

Supreme Ventures Limited (SVL)

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Company Background

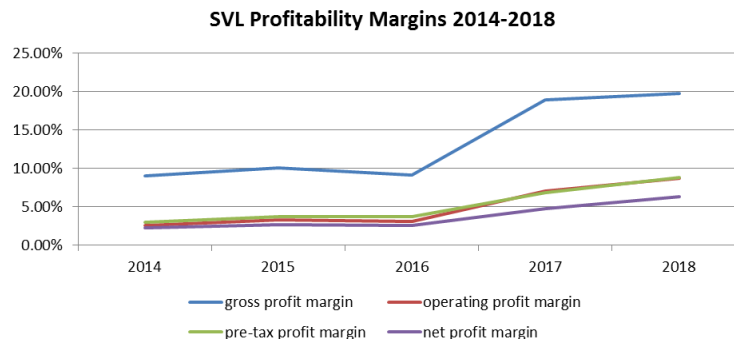
Supreme Ventures is a leading lottery and gaming provider in the Caribbean, with a diverse portfolio of lottery products. The Company focuses on utilizing the technology of its platforms and extensive retailer network to provide non-lottery commercial services to the market. SVL's business segments include Lottery – which includes the Top Draw, Money Time, Pick 3, Cash Pot, Lotto and Super Lotto Games; Sports Betting – which includes the JustBet brand that offers wagers on international sporting events; Gaming and hospitality – which offers Video Lottery Terminal (VLT) games at gaming lounges and food and beverage operations; Pin Codes – which sells phone pin codes through the agent's network; Horseracing – which consists of the operations of Caymanas Track Limited; and Other – which covers all other income.

Financial Performance – Year ended December 31, 2018

Profitability

SVL reported total gaming income of \$32.94B for the period, an 11.0% or \$3.26B increase over the prior year's result. This increase was driven by a \$1.61B increase in lottery revenues to \$15.98B and a \$1.47B increase in revenues generated from the horseracing segment. The sports betting segment saw a 42.1% increase in sports betting to \$247.88M while the "other" segment's revenues grew 34.4% to \$344.87M. The Gaming & Hospitality segment reported revenues of \$353.93M, down 2.5% year-over-year while Pin Codes generated revenues of \$9.88B, relatively unchanged (up 0.3%) year-over-year.

Direct expenses rose 9.8% or \$2.37B to \$26.44B for the period, resulting in gross profits of \$6.49B, a 15.8% increase year-over-year. This increase was driven by a 31.5% increase in horseracing dividends to \$4.11B, a 14.8% increase in lottery and gaming taxes to \$3.10B and a 13.3% increase in agents' commissions to \$3.01B. The gross profit margin improved from 18.9% in 2017 to 19.7% in 2018.



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Selling, general and administrative expenses rose 12.3% to \$3.84B; however, the growth in gross profits resulted in a 36.6% or \$769.46M increase in operating profits to \$2.87B. The operating profit margin was also improved, at 8.7% for the year, relative to 7.1% the year prior. The major driver behind the increase in operating expenses is a 24.7% increase in staff costs, which totalled \$1.32B for the year. Subscriptions and donations were down 27% to \$104.28M, equipment and motor vehicle expenses declined 40.1% to \$49.51M and bad debts fell 83.9% to \$4.98M.

Finance costs were down 7.9% to \$56.03M while a revaluation gain in investment property of \$72.5M was recorded during the year, relative to a revaluation gain of \$4.73M a year prior. Pre-tax profits rose 41.1% to \$2.89B. Taxation rose 22.0% to \$790.03M which resulted in net profits of \$2.10B, a 50.0% increase from the comparable period of 2017. The effective tax rate fell from 31.7% to 27.4% year-over-year which contributed to the increase in net profit margin, which stood at 6.4%, up from 4.7%.

Solvency & Liquidity

As at December 31, 2018, total assets amounted to \$6.62B, up 3.7% or \$1.87M from a year prior. Driving this increase was a 22.1% or \$538.77M increase in cash and cash equivalents to \$2.98B, partially offset by a 19.6% or \$195.78M decline in trade and other receivables to \$805.33M. SVL reported a 6.4% increase in property, plant & equipment to \$1.24B while investment properties closed at \$892.5M, up 8.8% year-over-year.

Total liabilities rose 9.0% or \$276.35M to \$3.33B as trade and other payables rose 19.9% to \$1.94B, prize liabilities climbed 39.6% to \$559.40M, and finance lease payable rose 34.2% to \$423.58M. This increase was partially offset by a 71.2% decline in long-term payables to \$79.64M and a 26.8% decline in income tax payable to \$230.11M.

Despite the increase in liabilities, the cash ratio improved to 1.05x, from 0.99x due to the rise and cash & cash equivalents. The current ratio declined to 1.39x, from 1.57x. The debt to equity ratio stood at 0.16x, up from 0.13x a year earlier. Total debt amounted to \$520.68M, a 16.7% increase year-over-year while shareholders' equity fell 1.1% to \$3.32B as retained earnings declined 2.9% to \$1.26B. SVL's shareholders' equity has declined over the last two years falling from \$3.8B in 2016 to \$3.32B in 2017. SVL's ability to service its debt remained strong with an interest coverage ratio of 53.3x, up from 34.9x in 2017.

