

# Okomu Oil Palm Company Plc.

## Volume, price, and cost pressures necessitate earnings revision; downgraded to HOLD

**Update:** OKOMUOIL recently released Q2-18 result, showing operational weakness, marked by lower revenue (-15% y/y), EBIT (-35% y/y), and net profit (-22%). Sales outturn (dragged by a combination of weaker volume and price) fell short of our expectation by 28% while earnings was 30% below our estimate. The overall performance produced an EPS of NGN2.59 (vs. NGN3.32 in Q2-17), bringing H1-18 EPS formation to NGN6.23 – compared to NGN6.54 over the corresponding period of 2017.

**Cut to volume and price estimates takes a toll on sales forecast:** Following the lower-than-expected performance in the three months to June 2018, we revise our volume and price expectations lower. We now look for 2018E revenue coming in 4.9% lower than our previous estimate but 1.7% above 2017 numbers. It is difficult to expect higher sales over H2-18, considering the traditional impact of seasonality, with FFB collections typically lower by c.20-25% in the off-peak season. Specifically, we have modelled for a 2% drop in CPO volume for the rest of the year. Locally, CPO prices dropped c.3% y/y in Q2-18, underpinned by both domestic and external factors. On the latter, it is easy to highlight increased output in Indonesia and Malaysia (jointly accounting for 85% of overall global CPO production), amid constrained import in India (on the back of higher palm oil import taxes), and rising uncertainty surrounding global trade war spooking stakeholders' activities in the market. For information, global CPO prices were lower by 11.5% y/y in Q2-18. To our mind, the aforementioned downside risks will linger for the rest of the year. Juxtaposing that with our position that sustained NGN exchange rate stability will continue to boost domestic CPO imports left us with a 4.1% cut to our 2018E price projection.

Further out, we see limited scope for higher export sales over H2-18, as rubber prices remain soft for the rest of the year. We would expect higher rubber supply in the market, underscored by increased export from Thailand, Indonesia, and Indonesia (collectively accounting for c.70% of total global rubber production) – as the impact of the expiration (on March 31) of a late December 2017 agreement by the three rubber giants to reduce export by 350,000MT persists. It is equally difficult to expect higher rubber prices, amid (1) tyre makers running at low capacity, (2) strict environmental requirements, and partly (3) global trade uncertainty.

**No revision to margin estimate:** At 79.6%, Q2-18 gross margin was ahead of our 75.0% forecast for the period. Compared to Q1-18 and Q2-17, however, the achieved gross margin was lower by 1,150 bps and 2,010 bps respectively – no thanks to a behemoth surge in cost of sales to NGN1.14 billion, from NGN22 million in Q2-17, and price pressures. Notwithstanding Q2-18 achieved gross margin tracking higher than our estimate, our understanding of (1) OKOMUOIL's maintenance cost tracking higher in the off-peak season, (2) potential pickup in start-up operations at Extension 2 in the event of improvement in weather condition, and (3) upside risks to inflationary conditions (which management cited as impacting COGS in Q2-18) over H2-18, indicates elevated cost profile for the rest of the year. We overlaid that with expected lower prices to retain our 80% forecast 2018E gross margin, 600 bps below H1-18 run rate.

# HOLD

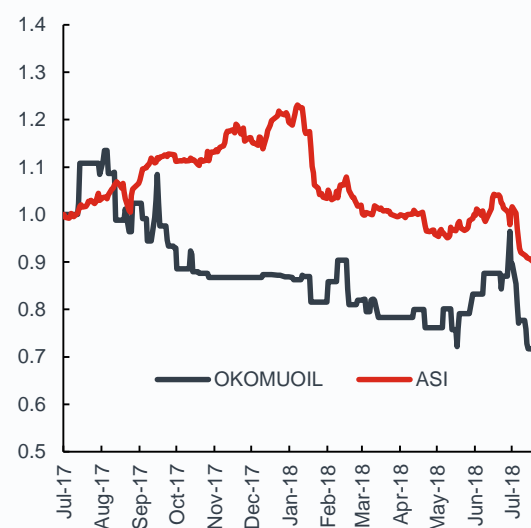
Target Price (NGN)	90.31
Current Price (NGN)	83.00
Implied Return (%)	8.10
2018E Dividend Yield (%)	4.25
Expected Total Returns (%)	12.35

### Company Data

NSE Code	OKOMUOIL
Bloomberg Code	OKOMUOIL NL
Reuters Code	OKOMUOIL.LG
Sector	AGRICULTURE
Market Cap. (NGN'bn)	79.17
Free Float (%)	37.31

Ratios	Q2-18	Q2-17	2017FY
Gross margin	79.6%	99.7%	79.1%
Opex margin	26.9%	30.9%	25.0%
EBIT margin	52.7%	68.7%	54.9%
PAT margin	44.1%	48.1%	35.6%
EPS (NGN)	2.59	3.32	9.6

### Price movement (OKOMUOIL vs. NSEASI)



Source: NSE, Bloomberg, Cordros Research

**Post-tax profit revised lower:** The combination of lower revenue and weaker margin reflects in our net profit expectation for 2018, revised lower by 9.2% (-5.7% vs. 2017 achieved PAT). We are not unaware of the net finance income of NGN15.39 million recorded in Q2-18, largely supported by a 50.5% decline in finance expense – itself benefiting from lower gross loan (recall that OKOMUOIL paid the final instalment of its FCY loan owed to its parent company in Q1-18). While we acknowledge the new NGN1.95 billion Bank of Industry loan, drawn down in April 2018, we see positive outcome from the ongoing negotiation over a potential moratorium period. However, we believe the overall impact of continued net finance income on earnings will be negligible.

