VM Wealth Management Limited

Company Update: Express Catering Limited (ECL) Q3 2022/23

VMWM Research | July 31, 2023

876-960-5000 vmwmclientservices@myvmgroup.com vmwealth.myvmgroup.com 53 Knutsford Boulevard, Kingston 5

- Stock Recommendation: **OVERWEIGHT**
- Price Target **J$6.23**
- Current Price: **J$5.25**

- Shares Outstanding: 1,673,500,000 units
- Financial Year End: May 31

ABOUT THE COMPANY

ECL has been in operation since 2001 and listed on the JSE Junior Market in 2017. The company provides food and beverage offerings to millions of passengers arriving and departing the island via the Sangster International Airport in Montego Bay, Jamaica. ECL also provides food and beverage offerings for the approximately 5,000 staff complement at the airport. ECL is a Jamaican registered company and a subsidiary of Margaritaville St. Lucia, Inc. The ultimate parent company is Margaritaville Caribbean Group Ltd (MCG), a Bahamian registered company. MCG, through its various subsidiaries and partnerships, owns and operates a diverse portfolio of restaurant and nightclub concepts in Jamaica, Cayman Islands, Turks and Caicos and St Thomas USVI.

The group is the franchise operator of the Jimmy Buffet's Margaritaville Restaurant, Bar and Retail Shops across the Caribbean. ECL has been the dominant food and beverage partner of MBJ Airports Limited since 2011 when the company successfully negotiated a long-term contract to manage and supply most of the food and beverage offerings at the Sangster International Airport.

FINANCIAL PERFOMANCE SUMMARY

US$	FY 2020/21	FY 2021/22	9M 2022/23	9M 2022/23
Revenue	4,412,511	14,241,229	9,610,522	15,153,418
Operating Profit	(1,544,443)	2,434,838	1,207,878	3,598,090
Net Profit	(1,734,512)	1,096,803	364,507	1,926,470
Total Assets	39,807,209	40,494,288	40,074,562	42,525,039
Total Liabilities	37,565,885	37,156,161	37,468,731	37,260,445
Total Equity	2,241,324	3,338,127	2,605,831	5,264,596

Dividend Policy

ECL has a dividend policy of no less than 25% of net profit to ordinary shareholders in the form of cash dividends that are declared and paid in USD. Since listing, ECL has made 3 dividend payments over the 25% threshold, which was paused due to a net loss recorded in 2021. The uptick in revenue for the financial year ended in 2023 may see a break to the hiatus.

Outlook

ECL is poised to continue benefiting from the revival of international travel and the rebound in tourism. Expansions and upgrades to the food court at the Sangster International Airport, to include 31 restaurants, along with the acquisition of additional franchises, are expected to bode well for the company's top line. However, elevated prices continue to increase the cost of sales and threaten the growth in the spend-rate per passenger.

Projections and Valuation

We used a Discounted Cash Flow model with a required rate of return of **14.98%** and a long-term growth rate of 6.00% to produce an intrinsic price of **$5.90**. We then applied a weighted average with our P/E and P/B market comparable prices, which yielded a target price of **$6.23**.

Risks to Price

Increased travelling, due to the removal of COVID-19 containment measures internationally, is the main upside risk to the target price, along with additional franchise openings and the completion of the ongoing expansion project. However, inflation remains the major downside risk.

NINE MONTHS ENDED FEBRUARY 28, 2023

Revenues for the 9-month period ended February 28, 2023, amounted to US$15.15 million, up 57.68% over the US$9.61 million recorded in the comparable period in the last financial year. The US$5.54 million growth in revenue during the 9-month period was driven by the uptick in passenger totals, coming in 2.60% above pre-pandemic levels, as well as the increase in the spend-rate per passenger from US$7.92 to US$8.65. Even as ECL continued to implement cost-saving initiatives, the cost of sales for the 9-month period grew by 60.66% to US$5.26 million due to the increases in the cost of raw materials. Although the growth in costs outpaced revenue growth, gross profit ended the period 56.13% higher to end at US$9.89 million. Subsequently, gross profit margin fell by 64 basis points to end at 65.27%.

Total expenses at the end of the period grew by 22.73% to US$6.29 million due mainly to the large hikes in promotional and administrative expenses. Despite the growth in expenses, the operational expense ratio declined from 53.30% for the 9-month period in 2022, to 41.50% in the current period, indicating improved efficiency by ECL as revenue growth surpassed the rise in operating expenses. As a result, operating profits grew to US$3.60 million, moving from US$1.21 million over the previous period, which in turn saw the operating profit margin almost doubling to 23.70% during the reporting period in comparison to 12.60% in the previous year.

During the reporting period, finance income declined by 52.52% to US$292 thousand, as interest income from financial assets fell. Meanwhile rising interest rates contributed to the 19.72% rise in overdraft and loan interests, which increased the finance costs by 6.48% to $1.66 million. The company's foreign exchange losses increased almost sixfold to US$14.27 thousand, due to volatility in the local exchange rate. As the pandemic abates, ECL did not receive any COVID-19 rent concessions during the 9-month period. Nonetheless, net profit showed a five-fold improvement, ending the period at US$1.93 million, in comparison to US$364.51 thousand recorded in the previous period, while the profit margin had a three-fold boost from 3.80% to 12.70%. Using the 12-month trailing (TTM) net profit, ECL saw its return on average equity for the reporting 9-month period increasing from 51.60% to 67.60%, implying greater efficiency in income generation.

Total Assets for the period ending February 28, 2023, was US$42.53 million up 5.01% from the US$40.49 million recorded twelve months before and was driven by the 72.68%, 45.17% and 33.65% increases in Trade and Other Receivables, Property, Plant and Equipment and Inventories, as ECL expands and retrofits the existing shops. The company's return on assets for the reporting period showed a noticeable improvement from 2.90% to 6.40%. Total Liabilities for the period increased marginally by 0.28% to US$37.26 million from the US$37.16 million recorded at the end of FY 2022/21, as additional long-term loans increased to fund the nearly completed expansion project. As retained earnings jumped 59.81% during the period, in comparison to the reporting period prior, shareholder's equity rose to US$5.26 million (BVPS: US$0.003) from US$3.34 million (BVPS: US$0.002) recorded at the end of financial year 2021/2022.

The growth of the company's current assets during the 9-months outpaced the growth of current liabilities, which resulted in an improvement of the current ratio from 1 .91x at financial year end 2021/22, to 2.05x, indicating that the company is comfortably positioned to cover its short-term obligations from the liquid resources on hand. However, the purchase of property, plant and equipment, contributed partly to the 69.90% decline in cash during the 9-months, when compared to financial year end 2021/22, leading to the cash ratio falling from 0.05x to 0.01x. The company's debt-to-assets increased to 26.75% at the end of the 9-month period, from 21.11% at financial year end 2021/22.

OUTLOOK

Rebound in Tourism and Physical Expansion are Expected to Yield Positive Financial Performance

During Q3 of the fiscal year 2022/2023, the company achieved its strongest financial performance to date. The projected record-breaking year of stop-over arrivals in Jamaica for 2023 is expected to be the primary driver behind ECL's further revenue growth. With an anticipated surge in visitor numbers passing through Sangster International Airport, the amount spent per passenger is likely to increase, leading to positive impacts on the company's financial performance.

Moreover, the completion of the food court at Sangster International Airport and the expansion of franchises throughout Jamaica will contribute to improved operations and efficiency for ECL. As a result, the company is forecasted to experience growth in both its top and bottom lines, despite facing increased costs due to elevated international price levels.

INVESTMENT POSITIVES

- The surge in revenue and net profit for the reporting 9-month period, as well as the tax remission from listing on the JSE Junior Market may see a return to dividend payment to existing shareholders.
- The resumption of international travel, expansion of the runway and addition of new airlines the Sangster International Airport are anticipated to reflect positively on the number of customers, boost revenue for the company and improve EPS.
- The supply backlogs are expected to continue easing, which will improve the company’s access to raw materials and see slower growth in the cost of sales, which should improve gross profit margins.
- ECL is expected to grow substantially by the projected opening of multiple Focus Brands franchises across Jamaica, adding more revenue lines to the business and boosting its fundamentals.
- The completion of the undergoing expansion project at the Sangster International Airport food court is anticipated to be advantageous to revenue generation.

INVESTMENT NEGATIVES

- Elevated international prices are anticipated to increase the cost of sales in the short to medium-term, which threatens the growth in profit margins.
- The menu costs associated with input price hikes may stall price increases, which may cause revenue to grow at a slower pace as costs grow, or increase operational expenses, which will also eat away from profits.
- The franchise costs that will be incurred from the anticipated expansions have the potential to increase leverage and operating expenses.

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CONCLUSION

ECL stands to gain from the ongoing recovery in global travel, as the rise in passenger numbers is projected to boost their revenue growth. The company's revenue is expected to receive a further boost due to the expansion and enhancement of the food court at Sangster International Airport, which will house 31 restaurants. Additionally, ECL's acquisition of more franchises throughout the island is also likely to have a positive impact on their overall performance.

However, the increased prices have led to higher costs of sales, posing a potential threat to the growth in the amount spent per passenger. Despite this challenge, it is anticipated that the company's EPS will continue to steadily increase, which should have a positive effect on the stock price.

We used a Discounted Cash Flow model with a required rate of return of 14.98% and a long-term growth rate of 6.00% to produce an intrinsic price of $5.90. We then applied a weighted average with our market comparable prices, which yielded a target price of $6.23. Therefore, we recommend that investors OVERWEIGHT the shares in their investment portfolios, even as the volumes traded remain muted.

SOURCES

ECL's Financial Statements, Bloomberg, IMF, Jamaica Observer, Jamaica Gleaner, JSE,

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.