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LOCAL EQUITY REPORT

SEPROD LIMITED

Barita Investments Limited
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Company Overview

Seprod is one of the largest food manufacturing and distribution companies in the English-speaking Caribbean. In the last three years, the company has grown considerably due to strategic improvements aimed at broadening its scope and increasing operational efficiency. This transformation was led by CEO, Richard Pandohie, former President of the Jamaica Manufacturers and Exporters Association. Since becoming CEO, Mr. Pandohie has made several changes that have benefited the Group's bottom line immensely. Seprod manufactures and distributes household food and beverage products, much of which is also offered online.

STOCK	SEPROD
Current Price	J$64.45
Dividend Yield	2.45%
YTD Return	-9.23%
Estiamte Fair Value	J$77.99
Trailing P/E	16.01x
Trailing P/B	1.68x
Forward P/E	10.96x
Potential Return	21.01%
Total Return	23.47%
Recommendation	OVERWEIGHT
(as at April 18, 2023)	

Executive Summary

Seprod Limited was incorporated in July 1940 to produce soap and edible products. Through strategic planning, company acquisitions, market responsiveness, and product diversification to meet the needs of local and international clientele, as well as strong local and export marketing, the company has grown to include several subsidiaries and is positioned among the largest in the food manufacturing and distribution sector locally. Since 2018, the Group has targeted growth primarily through the acquisition of the Facey Consumer Division and large-scale infrastructure development to streamline its manufacturing and distribution process. In FY2019, the Group added targeted cost reduction to its strategic goal, the chief decision in that regard, was the discontinuation of its loss-making sugar business. As such, the 2019 decisions were painful but a necessary process, marked by material earnings decrease despite strong top-line growth. In 2020, however, the strategic decisions of the years past paid off and the company saw a material improvement in its financial performance. In the 2021 financial year, net profit declined, primarily due to global factors that drove higher raw material costs. The 2022 Financial year saw Seprod grow revenues considerably in large part due to its recent acquisition of the Trinidad-based distribution company A.S. Bryden & Sons Holding Limited. Revenues and net profit for the year grew 81.6% and 83.2% respectively. According to management, even without the acquisition, 2022 profits would have grown by a satisfactory 8.0%.

As it looks toward 2023, Seprod is preparing for new product rollouts and full occupancy of its distribution campus. It began operations from the new distribution center in December 2022 and plans to exit all third-party warehouses by the first quarter of the 2023 financial year. The company outlined that it will be producing some of the new products under its brand but will see a significant amount being co-packed for other companies. Targeted markets include the Caribbean, the United States, Latin America, and Central America. Additionally, Seprod announced plans to expand its margarine plant to increase supply regionally. The company has been renovating and upgrading the equipment over the last eight months and is expected to ramp up the new capacity within another month. Following this, it will be producing more margarine for the region, as well as on behalf of a third party under contract. Seprod has spent US$6 million on the plant expansion so far.

Business Overview

The company operates between two main segments, Manufacturing and Distribution. The Distribution segment covers consumer goods – food, beverage, and pharmaceuticals. The Manufacturing segment covers the company's manufacturing and sale of oils and fats, corn and wheat products, cereals, milk products, juices, and biscuits. The company operates its manufacturing segment through three subsidiaries and a joint venture, namely:

- Caribbean Products Company Limited (CPL) – CPL is the principal manufacturer of cooking oil, margarine, and shortening in Jamaica. Brands manufactured at CPL include Chiffon and Uncle Sam's. It also produces specialty fats for third-party customers.
- Serge Dairies – Serge Dairies manufactures juice and milk-based products such as Serge, Delite, Cool Fruit, and Betty.
- International Biscuit Company Limited (IBL) – IBL produces a wide range of cookies and crackers under the Butterkist brand, a range of snacks under the Snackables brand, as well as third-party brands such as Ovaltine.
- Jamaica Grains and Cereal Limited (JGCL) – JGCL is a joint venture between Seprod and Seaboard Corporation, which from its dry-mill facility produces a wide range of corn products under the Pronto brand, along with a range of flour products under the Gold Seal Brand.

