

## JMMB INVESTMENT & SOVEREIGN RESEARCH

### Future Energy Source Company Limited (FESCO)



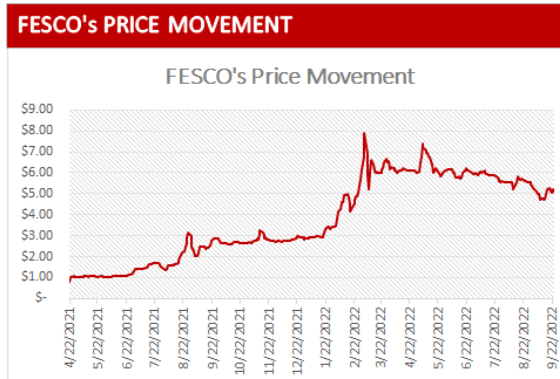
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#### EXECUTIVE SUMMARY

**Future Energy Source Company Limited (FESCO)** established in 2013, is the fifth (5th) largest transportation fuel marketer in Jamaica and the second (2nd) largest local marketer by volume/litres of fuel sold, as at March 2022. FESCO engages in the marketing and distribution of petroleum and automotive products. The company offers E10 87 and E10 90 octane, E10 88 blends, automotive diesel oil, ultra-low sulphur diesel, and lubricants to retail and commercial customers. It also provides oil-based coolants, coolants, windshield wash fluids, and deionized water under the FUTROIL and FUTRLUBE brands. In addition, it offers heavy fuel oil and kerosene; fuel storage tanks and dispensers; service station management equipment; fleet management; and tank gauging equipment and technology, as well as drinking water.

Over the past 3 years, FESCO has grown revenues by a Compound Annual Growth Rate (CAGR) of 32.6%, while net income improved by a CAGR of 85.6%. Over the 12-month period ended March 2022, FESCO has grown revenues to \$12.67B, a 116.4% increase over the 2020/21FY revenues of \$5.86B. Net Income for FESCO for the financial year ended March 31, 2022 amounted to \$253.64M. This represents an improvement in profit of \$145.48M over the \$108.16M recorded for the same period last year. Additionally, FESCO has also grown profits to \$151.79M for the quarter ended June 2022, compared to profits of \$39.94M for the corresponding three months period in 2021.

Utilizing FESCO's 1-year P/E average of 44.27x and the \$0.13 EPS estimate produces a price of \$7.01. With the 1-year P/B average of 16.33x and the \$0.43 BVPS estimate yields a price of \$5.79. **These estimates yield an average price of \$6.40.** The latest traded price for FESCO is \$5.13 as at October 12, 2022.



FESCO's Statistics		
Financial Year End		March
Stock Price (23/09/2022)	\$	5.12
EPS	\$	0.101
Book Value per share	\$	0.31
P/E		44.27x
P/B		16.33x
Net Profit 2022 (millions)	\$	253.6
Price Target	\$	6.40

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## ***Company Overview***

Future Energy Source Company Limited (FESCO) established in 2013, is the fifth (5th) largest transportation fuel marketer in Jamaica and the second (2nd) largest local marketer by volume/litres of fuel sold, as at March 2022. FESCO is also the only fuel company listed on Jamaica Stock Exchange (JSE). FESCO is a distributor of Petroleum products, Petroleum equipment and technologies, Lubricants, Chemicals and Purified drinking water. The company partners with Dealer Owned Dealer Operated (DODO) service stations and Company Invested Dealer Operated (CIDO) service stations, to brand their stations as FESCO Service Stations to provide both fuel equipment solutions and fuel supply to the construction, distribution, manufacturing, and transportation sectors island wide.

FESCO has grown from three (3) branded locations in 2014 to sixteen (16) as at March 2022. During that time, the Company has grown from being a new entrant (zero market share) to now having a share estimated at 7.9% of transportation fuels market (E10 87, E10 90, ADO and ULSD). Additionally, FESCO markets the following to industrial/commercial customers: fuel equipment solutions, transportation fuels and non-transportation petroleum-derived products such as Heavy Fuel Oil, Kerosene, Asphalt, Ultra Low Sulphur Diesel, Automotive Diesel Oil, proprietary lubricants, proprietary chemicals and proprietary bottled water.

