

## Scotia Group Jamaica Limited (SGJ)

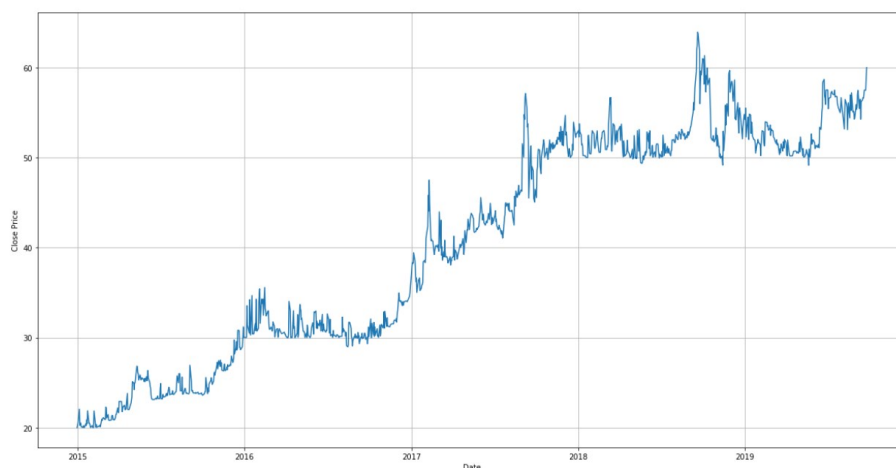
### Executive Summary

Scotia Group Jamaica (SGJ) reported net income of \$9.79 billion for the nine months ended July 2019, which represented a 12.28% decline over the comparable period last year. The decline in profits was due to non-recurring gains from the sale of Credi-Scotia in FY 2018 and an increase in staff costs. Total Operating Income (TOI) grew by only \$42 million or 0.13% for the nine months ended July 2019 versus the comparable period FY 2018. The weak growth in TOI was due to a decline in Net Interest Income (NII) of \$1.2 billion or 6.55%. However, it was offset by a Net Gain on Foreign Currency Activities (GFC) of \$1.6 billion or 45.39%.

SGJ pays dividends consistently; four times annually. The company has increased dividend payment at a compounded annual growth rate (CAGR) of 3.71% for the FY 2014 to FY 2018 period (period under review). **More recently SGJ declared a dividend of \$0.51 and a special dividend of \$0.74 payable on October 23, 2019 to stockholders on record as at October 1, 2019.**

As at the end of Q3 July 2019 total assets on SGJ's balance sheet is \$537.52 billion. SGJ's current balance sheet is dominated by loans of \$198.43 billion and investment securities valued at \$125.31 billion.

SGJ has experienced a steady increase in price over recent years, as indicated below. Most of these gains have been fuelled by P/E multiple expansion due to increased investor sentiment. For the period under review, profits have grown at a CAGR of 4.22% while SGJ's stock price increased at a CAGR of 27.97%. This has resulted in P/E multiples expanding from 5.84x at the end of FY 2014 to 12.79x at the end of FY 2018.



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## Scotia Group Jamaica Limited (SGJ)

### Company Background

Scotia Group Jamaica Limited (SGJ) is a 71.78% subsidiary of Scotiabank Caribbean Holdings Limited, which in turn is a 100% subsidiary of The Bank of Nova Scotia Canada. SGJ is the parent of the Bank of Nova Scotia Jamaica Limited (100%) and Scotia Investments Jamaica Limited (100%). The primary operations of SGJ include Banking, Mortgage Financing, Life Insurance, Investment Banking and Fund Management.

### Recent Developments

SGJ declared an interim dividend of \$0.51 and a special dividend of \$0.74 payable to shareholders on record as at October 1, 2019. This follows an interim dividend of \$0.51 and a special dividend of \$1.94 paid in July 2019. For the 3rd quarter in FY 2019, revenue has increased by \$392 million or 3.64% to \$11.15 billion. The primary contributor to that growth was Insurance Revenue of \$231 million or 44% to \$756.3 million. **However, profits fell by \$226.42 million or 5.2% due primarily to increased staff costs of \$321.1 million or 13.1%.**

