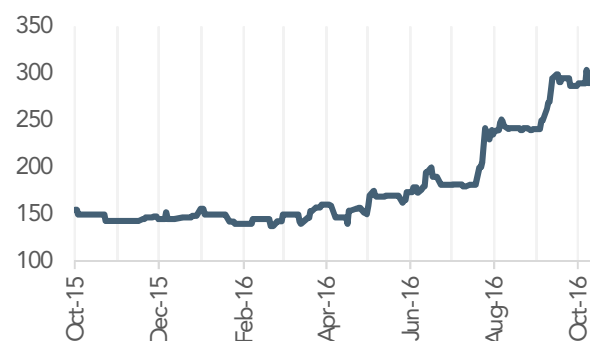


Total Nigeria Plc. | Earnings report
On track for a solid year despite slog in Q3 16 (₦356.93 - NEUTRAL)

- Our investment case for Total as per our H2 16 report on the company ***“Harnessing the dividend of flexible market pricing”*** is still on track for our 2016 FYE earnings. Particularly, 9M 16 EPS of ₦34.26 is 89% of our revised YE 16 forecast of ₦38.29 (76.5% of previous forecast of ₦44.8). However, Q3 16 showed underlying weakness as combination of tamer PMS sales, FX pressures and finance costs took its toll on Total’s results.
- For 9M 16, sales expanded 38.2% YoY to ₦220.2 billion driven by a 37% and 48% YoY growth in petroleum and Lubricants sales. Gross margin was up by 2.8pps on a year ago basis to 14.5%, which, in addition to a trivial rise (1% YoY) in opex and an almost five-fold YoY contraction in net finance cost to ₦232 million, drove PBT and PAT margins 4.6pps and 3.5pps higher YoY to 7.7% and 5.3% respectively. EPS of ₦34.26 is four-times that of 9M 15 (₦8.16). Accordingly, Total declared additional interim dividend of ₦7.00 per share, implying a dividend yield of 2.2% at current price. Combined interim dividend of ₦10.00 per share (₦3.00 per share in H1 16) is 34% of our FY 16E forecast of ₦29.1 dividend per share (Interim dividend in 9M 2015 was 18.2% of final dividend for the year).

Income Statement Data			
	2016 – 9M'm	2015 – 9M'm	%chg
Revenue	220,217	159,299	38.2%
PBT	17,004	4,947	243.7%
Tax	(5,372)	(2,177)	146.8%
PAT	11,632	2,770	319.9%
Balance Sheet Data			
	2016-9M 'm	2015-Dec 'm	%chg
Inventory	41,498	17,392	138.6%
Receivables	24,718	24,631	0.4%
Cash	22,141	13,502	64.0%
Payables	83,724	48,261	73.5%
Net Assets	22,782	16,242	40.3%
Stock Data			
Price	₦329.99		
52 week range	₦137.75 – ₦329.99		
Market Cap. (N'b)	112,039		
1-month Avg. Vol	124,827		
Curr. PE	9.6x		
Bloomberg Ticker	TOTAL:NL		
Total Nigeria - Share Price Trend			


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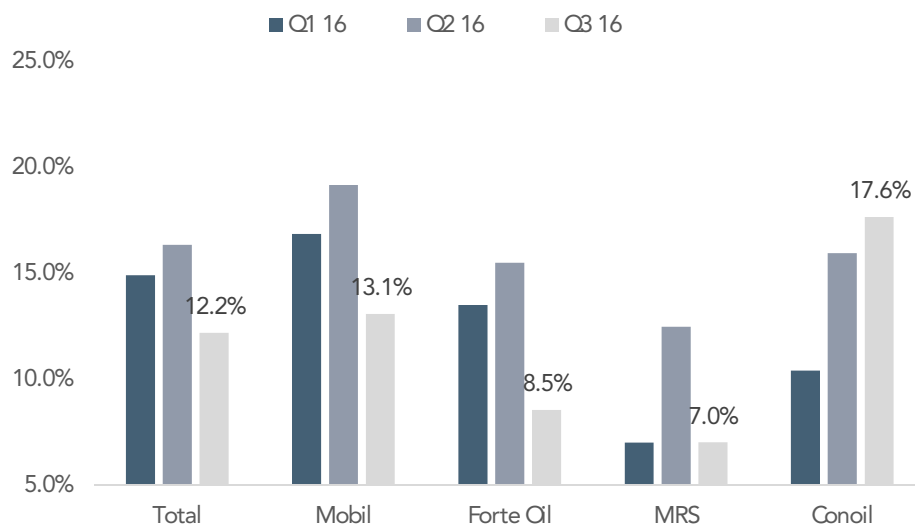
Sales falter owing to PMS volume contraction

