

Business Profile

Sygnus Credit Investments Limited (SCI/Sygnus) is a specialty private credit investment company which began operations on July 1, 2017 and was listed on the Jamaica Stock Exchange on June 18, 2018. SCI provides non-traditional financing to medium-sized firms, which it calls “Portfolio Companies,” across the Caribbean. Some of its products include bilateral notes, preference shares, asset-backed debt, mezzanine debt, and convertible debt, among others. SCI provides funding to Portfolio Companies operating across a broad range of sectors, including Manufacturing, Infrastructure, Hospitality, Financial, Distribution, Telecommunication Services, Construction, Energy, Media and Entertainment, and Mining & Quarrying, in order of size. These Portfolio Companies typically have annual revenues between US\$5M and US\$25M.

Financial Highlights

Net Interest Income (NII) has demonstrated strong growth since the company began operations, with a two-year Compound Annual Growth Rate (CAGR) of 95.87% in Fiscal Year Ended (FYE) June 2020. Robust growth in NII continued into Q1 2021 (18.45% Year-over-Year), driven by higher interest income (50.77% YoY) coming from a 121.75% YoY increase in investments. In order to fuel the growth in investments, SCI started raising capital via debt in Q2 2020 which led to interest expense growing by 908.67% YoY. Prior to FYE 2020, the company’s growth was fuelled exclusively by equity. SCI’s NII is expected to grow at a faster pace in the second half of FYE 2021 with the inflow of equity capital via the APO. Additionally, the company indicated that it plans to raise additional debt capital to further accelerate the growth of its investment portfolio and NII.

Net Profit – SCI realized a net profit of US\$1.973M in FYE 2020, a 17.71% two-year CAGR. Profitability in FYE 2020 did not increase as strongly as NII primarily because of a one-off FX loss associated with the ‘conversion of J\$1.2B to USD, being part proceeds of new JMD debt that was raised and part proceeds of JMD investments that were exited during Q3 2020 (SCI, 2020).’ It is possible that the company could realize another one-off FX loss in FYE 2021 with the likelihood of the company having to convert the JMD proceeds from its APO to USD in Jamaica’s volatile FX environment. On the other hand, the company has been significantly reducing its exposure to JMD investments which should mitigate FX losses. Additionally, SCI’s profitability in FYE 2020 was limited by the exit of an investment that would have represented 20% of its total investments. Through a mutual agreement with a portfolio company and in light of the current pandemic, unused funding to the tune of US\$10.3M was returned to SCI depriving the company of approximately US\$0.37M in net profit.

In Q1 2021, SCI saw a 51.11% YoY increase in net profit driven by higher NII and a pointedly smaller FX loss for the aforementioned reasons. This was offset by higher operating expenses (64.6% YoY), lower fair value gains (75.91% YoY), and higher impairment allowances (up US\$0.0826M). The primary contributor to higher operating expenses was larger Management Fees which are calculated as a percentage of increasingly larger Assets under

Key Details of APO and Instrument Summary

Opening Date and Time	9:00 AM on 18-Dec-20
Closing Date and Time	4:30 PM on 23-Dec-20
Use of Proceeds: (i) pay APO & listing expenses (ii) repay a short term bridge note for US\$10M (iii) to invest in credit instruments issued by medium-sized firms	
APO Offer Prices	
Existing Shareholders and Staff	US\$0.127 / J\$14.70 per share
Key Investors and General Public	US\$0.14 / J\$16.30 per share
Size of APO (if fully upsized)	196.37M (278.73M) units
Shares Currently Outstanding	350.1M units
Closing Prices as of December 16, 2020	
SCIUSD (USD) / SCIJMD (JMD)	US\$0.16 / J\$16.58
52 Week Price Range	
SCIUSD (USD) SCIJMD (JMD)	US\$0.12 to US\$0.21 J\$13.06 to J\$27.20
Market Capitalization	US\$47.68M / J\$6.89B
SIJL’s Valuation of SCI	
Fair Value	US\$0.23 / J\$33.22
12M Target Price	US\$0.26 / J\$37.92
Fiscal Year End	June 30

