INVESTMENT AND SOVEREIGN RESEARCH *February-9-2022*

Caribbean Cement Company Limited

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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.

Commencing in 2017, CEMEX has provided its expertise to CCC, which aided its operations. In November 2021, CCC announced that at its general meeting on December 7, 2021, it would propose entering a Master Services and Intellectual Property Agreement with CEMEX for services provided. The royalty fee payment will begin on January 1 2022, and will not exceed 4% of CCC's consolidated net sales. The news was received negatively by many investors as it would result in a significant increase in costs for CCC.

CCC currently trades at approximately 14.6x, its trailing 12-months EPS below its 5-year average of 24.3x. Meanwhile, CCC is relatively liquid, exchanging an average daily volume of 92.9K units over the past year, valued at approximately $7.7 million. Over the past month, CCC has had an average bid-ask spread of about 3.2%, indicating a relatively high implicit cost to trade shares.

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Recent Developments

For the 3rd quarter ended September 2021, revenue fell marginally; however, profits faced a material decline. In the 3rd quarter ended September 2021, revenue fell 4.8% to $5.5 billion. The Company indicated that the fall in revenue was due to heavy rainfall and lower cement and clinker production as a consequence of planned maintenance. Meanwhile, profits declined by 96.4% to $43.7 million among the weakest Q3 experienced under the review period. The decline was primarily due to a 44.3% surge in total expenses resulting from an increase in raw materials, repairs and maintenance costs and changes in inventory.

Key Financial Data

	YE 2016	YE 2017	YE 2018	YE 2019	YE 2020	CAGR	Q3 2020	Q3 2021	Change
BVPS	9.09	10.53	7.31	9.76	13.55	10.49%	12.43	17.35	39.61%
EPS	1.53	1.35	2.90	2.21	3.76	25.17%	2.62	3.68	40.32%
Share Price	17.86	18.00	30.00	38.01	35.00	18.32%	35.00	42.50	21.43%
Main Market	192,277	288,382	379,791	509,916	395,615	19.77%	380,426	414,890	9.06%
Abridged Income Statement (In Billions)									
Revenue	15.78	16.51	17.57	17.76	20.11	6.25%	15.10	17.80	17.87%
EBITDA	2.70	3.03	5.32	5.91	7.82	30.43%	6.08	5.98	-1.68%
Operating Profit	1.40	1.62	4.16	4.30	6.29	45.56%	4.93	4.84	-1.79%
Pre-tax Profit	1.35	1.56	3.29	2.74	4.42	34.53%	3.51	4.21	20.04%
Profits	1.30	1.15	2.47	1.88	3.20	25.18%	2.23	3.13	40.32%
Abridged Balance Sheet (In Billions)									
Non-Current Assets	6.71	8.29	23.78	23.63	22.98	36.03%	23.36	22.54	-3.53%
Current Assets	3.71	3.92	3.01	3.47	3.34	-2.59%	3.38	4.17	23.60%
Total Assets	10.42	12.21	26.79	27.10	26.32	26.07%	26.74	26.71	-0.11%
Non-Current Liabilities	0.03	0.12	15.89	13.84	8.20	315.93%	10.36	4.88	-52.92%
Current Liabilities	2.65	3.13	4.48	4.95	6.59	25.54%	5.83	7.07	21.16%
Debt	0.10	0.55	12.16	9.16	4.44	155.63%	4.43	0.5545	-87.47%
Equity (as reported)	7.74	8.96	6.22	8.31	11.53	10.49%	10.58	14.77	39.61%
Abridged Cash Flow Statement (In Billions)									
Operating Cash Flow	1.72	3.20	4.37	4.81	7.00	41.98%	5.23	4.27	-18.27%
Investing Cash Flow	(1.70)	(2.23)	(16.66)	(1.33)	(0.78)	-17.74%	(0.53)	(0.67)	26.32%
Financing Cash Flow	(0.21)	(0.00)	11.05	(3.38)	(6.26)	134.89%	(4.91)	(3.94)	-19.75%
Other Data In (,000)									
Cement Sold	904.15	864.85	881.49	851.06	975.01	1.90%			
Ratios						**Average**			
EBITDA Margin	17.13%	18.33%	30.27%	33.26%	38.90%	27.58%	40.24%	33.57%	-16.58%
Operating Margin	8.87%	9.82%	23.67%	24.23%	31.26%	19.57%	32.62%	27.18%	-16.68%
Net Profit Margin	8.25%	6.95%	14.03%	10.60%	15.90%	11.15%	14.79%	17.61%	19.05%
Current Ratio	1.40	1.25	0.67	0.70	0.51	0.91	0.58	0.59	2.01%
Debt-to Equity	0.01	0.06	1.96	1.10	0.39	0.70	0.42	0.04	-91.03%
ROE	18.36%	13.74%	32.50%	25.93%	32.22%	24.55%	27.40%	32.33%	17.98%
ROA	12.24%	10.14%	12.65%	6.99%	11.97%	10.80%	9.40%	15.33%	63.04%
P/E	22.75	24.08	14.63	37.69	16.72	23.18	15.80	22.67	43.52%
P/B	3.83	3.08	5.80	8.54	4.64	5.18	3.80	6.29	65.55%

