GCR GLOBAL CREDIT RATING CO.
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Flour Mills of Nigeria Plc N70bn Bond Issuance Programme (N20.1bn Series 1 and Series 2 Bonds)

Nigeria Corporate Bond Analysis – New Issuance Report **September 2018**

Security class	Rating scale	Indicative rating*	Rating outlook	Expiry date
Series 1 Senior Unsecured Bonds: N10.1bn	National	BBB+$_{(NG)}$	Stable	January 2019
Series 2 Senior Unsecured Bonds: N10bn	National	BBB+$_{(NG)}$	Stable	January 2019

Key Transaction counterparties:

Issuer: Flour Mills of Nigeria Plc ("FMN", or "the Company")

Issuer's long term credit rating: BBB+$_{(NG)}$

Lead Issuing House: Stanbic IBTC Capital Ltd.

Joint Issuing Houses: ARM Securities Ltd., FBNQuest Merchant Ltd., FCMB Capital Markets Ltd., United Capital Plc, Zenith Capital Ltd.

Joint Trustees: Stanbic IBTC Trustees Ltd., United Capital Trustees Ltd., ARM Trustees Ltd.

Solicitors to the Trustees: Udo Udoma & Belo-Osagie

Solicitor to the Programme: The New Practice

Key Transaction Documentation: Programme Trust Deed, Shelf Prospectus, Series 1 and Series 2 Trust Deeds, Series 1 and Series 2 Pricing Supplements.

Summary of Transaction:

Asset class	Senior unsecured
Programme limit	N70bn
Series 1 Bond	N10.1bn
Tenor	3 years
Maturity Date	2021
Interest rate	15.5%
Series 2 Bond	Up to N20bn
Tenor	5 years
Maturity	2023
Interest rate	16%
Interest basis	Fixed, payable semi-annually
Principal moratorium	Series 1 Bonds: N/A Series 2 Bonds: 12 months
Principal redemption basis	Series 1 Bonds: Bullet repayment upon maturity Series 2 Bonds: Semi-annual on an amortising basis, to commence following the expiration of the moratorium
Negative pledge	Yes

Related methodologies/research:

Global Master Criteria for rating Corporate entities, updated February 2018;
Flour Mills of Nigeria Plc Issuer rating reports, 2016-2018
Glossary of terms/ratios, February 2018

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Transaction summary

Flour Mills of Nigeria Plc has filed an application with Securities and Exchange Commission ("SEC") to issue Bonds into the Nigerian capital market, under a N70bn Bond Issuance Programme ("the Programme" or "BIP"). Under the Programme, Bonds will be issued in series, with an initial N20.1bn expected to be raised in two tranches of N10.1bn and N10bn respectively in 2018. Net proceeds would be utilised to reduce expensive short term debt. The Series 1 Bonds and Series 2 Bonds ("the Bonds") have tenors of three years and five years respectively with expected maturity in 2021 and 2023. The Bonds will constitute direct, unconditional, senior and unsecured obligations of the Issuer.

