

Lasco Manufacturing Limited

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Executive Summary

Lasco Manufacturing (LASM) was incorporated in October 1994 and is a member of the LASCO Affiliated Companies and listed on the Junior Market on October 12, 2010. The Company is domiciled in Jamaica with its registered office at 27 Red Hills Road Kingston 10 but operates from White Marl St. Catherine. LASM's range of products created at its dry plant includes LASCO Food Drink, LaSoy Lactose-Free, Porridge Mix, Enriched Milk Powder, Read Milk and Nutrify. Meanwhile, the liquid plant began operations in July 2014 and its portfolio includes iCool Juice Drinks, iCool Water, iCool Flavoured Water, iDrade, Lyrix and Konka.

Financial statements indicate that LASM is well-capitalised and has produced consistent returns for investors over the review period. Near-term liabilities appear sustainable, given the liquidity ratios. At the same time, solvency ratios continue to improve from an already strong position. Furthermore, operating cash flow has been consistently positive over the review period.

LASM currently trades at approximately 10.4x, its trailing 12-month EPS well below the 17.6x harmonic mean of the peer group. Meanwhile, LASM has relatively high liquidity, exchanging an average daily volume of 198.9K units over the past year, valued at approximately \$943.9 million. Over the past month, LASM has had an average bid-ask spread of about 4.4%, indicating a high implicit cost to acquire shares.



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Abridged Financials

| | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 | CAGR | Q1 2022 | Q1 2023 | Change |
|--|---------|---------|---------|---------|---------|----------------|---------|---------|---------------|
| BVPS | 1.20 | 1.43 | 1.63 | 1.92 | 2.26 | 17.08% | 2.01 | 2.29 | 13.76% |
| EPS | 0.14 | 0.26 | 0.24 | 0.33 | 0.41 | 31.76% | 0.10 | 0.10 | 3.02% |
| Dividend Per Share | 0.04 | 0.04 | 0.06 | 0.06 | 0.07 | 20.01% | - | 0.10 | N/A |
| Stock Price | 4.30 | 3.72 | 3.35 | 4.50 | 5.55 | 6.59% | 5.45 | 4.80 | -11.93% |
| Junior Market Index | 2,956 | 3,128 | 2,394 | 2,996 | 4,186 | 9.09% | 3,403 | 4,337 | 27.47% |
| Abridged Income Statement in \$B | | | | | | | | | |
| Revenue | 6.66 | 7.57 | 7.89 | 8.22 | 9.48 | 9.23% | 2.32 | 2.60 | 12.26% |
| Gross Profit | 2.29 | 2.68 | 2.92 | 3.11 | 3.48 | 11.05% | 0.84 | 0.90 | 6.85% |
| Operating Expense | 1.43 | 1.42 | 1.66 | 1.32 | 1.29 | -2.53% | 0.30 | 0.31 | 2.45% |
| Operating Profit | 0.86 | 1.26 | 1.29 | 1.81 | 2.22 | 26.75% | 0.57 | 0.57 | 0.31% |
| Pre-tax Profits | 0.73 | 1.15 | 1.20 | 1.76 | 2.18 | 31.43% | 0.56 | 0.57 | 1.76% |
| Profits | 0.56 | 1.08 | 0.98 | 1.38 | 1.71 | 32.11% | 0.40 | 0.41 | 3.07% |
| Abridged Balance Sheet in \$B | | | | | | | | | |
| PP&E | 4.70 | 5.05 | 4.97 | 4.95 | 4.73 | 0.16% | 4.77 | 4.54 | -4.73% |
| Non-Current Assets | 4.72 | 5.07 | 5.14 | 5.22 | 5.03 | 1.58% | 5.13 | 5.14 | 0.16% |
| Cash & Cash Equivalents | 0.19 | 0.92 | 1.35 | 1.86 | 2.03 | 79.60% | 1.55 | 1.02 | -34.24% |
| Current Assets | 3.00 | 3.72 | 4.60 | 5.63 | 7.04 | 23.76% | 6.10 | 7.13 | 17.00% |
| Current Liabilities | 1.34 | 1.46 | 1.79 | 1.79 | 1.74 | 6.81% | 1.88 | 1.88 | 0.13% |
| Total Assets | 7.72 | 8.79 | 9.74 | 10.85 | 12.07 | 11.80% | 11.23 | 12.27 | 9.30% |
| Debt | 1.64 | 1.40 | 1.04 | 0.82 | 0.36 | -31.30% | 0.69 | 0.31 | -55.32% |
| Non-Current Liabilities | 1.46 | 1.48 | 1.20 | 1.15 | 0.97 | -9.61% | 1.04 | 0.93 | -10.24% |
| Equity | 4.92 | 5.85 | 6.75 | 7.91 | 9.35 | 17.39% | 8.31 | 9.46 | 13.81% |
| Abridged Cash Flow Statement in \$B | | | | | | | | | |
| CFO before change in WC | 1.15 | 1.49 | 1.74 | 2.03 | 2.40 | 20.26% | 0.64 | 0.63 | -1.43% |
| CFO | 0.34 | 1.82 | 1.47 | 1.43 | 1.51 | 45.56% | (0.03) | (0.46) | 1383.84% |
| CFI | (0.34) | (0.59) | (0.48) | (0.42) | (0.60) | 15.50% | (0.13) | (0.01) | -90.69% |
| CFF | (0.26) | (0.13) | (0.56) | (0.53) | (0.80) | 31.92% | (0.14) | (0.47) | 238.22% |
| Ratios | | | | | | Average | | | Change |
| Gross Margin | 34.40% | 35.41% | 36.99% | 37.89% | 36.75% | 36.29% | 36.23% | 34.49% | -4.82% |
| Operating Margin | 12.93% | 16.63% | 16.39% | 22.09% | 23.45% | 18.30% | 24.61% | 21.99% | -10.65% |
| Net Profit Margin | 8.42% | 14.23% | 12.45% | 16.79% | 18.01% | 13.98% | 17.32% | 15.90% | -8.19% |
| Current Ratio | 2.24 | 2.54 | 2.57 | 3.14 | 4.04 | 2.91 | 3.25 | 3.80 | 16.85% |
| Cash Ratio | 0.15 | 0.15 | 0.68 | 0.89 | 1.03 | 0.58 | 0.99 | 1.01 | 2.76% |
| Debt-to-Equity | 0.33 | 0.24 | 0.15 | 0.10 | 0.04 | 0.17 | 0.08 | 0.03 | -60.74% |
| Days of Sales Outstanding | 92.47 | 88.32 | 88.81 | 95.98 | 93.13 | 91.74 | 102.28 | 116.09 | 13.50% |
| Days of Inventory on Hand | 61.35 | 64.92 | 72.81 | 83.60 | 87.51 | 74.04 | 87.57 | 94.92 | 8.39% |
| ROE | 11.97% | 20.00% | 15.59% | 18.82% | 19.79% | 17.23% | 18.69% | 19.35% | 3.55% |
| ROA | 7.58% | 13.04% | 10.60% | 13.40% | 14.90% | 11.90% | 13.65% | 14.64% | 7.25% |
| P/E | 31.37 | 14.13 | 14.15 | 13.47 | 13.43 | 17.31 | 15.61 | 11.53 | -26.13% |
| P/B | 3.57 | 2.60 | 2.06 | 2.35 | 2.45 | 2.61 | 2.71 | 2.10 | -22.58% |
| Payout Ratio | 25.53% | 14.43% | 25.81% | 18.18% | 17.57% | 20.30% | 0.00% | 99.81% | N/A |
| Dividend Yield | 0.80% | 1.02% | 1.40% | 1.56% | 1.48% | 1.25% | 0.00% | 1.91% | N/A |

