

Jamaica Producers Group Limited (JP)

PLEASE SEE **IMPORTANT DISCLOSURES IN THE APPENDIX**

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Company Background

Jamaica Producers Group Limited (JP), formerly the Jamaica Banana Producers Association Limited, is a wholly Jamaican-owned company listed on the Jamaica Stock Exchange. The Group was incorporated on April 1, 1929, as a direct descendant of the Jamaica Producers Association formed in 1925, under which separate co-operatives – one for the marketing of each agricultural product – were set up. The company was formed with the objective of protecting the co-operative and the local banana industry from failure due to fierce competition from the large foreign-owned fruit companies in the shipping and marketing of Jamaican bananas.

The business has grown, diversifying into shipping, food and juice manufacturing, and moving up the value chain to provide processed foods like smoothies, banana chips, rum cakes and juices, in addition to branching out into other agricultural products such as pineapples.

Financial Performance – Nine Months ended October 1, 2016

Profitability

JP reported revenues of \$8.23B for the first nine months of the 2016FY, an increase of 33.9% or \$2.08B year-over-year while net profits attributable to shareholders was up \$2.60B to \$3.38B. JP Food & Drink generated revenues of \$6.03B for the period, up 16.2% while the JP Logistics & Infrastructure segment recorded sales of \$2.15B, more than doubling the sales of the comparable period of the 2015FY. JP Corporate sales were down 21.3% to \$145.86M. At the start of the third quarter, the results of JP Logistics & Infrastructure were consolidated with the revenues, expenses and profits generated in the KW subsidiary, which explains the sharp increase in the segment's revenues. Prior to the third quarter, JP's share of KW's profit was included as that of an associate.

After a review of its ownership position in Kingston Wharves and its rights to representation on KW's board led it to conclude that it is appropriate to account for KW as a subsidiary. With the recognition of KW as a JP subsidiary, International Financial Reporting Standards required JP to account for this transaction on the basis of the fair value of its net assets. The fair value of the underlying assets of KW at the time of the accounting was worth more than the price per share that JP paid for its interest in the company and the value per share reflected on its balance sheet. As such, a \$2.46B gain was recorded to reflect the fair value of net assets at the end of the second quarter.

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JP GROUP Segment Results

9M16	JP Food & Drink	JP Logistics & Infrastructure	Corporate Services
<i>External Revenues</i>	6,026,265	2,149,612	145,864
<i>Profit before Finance Cost and Taxation</i>	67,813	767,834	2,974,557
9M15			
<i>External Revenues</i>	5,184,437	884,299	185,340
<i>Profit before Finance Cost and Taxation</i>	198,596	406,817	351,205

The JP Food & Drink division's 16% increase in revenues was driven by strong sales growth in the juice business as JP commenced production for new customers and markets in Europe. International sales of rum cake and tropical snacks also increased, due in part to depreciation of the Jamaican dollar. Despite the increase in revenues, the division earned just \$68M in profits before finance costs and taxation, down from \$199M for the comparable period of 2015. This result was influenced by a restructuring charge and start-up costs in connection with the launch of JP's new Tortuga bakery and commercial centre in Kingston.

Gross profits rose 52% to \$2.20B, despite a 28% increase in the cost of operating revenue, as the gross profit margin improved from 23.5% to 26.7%. Marketing, selling & distribution costs were up 24% to \$567.47M while administrative & other operating expenses increased by 36% to \$1.35B. Operating profits of \$281.81M were reported for the period, relative to a loss of \$5.02M in the 2015FY. Share of profit in associated companies and joint venture was down 10.7% to \$438.8M. A gain on disposal of joint venture of \$649.91M was reported in the quarter related to divestment of JP's 50% interest in Mavis Bank Coffee Factory Limited. Finance costs amounted to \$174.55M, up 16.7%.

Pre-tax earnings of \$3.64B were recorded for the nine month period, up \$2.83B. Tax expense rose 51% to \$142.08M but with the sharp increase in pre-tax earnings, the effective tax rate improved to 3.9%, which compared to a rate of 11.7% in 9M15.

