

# Flour Mills of Nig. Plc

Nigeria | Equities | Consumer Goods | November 12, 2018

PAC RESEARCH

## Unimpressive Performance Due to Logistics Challenges

### INVESTMENT SUMMARY

Flour Mills of Nigeria Plc reported unimpressive figures in its half year 2019 results as core business activities disappointed. Operations in Apapa continues to suffer major setback in logistics and this impacted the top-line as revenue dropped by 9.62% to ₦269.74 billion in H1'19 (vs. ₦298.44 billion in H1'18). However, the poor performance in top-line cuts across all the segments as Foods Segment, Agro-Allied Segment, Sugar Value Chain and Support Services Segment dropped. Although, cost of sales declined by 9.63% to ₦237.62 billion in H1'19 (vs. ₦262.93 billion reported in H1'18), cost-to-sales ratio is a major concern as it remains very high at 88.09% in H1'19 (vs. 88.10% recorded in H1'18). During the period, reduction in material costs and lower rent and rates can be attributed to the overall reduction in cost of sales. The effect of lower revenue outweighed the effect of lower cost of sales and as a result, gross profit declined by 9.56% to ₦32.12 billion in H1'19, from ₦35.51 billion reported in H1'18.

However, the company reported an improvement in non-operating activities as finance costs reduced by 30.79% to ₦11.23 billion in H1'19 (vs. ₦16.27 billion reported in H1'18). The unimpressive performance in the core operating activities outweighed the significant improvement in non-operating activities of the company and as a result, profit before tax declined by 38.40% to ₦8.30 billion in H1'19 (vs. ₦13.48 billion in H1'18). The company made a provision of ₦3.23 billion for tax in H1'19 (vs. ₦4.12 billion in H1'18). Consequently, profit after tax reduced by 45.81% to ₦5.07 billion in H1'19 (vs. ₦9.36 billion in H1'18). The disappointing results reflected on 12-month trailing EPS as it decreased by 20.45% to ₦2.28, from ₦2.86 recorded in the previous period. Based on the recent figures released by the company, we downgrade our target price to ₦21.91. However, we maintain a **BUY** recommendation as the current market price is below the intrinsic value.

Fig. 1: Quarterly results highlights

	2Q2019	1Q2019	2Q2018	Q/q Δ	Y/y Δ
Revenue (₦mn)	136,708	133,029	149,468	+2.77%	-8.54%
Operating profit (₦mn)	8,035	10,610	14,388	-24.27%	-44.15%
Net profit (₦mn)	1,420	3,649	4,822	-61.09%	-70.55%

Source: Bloomberg, PAC Research

Oluwole Adeyeye

oluwole.adeyeye@panafricancapitalholdings.com

Price:

- Current	₦16.50
- Target	₦21.91
<b>Recommendation:</b>	<b>BUY</b>

\* As at Monday November 12, 2018

Fig. 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	-43.10%/-47.12%
52-week range	₦39.50- ₦15.25
30-day Average vol.	2,068,599
Shares Outstanding ('mn)	4,100.38
Market Cap. (₦bn)	63.15
EPS, ₦- 12months trailing	2.28
DPS, ₦- FY2017	1.00

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

Fig. 3: Key ratios

	H1'19	H1'18
Gross profit margin	11.91%	11.90%
COS Margin	88.09%	88.10%
Net ProfitnTurn.	1.88%	3.13%
Asset turnover	0.66	0.74

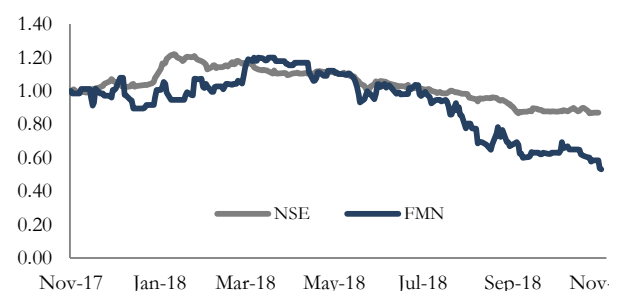
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018F	FY2019F
P/E	7.66	4.97	6.25	4.51
P/B	0.66	0.45	0.44	0.42
Div. Yield	6.06%	6.06%	6.06%	7.88%
Payout Ratio	46.40%	30.11%	37.87%	35.51%
Rev Per Share	-2.85	-2.77	-4.16	-4.30
ROE	127.91	132.35	127.32	136.87
ROA	8.62%	9.04%	7.02%	9.42%
Ev/Revenue	1.83%	3.33%	2.58%	3.46%

Source: NSE, PAC Research

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



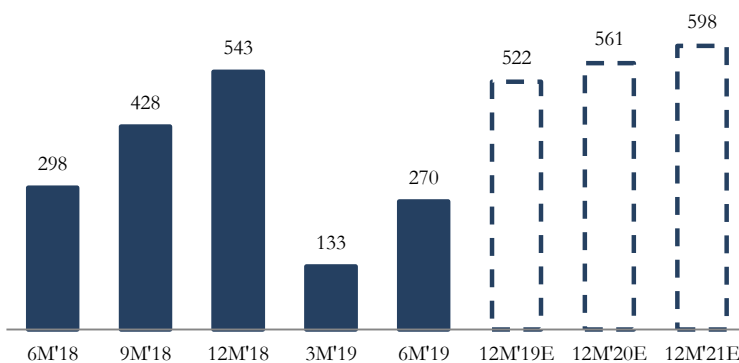
Source: Bloomberg, PAC Research

### Drop in sales volume as operations in Apapa suffer setback in traffic and logistics

During the six-month to September 2018, the company released an unimpressive figure in the top-line as it declined by 9.62% to ₦269.74 billion (vs ₦262.93 billion in six-month to September 2017). The decrease in total revenue can be attributed to lower sales volumes as operations in Apapa continued to suffer major setback in logistics as traffic in Apapa adversely affected the supply of raw materials and distribution of finished goods. Although there were increase in volumes of some product categories, reduction in prices in various product categories offset the increase in those volumes. This resulted in significant drop in Foods Segment, Agro-allied Segment, Sugar Value Chain and Support Services Segment. Food revenue, which contributed 64.32% to total revenue, declined by 7.10% to ₦173.50 billion in H1'19 (vs. ₦186.76 billion in H1'18). Revenue of Agro-allied segment fell by 14.08% to ₦47.02 billion (H1'18: ₦54.72 billion) while Sugar Value Chain's revenue dropped by 15.95% to ₦39.04 billion in H1'19 (H1'18: ₦46.45 billion). The setback in Agro Allied Segment's revenue can be attributed to the increased competition in animal feed segment and struggle in edible oil business.

*The decrease in total revenue can be attributed to lower sales volumes as operations in Apapa continued to suffer major setback in logistics as traffic in Apapa adversely affected the supply of raw materials and distribution of finished goods*

Fig. 6: Revenue – 6M'18-12M'21E (Billion NGN)



Source: NSE, PAC Research

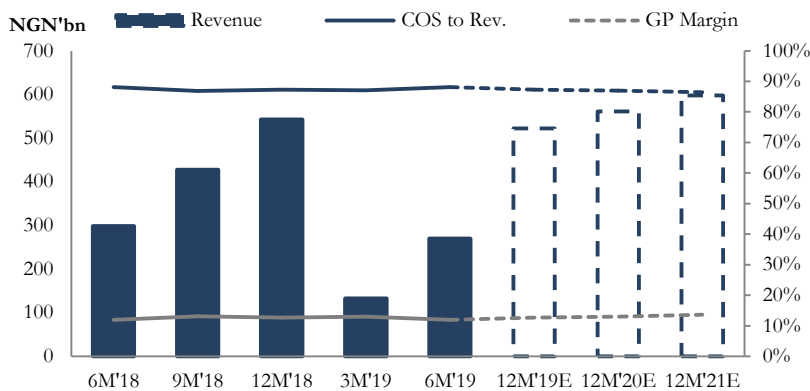
### Lower sales volume translates to lower cost of sales but cost-to-sales ratio remains a major problem

