Fan Milk Plc 1H2024 Results

Current rating **UNDER REVIEW**

Ghana | 30 July 2024

Rake in the dough

Fan Milk Plc ("FML") released its unaudited 1H2024 financial results yesterday, reporting an impressive profit outturn which significantly surpassed our expectations. The large ice cream producer churned out a net profit of GHS 23.9mn, a 51.7% y/y improvement, despite the slow growth in topline. The profit outturn was mainly as a result of a 2.0% y/y decline in input cost to GHS 200.8mn, a 17.1% y/y rise in other income to GHS 1.9mn, and a 37.9% y/y plunge in finance cost to GHS 9.4mn. We observed a slower-than-expected growth of 4.3% y/y in topline to GHS 318.6mn. Management attributes the slow growth in revenue for 1H2024 to the drop in export sales in 1Q2024. However, the improved operating margin was attributed to a better product mix and significant work on productivity initiatives such as the use of biomass energy. Overall, we are impressed by the significant surge in earnings. However, we remain cautious about the near-term prospect. In our view, the primary drivers for the 1H2024 earnings growth are not sustainable in the short to medium term. While the current results are commendable, we do not expect these contributing factors to provide the same level of support in subsequent quarters.

1H2024 Performance: A plunge in finance cost, decline in input cost and increase in other income propel bottom-line growth

- FML reported an impressive 51.7% y/y surge in net profit to GHS 318.6mn in 1H2024, mainly as a result of a 2.0% y/y decline in input cost to GHS 200.8mn, a 17.1% y/y rise in other income to GHS 1.9mn, and a 37.9%y/y plunge in finance cost to GHS 9.4mn.
- Revenue increased by 4.3% y/y in 1H2024 to GHS 318.6mn. Management attributes the slow growth in revenue for 1H2024 to the drop in export sales in 1Q2024.
- Input costs reduced by 2.0% y/y to GHS 200.8mn, driven by a fall in the price of FML's key input material such as skimmed milk powder (-3.4% y/y).
- However, we observed a 136.8% y/y surge in the price of cocoa futures, together with 18.6% and 16.0% YTD depreciation of the Cedi against the US Dollar and the Euro, respectively, in 1H2024.
- Furthermore, FML effectively controlled OPEX, capping its rise at 11.3% y/y to GHS 91.3mn. We believe the sharp moderation in price pressures partly helped to cap the rise in OPEX as inflation fell to 22.8% in 1H2024 (vs 42.5% in 1H2023).
- Depreciation and amortization declined by 12.4% y/y to GHS 13.6mn while sales and distribution cost was well contained, increasing by 10.7% y/y to GHS 52.2mn. However, administrative expense surged by 31.9% y/y to GHS 25.5mn, broadly reflecting the inflationary environment in the review period. In our view, the rise in administrative expense was partly underpinned by higher energy prices and transport fares in 1H2024 compared to 1H2023.
- As a result of the controlled OPEX, FML's operating margin increased by 2.3pp to 8.9% in 1H2024. Management attributed the improvement in operating margin to better product mix and significant work on productivity initiatives such as the use of biomass energy
- Resultantly, operating profit surged by 40.9% y/y to GHS 28.5mn
- Gross margin improved by 4.1pp to 37.0%
- Finance cost impressively declined by 37.9% y/y to GHS 9.4mn while finance income plunged by 23.6% y/y to GHS 13.9mn in 1H2024.
- Resultantly, net profit margin increased by 2.4pp to 7.5% in 1H2024

Outlook: We stay cautious amid slow revenue growth and potential upside risk on cost

- In 3Q2023, the FANYOGO quality issues hampered topline growth in FY2023. In 1Q2024 a decline in export sales had an adverse impact on revenue. We note that, this has continued into 1H2024. Given these challenges, we remain cautious about the near-term revenue outlook. Domestic consumer demand continues to be weakened by prolonged inflationary pressures, which further complicates the revenue growth prospects.
- We flag the recent utility tariff hike in July 2024 and higher energy prices as potential upside risks to operating cost.
- On a positive note, FML continues to benefit from the use of biomass energy and better product mix which helped to improve operating margin. We believe this initiative is both timely and strategically significant, particularly in the context of the current erratic power supply and the upside risk for increased electricity tariffs.
- 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 remains subdued
- 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 impressed by the significant surge in earnings. However, we remain cautious about the near-term prospect. In our view, the primary drivers for the 1H2024 earnings growth are not sustainable in the short to medium term. While the current results are commendable, we do not expect these contributing factors to provide the same level of support in subsequent quarters.

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 P/E of 12.04x and EV/SALES of 1.16x

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