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June-26-2024

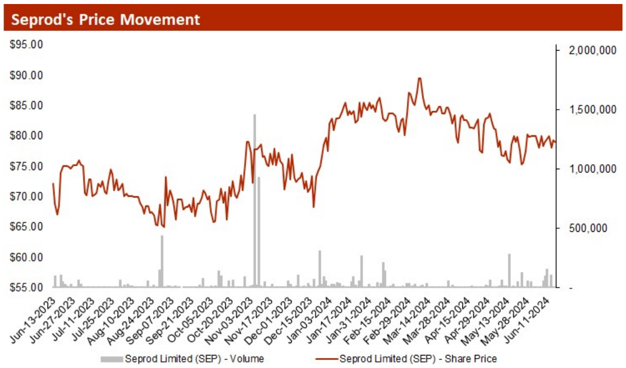
JMMB INVESTMENT & SOVEREIGN RESEARCH

Seprod Limited (SEP)

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

EXECUTIVE SUMMARY

Seprod Limited (SEP) is a leading Jamaican manufacturing, agribusiness and distribution company. The Company maintains large positions in the Jamaican market for several products including edible oils and fats, milk and sweetened condensed milk. In addition, it owns many consumer brands such as Betty, Butterkist, Chef, Chiffon, Cool Fruit, Gold Seal, Golden Grove, Lider, Miracle, Serge, Supligen and Swizzle. Seprod was found in 1944 and was listed on the Jamaica Stock Exchange in 1985.



Over the past four (4) years, SEP has grown revenues by a Compound Annual Growth Rate (CAGR) of 36.1%, while growing total net income by a CAGR of 47.2%. Over the 12-month period ended December 2023, SEP has grown revenues to $112.15B, a 43.0% increase over the 2022YE revenues of $78.43B. SEP has also grown total net income to $4.56B for the 2023FY. More recent, Seprod reported a decrease in total net profits to $1.20B for the three-month period ended March 2024, compared to net profits of $1.36B for the corresponding three-month period in 2023.

SEP's Statistics		
Financial Year End		December
Stock Price (17/06/2023)	$	78.95
Trailing EPS	$	3.89
Book Value per share	$	54.99
Trailing P/E		20.30x
P/B		1.44x
Net Profit FY2023 (millions)	$	4,564
Price Target	$	89.42
Dividend Yield		2.6%

We have placed a **MARKETPERFORM/HOLD** recommendation on the shares of SEP, as we believe the stock is trading within its fair value. Over the past few years, Seprod has made several moves, which have begun to bear fruit and has taken the decision to discontinue its failed venture in sugar manufacturing, which generated billions in losses over the years. The entity is susceptible to adverse economic conditions, this includes rising inflation driven by higher global commodity and freight costs. Nevertheless, SEP's future earnings should improve, on the basis that strategies continue to be implement by management to expand and diversify distribution reach to improve revenue, contain cost and improve profitability margins.

Company Background

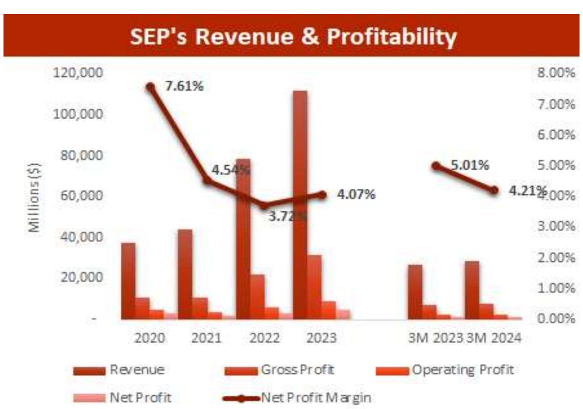
Seprod Limited was incorporated in Jamaica in July 1940 and became a publicly-listed company in 1985. Seprod now operates with three business lines: Ingredients, Dairy and Distribution. The Ingredients division consists of Seprod's joint venture with Seaboard Corporation, Jamaica Grain and Cereals Limited, which commenced flour production in December 2017. The operation also produces cornmeal and grits in bulk as well as consumer-size packages. In 2019, the company divested its sugar manufacturing operation after racking up significant losses over the years after acknowledging the sectors significant structural inefficiencies.

