

Valuation Report

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National Flour Mills Limited (NFM)

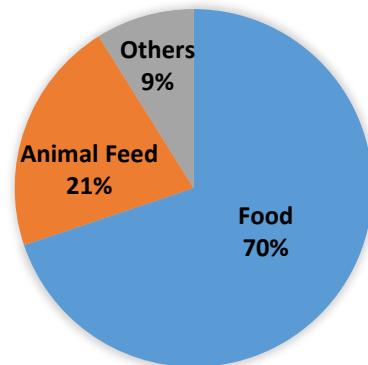
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NFM and its subsidiary (together, the Group) principal activities are the production and distribution of food products and animal and poultry feeds. The Group's major shareholder is National Enterprises Limited, owning 51% of the issued share capital.



Company Facts	
Symbol:	NFM
Target Price:	\$1.72
Sector:	Manufacturing 1
Market Cap.:	\$246,410,000
Issued Capital:	120,200,000
Financial Year End:	31-Dec

REVENUE MIX



Key Statistics				
	NFM	AHL	WCO	UCL
P/E	11.0X	22.1X	22.3X	N/A
P/B	0.9X	2.53X	16.53X	1.61X
ROCE** (Inflation 0.7%)	2.4%	12.9%	96.7%	-24.0%
Dividend Yield**	3.4%	1.6%	3.3%	13.1%*

*includes special dividend from sale of spreads business

**based on FYE 2019

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Company Overview & History

National Flours Mills Limited is the leader in flour milling, rice packaging, feed milling and dry mix operations in Trinidad and Tobago.

National Flour Mills Limited (NFM) commenced trading activities in 1966 as Trinidad Flour Mills which was then owned and operated by a group of local and foreign shareholders. NFM was incorporated on September 30, 1972, with the Government of Trinidad and Tobago holding the majority of the issued share capital; minority holdings were held by two foreign investors - Inter Continental Grain Company and Maple Leaf Limited. The shareholdings of these two foreign investors were purchased by the Government of Trinidad and Tobago in 1980, thus NFM became a wholly owned State Enterprise.

In 1995 NFM became a Public Limited Liability Company when its shares were sold on the open market and listed on the Trinidad and Tobago Stock Exchange. To date, 49% of its shareholding is owned by the public and 51% by the Government of Trinidad and Tobago.

Annual production of flour and animal feed is in excess of 72,000 MT and 60,000 MT respectively, and is supplied to bakers, food manufacturers, retailers and farmers throughout the local and regional markets.

Business Model

NFM largely operates in three segments, Food, Animal Feed and Others.

Food

Food is NFM's largest segment, making up 73% of NFM's 2019 revenue and comprises Flour, Dry Mix and Trading Operations. Margins for the past 5 years have averaged 25%, but have risen as high as 32% during times of favorable grain prices.

Flour & Dry Mix Operations product range for human consumption comprises of wheat-based products such as all-purpose flour, bakers flour, whole wheat flour, cake flour, self-rising flour, wheat germ, wheat bran and wheat cereal. Its dry mix operations manufactures products such as pholourie mix, split peas powder, baking powder, custard powder and icing sugar.

Trading Operations exists within the trading and distribution portfolio and sells parboiled rice, brown rice, soya bean oil, instant ginger tea, coconut milk powder and instant yeast.

Animal Feed

Animal Feed is NFM's second largest segment, making up 33% of NFM's 2019 revenue and comprises Animal Feed Operations. Margins for the past 5 years have averaged 24% and have remained fairly consistent.

Animal Feed Operations, under NFM's feed milling and packaging division, manufactures feeds for broilers, layers, ducks, goats, dairy, sheep, pigs, horses, fishes, rabbits & tilapia.

