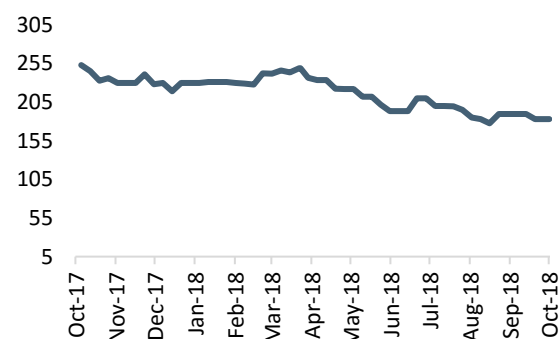


| | |
|--------------------|---------------------------|
| Rating | STRONG BUY |
| Price | ₦183.00 |
| FVE | ₦244.28 |
| 52-week range | ₦177.6- ₦254.0 |
| Market Cap. (₦'bn) | 62.13 |
| 1-month Avg. Vol | 45,898 |
| Curr. PE | 6.6x |

| Quarterly EPS | Q1 | Q2 | Q3 | Q4 |
|-----------------|------|-------|-------|-------|
| 2017A | 7.87 | 5.70 | 3.97 | 6.08 |
| 2018(E*) | 4.92 | 11.80 | 7.12* | 7.91* |

Total: NL - Share Price Trend



Analyst(s)

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Total Nigeria Plc. (Total: NL)

Stock Report

A Strong Speculative BUY

- We upgrade our FVE on Total Nigeria Plc to ₦244.28, as we now model a 24% hike in domestic petrol price to ₦180 per litre and increase in finance income in 2019 - following robust subsidy receivables as at H1 18. However, to adjust for the regulatory risk in the Nigerian downstream sector, we raised our equity risk premium on the stock to 8%. From a valuation perspective, Total is trading at a FY 19 P/E of 3.8x which is at a discount to its domestic peers of 8.1x.

Table 1: Financial metrics for domestic peers

| | FO | TOTAL | MOBIL | MRS |
|------------------------------------|-------|-------|-------|------|
| Current Price to Earnings | 30.7x | 6.6x | 9.3x | N/A |
| Fwd Price to Earnings | 10.9x | 3.8x | 7.7x | 5.6x |
| Return on Equity - FY 17 | 25% | 32.8% | 21.8% | 6.1% |
| Return on Equity -5 yr avg. | 14.0% | 43.4% | 40% | 4.9% |
| Return on Asset -FY 17 | 8.5% | 6.6% | 7.2% | 1.9% |
| Return on Asset - 5 yr avg. | 4.9% | 7.4% | 9.6% | 1.5% |

Source: Company Financials, ARM Research

Still the preferred of the pack

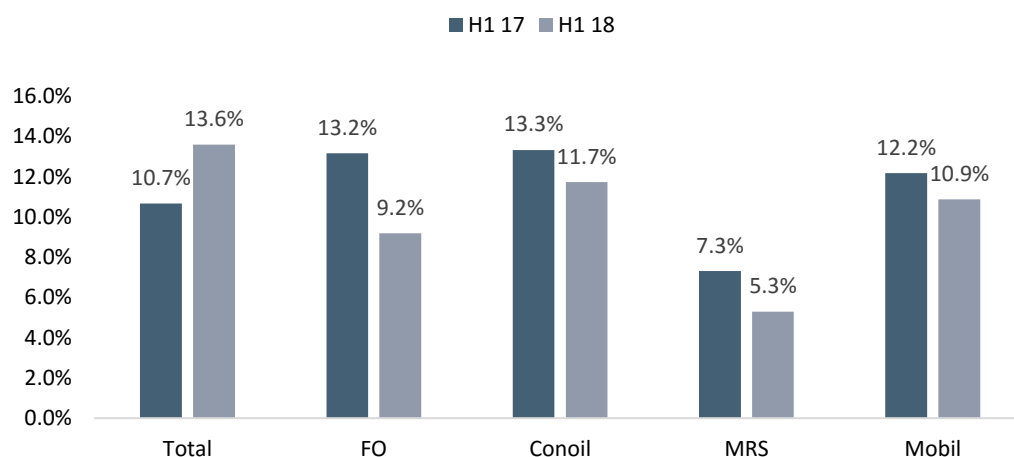
- Contrary to pressured margins experienced by other players in the downstream sector over H1 18, Total reported a gross margin expansion of 290bps YoY to 13.6%. Accordingly, margins expanded across its business reporting segments - network¹ at 14.1% (+272bps), General Trade² at 13.2% (+254bps) and Aviation at 10.7% (+10.3ppts). While we were unable to get clarifications from the

