Flour Mills of Nigeria Plc (FLOURMIL)

A new growth phase; deserves a price re-rate

United Capital
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Equity Research | Earnings Update

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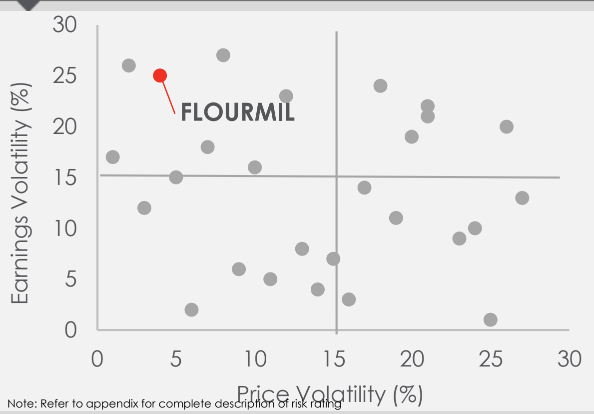
Stock Rating	Target Price	Expected Return
BUY	**Old: N46.0** **New: N46.6**	**59.5%**

Risk Rating: Medium

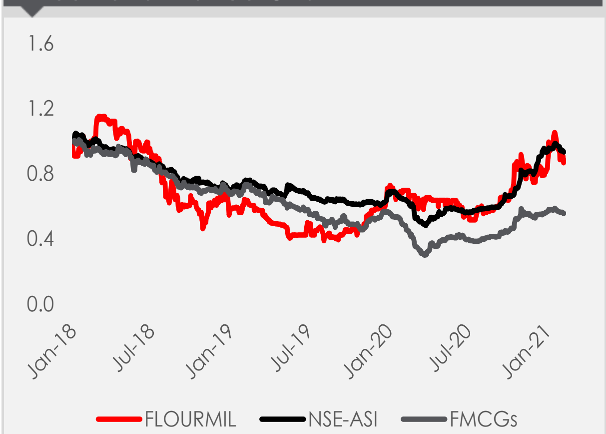


Note: Refer to appendix for complete description of risk rating

Key Data

Last Price (₦)	29.20
Last Price ($)	0.07
52 week High/Low (₦)	35.0/17.0
1M Price Change (%)	-8.8
3M Price Change (%)	5.2
6M Price Change (%)	57.8
YTD Change (%)	12.3
Beta	0.8
Market Capitalization (₦'bn)	119.7
Market Capitalization ($'m)	3,015.9
Shares Outstanding. (Units'm)	4,100.4
Float (%)	99.6
Dividend Yield (%)	4.8

Price Performance Chart



In its recently released 9M-2020/21 numbers, Flour Mills of Nigeria (FLOURMIL) reported a solid 31.1% y/y growth in Revenue to N555.3bn from N423.5bn. Q3-2020/21 numbers was also decent as Revenue grew 31.1% y/y to N200.1bn. Furthermore, slower growth in Cost of Sales and Operating expenses drove margin expansion and consequently faster growth in Operating Profit. Operating margin expanded 50bps y/y to print at 6.3% in 9M-2020/21 while Operating Profit surged 42.7% y/y. Also, Profit Before Tax (PBT) and Profit After Tax (PAT) grew 92.1% y/y and 90.9% y/y respectively.

Group Revenue sustains uptrend: In Flourmills' 9M-2020/21 results, the company reported growth of 31.1% y/y in Revenue to N555.3bn from N423.5bn in 9M-2019/20. The growth in Revenue was driven by broad-based growth across business units as Food (+31.2% y/y to N343.9bn), Agro-allied (+29.9% y/y to N105.6bn), Sugar (+33.4% y/y to N90.2bn) and Support Services (+24.8% y/y to N15.6bn) recorded solid y/y growths. The stellar revenue performance was broadly driven by a confluence of factors including; introduction of new products at lower price points to target price-sensitive consumers, resizing of popular products to lower SKUs and lower price points, and sustained investment in route to market. Notably, in the Support business, subdued influx of imported packaging alternatives and introduction of smaller SKU bags for Flour, Detergent & Cement supported BAGCO's Revenue. That said, we note that price increases on select products in the Food & Sugar businesses further supported Revenue.

