

Flour Mills of Nigeria Plc: Interim Results – Q3, Dec. 2010



March 04, 2011

BUY

Fair Value: NGN87.60

Current Price: NGN83.99

Valuation/Analyst Recommendation

In arriving at a fair value, we used two valuation methods which are Discounted Future Earnings (DFE) and Discounted Free Cash Flow (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 March 2011, 2012, 2013, 2014 and 2015. We estimate Turnover of **N216.94bn**, **N232.12bn**, **N255.34bn**, **N283.42bn** and **N311.77bn** respectively. We estimate EBIT of **N30.37bn**, **N44.10bn**, **N49.79bn**, **N51.02bn** and **N46.77bn**, and EBITDA of **N36.47bn**, **N50.40bn**, **N56.28bn**, **N57.70bn** and **N53.64bn** 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 and adjusting for the net working capital, we arrived at **Free Cash Flow (FCF)** of **N20.49bn**, **N34.97bn**, **N40.13bn**, **N41.83bn** and **N39.17bn**. We forecast PAT of **N16.70bn**, **N25.53bn**, **N32.43bn**, **N34.01bn** and **N34.29bn**. Using a dividend payout of 32% for the period, we arrived at **Dividend Payment** of **N5.35bn**, **N8.17bn**, **N10.38bn**, **N10.88bn** and **N10.97bn** which translates to **Dividend Per Share (DPS)** of **N2.84**, **N4.35**, **N5.52**, **N5.79** and **N5.84** respectively. We applied a terminal growth rate of 7.86%. We used a beta value of 1.12; risk free rate of 9.12% and a risk premium of 10.04%. Applying the foregoing parameters and taking into cognizance the long term interest bearing debt, the Weighted Average Cost of Capital (WACC) is 16.38%, which is our discount rate. Using 1.88bn shares in issue, the DCF Model generates **N97.64** per share and the DFE Model generates **N75.34** per share. Applying a weight of 55% to the DCF and 45% to the DFE, we arrive at a value of **N87.60** per share, which is our fair value. Buying the stock at the current market price of **N83.99** holding it to our fair value of **N87.60** and adding the present value of the 5-year forecast dividends, investors will earn a total return of **24.11%**. Relating this return to the WAAC at **16.38%**, investment in Flour Mills shares at the current market price will record alpha return of **7.73%**. The 2011 forward earnings yield based on our fair value generates **10.15%**, while the 2011 forward dividend yield based on our fair value generates **3.25%**. The forward earnings yield at current market price is **10.47%**. We therefore place a **BUY** on Flour Mills shares at the current market price.

Business Description

The activities of Flour Mills cut across food, cement, fertilizer, packaging, port operations and services.

Ticker	FLOURMILLS
Sector	Food/Beverages & Tobacco
Date of Incorporation	September 29, 1960
Date of Listing	August 14, 1979
Year End	March
No of Ordinary Shares	1,879,210,668
Capitalisation (N)	157,834,904,005
% of Market Cap.	1.91
52-Week High (N)	84.50
52-Week Low(N)	45.00
YTD Return (%)	21.72
52-Week Avg. Trade	1,206,760
Beta Value	1.12
Current EPS (N)	8.79
Current PE(x)	9.55

Growing and Creating Value:

The unaudited Q3, 2010 result of **Flour Mills of Nigeria Plc** for the period ended December 31, 2010 shows that its Turnover (TO) increased marginally by **4.47%** to **N122.71bn**, compared with **N117.46bn** in the corresponding period of 2009. Profit Before Tax (PBT) decreased by **4.94%** between 2009 and 2010 to **N11.92bn** from **N12.54bn**. The tax provision also decreased by 4.94% between 2009 and 2010 to **N3.81bn** from **N4.01bn** which resulted in the Profit After Tax (PAT) of **N8.11bn**, down from **N8.53bn** in 2009 representing a decline of **4.94%**. The PBT Margin in Q3, 2010 decreased over the Q3, 2009 and over the FY, 2010 figure. The PBT margin decreased to **9.71%** in Q3, 2010 from **10.68%** as at Q3, 2009, and down from **11.83%** as at the end of the financial year in March, 2010. PAT margin currently stands at **6.61%**, down from 7.26% in the corresponding period of 2009, and also down from 8.20% as at FY, 2010.

