Conference Call transcript

25 July 2019

FLOUR MILLS OF NIGERIA Q1 19/20 RESULTS

Operator
Good afternoon ladies and gentlemen and welcome to the Flour Mills of Nigeria Q1 analyst conference call. All participants will be in listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the presentation, please signal an operator by pressing star and then zero. Please note that this conference is being recorded. I would now like to hand the conference over to Anders Kristiansson. Please go ahead, sir.

Anders Kristiansson
Thank you very much. Welcome everybody to our quarter one call for Flour Mills Nigeria. Anders Kristiansson is my name. I'm the group CFO. I will walk you through the results as per the presentation that we distributed and uploaded on our webpage. The numbers that we will be presenting are looking at our April to June results which is what we call our Q1 2020. If you look at slide four of the presentation you see what we see as the main highlights. Effectively we saw an improvement in PBT, growing from ₦5.2 billion to ₦5.5 billion. And we saw a 17% improvement in after tax, going up to ₦4.2 billion. Overall we were pleased with the performance in Q1 especially in the sugar and agro-allied segment. And we expect in the coming quarter to see a bit more in the food segment.

The volume was up by 7% versus last year. The revenues were flat and the gross margin was broadly in line with last year at 12.2%. Overall we continued to see a very competitive wheat value chain and we see the turnaround strategy in agro-allied division working where we are now at a breakeven PBT level and a solid profit level on sugar and food. Overall we also saw the impact of the restructuring of the balance sheet where we had a 27% drop in financing costs compared to Q1 last year. So overall that's the key highlights. If I ask you to look at slide five you will see the detailed financials. You will see that revenue was up… [Break in audio].

Operator
We seem to have lost the main speaker. Ladies and gentlemen, apologies for the technical delay. I'm going to disconnect the main speaker and reconnect him. Please remain on the line. Thank you. Ladies and gentlemen, apologies for the delay. Please remain on the line. We are in the process of reconnecting the main speaker. Ladies and gentlemen, we thank you for your patience. We have been re-joined by Anders Kristiansson. Please go ahead sir.

Anders Kristiansson
Thank you so much. My apologies to everybody on the call. We were disconnected. We did the presentation for three minutes till we realised, so our apologies. Let me do a quick synopsis of the first two slides and then we will go through the rest in more detail. As mentioned what we are presenting to yourselves are the Q1 results covering the April to June timeframe. If we look at the Q1 results we saw an overall before tax profit increase of ₦300 million to ₦5.5 billion. And we saw the after tax profit increasing by 17% to ₦4.2 billion. We saw a 7% volume growth year on year. We saw the revenue being stable or up 1% versus Q1 last year. We saw a gross margin which broadly was in line with last year. We saw the impact of the continued deleveraging strategy and restructuring of the balance sheet with a further 27% drop in financing cost.

In terms of the segments the agro-allied division did quite well and the restructuring strategy that we put in place is yielding fruit. Whereas agro-allied made a loss of ₦1.2 billion last year they were now at breakeven. And we saw the sugar segment continuing to grow and generating a ₦1 billion profit, whereas food delivered a before tax profit of ₦4.5 billion.

If we look at the P&L on slide five you will effectively see the different line items. Revenue is up 1%. The gross margin contracted slightly and overall gross margin was marginally down. This is primarily coming from the food segment where we continue to see a very competitive environment and we are maintaining our market share, but we are at this stage down marginally in terms of margin. We are keeping the operating expenses flat while investing into the sales and distribution and route to market. And we are seeing the financing cost going from ₦6.2 billion in Q1 last year down to ₦4.6 billion in Q1 this year. As a consequence the before tax profit grew from ₦5.2 billion to ₦5.5 billion and the after tax profit grew by 17% up to ₦4.2 billion.

