



Honey Bun (1982) Limited (HONBUN)

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INFRINGEMENT IN THE APPENDIX**

Executive Summary

Honey Bun (1982) Limited is a producer of baked goods and snack products. The product line includes: donuts, cinnamon rolls, snack cakes, raisin breads, cheese breads, and its spiced buns with injected soft cheese. *We recommend HONBUN as MARKETWEIGHT.* While we view the expansion of the productive capacity and the addition of new product offerings favourably we also believe the stock is currently trading close to its fair value. HONBUN is suitable for investors with a medium risk appetite and a medium to long-term investment horizon seeking primarily capital appreciation. While HONBUN is a consistent dividend-payer, these dividends are modest as it continues to expand.

Company Background

Honey Bun (1982) Limited is a producer of baked goods and snack products. The product line includes: donuts, cinnamon rolls, snack cakes, raisin breads, cheese breads, and its spiced buns with injected soft cheese. The lines are distributed across Jamaica in supermarkets, small retail outlets, schools and service stations. The company also exports products such as its Honey Bun brand Easter buns and its Buccaneer brand rum cakes to the U.S., U.K. and the wider Caribbean.

The Company was formed in 1982 from the purchase of 2 small Kingston-based bakery outlets. Since then, HONBUN has grown to a staff of over 390 permanent and temporary workers with baking and distribution facilities capable of operating 24 hours a day, 7 day a week.

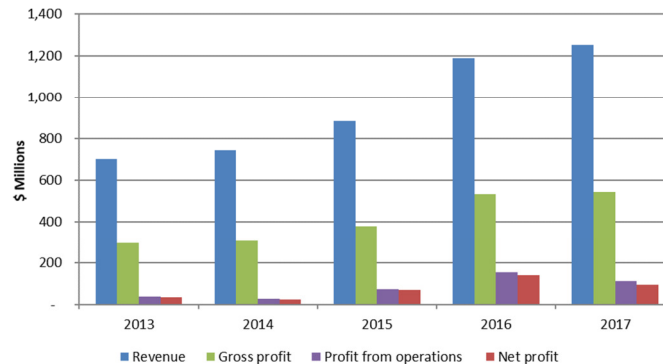
Financial Performance – Year ended September 2017

Profitability

HONBUN generated revenues of \$1.25B for the year ended September 30, 2017, a 5.1% or \$60.91M increase year-over-year. Cost of sales rose 7.3% to \$706.92M, which resulted in gross profits of \$544.20M, a 2.5% increase over the previous year's result. The gross profit margin declined to 43.5%, down from 44.6% in the previous year. Finance income rose by 50.7% to \$1.62M while "exchange gains and other income" fell 63.8% to \$3.14M.

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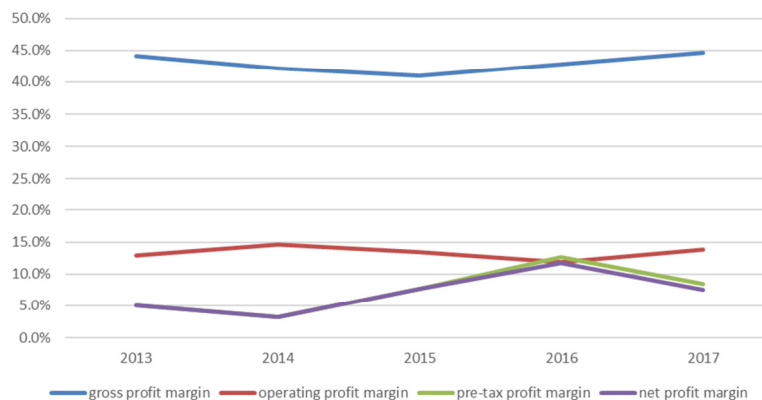
5-year Operating Performance



Operating profits fell by 28.2% to \$111.14M as operating expenses increased by 13.4% to \$437.81M. Administrative and other expenses rose 8% to \$264.35M while selling & distribution costs rose 22.9% to \$173.46M. The operating profit margin fell to 8.4% for the year, down from 13.0% in the 2016FY. Finance costs rose 14.5% to \$5.88M.

