

# Flour Mills of Nig. Plc

## Resilient Performance as all the Business Segments Record Strong Growth in H1'21/22

### INVESTMENT SUMMARY

Flour Mills of Nigeria continued with impressive performance in the first half of 2021/2022 as revenue improved significantly by 47.23% to ₦522.82 billion (vs. ₦355.11 billion in the first half 2020/21). The increase in the top-line was driven by the strong volume growth across the board as Food segment, Agro-allied segment and Support segment recorded, at least, 40% growth in revenue while the revenue from the Sugar segment grew by 19% during the period. However, the cost of sales increased significantly by 53.67% to ₦468.41 billion in H1'21/22 (vs. ₦304.82 billion in H1'20/21), due to improved production volumes and higher input costs (domestic and imported inputs) during the period. In addition, the administrative, selling and distribution expenses rose by 31.15% to ₦22.84 billion in H1'21/22 (vs. ₦17.42 billion reported in H1'20/21) due to higher expenses on advertisement, sales, salaries, wages and other staff costs, among others. Despite the higher operating expenses, the EBITDA of the company improved slightly by 0.72% to ₦36.00 billion in H1'21/22 (vs. ₦35.74 billion in H1'20/21).

The replacement of expensive short-term facilities with long-term loans resulted in a lower net finance cost of ₦8.57 billion in H1'21/22, when compared with ₦9.13 billion reported in H1'20/21. With impressive performance across the board, the profit before tax grew by 6.00% to ₦15.48 billion in H1'21/22 (vs. ₦14.61 billion in H1'20/21). The company made a higher provision of ₦4.95 billion for tax in H1'21/22 (vs. ₦4.67 billion in H1'20/21). Despite the higher tax provision, the company improved its profit after tax by 6.00% to ₦10.53 billion (vs. ₦9.93 billion in H1'20/21) and this resulted in 12-month trailing Earnings Per Share (EPS) of ₦6.42 in H1'21/22. Based on the recent figures released, we hereby upgrade our target price to ₦36.26 (Previous TP: ₦31.73) and upgrade to a **BUY** recommendation.

Fig. 1: Quarterly results highlights

	2Q2022	1Q2022	2Q2021	Q/q Δ	Y/y Δ
Revenue (₦mn)	289,118	233,703	200,530	+23.71%	+44.18%
Operating profit (₦mn)	12,540	11,515	12,741	+8.90%	-1.58%
Net profit (₦mn)	5,082	5,446	4,962	-6.68%	+2.42%

Source: Bloomberg, PAC Research

November 24, 2021

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#### Price:

- Current	₦29.75
- Target	₦36.26
<b>Recommendation:</b>	<b>BUY</b>

\* As at Tuesday November 23, 2021

Fig. 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	+14.42%/+7.21%
52-week range	₦35.00 - ₦24.65
30-day Average vol.	3,526,523
Shares Outstanding (mn)	4,100.38
Market Cap. (₦bn)	121.99
EPS, ₦- 12months trailing	6.42
DPS, ₦- FY2021	1.65

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

Fig. 3: Key ratios

	H1'22	H1'21
Gross profit margin	10.41%	14.16%
COS/Revenue	89.59%	85.84%
Net Profit Margin	2.01%	2.80%
Asset turnover	0.98	0.72

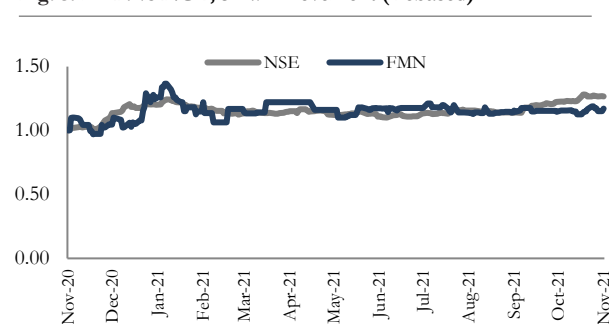
Source: NGX, PAC Research

Fig. 4: Valuations

	FY2020	FY2021	FY2022F	FY2023F
P/E(x)	10.72	4.74	3.91	3.52
P/B(x)	0.78	0.70	0.69	0.62
Div. Yield	4.71%	5.55%	5.55%	8.40%
Payout Ratio	50.46%	26.31%	21.71%	29.56%
Ev/Revenue	3.39	2.72	2.36	2.22
Rev Per Shr.	139.93	188.18	254.04	279.45
ROE	7.30%	14.73%	17.54%	17.74%
ROA	2.63%	4.72%	5.58%	5.64%

