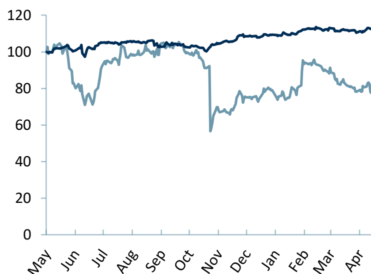
INITIATION

VALUE RANGE

USD 8.86 – 9.80



OMF 12m Price Rel. vs. NYSE Composite (darker)

Tuesday, 02 May 2017

Intrinsic Price	$9.30
Value Range Low	$8.83
Value Range High	$9.76
Implied MCAP (bn)	$1.258
Implied EV (bn)	$12.87
NYSE Index	OMF
Financial YE	31-Dec
Currency	USD

Business Activity

Consumer retail near-prime lending

Key Metrics

Close Price	$22.54
MCAP (bn)	$3.050
Net Debt (Cash) (bn)	$11.616
EV (bn)	$14.67
52 Wk Hi	$33.31
52 Wk Lo	$16.03
NAV trailing	$22.66

Key Ratios

S/P premium to NAV	-0.53%
Charge off	5.09%
Net Debt / Shareholder Equity %	378.86%

Financials Sector Research

NYSE Best Market Index

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ACF EQUITY RESEARCH

OneMain…while Rome Burns

Is the Branch Network on Fire?

OneMain Holdings, Inc. (OMF:NYSE) appears to be sleeping at the wheel. The 52 wk share price low suggests the market thinks the acquisiton value of OneMain by Springleaf (and so therefore PE House Fortress) may be about to go up in a puff of smoke. Springleaf's IPO price was $17.00 on 15th Oct 2013. It bought OMF and changed name to OneMain in 2015. The integration has taken longer than ancitipated and so cost more as well as hitting sales growth. But the real concern for markets is that the branch network strategy is a huge liability for future performance and that OMF has spent two years twiddling with an online offering instead of making this its core focus, whilst oversight costs and competition are set to rise and likely, accelerate. We explain why.

- Fortress's controlling 58% means other shareholders are hostages;
- Online strategy is peripheral rather than core to OMF;
- Branch strategy has no residual value – it is largely leased;
- Merger integration is turning out to be sticky…and costly;
- Oversight + competition + culture suggests cripplingly low agility;

	Revenue	EBITDA	FCF	EPS	EPS (diluted)	CPS
2017E	4,089	3,114	1,677	3.97	3.96	12.45
2018E	4,250	3,250	1,715	4.90	4.89	12.73

Multiples	EV/ Revenue	EV/ EBITDA	EV/ FCF	P/ EPS	P/ EPS (diluted)	P/ CPS
2017E	3.59x	4.71x	8.75x	5.68x	5.69x	1.81x
2018E	3.45x	4.51x	8.55x	4.60x	4.61x	1.77x

02/05/2017 Share Price History	No. of Shares in issue	Fully diluted
NoSh (m)	134.72	135.14
Implied Intrinsic Price	$9.30	$9.31
Value Range Low	$8.83	$8.81
Value Range High	$9.76	$9.73
NYSE	OMF	
Financial YE	31-Dec	
Reporting Currency	USD	
NoSh (m)		134.72
NoSh (m) expected dilution (Exp D)		134.72
NoSh (m) full dilution (FD)		135.14

Key Metrics		adj.
MCAP (bn)	$3.0	$3.0
Net Debt (Cash) (bn)	$11.62	$11.62
EV (bn)	$14.7	$14.7
52 Wk Hi	$33.3	$33.2
52 Wk Lo	$16.03	$15.98
Free Float	42%	42%

*Key Metrics FCF adj.	2017E	2018E
CPS (USD)	12.39	12.68
CPS (Exp D) (USD)	12.45	12.73
CPS (FD) (USD)	12.41	12.69
P/CPS	0.8x	0.7x
P/CPS (Exp D)	0.7x	0.7x
P/CPS (FD)	0.7x	0.7x

Above we show full dilution (FD) and expected dilution (Exp D). OMF shares in issue at the date of this note are 135,301,000. We assume there are no dilutive effects over our 5-yr valuation horizon.

Investment Case

Competitive background

OMF is the creation of a package of post financial crash unwanted assets of AIG (a name synonymous with appalling lending choices running up to the financial crisis), hopefully renamed Springleaf and Citigroup's equally unloved package OneMain, which the bank arguably needed to offload to pass its stress tests and appease its own regulators to simplify its business. Springleaf was bought by Fortress, a PE house likely to become part of Softbank shortly. Springleaf was subsequently listed – IPO price USD 17 - on 15th October 2013. The stock price performed very well during 2014 and 2015 and then Springleaf paid USD 4.25bn for Citi's OneMain. Since then the share price has averaged down - 52-week high of USD 33 on 28th April 2016 and its 52-week low of 16.03 on the 9th November 2016. Three factors are forcing the competitive environment online and centralised, rather than bricks and mortar and distributed – **i)** rising regulatory oversight costs, **ii)** the likelihood that lenders who exited the non-prime market may well return, but with online offerings, **iii)** the end of the Dodd-Frank Act 3-year moratorium on banks owned by non-financial businesses entering the consumer loans market.

Payday loan companies are also increasingly entering the consumer instalment market (OMF's core market) to ease the scrutiny over their other activities, where they charge 400%+ APR for pay-day loans vs. 28-29% APRs on instalment loans.

Online revenue generation per employee is >2x better than bricks and mortar.

Online cash cost acquisition (CCA) of loan customers is somewhere between 4-6% vs. bricks and mortar CCA costs of 8-10%.

Online processes are same-day from start through to approval and receipt of funds. Bricks and mortar struggles to achieve this – it is less cost and customer efficient;

We assess consumers resent shoe-leather and opportunity costs of branch visits;

Investors should note that the transformation to a digital and online world tends to occur with a dramatic flip rather than a gentle progression.

Low distribution costs online - An online strategy lowers costs of customer acquisition (CCA), is efficient for clients, is essential to digital natives and neo-natives (25s-35s) and makes a company highly scalable. OMF has a nascent online business, but the company sees it largely as a platform to bring customers into the branch network. OMF is missing the point…and the growth opportunity.

Catalysts for further valuation downgrades

Disappointing 1Q17A; lack of a dividend policy plus falling investment yields; contraction of the loan book, decelerated or no organic growth; Increased online competition and or oversight burden.

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Operational Strategy

Because of the bricks and mortar strategy, loan standards vary between branches.

Though overall delinquency rates are lower than online they are not low enough to justify the bricks and mortar opex and revenue generating inefficiencies vs. online, in our assessment.

Insurance products sold alongside personal loans is a revenue line at risk.

