Lasco Manufacturing Limited

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

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, it 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, Readi 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 flows have been consistently positive over the review period.

LASM currently trades at approximately 13.7x, its trailing 12-months EPS below the 18.6x harmonic mean of the peer group. Meanwhile, LASM has relatively high liquidity, exchanging an average daily volume of 175.8K units over the past year, valued at approximately $848.5 million. Over the past month, LASM has had an average bid-ask spread of about 1.68%, indicating a relatively low implicit cost to acquire shares.

Lasco Manufacturing Limited

Recent Developments

The 2nd quarter ended September 2021 produced mixed results. Revenue was up 2.7% to $2.3 billion for the 2nd quarter ended September 2021. However, gross profit fell 1.25%, resulting in a gross profit margin of 37.2% versus 38.7% for the same period in FY 2021. The gross profit margin declined because of increased materials and logistics costs that were not fully passed on to customers. At the same time, operating profit increased 11.7% due to a 10.7% decline in operating expense. Ultimately, profits fell 3.9% to $380.3 million due to an effective tax rate significantly higher than the same period last year.

Abridged Financials

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	CAGR	Q2 2021	Q2 2022	Change
BVPS	1.09	1.20	1.43	1.63	1.91	15.12%	1.75	2.03	15.97%
EPS	0.17	0.14	0.26	0.24	0.33	17.75%	0.18	0.19	6.10%
Dividend Per Share	0.03	0.04	0.04	0.06	0.06	19.27%	0.06	0.07	19.60%
Stock Price	5.00	4.12	3.44	2.99	4.50	-2.60%	3.42	4.85	41.71%
Junior Market Index	3,042	2,956	3,128	2,394	2,996	-0.38%	2,533	3,313	30.77%
Abridged Income Statement (,000)									
Revenue	6.95	6.66	7.57	7.89	8.22	4.27%	4.12	4.66	12.95%
Gross Profit	2.56	2.29	2.68	2.92	3.11	5.02%	1.60	1.71	6.84%
Operating Expense	1.49	1.43	1.42	1.66	1.32	-2.97%	0.67	0.62	-6.73%
Operating Profit	1.07	0.86	1.26	1.29	1.81	14.16%	0.91	1.14	24.44%
Pre-tax Profits	0.91	0.73	1.15	1.20	1.76	17.83%	0.88	1.11	25.63%
Profits	0.71	0.56	1.08	0.98	1.38	18.18%	0.74	0.78	6.05%
Abridged Balance Sheet (,000)									
PP&E	4.57	4.70	5.05	4.97	4.95	2.02%	4.51	4.70	4.21%
Non-Current Assets	4.60	4.72	5.07	5.14	5.22	3.24%	5.14	5.06	-1.45%
Cash & Cash Equivalents	0.24	0.19	0.92	1.35	1.86	66.73%	1.41	1.44	2.66%
Current Assets	2.48	3.00	3.72	4.60	5.63	22.76%	4.98	6.08	22.13%
Current Liabilities	1.15	1.34	1.46	1.79	1.79	11.78%	1.65	1.79	8.88%
Total Assets	7.08	7.72	8.79	9.74	10.85	11.28%	10.11	11.14	10.15%
Debt	1.41	1.64	1.40	1.04	0.82	-12.65%	1.04	0.58	-44.36%
Non-Current Liabilities	1.41	1.46	1.48	1.20	1.15	-5.02%	1.23	0.96	-22.30%
Equity	4.44	4.92	5.85	6.75	7.91	15.54%	7.24	8.39	15.97%
Abridged Cash Flow Statement (,000)									
CFO before change in WC	1.25	1.15	1.49	1.74	2.03	12.96%	1.04	1.28	22.75%
CFO	2.13	0.34	1.82	1.47	1.43	-9.50%	0.57	0.28	-50.58%
CFI	(1.26)	(0.34)	(0.59)	(0.48)	(0.42)	-23.80%	(0.24)	(0.13)	-45.32%
CFF	(0.50)	(0.26)	(0.13)	(0.56)	(0.53)	1.28%	(0.28)	(0.57)	101.88%
Ratios						**Average**			**Change**
Gross Margin	36.83%	34.40%	35.41%	36.99%	37.89%	36.31%	38.81%	36.71%	-5.41%
Operating Margin	15.37%	12.93%	16.63%	16.39%	22.09%	16.68%	22.18%	24.43%	10.18%
Net Profit Margin	10.17%	8.42%	14.23%	12.45%	16.79%	12.41%	17.88%	16.79%	-6.10%
Current Ratio	2.16	2.24	2.54	2.57	3.14	2.53	3.03	3.39	12.17%
Cash Ratio	0.26	0.15	0.15	0.68	0.89	0.42	0.50	0.93	87.25%
Debt-to-Equity	0.32	0.33	0.24	0.15	0.10	0.23	0.14	0.07	-52.02%
Inventory Turnover	6.11	5.95	5.62	5.01	4.37	5.41	4.88	4.60	-5.78%
Receivables Turnover	3.75	3.95	4.13	4.11	3.80	3.95	3.72	3.35	-9.82%
ROE	17.05%	11.97%	20.00%	15.59%	18.82%	16.69%	17.21%	18.22%	5.92%
ROA	10.15%	7.58%	13.04%	10.60%	13.40%	10.95%	12.14%	13.40%	10.40%
P/E	28.89	30.05	13.06	12.63	13.53	19.63	12.13	13.99	15.31%
P/B	4.60	3.42	2.41	1.84	2.36	2.93	1.95	2.39	22.20%
Payout Ratio	17.34%	25.53%	14.43%	25.81%	18.24%	20.27%	33.84%	38.15%	12.72%
Dividend Yield	0.63%	0.80%	1.02%	1.40%	1.56%	1.08%	1.60%	1.42%	-11.36%