- Total's underlying weakness in Q3 16 was largely on the back of feeble sales over the period which stemmed from volume contraction. Pertinently, sales during the review period stood at ₦74.7 billion –12.9% lower compared to the preceding quarter, though 57.9% higher on a year ago basis. The slower sales growth during the period was largely on the back of a 14.7% QoQ decline in petroleum sales to ₦64.5 billion which we adduce to volumes decline. By our estimate, volumes were down 43.2% QoQ to 444.7 million litres –a significant decline than expected which wiped out the +50% increase in average fuel prices during the period. Though in discussions with management, Total links the weaker volumes growth to an elastic demand response to the price hike, we think lower product imports – a fall-out of open financing organized early Q3 by the CBN led to product glut for the company. For lubricants, sales revenue was flat relative to the prior quarter at ₦10.24 billion.

Third party product sourcing crimps margins

- Our views regarding lower imports and reliance on third party product sourcing assumes firmer standing, looking through gross margins. In line with sector trends over Q3 16, gross margins slid 4.1pps QoQ to 12.2% with PMS margin contracting 3.9pps QoQ to 12.4%. Lubes margins shrank a wider 5.5pps QoQ to 10.8% which we attribute to FX pressures with regards to import of base oil for lubes
-

Figure 1: Gross margin across our coverage (Q1 16 – Q3 16)



Source: Company financials, ARM Research

- Further down, OPEX was tamer 6.4% QoQ (10.1% YoY) to ₦5.3 billion driven by S&D expenses which was down 21.3% QoQ. Other operating income came in three-times higher at ₦387 million, moderating the decline in EBIT (-53.4% QoQ). Net finance cost of ₦137 million, compared to net finance income of ₦70 million in Q2 16, further shoved PBT and PAT to ₦4.0 billion and ₦2.7 billion –a marked decline of 55.3% and 55.8% QoQ respectively. However, earnings (PBT, PAT) remained three-times higher YoY.

Earnings normalizing.... down but not out

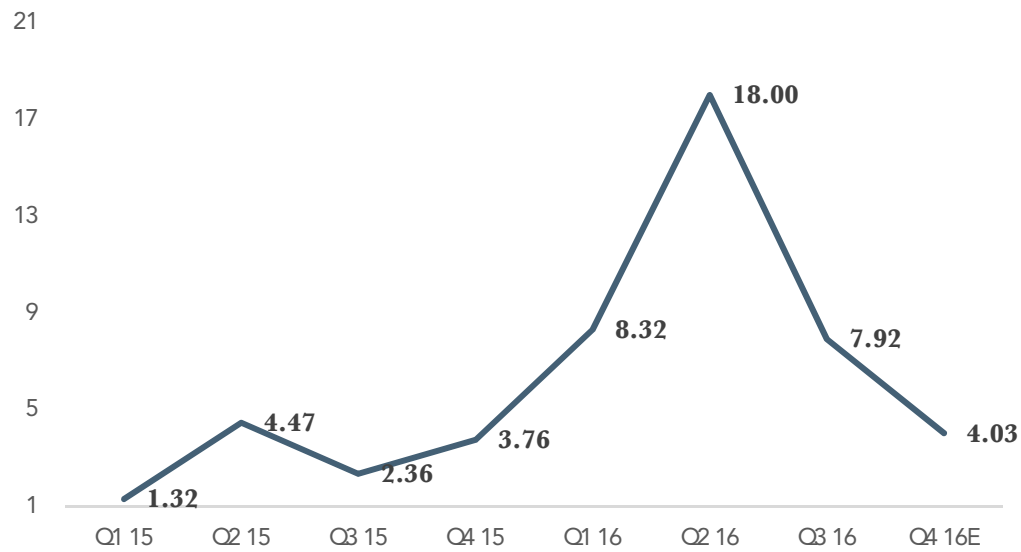
- The weaker earnings in Q3 16 when compared to the preceding quarter was due to the higher base effect as Q2 16 recorded abnormal profit following the tacit deregulation in May 2016. Consequently, we expect to see earnings normalize further in Q4 16, though higher relative to preceding year. Going into Q4 16, we assume a 10% QoQ decline in volumes to 400.3 million litres which at current pricing translates to ₦61.8 billion in petrol revenues. combined with forecast lubricants sales of ₦9.8 billion, we see Q4 16 revenue of ₦71.7 billion for Total in Q4 16. (-4.1% QoQ and +47.1% YoY).

