

Initial Public Offering: Sagicor Select Funds Limited

Summary Research Report¹

Company Description

Sagicor Select Funds Limited, was incorporated in Jamaica on the 11th of January 2019 as a public company, for the primary purpose of trading in securities listed on recognized exchanges. The leadership of the company is inviting investors to subscribe and purchase up to four billion (4,000,000,000) shares in the investment vehicle.

Sagicor Select Fund is structured as a passive Listed Equity Fund (“LEF”) or an Exchange Traded Fund (“ETF”) whereby separate classes of shares (Classes B, C, D & E) will represent separate Financial Select Funds. The Class C shares, the subject of this offer, will represent the manufacturing and distribution sector fund.

Analyst’s Opinion

Basics about Investment Funds

Investment Funds are formed by bringing the financial resources of different investors together to create a pool. The investment manager then uses that pool of funds to buy different assets based on the goal of the fund. For instance, the pool may be used to buy stocks if it is a stock fund, a bond if it is a bond fund or real estate if it is a real estate fund. Typically speaking, investment funds may be “passively” managed or “actively” managed.

Active Management vs Passive Management

Actively managed funds typically have a benchmark such as the S&P 500 index or the Jamaica Stock Exchange Main Market Index that the fund manager seeks to outperform. This means that if the fund produces a higher return than the benchmark within the stated timeline, then that manager is seen as successful. This requires asset allocation and security selection skills and the fund commands a fee for the usage of those skills. Examples of actively managed funds would include Hedge Funds, Mutual Funds or Unit Trusts.

The “Class A” shares, held by Sagicor Investments Jamaica Ltd., is designated for the Manager, Sagicor Investments Jamaica Ltd, and the purpose of the management share is to ensure that the structure and investment objective of the Company are not subverted by shareholders in the other share classes who may hold substantial interest in the company. The Manufacturing and Distribution Select Fund will primarily invest in securities that track the Manufacturing and Distribution Index established by the Jamaica Stock Exchange (JSE).

Passively managed funds typically don’t seek to “outperform” a benchmark, but rather to “match” or “track” that benchmark instead. For instance, the Sagicor Select Fund has the goal of tracking the performance and composition of the Jamaica Stock Exchange Manufacturing and Distribution Index. Thus, as the index moves upward or downward, so does the fund. ETFs such as the Sagicor Select Index can be expected to move in a similar pattern. Passive funds typically charge lower fees than actively managed funds.

An Initial Public Offering (IPO) describes the process where shares in an entity are being offered to the public and will be traded on an exchange for the first time. The main investment positives are for enhanced diversification and a desire for an equivalent exposure to the broad financial index. Meanwhile, the risks include increased volatility and potentially diluted returns. **For those investors who are seeking diversification via the manufacturing and distribution sectors and the ability to track the exposure to the manufacturing and distribution index the Sagicor Select Fund could be a suitable buy.**

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Summary of Offer

Sagicor Investment Jamaica Ltd. Is seeking to raise **J\$2.5B** from subscriptions in 2.5 Billion shares with the option to upsize to **4 Billion units of shares each priced at a J\$1.00 (J\$0.98 for reserve applicants)**. The Company has stated that funds will be used to purchase additional shares of manufacturing and distribution stocks on JSE.

Issuer	Sagicor Select Fund Ltd
Arranger and Lead Broker	Sagicor Investment Jamaica Ltd
Exchange	Jamaica Stock Exchange, Main Market
Opening Date	November 20th 2019 at 9:00 am
Closing Date	December 4th 2019 at 4:30 pm
Offer Period	Early applications may be submitted to Sagicor Investments. Any such applications will be treated as having been received at the same time, being 9 am on the Opening Date and shall be allocated pro rata. All other applications (that is, not early applications) will be received and processed on a first come, first served basis.
Securities	Up to 2.5B Ordinary Shares, with the right to upsize by an additional 1.5B inclusive of 1B Reserved Shares.
Pricing	J\$1.00 per share to the General Public and \$0.98 for Reserved Shares. Payments must be made at the time of application with a J\$163.10 Processing Fee.
Use of Proceeds	It is the Company's intention to purchase additional securities in order to match the securities that comprise the index as closely as possible
Proposed Dividend Policy	An amount equivalent to 90% of the net cash positions of the Fund is to be paid to shareholders by way of dividend
Acceptable Payments Methods	Either (1) Manager's Cheque payable to "Sagicor Investments Jamaica Limited" (2) cleared funds held in a Sagicor Investments account or (3) Transfer or Direct deposit to Sagicor Investments (details set out in application form). No cash payments accepted.

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Investment Positives

Diversification Benefit- The Sagicor Select Fund, an Exchange Traded Fund or “ETF” is the first investment offering of its kind in the Jamaican market. It allows institutional investors to gain increased exposure to individual stock that they may not be able to invest in directly due to limit periods on said individual stocks. Additionally, new investors, who may have limited experience and capital, may be able to access manufacturing and distribution sector stocks through the fund.