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Financial Overview

Income Statement Review

Revenue has consistently increased for the period under review and accelerated in FY 23. Revenue increased by 15.4% in FY 22, exceeding the CAGR of 9.2% for the review period (FY 18 to FY 22). Subsequently, in Q1 FY 23, revenue increased 12.3% to \$2.6 billion.

Operating expenses trended lower for the review period and decreased by 2.3% in FY 22 to \$1.3 billion. The Company's operating expenses decreased every FY under review except FY 20. The increased operating cost in FY 20 was due to stock options granted during the year under the Employee Stock Option Plan. **The reduced operating expense was aided by a gain of \$41.1 million due to foreign exchange change in FY 22 versus an FX loss of \$55.9 million in FY 21.** In contrast, operating expenses increased by 2.4% in the most recent quarter to \$311.7 million.

Ultimately, the Company grew profits by 23.8% in FY 22 to \$1.7 billion. LASM has consistently increased profits since FY 20 and experienced a CAGR of 32.1% over the review period. The critical component of FY 22 earnings growth has been LASM's ability to contain costs for the previously discussed reason.

Balance Sheet Review

Over the review period, current assets have steadily increased through cash and cash equivalents stockpiling. At the end of FY 22, the primary contributors to current assets were receivables, cash & equivalents and inventories, constituting 21.2%, 16.8% and 13.4%, respectively. Current assets increased at a CAGR of 23.8% for the review period and 25.1% in FY 22. Cash & equivalents increased 9.1% to a record of \$2 billion, which aided the increase in current assets for FY 22. However, the primary driver of current asset growth was short-term investments, increasing by \$600.9 million or 276% to \$818.7 million. Short-term investments are USD interest-bearing deposits.

