

Jamaica Stock Exchange Limited

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INFRINGEMENT IN THE APPENDIX**

Executive Summary

The Jamaica Stock Exchange Limited (JSE) is incorporated in Jamaica and has its registered office at 40 Harbour Street Kingston. The main activities of the JSE are the regulation & operation of the Stock Exchange in Jamaica and the development of the same. The Company also operates a platform to allow efficient trading of securities. The Company has a wholly-owned subsidiary, the Jamaica Central Securities Depository Limited (JCSD). The JCSD's subsidiary JCSD Trustee Services provides trustee custodianship and related services.

Cess Income is a significant revenue contributor to the JSE, derived from a fee of 0.33% applied to all Stock Exchange transactions. In FY 2020, transaction value fell 42.6%, resulting in Cess Income of \$380 million.

Fee Income is the primary revenue source for the JSE, which grew by 16.3% in FY 2020 despite economic weakness, indicating resilience. The primary contributors to Fee income include Annual Listing Fees, Trustee Services and Registrar Services.

In FY 2020, revenue and profits fell from FY 2019 record levels. Profits fell \$112.9 million or 21.7% in FY 2020, partially due to revenue declining 8.7% to \$1.7 billion.

The JSE's stock currently trades approximately 32x trailing earnings, in line with its average of 31x over the last year. The Company's stock has modest liquidity, trading over 83 thousand units of average daily volume (ADV) over the previous year.



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Recent Developments

For Q4 2020, revenue fell 7% to \$451.3 million, due to a 21.1% decline in Cess Income to \$148.5 million. However, Fee Income increased marginally by 2.9% to \$281.2 million. Meanwhile, expense rose 0.4% to \$298.1 million, resulting in profit before taxes declining 13.8% to \$163.7 million. However, profits increased 8.9% to \$120.7 million due to a lower effective tax rate.

The value of shares that changed hands on the Stock Exchange in Q1 FY 2021 fell to \$8.4 billion versus \$14 billion for a similar period the previous year. For perspective, the average Q1 value traded for the period FY 2016 to FY 2020 was \$19.7 billion.

Key Financial Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	CAGR
BVPS	1.15	1.35	1.60	2.10	2.19	17.39%
EPS	0.32	0.31	0.62	0.74	0.58	16.04%
Dividend Per Share	0.24	0.15	0.30	0.40	0.52	21.89%
JSE Close Price	5.50	7.00	10.26	27.58	20.01	38.11%
Main Market Index	192,277	288,382	379,791	509,916	395,615	19.77%
Cess Income	330,229	285,776	494,711	697,321	380,019	3.57%
Fee Income	457,516	611,563	808,148	1,045,070	1,215,106	27.66%
Revenue	917,589	1,007,469	1,409,941	1,874,372	1,711,389	16.86%
Operating Profit	334,736	338,052	592,502	803,073	618,467	16.59%
Net Profit	223,589	220,668	413,063	519,878	406,936	16.15%
PP&E	257,069	342,820	491,222	590,999	679,521	27.51%
Non-current Assets	646,485	745,837	787,616	1,082,546	1,155,053	15.61%
Cash & Cash Equivalents	281,314	310,053	455,333	427,280	440,645	11.87%
Current Assets	472,666	509,141	724,212	723,086	714,852	10.90%
Total Assets	1,119,151	1,254,978	1,511,828	1,805,632	1,869,905	13.69%
Total Equity	808,081	948,780	1,125,367	1,470,253	1,534,365	17.39%
Current Liabilities	234,195	225,691	332,303	231,505	229,826	-0.47%
Non-current Liabilities	76,875	80,507	54,158	103,874	105,714	8.29%
Total Liabilities	311,070	306,198	386,461	335,379	335,540	1.91%
						Average
Cash Ratio	1.20	1.37	1.37	1.85	1.92	1.54
Current Ratio	2.02	2.26	2.18	3.12	3.11	2.54
Efficiency Ratio	63.52%	66.33%	57.98%	58.33%	66.43%	62.52%
Financial Leverage	1.34	1.35	1.33	1.28	1.22	1.30
Operating Margin	36.48%	33.55%	42.02%	42.84%	36.14%	38.21%
Net Profit Margin	24.37%	21.90%	29.30%	27.74%	23.78%	25.42%
ROE	31.27%	25.12%	39.83%	40.06%	27.09%	32.67%
ROA	23.41%	18.59%	29.86%	31.34%	22.14%	25.07%
P/E	17.19	22.58	16.55	37.20	34.48	25.60
P/B	4.77	5.17	6.39	13.15	9.15	7.73
Dividend Payout Ratio	73.63%	46.97%	48.31%	53.95%	89.61%	62.49%
Dividend Yield	5.03%	2.06%	3.87%	1.76%	2.37%	3.02%

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Financial Overview

Cess Income is directly correlated to trading activity and is a critical revenue source for the JSE. Cess Income grew at a CAGR of 3.6% for the period under review (FY 2016 to FY 2020) due to value traded on the market declining from \$109.4 billion in FY 2019 to \$62.8 billion in FY 2020.

