VM Wealth Management Limited

Company Analysis: FosRich Company Limited (FosRich) FY 2023

VMWM Research | May 10,2023

876-960-5000 vmwmclientservices@myvmgroup.com vmwealth.myvmgroup.com 53 Knutsford Boulevard, Kingston 5

FosRich Group of companies

- Stock Recommendation: **OVERWEIGHT**
- Current Price: $2.08
- Price Target: $2.55

- Shares Outstanding: 5,078,485,197 units.
- Financial Year End: December 31

ABOUT THE COMPANY

FOSRICH Company Limited operates as a multifaceted enterprise engaged in manufacturing, distribution, and retail activities. It specializes in providing lighting, wiring, and associated products catering to both industrial and residential clientele. Situated at 79 Molynes Road, Kingston 10, the company's headquarters functions as both an administrative hub and a retail outlet. In addition to this central location, FOSRICH operates across nine retail outlets strategically positioned in Kingston, Clarendon, Mandeville, and Montego Bay. The company derives revenue from five primary business segments: electrical goods, energy solutions, hardware supplies, industrial machinery, and lighting products.

In 2019, FOSRICH diversified its operations by venturing into PVC pipe manufacturing, aiming to bolster its revenue streams in the long term. This expansion has flourished, leading to plans for manufacture and export of PCV pipes to Guyana. The completion date of the FosRich Superstore and Corporate Office at Molynes Road is projected to be Q3 2024. In addition to this massive project the company has opened a retail outlet in St. Ann and plans to open another in St. James.

FINANCIAL PERFORMANCE SUMMARY

J$'000	FY 2020	FY 2021	FY 2022	FY 2023
Total Revenues	1,895,680.002	2,351,146.32	3,372,945.924	3,696,595.282
Gross Profit	824,753.904	1,043,145.74	1,329,259.402	1,562,530.493
Operating Profit	285,717.298	384,512.65	508,156.45	496,951.455
NPAT to Parent	125,695.400	199,309.66	324,712.24	235,328.145
Total Assets	3,056,388.378	3,766,603.30	5,928,552.91	5,678,543.199
Total Liabilities	2,187,825.014	2,749,865.97	3,513,440.26	3,636,977.176
Equity to Parent	868,563.364	1,016,737.33	1,785,112.65	2,041,566.023

Dividend Policy

The company does not have a definitive dividend policy but paid out interim dividends of $0.021 to shareholders last year.

Outlook

FOSRICH remains committed to its ambitious growth plan, targeting revenues of $20 billion by 2027. Despite facing economic challenges this year, the company has demonstrated resilience by achieving enhanced revenues, albeit with profits affected by increased operational and financial expenses. Expansion plans include scaling up PVC pipe production to meet demand in the Guyanese market, yet high operational costs could potentially impede profit growth unless efficient inventory management and supply relationships are established. Furthermore, meeting the labor demands of the expanding business may pose additional challenges for the company.

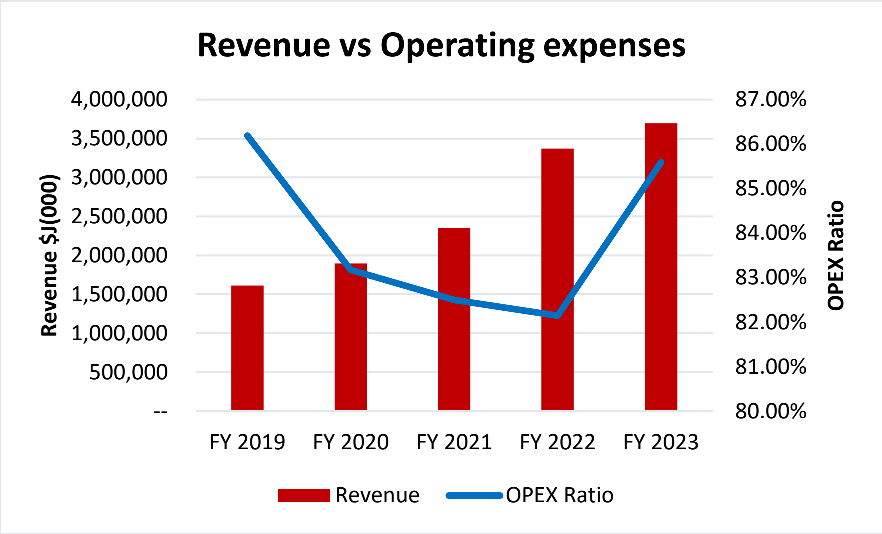
Projections and Valuation

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 13.00% and a long-term growth rate of 5.00%. We have used an applied P/E and P/B averages of 13.00x and 2.32x to our projected 2024 EPS and BVPS and arrived at an average price target of **$2.55.**

