INVESTMENT AND SOVEREIGN RESEARCH August-7-2020

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Seprod Limited

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Executive Summary

Seprod Limited 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 founded in 1944 and was listed on the Jamaica Stock Exchange in 1985.

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. Seprod is susceptible to economic headwinds such as weak economic growth, high inflation and weak business & consumer confidence especially given the uncertainty surrounding the economic impact of the coronavirus pandemic.

We face challenges in accurately estimating the impact the global pandemic has and will have on Seprod. With these limitations in mind, we estimate revenues of $37.22B for the 2020FY and net profit attributable to shareholders of $1.94B, increases of 13.8% and 81.3%, respectively. Shareholders' equity is seen increasing by 6.3% to $15.91B.

We recommend Seprod Limited as MARKETWEIGHT/MARKETPERFORM/HOLD as our estimate of the fair value is in line with the current market value.

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.

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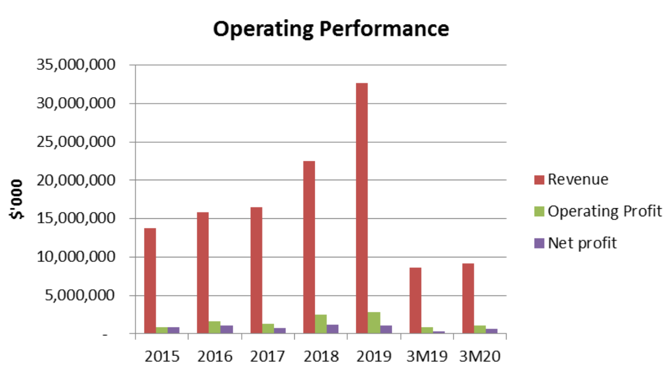
The Dairy line has been expanded with the integration of the dairy operation formerly owned and operated by the Nestle Group. The operation includes the physical assets based in Bog Walk, St. Catherine and the "Betty" and "Supligen" brands. The acquisition of Facey Consumer forms the foundation of the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

Financial Performance – Year ended December 31, 2019

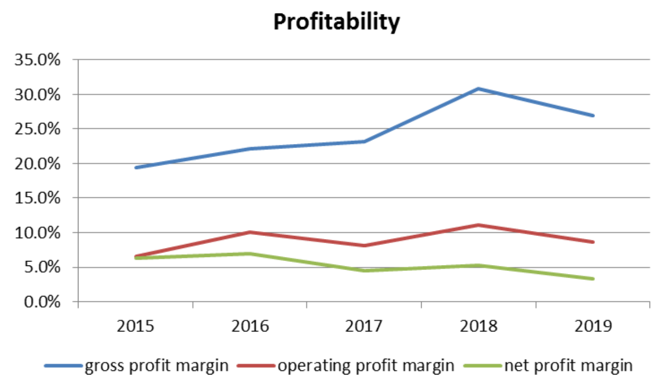
Profitability

Seprod Limited reported net profits attributable to shareholders of $1.07B for the 2019 financial year, down 9.7% or $114.59M year-over-year. Net profits from continuing operations attributable to shareholders amounted to $1.71B, up 24.3% or $333.22M year-over-year, while net loss from discontinued operations attributable to shareholders amounted to $638.21M, up 235.2% or $447.81M year-over-year. The increase in profits from continuing operations was attributed to "efficiencies gained from internal reorganizations of the ingredients and the distribution businesses, and from the consolidation of the dairy business. Losses from discontinued operations represent the sugar manufacturing business' results.

Revenues totalled $32.69B for the year, up 45.3% from the year prior or $10.2B while direct expenses were up 53.3% to $23.89B. The surge in revenues and direct costs reflects the first full year of Facey Consumer Division being integrated into the Seprod Group. Direct expenses grew faster than revenues, which resulted in a decline the gross profit margin to 26.9% from 30.7%. Gross profits amounted to $8.8B, up 27.3% year-over-year.



Finance and other operating income grew by 56.2% to $1.31B while selling expense fell by 36.5% to $449.96M and administrative expenses surged 52.8% to $6.89B. The increase in 'finance and other operating income' was driven by a 158% increase in 'net foreign exchange gains and losses' to $863.01M. As a result, Seprod reported an operating profit of $2.8B for the 2019FY, which was up 12.9% year-over-year. EBITDA amounted to $1.39B, down 0.9% year-over-year, driven by a 30.1% increase in depreciation expense to $900.83M and an 85.5% increase in amortisation of intangible assets to $243.03M. The EBITDA margin stood at 12.2%, which compared to 14.8% a year prior.



Pre-tax profits amounted to $1.39B, down 20.8% year-over-year, as finance costs rose 86.7% to $1.47B. Total net profit amounted to $973.33M, down 8.4% year-over-year. The pre-tax profit margin fell from 7.8% to 4.2% year-over-year while the net profit margin stood at 3.3%, down from 5.3% for the prior year. The return of assets stood at 3.0%, compared to 4.3% a year prior while the return on equity stood at 7.0%, relative to 9.2% in 2018.

