Fan Milk Plc 1Q2023 Results

Current rating **UNDER REVIEW**

Ghana | 28 April 2023

Profitable but Doubtful: Balancing Scepticism and Benefit of the Doubt

Fan Milk Plc ("FML") released its unaudited 1Q2023 financial results yesterday. Contrary to our expectations, the ice cream manufacturer posted a net profit outturn of GHS 4.9mn, reflecting a sixfold improvement over the previous comparable year's loss of GHS 1.0mn. From our analysis, FML's profit outturn was largely driven by robust double-digit revenue growth and effective management of operating costs. Although macroeconomic headwinds drove up FML's costs of sales and constrained gross margin growth, operating margin and net profit margin expanded on account of the reduced operating costs.

Performance: Profits linger on strong growth in revenue and effective operating costs management

- FML's earnings increased sixfold, from a loss of GHS 1.0mn in 1Q2022 to a profit of GHS 4.9mn 1Q2023
- We attribute earnings growth to a strong double-digit increase in revenue and effective operating cost management strategies
- Revenue increased by 22.2% y/y to GHS 166.8mn. In our view, FML's revenue growth was largely driven by upward price adjustments, ranging between 15.0% and 20.0% across pouches, new year festivities, and improved trade networks
- FML's cost of sales increased by 26.4% y/y to GHS 119.8mn on the back of the high average inflation rate of 50.5% in 1Q2023 and the 22.1%* depreciation of the Ghanaian Cedi against the US Dollar during the same period
- With cost of sales outpacing revenue growth by 4.2pps, gross margin fell by 2.4pps y/y to 28.2%
- However, operating margin improved by 3.9pps to 4.0%, on account of a reduction in operating expenses
- FML implemented stringent operating cost controls, which saw operating expenses reduce by 3.0% y/y to GHS 41.1mn
- This decrease was mainly due to a 4.3% y/y reduction in distribution costs to GHS 23.4mn and a 3.5% y/y marginal increase in administrative expenses to GHS 10.0mn
- Resultantly, net profit margin increased from -0.7% in 1Q2022 to 2.9% in 1Q2023

Outlook: Balancing scepticism and benefit of the doubt

- In our previous publication, we indicated that we did not expect FML to post profits in FY2023. We revise this expectation as we are now cautiously optimistic that FML can post profits in FY2023, albeit marginal
- Our revised view is based on the observation that while the adverse factors that drove FML into the red continue to linger, we foresee slight moderations in these factors in FY2023
- For instance, we continue to expect cost of sales to be elevated in the short term due to rising input material costs, elevated inflation, higher utility costs, and local currency weakness
- However, with inflation trickling downwards and the Cedi's appreciation towards the end of 1Q2023 into early April 2023, we expect cost of sales to be slightly tamed in the coming quarters
- On the OPEX front, however, we remain optimistic that FML will keep a tight lid on its operating expenses
- On our revenue outlook, we anticipate that FML's approach of prioritizing outdoor growth recovery, enhancing the indoor channel, expanding the Ice Cream brand, and promoting export business will contribute to a reasonable increase in revenue over the course of the year
- However, we do not foresee high 20.0% revenue growth resulting from the upward price adjustments as consumer purse strings continue to tighten, with a potential drag on sales volume
- The above notwithstanding, we expect FML to aggressively pursue the necessary marketing initiatives to help drive sales volume

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 a P/E of 25.3x and EV/EBITDA of 9.5x

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