

DANGOTE FLOUR MILLS PLC

Initial Public Offering (IPO)

Offer Method: Offer for Sale

Offer Opens/Closes: September 6-27, 2007.

EXECUTIVE SUMMARY & INVESTMENT RATIONALE:

- Dangote Flour Mills Plc (DFM) commenced operations in 1999 as a division of the Conglomerate **-Dangote Industries Limited (DIL)** - to engage in flour milling, processing and marketing of branded flour. The company was incorporated in 2006 sequel to the strategic decision of the Group to unbundle its various operations. The company is a group on its own with two wholly owned subsidiaries; viz: **Dangote Agro Sacks Limited (DAS)** and **Dangote Pasta Limited (DP)**. Its products portfolio comprises **Bread Flour, Pasta Semolina and Wheat Offals (Brans)**.
- In a swift reaction to the supply gap which stemmed from the increased national demand for flour and its allied products; as well as the quest of **Dangote Group** to grow its market share, the company underwent strategic expansions in January 2006 from the initial installed capacity of 500MT/day to 4,000metric tonnes (MT)/day, distributed among the 4 Plant Mills strategically located in Lagos, North, South and West regions of the country at Apapa (500MT/day); Kano (1500MT); Calabar (1,000MT); and Ilorin (500MT).
- Recent statistics from **USAID and Augusto & Co.** ranked Nigeria lowest on the list of wheat consumer nations in the developing economies. This further testifies to the growth potentials of the flour millers market in the country with over 140million people and a forecast annual growth rate of 3 per cent. Currently, there are two clear leaders in the industry, viz; **Flourmills of Nigeria Plc and Dangote Four Mills Plc** which control over 65 per cent of the entire market with approximately 11,000MT/day installed capacity, and two other key players with about 20 per cent of the market share as well as other niche millers.

- Moreover, its subsidiary: **Dangote Pasta Limited (DP)** has in its products portfolio two popular brands- **Dangote Spaghetti and Dangote Macaroni**. DP also plays dominant in the Nigerian Pasta industry which earned it the Nigerian Industrial Standards Awards for quality by the **Standard Organisation of Nigeria (SON) and I.S.O. 9000-2001 for systems quality**. The Nigerian Pasta market still has capacity for growth as the demand for convenient and fast food products increases due to growing urbanization and increased demand for a cosmopolitan nation. Premised on this, the company has plans underway to embark on further strategic expansions with a view to achieving economies of scale and competitive advantage.
- The other subsidiary-**Dangote Agro Sacks Limited (DAS)**, has two divisions **Agro sacks and AD* Star** established in 1998 and 2000 respectively for the production of polypropylene (PP) bags for packaging cement,sugar,flour,salt and other products. The company has a ready-made market within the Dangote Group, which consumes 85 per cent of its output while the remaining 15 per cent is sold externally. However, the company also plans to explore exports opportunities with a view to increasing its external supplies to about 25 per cent.
- The Group's turnover grew by 33.9 per cent compounded annual average growth rate **(CAGR)** between 2002 and 2006 while its cost of sales rose by 40.7 per cent over same period. However, reaping from economies of large scale, cost of sale growth rate steadily declined from 107.9 per cent in 2003 to 10.7 per cent in 2006 while turnover rose by 6.2 per cent from N45.399bn in 2005 to N48.22bn in 2006. Return on Capital Employed **(ROCE)** declined from 7.5 per cent in 2005 to 5.6 per cent in 2006, on the other hand, return on equity **(ROE)** soared from 3.8 per cent in 2005 to 9.9 per cent in 2006. However, ROCE averaged 12.6 per cent between 2002 and 2006, while **ROE** averaged 17.7 per cent over same period.
- **We recommend the Offer for momentum traders and value investors with long term investment horizon.**

- **Offer Details:**

DMF has a total of 5 billion Ordinary Shares, issued and fully paid up. The Offer quantity is 1.25 billion, representing 25 per cent of the total shares in issue, at N15 per units with a minimum of 1000 units and a multiple of 100 units subsequently. Meanwhile, the Offer is to be preferentially allotted to identified investors up to a maximum of 60 per cent (i.e. 750 million units). **However, 80 per cent of the Offer has been underwritten by 11 joint underwriter firms at the instance of the firm.**

- **Intent of the Offer:**

The Offer is aimed at giving the investing public the opportunity of becoming part owners of Dangote Flour Mill Plc (DFM), a wholly owned subsidiary of Dangote Industries Limited (DIL) and to meet the listing requirements of the Nigerian Stock Exchange (NSE).