OMF is a national player serving non-prime consumer burrowers in 44 states via its 1800 branches and 10,100 staff. OMF has online offerings via the website and **iLoan**, but they are peripheral in scale and management focus. US legislation discourages lenders from servicing the non-prime consumer lending segment and so the supply of credit to this demographic has declined. OMF believes there is a significant supply/demand disequilibrium in the non-prime consumer lending segment to be exploited. So far we agree with OMF, where we disagree is that investors best interests are served by prioritising a bricks and mortar strategy to address this disequilibrium.

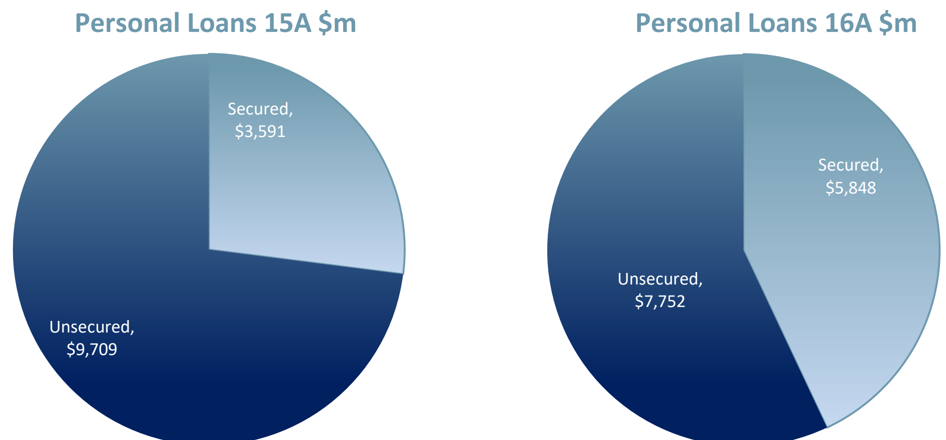
OneMain is defined by its **Personal Loans business**. In YE16A post accounting integration of the OneMain acquisition during 2015, OMF had 2.2m personal loans out, equating to USD 13.6bn of net finance receivables of which 43% were secured by collateral (up from 27% in 2015 and prior to the Springleaf/OneMain merger). The loans are typically non-revolving, fixed rate and have fixed terms of 3-6 years.

Insurance products (credit insurance such as life, disability and involuntary unemployment insurances and non-credit insurances are sold alongside the Personal Loans products). Essentially this business line is dependent upon selling collateral protection insurance with the personal loans, but customers do not explicitly agree to the costs of these insurance products and we expect the regulator to prohibit this type of product sooner rather than later. In which case, and as OMF acknowledges, there would be no distribution for its insurance products provided by the Springleaf insurance subsidiaries, Merit and Yosemite.

OMF is migrating towards the collateral backed instalment based consumer (personal) loans market with progress particularly within the Auto loans segment. not break the Auto numbers out, but this is very much an online market. So “Online” is the source of OMF’s scant growth and the driver for it migration from unsecured lending to secured lending. Yet “Online” is positioned as a peripheral to drive trade to the branch.

OMF secured loans-mix change driven by online auto collateral loans. But OMF is committed to a branch strategy with 10,100 employees and 1,800 branches.

Exhibit 1: **OMF Personal loans mix change secured 15A to 16A**



Source: ACF Research Estimates; Company Reports. Source: ACF Research Estimates; Company Reports.

It may feel like a "black swan" event at the denouement for investors.

● **Growth market** – The FDIC estimated in 2013 that 1 in 13 US households were underbanked (7.7% of pop. or 9.6m households). The Centre for Financial Services (CFS) estimated that the product category – short term credit – grew 37% from 2012-14 whilst single-payment credit, the primary competing product category grew 0.1%. Given statistical error, this suggests to us that the single lump-sum repayment market is probably contracting in favour of the instalment based market. It strikes us that bricks and mortar OneMain investors may well be ambling towards a "black swan" event.

● **Subprime loan market value** – this market can be broadly broken into two product categories – short term credit and single repayment loans (where the entire loan is paid down by the borrower in one payment). The short term credit market FY14A was estimated at USD 29bn and growing vs. single payment credit of USD 38bn contracting in favour of short term credit products. According to online competitors US short term credit markets already generate 2x revenue of the US single payment credit market.

● **Branch strategy –** We assess that most consumers dread a visit to a branch, because of the huge shoe leather and opportunity costs compared to the alternatives. Much of the globe seems unlikely to go down the financial services branch route at all, preferring (mobile) online financial services from the outset. We conclude that OMF's branch strategy is both antiquated and irrelevant in the mid to long term.

Instead of online being central to OMF's survival transition, it is peripheral. We conclude that OMF is missing the point and perhaps the entire growth opportunity.

Online providers offer same-day turnarounds in which cash is delivered to customer accounts. Whereas OMF offers online services, but closing is generally in-branch. OMF also states that it makes same-day decisions; it is not entirely clear that funds will be available same-day to the customer, who still has to "diarise" a time to get to the branch.

● **Disrupting the bricks and mortar competition model** - It seems to us that most bricks and mortar lenders such as OneMain should have already moved to a full online strategy, but OMF has not, suggesting cultural inertia. Bricks and mortar competitors do not appear to understand how disruptive brands work or the speed or network mechanisms that drive markets to flip from one behaviour to another.

● **Thin staff structure** - OMF currently employs 10,100 people and distributes its loan and insurance products via its network of 1,800 physical branches, which are more or less all on 3-5 year leases. This is **not a thin staff structure** and we estimate that staff at a bricks and mortar business generate about half the revenues per head of their equivalent online competitors. Online keeps customer acquisition costs low via cost per click advertising leading to online lead generation. Bricks and mortar relies on the slow development of personal interaction of employees in the community. Online does have a higher default and delinquency ratio but it is not twice that of bricks and mortar.

● **Market development** - The CFS suggests that upcoming regulatory changes will make the single lump-sum consumer loan payment market unattractive to operate. This suggests that investment in the lump-sum repayment market is probably on hold or diverted to the consumer instalment market.

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Exhibit 2: **Customer CCA online advantage**

	CCA Online %			CCA Traditional media %		
	4%	5%	6%	8%	9%	10%
USD						
Loan Principal	5,000	5,000	5,000	5,000	5,000	5,000
Cash CCA	200	250	300	400	450	500
Loan Revenue	5,975	5,975	5,975	5,975	5,975	5,975
Cash CCA	239	299	359	478	538	598

Source: ACF Research Estimates; Company Reports.
*CCA – Cash Cost of Acquisition of loan customers

Loan standards vary between branches as the decision process is decentralized.

