



Rating	<b>RESTRICTED</b>
Price	₦31.50
FVE ( <i>last communicated</i> )	<b>N/A</b>
52-week range	₦22.03- <del>₦39.50</del>
Market Cap. (₦'bn)	129.162
1-month Avg. Vol	1,792,874
Curr. PE	6.9x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2016 A</b>	0.37	(0.26)	(1.91)	(1.75)
<b>2017 A</b>	1.68	0.78	0.36	0.55
<b>2018 A</b>	1.73	1.84	1.48	0.09

#### FLOURMILL:NL - Share Price Trend



#### Analyst(s)

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## Flour Mills of Nigeria Plc. (Flourmill.NL)

### Call Memo

#### Discussion highlights

- Consequent to the release of its audited FY 18 results on the 2<sup>nd</sup> of July (***See report: Flourmill – A loss run saved by tax credit***), Flour Mills of Nigeria (Flourmill) hosted a conference call last week Thursday. Specific comments were made about volumes, the pricing environment, naira impact, borrowings, and finance charges. Please find below key discussion points;
- **Sales Performance:** Management attributed the record high revenue (+3.5% YoY to ₦542.7 billion) to volume growth and better product mix, as there was no increase in product prices over the 2018 fiscal year. According to management, volume growth reflected improved route-to-market and increased advertising particularly for its consumer products. Regarding the 14% YoY decline in revenue in the fourth quarter (Jan - Mar 2018), management mentioned that it was majorly due to slowdown in demand for wheat flour compared to 2018 as well as soft demand for products within its agro-allied segment. Management further mentioned that they have begun to see improvement in demand and thus, expect a turnaround in subsequent quarters.
- **Margins:** According to management, the steady gross margin of 12.7% (FY 17: 12.7%) was due to its ability to sustain sourcing of raw materials at lower prices coupled with local aggregation of raw materials (maize and soyabean) – which were previously imported. With regard its gross margin for its agro-allied business, which dipped to 1.2% (vs. 8.4% as at FY 17), management explained that

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it was the result of losses incurred related to Sunti sugar cane plant as well as slower than expected start up for ROM oil<sup>1</sup>. According to management, Sunti sugar plant was commissioned in March 2018 and is yet to achieve breakeven capacity hence, the losses that was reported. On ROM oil, management stated that it has reviewed its manufacturing, sourcing and route-to-market strategy and expects an improvement in gross profit from the division.

- **Net operating gains:** Management attributed net-operating gains of ₦5.9 billion (vs. net operating loss of ₦1.5 billion) to FX exchange gains (₦1.2 billion) and recognition of deferred income (₦2.2 billion) from the difference between the below market rate on government loans and commercial interest rates. On deferred income, according to additional information provided in the company's financial statements, loans obtained at below-market interest rate<sup>2</sup> were recorded at their fair value at inception using the appropriate market rate at date of drawdown while the benefit of the below-market rate was treated as government grants and included in deferred income. The deferred income is recognized in the income statement over the tenor of the loan.
- **Finance Charges:** Management attributed the high finance cost of ₦32.7 billion to elevated interest rates in the first half of its 2018 financial year (Apr – Sept 2017). However, in the fourth quarter (Jan – Mar 2018), management explained that the company benefitted from currently lower interest rates and has been actively substituting short-term loans and borrowings with commercial papers at prevailing low interest rates, which now accounts for 43% of its short-term loans and borrowings. This mainly drove the 15.2% QoQ moderation in finance cost to ₦7.2 billion over the final quarter.
- **Short-term loans and borrowings:** The 36% YoY and 24% QoQ reduction in short-term debts to ₦153.2 billion stemmed from the redemption of some of its bank debts with 75% of the proceeds (₦29 billion) from the rights issue – which was successfully completed in March 2018. Management explained that the impact of the rights issue, in terms of lower finance expense, will be more pronounced in its 2019 financial year.

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<sup>1</sup> Its edible oil business

<sup>2</sup> Mainly Bank of Industry and Commercial Agricultural Credit Scheme loans as well as Real Sector Support Facility which carry interest rates between 7% and 12%.

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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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimize exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio
<b>RESTRICTED</b>	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's engagement in an investment banking transaction and in certain other circumstances.

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