SN VALUATION
SN CAPITAL SN CONSULTING SN ENGLISH

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MicroFinancial (MFI)

Overview 114MM market cap. Annual dividend yield is at 3.0%. P/B at 1.34,

The stock has risen from $2 in 2009 to the current $8. Along with the stock appreciation was revenue growth from $28 to $40MM and NI growth from $5MM to $10MM. 152 employee company so not a large, consuming operation. The Co. finances small ticket items, on average, in the amount of $5,000, which is financed from the Co's credit line. They have maturities ranging from 12-60 months, with average of 42 months. Over 1,200 dealers originating leases. The products include copiers, POS cash registers, water filtration systems for small commercial enterprises.

The surprising piece is the fact the Co. has barely $5MM in hard assets such as PP&E compared to $170MM in assets. So, should the economy undergo another recessionary period, the Co. has very little downside protection as the assets are composed of predominantly receivables. This is reminiscent of MREITs, which enjoys favorable cash flow during low interest rate periods we enjoyed for the past 5 years, but will see much lower returns as they deleverage and net margin crimps. MFI too will see net margin crimp, and possibly big hits to their lease portfolio, which will eat away at their equity of $85MM.

The aggregate average yield on lease is 28%, below the 30% max ($40MM revenue off $130MM originated). So these guys are highway robbers, charging 30% on leases. This is offset by 4% cost of lending, which almost guarantees a profit while there are minimal write-downs in the portfolio. The leases act like a bond purchased at premium, so there will be a negative amortization from i.e. $2000/bond to $1,000/bond. Therefore, the Co. must be compensated with high yields during the lease period to offset the principal loss. The lessee aren't ripped off because they are essentially paying the equipment cost over the average 42 month period, with a markup for the Co.

Therefore, the cash received on the yield must be greater than the annual depreciation value of the equipment plus the hurdle rate of the investment. Now it makes sense why the yield is 30%, since the lease expires typically in 3.5 years, or 42 months. The residual value will most likely be about 10% of the face value, thus the Co. would need to recoup the depreciated value and the hurdle rate during that period. So, the Co. is not generating a net interest margin of 30% minus the cost of financing, of roughly 4%. Rather, the yield is offsetting the principal loss, and the extra amount, is booked as unearned income and the unearned income is the net margin on their investment.

We will try to back into the net interest margin by assuming the unearned income of $60MM is the gain off the net investment in leases of $160MM, or a 40% gain. Since the holding period for the lease is 3.5 years, the 40% gain results in a roughly 9% annualized return. Therefore, the net interest margin would be the 9% minus the cost of debt, which is 4%. Thus, the total net margin is 5%, off their entire investment of $160MM, which is about $8MM annually.

In operating cash flow, it realizes $120MM in cash received from customers, but only books $50MM in revenue. Where is the $70MM in cash flow that is not realized in revenue? The Co's website includes a PPT presentation that has a slide specifically addressing this, and shows the discrepancy between the GAAP revenue and actual cash flow.

With that operating cash flow, the Co. is reinvesting into their leases, since it is a high return business.

At the end of the lease term, the Co. either sells the equipment to the lessee, rents to the lessee, or sells it to equipment brokers.

Assessment We like how the Co. owns the equipment, which provides some downside protection, but they will be a holder of a bunch of used equipment, which is negligible in value. The Co. generates $80MM in operating cash flow. Yet, it seems the sum of the cash flow is reinvested in new leases, so there is no FCFF. Historically, the Co. has been profitable since its founding in early 90s and even through the financial crisis. The Co. pays out a decent dividend and we believe the business model is structured to overcome a recession. We are including in our portfolio, although we are not quite sure why they have that discrepancy between GAAP revenue and op. cash flow.

SN Valuation FIG Portfolio

As of 2013-09-06

Buy

Name	Ticker	Market Price*	Entry Price	Date	Gain/(Loss)
Premier Financial	PFBI	12.10	12.61	08/07/2013	-4.04%
Microfinancial	MFI	7.75	7.75	09/06/2013	0.00%
EZCORP	EZPW	17.40	16.98	09/02/2013	2.47%

Average Total Return -0.52%

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Name	Ticker	Market Price*	Entry Price	Date	Gain/(Loss)

*Intraday Market Price