

Jamaica, West Indies

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## BANK OF NOVA SCOTIA--BNS

### Recommendation-- Hold

#### → Summary

While the BNS group has a reputation for being a strong and stable financial institution, it is only normal for shareholders to raise concerns regarding the maintenance of current profitability given the current uncertainties surrounding the domestic financial markets and the Jamaican economy in general post- the Jamaica Debt Exchange (JDX). Based on our analysis the group's key indicators should come out as follows:-

#### Projections for the quarter ending April 31-2010 compared to the Jan-2010 forecasted quarter

- Net Profit of J\$2.1 Billion, a decline of J\$853 million or 28.6%.
- Profit before taxation down 30.2 % or J\$1.18 billion.
- Earnings per stock Unit of J\$0.68, a decline of 28.6% or 27 cents.
- A rolling P/E Ratio of 6.26 compared to 4.45.

Based on our valuation model, the Scotia Group's current price of J\$18.60 (Feb-10-10) indicates that the stock is marginally undervalued. Our model indicates that post JDX, the long run intrinsic value of the Scotia Group is J\$19.28. While this suggests that at the current price the stock is 3.55% undervalued, assuming rounding and variable estimation error in our long run intrinsic value computations it is our opinion that the stock is fairly priced. **Consequently we recommend the stock as a hold at this time.**

#### → Impact of the JDX

As anticipated, the JDX is projected to have a negative impact on the Scotia Group. While interest income on loans is projected to climb marginally (0.7%), interest income on securities should decline by approximately J\$1.58 billion or 32%. The decline in interest income is due to the anticipated reduction in the weighted average coupon rate on GOJ securities (due to the JDX) from 17.5% to approximately 12% and the reduction of the spread between the coupon on GOJ securities and the cost of repurchase agreements used to fund purchases.

#### Strategy

In our opinion Scotia's strategy will be similar to that of the NCB Group. Because of the massive hit on the interest income from securities side we anticipate that the group will not look to reduce interest rates on existing loans in the near term. In fact our forecast is for a possible reduction in deposit rates to closer to rock bottom levels and an increase in fees as the major short term (3 to 6 month) policy response. The medium to long term strategy (6-month and beyond) is projected to be a rebalancing of the books away from the repo and interest income on securities business to a greater emphasis on loans, portfolio banking, investment recommendation and further fee generation services.

This strategy is anticipated based on rational expectations combined with policy recommendations from the multilaterals to push the risk from the financial institution to the client.

In the longer term the group may be forced to not only offer lower interest rates on new loans (which the bank has already done) but also reduce the interest rates on existing loans. This may come if the competition gets more aggressive by offering loan refinancing options. While there is a charge for early closure of loan agreements the net benefit to the client for switching his business may still be worthwhile.

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Source: JSE, JMMBIR, Company Quarterly Report

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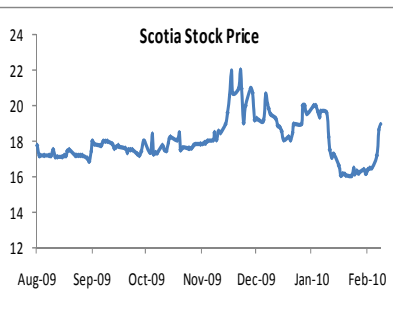


#### Projected End of Quarter (April-2010) Ratios

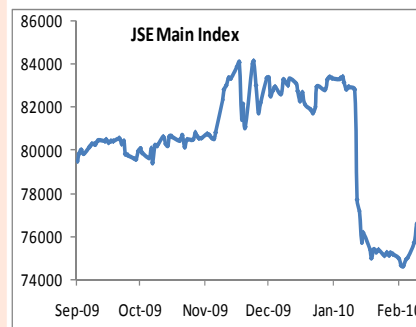
Price to Earnings (P/E)	6.26
Earnings Per Share (EPS)	J\$0.68
Net Profit	J\$2.1 billion

#### Company Profile

The Bank of Nova Scotia Jamaica Limited (Scotia bank Jamaica) is a subsidiary of The Bank of Nova Scotia, and one of the leading banks in Jamaica. The group offers a complete line of retail and commercial services including electronic cash management services through our extensive network of 35 branches across the country. Scotia bank has maintained a strong presence in Jamaica since 1889.



#### JSE Main Index Movements





BUY

Current Price (Feb-10-10)	J\$18.60
Intrinsic Value	J\$19.28
52-Week Range	J\$23 – J\$14
Quarter to Date	-2.96%
Year to Date	-2.96%

For longer term debt financing options such as mortgage agreements, there is normally no penalty for closure of the mortgage after the first three years. Consequently competition, especially from building societies may force the reduction of mortgage rates in the medium term.

It is our opinion that because of the JDX and the consequent narrowing of spreads the need to grow and increase volume **to remain viable** will force many firms to go after the business of their counterparts. This will inevitably spur aggression, reduce rates and lead to consolidation

## Forecasts

Our forecast indicates that the JDX should lead to a quarter over quarter (Jan-10 to April-10) reduction in net interest income of 19.54% (J\$1.56 billion). The firms renewed thrust for the rest of the financial year towards its loan and fee generation portfolio is projected to ease the negative impact on net interest income however for the April-2010 quarter when the JDX takes full effect, profitability should take a hit. Increases in operating expenses including redundancy payments and reduced foreign currency gains should also lead to reductions in both operating and net income.

To date the Scotia Group has acted aggressively to curtail costs with Scotia DBG closing its branches in May Pen and Ocho Rios. The Investment arm is leveraging the use of the Scotia Bank branches to maintain service to its clients.

	Forecasts		
	Jan 2010	April 2010	%-Change
Net Interest Income on Loans	3,082.7	3,105.7	0.75%
<b>Net Interest Income on Securities</b>	<b>4,929.9</b>	<b>3,341.1</b>	<b>-32.23%</b>
Net interest income	8,012.6	6,446.7	-19.54%
<b>Net interest income after provision for credit losses</b>	<b>7,443.6</b>	<b>5,877.7</b>	<b>-21.04%</b>
TOTAL OPERATING INCOME	8,948.6	7,408.6	-17.21%
TOTAL OPERATING EXPENSES	5,024.9	4,669.7	-7.07%
<b>PROFIT BEFORE TAXATION</b>	<b>3,923.7</b>	<b>2,738.9</b>	<b>-30.20%</b>
<b>NET INCOME</b>	<b>2,980.2</b>	<b>2,126.9</b>	<b>-28.63%</b>
<b>EPS</b>	<b>\$0.96</b>	<b>\$0.68</b>	<b>-28.63%</b>

## Long Run Intrinsic Value

Our view is that for the next two to three years overall economic growth will remain anaemic (0.5% to 1.2%) before possible policy measures and recovery of the global economy improves the forecast going forward. This forecast is woven into our two stage dividend discount model. Our initial assessment of the intrinsic value of Scotia pre-JDX (using our two stage dividend discount model) came in at J\$27.17. The paradigm shift or structural break which the JDX has brought led to a 29% (J\$7.89) reduction in the long run intrinsic value; currently our long term value for the Scotia Group is J\$19.28.

Given these facts the stock is recommended as a hold if an investor already owns the stock. At J\$18.60 it is our opinion that an investor who does not own the stock will only experience limited price appreciation (only a possible 3.55% appreciation). Given the possibility of rounding errors and errors associated with input variable assumptions to the model, we see the stock as fairly priced.

As with all stocks there is the possibility of price appreciation or depreciation. Concerns about the JDX (the sovereign's default) and where the yield curve will settle post-JDX and the lack of clarity around the use of IMF and multilateral flows affecting the sustainability of the debt program and fiscal programs are issues that may contribute to price declines.

On the positive side, over the last two weeks the stock price has regained some of its lost value (J\$16.0 to J\$18.60) primarily in our opinion because of the market's view that BNS is safe given its conservative policies and strong parent company in Canada. During periods of volatility local investors have viewed the company as a safe haven especially given memory of the financial sector collapse of the early 1990's.

Source: JSE, JMMBIR, Company Annual Report

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