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Caribbean Producers (Jamaica) Limited

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

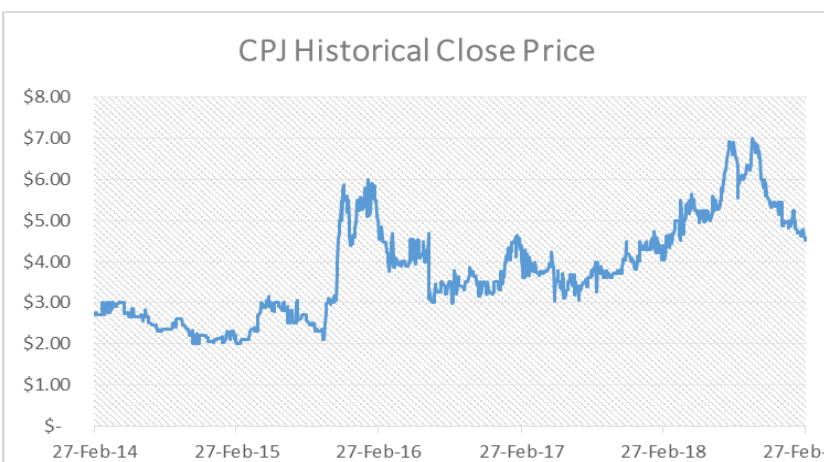
Executive Summary

Caribbean Producers (Jamaica) Limited (CPJ) was founded in April 1994 by Mark Hart and Thomas Tyler as a distributor selling consumable products to the hospitality industry. CPJ's registered office is at Shop No. 14 Montego Freeport Shopping Centre, Montego Bay, and St. James. The company is currently a distributor of food, non-food, beverages, wine & spirits, a manufacturer of meats & juices. CPJ listed on the Junior Market on July 20, 2011. As of March 18, 2018 CPJ holds 100% of the issued shares of CPJ Investments Limited (CPJIL). The primary activity of CPJIL is the holding of 51% investment in CPJ (St. Lucia) Limited, whose primary business is the wholesaling and distribution of non-food supplies.

CPJ distributes several wines and spirits including Yellow Tail, Jack Daniels, Patron, Grey Goose. CPJ also distributes premium beverages Bellot and Fiji and is the exclusive distributor of Lifespan water.

CPJ earnings have trended lower since FY 2014. In FY 2016 CPJ wrote down inventories due to increased competition, which led to profits of USD 1.05 million that FY. Also in Q1 for FY 2019 CPJ took an impairment charge of USD 700 thousand due to its IT platform not meeting expectations. Profits attributable to CPJ shareholders peaked in FY 2015 at USD 3.43 million meaningfully higher than the USD 2.10 million in FY 2018.

CPJ's earnings contracted over the period FY 2014 to FY 2018 despite the stock price rallying at a CAGR of 17% over the same period. This resulted in multiple expansion with P/E expanding from approximately 8x at the end of FY 2014 to 20x at the end of FY 2018.



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Recent Developments

Revenue and profits fell US$129 thousand (0.44%) and US$1.01 million (86.01%) respectively in Q2 ended December 31, 2018. CPJ indicated that revenue growth was constrained by a decline in protein sales to hotels. Gross Profit Margin also deteriorated in the quarter to 24.24% the average gross profit margin in Q2 over the last five years is 27.20% highlighting the significance of the decline. The decline in gross profit margin and an increase in selling & administrative expense resulted in a decrease in profits.

Meanwhile, the Q1 ended September 2018 CPJ reported a loss of USD 1.30 million versus a profit of USD 463.35 thousand for the comparable period in 2017. The primary reason for the decline in earnings for the period was intangible assets being written down by US$692.24 thousand. CPJ also faced increased charges of US$230 thousand related to the write-down. The write-down was due to the failed implementation of an IT platform in Q4 June 2018. The expected benefits were not realised, and the use of the platform was suspended in Q1 September 2018.