Financial Snapshot

	LTM	2020	2019	2018
Total Revenues (US\$M)	3.5920	3.5259	3.1353	1.8386
Net Interest Margin	9.41%	9.70%	8.92%	
Net Profit (US\$M)	2.243	1.973	2.051	1.424
Return on Equity	5.96%	5.24%	5.46%	3.89%
Dividend Yield	3.37%	4.15%	2.79%	0.00%
EPS (US\$)	0.0064	0.0056	0.0059	0.0085
Price / Earnings	24.98x	23.07x	18.81x	12.87x
Price / Book	1.49x	1.21x	1.03x	0.50x

Source: Company’s financials & SIJL’s estimates

Management (AUM - SCI's investments). Fair value gains decreased because of wider spreads YoY as a result of the COVID-19 induced recession. Impairment allowance increased because SCI reversed a previous impairment in Q1 2020 and recorded provisions for expected credit losses in Q1 2021 in response to the expected impact the COVID-19 pandemic had on its Portfolio Companies. SCI typically maintains a very low level of cumulative impairment allowance (0.37% of AUM as of Q1 2021). However, with the timeline of widespread distribution and acceptance of COVID-19 vaccines continuing to be a moving target, it is not improbable that the virus' prolonged impact could result in increased impairment allowances.

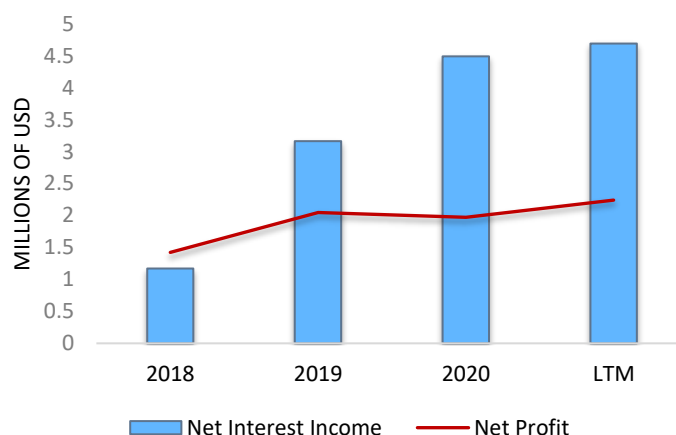
Total Assets are largely represented by Investments (84.45% of Total Assets) which grew at a two-year CAGR of 28.43% as at FYE 2020 and 121.75% YoY in Q1 2021. The growth in assets is expected to remain strong driven by the company's board authorizing a total of US\$50M to be raised in capital for investments. This offering (APO) could potentially raise approximately US\$37M of that authorized amount, with the difference likely to be raised through debt financing. Notwithstanding, an approval to raise US\$50M does not dictate that SCI must raise and invest the entire amount. Last year, the board approved for US\$35M in capital to be raised; however, the company raised a portion (61.09%) of the amount authorized.

Debt – SCI introduced debt to its books in Q2 of 2020 in the form of medium-term notes, revolving lines of credit and other short-term credit facilities with major banking institutions. In Q1 2021, the company had US\$26.84M in debt on its books resulting in a debt/equity ratio of 0.76x, far lower than that of the ten largest financial firms in Jamaica (1.83x) and under than that of its peers in the US (1.09x). The current APO would reduce this metric which indicates that SCI has room for additional leverage to aid growth of its investments. Based on the authorised increase in capital, SCI's debt/equity could move to either 0.96x if it does not fully upsize its APO or 0.63x if it does, assuming that it raises the entire US\$50M.

