Dangote Cement Plc

Nigeria, Construction materials

Accounting		Climate Assumptions		Audit		Date of analysis: May 17 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in KAMs	Consistency check	Year end: December 2020 Audit Report date: March 23 2021 AGM: May 26 2021
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Some concerns	Climate Action 100+ company, so seen by investors as key to driving global net zero emissions.

Summary view:

- As a producer of cement and related products, the company faces significant issues related to climate change and steps to combat it, relating to its production of CO2 as a by-product of producing clinker, an intermediate component of cement that is also sold separately by the company, and its current use of coal-fuelled kilns.
- There is an obvious lack of consistency between the acknowledged significant risks of climate change and issues for cement producers in particular, the dearth of specific risk assessment or mitigation steps for the company, and the lack of any apparent mention in the financial statements or the auditor's report.

Background

The Business

- Dangote Cement Plc (DCP) is a subsidiary of Dangote Industries Ltd, a Nigerian conglomerate with diverse business holdings that span sugar, salt, condiments, packaging, energy, port operations, fertiliser, and petrochemicals.
- DCP is listed on the Nigerian exchange, with a 12% free float.
- It manufactures and sells cement and related products, both to distributors and directly to end user customers. Sales of cement and clinker (an intermediate component of cement production) account for virtually all of its sales. It operates through two geographic segments, Nigeria and Pan Africa, accounting for roughly 70% and 30% of total sales respectively.
- As with all cement producers, its processes are energy intensive and produce substantial CO2 emissions. This is particularly true of the production of clinker, produced through a chemical process that breaks down limestone by heating it to high temperatures in a kiln, splitting off CO2. This part of CO2 emissions – well over half of overall emissions for traditional cement production – cannot be avoided.
- Emissions from cement production are often assessed by the clinker factor[1]; a lower factor giving lower emissions. DCP does not appear to mention the clinker factor of its products.
- 2020 GHG emissions from cement production, including captive power plants and generators, kilns and vehicles used at the quarries and sites (Scope 1) was 16m tCO2, up 7.6% from 2019. Higher clinker production led to the increase. DCP reveals that 89% of its emissions were from kiln-related activities.

Approach to climate change

- DCP has 5 strategic objectives, including one to 'Adhere to high standards of corporate governance and improve our efforts in sustainability'. Additionally, in 2020 it officially adopted 7 of the 17 Global SDGs, including Goal 13: Climate Action, aligning them with its 7 Sustainability Pillars (cultural, economic, operational, social, environmental, financial and institutional), so that they can be integrated into its operations and strategic decisions.
- Key focus areas of its operations pillar are: higher efficiency in the use of limestone, laterite, and other minerals; pollution reduction (dust, noise etc); optimised limestone and material mix; efficiency in lowering CO2 generation; efficiency in cement bag loading systems; improving profitability, while producing a higher-quality, stronger brand of cement at a lower cost. It is not clear whether the optimised mix in any way envisages a reduced clinker factor. While other cement companies are reducing their clinker factor, Dangote does not appear to

[1] Reflects the extent to which clinker is substituted with materials having lower CO2 emissions profiles.

be doing so. In fact, it is pursuing a strategy to export clinker; following the commissioning of an export terminal in June 2020, it began to ship clinker to Senegal and Cameroon.

- DCP suggests that the amount of energy consumed in its manufacturing process “cannot be out-rightly reduced”, and part of its strategy appears to be enhancing investments in alternative fuel sources and energy-saving initiatives, focusing on cleaner energy. However, the fuel mix continues to include coal, gas and PET coke. In Nigeria, its Obajana plant uses approximately 50% local coal and 50% gas, and its Ibese plant uses approximately 30% local coal and 10% PET coke. Coal also appears to be the predominant fuel for the company’s kilns in other countries. In November it commissioned a gas fired power plant in Tanzania.
- The only specific climate-related goal identified in our research is an ambition that by the end of 2025, alternative fuels will substitute approximately 25% TSR (thermal substitution rate) of fossil fuels currently used in kilns for the production of clinker.
- DCP acknowledges that risks attributed to climate change include physical (environmental), regulatory, financial (such as carbon taxes, offsetting costs, etc), litigation, and others could negatively impact competitiveness. However, it says it also sees opportunity for diversifying into the evolving ‘renewable’ waste management industry, leveraging the advantage of energy reduction through efficient kilns and overall decreases in the cost of doing business.
- Principal risks disclosed in the annual report do not appear to include any climate-related issues, while expressing concerns over the availability and cost of fuel, specifically risks relating to coal imports, considering restricted supply from its own coal mines and currency risks. Mitigants are stated as including more investment in coal (technical review and capacity utilisation of existing mines, opening of new mines), and bridging remaining supply gaps from third-party mines.
- DCP published its second CDP report in 2020, committing to improvement and environmental stewardship. We note that Nigeria is a party to the Paris Agreement.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- The financial statements are prepared in accordance with IFRS and requirements of the Companies and Allied Matters Act and the Financial Reporting Council of Nigeria Act.
- There is no explicit reference to climate change in the notes to the financials. It is not apparent that any consideration of climate has been built into the numbers.
- PP&E of ₦1,390bn at the end of 2020 represents 69% of total assets. DCP indicates that a majority of its plants were built in the last 15 years. Investment continues with capital work in process a significant 13% of gross PP&E at the end of 2020 (up from over 11% at 2019). Buildings and leasehold land improvements were 15% of PP&E, and plant and machinery 60%.
- For buildings and leasehold land improvements, depreciation lives are disclosed as between 25 and 50 years or the leasehold life, while 2020 depreciation expense roughly implies an average life of 24 years and remaining life of 22 years. For plant and machinery, useful lives are disclosed as being between 5 and 25 years, and 2020 depreciation implies average life of 22 years and remaining average life of 17 years[2]. No indications of impairment or revisions to useful lives appear to be disclosed.[3]
- Included in disclosure of future changes to IFRS requirements is an amendment to the requirement for recognising losses on contracts that are considered to be onerous. The change clarifies that all costs directly related to a contract should be included in the assessment, not just incremental costs. DCP anticipates that the amendment “will have an impact on the Financial Statements if such transactions occur”, implying that its current approach does not

