INVESTMENT AND SOVEREIGN RESEARCH March-8-2021

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Paramount Trading Jamaica Limited

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

Executive Summary

Paramount Trading Jamaica (PTL) Limited was incorporated in 1991 and effectively listed on the Junior Market on December 31, 2012 at $2.43 ($0.243 split adjusted) per share. The primary activities of PTL are the importation and distribution of chemicals, lubricants, other related products and haulage services. The company has five reportable segments namely Chemical, Construction & Adhesive, Manufacturing, Transportation and Lubricants. The three segments which contribute the most to revenue in FY 2020 are Chemicals, Manufacturing and Lubricants which make up 55.2%, 17.2% and 15.3% of revenue, respectively.

In January 2018, PTL expanded its relationship with Allegheny Petroleum Products Company (Allegheny) the supplier of its lubricants and commenced blending operations at the plant located at 39 ¼ Waltham Park Road. In November 2019, PTL amended its relationship with Allegheny through a License Agreement and Supply & Distribution Agreement. The License Agreement permits PTL to use formulae, trademarks and related expertise solely for the production of specified Allegheny lubricants in Jamaica with exclusive distribution rights to all member states of the Caribbean. During the FY 2020, PTL completed an Asset Purchase Agreement with Allegheny to acquire the rights, title and interest for all the assets used in constructing and equipping of the plant operated at 39 ¼ Waltham Park Road.

Below is the historical price chart of PTL adjusted for the 10-for-1 stock split executed in November 2016. PTL's stock price has trended lower since its peak in late calendar year 2016. The Company is currently trading in excess of 60x its trailing 12 months EPS, which is relatively high compared to many listed entities.

Paramount Trading Jamaica Limited

Recent Developments

PTL's Q2 FY 2021 revenue declined by $101.04 million or 24.79% to $306.6 million. However, gross profit margin increased from 30.58% in Q2 2020 to 32.62% in Q2 2021. This was due to increased sales of higher margin products. However, profits fell $20.4 million or 81.9% to $4.5 million. This was due to the insufficient decline in operating expenses to offset the material deterioration in revenue.

However, for the 6M period ended November 2020 PTL was able to generate Operating Cash Flow of $87.3 million versus $45.2 million generated in the same period the previous year. PTL also constrained cash flow from investing activities spending only $5.8 million so far on PP&E in FY 2021 versus $268.87 million at the same point in FY 2020. The result is the Company growing cash resources by $69 million versus a decline of $122.03 million.

On December 15, 2020 PTL's Board of Directors approved a resolution to declare an interim dividend of $0.04 payable on January 14, 2021 to shareholders on record as at December 30, 2020.

