Based on our estimate also, the absolute dividend per share to BCC shareholders post-merger would outweigh BCC's expected dividend per share if it remained a standalone entity from 2012, despite using a conservative stance in our forecasts for the post merger entity.

**Post merger synergy on efficiency** would further improve returns outlook for BCC, as higher profit margins would translate into higher expected dividend (on an absolute basis). While we recognize that BCC currently has the highest profit margins (2009 FY EBIT margin-46.1%) amidst publicly listed cement companies, Dangote Cement-Obajana Plant, even has higher profit margins (2009 EBIT<sup>2</sup> margin-63.8%), because it operates a dual-firing kiln-capable of using LPFO and gas unlike BCC which only operates on LPFO. At the completion of the on-going Obajana and Ibese lines, we expect a further rise in efficiency and profit margins, beyond what can be achieved with BCC as a standalone entity since it solely uses a more expensive fuel type (LPFO) for its operations. For BCC minority shareholders, the value-add here lies in the fact that the synergy expected in efficiency in the post merger entity would be more than BCC's current and forecast profit margins as a standalone entity even with the expected introduction of coal fuel by BCC from 2012.

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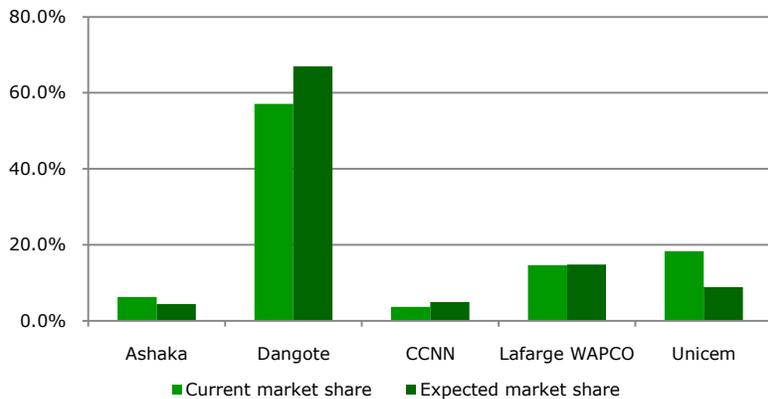
<sup>2</sup> EBIT Margin based on 10 month management accounts.



## Investment Thesis for Post Merger DCP

**Leverage on size:** Dangote Cement owns and operates the 5 million tonnes Obajana Cement Plant-known to be the biggest cement plant in Sub-Saharan Africa. With the construction of Ibeshe and expansion of Obajana to 10 million annual capacity tonnes underway, DCP can leverage on its expected size (about 19 million tonnes annual capacity) to significantly drive revenue through volumes. Based on current statistics, DCP controls 57% of local manufacturing. Using expected capacities at the completion of various expansion drives by sector players, DCP's share of local manufacturing capacity would increase to about 67% latest by 2012. We reiterate that volume would be the key driver of revenue growth in the long term as price would likely fall or at best remain constant. Evidently, DCP is best poised to drive revenue through volume growth.

### Market share (%) of cement manufacturers by annual capacity

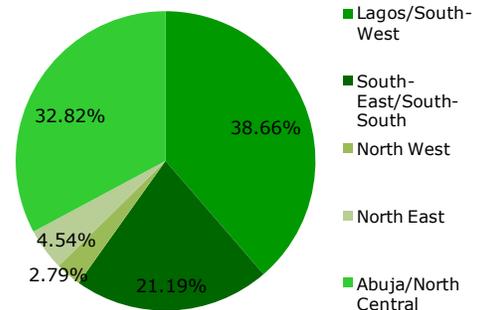


Source: Vetiva Research

**Strategic plant locations:** We highlight the fact that Dangote Plants are situated in close proximity to the major markets for cement consumption in Nigeria-Lagos and Abuja specifically. Given the spate of infrastructure and real estate development in these regions, Lagos and Abuja account for the two largest regional consumption of cement in Nigeria. Based on our estimates from 2009 cement consumption data, Lagos and Abuja regions account for about 38.7% and 32.8% of total cement consumption in Nigeria, respectively (see chart on right).

It is obvious therefore, that Dangote Cement, through its Obajana plant which is the closest cement plant to Abuja (about 220 km), has a monopolistic advantage in the Abuja market relative to other players. In a similar vein, Dangote Cement through its Ibeshe plant which is expected to become operational in 2011 is well positioned to tap into the growing potentials of the Lagos market, while increasing the competitive pressure on Lafarge WAPCO, which has been the dominant cement manufacturer in the south-western region of Nigeria. Furthermore, the Ibeshe plant is strategically poised to replace volumes of cement import in the Lagos market, in view of the recently imposed 35% import tariff which unarguably would make cement importation unattractive.

### Estimates of Regional Cement Consumption in Nigeria



Industry sources, Vetiva Research



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**Highly energy efficient plants:** Dangote Cement Plants use the most modern technology in cement production as its rotary kilns employ the pre-calciner dry process for converting raw meals into clinker.

Although other cement plants in Nigeria (except WAPCO’s Shagamu plant) also use the dry process, Dangote Cement Plants are perhaps more efficient because of their size and the fact that it uses a more advanced dry process technology. Pre-calciner dry kilns have the least energy consumption level of about 4.03GJ/tonne of clinker produced, and are the most energy efficient globally. We see this as an added advantage to DCP given the incessant stoppage of production usually encountered by local cement manufacturers as a result of energy problems. As seen in the table below, Dangote cement has the highest gross profit margins since its energy consumption level is the lowest.

**Table showing energy consumption and profit margin of Nigerian cement producers**

Company	Plant Location	Kiln Type	Average Energy GJ/tonne	Gross Profit Margin <sup>3</sup> (%)
Lafarge (WAPCO)	Ewekoro	Dry-Precalciner	4.03	33.1
	Shagamu	Wet	5.94	
CCNN	Sokoto	Small dry kiln	5.13	43.5
<b>Dangote Cement</b>	<b>BCC</b>	Dry Precalciner	<b>4.03</b>	<b>55.4</b>
	<b>Obajana<sup>4</sup></b>	Dry Precalciner	<b>4.03</b>	<b>72.4</b>
Lafarge (Ashaka)	Ashaka	Dry	4.29	34.3

**Sources:** Vetiva Research, "Alternative fuels in Cement manufacture" by Energy & Resource Group, and UC Berkeley

Note: <sup>3</sup>as at FY'09, <sup>4</sup>Obajana's EBITDA Margin is based on 10 month management accounts

