Fan Milk Plc 9M2022 Results

Current rating **UNDER REVIEW**

Ghana | 28 October 2022

Losses increase on rising input cost

Fan Milk Plc ("FML") released its unaudited 9M2022 financial results yesterday and in line with our expectations, posted a 23.7% y/y increase in loss to GHS 16.8m. Management attributed the company's loss largely to the rising input costs and increased finance charges. The increase in input costs stems from rising global commodity prices – particularly skimmed milk and cocoa powder, the soaring inflationary pressures and the continuous depreciation of the Cedi. In spite of the above, we are impressed that FML's strategy of growing its outdoor business and expanding its indoor distribution channel is paying off, as revenue has increased by double digits in each of the first three quarters of the year.

Performance: Higher input costs increase losses

- FML reported a net loss of GHS 16.8m in 9M2022 as against a loss of GHS 13.6m in 9M2021
- Management attributed the higher loss to higher input costs caused by the rising commodity prices, soaring inflation and the depreciation of the Cedi
- Input costs increased by 19.7% y/y to GHS 279.2m, mainly driven by a rise in the price of FML's key input materials such as skimmed milk powder (+35.1% y/y) and cocoa powder (+24.3% y/y) on the global market
- The rise in input costs was also supported by a 37.5% and 27.5% ytd depreciation of the Cedi against the US Dollar and Euro, respectively, in 9M2022. According to management, the company suffered a net exchange loss of GHS 19.0m due to the steep depreciation of the local currency against the USD and the EURO in 9M2022
- Inflation also soared from 10.6% in September 2021 to 37.2% in September 2022
- As a result of these macroeconomic pressures, cost of sales outpaced revenue by 8.1pps causing gross margin to fall by 4.9pps y/y to 26.9% in 9M2022
- Revenue increased by 11.6% y/y to GHS 382.2m, mainly driven by the upward price adjustments implemented in 9M2022 and improved trade networks
- FML controlled its OPEX in 9M2022 with a 7.4% y/y reduction to GHS 116.2m. This was influenced by a 31.6% y/y decrease in administrative expenses to GHS 24.5m
- On the back of OPEX containment, operating margin improved by 1.2pps, from -4.0% in 9M2021 to -2.7% in 9M2022
- FML's EBITDA margins also improved from 3.0% in 9M2021 to 3.5% in 9M2022
- Finance cost, however, soared over sevenfold (+755.5% y/y) to GHS 14.7m in 9M2022
- Resultantly, net loss margin increased from -4.0% in 9M2021 to -4.4% in 9M2022

Outlook: Cost of sales to remain elevated

- We expect cost of sales to remain elevated in the short-to-medium term due to the rising commodity and fuel prices, as well as the Cedi's continuous depreciation. As a result, we anticipate further margin compression in the coming quarters
- We also opine that, given the upside risks to consumer inflation, FML's sales volume outturn will be impacted in the near term as consumers' purse strings will remain tight, skewing a large portion of their purchases to necessities
- However, we anticipate that FML's launch of the "FANICE Y33KOR DUBAI PROMO" sales promotion as well as its growing social media presence will help drive sales in the short-term
- Moreover, we expect the upcoming festive season to influence FML's sales outturn positively in 4Q2022
- Furthermore, we are optimistic that FML will keep a tight lid on OPEX in the short-to-medium term, improving its operating margin. That notwithstanding, we do not foresee FML reporting profits for the FY2022 financial period

Valuation: Under Review

- We are in the process of re-initiating coverage on FML and have therefore placed our recommendation under review
- FML is trading at an EV/EBITDA of 30.5x and EV/SALES of 1.0x

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