INVESTMENT AND SOVEREIGN RESEARCH September-21-2020

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Express Catering Limited

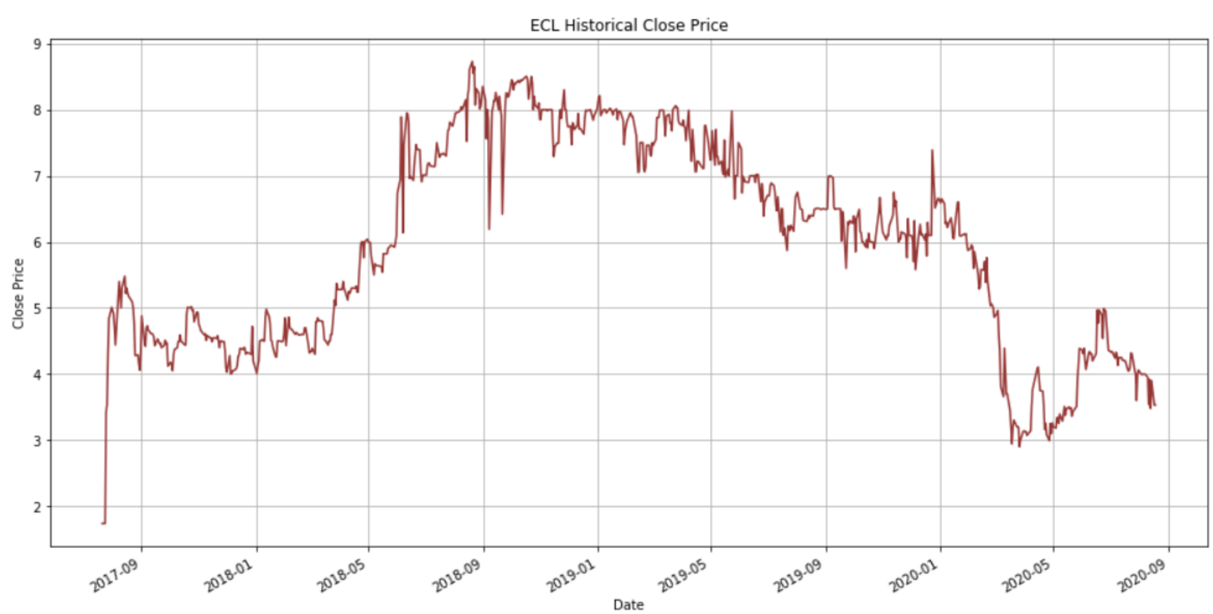
PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

Executive Summary

Express Catering Limited (ECL) was incorporated under the laws of Jamaica on June 26, 2001. ECL's primary activity is the operation of branded sports bars and restaurants at Sangster International Airport (SIA). The company is a subsidiary of Margaritaville St. Lucia Inc, whose ultimate parent is Margaritaville Caribbean Group Limited. ECL was listed on the Junior Market at J$1.50 in July 2017.

ECL has been in operation since 2001 providing food and beverage offerings to millions of individuals arriving and departing via the SIA annually. The company has been the primary food and beverage partner of MBJ Airports Limited since 2011 when it negotiated a long-term contract to manage and supply the majority of food and beverage offerings at the SIA. ECL has a meaningful share of pre-security food and beverage offerings and exclusive rights for the post security sections. **ECL currently operates several international franchises including American Dairy Queen, Starbucks, Quiznos, Wendy's and Domino's**.

Express Catering (ECL) experienced revenue growth at a CAGR of 6.23% to US$17.32 million for the period FY 2015 to FY 2019 (period under review). Meanwhile profits increased at a CAGR of 58.55% to US$3.73 million over the same period. ECL continued to produce growth in FY 2020, for the 9M period ended February 2020 revenue increased by US$803.7 thousand or 6.64% to US$12.91 million. However, profit for the 9M period was up only US$ 103.6 thousand or 4.07% to US$2.65 million.



