JMMB INVESTMENT & SOVEREIGN RESEARCH

Derrimon Trading Company Limited (DTL)

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EXECUTIVE SUMMARY

Derrimon Trading Company Limited (DTL) was founded in December 1998 as a private company which distributed commodities and was listed on the Junior Market of the Jamaica Stock Exchange (JSE) in December 2013. The corporate is seeking to raise $3.5 billion in capital in this APO.

Over the past three (3) years, DTL has grown revenues by a Compound Annual Growth Rate (CAGR) of 23.7% while increasing net income by a CAGR of 8.7%. The growth in net income in a competitive sector with slim margins underscores management's ability to not only contain costs but seek organic and inorganic growth opportunities. The management of DTL aims to continue the corporate's growth trend using the proceeds from APO). DTL earmarked the funds to complete two (2) acquisitions and retire debt. These activities could help to drive revenue growth and lower finance costs.

We attach an **OUTPERFORM/BUY** recommendation to this Offer. This investment suits investors seeking capital appreciation with a medium risk appetite and have a medium-term outlook. Our perspective is based on a one-year price target for the asset.

Offer Details

Issuer	Derrimon Trading Company Limited (DTL)
Broker	Barita Investments Limited
Arranger	Barita Investments Limited
Selling Agents	Barita Investments Limited, Proven Wealth Limited, Scotia Investments (Jamaica) Limited, Jamaica Money Market Brokers Limited, JN Fund Managers Limited, Sagicor Investments Jamaica Limited
Securities	1,498,698,931 New Ordinary Shares (with the option to upsize by inviting offers for an additional 301,301,069 New Ordinary Shares
Target Capitalization	J$ 3,500,000,002 (with the option to upsize the General Pool. In the case of an upsize, the target capitalization is $4,223,122,567)

Reserved Pools	1,014,185,625 New Ordinary Shares are reserved as follows: • Existing Shareholders or Derrimon Team Members – 484,387,164 New Ordinary Shares • Key Investors – 378,427,472 New Ordinary Shares • Lead Broker's Clients – 151,370,989
Prices	Existing Shareholders or Derrimon Team Members - $2.20 Key Investors, Lead Broker's Clients and General Public - $2.40
Minimum Subscription/Increments	1,000 New Ordinary Shares / 100 New Ordinary Shares
Use of Proceeds	• Reduction of Indebtedness – $1,200,000,000.00 • Potential Acquisition of Businesses in the United States $1,100,000,000.00 • Expansion of Retail Location in Clarendon, Jamaica - $500,000,000 • Working Capital Support - $284,750,000.00 • Transaction Costs - $205,250,000.00 • Expansion of Delect Brand and Product Lines - $200,000,000.00
Application Process	Applications must be made by either of the following methods: • Using the original application forms set out in the prospectus • By way of the Lead Broker's Online System • By way of your broker's/selling agent's online system (JMMB Money Line, NCB GoIPO, IPOPRO)
Proposed Dividend Policy	The directors expect to adopt a formal dividend policy to pay a semi-annual dividend of at least 30% of the annual distributable reserves.
Listing	The Company intends to apply to the JSE for the shares to be listed on the Junior Market. Listing is expected to be within 21 days of the closing date.
Key Dates	Opening Date: 9:00 am on January 6, 2021 Closing Date: 4:00 am on January 26, 2021, subject to early closure once fully subscribed.

Shareholdings

Shareholdings Pre-APO (September 30, 2020)		
Derrick Cotterell	1,113,797,633	40.75%
Mayberry Jamaican Equities Limited	439,859,497	16.09%
Monique Cotterell	400,000,000	14.63%
Ian C. Kelly	157,373,169	5.76%
Estate of E. Cotterell (Deceased)	100,000,000	3.66%
Winston Thomas	72,351,180	2.65%
JCSD Trustee Services A/C Barita Unit Trust Capital Growth Fund	59,351,180	2.19%
Sharon Harvey-Wilson	29,163,580	1.07%
Sagicor Pooled Equity Fund	27,756,920	1.02%
Sagicor Select Fund – ('Class C' Shares) Manufacturing & Distribution	22,600,000	0.83%
Other Shareholders	310,607,768	11.36%
Total	2,733,360,670	100.00%