Solvency & Liquidity

Total assets for JP amounted to \$28.84B, up 173% or \$18.29B from a year prior. The consolidation of KW into JP's accounts is the main driver behind this sharp rise in assets as "property, plant & equipment" became the largest asset class, amounting to \$18.56B, a \$16.61B increase from its value of \$1.95B as at September 26, 2015. Conversely, "interest in associated companies and joint venture" was down 89% or \$4.04B to \$490.48M. "Securities purchased under resale agreements" moved from \$343.14M to \$2.81B

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while accounts receivable doubled to \$2.18B. Inventories rose 70% to \$800.06M while investments rose 12% to \$302.94M. Jamaica Producers reported employee benefit assets of \$619.08M at the end of the period where none was recorded a year prior.

Cash & cash equivalents stood at \$566.45M, up 20.4% year-over-year. Accordingly, liquidity was improved as the cash ratio moved from 0.54x in September 2015 to 1.17x in October 2016. The current ratio stood at 1.42x, up from 2.0x from a year ago. Cash used by operating activities amounted to \$424.74M, up from \$116.16M in the nine months period of the previous year.

Total liabilities rose 136% to \$8.89B. Borrowings amounted to \$4.83B, up 122% or \$2.66B from a year earlier. Leverage increased as the debt to equity ratio stood at 0.48x at the end of the quarter, compared to 0.33x as at September 2015. Long-term loans were up 92% to \$3.85B while short-term debt moved from \$163.86M to \$977M. Accounts payable rose 67% year-over-year to \$2.57B at the close of the period while current portion of long-term loans were up 140.8% to \$346.27M. Shareholders' equity amounted to \$10.03B, up 54% or \$3.52B as reserves moved from \$6.49B a year prior to \$10.01B.

Outlook & Valuation

Jamaica Producers is aiming to “optimize the potential for greater synergy among our food businesses on the one hand and our logistics businesses on the other” over the next few years while focusing on promoting new product development, service improvement and innovation. The company exited the Four Rivers Mining aggregates business as its weak performance has weighed on profitability and added to its existing investment in Shipping Association of Jamaica Property Limited. This company engages in land and investment holdings primarily in the Newport West area of Kingston, which complements the division's existing activities. The divestment of the stake in Mavis Bank Coffee Factory unlocks capital which JP can utilize to achieve its long-term goals.

In the JP Food & Drink segment, the Group continues to focus on new product and package development. During the first quarter, JP launched flavoured coffees in the Caribbean, kettle-cooked potato chips in Jamaica and Panama, fresh fruit and vegetable spreads in Holland, and a new Florida Orange rum cake for the U.S. market.

Excluding the one-off gains on the recognition of KW as a subsidiary and the disposal of the share in Mavis Bank Coffee Factory as well as the restructuring costs stemming from JP Food & Drink, JP's profits fell to approximately \$490M for the nine month period. Assuming consistent growth levels in the final quarter produces a net profit of \$687M, which is approximately 12% higher than our previous estimate of \$613M for the 2016 financial year and translates to an EPS of \$0.64.

Applying the 3-year average P/E ratio of 6.81x to the forward EPS of \$0.64 yields a price of \$4.36 while the forward BVPS of \$9.10 and the 3-year average P/B ratio of 0.75x yields a price of \$5.60. As such, our

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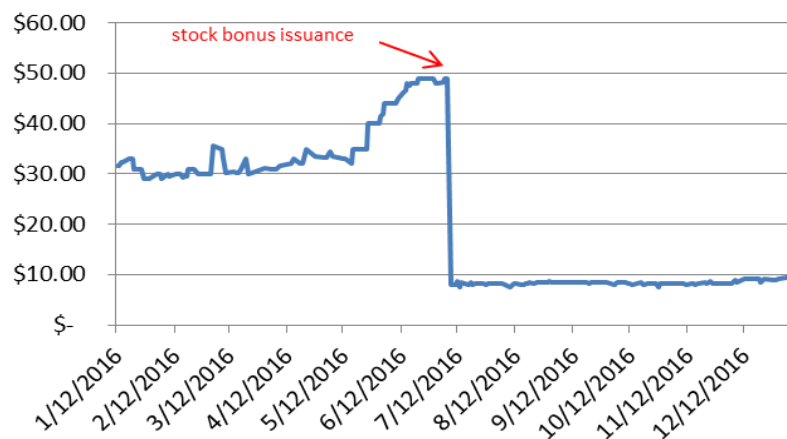
estimation of the fair value of JP's shares is \$5.6, which is 42% below the close price of \$9.7 as at January 10, 2017.