- **Other Key Selling Points:**

- The company is expected to ride on the strong brand name of the Dangote Group in the household market as well as in the capital market.
- DFM proposes a 40k cash dividend by the year end December 31, 2007 as the shares being issued rank pari passu in all respects with existing ordinary shares of the company (DFM).
- The Offer time table projected November 29, 2007 as the commencement date for the dispatch of share certificates to investors while the offered shares will be listed on the floor of the NSE on December 5, 2007. This serves as additional incentive, as investors can start to trade on their shares by early January 2008 for capital gains. This is also reinforced by the fact that demand for the shares will be very strong as returned monies may also be reapplied to buy more units from the secondary market.
- The chairman, Aliko Dangote promises to return surplus/rejected application monies with moderate interest as early as possible **(as exemplified in Dangote Sugar Refinery Offer).**

- DFM is also well positioned to leverage on the strategic locations of its plant mills and its wide distribution networks to gain quite an appreciable cost advantage, thus impacting positively on bottom-lines.
- There also exists well established and budding local market for bags, flour-based products, pasta and noodles. Opportunities also exist for the company to explore sub-sahara markets- **Abidjan, Benin, Cameroon, Chad, Gambia, Niger, Togo, and others.**

- **Threats/Risks Factors:**

- The company's going concern status is highly vulnerable to operating risks of fluctuations in raw material supplies and costs. Wheat, its key input material in flour production, constitutes 80 per cent of production costs and is single-handedly sourced from the United States. Expectedly, currency risk also exists as DFM's inputs costs are also affected by the volatility in exchange rates.
- Country and regulatory risks are also prominent. Any ripple in the political environment or reversal of current favourable economic reforms may impact negatively on performance forecasts. The company and other industry players are shielded by current import substitution policy of the Federal Government; a reversal of this might expose the company and others to unfair competition.
- DFM is also susceptible to competitive risks from potential new entrants and importers.

- **Risks Mitigants:**

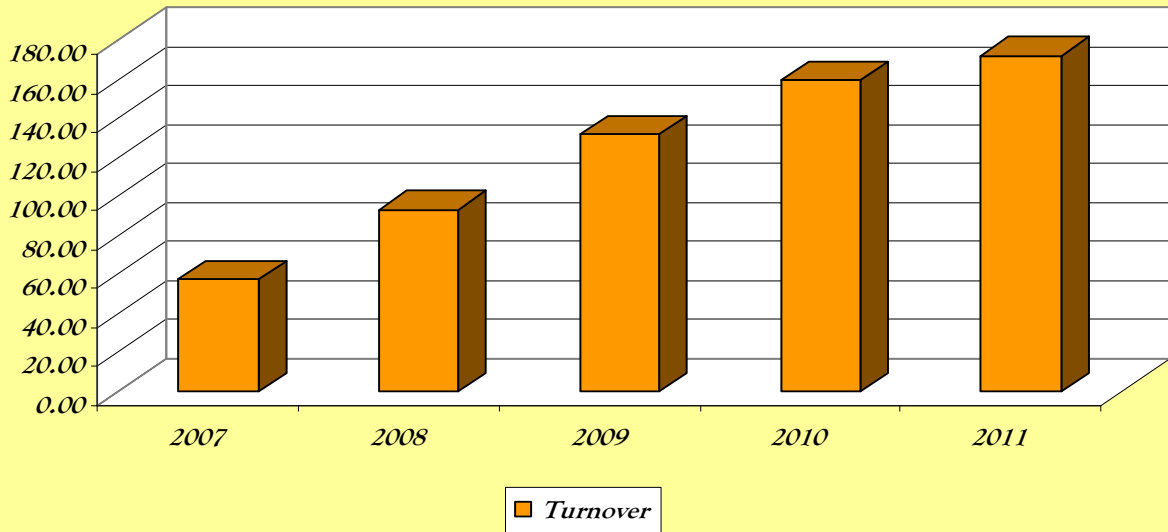
- The company is into strategic alliance with the US Wheat Associates for provision of information and technical assistance in addition to facilitating the procurement of wheat from the United States. It has established forward contract agreements with suppliers which guarantee the firm of 50 per cent of its wheat requirements as a hedge against the supply risk. Similarly, it is expected that the current policy adopted by the CBN in management of the exchange rate will be sustained vis-à-vis the management of the country's foreign reserves. This will serve as a hedge against the exchange rate risk.