Lower fees compared to Actively Managed Funds –

The management fees on actively managed funds such as Unit Trusts or Mutual Funds, usually range from 2% upward. The management fee on this fund is 0.5% which will not be charged until January 31, 2020. The lower fee of 0.5% would be expected however, due to the fact that the fund will be passively managed.

Exposure to Tightly held Equities - Sagicor Select Fund provides exposure to tightly held stocks such as Caribbean Flavours and Fragrances and Derrimon Trading Ltd which might have been difficult to obtain on the open market by purchasing them individually. This allows clients to diversify their portfolios more effectively.

Steady Income Inflows – Manufacturing and Distribution Select Fund shareholders are entitled to a share of the Financial Select Fund’s net realized gains on its investments. The company expects to distribute approximately **90%** of its net cash position to its shareholders by way of dividend. According to Sagicor Investment Jamaica Ltd, the Fund is expected to generate an average annual dividend yield of ~1.5% based on the dividend pay-out of the underlying stocks in the fund. This estimated dividend yield, which is net of fees, is close to the dividend yield paid on some of the companies with the largest weighting, but this is less than what an investor could expect from an outright purchase of shares.

Strong Liquidity – Sagicor Select Fund is currently priced at \$1 and has a minimum entry point of 1,000 units. This allows an easy entry into and exit out of the fund, allowing investors to rebalance their portfolios smoothly, at a lower cost.

Investment Risks

Potentially diluted returns- The Sagicor Select Fund will hold 30 stocks, with varying levels of success and financial performance. Holding such a wide variety of securities, with some having weaker future prospects than other stocks in the index, this has the effect of reducing portfolio returns as the weaker stocks dilute the performance of the stronger stocks. However, based on the weighting of the index we expect the dilution to be minimal

Sector risk- Due to the fund being linked to two sectors of the economy, there is a significant level of exposure to the risks which affect those sectors. For example, several of the stocks are cyclical which means a high sensitivity to changes in the business cycle of the economy such as recessions and booms. Additionally, commodity prices significantly impact the cost of inputs for the manufacturing and distribution sectors. In turn, this could significantly impact an investor's portfolio.

Market Risk - The trading activity could create a situation where the market price of the fund is below the NAV. This introduces market risks associated with both the underlying stocks and that of the fund. This could result in a lower returns for investors.

Tracking Risk/High Tracking Error - Sagicor Investments could possibly lack the ability to match the manufacturing and distribution index accurately if the shares of the companies in the index cannot be easily sourced. This could lead to high tracking error. Tracking error measures the degree to which a managed portfolio such as Sagicor Select Funds deviates from the benchmark it seeks to track. The uninvested cash in the fund will therefore lead to a cash drag ie. a loss in value owing to the low yields available on near cash investments.

Manufacturing and Distribution Sector Analysis

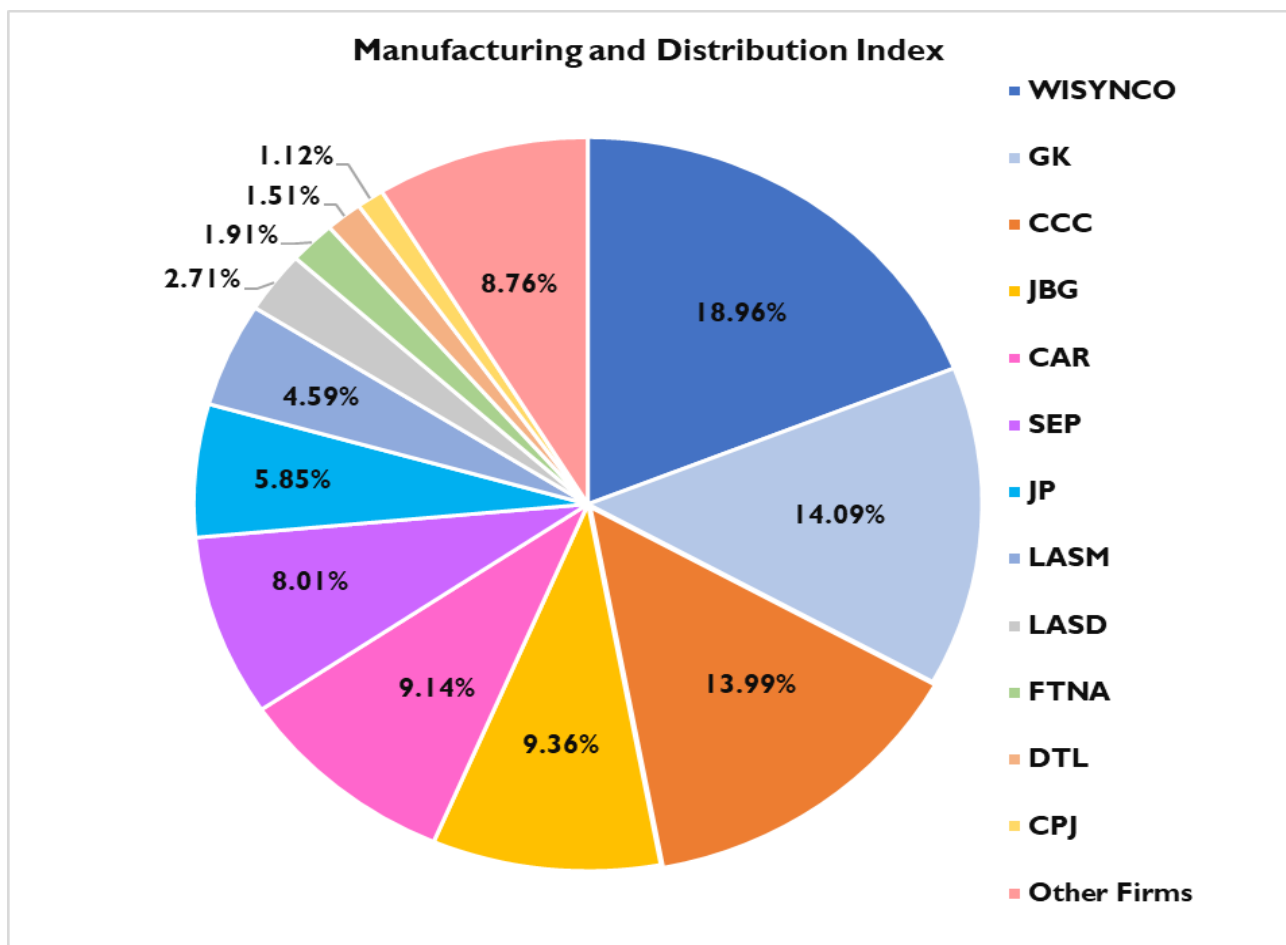
The manufacturing and distribution sectors are experiencing a transition largely due to an environment with low interest rates. This shift has allowed manufacturing and distribution companies to refinance debt and to finance capital projects such as replacing aging equipment and expanding operating capacity at a lower cost. Additionally, the equity market has deepened with the significant growth of the Junior Market since 2009 and the fundamental improvement of the Jamaican economy over the last decade. These factors have made equity capital more available and affordable to manufacturing and distribution firms. These companies can more easily de-lever their balance sheets and use capital structures that are more suited to their business models. As such, growth plans such as establishing new markets and

