



DANGOTE FLOUR MILLS PLC

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Vetiva Research
27 September 2010

FY'09 & H1'10 Earnings Release

On an Upward Growth Course ...

We have revised our previous Overweight rating on Dangote Flour Mills Plc (Dangflour) to an **Accumulate** premised on the likely increase in wheat prices resulting in a downward revision to our forecast. Consequently, we have lowered our FY'10 and FY'11 PBT estimates, to reflect our more conservative outlook for the Company in the near term. Dangflour's share price rallied earlier in the year, based mainly on anticipation of robust earnings (Year High: ₦25.82) but it currently has a YTD gain of 21% which is low compared to 160% garnered at its year high. Our fair Value range is between ₦25.80 - ₦28.57, implying a midpoint of ₦27.19.

- **FY Performance Lower than Expectation.** Although Dangflour's FY'09 figures grew YoY, the FY'09 result came in below expectations relative to robust guidance earlier provided by the company. The guidance put PBT for FY'09 at ₦15 billion, hence the actual PBT of ₦5.37 billion was quite disappointing and this sparked a sell-off in the stock, as it has declined 29.63% (as at report date) from the date of results release on 13th September 2010.
- **Growth Remains on Track.** Furthermore, Dangflour's Q4'09 result showed a dip in earnings from ₦8.46 billion as at Q3'09 to ₦5.37 billion. According to the management, the Company had to write-off some expenses and bad debts in the 2009 financial year. Furthermore, the company revealed that it experienced some wheat loss due to spillage and moisture in the Q4'09, which resulted in very low production figures for the last quarter of the year, which is typically the strongest quarter for flour millers. This contributed to the discrepancy in figures observed between Q3'09 and Q4'09; 37% and 22% decline in Turnover and PAT respectively. Our opinion is that the company's growth is still on track, as these events are viewed as one-offs, for which measures would have been out in place to curtail a reoccurrence.
- **Expansion on Course.** Even though Dangflour is the second largest flour miller in Nigeria with an installed capacity of c.4500MT per day, Dangflour remains focused on on-going expansion plans that would see current installed capacity climb by c.2000MT per day.
- **Increasing Demand for Flour-based Products** There has been an increase in the flour per capita consumption in Nigeria over the past 7-8 years, growing at a CAGR of c.7.7%. This is especially as a result of the health consciousness of the Nigerian populace and higher demand for wheat bread, semolina and pastries. This increased and still growing demand has encouraged flour millers to gradually increase their utilization rate and production volumes.
- **Risks to Valuation.** A major risk to our valuation is the volatility in global wheat prices (constitutes over 75% of total cost) which began to rise in July/August 2010. Further to this, we may see some pressure on the margins of most flour millers. Historically, the Company has successfully passed on cost increases to the consumers.

Analyst

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Fair Value Range
₦25.80 – ₦28.57

Stock Data

Symbol: NSE	DANGFLOUR
Bloomberg	DANGFLOU.NL
Reuters:	DANGFLO.LG

Current Price (NGN):	12.55
Trailing EPS (NGN):	1.33
Trailing P/E (x):	9.00
2010 P/E (x):	8.46

Shares Outstanding (mn):	5,000
Market Cap (NGNbn):	59.85
Year High (NGN):	25.82
Year Low (NGN):	10.42

Share Price Performance

30 Days (%):	-32.94
90 Days (%):	-45.86
52 weeks (%):	169.59

Ownership Structure:

DIL (%):	73.0
Others (%):	27.0

FMN VS FOOD & BEVERAGE VS NSE ALSI (YTD)



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Performance Highlights

Dangote flour Mills Plc released its FY'09, Q1 and Q2'10 performance on the floor of the Nigerian Stock Exchange.

Key Headlines	Q2'10	Q2'09	Chg	2010F	Q2 as %
	NGNbn		%	NGNbn	of 2010F
Turnover	37.46	30.74	21.86%	70.59	53.07%
PBT	4.92	3.74	31.55%	10.11	48.66%
Tax	-0.33	-0.243	35.80%	-3.03	10.89%
PAT	4.59	3.5	31.14%	7.08	64.83%

Source: Company financials, Vetiva Research

Key Headlines	Q1'10	Q1'09	Chg	2010F	Q1 as %
	NGNbn		%	NGNbn	of 2010F
Turnover	18.31	13.91	31.63%	70.59	25.94%
PBT	2.63	1.76	49.43%	10.11	26.01%
Tax	-0.16	-0.1	60.00%	-3.03	5.28%
PAT	2.47	1.66	48.80%	7.08	34.89%

Source: Company financials; Vetiva Research

Dangflour's Q1 & Q2 2010 performance shows the company is still in line with growth expectations. Although Dangflour fell short of earning forecasts in FY 2009, it seems to be close to achieving the target it set out for 2009 in the 2010 financial year, barring any unexpected occurrences again. Q2 result shows Top and Bottom lines growth of 21.86% and 31.14% respectively, while Q1 showed growth of 31.63% and 48.80% in Turnover and PAT respectively. We note the increasing profitability profile of Dangflour in the periods under review, as Before Tax Earnings grew faster than Turnover in both periods.

