Company Analysis: GraceKennedy Group Limited (GK)

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- Recommendation: **BUY**
- Price Target: $73.83
- Current Price: $65.35 [1]

- Shares Outstanding: 994,916,483 units
- Market Value of Shares Outstanding: $billion[1]
- Financial Year End: December 31

ABOUT THE COMPANY

GraceKennedy Limited (GKL), founded is February 1922, is a publicly listed company on both the Jamaica and Trinidad and Tobago Stock Exchanges. GKL is the parent company of the GraceKennedy Group.

The group operates through two main divisions: food trading and financial services. The Food Trading division, GK Food Services is responsible for the merchandising of general goods and food products both locally and internationally. It is also responsible for the processing and distribution of food products and the operation of the Hi-Lo chain of supermarkets. The Financial Services division has 3 categories Banking and Investments, Insurance and Money Services. The group also has partial ownership in the following subsidiaries: Dairy Industries (Jamaica) Limited, CSGK Finance Holdings Limited, Catherine's Peak Bottling Company Limited and GKMusson Limited.

FINANCIAL PERFORMANCE

	2015	2016	2017	2018	2019
Sales ($ M)	660.4	761.7	871.7	1,041.5	1,113.7
Gross Profit ($ M)	116.7	251.7	276.3	400.0	361.6
Net Profit ($ M)	31.7	68.9	68.7	219.2	141.4
Earnings Per Share ($)	0.40	0.72	0.67	2.12	1.37
Gross Profit Margin (%)	25.3	33.0	31.7	28.4	32.5

Outlook

We hold a positive outlook for GK as it begins a face a cost containment and improve efficiency. We believe that the company will benefit in the medium term from improved margins, reduced expense volatility along with expansion through both organic and inorganic means.

Projections and Valuations

Using a Discounted Cash Flow Valuation method and a required rate of return of 17.06%, we arrived at a fundamental value of GK of $73.83.

Risks to Price Target

A slowdown in the global economy as a result of the coronavirus is one of the most prominent short term risks the company currently faces due to changes in supply and demand. On the other hand, if the new mergers and acquisitions team is successful in finding inorganic growth opportunities for the group, the return to shareholders will be greater than anticipated.

[1] As at March 5,2019

FINANCIAL PERFORMANCE

	2015	2016	2017	2018	2019
Revenues ($ Bn)	79.7	88.3	92.5	97.5	103.1
Expenses ($ Bn)	76.9	84.7	88.9	94.4	99.4
Net Income ($ Bn)	3.3	4.5	4.8	5.6	5.1
P/E (x)	9.73	9.97	10.56	12.57	
EPS ($)	2.78	4.04	4.15	5.05	4.51
Total Assets ($ Bn)	108.7	126.5	130.0	135.2	154.7
Current Ratio	1.36	1.34	1.38	1.32	1.24
Net Profit Margin (%)	4.1	5.1	5.2	5.8	4.9

FOR THE LAST FIVE (5) YEARS:

The GraceKennedy Group has continued to strengthen its performance over the past few years achieving its 2022 goal of becoming a $100 billion company 2 years before schedule. Revenue increased over the last 5 years at a CAGR of 6.8% from $79.7 billion to $103.1 billion in 2019. This is attributable to Revenue growth in all operating segments. Profitability increased over the period as measured by the Net Profit Margin increasing from 4.1% in 2015 to 4.9% in 2019. There was a fall in profitability in 2019, however, due to an increase in non-cash expenses associated with the implementation of IAS 19, a new accounting standard that details the treatment of pension benefits. Net income increased at a CAGR of 11.9% from $2.8 billion to $5.1 billion.

GK's Insurance segment grew the most by 8.1% versus Food Trading and Banking and Investment which experienced a CAGR of 6.7% and 5.2% respectively. In 2018, the group, in collaboration with Musson Group launched a joint venture now known as Canopy Insurance. This Insurance company was created to take advantage of new and developing technologies in the health insurance sector to provide greater service to its customers. The Money Services division feared the worst with a CAGR of 4.7%. During the period GK experienced challenges in this segment due to the enforcement of risk and compliance measures which stunted growth.

Total assets have increased by 42.3% from $108.7 billion to $154.7 billion. The increase was attributable to a 181.8% increase in Fixed Assets, a 47.7% increase in Cash, 40.9% increase in Investment Securities and a 35.8% increase in Loans Receivable. The increase on the balance sheet was funded by a 44.2% increase in Total Liabilities and a 39% increase in Equity. The increase in Liabilities was caused by a 47.6% increase in Customer Deposits, and a 72.4% increase in Bank and Other Loans, slightly offset by a decrease in Securities Sold under Repurchase Agreements.

