

Lasco Distributors Limited (LASD)

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INFRINGEMENT IN THE APPENDIX**

Executive Summary

Founded in 1988, LASCO Distributors Limited is now a market leading distribution company in Jamaica. LASD is comprised of two divisions: Consumer and Pharmaceutical. The company is well known for several innovations and product introductions, namely its flagship product LASCO Food Drink and LaSoy - a range of soy beverage products, Curves Sanitary Napkins, and the iCool range of water, flavoured water and juice drinks.

We recommend an overweight position in LASCO Distributors Limited as we believe the stock is currently trading below its fair value. We maintain our favourable opinion of the company and its moves to improve its distribution capacity, widen its sales network and improve margins.

Company Background

Founded in 1988, LASCO Distributors Limited is a major distribution company in Jamaica. Market positioning and the focus on satisfying consumer needs has helped LASD to become a market leader in several major categories in the industry. The company is well known for several innovations and product introductions, namely its flagship product LASCO Food Drink and LaSoy a range of soy beverage products, Curves Sanitary Napkins, the iCool range of water, flavoured water and juice drinks.

The company comprises of two divisions - the Consumer Division and the Pharmaceutical Division. The Consumer Division's major segments are food, beverage, personal care, baby care, adult incontinence and home care products. On the Pharmaceutical side, the supply network includes the distribution of ethical and over the counter (OTC) pharmaceutical products, animal health and equipment for major international brands, as well as the LASCO brand of generics - LASMED.

LASD distributes Unilever's home and personal care portfolio, with brands such as Breeze, Dove, St. Ives, Mistolin and Axe. LASD also distributes Salada's Jamaica Mountain Peak and Mountain Bliss 876 coffee as well as their range of teas. LASD's route to market covers all core channels which include supermarkets; wholesalers; small shops; schools; pharmacies; government institutions and health care facilities across Jamaica.

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Financial Performance – Nine Months ended December 31, 2019

Profitability

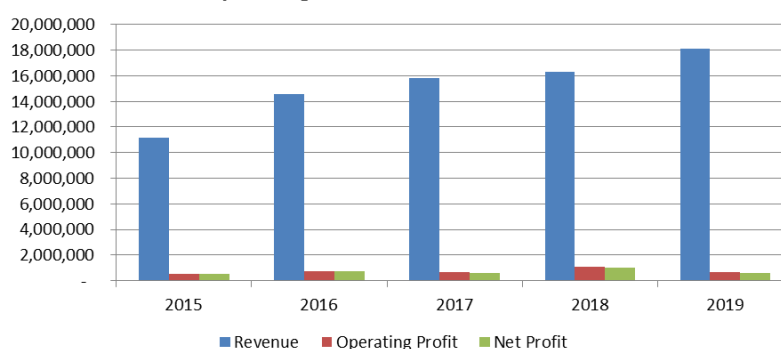
LASD reported a 7.3% or \$969.81M increase in revenues to \$14.3B for the nine months period ended Dec. 31, 2019. The Company recently launched its reduced sugar ICOOL beverage line and grape flavoured ICOOL water during the period which LASD noted has been doing well.

Cost of sales rose to \$11.48B, a 7.3% or \$777.17M increase year-over-year. As such, gross profits amounted to \$2.82B, also up 7.3% over the comparable period of the prior year. The gross profit margin held constant over the period at 19.7%. Other income amounted to \$70.73M, down 59.2% or \$102.59M from the prior year period.

Operating profit was down 5.7% to \$630.27M as operating expenses rose 6.0% to \$2.26B. Operating expenses as a percentage of revenues stood at 15.8%, a marginal improvement from 16.0% of revenues in the prior year period. Nevertheless, the operating profit margin fell from 5.0% in the prior year period to 4.4%.