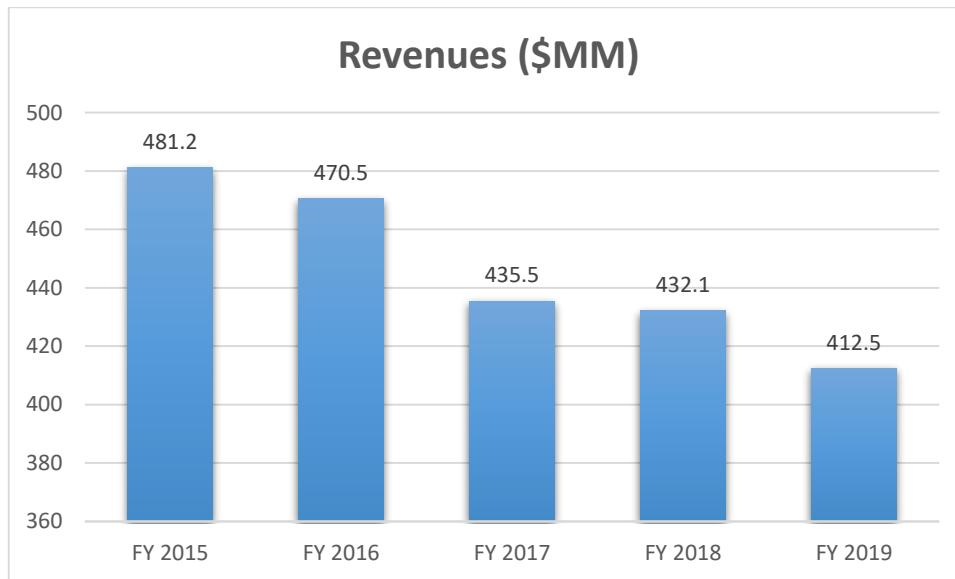
Other

Other is NFM's smallest segment, making up just 4% of NFM's 2019 revenue and comprises its Pet Food Operations. Margins for the past 5 years have averaged 20% and while inconsistent, they have been trending positively.

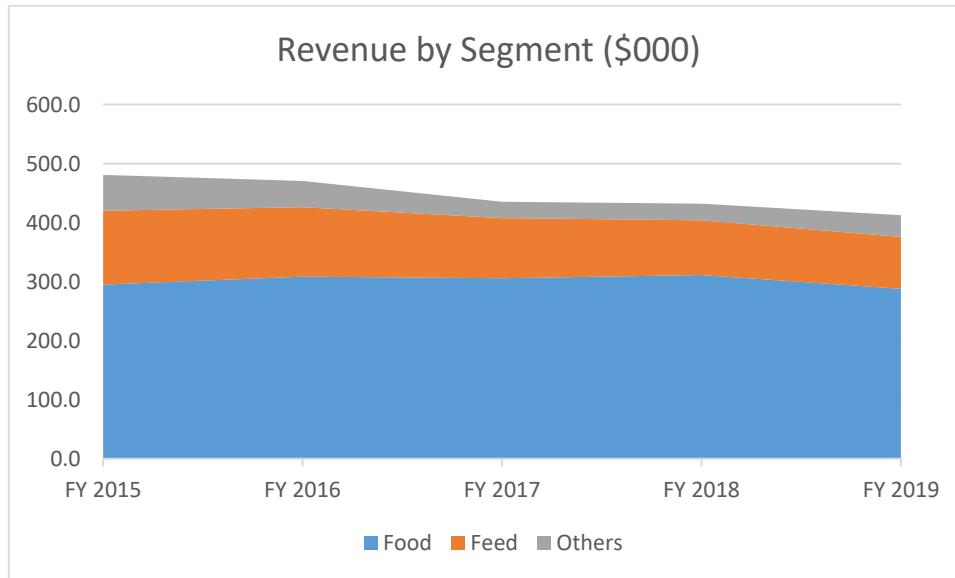
Pet Food Operations, also under NFM's feed milling and packaging division, manufactures feeds for puppies and dogs.

