VM Wealth Management Limited

IPO Analysis: 138 Student Living Jamaica Ltd APO Analysis (138SL)

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- APO Recommendation: **PARTICIPATE**
- Current Price: **$4.31**
- Reserved Pool Offer Price: **$4.05**
- General Public Offer Price: **$4.40**
- Price Target: **$4.69**

- Shares on Offer: 513,972,784 units
- Shares Outstanding: 414,500,000 units
- Shares Outstanding Post APO: 928,472,784 units

ABOUT THE COMPANY

138 Student Living Jamaica Limited ("138SL", or the "Company"), was incorporated on August 15, 2014. The Company was established to design, construct and operate living facilities at the University of the West Indies, Mona Campus ("UWI Mona") under a concession agreement between the Company and UWI Mona.

The Company was established as a special purpose real estate investment vehicle. It was founded by Mr. John Lee, the first chairman of 138SL, Mrs. Marrynette Lee (both of whom remain directors at this time), Messrs. Kingsley Thomas, Douglas Stiebel and other members of the founding group.

The 138SL Halls of Residence are the newest student accommodations on the UWI Mona Campus providing single and double occupancy rooms with en-suite bathrooms in clusters of 12 and a unique offer of a 4 cluster style single occupancy rooms with en-suite bathrooms for post graduate students.

FINANCIAL PERFORMANCE SUMMARY

J$'000	FY 2020/21	FY 2021/22	3M 2022/23	3M 2022/23
Revenue	860,479	1,199,854	893.565	1.048.106
Total Expenses	422,017	501,315	400.888	500.495
Operating Profit	438,462	698,539	492.677	547.611
Net Profit	221,279	318,052	238.664	270.064
Total Assets	10,049,380	9,722,975	10,477,479	9,695,128
Total Equity	4,334,915	4,555,134	4,661,915	4,771,313
Total Liabilities	5,714,465	5,167,841	5,815,564	4,923,815

Dividend Policy

The Directors expect the Company's short and medium-term investments and strategic plans to result in growth of its profits and distributable reserves. In the near future, the Directors anticipate paying a semiannual dividend amounting to up to 90% of distributable net income.

Use of Proceeds

The Company intends to use the proceeds of the equity raise to:

1. Reduce indebtedness ($1.5 billion)
2. Settle APO transaction cost ($102.5 million)

Outlook

The COVID-19 pandemic has pushed 138SL into diversifying its revenue streams. This led to an increased presence in the short-term rental market, specifically targeting sporting and UWI-affiliated groups. The positive trend is evident in the increase in short-term rental income, which grew by 101.00% in FY2022 and contributed $84.60 million or 8.07% of total revenue in the first nine months of FY2023. This diversification has been rewarding, with group bookings showing strong demand. Management's intent to deepen its footprint in this segment indicates a strategic approach to maintaining a diverse revenue base.

Projections and Valuation

Using the Discounted Free Cash Flow to Firm (FCFF) valuation and a two-stage dividend discount model, we arrived at our target price. The projected earnings for the company for the next five years were discounted using the needed rate of return, which was determined using the capital asset pricing model (CAPM), or 8.03%. As a result, each share's intrinsic value was $4.21. We arrived at a fair value of $5.17 by discounting 35% of projected future profits as distributable dividends over the next five years. The consensus price was determined to be $4.69 by averaging both.

Risks to Price Target

The company may not achieve the projected target price if it does not operate efficiently, if competition from neighboring housing developments increase, and if the business is unable to execute its strategy due to an unexpected strikes or reduction in events hosted by UWI.

ABRIDGED OFFER DETAILS

ISSUER	138 Student Living Ja. Limited
LEAD ARRANGER	GK Capital Management Limited
ISSUE	Total of 513,972,784 Ordinary Shares: • General Public – 195,457,784 units • Reserved Share Pool – 318,515,000 units *Directors reserve the right to elect to upsize the number of New Ordinary Shares made available for subscription by no more than 256,986,392 additional New Ordinary Shares in the event that the Invitation is oversubscribed*
OFFER PRICE	$4.04 per share – Reserved Share Applicants $4.40 per share – General Public Applicants
MINIMUM APPLICATION	1,000 shares with excess in increments of 1 share.
KEY DATES	Opening Date: September 8,2023, at 9:00 am Closing Date: October 6, 2023, at 4:30 pm
USE OF PROCEEDS	The proceeds will be used for: 1. Reducing debt ($1,500,000,000.00) 2. Paying listing and invitation expenses ($102,000,000.00)

Table 1. Abridged Offer Details

CORPORATE GOVERNANCE

The Board of Directors of 138 Student Living Jamaica Limited comprises of a non-executive chairman and eight (8) non-executive directors, including the deputy chairman. Each director brings a wealth of knowledge and experience in their respective fields of General Management, Property Management & Maintenance, Finance & Accounting and Legal & Risk Management to the company, which has been and will continue to be used as a tool for the company's expansion. The board has formed three committees: the Audit and Compliance Committee, Concession Committee, and Human Resource and Compensation Committee. Each committee is led by an independent chairperson. The directors receive fees based on the approved by the Human Resource and Compensation Committee, inclusive of reimbursement of reasonable fees and expenses, for attendance at each meeting of the Board of the Company, or any Committee.

