

ON THE RADAR

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ALTX RESEARCH FIRST EDITION 2009

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This individual company report forms part of On the Radar, a comprehensive fundamental AltX equity research report produced by Merchantec Research. On the Radar offers the investment community a better understanding of a number of small cap entities, as well as the AltX sector in general.

Other companies covered in the first edition of On the Radar are:

- 1Time Holdings Limited;
- African Dawn Capital Limited;
- Alert Steel Holdings Limited;
- B & W Instrumentation and Electrical Limited;
- Dialogue Group Holdings Limited;
- Dynamic Technology Holdings Limited;
- Huge Group Limited;
- Quantum Property Group Limited;
- RACEC Group Limited;
- SA French Limited;
- Simeka Business Group Limited;
- Taste Holdings Limited;
- Total Client Services Limited; and
- Telemaster Holdings Limited.

For more information or to obtain research on the above listed companies, please call Merchantec Research on 011 325 6363.

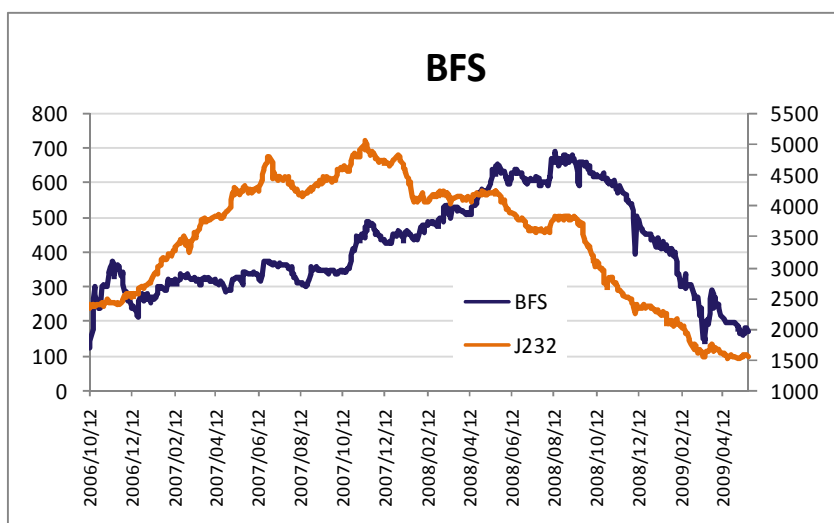
Blue Financial Services

S'thing borrowed, s'thing Blue

Price	R1.60
PE relative value	R3.16
DCF value	R2.86

Financial Services – General Financial

Price & price relative



Upside (downside) to PE fair value (%)	97.6%
Upside (downside) to DCF fair value (%)	78.9%

Price performance

	Absolute	Relative to FINDI
1month	-20%	-26%
3 month	-48%	-56%
12 month	-75%	-69%
12 month (SA cents)	High 669	Low 160

Forecasts

Yr to February	2008	2009	2010F	2011F
Turnover (Rm)	331	766	1302	1953
EBITDA	86	186	330	543
EBIT	71	148	293	488
PAT	62	119	224	371
HEPS (cents)	11.9	12.5	40.2	66.5
DPS	0	0	0	0
PER (x)	13.5	12.8	4.0	2.4
EV/EBITDA	12.7	10.3	9.1	7.3
DY%	7.4%	7.8%	25.1%	41.6%

Blue announced final results to February 2009 on the 21st May 2009. Interest, administration and insurance income grew by 131.3% from FY08, while the group's loan book increased by 200.5% to R1.45bn. Operating margins remained constant at 19.6%, with **operating profit increasing to R149.8m.**

The company reported fully diluted HEPS of 12.5 cps which is up 5.1% from last year. Our forecast for fully diluted HEPS for FY10 is 40.2 cps.

In the past year Blue has used acquisitions and penetration into new markets and countries to strengthen its position as the leading Pan-African microlender. By acting quickly the group has secured a "first-mover" advantage in a market which shows significant potential for growth and which is attracting large amounts of foreign investment.

