Company Analysis: Honey Bun (1982) Jamaica Ltd. (HONBUN) 9M 2023

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- Recommendation: **OVERWEIGHT**
- Current Price: $6.33
- Price Target: **$9.89**

- Shares Outstanding: 471,266,950 units.
- Financial Year End: September 30

ABOUT THE COMPANY

Honey Bun was established in 1982 when Herbert and Michelle Chong acquired two small bakery outlets in Kingston. They have since become known for producing and distributing baked goods under their three distinctive brands: Honey Bun, Island Bites, and Buccaneer Jamaican Rum Cakes. In 2011, guided by the Chong's and their advisors, Honey Bun (1982) Limited (HONBUN) achieved a significant milestone by becoming the first wholesale bakery to be publicly listed on the Junior Market of the Jamaica Stock Exchange. Since that momentous occasion, the company has garnered numerous awards for its exemplary leadership, innovation, and best practices, solidifying its role as an industry trailblazer. Honey Bun operates six locations in Kingston and has expanded its presence with three additional branches in Ocho Rios, Spanish Town, Old Harbour, and Montego Bay.

Its products are exported throughout the Caribbean region as well as to the UK, US, and Canada. The company is eyeing further expansion in 2023 with three more distribution outlets to come at the end of the year.

FINANCIAL PERFORMANCE SUMMARY

J$ 000	FY 2021	FY 2022	9M 2022	9M 2023
Revenue	2,145,397	2,953,316	2,162,812.5	2,561,745.2
Operating Profit	290,889	259,362	175,758,926	263,801,892
Net Profit	218,691	203,486	138,080,397	201,946,686
Total Assets	1,325,458	1,527,015	1,471,417.6	1,703,058.9
Total Liabilities	296,585	367,702	376,617,941	417,203,974
Total Equity	1,028,873	1,159,312	1,094,799.6	1,285,854.9

Dividend Policy

HONBUN does not have a definitive dividend policy but has recently declared interim dividends of $0.04 per share to be paid out to shareholders, an approximate yield of 0.6%.

Outlook

We expect HONBUN to enhance its profitability further, driven by the growing demand for its new products especially with the expansion of its distribution centers. The expansion to three more locations has boosted its 9-month financials and is expected to continue to grow as the company is looking to open more locations. Additionally, with school now completely face to face for all age groups, Domestic sales should increase, as there is likely to be more days of sale this year. Furthermore, we believe that HONBUN's projected profitability improvement will be influenced by its investment in additional automation systems, which should help mitigate rising raw material costs.

Projections and Valuation

We used a combination of a Comparative and a Discounted Cashflow Model to determine the value for the stock. For the DCF approach, a cost of equity of 16.94% was used to discount the future levered free cash flows. For the comparative approach, a 2024 forward BVPS and EPS of $3.33 and $0.73 respectively were used. An applied P/B and P/E of 2.50x and 16.00x were deemed appropriate and were used to determine a relative value. By averaging all three approaches, we obtained a consensus target price of **$9.89.**

Risks to Price Target

We believe that the company may experiences challenges to achieve our projected target price as the market is currently in a downturn and investor sentiment has not been strong despite the company being fundamentally sound. Additional risks to price include volatile commodity costs, along with other disruptions in its supply and distribution channels caused by geopolitical issues. However, the company's expansion and projected revenue growth from this expansion is expected to translate to the price target being achieved.

NINE (9) MONTHS ENDED JUNE 30, 2023

HONBUN managed to increase its revenue to $2.56 billion from $2.16 billion or by 18.45%, this was attributed to the improved efficiency in both production and distribution along with the expansion island wide with the three additional distribution centers.

Cost of sales (COGS) grew by 10.28%, a good indication that the company is demonstrating more efficient management as this growth did not outpace revenue growth. This resulted in the COGS margin having a 6.89% reduction from the 60.40% ratio in the comparable period to 56.30% in the current period. Since sales revenue growth was higher than the increase in the COGS, Gross Profit improved to $1.11 billion from $855.42 million when comparing the respective periods.

Operating Profit saw a 50.09% increase to $263.80 million from $175.76 million or by 10.8% despite the uptick in Administrative Expenses and Selling & Distribution costs which went up by 26.04% and 26.21% respectively. The growth in revenue spilled over into the company's net profit, which increased to $201.95 million or by 46.25% from $138.08 million in the corresponding period.

