

GraceKennedy Limited

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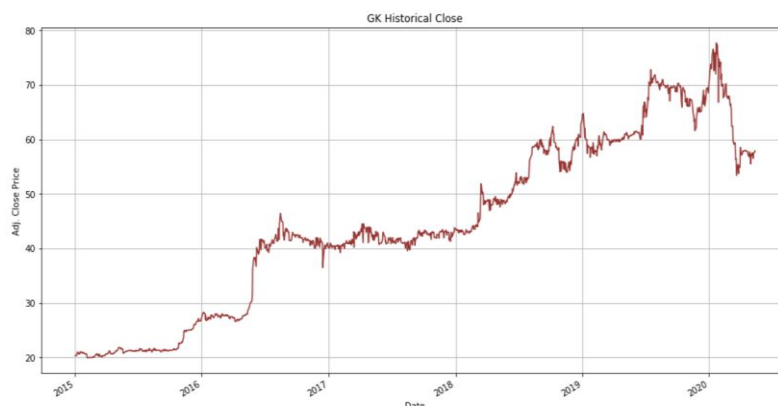
Executive Summary

GraceKennedy Limited (GK) was founded on February 14, 1922 and is listed on both the Jamaica Stock Exchange and the Trinidad & Tobago Stock Exchange. GK is structured into two primary divisions, namely **Food Trading** and **Financial Services**. The Financial Services division is further divided into four segments Food Trading, Banking & Investments, Insurance and Money Services. For the three months ended March 2020, Food Trading generated the majority of GK's revenue, \$23.45 billion or 81.28%. However, the Money Services segment is a significant contributor to operating profits, generating \$841.63 million or 40.17% for the same period.

Food Trading (GK Foods) operations include food manufacturing, distribution of Grace and Grace-owned brands locally and internationally and operation of retail outlets. GK Foods has operations in several countries including Jamaica, Central America, North America, Africa, the United Kingdom, and several European countries. Financial Services operates in the commercial banking, general insurance, insurance brokerage, investment banking, remittance, cambio and payment services business. **The majority of FY 2019 revenue was generated in three geographic locations, namely Jamaica (55.69%), North America (24.99%) and Europe, including the UK (12.51%).**

We expect steady long-term growth for GK going forward in line with recent history. Furthermore, we expect growth in FY 2020 aided by GK's strong Q1 performance, due to its main revenue and operating profit generators being relatively resilient despite the COVID-19 pandemic. Furthermore, GK is a net earner of foreign exchange and has net foreign assets therefore the devaluation of the J\$ versus US\$ is a net positive for GK's earnings.

GK currently trades at approximately 11.8x trailing 12-months EPS roughly in line with its 5-year average of 11.2x. The company is a dependable dividend payer with an average payout ratio of 28.6% for the period FY 2015 to FY 2019. **Of note since FY 2015 GK has paid dividends three times a year in May, September and December.**



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Recent Developments

In Q1 ended March 2020 revenue rose 11.28% or \$2.93 billion to \$28.85 billion. Meanwhile, profits attributable to GK shareholders increased by 46.88% or \$420.57 million to \$1.32 billion. Operating performance in the quarter was aided by growth from the Food Trading and Money Services segments but curtailed by declines in the Banking & Investment and Insurance segments. Operating profit from the Food Trading segment surged \$449.51 million or 59.79% to \$1.2 billion. Meanwhile, operating profit from the money services segment surged \$198.04 million or 30.77% to \$841.63 million.

Also, of note GK completed its acquisition of 65% of the issued shares of Key Insurance Limited in March 2020.