Most sales are to a related company (LASD), resulting in about 99.6% of trade receivables being 0-30 days aged at the end of FY 22 with no default history. Therefore, we view the quality of LASM receivables as quite favourable.

Inventory increased by 47.8% yoy to \$1.9 billion at the end of June 2022. The increase in raw material costs and the Company's goal to mitigate supply chain disruptions resulted in a significant increase in inventory.

Current liabilities have plateaued since FY 22 and declined 2.8% in FY 22 to \$1.7 billion. The primary contributor to the fall in FY 22 current liabilities was the current portion of long-term loans, declining by 54.4% to \$207.4 million. Meanwhile, the primary contributor to current liabilities is trade payables, accounting for 9.6% of FY 22 total assets.

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Non-current liabilities have steadily declined since peaking in FY 19, and this trend continued in its most recent FY. The pattern of decline is partially due to long-term debt falling from \$931.8 million in FY 19 to \$157.2 million in FY 22. Consequently, LASM's interest expense has declined under the review period. The rapid decline in debt has made deferred taxation the primary non-current liability, reaching \$817.7 million at the end of FY 22. The growth in deferred taxations results from the expansion in accelerated capital allowances.

Cash Flow Statement Review

In FY 22, cash flow from operating activities (CFO) increased by 6% to \$1.5 billion. CFO has been volatile during the review period due to the impacts of cash flow used for inventories and receivables. **However, CFO before changes in working capital has steadily increased and improved by 17.8% in FY 22 to \$2.4 billion.** A general increase in profitability for the period and increased depreciation expense are the primary drivers of the CFO before changes in working capital improvement. More recently, cash flow used in operating activities (CFO) declined to \$464.7 million in Q1 FY 23 (Q1 FY 22: Outflow \$31.3 million). The cash outflow from operating activities results from the surge in inventory and receivables. However, cash flow provided by operating activities before changes in working capital only declined by 1.4% to \$634.6 million.

Cash outflows used in financing activities surged 51.6% in FY 22 to \$801.9 million due to increased flows to primary components loan repayment and dividends. Dividend payments increased by 19.7% to \$300 million. Simultaneously, loan repayment surged by 64.9% to \$454.6 million. Subsequently, cash flow used in financing activities surged 238.2% to \$469.3 million in Q1 FY 23 (Q1 FY 22: outflow of \$138.8 million). This is primarily due to a dividend payment of \$413.3 million during the most recent quarter versus none in the same period the prior year. **The recent dividend payment represents a 37.7% increase versus FY 22.**

Cash used in investing activities increased 41.8% in FY 22 to \$602.3 million. The increase was mainly due to a 401.6% increase in short-term investments to \$600.9 million (FY 21: \$119.8 million). Afterwards, cash flow used in investing activities declined to \$12.5 million in Q1 FY 23 (Q1 FY 22: outflow of \$134.2 million). The difference results from LASM receiving a cash inflow from short-term investments of \$2.5 million versus an outflow of \$101.3 million in the prior year.

Key Ratios Review

Since FY 18, the gross profit margin has trended higher, but FY 22 gross profit margin fell to 36.8%. FY 21, the gross margin peaked at 37.9% due to manufacturing efficiencies and a favourable product mix. However, in FY 22, increased materials and logistics costs that were not fully passed to customers resulted in the gross margin decline. Furthermore, LASM's gross profit margin declined to 34.5% in Q1 FY 23 (Q1 FY 22: 36.2%) due to inflation pressure on materials, logistics, and energy costs.

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Net profit margin has been volatile for the review period but peaked in FY 22. The decline in operating expenses resulted in a net profit margin of 18% in FY 22. Subsequently, LASM's net profit margin declined to 15.9% in Q1 FY 23 (Q1 FY 22: 17.3%). The decline in net profit margin was exacerbated by the increased operating expense and a reduction in other operating income.

The current ratio trended higher under the review period and reached 4x at the end of FY 22. As previously discussed, the increase was due to increased current assets and simultaneous sedentary current liabilities. As a result of the elevated current assets, it is unlikely that LASM will have issues meeting near-term obligations.

Days of inventory on hand (DOH) have trended higher for the review period and increased by 4.7% in FY 22 to 88 days. The recent uptick could aid the Company in managing supply chain issues. At the same time, days of sales outstanding (DSO) declined by 3% in FY 22 to 93 days. However, as discussed earlier, we don't consider this much of an issue given the high quality of receivables.