Lasco Manufacturing Limited

Financial Overview

Income Statement Review

Revenue has consistently increased for the period under review, with this trend continuing in FY 2022. Revenue increased 4.21% in FY 2021, similar to the CAGR of 4.27% for the review period (FY 2017 to 2021). FY 2021 growth was possible due to the at-home product offerings performance making up for the lingering negative impacts of the global pandemic on products targeted at out-of-home and on-the-go consumption. More recently, revenue growth accelerated to 13% to $4.7 billion for the six months ended September 2021.

Operating expense trended lower for the review period, and that trend continued in FY 2022. Operating expenses decreased every FY in the review except FY 2020. The increased operating costs in FY 2020 was due to a change for stock options granted during the year under the Employee Stock Option Plan. Subsequently, FY 2021 staff costs declined 23.3% to $550.5 million, contributing to the decline in S&A. Furthermore, the rationalisation of advertising and promotion by 53% to $136.9 million also reduced expenses. It resulted in operating expenses reaching the lowest point for the review period at $1.3 billion.

Profits have been volatile but generally improved for the review period; however, the pace of growth slowed in FY 2022. The change in profits oscillated between increases and declines for the review period peaking at $1.4 billion in FY 2021. The primary reason for the FY 2021 earnings surge of 40.5% was lower operating costs due to the previously mentioned share options. More recently, the 6-months period ended September 2021, profits only increased 6.1% to $782.1 million. The slower profit growth was primarily due to a higher effective tax rate resulting from the Company paying taxes at the total applicable rate as of October 11, 2020.

Balance Sheet Review

Over the review period, current assets have steadily increased by a stockpiling of cash and cash equivalents. At the end of FY 2021, the primary contributors to current assets were receivables, inventories and cash and equivalents constituting 21%, 17.1% and 11.6%, respectively. Current assets have increased at a CAGR of 22.8% for the review period and increased 22.5% in FY 2021. Cash & equivalents surging 37.2% to a record of $1.9 billion drove the increase in current assets for FY 2021. At the end of FY 2021, accounts receivable and other receivables were $2.3 billion, of which $1.9 billion was trade receivables. The majority of sales are to a related company (LASM), resulting in about 99.4% of trade receivable being 0-30 days aged in FY 2021.

