Fair and Reasonable opinion: Finbond Group Limited

Preliminary opinion - supporting materials

BDO Corporate Finance
Mary 2017

Strictly private and confidential

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Contents

Executive summary

Introduction and scope

Transaction overview	• Finbond Group Limited ("Finbond" or "Company" or "Group") in an announcement released on the Stock Exchange News Service of the JSE Limited ("JSE") ("SENS") on 07 April 2017, informed holders of ordinary shares with a par value of R0.0001 in the issued share capital of Finbond ("Finbond Shares") ("Finbond Shareholders") that Ithuba Investments LP ("Ithuba"), Protea Asset Management LLC ("Protea Asset"), Conduit Capital Limited ("Conduit Capital") (collectively the "Concert Parties") and Riskowitz Value Fund LP ("RVF" or "Offeror"), have acquired a beneficial interest in Finbond Shares resulting in RVF and its Concert Parties being able to exercise more than 35% of the voting rights attaching to the Finbond Shares ("Acquisition"). Pursuant to the Acquisition, Concert Parties and RVF hold 36.8% of the total number of Finbond Shares in issue. • Consequently, in terms of Section 123 of the Companies Act, No. 71 of 2008, as amended, (the "Companies Act") read with the Takeover Regulations promulgated in terms of sections 120 and 223 of the Companies Act (the "Takeover Regulations"), the Offeror, is obligated to make an offer to Finbond Shareholders to acquire all shares held by Finbond Shareholders, other than those that it already owns, and excluding Finbond Shares held by Concert Parties and Finbond Shareholders that have elected to waive the benefit of the Offer ("Offer Shares"), at R2.91 per Offer Share (the "Offer Consideration"), being the highest price paid by the Offeror or any person acting in concert with the Offeror within the six month period before the commencement of the offer period (the "Mandatory Offer" or "Offer"). Kings Reign Investments Proprietary Limited, Net 1 Finance Holdings Proprietary Limited and its affiliates, Buckley Capital Management LLC and subsidiaries of Finbond ("Excluded Shareholders") have elected to waive the benefit of the Offer.
Fair and reasonable opinion required in respect of the Offer in terms of the Companies Act	• The Offer is an affected transaction as defined in section 117(1)(c)(vi) of the Companies Act and, accordingly, will be regulated by the Companies Act, the Takeover Regulations and the Takeover Regulation Panel ("TRP"). Regulation 90 (1) provides that the Company must retain an independent expert to compile a report to the members of the board of directors of Finbond ("Finbond Board") who are independent and have been appointed by the Finbond Board to consider the terms of the Offer ("Independent Board"), concerning the proposed Offer, which meets the requirements of Regulation 90(5) ("Fair and Reasonable Opinion"). • BDO Corporate Finance ("Independent Expert") has been appointed by the Independent Board to advise on whether the terms and conditions of the Offer are fair and reasonable to the remaining shareholders of Finbond.
Definition of the terms "fair" and "reasonable" in the context of the Offer	• The "fairness" of a transaction is based on quantitative issues. A transaction may be said to be fair if the benefits received, as a result of the transaction, are equal to or greater than the value given up. • The Offer, in respect of the Scheme, may be said to be fair to Scheme Participants if the Offer Consideration is equal to or greater than the fair value of a Share, or unfair if the Offer Consideration is less than the fair value of a Share. • The assessment of reasonableness of the Offer is based on the Offer Consideration in relation to the prevailing trading price of a Share as at the time of the Offer as well as qualitative factors.