Looking at the segment reporting you will see that we have seen a marginal decrease in food revenues whereas the volume is up. We have seen the before tax profit going down by ₦1.2 billion in food [unclear] by agro-allied which has gone from loss making last year to breakeven, and we expect to see agro-allied growing further. We have a next slide where we will walk you through the agro-allied strategy. But overall we have seen good growth in the animal feed and fertiliser business. Sugar continues well, 30% revenue growth and ₦600 million [?] before tax profit growth. [Unclear] at break even, a slight decline versus last year as the Bagco business saw slightly lower volume in Q1. We expect that to pick up in Q2 and Q3, so overall the bagging business is on line to deliver slightly better results than last year.

If you look at slide seven we have outlined the key drivers behind the agro-allied turnaround strategy. As we mentioned in the earlier call the agro-allied division has been restructured under a holding company called Golden Fertiliser Company. And in this company we have put all agro-allied businesses, so the edible oil business, the animal feed business, the fertilizer business, the aggregation business and the remaining farms. This is coordinated by one management team and we are awaiting the synergies between the different businesses. During Q1 we have seen significant improvements in the Premier Feeds business with the volume, margin and resulting bottom line picking up. We have seen strong growth in the fertiliser business and in the premium cassava business. And the strategy of aggregating as much as possible of the input material during the harvest season is definitely yielding fruit. We are also getting a stronger route to market especially in the feed business. We still have some work to do in the edible oil business and we see further potential there.

If we look at slide eight you will see the key ratios. The before tax profit has grown from ₦5.2 billion to ₦5.5 billion. The financing costs have gone down by 27% as we mentioned. And the opex is basically kept flat versus last year. So overall we are managing the P&L. And as we will see the other segments picking up, especially sugar and agro-allied, we are coming in an increasingly favourable position. Our long-term production is that when the B2C channel gains traction we will see a further strengthening in the B2C side in the food side as well.

Looking at the financial position we see the net debt to equity decreasing. Just for clarity when we saw Q1 2019 that is our 2018/19 and when we saw 2020 that's the current year. So we have gone from 0.87 to 0.73. You will see that we have increased the amount of long-term debt versus short-term debt. As mentioned in earlier calls, with the subsidised funding for the agri sector we are getting our fair share of those and we are with a higher ratio of long-term borrowing much less sensitive to interest rate fluctuations. And the interest coverage ratio is also improving. So overall we see the financial position strengthening.

If we go to slide ten you see the overall cash flow. On the cash flow basis we saw a marginal contraction in cash flow from operating activities, primarily coming from slightly higher inventory levels especially in the agri sector which was an anticipated impact. As we mentioned before, we are scaling down the capital investment as we now have the capacity in place in the oil, in the pasta and in the wheat production side. We are seeing a gain from other investing activities and we had some payments in the port business from some of our interested parties. You will see the big impact. So net cash from investing activities is improving by ₦3.1 billion versus last year. The big movement is of course that we are now in a much stronger cash position and we are therefore not having to take as much borrowing as we roll over the short-term commercial papers. And you will see a much lower borrowing. As a consequence of that the cash flow from financing activities is of course lower and we will see a lower cash flow generated during the period. We finished the quarter at ₦7.7 billion of cash which is a comfortable position at this stage of the cycle. So this is the financials.

If we look at the outlook we expect to see four things happening during the rest of the year. We are seeing continuing growth in the B2C channel. We started the year with 50% of the revenue coming from B2C. At the end of the quarter we have 60% of the revenue and gross margin coming from the B2C channel. We have launched some new pasta brands especially up in the north which are doing very well, and we are seeing continuing growth in pasta. We expect that the B2C channel will continue to grow and we expect that to generate a favourable margin impact over the year. With the cyclical price of wheat we expect Q2 and Q3 to come in with lower wheat prices than Q1, so we will see the cash generation going up in Q2 especially.

