Fund Managers Ltd.

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EQUITY RESEARCH REPORT

SUMMARY REPORT

One Great Studio Company Limited

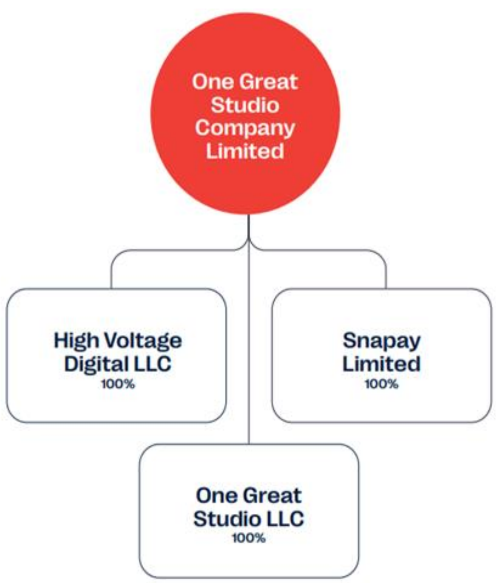
Reading Time: 15 mins

One Great Studio (1GS) is a full-service marketing agency that specializes in offering an extensive array of digital marketing services, placing a central emphasis on key digital channels including websites, social media platforms, mobile apps, and search engines. The Company was incorporated in Jamaica in 2012.

Since then, they have evolved from a modest 2-person design and development studio into a larger 55-member Digital-First Agency within a decade. The Company specializes in services engineered to propel revenue growth for clients across the globe. The team is led by co-founders Djuvane Browne and Gina DeLisser, who have over 3 decades of combined experience in technology and design. Prior to 2022, One Great Studio Company Limited (1GS) focused on organic expansion, growing mainly through client referrals and word-of-mouth. In 2021, to bolster expansion, 1GS began the acquisition of High Voltage SEO (HVSEO). To manage this acquisition, High Voltage Digital LLC (HV Digital) was created.

Corporate Structure

HV Digital, a US-based digital agency, outsources all its services to 1GS, with all its revenues credited to One Great Studio Company Limited.



One Great Studio LLC handles some key administrative roles for 1GS, including global payment processing, while Snapay Limited, a dormant company, was formed for a yet-to-be-marketed digital product.

1GS serves a wide client base including corporations, governments, and non-profits worldwide. Notable local clients are Barita Investments Limited and Jamaica Broilers Group Limited among others. 1GS is preparing for an Initial Public Offering (IPO) in 2023.

1GS Services in 2022

1GS specializes in digital marketing solutions aimed at enhancing brand reputation online. Their services span across five key areas:

1. **Web**: Covering website design, e-commerce development, and security measures.
2. **SEO**: Encompassing SEO audits, technical SEO, and Google Business optimization.
3. **Digital**: Services like digital strategy, ad placement, and social media marketing.
4. **Apps**: Focused on web and mobile app development, along with user experience design.
5. **Brand Strategy and Design**: Offers brand strategies, design guides, and logo creation.

IPO

BUY

Key Features	
Offer Price	J$1.00
Estimated Fair Value	J$1.14
Implied Discount	11.96%
Forward EPS	J$0.052

SUMMARY

One Great Studio Company Limited is seeking to raise J$338,627,439.00.

- No. of shares offered 338,627,439 Ordinary Shares @ ~J$1.00 per share. This offer includes Reserved Shares of 338,627,439.
- If successful, the Company will apply to the JSE for the Shares to be admitted to the Junior Market

Invitation Details

One Great Studio Company Limited is inviting offers for the subscription of up to 338,627,439 Ordinary Shares at a price of J$1.00 per share. The Offer is an "all or nothing" invitation as the Subscription Shares, if taken up in full, would represent exactly 20% of the fully paid, subscribed participating voting share capital of the Company, which is the minimum requirement for listing under the Junior Market Rules. If the Invitation is not fully subscribed by the Closing Date the Company will not make an application for the Shares to be admitted to the Junior Market of the JSE and all payments will be returned (or refunded in full) to the Applicants making them, without interest. Please see the Summary of the Terms of the Offer for more details.

