



Rating	BUY
Price	₦21.70
FVE	₦34.35
52-week range	₦22.20 – ₦57.22
Market Cap. (₦'bn)	29.957
1-month Avg. Vol	704,884
Curr. PE	2.09x

FO.NL - Share Price Trend**Analyst(s)****Olamide Adeboboye**Olamide.Adeboboye@arm.com.ng**Forte Oil Plc. (FO.NL)****Stock Report****Will planned divestment unlock value?**

- Having received approval from its shareholders in May 2018 to dissolve its subsidiaries, FO released its first financials detailing the performance of both the continuing and the discontinued operations¹. As at H1 18, revenue from discontinued operations printed at ₦21 billion (vs ₦18 billion in H1 17), with net earnings of ₦7.8 billion, accounting for 99% of the company's profit. Using comparable company analysis, the minimum expected proceed for the discontinued operations stands at ₦49.7 billion which is still a premium to its current net asset value (NAV) of ₦35 billion. For clarity, as at H1 18, the assets sum up to ₦94 billion, with liabilities of ₦34 billion, translating to a net asset value of ₦60 billion. Overlaying FO's stake² in the subsidiaries to the total NAV of ₦60 billion, translates to an asset value of ₦35 billion. Overall, given the expected proceeds from this sale, we think the company is likely to create more value for investors, given management's guidance of using the proceeds for expansion of its downstream operations. To add, the proposed divestment will steer special dividend payment in 2019, in our view.

¹ This includes the Forte Upstream Services Limited (FUS), AP Oil & Gas Ghana Limited (APOG), and Amperion Power Distribution Company Limited (Amperion).

² FUS – 100%, APOG – 100%, Amperion – 57%

Table 1: Comparable Company Analysis

EV/EBITDA	Power	Downstream	Upstream
EV/EBITDA	10.23x	5.64x	9.51x
Weights	70%	20%	10%
Weighted EV/EBITDA	7.16x	1.13x	0.95x
Sum (weighted EV/EBITDA)	9.24x		
EBITDA	8726		
EV	₦80,646.34		
Debt	10,566.53		
Cash	1,159.00		
Equity Value (N'mn)	₦68,921.08		

PRICE/SALES	Power	Downstream	Upstream
Price to sales	2.97x	0.23x	1.57x
Weights	70%	20%	10%
Weighted Price/Sales	2.08x	0.05x	0.16x
Sum (weighted Price/Sales)	2.28x		
Sales	21,837.00		
Equity Value (N'mn)	₦49,796.20		

PRICE/BOOK	Power	Downstream	Upstream
Price to book	1.63x	2.18x	0.62x
Weights	70%	20%	10%
Weighted Price/Book	1.14x	0.44x	0.06x
Sum (weighted Price/Book)	1.64x		
Book Value	₦59,959.00		
Equity Value (N'mn)	₦98,243.89		

Source: Bloomberg, ARM Research

Table 2: Summary of H1 18 Performance for Discontinued Operations

N'million	H1 18	H1 17
Revenue	21,837	18,945
Net finance Cost	(1,034)	(1,275)
PBT	5,788	4,061
PAT	7,820	3,776
Key Ratios		
Gross Margin	37%	32%
PBT Margin	27%	21%
PAT Margin	36%	20%

Balance Sheet (N'million)	H1 18
Assets	93,952
Liabilities	(34,001)
Net Assets	59,951
BVPS	54.90

