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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. DTL was listed on the Junior Market of the Jamaica Stock Exchange (JSE) in December of 2013.

Over the past 3 years, DTL has grown revenues by a Compound Annual Growth Rate (CAGR) of 23.86% while growing net income by a CAGR of 4%. This difference in the growth rate of revenues and net income illustrates that expenses have outpaced revenue growth over the period. One such expense which has experienced significant growth is finance costs, which has grown by a CAGR of 31.29%. Management has, however, signaled their intention to reduce this expense as they have used the proceeds from the recently concluded additional public offer (APO) to retire existing expensive debt and ease their interest burden. We have observed that margins have been decreasing over the past 3 years and this presents a risk as in an environment of increased unpredictability, the company may stand vulnerable.

We attach an **OUTPERFORM / BUY** recommendation to DTL's shares, as it is currently trading 17.54% below our fair value estimate. This investment suits investors seeking capital appreciation with a medium to high risk appetite. We are anticipating that the acquisitions made by DTL are likely to be accretive, as the initial results have pointed to such.

Company Overview

Derrimon Trading Company Limited (DTL) was founded in December of 1998 as a private company which distributes commodities. DTL was listed on the Junior Market of the Jamaica Stock Exchange (JSE) in December of 2013. The company has three (3) subsidiaries, Caribbean Flavours and Fragrances Limited (CFF), which is also listed on the JSE Junior Market, Woodcats International Limited and Marnock LLC. DTL took a 49.02% stake in CFF in 2014, then later acquired majority ownership in 2017. CFF engages in the manufacturing and distribution of flavours for the baking, confectionary and beverage industry. CFF also distributes fragrances for household and general use. Woodcats International, a leading manufacturer of wooden pallets and wood by-products, was acquired by DTL on September 18, 2018. Marnock LLC is 80% owned by DTL, and operates as Food Savers New York Inc. and Good Foods for Less, two New York based supermarkets. Marnock LLC was acquired in January of 2021. In addition to its subsidiaries, DTL has a 60% interest in the Select Grocers Supermarket, pursuant to a joint venture arrangement.

Company business

DTL's main business lines are Distribution, Retail and Wholesale as well as other operations via its three subsidiaries. Derrimon distributes several grocery items from different household 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 company co-distributes products from the Nestle brand, as well as it utilizes the company's retail operations for direct sales to small shops, restaurants and other users of Nestle products. The company also distributes cold food items such as meats, seafood, French fries and other frozen goods. The distribution arm is supported by DTL's proprietary cold storage facility, acquired in 2011.

DTL also engages in the importation and wholesale distribution of Rice, margarine and detergents. The corporate has a specialized division for the importation of rice for sale to wholesale customers, which was established back in 2006. Along with this, DTL exclusively distributes its own Delect brand of long grain white rice along with other brands of rice. DTL remains the exclusive distributor of the Sun Power and Ozon range of detergents and disinfectants, as well as 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 of the company. The retail operations have been expanded as the number of locations have increased to seven (7), with locations 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 – 2020FY, 6 Months ended June 2021

Profitability

Over the period 2017FY:2020FY, DTL has managed to grow revenues by CAGR of 23.86%. For the 2020FY, revenues amounted to $12.8B, which represents a 1% growth when compared to revenues of $12.6B in 2019FY. The revenue growth for the 2020FY was constrained by the advent of the pandemic, as well as the lockdown measures implemented to limit the spread of the novel coronavirus. For the 6-month period ended June 2021, revenues were $8.05B, which is a 27.75% increase over revenues of $6.3B for the same period last year. This increase was directly attributable to the consolidation of the results from DTL's new subsidiary, Marnock LLC[1]. Additionally, strong performance by the group's retail division also contributed to this growth. The group experienced a 0.73% decline in cost of sales in the 2020FY, as cost of sales dipped from $10.37B in 2019FY to $10.29. For the 6-month period ended June 2021 however, cost of sales grew by 27.63% year-over-year (y-o-y). Despite outpacing the 3 year CAGR of 24.09%, cost of sales for the 6 month period, grew by a smaller magnitude than revenue. Cost of sales containment in 2020FY led to an 8.94% y-o-y increase in gross profit. Gross profits grew from $2.28B in 2019FY to $2.48B in FY2020. Gross profits for the 6 months ended June 2021 totaled $1.54B, growing by 28.3% when compared to gross profits of $1.2B a year prior.