¹ Sales to the retail customers

² Sales to corporate customers

management, we perceive the margin expansion stemmed from the use of older stock for lubricants, as inventory declined by 5.31% YTD to ₦25.3 billion as at H1 18. Also, we perceive better pricing in the aviation segment further supported the increase in their margins, as it reported YoY revenue growth 75.7%. Overall, aggregate revenue rose 2.2% YoY to ₦156.3 billion while cost of sales declined by a modest 1.2% YoY to ₦135 billion. Further down, Total booked a lower effective tax rate of 34% (H1 17: 37%), which in addition to the improved margin drove a 23.2% YoY growth in PAT to ₦5.7 billion, translating to an EPS of ₦16.71 over H1 18.

Figure 1: Gross margins across the downstream sector (2017-2018)



Source: Company Financials, ARM Research

Moderation in input cost underpins core earnings

- In terms of our outlook for 2018, we project a flattish revenue of ₦288.1 billion, as we expect the volume driven decline in petroleum products and lubricant sales at the network segment (-5% YoY to ₦203.0 billion) to offset higher price and volume driven sales at the general trade (+7% YoY to ₦61.6 billion) and aviation sector (+40% YoY to ₦23.5 billion) segments.
- On cost, given the use of older inventory in H1 18, particularly for lubricants, we expect cost of sales for FY 18 to print at 86.9% (FY 17: 89.8%) necessitating our forecast of a decline in COGS (-3.3% YoY to ₦251 billion). For clarity, we expect the company's cost to increase in the second half in a bid to replace its used inventory³ which should instill pressures on its cost given the sustained increase in the price of base oil. Consequently, we forecast gross margin to expand 290bps to 13.1%. Elsewhere, operating expense is expected to grow by 7.7% YoY to ₦22.6 billion, hinged on the increase in staff cost. Coalescing growth in OPEX with gross earnings

³Going by historical numbers, it takes an average of 38 days to deplete its inventory.

expansion and other operating income of ₹1.5 billion translates to an EBIT of ₹16.7 billion (+36.2% YoY) with respective margin at 5.80% (FY 17: 4.26%).

Higher operating profit offset the jump in net finance cost

- Elsewhere, we expect a five-fold increase in the company's net finance cost to ₹3.3 billion (FY 17: ₹474 million), resulting from the decline in finance income due to the absence of any subsidy payment in our model and the significant jump in trade finance (+ 55.7% YTD to ₹5.5 billion) during the year. Irrespective, we expect gains from higher operating profit to offset the increase in net finance cost, translating to a profit before tax of ₹13.4 billion (+13.6% YoY) and FY18E EPS of ₹25.66 (+17.2 YoY).

Price hike to change the story in 2019

- Beyond 2018, given that the fixed nature of retail domestic PMS price relative to the rising importation cost has pressured margins for the downstream players, we believe there is possibility of a price hike in 2019, particularly post-election. For us, applying our 2018E average crude price of \$70 per barrel⁴ to the PPPRA pricing template, we think the domestic crude oil price could increase by 24% to ₹180 per litre, which we expect to bolster revenue. Accordingly, we expect a pick-up in the revenue with a 4- year CAGR of 5.6% between 2019 and 2022.
- The attendant impact of our modelled price hike post-election in 2019 results in gross margin improvement, with our 4-year forecast average of 14.6% (vs 12.7% between 2014 and 2017). Also, another upside for the company is the increase in finance income via the payment of its outstanding PSF receivables (₹3.2 billion) which we now expect to come in from 2019. Net impact of these adjustments necessitated our FVE of ₹244.28 which offers an upside of 33.5%, translating to a **STRONG BUY** on the stock.
- Downside risk to our forecast is if the domestic retail price is left unchanged, leaving margins at current level.