Risks to Price Target

If the company faces challenges in controlling its escalating operating expenses linked to its distribution and production expansion, it might not achieve the set price target. Moreover, a shift in demand away from construction goods and home lighting due to heightened cost-of-living pressures might lead to inflated annual forecasts. Furthermore, the company could encounter difficulties in restoring momentum and fostering positive investor sentiment following its stock split and recent rights issue, which resulted in further dilution of the company's stock price.

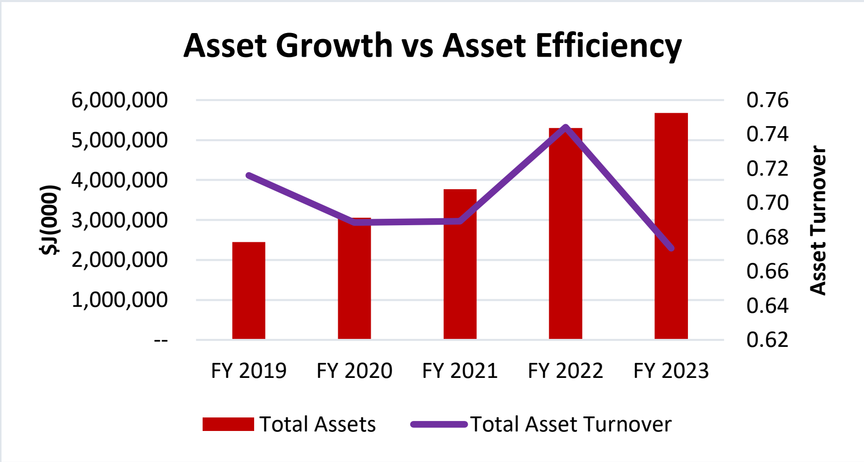
FINANCIAL YEAR ENDING DECEMBER 31,2023



FosRich reported $3.70 billion in Revenue for the financial year ending December 31, 2023, representing a 9.60% increase over the corresponding period in 2022, despite having to operate in the high interest rate environment. The growth in revenue outpaced the 7.74% growth in cost of sales which resulted in a 12.23% improvement in gross profit. The improved sales performance is accredited to strong performances in several product lines namely Hardware, Lighting, Wiring Devices, Wires and PVC products which all saw year over year increases raging from 53% to 11%. Geographically, sales in Manchester surged, making it the third largest sales volume region having contributed to 17% of the company's sales.

On the other hand, the positive gross profit was offset by a $239.88 million climb in administrative expenses, which amounted to $1.03 billion year to date. This 30.36% increase from the $790.01 million for the previous financial year is indicative of the increased advertising costs, staff-related costs for salary adjustments, increased sales commission due to improved sales performance and improvements in staff benefits, resulting in a 2.21% decline in operating profits from $508.16 million to $496.95 million. Moreover, finance costs for the period amounted to $219.57 million, 20.36% more than the $182.42 million for FY22. The increase can be attributed to higher bank charges and interest on loans.

Taxation of $42.15 million was recorded as the full tax remission arrangement has now matured for the latter 5 years since listing. Hence, Net profits fell by 27.55% to end at $235.24million (EPS: $0.05) from $324.71 million (EPS: $0.06). This decrease was driven by rises in total operating expenses, financial costs, and taxation outpacing revenue growth. The 28.17% increase in total operating expenses resulted in the worsening of the Operating ratio from 82.14% in FY22 to 85.59% in FY23.



As of December 30, 2023, the total asset base amounted to $5.68 billion, representing a 7.17% increase over the comparable period prior (FY22: $5.30 billion). The year-over-year growth was fueled by increases in Property, Plant and Equipment, Right of Use assets, Other receivables and Prepayments and Related parties, increasing by 4.73%, 6.76%,29.37% and 831.81% respectively. Despite this expansion in the company's total asset base, the total asset turnover worsened from 0.74x in FY22 to 0.67x. It can be observed that assets are not being utilized more efficiently to produce revenue which may allude to issues with the utilization of fixed assets or poor inventory management.

