Sephaku Cement 2019 year-end financial results and Métier operational update

Following Dangote Cement PLC’s (DCP) FY2019 financial results announcement for the period ended 31 December 2019, released on 26 February 2020, SepHold reports on Dangote Cement SA (Pty) Ltd.’s (“Sephaku Cement”, “SepCem” or “the associate”) performance. The commentary includes an update on Métier Mixed Concrete (Pty) Ltd.’s (“Métier” or “the subsidiary”) operational performance.

Any forward-looking information contained in this announcement has not been reviewed or reported on by the Company’s external auditors. All Sephaku Cement figures included below are shown on a 100% basis and do not reflect SepHold’s 36% attributable interest unless otherwise stated. Thirty-six per cent (36%) of SepCem’s profit after tax will be equity accounted in the SepHold financial results for the 12 months ending 31 March 2020.

Commentary

Sephaku Cement

Sales volume

Increased competition from blenders and importers in a low demand environment negatively impacted the building materials industry, including SepCem during the year. Imported cement volumes increased by approximately 12% year-on-year (y-o-y). SepCem’s sales volumes were 9.4% lower y-o-y with growth in the fourth quarter, during which the associate achieved an increase of 10.4%.

The cement industry’s application for a safeguard tariff from the International Trade Administration Commission of South Africa has progressed well, which if successful will result in the imposition of a non-country-specific flat tariff on all imported cement. The industry’s motivation for the tariffs is the higher cost of doing business in South Africa due to stringent legislative requirements and high regulatory standards compared to the importing countries.

Revenue and profitability

SepCem increased prices by between 8% - 10% per tonne in January 2019 for bulk and February 2019 for bagged cement. An additional price increase was implemented in July 2019 for carbon tax recovery. The combined impact of the price increases and the introduction of competitively priced Falcon was an effective annual increase in revenue per tonne of 5.2%. SepCem’s revenue decreased to R2,18 billion (2018: R2,29 billion) due to the volume decline. The annual earnings before interest, taxation, depreciation and amortisation (“EBITDA”) margin was 16% (R359,0 million) compared to 20% (R461,5 million) in 2018. The H2 2019 EBITDA margin was 17.5% compared to 15.2% in H1 2019 and 18.3% in H2 2018. The profit margins were further impacted by above-inflation cost increases in inputs such as coal, electricity and fuel. To improve profitability, SepCem has made significant progress towards developing initiatives to mitigate the escalating costs and is has established an alternative source for competitively priced coal.
The profit after tax was R1,3 million compared to R128,7 million in 2018 which was significantly higher due to an R81,7 million credit granted in terms of the section 12L tax incentive for energy savings during the 2017 tax period. Excluding the tax credit, the comparative profit after tax for 2018 was R46,9 million.

**Debt management**

By 31 December 2019 SepCem had repaid more than R1 billion of the project loan capital resulting in a balance of R1,372 billion and a net bank debt of R873 million. The total debt service in 2019 was R453 million, including interest payment of R178 million. The 17th quarterly principal of approximately R125 million was paid in February 2020 with the next instalment due on 1 May 2020. SepCem is up to date with all required payments as per the project loan agreement.

**Métier**

The subsidiary continues to experience intense competition in both the Gauteng and Kwa-Zulu Natal markets and profitability is under pressure. The stagnancy in the construction industry has resulted in high competition in supply nodes with relatively high-volume demand. The volumes as at the end of December 2019 were 13.7% lower and prices 1.5% higher per cubic metre y-o-y. The subsidiary is implementing strategic cost-cutting measures on non-core assets.

**Debt management**

Métier has continued to service its bank debt according to the repayment terms. However, the reduced profitability levels resulted in severe pressure on the debt to EBITDA covenant by December 2019. To cure the balance sheet and to ensure the Company’s continued compliance with bank debt covenants, the board of directors of SepHold approved a rights offer to raise R37,5 million (“Rights Offer”). The Rights Offer was successfully concluded on 14 February 2020. The outstanding capital on Métier’s term loan and revolving debt will be R2 million and R90 million, respectively by 31 March 2020, while the net debt position will be at R70 million.

The strategic intent of establishing SepHold as a renowned building materials investment entity entails developing the investment portfolio to encompass a variety of manufacturers along the construction value chain. To that end, Métier provides an important lever for both downstream and upstream expansion opportunities for the group.

**Outlook**

SepCem selectively implemented price increases of 5% to 9% in January 2020 and February 2020 for bulk and bagged cement, respectively. Most competitors opted to either delay or not increase pricing in the quest to maintain or improve sales volumes.

The associate has adopted a more strategic approach to price increases based on the combination of its unique competitive advantage and demand levels per market. The concept of **quality sales tonnes** defined as profitable volumes has been the vanguard of SepCem’s sales strategy from inception.
Overall, building materials demand will remain subdued as reflected by the 12.7% decline in building plans passed data for 2019 from Statistics SA. Building plans passed data is considered a leading indicator for construction activity and is, therefore, projecting a constrained building materials demand environment for the next 12 – 18 months.

SepCem and Métier will continue to focus on maintaining sustainable sales volumes and reducing debt.

Centurion
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Enquiries contact: Sakhile Ndlovu       Sephaku Holdings       Investor Relations       012 612 0210

Sponsor: Questco Corporate Advisory (Pty) Ltd

About Sephaku Holdings Limited
SepHold is a building and construction materials company with a portfolio of investments in the cement sector in South Africa. The strategy of SepHold is to generate growth and realise value for shareholders through the production of cement and ready mixed concrete in Southern Africa. The Company's core investments are a 36% stake in Dangote Cement South Africa (Pty) Ltd (Sephaku Cement) and 100% in Métier Mixed Concrete (Pty) Ltd.

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