INVESTMENT AND SOVEREIGN RESEARCH March-21- 2022

Honey Bun (1982) Limited

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

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. The Company 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 manufacturing and distributing baked products for local and export markets. 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's revenue increased at a CAGR of 14.4% between FY 2017 and FY 2021 to a record $2.1 billion. Meanwhile, profits have grown at a CAGR of 23.5% for the same period. Revenue and profit growth rate accelerated in Q1 FY 2022, up 44.1% and 30.9%, respectively.

Meanwhile, debt-to-equity has been stable, averaging 0.04x for the period under review; its highest level was 0.07x at the end of FY 2017. As at Q1 FY 2022, HONBUN has debt of only $20.4 million, resulting in a debt-to-equity ratio of 0.02x, indicating long-term liabilities are sustainable.

HONBUN currently trades at a P/E of approximately 18.9x, in line with the peer group harmonic mean. Meanwhile, HONBUN has modest liquidity, exchanging an average daily volume of 165.3K units over the past year, valued at approximately $1.4 million. Over the past month, HONBUN has had an average bid-ask spread of about 3.5%, indicating a relatively high implicit cost to trade shares.

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	YE 2017	YE 2018	YE 2019	YE 2020	YE 2021	CAGR	Q1 2021	Q1 2022	Change(%)
Per Share Data									
Share Price	4.30	3.95	6.57	4.78	8.33	17.99%	5.31	9.27	74.49%
BVPS	1.16	1.31	1.57	1.85	2.18	17.17%	1.92	2.28	18.81%
EPS	0.20	0.18	0.33	0.35	0.46	23.53%	0.32	0.49	50.57%
Dividend Per Share	0.04	0.04	0.06	0.08	0.13	33.22%	-	-	N/A
JSE Junior Market Index	2,906.77	3,395.02	3,533.27	2,555.68	3,296.35	3.19%	2,643.38	3,428.30	29.69%
Abridged Income Statement (In Millions)									
Revenue	1,251.12	1,317.18	1,543.98	1,674.78	2,145.40	14.43%	461.32	664.70	44.09%
Gross Profit	544.20	601.29	744.81	799.27	1,022.19	17.07%	218.06	264.59	21.34%
Operating Profit	109.53	101.26	177.06	182.54	276.85	26.09%	41.00	59.24	44.48%
Pre-tax Profit	105.27	98.10	182.58	191.04	290.20	28.86%	39.74	56.63	42.49%
Profits	93.90	86.42	156.47	166.75	218.69	23.53%	34.75	45.51	30.94%
Abridged Balance Sheet (In Millions)									
PP&E	386.95	491.54	510.60	553.45	583.87	10.83%	576.40	603.06	4.63%
Non-Current Assets	466.68	579.08	605.22	622.32	688.02	10.19%	645.93	714.24	10.58%
Current Assets	237.95	209.35	352.72	444.04	637.44	27.94%	453.04	655.23	44.63%
Cash and Cash Equivalents	101.64	99.55	192.76	296.98	404.25	41.22%	292.01	408.18	39.78%
Total Assets	704.63	788.43	957.94	1,066.36	1,325.46	17.11%	1,098.97	1,369.47	24.61%
Non-Current Liabilities	52.38	49.84	49.35	48.84	66.74	6.25%	47.45	65.25	37.52%
Current Liabilities	106.42	120.72	168.08	147.95	229.84	21.23%	147.21	229.84	56.13%
Total Liabilities	158.80	170.56	217.43	196.80	296.59	16.90%	194.65	295.09	51.60%
Debt	36.13	29.78	23.79	27.16	21.80	-11.86%	25.85	20.40	-21.08%
Equity	545.83	617.87	740.51	869.56	1,028.87	17.17%	904.31	1,074.38	18.81%
Abridged Cash Flow Statement (In Millions)									
Operating Cash Flow/(Outflow)	152.27	174.10	209.22	225.75	304.44	18.91%	36.32	44.93	23.70%
Financing Cash Flow/(Outflow)	3.39	(25.19)	(35.78)	(44.60)	(66.30)	N/A	(1.60)	(1.59)	-0.51%
Investing Cash Flow/(Outflow)	(126.03)	(151.00)	(80.23)	(82.64)	(133.71)	1.49%	(39.86)	(39.79)	-0.18%
Ratios						Average			Change(%)
Gross Margin	43.50%	45.65%	48.24%	47.72%	47.65%	46.55%	47.27%	39.81%	-15.79%
Operating Margin	8.75%	7.69%	11.47%	10.90%	12.90%	10.34%	8.89%	8.91%	0.28%
Net Profit Margin	7.51%	6.56%	10.13%	9.96%	10.19%	8.87%	7.53%	6.85%	-9.12%
Current Ratio	2.24	1.73	2.10	3.00	2.77	2.37	3.08	2.85	-7.37%
Debt-to Equity	0.07	0.05	0.03	0.03	0.02	0.04	0.03	0.02	-33.58%
ROE	18.46%	14.85%	23.04%	20.71%	23.04%	20.02%	18.09%	23.19%	28.22%
ROA	14.56%	11.58%	17.92%	16.47%	18.29%	15.76%	14.08%	18.59%	32.04%
P/E	21.58	21.54	19.79	13.50	17.96	18.87	16.43	19.04	15.88%
P/B	3.71	3.01	4.18	2.59	3.82	3.46	2.77	4.07	46.87%
Dividend Payout Ratio	20.07%	21.81%	18.07%	22.61%	27.15%	21.94%	0.00%	0.00%	N/A
Dividend Yield	0.93%	1.01%	0.91%	1.67%	1.51%	1.21%	0.00%	0.00%	N/A
HONBUN Share Performance	-25.73%	-8.14%	66.33%	-27.30%	74.50%	15.93%	11.23%	11.22%	-0.04%
Junior Market Index Performance	21.63%	16.80%	4.07%	-27.67%	28.98%	8.76%	3.43%	4.00%	16.65%

