

Sagicor Group Jamaica Limited

Recommendation: Buy

Ticker: SJ

Price Target: \$41.68

Current Price: \$31.50

Shares Outstanding: 3,905,634,916 units

Market Value of Shares Outstanding: \$123.03 Billion

Financial Year End: Dec 31

About the Company: Sagicor Group Jamaica Limited (SJ, the company) is incorporated and domiciled in Jamaica and is listed on the Jamaica Stock Exchange. The company is among the largest financial services group in Jamaica and is the leading life insurance company in Jamaica. SJ operates in several financial services including health insurance, annuities, retirement products, pension administration and investment services. SJ also controls 29.30% of Sagicor Real Estate X Fund giving it exposure to commercial real estate in Jamaica and the US. The ultimate parent of SJ is Sagicor Financial Corporation (SFC), which is incorporated and domiciled in Bermuda. SFC has an overall interest of 49.11% in SJ. Pan-Jamaican Investments Limited is the second largest shareholder of SJ with 31.58% of outstanding as at June 31, 2017.

Projections and Valuation:

We arrived at our price target using a Discounted Free Cash Flow (DCF) model. The required rate of return was calculated using the capital pricing model (CAPM) which yielded a required rate of return of 16.52%. The long-term growth rate assumption used for free cash flow is 7% (about in line with inflation assumptions of about 6%) which we view as conservative given the 10-year growth rate of about 14%. Our price target would put the forward P/E ratio as at December 2017 at approximately 10x earnings which we also view as reasonable given increased sentiment in the market and this multiple is below the average P/E on the Main Market of about 17x earnings.

Financial Performance

	Profit and Loss Summary		
	2015	2016	2017 ¹
Net Income (J\$,B)	9.79	11.26	5.65
EPS (J\$)	2.51	2.88	1.46
BVPS (J\$)	11.92	14.44	15.32
P/E (x)	7.96	10.07	9.76
Price	19.95	29.04	31.50

Outlook: In the near-term we expect the company to report improved performance in Net Investment income in the 3rd quarter ended September due to the repurchase of government bonds. We also expect the improved economy to help the drive earnings per share to our projection of \$1.05 and \$1.69 the 3rd and 4th quarter of 2017 respectively. Additionally, we expect 2018 earnings per share of \$5.03. We see Investment Income as the key driver for revenue growth going forward given the company's growing investment portfolio and the improving economic outlook. We expect modest growth from the Commercial bank segment given the increased competition in the commercial banking segment and the declining interest rate environment.

Risks and Assumptions in Price Target: The main risk to our price target is a downturn in the Jamaican or US economy leading to less demand for the company's products. The company's products and services such as Investment solutions, Insurance Premiums and Loans are all vulnerable to a slowing economy they are very cyclical in nature. Additionally, The banking segment could face declines from higher delinquency rates on loans and an overall decline in loan demand.

Dividend Policy: SJ has not indicated an explicit dividend payment policy. However, there are some observable patterns. The company usually pays dividends twice per year with the larger payment being made in the first half of the year and the balance in the second half of the year. Also, of note dividends have consistently increased since 2013 and is expected to increase for the financial year ended December 31, 2017.

	2013	2014	2015	2016	2017
Dividend Payment Per share	\$0.40	\$0.63	\$0.73	\$1.11	\$0.70 ²
Dividend Growth Rate	-28.57%	57.50%	15.87%	52.05%	6.06% ³
Dividend Payout Ratio	23.95%	28.51%	29.08%	38.28%	47.37%

¹ For the 6 month period ended June 2017

² First dividend payment on May 5, 2017

³ Compared to the \$0.66 per share in dividend for the first half of 2017

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Jamaican Economic Overview: SJ is highly exposed to the Jamaican economy with over 90% of its revenue being generated in Jamaica and over \$95.32 billion in direct exposure to GOJ bonds as at December 31, 2016. Therefore a detailed look at the recent Jamaican economic performance and future expectation are necessary to gain a comprehensive view on SJ future prospects.

Real GDP in Jamaica increased 1.4% in the calendar ended December 31, 2016, versus a 0.9% for the same period ended December 2015. Coupled with the improving GDP is the declining interest rate environment in Jamaica with the Bank of Jamaica (BOJ) reducing its benchmark rate from 3.75% to 3.50% effective August 25, 2017. Lower interest rates are expected to help the formation of new investments which can aid economic growth. The Jamaican dollar has been relatively stable against its US counterpart depreciating 0.65% to J\$128.65 for the period January 1, 2017, and August 25, 2017. This indicates improved confidence among Jamaican businesses about future growth prospects. Also according to Don Anderson poll business confidence remains high at 137.1 points as at the end of June 2017 close to its all time high of 144.6 recorded in the first quarter of 2016. Meanwhile, Net International Reserve (NIR) stood at US\$2.74 billion as at the end of July 2017, representing 20.93 weeks of imports for goods and services. In April 2017, there was a net improvement in the employment of about 19,000 which reduced the unemployment rate to 12.20% from 12.70%. The majority of the employment gains was among "Professionals, Senior and Technicians"

Management and Corporate Governance

The company has an experienced board and senior management team in a range of industries. The company currently has 13 members on the board with expertise in several disciplines including law, finance and real estate management.

The company also has exceeded the internationally best practice of at least 75% independent board members. Additionally, the company has separated the role of Chairman and CEO in line with international best practices.

Directors

Richard O Byles B.Sc, M.Sc

Non Executive Chairman, Appointed 2004

Christopher Zacca

President and CEO Executive Director

Peter E. Clarke B.A

Non-Executive Director Appointed 2012

Jeffrey Cobham B.A Dip

Non-Executive Director Appointed 2003

Jacqueline Coke-Lloyd

Non-Executive Director Appointed 2010

Richard Downer C.D, FCA

Non-Executive Director Appointed 2008

Paul A.B Facey, B.Sc., MBA

Non-Executive Director Appointed 2005

Stephen B. Facey B.A., M.Arch

Non-Executive Director Appointed 2004

Marjorie Fyffe Campbell M. Sc., FCA, DBA, JP.

Non-Executive Director Appointed 2003

Paul Hanworth M.A M.Sc A.C.A, C.P.A

Non-Executive Director Appointed 2008

Stephen Mcnamara CBE, LLD

Non-Executive Appointed 2014

Peter K. Melhado BSc. MBA

Non-Executive Director Appointed 2014

Dr. Dodridge Miller FCCA M.B.A, LLM, Hon LLD

Non-Executive Director Appointed 2001

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Senior Management

Christopher Zacca
President and CEO

Ivan B O'B. Carter MBA, M.Sc., FLMI
Executive Vice President
Finance and Information Technology and Group CFO

Mark Chisholm MBA (HONS), J.P.
Executive Vice President
Individual Life Insurance Division

Ingrid Card B.Sc. (HONS), MBA
Group Marketing Vice President
Executive Director, Sagicor Foundation

Willard Brown FSA, B.Sc (HONS.)
Executive VP
Employee Benefits and Actuary

Donovan H. Perkins B.A (HONS.), MBA
President and CEO of Sagicor Bank Limited

Rohan D. Miller B.Sc. (HONS) MBA
Executive Vice President, Sagicor Group Treasury and Asset Management

Philip Armstrong B.Sc.
Deputy CEO & Director
Sagicor Bank Jamaica Limited

Janice Grant Taffe LL.B. (HONS), CLE
Senior Vice President
General Counsel and Corporate Secretary

Karl Williams B.Sc., Executive MBA
Senior Vice President
Group Human Resources and Corporate Services

Shareholders	Number of Units Held	Percentage Held
Sagicor Financial Corporation	1,947,751,790	49.11
PanJamaican Investments	1,233,467,652	31.58
SJIML 3119	49,654,821	1.27
National Insurance Fund	47,611,210	1.22
Ideal Portfolio	43,965,713	1.13
ATL Group Pension	31,050,088	0.80
GK Pension Scheme	27,632,689	0.71
Richard Byles	23,864,048	0.59
Donwis Ltd	22,882,560	0.59
JPS Superannuation	20,047,940	0.51
Total	3,418,314,175	87.52

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SWOT Analysis

Strengths <ul style="list-style-type: none">• Strong brand recognition• Large diversified group with leading market share in several operating segments including Unit Trust and Life Insurance in Jamaica	Weaknesses <ul style="list-style-type: none">• The majority of revenue is generated in Jamaica; therefore the company is highly suitable to Jamaica's economic condition.• Operates in a highly competitive industry which constricts net profit margin growth
Opportunities <ul style="list-style-type: none">• Leverage customer base for new products and services	Threats <ul style="list-style-type: none">• Weak economic growth• The company has high exposure to GOJ bonds therefore any negative shock to the Jamaican economy could lead to significant trading losses.• Commercial Banking industry is more competitive with new entry JMMBGL

Industry Overview Porters Five Forces

Industry Competitiveness: High

There are over 20 different financial companies in Jamaica offering various financial services. These groups include Building Societies, Credit Unions, Wealth Management Firms, Pension Management firms and Commercial banks. While the majority of firms in the financial industry do not offer all services a few of the larger players in the industry such as NCB Financial Group, Sagicor Group and Scotia Group offer a complete suite of products ranging from pension management and insurance to car loans and credit card products. The financial services industry is highly competitive given the increasing amount of financial firms coupled with the similarity of product offerings.

Potential for New entrants: Medium

The barrier to new entrants in some segments in the financial sector is low. However, some of the more lucrative segments of the financial industry such as mortgage lending; credit card lending and motor vehicle loans are heavily regulated. Overall the barrier to entry is not overly high which has over time created a diverse financial landscape in Jamaica.

Bargaining Power for Suppliers: Low

Financial institutions have little bargaining power given the plethora of options available to consumers. This is manifesting in the industry through several channels such as lower interest rates. That being said the majority of customers represent a very small amount of revenue for most financial institutions which limit their ability to negotiate pricing directly with a financial institution.

Bargaining Power for Customers: High

This is high even among the most heavily regulated commercial banking segments has eight entities. Additionally, the products and services offered by the bigger financial institutions are similar giving customers a range of options.

Threat of Substitute products: High

Substitute products to the full services financial providers exist in the form of credit unions and building societies.

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Highlights from Financial Statements: The largest contributor to revenue over the past 5 years has been Insurance premiums and annuities. Premiums and Annuities revenue accounted for 56.10% of revenue for the period financial year ended December 31, 2017. This contribution to revenue represents a significant decline from the 65.45% for the financial year ended December 31, 2011. Net Investment Income (NII) is the second largest revenue generator hitting an all-time high of \$19.35 billion for the financial year ended December 31, 2017. Some of the largest contributors to NII is gains on available-for-sale securities and loans payments of \$8.32 billion and \$6.48 billion respectively. For the financial year ended December 31, 2016, Fees and Other Income contributed \$6.86 billion to revenues with \$2.36 billion and \$1.92 billion generated from Administrative Fees and Bank services fees respectively. For the period 2011 to 2016 revenue grew at a compounded annual growth rate (CAGR) of 15.80%.

Customer Deposits have increased \$93.06 billion or 839.11% over the period 2012 to 2016. The majority of the growth occurred over the period 2015 to 2016 due in part to the acquisition of RBC Bank. Pension funds under management have consistently improved and increased by \$75.01 billion over the period 2012 to 2016, at a CAGR of 18.03%. Other funds under management including SJ's unit trust products have consistently improved and have grown by \$73.16 billion at a CAGR of 29.34% for the period 2012 to 2016.

Net profit margins have remained fairly consistent with a dip in 2013 due to a surge in net insurance benefits incurred.

Per Share Data	2012	2013	2014	2015	2016
Book Value Per share (\$)	8.86	9.63	11.79	11.92	14.44
Earnings Per Share (\$)	1.55	1.65	2.19	2.51	2.88
Dividends Per Share (\$)	0.56	0.40	0.63	0.73	1.11
Income Statement Data (\$,000)					
Net Premium Revenue	22,960,833	29,224,496	29,168,788	32,482,414	33,494,641
Net Investment Income	9,529,379	8,784,969	12,552,316	16,301,549	19,348,572
Fee and other income	3,017,179	4,346,700	3,909,119	6,214,079	6,857,662
Operating Income	6,927,516	7,026,200	5,644,136	11,670,431	13,708,709
Effective Tax Rate (%)	12.36	8.01	3.37	15.66	20.79
Net Income	6,061,532	6,452,690	8,563,118	9,793,445	11,258,039
Balance Sheet Data (\$,000)					
Total Assets	174,531,916	198,310,297	284,215,813	300,389,927	340,954,832
Common Equity	34,614,834	37,620,843	46,065,358	46,569,411	56,410,982
Total Liabilities	139,917,082	160,538,110	238,150,455	253,820,516	284,543,850
Customer deposits	11,090,266	11,881,676	53,589,012	67,477,360	104,149,488
Pension FUM ⁴	79,725,000	85,506,000	98,209,000	130,311,000	154,734,000
Other FUM	40,683,000	45,692,000	78,865,000	95,616,000	113,842,000
Key Ratios					
ROE (%)	18.71	17.87	20.46	21.14	21.86
ROA (%)	3.62	3.46	3.55	3.35	3.51
Net Profit Margin (%)	17.07	15.23	18.77	17.81	18.86
P/E Ratio	6.51	6.16	4.63	7.96	10.07
P/BV Ratio	1.14	1.06	0.86	1.67	2.01

⁴ Funds Under Management

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Conclusion: SJ has a strong management team and board of directors with extensive experience in their respective fields. Investing in the company's stock does carry some risks with the main issue being the company's lack of geographical diversification. However, the company's strong capital base and diversified product offering over shadows the concern. Additionally, the balance sheet and income statement indicate the company is likely to continue being liquid and solvent for the foreseeable future. There are several key trends such as improving funds under management and over 10 years of consistent profit growth that indicate the company is well managed and is a good long-term investment.