Improvement in economic activities in the country which has relatively enhanced the purchasing power of consumers, growing acceptance of its Noodles Brand in the market, supported by strong marketing and promotional campaign and the good corporate social responsibility initiatives, have contributed to the growth in sales, thus changing the decline recorded in FY March 2010. We are of the opinion that with the production expansion in the core business of the company and diversification drive into complementary food business, the steady progress in its associated company, Unicem, which is engaged in cement production and marketing, the future of the company is bright. However, the adverse impact of the rising prices of food globally, especially wheat, did not allow the effects of growth in sales and aggressive cost management strategies employed by the management, to trickle down to profitability. The company has reiterated its commitment to adding cassava flour in the production of its flour. This strategy will help to lower the adverse impact of the current rise in the price of wheat at the global level. In addition, different governments around the globe are coming out with various measures to combat the impact of current food price increases. We also note that the commencement of cement production will add a boost to the company's bottom line because it has a high profit business margin.

A cursory look at the balance sheet position as at Q3, 2010, shows that short-term borrowing was down by 78.33% to stand at **N2.99bn** from **N13.78bn** as at FY 2010. The company's strategy to substitute the short-term expensive fund for long term cheaper fund is a good one. It will increase the profitability of the company in the medium term as a result of lower finance charge. Flour Mills raised about **N37bn** through corporate bond recently at a coupon rate of 12% being the first tranche of the capital raising exercise of about **N75bn**. The company intends to use the proceeds of the bonds issue to re-finance its existing term loans of about **N20bn**; provide funds for its future investments in capital projects aimed at enhancing its existing milling capacity over the next two years; undertake new investments in food and/or cement sectors; and, augment working capital. As part of its expansion projects, Flourmills intends to install two completely automated mills with capacity of 1,000mt/day of soft wheat and 500mt/day of pasta Semolina at its Apapa site. Within this framework, the Company would also install bulk holding silos for wheat, flour and wheat offal, as well as packing machines for such products to support the new mills. It has also embarked on construction of a state of the art Sugar Refinery at Apapa Ports in Lagos. The project also involves a gradual development of a 15,000-hectare sugar cane plantation. Once the refinery is completed, it would comprise of a 75,000mt per annum plant, storage silos & conveying systems, and a full-fledged power plant. The refinery is due to be completed in 2012.

Available data on the Nigerian Flour Milling Industry shows that the local market consumes about 2.5mn tonnes of flour per annum and consumption is estimated to rise in line with Nigeria's economic and population growth. Players in the Nigerian flour milling industry are raising production capacity to compete effectively and meet the growing demand for flour and flour based products in the country. It is the main ingredient of bread, which is a staple food in Nigeria. Other products made with flour include various types of pastries, noodles, cakes and biscuits. The consumption of pastries has increased in recent years on account of growth of fast food restaurant chains and a growing middle class. There are many players of various sizes competing for market share in the Nigerian flour milling industry. There are about 22 flour milling factories in the country, owned by 11 flour milling companies. Total milling capacity in the industry is estimated at about 6.5mn tonnes per year, at about 60% capacity utilisation between 2009 and March 2010. The industry is dominated by six flour milling companies, controlling about 80% of market share. Listed in order of market share are: Flour Mills of Nigeria Plc; Dangote Flour Mills Plc; Honeywell Flour Mills Plc; BUA Flour Mills Limited; Nigeria Eagle Flour Mills Limited; and Crown Flour Mills Limited. Flour Mills has production capacity of 6,000 tonnes per day representing about 34% of the market share.

