

JMMB EQUITY RESEARCH

FOSRICH LIMITED (FOSRICH)



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EXECUTIVE SUMMARY

Fosrich Company Ltd. (FOSRICH), was established in 1993 and its shares listed on the Junior Market of the Jamaica stock exchange on December 19, 2017. Fosrich's principal activities are the manufacturing of PVC pipes and fittings as well as the distribution of lighting, electrical and solar energy products. Fosrich has subsequently ventured into the transformer repairs business, via a recently created firm, Blue Emerald Limited.

Fosrich recorded \$1.89Bn in revenue and \$125.7M in net income for their 2020 financial year (FY). Revenues have grown by a 3 year compound average growth rate (CAGR) of 22% while the 3 year CAGR of net income has outpaced the growth in revenues as it stands at 32%.

We attach a **MARKETPERFORM/HOLD/MARKETWEIGHT** recommendation to Fosrich as we believe the stock is trading close to its fair value. Additionally, the company has taken steps to increase its capacity to be able to meet the growing demand for its products. Fosrich has also entered into a 4 year agreement with the Jamaica public service company (JPS), for the repair of transformers. This would be done through a newly created company, Blue Emerald Limited. These moves should add to the firm's revenue base and further bolster its net income.

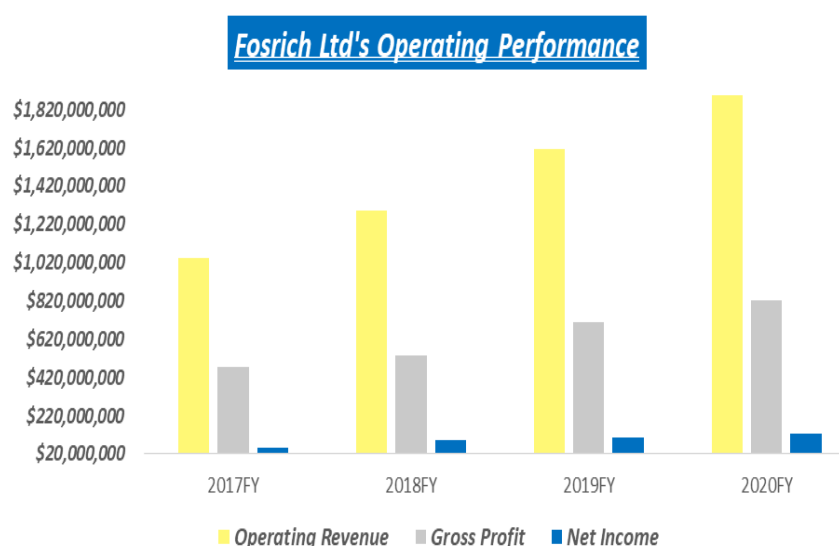
Financial Performance – 2020 Financial Year

Profitability

Fosrich reported revenues of \$1.89 billion for the FY ended December 2020. This represents a 17.6% year over year (y-o-y) increase. This growth was slightly below the 3 year CAGR of 22%. The rate of growth for revenues in 2020 was only slightly hampered by the advent of the pandemic, as containment measures to prevent the spread of the virus minimally affected business operations. The company has however experienced triple digit growth in several product lines, inclusive of PVC products (252%) and industrial electrical products (194%). Management attributed the growth in these product lines to greater demand for their products.

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Cost of sales increased by 18.7% from \$902M to \$1.07bn. The growth in Fosrich's cost of sales for the last 3 years has marginally outpaced the growth in revenues as the 3 year CAGR for cost of sales stands at 23%, compared to 22% for revenues. For the 2020FY, cost of sales growth has not significantly affected gross margins. The gross margin for the year was 43.5%, which is 0.5% higher than the 3 year average gross margin of 43%. Fosrich's gross profit of \$857M, represents a 12.5% increase from 2019's gross profit of \$762M.



Despite experiencing a 27% increase in administration expenses in Q1 due to new staff related costs, administrative expenses for the year totaled \$505M. This represents a marginal 3.8% increase when compared to 2019's administrative expenses of \$487M. Administrative expenses as a percentage of revenue has constantly been declining. For

the 2020FY, this figure was 26.7%, below the 3 year average of 29.9%.

Earnings before interest, taxation, depreciation and amortization amounted to \$276M, which is an increase of 12.6%. This corresponds to an EBITDA margin of 14.6%, which is below the EBITDA margin of 15.25% in 2019. Finance costs for Fosrich jumped by 46.2% for the 2020FY. Finance costs totaled \$160M for 2020 compared to \$109M in 2019. The increase in the finance costs is attributable to an increase in finance charges and bad debt impairment provisions. Bad debt provisions were \$31M for 2020 versus a reversal of impairment of \$6M in 2019. The increase in bad debt impairment was mainly due to an upward revision of the weighted average loss rate applied to credits outstanding for over 180 days. In 2019, the loss rate applied to this figure was 11.5% while in 2020, the applied rate was 32.5%. Fosrich's interest coverage ratio has improved from 3.29x in 2019, to 4.11x in 2020.