Current liabilities have plateaued recently following several years of steady increase. The primary contributor to current liabilities is trade payables, accounting for 10.30% of FY 2021 total assets. Current liabilities for the review period declined due to eliminated bank overdraft and modest increases in trade payables.

Your Best Interest At Heart. Full Stop.

Lasco Manufacturing Limited

Non-current liabilities has steadily declined since peaking in FY 2019, and this trend continued in its most recent quarter. The pattern of decline is partially due to long-term debt falling from $931.8 million in FY 2019 to $364.6 million in FY 2021. In fact, long-term debt has declined to $124.9 million at the end of Q2 FY 2022. The rapid decline in debt has made deferred taxation the primary non-current liability reaching $832.1 million at the end of Q2 FY 2022.

Cash Flow Statement Review

Cash flow from operations (CFO) has been volatile; however, CFO before changes in working capital has steadily increased. A general increase in profitability for the period and increased depreciation expense are the primary drivers of CFO before changes in working capital improvement. However, CFO has been volatile due to impacts of cash flow used for inventories and receivables.

Cash outflows used in financing activities have been relatively consistent for the review period and utilised mainly for dividend and loan payments. Dividends have steadily improved at a CAGR of 19.6%, from $122.6 million in FY 2017 to $250.7 million in FY 2021. Furthermore, dividends reached $300 million for the 6M period ended September 2021, representing a 19.7% increase.

Key Ratios Review

Since FY 2018, gross profit margin has trended higher; however, FY 2022 is on pace to experience a decline. In FY 2021, gross margin peaked at 37.9% due to manufacturing efficiencies and a favourable product mix. However, more recently, increased materials and logistics costs that were not fully passed to customers resulted in gross margin declining to 36.7% for the six months ended September 2021.

Net profit margin has been volatile for the review period but peaked in FY 2021. The significant decline in operating expenses resulted in a net profit margin of 16.8% in FY 2021. LASM produced a similar net profit margin for the six months ended September 2021. **Expanding net profit margin beyond current levels in the near term may be challenging given increased raw material costs, but we expect improvement in the long term.**

The current and cash ratios are relatively high, peaking in FY 2021, and both continue to advance, as seen in Q2 FY 2022. The current ratio climbed 22% to 3.1x at the end of FY 2021 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. Furthermore, at the end of September 2021, the current ratio advanced to about 3.4x.

Inventory turnover has trended lower for the review period, which may be an issue if this pattern continues. Inventory turnover declined 12.9% to 4.4x in FY 2021, the weakest for the review period. However, it marginally improved to 4.6x at the end of September 2021, possibly stabilising. At the same time, receivables turnover has steadily declined since FY 2019 and continues in Q2 FY 2022. However, we don't consider this much of an issue given the high quality of receivables.

Lasco Manufacturing Limited

Debt-to-equity has steadily receded since FY 2018 and continues in FY 2022. In fact, at the end of September 2021, it reached 0.07x. Therefore we expect long-term liabilities are sustainable. Furthermore, LASM could quickly raise debt to help finance profitable projects in the future if needed.

ROE has been volatile for the review period and experienced a modest uptick in FY 2021. DuPont analysis reveals that the primary driver of the FY 2021 increase was improved net profit margin. Therefore we expect a decline in the near term given the higher effective tax rate applicable in FY 2022.

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 $5.19. 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 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 $5.91 and $4.40, respectively.**

Chart 1 below indicates that LASM's P/E is trading at a 20% discount to peers. On average, market participants exchange LASM's stock with a 23.7% P/E discount relative to peers over the last three years. We see this discount as unusual given LASM has produced earnings growth and relatively high ROE and ROA for investors. In fact, only Honey Bun's (HONBUN) ROA and ROE exceed LASM's.

At the same time, LASM's P/B ratio is approximately at a 77.7% premium to peers, in line with the 3-year historical average of 74.2%. PURITY's meagre P/B ratio has resulted in the significant premium of LASM's P/B versus peers. However, LASM's P/B ratio still trails peers such as CFF despite having a higher ROA and ROE.