### Key Financial Data

	2014	2015	2016	2017	2018	CAGR	Q3 2018	Q3 2019	Change
BVPS	24.58	27.40	29.52	32.92	37.17	10.89%	36.29	37.34	2.90%
EPS	3.36	3.19	3.63	3.91	4.11	5.17%	3.59	3.15	-12.23%
Dividend Per Share	1.60	1.62	1.71	1.83	1.92	4.66%	1.44	3.47	140.97%
Share Price	19.60	26.17	31.07	51.97	52.56	27.97%	51.69	56.67	9.63%
Total Operating Income	33,833,677	35,139,477	37,337,193	39,492,799	40,293,260	4.46%	31,862,099	31,904,149	0.13%
Net fee and commission income	5,857,253	6,490,845	7,016,045	8,638,362	8,127,028	8.53%	6,113,210	5,985,020	-2.10%
Insurance revenue	2,314,048	3,203,932	2,369,309	2,785,032	2,931,627	6.09%	2,402,931	2,565,273	6.76%
Net gain on foreign currency activities	1,962,062	2,205,454	3,632,779	2,494,427	4,001,556	19.50%	3,605,444	5,241,949	45.39%
Salaries and staff benefits	10,340,817	10,654,035	10,428,959	10,641,141	10,446,820	0.26%	7,585,226	8,347,157	10.04%
Total Expenses	19,475,791	20,895,341	20,696,250	21,291,341	22,000,633	3.09%	16,260,766	18,382,049	13.05%
Profit	10,825,428	10,134,005	11,590,602	12,407,290	12,770,915	4.22%	11,157,428	9,787,580	-12.28%
Total Assets	407,030,262	432,631,945	477,391,654	490,882,681	521,862,287	6.41%	535,146,974	537,515,794	0.44%
Loans	145,732,002	154,499,373	166,826,780	166,493,591	182,607,258	5.80%	176,975,223	198,429,318	12.12%
Investment Securities	83,648,910	105,436,140	117,121,153	120,292,580	134,732,786	12.66%	130,487,683	125,312,521	-3.97%
Deposits by the public	190,726,667	209,461,602	248,416,381	260,559,467	287,948,379	10.85%	302,229,112	303,577,562	0.45%
Equity	76,484,253	85,257,232	91,855,773	102,431,566	115,647,730	10.89%	112,904,846	116,180,692	2.90%
	2014	2015	2016	2017	2018	Average	Q3 2018	Q3 2019	Change
Ratios									
P/B	0.80	0.96	1.05	1.58	1.41	1.16	1.42	1.52	6.54%
P/E	5.83	8.20	8.56	13.29	12.79	9.74	14.40	17.98	24.90%
Dividend Yield	8.16%	6.19%	5.50%	3.52%	3.65%	5.41%	2.79%	6.12%	119.80%
ROE	14.85%	12.53%	13.09%	12.77%	11.71%	12.99%	13.84%	9.95%	-28.06%
ROA	2.72%	2.41%	2.55%	2.56%	2.52%	2.55%	2.80%	2.13%	-24.14%
Dividend Payout Ratio	47.62%	50.78%	47.11%	46.80%	46.72%	47.81%	40.11%	110.12%	174.54%

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## Scotia Group Jamaica Limited (SGJ)

### Financial Overview

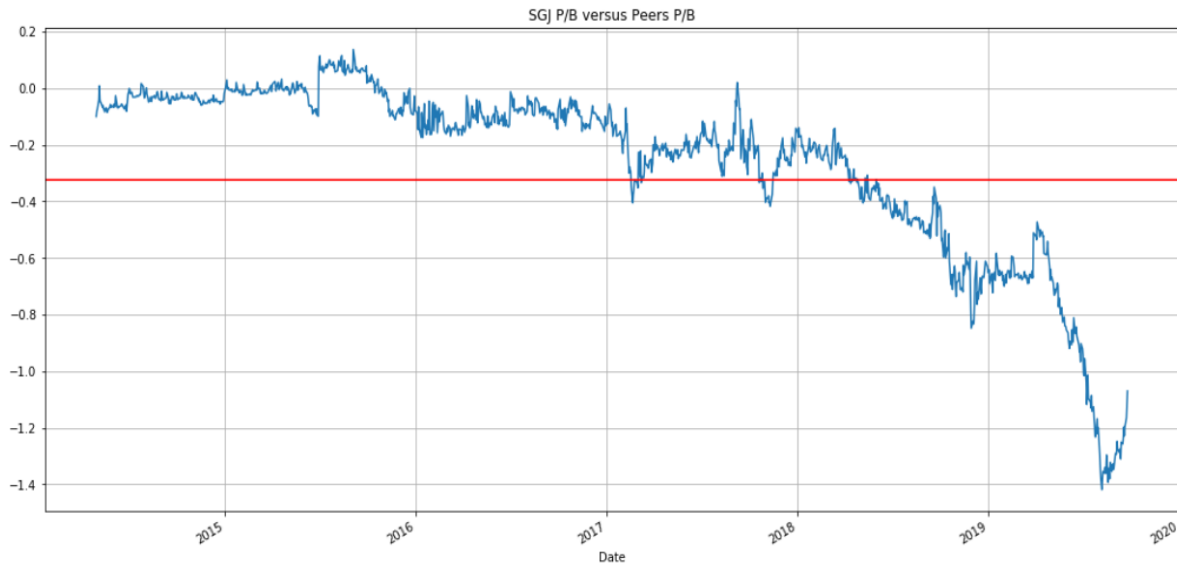
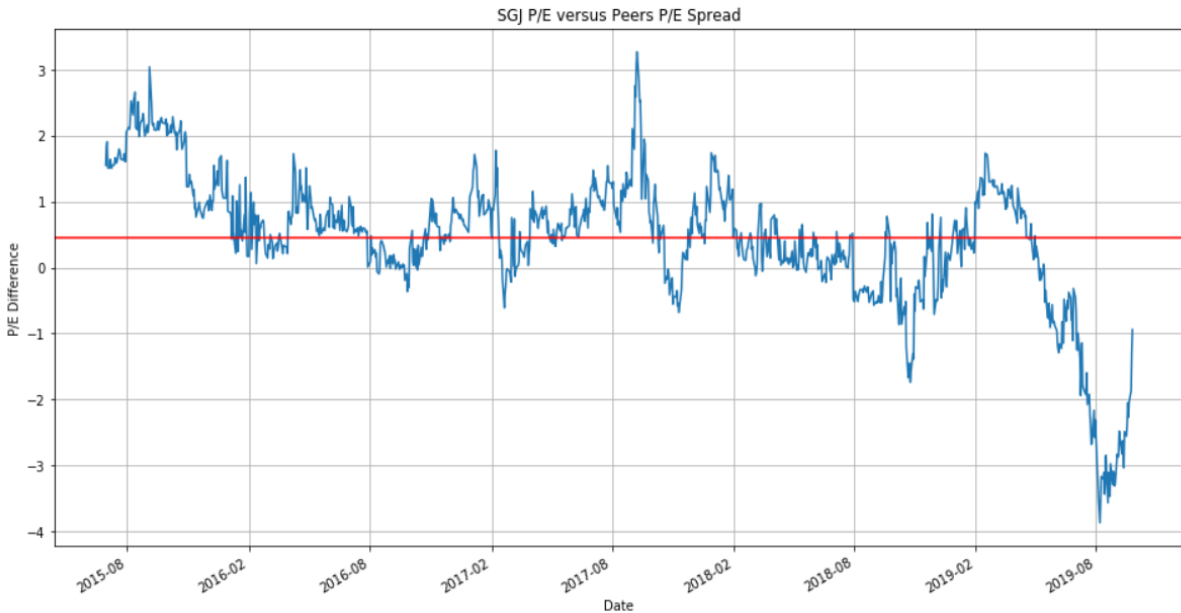
Earnings for the FY 2018 increased by 2.93% to close at \$12.57 billion (EPS of \$4.11) relative to \$12.41 billion (EPS of \$3.91) for FY 2017. The sale of Credi-Scotia for a gain of \$753.15 million boosted FY 2018 earnings. Therefore, excluding the sale of Credi-Scotia FY 2018 profits would have declined by approximately \$390 million or 3% to \$12 billion. The most significant contributor to total operating income (TOI) historically has been net interest income after adjustment for impairment losses (NII). In FY 2018, 57.80% of TOI was generated by NII, which indicates how vital growth in this line item is to the overall profitability of SGJ. Also, of note, FY 2018 revenue growth was aided by a record \$4 billion in net gain on foreign currency activities (GFC). The key driver of this was Q3 2018 GFC of \$1.95 billion, which was unusually large compared to the Q3 5-year average of \$967.76 million. Over the period FY 2014 to FY 2018, staff costs have increased at a compounded annual growth rate (CAGR) of 0.26% to \$10.45 billion. SGJ has improved efficiency through the use of technology which assisted SGJ in growing profits despite staff complement declining 25.27% from 2,311 in FY 2014 to 1,727 in FY 2018.

Total Assets for SGJ has increased at a CAGR of 6.41% to \$521.86 billion for the period under review. The most significant assets on the balance sheet are loans and investment securities accounting for 34.99% and 25.82% respectively as at October 2018. At the end of FY 2018 the largest loan segment is 'personal and credit card' (\$78.06 billion) followed by 'business and government' (\$72.43 billion). The majority of investment securities are GOJ securities, at the end of FY 2018, 85.4% or \$115.1 billion was reported. Deposits by the public have been steadily increasing at a CAGR of 10.85% for the period under review to \$287.45 billion.

Key relative value measures such as P/B and P/E have steadily increased for the period under review. The P/E ratio has seen notable expansion with an inflexion point occurring in 2015. The primary driver for this multiple expansion has been an increasingly positive sentiment among investors triggered by improved economic indicator. SGJ pays dividends consistently four times per year, making the stock attractive to income-seeking investors. SGJ's dividend yield began to trend lower in 2015 as investors pushed the stock price higher in a hunt for yield. However, in FY 2019, given the increase in dividends due to two special dividend payments of \$1.94 and \$0.74, the recent dividend yield has been relatively high.

## Scotia Group Jamaica Limited (SGJ)

### Forecast and Valuation



**Our price target of \$72.06 per share is based on the dividend discount (DDM) and relative value models.** Using the DDM model we arrived at a price target of \$62.69. Meanwhile, using a relative value method we arrived at a price target of \$81.44. The DDM and relative value methods form the lower and upper end of our price targets respectively. As indicated above SGJ

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has historically traded at a P/E multiple 0.44x higher than peers while P/B has been 0.32x lower than peers. Applying the P/E premium and the P/B discount to the industry average is our estimate for each multiple. We then applied these estimates to our expectations of FY 2020 EPS and BVPS this produces our relative value estimates.

### Outlook

We expect SGJ to continue to report marginal but steady profit growth primarily due to improved efficiencies in FY 2020. SGJ growth potential is limited given that it is restricted to Jamaica and is already a relatively large entity (third largest company by market cap). Additionally, the ever-increasing competition in the loans and asset management industries continue to limit the scope for growth. **The pending sale of Scotia Insurance for USD 144 million (approx. JMD 20 billion) may provide an injection of cash which we expect to result in a significant surge in dividend payments.**

### Key Risks to Our Price Target

A key risk to our price target is a decrease in NII from increased competition on loans which generates the majority of TOI. Other risks include a decrease in the risk appetite of investors, a sharp rise in GOJ interest rates or deterioration of the economy. We see these risks as credible but unlikely given current economic data and medium-term expectations.

Ticker	Market Cap (\$B)	P/E	P/B	Div Yield	ROA	ROE
SGJ	186.73	16.05	1.58	6.70%	2.13%	9.95%
NCBFG	520.22	18.39	3.79	1.61%	2.25%	21.47%
JMMBGL	67.06	16.90	2.06	1.18%	1.02%	14.34%
SJ	270.11	18.00	3.31	1.88%	4.03%	21.22%
<b>Average</b>	261.03	17.34	2.69	2.85%	2.36%	16.75%

## Scotia Group Jamaica Limited (SGJ)

### Recommendation:

**Our recommendation for SGJ is MARKETWEIGHT.** While SGJ's revenue and earnings growth has lagged peers, SGJ has commanded a marginally higher P/E multiple relative to peers historically. This is due to SGJ maintaining a higher dividend yield versus peers. Furthermore, SGJ has less inherent risk versus peers, given the current structure of its balance sheet. Investors seeking income and the potential for steady capital gains in the medium to long-term should consider adding SGJ to their portfolio. **SGJ's recent dividend yield of about 6.7%, which includes a special dividend payment far exceeds peers, which is less than 2%.** The impact of the potential sale of SGJ's insurance segment could impede near-term earnings growth. However, SGJ is likely to maintain the current trajectory of dividend growth regardless, given that the current interim dividend payout ratio is less than 50%.

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

## Scotia Group Jamaica Limited (SGJ)

# 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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**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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