Debt-to-equity has steadily receded since FY 18 and in FY 22 reached a low of 0.04x. Additionally, LASM's debt-to-equity declined 60.7% to 0.03x at the end of Q1 FY 23 (Q1 FY 22: 0.08x). Therefore, we expect long-term liabilities are sustainable. The Company is on a trajectory that could see it easily eliminating debt by the end of FY 23 if desired.

ROE has been volatile for the review period and experienced a modest uptick in FY 22. DuPont analysis reveals that the primary driver of the FY 22 increase was improved net profit margin and total asset turnover. Notably, LASM increased its ROE while experiencing a decline in financial leverage.

Forecast and Valuation

We used our projection of LASM's FY 2023 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 \$5.84. Crucial to our price target is the assumption that investor sentiment towards LASM's peer group remains relatively stable. Below are charts illustrating the relationship between LASM's P/B and P/E ratios relative to its peer group average over the last year. **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 \$6.51 and \$5.01 respectively.**

Chart 1 below indicates that LASM's P/E is trading at a 40.7% discount to peers. On average, market participants exchange LASM's stock with a 33.2% P/E discount relative to peers over the last year. This discount is unusual given that LASM has produced ROA and ROE that exceeds all its peers.

At the same time, LASM's P/B ratio is approximately at an 11.8% premium to peers, well below the average of 60.7% premium LASM experienced over the past year. We view the current P/B premium as low, given LASM's consistently improving equity and relatively high ROE.

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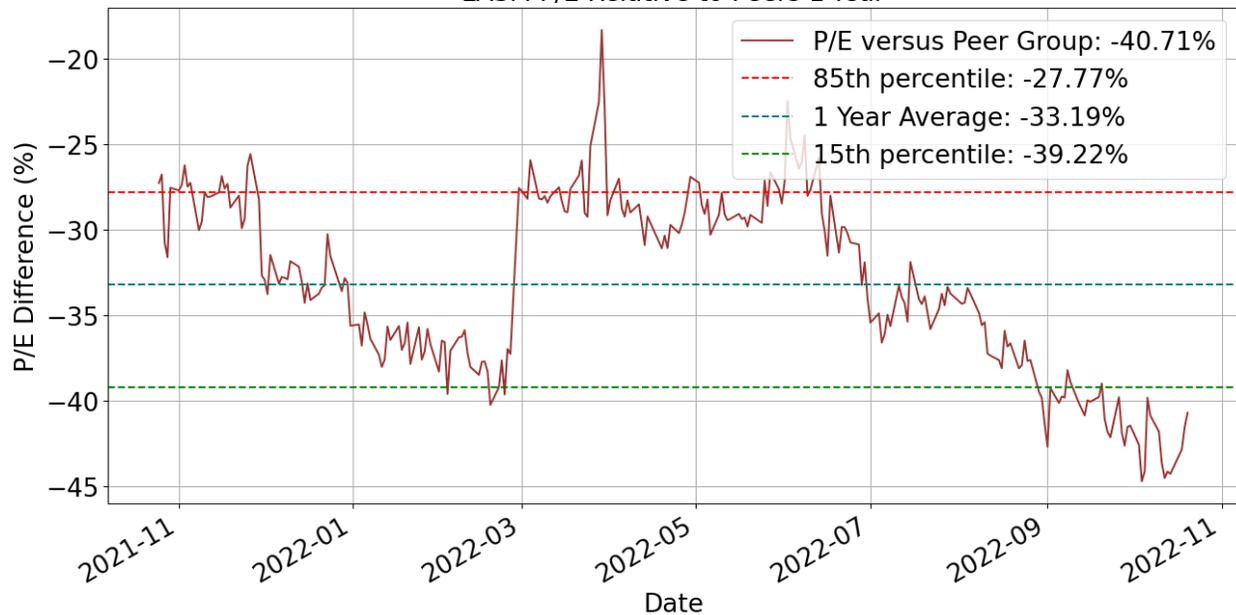
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| | Price Target | Implied Upside/(Downside) |
|--------------|--------------|---------------------------|
| Upper | 6.53 | 49.43% |
| Base | 5.85 | 33.87% |
| Lower | 4.94 | 13.04% |

| Junior Market Food Manufactures | | | | | |
|---------------------------------|-----------------|--------|------|--------|--------|
| Ticker | Market Cap(\$B) | P/E | P/B | ROA | ROE |
| CFF | 1.57 | 18.93 | 2.76 | 11.49% | 15.10% |
| HONBUN | 3.61 | 20.28 | 3.30 | 13.04% | 17.11% |
| PURITY | 0.57 | 34.30 | 0.81 | 1.60% | 2.39% |
| LASM | 17.87 | 10.45 | 1.89 | 14.64% | 19.35% |
| KREMI | 1.53 | -24.70 | 1.90 | -3.95% | -7.41% |
| Mean | 5.03 | 17.62 | 1.69 | 7.36% | 9.31% |

Chart 1.

