

JMMB INVESTMENT & SOVEREIGN RESEARCH

Derrimon Trading Company Limited (DTL)



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EXECUTIVE SUMMARY

Derrimon Trading Company Limited (DTL) was founded in December 1998 as a private company which distributed commodities. DTL was listed on the Junior Market of the Jamaica Stock Exchange (JSE) in December of 2013.

Over the past 3 years, DTL has grown revenues by a Compound Annual Growth Rate (CAGR) of 24% while growing net income by a CAGR of 17%. Over the 12-month period ended December 2021, DTL has grown revenues to \$17.74B, a 38.88% increase over the 2020YE revenues of \$12.78B. DTL has also grown profits to \$448.18M for the period under review, compared to profits of \$311.09M for the 2020YE.

DTL used the proceeds from the additional public offer (APO) that concluded January 2021, to fuel its acquisition initiatives, which has begun to bear fruit, as is evident in the company's top line. Additional, the proceeds of the APO were also used to retire existing expensive debt and ease their interest burden, which contributed to the growth in the company's bottom line.

We attach an **OUTPERFORM/BUY** recommendation to DTL's shares, as it is currently trading 18.04% below our fair value estimate. This investment suits investors seeking capital appreciation with a medium to high risk appetite. We are anticipating that the acquisitions made by DTL are likely to be accretive, as the initial results have pointed to such.

DTL'S PRICE MOVEMENT



DTL's Statistics

Financial Year End	December
Stock Price (21/03/2022)	\$ 2.60
EPS	\$ 0.088
Book Value per share	\$ 1.22
P/E	26.07x
P/B	1.88x
Net Profit FY2021 (millions)	\$ 448
Price Target	\$ 3.07
Recommendation	BUY

Company Overview

Derrimon Trading Company Limited (DTL) was founded in December of 1998 as a private company which distributes commodities. DTL was listed on the Junior Market of the Jamaica Stock Exchange (JSE) in December of 2013. The company has three (3) subsidiaries, Caribbean Flavours and Fragrances Limited (CFF), which is also listed on the JSE Junior Market, Woodcats International Limited and Marnock LLC. DTL took a 49.02% stake in CFF in 2014, then later acquired majority ownership in 2017. CFF engages in the manufacturing and distribution of flavours for the baking, confectionary and beverage industry. CFF also distributes fragrances for household and general use. Woodcats International, a leading manufacturer of wooden pallets and wood by-products, was acquired by DTL on September 18, 2018. Marnock LLC is 80% owned by DTL, and operates as Food Savers New York Inc. and Good Foods for Less, two New York based supermarkets. Marnock LLC was acquired in January of 2021. In addition to its subsidiaries, DTL has a 60% interest in the Select Grocers Supermarket, pursuant to a joint venture arrangement. More recent, DTL acquired Spicy Hill Farms on January 10, 2022, a manufacturer of authentic Jamaican products including the popular ram goat soup or “mannish water” product.

Company Business

DTL’s main business lines are Distribution, Retail and Wholesale as well as other operations via its three subsidiaries. Derrimon distributes several grocery items from different household names via exclusive and co-distribution deals. The company also engages in the distribution of rice, margarine and detergents on a wholesale basis. Its retail and wholesale arm includes seven (7) Sampars Cash ‘N’ Carry locations and the 60% interest in Select Grocers Supermarket.

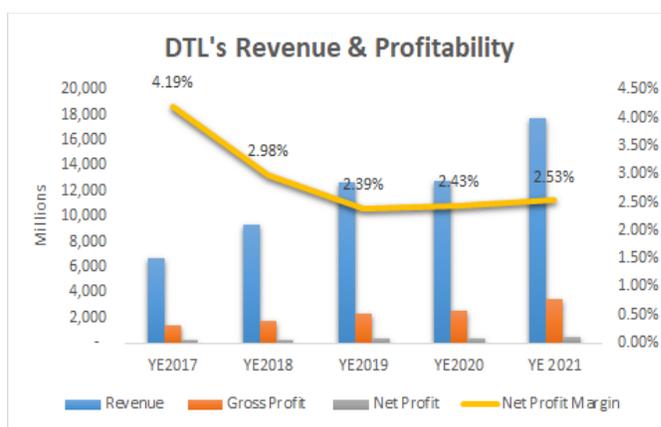
DTL has been one of the four (4) regional sub-distributors of Nestle Jamaica Limited’s products since 2002. The company co-distributes products from the Nestle brand, as well as it utilizes the company’s retail operations for direct sales to small shops, restaurants and other users of Nestle products. The company also distributes cold food items such as meats, seafood, French fries and other frozen goods. The distribution arm is supported by DTL’s proprietary cold storage facility, acquired in 2011.