Taxation expense of \$11.36M was reported for the year which was an 11.6% increase over the previous year's figure. Net profit amounted to \$93.9M, down 32.7% or \$45.66M year-over-year, which corresponds to an earnings per share of \$0.20 (shares outstanding - 471,266,950). The net profit margin fell to 7.5%, from 11.7% a year ago. The return on equity stood at 18.5% while the return on assets was 14.6%, which compared to 33.3% and 26.0% in the 2016FY, respectively.

Profitability Margins



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Solvency & Liquidity

As at September-end 2017, total assets for HONBUN amounted to \$704M, up 20.3% or \$118.99M from the balance at the start of the year. This increase was driven a 12.5% increase in property, plant & equipment (PPE) to \$386.95M, a 97.7% increase in investments to \$78.08M and a 38.7% increase in cash & cash equivalents to \$101.64M. During the year, HONBUN spent \$87.27M on capital investments. Inventories fell 3.4% to \$47.94M while receivables amounted to \$81.7M, a 5.5% increase year-over-year.

Total liabilities were up 38.9% to \$158.80M due to a 278% increase in long-term loans to \$29.61M and a 22.6% increase in payables to \$87.27M. During the year, a \$30M loan was taken out to help fund the expansion project. Total debt amounted to \$36.13M, more than doubling the balance of \$15.13M as at the start of the period. HONBUN's leverage more than doubled as the debt to equity ratio moved from 0.03x to 0.07x, year-over-year. This level of leverage is still relatively low and the Company is more than able to service it with an interest coverage ratio of 18.91x for the year, down from 30.17x in the 2016FY.

The cash ratio rose to 0.96x from 0.89x a year prior while the quick and current ratio rose to 1.72x and 2.24x, respectively from 1.83x and 2.43x a year earlier. Shareholders' equity stood at \$545.83M, up 15.8% from September 2016 as retained earnings closed the period at \$439.44M, a 20.6% increase year-over-year. This corresponds to a book value per share (BVPS) of \$1.16.

Outlook & Valuation

After becoming the first international Food Safety Certified (Hazards Analysis Critical Control Point – HACCP) bakery in Jamaica and spending \$100m in capital in expenditures in 2016, HONBUN spent another \$87M to increase its productive capacity in 2017. The Company purchased land adjacent to its Cross Roads facility with the aim of improving automation and efficiency in its manufacturing processes. The new facility was handed over by the contractor in March 2018 and the company added a fourth production line as it now has more room for inventory.

New flavours have been added to the Goldie cream-filled cake line and a pocket-size rum cake has also been launched. At the 2018 annual general meeting, two additional new products were previewed, a cassava muffin and a Shorty hamburger bun. The company is expecting to hit peak capacity by the end of the 2018 financial year and is considering further investment in new physical factories in addition to the acquisition of smaller bakeries.

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2017/2018 Year-to-Date

For the first quarter of the 2018FY, HONBUN reported a 3.3% year-over-year increase in sales to \$312.4M. However, net profit declined 27.5% to \$27.49M, due to a 52.6% increase in selling & distribution costs which resulted in a decline in operating margins, offsetting the 1.1% decline in administrative & other expenses. The increase in selling & distribution costs were attributed to greater spending on marketing initiatives and a restructuring of the Company's distribution network. We expect these expenses as a percentage of revenues to decline for the remainder of the financial year.

Total assets rose 16.8% or \$107.15M to \$746.66M as property, plant & equipment rose \$88.04M to \$428.69M while investments rose by 97.7% to \$78.08M. Liabilities rose by 33% or \$43.0M to \$173.34M, as long-term loans rose by \$19.32M to \$26.45M and HONBUN booked \$13.09M in tax payable.