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Recent Developments

ECL's most recent earnings report for its 3rd quarter ended February 2020 produced revenue growth of 3.44% or US$169.58 thousand to US$5.1 million. However, profits fell marginally by 0.80% to US$1.12 million. The decline was a consequence of lower gross profit margin in the quarter because of an unfavourable product mix. Furthermore, profit growth was constrained by higher administrative costs and a foreign exchange loss.

ECL's audited report for the year ended May 31, 2020 is due but, yet to be published because of the global pandemic. Q4 FY 2020 earnings is expected to be severely impacted by the drastic decline in stopover arrivals during the period, given travel restrictions implemented from March to June 2020.

	2015	2016	2017	2018	2019	CAGR	9M 2019	9M 2020	Chg %
Share Price	N/A	N/A	N/A	6.10	7.50	22.95%	7.50	4.86	-35.20%
BVPS	0.17	0.27	0.36	0.51	0.26	11.29%	0.16	0.46	186.36%
EPS	0.041	0.078	0.084	0.268	0.301	64.47%	0.21	0.22	7.42%
Dividend Per Share	N/A	N/A	N/A	0.12	0.56	380.09%	0.56	0.03	-94.07%
JSE Junior Market	871.93	2,135.76	3,331.90	2,949.87	3,077.23	37.06%	3,127.66	2,911.92	-6.90%
Revenue	13,599,073	14,058,053	14,232,136	15,705,421	17,316,372	6.23%	12,105,863	12,909,577	6.64%
Gross Profit	10,187,656	10,480,175	10,150,311	11,100,534	12,250,919	4.72%	8,857,109	9,356,520	5.64%
Operating Profit	1,254,853	1,595,305	1,638,131	3,947,458	4,022,513	33.81%	2,814,041	2,954,625	5.00%
Profit	590,566	1,070,380	1,079,489	3,447,791	3,731,471	58.55%	2,546,503	2,650,143	4.07%
PP&E	5,098,742	4,756,053	4,442,436	4,654,112	4,394,696	-3.65%	4,468,744	4,127,692	-7.63%
Non-Current Assets	5,938,934	5,504,535	5,094,347	5,554,242	5,413,846	-2.29%	5,442,909	5,110,098	-6.11%
Current Assets	828,761	554,888	4,468,655	6,856,942	3,117,215	39.26%	1,596,955	5,556,023	247.91%
Total Assets	6,767,695	6,059,423	9,563,002	12,411,184	8,531,061	5.96%	7,039,864	10,666,121	51.51%
Non-Current Liabiliites	512,592	162,894	3,604,350	3,597,122	3,635,861	63.20%	3,589,808	3,621,249	0.88%
Current Liabilities	3,858,899	2,429,945	1,412,579	2,330,475	1,681,273	-18.76%	1,421,100	1,581,991	11.32%
Debt	2,338,121	1,172,841	3,608,721	3,678,991	3,685,522	12.05%	3,500,000	3,596,528	2.76%
Equity	2,396,204	3,466,584	4,546,073	6,483,587	3,213,927	7.62%	2,028,958	5,462,882	169.25%
Operating Cash Flow	1,041,927	668,471	(2,404,448)	2,764,931	7,579,617	64.23%	7,153,692	823,551	-88.49%
Financing Cash Flow	(791,681)	(591,320)	2,721,255	(1,860,172)	(7,306,141)	N/A	(7,008,445)	(415,800)	N/A
Investing Cash Flow	(73,525)	(93,162)	(107,958)	(970,826)	(413,991)	N/A	(304,613)	(114,077)	N/A
						Avg.			
Gross Margin	74.91%	74.55%	71.32%	70.68%	70.75%	72.44%	73.16%	72.48%	-0.94%
Operating Margin	9.23%	11.35%	11.51%	25.13%	23.23%	16.09%	23.25%	22.89%	-1.54%
Net Profit Margin	4.34%	7.61%	7.58%	21.95%	21.55%	12.61%	21.04%	20.53%	-2.41%
Current Ratio	0.21	0.23	3.16	2.94	1.85	1.68	1.12	3.51	212.53%
Cash Ratio	0.04	0.07	0.08	0.07	0.05	0.06	0.01	0.09	731.05%
Debt-to-Equity	0.98	0.34	0.79	0.57	1.15	0.76	1.73	0.66	-61.83%
ROE	28.11%	36.51%	26.94%	62.52%	76.96%	46.21%	91.51%	102.38%	11.88%
ROA	8.56%	16.69%	13.82%	31.38%	35.64%	21.22%	39.18%	43.32%	10.56%
P/E	N/A	N/A	N/A	22.79	24.96	23.88	27.07	15.39	-43.15%
P/B	N/A	N/A	N/A	12.05	28.77	20.41	46.99	10.63	-77.37%
Dividend Payout Ratio	N/A	N/A	N/A	43.90%	187.70%	115.80%	274.88%	15.17%	-94.48%
Dividend Yield	N/A	N/A	N/A	2.47%	7.31%	4.89%	7.26%	0.53%	-92.66%
ECL Share Performance	N/A	N/A	N/A	N/A	22.95%	N/A	22.95%	-35.20%	N/A
Junior Market Index Performance	20.81%	144.95%	56.01%	-11.47%	4.32%	42.92%	6.03%	-5.37%	N/A