Summary rating rationale

- The Issuer maintains leadership position within the Nigerian flour milling industry, underpinned by its substantial multi-product milling capacity, wide distribution network, strong brands and business diversification. More significantly, its backward integration initiatives are beginning to underpin a more sustainable supply chain, while enhancing margins.
- The Programme Trust Deed ("PTD") does not offer Bondholders any security over assets but does feature a negative pledge and other covenants to protect the interest of Bondholders.
- As the Series 1 Bonds are direct, unconditional, senior and unsecured obligations of the Issuer, the Bonds will bear the same rating as the Issuer, and any change in the rating assigned to the Issuer will directly affect the Bond rating. Global Credit Rating Company Limited ("GCR") affirmed the Issuer's long term rating at BBB+$_{(NG)}$ in September 2018.
- Despite volatile economic environment, FMN has demonstrated earnings resilience, supported by increasing selling prices and volume growth as capacity expanded. Coupled with cost rigour, this has seen profit margins strengthen, with EBITDA margin widening above 10% in FY17 and FY18. Management plans to further mitigate the high cost of importation of its raw materials by internalising more aspects of its supply chain.
- The Issuer has evidenced volatile cash flows over the review period, attributable to high working capital pressures, particularly in FY17 and FY18. FMN undertook a N40bn rights issue, which, combined with N12bn of cash on hand was utilised to settle short term debt. Nevertheless, despite the decline in gross debt to N103bn at FY18, earning based gearing metrics remain fairly high (above 200%).
- Debt had climbed to N118bn as at 1Q FY19, almost double the forecast level, but management expects debt to reduce significantly in 2H and meet its budget. If the expected reduction in debt does not materialise, gearing metrics could rise further and would put pressure on the current rating. FMN will thus need to generate robust cash flows from core operations and maintain adequate liquidity to enable it achieve a substantial reduction in debt and improved gearing metrics, in line with expectations.
- Although GCR has highlighted its concern over the short term debt concentration, (with around 85% maturing during FY19), FMN has indicated that the bulk of the Series 1 Bonds and Series 2 Bonds Issue proceeds will be utilised to settle short term debt. If achieved, this should improve FMN's debt maturity profile.

#The final ratings will be accorded upon receipt of satisfactorily signed and executed final transaction documents.

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N70bn Bond Issuance Programme

Flour Mills of Nigeria Plc is in the process of issuing bonds into the Nigerian capital market under a N70bn Bond Issuance Programme. FMN's board authorised the N70bn BIP on 6 December, 2017 and an application has been filed with the Securities and Exchange Commission. Under the Programme, short[1] term or long[2] term bonds will be issued in series by way of private placement, book building, public offering, or any of the other methods described in the relevant Pricing Supplement.

The Programme Trust Deed contains various covenants binding the Issuer to repay the bond, pay interest and also comply with the provisions of the PTD and all applicable laws. Events of default and the various remedies are also stated in the Trust Deed. The Trustees will hold the payment obligations and other covenants of the Issuer in Trust for the benefit of the Bondholders, and perform the duties contained in the Trust Deed.

Series 1 Bonds and Series 2 Bonds

An initial N20.1bn is expected to be raised in two tranches in 2018; being Series 1 Bonds with a nominal value of N10.1bn and Series 2 Bonds with a nominal value of N10bn. The Bonds are direct, unconditional, senior and unsecured obligations, ranking *pari passu* with all other senior and unsecured obligations of the Issuer. The Series 1 Bonds and Series 2 Bonds will bear fixed interest rates of 15.5% and 16% respectively. Interest will accrue on the Bonds from the issue date and will be payable semi-annually in arrears. The Bonds have similar features, with the main differences being the size, tenor and principal redemption basis.

Table 1: Basic features	Series 1 Bonds	Series 2 Bonds
Amount	N10.1bn	N10bn
Tenor	3 years	5 years
Maturity Date	2021	2023
Principal moratorium	Not applicable	12 months
Principal redemption basis	Bullet repayment	Amortising, payable semi-annually in eight instalments

Other salient features of the Bonds are as follows:

- *Taxation*: The Federal Government of Nigeria issued a Tax Waiver on Bonds in March 2010 exempting certain taxes on all categories of bonds (including corporate bonds), up till January 2, 2022. After this date, the Issuer may be required by law to withhold tax on coupon payments to Bondholders.
- The Bonds bear a negative pledge
- An application will be made to list the Bonds on the FMDQ OTC Plc's platform and/or The Nigerian Stock Exchange

Utilisation of proceeds

The net proceeds (after deduction of c.N414.2m in Issue costs including value added tax) would be utilised to reduce expensive short term debt in the proportion indicated in Table 2.

