



The Official Plum

Title: Facey Group Ltd./ Seprod Ltd. Offer

Date: October 24, 2018

Company Profile

Seprod Ltd. [JSE: SEP] is a manufacturing, agribusiness and distribution company based in Jamaica. The company which was created in 1944 was listed on the Jamaica Stock Exchange in 1985. Seprod now operates three core businesses namely ingredients, dairy and distribution.

On the ingredients side of the business, SEP produces edible oils and fats, flour, cornmeal and sugar. The company went into a 50/50 joint venture agreement with Seaboard Corporation to construct a flour mill and is now one of two manufacturers in Jamaica.

SEP is the largest producer of milk in Jamaica through its subsidiaries Serge Island Farms Ltd and Serge Island Diaries Ltd. They also produce sweetened condensed milk, mostly under the Betty brand and is also the manufacturer of Supligen through its subsidiary Musson International Diaries Ltd.

The distribution arm traditionally distributed its own brand of products (see below). Facey Commodity Company (Ja.) Ltd also assisted with distributing Seprod's products.

In addition to its core business, Seprod also owns Industrial Biscuits Ltd. which produces a range of cookies, crackers and other baked goods under its Butterkist brand.

Offer

Shares: 91,914,894

Price: \$23.99

Use of Proceeds: None of the proceeds from the Invitation will be payable to Seprod Ltd as all the shares are being made available by Facey Group Ltd.

**Dates: Open: October 23, 2018
Close: October 30, 2018**



Recommendation:

We recommend a **BUY** at \$23.99 and implied capital gains yield of approximately 108% to 152% within a year.

Industry Outlook

According to the International Monetary Fund (IMF), Jamaica's economic outlook, since the implementation of the reform program began, still manages to disappoint, averaging only 0.9 per cent. Anchored by structural hurdles, including crime, bureaucratic processes, insufficient labour force skills, and poor access to finance, continue to hinder productivity and growth.

Having no accessible market share and industry data, the local market for manufacturing, agribusiness and distribution industry is a very competitive one. However, it is dominated by a few large players which include Grace Kennedy, Wisynco Group Limited, Lasco Manufacturing and Distribution and Seprod Limited.

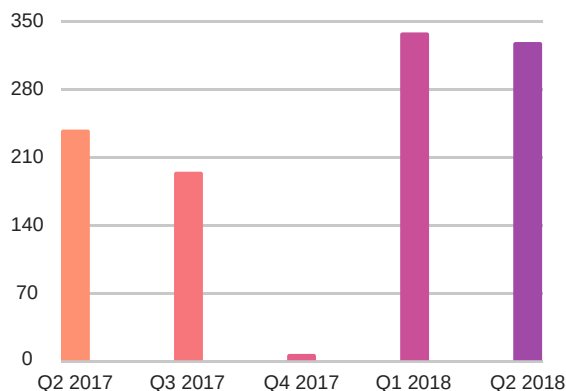
Moreover, given the product lines of these giants being homogenous, competition is solely driven by product differentiation based on standards, promotions to propel brand awareness and channels of distribution. However, the Industry is still not fully immune from the adverse effects of macroeconomic conditions, which can erode revenues stream earning power of the economy.

Financials

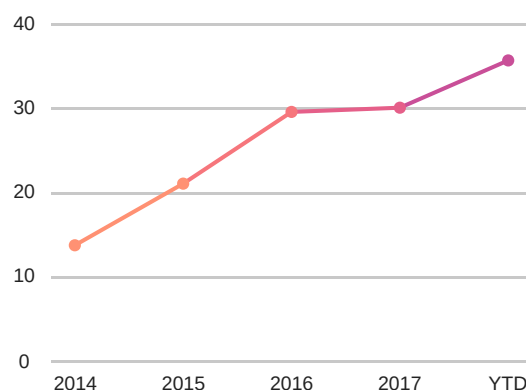
Seprod's revenues came in at J\$16.5B for the year ended Dec 31, 2017, an increase of 5% over prior year. Gross Profit was J\$3.8B or 23% and slightly higher than the previous year when they realized a Gross Profit of 22% of 2016's revenues. The company's Consolidated Net Profit amounted J\$647,843M, down 26% from J\$875,209M, but, it must be noted however, that last year's (2016) Net Profit was boosted by a \$360M gain on sale of financial assets.

