

Sterling Investments Limited (SIL)

Company Profile

Sterling Investments Limited (SIL) is registered as an international business company in St. Lucia, formed in 2012 to protect and grow the capital of its stockholders. The Company invests primarily in an array of fixed income securities denominated in United States dollars (USD). A small part of the Company's portfolio is also dedicated to private equity investments. SIL owns common shares in a hotel development project located in St. Kitts and Nevis. This investment accounts for ~7% of total assets. The Company generates income in two ways: (a) through interest income earned on the securities in the portfolio; (b) through capital gains because of increases in the price of the securities.

Sterling Investments Limited has no employees. The operations of Sterling Investments Limited are managed by "the Investment Manager" – Sterling Asset Management Limited (SAM). SAM is a licensed securities dealer registered with the Financial Services Commission in Jamaica. SAM is a full service financial planner, fund manager and global securities trader specializing in, but not limited to, US Dollar investments.



Key Features:

Current Price	J\$3.70
Rights Issue Price	J\$3.08
Estimated Fair Value	J\$4.19
Implied Upside	36.17%
52 Week High	J\$5.52
52 Week Low	J\$1.60
2018's % Gain/Loss	38.85%
Current P/E (x)	13.74
Current P/B (x)	1.23
Dividend Yield (T12M)	2.71%
TTM Net Income (J\$M)	J\$82.74M
TTM EPS (J\$)	J\$0.20
Market Capitalization (J\$B)	J\$1.14B

*TTM - Trailing Twelve Month

Information as at January 16, 2019

Summary of the Terms of the Offer

Issuer	Sterling Investments Limited (SIL)
Lead Arranger	NCB Capital Markets (NCBCM)
Securities	At least 200,000,000 Ordinary Shares (to be converted after issue to stock units)
Record Date	27-Dec-2018
Offer Opens	4-Jan-2019
Last Date for Renunciation	11-Jan-2019
Offering Price	J\$3.08
Share Allotment	2:3 (i.e. Two New Ordinary Shares for every three existing ordinary stock units currently held) The Company has also reserved the right to upsize the offer by offering additional new ordinary shares to each existing ordinary shares.
Capital being raised	At least J\$600M (Six Hundred Million Jamaican Dollars)
Dividend Payments	Quarterly
Offer Closes	For acceptance by Existing Ordinary Stockholders and/or their renounees, January 11, 2019. For applications by renounees and for "Excess Shares", January 25, 2019
Provisional Allotment Expires	25-Jan-2019

VALUATION SUMMARY	Offering Price	FAIR VALUE	POTENTIAL UPSIDE	RECOMMENDATION
	J\$3.08	J\$4.19	36.17%	ACCEPT

Global Investment Research Unit

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Invitation Details

Sterling Investments Limited (SIL) is inviting shareholders, as at the record date, to purchase up to 200,000,000 shares at an offer price of **J\$3.08**. Investors should note that this is **not** an Initial Public Offering (IPO) of shares but an invitation for **existing** shareholders as at the record date to participate in the issuance of new shares aimed to capitalize the institution. The Company retains the right to upsize the offer by offering additional ordinary shares to each existing Ordinary Stockholder. Additionally, all new ordinary shares not taken up by the existing shareholders to whom the offer is being made, may be allotted and/or issued on terms and conditions of the circular letter of the rights issue.

A rights issue is a way in which companies can raise additional capital by diluting existing shares. A rights issue effectively offers existing shareholders a chance to increase their exposure to the company. The transaction is expected to raise **J\$600M** for the company. Management has stated that these funds will be used to take advantage of undervalued assets in the international financial markets.

Analyst's Opinion: Sterling Investments Limited

Over the last few financial years, Sterling has successfully deployed its capital to generate returns for its shareholders. The Company has typically utilized short-term margin loans as well as rights issues to raise the capital needed to expand. However, given the Company's high exposure to the USD and the shifting domestic FX environment, in FY 2017, they suffered from a sharp increase in FX losses due to their natural long USD position and the revaluation of the JMD over the year. Given that the management of SIL has stated that they intend to invest the funds being raised in international markets, we believe that the choice being presented here is between 1) SIL's current shareholders gaining increased exposure to international markets, namely the US and European markets, 2) SIL's shareholders rejecting the offer, retaining their current exposure or 3) non existing shareholders buying units that may be leftover from the newly issued share pool.

