

Business Profile: Tropical Battery Company Limited (TBCL) was founded in 1950 by American businessman, Tex Williams. TBCL was subsequently purchased by John Melville in 1967, and is still controlled by the Melville family today. The company originally started as a manufacturer of lead acid storage batteries; however, in the early 1990s, TBCL shifted its business model and became a major battery distribution company. TBCL currently has its headquarters in Kingston, Jamaica with distribution centres located in Kingston and Montego Bay, five Retail Stores and approximately 1,000 resellers (Gas Stations, Auto Parts stores, etc.) to serve the Jamaican market.

The company's core business continues to be sales of automotive batteries, complimented by the distribution of several world renowned automotive consumer product brands including Caribroke brake fluids, oils and lubricants, and service items such as coolant, windscreen wash, tyres and automotive cleaning supplies. Whilst retail sales and distribution of batteries represents majority of the company's revenue, TBCL also exports more than one million tonnes of spent batteries each year, earning United States dollars (USD). Currently, Tropical Battery is wholly owned subsidiary of Dai Diverze Limited, a company incorporated in Jamaica, which in turn is a wholly owned subsidiary of Diverze Asset Inc. which is 60% owned by the Melville Family and 40% owned by Portland Private Equity. If shares from the IPO scheduled to open on September 22, 2020 are subscribed in full, Dai Diverze's shareholdings will be reduced to 75% while 10.8% will be owned by the general public, 5.5% by the broker, 5.4% by industry partners, 1.7% by their employees and 1.5% by strategic investors.

Financial Highlights

Total Revenues: The company experienced a compound annual growth rate (CAGR) of 14.73% in its top line between September 2015 and September 2019. For fiscal year ending (FYE) September 2019, revenues increased to J\$1.74B representing an 18.61% improvement over 2018. Whilst battery sales (81%) remained the primary revenue driver in 2019, the company generated just under 20% of its revenues from accessory and tyre sales (13%) and battery exports (6%). For the nine months ended June 2020, revenues were J\$1.36B compared to J\$1.25B for the same period in 2019. This was in spite of the business suffering significant disruptions during the months of March and April 2020 as a direct consequence of the containment measures implemented by the government to stem spread of the COVID-19 virus. TBCL saw its revenue decline by roughly 20% across both months; however, there was an uptick in business activity for the month of June coinciding with the loosening of the aforementioned containment measures. Revenues for June 2020 were up 48.6% versus the corresponding month in 2019.

Investment Opportunity Initial Public Offering (IPO)

Tropical Battery (TBCL)	IPO
Current Total Shrs/Out (MM)	1,137.50
Size of Offer (MM)	325.00
Total Upsized Offer (MM)	00.00
Max Total Shrs/Out	1,300.00
Offer Price	\$1.00

Pertinent Information/Dates

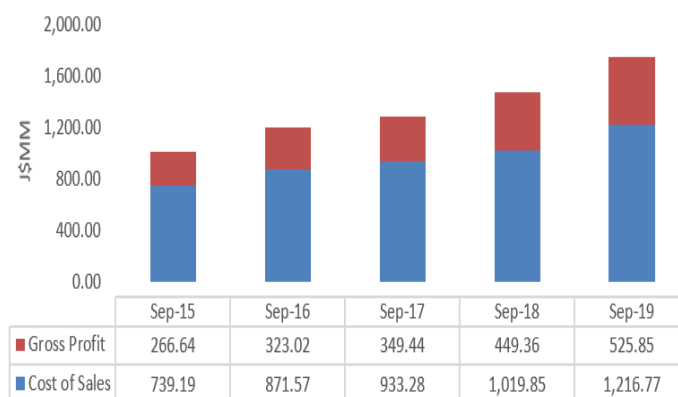
• Invitation Open Date	September 22, 2020
• Invitation Close Date	September 30, 2020

Reasons for Invitation/Use of proceeds

- New product lines, i.e. start-stop technology, lithium ion batteries and other renewable storage products.
- Expansion and renovation of retail stores.
- Expansion of parking at their number one retail store at Grove Road, St. Andrew.
- Completion of buildout of and relocating to a new warehouse, head office and retail store at Ferry.
- Acquire and install information technology systems.
- Expansion of Mobile/Home delivery fleet vehicles

TB's Financial Snapshot				
	Projected 2021	Trailing 12month	2019 (audited)	2018 (audited)
Net Revenue (\$M)	1,960.06	1,854.36	1,742.62	1,469.21
Revenue Growth	8.00%	6.41%	18.61%	14.54%
Dividend Yield	0%	0%	0%	0%
Return on Equity	6.49%	12.54%	11.5%	6.17%
EPS (\$)	0.06	0.06	0.06	0.03
Price/Earnings	16.33	16.63	N/A	N/A
Source: Company's data, SIJL estimates				