Summary of Offer Terms			
Company	One Great Studio Company Limited		
Lead Broker and Arranger	Barita Investments Limited		
Shares the Subject of the Invitation	Up To 338,627,439 Ordinary Shares		
Offer Open	9:00 a.m. on August 28th, 2023.		
Closing Date	4:30 p.m. September 18th, 2023.		
Share Allocation	**Key Strategic Partners**	**1GS Team Members**	**General**
	J$1.00	**J$1.00**	**J$1.00**
	152,382,348	**16,931,371**	**169,313,720**
Use of Proceeds	The proceeds will be used to pay the Invitation and Listing Expenses. The Company intends to use the balance of the proceeds of the Invitation for (i) reducing the debt owed to Barita Investments Limited, (ii) strategic growth initiatives, and (iii) developing human capital.		
Minimum Share offering	10,000 Shares, with increments of 1 Share thereafter		

Corporate Governance

The board comprises seven (7) members; Two (2) Executive Directors, Four (4) Independent Directors, and One (1) Non-Executive Director. Global best practices recommend that most directors be independent as they are more likely to consider the best interest of shareowners first[1]. In theory, independent directors will not be subject to pressure, and therefore are more likely to act in the shareholders' interests when those interests run counter to those of entrenched management. The directors selected for the Board of 1GS bring diverse backgrounds, encompassing legal, manufacturing, finance, and technology expertise. The Company has stated that they have formally applied to the JSE for an exemption from the mandatory mentor appointment requirement. 1GS asserts that several directors on the Board possess the requisite experience to offer guidance. In the event of an unfavourable outcome, the Company is prepared to designate Jacqueline Sharp, a director and an accredited JSE mentor, proficient in finance, risk management, and compliance, as its appointed mentor.

DIRECTORS		
Independent	**Executive Directors**	**Non-Executive Directors**
John Bailey	Djuvane Browne	Rachel Browne
Jacqueline Sharp	Gina Delisser	
Simone Bowie Jones		
Marc Ramsay		

[1] https://www.cfainstitute.org/en/advocacy/issues/board-independence#sort=%40pubbrowsedate%20descending

Industry

IGS operates as a digital-first marketing agency within a fiercely competitive industry characterized by accessible entry points. This landscape comprises a multitude of agencies and independent freelancers, transcending geographical boundaries. Notably, the Company strategically positions itself within a niche sector, catering to medium to large enterprises. Consequently, the barriers to entry are elevated in contrast to the less sophisticated end of the market.

The industry's core drivers encompass two pivotal factors: (i) the escalation in Internet penetration and (ii) the surge in digital marketing activities. These driving forces are projected to sustain their growth trajectories, owing to advancements in technology and infrastructure alongside significant societal shifts. However, the swift evolution of technology underscores the necessity for Digital-First Agencies to continually embrace the latest advancements, ensuring their ability to retain competitiveness in the market.

Financial Analysis

Revenue & Profitability

In the last five years of IGS' operations, the Company showed tremendous topline growth. Between FY 2018 to FY 2022, revenue grew at a CAGR of 82.7%, to reach J$238.9 million at the end of the five-year period from the J$21.4 million it reported for FY 2018. Between FY 2018 and FY 2022, majority of revenues were delivered through its web development service. The significant uplift in revenues over the period up to FY 2022 came as the company continued to expand its service offerings, culminating with the acquisition of the search engine optimization firm, HVSEO, in the last quarter of FY 2022. Based on FY 2022 results, search engine optimization (SEO) is now the largest contributor to revenues at 37.9%, while website and application development now accounts for 37.6%. Management believes that the recent acquisition has positioned the company as a comprehensive Digital-First Agency, providing it with a distinct competitive advantage. It is important to note that with the HVSEO acquisition, IGS is now generating close to 50% of its revenues from developed markets.

