EQUITY RESEARCH REPORT
SUMMARY REPORT

138SL Jamaica Ltd.

Reading Time: 12 mins

138 Student Living Jamaica Ltd. (138SL) is a real estate group operating in the education sector in Jamaica. It was incorporated in August 2014 as a special purpose project company by its founder, K Limited.

The company's establishment aimed to fulfil obligations and enjoy rights under a Concession Agreement that the Founder entered with the University of the West Indies (UWI Mona) in July 2014. Subsequently, K Limited transferred all its rights and obligations under the Concession Agreement to 138SL. As a result, 138SL bears responsibility for the design, financing, construction, maintenance, and operation of 1,584 student accommodation units in three development phases on the UWI Mona campus. 138 Student Living holds the rights to generate rental and services income from these 1,584 residence units for a duration of up to 65 years, with a UWI Occupancy Guarantee of 90% of the rooms each year. The Concession Agreement will remain in effect until the shareholders earn a real rate of return of 15%, with a minimum duration of 30 years.

In 2015, 138SL Restoration Limited (138SL Restoration), a wholly owned subsidiary of 138SL, was incorporated. The purpose of 138SL Restoration is to restore, reconstruct, and operate living facilities at UWI Mona under the Restoration Concession Agreement between 138SL Restoration and UWI Mona. Collectively, 138SL and 138SL Restoration constitute "the Group."

Use of Proceeds

If the Additional Public Offering (APO) is successful, 138SL intends to use the proceeds to reduce its indebtedness by approximately J$1.5 billion (up to J$2.0 billion if the offer is upsized). This reduction would equate to approximately 36%-48% of debt and would unlock approximately J$112.5 million to J$160.0 million of interest cost savings and possibly reduce principal payments by about J$143.0 million annually.

Expected Use of Proceeds	J$ Amount	J$ Amount (if Option to Upsize Fully exercised)
Reduction of Indebtedness	1,500,000,000	2,000,000,000
Other investment opportunities	547,500,000	1,085,000,000
Transaction Costs	102,500,000	140,000,000
Total	**2,150,000,000**	**3,225,000,000**

APO

BUY

Key Features	
Offer price	J$4.40
Estimated Fair Value	J$5.96
Implied Discount	26.17%

SUMMARY

138SL Jamaica Limited is seeking to raise J$2.15 billion.

- No. of Reserved Shares offered 318,515,000 Ordinary Shares @ ~J$4.05 per share.
- No. of Non-Reserved Shares offered 195,457,784 Ordinary Shares @ ~J$4.40 per share.

Invitation Details

138 Student Living Jamaica Limited is inviting offers for the subscription of 513,972,784 New Ordinary Shares, with the option to increase the offering size by an additional 256,986,392 New Ordinary Shares. The shares will be offered at a price of J$4.05 per Share for Reserved Share Applicants (Existing Shareholders, 138SL Team Members and Strategic Partners) and J$4.40 for Non-Reserved Share Applicants (General Public). If any of the Reserved Shares within the reserved pools are not fully subscribed to by the Reserved Share Applicants, these unallocated Reserved Shares will be reassigned to the Non-Reserved Share Pool. These shares will then become a part of the New Ordinary Shares available for allocation to Non-Reserved Share Applicants (General Public) at the price applicable to the Non-Reserved Share Applicants. If the Offer is oversubscribed, the company may exercise either one or a combination of the following actions: (i) the option to upsize the offer, (ii) allot the new ordinary shares on a first-come, first-serve basis or according to criteria determined solely by the company's discretion, which may include a pro-rata basis. In this case, applicants may be allotted fewer New Ordinary Shares than they applied for. Please see the Summary of Offer Terms below, for more details.