The Dairy line has been expanded with the integration of the dairy operation formerly owned and operated by the Nestle Group. The operation includes the physical assets based in Bog Walk, St. Catherine and the "Betty" and "Supligen" brands. The acquisition of Facey Consumer forms the foundation of the Distribution arm of Seprod.

Seprod acquired A.S. Bryden & Sons Holdings ("A.S. Bryden") in 2022, a 100 year-old Trinidad & Tobago company. A.S. Bryden distributes food, pharmaceuticals, hardware, houseware and industrial equipment.

Financial Overview

Profitability



Seprod's revenues experienced a compounded annual growth rate (CAGR) of 36.1% from FY2019 to FY2023, with total revenues of \$112.15B for FY2023. This represents a 43.0% increase or \$33.7B rise from the previous year, driven by the ongoing growth post the AS Bryden & Sons Holdings (ASBH) acquisition in June 2022 and a 45% increase in export sales. For the first quarter of FY2024, Seprod reported revenues of $28.59B, marking a 5.6% year-over-year increase. This growth was primarily driven by the normalization of margarine production following a substantial plant upgrade and strong demand for juice and dairy beverages, which exceeded existing capacity. Export sales also grew by 27.0% in Q1 2024 compared to Q1 2023. However, revenue growth was tempered by a decline in premium beverage revenues from ASBH due to a shorter carnival season in Trinidad and Tobago.

In FY2023, direct expenses outpaced revenue growth, rising by 43.9% to $80.78B from $56.12B in FY2022. Consequently, the direct expense margin increased slightly to 72.0% from 71.6% the previous year. Gross margin fell to 28.0% from 28.4%, with gross profits amounting to $31.37B, up from $22.31B the prior year. For the three-month period, gross profit rose by 8.4% year-over-year, reaching $7.49B. Gross margin for Q1 2024 improved to 26.2%, up from 25.5% a year ago. The increase in costs was partly due to the drought in Jamaica affecting dairy farm operations and supply chain challenges impacting the pharmaceutical business.

Total operating expenses for FY2023 rose by 34.9% to $24.35B from $18.05B the previous year. This increase was driven by significant rises in security, insurance, interest expenses, wage-related expenses, and distribution costs. These increases partially offset the benefits of reductions in global shipping costs and price reductions in key commodities. Despite these increases, the Group managed to pass on price reductions to consumers. The operating expense margin improved to 21.7% from 23.0% the previous year. As a result, operating profit surged by 45.5% year-over-year, reaching $8.69B, with the operating margin slightly improving to 7.7% from 7.6%.

Finance costs totaled $3.30B for FY2023, up from $1.84B in FY2022, primarily due to increased interest on long-term borrowings and additional debt. For the three-month period, operating profit rose to $2.40B from $2.27B in Q1 2023, with the operating margin remaining relatively stable at 8.4%.

For FY2023, profit before taxation amounted to $5.60B, up 32.1% year-over-year. The tax expense was $992.80M, resulting in an effective tax rate of 17.7%. Total net profit was $4.56B, a 56.4% increase year-over-year. However, the pre-tax profit margin fell to 5.0% from 5.4%, while the net profit margin improved to 4.1% from 3.7%. Net profit attributable to shareholders was $2.93 billion, with earnings per share (EPS) of $3.93. As of December 31, 2023, the return on average assets stood at 4.6%, up from 4.1% the previous year, while the return on average equity was 12.6%, up from 10.3% in 2022.

For Q1 2024, total net profit amounted to $1.20B, down 11.2% from $1.36B in Q1 2023. This decline was mainly due to a downturn in profitability margins and an increase in the effective tax rate to 29.5% from 22.5% the previous year. EPS for the three-month period FY2024 was $1.30, down from $1.34 in the same period the previous year. The trailing twelve-month (TTM) EPS for Seprod stands at $3.89, representing a slight 1.0% downturn compared to FY2023.