Shareholdings Post-APO (Assuming all New Ordinary Shares are subscribed for in full)		
Derrick Cotterell	1,113,797,633	26.32%
Mayberry Jamaican Equities Limited	439,859,497	10.39%
Monique Cotterell	400,000,000	9.45%
Ian C. Kelly	157,373,169	3.72%
Estate of E. Cotterell (Deceased)	100,000,000	2.36%
Winston Thomas	72,351,180	1.71%
JCSD Trustee Services A/C Barita Unit Trust Capital Growth Fund	59,351,180	1.41%
Sharon Harvey-Wilson	29,163,580	0.69%
Sagicor Pooled Equity Fund	27,756,920	0.65%
Sagicor Select Fund – ('Class C' Shares) Manufacturing & Distribution	22,600,000	0.53%
Other Shareholders	310,607,768	7.34%
Existing Shareholders and Derrimon Team Members	484,387,164	11.45%
Key Investors	378,427,472	8.94%
Lead Broker's Clients	151,370,989	3.58%
Non-Reserved Shares	1,014,185,625	23.96%
Total	4,232,059,601	100.00%

Company Overview

Derrimon Trading Company Limited (DTL) was founded in December 1998 as a private company which distributes commodities. DTL was listed on the Junior Market of the Jamaica Stock

Exchange (JSE) in December 2013. The corporate has two (2) subsidiaries, Caribbean Flavours and Fragrances Limited (CFF), which is listed on the JSE Junior Market, and Woodcats International Limited. DTL acquired a 49.02% stake in CFF in 2014, then later gained majority ownership in 2017. CFF manufactures and distributes flavours for the baking, confectionery and beverage industry. It also distributes fragrances for household and general use. Woodcats International is a leading manufacturer of wooden pallets and wood by-products. DTL acquired the company on September 18, 2018. Besides its subsidiaries, DTL has a 60% interest in the Select Grocers Supermarket, under a joint venture arrangement.

Company business

DTL's primary business lines are Distribution, Retail and Wholesale and other operations via its two subsidiaries. The corporate distributes several grocery items under different brand names via exclusive and co-distribution deals. The company also engages in the distribution of rice, margarine and detergents on a wholesale basis. Its retail and wholesale arm includes seven (7) Sampars Cash 'N' Carry locations and the 60% interest in Select Grocers Supermarket.

DTL has been one of the four (4) regional sub-distributors of Nestle Jamaica Limited's products since 2002. The corporate co-distributes products from the Nestle brand and it uses the company's retail operations for direct sales to small shops, restaurants and other users of Nestle products. DTL secured an exclusive distribution deal to become the sole Jamaican distributor for S.M Jaleel Limited (SMJL) in September 2018. Based in Trinidad, S.M Jaleel Limited is the largest non-alcoholic drinks manufacturer in the English speaking Caribbean. DTL provides logistic support for SMJL juice-flavoured beverages, including Busta, Fruta, Kool Kidz and Turbo. Having acquired a cold storage facility in 2011, DTL also distributes cold food items such as meats, seafood, French fries and other frozen good.

DTL imports and distributes rice, margarine and Detergents wholesale. The corporate has a specialized division for importing rice for sale to wholesale customers, which was established in 2006. DTL also distributes its Delect brand of long-grain white rice and other rice brands exclusively. DTL remains the exclusive distributor of the Sun Power and Ozone range of detergents and disinfectants and is the sole distributor of Golden Brand margarine.

In 2009, DTL acquired the Sampars Cash 'N' carry business and established it as a separate trading division. The retail operations have expanded as the number of locations has increased to seven

(7), mainly in the central parishes. These parishes include Kingston & St. Andrew, St. Catherine, Manchester and St. Ann. The company's retail and wholesale interests are furthered by its joint venture agreement, which sees it having a 60% interest in the Select Grocers Supermarket. The supermarket is located in Upper Manor Park Plaza in St. Andrew.

