

Company Analysis: Spur Tree Spices (SPURTREE) FY 2023

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- Stock Recommendation: **OVERWEIGHT**
- Price Target: **\$2.94**
- Current Price: **\$2.44**

- Shares Outstanding: **1,676,959,244**
- Financial Year End: **December 31st**

ABOUT THE COMPANY

Spur Tree Spices Jamaica Limited (SPURTREE) is a Jamaican manufacturing company specializing in production, distribution and the sale of Jamaican seasonings, sauces, and canned foods for both the retail and food service markets.

In 2022, after successfully completing an Initial Public Offering (IPO), SPURTREE achieved several milestones including sales growth of 44% in the local market and the appointment of Massey Distribution to represent a significant section of the market not previously covered.

Other achievements included the successful execution of investments in fixed capital through the upgrading of the Spur Tree Factory (Gamex Freezone), the upgrading and expansion of the Exotic Products Factory (the main ackee factory), the purchase of the Morant Bay ICT Factory to support ackee production and the investment for a controlling interest in Canco Limited.

In August 2023, SPURTREE announced that it has partnered with Atlanta's BAK Foods to expand its product distribution in the US, expecting a yearly revenue increase of several million dollars. It plans to produce products under a private label with the BAK Foods branding.

FINANCIAL PERFORMANCE SUMMARY

J\$'000	FY 2020	FY 2021	FY 2022	FY 2023
Revenues	700,663	859,718	1,028,530	1,459,350
Operating Profit	98,146	140,266	126,065	133,835
Profit before Tax	81,678	124,142	113,441	87,465
Total Assets	402,377	596,680	1,490,850	1,515,961
Total Liabilities	219,936	185,420	620,069	560,176
Total Equity	182,441	411,260	870,781	955,785

Dividend Policy

Under the dividend policy, the Directors intend to pursue a liberal dividend policy of up to 25% of net profits available for distribution, subject to the need for reinvestment. The Company paid a \$0.0175 dividend in December 2022 and currently it has an estimated Dividend Yield of 0.71%.

Outlook

Despite the significant shortages in raw materials being experienced in the Agro-Processing industry, SPURTREE has recorded a 10% increase in revenue in Q4 relative to Q3. Gross profit margin also improved from 28.3% to 30.6% attributed to SPUR's targeted cost of sales reduction initiatives. In light of the local farming sector being severely impacted by a prolonged drought during the first six months of 2023, and the persistent heavy rains that followed, SPURTREE aims to and has actively embarked on exploring alternative avenues for the supply of these critical goods. Additionally, SPURTREE seeks to make direct investments into farming activity to support and bolster the availability of these supplies. This is intended to reduce cost volatility and thereby increasing Gross Profit. This along with their strategic moves to expand product offerings and a rebranding campaign bodes well for the Company.

Projections and Valuation

The discounted cash flow method was used to estimate SPURTREE's fundamental value with a cost of equity of 12.56%. We also used a comparable method to come to a consensus price. Based on all assumptions, we obtained a target price of \$2.94.

Risks to Price Target

Inflation and supply-chain issues remain a looming threat to the Jamaican economy in general and can result in setbacks faced by SPURTREE over the near-term. Higher interest rates and the possibility of a slowdown in the global economy also presents a challenge particularly for SPURTREE's export market amid the risk of reduced demand. Due to these factors, the risks to the target price may be skewed to the downside if they materialize for a prolonged period.

FINANCIAL YEAR ENDED DECEMBER 31, 2023

For the twelve months ending December 31, 2023, SPURTREE recorded revenues totalling \$1.46 billion, representing an increase of 41.90% from the \$1.02 billion recorded during the same period in 2022. The growth was driven by a high demand for its products in all the existing markets, as well as the additional revenues from new products. The company is seemingly in a pole position for further revenue growth with many more new product offerings slated to be introduced in 2024. Cost of sales ended the reporting period at \$1.02 billion, approximately 305 million more than the previous year., stemming from higher input costs due to significantly elevated prices of raw materials. As a result, SPURTREE's Gross Profit for the period was \$434.40 million, up from \$331.10 million for the previous year, representing a growth of 31.20%. Despite an increase in Gross Profit, the Gross Profit Margin weakened to 29.70% from 32.22%. This was due a spike in the prices of raw material input, attributed to the low supply.

Administrative and Other Expenses for the period increased by a significant 57.70%, ending at \$307.96 million versus \$195.25 million in the previous year. This increase was mainly attributed to a 229.87% in staff cost compared to the prior period. The operating ratio was recorded at 21.70%, which is 3.70% above the stipulated target of 18%. Management aims to take corrective measures to bring it back to the target. The growth in Gross Profit was enough to offset expense growth, which culminated in Operating Profit increasing to \$133.80 million from \$126.10 million, representing an increase of 6.10% YoY.

Over the period, Finance costs also increased to \$46.40 million from the \$12.60 million recorded in the previous year. The increase is directly related to accounting for interest charges across the group for the entirety of 2023, compared to only three months in 2022. Net Income year-on-year declined to \$87.40 million from the \$115.60 million recorded in the previous year, representing a decline of 24.00% YoY. This was primarily attributed to raw material availability, which was mainly reflected in the second quarter performance.

Total Assets for FY 2023, grew to \$1.51 billion from \$1.49 billion recorded in the previous year, an increase of 1.30% YoY. This increase was driven primarily by an 8.16% YoY increase in Plant, property, and equipment and a 17.80% increase in Intangible Assets. Total Liabilities decreased to \$560.10 million from \$620.10 million. This was driven by a reduction in the non-current portion of Borrowing which declined by 14.50%. Total Shareholders' Equity stood at \$955.80 million versus \$870.70 the previous year, driven by a \$83.30 million or 24.00% increase in Retained Earnings.