NAME	POSITION
IAN PARSARD	Non-Executive Chairman
IVAN CARTER	Non-Executive Director and Deputy Chairman
JOHN W. LEE	Non-Executive Director
SHARON DONALDSON - LEVINE	Non-Executive Director
MARRYNETTE A. LEE	Non-Executive Director
BRENDA-LEE MARTIN	Non-Executive Director
PETER PEARSON	Non-Executive Director
MARK CHISHOLM	Non-Executive Director
DONNETTE SCARLETT	Non-Executive Director

Table 2. Corporate Governance

SHAREHOLDINGS

On offer are 513,972,784 newly created ordinary shares to be divided among the Reserved and Non-Reserved pool of applicants. Approximately 195,457,784 units will be made available to the public which represents 21.05% of the total shares outstanding, while the remaining 318,515,000 units are reserved for Existing Shareholders, 138SL Team members and Key Strategic Partners.

Shareholders	Shareholding (Pre-APO)	Issued Capital (%)	Shareholding (Post-APO)	Issued Capital (%)
Sagicor Related Share Account	154,560,817	37.29%	154,560,817	16.65%
NCB Insurance Agency and Fund Managers Limited	82,832,770	19.98%	82,832,770	8.92%
K Limited	68,803,832	16.60%	68,803,832	7.41%
VMPM Pooled Pension Real Estate Fund	13,729,048	3.31%	13,729,048	1.48%
Barita Related Share Accounts:	13,016,311	3.14%	13,016,311	1.40%
JMMB Related Share Accounts:	10,114,529	2.44%	10,114,529	1.09%
Wisynco Group Limited Pension Fund	10,000,000	2.41%	10,000,000	1.08%
Mr. Barrington Brown	7,334,592	1.77%	7,334,592	0.79%
Conley Salmon/Juliet Salmon	5,000,000	1.21%	5,000,000	0.54%
MF&G Asset Management-Jamaica Investments Fund	3,761,300	0.91%	3,761,300	0.41%
Other Existing Shareholders	45,346,801	10.94%	45,346,801	4.88%
Reserved Shareholders	-	-	318,515,000	34.31%
Other Shareholders	-	-	195,457,784	21.05%
Total	414,500,000	**100%**	928,472,784	**100%**

Table 3. Capital Structure and Shareholding Pre- and Post-IPO Breakdown

FINANCIAL PERFORMANCE

	FY 2017/18	FY 2018/19	FY 2019/20	FY 2020/21	FY 2021/22
Revenue	834,404	1,054,952	1,325,293	860,479	1,199,854
Operating Profit	315,262	260,924	567,727	438,462	698,539
Pre-Tax Profit	(91,128)	(19,607)	310,369	196,253	335,052
Profit After Tax	(16,251)	22,968	251,726	221,279	318,362
Net Profit Margin	(1.9%)	2.2%	19.0%	25.7%	26.5%
Admin Expense Ratio	35.3%	36.4%	28.0%	32.5%	27.53%
Return on Average Equity	-	0.5%	5.0%	5.0%	7.2%
Return on Average Assets	-	0.2%	2.4%	2.2%	3.2%
Current Ratio (x)	1.2x	0.6x	0.8x	1.0x	1.0x
Debt to Equity (x)	1.5x	0.9x	1.0x	1.1x	1.0x

Table 4. Financial Performance

Historical Five-Year Performance (FY2018 - FY2022)

Over the course of five years, the company achieved a consistent compound annual growth rate of 9.50% in total revenue. Revenue steadily increased year after year, starting at $8.34 million in FY 2017/18 and reaching $1.20 billion in FY 2021/22, with the exception of FY 2020/21 when the COVID-19 pandemic impacted the company. During FY 2020/21, the pandemic-related measures caused a 35.07% reduction in revenue, equivalent to $4.64 million year-over-year, as occupancy levels dropped to as low as 30%. Nevertheless, total revenue saw a significant rebound in FY 2021/22, surging by 39.44% year-over-year. Long-Term Rental Income from students played a significant role, contributing 39% to the total income in FY 2021/22, followed by Irvine Hall Claim, contributing 34%.