We expect agro-allied to continue its growth and whereas agro-allied was in the red last year we are driving agro-allied towards much closer to breakeven or positive results. We also expect to see that sugar will continue its trajectory over the last year or two, even if there will be ups and downs in that category. We will continue to manage the costs tightly and drive operational efficiency. And we expect to see the investments that we are doing in advertising and sales and distribution some further synergies in terms of cost. And we will continue to manage the balance sheet and further reduce the financing cost during the year. So overall Q1 is up versus last year, a turnaround is coming in agro-allied, sugar is doing well and increased traction in the food segment. That is our synopsis of the quarter. Thank you for listening to this, and over to any questions and answers.

Operator
Thank you very much, sir. Ladies and gentlemen, at this time if you would like to ask a question you are welcome to press star and then one on your touchtone phone or the keypad on your screen, at which time you will hear a confirmation tone. Following this process will place you in the question queue. If you however decide to withdraw the question you're welcome to press star then two on your touchtone phone to remove yourself from the question queue. Just a reminder, should you wish to ask a question you're welcome to press star and then one. The first question comes from Waheb [?] of Stanbic IBTC Pension Managers.

Waheb
Hi. Thanks for your presentation. I have just one question. Is the growth in the sugar business on B2C or B2B? And also would you say the growth in the sugar division is as a result of an overall expansion of the market or an increase in FMN's market share? Thanks.

Anders Kristiansson
Thank you very much for the question. If I understood the first question it was on the share of B2B versus B2C. We ended last year with a B2B versus B2C split of roughly 50/50. By the end of Q1 we have a split if you look on a gross margin basis of 60% B2C and 40% B2B. So we are now at the strongest year of B2C versus B2B. In terms of sugar we are seeing growth in the overall market. We are maybe marginally increasing our market share especially in the [unclear] and in the B2C segment. But overall we are seeing the majority of the growth coming from overall market growth.

Operator
Waheb, does that answer your question?

Waheb
Yes, it does. Thanks.

Operator
Thank you very much. The next question comes from Adedayo of Renaissance Capital.

Adedayo Ayeni
Thank you very much for taking the call, Anders. I've got two questions. The first is on your revenue. So that number based on what you presented ticks down, but in the presentation you also said that your volume went up. So could you give an indication for why that was? It would imply that you had weaker pricing. But in which segment, which food items did you maybe see a dilution to your mix, or did you have to reduce prices to generate [unclear]. Also is more like a broad industry thing or you had to take that move just so you could get that volume growth? Secondly, could you give a bit of guidance on what your capex plan is like for the rest of the year just so we know what we are working with? Thank you very much.

Anders Kristiansson
Thank you very much. In terms of the revenue for the food what we did see was that the bread flour segment continued to be very competitive. We are selling different grades of bread flour depending on which part of country you are in. We saw higher sales of the lower priced more economical bread flours. And we saw effectively more of the volume coming from that. So it is a bit of a down-trading from the consumer which is similar to what we flagged in Q3 and Q4. So that explains that we are selling more volume but we are getting a slightly lower revenue per ton. This is of course offset by lower material cost as well. But overall we did see a down-trading in bread flour. We did also see the semolina segment being flattish to down somewhat, i.e. the ball food segment.

We did see pasta doing very well. So we saw the growth coming from pasta where we now are in a very strong position. We launched a second pasta brand up in the north at the end of last year and that pasta brand continues to do well. So it is basically a down-trading in the bread flour segment and pasta growing. Our assessment is that this when it comes to bread flour an industry thing. When we look at the market share data we are holding the market share. In pasta we anticipate that we are gaining a little bit of market share. In terms of our capex plans we will have capital investment below depreciation. We are looking at capital spending in the mid-teens in terms of billion, so mid- to high teens for this year, whereas we had a cash payment of ₦27 billion last year.

Adedayo Ayeni
Thank you very much.

Anders Kristiansson
Did that answer the question?

Adedayo Ayeni
Yes. Thank you.

Operator
Ladies and gentlemen, just a reminder, should you wish to ask a question you're welcome to press star and then one. The next question comes from Shakirat of United Capital Plc.

Shakirat Anifowoshe

Hello. Good afternoon. Thank you for taking this call. Can you hear me?