Due to the significant drop in sales volume, cost of sales declined by 9.63% to ₦237.62 billion in H1'19 (vs. ₦262.93 billion reported in H1'18). Cost-to-sales ratio remains a major concern as it remains at 88.09% in the period under review (vs. 88.10% in H1'18). However, the reduction in the cost of sales can be largely ascribed to the reduction in material costs and rent & rates. Material costs, which is the largest contributor to the total cost of sales, fell by 12.11% to ₦206.91 billion in H1'19 (vs. ₦235.43 billion in H1'18) while rent and rates fell by 72.06% to ₦0.33 billion in Q1'19 (vs. ₦1.17 billion in H1'18).

*However, the reduction in the cost of sales can be largely ascribed to the reduction in material costs and rent and rates.*

However, we are not impressed with the high cost-to-sales ratio the company always report as we expected the company to have designed a model to reduce this margin. Cost-to-sales margin remains very high at 88.09% in H1'19 (vs. 88.10 reported in H1'18). Going forward, we expect 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 in April 2018 to boost the country self-sufficiency in wheat production in coming years. The effect of reduction in company's revenue outweighed the effect of reduction in total cost of sales and this reflected on gross profit as it fell by 9.56% to ₦32.12 billion in H1'19, from ₦35.51 reported in H1'18. Due to increase in advertisement expenditure, selling and distribution expenses increased by 49.14% to ₦4.13 billion in H1'19 (₦2.78 billion reported in H1'18). Administrative expenses increased by 17.96% to ₦9.85 billion in H1'19 (vs. ₦8.35 billion in H1'18), mainly driven by higher salaries, wages and other staff costs.

Fig. 7: Revenue, COS to Rev. and GP Margin – 6M'18-12M'21E



Source: NSE, PAC Research

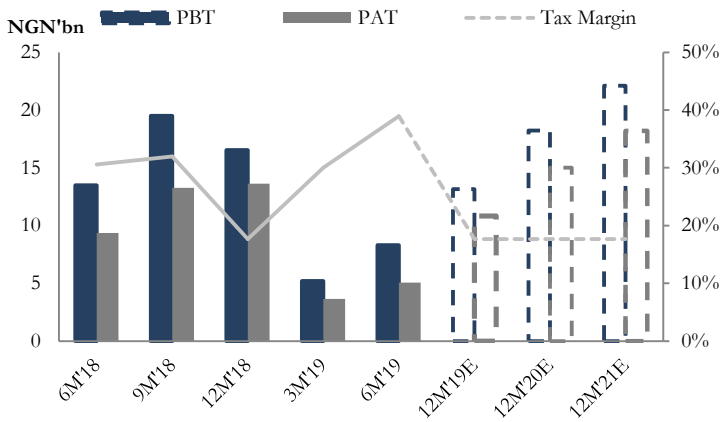
#### Improvement in finance costs lessens the adverse effects of unimpressive operating performance on bottom-line

During the period under review, the company reported a significant improvement in finance costs as it declined by 30.97% to ₦11.23 billion in H1'19 (₦16.27 billion recorded in H1'18), following refining of debts through the right issues as well as lower commercial interest rate. The unimpressive performance from the core operating activities of the company almost pushed the bottom-line to a loss. With significant reduction in finance costs, the company was able to record a profit before tax of ₦8.30 billion in H1'19 (vs. ₦13.48 billion in H1'18), representing a decrease of 38.40%. The company made a provision of ₦3.23 billion for tax in H1'19 (vs. ₦4.12 billion recorded in H1'18). As a result, profit after tax fell by 45.81% to ₦5.07 billion in H1'19, from ₦9.36 billion published in H1'18.

*With significant reduction in finance costs, the company was able to record a profit before tax of ₦8.30 billion in H1'19 (vs. ₦13.48 billion in H1'18)*

However, the disappointing results reflected on 12-month trailing EPS as it decreased by 20.45% to ₦2.28, from ₦2.86 recorded in the previous period.