- Gross margin estimate of 13.8% for Q4 16 is 163bps higher QoQ and 14bps higher YoY. Based on discussion with management and industry players, the NNPC FX intervention program which should roll-out in Q4 should support margin in the period. The program basically means the NNPC will guarantee supply of dollars for fuel imports at the official rate which will bolster access to FX for import. Despite the 6% increase in crude oil prices (from Q3 16 average of \$46.9/bbl. compared to average of \$49.71/bbl. QTD) which will likely trend higher, the softer FX weights should offset pressures from crude oil prices.
- The Q4 16E revisions drive modest changes to our 2016E financial performance for the company. Primarily driven by a downward revision in retail sales, which we now expect to climb 50% YoY (vs. 52% previously), as well as marginally higher input cost to ₦250 billion (₦248 billion previously), our gross profit is 65% higher YoY (vs. 80.9% YoY previously) to ₦41.9 billion. Gross margin of 14.4% (14.2% for petrol and 15.1% for lubricants) is 118bps lower than our prior estimate. However, given the payment of accrued interest on subsidy payments¹ and cut back in finance charge estimate to ₦883 billion, net finance cost is ₦343 million (₦811 million previously) which partly offset margin pressures. The foregoing drives our FY 2016 earnings estimate 14.5% lower, from prior, to ₦13.0 billion (EPS: ₦39.29). Over our forecast horizon (2017 to 2020), while we expect sales to remain sturdy under the price modulation regime, we see increased prospect of rebound in oil price as global crude market rebalance and FX to exert some margin pressure.
- On a YTD basis, Total has gained sturdily, appreciating 124.5%, outperforming the Oil & Gas sector which is down 31.3% and the All Share Index (-4.7%). Net adjustment to our models drive our FVE estimate 4% lower to ₦356.93 which implies an 8% upside from last closing price of ₦329.99. We place a **NEUTRAL** rating on the stock. Total trades at current P/E and FY 2016 P/E of 9.6x and 5.2x compared to peer average of 17.2x and 14.8x

¹ Given earlier FG's comment on non-refund of interest on subsidy payments, this item was not accrued for in prior quarters. However, recent DMO disbursement in from Q3 guides our forecast for finance income.

respectively.

Figure 2: Earnings per share (Q1 15 – Q4 16E)



Source: Company financials, ARM Research

Summary of Results and Forecasts

QUARTERLY					
Income Statement (N'000,000)*	Q1 2016A	Q2 2016A	Q3 2016F	Q4 2016F	
Sales	59,705	85,777	75,372	73,567	
Cogs	(50,812)	(71,764)	(64,378)	(61,608)	
Gross profit	8,893	14,013	10,994	11,959	
Operating cost	(5,189)	(5,111)	(6,044)	(7,425)	
Operating profit	4,009	9,025	5,299	5,183	
Profit before taxation	3,843	9,095	4,906	4,239	
Tax	(1,019)	(2,985)	(1,643)	(1,640)	
Profit after taxation	2,825	6,110	3,262	2,599	
ANNUAL					
Income Statement (N'000,000)*	FY 2015A	FY 2016E	FY 2017F	FY 2018F	FY 2019F
Sales	208,028	291,911	304,606	315,917	327,839
COGS	(182,682)	(249,998)	(261,385)	(271,007)	(281,661)
Gross profit	25,345	41,913	43,221	44,909	46,179
Operating cost	(20,295)	(23,590)	(24,758)	(26,121)	(27,259)
Operating profit	6,255	19,748	19,944	20,572	20,771
Net finance cost	240	(343)	(410)	(380)	(332)
PBT	6,495	19,405	19,534	20,193	20,439
Tax	(2,448)	(6,404)	(6,446)	(6,664)	(6,745)
PAT	4,047	13,001	13,088	13,529	13,694
Earnings per share	11.92	38.29	38.55	39.85	40.33
Dividend per share	11.00	29.10	28.28	27.21	28.99
Balance Sheet (N '000,000)*					
Assets					
Investment property	23,091	25,235	27,257	29,070	30,465
Inventories	17,392	23,800	24,884	25,800	26,814
Trade debtors	24,631	24,631	34,563	36,066	37,405
Cash and other bank balances	13,502	6,190	8,100	10,895	13,768
Total Assets	83,654	95,047	101,604	108,498	115,228
Liabilities					
Trade Creditors	48,261	66,044	69,052	71,594	74,408
Interest bearing loans & borrowings	13,587	4,076	4,137	4,199	4,262
Total liabilities	80,192	91,595	98,152	105,046	111,776
Shareholders' fund	16,242	19,364	22,851	27,141	30,994
Key Ratios					
	FY 2015A	FY 2016F	FY 2017F	FY 2018F	FY 2019F
Profitability margins					
Gross margin	12.2%	14.4%	14.2%	14.2%	14.1%
Operating margin	3.0%	6.8%	6.5%	6.5%	6.3%
PBT	3.1%	6.6%	6.4%	6.4%	6.2%
Net margin	1.9%	4.5%	4.3%	4.3%	4.2%
Valuation multiples					
EV/EBITDA	6.5	2.6	2.5	2.5	0.0
P/CF	6.4	3.9	4.0	3.8	3.7
P/B	4.2	3.5	3.0	2.5	2.2

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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