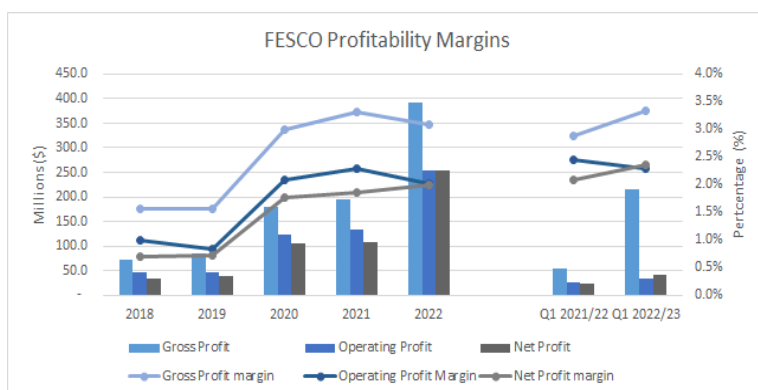
During the financial year ended March 2022, FESCO continued to execute on its strategy of expanding its network footprint with the additions of FESCO Ferry and FESCO Beechwood service stations. FESCO Beechwood, which the Company owns and operates, enabled the Company to enter the retail space and sell directly to consumers for the first time.

## ***Financial Overview***

### ***Profitability***

Revenue improved at a compound average growth rate (CAGR) of 32.6% for the period FY2019 – FY2022. FESCO reported revenues of \$12.67B for the year ended March 2022, an improvement of 116.4% or \$6.81B. A major component that affected the company's revenue, is the fluctuations in fuel prices as posted in the ex-refinery prices quoted and revised weekly by Petrojam. Between April 2021 and March 2022, per Petrojam Kingston refinery prices, E10 87 increased 41.3% or J\$55.89, E10 90 increases 42.0% or J\$58.07, ADO increased 54.5% or J\$69.45 and ULSD increased

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52.7% or J\$69.53. Additionally, FESCO revenue grew by expanding sales at its locations, expanding its distribution network by increasing FESCO's company-owned company-operated ("COCO") business line, dealer owned FESCO branded locations and increasing its supply to commercial and industrial

private supply firms. FESCO has no control over the supply price of fuel and, instead focuses more on quantity of fuel sold and gross profits. Notably, FESCO projections in its prospectus predicted revenue in FY2022 of \$10.57B. More recent, for the three months ended June 2022, FESCO reported revenue of \$6.46B, up 238.1% year over year.

Cost of sales marginally outpaced revenue growth for the year ended March 2022, up 116.9% or \$6.62B to \$12.28B. Gross profits grew by 100.8% or \$196.4M to \$391.22M. However, gross profit margin contracted to 3.09%, relative to 3.33% in the 2021FY. Interestingly, gross profit for the three months ended June 2022 of \$216.08M, up 293.8% year over year and exceeded the full year gross profits achieved for the financial year ended March 2021 by \$21.26M or 10.9%.

Operating and administrative expenses for the 2022FY totaled \$133.94M. This reflects a 125.6% increase when compared to 2021's operating and administrative expenses of \$59.37M, driven by staff related costs, advertising and promotion cost, legal and professional fees. The increase in expenses is associated with its first company-owned company-operated station on Beechwood Avenue and the advertising and promotion of new products, such as their introduction of new fuel blends.

As such, operating profit margin deteriorated to 2.01% from 2.30% the prior year. However, FESCO reported operating profit of \$254.95M for the 2022FY, an increase of 89.3% from \$134.69M the prior year. Notably, finance income fell by 51.8% year over year to \$2.94M.

Net Income for FESCO for the financial year ended March 31, 2022 amounted to \$253.64M. This represent an improvement in profit of \$145.48M over the \$108.16M recorded for the same period last year. Moreover, net profit margin improved from 1.85% a year ago to 2.00%. The return of average assets stood at 15.2%, compared to 21.1% a year prior, while the return on average equity stood at 46.6%, relative to 41.3% in 2021. More recent, net income increased to \$151.79M for the three months period ending June 2022, up from \$39.9M for the corresponding three months period in 2021.