Strategic Positioning

On January 1, 2018, 100% of the share capital of Musson Holdings Limited (MHL) and its wholly owned subsidiaries were transferred to Seprod from a related entity, resulting in a shift in ownership of dairy assets from Musson to Seprod. Additionally, on October 1, 2018, Seprod completed a major acquisition of Facey Commodities Holding Limited (FCHL) and its wholly-owned subsidiary Facey Commodity Company Limited. Since these acquisitions, Seprod has largely been in a growth phase which has made the Group significantly larger relative to 3 years prior. At present, the company is still in the process of fully integrating and streamlining processes post-acquisition and we expect continued improvement in cost efficiencies. This can be credited to the company's CEO who has made significant operational changes to enhance the company's capacity to deliver quality goods in Jamaica and abroad while delivering solid returns for shareholders. Going into 2023, the company's investment in operational growth and efficiency thus far includes the following:

- Facey Consumer Division: The acquisition of the Facey Consumer Division in 2018 had the immediate effect of a 53% increase in revenue in Q4 2018 and significantly increased the range of the company's products and brands.
- Nestle: The transfer of the former Jamaican dairy operations of Nestle to Seprod.
- Sugar Operations: The discontinuation of the sugar business which has been making losses over the last decade - Seprod's CEO, Richard Pandohie, noted that if the company hadn't decided to exit the business, Seprod would have been chalking up yearly losses of $400 million.

- Infrastructure Expansion: The acquisition of property adjacent to its head office as a means towards further expansion of its warehousing and distribution capacity by building a 50,000 sqft warehouse.
- Dairy Processing Consolidation: In 2019, Seprod merged its two dairy processing operations (Serge Island and MIDL) to become "Serge Dairies." This has resulted in a best-in-class facility that has significant volumes driving the profitability of the business. The closure and subsequent consolidation were necessary decisions that the company expects will yield material positive results. The consolidation represents the culmination of an $8.4 billion investment over the last five years. Essentially, it positions Seprod to grow the dairy business exponentially through innovation and exports fueled by aggressive growth targets.