Liquidity & Solvency

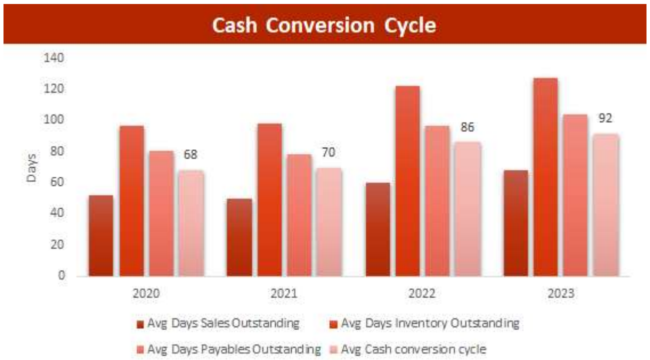
As of December 31, 2023, Seprod's total assets amounted to $104.56B, reflecting a 10.05% increase or $9.55B year-over-year. This growth was driven by both non-current and current assets. Non-current assets rose by 7.92% to $46.21B, primarily due to a booking of $23.12B in Property, Plant, and Equipment (PP&E) and a 49.0% increase in deferred tax assets, totalling $2.68B. Investments also increased, rising from $1.22B the previous year to $1.77B as at the end of FY2023.

Current assets saw an 11.8% increase, rising by $6.16B to $58.35B. This growth was driven by a 5.4% increase in inventories, amounting to $28.94B, and a 16.3% increase in trade and other receivables, which totalled $22.59B. Additionally, cash and bank balances increased by 26.9%, reaching $5.67B.

By the end of Q1 FY2024, total assets climbed to $103.15B, marking a 15.0% year-over-year increase. Fixed assets grew by 12.3%, driven by a 15.3% increase in PP&E, which reached $23.52B as of March 2024. Current assets rose by 17.4% year-over-year for the Q1 2024 period, moving from $47.36B to $55.62B. The primary drivers of this increase were inventories and trade and other receivables. Inventories increased by 6.3% to $25.29 billion at the end of Q1 FY2024, while trade and other receivables rose to $23.57B from $19.24B in the prior comparable period. Notably, cash and bank balances for the first quarter of 2024 increased to $5.89B from $3.79B.

For FY2023, total liabilities amounted to $65.73B, a 6.7% or $4.13B increase year-over-year. Non-current liabilities fell by 11.9% to $29.16B, mainly driven by a 13.3% downturn in long-term liabilities to $23.39B. Conversely, current liabilities grew by 28.2% to $36.57B, driven by a 16.6% increase in payables to $24.78B and an 85.5% increase in the current portion of long-term liabilities to $11.18B.

Seprod's liquidity position deteriorated year-over-year for FY2023 as current liabilities increased at a faster pace than current assets. The current ratio for the period under review was 1.60x, down from 1.83x in 2022. The quick ratio fell to 0.80x, while the cash ratio remained relatively stable at 0.16x. The average cash conversion cycle increased year-over-year, moving from 86 days to 92 days. This was due to an increase in average days inventories outstanding and average days sales outstanding, partially offset by an increase in average days payables outstanding to 104 days.



Total debt amounted to $34.57B, up 4.7% year-over-year. Seprod's leverage, as measured by the debt-to-equity ratio, stood at 0.89, down from 1.00. The company's ability to service its debt obligations deteriorated, with the interest coverage ratio decreasing from 4.0x to 3.6x for FY2023. Shareholders' equity rose by 16.2% year-over-year to $38.83B, driven by a 16.7% increase in retained earnings, which totalled $13.54B.

Cash Flow Overview

Cash from operating activities (CFO) represented an inflow of $7.69B for the twelve-month period, relative to outflows of $119.44M in 2022. The improvement in CFO was mainly driven by the increase in profit and the decrease in cash used for the change in inventories. Notably, the changes in working capital moved from an outflow of $6.22B in FY2022 to an outflow of $1.07B in FY2023, a main driver to the lower working capital is the downturn in change inventories from an outflow of $8.51B to an outflow of $1.47B. Moreover, the company's payables moved from an inflow of $5.28B to an inflow of $3.55B.

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Cash from investing activities represented an outflow of $2.35B for FY2023, relative to an inflow of $4.32B in FY2022. This was mainly driven by the outflow of cash used for the purchase of PP&E which amounted to $2.68B.

