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The Future of Small Dollar Lending

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Charles Darwin and the Small Dollar Loan

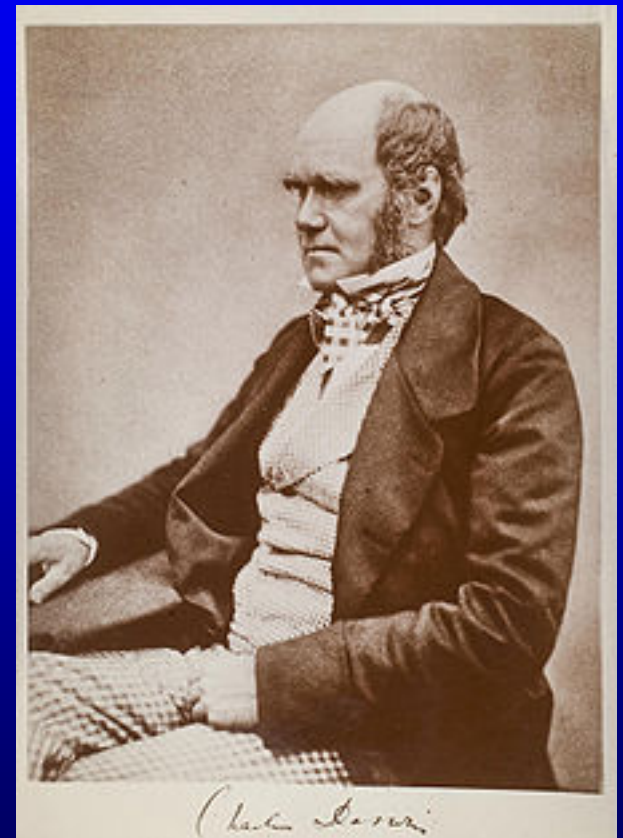
Like Darwin's theory of natural selection, the small dollar loan is expected to continue evolving over time into a more advanced "species" in the family of small dollar consumer lending products.

Adaptation Needed in Response to:

- A. Heightened Regulatory Scrutiny
- B. Highly Competitive and Saturated Marketplace
- C. Increasing Sophistication of Customer

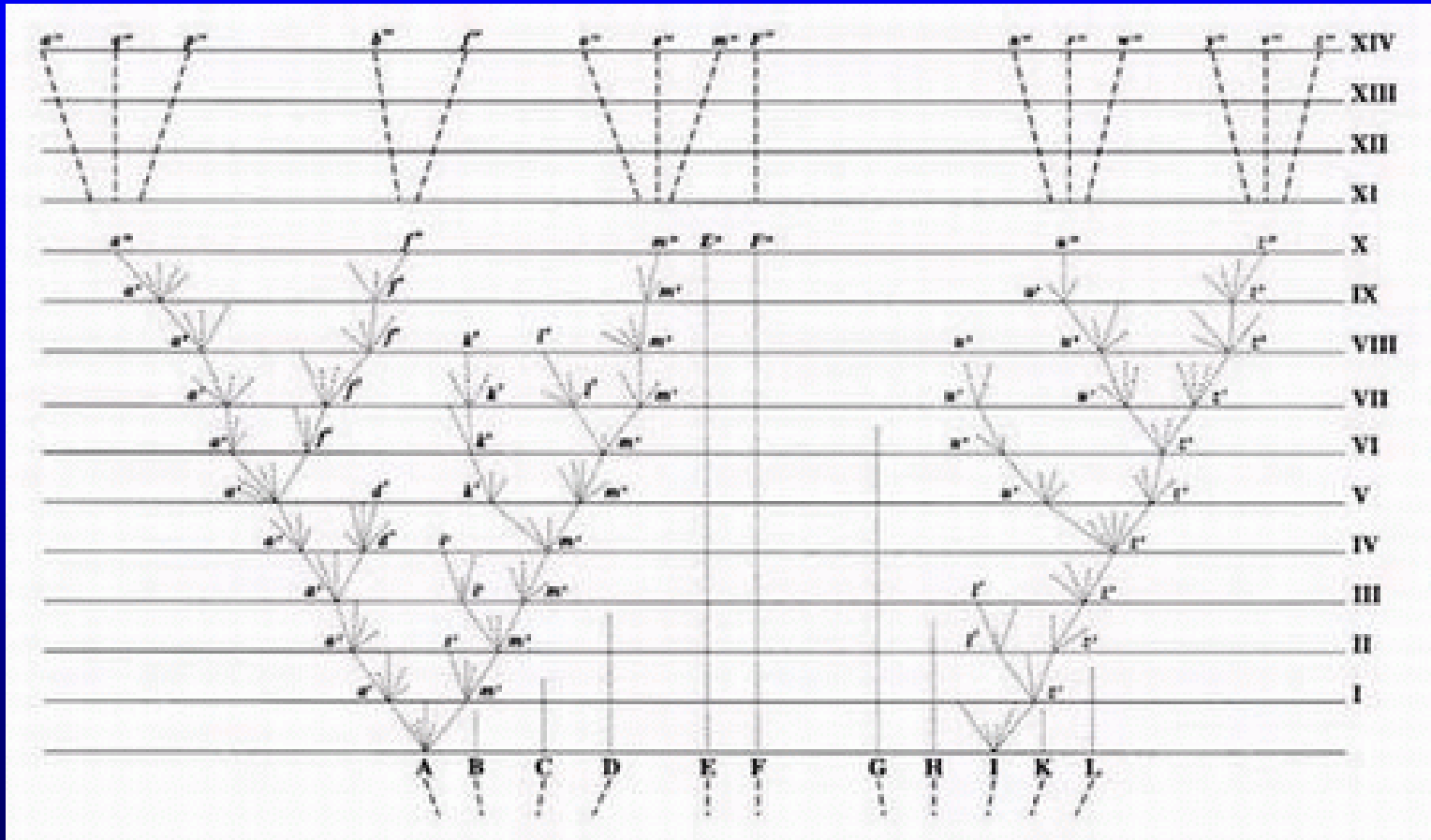
Product Mutations:

- A. Open-Ended Revolving Credit
- B. Installment Loans
- C. Amortizing Title Loans



Positioning the Single Payment Loan in the “Tree of Life”

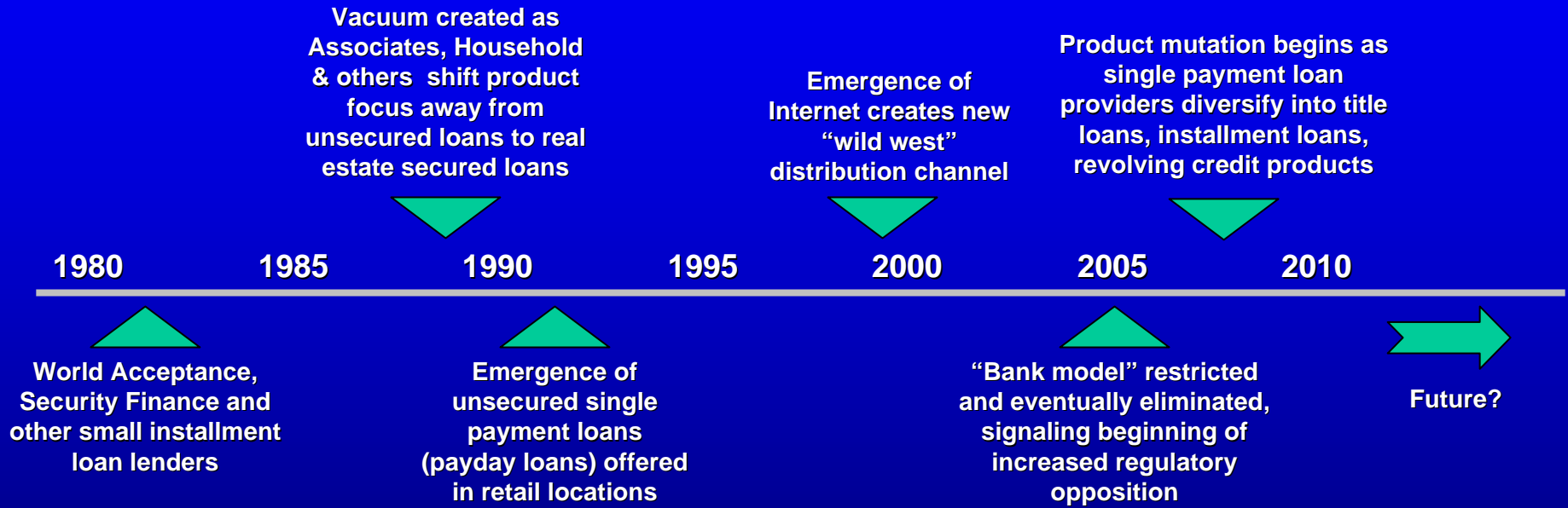
Our central belief is that the single payment loan is a non-growing “branch” in the small dollar loan’s “tree of life.”