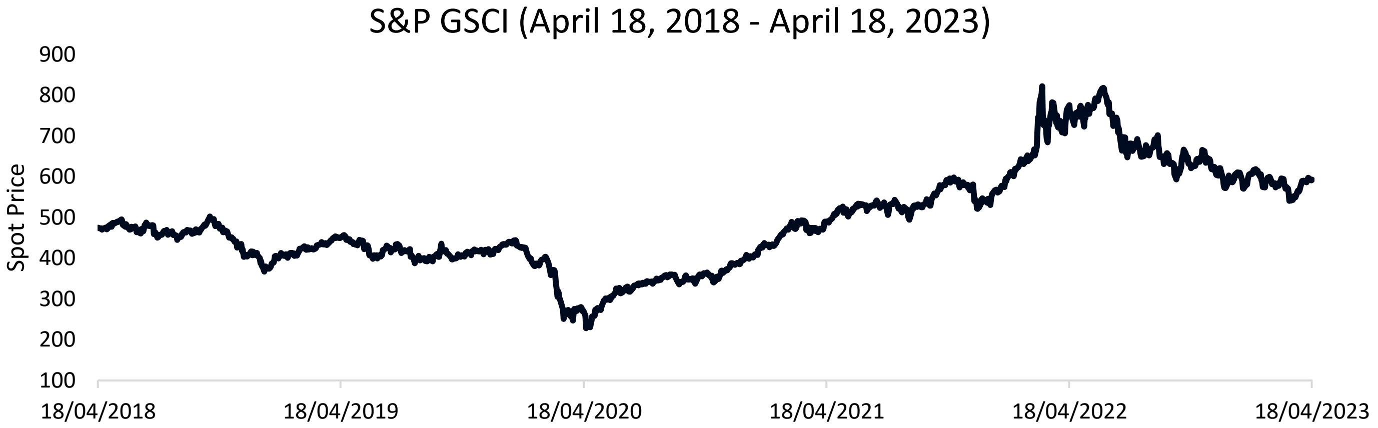
Acquisition of AS Bryden

In June 2022, Seprod announced the completion of its acquisition of 60% of A.S. Bryden & Sons Holdings Limited (A.S. Bryden). In November 2022 AS Bryden acquired 100% of Micon Holdings Limited. Consideration for the acquisition was the issue of AS Bryden Shares which reduced Seprod's shareholding to 54%. AS Bryden is an internationally recognized distributor of premium beverages, food, and grocery as well as hardware and household supplies. At the time of Seprod's acquisition, an estimation of the combined revenues of both companies totaled more than US$500 million, or just about $76 billion (Seprod reported revenues of $79.7 billion for the 2022 year-end (unaudited)). As a combined entity, both companies have secured a large footprint in The Caribbean, Latin America, Central America, and parts of the United States, and will position the group to build out an even stronger presence across Caricom as a regional company. Seprod plans to list AS Bryden on both the Jamaica and Trinidad and Tobago stock exchanges. Seprod also outlined plans to construct an AS Bryden logistics and distribution warehouse in Chaguanas, Trinidad & Tobago, with the company expecting to tender in July. The expected construction timeline is expected to be between 12 to 18 months, at an investment cost of US$ 25 million. This will allow for the consolidation of AS Bryden logistics into one location as opposed to 12 different warehouses situated around the country. Additionally, Seprod plans to expand its manufacturing line in Trinidad, looking to benefit from energy costs and people capability.

Global Market Conditions

Commodity Prices

As the ongoing war in Ukraine continues, agricultural commodities markets are still expected to be affected in 2023, while global supply-chain disruptions stemming from the covid-19 pandemic will likely subside. The price of agricultural commodities gradually increased in January 2023 due to an increase in grain prices. Corn and soybeans prices strengthened as severe drought in South America intensified supply concerns, while rice prices saw an increase stemming from greater demand. The further exacerbation of the war in Ukraine provides a risk to grain prices as poorer harvests in Ukraine and disruptions to grain exports from the Black Sea region could cause prices to rise further. Contrastingly, wheat prices saw a decline in early 2023 on higher supply expectations from projected record harvests in Australia and India, alongside recovering exports from Russia and Ukraine. Notwithstanding supply fears and upward pressures coming off the backend from China's reviving consumption, prices for major agricultural commodities are expected to stay softer in 2023 relative to the prior year, with the lingering cost-of-living crisis and higher borrowing costs translating into weaker demand for food and feed from consumers and farmers. Softer agrifood commodity prices are set to ease cost pressures for food and food service businesses.



Source: S&P Global

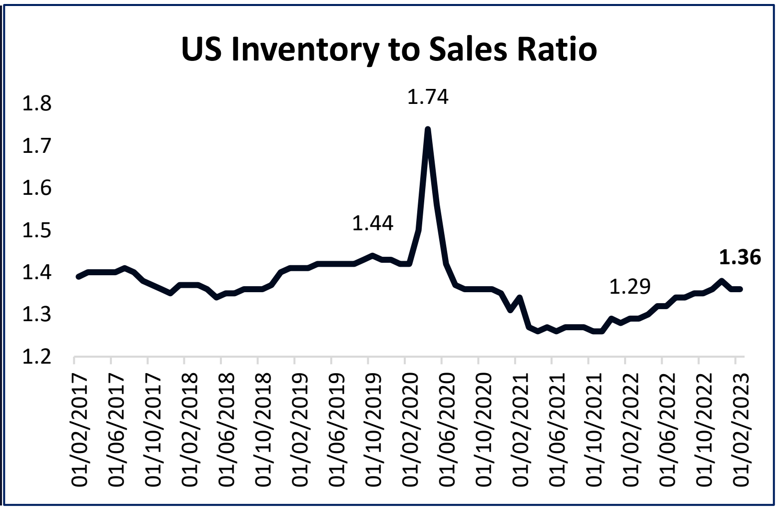
The S&P Goldman Sachs Commodity Index (S&P GSCI) is typically recognized as the leading measure of commodity prices. As indicated in the chart, commodity prices increased exponentially since the pandemic and peaked in the second quarter of last year (June 2022). Since then, the index has declined approximately 28%, as of April 18, 2023, and year to date has seen a decline of 2.77%.

