

Flour Mills of Nig. Plc

Nigeria | Equities | Consumer Goods | August 1, 2019

PAC RESEARCH

Input Costs Remain a Major Challenge as Lower Finance Cost Improves Overall Performance

INVESTMENT SUMMARY

The recent unaudited three-month to June 2019/20 financial results released by the Flour Mills of Nigeria Plc showed improvement in the top-line as revenue increased marginally by 1.29% to ₦134.75 billion (vs. ₦133.03 billion in three-month to June 2018/19). The improvement in the top-line can be mainly attributed to the significant growth in the Sugar segment and Agro-Allied segment during the period. Mainly as a result of higher material costs and direct staff costs, total cost of sales increased by 2.16% to ₦118.27 billion in Q1'19/20 (vs. ₦115.77 billion in Q1'18/19) and this translated to cost-to-sales ratio of 87.78% (vs. 87.03% in the same quarter of the previous year). Higher cost-to-sales ratio remains a major challenge, reflected in lower operating profit of ₦9.90 billion in the first quarter of 2019/20, compared to ₦11.21 billion achieved in the same period last year. However, the company recorded an impressive non-operating performance during the period as finance costs declined significantly by 26.56% to ₦4.56 billion in Q1'19/20 (vs. ₦6.20 billion reported in Q1'18/19).

The impressive non-operating performance outweighed unimpressive operating performance during the period and as a result, profit before tax increased by 5.54% to ₦5.50 billion in Q1'19/20 (vs. ₦5.21 billion in Q1'18/19). However, the company made a lower provision of ₦1.27 billion for tax in Q1'19/20 (vs. ₦1.56 billion in Q1'18/19). Consequently, profit after tax increased by 16.09% to ₦4.24 billion (vs. ₦3.65 billion in Q1'18/19). Due to a significant loss after tax in the previous quarter, 12-month trailing EPS fell by 63.97% to ₦1.12, from ₦3.11 recorded in the previous period. Based on the recent figures released by the company, we downgrade our target price to ₦19.32 (from ₦23.94 previously recommended). However, we maintain a **BUY** recommendation as the current market price is below the intrinsic value.

Fig. 1: Quarterly results highlights

	1Q2020	4Q2019	1Q2019	Q/q Δ	Y/y Δ
Revenue (₦mn)	134,745	126,763	133,029	+6.30%	+1.29%
Operating profit (₦mn)	9,895	5,004	11,207	+97.74%	-11.71%
Net profit (₦mn)	4,237	-3,895	3,649	-208.78%	+16.11%

Source: Bloomberg, PAC Research

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Price:

- Current	₦15.25
- Target	₦19.32
Recommendation:	BUY

* As at Thursday August 1, 2019

Fig. 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	-33.98%/-42.69%
52-week range	₦29.40 - ₦13.35
30-day Average vol.	2,186,168
Shares Outstanding (mn)	4,100.38
Market Cap. (₦bn)	62.53
EPS, ₦- 12months trailing	1.12
DPS, ₦- FY2019	1.20

Source: NSE, Company's Annual Reports, PAC Research

Fig. 3: Key ratios

	3M'20	3M'19
Gross profit margin	12.23%	12.98%
COS/Revenue	87.77%	87.02%
Net Profit Margin	3.14%	2.74%
Asset turnover	0.32	0.32

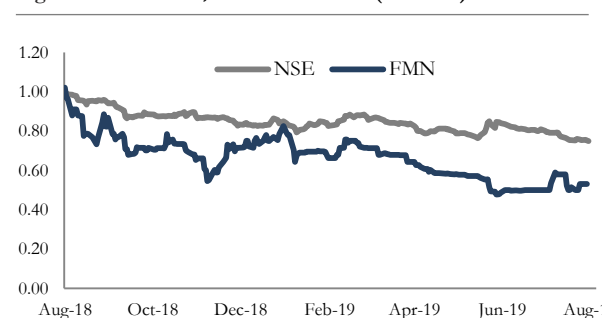
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020F	FY2021F
P/E(x)	4.59	15.63	6.06	4.26
P/B(x)	0.42	0.41	0.40	0.39
Div. Yield	6.56%	7.87%	8.52%	9.84%
Payout Ratio	30.11%	123.01%	51.70%	41.86%
Ev/Revenue	-2.77	-4.39	-6.02	-6.30
Rev Per Shr	132.35	128.62	129.46	131.58
ROE	9.04%	2.65%	6.52%	9.13%
ROA	3.33%	0.96%	2.47%	3.46%