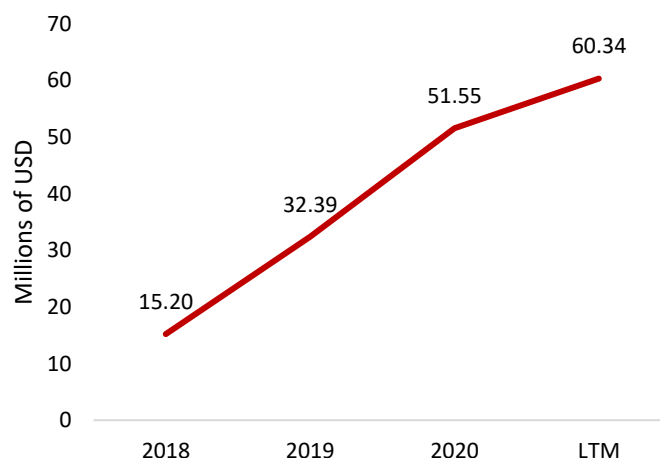
Total Shareholder's Equity has remained fairly flat since the SCI's IPO in 2018 with a two-year CAGR of 1.43% as at FYE 2020. This growth has been solely due to higher Retained Earnings, growing at a two-year CAGR of 34.22% over the same period despite the company paying out 73.62% of its earnings. SCI announced in its Q1 2021 report that it would be making a dividend payment of US\$0.00249 per share which would equate to a pay-out ratio of 53.41%. The reduced ratio may be attributable to the company's need to preserve cash in the midst of the pandemic. These ratios, though among the highest in the country, are several percentage points away from the maximum allowable amount (85%), according to SCI's Prospectus for its 2018 IPO, implying that future pay outs may be higher.

Depending on investors' appetite and the company's decision on whether to upsize the shares offered in its APO, Shareholder's Equity could move from US\$37.6M as reported in Q1 2021 to a range of approximately US\$60.18M to US\$71.69M.

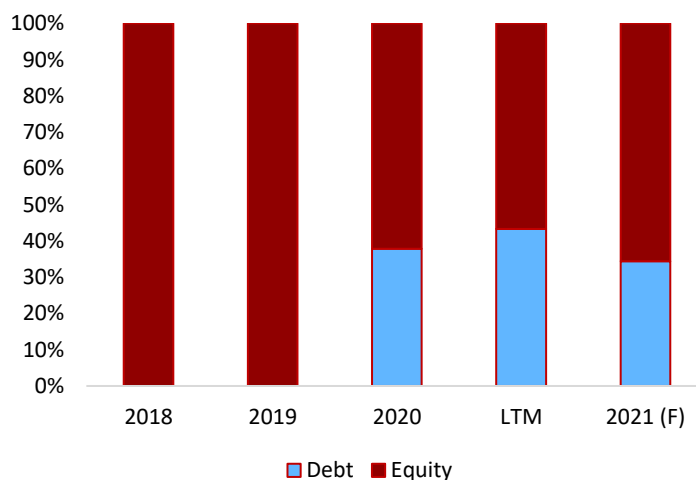
Net Interest Income and Net Profit



Investments as of Q1 2021



SCI's Capital Structure



Investment Thesis

One of the largest specialty Private Credit Investment (PCI) companies in the Caribbean - SCI is a company that engages in alternative investments, an area not widely explored by financial institutions in the Caribbean. This provides a niche for the company which it can explore to reap exponential profits. Additionally, with traditional banks being more cautious because of the current economic crisis, more firms are seeking alternative sources of funding to bridge the gap this creates.

High Dividend Payout Ratio and Rapidly Growing Dividend Yield – The company has stated its intention to pay out up to 85% of its earnings in dividends and has grown its Dividend Yield from 2.79% in FYE 2019 to 4.15% in FYE 2020.

Low Debt/Equity - SCI maintains a low debt/equity ratio, relative to its peers, which will move lower after its APO. This shift creates room for more debt should the company determine that leverage higher than current levels is still within its optimal capital structure.

Strong Board and Management – The Board of Directors and Management Team comprises of finance practitioners with decades of combined experience and a variety of relevant qualifications. All members of the board have relevant industry experience.

Private Equity (PE) Potential – The CEO of Sygnus Capital Ltd., the Investment Advisors to SCI, stated that the company stands ready to finance potential Portfolio Companies for a stake, should they be hesitant to take on debt during these turbulent times. The Chief Investment Officer and Head of Investment Management of Sygnus Capital Ltd. stated that this would come in the form of an equity payment-in-kind by the Portfolio Company whereby the owners would issue ordinary shares to Sygnus as payment, in addition to cash payments. Sygnus would then exit the investment in the future, possibly via an IPO, for returns higher than customary, should the venture be successful.

Growth Unrestricted by Taxation – SCI, which is incorporated in St. Lucia, is subject to an income tax rate of 1% but is exempt from income tax if its transactions are conducted with CARICOM member states, as is currently the case.

