

# FLOUR MILLS OF NIGERIA PLC



... Higher Cost Profile Dampens Earnings Growth

September 14, 2022

Earnings Note

## Event

Following the successful acquisition of Honeywell Flour Mills ('HFM' or 'Honeywell'), Flour Mills of Nigeria (FMN) incorporated the combined results of the two entities in its Q1 2023 results.

Revenue grew by 45% YoY to N339.60bn in Q1 2023, with the Group's entire business segments recording strong growth. Revenue growth in the Food segment was 45% YoY to N213.17bn and this accounted for 63% of the total revenue growth. In the Agro Allied segment and Sugar segment, revenue grew by 38% YoY to N65.65bn and 64% YoY to N55.02bn, respectively.

Across the segments, the growth drivers in Q1 2023 include increased market penetration, particularly into new markets through deployment of containers, tricycles, POS, and other digital channels. There were also new SKUs launches in the starch and fertiliser product segments. In summary, enhanced distribution via deepened route to market and higher pricing accounted for the Group's total revenue growth in Q1 2023.

Segments (N'mn)	Q1 2023	Q1 2022	Variance	YoY Change
Food	213,166	146,926	66,241	45%
Agro-Allied	65,652	47,688	17,964	38%
Sugar	55,022	33,527	21,495	64%
Support services	5,762	5,563	199	4%
<b>Total revenue</b>	<b>339,601</b>	<b>233,703</b>	<b>105,898</b>	<b>45%</b>

Source: Company Accounts, WSTC Research

## Higher Input Costs Pressure Margins

The Group contended with higher raw material costs during the quarter, as cost of sales rose by 47% YoY to N306.35bn. This resulted in a 100 basis points cost margin expansion to 90% in Q1 2023. The impact of the geopolitical conflict between Russia and Ukraine, relating to prices in the global commodities market, took a heavy toll on the Group's cost profile. The negative impact also reflected in the Group's cash position, given the significant inventory ramp-up (+97% YoY to N367bn).

## Inflationary Pressures and One-Off Costs Further Depress Margins

Operating expense grew by 52% YoY to N14.68bn. The transitional process of incorporating Honeywell resulted in a N1.10bn loss during the period. Heightened inflationary pressure and higher energy prices also factored in the operating expense increase in Q1 2023.

Buoyed by higher debt levels (majorly from Honeywell), finance cost spiked by 79% YoY to N8.15bn. Beyond the accounting and financial reporting impact of the Honeywell transaction, increased working capital need due to inventory build-up, also led to higher borrowings levels.

The combined impact of higher operating expense and finance costs dampened bottomline, as net profit grew marginally by 1% YoY to N5.49bn. However, if transitional expenses were stripped off, we estimated that net profit could have grown by 16% YoY.

# BUY

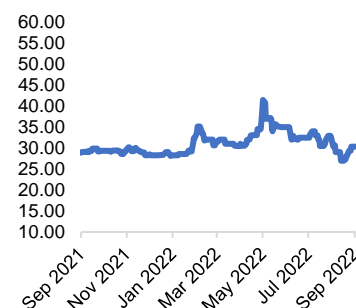
Fair Value: N43.72

Total Return: +51%

## Stock Data

Current price (N)	30.30
Shares Outstanding (mn)	4,100
Market Cap (Nmn)	124,230
52-week high (N)	41.45
52-week low (N)	27.00
Trailing EPS (N)	6.26
Forward EPS (N)	6.30
Forward PE (X)	4.81
Justified PE Multiple (X)	6.89

## Price Movement



## Stock Data

Stock Data	FY 2021	FY 2022	FY 2023F
P/E	4.75x	4.84x	4.81x
P/BV	0.71x	0.63x	0.58x
PBT Margin	5%	4%	3%
PAT Margin	3%	2%	2%
RoE	16%	15%	14%
Dividend Yield	5%	7%	7%

## Analysts

Abdulrauf Bello

[a.bello@wstc.com.ng](mailto:a.bello@wstc.com.ng)

Isaac Osaro

[i.osaro@wstc.com.ng](mailto:i.osaro@wstc.com.ng)

Oluwadamilola Pase

[o.pase@wstc.com.ng](mailto:o.pase@wstc.com.ng)

Flour Mills (N'mn)	Q1 2023	Q1 2022
Revenue	339,601	233,703
Revenue growth	45%	
Gross profit	33,248	25,699
Gross margin	10%	11%
Operating profit	19,666	16,040
Operating margin	6%	7%
Net profit	6,596	5,446
Net margin	2%	2%
Earnings per share	N1.61	N1.33