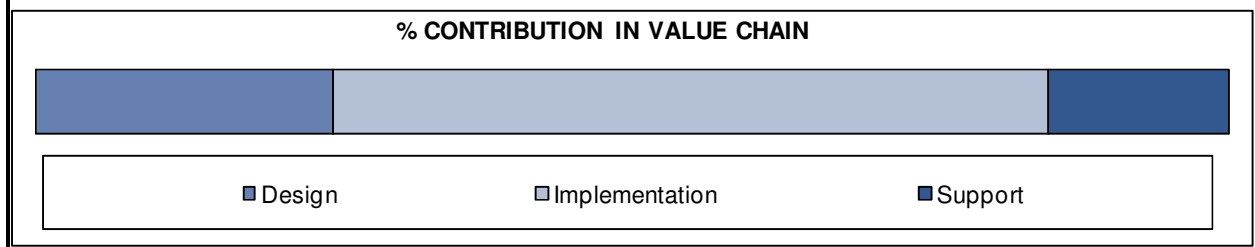
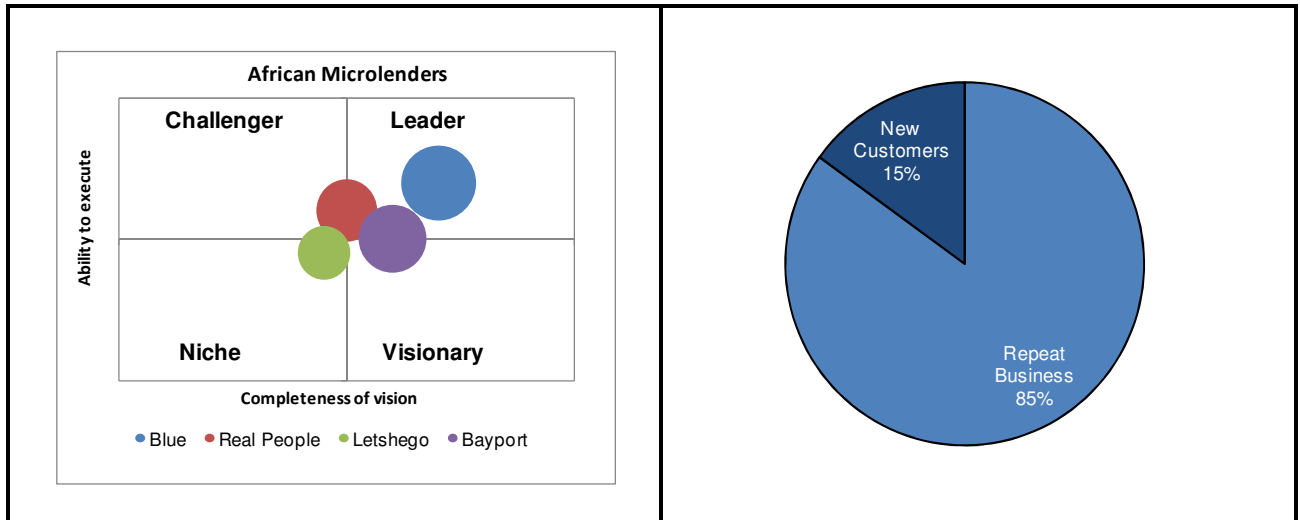
Both our relative PE and DCF valuation models indicate that shares in Blue are currently undervalued.

Share data

No. of shares (m)	556	EV (Rm)	1922
Monthly t/o (Rm)	35	Mkt cap (Rm)	894
		Price/NAV (x)	0.8

Key ratios

Yr to February	2008	2009	2010F	2011F
EBITDA margin (%)	26.1%	24.3%	25.4%	27.8%
EBIT margin (%)	21.4%	19.4%	22.5%	25.0%
Net debt/equity (%)	54.8%	87.3%	150.3%	173.8%
ROCE (%)	9.5%	9.7%	10.2%	11.6%
ROE (%)	11.7%	13.2%	17.4%	23.5%