Source: NSE, PAC Research

Fig. 5: FMN vs NSE, 52-wk Movement (Rebased)

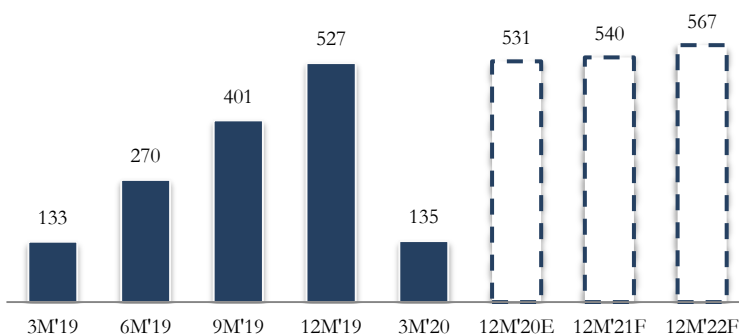


Source: Bloomberg, PAC Research

Agro-Allied restructuring and growth in Sugar segment drives overall revenue: During the period under review, Flour Mills of Nigeria reported revenue of ₦134.75 billion in Q1'19/20 (vs. ₦133.03 billion recorded in Q1'18/19), due to growth in Sugar and Agro-Allied segment of the group. The revenue of Sugar segment of the company increased by 20.31% to ₦24.08 billion (vs. ₦20.02 billion in Q1'18/19) while revenue for Agro-Allied segment increased by 3.78% to ₦25.63 billion in Q1'19/20 (vs. ₦24.71 billion in Q1'18/19). The Agro-Allied Division has been restructured, under a Holding Company (Golden Fertilizer Company Limited) and this led to a significant improvement in Premier Feeds business, solid growth in Golden Fertilizer and Premium Cassava Products. In line with our forecast for the fertilizer business in our last report, the company continued to benefit from the ban on importation of fertilizer by the Federal Government of Nigeria. The significant growth in Sugar segment of the company can be largely attributed to higher volume during the period. However, other segments of the company recorded lower figures in the first quarter of 2019/20. Revenue from Food Segment declined by 2.56% to ₦81.55 billion (vs. ₦83.70 billion in Q1'18/19) while revenue for Support Services segment declined by 24.72% to ₦3.47 billion in Q1'19/20 (vs. ₦4.61 billion reported in Q1'18/19.) Food segment remains the largest contributor to revenue as it contributed 60.53% to the revenue in Q1'19/20 (Q1'18/19 62.93%). Agro-Allied segment contributed 18.99% to overall revenue (Q1'18/19: 18.57%) while Sugar segment contributed 17.88% to overall revenue in Q1'19/20 (vs. 15.04% in Q1'18/20).

In line with our forecast for the fertilizer business in our last report, the company continued to benefit from the ban on importation of fertilizer by the Federal Government of Nigeria.

Fig. 6: Revenue – 3M'19-12M'22F (Billion NGN)



Source: NSE, PAC Research

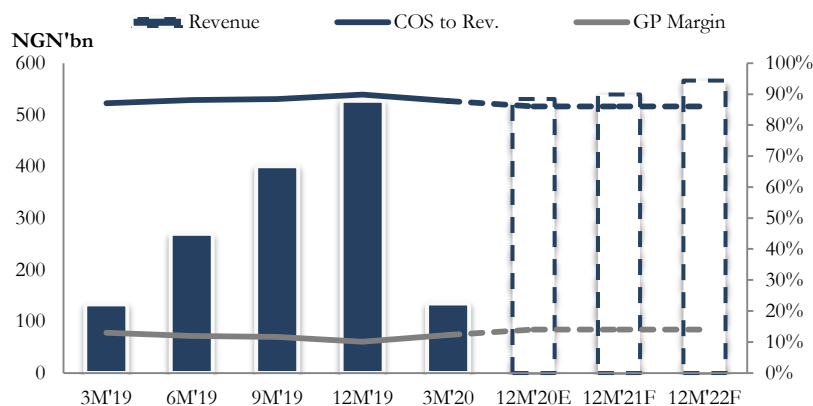
Inefficient cost management reflects on high cost of inputs: The company continued to battle with high cost of inputs in the first quarter of 2019/20 as cost of sales increased by 2.16% to ₦118.27 billion (vs. ₦115.77 billion in the first quarter of 2018/19). The higher input costs mirrored on cost-to-sales ratio as it increased to 87.77% in Q1'19/20 (Q1'18/19: 87.02%). The higher cost of sales during the period can be mainly attributed to higher material costs, increased direct staff costs and higher power cost.

