

# Blue Power Group Limited Analysis



The following analysis takes an in-depth look at the historical performance of Blue Power Group Limited and utilizes various valuation methodologies to determine the fair value of the Company's shares.

## **Company Overview**

Established in 1998 by founder and Board Chairman Dhiru Tanna, Blue Power Group Limited (BPOW) is incorporated and domiciled in Jamaica and is listed on the Junior Stock Exchange. BPOW operates two divisions: Lumber Depot, a retailer of construction and hardware supplies including cement, steel, lumber, plumbing and electrical supplies; and Blue Power; a manufacturer of laundry and beauty soaps including the popular Blue Power cake laundry soap.

## **Management and Corporate Government**

The Board of Directors of BPOW consisted of six members up until 2013, when the number of seats was increased to eight. This was done due to the small number of non-executive directors on the Board which led to the same directors being appointed to the various committees in order to achieve a balance of executives and non-executives. While majority of the board members are shareholders which helps to keep their interests aligned with minority shareholders, this is not in line with international best-practice standards which recommends that 75% of the board be totally independent.

Major Noel Dawes serves as the current Managing Director, with the rest of the board serving as non-executive members. This is in keeping with the Private Sector of Jamaica's Code on Corporate Governance which recommends that a minimum two-thirds (67%) of any board should consist of non-executive members. Tanna previously served as both Managing Director and Chairman up until 2012. This move has improved the management structure of BPOW by creating a clear division of responsibilities at the head of the Company between the running of the Board (the Chairman) and the executive responsible for the running of the Company's business (the CEO).

## Porter's 5 Forces Model

### *Bargaining Power of Buyers: Moderate to High*

The company focuses on a niche market which is very price sensitive. There is less bargaining power in the laundry soap market where it controls a significant portion of the market and its product is attractively priced relative to its only other competitor.

### *Bargaining Power of Supplier: Moderate*

There is no single supplier of raw materials locally. The major input for the soap manufacturers is vegetable oil or palm oil which is exported by only a few countries thereby giving suppliers a commanding position. However, several grades of palm oil are available so the manufacturer can switch between inputs to save costs. On the lumber division side, the company imports most of its products from several overseas suppliers and few local suppliers.

### *Rivalry amongst competitors: Moderate to High*

Customers are price sensitive and switching to another product is very simple given the wide range of products to choose from. The Soap Division caters mainly to the 'cheap soap' market where price means much more than brand loyalty thus there is great competition between suppliers. Rivalry amongst Lumber Division competitors is also high given customers desire to always get the best value for their money but is less so than in the Soap Division given Lumber Depot's geographical advantage.

### *Threat of New Entrants: Low*

Capital required for the manufacturing process is very high especially if a company aims to manufacture standardized quality soap. Furthermore, there exist high exit barriers in the industry due to high capital investment. This is not the case on the Lumber Division side as there is not much capital investment similar case on the lumber division side.

### *Threat of Substitutes: Moderate to High*

With consumers focusing mainly on bar soap prices and not brand loyalty along with low switching costs and a high number of substitutes, the threat of substitutes is high. Furthermore, there are also numerous powered laundry products available. In the Lumber division, there are several hardware stores in the Kingston area where consumers can switch to fairly easily.

