JMMB INVESTMENT & SOVEREIGN RESEARCH

Stationery and Office Supplies Limited (SOS)

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EXECUTIVE SUMMARY

Stationery and Office Supplies Ltd. (SOS), started operations in 1965. The company specialized in the selling of stationery items and office supplies but since then has expanded its product offerings to office furniture, shelves, partitions and fittings needed for an office space. The company is the sole local distributor for the Fursys and Boss brands of office furniture. In May 2018, SOS entered into the manufacturing space, with an $80M acquisition of the SEEK brand of notebooks. This acquisition started bearing fruit for SOS in the 2019FY as the business line became marginally profitable during this period. However, the pandemic has been a major setback to this business arm.

Revenues for the 2020FY decreased by 20.17% to a 3-year low of $972M, due to a falloff in demand as the pandemic led many businesses to implement work-from-home (WFH) policies. Additionally, all schools in Jamaica suspended face to face teaching, which led to demand for SEEK books to plummet. The year 2020 was a difficult one for SOS as their net income of $33M was the lowest it has been since 2015. SOS has managed to improve profits in Q1 of 2021, despite having lower revenues. They have been able to achieve this by cutting costs as well as benefitting from higher margins.

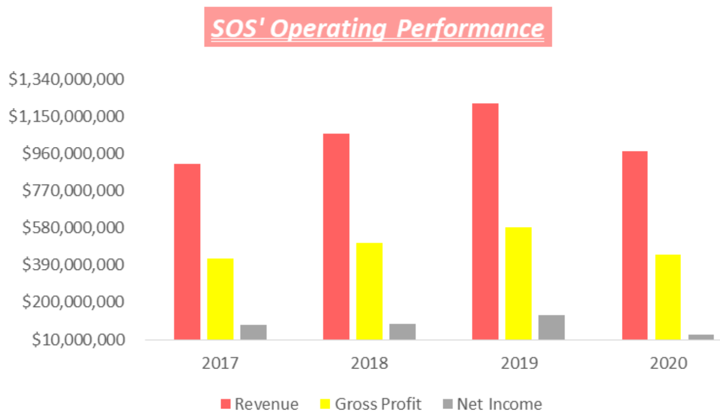
Due to the nature and cyclicality of SOS' business, the pandemic has had a direct and lingering impact on their operations. A strong economic environment encourages increased business activity and expansion, which SOS relies on to drive demand for its suite of office supplies. Measures implemented to stem the spread of COVID-19 such as work-from-home policies, have directly decreased demand for SOS's products. The continuation of WFH policies even after the economy recovers may also pose a challenge to SOS' recovery and revenue generation.

SOS has however managed to pivot to at home office equipment as well as exporting containers of equipment, which has boosted revenues. We have placed an **UNDERPERFORM / UNDERWEIGHT** recommendation on the shares of SOS, as despite the new revenue streams, the company still faces challenges in recovering to pre-pandemic levels.

2020 Financial Year

Profitability

SOS reported revenues of $972M for the year ended December 31, 2020. This represents a 20.17% decrease when compared to revenues of $1.2B for the 2019 financial year. The advent of the coronavirus pandemic, has significantly affected SOS' business operations, as demand for its products have plummeted. Work from home/remote work policies, combined with the closure of schools from the 2nd quarter of 2020 have directly affected SOS' revenue. Companies' demand for office equipment has declined and with schooling being shifted to virtual learning, sales from the company's SEEK Notebook manufacturing arm have dwindled. Gross profit fell by 23.55%, totaling $445M, down from $582.6M in 2019. Accompanying the decrease in customer demand, SOS' gross margin fell slightly to 45.8%, below the 3-year average of 48%.



For the 2021Q1 revenues decreased by 7.1%. Revenues amounted to $313M for the quarter versus $336M for 2020Q1. Gross margin for the quarter significantly improved to 55% from 49% in prior years. SOS has stated that they had exported 2 containers to St Lucia, which was one of the major contributors to its revenue numbers.