Material costs and power cost increased by 1.23% and 3.02% to ₦101.38 billion (Q1'18/19: ₦100.15 billion) and ₦3.89 billion (Q1'18/19: ₦3.77 billion) respectively in Q1'19/20. In addition, direct staff cost increased significantly by 14.27% to ₦4.17 billion in the first quarter of 2019/20, from ₦3.65 billion reported in the corresponding quarter of previous year. Over the next months, we expect a slight reduction in the cost of sales due to anticipated cyclical wheat price movement. In the coming years, we assume cost-to-sales margin to reduce as we expect the assistance of ₦70.00 million from Flour Milling Association of Nigeria (FMAN) to Wheat Farmers Association of Nigeria last year to boost the country self-sufficiency in wheat production.

Due to higher salaries, selling expenses and related staff costs, total selling and distribution expenses increased to ₦2.04 billion in Q1'19/20 (vs. ₦2.02 billion reported in Q1'18/19). However, total administrative expenses fell marginally by 0.43% to ₦4.67 billion in Q1'19/20 (vs. ₦4.69 billion in Q1'18/19). In general the higher costs led to a lower operating profit of ₦9.90 billion in the first quarter of 2019/20, when compared with ₦11.21 billion reported in the corresponding quarter of last year.

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Fig. 7: Revenue, COS to Rev. and GP Margin – 3M'19-12M'22F



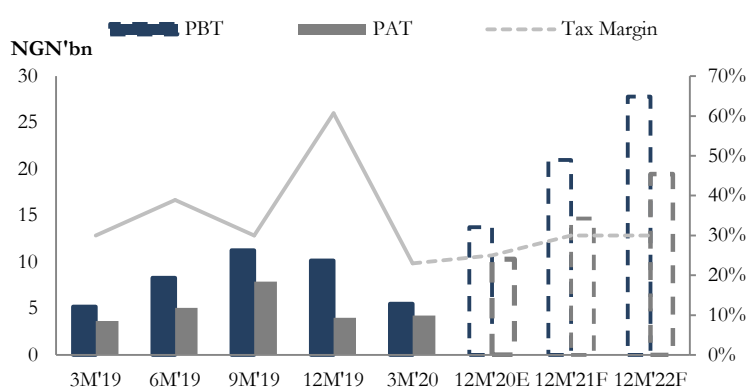
Source: NSE, PAC Research

Improvement in PBT due to reduced finance costs, strong performance in Sugar and Agro-Allied segments: In three-month to June 2019/20, FMN Plc reported a significant improvement in non-operating activities of the company as finance costs declined by 26.56% to ₦4.56 billion (vs. ₦6.20 billion reported in three-month to June 2018/19). According to the management of Flour Mills of Nigeria Plc, the reduction in finance costs came as a result of deleveraging strategy. However, investment income declined by 22.19% to ₦162.37 million in Q1'19/20, from ₦208.66 million achieved in Q1'18/19.

Meanwhile, the unimpressive performance from the core operating activities of the company, particularly in the Food segment and Support Services segment threatened the bottom-line of the company during the period. With significant reduction in finance costs and impressive performance in the Sugar segment of the company, profit before tax increased by 5.54% to ₦5.50 billion in Q1'19/20 (vs. ₦5.21 billion in Q1'18/19). The company made a lower provision of ₦1.27 billion for tax during the period (vs. ₦1.56 billion recorded in corresponding previous period). As a result, profit after tax increased by 16.09% to ₦4.24 billion, from ₦3.65 billion reported in the first quarter of 2018/19. Due to significant loss after tax in the previous quarter, 12-month trailing EPS fell by 63.97% to ₦1.12, from ₦3.11 recorded in the previous period

According to the management of Flour Mills of Nigeria Plc, the reduction in finance costs came as a result of deleveraging strategy.

