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LOCAL EQUITY REPORT

TROPICAL BATTERY

Barita Investments Limited
15 St. Lucia Way, Kingston
Tel #: 1-888-429-5333

Company Overview

Stock	TROPICAL
Close Price	J$2.13
Estimated Fair Value	J$3.00
Potential Upside	40.85%
Dividend Yield	0.78%
Total Return	41.63%
YTD Return	69.05%
Trailing P/E	21.99x
Forward P/E	15.53x
Recommendation	**Overweight**
March 16,2022	

Tropical Battery Limited is domiciled in Jamaica and has registered offices at 30 Automotive Parkway, Kingston 20, Jamaica. The Company was founded in 1950 by Tex Williams at which time, the principal activity was the manufacturing of lead-acid storage batteries. The Company was bought by John Melville in 1967 and more than 23 years later, in the 1990s the Company changed its business model from battery manufacturing to battery distribution. In September 2020, Tropical Battery was listed on the Junior Market of the Jamaica Stock Exchange. Today, the Company operates as a retailer, consisting of 5 retail stores and 2 distribution centers located in Kingston and Montego Bay, with a cohort of more than 1500 resellers that help to foster the Company's market reach.
Last year, the Company released details of a new Joint Venture Company, ENRVATE, with a joint interest in the Company shared with CAC 2000 Limited. Through ENRVATE, Tropical Battery aims to provide renewable energy solutions for commercial customers in Jamaica and the Caribbean. In the quarter ended December 2021, sub-subsidiaries of ENRVATE were made public, namely: Tropical Mobility Limited, Tropical Finance Limited, and Tropical Energy Limited under ENRVATE. These companies were created to provide renewable energy solutions to consumers.

Investment Rationale

Analyst Insight

Currently, Tropical Battery's business is heavily driven by the sale of batteries, which represents 77% of total revenues. In recent quarters, the Company has made efforts to expand the reach of its business through its sales team which has resulted in the expansion of its customer base from 23,500 to over 25,000 in the past year, a significant increase, as suggested by the Company's revenue growth. Of the additional 1,500+ customers, 500 are Small and Medium-sized Enterprises (SMEs) that earn a significant share of their revenue by reselling Tropical Battery's products. The addition of these businesses supports the increased sale of inventory, solidifies the Company's market position, and broadens the reach of its products. To build on this, Tropical Battery is expanding its top-selling retail store. The Company has also employed more efficient inventory management systems that result in reduced lead time between warehouses, its retail stores, and resellers and decrease the likelihood of these outlets experiencing stockouts. This measure has driven increased operational efficiency.

The aforementioned highlights the first mode of driving growth and creating shareholder value, i.e., the expansion of the current business, as is, while managing efficiency. As a result of these initiatives, the Company reported growth of 46.78% in revenue, 151.13% in operating profit, and 197.55% in net profit. In the upcoming quarters, we believe these initiatives are likely to persist and should consequently, result in continued growth.

Looking beyond the near term, the Company has aligned itself with what we believe is an inevitable path as it relates to energy consumption, both locally and internationally, i.e., renewable energy and the use of electric vehicles. Specifically, Tropical Battery's current joint venture Company, ENRVATE, through its subsidiaries, seeks to be a player in the renewable energy industry. Granted, the industry remains in its infancy, but we believe this will change over time, and positioning early places Tropical Battery in a position to benefit.

A brief review of each subsidiary is presented below:

1. **Tropical Mobility** was created to serve the emerging electric vehicles market in Jamaica by selling electric vehicle batteries.
2. **Tropical Energy Limited** was created to provide renewable energy solutions for commercial customers. This would see Tropical Energy designing and implementing renewable energy solutions such as solar panels, wind turbines, etc. for these customers.
3. **Tropical Finance Limited** was created to finance the purchase of these renewable energy solutions and electric vehicles for users.