Operator
We can hear you. You can go ahead with your question. Thank you.

Shakirat Anifowoshe
My question is also on the food business. Can you give some guidance as to the level of price [unclear] in the flour business, because clearly pressure must have been on the pricing side? So kindly some guidance on the pressure you had on prices for the flour business. Then secondly for your bond programme as you planning on [unclear] that tranche this financial year, and by how much do you plan on doing that? My final question is on the Apapa gridlock. Kindly give some context into how much improvement you're seeing. In terms of number of days by how many days improvement have you seen in [unclear] to move the materials from the port to your factory and deliveries to your customers. Thank you.

Anders Kristiansson
Thank you very much for the question. In terms of pricing for the food business we have done some marginal price increases. So we have not seen the pricing coming down. Neither have we seen the rebate levels coming down. And we have done some marginal price increases. But we haven't seen the prices coming up as much as we would have anticipated during the high season. But overall the prices are coming up, but it continues to be competitive. What we do see is the down-trading in the bread flour and we do see the increase of pasta partly offsetting that. For perspective, the margin of pasta is roughly three to four times the margin of bread flour. So the growth of the pasta gives us high comfort, even if we would want to see more of it naturally.

On the second question on the bond programme, we did the first ₦20 billion of the ₦70 billion tranche. We are looking at the market and with the interest rates coming down it could be an interesting period. It is something that we are assessing continuously and if the timing is right we might go for a second tranche. In terms of the Apapa gridlock it has been improving. It is clearly better in Q1 than what we saw during October to December period last year when the roads were being rehabilitated. But it is still volatile. We have seen a couple of very tough weeks when there have basically been trucks piled up and long waiting time. And we have seen days as today where the roads are more or less free. So it is improving but it is not at a level where it can be predicted. So we see a slow improvement but not as much as we would like.

Operator
Ma'am, does that answer your question?

Shakirat Anifowoshe
I have a follow-up question on your food business. So you said the grocery business is offsetting the weakness you see in the flour business. Can you give some guidance as to how much contribution the pasta business and the flour business give to the food revenue?

Anders Kristiansson
Oh, now we are getting into a space where we are probably not disclosing it. Let me answer the question the other way around. If I look at the pasta business compared to three years ago the absolute gross margin of pasta has doubled versus three years ago. And today pasta is making a fair share of the overall contribution. But we are not giving absolute percentages unfortunately. But we have double the absolute gross margin of pasta over the last three years.

Shakirat Anifowoshe
Okay. Thank you for taking my questions.

Operator
Thank you. The next question comes from Efemena of Stanbic IBTC.

Efemena Esalomi
Hello Anders. Thank you for the call. Sorry to take you back again to the food segment. I wanted to be clear on what you stated earlier. Did you say that bread flour volumes had increased but that you were only selling lower priced bread flour? That would be my first question. Regarding the growth in sugar what would you say the split is between volume and prices? I know you spoke to the overall growth in the sector earlier. I'd like to say congratulations for being able to keep your operating cost relatively flat. But when I look at it in terms of your sales it has been flattish at around 5% of sales. And still with the restructuring in the agro-allied division, some improvement with the Apapa gridlock can we expect to see a modest improvement in that line as a percentage of sales? Those will be my questions for now. Thank you.

Anders Kristiansson
Thank you very much for the questions. If we look at the volume of combined bread flours and corporate flours we have seen a marginal increase, not a significant increase, but we have seen a marginal increase in the combined corporate and bread flour segment. The key volume growth has of course been coming from the agro-allied segment, but we have seen a marginal increase even in that segment. If we look at the sugar, what is volume and what is price, we have basically seen the overall profit growing by… We have an overall revenue growth of 20%. I would say that of that 20% revenue growth around 5% is coming from volume and the rest is coming from price, which is then offset by the higher input costs, which is why we see a ₦4.1 billion revenue growth but a ₦600 million bottom line growth. So effectively with the pricing formula as the sugar input price goes up we will increase the price especially to the industrial segment on a formula basis.

