

## Oil Palm

### Earnings quality profile remains robust

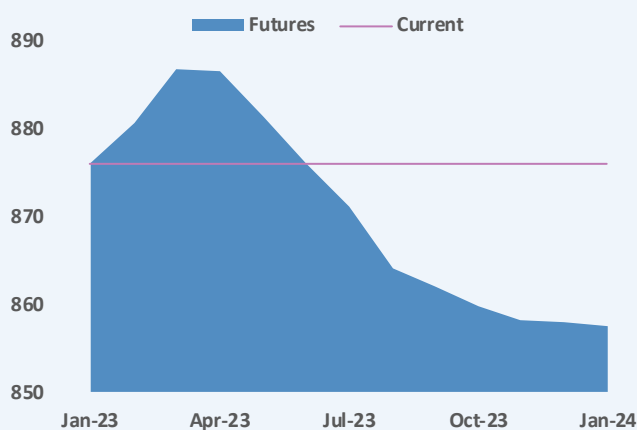
Our previous oil palm sector reports highlighted key drivers that could upturn the global CPO supply-demand balance and keep prices elevated. However, recent events across markets have led to a pullback in CPO prices. Specifically, increased supply from Malaysia and Indonesia (the two largest producers of CPO) and an expected slowdown in demand from China and India led to a 29.2% YoY pullback in CPO prices in Q4'22. Going into 2023, we expect global and domestic CPO prices to be slightly weaker.

Kayode Eseyin  
 Kayode.eseyin@cardinalstone.com

Jerry Nnebue  
 jerry.nnebue@cardinalstone.com

Philip Anegebe  
 Team Lead  
 philip.anegebe@cardinalstone.com

Figure 1: CPO forwards suggest a pullback in CPO prices (In US \$)



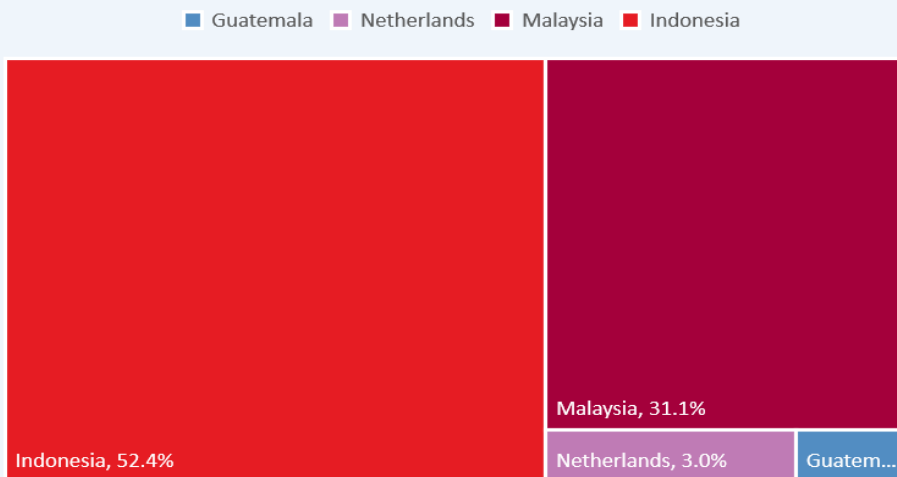
Source: Bloomberg; CardinalStone Research

#### Key price drivers point southwards

The Malaysian Palm Oil Council reckons that covid-induced labour shortages elicited a plunge in total palm production to 18.1 MT in 2021 (vs 19.8 MT in 2019). Though covid lockdowns were mostly a thing of the past in other climes in 2021, the country's border remained closed to immigrant workers, who accounted for 74.0% of the palm oil sector workforce. However, the government commenced a border reopening program in H1'22 that improved the 2022 outlook for CPO production in Malaysia. This initiative also bodes well for global supply and is a major downside risk to prices.

Elsewhere, Indonesia's decision to replace the export ban on CPO with a domestic market obligation policy is also expected to result in a net increase in the global supply of the commodity. For context, the new policy requires that 30.0% of CPO produced in the country be retained in the local market compared to the previous full export restriction. We believe the cumulative impact of the Malaysian and Indonesian developments contributed to the material moderation in global prices.

