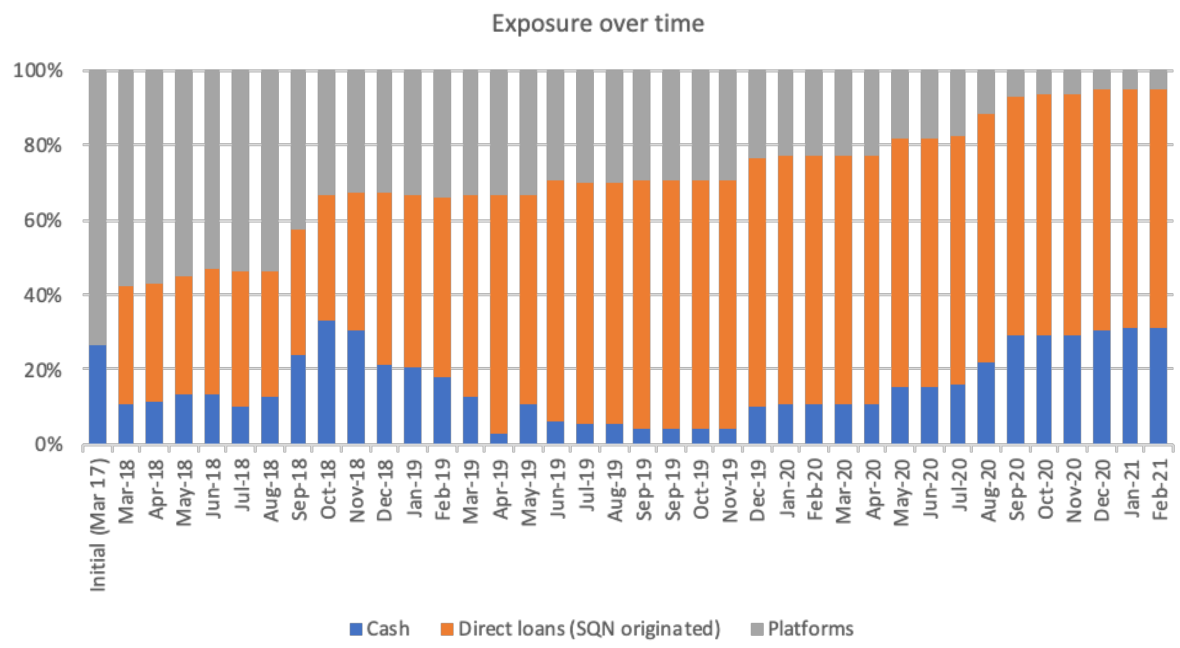
Investment Update – 7th October 2019

Ahead of the release of our full year financial report, we consider it a good time to release a broad and detailed investment update.

