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# Caribbean Cement Company Limited

**PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX**

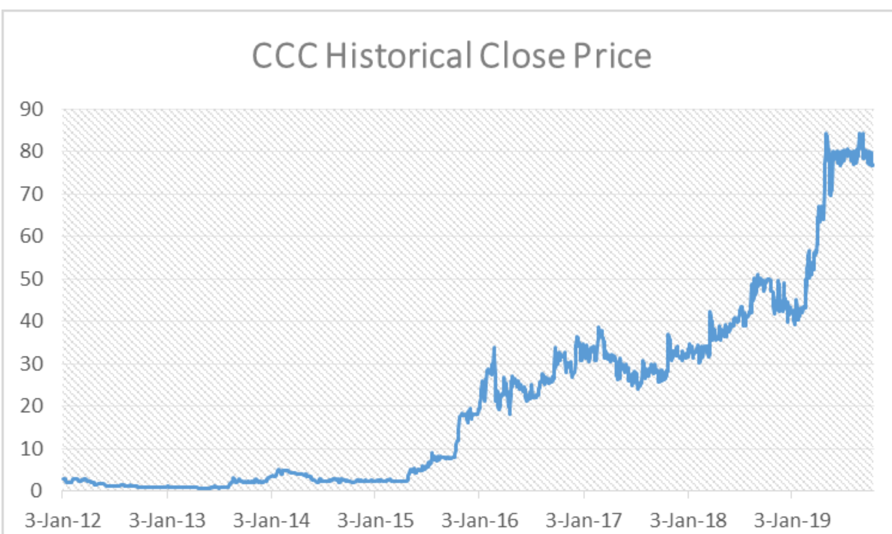
**Executive Summary**

Caribbean Cement Company (CCC) began operations in 1952 and is a member of the TCL Group, with CEMEX S.A.B de C.V being its ultimate parent. The main activities of CCC and its subsidiaries are the manufacture and sale of cement, clinker and the mining and sale of gypsum, shale and pozzolan. CCC is the sole manufacturer of Portland and blended cement in Jamaica with its central plant located at Rockfort, Kingston.

For the 9-months ended September 30, 2019 revenue increased by $274.1 million or 20.7% to $13.51 billion while profits increased by $260 million or 19.80% to $1.57 billion. The primary reason for the increase in profits was a drop in expenses which exceeded the escalation of finance costs.

Revenue for CCC has steadily increased for the period FY 2014 to FY 2018 (period under review) at a CAGR of 5.19%. Meanwhile EBITDA and Restructuring costs has increased at a CAGR 53.38% for the same period. EBITDA growth surged in FY 2018 to $2.29 billion or 75.71% to $5.32 billion, aided by reduced operating lease expense which fell from $3.3 billion in FY 2017 to $828.4 million in FY 2018. The improved fortune has resulted in CCC constructing profit CAGR of 105.24% for the period under review, coincidently the stock price has increased at a similar pace.

CCC's stock has increased at a CAGR of 104.80% for the period under review significantly higher than the Main Market increase which increased at a CAGR of 49.34% for the same period. However, profit growth has been hindered by one-off expenses incurred in FY 2016 and FY 2017.



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## Recent Developments

CCC reported an $80.64 million or 1.81% decline in revenue to $4.38 billion for the 3rd quarter ended September 30, 2019. The company indicated that the reduction in revenue was due to abnormal weather in the quarter which impacted cement sales. For the quarter EBITDA and restructuring costs tumbled 18% or $280.9 million to $1.27 billion due to increased maintenance costs and demolishing of old and obsolete structures. This, along with other expenses such as manpower restructuring costs and a higher effective tax rate, resulted in a reported decline in earnings of $228.25 million or 74.81% to $76.85 million.