Figure 2: Indonesia and Malaysia retain 83.5% of global CPO supply



Source: CPOPC; CardinalStone Research

#### La Niña persistence could lead to increased precipitation.

La Niña, the periodic cooling of ocean surface temperatures across the Pacific area, is notorious for inducing elevated rainfall levels in oil-palm regions of Indonesia and Malaysia. At the same time, it causes drier conditions across the South American continent, particularly affecting soybean-producing provinces in Argentina & Brazil. This climatic phenomenon is widely predicted to return in 2023, along with its inherent effects. In previous La Niña years, CPO producers reported higher palm oil yields, with Malaysia reporting a 5.3% YoY increase in crude palm oil production in the La Niña of 2017/18, for example. 2020 and 2021 were also La Niña years, but labour shortages and adverse government policies curtailed production in Indonesia and Malaysia. In addition, though water-table replenishment from increased precipitation bodes well for production, supply-side disruptions may ensue from excessive rainfall.

#### The availability of CPO substitutes remains constrained.

Intensifying hostilities between Russia and Ukraine, the two largest exporters of sunflower oil – the major CPO substitute – continue to derail its global supply chain. Pre-war, the two European countries accounted for 69.2% of global sunflower oil exports. With Russia's invasion inhibiting operations in Ukraine's seed-crushing facilities, akin to CPO, sunflower oil prices skyrocketed. Furthermore, Russia's sinusoidal approach to July's UN-brokered export pact has added to uncertainty over the supply of the commodity. For soybean oil

droughts in South America which have negatively impacted Brazil Argentina, and Paraguay (who jointly account for 51.0% of the global soybean supply), are likely to subsist in 2023 due to La Niña. This drought-related setback suggests that availability and affordability are likely to be constraining factors for another important CPO substitute over the next twelve months, leaving legroom for some demand support for CPO.

#### **Local CPO prices may remain elevated.**

In line with our expectation, average CPO prices in Nigeria traded at a 56.7% premium (57.8% premium in 2021) to global prices in 9M'22, primarily due to the impact of persistent Naira weakness in the parallel market. In 2022, local CPO prices were also 29.0% higher YoY, with FX illiquidity overhang and a largely "protectionist orientation" to currency management suggesting that the FX-induced premium may extend into 2023. Consequently, we expect CPO prices to average N900,000 per ton in 2023 (vs a mean of N922,750 in 2022). However, we model moderation in local CPO prices to an average of N853,130 (vs N931,400 per ton previously) over our forecast horizon to reflect the knock-on effect of global developments, improved supply of CPO and likely improvements in FX market conditions.

#### **CPO volumes to improve**

According to the Council of Palm Oil Producing Countries (CPOPC), Nigeria imported c1.1 million tons of palm oil in 2022 as local demand continued to outstrip production. Despite the implied strong influence of importers, our coverage companies posted volume growths in the review period (9M:22: 5.1% YoY on average), aided by capacity expansion and stricter border controls. In 2023, this volume growth trend appears poised to continue, given expectations of increased milling capacity at OKOMU and better FFB yields in the new plantation in PRESCO. The former's management has disclosed plans to expand milling capacity by 30t/hr in its extension 2 plantation to 60t/hr. For PRESCO, management expects about 600 hectares of palm plantation to mature in 2023, which would likely support output. In all, the combined impact of our volume and CPO price adjustments resulted in a five-year revenue CAGR of 15.2% for our coverage companies (compared to 10.5% in prior communication). A risk to our revenue projection is the possibility that a new pro market government rolls back the protectionist policies (e.g. CBN's inclusion of CPO in its FX restriction list and unorthodox currency management) that have benefited domestic producers in the past in 2023.

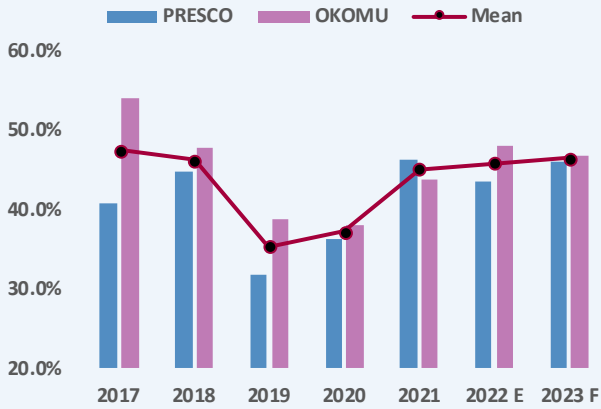
#### **Input cost pressures to abate in FY'23**

Over 9M'22, CPO manufacturers were not immune to the energy crises witnessed across the globe, with both PRESCO and OKOMU reporting surges in general expenses. For OKOMU, management revealed that the rise in Diesel and fertiliser prices led to a 55.1% surge in related costs.