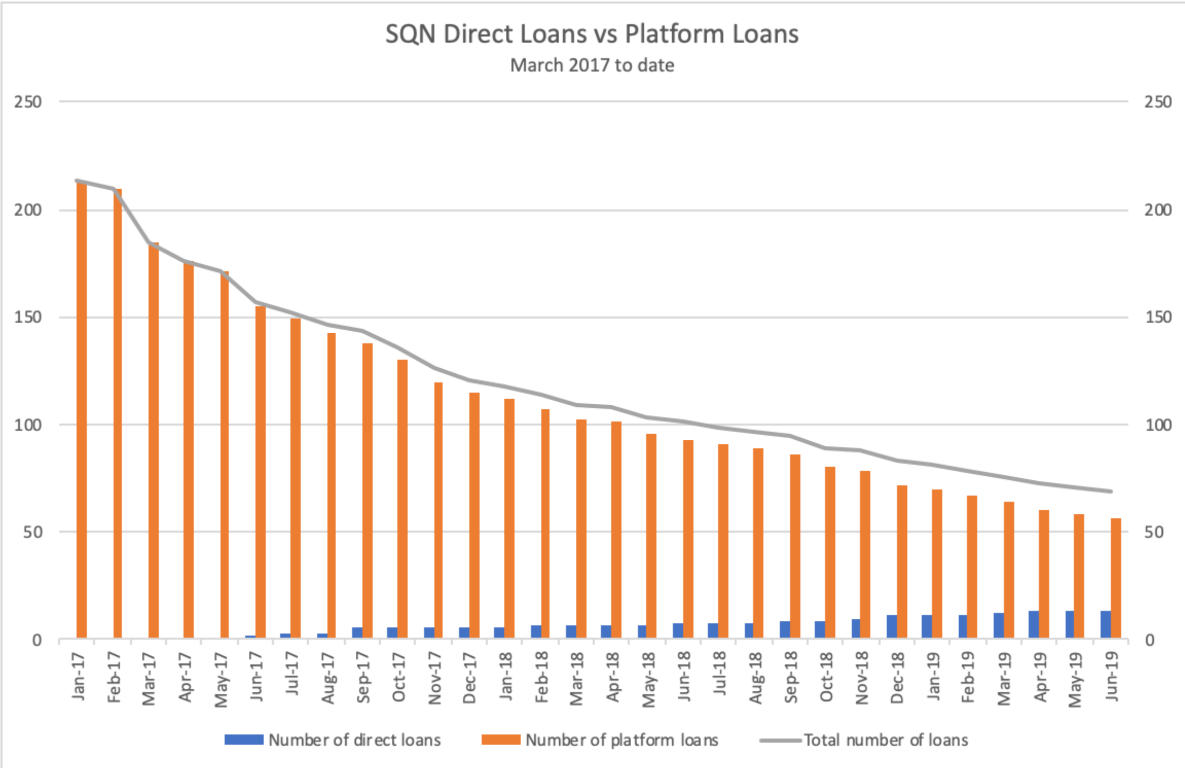
- Direct Loans represent 67.32% of the portfolio and have a gross yield of 10.9%
- Third party debt now represents 28.2% of total assets
- Peer to peer lending is at the lowest since SQN assumed management at 7%
- Dividend cover has doubled since SQN took over management rising from 0.52 in March 2017 to 1.01 in August 2019.
- IFRS 9 forward looking provisioning to rise as rump assets diminish in overall value.
- Proposals for the future of the Company are under review by the Board and we are conducting test marketing with Shareholders on options.

We are pleased to report continued steady progress in delivering a 7p per share dividend and have been able to deliver a stable NAV performance to date. This steady state belies an awful lot of work that has been done to invest a higher allocation to traditional underwriting and stabilisation of the legacy portfolio inherited from the previous management in April 2017.



		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total from 2017
NAV total return	2017	0.38%	0.33%	0.43%	0.26%	0.38%	0.14%	0.76%	0.34%	0.44%	-0.12%	0.64%	0.83%	
	2018	0.34%	0.27%	0.58%	0.47%	0.48%	0.39%	0.48%	0.28%	0.52%	0.33%	0.34%	1.38%	**11.67%**
	2019	0.44%	0.46%	0.44%	0.51%	0.44%	-1.32%							
Dividend per share	2017	0.600p	0.600p	0.600p	0.600p	0.676p	0.525p	0.525p	0.525p	0.525p	0.525p	0.525p	0.525p	
	2018	0.525p	0.525p	0.525p	0.525p	0.525p	0.525p	0.525p	0.525p	0.583p	0.583p	0.583p	0.583p	**17.95p**
	2019	0.583p	0.583p	0.583p	0.583p	0.583p	0.583p							
Share price performance*	2017	-0.27%	-2.41%	6.32%	1.55%	-0.51%	0.00%	-0.51%	0.00%	-0.77%	-0.78%	-0.26%	-1.96%	
	2018	-1.20%	0.00%	-1.62%	2.47%	-1.88%	0.00%	-0.82%	-1.10%	0.28%	1.11%	1.37%	0.00%	**-1.26%**
	2019	-0.27%	0.00%	-0.27%	-0.27%	0.55%	0.00%							

Source: Bloomberg
Data in italics subject to revision.



Source: SQN

The following table shows the breakdown of total exposure to specific loan types:

30/06/2019	Number of loans	Weight (%)		Total Value (£)	Average size (£)	Max size (£)		Min size (£)	Average term (years)	Max term (years)	Min term (years)	Average coupon (%)	Max coupon (%)	Min coupon (%)
Cash		6.95%	£	3,550,009										
Direct loans (SQN originated)	13	64.76%	£	33,098,053	£ 2,546,004	£ 10,000,000	£	184,889	2.34	6.72	0.08	10.9%	12.0%	10.0%
Direct loans in UK	11	57.44%	£	29,358,520	£ 2,668,956	£ 10,000,000	£	184,889	1.89	4.48	0.08	11.1%	12.0%	10.0%
Direct loans in Europe	2	7.32%	£	3,739,533	£ 1,869,767	£ 3,186,744	£	552,790	4.84	6.72	2.96	10.0%	10.0%	10.0%
UK Venture Debt Platform	1	16.28%	£	8,322,248	£ 8,322,248	£ 8,322,248	£	8,322,248	6.43	6.43	6.43	10.0%	10.0%	10.0%
European Real Estate Platform	1	1.96%	£	1,000,000	£ 1,000,000	£ 1,000,000	£	1,000,000	0.09	0.09	0.09	12.0%	12.0%	12.0%
UK Peer to Peer Platform	33	0.98%	£	965,419	£ 29,255	£ 373,047	£	80	0.83	2.11	0.05	11.2%	13.0%	9.0%
US Peer to Peer Platform	2	5.43%	£	2,775,330	£ 1,387,665	£ 2,263,358	£	511,972	1.09	1.09	1.09	8.5%	9.0%	8.0%
UK Small Company Venture Debt Platform	7	3.03%	£	1,654,210	£ 236,316	£ 804,000	£	44,500	0.79	1.17	0.30	9.6%	11.0%	8.8%
Spanish Peer to Peer Platform	12	0.61%	£	410,166	£ 34,181	£ 152,541	£	329	1.11	4.95	0.74	7.6%	11.0%	3.0%

Source SQN

The Company has successfully reduced peer to peer lending to only 7% of the portfolio value and has reduced overall legacy loan exposure to £14.9m. This continues to fall and will be accelerated by the run-off of our single biggest position in a co-invested venture debt book where we have started to receive larger cash sums as debt is refinanced by borrowers. At present, impairment data remains very low under IFRS 9 provisions, however we do expect the impairment provision related to the peer to peer segment of the portfolio to rise by circa 2.5% as we have reassessed the risks associated with this rump exposure and a fuller analysis of this follows the review of the portfolio below.

These positive developments for the portfolio have been achieved without the use of leverage for investment or working capital purposes. With Brexit uncertainty remaining a core theme for investors, we have analysed our direct loans and are comfortable that we have suitable downside protection embedded within the portfolio to sustain the portfolio through any impact of a recession in the UK and mainland Europe. By contrast, the legacy peer to peer segment of the portfolio remains a challenge.

Given the nature of the investments and the less predictable nature of repayments from legacy positions, we continue to see this as a challenge regarding timing of reinvestments. Despite this, we have paid close attention to delivering a covered dividend and can confirm that this is now stable, with the expectation that it will remain so for the next year. We have provided a review of progress below and compares favourably to the position as at March 2017 when dividend cover was 0.52 when compared to the position today where dividend cover stands at 1.01:

	Gross Portfolio Yield	Portfolio Yield including projected pipeline investments	Dividend Cover	Portfolio Cash %
August 2018	10.07%	10.07%	0.78	12.55%
September 2018	8.54%	8.54%	0.82	23.65%
October 2018	7.26%	7.63%	0.65	32.95%
November 2018	7.64%	9.35%	0.72	30.25%
December 2018	8.52%	9.28%	0.73	21.29%
January 2019	8.55%	9.32%	0.79	20.62%
February 2019	8.75%	9.52%	0.84	17.89%
March 2019	9.23%	9.62%	0.81	12.64%
April 2019	10.41%	10.50%	0.84	2.22%
May 2019	10.46%	10.80%	0.97	5.76%
June 2019	10.38%	10.84%	0.82	6.42%
July 2019	9.76%	9.76%	0.92	5.24%
August 2019	9.77%	9.77%	1.01	5.22%

Source: SQN

Portfolio Update

We are focussed on underwriting of the highest quality in the lower middle market segment of the market with thirteen loans now underwritten by SQN, with an average of £2.6m deployed per loan and at an average interest rate of 10.9%. Each loan has bespoke legal documentation and is designed to fit to the Company's and the borrower's requirements. There have been no late or missed payments in this portion of the portfolio and our covenant monitoring data is up to date. The outlook for the performance of these loans remains very good.

As reflected on our fact sheets published each month, we made a change to the way in which we categorise the legacy portfolio. We have differentiated between peer to peer loans and those that are held in Loan Note structures with professional counterparties. These latter loans are larger in quantum and we have a closer relationship with the underlying management companies. The total number of loans via third parties have been reduced from 213 to 55 with a small number of loans amortising out of the portfolio each month.

All non-Sterling capital and income continues to be fully hedged. Fluctuations in the value of Sterling during the reporting period has made for some significant moves in the cost of this hedging and this has been mitigated by reducing brokerage costs and careful monitoring of timing of hedge rolls.

Risk Management

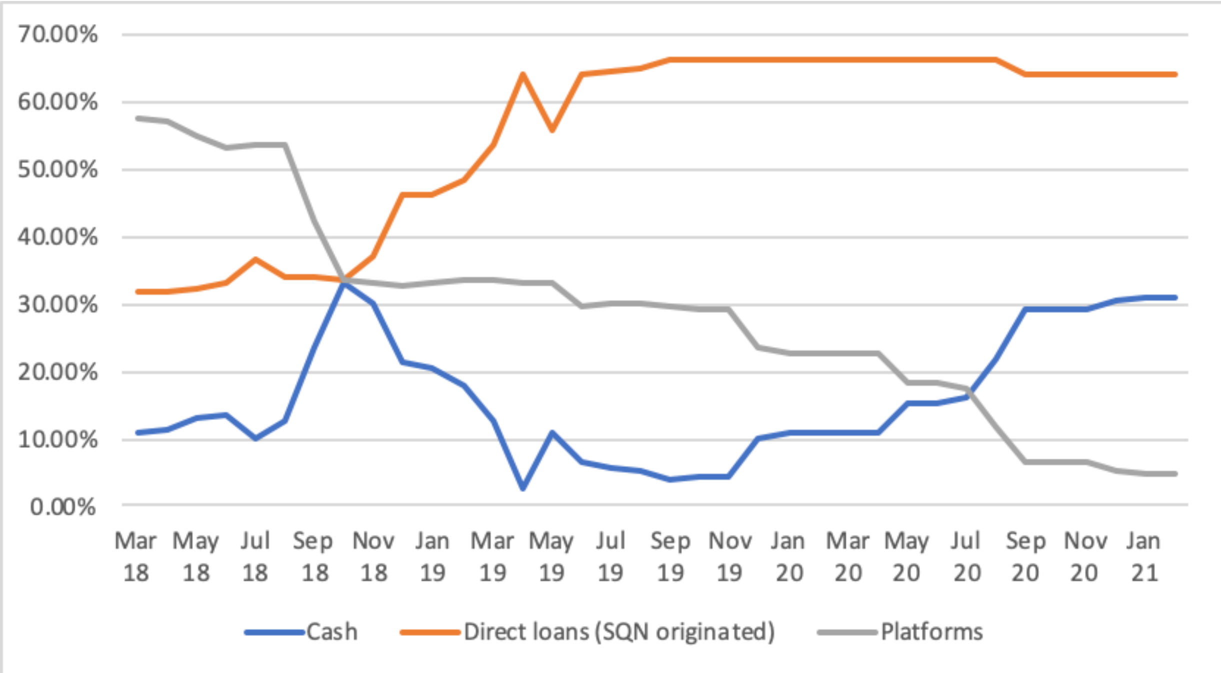
Brexit continues to dominate the investment landscape as delay in the exit of the UK from the European Union was extended from March 2019 to October 2019 and potentially beyond. We have considered the risk associated with our current and future investments with great care and have approached this work from four directions: underwriting, currency, interest rates and duration.

- Underwriting is stress tested for a 10% fall in cash flows with little impact. Our loans are senior, collateralised and we focus on debt service ratios. We use bespoke legal structures allowing us to take control of bank accounts in extremis. Covenants remain in keeping with expectations but as a lender of over two decades experience, we have never seen a default result from a non-financial breached covenant; cash management is the prerequisite factor we consider.

- All non-Sterling currency exposures are hedged. The Company has a Sterling base and Shareholders should expect to be hedged against adverse movements and we have fulfilled this requirement.

- All loans are fixed rate and our borrowers have a low sensitivity to interest rate movements. The overall portfolio has no gearing at the fund level.

- As a fixed income manager, Shareholders should expect us to monitor duration regularly. We have made great efforts to reduce duration and this has been successful. The single biggest duration contributor is our investment with a UK venture debt platform where we invested via a Loan Note structure with a nine year investment period. However, as this fund is now in run-off, we expect the weighted average duration of the portfolio to diminish further over the coming year. As demonstrated in the graph below, when the maturity of these loans is taken into account the maturity profile improves significantly.



Source: SQN

SQN Underwritten Direct Loans

The following provides a narrative relating to some of our direct loan investments. Names of counterparties have been omitted for commercial and business sensitive reasons for our borrowers. All borrowers are up to date with capital and interest payments and all interest and capital has been paid in accordance with our loan agreements.

- ***Medical Services Provider in UK*** – the business is well managed and provides an essential medical service to the NHS and private practices in London and the north of England. Patient numbers weakened for part of the year but the average has met target expectations with Summer 2019 delivering the highest patient treatments since 2017. The business is in a sale process and we have covenants requiring the loan to be repaid in the event of change of control with penalty costs applied.

- ***Wholesale Lending group*** - the business remains stable and has delivered the expected returns to the Company. All loan-to-value investments have remained within their limit and all indicators are "green" status under our monitoring regime. We also receive a quarterly external audit of the performance of the business. There were some management changes during the reporting period that we were concerned about, including a new FD and origination manager, to replace retiring personnel. After a short period, when it became clear that these new hires were not a good cultural fit, the executive management quickly reversed these decisions and reverted to a stable team.

- ***Leasing Group*** – strong performance from a very good management team based in the north of England. SQN provides a facility to fund a number of transactions which are then refinanced via block discounters at cheaper rates.

- ***Laser and LED manufacturer*** – weaker performance compared to last year but this is due to a one off cost of relocation of the entire business from UK to Ireland. We are relaxed as interest and capital is all being repaid on time and that the business has a suitable sales pipeline to meet their debt commitments.

- ***Marine Servicing Company*** – a service company specialising in renewable energy build and maintenance contracts as well as bridge and oil field service maintenance. The company expanded during the reporting period acquiring a significant fleet in the US as this was part of a strategic expansion plan implemented in 2018. They have equity support from a number of infrastructure investors. With this larger asset base and backed by strong and experienced shareholders, this company is well positioned to keep increasing its utilisation rates and to improve its profitability.

- ***Production Financing*** - Pre-sales and tax rebates plus completion insurance make these transactions offer the most balanced of risks for the rate of return and we have added comfort via a cross-collateralisation mechanism across all deals, providing healthy diversification. All assets are performing to expectation and within our monitoring guidelines. We keep a close business relationship with the principals and also advise on SPV structuring and currency hedging.

All in all, this book of loans is performing to expectations and we consider that each company has suitable cash reserves and capacity for growth to sustain even the hardest of economic shock. In volatile times, cash is the prevailing metric by which we judge our exposures. This is quite different to the obsession with strength of covenants that is so often the focus of high yield and leveraged loan investors. This was recently demonstrated when *Wrightbus*, the manufacturer of public transport vehicles, was placed into administration due to cash shortfall despite having a healthy order book.

