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LOCAL EQUITY REPORT

VICTORIA MUTUAL INVESTMENTS LIMITED

Barita Investments Limited
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Company Overview

Victoria Mutual Investment Limited ("VMIL") was incorporated in 1984 and is domiciled in Jamaica. It is 80% owned by Victoria Mutual Building Society, established in 1878. VMIL is the parent company of Victoria Mutual Wealth Management Limited ("VM Wealth"), which was founded in 1994. In 2017, as part of the VM Group's strategic goal of being a Strong Integrated Financial Group, the organization initiated the recapitalization of VMIL (the holding company of VM Wealth), as a vehicle to facilitate corporate lending and investing to support Jamaican businesses. This recapitalization was undertaken by offering 20% of the company's ordinary shares to the public through the Jamaica Stock Exchange (JSE). Today, VMIL provides credit financing solutions; offering margin loans, insurance premium financing, lease financing, corporate loans, and underwriting services. It also provides stock, investment brokering, financial and investment advisory, and money market dealing services.

Stock	VMIL
Close Price	J$6.40
Estimated Fair Value	J$7.42
Potential Upside	15.94%
Dividend Yield (1yr.)	0.00%
Total Return	15.94%
Year to Date Return	8.47%
Trailing P/B	2.36x
Trailing P/E	17.14x
Recommendation	MARKETWEIGHT
Date: July 15, 2021	

Analyst Insight

In its most recent March 2021 quarter, VMIL's performance improved relative to the prior year, underscoring the fact that the business climate has improved since the height of the pandemic in March 2020. Notably, however, the market's reaction to the company's performance has been somewhat muted as the share price remains in line with the March 2020 period, which reflected the decline in share price amidst the COVID-19 induced equity sell-off. After more than a year of living alongside the pandemic, however, COVID-related restrictions have been relaxed considerably, which supports a potential strengthening of the economic environment which, in turn, bodes well for the company's top line. With these factors in mind, we believe the stock trades at a discount, which underpins our fair value estimate and potential upside.

However, while this is the case, potential downside risks remain, particularly as it relates to the company's cost management which has deteriorated since Q1 2021 as well as the feasibility of generating revenue growth from gains on investment activities, net fees and commission income and net interest income. The risks largely stem from several factors including the significant increase in global bond prices, particularly Government of Jamaica securities, which we believe is unlikely to repeat to the magnitude seen in 2020, which therefore suggests the potential exists for lower gains from investment activities in subsequent quarters.

This also has linkages to the company's interest income which flows predominantly from investment securities that, at this point, have very low yields, reflective of the low interest rate environment globally. Finally, there are fees and commission income that are dependent on the level of capital market activities which remain subdued relative to pre-pandemic levels. With that said, on balance, we believe the upside seen in Q1 potentially represents the most Year-over-Year (YoY) upside the company will realize in FY2021 and should be the main driver of improved YoY profitability for the 2021 financial year. However, we believe the market dynamics will weigh on YoY performance, unless there's a significant improvement in business origination, beyond prior years, on the back of a strengthening economy or increased capital that can then be deployed towards growth initiatives. With that said, our **MARKETWEIGHT** recommendation balances the risks that remain against the potential upside embedded in our estimate of fair value.

Industry Overview

The Financial Services Industry has been severely affected by the Covid-19 pandemic and in many cases, more so than most other industries due to the decline in asset prices both locally and globally. As a consequence of market volatility and decline, many companies reported considerable losses from investment activities, while lower trading volumes affected fees and commission income. Additionally, the significant contraction in the real economy increased credit risk materially which led to higher Expected Credit Losses (ECL) which reduced incomes and dampened profitability during this period. While aspects of the underlying economics surrounding their business have improved since the worst period of the pandemic, industry earnings have collectively remained depressed relative to 2019 (pre-pandemic). Further, asset quality for the overall financial system remains below prior periods. In particular, the ratio of non-performing loans (NPLs) to total loans (gross), as at March 31, 2021, increased by 0.5 percentage points to 2.9% relative to 2.4% in March 2020 and March 2019, as indicated in the table below. Liquidity also remains below the pre-pandemic level as indicated by the average domestic cash reserve and liquid asset ratios but above the BoJ's requirements.

Relevant Ratios (Total Financial System)	Mar-21	Mar-20	Mar-19
Capital Adequacy Ratio [CAR]	14.3%	14.2%	14.7%
Income Assets : Expense Liabilities	102.1%	102.2%	104.3%
NPLs (3 mths & over)/Total Loans (gross)	2.9%	2.4%	2.4%
Average Domestic Currency Cash Reserve /Average Prescribed Liabilities	4.7%	6.5%	8.3%
Average Domestic Currency Liquid Assets/Average Prescribed Liabilities	25.7%	27.5%	27.5%
Source: Bank of Jamaica (BoJ)			

Despite these pandemic-induced effects, the financial system remains well-capitalized as reported by the Bank of Jamaica (BoJ) as the systemwide capital adequacy ratio is well above (14.3%) the regulatory requirement of 10%. This is further supported by the recently concluded financial stability report by the BOJ which highlighted some key factors summarized below:

- **Increased Resilience:** The results of DTIs' aggregate stress tests showed that the sector was more resilient to hypothetical shocks applied at the end of 2020.
- **Reduced Contagion Risk:** Network analysis revealed a reduction in the risks to the financial system from interconnectivity. Specifically, there were improvements in the systemic risk score which indicated a reduction in contagion.
- **Regulatory Compliance:** Despite the deterioration in the overall local economic environment caused by COVID-19, subsequently leading to a large GDP contraction, institutions broadly remained compliant with all regulatory measures including but not limited to the capital, liquidity, and concentration limits. There remains adequate liquidity within the financial system and sufficient capital buffers in place.

Industry Outlook

The profitability decline of the industry over this period is highly consistent with the underlying economics of banks. Essentially, the services provided by banking and financial institutions are inextricably linked to the strength of the economy. The recent decline in the economy, therefore, affects several areas of the banking business including tightened credit spreads that reduce net interest income, reduced market activity that weighs on trading income as well as fees and commissions, heightened credit risk of borrowers which, in turn, require that banks report a provision for the expected losses given the enhanced risk exposure, etc. **With that said, the cyclical nature of these companies has played a significant role in the industry's fairly weak performance throughout the pandemic. What's most important at this juncture, however, is that the industry is stable, which has been acknowledged by the BOJ.**

Against that backdrop, it's important to note that the cyclical nature of the financial services industry which characterized its decline in 2020 should support its rebound once the economy picks up. Specifically, the Bank of Jamaica estimates that real GDP contracted in the range of 5% - 7% in the March 2021 quarter, markedly better than the three previous quarters. The bank projects that following this contraction, the economy should rebound in subsequent quarters. Consequently, for FY2021/22, the BoJ projects real GDP growth in the range of 5% - 8% and a return to pre-pandemic real GDP by the March 2022 quarter. This indicates that, barring any material adverse event such as a catastrophic hurricane, Jamaica is on the cusp of an upward growth trajectory. Within that vein, the economic recovery should serve to improve the performance of the financial sector. Similarly, the underlying risks that have persisted such as slightly elevated NPLs, should be tempered within this economic backdrop.

Notably, this industry outlook sets the context for the industry as a whole. However, more important are the fundamental drivers of VMIL's performance and potential growth which are wholly addressed in the Financial Analysis Section below.

Financial Analysis (3 Months Ended March 31, 2021)

Performance Summary: For the quarter ended March 31, 2021, VMIL reported a net profit of $89.59 million relative to a net loss of $36.90 million in the prior year. The improved profitability was driven largely by increased gains on investment activities relative to losses reported in the previous year as well as a more than 7-fold increase in other income. Notwithstanding, fees, and commission income declined while net interest income was relatively flat.

Net Interest Income:
For the quarter ended March 31, 2021, VMIL reported net interest income of $80.15 million, $304 thousand above the previous year's $79.85 million, reflecting an improvement in gross interest income (+$14.93 million or 6.2%) which was nominally higher than the growth reported in interest expense (+$14.63 million or 9.0%).

Non-Interest Income:
For the period, **total non-interest income** amounted to $322.15 million, growing by $213.47 million (196.4%) YoY. The improvement was almost entirely attributable to **gains from investment activities**[1] which amounted to $199.39 million, an improvement of $206.29 million over the previous year's loss of $6.90 million. This growth was slightly supported by **other income** totalling $41.50 million relative to $5.39 million, a 670% YoY increase. However, growth was tempered by **Net fees and commission income** which amounted to $161.41 million, a decline of $28.63 million (15.1%) relative to the previous year.

Total operating revenue: representing the sum of net interest and non-interest revenue amounted to $482.45 million, a YoY improvement of $214.08 million (79.8%).

Operating Expenses: VMIL's operating expenses for the period totaled $374.61 million, an increase of approximately $26.80 million or 7.7% when compared to the prior year. The increase largely reflects growth in staff costs (+$17.83 million or 12.3%) and other operating costs (+$27.27 million or 16.8%). Notably, impairment losses on financial assets decreased over the period, moving from $40.73 million in 2020 to $22.43 million which implies reduced credit risk. As indicated by the company, except for the asset tax, the expenses are growth-focused and relate to the development of team members and other support services required to position VMIL for future growth.

Profit before tax and net profit: Profit before tax for the period amounted to $99.28 million, an improvement of $187.84 million relative to the prior year's loss of $88.56 million. This outturn incorporates improved revenue, slightly higher operating expenses, and a reduced loss from Associate of $8.56 million relative to $9.13 million in the previous year. Similarly, net profit improved, totaling $89.59 million, an increase over the previous year's loss of $36.90 million.

FY2020 Income Statement Summary

[1] **Gains from investment activities** includes gains and losses from fixed income securities, equities, unit trust funds and net FX translation gains/losses

Net Interest Income: In FY2020, the company reported net interest income of $289.62 million, an increase over the prior year of $29.24 million (11.2%).

Non-Interest Income: For the year, non-interest income amounted to $1.59 billion, an increase of $163.39 million (11.5%), driven by gains from investment activities (+$108.09 million or 22.2%), and the gain from the sale of margin loans (+$45.23 million) which was a one-time gain.

Net interest income and other operating revenue: Totaled $1.88 billion, an increase of $192.63 million (11.4%).

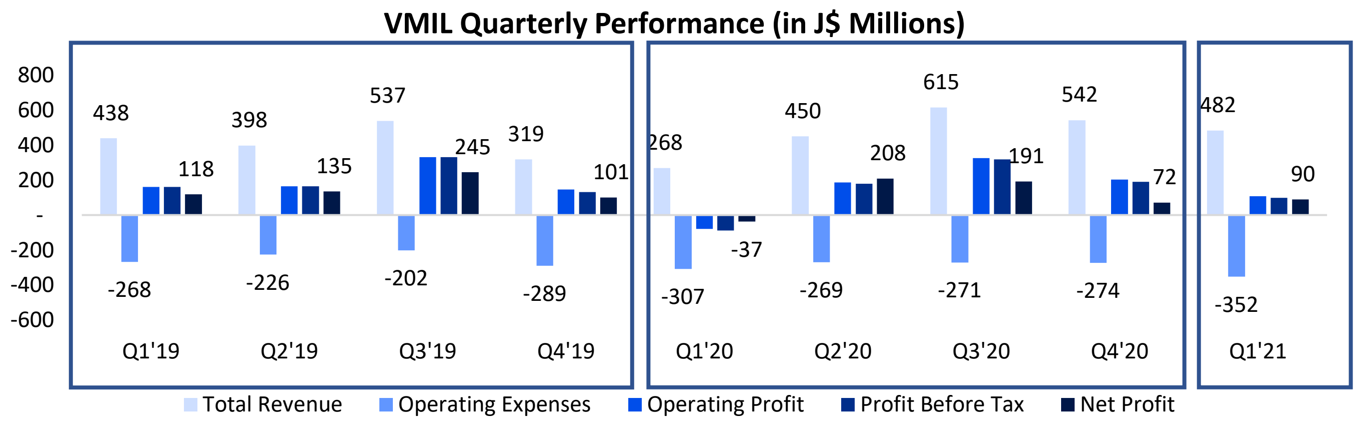
Total Expenses: For the year, total expenses amounted to $1.24 billion, an increase of $359.32 or 40.8% largely reflective of increased impairment losses related to heightened credit risks as a result of the pandemic.

Profit before tax and Net Profit: Despite the increase in revenue, the significant growth in costs was a major drag on the Group's profitability, resulting in profit before tax of $598.87 million, a YoY decrease of $187.35 million (23.8%). Similarly, net profit amounted to $433.59 million, a decline of $164.46 million (27.5%).

Summary Statement J$'000	FY2016	FY2017	FY2018	FY2019	FY2020	TTM	Q1 2020	Q1 2021
Net Interest Income	250,756	246,989	250,079	260,381	289,622	289,926	79,847	80,151
Non-Interest Income	560,047	719,466	1,056,696	1,422,580	1,585,967	1,799,742	188,525	402,300
Revenue	**810,803**	**966,455**	**1,306,775**	**1,682,961**	**1,875,589**	**2,089,668**	**268,372**	**482,451**
Staff Costs	- 216,293	- 292,329	- 349,068	- 518,023	- 587,487	- 605,316	- 144,534	- 162,363
Impairment Losses/Gains	-	-	- 105,442	-	-	-	- 40,726	- 22,427
Other Operating Costs	- 200,776	- 206,301	- 313,230	- 459,416	- 533,906	- 561,172	- 162,549	- 189,815
Total Expenses	**- 417,069**	**- 498,630**	**- 767,740**	**- 881,397**	**- 1,240,712**	**- 1,267,508**	**- 347,809**	**- 374,605**
Share of Profit/Loss	-	-	-	- 15,337	- 36,004	- 35,443	- 9,125	- 8,564
Profit before Tax	**393,734**	**467,825**	**539,035**	**786,227**	**598,873**	**786,717**	**- 88,562**	**99,282**
Net Profit	**317,278**	**346,302**	**397,598**	**598,049**	**433,590**	**560,082**	**- 36,901**	**89,591**

Performance Discussion

Notably, as indicated in the Summary Statement Table, the company's twelve trailing months net profit has outpaced the 2020's net profit. However, this is largely because Q1 2020's performance was dampened by the pandemic and as such, a loss was reported. Relative to a loss, Q1 2021's performance would, indeed, result in the company's TTM performance improving. However, if we look at **subsequent quarters in the Quarterly Performance Chart**, the Group's total revenue (net interest income and non-interest income) in 2020 was higher than in 2019. **The growth in Q2 to Q4 was on the back of fee and commission income in large part, and to a lesser extent, gains on investment activities**. Looking further at Q1 2021 indicates that while revenue has improved, net profit has waned relative to Q2 2020, for example, which we believe is a better comparison since the company was profitable in this quarter (unprofitable in Q1 2020). **The relative**



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OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO

decline was heavily due to a deterioration in expense management as the cost-to-income (adjusted for impairment) ratio in Q1 2021 was 73.0% relative to an average of 51.5% between Q2 2020 and Q4 2020. This is made clear in the chart as operating expenses increased to $352 million. Therefore, to drive increased YoY profitability for the rest of the year, the company will need to strengthen revenue to compensate for its heightened operating expenses which we believe will remain elevated relative to prior years. This expectation is somewhat grounded in VMIL's Q1 2021 quarterly statement which indicated that "With the exception of the asset tax, the expenses are growth-focused and relate to the development of team members and other support services required to position VMIL for future growth." This statement would suggest that costs will most likely remain or increase.

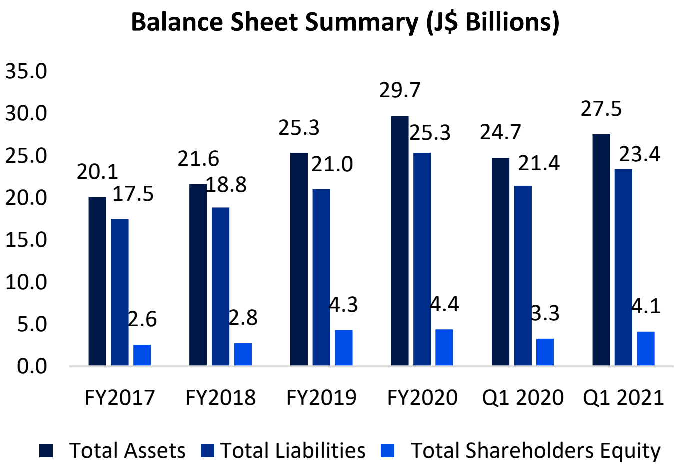
Despite the aforementioned quote, in our view, additional capital and potentially new business lines would be necessary to drive much larger growth. Noteworthy, the main drivers of revenue growth are gains on investment activities and net fees and commissions. We expect little growth in net interest income as elevated fixed income prices weigh on yields of most fixed income securities. Moreover, this also has implications for gains on investment activities where the company benefited immensely in 2020 from rising bond prices. Consequently, gains from fixed income securities (up by $385.60 million or 223% relative to FY2019) accounted for 94.0% of the company's gain on investment activities income in FY2020 and 29.8% of net revenue. We believe this is unlikely to recur throughout FY2021 as global bond prices have already rebounded significantly from pandemic lows. Notably, some upside potential is possible within local equities, unit trust funds, and from FX gains but it is unlikely to match the magnitude witnessed in global bond markets after the pandemic lows.

Finally, net fees and commission income, the largest component of net revenue at 49.3% was largely flat in FY2020 and has declined (-15.1%) on a YoY basis in Q1 2021**. Our expectation for growth in this line item is relatively soft, specifically because fees and commissions increased YoY by 36.8% in Q2 2020 and 41.6% in Q3 2020. Therefore, by beginning Q1 2021 with a fee and commission income decline of 15.1%, relative to last year's worst quarter for fees (Q1 2020); suggests to us that fee income in FY2021 could be, at best, flat, barring any significant increase in fee-related activities such as increased corporate advisory services or unit trust and other portfolio management services**.

On balance, therefore, we expect the company's FY2021 performance to be better than FY2020 largely due to its performance in Q1 which drove an improvement in its TTM performance. However, substantial drivers of potential weakness remain, particularly increased operating expenses coupled with reduced market opportunities and market activity.

Balance Sheet

Total Assets: For the period ended March 31, 2021, total assets amounted to $27.53 billion, a YoY increase of $2.79 billion (11.3%), driven predominantly by increased investment securities (up by $2.91 billion or 18.1%) and resale agreements (up by $973.11 million or 34.2%). Notably, this growth in the asset base was tempered by a $981.20 million (53.0%) reduction in cash and cash equivalents from $1.85 billion $846.64 million and loans receivables which amounted to $1.70 billion, a decline of $282.09 million (14.2%).



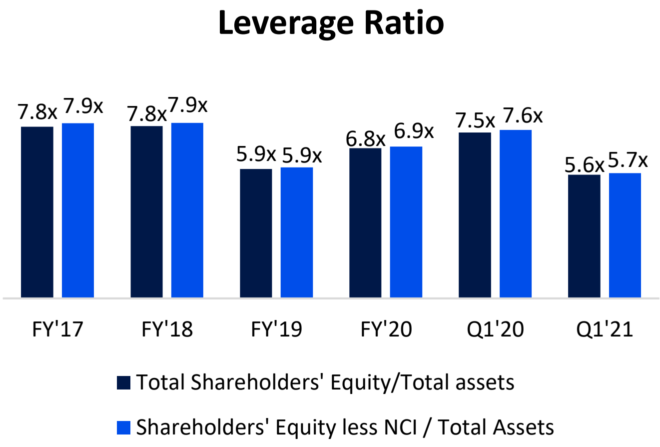
Total Liabilities: Total liabilities grew by 9.2% YoY ($1.98 billion) to a total of $23.42 billion. The increase was driven predominantly by an increase in repurchase agreements of $2.96

billion (18.0%) while it was tempered by a significant reduction in "other" accounts payables which decreased from $1.65 billion to $332.57 million.

Total Equity: Total equity amounted to $4.11 billion, a YoY increase of $813.67 million (24.7%) driven predominantly by retained earnings (up 28.5% or $560.08 million) and investment revaluation reserve (up 47.1% or $255.05 million). The increase in the investment revaluation reserve relative to the prior year reflects a lower loss from comprehensive income relative to the prior year.

Capital

The leverage ratio chart indicates that since listing on the JSE in FY2017, the Group's leverage has decreased, particularly in FY2019, due to increased retained earnings. In FY2020, given the heightened losses in financial markets driven by the pandemic, the Group's investment revaluation reserve declined, resulting in a lower equity base and, in turn, heightened leverage. Notably, losses that flow through fair value through OCI have reduced in Q1 of 2021 and profitability has increased; both of which have strengthened the company's equity base and reduced its overall leverage.



Cash Flow

Operating Cash Flow: For the quarter ended March 31, 2021, net operating cash inflow amounted to $2.44 billion, an improvement over the prior year's $327.11 million. This improvement was driven predominantly by changes in operating assets and liabilities which added $2.41 billion to the company's operating cash flow.

Net Investing Cash Flow: For the period, investing cash outflow amounted to $2.71 billion, an increase over the prior year of approximately $2.03 billion (302%). The increase reflects heightened investments in securities during the period (+$2.03 billion), supported by strong operating cash flows over the period.

Net Financing Cash Flow: Net financing cash outflow for the period amounted to $447.36 million, representing loan ($445.11 million) and lease liabilities repayments ($2.25 million).

Net cash movement for the period was an outflow of $712.35 million. Net cash position declined from $1.57 billion at the beginning of the year to $868.64 million at the end of the year.

Valuation Summary and Recommendation

Stock	VMIL
Close Price	J$6.40
Estimated Fair Value	J$7.42
Potential Upside	15.94%
Dividend Yield (1yr.)	0.00%
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Trailing P/B	2.36x
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Recommendation	MARKETWEIGHT
Date: July 15, 2021	

To determine a fair value for VMIL, a Single-Stage Residual Income and a Justified Price to Book valuation method were used.

Single-Stage Residual Income Model

The single-stage residual model was deemed appropriate given that since the pandemic, dividends have not been paid by the Company which would undermine a dividend discount approach.

Furthermore, the single-stage residual income model enables us to evaluate the value VMIL creates for shareholders in excess of its cost of equity. This makes the valuation method very constructive for valuing VMIL. Utilizing this approach, we arrived at a fair value estimate of **$8.22**.

Price to Book Value (P/B)

Our residual income model was coupled with a Justified P/B valuation approach. The use of the Justified P/B method provides an estimate of what the company's P/B multiple should be, derived from fundamentals as opposed to pure market movements. We estimated a 1-year book value per share of approximately $3.08 (12 months ended March 2022). Our P/B multiple was determined using the Justified Price to Book approach amounted to 2.15x, resulting in an intrinsic value per share of approximately **$6.62**.

Fair Value

Our estimated fair value is derived by averaging both values which essentially provide both an income and a market-based approximation of the Company's fair value. Consequently, our fair value estimate for the stock is **$7.42**. This represents an upside of **15.94%** relative to the July 15, 2021, close price of $6.40.
Given our valuation, the foregoing assessment of the Company, and the identified drivers of its performance, our **MARKETWEIGHT** recommendation balances the relative risks surrounding the market dynamics of the Company against the view that the market currently underprices the stock.

Conclusion

At present, VMIL's stock trades within the range of its lowest point ($6.30) during March 2020, a period reflective of heightened credit risks and a subsequent net loss reported by the company. In Q1 of 2021, the company has improved its profitability and as such, its twelve trailing months net profit is just 6.3% below FY2019's pre-pandemic level and well above (29.2%) the FY2020 outturn. Additionally, measures to contain the spread of COVID-19 which were the main drivers of the Group's FY2020 decline are continuously receding as economic growth becomes paramount.

The effect of these receding restrictions should provide an enabling environment to grow the company's top line. Notwithstanding, the share price remains subdued relative to its pre-pandemic level and as such, we believe there's value in holding the stock. On balance, however, we've considered that at this juncture, risks to the downside remain, such as the potential for relatively weak net interest income in an environment characterized by low interest rates and spreads, a fixed income market that has already rebounded significantly which dampens the outlook on potential gains within the space, and subdued fee and commission income in Q1 2021 when compared to Q1 2020 which signals the potential for a relatively low fee and commission income in subsequent quarters.

Furthermore, we've considered that outside of Q1 2020, the company's performance from a revenue perspective was robust during FY2020, i.e., above FY2019's outturn, indicating that costs were the main drivers of the company's weak net profit performance in Q3 2020 and Q4 2020 and these costs have elevated further in Q1 2021. Consequently, while net profit in Q1 2021 has improved relative to the prior year (Q1 2020), net profit remains subdued relative to Q2 2020 and Q3 2020 as a result of higher costs. With that said, the company's growth in revenue will need to compensate for the heightened expense. Therefore, the outlook is highly dependent on how well the company can strengthen its core business in a post-pandemic era which we believe will be difficult. Nonetheless, we believe the company's current price does not reflect its true value. This view is supported by our valuation upside of 15.94%. However, given the potential constraints for growth, we reaffirm our **MARKETWEIGHT** recommendation.

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