Certainly, these new ventures present clear risks, and we believe this, in particular, has been a driver for the structure of ENVRATE, i.e., ENRVATE's risk is spread between Tropical Battery and CAC 2000 since it is a joint venture. Outside of feasibility which we believe is a non-

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issue given the many tailwinds supporting renewable energy and electric vehicles in the long term, there is an obvious question of the margins that can be expected from these businesses since they are new. At present, the specific answer to this question is unknown. However, the important point here is how ENVRATE is accounted for on Tropical Battery's income statement. As a joint venture, Tropical Battery is represented under the equity method of accounting which means Tropical Battery benefits directly from ENRVATE generating profits, without adding the associated expenses to its income statement. We believe this places Tropical Battery in a very advantageous position and reduces risks to the Company's bottom line, profitability as measured by profit margins, and the Company's return on equity.

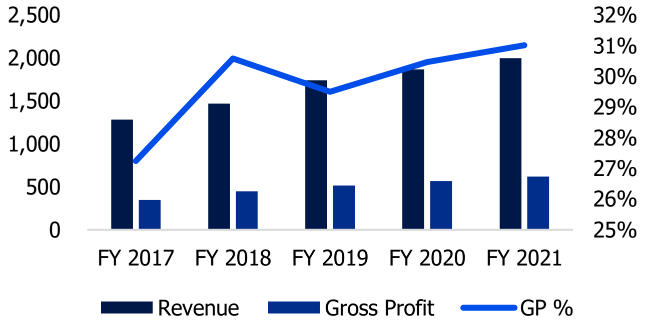
Presently, the Company's initiatives to expand its sales reach have positively affected revenue and profit. We believe this is likely to continue throughout the year, solidifying our near-term positive expectations for the Company. Longer-term, the positioning of Tropical Battery into areas we believe have significant growth potential stand to benefit the company immensely. Given the aforementioned, we've issued an **OVERWEIGHT** recommendation on the Company's stock.

Financial Performance

Income Statement (Five-year Review + Financial Year 2021)

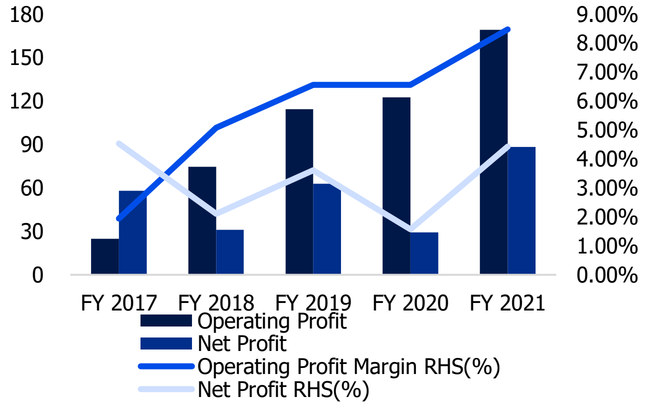
Over the last five financial years, Tropical Battery has effectively increased its revenue generation consistently. This is evidenced in the revenue and gross profit chart and is complemented by the Compounded Annual Growth Rate (CAGR) of revenue which was 9.26% over the last five years. Moreover, the Company's gross profit has grown by a CAGR of 12.13% over the last five years, indicating that gross profit margin has improved over this period.

Revenue, Gross Profit & Gross Profit Margin($Millions)



For the financial year that ended September 2021, the company had recorded revenues of $1.99 billion, which was an increase of 6.96% or $129 million YoY. Gross profit for the period amounted to $619.44 million, an increase of 8.88% or $50.52 million YoY. The gross profit margin for the period was 31.02% compared to that of 30.47% for the relative period the prior year. Given the current inflationary climate, the maintenance and improvement of gross profit margin suggest some amount of pricing power for Tropical Battery.

Tropical Battery Historical Profitability Performance ($ Millions)



Over the last five years, the Company has been able to drive strong growth in its operating profit. This is evidenced by the Compounded Annual Growth Rate (CAGR) of 46.70% in operating profit over the last five years which is significantly higher than the growth in revenue over the same period. The growth in the operating profit is underpinned by improved efficiencies in the operations of the business. For the period that ended September 2021, operating profit amounted to $169.16 million, which was an increase of 38.9% or $46.75 million YoY. This translated to an operating profit margin of 8.47% compared to that of 6.56% for the relative period in the prior year.