Financial Overview (Q1 December 2021)

Revenue up 44.1% to $664.7 million for the first quarter ended December 2021. The rate of Q1 growth accelerated beyond recent history, indicating strong demand for its products. For perspective, the next highest Q1 growth rate under the review period was Q1 FY 2020, when HONBUN recorded growth of 14.5%. Operating profit was up 44.5% to $59.2 million, but profit only advanced 31% to $45.5 million. A higher effective tax rate constrained profit growth due to the tax incentives ending in June 2021. The Company's gross profit margin declined to 39.8%, much lower than the usual figure of at least 47.2% experienced in the previous first quarters under the review period. This is a direct consequence of higher commodity prices which the Company partially absorbed.

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The balance sheet remains healthy, with cash and cash equivalents up 39.8% to $408.2 million from a year ago, accounting for 29.8% of total assets. Loans for the Company was down to $14.6 million versus $17.6 million in the same period last year. Therefore debt remains at relatively insignificant levels for the Company.

Meanwhile, operating cash flow remains strong, increasing 23.7% to $44.9 million. The Company continues to make long-term investments in PP&E with a spend of $32.3 million primarily on additional distribution vehicles and software to improve business intelligence.

Financial Overview

Income Statement Review (FY 2017 – FY 2021)

Revenue has consistently increased at a CAGR of 14.4% for the period under review. Revenue growth accelerated to 28% to $2.1 billion in FY 2021, driven by domestic sales with exports only increasing 9%. Gross profit grew at a CAGR of 17.1% over the review period outpacing revenue growth. This was due to the gross profit margin expanding from 43.5% to 47.7% in FY 2021. Gross profit increased 27.9% in FY 2021 to $1.02 billion.

Meanwhile, operating profit surged 51.7% to $276.8 million in FY 2021, well above the CAGR of 26.1% over the review period. This was due to the Company's ability to contain SG&A costs which only increased by 19.8% in FY 2021. However, this rate was higher than the 14.4% CAGR of SG&A over the review period.