Solvency & Liquidity

As at December 31, 2019, Seprod's total assets amounted to $36.5B, a 3.4% or $1.2B increase, year-over-year. Non-current assets amounted to $22.07B, a 6.7% increase year-over-year while current assets amounted to $14.43B, down 1.2% from the prior year's balance. The increase in non-current assets was driven by the booking of $1.04B in right of use assets and an 85% increase in deferred tax assets to $1.3B. A right-of-use asset is a lessee's right to use an asset over the life of a lease.

Property, plant & equipment amounted to $7.2B, down 3.1% year-over-year while intangible assets amounted to $9.4B, a 2.5% decline from the balance at the start of the year. Available-for-sale investments amounted to $1.5B, a 6.1% increase year-over-year, while investments in joint ventures rose 12.7% to $454.07M. Long-term receivables amounted to $713.82M, up 1.4% while biological assets amounted to $409.37M, up 19.5% year-over-year.

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The decline in current assets was driven by a 28.2% decline in cash and bank balances to $1.48B, a 95.3% decline in the current portion of long-term receivables to $17.5K and a 34.8% decline in biological assets to $286.55M. This decline was partially offset by a 5.6% increase in inventories to $6.91B and a 3.9% increase in trade & other receivables to $5.24B. Seprod also booked $289.24M in "non-current assets held for sale" which represents the carrying value of assets associated with the discontinued sugar manufacturing operations that are currently up for sale.

Total liabilities amounted to $21.53B, a 4.7% or $975.56M increase year-over-year. Non-current liabilities rose 17.4% to $14.07B while current liabilities were down 13.0% to $7.45B. Driving the increase in non-current liabilities was a 10.3% increase in long-term liabilities to $11.39B and the booking of $1.11B in lease obligations. The decrease in current liabilities was driven by a 59.6% decline in current portion of long-term liabilities to $829.44M. Payables were relatively unchanged (down 0.8%) and amounted to $6.32B.

The current ratio stood at 1.94x up from 1.71x a year prior while the quick ratio moved from 0.83x to 0.90x. These levels indicate Seprod's ability to adequately meet its short-term obligations.

Total debt amounted to $12.22B and was down 1.3% year-over-year. Seprod's leverage as measured by the debt-to-equity ratio stood at 0.82x, up from 0.79x. Net debt-to-EBITDA stood at 2.69x, versus 3.11x a year prior. Seprod's ability to service it debt obligations, as represented by the interest coverage ratio, deteriorated but remained sufficient. The interest coverage ratio moved from 3.20x to 2.02x for the 2019FY. Shareholders' equity amounted to $14.97B, down 4.9% year-over-year as retained earnings fell 9.8% to $8.1B.

Outlook and Valuation

Over the past few years, Seprod has made several moves which have begun to bear fruit. In addition to the acquisition of Facey Consumer in 2018, Seprod formerly acquired direct ownership of diary assets from its largest shareholder – Musson Jamaica, which acquired same from Nestle Jamaica in 2016. Seprod also formed a joint venture company, Jamaica Grain and Cereals Limited, with Seaboard Corporation and commenced flour production in December 2017. These moves drove the 24.3% increase in net profits from continuing operations which amounted to $1.71B.

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Despite this strong performance from continuing operations, the discontinued sugar operations still managed to incur losses of $638.21M for the year. It is expected that going forward, until the sugar assets are disposed of, the losses on these assets will be minimized. **This expectation held for the first half of the 2020FY** when the net loss from discontinued operations amounted to $16.13M, down 92.5% from the prior year period.

Net profit attributable to shareholders amounted to $1.20B, an 85.5% increase year-over-year as the net profit from continuing operations amounted to $1.22B, a 41.1% increase on the prior year period. Revenues for 1H20 amounted to $18.61B, a 12.1% increase year-over-year. Cost of sales rose 13.9% which led to an 8.9% increase in gross profits to $6.51B. Operating expenses were down 2.9% to $4.61B. The increase in gross profits, along with the decline in operating expense, led to a 36.3% increase in operating profit to $2.12B. Seprod attributed its first half performance to the consolidation of the dairy factories, rising exports and the expansion of its distribution footprint following the acquisition of the Facey Consumer business.

Seprod's debt servicing ability remained strong with an interest coverage ratio of 3.68x for the first half of the 2020FY. Debt-to-equity stood at 0.80x, down from 0.82x as at Dec. 31, 2019. Liquidity improved as the current ratio stood at 2.19x, up from 1.89x while the quick ratio moved from 1.19x to 1.16x over the first six months of the year.

Seprod has performed remarkably in the first half of the 2020 financial year. This performance can be explained by growth in its continuing operations as well the cessation of losses from its failed sugar manufacturing venture. Seprod has seen resilience in the demand for its goods as it sells many products that fall under the "Consumer Staples" category. Consumer staples are essential products that include typical products such as food & beverage, household goods, pharmaceutical drugs and hygiene products. Consumer staples are viewed as non-cyclical as they represent goods that consumers are unable, or unwilling, to cut from their budgets regardless of their financial situation. This attribute makes consumer staples impervious to business cycles as consumers demand these goods at a relatively constant price.