Revenue 2015-2019



Operating Expenses increased by 9.84% YoY to J\$411.58M in 2019 from J\$374.69M in 2018. Salaries and wages accounted for 51.89% of the total operating expenses, increasing by 14.76% YoY. For the nine months ended June 2020, operating expenses rose by 10.74% to J\$332.50M in spite of the company's cost management initiatives, which saw temporary adjustments to salaries between the months of April and June by: 10% for managers, 5% for supervisors, and 2.5% for all other staff. Operating expenses will likely continue to increase in the near term as the company seeks to improve their facilities.

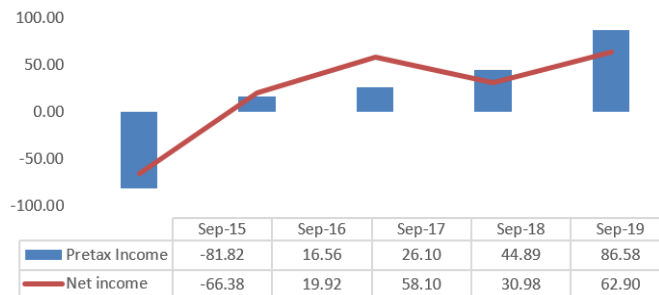
Cost of sales: TBCL incurred J\$1.22B in cost of sales during FYE 2019; this represented 19.31% increase YoY, whilst for the nine month ended June 2020 cost of sales were J\$937.76M compared with J\$871.39M in 2019. Cost of sales is primarily comprised of the cost to purchase and process inventory items such as batteries, oils, lubricants, tyres and other accessories. The company attributes the steady increase in cost of sales to the movement in the exchange rate which is particularly important since all of their batteries are imported. However, the company have been able to adjust their prices periodically to minimize foreign exchange risk. The CAGR between 2015 and 2019 was 13.27%.

Net profit rose to J\$62.9B in FY 2019 compared to J\$30.98M in FY 2018 reflecting a 103.29% increase YoY. Net profit margin improved from 2.11% in 2018 to 3.61% in 2019. For the nine months ended June 2020, net profit was J\$45.81M, 8.12% lower compared with J\$49.89M in the corresponding period of 2019. The decline in profits were attributable to disruptions in business activity as a result of the COVID-19 pandemic; this resulted in expense growth outpacing that of revenues. TBCL's profits grew by a CAGR of 46.71% between 2016 and 2019 which is noteworthy considering that in 2015 the company incurred a loss before tax of J\$82M with an after tax value of J\$66.38M. However, since then, the company has made a complete turnaround and has not only maintained profitability, but also achieve steady growth in its bottom line. TBCL attributes this to improvements on their management team, changes its inventory management, enhanced cash management and other cost management initiatives.

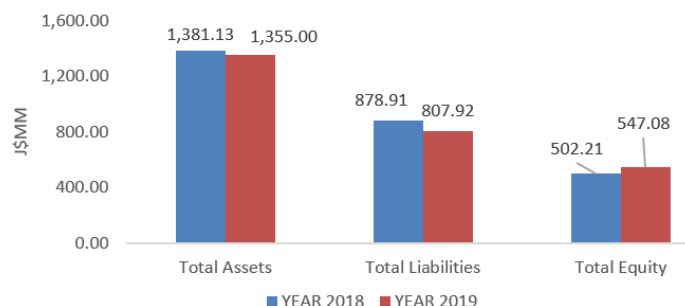
Total Assets:

As at FYE 2019, assets fell by J\$26.13M YoY to J\$1.36B reflecting a reduction in long term assets partially offset by an increase in short term assets. Current assets increased by J\$9.32M YoY to J\$1.18B in September 2019 comprising of a J\$64.66M increase in cash, a J\$28.33M decline in inventories and J\$33.22M reduction in payments owed from related parties. Long term assets fell by J\$35.44M to J\$171.21M due to a reduction in both deferred taxes and employee benefits of J\$10.92M and J\$18.12M, respectively. As at June 2020, assets fell by a further J\$56.9M to J\$1.3B compared to September 2019, largely due to the J\$82.97M reduction in payments owed by related parties,

PROFITABILITY



Financial Position YoY (2018-2019)



partially offset by moderate increases in assets both on the short term and long term component of the balance sheet. Total assets recorded a four-year CAGR (2015-2019) of 11.54%

Total Liabilities

As at September 2019, liabilities fell by 8.93% YoY to J\$807.92M which is mainly due to a reduction in long term loans. As at September 2018 the company incurred J\$654.82M in unsecured loans from their parent company, interest free, with no specified repayment date. By September 2019 the company repaid J\$359.57M and simultaneously authorized an interest bearing bond via private placement of J\$300M in secured notes at a rate of 7.5% which matures in April 2024. As at June 2020, liabilities were reduced by another J\$102.7M. This was mainly attributable to a further decline in unsecured related party loans. The company's liabilities have reduced by a CAGR of 2.34% between 2015 and 2019.

