

Consolidating for Long Term Value Creation

Stellar Q3 Performance Pushes Topline by 3.67% in 9M:2020

The 9M:2020 financial scorecard of Chemical and Allied Product Plc's. (CAP) came out better as the company's topline grew by 3.67%YoY to NGN5.99bn (vs NGN5.78bn in 9M:2019), in spite of the setback suffered in H1. Clearly, this is due to the 33.69%YoY growth recorded in Q3:2020. However, we take this with some caution as we notice the increase in credit sales evinced by a spike in trade receivables (+68.20%) from 2019FY. Considering the tough business environment, we worry over further delays in settlement, possible default by trade debtors and the resulting impairment charge. These concerns are validated by the NGN15.57mn impairment charge on receivables in 9M:2020 and the slightly elongated operating cycle (-33 days in 9M:2020 compared to -36 days in H1:2020). Nonetheless, we expect the company to remain open to credit sales in the short to medium term, in a bid to ramp up volumes amid the economic slowdown. **For 2020FY, we maintain our 5.07% growth outlook for topline. The gradual pick-up in economic activities and the company's drive to improve volumes inform our optimism.**

Impairments and Low interest Income Pressure Profitability

During the period, the company recorded higher cost of sales (+8.86%) due to higher cost of production. This brought the gross margin down to 44.93% in 9M:2020 (vs 47.56% in 9M:2019). It is expected that this trend will be sustained in subsequent quarters as higher costs of procuring raw materials already reflects adequately on the book value of raw materials stock in 9M:2020 – NGN510.44mn (vs. NGN295.43mn in 2019FY). Similarly, operating expenses surged by 18.41% on account of a 13.54x increase in impairment on trade receivables and NGN13.26mn recognized as impairment on short term deposit. Consequently, the operating margin declined to 19.54% in 9M:2020 (vs 25.62% in 9M:2019). Adding further pressure on profitability is the low interest environment as interest income (on short term bank deposits) declined by a significant 40.57% to NGN194.34mn in 9M:2020 (vs NGN327.02mn in 9M:2019). Hence, profit after tax dropped by 24.50% to NGN927.50mn (vs NGN1.23bn in 9M:2019). Overall, the company's earnings quality (Operating cashflow to net income) - 30.73% only weakened slightly compared to 9M:2019 (34.46%).

CAP Plc to Merge with Portland Paints Plc.

The management of Portland Paints Plc. and CAP Plc. subject to receipt of relevant regulatory and corporate approvals have agreed to merge both entities, with CAP Plc being the resulting entity. In our view, we see the merger as a good starting point to drive further market penetration. Per our analysis, we expect the merger to result in a dilution of CAP Plc's outstanding shares by about 28%. However, we expect the consolidated company to leverage on Portland Paint Plc's presence in the standard decorative segment and marine coatings segment to expand its market reach and thus improve earnings per share in subsequent years. Ultimately, we anticipate this to translate into value creation for shareholder's through improved asset utilization (Portland Paint -1.15x asset turnover) and profitability.

Recommendation

For 2020FY, we maintain our EPS expectation of NGN2.52 and P/E ratio of 9.50x. Thus, our price target remains unchanged at NGN23.93 (an upside potential of 17.59%). Hence, we maintain the counter's **BUY** rating.

Company	CAP
Valuation	
EPS	2.06
BVPS	4.93x
P/E	9.88x
P/BV	4.13x
Target P/E	9.50x
Dec-2020 Exp. EPS	2.52
Dec 2020 Target price	23.93
Current Price	20.35
Up/Downside Potential	+17.59%
Ratings	BUY
Key metrics	
ROE	41.78%
ROA	18.43%
Net margin	16.71%
Asset Turnover	1.10x
Leverage	0.00x
Yr Hi	27.50
Yr Lo	15.30
YTD return	-15.21%
Beta	0.18
Adjusted Beta	0.45
52-Week average volume ('000)	485.22
Shares outstanding	700.00mn
Market cap [NGN]	12.95bn
Financial year end	Dec
Most Recent Period (MRP)	9M:2020

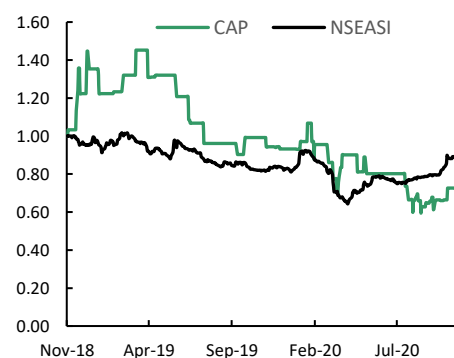


Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	22.51
						Max	25.38
						EPS	
		2.44	2.48	2.52	2.56	2.59	
Target P/E	9.22x	22.51	22.86	23.21	23.56	23.90	
	9.36x	22.86	23.21	23.57	23.92	24.27	
	9.50x	23.21	23.57	23.93	24.29	24.64	
	9.64x	23.56	23.92	24.29	24.65	25.01	
	9.79x	23.90	24.27	24.64	25.01	25.38	

Financial Highlights (NGN million) 9M:2020 Financial result

Profit & Loss Account	9M:2020	9M:2019	y/y Growth
Revenue	5,989.19	5,777.43	3.67%
Cost of Sales	3,297.96	3,029.54	8.86%
Gross Profit	2,691.24	2,747.89	-2.06%
Investment Income	194.34	327.02	-40.57%
Other Income	66.87	73.18	-8.62%
Operating Expense	1,588.03	1,341.15	18.41%
Finance Cost	0.43	0.43	0.00%
PBT	1,363.98	1,806.49	-24.50%
PAT	927.50	1,228.42	-24.50%
Balance Sheet	9M:2020	2019FY	
Inventories	1,107.00	1,050.10	5.42%
Trade and other Receivables	625.20	371.70	68.20%
Cash and bank	4,972.27	4,322.99	15.02%
Property, Plant and Equipment	831.80	869.67	-4.36%
Other Assets	282.31	146.50	92.7%
Total Assets	7,818.58	6,760.96	15.64%
Shareholders' fund	3,449.19	2,521.68	36.78%
Trade and Other Payables	1,752.23	1,801.55	-2.74%
Tax Liabilities	436.60	765.94	-43.00%
Total Liabilities	4,369.39	4,239.28	9.08%

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Movements in Price Target

Company Name: Chemical and Allied Products Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
02-Nov-2020	20.35	23.93	23.93	BUY	BUY
24-July-2020	18.95	23.87	23.93	HOLD	BUY

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