For PRESCO, the impact of the energy crises was more pronounced due to its decision to pivot towards a more energy-intensive RBDO output, as the company reported a 104.5% surge in its general expense. In the new year, the IEA expects crude oil prices to wane

and this could likely have a positive passthrough for both AGO and fertilizer prices. on the back of this, we, see scope for an average 60 bps increase in EBIT margins.

Figure 3: EBIT margins to inch higher in 2023

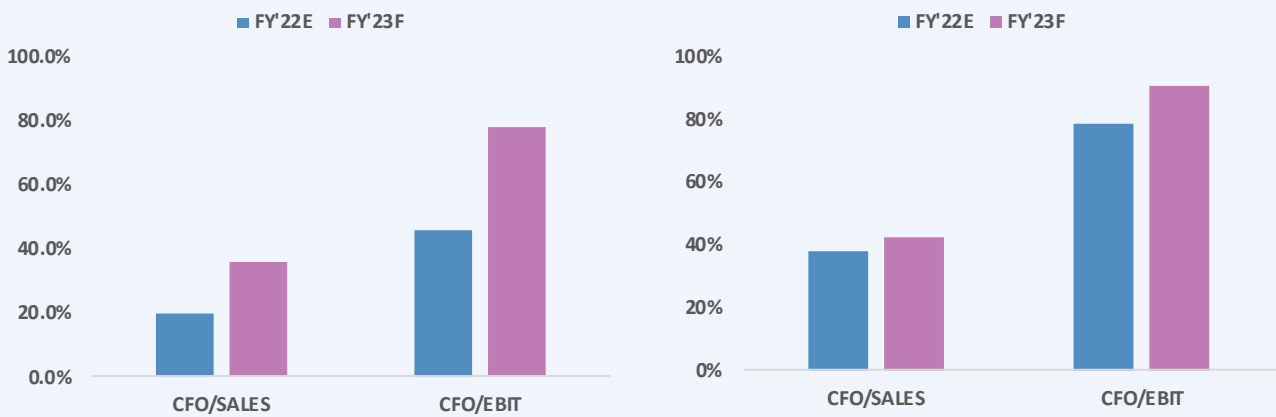


Source: Company financials; CardinalStone Research

**Working capital improvement to support the quality of earnings**

We forecast improvements in earnings quality (EQ) ratios - CFO/EBIT and CFO/Sales in FY'23. Our projected improvement in earnings quality is premised on the likely non-recurrence of the N16.6 billion payable outlay incurred by PRESCO in FY'22 and the expected progress in receivable and inventory days in OKOMU. Aided by such working capital improvements, PRESCO and OKOMU will likely grow FCFF by 418.0% and 63.1% in FY'23.

Figure 4: Earnings quality to Improve for PRESCO (LHS) and OKOMU (RHS)



Source: Company financials; CardinalStone Research

## The OKOMU OIL PALM PLC

BLOOMBERG: OKOMUOIL NL

### FCY weakness could protect topline

**BUY**

Target Price: N212.02

Ref Price: N165.00

Upside/(Downside): +28.5%

Revenue is likely to surge by 65.3% YoY in FY'22 (vs 61.6% in 9M'21) due to higher CPO prices (+30.6% YoY as of 9M'22) and greater FFB harvest from newly matured plantations. We forecast FY'22 EBIT and PAT margins to expand by 4.8ppts and 2.7ppts YoY to 48.5% and 33.8%, respectively. FY'22 margins are likely to be supported by the knock-on effect of robust revenue growth, as seen in 9M'22.