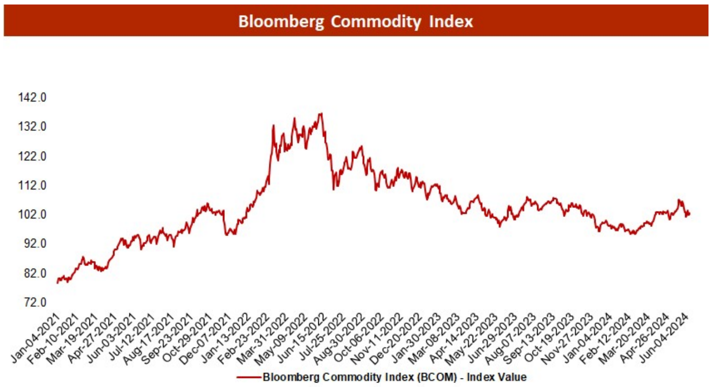
Cash from financing activities represented an outflow of $4.16B for the period, relative to an outflow of $1.37B in 2022. This was driven by interest payment and dividends paid in the amount of $3.01B and $1.52B respectively.

In FY2023, the company experienced a gain of $1.17B to its cash balance (not accounting for currency translation gains). To date, the working capital positioning of the Company has deteriorated. Specifically, operating cash flow before working capital amounted to $2.99B relative to $2.79B in the prior year, a 7.4% increase. However, the change in working capital for the period has amounted to an outflow of $2.17B, more than the prior year's outflow of $1.72B. Consequently, net operating cash flow for the 3M 2024FY period has amounted to an inflow of $289.75M relative to an inflow of $314.04M the prior year.

Outlook & Valuation

Over a four-year period (2019-2023), Seprod (SEP) has demonstrated consistent improvement in revenue generation, achieving a compound annual growth rate (CAGR) of 36.1%. This growth underscores the resilience of demand for Seprod's goods, many of which fall under the "Consumer Staples" category. Consumer staples include essential products such as food and beverages, household goods, pharmaceuticals, and hygiene products. These goods are viewed as non-cyclical because consumers are unable or unwilling to cut them from their budgets, regardless of their financial situation. As a result, consumer staples are less affected by business cycle fluctuations, with demand remaining relatively constant.

In 2023, global commodity prices fell by 10% in the first six months. Since June 2023, the World Bank commodity price index has declined by 25.7% from its historic peak in June 2022. The World Bank attributes this relaxation in prices to a combination of slowing economic activity and a global reallocation of commodity trade flows following Russia's invasion of Ukraine. Despite recent fluctuations in oil prices and a plateauing of many commodity prices in Q1 2024, commodity prices are projected to remain well above pre-pandemic levels. Heightened geopolitical tensions and signs of firming manufacturing activity have exerted upward price pressures.



Source: Bloomberg

Between mid-2022 and mid-2023, global commodity prices plummeted by nearly 40%, driving most of the approximately 2-percentage-point reduction in global inflation between 2022 and 2023. Since mid-2023, the World Bank's commodity price index has remained relatively unchanged. Assuming no further geopolitical tensions, the World Bank forecasts a 3% decline in global commodity prices in 2024 and a 4% decline in 2025. Despite these anticipated declines, commodity prices will remain approximately 38% higher than their pre-pandemic average, doing little to subdue inflation that remains above central bank targets in most countries.

Seprod has highlighted that lower input costs, as evidenced by the relatively lower commodity index, have allowed the group to pass on price reductions to consumers. With anticipated lower commodity costs, Seprod expects an improvement in its cost of sales margin, which should translate to improved profitability margins, provided the company effectively manages its operating expenses.

Over the past few years, Seprod has made strategic moves that have begun to yield positive results. In addition to acquiring Facey Consumer in 2018, Seprod acquired direct ownership of dairy assets from its largest shareholder, Musson Jamaica, which had acquired them from Nestle Jamaica in 2016. Seprod also formed a joint venture company, Jamaica Grain and Cereals Limited, with Seaboard Corporation, commencing flour production in December 2017. More recently, Seprod acquired A.S. Bryden & Sons Holdings (A.S. Bryden) in 2022, a 100-year-old Trinidad & Tobago company. A.S. Bryden distributes food, pharmaceuticals, hardware, houseware, and industrial equipment. This acquisition provides Seprod with gateways to both the Guyana and Barbados markets. One of A.S. Bryden's subsidiaries, Bryden pi, operates in Guyana through its subsidiary BPI Guyana and in Barbados through its joint venture Armstrong Healthcare Inc. Limited.