Finance costs moved from \$474K to \$12.56M which contributed to the 7.5% decline in pre-tax profits to \$617.71M. However, LASD's ability to service its debt remained strong as the interest coverage ratio for the period stood at 50.2x. After taxes of \$60.21M, LASD reported a net profit of \$557.5M, which was down 10.2% from the prior year period. The net profit margin declined to 3.9% from 4.7% in the prior year period, driven by the decline in pre-tax earnings and an increase in the effective tax rate to 9.7%, up from 7.0% in the comparable period of the previous year.

Operating Performance 2015-2019



Solvency & Liquidity

LASD's assets totalled \$9.49B as at Dec. 31, 2019, up 10.2% or \$879.54B from a year prior. Non-current assets increased by 15.3% or \$293.08M to \$2.21B as property, plant & equipment rose 7.1% to \$1.92B and 'financial assets' rose \$186.28M to \$202.63M. Current assets rose 8.8% or \$586.46M to \$7.28B, driven

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primarily by a 16.5% increase in receivables to \$3.26B and a 12.0% increase in cash & bank balances to \$1.23B. Inventories amounted to \$2.5B as well, up 0.9% year-over-year. Short-term investments of \$206.6M were up 4.4% year-over-year.

Total liabilities amounted to \$3.89B, up \$486.54M or 14.3% year-over-year. Driving this increase was a 15.4% or \$495.8M increase in payables, which closed the period at \$3.71B. Total debt was down 41.4% to \$113.33M as the outstanding balance of long-term loans fell 80.8% to \$33.33M. The current portion of long-term loans rose 300% to \$80.0M. Shareholders' equity amounted to \$5.6B, a 7.5% or \$393M improvement on its balance a year earlier. Retained earnings rose 7.9% to \$5.03B. As such, leverage, as measured by the debt-to-equity ratio, fell to 0.02x, down from 0.04x a year prior.

The cash ratio stood at 0.37x, down from 0.40x a year earlier, as current liabilities grew at a faster pace than cash and cash equivalents. The current ratio stood at 1.90x, which compares to 2.08x a year prior. Cash from operating activities amounted to \$845.44M, up from cash outflows of \$92.1M in the previous year period. This turn around was driven by the \$863.75M increase in payables, relative to a \$349.83M decline in the prior year period.

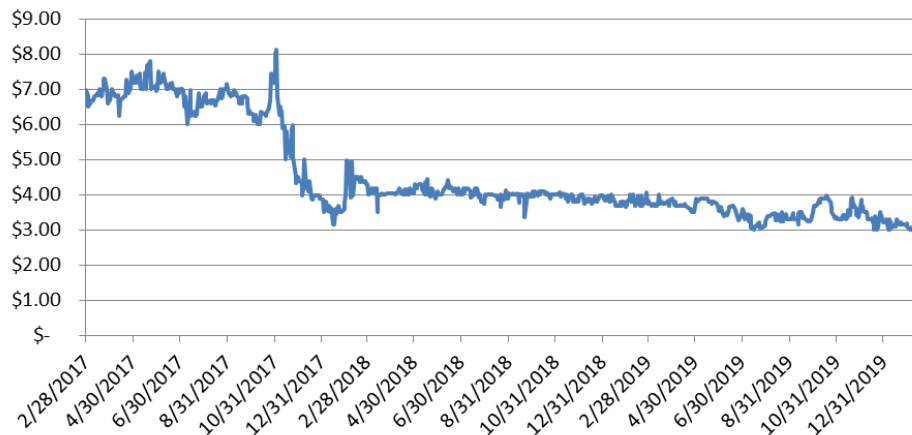
Outlook & Valuation

We anticipate a return to growth in net profits for the 2019/20FY following a 41% decline in the 2018/19FY due to the non-recurrence of \$273M in proceeds from the Pfizer award in the 2017/18FY. This increase is anticipated despite year-to-date performance being weaker than the previous year as we expect the company to recover from the loss made in the 4Q of the 2018/19FY. This growth is expected to continue into the 2020/21FY with revenues projected at \$20.2B with net profits of \$629.62M (EPS: \$0.18) as the company will begin to pay the full corporate tax rate.