Net profit has grown over the last five years, as evidenced in the chart, comparing FY2021 and FY2017. The improvement over this period reflects a Compounded Annual Growth Rate (CAGR) of 8.74%. For the financial year that ended September 2021, net profit amounted to $88.33 million. YoY growth in net profit amounted to $58.99 million or 201.10%. The growth in net profit YoY was because of improved efficiencies and a lower tax expense. For the 2020 financial year, the company had paid taxes amounting to $31.23 million; however, upon listing on the Junior Market of the Jamaica Stock Exchange, the company has benefited from the tax exemption that is a feature for Junior Market listed companies. For the 2021 financial year, the Company had a tax credit of 808 thousand dollars which was a result of the reversal of temporary differences. Therefore, for comparative purposes, we can utilize the profit before tax measure which improved from $60.58 million to $87.52 million, an increase of 44.49% YoY. This improvement reflects a strengthening of the Company's pre-tax profit margin which grew from 3.24% to 4.38%.

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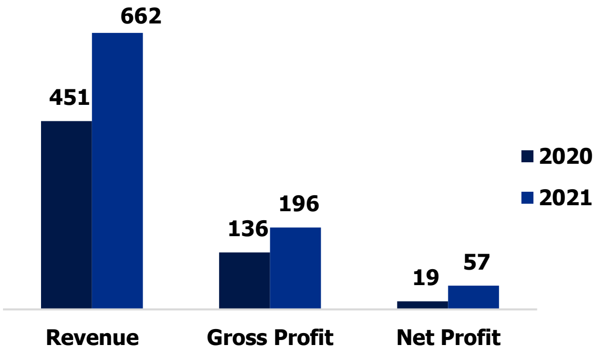
Income Statement- Q1 2022

Robust Growth and Increased Efficiencies

For the quarter that ended December 2021, Tropical Battery has delivered robust growth relative to the same period the prior year, demonstrated by the Company's revenue outturn of $662.43 million which represents an increase of 46.78% or $210 million. The driver for increased revenues over the last quarter is attributed to an aggressive sales campaign and promotions that were carried out by the Company in the quarter.

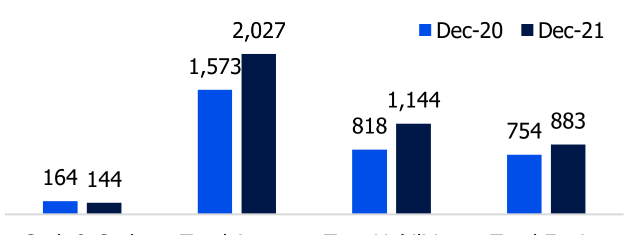


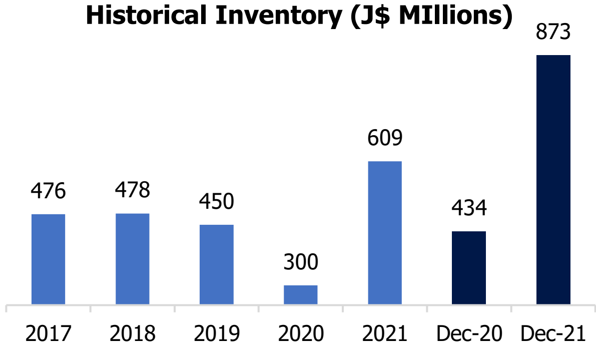
An important point to note is that during the quarter, Tropical battery increased its customer base from 23,500 to 25,000. Further, approximately 500 of these customers are small and medium-sized enterprises (SMEs), which earn a significant share of their revenue by reselling Tropical Battery's products. These new customers include gas stations, small auto parts stores, hardware stores, and supermarkets. This has positive implications for recurring revenue and faster movement of inventory as resellers require a larger supply of inventory than end-users to maintain or increase their supply of products.

Gross profit for the period was $196.35 million, which was an increase of 44.07% or $60.06 million. The gross profit margin declined slightly by 0.56%, from 30.22% to 29.66%. Also, a second contributory factor to the increased revenue was a result of the company's implementation of an inventory management system that better allows the Company to monitor inventory levels. This has resulted in the reduced likelihood of the Company experiencing stockouts at its retail outlets and improved lead times for products to reach resellers.
Operating expenses amounted to $114.46 million during the quarter, which represented an increase of 10.40% or $10.78 million YoY. It should be noted that the rate of growth of revenues and gross profit, exceeded the growth of operating expenses YoY. Consequently, the Company's operating profit increased by $49.28 million or 151.13% YoY. For the quarter that ended December 2021, the company's operating profit margin was 12.37% compared to 7.23% for the same period in the prior year. Net Profit amounted to $56.65 million, which was an increase of 197.55% or $37.6 million YoY. The improved financial performance of Tropical Battery has been a derivative of increased revenues and improved operational efficiencies.