LASM P/E Relative to Peers 1-Year

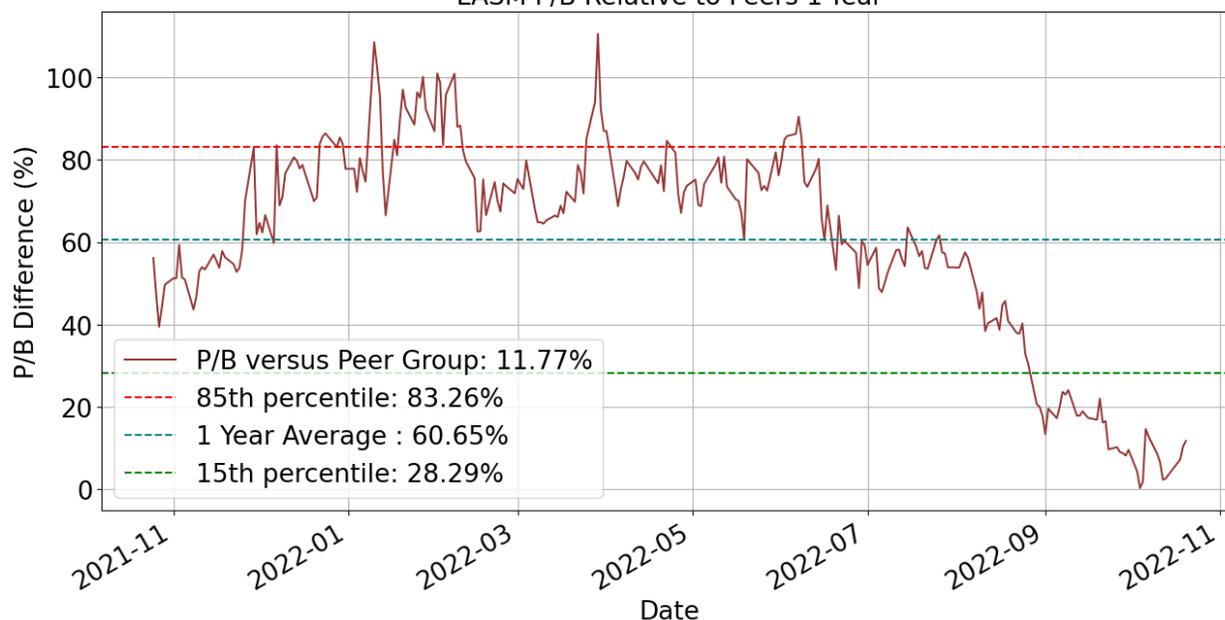


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Chart 2.

LASM P/B Relative to Peers 1-Year



Outlook

We have an overall positive outlook on LASM, given our expectation of steady improvement in operating cash flows and profitability. Furthermore, LASM could fund material expansions internally with the current high-level cash and short-term investments. Also, the Company could continue to grow its dividend payments significantly, attracting income-seeking investors. Finally, its debt reduction diminished direct exposure to the current higher interest rate environment.

LASM investors could see higher dividends, given the recent surge in dividend payments, lower debt at the Company and continued strong operating cash flows. The Company could materially increase dividend payments from current levels while continuing to grow due to its strong cash position, operating cash flow and dividend payout ratio well below 30%.

Conversely, our positive view on LASM is constrained by the negative impact of inflation on its gross margin and, ultimately, profit margin. As a result, LASM's growth could be hampered in the near term.

| FY | Q1 | Q2 | Q3 | Q4 | FY |
|------|------|-------|-------|-------|-------|
| 2023 | 0.10 | 0.10E | 0.10E | 0.11E | 0.41E |
| 2022 | 0.10 | 0.09 | 0.10 | 0.13 | 0.41 |