The “Tree of Life” image that appeared in Darwin’s *On the Origin of Species by Natural Selection*, 1859. It was the book’s only illustration.

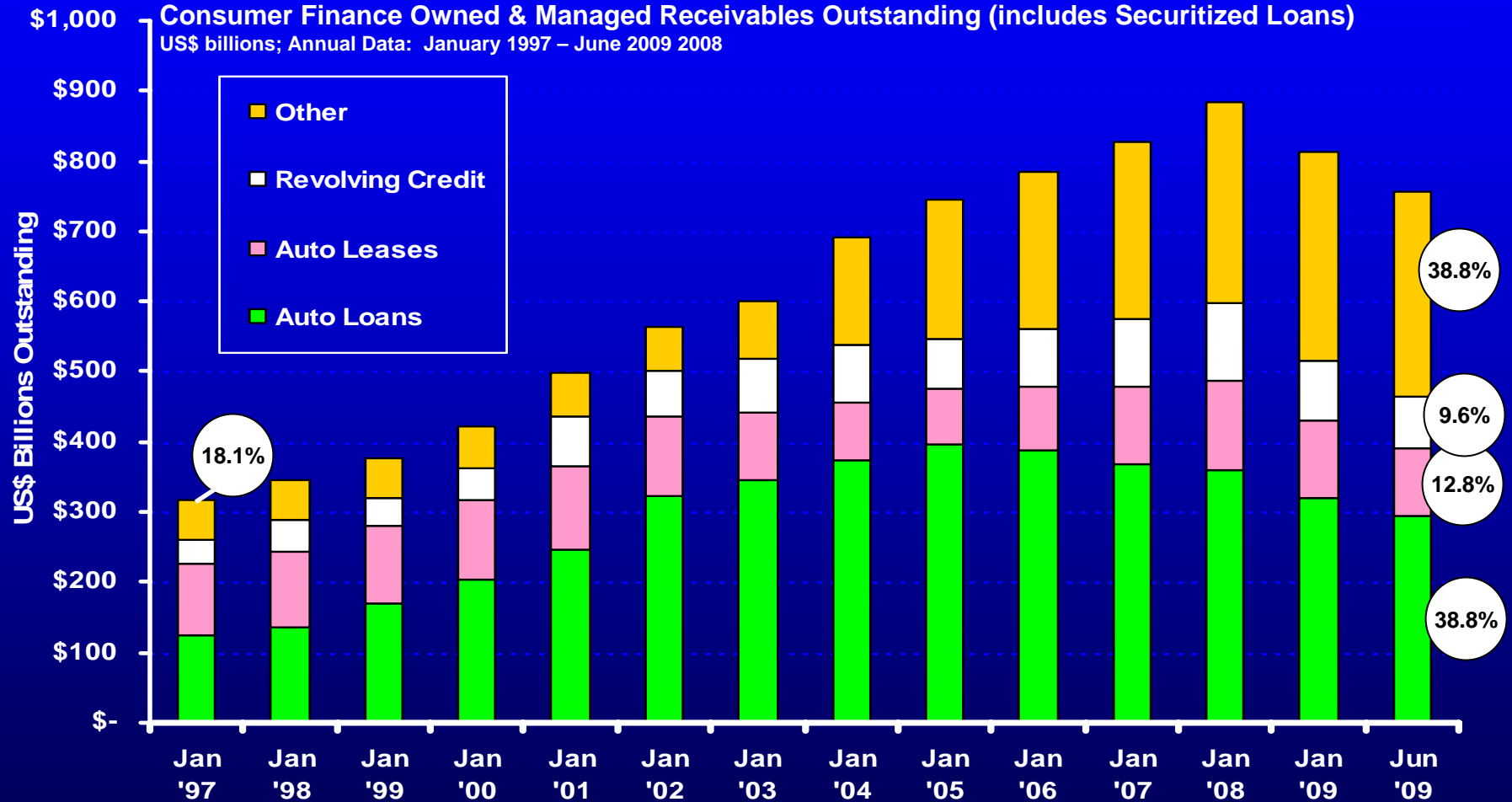
Brief History of the Small Dollar Loan

To assess the future, it may be helpful to take a step back and understand the recent history of the small dollar loan.



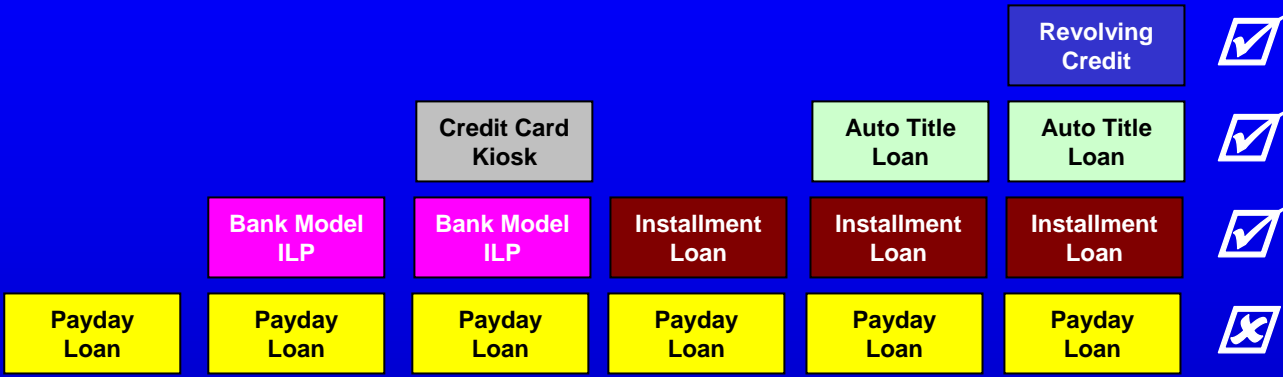
U.S. Consumer Debt Diversification

Over the past decade, U.S. consumers have diversified their borrowings away from traditional auto financing into revolving credit, student loans, personal cash loans and other loans to purchase other types of consumer goods such as appliances, apparel, boats, and recreation vehicles. We expect this trend to continue.



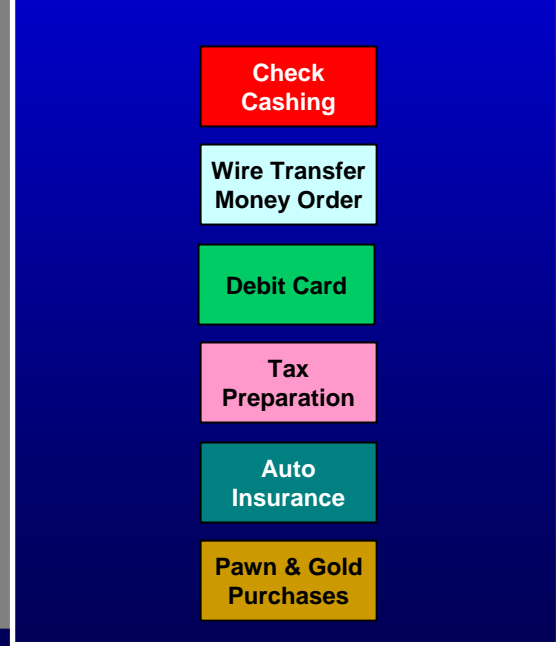
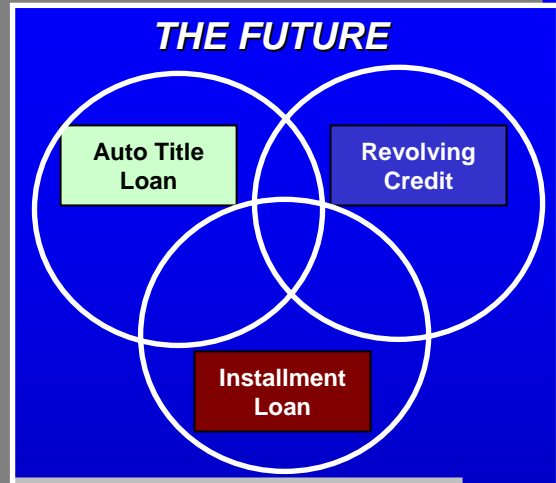
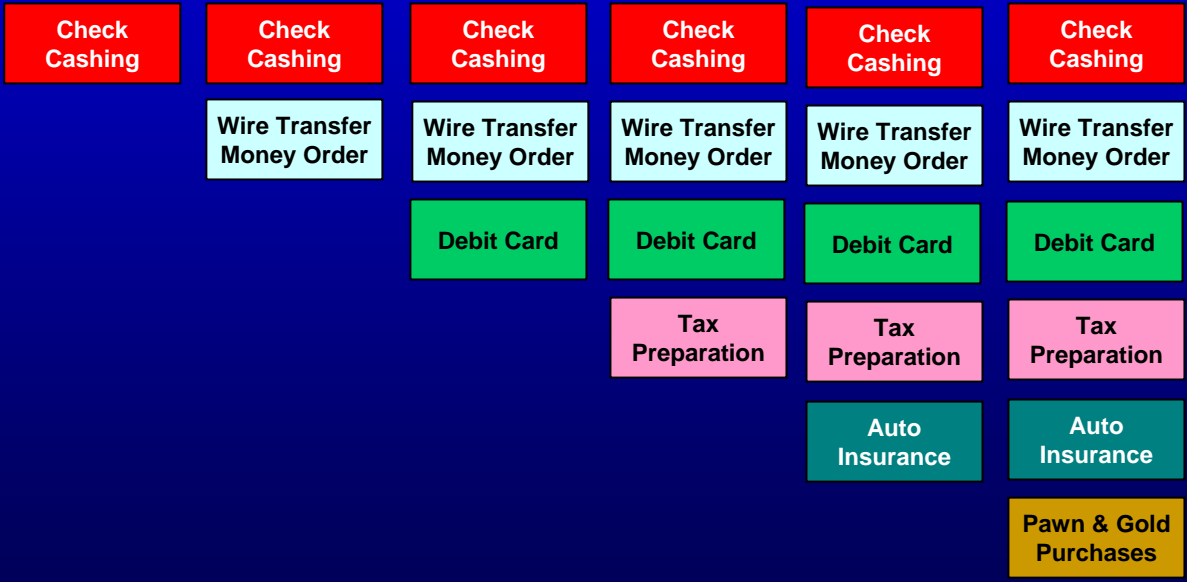
Source: U.S. Federal Reserve Board
 G.20 Release for Finance Companies

