Company Analysis: Caribbean Cement Company Limited (CCC) 9M 2023

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- Stock Recommendation: **OVERWEIGHT**
- Target Price: **$73.40**
- Current Price: $53.01

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

ABOUT THE COMPANY

Founded in 1952, Caribbean Cement Company Limited (CCCL) is a publicly listed entity and the exclusive producer of Portland and blended cement in Jamaica. The primary facilities and operations are in Rockfort, Kingston, complemented by quarry operations in St. Andrew and St. Thomas. CCCL prides itself on manufacturing top-quality products using 100% locally sourced raw materials, all extracted within a 10-mile radius of its main plant. In 2017, CEMEX, a Mexican-based company, acquired controlling shares of the Trinidad-based parent company, TCL, which owns Carib Cement, for approximately US$79 million.

The company has embarked on a $US 40-million-dollar expansion slated to be completed in 2025. This expansion will increase the company's capacity by 30% and is expected to meet growing local demand as well as potential export demand now comfortably.

FINANCIAL PERFORMANCE SUMMARY

J$'000	FY 2021	FY 2022	9M 2022	9M 2023
Revenue	23,840,001	25,837,228	19,683,782	21,267,039
Operating Profit	6,886,803	7,864,343	6,797,580	6,400,637
Net Profit	4,341,632	5,383,867	4,252,289	4,385,448
Total Assets	27,508,449	30,135,760	30,424,119	33,585,299
Total Liabilities	11,729,262	10,097,122	11,675,681	10,824,745
Total Equity	15,779,187	20,038,638	18,748,438	22,760,554
ROE (%)	31.80	30.10	32.58	26.58

Dividend Policy

At CCC's AGM held on September 8, 2023, shareholders declared a final dividend of $1.8976 per share, which was paid on September 9, 2022, to shareholders on record as of October 6, 2023, with an ex-dividend date of August 23, 2023. CCC paid out approximately $1.62 billion in dividends which equates to a payout ratio of 29.28%.

Outlook

We expect that CCC is poised to enhance its financial performance further, given the ongoing and anticipated growth in the demand for cement. Various public and private sector projects, spanning residential, commercial, industrial, and infrastructure developments, are in progress or in the planning stages. This is advantageous for the company, as these initiatives will necessitate significant amounts of cement, a crucial component of concrete. Since the business is in the process of expanding its production capacity, it will be able to take advantage of the increased demand to come. Additionally, with low levels of leverage, the business has the financial flexibility to potentially expand its production capacity further.

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 weight average cost of capital of 12.30% was used to discount the future levered free cash flows while an applied P/E and P/B of around 12.00x and 2.32x, respectively were deemed as appropriate and used to determine a relative value. Using these two approaches, we obtained a target price of **$73.40.**

Risks to Price Target

We hold the view that the potential positive outcomes currently surpass the negative possibilities. This is particularly evident if there is an upsurge in the demand for cement, driven by an escalation in both private and public construction projects. Conversely, there exists a certain degree of downside risk if the demand as higher interest rates, which might elevate for cement diminishes, particularly in commercial, industrial, infrastructure, and residential projects. This could be triggered by unfavorable changes in the macroeconomic landscape, such borrowing costs and impede the demand for cement. Additionally, the occurrence of geopolitical tensions could exacerbate disruptions in the global supply chain, potentially adversely impacting the business.

NINE MONTHS ENDED SEPTEMBER 30, 2023

During the nine months concluding on September 30, 2023, CCC experienced an 8.04% growth in revenue, reaching $21.27 billion, compared to the $19.68 billion reported in the same period the previous year. This positive performance was attributed to increased supply, exemplified by the export of 2,267 jumbo bags of its low carbon high-early strength cement product to the Turks and Caicos Islands.

The Cost of Sales (COGS) increased by 17.83% to $12.77 billion from $10.84 billion. Correspondingly, the COGS margin rose from 55.05% to 60.04%, outpacing the growth in revenues. As a result, Gross Profit marginally decreased to $8.50 billion from $8.85 billion, a 3.95% decline primarily due to higher costs of goods sold.

Total Operating Expenses saw a marginal increase of 2.32% to $2.10 billion from $2.05 billion. This was largely driven by rises in Administrative and Selling expenses of 16.73% and 6.91%, respectively. However, Distribution and logistics expenses decreased by 6.66%, mainly due to cost containment strategies which aid in stabilizing operational costs. Thus, contributing to a decrease in the Operating Expense Ratio from 10.41% to 9.86%.

Operating earnings declined to $6.40 billion from $6.80 billion compared to the same period in the previous year, reflecting the decrease in gross profit and the increase in operating expenses. Despite this, CCC reported a 3.13% increase in Net income. As of September 30, 2023, Total Assets stood at $33.58 billion, marking a 10.40% increase. This growth was driven by a 42.90% increase in current assets, notably in Accounts receivable from related parties and Trade and other accounts receivable, offset by a 42.53% decline in Cash at bank on hand.

Total Liabilities decreased to $10.82 billion from $11.68 billion, a 7.29% reduction attributed to decreases in Other financial obligations (current), Other financial obligations (non-current), and Employee benefits obligations. Days Payables Outstanding (DPO) declined from 95 days to 74 days, indicating a shorter time for the company to meet obligations to suppliers or financiers. Consequently, the Cash Conversion Cycle (CCC) increased from 10 days to 33 days.