In terms of the restructuring of the agro-allied the focus of the agro-allied restructuring was not so much to gain synergies. The focus of the agro-allied restructuring was to make sure that we coordinated the activities. All of the businesses in agro-allied are one way or the other interlinked. So in the ROM edible oil business we are using palm oil and soya beans from our farms. We are transferring the by-product, the soya bean mash, to the animal feed business where we are also taking some maize from the Kaboji farm. We are selling the products from the animal feed and the fertiliser business to the agro-allied farms across the country and we are buying some of the grains from the farms across the country as input. So it is more coordinating the different businesses.

It is also to ensure that they had the right level of capital so that they could buy the full year of demand during the harvest season, which in the past had been a challenge or some of the smaller companies. So in the agro-allied it is not so much a cost saving, even if we of course see a little bit of synergy. In the other businesses as we are managing the operations and as we are looking at how to combine the businesses we do see a little bit of synergies. We will see lower transport costs. We will see lower offloading demurrage cost as Apapa gridlock eases. So we expect to see some further savings in the admin line. We are looking at further investments into brand building and advertising, so we will see a shift from admin cost to advertising cost over the year and going forward. That is our projection.

Operator
Efemena, does that answer your question?

Efemena Esalomi
Yes thank you.

Operator

Thank you very much. The next question comes from Abiola of Chapel Hill Denham.

Abiola Gbemisola
Hello. Good afternoon. Thank you for the call. I have just one question left. It is around your capex. So during the presentation you mentioned that your capex is going to be decreasing going forward. But again I also recall that you are taking on some additional long-term loans because of the favourable rate given by the CBN. So my question is this. The loans that are being received, the long-term loans, what is the use of those funds that are going to be received? Thank you.

Anders Kristiansson
Thank you for the question. The loans that have been taken over the last year have been used for the investments that we did in an additional mill in Apapa. It has been used for the additional pasta line and it has been used for the investment that we have done in the sugar plantation in Sunti. So we have leveraged the funds primarily over the last year for those three investments. And we are going to be spending in the mid-teens in capex, and some of that capex we will of course see if we can benefit from any subsidised funding schemes that we would be eligible for as we continue to drive the agro-allied segment for the country.

Abiola Gbemisola
Okay.

Operator
Thank you. Ladies and gentlemen, just a reminder, should you wish to ask a question you're welcome to press star and then one. The next question comes from Ayorinde of CSL Stockbrokers.

Ayorinde Akinloye
Good afternoon.

Operator
Ayorinde, you can ask your question. Thank you.

Ayorinde Akinloye
Thank you. So just to confirm some of the points made earlier before I ask my questions, for the food segment the volume growth that was sold was basically trading down on lower priced bread flours, which is why the revenue for food declined while we saw volume growth. So just to confirm that. Then two, the growth in the sugar segment – because sugar grew significantly by 20% – is it more price driven or volume driven? Then of the growth in volumes that we saw within the quarter how much of the growth was from initiating the B2C strategy compared to the B2B focus that this company had before? Then finally, across the difference four major divisions can you give an idea of volume growth in each of the business divisions? Thank you.

Anders Kristiansson
Thank you very much for the detailed questions. To see to what extent we can answer, in the food segment we saw an absolute growth. We saw somewhat of a growth in the bread flour and corporate flour. And we saw the consumers down-trading, so buying slightly lower priced flours. We did see a slightly stronger growth in the pasta segment which was then somewhat mitigated with the contraction in the semolina ball food segment. But overall the growth was coming to a certain extent from bread flours, corporate flours and from pasta in the food segment. In terms of the sugar of the 20% revenue growth about 16% was coming from price – price adjustment – and the rest was coming from volume primarily in the dealer segment. In terms of the different segments we did see a strong growth in agro-allied. We did see the 5% growth that I talked about in sugar and a marginal

growth in food. And we did see a little bit of a contraction in the bagging business which is mostly seasonal depending on when the harvest finished compared to last year. Did that give a better perspective?

