Food and Agro-Allied Group

Conference Call transcript

31 October 2019

FLOUR MILLS OF NIGERIA Q2 RESULTS

Operator
Good day, ladies and gentlemen and welcome to the Flour Mills of Nigeria Plc Q2 analyst call. All participants will be in listen-only mode and there will be an opportunity for you to ask questions later during the conference. If you should need assistance during the call, please signal an operator by pressing star and then zero. Please also note that this call is being recorded. I would now like to turn the conference over to Mr Anders Kristiansson. Please go ahead, sir.

Anders Kristiansson
Thank you very much Chris. Welcome everybody to the call. We shared the presentation a while ago based on the results that we published last [break in audio]. I'm very pleased to present the half year results of Flour Mills of Nigeria Plc. With our accounting cycle running from April to March we are now presenting the results covering April 2019 to September 2019. As we mentioned in the overall highlights, we saw during the first half of the year a somewhat challenging market situation that has been reported by other FMCG companies as well. There was a 1.9% overall GDP growth in 2019 up to June and the overall manufacturing sector declined by 0.1%.

In this environment we saw our volume growing by 6% primarily driven by our agro-allied leg and our sugar leg which both were growing at double digits. Food was facing a mixed bag with bread flour and ball foods continuing to be under pressure, whereas we saw pasta and noodles showing double digit growth in the July to September timeframe. So in terms of food as we reported in Q1 there are challenges in the flour and the ball foods segment. And we will present to you what we are doing in this area, but we are seeing quite a bit of an uplift on both the pasta and on the noodles.

In terms of the impact of the border closure we did not see much impact in Q2. There was a little bit of an impact in September, but we estimate that the bigger impact will be in Q3 especially supporting our edible oil, our sugar, but also the pasta segment. What we have seen is we have seen a shift from rice as the prices have gone up to pasta, but the impact is less in the numbers that I'm presenting now. In terms of sugar we saw a solid Q2 with our volume continuing to pick up and the overall market doing well. In agro-allied we presented what we were doing to bring agro-allied into solid profit in the earlier call, and we are seeing the fruits of that and the restructuring that we have done, especially in [unclear] and in fertiliser for the second quarter. But we are also seeing the restructuring that we did of the farms being fruit, so overall in terms of volume a solid second quarter.

In terms of the product mix on slide five you see a snapshot of our products. We have during the first half of the year launched Massavita which is effectively a ball food that is based on sorghum for the northern market. We have launched [unclear] rice noodles which are doing quite well. During last year we launched Mai Kwabo in the north which is a pasta that is positioned at a slightly lower price point with a slightly different content which also continues to do very well. So overall we have over the last couple of months seen three product launches. We have a couple more coming in the pipeline.

If we look at the financial highlights on slide seven we saw overall the profit before tax growing by ₦300 million or 4% to ₦8.6 billion. We saw the after-tax profit growing by ₦800 million or 16%. That's come from a lower tax rate. For the first half of the year last year we accrued a 39%. At this year we are accruing at just north of 31%.

We will see less impact of Golden Sugar coming out of its pioneering status i.e. the double taxation during last year after pioneering status. So overall we saw a 16% growth of after-tax profit. The revenues remained flattish with sugar, agro-allied and pasta offsetting the bread flour. Still, food revenues were marginally down versus last year, but we see the mix impact of moving to B2C working.

We saw the 6% overall volume growth that I talked about, and more positively, whereas we in Q1 reported a 5% contraction on the gross margin we saw an uplift of the gross margin in Q2 and overall gross margin is now more or less in line with last year. We anticipate that will continue with the gross margin picking up further. We continue to reap the benefits of the balance sheet restructuring with interest rates dropping 21% compared to first half year of 2018/9, enabling a gain of ₦2.4 billion. And in terms of the overall financial features we saw the agro-allied division moving from a ₦2.9 billion loss last year to a slightly annoying ₦100 million loss during the first half year. But we are comfortable that we will bring agro-allied into an overall profit-making position. Effectively agro-allied was making a gain in Q2. So overall those are the key financials.

If you look at the detailed P&L the revenues were flat versus last year, cost of sales marginally up with the gross profit more or less in line with last year. Operating expenses were up by 7% and this is of course one of our watch areas. Overall operating expenses moved from ₦15 billion. Of that about half of it was coming from investments that we did in sales and distribution. We are as we have talked about in earlier calls focussing quite strongly on the route to market, which is part of the reason why we are seeing the benefit in pasta and noodles, but we need to do more. We are looking especially in the west and eastern region how we can get a stronger distribution network. So we are looking at trucks for the dealers which we are funding together with the bank. We are looking at smaller trucks that can penetrate the market further. They are being put in place. We anticipate to see the benefit more in the second half of the year. We also did see some inflationary increase of the admin cost, and the admin cost is something that we are watching fairly carefully and will scale down a bit during the second half of the year.

We had ₦1.1 billion of operating gains last year. This year operating gains were at breakeven. The movement in operating gains losses were primarily coming from exchange losses. As the Naira devalued from ₦359 at the end of last year to ₦363 it took a little bit of an impact on a couple of open FX positions. We had a little bit of a shift in subsidised loans. Overall the subsidised loan book is growing, but we had a couple of loans where we were booking the difference between the interest rate and the market rate during last year and we saw a little bit lower impact of that. So overall the movement in operating gains downwards was coming from FX and a little bit of the timing difference in terms of government subsidised funding. Financing costs are positive. Investment income is up. And we ended up with a profit before tax of ₦8.6 billion and a profit after tax of ₦5.9 billion, i.e. up 16% versus last year. And if you look at our cycle we normally show a very strong profit in Q3, so we are reasonably comfortable with where we are at this stage.

If you look at the segment financials food was down marginally in terms of segment revenue and down when it comes to segment profit. The segment profit was driven by a couple of things. Overall volumes were down with bread flour and ball foods, partly offset by pasta and noodles which are growing strongly. We also did see higher CFR costs in the first half of the year versus the first half of last year. One of the challenges is the ability to price on the more basic product. That is a challenge that will remain for a while. And as we see the CFR prices coming down during the second half of the year growth versus the first half of the year but also versus what we were paying second half last year. We have also done some investments in the route to market as I mentioned, and we have been doing some investments in brand building. That is the driver between the decline we saw in food for the first half of the year and we will see food picking up during the second half of the year.

Agro-allied as I mentioned and also the farm strategy we saw a ₦2.8 billion improvement. Sugar continues to do well with a ₦3.5 billion profit from the combined Golden Sugar and Sunti value chain. Support services, we have seen a lot of resilience in Bagco and we see a ₦600 million profit on overall support services. So overall in terms of segments two segments are doing really well, support services continued, some challenges in food which we are addressing on the bottom line basis.

If we look at the more detailed financial performance the profit after tax grew by ₦800 million from ₦5.1 billion to ₦5.9 billion. We saw a stable return on equity and an improved return on assets. The balance sheet continued to strengthen with 21% decrease in the financing cost as mentioned. And if you look at the subsequent slide you will see that we have reduced the short-term debt and increased the long-term borrowing in line with the strategy. We have seen the commercial interest rates coming down during Q2 partly behind the loan deposit ratios and partly because of the market dynamics. We believe that there is a very strong opportunity where we try to secure longer-term debt, and we have also increased the level of agro-allied related subsidised funding. We see the leverage improving and we see the net debt to equity coming down. So overall in terms of financials we are comfortable with the quarter.

If we look at cash generation we generated ₦13 billion of cash flow from operations and we ended the quarter at ₦21 billion. There is a little bit of a reduction of cash from operating activities which has gone down from ₦40 billion to ₦29 billion. This is more of a timing difference in shipments and [break in audio] paid for them during the last seven days of the quarter to the tune of ₦8 billion. And I'm very happy to take the criticism that we should have accepted them at the first part of next quarter, but that's the primary reason for the driver. If you look at the detailed cash flow statement you will see that it is all working capital. In the next quarter this will be back to normal. But overall we ended up with a cash position of ₦21 billion.

If you look at the outlook we are focussing quite a bit on the food segment. We are very pleased to see the growth in B2C and we are spending quite a bit of resources and effort on B2C and the route to market within B2C and B2B. As mentioned by Mr Hainsworth two quarters ago we are looking at trucks for the distributors which we are starting to roll out, but we will see the bigger benefit of the trucks in the second half of the year. We are looking at entering distribution points partly with the dealers and partly by ourselves in key areas where we are not reaching as well as we should today. And we are also looking at 15 ton trucks for some of our partners that can go deeper into the market.

We are continuing to look at affordability of the product. Golden Penny is the premium quality brand in the market and it will remain the premium quality brand in the market. And we are investing continuously behind ensuring the quality of Golden Penny. Still in the current affordability environment we launched a pasta in the north. We are looking at slightly more affordable product at a slightly different quality, still at a strong quality but at a higher affordability level to ensure that we can reach a bigger chunk of the market. And we are looking at a couple of launches during the second half of the year. We are also based on the current pricing seeing the CFR doing down in the second half of the year which will further help the food segment. We will see in the agro-allied segment primarily behind animal feed, which is doing well both in terms of the food [?] and we see good pick-up in aqua feed that we launched in Calabar. The fertiliser even if we are now coming to the tail end of the season and the cassava starch value chain.

We continue to drive up efficiency and cost optimisation and we are actively taking out cost in that area. We are generating further cash flow. We are seeing the debt level coming down and we are actively ensuring we can secure a lower interest cost over a slightly longer time period. So we will see the financing cost coming down further during the second half of the year. We are today starting to see of course a good impact of the border closure which should further help especially in the edible oil and in the sugar segment, and to a certain extent depending on consumer choices in the pasta segment. In terms of the Apapa situation the availability has been better during the first half of the year and it has been easier for the trucks to come in and out, but it is by no means stable. But we are seeing an overall improvement even if there are occasional blips. However, overall we are looking forward to a strong second half of the year. I think that concludes the formal presentation and I'm looking forward to any questions from yourselves.

Operator
Thank you very much sir. Ladies and gentlemen, at this time if you do wish to ask a question please press star and then one on your touchtone phone. If you decide to withdraw your question please press star and then two to remove yourself from the queue. Again if you wish to ask a question please press star and then one now. Our first question is from Ayorinde Akinloye of CSL Stockbrokers. Please go ahead.

Ayorinde Akinloye
Thank you, Anders, for the presentation. So my first question is on sugar. I have about two or three questions. The first question is on sugar revenue. So noticeably for Q2 sugar revenue was down about 13.4%. If you take out the Q1 sugar revenue from the half year revenue you see that Q2 was a bit down. So I just wanted to know what happened in Q2 that led to the decline. Then overall for each one what channels actually are growing in terms of driving sugar revenue? Is it the B2B channel or the B2C segment of the business for sugar? Then finally on the border closure that the government has implemented we saw a bit of impact for some of the palm oil producers and other sugar producers during the quarter, but that didn't seem to trickle during the quarter. Was there any major reason for that? And then by how much do you think that could impact revenue for agro-allied and the sugar business going forward? Thank you.

Anders Kristiansson
Hi Ayorinde. Thank you so much for the question. In terms of the sugar revenue overall we saw the sugar… And maybe we should compare numbers here. The number I have is that sugar had ₦20.8 billion of turnover in Q2 compared to ₦19 billion in Q2 last year. So from our records we saw a ₦1.8 billion growth in sugar revenue. If you want just pop us an email after and we can walk through the ₦1.8 billion growth in sugar revenues. What did happen was that the majority of the volume was coming from B2B. We still have quite a bit of an opportunity in the dealer market and in the B2C. So the absolute majority of our volume is coming from the industrial side. That is why we also saw a little bit less immediate impact of the border closure. We have always in the calls said that we are less affected by the smuggling than the other ones because we are selling more institutional. However, of course if there is less sugar available in the overall market we foresee to benefit from that going forward as well. But the growth in sugar was primarily B2B. In terms of the impact on the edible oil there was a little bit of an impact, but all of us were sitting with two to three weeks of stocks so we did not see much imported food. We expect to see food in terms of demand and potentially pricing some impacts in Q3.

Ayorinde Akinloye
Okay. Thank you.

Operator
Thank you. The next question is from of ARM Nigeria Stockbrokers. Please go ahead.

Feyisike Ilemore
Hi Anders. Thank you for the call. I have two questions. The first one is on your new product, Dawavita. I want to understand, is Flour Mills the pioneer in the market? Is Dawavita the only ball food product based on sorghum flour in the northern region? And secondly, what has market reception been like since the launch of the product? And then secondly for your flour product, bread flour, ball foods, pasta and noodles what is the B2B and B2C split in terms of revenue and gross profit? Thank you.

Anders Kristiansson

Hi Feyisike. Let me come back on the second question first and then we will clarify on the first one. For B2B to B2C we are now at 58% B2C versus 42% B2B if we look on a gross margin basis. In terms of volume we are still higher on B2B of course than B2C, but we are seeing a higher rate of the gross margin coming from the B2C than the B2B. In terms of Dawavita, it is a sorghum based ball food in line with other sorghum based [break in audio]. We are not the only product. We are when it comes to packaging quality the leading product out there, and we want to a certain extent replicate what we have done with Semovita and [unclear] product out there. So far the reception has been very positive.

Feyisike Ilemore
All right. Thank you.

Operator
Thank you very much. The next question is from Fola Abimbola of FBNQuest. Please go ahead.

Fola Abimbola
Thanks Anders. It is not really a question. It is more of a clarification because the call was not really clear when I was listening. I just want to know, you mentioned that the border closure was favourable to pasta, edible oil and sugar. And correct me if I am wrong. That's my key question. But I also want to know if the border closure was favourable to pasta and edible oil that implies that alongside sugar there was edible oil and pasta being smuggled. Would that be right in assuming that? Thank you.

Anders Kristiansson
Sorry, let me clarify that. I probably didn't explain it as well. For edible oil we are buying all of our oils naturally through the official channels. So if no oil is coming in from cheaper sources without paying the right duties etc. it will help us who are doing it the ethical way. So there is a clear improvement in the edible oil market. In pasta the effect that we are starting to see is as a consequence of the border closure the prices of rice have gone up. And a number of consumers substitute rice with pasta or they mix rice and pasta. That is why we see both the noodles and the pasta growing somewhat. It is less of an impact in Q2. In Q2 it was more due to the work that we have done internally with new launches and the route to market. But we are starting to see an uplift in Q3.

Fola Abimbola
Thanks.

Operator
Thank you very much. Ladies and gentlemen, again if you wish to ask a question please press star and then one now. We have no further questions in the queue, sir. Do you have any closing comments?

Anders Kristiansson
Thank you so much for everybody listening. As I said we are very pleased to present the results and we have a strong confidence for the balance of the year. So thank you so much. Me and the team are here if you have any further questions when you've been through the details. Goodbye.

Operator
Thank you very much sir. Ladies and gentlemen, that then concludes this conference call and you may now disconnect your lines.

END OF TRANSCRIPT