Stock Analysis: LIME

Fundamental Value: $1.44  Market Price: $0.20  

Symbol: LIME

Shares Outstanding: 16,817,439,740 units

Market Value of Shares Outstanding: $2,021,294,117.62

Financial Year End: March 31

Executive Summary: LIME is a subsidiary of the UK’s Cable & Wireless Communications Plc. The local company had been operating as a monopoly for over 40 years until Jamaica liberalized its telecommunications sector in 2001. Since then the company has been battling with archival, Digicel, for market share in the particularly competitive mobile market segment. In 2012, amendments to the Telecommunications Act allowed for a more transparent means of setting call rates. LIME took advantage of this by striking the savvy $2.99 offering, which, to date, is the lowest mobile rate, on average, in the market. For LIME, this deal added additional marketing muscle, thereby enhancing its competitive position. On the other hand, the land-line business, internet data services and, more so, the entertainment line remain significantly less prominent.

Company Overview: The company, headquartered in Kingston, Jamaica, is a communications provider owned by British-based Cable & Wireless Communications Plc. LIME, formerly Cable & Wireless Ja. Ltd, serves both business and residential customers in Jamaica by offering land-line, internet, mobile and entertainment services. The company is listed on the Jamaica Stock Exchange (JSE) with ordinary shares, as well as 2 classes of preference shares with coupons of 5% and 6%. On September 11, 2012 the company changed its Moniker from CWJA to LIME.

LIME had been operating as a monopoly for more than 40 years until Jamaica opened its telecommunications sector to competition in 2001. Digicel then emerged as the main rival in the mobile segment of the market. Other companies such as Mi-Phone (later acquired by Claro Jamaica) and Flow (internet and land-line) also entered the market. In 2011, Digicel acquired the Claro Ja operations, leaving only 2 mobile phone players, LIME and Digicel.

In 2012, the Telecoms Act was amended to give the Office of Utilities Regulation (OUR) the right to set inter-connectivity rates. In addition, the legislation is expected to allow for number portability later this year, which should result in more intense competition.

LIME currently boasts the lowest mobile rates, on average, in the market, using this as a strategy to entice new customers, in an effort to gain market share.

Financial Performance Snapshot

<table>
<thead>
<tr>
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<th>Q1-12</th>
<th>Mar-12 YE</th>
<th>Mar-11 YE</th>
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<tbody>
<tr>
<td>Assets ($billion)</td>
<td>19.65</td>
<td>19.69</td>
<td>35.70</td>
</tr>
<tr>
<td>Net Loss ($billion)</td>
<td>0.40</td>
<td>20.20</td>
<td>6.10</td>
</tr>
<tr>
<td>EPS ($)</td>
<td>-0.03</td>
<td>-1.20</td>
<td>-0.36</td>
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<tr>
<td>P/E (x)</td>
<td>-0.21</td>
<td>-0.13</td>
<td>-0.75</td>
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Outlook: Despite its increasingly competitive operational backdrop, we believe LIME could provide outsized returns to investors over the long-term. With a more concentrated emphasis on the company’s marketing, its reactive approach may be changing. The “Talk EZ” and “XL Value” campaigns introduced in June 2012 could see mobile revenues increasing for the company. In addition, LIME recently struck a deal with American company, Intcomex, that should expand its local outlets for Blackberry and Samsung cell phones. The number portability feature which could be introduced to the market this year could also pave the way to recovery for LIME. On the other hand, with the versatility of mobile technology, we believe the land-line division could become less important in the future thereby forcing the company to rely more heavily on mobile and broadband divisions. Though the company has intensified its marketing campaign around its mobile division, the issue of mobile coverage still exists, particularly in rural areas, thus contributing to the negative sentiments plaguing the product.

It appears that the Broadband Division which faces heavy competition from internet and land-line service provider, Flow, has not been given much prominence by the market. Research conducted by the Mona School of Business in 2011 stated that only 38% of the Jamaican population uses internet daily. This therefore provides an opportunity for LIME to grow that segment of the market. In addition, consumer awareness of the Mobile TV, which is unique to LIME, is lacking. Thus, if marketed well, this also presents an opportunity for the company to develop a new market segment.

On the technical side, demand for the stock is relatively high and could become higher if the price manages to claw its way up, say above $0.40. Without doubt, investors with low risk appetites may want to hold a smaller portion of this stock in their portfolio or none at all at this time.