[1] Tenor of one to three years
[2] Tenor of three years and above

Table 2: Use of net proceeds	N'bn	%
Refinancing of debt obligations		
Fidelity Bank Plc	2.3	11.7
FBNQuest Merchant Bank Limited	8.4	42.6
Zenith Bank Plc	9.0	42.7
Total	**19.7**	**100.0**

Issuer profile

FMN was incorporated as a private liability company in 1960 and commenced operations in 1962 with an installed flour milling capacity of 500 metric tonnes per day ("mtpd"). In 1978, the Company became a public limited liability company and its shares were subsequently listed on the Nigerian Stock Exchange ("NSE"). FMN's product offerings include flour, pasta, noodles, snacks, ball foods (ie. semovita and goldenvita), and cereals under the 'Golden Penny' brand. The Company has also vertically integrated into other agro-allied products such as fertilizer, as well as transport, packaging and logistics, all of which provide support to its core food businesses. FMN is the largest flour milling company in Nigeria, with about 28% of total installed milling capacity. The Company operates with about 3,500 employees and aims to expand its current businesses.

The Company has 17 subsidiaries who operate across various segments within the food and logistics value chain. A major constraint in the business has been the requirement to import most of the inputs into the final production process, both in the form of raw agricultural produce (particularly, wheat) and ancillary products such as fertilizer. In this regard, FMN has invested substantially in backward integration initiatives to mitigate foreign exchange and related risks and facilitate a more sustainable supply chain, while enhancing margins. FMN is well advanced in implementing strategies that will deepen market penetration, particularly in the agro-allied segment of its operations. The Issuer successfully completed a N40bn rights issue in 4Q FY18, with the proceeds thereof utilised to reduce debt and strengthen working capital.

GCR affirmed the Issuer's national scale long term rating of BBB+$_{(NG)}$ and short term rating of A2$_{(NG)}$ in September 2018. Please refer to GCR's corporate rating report on Flour Mills of Nigeria Plc published in September 2018, for detailed commentary and credit analysis.

Other key transaction parties

Issuing Houses

The Issuing House function is to be jointly rendered by Stanbic IBTC Capital Ltd., (as lead Issuing House), ARM Securities Ltd., FBNQuest Merchant Bank Ltd., FCMB Capital Markets Ltd., United Capital Plc and Zenith Capital Ltd.

Trustees

Stanbic IBTC Trustees Limited ("SITL"), United Capital Trustees Limited ("UCTL") and ARM Trustees Limited ("ARMT") have been appointed to jointly monitor compliance with the various clauses and covenants of the

Trust Deed. The Trustees' performance track record and experience in the local market are considered satisfactory. A brief overview of the Trustees is discussed hereafter.

SITL is a wholly owned subsidiary of Stanbic IBTC Holdings Plc (a member of the Standard Bank Group) registered in 2009 by SEC. SITL provides Institutional Trust Services (such as Facility Agent, Security Trusteeship, Escrow Agent, Trust Schemes, Public Trust, Employee Share Options Schemes), as well as Estate Planning and Administration.

UCTL was established in 1964 and has a broad experience in money, capital market and real estate transactions, with Trust mandates across various products including Debenture Trusts, Mutual Funds, Bonds and REITS.

ARMT has over 18 years' experience in Private Trust, Estate Planning and Commercial Trust, including corporate bond transactions.

Payment Account

FMN will establish a Payment Account for each Series, not later than five (5) business days after the issue date, which will be under the custody and management of the Trustees, on behalf of the Bondholders. The Payment Account is to be funded seven (7) business days before each Payment Date such that sufficient funds will be available to the Trustees to settle the coupon and principal payments on due dates.

Priority of Payments

All monies received by the Trustees under Trust Deed (including any enforcement proceeds) shall be applied by the Trustees in the following order of priority:

- all costs, charges, expenses and liabilities incurred and payments relating to execution of the trust deed including all remuneration payable to the Trustees and fees, charges, expenses and interest (in respect of late payment) if any, that is charged by any attorney, agent or other person appointed by the Trustees;
- any sum due or owing on the Bonds (other than principal sum);
- the principal amount owing on the Bonds.