Charting the Future of Small Dollar Loans



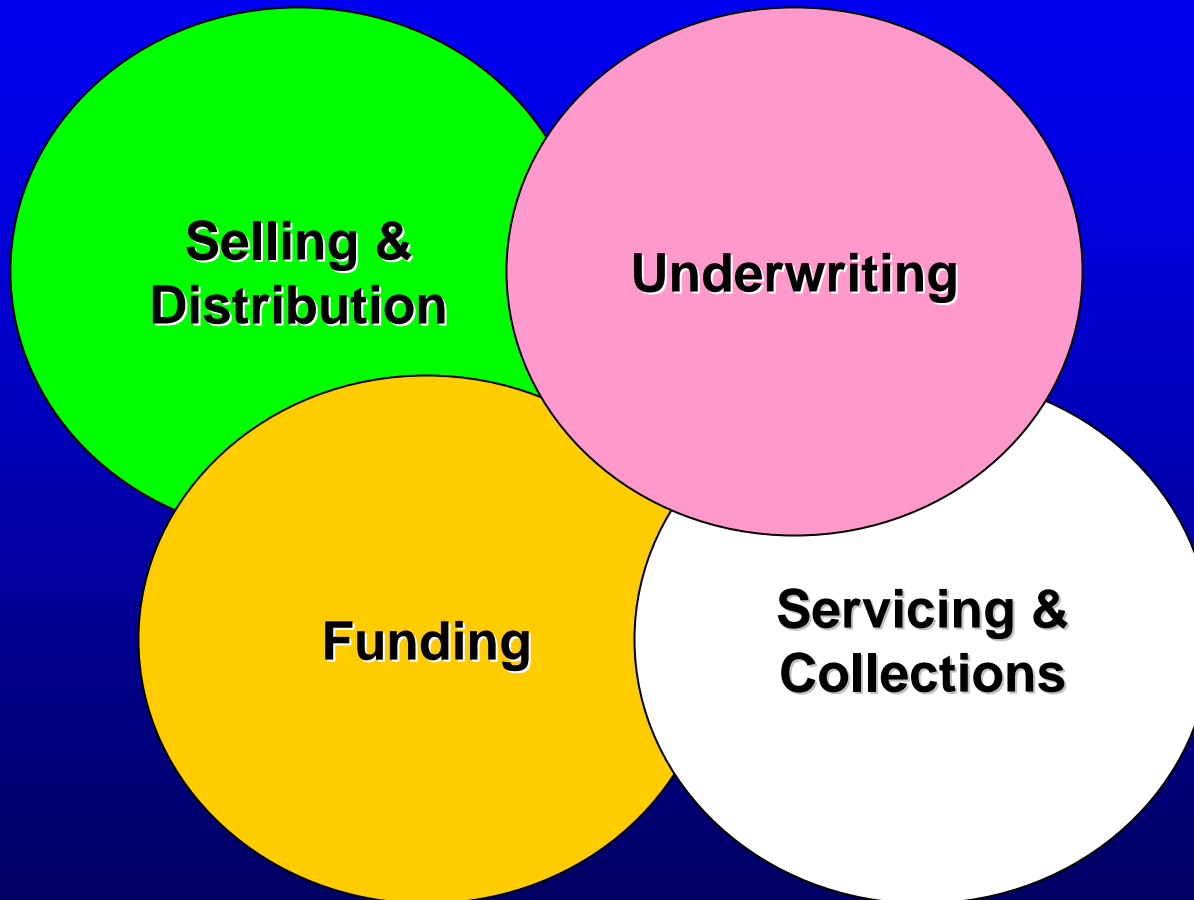
Loan Products →

Other Products →



Charting the Future of Small Dollar Loans

The future of the small dollar loan will be determined within the interdependent framework established by 4 mission critical phases of the loan process.



Selling & Distribution



- Retail storefront - lender location
- Retail storefront – third party location
- Internet driven acquisition and distribution
- Direct to consumer through mail or phone

- ❖ *Cost per acquisition is key*
- ❖ *Credit cards to this customer segment has dried up*

Underwriting



- ❑ Credit driven attributes for sub-prime credit
- ❑ Improved statistical analyses, resulting in reduced losses
- ❑ Centralized models have improved consistency
- ❑ Higher costs of underwriting have been offset by lower bad debt losses
- ❑ Higher the cost of credit the higher the default rate, inverse not true

❖ *Difficult to deliver a profitable product below 12% a month for SDL's due to default rate and costs of distribution, underwriting and collections*

Funding



- ❑ Costs associated with funding loans remains higher due to nature of the asset class; subprime and geographically scattered
- ❑ Few lenders interested in lending against sub-prime consumer loans
- ❑ Consistent performance of portfolios will drive lender participation, ultimately resulting in lower funding costs
- ❑ Individual portfolios are financed by those who really understand the asset and the associated risks