Source: NGX, PAC Research

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



Source: Bloomberg, PAC Research

**Revenue grows by 47.23% year-on-year as all the business segments**

**maintain double-digit growth:** In six-month to September 2021/22, the revenue of Flour Mills of Nigeria grew by 47.23% to ₦522.82 billion (vs ₦355.11 billion reported in the six-month to September 2020/21) due to the significant growth recorded in all the business segments of the company. Specifically, revenue of Food segment, which contributed about 65% to overall revenue of the group, improved by 56.30% to ₦337.45 billion in H1'21/22 (vs. ₦215.90 billion in H1'20/21). This can be attributed to the improved demand and expansion into northern market, which also resulted in 30% rise in Business-to-Business (B2B) and 20% growth in Business to Consumer (B2C) volumes. The breakdown of the volume growth in the core B2C categories shows that the volume of Flour, Ball Food, Noodles and Pasta improved by 35%, 12%, 12% and 9% respectively.

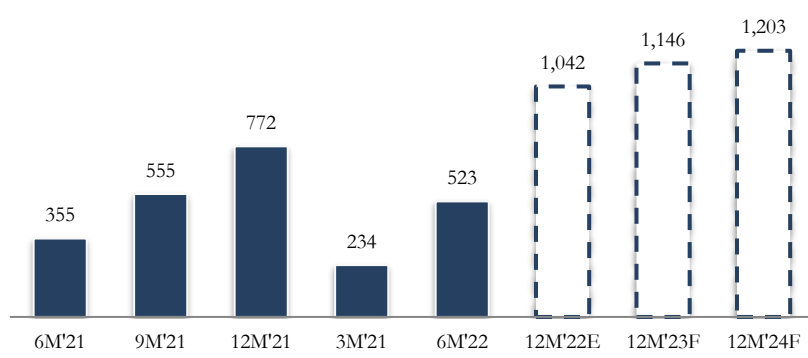
Also, the revenue of Agro-Allied segment improved by 40.25% to ₦101.06 billion in H1'21/22 (vs. ₦72.06 billion in H1'20/21), driven by 18% revenue growth in the Oil and Fats value chain and 14% volume growth in fertilizers. The growth in Oil and Fats value chain was driven by local demand and export sales, with progress in its toll milling activities in the North to increase market penetration.

Despite the global supply chain challenges, the revenue of the Sugar segment of FMN increased by 19.44% to ₦69.50 billion in H1'21/22 (vs. ₦58.19 billion in H1'20/21), which was driven by increase in demand for locally produced sugar during the period. In addition, the revenue of Support segment of the company improved significantly by 65.14% to ₦14.81 billion in H1'21/22 (vs. ₦8.97 billion in H1'20/21), largely driven by increased demand in Bagco (increased demand in locally produced packaging materials, Zero Fly and Hermetic Bags).

The proposed acquisition of 71.69% stake in Honeywell Flour Mill Plc (HFMP), extension of blending plants and sales outlets, as well as expansion of fertilizers business into northern and eastern markets is expected to improve the revenue of the company in the coming quarters. In addition, the installation of more Pasta line and exploration of opportunities in Brown Sugar packaging most likely continue to boost revenue in coming quarters.

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**Fig. 6: Revenue – 6M'21 – 12M'24F (Billion NGN)**



Source: NGX, PAC Research

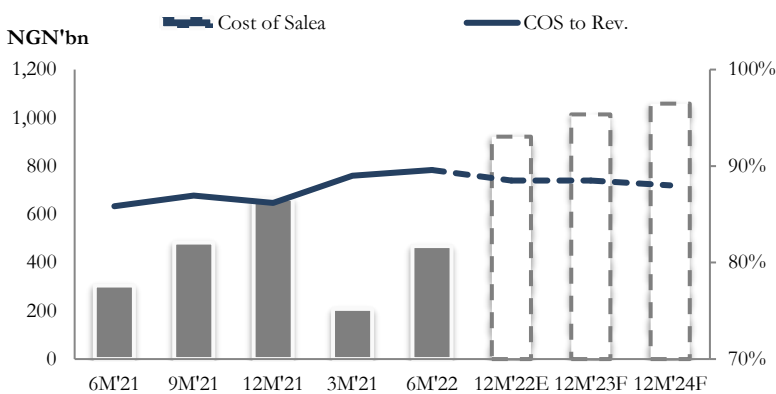
**Cost of sales rises by 53.67% year-on-year, driven by higher production**