Fig. 8: PBT, PAT and Tax Margin – 6M'18-12M'21E



Source: NSE, PAC Research

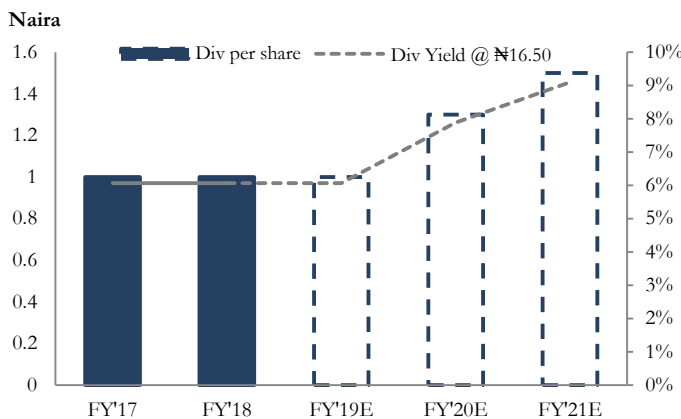
**Balance sheet remains solid as net assets improves by 40.56% YoY**

During the period under review, Flour Mills of Nigeria improved total assets by 0.78% to ₦408.71 billion (vs. ₦405.57 in Q2'18) while total liabilities reduced by 13.63% to ₦257.15 billion in Q2'19 (vs. ₦297.74 billion in Q2'18). Consequently, net assets improved by 40.56% to ₦151.57 billion in Q2'19, from ₦107.83 billion reported in Q2'18. Net Assets Per Shares (NAPS) of the company remains very strong as it increased by 40.56% to ₦36.96 in Q2'19 (vs. ₦26.30 reported in Q2'18).

With the strong position of balance sheet of the company, we expect the company to pay at least ₦1.00 as final dividend in full year of 2019 as 12-month trailing EPS remains solid at ₦2.28 (vs. ₦2.86 recorded in previous period).

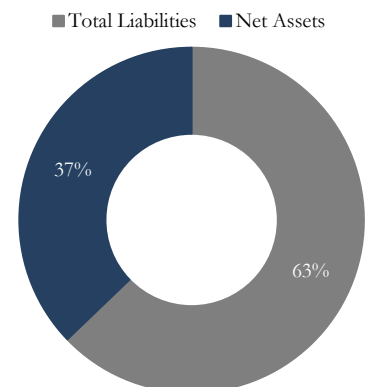
*With the strong position of balance sheet of the company, we expect the company to pay at least ₦1.00 as final dividend in full year of 2019...*

Fig. 9: Dividend Per Share and Dividend Yield – FY'17-FY'21E



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in Q2'19



## Valuation

Our valuation puts the target price of the stock at ₦21.91 and this shows that the stock is undervalued by 32.79% at the current market price of ₦16.50. In arriving at the target price, we employed discounted cashflow valuation 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 ₦21.91 and this shows that the stock is undervalued by 32.79% at the current market price of ₦16.50.*

**Fig. 11: Share Price History**



Source: NSE, PAC Research

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

	2017	2018	2019E	2020E
Revenue	524,464	542,670	522,049	561,203
<i>Change</i>		3.47%	-3.80%	7.50%
Cost of sales	-457,775	-473,895	-455,801	-488,246
<i>Change</i>		3.52%	-3.82%	7.12%
Gross profit	66,689	68,775	66,248	72,956
<i>Change</i>		3.13%	-3.67%	10.13%
Selling and distr exp.	-5,341	-6,180	-8,875	-9,260
<i>Change</i>		15.71%	43.60%	4.34%
Administrative exp.	-18,420	-20,115	-22,448	-24,693
<i>Change</i>		9.21%	11.60%	10.00%
Net Op. gains (losses)	-1,488	5,943	2,349	3,367
<i>Change</i>		-499.36%	-60.47%	43.33%
Operating profit	41,440	48,423	37,274	42,371
<i>Change</i>		16.85%	-23.02%	13.67%
investment income	1,562	816	940	1,122
<i>Change</i>		-47.75%	15.11%	19.44%
Profit Before Tax	10,473	16,542	13,156	18,239
<i>Change</i>		57.95%	-20.47%	38.64%
Taxation	-1,636	-2,926	-2,327	-3,226
<i>Change</i>		78.81%	-20.46%	38.64%
Profit After Tax	8,836	13,616	10,828	15,013
<i>Change</i>		54.09%	-20.47%	38.64%

