

Total Nigeria Plc. | Company Note
Total remains attractive despite subsisting risk
(BUY: ₦368.54)

- In this note, we update our views on Total Nigeria Plc. (TOTAL NL) as we take account of recent weakness in the company's share price (-12.04% YTD)—despite rally in the equities market—and roll forward our valuation model to 2017.
- Since our last update, Total's share price has been flat relative to last closing price, though the stock has declined to a low of ₦249/share, which we consider fair in context of salient downside risks to the stock. That said, while we note the downside risk, we think they are limited at this level and believe the stock is cheap enough to justify our **BUY** rating. Our recommendation is based on a revised target price of ₦368.54/share (from ₦384.72/share), which represents an expected total return of 40%. We revise our forecast to reflect recent developments including: (1) appreciation in the FX parallel market; (2) increase in diesel and lubricant prices; and (3) higher cost on the deregulated segments.

Income Statement Data			
(N'mn)	Q1 2017	Q1 2016	%chg
Revenue	80,463	59,705	34.8%
PBT	4,250	3,843	10.6%
Tax	(1,579)	(1,019)	55.0%
PAT	2,672	2,825	-5.4%
Balance Sheet Data			
	Q1 2017	FY 2016	%chg
Inventory	19,481	34,903	-44.2%
Receivables	85,522	48,498	76.3%
Cash	13,245	21,842	-39.4%
Payables	100,043	95,679	4.6%
Net Assets	26,242	23,815	10.2%
Stock Data			
Price	₦263.00		
52-week range	₦152.00 - ₦345.00		
Market Cap. (N'b)	89,294		
1-month Avg. Vol	270,761		
Curr. PE	6.1x		
Bloomberg Ticker	TOTAL:NL		
Total Nigeria - Share Price Trend			

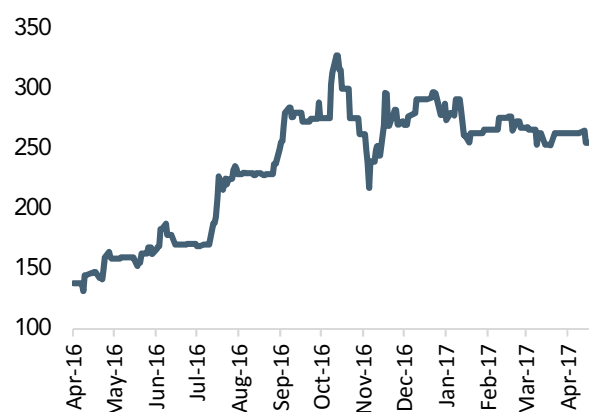

Analyst(s)
Kayode Omosebi
kayode.omosebi@arm.com.ng

Table 1: Financial Snapshot

	2015	2016	2017F	2018F	2019F
Revenue (mn)	208,028	290,953	315,567	322,390	329,364
Gross Profit (mn)	25,345	49,102	50,453	53,915	57,609
Operating profit (mn)	6,255	20,931	18,509	28,204	30,418
PAT (mn)	4,047	14,797	11,921	18,602	19,414
EPS	11.92	43.58	35.11	54.79	57.18
DPS	11.00	17.00	17.56	38.35	40.03
P/E (x)	12.94	6.68	7.49	5.32	5.09
Gross Margin (%)	12.2%	16.9%	16.0%	16.7%	17.5%
EBIT Margin (%)	3.0%	7.2%	5.9%	8.7%	9.2%
PAT Margin (%)	1.9%	5.1%	3.8%	5.8%	5.9%

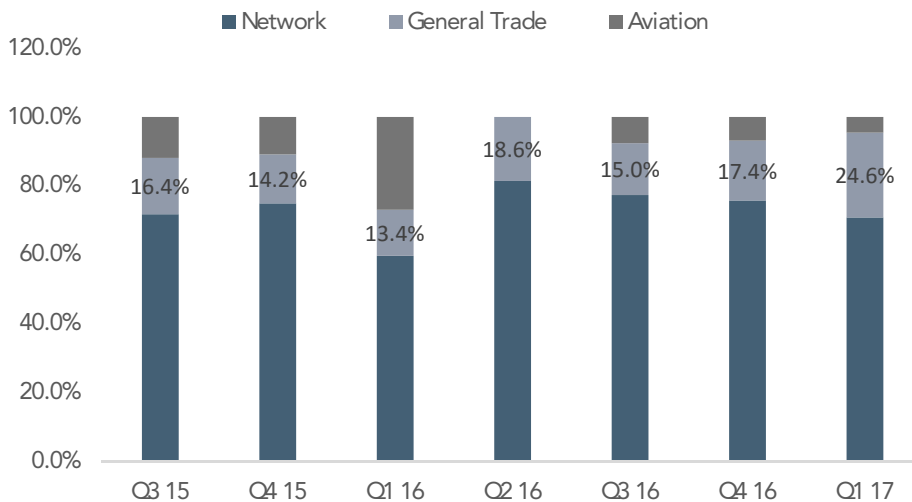
Source: Company Financials, ARM Research

