Jamaica Public Service Company Limited

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Transaction Overview

Jamaica Public Service Company Limited (JPS) is seeking to raise up to $180M or the JMD equivalent or part thereof by means of a private placement of bonds (up to US$34M and up to J$10.68B) and the concurrent syndicated loans (up to US$66M). The facilities will be unsecured and will be used to finance the prepayment of the JPS 11.00% Senior Notes due 2021.

Facility	J$ Bonds	US$ Bonds	Syndicated Loan
Offer Amount	Up to J$10,680,000,000.00	Up to US$34,000,000.00	Up to $66,000,000.00
Use of Funds	The proceeds will be used to finance in part the prepayment of JPS 11.00% Senior Notes due 2021		
Currency	Jamaican Dollars	United States Dollars	United States Dollars
Tenor	Fifteen (15) years	Ten (10) years	Ten (10) years
Coupon Rate	Fixed at 8.40% per annum	Fixed at 7.35% per annum	Fixed at 7.35% per annum
Risk Premium	2.602%	1.989%	1.989%
Coupon Frequency	Quarterly	Quarterly	Quarterly
Principal Moratorium	Moratorium on principal repayment for sixty (60) months following the Issue Date	Moratorium on principal repayment for sixty (60) months following the Issue Date	There will be a moratorium on principal repayment for sixty (60) months following the Issue Date.
Principal Repayment	Following the Principal Moratorium period, principal will be payable in equal quarterly instalments	Following the Principal Moratorium period, principal will be payable in equal quarterly instalments	Following the Principal Moratorium Period, principal will be amortized via twenty (20) quarterly payments of US$3,300,000.
Ranking	The obligations of the Issuer with respect to the Loans and the Bond will rank pari passu in right of payment.		
Security	The facilities are unsecured		

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Financial Requirements	The financial performance of the Issuer will be subject to the following financial covenants, subject to testing on a trailing twelve months' basis and measured quarterly: • Minimum debt service coverage ratio[1]: 1.20x • Maximum debt to EBITDA[2]: 4.0x • Minimum Current Ratio: 1.10x

Company Background

Jamaica Public Service Company Limited is a vertically-integrated electric utility company and the sole distributor of electricity in Jamaica. The Company is engaged in the generation, transmission and distribution of electricity, and purchases additional power from a number of Independent Power Producers.

JPS produces electricity using a mixture of steam, diesel, hydroelectric and gas turbine generating units. As of December 31, 2018, JPS owned and operated 26 generating units, 49 substations and over 12,000 km of distribution and transmission lines. The Company has four (4) thermal power stations, eight (8) hydroelectric plants, and one (1) wind farm.

JPS is incorporated and domiciled in Jamaica as a limited liability company and is owned by MaruEnergy JPSCO I SRL and EWP (Barbados) I SRL each holding 40% interest in the Company's shares, with the Government of Jamaica (GOJ) holding 19.9% and private individuals 0.1%. MaruEnergy JPSCO I SRL is incorporated in Barbados and is ultimately owned by Marubeni Corporation, which is incorporated in Japan. EWP (Barbados) I SRL is incorporated in Barbados and is ultimately owned by the Korea Electric Power Corporation which is incorporated in South Korea. The Government of Jamaica's ownership in the Company is held collectively through the Accountant General's Department and the Development Bank of Jamaica Limited.

JPS supplies electricity to approximately 658,000 residential, commercial and industrial customers throughout Jamaica with a workforce of 1,600 employees. In 2018, JPS' customer base grew by 15,055, driven by an increase in most customer categories. This increase was attributed to JPS' efforts to regularize informal consumers as well as new housing developments.

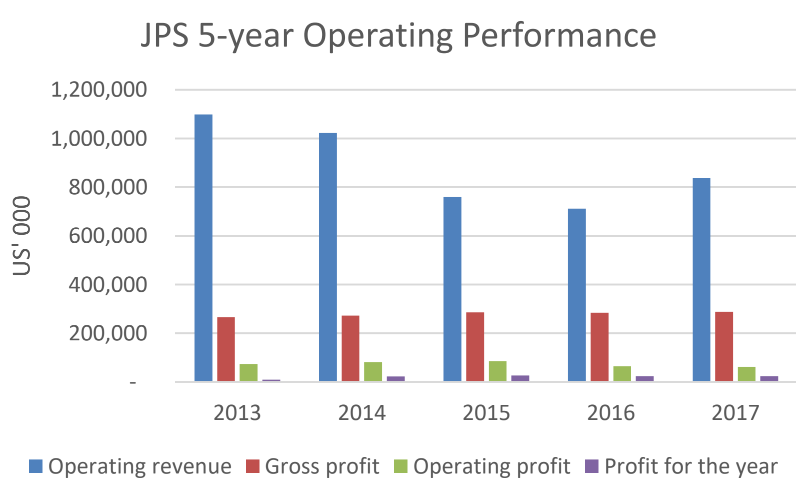
[1] EBITDA divided by (Current Portion of Long Term Debt + Interest Expenses for the last 12 months)

[2] Debt divided by the Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA)

Customer Categories	31-Dec-18	31-Dec-17	31-Dec-16	31-Dec-15	31-Dec-14
Residential	587,592	574,458	564,242	536,462	531,363
Commercial & Industrial (Small)	69,752	67,874	66,750	62,517	62,294
Commercial & Industrial (Large)	169	162	157	150	150
Other	486	450	419	401	389
Total	657,999	642,944	631,568	599,530	594,196

Financial Summary (US$) – Year ended December 31, 2018

Operating revenues for the 2017 financial year amounted to $836.87M, a 17.4% or $124.34M increase year-over-year. This performance was driven by a 32% increase in fuel costs recovered from customers as well as a 1% increase in energy sales (3,207 GWh in 2017 as opposed to 3,179 GWh in 2016). However, costs of sales surged by 28.3% to $548.97M, resulting in gross profits of $287.9M. The movement in cost of sales was attributed to an increase in the price of fuel over the year. Actual production for 2017 was 4,363 GWh as compared to 4,349 GWh in 2016, a marginal increase of 0.3%. As such, the gross profit margin narrowed to 34.4% in the year, relative to 40.0% in 2016.

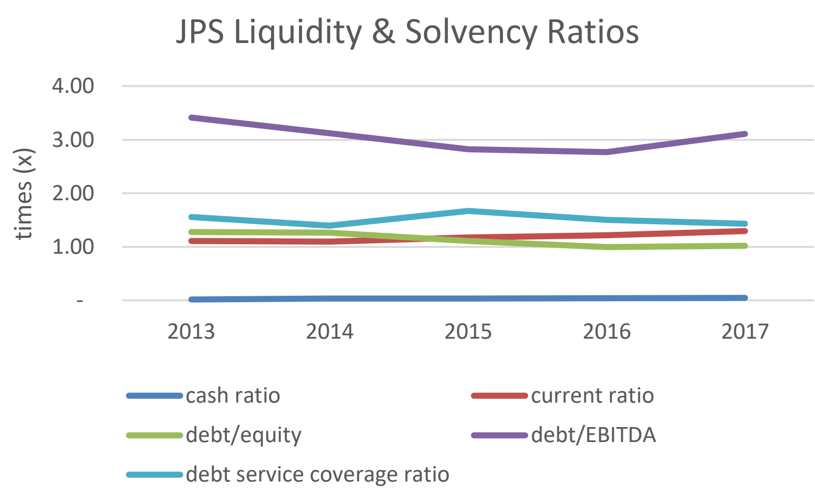


Operating expenses for the year totalled $225.56M, up just 2.4% from the prior year's result, driven by increases in payroll costs, third party services, bad debt and office and other expense. Operating profits amounted to $62.34M, down 3.2% year-over-year. The operating profit margin fell from 9.0% in 2016 to 7.4% in 2017. Earnings before interest, taxation, depreciation &

amortisation (EBITDA) amounted to $138.93M, down from $142.01M in 2016. The EBITDA margin also contracted in the year, down to 16.6% from 19.9% a year prior. Depreciation & amortisation amounted to $138.93M, a 2.2$ decline, year-over-year.

