Barita

MAKING MONEY WORK FOR YOU.

LOCAL EQUITY REPORT

SCOTIA GROUP JAMAICA LIMITED

Barita Investments Limited
15 St. Lucia Way, Kingston
Tel #: 1-888-429-5333

Company Overview

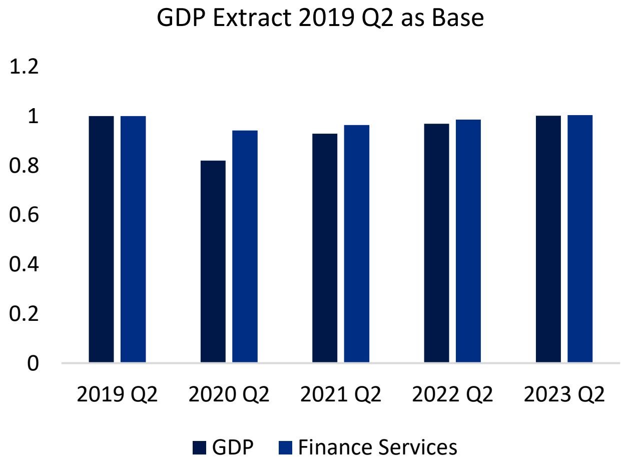
Stock	SGJ
Close Price	34.7
Estimated Fair Value	40.89
Potential Upside	17.84%
Dividends Yield	3.75%
Total Return	21.59%
Trailing P/B	0.95
Trailing P/E	6.30
Recommendation	Overweight
Date: October 20th 2023	

Scotia Group Jamaica Limited (SGJ) provides various banking/financial products and services in Jamaica. The Company is an approximately 71.78% subsidiary of Scotiabank Caribbean Holdings Limited incorporated in Barbados while the ultimate parent is The Bank of Nova Scotia Canada, which is incorporated in Canada. The Company operates through Retail Banking, Corporate and Commercial Banking, Treasury, Investment Management Services, and Insurance Services segments. The **Retail Banking segment** offers personal banking services, deposit accounts, credit and debit cards, consumer loans, and mortgages. The **Corporate and Commercial Banking segment** provides non-personal direct debit facilities, current accounts, deposits, overdrafts, loans, and other credit facilities. The Treasury segment is involved in foreign currency trading activities. The **Investment Management Services segment** offers investments, unit trusts, pension and other fund management services; brokerage and advisory services; and trust account administration services. The **Insurance Services segment** provides life and medical insurance products, individual pension administration services, and annuities.

Analyst Insight

To arrive at our price target for SGJ, we used both a 2-stage dividends discount model and a justified PE ratio metric. In averaging the outcome of both methods, we arrived at a 1-year price target for the stock of approximately **$40.89**. This represents an upside of **22.39%** relative to the October 20, 2023, close price of $34.70 and represents a total return of **21.59%** and as such we assigned an **OVERWEIGHT** recommendation to SGJ. We view SGJ as a relatively low-risk (in terms of business operations) large-cap financial services company that has in the past produced a modest financial performance. This modesty has worked in their favour, as evidenced by the quick rebounding from the COVID-19 pandemic, while still being able to make regular dividend payments to shareholders.

Given this, we think SGJ offers investors a more secure exposure to the financial sector, while also providing stable income. However, risks to our price target include the generally weak sentiment towards financial stocks, as well as the potential for our expectation of increased dividend payments (which is a discretionary choice by management) to not come to fruition. On the other hand, positive sensitivities to our view include higher-than-expected profitability, lower-than-expected provisioning needs, leading to a higher dividends payout ratio and lastly, an unexpectedly higher interest rate environment allowing for further longer-term support for net interest income. On the other hand, factors that affect these same variables negatively and cause them to evolve worse than expected over the coming year constitute downside risks to our current overweight recommendation.



Industry Overview

Macro Economy

The financial services sector was hard hit by the pandemic. The downturn in global and domestic asset prices led to a deterioration in the incumbent financial institutions' capital base through fair value losses as well as an increase in expected credit losses due to the quick deterioration in the macroeconomic environment. Since the nadir of the pandemic when GDP declined by approximately 15.6% during Q2 2020, the economy has made some amount of recovery, with the financial services industry following closely behind as seen in the figure on the right. Using Q2 2019 seasonally adjusted

Definitions:
Sell = REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO
UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
MARKETWEIGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO
OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO

quarterly GDP as the pandemic-free base quarter, it is evident that the general economy is now above pre-pandemic levels as of Q2 2023. Likewise, the financial sector based on economic output as represented by the Finance and Insurance sector in the national accounts is also above pre-pandemic levels. While we note that the economy has seen robust growth since the impact of the pandemic, we note that growth is currently above the estimated long-run potential growth of the country (of approximately 1%) and hence we have seen growth decline slightly in recent quarters but is still expected to be fairly robust heading into 2024. Potential headwinds continue to include the lagged impact of higher rates generally on the economy and the tightened monetary stance, which has the Central Bank angling for higher deposit rates and slower credit expansion, which are both negatives for the growth and profitability of the finance sector.

Commercial Banking Sector

Looking at the financial industry specifically, several things become clear. Firstly, using December of 2019 as the last pandemic-free quarter, the sector is currently not back to the pre-pandemic level of profitability. This is seen by the Return on Assets (ROA), which as of December 2022 stood at 0.38%. This compares to the pre-pandemic ROA of 3.00%. The decline in ROA for 2020, was due to the large downturn in asset prices due to the pandemic-related shutdowns, while the subsequent recovery and accommodative monetary policy boosted non-trading income and aided the mild recovery in 2021. However, the global shift in monetary policy has weighed on growth in 2022 and 2023. The BOJ made its first hike effective in October 2021 of 100 basis points to a policy rate of 1.5% and has since been hiking for the majority of 2022, while they have paused at 7.0% for the majority of 2023. The fed started its hiking cycle a bit later, in March 2022, but has likewise been hiking for the majority of 2022 before pausing mid-2023. This shift has culminated in a decline in asset prices, particularly bond prices with the largest decline in JAMAN bond prices for example occurring in early 2022. Notably, DTI net profits at the end of December 2022 were approximated at $44.2 billion, compared to pre-pandemic net profits of $57.0 billion.

Relevant Ration (Total Financial System)	Dec-19	Dec-20	Dec-21	Dec-22	Jun-22	Jun-23
Loans (net of prov.): Total Assets	50.60%	49.55%	48.07%	51.00%	48.57%	50.33%
Prov. for Loan Losses: Total Loans (gross)	2.76%	3.34%	3.12%	3.11%	3.27%	3.12%
Return on Assets (for the Calendar Quarter)	3.00%	1.30%	2.30%	1.90%	0.66%	0.38%
Capital Adequacy Ratio [CAR]	14.51%	14.35%	14.15%	14.20%	13.63%	14.33%
NPLs (3 mths & over): Capital Base + Prov. for Loan Losses	9.41%	11.48%	12.27%	11.13%	12.15%	10.97%
Net Profit Billions (DTIs)	57.00	25.00	47.00	44.20		
Source: Bank of Jamaica						

Sector Outlook

As mentioned prior, the industry is still below pre-pandemic levels of profitability as measured by net profits and return on assets. This is partly because of reduced non-interest income as asset markets are still being weighed down by the impact of both domestic and global monetary policy. However, the inflationary pressures that have facilitated higher domestic rates have been declining in recent months, which has facilitated a temporary pause in policy rate hiking by the BOJ. In addition, despite the profitability of the sector not fully rebounding, the economy is above pre-pandemic levels of output and is widely expected to avoid a recession in 2023 even as the global economy slows. These facts filter directly into our outlook for the finance industry.

Firstly, the Jamaican economy continuing its strong run and avoiding a major recession represents a net positive for the industry. This is facilitated through greater economic activity and by extension the prospect for increased fee income, a recovery in domestic asset prices, and a recovery in asset quality necessitating lower expected credit losses. While we don't forsee a recession risk in the short to medium term, we do remain cautiously optimistic due to the possible lagged impact of the current hiking cycle likely continuing to play out, coupled with any potential impact of slowing United States (US) growth on the domestic economy. However, we take solace in the fact that US consumer spending has been more resilient than previously expected which has increased the odds of continued US growth for the remainder of 2023 and early 2024.

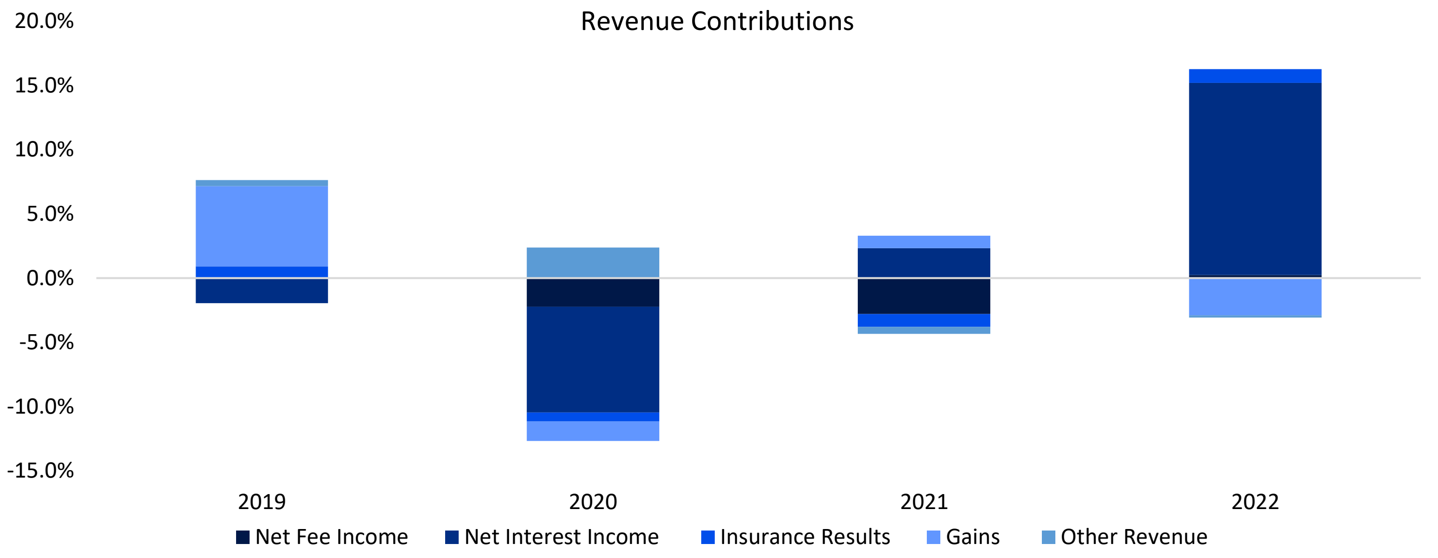
On the other hand, the declining pace of inflation, which has subsequently facilitated a pause in domestic rate hikes has its benefits for the industry. Being closer to the end of the hiking cycle is likely to bring greater stability to both domestic and global bond prices as Central Banks such as the Federal Reserve are also thought to be getting closer to peak rates. This, therefore, will likely provide benefits in terms of trading gain and capital adequacy. As such, our base case outlook is for a slower pace of hikes and consequently a relatively better market environment and trading performance this year relative to 2022. This will therefore translate to better trading income if our expectations come to pass.

Regarding net interest income, higher rates have a heterogeneous impact across the industry. That is, it is more so dependent on the composition of assets and specific asset liability management pursued by the institution in question. That is, it is dependent on how quickly assets re-price relative to liabilities. One such showing of this dynamic is the fact that since the start of the hiking cycle in October 2021 to July 2023, longer-term loan rates for DTIs have declined marginally, falling by 24 basis points to 11.72% while the weighted average deposit rate has increased by 124 basis points to 2.28% based on BOJ data. This, therefore, points to liabilities and shorter-term rates being re-priced more agressively than longer-term rates. Given this context, we do not conclusively believe that higher rates are necessarily better for the sector as a whole and lower rates in the case of a shift to a more accommodative policy are likely to benefit the sector.

Financial Analysis (5-Year Historical)

Total Operating Income: Pre covid Levels

Total operating income grew by 13.2% in 2022 to $42.8 billion from $37.8 billion in 2021. Notably, this represented a return to the pre-pandemic level of revenue (42.6. billion). At a more granular level, based on revenue line items, the main contributors to the 13.2% growth were Net Interest Income, (15.0%) followed by a 1.1% contribution to Insurance Results and then a mildly positive contribution from Net fee income of 0.2%. These increases were slightly offset by negative contributions from net realized and unrealized gains (-2.9%) and other revenues (0.2%).



Net Interest Income

The group generated Net Interest income of approximately $25.6 billion compared to $20.0 billion in 2021 representing growth of 26.0%. This figure is net of expected credit losses of $3.1 billion, which, while lower than the highs of over $5.8 billion recognized in 2020 due to the downturn caused by the pandemic, still represented a growth of over 8.8% compared to the year before. The improved net interest income came on the back of an over 23.7% increase in interest income followed by a much slower growth in interest expense of 3.7%. The improvement in interest income was primarily due to the expansion in the loan portfolio (13.7%

growth in loans for 2022) coupled with the Group benefiting from the higher rate environment. An example of the impact of the rising rate environment can be seen from the weighted average interest rate on investment securities rising from 2.3% to 5.6% in 2022. On the other hand, the weighted interest on deposits declined from 0.2% to 0.1% in 2022. Therefore, the stickiness of their deposit and the Company's focus on their pure banking operations underlies the benefit from the rate increases.

Insurance: Positive Contribution, New Initiatives

The second largest contributor to growth for 2022 was the insurance segment, which contributed 1.1 percentage points to the overall revenue growth of 13.2%. Insurance revenues for 2022 amounted to $3.0 billion, up 15.3% from the $2.6 billion seen in 2021. Management attributed this improvement to higher transaction volume, particularly associated with increased insurance advice and planning services being offered. Notably, this line item was still not back to pre-pandemic levels, which had lowered premium income in the years prior, and was only partially offset by higher interest income.

While this segment was the second largest contributor to growth in 2022, we note that it is generally the smallest of the varying income line items. However, Scotia has been routinely adding new insurance products in their main markets (namely Jamaica), despite reducing their exposure to smaller Caribbean countries (seen through the sale of Scotia Insurance Caribbean Limited to Grace Kennedy announced in 2022). These offerings include the launching of Scotia Protect, which will offer insurance protection underwritten by GK General and Scotia Solace, an affordable policy for anyone aged 18-70 with no medical exam required.

Stagnant Fee Income

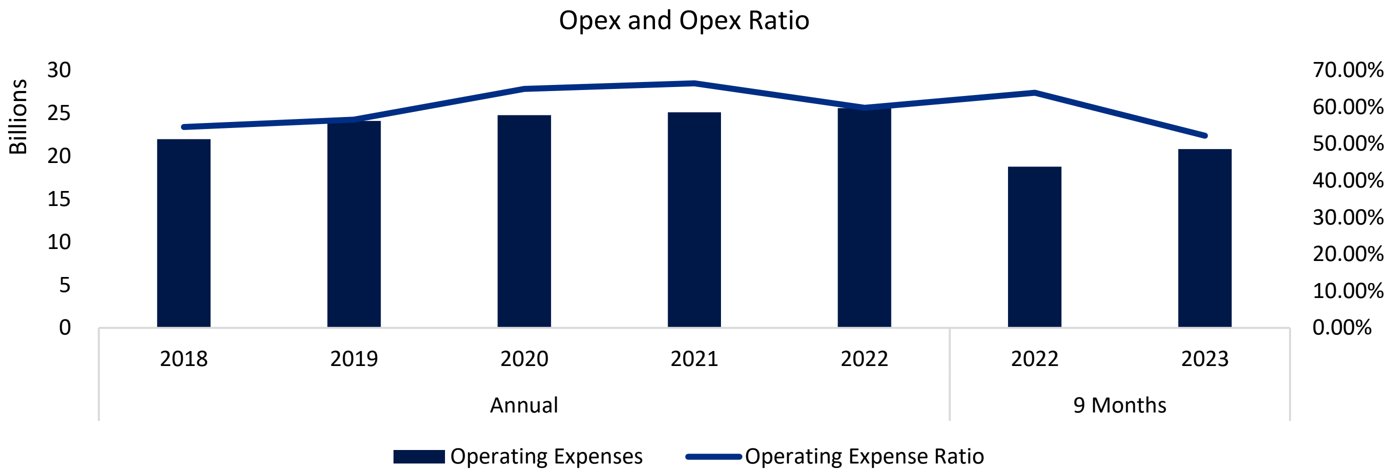
Fee income contributed only 0.2% to overall revenue growth in 2022 and came in at $6.2 billion, down from $6.1 billion in 2021 representing an increase of 1.1%. The increase was mainly due to increased consumer business activity. Over the financial years between 2018 and 2022 net fees and commission income have trended downwards. Part of the reason for this was the decline in the growth in fee income, partly due to the decline in consumer activity during the pandemic, which affected the 2020-2021 period. In addition to this, fee and commission expenses have remained relatively sticky thereby leading to the sustained decline in net fees and commission income (even before the pandemic net fee income declined in 2019). During this period, the fee income margin has declined from over 54.6% to 31.7%. However, it is expected that continued economic recovery will bode positively for fee and commission income.

Continued decline in Gains and Other Revenue

Gains and other revenues both contributed negatively to growth for 2022 of -2.9% and -0.2% respectively. Gains here refer to gains on foreign currency trading, investment securities, and the sale of subsidiaries. Total gains amounted to $7.1 billion for 2022, compared to $8.2 billion for 2021, representing a decline of 13.4%. This reflected a loss from financial assets compared to a gain made in 2021 and an over 4.6% reduction in gains from foreign currency trading. The Group's foreign currency revenue is typically a function of trading volumes and as such, the Group noted last year had increased trading volumes. Gain from financial assets primarily reflects the Group's holding on investment securities, and it is noted that the financial markets were relatively more challenging this year. Other income only represents a small fraction of overall revenue, it nonetheless declined 7.1% to $950.7 million for the 2022 fiscal year. This line item reflects gains on the sale of property, gains on the extinguishment of liabilities, and dividends and other income.

Improved Efficiency

The Group has made an intentional effort to contain operating expenses in the past 3 years particularly as they expected a challenging operating environment. In this context, total operating expenses for 2022 amounted to $25.6 billion, representing a marginal increase of only 1.8%. Supporting our prior point of increased focus on efficiency, over the last 3 years operating expenses have only grown marginally, with an average annual increase of 2.0%. This has facilitated an improvement in the group operating expense ratio to 59.8% in 2022, from 64.9% in 2020 given the rebound that we have seen in revenue. Notably, the metric remains above the pre-pandemic level of 56.6%.

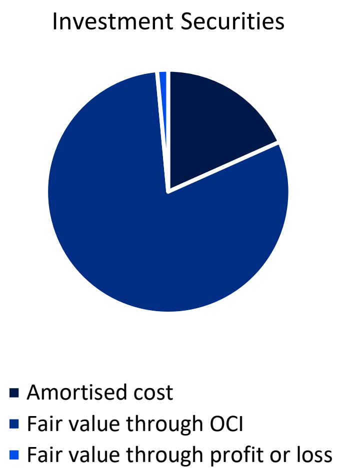


The Group's main expense item is wages salaries, and other employment benefits which represented approximately 40.3% of expenses as of year-end 2022, followed by other operating expenses which represented 44.3%. Included in other expenses are systems-related expenses and other technical and consultancy fees. Notably, the share of expenses related to staff cost has declined from 47.5% in 2018 to 40.3% in 2022, with management noting that this was a part of their deliberate attempts at cutting cost by lowering their staff complement and by extension, operating more efficiently.

Profit before tax and net profit: The prior mentioned rebound in revenues combined with greater operating efficiency means that profit before and after tax has improved significantly to $17.2 billion and $11.7 billion representing growth of 35.8% and 35.2% respectively for 2022.

Other Comprehensive Income

The group classifies most of their investment securities at fair value through other comprehensive income. Therefore, the impact of the rate increases has primarily been reflected in other comprehensive income as opposed to profit and loss. In 2022, the Group generated an other comprehensive loss of $10.5 billion, compared to a loss of $739.9 million in 2021. This outsized loss in 2022 relative to 2021 was primarily due to the global switch to contractionary monetary policy, which has hurt global bond prices. Government of Jamaica bonds, which represent the majority of SGJ's debt security holdings carried through comprehensive income were not exempt.



In this context, the Company generated increased unrealized losses from investment securities to the tune of $7.0 billion, compared to losses of only $2.1 billion in 2021. In addition to this, in 2022, the adjustment of assumptions used to calculate pension liabilities, which was likely in part a function of higher inflation, led to an $8.5 billion loss compared to a gain of $1.0 billion seen in 2021. We estimate that as we approach the end of the current monetary policy hiking cycle, the Group will start to experience less volatility in other comprehensive income as asset prices and key macro-economic variables such as inflation and interest rates continue to stabilize leading to less volatile pension asset adjustments.

Definitions:
Sell = REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO
UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
MARKETWEIGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO
OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO

9 Months Ended July 31, 2023

The overall trend of recovery post-pandemic continued for the nine months ended July 31, 2023 (9M 2023). Total operating income amounted to $26.7 billion up from $19.1 billion in the comparable period last year or an increase of 35.7%. The bulk of the increase in operating income was primarily due to increased net interest income which contributed 72.3% of the growth in total operating income). Other contributing line items include gains (on foreign currency, financial assets, and the sale of subsidiaries), which contributed 5.1 percentage points to the growth figure of 35.7%, and net fee income which contributed 3.9 percentage points.

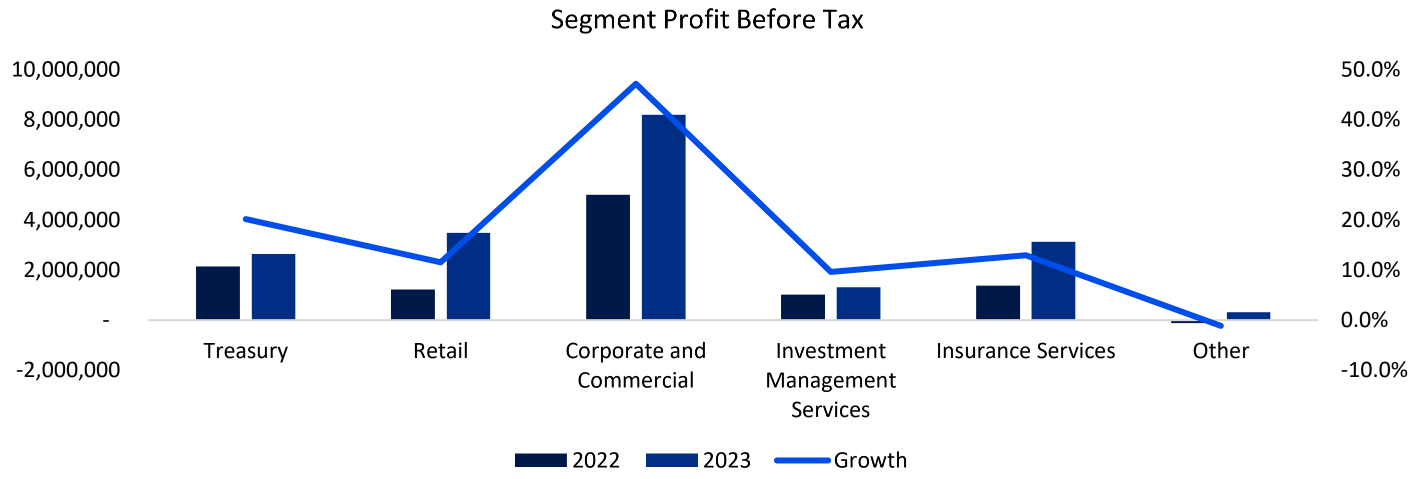
Building on the improvement seen in 2022, the Group recorded Net interest income of $29.2 billion, which represented an increase of approximately 39.7% relative to the comparable period in 2022, reflecting interest income growth of 34.7%, while interest expense declined marginally by 1.42%. Therefore this culminated in the net interest margin improving to 6.14% as of July 2023 compared to 5.01% for the same period last year. This comes as the Group saw strong growth in its loan portfolio (The Group's loan portfolio increased by $40.5 billion or 18.5%), while its main funding sources continue to be deposits, which have shown low relative responsiveness to higher rates. In addition to this, expected credit losses have also declined over the period in line with the continuing improvement in the general economy. In this regard, expected credit losses declined by $522.5 million for the period to $1.7 billion in 2023 compared to $2.2 billion in 2022.

The second largest contributor to operating income growth for the 9M 2023 was gains from trading (foreign currency and financial assets), which amounted to $6.8 billion compared to $5.3 billion in 2022 representing an increase of 28.2% year-over-year (YoY). The bulk of the improvement in the Group's trading gains came from the increased revenues from foreign currency trading which amounted to $5.8 billion, compared to $4.7 billion in the 9M 2022. This was followed by fee and commission income which contributed 3.9 percentage points to the overall operating income growth of 35.7% and amounted to $5.8 billion compared to $4.7 billion in 2022, representing an increase of 24.8% owing to significantly increased customer transaction volumes.

Improved Efficiency

The efficiency gains that SGJ had been making in recent years continued for the 9M 2023. Operating expenses amounted to $ 20.8 billion compared to $18.8 billion in the comparable period last year, representing growth of approximately 10.9%. However, this growth in expenses was notably slower than the overall growth in revenues of 35.7% leading to a significant improvement in the Group's operating expense ratio, which came in at 52.2% compared to 63.9% in the 9M 2022. The bulk of the increase in expenses relative to last year was due to "other operating expenses" which mainly comprised higher technical support fees arising from higher transaction volumes.

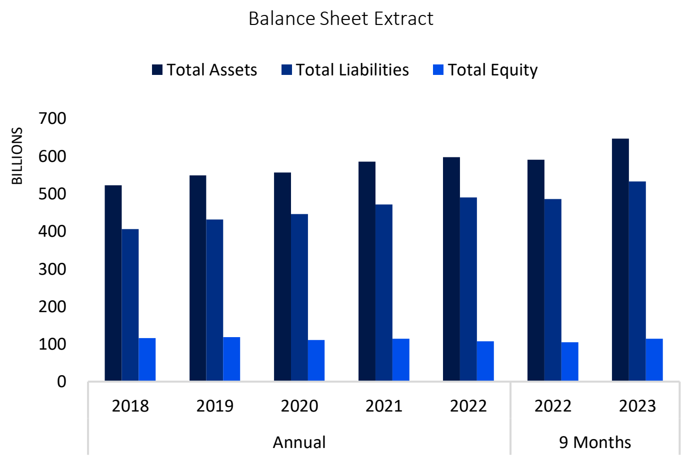
This greater efficiency along with strong revenue growth culminated in the Group growing profit before taxes to $19.0 billion compared to $10.6 billion in 2022, a growth of over 79.5%. Looking at the business segment breakdown of profit before tax, all major business segments saw increased profitability. However, the three most important segments to the growth seen in 2023 were the corporate banking, retail, and insurance segments which had growth contributions of 30.2, 21.3, and 16.5 percentage points respectively to the profit before tax growth of 70.5%. The retail and corporate banking segments continued to benefit from the higher rate environment and the expansion of their loan books. Management also noted from 2021-2022 that they had anticipated that insurance would be an important driver as they pushed protection products more heavily to their customers.



Net Profit and Other Comprehensive Income

This culminated in the Group seeing net profit increase to $12.8 billion compared to $7.3 billion representing growth of approximately 74.2%. Other comprehensive income likewise improved drastically moving from a loss of $12.6 billion to a loss of only $3.4 billion. The reduction in this loss was a function of lower losses from the remeasurement of defined benefits obligations as well as lower losses from investment securities over the 9M compared to last year. For the latter, this comes as Benchmark Jamaica government notes had a better price performance relative to last year in the middle of the hiking cycle.

Balance Sheet Latest and Historical



The Group's total assets stood at $646.4 million at the end of July 2023. These assets were primarily funded by $532.6 billion in total liabilities (82.4% of total assets) and $113.8 billion in equity (17.6% of total assets). The Group's total assets increased 9.5% (or $55.8 billion) year-over-year with the bulk of this increase funded by an increase in liabilities to the tune of $46.4 billion or a 9.6% increase, and a $9.4 billion increase in equity or a 9.0% increase.

Total Assets: The 9.5% increase in total assets year-over-year primarily reflected an over $40.4 billion increase in the Group's loan books, or a growth of approximately 18.5% despite the impact of the higher rate environment. Management also highlighted strong mortgage loan growth throughout the year, up 29.0% year-over-year, while commercial loans were up 20.0%. Along with solid loan performance, the Group also saw its cash balances increase (specifically cash at Bank of Jamaica) by $29.6 billion to $182.0 billion year-over-year. This increased cash balance comes as the Group has chosen to allocate less of the cash generated year-over-year to the purchase of investment securities and has net sold securities for the 9M 2023. This was combined with the increased operating cash generation from the group over the 9M 2023 period.

Historically, the Group has seen relatively stable growth in total assets over the 2018-2022 period. Moving from total assets of $521.9 billion in 2018 to $597.0 million in 2022. However, asset growth has typically averaged around 3.4% annually over the period which is lower than the 9M 2023 year-over-year growth which we have seen. This is due to a large rebound in liabilities growth/deposit growth in the last year as the Group opted to focus on its core business model. This can also be seen through the change in the historical composition of the Group's assets whereas investment securities now represent a smaller share of assets (25.8% of total assets in 2018 vs. 24.0% in 9m 2023), while loans have grown to take on a larger share of assets (35.0% in 2018 vs 40.16% in 9m 2023)

Total Liabilities: as of the 9m 2023 total liabilities stood at $532.6 billion having increased by $46.4 billion or 9.6% year-over-year. Much of this increase was seen in the growth in the Group's deposit base, which grew to $445.2 billion for an increase of approximately $46.2 billion or 10.4% year-over-year. Again, this occurs despite heightened interest rates and the current contractionary monetary policy stance which often has the effect of reducing deposit growth. Management specifically noted that this reflected higher inflows from their retail and commercial customers who they believe have continued to show confidence in the strength and safety of the Scotia Group.

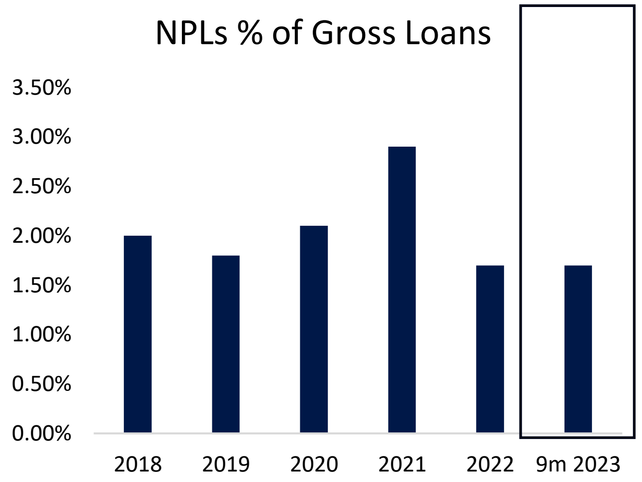
Historically, the Group has also seen stable total liability growth as it moved from $406.2 billion in 2018 to $489.6 billion in 2022. Annual growth in liabilities averaged 4.8% over the 2018-2022 period, with the main driver of this growth, as one would expect, was continued increased deposit flows. Looking at the historical composition of liabilities, we note that over the years, in line with the Group's focus on core banking services, deposits have grown to become a larger share of funding (in this case, represented as a percentage of total assets which moved from 55.2% of total assets in 2018 to 68.9% as at 9M 2023).

Total Equity: Total equity amounted to $113.8 billion, a YoY increase of 9.0% ($9.4 billion) driven predominantly by increased unappropriated profits (up 13.1% or $6.9 billion) and retained earnings (up 4.4% or $2.0 billion). Notably this improvement in retained earnings and reserves and unappropriated profits comes as the losses from other comprehensive income have subsided in the 9m 2023, particularly as we approach the peak of the global hiking cycle.

Historically, over the last five financial years, total equity has been relatively volatile. Total equity stood at $115.6 billion in 2018 and stood at $107.4 billion at the end of 2022, a decline of $8.2 billion. However, this volatility was due to the pandemic, which led to significant losses through other comprehensive income due to securities holdings in 2020, by extension facilitating the decline in equity. Further to this, the start of the global shift to contractionary monetary policy in 2022 also led to realized and realized investment security losses which weighed on equity.

Asset Quality

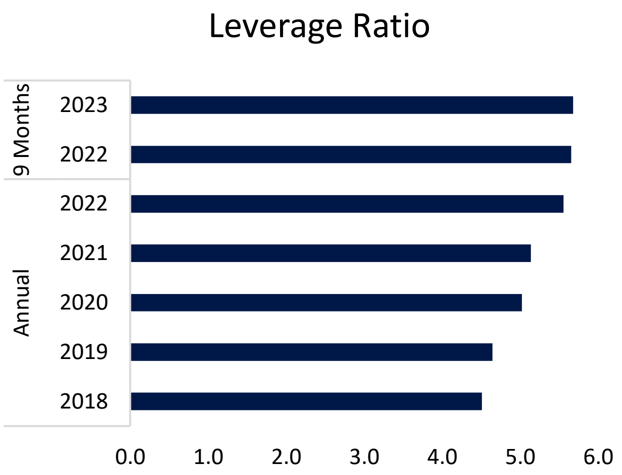
As a result of the pandemic, the Group's asset quality, as measured by its non-performing loans to total loans, deteriorated (increased) relative to prior periods. Notably, the deterioration has been most pronounced in FY2021. However, NPLs as of 9m 2023 currently stand at 1.7%, which is below the pre-pandemic level of 1.8% seen in 2019. This has come as the economy has seen a fairly robust recovery since the pandemic, which has likewise reduced credit risk in the economy and has been a net positive for the group's asset quality. For reference, NCBFG's NPL ratio for the 9M 2023 was 4.0%



Capital

The leverage ratio (total assets/total shareholders' equity) chart indicates that Group leverage increased consistently throughout the period 2018-2022. During this period the leverage ratio increased from 4.5x in 2018 to 5.6x in 2022. As of 9M 2023, the leverage ratio stood at 5.7x. The consistent increase in the leverage ratio over the period has primarily been a result of the Group growing its funding base through continued deposit inflows, combined with the impact of the decline in asset prices due to the pandemic and global contractionary monetary policy which has impacted equity growth.

Importantly, the Group remains adequately capitalized, as measured by its Capital Adequacy Ratio, which was 13.8% for the bank relative to the regulatory requirement of 10.00% as of 9M 2023.

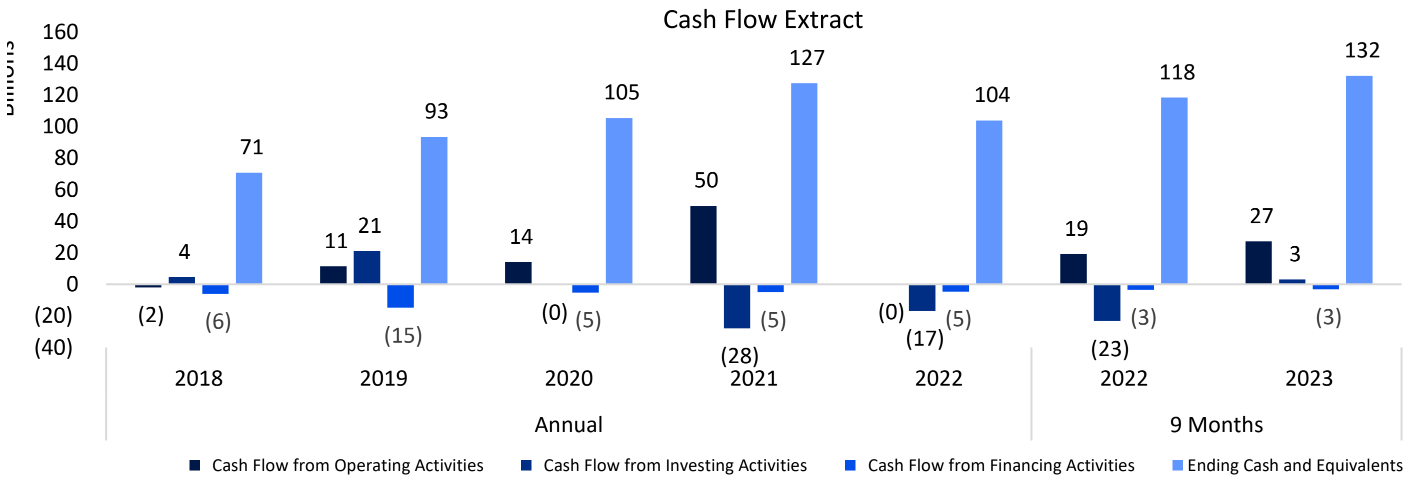


Cash Flow

Operating Cash Flow: For the 9 months ended July 31, 2023, net operating cash inflow amounted to $27.1 billion, an improvement over the prior year's net operating cash outflow of approximately $19.3 billion. This improvement was driven by a significant net interest received of $28.7 billion along with increased deposits ($43.1 billion).

Net Investing Cash Flow: For the period, investing cash inflow amounted to $3.0 billion, compared to a cash outflow of approximately $23.3 billion in 2022. The decrease was driven by lower net reinvestments during the period as the Group sold $3.7 billion in investments on a net basis compared to a net investment of $22.5 billion for the similar period last year.

Net Financing Cash Flow: Net financing cash outflow for the period amounted to $3.1 billion, representing dividends paid, a decrease over the previous year of $3.3 billion (9.5%).
Net cash movement for the period culminated in an inflow of $28.3 billion. Net cash position increased from $103.8 billion at the beginning of the year to $132.2 billion at the end of the year.