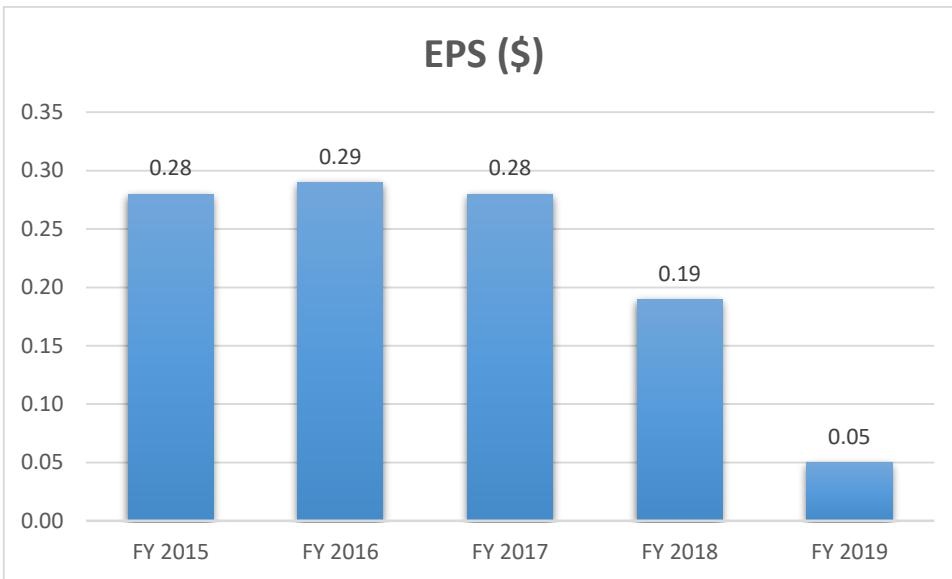
In addition to ever-widening local distribution throughout Trinidad and Tobago, NFM's aggressive export thrust has seen its products penetrate new markets gaining significant presence with strong brand recognition. They have added Belize in 2013 to their already long list of regional and extra-regional markets: Barbados, Dominica, Grenada, Guyana, Jamaica, St. Vincent, St. Lucia, Suriname, Canada and USA.

Financial Analysis



NFM's revenue has been gradually falling over the past 5 years as its "Feed" and "Other" segments saw average annual declines of approximately 8% each. Specifically, declines in the company's revenue from its Feedmill and Soya sales weighed heaviest on revenue. NFM's largest segment, "Food", was largely flat over the period, though the segment did record a decline in FY 2019 of \$23.1K or 7.4%. Seprod also opened a new mill in Jamaica in 2019, which took market share from NFM in that market.





Following fairly steady performance for the previous 3 years, NFM's EPS has declined sharply for the past 2 years. This has been the result of rising wheat prices since 2018, as drier than expected weather reduced global supply. Due to NFM's relationship with the government of Trinidad & Tobago, NFM has not raised prices on key flour products since 2008. This has led to a narrowing of NFM's margins year on year.

Profitability Ratios	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	5 Year Avg
Return on Common Equity	18.57	16.37	13.63	9.05	2.44	12.01
Return on Assets	8.19	7.44	6.52	4.76	1.37	5.66
Return on Capital	11.99	12.13	10.52	7.34	2.72	8.94
Gross Margin	24.05	29.75	30.86	28.00	22.15	26.96
EBITDA Margin	12.04	17.01	15.91	12.42	7.94	13.07
Operating Margin	9.50	14.15	13.00	8.92	3.59	9.83
Net Income Margin	7.07	7.37	7.52	5.25	1.49	5.74

NFM's Returns on Common Equity, Assets and Capital have all been trending downwards and all currently sit at 5-year lows, well below their 2015 levels. This indicates that although NFM has been profitable, reinvestment into the business has not been able to create sufficient value. Reinvestment has instead been used to try to maintain existing infrastructure, which is becoming more and more inefficient over time.

Liquidity Ratios	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	5 Year Avg
Current Ratio	1.30	1.62	1.98	2.02	1.96	1.78
Quick Ratio	0.78	0.87	0.78	0.77	1.02	0.84
Cash Ratio	0.36	0.50	0.38	0.36	0.38	0.39

NFM has maintained its healthy liquidity position over the past 5 years as evidenced by an average current ratio of 1.78X. The ratio also remained above 1X in all years under observation. We note that the quick ratio has remained below 1X for most of the last 5 years. This is due to the nature of NFM's business model, where inventory of raw materials and goods makes up a large portion of the company's current assets. In 2019, inventory made up almost 30% of NFM's current assets.

Credit Ratios	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	5 Year Avg
Total Debt/T12M EBITDA	1.90	1.89	1.75	1.65	2.18	1.87
Net Debt/EBITDA	0.77	0.71	0.95	0.83	0.85	0.82
EBITDA to Interest Expense	22.52	7.30	7.00	10.18	6.92	10.78
Total Debt/Equity	56.12	66.36	48.03	35.59	28.16	46.85
Total Debt/Total Assets	25.61	30.08	24.20	19.59	16.08	23.11
Avg Assets/Avg Equity	2.27	2.20	2.09	1.90	1.78	2.05

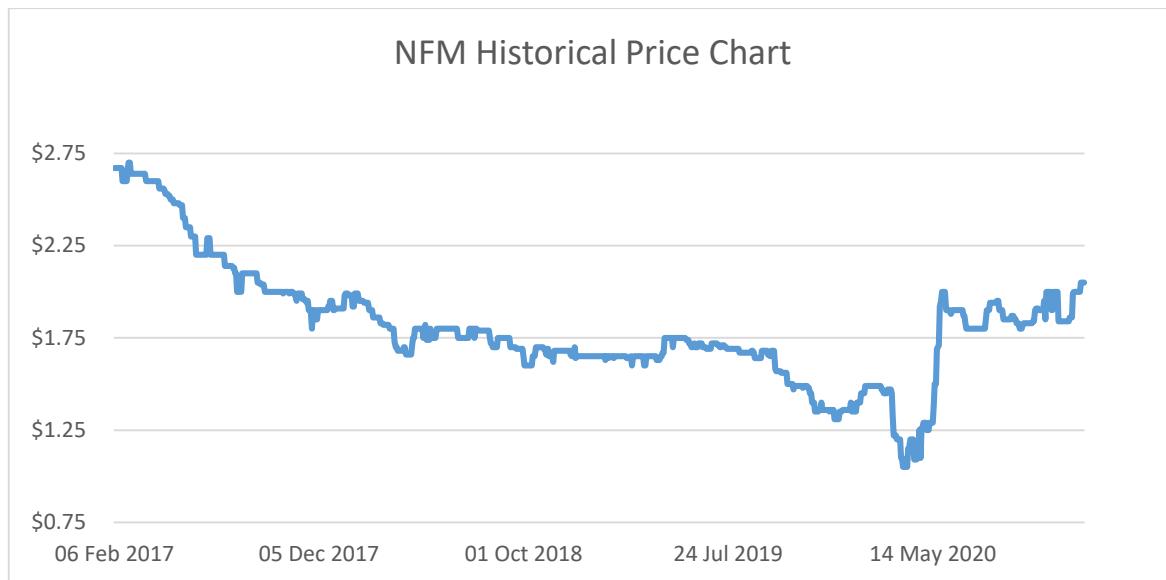
NFM has kept its Debt to EBITDA ratios fairly consistent from FY 2015 to 2019, despite the company's declining EBITDA for most of the period. This was done by the company managing its short term borrowings in line with its cash flow position, while also consistently servicing its existing long term debt obligations.

This consistent servicing of long term debt has resulted in a steady decrease in NFM's financial leverage ratio, measured by the Average Assets/Average Equity. This ratio was as high as 2.27X in FY 2015 but has trended downwards to 1.78X as at FY 2019. When businesses are profitable, leverage allows them to amplify their Return on Equity. However, with the narrowing of margins in recent years, NFM may be of the view that the additional returns provided through the use of leverage may no longer outweigh the cost of the debt.

