

Action Summary – 4 January 2021

Analyst Theodore R. O'Neill – F3Q21 results and a significant change to the way we calculate EPS

- FLES reported mixed F3Q21 results. The company reported a Basic EPS gain of \$1.03 on \$2.335MM of revenue. We had been looking for an EPS gain of \$0.06 on \$2.7MM in revenue. The shortfall to revenue was largely due to our own higher expectations, but revenue was still up 24% Y/Y. It beat our EPS estimate due to a one-time gain on settlement of debt. Operating income was below our expectations due to lower sales and margins as it had to purchase from distributors with higher prices in addition to its purchases from manufacturers, due to higher demand. Expenses were higher due to rehiring Covid related layoffs, higher commissions on higher sales and professional fees associated with its Reg. A filing.
- **We are changing our EPS calculation to align with the way FLES calculates diluted EPS and we encourage all financial platforms that carry estimates to report diluted EPS.** Most platforms are showing Basic EPS – our previous estimates should be ignored.
- Diluted EPS gives effect to all dilutive potential common shares outstanding during the period using the treasury stock method and convertible preferred stock using the *if-converted* method. In computing diluted EPS, the average stock price for the period is used to determine the number of shares assumed to be purchased from the exercise of stock options and/or warrants. The entire calculation is shown in the quarterly filings as Note 12 and here in Fig. 4.
- Diluted EPS is what investors care about and is critical to calculating target price and market cap. We have updated our estimates to include *the if-converted* shares of the Series C Pfd. and the expected Reg A. offering.
- **Attractive valuation. The shares appear to us inexpensive on an absolute and relative basis.**

12/31 Closing price: \$1.75	Market cap: \$9 million	2021 P/E: 35	2021 EV / Sales: 0.6
Shares outstanding: 5.3 million	Insider ownership: 4%	Avg. trading volume: 20,269	Dividend/Yield: NA/NA

GAAP estimates (EPS in dollars – Revenue in millions)

Period	EPS	Revenue	Op Margin
1Q20A	\$(0.01)	\$2.27	NMF
2Q20A	\$(0.01)	\$2.06	NMF
3Q20A	\$(0.01)	\$1.89	NMF
4Q20A	<u>\$(0.01)</u>	<u>\$1.97</u>	<u>NMF</u>
FY20A	<u>\$(0.04)</u>	<u>\$8.19</u>	<u>NME</u>
1Q21A	\$0.02	\$2.00	(10.4%)
2Q21A	\$0.00	\$2.92	2.8%
3Q21A	\$(0.13)	\$2.34	(1.1%)
4Q21E	<u>\$0.06</u>	<u>\$3.60</u>	<u>8.3%</u>
FY21E	<u>\$(0.05)</u>	<u>\$10.86</u>	<u>17.4%</u>
1Q22E	\$0.03	\$3.90	5.6%
2Q22E	\$0.01	\$3.90	3.8%
3Q22E	\$0.00	\$4.00	0.2%
4Q22E	<u>\$0.01</u>	<u>\$4.80</u>	<u>2.4%</u>
FY22E	<u>\$0.05</u>	<u>\$16.60</u>	<u>3.0%</u>

Note: Numbers may not add due to rounding. See our full model in the back of this report.

Cash balance (in thousands)

• 2020A	• \$162
• 2021E	• \$1,474
• 2022E	• \$6,189

Debt (in thousands)

• 2020A	• \$12
• 2021E	• \$1,100
• 2022E	• \$0

Adj. EBITDA (in thousands)

• 2020A	• (\$2,080)
• 2021E	• \$4,032
• 2022E	• \$1,541

Risks/Valuation

- Risks include: Highly competitive business; inconsistent earnings; changes in customer demand; commercialization of technology.
- Our \$20 target is derived using a discounted future earnings model

Company description: FLES is a holding company that operates as an e-commerce auto and truck parts sales company.

Figure 1 – The 4Less Group, Inc. – One-year Trading snapshot



Source: Refinitiv

Valuation Methodology

We believe FLES is undervalued and we support that belief with two valuation techniques, both of which suggest the shares are undervalued at the current price. For the purposes of determining our price target we use a discounted future earnings model. For the purpose of confirming our price target we look at comparable company valuations:

- 1) The discounted value of all future earnings was used for our price target (see Figure 2)
- 2) Valuation relative to peers (see Figure 3)

Discounted Future Earnings – Basis for Price Target

Our 12-month price target of \$20.00 is based on a discounted future earnings model (Figure 2). For the purposes of deriving an earnings-based price target, we assume the company generates a small profit for FY21 and continues to grow into the future. The model sums up all earnings per share, discounted at 7.5% to arrive at a per share valuation. Note, this model understates future novel product developments, probably understates the tax benefits, but offsetting that, the earnings never have a down year. The implied share price is \$19.79 which we round up to \$20.00.

