VM Wealth Management Limited

Company Analysis: Caribbean Cement Company Limited (CCC) Q1 2023

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CARIB CEMENT
BUILDING A GREATER JAMAICA

- Stock Recommendation: **OVERWEIGHT**
- Target Price: **$84.53**
- Current Price: $51.11

- Shares Outstanding: 851,136,591 units.
- Financial Year End: December 31

ABOUT THE COMPANY

Caribbean Cement Company Ltd (CCC) is a cement manufacturing company that was incorporated in 1947 in Jamaica. The company was officially opened to the public in 1952 and is located at Rockfort, Kingston. It has access to natural resources such as limestone and other minerals that are essential in the manufacturing of cement and clinker. In 2017, Mexican-based company CEMEX acquired enough shares to take control of the Trinidad-based Cement company, TCL, which is the parent company of Carib Cement, for around US$79 million. In the following year, CEMEX granted two loans totalling US$102million to CCC which was used to pay for the acquisition of Kiln 5 and Mill 5 which are manufacturing lines used to make cement. This deal terminated an operating lease agreement that originated back in 2010 and returned US$ 118 million of assets back to Carib Cement Company. This also included the redemption of preference shares issued by CCC to TCL valued at US$40.5 million.

FINANCIAL PERFORMANCE SUMMARY

J$'000	FY 2021	FY 2022	Q1 2022	Q1 2023
Revenue	23,840,001	25,837,228	6,814,750	6,802,247
Operating Profit	7,330,733	8,678,891	2,338,295	317,401
Net Profit	4,341,632	5,383,867	1,590,544	289,399
Total Assets	27,508,449	30,135,760	27,929,813	29,888,207
Total Liabilities	11,729,262	10,097,122	10,506,501	9,636,724
Total Equity	15,779,187	20,038,638	17,423,312	20,251,483
ROE (%)	31.8	30.1	28.9	21.6

Dividend Policy

At CCC's AGM held on July 19, 2022, shareholders declared a final dividend of $1.5032 per share, which was paid on September 9, 2022, to shareholders on record as of August 4, 2022, with an ex-dividend date of August 3, 2022. CCC paid out approximately $1.16 billion in dividends which equates to a payout ratio of 20%.

Outlook

We anticipate that CCC will likely continue to improve on its financial performance as the demand for cement continues to exhibit incremental growth. Several public and private sector developments are underway and are in the pipeline. These projects include residential, commercial, industrial and infrastructure developments. This bodes well for the company as these projects will require vast amounts of cement, which is an essential component of concrete. The business is also likely to continue to benefit from the 30% increase in production capacity which commenced in FY22. In addition, the business increased its cement prices by 7.8% effective March 1, 2023. This is likely to drive growth in revenues as cement is an inelastic good and is a key input in construction. The business also has low levels of leverage which could afford it the financial flexibility to further expand

Projections and Valuation

The Discounted Cash Flow Model (DCF) and P/E Multiple Approach were used to establish an intrinsic and relative value respectively for CCC. For the DCF approach, a cost of equity of 15.41% was used to discount the future levered free cash flows while a 2024 forward EPS of $7.39 and an applied P/E of around 15x were deemed as appropriate and used to determine a relative value. Using these two approaches, we obtained a target price of **$84.53.**

Risks to Price Target

We believe that the associated upside risks currently outweigh downside risks, i.e., if the demand for cement is amplified due to increases in the number of private and public construction projects. There is some possibility to downside risks if the demand for cement by commercial, industrial, infrastructure and residential projects begins to decrease due to adverse changes in the macroeconomic environment, namely, elevated levels of inflation which may impact the costs of borrowing and hinder the demand for cement. Also, if the Russia/Ukraine war is prolonged, this could exacerbate global supply chain disruptions which may adversely affect the business.

FIRST THREE MONTHS ENDED MARCH 31, 2023

For the first quarter ended March 31, 2023, CCC's revenue fell marginally by 0.2% to $6.80 billion, from the $6.81 billion recorded the same period of the prior year. This flat performance was attributed to the falloff in supply as the business had its kiln shutdown for over a month to facilitate the company's scheduled annual maintenance exercise.

Cost of sales (COGS) rose significantly to $5.49 billion from $3.64 billion or 50.8%. Similarly, COGS margin rose to 80.8% from 53.4% as the growth in COGS outpaced the rise in revenues. In light of this, Gross Profit fell to $1.30 billion from $3.17 billion or by 58.8% largely driven by the loss of revenue during the scheduled maintenance exercise coupled with the increase in COGS. In addition, the business incurred higher costs due to excess inventory items consumed and additional hired manpower.

Total Operating Expenses fell notably to $670.19 million from $630.03 million or by 637 basis points, which was largely attributed to increases in Administrative and Selling expenses which rose by 32.4% and 9.4% respectively influenced by the annual maintenance exercise. Operating Expense Ratio increased marginally to 9.8% to from 9.2% primarily due to a 32.4% in Administrative Expenses. The increase in Admin expense would have likely been influenced by the wage and supplemental benefit agreement signed following protracted negotiations. This agreement commenced on July 1, 2021 and covers the period ending June 30, 2023, and will see Production workers receiving a 7.5% increase in wage and benefits.