Any surplus will be paid to the Issuer or person(s) entitled to such surplus.

Covenants and other security features

The PTD contains various covenants binding the Issuer to repay the Bonds, pay interest and also comply with the provisions of the relevant Trust Deeds and all applicable laws. The Trustees will hold the payment obligations and other covenants of the Issuer in Trust for the benefit of the Series 1 and Series 2 Bondholders, and will perform the duties contained in the respective Trust Deeds. Clause 6 of the PTD contains the following covenants by the Issuer:

- ***Negative pledge***: for as long as any of the Bonds remain outstanding, the Issuer is restricted from encumbering its property or assets to secure debt, without the prior written consent of the Trustees. Where the Trustee's consent is obtained, the same security (as that intended for the indebtedness) would be granted to the Trustee for the Bondholders' benefit. However, this restriction does not apply to *Permitted Security.*

- ***Additional indebtedness***: for as long as the Bonds remain outstanding and except as provided in the PTD, the Issuer may incur any other indebtedness for borrowed moneys provided that such further indebtedness shall not be in breach of the *Negative pledge*.

- ***Restricted Payment:*** The Issuer shall not declare or pay any dividend in cash or make a distribution in respect of its share capital if an *Event of Default* or a *Potential Event of Default* is about to occur or has occurred and is sustained.

Events of default

Per Clause 19 of the PTD, these include the following events, *inter alia*:

- *Non-Payment*: if the Issuer does not pay any amount payable (interest, principal or premium) under the Bonds within ten 10 business days of due date. In the event of *Force Majeure*, an additional grace period may be granted at the Trustees' discretion, after determination (in conjunction with Issuer) that such an event can be remedied;
  (While noting the above, neither the Issuer nor the Trustees will be liable to the other for failure or delay in the performance of a required obligation under the Trust Deed if such failure or delay is caused by an event of *Force Majeure* provided that such party gives prompt written notice of such condition, the steps being taken or proposed to be taken in relation to such event, and resumes its performance as soon as reasonably possible after the cessation of such condition and the condition does not continue for a period exceeding 30 days, provided also that the other party is reasonably satisfied that such condition impedes the relevant party's ability to discharge its obligations under the Trust Deed);
- *Cross default:* If any financial indebtedness exceeding N20bn is not paid by due date or within an applicable grace period. (Any amounts being contested in good faith will not form part of the value);
- Enforcement proceedings against any asset(s) of the Issuer, having a total value of N10bn, and such action is not discharged within 90 days;
- Insolvency event in respect of the Issuer;
- Cessation of business;
- Material adverse event;
- Breach of other obligations.

Following an event of default, a Bond Acceleration Notice[3] may be given to the Issuer, stating that all amounts due to Bondholders will become immediately payable. The Trustees are authorised to take reasonable steps to effect payment.

Rating considerations for Series 1 Bonds and Series 2 Bonds

GCR has considered those factors impacting the general creditworthiness of Flour Mills of Nigeria Plc, in performing its analysis. Being senior unsecured debt, the Bonds bear the same probability of default as the Issuer and would reflect similar recovery prospects to senior unsecured creditors in the event of a default. As such, the Series 1 Bonds and Series 2 Bonds will garner the same long term rating as that accorded to the Issuer. In light of the above, and given that the Bonds constitute senior unsecured debt, GCR has accorded an indicative national scale credit rating of $BBB+_{(NG)}$ to the Series 1 and Series 2 bonds in line with the FMN corporate credit rating. Accordingly, any change in the Issuer rating would impact the Bond ratings.

Meaning of the Rating of the Series 1 Bonds and Series 2 Bonds

The ratings accorded to the Series 1 Bonds and Series 2 Bonds are *indicative, public* national scale ratings. National scale credit ratings are an assessment of credit quality relative to the rating of the lowest credit risk in a country. This lowest risk will normally, although not always, be accorded to financial commitments issued or guaranteed by the relevant sovereign state. GCR has reviewed the draft transaction documentation.