Cost pressure mask Q1 earnings

- From its Q1 17 numbers, revenue expanded 34.8% YoY (+13.8% QoQ) to ₦80.5billion (Q1 17E: ₦75.7billion) reflecting price induced growth in the turnover of the petrol (+30.4% YoY) and lubricants (+63.1%) segments respectively. However, input cost (+40.6% YoY to ₦71.5billion) tracked faster than top-line and relative to our expectations (Q1 17E: ₦60.4billion) dragging gross margin to an eight-quarter low of 11.2% (-3.7pps YoY). Parsing through the numbers suggest cost pressures was evident in the petroleum product segment (+41.3% YoY to ₦62.2billion) linked to the general trade section¹. Pertinently, despite spiraling cost on the back of naira weakness for most part of the quarter, the largely contractual nature of the general trade section strapped Total into incurring higher cost in supplies without being able to pass-on cost to its corporate customers. Notwithstanding flattish cost at the OPEX line (+0.7% YoY), the combined impact of spiraled cost and higher net finance charges (+28.6% YoY) drove EPS 5.4% lower YoY to ₦7.87.

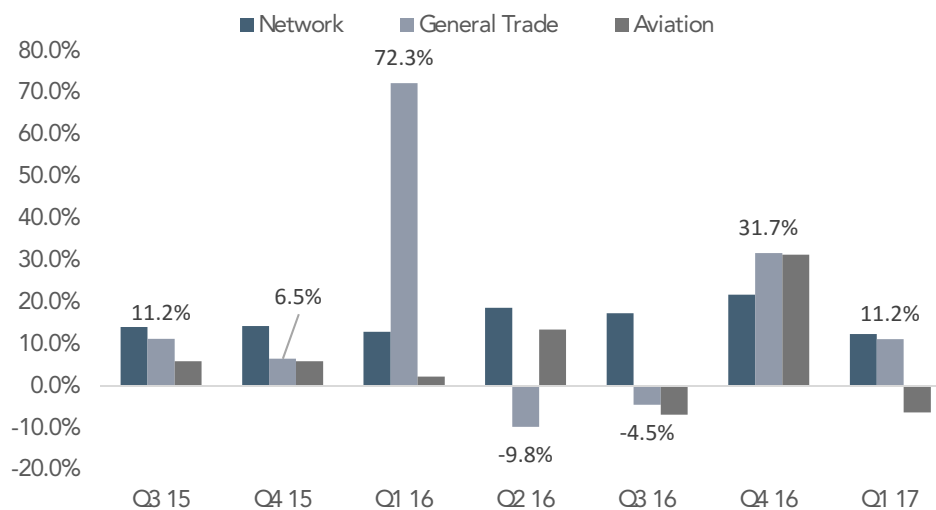
¹ Sales to corporate customers excluding customers in the aviation industry

Figure 1: Quarterly sales mix across business segment



Source: Company financials, ARM Research

Figure 2: Gross margin across business segment



Source: Company financials, ARM Research

From our findings, outstanding contracts have a duration of 4-6months, thus we expect Total to effect higher prices sometime in Q2 17, particularly for diesel products. However, given the relative descent in prices in March 2017, we think Total's miss on locking in on higher margins in January will keep margins lower YoY. Furthermore, given that the FX rate for sourcing of deregulated products is 7% higher from 2016 average of N379.95/\$, we expect cost pressures to remain a drag on Total's 2017 performance.