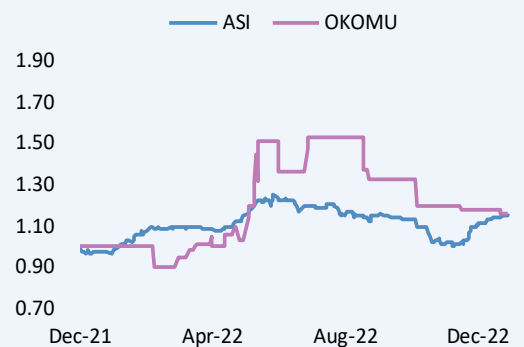
In FY'23, we forecast a tamer 6.7% YoY growth in revenue for the company due to the projected impact of lower prices (i.e., -5.8% YoY to N900,000 per ton). Increased volumes and the possible effect of devaluation on rubber revenue may offset this price reduction. FY'23 margins are also likely to improve, albeit slower, due to a likely moderation in energy cost pressures. The impact of this expected cost savings is a forecasted 40bps gross margin expansion to 77.0%. Operating margin is, however, likely to decline by 90bps primarily due to the effect of a potential increase in employee and direct costs linked to harvesting and the commencement of operations in the second 30t/hr oil mill in extension 2.

FCFF will likely surge 63.0% YoY in the coming year despite a sluggish EBIT growth due to more contained capex and working capital investments. On the former, management revealed that the company has no new projects in the pipeline for 2023, having completed the new oil mill, which is set for commissioning in early 2023. In all, EPS is expected to grow by a marginal 4.4% to N21.6 billion, with FY'23E ROAE at 46.0% (vs a five-year average of 33.2%). In addition, we also expect the FY'23 dividend payout to be mostly unchanged relative to FY'22.

After adjustments to our model, we arrived at a new 12-month TP of N212.02 (vs N190.29 previously). OKOMU is trading at a current P/E ratio of 8.75x (vs a five-year average of 9.83x). We have a **BUY** rating on the stock.

Market Data	OKOMUOIL
Market Cap (N'bn)	157.4
Last close price (N)	165.00
52-week high-low price (N)	216.9/127.8
Avg 3M daily volume (N'mn)	0.08

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Income Statement	2021A	2022E	2023E	2024F	2021A	2022A	2023E	2024F
	(N'Mn)				(\$'Mn)			
Revenue	37,395	61,796	65,639	70,858	90	149	158	171
Cost of Sales	(11,766)	(14,130)	(15,097)	(16,652)	(28)	(34)	(36)	(40)
Gross Profit	25,628	47,666	50,542	54,207	62	115	122	131
OPEX	(11,061)	(18,620)	(20,488)	(22,276)	(27)	(45)	(49)	(54)
EBITDA	19,163	34,915	36,854	39,076	46	84	89	94
Depreciation	(2,805)	(5,214)	(6,048)	(6,333)	(7)	(13)	(15)	(15)
EBIT/Operating profit	16,358	29,700	30,806	32,743	39	72	74	79
Interest Expense/Income	134	862	692	328	0	2	2	1
Pre-tax earnings	16,224	28,838	30,115	32,414	39	69	73	78
Taxation	(4,576)	(8,134)	(8,494)	(9,142)	(11)	(20)	(20)	(22)
Profit after tax	11,648	20,704	21,621	23,272	28	50	52	56
Statement of Financial Position	2021A	2022E	2023E	2024F	2021A	2022A	2023E	2024F
<b>Assets</b>								
Property, Plant and Equipment	30,550	37,077	38,249	39,711	74	89	92	96
Biological assets	19,109	18,211	17,152	15,884	46	44	41	38
Inventories	4,718	5,036	5,380	5,022	11	12	13	12
Trade and Other Receivables	790	5,756	6,114	6,601	2	14	15	16
Other Assets	651	651	651	651	2	2	2	2
Cash and Bank Equivalents	9,955	7,775	14,298	22,632	24	19	34	55
<b>Total Assets</b>	<b>65,772</b>	<b>74,506</b>	<b>81,845</b>	<b>90,501</b>	<b>158</b>	<b>180</b>	<b>197</b>	<b>218</b>
<b>Liabilities</b>								
Trade and Other Payables	4,817	8,316	8,884	9,799	12	20	21	24
Borrowings	8,895	7,192	5,347	3,347	21	17	13	8
Other Liabilities	18,009	16,457	16,208	16,408	43	40	39	40
<b>Total Liabilities</b>	<b>31,720</b>	<b>31,965</b>	<b>30,440</b>	<b>29,554</b>	<b>76</b>	<b>77</b>	<b>73</b>	<b>71</b>
Share capital	477	477	477	477	1	1	1	1
Share premium	1,867	1,867	1,867	1,867	4	4	4	4
Retained earnings	31,708	40,197	49,061	58,603	76	97	118	141
<b>Shareholders' funds</b>	<b>34,052</b>	<b>42,541</b>	<b>51,405</b>	<b>60,947</b>	<b>82</b>	<b>103</b>	<b>124</b>	<b>147</b>
Total liabilities and equity	65,772	74,506	81,845	90,501	158	180	197	218
Key Ratios	2019A	2022E	2021E	2022F	2019A	2020A	2021E	2022F
<b>Profitability</b>								
Return on Average Assets	34.2%	54.1%	46.0%	41.4%	34.2%	54.1%	46.0%	41.4%
Return on Average Equity	17.7%	29.5%	27.7%	27.0%	17.7%	29.5%	27.7%	27.0%
Net Profit Margin	31.1%	33.5%	32.9%	32.8%	31.1%	33.5%	32.9%	32.8%
<b>Valuation Multiples</b>								
P/E (x)	31.4	20.2	13.5	7.6	31.4	20.2	13.5	7.6
EV/EBITDA (x)	17.4	14.1	8.2	4.5	17.4	14.1	8.2	4.5
Dividend Yield (%)	1.8%	2.4%	4.2%	4.8%	1.8%	2.4%	4.2%	4.8%

