PEF Inflow propels PAT to profitability

United Capital
The Intelligent Choice

Equity Research | Earnings Update

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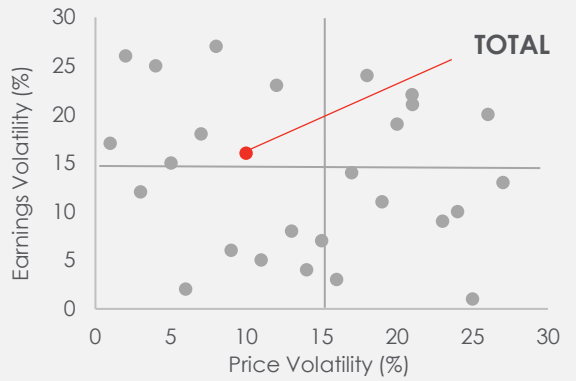
Stock Rating	Target Price	Upside
BUY	Old price :142.3 Newprice:167.4	**25.0%**

*Note: excluding expected dividend yield

Risk Rating: Medium

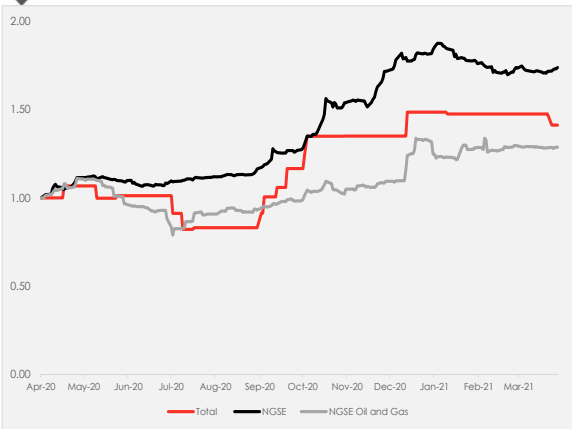


Note: Refer to appendix for complete description of risk rating

Key Data

Last Price (₦)	133.9
52 week High/Low (₦)	146.90/79.8
1M Price Change (%)	-5.7
3M Price Change (%)	-6.4
6M Price Change (%)	3.0
YTD Change (%)	+5.9
Beta	0.5
Market Capitalization (₦'m)	46,141.0
Shares Outstanding. (Units'mn)	339.5
Float (%)	38.0
Dividend Yield (%)	6.9

Price Performance Chart



Sources: Bloomberg, United Capital Research

Recently, major downstream player, TOTAL ("the company or the firm") released its audited financial result for FY-2020. It was evident that the peculiarities of the economic lockdown, which included the cancellation of local and international flights and the restriction of economic activities (and consequently vehicular movement), disrupted the business of petroleum products marketers. As a result, TOTAL's Revenue dipped across all business segments. Revenue fell by 29.1% y/y to N204.1bn in FY-2020, Cost of sales fell faster by 32.3% y/y to print at N173.9bn in FY-2020. Furthermore, due to the decline in sales, Gross Profit and Operating Profit declined by 12.3% y/y and 64.0% y/y to print at N30.7bn and N3.5bn, respectively. Overall, the company recorded a Profit before and after Tax of N2.9bn and N2.0bn respectively (vs Profit before and after Tax of N3.0bn and N2.2bn respectively in FY-2019). Earnings per Share (EPS) fell by 9.4% y/y to N6.08 per share in FY-2020. The firm proposed a dividend of N6.08 per share. Below, we highlight key details of the downstream operator's performance and our expectations for 2021.

Weak fuel demand and loss of market share hamper total sales: TOTAL's FY-2020 performance underwhelmed, as Revenue dropped by 29.1% y/y to N204.1bn in FY-2020. Undoubtedly, weaker economic activities triggered by the COVID-19 pandemic, which sparked a series of strict restrictive measures on the movement of people in Q2-2020, hampered sales. Total sales from petroleum products declined by 34.8% y/y to N157.0bn (which made up 76.7%) whilst sales from Lubricants and others fell by 6.8% y/y to N47.7bn in FY-2020. Lubricant sales consisted of 23.2% of Revenue in FY-2020.

Total records weaker demand across all its major segments: On a business segment basis, TOTAL experienced a drop in sales across all its reporting segments. Network sales (70% of total sales), which measures sales at service stations, declined by 29.2% y/y to N143.3bn. General trade (24% of total sales), which tracks sales to corporate customers, declined by 19.9%, as lockdown activity meant offices were fully or partially closed in 2020. Revenue from its Aviation segment (6% of total sales) dropped by 53.2% y/y to N12.2bn, as domestic and international travel restrictions led to a reduction in sales of Jet-fuel and other aviation products.

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Cost of sales falls faster than recovery: Cost of sales remained relatively large compared to Revenue due to the sheer nature of downstream oil and gas service. As such, Cost of sales declined faster than Revenue in FY-2020, down 32.3% y/y to N173.9bn in FY-2020. As such, the firms' cost margins printed at 85.0% in FY-2020 vs 88.0% in FY-2019.

Consequently, Gross profit declined by 12.3% to N30.2bn in FY-2020. However, Gross margin improved mildly to 14.8% in FY-2020, from 12.0% In FY-2019.

Similarly, TOTAL's Operating Profit printed lower by 64.0% y/y, owing to weaker demand from sales and a 68.3% y/y drop in other income to N1.0bn, which arose from a 99.0% drop in Gains on disposal of assets from FY-2019.

