

Company Analysis: Derrimon Trading Company Limited (DTL) 9M 2023

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- Stock Recommendation: **OVERWEIGHT**
 - Current Price: \$2.00
 - Price Target: \$2.38
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- Shares Outstanding: 4,533,360,670
 - Financial Year End: December 31

ABOUT THE COMPANY

Derrimon Trading Limited is a limited liability company established in 1998 that primarily earns revenue from the distribution and retail of bulk goods and the manufacturing, wholesale, retail and distribution of flavors and fragrances. Its registered office is located at 233 and 235 Marcus Garvey Drive Kingston 11.

Derrimon has acquired 100% stake in Spicy Hill Farms which took effect January 10, 2022. The Company was incorporated in 2006 and is based in Trelawny. It is known for manufacturing a range of Jamaican products such as the authentic Jamaican Ram Goat soup and dried seasoning sachets which have penetrated the Caribbean, United States, United Kingdom, and Canadian export markets. DTL has since relocated Spicy Hill factory to a more modernized plant located on Marcus Gavey Drive. Additionally, Derrimon also acquired Arosa on April 1, 2022, a St. Ann based food manufacturing company that is primarily involved in the distribution of food and equipment particularly for the hospitality sector.

FINANCIAL PERFORMANCE SUMMARY

J'(Millions)	FY 2021	FY 2022	9M 2022	9M 2023
Total Revenues	17,745	18,420	13,809	14,094
Gross Profit	3,410	4,639	3,018	3,198
Operating Profit	787	1,192	792	954
NPAT to Shareholders	400	579	461	237
Total Assets	11,548	15,372	13,994	15,766
Total Liabilities	5,786	8,999	7,750	9,118
Equity to Parent	5,762	6,373	6,244	6,648

Dividend Policy

Derrimon Trading Co. Limited has adopted a Dividend Policy that will allow for dividend payments of up to 30% of the Company's annual distributable reserves. Since listed on the JSE in 2013, Derrimon has made dividend payments only in 2019 and 2020. The Company has been focused on growth through acquisitions, capital management and navigating rising costs during the year which resulted in no dividend payment for financial years 2021-2023.

Outlook

DTL's strategic acquisitions of Arosa and Spicy Hill Farms have positioned the Company for sustained growth in the distribution and manufacturing industry. DTL is expected to benefit from synergies through the centralization of business units and processes as well as from the diversification of its Delect product line as the Company expands its proprietary portfolio into foreign markets. Furthermore, DTL intends to tap into the market share to grow the retail segment of Arosa which currently provides food services such as processed meats and distributes foods, wine, and equipment primarily for the hospitality sector. With the opening of Select Grocers, the largest supermarket in central Jamaica, DTL could use this platform to support other lines of products that it delivers as well as the Select Tech technology store situated above.

Projections and Valuation

We projected the Company's financials five years out given the risk involved in its strategic plan. Using a Discounted Cash Flow method, with a required rate of return of 15.6%, and applying a price to earnings of 19x to the projected 2024 EPS, we arrived at an average price target of \$2.38.

Risks to Price Target

The Company continues to be exposed to interest rate volatility and sticky inflation, though abated still not within the central bank interest rate targets. With interest rates high relative to pre-covid levels as countries race to moderate high inflation, riskier securities on the equity market have observed lower performance during the period. This has been exacerbated by the ongoing geopolitical conflict between Russia and Ukraine which continues to affect supply chain operations and fluctuations in commodity prices.

NINE MONTHS ENDING SEPTEMBER 30, 2023

For the period ending September 2023, Derrimon Trading Company Limited (DTL) reported revenue growth of 2.07%, an equivalent \$285.52 million increase to \$14.09 billion when compared to a similar period in the prior year (2022: \$13.81 billion). This was underpinned by improved performances across all subsidiaries and distribution channels, particularly for Caribbean Flavors & Fragrances Limited (75% stake) and Woodcats International Limited (100% stake) which both achieved record revenue growth. DTL's proprietary brands also bolstered revenue through increased volume demand for its Delect, Refresh and Gentle portfolios. Meanwhile, the revenue results of the Company's recent acquisitions, Arosa and Spicy Hill Farms, were sluggish and contributed marginally to DTL's topline.

Gross Profit for the Company was reported at \$3.20 billion for the 9-month ending September 2023, a 5.95% uptick when compared to a similar period in the prior year. As a result, Gross Profit Margin maintained an upward trend from 21.9% for 9M financial year 2022 to 22.7% for the same period in financial year 2023. For context, DTL's recent acquisitions benefited from synergies through centralized operations related to the manufacturing of products which assisted in mitigating associated costs. It is noteworthy that Operating Income increased significantly for the same period to \$180.75 million, almost three times the previous year's results.

Operating Expenses jumped 5.52% to \$2.42 billion reported in the 9-month period, which represents an equivalent increase of \$127.98 million over \$2.29 billion reported for a comparative period in the year prior. The lion's share was chiefly driven by a significant 21.90% increase in Selling and Distribution Expenses, which closed at \$485.20 million coming from \$398.04 million for a comparative period in the prior year. This was driven by the impact from the consolidation of DTL's subsidiaries as well as costs associated with Select Grocers and Select Tech stores located in May Pen, Clarendon.

This cascaded into reported Operating Profit of \$954.76 million for the 9-month September 2023 period, a 20.53% improvement against the previous year's results. However, this was lowered by elevated Finance Cost which doubled to \$647.82 million relative to \$266.92 million recorded in the previous year. Higher Finance Cost was attributable to IFRS16 accounting change for lease liabilities and rights of use assets, the refinancing of debt as well as increased depreciation as DTL's asset base broadens following the completion of the new stores. As a result, Profit before Tax (PBT) slumped to \$306.94 million, a 41.56% decline when compared to \$525.23 million reported in the prior year. Net profit for the period dwindled by 43.03% to close at \$274.72 million with a Net Profit Margin of 1.9% when compared to 3.5% for a similar period in the prior year. Net Profit attributable to shareholders was \$237.86 million which translated to Earnings Per Share (EPS) of \$0.102.

DTL's Total Assets increased to \$15.77 billion, showing a year-over-year uptick of 12.66% with the main drivers being Rights of use Assets \$2.15 billion (33.39%), Inventories \$4.51 billion (38.33%) and Cash and Bank doubling to \$290.44 million for the period. This was positively influenced by the acquisitions of Arosa, Spicy Hills as well as higher carrying balance inventory to support the new stores in Clarendon and other international stores such as the Brooklyn-based grocery store businesses, FoodSaver New York and Good Food for Less. DTL entered a partnership with Intcomex, supported by capital investments to ramp up inventory levels for its 5000 square feet Select Tech store located above Select Grocers. The Company intends to provide technology solutions through a full range of branded electronic products and appliances.

Total Liabilities for the period ended higher at \$9.12 billion owing largely to increases in the current portion of long-term loans which tripled to \$310.99 million, lease liability doubled to \$2.42 billion and total long-term liabilities increased to \$5.89 billion (33.03%). This was underscored by the refinancing of debt that the Company took to support inorganic growth through acquisitions and to integrate and centralize their manufacturing plant located on Marcus Garvey Drive as a bid to contain costs and improve operational efficiency.

Furthermore, Total Shareholders' Equity exceeded 9M financial year 2022 results by 6.47% to close September 2023 at \$6.65 billion. This was mainly attributable to higher reported retained earnings which increased by 17.35% to \$2.41 billion and foreign exchange reserves by 70.93% to \$3.22 million. As a result, DTL's debt to equity ratio increased marginally to 1.37x coming from 1.24x reported for the same period in the year prior. This was supported by the current ratio, which declined to 1.73x from 1.80x, which is indicative of total debt outpacing shareholders' equity. It is noteworthy that the Company refinanced some of its debt on more attractive terms, however, remains exposed to potential interest rate increases on its variable loans.

OUTLOOK

Building out the Delect Brand

The Company continues to embark on the expansion of the Delect Brands product line through the offering of various affordable products which is expected to be a catalyst and driving force for the distribution segment from commodity-based to diversifying into a pool of other products. Derrimon operational strategy includes innovations and development to maintain greater margins and increase its footprint locally and into foreign markets.

Opening of Select Tech Store in May Pen, Clarendon

Following the completion of Select Grocers which opened to the public November 2022 in Millennium Mall, May Pen Clarendon, and features two levels quickly became the largest supermarket in central Jamaica and have assisted positively to topline results. Derrimon recently partnered with Intcomex, a premier distributor of a wide range of technology products such as computers, accessories and value-added solutions across the Latin America and Caribbean region, to provide services to the newly built Select Tech store located above Select Grocers. The electronic store provides technology solutions to customers offering the latest technology in home security systems, surveillance solutions, phones, computers, accessories and features a gaming area.

INVESTMENT POSITIVES

- DTL has demonstrated sustained revenue growth through the expansion of its affordable product lines and proprietary brands.
- Through acquisitions the Company was able to diversify its income stream, recently through Arosa into the hospitality sector which is expected to show continued growth.
- DTL has recently partnered with Intcomex, a regional technology company, to add a Tech business on the upper level of the already established Select Grocers store in May Pen, Clarendon. The store aims to be the largest supplier of technological appliances and accessories such as games, phones, computers etc. and intends to eventually be in all Select Grocers locations.
- Improved subsidiary performances, in particularly Caribbean Flavors and Fragrances (CFF) have reported record revenue for the year-to-date September 2023 period which was underscored by growth in volume as the Company increases its customer base underpinned by product line expansion. Through the offering of a new ingredient solution focused on small bakery companies that increases the quality, texture, shape, and appeal of baked goods while extending its shelf life. The Company also benefited from the performances of its other subsidiaries, Woodcats International, Arosa and Spicy Hill Farms Limited.
- Furthermore, Derrimon has penetrated the international market through the food stores located in the USA which can support the export of its products.

INVESTMENT NEGATIVES

- Increased leverage to finance acquisitions has resulted in weakened liquidity and debt ratios where the current ratio dipped to 1.73x and debt to equity ratio increased to 1.37x for the 9-month period.
- Though DTL refinanced some of its debt on more attractive terms, the Company remains exposed to interest rate volatility on its variable loan agreements.
- Fluctuations in demurrage costs and shipping delays continue to impact production levels which resulted in increased cost for raw materials owing to the ongoing geopolitical conflict from the Russia-Ukraine war.



CONCLUSION

Derrimon, being one of the fastest growing distribution companies in Jamaica, plans to continue its acquisition streak by further expanding its operations into the North American market. It is expected to record significant growth from this inorganic growth as well as realize synergies to aid in its organic growth strategy via the expansion of its Delect brand and distribution operations. This has been the company's focus and is expected to be the driver of revenues in the immediate future.

Given that much of DTL's future value will be gained from its acquisitions and distribution partnerships, we valued the company using both the discounted cash flow method and the relative valuation method. Using a required rate of return of 15.60%, and a Price to Earnings multiple of 19x, we arrived at an average fair value of J\$2.38. This represents a 19.00% upside from the current price of J\$2.00 and therefore we recommend that investors **OVERWEIGHT** the stock in their portfolio.

SOURCES

Tropical Battery Company Limited Prospectus, Jamaica Stock Exchange (JSE), The Gleaner Company, Loop News Jamaica, The Jamaica Observer, and the Financial Services Commission (FSC)

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- **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.