Recent Developments

Equity History

Price Movement



2020 has seen NFM's share price appreciate 59.3%, climbing from \$1.35 to finish the year at \$2.15. This is in contrast to the broader market, with the TTCOMP and TTALL falling by 9.9% and 5.2% respectively during the same period. While NFM's price fell in Mid-March together with the rest of the market, the stock has seen an outsized recovery following its earnings report in May which brought it to levels not seen since 2017. The report stated that NFM benefitted from an upsurge in home cooking and baking due to the lockdown of the TT economy. Q2 and Q3 results were similarly strong, with earnings in line with FY 2018. The company was cautious going into Q4 however, as increased demand from China is expected to have pushed grain prices up and compressed NFM's margins.

Top Shareholders

Name	Shareholdings	Percentage
National Enterprises Limited	61,301,998	51.00%
National Insurance Board	8,476,410	7.05%
MASA Investments Limited	6,597,854	5.49%
Colonial Life Insurance Company (Trinidad) Limited	4,521,379	3.76%
Olympic Manufacturing	2,600,000	2.16%
RBC Trust (Trinidad & Tobago) Limited -T1154	2,294,982	1.88%
Olympic Rentals Limited	1,717,724	1.43%
Tatil Life Assurance Limited A/C C	1,008,811	0.84%
Tatil Life Assurance Limited	958,852	0.80%
ANSA McAL Foundation	800,000	0.67%

While officially a publicly traded company, NFM is significantly influenced by the Government of Trinidad & Tobago (GOTT). The National Insurance Board (NIB) is wholly owned by GOTT, while almost 87% of publicly traded National Enterprises Limited (NEL) is owned by GOTT. Combined, these equate to GOTT indirectly owning just over 51% of NFM's shares. It should be noted that this only takes into account GOTT ownership through the top 2 names in the table. GOTT may also have further holdings in smaller entities outside those mentioned above.

The most tangible result of this GOTT influence is the unofficial cap on the price of key flour products since 2008. While prices for NFM's imported grains are subject to international prices and have been on the rise, NFM appears unable to adjust its selling price to consumers. This is likely due to GOTT attempting to shield the wider population from increases in prices of such staple ingredients, albeit at the expense of NFM shareholders. The company does not expect price increases for these products in the short term and has chosen to focus on waste reduction and automation instead.

It should be noted that in NFM's 2019 Annual Report, Chairman Nigel Romano mentioned that "NFM can no longer rely on the sale of flour to make a profit". Investors may have initially interpreted the statement as NFM is losing money by supplying flour to the local market. We were able to clarify the statement with Mr. Romano, where he explained that such an interpretation would be incorrect and the statement referred to profit growth. He also elaborated that NFM's growth would instead come through building out its dry-mix and pet food businesses, which are higher margin.

Valuation Report

Discounted Cash Flow [DCF]

The discounted cash flow model is based on a detailed analysis and projection of company cash flows and accompanying financial statements. The basis of this forecast are assumptions made about the main value drivers for NFM. We projected EPS to be TT\$ 0.22 at the end of financial year 2020. The key determinants of NFM's projected cash flows are key value drivers affecting the firm's 1) Revenue 2) Profit Margin 3) Working Capital Spending and 4) Fixed Capital Spending. Intrinsic valuation on the FCFE model shows a share price of \$1.53 vs. a market price of \$2.15.

Price/Earnings [PE] Ratio

This model is a simple yet powerful measure of value that relies on historical market sentiment of the growth prospects of the stock. It uses the market implied multiple for NFM for the past 5 years and the firm's EPS over its 4 most recent quarters to arrive at the firm's 'fair value'. The analysis shows that NFM is undervalued by \$0.16 or 7.5%.

Price/Book Value [PB] Ratio

Simple P/B multiple has a similar methodology to the simple P/E. It uses the average P/B multiple for the past 5 years then determines a fair value by using the current book value per share (BVPS). The analysis shows that the stock is undervalued by \$0.28 or 13.1%.

Dividend Discount Model [DDM]

Our DDM assumes NFM will be able resume paying out 37% of its EPS as dividends in 2021 and 2022. From there onward we expect the payout ratio and EPS (and hence dividends) to gradually increase in line with the analyst's estimates for the firm earnings for the next 5 years and onwards. Intrinsic valuation on the DDM shows a share price of \$1.03 vs. a market price of \$2.15.