Key Headlines	FY'09	FY'08	Chg	2009F	Q2 as %
	NGNbn		%	NGNbn	of 2010F
Turnover	61.39	47.93	28.08%	54.64	112.35%
PBT	5.37	3.17	69.40%	10.96	49.00%
Tax	0.19	-0.18	-	-1.74	-10.92%
PAT	5.56	2.99	85.95%	9.23	60.24%

Source: Company financials; Vetiva Research

FY 2009 numbers showed top and bottom lines growth of 28.09% and 86.05% YoY respectively. This performance fell largely below our forecast which we had revised based on additional guidance given by Dangflour. The company's Turnover was in line with our forecast, however we had expected Before and After Tax Earnings of ₦15 billion (as provided by the company) and ₦10 billion instead the Company reported ₦5.37 billion and ₦5.56 billion. This FY PBT and PAT figures are below the previous quarter's (Q3'09) PBT and PAT of ₦8.46 billion and ₦7.158 billion respectively.

The Company proposed a final dividend of ₦0.50 (implies a total dividend of ₦0.80 following an interim dividend of ₦0.30). Dangflour's payout ratio of 72% is lower than 84% in the previous year.



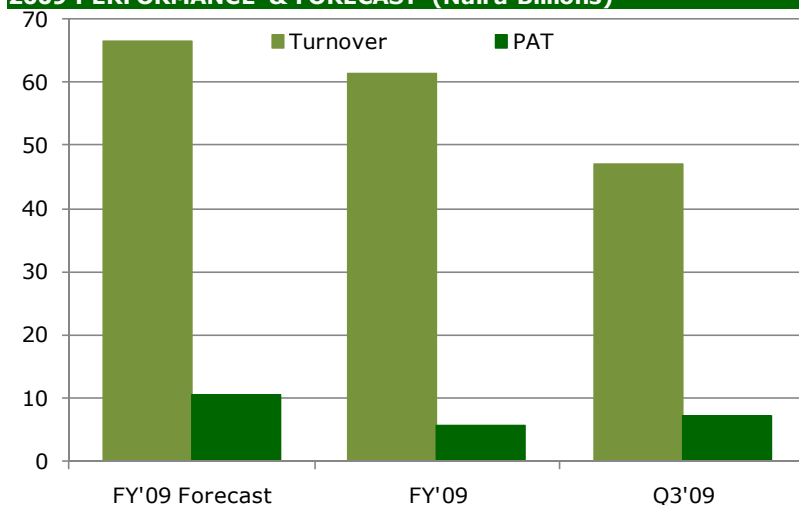
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OVERALL PERFORMANCE REVIEW

- **FY Revenue Continues to Improve:** The Company's Turnover was in line with expectation; however this did not trickle down to bottom line. This performance actually fell short of the company's Turnover forecast of ₦66.22 billion (Actual ₦61.39 billion) by 7.29% and PAT forecast of ₦10.41 billion (Actual ₦5.56 billion) by 46.59%. We aware of the company's efforts at growing market share especially after its launch of its brand of noodles in the 2009 financial year. Flour consumption in Nigeria has been growing majorly due to its usage in the preparation of bread, a staple food in the typical Nigerian diet. Furthermore, the increase in demand for semolina, a milled wheat variant, has also impacted positively on the industry and thereby increasing competition within the industry.
- **FY Profitability Margins Dip QoQ:** Dangflour's profitability margins declined to 8.75% (PBT) and 9.06% (PAT) QoQ from 18.02% and 15.23% as at Q3'09. Even though YoY margins improved from 6.61% (PBT) and 6.24% (PBT) as at FY'08. As noted earlier, the dip in profitability margins QoQ could be attributed to the decline in PBT in Q4'09 to ₦5.37 billion from ₦8.46 billion as at Q3'09. We also note a tax credit in Q4'09 shoring up PAT to ₦5.56 billion as at FY'09.

TURNOVER AND NET INCOME 2009 PERFORMANCE & FORECAST (Naira Billions)



Source: NSE; Vetiva Research

- **Wheat Loss Due to Spillage and Moisture:** According to management, in the Q4'09 period, Dangflour incurred losses in sales and profits, due to wheat spillage at the seaside and moisture while in transit. In our opinion, a reoccurrence of this unexpected, spillage incident will represent a risk for the company, in the attainment of forecasts for the year. Though we would expect the adequate measures would have been put in place to prevent the reoccurrence of any other such incidents.