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Financial Overview

Revenue has increased consistently at a CAGR of 6.23% for the period FY 2015 to FY 2019 (period under review). Operating Profit has increased at a CAGR of 33.81% to US$4.02 million over the same period, with a notable surge of 141% or US$2.31 million in FY 2018. The surge in FY 2018 operating profit was attributable to a decline in administrative expenses. Primary expenses such as franchise fees fell 57% or US$636.69 thousand while group related charges were eliminated. More recently, for the 9M period ended February 2020 revenue has increased by US$803.7 thousand or 6.64% to $12.91 million. However, profits only increased by US$103.64 thousand or 4.07% to $2.65 million, because it was constrained by higher operating costs. **ECL's primary operating expense is administrative costs, which in FY 2019 had three major components employee benefits, rent and franchise fees of US$2.04 million, US$3.67 million, and US$563.71 thousand, respectively.** Employee benefits and rent have increased at a CAGR of 5.62% and 7.76% respectively for the period under review.

As at the end of FY 2019, the largest contributors to assets are PP&E and 'owing by related companies' which accounts for 51.51% or US$4.39 million and 17.89% or US$1.53 million of total asset, respectively. The three primary contributors to PP&E and their respective amounts are 'Leasehold Improvements' (US$1.73 million), 'Furniture and Fixtures' (US$1.42 million) and 'Bar and Kitchen Equipment' (US$1.12 million). **Meanwhile 'owing by related companies' at the end of FY 2019 was due from Margaritaville Limited the amount is unsecured and has no fixed repayment terms**. **As at the end of February 2020 'owing by related party' has surged to US$4.3 million or 40.54% of total assets, making it the largest contributor at that point.** ECL's equity has increased at a CAGR of 7.62% to US$3.21 million for the period under review. However, equity fell 50.43% or US$3.27 million in FY 2019 on account of ECL making a dividend payment of US$7 million while producing profits of only US$3.73 million that year.

Operating cash flow has been volatile for the period under review peaking in FY 2019 at US$7.6 million. The main reason for the increase was due to a repayment from a related party for US$4.47 million. This aided ECL in producing the record financing cash outflow of US$7.31 million in FY 2019.

ECL's gross profit margin has remained relatively stable averaging 72.44% for the period under review. Meanwhile the company's operating margin increased substantially since FY 2018, well above its average of 16.09% for the period under review. The increase in recent years was supported by a decline in administrative expense relative to FY 2015 to FY 2017 levels. The decline in administrative expense was due to the elimination of group related expense of more than US$1.3 million. Furthermore, franchise fees which were more than US$1.1 million in FY 2015 to FY 2017 declined to about US$500 thousand. The increase in operating margin and decline in effective tax rate aided net profit margin expansion. ECL has maintained a current ratio of more than 1x since FY 2017 which indicates short-term liabilities can be readily met. However, ECL has had a relatively low cash ratio for the period under review averaging 0.06x. Debt to equity surged in FY 2019 primarily due to a decline in equity but has decreased to 0.66x at the end of February 2020, well below levels of concern.