Operating expenses increased from $1.69B in 2019FY to $1.84B in 2020FY. This increase was due to increased expenditure relating to DTL's new distribution center, as well as administrative expenses related to measures implemented to prevent the spread of the novel virus at the company. For the 6 month period ended June 2021, operating expenses grew by 25.63% y-o-y. This growth from $966M to $1.21B, represents the consolidation of expenses of the recently acquired US based grocery outlets. The DTL group has been faced with increased lease, salary and utility expenses. Additional operational expenses may have also arose as a result of DTL's efforts to integrate this acquisition with their existing businesses. Operating income for the 6 months ended June 2021 grew from $275M a year prior, to $368M, an increase of 33.63%.

DTL continues to pay down debt, restructure its balance sheet and ease its interest burden. The company restructured and swapped out its US-dollar denominated debt to Jamaica-dollar denominated debt at lower rates of interest. This also reduces the exchange rate volatility in debt service charges. The additional public offering (APO), which closed in January 2021, allowed DTL to further reduce finance costs, as the corporate retired $1.63B of existing short- and long-term debt. Included in this debt was their 2021 preference shares that paid coupon of 9%. For the 6-month period ended June 2021, finance costs fell by 31.5%, from $67.7M a year prior to $46.4M.

Despite the economic challenges caused by the pandemic, DTL has been able to grow revenues and increase profits. The corporate achieved this through a strategic focus on tradable goods with higher gross margins and cost containment. Notwithstanding these improvements, the company added to their top line through inorganic growth via acquisitions. DTL's net income fell by 3.75% from $291M in 2019FY to $280M in 2020FY, with net margin for the year falling to 2.2%. Net Income has however significantly improved since, as it grew by 68.92%. Net profit

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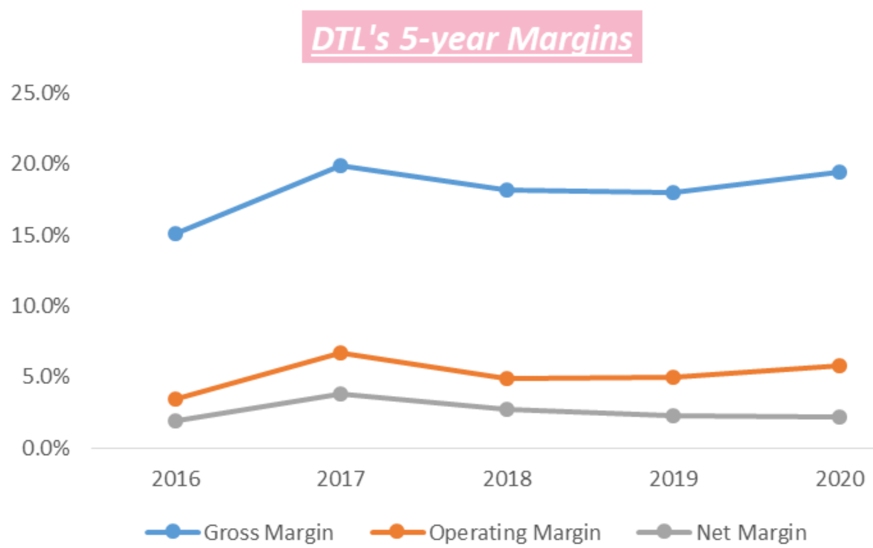
[1] Marnock LLC is an 80% subsidiary of DTL. Marnock LLC was created to operate the business of the two US supermarkets acquired by DTL.

attributable to shareholders of the company for the 6-month period ended June 2021 totaled $271.4M. This represents a growth of $110.7M over the $160.7M recorded for the same period last year. During the recently ended period, net margin improved from 2.5% a year ago, to 3.4%.

