Flour Mills of Nigeria Plc [FLOURMIL]

Tougher operating environment hamper top-line, masks debt restructuring gains

United Capital
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Equity Research | Earnings Update

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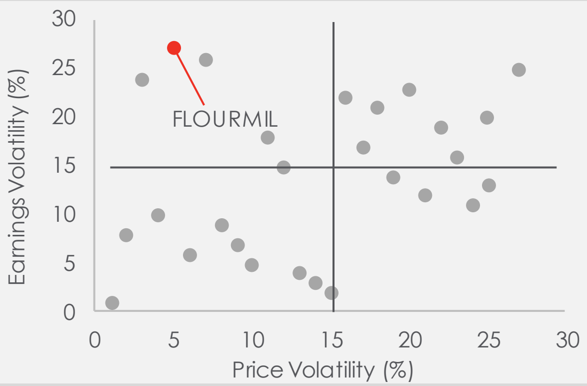
Research Analyst:
Shakirat Anifowoshe
shakirat.anifowoshe@unitedcapitalplcgroup.com

Stock Rating	Target Price	Expected Return
BUY	**N27.2**	**42.9%**

Risk Rating: Medium

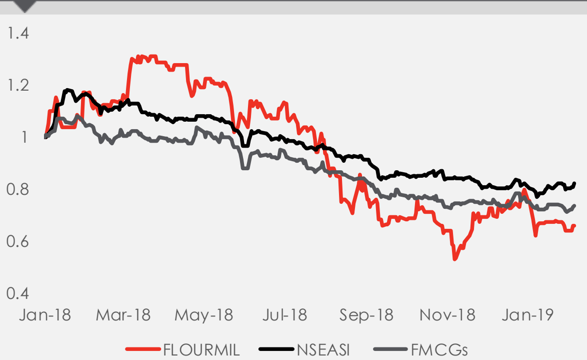


Note: Refer to disclosure appendix for complete description of risk rating

Key Data

Last Price (₦)	19.0
52 week High/Low (₦)	39.5/ 15.3
1M Price Change (%)	-3.6
3M Price Change (%)	+13.1
6M Price Change (%)	-25.5
12M Price Change (%)	-30.9
YTD Change (%)	-40.9
Beta	1.04
Market Capitalization (₦'m)	77,907.2
Market Capitalization ($'m)	393.6
Shares Outstanding. (Units'm)	4,100.4
Float (%)	66.2
Dividend Yield (%)	2.8

Price Performance Chart



Sources: Bloomberg, United Capital Research

Last week, Flour Mills of Nigeria Plc ("FMN") unveiled its 9M-18/19 financial statements for the period ended 31st December 2018. Therein, cumulative 9M revenue faltered 6.3% y/y to N400.6bn despite the slight uptick recorded q-o-q. Similarly, PBT and PAT declined 42.2% and 40.4% to N11.3bn and N7.9bn respectively. Below, we highlight our estimates for the firm and revise our position.

Constraints in operating environment pressure topline growth: FMN's 9M-18/19 revenue weakened 6.3% y/y to N400.6bn from N427.5bn last year, driven by a freefall in revenues generated across major business lines. Revenue from the Food Segment of the business (i.e the Flour, Pasta, and Noodles divisions), the largest component of group revenue which accounted for 63.5% as at 9M, fell 4.6% y/y. Although some gains were recorded in volume growth in the third quarter, price reduction implemented earlier in the financial year and reverberating effect of the gridlock and bad road network at the firm's major factory location, Apapa, weighed on the cumulative 9M-18/19 revenue. Similarly, the Agro-allied and Sugar Value Chain segments of the business took a beating in the 9M to end Dec-18, declining 10.1% and 13.6% y/y respectively. However, revenue from Support Services, though paltry (with 4.6% contribution), gained momentum as festive activities and range of innovative products in the bagging business (BAGCO) resulted in the segment's top line growth of 14.9%.

Buttressing on the Apapa gridlock, our field findings suggest that the gridlock in the region emanates from poor road network and vehicular congestion which impedes smooth transmission of raw materials and finished products to and from the region. Additionally, while successful completion of the ongoing road construction will ease the congestion, construction of holding bays and decongestion of the ports are pain-points that may linger.

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While Cost of Sales moderated by 4.7% y/y to N354.0bn, Gross Profit fell 16.8% y/y as the impact of weaker volume growth outweighed gains from lower input cost. Furthermore, Selling and Distribution expenses spiked 46.9% to N5.9bn, advertisement expenses increased by more than five folds y/y amid efforts to ramp-up brand equity and retain market share. Inevitably, Operating Profit tumbled 38.2% y/y to N27.3bn. Meanwhile, finance costs declined to N16.6bn, a 34.2% y/y plunge when compared to the N25.2bn recorded in the same period last year as the impact of rotating sources of capital from expensive short-term borrowing starts to hit home. Although a 15.3% upturn in investment income also provided some reprieve for already badly beaten bottom-line, it obviously could not avert the slumps in PBT and PAT recorded. The firm recorded a 42.2% y/y and 40.4% y/y plunge in PBT and PAT to close the period under review at N11.3bn and N7.9bn respectively.

Balance sheet: Reaping the seeds of debt restructuring; Following the successful completion of the first tranche of the firm's N70bn bond program, that saw the firm raise N20bn and already concluded N39.9bn Rights Issue program, we observed a marked improvement in the firm's debt structure. Specifically, short term borrowings and bank overdrafts reduced 43.9% and 27.5% respectively while long term borrowings spiked 135.3% when compared to the end of FY17/18. Accordingly, total borrowings declined 7.4% to N141.9bn for 9M to end Dec-18. Furthermore, Debt/Equity and Debt/Capital ratios moderated to 92.8% and 48.1% respectively, from 101.7% and 50.4% in the previous financial year. We are delighted that the firm has taken steps to mitigate the idiosyncratic risk of bloated financing costs and short-term borrowings hence translating to healthier balance sheet position.

Recommendation upgraded to BUY: Heading into 2019, amid the recovery in the broader economy, we opine that the possibility of minimum wage implementation could have a pass-through effect on consumer spending on staple foods. Furthermore, the relative availability of FX will continue to bode well for input costs while aggressive spending on marketing and selling costs could drive sales volume amid improving product mix. However, challenges in the operating environment mainly stemming from heinous congestions in Apapa, the headquarters and location of the main factory, may keep performance from core operations limb. Again, while lower financing costs may provide some reprieve, sustained increase in selling and distribution costs is likely to offset the impact on net income. On a balance of factors, we have upgraded our TP upgraded to N27.2 from N25.4. Notably, the stock price of FLOURMIL has shed 17.7% (currently at N19.0) since our last update, bringing PE ratio to 8.8x compared 21.6x for the sector. This presents an attractive entry opportunity ahead of a possible post-election equity market recovery. Dividend yield is estimated at 2.8% at current price as we anticipate a declaration of 0.75k/share by year end in Mar-19. As such, we adjust our recommendation from HOLD to BUY.

Flour Mills of Nigeria Plc: 9M 2018/19 Result Summary

Financial Highlights (N'Mn)			
Headlines	**9M- 2018/19**	**9M- 2017/18**	**Change**
Revenue	**400,642**	**427,509**	**-6.3%**
Cost of sales	-354,047	-371,473	-4.7%
Gross Profits	46,595	56,036	-16.8%
Net Finance (cost)/Income	-16,014	-24,692	-35.1%
Profit/Loss Before Tax	**11,278**	**19,502**	**-42.2%**
Taxation	-3,383	-6,255	-45.9%
Profit/Loss After Tax	**7,896**	**13,247**	**-40.4%**
	9M- 2018/19	**FY- 2017/18**	
Cash and cash equivalents	23,912	22,245	7.5%
Trade & Other Receivables	22,724	19,083	19.1%
Trade & Other Payables	87,944	56,994	54.3%
Net Assets	**152,796**	**150,617**	**1.4%**
Gross Margin	11.6%	13.1%	-1.5%
Net Margin	2.0%	3.1%	-1.1%
Cost to Sales	88.4%	86.9%	1.5%
Leverage (Total Liabilities/Total Assets)	64.6%	63.1%	1.5%
Price(N)	19.0		
Trailing 12M EPS (N)	2.0		
BVPS (N)	37.3		
P/E(X)	9.4		
P/BV	0.5		
ROE Annualised	5.4%		

Sources: NSE, United Capital Research

Disclosure Appendix

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Buy: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%). We consider this as the minimum return that may deserve our holding of a risk asset, like equity.

Hold: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

Sell: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

NR*: Please note that in addition to our three rating heads, we indicate stocks that we do not rate with NR; meaning Not-Rated. We may not rate a stock due to investment banking relationships, other sources of conflict of interests and other reasons which may from time to time prevent us from issuing a rating on the shares (or other instruments) of a company.

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Company	Disclosure
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Flour Mills of Nigeria Plc	g,h
FCMB Plc	h
Fidelity Bank Plc	g,h
Forte Oil Plc	g,h
Stanbic IBTC Plc	h
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