

# Company Analysis: Carreras Limited

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- Recommendation: OVERWEIGHT
- Price Target: \$8.55
- Current Price: \$6.43<sup>1</sup>

- Shares Outstanding: 4,854,400,000 units
- Market Value of Shares Outstanding: \$31.36 billion<sup>1</sup>
- Financial Year End: March 31st

## ABOUT THE COMPANY

Carreras Ltd is a marketing and distribution company that provides local consumers with access to tobacco products of its ultimate beneficial owner, British American Tobacco (BAT); a British multinational cigarette and tobacco manufacturing company with locations in over 180 countries. Rothman Holdings (CARICOM) Limited, a subsidiary of BAT, owns and operates Carreras Ltd. Carreras is considered the leading promoter and distributor of cigarettes locally, establishing Craven A and Matterhorn as prominent brands in the local market.

Registered in 1962, Carreras has developed a reputation of good performance through consistent growth in both revenues and profits over the years. The company is renowned for its consistency in rewarding shareholders with admirable dividend payments each year.

## CORPORATE STRATEGY

Carreras Limited's strategy follows that of its parent company, and seeks to create shareholder value, deliver profit growth and long-term business sustainability. The four (4) pillars of its strategy are growth, productivity, sustainability and developing a winning organisation. Growth for Carreras Limited is being driven by a focus on key strategic niches of the market such as their premium line of cigarettes and continuing to develop and utilise innovative, differentiated products, including flavoured cigarettes and vapourizers. The approach to productivity is leveraging its global network of resources to increase profits and generate funds for reinvesting in its various lines of business. Carreras continues to ensure it has a sustainable business by balancing its business objectives with the expectations of a broad range of stakeholders.

## FINANCIAL PERFORMANCE

	2016	2017	2018	2019	2020
Net Income (\$M)	3,011	3,806	3,484	3,406	3,583
Total Assets (\$M)	3,712	4,176	3,988	3,492	4,231
EPS (\$)	0.62	0.784	0.718	0.702	0.738
ROE (%)	169.9	178.9	170.7	255.1	202.2
Dividend Per Share (\$)	0.64	0.71	0.74	0.85	0.64

### Outlook

The supply and distribution channels of Carreras have been impacted by the pandemic, which has translated into subdued revenue generation. Additionally, sales growth has been subdued by competition from the sale of illicit cigarettes. Nonetheless, Carreras is expected to show some recovery in the next financial year as it implements measures geared towards ensuring consistent supply of its products, in the face of government restrictions related to the pandemic.

### Projections and Valuations

We used a Discounted Cash Flow Model to establish a price target for CAR. Based on our assumptions including a discount rate of 12.8% and a long-term growth rate of 5%, we arrived at a target price of \$8.55.

### Risks to Price Target

The company may be unable to grow revenues as expected due to multiple factors: any further increase in the SCT may adversely impact the cost of cigarettes to the consumer, growth of the illicit market could reduce local market share and a general increased focus on healthier living may curtail demand growth. On the other hand, increased efficiencies from changes to the distribution methodology and improved reach to its customer base could enable the company to grow revenues and exceed our price target.

**FINANCIAL PERFORMANCE**

\$'000	2016	2017	2018	2019	2020	2020 Q1	2021 Q1
<b>Operating Revenue</b>	\$11,980,138	\$13,509,228	\$12,550,132	\$12,906,497	\$14,126,523	\$3,458,024	\$2,697,701
<b>Operating Profit</b>	\$5,983,883	\$6,882,217	\$6,524,571	\$6,586,276	\$6,993,721	\$1,756,015	\$1,436,202
<b>Net Profit</b>	\$3,011,333	\$3,806,322	\$3,484,630	\$3,406,902	\$3,583,183	\$923,294	\$651,476
Total Assets	\$3,712,189	\$4,176,698	\$3,988,170	\$3,492,653	\$4,231,468	\$4,118,137	\$3,849,231
<b>Total Equity</b>	\$1,776,814	\$2,129,356	\$2,042,669	\$1,335,504	\$1,772,496	\$1,579,181	\$1,353,090

**FOR THE FIRST QUARTER ENDED JUNE 30, 2020:**

Over the three-month period ended June 30, 2020, Carreras Limited (CAR) reported operating revenue of \$2,697.70 million, a 22.0% decline when compared to the corresponding period of 2019, which reported \$3,458.02 million. This was a result of the heavy restrictions on imports of the company products and constraints on the primary supply chain driven by the COVID-19 pandemic. This impacted CAR's ability to fully supply the market in April and May. This resulted in a decline in the Net Profit for the period, moving from \$923.29 million in June 2019 to \$652.48 million in June 2020, a decline of 29.4%.

On the other hand, there were improvements in the Operating Expenses. The company reported a 5.3% decline in overheads for the period, with Administrative, Distribution and Marketing Expenses moving to \$508.92 million in June 2020 from a figure of \$537.58 million in the similar period of 2019. This was mainly attributable to the benefits of the route to market, making the channel from warehouse to customers more efficient and effective to grow sales and satisfy customers, and decrease in related party costs to ultimate parent company and other related companies. The route to market model was made more efficient as it was built in conjunction with the retail partners (Rebates, Wholesalers, Corner Shop) to increase presence in all avenues in an effort to combat the illegal cigarette trade.

There was a decrease in total assets to \$3,849.23 million, a 6.5% reduction in the total assets value compared to the corresponding period of 2019. This was mainly due to the decline of 8.9% in current assets figure, particularly cash and cash equivalents which saw an increase in dividend payments as well as a reduction in collections leading to an increase in accounts receivables. There was also a decline in total liabilities of the company with the figure moving from \$2,538.96 million in June 2019 to \$2,396.14 million in June 2020, a fall of 5.6% in value. This was attributable to a decline in the accounts payable of the company.

**FOR THE LAST FIVE (5) YEARS:**

Carreras has seen fluctuation in revenue figures, with an increase in 2017 from 2016 and then a subsequent decline through to 2019. The year 2017 saw improved strategies and increased efficiencies which led to a 12.8% increase in Revenue, despite the external pressures faced that year by the company which includes the increase Special Consumption Tax by the government. Similarly, Operating Profit and Net Profit also had initial increases in 2017 and then a fall in value for 2019. However, financial results for the 2020 financial year were positive, primarily evidenced by a 9.5% growth in Operating Profit and a 5.2% growth in Net Profit compared to the prior year, with a Compounded Annual Growth Rate (CAGR) of 4.2% over the five-year period. The delivery of \$14,126.52 million in Operating Revenue (\$12,906.50 million in 2019) was supported by a 10.2% increase in volumes versus 2019 and it constitutes the main driver behind the \$3,583.18 million of Net Profit (\$3,406.90 million in 2019). The increase in volume was driven by the positioning of the low-priced brand cigarette, Pall Mall, in areas where there was a noticeable presence of illicit cigarettes. Net Profit saw a CAGR of

4.4% over the five-year period. Carreras noted that the brands portfolio, led by Craven “A” and Matterhorn, strengthened its position as the industry’s leader and is poised to continue satisfying consumer moments for adult tobacco smokers.

Carreras Limited’s financial position remains strong and its working capital remains healthy. Compared to the prior period, increases were noted in cash and cash equivalents, accounts receivable and inventories. Furthermore, due to the adoption of the IFRS16 standard, related to right-of-use assets (Freehold land, buildings and leaseholds), which were not present in the previous period, contributed \$222.4 million to the increase in total assets for the company.

### **OUTLOOK:**

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#### **COVID-19 Impact**

The COVID-19 pandemic has impacted the economic state of the country. It has resulted in weakened productivity, depressed investment, lost human capital, and shortened global supply chains, all of which has impacted Carreras and its level of profitability. It has impacted the company’s performance due to restrictions placed on imports and on the company’s supply chain. Carreras has had to limit supply to various channels in order to benefit other channels. It is anticipated that the profitability of the company will continue to be impacted negatively as COVID-19 uncertainty remains until the development of a vaccine. With restrictions put in place for the health of the nation, it is expected to continue to impact supply chains used by Carreras as well as distribution channels normally used by the company. A return to normalcy could take place over the next two years.

Additionally, the COVID-19 pandemic has led to an increased requirement for persons to stay home as much as possible and limit social gatherings as a means of stemming the spread of the virus. This has led to a shutdown of the entertainment industry and loss of jobs for many, impacting on the mental health and social wellbeing of many individuals. This could impact the demand for the products offered by Carreras as persons may increase their usage of cigarettes as a means of coping with these restrictions. As a result, Carreras could benefit from this increased demand.

#### **Illegal Supply and Distribution**

Carreras is continuously impacted by the illegal distribution and sale of cigarettes in the country. The increasing prices of legal cigarette brands as a result of frequent and excessive excise increases directly impacts the company’s profitability as these contraband are sold at lower prices as they are not subject to heavy taxation placed on these products and are therefore sold at much lower prices of \$20 per stick, compared to \$55 per stick for cigarettes sold by Carreras. Until a specific measure is in place to prevent the importation, distribution and sale of these contraband are implemented and have an impact, it is anticipated that Carreras’ revenue will be directly impacted.

### **INVESTMENT POSITIVES:**

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- Carreras holds majority market share in the Jamaican market
  - Continued research on reduced risk products may create a catalyst for new products and revenue growth
  - Offers 2 well-known cigarette brands: Craven A and Matterhorn.

### **INVESTMENT NEGATIVES**

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- Cigarettes, the main product of the company, are heavily taxed.
  - Further increases in SCT decreases affordability to end consumers.
  - There has been growth of the illicit markets. The increased competition and market share from illicit trade of cigarettes as they are cheaper (no taxes).



- Concentrated efforts on health and wellness may negatively impact revenues as non-users and/or repeat users prohibit usage or reduce their usage.

## CONCLUSION

The COVID-19 pandemic has negatively impacted the revenue generation of Carreras. The protective measures put in place by the government has affected the supply chains and distribution channels of their products. Additionally, the increase in competition from illicit cigarettes has also dampened the profitability of the company. Nonetheless, the company continues to seek ways to counter these negative impacts. The management team has implemented measures to combat the effects on their supply and distribution caused by the pandemic. Furthermore, with an upgrade to their route to market strategy, they are able to reach more customers and limit the sale of illicit cigarettes in the market. Carreras also continues to pay quarterly dividends to its shareholder, yielding among the highest in the market. Based on our assessment of the current state of the company and outlook expected for the company, we have established a price target of \$8.55, which represents a 32.97% upside from stock's current market value. We therefore recommend investors OVERWEIGHT the stock in their portfolio.

## SOURCES

The Jamaica Stock Exchange, Carreras Annual Reports and Quarterly Financials.

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## 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.