

Flour Mills of Nig. Plc

Nigeria | Equities | Consumer Goods | September 13, 2018

PAC RESEARCH

Core Business Activities Suffer as Bottom-Line Declines

INVESTMENT SUMMARY

The first quarter result released by Flour Mills of Nigeria Plc shows a setback in its top-line as core business activities disappointed. Revenue declined by 10.70% to ₦133.03 billion in Q1'19 (vs. ₦148.98 billion in Q1'18), due to disappointing performance in its Foods Segment, Agro-Allied Segment and Packaging Segment. The major reason for the decline in Foods Segment can be ascribed to lower selling prices in Sugar and Flour while increased competition in animal feed market contributed to the setback in Agro-Allied Segment. However, Port Operation and Logistics and Real Estate Segment recorded a significant growth in Q1'19. Although cost of sales declined by 12.12% to ₦115.77 billion in Q1'19 (vs. ₦131.74 billion recorded in Q1'18), cost of sales to revenue ratio remains a major challenge as it stays at 87.02% in Q1'19 (vs. 88.43% reported in Q1'18). Relatively, lower cost of sales can be attributed to the reduction in material costs and reduced rent and rates. The lower cost of sales offsets the reduction in revenue and as a result, gross profit remained almost flat at ₦17.26 billion in Q1'19 (vs. ₦17.24 billion in Q1'18).

In non-operating activities of the business, net operating gain declined by 79.27% to ₦0.65 billion in Q1'19 (vs. ₦3.15 billion reported in Q1'18). The significant drop in net operating gain impacted on the profitability of the company as profit before tax declined by 15.84% to ₦5.21 billion in Q1'19 (vs. ₦6.19 billion reported in Q1'18). The company made a provision of ₦1.56 billion for tax in Q1'19 (vs. ₦1.66 billion in Q1'18) and as a result, profit after tax reduced by 19.47% to ₦3.65 billion in Q1'19 (vs. ₦4.53 billion in Q1'18). However, we are enthralled with the company's 12-month trailing EPS as it increased by 42.21% to ₦3.11 from ₦2.18 recorded in the previous period.

Based on the recent figures released by the company, we recommend a **BUY** position on the company shares at the current price of ₦19.80 as present forward estimate places the company share price at ₦27.92.

Fig. 1: Quarterly results highlights

	1Q2019	4Q2018	1Q2018	Q/q Δ	Y/y Δ
Revenue (₦mn)	133,029	115,162	148,975	+15.51%	-10.70%
Operating profit (₦mn)	10,610	4,558	11,887	+132.78%	-10.74%
Net profit (₦mn)	3,649	369	4,532	+888.89%	-19.48%

Source: Bloomberg, PAC Research

Oluwole Adeyeye

oluwole.adeyeye@panafricancapitalholdings.com

Price:

- Current	₦19.80
- Target	₦27.92
Recommendation:	BUY

* As at Thursday September 13, 2018

Fig. 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	-31.72%/9.20%
52-week range	₦39.50- ₦19.80
30-day Average vol.	1,144,321
Shares Outstanding ('mn)	4,100.38
Market Cap. (₦bn)	81,187.52
EPS, ₦- 12months trailing	3.11
DPS, ₦- FY2017	1.00

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

Fig. 3: Key ratios

	Q1'19	Q1'18
Gross profit margin	12.98%	11.57%
COS Margin	87.02%	88.43%
Net ProfitnTurn.	2.74%	3.04%
Asset turnover	0.32	0.34

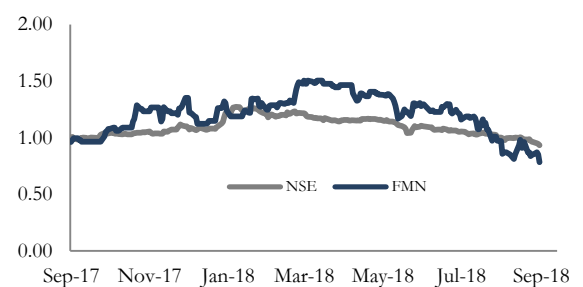
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2016	FY2017	FY2018F	FY2019F
P/E	9.19x	5.96x	6.66x	5.73x
P/B	0.79x	0.54x	0.50x	0.49x
Div. Yield	5.05%	5.05	5.56	6.57
Payout Ratio	46.40	30.11%	37.00%	37.61%
Rev Per Share	127.91	132.35	127.62	135.92
ROE	8.62%	9.04%	7.48%	8.48%
ROA	1.83%	3.33%	2.90%	3.29%
Ev/Revenue	-3.42	-3.34	-4.21	-4.23