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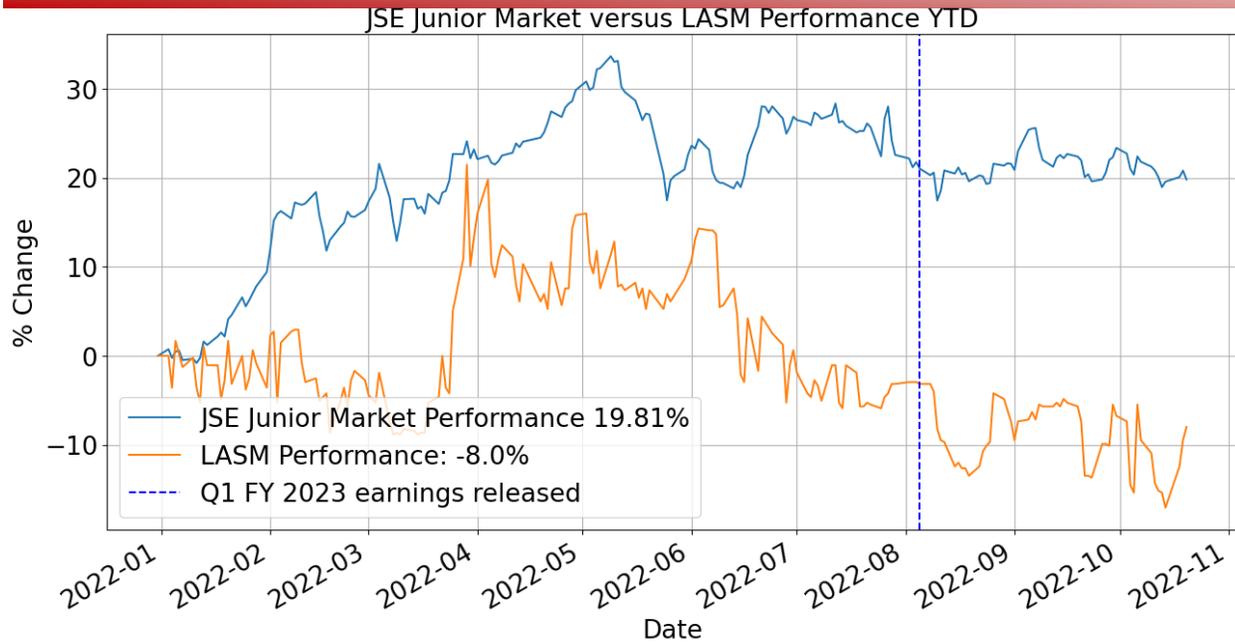
Recommendation:

We are upgrading our rating on LASM to OUTPERFORM, given that the stock currently trades below our lower price target. Our recommendation considers profit stability and growth potential, the strength of its balance sheet and share liquidity.

We expect steady revenue and profit growth going forward. Initiatives such as acquisitions, product expansion, increased exports, and strategic partnerships may help lift long-term profitability. Additionally, the Company's balance sheet and stable operating cash flows put it in a favourable position to execute desired growth initiatives and/or increase dividend payments. However, elevated commodity prices and slow economic expansion may constrain near-term growth.

LASM has declined 8% YTD, significantly underperforming the JSE Junior Market advance of 19.8% for the same period. LASM's stock is reasonably liquid among Junior Market listings, trading an average daily value of approximately \$943.9 million or 198.9K units over the last year. **See the charts below for more information on LASM's YTD performance, the volume traded, value exchanged, and historical closing bid-ask spread.**