## Key Financial Data

| | 2014 | 2015 | 2016 | 2017 | 2018 | CAGR | 9M 2018 | 9M 2019 | Change |
|---|---|---|---|---|---|---|---|---|---|
| **BVPS** | 5.75 | 7.56 | 9.09 | 10.53 | 7.31 | 6.19% | 11.33 | 9.39 | -17.10% |
| **EPS** | 0.16 | 1.82 | 1.53 | 1.35 | 2.90 | 106.29% | 1.54 | 1.85 | 20.01% |
| **Price** | 2.41 | 19.03 | 34.80 | 32.46 | 42.40 | 104.80% | 47.04 | 80.00 | 70.07% |
| **Main Market** | 76,353.39 | 150,692.13 | 192,276.64 | 288,381.97 | 379,790.86 | 49.34% | 358,320.11 | 516,042.91 | 44.02% |
| | | | | | | | | | |
| **Revenue** | 14,356,017 | 15,431,897 | 15,780,756 | 16,513,084 | 17,573,931 | 5.19% | 13,239,257 | 13,513,352 | 2.07% |
| **EBITDA** | 961,070 | 2,576,658 | 2,702,838 | 3,027,033 | 5,318,949 | 53.38% | 3,856,629 | 4,965,124 | 28.74% |
| **Operating Profit** | 596,242 | 1,743,355 | 1,400,253 | 1,620,765 | 4,159,762 | 62.52% | 3,080,588 | 3,724,827 | 20.91% |
| **Pre-tax Profit** | 255,985 | 1,726,388 | 1,350,862 | 1,557,994 | 3,294,661 | 89.41% | 2,013,073 | 2,284,580 | 13.49% |
| **Profits** | 138,985 | 1,546,140 | 1,301,702 | 1,147,421 | 2,466,093 | 105.24% | 1,313,067 | 1,573,067 | 19.80% |
| | | | | | | | | | |
| **Non-Current Assets** | 4,964,459 | 5,377,166 | 6,712,277 | 8,285,056 | 23,783,937 | 47.95% | 23,249,160 | 23,492,380 | 1.05% |
| **Current Assets** | 4,610,139 | 5,474,225 | 3,707,211 | 3,920,907 | 3,008,500 | -10.12% | 3,483,695 | 3,882,900 | 11.46% |
| **Total Assets** | 9,574,598 | 10,851,391 | 10,419,488 | 12,205,963 | 26,792,437 | 29.34% | 26,732,855 | 27,375,280 | 2.40% |
| **Non-Curren Liabilities** | 867,053 | 226,948 | 27,393 | 115,252 | 15,894,883 | 106.92% | 12,524,741 | 14,064,223 | 12.29% |
| **Current Liabilities** | 3,816,511 | 4,187,269 | 2,653,219 | 3,130,942 | 4,479,373 | 4.08% | 4,568,565 | 5,319,809 | 16.44% |
| **Debt** | - | 1,510,011 | 104,041 | 546,315 | 12,157,872 | 100.43% | 12,935,929 | 9,474,221 | -26.76% |
| **Equity** | 4,891,034 | 6,437,174 | 7,738,876 | 8,959,769 | 6,218,181 | 6.19% | 9,639,549 | 7,991,268 | -17.10% |
| | | | | | | | | | |
| **Operating Cash Flow** | 343,700 | 2,673,256 | 1,722,237 | 3,203,578 | 4,366,480 | 88.79% | 3,090,277 | 3,761,660 | 21.73% |
| **Investing Cash Flow** | (598,114) | 810,904 | 1,699,091 | 2,234,038 | 16,663,006 | 173.90% | 15,774,309 | 788,657 | -95.00% |
| **Financing Cash Flow** | 230,224 | (1,126,943) | (205,582) | (490) | 11,046,464 | 163.19% | (2,988,103) | 11,498,994 | -484.83% |
| | | | | | | | | | |
| **Cement Sold - tonnes** | 830,931 | 823,188 | 904,154 | 864,854 | 881,490 | 1.49% | | | |
| | | | | | | | | | |
| **Ratios** | | | | | | **Average** | | | |
| **EBITDA Margin** | 6.69% | 16.70% | 17.13% | 18.33% | 30.27% | 17.82% | 29.13% | 36.74% | 26.13% |
| **Operating Margin** | 4.15% | 11.30% | 8.87% | 9.82% | 23.67% | 11.56% | 23.27% | 27.56% | 18.46% |
| **Net Profit Margin** | 0.97% | 10.02% | 8.25% | 6.95% | 14.03% | 8.04% | 9.92% | 11.64% | 17.37% |
| **Current Ratio** | 1.21 | 1.31 | 1.40 | 1.25 | 0.67 | 1.17 | 0.76 | 0.73 | -4.28% |
| **Debt-to Equity** | - | 0.23 | 0.01 | 0.06 | 1.96 | 0.45 | 1.34 | 1.19 | -11.65% |
| **ROE** | 15.36% | 27.30% | 18.36% | 13.74% | 32.50% | 21.45% | 6.71% | 30.92% | 360.75% |
| **ROA** | | 15.14% | 12.24% | 10.14% | 13.03% | 12.64% | 3.31% | 10.08% | 204.64% |
| **P/E** | 15.06 | 10.46 | 22.75 | 24.04 | 14.63 | 17.39 | 61.93 | 24.98 | -59.67% |
| **P/B** | 0.42 | 2.52 | 3.83 | 3.08 | 5.80 | 3.13 | 4.15 | 8.52 | 105.15% |
| **Performance** | -31.14% | 689.63% | 82.87% | -6.72% | 30.62% | 153.05% | 44.92% | 88.68% | 97.43% |
| **Main Market Performance** | -5.31% | 97.36% | 27.60% | 49.98% | 31.70% | 40.27% | 24.25% | 35.88% | 47.93% |