Strengths	Weaknesses
Established in several African countries Access to international funding and backing Broad product range	Competition with native companies who have cultural affinities with the target market Widespread network could prove difficult to manage
Opportunities	Threats
Further expansion into Africa Rollout of full product range into all countries	Political instability in several African countries Success in Africa attracting new entrants

Customer size	Large	Mid-range	Small X
Sales model	Direct X	Resellers	Retail
Sectors	Financial X	Manufacturing	Mining
	Govt/Utilities	Telecomms	Retail

Company profile

History

Blue was founded in 2001 by a team who had previously been shareholders and senior management of one of the early specialist micro lending companies, Unity Financial Services Limited, which became part of African Bank Investments Limited in 1999. At that point Blue commenced operation in South Africa offering salary advances and home loans to lower income earners through contracts made directly with employers in order to reduce risk. The group then rapidly expanded into Africa, beginning with Botswana in 2003 before continuing into Zambia in 2004 and Uganda in 2006. On the 12th October 2006 Blue listed on AltX in order to fund further expansion as well as to elevate its profile in order to improve access to funding to grow its loan book.

Listing

African operations

Today Blue is the leading micro financier in Sub-Saharan Africa and operates 301 branches across the following countries:

COUNTRY	# BRANCHES
South Africa	178
Lesotho	3
Swaziland	2
Botswana	12
Namibia	11
Zambia	20
Malawi	5
Tanzania	12
Uganda	14
Kenya	6
Rwanda	1
Nigeria	36
Cameroon	1

Target market

Blue targets a market traditionally referred to as Africa's "unbanked". These are low income-earning yet formally employed and salaried individuals classified within the LSM 2-7 band who either do not have access to formal banking institutions or prefer not to use them because of the high banking fees charged and the strict credit granting policies and security requirements implemented by these institutions. Blue partners with employers to offer their employees a wide range of products specifically designed to address the needs of the financially underserved.

Products

Products offered include salary advances, personal loans, home improvement and education loans, bonded housing finance, pension and provident-fund backed home loans, as well as a range of personal short-term and life insurance products providing a wide range of cover including household, belongings, vehicles, personal liability, dread disease, disability, funeral expenses and loss of income. Blue now also provides a range of solutions for small business enterprises which include start-up loans and corporate short-term and life insurance products.

Dual listing

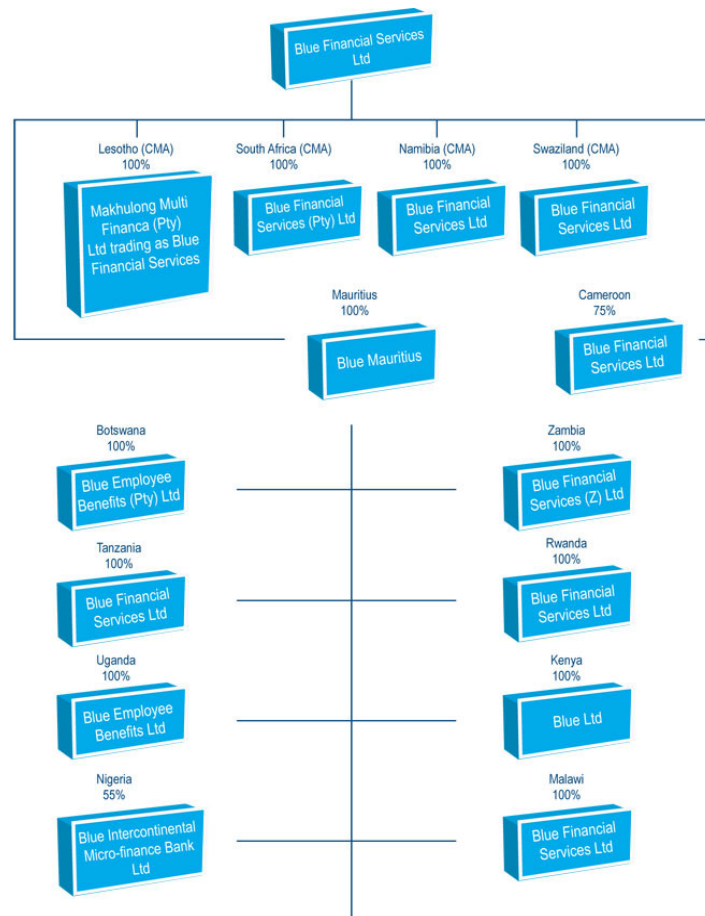
On the 15th May 2008 Blue dual-listed on the Botswana Stock Exchange and also has plans to list in Namibia, Zambia and Kenya in the future.