	Price Target	Implied Upside/(Downside)
Upper	5.91	24.42%
Base	5.19	9.26%
Lower	4.40	-7.37%

Junior Market Manufactures					
Ticker	**Market Cap($B)**	**P/E**	**P/B**	**ROA**	**ROE**
CFF	1.62	19.58	3.20	12.99%	17.01%
HONBUN	4.27	19.52	4.15	16.50%	21.26%
KREMI	2.20	24.93	2.53	6.81%	10.44%
LASM	19.62	13.71	2.34	13.40%	18.22%
PURITY	0.29	N/A	0.41	-2.84%	-4.07%
Mean	5.60	18.58	1.32	9.37%	12.57%

Lasco Manufacturing Limited

Chart 1.

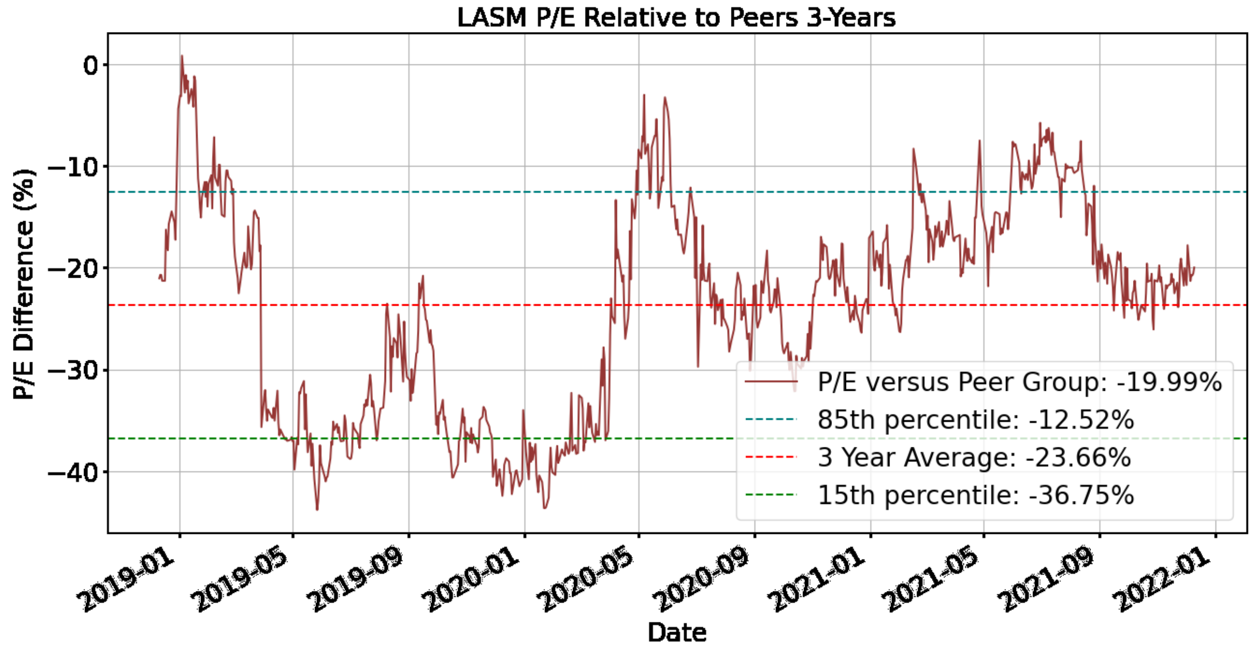
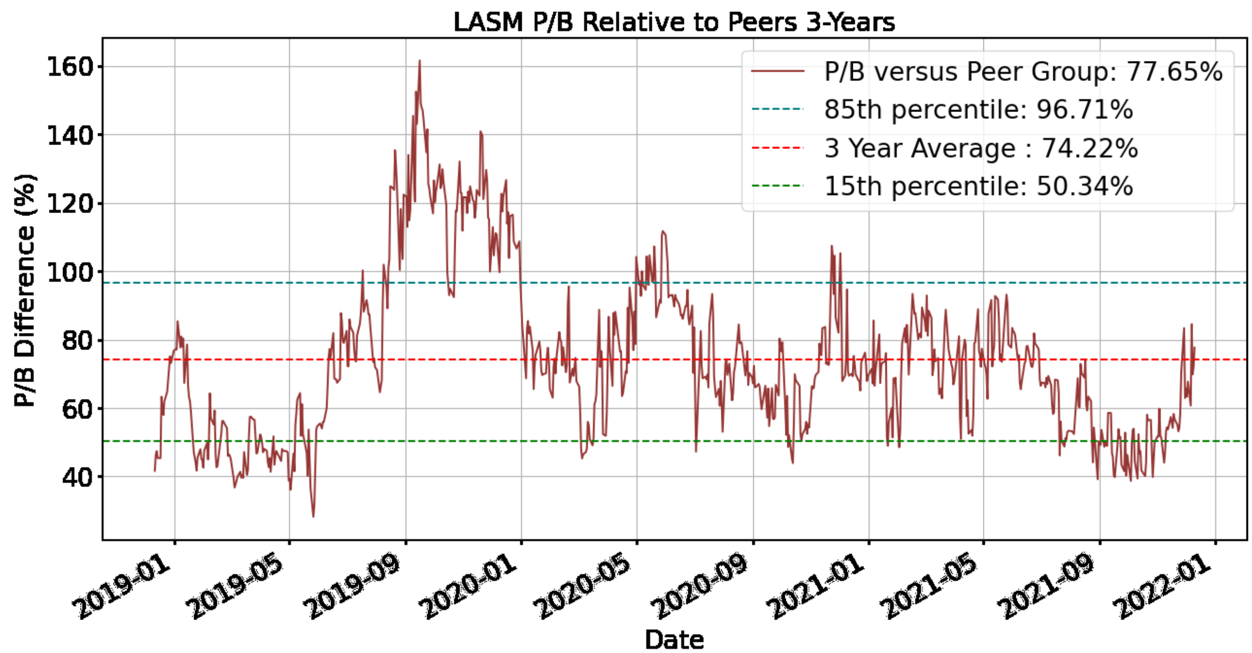