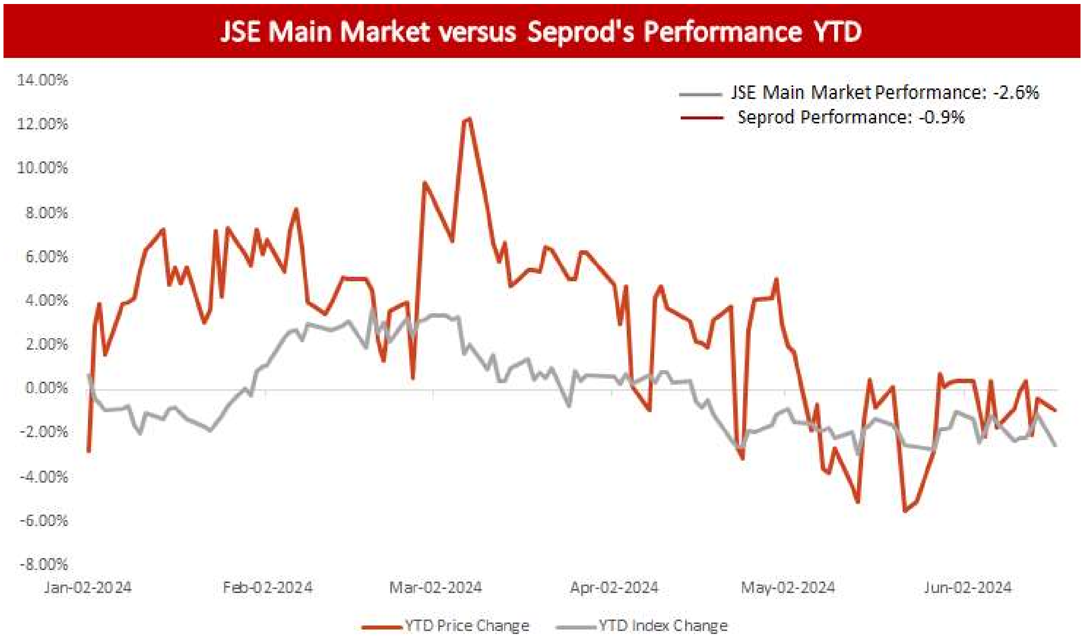
The acquisition of A.S. Bryden is expected to expand Seprod's regional footprint throughout the Caribbean, diversify its distribution reach, and drive export sales. This is already evident, as Seprod recorded a 45% increase in export sales for the 2023 financial year. Seprod aims to further improve the volume of goods sold overseas while simultaneously reducing production costs, which is likely to enhance the company's margins and overall profitability.

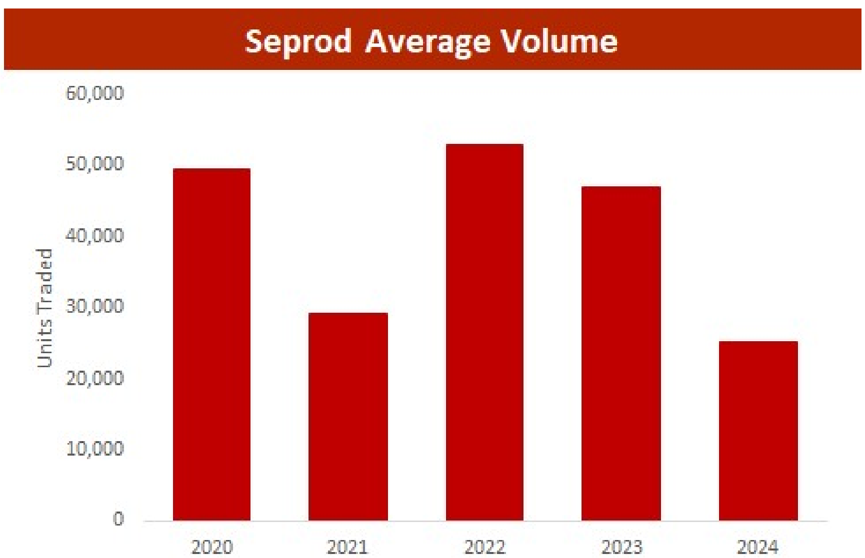
We are forecasting revenues of $140.7B for the year ended December 2024, and net profits attributable to shareholders of $3.45B, which corresponds to earnings per share (EPS) of $4.70. We are forecasting a forward book value of $40.5B as at December 31, 2024, which translates to a book value per share of $55.17. We employed the Discounted Cash Flow (DCF) and price-multiples approach to determine the fair price for Seprod. We arrived at our price target of $84.22 using the DCF model. We utilized the average P/E of comparable listed companies to arrive at a market multiple of 12.5x, which when applied to the forward EPS resulted in a target price of $58.90, while the P/B for the peer group of 2.5x yields a price of $137.92. Additionally, we applied our forward EPS to the 3-year historical average PE ratio of 17.9x, which provide an intrinsic value of $84.13. The 3-yr historical average for the P/B ratio is 2.1x, which when applied to the forward BVPS yields a price of $81.92. **Averaging these forecasts gives us a price target of $89.42, which is 13.3% higher than the closing price $78.95 on June 17, 2024.**

