

## Victoria Mutual Investments Limited

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#### Executive Summary

Victoria Mutual Investments Limited (VMIL) was incorporated in 1984. The company has a wholly-owned subsidiary Victoria Mutual Wealth Management Limited (VMWM), which was established in 1994. The primary activities of VMWM are investment brokering, advisory services and money market dealing. Meanwhile, VMIL offers margin loans, insurance premium financing, lease financing, underwriting services, and corporate loans. The company listed on the Jamaica Stock Exchange on December 29, 2017.

VMIL has undergone a significant shift in its revenue source for the period under review (FY 2015 to FY 2019). In FY 2015 less than 30% of net revenue was generated from 'Net Fees & Commissions' this has shifted to approximately 55% in FY 2019. Furthermore, in FY 2019 VMIL generated \$933.13 million in 'Net Fees and Commission' income, the primary contributors were 'Corporate Advisory Services' and 'Unit Trust Funds' fees of \$518.34 million and \$257.49 million, respectively.

Profits improved by \$200.45 million or 50.42% in FY 2019 to a record \$598.05 million. Suppressed FY 2018 earnings due to a provision for credit loss on financial assets of \$105.44 million aided FY 2019 earnings growth. The loss was partially reversed in FY 2019, resulting in a gain of \$96.04 million. If impairment loss and subsequent reversal were removed, gains in FY 2019 would have been significantly less.

VMIL is currently trading about 49% below its closing high of \$13.19 indicating a shift in investor sentiment towards the stock. VMIL now trades at trailing 12-month P/E and P/B of approximately 20x and 2.4x respectively.



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### Recent Developments

For Q2 ended June 2020 VMIL produced revenue and profit growth of 13.13% and 53.99% respectively. Revenue growth for Q2 2020 was primarily driven by a \$76.36 million or 36.75% increase in 'Net Fees and Commissions' (NFC). Also, 'Gains from Investment Activities' (GIA) increased \$39.83 million or 45.63% to \$127.11 million. However, growth in net revenue was constrained by a decline in 'Other Income' from \$37.35 million to a loss of \$21.17 million. Meanwhile, VMIL's primary expense 'Staff costs' increased by \$26.06 million or 21% to \$150.18 million. Ultimately pre-tax profit increased by \$15.15 million or 9.25%. However, in Q2 VMIL recorded a significant tax credit which aided profit growth of \$72.85 million or 53.99% to \$207.79 million.

### Key Financial Data

	2015	2016	2017	2018	2019	CAGR	6M2019	6M2020	Change (%)
BVPS	1.10	1.30	2.11	1.81	2.85	27.01%	2.69	2.77	2.89%
EPS	0.26	0.26	0.29	0.27	0.40	11.36%	0.17	0.11	-32.40%
Dividend Per Share	N/A	N/A	N/A	0.14	0.19	35.33%	0.03	0.03	0.00%
Stock Price	N/A	N/A	3.24	3.76	8.96	66.29%	4.63	7.50	61.99%
Main Market Index	N/A	N/A	288,381.97	379,790.86	509,916.44	32.97%	467,896.45	383,755.80	-17.98%
Net Interest Income	282,677	250,756	246,989	250,079	260,381	-2.03%	140,348	139,560	-0.56%
Gain on Investment Activities	294,088	278,624	193,077	213,879	485,899	13.37%	167,298	120,210	-28.15%
Net Fees and Commission Income	232,869	279,578	500,163	838,268	933,128	41.48%	489,507	474,169	-3.13%
Operating Revenue	811,140	810,803	966,455	1,306,775	1,682,961	20.02%	835,619	718,156	-14.06%
Operating Costs	382,158	417,069	498,630	767,740	881,397	23.23%	511,089	611,558	19.66%
Pre-Tax Profits	428,982	393,734	467,825	539,035	786,227	16.35%	324,530	90,434	-72.13%
Profits	311,122	317,278	346,302	397,598	598,049	17.75%	252,798	170,888	-32.40%
Corporate advisory services	153,851	164,094	316,537	614,476	518,339	35.48%			N/A
Investment Securities	13,088,110	13,076,406	11,683,640	13,241,358	16,718,180	6.31%	17,242,667	15,045,614	-12.74%
Earning Assets	14,580,293	15,057,341	15,055,049	17,458,499	20,655,455	9.10%	19,406,929	17,925,328	-7.63%
Total Assets	15,574,066	16,262,542	20,068,454	21,610,199	25,327,701	12.93%	24,661,013	23,548,980	-4.51%
Equity	1,314,725	1,565,690	2,534,022	2,722,424	4,276,828	34.30%	4,040,960	4,157,641	2.89%
Repos	13,363,857	13,940,198	13,164,960	15,454,981	16,999,392	6.20%	16,218,262	14,908,930	-8.07%
Borrowings	N/A	N/A	506,109	1,410,625	2,410,625	N/A	1,410,625	3,334,320	136.37%
Total Liabilities	14,209,341	14,646,852	17,484,432	18,837,775	21,000,873	10.26%	20,570,053	19,341,339	-5.97%
						<b>Average</b>			
Cost/Income Ratio	47.11%	51.44%	51.59%	58.75%	52.37%	52.25%	58.79%	58.64%	-0.26%
Net Profit Margin	38.36%	39.13%	35.83%	30.43%	35.54%	35.86%	30.25%	23.80%	-21.34%
Debt/Equity	N/A	N/A	0.20	0.52	0.56	0.43	0.35	0.80	129.74%
Dividend Yield	N/A	N/A	N/A	3.49%	3.26%	3.37%	0.71%	0.75%	5.00%
Dividend Payout Ratio	N/A	N/A	N/A	52.82%	47.52%	50.17%	17.80%	26.33%	47.93%
P/E	N/A	N/A	11.26	14.19	22.47	15.97	12.39	21.80	75.86%
P/B	N/A	N/A	1.54	2.07	3.14	2.25	1.70	2.67	57.48%
ROE	24.21%	22.03%	16.89%	15.13%	17.09%	19.07%	12.74%	7.22%	-43.35%
ROA	2.04%	1.99%	1.91%	1.91%	2.55%	2.08%	1.92%	1.24%	-35.45%

