

JMMB INVESTMENT & SOVEREIGN RESEARCH

Lumber Depot Trading Company Limited (LUMBER)



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EXECUTIVE SUMMARY

Lumber Depot Company Limited (LUMBER), born out of the Blue Power Group (BPOW), was incorporated and domiciled in Jamaica on July 30, 2019. The company began trading on August 1, 2019 and listed on the Junior Market of the Jamaica Stock Exchange on December 16, 2019. The main activities of the company comprise of the sale of lumber, hardware supplies and other construction related products.

Over the 12 month period ended April 2021, LUMBER has grown revenues to \$1.43B, a 55% increase over the 2020YE revenues of \$921M. LUMBER has also grown profits to \$145M for the period under review, compared to profits of \$22M for the 2020YE. Lumber Depot continues to service the growing construction sector which has seen a rise in commodity prices coupled with an increase in demand for these commodities.

We have placed a **MARKETPERFORM/HOLD** recommendation on the shares of Lumber Depot as we believe the stock is trading close to its fair value. Additionally, the company is positioned for growth, demonstrating favorable margins, positive liquidity and solvency positions. However, the entity is susceptible to adverse economic conditions, this includes rising inflation driven by higher global commodity and freight costs. The BOJ's move to increase interest rates, by a total of 200 bsp since August 2021, is also a concern as it has increased the cost of capital / borrowing rates which could have negative implications for the construction sector.

Shareholdings

<i>Top 10 Shareholder</i>		
Mayberry Jamaican Equities Ltd	132,468,464	18.76%
Blue Power Group Limited	101,989,250	14.44%
J Kenneth Benjamin & Sheila Benjamin	59,954,650	8.49%
Mary J. Fray	30,954,000	4.38%
JN Fund Managers	23,919,341	3.39%

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QWI Investments Limited	16,700,000	2.36%
Noel Dawes	15,627,150	2.21%
PAM – Pooled Equity Fund	9,893,510	1.40%
Mayberry CO A/C 120008	9,837,370	1.39%
Prime Asset Management – JPS Employees Superannuation Fund	9,837,370	1.39%
Other Shareholders	295,056,395	41.78%
Total		100.00%

Company Overview

Lumber Depot Company Limited (LUMBER) is a full service hardware and building materials company. LUMBER was incorporated and domiciled in Jamaica on July 30, 2019 and commenced trading on August 1, 2019.

LUMBER entered into an Intragroup Reconstruction Agreement with the Blue Power Group Limited (BPOW), which saw them assuming the benefit and burden of the Hardware Business. On August 1, 2019, Blue Power Group Limited sold its' Lumber division to the company, and at that time certain assets and liabilities of BPOW's Lumber division were transferred at book value to the company. The assets of the Hardware Business was transferred to LUMBER and there was no change to the management team of the Hardware Business. The Hardware Business has been in operation since 1998. The Company conducts its principal trading operations at 17c Gordon Town Road in Papine, St. Andrew. Lumber also operates an off-site overflow storage facility at 4 Victoria Avenue, in Kingston.

LUMBER's main business includes the sale of lumber, hardware supplies and other construction related products. Approximately 70% of the company's sales consist of cement, steel, lumber and paints. The company's main clientele includes small contractors, home owners and a few owners of commercial buildings. Lumber sources most of its supplies locally, such as cement from Caribbean Cement Co., paint from Berger Paints Ltd and steel from Tankweld Metals. The company however imports its lumber from Brazil, China and the USA.

Macroeconomic Overview

Local Economic Overview

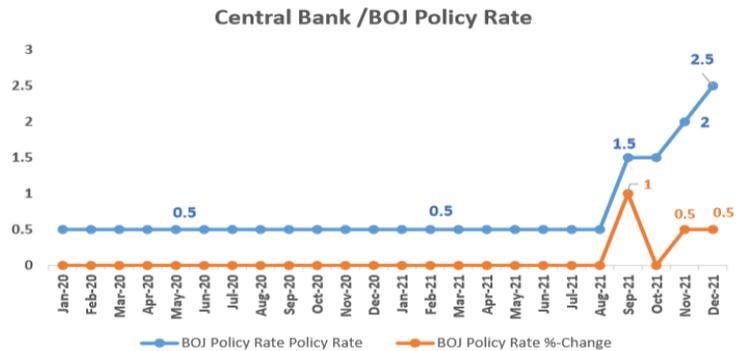
The latest data from the Bank of Jamaica (BOJ) indicates that the outlook for Jamaica's economy is generally positive as recovery from covid-19 continues. The BOJ has acted on three (3) occasions to increase interest rates by a total of 200 basis points. The central bank in December 2021, increased its policy by 50 basis points to 2.50% per annum. This decision was

based on the central banks' assessment that inflation continues to breach the upper limit of the Bank's target range of 4% to 6% and was likely to continue to successively breach the target range over the next 8 to 10 months. Due to the recent policy adjustments, interest rates in the money market have increase and indications from the Bank of Jamaica's credit conditions survey are that deposit-taking institutions intend to increase interest rates on loans. Additionally, as investors seek higher deposit / investment rates, non-deposit taking institutions will likely increase loan rates to maintain spreads.