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## *Liquidity & Solvency*

FESCO reported total assets of \$2.79B as at the end of March 2022, which represents a growth of 406.7% year over year, as total assets stood at \$551.49M for the same period last year. Non-current assets rose by 323% or \$870.98M, booked at \$1.14B, while current assets amounted to \$1.65B, up 486.9% or \$1.37B from the prior year's balance. The increase in non-current assets was driven by 344.4% or \$882.28M rise in property, plant and equipment (PPE) to \$1.14B, while the increase in current assets was mainly driven by the rise in inventories and cash and cash equivalents to \$49.03M and \$1.13B respectively. Additionally, "due from related parties" rose to \$187.14M, while receivables increased to \$280.24M, up 109% year over year as a result of increased fuels prices, increased credit facilities extended to dealers to maximize sales during to Christmas holidays as movement was more relaxed relative to the December 2020 period and prepayments on asset purchases.

Total liabilities amounted to \$2.02B, up \$1.79B year-over-year. Current liabilities amounted to \$1.02B, up 388.6% or \$809.03M year-over-year, as payables surged 417.5% to \$750.90M. Non-current liabilities increased to \$1.01B, driven by the \$1.00B bond issued in February 2022 at a 7.5% rate. Shareholders' equity amounted to \$770.59M, up 142% from the prior year, as retained earnings rose 72.9% to \$542.26M. Notably, the Company was listed on the Junior Market of the Jamaica Stock Exchange on April 23, 2021 and the proceeds of the fully subscribed 300,000,000 newly issued ordinary shares amounted to \$223.52M, which contributed to the increase in shareholders' equity. This has resulted in a book value per share of \$0.31, which is \$0.18 greater than the \$0.13 book value per share as at March 2021. Total debt amounted to \$1.27B, up \$809.03M year-over-year. FESCO's leverage, as measured by the debt-to-equity ratio, stood at 1.65x, up from 0.12x a year prior. FESCO's ability to service its debt obligations remains strong, as the interest coverage ratio moved from 38.7x in the 2021 to 32.6x as at March 2022.

FESCO's liquidity position improved, with a cash ratio of 1.11x, up from 0.35x a year prior, while the current ratio improved from 1.35x a year prior to 1.63x. The quick ratio was 1.58x, up from 1.26x. The liquid nature of the Company's business was highlighted by a cash conversion cycle of negative 3 days, which compared to negative 2 days in 2021. A negative cash conversion cycle indicates that a Company sells inventory and collects on receivables faster than it settles payables.

## **Cash Flow Statement Overview**

Cash from operating activities (CFO) represented inflows of \$496.01M for the twelve-month period, relative to inflows of \$68.35M in 2021. The improvement in CFO was mainly driven by the increase in profits and accounts payables. Notably, the changes in working capital moved from an outflow of \$46.41M in FY2021 to an inflow of \$257.44M in FY2022, the main driver to the higher working capital is the increase in payables from an outflow of \$22.08M to an inflow of \$580.80M. Moreover, the company's receivables moved from an outflow of \$4.86M to an outflow of \$143.14M, indicating more cash outstanding on credit from customers.

Cash from investing activities represented an outflow of \$893.63M for FY2022, relative to an outflow of \$130.98M in FY2021, driven by the purchase of PPE.

Cash from financing activities represented an inflow of \$1.46B for the period, relative to an outflow of \$8.46M in 2021. This was driven by loans received and shares issued during the period, which amounted to \$1.07B and \$223.53M respectively.

In FY2021/22, the company experienced a gain of \$1.06B to its cash balance (not accounting for currency translation gains). For the three-month period June 2022, the working capital positioning of the Company has improved year over year. Specifically, operating cash flow before working capital amounted to \$158.45M relative to \$40.10M in the prior year. The change in working capital for the period has amounted to an outflow of \$10.41M relative to an outflow of \$41.68M the prior comparable year. Consequently, net operating cash flow for the period has amounted to an inflow of \$153.24M relative to an outflow of \$360K the prior year.

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## **Outlook & Valuation**

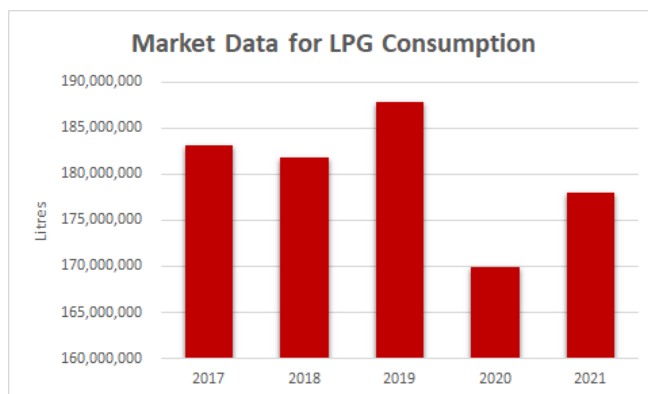
Our outlook for Future Energy Source Company (FESCO) is positive, as the first quarter financials for the June 2022 period reported both revenues and net profit exceeding their performance of the March 2021 financial year. For the quarter ended June 2022, revenue was reported at \$6.46B, while net profit amounted to \$151.79M, both which exceeded the entire 12 months period for the March 2021 financials year, by 10% and 40% respectively.

FESCO operates within the petroleum industry, in a competitive market dominated by multinational branded service stations. However, FESCO continues to expand with their increased presence in the Kingston and St. Andrew (KSA) area, with additions of the FESCO Ferry and FESCO Beechwood service stations. These two stations is expected benefit from significant

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traffic volumes due to their locations where their capacity and amenities will offer an attractive range of services to retail private and commercial vehicles, which should have a positive effect on the total fuel distributed and increased market share of transportation fuels. This is likely to improve FESCO's revenue and profitability margins.

FESCO intends to retail Liquefied natural gas (LNG) for the transportation industry at its FESCO Ferry (Mandela Highway) Service Station. LNG is an efficient and cost-effective alternative to diesel for trucks and buses. Management highlighted that local suppliers of new trucks, including Stewart Industrial and TankWeld Equipment Limited, have indicated their intention to supply LNG powered trucks for sale at prices that, when combined with the fuel cost savings of LNG, should prove to be an attractive alternative to traditional diesel-powered trucks. FESCO's Ferry location is ideally suited to retail LNG. Mandela Highway is the main corridor for entry to and exit from KSA as well as for accessing both coasts of Jamaica (North and South). FESCO's Ferry location could facilitate efficient LNG refuelling for major manufacturers and distributors island wide. Given the rising need for LNG fuel, FESCO is likely to benefit from the additional revenue stream, which can potentially increase profitability.



Source: Ministry of Science, Energy and Technology

FESCO indicated its intentions to enter the cooking gas/ Liquefied petroleum gas (LPG) market by FY2023. LPG has replaced charcoal as the primary household fuel in approximately 84% of Jamaican homes. The LPG/cooking gas market experienced a downturn for the 2020 period due to the effects of the pandemic, as restaurants and the hotel industry would have consumed less cooking gas as a result of lock down periods and travel restrictions. However, the

LPG/cooking gas market would have seen a recovery in market data since, as preliminary data from the Ministry of Science, Energy and Technology revealed that the market improved by 4.7% year over year for the 2021 period based on litres consumed. Notably, FESCO invested approximately \$894M in the cooking market, which management highlighted is capital intensive, as the business requires trucks to go to the refinery, storage, filling facilities, cylinders, etc. The LPG cooking gas market currently has five (5) players but is dominated by three (3) major players. Therefore, FESCO would have to capture market share from the players in the market. The company is likely to compete based on price and targeting existing customers, in order to capture



market share in the LPG market. Nevertheless, entry into the LPG/cooking gas market is likely to diversify the company's revenue stream and further improve the growth of the company.

In 2019, FESCO began to market its proprietary brands of fast-moving items typically sold at Service Stations and convenience stores. These now include, internationally certified API Lubricants (FUTROIL), Coolants (FUTRLUBE), and purified bottled water (FYC Water). Moreover, the first for your convenience (FYC) Supermarket provides customers with a one-stop shopping experience as customers can fuel their vehicles and do their grocery shopping. Notably, FESCO only earn revenues from its operation of its FYC Express store at its company owned company operated (COCO) service stations. Management highlighted that the FYC refill water store and express mart, will not dominate revenue. Nevertheless, non-fuel sales is likely to bring incremental earnings and will help the company to create an environment at COCO service stations such as on Beechwood Avenue, as a destination station allowing for greater fuel sale, which augurs well for the growth and profitability of the company.