Total Shareholder Equity

Total shareholder's equity grew by 8.93% YoY to J\$547.08M as at September 2019 compared to J\$502.21M as at September 2018 primarily due to a J\$44.87M increase in retained earnings during FY 2019. For the nine months ended June 2020 shareholder's equity grew by a further J\$45.81M, reflecting retained earnings from net profits.

Investment thesis:

Technology: The company aspires to be one of the most efficient and data driven company in the battery sales industry by strategically leveraging information technology in all aspects of their business. They are currently focusing on strengthening certain systems such as customer intelligence and relationship management, fully automated warehouse management systems, and reporting & analysis (business intelligence). For the foreseeable future, TBCL plans to continue to partner with suppliers to deliver new and improved batteries, tyres and automotive products.

Strong management: Tropical Battery has an experienced management team which has contributed to the growth and success of the organization. The company states that within the last five years there have been major improvements in the business performance due to management's efforts to turn the company around.

Strategic Growth: Tropical Battery strives to differentiate itself through quality product offerings and technical expertise. The company states that they were able to increase market share of batteries sold in Jamaica by tapping into various consumer price points. In FY 2014, the company introduced a unified sales and pricing strategy called "Good, Better, Best, providing a battery for every budget". This allowed TBCL to colour-code the batteries according to their capacity and warranty protection, and set prices accordingly, and after five years, this strategy has proven to be successful. The future growth will see the company adding new product lines such as renewable energy batteries.

Tax Incentive (10 year): If the company gets approval to be listed on the Jamaica Stock Exchange, they will take advantage of the special concessionary tax regime. Within the first five years profits will be exempted from taxation and 50% exemption for the next five years provided that they meet the ongoing junior market requirements for at least 15 years from date of listing. These funds could be used to launch projects in the pipeline such as the expansion and renovation of their stores among other planned initiatives.

Mobile Response: The company understands the needs of their customers and as such offers roadside assistance including jump starts, battery and electrical system diagnostics and new battery installation. For the nine month period ended June 2020, Mobile Sales were up 185.4% compared to the comparable period for FY2019

ESG Consideration: Tropical Battery is a licensed exporter of spent batteries and a National Environment and Planning Agency (NEPA) registered collection centre for spent batteries. Tropical Battery ensures that all used batteries are disposed of in an environmentally friendly way by collecting spent batteries and exporting them to licensed recycling plants. This is approved by NEPA and the environmental protection agencies of the countries where the recycling facilities are located.

Key Risk:

COVID-19: The pandemic created a slowdown in business activity earlier in the year. Revenues fell by as much as 20% in March 2020 and April 2020 when compared with the same months in the corresponding period of 2019. The recent resurgence of the virus could lead to another fall-off in business activity which may impact the company's ability to meet revenue and profitability targets.

Competition: The company operates in a highly competitive environment as there are low barriers to entry and exit. TBCL will rely on the strength of their brand and the loyalty of their customer base since more companies are vying for a share of the market. The company seeks to maintain its market position with quality products, strong warranty support, a good distribution network and experienced knowledgeable staff.

Foreign exchange risk: Most of the company's products are purchased from international suppliers and therefore payments are settled in USD. During the April-June quarter the Jamaican Dollar (JMD) experienced devaluation versus the USD making it more costly to purchase these products. Given that Tropical Battery quotes their prices in JMD for goods sold to its customers, the company is exposed to foreign exchange losses as they may not be able to adjust prices in line with the pace of the devalued currency.

Electric Vehicles (EV): Based on a study done by Bloomberg, automakers are accelerating their EV launch plans, partly to comply with increasingly stringent environmental regulations in Europe and China. COVID-19 will delay some of these ventures, but by 2022 there will be over 500 different EV models available globally. Consumer choice and competitive pricing will be key to attracting new buyers to the market. Expectations are that hybrids will play a role over the next ten years before fading as pure electronics continue to get cheaper. Presently, the company's core product is lead acid batteries. Ultimately, the company will have to venture into supplying lithium ion batteries for electric cars and possibly installing metered charging stations in public parking lots.

