Stock Market Review

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Farsons looks ahead after very difficult year

The Farsons Group recently published its Annual Report covering the financial year to January 31, 2009. The beverage and food conglomerate reported a pre-tax profit of only €0.9 million, a significant drop compared to the €4.1 million profit generated in the previous 12-month period. During its annual review meeting for stockbrokers, CEO Louis Farrugia immediately acknowledged that the past year produced an "unsatisfactory performance". However, Mr Farrugia is confident that the Group is "well positioned to handle the challenges ahead".

The chief executive officer explained that the financial year to January 31, 2009 was characterised by a number of factors some of which were due to internal productivity problems and write-offs on discontinued materials and products following the change in packaging formats from returnable bottles to one-way PET packages. Moreover, Farsons also suffered from a number of external factors in the form of higher raw material costs, a sudden substantial increase in water and electricity rates as well as the onset of new international retail discount stores hitting the local market offering strong competition mainly in the soft drinks sector.

While during the first half of the year to July 2008, Farsons reported a 4.6 per cent increase in turnover attributed to the strong performance of the tourist market in early 2008 as well as the increased consumption surrounding the general elections in March 2008, this growth was reduced to just 1.1 per cent during the entire financial year.

In addition to the factors mentioned above, the January 2009 financial year was also impacted by a lower profit on sale of property and fair value gains (€0.5 million vs €1.3 million in the previous year) as well as higher interest payments despite a slight reduction in borrowings and a significant decline in interest rates. This was as a result of interest payments on the new project now showing up in the income statement rather than being capitalised as was happening in the previous years to January 2008.

The segmental information contained in the Annual Report reveals that the main reason for the group's profitability decline came from the main source of revenue, namely the "brewing, production and sale of branded beer and beverages". Mr Farrugia was quick to point out that this was solely due to the soft drinks sector as Farsons continued to perform positively in the beer market. In the soft drinks sector, Farsons suffered as a result of the significant influx of imported beverages at very low prices.

The chief executive officer, also argued that a number of beverage importers achieved such low selling prices due to their evasion of some fiscal dues. Meanwhile, it is positive to note the continued strong performance of Quintano Foods Ltd, which proved to be an important acquisition for Farsons in 2004. Furthermore, the food franchising segment composed of Burger King, KFC and Pizza Hut also reported an encouraging increase in profitability with Mr Farrugia claiming that all outlets registered growth.

Within the same sector, Farsons finally decided to terminate the TGIF franchise after several disappointing years and the chief executive announced that the premises previously housing this franchise is being leased out to a pub operator for more than 7.5 years. Within the food franchising sector, further outlets are being opened with Mr Farrugia claiming encouraging results from the recent Burger King outlet at Malta International Airport. This is being followed by a KFC outlet as part of the food court within the air terminal.

Shareholders should be reassured that the initial productivity problems on the new packaging and production lines have been restored and production targets are being achieved. Moreover, a number of raw materials have been contracted at substantially lower prices. The Farsons directors, however, revealed in the Annual Report that the removal of a sugar subsidy and the new electricity tariffs for a full 12-month period will erode most of these gains. In view of the significant changes in the industry, Farsons has embarked on a permanent cost reduction programme.

Following the decrease in headcount by circa 100 in the past two years, the chief executive argued that the company is placing a strong focus on further reductions in the number of staff through early retirement schemes and non-replacement of staff leaving through natural attrition. Moreover, the company is continually seeking ways of reducing overheads to counteract the higher utility rates being imposed on the industry.

On the property front, following last year's revaluation exercise which saw a €55 million uplift to the property portfolio, Farsons has commenced working on a plan to develop two of its main sites, the ex-Wands site in Marsa and the brewery façade in Mrieħel. In respect of the latter development, Farsons must first relocate the brewhouse from the front part of the property onto an area on the back of the large parcel of land beside the logistics centre. The plans for the construction of the new brewhouse are expected to be submitted to the Malta Environment and Planning Authority shortly and works should commence within the next 12 months.

Mr Farrugia explained that in view of this, the redevelopment of the two large sites cannot commence before three years time. Meanwhile, the operation of Quintano foods has been relocated from Qormi to the ex-Wands site in Marsa pending this development which will also enable Farsons to dispose of the site previously occupied by Quintano.

Mr Farrugia also made reference to developments within the local financial market and in particular the strong appetite for bonds. The chief executive explained that the board is examining all options in the light of the company's financial requirements for the new brewhouse as well as the possibility of redeeming the existing bond issue amounting to €9.3 million in November 2010.

Given the group's recent volatile financial performances, the company's shareholders are likely to closely follow developments taking place during the current financial year to monitor whether the difficulties encountered in recent months are sufficiently managed to restore Farsons' profitability to more meaningful levels. Shareholders will also be mindful of the current economic climate and lower tourism numbers which will be negatively impacting the Farsons Group.

> **The (TGIF) premises previously housing this franchise is being leased out to a pub operator for more than 7.5 years.**