

Flour Mills of Nig. Plc

FMN Reaps the Benefits of Border Closure and Low Interest Rate Environment

INVESTMENT SUMMARY

The recently released unaudited nine-month to December 2019/20 financial results of Flour Mills of Nigeria showed improvement in the top-line as revenue increased by 5.70% to ₦423.48 billion (vs. ₦400.64 billion in nine-month to December 2018/19). The improvement in the top-line can be partly attributed to the benefit derived from the border closure as Sugar segment, Agro-Allied segment and Sugar Value Chain recorded significant growth during the period. The group CFO, Anders Kristiansson, attributed one-third of the growth to the border closure and claimed that the rest of the growth came from underlying operational performance. Total cost of sales increased by 6.10% to ₦375.65 billion in 9M'19/20 (vs. ₦354.05 billion in 9M'18/19), mainly as a result of higher sales during the period and this translates to cost-to-sales ratio of 88.71% (vs. 88.37% in the corresponding period of last year). However, operating profit of the company declined by 9.57% to ₦24.68 billion in 9M'19/20 (vs. ₦27.29 billion reported in 9M'18/19), due to higher administrative and selling expense. The company benefited from the low interest rate environment during the period as finance costs declined significantly by 20.74% to ₦13.12 billion in 9M'19/20 (vs. ₦16.55 billion in 9M'18/19).

Mainly as a result of lower finance costs during the period, profit before tax increased by 8.99% to ₦12.29 billion in 9M'19/20 (vs. ₦11.28 billion in 9M'18/19). Based on the provision of Companies Income Tax Act (CAP C21, LFN), the company made a higher provision of ₦4.13 billion for tax in 9M'19/20 (vs. ₦3.38 billion in 9M'18/19). Consequently, profit after tax rose by 3.36% to ₦8.16 billion (vs. ₦7.90 billion in 9M'18/19). Due to a significant loss after tax in Q4'18/19, 12-month trailing EPS fell by 48.39% to ₦1.04, from ₦2.02 recorded in the previous period. Based on the recent figures released, we upgrade our target price to ₦23.31 (from ₦19.32 previously recommended) and maintain a **HOLD** recommendation.

Fig. 1: Quarterly results highlights

	3Q2020	2Q2020	3Q2019	Q/q Δ	Y/y Δ
Revenue (₦mn)	152,717	136,017	130,904	+12.28%	+16.66%
Operating profit (₦mn)	7,860	7,253	8,016	+8.37%	-1.95%
Net profit (₦mn)	2,257	1,667	2,286	+35.39%	-1.27%

Source: Bloomberg, PAC Research

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Price:

- Current	₦23.00
- Target	₦23.31
Recommendation:	HOLD

* As at Wednesday February 19, 2020

Fig. 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	+16.75%/+9.52%
52-week range	₦24.00 - ₦12.50
30-day Average vol.	3,735,467
Shares Outstanding ('mn)	4,100.38
Market Cap. (₦bn)	94.31
EPS, ₦- 12months trailing	1.04
DPS, ₦- FY2019	1.20

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

Fig. 3: Key ratios

	9M'20	9M'19
Gross profit margin	11.29%	11.63%
COS/Revenue	88.71%	88.37%
Net Profit Margin	1.93%	1.97%
Asset turnover	1.05	0.93

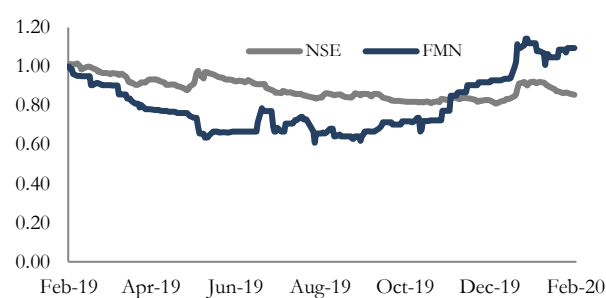
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2018	FY2019	FY2020F	FY2021F
P/E(x)	6.93	23.58	9.15	6.42
P/B(x)	0.63	0.62	0.63	0.61
Div. Yield	4.35%	5.22%	5.65%	7.17%
Payout Ratio	30.11%	123.01%	51.70%	46.05%
Ev/Revenue	0.38	0.37	0.40	0.39
Rev Per Shr	132.35	128.62	129.46	131.58
ROE	9.04%	2.65%	6.88%	9.47%
ROA	3.33%	0.96%	2.47%	3.46%