## PRESCO PLC

BLOOMBERG: PRESCO NL

## EPS to surge by 16.2%

BUY

Target Price: N180.40

Ref Price: N150.80

Upside/(Downside): +19.6%

PRESCO is on course to record its weakest EPS growth in five years in FY'22 (+4.8% YoY vs 9M'22 EPS growth of 15.3%) despite a robust revenue growth profile (FY'22E:54.3%, 9M'22: 72.9%). This weaker earnings growth reflects the impact of a 156.2% YoY surge in the average price of diesel on COGS and OPEX line items, as well as the high base of Q4'21.

However, FY'23 revenue is projected to rise by 10.2%% YoY on the impact of a 15.6% volume outturn, which should make up for moderation in CPO prices. Margins are also projected to improve due to expected temperance in energy inflation. To this point, the U.S. Energy Information Administration and OPEC have cut their energy demand outlook for 2023 on the risk of a global recession. Ceteris paribus, a weaker demand outlook should translate to a moderation in the deregulated diesel prices in 2023. On the back of this, we forecast a 1.4ppts EBIT margin expansion to 45.7% YoY in FY'23.

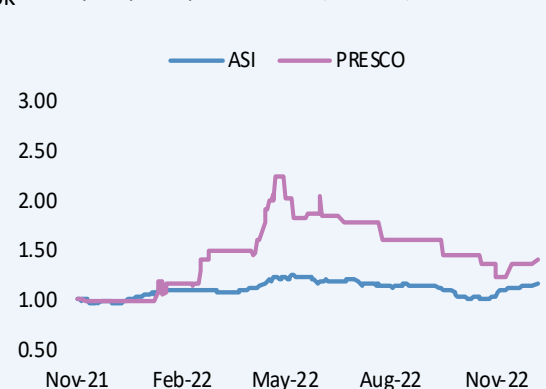
Finance costs are also likely to wane from the forecasted N6.2 billion in FY'22 due to a possible reduction in borrowings. Notably, the company revealed that it has loan maturities of N3.2 billion due for 2022, which is unlikely to be rolled over. Hence, despite higher interest rates, we foresee a 400 million naira reduction in net finance cost in the new year.

Elsewhere, the company's CFO is expected to improve by 79.7% to N23.6 billion in FY'23 due to improvements in working capital management. Specifically, 9M'22 financials revealed a c.N16.6 billion reduction in payable to a four-quarter low of N16.2 billion as the company utilised its strong cash position to settle some of its working capital debt. In 2023, we forecast a weaker payable outlay of N8.0 billion to take payables near their five-year mean. FCFE is also likely to remain robust in the current year, supported by a 6.4% growth in operating profit and this more contained working capital requirement.

Our model adjustments resulted in a new 12-month target price of N180.40 (vs N145.45 previously). The upward TP review reflects projections for cost moderation, weaker capex outlay, and working capital improvements across our forecast horizon. We, have a BUY rating on the ticker.