Notably, for the first quarter of 2022 "Jan-March", the index grew by 29.05%. As shown in the table, this represented the largest three-month increase in the year. In Q2 2022 (April to June) the index saw a 2.07% decline, and in Q3 2022 (July to September) the index saw a 14.31% decline. The index increased marginally in Q4 (October to December) by 0.38%, and as stated above year to date (as of April 18, 2023) has declined by 1.10%. ***What this dictates, is that though commodity prices remain elevated, the pace of the price increase has been declining. This suggests that from the perspective of manufacturers like Seprod, the cost of raw materials, though still high, now to some degree, has a level of predictability. This may improve the planning process and reduce input costs for the company which is important as it continues to navigate the current environment.***

2022	
Jan - March	29.05%
April - June	-2.07%
July - September	-14.31%
October - December	0.38%
2023	
Year to Date	-2.77%
Source:	S&P Global

Shipping

The cost of shipping has decreased precipitously, in comparison to where costs were in April 2022, as measured by the Freightos Baltic Index (FBX): Global Container Freight Index. The FBX has seen an 84.77% YoY decline, Moving from $9,232 as of April 16, 2022, to $1,406 as of April 14, 2023. The index has also seen a 3-month decline (January 20, 2023 – April 14, 2023) of 35.45%. Unlike commodity costs, shipping costs have declined to near pre-pandemic levels ($1358 on March 6, 2020). As shown in the US Inventory to Sales ratio chart below, inventory to sales, as of February 2023 has seen elevation relative to last year and currently mirrors levels seen in the pre-pandemic period, which points to easing of the tightening of inventory and suggests a recovery in the supply of goods, as supply chain pressure abates. The inventory-to-sales ratio can be used as an indication of the number of months of inventory on hand relative to sales for the month. Inventory to Sales stood at 1.36x for February 2023 in comparison to 1.29x in February 2022. Despite these improvements, supply chain disruptions are expected to remain a concern in 2023, as inflationary pressures, geopolitical tensions, and a potential recessionary environment hang.



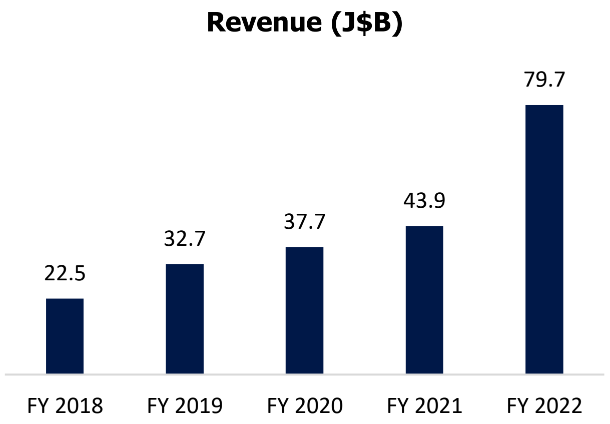
Source: Freightos Baltic Index

Source**:** Federal Reserve Economic Data

Financial Performance – FY 2022 Unaudited

Income Statement

Revenue: For the financial year ended December 2022, Seprod reported revenue of $79.7 billion, relative to $43.9 billion in the prior year, reflecting an increase of 81.6%. The increase in revenue was primarily attributable to the acquisition of AS Bryden, along with a 25% increase in exports and the addition of new product lines. For the fourth quarter ended December 31, 2022, the company saw year-over-year (YoY) growth in revenues of 121.7% amounting to $28.2 billion, relative to $12.7 billion in the prior year's comparable period. It is important to note that the company would have reflected the accretion in revenue in the last two quarters of FY 2022 (Q3 saw 108.8% growth to $23.6 billion). Considering this, the next six months' results (Six months FY 2023) will show trailing twelve-month revenue reflecting a full year of income statement consolidation following the acquisition.

