JMMB INVESTMENT & SOVEREIGN RESEARCH

Stationery and Office Supplies Limited (SOS)

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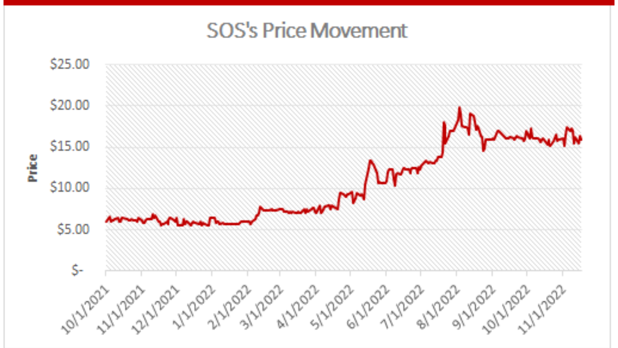
EXECUTIVE SUMMARY

Stationery and Office Supplies Ltd. (SOS), started operations in 1965. The company's shares were listed on the Junior Market of the Jamaica Stock Exchange on August 10, 2017. SOS 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 and industrial racks. The company is the sole local distributor for the Fursys and Boss brands of office furniture. Pre-pandemic, SOS was in acquisition and expansion mode, as they entered into the manufacturing space, with an $80M acquisition of the SEEK brand of notebooks during the 2018FY. 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.

SOS's PRICE MOVEMENT



SOS's Statistics		
Financial Year End		December
Stock Price (16/11/2022)	$	15.95
EPS	$	1.01
Book Value per share	$	3.54
P/E		15.80x
P/B		4.51x
Net Profit 9M2022 (millions)	$	253
Price Target	$	20.23
Dividend Yield		2.50%

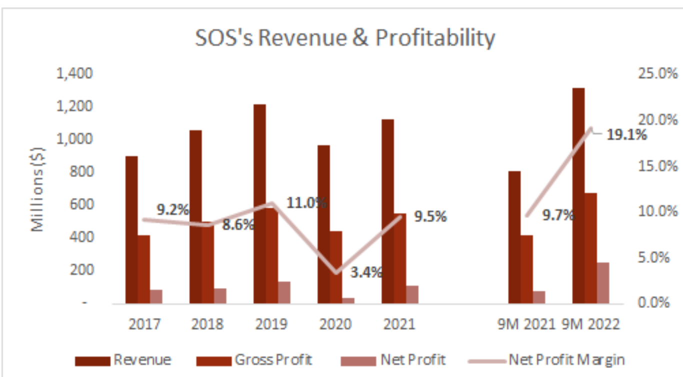
During the 2021FY, the economy began to show signs of recovery, which is reflected in SOS's revenue generation. SOS has grown revenues to $1.12B, a 15.7% increase over the 2020YE revenues of $972.32M. This improvement in revenue is an indication of the positive recovery of demand for the company's product offerings, as face to face class resumes and the termination of work from home (WFH) policies for some organizations. Subsequently, SOS reported revenue at $1.3B for the nine-month FY2022, that already outpaced the twelve month 2021FY by 17.4%.

SOS has continued efforts to contain cost and improve their profitably margins. SOS has grown profits to $107.12M for the 2021FY, compared to profits of $33.09M for the 2020YE. More recent, SOS reported profits of $252.54M for the nine-month period ended September 2022, compared to profits of $78.15M for the corresponding nine-month period in 2021.

We have placed an **OUTPERFORM/BUY** recommendation on the shares of Stationery and Office Supplies, as we believe the stock is trading below its fair value. Due to the nature and cyclicality of SOS's business, the pandemic has had a direct and lingering impact on their operations. A favorable economic environment encourages increased business activity and expansion; which SOS relies on to drive demand for its suite of office supplies.

Financial Performance

Profitability



SOS reported revenues of $1.12B for the year ended December 31, 2021. This represents a 15.7% increase when compared to revenues of $972M for the 2020 financial year. The rate of growth for revenues in 2021 was hindered by the advent of the pandemic, as containment measures to prevent the spread of the virus affected business operations.