As of December 2022, IGS had a client count of 117, and its top three clients collectively accounted for approximately 30% of total revenues. However, it is anticipated that after completing one full year following the acquisition, the customer concentration will decline further, thus reducing the company's vulnerability to reliance on any single client.

As the Company grew between FY 2018 and FY 2022 its staff complement expanded to adequately support its growing business. As a portion of its staff cost is captured in direct cost, the Company's direct expenses moved in line with its expansion from J$9.9 million at the end of FY 2018 to J$52.4 million at the end of FY 2021. In FY 2022 the direct cost was J$111.1 million, following an increase of J$58.7 million. With this increase, IGS' gross margin fell from 59.1% in FY 2021 to 53.5% in FY 2022. IGS outlines that this decline was as a result of the incorporated expenses of the SEO business, which are primarily weighted towards direct costs due to contract labour and commissions.

Between FY 2018 to FY 2022 IGS' operating expenses moved from J$7.58 million to J$65.8 million, a CAGR of 71.7%. As the Company underwent growth, as explained earlier, its team expanded. Given the nature of its business, staff costs have consistently been the major component of operating expenses. These staff costs can be considered as indirect in nature, as they were not directly related to a specific project. Conversely, the direct staff costs mentioned previously, relate to project expenses, and are therefore captured in the direct expenses associated with service delivery. Notwithstanding the expansion in operating expenses, the company's efficiency, as measured by its expense ratio, improved. The ratio moved from 35.3% in FY 2018 to 32.5% in FY 2021 and then further decreased to 27.5% in the year of the acquisition.

The strong topline growth, a relatively stable gross margin and the reduction in the expense ratio translated into improvement in several key profitability metrics. Operating profit margin moved from 18.5% in FY 2018 to 26.0% in FY 2022 while net profit margin moved from 9.0% in FY 2018 to 11.7% in FY 2022. Additionally, it is important to note that 1GS experienced a year-over-year decline in its net profit margin during FY 2022. This decline was attributed to the rise in interest expenses stemming from its debt financing, as well as other transaction costs related to the HVSEO acquisition. Nonetheless, the interest expense burden taken on to finance the transaction is expected to dramatically decline in the event the IPO (under review) is successful. Furthermore, the transaction costs in relation to the acquisition are one-off in nature and therefore not expected to recur. Net profits generated in FY 2022 amounted to J$27.9 million.

Balance Sheet

Being a technology-based marketing firm, 1GS has consistently been asset-light. As a result, Total assets grew from J$9.2 million in FY 2018 to only J$53.3 million in FY 2021. Over this period, the growth in assets was driven primarily by trade and other receivables and cash balances. The increase in its receivables and cash was a result of company's expansion, particularly the on boarding of new clients.

FY 2022 saw a significant change in the company's asset composition. At the end of that year, Total Assets stood at J$478.1 million, including intangible assets of J$339.9 million. This marked a substantial increase from the J$1.1 million recorded at the end of the previous year and was due to the acquisition of HVSEO. It is understood that intangibles include HVSEO's website, domain name, branding assets, social media pages, license, proprietary content, and goodwill. Similar to IGS pre-acquisition, HVSEO was also asset-light and as such, the difference between the acquisition price and the net asset value of HVSEO was accounted for as goodwill in the books of 1GS post-acquisition. In addition to the intangible assets, in FY 2022, short term investments and cash grew by J$59.3 million, while trade and other receivables climbed to J$27.7 million year over year.

Between the end of FY 2018 and the end of FY 2021, 1GS's Total liabilities moved from J$10.3 million to J$21.6 million. Over the period, the company exercised prudence in its use of debt to foster business growth. Consequently, up to FY 2021, its interest-bearing debt remained contained at J$8.2 million. Trade and other payables, climbed from J$1.36 million at the end of FY 2018 to J$9.1 million at the end of FY 2021. As 1GS grew and became more profitable its Shareholder's equity also expanded, moving from -J$1.1 million at the end of FY 2018 to J$31.7 million at the end of FY 2021.

In FY 2022, to complete its acquisition of HVSEO, the Company turned to the capital markets and borrowed approximately J$270.0 million. This resulted in a notable increase in its total liabilities from J$21.6 million at the end of FY 2021 to J$318.7

million at the end of FY 2022, with interest-bearing debt accounting for J$286.9 million of that amount. However, it is the company's intention to significantly reduce its indebtedness after the successful completion of its IPO.

At the end of FY 2022, IGS' equity base stood at J$159.4 million, representing an increase of 403.2% or J$127.7 million over the prior year's balance of J$31.7 million. This significant spike in equity arose primarily from an equity injection in FY 2022 to enhance its working capital and facilitate the acquisition. Therefore, the growth in the equity base noted above was not only driven by the increased profitability in FY 2022, but also a result of additional paid-in capital of J$110.6 million by new and existing shareholders and may be seen as a sign of confidence in the prospects of the firm.

Q1 2023 Performance

One Great Studio acquired HVSEO in the last quarter of FY 2022. As a result, the first quarter of FY 2023, marks the start of the full integration of the new SEO business line into the operations of 1GS. In Q1 2023, the company generated revenues of J$114.9 million, which was J$159.3 million above the amount posted over the same period a year earlier. Going forward, in the short to medium term, most of 1GS' revenue growth is expected to be driven by the SEO business line. This projection stems from the observation that revenue generation from the segment of the business that was established before the acquisition has experienced a notable slowdown. In Q1 2023, the revenues generated by the pre-SEO business lines amounted to J$30.8 million, which was less than the J$44.3 million generated in Q1 2022. However, management attributes the slowdown in those segments to a lack of focus and capacity constraints during that period. They expect that growth in those segments will be renewed going forward.

Consistent with its revenue growth, 1GS incurred higher direct costs related to the services provided during the first quarter of FY 2023 (J$54.9M vs J$16.6M). The increase in direct costs was a consequence of the introduction of the new SEO business line and the additional staff costs arising from the integrated operations post-acquisition. Against this backdrop, its gross profit margin decreased from 62.4% in Q1 2022 to 52.2% for Q1 2023. This compression can be largely attributed to the cost structure of the SEO business line, which is mostly comprised of direct contract labour and commissions. In the first quarter of 2023, contract labour accounted for 66.7% of total direct costs compared to 19.1% in the same period of the prior year. Moving forward, the management is optimistic that additional synergies stemming from the acquisition will materialize, leading to a gradual improvement in the gross margin over time. Gross profit for the period amounted to J$60.0 million, representing a YoY increase of 116.8%.

Operating profits for the first quarter increased and came in at J$42.6 million, more than 200.0% above the amount reported in the same quarter of the previous year. While operating expenses spiked due to the acquisition, the significant uplift in the topline revenue far outpaced the additional expenses. Additionally, certain efficiencies may have occurred post-acquisition, leading to a YoY improvement in the operating margin.

The significant revenue growth and improved operating profit margin resulted in the improved profitability of 1GS. This was despite the contraction in the gross profit margin and the marketing company's decision to increase its Expected Credit Loss (ECL) provision in the first quarter. For the period, Net profit amounted to J$23.0 million, representing an increase of 121.8% YoY.

Valuation Analysis

To arrive at a fair price for the One Great Studio, we used the Price to Earnings (P/E) method. The appropriate average P/E ratio was calculated by looking at the service companies listed on the JSE (Junior Market). The average P/E at the time of listing for the subset of companies on the Junior Market was 21.93x. 1GS' forward P/E was calculated at $0.052 and when multiplied by the average P/E for the subset of companies on the Junior market, a fair price of J$1.14 was determined. As the shares are being offered to the general public at J$1.00 per share, the stocks on offer at IPO are undervalued.

Investment Positives

Proof of Concept and Track Record: One Great Studio (1GS) has a proven track record of delivering high-quality work for some of Jamaica's most prominent companies. The Company has successfully helped its clients (including Barita) to grow very recognisable brands in recent years through innovative digital marketing solutions.

Strong Revenue and Profit Growth: Between FY 2018 and FY 2022, One Great Studio's revenue has grown at a CAGR of 82.4%, from J$21.5M in FY 2018 to J$238.9 in FY 2022. Consistent with their revenue growth, Profit before Taxation also showed robust growth over same period moving from J$2.34M to J$45.57M in FY 2022, resulting in a CAGR of 97.29%. The acquisition of the assets and operations of HVSEO, completed in September 2022, proved to be transformative for the Company as the SEO business line added J$90.53 million to total revenue in just over three months (mid-September to December 2022).

Stickiness of Clients: A significant portion of the company's generated revenues originates from clients with whom 1GS maintains relatively robust relationships and established retainer contracts. This structure implies that the revenues are relatively stable and not easily disrupted.

Discounted Offer: The shares are being offered to the public at J$1.00 per share while the estimated fair value is J$1.14. This implies that the stock is being offered at a moderate discount of approximately 12.0% to the fair value.

Diversification Benefit: One Great Studio is the first digital marketing company to list on the Jamaica Stock Exchange. 1GS offers a suite of services including brand strategy and design, mobile app and website design and development, and search engine optimization to clients from all around the world. Additionally, a portion of the proceeds from the offer will be going into funding regional and international expansion. An

Investment Negatives

Highly Competitive Industry: Barriers to entry in the industry in which the firm operates are relatively low which could lead to a reduction in market share and profit margins in the future. Additionally, due to the nature of the industry, IGS' competitors are not only local but could operate from anywhere in the world.

Concentration Risk: The nature of the industry is that most of the players have a few anchor clients providing the lion's share of revenues. To compound the issue, clients usually have relationships with all the major competitors. As a result, this creates concentration risk, as the loss of a large client to a competitor could materially threaten revenues and operational viability. However, with the addition of the SEO business line it is anticipated that IGS' revenue concentration among its clients will continue to decline.

Price Risk: The trading activity could result in the stock's price fluctuating without regard for the operating performance of One Great Studio and cause the stock price to remain below its fair value for an extended period, generating lower returns for the investor.

Threat of AI: Artificial intelligence (AI) is rapidly changing the digital marketing landscape. AI-powered tools are automating many of the tasks that were once done by human marketers, such as social media management, website design and search engine optimization. As AI becomes more widespread, it will level the playing field and make it easier for smaller businesses to compete with larger companies. This could put pressure on digital marketing companies to lower their prices or offer more specialized services. On the other hand, AI is a tool that 1GS could integrate in its platform to make its service delivery that much better.

investment in 1GS would therefore provide sector diversification and diversification across geographic locations as the company expands.

Analyst's Opinion

One Great Studio has experienced tremendous growth over the last five years leveraging its deep knowledge of design, tech, and business to elevate the reputation of brands and deliver results. Today, the Digital-First Agency has clients which include corporate enterprises, governments, and non-profit organizations, across industries and countries in the Caribbean, North America, Europe, Oceania, Asia, and other growing markets. Toward the end of FY 2022, the Company executed a transformative acquisition that introduced a new business line. This strategic move positions the company to enhance services to its extensive clientele, numbering over 100 customers.

The industry in which the company operates is characterized by intense competition. In this industry, the prevailing dynamic is that the marketing and branding requirements of both current clients and potential clients are fulfilled by numerous service providers. Companies within the industry usually serve a few large "anchor clients" to whom they try to cross sell their service offerings. Furthermore, to secure a greater portion of their clients' business, these firms are compelled to provide supplementary services, sometimes resulting in additional strain on their existing workforce. Some companies may find that growing inorganically helps to resolve this issue however this may prove costly over time. On the other hand, achieving success in listing on the Junior market of the JSE could also serve as a solution. This step would not only facilitate the firm's access to capital in a more streamlined manner but also enhance its visibility, potentially leading to smoother client acquisition processes.

We have an estimated fair value of 1GS' stock at J$1.14, implying that the shares are undervalued and investors who invest at the IPO could get a discount of ~12.0%. Based on this and the foregoing analysis, we recommend that investors **PARTICIPATE** in this offer, and we assign a **Medium to High-risk** rating to the stock.