Balance Sheet Overview

As of the end of December 2021, Tropical Battery had total assets of $2.03 billion, which was an increase of 28.88% relative to the same period in the prior year. The driver for the increase in total assets can be attributed to an increase of 47.51% or $519.19 million in current assets YoY, on account of an increase in the Company's inventory levels. Inventory increased by 101.39% or $439.69 million YoY. As can be seen from the inventory chart, the Company significantly increased its inventory in the most recent quarter. At the end of the last quarter, the company's inventory was $873.36 million which represents an increase of 101.15% YoY. This is the highest the Company's inventory has been over the last five financial years and reflects a strategic decision to ensure current global supply chain issues are less likely to disrupt business activity.





The Company's asset base is funded by total liabilities of $1.14 billion, and a total shareholders' equity of $882.53 million. YoY, total liabilities grew by 39.79%, or $325.64 million. The increase in total liabilities was driven by an increase of 98.13% or $336.36 million in current liabilities. The driver for the increase in current liabilities was driven by an increase in accounts payables. Accounts payables amounted to $564.29 million, an increase of $341.78 million or 153.61% YoY.
At the end of December 2021, total shareholders' equity amounted to $882.53 million, representing an increase of $128.44 million or 17.03% YoY.

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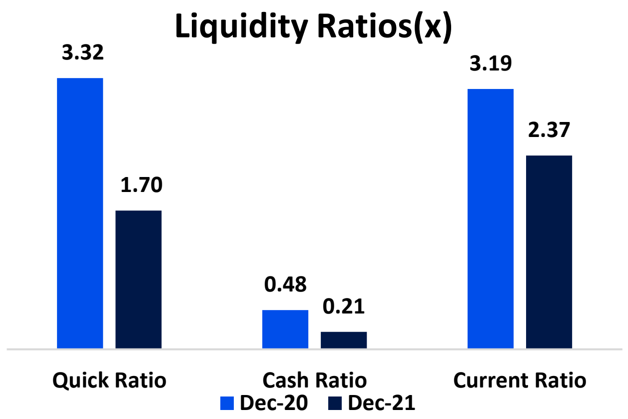
The increase in equity was a result of improved profitability by the company. This was demonstrated by the accumulated profit that amounted to $266.65 million, which was an increase of 92.94% YoY.

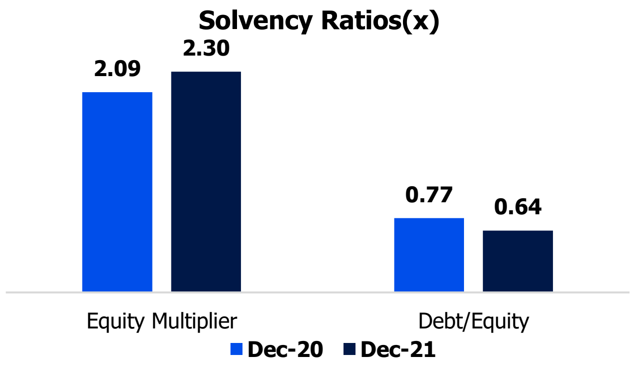
Liquidity

The Company's liquidity position has softened YoY as of the end of December 2021. The company's current ratio decreased from 3.19x to 2.37x. While this represents a decline, liquidity remains quite robust at more than 2x the required amount. The current ratio indicates that the Company has 2.37x more current assets than current liability which positions it in a fairly safe position from a liquidity perspective. The company's quick ratio has also softened, decreasing from 3.32x to 1.70x as of December 2021 and the cash ratio has moved from 0.48x to 0.21x. The decreases in the liquidity ratios occurred as the Company had spent more on inventory than it had done for the same period in the prior year. In an attempt to mitigate supply chain disruptions, the company had begun accumulating inventory by engaging in forward buying. As such, a far greater spend was made on inventory than in the prior year.



