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LOCAL EQUITY REPORT

# THE LIMNERS AND BARDS LIMITED

## Company Overview

| Stock | LAB |
|---|---|
| Close Price | J$2.74 |
| Estimated Fair Value | J$3.81 |
| Potential Upside | 39.05% |
| Dividend Yield | 2.70% |
| Total Return | 41.75% |
| Year to Date Return | -10.46% |
| Trailing P/E | 17.85x |
| Forward P/E | 14.42x |
| Recommendation | OVERWEIGHT |
| *May 6, 2021* | |

The Limners and Bards Limited ("The Lab") is a full-service and fully integrated advertising agency and film production company. The Lab provides its services under three main business divisions: Production, Media, and Advertising Agency; both in Jamaica and internationally. The Company's core services include brand/ communication strategy, campaign concepts and execution, media buying, and film production. Its day-to-day operations are supported by approximately 24 in-house staff and some 100 contracted workers/freelancers. With over 12 years of operations, the company has built a reputation for creating stand-out campaigns for clients such as Grace Kennedy, HEART Trust NTA, JPS, NCB, Wendy's, Domino's and the Digicel Group, through a data-driven approach that fosters strategic creativity. This creativity and high performance have brought the company beyond the borders of Jamaica to facilitate international film projects for persons like Drake, Rihanna, Nick Cannon, and Victoria Rowell.

## Investment Rationale

The Lab provides a unique opportunity for investors to get exposure to the first and only advertising and film production company listed on the Jamaica Stock Exchange (JSE). The Lab's business model is built on providing innovative solutions to clients through its main services including its brand/communication strategy, campaign concepts & execution, media buying, and film production. Throughout the pandemic, the company has repositioned its business to meet the demand of clients who needed digital solutions. Consequently, while many industries and companies faltered in 2020, The Lab reported strong top and bottom-line growth of 44.30% and 34.13%, respectively. This growth has continued into 2021, reflecting significant double-digit growth in two of the company's three operating segments. Against the backdrop of a strong, stable business model coupled with robust financial performance, we have issued an **OVERWEIGHT** recommendation for The Limners and Bards Limited.

## Business Positioning

The company's operation is separated into three main segments: agency, media, and production services. As indicated in the company's 2019 prospectus, the range of services provided is unique as The Lab's main competitors specialize in just one or two of these areas. With that said, customers and clients of the Lab benefit from a broader ecosystem than they would from a competitor. This, in effect, provides a "one-stop-shop" benefit for clients and improves the company's ability to drive value for customers.



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**UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET**
**MARKETWEIGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO**
**OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO**

Going forward, the company expects to continue its elevated growth by increasing its share of the Jamaican advertising market through three key strategies:

1. **New Client Acquisition:** The company is ready to target local entities for new business including small and medium enterprises (SMEs), large corporations as well as government agencies. The acquisition of new clients is a key step towards business and revenue growth for the company.
2. **Maximize share of wallet from its existing Clients:** The Lab has noted that some of its clients receive services from alternative providers which creates an opportunity for The Lab to increase its services to these clients. This can be beneficial to both the client through reduced cost and hassle as well as The Lab through increased revenue.
3. **Expansion of service offerings through acquisitions of new business:** The company intends to innovate and expand its offerings to its customers to meet and exceed their expectations and has a pipeline of new services it intends to offer. Since the pandemic began in 2020, the company has added some of these services. Additionally, the company aims to achieve further service broadening through acquisitions aimed at adding services and talents to the Company that will improve its profitability.

**Growth through the pandemic**

With the onset of the pandemic, the company's regional expansion implementation timeline was accelerated. Consequently, the company began the execution of several innovative solutions including updating its media software and strengthening capacity towards the expansion of its digital service offerings. **Importantly, the pandemic provided a boost for the company and while many industries were disrupted, the transition to online business activities supported the company's continued growth**. The Lab was able to capitalize on the increased demand for virtual solutions in the form of immediate, digital content and direct messaging to a captured audience.

COVID-19 has accelerated the digital imperative across industries and economies globally. This coupled with the tendency for companies to increase advertising spend during downturns ought to provide stable tailwinds for The LAB. With that said, we believe that the digital shift will continue as companies increasingly realize the benefits of a digital business. As such, The Lab is positioning to continue benefiting from this accelerated shift. Recently, the company created a new position – Head of Media and Digital Innovation; demonstrating the company's posture towards staying at the cutting edge of digital transformation, which is key to remaining relevant. This was further highlighted by the recent (May 6, 2021) announcement from the company that they've added a wholly-owned subsidiary, "SCOPE Caribbean Limited". This subsidiary is a user-generated influencer and talent platform which should add value to the creativity of the business which is a core part of The Lab's business model.

## Business Segments

**Advertising Agency or Agency:** Based on the company's prospectus, this division is the main creative engine of the Company and covers strategy development, concept creation, and execution. This unit collaborates with the client to understand their brand, market space, channels, and any specific challenges. This is supported by strategic analysis and creative conceptualization. Services provided under the Agency business segment include brand analysis and strategy, creative concept development, campaign, and promotion development, branding and design, copywriting, innovation sessions, public relations (future service), and product design/development (future service).

**Media:** This division purchases the time/space in media that the work created by the Agency (or delivered by the client) uses for broadcasting to the client's customer base. The value-added from this business involves careful understanding of media channels, polling numbers/viewership surveys, as well as cultural trends. Consequently, a media strategy can be developed to target each client's specific customer universe at the best possible times to deliver maximum exposure. The Lab generates a media commission of 15-18% of media sales. Services provided under the Media business segment include media strategy development, media investment management, media planning, media buying, social media management (future service), web optimization (future service), and digital geofencing advertising (future service).

**Production:** Production services entail both live production (shooting) and post-production (video editing and sound recording) for clients. Further, the company benefits from providing production services to other suppliers, including film production, equipment rental, and transport, audio and photo studio rental, as well as video and audio editing. Services provided under the Production business segment include creative direction, film and video production, production management, post-production, audio production, motion and 3D graphics, equipment rental, and digital content creation.

## Strategic Positioning

A defining characteristic of The Lab's business model is that the breadth of services offered is applicable across several (if not all) industries. At present, the company has clients from industries including telecommunications, financial services, food & beverage, gaming and sports, education, non-profit industries, and government. As indicated prior, one of the company's strategic aims is to increase the number of services provided to a single client; thereby creating an ecosystem of services that not only benefit the Lab but also the client.

By doing the aforementioned, the Lab could derive significant growth. This view is directly linked to the advertising spend of some of the company's major clients. We've detailed the advertising expenses for the companies on the JSE:

- **NCB Financial Group:** In FY2020, NCBFG spent $4.20 billion on marketing, customer care, advertising and donations during the year.
- **Grace Kennedy:** In FY2020, GK spent $3.04 billion on advertising and marketing.
- **Jamaica Public Service:** In FY2019, JPS spent US$ 454 thousand (approximately J$60.95 million) on Advertising and Marketing.

The LAB's last twelve months' revenue totals just $1.01 billion which implies that there's significant revenue potential by maximizing its "share of wallet" from existing clients while onboarding new clients. Essentially, the above clients represent at least $5 billion (conservative base estimate given NCB's expense includes donations and customer care) in advertising and marketing dollars and outside of these, the company has clients that are not listed. We expect that the use of its competitive advantage wherein the company offers agency, production and media services; as opposed to competitors who offer just one or two of these service segments places The Lab in an advantageous position to grow the share of wallet.

Another major driver of growth for the company relates to the applicability of services. Any business with intentions to increase brand awareness through advertising can benefit from a relationship with The Lab. In our view, this provides significant growth opportunities for the company with few industry-related restrictions. To the latter point, as displayed during the pandemic, The Lab's source of income is not tied to any single industry. For example, while a hotel is almost completely exposed to tourist arrivals and will falter if tourist travel declines significantly, The Lab's revenue stems from multiple industries with varying revenue drivers and risk exposures. With that said, the Lab's exposure to several clients across varying industries provides some insulation for the company.

## Financial Year Ended 2020 Profitability (Year ended October 31, 2020)

For the financial year ended October 30, 2020, The Lab reported revenue growth of 44.30% or $279.89 million to total $911.74 million. This was attributable to significant growth in all three of the company's business segments; production (growth of $8.3 million or 3.70%), media (growth of $199.7 million or 68.35%), and agency (growth of $71.7 million or 63.07%). Gross profit increased by 31.71% as the cost of sales increased and reduced gross profit margin (GPM) from 35.88% to 32.75%. The reduction in GPM was driven primarily by increased direct costs stemming from the agency and media segments of the business.

Operating income for the year amounted to $123.67 million, an increase over the prior year of 13.40%. The operating profit margin for the year amounted to 13.56% relative to 17.26% in the prior year. This out-turn is underpinned by an increase in total operating costs for the year of $56.19 million or 47.93%. The increased cost is primarily attributable to staff costs (due to increased work volume). While the company implemented a cost-containment strategy, some one-off costs also contributed to increased administration expenses. These included a 'systemization' initiative and training to support increased efficiencies linked to the company's growth drivers as well as a pay-out of 50% of the 2019 employee profit share.

For the year, the company reported net finance income of $3.65 million, reflecting income from short-term investments and FX gains of $9.28 million matched against finance costs (bank charges, loan & lease interest) of $5.34 million. Profit before tax for the year totalled $127.31 million, markedly higher than operating profit ($123.67 million), due to the addition of net finance income. This was reduced slightly by loss ($231.01 thousand) from equities carried at fair value and resulted in a net profit of $127.08 million, an increase over the prior year of $32.34 million or 34.13%

**Historical Profitability**

The profitability table below provides a snapshot of the company's five-year performance. It indicates that The Lab has been able to produce double-digit Return on Equity (ROE) in each year except FY2017. The decline in profitability in that year, as noted by the company, was due to management taking the strategic decision to focus on team development and training, while also reworking the Company structure with the objectives of increasing efficiency in service delivery. Importantly, after FY2017, the company's performance has strengthened as indicated by its net profit growth between FY2018 and FY2020. This growth comes on the back of the training done in FY2017 and has been further bolstered by the company's JSE listing in July 2019 which grew the company's equity capital from $15.23 million to $178.94 million.

Importantly, zooming in on FY2020 indicates that revenue growth remains robust at 44.30%. However, margins have declined. Management has noted that while the company implemented a cost-containment strategy, **some one-off costs also contributed to the increased administrative expenses in FY2020**. These included a systemization initiative and training to assist in efficiencies linked to growth drivers and a pay-out of 50% of the 2019 employee profit share, as indicated prior. Additionally, looking at the company's DuPont analysis indicates why ROE has trended down since FY2018. Given the company's increased asset base following the IPO, asset turnover has softened which is consistent with the company's high cash balance and favorable liquidity and solvency position.

Importantly, however, the Q1 2021 outturn indicates better cost management with the company demonstrating operating and net profit margins of 17.40% and 18.81%, respectively, which is an improvement over the FY2020 outturn as shown in the table below. This suggests that the company's ROE will improve once the cost to revenue structure is maintained. To increase its asset turnover, the company will need to increase revenue generation which is within the scope of the company based on the strategic plans detailed.

| 5-Yr Profitability | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 |
|---|---|---|---|---|---|
| Return on Equity | 43.51% | -5.12% | 67.98% | 39.57% | 30.98% |
| Gross Profit Margin | 33.31% | 37.54% | 33.67% | 35.88% | 32.75% |
| Operating Profit Margin | 7.91% | 0.63% | 16.65% | 17.26% | 13.56% |
| Net Profit Margin | 0.00% | 0.00% | 12.90% | 15.00% | 13.94% |
| Revenue Growth | 0.69% | -19.83% | 66.00% | 30.77% | 44.30% |
| Net Profit Growth | -2.79% | -113.98% | -2058.31% | 52.05% | 34.13% |
| Net Profit Growth ($'000) | -652.06 | -25,941.21 | 65,495.88 | 32,432.38 | 32,335.01 |

| DuPont Analysis | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 |
|---|---|---|---|---|---|
| Net Profit Margin | 6.3% | -1.1% | 12.9% | 15.0% | 13.9% |
| Asset Turnover | 4.05x | 2.88x | 2.79x | 1.73x | 1.57x |
| Equity Multiplier | 1.72x | 1.63x | 1.89x | 1.53x | 1.42x |
| ROE | 43.51% | -5.12% | 67.98% | 39.57% | 30.98% |

## 3 Months Performance (January 31, 2021)

### Revenue and Profitability

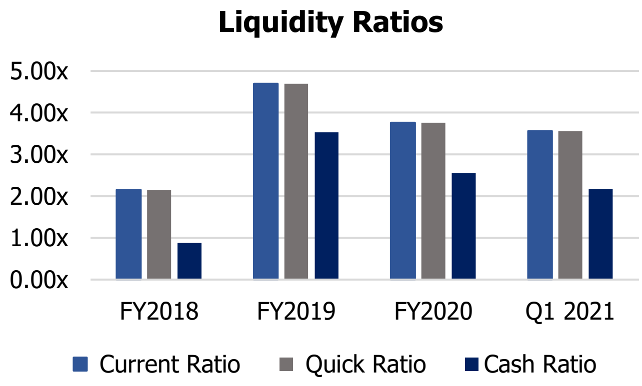
For the quarter ended January 31, 2021, The LAB reported total revenue of $356.26 million, representing an increase over the prior period of 35.46% or $93.27 million. This revenue growth is attributable to increases in the company's core business segments including media placement (growth of $21.3 million or 16.6%) and production (growth of $72.8 million or 92.3%). These increases were to some extent offset by a reduction in advertising agency income (down $0.9 million or 1.7%). Gross profit for the period amounted to $115.18 million, an improvement of 27.58% YoY. Given the slower-paced growth in gross profit, the company reported a decrease in its gross profit margin which moved from 34.33% to 32.33%, a 2.00% contraction reflective of a change in revenue mix relative to the prior period. Total operating expenses amounted to $53.17 million, an increase of $12.08 million or 29.41%. These increases are primarily attributable to staff costs (due to increased work volume), repairs and maintenance of production equipment, and depreciation and amortization costs. Despite the increase in costs, operating profit improved by $12.81 million (+26.05%). Profit for the year was further boosted by a net finance income position of $4.93 million as income from the company's short-term bank deposits ($7.04 million) was above the interest cost on debt and lease liability ($2.11 million). Additionally, the company owns equity investments that increased in value during the quarter and added $80.58 thousand to the bottom line in Q1 2021 relative to a loss of $-139.68 million in Q1 2020. **For the quarter, net profit amounted to $67.02 million, an increase over the prior period of 37.03% and an improvement in net profit margin, which moved from 18.60% to 18.81%.**

## Balance Sheet – Solvency and Liquidity

The LAB maintains a very robust balance sheet characterized by significant cash relative to current liabilities and relatively low debt. In Q1 2021, the company's total assets increased by 22.48% YoY ($124.93 million). This was driven by the recognition of a right of use asset which was added to the balance sheet in Q2 2020 after a sale and leaseback arrangement. This was not reflected in the company's Q1 2020 results, hence the double-digit increase in total assets.

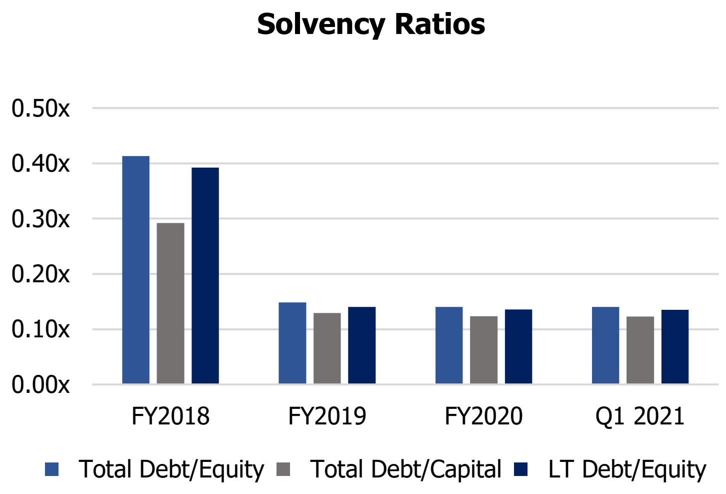
### Liquidity

The lab maintains a very high level of liquidity as shown in the Liquidity Ratios chart (all ratios greater than 1.0x). This liquidity position is predominantly supported by a strong cash balance, as demonstrated in the company's cash ratio which has been above 2.00x since FY2019. Similarly, the company's current ratio has consistently been sufficient to meet its current liabilities.



### Solvency

The Lab's balance sheet is largely funded by Shareholders' Equity. Over its years of operations, the company's profitability has driven a strong retained earnings balance. This coupled with the company's large cash balance has resulted in its low appetite for debt. Importantly, of its total interest-bearing liabilities, 82.5% is concentrated in lease liability which is a cheaper means of financing. This underscores the company's relatively low use of loans and strategic sourcing of capital.




### Cash Flow

For the quarter ended January 31, 2021, The Lab reported an operating cash flow of $38.33 million relative to $-21.83 million in the same period last year. In the previous year, operating cash flow was reduced by changes in accounts receivables which represented the use of funds totaling $-110.63 million. Importantly, since this quarter, the company has managed its receivables well, mitigating the significant growth that results in high use of cash. Consequently, the company's operating cash flow has been positive in every quarter since the January 31, 2020 quarter.

Over the current quarter, the company reported a net decrease in its cash, driven predominantly by the payout of dividends totaling $69.98 million. Had the company retained the dividends paid, the net cash position for the quarter would have increased by $31.82 million.

## Valuation

To determine a value for The Lab, the free cash flow to equity and the P/E valuation methodologies were used.

### Free Cash Flow to Equity

Our free cash flow model assumed the company grows at an average rate of 28.43% over the next 5 years (historically, the last three years showed growth of 47.02% and the last 5 years was 24.39%, having been impacted by 2017 which fell 19.83% on account of the company "reworking" its structure).

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In 2021 specifically, we assume revenue growth of 41.14%, a slightly smaller outturn than FY2020's 44.30%. This growth was determined by analyzing the company's quarterly growth patterns and adjusting based on the January 2021 results. In FY2021, we assumed an operating profit margin reduction to 12.82% from 13.56%. Importantly, while the net profit margin in Q1 2021 improved relative to Q1 2020, operating profit fell by 1.3%. We coupled this with the fact that one-off factors contributed to margin contraction in FY2020 which implies the FY2021 outturn could be higher in some quarters, particularly Q3.

WACC was determined to be 11.79%. **Once the firm value was determined, we deducted the company's total debt and added cash to arrive at the firm's equity value ($3.46 billion) which equates to a share price estimate of $3.66.**

**P/E Valuation**

**Our P/E valuation utilized our DCF's 2021 expected revenue outturn of $1.29 billion.** We utilized a net profit margin of 14.23% (FY2020 was 13.94% and Q1 2021 was 18.81%). Notably, the increase relative to the company's operating profit margin is due to net finance income from term deposits which increased net profit margin above operating profit margin since FY2020. Utilizing this revenue and net profit margin resulted in a net profit estimate of $183.11 million or $0.19 per share. At present, the Market prices The Lab at a trailing P/E multiple of 17.85x which is below the Junior Market average of approximately 29.95x. **Additionally, the company's average P/E since FY2019 has been 20.87x. Given its high growth and the discount relative to the Junior market, we utilized this 20.87x multiple to value the company at our expected 2021 EPS which results in a price target of $3.97.**

**Valuation Summary**

Averaging both our DCF and P/E valuation price estimates results in a price target of $3.81 which is 39.05% above the company's May 6, 2021 price of $2.74 and underpins our **OVERWEIGHT** recommendation. **Importantly, from a P/E perspective, this price target equates to a P/E of 20.05x relative to our 2021 EPS estimate. At 20.05x, the company would be trading just below its three-year average of 20.87x and well below the Junior market average of 29.95x.**

## Conclusion and Recommendation

The Lab has presented strong growth and return on shareholders' equity over the last three years. While many companies posted a decline in profitability during 2020, the company thrived by quickly adapting to the new normal and providing clients with digital solutions. We believe the pandemic has created an increased need for the services provided by the company as the benefits of digitization have been brought to the forefront. This presents an opportunity for the company to continue its double-digit growth in 2021 by delivering bespoke services to clients while expanding its business by taking advantage of the new digitization trend catalyzed by the pandemic. We believe that given the company's growth potential, at its current price, The Lab is undervalued. With that said, we recommend an **OVERWEIGHT** for the stock.



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