

## Knutsford Express Services Limited

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INFRINGEMENT IN THE APPENDIX**

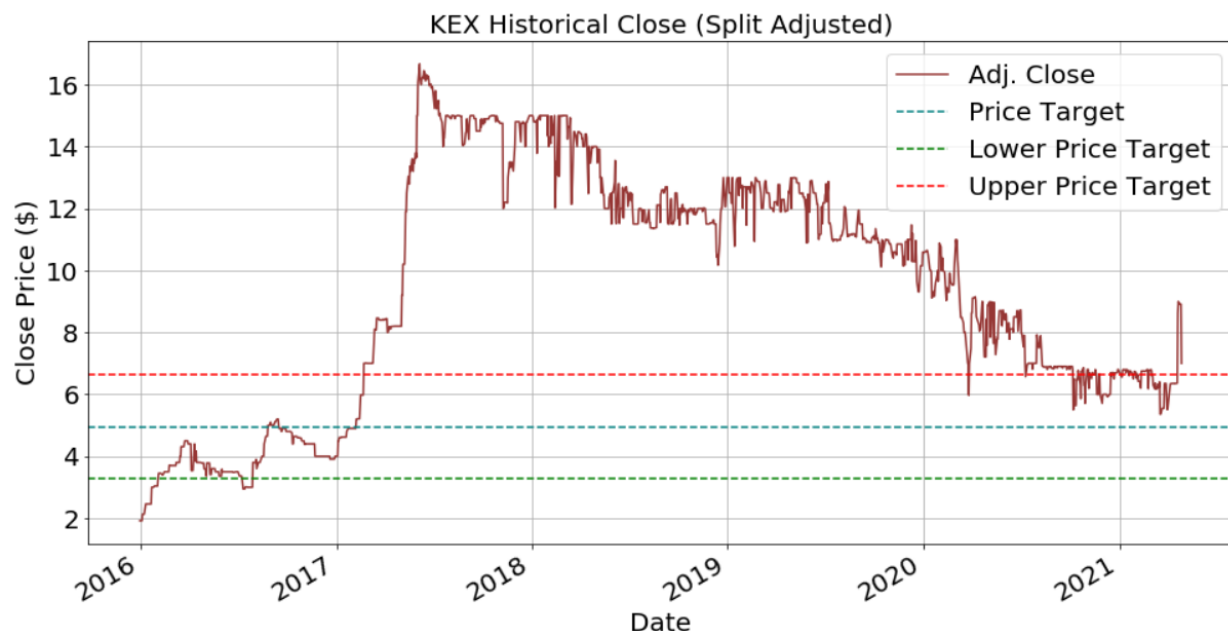
### Executive Summary

Knutsford Express Services Limited (KEX) is incorporated in Jamaica, and its registered office is located at 10 Harbour Circle, Montego Bay, St. James. The Company has three wholly-owned subsidiaries, which provide transportation services in Jamaica & Florida and undertake property development and other investments. KEX became a publicly listed company on January 14, 2014 and effected a five for one stock split in May 2017.

KEX has produced revenue growth at a CAGR of 15% to \$1.1 billion for FY 2016 to FY 2020 (period under review). Meanwhile, due to the negative impact of COVID-19, profits have declined at a CAGR of 27.6% for the same period.

The Company's operating profit margin steadily declined since FY 2016. However, the tumble in FY 2020 was more pronounced due to COVID-19. Additionally, KEX's debt-to-equity has averaged 0.20x for the period under review but has trended higher and is now at 0.42x at the end of February 2021.

KEX's stock currently trades approximately 4.9x its BVPS, roughly in line with its average over the last year of 4.7x. The Company's stock is illiquid, trading about 14.7 thousand units of average daily volume (ADV) over the previous year.



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## Knutsford Express Services Limited

### Recent Developments

For its 3<sup>rd</sup> quarter ended February 2021, revenue tumbled 41.8% to \$185 million. Meanwhile, the Company was able to reduce costs resulting in an operating loss of \$1.5 million. Despite the improvement in finance income to \$4 million versus \$757 thousand for the same period, the Company produced a loss of 1.6 million for the quarter.

While KEX has not returned to profitability since the advent of the global pandemic, the most recent quarter's loss was the lowest post-COVID-19. Meanwhile, the Company was able to produce cash flow from operations of \$82.6 million for the 9M period. The improvement versus the same period for the prior year was primarily due to a decline in operating assets versus an increase.

### Key Financial Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	CAGR	Q3 2020	Q3 2021	Change
<b>BVPS</b>	0.67	0.97	1.25	1.56	1.53	22.83%	1.69	1.42	-15.96%
<b>EPS</b>	0.24	0.34	0.36	0.38	0.07	-27.56%	0.21	-0.12	N/A
<b>Dividend</b>	0.03	0.05	0.07	0.07	0.08	27.79%	0.08	0.00	0.00%
<b>Adj. Close Price</b>	3.36	15.00	12.51	12.46	8.72	26.94%	10.09	6.77	-32.92%
<b>In Millions</b>									
<b>Revenue</b>	584.5	752.4	926.1	1,146.6	1,021.7	14.98%	925.2	456.4	-50.67%
<b>Operating Profit</b>	140.6	180.4	199.7	212.0	46.8	-24.03%	127.8	(57.5)	N/A
<b>Net Profit</b>	121.8	170.3	177.6	188.5	33.6	-27.56%	103.2	(60.6)	N/A
<b>Equity</b>	336.3	482.6	626.2	779.6	765.4	22.83%	844.8	709.9	-15.96%
<b>Current Assets</b>	137.2	230.7	304.7	312.5	214.3	11.79%	357.2	183.3	-48.69%
<b>Non-Current Assets</b>	305.6	356.7	447.3	750.7	878.3	30.21%	819.7	928.5	13.27%
<b>Total Assets</b>	442.8	587.4	752.0	1,063.2	1,092.5	25.33%	1,176.9	1,111.8	-5.53%
<b>Current Liabilities</b>	48.9	52.6	63.4	79.8	82.0	13.81%	93.9	95.5	1.76%
<b>Debt</b>	59.6	61.4	78.9	215.4	240.6	41.75%	243.2	299.1	22.97%
<b>Operating Cash Flow</b>	161.5	198.4	253.7	324.3	88.7	-13.91%	64.9	82.6	27.39%
<b>Investing Cash Flow</b>	188.2	156.2	163.9	425.9	17.6	-44.73%	61.2	136.9	123.49%
<b>Average</b>									
<b>Operating Profit Margin</b>	24.06%	23.97%	21.56%	18.49%	4.58%	18.53%	13.81%	-12.60%	N/A
<b>Net Profit Margin</b>	20.85%	22.64%	19.17%	16.44%	3.28%	16.48%	11.15%	-13.29%	N/A
<b>Current Ratio</b>	2.81	4.38	4.80	3.92	2.61	3.70	3.80	1.92	-49.58%
<b>Debt-to-Equity</b>	0.18	0.13	0.13	0.28	0.31	0.20	0.29	0.42	46.33%
<b>ROE</b>	43.07%	41.60%	32.03%	26.81%	4.34%	29.57%	16.78%	-16.76%	N/A
<b>ROA</b>	33.72%	33.07%	26.52%	20.77%	3.11%	23.44%	12.16%	-11.38%	N/A
<b>P/E</b>	13.79	44.03	35.22	33.06	129.97	51.21	37.74	-25.99	N/A
<b>P/B</b>	5.00	15.54	9.99	7.99	5.70	8.84	5.97	4.77	-20.17%
<b>Dividend Payout Ratio</b>	12.31%	14.09%	19.15%	18.57%	119.19%	36.66%	38.77%	0.00%	N/A
<b>Dividend Yield</b>	1.35%	0.86%	0.47%	0.58%	0.78%	0.81%	0.74%	0.00%	N/A

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## Knutsford Express Services Limited

### Financial Overview

Revenue is primarily earned from the provision of transportation and courier services. Revenue has increased consistently at a compounded annual growth rate of 15% from FY 2016 to FY 2020 (period under review). However, it fell 10.9% to \$1.02 billion in FY 2020 due to COVID-19's negative impact on Q4 FY 2020 revenue. In Q4 FY 2020, revenue fell 68.3% to \$96.4 million. Meanwhile, for the 9M period ended February 2021, revenue fell 50.7% versus the similar period the prior year.

Profits declined at a CAGR of 27.6% to \$33.6 million for the period due to profits deteriorating by 82.2% in FY 2020. **It should be noted that the decline in profitability was occurring before the negative impact of COVID-19.** The decline in profitability was partially due to higher operating expenses due to a surge in depreciation & amortization, insurance, and salary expenses. KEX produced a loss of \$69.6 million in Q4 FY 2020, the worst quarter for the period under review. Meanwhile, for the 9M period ended February 2021, the Company reported a loss of \$60.6 million versus a profit of \$103.2 million for the same period in the prior FY.

Total Assets has increased at a CAGR of 25.33% for the period under review to \$1.09 billion. However, total assets only increased by 2.8% in FY 2020 due to a 70.1% decline in cash and bank balances to \$39.5 million. However, the Company has seen a 0.9% increase in short-term investments to \$123.6 million. Therefore, the Company still has access to sufficient liquidity.

Meanwhile, debt has surged at a CAGR of 41.8% to \$240.6 million for the period under review. The Company's debt increased 11.7% in FY 2020 due primarily to an additional \$50 million 6.9% senior unsecured bond. The Company's debt continues to grow, reaching \$299.1 million at the end of Q3 FY 2021.

Meanwhile, equity has steadily increased for the period under review at a CAGR of 22.8% to \$765.4 million. However, KEX's equity fell 1.8% in FY 2020 due to its dividend payout ratio exceeding its earnings.

The period under review produced volatile Cash Flow from Operations (CFO) which declined 48.4% in FY 2020 to \$167.4 million. The main contributor to the material divergence between Profits and CFO is depreciation expenses. Depreciation expense has increased at a CAGR of 32.4% for the period under review to \$114.9 million as KEX increases its fleet of vehicles. Investment activities fell from FY 2019 levels when the Company spent \$237.6 million to acquire vehicles. In FY 2020, KEX spent only \$58.3 million on vehicle acquisitions and \$138.2 million to acquire land.

Since FY 2016, Operating Profit Margin (OPM) has steadily declined to reach a low of 4.6% in FY 2020. Increases in sales and depreciation expense constrained OPM in FY 2020 despite the material decline in revenue. KEX has maintained a relatively high current ratio for the period under review averaging 3.7x. Debt-to-equity climbed to 0.42x at the end of Q3 FY 2021 from 0.31x at the end of FY 2020.

## Knutsford Express Services Limited

### Forecast and Valuation

We arrived at our price target of \$4.92 using the Free Cash Flow to Equity (FCFE) model. Meanwhile, using the FCFE under two additional scenarios produced our upper- and lower-case price targets of \$6.63 and \$3.28, respectively. The primary differences between the various scenarios are the expectation for revenue growth and operating margins in FY 2022. The best-case scenario assumes the Company returns to pre-COVID revenue levels and produces superior operating margins. Meanwhile, under the worst-case scenario, revenue as a percentage of pre-COVID amount stalls and operating margins remain depressed. Meanwhile, under our base-case scenario the recovery of revenue to pre-COVID levels continues along its current path and operating margins remain stable.

### Outlook

In the near-term we expect curfews and reduced tourist travel to weigh on the transportation segment. KEX is in the process of completing its Drax Hall Super Terminal and Commercial Centre. The completion of its terminal is expected to aid long-term growth and diversify the Company's revenue stream. Phase 1 has already been completed, with Phase 2 scheduled to be completed in 2021. Phase 2 is a 23,000 sq. ft. 2-acre development of commercial/logistics space containing 14 storefronts.

Furthermore, the Company continues to open new courier offices, including recent additions at the new hut at Drax Hall and Sovereign (Centre) on The Boulevard. The completion of this new development is expected to help boost FY 2021 earnings. However, it could be overshadowed by the continued negative impact of COVID-19 on revenue from the transportation segment.

### Key Risks to Our Price Target

Key risks to our price target include the impact of variants and the speed/take-up of vaccinations. KEX primary revenue is highly dependent on domestic and tourist travel across the island, which will continue to be materially impacted by COVID-19 for several months.

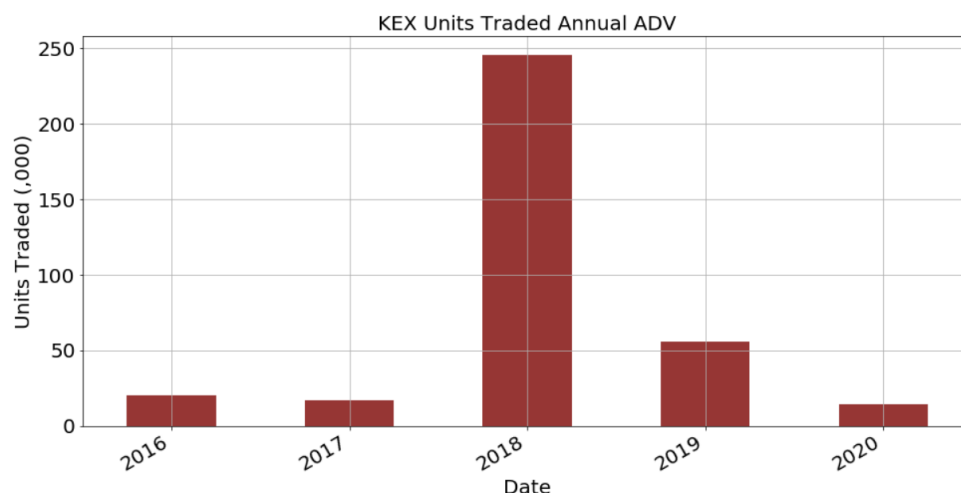
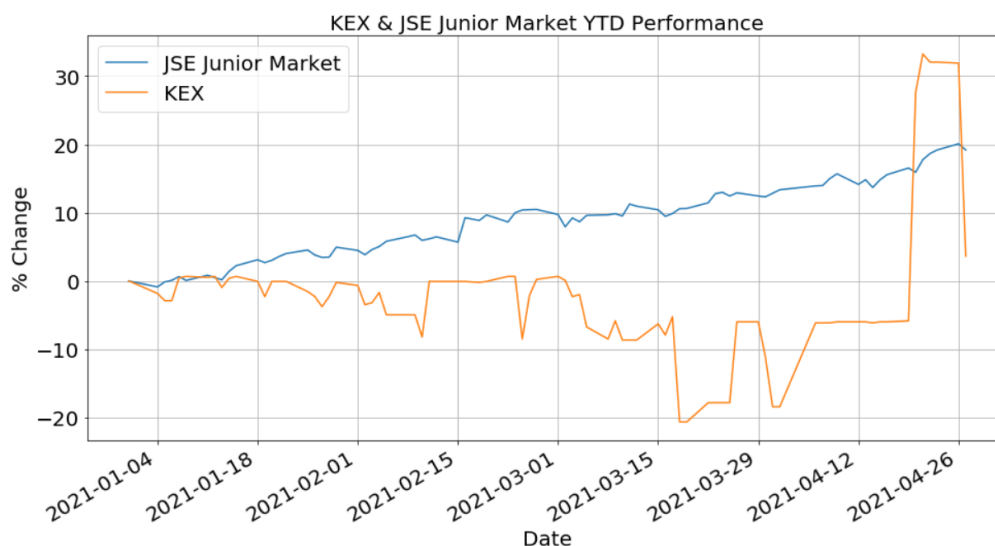
Furthermore, the Company is susceptible to a surge in fuel costs which is the second-highest expense for the Company, accounting for 15.9% of FY 2020 expenditures.

## Knutsford Express Services Limited

### Recommendation:

We recommend a **STRONGLY UNDERWEIGHT** rating on KEX at this point, given that the stock trades above our best-case price target. While we expect KEX revenue and FCFE to increase from their currently depressed levels, the current price reflects what we view as unattainable growth. Under our best-case price target, we expect profits to exceed the previous high of \$188.5 million in FY 2019. Which would have been difficult to attain before COVID-19, given that earnings growth was challenged from as early as Q3 February 2019.

Furthermore, KEX's stock is illiquid, trading an ADV of 14.7 thousand units over the last year. Therefore, its shares can be quite volatile on thin volume. Trading of 92 units caused the recent move from \$6.36 to \$8.62.



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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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