

Dangote Flour Plc: Interim Results – Q3, Sept. 2010



December 07, 2010

BUY

Fair Value: NGN 19.24

Current Price: NGN16.80

Valuation/Analyst Recommendation

In arriving at a fair value for the ordinary shares of DANGFLOUR, we used two valuation methods which are Discounted Future Earnings Method (DFE) and Discounted Free Cash Flow Method (DCF). We project Turnover, Earnings Before Interest and Tax (EBIT), Earnings Before Interest Tax Depreciation and Amortization (EBITDA) and Profit After Tax (PAT) for the periods ending December 2010, 2011, 2012, 2013 and 2014. We estimate the Turnover of **N73.67bn, N88.40bn, N101.66bn, N116.91bn and N128.60bn** for 2010, 2011, 2012, 2013 and 2014, respectively. We estimate EBIT of **N14.03bn, N17.68bn, N20.33bn, N19.87bn and N21.86bn** for the same period, based on EBIT Margin of 19.04% for 2010, 20.00% for 2011-2012 and 17.00% for 2013-2014. We estimate EBITDA of **N17.31bn, N21.44bn, N24.58bn, N24.59bn and N27.06bn** for the same period. Looking at our estimate of the capital expenditure of the company within the forecast period and the notional tax on EBIT for the same period and adjusting for the net working capital, we arrived at **Free Cash Flow (FCF)** of **N10.48bn, N15.27bn, N17.28bn, N17.81bn and N18.99bn**. Our forecast PAT of **N9.82bn, N12.02bn, N14.64bn, N16.20bn and N17.82bn** is based on PAT margin of 13.33% for 2010, and a range of 13.60% to 14.40% for 2011-2014. Using a dividend payout of 70% for the period we arrived at **Dividend Payment** of **N6.87bn, N8.42bn, N10.25bn, N11.34bn and N12.47bn**. We applied a terminal growth rate of 7.69%. We used a beta value of 1; risk free rate of 9.90% and a **market risk premium** of 10.04%. Applying foregoing parameters on the Capital Asset Pricing Model (CAPM), the cost of equity generates 19.94%, which is our cost of capital. The company had no long term interest bearing debt in its capital structure as at the last audited account. Using 5bn shares in issue, the DFE Model generates **N18.15** per share and the DCF Model generates **N20.12** per share. Applying a weight of 45% to the DFE and 55% to the DCF, we arrive at a value of **N19.24** per share, which is our fair value. Buying the stock at the current market price of **N16.80** and the price increases to our fair value of **N19.24** and adding the present value of the 5-year forecast dividend, investors will record a total return of 49.10%. Relating this return to the cost of Equity at 19.94%, investment in Dangote Flour shares at the current market price will record a positive alpha return of 29.16%. The 2010 forward earnings yield based on our fair value generates 10.21%, while the 2010 forward Dividend Yield based on **N1.37** Dividend Per Share at our fair value generates 7.14%. We therefore place a **BUY** on the share price of Dangote Flour Mills at the current market price.

Business Description

The principal activities of DANGFLOUR are flour milling, processing & marketing of branded flour and production & marketing of packaging materials.

Ticker	DangFlour
Sector	Food/Beverages & Tobacco
Date of Incorporation	January, 2006
Date of Listing	February 04, 2008
Year End	December
No of Ordinary Shares	5,000,000,000
Capitalisation (N)	84,000,000,000
% of Market Cap.	1.06
52-Week High (N)	28.82
52-Week Low(N)	7.35
YTD Return (%)	64.15
52-Week Avg. Trade	3,308,969
Beta Value	1.64
Current EPS (N)	1.39
Current PE(x)	12.12

Penetrating Additional Markets:

The unaudited Q3 2010 result of Dangote Flour Mills Plc (DANGFLOUR) for the period ended September 30, 2010 shows that its Turnover (TO) increased by 15.34% to **N54.26bn**, compared with **N47.03bn** in the corresponding period of 2009. The company improved on its cost management strategy as at Q3, 2010 over the corresponding period of last year and over the position as at full year 2009, leading to growth in profitability. The cost reduction may have been driven by the trucks it purchased in 2009 to bring about more efficient delivery of goods. Profit Before Tax (PBT) increased by 24.85% between 2009 and 2010 to **N7.07bn** from **N5.67bn** in the corresponding period of 2009. The tax provision of **N119.32mn** was charged during the period higher than **N80.51mn** in Q3, 2009. This led to Profit After Tax (PAT) of **N6.96bn**, from **N5.59bn** in 2009 representing a growth of 24.51%. We made efforts to speak with the management of the company to ascertain the nature of the tax benefit the company enjoys, but none was successful.

The PBT Margin in Q3, 2010 increased over the corresponding period in 2009 and over the FY, 2009 figure. The PBT margin increased to 13.04% in Q3 2010 from 12.05% as at Q3, 2009, and up from 8.75% as at the end of the financial year in December, 2009. This shows that the company's total costs as a percentage of TO stands at 86.96%, down from 87.95% recorded in the corresponding period of 2009 and down from 91.25% as at FY 2009. PAT margin currently stands at 12.82%, up from 11.88% and 9.06% in the corresponding period of 2009 and as at FY 2009 respectively. The result also indicated that the percentage of TO, PBT, and PAT in Q3 2010 to FY Audited TO, PBT and PAT for the period ended December, 2009 are: 88.39%, 131.63% and 125.07% respectively. Given the current run rates DANGFLOUR should surpass its previous year's performance with wide margins.

A cursory look at the balance sheet position as at Q3, 2010 compared with the position as at December 2009, shows that its fixed assets increased by 14.34% to **N40.98bn** from **N35.85bn** in FY 2009. This can be linked to the current expansion projects of the company to penetrate additional markets. The net assets increased by 23.45% to **N35.43bn** from **N28.70bn** as at FY, 2009. Cash and bank balances decreased from **N1.93bn** in FY, 2009 to **N1.58bn** in Q3, 2010. Short-term borrowing as at Q3, 2010 was down by 27.48% to stand at **N10.06bn** from **N13.87bn** as FY 2009. DANGFLOUR's working capital position improved from a negative position of **N6.58bn** in FY, 2009 to a negative of **N5.03bn**. Stocks however increased by 25.44% to **N10.34bn** from **N8.25bn** in FY, 2009. The trade debtors increased by 12.97% to **N10.62bn** from **N9.40bn**, while trade creditors increased significantly by 95.33% to **N12.52bn** in Q3, 2010 from **N6.41bn** as at FY, 2009.

Our analysis of the operating environment shows that the manufacturing and distribution businesses in which food and beverages firms operate in Nigeria, are faced with infrastructure challenges (transportation and power). In order to meet their power needs, manufacturing companies invest heavily in alternative sources of power. The cost of acquiring and maintaining this equipment add in no small measure to the operating costs. Manufacturing firms sometimes shift some of these costs to their customers in form of increase in the price of goods, while the firms bear a portion of it. In addition to the problem of infrastructure, the current financial crisis and the unwillingness of banks to lend has reduced credits to the real sector, while the available credits command high interest rates, thus increasing financing costs for the manufacturers. These factors have limited the growth of the manufacturing sector in the country, despite the huge market potentials within and in the neighboring countries. In the last one year, the manufacturing sector has not witnessed significant improvement as the capacity utilization fluctuates between 35% and 40%. In addition, the Nigerian manufacturing industry is relatively small in relation to the size of the domestic economy. The sector has not grown remarkably over the years due to the neglect of the sector for crude oil, epileptic power supply, and weak infrastructure, among others. Manufacturing sector's contribution to the Gross Domestic Product (GDP) as at June 2010 is 3.93%, while the growth rate is 7.69%.

Dangote Flour Group is currently embarking on a number of expansion projects to enlarge its manufacturing and packaging facilities within the country. It currently has ongoing projects in various mills aimed at achieving 7,300 metric tons per day. The projects are scheduled to be completed in the last quarter of 2010. DANGFLOUR plans the introduction of wheat meal brand, Alkama and retail packs for flour and Danvita. In order to gain additional market share, its plan to commence direct and indirect export into Chad, Cameroon, Niger and Sudan is at the final stage. It plans to site a mill in Senegal and increase the capacity of its subsidiary (Agrosacks Limited) by 5 million bags per day. It is expected that this expansion will contribute positively to the Group and assist in achieving greater economies of scale. In order to diversify its production, it acquired controlling interest in Dangote Pasta Ltd and Dangote Agro sacks Ltd. Dangote Pasta Limited manufactures Spaghetti and Macaroni while, Dangote Agro Sacks Limited manufactures packaging materials. DANGFLOUR is related to the following companies: Dangote Industries Ltd; Dangote Sugar Refineries Plc; Dangote Transport Ltd; Bluestar Shipping Company; Green View Development Nigeria Ltd; National Salt Company of Nig. Plc; Dangote Pasta Ltd; Bulk Pack (Nig) Ltd; MRS Plc and Dangote Agrosacks Ltd which controls 75% equity in Obajana Agro Sacks Limited. The products of DANGFLOUR include Flour, Bran, Danvita & Semolina, Sacks, Spaghetti Macaroni and Noodles. Its major competitors in the southern part of Nigeria are: Flour Mills of Nigeria and Honeywell Flour Mills. The shareholding structure as at December 31, 2009 shows that Dangote Industries Ltd held 73.35% of the ordinary shares in issue, while other Nigerians held the remaining 26.65%.

Comparable Analysis (Nmn)

Company	TO	PBT	PAT	PAT Margin (%)	ROAE (%)	EPS*	PE*
Dangote Flour	61,388	5,374	5,561	9.06	20.80	1.39	12.12
NNFM	10,220	632	410	4.01	39.42	2.55	15.68
Honeywell Flour	33,528	2,330	1,176	3.51	12.43	0.15	34.42
Flour Mills	206,608	24,440	16,948	8.20	39.31	9.53	7.22

Source: Company Annual Reports, NSE FACTBOOK. * Current. NNFM, Flour Mills & Honeywell Flour (FY March 2010) & Dang. Flour (FY Dec 2009).

Financial Performance (Nmn)

	Q3 2010	Q3 2009	%Δ	FY 2009	FY 2008	%Δ	FY 2010F
Turnover	54,262	47,029	15.38	61,388	47,927	28.09	73,666
PBT	7,074	5,666	24.85	5,374	3,168	69.66	10,908
PAT	6,955	5,586	24.51	5,561	2,990	86.02	9,817
PBT Margin (%)	13.04	12.05	0.99	8.75	6.61	2.15	19.60
PAT Margin (%)	12.82	11.88	0.94	9.06	6.24	2.82	13.33

Dangote Flour Mills Vs NSE ASI Rebased (Dec. 09-Dec. 10)



Directors As At December 31, 2009

Name	Position	Holding
Aliko Dangote	Chairman	38,148,029
Rohit Chaudhry	MD	-
Shuaibu Idris	DMD	118,680
Sani Dangote	Director	2,200,000
Olakunle Alake	Director	2,377,500
Uzoma Nwankwo	Director	271,500
Abdu Dantata	Director	-
Abdullahi Mahmoud	Director	43,750
Asue Ighodalo	Director	-
S.L. Teidi	Director	-

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