

Okomu Oil Palm Plc. (OKOMU.NL)

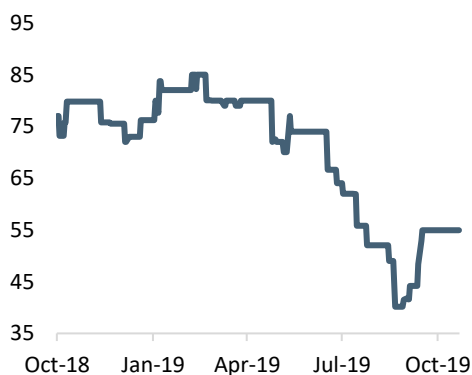
Stock Report

Glimmer of hope

Rating	NEUTRAL
Price	₦ 54.95
FVE	₦ 77.23
52-week range	₦ 40.15 – ₦ 88.5
Market Cap. (₦mn)	52,417.4
1-month Avg. Vol	153,889
Current. PE	9.74x

Quarterly EPS	Q1	Q2	Q3	Q4
2017 A	3.22	2.72	0.17	2.89
2018 A	3.64	2.59	1.36	1.32
2019 A	1.06	1.60	1.66	2.80*

OKOMU:NL - Share Price Trend



Analyst

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- Okomu Oil Palm Plc** released Q3 19 result yesterday, with reported revenue debunking the historically lower level during the quarter due to the onset of the lean season. Accordingly, reported EPS is higher by 21.8% YoY to ~~₦~~1.66 (also compared to Q1 19: ~~₦~~1.06 and Q2 19: ~~₦~~1.60). Notwithstanding, the EPS came in much lower than our expectation as a result of higher effective tax rate and operating expense. For context, reported tax spend, translates to an effective tax rate of 52%, compared to seven quarter average of 22% and 27% in Q3 18. Irrespective of the strong performance in Q3, smuggling impact on EPS in Q1 and Q2 kept EPS for 9M 19 lower at ~~₦~~4.31, which is 43% lower compared to ~~₦~~7.59 in 9M 18. The company declared an interim dividend of ~~₦~~2.00, which translates to a dividend yield of 4% using yesterday's closing price.
- Sales turned a corner:** Relative to prior quarters, the company witnessed increased demand for its products on the back of FG's directive to close major borders in the country in a bid to curb illegal influx of goods into the country. As a result, despite Q3 being a slow quarter due to the onset of the lean season, the company was able to draw down from its large pile of inventory, which translated to higher sales over the quarter (+86.3% YoY to ~~₦~~6.9 billion). Surprisingly, despite border closures, prices remained relatively flat at ~~~₦~~300,000/ton as ongoing trade spat between US and China and India's decision to raise tariff on CPO imports continue to bolster global market supplies, thereby leaving international prices depressed. The company also reported higher rubber sales (+71.4% YoY to ~~₦~~1 billion) which in our view is reflective of higher global rubber prices.
- Operating margin expansion despite cost pressures:** Over Q3 19, the company reported slight expansion in raw material cost (+3.9% YoY to ~~₦~~523 million). In our view, the rise in raw material cost is reminiscent of higher fertilizer cost over the period. Regardless, following faster rise in sales relative to raw material cost, gross margin expanded 600bps YoY to 92.5%. Looking at the numbers more closely, we do not rule out an adjustment to the raw material cost over Q4. Elsewhere, operating cost more than doubled to ~~₦~~3.4 billion, with OPEX to sales increasing to 49.2% from 39% in prior period. We believe this is related the higher operating cost on the ongoing construction work at the extension 2 plantation. Accordingly, EBIT margin contracted 420bps YoY to 43.3% in Q3 19.