At the same time, profit after tax increased by 31.2% in FY 2021, outpacing the CAGR of 23.5%. Profit growth in FY 2021 was constrained by a higher effective tax rate beginning in June 2021.

Balance Sheet Review (FY 2017 – FY 2021)

PP&E increased by 5.5% in FY 2021, lagging the CAGR of 10.8% under the review period. In FY 2021, the Company purchased $101.4 million in additional property, including equipment to boost efficiency and motor vehicles used to improve delivery frequency in FY 2021. The majority of PP&E spent was on $30.68 million on baking fixtures and $33.8 million on motor vehicles. However, depreciation expense of $70.7 million curtailed growth in net PP&E. At the end of FY 2021, PP&E constitutes 44.1% of total assets. Another significant contributor to non-current assets is investments that are $95.6 million and makeup 7.2% of total assets. The primary investments are a $45.6 million and $30.4 million investment in VMBS and JMMB securities, respectively.

Cash and cash equivalents increased by 36.1% in FY 2021 to $404.3 million, slower than the 41.2% CAGR under the review period. At the end of FY 2021, 30.5% of total assets are cash and cash equivalents.

Current Liabilities surged 55.34% in FY 2021, well above the CAGR of 21.23% under the review period. The increase in current liabilities is due to a 50.7% surge in trade and other payables to $195.8 million. The Company's equity position has consistently improved at a CAGR of 17.2% under the review period and marginally quickened to 18.3% in FY 2021. This is primarily due to HONBUN's consistent profitability under the review period.

Cash Flow Review (FY 2017 – FY 2021)

Cash flow from operating activities increased 34.8% to a high of $304.4 million in FY 2021. The growth in operating cash flow significantly outpaced the CAGR of 18.9% for the review period. Additionally, the surge in FY 2021 was partially due to increased profits and payables.

The increased operating cash flow aided the Company in distributing dividends of $59.4 million in FY 2021 versus $37.7 million in FY 2020. Dividends are the primary outflow from the Company's financing activities, which surged to $66.3 million versus the $44.6 million reported in FY 2020.

Cash flow used in investing activities was $133.7 million, used mainly for PP&E acquisition and investments of $34.4 million. Cash flow used in investing activities was up 61.8% versus FY 2020 but lower than the peak of $151 million used in FY 2018.

Ratios (FY 2017 – FY 2021)

HONBUN's current ratio has been relatively high for the period under review, averaging 2.4x and peaking in FY 2020 at 3x and falling marginally in FY 2021 to 2.8x. However, the current ratio indicates that short-term liabilities are easily sustainable. Meanwhile, its debt-to-equity ratio has an average of 0.04x for the period and declined to 0.02x in FY 2021, indicating long-term liabilities are sustainable.

Meanwhile, the Company has generated strong ROE over the review period averaging 20% and exceeding 23% in FY 2021.

The Company's dividend payout ratio has been relatively stable, averaging 21.9% for the period under review. However, in FY 2021, the dividend payout ratio has increased materially to 27.2% resulting in a dividend yield of 2.1%.

Key Insights

HONBUN has rewarded investors with consistent revenue and profit since FY 2018. Furthermore, the Company's balance sheet has relatively low debt and high cash, and therefore the Company is in a position to weather economic headwinds or expand. Furthermore, ongoing investments in PP&E continue to improve its service delivery potential.

The significant decline in gross profit margin seen in Q1 FY 2022 does reveal the material negative impact of rising commodity prices on profitability. However, the Company could pass on more of the price increase to customers, given the strong demand for its product. Additionally, as seen in Q1 FY 2022, increased efficiency by controlling SG&A could aid in increasing profitability. Conversely, the increased effective tax rate is a headwind to profit growth.