- It is hoped that the current import substitution policy of 60 per cent and 10 per cent on finished wheat and raw wheat will be sustained to help protect the local industries. Similarly, the Nigeria's two-year consecutive credit ratings of BB- by Standard & Poor and Fitch Ratings also hold good prospects for the company as it puts Nigeria on equal pedestal with other developing economies.
- The threats of meeting turnover target and uncompetitive pricing due to imports are also mitigated by the plans of the company to embark on extensive expansion strategies to corner more market share and enjoy competitive pricing through economies of large scale.

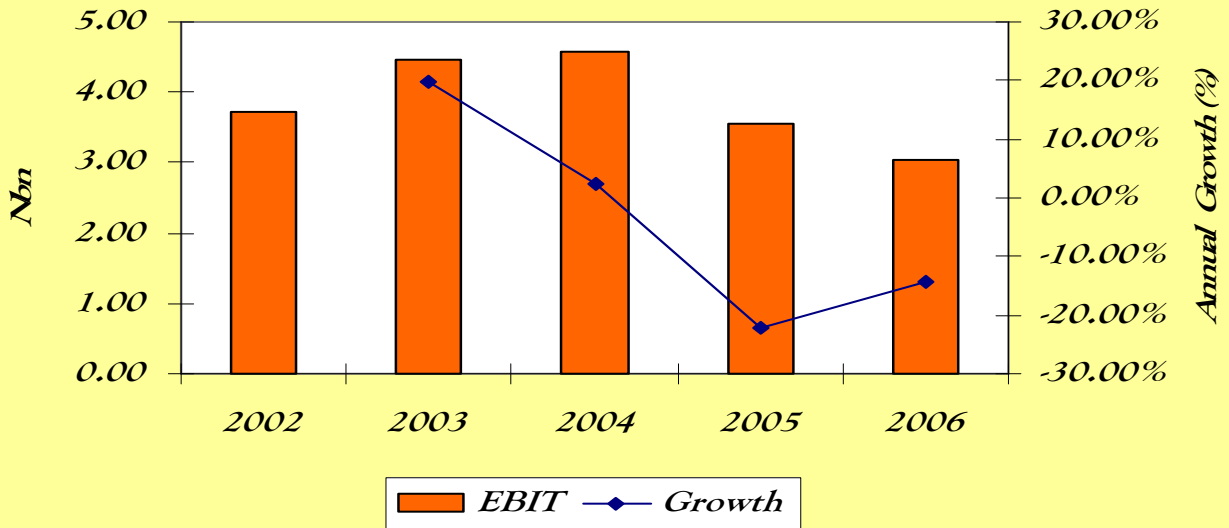
Future Prospects/Projections:

- In line with its strategic intent to become industry leader, the company has concluded plans to increase its flour milling capacity by 62.5 per cent to 6500MT/day in 6months.
- It also plans to diversify Dangote Agro Sacks into production of mats and inner lining for sugar bags and embark on progressive expansion of the business unit to cater for the growing needs of other companies in the group, especially the Obajana Cement Company Limited (OCC).
- The company has also commenced an expansion of production capacity of Dangote Pasta Limited (DP) to 21.6 millions cartons per annum with a view to competing favourably with imported/smuggled products in pricing. Similarly, the commissioning of the Dangote Noodles plants at Ikorodu factory, Lagos, is at an advanced stage and production is expected to commence in Q1-2008.
- The Group projected turnover of N57.27bn and after-tax profit of N2.76bn in financial year ending December 31, 2007. This implies growth forecasts of 18.8 per cent and 30 per cent for turnover and after-tax profit over N48.22bn and N2.11bn reported respectively in the previous year. The proposed earnings and dividend per share are 55k and 40k respectively.