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**Financial Overview**

Revenue steadily grew over the period FY 2014 to FY 2018 (period under review), the primary driver of growth has been local cement sales which steadily improved at a CAGR of 10.04% reaching 829,802 tonnes in FY 2018. However, the export of cement fell from 232,766 tonnes in FY 2014 to 4,526 tonnes in FY 2018. The substantial decline in export cement sales is a result of CCC focusing on the local market. However, CCC can produce up to 1.2MT, which exceeds current domestic demand. For the period under review, EBITDA has surged from $961.07 million to $5.32 billion. The recent growth in EBITDA is due to CCC purchasing Kiln 5 and Mill 5 in April 2018. The aforementioned has significantly reduced operating lease expense which fell from $3.3 billion in FY 2017 to $828.37 million in FY 2018. Furthermore, operating profit growth was hindered by 'stockholding and inventory restructuring costs' due to the write-down of overstock items of $400.77 million and $457.82 million in FY 2016 and FY 2017, respectively. Operating profit growth was also constrained by approximately 400 million in workforce restructuring costs each year throughout FY 2015 to FY 2017. The non-reoccurrence of 'manpower and inventory restructuring' costs aided the surge in FY 2018 operating profit of 156.65% to $4.16 billion.

The surge in non-current assets seen in FY 2018 was due to CCC acquiring Kiln 5 and Mill 5 in April 2018 (the asset purchase) previously discussed. CCC completed the acquisition of the assets for US$118 million (J$14.9 billion). The company made the purchase using cash on hand and two loan facilities negotiated with CEMEX España totalling US$82 million (Master Agreement for J$6.5 billion or US$50 million and Revolving Loan Agreement for J$4.2 billion or US$32 million). As a result, debt has surged to $12.16 billion at the end of FY 2018. As at the end of Q3 FY 2019 debt is currently $9.47 billion a decline of 26.76% or $3.46 billion from a year earlier. In November 2018 CCC entered a loan facility for J$3.08 billion with NCB Jamaica for five years at a fixed rate of 7.45% per annum with a portion to be used to pay down US$ debt. Therefore the exposure to J$ versus US$ volatility has been reduced. CCC's equity value has steadily increased for the period FY 2014 to FY 2017 but fell in FY 2018 due to preference shares being removed from equity. The equity value of the company has rebounded somewhat increasing to $7.99 billion at the end of September 2019 versus $6.22 billion at the end of FY 2018.