Outlook & Valuation

In 2018, SVL showed strong revenue growth in the lottery, horseracing and sports betting segments and continued to make headway in its goal to break even in the horseracing and sport betting segments, with losses down significantly year-over-year. SVL strategies include: capitalising on new product delivery channels; redefinition of their market – recognising the wider gaming and entertainment space and retooling their customer engagement kit; greater engagement of technology to build internal capacity and competitive strength; innovative product offerings; expansion – replicating the success in Jamaica in other markets.

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In March 2018, SVL announced that it had signed an agreement with the Guyana Gaming Authority with the intention of opening up operations in that country. In December 2018, SVL successfully launched its operations with the opening of a Super Store in Georgetown, Guyana. The operations include horse-racing and simulcast promotion as well as pari-mutuel pool operations. Video Gaming Terminals are also featured.

The Company also disclosed that it was in the process of implementing a mobile betting platform in May 2018 and was in the Soft Launch phase of the project at that time. In September 2018, SVL shared that it had introduced the MBet web-based platform in July 2018 which allowed the placing of a full suite of bets on either local horseracing or live simulcast racing from several overseas tracks.

We anticipate further efficiency gains in the sports betting and horseracing segments and continued growth in the main revenue lines as the company widens its network regionally.

Based on these factors, we are forecasting revenues of \$37.15B, a 12.8% increase year-over-year. Net profits are seen improving 9.9% to \$2.31B (earnings per share: \$0.87). Shareholders' equity is forecasted to increase 4.9% year-over-year to \$3.45B which corresponds to a BVPS (book value per share) of \$1.31.

Applying the 1-year average P/E ratio of 30.96x to the forward EPS of \$0.87 yields a price of \$27.08 while the forward BVPS of \$1.31 and the 1-year average P/B ratio of 14.32x yields a price of \$18.71. The Dividend Discount Model produced a price of \$24.36, in which we assumed a 5% growth rate and a 8.1% cost of equity using the Capital Asset Pricing Model. ***As such, our estimation of the fair value of SVL's shares is \$23.38, which is 6.4% below the close price as at March 21, 2019.***

Trade Performance

SVL closed trading on March 20, 2019 with a price of \$24.98, a 38.8% appreciation since the start of the year, and a 111.7% appreciation from a year ago.



Recommendation

SVL has seen its share price surge more than double over the past twelve months as its financial performance has improved significantly whilst also greatly increasing its dividend payment. Dividends

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amounting to \$0.81 per share were paid in 2018, relative to \$0.71 per share in 2017 and \$0.37 per share in 2016. The \$0.81 per share paid in 2018 equates to a dividend yield of 7.2%, if one were to have bought the stock at the end of 2017.

With the launch of its mobile apps and the foray into Guyana, SVL is poised for further growth and as such we *recommend SVL as MARKETWEIGHT for investors with a medium risk appetite and a medium to long-term investment horizon.*

Abridged Financials

J\$000	Year Ended December 31					Change %
	2014	2015	2016	2017	2018	
Revenues	41,309,545	43,847,020	44,921,339	29,680,827	32,936,030	11.0%
Direct Costs	37,586,698	39,429,684	40,812,837	24,074,214	26,443,983	9.8%
Gross Profit	3,722,847	4,417,336	4,108,502	5,606,613	6,492,047	15.8%
Operating Expenses	2,648,936	2,982,306	2,709,768	3,423,659	3,844,128	12.3%
Operating Profit	1,073,911	1,435,030	1,398,734	2,102,506	2,871,964	36.6%
Profit Before Taxation	1,215,741	1,614,830	1,661,892	2,046,369	2,888,438	41.1%
Profit for the year	929,917	1,183,750	1,178,468	1,398,656	2,098,408	50.0%
Total Assets	5,900,514	5,398,913	5,433,350	6,376,861	6,615,444	3.7%
Total Liabilities	1,855,129	1,804,876	1,633,149	3,053,935	3,330,286	9.0%
Shareholder's Equity	4,045,385	3,594,037	3,800,201	3,322,926	3,285,158	-1.1%
EPS (\$)	0.35	0.45	0.45	0.53	0.80	
Book Value per Share (\$)	1.53	1.36	1.44	1.26	1.25	
Key Ratios						
Gross profit margin	9.0%	10.1%	9.1%	18.9%	19.7%	
Operating profit margin	2.6%	3.3%	3.1%	7.1%	8.7%	
Net Margin	2.3%	2.7%	2.6%	4.7%	6.4%	
Return on Average Equity	24.2%	31.0%	31.9%	39.3%	63.5%	
Return on Average Assets	16.6%	21.0%	21.8%	23.7%	32.3%	
Debt/Equity (x)	0.02	-	-	0.13	0.16	

**2017 numbers were restated to reflect changes to accounting standards in 2018 for comparative purposes.*

Source: <http://www.Jamstockex.com>, JMMB Investment & Research, Bloomberg, Company Financials; Jamaica Gleaner Company

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APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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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

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