

## Knutsford Express Services Limited

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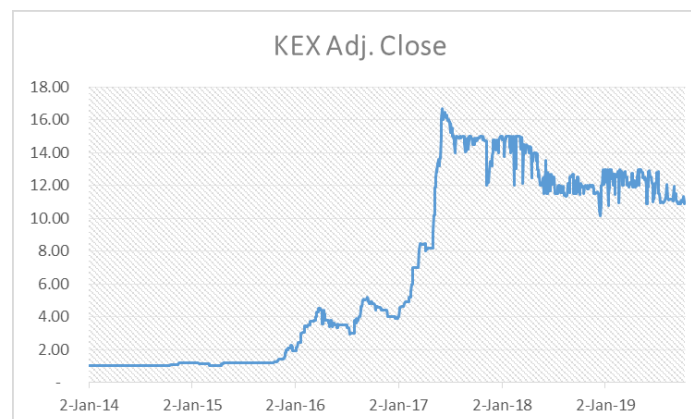
#### Executive Summary

Knutsford Express Services Limited (KEX) is incorporated in Jamaica, and its registered office is located at 10 Harbour Circle, Montego Bay, St. James. KEX has three wholly-owned subsidiaries KE Connect Limited, KE Connect US LLC and Knutsford Express Investments Limited. KE Connect Limited and Knutsford Express Investments Limited are registered and domiciled in Jamaica. The former provides transportation throughout the island, while Knutsford Express Investments undertakes property development and other investments. KE Connect US LLC is incorporated and domiciled in the state of Florida. KEX is a publicly listed company as at January 14, 2014, and effected a 5 for 1 stock split in May 2017. Given its listing date KEX has commenced paying taxes at half the effective rate starting in January 2019.

KEX has produced consistent revenue growth for the period FY 2015 to FY 2019 (period under review). Revenue has increased at a CAGR of 26.23% to a peak of \$1.15 billion for the period under review. Meanwhile, profits have increased at CAGR of 28.40% for the same period to its best levels of \$188.47 million. However, for the first quarter ended August 2019 profits tumbled 45.71% to \$47.78 million due to increased expenses.

KEX has maintained a relatively high Operating Profit Margin (OPM) averaging 21.19% for the period under review. The company has also maintained an elevated current ratio averaging 3.79x, indicating short-term liabilities can be readily met. Furthermore, debt-to-equity has averaged 0.16x for the same period indicating that long-term liabilities can be comfortably paid but peaked at the end of FY 2019 (FY end May 31) at 0.28x.

KEX currently trades more than 35x trailing 12-months earnings significantly above calendar year (CY) 2015 levels of about 9x. The company pays dividends once per year beginning in FY 2016 with a payout ratio averaging approximately 16% for the period under review.



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## Knutsford Express Services Limited

### Recent Developments

For the 1<sup>st</sup> quarter ended August 30, 2019 revenue rose 10.79% or \$31.59 million to \$324.52 million. Meanwhile, profits declined \$40.22 million or 45.71% to \$47.78 million. The decline in profits was attributed to expenses associated with refurbishing its fleet and the build-out of several new routes.

In January 2019 KEX raised \$150 million (Unsecured 5-year 7.25%) via a private bond to fund expansion locally and overseas, including a small bus charter company in Florida.