Net finance costs fell 12.3% to $34.93M as finance income rose 50.1% to $4.24M while finance costs declined 8.1% to $39.17M. The reduction in finance costs were as a result of the revaluation of the JMD versus the USD especially in the second half of the year. Those gains were partially offset be an increase in loan financing expenses due to an increase in the loan portfolio during the year.

Profit before tax amounted to $30.03M a 9.0% decrease year-on-year while net profit amounted to $24.59M, a 2.2% increase over the previous year's results. This increase was driven by a 39.1% decline in taxation as the company benefitted from an increase in tax investment allowances earned due to increased capital expenditure during the year. The pre-tax profit margin stood at 3.6%, down from 4.6% in 2016. The net profit margin also declined, falling to 2.9% from 3.4% in the prior year.

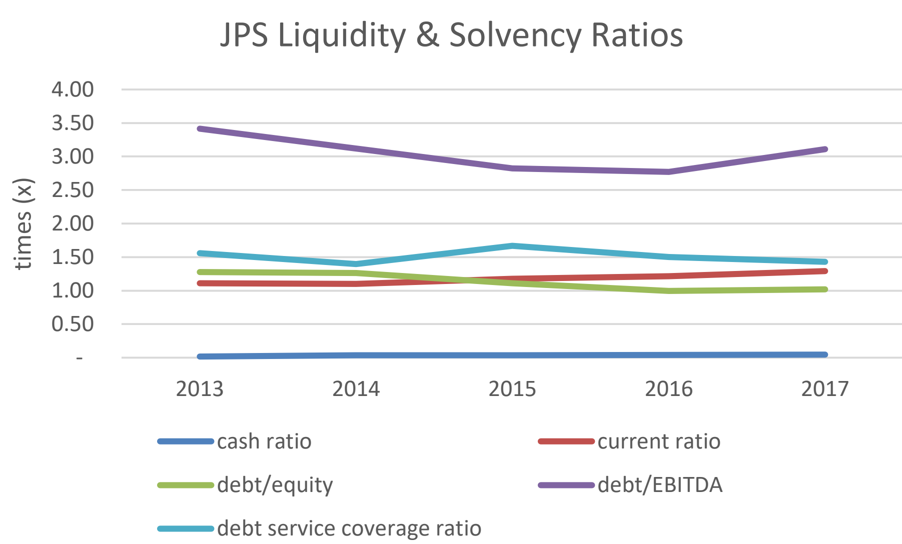


Solvency & Liquidity

As at December 31, 2017, JPS reported total assets of $1.11B, a 13.5% or $131.25M increase year-over-year. This increase was driven primarily by a 4.8% or $32.87M increase in property, plant & equipment to $710.94M, and a 39.2% or $61.13M increase in accounts receivable to $217.22M. Cash & cash equivalents amounted to $12.2M, a 41.1% increase year-over-year while inventories rose 28.8% to $41.41M. JPS also reported a 29.7% increase in employee benefits asset to $41.73M and a 62.1% increase in due from related party balances to $16.8M. Restricted cash stood at $38.44M, up 10.7% year-over-year.

Total liabilities amounted to $680.86M, up 17.7% year-over-year, or $102.51M. This movement was attributable to a 40.5% or $55.13M increase in accounts payable & provisions to $191.10M and a 11.6% or $33.12M increase in long-term loans to $317.70M. JPS recorded short term loans of $23,000 at the close of the year, relative to a zero balance at the start, while the current portion of long-term loans fell 39.0% or $23.28M to $36.34M. JPS reported total debt of $431.81M, a 9.8% or $38.62M increase year-over-year. The current ratio stood at 1.29x, up from 1.21x a year prior.

Shareholders' equity amounted to $424.15M, up 7.3% or $28.74M year-over-year, driven by a 22.2% or $28.12M increase in retained earnings, which amounted to $154.6M at yearend. The growth in debt outpaced that of equity, resulting in a slight increase in leverage. The debt-to-equity ratio rose from 0.99x in 2016 to 1.02x in 2017. JPS was able to comfortably service its debt, with a debt service coverage ratio of 1.43x for 2017, down from 1.50x in 2016 and 1.67x in 2015, but met the covenant minimum of 1.20x. The debt-to-EBITDA covenant's maximum value is 4.0x, for 2017; JPS reported a debt-to-EBITDA ratio of 3.11x, up from 2.77x in 2016 and 2.82x in 2015.



Net cash provided by operating activities declined marginally to $116.11M. Net cash used in financing activities amounted to $7.58M down 85.61% year over year as the company received loans totalling $98.85M while paying out $69.46M in loan repayments and $36.97M in interest and dividend payments, which totalled $106.43M. Net cash used in investing activities amounted to $107.9M, up 75.86% year-over-year due to $106.45M in capital expenditures.

Investment Positives & Negatives

Positives

- High barriers to entry into the industry - JPS has a long-term, exclusive right to transmit and distribute electricity, giving it monopoly status in Jamaica
- The licence awarded to JPS allows it to adjust its tariffs annually and set its revenue requirement every five years. JPS is allowed to adjust billing rates monthly for 80% of foreign exchange movement between the JMD and USD, partially insulating it from currency fluctuations – a significant risk as JPS must import oil to power its operations.
- JPS is in a strong financial position evidenced by positive cashflow generation and stable profitability and solvency ratios
- JMD and USD tranches provide options for investors with varying investment goals.

Negatives/Risks

- Loss of its exclusive licence or the opening up of the industry by regulators may impair JPS's ability to service its debt due to increased competition
- JPS' business is subject to substantial government regulation which limits its profit-making ability, for example, not all costs may be passed on to consumers.
- JPS' operations have been plagued with high rates of theft which result in significant system losses. The Office of Utility Regulation (OUR) had mandated a maximum limit of 21.3% of net generation for system losses. JPS experienced significant system losses that have averaged 26.6% of net generation over the 5-year period ended December 2017.

  As a result of exceeding the OUR target, JPS incurred system loss penalty fees over the last two years of US$34.9M, US$18.1M in 2017 and US$16.8M in 2016.
- With continued technological breakthroughs and increasing interest in alternative energy sources, JPS is at risk of losing customers as they seek to lower their energy costs by switching over to renewable energy.

- JPS frequently experiences delays in receiving payments from certain public sector and private customers which may have a material adverse effect on JPS' operations and financial stability

- Power generation involves significant risk of failure of equipment and is inherently hazardous. These risks have the potential to significantly impair JPS's operations and its ability to service its debt if realised.

Outlook & Recommendation

In the past five years JPS has seen significant improvement in its operating performance. In 2013, the Company generated US$1.1B in revenues but only US$9.19M in net profits. Fast forward to 2017, the company booked revenues of US$836.87M but US$24.59M in net profits. This improvement was attributed to the implementation of industry best practices and over US$1B in capital expenditure on the modernization of its generation facilities and distribution network and the improvement of its information technology, billing and collection systems.

To improve on this performance going forward, the company has identified key strategies which include: greater fuel diversification, grid modernisation, new business development, improving operating efficiencies and reducing electricity losses. To achieve fuel diversification, Liquefied Natural Gas (LNG) has been introduced into the fuel mix for electricity generation in 2016 and is expected to result in the stabilisation of fuel costs over the long term while enhancing energy security and the integration of more renewables to the grid.

The Company has invested over US$26M since 2016 to install over 160,000 smart meters across the island and has embarked on a Smart LED Street Lighting programme. In 2017, 36,000 Smart LED streetlights were installed as a part of a plan to replace 105,000 High Pressure Sodium streetlights on a phased basis. At the end of 2018, over 41,000 such lights have been installed. The Business Development Division was launched in 2017 with the goal of providing energy solutions, whether traditional, renewable or co-generative, as well as to support energy efficiency programmes that enable customers to save.

Reducing electricity losses will primarily target reducing non-technical losses as a result of electricity theft. JPS has pursued a number of strategies over the last five years which have included community outreach to regularize illegal connections, accelerating its deployment of smart meters, and the implementation of an Advanced Automated Theft Detection tool. It is hoped that with these initiatives as well as a revised OUR target of 23.45% that the high rates of system losses be alleviated. These measures coupled with the Advanced Automated Theft Detection

Analytical Tool led to more than 1,300 new customers being connected in 2017. However, JPS noted that losses due to theft may continue to be high as the problem stems from the poor socio-economic conditions of Jamaica, which are beyond its control.

The company performed positively in the first nine months of 2018 as operating revenue climbed 8.4% to $673.52M while net profit climbed 41.5% to $21.14M. Total assets rose 10.7% year-over-year to $1.12M while shareholders' equity climbed 8.0% to $443.35M. Total liabilities rose 12.5% to $677.46M as total debt climbed 6.9% to $443.31M. The debt-to-equity ratio stood at 1.00x as at September 30, 2018, relatively unchanged from a year prior. The notes being offered are being used to refinance the JPS 11% due 2021 notes which have a current outstanding balance of $179.2M. This transaction would lead to interest expense saving of approximately US$5.7M (9.1% of 2017 operating profits) and improvement in the profitability of the Company.

We recommend these notes at <u>MARKETWEIGHT</u>. The JMD notes have a higher yield and spread above the risk-free rate but are susceptible to greater foreign exchange risk as the long-term expectation for the JMD is still depreciation given a current account deficit. These notes are suitable for investors with a long-term investment horizon and may be more appropriate for institutional investors with lower required rates of return and are seeking long-dated assets for asset-liability matching purposes. As interest rates are at historical lows, investors should be mindful of interest rate risk as the coupons are fixed over their tenor so they would be locking their funds in at these rates when there is the potential for a rise in general interest rates.

Abridged Financials

US'000	Year ended December 31					
	2013	2014	2015	2016	2017	Change %
Operating Revenues	**1,099,383**	**1,023,240**	**759,819**	**712,534**	**836,869**	**17.4%**
Cost of Goods Sold	833,015	750,166	473,631	427,792	548,967	28.3%
Gross Profit	**266,368**	**273,074**	**286,188**	**284,742**	**287,902**	**1.1%**
Operating Expenses	192,433	191,140	200,042	220,337	225,558	2.4%
Operating Profit	**73,935**	**81,934**	**86,146**	**64,405**	**62,344**	**-3.2%**
Profit Before Taxation	12,242	22,158	30,829	32,992	30,031	-9.0%
Profit for the year	**9,188**	**23,005**	**26,507**	**24,051**	**24,587**	**2.2%**
Total Assets	**989,702**	**971,305**	**933,744**	**973,758**	**1,105,008**	**13.5%**
Total Liabilities	**660,949**	**635,085**	**566,853**	**578,347**	**680,861**	**17.7%**
Shareholder's Equity	**328,753**	**336,220**	**366,891**	**395,411**	**424,147**	**7.3%**
Net Cashflow from/(used in) Operations	**134,775**	**106,301**	**119,297**	**117,113**	**116,110**	
Net Cashflow from/(used in) Investing	**(91,818)**	**(64,048)**	**(64,907)**	**(61,357)**	**(107,903)**	
Net Cash from/(used in) Financing	**(67,534)**	**(36,433)**	**(56,568)**	**(52,664)**	**(7,578)**	
Key Ratios						
Gross profit margin	24.2%	26.7%	37.7%	40.0%	34.4%	
Operating profit margin	6.7%	8.0%	11.3%	9.0%	7.4%	
Net Margin	0.8%	2.2%	3.5%	3.4%	2.9%	
Current Ratio (x)	1.11	1.10	1.18	1.21	1.29	
Debt Service Coverage Ratio (x)	155.9%	139.7%	167.1%	150.2%	143.2%	
Debt/Equity (x)	1.28	1.26	1.11	0.99	1.02	

Source: http://www.Jamstockex.com, JMMB Investment & Research, Bloomberg, Company Financials, Offering Memorandum

APPENDIX

IMPORTANT DISCLOSURES

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

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

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

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