Source: NSE, PAC Research

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

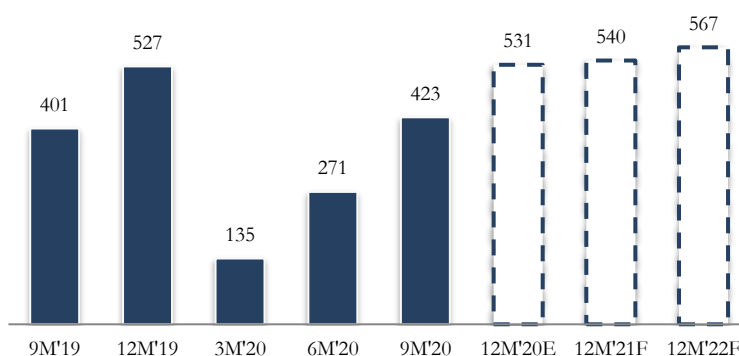


Source: Bloomberg, PAC Research

Border closure impacts top-line as revenue increased by 5.70%: Due to the border closure, the demand for products of Flour Mills of Nigeria increased significantly during the period under review. With impressive growth in Agro Allied segment, Food segment and Sugar Value chain segment, revenue increased by 5.70% to ₦423.48 billion in 9M'19/20 (vs. ₦400.64 billion recorded in 9M'18/19). As a result of a very strong growth in Pasta and improvements in bread flour, revenue from Food segment increased by 2.95% to ₦262.10 billion in 9M'19/20 (vs. ₦254.60 billion in 9M'18/19). In addition, Agro Allied segment continued to benefit from border closure and ban on importation of fertilizer by the Federal Government of Nigeria. This led to improved demand in this segment as revenue improved significantly by 19.56% to ₦81.30 billion in 9M'19/20 (vs. ₦68.00 billion in 9M'18/19) as Fertilizer and Animal feed businesses continued to grow, with edible oil showing positive signs in the period. As a result of increased demand for locally produced sugar, revenue from the Sugar segment of the company rose significantly by 13.42% to ₦67.60 billion (vs. ₦59.60 billion in 9M'18/19). However, Support Services segment recorded a significant decline in revenue as it fell by 32.43% to ₦12.50 billion in the period under review (vs. ₦18.50 billion in 9M'18/19). Food segment remains the largest contributor to revenue as it contributed 61.89% to revenue in 9M'19/20 (9M'18/19: 63.54%). Agro-Allied segment contributed 19.20% to overall revenue (9M'18/19: 16.97%) while Sugar segment contributed 15.96% to overall revenue in 9M'19/20 (vs. 14.87% in 9M'18/19).

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Fig. 6: Revenue – 9M'19-12M'22F (Billion NGN)



Source: NSE, PAC Research

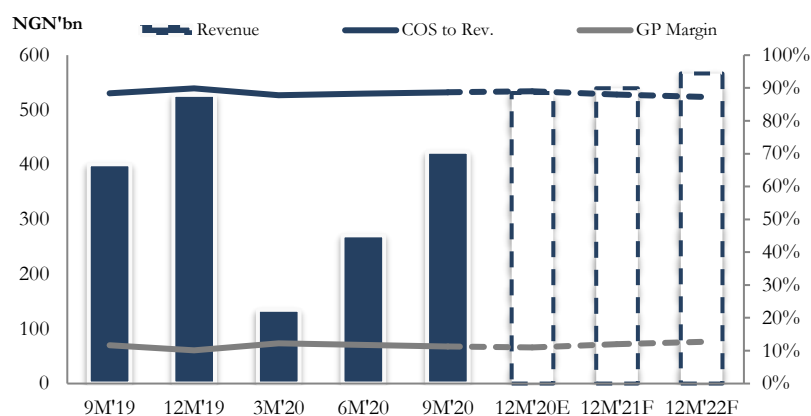
High operating expenses impairs impressive performance: During the period under review, cost of sales increased by 6.10% to ₦375.65 billion in 9M'19/20 (vs. ₦354.05 billion in 9M'18/19). Although, the high cost of sales could be attributed to high demand during the period, however the high cost-to-sale margin remain worrisome as it increased to 88.71% in 9M'19/20 (9M'18/19: 88.37%). The higher cost of sales during the period can be mainly ascribed to higher material costs, increased direct staff costs, high repair and maintenance cost.

The material costs and direct staff costs increased by 5.59% and 12.53% to ₦323.39 billion (9M'18/19: ₦306.25 billion) and ₦12.98 billion (9M'18/19: ₦11.53 billion) respectively in 9M'19/20. In addition, the costs of repair and maintenance increased significantly by 14.41% to ₦7.10 billion in 9M'19/20, from ₦6.20 billion reported in the corresponding quarter of previous year. In the coming years, we assume a reduction in the cost-to-sales margin as we expect the assistance of ₦70.00 million from Flour Milling Association of Nigeria (FMAN) to Wheat Farmers Association of Nigeria in 2018 to boost the country self-sufficiency in wheat production. Also, we expect farmers and agricultural investors in Nigeria to focus on the productions of wheat and other agricultural products to take advantage of border closure.