Credit U acquisition

Effective 15th December 2008, Blue acquired the entire issued share capital of South African micro financier Credit U Holdings Limited (previously known as Kagisano (Pty) Ltd) via the issue of 50.5m Blue shares worth approximately R278.1m. Blue became operationally involved in Credit U from 31 October 2008 and Credit U was delisted on 12th December 2008. Ninety-six South African branches of Credit U will be rebranded into the Blue SA network.

Divisional analysis

The group structure of Blue is as follows:



Source: BFS

Blue generally expands into new countries by first offering only its basic products to government employees, before rolling out its other products and expanding to private sector employees. Currently approximately 78% of the group’s clients are civil servants (outside of South Africa, this ratio is 94%). Below is a breakdown of the various loan products which are currently on offer in the different countries in which Blue operates:

COUNTRY	Personal loans	Short term loans	Education loans	Cellphone loans	Home improvement loans	Bonded housing finance	Pension backed home loans	Debt consolidation loans	Small business loans
South Africa	✓	✓	✓	✓	✓	✓	✓	✓	✓
Botswana	✓	✓	✓		✓				✓
Cameroon	✓								
Uganda	✓		✓					✓	
Namibia	✓		✓						✓
Rwanda	✓		✓					✓	
Zambia	✓	✓			✓			✓	
Kenya	✓		✓					✓	
Lesotho	✓	✓	✓		✓				✓
Swaziland	✓		✓		✓			✓	✓
Malawi	✓	✓	✓					✓	
Tanzania	✓		✓		✓				
Nigeria	✓								✓

Bad debts

South Africa holds the worst bad debt ratio of all the countries in which Blue operates. This can be attributed to a generally inferior debt repayment culture as well as the fact that local repayments are collected via direct debit orders, which creates competition with the banks and other creditors for payment deduction priority. Blue's provision for bad debts in South Africa is approximately 14%, whereas the group's blended provision across the entire operation is 9.3%.

Competitive position

African leader

Blue is the leading Pan-African microfinance institution (MFI), with 301 branches and an outstanding loan book of R1.5bn. It is the only South African MFI with significant penetration across Sub-Saharan Africa and the acquisition of Credit-U has greatly increased its South African footprint.

South African competitors

Local competing microlenders include Blue Dot Finance (Pty) Ltd which provides small size property finance and home improvement loans, Protea Financial Services Group (Pty) Ltd, a provider of personal and housing loans with a book exceeding R200m, and AMSA SA (Pty) Ltd, a financial services franchisor offering personal loans under the CashWise, Bafana Finance and NeWay Financial Services brands. Local listed competitors include African Dawn Capital Limited who provide short-term secured finance, home improvement finance and consumer loans through operating subsidiaries Nexus and Elite Group. African Dawn's loan book was worth approximately R1bn as at August 2008. Capitec Bank is a deposit taking retail bank that offers a range of personal loans through its network of 360 branches throughout South Africa. At the end of February 2009 Capitec's loan book was worth R2.9bn. African Bank is South Africa's leading supplier of unsecured personal loans, operating out of 1100 branches nationwide and with an outstanding loan book of R13.2bn as of September 2008. On a smaller scale Blue also competes with the local banks, particularly in the bonded housing finance market but ultimately Blue's target market are those typically ignored by the formal banking institutions, or those whose loan applications have been rejected by the big banks.