Key Financial Data

	2014	2015	2016	2017	2018	CAGR[1]
BVPS	1.65	2.01	2.22	2.56	2.78	13.91%
EPS	0.35	0.37	0.13	0.30	0.25	-8.14%
Dividend Per Share	0.03	0.04	011	0.00	0.06	18.92%
Dividend Payout Ratio	8.63%	10.71%	87.25%	0.00%	24.23%	26.16%[2]
Income Statement Data (USD)						
Revenue	79,006,082	86,850,246	94,104,389	98,288,970	107,795,501	8.08%
Gross Profit	22,930,789	24,724,426	25,106,055	27,133,304	28,427,764	5.52%
Selling & Admin. Expense	15,969,831	17,590,656	20,236,962	20,036,435	21,949,403	8.28%
Operating Profit	5,495,580	5,331,499	2,553,155	4,618,400	4,308,087	-5.90%
Profits to CPJ Shareholders	3,458,813	3,543,747	1,048,349	2,554,904	2,098,476	-11.74%
Balance Sheet Data (USD)						
Cash and Cash Equivalents	2,995,323	3,049,479	4,004,917	2,763,268	3,756,720	5.83%
Current Assets	35,169,118	39,069,758	41,431,251	41,297,379	44,878,115	6.28%
Non-Current Assets	12,009,810	13,760,918	14,416,777	13,277,084	13,510,667	2.99%
Total Assets	47,178,928	52,830,676	55,848,028	54,574,463	58,388,782	5.47%
Current Liabilities	16,022,542	16,688,357	18,693,662	15,352,205	17,995,254	2.95%
Non-Current Liabilities	14,968,554	17,383,135	17,887,407	17,365,652	16,748,055	2.85%
Debt	25,977,043	27,149,373	28,420,761	24,658,756	24,157,969	-1.80%
Equity	16,187,832	18,868,399	19,373,538	21,928,442	23,505,179	9.77%

[1] For the period FY 2014 to FY 2018
[2] Average

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	2014	2015	2016	2017	2018	Average[3]
			Ratios			
Inventory Turnover	4.25x	3.63x	3.88x	3.99x	4.16x	3.98x
Gross Profit Margin	29.02%	28.47%	26.68%	27.61%	26.37%	27.63%
Operating Profit Margin	6.96%	6.14%	2.71%	4.70%	4.00%	4.90%
Net Profit Margin	4.38%	4.08%	1.11%	2.60%	1.95%	2.82%
Debt-to-Equity	1.60x	1.44x	1.68x	1.12x	1.03x	1.37x
Current Ratio	2.19x	2.34x	2.22x	2.69x	2.49x	2.39x
ROE	23.67%	20.22%	5.85%	13.14%	9.24%	14.20%
ROA	7.63%	7.09%	1.93%	4.63%	3.72%	5.00%
P/E	7.76x	7.61x	34.11x	11.80x	20.60x	16.37x
P/B	1.63x	1.42x	1.93x	1.36x	1.83x	1.64x
Close Price	2.70	2.84	4.30	3.49	5.10	17.23%
J$ versus US$	112.20	116.67	126.08	128.62	130.33	3.82%

Financial Overview

Revenue has increased consistently at a compounded annual growth rate of 8.08% between FY 2014 to FY 2018 (period under review). However, for the six months ended December 2018 revenue marginally declined by 0.22% or US$118.23 thousand. The main reason for this decline was the failure of the newly implemented IT platform previously discussed. Gross Profit only increased at a CAGR of 5.52% for the period under review resulting in reduced gross profit margins. Selling & Administrative (SG&A) expense increased at a CAGR of 8.28% for the period under review. The major components of SG&A are staff costs and motor vehicle expenses, which contributed USD 8.37 million (38.13%) and USD 2.49 million (11.34%) respectively in FY 2018. Motor vehicle expense growth has been a significant component of FY 2018 SG&A increasing by US$510.84 thousand (25.82%). Operating profit has declined at a CAGR of 5.90% for the period under review and peaked in FY 2014 at USD 5.50 million. While earnings have collapsed at a more aggressive 11.74% for the period under review, this is partially due to the company facing a higher effective tax rate has the benefits of listing on the Junior Market come to an end.