❖ *Funding is tight and expensive but will return to “normal” over time*

Servicing & Collections

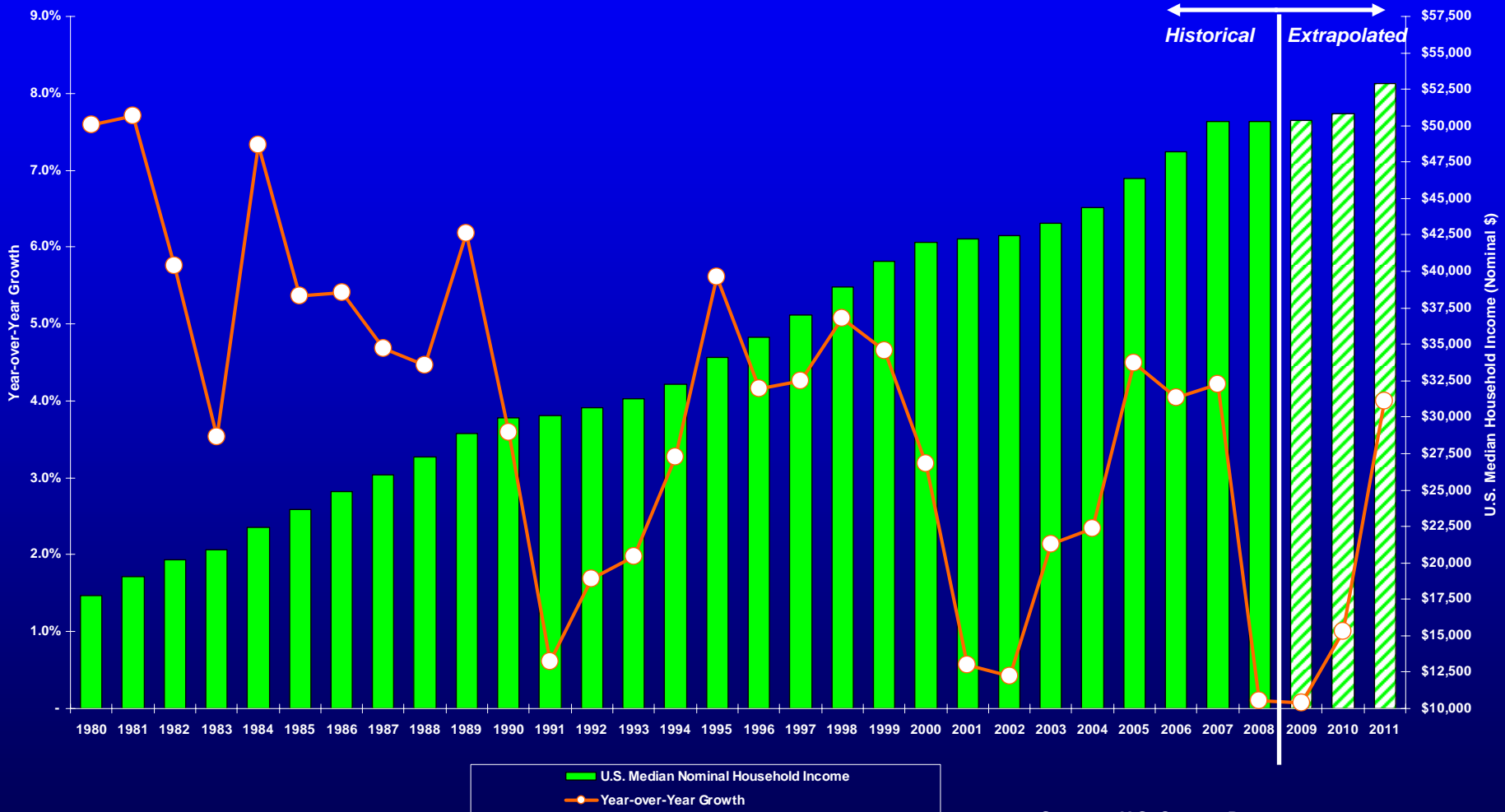


- ❑ For servicing and collections, debate is Retail vs. Centralized?
- ❑ In terms of cost and portfolio performance, the centralized model looks to be the long-term winner
- ❑ Economies of scale: Servicing costs will drive larger platforms and force out smaller players as prices (rates offered to consumers) fall
- ❑ Revolving credit loans require a more sophisticated level of processing than traditional installment and single payment loans

❖ *Costs associated with servicing and collections will increase the size of small dollar loans as economics become more important*

Median U.S. Household Income – Nominal \$

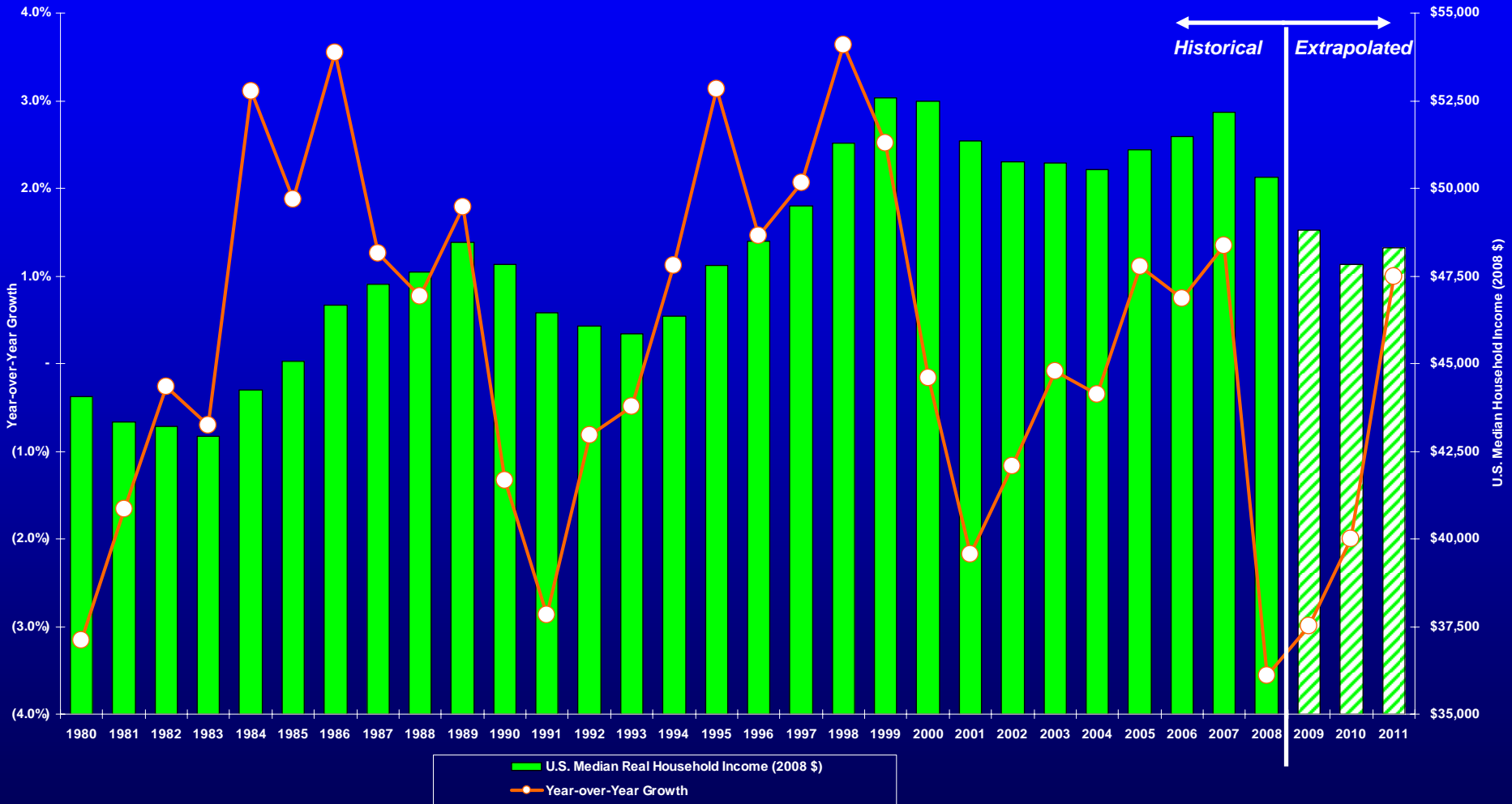
At first glance, U.S. household incomes appear to have increased every year since 1980. Unfortunately, the steady increase in household income that this chart depicts is deceptive since these numbers have been prepared on a nominal basis (not adjusted for inflation).



Source: U.S. Census Bureau

Median U.S. Household Income – Real \$

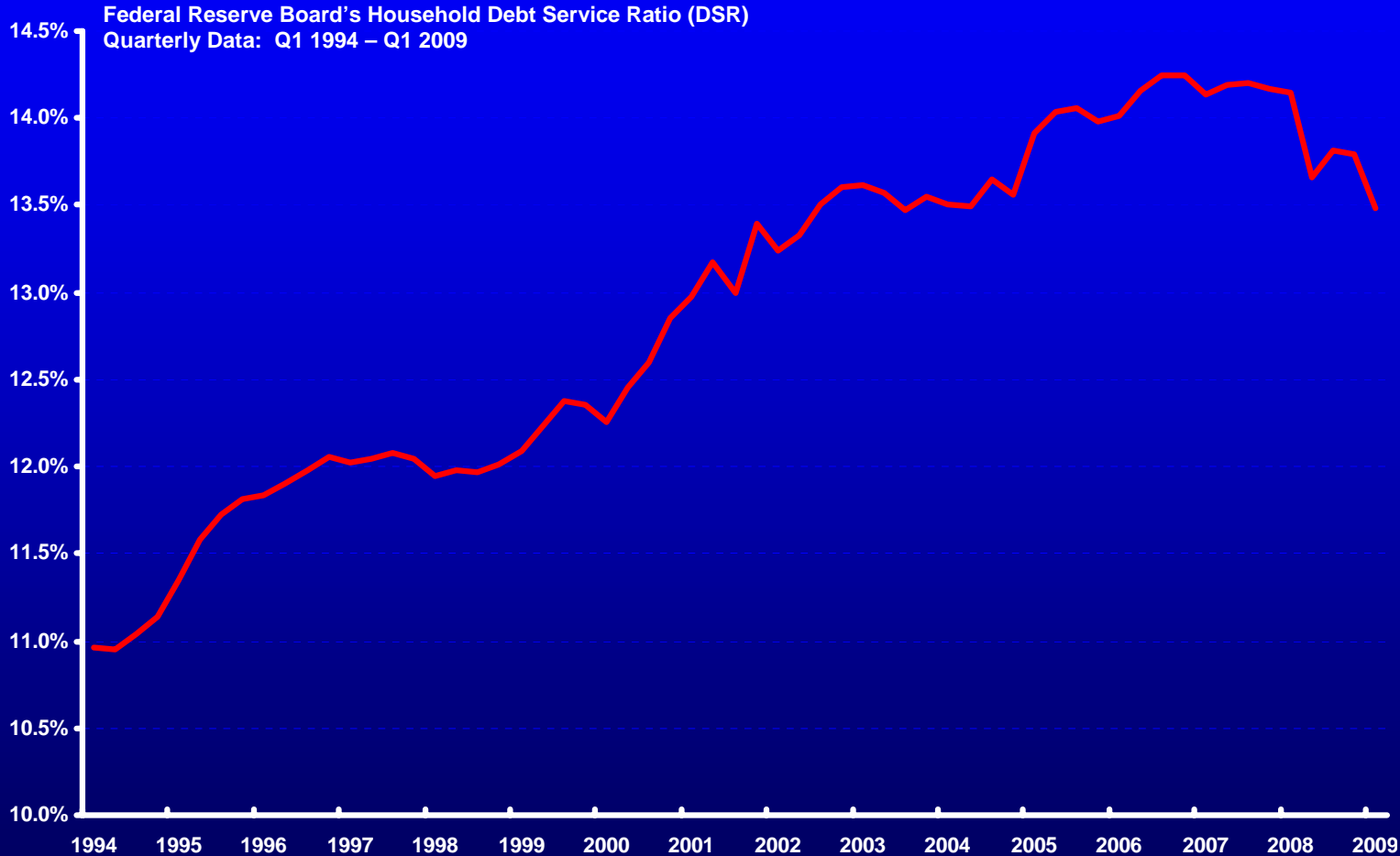
Growth in U.S. household incomes on a real basis (adjusted for inflation) actually declined during 2001 - 2004 before growing again from 2005 through 2007. Following the decline in 2008, real household incomes appear unlikely to recover to 1999-2000 levels in the near future.