The company's divisions have begun to recover positively from the onset of the pandemic, with a 26% year over year increase in the SEEK business segment for the 2021FY. This increase in demand for the SEEK notebook manufacturing business segment is as a result of the focus on corporate customers and the initial reopening of face to face classes in the latter quarters of the 2021FY. Subsequently, revenue increased by 83% to a Q3 record of $473M from $258.4M the corresponding quarter in 2021. This is mainly attributable to SOS's new furniture line, which generated revenues of $13.2M. Moreover, the expansion of the SEEK factory, which improved SEEK sales by 66% for the third quarter over the same period in 2021. Notably, for the 9M period, SOS reported revenue at $1.3B, that already outpaced the twelve month 2021FY by 17.4%.

Cost of sales increased by 9% from $526.89M to $573.70M for FY2021. Management highlighted that the company increased inventory and expanded product range based on the uncertainty of the ongoing supply chain issues, and the increase in cost of materials such as steel, paper and increased shipping costs.

However, 2021FY cost of sales growth has not significantly affected gross margins. The gross margin for the year was 49%, which is 1.5% higher than the 4-year average gross margin of 47.51%. SOS's gross profit of $551.15M, represents a 23.7% increase from 2020's gross profit of $445.43M.

Administrative expenses for the 2021FY totaled $319.53M. This reflects a 11.47% increase when compared to 2020's administrative expenses of $286.67M. In 2021FY, there were increases in staff related costs, increased legal and professional fees and rent. Additionally, selling and promotional expenses increased by 7.11% from $74.94M to $80.26M for FY2021.

Operating profit for the period under review amounted to $123.46M, which is an increase of 126.2%. After peaking at an operating margin of 13% in FY2019, the operating margin is at 11% in FY2021. More recent, for the 9M period, operating profit surged to $237.6M from $89.4M the previous comparable period in 2021. This is due to the reduction in company's operating expenses margin. Notably, operating margin for the 9M period rose from 11% to 18%.

Earnings before Interest, Tax, Depreciation and Amortization (EBITDA) for the 2021FY, increased by 80.6%, year over year, as it rose from $83M to $150M. The EBITDA margin also improved from 8.5% to 13.3%. Finance costs totaled $11.14M for 2021 compared to $14.91M in 2020. A repayment of debt totaling $42.58M was a major contributor to finance costs deteriorating.

Net Income for SOS for the financial year ended December 31, 2021 amounted to $107.12M. This represents a growth of $74M over the $33M recorded for the same period last year. Moreover, net margin significantly improved from 3.63% a year ago to 9.38%, above the 4-year average margin of 8.05%, which is an indication of SOS's continued recovery to pre-pandemic levels. Subsequently, for the 9M period, net profit amounted to $252.5M, up $174.4M from the $78.2M reported for the same period in 2021. The net profit margin stood at 19.1% for the 9M period, up from 9.7% for the previous comparable period.

Earnings per share (EPS) for the 2021FY came in at $0.43, up from $0.13 from the previous financial year. EPS recorded for the nine-month period FY2022 amounted to $1.01, up from $0.31 the previous comparable period. The trailing twelve month (TTM) EPS for SOS stands at $1.13

which when compared to the 2021FY represents an increase of 163%. The company's profitability continues to improve as revenue recovers and diversify, while cost containment measures begin to bear fruit.

Liquidity & Solvency

SOS's total assets grew to $928.02M as at December 2021, which represents a 4.5% increase year over year. Of this, fixed assets deteriorated from $427.1M to $404.1M, while current assets grew by 13.68%. Inventories and Trade and other receivables increased by 27.24% and 24.49% respectively. Management highlighted their decision to increase inventories for the period under review, in anticipation of shortage of inputs available for sale as a result of the ongoing supply chain issues and increasing cost. Moreover, prepayments increased from $31.07M to $68.63M as at FY2021.