Outlook

With the resurgence of COVID19 cases there is a possibility of the reintroduction of a raft of containment measures, including a government work from home order. If the latter measure is reintroduced, TBCL could experience a similar slowing of its business activity and revenues as it did when the measure was implemented at the onset of the pandemic. While the company was able to reduce operating expenses through temporary wage cuts earlier in the year, TBCL may be forced to consider more far-reaching initiatives if the crisis deepens.

Given TBCL's business model, foreign exchange risk is likely to remain a prominent concern in the medium term, as supply and demand imbalances in that market will continue to fuel heightened levels of volatility which will likely result in increased cost of sales and reduced margins. The company plans on "hedging" the USD by buying when the JMD has appreciated in value against the currency to offset some of the cost of importing batteries from the international markets, hence their current strategy focuses more on the timing of the exchange rate appreciation/devaluation which is unlikely to remain sustainable. Consequently, we expect cost of sales to remain high and susceptible to exchange rate volatility until a more appropriate hedging strategy is implemented.

If the offer is successful and the company is listed on the Jamaica Stock Exchange, they will be exempt from taxes for the first five years. While this augurs well for the company's margins in the short term, sustained improvement in operating profit margins will depend on the effective execution of its strategy to reduce administrative and other operating costs. If the strategies fail to improve efficiency, then growth in earnings per share will likely be due to the tax concession as opposed to sustained improvement in profit margins.

Indications are that over the long-term, lead acid batteries are likely to become less prevalent as consumers transition into electric vehicles powered by lithium ion batteries, which transmits less pollutants in the atmosphere. TBCL, having recognized the impending shift, is pursuing the development a lithium ion battery product line with its manufacturing partners supported the proceeds of the IPO. However, in light of the high development costs associated with these batteries, TBCL may need to supplement the proceeds of the IPO in order to effectively execute this strategy. Notwithstanding this concern, the shift towards lithium ion batteries will remain a key strategic objective for TBCL.

Valuation and Recommendation

Using a combination of the Free Cash Flow to Equity (FCFE) and Relative Valuation models equally weighted. We derived a sustainable long term growth rate of 6%. With an estimated Beta¹ of 0.99, a risk free rate of 4.97% and an estimated cost of equity of 12.72%. This resulted in a **fair value of \$0.80**. Based on a relative valuation model, with a 1-yr forward P/E of 16.63x, P/S of 0.61x and a P/B of 1.92X with equal weighting we obtained a, **target price is \$0.98**. Based on the above valuation, we believe the offer is overvalued at **\$1.00** and therefore we **DO NOT** recommend participation in this IPO.

¹ Beta derived by using peers listed on the Junior Market and was unlevered and re-levered to reflect the financial leverage of Tropical Battery.

General Disclosures:

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APPENDIX

As at the date of issue of this Prospectus, the holdings of Shares in the capital of the Company (including legal and, where known to the Company, beneficial holdings) were as follows:

Name of Shareholder	Number of Shares before Opening Date of Invitation	% of Issued Shares before Opening Date of Invitation
Dai Diverze (Jamaica) Limited	1,137,500,000 Ordinary Shares	100%
Total Issued Share Capital	1,137,500,000 Ordinary Shares	100%

After the subscription lists for the Invitation are closed, and assuming that the Invitation is fully subscribed by the public and also, by the Reserved Share Applicants, the percentage shareholdings in the Company will be as follows:

Name of Shareholder	Number of Shares after Opening Date of Invitation	% of Issued Shares after Opening Date of Invitation
Dai Diverze (Jamaica) Limited	975,000,000	75.0%
Tropical Battery Employees	22,500,000	1.7%
Industry Partners	70,000,000	5.4%
Strategic Investors	20,000,000	1.5%
Broker	75,000,000	5.6%
Public	137,500,000	10.8%
Total Issued Share Capital Following Invitation	1,300,000,000	100%

Use of Proceeds

The proceeds of sale of the Shares being sold by the Selling Shareholders (\$162,500,000.00) would accrue to the benefit of the Selling Shareholders and not to the Company.

The Company intends to use the balance of the proceeds of the Invitation of J\$162,500,000.00 for expansion and working capital purposes including, but not limited to, the following:

1. New product lines, i.e. start-stop technology, lithium ion batteries and other renewable storage products, tyres, lubricants, etc.
2. Expansion and renovation of retail stores.
3. Expansion of parking at our number one retail store at Grove Road, St Andrew.
4. Completion of buildout of and relocating to our new warehouse, head office and retail store at Ferry, which is located on the busiest motorway in Jamaica.
5. Acquire and install information technology systems which will give us greater efficiency and improve our customer experience.
6. Expansion of our Mobile/ Home delivery fleet of vehicles.