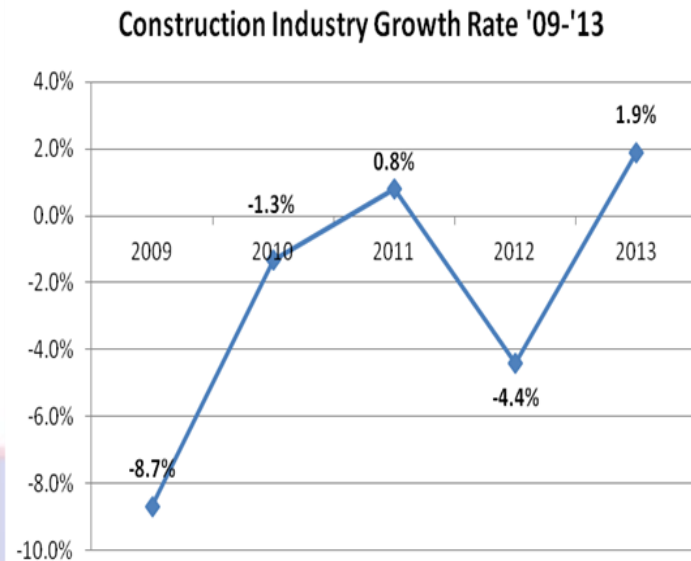
## SWOT Analysis

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• The largest manufacturer of soaps locally.</li> <li>• The Group has diversified revenue streams which reduces concentration risk and therefore vulnerability</li> <li>• Partnerships with several strong distribution companies augur well for increased production and revenue growth.</li> </ul>	<p><b>Weakness</b></p> <ul style="list-style-type: none"> <li>• The lumber depot division is susceptible to the downturn in the construction sector.</li> <li>• The relatively small percentage of individual income which laundry soap accounts for, means that some individuals may be indifferent among Cake Soap brands and the demand for the product could be inelastic.</li> <li>• The lumber division is small and may be insignificant to fulfil the demand in that geographical area.</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Overseas growth potential if the company's soap product can gain acceptance.</li> <li>• Further penetration of the local soap market through new and improved product offerings and promotional activities to gain market share.</li> <li>• Movement up the value chain in the soap division by also offering premium products.</li> <li>• Expansion of its lumber division into other areas of the island could help to drive bottom line growth.</li> <li>• Approximately 90% of bath soaps sales come from imports which points to significant market share up from grab via import substitution.</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Rising price of raw materials will be difficult to pass on in a competitive environment and likely put pressure on profit margins.</li> <li>• Reduction/Removal of the duty on imported soaps could put the company at a disadvantage relative to imported products.</li> <li>• Both divisions of the company operate in a competitive market which could keep margins low.</li> </ul>

## Industry Analysis

### Lumber Division

The flagship division, Lumber, operates out of one store located in the Papine area. The Division operates in a competitive market as it has to compete with several large hardware stores and contend with an anaemic construction industry - which has grown only 2 out of the past 5 years.



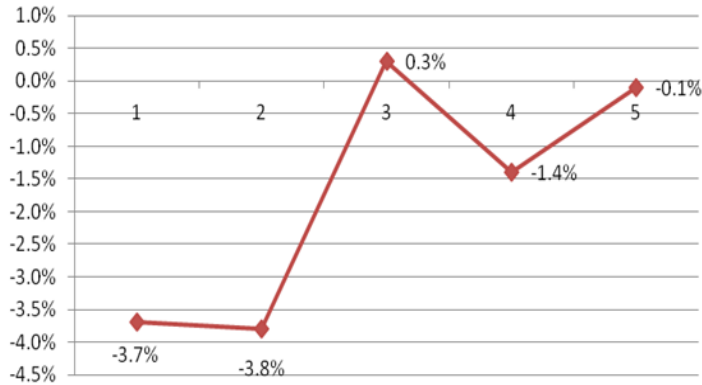
These factors have driven the low growth seen in the Lumber Division (compound average 6.5% growth per annum over the last 5 years) and low profit margins (5.8% 5-year average). The outlook for the construction industry has improved in the past year with the sector recording positive growth in 4 of the last 5 quarters. PIOJ stated that the short-term prospects for future growth are based on the implementation of growth-inducing capital projects in the areas of logistics; hotel; and road construction which should augur well for the Construction industry.<sup>1</sup> With the steadily improving economic outlook this growth may continue as businesses and consumers confidence levels improve spurring greater spending which may translate to growth in the Lumber division.

---

<sup>1</sup> Planning Institute of Jamaica

Blue Power Division

Wholesale & Retail; Repair & Installation of Machinery Growth Rate '09-'13



This division manufactures and distributes bath and laundry soaps under its own brand and also manufactures products for other distribution companies. The company targets consumers searching for a balance between quality and affordability which will work well in times of economic hardship. The Soap

Market, in particular bathing soap, is a highly competitive market, driven and affected by the disposable incomes of consumers. As such, sales are volume-driven as opposed to value-driven, and a wide distribution network is critical to soap manufacturers. According to Blue Power's management, over 50 brands of soaps are offered by major supermarkets, of which imports accounting for 90%.

Due to the large number of substitutes that sell at similar price points, the Soap Division's margins are low and the company has very little room in which to adjust prices. The Wholesale & Retail industry expanded just once in the past five years which indicates how difficult suppliers have had it in recent times. The industry's performance was negatively impacted by lower business and consumer confidence as well as reduced government spending, restricting growth.