[2] In the absence of better data, implied lives are roughly estimated using depreciation expense and, for average lives – start of year productive asset values, for remaining lives – ending values net of depreciation.

[3] While not having any implications for reported amounts, DCP’s disclosure of accounting policies on impairment appears to have misplaced text on non-financial assets within the section on financial assets, making this policy information slightly more difficult to decipher.

include other costs (such as depreciation of PP&E used) in fulfilling a contract. The change becomes mandatory for 2022. It is not clear whether any implicated contracts exist.
- DCP discloses that contingent liabilities in respect of pending litigation and other claims amounted to ₦117.5bn at the end of 2020. No provision is recorded, as DCP does not consider settlement to be probable; no additional information appears to be disclosed.

Consistency with other reporting		Significant concerns

- The 2020 report integrates financial and non-financial (sustainability) reporting in a single report; sustainability elements are prepared in accordance with GRI Standards (Core option).
- There is an obvious lack of consistency between the acknowledged significant risks of climate change and issues for cement producers. In particular, the absence of specific risk assessment or mitigation steps for the company, and no apparent mention in financial statement considerations, is of significant concern.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.

Paris alignment		Significant concerns

- With no visibility, there can be no alignment with the goals of the Paris Agreement.

Audit: visibility in KAMs and consistency check

Audit firm: KPMG	Responsible partner: Goodluck C. Obi, FCA
Audit standards: International Standards on Auditing (ISAs)	

- 2020 is the first year that KPMG has served as DCP's auditor, replacing its former joint auditors Deloitte and Ahmed Zakari & Co, as they had reached the maximum tenure.

Visibility in Key Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- There are 3 KAMs: (i) impairment assessment of investment in subsidiaries; (ii) road infrastructure tax credit; and (iii) provision for site restoration and rehabilitation.
- The first item focuses on valuation of investments in subsidiaries on the balance sheet of the parent company, at cost less impairment. The auditor noted that some of the subsidiaries are currently loss-making, and that a number are dependent on financial support from the parent, mostly in the form of loans and advances. In 2020, ₦3.4bn of loans and receivables was impaired in the parent company accounts. The auditor engaged valuation specialists to test the appropriateness of discount rates and terminal growth rates used, but there is no reference to the use of specialists with climate expertise or the consideration of climate risk.
- The third KAM relates to cost estimates for areas mined for raw material but not yet rehabilitated. Site restoration accruals doubled during 2020 to a liability of ₦6.9m. While not made clear, some of the increase may be attributable to new plant put into service during the year. We note that climate change risk and responses to it could increase the steps required to be taken, increasing costs or bringing them forward in time.

Consistency check		Some concerns

- The auditor's report identifies the 'other information' subject to consistency check as comprising the: Directors Report, Statement of Directors' Responsibilities, Statement of Corporate Responsibility for the Financial Statements, Certification Pursuant to Section 60 of Investment and Securities Act 2007 and Other National Disclosures. These are said to have been obtained prior to the date of the auditors' report (March 23 2021). Additionally, it signals that other information also includes: Corporate information, Chairman's Report and Audit Committee Report, together the "Outstanding reports" expected to be made available later.

- We note that the Chairman's Statement and Chairman's Introduction included in the annual report are both dated March 18 (i.e. prior to the auditor's report). Nonetheless, the auditor had nothing to report in regard to the other information available, and confirmed "When we read the Outstanding reports, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance."
- There is an obvious lack of consistency in the acknowledged significant risks of climate change and issues for cement producers in particular, however, the absence of specific risk assessment or mitigation steps for the company is in a limited sense consistent with there being no apparent mention in financial statement considerations or the auditor's report.

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.

	Key
	Good practice
	Few concerns
	Some concerns
	Significant concerns

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