

JMMB INVESTMENT & SOVEREIGN RESEARCH

FOSRICH LIMITED (FOSRICH)



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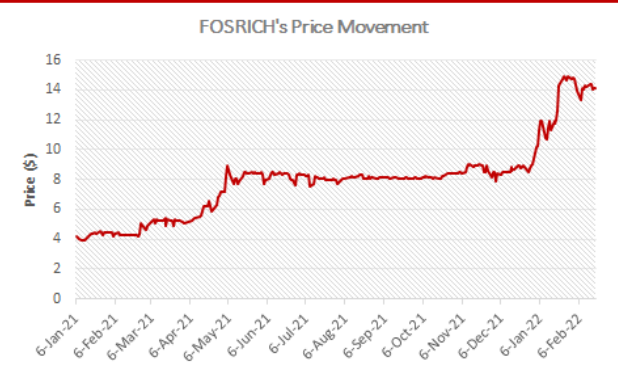
EXECUTIVE SUMMARY

Fosrich Company Ltd. (FOSRICH), was established in 1993 and had 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 recently created firm, Blue Emerald Limited.

Fosrich recorded \$2.35B in revenue and \$199.3M in net income for their 2021 financial year (FY). Revenues have grown by a 4-year compound average growth rate (CAGR) of 22% while the 4-year CAGR of net income has outpaced the growth in revenues as it stands at 38%.

We attach an **OUTPERFORM/BUY** recommendation to Fosrich as we believe the stock is trading below its fair value. Additionally, the company has taken steps to increase its capacity to be able to meet the growing demand for its products. Under their new subsidiary Blue Emerald Limited, the company intends to begin the repair of electric transformers and the manufacturing of PVC fittings. Blue Emerald Ltd is also set to commence the manufacturing of industrial PVC pipes as well as repairing and manufacturing of electric transformers for JPS. These moves should add to the company's revenue base and further bolster its net income.

FOSRICH'S PRICE MOVEMENT



Fosrich's Statistics

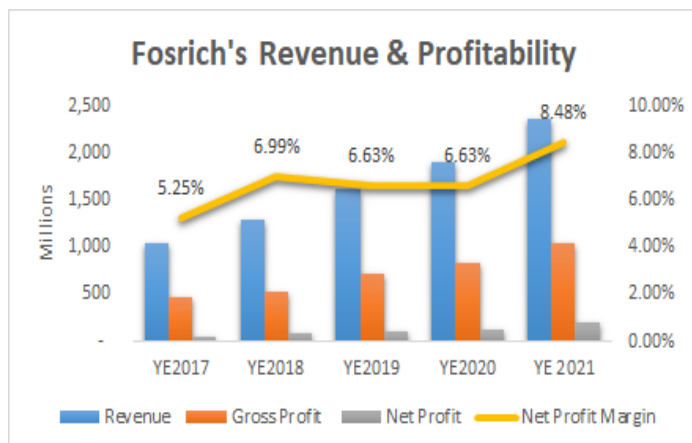
Financial Year End	December	
Stock Price (04/03/2022)	\$	14.77
EPS	\$	0.40
Book Value per share	\$	2.02
P/E		22.81x
P/B		4.47x
Net Profit FY2021 (millions)	\$	199
Price Target	\$	16.04
Dividend Yield		1.14%

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Financial Overview

Profitability



Fosrich reported revenues of \$2.35B for the FY ended December 2021. This represents a 24% year over year increase. This growth outpaced the 4 year CAGR of 22%. The rate of growth for revenues in 2021 was only slightly hindered 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 significant growth in

several product lines, inclusive of solar products (157%), control devices (55%), PVC products (45%) and wiring devices (37%). Management attributed the growth in these product lines to greater demand for their products.

Cost of sales increased by 22% from \$1.07B to \$1.31B for FY2021. Management highlighted that the company experienced fluctuations in volume and price increases throughout the financial year, driven by escalating copper and PVC material prices on the international market and increased shipping prices. However, 2021FY cost of sales growth has not significantly affected gross margins. The gross margin for the year was 44.4%, which is 1.1% higher than the 4-year average gross margin of 43.3%. Fosrich's gross profit of \$1.04B, represents a 26.5% increase from 2020's gross profit of \$824.75M.