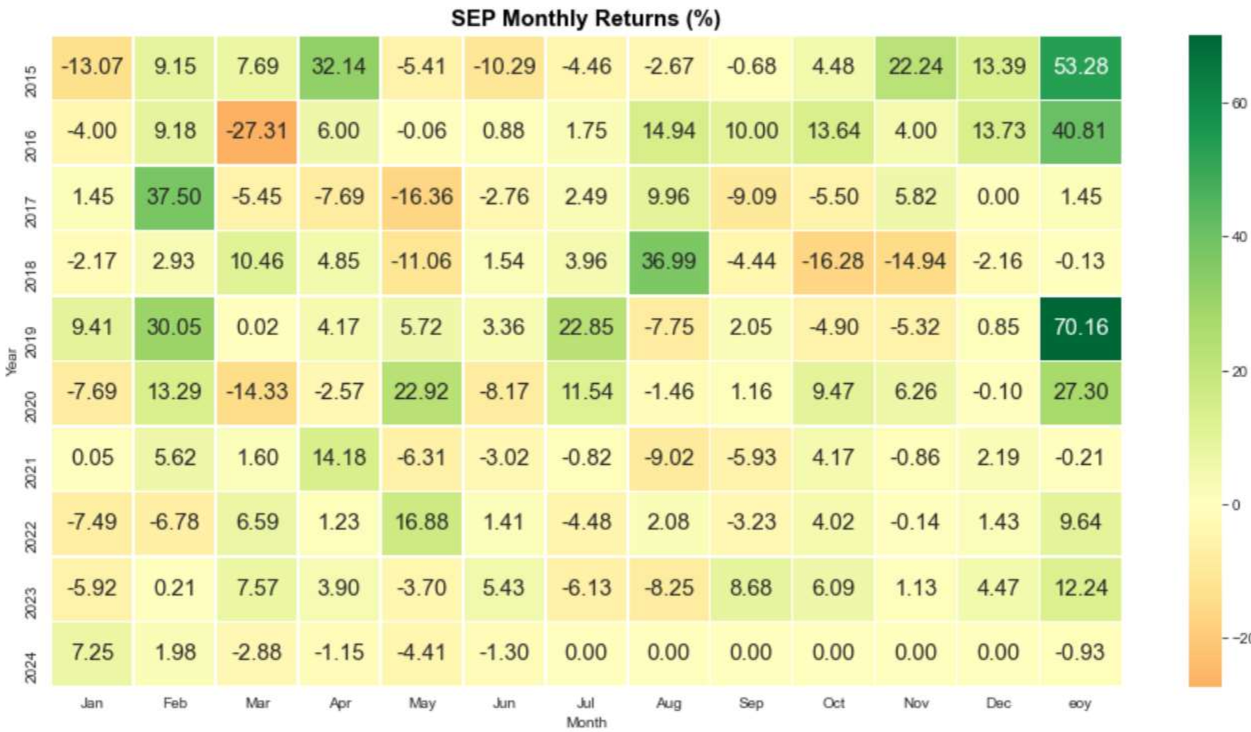
Recommendation

We recommend Seprod Limited as MARKETPERFORM/HOLD as our estimate of the fair value is in line with the current market value. The stock is suitable for investors with a long-term investment horizon and a low to medium risk appetite given Seprod's position as market leader in manufacturing and distribution and proven ability to withstand economic cycles.

