

Honey Bun (1982) Limited

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Executive Summary

Honey Bun (1982) Limited (HONBUN) is a limited liability company incorporated under the laws of Jamaica, and its registered office is 26 Retirement Crescent, Kingston 5. HONBUN was established in 1982 by Herbert Chong and Michelle Chong and listed on the JSE's Junior Market on June 3, 2011. Its primary activities are the manufacture and distribution of baked products for local and export markets. The company specializes in producing individually packaged pastries and baked snacks. HONBUN became Jamaica's first Internationally Food Safety Certified (Hazards Analysis Critical Control Point - HACCP) bakery in March 2016 and subsequently completed a 5 for 1 stock split on June 1, 2016.

HONBUN has increased revenue at a CAGR of 14.91% for the period FY 2015 to FY 2019 (period under review) to \$1.54 billion. Meanwhile, profits have grown at a CAGR of 23.09% for the same period. However, for the 6 months ended March 31, 2020 profits have declined by \$16.59 million or 15.22% to \$92.42 million versus the same period the previous year.

HONBUN has produced an operating margin average of 9.91% between FY 2015 and FY 2019 (the period under review) and peaked in FY 2016 at 12.92%. Meanwhile, debt-to-equity has been stable, averaging 0.06x for the period under review, its highest level was 0.14x at the end of FY 2015. As at March 31, 2020 HONBUN has debt of only \$29.70 million resulting in a debt-to-equity ratio of 0.04x, a marginal uptick from the end of FY 2019.

HONBUN's stock price has increased at a CAGR of 66.45% for the period under review, eclipsing the profit growth rate over the same period. This has resulted in significant P/E multiple expansion, which averaged 7.66x in FY 2015 and surged to an average of 19.51x in FY 2019. For FY 2020, the average P/E to date is 19.33x, and the stock is currently trading at 16.33x. **We expect a decline in FY 2020 profits and then a return to growth in FY 2021.**



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Recent Developments

For the six months ended March 31, 2020 revenue has increased by 12.96% or \$100.49 million to \$875.98 million, but it did not translate into profit growth. For the 6 months profits fell \$16.59 million or 15.22% to \$92.42 million. This was due to HONBUN reporting significant weakness in Q2 FY 2020, which saw profits declining by \$27.61 million or 38.94% to \$43.30 million, despite revenue growth of 11.57% or \$47.04 million. The decline was due to higher administrative costs associated with increased salaries and marketing expense.

Key Financial Data

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	CAGR	6M FY 2019	6M FY 2020	Change(%)
Share Price	0.86	5.79	4.30	3.95	6.57	66.45%	4.24	6.18	45.75%
BVPS	0.78	1.00	1.16	1.31	1.57	19.13%	1.51	1.72	13.56%
EPS	0.14	0.31	0.20	0.18	0.33	23.09%	0.23	0.20	-15.22%
Dividend Per Share	0.02	0.05	0.04	0.04	0.06	25.74%	0.03	0.05	66.68%
JSE Junior Market Index	980	2,390	2,907	3,395	3,533	37.79%	3,092	2,304	-25.48%
Revenue	885,669,774	1,190,211,495	1,251,119,903	1,317,178,606	1,543,975,287	14.91%	775,482,443	875,977,089	12.96%
Gross Profit	379,353,843	531,122,994	544,199,976	601,287,124	744,805,761	18.37%	376,555,877	425,993,231	13.13%
Operating Profit	74,196,469	153,805,525	109,527,085	101,262,224	182,582,486	25.25%	115,393,152	111,335,984	-3.52%
Pre-tax Profit	68,165,334	154,878,209	105,265,853	98,096,432	182,580,167	27.93%	112,159,402	107,557,614	-4.10%
Profits	68,165,334	144,695,964	93,902,343	86,422,725	156,469,434	23.09%	109,015,352	92,423,521	-15.22%
PP&E	278,775,252	343,924,732	386,947,599	491,544,316	510,604,374	16.33%	494,985,495	529,115,384	6.90%
Non-Current Assets	308,969,369	385,219,809	466,684,939	579,078,211	605,219,707	18.30%	583,461,745	591,682,391	1.41%
Current Assets	178,430,618	200,418,057	237,946,203	209,354,957	352,722,618	18.57%	288,212,249	473,544,522	64.30%
Total Assets	487,399,987	585,637,866	704,631,142	788,433,168	957,942,325	18.40%	871,673,994	1,065,226,913	22.20%
Non-Current Liabilities	42,874,679	31,935,006	52,375,954	49,843,880	49,348,453	3.58%	48,938,588	55,251,494	12.90%
Current Liabilities	76,863,529	82,429,388	106,423,761	120,718,355	168,079,107	21.60%	109,987,130	200,602,359	82.39%
Total Liabilities	119,738,208	114,364,394	158,799,715	170,562,235	217,427,560	16.08%	158,925,718	255,853,853	60.99%
Debt	51,339,297	15,129,991	36,126,022	29,783,152	23,788,867	-17.49%	26,568,859	29,704,423	11.80%
Equity	367,662,079	471,273,472	545,831,427	617,870,933	740,514,765	19.13%	712,748,276	809,373,060	13.56%
Operating Cash Flow	100,879,942	183,218,685	152,269,131	174,103,052	203,301,450	19.15%	122,547,194	92,734,546	-24.33%
Financing Cash Flow	(23,018,935)	(66,153,116)	3,391,562	(25,193,548)	(34,270,303)	10.46%	(21,313,095)	(18,306,369)	-14.11%
Investing Cash Flow	19,036,135	109,066,017	126,033,517	150,999,645	75,820,585	41.27%	35,163,349	9,147,531	-73.99%