● **Client selection criteria** – **YE16A** OMF's loan portfolio valued at USD 13,732m was spread by value between customers with FICO credit scores as follows: 25.3% (USD 3,470m) with a 660 score or greater; 24.8% (USD 3,408m) with a score between 620-659 and 49.7% (USD 6,828) below 619. **YE15A** 45.7% of customers by loan value (USD 7,075m) had FICO scores below 619. OMF uses proprietary software analysis to assess its underwriting opportunities in broad terms but each branch has significant autonomy within OMF's underwriting guidelines and as such lending criteria are both somewhat variable and driven by qualitative inputs based on branch staff knowledge of their communities and sometimes, can look idiosyncratic.

OMF sees its online provision as very much an adjunct to its branch offering, and largely as a way of pushing customers to branches where an online application is subsequently only closed in the branch. In our assessment the strategy choice to keep branches as the core distribution channel is based upon a significant strategic misunderstanding of consumer behavior and how it changes, particularly within the digital/online age.

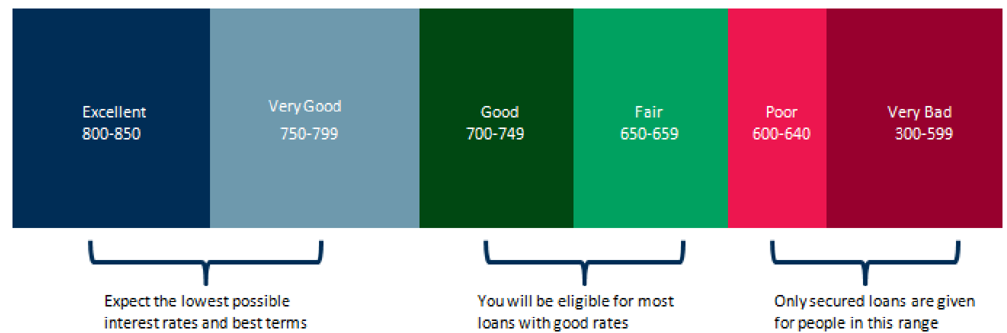
On balance default and delinquency ratios are lower for OMF than for online providers, but they are not half the rate of online, whereas online providers deliver over twice the revenue per employee and this gap is only likely to continue to expand in favour of online providers.

OMF's board does not strike us as composed of digital marketeers, and certainly not digital semi-natives. This is significant because the generation that should be OMF's core customer base for growth are in their late 20s to early 30s, they are semi-native and their behaviour is very different. Semi-natives in the digital environment see going to a branch for financial items not only as entirely unnecessary but also as an extraordinarily bad use of time and resources.

● **Lead generation** – Distribution is dominated by the branch network and OMF's front line employees' integration into local communities. The insurance products would currently cease to have any distribution without the branch network. There is a limited online offering via onemainfinancial.com, which is designed to drive online enquiries to branches for closing. There is a separate **iLoan** brand "tailored towards customers who prefer an end-to-end online and centrally serviced product". Investors could be forgiven for thinking they are reading the sales literature from a regional department store from the 1930s.

Competitors see online customer acquisition as the driving force for their businesses ,and much of the marketing and loan approval process is fully automated.

Exhibit 3: **ACF's normalised credit score range**



Source: ACF Research Estimates; credit scoring agencies.

● **Caveat emptor** - Investors should note that the transformation to a digital and online world tends to occur with a dramatic flip rather than a gentle progression, one moment a service or strategy seems relevant for years to come as it faces a gentle decline, the next it is more or less gone, this firestorm is followed by the flourishing of a few niche survivors making a profitable but nevertheless niche living. OMF by any measure is not a niche player but a significant national player, for now.

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Hostile Offer for OneMain (NYSE:OMF)

OMF does not intend to pay a dividend now or in the foreseeable future but investment yields are set to decline under its new strategy of moving to collateralized consumer lending.

IEGH (OTCQB:IEGH) launched an all paper hostile bid for OneMain Holdings Inc. (NYSE:OMF) on Friday, 5th January, 2017. There were few takers for the unlimited 2:1 OMF common stock offer and IEGH has since improved its offer materially to 20 IEGH shares for 1 OMF share for up to 6,747,723 OMF shares, equating to approximately 5% of OMF's share capital. IEGH may well be able to strip out USD 1bn of costs from property and personnel. We would expect any offer to make a significant impact on the approximate USD 40m of executive costs, particularly as OMF was loss making FY15A and does not pay a dividend. Since the offer commenced, OMF's share price has barely moved but IEGH has subsequently been subject to anomalous shorting, in our view.

IEGH's all paper offer for 5% of OMF could be interpreted as generous when compared to our valuation. Range for OMF.

Clearly the launch of the bid was initially positive for IEGH shares, why should this be, given that generally the acquirer faces a risk discount on announcing a bid? We argue that though IEGH is a small low liquidity-stock, its entirely online lending model is the growth future of the industry. OMF roundly ignored the IEGH offer and gave it either short shrift or arrogant dismissal (only time will tell). Since OMF's "dismissal" of IEGH's offer, shorting pressure has since been applied to IEGH equity, but OMF's share price has not undergone any dramatic rally, rather it has remained flatish.

● **Dropbox paradigm** - the table below gives an insight into why online-only lending is likely to be the future. The table shows FY16 revenues and staff for OMF and Dropbox and compares their relative efficiency with our FY17E revenues and employees for IEGH in order to attempt to normalise the comparison, as IEGH hits breakeven (1Q17E).

Dropbox, the disruptive online storage business, is included because certain metrics for online businesses recur. Revenue per employee is a key metric that amply demonstrates the difference between the potential efficiency (RoI and RoE) of online strategies compared to bricks and mortar strategies.

Exhibit 4: **Efficiency per employee**

OMF's response to IEGH's offer suggests OMF's board is furious rather than calm and considered, this usually comes out of fear and or arrogance. Neither of which bode well for current OMF shareholders.

	Revs	Emp	Rev/Emp	x diff
OMF	3,883	10,100	384,455	1.0x
IEGH	5.024	7	717,714	1.9x
Dropbox	1,000	1,200	833,333	2.2x

Source: ACF Research Estimates; Company Reports; Online sources.

Investors could be forgiven for thinking Fortress, as a 58% holder, has had a hand in the attitude and tactics displayed by OMF's board.

Retail borrowing and banking trends all over the globe suggest that the days of the office/ branch network are very limited.

As can be seen from the table above, IEGH's online strategy, according to our 2017 forecasts for IEGH will likely generate around 1.9x or 90% more revenue per employee than OMF's bricks and mortar strategy. Dropbox, another online business delivers 120% more revenue per employee based on our 17E forecasts. Online businesses across sectors share certain commonalities, revs/employee metrics is one of them. This suggests that IEGH's offer for 5% of OMF's shares is not ungenerous. We assess IEGH would push for change and as a wholly online provider is well positioned to assist.