<table>
<tr><th colspan="3">Summary of Offer Terms</th></tr>
<tr><td>Company</td><td colspan="2">138 Student Living Jamaica Limited</td></tr>
<tr><td>Lead Broker and Arranger</td><td colspan="2">GK Capital Management Limited</td></tr>
<tr><td>Shares the Subject of the Invitation</td><td colspan="2">513,972,784 New Ordinary Shares (with the option to upsize by inviting offers for an additional 256,986,392 New Ordinary Shares)</td></tr>
<tr><td>Offer Open</td><td colspan="2">9:00 a.m. on September 8th, 2023.</td></tr>
<tr><td>Closing Date</td><td colspan="2">4:30 p.m. on October 6th, 2023.</td></tr>
<tr><td rowspan="3">Share Allocation</td><td>Existing Shareholders or 138SL Team Members or Strategic Partners</td><td>Non-Reserved Share Applicants (General)</td></tr>
<tr><td>J$4.05</td><td>J$4.40</td></tr>
<tr><td>318,515,000</td><td>195,457,784</td></tr>
<tr><td>Use of Proceeds</td><td colspan="2">The proceeds will be used to (i) settle transaction costs associated with the APO, (ii) repay existing indebtedness, and (iii) take advantage of investment opportunities (including the exploration of expanding room capacity).</td></tr>
<tr><td>Minimum Share offering</td><td colspan="2">1,000 Shares, with increments of 100 Shares thereafter</td></tr>
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Outlook and Strategy

The 138SL Group provides student housing and has a unique three-pronged value proposition:

- Captive market: Limited competition coupled with the niche nature of the market allows the Group to report predictable and sustainable revenues.
- Inherent foreign exchange hedge: Under the Concession Agreements, the Group has the right to adjust the fee charged based on a formula which considers the movement in the USD vs JMD exchange rate.
- Occupancy guarantee: Based on the Concession Agreements, UWI Mona provides a guarantee of 90% occupancy of the residences for the duration of the Concession Agreements.

Looking ahead, the 138SL Group plans to deleverage its Balance Sheet by using the APO proceeds to significantly reduce debt. If successful, this strategy will free up cash that can potentially be used to pay dividends and pursue other growth opportunities for the Group. The Group is actively analysing various opportunities and is very confident about its capacity to consistently deliver high-quality student accommodation to meet the growing demand for this service, not only in Jamaica, but throughout the region. Additionally, the Group has indicated that it is open to exploring other untapped segments within the hospitality sector with the intention of capitalizing on any areas that are currently underserved.

Concession Agreements

138SL Concession Agreement

Currently 138SL holds a concession agreement with UWI Mona. In the agreement, 138SL is required to design, construct, and operate 1584 units over the course of three development phases within a four-year period. The 138SL Concession Agreement has a minimum duration of thirty (30) years and a maximum duration of sixty-five (65) years. The exact number of years depends on 138SL's ability to achieve a real after-tax 15.00% internal rate of return. Upon expiration of the 138SL Concession Agreement, 138SL will transfer the dormitories to UWI Mona. Under the agreement, 138SL has the right to adjust the fees charged annually, after considering the impact of the JMD vs USD exchange rate. Importantly, as part of the 138SL Concession Agreement, UWI Mona guarantees 138SL a minimum occupancy rate of 90%, for no less than fifty-one (51) weeks per year.

So far, 138SL has completed two (2) of the three (3) development phases as follows:

Phase	Hall Name	No. of Rooms
Phase 1	Leslie Robinson Hall	432
Phase 2	George Alleyne Hall	576

138SL Restoration Concession Agreement

In 2015, 138SL's subsidiary 138SL Restoration, entered into a concession agreement with UWI Mona. Under this agreement, 138SL Restoration committed to renovate, expand and operate Gerald Lalor Flats and Irvine Hall. Upon completion of this project, 138SL Restoration would have the responsibility to operate and manage up to 722 housing units as part of the agreement.

The Restoration Concession has a minimum term of twenty-five (25) years and a maximum term of thirty (30) years. The actual duration will be determined based on 138SL Restoration's ability to achieve a real after-tax 9.00% internal rate of return. Upon the expiration of the Restoration Concession Agreement, 138SL Restoration will transfer ownership and operation of the dormitories to UWI Mona. During the period of the Restoration Concession Agreement, 138SL Restoration holds the exclusive right to set and collect fees for occupancy of its accommodations and to make annual adjustments to these fees as necessary.