BPOW sees the Soap Division as the key to the company's future and has invested heavily into the division to allow it operate more efficiently and meet the demands of markets outside of Jamaica buy purchasing additional machinery to improve its turnaround time, while penetrating the market through increased product offerings.

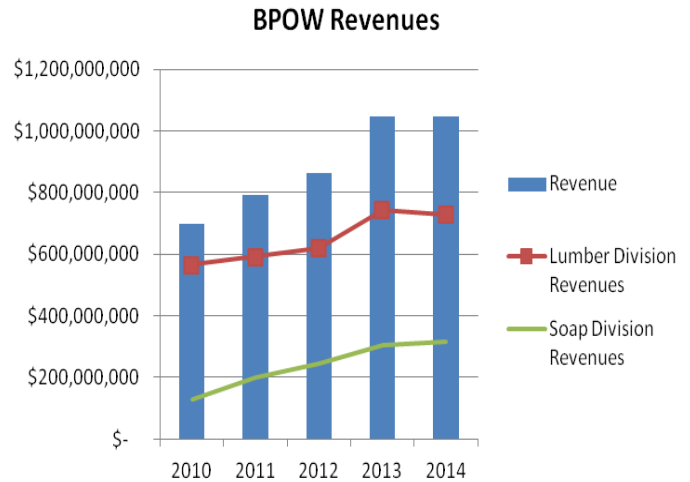
BPOW plans to add three new soaps to its product line which includes 10 different bars of Castile soap, as well as the brands produced for AriLabs, GraceKennedy and Lasco. With imports

accounting for such a large portion of the market, there is a significant import substitution opportunity for the company.

## Historical Performance

### Income Statement

Revenues have grown 50% from \$696 million in 2010 to \$1.05 billion in 2014. Revenues have grown at a compound average rate of 11% over the past 5 years. The lion's share of BPOW's revenues are generated by the Lumber Division, which contributed \$728 million (70%) of the \$1.05 billion recorded in 2014.



Revenues have grown slowly in the Lumber Division (average rate of 6%), compared to the 25% annual growth rate in the Soap Division. Consequently, the revenue share of Lumber to Soap division has moved from 81%-19% in the 2010 to 70%-30% in 2014.

After three consecutive years of growth, growth was flat in the 2013/2014 financial year due to the contraction of demand in the economy and the lack of demand from a foreign agency which engaged the services of BPOW in the previous two years.

Net profit closed 2014 at \$86 million, down 13% from the prior year but up 66% from 2010. Net profit have grown at a pace of 13% per annum over the past five years. The company has benefitted from the tax holiday awarded to Junior Market-listed companies, paying no tax from 2012 to the current period. Net profit has not grown consistently, down from the previous year in 2012 and 2014. This is due to the non-recurrence of significant contracts with a foreign agency in the previous year that was not repeated in the following year.

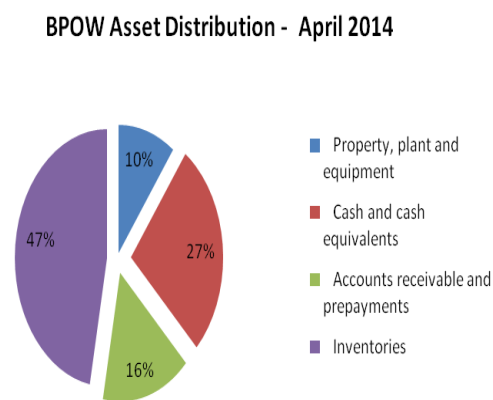
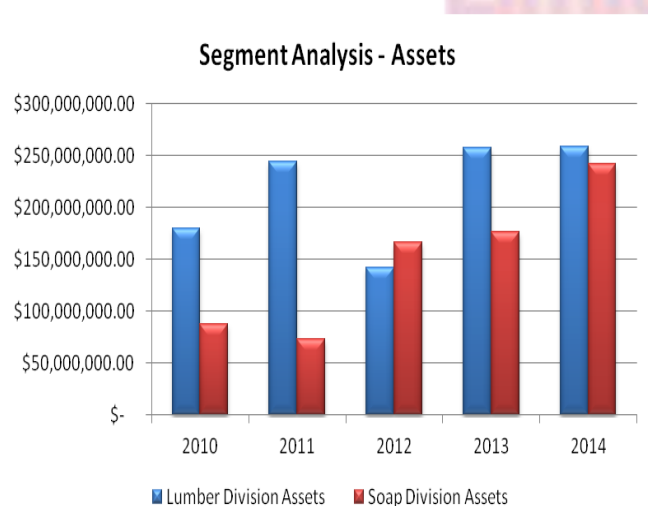
While the Lumber Division accounted for 70% of revenues in 2014, the Soap Division accounted for 54% of net profit for the period. The Soap Division's margins are higher than that of the Lumber Division, averaging a net profit margin of 10% over the past five years compared to 6% for the Lumber Division.