Chart 2.



Lasco Manufacturing Limited

Outlook

We have an overall neutral outlook on LASM, given the expected steady growth in FY 2022 & beyond, intense competitive pressures and increased tax rate. LASM has started paying taxes at the total applicable rate in October 2020. Earnings and revenues for FY 2021 were strong despite the global pandemic's negative impact due to improved manufacturing efficiencies. However, more recently, the increased commodity prices have pressured gross margin.

Meanwhile, LASM generates about 90% of revenues in Jamaica and experiences competition from established food and beverage manufacturers such as GraceKennedy and Wisynco. Therefore, while we expect steady long-term growth, we anticipate earnings growth below the 18% experienced for the review period.

FY	Q1	Q2	Q3	Q4	YE
2023	E0.102	E0.09	E0.087	E0.092	E0.371
2022	0.097	0.092	E0.082	E0.081	E0.352
2021	0.082	0.096	0.068	0.087	0.333

RECOMMENDATION:

We maintain our MARKETWEIGHT rating on LASM at this point, given that the stock currently trades below our price target. Our recommendation considers the stability and growth potential of earnings, the strength of its balance sheet and share liquidity.

We expect steady revenue and profit growth going forward. Initiatives such as acquisitions increased exports, and strategic partnerships may help lift long-term profitability. However, elevated commodity prices and slow economic growth may constrain near-term growth.

LASM has increased 23.4% YTD, marginally underperforming the JSE Junior Market advance of 26.3% for the same period. Finally, LASM's stock is reasonably liquid among Junior market listings, trading an average daily value of approximately $848.5 million or 175.8K units over the last year. **See charts 3 – 6 below for more information on LASM's YTD performance, the volume traded, value exchanged, and historical closing bid-ask spread.**

Lasco Manufacturing Limited

Chart 3.

