MerkantiHolding p.l.c.

**Merkanti Holding p.l.c.**
**Aragon House Business Centre**
**Dragonara Road**
**St. Julians, STJ 3140**
**Malta**

**COMPANY ANNOUNCEMENT**

*Reference: (04/2020)*

**Financial Analysis Summary of Merkanti Holding p.l.c.**

The Board of Directors of Merkanti Holding p.l.c. (the "Company") announces that the Financial Analysis Summary in relation to the financial year ended 31 December 2019 as prepared by Curmi & Partners Limited is hereby attached and can also be viewed on the Company's website.

By order of the Board.

Dr Andre Zerafa
Director
**Ganado Services Limited**

Company Secretary
30 June 2020

# Merkanti Holding Plc

Financial Analysis Summary

30th June 2020

CURMI & PARTNERS

**CURMI & PARTNERS**

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30th June 2020

The Directors
Merkanti Holding p.l.c.
Aragon House Business Centre
Dragonara Road
St Julians
STJ 2140
Malta

Dear Sirs

**Merkanti Holding p.l.c. – Financial Analysis Summary**

In accordance with your instructions, and in line with the requirements of the Listing Authority Policies, we have prepared the Financial Analysis Summary Update 2020 ("FAS Update June 2020") as an update to the Financial Analysis Summary 2019 ("FAS Report 2019") annexed to the Prospectus issued by Merkanti Holding p.l.c. ("the Issuer") dated 18th July 2019. A copy of the FAS Update June 2020 is attached to this letter.

The purpose of the financial analysis within the FAS Update June 2020 is that of summarising key financial data appertaining to Merkanti Holding p.l.c. ("the Issuer" or "Merkanti"), in addition to Merkanti Bank Limited ("Merkanti Bank" or "the Bank"), Merkanti (A) International Ltd ("Merkanti A"), Merkanti (D) International Ltd ("Merkanti D") (collectively, "the Subsidiaries"). The Issuer and the Subsidiaries are collectively referred to as "the Group". The data is derived from various sources, as disclosed, or is based on our own computations as follows:

1. Historical financial data for the three years ended 31st December 2017, 31st December 2018 and 31st December 2019 have been extracted from the Issuer's audited statutory financial statements for the three years in question.
2. The projected financial statements of the Issuer for the financial year ending 31st December 2020 have been extracted from the Issuer's financial projections which were provided by the management of the Issuer.
3. Historical financial data for Merkanti Bank for three years ended 31st December 2017, 31st December 2018 and 31st December 2019 have been extracted from the audited financial statements of Merkanti Bank.
4. Historical financial data for Merkanti (A) and for Merkanti (D) for years ended 31st December 2017 and 31st December 2018 have been extracted from reporting packages provided by management and those for year ended 31st December 2019 have been extracted from the draft audited financial statements of Merkanti (A) and Merkanti (D).
5. Our commentary on the results of the Issuer and of the Group, and on their financial position, is based on the explanations given by the Issuer.
6. The ratios quoted in the FAS Update June 2020 have been computed by us applying the definitions set out in Section 7 of this report.
7. The relevant peers listed in Section 6 of the FAS Update June 2020 have been identified by us. The relevant financial data in respect of such companies has been sourced from publicly available information, mainly the companies' financial statements.

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The FAS Update June 2020 is meant to assist potential investors by summarising the more important financial data of the Issuer. The FAS Update June 2020 does not contain all data that is relevant to potential investors and is meant to complement, and not replace, the information made available in the public domain by the Issuer. The FAS Update June 2020 does not constitute an endorsement by our firm of the securities of the Issuer and should not be interpreted as a recommendation to invest in any such securities. We shall not accept any liability for any loss or damage arising out of the use of the FAS Update June 2020. As with all investments, potential investors are encouraged to seek professional advice before investing in the securities of the Issuer.

Yours sincerely

Karl Falzon
Head - Capital Markets and Research
For and behalf of
**Curmi & Partners Limited**

CURMI & PARTNERS

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# 1 OVERVIEW OF THE ISSUER

## 1.1 History and Development of the Issuer

Merkanti Holding plc ("Merkanti Holding" or "the Issuer" or "the Company") is a diversified holding company based in Malta, fully owned and controlled by Scully Royalty Ltd ("Scully Royalty"), previously known as MFC Bancorp Ltd. Merkanti Holding was converted into a public liability company on 30th May 2019. The Issuer issued a bond on the Malta Stock Exchange ("MSE") amounting to €25 million bearing interest at a rate of 4% per annum and due in 2026 ("the Bond" or "the Bond Issue").

Merkanti Holding is the parent company of Merkanti (A) International Limited ("Merkanti (A)"), Merkanti (D) International Limited ("Merkanti (D)"), Merkanti Bank Ltd ("Merkanti Bank" or "the Bank") and Merkanti Diesel Limited ("Merkanti Diesel"), collectively referred to as "the Group". Merkanti (A) and Merkanti (D) are companies which hold real estate in Germany and are collectively referred to as "the Property Companies", whereas Merkanti Bank, Merkanti Diesel, Merkanti (A) and Merkanti (D) will be collectively referred to as "the Subsidiaries".

The Issuer is a holding company, with the Bank, the Property Companies, and Merkanti Diesel as subsidiaries. The Issuer's main activities relate to the acquisition, the holding and sale of property, shares and other assets, the raising of financing, the lending and advancing of funds to Group companies, and the collection of interest income on advances to and management fees from the Subsidiaries. Accordingly, the Issuer is dependent on the Group.

## 1.2 Shareholding of the Issuer

The Issuer's authorised share capital is EUR 100,000,000, divided into ninety-nine million, nine hundred ninety-nine thousand, nine hundred and ninety-nine (99,999,999) Ordinary "A" Shares of EUR 1 (€1) each and one (1) Ordinary "B" Share of EUR 1 (€1) each. The Issuer's issued share capital is forty-nine million, nine hundred ninety-nine thousand, and nine hundred and ninety-nine (49,999,999) Ordinary "A" Shares of EUR 1 (€1) each, all fully paid up and one (1) Ordinary "B" Share of EUR 1 (€1), fully paid up.

The Issuer's majority shareholder is Scully Royalty, which holds all of the Ordinary "A" Shares of the Issuer. Scully Royalty is a public company listed on the New York Stock Exchange with ticker symbol SRL. It is a holding company with several investments across a wide range of industries and provides financial services and proprietary capital to enterprises, seeking businesses and assets which offer the potential to increase or unlock value.

Scully Royalty's share capital consists of US$450,000 divided into 300,000,000 common shares, of which 12,550,000 are outstanding, and 150,000,000 preference shares of US$0.001 par value each. The main shareholders of Scully Royalty are outlined below:

| Scully Royalty Ltd Shareholding as at 8th May 2020 | Number of shares | Percentage Shareholding |
|---|---|---|
| IAT Group[1] | 4,372,480 | 34.9% |
| Lloyd I. Miller III, Estate | 1,862,523 | 14.8% |
| Nantahala Capital Management, LLC | 753,885 | 6.0% |
| Total shares | 12,554,801 | 100% |

*Source: U.S. Securities and Exchange Commission, Form 20-F, Scully Royalty Limited*

## 1.3 Directors and management

The Board of Directors consists of four directors who are entrusted with setting the overall direction and strategy of the Company.

As at the date of this financial analysis summary report, the Board of Directors of the Issuer is constituted as follows:

| | |
|---|---|
| Mario Galea | Independent Non-Executive Director and Chairman |
| Samuel Morrow | Executive Director |
| Benjamin Muscat | Independent Non-Executive Director |
| Silke Stenger | Independent Non-Executive Director |

Samuel Morrow leads the growth of the Group's merchant banking and trade finance activities and acts as the Bank's Chief Executive Officer.

[1] IAT Reinsurance Company Ltd. and Peter Kellogg are collectively referred to as the "IAT Group", which may be deemed to beneficially own an aggregate of 4,372,480 Common Shares.

# 2 OVERVIEW OF THE GROUP

## 2.1 History and Development of the Group

The Issuer was incorporated as a private limited liability company and was converted to a public limited liability company on 30th May 2019. The Issuer was originally incorporated in 2015 as a holding company for the purpose of the acquisition of Merkanti Bank Ltd (formerly known as MFC Merchant Bank and BAWAG Malta Bank Ltd. ("BAWAG"))

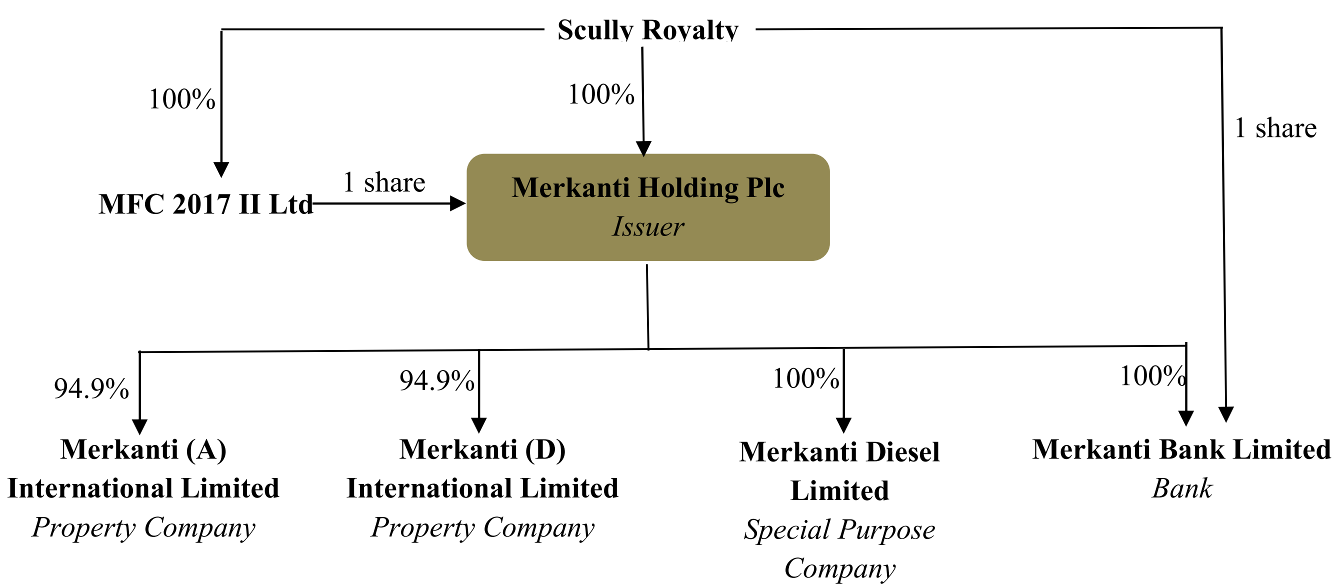
BAWAG had been fully-licensed in Malta since 2003. The acquisition reflected Scully Royalty's strategy to leverage its merchant banking and trade finance platform by offering additional complimentary trade and structured finance products, and other complimentary services. As part of Scully Royalty, the Bank was not expected to engage in retail banking, commercial banking or universal banking, but to focus on specialty banking services.

In late 2018, the Issuer commenced a restructuring process in preparation for the Bond. This restructuring process involved the acquisition of 85% of the two property companies, Merkanti (A) and Merkanti (D). The Property Companies were purchased from an indirect subsidiary of Scully Royalty for a purchase price of €29.5 million and were re-domiciled to Malta in 2019.

In 2019, Merkanti increased its shareholding of the Property Companies by a further 9.9% to 94.9%. In December 2019, a new entity was incorporated, Merkanti Diesel Limited ("Merkanti Diesel"), a special-purpose company that is operating in the area of litigation funding. In a Board meeting in June 2020, the acquisition by Merkanti Holding of A.I.M., the property management company that manages the Property Companies, was approved. A.I.M is a Scully Royalty company and management indicates the transaction value is less than €100k.

## 2.2 Organisational Structure

The corporate structure of the Group as at 31st December 2019 was as follows:



# 3 MAJOR ASSETS OF THE GROUP

## 3.1 Merkanti Bank Limited

Merkanti Bank's operations began in February 2016 after the ECB and MFSA approved the acquisition of Merkanti Bank. Prior to the acquisition, BAWAG's operations primarily related to the provision of corporate banking with the goal of generating interest income. Following the acquisition, Otto Karasek, who was Chief Executive Officer, continued in his role and focused on revamping the Bank's business model by changing internal procedures, systems, corporate governance structures and shifting operations towards the provision of traditional merchant banking services.

With respect to merchant banking, the Bank has been providing advisory and fee related services, typically to related parties. In the first 3 years of operation, the Bank engaged in a limited number of factoring, loan, trade finance and merchant banking advisory transactions.

Prior to the Bond Issue, Merkanti Bank decided to also access the trade finance market in addition to generating fee and interest income from its merchant banking activities. The Bank expects to earn fee and interest income from its merchant banking activities by providing credit and risk management, customised financial tools, structured financial solutions and corporate finance services, in addition to realising gains on its proprietary investments from time to time.

This investment in and growth of the Bank's activities is overseen and led by Samuel Morrow, who was appointed as the Bank's Chief Executive Officer in 2019. To further support these efforts, the Bank has hired additional personnel with experience in trade finance and merchant banking, revamped its procedures and structures, and updated its systems to accommodate the expected growth. The Bank plans to continue recruiting staff to implement the expansion of its merchant banking and trade finance activities.

During the latter part of 2019 into 2020, the Bank maintained a substantial level of liquidity with the expectation of capitalizing on potential opportunities that could arise going forward.

Management notes that it currently expects progress on certain potential projects throughout the second half of 2020 and the first half of 2021, in both merchant banking and trade finance. However, it is also indicated that the combination of geopolitical uncertainty, the disruption of certain international supply chains, and the COVID-19 crisis have induced the Bank to maintain a more cautious approach with respect to expansion of the Bank's trade finance activities.

### 3.1.1 Statement of Comprehensive Income

| **Merkanti Bank Ltd Financial Statements**<br>*Extracts of Statements of comprehensive income (€000) - 31 December* | **2017**<br>Audited | **2018**<br>Audited | **2019**<br>Audited |
|---|---|---|---|
| Total Net Interest Income | 305 | 204 | 236 |
| Total net fee and commission income | 2,024 | 2,242 | 2,304 |
| Net trading losses/ gains | (21) | (6) | 749 |
| Operating Income | 2,343 | 2,474 | 3,333 |
| Administrative expenses | (1,555) | (1,864) | (2,459) |
| Net Operating Income | 788 | 610 | 874 |
| **Profit before tax** | **962** | **621** | **783** |
| **Total comprehensive income for the year** | **895** | **621** | **783** |
| Total Capital Ratio | 83.02% | 110.39% | 97.95% |
| CET1 Capital Ratio | 83.02% | 110.39% | 73.51% |

*Source: Audited financial statements of Merkanti Bank Limited as at 31 December 2017 to 2019*

Following Scully Royalty's formal takeover of BAWAG in 2016, the Bank's operations shifted from primarily trade finance and forfaiting to traditional merchant banking services. Fee and commission income increased proportionately compared to interest income. In fact, net fee and commission income increased significantly on the basis of advisory services provided to a number of related parties within the Scully Royalty Group.

During 2019 net fee and commission income increased by 2.8% to €2.3million from the previous year. The Bank's overall operating income increased by 34.7% to €3.3million, driven by net trading gains amounting to €0.7million. Administrative expenses rose by 31.9% reflecting primarily increases in staff costs, in addition to expenses relating to IT and leases. Profit for the year increased to €0.8million in 2019.

### 3.1.2 Statement of Financial Position

| **Merkanti Bank Ltd Financial Statements**<br>*Extracts of Statements of financial position (€000) - 31 December* | **2017**<br>Audited | **2018**<br>Audited | **2019**<br>Audited |
|---|---|---|---|
| Total assets | 14,778 | 17,358 | 36,341 |
| Total equity | 13,053 | 13,612 | 14,342 |
| Total borrowings | 1,566 | 3,642 | 21,708 |
| Total liabilities | 1,726 | 3,746 | 21,999 |

*Source: Audited financial statements of Merkanti Bank Limited as at 31 December 2017 to 2019*

Following the acquisition in 2016, the Bank was restructured via a formal capital reduction process leading to a downsizing in both total assets and total equities. With activities primarily focused on merchant banking services at an intra-group level, on-balance sheet exposure was kept at a minimum in subsequent years.

During 2019, part of the proceeds raised from the Bond Issue were utilised by the Issuer to grant a subordinated loan to Merkanti Bank amounting to €4.5million, which qualifies as Tier 2 capital for the Bank. Additionally, funding at the Bank increased by a further amount of circa €14million consisting primarily of deposits by the other subsidiaries, the Company and related parties.

On the basis of the increase in this funding, total assets of the Bank expanded to €36.3million. Loans and advances to banks (€11.2million) and Balances with the Central Bank of Malta (€10.4million) accounted for the largest proportion of the Bank's asset base as at 31st December 2019. These balances reflect an elevated level of liquidity being maintained by the Bank so far, with such funds allocated towards overnight deposits and advances of 3 months or less. Management indicates that it expects that the Bank will re-allocate such amounts in the coming periods, taking advantage of attractive opportunities that are under consideration.

The majority of loans and advances to customers, which in total amounted to €5.6million as at 31st December 2019, include credit exposure with related parties amounting to €5.0million. As at the end of 2019, the Bank held investments, including financial assets measured at fair value through profit or loss and through other comprehensive income, totalling €8.4million (2018: €4.7million). These consisted mainly of foreign and local government debt issues. Management expects the relative importance of such investments to decline going forward, as merchant banking and trade finance projects are taken on.

## 3.2 The Property Companies

Merkanti Holding acquired an 85% shareholding in each of Merkanti (A) and Merkanti (D) in advance of the Bond Issue on 27th December 2018. The Property Companies were thereafter re-domiciled to Malta on 8th July 2019. Prior to the end of 2019, Merkanti Holding increased its interest by a further 9.9% of the issued share capital of Merkanti (A) and Merkanti (D). Accordingly, the Issuer currently holds 94.9% of the ordinary shares of each of the Property Companies.

The Property Companies operate in the industrial real estate leasing sector in Germany and hold assets valued at €35.1 million, yielding a combined rental income of approximately €2.2 million per annum.

The Property Companies own the real estate situated in Germany described below, which is currently leased out to a number of tenants on definite or indefinite term contracts. For the year ending 31st December 2019, 80% of the combined rental income was generated from areas leased out to third party tenants, with the remaining 20% generated from leases to related parties.

The properties are situated in the region of Saxony-Anhalt, in the central-eastern part of Germany, and borders the states Brandenburg, Saxony, Thuringia and Lower Saxony. The region is an attractive location for businesses. The industry sector is very diverse and includes automotive supply production and mechanical engineering, information technology, biotechnology, and medical technology. Important corporations are located in the region including: Bayer, Total and Dow Chemical.

### 3.2.1 Merkanti (A) International Limited

Merkanti (A) owns the largest (1,836,312m$^2$) industrial and commercial park in the German State of Saxony-Anhalt, known as the Industrial and Commercial Park Altmark, located in Arneburg, Germany. There are currently 34 buildings in Industrial and Commercial Park Altmark. This park is traditionally a centre for the pulp and paper industry but that has recently made developments towards sustainable energy, with a large solar park built there in 2014. The Industrial and Commercial Park Altmark is well connected via a railway system, a connection to its own harbour on the river Elbe, and a connection to modern roads for transportation by truck.

Industrial and Commercial Park Altmark presently yields a rental income of approximately €1.3 million per annum. As per the valuation on 31st December 2019, the property is valued at €26.2 million. Around 56% of the rental income generated by Merkanti (A) in 2019 was generated by wood processing industry tenants, whilst another 30% of rental income was generated from the construction industry. The rest was generated from various tenants operating in the property management and transport industries, with additional small-scale tenants operating in industries such as engineering and manufacturing.

This investment property was revalued by an external valuation expert reflecting actual market state at the end of 2019, which resulted in an increase of €2.1 million in the fair value of the asset, compared to the valuation as at earlier during 2019. Management notes that after the 2019 financial year end, Merkanti (A) sold a small portion of property for circa €3million to a major pulp and paper company that is expecting to develop the site. In turn, this planned project is expected to stimulate demand for properties in the area by suppliers, which management considers as a positive development.

In terms of usage type, the Industrial and Commercial Park Altmark is mainly used for storage purposes, with activity making up 68% of rental income during 2019. Approximately 18% of the space is being used for office and archiving purposes and the remaining minority is being used as a basement or outdoor area.

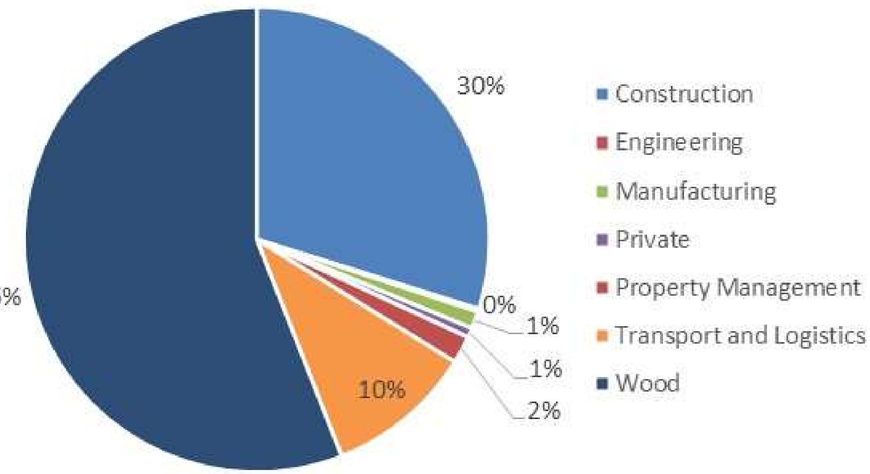



**Figure 1:** Merkanti (A) Rental Income by Industry

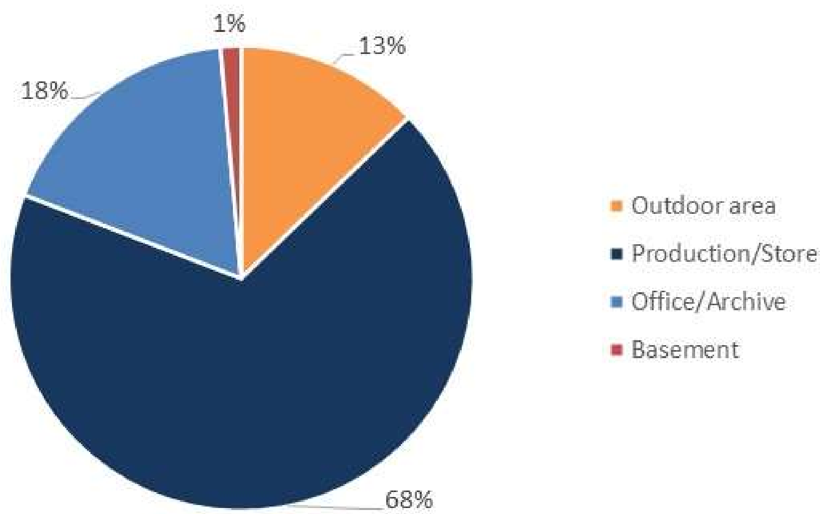



**Figure 2:** Merkanti (A) Rental Income by type of use

Merkanti (A)'s largest tenant by rental income accounted for 45% of Merkanti (A)'s total rental income in 2019, whereas the second largest tenant by rental income accounted for 30% of Merkanti (A)'s total rental income in 2019.

The largest tenant holds nine rental agreements with Merkanti (A), five of which are for indefinite terms and the other four expire in 2020 or 2021. These rental agreements are subject to automatic renewal for further terms, unless the lessee provides Merkanti (A) with written termination notice within the time period specified in the relevant agreement.

The second largest tenant has four rental agreements with Merkanti (A) and each of them have different terms. One rental agreement is a fixed term agreement which expires in 2022 and will not be automatically renewed for further terms unless specifically agreed to by both parties. The other three rental agreements expire in 2021, and each of them are subject to automatic renewal on similar conditions as per above.

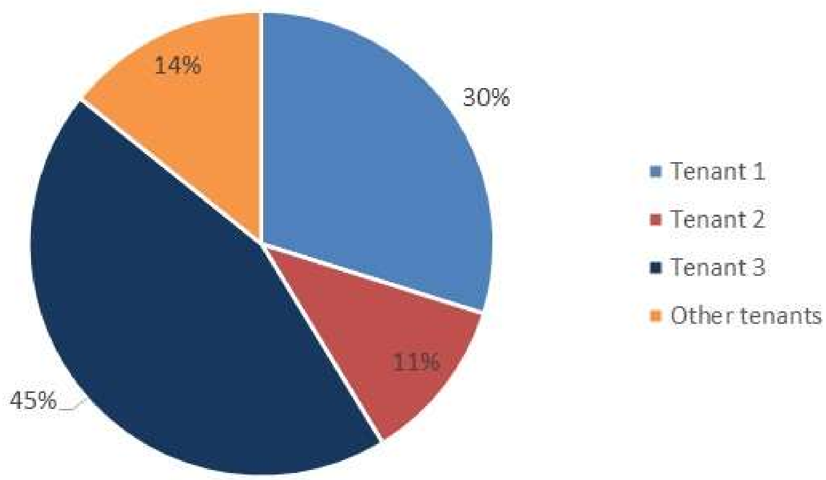



**Figure 3:** Merkanti (A) Rental income by tenant

### 3.2.1.1 Income Statement

| **Merkanti (A) Ltd**<br>*Statements of comprehensive income (€000) - 31 December* | **2017**<br>Mgt Accounts | **2018**<br>Mgt Accounts | **2019**<br>Draft Audited |
|---|---|---|---|
| **Rental Income** | **1,182** | **1,210** | **1,282** |
| Change in the fair value of investment property | - | - | 1,985 |
| Repairs and maintenance | (202) | (288) | (242) |
| Other direct property operating expenses | (333) | (32) | (33) |
| Administrative expenses | (228) | (1,005) | (373) |
| Other expenses | (26) | - | - |
| Total costs | (763) | (1,325) | (648) |
| **Operating Profit** | **419** | **(115)** | **2,619** |

| | | | |
|---|---|---|---|
| Finance Income | (80) | - | - |
| Finance Costs | (39) | - | (135) |
| Other Income | 81 | 2 | 1 |
| **Profit/ (Loss) before tax** | **355** | **(112)** | **2,485** |
| Tax | (58) | 17 | (393) |
| **Profit for the year** | **297** | **(95)** | **2,091** |

*Source: Management accounts of Merkanti (A) International Limited as at 31 December 2017, 2018, Draft Audited financial statements of Merkanti (A) International Limited as at 31 December 2019*

Total net revenue from rental and lease of property increased from €1.2 million in 2017 to €1.3 million in 2019, which was primarily due to the impact of new rental agreements concluded with new tenants at improved terms.

Repairs and maintenance amounted to €0.2 million, relating to improvements to the buildings. Administrative expenses decreased to €0.4million (-68.5%). This mainly reflects elevated selling, general and administrative costs incurred in 2018 related to an uncharacteristically high level of amounts receivable written-off from a third party that provided hedging services which declared insolvency during the year.

The investment property was revalued in 2019 in preparation of a sale of a small portion of property in 2020. The valuation of the investment property undertaken resulted in a gain in the fair value of investment property of €2.0million, contributing significantly to an operating profit of €2.6million.

During 2019, EBITDA estimate for Merkanti (A) improved substantially to €0.6million (2018: €-0.1 million). Finance costs of €0.1m reflect the interest payable on the loan of €6.75million at an interest rate of 6.5% advanced from Merkanti Holding following the Bond Issue. Profit before tax amounted to €2.5million (2018: loss €-0.1million). Excluding the change in fair value of investment property, profit for the year amounted to €0.5million.

### 3.2.1.2 Statement of Financial Position

| **Merkanti (A) Ltd**<br>*Extracts of Statements of financial position (€000) - 31 December* | **2017**<br>Mgt Accounts | **2018**<br>Mgt Accounts | **2019**<br>Draft Audited |
|---|---|---|---|
| **ASSETS** | | | |
| Investment Property | 25,020 | 24,213 | 26,198 |
| Financial assets measured at fair value through profit or loss | - | - | 1,650 |
| Trade receivables | 24 | 16 | 34 |
| Other receivables | 523 | 1,650 | 4,660 |

| | | | |
|---|---|---|---|
| Other assets | - | 0 | 58 |
| Cash and Cash equivalents | 888 | 368 | 2,905 |
| **Total assets** | **26,455** | **26,248** | **35,505** |
| **EQUITY AND LIABILITIES** | | | |
| **Total equity** | **25,563** | **25,467** | **27,558** |
| **LIABILITIES** | | | |
| Borrowings | - | - | 6,750 |
| Deferred tax liabilities | 743 | 694 | 1,008 |
| Trade payables | 124 | 42 | 41 |
| Other payables and accruals | 27 | 45 | 148 |
| **Total liabilities** | **894** | **781** | **7,947** |
| **Total equity and liabilities** | **26,457** | **26,248** | **35,505** |

*Source: Management accounts of Merkanti (A) International Limited as at 31 December 2017 to 2018, Draft Audited accounts of Merkanti (A) International Limited as at 31 December 2019*

Merkanti (A)'s capital employed was consistently circa €25million between 2016 and 2018, with total assets reaching €35.5million in 2019. Investment property accounted for the largest component of Merkanti (A)'s balance sheet, amounting to €26.2 million as at 31st December 2019. Other receivables increased to €4.7million (2018: €1.7million), consisting of a loan advanced by the company to Scully Royalty at an interest rate of 7.375%. Management notes that this balance represents the first step of an expected merchant banking transaction that is expected to close in 2020, and is viewed as an attractive utilisation of liquidity available.

Financial assets measured at fair value through profit or loss, amounting to €1.7million, consisting of equity securities assigned to Merkanti A in settlement of receivables due from a related party.

Merkanti (A) held a high level of liquidity, with €2.9million in cash and cash equivalents. In terms of funding, part of the proceeds of the Bond were granted as a loan to Merkanti (A), with borrowings amounting to €6.8million, resulting in net debt amounting to €3.8million. Total equity amounted to €27.6million which included other reserves of €24.2 million and retained earnings of €3.4 million.

### 3.2.2 Merkanti (D) International Limited

Merkanti (D) owns the Dessau-Mitte Industrial Park, located in Dessau, Germany. Management indicates that this 111,688m$^2$ industrial park offers 18 buildings comprising of office and administrative buildings, production halls and warehouses. The Dessau-Mitte Industrial Park is ideally situated for hosting production, engineering and servicing companies, currently housing traditional equipment for cement plants, mills, cooling apparatus, drums and rotary furnaces, as well as broad-based engineering services in the field of cement plants and medical technology. The industrial park benefits from connections to the autobahn, the national railway and the Elbe River. Dessau-Mitte Industrial Park presently yields a rental income of approximately €0.9million. The property was valued at €8.9 million as at 31st December 2019.

As indicated in the chart below, the majority (34%) of Merkanti (D)'s revenue generated in 2019 relates to tenants in the manufacturing industry. Merkanti (D)'s rental income is also highly dependent (46%) on the rental of production and storage space; and the remaining space is utilized as office space, an outdoor area and basements.

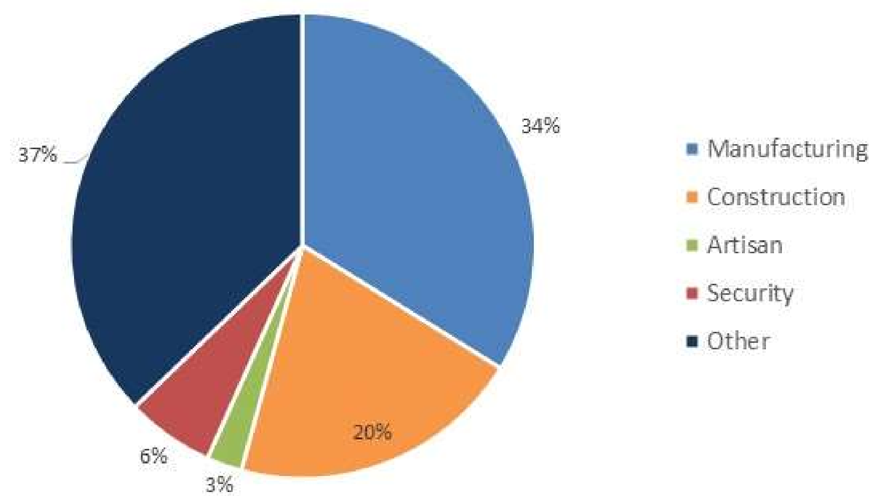



**Figure 4:** Merkanti (D) Rental income by industry

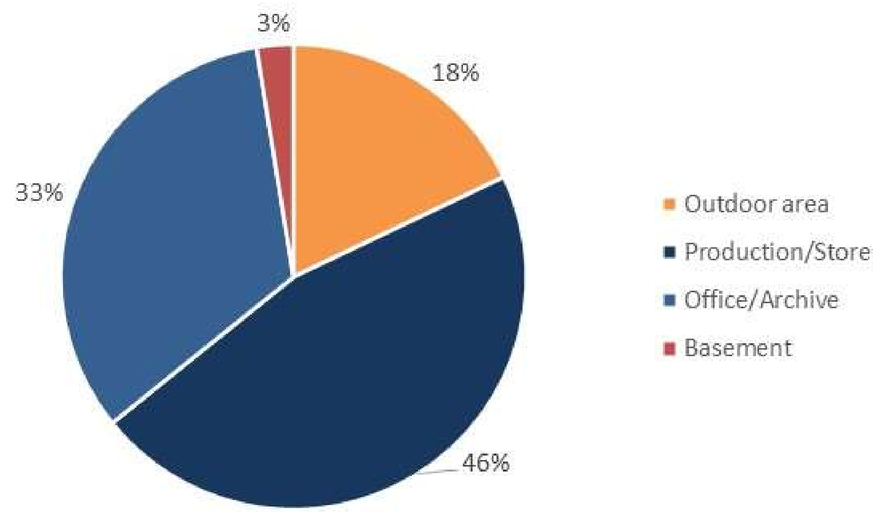



**Figure 5:** Merkanti (D) Rental income by type of use

Up to 2018, the majority of the rental income was generated by one tenant which rented the premises for storage purposes. The contracts with this tenant were terminated on 31st December 2018, with the space vacated temporarily taken up by a number of Scully Royalty group entities. Both Tenant 1 and Tenant 2 in Figure 6 below, which generate 45% of total revenue, are group entities. Management notes that in 2020, the lease with Scully Royalty was terminated as a new third party tenant in the logistics sector leased the premises.

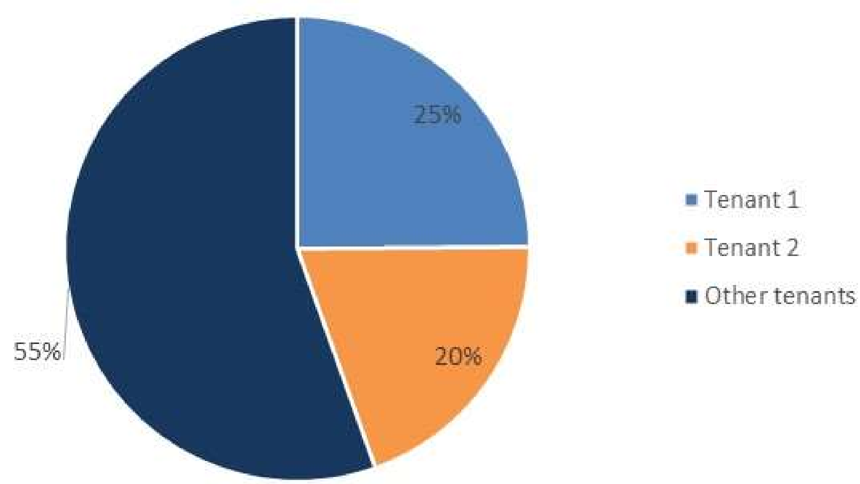



**Figure 6:** Merkanti (D) Rental income by tenant

### 3.2.2.1 Income Statement

| Merkanti (D) Ltd<br>*Statements of comprehensive income (€000) - 31 December* | 2017<br>Mgt Accounts | 2018<br>Mgt Accounts | 2019<br>Draft Audited |
|---|---|---|---|
| **Rental Income** | 1,155 | 1,189 | 928 |
| Changes in fair value of property | - | - | 84 |
| Repairs and maintenance | (112) | (422) | (360) |
| Other direct property operating expenses | (176) | (143) | (157) |
| Administrative expenses | (237) | (844) | (447) |
| Other income | 55 | 456 | 69 |
| Utilities | (110) | - | - |
| Other expenses | (6) | - | - |
| Total costs | (580) | (952) | (894) |
| **Operating Profit** | **575** | **237** | **118** |
| Finance Income | (10) | - | - |
| Finance Costs | (15) | - | (55) |
| **Profit/ (Loss) before tax** | **544** | **237** | **63** |
| Tax | (88) | (38) | (10) |
| **Profit for the year** | **456** | **198** | **53** |

*Source: Management accounts of Merkanti (D) International Limited as at 31 December 2017 to 2018, Draft Audited accounts of Merkanti (D) International Limited as at 31 December 2019*

Net revenue from rental and lease of properties owned by Merkanti (D) decreased from €1.2 million in 2018 to €0.9 million in 2019. Management notes that one of the tenants had exercised a special right of termination as at December 31, 2018. Administrative expenses declined by 47% to €0.5million, with the substantially higher expenses for 2018 including revaluation losses from real estate properties for that year. On the other hand, repairs and maintenance remained elevated during 2019, with management noting that typically these amounts entail improvement expenditures (including items such preparing for solar panels, lift upgrades) which would normally be capitalised.

EBITDA decreased to €34k in 2019 compared €0.1 million in 2018 due to lower rental income generated during the year and the trends in costs mentioned above. As in Merkanti (A), other income mainly consists of insurance recoveries and revaluation gains for real estate properties.

### 3.2.2.2 Statement of Financial Position

| **Merkanti (D) Ltd**<br>*Statements of financial position (€000) - 31 December* | **2017**<br>Mgt<br>Accounts | **2018**<br>Mgt<br>Accounts | **2019**<br>Draft<br>Audited |
|---|---|---|---|
| **ASSETS** | | | |
| Investment Property | 9,170 | 8,858 | 8,942 |
| Financial assets measured at fair value through profit and loss | - | - | 1,100 |
| Trade receivables | 64 | 33 | 97 |
| Other receivables | 135 | 600 | 0 |
| Prepaid expenses | 133 | - | - |
| Cash and cash equivalents | 654 | 865 | 2,978 |
| **Total assets** | **10,156** | **10,356** | **13,117** |
| | | | |
| **EQUITY AND LIABILITIES** | | | |
| **Total equity** | **9,019** | **9,217** | **9,270** |
| | | | |
| **LIABILITIES** | | | |
| Borrowings | - | - | 2,750 |
| Trade payables | 37 | 91 | 37 |
| Other payables and accruals | 146 | - | - |
| Deferred tax liabilities | 953 | 977 | 987 |
| Accrued expenses and other liabilities | - | 71 | 73 |
| **Total liabilities** | **1,136** | **1,139** | **3,847** |
| | | | |
| **Total equity and liabilities** | **10,155** | **10,356** | **13,117** |

*Source: Management accounts of Merkanti (D) International Limited as at 31 December 2017 to 2018, Draft Audited accounts of Merkanti (D) International Limited as at 31 December 2019*

Merkanti (D)'s asset base is significantly lower than that of Merkanti (A), reflecting the lower value of the underlying investment property of Merkanti (D). Financial assets measured at fair value through profit or loss, amounting to €1.1million, consist of equity securities assigned to Merkanti D in settlement of receivables due from a related party.

Merkanti Holding loaned €2.75million to Merkanti (D) from the Bond proceeds, thereby decreasing the net cash position to €0.2million (2018: €0.9million). Shareholders' funds amounted to €9.3 million in 2019, and consisted of other reserves of around €6.7 million and retained earnings of €2.5 million.

## 3.3 Merkanti Diesel Limited

Following the approval by the Board of Directors of Merkanti Holding, the Company established Merkanti Diesel in December 2019, with the objective of providing litigation financing. Litigation financing typically relates to the provision of funding to individuals and their legal counsels who are making legal claims against large corporations.

Merkanti Diesel is a special-purpose company, fully financed by Merkanti Bank, which via an agreement with a German litigation funder and two law firms, has provided financing to approximately 1,200 individual legal claims in Germany based upon the “Dieselgate” scandal. Management indicates that an amount of €1.7million has been drawn as at December 31, 2019. Management also notes that prospects for this business are encouraging going forward, allowing for the generation of both interest income from the financing activities and additionally fee income in collaboration with more law firms.

# 4 INDUSTRY OVERVIEW

## 4.1 German Industrial Real Estate

The real estate in Germany owned by the Property Companies is all located in the Saxony-Anhalt region in Germany. The area is a dynamic business environment set at the heart of Europe with an excellent location, high levels of direct investment, unique interlocking of all traffic routes that ascan cope with heavy loads. Saxony-Anhalt has a number of connections to pan-European traffic routes, is an international hub for air cargo via the Leipzig/Halle Airport, has one of the densest rail networks in Europe (with around 3,100km of track systems and 76 freight transport stations); and has one of the most modern waterway networks in Europe with the Elbe, Mittelland Canal, Elbe-Havel Canal and waterway cross. In 2019, around 5.7million tonnes of goods were handled in the inland ports and transhipment points in the region[2]. In 2019, Saxony's Gross Domestic Product amounted to €128.1million (3% higher than 2018) and employed 2.1million people. Saxony's economy has increased by more than 30% since 2000, exhibiting one of the highest GDP growth rates among all German federal states[3].

The European Commission adopted the Regional Innovation Strategy outlining priorities for using public funds allocated to Saxony-Anhalt for the 7-year period 2014-2020. Saxony-Anhalt's vision is to catch up with European innovation leaders by 2020. The innovation strategy identifies objectives for spurring regional development and develops strategic goals, activities and measures.

An American commercial real estate services and investment firm, CBRE, reports that German companies increased their demand for warehouse and logistics space was set to remain strong and the momentum on the warehouse and logistics market was expected to be ongoing in 2020[4]. The high demand on German commercial real estate investment market and the low interest rate environment enabled the industrial and logistics assets to continue performing well in 2019; ranking as the third strongest asset class in Germany, after office and retail[5].

JLL, a real estate company, notes that in the first quarter of 2020, the German market for warehousing and logistics space recorded a take-up of around 1.49million sqm. Although this figure was 14% lower than Q1 2019, it still corresponds to the 10-year average take up. In the same period, prime rents for warehousing space greater than 5,000sqm remained stable in all regions. Companies from the distribution/logistics segment accounted for 29% of the total take-up, whereas those from the manufacturing segment took up 22% of the share[6].

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[2] Sachsen-Anhalt. (2020, June 04). Invest in Saxony-Anhalt. Retrieved from Sachsen-Anhalt: https://www.investieren-in-sachsen-anhalt.de/logistik

[3] Saxony! (2020, June 04). Saxony's Economy - A Success Story. Retrieved from Saxony!: https://business-saxony.com/en/about-saxony/economy

[4] CBRE. (2019). German Logistics Real Estate Market: Lettings at High Year-Earlier Level. Frankfurt: CBRE.

[5] Kunz, P., Kiese, S., & Kinne, N. (2020, March 13). Germany: Industrial & Logistics Market Report 2020. Retrieved from Colliers International: https://www2.colliers.com/en-de/research/il-2020

[6] JLL. (2020, May). Industrial Market Overview - Q1 2020. Retrieved from JLL: https://www.jll.de/content/dam/jll-com/documents/pdf/research/emea/germany/en/Logistics-and-Industrial-Market-Overview--JLL-Germany.pdf

The Covid-19 pandemic doesn't seem to be slowing down this market so far. Head of Industrial Agency JLL, Frank Weber, stated "For very high-demand products such as food or sanitary items, there is currently a very strong demand for additional space in the vicinity of production facilities or distribution centres with short term rentals of up to one year"[7].

On the other hand in terms of the overall economic scenario, production in the manufacturing sector in Germany is expected to fall by roughly 10%-15% in real terms in 2020 because of the Covid-19,according to Deutsche Bank. Having said this, industrial production could rise by more than 10% in real terms on average over 2021. Deutsche Bank reports that overall, they anticipate "a risk that Germany may become less attractive as an industrial location over the coming years"[8].

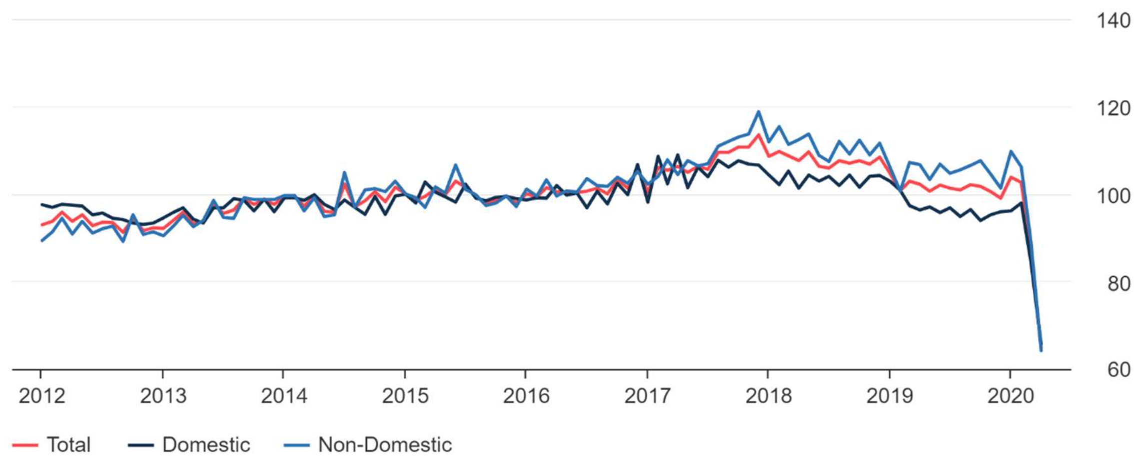



Figure 7: Index of new orders in manufacturing (Volume index 2015 = 100; seasonally and calendar adjusted)
*Source: Federal Statistical Office of Germany (Destatis)*

In fact, it should be noted that production activity in the manufacturing sector hit a record high in Germany in 2018. The ability of the industrial sector to once again match or exceed this production volume, and the speed at which it is able to do so, depends on structural location factors that are influenced by policy decisions. Ahead of the pandemic, there were signs of a potential recovery in German industrial activity after six quarters of recession. Order intake stabilised in Q2 2019, and the downtrend in the order backlog had slowed. Business expectations were improving from their low in September, and capacity utilisation rose for the first time in 2 years, at the beginning of 2020. Without concerted efforts to tackle the location-specific structural problems, manufacturing could see a sustained period of weakness in Germany following the pandemic. While the industry still plays a more important role in the German economy than in the EU average (in 2019, its share in total value added amounted to 15.6%) or other individual EU countries, the downtrend over the past three years (prior to the Coronavirus) is an alarming signal.

7 GTAI. (2020, April 20). Logistics in Germany Rises to Covid-19. Retrieved from GTAI: https://www.gtai.de/gtai-en/invest/industries/logistics/logistics-in-germany-rises-to-covid-19-241280

8 Heymann, E. (2020), German industry – Coronavirus crisis distracts from structural problems. Frankfurt: Deutsche Bank

## 4.2 Trade Finance and Merchant Banking

Trade financing (also known as supply chain and export finance) is a major driver of economic development and helps maintain the flow of credit in supply chains. It is predicted that 80-90% of global trade is reliant on trade and supply chain finance, and is estimated to be worth around USD $10 trillion a year[9].

Trade finance is the financing of international trade flows, whereby an entity acts as an intermediary between importers and exporters to mitigate the risks involved in the transaction, and enhance working capital efficiency in business. According to Allied Market Research, the global trade finance market was valued at $39,714.2 million in 2018 and is expected to reach $56,065.7 million by 2026, registering a CAGR of 3.79% from 2019 to 2026. They also report that banks were the main intermediary which generated most revenue in this sector and expect them to keep doing so in the foreseeable future, owing to the fact that banks accelerate trade finance processes by transforming paper-based methods to more efficient and transparent digitized models[10].

According to the International Chamber of Commerce (ICC), default rates between 2008 and 2018 across all trade finance products and regions were low, averaging 0.37% for import letters of credit, 0.05% for export letters of credit, 0.76% for import and export loans and 0.47% for performance guarantees. On the other hand, whilst trade finance has built momentum as a safe and solid asset class over the last few years it is expected to become riskier as default rates inevitably rise due to the Covid pandemic, says Naveed Sultan, global head of treasury and trade solutions at Citi[11].

In terms of wider structural aspects, as per a study in September 2019 by Kim, Beck, Tayag and Latoja[12], the estimated global trade finance gap is large but stable at $1.5 trillion. Despite trade finance transactions being considered a reliable and low-risk asset class, supply has not been sufficient to meet demand. The 2019 ADB Trade Finance Gaps, Growth, and Jobs Survey shows that 76% of surveyed banks highlighted the requirements on anti-money laundering and KYC as the largest barrier to expanding trade finance operations. This was followed by high transaction costs and/ or low fee income, low credit ratings for the country where a firm is located and low credit ratings of banks in developing countries where they act as intermediaries for trade. The results of this survey are shown in the figure below:

[9] Trade Finance Global. (2020, June 04). Trade Finance - At the Forefront of Global Trade. Retrieved from Trade Finance Global: https://www.tradefinanceglobal.com/trade-finance/

[10] Allied Market Research. (2019). Trade Finance Market by Product Type, service providers, and end user: global opportunity analysis and industry forecasts, 2019-2026. Allied Market Research.

[11] Saigal, K. (2020, March 26). Trade finance default rates expected to rise with Covid-19 disruption. Retrieved from Euromoney: https://www.euromoney.com/article/b1kxt05mkrgpzj/trade-finance-default-rates-expected-to-rise-with-covid-19-disruption

[12] Kijin, K., Steven, B., Tayag, M. C., & Latoja, M. C. (2019). 2019 Trade Finance Gaps, Growth,. ADB.


Figure 8: Barriers to trade finance (% of responses)
*Source: 2019 Trade Finance Gaps, Growth and Jobs Survey – Banks; ADB*

# 5 PERFORMANCE AND FINANCIAL POSITION OF THE ISSUER

The Issuer operates as a holding company, which is mainly involved in the holding of subsidiaries that generate diversified sources of income. Merkanti Holding's main activities relate to the acquisition, the holding and sale of property, shares and other assets, the raising of financing, raising of capital, the lending and advancing of funds to Group companies, and the collection of interest income on advances to and management fees from the Subsidiaries. It is therefore relevant to note that the Issuer's operations are not restricted to that of a finance company.

The Issuer's standalone audited financial statements for the financial years ended 31st December 2017, 31st December 2018 and 31st December 2019 have been audited by PricewaterhouseCoopers. This section also includes references to forecast financial statements provided by management for 2020, which are based on certain assumptions. Events and circumstances my differ from expectations, therefore, actual results may vary considerably from projections.

## 5.1 Income Statement

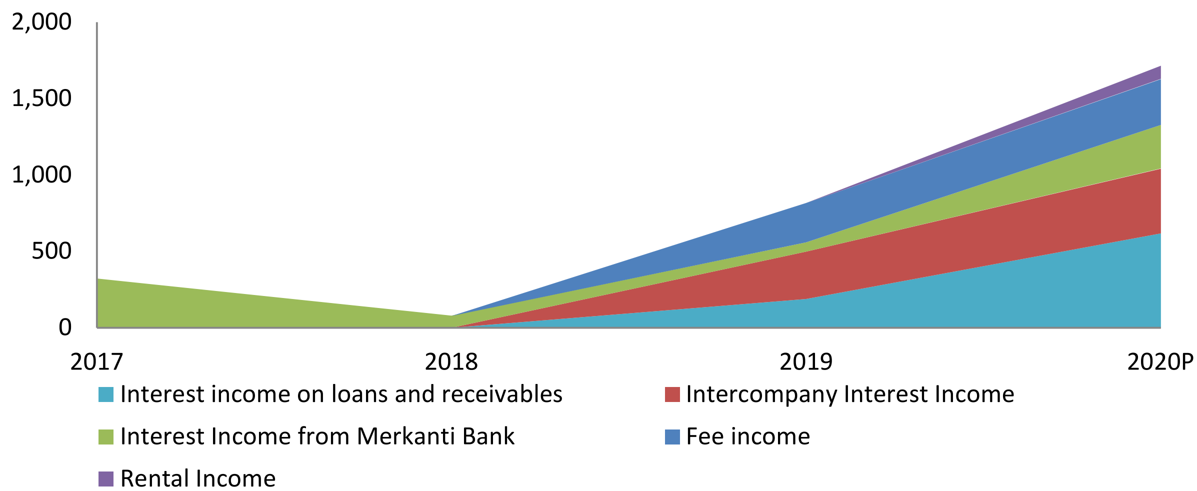
| **Merkanti Holding Plc** *Statement of comprehensive income (€000) - 31 December* | **2017** Actual | **2018** Actual | **2019** Actual | **2019** FAS 2019 | Variance | **2020P** Projected |
|---|---|---|---|---|---|---|
| Interest and similar income | 321 | 78 | 559 | 989 | -43.5% | 1,327 |
| Interest and similar expense | (110) | - | (378) | (707) | 46.5% | (1,149) |
| **Net interest income** | **211** | **78** | **180** | **282** | **-36.0%** | **178** |
| Fee and commission income | - | - | 404 | 300 | 34.7% | 962 |
| Fee and commission expense | - | - | (148) | - | - | (421) |
| **Net fee and commission income** | **-** | **-** | **256** | **300** | **-14.5%** | **542** |
| Other income -rental income | - | - | - | - | - | 88 |
| **Operating income** | **211** | **78** | **437** | **582** | **-25.0%** | **808** |
| Changes in expected credit losses | - | 517 | - | - | - | - |
| Administrative expenses | (250) | (16) | (446) | (246) | -81.4% | (498) |
| **Profit/(loss) before tax** | **(39)** | **578** | **(9)** | **336** | **-102.8%** | **310** |
| Tax expense | (2) | (1) | (1) | (20) | -94.1% | (0) |
| **Profit/(loss) for year** | **(41)** | **578** | **(11)** | **336** | **-103.2%** | **310** |

*Source: Audited accounts of Merkanti Holding plc as at 31 December 2017 to 2019, Management information*

Prior to 2018, the Issuer's main assets consisted solely of its shareholding in the Bank and amounts due from its parent company. The Issuer did not receive any dividends from the Bank and therefore, the only source of income generated between 2016 and 2018 related to interest income generated on the amounts due. The interest expense, on the other hand, related to amounts due by the Issuer to the Bank, which balance was settled following the reduction in the Bank's share capital in February 2017.

During 2019, net interest income amounted to €0.3million (+131%). Interest income was generated on receivables from the ultimate parent company amounting to €0.3million, relating to a revolving credit facility of €5.1million being charged an interest rate of 6%, and on receivables from the Subsidiaries equal to €0.3million. In turn, the income on the receivables from the Subsidiaries consists of interest receivable on loans to the Property Companies and on the subordinated Tier 2 loan to Merkanti Bank, bearing interest rates of 6.5% and 4.0% respectively.

Interest expenses amounted to €0.4million, with the main interest expense being the interest payable on the Bond. Net fee and commission income during 2019 amounted to €0.3million, driven by fees on merchant banking services. Operating income increased to €0.4million (2018: €0.1million), generally reflecting the overall increase in scope of operations of the Issuer following the corporate restructuring and the Bond Issue.




*Source: Audited Financial Statements of Merkanti Holdings plc 2017-2019, Curmi & Partners Ltd*

Administrative expenses increased substantially in 2019 to €0.5million (2018: €17k). The majority of such expenses related to professional fees, with management noting that these amounts include a one off-fee paid to the Bank and certain bond issue expenses that were not capitalised. The rise in administrative expenses was the prime factor driving the loss for the year of €11k.

The main variances from the 2019 Financial Analysis Summary ("2019 FAS") are related mainly to timing considerations. Both actual interest receivable and payable estimates were based on a shorter time period compared to the forecasts in the 2019 FAS.

Management notes that the interest rate on the Tier 2 loan advanced by Merkanti Holding to Merkanti Bank is bearing an interest rate of 5% as per relevant underlying subordinated loan agreement, and that the marginal amount receivable derived from the variance between 4.0% and 5.0% applicable for the latter months of 2019, will be reflected in the current financial year.

Additionally, whilst merchant banking fees that drove fee and commission income for 2019 were not included in the original forecasts, management fee agreements between Merkanti Holding and the Property Companies are applicable as from 2020. Administrative expenses at the standalone issuer level were higher than expected, due to the one-off costs mentioned above.

Net interest income is projected to amount to €0.2million in 2020, reflecting mainly a full year of interest receivable on the advances from the Issuer to the Subsidiaries and to the parent company, and the interest payable on the outstanding Bond. The Company expects to generate net fees and commissions amounting to €0.5million.

Administrative expenses are expected to increase by 106% to €0.9million, which includes higher fee expenses expected to support the projected increase in fee income, in addition to higher depreciation expenses relating to right of use assets and the fees that will be paid out to A.I.M, the property management entity. Profit for the year is projected to increase to €0.3million.

## 5.2 Statement of Cash flows

| **Merkanti Holding Plc**<br>*Statement of cash flows (€000) - 31 December* | **2017**<br>Actual | **2018**<br>Actual | **2019**<br>Actual | **2019**<br>FAS 2019 | Variance | **2020**<br>Projected |
|---|---|---|---|---|---|---|
| Net cash generated from operating activities | (0) | (0) | (1,436) | 1,082 | -232.7% | 60 |
| Net cash used in investing activities | - | - | (17,769) | (24,500) | -27.5% | 3,600 |
| Net cash used in financing activities | - | - | 24,258 | 24,513 | -1.0% | 1,082 |
| Net movement in cash and cash equivalents | (0) | (0) | 5,054 | 1,094 | 361.9% | 4,743 |
| Cash and cash equivalents at beginning of year | 0 | 0 | 0 | 0 | - | 5,054 |
| Cash and cash equivalents at end of year | 0 | - | 5,054 | 1,094 | 361.9% | 9,797 |

*Source: Audited accounts of Merkanti Holding plc as at 31 December 2017 to 2019, Management information*

Prior to 2018 the Issuer's cash flows reflected its limited trading activities. The Issuer previously prepared financial statements in accordance with the General Accounting Principles for Small and Medium Enterprises Rules, and therefore, were not required to issue cash flow statements.

In 2019, cash inflows were driven by the bond proceeds, amounting to €24.3million (net of issue costs). Cash outflows primarily include the advances to subsidiaries of €14.0million in addition to the acquisition of the additional 9.9% stakes in each of the Property Companies, which amounted to €3.6million. Net cash used in operating activities amounted to €1.4million, compared to the expected cash inflow of €1.1million, with this variance relating to the higher than expected administrative costs and increases in receivables. Cash and cash equivalents as at the end of 2019 amounted to €5.1million, with this amount including the deposits (loans and advances with a contractual maturity of three months or less) placed by Merkanti Holding at the Bank.

When compared to the projections provided in the 2019 FAS, the major variance, excluding variances related to solely to classification of the deposits in financial statements, relates to the utilisation of cash for investing purposes. Investing activities during 2019 include an outlay of €3.6million relating to the acquisition of additional stakes in the Property Companies. On the other hand, as at 31st December 2019, the balances deposited by the Issuer at the Bank are lower than indicated in the 2019 FAS projections.

Net cash generated from operating activities during 2020 is expected to amount to €0.06million, whilst financing inflows are expected to be driven by balances deposited by related parties at Merkanti Holding.

## 5.3 Statement of Financial Position

| **Merkanti Holding Plc** Statement of financial position (€000) - 31 December | **2017** Actual | **2018** Actual | **2019** Actual | **2019** FAS 2019 | Variance | **2020** Projected |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Non-current assets | | | | | | |
| Investments in subsidiary/ subsidiaries | 17,241 | 46,723 | 50,369 | 46,723 | 7.8% | 50,369 |
| Other receivables | 35,075 | 5,472 | 20,015 | 15,972 | 33.7% | 16,385 |
| Deposits with Merkanti Bank | - | - | - | 7,500 | -100% | - |
| Property, Plant & Equipment | - | - | 121 | - | - | 96 |
| Right of use assets | - | - | 651 | - | - | 520 |
| Allowance for credit losses | - | - | - | - | - | 330 |
| Total Non-current assets | 52,316 | 52,195 | 71,156 | 69,195 | 2.8% | 67,699 |
| | | | | | | |
| Current Assets | | | | | | |
| Deposits with Merkanti Bank | - | - | - | 7,500 | -100.0% | - |
| Accrued income and other assets | - | 97 | 1,407 | - | - | 348 |
| Loans and advances to banks | - | - | 5,054 | 1,094 | 361.9% | 9,797 |
| Cash and cash equivalents | 0 | - | - | - | - | - |
| Total Current Assets | 0 | 97 | 6,461 | 8,594 | -24.8% | 6,544 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total Assets | 52,316 | 52,292 | 77,617 | 77,789 | -0.2% | 77,844 |
| **EQUITY AND LIABILITIES** | | | | | | |
| Capital and Reserves | | | | | | |
| Issued Capital | 50,000 | 50,000 | 50,000 | 50,000 | 0.0% | 50,000 |
| Retained earnings and other reserves | 2,291 | 2,253 | 2,243 | 2,569 | -12.7% | 2,552 |
| Total Equity | 52,291 | 52,253 | 52,243 | 52,569 | -0.6% | 52,552 |
| Non-current liabilities | | | | | | |
| Bonds in issue | - | - | 24,287 | 24,553 | -1.1% | 24,381 |
| Total non-current liabilities | - | - | 24,287 | 24,553 | -1.1% | 24,381 |
| Current liabilities | | | | | | |
| Accrued Interest - Bond | - | 18 | 333 | 667 | -50.0% | 333 |
| Borrowings | 14 | - | - | - | - | - |
| Trade and other payables | 10 | 18 | 101 | - | - | 5 |
| Current tax liability | 2 | 2 | - | - | - | 11 |
| Other liabilities | - | - | - | - | - | 16 |
| Lease liabilities | - | - | 653 | - | - | 545 |
| Total current liabilities | 25 | 38 | 1,087 | 667 | 63% | 911 |
| Total liabilities | 25 | 38 | 25,374 | 25,220 | 0.6% | 25,291 |
| Total equity and liabilities | 51,316 | 52,292 | 77,617 | 77,789 | -0.2% | 77,844 |

*Source: Audited accounts of Merkanti Holding plc as at 31 December 2017 to 2019, Management information*

Total assets of the Company amounted to €77.6million (+48%) as at 31st December 2019, reflecting expansion of the group driven by the Bond Issue. Investments in subsidiaries, totalling €50.4million, remains the major asset of the Company, in line with the business model of Merkanti Holding to operate as a holding company.

During 2019, receivables increased by €14.5million to €20million, reflecting the loans to the Property Companies, the subordinated Tier 2 loan to the Bank, and the deposits held at the Bank, utilising the monies from the Bond Issue. Receivables also include a revolving credit facility granted to Scully Royalty amounting to €5.1million, which is subject to an interest rate of 6%, and a loan made to the same company amounting to €1.0million, which is interest-free and repayable on demand.

Total assets were slightly higher than projected, mainly due to the additional shareholding invested in the subsidiaries. Whilst the amounts deposited by Merkanti Holding at Merkanti Bank were lower than expected as at 31st December 2019, management notes that during 2020 such balances are expected to amount to circa €10million. Merkanti Holding is currently finalizing a transaction with Merkanti Bank which will generate additional cash proceeds at Merkanti Holding of €3.6million which it will then deposit at the bank. Management indicates that this will have the net impact of Merkanti Holding having acquired the increased holdings in the subsidiaries whilst maintaining the target amount of deposits.

With respect to funding, as at end of 2019 total liabilities amounted to €25.4million, consisting primarily of borrowings related to the Bond Issue, with total equity at €52.2million. Such amounts are expected to remain relatively unchanged during 2020.