Current assets have increased at a CAGR of 6.28% for the period under review. The most significant contributor to current assets is inventory which was US$25.91 million (57.73%) in FY 2018. During FY 2018 CPJ wrote-off US$2.02 million in inventory, this amounted to 7.23% of gross inventory higher than the average rate of inventory write-off of 5.50% for the period under review. The primary non-current asset is plant, property & equipment which was 87.17% of FY 2018 non-current assets. Debt has decreased marginally for the period under review and peaked in FY 2016 at US$28.42 million. The most significant contributor to debt is long-term promissory notes which are primarily due to related companies, and the majority attracts an interest rate of 9% denominated in US$.

[3] Except for close price and currency move

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Gross, operating and net profit margins have declined from their peak in FY 2014, this indicates a material decline in operating efficiencies. Net profit margin has decreased from 4.38% in FY 2014 to 1.95% in FY 2018 and averaged 2.82% for the period under review. Net Profit margin was partially impacted by higher effective tax rates and operating cost growth outpacing revenue growth. CPJ has maintained a relatively high current ratio averaging 2.39x for the period under review. Applying Dupont analysis to ROE reveals that the deterioration in net profit margin is responsible for the fall in ROE. For the period under review asset turnover increased and financial leverage marginally declined. For the period under review, CPJ's stock price has grown at a CAGR of 17.23% despite profits attributable to CPJ shareholders over the same period experiencing a CAGR of -11.74%.

Forecast and Valuation

We used the relative value approach to arrive at our price target of $4.73. Innate in our price target is the assumption that sentiment on CPJ's stock is in line over the past 5-years. We used the 5-year average P/B and P/E ratios applied to projected FY 2020 BVPS and EPS respectively to arrive at our base case price target. Our best case forecast also utilises the relative value approach and arrive at a price target of $7.73. **We see the best case price target as highly improbable given expected lacklustre earnings growth. Using the FCF model we arrived at a price target of $1.91 well below our base case, primarily due to the relatively high capital expenditure.** Over the last 5-years average spend on PP&E including intangible assets is USD 2.68 million. For the first half of FY 2019 CPJ has spent USD 3 million on PP&E. CPJ currently has a negative 12-month trailing P/E due to weakness in Q1 FY 2019 and Q4 FY 2018, highlighting the severe deficiency of recent performance. The negative trailing 12-month earnings have negatively impacted CPJ's current ROA and ROE. However, when comparing CPJ's 5-year average ROA and ROE of 5% and 14% respectively to DTL and LASD earnings, it is inferior.

Ticker	Market Cap(M)	P/E	P/B	Div Yield	ROA	ROE
CPJ	5,060	N/A	1.66	0.00%	-0.73%	-2.05%
DTL	7,107	8.56	0.82	0.00%	9.80%	35.33%
LASD	13,432	13.04	2.87	3.10%	13.00%	22.98%
Average	**8,532**	**10.80**	**1.78**	**1.03%**	**7.85%**	**20.09%**

Outlook

Our outlook on CPJ is negative given the lacklustre earnings growth due to deteriorating margins. The hurdle earnings growth in the short to medium term remains elevated given that as of July 2021 the company will begin paying taxes at the full applicable rate versus half currently. CPJ has announced some recent positive developments such as the completion of its 56,000 sq. foot distribution facility and strong growth at CPJ St. Lucia, a subsidiary. However, we see the negatives outweighing the positives.

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Key Risks to Our Price Target

CPJ is unable to produce gross and operating margins in line with our expectations. In FY 2016 and FY 2019 CPJ has experienced a significant write off resulting in a material impact to earnings. We see similar risks in the company's future, which can hurt sentiment for the stock. Our price target has a very conservative outlook on revenue growth, which we see as unlikely for CPJ to underperform. However, if such does occur this could result in a material downward revision to our price target.

Recommendation:

We recommend an UNDERWEIGHT rating on CPJ at this point despite the stock trading marginally below our price target. This is due to volatility in earnings and the trend of contracting margins. Also, we see significant barriers to profits exceeding FY 2017 levels before FY 2022. The major hurdle is increased the effective tax rate.

Source: http://www.Jamstockex.com, JMMB Investment & Research, Bloomberg, Various Company Financial Statements.

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.

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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