Dupont Method	2010	2011	2012	2013	2014
Net Margin	4%	7%	5%	10%	9%
Asset Turnover	260%	249%	279%	242%	209%
Equity Multiplier	177%	154%	125%	126%	116%
ROE	19%	27%	19%	30%	22%

BPOW's return on average equity (ROAE) has fluctuated over the past 5 years. As equity has consistently grown, net profit has fluctuated. ROAE was 22% in 2014, down from 23% in 2013 and 19% in 2010. The Dupont Method shows that the growth in ROE stemmed from the more than doubling in net profit margin, but tempered as leverage and asset turnover both steadily declined over the past five years. The fall in BPOW's asset turnover is worrying as it indicates a decline in efficiency in the company's operations.

### Balance Sheet

Total assets amounted to \$500 million as at April 30, 2014, up 15% over 2013 and up 87% since 2010. Despite being a manufacturing company, property, plant & equipment accounts for just 10% of total assets.





Non-current assets represented just 12% and 10% of segment assets for the Lumber and Soap Division, respectively. This can be explained by the fact that the Lumber Division retails construction supplies while the machinery required for soap production is relatively inexpensive.

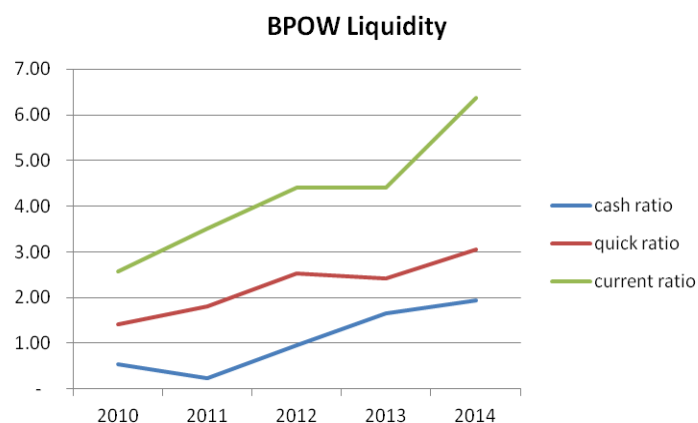
		2010	2011	2012	2013	2014
Days Inventory Outstanding		-	66	65	65	91
Days Sales Outstanding		-	46	41	28	25
Days Payables Outstanding		-	38	33	32	35
Cash Conversion Cycle		-	74	73	61	81

Inventories, representing 47% of total assets, amounted to \$234 million in 2014. Inventories have grown at an average rate of 24% per annum as BPOW increased the range of products it offers consumers. Days Inventory Outstanding (DIO) shows that BPOW has had issues in the past year offloading stock as the amount of days it takes to sell inventory has increased significantly.<sup>2</sup>

Accounts receivables amounted to \$78 million as at 2014, up 16% from the previous year but just 5% in the past five years and was below the five-year average of \$87 million. BPOW's success in collecting on credit sales is highlighted by Days Sales Outstanding which closed 2014 at 25 days, down from 46 days in 2011.<sup>3</sup>

BPOW has no debt or long-term liabilities. Total liabilities amounted to \$71 million as at April 30, 2014, 14% of total assets.

The second largest category was cash & cash equivalents which amounted to \$136 million which has grown at an average rate of 30%



<sup>2</sup> A financial measure of a company's performance that gives investors an idea of how long it takes a company to turn its inventory into sales. Days inventory outstanding = (average inventory / cost of goods sold) \* 365 days

<sup>3</sup> A measure of the average number of days that a company takes to collect revenue after a sale has been made. Days sales outstanding = (average receivables / sales) \* 365 days

per annum. BPOW maintains strong liquidity, evidenced by the strengthening cash, quick and current ratios.

BPOW's cash conversion cycle has increased from 74 days to 81 days, mostly due to the aforementioned issues the Company appears to be having in quickly selling inventory.