UWI Mona guarantees 138SL Restoration a minimum occupancy rate of 90%, for no less than fifty-one (51) weeks per year for the Gerald Lalor Flats and thirty-eight (38) weeks per year for Irvine Hall.

So far, 138SL Restoration has completed two (2) of the three (3) development phases as follows:

Phase	Hall Name	No. of Rooms
Phase 1	Gerald Lalor Flats	72
Phase 2	Irvine Hall (redevelopment)	384

The Restoration Concession Agreement initially planned for Gerald Lalor Flats to consist of 72 rooms and Irvine Hall to have 650 rooms. However, during the redevelopment of Irvine Hall, UWI Mona requested a modification to the original design outlined in the Restoration Concession Agreement. This variation, which was accepted by 138SL Restoration, resulted in a decrease in the number of double rooms and an increase in the number of single rooms. Following the accepted design variations, 138SL Restoration initiated a compensation claim known as "the Irvine Hall Claim" against UWI Mona. This claim aimed to address the adjustments made to the design as agreed upon in the Agreement.

The Irvine Hall Claim was resolved in FY 2022 and the resulting financial model for Irvine Hall was updated to reflect the actual "as built" structure.

Under the Restoration Concession Agreement, 138SL Restoration effectively has capacity to increase its existing number of rooms by an additional 266.

Financial Analysis

138SL's Revenue & Profitability

Over the last few full years of operations, 138SL has faced significant challenges. Over the five-year period (FY 2018 – FY 2022) the Group's total revenue grew at a compound annual growth rate of 9.5%, moving from J$834.4 million in FY 2018 to J$1.2 billion in FY 2022. The real estate group achieved commendable growth over the period, however, in FY 2021 the Group encountered substantial difficulties due to the COVID-19 pandemic. Occupancy levels dropped dramatically in that year, reaching as low as 30.0%, as restrictions on movement were implemented to curb the virus's spread and these restrictions severely limited in-person instruction on the UWI Mona campus. Nevertheless, 138SL displayed resilience and adaptability, managing to achieve a respectable total revenue of J$860.4 million in that difficult year. As the effects of the pandemic waned in FY 2022, 138SL's top-line rebounded significantly, with an impressive 39.4% growth. This was primarily attributable to an increase in long-term fees.

Administrative expenses came in at just J$501.3 million in FY 2022, up 18.8% year-over-year (YoY) but 3.4% lower than the J$519.1 million reported for FY 2018. Thanks to commendable top-line growth and effective cost management over the period, operating profit moved from J$315.3 million in FY 2018 to J$698.5 million in FY 2022, expanding the operating profit margin by 20.0% when compared to FY 2018.

The 138SL Group has used a combination of debt and equity to finance its operation over the years. After successfully raising capital through an IPO in FY 2014, the Group tapped the capital markets to raise debt to finance several of its projects over the years. Consequently, the Group's Finance cost as a percentage of revenue averaged 30.6% over the period. However, in FY 2022, the Group reported Finance cost of J$363.5 million which was 50.1% higher than in the previous year. The higher finance cost was a result of a restructuring exercise that the Group undertook in FY 2021. During this restructuring, the Group converted its variable-rate debt into fixed-rate instruments and extended the tenors by two years for all its debt instruments. It is anticipated that if the APO is successful the company's annual interest cost could see a significant reduction, which should positively impact the Group's bottom line and ability to distribute dividends.

Over the five-year period under review, except for FY 2018 when 138SL reported a net loss of J$16.3 million, the Group reported profit for each year. In FY 2022, 138SL posted its highest profit on record, J$318.4 million, which was 43.9% higher than the amount posted in the previous year.