5 Year Cash Flow:

We believe Scotia's cash flow statement largely demonstrates the bank's posture towards being a consistent dividend payer throughout the years. The Group has generally generated large operating cashflows funded by an increasing deposit base and consistent profitability. In recent years, the bank has allocated more of its operating cashflows towards investment purposes as can be seen between 2020-2022, contrasting with prior years where the Group had mainly positive investing inflows. This could also be seen from the balance sheet as the Group's investment security holdings moved from $116.4 billion in 2020 to $148.8 billion in 2022. Lastly, the Group has been seen to be a consistent dividends player even in the pandemic-hit years (2020-2021) with consistent financing cash outflows primarily reflecting these dividend payments.

Definitions:
Sell = REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO
UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
MARKETWEIGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO
OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO

Valuation Summary and Recommendation

Stock	SGJ
Close Price	34.7
Estimated Fair Value	40.89
Potential Upside	17.84%
Dividends Yield	3.75%
Total Return	21.59%
Trailing P/B	0.95
Trailing P/E	6.30
Recommendation	Overweight
Date: October 20th 2023	

To determine a fair value for SGJ, a two-stage dividend discount model and a Justified Price-to-earnings (P/E) valuation method were used.

2-Stage Dividend Discount Model (DDM)

Our 2-stage dividend discount model utilized the assumption of a payout ratio of 36.2% for 2024, which is higher than the trailing-twelve-month payout ratio of 23.6% but below the SGJ's historical payout ratio (for reference pre-pandemic 2018 the SGJ had a payout ratio of 46.8%). As such, we assume that despite profits recovering to pre-pandemic levels, likely due to potential capital needs given other comprehensive losses seen in 2020 and 2021 as well as potential Basel 3 safeguarding, the Group will opt for a historically more conservative payout ratio in the short term before returning to their historic payout ratio in the medium term. Our final stage for the DDM therefore incorporated this estimated stable long-run payout ratio and uses a long-run fundamentally derived growth rate of **6.0%**. Our estimated cost of equity which involved the averaging of two estimates came in at **13.4%** which led to a one-year price target of **$40.87**.

Justified Price to Earnings Value (P/E)

Our dividend discount model was coupled with a Justified P/E valuation. Our estimated 1-year forward earnings for the Group was **$5.69** per share and using the same cost of equity and long-run growth rate utilized in the above 2-stage DDM we arrived at a justified P/E multiple of approximately **7.19x**; hence this resulted in a 1-year price target of approximately **$40.92**.

Fair Value

Averaging the outcome from both methodologies gave us our final 1-year price target for the stock of approximately **$40.89**. This represents an upside of **17.84%** relative to the October 20, 2023, close price of $33.41 and represents a total return of **21.59%** and therefore we recommend investors **OVERWEIGHT** SGJ in their portfolio. This recommendation calls for an allocation of between 5% and 10% for the stock in a diversified portfolio. Importantly, in our view, SGJ has taken less risk than other large-cap financial services companies. As such, the Company's financial performance has been modest in recent years, but this has also worked in their favor in terms of quickly rebounding from the COVID-19 pandemic while continuing to make regular dividend payments. Against this backdrop, we think SGJ offers investors a more secure exposure to the financial sector while also providing stable dividend payments. However, the generally weak sentiment subduing financial stocks and the possibility of future profitability and dividends falling short of our expectation remains a risk to our price target.

Financial Statement Summary

	FY 2018 $M	FY 2019 $M	FY 2020 $M	FY 2021 $M	FY 2022 $M	9M 2022 $M	9M 2023 $M
Net Interest Income	25,208	25,119	24,858	22,711	28,619	21,275	28,329
Total Operating Income	40,293	42,581	38,197	37,808	42,794	29,382	39,860
Operating Expenses	22,001	24,099	24,800	25,139	25,590	18,779	20,825
Net Profit	12,771	13,190	9,052	8,639	11,680	7,342	12,789
Total Assets	521,862	549,002	556,281	585,583	596,979	590,565	646,405
Total Liabilities	406,215	430,888	445,526	471,588	489,582	486,126	532,570
Total Equity	115,648	118,114	110,756	113,995	107,396	104,439	113,836
Cash Flow from Operating Activities	(1,982)	11,331	13,974	49,776	(93)	19,284	27,135
Cash Flow from Investing Activities	4,446	21,067	(229)	(27,887)	(16,847)	(23,261)	3,039
Cash Flow from Financing Activities	(5,974)	(14,687)	(5,134)	(5,028)	(4,522)	(3,398)	(3,091)
Ending Cash and Equivalents	70,855	93,451	105,495	127,413	103,837	118,313	132,158
Leverage Ratio	4.51x	4.65x	5.02x	5.14x	5.56x	5.65x	5.68x
Net interest Margin	5.58%	5.34%	5.07%	4.37%	5.24%	5.01%	6.14%
Operating Expense Ratio	0.55x	0.57x	0.65x	0.66x	0.60x	0.64x	0.52x
Net Profit Margin	0.32x	0.31x	0.24x	0.23x	0.27x	0.25x	0.32x
Return on Average Equity	11.54%	11.25%	8.13%	7.47%	10.43%	7.79%	15.69%
Return on Assets	2.51%	2.46%	1.70%	1.48%	1.96%	4.05%	2.77%

Definitions:
Sell = REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO
UNDERWEIGHT = REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
MARKETWEIGHT/HOLD = EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO
OVERWEIGHT/BUY = EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO