

issue
#10
 2007

Provident Times

Managing Director's Letter

Dear Investors,

Fincorp Investments Limited

In recent editions of Provident Times we have sought to educate investors as to the risks associated with mezzanine investment and property development companies. The appointment of an administrator to Fincorp Investments Limited (Fincorp) further strengthens those warnings.

Before I give you my thoughts on the Fincorp Group, let me outline some of the differences between the business model of Fincorp and the business model of Provident Capital, namely:

- Fincorp is largely a property developer, relying on a mixture of first and second mortgage debt to fund its own property investments.
- Provident Capital's mortgage loans are only to external borrowers. We do not provide mezzanine finance facilities nor lend on second or subsequent mortgages.
- Fincorp has a large negative equity position.
- Provident Capital has a strong equity position of \$12.6 million as at 31 December 2006.

We wish to assure you that Provident Capital has no exposure to the Fincorp Group.

Early warning signs

In May of 2006 Fincorp issued Replacement Prospectus 6 which described the Fincorp business as a

“funds management and property development group, specialising in mortgage and property backed investment products and property development”. A closer examination of the prospectus will reveal that a better description may have been: property developers.

By April 2006 only 19% (\$28,283,349) of Fincorp's loan book was lent to external borrowers with the balance or 81% (\$123,670,099) being lent to the Fincorp Property Development Group.

Most, if not all loans to the Fincorp Property Development Group were lent on the basis of a second mortgage; that is, the security is behind the secured first mortgage lender. Furthermore, loans were made on the basis where “no principal or interest is required to be paid by the Fincorp Property Development Group companies during the term of the loan”. However, at that time, Fincorp may “(and historically has) agreed to extend the terms of the loan (rollover the loans). This means that no principal or interest is required to be paid on the maturity of the loans as that obligation is rolled over under a new one year loan”. It is hardly surprising then that Fincorp could boast in the very same prospectus that “as at the date of this replacement prospectus no Fincorp Property Development Group loan was in default”.

Cracks were also beginning to appear in the Fincorp Group financials. The 2006 Prospectus containing Fincorp's audited figures for the financial year ending 30 June 2005 revealed:

- a net loss on a consolidated basis of \$12,432,000;



- the group's equity was a negative \$14,962,000; with
- net cash outflow from operating activities of \$46,751,000.

The company itself noted a warning to investors under 'liquidity risk' that “cash inflow will come primarily from new issues of Fincorp notes ...” and that if the company could not issue as many new Fincorp notes as expected “there is a risk that the payment of interest and the repayment of the principal invested in a Fincorp note at the end of an investment term may be delayed or unable to be met”.

By mid-2006 the Fincorp picture was becoming clear:

- low level of loans to external borrowers;
- high level of loans to related companies for property development;
- general poor quality of loans to external borrowers and related companies most of which are on second or subsequent mortgage security; and
- no cash flow from borrowings or assets to meet operations and commitments to investors.

These factors suggest inadequate internal controls and poor quality of management.

Managing Director's Letter continued

What will this mean for Fincorp investors?

Investors' money is likely to remain tied up for some time while the administrator, and then possibly a receiver, determines the best course of action for the company. No doubt Sandhurst Trustee will also be considering the best course of action for Fincorp note holders. This process is likely to take some time.

It is likely that the best chance of recovery for note holders will come from the sale of Fincorp Property Development Group assets, the proceeds of which will firstly be applied to the secured first mortgage lender with any balance being applied in order of any priority.

What can we learn from the Fincorp collapse?

Drawing from my comments in the *Provident Times* newsletter issue 6, 'What can we learn from the Westpoint collapse' (in italics below):

"A badly run business will almost inevitably fail! Look at the recent spate of corporate collapses and you will find one common theme – they were badly managed. Good businesses can survive hard times, bad businesses never will."

I believe these statements still hold.

"The relationship between risk and return – Westpoint was promising investor rates of 10%+, advisors' commissions as high as 12% plus a further 8% for renewals. Good businesses don't need to buy support at these levels."

While Fincorp may not have been as aggressive as Westpoint, its rates were still above market. Take a closer look at the rates it was charging its external borrowers which were up to 48% for external borrowers and averaging 13.9% for related party loans. Fincorp investors may well be asking was the risk premium (the difference between Fincorp and an alternate investment) sufficient.

"Mezzanine and second mortgage lending is risky – don't let anyone tell you otherwise. Mezzanine and second mortgage lenders are at the mercy of the prior secured lender in the event of a default. The risk is even greater for construction loans."

Ultimately, this may well be the major reason for the Fincorp collapse.

To fund the company's property development ambitions, Fincorp has borrowed from the secured first mortgage lender the less risky first mortgage piece and used investors' funds to provide the balance required to complete the transaction.

As the assets purchased are largely non-income producing, more Fincorp notes have been issued to fund the company's operations (pay wages, rent, general expenses etc.) and the payment of interest to the secured lender and commitments to note holders.

