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LOCAL EQUITY REPORT

CARIBBEAN CEMENT COMPANY

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Caribbean Cement Company

Company Overview

Caribbean Cement Company (CCC) Limited is a publicly listed company that has been in operation since 1952 and is the sole manufacturer of Portland and blended cement in Jamaica. Its main plant and operations are situated in Rockfort, Kingston with additional quarry operations in both St. Andrew and St. Thomas. CCC manufactures and distributes high-quality Portland cement using one hundred percent Jamaican raw material. The raw material used in the manufacturing process are all mined within ten miles of the plant. CCC is a member of the TCL Group, which is owned by Mexican Company, CEMEX, S.A.B. de C.V, a global building materials company.

Stock	CCC
Close Price	67.48
Estimated Fair Value	87.98
Year to Date Return	7.44%
Dividend Yield	0.00%
Trailing P/E	17.95x
Forward P/E	14.61x
Potential Upside	**30.38%**
Recommendation	**OVERWEIGHT**
As at March 29, 2021	

Executive Summary

Throughout the COVID-19 pandemic, all industries have been affected by what has been a significant downturn in aggregate demand as the pandemic has created a need for persons to reduce travelling and physical interaction. Despite this setback which predominantly materialized in Q2 of 2020, the construction industry has rebounded significantly (7.0% in Q3 2020 and 6.2% in Q4 2020), ahead of many other industries and well ahead of the overall economy. This strong growth over the last two reported quarters has been a significant tailwind for Caribbean Cement and the company has consequently seen a significant increase in the demand for its product, well in excess of previous years. On the heels of what has been a great year for the company, management expects demand to increase further, fuelled by upcoming government projects that will require substantial cement deposits. The recent government budget lends to this expectation as one of the main components of the government's SERVE Programme is infrastructure development. With that said, the company is positioning itself to meet this demand while maintaining its more efficient cost structure which was displayed in 2020, chief among these was the reduction of debt, which in turn reduced the company's cost of debt. We believe the strong demand for its products coupled with its efficient expense management bodes well for Caribbean Cement. As such, we maintain our **OVERWEIGHT** recommendation on the company's stock.

Analyst Outlook

Since the peak period of the pandemic induced lockdown in Q2 of 2020 (June quarter), the construction sector has rebounded significantly relative to the prior year, as indicated in the executive summary. This rebound reflects strong demand throughout the industry which has resulted in CCC reporting its highest cement production since its inception. While this has been a tremendous milestone, the company's General Manager, Yago Castro, has indicated that the company anticipates further demand and will position to meet this demand by increasing reinvestment initiatives to broaden the company's production capabilities - pledging $1.5 billion annually in capital projects over the next five years. The company's management has also mentioned that in the event they are unable to meet the significant demand, they will import from the wider TCL Group. As noted prior, the government intends to target infrastructure development, allocating $31.1 billion towards infrastructure development. In addition to this, interest rates remain at an all-time low, providing a strong incentive for potential homeowners to purchase. We believe these factors lend well to the expectations put forth by the company's management and meeting this expected demand should support the company's further growth in FY2021. **This growth coupled with the cost management mentioned in our executive summary underpins our positive outlook for the company.**

Valuation Summary

We used the free cash flow to equity and P/E valuation methodologies to determine an intrinsic value of $87.98 for CCC. This represents a 30.38% upside relative to the March 29, 2021, close price of $67.48. Given the Company's strong expected growth and our fair value estimate, Barita Investments Limited recommends an **OVERWEIGHT** on CCC.

