



Supreme Ventures Limited (SVL)

PLEASE SEE **IMPORTANT DISCLOSURES IN THE APPENDIX**

Company Background

Supreme Ventures is a leading lottery and gaming provider in the Caribbean, with a diverse portfolio of lottery products. SVL's strategic objective is to be the leading provider of innovative and compelling gaming and lottery content through current and emerging mediums. 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 sell phone pin codes through the agent's network; and Other – which covers all other income.

Financial Performance – Nine Months ended September 2016

Profitability

SVL reported revenues of \$33.1B for the first nine months of the 2016 financial year, a 2.2% or \$714.2M increase over revenues for the comparable period of 2015. Direct expenses rose 3.1% to \$29.9B for the period, which resulted in a 5.8% or \$193.5M decrease in gross profits to \$3.2B. The fall in gross profits was attributed to lower margins on the lottery games and higher sports betting pay-outs. With the fall in gross profits, SVL has focused its attention on operating cost management resulting in a 4.4% decrease in operating expenses for the period, year-over-year. Despite this performance, operating profits fell 8.1% to \$1.1B.

The Lottery segment results were down 20% to \$1.2B as the segment saw a reduction in Cash Pot and Lotto sales. 2015 lottery sales were unusually high due to a record jackpot of \$395M. The Gaming & Hospitality segment reported a loss of \$5.7M, a \$130.8M improvement on the \$136.5M loss reported for the comparable period of the previous financial year. This performance was attributed to investments made to improve the product offerings and a new player loyalty system at the Acropolis Barbican. Sports betting's segment results fell 5.1% to \$144.2M, despite a 70.8% increase in revenues year-over-year. The fall in profitability due to roll-out costs related to the introduction of Quick Sports Virtual games in January, 2016 - the main driver behind the growth in sports betting revenues from the previous year.

Interest income fell 8.4% to \$49.2M while net foreign exchange gains rose 40% to \$8.0M. Finance costs declined 88% to \$355K resulting in a net profit of \$849.7M, which was down 5.7% from a year prior. Taxation amounted to \$343.4M, down 15.4% which corresponds to an effective tax rate of 28.8%, which compares to 31.1% in the comparable period of 2015. The net profit margin for the period was 2.6%, which compares to 2.8% a year earlier.

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Solvency & Liquidity

Total assets for SVL amounted to \$5.1B, up 1.9% or \$95.6M from a year prior. This increase was driven by a 198.2% increase in inventories to \$273.6M and a 30.7% increase in trade and other receivables to \$816.8M. Cash and cash equivalents were down 7.5% to \$1.3B while investment properties were down 16.3% to \$723.5M. Property, plant & equipment were down \$4.8M to \$710.7M while long-term receivables declined 7.8% to \$494.57M. Goodwill and intangible assets were relatively unchanged at \$640.8M.

The company had no interest-bearing liabilities at the end of September 2016 and only current liabilities of \$1.5B, which were down \$8.1M year-over-year. Current liabilities were composed mainly of trade and other payables of \$1.3B. Prize liabilities amounted to \$204.6M, down 21% from the prior year while income tax payable fell 92.7% to \$20.8M. Shareholders' equity stood at \$3.6B, up 3% from September 2015 as retained earnings closed the period at \$1.6B, a 7.1% increase year-over-year. This corresponds to a book value per share (BVPS) of \$1.36.

Outlook & Valuation

For 2016, SVL's goals were to: continue its focus on the growth of its lottery business through business diversification and promotions; attain profitability in the sports betting segment; launch mobile betting platform; implement a virtual games betting product; and complete the roll out of 500 VLT Route System machines. It was SVL's hope that the QuickSports line of virtual games would improve the fortunes of the sports betting portfolio and the nine months results have shown just that with a 71% increase in revenues and a \$131M reduction in losses in the segment.