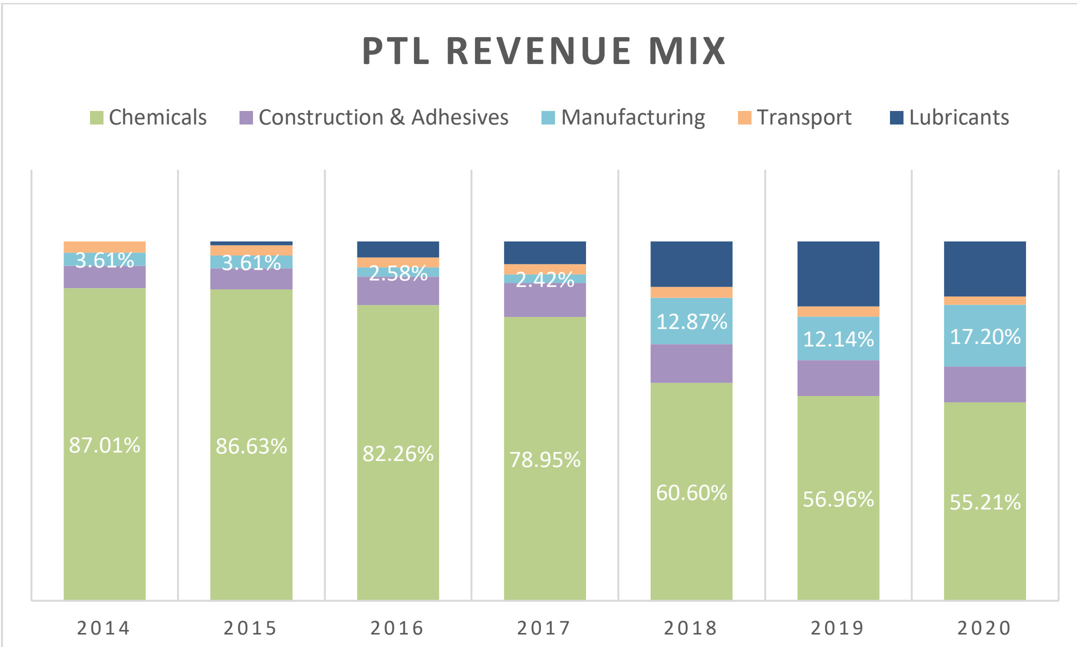
Key Financial Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	CAGR	Q2 FY 2020	Q2 FY 2021	Change(%)
BVPS	0.38	0.44	0.48	0.48	0.52	12.19%	0.51	0.53	4.25%
EPS	0.11	0.07	0.04	0.04	0.03	-19.07%	0.03	0.01	-50.20%
Dividend Per Share	0.039	-	-	0.040	-	27.58%	-	-	N/A
Price	1.10	3.01	2.88	2.10	2.00	53.32%	1.98	1.51	-23.79%
Revenue	1,024,351,766	1,155,871,702	1,398,409,815	1,595,644,995	1,515,582,258	10.29%	768,217,833	668,610,498	-12.97%
Direct Expense	688,557,566	801,829,362	972,056,069	1,093,782,137	1,047,403,570	11.06%	537,092,154	452,254,934	-15.80%
Gross Profit	335,794,200	354,042,340	426,353,746	501,862,858	468,178,688	8.66%	231,125,679	216,355,564	-6.39%
EBITDA	192,371,939	131,559,955	121,657,585	133,218,854	107,419,521	-13.56%	62,863,688	47,073,097	-25.12%
Operating Expense	193,811,358	255,068,753	352,763,278	421,708,051	385,695,877	18.77%	191,160,450	182,030,102	-4.78%
Operating Profit	180,804,200	110,644,012	79,338,043	88,185,697	107,419,521	-12.21%	62,863,688	47,073,097	-25.12%
Interest Expense	9,483,834	10,747,259	13,253,914	14,201,555	47,935,902	49.94%	8,074,977	25,750,717	218.90%
Pre-tax Profits	173,043,013	101,002,560	67,044,079	75,621,619	62,018,240	-22.63%	45,194,507	22,508,763	-50.20%
Profits	173,043,013	101,002,560	58,644,473	62,643,098	53,019,489	-25.60%	39,545,194	19,695,167	-50.20%
PP&E	126,571,503	239,971,127	263,597,645	360,287,984	609,095,561	48.11%	604,895,095	590,583,800	-2.37%
Cash and Cash Equivalents	80,920,662	49,633,811	28,205,145	45,455,080	178,386,497	21.85%	78,345,731	115,101,542	46.91%
Current Assets	675,644,447	722,396,204	907,692,797	968,036,767	1,136,375,233	13.88%	961,650,244	868,577,011	-9.68%
Inventory	336,321,271	367,058,842	500,024,099	547,909,019	683,563,912	19.40%	532,673,898	500,795,945	-5.98%
Current Liabilities	268,230,651	293,376,925	427,444,133	504,894,457	558,109,681	20.10%	446,978,410	392,257,971	-12.24%
Total Assets	859,690,248	1,021,272,842	1,229,165,911	1,579,773,674	1,862,766,275	21.33%	1,663,076,858	1,625,465,002	-2.26%
Total Liabilities	278,912,466	339,492,500	488,741,096	838,404,444	1,068,377,556	39.90%	882,162,434	890,031,687	0.89%
Debt	18,311,842	58,711,326	69,545,450	337,250,570	450,148,677	122.67%	438,911,148	441,425,484	0.57%
Equity	580,777,782	681,780,342	740,424,815	741,369,230	794,388,719	8.14%	780,914,423	814,083,887	4.25%
CFO	161,054,557	59,339,415	32,653,228	146,540,546	99,897,114	-11.25%	45,183,719	87,328,753	93.27%
CFI	39,510,773	129,594,537	65,946,060	141,723,594	382,859,386	76.43%	268,871,051	5,833,764	-97.83%
CFF	(78,072,462)	40,399,484	10,834,124	206,006,437	198,463,171	N/A	101,660,578	(12,494,158)	-112.29%
FCFE	103,627,538	(29,855,638)	(22,458,708)	272,522,072	(177,029,185)	N/A	(223,687,332)	81,494,989	-136.43%

Financial Overview

Revenue has increased at a CAGR of 10.29% for the period under review (FY 2016 to FY 2020). Meanwhile, EBITDA has declined at a CAGR of 13.56% for the same period peaking in FY 2016 at $192.4 million. The primary reasons for the constrained growth in EBITDA were increased operating expenses and lower gross profit margins. The increase in expenses is primarily due to increased staff cost as the company endeavours to enter new business lines. Staff costs increased from $74.8 million from FY 2016 to $178.9 million in FY 2020. The Company also faced increased depreciation expense as it increased its PP&E.