CCC's Equity balance increased to $22.76 billion from $18.75 billion, a 21.40% growth due to improvements in other equity reserves and accumulated net income, increasing by 40.71% and 31.51%, respectively. However, this increase in equity outpaced earnings growth which led to a reduced Return on Equity (ROE), falling from 32.58% to 26.58%.

The Current ratio strengthened to 1.50x from 0.91x, a 63.41% increase, mainly attributed to the 42.90% rise in total current assets against a 12.55% decrease in total current liabilities. The current assets which contributed most to the improvement of the ratio were increases in Trade accounts receivable and other accounts receivable. While reductions in current liabilities such as Other financial obligations and Other current liabilities aided in improving the company's liquidity. This improvement signifies the company's enhanced liquidity as a ratio above 1x implies that the business can comfortably meet its short-term obligations.

OUTLOOK

Mega expansion project rollout underway

The company has launched an extensive expansion project which began in October 2023 to increase production capacity at its Rockfort Kingston plant by 30% to 1.3 million tonnes a year. The project is expected to be completed by 2025 and already has the enlisted help of 20 engineers and costs an estimated US$40 million. The aim of this expansion is to strengthen Jamaica's self-sufficiency in cement. The project is being financed from internal resources and loans and will see additional upgrades being made to the company's kiln and transport system. This will result in more efficient and larger manufacturing capabilities.

New export opportunities

Carib Cement is looking to ramp up its export capabilities as the company is now in a better position to supply the Jamaican market. Since the company can now comfortably meet its local demand, the business is now making available any spare capacity for export. The business is actively seeking export opportunities to relocate spare capacity as evidenced by its export of 3400 tonnes of cement to the Turks and Caicos Islands.

New local infrastructural development and increased housing development to boost future demand.

The GOJ has indicated that they intend to construct between 70,000 to 100,000 houses within the next five years. Given this goal, the Housing Agency of Jamaica is expected to undertake the development of 14,000 housing solutions. The HAJ projects approximately 10,000 housing starts and 6,000 deliveries in the next four years. Hence CCC is expected to benefit from these developments especially as their expansionary project is already underway.

Additionally, the GOJ has indicated in its 2023/24 budget that its will be implementing a multi-billion-dollar Jamaican Dollar Capital Expenditure Programme during 2023/2024 which will result in the development of major corridors in the Corporate Area. The projects which are expected to be advanced are:

- The new Parliament Building- Scheduled to commence this year (high cement content)
- The Government Campus- Scheduled to commence this year (high cement content)
- The Portmore Resilience Park- In progress (moderate cement content)
- The Kingston Harbour Walk- Expected to commence late 2024/2025 (moderate cement content)

INVESTMENTS POSITIVES:

- Revenue is expected to continue an upward trajectory as the business expands its production capacity.
- The company's products continue to meet world-class standards and the company has retained standard certifications.
- The business has low levels of leverage.
- The introduction of exporting spare capacity makes profitability more attractive as well as provides a way to reduce excess inventory waste.
- The company is expected to continue to see improved demand as Jamaica becomes more infrastructurally developed.
- The increased real estate activity in Jamaica namely more private housing developments and construction to meet both residential and tourist demand should also contribute to higher demand.

INVESTMENT NEGATIVES

- The risk of geopolitical tensions affecting global supply chains poses a threat to the price of commodities used in manufacturing.
- Natural disasters such as earthquakes pose a threat to business operations.
- Over 95% of revenue comes from domestic sales, which implies that the company has a high concentration risk, however with new export capabilities being explored this risk has been reduced.
- Periodic shutdowns in cement kiln may present operational risks and negatively impact revenues.
- Increased environmental awareness and assessment of the impact of the plant's operations such as its silt pollution and carbon emissions may result in stricter legislation which may impact the business's profitability.
- A prolonged higher interest rate environment may decrease the demand for cement as developers may consider lessening housing supply especially for residential housing starts.

CONCLUSION

The robust demand for cement emanating from various private and public sector projects in industrial, commercial, infrastructure, and residential development sectors continues to present growth opportunities for CCC. Despite encountering an increase in operating expenses, the company maintains profitability and is well-positioned for expansion. This is attributed to the diversification of the company's market reach through exports and its ongoing efforts to increase production capacity.

Considering our evaluation of the current state of the company, we have established a price target of $73.40, reflecting a potential upside of 38.46% compared to the stock's current market value. Consequently, we recommend investors seeking exposure to the construction sector to overweight this stock at present, considering its undervalued nature and the upside-skewed associated risks.

CCC's recent dividend policy introduces an additional avenue for shareholders to derive value from the stock in the form of income. As of October 2023, CCC paid out approximately $1.62 billion in dividends, resulting in a payout ratio of 29.28%. With our target price of $73.40 and the latest dividend per share of $1.8976, this translates to a dividend yield of around 3.56%. When combined with the potential price appreciation, it leads to a potential total return of 42.02%.

SOURCES

Caribbean Cement Company Limited Annual & Quarterly Reports, Jamaica Stock Exchange (JSE), The Gleaner Company, Loop News Jamaica, The Jamaica Observer, Jamaica Information Service.

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.