Furthermore, the BOJ has identified 12-month inflation at 7.3% as at December 2021, being above the upper bound of the BOJ's targeted inflation range of 4% to 6%. The Bank noted that increases in international commodity and shipping prices have been the principal contributor to domestic inflation rising above the target range and one-off increases in regulated transportation and energy prices.

The JMD/USD exchange rate over the last twelve quarters has depreciated by 6% to 9%. The BOJ has nonetheless continued to intervene in the market when temporary shortfalls between inflows to and outflows from the market have been identified, by the B-FXITT flash sale operations and the FX Swap Arrangement.

• BOJ Increases Interest Rates



REAL VALUE ADDED IN THE GOODS PRODUCING INDUSTRIES (%)

	Jul-Sep 2020	Oct-Dec 2020	Jan-Mar 2021	Apr-Jun 2021	Jul-Sep 2021
Goods Producing	-3.4	0.2	2.7	12.7	2.8
Agriculture, Forestry & Fishing	2.4	-7.2	-1.9	15.0	7.2
Mining & Quarrying	-20.1	6.3	7.2	-9.2	-31.0
Manufacturing	-10.8	-0.4	-0.9	12.9	8.5
Construction	7.0	6.3	10.5	17.4	1.7

November 24, 2021 Planning Institute of Jamaica

The Jamaican economy continued its recovery in Q3 2021 (July-September) recording a year over year increase of 6.3%. The goods producing sector recorded a 2.8% increase while the services sector recorded a strong 7.3% increase. Increased employment (up by 93,400 year over year), a relaxation of curfew and safety measures and increased business

confidence, as firms adapt to operating during the pandemic underpinned the improved performance. The goods producing sector recorded its fourth consecutive quarter of growth with Agriculture (7.2%), Manufacturing (8.5%) and Construction (1.7%) recording notable increases in Q3. Notably, the construction sector experienced a slowdown in growth, following 17.4% growth (April-June-2021) and 10.5% for the Jan-Mar 2021 quarter. There was a 5.6% increase in the real sales of construction inputs which supported the building construction division. Building Construction growth was driven by non-residential construction as residential construction would likely have been negatively impacted by rising interest rates.

Global Economic Trends

The IMF estimated (World Economic Outlook database Oct-2021) that global GDP made a solid recovery in 2021 recorded at 5.9%. Advanced economies are estimated to have experienced growth in the region of 5.2% while Emerging & Developing economies are estimated to have grown by a robust 6.4%.

The US has maintained its low rates with no rate increase as at Q4 December 2021. The US Federal Reserve has remained cautious citing global supply bottlenecks and the covid-19 pandemic as its rationale. The US 12-month inflation rate is at 6.8% as at November 2021, which is the highest rate since June 1982. The US inflation target is 2% which indicates that the current inflation rate is three times the inflation target. Nevertheless, the Fed maintained a low interest rate environment.

Financial Performance – 2021 Financial Year

Profitability

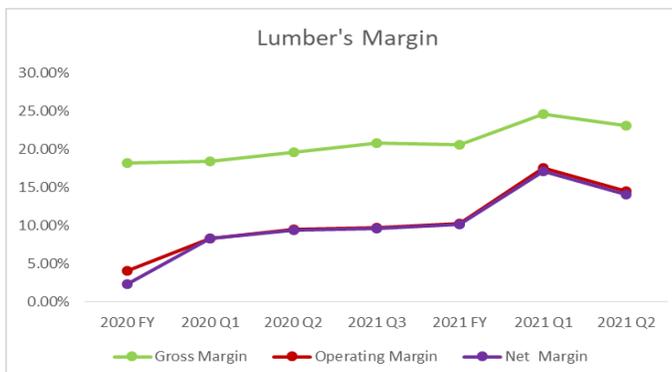


LUMBER reported revenue of \$1.43B, a 55% year over year increased for the 2021 financial year, relative to \$921.45M in 2020. This growth in revenues was driven by demand for lumber and other construction materials supplied by the company as a result of the growth in Jamaica's construction sector. Additionally, the global prices of these

materials, particularly lumber, have increased significantly over the past 12 months. Lumber futures¹ have risen by 61% over the past year, as the demand for lumber has outstripped supply. This increase was not fully absorbed by the company, who passed it on partially to customers.