As of June 30, 2023, Honey Bun's total assets amounted to $1.70 billion, reflecting a 15.74% rise compared to its asset position on June 30, 2022, when it stood at $1.47 billion. This growth can be primarily attributed to the expansion of its Property, Plant and Equipment, Investments, and Cash and cash equivalents, which increased by 14.85%, 14.12%, and 32.96% respectively. Furthermore, the substantial increase in Right of Use Assets also played a significant role in boosting the total assets, surging from $29.62 million to $59.99 million.

Total Liabilities saw an uptick to $417.20 million from $376.62 million, marking a 10.78% increase. This increase was mainly driven by significant growth in Taxation payable, lease liability, and Deferred tax liabilities, which expanded by 79.87%, 55.65%, and 11.62%, respectively. Additionally, the current portion of lease liabilities made a substantial contribution to the overall increase in Total Liabilities.

Total Equity increased to $1.29 billion from $1.09 billion, representing a substantial growth of 17.45%, primarily driven by a 19.21% increase in retained earnings. This enhancement in both the company's earnings and its total equity resulted in an improved Return on Average Equity (ROAE), which surged from 17.32% as at June 30, 2022, to 22.46% as at June 30, 2023.

Current Ratio rose to 2.63x from 2.51x or by 4.96% as Current Assets outpaced the growth in Current Liabilities, mainly attributed to the increase in Cash and cash equivalents. Notwithstanding, the current ratio for the period is above 1.00x and indicates that the company is not likely to have any challenges in meeting all its short-term obligations and would not have to liquidate non-current assets and or seek more long-term funding.

OUTLOOK

Expansion of distribution centres

The company has been committed to steadily growing its distribution network and as such expansion has been accelerated since 2020, with four new locations being added since then. However, the company has maintained an aggressive approach which has resulted in them actively seeking new locations across major towns in Jamaica to expand its outlets. The company is currently eyeing Linstead and Savana la Mar as its two latest additions. The shift in the growth strategy of the business has led to increased revenues as it aims to reach customers in remote areas.

Safe Quality Food Certification

Honey Bun has attained the coveted highly internationally recognized Safe Quality Food Certification. This certification assures customers of the company that Honey Bun products are manufactured under the highest food and safety quality standards. This addition in certification provides more credibility and assurance to customers as well as more positive marketing of the brand. This should also assist in its reach especially now that the company exports its products.

INVESTMENTS POSITIVES:

- The company has seen increased sales due to its strategic expansion of distribution centers.
- Maintenance of costs to production in a difficult economic environment is proof of the company's dedication to efficient cost strategies.
- Improved profits and earnings are expected to continue as the company is still on its path of expansion of distribution centres.
- The company has maintained comfortable liquidity as evidenced by its improved current ratio.
- The attainment of its Safe Food Quality certification is proof the company provides value to its customers and builds brand loyalty.

INVESTMENT NEGATIVES

- The expansion plans for the company may be delayed if adequate locations cannot be found to conduct its operations.
- The increased operational costs that will accompany more manufacturing activity may further strain profit margins and efficiency.
- The business is exposed to the volatility of the global commodity market which may result in increased raw material costs.
- Diseconomies of scale such as inefficient inventory management and high labour costs because of too much regional expansion.

CONCLUSION

HONBUN is expected to continue to grow and improve its profit lines as the business is in a stage of organic growth which is concerned with expanding its distribution channels. This expansion in distribution is expected to meet untapped demand in many areas of the island and thus boost its margins. Risks to the achievement of this strategy remain the ability to efficiently operate via cost effective inventory management and production.The company maintains a strong cash position which bodes well for the company as this is likely to provide strong financial flexibility as it intends to expand its production and distribution capacity in the future.

Using an Intrinsic Approach with a cost of equity of 16.94%, we valued the company at $9.69 per share. Applying a P/E multiple of 16.00x and a P/B multiple of 2.5x, in line with the average of its peers on the Jamaica Stock Exchange, we arrived at a consensus target price of $9.89 which is a 56.24% upside from the current price of $6.33. Considering this, we have assigned an **OVERWEIGHT** rating to the stock.

Investors may also realize additional capital gains via dividend payments.

SOURCES

Honey Bun (1982) Jamaica Limited Annual Reports and Quarterly Financial Statements

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.