Forecast and Valuation

We used our projection of HONBUN FY 2022 EPS and BVPS and then applied the harmonic mean P/E and P/B multiple of peers (adjusted for historical differences) to arrive at our price target of $8.28. Crucial to our price target is the assumption that investor sentiment towards HONBUN's peer group remains relatively stable. Below are charts illustrating the relationship between HONBUN's P/B and P/E ratios relative to its peer group average over the last three years. **We used the 85th and 15th percentile of the P/B and the P/E valuation difference to derive our upper and lower price targets of $9.68 and $6.94, respectively.**

Chart 1 below indicates that HONBUN's P/E is trading at a 1.1% premium to the peer group. Usually, market participants exchange HONBUN's stock at an 11.6% P/E discount relative to peers over the last three years. At the same time, we see the current premium to the peer group average as reasonable, given superior ROA and ROE and the recent strong earnings report. Conversely, a higher effective tax rate and higher commodity prices can negatively impact gross profit margins limiting our optimism. Furthermore, we expect HONBUN earnings growth to slow to 14.6% in FY 2022 (see table 2.) below the 5-year CAGR.

At the same time, HONBUN's P/B ratio is approximately at a 233.9% premium to peers, exceeding the upper end of 201% premium to peers over the prior three years. The material premium is due to PURITY's P/B influence on the harmonic mean P/B calculation.

	Price Target	Implied Upside/(Downside)
Upper	9.68	5.22%
Base	8.28	-10.00%
Lower	6.94	-24.57%

Table 1.

Junior Market Food Manufactures					
Ticker	**Market Cap($B)**	**P/E**	**P/B**	**ROA**	**ROE**
CFF	1.76	22.14	3.36	11.70%	15.69%
HONBUN	4.34	18.90	4.04	18.59%	23.19%
KREMI	1.77	34.06	2.09	3.64%	6.24%
LASM	18.00	11.55	2.05	14.09%	18.96%
PURITY	0.26	N/A	0.38	-2.15%	-3.15%
Mean	5.22	18.69	1.21	12.01%	16.02%

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Table 2.

FY	Q1	Q2	Q3	Q4	YE
2022	0.10	E 0.16	E 0.14	E 0.13	E 0.53
2021	0.07	0.16	0.14	0.09	0.46

Chart 1.