Table 1: Scenarios analysis on revenue growth and FVE (2018 – 2022)

| PMS PRICE HIKE | 2018E | 2019E | 2020E | 2021E | 2022E | FVE (₹) | UPSIDE |
|--------------------|-------|-------|-------|-------|-------|---------|--------------|
| Price hike in 2019 | -5.0% | 25.0% | 20.0% | 5.0% | 3.0% | 244.28 | 33.5% |
| Price hike in 2020 | -5.0% | 3.0% | 20.0% | 15.0% | 3.0% | 235.56 | 28.7% |
| No hike in Price | -5.0% | 3.0% | 2.0% | 2.0% | 2.0% | 202.33 | 10.6% |

Source: ARM Research

⁴ As at Sept 27, Average crude price for FY 18 stands at \$74 per barrel

Summary of Results and Forecasts - Naira (₦)

| ANNUAL | | | | | |
|-------------------------------------|----------|----------|----------|----------|----------|
| Income Statement (N'm) * | FY 2017A | FY 2018F | FY 2019F | FY 2020F | FY 2021F |
| Sales | 288,063 | 288,129 | 326,650 | 361,225 | 375,796 |
| COGS | -258,767 | -250,363 | -278,361 | -307,709 | -321,602 |
| Gross profit | 29,296 | 37,766 | 48,289 | 53,516 | 54,195 |
| Operating cost | -20,963 | -22,570 | -24,165 | -26,195 | -27,660 |
| Operating profit | 12,269 | 16,705 | 25,485 | 28,689 | 27,908 |
| Net finance cost | -474 | -3,303 | -1,305 | -1,055 | -3,019 |
| PBT | 11,795 | 13,401 | 24,180 | 27,634 | 24,889 |
| Tax | -3,776 | -4,006 | -7,671 | -8,354 | -7,707 |
| PAT | 8,019 | 9,395 | 16,509 | 19,279 | 17,182 |
| Balance Sheet (N '000) * | | | | | |
| Assets | | | | | |
| Investment property | 28,520 | 29,843 | 32,093 | 34,727 | 37,381 |
| Inventories | 26,666 | 27,290 | 30,898 | 35,386 | 36,984 |
| Trade debtors | 48,498 | 32,726 | 38,321 | 44,098 | 49,849 |
| Cash and other bank balances | 12,163 | 9,111 | 15,012 | 19,651 | 24,513 |
| Total Assets | 107,982 | 112,533 | 130,152 | 147,754 | 158,920 |
| Liabilities | | | | | |
| Trade Creditors | 63,420 | 62,591 | 69,033 | 75,696 | 78,792 |
| Interest bearing loans & borrowings | 13,135 | 12,741 | 12,996 | 13,256 | 13,521 |
| Total liabilities | 105,164 | 109,915 | 127,535 | 145,136 | 156,302 |
| Shareholders' fund | 25,819 | 33,869 | 44,790 | 55,469 | 63,274 |
| Key Ratios | | | | | |
| | FY 2017A | FY 2018E | FY 2019F | FY 2020F | FY 2021F |
| Gross margin | 10.2% | 13.1% | 14.8% | 14.8% | 14.4% |
| Operating margin | 4.3% | 5.8% | 7.8% | 7.9% | 7.4% |
| PBT | 4.1% | 4.7% | 7.4% | 7.7% | 6.6% |
| Net margin | 2.8% | 3.3% | 5.1% | 5.3% | 4.6% |
| Valuation multiples | | | | | |
| EV/EBITDA | 3.8 | 2.9 | 2.0 | 1.8 | 1.9 |
| P/CF | 8.4 | 10.6 | 3.6 | 3.1 | 2.9 |
| P/B | 3.0 | 1.8 | 1.4 | 1.1 | 1.0 |
| P/E | 9.7 | 6.6 | 3.8 | 4.0 | 4.5 |

Source: Company Financials, ARM Research

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 | 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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