



# Exchange Income Corporation. (EIFZF)

Updated November 16<sup>th</sup>, 2020 by Nikolaos Sismanis

## Key Metrics

|                             |         |  |       |   |            |
|-----------------------------|---------|--|-------|---|------------|
| <b>Current Price:</b>       | \$27.60 | <b>5 Year CAGR Estimate:</b>               | 9.2%  | <b>Market Cap:</b>                        | \$978 M    |
| <b>Fair Value Price:</b>    | \$27.50 | <b>5 Year Growth Estimate:</b>             | 4.0%  | <b>Ex-Dividend Date<sup>1</sup>:</b>      | 11/29/2020 |
| <b>% Fair Value:</b>        | 100%    | <b>5 Year Valuation Multiple Estimate:</b> | -0.1% | <b>Dividend Payment Date<sup>1</sup>:</b> | 12/15/2020 |
| <b>Dividend Yield:</b>      | 6.0%    | <b>5 Year Price Target</b>                 | \$33  | <b>Years Of Dividend Growth:</b>          | 0          |
| <b>Dividend Risk Score:</b> | F       | <b>Retirement Suitability Score:</b>       | D     | <b>Last Dividend Increase:</b>            | N/A        |

## Overview & Current Events

Exchange Income Corporation engages in aerospace and aviation services by offering scheduled airline and charter services, emergency medical services, after-market aircraft & engines, and pilot flight training services. Additionally, the company is invested in manufacturing window wall systems used in skyscrapers, vessels, and other industrial purposes. Finally, Exchange Income also owns telecom towers, which it leases to America's and Canada's major telecom providers. The company generates just over \$1 billion in annual revenue, is based in Winnipeg, Canada, and aims to pay out the majority of its earnings through monthly dividends while it grows through acquisitions. All numbers in this report have been converted into \$US, unless specified otherwise.

On November 12<sup>th</sup>, 2020 Exchange Income reported its Q3 2020 results for the quarter ending September 30<sup>th</sup>, 2020. Revenue came in at \$227 million, a -16% decrease year-over-year. Lower sales were primarily attributed to the aviation industry suffering as a result of COVID-19, which reduced demand for the company's aircraft and other parts. Still, lower sales were not that devastating, as its niche operations include medevac, seismic support, and other services usually contractually-secured by governmental entities. Adjusted EPS was \$0.45, a -43% decrease against Q3-2019, as lower revenues squeezed margins against constant expenses. Despite the quarter's weaker results, management remained very optimistic, seeing real recovery trends. For example, aviation passenger volumes recovered from a low of approximately 10% of normal to a high of about 60% as of its latest data. Additionally, Mr. Pyle, Exchange Income's CEO, reassured investors that the company had modeled such an adverse economic scenario, carefully managing its financials to ensure investors' income and the company's future growth. He even made the bold statement that "...with the proven resilience of our business model, you can count on [Exchange Income] to remain one of Canada's most dependable dividend stocks." Based on the its first nine-month results, we expect a FY2020 adjusted EPS of \$1.07.

## Growth on a Per-Share Basis

| Year                      | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020          | 2025          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$1.18 | \$1.42 | \$1.46 | \$0.54 | \$0.61 | \$1.70 | \$1.85 | \$2.17 | \$2.19 | \$2.94 | <b>\$1.07</b> | <b>\$3.04</b> |
| <b>DPS</b>                | \$1.57 | \$1.58 | \$1.64 | \$1.58 | \$1.46 | \$1.31 | \$1.49 | \$1.67 | \$1.59 | \$1.72 | <b>\$1.67</b> | <b>\$2.03</b> |
| <b>Shares<sup>2</sup></b> | 12.9   | 16.8   | 20.0   | 21.3   | 22.1   | 24.7   | 28.2   | 31.0   | 31.5   | 32.4   | <b>34.7</b>   | <b>40.0</b>   |

Exchange Income pays dividends on a monthly basis. In its original Toronto listing, the company has never cut its payment since its first one in 2004, only growing them whenever management sees fit. For context, its monthly dividend has grown from C\$0.10 in 2005 to C\$0.19, as of today. However, American investors have mostly seen stable dividends due to the depreciation of the C\$ to the \$US. We estimate adjusted EPS and DPS growth of around 4% in the medium term, slightly lower than the company's historical (Canadian) average, which prices in some lag amid its recovery efforts. Additionally, we are assuming constant USD/CAD and using an underlying earnings power estimate of \$2.50 for valuation and fair value calculations. This reflects a nearly full recovery in earnings, after depressed earnings this year.

<sup>1</sup> Estimated dates based on past monthly-dividend dates.

<sup>2</sup> Share count is in millions.

