Caribbean Cement Company Limited

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

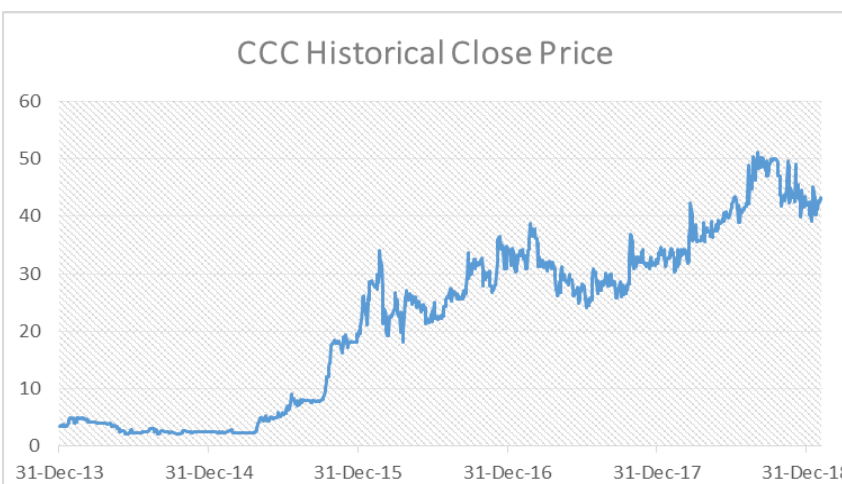
Executive Summary

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, 2018 revenue increased by $1.17 billion to $13.44 billion while profits slipped 27.62% to $1.31 billion. The primary reasons for the decline in profits are increased depreciation of more than $400 million and net finance cost of more than $1.08 billion. Both expense increases were due to the acquisition of Kiln 5 and Mill 5 in April 2018, elaborated on below.

A loan from CEMEX financed CCC's Kiln 5 and Mill 5 acquisition. CCC completed the purchase of the assets at a cost of US$118 million (J$14.9 billion). CCC 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). In November 2018 CCC entered a loan facility for J$3.08 billion with NCB Jamaica at a fixed rate of 7.45% per annum for 5 years. Therefore the exposure to J$ versus US$ volatility has been reduced, nevertheless the company faces meaningful volatility in earnings due to debt denominated in US$.

CCC has seen a significant price appreciation over the years as indicated below. However, profit growth has been hindered by one-off expenses incurred in FY 2016 and FY 2017.



Your Best Interest At Heart. Full Stop.

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Company 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.

Key Financial Data

	2014	*2015*	*2016*	*2017*	*9M 2018*	*CAGR*
BVPS	5.75	7.56	9.09	10.53	12.05	22.36%
EPS	0.16	1.82	1.53	1.35	1.54	103.58%
Revenue ($000)	14,356,017	15,431,897	15,780,756	16,513,084	13,439,257	4.78%
EBITDA($,000)[1]	961,070	2,576,658	2,702,838	3,027,033	3,856,629	46.58%
Operating Profit($,000)	596,242	1,743,355	1,400,253	1,620,765	3,080,588	39.56%
Pre-tax Profit ($,000)	255,985	1,726,388	1,350,862	1,557,994	2,013,073	82.58%
Profits	138,985	1,546,140	1,301,702	1,147,421	1,313,067	102.11%
Non-Current Assets	4,964,459	5,377,166	6,712,277	8,285,056	23,249,160	47.11%
Current Assets	4,610,139	5,474,225	3,707,211	3,920,907	3,483,695	-6.76%
Non-Current Liabilities						
Current Liabilities	3,816,511	4,187,269	2,653,219	3,130,942	4,568,565	4.60%
Debt		1,510,011	104,041	546,315	12,935,929	104.62%
Equity	4,891,034	6,437,174	7,738,876	8,959,769	10,259,288	20.35%
Ratios						Average
EBITDA Margin	6.69%	16.70%	17.13%	18.33%	28.70%	17.51%
Operating Margin	4.15%	11.30%	8.87%	9.82%	22.92%	11.41%
Net Profit Margin	0.97%	10.02%	8.25%	6.95%	9.77%	7.19%
Current Ratio	1.21	1.31	1.40	1.25	0.76	1.19
Debt-to-Equity		0.23	0.01	0.06	1.26	0.31
ROE	2.88%	27.30%	18.36%	13.74%	6.50%	13.76%
ROA	1.49%	15.14%	12.24%	10.14%	3.31%	8.46%
P/E	14.76	10.48	22.75	24.08	61.93	26.80
P/B	0.42	2.52	3.83	3.08	3.90	2.75
Stock Price	2.41	19.03	34.80	32.46	47.04	110.19%[2]

[1] EBITDA and Restructuring Costs

[2] CAGR

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Financial Overview

Revenue steadily grew over the period FY 2014 – FY 2017 (period under review), the primary driver of this growth is local market cement sales which were 829,802 tonnes in FY 2017. For the period under review, domestic cement sales grew every year at a CAGR of 11.53%. However, the export of cement fell from 232,766 tonnes in FY 2014 to 35,052 tonnes in FY 2017. The significant decline in cement sales in FY 2017 was due to CCC focusing on the local market cement sales. However, in FY 2018 the company renewed focus on exports, as the capacity for cement production of 1.2MT, exceeds domestic demand. For the period under review, EBITDA has surged from $961.07 million to $3.03 billion. **Of note, EBITDA is $3.86 billion for the 9-months ended September 2018, which has already exceeded EBITDA for all of FY 2017.** The recent growth in EBITDA is due to the CCC purchasing Kiln 5 and Mill 5 April 2018. The aforementioned has significantly reduced 'other operating expense' which declined 80.66% or $892.50 million to $213.98 million in the Q3 FY 2018. While operating income has increased for the period under review, it peaked in FY 2015. Operating profit growth was hindered by 'stockholding and inventory restricting costs' due to the write-down of overstock items of $400.77 million and $457.82 million in FY 2016 and FY 2017 respectively.