Seprod's stock performance year to date (YTD), depreciated by 0.9%, while the YTD performance of the Jamaica Stock Exchange (JSE) Main Market down 2.6%. Moreover, Seprod's liquidity has deteriorated year over for the 2023YE, the average daily volume stood at 47.1K units traded in comparison to 53.1K units traded the 2022YE.


JSE Main Market versus Seprod's Performance YTD
JSE Main Market Performance: -2.6%
Seprod Performance: -0.9%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
-6.00%
-8.00%
Jan-02-2024
Feb-02-2024
Mar-02-2024
Apr-02-2024
May-02-2024
Jun-02-2024
YTD Price Change
YTD Index Change


Seprod Average Volume
Units Traded
60,000
50,000
40,000
30,000
20,000
10,000
0
2020
2021
2022
2023
2024



The heat map above presents the monthly and yearly performance of Seprod over various calendar years. The Group registered its most dramatic decline in 2016, recording a dip of 27.31%. On the other hand, its most impressive achievement was in 2019, with an outstanding growth of 70.16%. Positively, Seprod's shares have kicked off the 2024 calendar year on a positive note with a 7.25% in January 2024. However, since then for 2024, SEP's share price experienced a slowdown, with 0.93% depreciation year to date.

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Abridged Financials $'000	2019	2020	2021	2022	2023	Change	THREE MONTHS Mar-23	Mar-24	Change
Revenue	32,694,821	37,737,080	43,883,405	78,433,836	112,149,457	43.0%	27,062,574	28,588,928	5.64%
Cost of Sales	(23,894,709)	(27,252,457)	(32,972,098)	(56,123,964)	(80,779,877)	43.9%	(20,150,266)	(21,097,772)	4.7%
Gross Profit	8,800,112	10,484,623	10,911,307	22,309,872	31,369,580	40.6%	6,912,308	7,491,156	8.4%
Operating Profit	2,802,635	4,681,143	3,599,483	5,974,539	8,695,095	45.5%	2,274,290	2,396,568	5.4%
Net Profit	973,334	2,871,916	1,993,421	2,917,992	4,563,631	56.4%	1,356,120	1,204,268	-11.2%
Total Assets	36,498,540	38,079,974	46,911,644	95,017,743	104,565,143	10.0%	89,666,659	103,147,269	15.0%
Total Liabilities	21,528,303	21,186,947	23,462,740	61,602,422	65,731,256	6.7%	55,418,897	62,807,817	13.3%
Total Shareholder's Equity	14,970,237	16,893,027	23,448,904	33,415,321	38,833,887	16.2%	34,247,762	40,339,452	17.8%
EPS ($)	1.46	3.92	2.72	3.17	4.00		1.34	1.30	
Book Value per share ($)	20.41	23.03	31.97	33.29	38.46		46.69	54.99	
Key Ratios									
Gross Profit margin	26.9%	27.8%	24.9%	28.4%	28.0%		25.5%	26.2%	
Operating Profit Margin	8.6%	12.4%	8.2%	7.6%	7.8%		8.4%	8.4%	
Net Profit margin	3.0%	7.6%	4.5%	3.7%	4.1%		5.0%	4.2%	
Return on Assets	2.7%	7.7%	4.7%	4.1%	4.6%		1.5%	1.2%	
Return on Equity	6.6%	18.0%	9.9%	10.3%	12.6%		4.0%	3.0%	
Current ratio (x)	1.94	1.72	1.61	1.83	1.60		2.04	1.76	
Quick ratio (x)	1.01	0.96	0.75	0.87	0.80		1.01	0.96	
Cash ratio (x)	0.20	0.28	0.14	0.16	0.16		0.16	0.19	
Debt/Equity (x)	0.82	0.77	0.53	0.99	0.89		0.96	0.92	

Source: www.jamstockex.com, www.worldbank.org, Bloomberg, Company Financials, Company Prospectus, JMMB Investment Research.

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

STRONGLY UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 2.5% FOR THIS PARTICULAR ASSET

UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO 2.5% - 4.9% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETPERFORM—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OUTPERFORM/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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