Furthermore, Seprod's Net Profit for the six months ended June 30, 2018, came in at J\$598M and increase of 29% over 2017, due mainly to the integration of the former Jamaican dairy operations of Nestle. Heading into the festive season our assumption is that Seprod's Net income for the last two quarters should at least double as consumers purchase the necessary ingredients for their baked products etc. With this conservative assumption, Net Income for the FY ending December 2018 should amount to J\$1.2B before the inclusion of operations of the acquired Facey business. The inclusion of the former Facey business should see Seprod's earnings come in at 1.73B to 1.92M or EPS \$2.35 to \$2.61. Over the last two trading day after the offer was made public, the price of SEP has seen a sharp decline.

Seprod's Net Profit (J\$ M)



Seprod's Share Price (J\$)



Acquisition of Facey Consumer

Facey Group Ltd. (FGL) sold its consumer business to Seprod Ltd. and the transaction closed in September 2018. Seprod paid US\$53.8M to acquire FGL's company; US\$16M in cash 217,148,936 shares in SEP. These shares were thought to have a value of US\$37.8M (US\$.174 or J\$23.50 per share).

As Facey Consumers' net debt was US\$20M at the time of acquisition, Seprod paid approximately 8.05X. The total Enterprise value for Facey Consumer's amounted to approximately US\$73.8M and the debt acquired by Seprod had a weighted average interest of approximately 7.29%. Facey Group Ltd., with this offer, is seeking to sell 91,914,894 of the new shares issued by Seprod as part of the purchase for their consumer business to prospective investors. The shares are being offered to the investing community at J\$23.99 and prior to the offer being public shares were being traded at around \$49.50.

The stock was trading at around \$49.00 on October 12, 2018, but lost 16% and 12% on the two trading days following the public holiday, with volumes within the 52-week range of 100 to 400,000 units. This slide is consistent with the issuance of the new shares and we believe that the dilution should see the share shedding around 42% and settling at around the \$34.85 by the time the offer opens.

Facey Commodity Co. Ltd reported revenues of US\$129M in 2017 and US\$113M and US\$104M in 2016 and 2015 respectively. While it is still left to be seen whether Seprod will continue to carry all of the Non-Seprod brands Facey carried, it is expected that the addition of the new business will result in an increased revenue of around US\$135M for the FY 2018. Assuming EBITDA remains at around 7% of revenues, its EBITDA for the year-end December 2018 should climb to approximately US\$9.5M. With Facey's pre-acquisition debt being US\$20M and the weighted average interest rate being 7.29%, interest cost is expected to be US\$1.5M in debt. Distribution companies usually maintain a Net Profit Margin of approximately 3-4% of revenues, meaning that our estimate is that Seprod's bottom line stands to be boosted by US\$4.0M US\$5.4M.

Using an exchange rate of J\$133/US\$1.00, this translates to between J\$532M and J\$718.2M in Net Profit from the acquired entity ignoring synergies and other effects that may accrue to Seprod.

We used the market-based P/E analysis to evaluate whether the offer of Seprod at 23.99 was fair using Grace Kennedy Ltd (GK), Caribbean Flavors and Fragrances (CFF) and Lasco Manufacturing Ltd. as comparables.

INDUSTRY AVERAGE P/E	
Company	P/E
GK	9.63
CFF	29.19
LASM	19.12
Average P/E	19.31

With an industry average of 19.31X, we estimate that Seprod's projected price should fall within the bands of \$45.54 and \$50.40 within a year.

S.W.O.T

Strengths

- Having Acquired Facey Consumer Business, Seprod has strengthened its existing product and distribution line being associated with products such as Miracle, Serge Island, Betty and Chiffon to name a few, adding Arm and Hammer, Kraft and Limacol among others.

Weakness

- The large majority of SEP's revenues and profitability come from within the Caricom region. As a result, they are susceptible to negative economic shocks affecting the region.

Opportunities

- Seprod Limited exports its products predominantly to the Caribbean. However, with the increase in the distribution arm, it can expand its reach to other countries outside of the Caribbean.

Threats

- A lot of the raw materials used in manufacturing Seprod's products are sourced overseas. With that said, due to the ongoing trade war, the company faces an increase in raw material price, which will in turn, increase production cost.

CONCLUSION

Reiterating our recommendation of a 'BUY' for this offer, Seprod Ltd is one of Jamaica's leading manufacturing, agribusiness and distribution company in Jamaica. The company is among the market leaders for several of its consumer products which have resulted in the company being a very profitable company over the years. Furthermore, its profitability management has been finding it difficult to shed its loss-making sugar business, which has been racking up losses for over nine years.

While it is expected that there will be a pullback in the price of Seprod over the short term, as investors react to the thought of a dilution of earnings, we are of the view that the addition and integration of Facey's consumer business will eventually lead to a significant improvement in the company's profitability and earnings per share going forward, as the synergies of the dairy operations and the Facey consumer division come to fruition.

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