The company's efforts to increase revenues and maintain healthy profit margins despite the pandemic, has proven fruitful as net income increased by 17.6%. The net profit margin for both 2020 and 2019 was 6.63%. This was however slightly below the 3 year average net margin of 6.75%. Earnings per share (EPS) for the 2020FY came in at \$0.25. At the time of listing in

December 2017, Fosrich's weighted average EPS stood at \$0.14. EPS has increased by 78.6% since then, or 21% on average annually.

Liquidity & Solvency

Fosrich's total assets as at December 2020 stood at \$3.05bn. This represents an increase of 24.7% from total assets of \$2.45bn as at December 2019. Fixed assets grew by 25.8%, from \$832M in December 2019, to \$1.04bn. This growth was mainly due to an increase in 'lease right of use asset' as the company secured leases on additional properties to assist with the warehousing and distribution of their merchandise. Right of use asset increased 88%, moving from \$208M, to \$393M. Additionally, the company acquired a 20% stake in a newly created entity, Blue Emerald Limited, a company established to conduct transformer repairs as well as, the manufacture of large diameter PVC pipes and PVC fittings. The value of this investment in associate amounted to \$24M.

Current assets increased by 24%, moving to \$2bn from \$1.62bn, despite a 34% fall in cash and bank balances. Cash and bank balances fell from \$56M in 2019 to \$34M in 2020. Inventories increased from \$1.17bn to \$1.46bn while trade receivables increased by 14.6%, amounting to \$245M versus \$214M in 2019. Other receivables and prepayments saw the largest increase, up by 93.5%. Other receivables and prepayments amounted to \$191M in 2020, up from \$98M in 2019. This jump was attributable to Fosrich's deposits with suppliers totalling \$85M, when they had no such deposits with suppliers in 2019.

The company's current ratio for the period under review was 3.46x, a decline from a ratio of 4.3x in 2019. While the company's current ratio is relatively high, its quick ratio for 2020FY dipped below 1x, as it stood at 0.95x.

Total liabilities increased by \$537M, or 32.6%, and stood at \$2.19bn as at December 2020. Current liabilities increased by 54%, from \$375M to \$579M. This jump is attributable to a 72% increase in trade payables. Trade payables as at the end of the 2020FY were \$463M, compared to \$268M as at the end of the 2019FY. Long term liabilities grew by a smaller percentage than current liabilities. Long term abilities totalled \$1.6bn as at the end of the 2019FY, up by 26% when compared to the 2019FY. This increase in long term liabilities was due to a drawdown on an already existing line of credit facility to help with foreign purchases as well as liabilities due to new long term lease arrangements.

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Despite this level of growth in liabilities, total interest bearing debt only grew by 15% to \$1.216bn, up from \$1.05bn. As such, the company's leverage slightly increased, as the debt/equity ratio moved from 1.41x to 1.46x.

Fosrich's total equity increased by 8.6%, from \$799M in 2019, to \$868M in 2020. The main contributor to this growth was retained earnings as it grew by 21%, from \$362M to \$440M. The company's share capital fell to \$361M from \$369.6M, as Fosrich purchased 2,372,038 of its shares at a fair value of \$8.6M during the year. This decreased the total number of issued shares as these 2 million units are now treasury shares.

Outlook & Valuation

Fosrich is in the growth phase of its life cycle, as evidenced by both the CAGR of revenues and net income, as well as the moves being made to diversify their revenue streams. The company has recently completed the build out of a warehouse facility at 76 Molynes Road in order to be able to house inventory, which will improve their capacity to meet market demand. Fosrich has also recently acquired a 120,000 square foot plant in Hayes, Clarendon on a long term lease. This plant will be home to the manufacturing of large diameter PVC pipes and PVC fittings.

Fosrich signed a 4 year renewable contract with the Jamaica public service company (JPS), for the repair of pole mounts and pad mount transformers. These repairs would be done exclusively through newly created company, Blue Emerald Limited. Blue Emerald Limited will carry out these repairs at the recently leased facility in Hayes, Clarendon. As per the 2020 audited financials, Fosrich owns 20% of Blue Emerald Ltd. Talks to have this newly established company certified as a Special Economic Zone (SEZ) are advanced, and if successful would materially reduce the tax rate applied to the entity's earnings.

The pandemic has not had a significantly negative impact on Fosrich's operations or its distribution network. However, management highlighted that given the challenging financial times, increased efforts have been made to manage receivables. Management has increased provisions for doubtful debts and implemented strategies to recoup balances outstanding for over 180 days, while reevaluating credit terms and relationships.