In 2019, the US economy is likely to experience subdued economic growth; though a recession is unlikely. Also, companies are becoming increasingly concerned about uncertainty resulting from the trade war. As a result, the yield curve in Treasury notes created an inversion for about a week in December. It signaled that investors believed another recession is probably two to three years out. However, the US stock market hit several new highs in 2018, likely indicating the peak of the business cycle. But it also dropped significantly, stirring fears of a recession in the latter half of December. Ultimately, we believe that the US' Gross Domestic Product (GDP) signals a healthy economy, unemployment is low, inflation is relatively low, and though there are concerns about an impending recession, this is unlikely to happen in 2019.

Based on our use of the P/B and P/E relative valuation methods, the newly issued Sterling shares that are being offered are undervalued at the offering price of **J\$3.08**. Our estimated fair value is **J\$4.19** based on the Company's projected performance in FY 2019 ending December 2019. This represents an approximately **37.06%** upside from the offering price. With a potential dividend yield of over **4%** on the offering price, the estimated 1-Year Total Return is likely to be **41.51%**. We are therefore recommending that investors **ACCEPT** the rights offering by SIL at the offering price.

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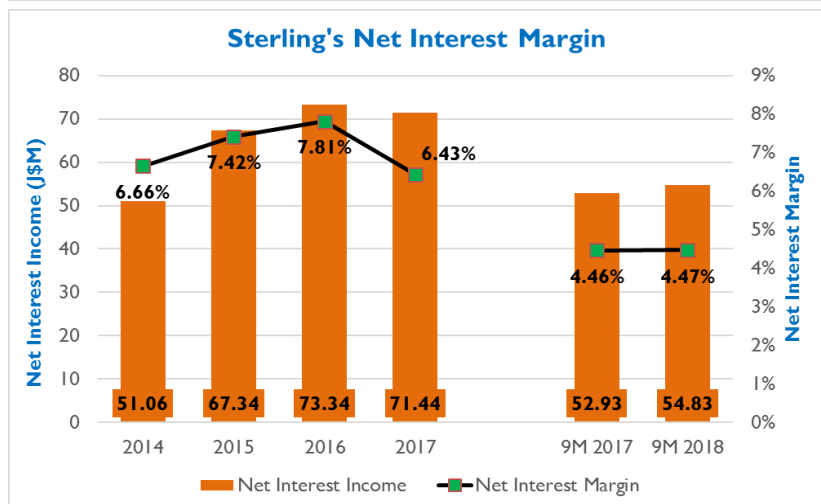
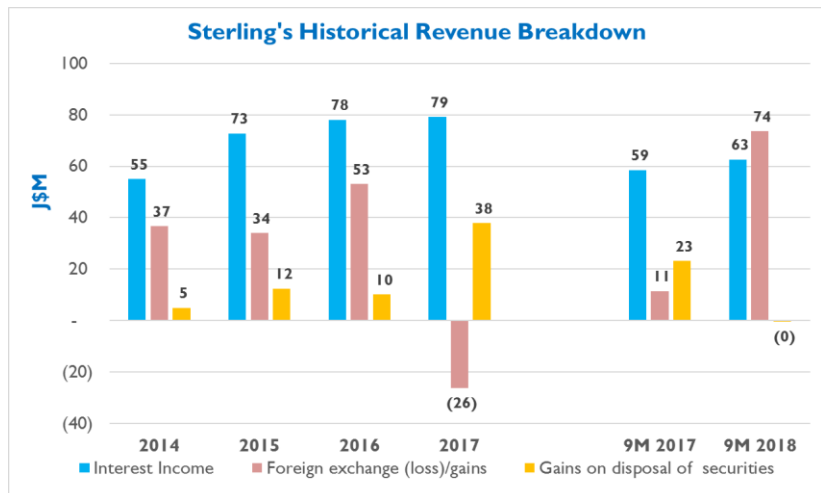
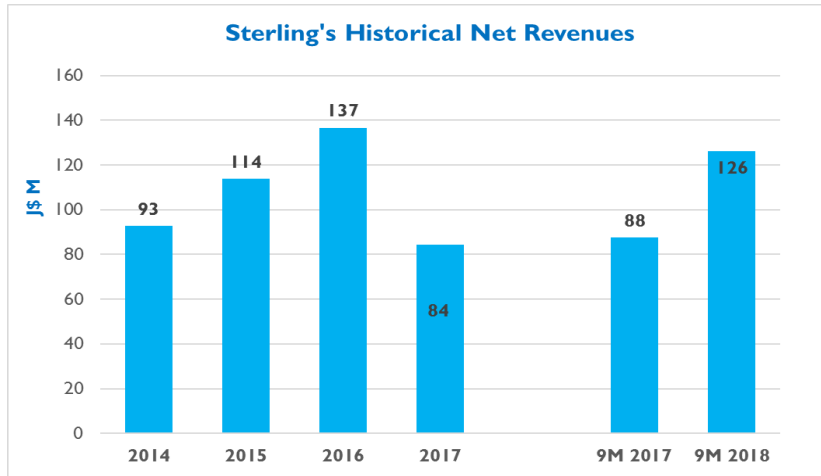
Financial Analysis