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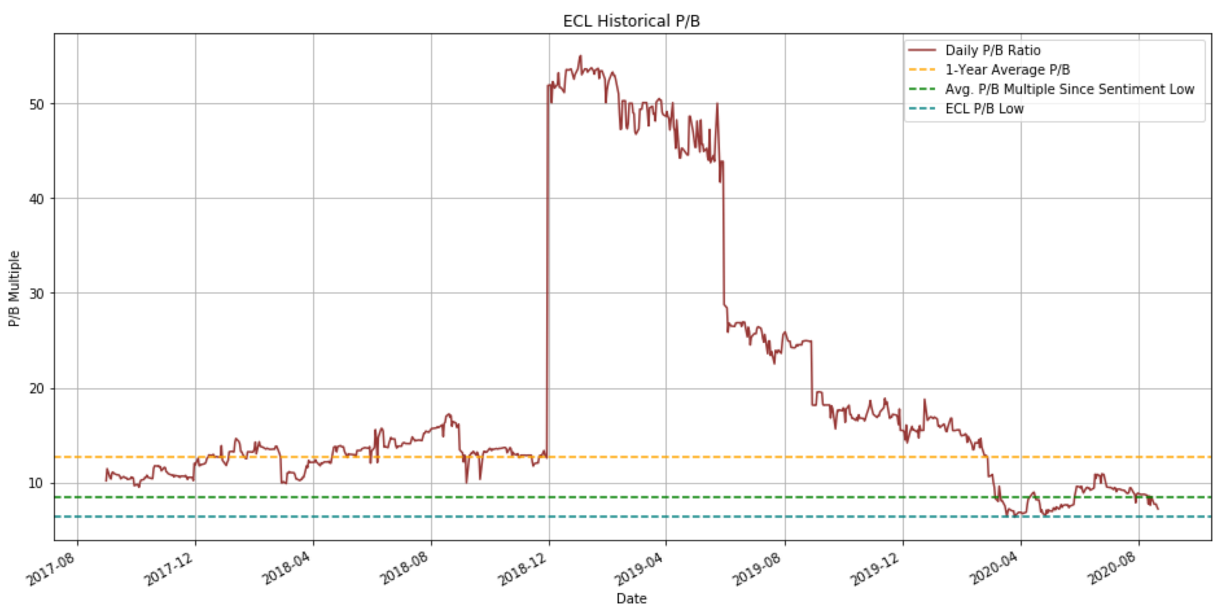
Forecast and Valuation

We used the relative value method to arrive at our price target of J$3.39. We applied our estimate of BVPS at the end of FY 2021 to ECL's average P/B multiple since reaching a low in late March 2020. Our view is that the decline and subsequent rebound reflects investor expectation of the expected impact of the global pandemic on ECL's earnings. ECL is down 50% year-to-date, twice the Junior Market's decline of 25% for the same period, reflecting investors' expectation that the pandemic will have a larger impact on ECL than most companies. **Meanwhile for our upper end price target of J$5.08 we applied ECL's 1-year average P/B which reflects a mix of higher sentiment towards ECL before the global pandemic and lower sentiment attributable to the same. Meanwhile for our lower end price target of J$2.52 we applied ECL's P/B low.** This reflects our view that there is a reasonable chance that sentiment towards ECL sours as earnings negatively impacted by the global pandemic are reported.

We expect ECL to report a loss in FY 2021 therefore we view using ECL's P/E multiple as inappropriate. We also view the use of DDM as inappropriate given ECL's short history of dividend payments which have been volatile.