### Key Financial Data

|                         | FY 2015     | FY 2016     | FY 2017     | FY 2018     | FY 2019       | CAGR           | Q1 2019     | Q1 2020       | Change  |
|-------------------------|-------------|-------------|-------------|-------------|---------------|----------------|-------------|---------------|---------|
| BVPS                    | 0.46        | 0.67        | 0.97        | 1.25        | 1.56          | 35.77%         | 1.43        | 1.65          | 15.85%  |
| EPS                     | 0.14        | 0.24        | 0.34        | 0.36        | 0.38          | 28.40%         | 0.18        | 0.10          | -45.71% |
| Dividend                | 0.00        | 0.03        | 0.05        | 0.07        | 0.07          | 32.64%         | 0.00        | 0.00          | 0.00%   |
| Adj. Close Price        | 1.20        | 3.36        | 15.00       | 12.51       | 12.46         | 79.51%         | 12.60       | 11.40         | -9.52%  |
| Revenue                 | 451,601,345 | 584,489,311 | 752,399,634 | 926,149,391 | 1,146,606,736 | 26.23%         | 292,929,999 | 324,523,458   | 10.79%  |
| Operating Profit        | 80,699,941  | 140,622,572 | 180,361,803 | 199,663,483 | 212,044,776   | 27.32%         | 88,920,593  | 57,378,831    | -35.47% |
| Net Profit              | 69,335,796  | 121,840,069 | 170,340,281 | 177,587,133 | 188,471,685   | 28.40%         | 88,001,129  | 47,775,983    | -45.71% |
| Equity                  | 229,452,944 | 336,293,014 | 482,633,295 | 626,220,428 | 779,646,316   | 35.77%         | 714,221,557 | 827,410,791   | 15.85%  |
| Current Assets          | 94,072,605  | 137,203,897 | 230,710,380 | 304,723,137 | 312,484,107   | 35.00%         | 345,462,970 | 393,133,036   | 13.80%  |
| Non-Current Assets      | 185,911,359 | 305,566,654 | 356,706,915 | 447,298,296 | 750,684,887   | 41.75%         | 488,948,899 | 742,551,436   | 51.87%  |
| Total Assets            | 279,983,964 | 442,770,551 | 587,417,295 | 752,021,433 | 1,063,168,994 | 39.59%         | 834,411,869 | 1,135,684,472 | 36.11%  |
| Current Liabilities     | 30,860,866  | 48,858,740  | 52,645,704  | 63,437,999  | 79,781,943    | 26.80%         | 65,529,946  | 114,065,817   | 74.07%  |
| Debt                    | 18,554,773  | 59,585,295  | 61,386,305  | 78,869,066  | 215,421,053   | 84.59%         | 71,166,426  | 205,888,182   | 189.31% |
| Operating Cash Flow     | 83,881,282  | 161,492,791 | 198,438,788 | 253,709,572 | 318,609,405   | 39.60%         | 64,869,854  | 88,652,021    | 36.66%  |
| Investing Cash Flow     | 74,088,300  | 188,193,695 | 156,193,191 | 163,856,078 | 425,949,935   | 54.85%         | 61,245,800  | 17,503,951    | -71.42% |
|                         |             |             |             |             |               | <b>Average</b> |             |               |         |
| Operating Profit Margin | 17.87%      | 24.06%      | 23.97%      | 21.56%      | 18.49%        | 21.19%         | 30.36%      | 17.68%        | -41.75% |
| Net Profit Margin       | 15.35%      | 20.85%      | 22.64%      | 19.17%      | 16.44%        | 18.89%         | 30.04%      | 14.72%        | -51.00% |
| Current Ratio           | 3.05        | 2.81        | 4.38        | 4.80        | 3.92          | 3.79           | 5.27        | 3.45          | -34.62% |
| Debt-to-Equity          | 0.08        | 0.18        | 0.13        | 0.13        | 0.28          | 0.16           | 0.10        | 0.25          | 149.73% |
| ROE                     | 35.60%      | 43.07%      | 41.60%      | 32.03%      | 26.81%        | 35.82%         | 33.35%      | 19.23%        | -42.33% |
| ROA                     | 28.00%      | 33.72%      | 33.07%      | 26.52%      | 20.77%        | 28.41%         | 28.19%      | 15.05%        | -46.62% |
| P/E                     | 8.65        | 13.79       | 44.03       | 35.22       | 33.06         | 26.95          | 30.14       | 38.45         | 27.56%  |
| P/B                     | 2.61        | 5.00        | 15.54       | 9.99        | 7.99          | 8.23           | 8.82        | 6.89          | -21.90% |
| Dividend Payout Ratio   | 0.00%       | 12.31%      | 14.09%      | 19.15%      | 18.57%        | 16.03%         | 0.00%       | 0.00%         | 0.00%   |
| Dividend Yield          |             | 0.89%       | 0.32%       | 0.54%       | 0.56%         | 0.58%          | 0.00%       | 0.00%         | 0.00%   |

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## Knutsford Express Services Limited

### Financial Overview

Revenue represents income earned from the provision of transportation and courier services. Revenue has increased consistently at a compounded annual growth rate of 26.23% for the period FY 2015 to FY 2019 (period under review). However, the growth rate in revenue has declined from a high of 59.05% for FY 2014 to 23.80% in FY 2019. For the 1st quarter of FY 2020 ended August 30, 2019 revenue growth slowed to the lowest for the period under review, increasing only 10.79%. Meanwhile, for the period under review, profits have grown at a CAGR of 28.40% to a record high of \$188.47 million. However, profit growth in recent years has been materially lower recording 4.25% and 6.13% in FY 2018 and FY 2019 respectively. In FY 2016, profit growth reached a high of 75.72% and has slowed since. **The decline in profit growth can be attributed to the increase in Salaries, Fuel and Depreciation & Amortization. These three items represent the majority of expenses for KEX, approximately 59.48% in FY 2019.**

Total Assets have increased at a CAGR of 39.59% for the period under review to \$1.06 billion. In FY 2019, total assets surged 41.37% or \$311.15 million, this was due in part to a property purchase by KE Investments Limited. The subsidiary is developing a 2 acre Drax Hall Property for a new KE Super Terminal and logistics and light industrial lease space. Meanwhile, debt has surged at a CAGR of 84.59% to \$215.42 million for the period under review. The primary reason for the increase was the private placement of a 5-year, unsecured bond for \$150 million in Q3 FY 2019. Equity has steadily increased for the period under review at a CAGR of 35.77% to \$779.65 million. The driver of equity growth has been consistent profitability for the period under review.

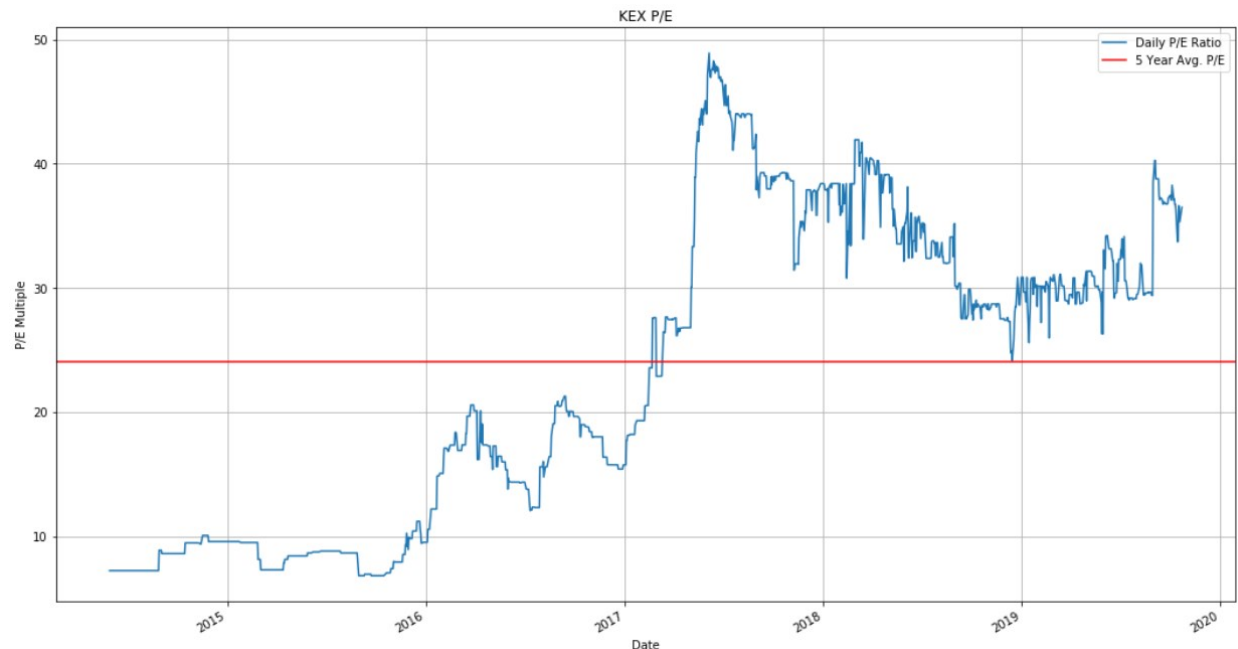
For the period under review Operating Cash Flow (OCF) has increased at a CAGR of 39.60% to \$318.61 million. For the first quarter of FY 2020, OCF increased by \$23.78 million or 36.66% to \$88.65 million. The main contributor to the material divergence between Profits and OCF is depreciation expenses. Depreciation expense has increased at a CAGR of 39.03% to for the period under review to \$94.23 million as KEX increases its fleet of vehicles. Investment activities ramped up in FY 2019 to \$425.95 million materially higher than the average of \$201.66 million for the period under review. However, there was a meaningful decline in cash used in investing activities for the first quarter of FY 2020 of 71.42%, indicating investing activities could revert to its average.

Since FY 2016 Operating Profit Margin (OPM) has steadily declined to reach a low in FY 2019 of 18.49%. OPM in FY 2019 was constrained by a surge in fuel costs to \$162.55 million and depreciation to \$94.23 million increases of 27.74% and 30.12% respectively. Net profit margin (NPM) followed a similar pattern to OPM beginning its descent in FY 2017. KEX has maintained a relatively high current ratio for the period under review averaging 3.79x. Debt to Equity hit an all-time high of 0.28x at the end of FY 2019 however, it has declined marginally for Q1 FY 2020 to 0.25x.

## Knutsford Express Services Limited

### Forecast and Valuation

We used a combination of the relative value and DCF models to arrive at our price target of \$8.82. For our relative value price target, we used expected FY 2020 EPS of \$0.30 and applied the 5-year average P/E of 24.07x. This would result in P/E multiple contraction from current levels, we see this as fair, given our expectations for a decline in FY 2020 profit. The relative value and DCF methods produced price targets of \$7.33 and \$10.30, respectively, which represents our worst-case and best-case price targets.



### Outlook

Our outlook for KEX in the near-term is neutral, given strong OCF and free cash flow. However, our expectation is tempered by slowing revenue and profit growth. Furthermore, as of January 2019, KEX has started to pay taxes at half the effective rate, this could further limit earnings growth. The initiatives being undertaken by KE Investments could provide an increase in profitability in the medium to long-term. Nevertheless, we expect ROE and ROA to continue to trend lower as the business matures.

### Key Risks to Our Price Target

A key risk to our price target is a surge in fuel costs beyond the normal expected levels, which accounted for 17% of FY 2019 expenses. Additional hazards include, revenue growth being lower than projected, which could result in earnings failing to meet our expectations. As indicated previously, Q1 FY 2020 revenue growth was the lowest for the period under review, a further slide could be problematic.

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## Knutsford Express Services Limited

### Recommendation:

We recommend a **SELL** rating on KEX at this point, given that the stock trades materially above our price target and marginally above our best-case price target. While we expect KEX to see continued growth in free cash flow, the current price is overly optimistic given our expectations of growth. We expect earnings to decline marginally in FY 2020, which could lower investor sentiment toward the stock. KEX stock price peaked in June 2017 to a split-adjusted \$16.67, this occurred almost concurrently with the stock split, which aided the ascent of investor sentiment to peak levels producing a P/E in excess of 45x. **KEX stock has declined meaningfully since, due to slowing profit growth and resulting lower investor sentiment, which has resulted in P/E multiple contraction.**

*Source: <http://www.Jamstockex.com>, JMMB Investment & Research, Bloomberg, Various Company Financial Statements.*

## APPENDIX

### IMPORTANT DISCLOSURES

**ABSTRACT**—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

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**UNDERPERFORM**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO 2.5% - 4.9% FOR THIS PARTICULAR ASSET

**SELL**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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## Knutsford Express Services Limited

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**OUTPERFORM / BUY**—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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## Knutsford Express Services Limited

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