

Corporate Focus : Flour Mills of Nigeria



Market Cap : N126.09bn

Share Price : N30.75

July 26, 2021

Analyst Note

Flour Mills of Nigeria's stock is currently trading at N30.75 which is 18.3% higher than its opening price of N26 in 2021. While it has not fully compensated investors for inflation, it remains one of the most attractive stocks on the exchange. Its holding period return (dividend + capital appreciation) of 25% is higher than the rate of inflation. At the current price of N30.75, the stock remains a Buy based on an earnings multiple of 5.9x, its double digit growth across its entire business segments (propped by aggressive backward integration into domestic agriculture) and a well-diversified brand portfolio. In addition, Flour Mills of Nigeria is poised to enjoy better access to forex following the CBN's licensing of only three companies for raw sugar importation as a reward for their backward integration efforts.

Double digit growth across the entire business segments

Flour Mills of Nigeria (FMN) reported a double digit top line increase of 34% in FY'21 to N771 billion from N573 billion in the corresponding period of 2020. When compared to the manufacturing sector growth of 3.4% in Q1'21, FMN is not only outperforming its sector but is roaring to go faster. The company enjoyed both volume and value growth across all its businesses. The food business was up by 33% to N478 billion supported by improved packaging, new product innovation and efficient distribution channels. Flour Mills recorded a surge in its main Business-to-Consumer (B2C) segments: noodles, pasta and semovita. The company's strategic reform and innovations in the agro-allied business delivered a 32% jump to N139 billion. Despite the forex challenges faced by the company due to regulatory fx restrictions, the sugar segment revenue grew by 28% to N124.6 billion. This impressive performance was however achieved on the back of continuous expansion through the group's backward integration strategy.

A spike in operating profit despite a one-off exchange rate loss

The group's operating profit increased by 49% to N52 billion from N35 billion in FY'20, supported by impressive revenue growth. Operating expenses also moved in tandem with top line growth. Improved marketing and enhanced distribution channels including employee related cost contributed to the 26% increase in operating expenses to N41 billion. FMN is however vulnerable to exchange rate volatility from two sources: forex availability and exchange rate instability, which culminated into a one-off foreign transaction loss of N12 billion.



Moderation in finance cost aids bottom line growth

The company's profit after tax increased by 126% in FY'21 to N25.7 billion, relative to its competitors due to its defensive portfolio. The company's backward integration strategy, which cuts across its agro allied business, feed milling and sugar production, contributed to this stellar performance. In addition, a 49% growth in operating profit and a 6.5% reduction in finance cost to N18.6 billion supported the bottom line performance. The reduction in finance cost is attributable to the successfully issued N30 billion corporate bonds raised to substitute for expensive short term obligations. Interest on bank loans reduced significantly by 53% to N9.89 billion in FY'21.

Company Overview

Flour Mills of Nigeria Plc is a dominant player in the Nigerian food and agro allied industry and controls about 80% of the flour milling industry in Nigeria. The group's operations are classified into four major sectors of Food, Sugar, Agro-allied, and Support services.

The group has retained its market share through an increased product mix, effective backward integration, investment in agriculture to boost local production and improved distribution network. The group's increased investment in the Business-to-Consumer (B2C) segment through improved distribution channels delivered a stellar performance in FY'21.



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Over the years, the industry's top player suffered stiff competition from smaller peers who gained entry into the market through attractive product pricing. However, Flour mills reported resilient performance in 2020, attributed to the positive effect of border closure, which heightened Flour Mills competitive position in the market.

Aggressive Backward Integration and Product Innovation

Following the Apex bank's fx restriction on wheat and sugar importation, FMN intensified its focus on local production of raw materials with aggressive investment in backward integration and strategic partnership with Flour Milling Association of Nigeria (FMAN) and local farmers in order to strengthen value chains. Also, in a bid to achieve self-sufficiency in the production of sugar in Nigeria, the group invested heavily in sugar production. The group's Sunti Golden Sugar Estates remains one of the best performing under the National Sugar Master plan.



The group recently launched a breakfast cereal (Amazing Day) to deepen its penetration in the FMCG industry and to meet the increasing demand for Ready-To-Eat Cereal (RTEC), which represents about 65% of breakfast consumption in Nigeria. Based on the group's innovative strategy and the need to meet dwindling consumers' disposable income, the group had other new products introduced into the market (Auntie B Spaghetti and Spaghetti Slim).

What the bulls say:

- Largest market share (45%) in flour
- Strong brand name- Golden Penny/ Semovita
- Capacity expansion located at the port with its own terminal

What the bears say:

- Stiff competition from other players
- Weak consumers' purchasing power
- Harsh operating environment
- Heightened insecurity

Outlook

Whilst there are headwinds that are not peculiar to the company, the earnings momentum of FMN is far in excess of the temporary impediments to its growth and dominance in an industry where its track record is unquestionable and its leadership not in doubt.

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