In 2015, Supreme Ventures Limited made a bid expressing an interest in acquiring the state-run horse racing promotions company, Caymanas Track Limited (CTL). SVL was scheduled to take formal control on January 5, 2017, according to an announcement by finance minister Audley Shaw. According to reports in the Jamaica Gleaner, SVL would pay a US\$305,000 annual lease and handover 1.875% of pre-tax profits from the operation of CTL to the Government. The government would be then entitled to 3.75% of pre-tax earnings from associated non-regulated businesses after the fifth anniversary of operation.

Initial investment by SVL will be significant as the finance minister estimates it could rise to as much as \$1B as SVL will have to correct a number of regulatory and environmental breaches by CTL. SVL was granted 15 years exclusivity in the market, with an assessment to be carried out after that period. CTL is likely to impair SVL's profitability in the short to medium term as it seeks to restructure the business and usher in an era of profitability.

CTL's 2014 annual report revealed revenues of \$4.3B for the year ended March 31, 2014, up 4.3% year-over-year. However, an operating loss of \$39.7M and a net loss of \$38.1M was reported, albeit an

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improvement on the operating loss of \$68.5M and net loss of \$67.8M in the 2014 financial year. A net shareholders' deficit of \$489.8M was also reported on the balance sheet with total assets amounting to \$499.3M while current liabilities amounting to \$989M.

Caymanas Track Limited Financial Highlights 2014/15			
Income Statement Highlights	2013	2014	% change
Revenue	4,162,666	4,339,925	4.3%
Gross profit	369,986	374,929	1.3%
Operating loss	(68,533)	(39,650)	-42.1%
Net loss	(67,790)	(38,122)	-43.8%
Balance Sheet Highlights			
Property, plant & equipment	357,127	345,980	-3.1%
Accounts receivable	95,587	96,847	1.3%
Cash & cash equivalents	36,101	22,142	-38.7%
Accounts payable	924,640	969,041	4.8%
Loans	48,000	20,000	-58.3%
Net shareholders' deficit	(451,645)	(489,767)	8.4%
Total assets	520,995	499,274	-4.2%
Total liabilities	972,640	989,041	1.7%

After reporting a strong 27.3% or \$253.8M increase in net profits for the 2015 financial year, which amounted to \$1.18B, SVL has seen a reversal of its fortunes to start 2016. The 2015 performance was driven by a 6.1% increase in revenues and a fall in cash pot liabilities by 3.08 percentage points to 71.3%.

The gaming industry was spared in the latest revenue measures announced by the JLP-led government but with the adjustments to the income tax threshold and the subsequent revenue shortfall, policymakers may look to increase sin taxes on the industry to meet its obligations. On the other hand, the increase in disposable income could positively impact SVL's revenues due to the increase in disposable income stemming from the rise in the threshold for taxpayers who also gamble.

Based on these factors, we projected a 5.4% increase in revenues for the 2016 financial year to \$46.21B and net profits attributable to shareholders of \$1.16B, a 2.1% decrease on the 2015 profits which corresponds to an EPS (earnings per share) of \$0.44 (2015: \$0.45). While year-to-date revenues have trailed our expectations, SVL has improved its profit margins. As such, we maintain our projection for earning. Shareholders' equity is forecasted to increase 6.1% year-over-year to \$3.81B which corresponds to a BVPS (book value per share) of \$1.45.