Over the period, profitability increased. The Net Profit Margin improved from 4.1% in 2015 to 4.9% in 2019 and Return on Equity increased from 8.4% to 10.1%. The group has maintained adequate liquidity levels as its Current Ratio has averaged 1.33x over the period.

OUTLOOK:

During the 2020 financial year, the management of GK intends to focus on increasing efficiency and profit margins along with expansion of the group.

Improved Margin Management and Efficiency for Greater Profitability

The company has plans to reduce its expenses and losses in several ways. In the food trading segment, GK will implement better margin management to increase the amount of revenue that flows through to the bottom line. The Food Manufacturing and Distribution industry structurally has lower margins, however, GK plans to implement new strategies to overcome some of these hurdles and improve profitability. Additionally, the group plans to better leverage technology to become more efficient. Some of the other cost saving strategies include improved management of foreign exchange volatility as well as finding measures to reduce the effect of the newly implemented IAS 19, which cost the company $1.2 million in 2019.

Expansion of Products and Services in all Segments

The group plans to expand the products and services it offers in all of its operating segments. Signia Global, a Barbadian bank associated with the group, has plans to expand its footprint to the wider Caribbean. This will increase the company's customer base and revenue, thus increasing GK's income. In Insurance, the group will be acquiring up to 80% of Key Insurance Company, a local General Insurer. On acquisition, the group will combine the business of Key Insurance and the group's own general Insurance company, GraceKennedy General Insurance, in order extract synergies and make this segment more profitable. Canopy Insurance, the groups joint venture with Musson, is also reported beating the expectations of management and is expected to continue this track. Within Money Services, the group will digitize the way money is transferred offering multiple channels to its customers. As the industry for digital money transfer is growing at a much quicker rate than traditional money transfer, GK Money Services is expected to have greater growth on implementation of this service.

Growth Is Expected Through Mergers and Acquisitions

The group has noticed opportunities where it can either merge its operations with another company or acquire another company's operations for further expansion and growth. In order to adequately capitalize on these opportunities, the company is forming its own Mergers and Acquisitions unit. This team's focus will be placed on identifying inorganic group opportunities for the group allowing it to expand and achieve its future target.

A Slowdown in the Global Economy will Have Negative Effects on The Group

Since the start of 2020, the coronavirus, which originated in China, has spread exponentially worldwide and is expected to have a severe impact on the global economy. This virus can affect GK in terms of both demand and supply. In terms of demand, consumers have adopted stockpiling and hoarding tendencies inducing an artificially heightened level of demand. This heightened demand has caused many companies to increase production to keep shelves stocked. In response, many companies have increased production to keep up with this spike in demand. However, there are other factors outside of the company's control that can impact supply. These include availability of raw materials, a reduced labour force due to sickness as well as challenges with distribution. GK has noted that if necessary, it may have to change its current supplies which will incur higher costs.

INVESTMENTS POSITIVES:

- GK has the capacity to continue expansion of their product and services in accordance with their customers' needs as well as the general market.
- GK is a well-known brand by many both locally and internationally.
- The geographic diversification of the company's markets reduces the risks associated with weakness in any one market
- GK has implemented a quarterly dividend policy

INVESTMENT NEGATIVES

- Grace conducts business internationally and is therefore subjected to the volatility of the exchange rate which can negatively affect revenue and profits.
- The majority of GK's products are not unique and therefore face significant of competition from products and services of similar price and quality.
- A slowdown in the global economy is likely to reduce GK's profits.

CONCLUSION

We hold a positive outlook for GK's operations. We believe that the group will be effectively managed to reduce expenses, manage volatility and thus increase the company's return to shareholders. Currently, with the outbreak of the coronavirus, the Food Trading segment faces heightened risks of supply disruption as well as decreased demand if the global economy slows. Nonetheless, the group has implemented measures to adequately mitigate these risks.

Considering the company's historical performance and its future objects, we used a discounted cash flow model to derive the company's intrinsic value of $73.83 implying a forward P/E of 14.62x. This target price represents a 12.97% price appreciation from current levels; therefore, we recommend GK as a **BUY.**

SOURCES

The Jamaica Stock Exchange, GraceKennedy Group Annual Report and Audited Financial Statements

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