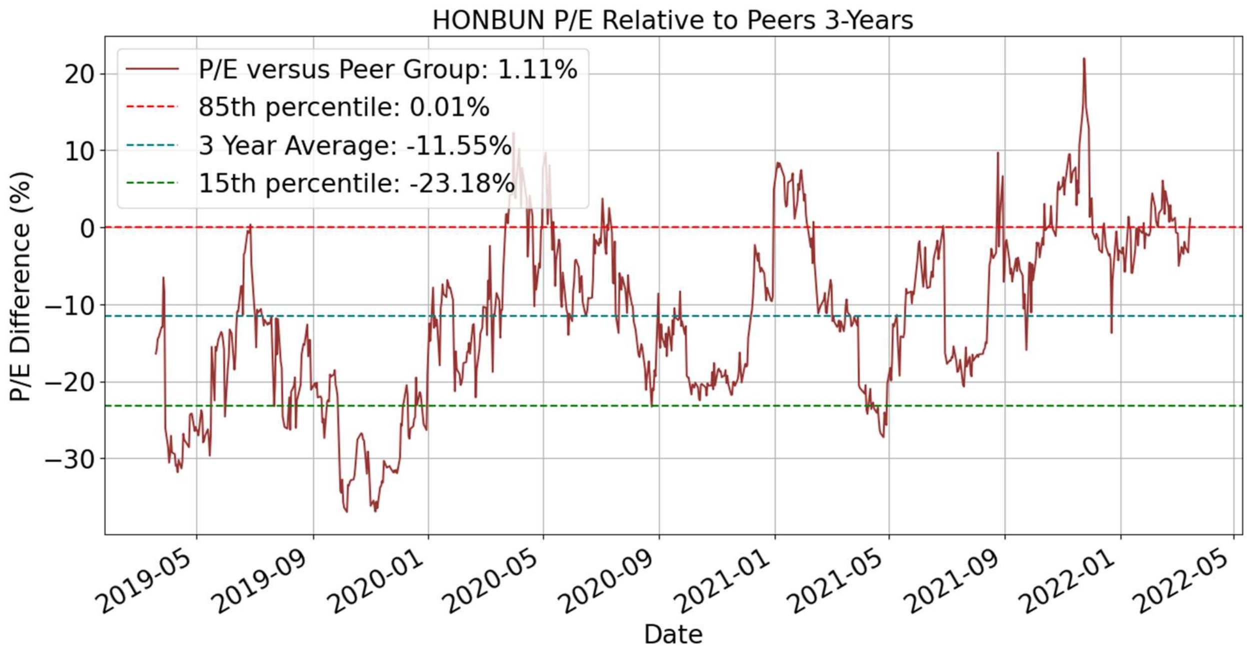
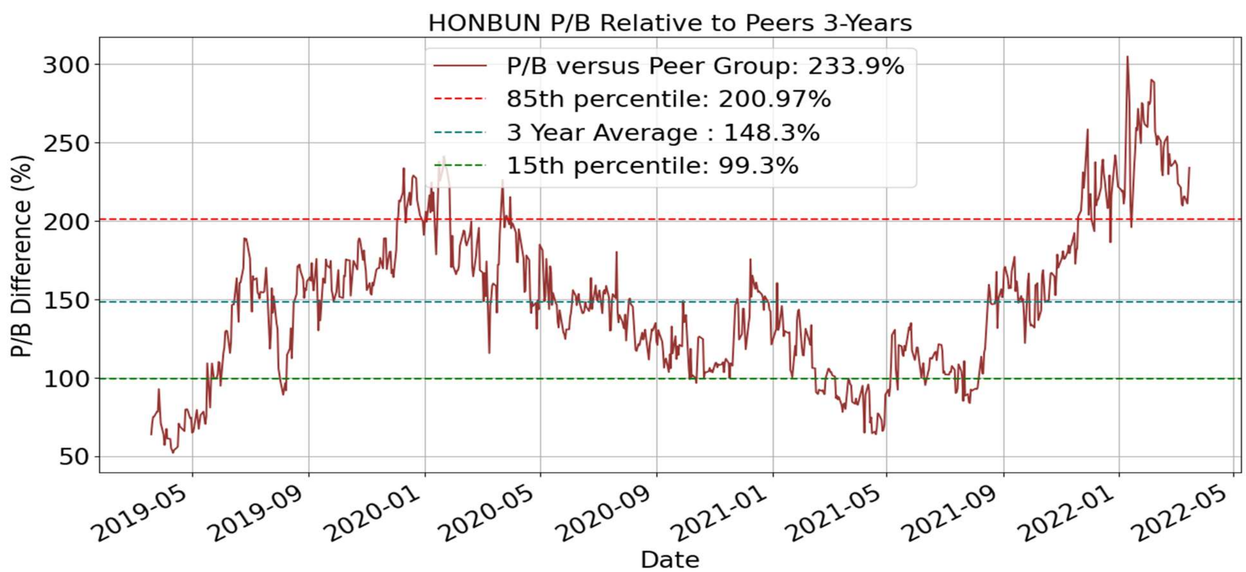


Chart 2.



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Outlook

We have a positive long-term outlook on HONBUN given its potential to continue to generate growth via the introduction of new products and exports. Exports only increased 9% in FY 2021, well below overall revenue growth; therefore, strong growth in exports could meaningfully grow the top line. Furthermore, the Company's substantial cash pile and operating cash flows will aid its ability to execute on opportunities to expand organically and inorganically. Given the current environment of increasing interest rates, HONBUN could benefit by investing excess cash at higher interest rates. Additionally, given its low debt, it's not vulnerable to increased financing costs.