● **Branch banking analogy -** we are strongly of the view that the majority of individuals, and especially those that consider themselves revenue constrained find online applications far more efficient and convenient. We accept that the personal relationship that OMF offers via its personnel and branches is valued, largely we suspect because borrowers feel they can exercise a degree of personal chemistry in the decision making process. The reality, in our view, is that this assumption is 20 years out of date and certainly cannot be justified by specialist lenders and retail banks post the 07/08 financial crisis.

Netflix offered itself for USD 50m to Blockbuster in 2000. Netflix is now worth USD 55bn; Blockbuster began a long process of liquidation in 2010.

● **Netflix Blockbuster analogy** IEGH draws the comparison between online video provider Netflix and bricks and mortar video provider Blockbuster that was **summarily dismissed** by the Blockbuster board, but which with hindsight would have saved Blockbuster at least as a brand. Blockbuster disappeared within 10 years. Netflix attacked its model because it transpired that much of Blockbuster's margins were based upon late-return charges to clients. Is OMF's insurance business delivering the bulk of margins for OMF? The margin data is not broken out by OMF to make this assessment, we think it should be.

Nokia died of arrogance and a long standing inflexible culture.

Even in 2010 Nokia had a value high just short of EUR 50bn, around 75% of which was attributable to the handset business. 3 years later the handset business was sold to MSFT for just under EUR 6bn. At its height in 2000 Nokia was valued at USD 300bn. In May 2016 MSFT sold the Nokia brand back to ex-Nokia employees for USD 350m having written the handset business down to zero in 2015.

● **Nokia analogy** – we have had considerable exposure to Nokia (NOK1V:OMX), the Finnish paper producer that legendarily reinvented itself by turning its hand to making telco kit and handsets and became the world's dominant handset maker. However, once the sunset arrived for Nokia's handset business, it came on very swiftly (within 24 months) and took Nokia completely by surprise. One notable characteristic within Nokia before the fall was significant **arrogance** with respect to its position, market share and communications with stakeholders. Nokia's handset business was sold to Microsoft NYSE:MSFT) for USD 7.9bn a relative pittance compared to its highs, and has since been written down to zero by 100% shareholder MSFT. **Disclosure:** one of ACF's AiM listed telco software clients was sold to Nokia around 12 months before the MSFT sale.

● **Our message is twofold** 1) Investors ought to be very watchful of disruptors and to carefully consider which baby they'd rather be holding.

Disruptors come from nowhere and always look like minnows until it is too late.

2) In our experience, nothing presages the end of a business model more than stubborn pride, comfortable remuneration packages and an entrenched culture. OMF is 100 years old and management is well remunerated. Changing culture/strategy is a very difficult, time consuming and expensive process for the incumbent management teams that are culturally entangled.

For OMF shareholders, in our view, there is more of an active effort required to get better value from the OMF assets.

Fortress's controlling 58% holds the key.

● **Aftermath** If IEGH managed to coral even a 5% minority stake the jolt to OMF management could accelerate internal change, which would be positive for shareholders on both sides. We hope positive change for shareholders may still come for OMF's board whatever the outcome, but long experience tells us this is unlikely and that 58% stake holder Fortress, which holds the control card, will change without regular kicking at its heals by a minority shareholder such as IEGH. Whilst Fortress maintains its 58% holding, other shareholders without the appetite for difficult discussions, are hostages/passengers.

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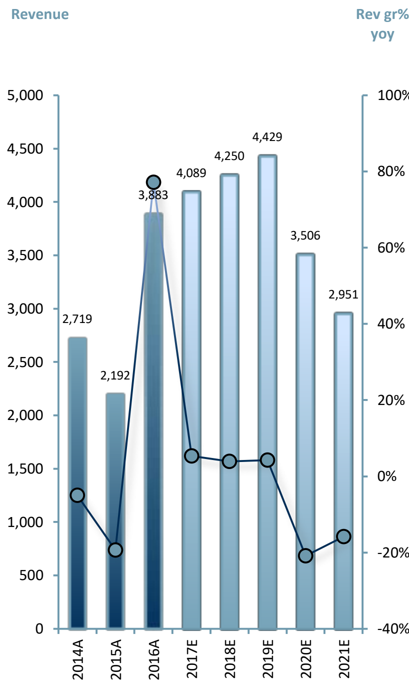
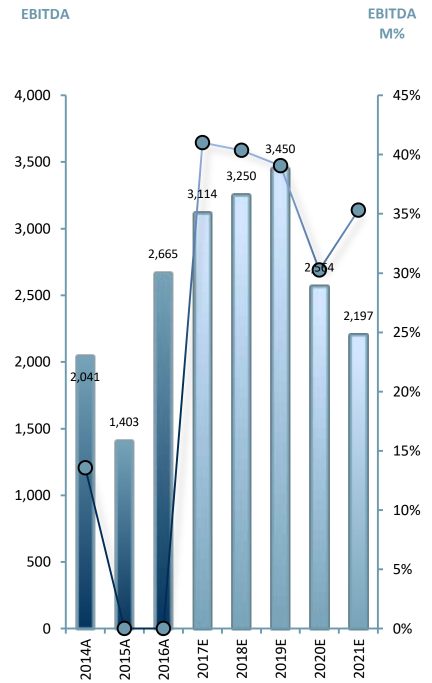
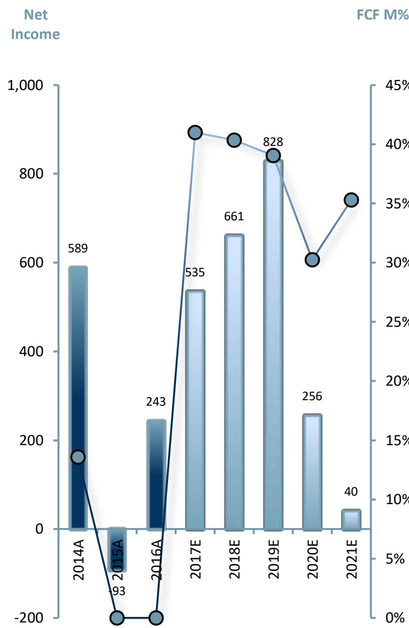
Forecasts

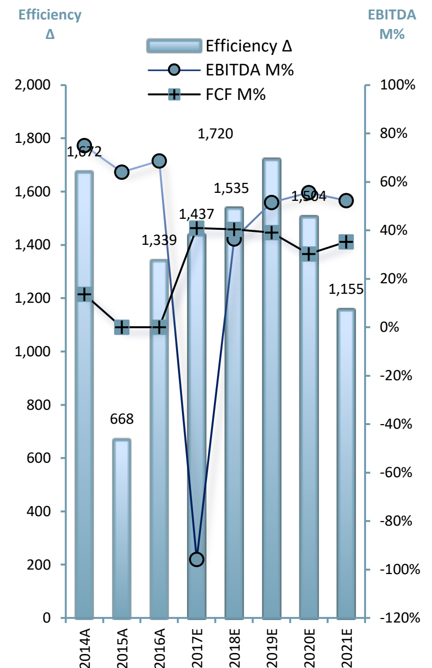
Our OMF "black swan" event is just out of sight of the usual published forecast horizons in our scenario, where revenues drop off by 20% during 2020 and management takes remedial action there in on in response to the online behavior flip in its core business. We have assumed that insurance revenues continue to have a distribution channel but in reality this is likely to be halted by regulation.