Revenue & Profitability

Sterling Investments has exhibited a Compounded Annual Growth Rate (CAGR) in revenue of **12.86%** between FY 2014 and FY 2017. This performance has been primarily driven by Interest Income and Trading gains. Net Revenue for FY 2017 ending December 2017 fell sharply by **J\$49.46M** or **34.97%** to **J\$91.98** year-over-year (YoY). This was primarily due to **J\$26.24M** in foreign exchange (FX) losses over the year relative to a gain of **J\$53.16M** in the previous year. Contrary to what had become the norm in the local FX market, the JMD strengthened against its USD counterpart in FY 2017 by **2.68%** relative to a **6.66%** weakening in the prior year.

However, for the 9-Months ending September 30th, 2018, SIL recognized **J\$73.54M** in FX gains relative to **J\$11.46M** over the corresponding period last year. This was due to the JMD ending the period at J\$134.65 per 1US\$, a **J\$9.65** 9-Month gain on the J\$125per 1US\$ recorded at the start of the Year. This was the largest contributor to the **43.90%** or **J\$38.47M** increase in Net Revenues over the period. This was large enough to negate a sharp reduction in gains from trading over the 9-Months 2018 period to a loss of **J\$339.78K** relative to **J\$23.23M** in 9M 2017.

Given the domestic market environment being characterised by lower interest rates due largely to the Bank of Jamaica's (BOJ) accommodative



monetary policy and the reduced crowding out effect of the government, SIL's Net Interest Margin (NIM) fell in FY 2017 and has remained relatively flat for the 9M period ending September 2018. The reduction in domestic rates locally may not be completely reflected in the Company's NIM due to SIL's exposure to the US market which has seen rates go the opposite direction over the past few years.

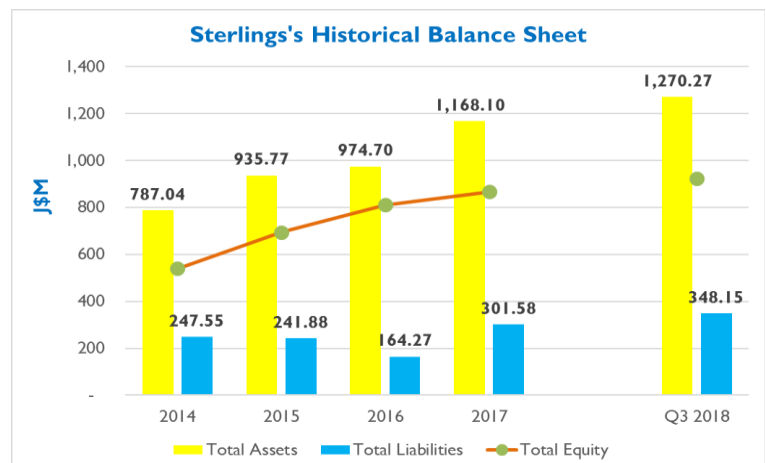
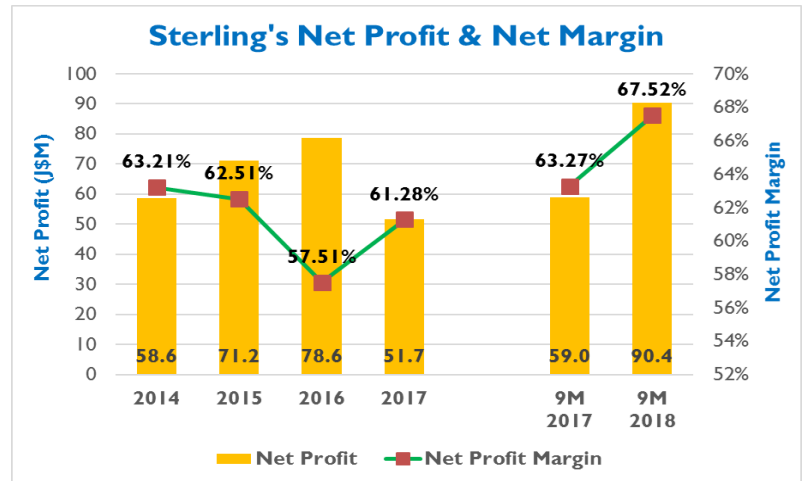
Sterling's Net Profits have largely reflected

