VM Wealth Management Limited

Company Analysis: FosRich Company Limited (FosRich) 6M 2023

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FosRich Group of companies

- Stock Recommendation: **MARKETWEIGHT**
- Current Price: $2.04
- Price Target: $1.84

- Shares Outstanding: 5,022,755,550 units.
- Financial Year End: December 31

ABOUT THE COMPANY

FOSRICH Company Limited is a diverse business involved in manufacturing, distribution, and retail. It specializes in offering lighting, wiring, and related products to industrial and residential customers. The company's central office is located at 79 Molynes Road, Kingston 10 serves as both an administrative centre and retail store. Aside from this location, the company operates four more outlets strategically placed in Montego Bay, Mandeville, and different parts of Kingston. The company generates revenue from five key business areas: electrical goods, energy solutions, hardware supplies, industrial machinery, and lighting products.

FosRich branched out further into PVC pipe manufacturing in 2019 to improve its revenue stream in the long run. This business endeavor has blossomed into the company now with arrangements to export PVC pipes to the USA by the end of 2023. This will be accomplished through the establishment of a new company overseas as well as their efficient manufacturing plants in Kingston and Clarendon.

FosRich launched a rights issue on June 2, 2023, to raise $139.32 million to fund the completions of its 30,000 square foot supercenter. The issuance offered additional shares to existing shareholders at a premium of $2.50 per share and gave shareholders one new ordinary share for every 90 ordinary shares held at the record date.

FINANCIAL PERFORMANCE SUMMARY

J$'000	FY 2021	FY 2022	6M 2022	6M 2023
Total Revenues	2,351,146.32	3,357,523.90	1,799,088.63	2,024,653.09
Gross Profit	1,043,145.74	1,386,641.84	788,409.75	817,850.64
Operating Profit	384,512.65	510,084.52	297,970.11	185,601.69
NPAT to Parent	199,309.66	328,752.15	297,970.11	162,496.61
Total Assets	3,766,603.30	5,072,552.91	4,690,190.66	5,081,880.35
Total Liabilities	2,749,865.97	3,287,440.26	2,872,110.20	3,139,281.83
Equity to Parent	1,016,737.33	1,785,112.65	1,818,080.46	1,942,598.53

Dividend Policy

The company doesn't have a definitive dividend policy but paid out interim dividends of $0.012 to shareholders last year.

Outlook

FOSRICH continues to execute its aggressive growth strategy which aims to realize revenues of $20 billion by 2027. The company has proven to weather the economic turbulence of the current year adequately so far registering improved revenues and profits despite rising operational and finance costs. Further growth is expected as the company intends to double PVC pipe production in the next 24 months as well as exports of PVC pipes overseas. High operational costs may however dampen FosRich's profit growth if cost effective inventory management and supply relationships are not established. Additionally, the company may face challenges to meet the labour demand of its growing business.

Projections and Valuation

To determine a fair value for FOSRICH, we averaged values from both the relative valuation method and a discounted free cash flow to equity valuation method. We projected the company's financials five years out given the risk involved in its strategic plan and estimated a discount rate of 15.7% and a long-term growth rate of 7.00%. We've applied the junior market retail industry P/E and P/B averages of 16.96x and 2.47x to our projected 2024 EPS and BVPS and arrived at an average price target of **$1.84.**

Risks to Price Target

The price target obtained may not be realized if the company is unable to manage its growing operating costs due to its expansion in distribution and production. Additionally, a demand shift from construction products and home lighting could overstate or understate our annual projections. The company may also struggle to regain momentum and positive investor sentiment after its stock split and recent rights issue saw the company's stock price further diluted.

SIX (6) MONTHS ENDING JUNE 30,2023

FosRich reported $2.02 billion in Revenue over the six months ending June 30, 2023, representing a 12.54% increase over the corresponding period last year, despite the high interest rate environment businesses currently operate in. Cost of Sales growth outpaced revenue growth at 19.41% which resulted in a marginal 3.73% improvement in gross profit. With the cost of goods sold outpacing revenue growth, gross profit margins have fallen by 3.43% relative to the corresponding period last year. The overall performance was due to increased sales in eight (8) of the company's twelve (12) Product Groups.

On the other hand, the improvement in sales was offset by a $121.61 million climb in administrative expenses, which amounted to $526.73 million year to date. This 30% increase from the $405.12 million for the same period last year is indicative of the increased staff-related costs for salary adjustments, increased sales commission due to improved sales performance and improvements in staff benefits. Finance costs for the period were $108.01 million, 19.25% more than the $90.58 million for the period last year. The increase in finance costs is reflected in rising bond renewal rates and bank financing.