Financial Performance

Profitability

For the nine months ended September 2020, DTL's generated revenues amounting to $9.6 billion, which was 1% higher than outturn for the similar period in 2019. Despite not being able to grow trading income significantly, DTL was able to contain the cost of sales. Cost of sales fell by $94 million or 1.2%. Marginal reduction in costs coupled with an increase in trading income led to a $181 million or 10.9% increase in gross profit. Gross profit for the period amounted to $1.84 billion. The trailing 12-month gross profit amounted to $2.46 billion, which increases 8% over the 2019 FY.

On the expenditure side for the nine months period, the company's operating expenses increased by $171 million or 13.9% because of higher spending related to the new distribution centre, and increased administrative costs associated with measures implemented to curtail the spread of the coronavirus. Despite this, operating profit increased by $47 million or 11.6% for the nine months, and 7.6% for the trailing 12-month period compared to 2019FY.

Earnings before Interest, Tax Depreciation and Amortisation (EBITDA) expanded to $487 million from $444 million, an increase of 9.7%, y-o-y. The EBITDA margin also improved from 4.7% for the nine months ended September 2019 to 5.1% for the nine months ended September 2020. Gross margin improved to 19.1%, up from 17.4%, while the trailing 12-months gross margin was 19.3%. DTL's operating profit margin of 5.5% for the trailing 12 months is slightly below the 3-year average of 5.5%. Increase administrative expenses occasioned the lower profit margin over the past nine months. Finance costs fell from $159 million to $146 million, which represents an 8.4% decline y-o-y. DTL is committed to paying down debt, restructure its balance sheet and ease its interest burden. The company swapped out its US-dollar debt to Jamaica-dollar denominated debt at lower rates of interest. This reduces the exchange rate volatility that was inherent in debt service charge. The APO will allow DTL to reduce its finance costs further, as the corporate has earmarked $1.2 billion or 34% of the total raise to retire existing debt, including the 2021 preference shares that pay a coupon of 9%.

Despite the economic challenges caused by the coronavirus pandemic, DTL has grown revenues and increased profits. The corporate achieved this through the strategic focus of tradable goods with high-profit margin and cost containment. The company aims to add to the top line through inorganic growth via acquisitions. Over the last three years, DTL net income expanded at a CAGR of 8.7%. Revenue growth has slowed marginally over the past year because of the slowdown in the domestic economy occasioned by the coronavirus pandemic. However, the company sought to maintain sales volume by capitalising on its online shopping platform to reach a broader customer base. The trailing 12-months net income of $362 million increase by 19% over 2019 FY. The trailing EPS stands at $0.127 while the EPS for the 2019 FY is $0.106**.**

Liquidity & Solvency

Total assets for DTL experienced a 26.5% increase y-o-y, from $4.5 billion to $5.7 billion. The expansion in assets was due primarily to the increase in Plant, Property and Equipment, mainly Right of Use of building. DTL secured a new building under a lease agreement during the fourth quarter of the 2019 FY. Current assets increased by 9% to $3.8 billion for the period under review. Inventories increased by 35%, from $1.3 billion to $1.8billion. However, cash and cash equivalents decreased by 47%, falling from $483 million to $254 million.

Total liabilities stood at $4.125 billion, an increase of 33.9% y-o-y. Long-term borrowings fell to $1.45 billion, a reduction of 11.3%. In comparison, short-term loans and payables increased by $215 million or 169% and $108 million or 13%, respectively. We expect total liabilities to fall as DTL uses the proceeds from the APO to retire debt.

For the nine months ended September 2020, the company increases its total assets base, while both the current and cash ratio declined. The current ratio fell to 2.08x compared to 2.2x for the comparable period in 2019. The cash ratio dipped to 0.14x versus 0.30x in the previous year. In contrast, the quick ratio improved slightly to 1.10x relative to the 1.06x in 2019.

Outlook & Valuation

DTL has shown a commitment to seek avenues to grow and differentiate itself in a highly competitive sector. Although the company operates with slim margins, it has effectively decreased the cost of sales and managed administrative costs. DTL has expanded its reach by branching out into the distribution of goods with relatively higher demand, which resulted in increased inventory turnover. The corporate has attempted to distribute products with more significant margins, and there is a strategic thrust to grow inorganically. The acquisition of CFF highlights the company's vision to achieve synergies. The purchase of Woodcats shows the company's willingness to diversify revenue streams.

