

## Scotia Group Jamaica Limited (SGJ)

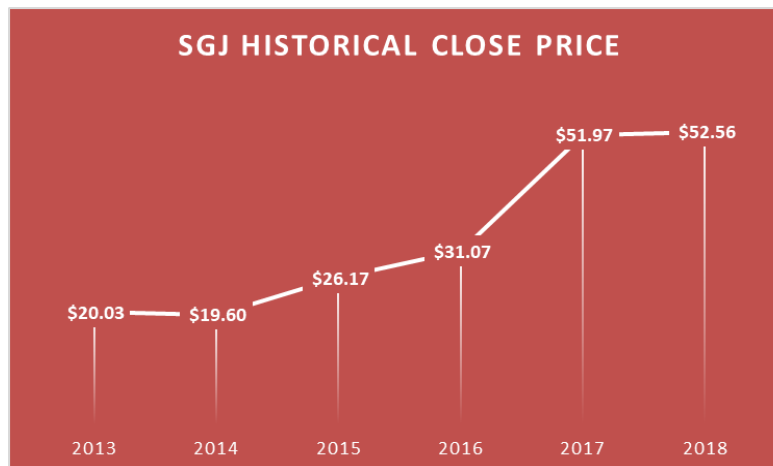
### Executive Summary

Scotia Group Jamaica (SGJ) reported net income of \$12.77 billion for the FY 2018 ended October 2018, which represented a 2.93% increase over the comparable period last year. The marginal rise in profits was assisted by a surge in net gain on foreign currency activities and the sale of Credi-Scotia for a gain of \$753.15 million. In Q4 ended October 2018 profits fell 52.80% or \$1.81 billion to \$1.61 billion over the comparable period last year. SGJ faced these declines due to a reduction in net gain on foreign currency activities due to the JMD revaluing 5.06% versus the USD in the quarter. **Also, of note all revenue line items with the expectation of insurance revenue declined in the Q4.**

SGJ has proved to be a consistent dividend paying stock, paying four times per year. SGJ has increased dividend payment at a CAGR of 3.71% over the FY 2013 to FY 2018. **More recently SGJ declared a dividend of \$0.51 a \$0.03 or a 6.25% increase over its FY 2018 quarterly payments. Given SGJ's dividend payment history \$0.51 is expected to be the new level of dividend payments going forward for investors.**

As at the end of FY 2018 total assets on SGJ's balance sheet is \$521.86 billion. SGJ balance sheet is dominated by loans of \$182.61 billion and investment securities valued at \$134.73 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 improved investor sentiment. Over the FY 2014 to FY 2018 period profits have grown at a CAGR of 4.22% while the SGJ's stock price increased at a CAGR of 27.97%. Leading to P/E multiples increasing from 5.84x in FY 2014 to 12.79x in FY 2018.



Data Above represents stock price as at October 31

## 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. SGJ has improving efficiency through the use of technology which assisted SGJ in growing profits despite staff complement declining 18.82% from 2,311 in FY 2014 to 1,876 in FY 2017.

### Recent Developments

On December 1, 2017, the Group disposed of its shares in Scotia Jamaica Microfinance Company Limited to Lasco Financial (LASF) and realised a gain on sale of a subsidiary of \$753.15 million. SGJ disclosed in November 2018 that it would be selling its shares in Scotia Life Insurance Company Limited for US\$144 million to Sagicor Financial Corporation. These transactions are in line with the group's strategic objective to simplify its operations and focus on expanding its core banking and investment business and deliver value to shareholders.

### Key Financial Data

	2014	2015	2016	2017	2018	CAGR
<b>BVPS</b>	24.58	27.40	29.52	32.92	37.17	10.89%
<b>EPS</b>	3.36	3.19	3.63	3.91	4.11	5.17%
<b>Dividend Per Share</b>	1.60	1.62	1.71	1.83	1.92	4.66%
<b>Operating Income(\$B)</b>	33.83	35.14	37.34	39.49	40.29	4.46%
<b>Total Expense(\$B)</b>	19.48	20.90	20.70	21.29	22.00	3.09%
<b>Profit (\$B)</b>	10.83	10.13	11.59	12.41	12.77	4.22%
<b>Total Assets</b>	407.03	432.63	477.39	490.88	521.86	6.41%
<b>Loans</b>	145.73	154.50	166.83	166.49	182.61	5.80%
<b>Investment Securities (\$B)</b>	83.65	105.44	117.12	120.29	134.73	12.66%
<b>Deposits by public</b>	190.73	209.46	248.42	260.60	287.95	10.85%
<b>Equity</b>	76.48	85.26	91.86	102.43	115.65	10.89%
<b>P/B</b>	0.80	0.96	1.05	1.58	1.41	
<b>P/E</b>	5.83	8.20	8.56	13.29	12.79	
<b>Dividend Yield</b>	8.16%	6.19%	5.50%	3.52%	3.65%	
<b>Div Payout Ratio</b>	47.62%	50.78%	47.11%	46.80%	46.72%	
<b>ROA</b>	2.72%	2.41%	2.55%	2.56%	2.52%	
<b>ROE</b>	14.85%	12.53%	13.09%	12.77%	11.71%	
<b>Share Price</b>	19.60	26.17	31.07	51.97	52.56	27.97%
<b>Share Performance</b>	-2.15%	33.52%	18.72%	67.27%	1.14%	

All information contained herein is obtained by JMMB® Investment Research from sources believed by it to be accurate and reliable. All opinions and estimates constitute the Analyst's judgment as of the date of the report. However, neither its accuracy and completeness NOR THE OPINIONS BASED THEREON ARE GUARANTEED. As such NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS OR COMPLETENESS OF THIS REPORT IS GIVEN OR MADE BY JMMB® IN ANY FORM WHATSOEVER.

## Scotia Group Jamaica Limited (SGJ)

### Financial overview

Net earnings for the FY 2018 increased by 2.93% to close at \$12.57 billion (or EPS of \$4.11) relative to \$12.41 billion (or EPS of \$3.91) reported last year. The sale of Credit Scotia for a gain of \$753.15 million boosted FY 2018 earnings. Therefore, excluding the sale of Credit 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) for SGJ historically has been net interest income after adjustment for impairment losses (NIIAIL).

In FY 2018, 57.80% of TOI was generated by NIIAIL which indicates how vital growth in this line item is to the overall profitability of SGJ. **In the last two quarters for the periods ended July 2018 and October 2018, a concerning pattern is forming. In both these quarters, NIIAIL has been lower than they were in the corresponding periods in FY 2013. Despite the growth in interest-earning assets over the period this decline is fuelled by the lower interest rate environment, the sale of Credit Scotia and increased competition in the segments in which SGJ operates.** This could lead to stagnant earnings growth in the near to medium-term. Also, of note, FY 2018 revenue growth was aided by a record \$4 billion in net gain on foreign currency activities (GFCA). The key driver of this was Q3 2018 GFCA of \$1.95 billion which was unusually large compared to the 5-year average of \$967.76 million. This was exceptionally large and aided by at 8.08% devaluation of the JMD versus the USD over that quarter. Over the period FY 2014 to FY 2018 staff costs has increased at a compounded annual growth rate (CAGR) of 0.26% to \$10.45 billion, the marginal growth is due to improved efficiency via technology which has allowed SGJ to reduce staff count.

Total Assets for SGJ has increased at a CAGR of 6.41% to \$521.86 million over the period FY 2013 to FY 2018. 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. The largest loan segment is 'personal and credit card' followed by 'business and government'. The majority of investment securities are GOJ securities, in FY 2017, 71.61% or \$86.15 billion was reported. Deposits by the public have been steadily increased at a CAGR of 10.85% over the FY 2014 to FY 2018 period to \$287.45 billion.

Key relative value measures such as P/B and P/E have trended higher over the FY 2013 to FY 2018 period. 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 indicators which began in 2015. However, its P/E multiple appears to have peaked in FY 2017. SGJ pays dividends four times per year and is a consistent dividend paying stock with steady increases. Dividend yield began to trend lower in 2015 as investors pushed SGJ's stock price higher in a hunt for yield. SGJ stock has increased every FY since FY 2015.

## Scotia Group Jamaica Limited (SGJ)

### Forecast and Valuation

Our price target is based on a dividend discount model (DDM). We see this as the most appropriate measure of long-term value for SGJ given that it has a predictable history of dividend payments. While we do project a significant decline in earnings in FY 2020 due to the sale of SGJ's insurance division, we still expect dividends to continue higher from current levels given that the current payout ratio is 46.72% and therefore has room for expansion. **Using the DDM, we have arrived at a price target of \$46.45 per share.**

### Outlook

We expect SGJ to continue to report marginal but steady profit growth primarily due to improved efficiencies in FY 2019. SGJ growth potential is limited given that it is restricted to Jamaica and is already a relatively large entity (second largest company by market cap). Additionally, the ever-increasing competition for loans and asset management industries continue to limit the scope for growth. **The pending sale of Scotia Insurance for USD 144 million (approx. JMD 18 billion) in 2020 can help provide an injection of cash which we expect to result in a significant surge in dividend payout. This payment could be north of \$4 per share creating strong short-term demand for SGJ.** However, on the downside, SGJ's insurance division generated \$3.81 billion in pre-tax profits or 20.82% of SGJ's FY 2018 pre-tax profits. **For perspective, excluding SGJ's insurance division earnings for FY 2018 would amount to \$9.92 billion.** Therefore, going forward starting FY 2020 assuming approval of the sale SGJ's insurance assets the company will face a steep decline in profitability and steady growth after that.

### Key Risks to Our Price Target

Key risks to our price target are continued declines in NII from increased competition on loans which generates the majority of TOI. Also, a decrease in the risk appetite of investors due to higher GOJ interest rates or deterioration of the economy. We see both these risks as credible but unlikely given current economic data and medium-term expectations.

Ticker	Market Cap	P/E	P/B	Div Yield	ROA	ROE
SGJ	174.25	13.63	1.51	3.48%	2.52%	11.71%
NCBFG	362.98	12.98	2.79	1.90%	3.34%	22.73%
JMMBGL	55.44	15.60	2.11	1.26%	1.31%	13.63%
SJ	149.2	12.57	2.03	1.02%	3.21%	17.12%

All information contained herein is obtained by JMMB® Investment Research from sources believed by it to be accurate and reliable. All opinions and estimates constitute the Analyst's judgment as of the date of the report. However, neither its accuracy and completeness NOR THE OPINIONS BASED THEREON ARE GUARANTEED. As such NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS OR COMPLETENESS OF THIS REPORT IS GIVEN OR MADE BY JMMB® IN ANY FORM WHATSOEVER.

## Scotia Group Jamaica Limited (SGJ)

### **Recommendation:**

While we see a meaningful decline from current SGJ's price of \$55.53 in the medium to our long term price target we see it going higher in the near-term. **Our expectation is for the sale of SGJ's insurance segment and the subsequent dividend payout to boost additional investor optimism. However, following this we expect the stock to trade down towards our long-term projections. Therefore we recommend that investors underweight SGJ in their portfolio. Investors can use the near-term optimistic sentiment to provide that selling opportunity.** Put succinctly medium to long-term we maintain an **UNDERWEIGHT** but near-term we see the stock moving higher.

*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**.

**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

### ***COPYRIGHT INFRINGEMENT***

“Unless otherwise expressly stated, copyright or similar rights in all material in this research report (including graphical images) is owned, controlled or licensed by Jamaica Money Market Brokers Limited or its affiliates (JMMB) and is protected or covered by copyright, trade mark, intellectual property law and other proprietary rights. No part of this research report or the report in its entirety may be published, used, reproduced, distributed, displayed or copied for public or private use in any form including by any mechanical, photographic or electronic process (electronically, digitally on the Internet or World Wide Web, or over any network, or local area network or otherwise) without written permission from JMMB.

All information contained herein is obtained by JMMB® Investment Research from sources believed by it to be accurate and reliable. All opinions and estimates constitute the Analyst’s judgment as of the date of the report. However, neither its accuracy and completeness NOR THE OPINIONS BASED THEREON ARE GUARANTEED. As such NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS OR COMPLETENESS OF THIS REPORT IS GIVEN OR MADE BY JMMB® IN ANY FORM WHATSOEVER.

## Scotia Group Jamaica Limited (SGJ)

No part of this research report may be modified or changed or exploited or used in any way for derivative works, or offered for sale, or used to construct any kind of database or mirrored at any other location without the express written permission of JMMB.

Thank you for respecting our intellectual property rights.”

*The investments referred to in this report may not be suitable for you should consult your licensed investment advisor. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable to your individual circumstances or otherwise constitutes a personal recommendation to you.*

### **Disclosure Under The Securities Act**

*This disclosure is being provided pursuant to section 39 of the Securities Act. This research report is prepared by Jamaica Money Market Brokers Limited (JMMB) and the information and views expressed are those of JMMB. JMMB is a subsidiary of the JMMB Group Limited (JMMBGL). Associated persons of JMMB include JMMBGL and its subsidiaries and affiliated companies, including JMMB Fund Managers Limited, a licensed securities dealer and manager of collective investment schemes.*

*As at the date of this report, JMMB and its affiliates, directors, officers, employees and other associated persons may from time to time buy or sell, or act as principal or agent in, the securities mentioned in this research report. JMMB or its affiliates, directors, officers and employees have no interest in or interest in the acquisition or disposal of the securities other than expressed above. No part of their compensation is or will be related to the recommendations or opinions in this report.*