Okomu Oil Palm Company Plc

Nigeria | Equities | Agriculture | September 2, 2015 — PAC RESEARCH

Excess supply of palm oil weighs on revenue growth

1H 2015 revenue improves by 2.5% y/y and 5.9% q/q. In the first six months to June 2015, Okomu Oil recorded revenue of ₦4.99billion, up by 2.5% compared with ₦4.87billion in the corresponding period of the previous year. On a quarterly basis, the company's revenue of ₦2.57billion in 2Q2015 moved up by 5.9% against ₦2.42billion in the first quarter of the review period, but declined by 15.5% compared with ₦3.04billion in the second quarter of the preceding year. Also, the latest quarter's revenue exceeded 8-quarter average of ₦2.21billion by 16.2%. On a geographical basis, Okomu Oil derived 81.6% of its revenue from domestic sales while 18.4% was generated from export **(fig.6)**. In addition, revenue derived from domestic sales increased by 3.7% to ₦4.07billion compared with ₦3.93billion in 2014. On the contrary, revenue from export sales declined by 2.7% to ₦917million against ₦942million in the previous year.

Furthermore, according to the recent trends in the prices of commodity in the global market, several agricultural products are affected by oversupply as a result of bumper harvest in the past two years and subsidy scheme in some producing nations. Therefore, the prices of palm oil declined by 15.5% to an average of US$2,194 metric tonnes (mt) in the review period compared with an average of US$2,597mt in 1H2014 **(fig.7)**. However, global consumption of palm oil is expected to be boosted in the short term by lower trading prices relative to the prices of other vegetable oils, and recent reports of increasing imports into major consuming countries. Hence, consumption is expected to grow modestly by 2.8% in 2014/15, whereas this is expected to firm up to c.5.8% in 2015/16 season. Also, palm oil supply is expected to improve marginally in 2014/15 as global output has been exceeding production in the recent years, therefore output is expected to reach 60.8mt compared with 60.5mt in 2013/14 season. Although, adverse weather condition may undermine harvests in some key producing countries like Indonesia and Malaysia.

Fig. 1: Quarterly results highlights

	2Q2015	1Q2015	2Q2014	Q/q Δ	Y/y Δ
Revenue (₦'mn)	2,567	2,424	3,039	+5.90%	-15.53%
Operating profit (₦'mn)	1,060	1,287	1,149	-17.64%	-7.75%
Net profit (₦'mn)	809	1,033	842	-21.68%	-3.92%

Source: NSE, PAC Research

Moses Ojo
moses.ojo@panafricancapitalplc.com

Price:

- Current	**₦23.75***
- Target	**₦28.75**
Recommendation:	**BUY**

** As at Wednesday September 02, 2015*

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-6.31%/-30.99%
52-week range	₦19.60 - ₦35.35
Average daily vol./val.	345,209 /₦9.896mn
Shares Outstanding (mn)	953
Market Cap. (₦'mn)	20,604 ($103.02mn)
EPS, ₦- 12months trailing	2.38
DPS, ₦- FY2014	0.25
FCF, ₦- FY2014	-1.32

Source: NSE, Company's Annual Reports, PAC Research

Fig. 3: Key ratios

	1H2015	1H2014
Gross profit margin	85.47%	88.13%
Net profit margin	36.89%	29.04%
Equity multiplier	1.41x	1.41x
Asset turnover	0.26x	0.27x

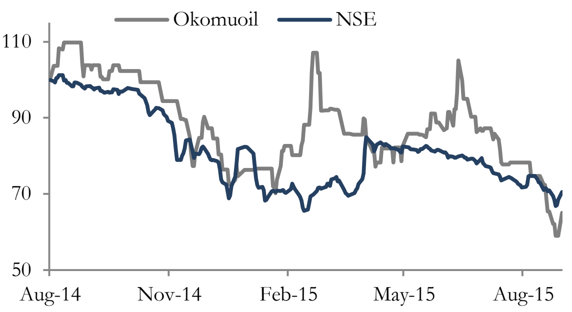
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2014	FY2015E	FY2016F	FY2017F
P/Sales	2.16x	2.12x	2.07x	2.10x
P/E	12.03x	12.69x	12.34x	11.84x
PEG	n/a	2.54	0.77	1.97
EV/EBITDA	7.57x	7.41x	7.21x	5.81x
P/B	0.80x	0.77x	0.73x	0.70x
ROE	6.69%	6.04%	5.93%	5.92%
ROA	4.73%	4.39%	4.28%	4.26%
Div. Yield	1.28%	1.53%	2.04%	2.55%