The likely fallout from the Fincorp collapse

Again, I reiterate my comments from *Provident Times* issue 6, 'The likely fallout from the Westpoint collapse'. In this edition I noted my own observations that:

"Although mezzanine finance has an important place in the funding of construction and development projects, it is best left to institutions which can both understand and price the risk involved."

Unfortunately some mezzanine lenders have sourced their funds from retail investors via debentures and unsecured notes. Before investing with these companies, investors should ensure their risk profile matches the risk profile of the mezzanine lender and as is always appropriate seek suitable professional advice."

It is likely that a number of the separate mezzanine funding vehicles will also go into receivership or liquidation."

It is my firm opinion that the second mortgage lending/mezzanine fund model for retail investors is fatally flawed. Participants to this market are lured by the attraction of high interest rates and massive fees and charges without any appreciation of the risks involved.

Unfortunately many operators in this area are developers themselves seeking funds for their own developments (Westpoint, Fincorp and others). Successful mezzanine lenders possess a different skill set, and in the main obtain funding from institutions who both understand the risk and who can afford to lose the money.

I can't help but wonder how successful Fincorp's fund raising would have been if their business description would have been clearly stated as property developer.

Provident's business is different to Fincorp's

For those of you who have been advocates of *Provident Times* you will have observed that we have for some time been seeking to educate investors as to the risks associated with second mortgage lending and mezzanine debt.

We wish to assure you that Provident Capital has no exposure to the Fincorp Group nor do we provide mezzanine finance facilities nor lend on second or subsequent mortgages.

It is important that investors recognise that the rates offered on fixed interest investments must be both competitive and sustainable. Look closely at the prospectus and ask yourself:

1. Does it provide a clear and accurate picture of the company's activities and am I happy with the risk profile of those activities?
2. Does the rate of return compare with other fixed interest investments?
3. If the issuer on-lends to other borrowers, is it genuinely done at arm's length or are the loans generally offered to related companies?
4. Do the financial statements of the company present a picture of solid financial health or do they show evidence of some financial strain?

Although there will always be rates higher than Provident Capital's in the market, it is likely that these higher rates are being offered by companies investing in second mortgages, mezzanine finance and direct property investment. We believe that these investments carry a different risk profile to our debenture offer which is supported by a pool of first registered mortgages to external parties.

Kind regards



Michael R O'Sullivan
Managing Director

Company News

Queensland Office

In February, we opened a full service office in Queensland at Level 2, "Emirates House", 167 Eagle Street, Brisbane, Queensland. The office will ultimately drive all investment and lending activities in Queensland and northern NSW as well as support the broader operational activities of the company.

The opening of a Queensland office is in response to the growing demand from investors, financial planners, borrowers and mortgage professionals domiciled or operating in Queensland. Our physical presence in Queensland demonstrates our commitment to a market where we anticipate strong, long-term growth.

The initial response from mortgage and investment professionals has already exceeded all expectations. Provident Capital has a great reputation in the Queensland market which will be further strengthened with local knowledge and expertise.

We are delighted to secure the services of Andrew Parker as State Manager – Queensland. Andrew has had a strong exposure to all aspects of consumer and business banking, wealth management and insurance services. With more than 15 years' experience in the Financial and Professional Services industry, Andrew's previous roles include General Manager, Local Business Banking, Commonwealth Bank and Assistant Vice President, Citigroup Investment and Corporate Banking.

Andrew and his team invite you to "drop in" when next in the area.



Andrew Parker
State Manager – Queensland
B.Comm, B.Econ, Grad Dip. Applied Fin.
& Invest, MBA, CA, SA Finsia.

Bonus Rate Offer for All Investors

From 15 March to 15 May 2007, we are offering a special bonus rate of 0.25% p.a. to our valued investors. To qualify, any investor needs to either:

- roll over a maturing debenture during this period; or
- add new funds to a maturing debenture by 15 May 2007.

Any new investors can receive the 0.25% p.a. bonus rate if they invest \$5,000 or more for a minimum of 12 months by 15 May 2007.

If you are rolling over a debenture during this period, you will automatically qualify for the special offer when we receive your completed maturity instructions.

If you wish to make a new investment or if you require further information on this special offer, please contact Client Services.

Debenture Interest Rates

Rate increases are published in our print advertisements, but if you wish to receive updates by email, please write to info@providentcapital.com.au and write "email interest rates" in the subject line.

Our current rates are available at www.providentcapital.com.au or by calling a member of our Client Services team on 1800 650 422, Monday to Friday between 8.30am and 5.30pm (EST).