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As a result of high advertisement cost, high salaries and related staff costs, total selling and distribution expenses increased by 7.95% to ₦6.40 billion in 9M'19/20 (vs. ₦5.93 billion recorded in 9M'18/19). In addition, total administrative expenses rose significantly by 15.56% to ₦17.26 billion in 9M'19/20 (vs. ₦14.94 billion in 9M'18/19) due to higher bank charges, higher general administrative expenses and significant increase in salaries, wages and other staff costs. Consequently, higher operating expenses led to the poor operating performance as operating profit declined by 9.57% to ₦24.68 billion in 9M'19/20 (vs. ₦27.29 billion reported 9M'18/19).

Fig. 7: Revenue, COS to Rev. and GP Margin – 9M'19 - 12M'22F



Source: NSE, PAC Research

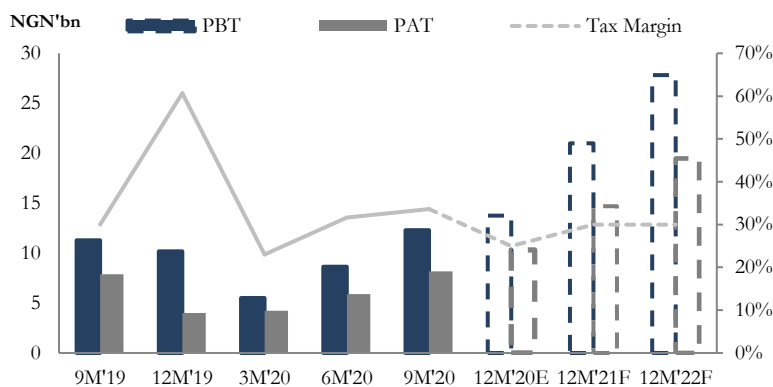
Lower finance costs makes up for unimpressive operating performance as PBT grows by 8.99%: In nine-month to December 2019/20, FMN Plc benefited from the border closure as the company recorded high demand in its three major lines of business – Food, Agro Allied and Sugar Value Chain segments. Meanwhile, higher operating expenses watered down the impressive performance as operating profit declined by 9.57% during the period.

However, FMN recorded impressive figure for finance cost as it declined significantly by 20.74% to ₦13.12 billion (vs. ₦16.55 billion 9M'18/19), as the company took the advantage of lower interest rate in the fixed income market during the period.

With significant reduction in finance costs and benefits derived from the border closure, profit before tax rose by 8.99% to ₦12.92 billion in 9M'19/20 (vs. ₦11.28 billion in 9M'18/19). However, the company made a higher provision of ₦4.13 billion for tax during the period (vs. ₦3.38 billion reported in the corresponding previous period). Consequently, profit after tax increased by 3.36% to ₦8.16 billion, from ₦7.90 billion reported in nine-month to 2018/19. As a result of a significant loss after tax in Q4'18/19, 12-month trailing EPS fell by 48.39% to ₦1.04, from ₦2.02 recorded in the previous period

With significant reduction in finance costs and benefits derived from the border closure, profit before tax rose by 8.99% to ₦12.92 billion in 9M'19/20.