Diversified Investment Base – SCI's investments are geographically diversified and diversified by sector. The company currently lends to businesses in 10 sectors across seven (7) countries in the Caribbean. The economies of these Caribbean nations are heavily driven by oil prices, tourism and financial services, all of which may see more meaningful improvements in 2021 based on the latest vaccine developments.

Risks

COVID-19 – In its Q1 2021 report, SCI indicated that 16% of its investments were exposed to the hospitality industry, 7% to the construction industry, 6% to the energy industry, 5% to the media and entertainment industry and 4% to the mining and quarrying industry. These sectors have been most severely impacted by the COVID-19 pandemic. Nevertheless, the crisis has taken a toll on all sectors. Additionally, if the crisis persists for much longer, it is possible that SCI could bear losses from these investments, negatively impacting its bottom line.

Sygnus typically takes on more credit risk than traditional financial institutions. The recession caused by the COVID-19 pandemic is expected to increase the likelihood of default among Portfolio Companies. Sygnus has stated that it has and will continue to mitigate these risks by working closely with the Portfolio Companies. We believe that the company will also be more cautious in the selection of Portfolio Companies and the timing of the release of funding, in order to further mitigate the additional risks the crisis brings.

Foreign Exchange (FX) Translation and Conversion Risk – With 50% of SCI's Portfolio Companies being domiciled in Jamaica, the company is exposed to FX translation risk as it maintains some of its assets in JMD. Additionally, with the company's primary banking relationships localized in Jamaica, and with the tightness of the FX market in Jamaica, it is likely that Sygnus will continue to source some of its funding in JMD which could cause it to incur FX losses from conversion as it primarily lends in USD. The company could engage in currency swaps or forwards and/or establish relationships with banks in other countries to hedge this risk but it has not yet engaged these strategies.

Regulatory – Regulations in this sub-sector of Finance are in their developmental stages. SCI's primary exposure to regulatory risk involves its Investment Manager, Sygnus Capital Management Ltd., registered with the Cayman Islands Monetary Authority (CIMA), and its Investment Advisor, Sygnus Capital Ltd., registered as a Licensed Securities Dealer with the FSC Jamaica. Changes in regulations or legislation such as restrictive new requirements could negatively impact the company's profitability. Additionally, if there are changes in tax treaties between the Caribbean countries or local tax laws Sygnus could begin paying income tax which would place downward pressure on its bottom line.

Competitive Pressure – Competitors currently engaging in other forms of alternative investments could start to venture into private credit, thereby reducing the potential profitability of SCI. One competitor in the local market space is Eppley Limited which has worked in conjunction with NCB Capital Markets to establish a "Caribbean Mezzanine Fund" in 2017 which, as of September 2019, has fully deployed US\$15.9M.

Outlook

The COVID-19 pandemic has presented opportunities for SCI but has also brought on difficulties for some of its existing Portfolio Companies causing it to increase its impairment allowance thereby negatively impacting its profitability. Despite the headwinds, the short-term outlook for the company is positive, as the company has the opportunity to grow its investments from US\$60.3M at the end of Q1 2021 to US\$114M by the end of FYE 2021, should it raise and deploy the maximum authorized capital. In the medium- to long-term, our expectation is that the company will see double digit growth but not at the pace it has experienced so far as there is likely to be increased competition from existing and potential players.¹ If this crowding does not occur, Sygnus may be able to extend its high growth phase by a few more years.

Valuation

With SCI committing to an extremely high Dividend Payout Ratio, we elected to use a Three-Stage Dividend Discount Model to determine **the fair value of** the company to be **US\$0.23 or J\$33.22² per share**. This model factors in a long-run beta of 0.94, a risk-free rate of 4.62% and an estimated long-run cost of equity of 9.70%. The Relative Valuation Model was used to determine **a twelve-month target price of US\$0.26 or J\$37.92** for SCI. SCIJMD and SCIUSD currently trade at a P/B of 1.07x and 1.49x, respectively, the former being lower than its peers on the JMD Main Index (3.03x) and the latter being higher than its peers on the USD Main Index (1.39x). This model factored in a 1-year forward P/B of 2.25x.