The company's margins prior to 2020, had been faltering. Operating margin fell from a high of 6.7% in 2017FY to 5% in 2019FY, before climbing to 5.8% in 2020FY. Net margin similarly fell from 3.8% in 2017FY to 2.3% in 2019FY, before slipping to 2.2% in 2020FY.



Liquidity & Solvency

Total assets for DTL experienced a 28.24% increase, from $5.78B as at 2019FY to $7.2B for the 2020FY. The growth in assets for this period was mainly due to the growth increases in Plant, Property and Equipment and Right of Use of building assets as the group secured fixed assets to assist with their expansion plans. Current assets over this same period increased from $3.7B to $4.8B. A majority of this increase in current assets was due to the movement in receivables, up from $1.03B to $1.87B. This receivables line item, consisted of $918M, which was a deposit on the acquisitions of the New York supermarkets, which DTL eventually closed in 2021Q1.

Total assets as at June 2021 were $10.3B, an increase of 78.99% on total assets of $5.77B one year prior. Growth in total assets was a direct result of the moves made by the group, post APO. DTL's acquisition in 2021Q1 saw them booking a $1.3B investment in subsidiary. They also increased their investments from $397M as at June 2020, to $961M as at June 2021. **DTL's cash and cash equivalents also increased by 110.6%, moving from $252M to $531M.**

Total interest bearing debt fell from $5.06B as at the end of 2020FY to $2.96B as at June 2021. DTL retired $1.6B in long and short term debt over the first 6 months of 2021 with a portion of the proceeds from the APO. Included in this long term debt, was their 9% 2021 preference shares as well as short term debt, which was acquired in the last half of 2020FY, for the purpose of making a deposit on the prospective acquisition.

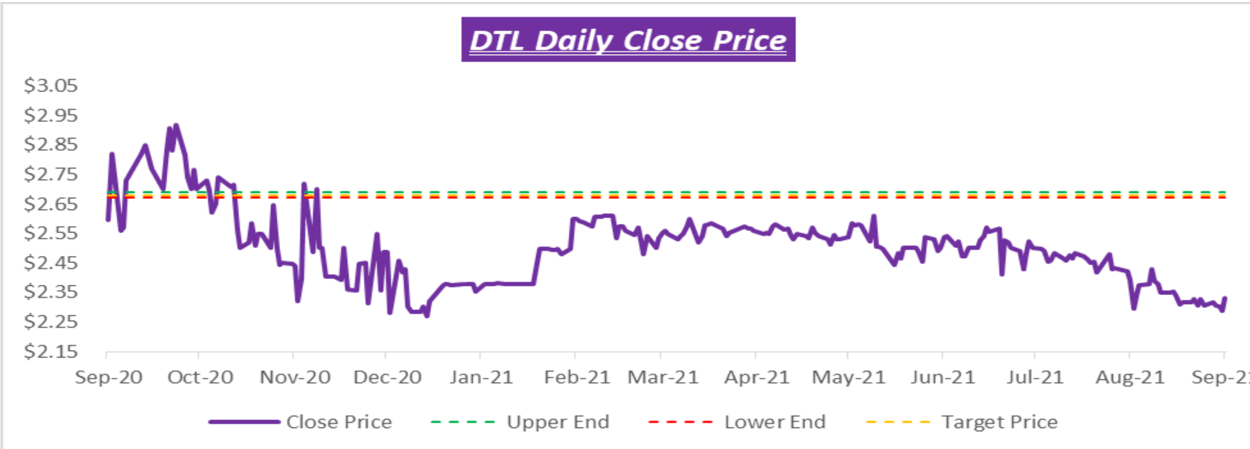
The APO has allowed DTL to increase its total asset base, as well as improve its liquidity and leverage ratios. As at the end of June 2021, the group's current ratio stood at 2.82x while its quick ratio stood at 1.47x. The group's debt/equity ratio has decreased from 3.89x as at the end of 2020FY to 0.83x as at June 2021.