Key Financial Data

	2015	2016	2017	2018	2019	CAGR	3M 2019	3M 2020	Change
BVPS	38.32	42.28	45.46	44.84	52.59	8.23%	45.98	52.78	14.78%
EPS	2.78	4.04	4.15	5.04	4.51	12.86%	0.90	1.32	47.14%
Dividend per share	0.83	1.02	1.13	1.35	1.55	16.98%	-	-	N/A
Adj. Close Price	27.08	40.29	43.84	63.50	69.43	26.54%	59.75	58.54	-2.03%
JSE Main Market Index	150,692.13	192,276.64	288,381.97	379,790.86	509,916.44	35.63%	388,276.91	379,242.11	-2.33%
Revenue	79,742,230	88,267,589	92,475,652	97,544,731	103,089,893	6.63%	25,928,837	28,854,756	11.28%
Operating Profit	4,364,174	5,966,759	5,619,235	6,626,524	6,259,213	9.43%	1,199,341	1,922,000	60.25%
Other Income	1,571,132	2,383,733	2,088,006	3,486,010	2,520,212	12.54%	314,251	641,212	104.04%
Share of Profit from Associated Company	316,191	441,151	484,972	490,873	518,887	13.18%	254,567	233,630	-8.22%
Pre-tax Profit	4,303,813	6,103,330	5,819,562	6,963,025	6,127,595	9.23%	1,320,944	1,989,873	50.64%
Profits	2,759,498	4,004,539	4,116,101	5,005,915	4,487,389	12.93%	897,048	1,317,621	46.88%
Non-Current Assets	44,305,021	49,759,309	54,022,347	54,207,449	70,961,261	12.50%	60,851,870	73,142,693	20.20%
Current Assets	64,388,423	76,719,840	75,966,293	81,027,951	83,744,620	6.79%	80,092,648	85,927,447	7.29%
Total Assets	108,693,444	126,479,149	129,988,640	135,235,400	154,705,881	9.23%	140,944,518	159,070,140	12.86%
Non-Current Liabilities	35,213,147	41,800,819	45,356,018	41,141,782	43,164,573	5.22%	40,596,851	46,171,176	13.73%
Current Liabilities	34,107,245	41,139,722	37,620,509	47,404,226	56,829,621	13.61%	52,410,206	57,693,674	10.08%
Total Liabilities	69,320,392	82,940,541	82,976,527	88,546,008	99,994,194	9.59%	93,007,057	103,864,850	11.67%
Debt	13,936,107	13,242,037	16,515,615	16,529,313	24,032,254	14.59%	23,889,025	24,853,491	4.04%
Equity	38,047,441	42,063,925	45,222,812	44,614,427	52,326,410	8.29%	47,937,461	55,205,290	15.16%
Ratios						Average			
Operating Margin	5.47%	6.76%	6.08%	6.79%	6.07%	6.23%	4.63%	6.66%	44.00%
Net Profit Margin	3.46%	4.54%	4.45%	5.13%	4.35%	4.39%	3.46%	4.57%	31.99%
Current Ratio	1.89	1.86	2.02	1.71	1.47	1.79	1.53	1.49	-2.54%
Inventory Turnover	4.17	4.43	4.44	4.50	4.29	4.37	N/A	N/A	0.00%
Receivables Turnover	6.92	6.99	6.26	6.28	6.62	6.61	5.66	5.60	-1.08%
Debt-to Equity	36.63%	31.48%	36.52%	37.05%	45.93%	37.52%	49.83%	45.02%	-9.66%
ROE	7.40%	10.00%	9.43%	11.14%	9.26%	9.45%	9.67%	10.01%	3.52%
ROA	2.62%	3.41%	3.21%	3.77%	3.10%	3.22%	3.34%	3.40%	2.06%
P/E	9.74	9.97	10.56	12.60	15.39	11.65	11.86	13.68	15.34%
P/B	0.71	0.95	0.96	1.42	1.32	1.07	1.12	1.31	16.93%
Dividend Payout Ratio	29.71%	25.14%	27.16%	26.72%	34.30%	28.61%	44.35%	56.54%	27.49%
Dividend Yield	3.80%	2.83%	2.71%	2.59%	2.41%	2.87%	0.67%	1.28%	91.46%
JSE Main Market Performance	97.36%	27.60%	49.98%	31.70%	34.26%	48.18%	2.23%	-25.63%	N/A
GK Stock Performance	33.13%	48.76%	8.81%	44.84%	9.34%	28.98%	-5.91%	-15.68%	165.60%