BDO Corporate Finance's role and procedures

Nature and procedures

- Audited annual financial statements of Finbond for the year ended 29 February 2016;
- Unaudited management accounts of Finbond, on a consolidated basis and in respect of Finbond's South African and International Operations, for the year ended 28 February 2017;
- Reviewed and obtained an understanding from management as to the forecast financial information of Finbond, on a consolidated basis and in respect of Finbond's South African and International Operations, for the financial years ending 28 February 2018 – 2022 prepared by management of Finbond. Considered the forecast cash flows and the basis of the assumptions therein including the prospects of the business of Finbond. This review included an assessment of the recent historical performance to date as well as the reasonableness of the outlook assumed based on discussions with management and assessed the achievability thereof by considering historical information as well as macro-economic and sector-specific data;
- Performed such other studies and analyses as we considered appropriate and have taken into account our assessment of general economic, market and financial conditions and our experience in other transactions, as well as our experience in securities valuation and knowledge of the microfinance and banking industries generally;
- Held discussions with directors and senior management of Finbond regarding the past and current business operations, regulatory requirements, financial condition and future prospects of the Group and such other matters as we have deemed relevant to our inquiry;
- Held discussions with Finbond directors and management regarding the rationale for the Offer;
- Determined the fair value of Finbond's operations by applying appropriate generally accepted valuation approaches and methods in use in the market from time to time;
- Assessed the long-term potential of Finbond;
- Considered the share price information of Finbond;
- Evaluated the relative risks associated with Finbond and the banking and microfinance industries;
- Reviewed certain publicly available information relating to Finbond and the banking and microfinance industries that we deemed to be relevant, including Company announcements and media articles, including available analyst coverage; and
- Where relevant, representations made by management and/or directors were corroborated to source documents or independent analytical procedures were performed by us, to examine and understand the industry in which Finbond operates, and to analyse external factors that could influence the business of Finbond.

Valuation methodology and approach

Summary	• The valuation has been prepared on the basis of "Market Value". The generally accepted definition of "Market Value" is the value as applied between a hypothetical willing vendor and a hypothetical willing prudent buyer in an open market and with access to all relevant information. We have valued an ordinary share of Finbond on a marketable controlling basis as at 28 February 2017. This valuation basis includes a control premium, based on guideline Merger and Acquisition transactions. • BDO Corporate Finance used a number of standard valuation methodologies based on market recommended approaches for microfinance institutions ("MFIs"). • MFIs are typically valued the same way as traditional banks. However, MFIs exhibit a number of characteristics that differentiate MFIs from traditional banks, and justify a slightly different valuation approach: the quality of the loan portfolio measured in terms of non performing loans ("NPLs"), high net interest margins ("NIMs"), high operating costs, and longer term funding available from developmental investors. • Book value and earnings multiples are the most widely used valuation tools but the residual income method is also recommended. Relative value valuation methods, price-to-book, and, to a lesser extent, price-to-earnings multiples remain the most common valuation methods in microfinance equity. An absolute valuation method, the residual income method and fair price to book, would also be appropriate for MFIs because it combines the current book value with future earnings.
Technical overview of Valuation Methods	• The three most widely used valuation techniques involve two types of multiples and future cash flows. Multiples can be based on historical values (trailing multiple) or future estimates (forward multiple) of prior transactions of the same institutions or comparables transactions at other institutions. • The table on the next page summarizes four approaches and highlights their relative advantages and limitations. Valuation Practitioners tend to rely on both absolute and relative valuation methods. BDO house view recommends residual income analysis as a sound absolute valuation method together with fair price to book ("fair value P/B") based on forecast Return on Equity ("ROE") relative to cost of capital. Empirically, forecast ROE is a good indicator of fair value P/B for financial services firms. We set the fair value multiples using a Gordon Growth Model derived P/B. • We also cross-check the valuation with multiples of comparable transactions and companies, which comprises the relative approach.