Valuation

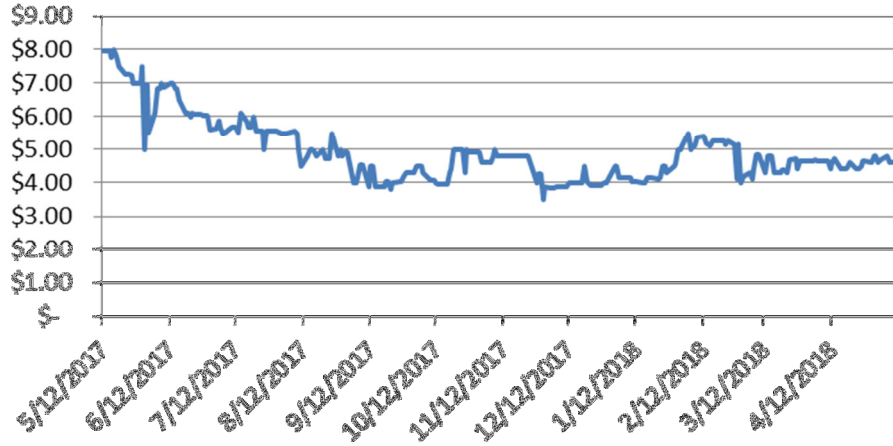
We are forecasting revenues of \$1.33B for the current financial year, which represents a 6.2% increase over the previous year and net profits of \$104.7M, an 11.5% increase year-over-year. Shareholders' equity is expected to increase 15.8% to \$631.84M. These results correspond to an earnings per share of \$0.22, based on the shares outstanding of 471.3M, and a book value per share of \$1.34. Applying the 3-year average P/E ratio of 20.40x to the forward EPS of \$0.22 yields a price of \$4.53 while the forward BVPS of \$1.34 and the 3-year average P/B ratio of 4.30x yields a price of \$5.77. The estimates average to \$5.15, which is 7.3% higher than the last traded price of \$4.80 on May 14, 2018.

Recommendation

We recommend HONBUN as MARKETWEIGHT. While we view the expansion of the productive capacity and the addition of new product offerings favourably we also believe the stock is currently trading close to its fair value. HONBUN is suitable for investors with a medium risk appetite and a medium to long-term investment horizon seeking primarily capital appreciation as while HONBUN is a consistent dividend-payer, these dividends are modest as it continues to expand.

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HONBUN 1 YR Stock Performance



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Abridged Financials

J\$	Year Ended December 31					3M17	3M18	% Change
	2013	2014	2015	2016	2017			
Turnover	701,712,140	741,950,751	885,669,774	1,190,211,495	1,251,119,903	312,441,478	322,825,214	3.3%
Cost of Sales	406,361,643	437,749,558	506,315,931	659,088,501	706,919,927	173,801,522	178,867,697	2.9%
Gross Profit	295,350,497	304,201,193	379,353,843	531,122,994	544,199,976	138,639,956	143,957,517	3.8%
Operating Expenses	264,084,689	280,344,361	306,777,054	385,999,527	437,814,879	94,311,776	111,245,196	18.0%
Operating Profit	38,220,219	28,504,182	74,342,499	154,878,209	111,143,767	44,398,253	32,703,109	-26.3%
Profit Before Taxation	35,317,216	23,300,032	68,165,334	149,743,955	105,265,853	43,288,766	31,411,567	-27.4%
Profit for the year	35,317,216	23,300,032	68,165,334	139,561,710	93,902,343	37,886,300	27,485,121	-27.5%
Total Assets	392,837,561	456,656,238	487,400,287	585,637,866	704,631,142	639,506,100	746,659,143	16.8%
Total Liabilities	101,434,323	147,659,649	119,738,208	114,364,394	158,799,715	130,346,330	173,342,594	33.0%
Shareholder's Equity	291,403,238	308,996,589	367,662,079	471,273,472	545,831,427	509,159,771	573,316,548	12.6%
EPS (\$)	0.07	0.05	0.14	0.30	0.20	0.08	0.06	
Book Value per Share (\$)	0.62	0.66	0.78	1.00	1.16	1.08	1.22	
Key Ratios								
Gross profit margin	42.1%	41.0%	42.8%	44.6%	43.5%	44.4%	44.6%	
Operating profit margin	5.4%	3.8%	8.4%	13.0%	8.9%	14.2%	10.1%	
Net Margin	5.0%	3.1%	7.7%	11.7%	7.5%	12.1%	8.5%	
Return on Average Equity	12.6%	7.8%	20.1%	33.3%	18.5%			
Return on Average Assets	9.8%	5.5%	14.4%	26.0%	14.6%			
Debt/Equity (x)	0.09	0.24	0.14	0.03	0.07	0.02	0.06	

Source: <http://www.Jamstockex.com>, **JMMB Investment & Research**, **Bloomberg**, **Company Financials**; **Betting Gaming & Lotteries Commission Annual Reports**

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APPENDIX

IMPORTANT DISCLOSURES

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

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UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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

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

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