Source: Company Accounts, WSTC Research

### Q1 2023 Financial Performance

Income Statement (N'mn)	Q1 2023	Q1 2022	YoY Change (%)
<b>Revenue</b>	<b>339,601</b>	<b>233,703</b>	<b>45%</b>
Cost of sales	(306,353)	(208,004)	47%
<b>Gross profit</b>	<b>33,248</b>	<b>25,699</b>	<b>29%</b>
Selling and distribution expense	(4,609)	(3,062)	51%
Administrative expense	(10,074)	(6,597)	53%
<b>Operating expense</b>	<b>(14,683)</b>	<b>(9,659)</b>	<b>52%</b>
<b>Operating profit</b>	<b>18,566</b>	<b>16,040</b>	<b>16%</b>
<b>Non-operating profit/(loss)</b>	<b>(11,237)</b>	<b>(8,778)</b>	<b>28%</b>
Impairment	(659)	(1,399)	-53%
Operating (losses) and gains	(2,621)	(3,126)	-16%
Finance income	193	298	-35%
Finance costs	(8,150)	(4,551)	79%
<b>Profit before tax</b>	<b>7,328</b>	<b>7,261</b>	<b>1%</b>
Income tax	(1,832)	(1,815)	1%
<b>Profit after tax</b>	<b>5,496</b>	<b>5,446</b>	<b>1%</b>
Balance Sheet (N'mn)	Q1 2023	Q1 2022	YoY Change (%)
PPE	331,567	208,881	59%
Inventory	367,032	186,443	97%
Receivables	36,796	24,140	52%
Cash	50,136	43,215	16%
Others	94,924	77,728	22%
<b>Total Assets</b>	<b>880,455</b>	<b>540,407</b>	<b>63%</b>
Borrowings	340,764	157,797	116%
Payables	216,201	89,727	141%
Others	121,642	112,823	8%
<b>Total Liabilities</b>	<b>678,608</b>	<b>360,347</b>	<b>88%</b>
<b>Net Assets</b>	<b>201,847</b>	<b>180,060</b>	<b>12%</b>

**Outlook**

We maintain our BUY recommendation for the stock; however, we lower our fair value estimate to N43.46 (previous: N52.77). This is because we lowered our earnings projections across our seven years forecasts due to increased cost pressure and working capital constraints – particularly from the Honeywell business. We also posit that heightened inflationary pressure and what it means for household purchasing power would begin to reflect in the Group's performance in the form of weak volume sales and downtrading. Increased downtrading by consumers could hurt margins.

Nonetheless, we think that FMN's investment thesis is strong. Market leadership, product innovation, enhanced distribution network, and sound management are some of the investment considerations of the Group. While we note the historically weak margins of the business, cash flow generation is relatively strong. Over the long term, we see scope for improved margins and return on equity, given the ongoing investments in backward integration.

**Financial Projections**

<b>Income statement (NGN mn)</b>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023F</b>	<b>FY 2024F</b>	<b>FY 2025F</b>	<b>FY 2026F</b>	<b>FY 2027F</b>
Revenue	771,608	1,163,803	1,509,831	1,741,137	1,973,927	2,221,655	2,469,147
EBITDA	91,634	90,113	109,154	128,622	147,724	171,297	168,149
EBIT	67,725	65,649	83,311	103,946	122,186	142,852	168,149
Profit before taxation (PBT)	37,194	41,118	41,398	49,184	69,441	95,812	124,917
Net profit (PAT)	25,717	28,015	28,206	33,511	47,312	65,280	85,110
EPS (₦)	6.38	6.26	6.30	7.49	10.58	14.59	19.02
DPS (₦)	1.65	2.15	2.20	2.70	3.69	5.09	6.64
<b>Balance sheet (NGN mn)</b>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023F</b>	<b>FY 2024F</b>	<b>FY 2025F</b>	<b>FY 2026F</b>	<b>FY 2027F</b>
Current assets	306,005	412,116	541,367	558,868	593,146	623,182	666,871
Non-current assets	238,728	254,895	385,772	408,978	430,419	460,848	485,306
Total assets	544,733	667,012	927,139	967,845	1,023,564	1,084,030	1,152,177
Current liabilities	209,696	293,586	457,512	487,633	523,729	515,921	552,771
Non-current liabilities	160,423	177,521	256,688	245,581	232,913	256,489	230,660
Shareholders' equity	174,614	195,905	212,940	234,631	266,922	311,620	368,746
Book value per share (₦)	42.58	47.78	51.93	57.22	65.10	76.00	89.93
<b>Cash flow statement (NGN mn)</b>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023F</b>	<b>FY 2024F</b>	<b>FY 2025F</b>	<b>FY 2026F</b>	<b>FY 2027F</b>
Cash from operating activities	29,851	44,037	52,593	132,049	128,124	141,241	175,443
Cash from investing activities	(18,425)	(44,848)	(154,889)	(45,689)	(44,585)	(56,350)	(52,580)
Cash from financing activities	649	(11,378)	151,753	(72,069)	(95,078)	(87,951)	(92,886)
Net increase/ (decrease) in cash	12,075	(12,189)	49,458	14,291	(11,539)	(3,061)	29,978
Free cash flow to equity	17,068	225	62,179	30,696	98	12,880	51,583
<b>Ratio analysis</b>	<b>FY 2021</b>	<b>FY 2022</b>	<b>FY 2023F</b>	<b>FY 2024F</b>	<b>FY 2025F</b>	<b>FY 2026F</b>	<b>FY 2027F</b>
EBITDA margin	12%	8%	7%	7%	7%	8%	7%
Operating margin	9%	6%	6%	6%	6%	6%	7%
ROE	16%	15%	14%	15%	19%	23%	25%
ROA	5%	5%	4%	4%	5%	6%	8%
Dividend payout ratio (%)	26%	34%	35%	36%	35%	35%	35%

**Source:** Company Accounts, WSTC Research

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- Buy Rating: estimated fair value is  $\geq 15\%$  above current market price.
- Hold Rating: estimated change in price is between  $-10\%$  and  $15\%$  of current market price.
- Sell Rating: estimated change in price is  $\leq -10\%$  of current market price.

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WSTC Securities Limited has its registered office at 2, Maitama Sule Street, South-West Ikoyi, Lagos, Nigeria.

Email: [research@wstc.com.ng](mailto:research@wstc.com.ng)

Website: [www.wstc.com.ng](http://www.wstc.com.ng)

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