movements in Net revenues over the past few years. Being an investment holding company means that they operate as an investment vehicle with no employees. The operations of SIL are managed by Sterling Asset Management to which a management fee is paid. Consequently, SIL has the highest net profit margin and lowest efficiency ratios of any company listed on the Jamaica Stock Exchange (JSE). In FY 2017 ended December 2017, SIL posted Net Profits of **J\$51.68M**, **34.25%** or **J\$26.92M**, less than FY 2016's **J\$78.60M** outturn. This was largely due to the sharp reversal in FX gains made in the previous year to a FX loss of **J\$26.24M**. However, for the 9-Months ending September 2017, Sil generated **J\$73.54M** in FX gains, a significant improvement from the **J\$11.46M** posted in the corresponding period last year. This was the main driver of profitability for SIL over the 9-Month period.

Given the shifting local FX rate environment and the increasingly unpredictable nature of the FX rate, SIL's large USD denominated investments are likely to face continued volatility. This is as the typical constant level of JMD depreciation that local investors have gotten accustomed to has changed. Broadly, over the long-term, however, we believe that as the economy adjusts to the new monetary and fiscal policy regimes being executed by the BOJ and the GOJ, movements in the local currency should better reflect factors such as the differences between inflation in Jamaica and the US.

Liquidity, Solvency & Asset Quality

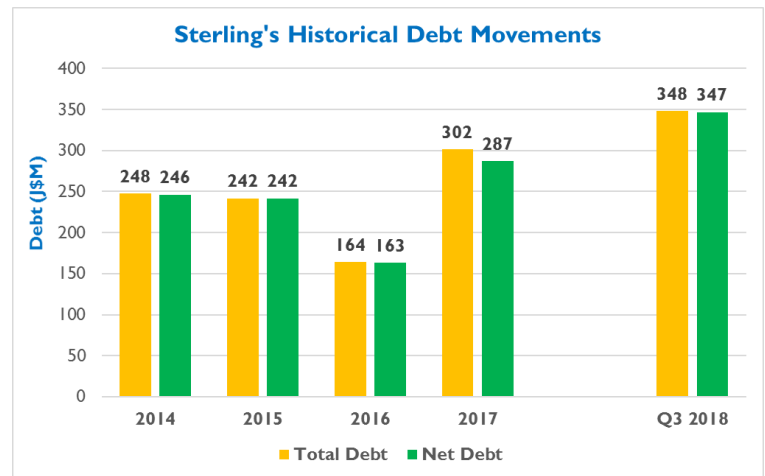
SIL's asset base has exhibited a CAGR of **14.07%** between FY 2014 and FY 2017 and closed the FY 2017 at **J\$1.17B**. This represented a YoY expansion of **J\$193.39M**, or **19.84%**. This balance sheet expansion was driven by a **J\$172.33M**, or **18.36%**, growth in Investment Securities. This was funded by a combination of retained earnings and the proceeds of Dividend Re-Investment Programme (DRIP) and Complementary Share Purchase Programme (CSPP) introduced in the



second half of FY 2016. Year-to-Date (YTD), Total Assets have increased by **J\$102.18M** or **8.75%** due to a continued expansion in Investment Securities.

Total liabilities grew by **183.58%** or **J\$137.30M**, YoY from **J\$164.27M** in FY 2016 to **J\$301.58M** in FY 2017. Driving the expansion in liabilities was an increase in margin loans, which rose by **J\$143M** or **108.5%** to **J\$274.81M**. This expansion in margin loans represents **24.7%** of the portfolio of investment securities,

compared to **14.0%** of investment securities in FY 2016. YTD, Total Liabilities have increased by **J\$46.58M** or **15.44%** due to a continued expansion in the margin loans portfolio. Total Shareholder Equity's grew at a CAGR of **17.11%** between FY 2014 and FY 2017 due to the steady growth in retained earnings as well as a steady increase in share capital as the Company has undertaken a number of rights issues over the last few years.