Fig. 8: PBT, PAT and Tax Margin – 9M'19-12M'22F



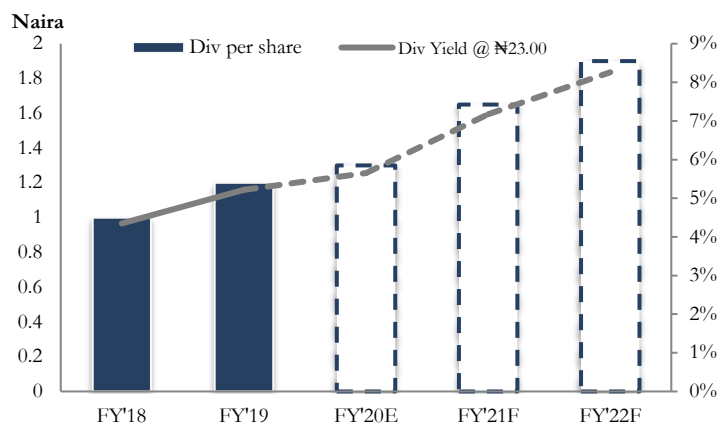
Source: NSE, PAC Research

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

In the third quarter of 2019/20, FMN Plc reported improved balance sheet as net assets increased by 0.92% to ₦154.21 billion (vs. ₦152.80 in the third quarter of 2018/19). This was majorly boosted by the significant improvement in the total liabilities of the company, which declined by 10.23% to ₦250.84 billion in third quarter of 2019/20 (vs. ₦279.42 billion in third quarter of 2019/18). The improvement in total liabilities can be mainly attributed to significantly reduction in bank overdraft and short-term borrowings, as the company positioned for long term borrowing. However, total assets of the company fell by 6.29% to ₦405.04 billion in Q3'19/20 (vs. ₦432.22 billion in Q3'18/19) due to notable reduction in total inventories, trades and other receivables. Consequently, the net assets per share (NAPS) increased to ₦37.61 in Q3'19/20 (vs. ₦37.26 in Q3'18/19). We expect the company to pay a minimum dividend per share of ₦1.30 in FY'19/20 due to current impressive profit after tax and improved balance sheet position.

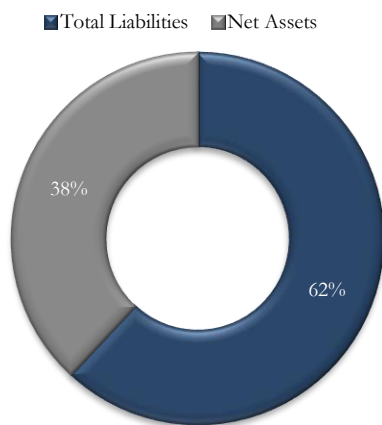
We expect the company to pay a minimum dividend per share of ₦1.30 in FY'19/20 due to current impressive profit after tax and improved balance sheet position.

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



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in Q3'19/20



Source: NSE, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦23.31 and this shows that the stock is almost fairly valued at the current market price of ₦23.00. In arriving at the target price, we employed dividend discount methodology. Consequently, we maintained a **HOLD** 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.

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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
Change		-2.81%	0.65%	1.64%
Cost of sales	-473,895	-474,057	-472,441	-474,794
Change		0.03%	-0.34%	0.50%
Gross profit	68,775	53,348	58,392	64,745
Change		-22.43%	9.46%	10.88%
Selling and distr exp.	-6,180	-8,166	-8,759	-9,442
Change		32.13%	7.26%	7.80%
Administrative exp.	-19,423	-19,424	-20,172	-20,502
Change		0.00%	3.85%	1.64%
Net Op. gains (losses)	5,943	6,211	1,592	2,698
Change		4.51%	-74.36%	69.40%
Operating profit	48,423	32,297	31,054	37,498
Change		-33.30%	-3.85%	20.75%
investment income	816	769	637	755
Change		-5.85%	-17.12%	18.58%
Profit Before Tax	16,542	10,174	13,749	20,988
Change		-38.49%	35.13%	52.66%
Taxation	-2,926	-6,174	-3,437	-6,296
Change		111.01%	-44.33%	83.19%
Profit After Tax	13,616	4,000	10,311	14,692
Change		-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	2,654	2,698
Trade & other payables	56,994	79,040	74,317	72,838
Borrowings	103,923	71,053	53,083	53,954
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	268,336	269,931
Net Assets	150,617	150,972	149,925	155,190

Fig. 14: Profitability Ratio

	2018	2019	2020E	2021F
Gross profit margin	12.67%	10.12%	11.00%	12.00%
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%	6.88%	9.47%
Return on Assets	3.33%	0.96%	2.47%	3.46%
ROCE	20.37%	0.33%	0.24%	0.28%

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	11.36	10.47	9.57
Sales to total fixed assets	2.49	2.38	2.38	2.38
Equity multiplier	2.71	2.76	2.79	2.74

Fig. 16: Liquidity Ratios

	2018	2019	2020E	2021F
Quick ratio	0.31	0.33	0.40	0.41
Current ratio	0.87	0.98	1.19	1.21
Cash ratio	0.11	0.10	0.13	0.13
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	7.98	5.69
Debt/operating profit	3.16	72.71	129.17	110.71
Debt to asset	0.38	0.13	0.20	0.20
Debt to equity	1.02	0.84	0.55	0.54
Total liabilities/equity	1.71	1.76	1.79	1.74
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	57.42	55.99

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	1.65
NAVPS	36.73	36.82	36.56	37.85
Earnings yield	14.44%	4.24%	10.93%	15.58%
P/S ratio	0.174	0.179	0.178	0.175

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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