We utilized the 1-year P/E average of 21.31x, which when applied to our forward EPS yielded a price of \$3.82. Shareholders' equity is seen closing the 2021FY at \$6.02B, which translates to book value of \$1.72. Utilizing the 1-year P/B average of 2.27x yields a price of \$3.90. **Averaging these estimates gives us a fair value of \$3.86 per share, 29.5% higher than the closing price of \$2.98 on March 3, 2020.**

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LASD 3-year Trading History



Shares of LASD are down 7.2% year-to-date and 19.5% year-over-year. The subpar performance of LASD's share price may be explained by the general downturn in the local market indices as well weak year-to-date financial performance. Shareholders may also be expressing pessimism around the chances of success in LASD's appeal of its J\$273M award in the Pfizer case, where LASD and Medimpex sought damages related to an injunction granted to Pfizer in 2005 as Pfizer claimed the two local firms violated its patents.

LASD had sought US\$490M from Pfizer and optimism around the case drove the stock price above \$7.00 per share but was ultimately awarded just J\$273M in a November 2017 Supreme Court ruling which it has since appealed. Shareholders may have anticipated a much higher pay-out and no longer believe the company will be successful in its efforts in a case that began in 2005 and as such have cooled their interest, leading to the stock trading below our estimate of its fair value.

Recommendation

We recommend an OUTPERFORM/OVERWEIGHT/BUY position in LASCO Distributors Limited as we believe the stock is currently trading below its fair value. We view the company's efforts to improve its distribution capacity, widen its sales network and continue to innovate its product line as favourable. Moderate inflation expectations should continue to support revenue growth and the company is expected to continue to show recovery in profitability. The Company is also expected to continue to benefit from its relationship with LASCO Manufacturing Limited as it serves as a distributor for its products. Growth prospects are tempered by the competitive nature of the distribution industry. LASD is most suitable for the medium to long-term investor with a medium to high-risk appetite as the distribution sector remains highly competitive.

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Abridged Financials

J\$000	Year Ended June 30					9M19	9M20	% change
	2015	2016	2017	2018	2019			
Turnover	11,146,892	14,549,098	15,803,329	16,269,083	18,130,689	13,330,780	14,300,588	7.3%
Operating Expenses	1,531,113	1,984,020	2,363,076	2,487,376	2,979,036	2,131,201	2,259,380	6.0%
Operating Profit	548,917	758,930	689,508	1,079,893	705,859	668,394	630,270	-5.7%
Profit Before Taxation	546,730	757,495	686,892	1,079,369	691,942	667,920	617,713	-7.5%
Profit for the year	546,730	716,751	609,678	1,003,879	597,781	620,853	557,499	-10.2%
Total Assets	5,334,577	6,496,070	7,392,240	8,510,266	8,639,662	8,611,988	9,491,525	10.2%
Total Liabilities	2,451,616	2,938,026	3,344,104	3,940,412	3,450,675	3,405,586	3,892,128	14.3%
Shareholder's Equity	2,882,961	3,558,044	4,048,136	4,569,854	5,188,987	5,206,402	5,599,397	7.5%
EPS (\$)	0.16	0.20	0.17	0.29	0.17	0.18	0.16	
Book Value per Share (\$)	0.82	1.01	1.15	1.30	1.48	1.48	1.60	
Key Ratios								
Gross profit margin	18.0%	18.3%	18.6%	19.5%	19.6%	19.7%	19.7%	
Operating profit margin	4.9%	5.2%	4.4%	6.6%	3.9%	5.0%	4.4%	
Net Margin	4.9%	4.9%	3.9%	6.2%	3.3%	4.7%	3.9%	
Return on Average Equity	20.7%	22.3%	16.0%	23.3%	12.3%			
Return on Average Assets	11.5%	12.1%	8.8%	12.6%	7.0%			
Debt/Equity (x)	-	0.00	0.06	0.09	0.06	0.04	0.02	

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

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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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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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