For terms of one to five years, interest payment terms are available quarterly, half-yearly, annually or on maturity. Below are selected rates:

DEBENTURE TERMS	INTEREST PAID ON MATURITY	INTEREST PAID MONTHLY
90 days	6.75% pa	—
180 days	7.00% pa	—
270 days	7.25% pa	—
1 year	8.25% pa	7.75% pa
2 years	8.70% pa	8.00% pa
3 years	9.25% pa	8.45% pa
5 years	9.75% pa	9.00% pa

Interest is calculated for all interest elections on a simple interest basis for the term of the debenture.

All rates are per annum. Rates are effective 13/11/06 and are subject to change. All applications for debentures must be completed on the form contained in the current prospectus and lodged with the Australian Securities and Investments Commission (ASIC) by Provident Capital.

Information Seminars

We are looking at offering seminars to our investors this year. We welcome your suggestions as to what topics would interest you. Please contact Client Services.

If you would like to receive a copy of our latest prospectus please call us on 1800 650 422

Customer Profile

Eric Tang, NSW

Eric Tang plans to use his debentures to realise the great Australian dream of buying your own home.

A loyal investor for the past eight years with Provident Capital, Eric, 45, has almost \$200,000 invested, a tidy amount for a deposit on a house somewhere in Sydney's inner west.

"I use my salary to pay for my holidays and I have been saving the debentures for something major like buying a property," says the Energy Australia IT worker.

"My debentures are for one year because you never know if you will find the property you want to buy. I have been



doing some research on locations and price ranges and am just about to start looking."

Eric has great confidence in Provident Capital. "I have been using their debentures for such a long time," he says.

"I have never had any issues with them and I prefer to keep investing where I feel secure.

"I would recommend debentures for people wanting to save for a goal.

The interest rate is higher than what the banks offer and the risk is low, much lower than the share market.

"That is the big attraction for me as well as the guaranteed interest rate of 8.5 per cent no matter what. With shares, you can lose all your money and that is something I don't want to experience. I just invest with Provident Capital's debentures and I know don't have to worry about it."

Eric began investing with Provident Capital after seeing newspaper advertisements promoting their debentures. "I thought I would invest some money to see how I go. At the time, the share market wasn't doing very well and I wanted to save up some money to buy a property such as a house or townhouse."

Eight years on, that dream is about to become a reality.

Frequently Asked Questions

Why don't I always receive my interest payment on the date which appears on my interest payment schedule?

When you invest with Provident Capital we issue you with a debenture certificate and an interest payment schedule which lists the payment date(s) and amount(s) you can expect. While our prospectus allows seven days for payment after the due date, we normally process such payments on the due date.

However, the date you receive your interest also depends on whether you requested the interest payment by cheque or Electronic Funds Transfer (EFT).

1) Interest payments sent by cheque

- ~Minimum 1-2 working days for postage (more if a weekend).
- ~Most banks have three working days

for cheque clearance once you have deposited the cheque.

2) Interest payments sent via EFT

- ~The fastest way to receive your funds is by EFT direct deposit into your nominated bank account.
- ~As soon as the money arrives in your account it is available for use.
- ~We have found occasionally that there has been a payment delay of a day which is dependent on the bank processing (clearing) of the EFT instruction. Should you experience a longer delay at any time please call Client Services for clarification on 1800 650 422 during business hours.

The payment of interest by EFT is faster than cheque

- ~All that is required is a phone call to our Client Services team who will issue a standard form to be signed; or

~When returning your Maturity Instructions for reinvestment, simply include your banking details in the space provided and we will make the necessary changes. Any future payments can then be processed to your nominated bank account.

Interest rates at rollover

A number of investors asked for clarification of interest rates provided at rollover. The rate you will receive on a rollover of your debenture is the then current interest rate for the term selected.

Consolidation of investments

Many of our customers have multiple investments under the same name. You can consolidate these into one investment at the maturity of one of the investments without penalty. Please contact our Client Services team if you wish to discuss this opportunity.

Feedback

Your feedback is important and helps us ensure the services we provide meet your needs. If you would like to see an article on a particular topic, please let us know. Please do not hesitate to contact us with any questions.

Internet and Email

Has your email address changed in the last six months? If you have internet access and wish to receive future newsletters via email, please write 'email newsletter' in the subject line and email to: info@providentcapital.com.au

Contact us

- Call Client Services toll free on 1800 650 422, Monday to Friday between 8.30am and 5.30pm (EST)
- Email us at info@providentcapital.com.au
- Visit our website at www.providentcapital.com.au

Provident Capital Limited | ABN 78 082 735 573 | AFSL 225172, Level 42, Tower Building, Australia Square, 264-278 George Street, Sydney NSW 2000 | 1800 650 422 | www.providentcapital.com.au

This newsletter is published as a service to Provident Capital clients. It contains information of a general nature only. The reader should not act on the information contained in this newsletter without first obtaining professional advice tailored to the reader's particular objectives, financial situation and needs. The reader should obtain a copy of the current prospectus issued by Provident Capital Limited before making any decision about whether to invest in Provident Capital.