African competitors

Within each of the African countries in which the group operates, Blue competes with several small, local "cash loan" operators who collect repayments directly from clients in cash. There are only a few competing companies with significant penetration across several countries. Real People (Pty) Ltd is based in South Africa and provides unsecured personal loans to middle and low income earners through over 140 branches in South Africa, Lesotho, Swaziland, Malawi, Tanzania and Kenya. Real People's net advances were worth approximately R740m as of March 2008. Bayport Financial Services, established in 2002, is based in Mauritius and offers its unsecured credit products through 235 branches in Ghana, South Africa, Tanzania, Uganda and Zambia. Letshego, which was founded in 1998 and listed on the Botswana Stock Exchange in 2002 is now the largest microfinancier in Botswana. Letshego operates 20 branches across Zambia, Swaziland, Tanzania, Uganda and Botswana, with the loan book worth approximately R900m as at January 2008. Blue's most closely aligned competitor is Equity Bank Kenya (EBK). EBK began in 1984 as a building society servicing tea and coffee farmers, before expanding into a top microlender and later into a fully fledged commercial bank listed on the Nairobi Stock Exchange. EBK operates over 1000 branches across Kenya and Tanzania, with planned expansion into Rwanda and Uganda and was the recipient of the African Bankers Award 2008 for Microfinance Bank of the year. The bank's loan book was worth approximately R5.8bn as at December 2008.

Experience

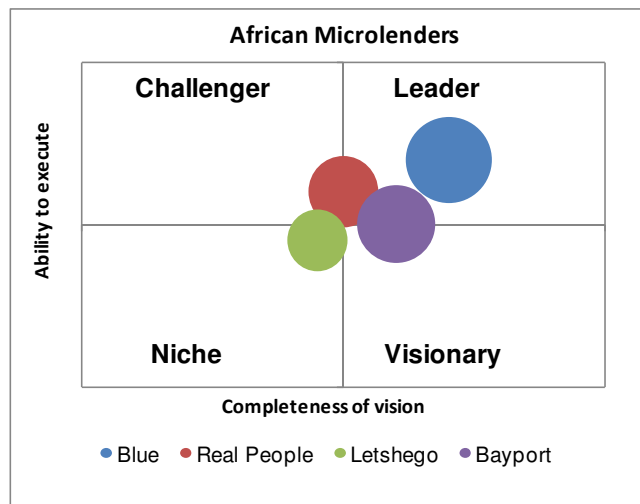
Blue holds a competitive advantage over its competitors due to management's experience in the industry, the group's wider range of products, many of which

First-mover advantage

have been the first of their kind in Africa, and their wide and deep penetration of the African market. Research by RMB Morgan Stanley (EMEA Banks, 2008) concluded that as the industry grows it is going to become increasingly difficult for new entrants to enter each country. Blue has expanded quickly and has already obtained “first-mover” advantage in numerous markets. Blue also focuses on enhancing the brand image and increasing awareness at a household level. The group employs ground-level marketing agents and advertises extensively on radio and television and has advertisements on over 200 billboards across Africa. Blue also produces the highly successful “Mr Blue” comic book which is published monthly and distributed as an entertaining way to educate the public about financial literacy.

Funding access

Blue enjoys an elevated profile relative to its competitors as a result of its wide network and corporate social responsibility projects which have given it access to various sources of international funding and backing, enabling the rapid growth of the group’s loan book. Accordingly we position Blue as the leading Pan-African microlender.



Customer satisfaction

Blue uses an innovative, market leading ICT system across its network which improves customer service and enables the rapid processing of loan applications. Decisions are typically reached within one hour, and although the average approval rate is only between 40% and 50%, Blue differs from many of its competitors in that it will often negotiate with customers who do not qualify for their applied loan in order to arrive at a “best-fit” loan for both parties, meaning that Blue will offer most clients at least a partial loan.