Market Data	PRESCO
Market Cap (N'bn)	150.80
Last close price (N)	150.80
52-week high-low price (N)	200.0/94.5
Avg 3M daily volume (N'mn)	0.38

1-year price performance (rebased)



Source: NSE; CardinalStone Research

Income Statement	2021A	2022E	2023E	2024F	2021A	2022A	2023E	2024F
	(N'Mn)				(\$'Mn)			
Revenue	47,426	72,360	79,748	87,062	114	174	192	210
Cost of Sales	(15,674)	(24,245)	(25,975)	(28,357)	(38)	(58)	(63)	(68)
<b>Gross Profit</b>	31,753	48,116	53,773	58,704	77	116	130	141
OPEX	(21,998)	(31,573)	(36,644)	(36,698)	(53)	(76)	(88)	(88)
<b>EBITDA</b>	24,614	35,114	40,224	40,300	59	85	97	97
Depreciation	(2,616)	(3,541)	(3,580)	(3,602)	(6)	(9)	(9)	(9)
<b>EBIT/Operating profit</b>	21,998	31,573	36,644	36,698	53	76	88	88
Interest Expense/Income	(2,562)	(6,257)	(5,547)	(4,754)	(6)	(15)	(13)	(11)
<b>Pre-tax earnings</b>	26,398	30,239	35,123	31,943	64	73	85	77
Taxation	(7,058)	(9,072)	(10,537)	(9,583)	(17)	(22)	(25)	(23)
<b>Profit after tax</b>	19,340	21,167	24,586	22,360	47	51	59	54
Statement of Financial Position	2021A	2022E	2023E	2024F	2021A	2022A	2023E	2024F
<b>Assets</b>								
Property, Plant and Equipment	84,568	85,527	86,094	87,003	204	206	207	210
Biological assets	15,236	21,525	23,518	25,712	37	52	57	62
Inventories	4,196	5,990	12,245	13,994	10	14	30	34
Trade and Other Receivables	10,081	14,869	16,387	17,889	24	36	39	43
Other Assets	4,160	4,160	4,160	4,160	10	10	10	10
Cash and Bank Equivalents	22,365	23,756	27,884	24,979	54	57	67	60
<b>Total Assets</b>	140,606	155,826	170,287	173,737	339	375	410	419
<b>Liabilities</b>								
Trade and Other Payables	32,841	22,720	21,361	23,320	79	55	51	56
Borrowings	56,714	63,689	58,817	43,544	137	153	142	105
Other Liabilities	21,270	26,458	30,552	32,945	51	64	74	79
<b>Total Liabilities</b>	110,825	112,867	110,730	99,809	267	272	267	241
<b>Shareholders' funds</b>								
Share capital	500	500	500	500	1	1	1	1
Share premium	1,174	1,174	1,174	1,174	3	3	3	3
Retained earnings	45,843	59,021	75,618	89,990	110	142	182	217
<b>Shareholders' funds</b>	29,781	42,960	59,557	73,928	114	146	186	221
Total liabilities and equity	140,606	155,826	170,287	173,737	382	418	453	461
Key Ratios	2019A	2022E	2021E	2022F	2019A	2020A	2021E	2022F
<b>Profitability</b>								
Return on Average Assets	64.9%	49.3%	41.3%	30.2%	64.9%	49.3%	41.3%	30.2%
Return on Average Equity	13.8%	13.6%	14.4%	12.9%	13.8%	13.6%	14.4%	12.9%
Net Profit Margin	40.8%	29.3%	30.8%	25.7%	40.8%	29.3%	30.8%	25.7%
<b>Valuation Multiples</b>								
P/E (x)	28.7	7.8	7.1	6.1	28.7	7.8	7.1	6.1
EV/EBITDA (x)	16.6	7.7	5.4	4.7	16.6	7.7	5.4	4.7
Dividend Yield (%)	1.3%	5.0%	5.3%	5.3%	1.3%	5.0%	5.3%	5.3%

## Disclosure

### Analyst Certification

The research analyst(s) denoted by an “\*” on the cover of this report certifies (or, where multiple research analysts are primarily responsible for this report, the research analysts denoted by an “\*” on the cover or within the document individually certifies, with respect to each security or issuer that the research analyst(s) cover in this research) that: (1) all of the views expressed in this report accurately articulate the research analyst(s) independent views/opinions, based on public information regarding the companies, securities, industries or markets discussed in this report. (2) The research analyst(s) compensation or remuneration is in no way connected (either directly or indirectly) to the specific recommendations, estimates or opinions expressed in this report.