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*



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## Valuation Analysis

| Year      | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now         | 2025        |
|-----------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E  | 15.7 | 23   | 19   | ---  | ---  | 10.8 | 12.7 | 12.1 | 11.8 | 9.9  | <b>11.0</b> | <b>11.0</b> |
| Avg. Yld. | 6.0% | 6.1% | 6.1% | 5.9% | 7.9% | 7.3% | 7.4% | 5.9% | 6.8% | 5.6% | <b>6.0%</b> | <b>6.0%</b> |

Exchange Income shares have retained a relatively moderate valuation multiple throughout the years, as its operations mainly involve investing in other businesses (a holding company). The stock has mostly traded based on its yield, which the market has continuously found fitting at around 6%. The OTC shares have remained flat since their 2012 listing due to dividend increases being offset by currency fluctuations. On its Canadian listing, shares have appreciated in line with the company's dividend increases, also retaining a yield of around 6%.

We believe the current valuation near 11 times earnings is fair, taking into consideration the security's history, reliable yield and average growth prospects.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

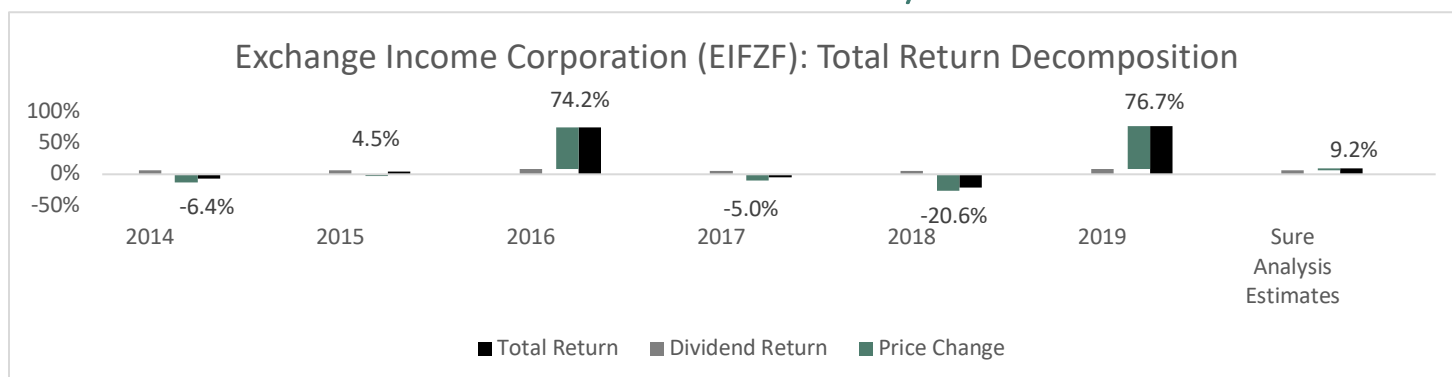
| Year   | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025       |
|--------|------|------|------|------|------|------|------|------|------|------|------|------------|
| Payout | 133% | 111% | 112% | ---  | ---  | 77%  | 81%  | 77%  | 73%  | 59%  | 67%  | <b>67%</b> |

At the beginning of the decade, the company had an artificially high payout ratio, mostly attributed to accounting reasons amid its serial acquisitions. Exchange Income's adjusted EPS, at least from 2015, appears to adequately cover the current dividend run rate, allowing for some cash retention to be utilized in times of uncertainty, such as the current one. In line with management's confident dividend coverage guidance, we believe that the stock's dividend remains quite safe. Additionally, while the company's businesses such as aviation and manufacturing are very recession-sensitive and subject to brutal competition, they are usually powered by multi-year contracts, resulting in a bit more stable revenues (i.e., -16% revenue decline under such adverse economic conditions).

## Final Thoughts & Recommendation

Exchange Income's goal is to provide sustainable and growing income to its shareholders, as its name suggests. While U.S. investors may have lacked the latter due to currency fluctuations, the CAD/USD rate has mostly been stable over the past few years, which could indicate a more comparable performance to the stock's original Toronto listing going forward. Despite the adverse impact of COVID-19 to the company's subsidiaries, Exchange Income's financials remain relatively robust, currently supporting a 6% yield. We forecast annualized returns of around 9.2% over the medium term, primarily powered by the company's dividend yield. For conservative investors looking for a reliable stream of income, Exchange Income could be an attractive non-U.S. option. Shares earn a hold rating.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year                    | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Revenue</b>          | 237   | 516   | 801   | 494   | 491   | 633   | 673   | 782   | 929   | 1,011 |
| <b>Gross Profit</b>     | 94    | 108   | 132   | 104   | 108   | 158   | 183   | 216   | 249   | 273   |
| <b>Gross Margin</b>     | 39.5% | 20.9% | 16.5% | 21.0% | 22.0% | 25.0% | 27.1% | 27.6% | 26.8% | 27.1% |
| <b>SG&amp;A Exp.</b>    | 51    | 63    | 76    | 67    | 68    | 84    | 93    | 116   | 141   | 154   |
| <b>D&amp;A Exp.</b>     | 16    | 31    | 38    | 47    | 49    | 66    | 71    | 92    | 107   | 128   |
| <b>Operating Profit</b> | 27    | 45    | 56    | 36    | 40    | 74    | 89    | 100   | 108   | 120   |
| <b>Op. Margin</b>       | 11.3% | 8.7%  | 7.0%  | 7.4%  | 8.1%  | 11.7% | 13.3% | 12.8% | 11.6% | 11.8% |
| <b>Net Profit</b>       | 13    | 21    | 25    | 9     | 7     | 32    | 46    | 56    | 55    | 63    |
| <b>Net Margin</b>       | 5.6%  | 4.1%  | 3.2%  | 1.8%  | 1.5%  | 5.0%  | 6.9%  | 7.1%  | 5.9%  | 6.2%  |
| <b>Free Cash Flow</b>   | (21)  | 14    | (87)  | (84)  | 14    | (37)  | (98)  | (110) | (21)  | (28)  |
| <b>Income Tax</b>       | 6     | 9     | 13    | 8     | 29    | 15    | 19    | 18    | 14    | 17    |

## Balance Sheet Metrics

| Year                          | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016  | 2017  | 2018  | 2019  |
|-------------------------------|------|------|------|------|------|------|-------|-------|-------|-------|
| <b>Total Assets</b>           | 326  | 469  | 713  | 903  | 616  | 886  | 1,057 | 1,391 | 1,437 | 1,735 |
| <b>Cash &amp; Equivalents</b> | 1    | 11   | 4    | 22   | 13   | 11   | 20    | 58    | 32    | 17    |
| <b>Acc. Receivable</b>        | 30   | 68   | 135  | 133  | 71   | 90   | 112   | 163   | 171   | 216   |
| <b>Inventories</b>            | 23   | 39   | 64   | 103  | 72   | 85   | 96    | 142   | 159   | 172   |
| <b>Goodwill &amp; Int.</b>    | 52   | 90   | 102  | 144  | 122  | 259  | 272   | 337   | 342   | 401   |
| <b>Total Liabilities</b>      | 149  | 248  | 417  | 616  | 358  | 564  | 696   | 932   | 984   | 1,176 |
| <b>Accounts Payable</b>       | 35   | 57   | 126  | 142  | 72   | 78   | 95    | ---   | ---   | ---   |
| <b>Long-Term Debt</b>         | 51   | 158  | 229  | 411  | 233  | 365  | 487   | 673   | 718   | 789   |
| <b>Total Equity</b>           | 178  | 221  | 296  | 287  | 258  | 322  | 361   | 459   | 453   | 559   |
| <b>D/E Ratio</b>              | 0.29 | 0.72 | 0.77 | 1.43 | 0.90 | 1.13 | 1.35  | 1.47  | 1.59  | 1.41  |

## Profitability & Per Share Metrics

| Year                    | 2010   | 2011  | 2012   | 2013   | 2014  | 2015   | 2016   | 2017   | 2018   | 2019   |
|-------------------------|--------|-------|--------|--------|-------|--------|--------|--------|--------|--------|
| <b>Return on Assets</b> | 4.6%   | 5.3%  | 4.3%   | 1.1%   | 1.0%  | 4.2%   | 4.8%   | 4.5%   | 3.9%   | 4.0%   |
| <b>Return on Equity</b> | 9.6%   | 10.5% | 9.8%   | 3.0%   | 2.7%  | 10.9%  | 13.6%  | 13.6%  | 12.0%  | 12.5%  |
| <b>ROIC</b>             | 7.0%   | 6.9%  | 5.6%   | 1.4%   | 1.3%  | 5.4%   | 6.1%   | 5.6%   | 4.7%   | 5.0%   |
| <b>Shares Out.</b>      | 12.9   | 16.8  | 20.0   | 21.3   | 22.1  | 24.7   | 28.2   | 31.0   | 31.5   | 32.4   |
| <b>Revenue/Share</b>    | 17.66  | 26.82 | 36.77  | 23.03  | 22.21 | 24.68  | 19.82  | 21.71  | 26.72  | 26.53  |
| <b>FCF/Share</b>        | (1.54) | 0.72  | (3.98) | (3.93) | 0.63  | (1.45) | (2.87) | (3.06) | (0.59) | (0.74) |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

### Disclaimer

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