The growth in PTL's revenue has been constrained by its largest revenue segment 'Chemicals' decreasing at a CAGR of 0.17% for the period under review. However, prodigious CAGR of 77.29% at its Manufacturing segment for the period under review aided PTL's overall top line.



Meanwhile for the 6M period ended November 2020 revenue declined 12.97% or $99.61 million to $668.6 million. However, the profit decline for the period was steeper, 50.2% or $19.9 million to $19.7 million. This was due to the decline in revenue outpacing the decline in operating expense.

The most considerable contributor to total assets as at the end of FY 2020 has been inventory which was $683.6 million or 36.7% of total assets. The bulk of inventory is in chemicals amounting to $400.8 million at the end of FY 2020. Meanwhile, most liabilities are in the form of payables which was $515.0 million or 27.65% of total assets at the end of FY 2020. More than half of payables at the end of FY 2020 are foreign payables, resulting in currency risk.

PTL has consistently generated positive operating cash flow for the period under review albeit volatile. For the 6M period ended November 2020 while profits have deteriorated, operating cash flow surged. Operating cash flow increased by 93.3% to $87.3 million. This was buoyed by a decrease in inventory but constrained by a decrease in payables. Ultimately free cash flow to equity holders was $81.5 million versus an outflow of $223.7 million for the same period in FY 2020.

EBITDA, Operating and Net Profit Margins have all declined from their peak levels in FY 2016. ROE for the company has steadily declined for the period under review peaking in FY 2016 at 33% and has declined to 6.90% in FY 2020. **Dupont analysis reveals that the primary reasons for the fall in ROE has been the decline in net profit margin and total asset turnover.**

Ratios	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Average	Q2 FY 2020	Q2 FY 2021	Change(%)
Gross Margin	32.78%	30.63%	30.49%	31.45%	30.89%	31.25%	30.09%	32.36%	7.56%
EBITDA Margin	18.78%	11.38%	8.70%	8.35%	7.09%	10.86%	8.18%	7.04%	-13.96%
Operating Margin	17.65%	9.57%	5.67%	5.53%	7.09%	9.10%	8.18%	7.04%	-13.96%
Net Profit Margin	16.89%	8.74%	4.19%	3.93%	3.50%	7.45%	5.15%	2.95%	-42.78%
Current Ratio	2.52	2.46	2.12	1.92	2.04	2.21	2.15	2.21	2.92%
Debt-to-Equity	0.03	0.09	0.09	0.45	0.57	0.25	0.56	0.54	-3.52%
Inventory Turnover	2.24	2.28	2.24	2.09	1.70	2.11	2.15	1.86	-13.22%
Debt Ratio	0.02	0.06	0.06	0.21	0.24	0.12	0.26	0.27	2.90%
Receivables Turnover	5.06	4.11	4.10	4.25	3.89	4.28	4.46	4.73	6.08%
ROE	33.00%	16.00%	8.25%	8.46%	6.90%	14.52%	9.32%	4.16%	-55.39%
ROA	23.48%	10.74%	5.21%	4.46%	3.08%	9.39%	4.75%	1.97%	-58.54%
P/E	9.80	45.97	75.75	51.71	58.13	48.27	43.85	70.17	60.04%
P/B	2.92	6.81	6.00	4.37	3.88	4.80	3.91	2.86	-26.89%
Payout Ratio	34.76%	0.00%	0.00%	98.49%	0.00%	26.65%	-	-	N/A
EBITDA Coverage	20.28	12.24	9.18	9.38	2.24	10.67	7.78	1.83	-76.52%
Interest Coverage Ratio	19.06	10.30	5.99	6.21	2.24	8.76	7.78	1.83	-76.52%
Cash Ratio	0.30	0.17	0.07	0.09	0.32	0.19	0.18	0.29	67.41%

Key Assumptions & Projections

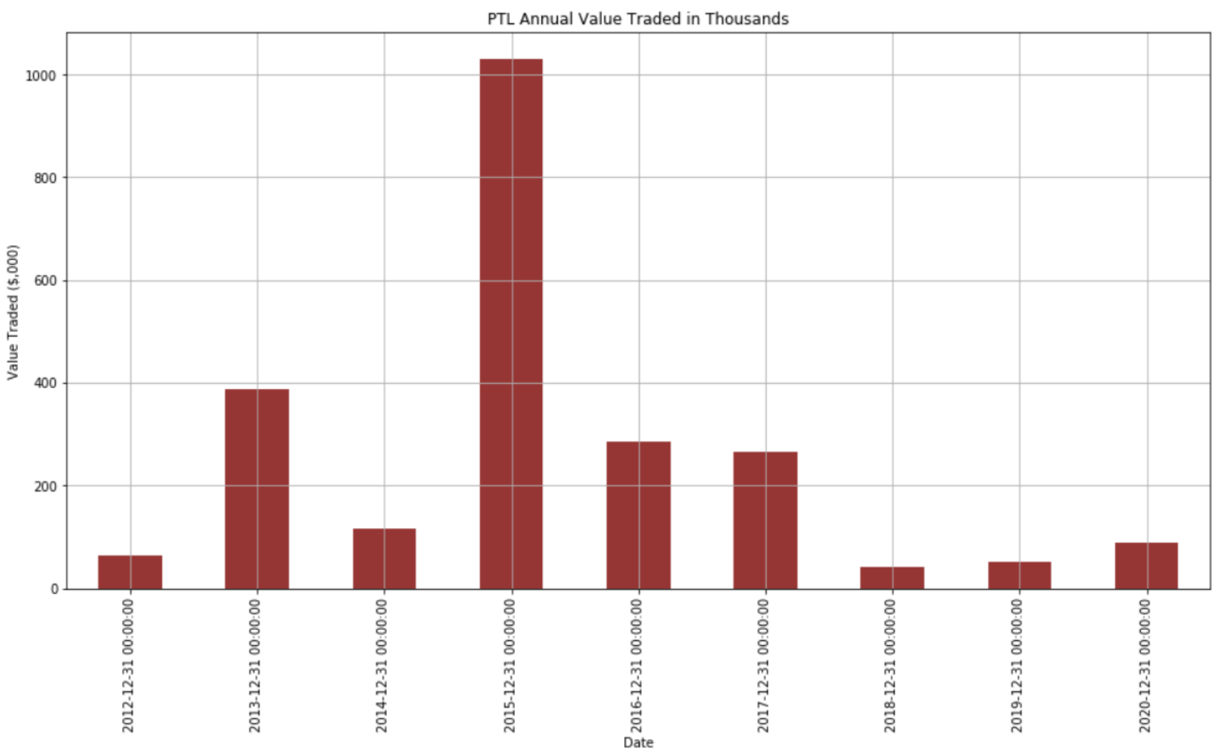
We arrived at our price target of $0.75 using free cash flow to equity (FCFE) approach. Meanwhile our upper- and lower-case price targets of $0.55 and $0.81 were arrived at using a FCFE assuming two different scenarios of earnings and by extension free cash flow. For the upper end price target, we expect PTL's FY 2022 net profit margin to be 4.19% in line with Q1 FY 2021. The Company produced a similar net profit margin in FY 2018 which is notably before any negative impacts of the global pandemic. Meanwhile for the lower end price target PTL produces FY 2022 net profit margin of 2.95% in line with the first half of FY 2021. The lowest net profit margin produced for the period under review was 3.50% in FY 2020, therefore the lower-case estimate is conservative.

Outlook

We expect earnings growth to be subdued in the short to medium-term due to continued stagnation of growth at PTL's largest revenue segment Chemicals. However, our expectation is for strong revenue growth at PTL's manufacturing segment to aid earnings expansion in the long-term as its share of PTL's total revenue continues to grow. Furthermore, PTL continues to seek out contract manufacturing in its Lubricant Division, which could provide other avenues of growth.

Recommendation

Our recommendation for PTL is STRONGLY UNDERPERFORM, given that the stock trades above our best-case price target of $0.81. While we expect steady growth following our expectation of a decline in earnings for FY 2021, we believe investor expectations implied by PTL's current price is overly optimistic. We see material risk to the stock continuing to decline. PTL currently trades at a trailing 12M P/E of 62x, which in our view is excessive given current P/E of other junior market listed entities and PTL's declining ROE. Furthermore, the liquidity of PTL shares has been declining, with average value traded on a given day in FY 2020 of $87.7 thousand.



Source: http://www.jamstockex.com, JMMB Investment & Research, Bloomberg, Company Annual and Quarterly reports, BOJ

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.

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

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

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

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

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

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