Divisional forecasts

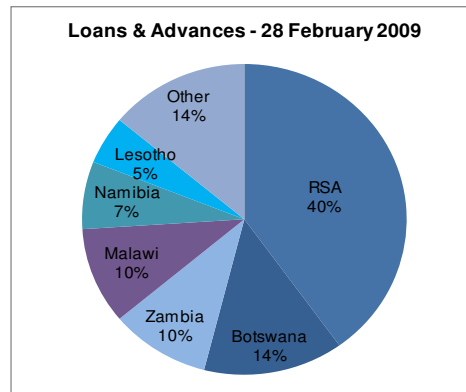
Results

Blue announced its final results to 28th February 2009 on the 21st May 2009.

Loan book growth

Revenue increase

The loan book increased by 200.5% from R489.1m to R1.45bn, of which R700m was organic growth, with the remainder coming from the Credit-U and Nedfin acquisitions. Interest, administration and insurance income increased by 131.3% year on year to R765.7m. This growth is attributable to strong organic growth in the group’s African operations, together with mostly acquisitive growth in South Africa. The chart below shows the breakdown of the group’s loan book by region:



Margins constant

HEPS growth

Extraordinary items

The group increased its overall blended provision for bad debts from 6.1% to 9.4%. Operating margins remained constant at 19.6% with operating profit improving by 131.2% to R149.8m. Blue reported a 5.1% increase in fully diluted HEPS from 11.9 cps to 12.5 cps.

Important to note is that the group's reported headline earnings were negatively impacted by several extraordinary expenses. The first was a R46m foreign exchange loss on unhedged foreign borrowings caused by the rapid depreciation of the Rand towards the end of the year. Since year-end this amount has already been mostly recovered due to the improvement in the exchange rate, and the group is in the process of hedging their exposure to prevent the loss from recurring. Accounting regulations also required an after-tax charge of R10.7m arising from the cost of transferring shares to staff under an equity-based employee compensation scheme. Management believes that were it not for these extraordinary items, headline earnings for the year would have totalled R123.6m, which would have resulted in an 86.6% increase in HEPS from FY08 to 22.2 cps.

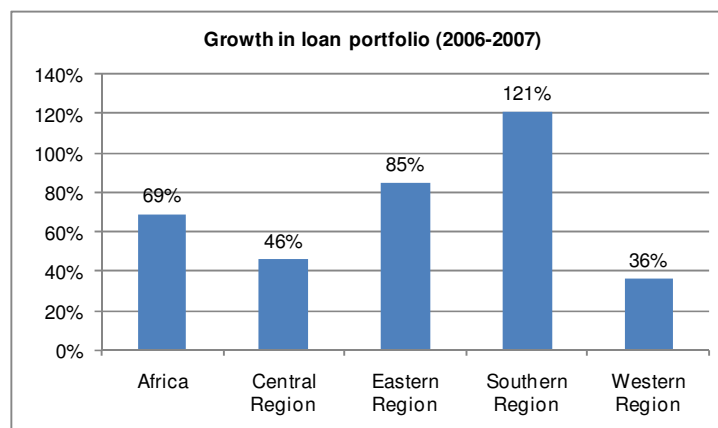
Outlook and forecasts

Market penetration

RMB Morgan Stanley (EMEA Banks, 2008) estimates that the Sub-Saharan African microfinance market is worth approximately US\$5.5bn, with current microlending borrowings totalling only US\$1bn. Their research shows that under 5% of the market has been penetrated, compared to the global peer average of over 15% penetration, leaving significant room for growth. Blue estimates that there are 14m potential payroll deduction clients throughout Africa, of which the group has only reached approximately 400 000.

Market growth

Data collected by the Microfinance Information Exchange (MIX) show the following increases in the loan portfolio of the different African regions between 2006 and 2007:



Source: Africa Microfinance Analysis and Benchmarking Report, 2008 (MIX)

Growth strategy

Blue intends to continue its growth strategy through organic growth to build critical mass in the 13 countries in which it already operates, as well as through continued expansion further into Africa. The group is targeting 14 additional countries in which to operate and will continue to pursue international lines of funding in order to finance the rapid growth of its loan book.

