INVESTMENT AND SOVEREIGN RESEARCH January-26-2022

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Jamaica Stock Exchange Limited

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT 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 Jamaican Stock Exchange 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 Trustee Services a subsidiary of the JCSD, provides trustee custodianship and related services.

Cess Income is a significant but volatile revenue source derived from a fee of 0.33% applied to all Stock Exchange transactions. Another substantial and stable revenue source for the JSE is Fee Income; major contributors include Registrar, Trustee and Annual Listing fees.

The Company has maintained high margins, high liquidity levels, low solvency ratios and strong cash flows for the review period (2016-2020). Furthermore, several credible avenues for growth are being pursued to aid long-term growth.

The JSE currently trades at approximately 24.5x, it's trailing 12-months EPS below its 5-year average of 28.7x. Meanwhile, JSE has relatively low liquidity, exchanging an average daily volume of 42.8K units over the past year, valued at approximately $771.1 thousand. Over the past month, JSE has had an average bid-ask spread of about 2.9%, indicating a relatively modest implicit cost to acquire shares.

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Recent Developments

Revenue surged to a record for the 3rd quarter ended September 2021, primarily driven by a surge in cess income. Revenue surged 66.5% to $621.4 million, driven by a 307% increase in cess income to $232.4 million. Trading activity in Q3 surged to $38.1 billion versus the $9.5 billion in the prior year, this was the primary driver of the increase. At the same time, fee income also continued its steady march higher, improving 23.7% to $369.2 million.

Meanwhile, expenses increased by 33.7% to $352.2 million. The primary driver of the increased costs was staff expense which surged 47.1% to $166.5 million to support the expansion of services.

Key Financial Data

	YE 2016	YE 2017	YE 2018	YE 2019	YE 2020	CAGR	Q3 2020	Q3 2021	Change (%)
BVPS	1.15	1.35	1.60	2.10	2.19	17.39%	1.98	2.45	23.68%
EPS	0.32	0.31	0.59	0.74	0.58	16.04%	0.41	0.54	31.95%
Dividend Per Share	0.66	0.15	0.30	0.40	0.52	-5.77%	0.52	0.27	-47.50%
JSE Close Price	3.72	5.30	6.00	9.40	15.00	41.71%	15.00	15.02	0.13%
Main Market Index	192,277	288,382	379,791	509,916	395,615	19.77%	380,426	414,890	9.06%
Abridged Income Statement ($M)									
Cess Income	330.23	285.78	494.71	697.32	380.02	3.57%	231.56	366.02	58.06%
Fee Income	457.52	611.56	808.15	1,045.07	1,215.11	27.66%	933.90	1,015.67	8.76%
Revenue	865.78	991.15	1,390.85	1,874.37	1,711.39	18.57%	1,260.08	1,473.34	16.92%
Operating Profit	334.74	338.05	592.50	803.07	618.47	16.59%	454.72	561.12	23.40%
Net Profit	223.59	220.67	413.06	519.88	406.94	16.15%	286.27	377.74	31.95%
Abridged Balance Sheet ($M)									
PP&E	257.07	342.82	491.22	591.00	679.52	27.51%	612.14	703.02	14.85%
Non-current Assets	646.49	745.84	787.62	1,082.55	1,155.05	15.61%	1,112.24	1,180.04	6.10%
Cash & Cash Equivalents	281.31	310.05	455.33	427.28	440.65	11.87%	401.79	629.31	56.63%
Current Assets	472.67	509.14	724.21	723.09	714.85	10.90%	700.87	980.98	39.97%
Total Assets	1,119.15	1,254.98	1,511.83	1,805.63	1,869.91	13.69%	1,813.11	2,161.01	19.19%
Total Equity	808.08	948.78	1,125.37	1,470.25	1,534.37	17.39%	1,390.28	1,719.55	23.68%
Current Liabilities	234.20	225.69	332.30	231.51	229.83	-0.47%	319.76	336.34	5.19%
Non-current Liabilities	76.88	80.51	54.16	103.87	105.71	8.29%	103.07	105.12	1.99%
Total Liabilities	311.07	306.20	386.46	335.38	335.54	1.91%	422.83	441.46	4.41%
Ratios						**Average**			
Cash Ratio	1.20	1.37	1.37	1.85	1.92	1.54	1.26	1.87	48.91%
Current Ratio	2.02	2.26	2.18	3.12	3.11	2.54	2.19	2.92	33.07%
Efficiency Ratio	67.32%	67.42%	58.77%	58.33%	66.43%	63.65%	66.57%	63.95%	-3.93%
Financial Leverage	1.27	1.35	1.33	1.28	1.22	1.29	1.30	1.28	-2.00%
Operating Margin	38.66%	34.11%	42.60%	42.84%	36.14%	38.87%	36.09%	38.08%	5.54%
Net Profit Margin	25.83%	22.26%	29.70%	27.74%	23.78%	25.86%	22.72%	25.64%	12.85%
ROE	31.27%	25.12%	39.83%	40.06%	27.09%	32.67%	29.85%	32.05%	7.37%
ROA	23.41%	18.59%	29.86%	31.34%	22.14%	25.07%	22.96%	25.08%	9.23%
P/E	17.19	22.58	16.55	37.20	34.48	25.60	33.83	24.26	-28.29%
P/B	4.77	5.17	6.39	13.15	9.14	7.73	9.66	7.03	-27.21%
Dividend Payout Ratio	206.13%	46.97%	50.76%	53.95%	89.61%	89.48%	127.38%	50.68%	-60.21%
Dividend Yield	14.11%	2.06%	3.88%	1.76%	2.37%	4.83%	2.55%	1.58%	-38.11%