Projections and Valuation: Given its negative equity position, most accepted models for valuing stocks are unsuitable for valuing LIME. Using the EV/EBITDA Model the stock has a fundamental value of $1.44. However, it is not expected that the market will support this price in the short to medium term, especially given that the recent marketing campaign, which is the company’s most favourable public feat in years, has not resulted in any significant change in the stock price.

1 As at October 2 2012
2 As at October 2 2012
3 A moniker is a symbol or name that represents a company. Also known as a ticker.
Stock Analysis: LIME

Operational Structure

LIME offers a range of products to both corporate and individual clients. The company has four main business lines, Land-line, Internet, Mobile and Entertainment, hence the trading name “LIME.” It offers bundled packages and prepaid and postpaid services.

The Land-line Division is the company’s oldest product catering to residential and corporate customers. Currently it faces competition from Flow Jamaica and recorded a 6% year on year reduction in land-line revenues for the 2011/2012 period, resulting from a decline in the subscriber base. This decline in subscriber base is expected to continue as the local market follows the global trend toward mobile substitution.

LIME was one of the first internet providers in Jamaica along with others such as Anbell (which discontinued internet services in 2010) and Info Chan (which merged with Flow in 2011). The company started offering dial-up services then introduced broadband services as the market got more advanced and competitive. Currently, there are 3 internet providers in Jamaica, LIME, Flow and Digicel. In 2011, the Mona School of Business researched internet usage and access in Jamaica and found that only 24% of the Jamaican population has access to internet at home daily. This highlights that internet has tremendous growth potential. Hence, LIME could use this as an opportunity to capitalize on the remaining 62% of Jamaicans who do not use internet daily and, especially those who do not have any access to internet at all.

The mobile division, which contributes approximately 25% of the company’s revenues, continues to grapple with intense competition from mobile giant, Digicel. In recent months, as a result of the new pricing strategy, LIME indicated that it has seen an increase in its subscriber base. With the proliferation of mobile phones and its ease of use, access and adaptability, the land-line division which currently contributes approximately 45% to the company’s revenues could become less important to the bottom line and contribute a diminishing share of revenues.

The company launched its Mobile TV product, which delivers news, sports and entertainment to consumers in the Kingston Metropolitan Area, in 2011. Currently LIME is the sole provider of this service in Jamaica. Ostensibly, mobile TV has not ignited the imagination of the masses, thus contributing to the underperformance of this division.

Management and Corporate Governance

The senior management team is led by Managing Director, Garfield Sinclair, who brings twenty years of business management experience to the company. Prior to joining LIME, Garfield was President and Chief Operating Officer at investment house, DB&G (now Scotia Investments Ja. Ltd. (SUL)). He holds a Bachelor in Business Administration, an Executive Certificate in Strategy and Innovation from MIT and the CPA certification. Garfield currently sits on the Board of several organizations in Jamaica including Kingston Properties (KPREIT) and Proven Investments.

Head of Retail, Stephen Price, joined LIME in 2010 with over 14 years experience in the telecoms industry. Prior to joining LIME, Stephen was a senior manager at Digicel and World Cup commercial director. He holds a Bachelor of Business Management from UTech.

The Board of Directors is primarily responsible for the company’s system of internal control and for reviewing its effectiveness on a continual basis. The Board has formed two committees, an Audit Committee and a Corporate Governance Committee. However, the PSOJ Corporate Governance Code states that companies should also have a Remuneration Committee that is responsible for the development of a remuneration policy and a Nomination Committee that is responsible for election and re-election of directors. LIME currently has neither of these, speaking to a need to fortify its corporate governance framework.

<table>
<thead>
<tr>
<th>Directors</th>
<th>Experience</th>
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<tbody>
<tr>
<td>Chris Dehring (Chairman)</td>
<td>Former CEO- ICC Cricket World Cup 2007; Founding Partner &amp; CEO- DB&amp;G (now SUL); Former CMO- West Indies Cricket Board (WICB)</td>
</tr>
<tr>
<td>Mark Kerr-Jarret</td>
<td>Managing Director- Barnett Group of Companies; Director- Greater Mo-Bay Re-Development Co Ltd; Chairman- St. James Parish Development Committee; Former President- Mo-Bay Chamber of Commerce; Former Director- Guardian Asset Management</td>
</tr>
<tr>
<td>Patrick Rousseau</td>
<td>Attorney-at-law; Consultant- Myers, Fletcher &amp; Gordon; Former Director- LOJ (now Sagicor); Former Director- CCC; Former Director, DB&amp;G; Former Director- WICB</td>
</tr>
<tr>
<td>David Shaw</td>
<td>CEO- LIME Caribbean; Former Director- Energis; Former Chief Commercial Officer- CW-Europe, Asia and US</td>
</tr>
<tr>
<td>Garfield Sinclair</td>
<td>Managing Director- LIME; Chairman- JSE Pension Fund; Chairman- KPREIT; Director-Proven Investments; Former President &amp; COO- DB&amp;G (now SUL);</td>
</tr>
<tr>
<td>Kamina Johnson-Smith</td>
<td>Attorney-at-law; Senior Legal &amp; Regulatory Counsel-LIME; GOJ Senator; Former Director- Factories Corporation of Jamaica</td>
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Stock Analysis: LIME