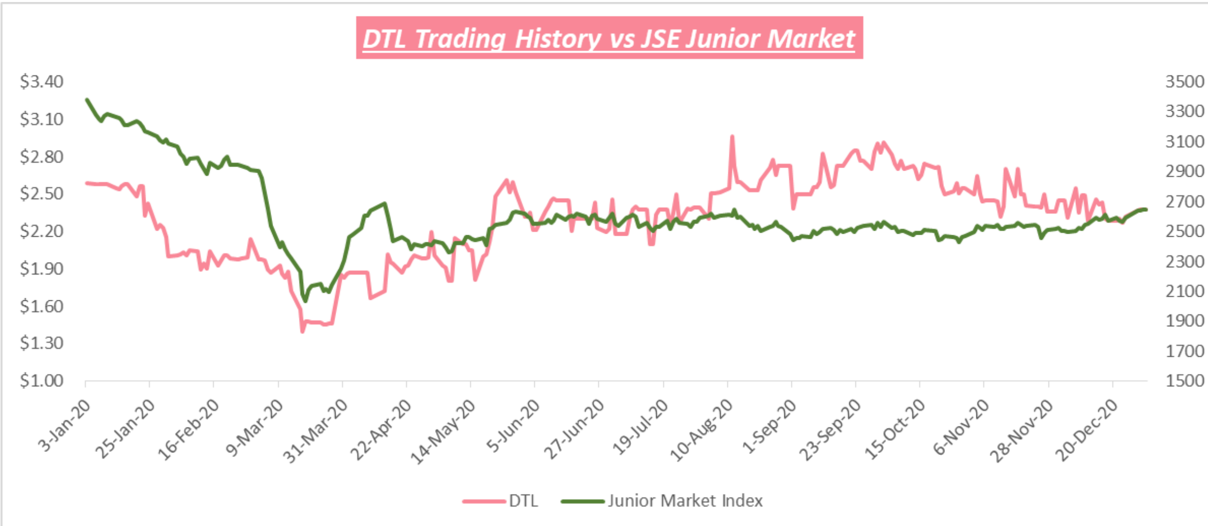
With the APO expected to raise $3.5 billion, we expect DTL to grow inorganically as the corporation completes two (2) acquisitions in the USA. The APO funds will also allow DTL to improve its leverage. The corporate plans to retire high-interest cost debt, which will lower its interest burden. The funds will also be used to expand DTL's Delect brand and expand its retail location in Clarendon. Both the businesses in the USA and the retail space expansion in Clarendon will form part of DTL's strategy to increase its web-store offerings. The company is banking on the continuation of a shift in consumer behaviour observed during the pandemic, as sales volume trended upwards via its digital platform in the wake of the "new normal".

We forecasted the impact of the capital being raised on DTL's revenues. We then factored in the potential gains from the planned acquisitions. We conservatively estimated that DTL would complete the investments by the end of the first quarter of its financial year. We do not expect the corporate to benefit from the expected revenue gains associated with the acquisitions until the second quarter under this scenario. We expect costs to rise as the corporate streamline the new line of activities to dovetail with its existing business operations. These costs, however, are not likely to be sustained over the long run. When taken into consideration, acquisition costs lower the forecasted net income margins from 6.8% to 4.0%, closer to DTL's average net income margin of 3% over the last three years.

Company	**Market Capitalization**	**Price to Earnings**	**Price to Book**	**Return on Equity**	**Return on Assets**
CAC	1,677,419,354	51.55x	4.32x	8.74%	2.95%
CPJ	2,926,000,000		1.31x	-30.95%	-9.72%
EFRESH	1,300,893,687		1.38x	-27.61%	-14.56%
FOSRICH	2,034,215,998	13.92x	2.34x	17.52%	5.98%
FTNA	7,021,486,517	24.15x	4.88x	21.36%	9.30%
INDIES	3,597,848,952	18.13x	4.62x	26.93%	16.04%
JETCON	460,965,000	22.67x	0.83x	3.75%	3.15%
LASD	10,943,685,873	13.21x	1.81x	14.44%	8.50%
MDS	1,065,789,475		1.3x	-0.15%	-0.07%
Sector Average	3,447,589,428	23.94x	2.53x	15.5%	7.7%
DTL	**6,505,398,395**	**17.96x**	**4.59x**	**27.10%**	**7.10%**