However, rising commodity prices which negatively impacted Q1 FY 2021 gross margins, temper our expectations. While we expect the Company can successfully recoup some of the lost gross margins, we don't expect gross margins in line with historical levels for the medium term. **Additionally, the Company has entered its first FY at the full applicable tax rate since listing;** we expect this to limit FY 2022 profit growth significantly.

Key Risks to Our Price Target

The primary risk to our price target is HONBUN's inability to meet our growth expectations, translating to lower profits and cash flows than expected. In addition, a critical risk is HONBUN's ability to balance the need to raise prices to offset higher input costs against the backdrop of constrained customers' disposable income.

Recommendation:

We are downgrading HONBUN to an **UNDERWEIGHT** rating, given that the stock trades above our base price target and marginally below our upper price target. **Our rating considers several factors, including the quality of the Company's balance sheet, FCFE and stock liquidity.**

HONBUN has a liquid balance sheet with a current ratio averaging 2.4x for the period under review. In addition, the Company has maintained a debt-to-equity ratio averaging 0.04x for the same period. Furthermore, as of December 2021, it has $404.3 million in cash & cash equivalents; therefore, we view HONBUN's balance sheet favourably. HONBUN has also produced strong operating cash flow for the period and continues to make PP&E investments to aid revenue expansion via new product offerings. Additionally, HONBUN's stock is a fairly liquid Junior Market listing, trading an average daily value of about $1.8 million over the last year. **See charts 3 – 6 below for additional trading information on HONBUN.**

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Chart 3.

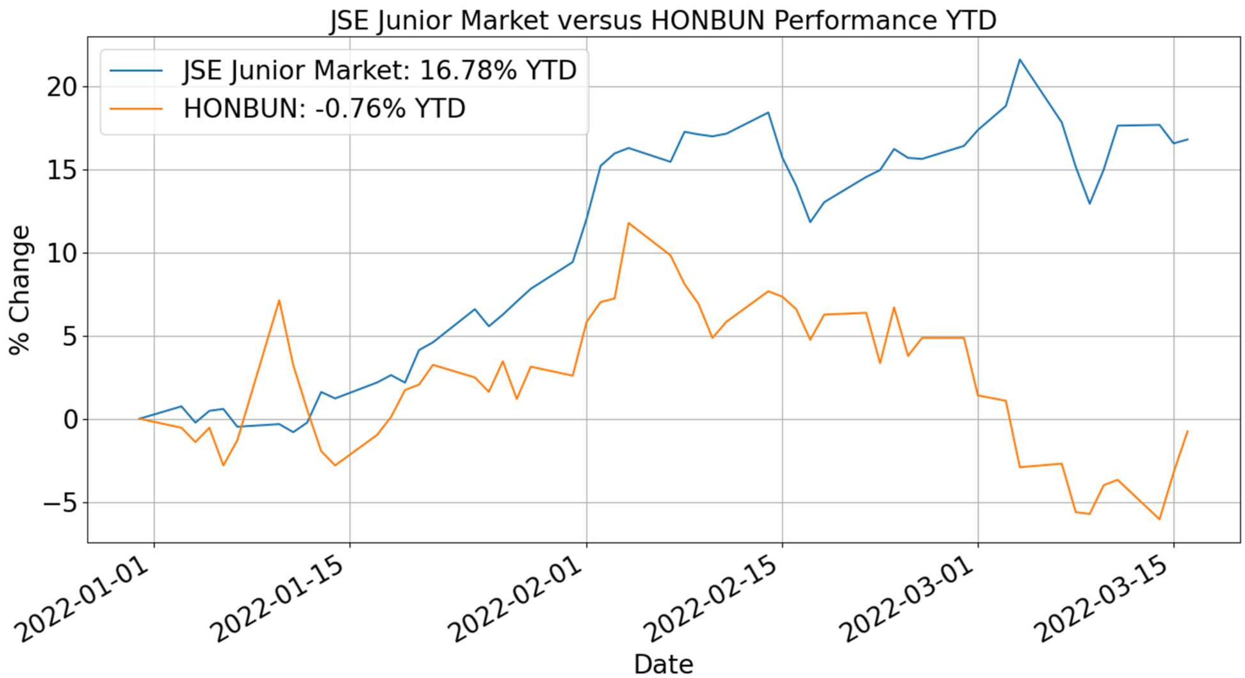

Chart 4.