Based on the fair value of the company's stock and its current market prices, we place a **Buy** recommendation on SCIJMD and SCIUSD. We therefore recommend that investors participate in the offer if this investment is a suitable addition to their portfolio based on their risk profile, investment knowledge and financial circumstances, among other factors. SCI has shown tremendous growth in profitability, and strategic plans are in place to take advantage of the opportunities the COVID-19 pandemic presents. However, the pandemic also heightens the risks of SCI's investments which could create credit losses.

General Disclosures

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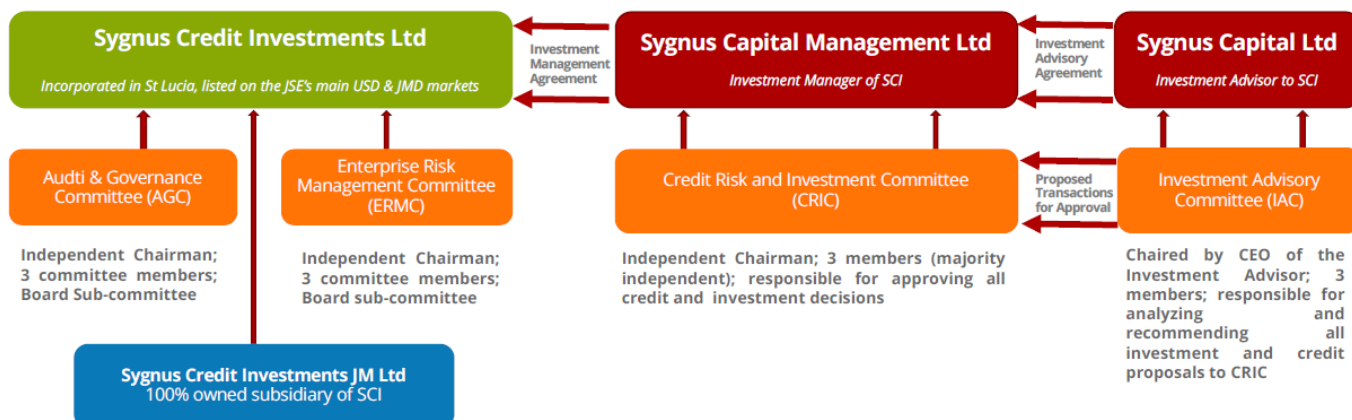
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¹ Existing players include Eppley, and NCB Capital Markets and potential players include Private Equity firms such as Portland Private Equity, Proven Investments Ltd. and SSL Growth Equity Ltd.

² Based on BOJ Weighted Average Selling Rate (JMD to USD) as of 11-Dec-20

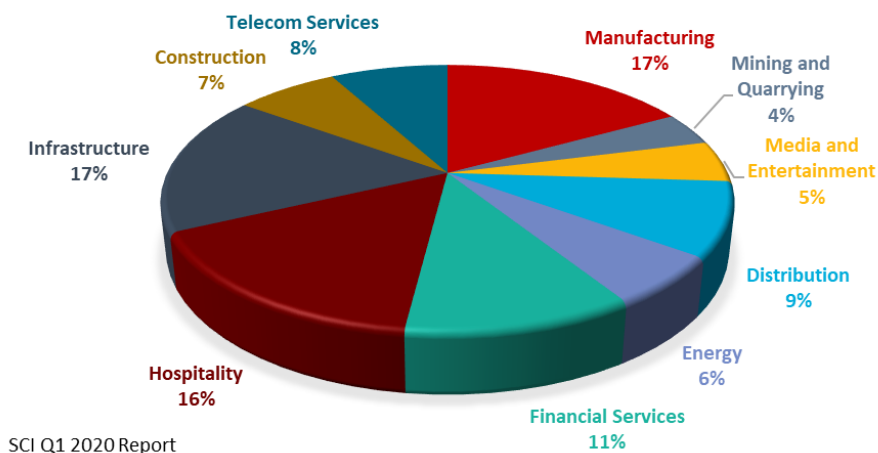
Appendices

Corporate Structure



Source: SCI

PORTFOLIO COMPANY INDUSTRY ALLOCATION



PORTFOLIO COMPANY INCORPORATION BY REGION