Source: U.S. Census Bureau

Leverage in the U.S. Household

As a proxy for the ratio of U.S. household debt payments to disposable personal income, the Federal Reserve Board's household Debt Service Ratio ("DSR") has started to decline after a decade of steady increases.

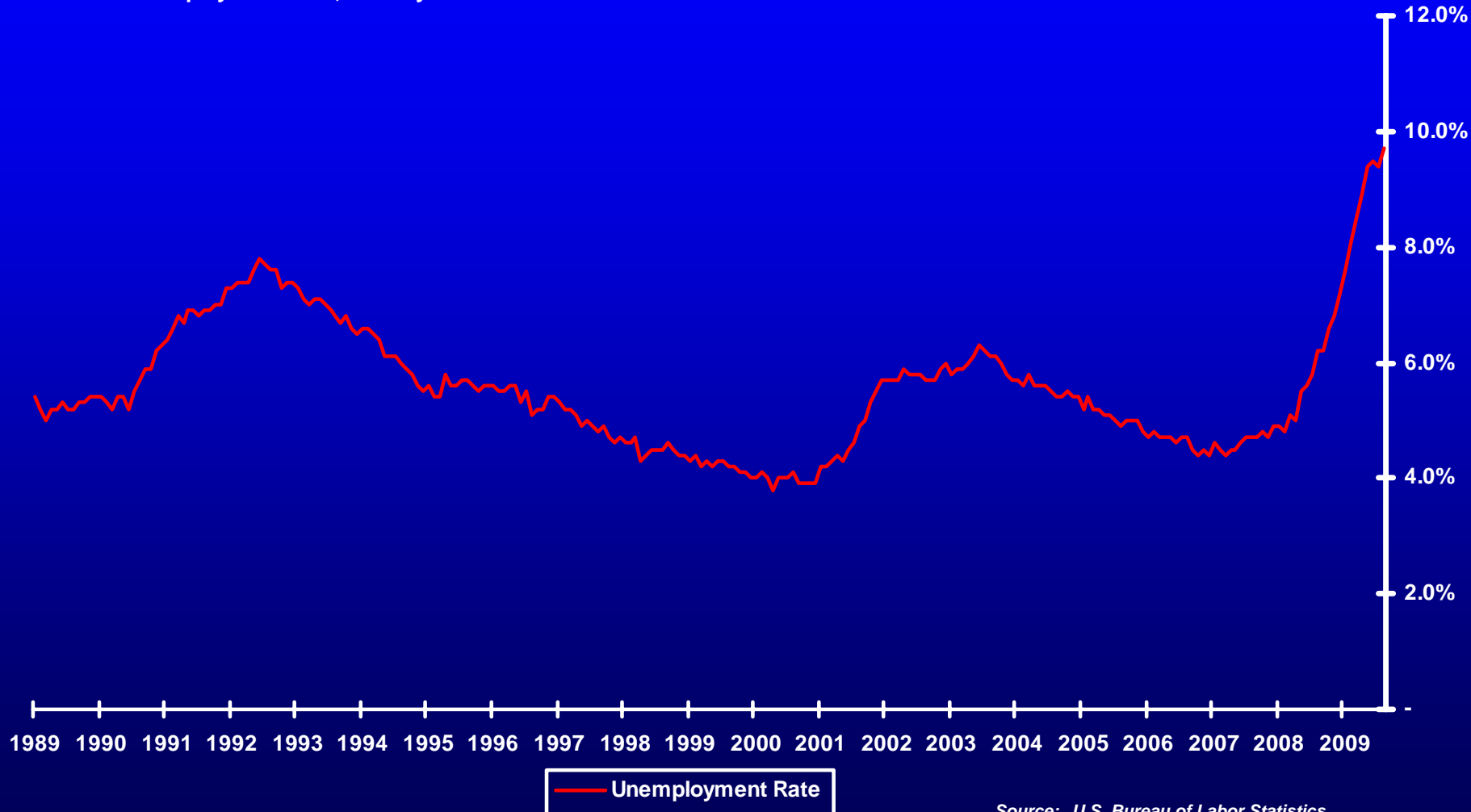


Source: U.S. Federal Reserve Board

U.S. Unemployment Rate

The U.S. unemployment rate has increased to 9.7%.

