

## Flour Mills Earnings Update 9M 2020

### Strong Q3 provides support for 2020 financial year

- Land border closure drives up revenues
- Opex remain high
- Improving leverage position

Target price:	N28.80
Closing price:	N22.80
Stock Rating:	Buy

#### FMN reaps benefit of border closure as food revenue turns a corner

Recently, Flour Mills of Nigeria (FMN) released its 9M 2020 (Apr 2019 – Dec 2019) results where it announced a 5.7% y/y growth in revenue to N423.5bn, from N400.6bn in 9M 2019. We note that the improved performance came largely in Q3 2020 with revenue in Q3 climbing 12.3% q/q to N152.7bn. The improved performance in Q3 is evidenced in the 8% growth in volumes sold, as against 6% in the first 2 quarters of the financial period. Across business segments, food revenue turned a corner growing 3.0% y/y to N262.1bn in 9M 2020. The improvement in food revenue was driven by improved volumes in pasta and bread flour which we believed was as a result of the land border closure which prevented influx of lower quality flour, while consumers switched to pasta products as an alternative to rice. The fastest growing business units as at 9M 2020 were agro-allied (+19.6% y/y to N81.3bn) and sugar (+13.5% y/y to N67.6bn) while support services (-32.8% y/y to N12.5bn) disappointed. The growth in agro-allied business was driven by higher volumes in fertilizer and animal feed sales.

#### Cost of sales edge higher on higher volumes

Cost of sales grew 6.1% y/y to N375.7bn in 9M 2020 from N354.0bn in 9M 2019. The increase in cost of sales was largely in line with growth in revenue albeit higher by 0.4ppts. Thus, we think the growth in cost of sales was largely volume driven. The growth in cost of sales was driven by higher material costs (+5.6% y/y to N323.4bn) and factory staff payments (+12.5% y/y to N13.0bn). Consequent to the slightly faster growth in cost of sales, gross margin was pressured lower by 0.3ppt y/y to 11.3% in 9M 2020. Nevertheless, gross profit was still higher by 2.6% y/y to N47.8bn in 9M 2020 from N46.6bn in 9M 2019.

#### Operating expenses remain high...puts pressure on operating income

The company recorded a 13.4% y/y increase in operating expenses driven by increases in selling & distribution expenses (up 8.0% y/y) and administrative expenses (up 15.6% y/y). Increased spending on advertising, in a bid to expand B2C channels due to presence of better margins, continues to drive the increase in Opex. The faster pace of increase in operating expenses weighed on EBITDA as it declined 5.8% y/y to N34.6bn for 9M 2020, from N36.8bn in 9M 2019. Increase in depreciation & amortisation (+5.1% y/y to N9.9bn in 9M 2020) and a decline in net operating gain (-66.9% y/y to N518.4m) pressured operating profit lower, which was down 9.6% y/y to N24.7bn in 9M 2020.

#### Leverage position continues improvement

The company's sustained efforts at deleveraging its balance continued to bear fruits as finance costs dipped lower by 20.7% y/y to N13.1bn in 9M 2020, from N16.6bn in 9M 2019. Finance income increased by a 35.8% rise to N728.3m in 9M 2020. Consequently, net finance costs slid lower by 22.6% to N12.4bn in 9M 2020, from N16.0bn in 9M 2019. Against this backdrop, profit before tax edged higher by 9.0% y/y to N12.3bn for 9M 2020, from N11.3bn for 9M 2019. Tax expense jumped higher, recording a 22.1% y/y increase to N4.1bn, with management declaring it took a prudent approach in estimating the impact of the finance bill on its tax assessment. Nevertheless, net income climbed higher by 3.4% y/y to N8.2bn in 9M 2020. However, earnings per share for 9M 2020 declined to N1.84/s from N1.89/s in 9M 2019 on the back of lower net income attributable to shareholders, with profit growth driven by subsidiaries.

#### Overall view – revenue recovers but operating performance remains a concern

Flour Mills recorded a significantly improved performance in Q3 2020 as the company recorded impressive revenue growth while reining in on operating expenses within the quarter, while the high base in H1 2020 still created pressures. In our last note, we highlighted how we expected the border closure to impact flour and pasta sales as well as sustained recovery in sugar, following the reduction in the influx of smuggled low-quality sugar. These factors played out within the quarter. However, we remain cautious on the strength of this recovery as the reopening of the border may bring in renewed pressures, from smuggled low-quality flour and sugar coupled with an increase in rice imports, thus weakening demand for pasta products. Nevertheless, we expect FMN to continue to be resilient and to post improved performance.

## Flour Mills of Nigeria Earnings Highlight 9M 2020

N'm	9M 2020	9M 2019	y/y	Q3 2020	Q2 2019	q/q
Revenue	423,479	400,642	5.7%	152,717	136,017	12.3%
Cost of Sales	(375,650)	(354,047)	6.1%	(136,665)	(120,712)	13.2%
<b>Gross Profit</b>	<b>47,829</b>	<b>46,595</b>	<b>2.6%</b>	<b>16,052</b>	<b>15,304</b>	<b>4.9%</b>
Administrative expenses	(17,262)	(14,937)	15.6%	(6,744)	(5,851)	15.3%
Selling and Distribution Expenses	(6,404)	(5,933)	8.0%	(1,921)	(2,446)	-21.5%
Net Operating Gains/(Losses)	518	1,568	-66.9%	473	(81)	-685.0%
Impairment (Loss)/Writeback	-	-	-	-	-	-
<b>Profit from Operating Activities</b>	<b>24,681</b>	<b>27,293</b>	<b>-9.6%</b>	<b>7,860</b>	<b>6,926</b>	<b>13.5%</b>
Finance Income	728	536	35.8%	77	489	-84.3%
Finance Costs	(13,118)	(16,551)	-20.7%	(4,279)	(4,283)	-0.1%
<b>Net Finance Cost</b>	<b>(12,389)</b>	<b>(16,014)</b>	<b>-22.6%</b>	<b>(4,203)</b>	<b>(3,794)</b>	<b>10.8%</b>
<b>Profit before Tax</b>	<b>12,292</b>	<b>11,278</b>	<b>9.0%</b>	<b>3,658</b>	<b>3,132</b>	<b>16.8%</b>
Income Tax (Expense)/Credit	(4,131)	(3,383)	22.1%	(1,400)	(1,466)	-4.4%
<b>Profit for the Period</b>	<b>8,161</b>	<b>7,896</b>	<b>3.4%</b>	<b>2,257</b>	<b>1,667</b>	<b>35.4%</b>
	-33.6%	-30.0%				
<b>Profit for the period attributable to:</b>						
Owners of the Company	7,531	7,733	-2.6%	1,257	2,047	-38.6%
Non-Controlling Interests	630	163	287.0%	1,000	(381)	-362.7%
	<b>8,161</b>	<b>7,896</b>	<b>3.4%</b>	<b>2,257</b>	<b>1,667</b>	<b>35.4%</b>

Other Key Inputs	9M 2020	9M 2019	y/y	Q3 2020	Q2 2019	q/q
Earnings Per Share	1.84	1.89	-2.6%	0.31	0.50	-38.6%
EBITDA	34,618	36,751	-5.8%	12,988	12,054	7.8%

Margins	9M 2020	9M 2019	y/y	Q3 2020	Q2 2019	q/q
Gross Margin	11.3%	11.6%	-0.3ppts	10.5%	11.3%	-0.7ppts
EBITDA Margin	8.2%	9.2%	-1.0ppts	8.5%	8.9%	-0.4ppts
Operating Margin	5.8%	6.8%	-1.0ppts	5.1%	5.1%	0.1ppts
Net Margin	1.9%	2.0%	-0.0ppts	1.5%	1.2%	0.3ppts
No of Outstanding Shares	4,100	4,100		4,100	4,100	
Depreciation & Amortisation	9,937	9,458	5.1%	5,128	5,128	0.0%

Source: Company Financials, FSDH Research

Flour Mills operates and April – March calendar year, thus 9M 2020 covers April 2019 – Dec 2019.

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