The surge in non-current assets seen in Q2 FY 2018 was due to CCC acquiring Kiln 5 and Mill 5 in April 2018 (the asset purchase) as previously discussed. CCC completed the acquisition of the assets at the cost of 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 $12.94 billion at the end of Q3 FY 2018. 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.

Equity value has steadily increased for the period under review, due to steady profitably but CCC still has accumulated loss of $1.95 billion as at Q3 FY 2018. The most significant component of equity is preference shares of $5.08 billion. **The preference shares confer upon the holders thereof no right at any time to receive any dividend beyond such dividend as the Company may, at its discretion, declare upon the preference shares provided that if the Company declares any dividend on its ordinary shares it shall at the same time declare a dividend on the preference shares at a rate no lower than the rate declared on the ordinary shares. All dividends declared upon the preference shares shall be paid in United States dollars. The preference shares may be redeemed at any time at the sole discretion of the Company.** Therefore it can be deemed equity given no regular payments are required.

Current Ratio has remained above 1x for FY 2014 – FY 2017 however, it fell to 0.76x in Q3 FY 2018. The decline was due to higher short-term loan obligations and a reduction in cash and cash equivalents due to the asset purchase discussed above. Debt to equity also surged in Q3 FY 2018 due to higher debt associated with the asset purchase.

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Forecast and Valuation

We used a combination of FCFF and relative value method to arrive at our price target of $41.81 per share. Applying the average P/E over the last five years to our projected FY 2019 EPS results in a price target of $79.71. However, given that average P/E over the past 5-years is 21x and the standard deviation is 14x, the volatile nature of this relative value metric is evident. Our forecast of earnings and cash flow assume significant expenses of restructuring in FY 2016 and FY 2017 don't reoccur. **We also expect higher debt expense and depreciation expense due to the purchase of the long-term assets in April 2018.** CCC currently trades at a relatively high P/E to peers as indicated below. This is due in part to a loss in Q4 FY 2017 of $666.62 million resulting in a depressed trailing 12-month EPS. Also, P/B ratio below is relatively high due to preference shares being excluded in if including current P/B would be 3.57x. CCC has not paid a dividend for the period under review, and we don't expect this to change in the medium to long-term given as the preference shares as discussed early make it challenging to do so. ROA and ROE both lag peers, ROE in particular below is calculated using equity ex-preference shares and still lags peers.

TICKER	MARKET CAP ($M)	P/E	P/B	DIV YIELD	ROA	ROE
CCC	**35,790.29**	**62.16**	**6.91**	**0.00%**	**4.91%**	**19.72%**
BRG	4,470.77	14.84	4.84	0.96	15.06%	24.73%
SALF	4,072.22	9.01	4.34	0.00%	21.28%	25.24%
SEP	25,615.46	20.01	1.68	2.72%	5.07%	9.97%
AVERAGE	**17,487.18**	**26.51**	**4.29**	**0.92%**	**11.58%**	**19.91%**

Recent Developments

CCC and one of its subsidiaries entered a revolving loan facility with NCB for a principal of J$3.08 billion. CCC's board authorised the loan facility on November 30, 2018. It will be partially used to repay related party debt denominated in US$ and general corporate purposes. The loan is for five years and attracts a fixed interest rate of 7.45%. In CCC's 3rd quarter in FY 2018 profits fell by 59.21% or $442.79 million to $305.09 million, despite revenue increasing 11.51% to $4.66 billion. The primary reason for the decline is the surge in net finance costs to $690.932 million. The rise in finance cost was due to in part to a $464 million in FX losses as the J$ versus the US$ depreciated by approximately 3% in the quarter.

Outlook

Our immediate term outlook for Q4 2018 is favourable given the rapid strengthening of the J$ versus US$ in Q4 FY 2018, and we don't expect significant write-offs as occurred in Q4 2017. However, in January 2019 the J$ lost ground versus the US$ at a rate of about 7%, therefore if this holds

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for the Q1 2019 profit growth could be significantly hindered. In the medium to long-term though, we expect earnings strength to persist as exports sales and the local construction industry continues to grow. Also, CCC paid approximately $3.3 billion per annum in an operating lease, which was discounted in April 2018. While expenses rose as a result, the net benefit per annum is expected to be approximately $1 billion annually.

Recommendation:

We recommend an MARKETWEIGHT on CCC at this point given that the stock currently trades at a marginal premium to our price target of $41.81. Also if the stock trades towards the high end of our forecast of $79.71, there would be meaningful upside. However, our outlook on the stock is tempered by the volatile nature of earnings and the significant impact that a move in the J$ can have on earnings in any given quarter.

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.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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