Notwithstanding the company's efforts to contain the impact of rapidly increasing global commodity prices and transport prices, by fostering relationships with key construction suppliers locally and overseas, cost of sales for the period amounted to \$1.14 billion, a 51% year over year increase relative to \$754.01 million in 2020. This is attributable to an increase in the company's key hardware item as a result of the depreciation of the Jamaican dollar and the spike in global demand. Nevertheless, there was a slight downturn in the company's cost of sale margin from 82% (2020) to 80% for the 2021 year-end.

¹ Lumber futures do not create cash prices; they however, generate a current view of an equilibrium price.



Gross margin for the 2021 period improved to 20.53% relative to 18.17% reported for the 2020 year-end. Consequently, gross profit for the period closed at \$293.45M, up 75% year over year from the \$167.44M booked in 2020 financial year.

In the year ended April 2021, there was a reversal of losses on trade receivables, totaling \$3.17M. Reversal of impairment losses occurs when there is a collection of outstanding credits which factored into the calculation of loss allowances. The corresponding 2020 period, had an impairment loss on trade receivables, which amounted to \$20.28 million.

Additionally, the company reported administrative and other expenses of \$154.22M, up 42% from \$108.29M reported in the corresponding period. Quarter over quarter, administrative expenses noticed an uptick of 4%, in the 4th quarter ended April 2021. This demonstrates LUMBER's efforts in containing its expenses, which will have a profitable impact on its bottom line. LUMBER's net finance costs declined by 58%, falling to \$2.57M from 2020YE costs of \$6.11M. Of this, finance income amounted to \$6.53M (2020: \$993,398). Conversely, finance cost amounted to \$9.09M (2020: \$7.10M). This fall was primarily due to two factors; a significant increase in interest income earned and an increase in interest expense on lease liabilities and bank charges and fees.

Net Income increased significantly by 554% to \$144M, up from \$22M for the 2020YE. This significant jump in net income was attributable to several factors. These include, an increase in revenues, improvement in margins, reversal of impairment losses as well as a spike in finance income.

Liquidity & Solvency

Total assets for LUMBER grew by 40.8%, from \$374M as at April 2020 to \$526.6M as at April 2021. Of this, fixed assets grew from \$196M to \$209.3M, there was a 78.3% growth in current assets, as it jumped to \$317M from \$177M. This significant increase was due to a rise in cash and cash equivalents and an uptick in inventories. Cash and cash equivalents soared to \$142.6M from \$29M. This significant gain is mainly attributable to cash provided by operating activities, which totalled \$185.67M for the period. As at 2021FY, Lumber depot has more cash on hand

than inventories. Inventories increased to \$131.6M from \$104.7M, as the company sought to better meet customer demand.

Total liabilities stood at \$203.5M, an increase of 12% from \$181.7M as at 2020YE. Long-term liabilities fell by 21.7% from \$82.6M to \$64.7M. This fall was due to LUMBER repaying the full balance of its \$25M loan, back to BPOW in the 2nd quarter of the 2020/21 financial year. Current liabilities grew by 40% to \$138.8M from \$99M. This growth was due to a 91% spike in accounts payable, which grew from \$66.2M to \$126.5M.

The company has improved its liquidity and solvency position over the last 12 months. LUMBER has grown its current ratio from 1.79x as at the 2020YE, to 2.29x as at April 2021. The company's quick and cash ratios also followed the same trend, as they saw significant improvements. The quick ratio improved from 0.74x to 1.34x, showing that LUMBER's current assets, not including inventory, can more than cover all of its liabilities. The cash ratio climbed from 0.29x to 1.03x, indicating the company has sufficient cash on hand to cover its current liabilities.

Year to Date (Six Months Financials):

Profitability - Lumber reported revenue of \$760M for the six months period ended October 2021, a 9% increase relative to \$699M in 2020. Revenue for the quarter rose to \$339.86M from \$338.35M reported in 2020. Cost of sales for the six months period totaled \$584.43M, a 4% uptick from \$562.14 in the 2020 corresponding period.

Gross margin for the six month period improved to 23.09% relative to 19.64% reported for the 2020 corresponding period. Consequently, gross profit for the period closed at \$175.51M, up 28% from the \$137.4M booked in the 2020 six months period. Gross profit for the quarter rose marginally to \$72M from \$70M booked in 2020.

