Company Analysis: GraceKennedy Limited (GK) 9M 2023

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- Recommendation: **OVERWEIGHT**
- Current Price: $77.16
- Price Target: **$97.39**

- Shares Outstanding: 994,387,576 units.
- Financial Year End: December 31

ABOUT THE COMPANY

Grace Kennedy (GK) is a Jamaican-based conglomerate with a diverse range of business interests. The Group primarily operates in two main business segments:

Food Trading: This division is represented by GK Foods. Grace Kennedy is involved in the distribution and trading of various food products both locally and internationally. They offer a wide range of food items and brands, including canned goods, seasonings, sauces, beverages, and more. Grace Kennedy has a strong presence in the Caribbean and also exports its products to other regions.

Banking and Investments, Insurance, and Money Services: These areas are collectively managed under the GK Financial Group division. Grace Kennedy has ventured into the financial services sector, offering banking, insurance, and money services. This diversification allows them to provide a comprehensive range of financial products and services to their customers.

The company's registered office is located at 73 Harbour Street in Kingston, Jamaica, which is a significant commercial area in the capital city. Additionally, Grace Kennedy is cross listed on both the Jamaica Stock Exchange (JSE) and the Trinidadian Stock Exchange, which means that its shares are traded on both of these stock exchanges. The company's initial listing on the JSE took place in 1986, indicating its long-standing presence in the Jamaican business landscape. Grace Kennedy is an important player in Jamaica's economy and has expanded its operations beyond its home country, contributing to its status as a prominent conglomerate in the Caribbean region.

FINANCIAL PERFORMANCE SUMMARY

J$ 000	FY 2021	FY 2022	9M 2022	9M 2023
Revenue	129,309,871	142,931,701	107,435,597	117,811,024
Operating Profit	11,901,586	10,239,672	7,648,413	8,866,425
Net Profit	8,940,309	7,594,392	5,603,436	6,398,755
Total Assets	199,796,991	201,022,706	196,618,084	218,541,384
Total Liabilities	128,791,016	125,265,713	123,094,356	136,409,864
Total Equity	71,005,975	71,995,793	73,523,728	82,131,520

Dividend Policy

GK's dividend policy is to distribute at least 20% of Net Profit Attributable to Stockholders subject to the operating requirements of GraceKennedy Limited, in light of an unpredictable economy and is subject to available cash flow. Over the last three (3) years the company has had a payout ratio of around 25% on average.

Outlook

We view the Group's outlook as cautiously positive. Jamaica's manufacturing sector, including food manufacturing, has grown encouragingly in recent years, exceeding pre-COVID levels and boosting GDP. GK's financial subsidiaries show cautious optimism in Jamaica's stable economy, with potential growth in lending and insurance, amid continued GDP growth and unprecedented low unemployment. GK is also expanding through strategic acquisitions in the spring water and insurance sectors and enhancing digital capabilities with the GK One app and GK Life's platform. The company is also fostering growth through events like 'GK Marketplace,' a share buy-back program, and partnerships for remittance services expansion.

Projections and Valuation

We used a combination of Discounted Cash Flow (DCF) Model and Market Comparable Approach to determine the value of the stock. For the DCF Model, we used a cost of equity of 15.31% as the appropriate equity charge. For the Market Comparable Approach, we used a 2024 forward BVPS of $86.34 with an applied P/B of 0.9x to determine relative value. By averaging both approaches, we obtained a consensus target price of $97.39.

Risks to Price Target

The emergence of substantial supply chain challenges would impact the company's ability to sustain revenue growth in line with our expectations. On the other hand, there may be unforeseen upside from the successful execution of future M&A deals.

NINE (9) MONTHS ENDED SEPTEMBER 30, 2023

For the nine-month period ending September 30, 2023, GK achieved revenues of $117.8 billion, an increase of 9.7% or $10.4 billion over the $107.5 billion recorded during the same period in 2022. Growth in revenue was attributed to robust performance across its business segments. The food division, including Jamaican distribution, manufacturing, and international businesses, showed significant top-line growth, driven by strategic initiatives and market expansion. However, Grace Agro-Processors (meats) faced drought-related challenges. The financial services subsidiaries, falling under GraceKennedy Financial Group, also recorded growth, with strong performances in insurance and banking, despite slight declines in money services due to global economic challenges. Efforts to enhance customer offerings and digital expansion were key highlights in this segment.

Total expenses increased to $111.7 billion from the $102.1 billion recorded in 2022, representing growth of approximately 9.4% year-over-year (YoY). This increase was driven by higher operating costs. The foregoing increases in revenue and expenses culminated in Profit before other income of $6.1 billion during the period, compared to the $5.2 billion recorded in 2022. After accounting for other income of $2.7 billion, Profit from operations amounted to $8.8 billion during the period compared to the $7.6 billion recorded in the previous year, representing growth of approximately 15.7% YoY. The Operating Profit Margin also improved to approximately 7.5% from 7.1%. Net Profit for the period increased to $6.3 billion from $5.6 billion, with the Net Profit Margin improving to 5.4% from 5.2%. These results indicate improving profitability year on year, with expenses being reasonably contained amid rising revenue.

Total Assets increased by approximately 11.1% compared to the previous year, rising to $218.5 billion from $196.6 billion. The substantial increase in investment securities from $36.9 billion to $51.5 billion was a significant driver of the total asset growth. Additionally, receivables saw a notable rise from $19.4 billion to $26.2 billion. Total liabilities increased by approximately 10.8%, increasing to $136.4 billion from $123.0 billion. The increase in payables from $31.2 billion to $35.6 billion and other post-employment obligations, which went up from $4.4 billion to $5.8 billion largely contributed to the growth in total liabilities. Total Equity increased by approximately 11.7%, growing to $84.1 billion from $73.5 billion. The rise in retained earnings from $53.9 billion to $58.9 billion and capital and fair value reserves from $6.8 billion to $8.6 billion were key contributors to the increase in total equity. These line items suggest that the company's growth is fueled by an increase in investment activities and a solid increase in earnings retained within the company, along with a higher valuation of assets and a rise in liabilities related to post-employment obligations.

The debt-to-equity ratio for the period ending September 30, 2023, is approximately 0.3x, and for the restated year ending September 30, 2022, it is approximately 0.4x. This indicates that for every dollar of equity, the company had $0.30 in debt in 2023, down from $0.40 in debt in 2022, reflecting a slight reduction in leverage over the year. The estimated current ratio for the period is approximately 3.4x, and for the restated year ending September 30, 2022, it is approximately 3.6x. This suggests that for both years, the company had more than three times the current assets to cover its current liabilities, indicating good short-term financial health. However, the slight decrease from 2022 to 2023 suggests some reduction in the company's liquidity position. It's important to note that this is an estimate, as the exact composition of current assets and current liabilities is not specified in the financial statements for the period.

OUTLOOK

Growth and Future Optimism in Jamaica's Manufacturing Sector: As of 2023, Jamaica's manufacturing sector, including food manufacturing, is experiencing significant growth. The sector has shown resilience, recovering from the COVID-19 pandemic with output levels in 2022 being 3.5% higher than pre-COVID levels in 2019. This growth is also reflected in the country's GDP, which saw an increase of 5.2% in 2022. Notably, the food, beverages, and tobacco sector has become increasingly important, accounting for 25.3% of Jamaica's total exports in 2022, a considerable rise from 13.5% in 2018. This growth is supported by increased investment in the sector, as exemplified by Pepsi's US$30-million investment in a new production line, which also contributes to job creation and economic stability in Jamaica. The manufacturing sector's expansion is further supported by government initiatives and policies aimed at fostering economic growth and improving workforce readiness. The growth in Jamaica's manufacturing sector, including food manufacturing, is expected to continue. This optimism is based on the sector's strong performance in recent years, the significant role it plays in the country's economy, and the support it receives from government policies and investments. The continued expansion of major players in the sector, such as the investment by Pepsi, and the sector's increasing contribution to the country's GDP and export figures, suggest a positive trend for the future. The government's commitment to creating supportive programs and policies for the sector's development further reinforces this expectation of sustained growth. The foregoing should benefit GK's food division.

Stable Yet Cautiously Optimistic Outlook for GK's Financial Subsidiaries in the Evolving Jamaican Economic Landscape: The outlook for GK's financial subsidiaries in the banking, insurance, and money transfer services sectors in Jamaica, based on the Bank of Jamaica's monetary policy report from December 2023, appears cautiously optimistic. The stable yet slightly elevated inflation rate and controlled core inflation suggest a reasonably stable economic environment, which is generally favorable for financial services. The banking sector, in particular, is likely to benefit from the soundness of the domestic banking system and the growing preference for Jamaican dollar deposits. However, the anticipated inflation fluctuations and potential global economic challenges might require strategic responses from GK's financial subsidiaries. The ongoing economic expansion and a tight domestic labor market might offer growth opportunities, particularly in lending and insurance services, while the money transfer segment could benefit from stable remittance inflows.

Strategic Mergers & Acquisitions: GK has been actively expanding its market presence through strategic acquisitions. This includes the purchase of Unibev Limited, a manufacturer specializing in spring water, and the acquisition of 876 spring water and an increased stake in Catherine's Peak, signifying a focused expansion in the spring water market. Additionally, the acquisition and rebranding of Scotia Insurance Caribbean to GK Life, now operating across 13 Caribbean markets, marks a significant move into the insurance sector, showcasing successful expansion and performance.

Commitment to Digital Transformation and Innovation: GK is demonstrating a strong commitment to digital innovation. This is evident in the enhancement of the GK One app with new features like peer-to-peer transfers and mobile wallet top-ups at Bill Express locations. The expansion of this app into other Caribbean territories and the launch of GK Life's core insurance platform, starting in Antigua, are set to further drive growth and operational efficiency, underlining the company's dedication to technological advancement.

Diverse Growth Strategies and Shareholder Value Enhancement: GK is adopting a multifaceted approach to growth and value creation. This includes hosting the 'GK Marketplace' event to promote cross-selling among its subsidiaries, which is expected to boost collaboration and revenue generation. Additionally, the company has launched a share buy-back programme, aiming to repurchase up to 1% of its shares using cash reserves. This reflects confidence in GK's future and a commitment to enhancing shareholder value. Moreover, GK's partnerships with Unicomer Jamaica Limited and digital wallet Lynk for remittance services expansion, including the addition of new Western Union locations, demonstrate a strategic approach to growing its remittance business and improving customer convenience.

INVESTMENT POSITIVES

1. **Revenue Growth**: GK achieved a significant 9.7% increase in revenues compared to the previous year, indicating strong overall business performance.
2. **Diverse Business Expansion:** The company is successfully expanding across various sectors, such as the food division showing significant growth and strategic acquisitions in the spring water and insurance markets.

3. **Improved Profitability:** There was a notable improvement in Profit from operations and Net Profit, with the Operating Profit Margin and Net Profit Margin both increasing. This suggests effective cost management and increased profitability.
4. **Asset Growth:** A substantial 11.1% increase in Total Assets, driven by significant rises in investment securities and receivables, indicates healthy asset growth and investment activities.
5. **Stable Financial Subsidiaries:** The financial services subsidiaries, including insurance and banking, recorded growth despite global economic challenges, suggesting resilience and potential for further growth.
6. **Commitment to Digital Transformation:** The company's focus on digital innovation, such as enhancing the GK One app and launching GK Life's core insurance platform, demonstrates its commitment to staying competitive through technological advancement.

INVESTMENT NEGATIVES

1. **Rising Operating Costs:** Total expenses increased by approximately 9.4% YoY, primarily due to higher operating costs, which could pressure margins if not managed effectively.
2. **Challenges in the Agro-Processors Division:** The Grace Agro-Processors (meats) division faced drought-related challenges, indicating vulnerability to environmental factors.
3. **Decrease in Liquidity Position:** The slight decrease in the current ratio from 2022 to 2023 suggests some reduction in the company's short-term liquidity, which could impact its ability to meet immediate obligations.
4. **Decline in Money Services:** There was a slight decline in money services, reflecting the impact of global economic challenges and possibly indicating a need for strategic realignment in this segment.
5. **Increased Liabilities:** Total liabilities increased by approximately 10.8%, with notable rises in payables and other post-employment obligations, which could impact on the company's financial flexibility.
6. **Market Risks and External Factors:** While the company is showing growth, it remains susceptible to external market risks, such as inflation fluctuations, global economic challenges, and environmental factors that could affect its diverse business segments.

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CONCLUSION

The 2023 outlook for Jamaica's manufacturing sector, including food manufacturing, is optimistic. The sector has surpassed pre-COVID levels by 3.5% in 2022, contributing to a 5.2% rise in GDP. The food and beverages sector now accounts for 25.3% of exports, fueled by investments like Pepsi's $30 million in new production.

GK's financial subsidiaries in Jamaica have a cautiously optimistic outlook, benefiting from a stable economic environment, with opportunities in lending and insurance due to a tight labor market.

GK's expansion through strategic acquisitions, like Unibev Limited in the spring water market and Scotia Insurance Caribbean in the insurance sector, demonstrates a focused growth strategy.

The company's commitment to digital innovation is evident in enhancing the GK One app and launching GK Life's insurance platform. GK's growth strategies also include hosting events like 'GK Marketplace' for cross-selling and a share buy-back program to enhance shareholder value. Strategic partnerships for remittance services expansion further underline GK's growth-oriented approach.

We used a combination of Discounted Cash Flow (DCF) Model and Market Comparable Approach to determine the value of the stock. For the DCF Model, we used a cost of equity of 15.31% as the appropriate equity charge. For the Market Comparable Approach, we used a 2024 forward EPS of $86.34 with an applied P/E of 7.2x to determine relative value. By averaging both approaches, we obtained a consensus target price of $97.39, which is a 26.22% upside from the current market price. Considering this, we have assigned an **OVERWEIGHT** rating to the stock.

SOURCES

Bloomberg, The Jamaica Stock Exchange, GraceKennedy Annual Reports and Quarterly Financial Statements, Trinidad and Tobago Stock Exchange, News from the Office of the Prime Minister (Jamaica), Jamaica Information Service (JIS), The Jamaica Gleaner, The Jamaica Observer, Bank of Jamaica (BOJ),

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.