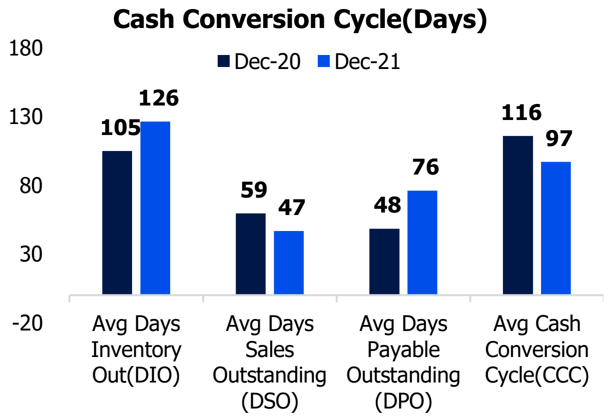
Solvency Ratios

The Company's solvency position as measured by the equity multiplier (leverage) and the debt-to-equity ratio presented in the solvency ratio chart suggests that Tropical Battery is relatively lowly leveraged which generally has positive implications for profitability, as the interest cost of debt does not weigh heavily on profit generation. Further, its places the Company in a position to utilize debt if the need arises without significantly burdening its balance sheet with too much debt. Given these considerations, we believe the Company is well-positioned from a solvency perspective.



Cash Conversion Cycle

The Company's Cash Conversion Cycle (CCC) has improved (lower is better) significantly YoY; it has decreased from 116 days in December 2020 to 97 days at the end of December 2021. This improvement in the Company's cash conversion cycle suggests improved working capital management. The reduction in the CCC is indicative of the Company generating cash at a faster rate.



Decomposing the CCC indicates that the average Days Sale Outstanding (DSO) has decreased, which is an indication that the company takes fewer days to collect payments for credit sales and suggests an improvement in supplier power. This aids in the bolstering of the company's cash flow management. The company's average Days Inventory Out (DIO) has increased, which means that cash is being tied up longer inventory. This is likely a result of the Company's increased inventory, in which case, this reflects a strategic increase. The average Days Payable Outstanding (DPO) has increased, year over which is indicative that the company has taken a longer period to pay its bills and invoices as well as trade credit which slows the Company's outflow of cash and helps to mitigate the higher DIO.

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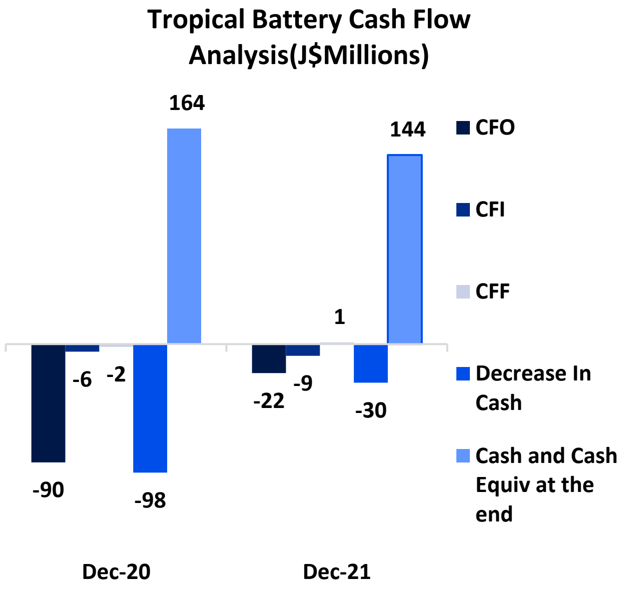
Cash Flow Statement

During the quarter, net cash used by operating activities amounted to $-22.14 million for the three months ending December 2021 compared to $-90.22 million in the same period for the prior year, amounting to a reduction of 76%.

Consistent with the cash conversion cycle, the increase in inventory was the main driver of the reduction in operating cash flow, reflecting a cash outflow of $264.77 million during the quarter relative to an outflow of $134.06 million in the prior year. This reflects the Company's effort to increase its store of inventory to meet growing demand and manage the effects of rising prices.