For the 2021 FY, we are forecasting total revenues of $20.6 billion and net income of $634 million. DTL's forward EPS is estimated at $0.145 after considering the new ordinary shares, representing a 15% rise over the 2020 FY trailing EPS. Our estimate of the forward P/E ratio is 16.51x. We also forecasted an increase in the BVPS of DTL to $1.24. To get an appropriate valuation for the corporate, we used the current trailing average P/E and P/B ratio for industry peers. We applied these to the forward EPS and BVPS. **The result yielded an average price of $2.88**. **The price estimate is 30.8% greater than the**

reserved price of $2.20 for existing shareholders and team members and 19.9% greater than the price of $2.4 for the general public.



Recommendation

We assign an **OUTPERFORM** recommendation to DTL, given that it is currently trading below our fair price estimate of $2.88. We recommend that clients participate in the offer, as both the reserved and non-reserved prices are materially below our fair price estimate. With the completion of the acquisitions, store expansions, and the Delect brand's expansion, we expect the corporate's profits to expand in 2021 FY and beyond. We believe that the capital raised will enable the company to increase the volume of goods traded, which will help drive revenue.

This stock is most suitable for investors with a medium risk appetite who are seeking capital appreciation. DTL is currently still in the growth phase, and we do not expect any substantial dividend payments in the near term. The major risk to our price target is the timeframe within which the company will merge the accounting numbers from the proposed acquisitions and contain the acquisition costs. The headwinds from the coronavirus pandemic on the domestic economy could increase, leading to lower revenues and profitability relative to estimates.

Abridged Financials

J$'000	Year Ended December 31			Trailing	9 Months ended Sep 30		%
	2017	2018	2019	2020	2019	2020	Change
Trading Income	**6,723,810**	**9,303,460**	**12,649,017**	**12,736,598**	**9,530,761**	**9,618,342**	0.9%
Operating Expenses	(1,141,231)	(1,303,213)	(1,687,679)	(1,863,882)	(1,265,744)	(1,441,947)	13.9%
Operating Profit	451,697	454,068	628,922	676,805	413,652	461,535	11.6%
Profit Before Taxation	281,796	281,845	345,726	406,949	254,277	315,500	24.1%
Net Income	281,796	277,213	302,708	362,248	221,122	280,662	26.9%
Total Assets	2,887,219	4,048,095	5,782,684	6,982,447.00	4,519,803	5,719,566	26.5%
Total Liabilities	1,852,044	2,829,859	4,449,172	5,494,371.00	3,080,445	4,125,644	33.9%
Shareholder's Equity	864,068	1,055,639	1,170,130	1,327,623.00	1,259,187	1,416,680	12.5%
EPS ($)	0.092	0.091	0.106	0.127	0.074	0.095	27.0%
Book Value per Share ($)	0.32	0.39	0.428	0.49	0.46	0.52	12.5%
Key Ratios							
Operating profit margin	6.7%	4.9%	5.0%	5.3%	4.3%	4.8%	
Net Margin	3.8%	2.7%	2.3%	2.7%	2.1%	2.7%	
Return on Average Assets	9.8%	7.2%	6.2%	6.7%	5%	5%	
Return on Average Equity	35.3%	26.0%	27.2%	30.3%	15%	19%	
Quick Ratio (x)	1.20	0.88	1.06		1.50	1.10	
Current Ratio (x)	1.93	1.53	2.23		1.94	2.08	
Debt/Equity (x)	1.21	1.59	2.90		1.81	2.25	

Source: www.jamstockex.com, Bloomberg, Company Financials, Company Prospectus, JMMB Investment Research.

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.

STRONGLY UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 2.5% FOR THIS PARTICULAR ASSET

UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO 2.5% - 4.9% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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

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

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