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Financial Overview

Income Statement Review

Revenue growth stalled in FY 2020 due to a decline in one of its key drivers. Notably, Fee and Cess Income are the primary contributors to revenue. Revenue fell 8.7% to $1.7 billion in FY 2020 due to Cess Income declining 45.5% to $380 million. However, Fee Income growth of 16.3% to $1.2 billion attenuated the overall revenue decline. More recently, the 9-months ended September 2021 revenue increased 16.9% to $1.5 billion aided by increased Cess and Fee Income.

The decline in Cess Income for FY 2020 was primarily due to reduced trading activity; the value traded fell from $109 billion in 2019 to $62.9 billion in FY 2020. The decline in volume coincided with weak performance in the Main Market due to the negative impact of COVID-19 on several companies financial performance and investor sentiment. However, for the 9-months ended September 2021, trading activity has revived somewhat, with stock trades valued at about $60 billion, a significant improvement over the $38 billion recorded over the prior year.

Fee Income has consistently improved under the review period and continues to improve for the more recent 9M period. Some of the primary contributors to Fee Income in FY 2020 are Trustee, Registrar and Annual Listing fees of $479.1 million, $228.6 million and $170.4 million, respectively. Trustee Fee has increased at a CAGR of 31.9% over the review period. However, the growth rate slowed in FY 2020 to 18.1%. Meanwhile, registrar fees surged in FY 2020 by 53.9% to $228.6 million, an increase from the CAGR of 31.5% over the review period. The growth in Fee Income slowed materially in the 9M period to only 8.8%, well below the CAGR of 27.7% produced in the review period.

Profits have been somewhat volatile over the review period but improved in the 9M period. Profits declined 21.7% in FY 2020 due to reduced revenue and increased operating expenses. For the recent 9M period, profits rose 32% to $377.7 million. However, current profits trail the amounts produced in the 9M period ended September 2019 of $409.1 million.