Outlook & Valuation

After raising $4B from its APO in January 2021, DTL has begun making strategic moves to improve operations, via organic and inorganic means. DTL completed transactions to acquire control of Food Savers New York Inc. and Good Foods for Less, in 2021Q1. This acquisition was done via a purchase of 80% of Marnock LLC which was formed to operate the business of the two supermarkets, New York Inc. and Good Foods for Less. This acquisition has already begun to bear fruit, as the net income for the period ended June 2021 was 68.92% greater than that of the same period last year. DTL's EPS moved from $0.059 to $0.064, which suggests that initiatives undertaken are already proving to be accretive. In addition to this acquisition, DTL have stated that they plan to expand their Delect brand and expand their retail location in Clarendon.

The pandemic has had an effect on consumption patterns, as persons have been demanding greater quantities of fast moving consumer goods (FMCG) due to the continuous lockdowns. Being one of the largest retailers and distributors of FMCG in Jamaica, DTL has benefitted through increased earnings from this consumption shift. The severity of the lockdowns may however reduce the earning potential of the group. The implementation of no movement days and very limited business hours due to tight curfews, could possibly begin to show up in the revenue numbers for the company.

After assessing these factors, we have forecasted revenues of $17.88B for the full 2021FY. We have also forecasted net income of $543M, which is 89.9% greater than profits recorded in 2020FY in absolute terms and 17% greater on a per share basis. To get an appropriate valuation for DTL, we used a price multiples approach. We applied our forward EPS of $0.12 to the 1-year average P/E ratio. This yielded an estimate of $2.69. We also applied our forward BVPS of $1.28 to DTL's average P/B ratio post APO. This yielded a price estimate of $2.66. **The average of our price estimates, $2.68 is our target price. This price estimate is 17.54% greater than the closing price of $2.28 on September 23, 2021.**



Recommendation

We assign an **<u>OUTPERFORM/BUY</u>** recommendation to DTL at this time, given that it is currently trading below our fair price estimate of $2.68. This stock is most suitable for investors with a medium to high risk appetite. DTL is currently still in their growth phase and as such, we expect the company to prioritize the retention of profits to fuel expansion.

The main risks to our price target include: headwinds from the pandemic as increasing distribution costs could affect operational expenses. Also, lockdowns have become stricter to the point where they totally restrict all forms of movement. This could potentially affect company business, causing DTL to generate revenues below our estimates.

Abridged Financials

J$'000	Year Ended December 31				6 Months ended June 30		%
	2017	2018	2019	2020	2020	2021	Change
Trading Income	**6,723,810**	**9,303,460**	**12,649,017**	**12,777,464**	**6,302,952**	**8,052,408**	27.8%
Operating Expenses	(1,141,231)	(1,303,213)	(1,687,679)	(10,294,801)	(5,103,388)	(6,513,539)	27.6%
Operating Profit	451,697	454,068	628,922	737,032	275,258	367,823	33.6%
Profit Before Taxation	281,796	281,845	345,726	352,542	207,473	321,417	54.9%
Net Income	252,369	249,120	290,744	279,834	160,661	271,386	68.9%
Total Assets	2,887,219	4,048,095	5,782,684	7,415,814.00	5,765,399	10,319,365	79.0%
Total Liabilities	1,852,044	2,829,859	4,449,172	5,811,877.00	4,255,642	4,705,815	10.6%
Shareholder's Equity	864,068	1,055,639	1,170,130	1,425,702.00	1,329,944	5,420,893	307.6%
EPS ($)	0.092	0.091	0.106	0.102	0.059	0.060	1.8%
Book Value per Share ($)	0.32	0.39	0.428	0.522	0.49	1.20	145.8%
Key Ratios							
Operating profit margin	6.7%	4.9%	5.0%	5.8%	4.4%	4.6%	
Net Margin	3.8%	2.7%	2.3%	2.2%	3.3%	4.0%	
Quick Ratio (x)	1.20	0.88	1.06	1.17	1.48	1.47	
Current Ratio (x)	1.93	1.53	2.23	2.16	1.82	2.82	
Debt/Equity (x)	1.21	1.59	2.94	3.89	2.04	0.83	
Return on Average Assets	9.8%	7.2%	6.2%	4.7%			
Return on Average Equity	35.3%	26.0%	27.2%	23.7%			

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**.

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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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