Ratios	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	Average	6M FY 2019	6M FY 2020	Change(%)
Gross Margin	42.83%	44.62%	43.50%	45.65%	48.24%	44.97%	48.56%	48.63%	0.15%
Operating Margin	8.38%	12.92%	8.75%	7.69%	11.83%	9.91%	14.88%	12.71%	-14.58%
Net Profit Margin	7.70%	12.16%	7.51%	6.56%	10.13%	8.81%	14.06%	10.55%	-24.95%
Current Ratio	2.32	2.43	2.24	1.73	2.10	2.16	2.62	2.36	-9.91%
Quick Ratio	1.73	1.83	1.79	1.39	1.73	1.69	2.07	1.89	-8.59%
Debt-to Equity	0.14	0.03	0.07	0.05	0.03	0.06	0.04	0.04	-1.55%
Debt Ratio	0.11	0.03	0.05	0.04	0.02	0.05	0.03	0.03	-8.51%
ROE	20.15%	34.50%	18.46%	14.85%	23.04%	22.20%	20.30%	18.38%	-9.46%
ROA	14.44%	26.97%	14.56%	11.58%	17.92%	17.09%	16.29%	14.44%	-11.34%
P/E	5.92	18.86	21.58	21.54	19.79	17.54	15.14	17.17	13.42%
P/B	1.10	5.79	3.71	3.01	4.18	3.56	2.80	3.68	31.43%
Dividend Payout Ratio	16.59%	16.28%	20.07%	21.81%	18.07%	18.57%	12.97%	25.50%	96.60%
Dividend Yield	4.90%	1.53%	0.65%	0.88%	1.27%	1.85%	0.779%	0.781%	0.27%
HONBUN Share Performance	101.89%	576.40%	-25.73%	-8.14%	66.33%	142.15%	7.34%	-5.94%	-180.85%
Junior Market Index Performance	49.94%	143.79%	21.63%	16.80%	4.07%	47.25%	-8.92%	-34.79%	N/A

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Financial Overview

Revenue has increased at a CAGR of 14.91% for the period FY 2015 to FY 2019 (period under review). In FY 2016 revenue grew by 34.39% or \$304.54 million the most significant for the period under review, it subsequently slowed to a growth rate of 5.12% and 5.28% in FY 2017 and FY 2018 respectively. However, FY 2019 saw a resurgence of revenue growth which increased by 17.22% to a record high of \$1.54 billion. Operating Profit has increased at a CAGR of 25.25% to \$182.58 million for the period under review. More recently, for the first half of FY 2020 revenue has increased by \$100.49 million or 12.96% to \$775.48 million. However, operating profit declined by \$4.06 million or 3.52% to \$111.34 million in the first half of FY 2020. The weakness in operating profit and earnings is due to administrative expense increasing \$21.32 million or 29% to \$94.86 million due to higher salaries and marketing expense.

Current assets have increased at a CAGR of 18.57% to \$352.72 million at the end of FY 2019. Furthermore, since the end of FY 2019, current assets have increased by \$120.82 million or 34.25% to \$473.54 million at the end of March 2020. The primary reason for this increase over the last 6-months is growth in cash and cash equivalents, which was up 33.87% or \$65.28 million to \$258.05 million. The increased cash position was aided by positive operating cash flows, while cash outflows from investing activities was curtailed. The enhanced cash position propelled the company's quick ratio to 1.89x as at March 2020, marginally lower than the same point in FY 2019. As at the end of FY 2019 non-current assets are primarily made up of PP&E and Investments which account for 53.30% and 9.6% of total assets respectively. Investments are made up of mainly fixed income securities and a small stock portfolio valued at \$22.08 million at the end of FY 2019. Most of its fixed income securities are VMBS notes denominated in USD. As at the end of FY 2019 HONBUN has debt of only \$23.79 million, the majority of which matures in September 2027 and attracts a fixed interest rate of 5.65% per annum. The primary collateral for the debt is the previously mentioned VMBS notes.

Gross Profit Margin has been reasonably consistent over the last five years averaging 44.97% but surging in FY 2019 to a peak of 48.24%. For the first half of FY 2020 gross profit margin was 48.63% roughly in line with the first half of FY 2019. HONBUN's current and quick ratios at the end of March 2020 were 2.36x and 1.89x respectively indicating that short-term liabilities can be readily met. Meanwhile, debt-to-equity at the end of March 2020 was 0.04x indicating that long-term obligations can be easily met. Days Sales Outstanding and Days Inventory Outstanding have trended lower for the period under review, indicating increased operational efficiency. Dupont analysis reveals that the primary reasons for the decline in ROE from its peak in FY 2016 of 34.50% are the declines in Net Income Margin and Total Asset Turnover.

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Forecast and Valuation

We arrived at our price target of \$5.49 using a combination of discounted FCFE and the relative value approach. We discounted FCFE assuming a constant growth rate of 5% significantly below HONBUN's CAGR for the period under review, indicating our conservative expectations. This resulted in a value of \$4.07, the lower end of our price target. Using relative value, we applied the 5-year average P/E to our projected FY 2021 EPS resulting in a price target of \$6.90. **Averaging our upper price target of \$6.90 and our lower price target of \$4.07 produces our price target.**

Junior Market Food Manufacturing Peers					
Ticker	Market Cap(\$M)	P/E	P/B	ROA	ROE
LASM	14,596.95	14.87	2.16	10.60%	15.59%
CFF	1,034.08	30.61	2.33	6.53%	7.65%
HONBUN	2,310.81	16.52	2.86	14.44%	18.38%
JAMT	3,483.94	N/A	2.27	-3.67%	-6.22%
KREMI	1,287.24	21.10	1.67	5.55%	8.14%
PURITY	271.71	N/A	0.38	-1.27%	-1.75%
Average	3,830.79	20.77	1.94	5.36%	6.96%

The chart below illustrates the average trailing P/E of HONBUN for several years. Evident on the chart below is the limited range of HONBUN's P/E since mid-calendar year 2016. The extraordinary pace of multiple expansion seen in early 2016 was due to a stock split and phenomenal earnings growth in FY 2016 of 112.27%. The blue dotted line below shows HONBUN average P/E in 2016 of 13.5x; which HONBUN's P/E ratio has remained largely above since early 2016.



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Outlook

We expect FY 2020 earnings for HONBUN to be lower than FY 2019 due to the global pandemic, and weakness in the first half of FY 2020. However, we forecast a lesser impact on HONBUN than companies in more cyclical industries such as construction and finance. In the medium to long-term we anticipate HONBUN will continue to produce steady growth albeit impaired by a higher tax rate as the company begins to pay taxes at the full applicable rate. HONBUN can comfortably meet near-term obligations with quick and current ratios of 1.89x and 2.36x respectively. The company has maintained an average debt-to-equity ratio of 0.06x for the period under review indicating that long-term liabilities can be readily met. Furthermore, the company has maintained a healthy level of days sales outstanding and days inventory outstanding, indicating good sales practises and inventory management, respectively. Therefore, while we expect near-term obstacles from the negative impact of the global pandemic in the medium to long-term, HONBUN is sufficiently capitalized to endure.

Key Risks to Our Price Target

HONBUN is unable to contain costs, which could restrain profit growth even if revenue growth continues. While we expect COVID-19 to weigh on FY 2020 earnings if the impact is materially worse than our expectations this could result in HONBUN earnings and revenue being less than forecast. **Another key risk is HONBUN being unable to meet our conservative expectation for steady long-term growth.**

Recommendation:

We recommend a **MARKETWEIGHT/HOLD** rating on HONBUN at this point given that the stock trades marginally below our price target. Additionally, an increase in the stock price towards our upper price target would produce material gains. **HONBUN's current P/E ratio of approximately 16.5x, is below peers despite its ROA and ROE being the best.**

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

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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.

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