SWOT Analysis

Strengths
- Jamaica’s only full service provider
- Diversified product line (land-line, internet, mobile, entertainment (TV))
- Lowest average mobile rates in the Jamaican market
- Management is cognizant of the precarious position it is in and is realistic about the options to move forward

Weaknesses
- Company has been operating at a loss for 4 years
- Negative equity (liabilities exceed company assets)
- Heavy competition from Digicel and Flow
- Negative sentiments attached to the company
- High turnover in personnel, especially in leadership positions

Opportunities
- Number portability could make it easier to acquire new subscribers
- Company’s relatively small subscriber base offers larger growth potential
- Low internet penetration across the Jamaican population offers growth potential in internet division
- Company could venture into more ‘entertainment’ products

Threats
- New data provider is slated to enter market by year-end 2012
- Land-lines could become less relevant in the future

Dividend Schedule

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<tbody>
<tr>
<td>Payment Date</td>
<td>Feb 18</td>
<td>Nov 26</td>
<td>Sep 8</td>
<td>Sep 21</td>
<td>Jan 30</td>
</tr>
<tr>
<td>Amount (J$)</td>
<td>0.015</td>
<td>0.015</td>
<td>0.04</td>
<td>0.06</td>
<td>0.024</td>
</tr>
</tbody>
</table>

The company’s history of dividend payments would suggest that, in the past, it maintained a dividend policy of paying a dividend once per year. However, the company has not paid a dividend since 2008, most likely as a result of the weakening of its financial position. Given its continuing loss making position, it is not expected that the company would resume making dividend payments over the medium term. Should the company’s fortunes change, however, it could resume dividend payments. Investors in this stock should not rely on it for regular income needs. Of note, the company declared dividends on its 2 preference share issues, a move that could signal that it is positioning itself to be able to pay ordinary dividends in the near future. Companies are not permitted to pay ordinary dividends if there are outstanding preference dividends.

<table>
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<tr>
<th>Top 10 Shareholders</th>
<th>Number of Units Held</th>
<th>Percentage Held</th>
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<tbody>
<tr>
<td>CWC CALA Holdings Ltd</td>
<td>13,285,777,982</td>
<td>79.00%</td>
</tr>
<tr>
<td>Kelfenora Ltd</td>
<td>504,523,212</td>
<td>3.00%</td>
</tr>
<tr>
<td>LOJ PIF Equity Fund</td>
<td>185,202,894</td>
<td>1.10%</td>
</tr>
<tr>
<td>Carl Marks and Company Inc</td>
<td>156,889,759</td>
<td>0.93%</td>
</tr>
<tr>
<td>Trading A/C- National Insurance Fund</td>
<td>96,273,768</td>
<td>0.57%</td>
</tr>
<tr>
<td>CASA Corporation Ltd</td>
<td>64,960,272</td>
<td>0.38%</td>
</tr>
<tr>
<td>Peter Forde</td>
<td>60,117,493</td>
<td>0.35%</td>
</tr>
<tr>
<td>Fortress Mutual Fund Ltd/FCIB C1191</td>
<td>52,925,499</td>
<td>0.31%</td>
</tr>
<tr>
<td>Mayberry West Indies Ltd</td>
<td>51,172,318</td>
<td>0.30%</td>
</tr>
<tr>
<td>MF&amp;G Trust &amp; Finance Ltd</td>
<td>50,340,069</td>
<td>0.29%</td>
</tr>
<tr>
<td>Total</td>
<td>14,508,183,266</td>
<td>86.23%</td>
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Stock Analysis: LIME

Financial Analysis: The company’s financial year ends March 31. We have analyzed the results for the last 4 years (2009-2012) and the June 2012 (Q1) quarter.

Revenues: LIME recorded a marginal decline in revenues for year ended March 2012, reflecting a decline in land-line revenues as a result of a decline in subscriber base and usage. Meanwhile mobile revenues increased 3% year on year and Enterprise/Data (internet) revenues increased 12% year on year driven by increased sales to corporate customers.