EBITDA Margin has improved for the period under review peaking in FY 2018 at 30.27%. The increase in EBITDA Margin was aided by the reduction in operating lease, previously discussed. Operating and net profit margins have also improved for the period under review. The increase in margins indicate that CCC is improving in efficiency as profit grows and the company continues to make fixed capital investments. CCC's current ratio has remained above 1x for FY 2014 to FY 2017 however, it fell to 0.67x at the end of FY 2018. The decline was due to an increase in current portion of redeemable shares liability & loans due to parent coupled with a decline in cash & equivalents in excess of $1 billion. Debt to equity also surged at the end of FY 2018 to 1.96x due to higher debt associated with the asset purchase. However, at the end of Q3 FY 2019 it declined to 1.19x indicating reduced solvency risk for the company. CCC's stock performance has materially exceeded the Main Market Index for the period under review. Additionally, for the 9M period ended September 2019 CCC's stock has increased 88.68% exceeding the Main Market performance of 35.88% for the same period.

**Forecast and Valuation**

**We used a combination of DCF and relative value methods to arrive at our price target of $67.05 per share.** To arrive at our relative value price target we used a combination of P/EBITDA and P/E average multiple applied to our expectation for EBITDA and EPS for FY 2020. This provided our lower end price target of $53.40. For the upper end price target we discounted the expected series of FCFE to arrive at our price target of $80.71. P/EBITDA has been largely range bound since the start of FY 2016 as indicated below. P/E ratio of CCC has been volatile for the period under review exceeding 60x near the end of FY 2019. CCC has not paid a dividend for the period under review, and we don't expect this to change in the medium-term as the company will likely use a significant portion of cash flows to pay down its debt.

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| Ticker | Market Cap($M) | P/E | P/B | Div Yield | ROA | ROE |
|---|---|---|---|---|---|---|
| CCC | 65,469.53 | 24.02 | 8.19 | 0.00% | 10.08% | 30.92% |
| BRG | 3,832.08 | 21.90 | 3.46 | 1.72% | 10.01% | 16.42% |
| Average | 34,650.81 | 22.96 | 5.83 | 0.86% | 10.04% | 23.67% |

**Outlook**

**Our immediate outlook for Q4 2019 is negative given the rapid devaluation of the J$ versus the USD in Q4 2019 to date, relative to the revaluation experienced in Q4 2018.** In Q4 2018 CCC recorded profits of $1.15 billion driven primarily by two factors. Firstly the J$ revalued approximately 5% versus the USD which triggered a net finance income, which is unlikely to reoccur in Q4 2019. Secondly the company reported an unusually low effective tax rate. The net effect of these factors is expected to trigger a decline in Q4 2019 earnings which will ultimately cause a decline in FY 2019 earnings relative to FY 2018 levels. This could trigger a decline in investor sentiment towards CCC in the near-term. However our medium to long-term outlook remains neutral, boosted by growth in local construction but constrained by the company's sensitivity to the economic cycle.

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**Recommendation:**

**We are downgrading CCC's stock from MARKETWEIGHT to STRONGLY UNDERPERFORM at this point given that it currently trades at a premium to our price target of $67.05.** We see several headwinds ahead that tempers our view on the stock. The exposure to the devaluation of the J$ versus the USD remains an issue, albeit somewhat reduced due to lower debt levels. Also we see the highly volatile nature of the stock as a major risk factor for the average investor. Furthermore the company is highly exposed to the Jamaican economy with current export cement sales being insignificant. Therefore a material slowdown in local construction activity while not expected would substantially impact CCC's sales.

***Source: http://www.Jamstockex.com, JMMB Investment & Research, Bloomberg, Various Company Financial Statements***

# APPENDIX

## IMPORTANT DISCLOSURES

**ABSTRACT**—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

**PLEASE NOTE** THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

**UNDERPERFORM/UNDERWEIGHT**— ADJUST EXPOSURE IN YOUR PORTFOLIO HELD AT JMMB TO BETWEEN 2.5% AND 4.9% FOR THIS PARTICULAR ASSET

**SELL**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO (0%).

**MARKETPERFORM/HOLD/MARKETWEIGHT**—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

**OUTPERFORM/OVERWEIGHT/BUY**—EXPOSURE TO THIS ASSET SHOULD BE UP TO 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

**STRONGLY UNDERPERFORM**—REDUCE EXPOSURE TO THIS ASSET TO BELOW 2.5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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