Incoming funding

Recently Blue has secured several financing facilities which will facilitate further expansion of the group's operations. In October 2008 the group was granted a R100m facility from the National Housing Finance Corporation (NHFC) to be used to expand the South African mortgage lending operations. In December 2008 the Overseas Private Investment Corporation approved a US\$70m (approximately R700m at the time) loan facility which Blue will use to grow its small business loans book. In early 2009 Blue raised R140m through the issue of commercial paper in Botswana worth R70m in January, and another R70m in Zambia in March, which will be used to grow operations in those countries. Also in March 2009 Blue was granted a five year unsecured debt facility of R130m by Dutch entrepreneurial development bank, Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden (FMO), which will be used to grow the consumer loans book in the non-Rand Common Monetary Areas (operations outside of South Africa, Swaziland, Namibia and Lesotho). In May 2009 Blue secured a seven year unsecured debt facility of \$15m from the OPEC Fund for International Development (OFID) which will be utilised across all of the African operations.

Regional performance

Southern Africa: Interest and insurance revenue in this segment increased by 99.6% to R474.5m, with operating margins declining from 9.4% to 2.7%. This is a result of a 141.9% increase in operating expenses largely due to the acquisition of Credit-U and the associated rebranding and systems changes. Blue's acquisition of Credit U became effective 15th December 2008 and will ultimately see 96 branches rebranded under the Blue banner.

East Africa: Revenue in this segment improved by 196.4% year on year to R140.5m, and operating margins fell from 21.9% to 0.6%.

West Africa: Revenue in this segment improved by 134.0% to R150.7m with operating margins improving from 49.8% to 77.0%. Effective 1 April 2008 Blue Employee Benefits (Pty) Ltd, a subsidiary of Blue acquired Nedfin Limited, which operated 8 microlending branches in Zambia, increasing Blue's total number of Zambian branches up to 20.

Revenue increase

Overall revenue growth of 70% is forecast to FY10 followed by 50% growth thereafter, driven by consolidation of the acquisitions, further organic growth within existing countries of operation and the expansion of the group's footprint into additional African countries. The group is consolidating its acquisitions and will complete the rebranding and systems migration of the new branches during the year ahead. Cost cutting initiatives such as the closing of the Credit-U head offices and natural staff attrition following the acquisition, as well as lower cost funding, are expected to improve operating margins to 22.5% in FY10 and 25% thereafter.

Margin improvement

HEPS growth forecast

Fully diluted HEPS are expected to improve by 222.2% to 40.2 cps in FY10 off the low FY09 figure that resulted from the aforementioned extraordinary items. This represents growth of 81.1% off the aforementioned potential HEPS had the extraordinary items not been charged. Thereafter HEPS growth of 65.6% to 66.5 cps is forecast to FY11.

Valuation

We have considered a discounted cash flow analysis and have taken cash flow forecasts out to FY11, and then utilised a terminal cash flow growth of 6% to

DCF Value of R2.86

yield the following sensitivity table, for which we select a discount rate of 30% to yield a DCF value of R2.86

Growth rate	Discount rate				
	20.00%	25.00%	30.00%	35.00%	40.00%
0.00%	3.91	2.99	2.39	1.97	1.66
2.00%	4.28	3.20	2.52	2.06	1.72
4.00%	4.75	3.46	2.68	2.16	1.79
6.00%	5.34	3.77	2.86	2.28	1.87
8.00%	6.14	4.15	3.08	2.41	1.96
10.00%	7.26	4.64	3.34	2.57	2.07
12.00%	8.94	5.27	3.66	2.76	2.18

PE relative value of R3.16

With reference to the table below, we believe it is appropriate to compare Blue to other microlending and banking institutions in SA. Due to the group's massive growth potential we believe it is appropriate to maintain Blue at par with the peer group average. The implied forward PE valuation of 6.8 places Blue at a price of R3.16.