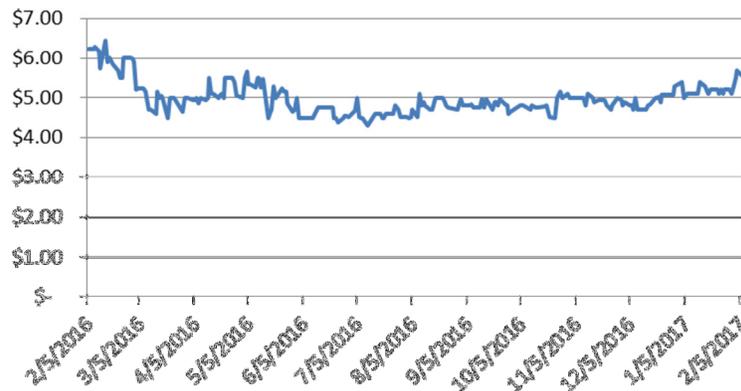
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Applying the 1-year average P/E ratio of 11.74x to the forward EPS of \$0.44 yields a price of \$5.16 while the forward BVPS of \$1.45 and the 1-year average P/B ratio of 3.61x yields a price of \$5.22. The Gordon Growth Model produced a price of \$4.81, in which we assumed a 5% growth rate and a 12.95% cost of equity using the Capital Asset Pricing Model. As such, our estimation of the fair value of KW's shares is \$5.06, which is 12.7% below the close price as at February 8, 2017.

Recommendation

We recommend SVL as HOLD for investors with a medium risk appetite and a medium to long-term investment horizon. While we have not observed any factor that would suggest the potential for significant capital appreciation in the short term, we make note of the 8.0% dividend yield for the 2016 calendar. Over the past five years, SVL has averaged a dividend pay-out ratio of 81% making it a suitable stock for investors seeking income. The stock closed at \$5.55 on February 6, 2017, down 11.2% from a year ago, while up 4.7% calendar year-to-date.

SVL 1-year Trading Performance



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Abridged Financials

J\$000	Year Ended December 31							Change %
	2011	2012	2013	2014	2015	9M15	9M16	
Revenues	27,961,628	29,726,146	34,140,265	41,309,545	43,847,020	32,341,136	33,055,306	2.2%
Direct Costs	24,659,683	25,710,180	30,808,867	37,586,698	39,429,684	28,986,484	29,894,140	3.1%
Gross Profit	3,301,945	4,015,966	3,331,398	3,722,847	4,417,336	3,354,652	3,161,166	-5.8%
Operating Expenses	2,439,217	2,657,317	2,768,146	2,648,936	2,982,306	2,121,744	2,028,393	-4.4%
Operating Profit	862,728	1,358,649	563,252	1,073,911	1,435,030	1,232,908	1,132,773	-8.1%
Profit Before Taxation	1,063,561	1,449,901	711,092	1,215,741	1,614,830	1,307,282	1,193,137	-8.7%
Profit for the year	606,326	1,069,224	482,569	929,917	1,183,750	901,174	849,704	-5.7%
Total Assets	5,005,187	5,656,846	5,323,844	5,900,514	5,398,913	5,052,154	5,147,757	1.9%
Total Liabilities	1,678,415	1,863,554	1,680,925	1,855,129	1,804,876	1,556,086	1,547,938	-0.5%
Shareholder's Equity	3,326,772	3,793,292	3,642,919	4,045,385	3,594,037	3,496,068	3,599,819	3.0%
EPS (\$)	0.23	0.41	0.18	0.35	0.45	0.34	0.32	
Book Value per Share (\$)	1.26	1.44	1.38	1.53	1.36	1.33	1.36	
Key Ratios								
Gross profit margin	11.8%	13.5%	9.8%	9.0%	10.1%	10.4%	9.6%	
Operating profit margin	3.1%	4.6%	1.6%	2.6%	3.3%	3.8%	3.4%	
Net Margin	2.2%	3.6%	1.4%	2.3%	2.7%	2.8%	2.6%	
Return on Average Equity		30.0%	13.0%	24.2%	31.0%			
Return on Average Assets		20.1%	8.8%	16.6%	21.0%			
Debt/Equity (x)	0.12	0.09	0.06	0.02	-	-	-	

Source: <http://www.Jamstockex.com>, *JMMB Investment & Research*, *Bloomberg*, *Company Financials*; *Betting Gaming & Lotteries Commission Annual Reports*

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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.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

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