The company’s consolidated revenues have been declining since 2010 owing to declines in land-line revenues as consumers move to data and mobile as the primary mode of communication. In the past LIME’s mobile segment was not marketed well when compared to main rival, Digicel, resulting in Digicel capturing majority mobile market share. However, with the lowering of mobile rates and a newly energized marketing team, average revenue per user is expected to increase going forward. In addition, 5% growth in revenues as reported in the Q1 (April-June 2012) results could improve going forward.

Expenses: Total operating expenses, which increased up to 2011, declined 5% in 2012. Employee expenses and selling expenses have been increasing while administrative expenses have been declining over the four year period. Marketing expenses have fluctuated over the period in review. Notably, the company allocates the least amount of money to marketing while selling attracts a larger portion suggesting that the company has been using a strategy of direct selling rather than marketing (with mass media). However, going forward, this may change. Given the recent $2.99 campaign and an energized marketing team, marketing expense is expected to rise in the 2012/2013 financial year.

Balance Sheet: YE 2012 results showed a 45% decline in asset base when compared to the previous year, reflecting a non-cash impairment adjustment to fixed assets. The need to recognize impairment charges was triggered as the company’s actual results continued to be lower than anticipated. Liabilities increased 25% YOY reflecting a $25 billion revolving loan facility with Cable & Wireless Jamaica Finance (Cayman) Ltd. LIME recorded a stockholder’s deficit of $14 million owing largely to the foregoing. This deficit or negative equity position caused the company to be in breach of the JSE capital adequacy rules and, if not corrected, could eventually result in delisting from the JSE.

Cash Flow: Net Cash Flow provided by Operating Activities fell by $4 billion, with LIME using $1billion in FY 2012, mainly due to the $20 billion losses incurred in FY 2012. Net Cash provided by Financing Activities increased 288% due to an increase of $3 billion in loans from other group companies. In addition, the company reported $59 million in dividends forfeited in 2012, which boosted Cash from Financing Activities. Net Cash used by Investing Activities declined 50% due to inflows of $50 million from the disposal of assets. In addition, the company invested $3 billion on the continued expansion of its network, energy saving projects, customer-facing software and the LIME TV product. This investment resulted in a 50% increase in capital expenditure YOY. At the end of the year the company recorded a 25% increase in cash and cash equivalents.

1. The company amended its Articles of Incorporation to declare that all dividends left unclaimed for a year would be invested or otherwise made use of by the Directors until claimed. This $59 million represents dividends unclaimed for 12 years.
Stock Analysis: LIME

Ratio Analysis

Financial Health: LIME’s total debt increased over the period under review as the company sought assistance from the parent and other affiliated companies. In addition the company’s assets have been declining. As a result the debt to asset ratio has been increasing year over year.

Liquidity: LIME’s cash in hand position for FY 2012 increased 25% year over year and is reflected in an increase in the cash ratio. For the period 2010 to 2012, the company recorded marginal increases year over year in current assets. Meanwhile current liabilities increased for the period 2009 to 2011 and decreased in 2012. The decrease in 2012 reflects decreases in bank overdraft, payables and a line of credit from Proven Wealth that was not renewed. As a result, the current ratio increased 54% in 2012.
Stock Analysis: LIME

Inventory turnover which represents the amount of times LIME’s inventory is sold and replaced over the year has been declining. This supports the claim that consumer demand has been shrinking. Consumer demand may increase going forward as consumers are lured by the low rates. However, the company cannot rely solely on low rates to new customers but should also focus on other aspects of customer retention which, over the years, it has not been addressed successfully, such as mobile coverage and customer service standards.

Profitability: Profitability continues to be dampened by the heavy competition, particularly in the mobile industry. The company recorded $20 billion in net losses for FY ended March 2012, largely due to impairment charges of $15 million. This represents a YOY increase in losses of over 300%. Excluding impairment charges the company would have recorded losses of $5 billion, a 20% increase in losses from the previous year. Operating losses were also recorded for the period 2010-2012. Consequently, both operating profit margin and net profit margin have been in the negative realm since 2010. It is noteworthy that LIME has been recording losses since 2008 while revenues have remained relatively stable. As a result, ROE and ROA too have been negative.
Stock Analysis: LIME

Price Movement
This stock traded at a 52-week high of $0.24 at a time when LIME has revamped its marketing team. LIME’s newest marketing campaign, the savvy $2.99 offering, to date, is the lowest mobile rate, on average, in the market. For LIME, this deal added wireless spectrum and additional marketing muscle, thereby enhancing its competitive position. Hence, investors saw this as a positive turning point for the besieged company and, as such, demand for the stock increased. Prior to this, in August 2011, the stock traded at its 52 week low ($0.14) during a period when the company was being plagued by high competition and a marketing strategy that was not apparent. As a result, investor confidence dwindled and so did the demand for the stock.

LIME’s stock is liquid with trading taking place daily. Trading volumes are often high relative to other companies on the JSE possibly due to the low price of the stock.

Outlook
Because of the prominence of the mobile market, with Digicel’s aggressive marketing approach, LIME has placed great emphasis on its mobile division, which has suffered due to the company’s alienation of its client base, particularly in the 1990s. As a result, and given the lower level of competition in its other lines of business, it appears that LIME has not been focusing as much on the other business lines such as internet, land-line and entertainment divisions. While worldwide trends indicate that data will become the primary mode of communication over the next five years, research conducted by the Mona School of Business in 2011 stated that only 38% of the Jamaican population uses internet daily. This provides an opportunity for LIME to capitalize on the remaining 62%. The Broadband Division which faces heavy competition from internet service provider, Flow, has not been given much prominence in the media. In addition, product awareness of the mobile TV, which is unique to LIME, is lacking.

Since the start of 2012, the company has placed a more concentrated emphasis on marketing, particularly surrounding the mobile division. Whilst this could see revenues increasing, the other business lines which currently contribute 75% of the company’s revenues still require attention.

Going forward, the number portability feature, which could be introduced in the market this year, could also pave the way to recovery for LIME. However, the issue of mobile coverage still exists, specifically in rural areas, thus contributing to the negative perception attached to the product and, by extension, the company.

On the technical side, demand for the stock is relatively high and could become higher if the price surpasses its 52-week high, perhaps hitting 40 cents. Without doubt, investors with low risk appetites may want to hold a smaller portion of this stock in their portfolio or none at all at this time.

The recent marketing campaign, which may have been LIME’s most promising opportunity since the emergence of Digicel, has not caused any
Stock Analysis: LIME

significant improvements in the stock price outside of its 52-week trading range. Although the full effect of the “$2.99” campaign spending has not yet been reflected in the company’s financials, we are aware that marketing and advertising costs too have increased, which could result in exacerbated losses if this is not translated into higher revenue. In addition, the negative equity position has put the company in a position where it has breached JSE capital adequacy rules and so risks delisting from the Exchange. However, this deficit position, which stemmed from impairment charges, is a one-off event so LIME is not expected to remain in this position when the company publishes its 2013 financial results.

Projections and Valuation

The Enterprise Value/EBITDA is the most appropriate method for valuing LIME. The Enterprise Value is the total value of a firm in excess of the value of any cash and investments held. This method uses market values since it approximates the price a buyer would pay for the whole firm. EBITDA represents the prospective cash flows to all the firm’s capital providers. The EV/EBITDA method yields an intrinsic value of $1.44. For a stock that traded at $0.20 on October 2, 2012, this means it is significantly undervalued. However, it is important to note that we do not expect the stock price to reach this value of $1.44 in the short to medium term. A turnaround from losses of $20 billion and an equity deficit of $14 billion is a difficult situation for a company that operates in a highly competitive market to emerge from, especially when there are negative sentiments still attached to it. In essence, it will take time for LIME to recover.

Conclusion and Recommendation

LIME continues to be plagued by heavy competition. Its main rival in the Mobile Division, Digicel, brought access to the market to a wide cross-section of people who were previously locked out by LIME either because of the prohibitively high prices or because the company did not offer the service to a wide enough geographical area. Digicel built a strong reputation in the market while consumers have maintained the perception of poor service by LIME. In addition, Flow, which provides internet and land-line services also entered the market with a superior product, and has been successful at taking market share from LIME. The company has not signaled a strategy to compete aggressively with Flow on its internet and land-line services in the same prominent manner with which it competes with Digicel. Evidently the company has sought to place more emphasis on mobile services and products in its mass marketing campaign. However, this strategy could result in broadband and land-line revenues declining further, perhaps placing these divisions in a vulnerable position, similar to where the mobile division is now.

LIME is a very risky investment. Importantly, higher risk yields greater expected returns and so it may be in the case of LIME. At current market price levels, the stock offers an excellent entry price for investors who could earn favourable returns if the stock hits its current fundamental value of $1.44 which may be the case over the long term, should the company survive. Therefore, we recommend this stock as a HOLD. Notably, this stock is not appropriate for risk adverse investors.

Prepared by VMWM Research Department, October 19, 2012