Earnings remains upbeat but replicating 2016 is a tough call

- Over FY 17, we expect overall top-line +8.5% YoY (to ~~₦~~315.6billion) to remain buoyed by higher YoY PMS prices (2017 projection: ~~₦~~145/litre vs. ~~₦~~123/litre for 2016) and increment in lubes prices, irrespective of our projections for weaker petrol volumes (-8% YoY to 1.6billion litres). On cost, notwithstanding recent NGN appreciation at the parallel market which should ordinarily moderate input cost, our average crude oil price estimate (22% YoY to \$55/bbl.) and expected 2017 FX rate (+18% to ₦360/\$) should leave COGS at elevated levels. Consequently, gross margin should come in 90bps lower YoY at 16.0%. Further down, amidst the still elevated payables, second order impact of weaker naira underpins our expectation for FX loss of ~~₦~~6.4billion over 2017. The foregoing should combine with higher net finance charges (+24% YoY to ~~₦~~717million), reflecting absence of payment of accrued interest on delayed subsidy, to drive our FY 17 EPS to ~~₦~~35.11 (-19.4% YoY) with total dividend at ~~₦~~17.56 (assuming a 50% pay-out).
- Total has had a good run over the last one year and currently trades at a P/E of 6.1x relative to 13.6x for peers. We have lowered our FVE to **₦368.54** (from ~~₦~~384.72) using the same valuation methodology and parameters as previously, namely a 70:30 weighting for DCF and relative valuation. We retain a **BUY** rating on the stock given 40% upside from last closing price of ~~₦~~262/share

Risks to our valuation

Key risks to our forecasts, valuation and recommendation include:

Upside Risk	Downside Risk
<ul style="list-style-type: none">• Increase in PMS prices	<ul style="list-style-type: none">• A bigger than expected depreciation in the naira which would drive cost higher
<ul style="list-style-type: none">• Sizable appreciation of the naira	<ul style="list-style-type: none">• Influx of previously banned imported (cheaper) lubricants which would pressure lubricants' volumes and prices
	<ul style="list-style-type: none">• Greater-than-expected contraction in PMS volumes

Summary of Results and Forecasts

ANNUAL

Income Statement (R'mn)*	FY 2015A	FY 2016A	FY 2017F	FY 2018F	FY 2019F
Sales	208,028	290,953	315,567	322,390	329,364
COGS	(182,682)	(241,851)	(265,113)	(268,475)	(271,756)
Gross profit	25,345	49,102	50,453	53,915	57,609
Operating cost	(20,295)	(20,563)	(26,969)	(27,101)	(28,565)
Operating profit	6,255	29,988	24,891	28,204	30,418
Net finance cost	240	(578)	(717)	(440)	(550)
PBT	6,495	20,353	17,793	27,765	29,868
Tax	(2,448)	(5,556)	(5,872)	(9,162)	(10,454)
PAT	4,047	14,797	11,921	18,602	19,414
Earnings per share	11.92	43.58	35.11	54.79	57.18
Dividend per share	11.00	17.00	13.14	28.02	40.20
Balance Sheet (R'mn)*	FY 2015A	FY 2016A	FY 2017F	FY 2018F	FY 2019F
Assets					
Investment property	23,091	25,228	29,088	30,997	32,398
Inventories	17,392	34,903	25,239	25,559	25,871
Trade debtors	24,631	24,631	48,498	37,364	38,171
Cash and other bank balances	13,502	21,842	20,429	27,420	31,565
Total Assets	83,654	136,928	117,923	127,961	134,656
Liabilities					
Trade Creditors	48,261	95,679	70,037	70,925	71,792
Interest bearing loans & borrowings	13,587	9,220	4,137	4,199	4,262
Total liabilities	80,192	136,683	117,690	127,729	134,424
Shareholders' fund	16,242	23,570	32,727	41,815	47,580
Key Ratios	FY 2015A	FY 2016A	FY 2017F	FY 2018F	FY 2019F
Profitability margins					
Gross margin	12.2%	16.9%	16.0%	16.7%	17.5%
Operating margin	3.0%	10.3%	7.9%	8.7%	9.2%
PBT	3.1%	7.0%	5.6%	8.6%	9.1%
Net margin	1.9%	5.1%	3.8%	5.8%	5.9%
Valuation multiples					
EV/EBITDA	6.5	2.5	2.7	1.9	0.0
P/CF	6.4	7.4	10.2	4.4	4.2
P/B	4.2	4.2	3.0	2.4	2.1
P/E	12.9	6.7	7.49	5.3	5.1

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	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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