Operating earnings showed a significant decline, as it fell to $317.40 million from $2.33 billion relative to the same period of the previous year on the back of the aforementioned scheduled annual maintenance which occurred during the first two months of operation. CCC views this investment in maintenance as a trade-off that will ultimately improve operational efficiencies whilst staying in alignment with its export and production capacity objectives.

As at March 31, 2023, Total Assets stood at $29.88 billion which represented a 7.0% increase relative to its position as at March 31, 2023. This increase was largely driven by increases in the company's Cash, Other accounts receivable, Inventories, Account receivable from related parties and Other current Assets. Day Sales Outstanding (DSO) fell slightly notably to 4.84 days from 5.38 days or by 10.0%, meaning that it now takes 0.54 less days on average for the company to receive its payments for sale. Days Sales of Inventory (DSI) rose to 100.19 days from 74.74 days which represents a 34.0% increase and implies that the company now takes 25.44 more days on average to sell off its inventory stock. Despite the increase on DSO, the company still has a relatively short cash conversion cycle of 25.38 days.

Total Liabilities saw a decline to $9.6 billion from $10.50 billion or by 8.2% attributed to reductions in Other financial obligations (current), Trade Payables, Accounts payable to related parties, Other financial obligations (non-current) and Employee benefits obligation. Days Payable Outstanding (DPO) saw a reduction to 79.64 days from 84.79 days or by 6.0%. With this change, it now takes the company roughly 30 more days to meet its annual obligations to suppliers or financiers.

CCC's Equity balanced increased notably to $20.25 billion from $17.42 billion or by 16.2% due improvement in other equity reserves and accumulated net income which grew by 37.7% and 21.6% respectively. This increase in equity, along with the 81.8% decline in earnings led to a reduction in ROE which fell to 21.6% from 28.9%.

The Current ratio improved notably to 1.10x from 0.68x or by 62.2%, largely attributed to the increases in Cash, Other accounts receivable, Inventories, Account receivable from related parties and Other current Assets. A ratio above 1x implies that the business has enough liquidity to meet it short-term obligations.

OUTLOOK

CCC expected to benefit from local housing, infrastructure and roadworks plans over the next few years.

The GOJ has indicated that they intend to construct between 70,000 to 100,000 houses within the next five years. In efforts to address the anticipated spike in demand, CCC has already expanded its capacity and has spent around J$1.8 billion in capital expenditure to meet this demand.

As the pandemic continues to wane, the GOJ has readjusted its focus and has given priority to major Infrastructure and roadworks projects. The following is a list of scheduled pipeline Public Sector projects that are scheduled to occur within the near-term:

Major Pipeline Public Sector Projects:

- Southern Coastal Highway Improvement Project (SCHIP)- In progress (moderate cement content)
- Montego Bay Perimeter Road Project- Scheduled to commence this year (moderate cement content)
- South Coast Bridges in St. Thomas- In progress (high cement content)

INVESTMENTS POSITIVES:

- Robust production capacity as the business expanded its production capacity last year by 30% which means CCC can now produce 1,300,000 Metric Tonnes of cement. CCC's exploitable limestone reserves are anticipated to have a useful life of 30 years which bodes well for production process.
- Revenues have been outpacing inflation year over year by a CAGR of 10.1% between FY18-FY22.
- The company's products continue to meet world-class standards and the company has retained standard certifications.
- The business has low levels of leverage.

INVESTMENT NEGATIVES

- Ongoing Russia/Ukraine war continues to create global supply chain challenges which have led to increases in the price of commodities.
- Over 95% of revenue comes from domestic sales, which implies that the company has a high concentration risk.
- Periodic shutdowns in cement kiln may present operational risks and negatively impact revenues.

CONCLUSION

The high demand for cement from several private and public sector industrial, commercial, infrastructure and residential development projects continues present growth opportunities for CCC. Despite experiencing a falloff in earnings for its March 2023 quarter, the business is still poised for growth as the average selling price for cement has increased, along with the company's ability to supply more cement due to its increased production capacity.

In light of this and based on our assessment of the current state of the company, we have established a price target of **$84.53** which is above the stock's current market value and represent a potential 65% upside. We therefore recommend investors with the intent to gain exposure to the construction sector to **OVERWEIGHT** this stock at this time, as the stock is somewhat undervalued and associated risks are skewed to the upside.

CCC's new dividend policy also adds another avenue for shareholders to extract value from the stock. In FY22, CCC approved a new policy for the payment of dividends which will include the framework that would be considered to declare payments. It is important to note that CCC new policy does not represent a commitment by the business to declare and pay dividends but rather outlines the factors that must always be considered for the board to make a payment decision. In FY22 CCC paid out approximately $1.16 billion in dividends which equates to a payout ratio of 20%. Based on our target price of $84.53 and annual dividend per share (D.P.S) of $1.50 this translates to a dividend yield of around 1.7%, and when added to the potential price appreciation leads to a possible total return of 66.7%.

SOURCES

Caribbean Cement Company Limited Annual & Quarterly Reports, Jamaica Stock Exchange (JSE), The Gleaner Company, Loop News Jamaica, The Jamaica Observer, and the Financial Services Commission (FSC)

DISCLAIMER

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.

- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.

- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.

- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.