Over the five-year period, the company faced increasing administrative expenses, but through cost-cutting measures, 138SL successfully reduced administrative costs over the last three financial years. Administrative expenses peaked at $7.94 million in FY 2018/19, but they decreased to a low of $4.22 million in FY 2020/21. However, in FY 2021/22, administrative expenses increased by 18.79% year-over-year to $5.01 million due to rising staff costs, utilities, repairs, maintenance, and other operating expenses. Remarkably, 138SL maintained a positive operating profit over the five-year period, which grew at a compound annual growth rate of 22.01%, moving from $3.15 million in FY 2017/18 to $6.99 million in FY 2021/22, driven by increased room rates and occupancy levels. The operating efficiency ratio improved during this period, decreasing from 62.22% in FY 2017/18 to 41.78% in FY 2021/22, despite a temporary spike to 75.27% in FY 2018/19 when administrative expenses surged.

The company's finance costs declined from $4.06 million in FY 2017/2018 to $2.42 million in FY 2020/21. However, a series of interest rate hikes by local and international central banks resulted in a 50.07% year-over-year increase in finance costs to $3.63 million in FY 2021/22. Despite the rise in finance costs for FY 2022, 138SL secured fixed-rate instruments while interest rates were still low, allowing it to enjoy more favorable rates compared to prevailing market rates. In FY 2021/22, 138SL achieved a pre-tax profit of $335.05 million, marking a $138.80 million year-over-year increase and a $310.37 million increase over the pre-pandemic pre-tax profit in FY 2019/20, indicating a strong rebound in the company's performance and increased demand. While 138SL reported a net loss of $16.25 million in FY 2017/18 due to finalizing the building-out and commencing operations of the George Alleyne Hall, the net profit for FY 2021/22 reached $318.36 million, a 43.87% or $97.08 million increase compared to FY 2020/21 and the highest since listing on the JSE. The net profit margin improved year-over-year, reaching 26.50% at the end of the reporting period. Similarly, earnings per share (EPS) showed growth, moving from a negative trajectory in FY 2017/18 to $0.7681 in FY 2021/22, despite fluctuations during the period.

As of September 30, 2022, total assets amounted to $9.72 billion, compared to $10.05 billion for FY 2020/21. The decline in total assets was primarily attributed to a decrease in receivables, which dropped from $1.28 billion in FY 2020/21 to $903.29 million in FY 2021/22. This reduction in receivables was mainly due to collections from UWI, Mona, related to the 90% Occupancy Guarantee Claim and Irvine Hall Claim. The company's return on average assets (ROA) improved year-over-year, ending the reporting period at 3.20%, marking a 100 basis points increase from the previous year despite the decline in total assets.

Current liabilities stood at $1.15 billion as of September 30, 2022, representing a $182.10 million decrease compared to the previous period's balance of $1.33 billion. The decline in current liabilities was primarily attributed to a reduction in trade payables, which decreased from $1.11 billion in FY 2020/21 to $561.87 million in FY 2021/22, marking a 49.50% decline. With the decrease in current liabilities, the current ratio for FY 2021/22 was 0.96x, compared to 1.01x in FY 2020/21. The 5-basis point decrease in the current ratio was mainly due to the significant reduction in accounts receivable compared to the reduction in current liabilities. Non-current liabilities also decreased by 8.31% year-over-year in FY 2021/22, reaching $4.02 billion. This decline in non-current liabilities was attributable to a reduction in long-term loans, moving from J$4.21 billion in FY 2020/21 to $3.85 billion.

Total shareholders' equity exhibited fluctuations during the reporting period, primarily driven by changes in retained earnings, which experienced a compound annual growth rate of 81.64%. In FY 2021/22, the return on average equity (ROE) increased by 213 basis points to 7.16% compared to 5.03% in FY 2020/21. The book value per share (BVPS) concluded the period at $10.99.

Nine Months Ended June 30, 2023

For the nine months ending on June 30, 2023, the total revenue saw a notable increase of 17.29%, rising to $1.05 billion from $893.57 million in the corresponding period of FY 2021/22. The primary sources of revenue were long-term and short-term income, which grew by 11.77% or $103.44 million, reaching $982.14 million, mainly due to the recovery in occupancy rates. The principal driver behind the $51.11 million increase in operating income was the interest charged on balances from UWI, Mona, following the Concession Agreements.

Administrative expenses surged by 24.85%, climbing from $4.01 million to $5.01 million, largely due to heightened inflation. Despite expenses growing faster than revenue, the operating profit improved during the period, rising from $492.68 million to $547.61 million. However, the operating efficiency ratio worsened, increasing from 44.86% in the first nine months of the previous financial year to 47.75% in the current year.

Finance costs declined slightly to $2.70 million, contributing marginally to a pre-tax profit increase from $220.75 million to $277.78, marking a 25.84% or $57.03 million YOY increase. Net profit also experienced a similar uptick of 13.16% compared to the first nine months of the prior financial year, concluding the period at $270.06 million. EPS increased from $0.5758 to $0.6515 during the reporting period.

As of June 30, 2023, the total assets decreased from $10.48 billion to $9.70 billion, primarily due to a 38.10% or $608 million decline in accounts receivable. The trailing twelve-month (TTM) ROA showed a significant improvement of 178 basis points. Current liabilities saw an 18.07% decline, ending the period at $1.17 billion, with a $258.88 million reduction primarily driven by a 57.95% or $704.46 million decrease in accounts payable. Total shareholders' equity increased by $109.40 million, reaching $4.77 billion at the end of the reporting period, primarily driven by an increase in retained earnings. The TTM ROE saw a substantial uptick from 3.72% in the previous period to 7.42%.

OUTLOOK

1. Value Proposition and Competitive Advantage:

- Captive Market - The Group operates in a niche market with limited competition. This means that the Group's revenue is predictable and not easily affected by general economic downturns, making it less susceptible to economic swings.
- Inherent Foreign Exchange Hedge: With the Concession Agreements, the Group can adjust the fee charged considering the USD/JMD exchange rate, offering protection against potential currency fluctuations.
- Occupancy Guarantee: The Group has a solid guarantee from UWI, Mona, ensuring 90% occupancy of the residences throughout the Concession Agreements' duration. This guarantee offers further predictability in revenues.

2. Financial Restructuring and Dividend Strategy:

The Group's capital structure is predominantly debt-driven, limiting its ability to pay significant dividends. The company plans to reduce its debt with the APO's net proceeds significantly. This reduction will lead to interest savings and allow the company to adopt and maintain a robust dividend policy. The strategy aims to offer better returns to shareholders and provide financial flexibility for near-term growth opportunities.

3. Opportunities to Expand Capacity:

With room occupancy rebounding to pre-COVID-19 levels and noticeable demand surpassing current capacity, the Group strategically focuses on increasing its housing offerings. Initiatives include constructing new student housing towers, which aligns with the Concession Agreements that permit an additional 842 student rooms. Moreover, the Group is actively exploring partnerships with local and regional universities to capitalize on increasing student accommodation needs. This expansion strategy can enhance the Group's market leadership position and enable it to venture into real estate management operations.

INVESTMENTS POSITIVES

- The company will lessen their indebtedness which will result in reduced debt servicing costs and free up cash flow so the company can possibly pay out dividends.
- Clear intention to facilitate organic revenue growth through expanding its room capacity with prospects of an additional 842 rooms.
- There is an occupancy guarantee in their concession agreement with UWI Mona which guarantees a 90% occupancy rate of residencies for the duration of the agreement.

- The company has eyed diversification of revenue stream with the intention to develop and manage operations of real estate properties locally and regionally as well as partnerships with other local and regional universities to provide student accommodation.

INVESTMENTS NEGATIVES

- High construction costs may lessen the projected additional rooms that would be constructed, hence possibly overstating revenue growth projections.
- The company's profitability is solely reliant on the occupancy by students at the UWI Mona campus, resulting in high concentration risk.
- High risk to adverse effects from natural disasters on student residence especially as the intensity of such disasters continues to increase due to climate change.
- Operational costs may exceed budget especially if the company does more repairs than estimated which could then restrict operating cash flow to the business.

CONCLUSION

Several key data points highlight the exceptionally positive outlook for student housing at the beginning of the 2023 calendar year. Notably, the industry recently saw its highest-ever annual growth in rent and occupancy rates. Additionally, the return to more traditional university settings, including in-person classes and extracurricular activities has given operators in the sector a revitalized energy.

The resurgence of students on campus plays a pivotal role in the recent strong performance of purpose-built off-campus student housing solutions. Early signs indicate that the greatly anticipated increase in enrollment in the post-2020 timeframe has certainly occurred. This bodes well for the earnings generation of 138SL who is guaranteed 90% occupancy by the UWI, Mona.

We have established a price target of $4.69, which is 8.83% higher than the stock's current offer price of $4.31, 15.81% more than the reserved share applicant price of $4.05 and 6.60% more than the general public price. This successful completion of this offer would lead to a reduction of the company's annual debt by an estimated total savings between $255.5 million and J$420 million, increased dividend payments can be consistent distributed to shareholders. We therefore advise investors to TAKE PART IN THIS OFFER since the stock has some growth potential in the short- to medium-term.

SOURCES

138SL APO Prospectus, the Gleaner Company, The Jamaica Observer, and the Financial Services Commission (FSC), BOJ, STATIN, Bloomberg, PSOJ

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.