General Financial	Price (R)	Mkt cap (Rm)	1 year fwd PE
BLUE FINANCIAL SERVICES	1.60	923.65	3.4
AFRICAN DAWN	2.00	445.85	1.6
CAPITEC*	38.25	3224.98	9.2
AFRICAN BANK*	27.75	21913.77	8.3
STANDARD BANK*	85.60	131521.65	8.7
NEDCOR*	91.32	42844.30	7.3
ABSA*	106.00	71228.17	7.5
FIRSTRAND*	14.00	78367.39	8.3
Average			6.8
			-49%
BFS: Actual current	1.60	924	3.4
Premium (Discount) applied to average:			0%
BFS: Implied current (gain):	3.16	98%	6.8

* I-Net Bridge Consensus Forecasts

Recommendation

Blue shows strong potential to achieve its goal of doubling its loan book size each year in the near future. The group has developed relationships with and secured funding from a wide range of local and international partners and has broken ground in a large number of African countries which are widely agreed to exhibit massive growth potential in the microlending arena. The recent acquisition of Credit U will likely result in Blue becoming the largest non-deposit taking microlender in South Africa.

Both our relative PE and DCF valuation models indicate the stock is currently undervalued.

Appendix

Forecasts

Income Statement to February	2008	2009	2010F	2011F
Turnover	331	766	1,302	1,953
Trading profit	64.8	149.8	292.9	488.1
Net interest received	12.6	6.6	6.8	16.5
P B T (incl exceptionals)	83.6	154.9	299.7	504.7
Taxation	21.9	44.0	83.9	141.3
Outside shareholders	-	(8.1)	(8.1)	(8.1)
Attrib earnings	61.7	119.0	223.9	371.5
Attrib earnings - (Headline)	55.8	69.4	223.9	371.5
Issued shares ave (m)	470.5	556.3	557.3	558.3
EPS (R) - (Headline)	0.119	0.125	0.402	0.665
EPS growth %	20%	5%	222%	66%

Balance Sheet at February	2008	2009	2010F	2011F
Share capital	491.9	888.6	888.6	888.6
Dist. reserves	95.9	220.2	444.1	815.6
S/holders equity	587.8	1,108.8	1,332.7	1,704.2
Outside s/holders	(0.2)	36.2	28.1	20.0
Pref shares	35.0	37.4	37.4	37.4
Total s/holders interest	622.6	1,182.4	1,398.2	1,761.6
Interest bearing debt	395.1	1,120.6	2,241.2	3,473.9
Deferred tax	(2.3)	(82.7)	(124.7)	(195.3)
Capital Employed:	1,015.4	2,220.3	3,514.7	5,040.1
Employment of capital	1,015.4	2,220.3	3,514.7	5,040.1
Fixed assets	44.1	107.2	157.7	200.5
Investments/Non-current assets	486.0	759.3	759.3	759.3
Net current assets	485.3	1,353.8	2,597.8	4,080.3
Current assets	544.5	1,584.7	2,811.7	4,421.0
Cash	54.2	88.7	139.1	412.0
Current liabilities	59.2	230.9	214.0	340.6

Cash Flow to February	2008	2009	2010F	2011F
Pretax profit	83.6	154.9	299.7	504.7
Non cash items:				
Depreciation & amortisation	15.3	37.7	37.5	55.2
Other adjustments	(7.3)	(70.0)	-	-
Work. cap. decrease (increase)	(329.6)	(690.0)	(1,185.9)	(1,282.8)
Tax paid	(23.9)	(11.1)	(133.6)	(138.8)
Net cash flow	(261.9)	(578.5)	(982.2)	(861.8)
Dividends paid	-	-	-	-
Capital expenditure :				
Maintenance	(16.0)	(38.0)	(38.0)	(48.0)
Capacity increases	(55.0)	144.3	(50.0)	(50.0)
Investments	(42.0)	(29.7)	-	-
Financing activities	449.6	536.4	1,120.6	1,232.7
Increase (decr) in net cash	74.7	34.5	50.4	272.9
Net cash(debt) at start	(20.5)	54.2	88.7	139.1
Net cash(debt) at end	54.2	88.7	139.1	412.0

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