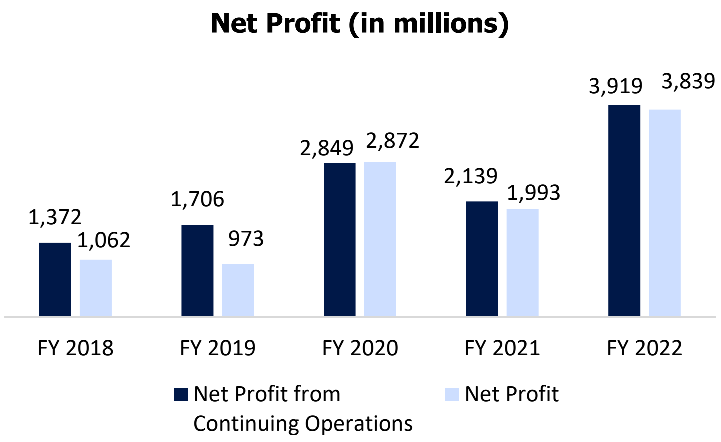


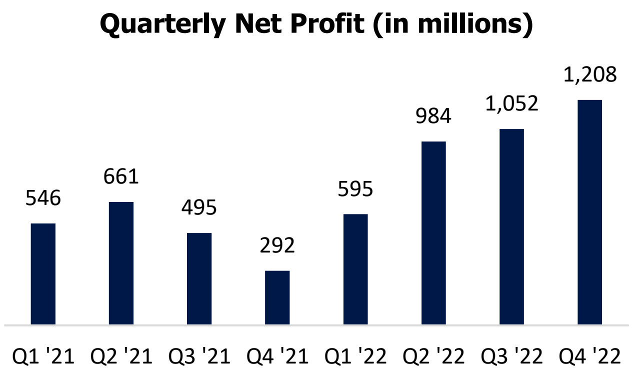
Gross Profit: Gross profit amounted to $20.7 billion for FY 2022, representing an increase of 86.9% over the prior year's outturn of $10.9 billion. The Company's cost of goods sold increased at a slower pace than revenue, driving the gross profit margin from 24.9% in FY 2021 to 26.0% in FY 2022. Notably, the company faced pandemic-induced price increases, which it has begun to reverse as lower commodities prices, shipping costs, and other factors filtered into the inventory replacement cost. In that vein, during the fourth quarter of the year, the company reduced prices on certain products such as cooking oil and flour.

Operating Profit: Operating Profit saw a rebound in comparison to the prior year (a decrease of 23.1% in FY 2021) increasing by 84.8% to amount to $6.7 billion, compared to the prior year amount of $3.6 billion. Operating expenses moved from $8.4 billion in FY 2021 to $14.8 billion in FY 2022. This increase would have stemmed from the acquisition as administrative expenses would have been consolidated for the last two quarters of the year.

Profit Before Tax: Finance costs saw a 63.5% increase, moving from $1.2 billion in the prior year to $2.0 billion in the current year, primarily due to an increase in long-term debt obligations. The share of profit from joint ventures amounted to $121.3 million, compared to $79.1 million last year, however, details were not given behind the driving force behind the surge. Share of profit comes from Seprod's 50% ownership of Jamaica Grains and Cereals Limited (a former subsidiary) which manufactures and sells corn and wheat products and cereals. Profit before tax (PBT) for the period was $4.8 billion, a YoY increase of $108.3% over the prior year's amount of $2.3 billion.

Net Profit: Net profit from continuing operations amounted to $3.9 billion, representing an increase of $1.8 billion (83.2%). Net profit grew at a slower pace than PBT, with the effective tax rate for the period increasing from 7.4% in FY 2021 to 18.6% in FY 2022. The effective tax rate for FY 2021 was lower than the 2020 rate of 16.5% due to the effect of deferred tax credits. Net profit inclusive of discontinued operations totalled $3.8 billion.





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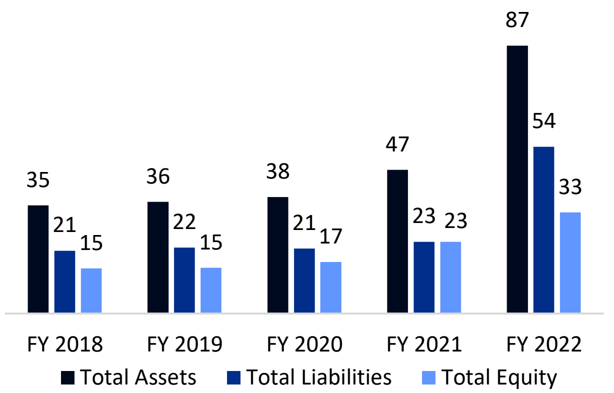
Balance Sheet

Assets: As of December 31, 2022, the company's total assets stood at $87.5 billion relative to $46.9 billion in the prior year, representing a YoY increase of approximately $40.6 billion (86.5%). This large increase reflects the consolidation of AS Bryden's asset base. The most prominent contributors to the increase came from inventory on hand, which rose 136.28% to $24.1 billion, receivables, which increased 181.54% to $18.3 billion, an increase in property, plant, and equipment of 46.76% to $20.4 billion and an increase in intangible assets of 35.96% to $12.1 billion.