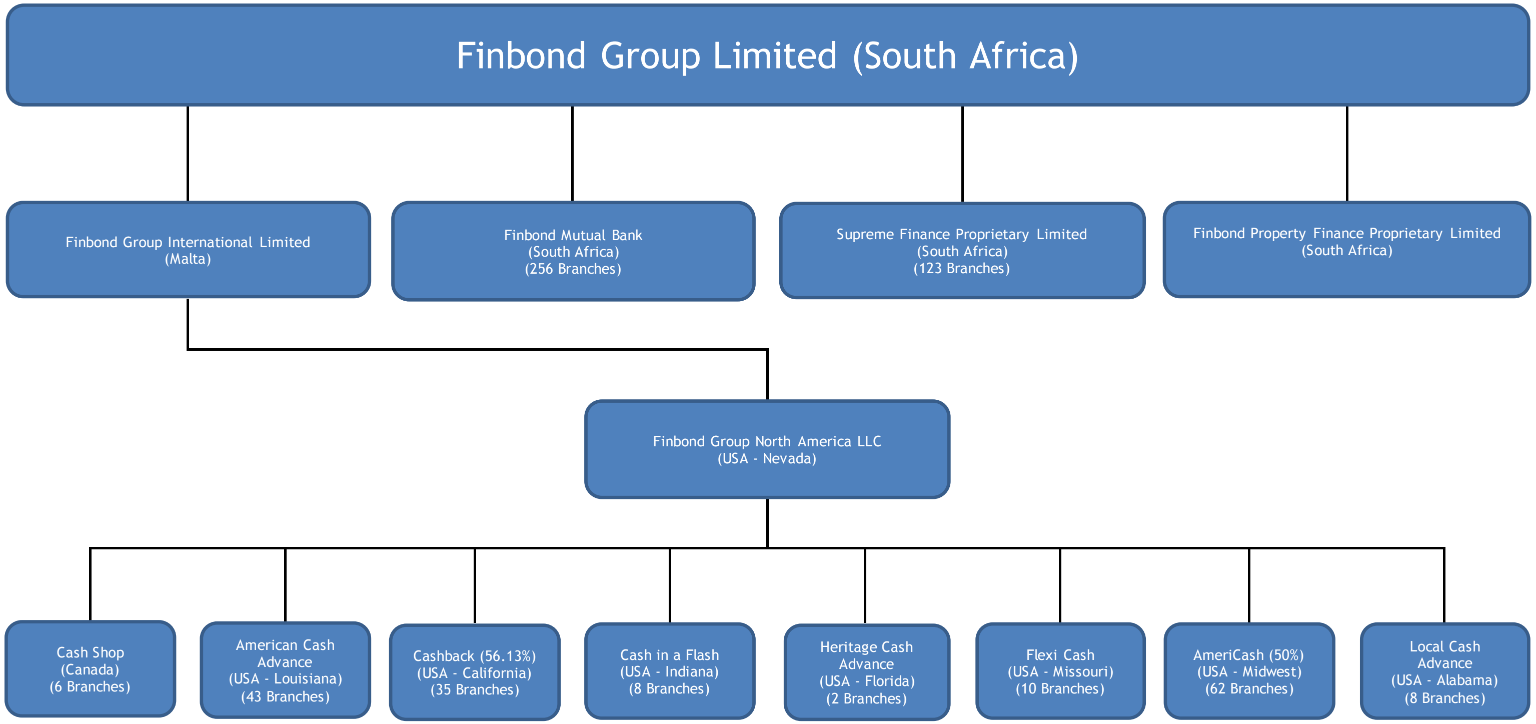
Valuation methodology and approach

Method	Pros	Cons
Multiple: Price to Book	• Simple and most widely used in the industry • Book value being a positive number, P/BV is always meaningful • Looking at multiples is an alternative way to address the issue of premium / discount • Fair P/B can also be modelled based on expected ROE which is a fundamental/ absolute valuation approach rather than a relative valuation method	• Comparison with other transactions is difficult because of differences in context, accounting standards, tax treatment, and different leverage of the institutions (no true comparable) • Book value does not indicate future earnings potential of the institution • Book value could be subject to impairments • Multiples comparison is subject to market exuberance (bubbles)
Multiple: Price to earnings	• Simple and widely used in the industry • Looking at multiples is an alternative way to address the issue of premium / discount	• Comparison with other transactions is difficult because of differences in context, accounting standards and tax treatment (no true comparable) • Cannot be used if earnings are negative; mostly used in the case of a stable and predictable earnings stream • Historical earnings do not indicate future earnings power of the institution • Multiples comparison is subject to market exuberance (bubbles)
Discounted cash flow analysis	• Detailed valuation method • Conceptually sound method, because investor should be willing to pay for the present value of future cash flows	• Not appropriate for young MFIs, for which future assumptions may be unrealistic • Valuation is very sensitive to terminal value present value of future cash flows and discount rate used in the valuation, which by nature are subject to error • Not the best method in the case of minority shareholders, because only majority shareholders can decide the use of future cash flows
Residual income	• Detailed valuation method • Conceptually sound method, because it adds the present value of expected future residual income to the current book value • Conceptually sound method, because it includes a charge for equity capital • Terminal value represents a smaller portion of total valuation, if compared with discounted cash flow method • Appropriate for young MFIs that may have no earnings in the short term	• Valuation is very sensitive to discount rate • Not appropriate if the capital structure of the MFI is expected to change significantly