Business Management

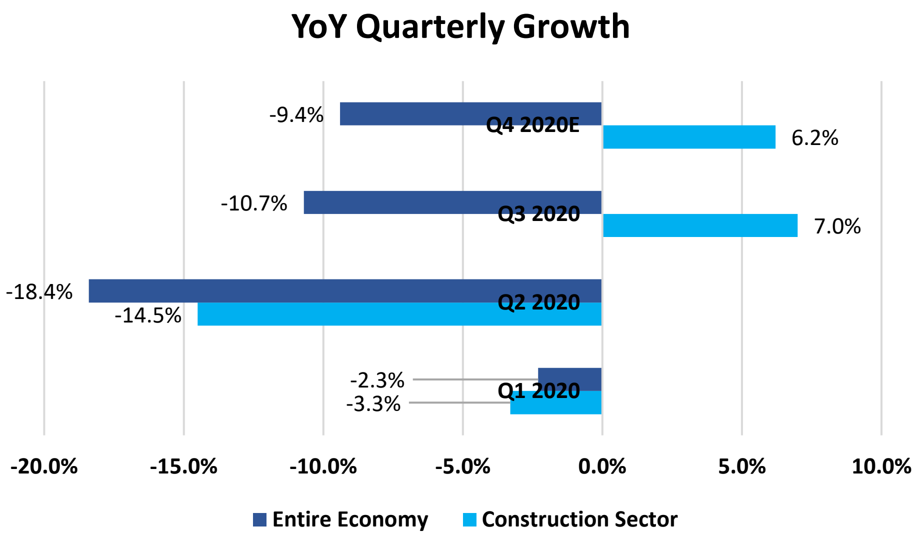
CCC's Board of Directors comprises individuals with international exposure to the global cement industry. With board guidance from their larger counterparty in the international marketplace in Cemex S.A.B de C.V, the Company will be able to operate at global standards. The board will also be able to guide the continued growth in the expansion of the company's operations, developing further innovative ways to manage costs while ensuring on-site safety at all times.

Board of Directors
Parris A. Lyew-Ayee, CD, Chairman
Jose Luis Seijo Gonzalez, Managing Director
Yago Castro Izaguirre, General Manager
Hollis N. Hosein, Non- Executive Director
Peter Moses, Non-Executive Director
Luis Gilberto Ali Moya, Director
Dania Jocelyn Heredia Ramirez, Director

Industry Overview and Outlook

At present, the PIOJ projects that the economy will grow by 4% to 8% in Fiscal Year (FY) 2021/2022. This growth comes on the heels of a significant decline in FY2020/2021, projected at -10.5% to -12.5% YoY. Within that context, the construction sector, based on the PIOJ's estimates, is expected to decline marginally by -0.8% YoY in FY2020/21, an outturn second only to "Producers of Government Services" which increased slightly by 0.10%.

While the industry declined marginally, we believe the trajectory of growth is most important. With that said, the chart below depicts the outturn for construction relative to the overall economy in each quarter.



Sources: Statin and PIOJ

It essentially indicates that while the overall economy remained subdued since the contraction in Q1 2020, the construction industry has rebounded significantly. This growth in the industry was recorded for all groups: building construction, civil engineering, and building installation. The performance of building construction was mainly influenced by increased activity in residential and nonresidential construction. Civil engineering was positively impacted by increased levels of expenditure on road rehabilitation works and telecommunication infrastructure. This positive industry performance underpins the strong growth witnessed by Caribbean Cement over the 2020 financial year. As we look towards 2021 and beyond, we believe the current goals of the government to spend significantly on infrastructure will be a key driver for the industry.

Financial Performance Summary (Year Ended December 31, 2020)

Income Statement

For the year ended December 31, 2020, Carib Cement's revenue increased from $17.76 to $20.11 billion, representing YoY growth of 13.19% on the back of higher production volumes as indicated by the company's new record in 2020 of manufacturing more than 950,000 tonnes of cement in response to increased market demand. As reported by the General Manager of Caribbean Cement, Yago Castro, the market responded oppositely to what might have been expected given the pandemic. Instead of slowing down, construction grew, and CCC kept in step with its customers by meeting that demand consistently. Importantly, while revenue increase has been robust, the company faces concentration risk as 5 customers account for $8.00 billion or 40.14% of total revenue. In the event that one or more of these customers' demand for cement decreases materially, then CCC would automatically lose a large source of revenue.

Despite the strong growth witnessed in revenue, cost of sales increased at a slower pace of just 4.10%, owing to the company's increased cost management. This added 4.76% to the company's gross profit margin (from 40.67% in the prior year to 45.44%) and drove gross profit growth of 26.44% YoY.

The cost mitigation steps were even more pronounced in the company's operational and other expenses which, in total, decreased by -2.42% YoY (from $-2.49 billion to $-2.35 billion). This reduction in the company's operating expenses had a disproportionate effect on operating profits which increased by 46.03%, much higher than the company's gross profit increase of 26.44%. The company's directors have noted that this significant cost control, despite the increased production, is due to the company's direct cost containment measures and operational efficiencies.