Fee Income is the most significant contributor to revenue and is derived from various sources, including Trustee, Annual Listing and Transaction fees. Fee Income has increased at a CAGR of 27.7% for the period under review to a record \$1.2 billion in FY 2020. Fee Income has been a constant source of revenue growth for the period under review. However, it grew by 16.3% in FY 2020, meaningfully slower than recent FYs. Ultimately revenue increased at a CAGR of 16.9% for the period under review to \$1.87 billion. However, revenue fell 8.7% or \$163 million in FY 2020 due to a decline in trading activity.

The Company has experienced steady growth in its non-current assets for the period under review at a CAGR of 15.6%. The main contributors to non-current assets in FY 2020 are PP&E (\$680 million or 36.3% of total assets) and Investment Securities (\$221.4 million or 11.9% of total assets). The primary component of Investment Securities is GOJ USD 8% 2039 Global Bonds.

As at the end of FY 2020, critical current assets include repurchase agreements, trade & other receivables and cash and cash equivalents valued at \$300.1 million, \$262 million and \$140.5 million, respectively. Repo & cash equivalents account for 23.6% of total assets as at the end of FY 2020. GOJ securities back the repurchase agreements with the majority (\$198 million) denominated in Jamaican dollars. Meanwhile, trade & other receivables are primarily made of Fees Receivable (\$133.8 million) and Cess Receivable (\$59.1 million). The most significant liability is payables & accruals, which stands at \$184.5 million or 9.9% of total assets at the end of FY 2020.

Meanwhile, total equity has increased steadily at a CAGR of 17.4% to \$1.5 billion due to consistent profitability. However, equity growth has been constrained by the relatively high dividend payout ratio, which averaged 62.5% for the period under review. However, the dividend payout ratios spiked to 89.6% in FY 2020 due to earnings declining 21.7% while dividend paid increased 30%, resulting in the JSE's equity position only growing 4.4% in FY 2020.

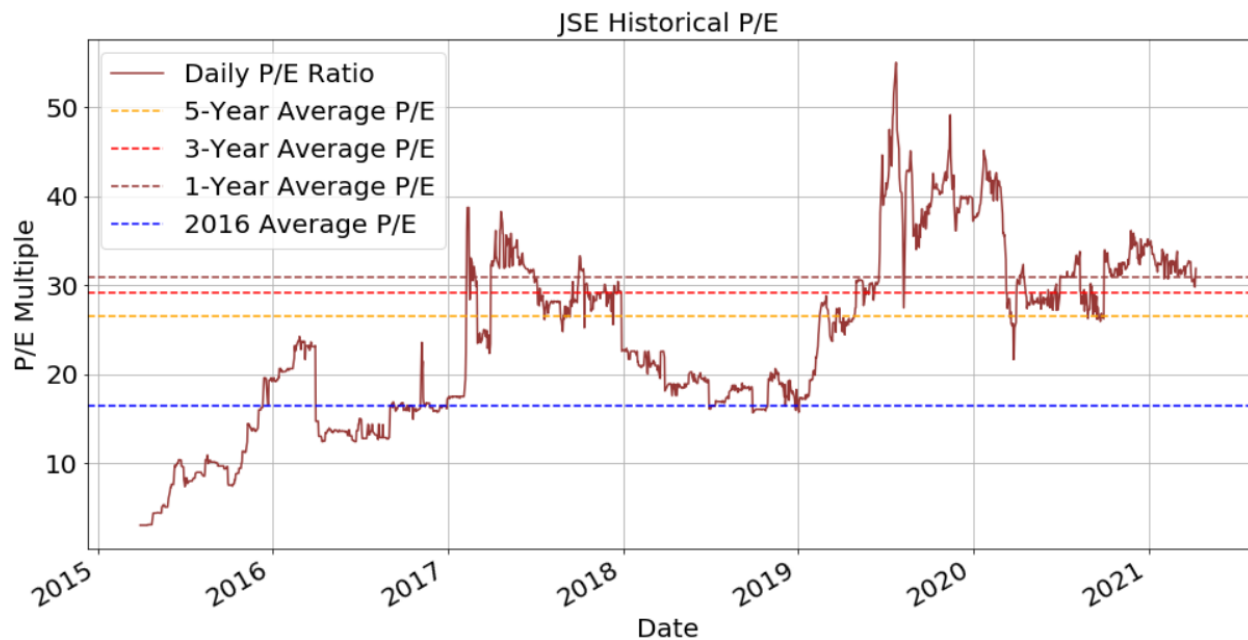
The Company's cash ratio peaked in FY 2020 at 1.92x and has averaged 1.54x for the period under review. Additionally, the current ratio has remained above 2x for the period under review, highlighting that near-term liabilities can be readily met. The Company's efficiency ratio was elevated in FY 2020 at 66.4%, primarily due to falling revenue. The JSE has recorded relatively high ROE and ROA, averaging 32.7% and 25.1%, respectively, for the period under review. **The JSE balance sheet is robust with no debt, high liquidity, and sustainable revenue sources.** The Company's P/E and P/B ratio has been relatively high compared to most financial companies, which may be due to the JSE's unique position in the financial industry.

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Forecast and Valuation

We arrived at our price target of \$9.65 using the Dividend Discount Model (DDM). Meanwhile, using the DDM under two additional scenarios produced our upper- and lower-case price targets of \$11.71 and \$7.65, respectively. The primary difference between the various scenarios is the expectation for FY 2022 trading activity. The best-case scenario assumes trading activity matches the peak levels experienced each quarter for the previous three years. Meanwhile, under the worst-case scenario, we assume trading activity declines to the weakest levels experienced each quarter for the last three years.

The JSE's current P/E of approximately 32x is relatively high compared to most Main Market companies and has been sustained for an extended period. The Company's one year and 3-year average P/E of 31x and 29.2x, respectively, could be partially due to JSE's well above average performance on key metrics. Even with the decline in profitability for FY 2020, it produced ROE and ROA of 27.1% and 22.1%, respectively, which may explain investor's positive sentiment towards JSE despite the decline in profitability. The JSE can produce such high operating metrics because it offers services with few or no other competitors.



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Outlook

Our outlook on the JSE is negative in the near term, as we expect trading activity to be relatively muted. In its first quarter ended March 2021, the exchange-traded value was \$8.4 billion, 40% below the same period last year. We expect value traded for the rest of FY 2021 to match levels seen in FY 2020, which would constrain near-term earnings growth.

As market sentiment improves and the JSE offers more investment options to investors, we expect trading activity to trend higher in the long term. Furthermore, we expect the Company's Fee Income to continue to drive growth.

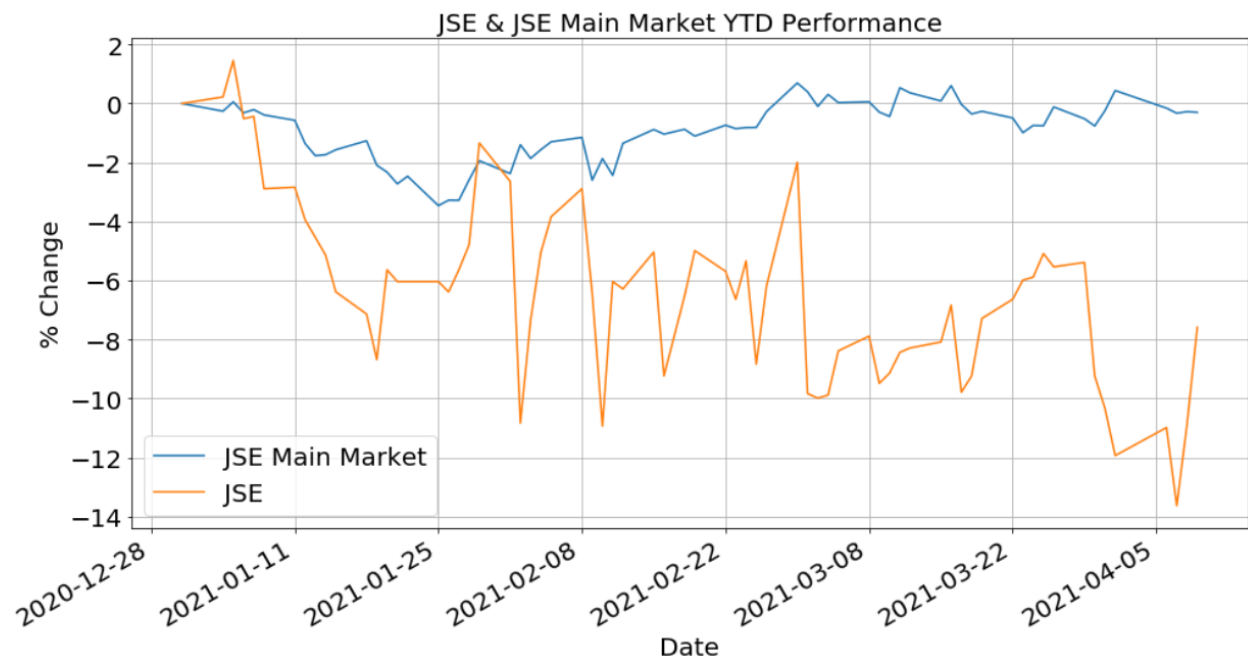
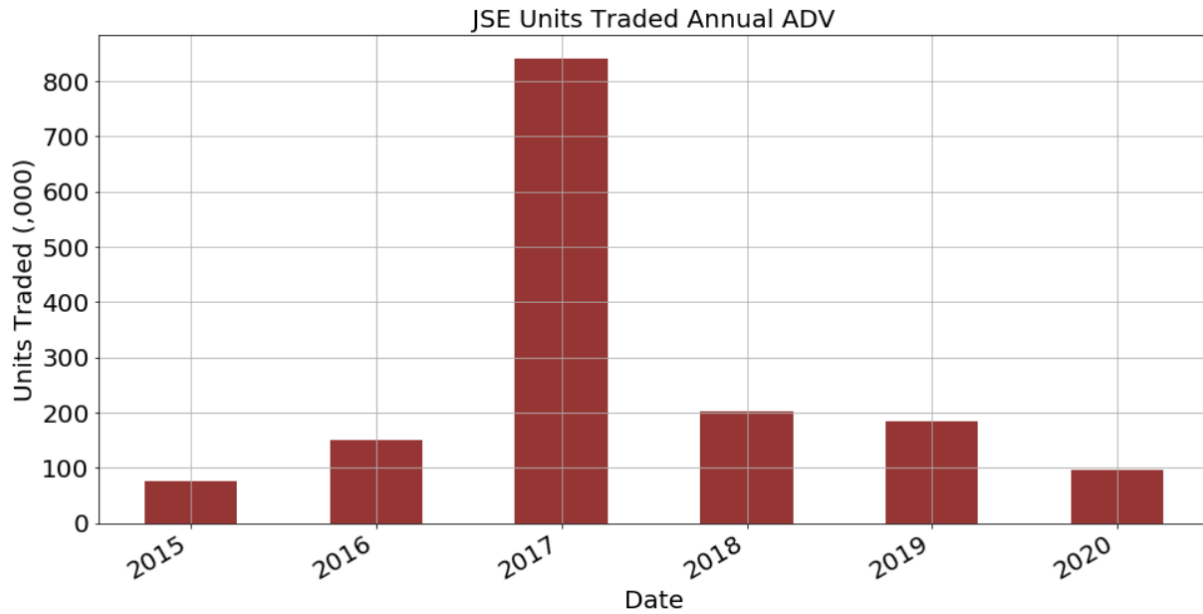
Key Risks to Our Price Target

We expect growth in Fee Income for FY 2021, albeit slower than the period under review. The significant risk to revenue growth in our view is Cess Income, which we expect to decline marginally from FY 2020 levels, which was negatively impacted by the decline in market sentiment. If trading activity continues to fall in line with levels seen in Q1 FY 2021, this would significantly impact earnings and, by extension, the Company's ability to paid dividends in line with our expectations.

Recommendation:

We maintain our **STRONGLY UNDERWEIGHT** rating on JSE at this point, given that the stock trades above the upper range of our price target. We expect a material decline in revenue and profits in FY 2021 relative to FY 2019 levels. We don't think that the current market price of JSE reflects the high probability of earnings decline and the resulting fall in investor sentiment. Therefore, an investor in this stock at the current price or higher should be aware that the potential downside is significant.

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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**.

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.

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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