Source: NSE, PAC Research

Fig. 5: Okomuoil vs. NSE, 52-wk movement (rebased)



Source: Bloomberg, PAC Research

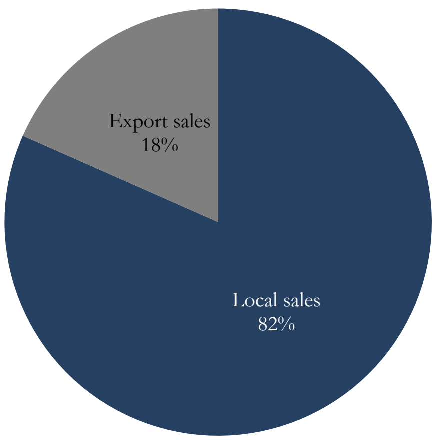
From the foregoing, the prices of palm oil is expected to remain low in the months ahead as supply is projected to be higher than demand in the global market. However, since about 80.0% of palm oil produced by Okomu Oil is being sold domestically, the revenue of the company is not expected to be affected significantly by the low trading prices at the global market.

" From the foregoing, the prices of palm oil is expected to remain low in the months ahead as supply is projected to be higher than demand in the global market. "

Slow growth in global consumption of natural rubber is expected to impact revenue. In the recent past, about 23.4% of revenue of the company comprises of proceeds from sale of natural rubber. According to the International Rubber Study Group (IRSG), the growth in the consumption of natural rubber started to slow down in the second half of 2014 and it was virtually unchanged year-on-year in the first quarter of the review period. With the rebound in economic activities in some major natural rubber markets like India, the U.S. and South-east Asia, rubber usage was initially expected to pick up towards the end of 2015. But the lacklustre growth in the global economic activities in the first quarter of 2015 and its effects on rubber usage indicates that global growth in rubber usage might slow to 2.5% in 2015, down from 6.8% in the preceding year. However, stronger consumption growth of c.3.2% is expected in 2016.

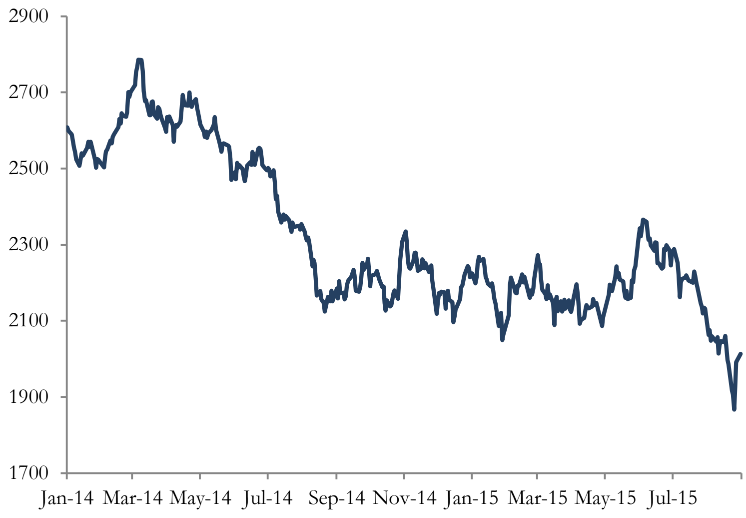
Also, rubber production contracted in 2014, falling by 1.5% as some farmers withheld tapping or switched to alternative crops in response to sharp fall in prices in 2013/14. Again, the 3.0% y/y fall in production in the first quarter of 2015 signified that production might pick up in the remaining part of the year which is expected to lead to a further decline in prices of natural rubber in the global market. Therefore, the persistent low prices of rubber is expected to impact negatively on the revenue of Okomu Oil in the quarters ahead. However, the average prices of rubber declined by 19.4% to US80¢/lb in the review period against average prices of US99¢/lb in the corresponding period of 2014. **(fig.8)**