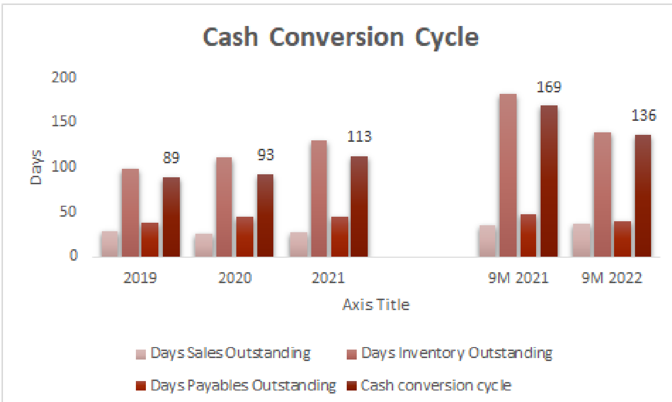
Cash and cash equivalents fell from $96.90M to $34.36M. This deterioration in cash and cash equivalents is mainly attributable to the decrease in cash provided by operating activities to $25.98M (2020: $125.93M), as a result of the increase in inventories, trade and other receivables and prepayments. Also, the repayment of loans also contributed to the decrease in cash and cash equivalents for the 2021 period.

Furthermore, Total assets climbed to $1.1B at the end of Q3 FY 22, a yoy increase of 22.2%. This increase is primarily due to a 38.3% yoy increase in current assets. Inventories, trade and other receivable and cash and cash equivalents increases are the primary drivers of the higher current assets. Cash and equivalents increased by 56.6% to $99.3M at the end of Q3 FY2022 (FY2021: $63.4M). Meanwhile, inventories and accounts receivables to $356M and $193.7M respectively.

For the 2021FY, the company had an increase in total equity of 11% or $67M. Shareholders' equity totalled $677M as at the end of the 2021FY while it stood at $610M at the end of the 2020FY. This increase in shareholders' equity is attributable to the increase in retained earnings to $476M from $409M booked in FY2020. The return on equity for the company improved significantly to 15.83% from 5.43% in FY2020.

SOS' total liabilities for the 2021FY fell to $251M from $278M, a decrease of 10% year over year. This was largely due to the company's decision to reduce its long term borrowings, which fell 42%, from $81.5M to $47M. This contributed to an overall 27.6% decline in non-current liabilities. SOS' interest bearing debt fell by 20.3%, down from $172M to $137M. This has had a direct impact on the company's finance costs as well as its debt to equity ratio, which fell to 0.20x from 0.28x.

The company's current ratio for the period under review was 3.57x, an increase from a ratio of 3.45x in 2020. However, the company's quick ratio fell to 1.56x from 1.71x in 2020, and the cash ratio followed a similar trend which stood at 0.07x, a decline from 0.21x in 2020.



Additionally, the company's cash conversion cycle has increased to 113 days from 93 days. This indicates that the company is taking a relatively longer time to sell inventories and recovering cash from these sales while paying suppliers. The main contributor to the increase in the cash conversion cycle is the increase in Days Inventory Outstanding (DIO) from 111 days during the 2020FY to 130 days 2021FY. This is due to the company holding a greater amount of inventory from $232.65M to $296.02M. However, for the 9M FY2022, the company's cash conversion cycle improved year over year from 169 days to 136 days. This is mainly due to the reduction in days inventory outstanding.

Cash Flow Statement Overview

SOS's cash from operating activities (CFO) represented inflows of $25.98 for the twelve-month period, relative to inflows of $125.93M in 2020. The deterioration in CFO was mainly driven by the increase in cash used for the increase in inventories and prepayments. Notably, the changes in working capital moved from an inflow of $58.75M in FY2020 to an outflow of $115.77M in FY2021, a main driver to the lower working capital is the increase in inventories from an inflow of $16.4M to an outflow of $63.4M. Moreover, the company's prepayments moved from an inflow of $5.2M to an outflow of $37.6M, indicating the company used more cash to pay suppliers. Also, accounts receivable represented an outflow of $24.3M from an inflow of $41M the previous year, indicating an increase in purchases on credit by consumers.

Cash from investing activities represented an outflow of $8.74M for FY2021, relative to an outflow of $41.49M in FY2020. Purchase of PPE was the primary outflow from investing activities, amounted to $9.52M.

Cash from financing activities represented an outflow of $79.67M for the period, relative to an outflow of $50.08 in 2021. This was mainly driven by the increase in dividends paid and the repayment of borrowings, which amounted to $40.02M and $36.58M respectively.

In FY2021, the company experienced a loss of $62.4M to its cash balance. To date, for the 9M 2022 period, the working capital positioning of the Company has deteriorated year over year. However, operating cash flow before working capital amounted to $265.2M relative to $114M in the prior year, a 133% increase due to improved profits reported for the quarter. The change in working capital for the period has amounted to an outflow of $125.5M from an outflow of $105.4M the prior comparable period. Consequently, net operating cash flow for the 9M period ended September 2022 has amounted to an inflow of $133.1M relative to an inflow of $368.8K the prior year.

Outlook & Valuation

The Jamaica economy is expected to have a positive recovery based on the projected upward trends of various indicators such as, real GP growth which is expected to trend upwards within the range of 2.5% to 4.5% for FY2022/23 and 1.0% to 3.0% for FY2023/24. According to the Bank of Jamaica (BOJ), the anticipated continued moderation in the unemployment rate over the medium term, is projected to decline to 5.9% over the September to June 2024 quarters. The expected improvement reflects employment growth in various industries, including, manufacturing, tourism, distribution, finance & insurance and business process outsourcing. The projected growth in the economy is largely reflective of a normalization of economic activity.

As the office supplies industry mirrors the economy as a whole, with the favorable projections of the Jamaican economy, SOS is projected to generate positive returns. SOS anticipates growth within the business, as plans are in place for further warehouse expansion which will increase storage capacity and an agreement with a manufacturer who supplies companies in the United States. Furthermore, with the relaxation of covid-19 containment measures, lower unemployment rates, the easing of work from home (WFH) policies by government agencies, the re-opening of schools and the resumption of face to face classes, we anticipate a recovery in demand of SOS's product offerings, which is likely to improve revenue generation and earnings.

Moreover, with the addition of the company new furniture line, "EVOLVE" and industrial racks to SOS's product line, and the company's aim distribute throughout the Caribbean, this is likely to further diversify and improve revenue and profitability margins.

We are forecasting revenues of $1.69B for the year ended December 2022, a 50% increase year over year and net profits of $305M, which corresponds to earnings per share (EPS) of $1.22. SOS has shown signs of recovery with record improvement in quarterly revenue results for the 2022FY.

We are forecasting a forward book value of $936.9M as at December 31, 2022, which translates to a book value per share of $3.75. We employed the price-multiples approach to determine the fair price for SOS. We utilized the average P/E of comparable listed companies to arrive at a market multiple of 22.47x, which when applied to the forward EPS of 1.22x resulted in a target price of $25.30, while the P/B for the peer group of 4.55x yields a price of $17.04.

The 1-yr historical average for the P/B ratio is 4.81x, which when applied to the forward BVPS yields a price of $18.03. The 1-year historical average for the P/E ratio is 16.86x, which when applied to the forward EPS yields a price of $20.56. **The average of our price forecasts, $20.23 is 26.8% higher than the closing price of approximately $15.95 recorded in the late November to early December period.**

Company	Market Capitalization	Price to Earnings	Price to Book	Return on Equity	Return on Assets	Dividend Payout	Dividend Yield
CAC	967,741,935	26.91x	2.50x	9.30%	2.78%	63.61%	2.36%
DTL	10,070,289,525	23.26x	1.81x	7.78%	3.89%		
EFRESH	1,007,190,000		2.36x	-10.68%	-3.54%		
FOSRICH	4,545,593,773	104.08x	20.40x	19.60%	5.29%	25.96%	0.25%
FTNA	9,332,829,943	21.00x	5.89x	28.04%	13.32%	41.22%	1.96%
INDIES	4,424,021,675	25.22x	4.07x	16.13%	8.77%	82.09%	3.25%
JETCON	542,655,000	35.19x	0.98x	2.77%	2.06%		0.00%
LASD	11,901,282,160	10.64x	1.48x	13.95%	8.16%	22.45%	2.11%
MDS	1,707,894,739	15.10x	1.44x	9.55%	3.94%	17.47%	1.16%
Sector Average	4,944,388,750	22.47x	4.55x	13.4%	6.0%	31.5%	1.8%
SOS	**3,989,421,975**	**21.20x**	**3.36x**	**15.83%**	**11.54%**	**37.36%**	**2.50%**

Recommendation

We assign a **OUTPERFORM/BUY** recommendation to SOS at this time. We anticipate a recovery in SOS's revenue generation, with the return of face to face classes and the WFH orders enforced by the government coming to an end. Furthermore, with the recovery of the economy and the improvement in unemployment rate, there is likely to be an increase in demand of SOS's products in the 2022FY. However, SOS still faces headwinds with the possibility of another wave of the coronavirus which is likely to impact business operations. 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 recover a significant portion of revenues which is likely to be lost due to the continuation of remote work.

Nevertheless, we anticipate a growth in SOS's revenue stream and profitably margins with the ongoing cost containment measures, expansion projects in the pipeline and as the economy recovers.

While this stock is most suitable for retail investors with a medium to high risk appetite, we are still expressing caution as the company's recovery is dependent upon the containment of the pandemic.

Abridged Financials	YEAR END						NINE MONTHS		
	YE2017	YE2018	YE2019	YE2020	YE2021	Change	Sep-21	Sep-22	Change
Revenue	$ 906,505,818	$ 1,064,360,671	$ 1,217,983,130	$ 972,318,382	$ 1,124,846,375	15.7%	$ 809,331,802	$ 1,320,810,385	63.2%
COGS	$ (483,492,384)	$ (559,850,241)	$ (635,366,957)	$ (526,892,239)	$ (573,699,215)	8.9%	$ (389,649,058)	$ (646,348,175)	65.9%
Gross Profit	$ 423,013,434	$ 504,510,430	$ 582,616,173	$ 445,426,143	$ 551,147,160	23.7%	$ 419,682,744	$ 674,462,210	60.7%
Operating Profit	$ 91,197,233	$ 98,252,564	$ 155,957,851	$ 54,580,079	$ 123,460,753	126.2%	$ 89,410,789	$ 237,559,182	165.7%
Profit for the year	$ 82,966,445	$ 91,673,074	$ 134,564,989	$ 33,091,492	$ 107,119,804	223.7%	$ 78,152,171	$ 252,541,888	223.1%
Total Assets	$ 655,203,852	$ 853,335,321	$ 907,044,937	$ 888,015,577	$ 928,019,172	4.5%	$ 918,757,104	$ 1,122,386,808	22.2%
Total liabilties	$ 241,449,170	$ 358,736,055	$ 310,396,347	$ 278,285,135	$ 251,188,206	-9.7%	$ 230,874,491	$ 238,035,644	3.1%
Total Shareholder's Equity	$ 413,754,682	$ 494,599,266	$ 596,648,590	$ 609,730,442	$ 676,830,966	11.0%	$ 687,882,613	$ 884,351,164	28.6%
EPS ($)	0.33	0.37	0.54	0.13	0.43		0.31	1.01	
Book Value per share ($)	1.65	1.98	2.39	2.44	2.71		2.75	3.54	
Key Ratios									
Gross Profit margin	46.7%	47.4%	47.8%	45.8%	49.0%		51.9%	51.1%	
Operating Margin	10.1%	9.2%	12.8%	5.6%	11.0%		11.0%	18.0%	
Net Profit margin	9.2%	8.6%	11.0%	3.4%	9.5%		9.7%	19.1%	
Return on Assets	12.7%	10.7%	14.8%	3.7%	11.5%		8.5%	22.5%	
Return on Equity	20.1%	18.5%	22.6%	5.4%	15.8%		11.4%	28.6%	
Current ratio (x)	2.69	2.64	3.75	3.45	3.57		4.72	5.08	
Quick ratio (x)	1.38	1.37	1.84	1.71	1.56		2.15	2.54	
Cash ratio (x)	0.03	0.12	0.13	0.21	0.07		0.12	0.14	
Debt/Equity (x)	0.29	0.41	0.34	0.28	0.20		0.21	0.13	

Source: www.jamstockex.com, boj.org.jm, pioj.gov.jm, 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

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