VM Wealth Management Limited

Company Analysis: Kingston Wharves Limited (KW) 6M 2023

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KINGSTON WHARVES LIMITED

- Recommendation: **OVERWEIGHT**
- Current Price: **$27.75**
- Price Target: **$38.54**

- Shares Outstanding: 1,427,442,000 units
- Financial Year End: December 31st

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 of 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 SUMMARY

J$'000	FY 2021	FY 2022	6M 2022	6M 2023
Revenue	8,674,001	9,476,406	4,560,232	4,426,675
Gross Profit	4,395,118	4,477,221	2,206,983	1,961,961
Operating Profit	3,868,736	3,265,491	1,469,497	1,603,490
Net Profit	3,250,845	2,738,470	1,226,310	1,304,179
Total Assets	41,307,043	42,680,569	41,551,099	46,347,563
Equity to Parent	34,968,279	35,827,572	35,842,922	36,518,021
Total Liabilities	6,067,710	6,537,500	5,708,177	9,829,542

Dividend Policy

KW does not have a stated dividend policy. However, the company maintains steady dividend payments to shareholders. Recently, KW declared a dividend of $0.25, announced in June 2023.

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, strengthening its prospects as a multi-purpose port terminal and a strategic gateway for domestic and transshipment cargo.

Projections and Valuation

We used a Discounted Cash Flow Model with a cost of equity of 11.97% and a long-term growth rate of 3.0% to arrive at our target price of $38.54.

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.

SIX (6) MONTHS ENDED JUNE 30, 2023

During the six months concluding on June 30, 2023, KW recorded consolidated revenues of $4.4 billion, reflecting a 3.0% decline compared to the $4.5 billion recorded during the same period in 2022. Specifically, the Terminal Division posted operating Revenue of $3.4 billion during the six months, marking a 6.0% decline compared to the same period in the previous year. The Terminal Operations Division, the more significant portion of the Group's operations, accounted for 69.0% of the total revenues. A global decrease predominantly influenced the performance in this division in containerized cargo volume, although this decline was partially counterbalanced by growth in bulk and breakbulk cargoes. The Logistics Services Division achieved revenues of $1.5 billion, marking a 6.0% growth equivalent to $80 million compared to the previous year. This segment's success is attributed to continual investments in personnel, logistics facilities, advanced scanning and security systems, and integrated information technology platforms for efficient cargo tracking, inventory management, and handling.

Cost of Sales increased to $2.4 billion from $2.3 billion in the previous year, representing an increase of 4.3% year-over-year (YoY). The growth was attributed to rising operating costs due to inflation. Declining Revenue in tandem with increased Cost of Sales resulted in Gross Profit decreasing to $1.9 billion from $2.2 billion, representing a 13.6% drop YoY. Administrative expenses for the six months grew to $816.6 million compared to $757.7 million in the previous year for the same period, increasing by 7.7%. Higher Administrative expenses were the result of rising operating costs due to inflation, as well as higher expenses associated with the development of the business. Despite higher Administrative expenses, an influx of Other operating income amounting to $458.2 million contributed to an Operating Profit of $1.6 billion compared to $1.4 billion in the previous, representing an improvement of 14.2% YoY. According to the Company, Other operating income consists of (but is not limited to) Dividends, Interest and Foreign exchange gains. Finance Costs fell to $53.6 million from $56.7 million, a decrease of 5.5% YoY. Net Profit allocated to shareholders amounted to $1.3 billion, reflecting a 7.0% increase or $83 million compared to the previous year's Net Profit of $1.2 billion.

KW's asset base grew to $46.3 billion compared to $41.5 billion in the previous year, representing a growth of 11.5% YoY. The increase in Property, plant, and equipment combined with increments in Short-term investments, Cash and bank, and Inventories were the primary drivers of the rise in Total Assets. Property, plant, and equipment increased by nearly $4.9 billion. Short-term investments saw an increase of around $762.4 million, followed by Cash and bank and Inventories, with increases of approximately $241.8 million and $109.3 million, respectively.

Total Liabilities grew by 71.9% to $9.8 billion from the $5.7 billion recorded last year. The dominant factor behind the rise in total liabilities from June 2022 to June 2023 was an estimated $4.0 billion increase in Borrowings under non-current and current liabilities, complemented by a surge in Trade and other payables under current liabilities, which grew by about $613.0 million YoY.

Total Equity attributable to Parent increased to $36.5 billion from $35.8 billion in the previous year, increasing by 1.9% YoY. This was driven primarily by a $908.2 million increase in Retained Earnings.

The Current Ratio weakened to 4.2x from 5.2x in the previous year, driven by growth in Current liabilities (mainly Accounts payable), which outpaced the growth in Current assets. Despite being weaker, the Current ratio remains robustly above acceptable levels, indicating that KW's liquidity remains adequate with continued ability to meet short-term obligations as they fall due. Trailing Twelve Month Return on Equity (TTM ROE) for the period was 7.7% compared to 9.1% in the previous year, as TTM Earnings decreased while Equity attributable to shareholders rose.

OUTLOOK

Jamaica's Position in the Caribbean Offers Several Strategic Advantages for Near-shoring

In the context of global supply chains and logistics, "near-shoring" refers to transferring business processes or production to nearby countries rather than sourcing them from more distant locations (often referred to as "offshoring"). Given recent global disruptions, diversifying supply chain sources has become crucial. Near-shoring to locations like Jamaica can help businesses spread risk more effectively, and Jamaica's location places it near major North and South American markets, especially the USA. This proximity can result in faster shipping times, reduced transportation costs, and quicker response to market changes compared to distant sourcing locations. Jamaica also lies at the crossroads of the North-South and East-West shipping lanes, making it a natural transhipment hub. This location means it can serve as a pivotal point in regional supply chains, catering to the Americas and beyond.

KW Moves Ahead with Bullish Expansion Plans

Recently, KW has committed over US$60 million in capital to its operations. The investment in terminal infrastructure, logistics services, and digital transformation aligns KWL to serve as a preferred partner in these near-shoring endeavours. Terminal development involves the US$30 million redevelopment of Berth 7, along with the terminal optimization and cargo segmentation strategy, which should bolster supply chain resilience. These investments in terminal development ensure the port can swiftly adapt to and recover from disruptions, keeping goods moving and stakeholders satisfied. The redevelopment of Berth 7 specifically should increase KW's ability to accommodate more or larger ships. Terminal Optimization should contribute to streamlined operations, reducing turnaround times, and improving cargo handling efficiency, ensuring that even in the face of increased demand or staff shortages, the port can continue to operate effectively. The Cargo Segmentation Strategy creates dedicated areas or processes for different types of cargo. This specialization can increase efficiency and allow the port to adapt to changes in cargo types or volumes swiftly.

Beyond its core port terminal services, KWL is also investing in enhancing its logistics capabilities. This positions them as a port operator and an integrated logistics provider. The US$25 million investment in a 130,000 sq. ft. integrated warehouse complex underscores the Company's forward-looking approach. One of KW's key revenue drivers is motor unit moves, which have grown by 66.0% over the last five years. The Company believes increased wharf space should facilitate further growth in this and other revenue segments.

Emphasis on digital enhancements indicates that the Company is gearing towards modernizing its operations and improving efficiency. In 2021, as part of its push for digital transformation, KWL introduced its "click-n-connect" service, an e-platform that streamlines the once tedious process of personal cargo collection, making it contactless and more user-friendly. It simply involves using a smartphone to pay all associated fees, including those for Jamaica Customs. With the curbside pickup feature, wait time at the wharf is reduced, and everything can be accomplished in just 10 minutes using a mobile device.

Strategic Partnership with Global Shopping Club PriceSmart

In July 2023, KW announced signing a 20-year deal with PriceSmart, which guarantees a 10-year lease arrangement and comes with the option to renew in five-year increments. It will allow the international company, now operating 50 stores across 30 markets in Latin America and the Caribbean, to occupy a portion of KW's 300,000 square feet integrated modular logistics complex. PriceSmart is expected to gain access to the facility by the end of this year, which will consist of an initial 75,000 square feet of dry goods warehouse and 57,000 square feet of cold storage. Securing long-term leases with significant players, such as a global club shopping company, provides a solid revenue outlook for the new warehousing facilities. Such partnerships also validate the attractiveness and utility of KWL's new facilities.

INVESTMENT POSITIVES

1. **Growth in Logistics Services Division:** Revenues in the Logistics Services Division grew by 6.0% or $80 million YoY, thanks to ongoing investments in personnel, logistics facilities, advanced scanning/security systems, and integrated IT platforms for efficient cargo handling.
2. **Rise in Operating Profit:** Despite the rise in administrative expenses, an increase in other operating income led to an Operating Profit of $1.6 billion, up by 14.2% YoY.
3. **Increased Asset Base:** KW's assets grew by 11.5% YoY, driven by increments in property, plant, equipment, short-term investments, cash and bank, and inventories.
4. **Strategic Position and Expansion:** KW's location in Jamaica provides strategic near-shoring advantages. The company's investment in terminal development, logistics services, and digital transformation, including the "click-n-connect" service, demonstrates forward-thinking and adaptability to modern trends.
5. **Strategic Partnership with PriceSmart:** The 20-year deal with PriceSmart provides a stable, long-term revenue stream for KW. Such a partnership with a global shopping club company speaks to KW's attractiveness and capability in the logistics space.
6. **Robust Liquidity:** Despite a weakened Current Ratio from 5.2x to 4.2x YoY, it still remains at a strong level, indicating KW's continued capability to handle short-term financial obligations effectively.

INVESTMENT NEGATIVES

1. **Decline in Revenues:** Consolidated revenues for KW fell by 3.0%, and the Terminal Division, which makes up 69.0% of total revenues, experienced a 6.0% drop YoY.
2. **Increased Cost of Sales and Declining Gross Profit:** Cost of Sales rose by 4.3% YoY, resulting in a 13.6% drop in Gross Profit.
3. **Rising Administrative Expenses:** Administrative expenses grew by 7.7% YoY due to inflation and higher costs related to business expansion.
4. **Increased Liabilities:** Total Liabilities surged to $9.8 billion from $5.7 billion, primarily driven by an estimated $4.0 billion rise in borrowings and a growth in trade and other payables by about $613.0 million YoY.
5. **Decreased Return on Equity:** The Trailing Twelve Month Return on Equity (TTM ROE) decreased from 9.1% in the previous year to 7.7%, indicating that the company might be generating less return on shareholders' equity.
6. **Dependence on Terminal Operations:** While diversity in revenue streams is ideal, the Terminal Operations Division still accounts for 69.0% of the total revenues, making the company vulnerable to global decreases in containerized cargo volume or other shifts in the shipping industry.

CONCLUSION

Shipping logistics has been regarded as an economic cornerstone, providing efficient and cost- effective flow of goods on which other commercial sectors depend. Moreover, Jamaica's proximity to major American markets makes it an attractive near-shoring location. Its unique position at the intersection of key shipping routes also makes it a prime transhipment hub, serving both North and South America. This geographic advantage can lead to faster shipping, reduced costs, and an agile response to market fluctuations.

KW has invested over US$60 million in bolstering its operations, focusing on terminal infrastructure, logistics services, and digital initiatives. Additionally, the Company entered into a 20-year agreement with PriceSmart, a leading shopping club with broad market presence. PriceSmart will lease space in KW's logistics complex, which includes substantial dry goods and cold storage facilities. This partnership not only solidifies a promising revenue stream for KW but also underscores the value and potential of its newly developed facilities.

KW also maintains a strong liquidity position and has 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 $38.54 relative to the current market price of $27.75, we recommend KW as **OVERWEIGHT.**

SOURCES

Kingston Wharves Financial Reports, Jamaica Stock Exchange (JSE), The Gleaner Company, Loop News Jamaica, The Jamaica Observer, and the Financial Services Commission (FSC), OUR Today

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.