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Financial Overview

Income Statement Review

Revenue grew consistently at a CAGR of 6.3% to $20.11 billion for FY 2016 to FY 2020 (review period); growth was primarily due to solid domestic cement sales. For the review period, cement sales increased at a CAGR of 2% to a record of 975 thousand tonnes in FY 2020. Revenue growth accelerated to 17.9% in the 9M period ended September 2021. However, revenue experienced its first quarterly decline since Q4 December 2019 in Q3 September 2021.

EBITDA has surged from $2.7 billion to $7.8 billion, producing a CAGR of 30.4% for the review period. The primary reason for the EBITDA growth rate was the restructuring in Q2 FY 2018, which allowed the Company to generate FY 2020 expenses in line with FY 2016 expenses. However, EBITDA declined by 1.7% more recently for the 9M period ended September 2021. This decline is primarily due to a surge in cost of sales which increased by 33% to $10.8 billion, outpacing revenue growth.

Profit has been volatile; however, it finished FY 2020 at a review period high. The earnings strength experienced in FY 2020 was partly due to revenue increasing 13.2% while containing costs. Furthermore, profit growth accelerated in the 9M period to 40.3% versus the 25.2% experienced under the review period. A significant contributor to FY 2021 YTD performance was the aggressive debt repayment which has reduced net finance costs and losses associated with foreign currency-denominated debt. Currency exchange losses and finance costs declined to $635.6 million from $1.4 billion the prior financial year.

Balance Sheet Review

For FY 2016 to FY 2020, non-current assets increased at a CAGR of 36% due to CCC acquiring Kiln 5 and Mill 5 in April 2018. As a result, debt surged to $12.2 billion at the end of FY 2018. Subsequently, the Company has aggressively paid down its debt to $4.44 billion at the end of FY 2020. Furthermore, debt levels declined further in Q3 FY 2021 to $554.5 million. The debt reduction has aided profit growth, as previously discussed.

The removal of preference shares from equity resulted in CCC's "reported" equity value dropping in FY 2018. However, it has since steadily improved, reaching $11.5 billion at the end of FY 2020. More recently, equity has increased to $14.8 billion at the end of Q3 FY 2022 due to consistent profitability.

Cash Flow Statement Review

Cash flow from operations (CFO) has surged at a CAGR of 42% to $7 billion at the end of the review period. The increase in CFO has allowed the Company to make aggressive cash outflow for financing activities of $6.3 billion in FY 2020. The primary use of cash in financing activities for FY 2020 was repaying debt and preference shares of $4.7 billion and $1.5 billion, respectively. A similar pattern continued in FY 2021, with over $3.4 billion spent to repay debt. However, more recently, for the 9M period operating cash flow fell 18.3% to $4.3 billion due to lower profitability in Q3 2021.

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Ratios Review

EBITDA margin has improved for the period under review peaking in FY 2020 at 38.9%. The decrease in operating lease due to the assets purchased in FY 2018 aided the EBITDA margin increase. Conversely, in the 9M period, the EBITDA margin has declined 16.6% versus the same period last year, primarily due to the weak performance in Q3 2021.

CCC's current ratio has been consistently below 1x since FY 2017, partially due to the Company not keeping a high cash reserve and instead opting to pay down debt rapidly. We do not see this as being severely risky at this point, given the Company's current debt load, which would allow it to raise debt to meet near-term obligations if required. Furthermore, strong operating cash flows could assist with near-term cash needs.

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 FY 2020, it declined to 0.39x as the Company paid down debt and continued to grow equity. Furthermore, at the end of Q3 FY 2021, debt-to-equity fell to 0.04x.

Forecast and Valuation

We arrived at our price target of $80.80 using the Free Cash Flow to Equity (FCFE) model. Meanwhile, using the FCFE under two additional scenarios produced our upper- and lower-case price targets of $104.57 and $66.44, respectively. The two primary differences between the various scenarios are the expectation for operating margins and royalty fees in FY 2022 and beyond. The best-case scenario assumes that CCC can maintain strong operating margins and pays a royalty fee of 1% on net sales per annum. Meanwhile, we expect operating margins to fall modestly below historical levels and a royalty fee of 4% under the worst-case scenario. Finally, we see revenue growth and operating margins reverting to their long-run levels under our base-case scenario and a royalty fee of 2%.

	Price Target	Implied Upside/(Downside)
Upper	104.57	49.13%
Base	80.80	15.24%
Lower	66.44	-5.25%

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Outlook

The Company is on a path to complete paying debt obligations in the near term. At its current debt levels, a significant reduction in net finance and loss on currency exchange may be expected for FY 2022 and beyond. At the same time, expansion plans will require substantial outlay, which could result in the Company taking on additional debt. However, given our expectation for FY 2022, funding requirements could be met from cash flows. Therefore, the increase in debt may be modest.

On the other hand, the revenue decline experienced in Q3 FY 2021 may be an early indication of the recent growth surge being unsustainable. Furthermore, the recent surge in costs may persist, eroding operating margins. Moreover, the addition of royalty fees on the cost structure is likely to weigh on profitability.

Overall, the impact of the royalty fees is significant. However, due to the decline in debt related expenses and the potential for a more robust Q3 in 2022, we expect growth in FY 2022 under our base-case scenario. Finally, meaningful dividends in FY 2022 could help lift investor sentiment.

Base Case					
FY	Q1	Q2	Q3	Q4	YE
2022	1.71	1.84	0.99	0.97	5.51
2021	1.79	1.84	0.05	0.94	4.62

RECOMMENDATION:

We maintain a HOLD rating on CCC at this point, given that it trades marginally above our base-case price target and materially below our best-case price target. In addition, our recommendation considers the stability of CCC's earnings, operating cash flow, balance sheet strength and share liquidity.

As implicitly applied in our price target, our view on CCC could differ materially based on the agreed royalty fees. While we see significant tailwinds to earnings due to the lower debt load, but the potential size of the fee agreement tempers our optimistic view. Furthermore, if the construction industry were to slow, revenue growth could fail to materialize.

CCC has declined 11.6% YTD, outperforming the JSE Main Market advance of 0.9% over the same period. However, CCC was up over 80% early in the year but lost most of its gains following a press release indicating a potential royalty fee on net sales. The Company's stock is relatively liquid, trading an average daily value of approximately $7.7 million or 92.9K units over the last year. **See charts 1 – 4 below for more information on CCC's YTD performance, the volume traded, value exchanged, and historical closing bid-ask spread.**

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Chart 1.

