

## JMMB EQUITY RESEARCH

# Lumber Depot Trading Company Limited (LUMBER)



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### EXECUTIVE SUMMARY

**Lumber Depot Company Limited (LUMBER)**, born out of the Blue Power Group (BPOW), was incorporated and domiciled in Jamaica on July 30, 2019. The company began trading on August 1, 2019 and listed on the Junior Market of the Jamaica Stock Exchange on December 16, 2019. The main activities of the company comprise the sale of lumber, hardware supplies and other construction related products.

Over the 9 month period ended January 2021, LUMBER has grown revenues to \$1.05B, a 14.2% increase over the 2020YE revenues of \$921M. LUMBER has also grown profits to \$100M for the period under review, compared to profits of \$22M for the 2020YE. Lumber Depot continues to service the growing construction sector which has seen a rise in commodity prices coupled with an increase in demand for these commodities.

We have placed an **OUTPERFORM/BUY** recommendation on the shares of Lumber Depot as it is trading materially below our fair value estimate. We also are of the view that the company will continue to increase revenues and profitability as the demand for construction related materials continues to grow. This investment is suitable for investors seeking capital appreciation with a medium to high risk appetite. We expect LUMBER to approach our price target in the next 14 months.

### Shareholdings

Top 10 Shareholder		
Mayberry Jamaican Equities Ltd	179,369,948	25.40%
Blue Power Group Limited	113,989,250	16.14%
J Kenneth Benjamin & Sheila Benjamin	49,954,650	7.07%
Mary J. Fray	30,954,000	4.38%
JN Fund Managers	23,919,341	3.39%
Noel Dawes	14,627,150	2.07%

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Silver Investments Limited	10,778,160	1.53%
QWI Investments Limited	9,986,245	1.41%
PAM-Pooled Equity Fund	9,893,510	1.40%
Mayberry CO A/C 120008	9,837,370	1.39%
Other Shareholders	252,927,876	35.81%
<b>Total</b>		<b>100.00%</b>

## Company Overview

**Lumber Depot Company Limited (LUMBER)** is a full service hardware and building material company. LUMBER was incorporated and domiciled in Jamaica on July 30, 2019 and commenced trading on August 1, 2019.

LUMBER entered into an Intragroup Reconstruction Agreement with the Blue Power Group Limited (BPOW), which saw them assuming the benefit and burden of the Hardware Business. On August 1, 2019, Blue Power Group Limited sold its' Lumber division to the company, and at that time certain assets and liabilities of BPOW's Lumber division were transferred at book value to the company. The assets of the Hardware Business was transferred to LUMBER and there was no change to the management team of the Hardware Business. The Hardware Business has been in operation since 1998. The Company conducts its principal trading operations at 17c Gordon Town Road in Papine, St. Andrew. Lumber also operates an off-site overflow storage facility at 4 Victoria Avenue, in Kingston.

LUMBER's main businesses includes the sale of lumber, hardware supplies and other construction related products. Approximately 70% of the company's sales consists of cement, steel, lumber and paints. The company's main clientele includes small contractors, home owners and a few owners of commercial buildings. Lumber sources most of its supplies locally, such as cement from Caribbean Cement Co. Ltd., paint from Berger Paints Ltd and steel from Tankweld Metals. The company however imports its lumber from Brazil, China and the USA.

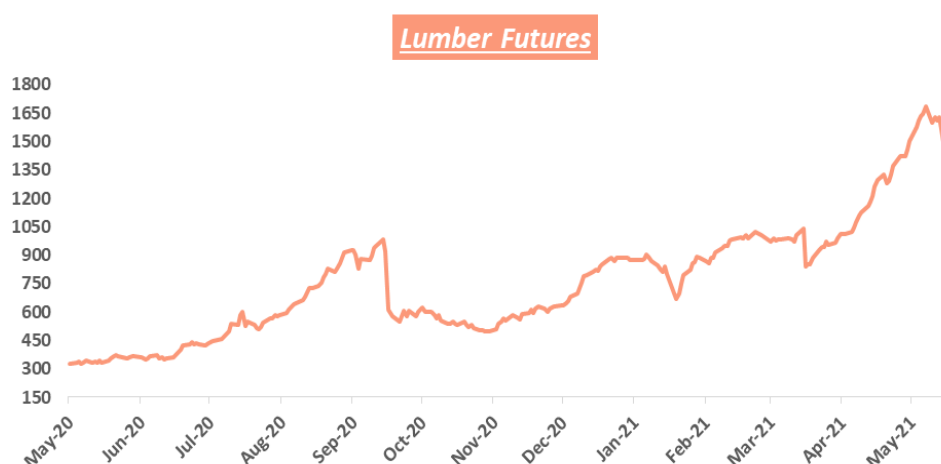
## Financial Performance

### Profitability

LUMBER's revenues for the 9 months ended January 2021 amounted to \$1.05B. These revenue numbers represent a 14% increase over the revenues of \$921M recorded for the year ended April 2020<sup>1</sup>(2020YE). This growth in revenues was driven by demand for lumber and other

