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LOCAL EQUITY REPORT

TRANSJAMAICAN HIGHWAY LIMITED

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Company Overview

Stock	TJH
Last Closing	J$2.97
52 Week High	J$3.00
52 Week Low	J$1.35
YTD Return	9.96%
Target Price	J$3.42
Upside Potential	15.24%
Dividends Yield	6.24%
Total Return	21.48%
Recommendation	OVERWEIGHT
Date: January 23, 2024	

TRANSJAMAICAN HIGHWAY LIMITED (TJH), has been the concessionaire of Highway 2000 East-West since 2001, which is Jamaica's first toll road and the largest infrastructure project in the English-speaking Caribbean. The Company's core business activity is the development, operation, and maintenance of a tolled road network in Jamaica known as the Highway 2000 East-West under a Concession Agreement with the National Road Operating & Constructing Company ("NROCC") (the "Grantor") made on November 21, 2001 (Amended and Restated on January 28, 2011, and January 20, 2020). The concession is for 35 years. The toll is operated directly by the company's subsidiary Jamaican Infrastructure Operator, (JIO) in which the group owns a 51% stake (with a call option for the other 49% with a maturity date of December 2024).

Analyst insight

The Group continues to experience stronger-than-projected traffic growth, as evidenced by the performance during the third quarter of the 2023 financial year, and this trend is expected to persist at least in the short term. Additionally, the JIO acquisition has improved operating efficiency, and it is expected that as the group continues to reduce debt, profitability and cash flow generation will continue to improve. We utilized a Free Cash Flow to Equity Model and arrived at a fair value price target of $3.42 over the next year, compared to the last closing market price of $2.97, representing an upside potential of approximately 15.24%. Considering this, along with the relatively attractive dividend yield of approximately 6.24%, we assigned an **OVERWEIGHT** recommendation to TJH. Dividend investors may choose to purchase for additional income while benefiting from the upside potential resulting from the ongoing negotiations. Even if negotiations were to fall through, we still believe that the income and growth potential, aided by improved operating efficiency, would justify the inclusion of this stock in one's investment portfolio.

Business Model Summary

The Company essentially generates revenues by charging for the use of its toll assets, which it operates under concession provided by the Government through NROCC, which also owns 20% of the outstanding share capital in the Company. As a result, its revenues are highly linked to toll usage, which is in turn highly linked to factors that might be outside of the Company's control such as general economic growth, population, and demographic trends. However, the Company has the right to set the rates charged at the toll annually, which it does through a yearly revenue optimization study with an independent traffic consultant. While this affords some flexibility, there is a cap on the rate the Company can charge defined in the concession agreement, which is determined based on the US$-J$ exchange rate, the inflation rate of the currency in which the Company's senior debt is denominated and an additional 1.0% growth per annum to the initial toll rates agreed in 2001 (the Annual Capped Toll Rate).

A caveat to the above is that revenues are subject to an annual cap outlined in the TJH Concession Agreement that considers the projected gross toll revenues and the internal rate of return (IRR) of the Shareholders of TJH. If the annual gross toll revenues exceed such annual cap amount, the Company must share such upside with NROCC per a formula outlined in the Concession Agreement. However, the group has never met that revenue cap to date. In addition to this, the Company pays fees to the toll road operator inclusive of a monthly fixed fee (adjusted to US$447,500 in December 2022), a pre-operating lumpsum fee on contract signing, and a monthly variable fee corresponding to 5% of the Theoretical Toll Revenues ("Variable Operational Fee") These fees are payable to the operator of the toll, namely the subsidiary, JIO.

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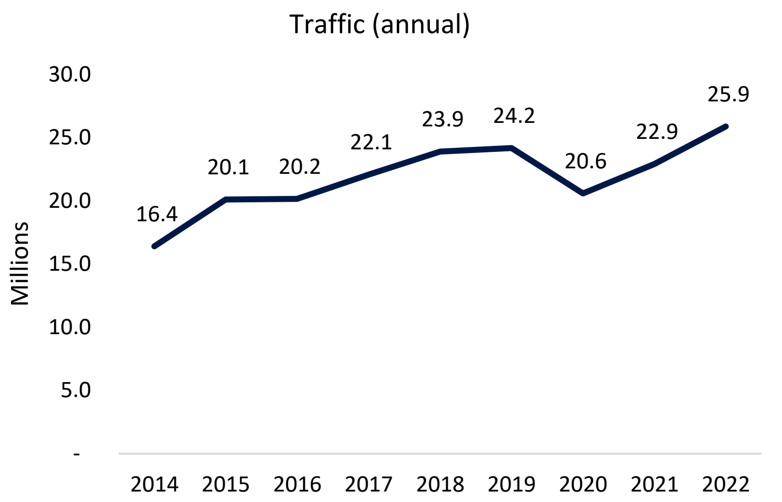
Traffic History