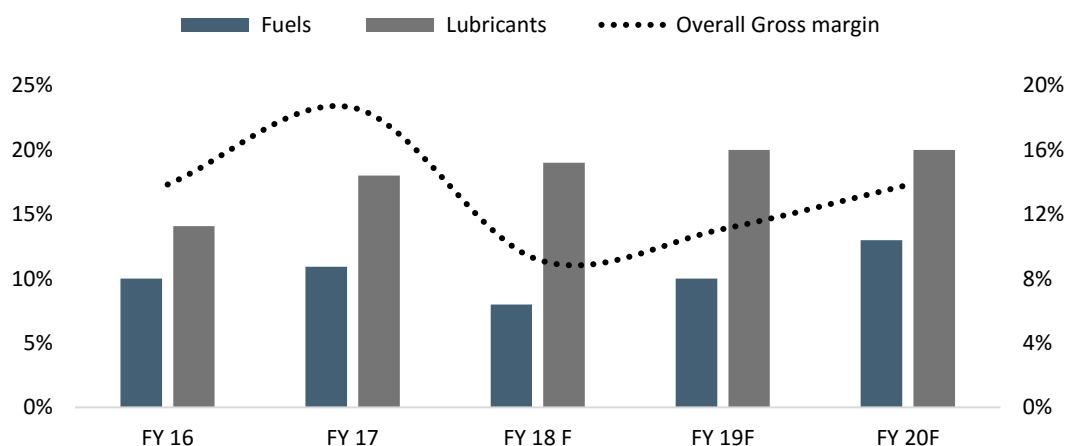
Source: Company Financials, ARM Research

Estimating the worth of the continued business

- Focusing on FO's continuing operations, we adjust our model to mirror the new business model (Nigerian downstream operations and solar systems). To recall, major pressure points for the company in 2017 was higher input and finance cost – related to power loans. However, given the new business structure, we foresee a significant drop in its finance charge, following the reduction in its borrowing and the extinction of the power business. For context, the company's borrowings dropped from ₦20.7 billion as at FY 17 to ₦7.2 billion to H1 18.
- On our 2018 numbers, we forecast a revenue estimate ₦107 billion (+18% YoY) driven by increased receipts from petroleum products and lubricants. On petroleum products, we expect FY 18 volumes to print at 507 million litres (+22% YoY) which overlaid on our expected average petroleum products³ price forecast of ₦186.25/litre, should settle FY 18 revenue at ₦94.6 billion. For context, petroleum products sold over H1 18, by our estimate, stands at 300 million litres (H1 17: 218 million litres) – a fallout of significant supply by the NNPC in a bid to combat fuel scarcity. However, over H2 18, we see a moderation in supply as NNPC normalizes its importation of PMS. In addition, we expect a soft growth in lubricants' sales (+5% YoY to ₦12.7 billion).
- For us, we perceive the input cost pressures would likely persist over the rest of the year, given the uptrend in the landing cost of petroleum products in line with rising crude oil price. That said, we model a 91% cost to sales (FY 17: 88%) ratio, which translates to ₦97 billion for FY 18. Accordingly, gross profit would drop to ₦9.8 billion with respective margin at 9.2%.

³ Made up of Petrol, Diesel and Aviation fuel.

Figure 1: Movement in Gross margin (Fuels and Lubricants)



Source: Company's Financials, ARM Research

- Elsewhere, given that the turbine related depreciation expense would no longer reflect in its financials, the company's operating expense is expected to print at ~~₹~~8.3 billion. Overlaying the numbers with other income of ~~₹~~1.7 billion translates to an operating income of ~~₹~~3.2 billion. Another positive is a reduction in finance cost, given that the company paid down a significant portion of its long-term debt as at H1 18 to ~~₹~~7.2 billion (Dec 17: ~~₹~~20.7 billion). We therefore forecast a net finance cost of ~~₹~~2.0 billion (FY 17: ~~₹~~3.6 billion) which should settle PBT for the year at ~~₹~~1.2 billion and PAT at ~~₹~~839 million.
- Beyond 2018, we model a gradual growth in sales with our 4-year CAGR of 5.1% hinged on the possibility of upward adjustment in domestic PMS price, while cost is expected to rise at a slower pace with 4-year CAGR of 3.1%. Accordingly, we forecast gross margin to average 13.1% over our forecast horizon (vs 5-year historical average of 10.2%). Elsewhere, we also perceive a moderation in finance cost as our estimate of proceeds of sale from the discontinued operations should reduce its borrowing burden in the near term. Also, the company has given no indications of raising funds in the debt market in the near term. That said, we expect earnings CAGR of 56.4% to ~~₹~~4.7 billion in 2022.
- Therefore, on our revised numbers, we now have a blended FVE of **₹34.35** (vs ~~₹~~61.44 in previous communication) using a blend of DCF and Residual Income with respective weights at 50% each. Relative to last closing price, this translates to 58.3% premium and a **BUY** rating on the shares. The company currently trades at a forward P/E of 5.37x which is at a discount to peer average of 7.54x.