Ayorinde Akinloye
Yes. Concerning the B2B and the B2C strategy how much growth has been driven by the B2C strategy implemented by the company now?

Anders Kristiansson
You mean how much of the growth is coming from B2B versus B2C?

Ayorinde Akinloye
Yes.

Anders Kristiansson
Well, we saw about an equal growth in… We saw a slightly higher growth in B2C than in B2B if we look at absolute numbers. We did see a strong growth in pasta. We did see a little bit of a contraction in the ball food segment of B2C. And we did see a growth in the combined corporate and bread flours. I'm afraid that's the level we can disclose with that.

Operator
Does that answer your question?

Ayorinde Akinloye
Yes, it answers my question. I have one more question.

Operator
Please go ahead. Thank you.

Ayorinde Akinloye
Okay. So in terms of costs when you look at… Because we are looking at your cost of raw materials relatively flat. So just by the growth in volumes raw material costs are still relatively flat, maybe just about ₦1 billion increase. Which of your raw materials would you say you saw lower cost pressures and then the ones that look like costs were much higher? Looking at the international markets for example comparing wheat prices in Q1 2020 and Q1 2019 wheat prices have trended a bit lower. So which of your products do you see costs reducing, like you mentioned for the agro-allied business, and then which ones do you see more pressures? That will be all.

Anders Kristiansson
Yes. Thank you very much. If we look at the absolute numbers the revenue increased by ₦1.7 billion. This is because of sales increase by ₦2.5 billion. We did see an increase of the sugar cost. We did see a marginal decline within the bread flours as we were selling slightly cheaper flours. In terms of absolute wheat prices we did see them slightly up versus Q1 last year, taking exchange rate and everything into account. So those are the three key drivers. The sugar costs went up. We did see a slightly higher wheat price compared to last year. And we did see the shift in terms of spending to slightly lower margin flours.

Operator
Ayorinde?

Ayorinde Akinloye
Yes. Thank you. That's fine.

Operator
Thank you. The next question comes from Aaron Moseli [?] of Tellimer. Erin Moseli, your line is open for questions.

Aaron Moseli
Good afternoon. Thanks for the presentation. Apologies if my question is taking us back. I joined relatively late. My question is on volumes. I know overall there was a 7% improvement in volumes which was driven by agro-allied and sugar. I was just wondering if you could give specifics, actual values for volume movement for food, agro-allied and sugar, or at least a range or something.

Anders Kristiansson
Thank you for the question. Unfortunately we do not disclose volumes at those levels. What we do is we measure the tonnes, and giving the values of the different volumes might not be the most applicable way of looking at it. As mentioned we did see a fairly strong volume growth in agro-allied. We did see a marginal improvement in agro-allied as we are now seeing traction on Premier Feeds. We did see a volume growth in sugar impacting the bottom line, to some extent from the dealer segment. And we did see some growth of volume to a lower level in the food segment with pasta doing very well and a little bit of a downward trend in ball food. So overall the B2C segment is growing in food compared to the B2B segment. But I'm afraid we do not disclose absolute volumes. I think what we are trying to do with the segment reporting is trying to give an indication of the profit impact instead.

Aaron Moseli
Thank you.

Operator
Ladies and gentlemen, just a final reminder, should you wish to ask a question you're welcome to press star and then one. At this stage we have no further questions in the queue. Do you have any closing comments?

Anders Kristiansson
All right. Thank you so much for taking the time and listening. As a company we are quite pleased with the results. We have generated ₦4.2 billion of profit in Q1 which will put us at the trajectory that we had anticipated for the year. As we mentioned in the full year call we see this year delivering a stronger performance than what we saw last year. And based on what we are seeing in Q1 we are very much on track for that. Thank you so much for the call, and if there are any follow-up questions please reach out to myself or the team here.

Operator
Thank you very much sir. Ladies and gentlemen, on behalf of Flour Mills of Nigeria that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT