INVESTMENT AND SOVEREIGN RESEARCH **February-28-2023**

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Jamaica Stock Exchange Limited

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Executive Summary

The Jamaica Stock Exchange Limited (JSE), incorporated in Jamaica, operates and regulates the Jamaica Stock Exchange with its registered office located at 40 Harbour Street in Kingston. The Company's primary function is to facilitate efficient securities trading through its proprietary platform and the development of the stock exchange. The JSE also owns a wholly owned subsidiary, the Jamaica Central Securities Depository Limited (JCSD), which offers trustee custodianship and related services through its subsidiary, JCSD Trustee Services.

The JSE's revenue streams consist of Cess Income and Fee Income. Although a significant contributor, Cess Income is a volatile source derived from a 35-basis point fee applied to all Stock Exchange transactions. In contrast, Fee Income is a substantial and stable revenue source, with major contributors including Registrar, Trustee, and Annual Listing fees. The Company has demonstrated financial stability, with high margins, high liquidity levels, low solvency ratios, and strong cash flows for the review period (2017-2021).

The JSE currently exhibits a P/E ratio of 17.8x, below its 5-year average of 27.3x, calculated using its trailing 12-month EPS. In terms of liquidity, the JSE has demonstrated relatively low trading activity, with an average daily volume of 226.8K units over the past year, resulting in an approximate value of $5.1 million. Additionally, the JSE has exhibited a relatively modest implicit cost to acquire shares, with an average bid-ask spread of 4.1% over the past month.

Recommendation: UNDERWEIGHT

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Key Financial Data

	YE 2017	YE 2018	YE 2019	YE 2020	YE 2021	CAGR	Q3 2021	Q3 2022	% ▲
BVPS	1.35	1.60	2.10	2.19	2.70	18.8%	2.45	2.82	14.9%
EPS	0.31	0.59	0.74	0.58	0.71	23.0%	0.54	0.60	10.5%
Dividend Per Share	0.15	0.30	0.40	0.52	0.27	17.0%	0.27	0.44	59.3%
JSE Close Price	13.50	12.00	40.01	34.98	20.50	11.0%	21.23	24.20	14.0%
Main Market Index	288,382	379,791	509,916	395,615	396,156	8.3%	414,890	361,692	-12.8%
Abridged Income Statement ($M)									
Cess Income	285.8	494.7	697.3	380.0	469.5	13.2%	366.0	408.1	11.5%
Fee Income	611.6	808.1	1,045.1	1,215.1	1,339.7	21.7%	1,015.7	1,201.4	18.3%
Revenue	991.2	1,390.8	1,874.4	1,711.4	1,927.7	18.1%	1,473.3	1,711.8	16.2%
Operating Profit	338.1	592.5	803.1	618.5	741.0	21.7%	561.1	624.5	11.3%
Net Profit	220.7	413.1	519.9	406.9	497.3	22.5%	377.7	417.6	10.5%
Abridged Balance Sheet ($M)									
PP&E	342.8	491.2	591.0	679.5	870.0	26.2%	703.0	910.9	29.6%
Non-current Assets	745.8	787.6	1,082.5	1,155.1	1,352.6	16.0%	1,180.0	1,414.7	19.9%
Cash & Cash Equivalents	310.1	455.3	427.3	440.6	565.2	16.2%	629.3	662.6	5.3%
Current Assets	509.1	724.2	723.1	714.9	880.8	14.7%	981.0	992.2	1.1%
Total Assets	1,255.0	1,511.8	1,805.6	1,869.9	2,233.4	15.5%	2,161.0	2,406.9	11.4%
Total Equity	948.8	1,125.4	1,470.3	1,534.4	1,891.8	18.8%	1,719.6	1,976.2	14.9%
Current Liabilities	225.7	332.3	231.5	229.8	234.7	1.0%	336.3	337.9	0.5%
Non-current Liabilities	80.5	54.2	103.9	105.7	106.9	7.3%	105.1	92.8	-11.7%
Total Liabilities	306.2	386.5	335.4	335.5	341.6	2.8%	441.5	430.8	-2.4%
Abridged Cash Flow Statement ($M)									
Cash (used in)/provided by operating activities	169.5	458.4	452.0	405.7	443.8	27.2%	430.3	566.4	31.6%
Cash (used in)/provided by investing activities	(69.1)	(151.5)	(306.4)	(22.3)	(320.6)	46.7%	(243.8)	(282.7)	16.0%
Cash (used in)/provided by financing activities	(102.1)	(210.0)	(280.5)	(364.7)	(191.4)	17.0%	(191.4)	(305.0)	59.3%
Ratios						**Average**			
Cash Ratio	1.4	1.4	1.8	1.9	2.4	1.8	1.9	2.0	4.8%
Current Ratio	2.3	2.2	3.1	3.1	3.8	2.9	2.9	2.9	0.7%
Efficiency Ratio	67.4%	58.8%	58.3%	66.4%	64.1%	63.0%	64.0%	64.0%	0.1%
Financial Leverage	1.35	1.33	1.28	1.22	1.20	1.3	1.26	1.24	-1.6%
Operating Margin	34.1%	42.6%	42.8%	36.1%	38.4%	38.8%	38.08%	36.48%	-4.2%
Net Profit Margin	22.3%	29.7%	27.7%	23.8%	25.8%	25.9%	25.64%	24.39%	-4.9%
ROE	25.1%	39.8%	40.1%	27.1%	29.0%	32.2%	32.05%	29.07%	-9.3%
ROA	18.6%	29.9%	31.3%	22.1%	24.2%	25.2%	25.08%	23.52%	-6.2%
P/E	24.2	18.5	37.7	35.2	27.1	28.5	25.19	23.17	-8.0%
P/B	5.5	7.1	13.3	9.3	7.1	8.5	7.30	6.30	-13.7%
Dividend Payout Ratio	47.0%	50.8%	54.0%	89.6%	38.5%	56.0%	50.68%	73.05%	44.1%
Dividend Yield	2.1%	3.9%	1.8%	2.4%	1.5%	2.3%	1.58%	2.55%	61.9%

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Financial Overview

Income Statement Review

In FY 21, the Company's revenue exhibited a 12.6% increase, driven primarily by a rise in one of its key revenue drivers. Income generated from fees and cess were the primary contributors to this revenue growth. Specifically, Cess Income saw a growth of 23.5%, reaching $469.5 million, which was the main contributor to the overall revenue increase. The increase in Cess Income for FY 21 can be attributed to a surge in trading activity, with the value traded rising from $62.9 billion in 2020 to $76.7 billion in 2021. Despite this increase, Cess Income remains lower than the peak recorded during the review period of $697.3 million recorded in FY 19.

Fee Income continues to serve as the primary source of revenue for the Company, accounting for 69.5% of total revenue in FY 21. Fee Income has consistently demonstrated an upward trend throughout the review period, with Trustee, Registrar, and Annual Listing fees being the primary contributors. Trustee Fee has displayed a compound annual growth rate (CAGR) of 23.5% over the review period. However, the growth rate decelerated to 7.7% in FY 21. Similarly, Registrar Fees only increased by 4.1% in FY 21 to $238.1 million, which represents a slower pace in comparison to the 30.3% CAGR under the review period. Additionally, growth in Annual Listing Fees also slowed down to 9.9% as opposed to a CAGR of 27.6% recorded over the last 5 years.

More recently, total revenue has exhibited an uptick of 16.2% in the most recent 9M to $1.8 billion, with a significant increase of 36.9% in Q1 FY 22 driven primarily by a surge in Cess Income. Despite this, in Q3 FY 22, total revenue experienced a decline of 6.8% due to a decline of 40.3% in Cess income.

Profit for FY 21 increased by 22.2% to $497.3 million. However, it still lags behind the peak of $519.9 million recorded in FY 19. The decline in FY 21 profits compared to FY 19 is primarily due to significantly higher operating expenses, while revenue only demonstrated a marginal increase. Furthermore, Net profit increased by 10.5% in the most recent 9M to $417.6 million. Earnings growth was augmented by a net profit increase of 83.4% in Q1 FY 22 but constrained by a decline of 26.4% in Q3 FY 22 earnings.

Balance Sheet Review

The Company has exhibited consistent expansion in its non-current assets over the reviewed period, with a compound annual growth rate (CAGR) of 16.1%. The primary contributors to this category of assets in FY 21 are Property, Plant, and Equipment (PP&E) and Investment Securities, accounting for 39% and 10.2% of total assets, respectively. Of the Investment Securities, GOJ USD 8% 2039 Global Bonds carry the most weight, valued at $173.6 million at the end of FY 21.

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In terms of current assets, repurchase agreements, trade & other receivables, and cash and cash equivalents are key considerations, with respective values of $487.8 million, $300.5 million, and $77.4 million as of the end of FY 21. These assets make up 25.3% of total assets, with GOJ securities backing the repurchase agreements, the majority of which are denominated in Jamaican dollars. Additionally, trade & other receivables are driven by Fees Receivable and Cess Receivable, valued at $157 million and $62.5 million, respectively. On the liability side, payables & accruals are the most significant, accounting for 8.1% of total assets at the end of FY 21.

In recent times, current assets have seen a marginal increase of 1.1% to $992.2 million in the 9M ended September 2022. This growth was tempered by a decline in trade and other receivables but was supported by a 17.2% increase in cash & cash equivalents, including repos, to $662.6 million.

Total equity has also grown steadily, with a CAGR of 18.8% and acceleration to 23.3% in FY 21. Despite an average dividend payout ratio of 56%, equity growth has been sustained by consistent profitability and an increase in the property revaluation reserve, which grew by 34.8% to $392.2 million at the end of FY 21. In the 9M ended September 2022, total equity has continued to expand by 4.5% to $2 billion, with the primary constraint being a fall in fair value reserve.

Concurrently, total liabilities have seen a 26.1% increase in the 9M ended September 2022, with current liabilities surging by 44% to $337.9 million. This increase is primarily driven by increased contract liabilities.

Cash Flow Review

In FY 21, cash provided by operating activities increased by 9.4% to $443.8 million, although it is still lower than the peak of $458.4 million recorded in FY 18. However, cash flow from operations (CFO) in the most recent 9M has seen a significant surge of 31.6% to $566.4 million, primarily due to increased profitability and reduced trade and other receivables.

On the other hand, cash used in investing activities in FY 21 surged to $320.6 million, primarily due to purchases of repurchase agreements for $180.8 million and the acquisition of property, plant, and equipment for $70.5 million. This represents an increase of 16% compared to an outflow of $282.7 million in the same period last year.

In terms of financing activities, cash used fell 47.5% to $191.4 million in FY 21, primarily due to a decrease in dividend payments from $364.6 million in FY 20. However, in the most recent 9M, cash used in financing activities increased by 59.3% to $305 million, driven by an increase in dividends per share from $0.27 to $0.44.

Ratios Review

The Company's liquidity position is robust, as evidenced by consistently high ratios over the review period. Specifically, the cash ratio reached a peak of 2.4x during FY 21, with an average of 1.8x, while the current ratio remained above 2x throughout the review period and ended FY 21 at 3.8x. Despite a slight decline to 2.9x in Q3 FY 22, it remains at a level that is well above an adequate standard.

Additionally, the Company's efficiency has improved, as evidenced by a decrease in the efficiency ratio to 64.1% in FY 21 (FY 20: 66.4%) due to a surge in revenue. The Company's financial leverage has trended lower throughout the review period, reaching a low of 1.2x in FY 21 (compared to 1.22x in FY 20). This can be attributed to the fact that the Company's operations are primarily funded by equity. As of the end of FY 21, the Company had equity of $1.9 billion and total liabilities of $341.6 million.

The Company's returns on equity and assets have been consistently high, averaging 32.2% and 25.2%, respectively, over the review period, and the net profit margin has been substantial throughout the review period, improving to 25.8% in FY 21 (compared to 23.8% in FY 20). The Company's balance sheet is robust, with no debt and high liquidity, as well as sustainable revenue sources. Furthermore, the Company's P/E and P/B ratios have been relatively high compared to most financial companies, which may be due to its unique position in the financial industry.

However, the Company's P/E ratio of approximately 17.8x is relatively low compared to its historical levels, which may be attributed to its well-above-average performance on key metrics. Despite a significant improvement in profitability in FY 21, the Company's profits still lag the peak recorded in FY 19. Nevertheless, the Company's ability to consistently deliver elevated ROE and ROA may explain investors' positive sentiment towards it.

Forecast and Valuation

In determining our price target of $11.88, we employed the Free Cash Flow to Equity (FCFE) model. Further analysis utilising the FCFE model in two additional scenarios yielded upper and lower price targets of $14.95 and $9.29, respectively. The variations in these scenarios are primarily attributed to expectations of trading activity in FY 2023 and beyond. The best-case scenario is based on the assumption that trading activity will reach the highest levels recorded in each quarter over the last three years. Conversely, the worst-case scenario forecasts a decline in trading activity to the lowest levels observed in each quarter during the same period**.**

	Price Target	Implied Upside/(Downside)
Upper	14.95	▲ 9.0%
Base	11.88	▼-13.4%
Lower	9.29	▼-32.3%

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Outlook

During the review period, Fee Income, a significant revenue source, has exhibited a consistent slowdown in growth. However, in the most recent 9M, Fee Income growth has accelerated. Despite this, based on our expectation that Trustee fees, a significant source of Fee Income, will continue to slow in the medium to long term, we anticipate the trend of slowing Fee Income growth to persist in FY 23 and beyond.

Furthermore, Cess income has been consistently underperforming compared to FY 19 figures due to trading levels that remain significantly lower than those seen in FY 19. The stagnation in trading activity is a significant revenue and profit growth obstacle. Therefore, the Company's ability to sustain growth will depend on its ability to effectively introduce new offerings and products that can drive an increase in trading activity on the market, which would subsequently aid profit and revenue growth.

Key Risks to Our Price Target

Based on our analysis, we anticipate an increase in Fee Income for FY 22 and beyond, although at a slower rate compared to the review period. Our assessment indicates that the primary risk factor in this scenario is Cess Income, which displays significant volatility and serves as a crucial component of revenue. A substantial portion of the value traded on the exchange is derived from large institutional transactions, and any failure to materialise these transactions could potentially result in a deviation from our projected profitability. Nevertheless, the growing proportion of Fee Income in total revenue serves to mitigate this risk.

We also note that with the central bank's moves to increase interest rates in an attempt to control inflation, equity / stocks should be relatively less attractive when compared to fixed income instruments. Further, the non-payment of dividends by some highly capitalized entities (financial and otherwise) listed on the JSE should negatively impact market liquidity, further negatively impacting stock market activity.

Recommendation:

Our analysis of the JSE reveals a strong financial position as evidenced by favourable liquidity, solvency, and activity ratios. However, our primary concern is the current valuation of the stock in comparison to its current stock price. Based on this evaluation, we are upgrading our recommendation to an **UNDERWEIGHT** rating on JSE, as the stock is currently trading above our base case price target but below our upper price target. Despite stagnation in growth income, JSE has been able to maintain solid financial stability through an increase in fee income.

JSE has underperformed the JSE Main Market, declining 11.8% YTD compared to a 4.4% decline for the same period. Furthermore, the Company's liquidity is relatively low, with an average daily volume of 226.8K units traded over the past year, valued at approximately $5.1 million. **Further details on JSE's stock performance, volume and value traded, and historical closing bid-ask spread can be found in the provided charts.**

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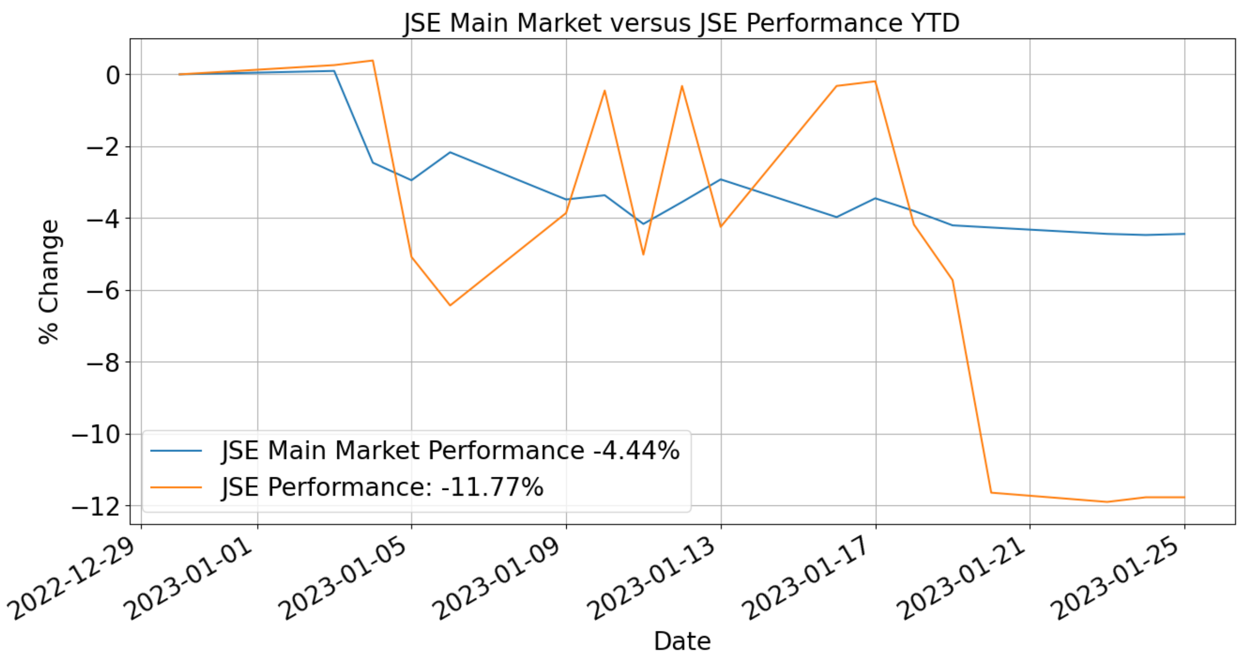

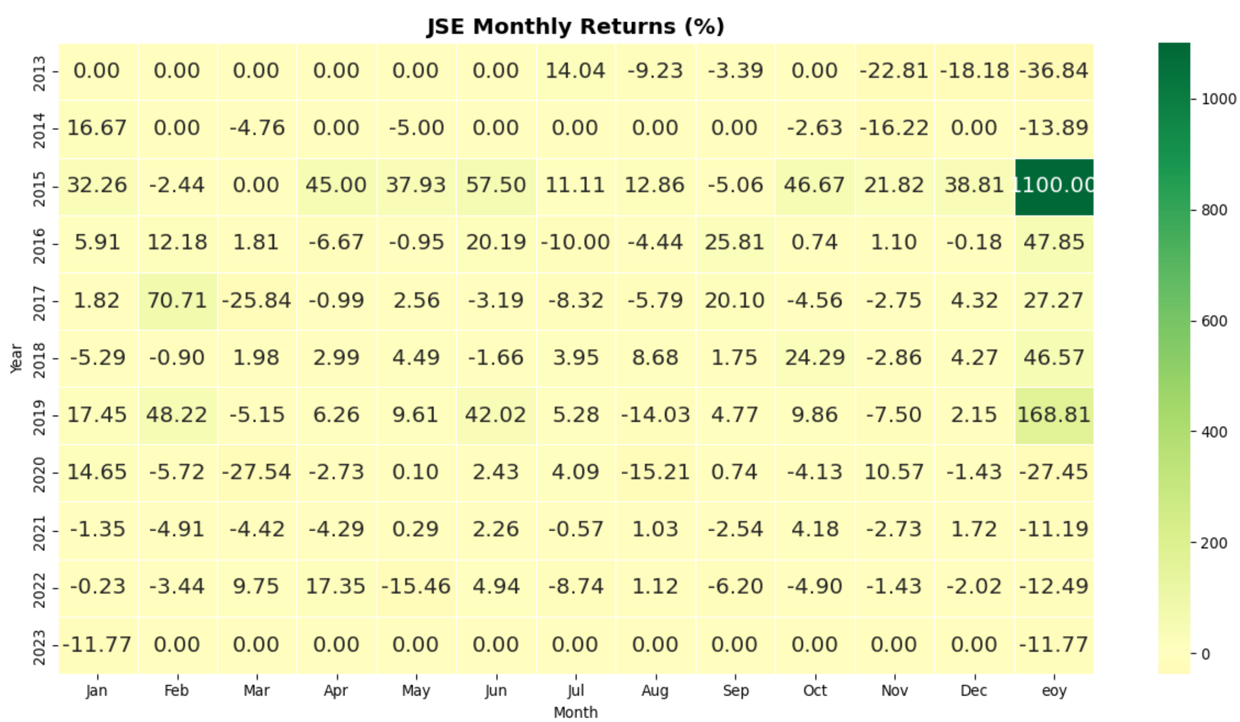

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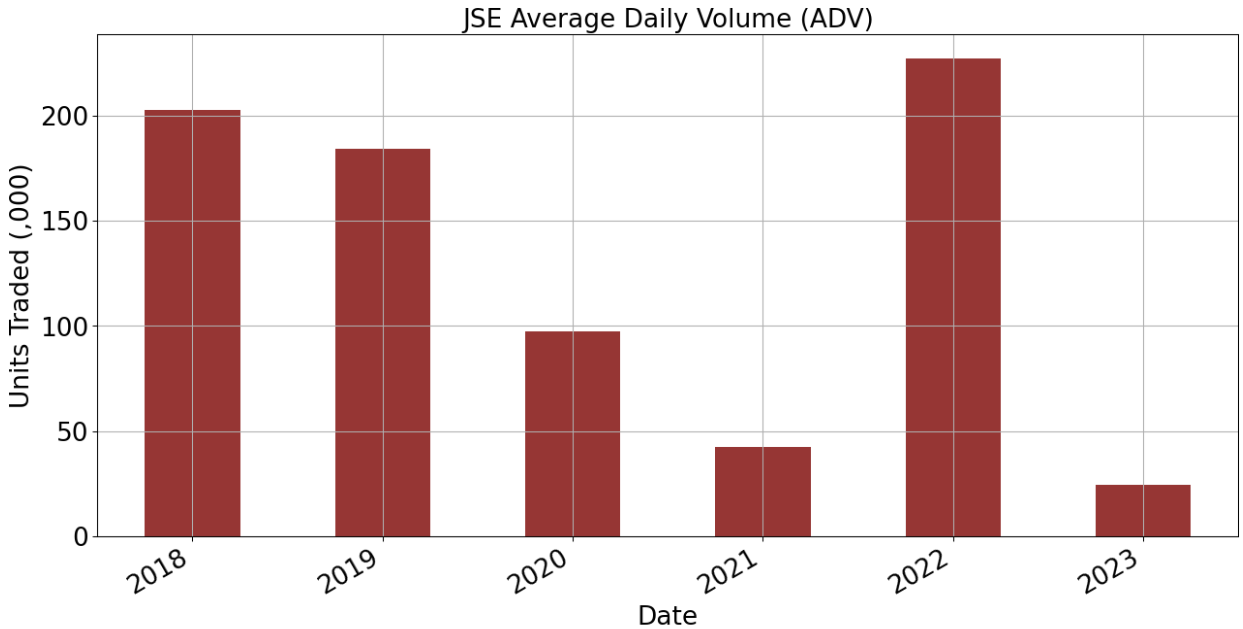

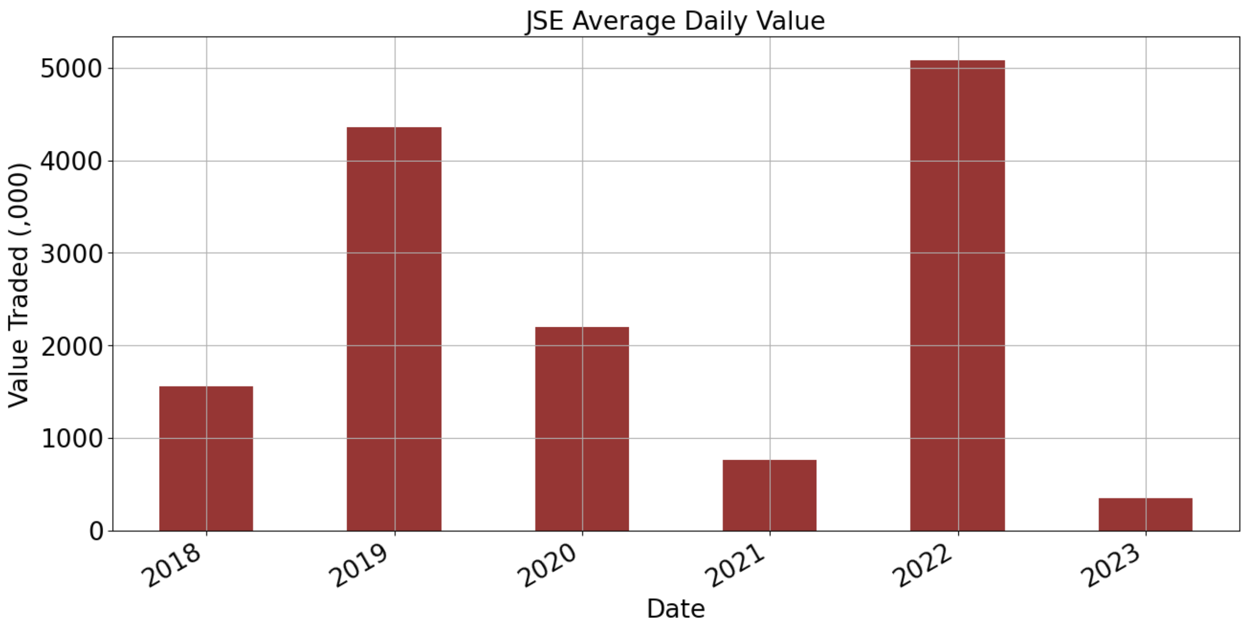

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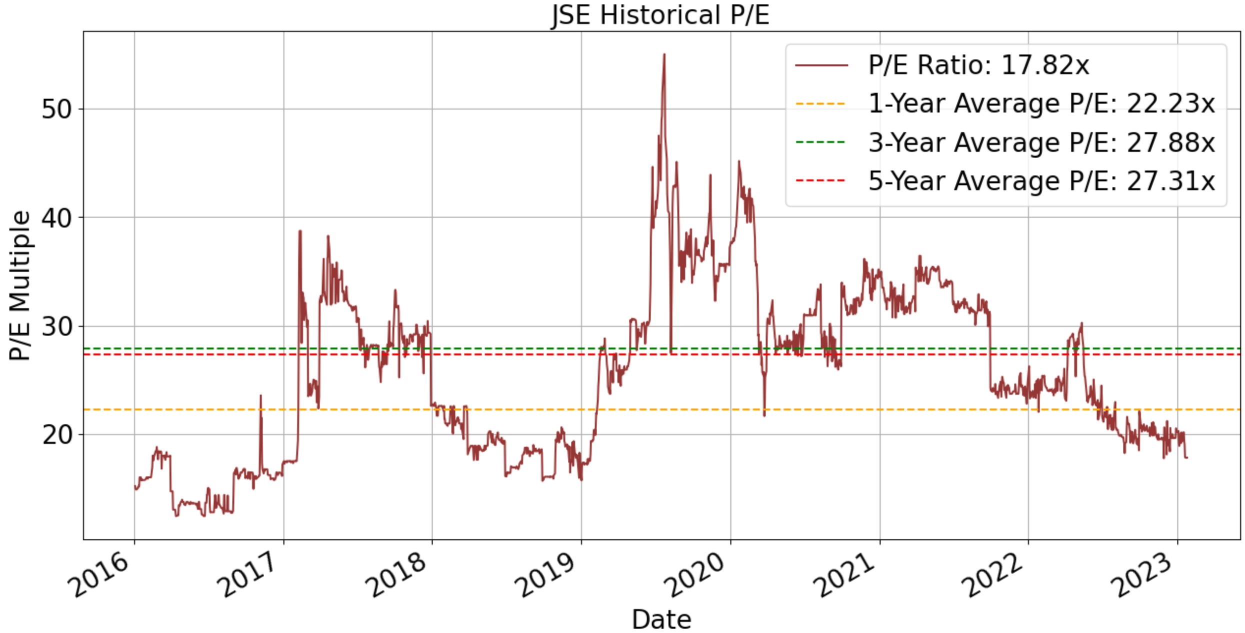

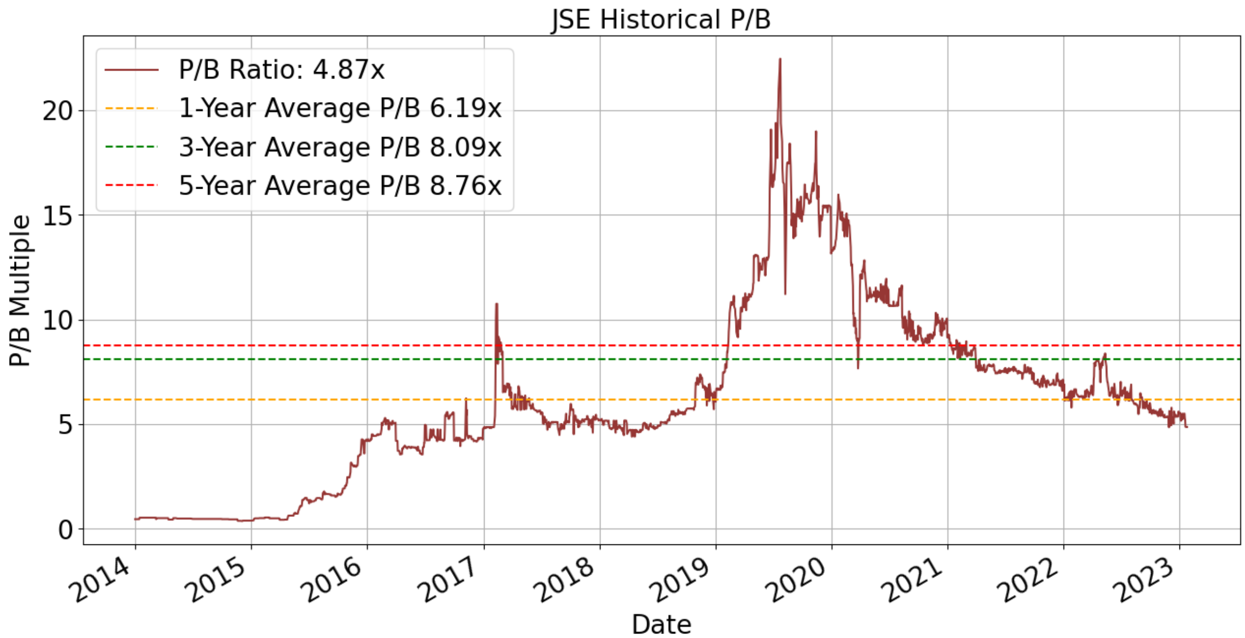

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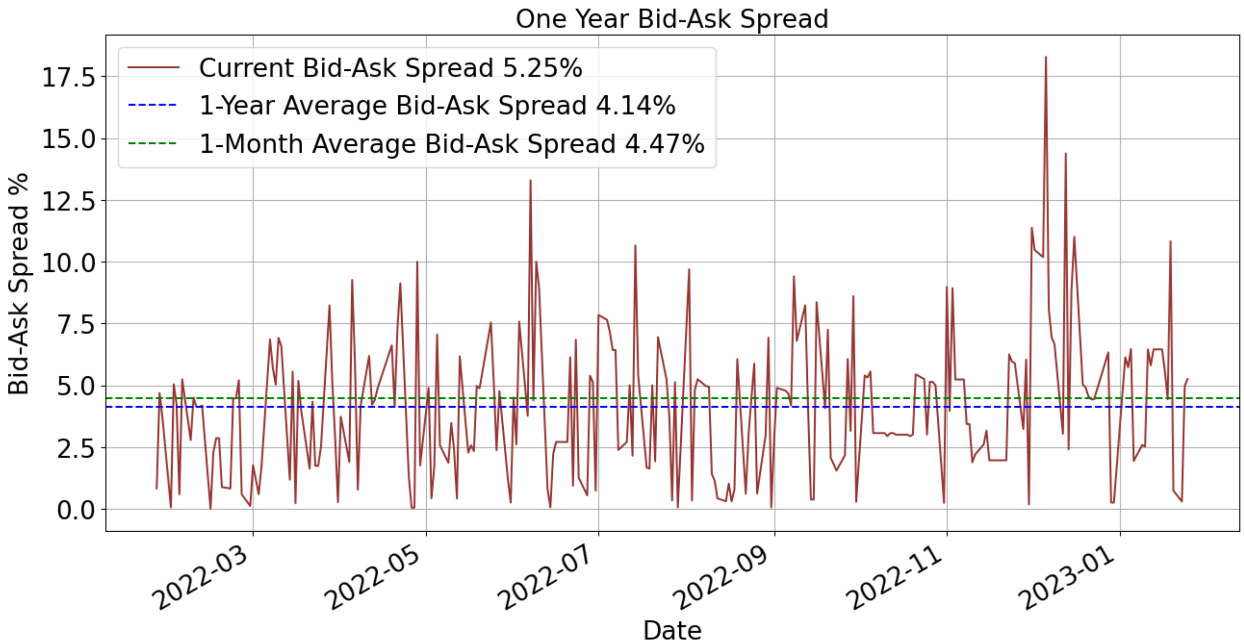

Source: http://www.jamstockex.com, JMMB Investment & Research, Bloomberg, Various Company Financial Statements.

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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