VM Wealth Management Limited

Company Analysis: Stationary & Office Supplies Limited (SOS) 9M 2023

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STATIONERY & OFFICE SUPPLIES LTD.

- Recommendation: **OVERWEIGHT**
- Current Price: $1.68
- Price Target: $1.97

- Shares Outstanding: 2,251,084,500 units.
- Financial Year End: December 31

ABOUT THE COMPANY

Established in 1965, Stationery and Office Supplies Limited (SOS) is a versatile company engaged in retail, manufacturing, and distribution, specializing in stationery and office furniture. The primary office is situated at 23 Beechwood Avenue, Kingston 5, while SOS also operates from an additional location in Montego Bay. With a combined footprint of around 35,000 square feet, the company is supported by a workforce of 110 employees across both locations.

In May 2018, the company purchased the manufacturing assets of Book Empire Limited. This acquisition allowed the company to bring in-house the production of pads and paper stationery, eliminating the necessity for outsourcing. The company then established the 'SEEK Manufacturing Division.'

SOS shareholders made a unanimous approval for a 9:1 stock split, scheduled for implementation on August 2, 2023. This raised total shares issued from 250,120,500 to 2,251,084,500 and resulted in each shareholder receiving nine additional shares for each share they held.

FINANCIAL PERFORMANCE SUMMARY

J$'000	FY 2021 Dec-2021	FY 2022 Dec-2022	9M 2022 Sep-2022	9M 2023 Sep-2023
Revenue	1,124,846	1,748,143	1,320,810	1,532,320
Operating Profit	123,461	263,648	237,559	327,902
Net Profit	107,120	256,538	252,542	294,337.76
Total Assets	928,019	1,385,149	1,122,387	1,728,005
Total Liabilities	251,188	281,925	380,467	238,036
Total Equity	23,448,904	32,894,615	27,830,621	29,694,296
Current Ratio (x)	1.61	1.83	1.75	1.91

Dividend Policy

SOS does not have a definitive dividend policy. Notwithstanding, the company has maintained steady dividend payments over the last five years and has paid out 30% of its annual earnings to Shareholders on average. Their latest dividend declared was $0.20 per share as of June 23, 2023.

Outlook

The company has adopted a proactive strategy for its growth and performance, focusing on enhancing revenues across diverse business lines and expanding regionally. The completion of the expansion of an existing warehouse and the investment in another indicate a clear trajectory for ongoing revenue growth and improved profitability. Nevertheless, SOS needs to exercise caution and monitor the potential diseconomies of scale that could emerge during expansion. It is crucial to be aware of the challenges that may arise from increased production and further expansion, as these factors can negatively impact profits. If these risks are carefully considered and managed, SOS can confidently pursue continued growth in both revenue and profits.

Projections and Valuation

We used a combination of the Market Comparable Approach and a Discounted Cashflow (DCF) Model to determine the value for the stock. For the DCF approach, a cost of equity of 16.47% was used to discount the future levered free cash flows. For the comparative approach, a 2024 forward BVPS and EPS of $0.71 and $0.19, respectively were used. An implied P/B and P/E of 3.00x and 14.00x were deemed appropriate and were used to determine a relative value. By averaging all three approaches, we obtained a consensus target price of **$1.97.**

Risks to Price Target

We foresee potential challenges for the Company in achieving our projected target price, especially if the ongoing market downturn and relatively subdued investor sentiment persist, despite the Company's solid fundamental strength. The uncertainties surrounding prices are further influenced by fluctuating commodity costs and the potential for disruptions in supply and distribution channels. However, the Company has proactively addressed these risks through local expansions and regional partnerships. Considering both the recognized risks and the implemented mitigations, the company is well-positioned to reach its price target over the medium to long term.

NINE (9) MONTHS ENDED September 30, 2023

For the nine-month period ending in September 2021, SOS experienced a 16.00% increase in revenue, rising from $1.32 billion to $1.53 billion. This growth was attributed to ongoing expansion across all business lines, particularly notable in heightened revenues at the Montego Bay branch, increased demand for document destruction services, and a surge in the popularity of SEEK-branded books and BOSS chairs. The upturn in revenue led to an 8.69% increase in the cost of goods sold, reaching $702.52 million from $646.45 million. Despite this, the Cost of Goods Sold (COGS) Margin dropped by 631 basis points to 45.85%, down from 48.94%, primarily due to the substantial improvement in revenue. Gross Profit saw a significant boost, reaching $829.80 million, up by 23.03% from $674.46 million, driven by the improved revenue performance.

Operating Profit witnessed a 38.03% improvement, ascending to $327.90 million from $237.56 million. This surge was mainly attributed to enhanced sales, accompanied by a notable increase in other income and a slight decrease in Depreciation and Amortization. However, the rise in Operating Profit was mitigated by a substantial increase in impairment loss on financial assets and elevated Administrative and General Expenses, along with a 20.42% growth in Selling and Promotional costs, and a marginal 0.70% increase in these expenses, respectively. Net Profits increased by 16.55%, reaching $294.34 million, up from $252.54 million, driven by extraordinary foreign exchange gains and a 19.78% reduction in finance costs.

