

Quarterly Equity Review

Rating **BUY**

KINGSTON WHARVES LIMITED

Sector: Services
Sub Industry: Logistics, Warehousing

JSE: KW
Bloomberg: KW JA

HI 2023: Kingston Wharves Limited continues ambitious expansion despite varied performance and weaker global trade outlook.

Reading time: 8-10 minutes

Investment Rationale

Kingston Wharves Limited (KWL) is the region's leading multipurpose port terminal operator, connecting Jamaica's importers and exporters to over forty-five ports worldwide. Essentially, KWL's ports and its other vital infrastructure form the cornerstone of Jamaica's ambition to evolve into a regional and global transshipment and logistics hub. This strategic development is expected to enhance economic growth by providing additional value-added opportunities. With control of one of Jamaica's most critical infrastructure, KWL remains crucial to the growth, security and overall health of the economy.

Located on the Port of Kingston, KWL is strategically positioned to provide full-range cargo handling and logistics services all year round. Additionally, as many companies seek to strengthen or reduce risk in their supply chain and ensure that essential supplies are close to home, KWL aims to capitalize on this opportunity by providing crucial storage space for these entities.

Over the last five years the Group has delivered profits to shareholders which grew at a CAGR of 8.49%. However, in FY 2022 its Net profits declined by almost 16.0% despite the continued topline expansion. The mixed results reported for that year were largely due to foreign exchange losses incurred coupled with a slowdown in global trade volume, which largely begun in 2022. This decline stemmed from several factors including rising geopolitical tensions, global food insecurity, and increasing levels of debt. Currently, the WTO projects world merchandise trade volume growth will slow to only 1.7% in 2023, a figure significantly below the 12-year average of 2.6%. However, Kingston Wharves' performance YTD (6M 2023) suggests that the Group could return to profit growth in FY 2023, as seen in the trend observed for the majority of the last five years.

Despite the muted outlook for global trade over at least the short to medium term, KWL continues to strengthen its infrastructure and has forged ahead with the planned expansion of its facilities. The Group is investing capital to ensure that when the anticipated growth eventually returns, it remains at the forefront of logistics business in the region, capable of efficiently delivering the high-quality service demanded by its customers.

The stock currently trades at J\$28.53 while our target price is J\$34.96, implying that the stock is trading at a 18.4% discount based on this target price.

November 2, 2023

Closing price	28.53
Forecast dividend	0.77
Current target price	34.96
TOTAL RETURN^{proj.}	25.2%

Company Data

Outstanding shares	1,430,199,578
Market Cap	40,803,593,960
52-Week (Lo/Hi)	24.00/39.50
1 Yr Daily Average Volume	223,175
5 Yr Daily Average Volume	120,950

Major Shareholders

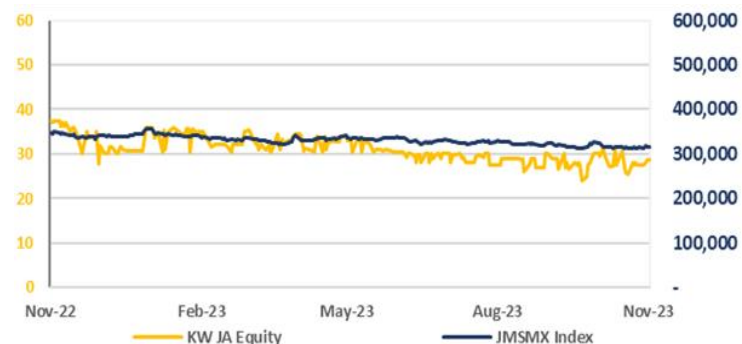
JP GLOBAL HOLDINGS LIMITED	42.03%
S.B.D. LLC	21.02%
SAJE LOGISTICS INFRASTRUCTURE LTD.	6.94%

Key Financials

J\$ Mn	FY21	FY22	FY23e	FY24e
Total Revenues	8,674	9,476	10,187	11,206
Operating Profit	3,869	3,265	3,820	4,370
Net Profit	3,251	2,738	3,146	3,607
Net Profit Change (%)	42.8%	-15.8%	14.9%	14.6%
EPS	2.24	1.89	2.20	2.48
Dividend Yield	1.28%	1.56%	2.14%	2.42%