Table 3: Valuation Table

	Value per share (₹)	Weights
DCF	30.16	50%
Residual Income	38.54	50%
P/E	6.96	0%
Weighted Average	34.35	100%

Summary of Results and Forecasts

ANNUAL					
Income Statement	FY 2017A	FY 2018F	FY 2019F	FY 2020F	FY 2021F
Sales	129,444	107,299	116,137	121,595	127,101
COGS	-105,328	-97,444	-103,265	-104,784	-107,312
Gross profit	24,116	9,855	12,872	16,811	19,789
Operating cost	-11,916	-8,320	-9,773	-11,106	-12,122
Operating profit	12,200	3,239	4,949	7,649	9,700
Net finance cost	-3,669	-2,041	-1,589	2,446	2,855
PBT	10,627	1,198	3,360	10,096	12,555
Tax	1,599	-359	-1,176	-3,533	-4,394
PAT	12,227	839	2,184	6,562	8,161
Earnings per share	11.20	0.77	2.00	6.01	7.47
Balance Sheet (₹ 'm) *					
Investment property	65,731	9,356	11,679	14,111	16,653
Inventories	6,100	10,483	7,435	7,859	8,048
Trade debtors	46,819	68,146	33,225	42,748	44,757
Cash and other bank balances	1,772	3,254	31,304	35,238	38,736
Total Assets	147,238	152,581	95,170	103,969	112,225
Liabilities					
Trade Creditors	53,360	29,568	36,143	38,264	38,373
Interest bearing loans & borrowings	1,370	10,974	10,817	11,899	13,089
Total liabilities	144,581	150,700	93,454	102,253	110,509
Key Ratios	FY 2017A	FY 2018F	FY 2019F	FY 2020F	FY 2021F
Profitability margins					
Gross margin	18.6%	9.2%	11.1%	13.8%	15.6%
Operating margin	9.4%	3.0%	4.3%	6.3%	7.6%
PBT	8.2%	1.1%	2.9%	8.3%	9.9%
Net margin	9.4%	0.8%	1.9%	5.4%	6.4%
Valuation multiples					
EV/EBITDA	14.4	9.3	31.2	22.2	15.7
P/CF	13.3	11.5	5.3	11.2	5.4
P/B	3.8	0.9	0.8	1.3	1.2
P/E	57.4	3.9	56.6	21.7	7.2

Source: ARM Research *unless otherwise stated

APPENDIX

Power Companies	P/B (x)	P/S	EV/EBITDA
Taqia Morocco	3.8	2.5	N/A
Qatar Electricity & Water Co	2.2	7.2	14.0
Kenya Electricity Generating	0.2	0.4	N/A
Acwa Power Barka Saog	2.2	1.7	7.7
Al Batinah Power	1.0	1.1	8.7
Phoenix Power Co Saoc	1.0	1.3	11.4
Salam International Investme	0.4	0.2	N/A
Sembcorp Salalah Power & Wat	2.2	3.0	9.3
Average	1.6	2.2	10.2

Downstream Ghana Peers	P/B (x)	P/S	EV/EBITDA
Qatar Fuel Qsc	2.1	0.7	N/A
Kenolkobil Ltd Group	2.3	0.2	8.7
Oando NI Equity	0.3	0.1	5.6
Oman Oil Marketing Company	1.0	0.1	4.2
Shell Oman Marketing	3.7	0.3	3.3
Al Maha Petroleum Products M	1.1	0.1	7.8
Total Morroco	5.5	0.0	8.7
Ghana Oil Co Ltd	3.2	0.3	N/A
Total Nigeria Plc	2.1	0.2	3.6
Eterna Plc	0.6	0.0	3.0
Average	2.2	0.2	5.6

Upstream Servicing	P/B (x)	P/S	EV/EBITDA
Al Safat Energy Holding Comp	0.4	1.9	N/A
Gulf International Services	0.9	1.2	9.5
Average	0.6	1.6	9.5

ARM ratings and recommendations

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's engagement in an investment banking transaction and in certain other circumstances.

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