

Flour Mills of Nigeria Plc. (FLOURMILL.NL)

Initial View

Weaker earnings despite lower finance expense

- Yesterday, Flour Mills of Nigeria (Flourmill) released its first quarter results (FQ1 19) reporting weaker earnings of ₦3.6 billion (-19.5% YoY). On a per-share basis, EPS printed at ₦0.90, representing a 42% decline from Q2 17 (₦1.54) due to the dilutive impact of additional shares (1.47 billion new shares) from the rights issue which was concluded in March 2018.
- Broadly, despite a marginal increase in gross profit (+0.13% to ₦17.3 billion) the contraction in earnings ensued due to higher operating expenses (+26.3% YoY to ₦6.7 billion) and lower “other operating income” which neutered lower finance expense (-30.5% YoY to ₦6.2 billion). To buttress on the decline in “other operating income”, last year was a high base bloated by foreign exchange gains which wasn’t present in FQ1 19 result.
- **Slow recovery in topline:** In the review quarter, revenue declined by 10.7% YoY to ₦133 billion, extending the YoY topline contraction that began in FQ3 18. According to provided breakdown, the decline in revenue stemmed from weakness in its food (-10.5% YoY to ₦103.6 billion) and agro-allied business (-9.7% YoY to ₦24.8 billion). Based on management’s last communication, prices have remained stable hence, we attribute the decline in sales to weaker volumes. It appears the slowdown in wheat flour as well as soft demand for its agro-allied products which management alluded to in its FY 18 conference call is still playing out to drive weaker volume and revenue. Also, concerning its sugar subsidiary, we believe the company might have lost volumes taking a cue from the current operating environment where the influx of smuggled sugar is threatening local manufacturers volumes.

Rating	RESTRICTED
Price	₦28.00
52-week range	₦24.32-₦39.50
Market Cap. (₦'bn)	120.551
1-month Avg. Vol	1,363,725
Curr. PE	6.9x

FLOURMILL:NL - Share Price Trend



Analyst(s)

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- ***Faster increase in OPEX erode gross margin expansion:*** On the other hand, cost of Sales declined faster (-12.1% YoY to ₦115.8 billion) than sales, indicating tamer cost pressures over the period. According to breakdown provided, material costs declined 15.4% YoY to ₦100.2 billion which we attribute to softer raw sugar prices (-21.3% YoY) which offset higher wheat prices (+14.7% YoY). Accordingly, gross margin expanded 140bps to 13% (vs. FQ4 18: 11.1%; FQ1 18: 11.6%). However, the expansion in gross margin was eroded as an increase in OPEX to sales ratio (+148bps to 5%) – due to higher operating expenses (+26.3% YoY to ₦6.7 billion) – drove EBIT margin to contract 7bps to 7.9% in FQ1 19 (vs. 5-year average of 5.8%) while related profit expanded declined 11.5% to ₦10.6 billion.
 - ***Finance expense extends its moderation:*** In the review period, Flourmill total debt increased 12% QoQ to ₦171 billion owing to higher borrowings from commercial banks and Bank of Industry (BOI). However, due to higher cash (+68% QoQ to ₦37.3 billion), net-debt to equity ratio remained unchanged QoQ at 87% (vs. 140% as at FQ1 17). Irrespective of higher borrowings, finance expense extended its downward trend to print at ₦6.2 billion (YoY: -30.5%; QoQ: -17.7%). We link the moderation in finance cost to the company's strategy of refinancing its expensive short-term borrowings with cheaper commercial papers at currently low interest rates as well as lower borrowings (-9.7%).
 - Flourmill trades at P/E and EV/EBITDA multiples of 6.9x and 4.3x compared to Bloomberg Middle East and Africa peers of 13.5x and 10.8x respectively.
 - Flour Mills of Nigeria Plc will be hosting a teleconference call for analysts and investors on Friday 3rd August at 14.30 Lagos / 14:30 London / 09.30 New York / 15:30 Johannesburg to review the company's group results for the quarter ended 30th June 2018 and to reply to questions. Kindly click [here](#) for details.
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Summary of Results and Forecasts - Naira (₦)

Income statement – (₦'million)	FQ1 19	YoY growth	FY 18	YoY growth
Revenue	133,029	-10.7%	542,670	3.5%
Cost of sales	115,768	-12.1%	473,895	3.5%
Gross profit	17,261	0.1%	68,775	3.1%
Operating expenses	6,707	26.3%	26,295	10.7%
Operating profit	10,554	-11.5%	42,480	-1.0%
Net interest expense	(5,994)	-32.6%	31,881	3.0%
PBT	5,213	-15.8%	16,542	173.3%
PAT	3,649	-19.5%	13,616	54.1%

Key Ratios	FQ1 19	FQ1 18	Change (pps)	FY 18	FY 17	Change(pps)
Gross margin	13.0%	11.6%	1.4%	12.7%	12.7%	0.0%
EBIT margin	7.9%	8.0%	-0.1%	7.8%	8.2%	-0.4%
PBT margin	3.9%	4.2%	-0.2%	3.0%	2.0%	1.1%
PAT margin	2.7%	3.0%	-0.3%	2.5%	1.7%	0.8%
Effective tax rate	30.0%	26.8%	3.16%	17.69%	15.6%	2.1%

Source: ARM Research *unless otherwise stated

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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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