



Flour Mills of Nigeria Plc (FLOURMILL.NL)

Initial View

Earnings down on lower revenues

Rating	RESTRICTED
Price	₦19.05
52-week range	₦18.90–₦39.50
Market Cap. (₦'bn)	78.11
1-month Avg. Vol	1,110,406
Current PE	6.5x

FLOURMILL: NL - Share Price Trend



Analyst(s)

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- Late yesterday, Flour Mills of Nigeria released its second quarter (FQ2 19) result for the period ended September 2018. EPS remained miserable, as it fell 78.5% YoY to ₦0.35 due to depressed margins from weaker revenue (-8.5% YoY), higher operating expenses (+25.1% YoY) and higher effective tax of 54% (vs. 34% in FQ2 18). With FQ2 19 in, EPS is down 60.6% YoY to ₦1.25 over the first half of its fiscal year ended March 2019.
- Revenue growth remained weaker YoY which we attribute to lower prices. We recall that Flourmills cut its selling prices modestly in FQ1 19 due to intense competition majorly from smuggled wheat and sugar which impacted on its market share. Breakdown of its revenue in FQ2 19 revealed that the food segment declined 7.2% YoY although, we note that the pace of decline is slower than the slump of 10.5% for the food segment in FQ1 19, suggesting that its strategy to cut prices, particularly for wheat might be paying off.
- Gross margin was down 136bps YoY to 10.9% due to high fixed costs (direct staff cost & depreciation) which outweighed the moderation in raw material costs (-8.8% YoY). EBIT margin contracted by 279bps to 5.6%, pressured by higher operating expenses (+25.1% YoY to ₦7.3 billion). Higher OPEX stemmed mainly from a five-hundred-fold increase in advertising and a 20% increase in admin expenses. We note that OPEX in FQ1 19 was up double-digit and management explained that the growth came from increased advertising for its B2C food products (pasta & noodles) in a bid to maintain market share. We think this continued into the second quarter considering the five-fold jump in advertising expense.

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- We observed further balance sheet deleveraging in FQ2 19, as net debt declined to ₦115 billion from ₦134 billion and ₦154 billion as at FQ1 19 and FH1 18 respectively. The moderation in debt was majorly driven by a 28% decline in short-term borrowings (including bank overdrafts). Given this, net debt to equity ratio improved to 76% from 87% in FQ1 19. We believe the moderation in debt alongside the relatively lower yield environment prompted the 31.5% YoY decline in finance costs to ₦5 billion. The company approached the debt market in September to raise ₦30 billion in medium term bonds to refinance some its short-term borrowings at a lower interest rate. If successful, we see this providing further support to finance costs and earnings in the second half of its financial year.
 - Flourmill trades at P/E and EV/EBITDA multiples of 6.5x and 3.7x compared to Bloomberg Middle East and Africa peers of 18.1x and 7.2x respectively.
 - Flour Mills of Nigeria Plc will be hosting a teleconference call for analysts and investors today 31st October at 14.00 Lagos / 13.00 London / 09.00 New York / 15:00 Johannesburg to review the company's group results for the six months ended 30th September 2018 and to reply to questions. Kindly click [here](#) for details.
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Summary of Results and Forecast

Income statement – (¥ million)	Q2 19	YoY growth	H1 19	YoY growth
Revenue	136,708	-8.5%	269,737	-9.6%
Cost of sales	121,850	-7.1%	237,618	-9.6%
Gross profit	14,859	-18.7%	32,120	-9.6%
OPEX	7,270	25.1%	13,977	25.7%
Operating profit	7,589	-39.1%	18,143	-25.6%
Finance expense	(4,947)	-30.4%	(10,941)	-31.6%
PBT	3,089	-57.6%	8,302	-38.4%
PAT	1,420	-70.6%	5,069	-45.8%

*N/M means not meaningful

Key Ratios	Q2 19	Q2 18	Change(pps)	H1 19	H1 18	Change(pps)
Gross margin	10.9%	12.2%	-1.4%	11.9%	11.9%	0.0%
EBIT margin	5.6%	8.3%	-2.8%	6.7%	8.2%	-1.4%
PBT margin	2.3%	4.9%	-2.6%	3.1%	4.5%	-1.4%
PAT margin	1.0%	3.2%	-2.2%	1.9%	3.1%	-1.3%
Effective tax rate	54.0%	33.8%	20.3%	38.94%	30.6%	8.4%

Source: ARM Research

ARM ratings and recommendations

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

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