Balance Sheet Review

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 of 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 at the end of FY 2020. GOJ securities back the repurchase agreements with the majority ($198 million) denominated in Jamaican dollars. Meanwhile, Fees Receivable ($133.8 million) and Cess Receivable ($59.1 million) are the primary drivers of trade &

other receivables. 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, the dividend payout ratio, which averaged 63% for the period under review, has constrained equity growth. 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. However, more recently, total equity has increased to $1.7 billion at the end of September 2021. The decline in dividends paid YTD versus the same period the prior year aided the increase in equity. Only $191.4 million has been paid in dividends for the 9M period, well below the $364.7 million paid for the same period the prior year.

Ratios Review

Liquidity ratios have been consistently high, indicating short-term liabilities are sustainable. The cash ratio peaked in FY 2020 at 1.92x and fell marginally to 1.87x at the end of September 2021. Additionally, the current ratio has remained above 2x for the review period and is currently 2.9x.

The Company's efficiency ratio was elevated in FY 2020 to 66.4%, primarily due to falling revenue. Subsequently, efficiency has improved, reaching 64% in the 9M period ended September 2021.

The JSE has recorded relatively high ROE and ROA, averaging 32.7% and 25.1%, respectively, for the period under review. Furthermore, the net profit margin has been consistently substantial for the review period but fell to 23.8% in FY 2020. It has subsequently improved for the 9M period to 25.6%, close to its 5-year average of 25.9%.

The Company's 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. Additionally, as previously noted, ROE and net profit margins have been consistently high relative to most financial firms.

The JSE's current P/E of approximately 24.5x is relatively low compared to its historical levels. The Company's one year and 3-year average P/E of 31x and 32x, 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 investors' positive sentiment towards JSE despite the decline in profitability. The JSE can produce such high operating metrics because it has limited competition.

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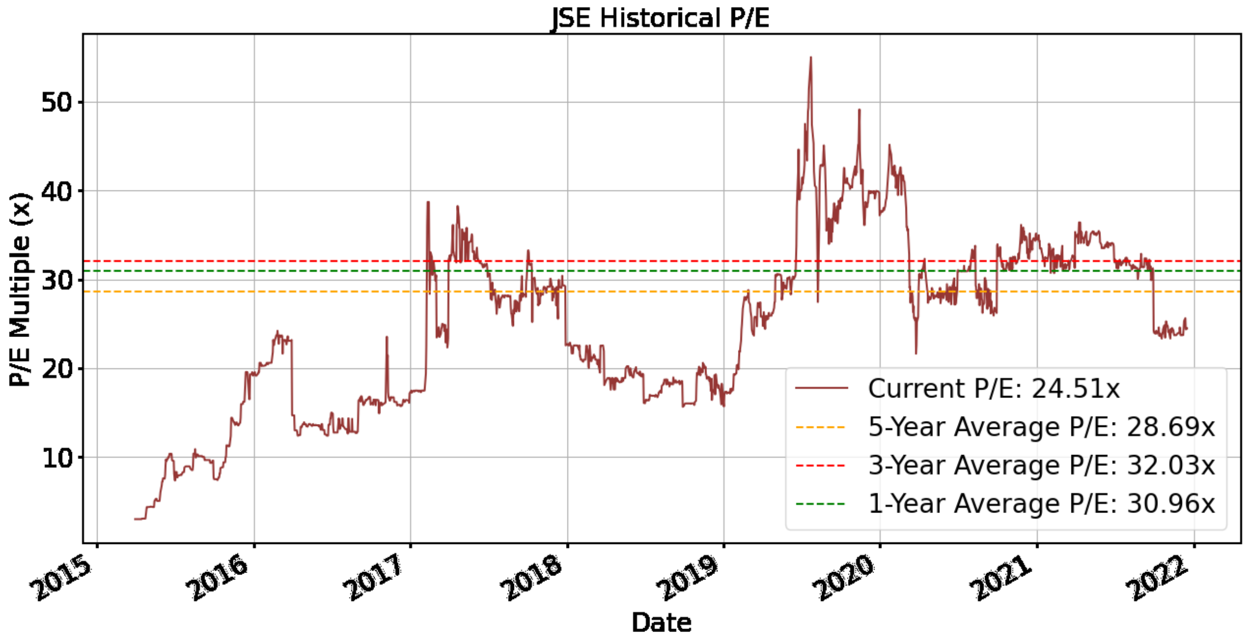

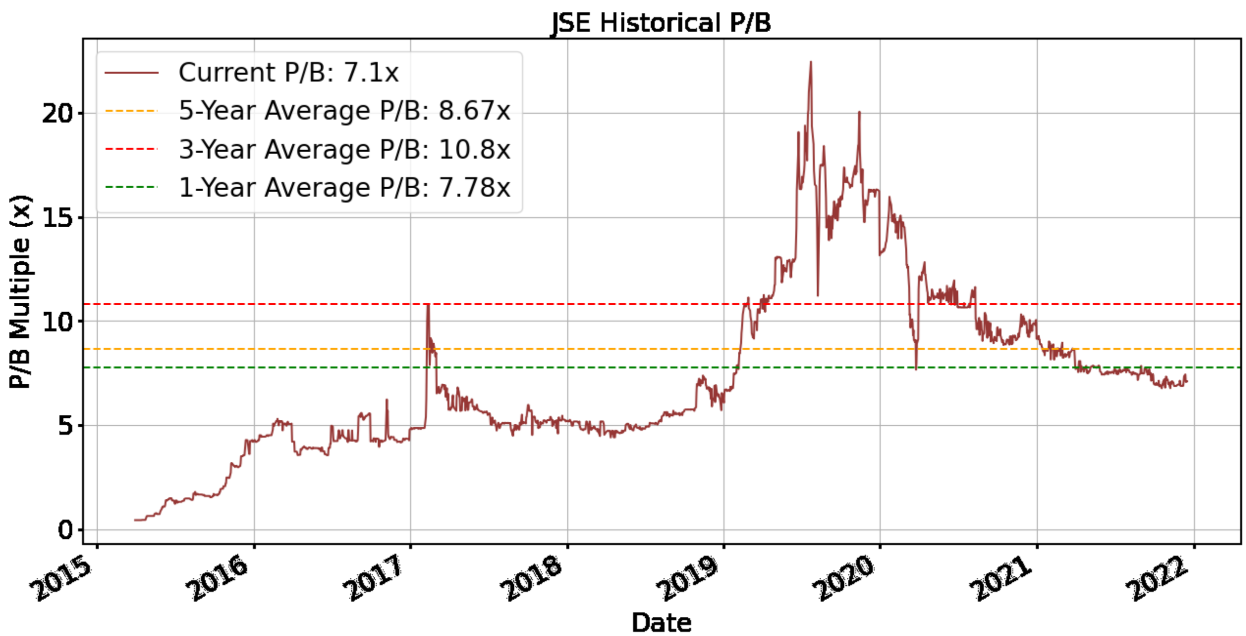

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Forecast and Valuation

We arrived at our price target of $12.22 using the Dividend Discount Model (DDM). Meanwhile, using the DDM under two additional scenarios produced our upper- and lower-case price targets of $13.49 and $10.67, respectively. The primary difference between the scenarios is FY 2023 trading activity expectations. The best-case scenario assumes trading activity matches the peak levels experienced each quarter for the previous three years. Meanwhile, we forecast trading activity has declined to the weakest levels experienced each quarter for the last three years under the worst-case scenario.

	Price Target	Implied Upside/(Downside)
Upper	13.49	-22.47%
Base	12.22	-29.77%
Lower	10.67	-38.68%

Outlook

We have a positive long-term outlook on the JSE, given its unique position in the financial sector. Furthermore, the Company has recently announced plans to increase Cess Fee to 35 basis points from the current 33 basis points starting January 1, 2022, which could help boost profitability. Additionally, the increase in online trading activity may help reduce the volatility of cess income as retail trading becomes a larger share of market activity. Finally, introducing new investment options and products could help drive long-term revenue growth.

Key Risks to Our Price Target

We expect growth in Fee Income for FY 2022, albeit slower than the period under review. Therefore in our view, the significant risk is Cess Income, which is volatile and a pivotal contributor to revenue. Large institutional transactions dominate value traded on the exchange; profitability could easily miss our expectations if they fail to materialise. However, this risk is being reduced by Fee Income, becoming an ever-larger share of total revenue.

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Recommendation:

While the liquidity, solvency and activity ratios for the JSE indicate a robust financial position, our primary concern is the current valuation versus stock price. We maintain our **STRONGLY UNDERWEIGHT** rating on JSE at this point, given that the stock trades above the upper range of our price target. Furthermore, a significant revenue source, Cess Income, is quite volatile and linked to large institutional transactions. Therefore, reducing the reliability of cash flows. However, this is curtailed somewhat by Fee Income becoming a larger share of total revenues.

JSE has declined 13% YTD, underperforming the JSE Main Market, which dropped about 2% for the same period. Finally, the JSE has relatively low liquidity, exchanging an average daily volume of 42.8K units, valued at approximately $771.1 thousand over the past year. **See charts 1 – 4 below for volume and value exchanged annually for the period under review and PJAM's YTD performance.**

Chart 1.

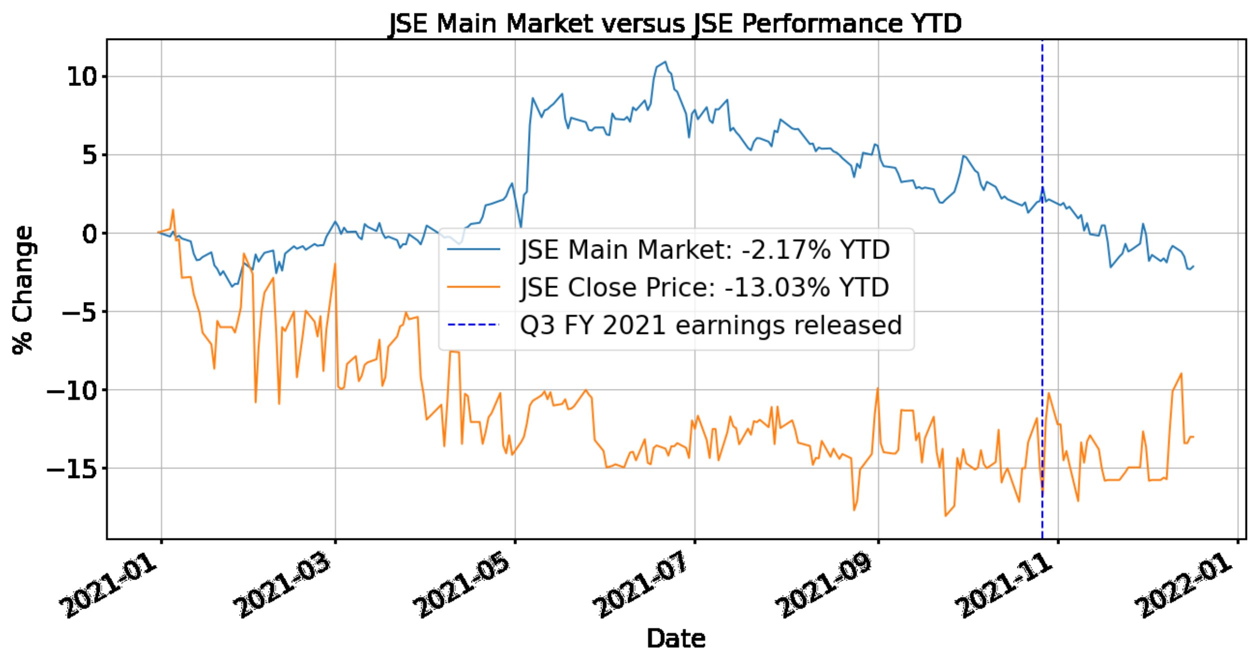

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Chart 2.

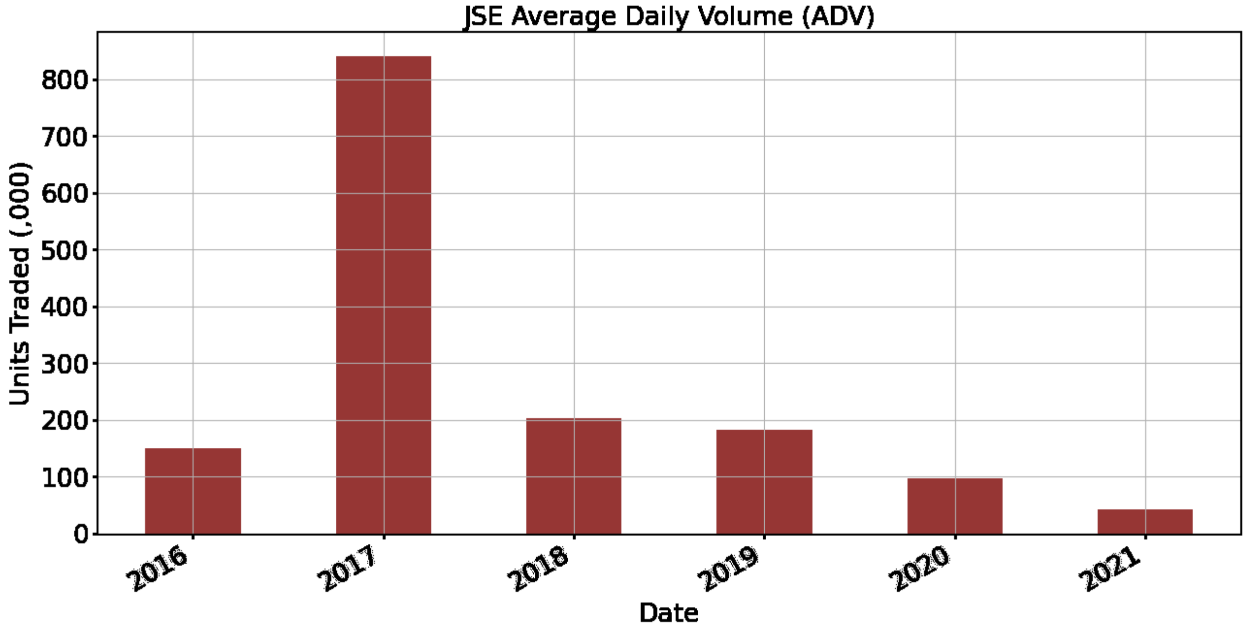

Chart 3.