Darker values are historical, lighter values are forecasts









Our forecasts are based upon management guidance and our own sensitivity analysis. We focus on cash proxies (EBITDA) and free cash flow (FCF). However, Net Income remains important for assessing elements of balance sheet strength, nevertheless we are strongly of the view that only cash matters.

Valuation

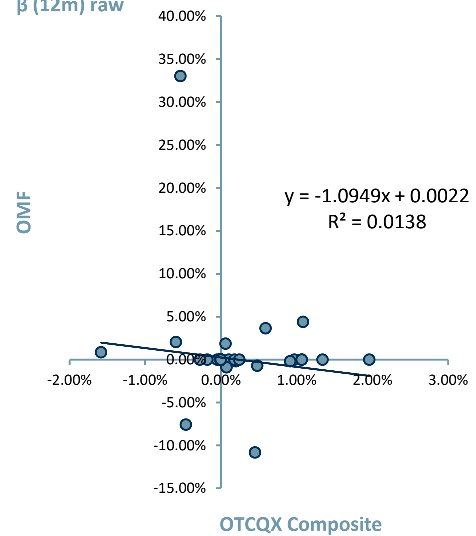
ACF est. USD (m)	2016A	2017E	2018E	2019E	2020E
Revenue	3,883	4,089	4,250	4,429	3,506
EBITDA	2,665	3,114	3,250	3,450	2,564
Net Income	243	535	661	828	256
FCF	1,326	1,677	1,715	1,730	1,060
CPS (diluted)	9.81	12.41	12.69	12.80	7.85

OMF WACC Calc	
Pre-tax cost of debt	5.4%
ETR	40.0%
After-tax cost of debt	3.2%
Current Leverage	
Debt	457.7%
Equity	3,050
Target Leverage	
D / (D+E)	60.0%
ACF β adj levered	2.24
rf	0.80%
Rm	6.2%
ERP	5.4%
Cost of equity	12.88%
Risk adj.	0.00%
WACC	7.09%

*Bloomberg ticker indicates ACF market ERP

Note: We assume the conservative Debt / Equity target mix 10%, up from 0% at initiation. It is likely that IEGH will raise this target ratio in the future.

β (12m) raw



we assumed a target Debt/Equity mix of 60% vs. the current ratio of 80% debt, this target assumption lowers our WACC for OMF as the balance sheet becomes more optimally geared.

Valuation Range		
NPV FCF (m)	5,478	
NPV TV FCF (m)	7,396	
EVF (m)	12,874	
TV Mulitple	10.0x	
% TV of total NPV	57.45%	
Net Debt (m)	11,616	
Fair Value (m)	1,258	
NoSh (m)	135.30	
NoSh (diluted) (m)	135.14	
Intrinsic Value Per Share USD	9.30	
Close Price USD	22.54	
VR (low - high)	**8.83**	**9.76**
VR Spread	10.00%	
Implied VR Return (low - high)	-60.8%	-56.7%

Note: Close price on front page of this ACF research note is based on shares in issue (NoSh) on 02/05/2017 of 135,301,000.

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Sensitivity Analysis

We have assumed revenue growth continues somewhere between 3-5% for OMF out until 2020. During 2020 in our scenario the flip to online occurs and OMF revenues decrease 20%, OMF then takes remedial action and so the decay rate falls to around 15% in 2021. We assume that management takes further extreme action to stem the steep decline in revenues and cuts costs so that OMF does not end up with a zero valuation. Our OMF WACC is cut to 7.09% by assuming that OMF cuts its debt to equity ratio to 60% from the current 80%, this is achievable based on our OMF balance sheet cash accumulation between FY17E to 20E. We have assumed an FCF TV multiple of 10x vs. 8.75x 17E forecast, which we believe shows a strenuous test of our valuation case. Our new OMF FCF TV multiple DCF VR of USD 8.86 to 9.80 is published in this note. When we run the valuation using an EBITDA TV of 5x we generate a valuation range of USD 11.59 - 12.62, given that the 17E EV/EBITDA multiple is 4.7x in our view this is a fair approximation. Our scenario is highly sensitive to changes in WACC and TV multiples between some value for OMF, and nil value for OMF.

Exhibit 5: **IEGH multiples based on close price**

	Revenue	EBITDA	FCF	EPS	EPS (diluted)	CPS	CPS (diluted)
2017E	4,089	3,114	1,677	3.97	3.96	12.45	12.41
2018E	4,250	3,250	1,715	4.90	4.89	12.73	12.69

Multiples	EV/ Revenue	EV/ EBITDA	EV/ FCF	P/ EPS	P/ EPS (diluted)	P/ CPS	P/ CPS (diluted)
2017E	3.59x	4.71x	8.75x	5.68x	5.69x	1.81x	1.82x
2018E	3.45x	4.51x	8.55x	4.60x	4.61x	1.77x	1.78x

Source: ACF Research Estimates.

Exhibit 6: **WACC/Multiple table shows longer-term valuation potential**

Share Price

Terminal EBITDA Multiple	WACC 4.00%	5.00%	6.00%	**7.00%**	8.00%	9.00%
2.0x	-18.76	-19.93	-21.04	-22.12	-23.15	-24.14
3.0x	-7.18	-8.35	-9.47	-10.54	-11.57	-12.56
4.0x	4.39	3.23	2.11	**1.04**	**0.01**	-0.98
5.0x	15.97	14.81	13.69	**12.62**	**11.59**	10.60
6.0x	27.55	26.38	25.27	**24.19**	**23.16**	22.18
7.0x	39.13	37.96	36.84	35.77	34.74	33.75
8.0x	50.71	49.54	48.42	47.35	46.32	45.33

Source: ACF Research Estimates.

Exhibit 7 above shows the valuation range based on perpetuity EBITDA growth, whereas our actual DCF calculation uses a TV multiple derived from discounted FCF.

Peer Group Comparators

Exhibit 7: **Trailing OMF consumer lending peer group metrics**

Trailing 16A Metrics / Company Name	Market	MCAP (m)	Div %	EBITDA / M%	MCAP / REVS	MCAP / EBITDA	MCAP / NI
OneMain Holdings Inc	**NYSE**	**3049.68**	**0.0%**	**68.63**	**0.79x**	**1.14x**	**12.55x**
World Acceptance	NASDAQ	471.41	0.0%	26	0.85x	3.25x	5.39x
Enova	NYSE	513.08	0.0%	18.82	0.69x	3.66x	14.83x
LendingClub	NYSE	2416.07	0.0%	-6.9	2.03x	-29.43x	-16.55x
IEG Holdings Corp	NYSE	19.44	0.0%	-221.66	9.08x	-4.11x	-4.11x
Average			**0.00%**	**-45.94%**	**3.16x**	**-6.66x**	**-0.11x**
Median			**0.00%**	**5.96%**	**1.44x**	**-0.43x**	**0.64x**

Source: ACF Research Estimates; Companies reports; Factset.