We have forecasted revenues of \$2.3bn for the 2021 FY. This represents a 21.9% y-o-y increase, when compared to revenues from the 2019FY. This increase is expected to be driven by Fosrich's effort to increase inventory to match the growing demand for its products, in addition to sales of its PVC and Industrial Electrical products. The company's recently constructed warehouse facility

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at 76 Molynes Road will double as a fulfillment center for its products, improving operational capacity.

We have forecasted net income to be \$163.5M, a 30.6% increase when compared to net income of 125M in the 2020FY. Contributing to this net income forecast is the share of profit from associate company, Blue Emerald Ltd. Fosrich expects that Blue Emerald Ltd will be able to complete upwards of 1,000 transformer repairs per annum. The last publicly available costs for transformer repairs was in the region of \$115,000¹ in 2009. There is, however, no publicly available data on what the margins are on the transformer repair business. After adjusting for inflation and applying a conservative margin of 10%, we forecasted the net income to be generated from the transformer repair line of business could amount to approximately \$16.5M. Blue Emerald will also generate revenues from the manufacture of PVC pipes and pipe fittings. If Fosrich accounts for Blue Emerald as an associate/non consolidating subsidiary, they would only book 20% of total income generated by Blue Emerald Ltd. We have forecasted this share of profit to be \$5M for the financial year.

We applied our forward EPS of \$0.327 and BVPS of \$1.96 to the 1 year average PE ratio of 18.03x and price to book ratio of 2.45x. This yielded price estimates of \$5.90 and \$4.72 respectively. Additionally, we decided to apply our forward EPS and BVPS to the peer group PE and PB ratio. This yielded price estimates of \$7.52 and \$6.23. **Averaging these forecasts gives us a price target of \$6.09 which is 1.7% lower than the closing price of \$6.20 on April 26, 2021.**



¹ <https://jis.gov.im/road-crashes-proving-costly-to-jps/>

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Key Risks to our price target

While Fosrich's business model is sound, they still face operational risks. These risks have the potential to affect the company's revenue base and income. Due to Fosrich's high level of inventories, a decrease in market demand could cause inventory to face a greater susceptibility to becoming obsolete. Fosrich's associate company, Blue Emerald Ltd, poses an additional risk. The margins on the transformer repair business are not publicly known as well as the full costs associated with the company getting to full capacity. The company only started activity in the first month of 2021 and full details of this business line is yet to be known.

Recommendation

We assign a **MARKETPERFORM/HOLD/MARKETWEIGHT** recommendation to Fosrich at this time. This asset is most suitable for equity investors with a medium risk tolerance. This stock has appreciated by 50.7% year to date, as investors are optimistic about the future prospects of the company. The stock has moderate levels of liquidity, as it trades over 119,000 units of average daily volume, over the past 12 months.

Abridged Financials						
Year Ended December 31						% Change
	2016	2017	2018	2019	2020	
Turnover	1,155,557,852	1,046,241,522	1,293,223,605	1,612,164,170	1,895,680,002	17.6%
Cost of Sales	(686,663,459)	(573,008,705)	(759,227,812)	(902,215,700)	(1,070,926,098)	18.7%
Gross Profit	468,894,393	473,232,817	533,995,793	709,948,470	824,753,904	16.2%
Net Income	30,337,614	54,941,175	90,390,215	106,886,060	125,695,400	17.6%
Total Assets	1,119,683,835	1,298,255,352	2,052,591,330	2,450,604,317	3,056,388,378.00	24.7%
Total Liabilities	720,777,227	689,286,959	1,359,243,144	1,650,469,445	2,187,825,014.00	32.6%
Shareholder's Equity	398,906,608	608,968,393	693,348,187	799,594,872	868,563,365.00	8.6%
EPS (\$)	0.076	0.140	0.180	0.213	0.250	17.6%
Book Value per Share (\$)	0.99	1.21	1.380	1.592	1.73	8.6%
Key Ratios						
Gross Margin	40.6%	45.2%	41.3%	44.0%	43.5%	
Net Margin	2.6%	5.3%	7.0%	6.6%	6.6%	
Return on Average Assets	2.7%	4.2%	4.4%	4.4%	4.1%	
Return on Average Equity	7.6%	10.9%	13.9%	14.3%	15.1%	
Quick Ratio (x)	0.29	0.83	1.12	1.20	0.95	
Current Ratio (x)	1.60	2.71	4.16	4.30	3.46	
Debt/Equity (x)	0.42	0.58	1.49	1.41	1.46	

Source: www.jamstockex.com, *Bloomberg*, *Company Financials*, *Company Prospectus*, *JMMB Investment Research*.

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APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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STRONGLY UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 2.5% FOR THIS PARTICULAR ASSET

UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO 2.5% - 4.9% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETPERFORM—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OUTPERFORM/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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