

Company Analysis: Barita Investments Limited (BIL) 9M 2022/23

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- Stock Recommendation: **MARKETWEIGHT**
- Current Price: J\$ 71.89
- Price Target: **J\$ 77.58**

- Shares Outstanding: 1,220,388,243 units
- Financial Year End: September 30

ABOUT THE COMPANY

Barita Investments Limited (BIL) is a publicly traded company listed on the Jamaica Stock Exchange (JSE) and is 79.7% owned by Cornerstone Investments Holdings Limited. Founded by Rita Humphries-Lewin in 1977, the Company has the distinction of being one of the oldest stock-broking companies in Jamaica. The Company is licensed by the Financial Services Commission (FSC), is a member dealer of the JSE and is a Primary Dealer and Cambio Dealer for the Bank of Jamaica (BOJ).

BIL is recognized as a strong player in the middle market retail segment. Its products and service offerings include Cambio Trading, Fixed Income Trading, Stock Brokerage, Pooled Funds Management, Structured Products, Retirement Planning, Wealth Management and Investment Banking. BIL serves its clients island-wide through its Head Office in Kingston and branches in Mandeville and Montego Bay.

FINANCIAL PERFORMANCE SUMMARY

J\$'000	FY 2020/21	FY 2021/22	9M 2021/22	9M 2022/23
Net Interest Income	1,541,340	1,672,170	1,387,573	422,554
Net Operating Revenues	8,116,262	8,951,733	7,222,672	7,387,191
Net Profit	4,058,597	4,221,262	3,831,062	3,082,319
Total Assets	90,209,025	109,700,695	109,928,430	124,095,207
Total Liabilities	53,962,709	77,517,217	72,527,582	88,589,702
Total Equity	13,669,278	27,480,6840	37,400,848	35,505,505

Dividend Policy

Barita Investments Limited has adopted a Dividend Policy that states the company may pay at least 80% of its annual earnings as dividends. However, the Board may vary the amount paid at its discretion.

Outlook

BIL's operations are significantly swayed by the Bank of Jamaica's policies, particularly the 7.0% policy rate, impacting market preferences towards shorter-term investments. This, driven by global inflation concerns chiefly from rising oil prices, has temporarily halted interest rate hikes, potentially constraining BIL's Net Interest Income in upcoming quarters. Nevertheless, prospects of recovery exist as BIL re-prices assets and expands its funding base for better-yielding investments. Additionally, by diversifying revenue sources, BIL aims for greater earnings resilience. Parallely, BIL is advancing in real estate through its alternative investment platform, forming strategic alliances for long-term value creation. However, persistent high interest rates could deter external financing, delaying project executions.

Projections and Valuation

We used a combination of the Residual Income Model with a required rate of return of 12.3% and a market approach based on the price-to-book ratio to arrive at a price target of **\$77.58**.

Risks to Price Target

The negative impact of high inflation and high interest rates on the financial markets threatens the Company's ability to meet its targets and execute its strategic agenda over the short- to medium term. On the upside, if a faster-than-anticipated recovery in inflation levels materializes, this should cause interest rates to fall and allow BIL to expand its asset management, investment banking and other services faster than our base case expectation, which would reflect positively on long-term shareholder value creation.

NINE (9) MONTHS ENDING JUNE 30, 2023

For the nine months ended June 30, 2023, BIL recorded Net Interest Income (NII) of \$423.0 million, reflecting a \$965.0 million decrease (70.0%) year-over-year (YoY) compared to the \$1.3 billion posted during the same period in 2022. Market conditions continue to be influenced by the Bank of Jamaica's (BOJ) policy measures to control high inflation levels. As a result, interest rates on funding liabilities remain elevated throughout the sector. Non-interest income reflected a robust YoY increase of 19.0% or \$1.1 billion to end the period at \$7.0 billion compared to the \$5.8 billion recorded in the previous year. The increase was driven by a 40.0% boost in gain on investment activities (primarily real estate), which offset a 28.0% YoY reduction in foreign exchange translation gains (due to prevailing market conditions); Fees and commission income recorded a commendable 8.% growth YoY, generated from asset management and investment banking, with the increase arising from portfolio management fees.

Non-interest expenses for the nine months rose 22.0% to \$3.3 billion compared with the \$2.7 billion recorded in the previous year. The rise was driven by increases in administrative costs (48.0%) due to higher professional and consultation fees, software maintenance, asset tax and management fees. Staff costs also rose by 12.0% YoY. The Group's expected credit losses (ECL) were negative \$136 million, relative to \$92.0 million in the previous year, reflecting writebacks of ECL on some loans that have been repaid. The foregoing resulted in the Group's efficiency ratio increasing to 45% for the nine months relative to 37% in 2022. Overall, Net income decreased by 20.0%, falling to \$3.1 billion from the \$3.8 billion recorded in the previous year, as growth in operating expenses outweighed growth in net operating revenue.

Total assets stood at \$124.1 billion for the nine months, representing a \$14.3 billion or 13.0% increase over the balance of \$109.9 billion recorded in the same period for 2022. This increase was due to \$14.4 billion growth in the securities portfolio, which largely comprised credit assets to include local, regional & international government and corporate bonds. Total Liabilities stood at \$88.6 billion, representing a growth of \$16.0 billion or 22.1% compared to the previous year. The rise was mainly due to an increase in the Company's funding from repurchase agreements, which rose by 10.7 billion. Shareholders' equity decreased to \$35.5 billion relative to \$37.4 billion in 2022, mainly due to lower share capital.

Return on Average Equity marginally decreased to 11.8% versus 14.2% in the previous year amid lower Net income, which outpaced the decline in Shareholders' equity. The reduction in this metric indicates that the Company was less efficient in generating profits relative to its equity base in the current year compared to the previous year.

OUTLOOK

Operations Should Continue to Be Influenced by Central Bank

We acknowledge the strength of the local economy, characterized by a robust labour market and expectations of above-average economic growth. However, BIL's operations are influenced by the decisions of the Bank of Jamaica (BOJ), which has maintained a 7.0% policy rate and limited Jamaican dollar liquidity. Market participants have shown a preference for shorter-term investments. BOJ has put a temporary halt to its interest rate increase cycle, and this pause is expected to continue in the foreseeable future. This decision is driven by concerns about the possibility of a 'double peak' in inflation in advanced economies like the USA, primarily due to a resurgence in oil prices. Due to these factors, Net Interest Income (NII) for BIL may remain constrained in the coming quarters. However, there is potential for some recovery as existing assets are repriced and BIL's funding base expands, allowing it to invest in high-quality assets that offer attractive yields. While BIL positions itself for this eventual recovery, it also aims to focus on diversifying its sources of revenue to bolster the resilience of earnings further.

Real Estate Initiatives and Strategic Partnerships In the Pipeline; But Higher Rates Might Slow Progress

BIL has a strategy to establish a foundation for the Company to create sustained value in the medium to long run. Consequently, BIL is emphasizing diversification through its alternative investment platform. The Company is making progress in this line of business, particularly in real estate initiatives. During the recent quarter, BIL announced critical milestones and formed strategic partnerships, bringing them closer to the following stages of its alternative investment endeavours. As a result, it anticipates shifting from revaluation gains to generating realized cash-based revenues in the coming three to seven years through financing, development, and sale of various real estate projects. Some of the initiatives include the development of a commercial hub, residences, a resort project, and an ultra-modern warehouse, among other projects. Additionally, Barita has been building a strategic relationship with T&T's indigenous bank, First Citizens, as part of its ambition to become a major financial player in the region. Despite ambitious strategies, higher interest rates for longer may slow BIL's willingness to seek external financing, thereby slowing its ability to execute within the desired timeline.

INVESTMENT POSITIVES

1. **Non-Interest Income Growth:** Barita Investments recorded a robust 19.0% year-over-year increase in non-interest income, primarily driven by a 40.0% boost in gain on investment activities, particularly in real estate. This indicates the potential for revenue diversification and the ability to generate gains from alternative investments.
2. **Total Assets Growth:** The company's total assets increased by 13.0% year-over-year, reaching \$124.1 billion. This growth is mainly attributed to the expansion of the securities portfolio, including credit assets like government and corporate bonds. A larger asset base can provide opportunities for higher returns.
3. **Strategic Focus on Real Estate:** Barita Investments is actively pursuing real estate initiatives and strategic partnerships. This strategy positions the company to benefit from potential long-term gains in the real estate market, including the development and sale of various real estate projects over the next three to seven years.
4. **ECL Writebacks:** The Group reported negative expected credit losses (ECL) of \$136 million, reflecting writebacks of ECL on some loans that have been repaid. This suggests a positive credit quality trend and potentially lower credit-related risks.
5. **Diversification Efforts:** Barita Investments is emphasizing diversification through its alternative investment platform, aiming to generate realized cash-based revenues from various projects. This diversification strategy can help mitigate risks associated with reliance on a single source of income.
6. **Dividend Paying:** BIL pays out consistent dividends, which is an investment positive for investors seeking that type of return.

INVESTMENT NEGATIVES

1. **Significant Decrease in Net Interest Income (NII):** NII for Barita Investments decreased by 70.0% year-over-year, primarily due to elevated interest rates on funding liabilities influenced by the Bank of Jamaica's policy measures. This significant decline in NII reflects a challenging interest rate environment that may continue to constrain profitability.
2. **Increase in Non-Interest Expenses:** Non-interest expenses rose by 22.0% year-over-year, driven by increases in administrative costs and staff costs. Higher operating expenses can put pressure on profitability and efficiency.
3. **Efficiency Ratio Increase:** The Group's efficiency ratio increased from 37% to 45% for the nine months, indicating that the company became less efficient in generating profits relative to its equity base. This suggests a potential challenge in cost management.
4. **Decrease in Shareholders' Equity:** Shareholders' equity decreased from \$37.4 billion to \$35.5 billion, mainly due to lower share capital. A reduction in equity may impact the company's ability to absorb losses and maintain capital adequacy.
5. **Continued Influence of Central Bank:** Barita Investments' operations are influenced by the decisions of the Bank of Jamaica



(BOJ), including a 7.0% policy rate and limited Jamaican dollar liquidity. Market participants' preference for shorter-term investments and uncertainties in interest rate policy may continue to affect the company's performance.



CONCLUSION

BIL's operations are significantly swayed by the Bank of Jamaica's policies, particularly the 7.0% policy rate, impacting market preferences towards shorter-term investments. This, driven by global inflation concerns chiefly from rising oil prices, has temporarily halted interest rate hikes, potentially constraining BIL's Net Interest Income in upcoming quarters. Nevertheless, prospects of recovery exist as BIL re-prices assets and expands its funding base for better-yielding investments. Additionally, by diversifying revenue sources, BIL aims for greater earnings resilience. Parallely, BIL is advancing in real estate through its alternative investment platform, forming strategic alliances for long-term value creation. However, persistent high interest rates could deter external financing, delaying project executions.

In considering the factors above and our assessment of the prospects for the growth and profitability of BIL. We arrived at a target price of \$77.58 which is a 7.9% upside from current price \$71.89 and therefore, we assign a **MARKETWEIGHT** recommendation to the stock at current levels.

SOURCES

The Jamaica Stock Exchange, Barita Investments Limited Annual Reports, Quarterly Financial Statements, Jamaica Observer, Jamaica Gleaner, CNC3 News Trinidad and Tobago (CNC3).

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DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.