

Backward Integration Strategies Take Center Stage

Agro-allied Segment Delivers impressive Results

Flourmill of Nigeria Plc (FLOURMILL) began its 2022FY (*full year-end is March*) on a solid footing reporting an all-time-high first-quarter revenue. *The firm's performance was supported substantially by volume growth and a slight element of price increase in the food segment. Overall, revenue increased by 51.19% in Q1:2021 to NGN233.70bnbn.* The food segment saw revenue expand sharply by 61.39% to NGN146.93bn (vs. NGN91.04bn in the corresponding period), buoyed by a 42.00% increase in Business-to-Business (B2B) sales, a 12.00% improvement in Business -to-customer(B2C) sales as well a slight increase in the price of Golden penny pasta. A new product - *Golden penny Goat Meat Pepper Soup Flavour*- was also introduced in the noodles product line to cater to consumers' taste preferences, expanding the firm's product portfolio. In the agro-allied segment, top-line surged 44.08% year on year, on the back of sustained demand for Edible oil and fertilizer products. Revenue in other business segments also moved in a similar direction, up by 24.01% and 63.26% in the Sugar and Support businesses, respectively.

For the rest of the financial year, we see the case for an upward review in product prices as well as repackaging of products into smaller and affordable units to meet the needs of consumers at the bottom of the price pyramid. We also expect sustained demand in the support segment as manufacturers continue to opt for locally produced bagging materials due to innovative packaging solutions being implemented in the segment. Overall, we maintain our positive outlook for volume growth chiefly anchored on the essential nature of the firm's product and hence topline expansion for 2022FY. We project a 19.40% topline expansion to NGN921.30bn in 2020FY.

Increased Materials Cost Impact Profitability Margins

FLOURMILL's production costs firmed up by 61.21%YoY in the quarter outpacing the growth in revenue and resulting in a higher cost-to-sales ratio (89.00% vs. 83.47% in Q1:2021). This came on the heel of a spike of 68.69% in materials cost across business units. Operating expenses also increased significantly by 39.66% to NGN 9.66bn, pressuring operating margin downwards to 4.93% from 7.13% in Q1:2021.

The firm continues to reap the benefits of using relatively cheaper debt sources as its finance cost declined by 6.44% despite the slight uptick of 8.76% in its debt profile. The interest coverage ratio thereafter increased slightly to 2.53x from 2.26x. *We do not rule out the possibility of the firm tapping into the debt market in the near term as it continues scouting for cheaper debt sources to refinance its expensive debt obligations.* There is also the need to fund its CAPEX investments as it continues on its backward integration drive. Overall, while PAT improved by 9.57%, net margin gave in to cost pressures during the period, moderating to 2.33% from 3.22% in Q1:2021.

For 2022FY, we project a net profit of NGN33.33bn (implying a 3.62% net margin).

Update On Backward Integration Drive

Backward integration strategies took up the front burner in the quarter as the firm deployed several activities to shore up locally produced content of its raw materials. Sugar, Cassava, wheat, agro-allied (edible oils and fats), and fertilizer saw significant investment. The firm is also strategizing with organizations such as the Flour Millers Association of Nigeria (FMAN) to establish seed multiplication businesses to improve the yield quality of wheat seeds in Nigeria.

Recommendation

We revise our target price for 2022FY slightly upwards to NGN40.65 from 38.80 on the back of a target P/E of 5.00x and an expected EPS of NGN8.13. This represents a 36.64% upside to its closing price of NGN29.75 on 9th August 2021. Thus, we rate the ticker a "BUY".

| Company | FLOURMILL |
|--------------------------|----------------|
| Valuation | |
| Trailing EPS | 6.39 |
| BVPS | 43.91 |
| P/E | 4.71X |
| P/BV | 0.69x |
| Target PE | 5.00X |
| Dec-2021 Exp. EPS | NGN8.13 |
| Dec 2021 Target price | 40.65 |
| Current Price | 29.75 |
| Up/Downside Potential | +36.64% |
| Ratings | BUY |
| Key metrics | |
| ROE | 14.77% |
| ROA | 4.83% |
| Net margin | 2.33% |
| Asset Turnover | 1.57 |
| Leverage | 3.06 |
| Share Price Data | |
| Year High | 34.70 |
| Year Low | 26.10 |
| YTD return | +13.85% |
| Beta | 0.87 |
| Adjusted Beta | 0.80 |
| Shares outstanding | 4.10bn |
| Market cap [NGN] | 121.99bn |
| Financial year end | March |
| Most Recent Period (MRP) | Q1:2022 |

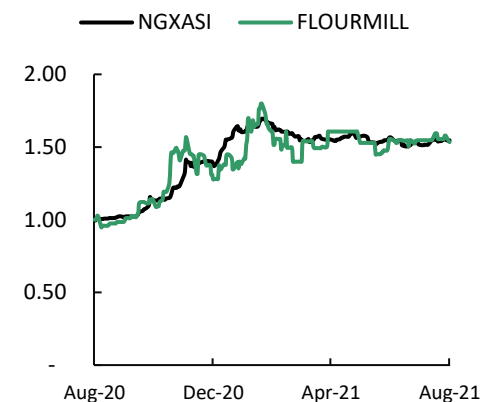


Chart 1: Sensitivity Analysis

| Sensitivity Analysis of Dec-2021 Target Price to key model inputs | | | | | | Min | 33.86 |
|---|------|-------|-------|-------|-------|-------|-------|
| | | | | | | Max | 48.18 |
| | | | | | | EPS | |
| | | 7.52 | 7.82 | 8.13 | 8.44 | 8.76 | |
| Target PE | 4.5x | 33.86 | 35.19 | 36.59 | 37.98 | 39.42 | |
| | 4.8x | 35.74 | 37.15 | 38.62 | 40.08 | 41.61 | |
| | 5.0x | 37.62 | 39.11 | 40.65 | 42.19 | 43.80 | |
| | 5.3x | 39.50 | 41.06 | 42.68 | 44.30 | 45.99 | |
| | 5.5x | 41.38 | 43.02 | 44.72 | 46.41 | 48.18 | |

Financial Highlights and Forecasts (NGN billion)

| Profit & Loss Account | Q1:2021 | Q1:2022 | 2022F | 2023F | 2024F | 2025F | 2026F |
|-----------------------|---------|---------|--------|-------|----------|----------|----------|
| Revenue | 154.58 | 233.7 | 921.3 | 962.9 | 1,027.45 | 1,089.05 | 1,155.09 |
| Cost of sales | 129.03 | 208 | 782.18 | 815.1 | 869.98 | 922.56 | 979.6 |
| Gross profit | 25.55 | 25.7 | 139.12 | 147.8 | 157.47 | 166.5 | 175.49 |
| Operating expense | 6.92 | 9.66 | 45.72 | 48.03 | 51.21 | 55.43 | 58.95 |
| Operating profit | 10.99 | 11.51 | 90.5 | 95.61 | 104.92 | 106.56 | 118.99 |
| Finance cost | 4.86 | 4.55 | 19.17 | 20.43 | 23.74 | 26.31 | 31.82 |
| PBT | 6.46 | 7.26 | 49.01 | 48.92 | 51.29 | 46.17 | 49.33 |
| PBT | 4.97 | 5.45 | 33.33 | 33.26 | 34.87 | 31.4 | 33.55 |

| Balance Sheet | 2021FY | Q1:2022 | 2022F | 2023F | 2024F | 2025F | 2026F |
|-------------------------------|--------|---------|--------|--------|--------|--------|-------|
| Property, Plant and Equipment | 208.72 | 208.88 | 245.48 | 286.75 | 328.28 | 367.98 | 28.61 |
| Total Debt | 128.68 | 139.95 | 156.54 | 162.01 | 182.6 | 219.78 | 0.04 |
| Total Assets | 174.61 | 180.06 | 201.04 | 226.49 | 252.95 | 275.05 | 60.92 |
| Total Equity | 209.7 | 191.56 | 222.29 | 230.39 | 245.82 | 264.94 | 22.08 |
| Total Current Liabilities | 370.12 | 360.35 | 408.1 | 424.15 | 459.63 | 511.3 | 29.73 |
| Non-Current Liabilities | 208.72 | 208.88 | 245.48 | 286.75 | 328.28 | 367.98 | 9.11 |
| Total Liabilities | 128.68 | 139.95 | 156.54 | 162.01 | 182.6 | 219.78 | 38.85 |

| Financial Ratios | 2021FY | Q1:2022 | 2022F | 2023F | 2024F | 2025F | 2026F |
|----------------------------|--------|---------|--------|--------|--------|--------|--------|
| Gross Margin | 12.61% | 12.57% | 15.10% | 15.35% | 15.33% | 15.29% | 15.19% |
| Operating Margin | 6.09% | 6.20% | 9.82% | 9.93% | 10.21% | 9.78% | 10.30% |
| Net Margin | 2.04% | 3.08% | 3.62% | 3.45% | 3.39% | 2.88% | 2.90% |
| Return on Asset | 4.45% | 4.83% | 5.78% | 5.28% | 5.12% | 4.19% | 4.05% |
| Return on Equity | 13.87% | 14.77% | 5.78% | 5.28% | 5.12% | 4.19% | 4.05% |
| Return on Invested Capital | 14.00% | 21.84% | 15.04% | 13.25% | 12.34% | 10.82% | 10.82% |
| Earnings per share | 2.95 | 6.39 | 8.13 | 8.11 | 8.51 | 7.66 | 8.18 |
| Asset Turnover | 1.09 | 1.57 | 1.6 | 1.53 | 1.51 | 1.45 | 1.4 |
| Financial Leverage | 3.12 | 3.06 | 3.07 | 2.95 | 2.84 | 2.84 | 2.88 |
| Debt to Asset Ratio | 0.24 | 0.26 | 0.25 | 0.25 | 0.25 | 0.27 | 0.29 |
| Debt to EBIT Ratio | 3.54 | 1.83 | 2.64 | 2.84 | 3.05 | 3.4 | 3.36 |
| Current Ratio | 1.46 | 1.58 | 1.5 | 1.44 | 1.43 | 1.45 | 1.48 |
| Quick Ratio | 0.53 | 0.6 | 0.64 | 0.6 | 0.59 | 0.62 | 0.66 |

(Q1- First-Quarter); (H1- First-Half); (H2- Second Half) (FY- Full Year) (F- Forecast)

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com (+234 905 569 0627)
 olatunjifaniyi@meristemng.com (+234 803 446 3118)
 contact@meristemng.com

Investment Banking/Corporate Finance

rasakisalawu@meristemng.com (+234 806 022 9889)
 seunlijofi@meristemng.com (+234 808 536 5766)

Wealth Management

funmilolaadekola-daramola@meristemng.com (+234 805 498 4522)
 crmwealth@meristemng.com
 Tel : +234 01 738 9948

Registrars

muboolasoko@meristemregistrars.com (+234 803 324 7996)
 martinaosague@meristemregistrars.com (+234 802 303 1783)
 www.meristemregistrars.com
 Tel: +23401-280 9250

Trust Services

damilolahassan@meristemng.com (+234 803 613 9123)
 crmwealth@meristemng.com

Group Business Development

saheedbashir@mersitemng.com (+234 802 454 6575)
 ifeomaogalue@meristemng.com (+234 802 3942967)
 info@meristemng.com

Client Services

adefemitaiwo@meristemng.com (+234 803 694 3034)
 blessingogwuiche@meristemng.com (+234 706 896 5173)
 car@meristemng.com

Investment Research

ahmedjinad@meristemng.com (+234 809 183 9487)
 research@meristemng.com

Corporate websites: www.meristemng.com www.meristemwealth.com www.meristemregistrars.com

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Asset allocation: The recommended weighting for equities, cash and fixed income instrument is based on a number of metrics and does not relate to a particular size change in one variable.

Movements in Price Target

Company Name: Flour Mills Of Nigeria Plc

| Date | Price (N) | Previous Target Price(N) | New Target Price (N) | Previous Recommendation | New Recommendation |
|-------------|-----------|--------------------------|----------------------|-------------------------|--------------------|
| 02-Feb-2021 | 33.00 | 29.48 | 31.82 | HOLD | HOLD |
| 06-Jul-2021 | 29.40 | 31.82 | 38.80 | HOLD | BUY |
| 09-Aug-2021 | 30.45 | 38.80 | 40.65 | BUY | BUY |

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| Company | Disclosure |
|----------------------------|------------|
| Flour Mills of Nigeria Plc | |
| | |

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