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

	2017	2018	2018E	2019E
Property plant and equip.	216,866	217,901	219,261	225,042
Investment property	1,929	1,842	1,920	2,064
Goodwill	4,148	4,148	4,129	4,439
Deffered tax	1,846	6,460	6,526	6,734
Long term recievables	989	944	984	1,058
Inventories	117,296	111,373	104,410	112,241
Biological assets	558	180	261	281
Trade and other rec.	21,403	19,083	21,304	22,902
Total Assets	482,599	408,348	419,768	433,573
Bank overdraft	49,023	19,934	26,102	28,060
Trade & other payables	94,567	56,994	57,425	61,732
Borrowings	141,702	103,923	104,410	101,016
Retirement benefit oblig.	3,676	5,194	522	561
Long service award	1,568	1,948	1,879	2,020
deffered tax	7,819	12,308	11,485	12,346
Total liabilities	380,054	257,731	265,583	274,165
Net Assets	102,545	150,617	154,185	159,407

**Fig. 14: Profitability Ratio**

	2017	2018	2019E	2020E
Gross profit margin	12.72%	12.67%	14.00%	14.00%
Net Profit Margin	1.68%	2.51%	2.07%	2.68%
operating profit margin	7.90%	8.92%	8.80%	8.80%
Return on Equity	8.62%	9.04%	7.02%	9.42%
Return on Assets	1.83%	3.33%	2.58%	3.46%
ROCE	24.52%	20.37%	0.44%	0.50%

**Fig. 15: Asset Utilisation**

	2017	2018	2019E	2020E
cash/.sales	0.09	0.04	0.04	0.04
Sales to inventory (x)	4.47	4.87	5.00	5.00
Sales to total assets (x)	1.09	1.33	1.24	1.29
sales/EBITDA	8.97	9.03	-20.83	-22.22
Sales to total fixed assets	2.42	2.49	2.38	2.49
Equity multiplier	4.71	2.71	2.72	2.72

**Fig. 16: Liquidity Ratios**

	2017	2018	2019E	2020E
Quick ratio	0.45	0.31	0.39	0.37
Current ratio	0.83	0.87	0.89	0.91
Cash ratio	0.15	0.11	0.10	0.10
Interest Coverage	0.32	0.51	0.53	0.72
Operating Cash Flow Ratio	0.00	0.00	0.00	0.00
Debt/net income	27.74	11.25	5.79	4.49
Debt/operating profit	5.91	3.16	66.67	60.00
Debt to asset	0.51	0.38	0.15	0.16
Debt to equity	2.39	1.02	1.08	0.42
Total liabilities/equity	3.71	1.71	1.72	1.72
Inventory turnover days	93.52	85.78	83.61	83.91
Account receivable days	14.90	12.84	0.18	0.18
Account payable days	75.40	43.90	45.99	46.15

**Fig. 17: Shareholders' Investment Ratios**

	2017	2018	2019E	2020E
Earnings per share	2.16	3.32	2.64	3.66
DiV per share	1.00	1.00	1.00	1.30
NAVPS	25.01	36.73	37.60	38.88
Earnings yield	13.06%	20.12%	16.01%	22.19%
P/S ratio	0.12	0.12	0.12	0.11

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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**PanAfrican Capital Holdings Ltd**

8A, Elsie Femi Pearse Street

Victoria Island

Lagos, Nigeria

Tel: +234 (1) 2716899, 2718630

[www.panafricancapitalholdings.com](http://www.panafricancapitalholdings.com)