Stock Market Review

Record interim performance by Farsons Group in first half

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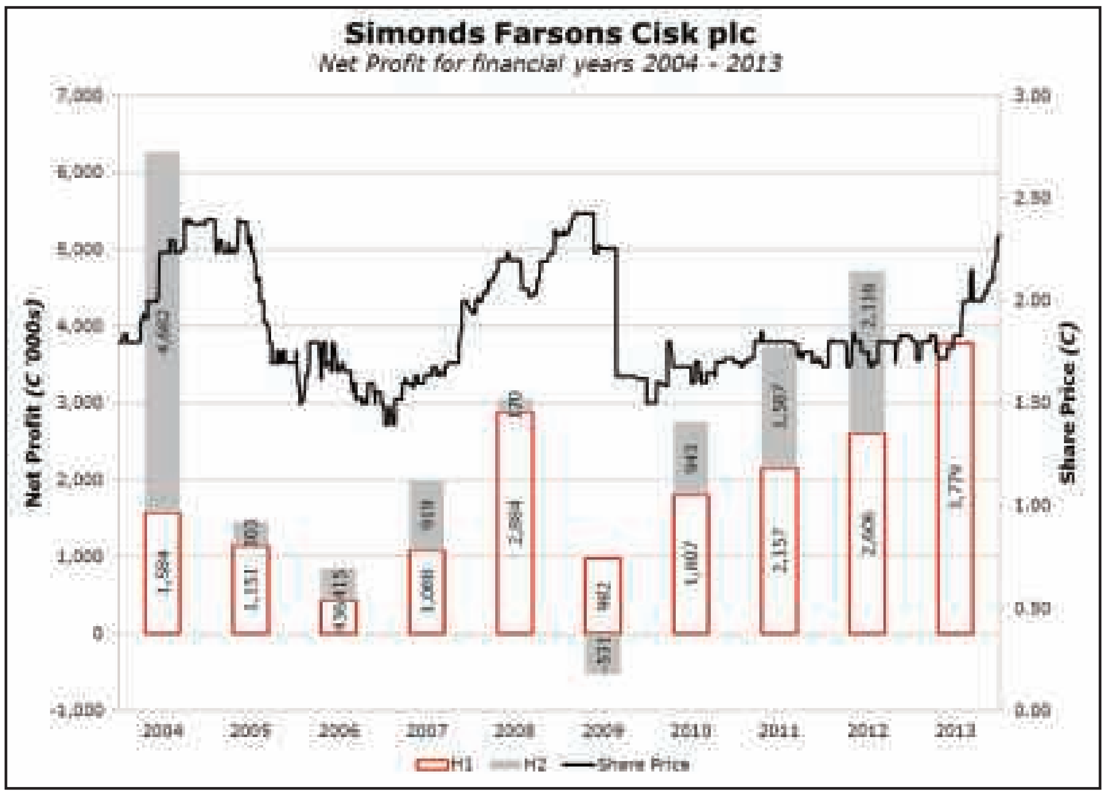

The July 2012 interim financial statements that were published by Simonds Farsons Cisk plc on September 26 reveal a record performance with revenue rising by 9.7 per cent to €39.6 million and profit after tax up 45 per cent to €3.8 million.

The segment results included in the recent company announcement indicate some interesting highlights of the group performance during the first half of their current financial year. The directors attributed the growth in revenue to a strong performance of Cisk and Kinnie as well as increased volumes from the beverage importation arm. Higher revenue was also generated from the operation of the food establishments notwithstanding the leasing out of one of the restaurants from January 1. Undoubtedly, the significant increase in tourist arrivals to record levels this year as well as the exceptionally hot weather conditions in June and July contributed to the higher sales of beverages in the first half of the year.

The more interesting aspect of the segmental information is the profit from each of the group's main business areas. It was indeed surprising that the €1 million growth in revenue from the main business area (brewing, production and sale of branded beers and beverages) all filtered down to an improved profitability. This reflects the strong contribution of the company-owned brands (Cisk and Kinnie) to the overall group results as these generate significantly higher margins than the beverage importation arm.

Cisk and Kinnie provide a competitive edge to Farsons over other local beverage and importation companies, and this is evident from the latest interim results. The success of Cisk and Kinnie over the years has been remarkable. The popular innovative product lines launched in recent years of these two brands (such as Kinnie Zest, Cisk Excel and Cisk Chill) have helped improve the group's market share in these areas, and this has become evident from the recent overall performance. Cisk and Kinnie can be regarded as key strategic assets for the group, and the importance of these brands may have gone unnoticed over the years by financial analysts and general public investors.

Product innovation across the company-owned brands and the strong focus on increased export volumes remain among the cornerstones of the group's business model to achieve further profitable growth. The export sector was possibly one of the few disappointing items in the latest interim financial statements. From a discussion with the group's management team, it transpires that export volumes were weaker than expected in Q1 (February to April) but picked up since then. One must not overlook the challenging global economic conditions which may have affected the export perform-ance in recent months.

The group's success in the export markets and the ability to launch innovative variations of the traditional company-owned brands are heavily dependent on the quality of the product and the overall production capacity of the manufacturing plant. The Farsons Group has undertaken significant investments in recent years, culminating in the new brewhouse which was officially inaugurated last month.

The foresight and vision of the Farsons board and executive management team must be commended in identifying the group's requirements many years ago, also taking into consideration the expected changes to the overall landscape brought about by the complete liberalisation of the soft drinks sector from 2008. The investments in the soft drinks hall, the logistics centre and the newly inaugurated brewhouse enhanced the group's competitiveness and also provided additional flexibility to cater for the expected increase in production volumes without incurring any major additional administrative costs.

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The latest set of interim results must also be placed in the context of the group's performance in recent years. The half-year net profit of €3.8 million marked as a red column in this graph shows that this level is well beyond the profits achieved in the last 10 interim periods. The graph provides a comparison of the profitability during the first half of the group's financial year (February to July) and the second half (August to January), as well as the share price performance over the same period.

It is interesting to note that the price of Farsons' shares had only surpassed the €2.25 level on two occasions – in 2004/5 and in 2008. However, it is worth highlighting that both these peaks in the share price coincided with strong results, but these had been boosted by significant one-off transactions. In 2004 Farsons benefited from a tax credit of €3.5 million and in 2008, the overall profit of €3.05 million included €1.1 million generated from the sale of investment property. As such, it is important for investors to understand that this year's interim record profitability of €3.8 million is purely from the core operational perform-ance without any one-off items.

Meanwhile, the group retains an investment property portfolio which was valued at circa €45 million on the latest balance sheet. While this is in large part made up of the sizeable Mriehel frontage which has now been almost entirely released and therefore available for future development, investors correctly focus on the performance of the group from the core operations. As such, the market may not be assigning a value to the property asset because it is currently not generating any form of rental income.

This would justify the consideration of splitting up the group into two separate publicly-traded companies on the Malta Stock Exchange – one owning the operational businesses and the other company solely retaining the investment property portfolio.

The current group structure with the investment property already on the books of a stand-alone company (Trident Properties) also caters for such a possibility. This segregation was advocated by the board some years ago and the market would be pleased to see some further progress in this respect in the near future, once the necessary plans are duly considered by the Farsons' board.

The added focus on product innovation and exports coupled with management's efforts for cost reduction is very evident from the results achieved over the past three-and-a-half years.

In its earlier years the Farsons Group was generally regarded as a company producing erratic performances from one year to the next. Such an inconsistent performance is generally not well received by the market at large. However, since the initial problems with the new soft drinks hall and logistics centre were dealt with in 2009, the results speak for themselves.

The management team has succeeded in revealing the true earnings capability of the group from its core operations. Barring any unforeseen circumstances over the next three months, the current financial year (ending January 31, 2013) should produce a very strong set of results on the back of the record first half of the year.

This will be a further signal to the market that the young, dynamic management team led by an experienced board has the right credentials to lead the group to more success in the future despite the ever-increasing competition in the market, locally and internationally.

Following such a strong start to the current financial year, one would have expected the board to have declared a higher interim dividend to shareholders. This would have also sent a clear message to the market on the board's intentions to reward shareholders accordingly by providing adequate returns in the form of cash dividends.

However, shareholders should be pleased that the strong operational performance is being reflected in the share price as this has climbed to a level of €2.32, which is only 4.4 per cent below the previous adjusted all-time high of €2.427 in July 2008.

In anticipation of the confirmation of a good financial performance also in the second half of the year and an expected hike in the final dividend, it may not be too long before the market rewards shareholders further.