Price Performance

	1MTH	3MTH	1YR
KW	-4.7%	3.8%	-23.7%
Main Index	6.0%	-4.0%	-8.9%



Source: Bloomberg; JN Fund Managers Limited

ROE 2022	Current Ratio 2022	Debt / Equity 2022	Gross Margin 2022	Net Profit Margin 2022
7.6% -17.8%	3.75x -17.2%	7.1% 12.7%	47.3% -6.8%	28.9% -22.9%
2021: 9.3%	2021: 4.52x	2021: .6.2%	2021: 50.7%	2021: 37.5%

Financial Overview

Revenue & Profitability

Following a commendable (9.3%) topline growth in FY 2022, KWL experienced challenges characterized by FX Losses and higher overall costs, leading to an erosion of several performance metrics. The 6-Month 2023 results of the terminal and logistics company highlights ongoing struggles during a gradually improving, but still challenging global environment.

In FY 2022 KWL reported revenues of J\$9.48 billion which was higher than the J\$8.67 billion generated in the previous year. However, net profits came in (15.8%) lower in FY 2022 as KWL recorded FX Losses during the year versus a substantial gain in FY 2021. The Group holds a substantial sum of US Dollars on its balance sheet.

For the 6-month period ended June 30, 2023 (HI 2023), Kingston Wharves' revenues was J\$4.43 billion, a decline of 3.0% when compared to the first half of FY 2022. This decline was linked to a slowdown in its Terminal Operations business as global industrial production and containerized freight flows slowed throughout 2023.¹ This trend emerged as the post pandemic shift from goods to services persisted in the initial part of the year. During the 6-month period the terminal business generated J\$3.40 billion or 69.0% of KWL's revenues.

KWL's Logistics Services division generated J\$1.50 billion in revenues in 6-Month 2023, reflecting an approximate 6.0% increase on the amount generated in the same period last year. Strategically, KWL continues to invest in its team, logistics facilities, security systems and integrated information technology platform for cargo tracking and inventory management. This aims to establish KWL as a leading player in the logistics services industry in Jamaica and the broader region. These logistic services include the receipt and delivery of cargo.

Direct costs for KWL was J\$2.46 billion over the first half of FY 2023, increasing slightly by 1.9% from J\$2.35 billion in the comparable period in FY 2022. This pushed the gross margin down to 44.3% from 48.4% recorded in the same period last year. Other operating income was J\$458.21 million in the first half of FY 2022, versus J\$20.25 million in FY 2021. This considerable increase likely resulted from a strengthening USD relative to the local currency, in contrast to FY 2021, as KWL holds significant USD balances. Up to June 30, 2023, the JMD depreciated by ~2.0% vs USD.

Although the impact of the COVID-19 pandemic has significantly reduced, the environment in which KWL operates is still challenging. However, despite the resulting lower revenues and moderate increases in direct cost and administrative expenses, Kingston Wharves Limited managed to deliver a 9.7% increase in Profit before taxes. Taxation for the period came in at J\$245.69 million, 31.8% higher than last year's. As such, the marginal tax rate moved from 13.2% to 15.9% for the six-month period ending June 2023.

Notwithstanding, Net profits came in 6.8% higher at J\$1.29 billion.

6M Highlights

Improved Profitability Despite Lower Revenues – For the six months ended June 30, 2023, Kingston Wharves Limited generated revenues of \$4.4 billion which was 3.00% lower than in HI 2022. Despite this, the group was able to achieve 6.8% growth in its net profit attributable to shareholders, largely due to a substantial increase in other operating income during the period.

Terminal & Logistics Expansion Boost Asset Growth – During HI 2023, Kingston Wharves continued its US\$60 million expansion project at Shipping Berth 7 and at the Ashenheim Road Warehouse Complex. These improvements will enable KW to maximise services to the shipping lines that currently call at their terminal, bolster overall terminal efficiency, and attract new business. So far this has resulted in its PP&E increasing by over J\$3.50 billion.

PriceSmart Lease Deal – During HI 2023, Kingston Wharves signed a 20-year deal with international club shopping company PriceSmart. The arrangement allows PriceSmart to enter a new lease to occupy a portion of KW's 300,000-square-foot warehouse complex. The first phase of the complex is under construction and is set for completion in Q1 of 2024.



CEO Mark Williams with President and CEO of Seaboard Marine Edward Gonzalez.

¹ Containerized freight means general goods, commodities or wares that are shipped in non-disposable, reusable, commercial sized shipping containers that are customarily used on sea- and ocean-going vessels.

Financial Overview (cont.)

Balance Sheet and Expansion Plans

At the end of the first six months of FY 2023 (H1 2023), KWL reported Total Assets of J\$46.35 billion, indicating an increase of 8.6% or \$3.67 billion above the amount reported at the end of FY 2022. This asset growth likely reflects the early stages of KWL's aggressive expansion plans. KWL has embarked on these initiatives as it seeks to ensure that the Group remains a pivotal pillar in the development and expansion of Jamaica and the broader region.

KWL has undertaken a US\$60 million capital investment to accommodate larger ships and increase commercial activity. This is expected to increase its yard space by 25.00% over the next 18 months and allow the company to handle up to one million containers and multiple Panamax vessels simultaneously. The current investment programme also includes US\$25 million for the build-out of the logistics center, to be operated by Kingston Wharves. These plans include the installation of approximately 60,000 square feet (sq. ft.) of cold storage facility and 70,000 sq. ft. of dry storage facility. When completed this will bring KWL's logistics and warehousing capacity to over 600,000 sq. ft.

Coming out of the COVID-19 pandemic many companies have begun implementing 'nearshoring' strategies. This approach aims to strengthen their supply chains by ensuring that critical supplies are kept close to their consumer markets or manufacturing facilities. To that end, PriceSmart and another major cold storage provider have both signed long term lease agreements with KWL, which will see them occupying a portion of the new facility upon completion. Additionally, KWL will be reorganizing the buildings on its terminal. This will include relocating those not essential for the delivery of service on the terminal, to facilitate the efficient management of the yard space.

KWL's liquidity management seeks to balance its funding needs for:

1. its capital projects,
2. debt servicing,
3. to capitalize on opportunities and
4. for the payment of dividends to shareholders.

At the end of the six-month period June 2023, the Group's liabilities stood at J\$9.50 billion following growth of 45.38% on the amount (J\$6.54 billion) reported at the end of FY 2022. This jump in liabilities was due to KWL's financing activities over the period, primarily to fund the expansion of its facilities. Over the period the Group's Short-term and Long-term Borrowings grew by J\$3.32 billion, reaching J\$5.81 billion at the end of June 2023. Consequently, this pushed Total Debt to Assets to 15.94%, way above its 5-year average of 7.93%.

Total shareholders' equity was J\$36.52 billion at the end of the six-month period ended June 2023 reflecting growth of 1.93%. The movement in shareholders' equity reflects the profitability of the Groups' operations over the period, adjusted for the effects of share repurchases and the payment of dividend to shareholders.

Risks to monitor:

Supply Chain Disruption/Global Trade Slowdown – The World Trade Organization is projecting global trade to increase by 1.0% in 2023 compared to the 3.5% growth recorded in 2022, signalling the present risk of external shocks on the global economy. If geopolitical instability such as the Russia-Ukraine war and other similar states of unrest continue to persist, the resulting supply constraints and restricted global trade could negatively impact KW's revenue growth as the group's earnings are generally dependent on the stability of global shipping.

Natural Disasters – Kingston Wharves' primary operations are located at the port in Kingston which leaves it open to several natural disaster risks that are inherent to that geographical location. Hurricanes, earthquakes, and tsunamis could potentially cause significant damage to infrastructure, disrupt port operations, and lead to significant economic losses.

Foreign Exchange Risk – KW holds a predominantly USD-denominated cash position and as such any appreciation of the Jamaican dollar, relative to the US dollar, can lead to a foreign exchange loss.

Recession Fears – With inflationary pressures still high, central banks have continued to tighten monetary policy, increasing the risk of a severe slowdown in economic activities in FY 2023/24. A significant slowdown could curtail Kingston Wharves' revenue and profit growth in the future.

Lower sea traffic due to drought along major shipping route – Currently, drought conditions in Panama has left the canal without enough water, used to raise/lower ships, forcing officials to reduce the number of ships they allow through the Panama Canal. This has caused an expensive problem for shipping companies and therefore could continue to negatively impact global trade. Currently, about 5.0% of global seaborne trade use the Panama Canal.

Valuation

1. Relative Valuation Method (Summary)

KWL's Historical Average P/E² Ratio = 17.75x
 KWL's Forward Earning = J\$2.20³
 P/E Valuation Est. = J\$39.05

2. FCFE Valuation Method (Summary)

Required rate of return = 15.40%
 Sustainable growth rate = 5.20%,
 FCFE Valuation Est. = J\$30.86

KWL's Average Valuation Est. = \$34.96

² KWL's historical 10-year p/e adjusted for outliers.

³ Projected EPS for FY 2023.