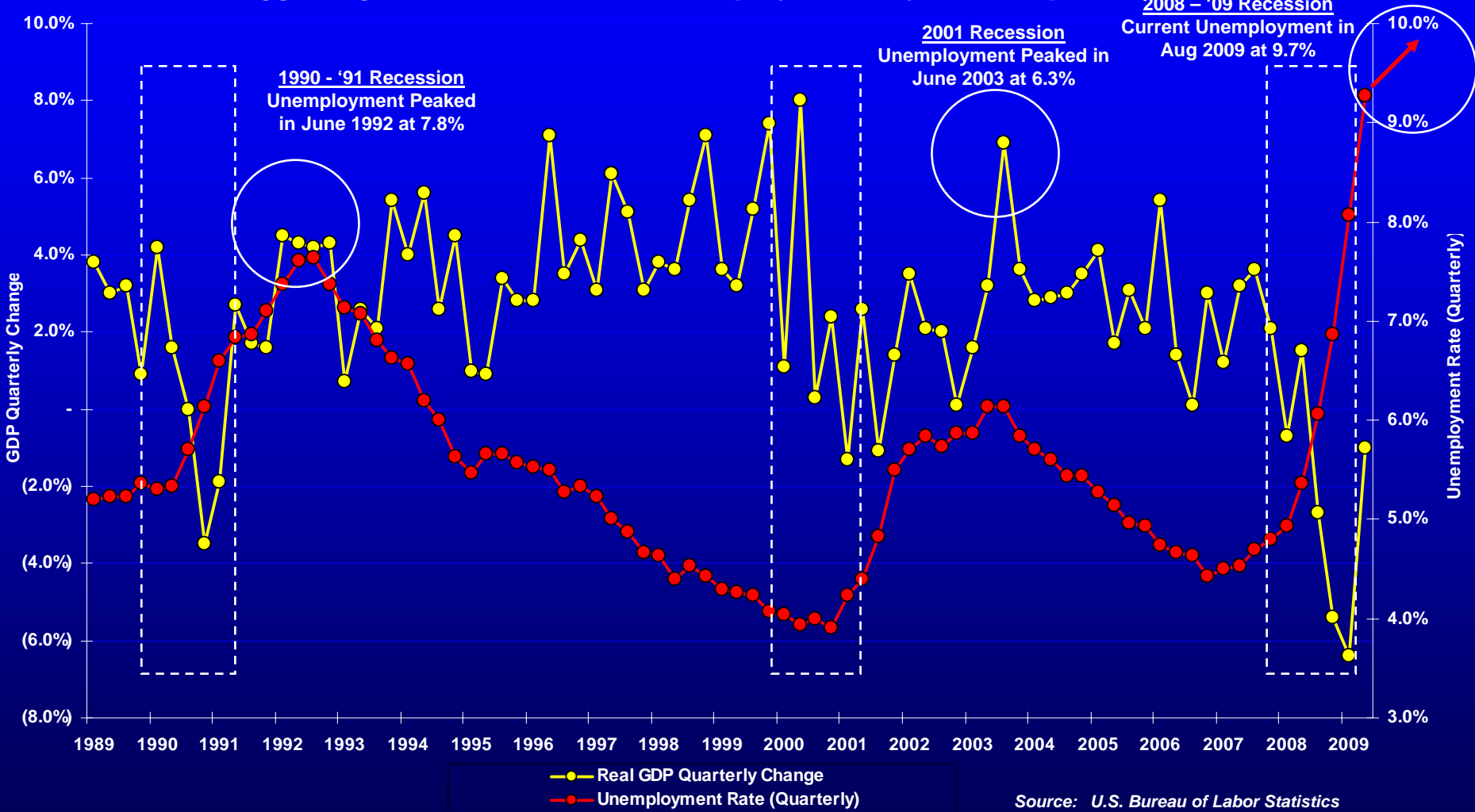
U.S. Unemployment Rate, Monthly



Source: U.S. Bureau of Labor Statistics

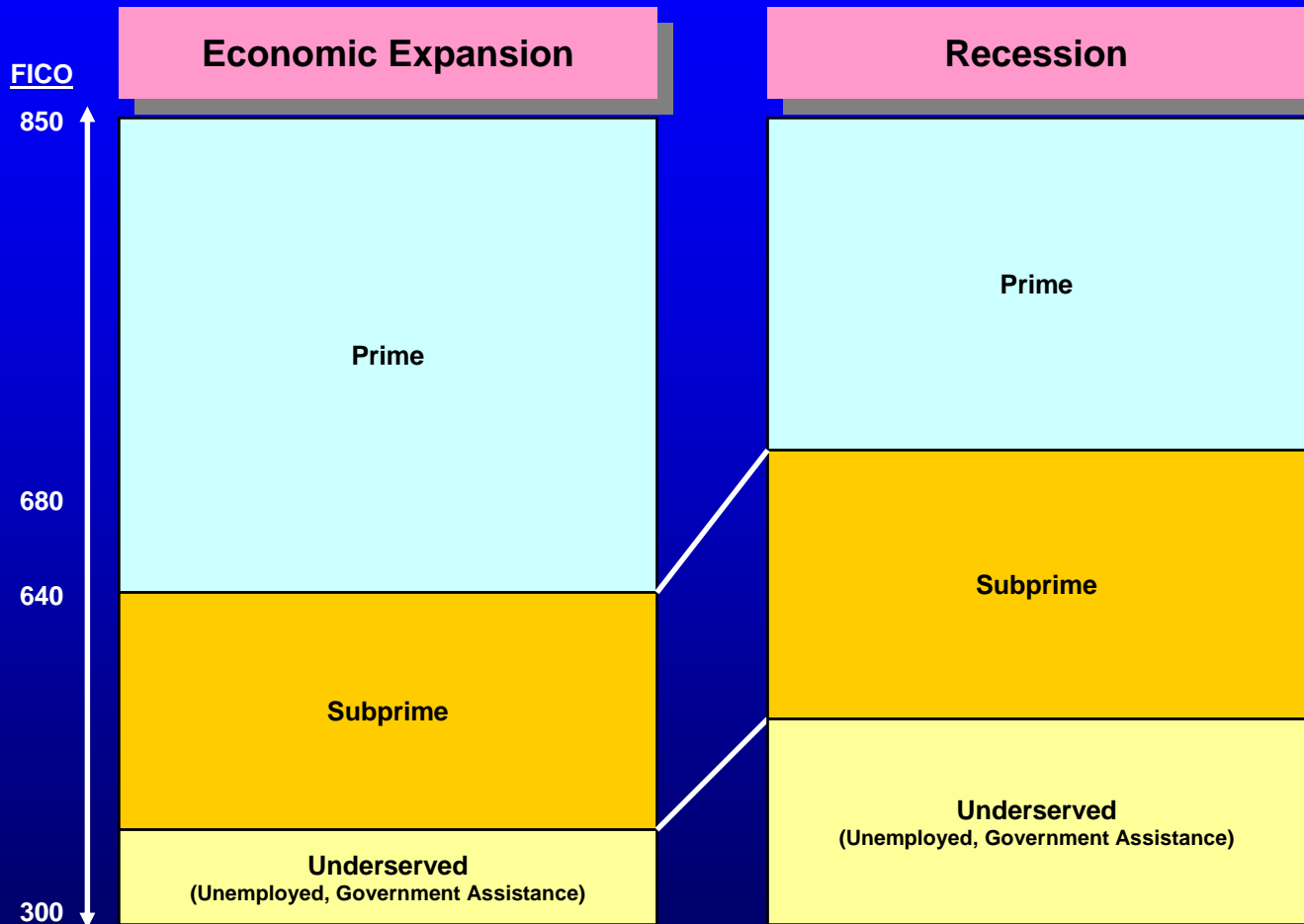
U.S. Unemployment Rate & GDP Growth

Unfortunately, the national unemployment rate has been a lagging indicator in the previous two recessions, suggesting that the current 9.7% unemployment may not have peaked.



Source: U.S. Bureau of Labor Statistics
U.S. Bureau of Economic Analysis

Credit Spectrum Shifts Up in Slower Economic Times



Does this apply in a severe recession with double-digit unemployment?

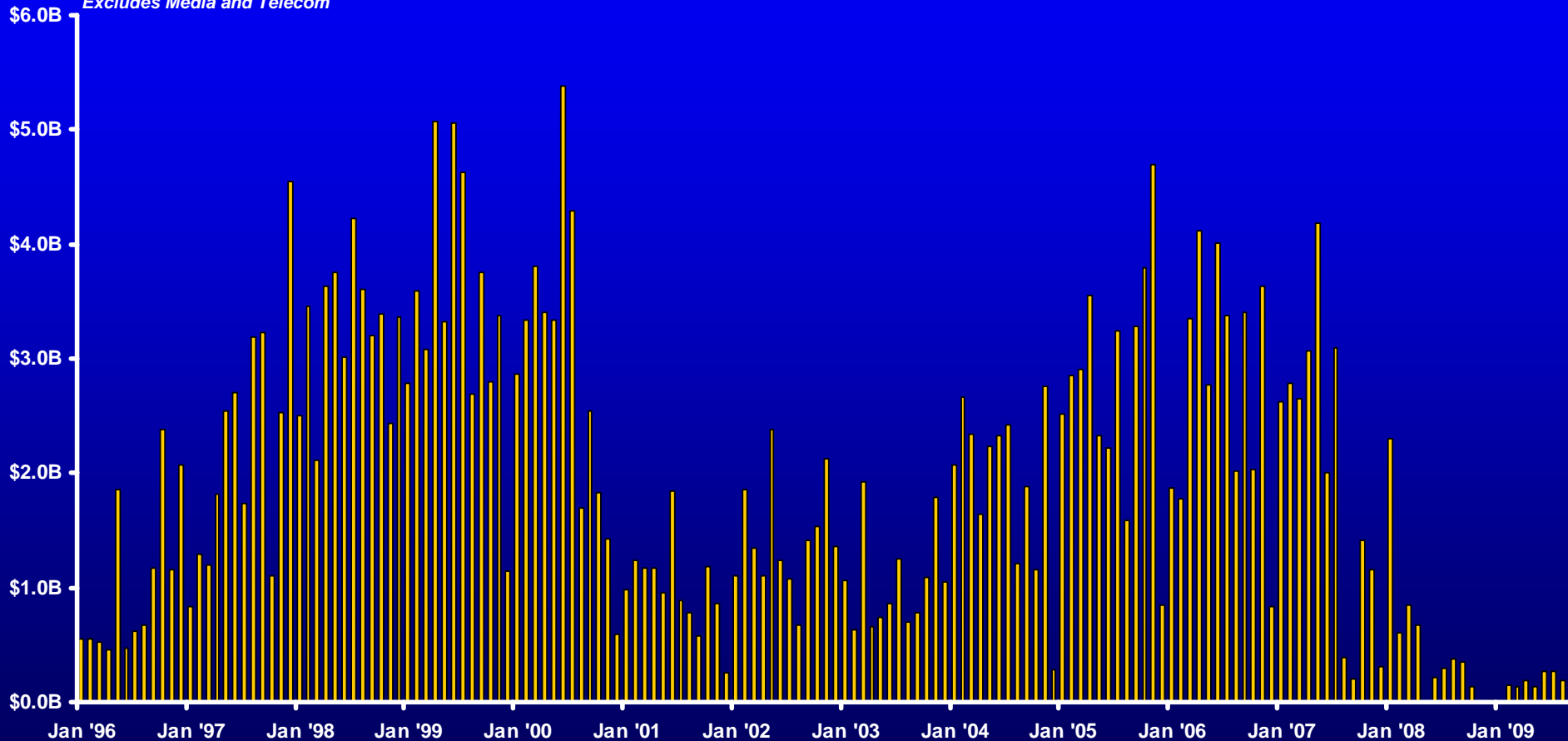
Leveraged Loan Issuance Volume

Leveraged loan issuance by middle market issuers has fallen off dramatically over the past 24 months.