138SL's Balance Sheet

As at the end of FY 2022 (September 30, 2022), 138SL's Total assets stood at J$9.7 billion, a slight decrease of 3.3% compared to the J$10.1 billion reported at the end of FY 2021. Over the five-year period leading up to FY 2022, the Group's Total assets grew at a moderate Compound Annual Growth Rate (CAGR) of 2.4%. The majority of the Group's assets are in the form of Financial assets – service concessions, carried at a value of J$8.4 billion at the end of FY 2022. These relate to the long-term concession agreements (138SL Concession Agreement[1] and the Restoration Concession Agreement[2]) that the Group owns.

With the Concession Agreements, 138SL has the right to set and collect fees for occupying its accommodations. Additionally, through these Agreements, UWI Mona guarantees 138SL and 138SL Restoration a minimum 90% occupancy rate over at least 51 weeks per year. Consequently, in FY 2020 and FY 2021, when COVID-19 restrictions halted face to face classes at the university and reduced occupancy levels, the Group's receivables experienced significant growth. Receivables moved from J$236.4 million at the end of FY 2019 to J$619.9 million in FY 2020 and then jumped further to J$1.3 billion at the end of FY 2021. 138 Student Living's receivables include a claim under its Concession Agreement for revenues that the Group had to forgo due to the request made by UWI for a change in some of the Irvine Hall residences, from two-bedroom units to one-bedroom units. In FY 2022, the real estate group's receivables balance declined by 29.3% YoY. The lower receivables in that year were primarily attributed to the collection from UWI, Mona in relation to the 90% Occupancy Guarantee and Irvine Hall Claims.

[1] The 138SL Concession Agreement is for a minimum of thirty (30) years and a maximum of sixty-five (65) years.
[2] The Restoration Concession is for a minimum term of twenty-five (25) years and a maximum of thirty (30) years.

Significant amounts of leverage are typically used in commercial real estate financing. Developers often use leverage to increase the potential return on their investment, given that the cost of debt is usually lower than the cost of equity. However, at certain levels too much leverage may translate to an unsustainable level of risk. At the end of FY 2022, the Group's debt to equity (D/E) was 0.97x, significantly lower than the level it was at the end of FY 2018 (1.40x). The lowest D/E recorded over the period under review was at the end of FY 2019 (0.84x), prior to the COVID-19 pandemic. This decrease in the D/E ratio over the years indicates that the Group has managed its debt levels effectively, and the ratio has experienced fluctuations, influenced in part by the impact of the COVID-19 pandemic.

At the end of FY 2022, 138SL's total liabilities stood at J$5.2 billion, 9.6% lower than the level at which it ended the prior year. The debt for the group was J$4.4 billion at the end of FY 2022, almost unchanged from the level it was in the previous year. If the current APO is successful, the company intends to reduce its indebtedness by at least J$1.5 billion. This reduction in debt could potentially lower the Group's D/E ratio to as low as 0.15x, signifying a stronger financial position with lower leverage.

The continued profitability of the Group has led to an increasing trend in Equity over the years under review, with FY 2020 and FY 2021 being exceptions. Total shareholders' equity which was J$3.4 billion in FY 2018 climbed to J$4.6 billion at the end of FY 2022. In FY 2020 and FY 2021, a decline in fair value reserves led to a decrease in the Group's total shareholders' equity, from J$5.5 billion in FY 2019 to J$4.4 billion in FY 2020, however the equity remained at J$4.4 billion at the end of FY 2021.

138SL's Cash Flow

Over the last five years, 138SL's operating cash flow has displayed an increasing trend moving from J$288.2 million in FY 2018 to J$505.0 million in FY 2022. In FY 2021, the Group's operating cash flow dipped to J$141.4 billion, the lowest level over the period under review, largely driven by the growth in receivables during the pandemic. Since then, the Group's operating cash flow has rebounded, which is a good sign as it demonstrates the Group's ability to generate cash from its core business activities under normal circumstances. Additionally, a company with robust operating cash flows may have more opportunities to invest. If the company succeeds in reducing its debt stock, further improvements in operating cash flows are expected. Such a scenario would increase the possibility of the 138SL Group being able to sustainably pay dividends to its shareholders.

9-Month Review

In the first nine months of FY 2023 the 138SL Group reported total revenue of J$1.0 billion which was 17.3% higher than the amount reported for the same period a year earlier. Following the return of face-to-face classes, demand for accommodations on the campus rebounded in FY 2022 and this momentum has continued and improved significantly in the current year. As a result, average room occupancy levels moved from about 50.0% during the nine months ended June 30, 2022, to approximately 86.0% during the 9-month period ended June 30, 2023. Additionally, the Group has successfully capitalized on the robust short-term rental opportunities, which now represents 8.1% of its total revenue. The increase in occupancy rates resulted in a reduction in the UWI Mona 90% guarantee claim, which also led to the decline in UWI Mona receivables over the period.

The Group's improved top-line and moderate cost control led to an operating profit of J$547.6 million for the 9-month period ended June 30, 2023, an 11.2% improvement over the same period a year earlier. Finance cost was only slightly changed at J$269.8 million (up 0.8%) and Profit before taxation increased from J$220.8 million for 9-month 2022 to J$277.8 million. Net profit came in at J$270.1 million, up 13.2% over the previous year.

As at June 30, 2023, the Group's Total assets amounted to J$9.7 billion, which was slightly lower than the level it was at the end of FY 2022. A dividend was distributed to shareholders and the Group made interest and principal payments to its bondholders over the nine-month period. As a result, the Cash & cash equivalents balance for the Group closed the 9-month period at J$26.4 million, down from the J$170.4 million which it closed FY 2022.

Total liabilities stood at J$4.9 billion as at the June 30, 2023, J$244.0 million or 2.5% lower than the J$5.2 billion recorded at the end of FY 2022. This reduction was primarily driven by a J$198.4 million drop in its debt and a J$50.6 million decline in Payables.

Total Shareholders' equity increased by J$216.2 million over the first 9-months of FY 2023 to end the third quarter at J$4.8 billion. This increase was primarily driven by the continued profitability of the Group. However, this was partially offset by the J$53.9 million dividend payment made in January 2023.

Valuation Analysis

To arrive at a fair price for the 138SL shares, we used the price to book (P/B) and P/E methods. The appropriate average P/B ratio and P/E ratios were determined by assessing the real estate companies listed on the Main Market of the JSE, with similar strategies. The weighted average P/B for the selected companies operating within the real estate sector and listed on the Main Market was 0.52x and given that the Group's current book value is J$11.52 this translates to a value of J$5.96 per share.

Investment Positives

Proof of Concept and Track Record: Since its inception, 138SL has successfully implemented its vision of providing high-quality and secure accommodations for students. As of June 2023, the occupancy level stands above 90%, driven by the strong demand for the services it provides. Despite the impact of COVID-19 on some years, the Concession Agreements essentially guaranteed a minimum occupancy rate, providing a safety net. As a result, the company has generated revenues exceeding J$1.0 billion in three of the last five completed financial years and has achieved profits in four consecutive years.

Strong Demand creates potential for steady income: 138SL generates rental income by providing accommodation to students at the UWI Mona campus, and its revenue stream is highly reliable due to its concession agreements with UWI Mona. It is anticipated that the Group could continue to generate steady top-line revenue growth and profitability given the strong current and projected demand for accommodation as the university expands. This is expected to have a positive impact on the Group's bottom line, ultimately benefitting shareholders through consistent dividends.

Concession agreement guarantees long term revenue: 138SL and 138SL Restoration both hold long-term concession agreements which gives them the right to set and collect rental income for accommodation provided, with an average duration of over 25 years. Additionally, the Group has the right of first refusal for any new construction of student accommodation, which puts the Group in a good competitive position. Furthermore, the included minimum occupancy guarantee agreement essentially provides a revenue floor and thereby stabilizes the Group's revenues over both the short-term and long-term.

Real estate provides potential diversification benefit: 138SL is a company operating in the real estate sector. For investors who do not currently have real state exposure, an investment in 138SL may provide diversification benefits.

Debt reduction increases the possibility of sustainable dividends: Currently 138SL's total debt stands at J$4.2 billion. If this APO is successful, the Group anticipates reducing its indebtedness by ~36%. This could translate into interest cost savings of ~J$120.0 million annually, a scenario which could position the company to sustainably make dividend payments to shareholders.

Investment Negatives

Potential Construction Risk: The Group holds the right of first refusal in the event additional residences are to be constructed on the university campus. While this provides potential investment opportunities, investors should be aware of the associated construction risks. These risks may include construction delays, budget overruns and legal disputes, among other potential challenges. In fact, 138SL Restoration previously settled a dispute with UWI Mona which arose out of a variation in the construction of one of its earlier dormitories on the UWI Campus. This adjustment resulted in lower revenues than initially forecasted, highlighting the impact that construction-related issues can have on the financial outcomes of such projects.

Exposure to UWI: The concession agreement with UWI establishes a minimum occupancy level floor at 90%. While this is a valuable safeguard against low accommodation occupancy, it also exposes the entity to the credit worthiness of UWI Mona.

Price Risk: Trading activity on the JSE could result in the stock's price fluctuating, without regard for the operating performance of 138SL. These fluctuations can sometimes cause the stock price to remain below its fair value for an extended period, potentially resulting in lower returns for investors.

Level of interest rates could increase difficulty of raising equity in Capital Market: Currently, investor sentiments towards the local equities market is relatively low compared to the pre-COVID-19 period. Consequently, more investors have been diverting their funds away from equity investments, leading to annual declines in market indices over the past three years. Instead, they have been seeking refuge in money market products that offer relatively attractive rates. In this environment, companies like 138SL that are seeking to raise equity capital may find it difficult at this time. If this APO is not successful, it could potentially delay the Group's ability to consistently distribute dividends to shareholders.

Natural Disaster - A natural disaster such as a hurricane could have adverse effects on the accommodations at the UWI Mona campus and potentially impact the university's financial stability. This could result in disruptions/delays in making payments to the Group. Additionally, there could be damage to the Group's infrastructure, which limits their ability to consistently provide accommodations to clients, until repairs are completed. Further, while the Group has property insurance in place, any settlement under the policy could be less than anticipated and so the Group may need to rely on funds from its operations to complete repairs.

Analyst's Opinion

The 138SL Group has demonstrated commendable growth over the past five years even as it faced extensive challenges due to the COVID-19 pandemic and a decrease in occupancy levels, particularly in FY 2021. Despite these difficulties, 138SL has demonstrated resilience and adaptability, achieving a respectable level of revenue in the difficult year and a significant rebound the following year as the pandemic's effects lessened. The Group also implemented effective cost management strategies that contributed to improved operating profits over the period. Furthermore, the Group has consistently generated profits over most of the past few years, highlighting the strength of its business model, which underpins its financial performance and resilience over the period.

Looking ahead, the Group's results for the current period indicate its ability to sustain growth and profitability in FY 2023, building on the positive momentum from the previous fiscal year. The Group is also well-positioned to continue its steady top-line revenue growth and profitability, benefiting from strong demand as the university expands. Additionally, there is potential for further growth given the high demand for its service and the possibility for the Group to expand its services to other tertiary students (non-UWI students) and into new territories.

The presence of a minimum occupancy guarantee and other beneficial clauses in the Concession Agreements with UWI Mona serves as a safeguard for the Group's revenue over the term. Combined with the niche nature of the market, this favourably positions the Group to consistently report predictable and sustainable revenues. However, it's worth noting that current market conditions and relatively weak investor sentiments towards the equity market, may present challenges for the Group in meeting its expectations, with this offer impacting the reduction in its interest costs and future dividend payments.

Our estimated fair value of the 138SL shares is J$5.96, which implies that shares in this APO are being offered at a discount of 26.17% at its offer price of J$4.40. Additionally, as of September 21, 2023, the market price of the shares on the Jamaica Stock Exchange is below the APO price, thus shares purchased on the market may provide an even greater discount at this time.

Based on the aforementioned we recommend that investors **PARTICIPATE** in this offer and assign a **Medium to High-risk** rating to the stock.