**volumes and higher input costs:** The cost of sales of Flour Mills of Nigeria accelerated by 53.67% to ₦468.41 billion in the first half of 2021/22, when compared with ₦304.82 billion recorded in the first half of 2020/21. The increase in the cost of sales was mainly driven by higher production volumes and higher input costs during the period. Specifically, the material costs, which constitutes about 90% of the total cost of sales, increased by 58.54% to ₦422.78 billion in H1'21/22 (H1'20/21: ₦266.68 billion). Although, the improved volume growth and higher input costs contributed to the overall rise in the cost of sales, the cost-to-sales margin which increased significantly to 89.59% in H1'21/22 (from 85.84% in H1'20/21), continued to pose a major threat to the profitability of the company. We maintain that FMN should strengthen its cost-minimization strategy as this will support the profitability of the company going forward.

In addition to the higher cost of sales, the administrative, selling and distribution expenses of the company increased by 31.15% to ₦22.84 billion in H1'21/22 (vs. ₦17.42 billion reported in H1'20/21), due to higher expenses on advertisement, sales, salaries, wages and other staff costs, among others. We may likely see further increase in the expenses on selling, distribution, and administration in the coming quarters due to the relatively higher inflation rate in the country and expectation of higher production volumes.

*We maintain that FMN should strengthen its cost-minimization strategy as this will support the profitability of the company going forward*

Fig. 7: Cost of Sale and COS to Revenue – 6M'21 – 12M'24F



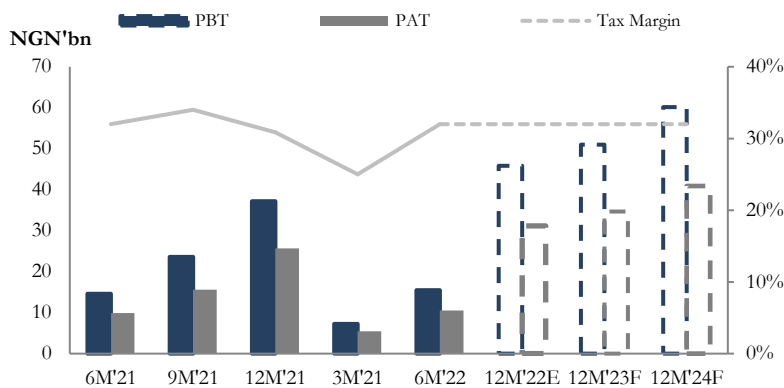
Source: NGX, PAC Research

**Despite the higher operating expenses, PBT improves by 6.00% year-on-**

**year:** In addition to the impressive operation performance recorded during the period, the net finance costs of the company fell by 6.06% to ₦8.57 billion in H1'21/22 (vs. ₦9.13 billion in H1'20/21), mainly because of lower finance costs as the company continued to benefit from its decision to replace the expensive short-term facilities with long-term loans.

With the impressive performance recorded across the board, the profit before tax improved by 6.00% to ₦15.48 billion in H1'21/22 (vs. ₦14.61 billion in H1'20/21). However, the company made a higher provision of ₦4.95 billion for tax in the first half of 2021/22 (vs. ₦4.67 billion in the first half of 2020/21). Despite the higher provision for tax during the period, profit after tax grew by 6.00% to ₦10.53 billion in first half of 2021/22 (vs. ₦9.93 billion reported in the first half of 2020/21).