Exhibit 8: **Trailing OMF consumer lending peer group metrics**

Trailing 16A Metrics / Company Name	Market	MCAP (m)	Gross Debt / Assets	Gross Debt / Equity	RoA %	RoE %	RoI %
OneMain Holdings Inc	**NYSE**	**3049.68**	**77.02**	**455.28**	**1.24**	**7.93**	**1.25**
World Acceptance	NASDAQ	471.41	46.47	95.61	10.45	24.71	11.04
Enova	NYSE	513.08	66.77	270.13	3.81	15.46	4.13
LendingClub	NYSE	2416.07	77.68	442.82	-2.57	-14.47	-2.67
IEG Holdings Corp	NYSE	19.44	0.00	0.00	-64.87	-65.85	-65.36
Average			**47.73%**	**202.14%**	**-13.30%**	**-10.04%**	**-13.22%**
Median			**56.62%**	**182.87%**	**0.62%**	**0.49%**	**0.73%**

Source: ACF Research Estimates; Companies reports; Factset.

Our OMF peer group includes online lenders Enova, Lending Club and IEGH.

OMF does not make up a constituent of our average or median values in the peer group metrics. We have excluded OMF from these values to make comparison with the rest of the peer group as clean and undistorted as possible. We have used trailing metrics and we invite readers to compare the FY16A trailing metrics in the exhibits above with the forward multiples FY17E and 18E in our sensitivity analysis and on the front page of this note. Also be aware that our metrics, which look fairly attractive in the short run, demonstrate how the dangers that we capture in our valuation range are just out of sight – this is why we characterize our investment case as a "black swan" type scenario driven by a flip to online from branches.

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Peer Group Selection

OneMain Holdings, Inc., (**NYSE:OMF**, **NYSE** listed) is a **bricks and mortar** financial services company providing consumer finance and insurance (credit and non-credit insurance) in all 50 US states via its subsidiaries. OMF has >1,800 branches in 44 US sates and >10,000 employees. The Company historically has been acquisitive. OMF has three segments: Consumer and Insurance; Acquisitions and Servicing, and Real Estate. The Company's real estate loans for sale total greater than USD 179m and its real estate loans held for investment are valued at over USD 524m.

World Acceptance Corporation (**NASDAQ:WRLD**, **NASDAQ** listed) is a US consumer finance company. WRLD provides installment and payment deduct loans of a standardized amount and maturity between USD 300 and USD 4,000 as its principal products via its 1,339 **bricks and mortar** branches in the US and New Mexico. WRLD also sells automobile club memberships for which it receives a commission on each sale but is not responsible for the administration of the club. ParaData Financial Systems is a subsidiary of WRLD; it automates loan account processing and collection, provides management information and control capability. WRLD also sells ParaData software systems to other loan providers.

Enova International (**NYSE:ENVA**, **NYSE** listed) provides **online** financial services to non-prime consumers and SoHo/SMEs. ENVA offers short term multi-installment unsecured consumer loans in 20 US states, the UK Australia and Brazil. The Company has over USD 17bn in loans and financing out to 4m customers.

LendingClub Corporation (Lending Club; **NYSE:LC**, **NYSE** listed) offers **online** application installment loans with fixed monthly payments to consumers and loans and lines of credit to the SoHo/SME business market. The loans bare no prepayment penalty for early redemption. The potential loan book is then offered to qualified private investors to fill the book. The loan book attracts a wide range of investors from retail, HNW and family offices, through to banks and hedge funds.

IEG Holdings Corp. (**OTCQB:IEGH**, **OTC Markets** listed) is a US consumer finance company. The Company provides an **online** unsecured installment based consumer loans of USD 5,000 or 10,000 with a 60-month term and APRs between 19.9% and 29.9% (State regulation dependent) via an online-only platform under the brand Mr. Amazing Loans on its website www.mramazingloans.com. The Company has one office and 7 employees, but online lending licenses in 19 US states and is planning to raise this to 25 states by mid-2017. The Company's personal loan products are fully amortizing, fixed rate and unsecured installment loans.

Financial Analysis

● **Revenue model assumptions** – We assume that OMF continues to grow above GDP for the next two years, but to model our "black swan" type scenario for investors we assume that buying loans online gains critical mass and revenues then decline at 20% per annum (the rate of decline could easily be more dramatic than this by the third year of declines, perhaps 50% or more).

● **Personal loans** - OneMain is defined by its Personal Loans business. In YE16A post accounting integration of the OneMain acquisition during 2015, OMF had 2.2m personal loans out equating to USD 13.6bn of net finance receivables or which 43% were secured by collateral (up from 27% in 2015 and prior to the merger between Springleaf and OneMain). The loans are typically non-revolving, fixed rate and have fixed terms of 3-6 years.

OMF's margin contribution from its insurance products, which we believe is at risk is not revealed, it is likely to be relatively significant.

● **Insurance products** - Insurance products (credit insurance such as life, disability and involuntary unemployment insurances and non-credit insurances are sold alongside the Personal Loans products). Essentially, this business line is dependent upon selling collateral protection insurance alongside personal loans, but customers do not explicitly agree to the costs of these insurance products and we expect the regulator to prohibit this type of product sooner rather than later. In which case, and as OMF acknowledges, there would be no distribution channel for its insurance products provided by the Springleaf insurance subsidiaries Merit and Yosemite.

● **Portfolio servicing** - Portfolio servicing – OMF sold its 47% JV equity interest in SpringCastle Portfolio but has a contract to service the loans. The SpringCastle portfolio consisted of closed-end (e.g. fixed term instalment loans) and open-end lines of credit, which functions like a credit card - pay back the amount and customer can borrow it again up to the approved limit.

● **Real Estate loans** -Real Estate loans – OMF ended real estate lending January 2012 and sold off its lending book in 2014 (USD 6.4bn) and in 2016 (USD 304m). The real estate loans are closed-end and open-end home equity lines (HELOCs).

● **Retail sales finance** - Retail sales finance was exited in January 2016 but OMF continues to service the liquidating retail sales contracts and provide revolving retail sales financing services.

● **Ocean Finance** - UK subsidiary Ocean Finance and Mortgages Limited was liquidated 16th August 2016 after ceasing real estate loan origination in 2012. OMF booked a USD 4m FX gain in other revenues on the liquidation. The Ocean Finance brand was bought by a credit card entity – see glossary for additional detail.