Balance Sheet (J$B)

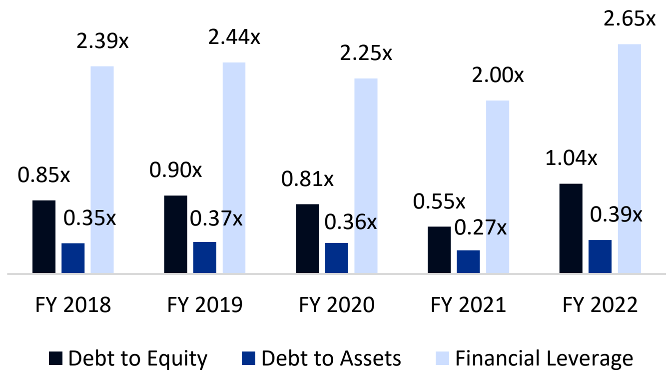


Liabilities and Equity: The Company's funding is driven predominantly by liabilities which amounted to $54.5 billion compared to $23.5 billion in the prior year, representing an increase of $31.0 billion or 132.3%. Not unlike the asset side of the balance sheet, the acquisition and further consolidation drove the YoY growth in liabilities. This was driven by increased payables to $16.6 billion (+$8.2 billion or 96.6%) and increased long-term debt (current and non-current) to $32.5 billion (+20.0 billion or 160.0%).

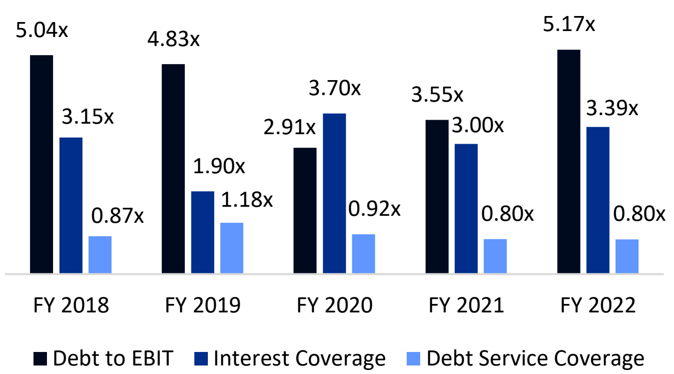
Shareholder's Equity for the period amounted to $28.1 billion, representing a YoY increase of 20.0% which was largely due to increased retained earnings which amounted to $12.8 billion (+$1.9 billion YoY or 16.9%), along with the addition of preferred stock amounting to $3.1 billion. Total Equity, inclusive of the minority interest ($4.9 billion) amounted to $33.0 billion, while equity attributable to stockholders of the parent stood at $28.1 billion.