The significant outflow of cash used to purchase inventories was predominantly mitigated through slower payment of monies owed to creditors, resulting in payables reflecting a positive change of $236.62 million, relative to $134.06 million in the prior year.



Net cash flow from investing activities reflected an outflow of $8.81 million due to the purchases of Property Plant and Equipment (PPE) while the prior year had a net outflow of $5.76 million, the net result of $13.34 million being allocated towards the purchase of PPE matched against an inflow of $7.59 million.

Cash inflow from financing activities amounted to $1.42 million compared to an outflow of $2.07 million in the prior year. At the end of the quarter, the Company has cash and equivalents of $144.30 million compared to $164.46 million in the prior year, reflecting a decrease of $20.16 million (12.26%).

Growth Expectations

Going forward, we believe that Tropical Battery has several key tailwinds that position the Company for future growth. Our positive outlook is anchored by the following points:

- **Business Diversification:** The Company's recent joint venture, ENRVATE presents the opportunity for Tropical Battery to be one of the first movers in the renewable energy and electric vehicle industry. As a joint venture, the accounting for ENRVATE sees Tropical Battery booking net profit without consolidating the associated expenses of the joint venture. Given the early stage of the associated businesses, we believe this structure is ideal for Tropical Battery.

- **Strategic Partnerships:** The Company has forged a relationship with one of the largest lithium-ion battery recyclers in North America. This will enable the company to effectively increase its battery exports, which will drive growth in the Tropical's revenue.

- **Improved Efficiencies:** The Company has recently implemented a new inventory management system, that allows the Company to better be able to monitor its inventory levels and reduce the likelihood of stockouts and prolonged lead times between distribution centers and retail outlets.

Despite these positive tailwinds, we believe that there exist some underlying risks that may affect Tropical Battery's business operations. These include:

- **Interest Rate Risk**: With the company's entrance into renewable energy financing, the rising interest rate environment may create a challenge for Tropical Finance's attractiveness. With rising rates, end users may delay large-scale renewable energy projects that require debt funding. An added point here is that Tropical Finance will be encroaching on the business of banks and it will be difficult to be competitive since lending is not the Company's core business. The upside, however, is that there are 2 additional subsidiaries that are directly involved in the provision of goods and are less susceptible to this drawback.

- **Supply Chain Disruption:** As supply-chain challenges remain amid COVID and the ongoing geopolitical crisis in Ukraine, several earth minerals have become scarce. Russia represents one of the largest producers of these minerals and as the conflict continues, it can affect Tropical Battery's ability to procure batteries in a timely and cost-effective manner. Minerals such as cobalt are the primary input for battery production and increases in these input and supply chain costs could reduce Tropical Battery's gross profit margins. We believe that this can be mitigated via forward buying by Tropical Battery which the Company has been doing avidly.

Despite these negatives, we believe that the positive attributes outweigh the negative and as such, we believe that the company is positioned for sustainable future growth.

Valuation

To obtain a target price for Tropical Battery, we employed two methods. These were the **Discounted Cash Flow** and a **P/E valuation**. We firstly forecasted the company's income statement and arrived at a 1-year EPS of **$0.14.**

For our comparative analysis, we used companies that were listed on the junior market of the Jamaican Stock Exchange, whose businesses are centered primarily around distribution. Using these companies, we obtained an average P/E multiple of **22.21x.** This tracks very closely to the Company's trailing multiple of 21.99x. Using this multiple alongside the projected EPS of **$0.14** we obtained a fair value estimate of **$3.05.** We also note that even at a multiple of 18.00x, the Company would still trade at 18.31% above its present price and above our cost of equity as indicated below.

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To complement the relative PE valuation, we then employed a Discount Cash Flow model of five years, the assumptions that guided this model included a cost of equity of 14% and a long-term growth rate of 6.46%. Using these assumptions, we arrived at a fair estimate value of **$2.95.**

Using a simple average of the two fair value estimates we arrived at a price target of **$3.00** which represents a potential upside of **40.85%.**

Given the Company's recent outsized growth, our positive outlook on its near-term and long-term potential, and the supporting valuation, we are recommending an **OVERWEIGHT** for Tropical Battery's stock.

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