The current ratio fell to 3.4x from 3.6x the previous year, representing a slight decrease in liquidity. Even so, the ratio remains at an adequate level. The decrease was due to an 86.58 million or a 58.40% decline in cash & cash equivalents in tandem with a \$37.10 million or a 63.70% increase in current portions of borrowings. Trailing twelve months Return on average Equity (TTM ROAE) was 15.40% compared to 26.20% in the previous. This decrease resulted from lower profitability.

OUTLOOK

SPURTREE Partners with BAK Foods for Major US Expansion

In August 2023, SPURTREE made public a collaboration with BAK Foods in Atlanta, aiming to broaden its distribution in the US and foreseeing a substantial increase in yearly revenue. The plan involves SPURTREE manufacturing products for the BAK Foods brand under a private labelling agreement. BAK Foods, under the ownership of Jamaican Boris Smith, handles distribution for various brands like GraceKennedy and Wisynco Group. The goal of this partnership is to provide genuine Jamaican products, produced in Jamaica, specifically for Jamaican-operated restaurants in the US. SPURTREE intends to boost its production capacity and product variety, seeking strategic growth through new collaborations such as this one. This moves to diversify revenue aligns with SPURTREE's vision of expanding beyond its primary focus on spices and seasonings. With BAK Foods reaching more than 600 Jamaican restaurants across 12 US states, SPURTREE gains a foothold in the market. This venture into the US market comes at an opportune moment, given the rising global demand for authentic Jamaican flavours. By using their expertise in crafting authentic Jamaican products within the private labelling framework, SPURTREE is well-positioned to attract customers from competitors.

SPURTREE enters strategic joint venture to bolster raw material inputs sustainability.

The recent challenges stemming from low vital raw materials supply have prompted SPURTREE to enter into a joint venture agreement. This agreement will ensure a stable supply of raw materials at reasonable prices. Management has also highlighted the implications of the growing agro-processing and tourism sectors on the demand for these raw materials. With this in mind, the current supply of raw materials has been branded as woefully inadequate to meet the current and future demand. This will help to potentially reduce cost and therefore increase profitability and profit margins. This initiative is a potentially fruitful cost-reduction initiative which may benefit SPURTREE's bottom-line in the near and medium-term.

INVESTMENT POSITIVES

- **Revenue Growth:** SPURTREE achieved significant revenue growth, with a 41.80% increase in FY 2023 compared to the previous year. This growth was primarily driven by significant demand in all segments, along with the addition of revenues from new streams.
- **Expansion into the US Market:** The partnership with BAK Foods in Atlanta presents an exciting opportunity for SPURTREE to expand its US distribution and anticipate annual revenue growth. This strategic move aligns with the increasing global demand for authentic Jamaican flavours and demonstrates the company's commitment to market expansion.
- **Diversification Efforts:** The expansion initiatives of Exotic Products and Canco, including the introduction of new canned products and the launch of the Linstead Market brand, signify a commitment to diversification. These initiatives aim to drive revenue growth, especially during periods of low ackee supply, and enhance the brand's appeal, contributing to long-term profitability.
- **Joint venture to increase supply:** The joint venture strategic initiative to increase the supply of necessary raw material inputs, will benefit SPURTREE in the medium to long-term. This will help with cost reduction as an increase in raw material supply will be favourable for their prices. This will consequently have a positive impact on the profitability and profit margin of SPURTREE going forward.

INVESTMENT NEGATIVES

- **Recent Margin Pressure:** Despite revenue growth, SPURTREE experienced a decline in gross profit margin, falling from 32.10% in FY 2022 to 29.70% in FY 2023. This decrease was attributed to a spike in the cost of raw material input.
- **Significant Expense Increase:** Administrative and other expenses increased by a substantial 57.70% YoY, in spite of the operating profit growing relative to the prior year, this continuous increase in expenses is unsustainable and may be a cause for concern if not addressed effectively.
- **ROAE Reduction:** Trailing Twelve Months Return on Average Equity (TTM ROAE) decreased from 26.20% to 15.40% due mainly to lower profitability. A lower ROAE suggests reduced returns for shareholders compared to the previous year, which may impact investor sentiment.
- **Exposure to the negative impact of natural disasters:** The uncontrollable impact of natural disasters on the supply of important raw material may continue to result in the upward adjustments of input cost.



CONCLUSION

SPURTREE aims to increase revenue in existing and new markets with new product lines, expand distribution partners internationally, and strengthen their presence in regional and local markets. It has also entered into contract packing arrangements with a US-based company, gearing up for increased production and distribution.

The strategic joint venture to support the provision of necessary raw material input will potentially bear fruit for SPURTREE in the medium to long term. The unpredictability of price movements based on the supply has negatively impacted SPURTREE's profitability and profit margin. This initiative seeks to address that problem and therefore will potentially be of benefit to the bottom-line.

The discounted cash flow method was used to estimate SPURTREE's intrinsic value with a weighted average cost of capital 12.56%. The relative valuation method was also used to determine the market value and when averaged, a consensus price of **\$2.94** was attained. Based on our assessment of the company, considering its expansion initiatives and its cost mitigating strategy, we expect this investment to provide returns above the general market. As such, we recommend investors **OVERWEIGHT** this stock in their portfolios.

SOURCES

SPURTREE IPO Prospectus, SPURTREE Financial Statements, The Gleaner Company, The Jamaica Observer, Bloomberg..

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- **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.
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