



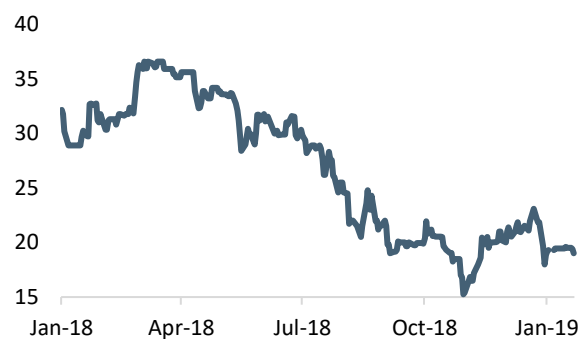
Flour Mills of Nigeria Plc (FLOURMILL.NL)

Initial View

Earnings down on higher cost and operating expense

Rating	UNDER REVIEW
Price	₦19.00
52-week range	₦15.25–₦39.50
Market Cap. (₦'bn)	77.91
1-month Avg. Vol	1,079,779.5
Current PE	8.78x

FLOURMILL: NL - Share Price Trend



Analyst(s)

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- Yesterday, Flour Mills of Nigeria released its third quarter (FQ3 19) result for the period ended December 2019, which showed a 27.4% YoY contraction in EPS by 27.4% YoY to ₦0.69 following persisting pressure on margins from higher cost of sales (+7.3% YoY) and higher operating expense (+10.6% YoY). Accordingly, EPS over the first nine month of the year declined 40.4% to ₦1.93.
- Despite the downward adjustment to prices which started in FQ1 19, the company reported slight revenue growth in FQ3 19 (+1.4% YoY ₦130.9 billion) with management linking this to accelerated volumes growth in the period. According to management a sizeable chunk of the revenue growth emanated from the food segment following strong sales from Flour and Pasta products. Furthermore, the revenue growth was in-part fed by marginal growth in the Agro Allied and Support Services – driven by festivity related improved sales of edible oil and the bagging business respectively.
- However, reflecting the 21% YoY increase in global wheat prices over FQ3 19, raw material costs expanded 4% YoY – the largest constituent of COGS—with cost of sales coming higher by 7.3% YoY. Accordingly, gross margin contracted 480bps YoY to 11.1%. This, in addition to higher operating expense over the period (+10.6% YoY to ₦6.9 billion) resulted in EBIT margin contraction by 530bps to 5.8%.
- On the positive, following the rights issue proceed of ₦39 billion in FQ4 18, which was used to pay down expensive short-term borrowings, coupled with the successful completion of the first tranche of the ₦70 billion bond program with ₦20 billion being

raised with 3 and 5 years maturity at respective rates of 15.5% and 16%, compared to average rates on short term borrowings of 18% in FQ3 18, finance expense in FQ3 19 declined by 40.1% YoY to ₦5.3 billion. Notwithstanding the moderation in finance cost, the combination of weaker gross margin and higher operating expense translated to a 27.4% YoY decline in PAT to ₦2.8 billion.

- The key takeaway, as regards future performance, from our discussion with the management yesterday, was management's plan to embark on corporate restructuring of the agro allied division to optimize investments and costs. The process has been initiated and expected to be concluded by end of the 2018/19.
- Flourmill trades at P/E and EV/EBITDA multiples of 8.78x and 3.81x compared to Bloomberg Middle East and Africa peers of 18.1x and 7.2x respectively.
- **More analysis to follow**



Summary of Results and Forecast

Income Statement (₹ Million)	FQ3 19	FQ3 18	YoY growth	F9M 19	F9M 18	YoY growth
Revenue	130,904	129,066	1.4%	400,642	427,509	-6.3%
Cost of sales	116,430	108,543	7.3%	354,047	371,473	-4.7%
Gross profit	14,475	20,523	-29.5%	46,595	56,036	-16.8%
Operating expenses	6,893	6,231	10.6%	20,870	17,349	20.3%
Operating profit	7,582	14,292	-47.0%	25,725	38,687	-33.5%
Net interest expense	(5,074)	(8,699)	-41.7%	(16,014)	(24,692)	-35.1%
Other operating loss	-	-		-	-	
PBT	2,976	6,025	-50.6%	11,278	19,502	-42.2%
PAT	2,826	3,891	-27.4%	7,896	13,247	-40.4%

Note; Financial year ends in March.

Key Ratios	FQ3 19	FQ3 18	Change(pps)	F9M 19	F9M 18
Gross margin	11.1%	15.9%	-4.8%	11.6%	13.1%
EBIT margin	5.8%	11.1%	-5.3%	6.4%	9.0%
PBT margin	2.3%	4.7%	-2.4%	2.8%	4.6%
PAT margin	2.2%	3.0%	-0.9%	2.0%	3.1%
Effective tax rate	N/M	N/M	N/M	29.99%	15.6%

*N/M means not meaningful

Source: ARM Research

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
RESTRICTED	In certain circumstances, Asset & Resource Management (“ARM”) Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group engagement in an investment banking transaction and in certain other circumstances.

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