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- ***Going forward, we see scope for higher sales:*** Following FG's decision to extend the partial closure of the country's borders beyond the 28 days earlier stated, we see scope for higher CPO sales over the rest of the year. Despite the onset of the lean season, we believe the elevated inventory levels (9M 19: ₦3.3 billion vs ₦2.7 billion in 9M 18) would cater to rising demand for local CPO in Q4 19. As a result, we raise FY 19 revenue by 25% to ₦20.3 billion. Farther out, our discussion with management revealed that the ongoing plan to expand its Okomu 1 oil mill to 75 ton/ hour (from 60 ton/ hour) in March 2020 is still intact. Accordingly, at peak, the company's CPO production is expected to increase to 70,000 MT from 40,000 MT. This alongside the ongoing construction of a new 30 ton/ hour oil mill in Extension 2 bodes well for sales growth over the near to medium term. More so, given the subsisting market deficit in Nigeria's CPO market (USDA 2019 estimates: 375,000MT) and FG's efforts to clamp down on illegal importation of CPO, we think a ready market exist for the ramp up in volumes by Okomu over the medium term.
 - ***We raise operating cost higher:*** In line with prior periods, we see room for some right backs in operating expenses in the last quarter of the year. This view is premised on significantly higher prepayments to supplier at the time of reporting (₦7 billion vs ₦648 million last year). Thus, we raise our operating cost by 32% YoY to ₦6.6 billion, as we expect OPEX write backs to the tune of ₦735 million in Q4 19. The cumulative impact of our adjustment translates to a 6% increase in our FY 19 EPS to ₦7.11 (-20% YoY). Over in 2020, factoring expectation of higher sales emanating from expansion in capacity, we model a 39% YoY increase in FY 2020 EPS to ₦9.91.
 - Rolling forward our model and taking into cognizance adjustments made to our model, we maintain our **BUY** recommendation on OKOMU and raise our FVE by 2% to **₦77.23**. This solely reflects the positive change in market dynamics following the extension of the partial closure to the country's borders which bodes well for sales and capacity expansion in 2020 and 2021. Okomu trades at a P/E of 9.74x at a discount to Presco and Bloomberg MENA peers of 11.45x and 9.79x respectively.
 - ***Risk:*** Risk to our estimate are abrupt end to the border closure which would pave room for the return of illegal CPO to the country and further declines in global CPO prices which would leave sales depressed.
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Summary of Results

ANNUAL					
Income Statement (N'm) *	2017A	2018A	2019E	2020F	2021F
Revenue	20,262	20,258	20,179	23,240	30,085
COGS	4,226	5,019	5,045	5,810	7,521
Gross Profit	16,035	15,238	15,134	17,430	22,564
Operating Cost	5,061	5,162	6,659	6,739	8,123
Operating Profit	11,128	10,260	8,596	10,830	14,621
Interest expense	484	293	308	368	399
Interest income	491	354	144	450	439
PBT	11,140	10,337	8,268	10,993	14,701
Tax	1,992	1,835	1,488	1,539	1,470
PAT	9,148	8,502	6,780	9,454	13,231
Balance Sheet (N '000) *					
Fixed Assets	11,217	13,392	12,321	14,434	14,441
Stocks	2,687	3,149	2,321	2,673	3,460
Trade debtors	978	744	807	930	1,203
Cash & other bank balances	3,094	4,129	4,863	7,669	14,272
Total Assets	31,372	38,418	37,689	45,081	55,491
Liabilities					
Trade Creditors	488	1,548	908	1,046	1,354
Non-current Liabilities	3,097	4,981	4,146	4,279	4,424
Total liabilities	6,865	9,904	8,427	8,729	9,216
Shareholders' fund	31,372	38,418	43,611	51,003	61,413
Key Ratios	2017A	2018A	2019E	2020E	2021E
Gross Margin	79.14%	75.22%	75.00%	75.00%	75.00%
EBIT Margin	54.92%	50.65%	42.60%	46.60%	48.60%
PBT Margin	54.98%	51.03%	40.98%	47.30%	48.86%
Net Margin	45.15%	41.97%	33.60%	40.68%	43.98%
EPS	9.59	8.91	7.11	9.91	13.87
P/E	5.48	8.95	11.23	8.05	5.75
EV/EBITDA	3.89	6.53	6.19	4.91	3.47
ROA	29.16%	22.13%	17.99%	20.97%	23.84%
ROE	37.33%	29.82%	19.27%	22.36%	25.35%

Source: ARM Research *unless otherwise stated

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