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Lower-interest environment and Improved PEF Inflows cushions Net finance cost: The low-yield environment favoured TOTAL in 2020, as Net finance cost declined of 973.4% to N629.1mn, a considerable improvement from N6.7bn in 2019. This was due to the average interest rate on the firm's overdraft and bank charges falling to 8.4% in FY-2020, from 14.8% in FY-2019. Additionally, the improvement in Net finance cost was boosted by a 175.2% y/y increase in finance income, mainly owing to a 96.7% y/y increase in inflows from the Petroleum equalisation fund (PEF). Noteworthy to mention, adjusting for the PEF inflow, PAT would have printed at a meagre N30.0m in FY-2020. Overall, the company recorded a Profit before and after Tax of N2.9bn and N2.2bn, respectively, as PBT and PAT fell by 5.2% y/y and 9.4% y/y. The company proposed a N6.08 per share dividend payment for FY-2020, a 9.3% y/y decline from FY-2019.

Working capital Management -improvement in net cash flows: In terms of working capital management, the company's cash balances, excluding balances with Total's treasury, improved by 10.5% y/y to N4.2bn. This was largely due to a drop in inventory purchases and an increase in accounts payable, up 35% to N73.7bn, mostly to the Total SA group's sister companies, resulting in an increase in Total liabilities to N115.0bn from N105.0bn in FY -2019. The company's total amount owned to related subsidiaries increased 418% to N31.4bn in FY-2020 (previously N6.1bn).

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Elsewhere, we note that the company generated Net cash from operating activities worth N43.5bn in FY-2020 from N15.1bn in FY-2019. This was due to a significant drop in inventories, given the fact that the lower fuel demand during the period does not warrant building up inventory level. Also, the N2.0bn recorded from the Petroleum Subsidy Fund aided cash-inflows. Finally, the company's leverage position (using debt/equity) reduced to 122.2% in FY-2020 from 140.8% in FY-2019.

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Outlook for TOTAL – Rebound in economic activities to boost demand in 2021

Our outlook for the downstream oil and gas sector remains moderate. Our position is predicated on an expected rebound in demand for petroleum products and lubricants following the lockdown in Q2-2020. However, in our view, this remains the only significant bright spot for companies in the downstream oil and gas sector. On the downside, the prospect of full price discovery for Premium Motor Spirit (PMS) remains hindered by policy backflips by the FGN and NNPC. Also, on the downside, the persistent FX challenges, which makes NNPC the largest importer in the market, would mean that TOTAL, for the most part, will only earn a distributors' margin and be unable to capitalise on wholesaler's margins as the NNPC remains the primary wholesaler in the country.

For lubricants, we are partly optimistic concerning the growth of TOTAL's lubricant business looking forward, considering the FX challenges its competitors will face in 2021, we expect TOTAL to leverage on its group structure for FX sourcing, as its lubricant sales segment remains more profitable than the PMS segment. We expect TOTAL to retain its market share in this segment. With this in mind, we modelled for improved gross margins in 2021. Also our valuation takes into consideration TOTAL's efforts to moderate its interest expense by issuing a commercial paper worth N30bn in late 2020 at 1.75% and 2.0% for its 183-day and 253-day papers respectively.

We modelled for TOTAL, incorporating the current market dynamics/fundamentals, which show that most downstream firms earn only a retailer's margin, as shown by the most recent policy backflip by the NNPC and the FGN in Q1-2021. We review our year-end target price for TOTAL upwards to **N167.4 per share** with an upside of 25.0%, from its current price of **N133.9 per share.** We raise our to **BUY** recommendation on the stock.

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Financial Highlights (N'Mn)

Earnings Flash | Total Nigeria Plc FY-2020 Result

Financial Highlights (N'Mn)			
Headlines	**FY-2020**	**FY-2019**	**Change**
Revenue	**204,721**	**292,177**	**-29.9%**
Cost of sales	-173,974	-257,125	-32.3%
	30,747	**35,052**	**-12.3%**
Other Income	1,040	3,338	-68.8%
Operating Expenses	**-28,020**	**-28,341**	**-1.1%**
Impairment loss	-228	-226	0.9%
Operating Profit	**3,539**	**9,823**	**-64.0%**
Finance Income	2,263	1,149	97.0%
Finance Cost	-2,892	-7,901	-63.4%
Profit/Loss Before Tax	**2,910**	**3,071**	**-5.2%**
Taxation	-845	-791	6.8%
Profit/Loss After Tax	**2,065**	**2,280**	**-9.4%**
	FY-2020	**FY- 2019**	
Cash and Cash Equivalents	31,404	8,233	281.5%
Trade & Other Receivables (current)	**41,335**	**45,435**	**-9.0%**
Trade & Other Payables	**73,485**	**57,178**	**28.5%**
Total Debt	**34,627**	**40,634**	**-14.8%**
Total Assets	**143,612**	**133,788**	**7.3%**
Net Assets	28,150	28,320	-0.6%
Gross Margin	15.0%	12.0%	**3.0%**
Net Margin	1.0%	0.8%	**0.2%**
Cost to Sales	85.0%	88.0%	**-3.0%**
Leverage (Debt/ Equity)	123.0%	143.5%	**-20.5%**
Leverage (Net Debt/ Equity)	11.4%	114.4%	**-103.0%**
Price(N)	135.9		
EPS(N)	6.1		
BVPS(N)	82.9		
P/E (x)	22.4		
P/BV (x)	1.6		
ROAE	7.3%		
Final Dividend (N)	6.1		
Dividend Yield	4.5%		

Disclosure Appendix

Investment Rating Criteria and Disclosure

United Capital Research adopts a 3-tier recommendation system for assets under our coverage: Buy, Hold and Sell. These generic ratings are defined below;

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