Liquidity and Solvency

Debt Ratios



Debt Sustainability



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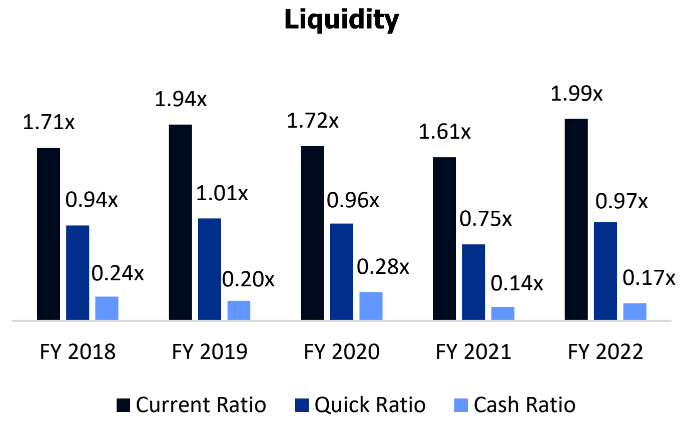
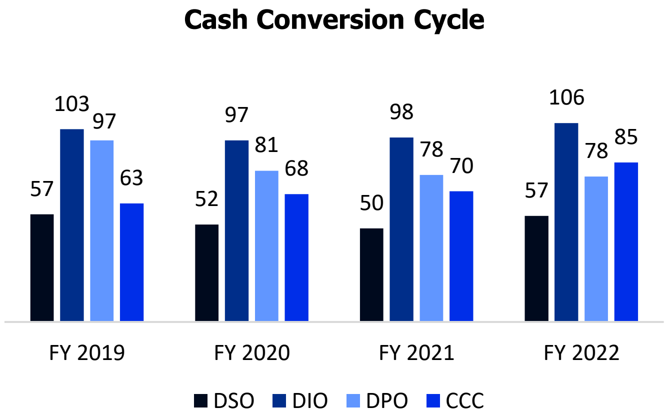
Solvency and Debt Coverage: The Group's leverage increased in FY 2022 relative to FY 2021 largely due to the acquisition of AS Bryden. Notwithstanding, the company's leverage position remained at a modest level as demonstrated by its debt-to-equity and debt-to-asset ratios which amounted to 1.04x and 0.39x. As it pertains to coverage, despite the increases in total debt outstanding ($34.4 Billion in FY 2022 in comparison to $12.8 billion in FY 2021) interest coverage has strengthened YoY, and debt service has remained unchanged. Debt to EBIT stood at 5.17x for FY 2022, in comparison to 3.55x in FY 2021, and was the highest level in comparison to the past five financial years (5.04x in FY 2018 and 3.70x in FY 2020). This was due to the variance in consolidated debt on the balance sheet and consolidated operating profit.

Liquidity: Seprod's liquidity has generally been sufficient as indicated by the company's current ratio which has averaged 1.79x between FY2018 and FY2022. The company saw an improvement in its liquidity ratios in FY 2022 relative to the prior year. This was primarily due to current assets growing at a faster pace (145.4%) than current liabilities (99.0%) YoY.





For FY2022 the company saw an increase in its Cash Conversion Cycle (CCC), with a cycle of 85 days relative to 70 days in the prior period. Noteworthy, the recent acquisition would have impacted turnover ratios YoY. Notwithstanding, Seprod remains a high cash-generating business that should support continued working capital management, and despite the recent increase in the CCC, liquidity is expected to remain relatively strong. Days Sales Outstanding (DSO) stood at 57 days relative to the prior year's outturn of 50 days. Days Inventory Outstanding (DIO) stood at 106 days, an increase over the prior year of 98 days. The company has historically (FY2017-22) had a high DIO, causing an extension in the company's operating cycle (DSO+DIO). This is partially offset by the company's relatively high Days Payables Outstanding (DPO), which supports cash retention as the company can hold money it owes to vendors for longer periods. DPO for the current period remained unchanged over the prior year at 78 days.

