A PRIMER ON NON-BANK LENDING

A PRESENTATION FOR MBDA

AUGUST 31, 2016

Sam Graziano | Chief Executive Officer | Fundation Group LLC
<table>
<thead>
<tr>
<th>Market Description</th>
<th>Small Balance Commercial</th>
<th>Larger Balance Commercial Lending</th>
<th>Commercial Real Estate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Businesses seeking credit for working capital, liquidity, equipment or expansion in amounts less than $500K</td>
<td>Businesses seeking credit for working capital, liquidity, equipment or expansion in amounts of $500K or more</td>
<td>Businesses seeking capital for real estate purchase or refinance in any amount</td>
</tr>
</tbody>
</table>
The Non-Bank Small Balance Commercial Lending Industry

• **Highly diverse universe of businesses** in the United States - ~1,100 classifications of businesses according to the North American Industry Classification System (NAICS) resulting in substantial differences in:
  - Cyclicality (exposure to the boom and bust of economic cycle)
  - Growth prospects
  - Profitability / profit margins
  - Capital intensity (machinery, inventory, etc.)
  - Regulatory influence

• Resulting, in **highly diverse needs for capital**
  - “Working capital” / manage uneven cash flow
  - Accounts receivable financing (liquidity)
  - Inventory financing
  - Investments for capital improvements or expansion
  - Equipment finance
  - Real estate finance

• Resulting, in a **highly diverse ecosystem of products and business models** serving the debt capital needs of the business community
The Market for SMBs Seeking Credit for Working Capital and Expansion

The small ticket segment has the largest ‘credit gap’ of demand not met by banks.

Figures are estimates based on the Federal Reserve’s most recent joint study on SMB finance.
## Putting Business Lending in Perspective

<table>
<thead>
<tr>
<th>Challenge</th>
<th>SMB Balance Commercial</th>
<th>Larger Commercial</th>
<th>Commercial Real Estate</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Deficiency of Collateral</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Extremely Heterogeneous Customer Population</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Relatively High Volatility of Loan Performance Across Economic Cycles</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Most Predictive Third Party Data is Still in a Maturation Stage (e.g., Commercial Payment Data)</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘Thin File’ Customers (lack of availability of audited financial statements, budgets, business plans)</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manual Underwriting is Cost Inefficient Relative to Revenue Potential on Lending</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**These challenges are most acute for transactions less than $250K**
Technology is Making Small Balance Lending More Efficient

**AUTOMATION**

1. **3rd Party Data**
   - Data Aggregation
   - Automated Decisioning

**MANUAL**

(when necessary)

- Document Collection
- Brief Manual Review Process
- Final Decision

- **Personal credit history**
- **Business credit history**
- **Personal and business related public records**
- **Business verification and fraud related data**
- **Industry performance related data**
- **Quantifies / scores risk using proprietary algorithms**
- **Some automated systems deliver offers in real time**

- **Verification of information**
- **Review of key risk factors found during automated process**
- **Depending on the company or size of the loan requests, a cash flow analysis may be performed**
Data Aggregation – Capturing Data Available on You and Your Business

NOT USED TO PREDICT CREDIT RISK!

Traditional Credit Data

Social Data

Accounting & Financial Statement Data

Transactional Data

Alternative Credit Data

Public Records

There is a lot of data out there but not all of it is useful!
How Does a Non-Bank Lender Decide to Lend?

“Risk Based Pricing”
(Banks)

- Is my probability of default greater than X%?
  - YES
  - NO

Upon default, is there sufficient collateral to recover my investment?

- YES
- NO

Then my price is Y%

- Decline Transaction

Risk Based Pricing
(Non-Bank Lenders)

- Probability of Default
  - Marginal Risk Tolerance
  - 5% → 25%

- Estimated Recovery Upon Default

- Probability of Loss

- Decline Transaction

NON-BANK LENDERS HAVE DIFFERENT RISK TOLERANCE THAN BANKS DO …… BUT THEY PRICE FOR RISK
<table>
<thead>
<tr>
<th>Sourcing Customers</th>
<th>Underwriting &amp; Risk Management</th>
<th>Servicing &amp; Collections</th>
<th>Capital</th>
<th>Who</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGGREGATOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“MARKETPLACE LENDERS”</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DIRECT LENDERS AND CASH ADVANCE COMPANIES</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“CREDIT SOLUTIONS PROVIDER”</td>
<td></td>
<td></td>
<td>FUNDATION</td>
<td></td>
</tr>
</tbody>
</table>

Hybrid Models
(Aggregators that also Deploy a Balance Sheet)
## Simplifying the Business Models

<table>
<thead>
<tr>
<th>Description</th>
<th>Agents or Intermediaries</th>
<th>Principals</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
<td>Provide advice or other services to businesses seeking capital, generally including preparing their applications and obtaining offers from lenders (Principals)</td>
<td>Businesses seeking capital for real estate purchase or refinance in any amount</td>
</tr>
<tr>
<td><strong>Economic Model</strong></td>
<td>Receives a transaction fee (commission) from the lender (and, in some cases, the borrower) for rendering these services</td>
<td>Earns interest, fees and other income from investing its own capital in a loan (or other form of credit)</td>
</tr>
</tbody>
</table>
High - Low

Short-Term Cash Flow Management (Short Term)

Bank Line of Credit

Expansion/Productive Investments (Intermediate Term)

Bank Loans

Typical Reasons for Borrowing

• Daily Payment Contracts
• Cash Advances
• Invoice Financing
• Factoring

Conventional Term Loans from Non-Bank Lenders

Equipment Financing Acquisition Financing (Longest Term)