Legacy portfolio

Co-Investments

As mentioned, SQN decided to reclassify the way in which the legacy portfolio is described. This reflects the specific difference between pure peer to peer, technology platform based lending and three investments that are characterised by professional co-investment alongside the British Business Bank and another counterparty. There has been some significant corporate change for all three of these investments and we provide the following narrative:

UK Venture Debt – two of the three principals of the company resigned during the reporting period. This triggered a clause in the Loan Note agreement that allowed us to take closer control of the process of managing the portfolio. In reality, this means that any investment decision needs to be agreed by shareholders and gives us flexibility in guiding assets therein. The remaining principal remains committed to the successful run-off of the portfolio and has recruited suitable colleagues as replacements. As the portfolio runs off, we will receive cash earlier than the original maturity of the Loan Note, allowing for accelerated reinvestment into traditionally underwritten direct loans.

Irish Venture Debt – this company was transferred to Beach Point Capital, "BPC", a US Private Equity company. We made a decision to follow the manager and reinvest under this new entity. Although we have limited bandwidth to invest in the segment in which BPC specialises, we have a high degree of confidence in their capability to deliver risk managed returns of 10-14%. This investment is now categorised as a direct investment and will not exceed more than 10% of the portfolio.

Small Company Bond Platform was a UK based debt platform for very small businesses requiring circa £1m loans. In October 2018, we noted an alert from the Companies House service that all the original directors had resigned. In December, we received a no-reply notification via email that administration of our investment had transferred to a third party. We have since discovered that the company has now re-emerged as a crypto-currency brokerage. Prior to these events, we had assessed this relationship to be of the highest risk to the portfolio and had engaged in a direct dialogue with all three counterparties with whom we had outstanding loans via the platform and an existing bankruptcy case already impaired within the portfolio where we have a direct relationship with the liquidator. This action proved to be prescient and has ensured that we have been able to negotiate a refinancing of two of the three loans which will both roll-off our loan book in Q4, 2019. The final loan is due to mature in 2020 and we are in direct dialogue with the parent company of the borrower to facilitate early repayment in Q4, 2019. We have also had good interactions with the new administration agent and have been receiving interest and capital payments on all three outstanding loans. The impaired loan involves an investigation of irregular financial accounting, is making slow progress but there is a possibility of recovering some value and we will remain persistent in our endeavour to recoup as much capital as possible for Shareholders despite the platform omitting to include it in the items sent to the administrator. We receive regular reports on progress from the liquidation agents and again, our relationships are helping to maintain momentum.

Despite disappointment at the provision for transitional arrangements from the previous and present owners of this platform, we are pleased to report that further to our careful actions, loan capital has been secured for our Shareholders and we have been able to claw back cash that would have otherwise been impaired.

We classify this segment of the portfolio as less of a risk than peer to peer given the close interaction with borrowers and managers and the quality of the companies underwritten. However, as demonstrated, they are still exposed to unorthodox management standards and changes in focus of parent companies and personnel change which requires us to be vigilant.

Peer to Peer

Throughout SQN's term as manager of this portfolio, we have consistently warned of the risks associated with peer to peer lending and have endeavoured to diminish risk associated with this asset class for our Shareholders. As a reminder, it is our view that weak underwriting standards, volume driven lending and no direct contact with the borrowers makes this sector too volatile for a vehicle associated with senior, secured lending. To this end, it has been our intention and objective to reduce risk exposure to this asset class as quickly as practicable. We assess the probability of repayment on a continuous basis, making impairment adjustments as appropriate. We have continued to mitigate these risks since April 2017 by reducing overall exposure and keeping close relationships with the platform providers.

Having inherited six lending platforms from the previous manager, our strategy has been to divest as rapidly as possible. Since assuming management of the Fund, we have removed three of these investment platforms from the portfolio by selling the exposure or encouraging early repayment. However, as these positions continue to mature corporate change has occurred at the remaining platforms which means they remain a time-consuming challenge. Three such investments remain within the portfolio and we comment on our assessment of these platforms as follows:

UK Peer to Peer lender – the owner changed the name of the platform and merged it with other property-based lending businesses held under their corporate structure. The parent company has stated their intention to withdraw from this segment of the market and is managing a run-off portfolio. We monitor carefully and intervene when we consider them to be too lenient with borrowers. It would be far too easy for an intermediary to write-down debt, allowing borrowers to walk away from their liabilities, leaving not only us but a minority of retail investors with losses. Therefore, we apply maximum pressure to construct manageable repayment plans and, in some cases, liens on property or other assets, allowing for additional recoup of value for our Shareholders.

US Peer to Peer lender – this remains our largest peer to peer investment and although the relationship remains genial, this position is junior in the capital structure of the platform and represents a risk of loan impairment and therefore of write-down. In March 2019, we met with the peer to peer platform owner/founder and agreed an incentive plan for them to work harder on collections and agreed a quarter year for improvement. They informed us that they had written down 100% of this portfolio in their accounts and we found it perplexing given previous reporting although not surprising given that they were in negotiations with a European direct lender owned by a larger retail bank to sell their business and that this portfolio was their first with the senior debt held by an aggressive hedge fund financier. A sale would leave the business in a stronger position financially and give added comfort for the additional promissory note held by the Fund against the parent company, so we do not want to thwart this process by sapping resources.

We also advised the platform owner/ founder that if no improvement was forthcoming, we would take over collections and explained that we have a good track record, together with our partners, in achieving better returns. Our work-out rate for transactions can be demonstrated by our performance in our asset finance strategy and direct loan strategy over the last twenty years.

In June, having observed slow progress, we began a series of meetings to agree plans outlined in the previous quarter. Two executives from SQN visited New York in July and August, to agree a process for the way forward and to have an update on the sale of the business. At the time, they were in the middle of a two stage Due Diligence being conducted by the potential buyer and KPMG. Due to the resource drag for this work, they requested until end August to commence sending files.

At the time of writing, we are waiting for the platform to transfer all borrower files to us. On receipt, we will begin the process of making our own assessment of the probability of recovery and engage with attorneys and collection agencies. Again, this represents a significant resource commitment for SQN and we will remain uncompromising in our pursuit of this endeavour even though it represents a small portion of the overall portfolio. We also intend to engage Valentine & Kebartas, https://valentineandkebartas.com/ who have an aggressive reputation for collections. Given the time that has passed and speed at which information is received, we have decided to impair this platform exposure by 25%. This is a pre-emptive move and takes into account our own assessment of individual loans that are now being managed out by attorneys.

Spanish Peer to Peer lender – this company has now obtained government support for their lending strategy and can offer loans at lower rates than our criteria, so this tranche is in run-off. We have already reflected a significant write-down of these assets in the NAV, so this exposure is now *de minimus* at 0.7% of the Fund's total asset base. However, we have two Spanish speaking colleagues who engage on a bi-weekly basis with them and have a quiet confidence that we will be able to recover some of these write-downs to the benefit of the Company.

Throughout the process of restructuring the Fund's portfolio, the peer to peer exposure has been the biggest test and the greatest draw on resource when compared to the size of the loans and expected return.

IFRS 9

Since July 2018, the Company has adopted an IFRS 9 methodology to provide information regarding forward expectations of impairment. This was a change in the accounting policy whereby loans previously had an impairment assigned to them reflecting current information only. This is a new accounting standard and has been open to interpretation by peers and by other lenders and so we will provide a description of our own methods in this regard in the Company's Report and Accounts for year end June 2019. For now, we shall focus on the changes we have made to the percentage provisioning for the riskier Platform investments in the portfolio.

In July 2018, the Company chose to distinguish between SQN's direct loans and legacy platform loans, making a higher average portfolio provision for legacy positions. The rates of impairment were as follows:

	Probability of Default (Platforms)
Stage 1	2%
Stage 2	15%
Stage 3	25%

As a result of taking the average impairment position for the whole platform segment, the overall IFRS 9 provision dropped from 1.36% to 0.42% as reported in an RNS in July 2018. One year on, we have revisited this approach and have revised the range of provisioning allocated to legacy loans as follows and have now taken account of explicit risks to individual loans:

	Probability of Default (Platforms)
Stage 1	2%
Stage 2	15%-100%
Stage 3	25%-100%

This will mean that Shareholders should expect an increase in the IFRS 9 provisioning made by the manager over the coming months. This increase is solely attributable to the UK and US peer to peer lenders which represent c. 7% of the Fund's asset base.

The reasons for this change are as follows:

- The platforms are no longer underwriting new business and are treating these loans as legacy portfolio positions themselves. This has resulted in a diminished attention to the task of collections resulting in a slower recoup of loan capital.
- As the legacy portfolio becomes a smaller percentage of the total portfolio, the impaired loans will represent a greater proportion in percentage terms of the remainder. Over the past year, the total proportion of the Company's asset base invested in platform loans has reduced from 53.6% to 28.2%.
- There have been some significant changes in ownership and focus of the businesses in the legacy portfolio that has increased risk to the capital deployed.

- One of the platforms was in sale negotiations and was at an advanced stage in Due Diligence that would have meant a stabilisation of the outlook for the assets. This corporate action has now been placed on hold.

So, despite reducing the overall exposure in platforms to 28.2% of the overall portfolio, we consider it prudent to reflect these changes in conditions as they now present themselves and have adopted a methodology that reflects these specific circumstances.

Even with these impairment provisions, dividend cover remains consistent and we have confidence that 8% total return on the portfolio in the medium term is achievable.

Investment Outlook

After a troubled start, SQN assumed management of the Secured Income Fund in April 2017. Since then, the Company has stabilised and is now delivering steady dividend cover and the net asset value has reflected the careful management of direct loans and legacy third party investments. As we consider risks, as demonstrated in our candid assessment above, SQN has carefully managed the relationships with legacy counterparties but as this part of the portfolio matures, it is unsurprising that the remainder will represent a significant challenge.

Without further shareholder capital and without an adjustment to the investment mandate, whilst we will be able to maintain dividend cover it will be a challenge to make further improvements in NAV, nor will we be able to control the potential negative impact of impairments from legacy investments as the owners of these businesses try to walk away from their responsibilities. We have always advised that the best way to manage these risks is to grow the assets to diminish this impact.

Continuation Vote

Current market conditions and legacy exposure to an out-of-favour investment strategy have resulted in the inability to attract substantial new capital into the Company. Under the terms of the prospectus, the Company will be subject to a Continuation Vote in 2020 if it has not reached £250 million in total assets by year end. Given that this is now unlikely, there are three paths forward:

- The Investment Manager would continue running the portfolio with dividend cover at a sustainable level and reinvest run-off proceeds into SQN originated loans that provide steady and low-risk income.

- Secondly, the Board can present investors with a wind down plan that will likely take two or three years to execute with the objective of delivering investors total proceeds as close to NAV as possible less the unavoidable expenses required in the process.

- The third option is for the introduction of a change in strategy, whereby the Investment Manager has made a proposal to the Board, that is being considered, which should return investor capital in a quicker time frame with more certainty in the overall returns and we have embarked on a process of test marketing with existing Shareholders to gauge support for this way forward.

Somerston Shareholding

As investors are aware, the conversion of the SME Loan Fund to the SQN Secured Income Fund was accomplished with cooperation of the largest shareholder, Somerston Group. As part of the take-over and restructuring, Somerston agreed to hold its position while SQN raised additional capital and facilitated greater liquidity for the benefit of all shareholders. SQN is scheduled to meet with Somerston in hopes of reaching a mutually agreeable path forward.

Conclusion

With the continuation vote approaching, we will be engaging with Shareholders to agree a suitable way forward. SQN has a high degree of confidence that it has, not only a structure but, most importantly, an identified new investor base capable of providing liquidity to all investors at attractive levels. SQN believes that it can execute its strategy with the cooperation of our Shareholders and looks forward to this dialogue over the coming weeks. Expectations are that a solution that benefits all parties is likely to come together before the continuation vote.

SQN Asset Management
October 7th, 2019.