As it relates to gross profit, we believe management has been on a cost curbing initiative even before the pandemic. In 2020, while revenue grew by 13.19% YoY (+$2.34 billion), the cost of sales only increased by 4.10% YoY (+432.55 million). If we look back to FY2019, we notice that compared to FY2018, the cost of sales was on a declining trajectory, falling by -6.16% ($691.25 million) despite a revenue uptick of 1.09%. This would suggest that the company's cost of sales in the years prior to FY2019 was higher than necessary. The cost-cutting initiatives employed have simply been maintained in 2020, hence the slower pace of cost of sales growth relative to revenue growth. We believe the company will be able to maintain this new gross profit margin given the consistency seen since FY2019.

As it relates to operating profit, this was improved on the back of a reduction in administrative expenses, a potential benefit from the pandemic given the reduced number of workers that would be required to be in office, for example. In our view, all things being equal, the operating profit margin should remain elevated relative to prior years if the company maintains its current working structure.

Net finance costs for the company totaled $801.39 million relative to $927.22 million in the prior year, a decrease of -13.57% which largely demonstrates the company's aggressive repayment of its USD denominated debt (repaid J$4.73 billion of J$6.08 billion) which resulted in long term debt declining by 45.86% YoY. The company, however, reported increased foreign exchange loss which amounted to -$1.06 billion relative to -$0.64 billion in FY2019, representing an increase of 65.57% which weighed on earnings for the year. This increase mirrors the increased volatility within the FX market, and heightened depreciation of the J$ versus the US$ at various points throughout the year. **With the significant reduction in the company's USD debt burden, however, we expect FX movements will have less of an impact on the company's income statement which bodes well for future earnings, particularly when viewed relative to FY2020 in which the company reported a large FX loss.**

Despite the significant increase in FX loss, however, the company reported pretax profit of $4.42 billion which is 61.65% above the $2.74 billion reported in FY2019. Additionally, the company saw a relative decrease in its effective tax rate which declined from 31.19% in FY2019 to 27.76% in FY2020. This resulted in a net profit of approximately $3.20 billion, an increase of 69.70% above the prior year.

Profitability Metrics	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
ROE	18.36%	13.83%	33.42%	25.58%	32.22%
ROA	12.24%	9.77%	12.61%	6.99%	11.97%
Gross Profit Margin	-	-	36.10%	40.67%	45.44%
Operating Profit Margin	8.87%	9.53%	23.67%	24.23%	31.26%
Net Profit Margin	8.25%	6.73%	14.03%	10.60%	15.90%
Revenue Growth	2.26%	4.64%	6.42%	1.09%	13.19%
Operating Profit Growth	-22.38%	12.35%	164.42%	3.49%	46.03%
Net Profit Growth	-15.81%	-14.59%	121.82%	-23.62%	69.70%

Source: *Barita Research, CCC Financial Release*
NB: *The company began reporting gross profit in FY2018*

The table above shows the company's profitability performance over the last 5 years. The main item of note is that the company's cost structure changed significantly in FY2018 as management ended an expensive operating lease that the company had with Trinidad Cement Limited (TCL).

In the years before FY2018, CCC operated its Kiln 5 and Mill 5 equipment through an operating lease with TCL which was payable semi-annually in USD. By raising debt capital, the company acquired kiln 5 and mill 5 and discontinued that operating lease which had been a significant drag on profitability. Since then, profitability metrics like operating profit margin, for example, have increased materially. **In FY2019, the company reported a decline in net profit growth which when viewed alongside operating profit growth of 3.49% indicates that this decline in net profit was due to FX losses and interest expense. In 2020, the company reduced its FX exposure by lowering its debt. Given the top-line growth expected beyond FY2020 coupled with its cost mitigation efforts, we expect the company's margins and bottom-line growth to improve.**

Balance Sheet

As at December 31, 2020, CCC reported total assets of $26.21 billion relative to $27.10 billion in the prior year, representing a YoY decrease of approximately -2.88% in the company's asset base. This marginal decline largely reflects the company's reduction in trade receivables which totalled $141.40 million for the year relative to $509.42 million in the prior year, a decline of $368 million or -72.24%. Considering the significant growth in the company's revenue coupled with the decline in its accounts receivables, this indicates that the company's revenues are largely cash-based which is positive for cash flow generation and is exhibited in the company's strong cash from operation (details in cash flow statement section). The total asset decline also reflects a decline in net Property Plant and

Equipment (PPE) which totaled $22.98 billion relative to $23.63 billion in FY2019, a decline of -$648.25 million or -2.74%. The reduction in net PPE is largely due to an increase in depreciation of $1.51 billion or 18.42%.