**Analysts’ Compensation:** The research analyst(s) responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues from, among other business units, Investment Banking and Asset Management.

### Investment Ratings

CardinalStone employs a 3-step rating system for equities under coverage: Buy, Hold, and Sell.

**Buy** ≥ +15.00% expected share price performance

**Hold** +0.00% to +14.99% expected share price performance

**Sell** < 0.00% expected share price performance

A **BUY** rating is given to equities with strong fundamentals, which have the potential to rise by at least +15.00% between the current price and the analyst’s target price

An **HOLD** rating is given to equities with good fundamentals, which have upside potential within a range of +0.00% and +14.99%,

A **SELL** rating is given to equities that are highly overvalued or with weak fundamentals, where potential returns of less than 0.00% is expected, between the current price and analyst’s target price.

A **NEGATIVE WATCH** is given to equities whose fundamentals may deteriorate significantly over the next six (6) months, in our view.

### CardinalStone Research distribution of ratings/Investment banking relationships as of January 18, 2023

Rating	Buy	Sell	Hold	Negative Watch
% of total recommendations	52%	19%	29%	0%
% with investment banking relationships	0%	0%	0%	0%

**Valuation and Risks:** Please see the most recent company-specific research report for an analysis of valuation methodology and risks on any security recommended herein. You can contact the analyst named on the front of this note for further details.

**Frequency of Next Update:** An update of our view on the company (ies) would be provided when next there are substantial developments/ financial news on the company.

**Conflict of Interest:** It is the policy of CardinalStone Partners Limited and its subsidiaries and affiliates (individually and collectively referred to as “CardinalStone”) that research analysts may not be involved in activities that suggest that they are representing the interests of Cardinal Stone in a way likely to appear to be inconsistent with providing independent investment research. In addition, research analysts’ reporting lines are structured to avoid any conflict of interests. For example, research analysts are not subject to the supervision or control of anyone in CardinalStone’s Investment Banking or Sales and Trading departments.

However, such sales and trading departments may trade, as principal, based on the research analyst’s published research. Therefore, the proprietary interests of those Sales and Trading departments may conflict with your interests.

**Company Disclosure:**

CardinalStone may have financial or beneficial interest in securities or related investments discussed in this report, which could, unintentionally, affect the objectivity of this report. Material interests, which CardinalStone has with companies or in securities discussed in this report, are disclosed hereunder:

Company	Disclosure
OKOMU OIL PALM PLC	M
PRESCO PLC	D,G,M

- a. The analyst holds personal positions (directly or indirectly) in a class of the common equity securities of the company
- b. The analyst responsible for this report as indicated on the front page is a board member, officer or director of the Company
- c. CardinalStone is a market maker in the publicly traded equities of the Company
- d. CardinalStone has been lead arranger or co-lead arranger over the past 12 months of any publicly disclosed offer of securities of the Company
- e. CardinalStone beneficially own 1% or more of the equity securities of the Company
- f. CardinalStone holds a major interest in the debt of the Company
- g. CardinalStone has received compensation for investment banking activities from the Company within the last 12 months
- h. CardinalStone intends to seek, or anticipates to receive compensation for investment banking services from the Company in the next 3 months
- i. The content of this research report has been communicated with the Company, following which this research report has been materially amended before its distribution
- j. The Company is a client of CardinalStone
- k. The Company owns more than 5% of the issued share capital of CardinalStone
- l. CardinalStone has other financial or other material interest in the Company
- m. Shareholder and/or bond register(s) managed by CardinalStone Registrars Limited

**Important Regional Disclosures**

The analyst(s) involved in the preparation of this report may not have visited the material operations of the subject Company (ies) within the past 12 months. To the extent this is a report authored in whole or in part by a Non-U.S. analyst and is made available in the U.S., the following are important disclosures regarding any Non-U.S. analyst contributors: The Non-U.S. research analysts (denoted by an \* in the report) are not registered/qualified as research analysts with FINRA; and therefore, may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account. Each analyst (denoted by an \*) is a Non-U.S. Analyst and is currently employed by Cardinal Stone.

**Legal Entities**

Legal entity disclosures: CardinalStone Partners is authorized and regulated by the Securities and Exchange Commission (SEC) to conduct investment business in Nigeria.