<sup>1</sup> Lumber Depot started Operations August 1, 2019 and as such, the year ended April 2020 only has 9 months' worth of financial data. This 9 month period is used throughout the report for comparative analysis  
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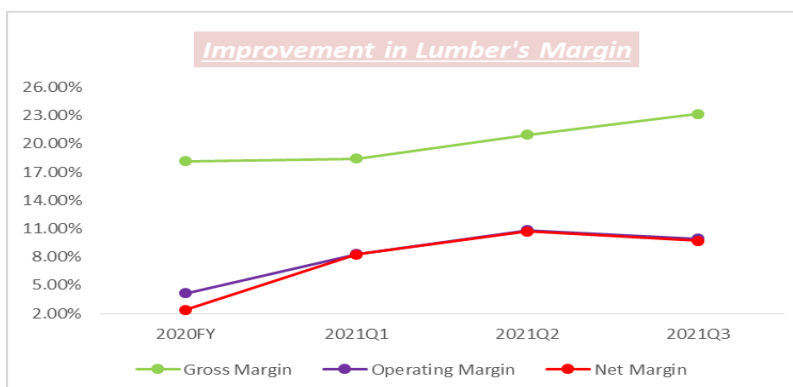
construction materials supplied by the company as a result of the growth in Jamaica's construction sector over the past 2 quarters. Additionally, the global prices of these materials, particularly lumber, have increased significantly over the past 12 months. Lumber futures<sup>2</sup> have risen by 274% over the past year, as the demand for lumber has far outstripped supply. This increase was not fully absorbed by the company, who passed on the increase partially to its customers.



LUMBER has been able to contain the cost of sales, as cost of revenues for the 9 months ended January 2021 was \$833M. This was only a 10.53% increase over the \$754M cost of sales for the 2020YE. Lumber Depot has increased its gross margin every quarter since the 2020YE. Gross margin for the 2020YE was 18.17%; it climbed to 18.43% in Q1, 20.93% in Q2 then to 23.18% in Q3. For the 9 month period ended January 2021, the total gross margin was 20.83%. Gross profits increased by 30.95% as they amounted to \$219M for the period under review versus \$167M for the 2020YE. An increase in the company's margins and top line revenue, spurred this growth in gross profit.

<sup>2</sup> Lumber futures do not create cash prices; they however, generate a current view of an equilibrium price.

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In the year ended April 2020, the company had an impairment loss on trade receivables which amounted to \$20M. This loss in receivables was arrived at by applying an expected weighted average loss rate to the gross carrying amount of receivables. These receivables ranged from current to past due for more than 90 days. For the 9 month period ended January 2021, there was a reversal of losses on trade receivables, totaling \$1.27M. Reversal of impairment losses occurs when there is a collection of outstanding credits which factored into the calculation of loss allowances. Over the last 9 months, the company has been able to recover credits, and management has stated that to date, all credits are 'collectible'.

Administrative expenses have climbed to \$119.6M from \$108M in the YE2020. Quarter over quarter, administrative expenses spiked by 20.1%, in the 3<sup>rd</sup> quarter ended January 2021. This uptrend in expenses if not controlled, may impact LUMBER's profitability. LUMBER's net finance costs has declined by 8.16%, falling to \$1.4M from 2020YE costs of \$7.1M. This fall was primarily due to two factors; an increase in interest income earned and a decrease in interest expense, due to repayment of their long term loan.

**Net Income increased significantly by 352% to \$100M, up from \$22M for the 2020YE.** This significant jump in net income was attributable to several factors. These include, an increase in revenues, improvement in margins, reversal of impairment losses as well as a dip in finance costs. LUMBER has had a strong performance so far this financial year and we anticipate an equally impressive 4<sup>th</sup> quarter performance.

### **Liquidity & Solvency**

Total assets for LUMBER grew by 33.8%, from \$374M as at April 2020 to \$500.5M as at January 2021. While fixed assets fell from \$196M to \$192M, there was a 173% growth in current assets, as it jumped to \$308M from \$177M. This significant increase was due to a rise in cash and cash equivalents and a slight uptick in inventories. Cash and cash equivalents soared to \$140.6M from \$29M. This significant gain is mainly attributable to cash provided by operating activities,

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which totalled \$149M for the period. As it stands, Lumber depot has more cash on hand than inventories. Inventories increased to \$133M from \$104M, as the company sought to better meet customer demand.

Total liabilities stood at \$222M, an increase of 21.9% from \$181.7M as at 2020YE. Long-term liabilities fell by 19.3% from \$82.6M to \$66.7M. This fall was due to LUMBER repaying the full balance of its \$25M loan, back to BPOW in the 2<sup>nd</sup> quarter of the 2020/21 financial year. Current liabilities grew by 56.2% to \$154.9M from \$99M. This growth was due to a 76.7% spike in accounts payable, which grew from \$66M to \$117M.