## 5.4 Evaluation of Performance and Financial Position

| **Merkanti Holding Plc**<br>*Key Ratios* | **2017**<br>Actual | **2018**<br>Actual | **2019**<br>Actual | **2019**<br>FAS 2019 | **2020P**<br>Projected |
|---|---|---|---|---|---|
| Operating Income Margin<br>(Operating Income / Revenue) | 66% | 100% | 45% | 45% | 54% |
| Profit Margin<br>(Profit for the year / Revenue) | -12% | 745% | -1% | 26% | 14% |
| Interest Coverage<br>(Operating Income before interest expense / Interest Payable) | 0.6x | N/A | 1.0x | 1.5x | 2.1x |
| Return on Assets<br>(Operating Income / Average Total Assets) | -0.1% | 0.1% | 0.0% | 0.5% | 1.6% |
| Return on Capital Employed<br>(Operating Income / Average Capital Employed) | -0.1% | 0.1% | 0.0% | 0.5% | 1.6% |
| Return on Equity<br>(Profit for the year / Average Total Equity) | -0.1% | 1.1% | 0.0% | 0.6% | 0.6% |
| Debt-to-Total Capital<br>(Borrowings / {Total Equity + Borrowings}) | 0.0% | 0.0% | 31.7% | 31.8% | 31.7% |

*Source: Audited accounts of Merkanti Holding plc as at 31 December 2017 to 2019, Management information, Curmi & Partners Ltd*

The Issuer is a diversified holding company, with subsidiaries operating in the banking and industrial real estate sectors. Prior to the Bond Issue, Merkanti Holding generated income solely on interest earned on amounts owed by related parties. However, after the Bond Issue, the Issuer benefits from a diversified income stream on the bases of an enhanced asset base.

Whilst in 2019 the largest component of interest income was derived from the revolving credit facility to the Parent (reflecting a full year period), going forward the Issuer is expected to continue generating interest income from the loans advanced to subsidiaries, via the proceeds of the Bond. The Issuer will also receive management and potentially merchant banking fees.

The operating income margin[13], at 45%, was in line with projections in the 2019 FAS. The decline over 2018 reflects the lack of interest or fee expenses during the previous year. Interest cover was at at 1.0x in FY2019. Overall, interest cover was slightly lower during 2019 than projected mainly because of the higher than expected administrative expenses. The proportionately higher interest income receivable and the contractual management fees receivable, in addition to the moderation in administrative expenses, are expected to contribute to enhancing the Issuer's profitability going forward.

Capital employed is very similar to average total assets given that current liabilities only include accrued interest and lease liabilities totalling circa €1million in 2019. Return on Assets, return on capital employed and return on equity declined, reflecting the lower level of profit for the year (in turn driven mainly by the higher administrative expenses).

Debt-to-total capital, or gearing, was in line with expectations, at 31.7%, reflecting the Bond borrowings. Gearing is expected to decline moderately over the years as a result of year-on-year increases in the Issuer's retained earnings and due to amortizing bond issue costs.

With respect to the underlying assets, the Group's management expects the Property Companies to continue to generate stable rental income benefiting from the attractiveness of the region and the industrial real estate sector, and that the property valuations will remain relatively stable over business cycles. Management notes that as yet the economic challenges related to COVID-19 have not had an evident impact, in terms of late payments or similar adverse developments. However, it is acknowledged that a few of the tenants could possibly be impacted over the longer term.

Merkanti Bank's operations remained subdued during 2019, with the Bank ending last year with substantial amounts of liquidity. However, management notes that it expects to be able to benefit from potential opportunity in the coming periods, both in merchant banking and trade finance. At the core level of the Issuer, the financial profile is expected to remain relatively stable, driven by income streams that benefit from relatively strong visibility.

[13] Operating income / (Interest income + Fee income)

# 6 COMPARABLES

The table below provides an indication of the relative financial performance and debt servicing capability of the Issuer. The credit metrics of the Issuer are hereby compared to those of a selection of finance companies, that in this respect could be considered to have a similarly relatively stable earnings profile. The ratios indicated below are calculated using the audited financial statements for FY 2019 of each respective company.

| Issuer/ Group | Gearing | Interest Coverage* |
|---|---|---|
| **Merkanti Holdings** | 31.74% | 0.98x |
| **Exalco Finance** | 98.17% | 1.06x |
| **Eden Finance (2018)** | 96.19% | 1.01x |
| **Dizz Finance (2018)** | 69.61% | 1.85x |
| **United Finance (2018)** | 60.83% | 1.33x |
| **Tumas Investments (2018)** | 98.73% | 0.99x |
| **AX Investments (2018)** | 67.34% | 1.22x |

**In order to estimate the ability to service the borrowings, interest coverage is estimated as the ratio of financial income (after adjusting for administrative expenses) to interest payable.*
*Source: Exalco Finance plc Audited Financial Statements 2019, Eden Finance plc Audited Financial Statements 2019, Dizz Finance plc Audited Financial Statements 2019, United Finance plc Audited Financial Statements 2019, Tumas Investments plc Audited Financial Statements 2019, AX Investments plc Audited Financial Statements 2019*

The table below compares a selection of ratios of Merkanti Holding to a selection of issuers which have issued bonds similarly secured by property. One should note that there is still a variance in the operations of these companies and that of the Issuer, due to the nature and location of the underlying property. Furthermore, certain differences include characteristics of the specific debt instruments.

| Issuer/ Group | Gearing | Interest Coverage |
|---|---|---|
| **Merkanti Holdings** | 31.8% | 0.98x |
| **Medserv** | 78.94% | 2.23x |
| **Gap** | 84.98% | 1.76x |
| **Hili Properties** | 58.70% | 1.59x |
| **Pendergardens Developments** | 59.33% | 3.52x |
| **International Hotel Investments** | 39.78% | 2.98x |
| **MIDI** | 36.36% | 4.83x |

*Source: International Hotel Investments Audited Financial Statements 2019, Pendergardens Developments plc Audited Financial Statements 2019, MIDI Plc Audited Financial Statements 2019, Medserv plc Audited Financial Statements 2019, GAP Group plc Audited Financial Statements 2019, Hili Properties plc Audited Financial Statements 2019*

# 7 GLOSSARY

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|---|---|
| Cash flow from financing activities | Cash flows from financing activities shows the cash inflows and outflows related to financing transactions with providers of funding, owners and the creditors. |
| Cash flow from investing activities | Cash flows from investing activities reflect the change in cash position resulting from investments and divestments. |
| Cash flow from operating activities | Cash flow from operating activities illustrates the cash-generating abilities of a company's core activities, and includes cash inflows and outflows that are related to operating activities. |
| Current assets | Current assets are all assets that are realisable within one year from the statement of financial position date. Such amounts include trade receivables, inventory, cash and bank balances. |
| Current liabilities | Current liabilities are liabilities payable within a period of one year from the statement of financial position date, and include trade payables and short-term borrowings. |
| EBITDA | Earnings before interest, tax, depreciation and amortisation (EBITDA) is a measure of operating profitability. It excludes depreciation and amortisation, and is viewed as measure of a company's core profitability and cash generating ability. |
| | |
| Non-current assets | Non-current assets are long-term investments, the full value of which will not be realised within the accounting year. |
| Non-current liabilities | Long-term financial obligations or borrowings that are not due within the present accounting year. Non-current liabilities include long-term borrowings, bonds and long-term lease obligations. |
| Total Equity | Total equity includes share capital, reserves, retained earnings and minority interests. It relates to the capital and reserves that are attributable to owners of the company. |
| Financial Ratios | |

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|---|---|
| Current ratio | The current ratio measures the ability to pay short term debts over the next 12 months. It compares a company's current assets to its current liabilities. |
| Debt to total capital ratio | The Issuer's interest-bearing borrowings divided by the Issuer's total capital, with total capital being the sum of interest-bearing borrowings plus total equity. |
| EBITDA Margin | Similarly to operating margin, EBITDA margin is a measure of profitability that measures the proportion of revenue that is left over after paying for all costs of production incurred in ordinary operations. |
| Gearing or leverage ratio | The gearing or leverage ratio indicates the relative proportion of borrowings and equity used to finance a company's assets. It is estimated by dividing total borrowings by total borrowings plus total equity, or as the ratio of total borrowings to total equity. |
| Gross Profit Margin | Gross profit margin is the ratio of gross profit to revenue. It is the percentage by which gross profits exceed cost of sales, and is a measure of profitability at the most fundamental level. |
| Interest Cover ratio | The Issuer's operating income divided by the Issuer's interest expenses for the same period. |
| Net Profit Margin | Net profit margin is the ratio of profit for the period to revenues, and is a measure of how much of revenues is converted into bottom line profits. |
| Operating Income Margin | Operating margin is a measure of profitability that measures the proportion of revenue that is left over after paying for all costs of production incurred in ordinary operations. |
| Quick ratio | Similar to the current ratio, the quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets. It excludes inventories from current assets. |
| Return on Assets (ROA) | Return on assets is the ratio of profit for the period or operating income to average total assets for the period. It measures efficiency in using its assets to generate income. |

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|---|---|
| Return on Capital Employed (ROCE) | This ratio measures efficiency in generating income but takes into consideration the sources of financing. Profit for the period or operating profit or operating income is divided by the capital employed (fixed assets plus working capital or total assets less current liabilities) |
| Return on Equity (ROE) | Measures the profitability in terms of how much profit is generated in relation to owners' investment. |