Total Volume for Middle Market Issuers (\$50M or less in EBITDA)

Monthly Data: January 1996 – August 2009

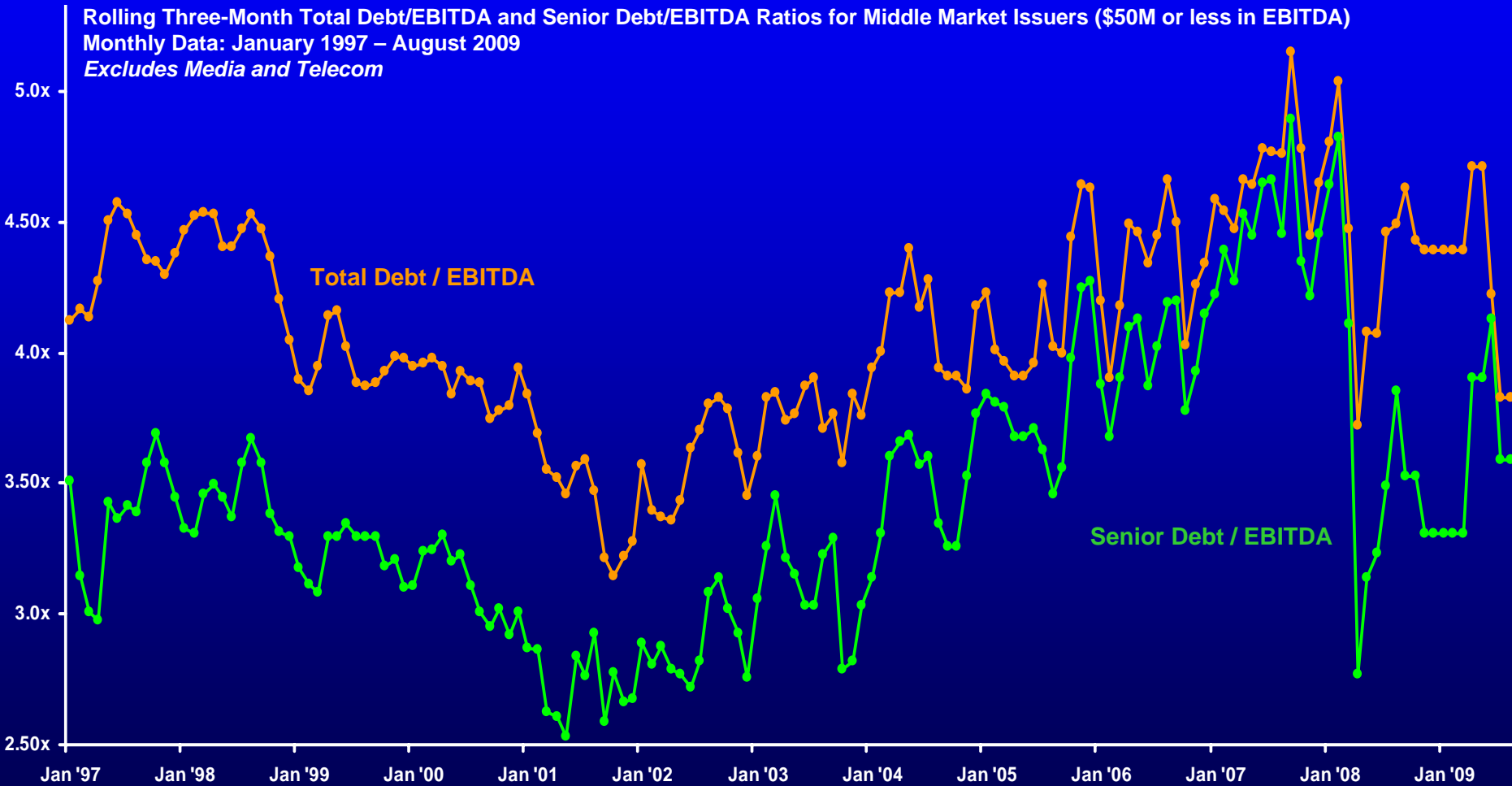
Excludes Media and Telecom



Source: Standard & Poor's LCD

Leverage Ratio Trends for Leveraged Loans

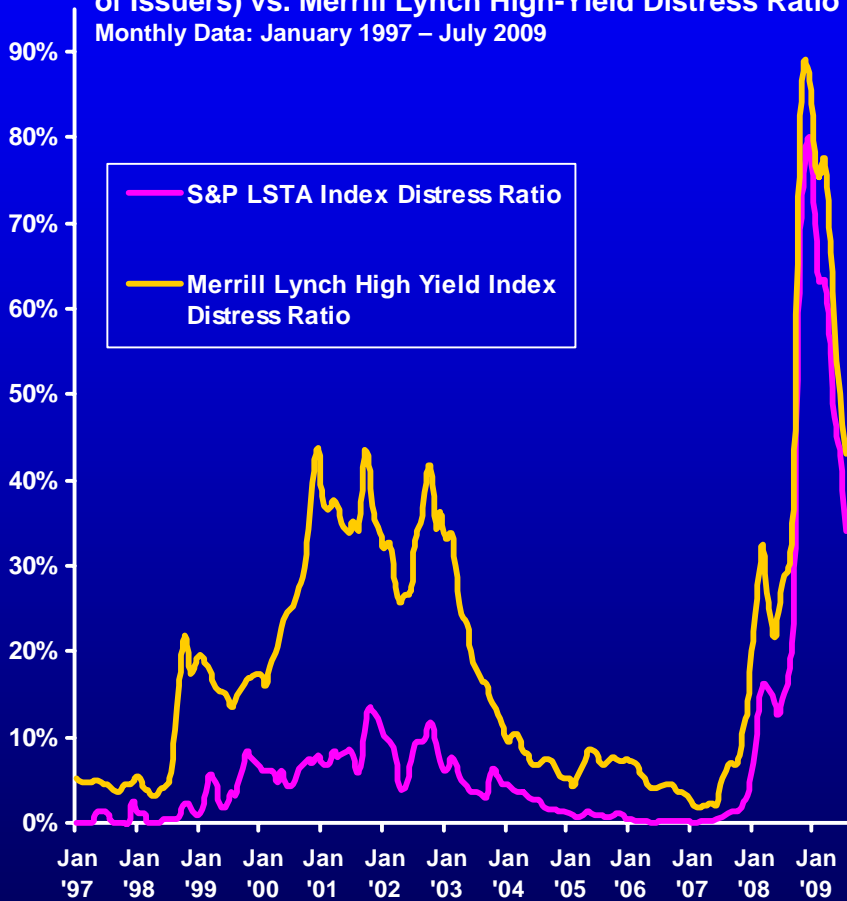
With the emergence of second-lien loans in 2003, an increasing supply of senior debt pushed leverage ratios for middle market issuers to historical levels in 2007. Following the broader credit market freeze, not only have leverage ratios fallen precipitously from their early 2007 peaks but the number of leveraged loan transactions per month has fallen from 30+ transactions per month in 2007 to an average of 3 transactions per month in 2009.