Annualized Cost to Borrower
Product Vocabulary

Cost Measurement and Fees

- ‘Cents on the Dollar’ – A fixed amount of money to be paid back on every dollar borrowed
- Factor Rate (aka: Total Payback) – A quote on the total cost of a loan (ex: 1.30) – Multiplying the factor rate by the amount borrowed will give you the total amount a borrower must pay back
- Total Interest Percentage (aka: Simple Interest) – the total amount of interest paid as a % of the principal balance of the loan
- Annual Percentage Rate – The amount of interest charged depicted as an annualized rate that is inclusive of all fees
- Prepayment Fee – A fee charged to a customer when a loan is paid off in full or partially before its maturation date

Types of Contracts

- Conventional Term Loan – Fully amortizing loan with fixed payments comprised of principal and interest
- Line of Credit – A specific amount of credit a borrower is given access to that can be used at its discretion – the most common types are “revolving lines of credit” and “term lines of credit”
- Merchant Cash Advance – An advancement of capital against a business’s credit card receivables and collected by taking a fixed percentage of daily credit card transactions – loan costs are typically quoted as a Factor Rate or Total Interest Percentage. These products are technically not a loan.
- Fixed Repayment Loan – A loan agreement that requires a fixed payment amount typically with daily or weekly payment terms and loan costs quoted using a factor rate or Total Interest Percentage
## Products in the Market

<table>
<thead>
<tr>
<th></th>
<th>MERCHANT CASH ADVANCE</th>
<th>FIXED REPAYMENT LOANS</th>
<th>CONVENTIONAL TERM LOANS</th>
<th>LINES OF CREDIT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loan Amounts</strong></td>
<td>~$5,000 - $150,000+</td>
<td>~$5,000 - $500,000</td>
<td>~$10,000 - $1,000,000</td>
<td>~$10,000 - $150,000+</td>
</tr>
<tr>
<td><strong>Terms</strong></td>
<td>3 – 18 month</td>
<td>3 – 24 months</td>
<td>1 – 5 years</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>“Type of Interest Charged”</strong></td>
<td>Factor Rate</td>
<td>Factor Rate / AIR</td>
<td>APR</td>
<td>APR</td>
</tr>
<tr>
<td><strong>APRs</strong></td>
<td>~40% +</td>
<td>~30% +</td>
<td>5% - 30%</td>
<td>5% - 30%</td>
</tr>
<tr>
<td><strong>Payment Frequency</strong></td>
<td>Daily</td>
<td>Daily or Weekly</td>
<td>Twice Monthly or Monthly</td>
<td>Monthly</td>
</tr>
<tr>
<td><strong>Security</strong></td>
<td>All Asset Lien + PG (Lender Dependent)</td>
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</tr>
<tr>
<td><strong>Approval And Funding Timeline</strong></td>
<td>~24 – 48 Hours</td>
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<td>~24 – 48 Hours (Some lenders take 7 days +)</td>
<td>~24 – 48 Hours</td>
</tr>
</tbody>
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# Things That Sound Alike are Actually VERY Different …..

<table>
<thead>
<tr>
<th>MERCHANT CASH ADVANCE AND PAYMENT CONTRACT LOANS</th>
<th>CONVENTIONAL TERM LOAN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loan Amount</strong></td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Repayment</strong></td>
<td>1 Year</td>
</tr>
<tr>
<td><strong>Interest Rate</strong></td>
<td>$1.20 on the $1.00 Quoted as 20% “interest”</td>
</tr>
<tr>
<td><strong>Total Interest Over Life of the Loan</strong></td>
<td>$20,000 20% of the original loan balance</td>
</tr>
<tr>
<td><strong>Total Payments if Paid Through Maturity</strong></td>
<td>$120,000</td>
</tr>
<tr>
<td><strong>Total Payments if Paid Back the Next Day</strong></td>
<td>$120,000</td>
</tr>
<tr>
<td><strong>Effective Annual Percentage Rate if paid through maturity</strong></td>
<td>~45%</td>
</tr>
</tbody>
</table>

* Based on semi-monthly payments instead of one payment per month. 1 payment per month would result in $11,161 total interest over the life of the loan

** Based on semi-monthly payments. One payment per month would result in $111,161 total payments if paid through maturity
Practices to Be Aware of

“Stacking” – when lenders (often merchant cash advance companies) will seek out businesses that recently took on debt, pressuring the borrower to take on more debt, often at a higher cost over a shorter period of time putting borrower’s in a challenging economic condition

“Wholesaling” – a practice where brokers will obtain a financing rate from a lender and then seek to ‘mark-up’ the price (cost) of the loan to the borrower

“Double Dipping” – for contracts that have a fixed repayment, some lenders will proactively influence borrowers to refinance early, allowing the lender to accelerate their income and thereby capture more income over a shorter period of time

Our advice

- Read a contract before executing and make sure you understand all terms

- Ask your Agent or Principal about
  - All costs in the contract
  - The costs of early prepayment
  - Your financing rate expressed as a % of the original balance and on an annualized basis
Conclusions

• The non-bank lending market is incredibly diverse because the businesses that need capital are diverse, as are their needs for capital

• There are a lot of different types of businesses that can facilitate your needs for capital – some serve as agents or intermediaries, and other lend directly

• Be prepared for the application process with the documents you may need to provide and a good explanation of why you are seeking funds

• Don’t be discouraged if you are not successful with the first firm you work with. There are a lot of options out there

• There are a lot of very ethical companies in the non-bank commercial lending market but, like in any market, there are some bad actors – protect yourself by asking the right questions and understanding the financing arrangement you may enter