The company reported an impairment loss on trade receivables, which amounted to \$1.10M. The corresponding 2020 period had a reversal of losses on trade receivables totaling \$4.17M. Moreover, Lumber reported administrative and other expenses of \$73.29M, down 3% from \$75.65M reported in the corresponding period. For the quarter, administrative expenses amounted to \$36.53, fell by 10.6% from \$40.86M booked in the corresponding 2020 period.

Operating profit for the period amounted to \$101.23M, up 54% relative to the \$65.93 million reported in 2020. Notably, operating profit for the quarter amounted \$36.58M from \$36.60M booked in 2020. Finance costs and income for the period under review amounted to \$4.84M (2020: \$4.40M) and \$1.60M (2020: \$3.78M), respectively.

Net Income increased by 62% to \$107M, up from \$66M for the corresponding six months period ended October 2020. This jump in net income was attributable to several factors, which includes increase in revenue, other income and improvement in margins.

Liquidity & Solvency

Total assets for LUMBER grew by 45%, from \$434M as at October 2020 to \$630M as at October 2021. Of this, fixed assets grew from \$194.7M to \$300.8M. This significant increase was due to a \$50M investment in 'Land' while property, plant and equipment increased significantly to \$132.2M from \$18.8M. There was a 38% growth in current assets, as it jumped to \$329.2M from \$239.3M. This significant increase was due to a rise in cash and cash equivalents and an uptick in inventories. Cash and cash equivalents soared to \$115M from \$57.7M. This significant gain is mainly attributable to cash provided by operating activities, which totaled \$169M for the period. Inventories increased to \$161.7M from \$131.7M, as the company sought to better meet customer demand.

Total liabilities stood at \$227.9M, an increase of 29.6% from \$175.8M as at October 2020. Of this, current liabilities makes up Lumber's total liabilities, which saw a growth from \$107.14M booked in 2020 corresponding period. This growth was due to other payables booked at \$127.6M and an 8% growth in accounts payable, which grew from \$89.4M to \$96.8M. As at the 2021 six months period, the company has no long term liabilities.

LUMBER's current ratio has deteriorated from 2.23x as at October 2020, to 1.44x as at October 2021. The company's quick and cash ratios also followed the same trend. The quick ratio fell from 1.00x to 0.74x, while the cash ratio fell from 0.54x to 0.50x, indicating that LUMBER's cash on hand can cover 50% of its current liabilities.

Cash Flow Adequacy

Cash from operating activities represented inflows of \$169.21M for the six months period, relative to inflows of \$63.10M in 2020. Cash from investing activities represented an outflow of \$164.63M for the 2021 six months period, relative to an outflow of \$5.64M in 2020. Cash from financing activities represented an outflow of \$32.18M for the period, relative to an outflow of \$28.82M in 2020.

Lumber demonstrated favorable cash flow adequacy for the six month period. The company had a cash flow yield of 1.58x, an increase from 0.96x booked in 2020, demonstrating an improvement in Lumber's ability to generate operating cash flows in relation to net income. Furthermore, cash flow to sales and cash flow to assets both improved to 0.22x (2020: 0.09x) and

0.27x (2020: 0.15x) respectively. However, the entity had a free cash flow deficit of \$23.45M, which was driven by dividends paid of \$23.25M and purchase of PPE of \$164.4M.

Outlook & Valuation

LUMBER has benefitted from a surge in the demand for construction products, as the sector is experiencing continued growth. Additionally, these products have seen significant price increases over the past 12 months. Lumber has been able to contain the impact this on their cost of goods sold.

The company's primary product, lumber, has seen a global price increase of 61% over the past year. This rise was primarily due to demand outpacing supply, increased housing starts in the USA, continued high wood demand in the repair and remodeling sector, low lumber inventories throughout the supply chain, labor shortages in the transportation and processing sector, and limited expansion of lumber production. To combat this, the company has proactively developed relationships with key suppliers of construction inputs overseas and sought to buy strategically in order to contain the impact of rapidly increasing global commodity prices and transport costs. This has helped Lumber Depot to mitigate the 'shortage' in the commodity.

Furthermore, the company has positioned itself to increase assets and the development of an additional off-site warehouse facility to capitalize on larger volumes of a wide range of imported products to meet consumer demand. Also, Lumber is in a favorable position to raise debt capital if desirable to sustain operations and/or to meet strategic objectives to grow the business.

Nevertheless, we are of the view that there may be a slowdown in construction throughout the remainder of the financial year. This assumption was formed due to a slowdown of growth in the construction sector in the preceding quarter (Q3 2021: 1.7%) and the likely negative impact rising interest rates would have on the industry.

We expect a tightening of the monetary policy environment to contain inflation, and as such this would translate to higher rates to finance housing developments and purchases, i.e. higher mortgage rates. This could possibly adversely impact Lumber, which could see a reduction or slowing of the growth rate at which the entity's products will be demanded. Essentially, a possibly subdued construction industry for the projected period is likely to have a corresponding effect on Lumber's revenue generation.

We have forecasted LUMBER's financial performance for the 2021/22FY as well as the 2022/23FY. We estimate that Lumber Depot may end their 2022FY with revenues of \$1.60B. We expect them to see net income climb to \$169M for the full year, putting EPS at \$0.24.

For the 2023FY, we are forecasting total revenues of \$1.80B. We anticipate an uptick in gross margin to 21.17% from 20.53% currently. Our forecasts yielded a net income of \$156.96M, and earnings per share (EPS) of \$0.22. This represents a 16% decrease over trailing EPS.

Based on the assumptions used in the Discounted Cash Flow (DCF) model over a two-year period, FY2022-FY2023, an *intrinsic value of \$2.96* was obtained. Meanwhile using the DCF under two additional scenarios produced our upper and lower case price targets of \$3.89 and \$2.11 respectively. The primary difference between the scenarios is the trajectory of interest rates, global commodity prices and the impact it may have on the construction industry. The best-case scenario assumes a reduction in interest rates, which would likely improve financing of housing developments, and a recovery in global commodity prices, and a booming construction industry. Meanwhile, we looked at a different scenario with revenue generation deteriorating due to increased interest rates and global commodity prices, and a dampening in the construction industry.

	Price Target	Implied Upside/Downside
Upper	\$ 3.89	35%
Base	\$ 2.96	2%
Lower	\$ 2.11	-27%

Additionally, we used the current trailing average P/E ratio for its industry peers of 14.08x and applied this to the forward EPS, which provided an intrinsic value of \$3.13. **Averaging these forecasts gives us a price target of \$3.04, which is 5.35% higher than the closing price \$2.89 on January 21, 2022.**

Company	Market Capitalization	Price to Earnings	Price to Book	Return on Equity	Return on Assets	Dividend Payout	Dividend Yield
CAC	967,741,935		2.33x	-8.37%	-2.93%		
DTL	10,070,289,525	33.52x	1.94x	5.78%	3.20%	17.49%	0.52%
EFRESH	1,007,190,000		2.26x	-55.13%	-24.32%		
FOSRICH	4,545,593,773	36.16x	4.34x	11.99%	3.66%	37.96%	1.05%
FTNA	9,332,829,943	18.22x	5.00x	27.45%	13.08%	24.39%	1.34%
INDIES	4,424,021,675	27.57x	4.05x	14.70%	7.94%	91.35%	3.31%
JETCON	542,655,000	6.62x	0.99x	15.00%	12.37%	0.00%	0.00%
LASD	11,901,282,160	13.09x	1.75x	13.37%	7.63%	25.09%	1.92%
MDS	1,707,894,739	24.53x	1.63x	6.66%	2.66%	26.46%	1.08%
Sector Average	4,944,388,750	14.20x	2.70x	13.6%	7.2%	37.1%	1.5%
LUMBER	2,041,026,375	14.08x	5.08x	36.06%	23.02%	26.35%	1.38%

Key Risks

The key risks to our earnings target are Lumber's ability to contain its cost of goods sold, and administrative expenses. 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. Lumber pays administrative expenses to BPOW based on the terms of a Corporate Service Agreement. The company pays for management, administrative, accounting and financial services.

Recommendation

We assign a **MARKETPERFORM/HOLD** recommendation to LUMBER at this time, given that we believe the stock is trading below our base price target of \$3.06 and above our lower price target of \$2.11. The company is positioned for growth, as there is little to no debt on its balance sheet and it demonstrates healthy profitability margins. Nevertheless, the company is susceptible to economic conditions, such as the tightening of monetary policy which could have an adverse effect on the construction industry from which majority of its revenue is generated.

This stock is most suitable for investors with a medium to high risk appetite who are seeking capital appreciation. LUMBER is currently in the growth phase and while management has signaled its intention to pay annual dividends, we expect a majority of earnings to be retained. This is likely to impact the outlook of the company and its stock price, especially from investors seeking dividend payments, which has become more prevalent during the pandemic. Given our 18 month outlook, the risk to our price target is the company releasing results which are below our expectations, which would lead to a decrease in investor demand for this stock.

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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**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

STRONGLY UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 2.5% FOR THIS PARTICULAR ASSET

UNDERPERFORM—REDUCE EXPOSURE IN YOUR PORTFOLIO TO 2.5% - 4.9% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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OUTPERFORM/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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