Leveraged Loan Credit Trends

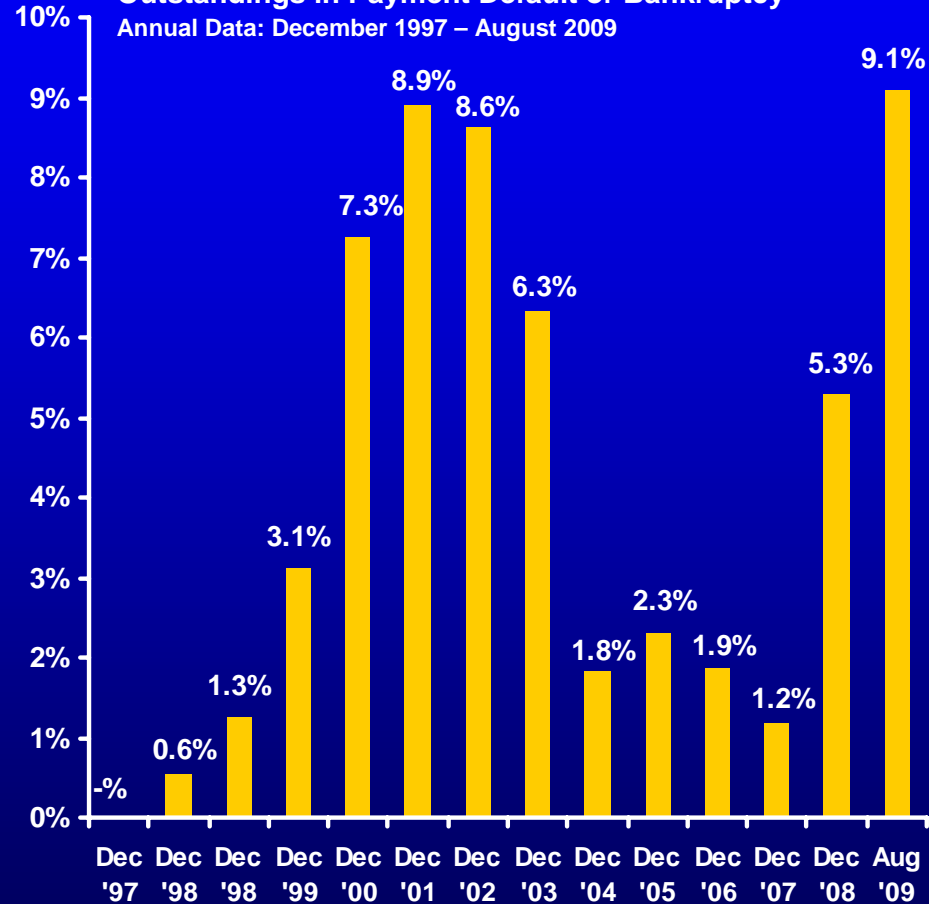
More pronounced than in the 2001 recession, the recent spike in distress ratio indices may serve as a leading indicator of future defaults.

Standard and Poor's LCD Distress Ratio (by Number of Issuers) vs. Merrill Lynch High-Yield Distress Ratio
Monthly Data: January 1997 – July 2009



Note: S&P Distress Ratio is the percent of performing loans trading below 80. Merrill Lynch High Index Distress Ratio is the percent of performing high-yield bonds outyielding Treasuries by 1,000 bp or more.
Source: Standard and Poor's LCD and S&P/LSTA Leveraged Loan Index & Merrill Lynch

Percentage of Leverage Loan Borrowers with Outstandings in Payment Default or Bankruptcy
Annual Data: December 1997 – August 2009

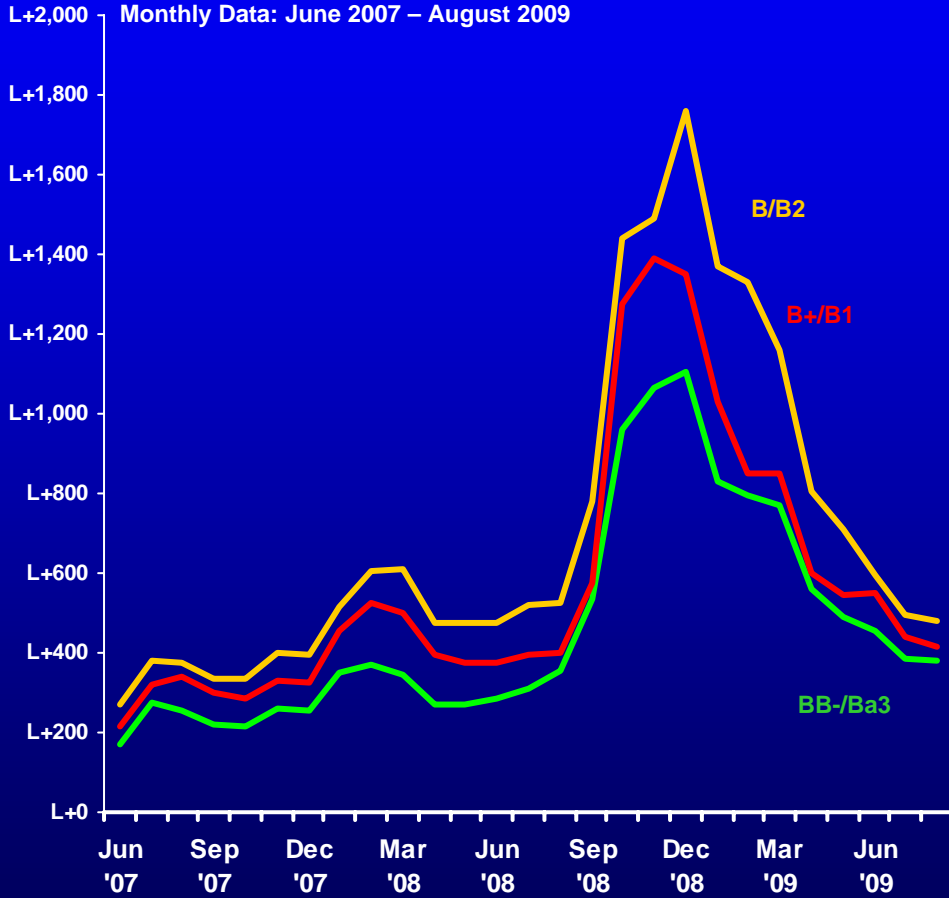


Note: Comprises all loans, including those not tracked in the LSTA/LPC mark-to-market service
Source: Standard and Poor's LCD and S&P/LSTA Leveraged Loan Index

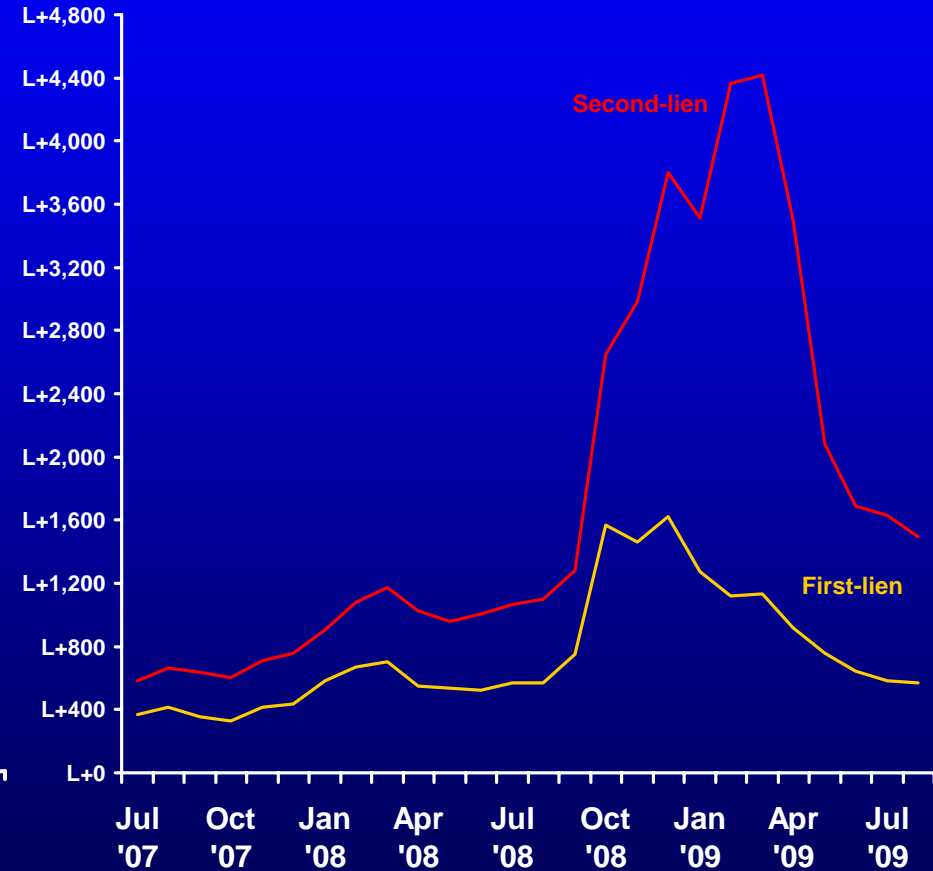
Leveraged Loan Secondary Pricing Trends

After a dramatic widening in late 2008 across all credits, secondary spreads for leveraged loans have declined almost as quickly in 2009.

Average Secondary Spreads to Maturity by Corporate Credit Rating
 Reflects 15 Largest Index Names in Each Category
 Monthly Data: June 2007 – August 2009



Average Secondary Spread of 15 Largest Second-Lien Loans
 First-Lien Spread vs. Second-Lien Spread
 Monthly Data: July 2007 – August 2009



Source: Standard & Poor's LCD