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

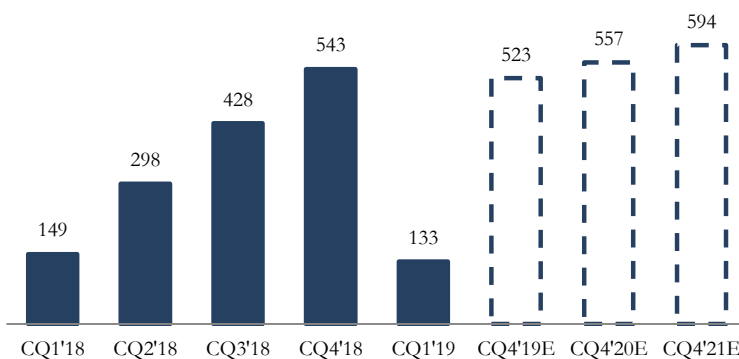
Increased volume offset by lower prices as revenue declines by 10.70% YoY

During the review period, the company recorded a fall in its top line as revenue declined by 10.70% to ₦133.03 billion (vs ₦148.98 billion in Q1'18). The decrease in total revenue can be attributed to significant drop in Foods, Agro-allied, Packaging segment. Food revenue, which contributed 77.89% to total revenue, declined by 10.50% to ₦103.62 billion Q1'19 (vs. ₦115.81 billion in Q1'18). Food revenue growth was driven mostly by Pasta, Noodles and Sugar business, offset by lower selling prices in Sugar and Flour.

Revenue of Agro-allied segment dropped by 9.7% to ₦24.80 billion in Q1'19 (vs. ₦27.48 billion in Q1'18). The edible oil business of agro-allied segment is still struggling to fully deliver its growth objectives while increased competition in animal feed market affected both the top and bottom line. Only fertilizer division of the agro-allied segment reported a very good performance. Packaging segment of the company declined by 21.1% to ₦4.26 billion in Q1'19 (vs. ₦5.40 billion in Q1'18). However, Port Operations & Logistics and Real Estate segments grew by 8.5% and 199.2% to ₦288.13 million and ₦65.93 million in Q1'19 respectively.

Revenue of Agro-allied segment dropped by 9.7% to ₦24.80 billion in Q1'19 (vs. ₦27.48 billion in Q1'18). The edible oil business of agro-allied segment is still struggling to fully deliver its growth objectives...

Fig. 6: Net Revenue – Cum. Quarters – CQ1'18-CQ4'21E (Billion NGN)



Source: NSE, PAC Research

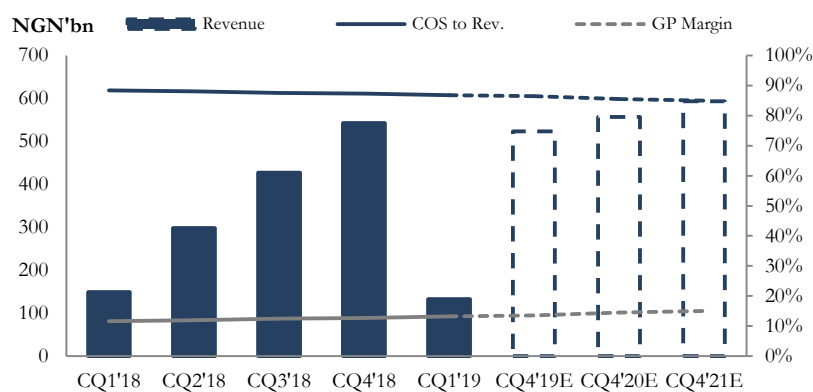
Cost of sales falls but cost of sales to revenue ratio remains a major challenge

The company managed to reduce its cost of sales by 12.12% to ₦115.77 billion in Q1'19 (vs. ₦131.74 billion in Q1'18), sales-to-revenue ratio remains a major concern as it remains at 87.02% in the period under review (vs. 88.43% in Q1'18). However, the reduction in the cost of sales can be largely attributed to the reduction in material costs and rent and rates. Material costs, which is the largest contributor to the total cost of sales, declined by 15.43% to ₦100.15 billion in Q1'19 (vs. ₦118.43 billion in Q1'18) while rent and rates fell by 52.03% to ₦0.63 billion in Q1'19 (vs. 1.32 billion reported in Q1'18).

Material costs, which is the largest contributor to the total cost of sales, declined by 15.43% to ₦100.15 billion in Q1'19 (vs. ₦118.43 billion in Q1'18)...

The reduction in total cost of sales offset the drop in top line and this reflects on gross profit as it increased marginally by 0.13% to ₦17.26 billion in Q1'19, from ₦17.24 reported in Q1'18. Due to higher advertising activities in the food business of the company, selling and administrative expenses increased by 60.96% to ₦2.02 billion in Q1'19, from ₦1.26 billion reported in Q1'18. Administrative expenses increased by 15.62% to ₦4.69 billion in Q1'19 (vs. ₦4.05 billion in Q1'18), mainly driven by higher cost of employment and other general overheads.

Fig. 7: Revenue, COS to Rev. and GP Margin – CQ1'18-CQ4'21E



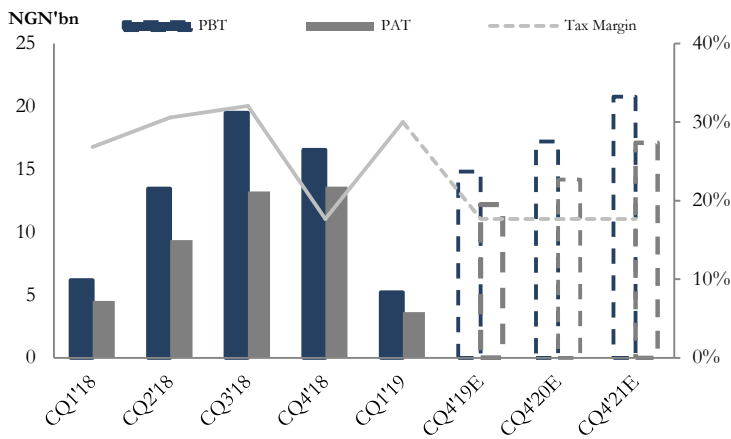
Source: NSE, PAC Research

Lower net operating gain impacts bottom-line as PAT declined by 22.38% YoY

There is a significant reduction in net operating gain of the company, when compared with corresponding previous quarter. Net operating gain reduced by 79.27% to ₦0.65 billion in Q1'19, from ₦3.15 billion reported in Q1'18. Net operating gains in the review period lacks exceptional income from fair value gain on derivatives, which the company benefited from in the corresponding quarter of the previous year. Finance costs declined by 30.53% to ₦6.20 billion in Q1'19 (vs. ₦8.93 billion recorded in Q1'18). Reduction in financial costs can be attributed to the refinancing of debt through the right issue, coupled with lower commercial interest rates. As a result, profit before tax dropped by 15.84% to ₦5.21 billion in Q1'19 (vs. ₦6.21 billion in Q1'18). The company made a provision of ₦1.56 billion for tax in Q1'19 (vs. ₦1.66 billion reported in Q1'18). Consequently, profit after tax declined by 19.47% to ₦3.65 billion in Q1'19, from ₦4.53 billion published in Q1'18. However, we are impressed with the company's 12-month trailing EPS as it increased by 42.21% to ₦3.11 from ₦2.18 recorded in the previous period.

Net operating gains in the review period lacks exceptional income from fair value gain on derivatives, which the company benefited from in the corresponding quarter of the previous year

Fig. 8: PBT, PAT and Tax Margin – CQ1'18-CQ4'21E



Source: NSE, PAC Research

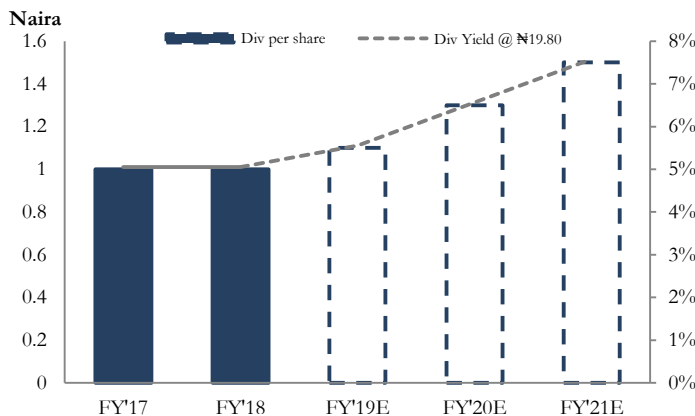
Balance sheet remains strong as net assets improve by 46.02% YoY

During the period, the company’s total assets decreased by 6.46% to ₦414.88 billion (vs. ₦443.52 billion in Q1'18) while total liabilities reduced by 22.87% to ₦260.62 billion in Q1'19 (vs. ₦337.88 billion in Q1'18). Consequently, net assets improved by 46.02% to ₦154.25 billion in Q1'19, from ₦105.64 billion reported in Q1'18. Net Assets Per Shares (NAPS) of the company remains very strong as it increased by 46.02% to ₦37.62 in Q1'19 (vs. ₦22.26 realised in Q1'18).

Looking at the strong position of balance sheet of the company, we expect the company to continue its dividend payment in full year of 2019 as 12-month trailing EPS remains solid at ₦3.11 in Q1'19 (vs. ₦2.18 recorded in Q1'18).

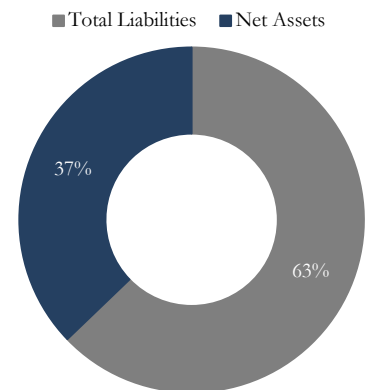
Looking at the strong position of balance sheet of the company, we expect the company to continue its dividend payment in full year of 2019 as 12-month trailing EPS remains solid...

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



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in Q1'19



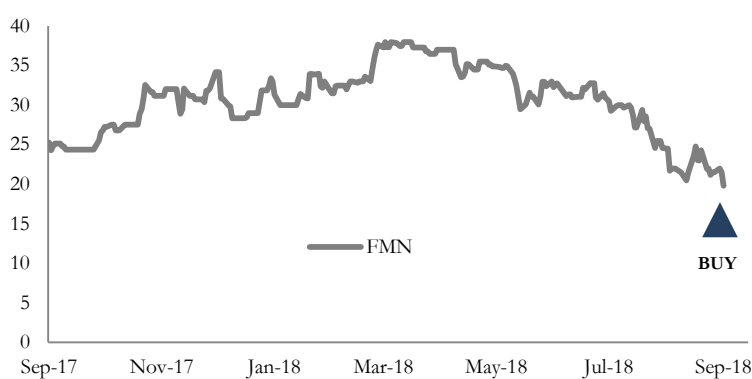
Valuation

Our valuation puts the target price of the stock at ₦27.92 and this shows that the stock is undervalued by 41.02% at current price of ₦19.80. In arriving at the target price, we employed dividend discount model and 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 positive outlook from the management.

Our valuation puts the target price of the stock at ₦27.92 and this shows that the stock is undervalued by 41.02% at current price of ₦19.80

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	523,297	557,311
<i>Change</i>		3.47%	-3.57%	6.50%
Cost of sales	-457,775	-473,895	-454,222	-482,074
<i>Change</i>		3.52%	-4.15%	6.13%
Gross profit	66,689	68,775	69,075	75,237
<i>Change</i>		3.13%	0.44%	8.92%
Selling and distr exp.	-5,341	-6,180	-7,849	-8,694
<i>Change</i>		15.71%	27.01%	10.76%
Administrative exp.	-18,420	-20,115	-22,502	-24,522
<i>Change</i>		9.21%	11.86%	8.98%
Net Op. gains (losses)	-1,488	5,943	1,308	1,672
<i>Change</i>		-499.36%	-77.99%	27.80%
Operating profit	41,440	48,423	40,032	43,693
<i>Change</i>		16.85%	-17.33%	9.15%
investment income	1,562	816	1,989	1,393
<i>Change</i>		-47.75%	143.60%	-29.93%
Profit Before Tax	10,473	16,542	14,809	17,221
<i>Change</i>		57.95%	-10.47%	16.28%
Taxation	-1,636	-2,926	-2,620	-3,046
<i>Change</i>		78.81%	-10.47%	16.28%
Profit After Tax	8,836	13,616	12,190	14,175
<i>Change</i>		54.09%	-10.47%	16.28%

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

	2017	2018	2018E	2019E
Property plant and equip.	216,866	217,901	219,785	223,482
Investment property	1,929	1,842	1,925	2,050
Goodwill	4,148	4,148	4,139	4,408
Deffered tax	1,846	6,460	6,541	6,688
Long term recievables	989	944	987	1,051
Inventories	117,296	111,373	104,659	111,462
Biological assets	558	180	262	279
Trade and other rec.	21,403	19,083	21,355	22,743
Total Assets	482,599	408,348	420,772	430,567
Bank overdraft	49,023	19,934	26,165	27,866
Trade & other payables	94,567	56,994	57,563	61,304
Borrowings	141,702	103,923	104,659	100,316
Retirement benefit oblig.	3,676	5,194	523	557
Long service award	1,568	1,948	1,884	2,006
deffered tax	7,819	12,308	11,513	12,261
Total liabilities	380,054	257,731	257,845	263,347
Net Assets	102,545	150,617	162,927	167,219