**Valuation:** Our model workings produced a TP of NGN90.31 (previously NGN96.52) for OKOMUOIL. Compared to the current market price of NGN83.00, our revised TP implies potential upside of 8.1%. Accordingly, we downgrade rating to HOLD. The stock is trading at forward (2018E) P/E and EV/EBITDA multiples of 8.74x and 6.27x respectively, still at discounts to its 5-year historical averages of 12.31x and 8.30x.

**Risks:** Here, we highlight (1) unfavourable weather condition, (2) lower-than-expected decline in CPO and rubber prices, (3) security threat, and (4) policy reversal.

## Summary of Quarterly Results.

Income Statement (N'bn)	30-Jun-18	30-Jun-17	y/y	q/q	Q1-18	Q4-17
Revenue	5.60	6.58	-14.9%	-23.8%	7.34	4.15
Cost of Sales	1.14	0.02	4892.7%	74.4%	0.66	1.67
Gross profit	4.45	6.56	-32.1%	-33.4%	6.69	2.48
Operating Expense	1.51	2.03	-25.9%	-43.6%	2.67	0.17
Other Income	0.00	0.00			0.00	0.00
EBIT	2.95	4.52	-34.8%	-26.6%	4.02	2.31
Finance income	0.14	0.15	-3.5%	54.3%	0.09	0.12
Finance charges	0.13	0.25	-50.5%	-1.9%	0.13	0.31
Profit/Loss Before Tax	2.96	4.42	-32.9%	-25.5%	3.98	2.12
Taxation	0.49	1.25	-60.5%	-2.6%	0.51	-0.79
Profit/Loss After Tax	2.47	3.17	-22.0%	-28.9%	3.47	2.75

Ratios	30-Jun-18	30-Jun-17	Q1-18	Q4-17
Gross profit margin	79.6%	99.7%	91.1%	59.8%
Cost of sales margin	20.4%	0.3%	8.9%	40.2%
Gross opex margin	26.9%	30.9%	36.4%	4.1%
Operating profit margin	52.7%	68.7%	54.7%	55.7%
PBT margin	53.0%	67.1%	54.2%	51.1%
Net profit margin	44.1%	48.1%	47.3%	66.3%
Effective tax rate	16.7%	28.3%	12.7%	-37.1%

Source: Company Accounts, Cordros Research

# Financial Statement (NGN'billion).

Income Statement (NGN'bn)	2015a	2016a	2017a	2018e	2019e	2020e	Profitability Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Turnover	9.74	14.36	20.26	21.09	28.73	31.51	Gross margin	64.8%	75.0%	79.1%	80.1%	80.0%	80.0%
Cost of sales	-3.43	-3.59	4.23	4.2	-5.75	-6.30	Operating Margin	33.7%	48.4%	54.9%	50.5%	57.5%	57.5%
<b>Gross Profit</b>	<b>6.31</b>	<b>10.78</b>	<b>16.04</b>	<b>16.89</b>	<b>22.98</b>	<b>25.21</b>	EBITDA Margin	44.5%	56.7%	61.2%	59.4%	66.0%	66.0%
other income	0.29	0.12	0.15	0.21	0.29	0.32	PBT Margin	29.8%	41.1%	55.0%	50.6%	58.0%	58.5%
Admin Expenses	2.27	-2.02	3.11	3.16	-4.31	-4.73	Net Margin	27.0%	34.2%	45.1%	43.0%	46.4%	46.8%
Depreciation	-1.05	-1.20	1.28	1.88	-2.44	-2.68	ROAE	24.3%	33.8%	44.1%	37.3%	38.2%	33.1%
Total OPEX	-3.32	-3.94	-5.06	6.46	-6.75	-7.40	ROAA	13.9%	22.0%	32.7%	29.0%	30.7%	29.6%
<b>EBIT</b>	<b>3.28</b>	<b>6.96</b>	<b>11.13</b>	<b>10.65</b>	<b>16.52</b>	<b>18.12</b>							
<b>EBITDA</b>	<b>4.33</b>	<b>8.15</b>	<b>13.12</b>	<b>12.53</b>	<b>18.96</b>	<b>20.79</b>	Liquidity Ratios	2015a	2016a	2017a	2018e	2019e	2020e
Interest income	0.04	0.29	0.49	0.21	0.57	0.63	Working capital (NGN'mn)	460.6	(1,067.7)	3,971.2	(958.7)	330.5	483.6
Interest Expense	-0.43	-1.34	0.48	0.39	-0.43	-0.32	Current ratio (x)	1.1	2.0	1.9	2.8	4.9	8.5
Net Interest Earnings	-0.39	-1.05	0.01	0.42	0.14	0.32	Quick Ratio (x)	0.5	1.4	1.2	2.1	3.7	6.5
<b>Profit-before-tax</b>	<b>2.90</b>	<b>5.91</b>	<b>11.14</b>	<b>10.67</b>	<b>16.66</b>	<b>18.43</b>	Cash Ratio (x)	0.4	1.1	0.8	1.9	3.1	5.5
Taxation	0.27	1.00	1.99	1.6	3.33	3.69							
<b>Profit-after-tax</b>	<b>2.63</b>	<b>4.91</b>	<b>9.15</b>	<b>9.07</b>	<b>13.33</b>	<b>14.75</b>	Solvency Ratios	2015a	2016a	2017a	2018e	2019e	2020e
							Debt to Equity	30.9%	16.4%	5.1%	14.7%	7.5%	0.0
							Debt to Capital	23.6%	14.1%	4.9%	12.8%	7.0%	0.0
							Financial Leverage (x)	1.5	1.5	1.3	1.0	1.0	1.1
							Interest Coverage (x)	7.7	5.2	23.0	114.2	38.3	57.5
							Activity Ratios (x)	2015a	2016a	2017a	2018e	2019e	2020e
							Inventory Turnover	0.6	0.6	0.5	0.3	0.4	0.4
							Payables Turnover	1.0	1.2	1.9	1.0	1.5	2.8
							Asset Turnover	0.5	0.6	-1.4	0.6	0.6	0.6
							Fixed Asset Turnover	1.0	1.6	1.8	1.6	1.8	1.7
							Investment Ratios	2015a	2016a	2017a	2018e	2019e	2020e
							DPS (NGN)	0.1	1.5	3.0	3.5	4.8	6.2
							EPS (NGN)	2.8	5.1	9.6	10.1	14.0	15.4
							Payout Ratio	3.6%	29.1%	31.0%	35.0%	34.0%	40.0%