Administrative expenses for the 2021FY totaled \$631.63M. This reflects a 24.89% increase when compared to 2020's administrative expenses of \$505.75M. In 2021FY, there were increases in staff related costs, increased legal and professional fees and rent associated with the factory space in Hayes Clarendon. However, administrative expenses as a percentage of revenue has constantly been declining. For the 2021FY, the administrative expense margin was 26.9%, below the 4-year average of 31%.

Earnings before interest, taxation, depreciation and amortization (EBITDA) for 2021FY amounted to \$467.65M, which is an increase of 33%. This corresponds to an EBITDA margin of 19.9%, which

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is above the EBITDA margin of 18.5% in 2020. Finance costs for Fosrich jumped by 15.7% for the 2021FY. Finance costs totaled \$185M for 2021 compared to \$160M in 2020. The increase in the finance costs is attributable to an increase in bank charges and bad debt impairment provisions. Bad debt provisions were \$43.79M for 2021 versus a bad debt impairment of \$31.77M in 2020. Additionally, interest on long term and short term borrowings totaled \$50.37M versus \$33.83M in 2020, due to an increase in the company's debt to finance operations.

The company's efforts to increase revenues and maintain healthy profit margins despite the pandemic, has proven fruitful as net income increased by 58.6%. The net profit margin improved to 8.48% from 6.63% in 2020.

Earnings per share (EPS) for the 2021FY came in at \$0.40, from \$0.25 in FY2020. At the time of listing in December 2017, Fosrich's weighted average EPS stood at \$0.14. EPS has increased by 183% since then, or 30% on average annually.

Liquidity & Solvency

Fosrich's total assets as at December 2021 stood at \$3.76B. This represents an increase of 23.24% from total assets of \$3.05B as at December 2020. Fixed assets grew by 37.53%, from \$1.05M in December 2020, to \$1.44B. This growth was mainly due to an increase in 'investment in associated company' and 'lease right of use asset'. Right of use asset increased 43.6%, moving from \$393.3M to \$564.8M, as the company secured leases on additional properties to assist with the warehousing and distribution of their merchandise. Additionally, Fosrich increased their stake in associated company Blue Emerald to 80%, 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 the associate company grew to \$121.6M from \$24.3M booked in FY2020.

Current assets grew by 15.8%, moving from \$2B to \$2.3B as FY2021. Fosrich's trade receivables increased by 11.6%, from \$245M to \$274M. Additionally, inventories increased from \$1.45B to \$1.78B, as the company made strides to increase inventories to meet consumer demand. Notably cash and cash equivalents surged to \$72M from \$34M booked in FY2020.

The company's current ratio for the period under review was 2.83x, a decline from a ratio of 3.46x in 2020. The company's quick ratio followed a similar trend, which stood at 0.66x, a decline from 0.95x in 2020.

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Total liabilities increased by \$562M, or 25.7%, and stood at \$2.75B as at December 2021. Current liabilities increased by 41.9%, from \$579.8M to \$822.5M. This jump is attributable to a 28.6% increase in trade payables. Trade payables as at the end of the 2021FY were booked at \$597M, compared to \$464M as at the end of the 2020FY. Non-current liabilities grew by a smaller percentage than current liabilities. Non-current liabilities totalled \$1.93B as at the end of the 2021FY, up by 20% when compared to the 2020FY. This increase in non-current liabilities was primarily driven by a 47% increase in right use of liability, due to long term lease obligation in connection with the lease of the second Hayes factory building which commenced in January 2021. Additionally, long term liabilities grew by 14%, booked at \$1.38B in comparison to \$1.22B in FY2020.

The growth in Fosrich's liabilities corresponds to a growth in total interest bearing debt by 21% to \$1.56B, up from \$1.29B. As such, the company's leverage increased, as the debt/equity ratio moved from 1.49x to 1.54x. Fosrich's total equity increased by 17%, from \$858.5M in 2020, to \$1.02B in 2021. The main contributor to this growth was retained earnings as it grew by 33.5%, from \$440M to \$588M.

Cash Flow Adequacy

Cash from operating activities (CFO) represented outflows of \$67.76M for the twelve-month period, relative to inflows of \$2.92M in 2020. CFO outflows was mainly driven by Fosrich's increased stake in associated company Blue Emerald. CFO was further impacted due to cash flow used for inventories and related parties.