Flour Mills is a group of companies that has several subsidiaries and an associate company that are involved in flour milling; pasta production; operation of the bulk cement handling facility at Apapa; sale of bulk and bagged cement; manufacturing and marketing of woven polypropylene sacks; blending, sale and distribution of fertilizer; haulage of products and the management of mills in Maiduguri Flour Mills Ltd and Port Harcourt Flour Mills Ltd. The subsidiaries are: Nigerian Bag Manufacturing Company, Apapa Bulk Terminal Ltd, Northern Nigeria Flour Mills Plc, Golden Pasta Company Ltd, Niger Mills Company Ltd Calabar, Golden Noodles Company Ltd and Kaboji Farms Ltd. United Cement Company of Nigeria Ltd (Unicem) is an associate company to Flourmills. It recently increased its equity stake in Unicem from 22% to 28%. The business class of Flour Mills includes **Food, Cement, Fertilizer, Packaging and Port Operations & Services** and accounted for **62.8%**, **22.0%**, **5.4%**, **7.8%** and **1.9%** respectively of turnover, while gross profit margin for the various business lines stood at **20.64%**, **19.42%**, **23.22%**, **30.30%** and **74.46%** respectively. As at March 31, 2010, Excelsior Shipping Company Ltd owned **51.59%** of the paid-up share capital while other shareholders owned **48.41%**. The capital employed by Flour Mills as at March 31, 2010 at **N90.79bn** was such that equity accounted for **58.67%** while long term liabilities accounted for **41.33%** of the total.

Comparable Analysis (Nmn)							
Company	TO	PBT	PAT	PAT Margin (%)	ROE (%)	EPS*	PE*
Flour Mills	206,608	24,440	16,948	8.20	33.13	8.79	9.55
Honeywell Flour	33,528	2,330	1,176	3.51	8.70	-	-
Dangote Flour	61,388	5,374	5,561	9.06	19.43	1.39	11.60
NNFM	10,220	632	410	4.01	33.73	2.71	14.66

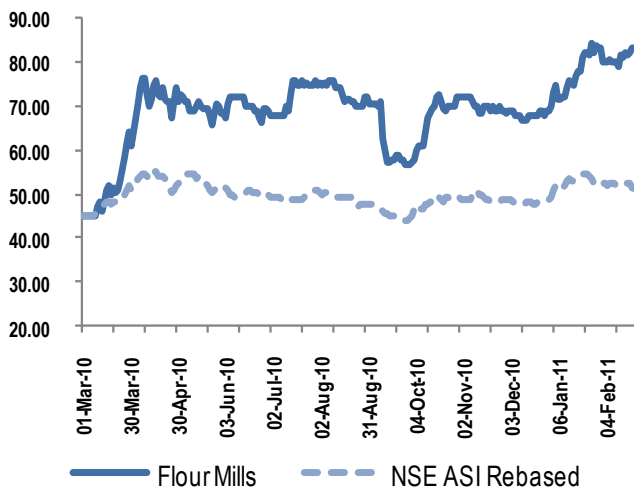
*Source: Company Annual Reports, NSE FACTBOOK. * Current. NNFM, Honeywell Flour Mills & Flour Mills (FY March 2010) & Dang. Flour (FY Dec 2009).*

Financial Performance (Nmn)							
	Q3 2010	Q3 2009	%Δ	FY 2010	FY 2009	%Δ	FY 2011F
Turnover	122,707	117,457	4.47	206,608	180,068	14.74	216,938
PBT	11,920	12,540	(4.94)	24,440	5,470	346.76	24,565
PAT	8,106	8,527	(4.94)	16,948	3,892	335.48	16,704
PBT Margin (%)	9.71	10.68	(0.96)	11.83	3.04	7.79	11.32
PAT Margin (%)	6.61	7.26	(0.65)	8.20	2.16	6.04	7.70

Directors Holding As At March 31, 2010

Name	Position	Holding
G.S. Coumantaros	Chairman	-
A.A. Joda	Vice Chairman	355,883
E.A. Ukpabi	Group MD	2,533,283
A.Plytas	Director	-
A.A. Abba	Director	-
A.Alade-loba	Director	-
J.G. Coumantaros	Director	-
J. O. Fagbemi	Director	1,148,883
K. Katsaounis	Director	1,337,848
A.Kotoko	Director	770,000
T. Mazarakis	Director	-
Y.O.A. Saliu	Director	723,185
F.R.A Williams	Director	-
R.M. Gwarzo	Director	-
A.N.A Peterside	Director	-

Flour Mills Vs NSE ASI Rebased (Mar. 10 - Mar.11)



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