Financial Position (NGN'bn)	2015a	2016a	2017a	2018e	2019e	2020e
Fixed Assets	9.85	9.22	11.22	14.12	16.22	18.69
Biological Asset	7.40	9.40	12.90	13.31	15.29	17.62
<b>Total Fixed Assets</b>	<b>17.24</b>	<b>18.62</b>	<b>24.12</b>	<b>27.43</b>	<b>31.51</b>	<b>36.31</b>
Inventories	1.49	1.72	2.69	3.07	3.52	4.06
Trade receivables	0.06	0.12	0.47	0.35	0.40	0.45
Due from related companies	-	0.47	0.50	-	-	-
other Receivables	0.30	0.38	0.51	1.01	1.39	1.60
Cash at bank and in hand	0.96	3.20	3.09	8.48	9.52	10.98
<b>Total Current Asset</b>	<b>2.81</b>	<b>5.89</b>	<b>7.26</b>	<b>12.91</b>	<b>14.83</b>	<b>17.09</b>
<b>Total Assets</b>	<b>20.05</b>	<b>24.51</b>	<b>31.37</b>	<b>40.33</b>	<b>46.34</b>	<b>53.40</b>
Trade Creditors	0.89	0.64	0.49	1.14	0.74	0.50
Other Creditors	0.58	0.11	0.03	0.41	0.27	0.20
Due to related companies	0.01	0.00	0.00	0.05	0.03	0.02
Borrowings	0.34	0.37	0.49	0.50	0.35	0.26
Retirement Benefit Obligations	0.02	0.43	0.44	0.07	0.02	0.01
Bank Overdraft	0.00	0.00	0.00	1.03	0.68	-
Dividend Payable	0.06	0.06	0.06	0.11	0.08	0.07
Taxation	0.61	1.39	2.26	1.30	0.86	0.63
<b>Total Current Liabilities</b>	<b>2.52</b>	<b>3.01</b>	<b>3.77</b>	<b>4.60</b>	<b>3.03</b>	<b>2.24</b>
Long Term Loans	3.39	2.42	0.77	2.93	1.93	1.42
Defefered taxation	1.73	1.76	1.66	2.30	1.52	1.12
Staff Retirement benefit	0.35	0.32	0.67	0.44	0.29	0.75
<b>Total Non-Current Liabilities</b>	<b>5.47</b>	<b>4.49</b>	<b>3.10</b>	<b>23.21</b>	<b>26.55</b>	<b>30.60</b>
<b>Total Liabilities</b>	<b>7.99</b>	<b>7.50</b>	<b>6.87</b>	<b>10.27</b>	<b>6.77</b>	<b>4.99</b>
Net Asset/Equity	12.06	17.01	24.51	30.23	39.56	48.41
Share Capital	0.48	0.48	0.48	0.48	0.48	0.48
Share Premium	1.87	1.87	1.87	1.87	1.87	1.87
General Reserves	9.72	14.67	22.16	27.89	37.22	46.07
<b>Shareholders' Funds</b>	<b>12.06</b>	<b>17.01</b>	<b>24.51</b>	<b>30.23</b>	<b>39.56</b>	<b>48.41</b>

Source: Company Accounts, Cordros Research

# Disclosures.

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