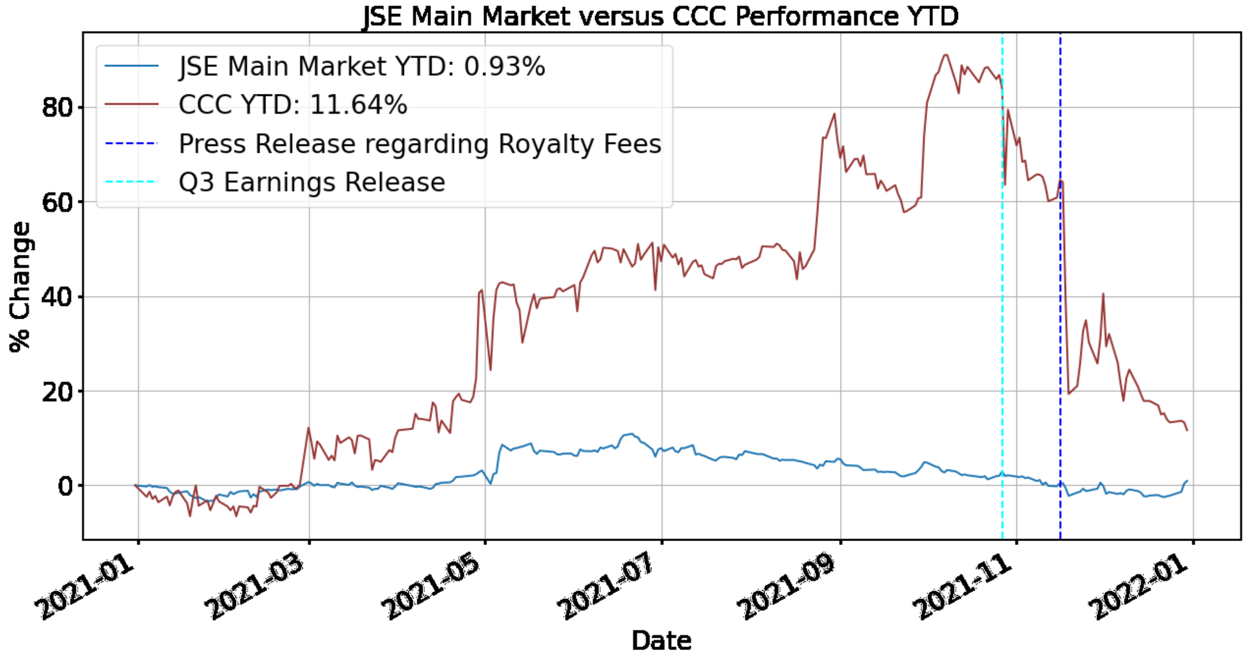
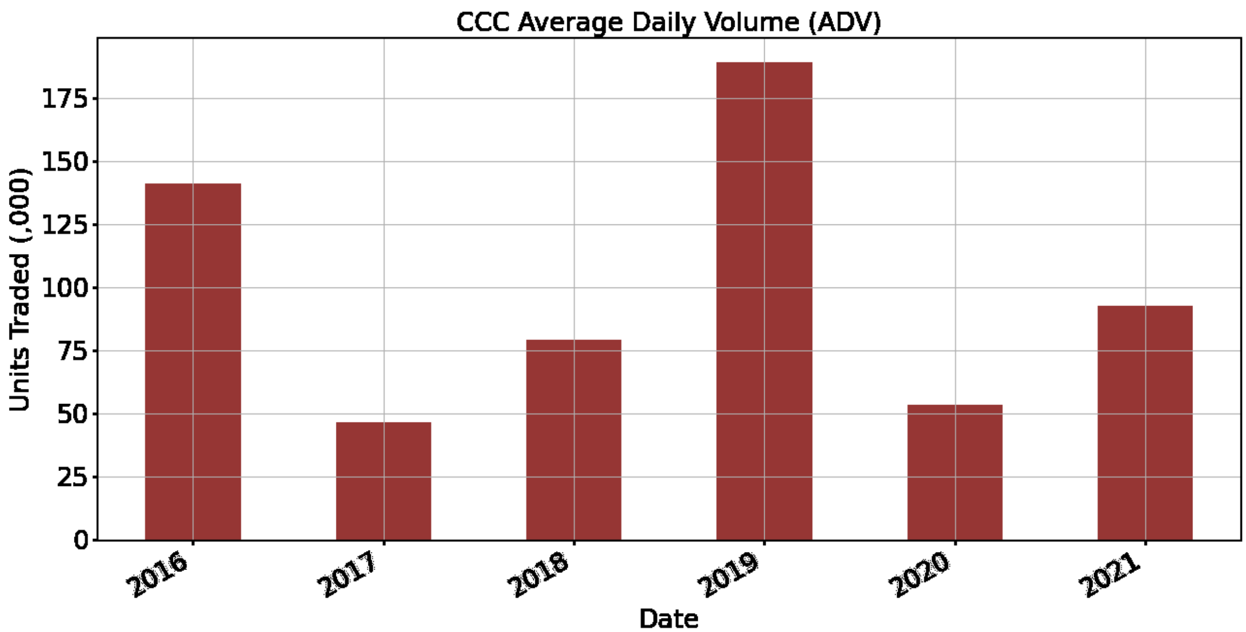


Chart 2.



Your Best Interest At Heart. Full Stop.

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Chart 3.