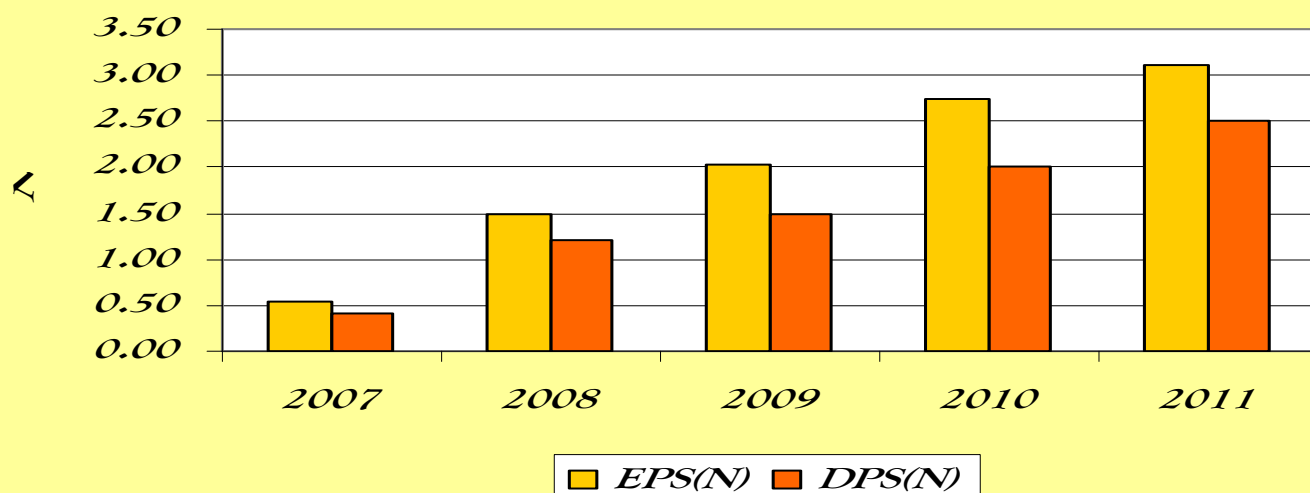
5-Year Projections for Turnover (N'bn):2007-2011



*DANGOTE FLOUR MILLS PLC:
TRENDS IN EBIT & EBIT GROWTH 2002-2006*



**DANGOTE FLOUR MILLS PLC:
GROUP FORECAST S FOR EPS & DPS 2007-2011**



KEY STATISTICS/PEER COMPARISONS

Key Performance Indices	Dangote Flour Mill Plc		Flour Mill of Nigeria Plc
	2006	2007e*	2006
Turnover (Nbn)	48.22	57.27	86.57
PAT(Nbn)	2.11	2.74	4.67
Mkt Cap.(Nbn)	75.0	75.0	100.71
Share Out.(bn)	5.00	5.00	1.55
EPS(N)	0.42	0.55	4.01
DPS(N)	0.00	0.40	0.85
Net Profit Margin (%)	4.4%	4.8%	5.4%
ROE (%)	9.9%	n/a	0.31
P/E ratio	35.71	27.33	16.17
P/BV	3.50	2.97	6.62

* Firm's forecasts as contained in the Offer Prospectus

Valuation/Recommendation:

We employed Price-to-Book Value (P/BV); Price-to-Sales (P/S); Price-to-Earnings (P/E) relative valuation metrics, using relative indices of comparable companies. We also used Discounted Dividend Valuation method with a discount rate of 19.27 per cent. in valuing Dangote Flour Mills Plc. Our valuation is based on forecast Sales/Share, Earnings/Share and Book Value/Share of N11.09, N0.53 and N4.45 respectively. After attaching appropriate weights to the results obtained from the various valuation methods, we arrived at a fair value of N16.00, which implies that Dangote Flour Shares are being offered at a discount of 6.25% to valuation.

However, given the fact the Dangote Group retains 74.35 per cent of Dangote Flour Mill Plc post-offer and the good brand name of group in the market, we believe stock will trade at good premium above the fair value. In addition, we also anticipate an increased demand for the shares post-offer as investors who can not participate in the on-going Offer for one reason or another will like rush to buy from the secondary market prior to the release of the share certificates and declaration of the proposed dividend of 40k/share when it is eventually listed on the Exchange.

We recommend the Offer a BUY for speculators and long term investors.

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