Total Assets experienced a surge of 53.96%, reaching $1.73 billion from $1.12 billion. This growth was fueled by increases in Property, Plant and Equipment, Trade and Other Receivables, expanding by 69.07% and 63.83%, respectively, and a substantial rise in Bank and Cash. Total Liabilities increased by 59.84%, reaching $380.47 million from $238.03 million to $230.87 million, primarily due to notable increases in Trade & Other Payables and Deferred Tax Liability. However, these increases were partially offset by reductions in the current portion of borrowing and borrowings, down by 21.97% and 83.16%, respectively, indicating a proactive approach to debt reduction, which decreased by 49.35%. Total Equity surged to $1.35 billion from $884.35 million, marking a 52.38% increase, attributable to a 9:1 stock split boosting capital reserve by over 100%, and a 36.31% improvement in retained earnings due to enhanced profits.

Return on Equity decreased to 26.73% from 35.61%, a decline of 24.92%, primarily due to the increase in total equity surpassing the growth in earnings for the period. The Current Ratio fell by 29.59% to 3.38x from 4.81x, resulting from a rise in current liabilities outpacing the increase in current assets. The upswing in Trade & Other Payables contributed to the elevation in current liabilities. Nevertheless, the company remains in a comfortable position to meet short-term debt obligations, as the current ratio, though decreased, remains satisfactory. Debt to Equity fell impressively to 0.04x from 0.13x, a reduction of 66.76%, attributable to the 49.35% cut in total debt.

OUTLOOK

Regional and local expansion to boost revenues.

Stationery and Office Supplies (SOS) has acquired a new facility located at 5 West Arcadia Avenue, Kingston 5, to expand its warehousing capacity. The $100 million investment, covering a quarter of an acre, serves not only to strengthen the company's warehousing capabilities but also strategically positions it to enhance supply chain operations and fulfil local and regional demand more efficiently and boost its revenue and by extension profits.

Stationery & Office Supplies Limited (SOS) has also established a presence in Trinidad & Tobago through a partnership with The Office Authority Limited, a regional supplier of school and office products. This collaboration involves the distribution of three furniture lines by SOS in the Trinidad & Tobago market. Additionally, SOS will engage in business activities on behalf of The Office Authority Limited within its domestic market. This partnership will provide an additional supply route to the local market while opening up opportunities for expansion in other islands.

INVESTMENTS POSITIVES:

- The Company continues to improve its sales as demand remains strong.
- Expanding warehouses island wide is expected to boost operational efficiency as well as meet growing demand.
- Regional expansion is expected to provide further boost to revenue and profits.
- Profitability is expected to continue to improve, especially after the completion of the second warehouse in Kingston.
- SOS faces little market competition locally.
- The Company has maintained comfortable liquidity, as evidenced by its strong current ratio.
- The stock split provides the company with the opportunity to increase investors and improve market presence.

INVESTMENT NEGATIVES

- Increased operational costs and direct expenses due to warehouse expansion could cause concern if operational efficiency is not addressed.
- The increased operational costs that should accompany the entrance into a new market may strain profit margins.
- The company could face market saturation if local demand remains relatively the same in coming years.
- The stock split, though done for strategic growth reasons could leave existing shareholders with negative sentiment as it resulted in the share price falling.
- SOS may have to diversify into more product offerings in the coming years as a shift away from paper products occurs as technology becomes more accessible as well as increased environmental awareness.

CONCLUSION

SOS is poised to remain a fundamentally sound company as it continues to exercise its growth strategies through expansion and increased market presence. The company's consistent success in revenue growth and profitability positions it favorably to emerge as a dominant market leader both locally and regionally in its specific business line. Its ongoing expansions and new investments into more warehouse spaces is a testament to the strong and growing demand locally. The continuous expansions and new investments in additional warehouse spaces underscore the robust and growing local demand. The company's sustained achievements rely on effective inventory management and a commitment to seamless operational efficiency, as demonstrated by the reinforcement of its warehouses and the enhancement of supply chains through its partnership with The Office Authority Limited in Trinidad.

Using an Intrinsic Approach with a cost of equity of 16.47%, we valued the company at $2.13 per share. Applying a P/E multiple of 14.00x and a P/B multiple of 3.00x, in line with the average of its peers on the Jamaica Stock Exchange, we arrived at a consensus target price of $1.97 which is a 17.23% upside from the current price of $1.68. Considering this, we have assigned an **OVERWEIGHT** rating to the stock.

Additionally, investors may potentially realize further capital gains through dividend payments.

SOURCES

SOS Annual Reports and Quarterly Financial Statements , Jamaica Observer, The Gleaner, Jamaica Stock Exchange

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- **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.