Taxation of $23.11 million was recorded as the full tax remission arrangement has now matured for the latter 5 years since listing. Hence, Net profits fell by 45.47% to end at $162.50million (EPS: $3.00) from $297.97 million (EPS: $6.00). This decrease was driven by the increases in cost of goods sold, administration expenses and financial costs outpacing revenue growth.

The total asset base stood at $5.08 billion as of June 30, 2023, representing an 8.35% increase over the comparable period prior (6M 2022: $4.69 billion). The year-over-year growth was driven mainly by increases in Due from related parties, Inventories, and other receivables by 47.19%, 91.12% and 11.36% respectively. This has resulted in an improvement in the total asset turnover to 0.40x from 0.38x in 2022, thus the company has become more efficient in managing its assets to produce revenue.

Total Liabilities grew at a slightly higher pace than total assets Y.o.Y, at 9.30%, to end the half of the year at $3.14 billion. The increase was mainly due to increases in trade payables ($819.10 million) and long-term liabilities ($1.53 billion) by 31.30% and 2.18% respectively. Despite this, the company was still able to lower its long-term debt to asset ratio with a decline of 5.69% from 0.32x in 2022 to 0.30x in 2023, proof the company has strengthened its solvency as total asset growth was able to offset the rise in long term liabilities.

Shareholders' equity stands at $1.94 billion (BVPS: $0.39), up from $1.79 billion (BVPS: $0.36) in FY 22. The net increase arose due to an approximately $162 million increase in retained profits for the year-to-date.

OUTLOOK

Completion of new Supercentre

The four-storey supercentre being constructed at 76 Molynes Road through a partnership with Grace Kennedy Pension fund is expected to be completed by Q2 of 2024, the multi-use centre is expected to provide an estimated 1,500 jobs and house both the company's warehouse and corporate offices on the third and fourth floors. FosRich will hold a long-term lease for the property but will sublet office space on the building to a BPO. The completion of the project should see the company increasing its hardware offerings as well as becoming a one stop shop for electrical, PVC, energy, tiles, and other supplies. The company will spend approximately $200 million to outfit the building to meet its needs.

Market expansion via exportation of PVC pipes

The company is targeting the US PVC pipe market as manufacturing plants have been unable to properly fulfil the demand of some sectors of the market. This where FosRich intends to leverage the manufacturing of its three lines of electrical, water and drainpipes. The company is poised to start this initiative by the end of the year as their manufacturing plants have been producing efficiently at international quality standards. To smoothly execute their plans, the company has established a company in the USA to conduct business.

INVESTMENTS POSITIVES:

- The company has adopted an aggressive organic growth strategy through the expansion of its product offerings such as PVC piping thus increasing their revenue prospects.
- PVC pipe exports its PVC pipes to the USA will increase revenue streams and provide exposure to a wider market.
- The construction of the new FosRich Superstore and corporate offices which is set to be completed by Q2 of 2024 is more evidence of the company's growth.
- The company has distribution partnerships with large global companies such as Phillips Lighting and General Electric
- The increased demand for renewable energy solutions will work to the company's advantage as they provide installation for solar products.

INVESTMENT NEGATIVES

- The current high interest rate environment will pose a challenge to its debt servicing and financing costs.
- The increased operational costs that will accompany more manufacturing activity may further strain profit margins and efficiency.
- The business is exposed to the volatility of the global commodity market which may result in increased raw material costs.
- The low barriers to entry within the solar energy and lighting industry expose Fosrich to competition risk as the market becomes more saturated.
- Diseconomies of scale such as inefficient inventory management and high labour costs as a result of its supercenter opening.
- The recent rights issue could dampen investor sentiment towards the company as it may allude to the company having funding issues.

CONCLUSION

Fosrich's financial performance has demonstrated that the company continues to perform in alignment with their growth objectives for organic growth through revenue improvement. This occurred against the backdrop of a high interest rate environment in response to elevated inflation. The increased operational and administrative costs have translated into the reduced Net Profit after tax. The company however has a robust asset base and adequate equity.

Prospects for continuous growth are being observed through the construction of their supercentre as well as plans to export their PVC pipes to America. The outlook continues to weigh towards the upside while the most imminent risks to the price are its growing operating expenses through expanding production as well as exogenous economic shocks.

We valued the company by applying the junior market retail industry P/E and P/B of 16.96x and 2.47x to our projected 2024 EPS and BVPS and arrived at an average price target of $1.84. The stock is trading ($2.04) slightly above the target price thus we recommend that investors MARKETWEIGHT the stock in their portfolios and be very speculative about the security.

SOURCES

Supreme Ventures Limited Annual Reports, Jamaica Stock Exchange (JSE), The Gleaner Company, Loop News Jamaica, The Jamaica Observer, and the Financial Services Commission (FSC), RJR News, OUR Today, Caribbean National Weekly

DISCLAIMER

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.