Fig. 6: Geographical sales revenue - 1H2015



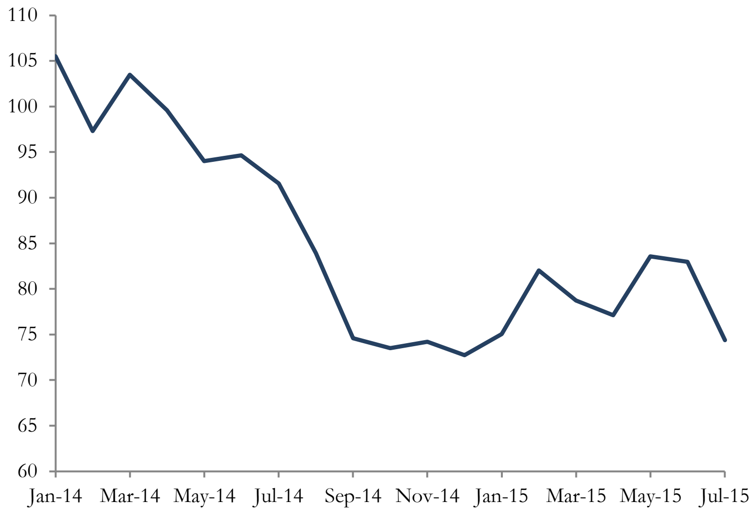
Source: NSE, PAC Research

Fig. 7: Prices of palm oil (US$/mt)



Source: NSE, PAC Research

Fig. 8: Prices of natural rubber (US¢/lb)



Source: NSE, PAC Research

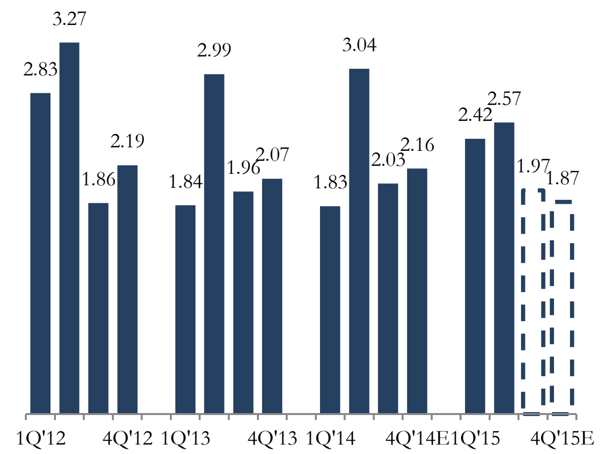
Higher increase in cost of sales pressurised gross profit margin. Okomu Oil's cost of sales (COS) of ₦725million in the review period was up by 25.4% compared with ₦578million in 2014. The disproportionate increase in the COS and revenue resulted in a higher COS/revenue ratio of 14.5% relative to 11.9% in the previous period. On a quarterly basis, the company recorded COS of ₦533million in 2Q2015, up by 177.6% against ₦192million in the first quarter. On the contrary, the 2Q2015 COS is lower than ₦1.04billion reported in 2Q2014 by 48.9% and it is also lower than 8-quarter average of ₦761million by 30.0%. Therefore, gross profit declined marginally by 0.6% to ₦4.27billion compared with ₦4.29billion in 2014, and gross profit margin stood at 85.5% in the review period relative to 88.1% in the preceding year.

Operating profit margin improves on the back of lower running costs. For the review period, the company's reported operating expenses of ₦1.92billion was down by 20.7% compared with ₦2.42billion in 2014. The decline in the operating expenses despite a marginal increase in revenue led to a lower operating expenses/revenue ratio of 38.4% relative to 49.7% in the previous period. The latest quarter's operating expense of ₦974million is higher than ₦945million and N928million by 3.1% and 5.0% respectively in the first quarter of the review period and the second quarter of 2014. It is also higher than 8-quarter average of ₦721million by 35.1%. In addition, operating expenses/revenue ratio of 37.9% in 2Q2015 is lower than 39.0% in the first quarter but higher than both 30.5% in 2Q2014 and 8-quarter average of 32.8%.