The *indicative, public* rating accorded to the Bonds relate to ultimate payment of interest and principal (as opposed to timely, akin to an expected loss rating, which is a function of probability of default and loss severity). The ratings exclude an assessment of the Issuer's ability to pay any (early repayment) penalties.

Should the rating of the Issuer change, the rating of the Series 1 Bonds and Series 2 Bonds will also change, but not necessarily in the same quantum.

The suffix code identifies to which country the rating relates; 'NG' means Federal Republic of Nigeria. A Rating outlook indicates the potential direction of a rating over the medium term, typically a one or two year period. The *indicative public* rating of the Series 1 Bonds and Series 2 Bonds will be finalised upon receipt of final signed and executed transaction documents.

The final ratings of the Series 1 Bonds and Series 2 Bonds will be accorded upon receipt of satisfactorily signed and executed transaction documents. The final ratings will be monitored, and thereafter GCR will perform regular surveillance on the transaction. Surveillance reports will be made available to subscribers to GCR's information services.

[3] If requested by majority of bondholders.

Flour Mills of Nigeria Plc

(Naira in millions except as noted)

Statement of comprehensive income					
Year end: 31 March	**2014**	**2015**	**2016**	**2017**	**2018**
Turnover	245,701.4	229,777.9	247,876.5	375,225.3	389,397.8
EBITDA	**23,761.6**	**17,311.4**	**16,081.1**	**44,790.8**	**44,166.3**
Depreciation	(6,783.7)	(5,833.5)	(7,818.7)	(8,395.3)	(8,376.5)
Operating income	**16,977.9**	**11,477.8**	**8,262.4**	**36,395.5**	**35,789.8**
Net finance charges	(4,811.7)	(5,895.3)	(12,003.7)	(18,969.3)	(15,131.0)
Abnormal/Exceptional items	290.8	(4,671.5)	9,989.8	(6,446.6)	(2,446.5)
NPBT	**12,457.0**	**911.0**	**6,248.5**	**10,979.6**	**14,154.0**
Taxation paid	(2,019.5)	1,508.6	4,177.3	(1,150.5)	(4,909.3)
Profit from continuing operation	**10,437.5**	**2,419.5**	**10,425.8**	**9,829.0**	**9,244.7**
Other comprehensive income	675.8	298.9	(474.9)	644.4	(461.1)
Total comprehensive income	**11,113.4**	**2,718.5**	**9,950.9**	**10,473.4**	**8,783.6**
Cash flow statement					
Cash generated by operations	**24,674.7**	**15,904.5**	**15,691.3**	**37,576.3**	**46,355.0**
Utilised to increase working capital	(12,737.9)	(25,804.6)	6,013.4	(51,903.9)	(72,538.3)
Net finance charges	(4,847.3)	(6,766.2)	(12,029.2)	(16,000.3)	(15,131.0)
Taxation paid	(2,002.3)	(1,245.3)	(102.2)	(1.3)	(226.5)
Cash flow from operations	**5,087.3**	**(17,911.6)**	**9,573.2**	**(30,329.2)**	**(41,540.8)**
Maintenance capex‡	(6,783.7)	(5,833.5)	(6,513.1)	(6,842.8)	(8,376.5)
Discretionary cash flow from operations	**(1,696.4)**	**(23,745.1)**	**3,060.1**	**(37,171.9)**	**(49,917.3)**
Dividends paid	(4,868.9)	(4,981.9)	(3,660.9)	(2,971.3)	(2,838.6)
Retained cash flow	**(6,565.3)**	**(28,727.0)**	**(600.9)**	**(40,143.3)**	**(52,755.9)**
Net expansionary capex	(3,455.7)	(11,356.7)	0.0	0.0	(80.0)
Investments and other	(6,041.1)	680.2	(37.5)	(272.0)	(1,888.6)