Operational efficiency, better pricing, improved volume mix drove margin expansion: Cost of Sales grew, albeit at a slower pace to Revenue, climbing higher by 28.5% y/y to N482.9bn in 9M-2020/21 from N375.7bn in 9M-2019/20. As a result, Gross Profit accelerated, up 51.5% y/y to N72.4bn in 9M-2020/21. Furthermore, the slower growth in Cost of Sales supported an expansion in Gross margin (+170bps y/y to 13.0%). The improvement in margins was majorly supported by price increment across some key product categories which we estimate at

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an average of 23.6% given the single digit 6.0% growth in volumes across all business segments. In addition, improved operational efficiency in the Agro-allied business provided further support for cost management. Lastly, we note the company benefitted from improved volume mix in Flour, Sugar and Oils, where demand was skewed to high margin products.

OPEX growth curtailed but FX losses dent performance: Operating expenses grew at a sub-inflationary rate of 6.1% y/y to N25.1bn in 9M-2020/21 from N23.7bn in 9M-2019/20. The growth in OPEX was driven by upticks in Selling & Distribution expenses (+5.5% y/y) and Administrative expenses (+6.3% y/y). However, the company reported Other Operating Loss of N12.6bn in 9M-2020/21 (Compared to N0.5bn Other Operating Gain in 9M-2019/20). The Other Operating Loss was driven by FX loss of N14.6bn recorded during the period. The FX losses incurred was due to IFRS 16 accounting revaluation of the USD denominated long term port concession contract which largely impacts the Support business. Nevertheless, Operating Profit grew by a sturdy 42.7% y/y to print at N35.2bn in 9M-2020/21 from N24.7bn in 9M-2019/20. In addition, Operating margin expanded 50bps y/y to 6.3% in 9M-2020/21.

...Post-tax profit rose by 90.9% y/y to N15.6bn. Elsewhere, Net debt to equity ratio sharply moderated from 0.6x to 0.4x.

Balance sheet optimization strategies paid off: In 9M-2020/21, Flourmills sustained efforts at restructuring and optimizing its balance sheet following the depressed yield environment. As a result, the company raised long term finance via bond issuances at cheaper rates while paying down some of its short term debt in form of Commercial Papers. In addition, proper working capital management strategies helped drive a surge in cash generation. Consequently, the company recorded a 30.8% y/y decline in Net debt to N66.2bn in 9M – 2020/21. Against this backdrop, Net Finance Cost fell 6.4% y/y to N11.6bn in 9M-2020/21 on the back of higher Finance Income (+356.7% y/y to N3.3bn) despite the increase in Finance cost (+13.8% y/y to N14.9bn). As a result, Profit Before Tax galloped by 92.1% y/y to N23.6bn in 9M-2020/21 from N12.3bn in 9M-2019/20. While Effective Tax Rate edged higher by 4bps, it had minimal impact on Net Income which surged 90.9% y/y to print at N15.6bn in 9M-2020/21 from N8.2bn in 9M-2019/20.

Strong outing expected in Q4: Looking ahead, we hold an optimistic view on the performance of Flourmills for the end of the 2020/21 financial year. We expect volume growth to remain decent in Q4-2020/21 as market sentiments indicates demand for the company's brands remain strong despite recent price increases implemented. In addition, the company announced it will continue to invest in its route to market with focus on its B2C strategy which continues to pay-off. Lastly, we note that revenue growth in the Agro-allied business slowed in Q3-2020/21 on the back of scarcity of key raw materials which prevented the company from meeting demand. Thus, we expect Revenue growth in Q4-2020/21 to print higher than recent quarterly revenue growth. We forecast revenue growth of 30.3% for FY-2020/21E.

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Immune to COVID-19?

We expect margins to remain strong through FY-2020/21E premised on the impact of improved product pricing, improved volume mix tilting towards high margin products and sustained operational efficiency in Agro-allied business. We expect this to outweigh the impact of currency pressures resulting from multiple naira devaluations as well as uptick in prices of local raw materials. As a result, we model a cost margin of 87.0% in FY 2020/21E (vs. 88.5% in FY 2019/20E). Also, we expect operating margin to remain strong as the company's efforts at curtailing operating expenses growth have paid off. That said, we expect the FX losses booked on the long term port concession deal for the Support business to continue to weigh on operating performance. Lastly, we expect to see further evidence of the balance sheet optimization strategies and working capital management on bottom line. We expect these to translate into lower Net Finance cost for FY 2020/21 relative to FY 2019/20. Overall, we estimate Net Income to print at N19.7bn for FY 2020/21 which implies a 73.5% y/y growth compared to FY 2019/20.

Growth momentum may taper over 2022E-2025E: However, we note that subsequent forecast years is expected to see the growth momentum taper. We expect to see the impact of the border reopening to begin to weigh on the Sugar and Flour business. While management stated that the Federal government has agreed to put in place measures to curb the problem of incessant smuggling, history indicates such promises can only be taken with a pinch of salt. In addition, we note that revenue growth in 9M-2020/21 has been largely price driven (price grew by an average estimate of 23.6% y/y vs volume growth of 6.0%). Thus, we think the underlying impact of depressed consumer pockets would weigh on Revenue growth and consequently force consumers to trade down the product chain.

Current price point presents attractive entry opportunity: Following marginal revisions to our forecasts, we raise our target price to N46.6/s from N46.0/s previously largely reflective of the marginal adjustments to revenue and cost line items. Our target price implies a 59.5% upside to current price of N29.20/s. We forecast FY-2020/21E dividend of N2.00/s (at an estimated payout ratio of 41.5%) which implies a dividend yield of 6.8%. Justifying our TP, Flourmills currently trades at a PE ratio of 6.4x compared to a 5-year average of 8.7x implying a 35.9% discount. In our opinion, the company's pricing deserves a re-rating considering the record Revenue and Profits level set which is reflected in our target price.

...we revise our TP upwards from N46.0/ share to N46.60/share, and retain our BUY recommendation.

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Financial Highlights (N'Mn)

Headlines	9M- 2020/21	9M- 2019/20	Change
Revenue	**555,342**	**423,479**	31.1%
Cost of Sales	-482,896	-375,650	28.5%
Gross Profit	**72,446**	**47,829**	**51.5%**
Operating Expense	-25,105	-23,666	6.1%
Impairment writeback/(loss)	447	0	NM
Net Operating Gains/(Losses)	-12,578	518.4	-2526.2%
Operating Profit	**35,210**	**24,681**	**42.7%**
Finance Income	3,326	728	356.7%
Finance Costs	-14,927	-13,118	13.8%
Profit/Loss Before Tax	**23,608**	**12,292**	92.1%
Taxation	-8,027	-4,131	94.3%
Profit/Loss After Tax	**15,582**	**8,161**	90.9%
	9M- 2020/21	FY - 2019/20	
Cash and Cash Equivalents	81,177	26,211	209.7%
Trade & Other Receivables	**25,416**	**25,731**	**-1.2%**
Trade & Other Payables	**91,419**	**83,614**	**9.3%**
Total Borrowings	**46,898**	**122,919**	**-61.8%**
Total Assets	**493,158**	**432,454**	**14.0%**
Net Assets	165,658	155,808	6.3%
Gross Margin	13.0%	11.3%	**1.8%**
Net Margin	2.8%	1.9%	**0.9%**
Cost to Sales	87.0%	88.7%	**-1.8%**
Leverage (Debt/Equity)	28.3%	78.9%	**-50.6%**
Leverage (Net Debt/Equity)	-20.7%	62.1%	**-82.8%**
Price(N)	29.2		
Trailing 12M EPS(N)	4.58		
BVPS(N)	40.4		
Trailing 12M P/E (x)	6.4		
P/BV (x)	0.7		
Trailing 12M ROAE	11.7%		

Sources: Company Financials, United Capital Research

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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
Dangote Cement Plc	a,h
Fidelity Bank Plc	h
Flour Mills of Nigeria Plc	h
Forte Oil Plc	g
International Breweries Plc	a,h
Nigerian Breweries Plc	h
PZ Nigeria Plc	h
Stanbic IBTC Plc	g
Total Nigeria Plc	h
UAC of Nigeria Plc	h
Zenith Nigeria Plc	a

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