Company Analysis: Kingston Wharves Limited (KW)

VMWM Research and Stockbroking | September 10, 2020

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- Recommendation: UNDERWEIGHT
- Price Target: $41.43
- Current Price: $46.45

- Shares Outstanding: 1,430,199,578 units
- Financial Year End: December 31

ABOUT THE COMPANY

Kingston Wharves Ltd. (KW) is a publicly listed company on the Jamaica Stock Exchange that operates from Newport West, Third Street, Kingston Jamaica. It is recognized in the Caribbean as one of the top multi-purpose port terminal operators in the region and offers cargo handling and logistics services which include: equipment rental, mooring and unmooring of vessels, storage and warehousing and stripping and stuffing containers.

The company has garnered several awards over the years, most notably the "Multi-purpose Terminal of the Year" Award for 2006, 2007, 2009 and 2013 by the Caribbean Shipping Association (CSA). KW has over a decade of steady performance and has expanded its operations to become a major player in the logistics industry. The company envisions establishing Jamaica as a major logistics hub, taking advantage of its location to facilitate increased traffic flow through the Panama Canal. It is anticipated that if this occurs, the increased traffic coming through Jamaica's ports would be economically beneficial, not only for our biggest multi-purpose port operator but for the overall Jamaican economy.

FINANCIAL PERFORMANCE

(JMD '000)	2018	2019	2019 (6M)	2020(6M)
Revenue	7,253,571	7,898,207	3,802,209	3,352,120
Gross Profit	3,500,491	4,044,303	1,957,411	1,788,264
Net Income Att. To Parent	1,945,450	2,600,817	1,181,612	1,043,855
Total Assets	31,456,820	32,580,694	32,871,064	32,736,311
Total Liabilities	6,549,688	5,809,321	7,031,163	5,404,380
Equity Attributable To Parent	24,765,896	26,593,460	25,270,176	27,270,176

Dividend Policy

KW does not have a stated dividend policy. However, the company maintains steady dividend payments to shareholders. Over the last five years, KW paid out on average 29% of net income to Shareholders via dividend payments.

Outlook

We see KW having growth potential in the medium to long-term as the global shipping industry emerges from the impact of Covid-19. We expect recent investments to contribute positively to the company's operating efficiency. Moreover, KW's revenue should improve through synergies between its terminal operations and its logistics services. The transshipment and storage of automobiles, bulk and breakbulk cargo looks to have further growth potential for the company as well. Additionally, the company's capital base and liquidity remain strong, positioning the company for resilience throughout the crisis.

Projections and Valuations

We assumed that revenues and shareholder's equity would grow to $9.5 Billion and $30.2 Billion for the FY 2021 resulting in an EPS and BVPS of $1.98 and $21.15, respectively. We used a discounted cash flow model with a cost of equity of 14.94% to arrive at a price target of $41.43.

Risks to Price Target

If KW experiences challenges with its IT framework that adversely impacts its ability to operate efficiently and grow its bottom line, or if Jamaica is not able to attract more activity to the ports due to competition from other regional players, the company may not perform as anticipated and the price target may not be attained. Also, if the current pandemic persists for more than a year then our projection may have to be revisited.

FOR THE LAST FIVE (5) YEARS:

(JMD '000)	2015	2016	2017	2018	2019	2020 (P)	2021(P)
Revenues	4,672,884	5,409,801	6,369,238	7,253,571	7,898,207	8,293,117	9,537,085
Direct Cost	2,525,895	2,897,704	3,310,521	3,753,080	3,853,904	4,188,024	4,673,172
Gross Profit	2,146,989	2,512,097	3,058,717	3,500,491	4,044,303	4,105,093	4,863,913
Net Income (Attributable to Parent)	1,256,397	1,312,787	1,647,496	2,026,685	2,600,817	2,375,167	2,837,843
Shareholder's Equity (Attributable to Parent)	17,574,154	18,540,246	22,981,794	24,765,896	26,593,460	28,256,077	30,242,567
Earnings Per Share	$0.88	$0.90	$1.14	$1.36	$01.82	$1.66	$1.98
Book Value Per Share	$12.23	$12.96	$16.07	$17.32	$18.59	$19.76	$21.15
Return on Average Equity	7.29%	7.18%	7.84%	8.15%	10.17%	7.62%	8.41%
Net Income Margin	27.12%	24.27%	25.87%	27.18%	33.39%	29.08%	30.21%