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Financial Overview

Revenue has consistently improved at a compounded annual growth rate of 6.63% for the period FY 2015 to FY 2019 (period under review). Food Trading has been the primary contributor to revenue growth, increasing at a CAGR of 6.77% from \$62.67 billion in FY 2015 to \$81.44 billion in FY 2019. The second-largest contributor to revenue is money services, but it only provided 7.67% of FY 2019 revenue. However, for FY 2019 money services supplied 44.39% of operating profits exceeding the 31.66% contributed by the Food Trading segment. For FY 2019 profits attributable to GK shareholders fell 10.36% or \$518.53 million to \$4.49 billion. **The primary reason for the decline was an extraordinary gain on the disposal of investments in FY 2018 of \$1.07 billion.**

Meanwhile share of results from associates continues to climb steadily, reaching a record of \$518.89 million in FY 2019, an increase of 5.7% y-o-y. GK's associated companies at the end of 2019 include Dairy Industries (Jamaica) Limited, CSGK Finance Holding Limited, Catherine's Peak Bottling Company and Canopy Insurance Limited. GK has a 50% stake in Dairy Industries (Jamaica) Limited, which is the main contributor to share of results from associates, generating \$745.44 million in pre-tax profit in FY 2019. The second-largest contributor to share of profits from associates is CSGK in which GK has a 40% stake, and it generated a pre-tax profit of \$345.56 million in FY 2019. CSGK is a finance company with principal activities, through its wholly-owned subsidiary Signa Finance Group Inc. Signa Finance activities include provision of term finance, motor vehicle leasing, acceptance of deposits, foreign exchange dealing, and stock brokering incorporated under the laws of Barbados.

Total Assets have increased at a CAGR of 6.79% for the period under review to \$154.71 billion. **The most significant assets at the end of FY 2019 are Investment Securities and Loans Receivables which constitute 19.82% and 19.83% of total assets, respectively.** As at December 2019, \$13.16 billion is invested in GOJ securities of the \$39.89 billion in investment security holdings. Total liabilities have increased at a CAGR of 9.59% to \$99.99 billion at the end of FY 2019. The primary reason for the increase in total liabilities is bank & other loans surging \$7.50 billion y-o-y. Debt has grown at a CAGR of 14.59% for the period under review, escalating \$7.5 billion or 45.39% in FY 2019 to \$24.03 billion. **However, of note the increased in debt is due to lease liabilities from the adoption of IFRS 16.**

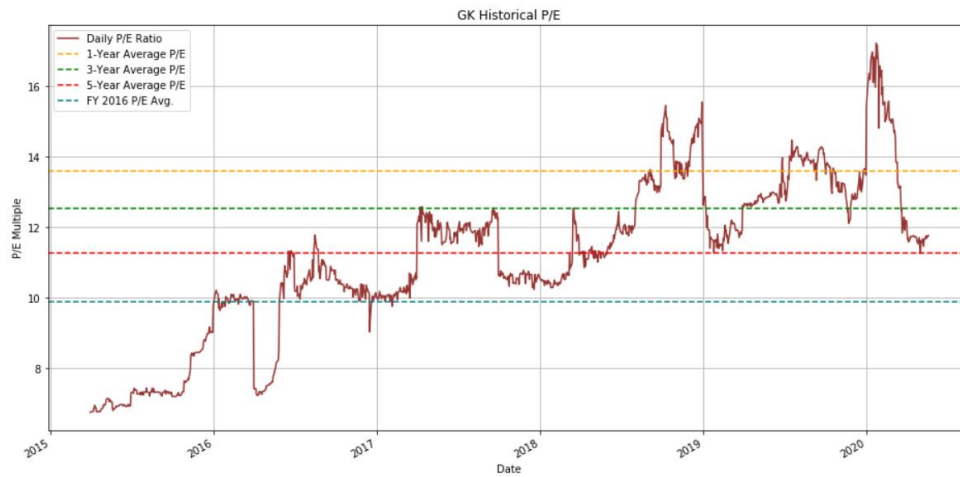
Operating profit margin peaked in FY 2018, due to a surge in other income from the disposal of investments. Meanwhile, GK's current ratio has remained relatively high, averaging 1.79x for the period under review indicating that short-term liabilities can be readily met but declined to a low of 1.47x in FY 2019. **Debt-to-Equity has averaged 37.52% for the period under review but surged to 45.93% at the end of FY 2019, due to IFRS 16 adoption.** While the current debt-to-equity ratio is manageable in our view, given GK'S consistent profitability if this trend continues, it will elevate the risk of the company. DuPont analysis of ROE reveals the reduction was due to a lower profit margin and total asset turnover. Meanwhile, P/E and P/B ratios have expanded consistently for the period under review. P/E expansion was due to the stock price increasing at a CAGR of 26.54% while earnings only grew at a CAGR of 12.93% for the period under review.

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Forecast and Valuation

We used the relative value method to derive our price target of \$55.02. Inherent to our price target is the assumption that investor expectations towards GK remain in line with the last 5-years. We view this assumption as fair, given our expectation of steady earnings growth. **Our upper price target of \$67.80 uses a combination of 1-year historical 52-week P/B and P/E ratios and our FY 2020 forecast of EPS and BVPS. We applied a similar method to FY 2016 historical average P/E and P/B ratios to arrive at the lower price target of \$48.20.** GK could drift towards our lower-end price target if sentiment towards the company continues to decline. However, we see this as unlikely if GK can meet our conservative estimate of FY 2020 EPS. Meanwhile, GK could move towards the upper end of our price target if investor sentiment turns bullish. However, we see this as unlikely, given the current economic environment.



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Ticker	Market Cap(\$M)	P/E	P/B	ROA	ROE
GK	57,472.94	11.71	1.09	3.27%	9.99%
PJAM	80,272.42	10.82	1.98	14.34%	19.61%
JP	21,439.68	17.96	1.52	3.19%	9.06%
Average	53,061.68	13.49	1.53	6.93%	12.89%

Outlook

Our outlook on GK's near-term performance is positive. The company's primary sources of revenue and profit are resilient to the current global pandemic. Furthermore, GK is a net foreign exchange earner; therefore, rapid devaluation seen in Q2 FY 2020 is a net positive for GK. **Since the beginning of Q2 to-date the depreciation of the J\$ relative to the US\$ is unusually high, corresponding to levels last seen in Q4 2008 and Q1 2009.** Long-term, we expect the company to steadily improve profits attributable to GK shareholders in line with its historical performance for the period under review driven by a mix of acquisitions and organic growth. We see the Canopy joint venture as a potential avenue for material earnings growth in the medium to long-term. **However, given the market dominance of the notable players in the group life insurance industry, we are cautiously optimistic.**

Key Risks to Our Price Target

The main risk to our price target is a decrease in pre-tax profits earned by GK Money Services (GKMS). While in Q1 2020 the money services segment produced strong growth for the period under review it has increased at a CAGR of 6.73%. Given the significance of this segment to operating profit growth, a decline could have a deleterious effect on GK's growth. Furthermore, threats to this segment from new technologies and increased regulation pose an issue. In FY 2017 GKMS and Western Union temporarily suspended operations at 10 locations, and by year-end, eight were reopened. The suspension of end operations was due to GK's need to increase oversight. Furthermore, a decline in remittances could materially impact GK earnings.

Recommendation:

We recommend a HOLD rating on GK at this point given that the stock trades in line with our price target. GK's market dominance in several market segments has proven resilient in the current economic environment. While the Banking & Investments and Insurance segments produced weak results in Q1 2020, it was outweighed by the strength of the Food Trading and Money Services segment. Furthermore, we forecast a steady increase in GK's earnings in 2021 and beyond following a strong FY 2020.

Source: <http://www.Jamstockex.com>, **JMMB Investment & Research, Bloomberg, Various Company Financial Statements.**

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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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