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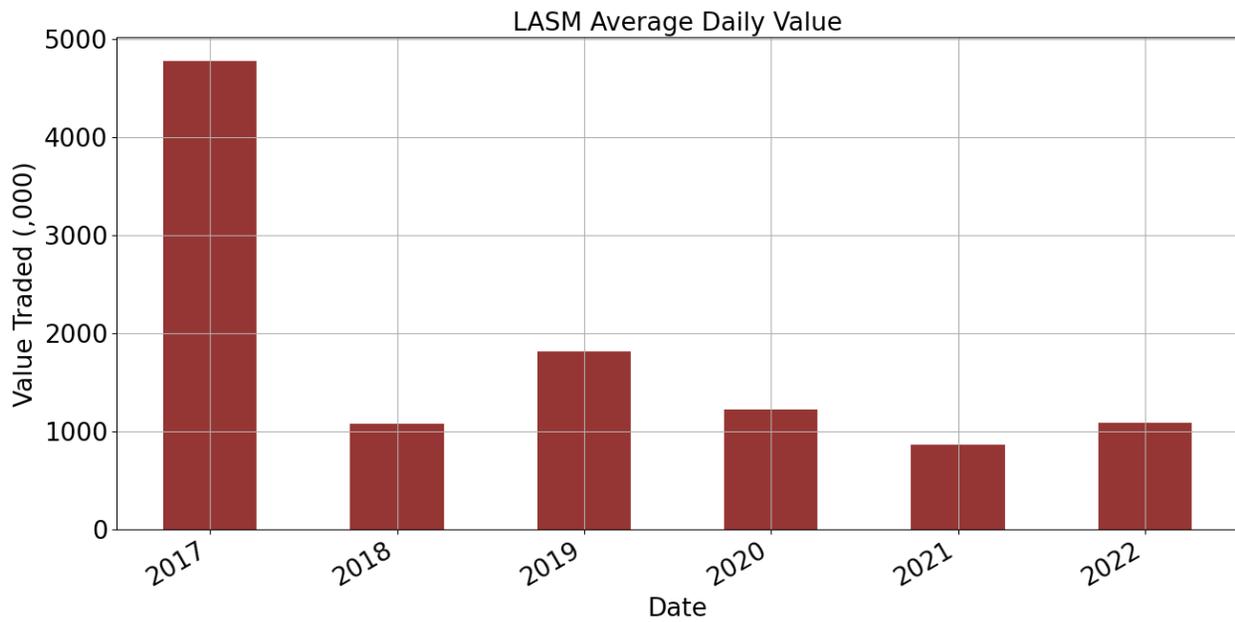
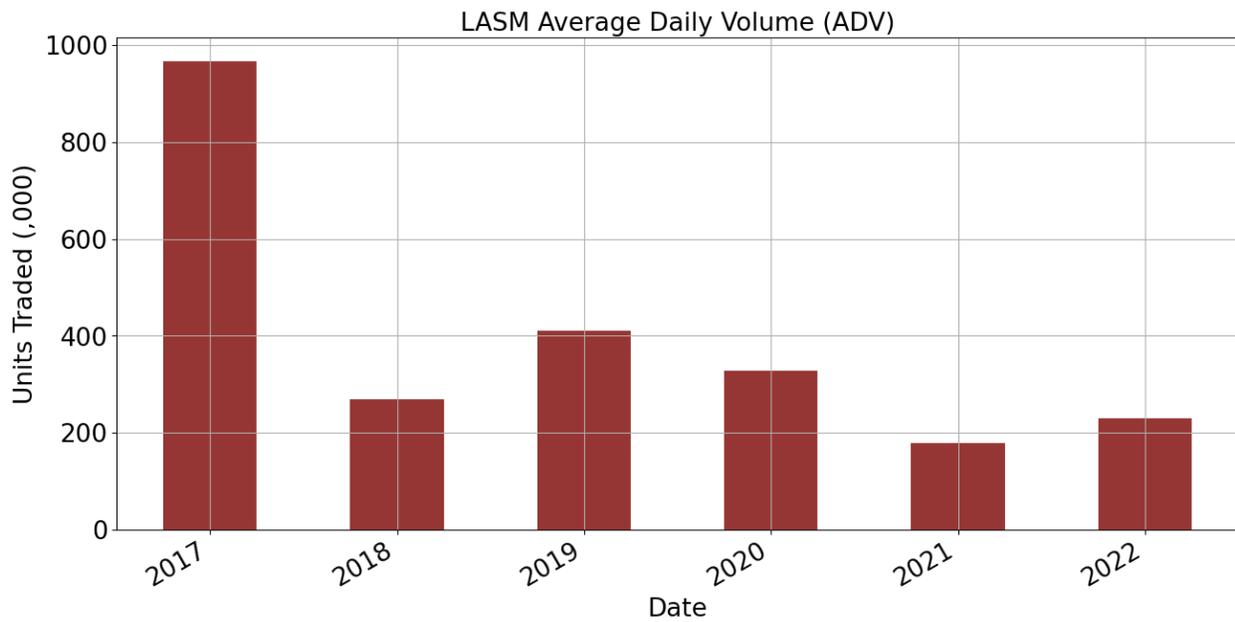


LASM Monthly Returns (%)