Fig. 8: PBT, PAT and Tax Margin – 6M'21 - 12M'24F



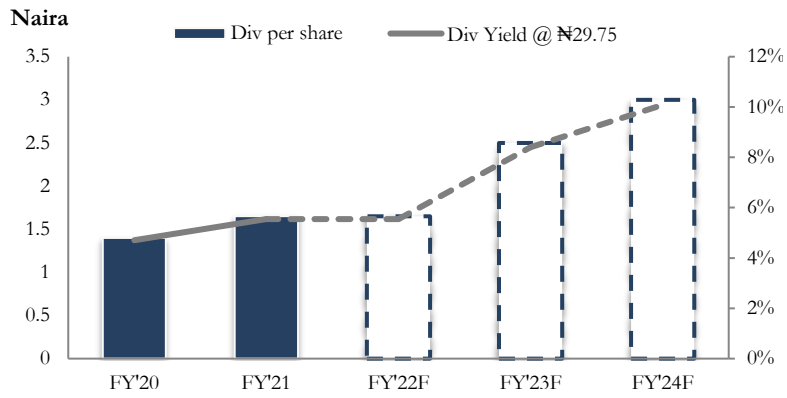
Source: NGX, PAC Research

**Balance sheet remains strong: Expectation of dividend payment in FY'21/22:** In the second quarter of 2021/22, Flour Mills of Nigeria maintained a healthy balance sheet as the total assets of the company grew by 7.98% to ₦536.09 billion (vs. ₦496.45 billion in first quarter of 2020/21), driven mainly by the progress recorded in the current assets during the period. The current assets improved by 15.52% to ₦298.04 billion in Q2'21/22 (vs. ₦258.01 billion in Q2'20/21), driven by 46.93% increase in inventory and 65.45% increase in prepayment and deposit for import during the period. However, the total liabilities of the company grew by 6.32% to ₦357.72 billion in Q2'21/22 (vs. ₦336.46 billion in Q2'20/21), due to the significant increase in customer deposits, long term borrowing and deferred tax payables, among others. The rise in the total assets outweighed the increase in the total liabilities of the company during the period. Consequently, the net assets grew by 11.48% to ₦178.37 billion in Q2'21/22 (vs. ₦160.00 billion in Q2'20/21), and this resulted in a net assets per share (NAPS) of ₦43.50 (Q2'20/21: ₦39.02).

Although, we assume that Flour Mills of Nigeria will maintain its historical dividend payment, we may likely see a slowdown in the growth of final dividend payment in the FY'21/22. This is because the company needs to dip its hands into the balance sheet to complete the proposed acquisition of 71.69% stake in Honeywell Flour Mill Plc (HFMP). However, we may likely see improved dividend payment in the long term as we expect the acquisition to improve the economies of scale, raise productivity, reduce competition, and increase the profitability of the company going forward.

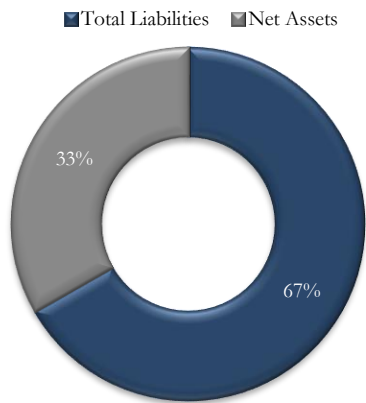
*Although, we assume that Flour Mills of Nigeria will maintain its historical dividend payment, we may likely see a slowdown in the growth of final dividend payment in the FY'21/22.*

**Fig. 9: Dividend Per Share and Dividend Yield – FY'20-FY'24F**



Source: NGX, PAC Research

**Fig. 10: Total Liabilities Vs Net Asset in Q2'21/22**



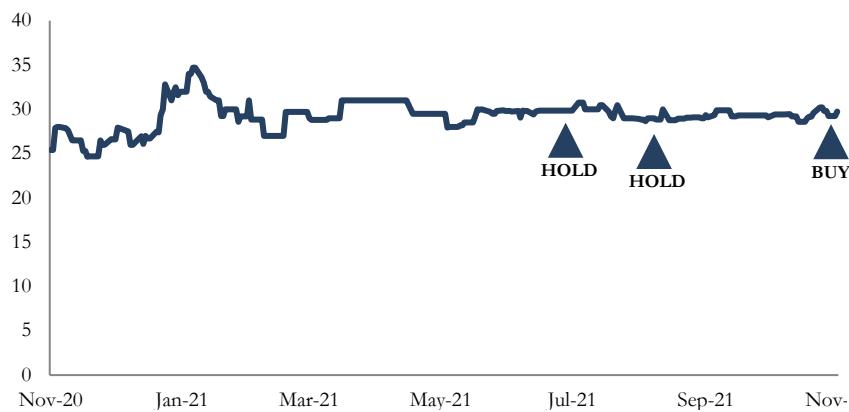
Source: NGX, PAC Research

## Valuation

Our valuation puts the target price of the stock at ₦36.26, representing an increase of 21.89% from the current market price of ₦29.75. In arriving at the target price, we employed dividend discount model and residual income valuation methodology. Consequently, we upgraded to **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 proposed acquisition of Honeywell Flour Mill Plc (HFMP) and the outlook from the management.