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● **Credit losses and impaired loans** – OMF maintains a provision for credit losses because it is probable that a portion of the loans receivable will not be collected. The provision number is based on a range of factors, including specific circumstances of the individual loans and industry trends and OMF's bespoke insights into the market.

The allowance for **credit losses** is determined using a systematic methodology designed by the Company but based upon a combination of historical bad debts of comparable companies. **Impaired loans** are considered separately and 100% **charged off**. We estimate the net charge off rate for the group is approximately **5%** and for the personal loans business approximately **4.87%**.

Financial Projections

Exhibit 9: **OMF P&L and forecasts**

P&L USD (m)	2015A	2016A	2017E	2018E	2019E
Revs	**2,192**	**3,883**	**4,089**	**4,250**	**4,429**
gr%	-19%	77%	5.3%	3.9%	4.2%
GP	2,192	3,883	4.089	4,322	4,473
% Revs	100%	100%	100%	102%	101%
SGA	789	1,218	975	1,000	979
% Revs	36%	31%	24%	24%	22%
EBITDA	**1,403**	**2,665**	**3,114**	**3,250**	**3,450**
% Revs	64%	69%	76%	76%	78%
Provisions credit loss	716	932	979	1,028	976
% Revs	33%	24%	24%	24%	22%
EBIT	**489**	**1,212**	**1,640**	**1,825**	**2,071**
EBT	-226	356	787	971	1,218
ETR	-59%	32%	32%	32%	32%
Tax	-133	113	252	311	390
NI	**-93**	**243**	**535**	**661**	**828**
% Revs	-4%	6%	13%	16%	19%

Source: ACF Research Estimates; Company reports.

Exhibit 10: **OMF Cash Flow and forecasts**

Cash Flow USD (m)	2015A	2016A	2017E	2018E	2019E
Profit/(loss) for period	-93	243	535	661	828
Provisions credit loss	716	932	979	1,028	976
D&A	198	521	495	470	447
Othe non-cash items	-183	-255	0	0	0
WCap Change	-16	-68	-219	-191	-210
Net CFO	**622**	**1,373**	**1,790**	**1,967**	**2,040**
Cash Taxes	-113	47	113	252	311
Capex maintenance	0	0	0	0	0
FCF	**735**	**1,326**	**1,677**	**1,715**	**1,730**
Capex for growth	3,902	0	0	0	0
CF from Investing	1,264	-2	0	0	0
CF from Financing	1,963	-1,684	0	0	0
Net Cash In/(Out)	60	-360	1,677	1,715	1,730
Cash previous YE	879	939	579	2,256	3,971
Cash & CE	**939**	**579**	**2,256**	**3,971**	**5,701**

Source: ACF Research Estimates; Company reports.

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Exhibit 11: **OMF Balance Sheet and forecasts**

Balance Sheet GBP (k)	2015A	2016A	2017E	2018E	2019E
Tangible Assets	611	688	688	688	688
Investments	1,867	1,764	1,520	1,288	1,068
Intangible Assets	1,999	1,914	1,914	1,914	1,914
Total Fixed Assets	**4,477**	**4,366**	**4,122**	**3,890**	**3,670**
Trade & Other rcvbls	15,774	13,178	13,876	14,423	15,030
Assets held for sale	0	0	0	0	0
Cash	939	579	2,256	3,971	5,701
Total Current Assets	**16,713**	**13,757**	**16,132**	**18,394**	**20,731**
Total Assets	**21,190**	**18,123**	**20,254**	**22,284**	**24,401**
Creditors	747	757	797	829	863
Other	384	332	0	0	0
Accruals	0	0	0	0	0
Deferred Tax	20	9	0	0	0
Loans	17,300	13,959	13,727	13,495	13,275
Total Liabilities	**18,451**	**15,057**	**14,524**	**14,324**	**14,139**
Net Assets	**2,739**	**3,066**	**5,730**	**7,960**	**10,262**
Share Capital	1,534	1,549	1,549	1,549	1,549
Reserves	0	0	0	0	0
Share Premium	-24	-6	2,123	3,693	5,167
Accum. Profit/(loss)	1,308	1,523	2,058	2,718	3,546
Non-cntrllng Interests	-79	0	0	0	0
Total Equity	**2,739**	**3,066**	**5,730**	**7,960**	**10,262**
Total Equity & Liabilities	**21,190**	**18,123**	**20,254**	**22,284**	**24,401**

Source: ACF Research Estimates; Company reports.

Glossary

CFPB	Consumer Financial Protection Bureau (CFPB) is an agency of the United States government responsible for consumer protection in the financial sector. CFPB jurisdiction includes banks, credit unions, securities firms, payday lenders, mortgage-servicing operations, foreclosure relief services, debt collectors and other financial companies operating in the United States. The CFPB's creation was authorized by the Dodd–Frank Wall Street Reform and Consumer Protection Act, whose passage in 2010 was a legislative response to the financial crisis of 2007–08 and the subsequent Great Recession. The CFPB was established as an independent agency, but this status is being reviewed by the US Court of Appeals.
CFS	Centre for Financial Services
Charge Off (Gross)	Gross charge off is the USD amount of debt that a creditor declares is unlikely to be collected. Gross charge off is triggered by a consumer becoming severely delinquent on a debt. A charge-off is a form of write-off.
Charge Off (Net)	Net charge off is the USD amount that is the difference between gross charge-offs and subsequent recoveries of delinquent debt. Net charge offs refer to the debt owed to a company that is unlikely ever to be recovered by that company i.e. bad debt
Closed-end	Closed-end lines of credit are those which are characterised by instalment repayments over a set schedule, e.g. auto (car) loans.
CoS	Cost of Sales is, in ACF's financial models, a variable cost linked directly to revenue development, e.g. sales team commissions, but for example, not sales team salaries.
CT	Corporation Tax is the tax owed by corporation on taxable profits less exemptions to IRS.

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Dodd-Frank Act	Dodd–Frank Wall Street Reform and Consumer Protection Act, was passed in 2010 and signed into law 21st July of that year by President Barack Obama as a legislative response to the financial crisis of 2007–08 and the subsequent Great Recession. The Act introduced the most significant regulatory reform to financial services in the US since the Great Depression. The Act touched almost every element imaginable of the US financial services industry and its regulation.
EAT	Earnings after tax. Also often expressed as PAT – profit after tax, and post-tax profit.
EBIT	Earnings before interest and tax (also often referred to or equates to operating profit).
EBITDA	Earnings before interest, depreciation and amortisation – the presentation of EBITDA by companies is not a requirement of UK GAAP or IFRS accounting standards. However, in certain cases it can act as a close proxy to free cash flow.
EBT	Earnings before tax. Also often expressed as PBT – profit before tax.
FCF	Free Cash Flow generated in ACF's models after all obligatory cash costs have been satisfied such as Interest payable (Ip), cash taxes and maintenance capex (as opposed to investment capex). FCF represents the cash remaining for theoretical distribution or investment after all obligatory cash based costs including net interest payable have been deducted.
FDIC	The Federal Deposit Insurance Corporation preserves and promotes public confidence in the US financial system by insuring bank deposits and thrift institutions for a minimum USD 250k. The FDIC is also responsible for identifying, monitoring and addressing risks to the deposit insurance funds. FDIC was set up on 1933 after the thousands of bank failures during 1920s and early 30s.