Figure 2 – The 4Less Group, Inc. – Implied Price Target Calculation

Discounted future earnings		\$19.79
Years	EPS	Discounted EPS
FY21	\$0.05	\$0.05
2	\$0.25	\$0.22
3	\$0.70	\$0.56
4	\$1.00	\$0.75
5	\$1.10	\$0.77
	Terminal Value	\$16.67

Source: Litchfield Hills Research LLC

Valuation Relative to Peers

If we compare FLES to a simple average of its peers (Figure 3), the shares sell at a significant discount on every metric except PE, however PE metrics often look overvalued in early-stage growth companies. These metrics indicate the stock price should be more than 100% higher than where it is today. This supports our \$20 price target. If the shares traded for \$20.00 today, its 2021 Sales Multiple would still be below average. Details on each of the peers can be found in Figure 5. The companies we used in Figure 5 are in similar lines of business although none of them are a perfect match.

Figure 3 – The 4Less Group, Inc. – Summary Discount to Peers

	2021 Sales Multiple	2021 EV / Sales	2021 EV / EBITDA
Peers	3.95	3.99	18.28
FLES	0.56	0.60	6.67
Discount to Peers	86%	85%	64%

Source: Litchfield Hills Research LLC and Refinitiv Eikon

Guidance and Financial Forecasts

The company provides no guidance. Our financial forecast makes many assumptions in order to determine a valuation. We have tried to be as conservative as possible, but the company appears to be at an inflection point where it could get profitable very quickly.

Quarterly Results

The company has an unusual capital structure that adds in millions of shares to the diluted EPS calculation as we show in Figure 4. We believe that because the details of the calculation are in Note 12 near the back of the Q, it has



The 4Less Group, Inc.

FLES-Buy-\$20 PT

not been picked up correctly by any of the financial platforms. Nor was it properly understood by us. For ease of understanding we have merged both the Basic EPS and Diluted EPS calculations on the same page.

The company reported a Basic EPS gain of \$1.03 on \$2.335MM of revenue. We had been looking for an EPS gain of \$0.06 on \$2.7MM in revenue. The shortfall to revenue was largely due to our own higher expectations, but revenue was still up Y/Y by double-digits. It beat our EPS estimate due to a one-time gain on settlement of debt. Operating income was below our expectations due primarily to lower sales and margins as it had to purchase from distributors with higher prices in addition to its purchases from manufacturers, due to higher demand. Expenses were higher due to rehiring Covid related layoffs, higher commissions on higher sales and professional fees associated with its Reg. A filing.

We have changed our estimates to reflect our expectations for diluted share EPS. You should disregard our previous estimates.

Figure 4 – The 4Less Group, Inc. – Quarterly Variance and Diluted EPS Calculation
(\$000)

	FY21 Q3E	FY21 Q3A	Better/(Worse) than forecast
Income Statement			
Total Revenue	\$2,700	\$2,335	(\$365)
Total cost of products sold	1,863	1,861	2
Total Gross Profit	837	474	(363)
Operating expenses:			
Depreciation	5	6	(\$1)
Postage, shipping and freight	175	114	61
Marketing and advertising	4	25	(21)
E Commerce services	250	222	(28)
Operating lease cost	34	23	(11)
Personnel costs	240	330	90
G&A	\$160	\$264	104
Total Expenses	868	985	(117)
Earnings (loss) from Operations	(31)	(511)	(\$480)
Total Other income/(expense)	100	1,611	\$1,511
Earnings before taxes	69	1,100	1,031
Tax expense/(benefit)	0	0	0
Net income	\$69	\$1,100	1,031
Basic EPS	\$0.06	\$1.03	\$0.97
BASIC EPS Share count	1,200	1,067	
Calculation of diluted EPS:			
Net Income from Basic EPS Calculation		1,100	
Add: interest expense on convertible debt		44	
Add: amortizations of debt discount		67	
Less: gain on settlement of debt of convertible notes		(2,846)	
Add (Less): loss (gain) on change of derivative liabilities		940	
Net Income (loss) adjusted for common stock equivalents		(694)	
Dilutive effect of common stock equivalents:			
Basic EPS share count from above		1,067	
Convertible notes and accrued interest		144	
Convertible Class C Preferred Shares		3,108	
Warrants issued in exchange for conv. Notes		950	
Diluted share count		5,269	
Diluted Share EPS		(0.13)	

Source: Company filings and Litchfield Hills Research LLC

Figure 6 – The 4Less Group, Inc. – Income Statement (\$'000)

January ending year	2019A Year	2020A Year	Q1A	2021E				2021E Year	2022E				2022E Year
				Q2A	Q3A	Q4E		Q1E	Q2E	Q3E	Q4E		
Total revenue	\$8,313	\$8,186	\$2,000	\$2,927	\$2,335	\$3,600	\$10,862	\$3,900	\$3,900	\$4,000	\$4,800	\$16,600	
<i>Growth</i>	19%	-2%	-12%	42%	24%	83%	33%	95%	33%	71%	33%	53%	
Cost of Goods	6,116	6,275	1,428	2,002	1,861	2,412	7,703	2,730	2,730	2,800	3,360	11,620	
Gross Profit	2,197	1,911	572	926	474	1,188	3,159	1,170	1,170	1,200	1,440	4,980	
Gross Margin	26.4%	23.3%	28.6%	31.6%	20.3%	33.0%	29.1%	30.0%	30.0%	30.0%	30.0%	30.0%	
Operating expenses:													
Depreciation	41	35	7	6	6	5	24	6	6	6	6	24	
Postage, shipping and freight	402	453	113	152	114	185	564	200	200	250	300	950	
Marketing and advertising	180	205	18	6	25	4	53	50	100	150	200	500	
E Commerce services	963	763	166	253	222	250	892	250	250	250	250	1,000	
Operating lease cost	75	118	34	34	23	34	125	35	35	35	35	140	
Personnel costs	1,200	1,275	267	233	330	250	1,080	250	250	300	325	1,125	
G&A	328	916	176	159	264	160	758	160	180	200	210	750	
Total Operating Expenses	3,188	3,764	781	843	985	888	3,496	951	1,021	1,191	1,326	4,489	
Operating Income	(991)	(1,853)	(209)	83	(511)	300	(337)	219	149	9	114	491	
Operating Margin	-11.9%	-22.6%	-10.4%	2.8%	-21.9%	8.3%	-3.1%	5.6%	3.8%	0.2%	2.4%	3.0%	
Total Other Items	(7,135)	(2,027)	1,396	312	1,611	0	3,319	0	0	0	0	0	
Pre-Tax Income	(8,125)	(3,880)	1,187	395	1,100	300	2,982	219	149	9	114	491	
Pre-Tax Margin	-97.7%	-47.4%	59.3%	13.5%	47.1%	8.3%	27.5%	5.6%	3.8%	0.2%	2.4%	3.0%	
Taxes (benefit)	0	0	0	0	0	0	0	0	0	0	0	0	
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Net Income (loss)	(8,125)	(3,880)	1,187	395	1,100	300	2,982	219	149	9	114	491	
Net Margin	-97.7%	-47.4%	59.3%	13.5%	47.1%	8.3%	27.5%	5.6%	3.8%	0.2%	2.4%	3.0%	
Diluted EPS	(\$427,657.79)	(\$44.83)	\$0.02	\$0.00	(\$0.13)	\$0.06	(\$0.05)	\$0.03	\$0.01	\$0.00	\$0.01	\$0.05	
Diluted Shares Outstanding	19.0	86.5	551.6	763.2	5,269.0	5,300.0	2,970.9	8,000.0	10,000.0	12,000.0	12,000.0	10,500.0	

Source: Company reports and Litchfield Hills Research LLC

Figure 7 – The 4Less Group, Inc. – Balance Sheet (\$000)

January ending year	FY2022E	FY2021E	FY2020	FY2019
Balance sheet				
Current Assets				
Cash and S.T.I.	\$6,189	\$1,474	\$162	\$59
Accounts receivable	2,000	0	0	0
Inventories	1,000	300	372	293
Other assets	15	14	9	101
Total Current Assets	9,204	1,788	543	454
Net PP&E	500	350	483	454
Other non-current assets	100	85	115	242
Total Assets	\$9,804	\$2,223	\$1,141	\$1,150
Current Liabilities				
Accounts payable	\$1,000	\$600	\$534	\$216
Accrued expenses	2,500	3,400	4,766	3,519
Other current liabilities	3,000	500	2,713	2,115
Total current liabilities	6,500	4,500	8,014	5,851
Long-term debt	0	1,100	12	45
Other non-current	400	340	365	380
Total Liabilities	6,900	5,940	8,391	6,275
Stockholders' Equity				
Preferred stock				
Total stockholders' equity	2,904	(4,587)	(8,120)	(5,995)
Total Liabilities and equity	\$9,804	\$1,353	\$1,141	\$1,150

Source: Company reports and Litchfield Hills Research LLC

Figure 8 – The 4Less Group, Inc. – Cash Flow (\$'000)

Cash Flow	2022E	2021E	2020A
Net Income	\$491	\$2,982	(\$3,880)
Accounts receivable	(2,000)	0	0
Inventories	(700)	72	(79)
Other assets	(1)	(5)	92
PP&E	(150)	133	(29)
Other non-current	(15)	30	128
Accounts payable	400	66	318
Accrued expenses	1,100	(466)	640
Short-term debt	(2,000)	(901)	607
Other current liabilities	2,500	(2,213)	598
Long-term debt	(1,100)	1,088	(33)
Other non-current	60	(25)	(15)
Pfd. Stock	(870)	(0)	0
Common stock	0	0	0
Capital in excess of par	7,000	551	1,755
Accumulated other comp. income	0	0	0
Treasury stock and note	0	0	0
Dividend and tax adj.	0	0	0
Total Cash Flow	\$4,715	\$1,312	\$103

Source: Litchfield Hills Research LLC

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