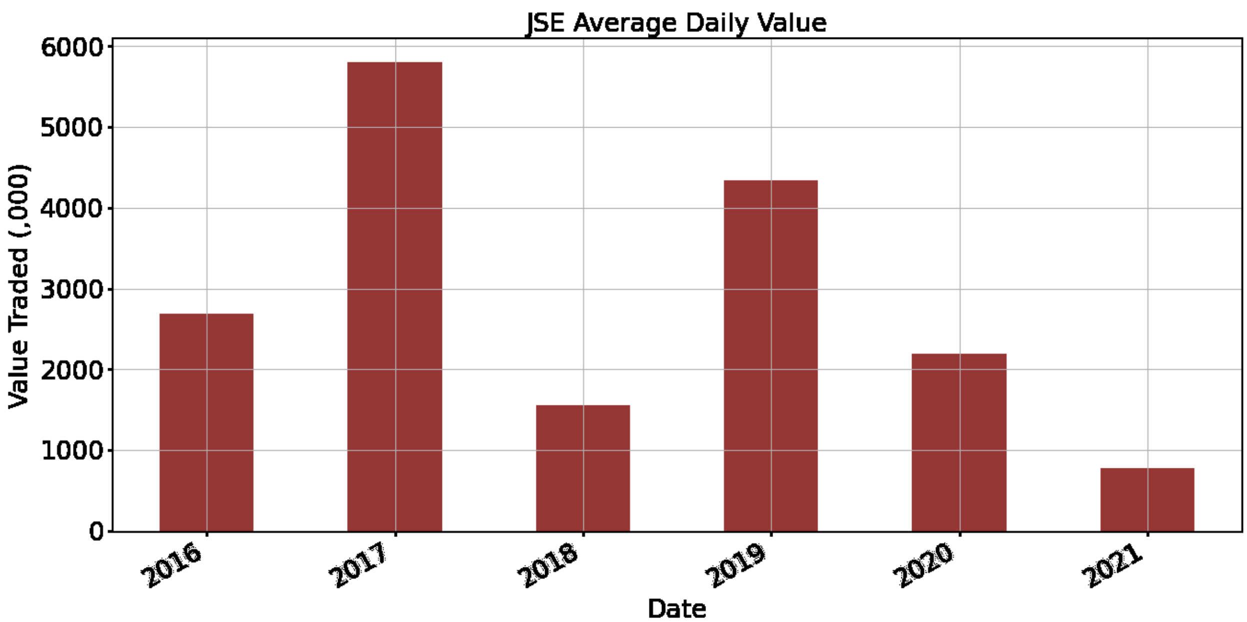

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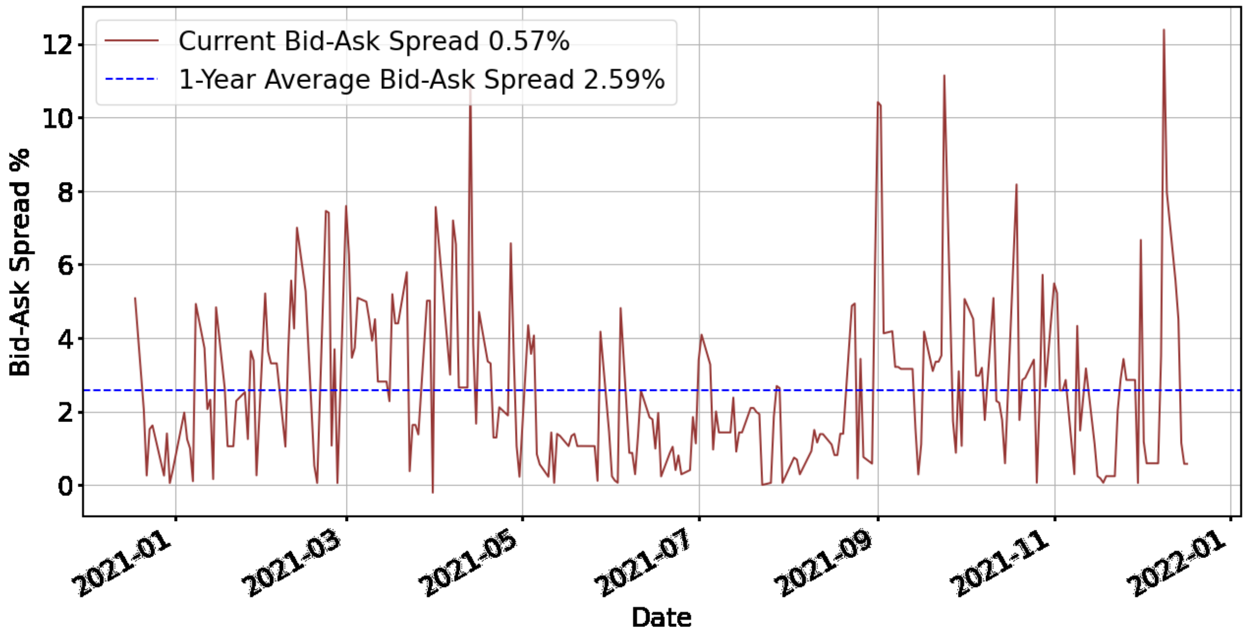
Chart 4.



Source: http://www.jamstockex.com, JMMB Investment & Research, Bloomberg, Various Company Financial Statements.

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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