Overall, total costs declined by 11.8% y/y to ₦2.64billion in 1H2015 compared with ₦2.30billion in 2014, and total costs/revenue ratio stood at 53.0% relative to 61.6% in the corresponding period of the previous year. Therefore, operating profit increased by 25.4% to ₦2.35billion against ₦1.87billion in 2014 and operating profit margin improved to 47.0% relative to 38.4% in the previous year. Worthy of note is an increase of 54.4% in interest expenses to ₦244million compared with ₦158million in the previous year. This on the back of an increase of 29.3% y/y in total financial liabilities to ₦3.92billion compared with ₦3.03billion in 2014, although short-term financial liabilities declined by 59.3% to ₦758million. On the contrary, long-term financial liabilities moved up to ₦3.16billion, i.e. an increase of 170.9% compared with ₦1.17billion in 1H2014. Consequently, net profit increased by 30.2% to ₦1.84billion against ₦1.41billion in the preceding year, and net profit margin improved to 36.9% relative to 29.0% in 2014.

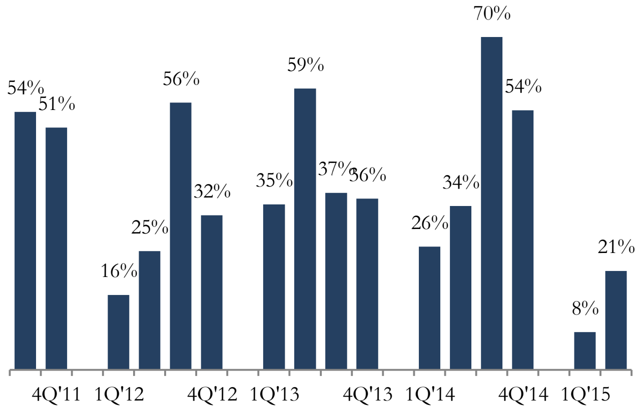
"Therefore, operating profit increased by 25.4% to ₦2.35billion against ₦1.87billion in 2014 and operating profit margin improved to 47.0% relative to 38.4% in the previous year."

Fig. 9: Quarterly revenue (₦'billion)



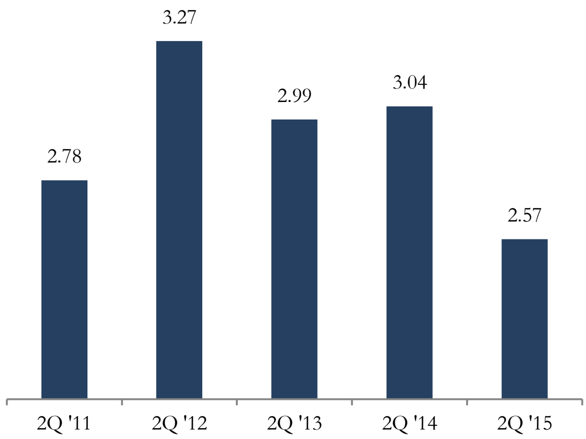
Source: NSE, PAC Research

Fig. 10: Quarterly COS/revenue ratio



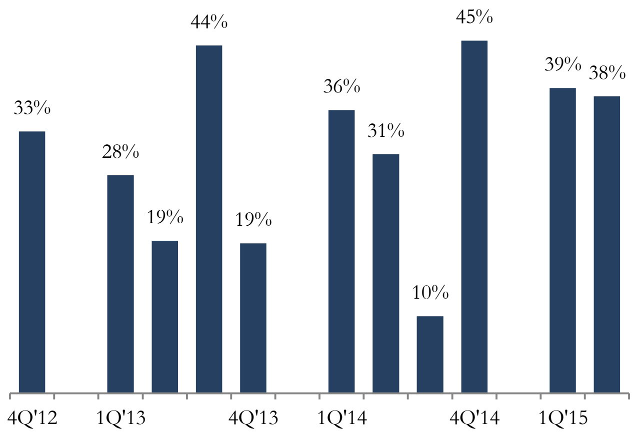
Source: NSE, PAC Research

Fig. 11: Second quarter revenue (₦'billion)