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### Financial Overview

VMIL has three primary revenue sources which are 'Net Interest Income' (NII), 'Gains from Investment Activities' (GIA) and 'Net Fees & Commissions' (NFC). NII has been volatile for the period under review (FY 2015 – FY 2019) and declined at a CAGR of 2.03%. The stall in growth of NII has resulted in its share of Net Revenue declining for the period under review. In FY 2015 NII constituted 34.85% of net revenue meanwhile in FY 2019 it made up approximately 15.5%. GIA (Gain from Investment Activities) surged \$272.02 million or 127.18% in FY 2019 to a record of \$485.90 million. **This surge was due to gains from equities surging from \$14.35 million in FY 2018 to \$145.91 million in FY 2019. Also gains from fixed income trading increased \$63.12 million or 57.65% to \$172.6 million. However, for the 6 months period ended June 2020 GIA has declined \$47.09 million or 28.15% to \$120.21 million, this may be due to a decline in equities gains resulting from the fall in the stock market which has declined 24.7% in the first half of FY 2020.**

'Net Fees and Commission' (NFC) was the primary revenue source in FY 2019, accounting for \$933.13 million or 55.45% of FY 2019 net revenue. The principal contributors to NFC in FY 2019 are 'Corporate Advisory Services' (CAS) and 'Management Fees for the Unit Trust' (UT) Funds, which were \$518.34 million and \$257.49 million, respectively. CAS has increased at a CAGR of 35.48% over the period FY 2015 to FY 2019 and has been a critical driver of net revenue growth for the period under review. Meanwhile, Management Fees from UT funds has increased meaningfully from \$2.76 million in FY 2016 when it was launched to \$257.49 million in FY 2019, an increase of 151.85% over FY 2018 levels of \$102.24 million. Ultimately net revenue has increased at a CAGR, for the period under review, of 20.02% to \$1.68 billion. **For the 6M period ended June 2020 revenue from NFC was down 3.13% indicating an inflection point from the CAGR of 41.48% experienced for the period under review. Additionally, net revenue is down 14.06% or \$117.46 million to \$718.16 million due to all major revenue sources declining.** Furthermore, operating costs increased by \$100.47 million or 19.66% to \$611.56 million, resulting in pre-tax profits falling 72.13% or \$234.10 million to \$90.43 million.

The most significant asset on the company's balance sheet is Investment Securities which accounts for \$16.72 billion or 66.01% of total assets as at the end of FY 2019. Most of VMIL's Investment Assets are in Government of Jamaica (GOJ) securities, \$11.6 billion or 69% of Investments Securities as at the end of FY 2019 and approximately 44% of the GOJ securities are denominated in USD. VMIL's Investment Securities as at the end of FY 2019 mature as follows: \$6.77 billion in 1 to 5 years and \$9.96 billion in 5 or more years. The most substantial liability on the balance sheet is repurchase agreements (repos) at the end of FY 2019 it accounted for \$17 billion or 67.12% of total assets. Another major liability is borrowings which was \$2.41 billion or 9.52% of total assets. These 'borrowings' include fixed and variable notes, secured and unsecured. 'Borrowings' has increased to \$3.33 billion as at June 2020 and resulted in a debt-to-equity of 0.80x. While we do not see the current level of debt as concerning, the trend of increased debt-to-equity should be monitored carefully as it adds incrementally to risk.

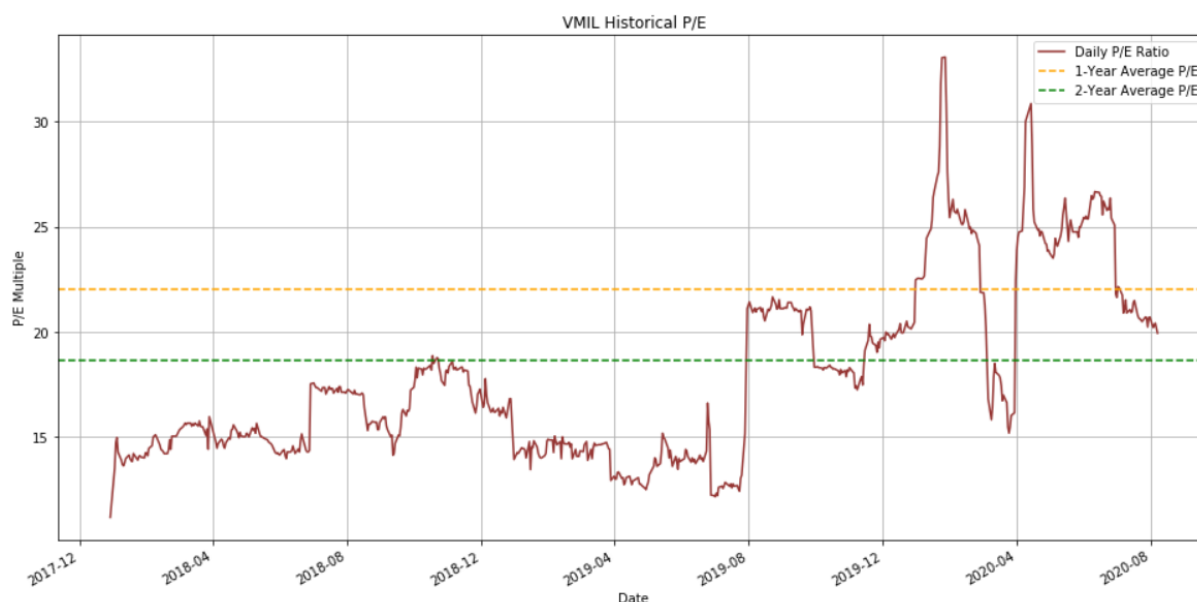
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### Forecast and Valuation

We used the relative value and the dividend discount model to arrive at our price target of \$5.52. Innate in our relative value assumptions, is the fact that sentiment towards VMIL's stock remains in line with the average over the last 2 years. We view this as reasonable given our expectation of steady improvements in earnings and revenue in the medium to long-term. **The relative value method produces our upper-end price target of \$6.95. Applying the dividend discount model, we arrived at a price target of \$4.09, which is the lower end of our price target range.**

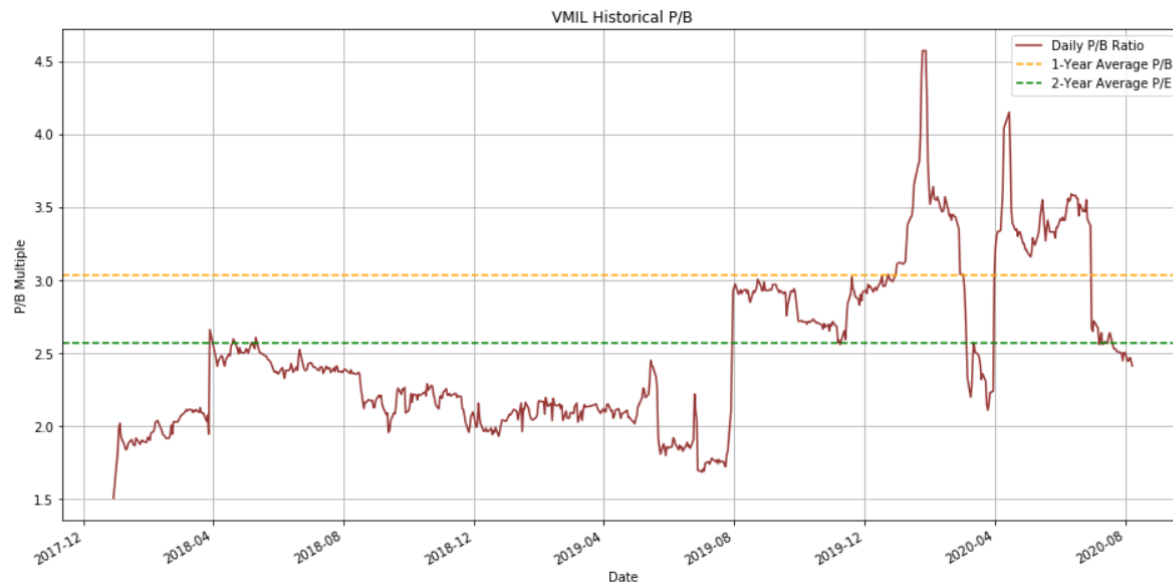
We view VMIL peers as companies operating primarily in the Diversified Financial Services and Capital Markets sector. The table below indicates that BIL's P/E is below VMIL despite, producing better ROA and ROE.

VMIL Peers					
Ticker	Market Cap(\$M)	P/E	P/B	ROA	ROE
VMIL	10,549.27	20.44	2.51	2.14%	12.44%
MIL	6,858.83	N/A	0.73	-2.13%	-5.90%
BIL	49,112.19	16.99	3.22	6.95%	23.59%
Average	22,173.43	18.71	2.15	2.32%	10.04%



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### Outlook

Our outlook on VMIL is neutral given our expectation of materially slower growth in FY 2021 and beyond. Furthermore, we expect revenue growth from CAS and fees from unit trust funds to slow. **In FY 2019 CAS declined \$96.14 million or 15.65% to \$518.34 million, indicating going forward growth may be lower. Meanwhile FUM is down from its high of \$29.48 billion at the end of FY 2019 which may hinder growth in fees from UT.** For the 6-months ended June 30, 2020 profit is down 32% or \$81.91 million to \$170.89 million due in part to the impact of the global pandemic on revenue and higher operating cost. **Of note, pre-tax profit is down 72.13% or \$234.10 million to \$90.43 million for the 6 months period ended June 2020.** Therefore, while we expect a strong rebound in pre-tax profits in FY 2021, we expect marginal profit growth as VMIL's effective tax rate reverts to normal levels.

### Key Risks to Our Price Target

The major driver of revenue growth for the period under review is 'Net Fees and Commission' (NFC) income. If this revenue source underperforms our expectation, this could lead to earnings and revenue being well below our forecasts. In the near-term this is a significant risk given the impact of the global pandemic on business activity. Furthermore, if VMIL's cost to income ratio surges above our expectation due to higher costs, earnings could fall short of our forecast.

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### Recommendation:

We maintain our **STRONGLY UNDERWEIGHT** rating on VMIL given that the stock trades significantly above our price target. While we expect steady growth in the medium to long-term, we see meaningful headwinds for the company going forward. The key source of revenue growth, 'Net Fees and Commission income' is showing signs of stagnation. Furthermore, VMIL has seen a meaningful increase in operating costs which could further limit earnings growth. **Finally, we view the current sentiment on VMIL as too optimistic given the current economic environment and potential for earnings growth in the medium to long-term.**

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

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## 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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**OUTPERFORM/OVERWEIGHT/BUY**—EXPOSURE TO THIS ASSET SHOULD BE UP TO 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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

**UNDERPERFORM/UNDERWEIGHT**— ADJUST EXPOSURE IN YOUR PORTFOLIO HELD AT JMMB TO BETWEEN 2.5% AND 4.9% FOR THIS PARTICULAR ASSET

**STRONGLY UNDERPERFORM/UNDERWEIGHT**—REDUCE EXPOSURE TO THIS ASSET TO BELOW 2.5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

**SELL**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO (0%).

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