HELOC	Home Equity Line of Credit (HELOC) - A loan in which the lender agrees to lend a maximum amount within an agreed period, where the collateral is the borrower's equity in his/her house. Because a home often is a consumer's most valuable asset, many homeowners use home equity credit lines only for major items, such as education, home improvements, or medical bills, and choose not to use them for day-to-day expenses. HELOC abuse is often cited as one cause of the subprime mortgage crisis. OMF refers to HELOCs as Open-End Home Equity Lines and by Open-End it means that the line of credit is revolving, so that if the customers pays down the credit the customer can use the credit again within the constraints of the customer's credit limit.
IFRS	International Financial Reporting Standards are a set of standards developed by the International Accounting Standards Board. IFRS is an internationally recognised standard and in principle means that investors from different legal geographies can compare financial performance between potential competing investments more easily (cheaply) openly and fairly, when compared to say comparing UK GAAP vs. US GAAP or other "regional" accounting standards.
IRS	Internal Revenues Service. The IRS is the tax collecting government agency in the US (equivalent to HMRC in the UK), which is also responsible for administering the Internal Revenue Code – the US tax law. The IRS is a bureau of the Department of Treasury under the direction of the Commissioner of Internal Revenue.
JV	Joint Venture – generally a legal structure between two corporate entities involving participation in equity capital in the JV vehicle. JV can also refer to more informal arrangements.
NoSh	Number of Shares in issue (NoSh).

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Ocean Finance

Ocean Finance was a loans and mortgages business set up in 1991 in Staffordshire, United Kingdom. It became infamous in the late 1990s and early 2000s for its advertising, including sponsoring its own channel on Sky TV and its advertising became widely parodied. The firm prospered on the back of rising house prices and the credit boom. By 2002 the firm was a leading player in the UK's secured loan market valued at over £14bn.

The firm was bought by US insurance company American International Group (AIG) in 2006 for over £200m, later wrapped into AIG’s Springleaf, itself sold to PE house Fortress and then floated on the US market. Springleaf bought OMF and rebranded. Paul Newey stepped down as Ocean Finance CEO in 2009.

Ocean Finance was the shirt sponsor of Tamworth F.C. from 2004 - 2009. In 2008, it launched the UK's first TV channel dedicated to promoting loans and mortgages.

Like many other mortgage businesses, it struggled after the 2008 global credit crunch.

The Ocean Finance brand was acquired by Think Money Group in 2012. In 2014 the company launched the Ocean Credit Card in conjunction with Capital One. In 2004, the firm was criticized by some for its focus on offering second charge (secured) loans, to sub-prime customers, often used for debt consolidation

RoA

Return on Assets is a ratio that provides insight into profitability. RoA is defined as Net Income divided by total assets. RoA is used to help investors understand how well a company management ream is using assets to generate earnings. Like most ratios a low value can also indicate an inflexion point or optimum time to buy rather than sell the related stock. Some analysts like to add back interest expense to net income as this gives a metric to compare operating returns before cost of borrowing. This is most helpful if borrowing costs are the same for the peer group under analysis.

RoE

Return on Equity is a ratio designed to provide insight into the profitability of a company by showing profit generated in comparison to cash invested by equity holders. RoE is defined as net income divided by shareholder's equity (see definitions in this glossary).

RoI

Return on Investment is a ratio that provides insight into the efficiency of an investment. RoI attempts to measure the return on an investment vs. the cost of the investment. The ratio is defined as the gain from investment less cost of investment subsequently divided by cost of investment. Most RoI calculations do not account for the time value of money. This changes investment performance considerably and can easily lead to the wrong conclusions because no account is taken of the rate of return only of the total return.

SGA

Sales, General and Administrative expenses, often equates to or is equivalent to Cost of Sales (CoS) plus operating expenses. However ACF uses SGA to classify relatively invariable expenses as opposed to variable expenses linked more or less directly to revenue generation, as such sales commissions might typically end up in CoS, whereas salaries for sales people would be classed as relatively invariable and be booked under SGA in an ACF model.

Shareholders' Equity

Shareholders equity is a line on the balance sheet calculated from the deduction of total liabilities from total assets and represents the value (or lack of it) available for distribution to shareholders should the entity wind up operations. It differs from the equity value expressed in market capitalisation (MCap), which is number of shares in issue (NoSh) multiplied by share price. The ratio Debt/Equity commonly uses the Debt/MCap formula as opposed to the Debt/Shareholder equity formula.

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TDR

Troubled Debt Restructuring (TDR) is defined as a debt restructuring in which a creditor, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. As such, in order for a debt restructuring to be a considered a TDR, two conditions must be present: The debtor must be experiencing financial difficulties. The creditor must grant a concession in consequence of the debtor's financial difficulties.

uFCF

Unlevered Free Cash Flow is FCF from which cash based interest payments are not deducted. It represents the total maximum cash flow available to both bond and equity holders over a given period.

Uplift Potential

Uplift potential is the potential for a re-rating of the value of a stock. For example, a company is valued by market participants at the equivalent of 10x a particular metric such as EBITDA, the value then rises (due to an uplift) to the equivalent of 12x EBITDA, this is the rerating (by 2 turns in our example).

VIE

Variable Interest Entity (VIE) used historically by institutions to hide sub-prime lending exposure, in OMF's case it is very open that it lends in the non-prime spectrum. Variable interest entity (VIE) is a term used by the United States Financial Accounting Standards Board (FASB) in FIN 46 to refer to an entity (the investee) in which the investor holds a controlling interest that is not based on the majority of voting rights. It is closely related to the concept of a special purpose vehicle (SPV). The importance of identifying a VIE is that a company needs to consolidate such entities if it is the primary beneficiary of the VIE. A VIE is an entity meeting one of the following three criteria as elaborated in FASB ASC 810-10 [formerly FIN 46 (Revised)] 1. The equity-at-risk is not sufficient to support the entity's activities (e.g.: the entity is thinly capitalized, the group of equity holders possess no substantive voting rights, etc.) 2. As a group, the equity-at-risk holders cannot control the entity 3. The economics do not coincide with the voting interests (commonly known as the "anti-abuse rule") Note: The guidance in FIN 46 and FIN 46R was subsequently revised when FASB issued Statement 167.

Notes [Intentionally Blank]

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