Fig. 8: PBT, PAT and Tax Margin – 3M'19-12M'22F



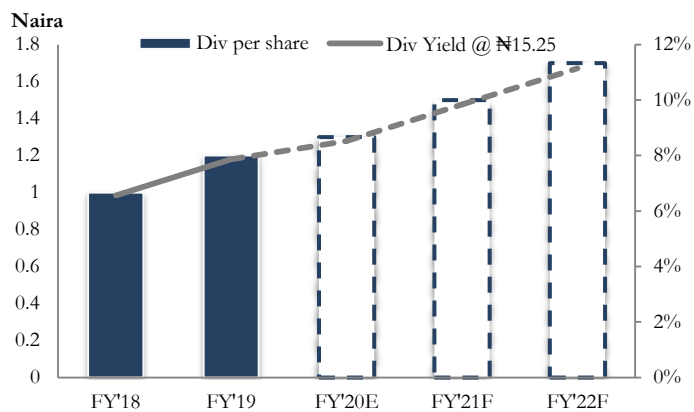
Source: NSE, PAC Research

Balance sheet remains strong; Expectation of improved dividend payment in FY'20

FMN Plc reported improved balance sheet in the first quarter of 2019/20 as total assets increased by 1.28% to ₦420.17 billion (vs. ₦414.88 in the first quarter of 2018/19). The improvement in total asset can be mainly attributed to higher investment in property, plant and equipment, more inventories and higher trades and other receivables. However, total liabilities of the company increased by 1.67% to ₦264.97 billion in Q1'19/20 (vs. ₦260.62 billion in Q1'18/19), mainly as a result of higher long term borrowings. Long term borrowing increased by 42.38% to ₦55.30 billion in Q1'19/20 (vs. ₦38.84 billion in Q1'18/19). Consequently, net assets improved by 0.62% to ₦155.21 billion (vs. ₦154.25 billion reported in Q1'18/19), with net assets per shares increasing to ₦37.85 in Q1'19/20 (vs. ₦37.62 in Q1'18/19). The company paid an improved dividend per share of ₦1.20 in FY'18/19 (vs. ₦1.00 dividend per share payment in 2017/18). We expect the company to pay a higher dividend per share in FY'19/20 as the current first quarter EPS remains solid at ₦1.03 (vs. ₦0.90 recorded in previous period).

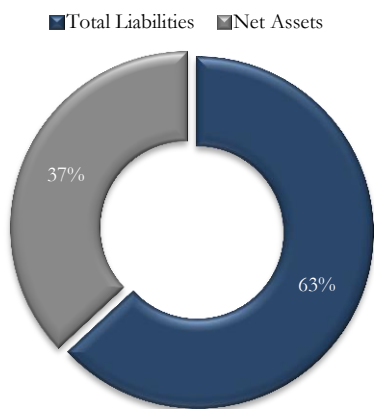
We expect the company to pay a higher dividend per share in FY'19/20 as the current first quarter EPS remains solid at ₦1.03 (vs. ₦0.90 recorded in previous period).

Fig. 9: Dividend Per Share and Dividend Yield – FY'18-FY'22F



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in Q1'20



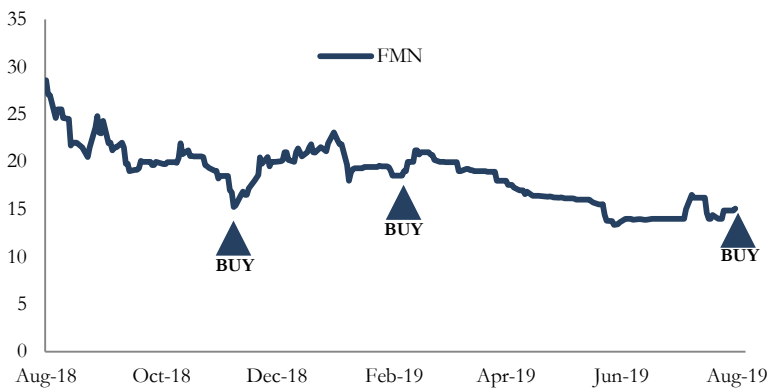
Source: NSE, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦19.32 and this shows that the stock is undervalued by 26.71% at the current market price of ₦15.25. In arriving at the target price, we employed dividend discount methodology. Consequently, we maintained **BUY** recommendation on the stock of the company. Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company, the challenging operating environment in Nigeria, increased competition within the industry and outlook from the management.

Our valuation puts the target price of the stock at ₦19.32 and this shows that the stock is undervalued by 26.71% at the current market price of ₦15.25.