DTL also engages in the importation and wholesale distribution of Rice, margarine and detergents. The corporate has a specialized division for the importation of rice for sale to wholesale customers, which was established back in 2006. Along with this, DTL exclusively distributes its own Delect brand of long grain white rice along with other brands of rice. DTL remains the exclusive distributor of the Sun Power and Ozon range of detergents and disinfectants, as well as the sole distributor of Golden Brand margarine.

In 2009, DTL acquired the Sampars Cash ‘N’ carry business and established it as a separate trading division of the company. The retail operations have been expanded as the number of locations have increased to seven (7), with locations mainly in the central parishes. These parishes include Kingston & St. Andrew, St. Catherine, Manchester and St. Ann. The company’s retail and wholesale interests are furthered by its joint venture agreement, which sees it having a 60% interest in the Select Grocers Supermarket. The supermarket is located in Upper Manor Park Plaza in St. Andrew and the new Select Grocers store located at Millennium Mall in Mineral Heights, Clarendon.

Financial Performance – 2021FY

Profitability



Over the period 2018FY to 2021FY, DTL has managed to grow revenues by CAGR of 24%. For the 2021FY, revenues amounted to \$17.74B, which represents a 38.88% growth when compared to revenues of \$12.78B in 2020FY. The rate of growth for revenues in 2021 was constrained by the advent of the pandemic, as containment measures to prevent the spread of the virus minimally affected business operations.

DTL has experienced significant growth in its ‘Wholesale and Retail’ business segment (89%), ‘Other operations’ (21%), while the ‘Distribution’ segment slightly declined 1.21%. The significant increase in DTL’s Wholesale and Retail division was directly attributable to the consolidation of the results from DTL’s new subsidiary, Marnock LLC¹. Additionally, strong performance by the group’s retail division also contributed to this growth.

The group experienced a 39% increase in cost of sales in the 2021FY, as cost of sales surged from \$10.29B in 2020FY to \$14.33B. This is driven by inflationary pressures, higher raw material and commodity cost across business segments, as well as the ongoing logistics challenges and elevated shipping costs. Nevertheless, DTL’s cost of sales margin was maintained at 81% which translated to a year over year growth in gross profit by 37% in FY2021 to \$3.41B.

Operating expenses surged by 48%, outpacing its 3 year CAGR of 28%, an increase from \$1.84B in 2020FY to \$2.73B in 2021FY. This increase was driven by the consolidation of expenses of the

¹ Marnock LLC is an 80% subsidiary of DTL. Marnock LLC was created to operate the business of the two US supermarkets acquired by DTL.

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recently acquired US based grocery outlets, higher utility expenses, lease payments, salaries and rent costs. Operating income for the period under review grew from \$740M a year prior, to \$787M, an increase of 6.4%.

DTL continues to pay down debt, restructure its balance sheet and ease its interest burden. The company restructured and swapped out its US-dollar denominated debt to Jamaica-dollar denominated debt at lower rates of interest. This also reduced the exchange rate volatility in debt service charges. The additional public offering (APO), which closed in January 2021, allowed DTL to further reduce finance costs, as the corporate retired \$1.29B of existing short- and long-term debt. Included in this debt was their 2021 preference shares that paid coupon of 9%. For the 2021 financial year, finance costs fell by 40%, from \$384.5M a year prior to \$231.3M.

Despite the economic challenges caused by the pandemic, DTL has been able to grow revenues and increase profits. Notwithstanding these improvements, the company added to their top line through inorganic growth via acquisitions. DTL's net income surged 44%, outpacing the CAGR of 17%. Net profit attributable to shareholders of the company for the period under review totaled \$399.94M. This represents a growth of \$120M over the \$279.8M recorded for the same period last year. Moreover, net margin slightly improved from 2.43% a year ago, to 2.53%.

Liquidity & Solvency

Total assets for DTL experienced a 55% increase, from \$7.42B as at 2020FY to \$11.51B for the 2021FY. The growth in assets for this period was mainly due to the growth increases in Plant, Property and Equipment (PPE) and Right of Use of building assets as the group secured fixed assets to assist with their expansion plans. PPE increased significantly from \$537.78M to \$2.25B as at the 2021FY, this growth is in line with the company's acquisition initiative.

Current assets over this same period increased from \$4.78B to \$5.42B. A majority of this increase in current assets was due to the movement in inventories, up from \$2.19B to \$2.68B. Management highlighted that due to ongoing global supply chain issues, DTL has taken the initiative to order additional stock in anticipation of future supply interruption. DTL's cash and cash equivalents also increased by 60%, moving from \$717M to \$1.15B.

Total interest bearing debt fell from \$3.40B as at the end of 2020FY to \$2.04B as at the 2021FY. DTL has restructured its debt and used proceeds from the APO to repay some of its debt. DTL retired \$1.6B in long and short term debt over the first 6 months of 2021 with a portion of the proceeds from the APO. Included in this long term debt, was their 9% 2021 preference shares as well as short term debt, which was acquired in the last half of 2020FY, for the purpose of making a deposit on the prospective acquisition. Furthermore, DTL switched from US Dollar

loans to Jamaican Dollar facilities and re-negotiated interest rates on their outstanding debts which positively impacted the finance cost of the Group.

The APO has allowed DTL to increase its total asset base, as well as improve its liquidity and leverage ratios. As at the 2021FY, the group's current ratio stood at 2.42x while its quick ratio stood at 1.22x. The group's debt/equity ratio has decreased from 2.12x as at the end of 2020FY to 0.35x as at the 2021FY.

Cash Flow Adequacy

Cash from operating activities (CFO) represented inflows of \$1.86B for the twelve-month period, relative to outflows of \$698M in 2020. CFO inflows was mainly driven by an increase in payables and profits amounted to \$1.06B and \$555.72M respectively.

Cash from investing activities represented an outflow of \$3.63B for FY2021, relative to an outflow of \$120.69M in FY2020. Purchase of PPE and investments in subsidiary are the primary outflows from investing activities. PPE surged to \$1.93B versus \$102.62M reported in FY2020, while investments in subsidiary amounted to \$1.57B.

Cash from financing activities represented an inflow of \$2.15B for the period, relative to an inflow of \$877.18M in 2020. This was mainly driven by the increase in share capital amounted to \$3.72B in FY2021.

Outlook & Valuation

After raising \$4B from its APO in January 2021, DTL has begun making strategic moves to improve operations, via organic and inorganic means. DTL completed transactions to acquire control of Food Savers New York Inc. and Good Foods for Less, in 2021Q1. This acquisition was done via a purchase of 80% of Marnock LLC which was formed to operate the business of the two supermarkets, Food Savers New York Inc. and Good Foods for Less. Based on the US projected growth rate of 4% in 2022 by the IMF and the continued decline in the unemployment rate in the US. This is likely to strengthen the performance of the newly acquired supermarkets in the US and its contribution to DTL's revenue.

Both subsidiaries represent diversity of earnings in both location and economies and foreign currency (USD). The margins generated by these entities are also relatively attractive and they should ensure that DTL has a hedge against currency devaluation in its Jamaican dollar (JMD) reporting currency. Additionally, generating revenue in foreign currency is likely to assist offset expenses and currency risk, as majority of DTL's inputs are sourced from overseas. As such, DTL's presence in the US market is expected to improve its profitability margins.

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In addition to this acquisition, DTL also expanded its portfolio when it acquired Spicy Hill Farms, a manufacturer of authentic Jamaican products including the popular ram goat soup or “mannish water” product, Granulated Scotch Bonnet Pepper, and Dried Thyme Leaves. The products manufactured by this Company are available in over 200 retail outlets throughout the island in addition to major stores within markets such as the United States, Canada, the United Kingdom and the Caribbean. The acquisition of Spicy Hill provides DTL with its first food manufacturing business and provides more diversification into the Jamaican diaspora as well as the African, Caribbean and Indian diaspora. This could have positive implications for margins and foreign currency earnings.

Furthermore, the opening of the new Select Grocers supermarket in Clarendon has been delayed. However, the build out of the store is expected to be completed in the first quarter of 2022 and is expected to further improve DTL’s earnings.

Though the wholesale and retail business segment contributed to the significant increase in DTL’s revenue generation, there pose some downside risks with the recent economic conditions. The pandemic coupled with the Ukraine invasion, has further increased commodity prices, oil prices and higher inflation which is likely to increase DTL’s cost of sales and other operating expenses and as such cause downward pressure on their profitability margins. The wholesale and retail industry is expose to possible increase in final sale price and the dilemma of absorbing these cost or passing on the increase in cost to consumers. This is likely to risk inventory increases, especially since recently, DTL has taken the initiative to increase inventory in anticipation of further supply chain issues.

The relaxation of covid-19 containment measures internationally and locally will weigh positively on travel and tourism which should increase demand for local manufactured goods. Furthermore, with the re-opening of schools and lower unemployment rates, we anticipate a recovery in demand for DTL’s products by students and parents.

We have a positive outlook on DTL, as the company is in acquisition mode, we anticipate continued pursuit of opportunities to diversify revenue streams through further business acquisitions, industry integration, new product offerings, currency diversification and operational efficiency.

Based on these assumptions, we arrived at our price target of \$3.08 using the Discounted Cash Flow (DCF) model. Meanwhile using the DCF under two additional scenarios produced our upper and lower case price targets of \$3.21 and \$2.45 respectively. The primary difference between the scenarios is the trajectory of interest rates, inflationary pressures, global commodity prices and the impact it has on the Wholesale & Retail trade and Distribution industry. The best-case scenario assumes recovery in global commodity prices, lower inflationary pressures, more

acquisition projects in the pipeline, which will further diversify DTL’s revenue streams and improve their earnings. Meanwhile, we looked at a different scenario with revenue generation deteriorating and increase in cost, due to the rise in global commodity prices, which will likely result in an increase in the final price of products and essentially a downturn in the Wholesale & Retail and Distributions industry, as well as the halt of acquisition projects due to rising cost of financing.

	Price Target	Implied Upside/Downside
Upper	\$ 3.21	24%
Base	\$ 3.08	18%
Lower	\$ 2.45	-6%

Additionally, we applied our forward EPS to the 3-year average PE ratio of 24.48x, which provided an intrinsic value of \$3.06. **Averaging these forecasts gives us a price target of \$3.07, which is 18% higher than the closing price of \$2.60 at early April, 2022.**

Key Risks

The main risks to our price target include: headwinds from the pandemic as increasing distribution costs could affect operational expenses. Also, due to DTL’s higher level of inventories, a decrease in market demand would leave the company carrying inventories it is unable to clear in a timely manner.

Additionally, a key risk to our earnings target are DTL’s ability to contain its cost of goods sold. Cost of goods sold can be impacted due to increasing cost of global commodities, as a result of demand outpacing supply, ongoing global supply chain issues and increasing transport cost.

Recommendation

We assign an **OUTPERFORM/BUY** recommendation to DTL at this time, given that it is currently trading below our fair price estimate of \$3.07. This stock is most suitable for investors with a medium to high risk appetite. DTL is currently still in their growth phase and as such, we expect the company to prioritize the retention of profits to fuel expansion.

Abridged Financials

Abridged Financials	YEAR END					Change
	YE2017	YE2018	YE2019	YE2020	YE2021	
	\$'000	\$'000	\$'000	\$'000	\$'000	
Revenue	6,723,810	9,303,460	12,649,017	12,777,464	17,744,717	38.9%
Cost of Sales	(5,388,010)	(7,612,427)	(10,370,183)	(10,294,801)	(14,335,509)	39.2%
Gross Profit	1,335,800	1,691,033	2,278,834	2,482,663	3,409,208	37.3%
Profit Before Taxation	281,796	281,845	345,726	355,189	555,719	56.5%
Net Income	281,796	277,213	302,708	311,089	448,183	44.1%
Total Assets	2,887,219	4,048,095	5,782,684	7,415,814	11,509,215	55.2%
Total Liabilities	1,852,044	2,829,859	4,449,199	5,811,877	5,747,048	-1.1%
Total Shareholder's Equity	864,068	1,055,639	1,178,668	1,425,702	5,551,334	289.4%
EPS (\$)	0.092	0.091	0.106	0.102	0.088	
Book Value per share (\$)	0.38	0.45	0.49	0.59	1.22	
Price to Earnings (x)		28.20	24.11	23.25	26.07	
Price to Book (x)		5.77	5.26	4.06	1.88	
Key Ratios						
Gross Profit margin	19.9%	18.2%	18.0%	19.4%	19.2%	
Net Profit margin	4.2%	3.0%	2.4%	2.4%	2.5%	
Return on Assets	13.3%	9.2%	8.2%	6.5%	8.3%	
Return on Equity	27.2%	22.8%	22.7%	19.4%	7.8%	
Debt to Equity (x)	1.01	1.37	1.79	2.12	0.35	
Current ratio (x)	1.93	1.53	2.15	2.16	2.42	
Quick ratio (x)	1.20	0.88	0.98	1.17	1.22	
Cash ratio (x)	0.24	0.20	0.38	0.32	0.51	

Source: www.jamstockex.com, Bloomberg, Company Financials, Company Prospectus, JMMB Investment Research.

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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