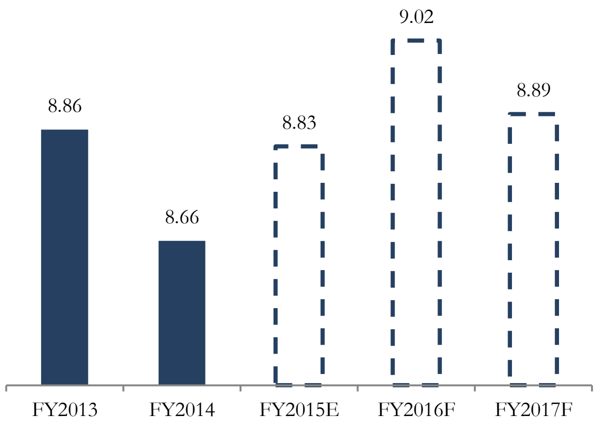
Source: NSE, PAC Research

Fig. 12: Quarterly operating expenses/revenue ratio



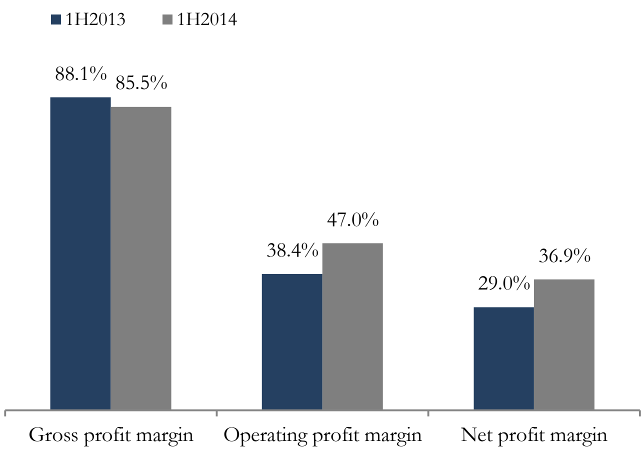
Source: NSE, PAC Research

Fig. 13: Annual sales revenue (₦'billion)



Source: NSE, PAC Research

Fig. 14: Profit margins



Source: NSE, PAC Research

Okomu Oil out-performed the broad equity market in the review period. The company recorded total shareholders' returns (TSR) of +14.4% relative to -0.5% achieved by the equity market in the review period; on the contrary, Okomu Oil under-performed the market in the corresponding period of 2014 with TSR of -20.6% compared with +6.2% achieved by the market. In addition, the company recorded TSR of -14.1% against -11.4% year-to-date, and it recorded 5-year TSR of +399.7% relative to +53.7% achieved by the broad market in the same period.

Valuation

Our valuation puts the target price of the stock of Okomu Oil Palm Company Plc at ₦28.11. In arriving at the target price, we employed multiples of price/earnings, price/sales, price/book, and EV/sales. We also employed the discounted cashflow valuation methodology. Consequently, we recommend a BUY on the stock of the company.

"Our valuation puts the target price of the stock of Okomu Oil Palm Company Plc at ₦28.11."

Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the challenging operating environment in Nigeria, the trends in the price of commodities in the global market, insecurity challenges in the northern part of the country, demographic factor of Nigeria, the strength of consumer spending and the intensity of competition in the market.

Fig. 15: Statement of Profit or Loss, ₦'mn

	FY2014	FY2015E	FY2016F	FY2017F
Revenue	8,656	8,829	9,023	8,888
Change		*2.00%*	*2.20%*	*-1.50%*
Cost of sales	3,890	3,973	4,088	4,044
Change		*2.14%*	*2.88%*	*-1.07%*
Gross profit	4,766	4,856	4,936	4,844
Change		*1.89%*	*1.64%*	*-1.86%*
Operating expenses	2,773	3,002	3,158	2,933
Change		*8.25%*	*5.21%*	*-7.13%*
Other operating income	192	240	336	323
Change		*25.00%*	*40.00%*	*-4.00%*
Operating profit	2,185	2,094	2,114	2,233
Change		*-4.16%*	*0.93%*	*5.67%*
Interest income	86	138	135	125
Change		*60.00%*	*-2.00%*	*-7.00%*
Interest expenses	142	185	114	103
Change		*30.00%*	*-38.00%*	*-10.00%*
Profit before tax	2,129	2,047	2,134	2,256
Change		*-3.85%*	*4.24%*	*5.71%*
Income tax expenses	575	573	619	677
Change		*-0.31%*	*7.97%*	*9.36%*
Profit for the year	1,554	1,474	1,515	1,579
Change		*-5.15%*	*2.80%*	*4.22%*