Over the 5 years ending December 2018, the Price to Earnings (P/E) ratios for the stocks within the JSE Manufacturing and Distribution Index ranged from **17x** to **22x** on average. As at November 15th, 2019, we estimate the weighted average P/E of the JSE Financial Index to be **20.83x**. The Manufacturing and Distribution sector experiencing lower interest margins have had to transition to new areas of business which generate greater fee income or through inorganic growth. Improving economic conditions over the last five years have helped to increase revenues for financial entities locally. Additionally, the Jamaica Stock Exchange has been identified as a viable

products and making acquisitions can be more easily executed. Hence, listed companies in these sectors have a marked advantage over non-listed peers which is evidenced by the post-listing results of many of these firms.

investment option by investors seeking returns due to declining interest rates.

JSE Financial Index Composition as at November 15, 2019



NB: “Other Financials” include Indies Pharma, Jamaican Teas, Blue Power, Honey Bun, Berger Paints, Salada Foods, Paramount Trading, Stationery and Office Supplies, Fosrich, Medical Disposables and Supplies, Caribbean Cream and Jetcon.

Upon completion of the IPO Sagicor Select Fund will seek to purchase additional equities of the companies in the financial sector on the JSE to track the index. From time to time the Manufacturing and Distribution Select Fund and the index may vary but the investment manager, Sagicor, will rebalance the fund monthly if necessary, to maintain the goal of tracking the index. The exchange traded fund allows investors to buy into a wide variety of manufacturing and distribution sector stocks including those on the Junior Market and Main Market through one investment vehicle. This forms a strong diversification tool as it provides access to diverse companies including those in manufacturing and distribution services through one fund. It is worth noting that as at November 15, 2019 the five largest weighted stocks in the index represents approximately **65.54%** of the entire fund. This therefore means that movements in these five stocks will notably influence the index. Additionally, with the fund tracking the index, it will include exposure to all thirty stocks, some with ‘strong’, ‘moderate’ or ‘weak’ fundamentals which could dilute returns as opposed to picking only the ‘best of the batch’ based on the investor’s investment selection criteria. However, based on the weighting of the index we expect the dilution to be minimal.

Conclusion

We are of the view that Sagicor Select Fund provides a new investment opportunity to the investment landscape as it is the second Exchange Traded Fund (ETF) to list on the Jamaica Stock Exchange but the first of its nature in terms of sector. This signals the growing depth of our financial markets. For investors who are seeking diversified exposure to the manufacturing and distribution sectors, the ability to track the exposure to the manufacturing and distribution index and have a long-term investment horizon (3 years or more) this Sagicor Select Fund could be a suitable **BUY** with a **Moderate** risk rating. However, investors could see greater returns by investing directly in the individual shares of the companies that comprise the manufacturing and distribution index.

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