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%	2.33%	2.54%
operating profit margin	7.90%	8.92%	8.80%	8.80%
Return on Equity	8.62%	9.04%	7.48%	8.48%
Return on Assets	1.83%	3.33%	2.90%	3.29%
ROCE	24.52%	20.37%	0.93%	0.63%

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	-19.23	-20.00
Sales to total fixed assets	2.42	2.49	2.38	2.49
Equity multiplier	4.71	2.71	2.58	2.57

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	0.54	0.62
Operating Cash Flow Ratio	0.00	0.00	0.00	0.00
Debt/net income	27.74	11.25	4.46	4.09
Debt/operating profit	5.91	3.16	27.37	41.60
Debt to asset	0.51	0.38	0.13	0.13
Debt to equity	2.39	1.02	0.98	0.35
Total liabilities/equity	3.71	1.71	1.58	1.57
Inventory turnover days	93.52	85.78	84.10	84.39
Account receivable days	14.90	12.84	0.18	0.18
Account payable days	75.40	43.90	46.26	46.42

Fig. 17: Shareholders' Investment Ratios

	2017	2018	2019E	2020E
Earnings per share	2.16	3.32	2.97	3.46
DiV per share	1.00	1.00	1.10	1.30
NAVPS	25.01	36.73	39.73	40.78
Earnings yield	10.88%	16.77%	15.01%	17.46%
P/S ratio	0.15	0.15	0.16	0.15

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

IMPORTANT DISCLOSURES

This research report has been prepared by the analyst(s), whose name(s) appear on the front page of this document, to provide background information about the issues which are the subject matter of this report. It is given for information purposes only.

Each analyst hereby certifies that with respect to the issues discussed herein, all the views expressed in this document are his or her own and reflect his or her personal views about any and all of such matters. These views are not necessarily held or shared by PanAfrican Capital or any of its affiliate companies. The analyst(s) views herein are expressed in good faith and every effort has been made to base our opinion on reliable comprehensive information but no representation is made as to its accuracy or completeness. The opinions and information contained in this report are subject to change and neither the analysts nor PanAfrican Capital is under any obligation to notify you or make public any announcement with respect to such change.

This report is produced independently of PanAfrican Capital and the recommendations (if any), forecasts, opinions, estimates, expectations and views contained herein are entirely those of the analysts. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the recommendations, forecasts, opinions, estimates, expectations and views contained herein are fair and reasonable, none of the analysts, PanAfrican Capital nor any of its directors, officers or employees has verified the contents hereof and accordingly, none of the analysts, PanAfrican Capital nor any of its respective directors, officers or employees, shall be in any way responsible for the contents hereof.

With the exception of information regarding PanAfrican Capital, reports prepared by PanAfrican Capital analysts are based on public information. Facts and views presented in this report have not been reviewed and may not reflect information known to professionals on other PanAfrican Capital business areas including investment banking. This report does not provide individually tailored investment advice. Reports are prepared without regard to individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. It is recommended that investors independently evaluate particular investments and strategies. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances or objectives. Neither the analyst(s), PanAfrican Capital, any of its respective directors, officers nor employees accepts any liability whatsoever for any loss so ever arising from any use of this report or its contents or otherwise arising in connection therewith. Each analyst and/or any person connected with any analyst may have acted upon or used the information herein contained, or the research or analysis on which it is based prior to its publication date. This document may not be relied upon by any of its recipients or any other person in making investment decisions.

Each research analyst certifies that no part of his or her compensation was, or will be directly or indirectly related to the specific recommendations (if any), opinions, forecasts, estimates or views in this report. Analysts' compensation is based upon activities and services intended to benefit clients of PanAfrican Capital. As with other employees of PanAfrican Capital, analysts' compensation is impacted by the overall profitability of PanAfrican Capital, which includes revenues from all business areas of PanAfrican Capital.

PanAfrican Capital Holdings Ltd

8A, Elsie Femi Pearse Street

Victoria Island

Lagos, Nigeria

Tel: +234 (1) 2716899, 2718630

www.panafricancapitalholdings.com