Flour Mills of Nig. Plc

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Impressive Performance as FMN Continues to Benefit from Border Closure

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Price:	
- Current	**₦27.60**
- Target	**₦28.50**
Recommendation:	**HOLD**

** As at Tuesday December 1, 2020*

INVESTMENT SUMMARY

The unaudited 2020/21 half year reports released by Flour Mills of Nigeria showed a significant improvement in the top-line as revenue increased by 31.15% to ₦355.11 billion (vs. ₦270.76 billion in the half year of 2019/20). The improvement in the top-line could be attributed to the benefit derived from the border closure as all the business segments of the company recorded significant improvement during the period: Food segment, Agro-Allied segment, Sugar Value Chain and Support Segment recorded impressive growth. The cost of sales increased by 27.55% to ₦304.82 billion in H1'20/21 (vs. ₦238.99 billion in H1'19/20), mainly as a result of higher sales during the period and this translated to a lower cost-to-sales ratio of 85.84%, when compared with 88.26% recorded in the corresponding period of previous year. Mainly as a result of improved salaries, wages and other staff costs, the administrative expenses of the company increased by 23.71% to ₦13.01 billion in H1'20/21 (vs. ₦10.52 billion reported in H1'19/20) However, the selling and distribution expenses was almost flat at ₦4.41 billion in H1'20/21 (vs. ₦4.48 billion reported in H1'19/20). With the impressive operating performance, EBITDA improved by 66.95% to ₦44.60 billion in H1'20/21 (vs. ₦26.71 billion in H1'19/20).

Mainly as a result of lease costs (new IFRS 16) accounting adjustment of about ₦0.80 billion for this year, finance costs rose by 12.59% to ₦9.95 billion in H1'20/21 (vs. ₦8.84 billion in H1'19/20). With the impressive operating performance, profit before tax rose significantly by 69.17% to ₦14.61 billion in H1'20/21 (vs. ₦8.63 billion in H1'19/20). However, the company made a provision of ₦4.67 billion for tax in H1'20/21 (vs. ₦2.73 billion in H1'19/20). Consequently, profit after tax improved by 68.26% to ₦9.93 billion (vs. ₦5.90 billion in H1'19/20). Based on the recent figures released, we upgrade our target price to ₦28.50 (from ₦23.31 previously recommended) and downgrade to a **HOLD** recommendation.

Fig. 1: Quarterly results highlights

	2Q2021	1Q2021	2Q2020	Q/q Δ	Y/y Δ
Revenue (₦'mn)	200,530	154,579	136,016	+29.73%	+47.43%
Operating profit (₦'mn)	12,741	10,991	6,926	+15.92%	+83.96%
Net profit (₦'mn)	4,962	4,971	1,667	-0.18%	+197.7%

Source: Bloomberg, PAC Research

Fig. 2: Stock data

FYE	March
Price Mov't: YtD / 52wk	+40.10%/+51.23%
52-week range	₦30.95 - ₦17.00
30-day Average vol.	5,603,001
Shares Outstanding ('mn)	4,100.38
Market Cap. (₦bn)	113.17
EPS, ₦- 12months trailing	3.76
DPS, ₦- FY2020	1.40

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

Fig. 3: Key ratios

	H1'21	H1'20
Gross profit margin	14.16%	11.74%
COS/Revenue	85.84%	88.26%
Net Profit Margin	2.80%	2.18%
Asset turnover	0.72	0.70

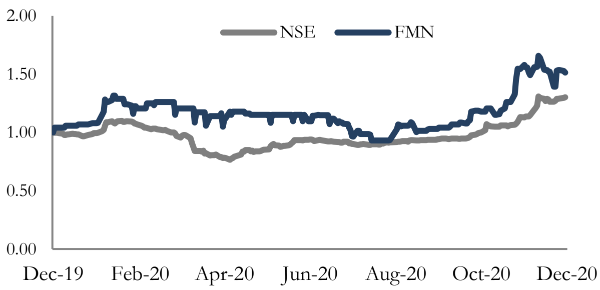
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2019	FY2020	FY2021E	FY2022F
P/E(x)	28.29	9.95	5.90	4.45
P/B(x)	0.75	0.73	0.69	0.68
Div. Yield	4.35%	5.07%	7.97%	10.14%
Payout Ratio	123.01%	50.46%	47.04%	45.19%
Ev/Revenue	0.40	0.33	0.22	0.23
Rev Per Shr	128.62	139.93	174.92	183.66
ROE	2.65%	7.30%	11.70%	15.33%
ROA	0.96%	2.63%	3.76%	4.87%

Source: NSE, PAC Research

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



Source: Bloomberg, PAC Research

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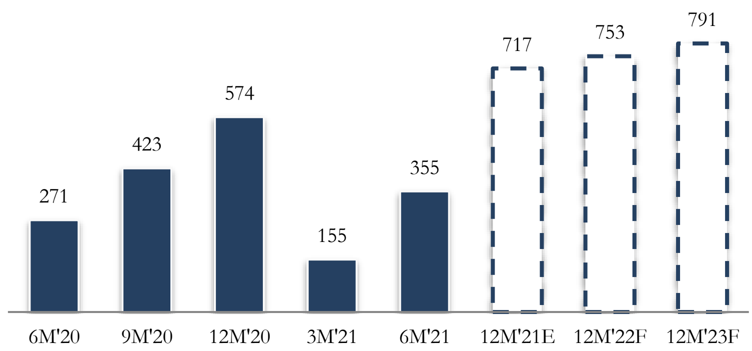
Border closure impacts top-line as revenue from all the business segments improves significantly in the half year of 2020/21: Flour Mills of Nigeria continued to benefit from the land border closure as demand for products in Food segment, Agro-allied segment, Sugar segment and Support Services segment increased significantly during the period. Revenue from the food segment improved significantly by 27.00% to ₦215.89 billion (vs. ₦170.04 billion in H1’19/20), due to improved demand for Pasta and Semovita during the period. In addition to border closure, the company continue to benefit from the ban on importation of fertilizer by the Federal Government of Nigeria, as Agro-allied segment improved its revenue by 45.87% to ₦72.06 billion in H1’20/21 (vs. ₦49.40 billion in H1’19/20). With the scarcity of Sugar in the country during the period, the local sugar volume of FMN doubled during the period and this improved the revenue from the Sugar segment of the company by 29.48% to ₦58.19 billion in H1’20/21 (vs. ₦44.94 billion in H1’19/20). Again, with the strong demand for BagCo during the period, the revenue of Support Segment improved significantly by 40.60% to ₦8.97 billon in H1’20/21 (vs. ₦6.38 billion in H1’19/20). The impressive performance across the board reflected on the top-line as total revenue improved by 31.15% to ₦355.11 billion in H1’20/21 (vs. ₦270.76 billion recorded in H1’19/20).

In addition to border closure, the company continue to benefit from the ban on importation of fertilizer by the Federal Government of Nigeria, as Agro-allied segment improved its revenue by 45.87%...

In the months ahead, we expect the demand for the products of FMN to increase, especially if the land borders remain closed. Food segment remains the largest contributor to revenue as it contributed 60.80% to revenue in H1’20/21 (H1’19/20: 62.80%). Agro-Allied segment contributed 20.29% to overall revenue (H1’19/20: 18.24%) while Sugar segment contributed 16.39% to overall revenue in H1’20/21 (H1’19/20: 16.60%).

Fig. 6: Revenue – 6M’20-12M’23F (Billion NGN)



Source: NSE, PAC Research

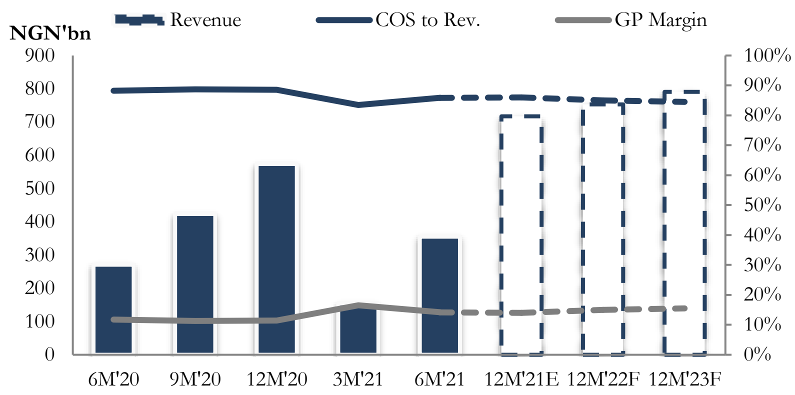
Cost of sales rises by 31.15% year-on-year due to higher volumes: During the period under review, cost of sales rose significantly by 27.55% to ₦304.82 billion (vs. ₦238.99 billion in six-month to September 2019/20), due to higher volumes. The higher cost of sales during the period could be mainly attributed to higher material costs as it increased by 30.08% to ₦266.68 billion in H1’20/21 (H1’19/20: ₦205.01 billion).

Although, the cost of sales increased by 27.55%, cost-to-sales margin declined to 85.84% in H1'20/21 (H1'19/20: 88.26%) and this showed an improvement in the cost management of the company. In line with our prediction on lower cost-to-sales margin, the company continue to benefit from its assistance of ₦70.00 million to Wheat Farmers Association of Nigeria in 2018 to boost the country self-sufficiency in wheat production. In addition, the focus of farmers and agricultural investors in Nigeria on the productions of wheat and other agricultural products, in taking the advantage of border closure, as helped the prices of inputs in a way.

In line with our prediction on lower cost-to-sales margin, the company continue to benefit from its assistance of ₦70.00 million to Wheat Farmers Association…

Mainly as a result of high general administrative expenses, high salaries, wages and other staff costs, total administrative expenses increased by 23.71% to ₦13.01 billion in H1'20/21 (vs. ₦10.52 billion recorded in H1'19/20). However, total administrative expenses remained almost flat at ₦4.41 billion in H1'20/21 (vs. ₦4.48 billion in H1'19/20).

Fig. 7: Revenue, COS to Rev. and GP Margin – 6M'20 - 12M'23F



Source: NSE, PAC Research

With impressive operating performance, PBT improves by 69.17% year-on-year: In six-month to September 2020/21, FMN Plc recorded a setback in the non-operating activity as finance costs increased by 12.59% to ₦9.95 billion (vs. ₦8.84 billion in six-month to September 2019/20), mainly as a result of lease costs (new IFRS 16) accounting adjustment of ₦0.80 billion for this year.

The impressive operating performance outweighed the setback in non-operating activity of the company as profit before tax improved significantly by 69.17% to ₦14.61 billion in H1'20/21 (vs. ₦8.63 billion in H1'19/20). However, the company made a higher provision of ₦4.67 billion for tax during the period (vs. ₦2.73 billion reported in the corresponding period of previous year). Consequently, profit after tax increased by 68.26% to ₦9.93 billion in H1'20/21, from ₦5.90 billion recorded in H1'19/20. This translated to trailing EPS of ₦3.76 during the period.

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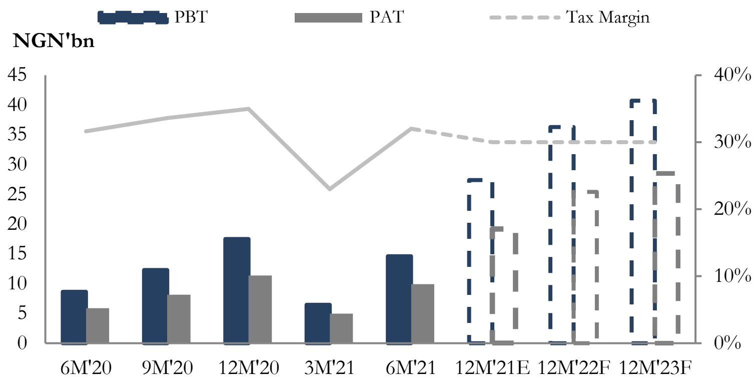
Fig. 8: PBT, PAT and Tax Margin – 6M'20-12M'23F



Source: NSE, PAC Research

Balance sheet remains strong; Expectation of improved dividend in FY'21: FMN Plc reported improved balance sheet in the second quarter of 2020/21, as net assets increased by 5.30% to ₦160.00 billion (vs. ₦151.95 in the second quarter of 2019/20). This was majorly boosted by the significant improvement in the total assets of the company, which improved by 27.77% to ₦496.45 billion in second quarter of 2020/21 (vs. ₦388.54 billion in second quarter of 2019/20). The improvement in total asset can be mainly attributed to the significant increase in cash & cash equivalents and inventories. However, total liabilities of the company increased by 42.21% to ₦336.46 billion in Q2'20/21 (vs. ₦236.59 billion in Q2'19/20), due to notable increase in long term borrowing, customer deposits and trades and other payables. Consequently, the net assets per share (NAPS) increased to ₦39.02 in Q2'20/21 (vs. ₦37.06 in Q2'19/20). With the improved balance sheet and impressive operating performance, we expect improved dividend payment from the company in full year of 2021.

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Fig. 9: Dividend Per Share and Dividend Yield – FY'19-FY'23F

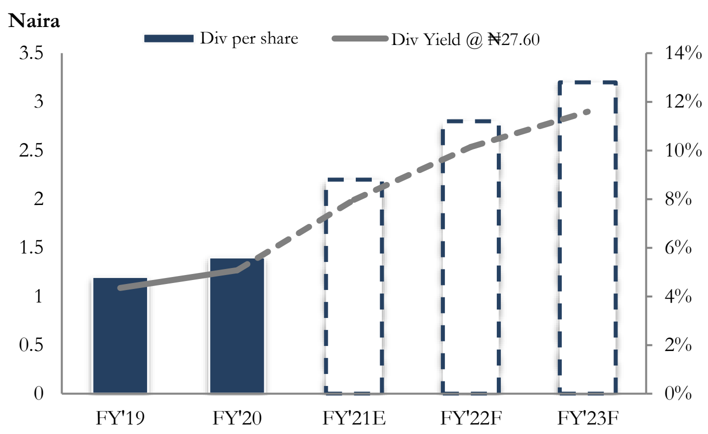
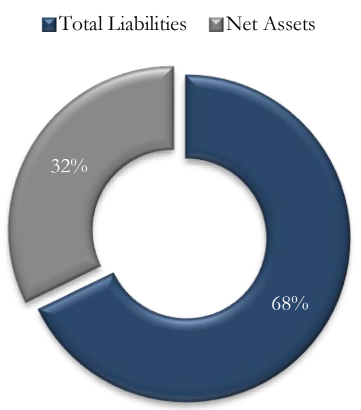


Fig. 10: Total Liabilities Vs Net Asset in Q2'20/21



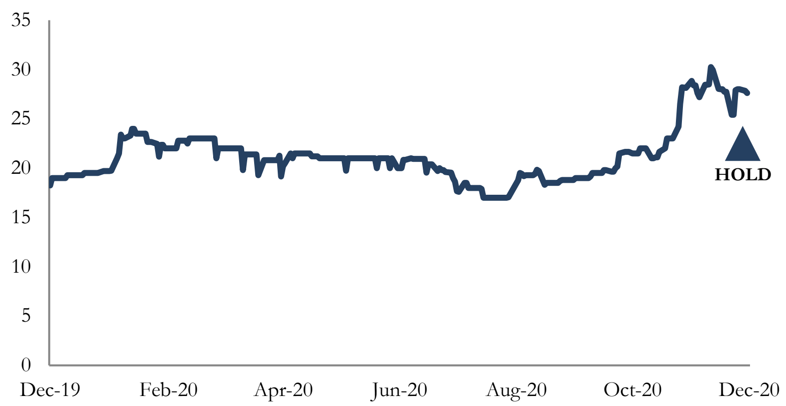
Source: NSE, PAC Research

Valuation

Our valuation puts the target price of the stock at ₦28.50, representing an increase of 3.27% from the current market price of ₦27.60. In arriving at the target price, we employed discounted free cash flow methodology. Consequently, we downgrade to 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 benefits to be derived from the Nigeria's land border closure and outlook from the management.

Our valuation puts the target price of the stock at ₦28.50, representing an increase of 3.27% from the current market price of ₦27.60.

Fig. 11: Share Price History



Source: NSE, PAC Research

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

	2019	2020	2021E	2022F
Revenue	527,405	573,774	717,218	753,079
Change	*-2.81%*	*8.79%*	*25.00%*	*5.00%*
Cost of sales	-474,057	-507,987	-616,807	-640,117
Change	*0.03%*	*7.16%*	*21.42%*	*3.78%*
Gross profit	53,348	65,787	100,411	112,962
Change	*-22.43%*	*23.32%*	*52.63%*	*12.50%*
Selling and distr exp.	-8,166	-9,278	-9,324	-9,790
Change	*32.13%*	*13.63%*	*0.49%*	*5.00%*
Administrative exp.	-19,424	-23,346	-27,254	-28,617
Change	*0.00%*	*20.19%*	*16.74%*	*5.00%*
Net Op. gains (losses)	6,211	4,906	-17,930	-18,827
Change	*4.51%*	*-21.02%*	*-465.50%*	*5.00%*
Operating profit	32,297	35,080	45,902	55,728
Change	*-33.30%*	*8.62%*	*30.85%*	*21.41%*
investment income	769	2,393	1,578	1,657
Change	*-5.85%*	*211.30%*	*-34.05%*	*5.00%*
Profit Before Tax	10,174	17,497	27,398	36,298
Change	*-38.49%*	*71.97%*	*56.59%*	*32.49%*
Taxation	-6,174	-6,120	-8,219	-10,890
Change	*111.01%*	*-0.88%*	*34.30%*	*32.49%*
Profit After Tax	4,000	11,377	19,178	25,409
Change	*-70.62%*	*184.41%*	*68.58%*	*32.49%*

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

	2019	2020	2021E	2022F
Property plant and equip.	221,465	216,890	213,731	222,158
Investment property	1,738	1,633	1,650	1,657
Goodwill	4,148	4,148	4,148	4,180
Deferred tax	3,964	3,578	3,945	4,067
Long term receivables	1,402	359	359	377
Inventories	118,867	115,596	129,099	135,554
Biological assets	18	148	143	151
Trade and other rec.	26,085	25,731	27,254	27,111
Total Assets	416,822	432,454	509,500	522,223
Bank overdraft	9,651	5,543	1,434	3,765
Trade & other payables	79,040	83,614	114,755	112,962
Borrowings	71,053	23,344	50,205	52,716
Retirement benefit oblig.	5,848	7,135	7,889	7,531
Long service award	2,183	2,738	2,582	2,711
deferred tax	10,588	11,849	15,348	16,116
Total liabilities	265,849	276,646	345,556	356,432
Net Assets	150,972	155,808	163,945	165,790

Fig. 14: Profitability Ratio

	2019	2020	2021E	2022F
Gross profit margin	10.12%	11.47%	14.00%	15.00%
Net Profit Margin	0.76%	1.98%	2.67%	3.37%
operating profit margin	6.12%	6.11%	6.70%	6.70%
Return on Equity	2.65%	7.30%	11.70%	15.33%
Return on Assets	0.96%	2.63%	3.76%	4.87%
ROCE	0.33%	0.84%	0.52%	0.53%

Fig. 15: Asset Utilisation

	2019	2020	2021E	2022F
cash/sales	0.03	0.03	0.04	0.03
Sales to inventory (x)	4.44	4.96	5.56	5.56
Sales to total assets (x)	1.27	1.33	1.41	1.44
sales/EBITDA	11.24	11.30	7.75	7.19
Sales to total fixed assets	2.38	2.65	3.36	3.39
Equity multiplier	2.76	2.78	3.11	3.15

Fig. 16: Liquidity Ratios

	2019	2020	2021E	2022F
Quick ratio	*0.33*	*0.50*	*0.67*	*0.64*
Current ratio	*0.98*	*1.28*	*1.30*	*1.29*
Cash ratio	*0.10*	*0.12*	*0.12*	*0.12*
Interest Coverage	*0.44*	*0.88*	*1.36*	*1.72*
Operating Cash Flow Ratio	*0.00*	*0.00*	*0.00*	*0.00*
Debt/net income	*13.97*	*7.58*	*4.19*	*3.41*
Debt/operating profit	*72.71*	*36.03*	*50.91*	*52.27*
Debt to asset	*0.13*	*0.20*	*0.16*	*0.17*
Debt to equity	*0.84*	*0.55*	*0.49*	*0.52*
Total liabilities/equity	*1.76*	*1.78*	*2.11*	*2.15*
Inventory turnover days	*91.52*	*83.06*	*76.40*	*77.29*
Account receivable days	*18.05*	*16.37*	*13.87*	*13.14*
Account payable days	*60.86*	*60.08*	*67.91*	*64.41*

Fig. 17: Shareholders' Investment Ratios

	2019	2020	2021E	2022F
Earnings per share	0.98	2.77	4.68	6.20
DiV per share	1.20	1.40	2.20	2.80
NAVPS	36.82	38.00	39.98	40.43
Earnings yield	3.53%	10.05%	16.95%	22.45%
P/S ratio	0.215	0.197	0.158	0.150

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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