The company has improved its liquidity and solvency position over the past 9 months. LUMBER has grown its current ratio from 1.79x as at the 2020YE, to 1.99x as at January 2021. The company's quick and cash ratios also followed the same trend, as they saw significant improvements. The quick ratio improved from 0.74x to 1.13x, showing that LUMBER's current assets, not including inventory, can more than cover all of its liabilities. The cash ratio climbed from 0.29x to 0.91x, indicating that LUMBER's cash on hand, can cover 91% of its current liabilities.

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## Outlook & Valuation

LUMBER has benefitted from a surge in the demand for construction products, as the sector is experiencing continued growth. Additionally, these products have seen significant price increases over the past 12 months. Lumber has been able to contain the impact this has on their cost of goods sold. The company has also benefitted from an improvement in their gross margins for three consecutive quarters.

The company's primary product, lumber, has seen a global price increase of 274% over the past year. This rise was primarily due to demand far outpacing supply, as construction in the USA has seen a spike while many lumber plants are yet to reopen, after closing on the advent of the pandemic. To combat this, the company has turned to purchasing lumber from BPOW, who now are responsible for importing the commodity. This arrangement sees BPOW leveraging its previously built relationships with lumber plants overseas, to secure adequate supply of lumber at preferential prices. This has helped Lumber Depot to mitigate the 'shortage' in the commodity.

We expect the growth in construction to continue throughout the remainder of the financial year. We expect an increase in residential developments and renovations in and around the corporate

area as well as a resumption of projects halted during the pandemic. This should in turn translate to increased demand for the entity's products.

We have forecasted LUMBER's financial performance for the final quarter of their 2020/21FY as well as their 2021/22FY. We estimate that Lumber Depot may end their FY with revenues of \$1.4B. We expect them to see net income climb to \$136M for the full year, putting EPS at \$0.19.

For the 2022FY, we are forecasting total revenues of \$1.57B. We anticipate gross margin increasing to 22% from 20.83% currently. Our forecasts yielded a net income of \$154.6M, and earnings per share (EPS) of \$0.22. This represents a 13% increase over our forecasted 2020/21YE EPS of \$0.19 and an 81.9% increase over trailing EPS. LUMBER's limited financial information made it hard to identify discernable trends, which added to the difficulty in the forecasting and valuation of this stock. To get an appropriate valuation for the corporate, we used the current trailing average P/E ratio for its industry peers of 24.84x<sup>3</sup> and applied this to the forward EPS.

**This yielded a price of \$5.44. This price estimate is 61.4% greater than the closing price of \$3.37.**

Company	Market Capitalization	Price to Earnings	Price to Book	Return on Equity	Return on Assets
CAC	1,251,612,903	31.96x	3.4x	10.24%	3.44%
CPJ	4,015,000,000		1.33x	-42.48%	-11.67%
DTL	11,333,401,675	33.10x	7.91x	9.89%	6.49%
EFRESH	819,000,000		1.52x	-45.49%	-22.30%
FOSRICH	4,219,114,662	26.57x	4.86x	17.89%	5.68%
FTNA	7,521,236,447	21.82x	5.18x	21.47%	10.36%
INDIES	5,103,615,366	17.85x	6.95x	36.45%	21.27%
JETCON	618,510,000		1.11x	-0.99%	-0.83%
LASD	13,854,986,923	14.86x	2.47x	15.67%	9.48%
MDS	1,315,789,475	74.4x	1.6x	2.20%	1.00%
<b>Sector Average</b>	<b>5,005,226,745</b>	<b>24.84x</b>	<b>3.63x</b>	<b>16.3%</b>	<b>8.2%</b>
<b>LUMBER</b>	<b>2,252,897,625</b>	<b>26.33x</b>	<b>10.86x</b>	<b>35.20%</b>	<b>20.10%</b>

This key risks to our earnings target are Lumber's ability to contain its administrative expenses. Lumber pays administrative expenses to BPOW based on the terms of a Corporate Service Agreement. The company pays for management, administrative, accounting and financial services. Lumber's administrative expenses have climbed for every quarter so far this financial year and in the 3<sup>rd</sup> quarter ended January 2021, expenses increased by 20.1% q-o-q.

<sup>3</sup> This was arrived at by finding the harmonic mean of the p/e ratios of the industry peers.

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## Recommendation

We assign an **OUTPERFORM** recommendation to LUMBER at this time, given that it is currently trading below our fair price estimate of \$5.44. We are optimistic about the company's growth potential as they service a sector of the economy which is experiencing continuous growth. They have additionally leveraged BPOW's existing relationships, to secure lumber on preferential prices, in order to effectively control their COGS.

This stock is most suitable for investors with a medium to high risk appetite who are seeking capital appreciation. LUMBER is currently in the growth phase and while management has signaled its intention to pay annual dividends, we expect a majority of earnings to be retained. Given our 14 month outlook, the risk to our price target is the company releasing results which are below our expectations, which would lead to a decrease in investor demand for this stock.

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

# 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.

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**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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