Total Liabilities grew at a slower pace than total assets Y.o.Y to end at $3.64 billion. The growth in liabilities was predominantly driven by a 48.98% growth in long-term liabilities ($1.37 billion), most notably motor vehicle loans and a non-revolving loan facility from First Global Bank. Additionally, trade payables increased by 36.45% ($1.08 billion) leading to a longer Days Payables Outstanding (DPO)from 128 days in F22 to 160 days in FY23, indicating delayed accounts payables repayment. Despite the rise in liabilities, the company maintained its long-term debt to asset ratio at 0.34x, indicating sustained solvency as total asset growth was able to offset the rise in long-term liabilities.

Shareholders' equity rose to $2.04 billion (BVPS: $0.40) from $1.79 billion (BVPS: $0.35) in FY22, marking a net increase of 14.37%. This increase stemmed from rises in share capital ($491.30 million) and retained earnings ($981.17 million), growing by 32.92% and 15.08% respectively. However, the reduction in profitability combined with increased shareholders' equity led to a decreased Return on Average Equity (R.O.A.E), declining from 23.20% in FY22 to 12.30% in FY23. This decline in return was influenced by the dilution of the company's share pool resulting from its rights issue in June 2023 and its 10-1 stock split in July 2022.

OUTLOOK

Commercial Energy Storage Partnership with Huawei

FosRich Company Limited, in partnership with Huawei, is launching a commercial-grade energy storage system in Jamaica, aiming to assess market reception. The Luna 2000 system, equipped with lithium-ion batteries and AI, targets reducing energy bills by up to 30% during peak hours. Initial investment for businesses is around $20 million, but financing options are available. FosRich plans to target various sectors, including aviation, construction, and retail, and aims to expand into government institutions and charging stations. The company has diversified its offerings over the years and is now involved in transformer manufacturing and repair, among other ventures thus staying consistent with the company's continuous product innovation strategy.

Guyanese Market Expansion

FosRich raised $900 million through a bond offering to address demand in the Guyanese market. The funds will support the purchase of raw materials for PVC pipes and electric transformer repairs. With Guyana's significant infrastructure projects, the business sees opportunities for its products and services. Discussions are underway with Guyana Power and Light Incorporated for transformer repairs. Collaborations with partners like Huawei and China Harbour Engineering Company will also facilitate solar projects and infrastructure development. While there are no plans for a physical presence in Guyana, FosRich aims to meet demand and explore further opportunities in the market.

Hardware Retail Expansion

The company has acquired Bayside Supersaver Hardware in Montego Bay for $1 billion, marking its entry into the hardware retail business. CEO Cecil Foster plans to reopen the store under a new name in two weeks. This move aligns with the company's key strategic objective of strategic partnerships and aggressive market expansion.

INVESTMENTS POSITIVES:

- The company has adopted an aggressive organic and inorganic growth strategy through the expansion of its product offerings such as PVC piping as well as acquisition of other businesses to increase their revenue prospects.
- More strategic partnerships and acquisitions with Huawei and Bayside Supersaver Hardware will allow for the company to better realize its Pinnacle 2027 revenue target of $20 billion.
- The Guyanese market expansion will result in further profitability for the company whilst growing the business's market's presence regionally.
- Entrance into hardware retail business demonstrates the company's alignment with its continuous product innovation which further diversifies earning possibilities.
- 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 as a result of regional expansion may arise such as inefficient inventory management and higher labour costs to service higher demand.
- The debt raised to fund its Guyanese expansion may impact the company’s solvency as it becomes more highly leveraged.

CONCLUSION

FosRich's financial performance reaffirms its commitment to achieving organic growth by enhancing revenues, aligning with its growth objectives. This progress occurred despite operating in a high-interest-rate environment amid heightened inflation. However, increased operational and administrative costs have led to a decline in Net Profit after tax. Nevertheless, the company maintains a strong asset base and sufficient equity.

Continuous growth prospects are anticipated, driven by strategic partnerships and the recent acquisition in the hardware retail sector. The overall outlook leans towards a positive trajectory, although the most immediate risks to the stock price include escalating operating expenses due to expanding production and operations, as well as unforeseen economic shocks.

We valued the company by using an applied P/E and P/B of 13.00x and 2.32x to our projected 2024 EPS and BVPS and arrived at an average price target of $2.55. The stock is trading ($2.08) which is below target price thus presenting an opportunity to realize 22.73% in capital gains. Hence, we recommend that investors OVERWEIGHT the stock in their portfolios given the company has greater intrinsic value than its currently traded price.

SOURCES

FosRich Company Limited Annual Reports, Jamaica Stock Exchange (JSE), The Gleaner Company, The Jamaica Observer, RJR News,

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.