As it relates to liquidity, the company has fairly large current liabilities ($6.59 billion relative to current assets of $3.34 billion), much of which represents its trade payables which account for 46.41% of total current liabilities. This large payables balance represents the company's ability to owe suppliers for significant periods of time (up to 108 days - see cash conversion cycle table), which is an indication of strong buyer power.
As it relates to receivables, the company's sales are largely cash-based, as previously indicated, which results in a small receivables balance and the company's debtors tend to repay very quickly. Consequently, the company's liquidity ratios are all below 1.00x, as shown in the table below. At first glance, this appears to indicate some liquidity constraints.

Liquidity	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Cash Ratio	0.27	0.53	0.09	0.11	0.08
Quick Ratio	0.61	0.79	0.28	0.25	0.15
Current Ratio	1.40	1.25	0.67	0.70	0.51
Working Capital ($'000)	1,053,992	789,965	-1,470,873	-1,483,548	-3,252,390
Source: *Caribbean Cement Financial Release*					

However, the company's high cash generation and ability to owe creditors for long periods presents a dynamic wherein, throughout the year, the company manages its working capital through this high cash generation.

The table below indicates that Caribbean Cement has a negative Cash Conversion Cycle which means that its working capital isn't "tied up" for long, its business has great cash generation and liquidity, and this represents a form of financing from the company's creditors.

Cash Conversion Cycle	FY 2018	FY 2019	FY 2020
Avg. Days Sales Out.	9.72	10.21	7.96
Avg. Days Inventory Out.	53.61	71.03	78.09
Avg. Days Payable Out.	66.97	95.02	108.34
Avg. Cash Conversion Cycle	**- 3.60**	**- 13.80**	**- 22.30**
Source: *Standard & Poor's*			

With that said, while the company's liquidity ratios in the liquidity table are below the conventional required level of at least 1.00x and have been so since FY2018, CCC has strong cash generation and strong liquidity as indicated by the cash conversion cycle. The use of cash is further explained in the cash flow statement section below.

As it relates to funding, the Group currently has total debt and finance lease liabilities of approximately $6.67 billion and total equity of approximately $11.54 billion, which implies total funding capital of $18.21 billion, debt-to-equity of 0.58x, and a capital structure of 36.65% debt (inclusive of finance lease liability) relative to 63.35% equity. **This is a significant contrast to FY2018 and FY2019 as the company increased its leverage to pay off its then, operating lease**. For clarity, in the years before FY2018, CCC operated its Kiln 5 and Mill 5 equipment through an operating lease with Trinidad Cement Company which was payable semi-annually in USD. By raising debt capital, the company acquired kiln 5 and mill 5 and discontinued that operating lease which had been a significant drag on profitability.

Now, the company is essentially repaying the debt used to acquire kiln 5 and mill 5. The significant reduction in total debt (reduction of $5.65 billion or 45.86%) and improved debt metrics as shown in the table below, was driven by the company's strong performance in 2020 which allowed management to reduce debt significantly.

Solvency Ratios	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Debt to Equity	0.00x	0.00x	2.37x	1.48x	0.58x
Debt Ratio	0.00x	0.00x	0.60x	0.45x	0.25x
Equity Multiplier	1.35x	1.48x	4.17x	3.26x	2.28x
Source: *Barita Research, CCC Financial Release, S&P*					

Cash Flow Statement

CCC's operations are largely cash-based as demonstrated by the table below which indicates that the company's operating cash flows have been strong and consistent over the last 5 years and in all years have outpaced its net profit. What's more important, given the high CAPEX needs of the company, is that free cash flows have also been quite significant, with the exception of FY2018 in which the company levered-up its balance sheet and acquired the equipment (kiln 5 and mill 5) it originally used under an operating lease arrangement with the TCL Group.