Cash from investing activities represented an outflow of \$71.24M for FY2021, relative to an outflow of \$64.24M in 2020. This was driven by the year over year increase in purchase of PPE, an increase of 41%. Cash from financing activities represented an inflow of \$174.62M for the period, relative to an inflow of \$38.52M in 2020. This was mainly driven by the increase loans received from \$130.4M in FY2020 to \$591.5M in FY2021.

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 initiatives 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

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inventory, which will improve their capacity to meet market demand. Additionally, a section of the space will be retrofitted with shops and stores to be rented to different operators including business process outsourcing (BPO) entities and other spaces befitting modern business requirements, which is expected to positively impact the company's earnings and growth prospects. Fosrich has also 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, PVC fittings and transformers repair. Management indicated that within the first quarter of the 2022 calendar year, the plant will begin manufacturing about 14 new products, adding another 16 new products over the remainder.

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 Fosrich's associated company, Blue Emerald Limited, which is now an 80% subsidiary of Fosrich. It is expected that Blue Emerald Ltd should be able to complete approximately 2,000 transformer repairs per annum. Notably, discussions 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.

Moreover, Fosrich stated their intentions to target the energy sector by plans to offer more solar energy solutions to the Jamaican market. The increase in inflation and oil prices is likely to increase consumers' electricity bills. As such, this is likely to grow consumers/businesses uptake of transitioning to solar energy. Additionally, Fosrich highlighted its intentions to operate all their plants on solar energy. Therefore, these initiatives are likely to improve revenue, reduce cost and improve future earnings.

We have a positive outlook on Fosrich, as they continue to grow their business to take advantage of the upsurge in demand for PVC pipes and fittings as well as electrical supplies. The manufacture of PVC pipes was slated to begin in Q4 2021, which will coincide with their plans to ramp up production of PVC fittings. The transformer repair business line and the commencement of the manufacture of electrical transfers will further diversify Fosrich's revenues.

Based on these assumptions, we arrived at our price target of \$16.82 using the Discounted Cash Flow (DCF) model. Meanwhile using the DCF under two additional scenarios produced our upper and lower case price targets of \$20.51 and \$10.10 respectively. The primary difference between the scenarios is the trajectory of interest rates, global commodity prices and the impact it has on the energy and construction industry. The best-case scenario assumes a reduction in

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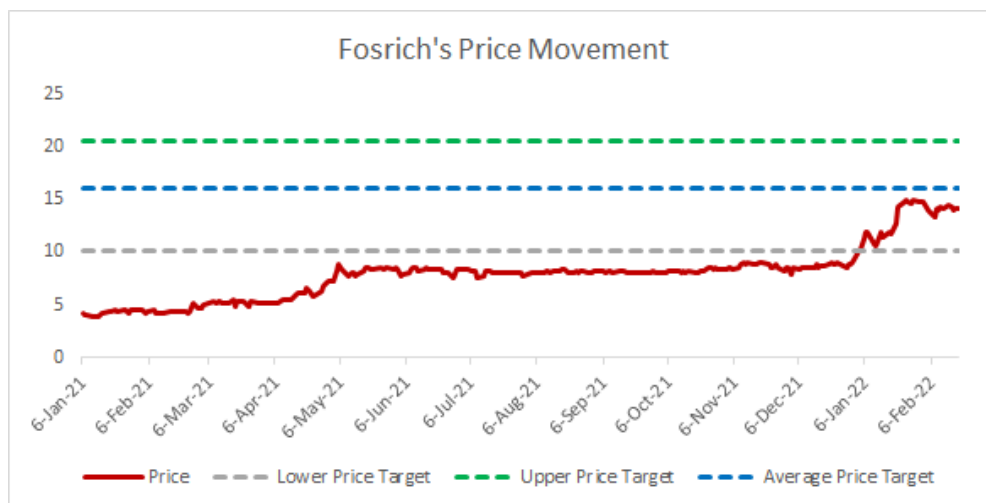
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interest rates, which would likely improve financing of housing developments, a recovery in global commodity prices, and a booming construction industry and increased demand for lighting and electrical products. Meanwhile, we looked at a different scenario with revenue generation deteriorating and increase in cost, due to increased interest rates and a rise in global commodity prices, which will likely result in a dampening in the construction industry and decreased demand for lighting and electrical products.

	Price Target	Implied Upside/Downside
Upper	\$ 20.51	39%
Base	\$ 16.82	14%
Lower	\$ 10.10	-32%

Additionally, we applied our forward EPS to the 1-year average PE ratio of 37.19x, which provided an intrinsic value of \$15.27. **Averaging these forecasts gives us a price target of \$16.04, which is 8.6% higher than the closing price \$14.77 on March 4, 2022.**



Key Risks to our price target

While we believe Fosrich's business model to be sound, it still faces operational risks. Due to Fosrich's higher level of inventories, a decrease in market demand would leave the company carrying inventories it is unable to clear in a timely manner.

Moreover, Forsich has upgraded their associate stake in Blue Emerald Ltd to a subsidiary. Blue emerald is set to begin manufacturing and repairing JPS trasnformers while also commencing the manufacturing of PVC pipes. The margins on these new activities are not yet known, neither is it

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clear if these new operations will be immediately profitable. The company faces the risk of consolidating a possible loss if these new activities under Blue Emerald are not profitable. Furthermore, the risk of Blue Emerald not being approved for Special Economic Zone Authority (SEZA) will likely prove to be costly for the company. The structure and conditions under which the SEZA operates is susceptible to changes in policy impetus by successive governments which could impact the profitability of Blue Emerald and ultimately Fosrich's profitability.

Additionally, a key risk to our earnings target are Fosrich's ability to contain its cost of goods sold. Cost of goods sold can be impacted due to increasing cost of global commodities, as a result of demand outpacing supply, ongoing global supply chain issues and increasing transport cost.

RECOMMENDATION

We assign an **OUTPERFORM/BUY** recommendation to Fosrich at this time, given that it is currently trading below our fair price estimate of \$16.04. This asset is most suitable for equity investors with a medium to high risk tolerance. This stock has appreciated by 47% year to date, as investors are optimistic about the future prospects of the company.

Abridged Financials	YEAR END						Change
	YE2016	YE2017	YE2018	YE2019	YE2020	YE2021	
Revenue	1,155,557,852	1,046,241,522	1,293,223,605	1,612,164,170	1,895,680,002	2,351,146,322	24.0%
Cost of Sales	(686,663,459)	(573,008,705)	(759,227,812)	(902,215,700)	(1,070,926,098)	(1,308,000,581)	22.1%
Gross Profit	468,894,393	473,232,817	533,995,793	709,948,470	824,753,904	1,043,145,741	26.5%
Administrative distribution and marketing expense	(384,296,428)	(404,831,281)	(422,793,468)	(487,324,506)	(505,750,293)	(631,626,512)	24.9%
Net Income	30,337,614	54,941,175	90,390,215	106,886,060	125,695,400	199,309,658	58.6%
Total Assets	1,119,683,835	1,294,218,493	2,052,591,331	2,450,064,317	3,056,388,378	3,766,603,299	23.2%
Total Liabilities	720,777,227	689,286,959	1,359,243,144	1,650,469,444	2,187,825,014	2,749,865,968	25.7%
Total Shareholder's Equity	398,906,608	604,931,534	693,348,187	799,594,872	868,563,364	1,016,737,331	17.1%
EPS (\$)	0.06	0.11	0.18	0.21	0.25	0.40	
Book Value per share (\$)	0.79	1.20	1.38	1.59	1.73	2.02	
Price to Earnings (x)			21.56	19.65	16.42	22.81	
Price to Book (x)			1.38	1.59	1.73	2.02	
Key Ratios							
Gross Profit margin	40.6%	45.2%	41.3%	44.0%	43.5%	44.4%	
Net Profit margin	2.6%	5.3%	7.0%	6.6%	6.6%	8.5%	
Return on Assets	2.7%	4.2%	4.4%	4.4%	4.1%	5.3%	
Return on Equity	7.6%	9.1%	13.0%	13.4%	14.5%	19.6%	
Current ratio (x)	1.60	2.71	4.16	4.30	3.46	2.83	
Quick ratio (x)	0.29	0.82	1.12	1.20	0.95	0.66	
Cash ratio (x)	0.03	0.05	0.21	0.15	0.06	0.09	

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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