Based on these assumptions, we are projecting a 7.7% increase in revenues for the 2022/23 financial year to \$13.65B and net profits attributable to shareholders of \$327.12M, a 29% increase on the 2021/22FY, which corresponds to an EPS (earnings per share) of \$0.13. We are forecasting a forward book value of \$1.07B as at March 31, 2023, which translates to a book value per share of \$0.43.

We employed the price-multiples approach to determine the fair price for FESCO. The 1-yr historical average for the P/B ratio is 16.33x, which when applied to the forward BVPS yields a price of \$7.01. The 1-year historical average for the P/E ratio is 44.27x, which when applied to the forward EPS yields a price of \$5.79. **The average of our price forecasts, \$6.40 is 25% higher than the closing price of \$5.12 on September 23, 2022.**

## **Recommendation**

***We recommend Future Energy Source Company Limited (FESCO) at OUTPERFORM/BUY, as we believe the stock is currently trading below our intrinsic price for the company.*** The company is currently in the growth phase of the business and stand to benefit from the expansion of FESCO's company owned company operated business line, entry into the LNG and LPG market space and increase in sales of its lubricants and other FESCO branded merchandise. We positively view the company's efforts to continually improve and diversify its revenue stream, widen its sales network and innovate its product line. Shares of FESCO is most suitable for investors with a medium to high-risk appetite, as the company operates within a highly competitive industry.

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Abridged Financials \$'000	Year Ended March						THREE MONTHS		
	2018	2019	2020	2021	2022	Change	Jun-21	Jun-22	Change
Revenue	4,610,895,083	5,434,246,867	5,936,346,825	5,856,757,502	12,671,115,147	116.4%	1,909,316,560	6,456,296,412	238.15%
Cost of Sales	(4,538,638,076)	(5,348,995,804)	(5,758,006,328)	(5,661,937,112)	(12,279,898,907)	116.9%	(1,854,452,529)	(6,240,219,906)	236.5%
Gross Profit	72,257,007	85,251,063	178,340,497	194,820,390	391,216,240	100.8%	54,864,031	216,076,506	293.8%
Operating Profit	45,429,991	45,205,221	123,810,306	134,691,794	254,948,999	89.3%	34,341,843	151,028,532	339.8%
Net Profit	32,570,180	39,692,675	104,771,672	108,160,399	253,640,444	134.5%	39,941,003	151,788,099	280.0%
Total Assets	270,455,459	386,599,711	473,876,421	551,486,121	2,794,546,773	406.7%	918,307,528	3,126,248,402	240.4%
Total Liabilities	206,703,623	285,908,740	268,413,778	233,061,979	2,023,956,214	768.4%	336,416,410	2,203,869,744	555.1%
Total Shareholder's Equity	63,751,836	100,690,971	205,462,643	318,424,142	770,590,559	142.0%	581,891,118	922,378,658	58.5%
EPS (\$)	0.01	0.02	0.04	0.04	0.10		0.02	0.06	
Book Value per share (\$)	0.03	0.04	0.08	0.13	0.31		0.23	0.37	
<b>Key Ratios</b>									
Gross Profit margin	1.6%	1.6%	3.0%	3.3%	3.1%		2.9%	3.3%	
Operating Profit Margin	1.0%	0.8%	2.1%	2.3%	2.0%		2.4%	2.3%	
Net Profit margin	0.7%	0.7%	1.8%	1.8%	2.0%		2.1%	2.4%	
Return on Average Assets	16.5%	12.1%	24.4%	21.1%	15.2%		4.3%	7.5%	
Return on Average Equity	68.6%	48.3%	68.4%	41.3%	46.6%		6.9%	20.2%	
Current ratio (x)	1.98	1.37	1.55	1.35	1.63		2.60	1.26	
Quick ratio (x)	1.98	1.33	1.48	1.26	1.58		2.53	1.22	
Cash ratio (x)	0.47	0.49	0.66	0.35	1.11		1.34	0.70	
Debt/Equity (x)	-	0.58	0.23	0.12	1.65		0.22	1.19	

**Source:** *www.jamstockex.com, www.mset.gov.jm, Bloomberg, Company Financials, Company Prospectus, JMMB Investment Research.*

## 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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