Proceeds on sale of assets/investments	238.1	26,929.6	27,352.3	156.5	1,864.1
Shares issued	0.0	0.0	0.0	0.0	39,303.0
Cash movement: (increase)/decrease	5,690.2	(7,091.1)	(9,178.6)	(7,158.3)	12,914.0
Borrowings: increase/(decrease)	10,133.8	19,565.0	(17,535.4)	47,417.1	643.4
Net increase/(decrease) in debt	**15,824.0**	**12,473.9**	**(26,714.0)**	**40,258.8**	**13,557.4**
Statement of financial position					
Ordinary shareholders interest*	98,826.3	96,555.0	98,280.9	106,047.4	148,481.0
Outside shareholders interest	0.0	0.0	0.0	0.0	0.0
Pref. shares and conv. debentures	0.0	0.0	0.0	0.0	0.0
Total shareholders' interest	**98,826.3**	**96,555.0**	**98,280.9**	**106,047.4**	**148,481.0**
Short term debt	53,363.8	83,603.4	73,703.2	145,779.0	87,849.1
Long term debt	23,354.1	5,164.6	8,209.2	7,363.9	14,984.4
Total interest-bearing debt	**76,718.0**	**88,768.0**	**81,912.4**	**153,142.9**	**102,833.5**
Interest-free liabilities	44,426.6	46,110.2	51,140.1	82,674.6	68,324.8
Total liabilities	**219,970.9**	**231,433.2**	**231,333.4**	**341,864.8**	**319,639.3**
Property, plant and equipment	70,264.8	80,421.8	85,732.4	85,394.0	83,837.2
Investments and other	42,669.4	9,506.4	7,987.9	30,596.3	81,421.3
Cash and cash equivalent	11,224.4	13,120.9	21,671.2	28,829.5	16,300.4
Other current assets	95,812.2	128,384.2	115,941.9	197,045.1	138,080.4
Total assets	**219,970.9**	**231,433.2**	**231,333.4**	**341,864.8**	**319,639.3**
Ratios					
Cash flow:					
Operating cash flow: total debt (%)	6.6	neg	11.7	neg	neg
Discretionary cash flow: net debt (%)	neg	neg	5.1	neg	neg
Profitability:					
Turnover growth (%)	8.9	(6.5)	7.9	51.4	3.8
Gross profit margin (%)	11.9	10.9	9.8	13.4	13.2
EBITDA: revenues (%)	9.7	7.5	6.5	11.9	10.3
Operating profit margin (%)	6.9	5.0	3.3	9.7	8.1
EBITDA: average total assets (%)	11.4	8.1	7.5	17.1	13.0
Return on equity (%)	10.9	2.5	10.7	9.6	7.3
Coverage:					
Operating income : gross interest (x)	1.8	1.2	0.6	1.6	1.4
Operating income : net interest (x)	3.5	1.9	0.7	1.9	2.4
Activity and liquidity:					
Trading assets turnover (x)	7.3	6.2	8.9	17.8	12.2
Days receivable outstanding (days)	9.5	8.1	8.0	6.0	5.6
Current ratio (:1)	1.3	1.2	1.2	1.0	1.1
Capitalisation:					
Net debt: equity (%)	66.3	78.3	61.3	117.2	58.3
Total debt: equity (%)	77.6	91.9	83.3	144.4	69.3
Net debt: EBITDA (%)	275.6	437.0	374.6	277.5	215.8
Total debt: EBITDA (%)	322.9	512.8	509.4	341.9	256.4

‡Depreciation used as a proxy for maintenance of capex expenditure.

*Net of intangible assets.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the indicative Bond ratings expire in January 2019

Flour Mills of Nigeria Plc and the Issuing Houses participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The indicative Bond ratings have been disclosed to Flour Mills of Nigeria Plc with no contestation of the ratings.

The information received from the Issuer, the lead Issuing House and other reliable third parties to accord the Bond rating included: Draft Shelf Prospectus, Draft Series 1 and Series 2 Pricing Supplements, Draft Programme Trust Deed as well as Draft Series 1 and Series 2 Trust Deeds.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.