| Year | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | eoy |
|------|--------|--------|--------|-------|--------|--------|--------|-------|--------|--------|--------|-------|--------|
| 2012 | 1.45 | -15.71 | 0.85 | 0.84 | -10.00 | 2.78 | 10.81 | 1.63 | -4.00 | 8.33 | -8.46 | -7.56 | -20.29 |
| 2013 | -0.00 | -14.55 | 11.70 | -1.90 | 46.60 | 3.97 | -3.82 | 7.28 | -6.79 | -5.96 | -8.45 | -4.62 | 12.73 |
| 2014 | 7.26 | -11.28 | 4.24 | -2.44 | -8.33 | -2.73 | -23.36 | 14.63 | -7.45 | 6.90 | 9.68 | 9.80 | -9.68 |
| 2015 | 7.14 | -4.17 | 0.00 | 5.22 | 5.79 | 13.28 | 12.41 | 11.04 | 10.50 | 69.00 | 7.10 | -1.38 | 218.75 |
| 2016 | 35.85 | -15.05 | -8.01 | 9.23 | 11.59 | 8.01 | -0.40 | -9.26 | 10.86 | 1.80 | -7.86 | 4.48 | 37.25 |
| 2017 | 4.90 | -11.67 | 10.13 | 12.40 | -13.52 | 5.56 | -14.81 | 2.75 | -21.16 | 26.84 | -17.37 | 1.89 | -22.86 |
| 2018 | 16.14 | 2.05 | -8.04 | -0.97 | -1.96 | -2.00 | 3.32 | -2.96 | -1.53 | -10.08 | -2.01 | 8.50 | -2.12 |
| 2019 | -11.89 | -0.61 | 6.17 | -7.56 | 17.92 | 8.00 | 7.41 | 31.26 | -5.43 | -6.67 | -4.56 | -2.49 | 26.76 |
| 2020 | -12.79 | -2.20 | -25.25 | 22.74 | 22.62 | -16.22 | -5.31 | 0.84 | -5.00 | -0.29 | 8.80 | 3.77 | -17.91 |
| 2021 | 1.82 | 18.62 | -3.23 | 13.78 | 7.62 | -1.09 | -3.67 | -5.33 | -2.41 | -2.89 | 3.82 | -2.86 | 23.38 |
| 2022 | -3.58 | 0.87 | 16.45 | 2.23 | -5.27 | -8.25 | -3.77 | -4.35 | 0.68 | -1.35 | 0.00 | 0.00 | -8.00 |

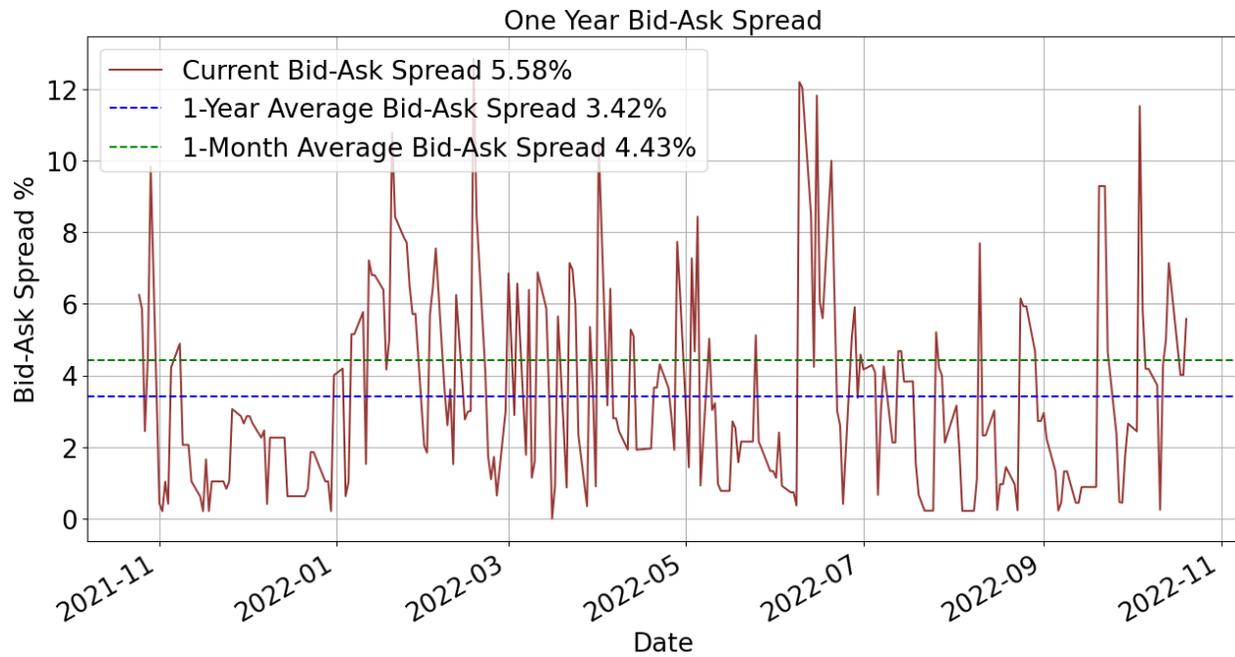
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APPENDIX

IMPORTANT DISCLOSURES

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

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 - up to 10% of your portfolio

MARKETPERFORM - 5% of your portfolio

UNDERPERFORM - 2.5% to 4.9% of your portfolio

STRONGLY UNDERPERFORM - less than 2.5% of your portfolio

SELL - 0% of your portfolio

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