Preliminary analysis of Finbond

Overview of Finbond

- Finbond is a North-American and South African Financial Services institution that specialises in the design and delivery of unique value and solution based savings, credit and insurance solutions tailored around depositor and borrower requirements rather than institutionalised policies and practices. The business has been significantly transformed from when Finbond commenced trading in 2003 primarily as a mortgage-origination business, which was listed on the Johannesburg Stock Exchange operated by the JSE in 2007 and received its Mutual Banking license from the South African Reserve Bank in 2012. Finbond expanded operations to the USA and Canada in 2016 with a number of acquisitions.
- Finbond conducts its business through Finbond's two divisions focused on:
  - Micro Credit Products and
  - Investment and Savings Products
- Micro Credit Products are offered through 379 branches in South Africa, 256 Finbond Mutual Bank branches and 123 Supreme Finance branches, with 1,265 employees. Finbond's North-American Micro Credit division currently operates through 174 branches of which 43 are American Cash Advance branches in Louisiana, 35 are Cash Back branches in California, 8 are Cash in a Flash branches in Indiana and 6 are Cash Shop branches in Toronto.



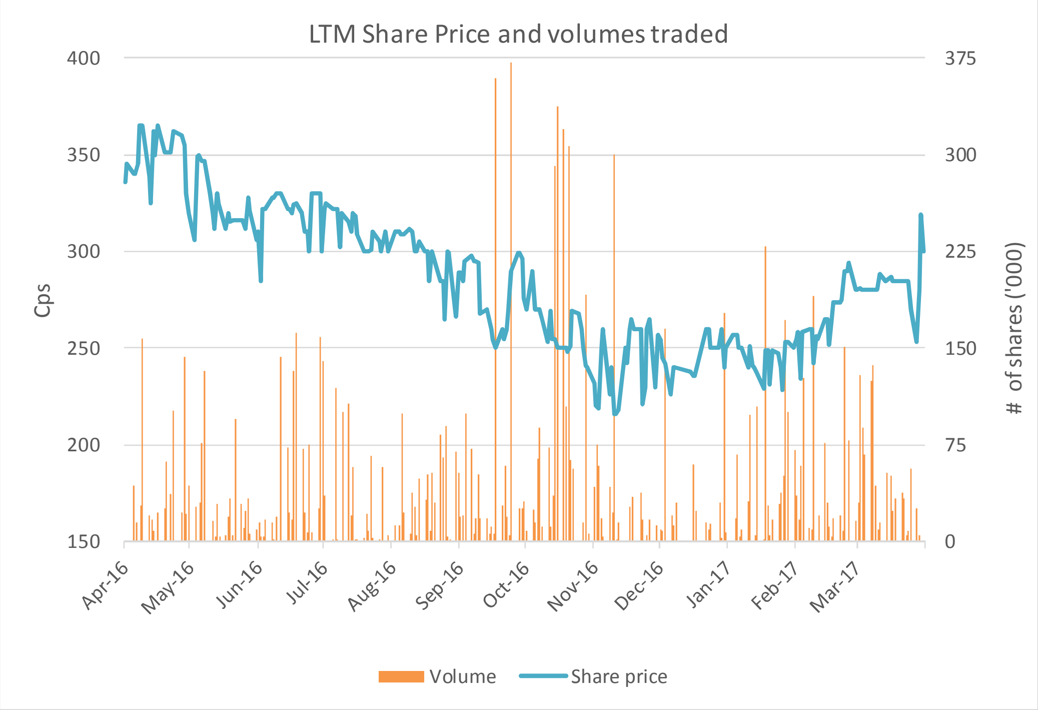
Expansion into North America

- As part of its long-term strategy, Finbond embarked on an earnings enhancing growth strategy of establishing a business presence in the North American payday lending market through acquisitions and subsequent organic growth of a number of payday lenders in North America that specialise in the advancement of short-term credit.
- The initial phase of this strategy was implemented through the acquisition of four North American payday lending businesses in the United States of America ("USA") and Canada. This provided Finbond with an initial branch network of 91 branches in the USA (85) and Canada (6).
- The expansion into North America was in terms of the Company's strategy to diversify risk and provide it with an effective rand hedge.
- Following these acquisitions approximately 40% - 50% of Finbond's net earnings will be denominated in US Dollars ("US$") within 12 months of the effective date and the intention is to grow US$ earnings to approximately 70% - 80% of net earnings in 3 to 5 years.
- The table below provides certain information regarding the acquisitions:

Company name	Location	Effective date	% holding	Currency	Purchase Price
American Cash Advance	USA - Louisiana	1 March 2016	100%	USD	8,000,000
Cashback	USA - California	1 March 2016	56.13%	USD	8,980,000
Cash in a Flash	USA - Indiana	1 March 2016	100%	USD	1,200,000
Cash Shop	CAD - Toronto	1 March 2016	100%	CAD	6,500,000
AmeriCash	USA - Midwest	1 September 2016	50%	USD	37,500,000
Heritage Cash Advance	USA - Florida	22 September 2016	100%	USD	670,000
Local Cash Advance	USA - Alabama	30 September 2016	100%	USD	681,038
Flexicash	USA - Missouri	12 October 2016	100%	USD	913,624

Historical share price and trading of Finbond

Finbond share price and trading performance



Source: Thomson Reuters

Stock Exchange Performance (12 months to 6 April 2017)	
Share price (cents)	
- Lowest	216
- Highest	365
- Closing	300
VWAP (cents)	
- 30-days	282
- 60-days	267
- 90-days	257
Issued ordinary share capital	
# shares in issue (15,499,014 treasury shares)	762,210,879
Volume traded (LTM)	89,115,438
Market capitalisation (R'000)	2,286,633
Liquidity	11.7%
Ratios	
Return on Equity (FY16 actual)	14.7%
Cost of Equity - SA Operations	18.4%
Cost of Equity - International Operations	15.6%
Dividend yield	1.3%

Financial projections – per Forecast 2018 to 2022

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Financial projections – South African Operations

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Financial projections – International Operations

REDACTED

Financial projections – Balance Sheet – SA Operations

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Financial projections – Balance Sheet – Int’l Operations

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Microfinance industry analysis

Valuation of low-income publicly listed finance institutions

- In this section, we analyze data on low-income finance institutions ("LIFIs"). These institutions provide financial services (consumer and microenterprises loans, payments, and insurance) to low-income segments of the market. They offer interesting comparables for MFI valuation as they operate in the same market. JP Morgan has historically identified 10 listed LIFIs with a broad microfinance focus which they incorporated into a Low Income Finance Index ("LIFI"). They include two publicly listed MFIs (Compartamos and Equity), four banks with an emphasis on SME and microenterprise lending, and four consumer lenders. These are are detailed in the table below (African Bank, Equity Bank Kenya and Compartamos have been delisted and removed from the index. These have been replaced by World Acceptance Corporation, OneMain Holdings Inc and Regional Management Corporation as US proxies):

Company	Country	Focus
Bank Rakyat	Indonesia	Government-owned bank (57%) focusing on rural microlending (>4,400 outlets across Indonesia). Micro- and payroll loans represent ~50% of the loan book, but a higher stake in revenues.
Bank Danamon	Indonesia	Consumer mass market lending, with more than 1,000 outlets. Self-employed entrepreneurs are ~20% of loans, while segment of 2- and 4-wheelers represents ~40% of total loans.
Bank Tabungan Pensiunan	Indonesia	Mostly focused on pensioners, while ~20% of loans go to Pensiunan microborrowers.
SKS	India	Largest MFI in India, with loan growth of ~15x before the crisis. Andhra Pradesh represents ~30% of total loans of SKS.
Capitec	South Africa	Individual consumer lending. Capitec offers a full suite of transactional banking services.
Compartamos	Mexico/Peru	Microloans to entrepreneurs in Mexico, Peru, and a greenfield operation in Guatemala; group lending methodology (more than 80% of total loans).
Financiera Independencia	Mexico	Microloans to individual consumers (~80%) and group lending to entrepreneurs (~20%).
First Cash Financial	Mexico/USA	Pawn store, with half of revenues coming from interest income and half coming from inventory sales.
International Personal Fin.	E Europe/Mexico	Consumer lending present in six countries, originated through independent workforce.
World Acceptance	United States	Small-loan consumer finance business in 15 states and Mexico offering short-term small installment loans, medium-term larger installment loans, related credit insurance and ancillary products.
Onemain Holdings	United States	Consumer finance provider of personal loan products; credit and non-credit insurance, and service loans owned by it and service or subservice loans owned by third-parties. 1,800 branches in 44 states.
Regional Management	United States	Provides array of loan products to customers with limited access to consumer credit, including small loans, large loans, automobile loans, retail loans, and optional payment and collateral protection insurance products

Current valuation of LIFI Index

- The LIFI Index currently trades on 1.7x forward P/B, for an average expected ROE in FY17 of 16.5%. Capitec has the highest expected ROE of c.26% and trades at a forward P/B of 4.3x and forward P/E of 17.1x.

								ROE			
Company Name	**Ticker**	**Year-end**	**Market Cap (USD'm)**	**P/B (LTM)**	**P/B (NTM)**	**P/E (LTM)**	**P/E (NTM)**	**FY17E**	**FY18E**	**FY19E**	**Beta**
Capitec Bank Holdings Ltd	CPIJ.J	Mar	6,588	5.8x	4.3x	24.5x	17.1x	26.0%	26.6%	26.4%	1.25
Bharat Financial Inclusion Ltd	BHAF.NS	Mar	1,764	4.7x	3.3x	18.4x	19.1x	32.0%	19.9%	20.6%	1.33
Bank Rakyat Indonesia (Persero) Tbk PT	BBRI.JK	Dec	21,959	2.0x	1.8x	11.2x	10.0x	18.2%	18.6%	18.8%	1.71
FirstCash Inc	FCFS.K	Dec	2,110	1.5x	1.4x	25.4x	15.5x	8.6%	9.1%	8.5%	0.62
Bank Danamon Indonesia Tbk PT	BDMN.JK	Dec	3,413	1.3x	1.2x	17.2x	12.0x	9.8%	10.6%	10.4%	1.87
Onemain Holdings Inc	OMF.N	Dec	3,697	1.2x	1.1x	17.2x	7.0x	19.1%	16.9%		1.62
Regional Management Corp	RM	Dec	232	1.1x	1.0x	10.1x	7.8x	12.6%	13.2%		1.63
World Acceptance Corp	WRLD.OQ	Mar	450	1.1x	0.9x	6.3x	7.6x	16.5%	15.0%	15.8%	2.11
Bank Tabungan Pensiunan Nasional Tbk PT	BTPN.JK	Dec	1,196	1.0x	0.9x	9.1x	8.2x	11.4%	11.1%		0.55
International Personal Finance PLC	IPF.L	Dec	460	0.9x	0.9x	5.8x	5.1x	17.8%	16.5%	18.0%	1.08
Financiera Independencia SAB de CV SOFOM ENR	FINDEP.MX	Dec	120	1.1x		10.1x		9.7%			0.31
Average - LIFI Index				**2.0x**	**1.7x**	**14.1x**	**10.9x**	**16.5%**	**15.8%**	**16.9%**	**1.28**

Source: Thomson Reuters

- The matrix of equivalence for global banks as published by J.P. Morgan is detailed alongside
- According to this matrix, a bank with a ROE of 20% would trade at a fair multiple of c.2.0x Book.

Theoretical ROE (%)	Corresponding P/BV
0	0.4x
5	0.6
10	0.9
15	1.3
20	1.8
25	2.7
30	3.9

Source: J.P. Morgan estimates, using the relationship between ROE and P/B multiples. The correlation reaches 68%.

Current valuation of South African banking sector

- The market parameters for South African listed banking stocks are detailed below.

Company Name	Ticker	Year-end	Market Cap (ZAR'm)	P/B (LTM)	P/B (NTM)	P/E (LTM)	P/E (NTM)	ROE FY17E	ROE FY18E	ROE FY19E	Beta
FirstRand Limited	FSRJ.J	June	294,738	2.8x	2.4x	12.7x	11.2x	23.7%	23.1%	23.0%	1.35
Capitec Bank Holdings Ltd	CPIJ.J	Feb	87,157	5.8x	4.3x	24.5x	17.1x	26.0%	26.6%	26.4%	1.25
Investec Bank Limited	INLJ.J	Mar	96,338	1.4x	1.4x	15.0x	10.6x	11.1%	13.3%	13.9%	1.70
Barclays Africa Group Limited	BGAJ.J	Dec	128,862	1.4x	1.2x	8.6x	7.9x	16.4%	16.5%	16.7%	1.10
Standard Bank Group Limited	SBKJ.J	Dec	258,573	1.6x	1.5x	11.3x	9.7x	15.8%	16.0%	17.0%	1.45
Nedbank Group Limited	NEDJ.J	Dec	126,923	1.6x	1.5x	11.3x	9.7x	15.6%	15.6%	16.1%	1.15
Average - SA Banking Sector				**2.4x**	**2.0x**	**13.9x**	**11.0x**	**18.1%**	**18.5%**	**18.9%**	**1.34**

Source: Thomson Reuters

- The South African banking sector currently trades on 2.0x forward P/B, for an average expected ROE in FY17 of 18.1%.
- Capitec trades at a significant premium to the sector due to higher profitability metrics.

Valuation analysis

Fair P/B methodology

Fair P/B

- Empirically, forecast RoE is a good indicator of fair value P/B for financial services firms. We set the fair value multiples using a Gordon Growth Model derived P/B.
- The valuation multiple is based on a standard Gordon Growth Model as follows:

$$\frac{(\text{forecast RoE}) - g}{\text{COE} - g}$$

where:

- RoE – We have used the budgeted RoE which reflects our view on the maintainable RoE through the economic cycle.
- Cost of equity – We calculate the cost of equity based on the following formula: COE = RFR + (beta * ERP).
- Terminal g – We apply a terminal “g” which is based on the company’s medium-term growth forecasts.

Fair P/B methodology – South African Operations

Fair P/B - TNAV attributable to Finbond shareholders

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Fair P/B methodology – International Operations

Fair P/B - TNAV attributable to Finbond shareholders

REDACTED

Valuation metrics

Valuation

Valuation summary

REDACTED

Conclusion

Consideration received and valuation results

Consideration received

- The Cash Consideration is R2.91 per Offer Share.

Valuation results

- Based on the results of our procedures performed, our detailed valuation work and other considerations, we determined a valuation range of R3.61 to R4.21 per Finbond Share with a most likely value of R3.88 per Finbond Share.
- The valuation range above is provided solely in respect of this fair and reasonable opinion and should not be used for any other purposes.

Conclusion

- The Offer Consideration of R2.91 is below the core fair value of R3.88 per Finbond Share and the closing price of a Finbond Share on the JSE of R3.00 prior to the date of publication of the Notification. We are not aware of any material adverse effects of the Offer.
- BDO has considered the proposed terms and conditions of the Offer, based upon and subject to the conditions set out herein, and is of the opinion that the terms and conditions of the Offer Consideration, in respect of the Offer, based on quantitative considerations, are not fair to Finbond Shareholders. Based on qualitative factors, we are of the opinion that the terms and conditions of the Offer are not reasonable from the perspective of Finbond Shareholders.
- Our opinion is necessarily based upon the information available to us up to 10 May 2017, including in respect of the financial, market and other conditions and circumstances existing and disclosed to us at the date thereof. We have furthermore assumed that all conditions precedent, including any material regulatory and other approvals and consents required in connection with the Offer have been or will be fulfilled and/or obtained.
- Accordingly, it should be understood that subsequent developments may affect this opinion, which we are under no obligation to update, revise or re-affirm.

Reasonableness of the Offer

Considerations

- The Offer Consideration represents a discount to the date of publication of the announcement by Finbond on 07 April 2017:

	Price per Finbond Share (R)	Discount of Offer Price
● the closing price per ordinary share on the JSE as at 06 April 2017, being the last business day immediately prior to the notification;	3.00	-3.00%
● the volume weighted average price ("VWAP") of ordianry shares on the JSE for the 30 days up to 06 April 2017;	2.82	3.14%
● the VWAP of ordianry shares on the JSE for the 60 days up to 06 April 2017; and	2.67	9.10%
● the VWAP of ordianry shares on the JSE for the 90 days up to 06 April 2017.	2.57	13.28%

Reasonableness conclusion

- Based on qualitative factors, we are of the opinion that the terms and conditions of the Offer are not reasonable from the perspective of Finbond Shareholders.

Annexure I - Draft opinion letter

Disclaimer

Important notice

This report provides a summary of our detailed work. The report is intended to provide sufficient information to the Directors of Finbond to assist in determining the fairness of the proposed Offer. This report should not be relied upon for any other purpose and may not be distributed in part or whole without the prior consent of BDO Corporate Finance

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