

Supreme Ventures Limited (SVL)

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Executive Summary

Supreme Ventures Limited is the leading gaming and entertainment company in the Caribbean. The Group focuses on utilizing the technology of its platforms and extensive retailer network to provide non-lottery commercial services to the market. Following acquisitions and the expansion into Guyana, SVL was seemingly on its way to another year of growth, however, the coronavirus pandemic exploded in Jamaica. This led to a ramp up in shelter-in-place protocols by the Government of Jamaica which SVL stated had a negative impact on its businesses in the final month of the first quarter.

As businesses downsize due to the economic slowdown stemming from the Coronavirus pandemic, the disposable income available to SVL's customers for gambling is likely to be weakened which may translate to lower gaming income for the entity. As such, we are forecasting revenues of \$37.27B for the 2020 financial year, a 3.2% decline year-over-year. Net profits attributable to shareholders are estimated at \$2.28B, a 6.4% decline. Our estimate of the fair value of SVL's shares is \$17.9, which is 19.4% above the close price as at March 12, 2020.

We recommend SVL as MARKETWEIGHT as the current market price is below our estimate of its fair value. SVL is suitable for investors with a medium risk appetite and a medium to long-term investment horizon.

Company Background

Supreme Ventures Limited is the leading gaming and entertainment company in the Caribbean. The Group 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 and AnyBet brands that offer 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 sells

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Supreme Ventures Limited (SVL)

phone pin codes through the agent's network; Horseracing – which consists of the operations of Caymanas Track Limited; and Other – which covers all other income.

Financial Performance – Year ended December 31, 2019

Profitability

SVL booked gross ticket sales of \$73B, a 16.1% increase over the 2018FY. Total gaming income was \$38.52B for the period, a 16.9% or \$5.58B increase over the prior year's result. All segments reported a year-over-year increase. Lottery revenues rose 14.1%, or \$2.25B, to \$18.24B; pin codes revenues rose 14.9%, or \$1.47B, to \$11.35B; Sports betting rose 372.1%, or \$922.25M, to \$1.17B; while Horseracing revenues rose 13.8%, or \$846.59M, to \$6.97B.

Revenue by Segment	2017	2018	2019	% change
Lottery	14,373,808	15,983,754	18,237,745	14.1%
Horseracing	4,657,891	6,123,309	6,969,900	13.8%
Gaming & Hospitality	363,084	353,927	383,871	8.5%
Sports Betting	174,392	247,877	1,170,123	372.1%
Pin Codes	9,855,046	9,882,295	11,351,275	14.9%
Other	256,606	344,868	403,396	17.0%
Total	29,680,827	32,936,030	38,516,310	16.9%

The growth in lottery revenues was attributed to the expansion of the distribution network and promotional activities aimed at increasing access to and awareness of SVL's products. The Sports Betting segment reported the largest percentage growth in 2019, which is notable as it represented a non-World Cup year. This growth was a result of SVL's targeted focus on the segment and the acquisition of 51% of Post to Post Betting (trading as Anybet) during the year.

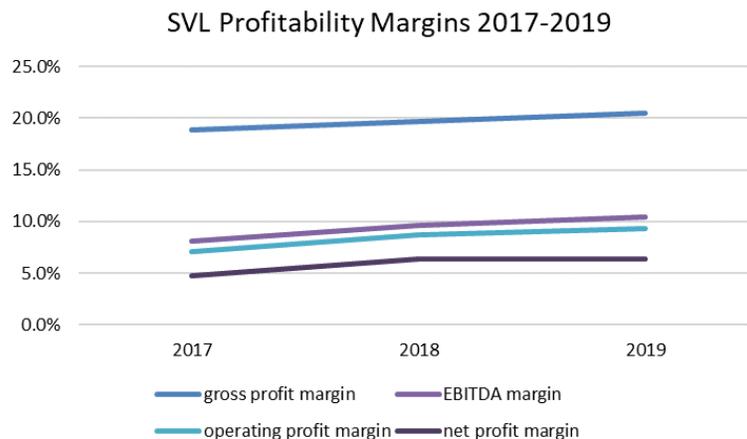
The growth in pin code revenues was attributed to increased use of data across service providers and the subsequent rise in demand for top up. The horseracing segment's growth was attributed to further expansion of the off-track betting parlours, introduction of English racing, the exportation of signal, and another successful staging of the Diamond Mile – the richest prize race in Jamaica. In addition to the acquisition of the majority stake in Post to Post Betting during the year, SVL also acquired Champion Gaming Limited – a Jamaican-owned company which has more than 1,200 machines in the Route Video Lounge Terminal (VLT – slot

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Supreme Ventures Limited (SVL)

machines) business in Jamaica. Champion Gaming commanded approximately 15% of the slot machines market in the country. The Gaming & Hospitality segment reported at 8.5% increase year-over-year, amounting to \$383.87M.

Direct expenses rose 15.8%, or \$4.17B, to \$30.61B for the period, resulting in gross profits of \$7.9B, a 21.7% increase year-over-year. The gross profit margin improved to 20.5% from 19.7% in 2018.



Selling, general and administrative expenses rose 15.4% to \$4.44B while other income declined by 22.3% to \$174.11M. SVL also reported net impairment losses on intangible assets of \$41.43M. As such, operating profit amounted to \$3.60B, a 25.3% year-on-year. The operating margin stood at 9.3%, up from 8.7% in the previous year. EBITDA amounted to \$4.02B, a 27.0% improvement while the EBITDA margin increased to 10.4%, compared to 9.6% in the prior year.

Finance costs more than doubled (up 160.2%) to \$145.8M as SVL's debt rose by 301.8% year-over-year. Despite the jump in finance costs, SVL is able to adequately cover its debt obligations as evidenced by an interest coverage ratio of 24.7x. Pre-tax profits rose 19.8% to \$3.46B. Taxation rose 25.1% to \$988.08M which resulted in net profits attributable to shareholders of \$2.44B, a 16.4% increase from the comparable period of 2018. The effective tax rate rose to 28.5% from 27.4% in the previous year. SVL's return on equity stood at 70.0% for the year, compared to 63.5% a year prior while the return on assets fell to 30.5% from 32.3% in 2018.

Supreme Ventures Limited (SVL)

Solvency & Liquidity

As at December 31, 2019, total assets amounted to \$9.42B, up 42.4% or \$2.81B from a year prior, driven primarily by the acquisition discussed above. Constituting this increase was a 20.6% or \$612.94M increase in cash and cash equivalents to \$3.59B; a 103.8%, or \$835.59M, increase in trade & other receivables to \$1.64B, a 268.1%, or \$796.2M, increase in goodwill & intangible assets to \$1.09B and a 47.6%, or \$589.42M, increase in property, plant & equipment to \$1.83B. Investment properties were up marginally (1.1%), closing the year at \$901.95M. Inventories amounted to \$191.9M, up 46.4% year-over-year.

Total liabilities rose 60.9%, or \$2.03B, to \$5.36B as long-term payables rose 1,694% (\$1.35B) to \$1.43B. Also contributing to the increase in total liabilities were a 73.0% increase in finance lease payable to \$732.64M and an 18.3% increase in 'trade and other payables' to \$2.29B. Total debt amounted to \$2.341B, up \$1.76B year-on-year. This increase in debt drove an increase in SVL's leverage, as measured by the debt to equity ratio which moved from 0.18x to 0.63x in 2019. Shareholders' equity amounted to \$3.7B during the year, and was up 12.5% year-over-year as retained earnings rose 32.7% to \$1.67B.

SVL remains well capitalized as the cash ratio stood at 1.12x, up from 1.05x while the current ratio ended the period at 1.71x, which compares to 1.39x in 2018. The Group generated \$2.16B in net cash inflows from operating activities, down 19% from the prior year.

Outlook

After reporting strong financial results for the 2019 year, with the acquisition of Post to Post Betting majority stake, the acquisition of Champion Gaming Limited and the expansion into Guyana, SVL was seemingly on its way to yet another year of growth. However, the coronavirus pandemic exploded in Jamaica. This led to a ramp up in shelter-in-place protocols by the Government of Jamaica. In its 1Q2020 report, SVL stated that it had achieved favourable results in all segments in the first two months of the quarter, but the final month was negatively impacted by the COVID-19 crisis.

In 1Q2020, gaming income was up 8.9% to \$10.13B, with all segments but Horseracing showing growth year-over-year. This increase was driven by a 7.4% increase in the Lottery segment to \$4.99B; a 415.2% increase in Sports Betting revenues to \$449.87M; and a 10.5% increase in Pin Code revenue which amounted to \$3.06B. Horseracing revenues fell 11.8% to \$1.47B.

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Supreme Ventures Limited (SVL)

Lottery revenues' growth was attributed to focus on key initiatives and terminal expansion. The Sports Betting segment performed well in the first two months but was impacted by the postponement and cancellation of major sporting events in March 2020. Nevertheless, the segment saw the largest percentage increase in segment result during the quarter (90.4%), amounting to \$32.47M, driven by a partnership with a new service provider, Altenar, and the inclusion of the Post to Post Betting operations. This performance highlights the success SVL was having in the implementation of its growth strategies before the coronavirus outbreak.

The fall in horseracing revenues was attributed to the cancellation of local races and closure of overseas tracks during the month of March. Despite the fall in revenues, the Horseracing segment was able to post a 69.6% decline in segment losses, moving from \$87.05M to \$26.50M. Operating profit for the quarter amounted to \$1.06B, a 12.7% increase year-over-year, while net profits attributable to shareholders was up 18.9% to \$738.37M.

We are now halfway through the month of May and major sporting events, both local and global, remain suspended, which continues to drag on the Sports Betting and Horseracing segments. The closure of bars and gaming lounges have also undoubtedly dragged on the Gaming & Hospitality segment with no VLT gaming.

Covid Response

In response to the COVID-19 threat, SVL has stated that its draw operations remain unchanged with the new curfew hours and has implemented a work-from-home plan for all staff who are equipped to and whose duties allow them to work from home. Sanitization protocols and the screening of patrons displaying flu-like symptoms or symptoms of malaise or illness policies have been implemented at regional offices. Frequent daily cleaning of gaming machines has been implemented as well as the requirement for cashiers to sanitize their hands when they handle cash or cards.

For retail and OTB (off track betting) locations, SVL sanitizes each patron on entry and has ceased bar and machine operations at these locations. Entry is limited to no more than 10 persons at a time. Effective March 21, 2020, the operations of Caymanas Park was closed indefinitely while the Acropolis Gaming Lounge was also closed indefinitely on March 18th, 2020.

Supreme Ventures Limited (SVL)

As businesses downsize due to the economic slowdown stemming from the Coronavirus pandemic, the disposable income available to SVL's customers for gambling is likely to be weakened which may translate to lower gaming income for the entity.

Valuation

We are forecasting revenues of \$37.27B for the 2020 financial year, a 3.2% decline year-over-year. Net profits attributable to shareholders are estimated at \$2.28B, a 6.4% decline, driven by the fall in revenues due to COVID-19. As the shelter-in-place protocols are loosened we believe limitations on public gatherings to prevent a second surge in cases will remain in place into the second half of the year and as such hamper SVL's recovery to pre-COVID revenues. Shareholders' equity is forecasted to increase 9.3% year-over-year to \$4.04B which corresponds to a BVPS (book value per share) of \$1.53.

Applying the 5-year average P/E ratio of 18.25x to the forward EPS of \$0.88 yields a price of \$16.02 while the forward BVPS of \$1.53 and the 5-year average P/B ratio of 9.41x yields a price of \$14.41. This pandemic has reduced investors optimism around the market and as such we have utilized historical price multiples that incorporate periods where investor confidence was not as high as it has been in recent times.

The Dividend Discount Model produced a price of \$23.31, in which we assumed a 4.9% long-term growth rate and an 8.44% cost of equity using the Capital Asset Pricing Model. ***As such, our estimation of the fair value of SVL's shares is \$17.9, which is 19.4% above the close price as at March 12, 2020 of \$15.24.***

Trade Performance

SVL closed trading on May 12, 2020 with a price of \$15.24, a 39.0% decline since the start of the year, and a 51.65% decline from a year ago. SVL's share price trended upwards from the first quarter of 2017 before peaking in May 2019. Since then, the stock has trended downwards hitting a 52-week low of \$11.72 amidst the coronavirus outbreak driven market collapse in March 2020.

Supreme Ventures Limited (SVL)

SVL 5-yr Stock Performance



Recommendation

We recommend SVL as MARKETWEIGHT as the current market price is below our estimate of its fair value. Following the passing of the coronavirus outbreak, we believe the Company will return to the double-digit growth it was enjoying in recent years, driven by an aggressive growth strategy. We believe the Company is adequately capitalized to weather the current crisis throughout 2020. However, our forecasts are limited by the unknown timeline for the passing of the COVID-19 outbreak in Jamaica. If the authorities are unable to “flatten the curve” and the number of cases surges, shelter-in-place protocols are likely to be extended which would drag on the Company’s earnings beyond our current estimates.

The Company has significantly increased its dividend pay-out ratio in recent times, averaging 107% in the past 3 years, which compares to an average pay-out ratio of 81% over the 5 years prior to 2017. The Company may choose to lower its pay-out ratio to preserve liquidity during 2020. If it were to hold its pay-out ratio to the 85% seen in 2019, this corresponds to a potential dividend yield of 4.9%, which translates to a total potential return of 22.3%. **SVL is suitable for investors with a medium risk appetite and a medium to long-term investment horizon.**

Supreme Ventures Limited (SVL)

Abridged Financials

J\$000	Year Ended December 31					Change %
	2015	2016	2017	2018	2019	
Revenues	43,847,020	44,921,339	29,680,827	32,936,030	38,516,310	16.9%
Direct Costs	39,429,684	40,812,837	24,074,214	26,443,983	30,614,036	15.8%
Gross Profit	4,417,336	4,108,502	5,606,613	6,492,047	7,902,274	21.7%
Operating Expenses	2,982,306	2,709,768	3,423,659	3,844,128	4,436,894	15.4%
Operating Profit	1,435,030	1,398,734	2,102,506	2,871,964	3,598,061	25.3%
Profit Before Taxation	1,614,830	1,661,892	2,046,369	2,888,438	3,461,710	19.8%
Profit for the year	1,183,750	1,178,468	1,398,656	2,098,408	2,473,634	17.9%
Total Assets	5,398,913	5,433,350	6,376,861	6,615,444	9,421,680	42.4%
Total Liabilities	1,804,876	1,633,149	3,053,935	3,330,286	5,357,050	60.9%
Shareholder's Equity	3,594,037	3,800,201	3,322,926	3,285,158	3,696,288	12.5%
EPS (\$)	0.45	0.45	0.53	0.80	0.93	
Book Value per Share (\$)	1.36	1.44	1.26	1.25	1.40	
Key Ratios						
Gross profit margin	10.1%	9.1%	18.9%	19.7%	20.5%	
Operating profit margin	3.3%	3.1%	7.1%	8.7%	9.3%	
Net Margin	2.7%	2.6%	4.7%	6.4%	6.3%	
Return on Average Equity	31.0%	31.9%	39.3%	63.5%	70.0%	
Return on Average Assets	21.0%	21.8%	23.7%	32.3%	30.5%	
Debt/Equity (x)	-	-	0.21	0.18	0.63	

Source: <http://www.Jamstockex.com>, JMMB Investment & Research, Bloomberg, Company Financials

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Supreme Ventures Limited (SVL)

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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OUTPERFORM/OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE UP TO 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

MARKETPERFORM/HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

UNDERPERFORM/UNDERWEIGHT— ADJUST EXPOSURE IN YOUR PORTFOLIO HELD AT JMMB TO BETWEEN 2.5% AND 4.9% FOR THIS PARTICULAR ASSET

STRONGLY UNDERPERFORM/UNDERWEIGHT—REDUCE EXPOSURE TO THIS ASSET TO BELOW 2.5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO (0%).

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Supreme Ventures Limited (SVL)

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