Valuation Analysis

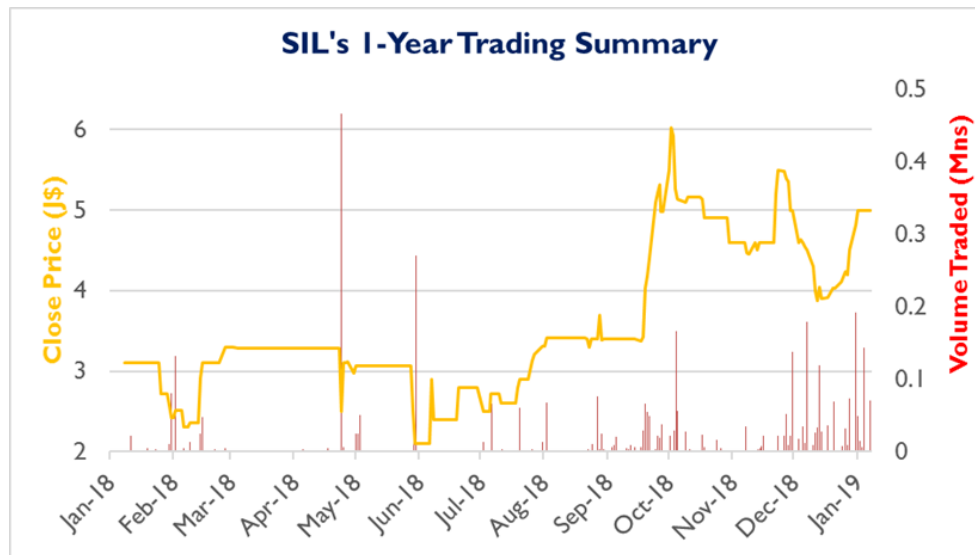
The estimated fair value of Sterling's stock was computed utilizing a combination of a Price to Book (P/B) model and a Price to Earnings (P/E) model. Sterling is projected to earn approximately **J\$71.30M** (EPS: **J\$0.23**) in FY 2019 ending December 2019. These projections were made under the assumption that the Company follows consistent growth levels and is not the beneficiary or victim of an exceptional event. SIL's fair value was derived by finding the average of the two (2) models described above. We utilized a select Main Market Financial Industry Average P/E and a 3-Year Average P/B multiple of **16.50X** and **0.99X** (based on historical, market and industry multiples). We then applied these multiples to FY 2019 year-end EPS and BVPS estimates of **J\$0.23** and **J\$4.99**, respectively. This method implies an estimated 1-Year fair value of **J\$4.19**, which implies a **36.17%** upside from the offering price of **J\$3.08**, which implies that investors should **ACCEPT** Sterling's stock offering at its current trading price.

Risks to Valuation:

- Sterling's Investment portfolio is highly exposed to the US economy which is currently entering the 10th year of its bull run. Many analysts globally believe that if the Fed sees need to continue to increase rates in FY 2019 then the yield curve may invert, increasing the likelihood of a recession over the next two to three years.
- It is possible that the Company may undertake additional capital market transactions that may impact our projections going forward.
- A general downturn in the broad local equity market could negatively impact market multiples.

Appendix

Shareholders for Sterling Investments Limited		
Name of Shareholder	Share Capital	Percentage Ownership
ATL Group Pension Fund Trustees Nominee	10,000,000	16.34%
Lloyd Badal	5,706,480	9.25%
GraceKennedy Limited Pension Scheme	5,227,270	8.54%
Pam- Pooled Equity Fund	4,405,035	7.20%
Pam- Cable & Wireless Real Estate Fund	2,898,403	4.74%
Satyanarayana Parvataneni	2,102,333	3.44%
National Insurance Fund	2,016,129	3.29%
Charles A. Ross	1,992,478	3.26%
Winnifred M. Mullings	1,658,484	2.71%
Everton Lloyd McDonald	1,599,790	2.61%
TOTAL	37,606,402	61.38%



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Financial Statement Extracts