### First Quarter Summary

For the first quarter ended July 31, 2014, Blue Power posted revenues of \$278 million, 13% greater than the \$246 million reported for the corresponding period of the previous financial year. Lumber Depot sales rose just 5% to \$185 million while the Blue Power division's sales jumped 33% to \$93 million. Net profit amounted to \$29 million, down 4% from \$30 million.

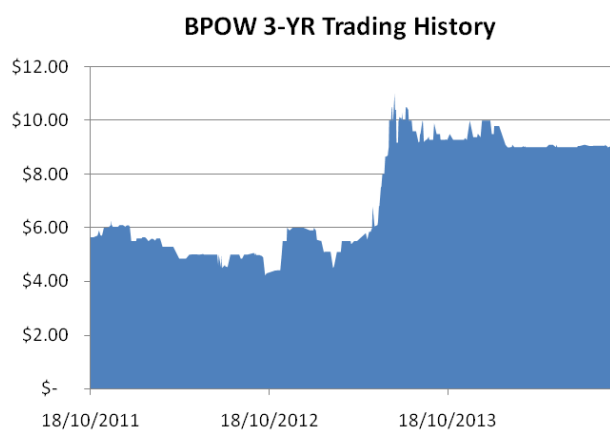
### Technical Analysis

BPOW last traded at \$8.00 which is just 3.9% above its 52-week low of \$7.70 and 20% below its 52-week high of \$10.00.<sup>4</sup>

The stock price dipped in January 2014, falling from the high of \$10.00 to settle around \$9.00. The share price hovered at that level until October 15, 2014, when

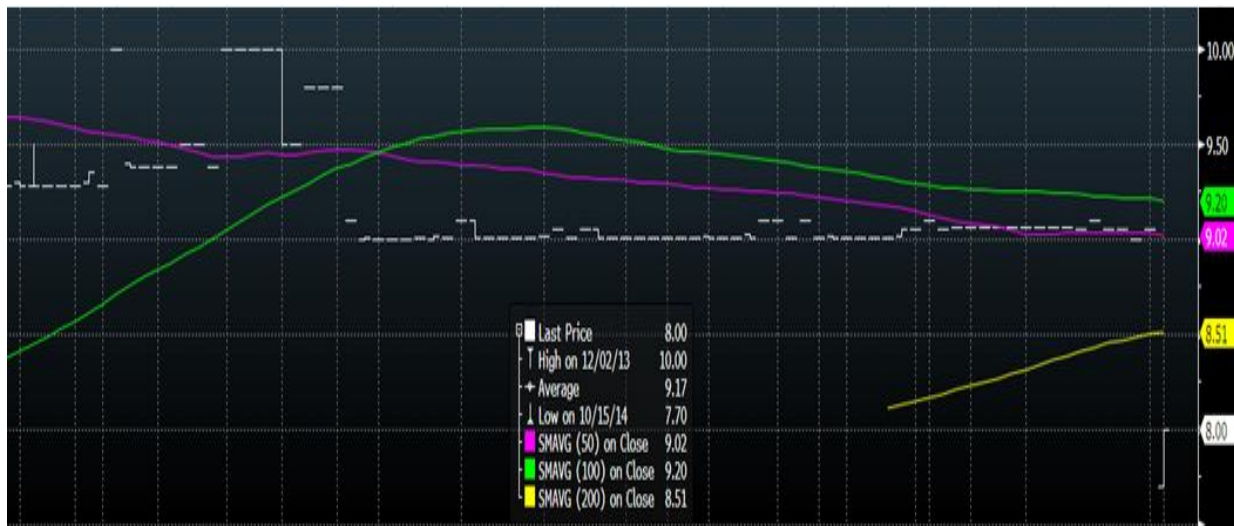
the stock price fell 14% to close at \$7.76. BPOW fell 0.11% during September 2014 from August and is down 20% year-to-date and 15.8% from a year ago when it traded at \$9.50.

Trading has been fairly mute over the last twelve months with shares moving across the floor on just 104 of the 281 trading days in the past year, or 37%. The average daily trading average was 70.3k shares which represents a negligible 0.12% of the total float of shares outstanding. The low trading activity of BPOW can also be attributed to the fact that the top 10 shareholders account for all of 90% of the total float.