Looking at FY 2020, specifically, demonstrates why we indicated prior that while the company's liquidity metrics are below 1.00x, this is a deliberate decision taken by management. Essentially, free cash flow from the company is over $6.2 billion. If we get more granular and assess the company's total cash flow not used to repay **long term debt** (this debt is considered a discretionary payment since it was not due in FY2020), we arrive at an ending cash balance of $5.25 billion as opposed to $513.14 million that is currently reported. Now, if the company opted not to make this discretionary debt payment and added the cash used for repayment to the balance sheet, CCC would have recorded current assets of $8.07 billion as opposed to the $3.34 billion reported, and would thereby improve its current ratio, to 1.22x. However, the company used its cash to repay debt which has a net positive effect for shareholders since the company reduced interest expense and negative FX exposure.

Cash Flow ($'000)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Net Profit	1,301,702	1,111,734	2,466,093	1,883,678	3,196,693
Operating Cash Flow	1,722,237	3,203,578	4,366,480	4,810,325	6,998,098
CAPEX	- 1,699,091	- 2,234,050	- 16,663,006	- 1,334,340	- 778,029
Free Cash Flow	**23,146**	**969,528**	**- 12,296,526**	**3,475,985**	**6,220,069**
Net Debt Repayment	0.00	0.00	11,046,464	- 3,379,430	- 6,258,586
Cash Balance	717,568	1,673,067	420,790	544,570	513,136

Source: *CCC Financial Release*

Growth Expectations

<u>Local Demand for Cement Remains Heightened –</u> *<u>Government Initiatives</u>*

As indicated previously, the strong growth in revenue and earnings reported by the company in FY2020 comes on the heels of strong demand for Cement throughout 2020. With this demand, the company produced 950,000 metric tonnes of cement which was a record amount of cement relative to prior years.

As we look ahead towards future developments, the Ministry of Finance has put forward its $60 billion Social and Economic Recovery and Vaccine Programme; SERVE Jamaica Programme. Of the total amount, $31.1 billion will go towards infrastructure development which has positive implications for the demand for cement throughout this fiscal year.

Housing Developments

As it relates to future demand, the Government of Jamaica has indicated its intention to construct between 70,000 and 100,000 houses over the next five years and CCC is positioning to meet the expected demand. With that, CCC's management indicated its intention to spend US$12million or J$1.8 billion in 2021 towards increasing its production capacity.

Additionally, beyond 2021, the company anticipates spending totaling US$10 million each year for the next five years to meet the demand set forth by the government. At present, the company aims to increase the 950,000-tonne cement production reported in 2020 to 1.3 million tonnes over time and to more than 1 million tonnes in 2021 if needed.

Continuation of Projects – May Pen to Williamsfield leg of the South Coast Highway

An important thing to note with construction projects is that they are typically multi-year projects. The May Pen to Williamsfield leg of the South Coast Highway is one such example. Caribbean Cement would have benefited from this project in 2020 and we expect this to continue in 2021 as the government has allocated $17.7 billion to the Southern Coastal Highway Improvement Project (SCHIP) based on the FY2021/22 budget. In January 2021, it was noted that the expected completion date for the project is October 2022. Since then, there have been some disruptions so the potential exists that the project will continue just beyond October 2022. The continuation of this and other construction projects that span multiple years has positive implications for the company.

Local Demand for Cement Remains Heightened – *Favourably Housing Climate*

The National Housing Trust (NHT) accounts for almost 50% market share in Jamaica's mortgage market and has been stimulating the real estate market through special measures aimed at keeping mortgages affordable. This was done prior to the pandemic and since the pandemic, the agency has increased its efforts. Specifically, actions taken include the following:

- **Reduced Rates on New Loans:** A reduction of interest rates by 1% for all new mortgagors effective April 1, 2020. The adjustment in the interest rates on new mortgages means more contributors can now access NHT loans at 0%. This reduction is expected to benefit some 8,000 new mortgagers annually.
- **Existing Mortgagors:** Existing mortgagors will also see reductions in their interest rates by 0.5% which benefits more than 100,000 mortgagors.
- **Expansion of the Intergenerational Mortgage Programme:** Beginning April 1, 2020, the NHT extended this benefit for eligible applicants for other loan products, such as open market purchases and construction loans. Funding under this Programme is capped at the prevailing loan limit.

In addition to these, the NHT has implemented other measures with the overarching aim being to increase the accessibility of homeownership by making it more affordable. These measures, in turn, promote increased residential homeownership, thereby increasing the demand for cement.