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- **Accounting Adjustments and Bad Debt:** Dangflour also disclosed that it had made some major adjustments and reconciliations during audit as well as written-off bad debts, and other expenses. This led to a downward revision in Q3'09 figures which appeared to have been overstated before the audit. According to management, these adjustments are partially responsible to declines in PBT between Q3 and Q4'09.
- **Stronger H1 2010 Performance:** The Company's H1 2010 performance came in stronger than that for 2009, as we saw significant growth in Q1 and Q2 2010. Although we note that the growth in top and bottom lines were stronger in Q1 than in Q2 2010. The Company attributed the improvement to the deepening and growth of its relationship with clients and a more efficient distribution system especially with the company's acquisition of new fleet of vehicles for haulage of products and raw materials across market locations
- **H1'10 Margins Improve:** Dangflour's profitability margins in Q1'10 improved YoY to 14.37% (PBT) and 13.49% (PAT) from 12.67% and 11.94% respectively as at Q1'09. Profitability margins also improved from 8.94% (PBT) and 9.06% (PAT) as at FY'09 respectively. Q2'10 profitability margins inched up YoY to 13.13% and 12.25% from 12.16% (PBT) and 11.38% (PAT) respectively as at Q2'09. On a QoQ basis however, profit margins (PBT and PAT) dipped to 11.95% and 11.07% from 14.37% and 13.49% respectively as at Q1'10.

DAILY WHEAT PRICES – January 2010 till date Dollars Per Bushel



Source: Bloomberg



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Outlook and forecast revision

- The Nigerian economy currently has annual wheat consumption per capita of about 25kg, relative to average global wheat consumption per capita of 67kg. Nigeria has one of the lowest wheat consumption rates in the world. This shows there's still significant potential for growth in the Nigerian market, to further give credence to this, Olam International (an integrated supply chain manager and processor of agricultural raw materials and food ingredients, based in Singapore) made its debut into the Nigerian Flour Milling industry in January 2010 via its acquisition of Crown Flour Mills Limited makers of Cherie Noodles and Crown Flour.
- Furthermore, the most common product of wheat flour is bread and which is a necessity in most households and will continue to be in demand due to its staple nature and its increasing demand on an industrial scale (fast food restaurants etc).
- Following from the above, our outlook for Dangflour remains stable and we expect the company to strive to meet set forth targets in 2010 given the disappointing FY'09 performance, as most investors had modeled in robust earnings into the pricing of the stock.
- We are of the opinion that the stock is currently underpriced, at its current PE of 9.00x compared to an average Sector PE multiple of 11.37x.
- **Changes to estimates:** We had earlier estimated FY'10 earnings at ₦18.67 billion but this was dependent on FY'09 earnings of ₦10.41 billion which did not materialize. The release of a less than expected result necessitated a review of our assumptions thereby resulting in a downward revision to our top and bottom lines forecast figures. This also affected our longer term forecast which we have revised accordingly. **Our FY'10 projection for sales and After Tax Earnings** stands at ₦70.59 billion (15% YoY) and ₦7.08 billion (27% YoY), hence we expect an EPS of ₦1.42. For Q3'10, we expect Sales growth of 15.86% and 13.97% dip in PAT YoY.

	2010E			2011E		
	New	Old	% Chg	New	Old	% Chg
Turnover	70596	66139	6.7%	78715	73745	6.7%
EBIT	13662	27211	-49.8%	14566	29877	-51.2%
PBT	10112	25926	-61.0%	10314	26445	-61.0%
Tax	-3034	-7259	-58.2%	-2888	-7405	-61.0%
PAT	7079	18667	-62.1%	7426	19040	-61.0%
EPS	1.42	3.73	-62.1%	1.49	3.81	-61.0%
DPS*	1.02	1.23	-17.3%	1.11	1.26	-11.6%

Source: Vetiva Research



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Valuation

Our valuation is tempered by the likelihood of a sustained increase in global wheat prices due to speculations about shortage in global wheat supply both in the current and coming year. Our valuation for Dangflour is based on the Discounted Cash Flow (DCF) method, with forecasts spanning across a five year period from 2010 to 2014.

We have assumed a Cost of Equity of 18.90% and Terminal Growth Rate of 4.5%. Using Sensitivity Analysis to vary the Discount Factor and Growth Rate, we derived a Fair Value range of **₦25.80 – ₦28.57**, implying a midpoint of ₦27.19. We expect the stock to trade within this range in normal market conditions.

At the current price of ₦11.97, we see Dangflour's shares price offering a total upside potential of 127.11% over the next 12 months.

Hence, we rate the shares **ACCUMULATE on the basis of this return potential, slightly tempered by wheat price concerns.**

Appendix:



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Dangote Flour Mills Plc Financial Model

INCOME STATEMENT (N'Mill)	2007	2008	2009¹	2010F	2011F	2012F
Income						
Turnover	42,153	47,927	61,388	70,596	78,715	87,767
Cost of Sales	(37,417)	(38,288)	-	(50,602)	(57,180)	(64,613)
Gross Profit	4,736	9,639	-	19,995	21,535	23,154
Distribution & Administrative Expenses	(3,580)	(5,183)	-	(6,628)	(7,290)	(8,019)
Core operating profit	1,156	4,456	-	13,367	14,245	15,134
Other income	174	1,110	-	295	322	338
EBIT	1,331	5,566	-	13,662	14,566	15,472
Interest Expense & Similar charges	(655)	(2,399)	-	(3,550)	(2,711)	(3,939)
Profit from operations	676	3,167	-	10,112	11,855	11,533
Profit before taxation	676	3,167	5,374	10,112	10,314	10,521
Taxation	(114)	(178)	187	(3,034)	(2,888)	(2,946)
Profit after taxation	562	2,989	5,561	7,079	7,426	7,575
BALANCE SHEET (N'Mn)						
Assets Employed						
Fixed Assets	27,358	33,051	35,238	38,762	42,638	46,902
<u>Current Assets</u>						
Stocks	11,428	9,911	8,246	9,921	12,059	15,027
Debtors & Prepayments	8,108	15,876	16,976	18,463	19,630	22,087
Cash and bank balances	1,680	1,648	512	1,070	1,966	1,966
Due from related companies	9,546	8,264	5,045	5,267	2,547	-
Total Current Assets	30,762	35,699	41,428	48,077	55,793	64,748
Total Assets	58,119	68,750	66,017	73,483	78,840	85,982
Capital and Reserves						
Share capital	2,500	2,500	-	2,500	2,500	2,500
Share premium	11,807	11,807	-	11,807	11,807	11,807
General Reserve	7,679	10,046	8,478	14,960	16,817	18,710
Shareholder's Fund	22,145	24,630	28,469	29,267	31,123	33,017

¹ The company is yet to provide the full accounts for FY'09.



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Key financial ratios and forecasts

RATIOS	2007	2008	2009	2010F	2011F	2012F
GROWTH RATES	2007	2008	2009	2010F	2011F	2012F
Turnover growth	18%	14%	28%	15%	12%	24%
Growth in Core Operating profit	-18%	285%	115%	39%	7%	13%
Growth in PBT	-6%	369%	70%	88%	2%	4%
Growth in PAT	-22%	432%	86%	27%	5%	7%
PROFITABILITY	2007	2008	2009	2010F	2011F	2012F
Return on Equity	3%	13%	21%	25%	25%	24%
Return on Assets	1%	5%	8%	10%	10%	10%
Return on Net fixed assets	3%	10%	16%	19%	18%	18%
Return on Invested Capital	3%	11%	21%	20%	20%	19%
Growth rate (g)	3%	2%	6%	7%	6%	43%
MARGINS	2007	2008	2009	2010F	2011F	2012F
EBIT/Sales	3.2%	11.6%	16.0%	19.4%	18.5%	17.6%
Pretax Income/Sales	1.6%	6.6%	8.8%	14.3%	13.1%	12.0%
Net Profit Margin	1.3%	6.2%	9.1%	10.0%	9.4%	8.6%
PER SHARE DATA	2007	2008	2009	2010F	2011F	2012F
EPS	0.11	0.60	1.11	1.42	1.49	1.51
DPS	0.00	0.50	0.80	1.02	0.24	0.42
NAPS	4.43	4.93	5.69	5.85	5.59	5.59
Sales/Share	8.43	9.59	12.28	14.12	15.74	17.55



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Buy/Overweight \geq +25% expected absolute price performance

Accumulate +10% to +25% expected absolute price performance

Neutral/Hold +/-10% range expected absolute price performance

Reduce -10% to -20% expected absolute price performance

Sell/Underweight \leq -20% expected absolute price performance

Definition of Ratings

Buy/Overweight recommendation refers to stocks that are highly undervalued but with strong fundamentals and where potential return in excess of or equal to **20%** is expected to be realized between the current price and analysts' target price.

Accumulate recommendation refers to stocks that are undervalued but with good fundamentals and where potential return of between **10%** and **20%** is expected to be realized between the current price and analysts' target price.

Neutral/Hold recommendation refers to stocks that are correctly valued with little upside or downside where potential return of between **+/- 10%** is expected to be realized between current price and analysts' target price.

Reduce recommendation refers to stocks that are overvalued but with good or weakening fundamentals and where potential return of between **-10%** and **-20%** is expected to be realized between current price and analysts' target price.

Sell/Underweight recommendation refers to stocks that are highly overvalued but with weak fundamentals and where potential return in excess of or equal to **-20%** is expected to be realized between current price and analysts' target price.



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