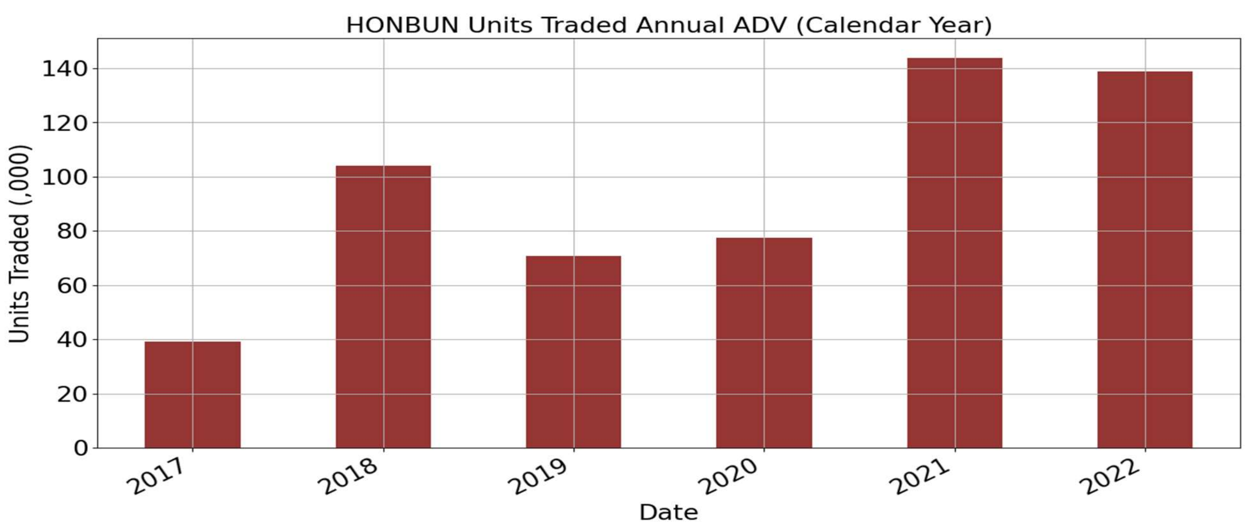

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Chart 5.