Kingston Wharves Ltd. earns revenues from the following services: storage and warehousing, mooring and unmooring of vessels, storage and warehousing stripping and stuffing containers. Revenues have grown by a CAGR of 15.6% between 2014 and 2019. This came mainly from terminal operations which accounts for more than 70% of revenue annually. Revenue from terminal operations grew by 74% over the five-year period which is attributable to the significant growth in KW's motor vehicle business, as well as higher than anticipated volume in break bulk services. On the other hand, direct costs grew at a slower pace than revenues over the period, at a CAGR of 12.4% between 2014 and 2019. This led to gross profit growing at a faster pace than revenue, achieving a CAGR of 19.4%. This resulted in an improvement in the company's gross profit margin by over 5 percentage points over the review period (46.0% in 2014 to 51.2% in 2019). Operating profits grew at an even faster pace, with a CAGR of 22.1%, due primarily to an only 8.6% average annual increase in administrative expenses over the last five year. KW's Net Income grew by 33.4% between 2018 and 2019, 8.0% higher than five-year CAGR of 25.4%.

Total Assets grew by a CAGR of 9.2% over the 5-year period, mainly due to increases in property, plant and equipment, retirement benefit assets and short-term investments. This primarily reflects investments geared towards the pursuit of readiness to facilitate the operation of a regional logistics hub. There was also an increased emphasis on technology in improving overall efficiency in the delivery of service to its customers. Increases in borrowings, deferred tax liabilities, retirement obligations and trade and other payables contributed to total liabilities to growing by a CAGR of 7.9%.

The company has strengthened its financial position over the review period, with their current ratio improving to 3.44x in 2019 from 2.68x in 2015. Additionally, the quick ratio increased to 3.24X in 2019 from 2.53x in 2015. The cash ratio improved to 0.33X in 2019 from 0.25x in 2015 due to growth in the company's short term investments owing to an increase in the weighted average interest rates on KW's short term deposits from 1.74% to 2.98% over the period. These ratios imply the company's liquidity is strong and indicates KW is more than able to meet their short-term obligations through liquid assets. From a solvency perspective, KW's debt to equity ratio fell to 8.55% in 2019 from a high of 13.01x in 2016. This improvement in solvency shows KW's low leverage and its ability to meet its long-term obligations. The excess liquidity when coupled with the low debt, positions the company well for the execution of attractive expansion or acquisition opportunities identified by management.

FOR THE HALF YEAR ENDED JUNE 30, 2020

The Group recorded consolidated revenues of $3.35 billion for half year ended June 30, 2020, an 11.8% decrease over the corresponding period in the prior year driven by declines in both terminal operations. Direct costs followed the same trajectory declining by 3.1% to $1.79 billion, resulting in gross profits falling by 20.1% to $1.56 billion with a gross profit margin of 46.7%.

A surge in other operating income to $330.15 million was offset by a 5.8% decline in administrative expenses to $582.03 million and led to a 12.9% year-over-year (YoY) reduction in operating profit to $1.31 billion.

Finance costs decreased to $78.3 million, a 16.3% reduction as the company reduces its debt. Pre-tax profits fell by 12.7% to $1.23 billion year-over-year (YoY). After taxes, KW recorded a 11.4% decrease in net profits to $1.06 billion, representing a profit margin of 31.7%, 20 basis points more than the comparable period year. Net profit attributable to equity holders of the company represents 98.3% of net-income and declined by 11.7% to $1.04 billion.

The Terminal Operations division generated operating revenue of $2.7 billion for the three-month period, a decrease of 12% over the corresponding period of the prior year. Divisional profits declined by 17% from $1.2 billion to $1.0 billion YoY. Management states that the Terminal operations were affected by the fallout from measures to limit COVID-19 cases in Jamaica as well as in major markets around the world which saw a marked reduction in the movement of some cargo types, primarily containers.

On the other hand, the Logistics Services division saw some growth, with revenues up 2% YoY to $980 million. The division generated operating profits of $302 million, a marginal 2.0% increase over the prior year. The division performed creditably when taken in the context of the adverse market conditions precipitated by the COVID-19 pandemic.

KW's asset base marginally grew by 0.4%, ending the period at $32.8 billion. Growth in Short term investments was offset by a decline in trade and other receivables. Total liabilities declined by 23.1% to $5.0 billion from $7.0 billion driven by reductions in borrowings and trade and other payables. Additionally, a 17.9% increase in retained earnings drove a 6.7% increase in shareholders' equity to $27.3 billion.

Due to the strengthening of the KW's financial position, their current, quick and cash ratio improved to 4.03x, 3.77x and 0.29x as at June 30, 2020 from 3.17x, 2.76x and 0.18x the comparable period prior. These liquidity metrics demonstrate KW's ability to meet their short-term obligations based on the assets they have on hand.

OUTLOOK

Kingston Wharves remains optimistic about the performance of the company's core business lines amidst the negative impact from COVID-19.

To mitigate the spread of the pandemic, the GOJ implemented nightly island wide curfews, schools and businesses temporary closures, suspension or cancellation of entertainment events, and international travel restrictions. These all have negative economic consequences, one of which is the reduction of shipping and logistic services. As a provider of terminal and logistics services for the domestic and transshipment market, the group's operations are at varying stages of the impact cycle. However, operations have remained resilient and the liquidity and capital base of the company remain strong, which will allow KW to come out on the other side of the crisis on strong footing.

The company's business strategy is in line with Jamaica's Logistics Hub Initiative which looks to transform the Country's Economy.

As the Caribbean's leading multi-purpose port terminal, Kingston Wharves runs a diverse operation, handling a wide range of cargo for both the domestic and transshipment markets. KW sought long-term strategic relationships with the major importers and exporters, shipping lines, and Non-Vessel Operating Common Carriers (NVOCCs) which are prepared to consider Kingston as a place from which to develop their regional and/or international business. KW has also expanded their transshipment services which involves building out its Total Logistics Facility (TLF), including the Total Auto Logistics Centre which offers automotive shipping and storage services for new and used car dealers in Jamaica.

Initiatives geared towards increased efficiency could improve operating margins.

KW has supported their Business continuity strategy with the rollout of new technology to facilitate digital transactions by customers while allowing staff to work remotely or on flexi-time. The company's goal is to co-operate with the Jamaica Customs Agency and other industry stakeholders to further develop technological capabilities in operating within this new norm. These adjustments seek to improve operational efficiency, enhance margins and bolster earnings.

Further cost containment initiatives such as the consolidation in shipping lines could also lead to a larger bottom-line for the company especially as the e-commerce market continues to grow. The automation and modernization of information systems have prompted KW to re-imagine operations for enhanced growth, and in so doing, maintain its position as a market leading multipurpose port and logistics service provider.

Strong capital base and liquid reserves positions can facilitate acquisition opportunities.
KW's parent company Jamaica Producers Group (JP) is looking to acquisitions as part of their growth strategy, capitalizing on opportunities that may present themselves in the current business environment. Given the significant contribution KW makes to JP's overall liquid reserves, it is possible that KW may be used as a vehicle for strategic acquisition opportunities.

INVESTMENT POSITIVES

- The company's position in the local market is enhanced by legislations promoting growth in logistics.
- The company was granted free zone status under the Jamaica Export Free Zones Act which resulted in a lower effective tax rate and improved bottom-line.
- The company has a strong distribution network.
- The company has a low debt balance which puts them in a better position to acquire additional debt to execute on acquisition and expansion initiatives.
- The company has paid out 29% of earnings over the last five years as dividend payments.

INVESTMENT NEGATIVES

- Exists in a highly competitive industry globally with a low barrier to entry for some of the company's business lines.
- The company may exhibit concentration risks as all its operations are based in Jamaica.
- The company's revenue is cyclical and is sensitive to downturns in the broader economy
- Competition from other Caribbean ports could pose a challenge for the company's growth.

CONCLUSION

The global logistics market is projected to increase by 18% in 2021 driven by increased focus on the continued supply of essential commodities, creation of supply chain stabilization task force to fight COVID-19, and growing demand and distribution of personal protective equipment. The social distancing adjustments, extended curfew hours and lockdown in some segments of the economy are some of the factors that should KW's growth in the short to medium-term. However, as the country adjust to the new norms, operations should return closer to a pre COVID-19 state, should a reliable method of prevention or remedy for the virus emerge.

The company maintains a strong liquidity position and has a low debt which positions the company well to execute on any potential acquisition and expansion opportunities. Given the factors above and our assessment of the valuation of the company at $41.43 relative to the offer price of $46.45, we recommend KW as **UNDERWEIGHT.**

SOURCES

The Jamaica Observer, Kingston Wharves Limited Audited Financials, Jamaica Gleaner, Jamaica Stock Exchange

DISCLAIMER

DEFINITIONS

- **OVERWEIGHT –** More than 10% price appreciation anticipated (Higher weight in your portfolio relative to the market)
- **MARKET WEIGHT** – Price expected to fluctuate between 10% on the upside or downside (Similar weight in your portfolio relative to the market)
- **UNDER WEIGHT** – Price expected to decline by more than 10% (Lower weight in your portfolio relative to the market)
- **ZERO WEIGHT –** Do not hold this stock