

May 24, 2019

**Dear clients and colleagues,**

We recently reduced our under-exposure in the financial sector. One company we added to our portfolios is OneSavings Bank.

OneSavings Bank (OSB), a UK challenger bank, focuses on the professional landlord buy-to-let market. In addition to the buy-to-let market, the bank is also involved in residential, commercial and high-net-worth lending. OSB conducts the majority of its buy-to-let business in the greater London area and in the Southeast UK. It distributes its product mainly through a large number of intermediary brokers. Its average loan is £260,000, and the entire lending book is secure financing. Despite ongoing investment in the business, OSB has delivered great performance over recent years.

Looking at OSB's fiscal year 2018 results and Q1 trading updates, we find that revenue, costs and impairments were all better than expected. OSB is one of a few banks that can deliver good top- and bottom-line growth while maintaining a strong return on equity of above 20%. The stock appears cheap, trading at 1.4x tangible book value, 6.5x expected 2019 earnings and offering a 3.6% dividend yield.

OSB recently proposed a merger with another bank, Charter Court. If approved by their respective boards, the new combine entity will represent one of UK's biggest specialist lenders. The new group is expected to benefit from a better-diversified loan book and a more varied source of funding. The cost synergies realized should offset the higher insurance costs.

### ***Market size***

- The buy-to-let market in the UK is estimated at £35 billion in gross lending terms.
- Approximately 90% of the lending application flows are from professional clients.

### ***Growth strategy***

- Organic origination by rolling out its old book of business.
- Gaining share from traditional lenders. Stricter mortgage rules for applicants tend to lead to further professionalization in the buy-to-let segment.
- Developing new banking products, possibly in the owner-occupied business or in the asset financing segment.
- Could do securitization to acquire new business

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

### *Strengths*

- One of the market leaders in the buy-to-let specialist market with 5% market share.
- Strong return on equity (ROE) that translates into a good level of capital to support investment in the business.
- Strong relationships with brokers to facilitate efficient distribution of its products.
- Quality over price. OSB does not sacrifice returns for volume as it tends to be slightly more expensive than its peers.
- Uses a mix of manual and technology-assisted processes to reach a lending decision. This leads to a slower process but generates very strong conversion rates.
- Combines a good growth profile with sound profitability.

### *Opportunities*

- Specialist lenders are gaining market share over traditional banks.
- Lower real estate prices combined with a weakening of the pound has created some opportunity in the professional buy-to-let market.
- OSB will be applying to use the Internal Ratings Based (IRB) rules this year. If granted, its capital requirements would drop.
- Stricter regulatory requirements tend to be an opportunity for challenger banks like OSB. As affordability criteria become more stringent, challenger banks tend to be better-positioned than traditional banks.
- Diversifying into other product segments.
- There is some consolidation in the specialists/challenger bank space.

### *Risks*

- Slowdown in the buy-to-let market.
- Funding costs could pressure margins.
- OSB is facing competition from traditional banks to other challenger banks.

Have a good weekend.

### The Global Alpha Team

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.