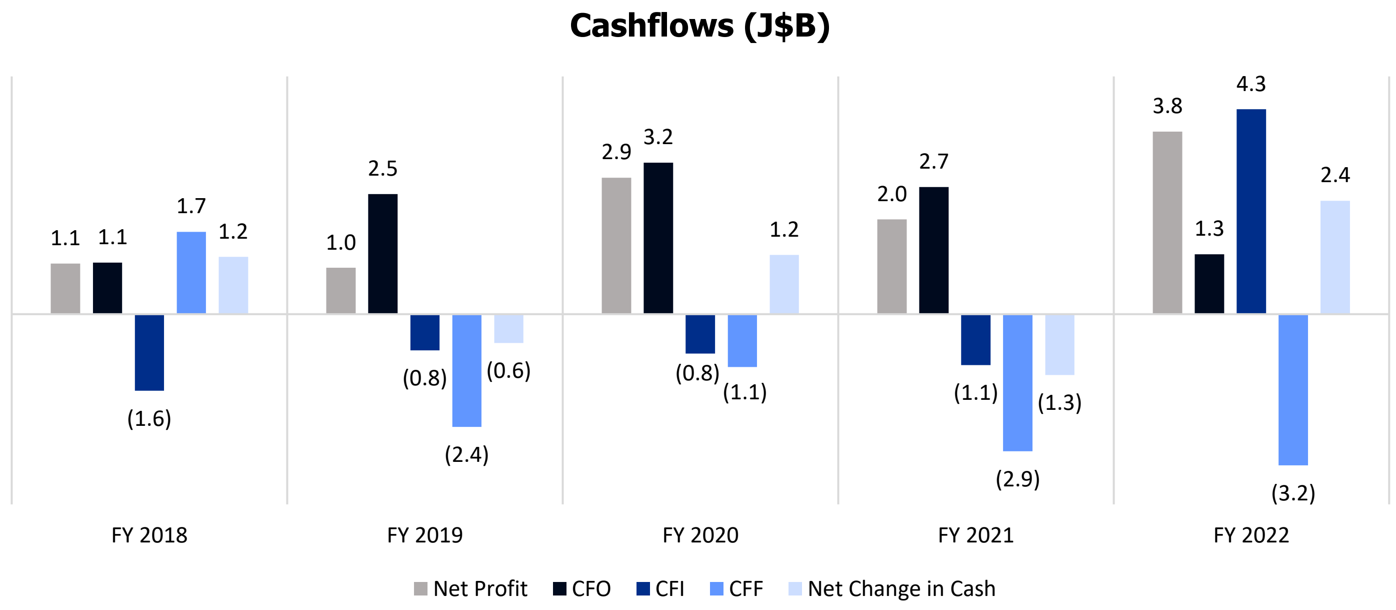
Cashflows

For the year ended months ended 2022, Cash Flow from Operations (CFO) amounted to $1.3 billion compared to $2.7 billion in the prior year, representing a decrease of $1.4 billion YoY. The decrease in operating was due to working capital changes driven predominantly by receivables and inventory. Apart from this year, Seprod over the past four years (FY 2018-FY2021) has generated higher operational cash flows relative to net profit for the period, an indication of good quality of earnings along with working capital management.

Cashflow From Investing Activities (CFI) for the current period amounted to an inflow of $4.3 billion compared to an outflow of $1.1 billion in the prior year. The major driver of the increase was the gain on the acquisition of AS Bryden, which amounted to $6.0 billion. Additions to Fixed Assets for the period amounted to $1.8 billion an increase of $245.4 million or 8.2% YoY, while repayment of long-term receivables (positive cash flow) saw a decline to $73.3 million, in comparison to $506.1 million in the prior year.

Cash Flow from Financing Activities (CFF) for the year amounted to an outflow of $3.2 billion, a 10.3% over the prior year's outflow of $2.9 billion. Net loans received for the year totalled $337.6 million, compared to a net repayment of $721.6 million in the prior year. Lease repayments saw a YoY increase of 189.6% to $623.6 million from $215.3 million in the prior year. The increase is due to increased lease payments for third-party warehouses due to damage from the fire of their main logistics center in 2021. For the year, the dividends paid amounted to $1.2 billion which was a 21.6% increase over the prior year's dividends of $953.6 million. Interest paid amounted to $1.7 billion, a 74.6% interest over the prior year's amount of $994.6 million.

The net change in cash for the 2022 financial year was an increase of $2.4 billion, relative to a decline of $1.3 billion in the prior year. Cash and cash equivalents at the end of the period hence amounted to $4.1 billion which was an increase of 147.8% YoY.



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Valuation

To arrive at a valuation for Seprod, we utilized a relative Price-to-Earnings (P/E) approach. We estimated YoY net profit growth of 46.02% for 2023, largely representing the total impact of the AS Bryden acquisition, alongside increased growth from exports and achieved synergies. Against this backdrop, we ultimately arrived at a forecast for net profit for 2023 of $4.3 billion. This is commensurate with an EPS estimate of $5.88. We've utilized the average P/E of comparable listed companies to arrive at a multiple of 13.27x, which was applied to our EPS forecast. Utilizing this multiple resulted in a target price of **$77.99**, representing a potential upside of 21.01% and a total return of 23.47%. In light of this fair value estimate, alongside the aforementioned in the report, we recommend investors **OVERWEIGHT** Seprod.

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