Fig. 16: Statement of Financial Position, ₦'mn

	FY2014	FY2015E	FY2016F	FY2017F
Non-Current Assets				
Property, plant & equipment	10,255	11,486	12,404	13,397
Biological assets	20,120	19,515	20,492	21,107
Total non-current assets	30,375	31,002	32,897	34,504
Current Assets				
Inventories	1,415	1,557	1,432	1,403
Trade & other receivables	732	659	600	629
Cash & cash equivalents	358	335	476	530
Total Current assets	2,505	2,550	2,507	2,563
Total assets	32,880	35,552	35,404	37,067
Equity	23,233	24,421	25,554	26,656
Non-Current Liabilities				
Deferred tax	3,085	2,869	2,955	3,014
Employee benefits	496	546	562	590
Total non-current liabilities	4,589	4,536	5,269	5,870
Current Liabilities				
Trade & other payables	1,237	1,361	1,551	1,737
Short-term borrowings	2,286	1,943	2,235	2,451
Dividend payable	63	286	382	477
Current tax liabilities	1,003	946	1,102	1,205
Total current liabilities	4,589	4,536	5,269	5,870
Total equity and liabilities	28,820	30,158	30,879	31,331

Fig. 17: Profitability & return

	FY2014	FY2015E	FY2016F	FY2017F
Gross profit margin	55.06%	55.00%	54.70%	54.50%
Operating profit margin	25.24%	23.72%	23.42%	25.13%
Net profit margin	17.95%	16.69%	16.79%	17.77%
ROCE	8.84%	8.18%	7.94%	8.09%
ROE	6.69%	6.04%	5.93%	5.92%
ROA	4.73%	4.39%	4.28%	4.26%

Source: Company's Annual Reports, PAC Research

Fig. 18: DuPont Analysis

	FY2014	FY2015E	FY2016F	FY2017F
Total assets turnover	0.35x	0.34x	0.34x	0.32x
Operating profit margin	25.24%	23.72%	23.42%	25.13%
Equity multiplier	1.42x	1.37x	1.39x	1.39x
ROCE	8.84%	8.18%	7.94%	8.09%

Fig. 19: Efficiency ratios

	FY2014	FY2015E	FY2016F	FY2017F
Fixed assets turnover	0.28x	0.27x	0.26x	0.26x
Current assets turnover	3.46x	3.46x	3.56x	3.47x
Total assets turnover	0.35x	0.34x	0.34x	0.32x
Inventory turnover	2.84x	2.67x	2.74x	2.85x
Receivables turnover	72.44x	80.08x	74.76x	75.07x
Payables turnover	6.71x	5.08x	4.36x	4.17x
Days inventory outstanding	128	136	133	128
Days collection outstanding	5	5	5	5
Days payable outstanding	54	72	84	88
Operating cycle (days)	79	69	55	45

Fig. 20: Liquidity ratios

	FY2014	FY2015E	FY2016F	FY2017F
Working capital (₦'millions)	-2,084	-1,985	-2,731	-3,307
Current ratio	0.55	0.56	0.48	0.44
Quick ratio	0.24	0.22	0.21	0.20
Cash ratio	0.08	0.07	0.09	0.09

Fig. 21: Long-term solvency & stability ratios

	FY2014	FY2015E	FY2016F	FY2017F
Gearing	5.98%	4.62%	4.00%	3.39%
Equity multiplier	1.42x	1.37x	1.39x	1.39x
Total debt-to-equity	0.42x	0.37x	0.39x	0.39x
Total debt-to-assets	29.34%	27.22%	27.88%	28.09%
Proprietary	70.66%	72.78%	72.12%	71.91%
Interest coverage	15.39x	11.34x	18.47x	21.68x
Cash coverage	22.69x	17.10x	28.69x	28.05x

Fig. 22: Shareholders' investment ratios

	FY2014	FY2015E	FY2016F	FY2017F
EPS, ₦	1.63	1.54	1.59	1.66
DPS, ₦	0.25	0.30	0.40	0.50
Payout	15.35%	19.42%	25.19%	30.21%
FCFPS, ₦	-1.32	2.14	2.27	2.38

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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PanAfrican Capital Plc
8A, Elsie Femi Pearse Street
Victoria Island
Lagos, Nigeria
Tel: +234 (1) 2716899, 2718630
www.panafricancapitalplc.com