Conference Call transcript

30 January 2020

FLOUR MILLS OF NIGERIA Q3 RESULTS

Operator
Good day, ladies and gentlemen and welcome to the Flour Mills of Nigeria Plc Q3 analyst call. All participants will be in listen-only mode. There will be an opportunity 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 note that this call is being recorded. I would now like to turn the conference over to Anders Kristiansson. Please go ahead, sir.

Anders Kristiansson
Good afternoon everybody. My name is Anders Kristiansson. I'm the group CFO of Flour Mills of Nigeria Plc. I have the pleasure of presenting our Q3 results, our financials running from October to December 2019. And the related financials are available on our website, as are the contact details of our investor relations team if anybody would have any follow-ups. If you look at slide four in the presentation deck that we shared it is basically a synopsis of Q3. Our Q3, i.e. October to December resulted in a 23% profit growth, and we are very pleased with the results for Q3. On an overall macroeconomic basis the [break in audio] July to September showed a 2.3% overall GDP growth. We published for October to December an 8% volume growth. And we saw currency being stable during the period, hovering around ₦362. We had availability of the Naira and we faced no currency challenges.

If you look at our four business segments, which is food, agro-allied, sugar and support services, in the prior two quarters we saw a strong growth in agro-allied which has turned a corner from a start-up phase where we invested, where we might have had one or two teething problems, to a solid cash generation and turning into [break in audio]. Sugar, which we started five years ago, is now one of the main cash generators and had another solid quarter. Food has for the first half of the year been doing well in the B2C segment, but [break in audio] market in the B2B segment. [Break in audio] quite a few internal actions as we have mentioned before in terms of ensuring regional strategies, in terms of ensuring the right route to market, and we have launched a couple of additional SKUs. All of this has borne fruit and we saw an overall 23% profit growth in Q3 versus prior year.

Overall this is what has given the 23% profit growth. Of course there was a favourable domestic and economic environment with the border closure coming in to impact and causing a more even playing field. And we can attribute roughly one-third of the growth to the border closure, the rest of the growth coming from underlying operational performance. And as we have shown over the last year, year and a half, we are continuing to deleverage the company and we closed Q3 with a ₦96 billion net debt. And we saw versus last year a 21% reduction in our financial costs. So, overall a 23% overall profit growth behind the levers that I mentioned.

If I ask you to look at slide six you will see the more detailed financial highlights. We saw the volume growing by 8% versus Q3 last year. For the first half year we published a 6% year on year volume growth, so we saw the volume coming up in Q3. We saw a 9% growth in food volume, we saw a 9% growth in sugar volume and a 6% growth in agro-allied volume, so overall we saw a solid volume growth across all the various segments. The gross profit grew by 11%, so ahead of the volume. The ₦96 billion net debt and the lower interest rate [break in audio] and we saw the rates coming down during Q3 with some of the intervention done on a macroeconomic level, and also behind our focus on going into slightly longer finance projects playing more of a role, so we saw the overall finance cost go down.

The profit before tax for the quarter grew by 23% and year to date is up by 9%. The one thing that might be sticking out a little bit in the financials is the tax that we have included at 40% for Q3. We [break in audio] in mid-January there is a little bit of an ambiguity when the [unclear] tax which has been set at 0.5% will be applicable for a company that has an accounting year from April to March next year, and when the abolishment of the tax holiday commencement ruling i.e. the double taxation that has been in place before will cease. The Finance Bill basically has an increase in minimum tax and an abolishment of the commencement ruling. We have taken a very prudent approach to those and we will give further guidance as we publish the year.

If we look at the detailed financials on slide seven you will basically see the impacts that I mentioned. Revenues up 17%, gross profit up 11%. You will see that the operating expense [break in audio]. As we commented in the Q2 call there is a big timing to this as we are accruing all the expenses over the physical year. There is also some impact of IFRS 9, and then we make provision for potential theoretical bad debts, and there is an impact of the IFRS 16 lease agreement. We have reflected all of that on a year to date basis. Still, one of the things that we are constantly looking at is the operating expenses. Our assessment is that roughly 8% of the 13% year to date increase is due to cost increases. [Break in audio] we will be mentioning a right-sizing exercise that we have embarked on that the ambition will be to take down the overheads going forward by around ₦700 million on a going forward basis. If we look at the financing cost we see the 21% improvement. And if we look at the before tax profit we see the 23% in Q3 and the 9% year to date. So, overall a strong quarter from our perspective.

If you go to the next slide you will see the profitability by segment. As mentioned we saw [break in audio] and we had an 18% profit growth in Q3 for food. This is primarily behind continuous strong growth in pasta and improvements in [break in audio]. We saw bread flours affected by a fairly competitive environment during the first half of the year show solid volume growth in Q3 and we anticipate this to continue. We saw the agro-allied business basically turning from a ₦3.9 billion year to date loss in the last year to a breakeven ₦100 million profit during the first nine months of the year. So effectively they are seeing a ₦4 billion profit improvement in agro-allied primarily behind the fertiliser and the animal feed business over the last nine months. Over November/December [break in audio] the edible oil as well. Sugar continues to do well and this supports [break in audio] projection.

If we go to slide nine you will see the key financial [break in audio]. And effectively you will see the growth of 6% year to date, in Q3 growing by 17% because you will see improvement in EBITDA and you will see improvement in profit after tax. The indicators are going the right way. The one clarification that we are having is the impact of the Finance Bill as explained before. We estimate that the year-end after-tax number can be slightly better than what we have been [break in audio].

We are more or less even with last year. We have maintained the ratios while growing the other levels. If we look at [break in audio] the net working capital is coming down. We have had somewhat more [break in audio] resourcing strategy. Especially for the agro-allied segment we buy a large chunk of the future volume during the harvesting period. We have continued to do that, but it is now [unclear]. The leverage, both net debt to equity and net debt to EBITDA, is coming down and we have reduced the net debt to ₦96 billion. The long-term debt stood at ₦70.5 billion and we are looking at how we can source our long-term capital funding as we see a very favourable interest rate.

Looking at the overall cash flow we generated ₦43 billion of cash from operating activities. We have invested ₦12 billion in capex. We have paid down the borrowings by ₦6 billion, [unclear] ₦4.8 billion and interest around ₦12 billion. So we ended up with a net cash position of ₦15.5 billion. If you look at slide 13 you will see our cash flow. What we wanted to draw your attention to is that if we look at [break in audio] we will always have a cash outflow in Q3 behind the aggregation strategy that we follow. And in this year we decreased the cash by ₦13 billion compared to ₦20 billion. The lower cash made in Q3 is coming from ₦5.7 billion more cash generated from operating activities, basically more cash generative across the value chain. And we continued to invest into lower-priced local commodities during the harvest season. We ended the period at ₦15.5 billion of cash as mentioned before.

If we look at the outlook we are quite pleased with the momentum in the value chain in Q3, even if [break in audio] a bit of headroom to take it further. The momentum that we saw in especially November/December has continued in January and we are looking at a strong January. Food, which turned into year on year profitability in Q3, is [break in audio] primarily behind the distribution regional strategy, the volume momentum behind the new SKUs and brands that have been launched. We see fertiliser coming down as we are outside of the season for fertiliser, but we are seeing a very healthy uplift in edible oil. We will continue to invest in branding and distribution, and we are very actively working on optimising the operational efficiencies. As mentioned earlier, we undertook a smaller right-sizing activity [break in audio] the central head office functions, and we estimate that this will generate annualised savings going forward.

We are very much looking at the balance sheet, and as we announced two weeks ago [break in audio] additional ₦20 billion bond under the ₦70 billion bond programme. With the current interest rates in Nigeria we believe that we can issue a bond at very low teen figures, and we want to lock in some of the future cash flow needs for the next years. So overall this is what we are looking at. The big question is of course what will happen if the borders open up again. As I mentioned, we estimate that roughly one-third of the growth that we saw in Q3 is coming from the border closure. Two-thirds is coming from the activities we are taking on internally. We believe that the border closure has created a more even playing field, so even if the environment changes we would see some positive impact on that as well. That finishes the presentation and we now leave it with the questions. If there are any questions if I can ask you to just [unclear] to the operator and she will coordinate them.

Operator
Ladies and gentlemen, if you would like to ask a question you're welcome to press star and then one on your touchtone phone. If you however wish to withdraw your question you may press star and then two to remove yourself from the question queue. If anyone would like to ask a question please press star and then one. Ladies and gentlemen, just once again, if you would like to ask a question you're welcome to press star and then one. Our first question is from Olukayode Odesola of Sterling Bank Plc.

Olukayode Odesola
I didn't really get the… [Break in audio] the CFO was talking about trying to issue a bond and then lock in some of the future cash flows into the bond. So basically the idea is to have… Can you give an idea of the total exposure that the company currently has and how it plans to relate this with the [unclear]? That's the first question. The second question. The industry is in consolidation, so what is the outlook of the company from that perspective?

Anders Kristiansson
Thank you for the question. On the bond let me clarify further. We find for a ₦70 billion bond programme we issued a bond in November last year of ₦20 billion as we now see [break in audio] coming down to [break in audio] level we are looking at issuing a second bond of up to ₦20 billion to increase that bond to [break in audio]. We are also looking at the investment needs that we see for the next two to three years, and we want to fund them now and lock in the funds at three to five years. But the primary purpose of the bond is to refinance more higher-priced debt at the lower price and ensure that we have enough funds to take on the investments that we are looking at for the next two to three years at a low teen rate, if that explains it, Olukayode. In terms of the consolidation, yes, the industry is at a consolidation and the industry has been in a consolidation for some time. We are the market leaders in flours. We are the market leaders in pasta and a number of the other segments that we are competing in. We are very comfortable that we with the size of the company we have can compete very

effectively. [Break in audio] is of course a natural [break in audio] and we are taking steps that we continue to maintain the segments.

Olukayode Odesola
Thank you very much. Thank you.

Operator
Our next question is from Abiola Gbemisola of Chapel Hill Denham.

Abiola Gbemisola
Hello. Thank you for the call. I have two questions that I want clarification on. The first is around your engagement with the government as regards the border closure. From what I can see from your numbers I believe you have benefitted from that directive from the government. So based on your conversations with the government and engagement do you think this will be a sustained policy going forward? And the second question is around what you disclosed as a [unclear] right-sizing. I need to get more picture around that. Are you looking to sell off a business or discontinue an operation within a particular business segment? I just want more clarity on what you mean by right-sizing. Thank you.

Anders Kristiansson
If I may start with [break in audio]. Sorry for not being clearer. We looked at activities that were done in that could be outsourced more in terms of services, and we did some outsourcing of activities where maybe we don't have the expertise. We also [break in audio] staff strength in some areas in the head office with a little bit of an adjustment. So when we talk about right-sizing it is more right-sizing in the non-operational segment where we went through [break in audio]. But we did outsource some aspects [break in audio] as part of this exercise. [Break in audio] in edible oil and in pasta as the [unclear] and the availability [break in audio] costs etc. So we have seen a positive from the border closure. We have also seen the potential of the Nigerian [break in audio] when there is an even playing field. It's not for us to have an opinion whether the border should remain open or closed, but of course we would like for everybody to compete on similar [break in audio].

Abiola Gbemisola
Okay.

Operator
Our next question is from Adetumi Atayero of Quantum Zenith Asset Management.

Adetumi Atayero
Hi. Good afternoon. I'd like to find out about the operating profit, because if you look at the results revenue was higher but sales and administrative expenses was still [unclear]. Operating profit came down by 9.5% about. So in terms of right-sizing how do you think that will have an effect on improving these figures, because PBT went up basically because finance cost was lower, which might not be a sustainable strategy in the long run? So I just want to know, how do you rein in administration expenses such that more revenue comes into operating profit? Thank you.

Anders Kristiansson
Thank you for the question. And it is a fair question. If you look at the Q3 number the gross profit was up by 11% but we saw an increase of administration expenses. Some of this is timing differences depending on when we reflect [unclear] cost. But not an insignificant component is the investments we have done into the route to market, sales and distribution and advertising expenses versus last year. Still, we do have a [break in audio]. That's

why we engaged on the right-sizing exercise. [Break in audio] from the right-sizing exercise [break in audio] of ₦700 million [?] going forward. Did that answer the question?

Operator
Adetumi, did that answer your question? There seems to be no further response from that line. Ladies and gentlemen, if anyone else would like to ask a question please press star and then one. We will pause a moment to see if we have any further questions. We have a question from Damilola Olupona of ARM.

Damilola Olupona
Hello. Thank you for the presentation. I just have one question around your interest expense and your plan regarding that going forward. I know [unclear] ₦50 billion on debt programme, and considering the lower interest rate environment are you looking to take advantage of that to reduce your interest expense? And if you will be doing so, by how much would that impact interest expense in your books?

Anders Kristiansson
Thank you for the question. We have seen the financing cost going down by 21% during the half year. We believe that there is a window to lock in longer term debt at effectively low single-digit interest rates, which is why we prepared filling [unclear] to be able to issue [break in audio]. And we have now launched a bond, so we hope to close it up in one to weeks' time. We also looked at some other shorter term debt. We see the long-term versus the short-term debt going up and further reducing interest. So we have had an active debt programme where we have reduced the debt year on year. We still see some further debt reduction, but what remains we want to have at the optimal rate, which is what we are trying to do to lock in a part of the debt on a three to five year basis.

Damilola Olupona
All right. Thank you.

Operator
Ladies and gentlemen, just a final reminder, if anyone else would like to ask a question you're welcome to press star and then one. We will pause a moment to see if we have any further questions. It seems we have no further questions on the line, sir. Would you like to make any closing comments?

Anders Kristiansson
Thank you so much for your time. Thank you for your interest in the company. All the material that we have discussed is available on our webpage. We will in the future be looking forward to discussing Q4 with you in the not too long future. Thank you so much.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT