

# Initial Public Offering: Sagicor Select Funds Limited

## Summary Research Report<sup>1</sup>

### 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 B shares, the subject of this offer, will represent the financial 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 the usage of those skills.

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 Financial Select Fund will primarily invest in securities that track the Financial Index established by the Jamaica Stock Exchange (JSE). Before we go deeper into the analysis, let us look at the basics of investment funds.

Examples of actively managed funds would include Hedge Funds, Mutual Funds or Unit Trusts.

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 Financial 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.

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 a diversified exposure to the financial sector and the ability to track the exposure to the financial index the Sagicor Select Fund could be a suitable buy.**

<sup>1</sup> If needed, please request full version of research report by emailing [info@jnfunds.com](mailto:info@jnfunds.com)

## Summary of Offer

Sagicor Investment Jamaica Ltd. Is seeking to raise a minimum of ~ **J\$500M** 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\$.98 for reserve applicants)**. The Company has stated that funds will be used to purchase additional shares financial stocks on JSE.

<b>Issuer</b>	Sagicor Select Fund Ltd
<b>Arranger and Lead broker</b>	Sagicor Investment Jamaica Ltd
<b>Exchange</b>	Jamaica Stock Exchange, Main Market
<b>Offer Period</b>	Opening Date: July 03, 2019 at 9 am Closing Date: July 17, 2019 at 4:30pm
	Early applications may be submitted to Sagicor Investments. Any such applications will be received, but not processed until the Opening Date. All early 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.
<b>Securities</b>	Up to 2,500,000,000 Shares, with right to upsize by an additional 1,500,000,000, inclusive of 1,000,000,000 Reserved Shares.
<b>Pricing</b>	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.
<b>Use of Proceeds</b>	It is the Company's intention to purchase additional securities in order to match the securities that compose the index as closely as possible
<b>Proposed Dividend Policy</b>	An amount equivalent to 90% of the net cash position of the Fund is to be paid to shareholders by way of dividend
<b>Acceptable Payments Methods</b>	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.

## 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 financial 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 .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 Proven and Access Financial Services 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 –** Financial 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 ~2% 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 23 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 one sector of the economy, there is a significant level of exposure to the risks which affect that sector. For example, a change in interest rates could significantly impact most, if not all the stocks in the index. 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.

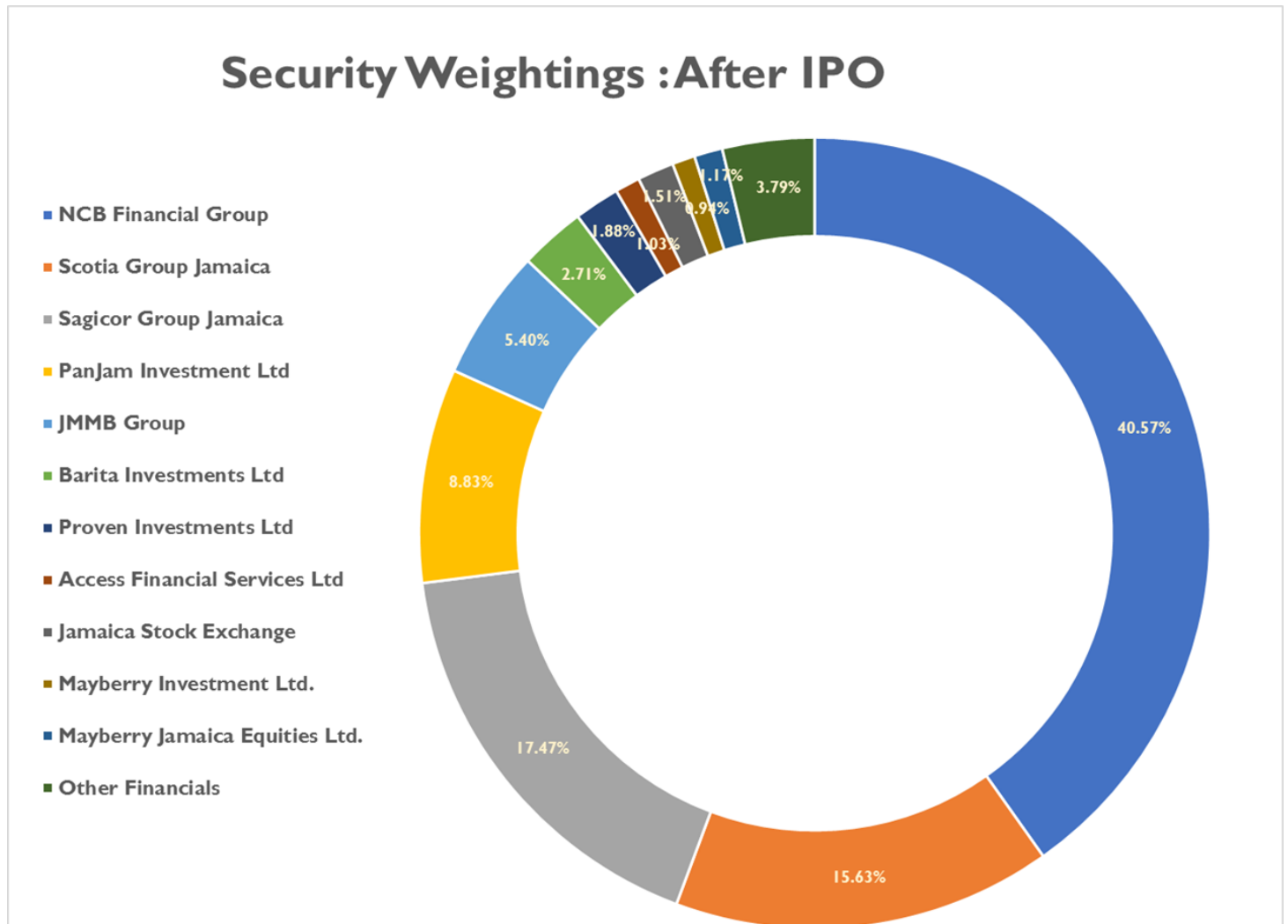
**Tracking Risk/High Tracking Error -** Sagicor Investments could possibly lack the ability to match the financial index accurately if the shares of the companies in the index cannot be easily sourced. This could lead to high tracking error. Tracking error measures the degree to which a managed portfolio 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.

## Financial Sector Analysis

The financial sector is currently undergoing a transition, with interest rates trending downward to their lowest point in the last fifty years. This shift has influenced lower interest margins from interest bearing assets such as repos, which traditionally formed the “bread and butter” of the local financial sector's earnings. As a result, financial entities including investment companies and banks have had to diversify their income streams, particularly in the last five to seven years, towards fee income generating areas such as fund management and investment banking. To the extent that these companies in the sector can diversify their income, this will create more robust companies that are better able to perform through the various business cycles going forward.

Over the 5 years ending December 2018, the Price to Earnings (P/E) ratios for the stocks within the JSE Financial Index ranged from **15x** to **18x** on average. As at June 21<sup>st</sup>, 2019, we estimate the weighted average P/E of the JSE Financial Index to be **19.34x**. The financial 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 investment option by investors seeking returns due to declining interest rates.

## JSE Financial Index Composition as at March 1, 2019



**NB:** “Other Financials” include Portland JSX, Victoria Mutual Investments Limited, Sygnus Credit Investments JMD, Sterling Investments Ltd, SSL Venture Capital, Iron Rock Insurance Company, Key Insurance Company, ISP Finance, Eppley, General Accident Insurance Company, Lasco Financial Services and Mayberry Investments

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 Financial 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 financial 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 companies including those in insurance, investment and banking through one fund. It is worth noting that as at March 1, 2019 the five largest weighted stocks in the index represents approximately **87%** 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 twenty-three stocks, some with 'strong', 'moderate' or 'weak' value 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 first Exchange Traded Fund (ETF) to list on the Jamaica Stock Exchange and signals the growing depth of our financial markets. For investors who are seeking a diversified exposure to the financial sector, the ability to track the exposure to the financial index, and have a long term investment horizon (3 years or more) the 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 financial index.

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