<sup>4</sup> Last day accounted for is October 15, 2014

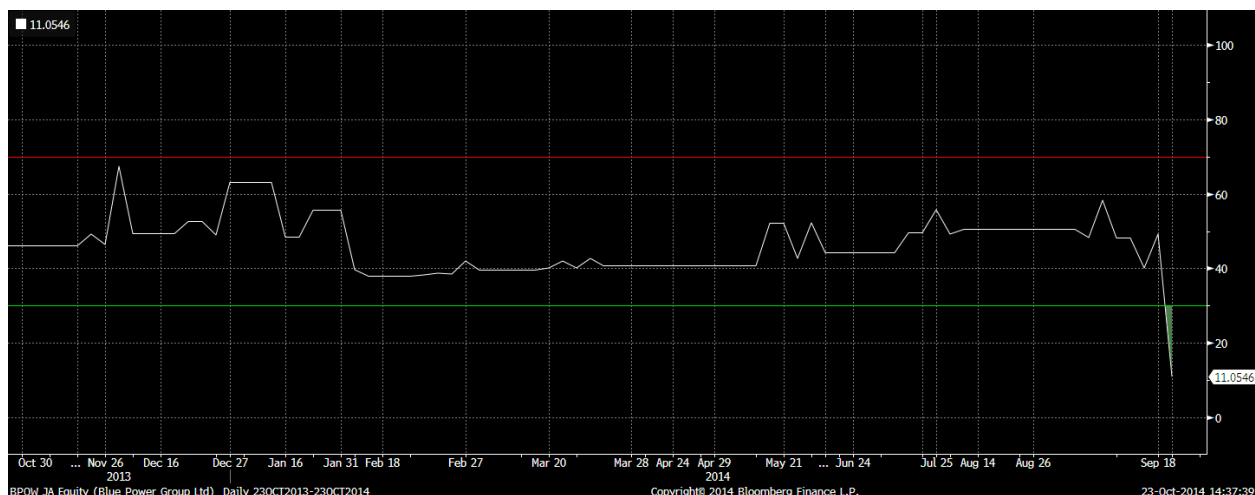
The 50 and 100-day Simple Moving Averages (SMA) have both been on the decline since January 2014, indicating the stock is moving in a downward trend. In January, the 50-day SMA crossed over the 100-day SMA a signal of a trend reversal. Since then the stock has traded downward. The BPOW's 50-day Simple Moving Average (SMA) closed at \$9.02 on October 15, 2014, below the 100-day SMA of \$9.20, which also signals a downward movement in the trend.



### Momentum Technical Indicator: Relative Strength Indicators

The Relative Strength Indicators (RSI) is a momentum indicator which measures the velocity of a security's price movement to identify overbought and oversold conditions. RSI is used to recognize potential turning points to help make entry/exit decisions. BPOW has an RSI of 11.05<sup>5</sup>, which is a strong BUY signal from a technical standpoint.

<sup>5</sup>RSI = 100 - 100/(1 + RS\*) where RS = Average of x days' up closes / Average of x days' down closes. A RSI value greater than 70 indicates an overbought condition while a sell signal is usually triggered when the indicator crosses 70 from above.



## Outlook and Financial Projections

Revenues are seen growing 11% for the 2014/15 financial year to \$1.16 billion with net profit growing 15% to \$107 million (EPS: 1.90), This projection is based on the assumptions that: 1) the Lumber Division's sales will benefit from the slowly improving economic outlook which should translate into greater construction expenditure; 2) continued growth in the Soap Division sales through greater product offerings, increased awareness through stronger marketing efforts and improved consumer spending as the benefits of the recent moderate economic expansion trickles down to households; 3) cost-savings stemming from solar installations and lower operating costs due to the recent stability seen in the foreign exchange market and its impact on fuel and raw material expenses.

## Valuation Methodology

### Price Multiples Approach

Utilizing the 1-year historical price-to-earnings (P/E) ratio of 4.99X, which compares favourably to the current junior market P/E of 6.09X for manufacturing companies, a \$9.47 share value was derived based on the projected EPS of \$1.90. Based on a projected book value per share of

\$9.32<sup>6</sup> at the close of the 2014/15 financial year and a 1-year historical price-to-book value ratio (P/BV) of approximately 1.25X, a price of \$11.67 was derived.

### Dividend Discount Method

This method is used to assess the value of a minority stake in a company. We have used the 2-Stage Dividend Discount Model (DDM) given the company pays dividends consistently and is in a phase of high growth due to the tax concessions awarded to the company while listed on the Junior Market. The 2-stage DDM produced a value of \$8.39.

Beta	Risk-free Rate	Risk Premium	Cost of Equity	High Growth Rate	Stable Growth Rate
0.61	10.80%	4.00%	13.25%	19.77%	10.00%

***The average target price is \$9.84 which is 23% greater than the stock's last traded price of \$8.00 on October 15, 2014. Given a dividend yield of 1.50% for 2014, the total potential return on BPOW is approximately 24.5%. As such, the stock is a recommended BUY at the current price.***

### **Conclusion**

Blue Power Group Limited operates in fairly competitive business spaces with several competitors and relatively low margins. However, the management has been able to utilize the benefits of listing on the Junior Stock Exchange to its full potential and has seen its revenues and profits increase significantly in the past five years. There remains room for further growth if the Company continues to focus on the Soap Division which currently has the most opportunities. This stock is appropriate for investors with a medium to long-term investment horizon who are willing to accept small dividends in the medium-term while the Company reinvests the bulk of profits back into the business to drive growth.

---

<sup>6</sup>The projected book value was derived by applying the historical retention rate of approximately 91% to the estimate of net profit for 2014/15 which was then added to BPOW's retained earnings as at April 2014. The current Junior Market manufacturing sector P/BV average is 0.89 times

## Appendix

### Abridged Financials

J\$	FY2012	FY2013	FY2014	% Δ 14/13	3 MThs ended July 2014
<b>Income Statement Highlights</b>					
Revenues	863,003,193	1,047,851,665	1,045,837,048	(0.2%)	277,890,318
Cost of Revenues	698,585,331	815,583,312	827,542,842	1.5%	211,885,950
Gross Profit	164,417,862	232,268,353	218,296,206	(6.0%)	66,004,368
Operating Expenses	117,947,495	136,505,302	134,958,430	(1.1%)	40,350,496
Operating Income	46,470,367	95,763,0510	83,337,776	(13.0%)	28,516,877
Net Income	47,105,559	103,979,553	93,102,412	(10.5%)	28,683,100
<b>Balance Sheet and Cash Flow Highlights</b>					
PPE	39,152,257	42,996,708	50,183,909	16.7%	63,817,880
Cash and cash Equivalents	58,434,760	145,350,305	136,283,747	(6.2%)	155,818,875
Accounts Receivables	94,550,969	67,326,288	77,859,110	15.6%	81,338,253
Inventories	114,691,3180	176,852,754	234,444,144	32.6%	220,454,994
Accounts Payable	57,504,015	87,092,022	70,356,085	(19.2%)	64,601,677
Short-term Debt	2,500,000	552,525	n/a	(100.0%)	n/a
Long-term Debt	552,525	n/a	n/a	n/a	n/a
Shareholders' Equity	247,261,590	345,308,748	429,936,310	24.5%	458,619,410
Operating Cash Flows	102,177,088	104,710,953	12,936,660	(87.6%)	34,040,181
Capital Expenditure	1,989,607	10,311,061	12,337,302	19.7%	14,527,348
Free Cash Flow	100,187,481	94,399,892	599,358	(99.4%)	19,512,833
<b>Ratios</b>				<b>Δ 14/13</b>	
Gross margin (%)	19.1	22.2	20.9	↓	
Operating margin (%)	5.4	9.1	8.0	↓	
Net Margin (%)	5.5	9.9	8.9	↓	
Cash ratio (times)	1.0	1.6	1.9	↑	
Quick Ratio (times)	2.5	2.4	3.1	↑	

*Sources of information:*

- ✚ Bloomberg Terminal
- ✚ Investopedia.com
- ✚ Blue Power Group Limited Annual Reports
- ✚ Jamaica Stock Exchange
- ✚ Planning Institute of Jamaica
- ✚ Statistical Institute of Jamaica
- ✚ The Jamaica Gleaner
- ✚ The Jamaica Observer

*Lumber Depot Competitors in Kingston Region*

- ✚ Tools Hardware & Supplies - 2 S Camp Road
- ✚ Lloyd's Sales Hardware - Barbican Rd
- ✚ Hardware & Lumber Limited 11 Spanish Town Rd
- ✚ Phil's Hardware Ltd - 66a Constant Spring Rd
- ✚ Hughenden Hardware - Molynes Road
- ✚ Rapid True Value - 26c Constant Spring Road
- ✚ Highqual Industry Limited - 597 Spanish Town Rd