As stated, prior, daily traffic on the toll road will be linked to macro-economic, social, and democratic factors. It will also be impacted by the efficiency of the toll road and the availability of competitors (with the Group's major Portmore toll road having to compete with the Mandela Highway). Despite not having a great deal of power to influence traffic apart from efficiency and maintenance, traffic growth has been stable and growing over the last several years. For example, the yearly, traffic on the Group's toll plazas has increased from a little under 16.4 million in 2014 to over 25.9 million in 2022. This represents a CAGR of 5.9%, which has so far been above the Group's forecast for average growth to the tune of 2.3% annually over the concession period. In line with this, the Group has seen positive growth in every year over this 2016-2022 period except for the pandemic-stricken 2020 financial year, which had several shutdowns and no movement days. The stable growth over this period occurred within the context of relatively few new roadways/projects and therefore, represented organic growth in the usage of current toll roads.

In terms of the distribution of traffic, we note that the Group's largest toll road by usage continues to be its Portmore toll Plaza. It also contributes the most to top-line revenue with the 2021 breakout showing an over 50% contribution from Portmore followed by the vineyard toll plaza at approximately 33.0% of total revenue. It is expected, particularly as more developments occur in dormitory locations such as Portmore, which continues to see new housing developments, that usage on the toll roads will continue to grow modestly during the period of the concession. However, the Company's financial projection at the time of the IPO and through to the end of the concessionary period shows the expectation that the Spanish town toll plaza is expected to generate the fastest growth over the period, (in terms of revenues) with a CAGR of 8.5%. Notwithstanding, the Portmore Toll Plaza is still expected to be the most significant revenue contributor, with a share still close to 50% in 2036.

Financial Performance

All items are expressed in US dollars unless otherwise specified.

Brief History 2020-2022

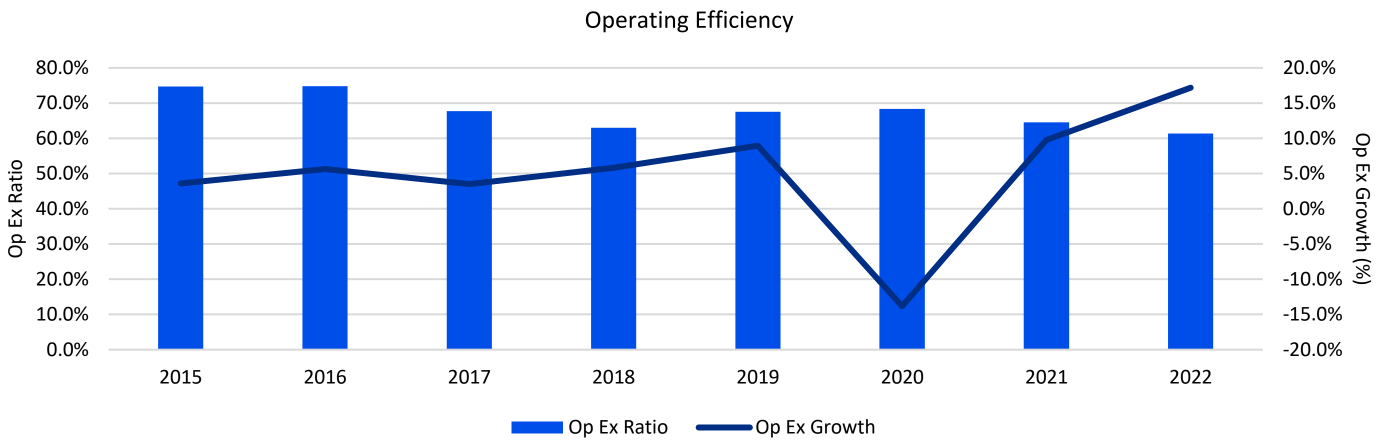
Covid Rebound Continued Revenue Growth

As illustrated in the chart above, the pandemic led to a slippage in toll usage in 2020. However, there was a quick rebound in the following year, 2021, and as of 2022, it was still 1.9% above what was projected in the Group's 2020 IPO prospectus. In this vein, revenues for the Group declined by 14.8% in 2020, followed by a strong rebound with 16.2% and 23.2% growth in 2021 and 2022 respectively, ending the 2022 financial year at $65.0 million. In decomposing this revenue growth, it is notable that it comprises both the strong growth in traffic of approximately 13.0% between 2020 and 2021 and also a growth in the toll rate. This growth was also distributed throughout the Group's toll plazas, with each plaza registering more than 20% growth in revenues. The Maypen Toll Plaza registered the largest increase in 2022 at 27%, followed by Portmore at 24%.

The Group also recognizes non-toll-related revenues that are classified as other gains and losses. These include gains on the sale of property, foreign exchange gains, interest income on bank balances, and other operating income. Regarding the latter, under the Concession Agreement, the Company also has the right to collect revenues generated from commercial exploitation of the areas surrounding the Toll Road. However, this line item saw a decline of 66.6 % or $2.1 million in 2022 to $1.0 million, as a result of lower gains on foreign exchange.

Operating Expense: Efficiency Improved.

In line with the increased usage in 2022 following the strong rebound in growth since 2020, operating expense growth has picked up over the last two years, resulting in 9.8% and 17.2% growth in 2021 and 2022, respectively. Operating expenses for 2022 amounted to $39.9 million. Despite its substantial growth, the even stronger increase in revenue has led to improved operating efficiency for 2022, with the operating expense (Op-Ex) ratio declining to 61.4%. The primary component of operating expenses, however, is the amortization of intangibles, which largely reflects the Group's concession asset and, therefore, is a non-cash expense, accounting for 34.3% of all expenses. When examining expenses excluding these amortization costs, they amounted to $26.2 million in 2022, representing a growth of 20.5%, or $4.5 million. The main contributing factors to this growth are a $2.2 million increase in professional fees associated with the acquisition of the 51% stake in JIO, as well as a $1.2 million increase in operating fees paid to JIO before the acquisition. Consequently, it is expected that these fees will not recur, leading to greater operating efficiency in the future.



Apart from the aforementioned operating expenses, the group experienced a one-time loss related to the acquisition of JIO amounting to $13.9 million, which had an impact on profitability in 2022. The transaction involved the execution of a call option on the then interests of Vinci Concessions S.A.S and Bouygues Travaux Publics in the Operator, for US$16.1 million. Out of this cost, an immediate settlement loss representing the amounts paid for settling the pre-existing contractual relationship with the Operator on the business combination was $13.9 million, while the remaining $2.2 million was recorded as net assets acquired. However, management stated that the acquisition allowed for an amendment of the fees payable under the Operation and Maintenance Agreement, resulting in a reduction of the gross fees payable to JIO from approximately US$1.7 million per month in 2022 to approximately US$0.7 million per month post-acquisition.

Finance Cost and Profits

At the end of the 2022 financial year, the Group had debt, which included a US$255 million senior note issued in February 2020. This note pays interest quarterly at a rate of 5.75% and matures in 2036. However, the note is amortizing, leading to a reduction in finance costs by $0.5 million to $14.8 million due to the reduction in principal. This loan was originally issued in February 2020 to repay a bridge loan that was initially used to settle a multilateral pre-IPO loan from IADB, IFC, EIB, and Proparco (collectively referred to as ECA) that was issued in 2011.

In the context of improved revenues, better efficiency, and lower finance costs, which, when combined, were still outweighed by a one-off cost related to the acquisition, the group recognized a loss of $4.3 million in 2022, compared to a profit before tax of

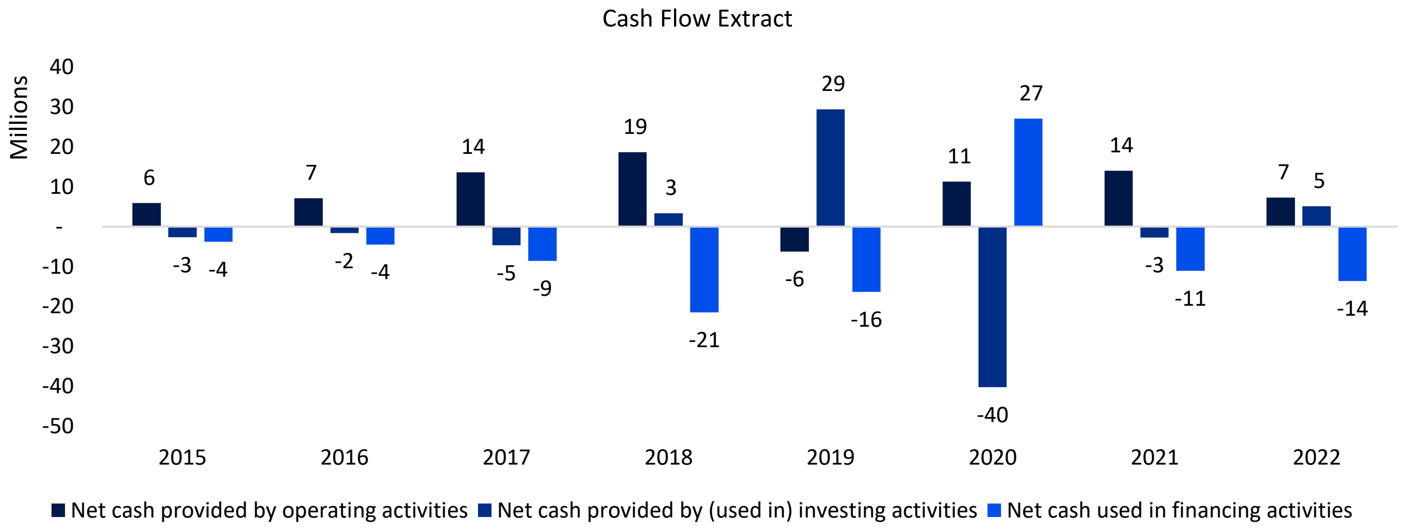
$5.3 million in 2021. Likewise, the Group reported losses after tax of $7.1 million in 2022, compared to profits of $4.0 million in 2021.

Cashflows Matter: Consistent

As previously mentioned, the Group has a significant non-cash expense item, namely the amortization of the concessionary asset. Consequently, the group has typically generated positive cash flow over the years, diverging from net income, even in 2022 when losses were recognized. In this regard, the Group recorded positive operating cash flows every year from 2016 to 2022, with the exception of 2019 when the group had to pay a penalty related to loan prepayments as part of the restructuring before their 2020 IPO. In 2022, the Group generated $7.3 million in operating cash flow, despite the amounts paid for the acquisition. Nevertheless, this represented a decline of 48.2% compared to the previous year. However, the Group's historical operating cash flows have generally been substantial and positive, except for one-off transactions that affected it in the past and are unlikely to be repeated in the future.

Similarly, the Group's EBITDA has generally shown a positive trend of growth historically, increasing from $22.6 million in 2013 to $38.8 million in 2018. However, the years following were impacted by construction work on Marcus Garvey Drive (2019) and the effects of the pandemic in 2020. In 2022, EBITDA amounted to $24.3 million, representing a decline of 26.5% compared to 2021, primarily due to the acquisition payment, which included a settlement fee that effectively reduced earnings for the year.

The majority of the cash generated by the Group is typically used for debt repayments and dividends. The Company consistently pays down the principal of its amortizing loans quarterly, and the Group is committed to maintaining a consistent dividend payment policy going forward. In terms of the group's stated dividend policy in its IPO prospectus, the projected dividend payout ratio ranges from just over 20% in 2020 to a high of 85% by 2025, where it will remain constant until 2033, after which it will gradually decrease on an annual basis, reaching a low of 70% in 2036. (Please note that these projections were made before the JIO acquisition, which may impact planned dividends in the future.)



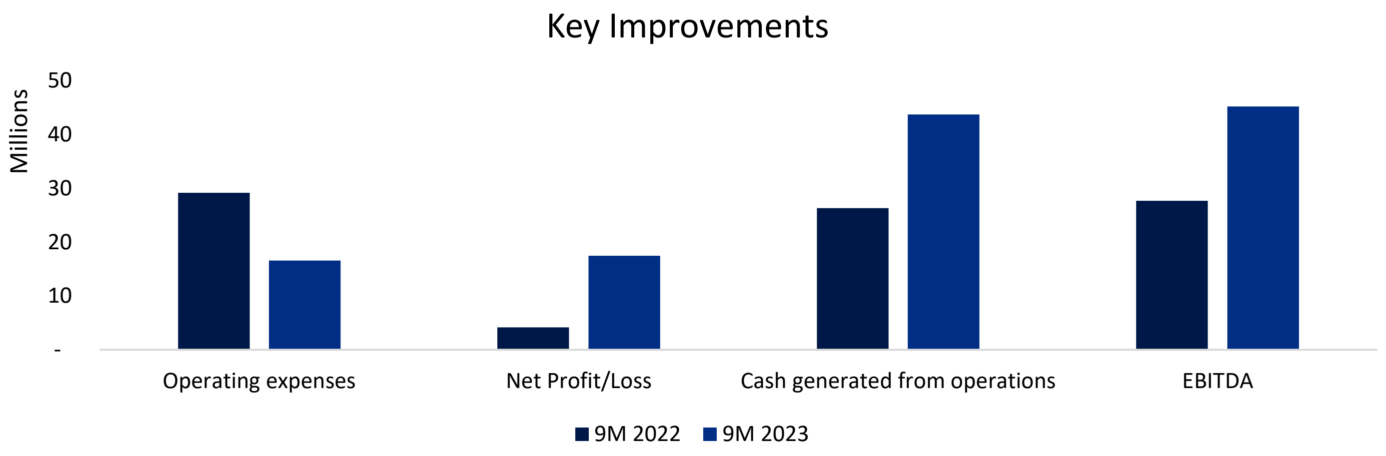
<u>9-Month Year-to-Date Results: Acquisition Paying Dividends.</u>

Revenues Continue Strong Growth

For the nine months ended September 30, 2023 (9M 2023), toll revenues continued its strong growth seen in 2022, increasing by 17.8% to $55.4 million compared to $47.0 million for the 9M 2022. While management did not provide traffic breakouts during the interim report, they noted that the increase in revenue was due to both the annual upward adjustments in toll rates as well as increased traffic. Other gains and losses increased by $1.3 million for the 9M 2023 due to positive foreign exchange gains on the Group's preferred shares as well as gains on interest on reserve cash balances.

Lower Operating Expenses

The benefit of the JIO acquisition is demonstrated through the reduction of the Group's operating expenses via the fees paid to the operator, JIO. It is noteworthy that the Group currently treats JIO as if they own 100% of it. This is because the Group is confident they will exercise their call option, which has a price of $1.00, and they effectively have the right to decide whether to declare dividends in the subsidiary or not. As a consequence of this, the Group does not recognize operating expenses paid to JIO on a consolidated basis. Consequently, operating expenses amounted to $16.6 million, down from the $29.1 million observed in 2022. However, administrative expenses increased by over $5.0 million, representing a 490.2% increase. This increase was primarily due to the subsidiary now being incorporated into the financials, leading to higher salaries, wages, and other routine office expenses.



Record Profitability

Finance costs were marginally reduced for the 9M 2023, aligning with the Group's ongoing repayment of the principal on their borrowings. The combination of stronger revenue growth, lower operating costs, and a continued reduction in finance costs resulted in record profitability. Profit before tax amounted to $23.2 million, representing a remarkable 2988.1% improvement over 2022. Likewise, profit after tax increased significantly to $17.5 million, marking a growth of 322.0% compared to 2022. It is worth noting that these 9M 2023 profits surpass any full-year earnings in the history of the Company.

Record Operating Cashflow

In line with record profitability, the Group witnessed record operating cash flow, with cash flow from operations totaling $43.7 million, compared to $26.3 million in 2022. This increase can be attributed to the significantly improved profitability of the Group, resulting from enhanced operating efficiency due to the acquisition. Notably, in alignment with this, EBITDA has risen to $45.2 million, compared to $27.7 million in the previous year. Regarding the utilization of this cash, the Group continues to reduce its amortizing debt and has declared dividends of $15.0 million, which, due to the payment date being beyond the latest quarterly report, appears as a current liability.

Balance Sheet Historical and 9M 2023.

As of the 9M 2023, the Group's total assets stood at $301.6 million, compared to $300.8 million at the end of 9M 2022. This decline is primarily attributed to the reduction in intangible assets, reflecting the amortization of the Group's concession assets. It's important to note that, given the Group's value proposition as a dividends player and its general business model, a continued decline in total assets is expected as intangibles are amortized, and profits are distributed to debt holders and shareholders (unless new contract/concession offers are secured). This trend is evident, with total assets decreasing from $360.3 million in 2014 to $301.6 million in the latest quarterly report, while intangible assets have decreased from $325.8 million to $212.1 million during the same time frame. In this context, the Group's intangible assets represent the majority of its total assets, accounting for just under 66.75% of total assets as of the 9M 2023.

Regarding equity and liabilities, total equity has gradually declined from over $67.4 million in 2014 to $42.5 million in the 9M 2023. The Group's equity base is likely to remain stable within this range, without significant growth, given the Group's aforementioned business model of paying out dividends, which will exert downward pressure on accumulated profit.

Total liabilities as of the 9M 2023 amounted to $259.2 million, compared to $257.9 million the previous year. This increase is primarily attributed to the recently declared, but unpaid dividends of $15.0 million, which are categorized as a current liability. Other major liability items, such as the $225 million loan used to retire the ECA loan, have decreased during the period as the Group continues to pay down the principal. Therefore, in line with the previous point, it is expected that the Group's liabilities and debt will continue to follow a downward trajectory in the future.

Outlook

The Group continues to experience stronger-than-projected traffic growth, which, based on the last quarter, is expected to persist at least in the short term. Additionally, the acquisition has enhanced operating efficiency, and it is anticipated that as the Group continues to reduce its debt, profitability and cash flow generation will continue to improve. In terms of long-term growth projections, the Group currently holds the right of first refusal to operate the Phase 1C leg of Highway 2000 East-West network between May Pen and Williamsfield, which could potentially boost future profitability and is presently under negotiation by the Group. Moreover, the Group generates revenue from leased lands near their toll plazas and has announced the identification of a preferred operator for a gas station near their Portmore Toll Plaza. Nevertheless, it is worth noting that this is likely to represent a small fraction of the Group's overall revenues.

Valuation

To value TJH, we chose to use a free cash flow to equity (FCFE) model, in which we forecast the Group's financial statements from FY 2023 to FY 2036, coinciding with the expected end of the concession. In this regard, we made modifications to the long-term revenue forecast that management had provided during the IPO, with the most noticeable change being an upgrade in short-term growth, given the Group's better-than-expected revenue performance.

Additionally, we ensured the incorporation of cost savings resulting from the new ownership structure with the acquisition of JIO, which will lead to significantly lower operating costs. The only drawback from this is the anticipation that the acquisition will result in higher administrative expenses, which the Group now includes from their subsidiary. However, the overall impact is a dramatic improvement in operating performance, as evidenced by higher net profits and increased cash flow generation.

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Target Price	J$3.42
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Dividends Yield	6.24%
Total Return	21.48%
Recommendation	**OVERWEIGHT**
Date: January 23, 2024	

Model-specific inputs include an estimated cost of equity of 13.75%. As a result, we forecasted free cash flow through 2036 and determined a fair value price target of $3.42 within the next year, compared to the last closing market price of $2.97. This represents an upside potential of approximately 15.24%. Please note that this analysis does not include the potential impact of the ongoing negotiations for the concession agreement for the new leg of Highway 2000 and a possible extension of the current concessionary arrangement held by the Group. Depending on the funding structure of the deal, this current price estimate may err on the conservative side. Combining this with the relatively attractive dividend yield of approximately 6.24%, we assigned an **OVERWEIGHT** recommendation to TJH. Dividend investors may choose to purchase for additional income while benefiting from the upside potential resulting from the ongoing negotiations. Even if negotiations were to fall through, we still believe that the

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income and growth potential, aided by improved operating efficiency, would justify the inclusion of this stock in one's investment portfolio.

Financial Summary

		2018	2019	2020	2021	2022	9M 2023 TTM
Revenue	US'000	52,430	53,285	45,382	52,755	65,006	73,360
Operating expenses	US'000	-33,049	-36,008	-31,029	-34,057	-39,909	-27,355
Net profit/loss	US'000	6,350	8,300	-1,871	3,991	-7,140	6,189
Revenue growth	%	13.7%	1.6%	-14.8%	16.2%	23.2%	N/A
Traffic	Millions Annual	23.89	24.17	20.59	22.91	25.88	N/A
Op Ex ratio	%	63.0%	67.6%	68.4%	64.6%	61.4%	37.3%
Total assets	US'000	310,511	292,209	320,479	309,238	288,137	301,628
Intangible assets	US'000	266,175	249,308	238,057	225,767	212,091	201,336
Debt	US'000	166,339	148,301	219,724	216,084	209,769	204,769
Interest coverage	X	1.32	1.02	1.06	1.39	0.73	1.95
Leverage	X	7.43	7.47	15.01	10.48	19.96	7.40
Net cash provided by operating activities	US'000	18,640	-6,240	11,270	13,990	7,253	22,156
Net cash provided by (used in) investing activities	US'000	3,377	29,379	-40,231	-2,735	5,117	-1,962
Net cash used in financing activities	US'000	-21,480	-16,334	27,004	-11,079	-13,631	-14,304
EBITDA	US'000	38,793	36,989	26,117	33,126	24,346	41,860
EBITDA Margin	%	74.0%	69.4%	57.5%	62.8%	37.5%	57.1%

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