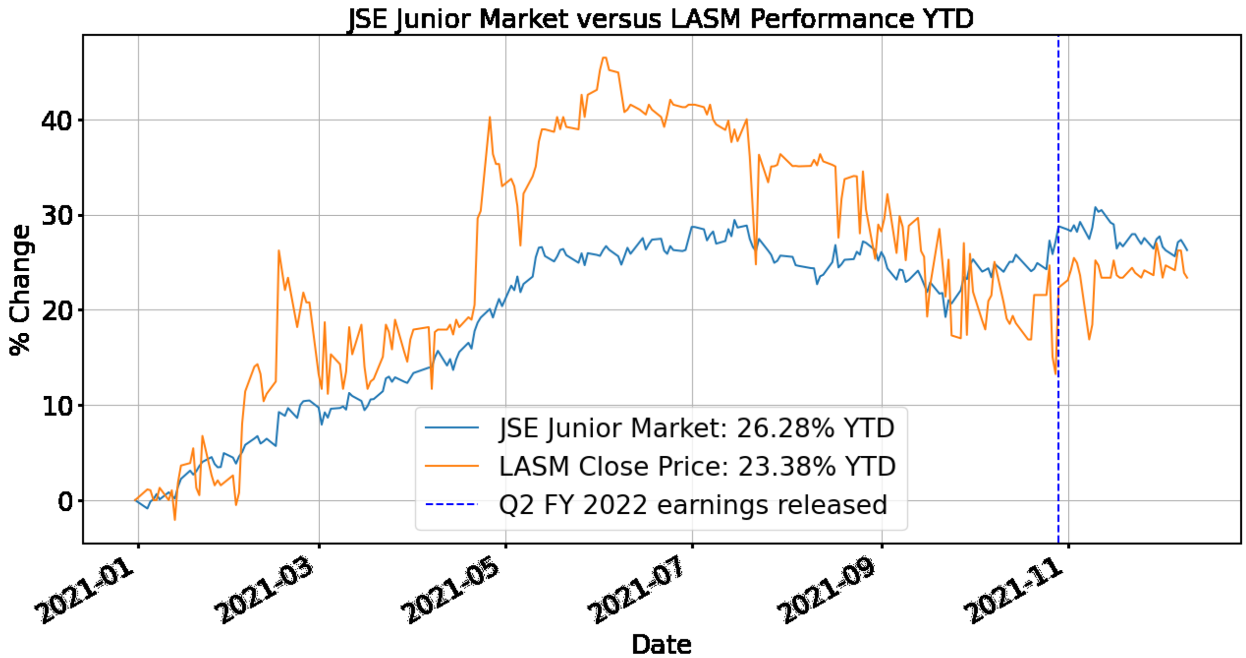
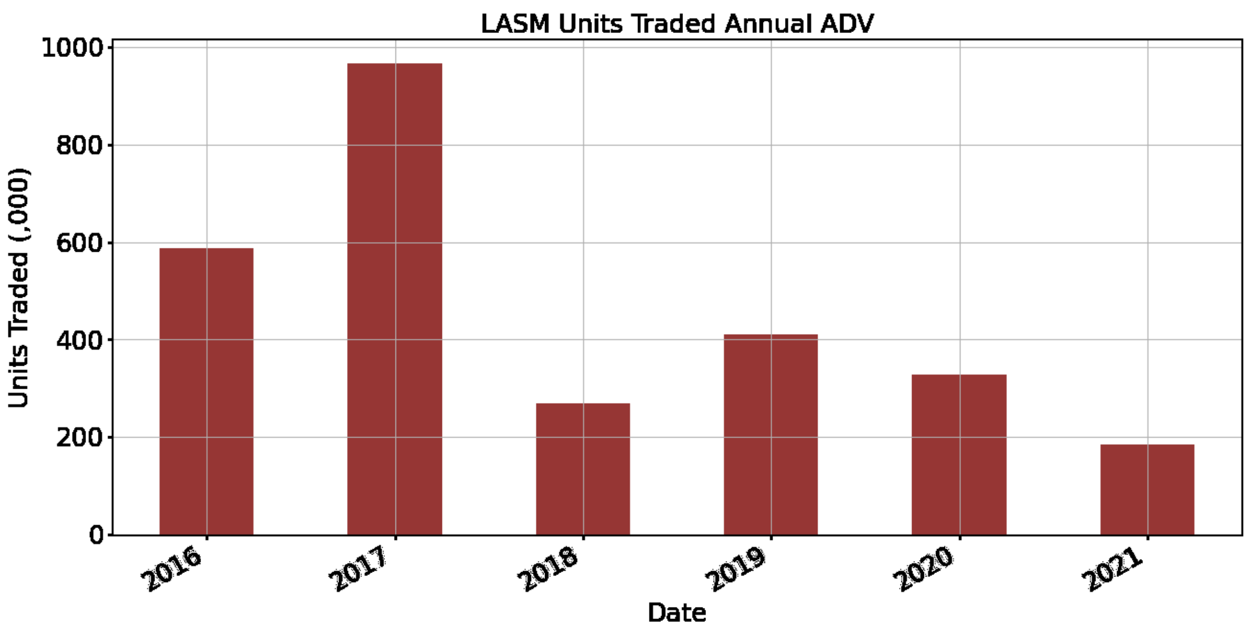


Chart 4.



Lasco Manufacturing Limited

Chart 5.

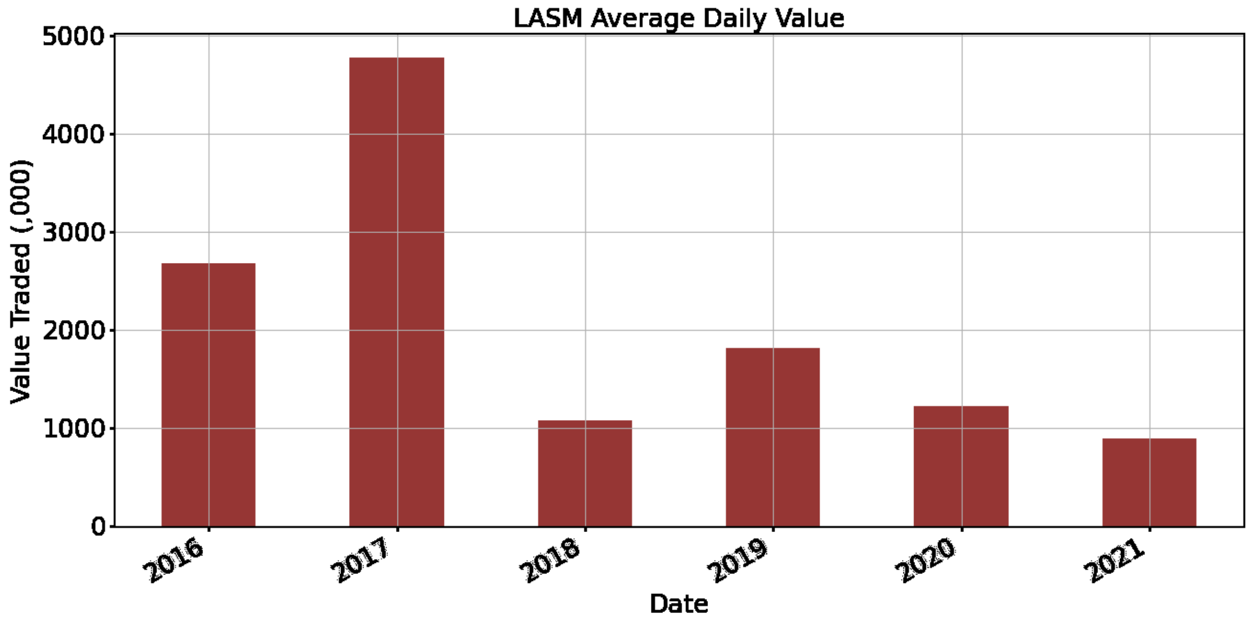
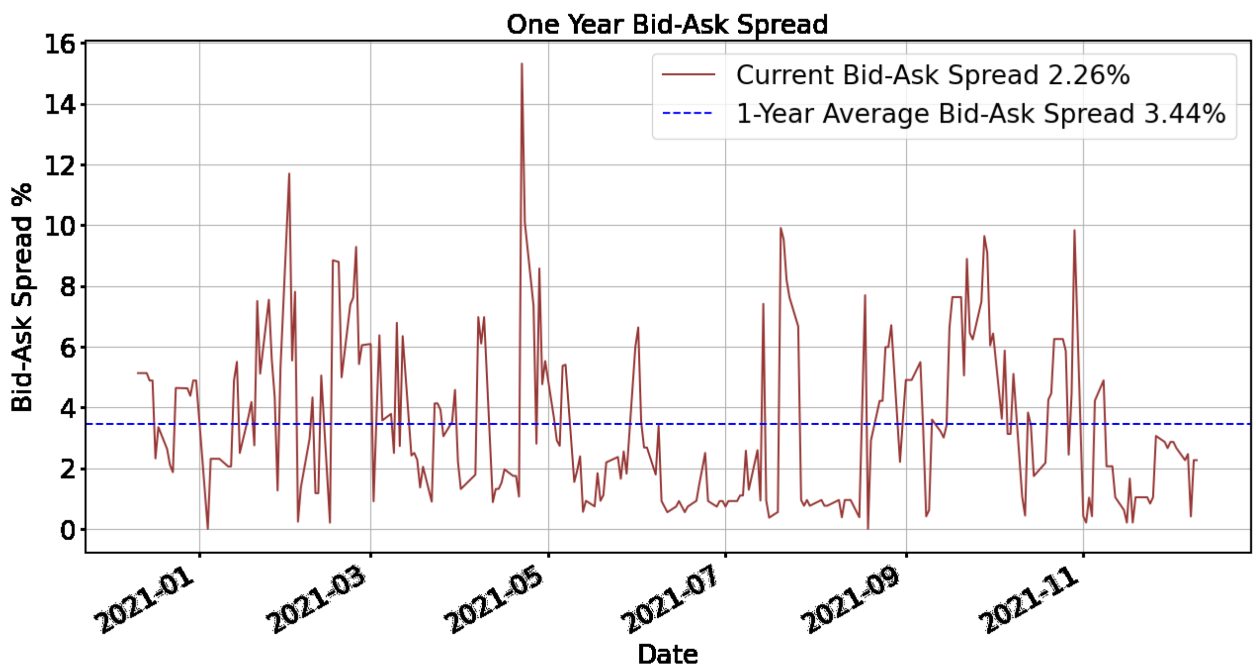


Chart 6.



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

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

COPYRIGHT INFRINGEMENT

No part of this research report may be modified or changed or exploited or used in any way for derivative works, or offered for sale, or used to construct any kind of database or mirrored at any other location without the express written permission of JMMB.

Thank you for respecting our intellectual property rights."

The investments referred to in this report may not be suitable for you should consult your licensed investment advisor. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable to your individual circumstances or otherwise constitutes a personal recommendation to you.

Disclosure Under The Securities Act

This disclosure is being provided pursuant to section 39 of the Securities Act. This research report is prepared by Jamaica Money Market Brokers Limited (JMMB) and the information and views expressed are those of JMMB. JMMB is a subsidiary of the JMMB Group Limited (JMMBGL). Associated persons of JMMB include JMMBGL and its subsidiaries and affiliated companies, including JMMB Fund Managers Limited, a licensed securities dealer and manager of collective investment schemes.

As at the date of this report, JMMB and its affiliates, directors, officers, employees and other associated persons may from time to time buy or sell, or act as principal or agent in, the securities mentioned in this research report. JMMB or its affiliates, directors, officers and employees have no interest in or interest in the acquisition or disposal of the securities other than expressed above. No part of their compensation is or will be related to the recommendations or opinions in this report.