


APO Analysis: Barita Investments Limited (BIL)

VMWM Research | September 2021

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- APO Recommendation: **PARTICIPATE**
- Stock Recommendation: **MARKETWEIGHT**
- Offer Price: \$80.00
- Current Price: \$88.98¹
- Price Target: **\$95.21**

- Shares on offer: 125,000,000 units
- Shares on offer if upsized: 187,500,000 units
- Shares Outstanding Pre-Offer: 1,085,603,093
- Financial Year End: September 30

ABOUT THE COMPANY

Barita Investments Limited (Barita) 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). Barita 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.

Through its subsidiary Barita Unit Trusts Management Company Limited ("BUTM"), Barita currently offers eight (8) unit trust products spanning fixed income, equities and real estate. Barita serves its clients island-wide through its Head Office in Kingston and branches in Mandeville and Montego Bay. Barita manages over \$180.0 billion dollars in funds, with a team of 128 members across its operations island-wide.

CORPORATE STRATEGY

Barita Investments Limited (BIL) has grown to become a major contender in stock brokerage and fund management in Jamaica and continues to expand its service offerings locally & regionally. It's 2019 strategy is built on the brand pillars: Bold, Smart, and Game Changers. Through this strategy BIL will place its focus on improving client experience through innovation as well as creating attractive investment products to suit the needs of its customers.

FINANCIAL PERFORMANCE

(\$'M)	FY 2018	FY 2019	FY 2020	9M 2020	9M 2021
Net Interest Income	422.3	651.0	882.6	837	1,153
Net Operating Rev.	1,304.7	3,979.8	5,214.0	3,777	6,688
Net Profit	363.2	1,712.8	2,758.5	2,003	3,669
Net Interest Margin	2.6%	2.3%	1.7%	2.4%	2.0%
Return on Equity	12.4%	20.5%	13.4%	16.4%	16.1%
Return on Assets	2.1%	5.7%	4.9%	4.8%	5.4%

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.

Use of Proceeds

The company intends to use the proceeds from the sale of the shares as outlined below:

- To add capacity to the Company's principal investment portfolios.
- To expand locally and regionally.
- To expand investment banking underwriting capacity. To pay transaction fees associated with this offering.

Outlook

We believe that Barita has significant potential for continued growth. This is expected to be driven by the company's investment banking business along with both local and regional expansion, primarily through strategic partnerships, opening the company to a larger client base. In addition, the company's low leverage allows for strategic flexibility in executing on investment opportunities that may arise.

Projections and Valuations

We used a combination of a residual income model with a required rate of return of 10.6% and a market approach based on the price to earnings ratio in arriving at a price target of **\$95.21**.

Risks to Price Target

The negative impact of the pandemic on the financial markets poses a threat to Barita meeting its targets and executing on its strategic agenda. On the upside, if a faster than anticipated of recovery materializes, this will allow the company to expand its asset management, investment banking and other services faster than our base case expectation which would reflect positively for long-term shareholder value creation.

ABRIDGE OFFER DETAILS

ISSUER	Barita Investments Limited
LEAD BROKER AND ARRANGER	Barita Investments Limited
CO-BROKER	JN Fund Managers Limited
SELLING AGENT	Barita Investments Ltd., JN Fund Managers Ltd., Victoria Mutual Wealth Management Ltd., Scotia Investments Jamaica Ltd., Jamaica Money Market Ltd., and CUMAX Wealth Management Ltd.
ISSUE	<p>Total of 125,000,000 Ordinary Shares:</p> <ul style="list-style-type: none"> Existing Shareholders and Barita Clients – 18,750,000 Cornerstone Investor and Key Investors– 93,750,000 Non-Reserved Clients – 12,500,000 <p>The Company reserves the full, unqualified, and absolute right to increase the number of Shares in the APO by up to a further 62,500,000 (187,500,000 total units).</p>
OFFER PRICE	\$80 per share – For all eligible applicants (Cornerstone Investor, Key Investors, Existing Shareholders, Barita Clients and General Public)
MINIMUM APPLICATION	300 shares with excess in increments of 100 shares.
TARGET AMOUNT	\$10,000,000,000 (subject to the right of the Company to upsize the offer on oversubscription).
KEY DATES	Opens September 6, 2021, at 9:00 am Closes September 21, 2021, at 4:30 pm
USE OF PROCEEDS	<ul style="list-style-type: none"> Add capacity to the Company’s principal investment portfolios. Expand locally and regionally. Expand investment banking underwriting capacity. Pay transaction fees associated with this offering. (Approximately \$200,000,000.00)

Table 1. Offer Details – (The issue has not been underwritten however Cornerstone Financial Holdings Limited has agreed to the Committed Subscription of 93,750,000 shares.)

CORPORATE GOVERNANCE

The Board of Directors of Barita comprises seven (9) persons, three (3) of whom are directly involved in the business operations.

NAME	POSITION
Mark Myers	Chairman
Paul Simpson	Deputy Chairman
James Godfrey	Director
Phillip Lee	Director
Duncan Stewart	Director & Chairman of Investment Committee
Carl Domville	Director & Chairman of Audit Committee
Michael Hylton Q.C	Director & Chairman of Corporate Governance & Conduct Review Committee
Jason Chambers	Director
Robert Drummond	Director

Table 2. Corporate Governance

CAPITAL STRUCTURE AND SHAREHOLDING

SHAREHOLDERS	SHAREHOLDING (PRE-APO)	ISSUED CAPITAL (%)	SHAREHOLDING (POST-APO)	ISSUED CAPITAL (%)
Existing Ordinary Shares	1,085,603,093	100%	1,085,603,093	89.7%
Cornerstone Investor and Key Investors	-	0%	93,750,000	7.7%
Existing Shareholders and Barita Clients	-	0%	18,750,000	1.6%
Non-Reserved Shares (General Public)	-	0%	12,500,000	1.0%
Total	1,085,603,093	100%	1,210,603,093	100%

Table 3. Capital Structure and Shareholding Pre and Post APO Breakdown

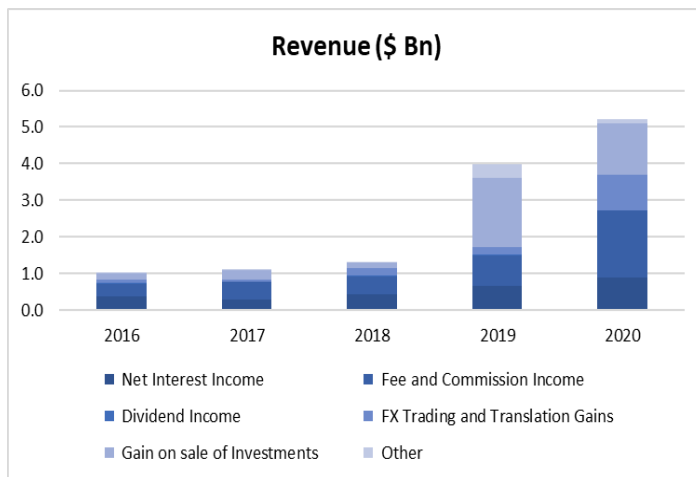
The company will be offering 125,000,000 shares divided amongst Cornerstone investor, key investors, existing shareholders, Barita clients and public applicants. The shares being offered will represent 10.33% of the post-APO total shares outstanding, while existing shareholders will own 89.67%. A further breakdown shows that of the 10.33%, reserved share applicants will be offered 9.29% of the company, while 1.04% will be privy to public applicants; the Company reserves the right to upsize the APO by 62,500,00 shares.

FINANCIAL PERFORMANCE

JMD (\$M)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	9M 2020	9M 2021
Net Interest Income	366.1	286.9	422.3	651.0	882.6	836.5	1,153.0
Operating Revenue	1,017.4	1,110.0	1,304.7	3,979.8	5,214.0	3,776.9	6,687.7
Net Profit	207.2	203.0	363.2	1,712.8	2,758.5	2,003.3	3,668.8
Earnings Per Share (\$)	0.47	0.46	0.82	2.42	2.54	2.45%	3.38%
Return on Equity (%)	9.5%	7.7%	12.4%	20.5%	13.4%	18.7%	19.5%
Return on Assets (%)	1.5%	1.3%	2.1%	5.7%	4.9%	4.1%	4.1%
Net Interest Margin (%)	2.8%	2.0%	2.6%	2.3%	1.7%	2.4%	2.0%

² EPS, ROE, ROA and Net Interest Income are calculated on a trailing twelve-month basis

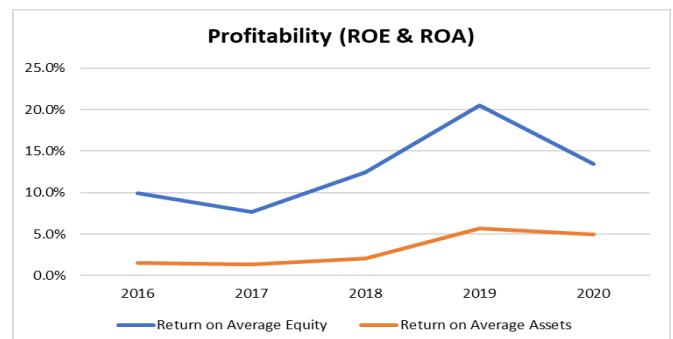
FIVE YEARS HISTORICAL ANALYSIS (2016 – 2020)



Since Cornerstone United Holdings took majority shareholding of Barita in 2018, the company's performance has significantly improved. At the end of the 2018 financial year, BIL reported Profits of \$363.2 million from Total Operating Revenue of \$1.3 billion. Most of this Revenue came from Net Interest Income and Fee and Commission Income which contributed 32.4% and 38.7% respectively. Since then, Operating Revenue increased to \$5.2 billion as BIL focused on diversifying its revenue lines, placing more attention on its non-interest income business lines. Much of the growth stemmed from increased trading gains, the company's asset management business along with the most recently launched investment banking business line. This led to a more diversified revenue stream with the largest components being Fee and Commission Income (35.0%) and Gain on Sale of Investments

(27.1%), with Net Interest Income contributing only 16.9%. Notably, though Net Interest Income has continued to increase as the company has continued to grow its asset base in mainly interest-bearing assets, the overall decline in interest rates has resulted in a decline in the Net Interest Margin from 2.8% in 2016 to 1.7% in 2020.

Operating Expenses grew by a Compounded Annual Growth Rate (CAGR) of 33.2% between 2016 and 2020, with much of the growth occurring in 2019 and 2020. The growth was largely attributable to an increase in the staff complement which saw a rise in Staff Costs from \$340.5 million to \$846.1 million, along with an increase in Administrative Costs from \$324.3 million to \$1.2 billion. This resulted in profits increasing from \$207.2 million to \$2.8 billion. Profitability also improved with the Return on Equity increasing from 9.9% in 2016 to 13.4% in 2020 and Return on Assets increasing to 4.9% from 1.5%.



BIL's asset base increased from \$14.8 billion to just under \$70.7 billion during the period under review. Within the last 4 years, BIL has undertaken several capital raising activities including two (2) rights issues, a preference share issuance and an additional public offering. BIL raised approximately \$23.4 billion which was mainly used to increase Interest Bearing Assets, namely Cash and Bank Balance, Securities purchased Under Resale Agreements, Marketable Securities, Pledged Assets and Loans Receivables. This allowed for continued growth in Net Interest Income which increased by a CAGR of 24.6% in the five-year period from \$366.1 million to \$882.6 billion. Outside of these capital raising activities, the growth in assets was also funded by a 200.3% increase in Securities Sold under Repurchase Agreements. Shareholder's Equity increased 1001.8% from \$2.5 billion to \$27.9 billion.

NINE MONTHS ENDING JUNE 30, 2021:

BIL continues to improve its performance year-over-year, with Earnings Per Share growing by 37.96% to \$3.38 for the 9 months ended June 30, 2021. Operating Revenue increased from \$3.78 billion to \$6.69 billion largely due to increases in Fee and Commission Income which improved by 95.2% and Foreign Exchange Trading and Translation Gains which more than tripled (\$1.8 billion in 2021 vs \$427.7 million in 2020). All revenue line items recorded growth except for Gains on Investment Activities and Dividend Income. Expenses also recorded a growth of 86.6% overall, with Staff Costs and Admin Expenses recording increases of 67.6% and 85.6% respectively. However, the efficiency ratio (Operating Expenses/Operating Revenue) remained low at 36.4%, compared to 34.5% for the comparable period last year. The improvement in Net Profit contributed to better profitability as measured by the ROE which increased 80 basis points to 19.5% from 18.7% while the ROA remained flat at 4.1% as at June 30, 2020.

Assets increased by 61.8% YoY with the increases mainly seen in Pledged Assets and Loans Receivable. In addition, BIL took a 20% stake in Derrimon Trading Limited, a Jamaican retailer and distributor of bulk goods. To fund the increases in total assets, liabilities grew by 46.0% to \$17.1 billion, driven by a 50% increase in Securities sold under Repurchase Agreements.

The growth in assets outpaced that of liabilities and resulted in an equity base of \$30.3 billion which represents a 98.5% increase and is largely due proceeds from the September 2020 APO and an increase in retained earnings over the period.

VALUATION METHODOLOGY

We expect Barita to achieve above average growth in profitability relative to its peer group on the back of both growth in revenue and margin expansion as the company takes advantage of its increased scale of operation. As such, our base expectation sees Barita achieving a return on equity averaging roughly 17% in our four-year forecast period.

LISTED COMPANY	P/E RATIO	P/B RATIO	ROE
Barita Inv. Ltd	22.26x	3.25x	19.45%
Victoria Mutual Inv. Ltd.	16.27x	2.02x	12.48%
Mayberry Inv. Ltd	7.92x	0.49x	7.41%
Proven Inv. Ltd.	11.93x	0.84x	8.51%
Comparable Average	14.60x	1.65x	-
Financial Sector Main Market Average	17.21x	1.38x	-
Main Market Average	14.73x	2.07x	-

We arrived at a target price for Barita using both the Residual Income valuation method along with a comparable company approach based on both P/E and P/B multiples. In the residual income method, we used a 10.6% required rate of return, valuing the company at \$90.57 per share. This price implied a 16.39x forward P/E based on our expected 2022 EPS

which is slightly higher than that of BIL's peer group average P/E (14.60x) and but lower than the current trailing P/E (22.26x). BIL has generally traded in excess in 25x in the recent past, while its peers traded around the peer group average. Taking these factors into consideration, for our comparable company approach, we applied a P/E of 18.5x and P/B of 2.5x to BIL's estimated 2022 EPS and book value per share, respectively, which would imply prices of \$102.23 and \$92.85. We believe that trading multiples above the peer group averages are appropriate given expectations of above average growth and profitability ratios.

OUTLOOK:

Investment Banking to Drive Revenue Growth

BIL launched its Investment Banking line in December 2018 and since then, the unit has aided in Barita's overall growth. Most recently, BIL arranged and brokered the successful Derrimon Limited APO which was also a contributor to the company's operating success in the first half of the year. As part of the APO, Barita took a 20% stake in DTL. BIL has also noted that product development is a part of its current growth strategy, as evidenced by the launch of its Structured Products Program and the establishment of Barita Finance Limited¹, a St. Lucian International Business Company geared towards executing this program. The company also recently recruited an Assistant Vice President in Alternative Investments and Structured Finance which should also help the investment banking business. Against this backdrop, we expect that BIL will be able to tailor its products for clients thereby aiding in client attraction and retention. We expect Fee Income derived from Investment Banking to be one of the main drivers of growth aided by the addition of \$1.68 billion in underwriting capacity.

Expansion of Asset Management Business Lines

Through its subsidiary, Barita Unit Trust Management Company, the company offers 8-unit trust portfolios spanning a variety of asset classes to its customers. Particularly through social media promotions, BIL has been promoting its suite of products. As the company continues to increase its market presence, this should help it to grow its funds under management (FUM) which recorded a 59.5% increase in FY2020. BIL's plans for local and regional expansion is expected to aid in the growth of its FUM through the increase in potential customer base. In addition, the company is expected to launch new managed funds' portfolios to enhance client offerings.

Increased Profitability of Proprietary Portfolios

As BIL grew its investment portfolio, it also diversified its portfolio quite a bit, especially in FY20. Despite interest rates remaining low, we expect that BIL will record a slightly higher Net Interest Income as it has deployed some capital into higher interest earning assets, namely corporate bonds which it has done in the past. Due to the challenges posed by the COVID-19 pandemic, elevated volatility and long-term structural trends presents a unique opportunity for investing in non-traditional investments. Adding alternatives can provide various potential benefits for investors, including improved portfolio diversification, downside protection, and risk-adjusted return potential.

Bearing this in mind, last year's capital raise saw \$6 billion going towards seeding alternative investment strategies. This time around the company intends to diversify further with \$4 billion of the targeted APO funding being earmarked for private equity, private credit, infrastructure and alternative investments.

Optimizing Operating Structure

The company has managed to maintain a fairly low-cost structure, with an expressed intention of targeting high margin opportunities. The company has prioritized expanding its digital capabilities, notably with the introduction of the BOSS online platform. Additionally, the company has taken steps to bolster its human capital, building out a robust sales team and adding a project management office and a strategy and analytics unit, while expanding the information technology function. These and other initiatives will position the company well to transition smoothly through various stages of growth.

¹ An article was published on September 7th, 2021, questioning the relationship between BIL, Barita Finance Limited, Cornerstone Financial Holdings and 294 Inc. Based on the information that has been made publicly available on the matter, we cannot conclude that there has been any impropriety in the dealings between these entities. We will continue to monitor developments on the matter and make adjustments to our analysis if need be.



INVESTMENTS POSITIVES:

- BIL is well capitalized and has enough liquidity to withstand economic downturns.
- Poised for growth via the expansion of the products and services offered
- Diversified Revenue Stream
- Low leverage
- Attractive profit margins
- High return on equity

INVESTMENT NEGATIVES

- Exists in a highly competitive market
- Staff morale may be impacted due to changes at the management level
- Regulatory changes may hinder or slow plans for expansion
- Rapidly evolving economic landscape may present headwinds



CONCLUSION

We expect that the company will continue to build on its current momentum, with revenue growth expected to average around 21.5% over the next 4 years. This continued growth is expected to come from further product and geographic diversification and by leveraging its strong capital base to remain flexible. The company had a capital to risk weighted assets ratio of 41%, which would increase following a successful closure of the APO. This affords the company substantial capacity to expand via further leverage, should sufficiently attractive opportunities arise. Notwithstanding, the company will continue to operate in a challenging environment as the global and local economy continues to be plagued by the lingering effects of the pandemic.

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 \$95.21 which is a 7.0% upside from current price (\$88.98) and 19.0% more than the APO offer price (\$80.00). Therefore, we recommend that investors **PARTICIPATE** in this APO and have assigned a **MARKETWEIGHT** rating at current levels.

SOURCES

The Jamaica Stock Exchange, Barita Investments Limited Annual Reports, Quarterly Financial Statements, Jamaica Observer

DISCLAIMER

This Research Paper is for information purposes only. The information stated herein may reflect the opinion and views of VM Wealth Management in relation to market conditions and does not constitute any representation or warranties in relation to investment returns and the credibility of the sources of information relied upon in the preparation of this report, without further research and verification. Before making any investment decision, please consult a VM Wealth Management Advisor.

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.