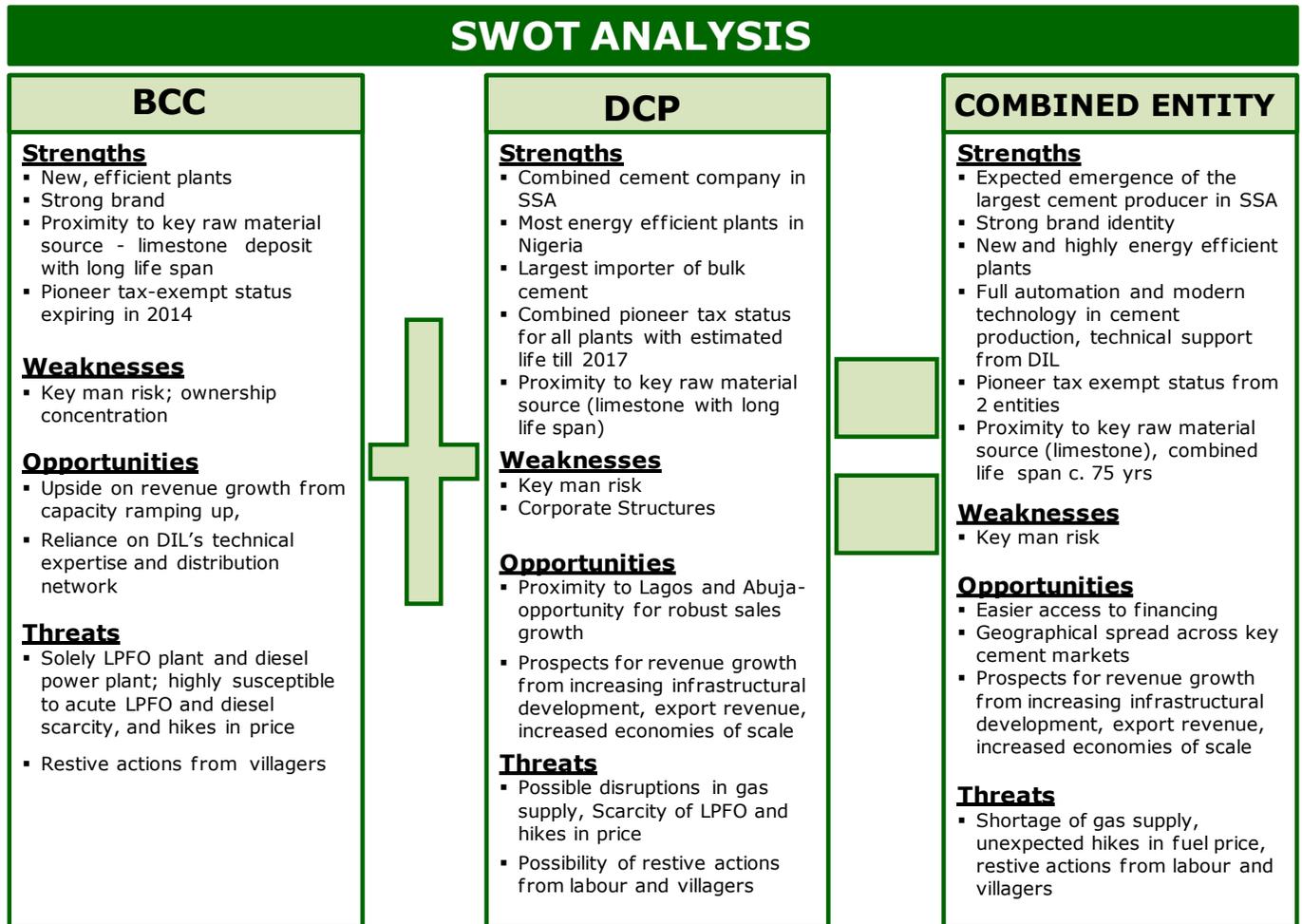
**The Export advantage:** Given the presence of the other cement entities within the Dangote Group in Ghana, Senegal, Benin Republic and other West African countries, we believe DCP is adequately positioned to generate earnings from export if the local market becomes saturated in the longer term. The export incentives extended to local manufacturers in form of Export Expansion Grant (EEG - up to 30%), ECOWAS Trade Liberalisation Scheme (ETLS), Export Development Fund Scheme, among others would also be a boost for Dangote Cement as its exports would be more competitive in foreign markets. By our estimates of ongoing and expected expansion in the sector, cement production capacity would reach about 28 million tonnes per annum by 2012. Due to gradual ramping up of capacity utilization however, actual production level is not likely to reach 28 million tonnes in the medium term. In the longer term however (4 to 5 years onwards), we expect cement production level to reach the maximum, and cement imports would likely be phased out. Thus, local markets would become intensely competitive, possibly oversupplied, profit margins would be pressured and exports would be very key to sustaining revenue growth and profit margins. Dangote Cement's recent expansion of its cement import terminal in Ghana is a pointer to the company's preparedness and foresight beyond the Nigerian market. Earlier this year, DCP's management has stated that the company, through Dangote Industries Limited's Ghana subsidiary-Green View International Limited, would soon start the importation of bulk cement from Nigeria, rather than China, Indonesia and Thailand.



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We note therefore that there's a readymade market for Dangote Cement in Ghana as the two major cement producers in Ghana (Ghana Cement – GHACEM and West African Cement – WACEM), which have a combined capacity of about 2.5 million tonnes, have not been able to meet local demand, estimated at 4 million tonnes.



## Key risks to the Merger

We highlight the following as major risks to the merger of BCC and DCP:

- Merger Assumptions:** As detailed in the merger document, we highlight completion risk and hikes in gas and fuel price, and scarcity of fuel supply as risks to revenue forecasts for the post merger entity. Apart from these however, the company's utilization rates assumptions, in our view, are stretched and they show a deviation from the historical attainable level in the Nigerian Cement Industry given the time-lag before a new plant typically reaches full utilization.
- Key Man Risk:** In our view, the concentrated shareholding structure of post merger DCP raises some concerns on the company's corporate governance given that Dangote Industries Limited will hold 95.9% of total outstanding shares of the post-merger entity, pending the sell-down of at least 25% required by the NSE as a listing condition. We highlight that post-merger DCP has been given a 24 month period to conclude the sell-down process.



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- **Market Risk:** The post-merger DCP would represent about 25% of the Nigerian Stock Exchange total market capitalization. In our view, this constitutes a major risk to the stock market since its performance would be strongly correlated to Dangote Cement's performance, regardless of the activities or performance of other sectors.



## Appendix: Definition of Merger Terms

**Qualifying Shareholders:** The shareholders whose name appear in the Register of Members of DCP and BCC as at the Qualification Date and are eligible to attend the Court Ordered Meetings

**Qualification Date:** Monday 30 August 2010; the cut off date to become a "qualifying share holder".

**Effective Date:** The date on which the court sanctions the Scheme

**Terminal Date:** The business day immediately preceding the "Effective Date"

**Scheme Document:** The document containing the Scheme, the explanatory statements and notices of Court Ordered Meetings.



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