INCOME STATEMENT EXTRACT					
J\$- December Year End	2014	2015	2016	2017	9M 2018
Revenue					
Interest Income	55,016,387	72,778,939	78,099,467	79,081,255	62,615,728
Foreign exchange (loss)/gains	36,708,090	34,073,892	53,159,616	(26,241,648)	73,540,796
Gains on disposal of available-for-sale securities	4,979,908	12,437,526	10,174,691	37,818,293	(339,777)
Unrealised gain on quoted equities	-	-	-	1,318,999	(1,927,903)
	96,704,385	119,290,357	141,433,774	91,976,899	133,888,844
Expenses					
Interest	(3,953,304)	(5,442,115)	(4,759,702)	(7,642,960)	(7,785,248)
Impairment loss on AFS Securities	-	(9,651,021)	(18,772,015)	(1,158,490)	4,022,737
Unrealized loss on embedded derivative	-	(147,575)	(1,113,392)	(392,078)	-
Other operating expenses	(24,541,621)	(21,719,906)	(24,743,062)	(28,399,108)	(21,005,524)
	(28,494,925)	(36,960,617)	(49,388,171)	(37,592,636)	(24,768,035)
Operating Profit	68,209,460	82,329,740	92,045,603	54,384,263	158,656,879
Other Income	7,493	8,875	422,338	1,087	103,490
Manager's Preference Share Interest	(9,271,165)	(10,573,808)	(13,278,611)	(1,899,545)	(18,278,002)
Profit before Taxation	58,945,788	71,764,807	79,189,330	52,485,805	140,482,367
Taxation	(315,089)	(596,800)	(591,937)	(808,586)	(545,356)
Profit for the year	58,630,699	71,168,007	78,597,393	51,677,219	139,937,011
EPS	1.53	15.09	1.41	0.89	1.51

BALANCE SHEET EXTRACT					
J\$- December Year End	2014	2015	2016	2017	9M 2018
Assets					
Cash and Cash Equivalents	1,343,020	213,152	1,155,576	14,696,494	1,384,478
Accounts receivable	18,963,875	27,731,676	34,924,407	42,462,081	42,127,887
Income tax recoverable	-	-	18,269	-	-
Investment securities	766,737,135	907,825,257	938,603,156	1,110,936,549	1,226,757,925
Total Assets	787,044,030	935,770,085	974,701,408	1,168,095,124	1,270,270,290
Liabilities					
Margin loans payable	223,886,387	214,341,641	131,808,102	274,814,733	313,041,747
Other payables	12,508,133	14,039,600	17,191,962	6,687,475	21,863,811
Due to related company	10,650,889	13,124,190	15,264,740	19,855,271	13,236,002
Manager's preference shares	10,000	10,000	10,000	10,000	10,000
Income tax payable	495,510	366,028	-	208,351	-
Total Liabilities	247,550,919	241,881,459	164,274,804	301,575,830	348,151,560
Equity					
Share Capital	437,296,904	627,796,101	630,913,829	669,453,676	696,589,430
Prepaid Share reserve	-	-	12,266,188	2,195,194	134,540
Fair Value reserve	10,976,493	(78,774,046)	(36,893,285)	(30,491,694)	(25,228,738)
Retained Earnings	91,219,714	144,866,571	204,139,872	225,362,118	250,623,499
Total Equity	539,493,111	693,888,626	810,426,604	866,519,294	922,118,731

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KEY FINANCIAL STATISTICS					
J\$- December Year End	2014	2015	2016	2017	9M 2018
Valuation Measures					
Book Value Per Share	1.76	2.26	2.64	2.82	3.00
Dividends Per Share	0.03	0.06	0.06	0.10	0.07
Earnings Per Share	0.19	0.23	0.26	0.17	0.29
Dividend Payout Ratio	16%	25%	25%	59%	23%
Profitability Ratios					
Return on Equity	10.87%	11.54%	10.45%	6.16%	9.15%
Return on Assets	7.45%	8.26%	8.23%	4.82%	6.66%
Operating Margin	73.54%	72.32%	67.35%	64.49%	86.53%
Profit Margin	63.21%	62.51%	57.51%	61.28%	71.69%
Net Interest Margin	6.66%	7.42%	7.81%	6.43%	4.47%
Efficiency Ratios					
Asset Turnover Ratio (x)	0.12	0.12	0.14	0.07	0.10
Credit Ratios					
Leverage Ratio (x)	1.46	1.40	1.27	1.28	1.37
Total Debt/Total Equity (x)	0.46	0.35	0.20	0.35	0.38
Total Debt/Total Assets (x)	0.31	0.26	0.17	0.26	0.27

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