Fig. 11: Share Price History



Source: NSE, PAC Research

Fig. 12: Statement of Profit or Loss, N'mn

	2018	2019	2020E	2021F
Revenue	542,670	527,405	530,833	539,538
<i>Change</i>		-2.81%	0.65%	1.64%
Cost of sales	-473,895	-474,057	-472,441	-474,794
<i>Change</i>		0.03%	-0.34%	0.50%
Gross profit	68,775	53,348	58,392	64,745
<i>Change</i>		-22.43%	9.46%	10.88%
Selling and distr exp.	-6,180	-8,166	-8,759	-9,442
<i>Change</i>		32.13%	7.26%	7.80%
Administrative exp.	-19,423	-19,424	-20,172	-20,502
<i>Change</i>		0.00%	3.85%	1.64%
Net Op. gains (losses)	5,943	6,211	1,592	2,698
<i>Change</i>		4.51%	-74.36%	69.40%
Operating profit	48,423	32,297	31,054	37,498
<i>Change</i>		-33.30%	-3.85%	20.75%
investment income	816	769	637	755
<i>Change</i>		-5.85%	-17.12%	18.58%
Profit Before Tax	16,542	10,174	13,749	20,988
<i>Change</i>		-38.49%	35.13%	52.66%
Taxation	-2,926	-6,174	-3,437	-6,296
<i>Change</i>		111.01%	-44.33%	83.19%
Profit After Tax	13,616	4,000	10,311	14,692
<i>Change</i>		-70.62%	157.78%	42.48%

Fig. 13: Statement of Financial Position, N'mn

	2018	2019	2020E	2021F
Property plant and equip.	217,901	221,465	222,950	226,606
Investment property	1,842	1,738	1,858	1,888
Goodwill	4,148	4,148	4,198	4,267
Deferred tax	6,460	3,964	3,079	3,129
Long term receivables	944	1,402	1,115	1,133
Inventories	111,373	118,867	119,172	121,126
Biological assets	180	18	106	108
Trade and other rec.	19,083	26,085	25,055	25,466
Total Assets	408,348	416,822	418,261	425,121
Bank overdraft	19,934	9,651	14,598	14,837
Trade & other payables	56,994	79,040	79,625	80,931
Borrowings	103,923	71,053	58,392	59,349
Retirement benefit oblig.	5,194	5,848	6,370	6,474
Long service award	1,948	2,183	1,911	1,942
deferred tax	12,308	10,588	11,360	11,546
Total liabilities	257,731	265,849	260,108	264,266
Net Assets	150,617	150,972	158,153	160,855

Fig. 14: Profitability Ratio

	2018	2019	2020E	2021F
Gross profit margin	12.67%	10.12%	14.00%	14.00%
Net Profit Margin	2.51%	0.76%	1.94%	2.72%
operating profit margin	8.92%	6.12%	8.80%	8.80%
Return on Equity	9.04%	2.65%	6.52%	9.13%
Return on Assets	3.33%	0.96%	2.47%	3.46%
ROCE	20.37%	0.33%	0.26%	0.30%

Fig. 15: Asset Utilisation

	2018	2019	2020E	2021F
cash/.sales	0.04	0.03	0.04	0.04
Sales to inventory (x)	4.87	4.44	4.45	4.45
Sales to total assets (x)	1.33	1.27	1.27	1.27
sales/EBITDA	9.03	-23.04	-29.59	-31.25
Sales to total fixed assets	2.49	2.38	2.38	2.38
Equity multiplier	2.71	2.76	2.64	2.64

Fig. 16: Liquidity Ratios

	2018	2019	2020E	2021F
Quick ratio	0.31	0.33	0.36	0.36
Current ratio	0.87	0.98	1.04	1.04
Cash ratio	0.11	0.10	0.11	0.11
Interest Coverage	0.51	0.44	0.77	1.22
Operating Cash Flow Ratio	0.00	0.00	0.00	0.00
Debt/net income	11.25	13.97	6.29	4.49
Debt/operating profit	3.16	72.71	101.83	87.29
Debt to asset	0.38	0.13	0.16	0.16
Debt to equity	1.02	0.84	0.41	0.41
Total liabilities/equity	1.71	1.76	1.64	1.64
Inventory turnover days	85.78	91.52	92.07	93.12
Account receivable days	12.84	18.05	17.23	17.23
Account payable days	43.90	60.86	61.52	62.22

Fig. 17: Shareholders' Investment Ratios

	2018	2019	2020E	2021F
Earnings per share	3.32	0.98	2.51	3.58
DiV per share	1.00	1.20	1.30	1.50
NAVPS	36.73	36.82	38.57	39.23
Earnings yield	21.77%	6.40%	16.49%	23.50%
P/S ratio	0.115	0.119	0.118	0.116

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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