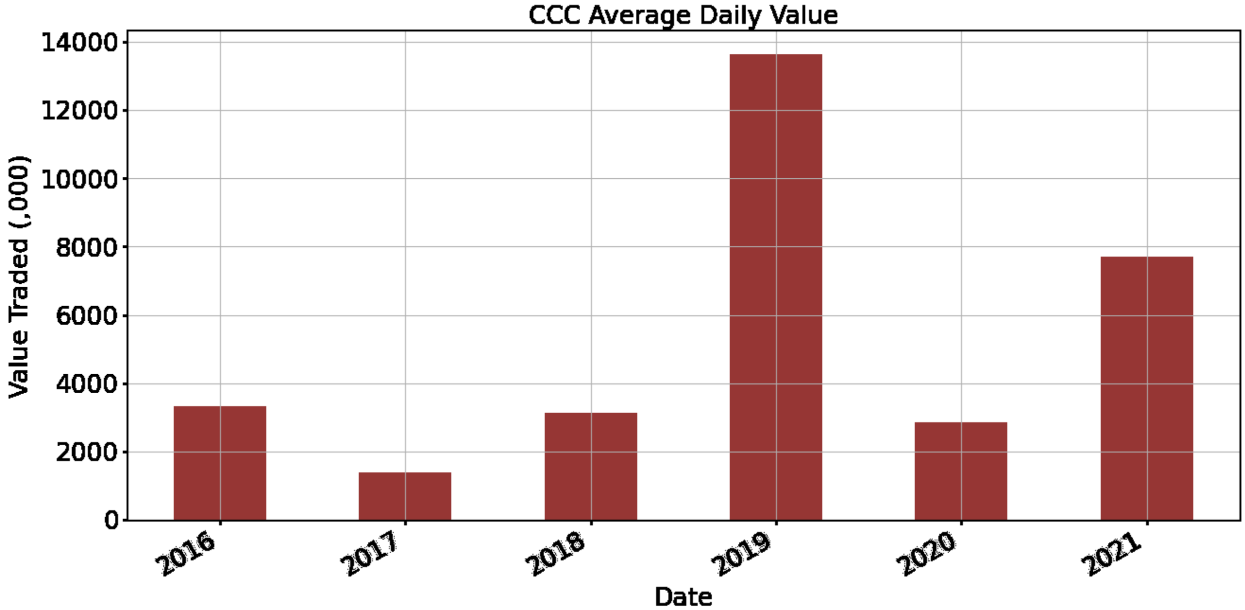
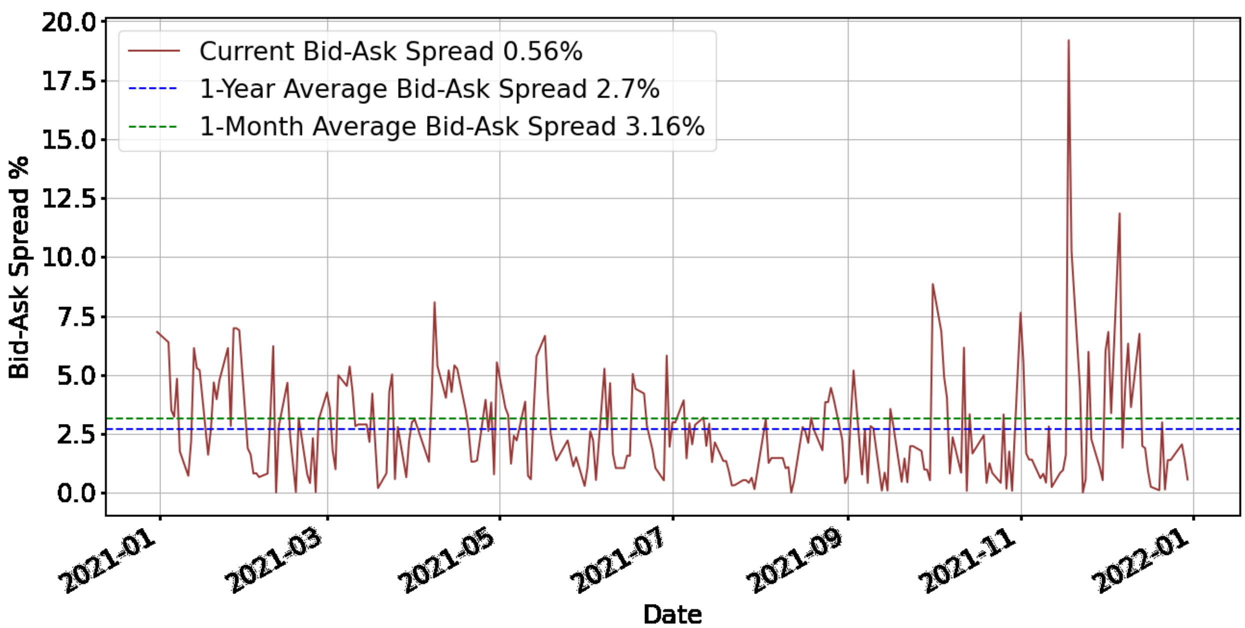


Chart 4.



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.

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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