Valuation

Using the average intrinsic value from our discounted cash flow model ($88.34) and forward P/E valuation ($87.62) methodologies resulted in our intrinsic value per share estimate of **$87.98** for CCC. This price target represents an upside potential of 30.38% and coupled with our favourable outlook for the company and the industry, underpin our **OVERWEIGHT** recommendation.

P/E Valuation

Our P/E valuation for the company assumed YoY revenue growth in 2021 of 15% which is 1.81% above the 13.1 9% growth reported in 2020. We believe this level of growth is achievable by the company given the continued demand expected within the construction industry.

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Recommendation	OVERWEIGHT
As at March 29, 2021	

We then coupled this growth with an expected net profit margin of 17% which is 1.10% above the 2020 outturn which we believe is well within the range of the company's achievable margin as we expect finance costs to decline further as the company suffered a significant FX loss in 2020 (an increase of 65.57%) which should decrease since the USD denominated debt on the company's balance sheet has decreased.

Definitions:
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UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
HOLD/MARKETWEIGHT = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO
OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO

As for our P/E multiple, based on the March 29, 2021, close price of $67.48, the company trades at a P/E multiple of 17.95x. Our estimate of average listed comparable P/E is approximately 18.97x which we believe is a more appropriate multiple given the positive growth expectations. **Using this multiple and our expected 1-year target EPS of $4.62 results in an intrinsic value of $87.62.**

Discounted Cash Flow Model

Our DCF model also assumes revenue growth of 15% in 2021 followed by a gradual slowdown over the 5 year-forecasted period to our terminal growth rate of 5.66%. This terminal growth is reflective of nominal GDP growth as projected by the IMF over a 5 year period. Over the last 5 years, the company has averaged revenue growth of 5.52% which is therefore in line with what we expect should be reasonable after this high growth period which is currently underway.

Operating profit margin is projected to increase to 35% by the terminal year, gradually increasing from our projected 33% in 2021. This implies margin expansion when compared to the FY2020 outturn of 31.26%, driven by added cost efficiencies. This is reduced by our estimate of tax which averages 26.15% over the forecasted period and is consistent with historical levels which have averaged 27.62% over the last 4 years.

Our estimate of free cash flow to the firm is determined by reducing our NOPAT by reinvestment which is estimated using the company sales to capital ratio of 1.14x. These cash flows were then discounted using our estimate of company WACC of 12.26%, derived using CAPM. **Our firm value was adjusted by removing total debt and adding the company's current cash balance to arrive at its equity value per share estimate of $88.34.**

Recommendation - OVERWEIGHT

We believe Caribbean Cement will realize significant growth in 2021 and beyond, spurred by significant growth in the construction industry and in turn, the high demand for cement. In 2020, the company repositioned its balance sheet significantly by reducing its debt burden, a strategic move we believe will pay dividends in 2021 as the company’s interest costs are reduced and its FX exposure minimized. This positive outlook is reflected in our fair value estimate which implies the company is undervalued by double digits. With that said, we maintain or OVERWEIGHT recommendation for this stock.

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Investment Merits & Risk

Investment Positives	Investment Risks/Considerations
High Cement Demand: The construction industry is currently on a high growth trajectory which has increased the demand for cement. This places Caribbean Cement in a position to benefit from this industry growth.	**Cyclicality:** The Company's performance is significantly dependent on the construction industry, which historically is a cyclical sector despite its recent resilience. Over the near term, we do not foresee this being a significant risk for the company.
Major Economic Contributor: The Company operates the largest cement-making factory in Jamaica, which supplies 100% of the domestic demand for cement; this drives the sustainability and growth of many industries and firms in the country.	**Industry Growth Unrealized:** The major risk to CCC is that the expected growth in the construction industry is not realized. We believe this is unlikely given the low interest rate environment which incentivizes new residential and commercial building spaces as well as the government's SERVE programme which has been set out in the budget.
Executive Leadership: The Company boasts a diverse Board of Directors who has individual track records of success in both the private and public sectors, domestically and internationally.	**Revenue Concentration:** Five customers account for 40.14% of the company's revenue. The loss of any or a combination of these customers can have an immediate negative impact on CCC.
Strategic Development: CCC's relationship with its parent company opens additional opportunities to reach new markets.	

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