*Our valuation puts the target price of the stock at ₦36.26, representing an increase of 21.89% from the current market price of ₦29.75.*

**Fig. 11: Share Price History (Naira)**



Source: Bloomberg, PAC Research

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

	2020	2021	2022E	2023F
Revenue	573,774	771,608	1,041,671	1,145,838
Change		34.48%	35.00%	10.00%
Cost of sales	-507,987	-664,851	-921,879	-1,014,06
Change		30.88%	38.66%	10.00%
Gross profit	65,787	106,757	119,792	131,771
Change		62.28%	12.21%	10.00%
Selling and distr exp.	-9,278	-12,080	-15,625	-16,615
Change		30.19%	29.35%	6.33%
Administrative exp.	-23,346	-29,046	-31,250	-34,375
Change		24.41%	7.59%	10.00%
Net Op. gains (losses)	4,906	-15,528	-14,583	-16,042
Change		-416.54%	-6.09%	10.00%
Operating profit	35,080	52,197	61,146	67,834
Change		48.79%	17.15%	10.94%
investment income	2,393	3,652	4,479	4,927
Change		52.64%	22.65%	10.00%
Profit Before Tax	17,497	37,194	45,834	50,990
Change		112.57%	23.23%	11.25%
Taxation	-6,120	-11,477	-14,667	-16,317
Change		87.53%	27.80%	11.25%
Profit After Tax	11,377	25,717	31,167	34,673
Change		126.05%	21.19%	11.25%

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

	2020	2021	2022E	2023F
Property plant and equip.	216,890	208,721	208,334	229,168
Investment property	1,633	1,533	1,875	2,063
Goodwill	4,148	4,148	5,417	5,958
Deferred tax	3,578	6,974	7,083	7,792
Long term receivables	359	39	313	344
Inventories	115,596	195,449	197,917	217,709
Biological assets	148	376	1,563	1,719
Trade and other rec.	25,731	25,826	23,958	26,354
Total Assets	432,454	544,732	558,577	614,433
Bank overdraft	5,543	4,001	1,563	1,719
Trade & other payables	83,614	120,152	109,375	120,313
Borrowings	23,344	26,913	26,042	28,646
Retirement benefit oblig.	7,135	10,397	14,583	16,042
Long service award	2,738	3,713	3,750	4,125
deferred tax	11,849	16,857	20,313	22,344
Total liabilities	276,646	370,119	380,866	418,953
Net Assets	155,808	174,613	177,711	195,480

Fig. 14: Profitability Ratio

	2020	2021	2022E	2023F
Gross profit margin	11.47%	13.84%	11.50%	11.50%
Net Profit Margin	1.98%	3.33%	2.99%	3.03%
operating profit margin	6.11%	6.76%	0.00%	0.00%
Return on Equity	7.30%	14.73%	17.54%	17.74%
Return on Assets	2.63%	4.72%	5.58%	5.64%
ROCE	0.84%	1.09%	1.23%	1.23%

Fig. 15: Asset Utilisation

	2020	2021	2022E	2023F
cash/sales	0.03	0.06	0.04	0.04
Sales to inventory (x)	4.96	3.95	5.26	5.26
Sales to total assets (x)	1.33	1.42	1.86	1.86
sales/EBITDA	9.73	9.83	11.67	11.60
Sales to total fixed assets	2.65	3.70	5.00	5.00
Equity multiplier	2.78	3.12	3.14	3.14

Fig. 16: Liquidity Ratios

	2020	2021	2022E	2023F
Quick ratio	0.50	0.53	0.60	0.60
Current ratio	1.28	1.46	1.62	1.62
Cash ratio	0.12	0.22	0.20	0.20
Interest Coverage	0.88	1.99	2.32	2.34
Operating Cash Flow Ratio	0.00	0.00	0.00	0.00
Debt/net income	7.58	4.11	3.73	3.68
Debt/operating profit	36.03	28.96	25.93	25.93
Debt to asset	0.20	0.19	0.21	0.21
Debt to equity	0.55	0.61	0.65	0.65
Total liabilities/equity	1.78	2.12	2.14	2.14
Inventory turnover days	83.06	107.30	78.36	78.36
Account receivable days	16.37	12.22	8.40	0.55
Account payable days	60.08	65.96	43.31	43.31

Fig. 17: Shareholders' Investment Ratios

	2020	2021	2022E	2023F
Earnings per share	2.77	6.27	7.60	8.46
DiV per share	1.40	1.65	1.65	2.50
NAVPS	38.00	42.58	43.34	47.67
Earnings yield	9.33%	21.08%	25.55%	28.42%
P/S ratio	0.213	0.158	0.117	0.106

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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