Risk Factors

Slow economic growth/recovery in Trinidad and Tobago, where NFM is based and earns the lion's share of its revenue and profits. Covid-19 has had a more severe impact on T&T's Caribbean neighbours due to their reliance on tourism. However, T&T has been experiencing negative economic growth since 2015 as its energy sector has been in steady decline since the US became energy independent. This means that while T&T was not as severely impacted this year economically, its recovery may also be less pronounced as the world begins returning to normal, as T&T is more reliant on its energy sector vs tourism.

Commodity prices are set on the international market where NFM is a price taker. In addition, GOTT's unofficial cap on the price of key flour products serves to squeeze NFM's margins during times where grain prices are high as the company is unable to adjust its retail prices.

Foreign Exchange shortages are becoming a greater and greater issue as reserves in Trinidad and Tobago continue to be eroded. NFM will be seriously affected if T&T were to devalue its currency as its imports would become significantly more expensive, resulting in significant downward pressure on NFM's stock price. It should be noted that Chairman Romano has indicated to us that NFM has a special line with the Ministry of Finance and has obtained a significant percentage of its requirements over the last year. This is expected to continue as the food sector is being given priority.

Regional competition from companies such as Seprod in Jamaica may dampen NFM's growth prospects. While NFM is expected to maintain its dominant position in T&T, Seprod's foray into flour production has pushed NFM out of the Jamaican market, and may provide significant competition for export markets in the region. To mitigate this, NFM is looking to diversify into different lines of business, with initial banana and cocoa production scheduled to begin in late 2021.

Limitations

Projection Errors - The group operates a number of business lines, each with its own risk factors which contribute to possible errors in the analyst's assumption for projections.

Model Errors - DDM, FCFE, P/B and both P/E models were created in excel with the most room for model error in the FCFE model.

Recommendation

Model	Intrinsic/Fair Price	Overvalued (Undervalued) by	Weighting
Discounted Cash Flow (FCFE)	\$ 1.53	0.62	30.0%
Multistage DDM	\$ 1.03	1.12	30.0%
Simple P/E Trailing Valuation	\$ 2.31	(0.16)	20.0%
Simple P/B Trailing Valuation	\$ 2.43	(0.28)	20.0%
Weighted average Intrinsic Value		\$1.72	
5% Above Average		\$1.80	
5% Below Average		\$1.63	

Our models give a range of values from \$1.03 to \$2.43, each with its own margin of error. The models have been assigned various weightings as detailed in the table above. A 5% margin of error was applied to the weighted price to give a fair value range of \$1.63 - \$1.80. This is compared to the current market price of \$2.15. **JMMB Investments Limited recommendation on NFM is Underperform with an intrinsic price of \$1.72.**

This Underperform rating is given on the following basis:

- The economic climate in T&T remains uncertain, with international agencies ascribing a negative outlook going forward. NFM is based and largely operates in T&T.
- NFM's share price has enjoyed a rise of 59.3% in 2020, which currently places it above our fair value range.
- The unofficial price cap imposed by the GOTT hinders NFM's ability to increase prices. This is exacerbated by the volatility of commodity prices and squeezes NFM's margins during times of high grain prices.

These points are balanced by the following:

- 2020 may be a turnaround year for NFM. The company has seemingly resolved its gross margin issues from 2019 and has streamlined senior management to improve efficiency and cut costs.

APPENDIX

IMPORTANT DISCLOSURES

Abstract— as a part of our new portfolio strategy we are recommending strict adherence to the following portfolio allocation **definitions/recommendations**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 10% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER/ INVESTMENT ADVISOR OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY, THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

OUTPERFORM - up to 10% of your portfolio

MARKETPERFORM - 5% of your portfolio

UNDERPERFORM - 2.5% to 4.9% of your portfolio

STRONGLY UNDERPERFORM - less than 2.5% of your portfolio

SELL - 0% of your portfolio

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