The pandemic has seen SOS implement several strategies to retain 98% of its staff compliment. These strategies include, but are not limited, to shift rotations and flexible remote work policies for some employees. Despite these measures, administrative and general expenses only fell by 6.37%, as it totaled $287M in 2020 versus $306M in 2019. Administrative Expenses for 2021Q1 was $80.M, a 7.4% decrease from $86M in same period last year.

Operating Profit declined by 65% for the 2020FY, from a record $156M, down to $54.6M. This is the lowest operating profit has been in 5 years. After peaking at 13% in 2019, the operating profit margin was cut in half for 2020, falling to 6%, due to the significant fall off in revenue, while expenses remained somewhat flat.

Earnings before Interest, Tax, Depreciation and Amortization (EBITDA) for the 2020FY, decreased by 52.88%, y-o-y, as it fell from $189M to $89M. The EBITDA margin also worsened from 16% to 9%. Finance costs were relatively flat y-o-y at $14.9M, compared to $15.2M in 2019. A repayment of debt totaling $35.7M was a major contributor to finance costs remaining flat.

Net Income for SOS for the financial year ended December 31, 2020 amounted to just $33M. This is the lowest profits have been since 2015. The pandemic and the subsequent deterioration of general economic conditions have had a debilitating impact on SOS. When compared to a net profit of $134.5M in 2019; profits in 2020 fell by 75.41% and net margin was slashed from 11% to 3%. Net Income for the 2021Q1 amounted to $55M, which represents a 28% increase y–o-y. This increase was primarily due to an increase in gross margins and a fall in administrative expenses.

Liquidity & Solvency

Total assets for SOS marginally fell by 2.1%, from $907M to $888M. The decrease in total assets was mainly attributable to the decrease in current assets. Despite cash increasing by $34M, a 29.2% fall in trade receivables, seemingly due to lower sales volume, saw current assets falling to $460M from $489M. Non-current assets grew by 2.2% to $427M, from $417M in 2020. This growth was spurred by an increase in property, plant and equipment (PPE). While this purchase was enough to increase non-current assets, it could not prevent total assets from being lower y-o-y. A comparison between total assets as at the end of 2021Q1 and 2020Q1 shows that growth in assets was flat. Total assets as at 2021Q1 amounted to $941M and for the same period last year, $938M

The company had a minimal increase in total equity of 2.19% or $23M. Shareholders' equity totalled $633M as at the end of the 2020FY while it stood at 610M at the end of the 2019FY. A marginal increase in retained profits to $432M, from $409M was the reason for the growth in total equity. The return on average equity for the company fell to the lowest it has been in over 6 years as it fell from a record 25.66% to 5.49. Total Equity as at March 2021 increased to 665M, a 25M increase when compared to March 2020.

SOS' total liabilities for the 2020FY fell to $278M from $310M, a decrease of 10.3% y-o-y. This was largely due to the company's decision to reduce its long term borrowings, which fell 31%, from $118M to $81.5M. This contributed to an overall 19.7% decline in non-current liabilities. SOS' interest bearing debt fell by 15%, down from $202M to $172M. This has had a direct impact on the company's finance costs as well as its debt to equity ratio, which fell to 0.28x from 0.34x. Net debt/EBITDA for the 2020FY however increased to 0.84x from 0.74x in 2019.

There was a further reduction in liabilities for SOS as liabilities as at the end of 2021Q1 fell by $38M y-o-y and 4M quarter over quarter to $140M. SOS has continued to repay its long term loans which has led to an overall decline in liabilities.

While the pandemic has negatively affected SOS' profitability in 2020, the impact on the company's liquidity has been muted. The firm's current ratio remains healthy, despite falling to 3.44x from 3.74x. The company's quick ratio also remains over 1.5x and stands at 1.7x despite falling from 1.83x in 2019. Management has made the necessary adjustments to ensure that the company's liabilities are efficiently managed and its liquidity remains strong while profitability has been challenged.

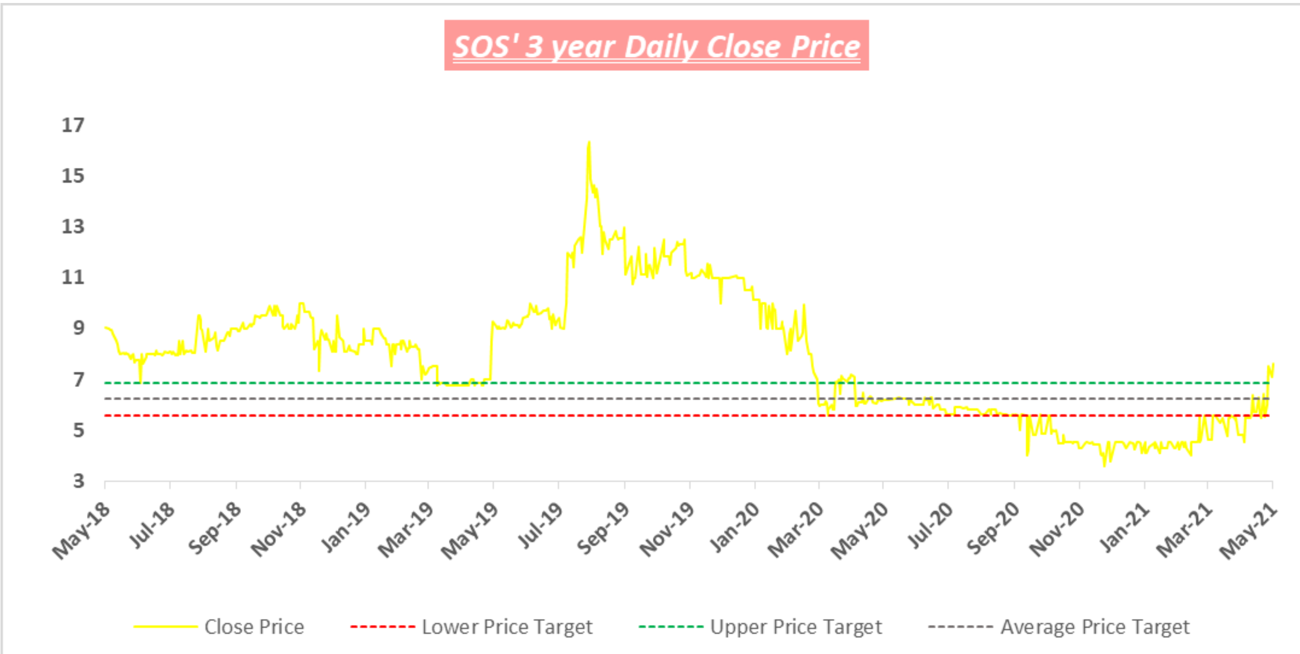
Outlook & Valuation

SOS' growth and recovery going forward are likely to be constrained by the factors surrounding the COVID-19 pandemic. The company faces negative headwinds as the pandemic has kept schools closed and caused some businesses to enforce WFH policies. With schools mostly closed for the 2020/21 academic year, SOS' SEEK Notebook operations have been severely impacted. We anticipate that some companies may have more of their staff returning to office as vaccination numbers increase and the number of covid cases begin to stabilize. We expect that a possible relaxation of the WFH policies by government agencies and the BPO sector throughout the second half of the year, may lead to increased revenue generation for the firm.

SOS has stated that they have been reaping rewards from their new product lines of home office furniture and industrial racking. These product lines also carry a greater margin. This, combined with SOS' success in being able to export 2 containers to St. Lucia, has seen revenues recover, albeit below pre-pandemic levels. The replicability of SOS' 2021Q1 performance is dependent upon further demand for home office equipment, securing sufficient demand to export additional containers as well as the relaxation of WFH orders.

The combination of the above factors has led us to forecast a 10.51% increase in revenues for the 2021FY. We expect revenues to amount to $1.07B, with gross profit totaling $543M. We are forecasting an 8.7% rise in administrative expenses to 311M for the 2021FY, as well as $103M in operating profit. Our forecasts also point to net income for the 2021FY amounting to $85.9M, with EPS amounting to $0.34.

To get an appropriate valuation for SOS we applied our forecasts of the company's 1 year forward EPS and BVPS to the average 1 year P/E and P/B ratio of the company. This provided price estimates of $6.84 and $5.59 respectively. The average of these estimates yields $6.22, which is 18.56% lower than the close price of $7.63.



Recommendation

We assign an **UNDERPERFORM** recommendation to SOS at this time. The company currently trades above our fair price estimate and its recovery faces risks which are tilted to the downside. The company's operations may continue to be affected as coronavirus infections remain relatively high and WFH orders are still enforced by the government. As vaccination numbers start to increase and the rate of infections start to decline, we may see more companies reverting to in office work policies. We expect that this may lead to an increase in demand for SOS' goods in the 2021FY. It may however take more than one financial year for SOS to return to peak levels of profitability. The prolonged nature of the pandemic has seen WFH policies remain for a few firms and this constrains the growth in the office supplies replacement rate for these firms. It is also not yet immediately clear on whether or not SOS' new at home work station set-up offerings will enable them to recoup a significant portion of revenues which will be lost due to the continuation of remote work. This new revenue stream however, carries a higher margin.

The company's SEEK notebook manufacturing arm has suffered in 2020 due to the suspension of face to face classes, which has decreased the demand for notebooks. There is currently no clear cut date for the resumption of face to face classes and with the Ministry of Education proposing a blended approach between virtual and face to face learning for the new school year, the outlook for SEEK is dim at this time.

We are forecasting that SOS will have a recovery in their revenue and profit numbers, albeit, below pre-pandemic levels.

While this stock is most suitable for retail investors with a high risk appetite, we are still expressing caution as the company's recovery is dependent upon the containment of the pandemic. Additionally, the one year daily average volume traded for SOS is 23,000 units, which shows the stock has low levels of liquidity.

	SOS Abridged Financials							
	YE2016	YE2017	YE2018	YE2019	YE2020	Q12020	Q12021	% Change
Revenue	$ 702,070,851	$ 906,505,818	$ 1,064,360,671	$ 1,217,983,130	$ 972,318,382	$ 336,902,416	$ 313,315,789	**-7.00%**
COGS	$ (363,402,612)	$ (483,492,384)	$ (559,850,241)	$ (635,366,957)	$ (526,892,239)	$ (171,691,371)	$ (143,705,662)	**-16.30%**
Gross Profit	$ 338,668,239	$ 423,013,434	$ 504,510,430	$ 582,616,173	$ 445,426,143	$ 165,211,045	$ 169,610,127	**2.66%**
Operating Profit	$ 68,942,327	$ 91,197,233	$ 98,252,564	$ 155,957,851	$ 54,580,079	$ 45,544,025	$ 59,715,432	**31.12%**
Net Income	$ 46,586,193	$ 82,966,445	$ 91,673,074	$ 134,564,989	$ 33,091,492	$ 43,801,731	$ 55,339,251	**26.34%**
Total Assets	$ 484,741,011	$ 655,203,852	$ 853,335,321	$ 907,044,937	$ 888,015,577	$ 938,676,101	$ 941,253,975	**0.27%**
Total Liabilities	$ 242,099,988	$ 241,449,170	$ 358,736,055	$ 310,396,347	$ 278,285,135	$ 298,226,780	$ 276,184,282	**-7.39%**
Shareholder's Equity	$ 242,641,023	$ 413,754,682	$ 494,599,266	$ 596,648,590	$ 609,730,442	$ 640,450,321	$ 665,069,693	**3.84%**
EPS ($)	$ 0.23	$ 0.33	$ 0.37	$ 0.54	$ 0.13	$ 0.18	$ 0.22	**26.34%**
BVPS ($)	$ 1.21	$ 1.65	$ 1.98	$ 2.39	$ 2.44	$ 2.56	$ 2.66	**3.84%**
Key Ratios								
Gross Margin	48%	47%	47%	48%	46%			
Operating Margin	10%	10%	9%	13%	6%			
Net Margin	7%	9%	9%	11%	3%			
Return on Average Assets	12%	15%	12%	15%	4%			
Return on Average Equity	19%	20%	19%	23%	5%			
Asset Turnover (x)	1.79	1.59	1.50	1.38	1.08			
Quick Ratio (x)	0.90	1.38	1.37	1.83	1.70			
Current Ratio (x)	1.84	2.69	2.64	3.75	3.45			
Debt/Equity (x)	0.54	0.34	0.43	0.34	0.28			

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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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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