Fan Milk Plc 1Q2024 Results

Current rating **UNDER REVIEW**

Ghana | 03 May 2024

FML scoops up profit amidst topline woes

Fan Milk Plc ("FML") released its unaudited 1Q2024 financial results on 29 April 2024, reporting an impressive profit outturn as expected. The large ice cream producer churned out a net profit of GHS 6.0mn, a 23.7% y/y improvement, despite the disappointing performance in topline. The profit outturn was as a result of a 10.8% y/y decline in input cost to GHS 106.9mn, a 37.4% y/y surge in finance income to GHS 12.3mn and a 28.6% y/y drop in finance cost to GHS 6.6mn. Management attributes the decline in revenue for 1Q2024 to a substantial drop in export sales. However, the improved gross margin was attributed to a better product mix and significant work on productivity initiatives on cost of sales.

1Q2024 Performance: Surge in finance income, decline in finance cost and cost of sale propel bottom-line growth

- FML reported a 23.7% y/y increase in net profit to GHS 6.0mn in 1Q2024
- Revenue unexpectedly declined by 7.3% y/y in 1Q2024 to GHS 154.6mn. Management attributes the decline in revenue to a drop in export sales for 1Q2024
- Input costs significantly reduced by 10.8% y/y to GHS 106.9mn, driven by a fall in the price of FML's key input material such as skimmed milk powder (-4.6% y/y) coupled with management's indication of better product mix and productivity initiatives on cost of sales.
- Furthermore, FML effectively controlled OPEX, capping its rise at 12.6% y/y to GHS 46.3mn. We believe the sharp moderation in price pressures partly helped to cap the rise in OPEX as inflation fell to an average of 24.2% in 1Q2024 (vs 50.5% in 1Q2023)
- Depreciation and amortization declined by 15.8% y/y to GHS 6.4mn while sales and distribution cost was well contained, increasing by 12.1% y/y to GHS 26.3mn. However, administrative expense surged by 35.4% y/y to GHS 13.6mn, broadly reflecting the inflationary environment in the review period. In our view, the rise in administrative expense was partly underpinned by higher utility tariffs in 1Q2024 compared to 1Q2023.
- In spite of the controlled OPEX, FML's operating margin dropped by 2.3pp to 1.7% in 1Q2024 as a result of the decline in revenue
- Gross margin improved by 2.7pp to 30.9%, supported by better product mix and productivity initiatives on cost of sales
- Finance cost impressively declined by 28.6% y/y to GHS 6.6mn while finance income surged by 37.4% y/y to GHS 12.3mn in 1Q2024. These favourable movements in finance flows further mitigated the decline in topline and provided additional tailwind to profit growth
- Resultantly, net profit margin slightly increased by 1.0pp to 3.9% in 1Q2024

Outlook: We stay cautious amid revenue decline and potential downside risk to FY2024 earnings

- In our FY2023 report, we anticipated a resurgence in revenue growth for 1Q2024, considering the resolution of setbacks faced with FANYOGO quality issues in 3Q2023, which had an adverse impact on revenue in 4Q2023. However, the notable decline in export sales during 1Q2024 has dampened the revenue outlook, in our view, as domestic consumer demand remains weakened by the protracted inflationary pressures. We note that FML's export segment continues to be a major contributor to its revenue streams and a prolonged disruption to this segment will hurt topline growth in FY2024.
- On a positive note, FML was able to improve gross margin due to better product mix and productivity initiatives such as the use of biomass energy. In our view, this initiative is timely and will be crucial for productivity and margin expansion, given the prevailing erratic power supply and upside risk to electricity tariff.
- We expect management to continue to keep a tight lid on OPEX to improve margins. We also expect input cost to remain under control in the near-term as price of skimmed milk powder continues to decline
- On sales and distribution, we expect FML to keep expanding its agent base and footprint in the indoor and outdoor channels, as well as deploy solutions to revive growth in export sales, with positive impact on topline growth
- Overall, we are cautious about the near-term prospect on account of the drop in revenue, occasioned by the unexpected decline in export sales. Management did not disclose the cause of the lower export sales in 1Q2024 and we are unable to confirm whether this is a one-off event or a market access issue. We view a sustained decline in export sales as a major downside risk to topline performance and earnings growth as this is one of the four strategic pillars for FML's revenue growth.

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 TTM PE of 13.04x and EV/SALES of 2.08x

Analyst:
Emmanuel Dadzoe: +233 30 825 0051
For further information, please contact our Research Team. T: 233 308-250051l +233 302-252517 Email: research@icsecurities.com