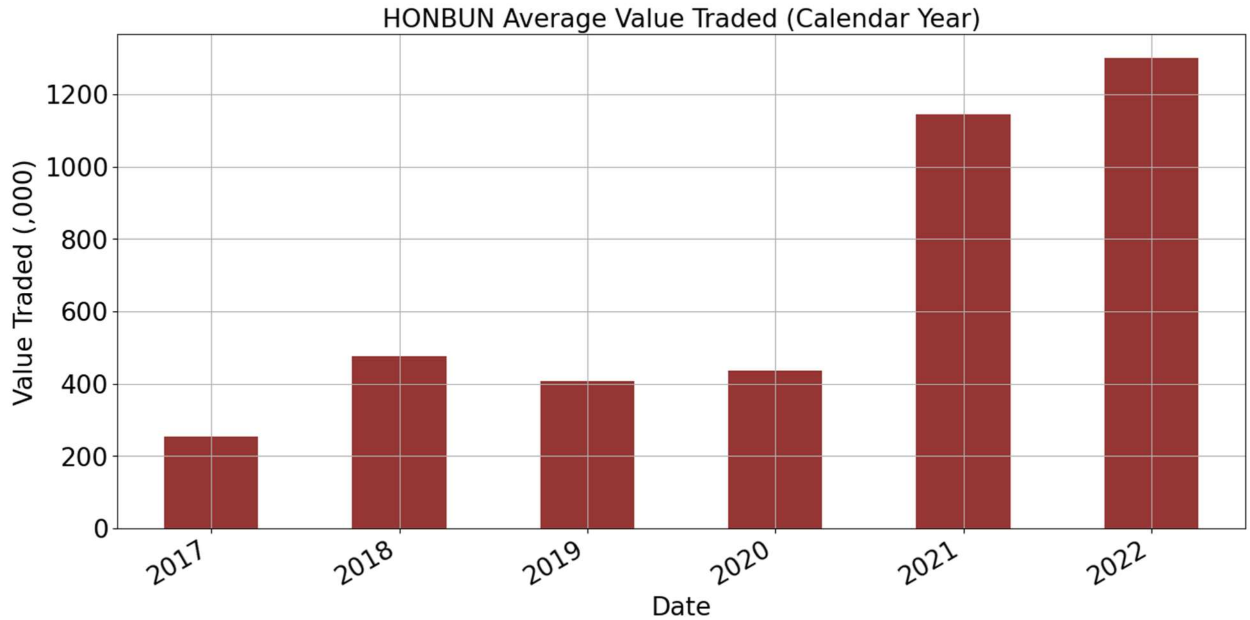
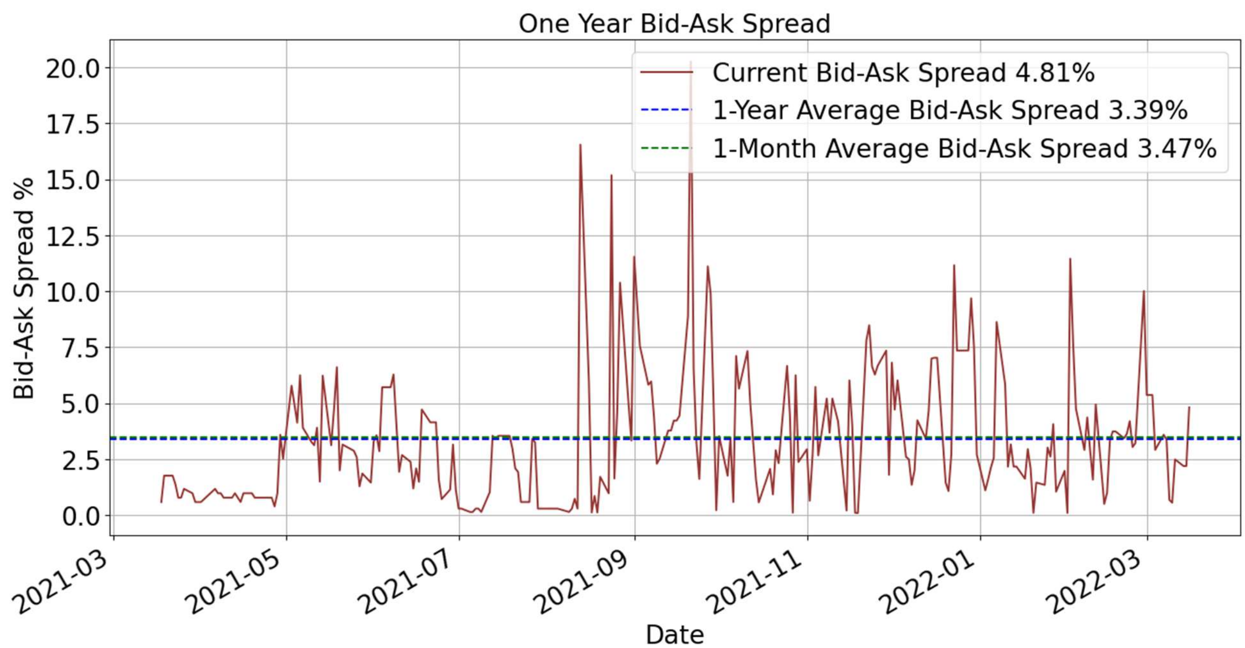


Chart 6.



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.

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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