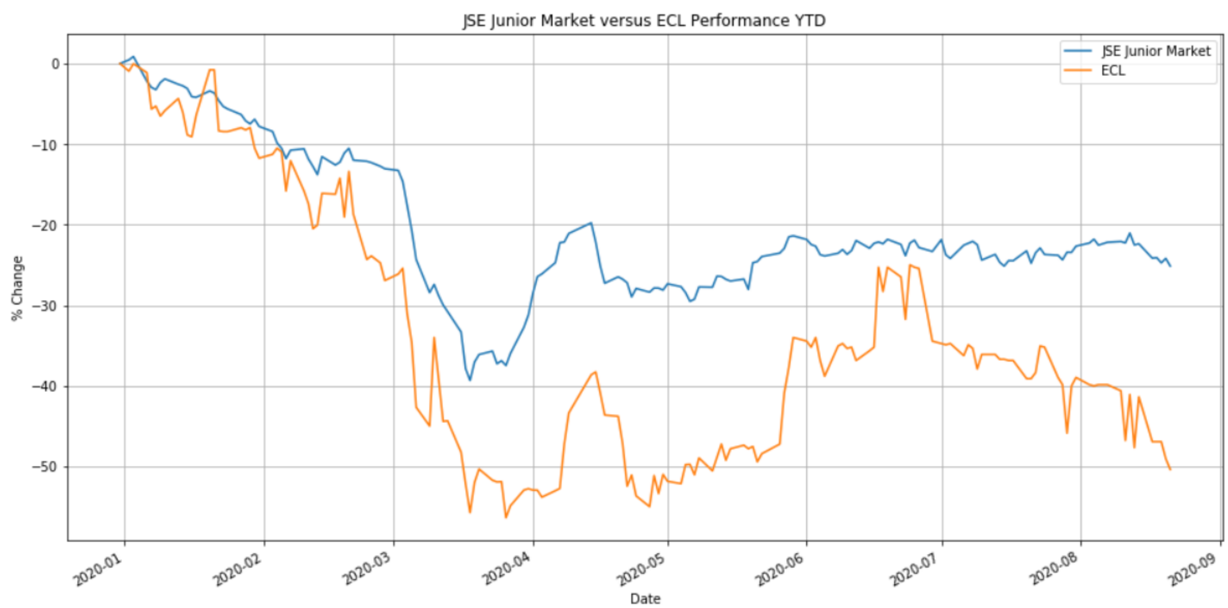


Outlook

We expect a significant decline in ECL's revenue and earnings in Q4 and FY 2021 due to the global pandemic. We foresee the global pandemic having an outsized impact on ECL given the nature of its business which is intricately tied to Jamaica's tourism industry. However, despite the decline in revenue we expect certain costs such as rent and franchise fees to be largely fixed which could result in substantial losses for ECL in the near-term. Of note ECL operates under a Concession Lease Agreement granted to it by MBJ Airport Limited. In the lease agreement it has two primary components, firstly a Minimum Annual Guaranteed Fee and secondly a percentage fee based on gross sales on food, beverage, and merchandise sales. Therefore, a decrease in revenue for ECL will result in a decline in rent, which will offer some reprieve from a cost standpoint.

Recommendation

Our recommendation on ECL is ***UNDERWEIGHT*** despite it trading close to our base-case price target. **Our rating considers several factors including the quality of balance sheet assets, the uncertainty due to the global pandemic and ECL is yet to report FY 2020 earnings.** The primary asset on ECL's balance sheet is 'owing by related party' which is unsecured with no repayment date, this asset is likely to be an essential source of cash flow in the near-term given the global pandemic. Finally, ECL is due to report FY 2020 earnings which will provide crucial insight of the global pandemic effect on its operations. While we expect Q4 FY 2020 revenue to fall 80% this could prove too optimistic given ECL's business operations and Jamaica's boarder closure. Furthermore, our expectations for aggressive cost containment may be unattainable.



Source: http://www.jamstockex.com, JMMB Investment & Research, Bloomberg, Express Catering Annual Reports

APPENDIX

IMPORTANT DISCLOSURES

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

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

OUTPERFORM/OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE UP TO 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

MARKETPERFORM/HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

UNDERPERFORM/UNDERWEIGHT— ADJUST EXPOSURE IN YOUR PORTFOLIO HELD AT JMMB TO BETWEEN 2.5% AND 4.9% FOR THIS PARTICULAR ASSET

STRONGLY UNDERPERFORM/UNDERWEIGHT—REDUCE EXPOSURE TO THIS ASSET TO BELOW 2.5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO (0%).

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