Seprod noted that with the exception of its biscuits factory, it has not eased production outputs as it aims to maintain stability in its food supply chain for Jamaica and its export markets. **This ability to maintain production capacity despite the challenges faced from measures put in place to curtail the transmission of the COVID-19 disease, as well as strong demand for its range of consumer staples, has combined to drive the outperformance for the first half of the year**. This has occurred in the context of many other listed companies reporting some of their worst quarters in recent history.

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Seprod still remains susceptible to economic headwinds such as weak economic growth, high inflation and weak business & consumer confidence. Deterioration in these factors could have a negative impact on the company's outlook. We face challenges in accurately estimating the full impact the global pandemic will have on Seprod even as the country begins to loosen the restrictions put in place to stem the spread as another spike in cases could occur.

With these limitations in mind, we estimate revenues of $37.22B for the 2020FY and net profit attributable to shareholders of $1.94B, increases of 13.8% and 81.3%, respectively. Shareholders' equity is projected to increase by 6.3% to $15.91B.

We utilized the price multiples approach to determine Seprod's fair value. Using the industry P/E average of 26.03x yields a price of $68.68 while the industry P/B average of 3.03x yields a price of $65.62. The 1-year historical P/E average of 20.66x yields a price of $54.50 while the 1-year historical P/B average of 2.37x yields a price of $51.34. The average of these estimates is $60.03, which is 7.2% above the closing price of $56.02 as at July 31, 2020.

Recommendation

We recommend Seprod Limited as MARKETWEIGHT/MARKETPERFORM/HOLD as our estimate of the fair value is 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.

Source: http://www.Jamstockex.com, JMMB Investment & Research, Bloomberg, Company Financials,

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Abridged Financials

J$	Year Ended December 31							
	2015	**2016**	**2017**	**2018**	**2019**	**6M19**	**6M20**	**Change %**
Turnover	**13,777,863**	**15,781,917**	**16,511,206**	**22,499,784**	**32,694,821**	**16,602,720**	**18,607,715**	**12.1%**
Cost of Sales	11,114,536	12,291,448	12,687,358	15,585,707	23,894,709	10,623,492	12,095,015	13.9%
Gross Profit	**2,663,327**	**3,490,469**	**3,823,848**	**6,914,077**	**8,800,112**	**5,979,228**	**6,512,700**	**8.9%**
Operating Expenses	2,309,243	2,760,879	2,977,371	5,215,149	7,336,293	4,744,978	4,606,791	-2.9%
Operating Profit	**900,823**	**1,588,716**	**1,330,969**	**2,482,280**	**2,802,635**	**1,558,308**	**2,123,239**	**36.3%**
Profit Before Taxation	604,058	1,185,924	938,960	1,751,184	1,387,393	1,060,802	1,532,984	44.5%
Net profit attributable to shareholders	**865,953**	**1,092,043**	**735,043**	**1,182,025**	**1,067,434**	**354,603**	**632,715**	**78.4%**
Total Assets	**15,296,202**	**17,216,750**	**20,008,056**	**35,298,364**	**36,498,540**	**36,058,603**	**36,446,484**	**1.1%**
Total Liabilities	**5,562,042**	**8,241,008**	**10,998,244**	**20,552,742**	**21,528,303**	**20,718,916**	**20,176,977**	**-2.6%**
Shareholder's Equity	**10,309,528**	**9,767,944**	**9,889,214**	**15,744,994**	**14,970,237**	**16,433,159**	**16,269,507**	**-1.0%**
EPS ($)	1.18	1.49	1.00	1.61	1.46	0.88	1.64	
Book Value per Share ($)	14.05	13.32	13.48	21.46	20.41	22.40	22.18	
Key Ratios								
Gross profit margin	19.3%	22.1%	23.2%	30.7%	26.9%	36.0%	35.0%	
Operating profit margin	6.5%	10.1%	8.1%	11.0%	8.6%	9.4%	11.4%	
Pre-tax Margin	4.4%	7.5%	5.7%	7.8%	4.2%	6.4%	8.2%	
Net Margin	6.3%	6.9%	4.5%	5.3%	3.3%	3.9%	6.5%	
Return on Average Equity	8.50%	10.88%	7.48%	9.22%	6.95%			
Return on Average Assets	5.90%	6.72%	3.95%	4.27%	2.97%			
Cash Ratio (x)	0.64	0.12	0.09	0.24	0.20	0.17	0.34	
Current Ratio (x)	1.83	1.11	1.30	1.71	1.94	1.89	2.19	
Debt/Equity (x)	0.29	0.35	0.38	0.79	0.82	0.77	0.80	
Net debt/EBITDA (x)	1.25	1.32	1.59	3.11	2.69			

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.

OUTPERFORM/OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE UP TO 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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

UNDERPERFORM/UNDERWEIGHT— ADJUST EXPOSURE IN YOUR PORTFOLIO HELD AT JMMB TO BETWEEN 2.5% AND 4.9% FOR THIS PARTICULAR ASSET

STRONGLY UNDERPERFORM/UNDERWEIGHT—REDUCE EXPOSURE TO THIS ASSET TO BELOW 2.5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO (0%).

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