Recommendation

We continue to recommend Jamaica Producers as SELL. Despite the upward revision of our fair price on improved year-to-date results, we maintain that the stock continues to trade wide of its intrinsic value and advise clients to crystallize some of their gains. Investors should be mindful that the nine months profits have been heavily influenced by one-off events and as such should not expect to see a repeat of this in the 2017 financial year. On a pro-forma basis, we expect improved results as the outlook for Kingston Wharves remains positive as it expands its logistics capabilities while the restructuring in the Food & Drink segment allows JP to refocus capital on avenues with greater profit potential. Concern remains around the potential impact of the "Brexit" vote as over 50% of the Group's revenues are generated in Europe. In its 2015 annual report, JP noted that its revenues and profits were impacted by the 12% depreciation of the euro versus the Jamaican dollar.

This stock is suitable for investors with a medium to high risk appetite with a medium term investment horizon given the company's renewed focus on its core operations as the company will need time to sufficiently realign its businesses.

JP 1-yr Stock Performance



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Abridged Financials

J\$000	Year Ended December 31					9M15	9M16	Change %
	2011	2012	2013	2014	2015			
Turnover	6,180,569	6,790,257	7,753,863	8,817,029	8,705,924	6,147,658	8,230,893	33.9%
Direct Costs	4,921,639	5,349,882	5,977,926	6,846,671	6,691,496	4,702,357	6,030,350	28.2%
Gross Profit	1,258,930	1,440,375	1,775,937	1,970,358	2,014,428	1,445,301	2,200,543	52.3%
Operating Expenses	1,216,138	1,477,022	1,731,725	1,967,939	1,999,769	1,450,318	1,918,738	32.3%
Operating Profit	42,792	(36,647)	44,212	2,419	14,659	(5,017)	281,805	-5717.0%
Profit Before Taxation	995,131	272,449	431,022	404,905	748,383	956,618	3,810,204	298.3%
Profit for the year	962,907	189,406	252,273	358,220	792,256	712,579	3,493,570	390.3%
Total Assets	6,069,862	7,505,392	8,553,150	9,943,446	10,248,203	10,549,520	28,835,055	173.3%
Total Liabilities	1,295,725	2,230,130	2,522,047	3,757,709	3,687,739	3,770,788	8,892,836	135.8%
Shareholder's Equity	4,790,296	5,016,175	5,697,807	5,863,693	6,399,006	6,511,572	10,033,134	54.1%
EPS (\$)	0.86	0.17	0.22	0.32	0.71	0.70	3.01	
Book Value per Share (\$)	4.27	4.47	5.08	5.23	5.70	5.80	8.94	
Key Ratios								
Gross profit margin	20.4%	21.2%	22.9%	22.3%	23.1%	23.5%	26.7%	
Operating profit margin	0.7%	-0.5%	0.6%	0.0%	0.2%	-0.1%	3.4%	
Net Margin	15.6%	2.8%	3.3%	4.1%	9.1%	12.7%	41.1%	
Return on Average Equity	19.9%	3.9%	4.7%	6.2%	12.9%			
Return on Average Assets	16.1%	2.8%	3.1%	3.9%	7.8%			
Debt/Equity (x)	0.04	0.25	0.22	0.37	0.35	0.33	0.48	

Source: <http://www.Jamstockex.com>, **JMMB Investment & Research**, **Bloomberg**, **Company Financials**; **Betting Gaming & Lotteries Commission Annual Reports**

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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.

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.

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB