Company Analysis: Pulse Investments Limited (PULS) FY 2023

VMWM Research | October 26, 2023

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

- Recommendation: **MARKETWEIGHT**
- Price Target: **$2.17**
- Current Price: $2.14

- Shares Outstanding: **6,522,952,176 units**
- Financial Year End: **June 30**

ABOUT THE COMPANY

Pulse Investments Limited (PULS) is a modelling and entertainment agency based in Kingston, Jamaica, founded in January 1980. PULS later launched a personal development programme and established the Pulse Model Agency in 1982. PULS has found and nurtured models in Jamaica through its annual Caribbean Model Search and trained them for the global market.

After a few decades of operation, PULS added media and real estate to its core lines of business. Under a 50-year lease agreement, PULS rents a 60-unit mix of shops, offices and beauty services outlets at the Pulse Centre on Trafalgar Road. In addition, PULS invested in the Pulse Suites, a 75-unit mix in Villa Ronai, Stony Hill. A 30-unit Pulse Homes development is now underway in Villa Ronai in the valley, along with the contracting of its 70-unit lifestyle village.

In March 2023, PULS announced that it expects to generate revenues of approximately $500.0 million from selling a 16-unit development now on the market. The development, known as the Pulse Lofts, is part of the Villa Ronai property and consists mainly of studios and one-bedroom apartments.

FINANCIAL PERFORMANCE

J$'000	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23
Revenue	678,067	807,034	930,603	948,933
Operating Profit	866,348	1,546,214	1,929,162	1,604,071
Net Profit	840,364	1,468,990	1,786,644	1,573,099
Total Assets	4,702,488	6,913,059	9,319,991	11,379,597
Total Equity	4,088,510	5,588,379	7,443,355	9,070,008
Total Liabilities	613,978	1,324,680	1,876,636	2,309,589
Gross Profit Margin (%)	41.7	52.5	70.9	66.1
ROA (%)	20.1	25.3	22.0	15.2
EPS ($)	0.13	0.23	0.27	0.24

Dividend Policy

In April 2023, PULS announced that it is committed to providing an annual return to shareholders through a dividend payment. The dividend shall be no less than 15.0% of the cash portion of the company's net profits for any given year and is still subject to cash needs required for future company development.

Outlook

The reopening of the global economy and the removal of COVID-19 containment measures are expected to boost the entertainment business lines of PULS over the short to medium term. Through heavy investments in real estate, the company is expected to expand its portfolio further and benefit long-term from increased rental income. On the other hand, we expect subdued revenue from sponsorships and advertising entitlements as companies across the nation grapple with high inflation and interest rates, which may cause them to be more conservative with their marketing budgets.

Projections and Valuations

We arrived at our price target using the Discounted Free Cash Flow (DCF) model and a Comparable P/E Model. The required rate of return on equity was calculated using the capital asset pricing model (CAPM) which ultimately yielded a weighted average cost of capital of 12.93%. We applied a P/E of 9.2x to 2024 Net Income, which we view as reasonable given the company's high ROE of 19.10%. The weighted average value per share of both models resulted in a consensus target price of **$2.17**.

Risks to Price Target

Tighter monetary conditions threaten accessing funding for expansions, upgrades, and operational expenses. Higher finance costs through new debt proceeds or the variable portion of the current bond can potentially reduce the company's earnings. Additionally, a possible global slowdown can create liquidity risks, which can minimize investor sentiment and, ultimately, the price target. On the other hand, the rebound in international travel and the reopening of the local entertainment sector bodes well for the revenue streams of the business, which can pose upside risks to the price target. Furthermore, the target price may be boosted if investors demand the stock due to the projected appreciation of properties, even during economic depressions, which should preserve the company's earnings.

FINANCIAL YEAR ENDED JUNE 30, 2023:

For the financial year ended June 30, 2023, PULS experienced a 2.0% growth in Total Revenue, rising to $948.9 million from the $930.6 million recorded in the previous. This increase was predominantly supported by the 12.3% increase in Model agency income and the 16.8% increase in Rental of properties. However, these increases were offset by a 1.5% decrease in Market sponsorship and advertising entitlements, which comprise 77.0% of Total Revenue. Total Expenses for the period grew to $321.3 million compared to the $270.9 million recorded in 2022, representing growth of 18.6% year-over-year (YoY). The increase in expenses was mainly driven by a $14.0 million jump in Impairment on receivables and an $8.0 million increase in Insurance. Due to the foregoing changes in Revenue and Expenses, the Gross Profit Margin weakened to 66.1% from the 70.9% recorded in 2022.

Other Income decreased by 23.1%, falling to $976.5 million from the $1.2 billion recorded in the previous year, contributing to the 16.9% decrease in Operating Profit (EBIT). This resulted in the EBIT Margin declining to 169.0% compared to the 207.3% in 2022. Finance costs brought about by Loans, Overdraft and Amortised bond transaction costs decreased by 70.7% amid lower interest expense on Loans and the non-recurrence of a Loan extension fee recorded in 2022. Despite lower Finance costs, Profit before tax declined by 15.6%, and a Tax charge of $17.8 million resulted in Net Income decreasing to $1.5 billion compared to the $1.7 billion recorded in 2022, representing a fall of 11.9% YoY.

On the balance sheet, Total Assets jumped to $11.1 billion compared to the $9.0 billion recorded in 2022, showing growth of 22.1% The increase was primarily driven by a $1.3 billion increase in Investment properties, representing growth of 66.3% YoY. Growth in Assets was also influenced by a $486.5 million increase in Advertising entitlements over the period. Total Liabilities increased to $2.3 billion compared to $1.8 billion in the previous year, attributed to a $303.8 million increase in Related party transaction and a $89.0 million increase in Bond payable. Shareholders' equity improved to $9.0 billion compared to $7.4 billion in 2022, brought about by the $1.5 billion influx from Net income, which positively impacted Retained earnings.

The Current Ratio weakened to 1.9x during the period compared to the 2.4x in 2022. This was driven by $23.3 million increase in Current Liabilities (mainly Taxation) which outweighed the $9.3 million decrease in Current Assets (mainly Cash and bank balances). A higher current ratio is generally considered better because it implies that the company has more current assets to cover its current liabilities. Therefore, the decrease in the current ratio may be a cause for concern, as it could indicate that the company's short-term liquidity position has weakened.

Return on Equity (ROE) weakened to 19.1% compared to the 27.4% recorded in the previous year. This was driven by lower Net Income while there was an increase in Total Equity. A lower ROE suggests that the company is less efficient in generating profits from its equity base. Return on Assets (ROA) weakened to 15.2% compared to the 22.0% recorded in 2022. This was also driven by lower Net Income in tandem with higher Total Assets. A lower ROA implies that the company is less effective at generating profits from its assets. There was a marginal improvement in the Debt-to-equity which ended the year at 0.079x compared to 0.085x in 2022. This indicates that debt continues to make up a minimal portion of the total capital structure which enhances the company's ability to be financially flexible. It also reduces the risks associated with higher levels of debt.

OUTLOOK:

Subdued Marketing and Advertising Budgets to Constrain Revenue Growth

For the year ended June 30, 2023, PULS generated most of its revenue (approx. 77.0%) from Market Sponsorships and Advertising Entitlements. Sponsorships typically involve a company or organization providing financial support to an event in exchange for advertising and brand promotion opportunities. Advertising entitlements usually refer to agreements or contracts where a party is entitled to advertise in specific spaces or during particular events, often in exchange for payment. The revenue from Market Sponsorship and Advertising Entitlements can be crucial for companies such as PULS, which operate in the media, entertainment, or event management sectors, as it often forms a substantial part of their total income. It's a way for PULS to monetize its platforms, audiences, or events by providing advertising opportunities to other businesses. However, marketing and advertising expenses are generally among the first costs businesses cut during challenging times. We expect that subdued advertising activity should continue to pressure PULS' revenue growth over the short-to-medium term as companies continue to undergo strain due to the current inflationary environment with high interest rates.

Stable Outlook for Jamaica's Real Estate Sector Supports Revenue from Rent and Sale of Developed Properties

Regarding commercial real estate, PULS has developed properties that generate rental income from diverse sources, such as shops, offices, restaurants, event spaces, and accommodations. These properties have added value to the company's top line and balance sheet while offering the benefit of diversification. Although commercial real estate was projected to experience a slowdown during the COVID-19 pandemic, the market hasn't regressed, and the sector remains a viable investment, mainly due to demand from entities like business process outsourcing (BPO) companies seeking additional spaces. The lifting of pandemic restrictions for well over a year has also resulted in an economic rebound, which supports a stable outlook for this segment of the real estate space.

Regarding residential real estate, PULS announced in March 2023 that it expects to generate approximately $500.0 million from selling a 16-unit development now on the market. The development, known as the Pulse Lofts, is part of the Villa Ronai property and consists mainly of studios and one-bedroom apartments. Besides Pulse Lofts, the company has other ongoing and upcoming real estate projects, including the 70-unit Villa Ronai Lifestyle Village and the 30-unit Pulse Homes development, expected to hit the market by 2024. This diversification within the real estate sector could shield the company from market volatility and create multiple revenue streams. The various real estate ventures reflect a long-term vision to build a more substantial presence in this market, possibly ensuring sustained growth and revenue generation. Like commercial real estate, we view Jamaica's broader economic rebound as supportive of a stable residential real estate sales outlook. Despite concerns about rising interest rates, data suggests that residential sales have remained robust, with mortgage demand continuing to be strong.

Global Expansion Plans in the Pipeline, But Risks Might Limit Meaningful Execution

PULS seeks to expand its presence in international markets by leveraging partnerships in Africa, North America, the Caribbean, and Europe. This includes media, model agencies, fashion, and show production partnerships. International expansion through strategic partnerships could provide PULS with a platform to leverage its capabilities and explore new growth avenues. However, we are cautious about any meaningful execution of these initiatives. It would also necessitate meticulous planning, significant investment, and a robust strategy to navigate the challenges of entering new markets and industries.

Additionally, we find that the fashion and model agency spaces experience intense competition. Many established brands, designers and modelling agencies dominate the fashion industry, making it challenging for newer or smaller entities to gain a foothold. Additionally, the industry attracts a constant influx of new entrants, adding to the competition. Also, consumer tastes and preferences can be quite volatile in the fashion industry and keeping up with these changing preferences requires a keen understanding of market trends.

INVESTMENT POSITIVES:

1. **Diversified Revenue Streams:** PULS experienced growth in various revenue sources, including model agency income and rental of properties. Diversification in revenue streams can help mitigate risks associated with over-reliance on a single income source.
2. **Significant Increase in Total Assets:** The company's total assets increased by 22.1%, primarily driven by a substantial increase in investment properties. This expansion in assets could indicate growth opportunities and potential for increased future income.
3. **Improved Debt-to-Equity Ratio:** The company's debt-to-equity ratio improved from 0.085x to 0.079x, indicating a conservative capital structure and reduced financial risk. This may enhance the company's financial flexibility.
4. **Stable Real Estate Sector:** PULS generates revenue from the rent and sale of developed properties. The stable outlook for Jamaica's real estate sector, supported by demand from BPO companies and economic rebound, can provide a stable source of income.
5. **Global Expansion Plans:** PULS has plans to expand internationally through strategic partnerships in various markets. Successful execution of these initiatives could open up new growth avenues and increase the company's global presence.
6. **Cash flow from Operations (CFO):** CFO has been consistently positive since at least 2019. Positive CFO over an extended period, such as since at least 2019, indicates that the company's core operations are generating more cash than they are

consuming. This suggests that the company's business model is sustainable and capable of covering its day-to-day operating expenses.

7. **Dividend Payments:** PULS has a history of paying dividends, although not consistently.

INVESTMENT NEGATIVES:

1. **Declining Profitability:** PULS experienced a decline in both ROE and ROA, indicating lower profitability and efficiency in generating profits from equity and assets. This could be a cause for concern for investors.
2. **Decreasing Gross Profit Margin:** The gross profit margin weakened from 70.9% to 66.1%, suggesting that the company's profitability from core operations declined. This trend may indicate increased cost pressures or pricing challenges.
3. **High Reliance on Market Sponsorships and Advertising:** Approximately 77.0% of PULS's total revenue comes from market sponsorships and advertising entitlements. Any slowdown in marketing and advertising budgets could negatively impact the company's revenue growth.
4. **Uncertainty in International Expansion:** While international expansion plans are in place, entering new markets and industries can be challenging, and success is not guaranteed. The company may face competition and market-specific risks.
5. **Volatility in Fashion Industry:** PULS operates in the fashion and model agency space, which is known for its intense competition and rapidly changing consumer preferences. Keeping up with market trends and standing out in this industry can be difficult.

CONCLUSION

The reopening of the global economy and the removal of COVID-19 containment measures are expected to boost the entertainment business lines of PULS over the short to medium term. Through heavy investments in real estate, the company is expected to expand its portfolio further and benefit long-term from increased rental income. On the other hand, we expect subdued revenue from sponsorships and advertising entitlements as companies across the nation grapple with high inflation and interest rates, which may cause them to be more conservative with their marketing budgets.

We arrived at our price target using the Discounted Free Cash Flow (DCF) model and a Comparable P/E Model. The required rate of return on equity was calculated using the capital asset pricing model (CAPM) which ultimately yielded a weighted average cost of capital of 12.93%. We applied a P/E of 9.2x to 2024 Net Income, which we view as reasonable given the company's high ROE of 19.10%. The weighted average value per share of both models resulted in a consensus target price of **$2.17**. Therefore, we recommend that investors **MARKETWEIGHT** the stock in their portfolio.

SOURCES

Bloomberg, The Jamaica Stock Exchange and Pulse Investments Limited Annual & Quarterly Reports, The Jamaican Gleaner, The Jamaica Observer, ScienceDirect, McKinsey & Company

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.