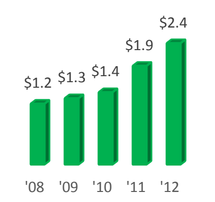
SELECTIVE
WEALTH MANAGEMENT

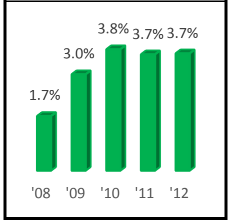
BofI Holdings
April 5, 2013

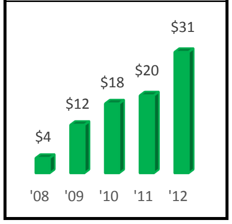
General Overview

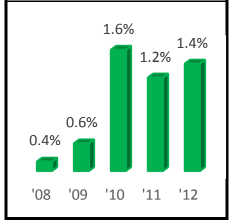
BofI Holding is the holding company of BofI Federal Bank - an online bank that focuses on providing banking services through multiple low-cost digital channels. The bank has customers nationwide and provides financing for single family and multifamily residential properties, small-to-mid size businesses, and select specialty finance receivables. In the last decade BofI has been one of the most successful banks in the nation with industry leading of cost controls, profitability, underwriting, and growth.

Total Assets	Net Interest Margin	Core Earnings	EPS	Return On Assets
$2,386,845,000	3.70%	$30,677,000	$2.33	1.36%
5-Year CAGR = 18.9%	5-Year AVG = 3.19%	5-Year CAGR = 68.6%	5-Year CAGR = 14.8%	5-Year AVG = 1.02%









Purchase Logic

The purchase logic for BofI was relatively straight forward: The company is emerging as one of the most efficient banks in the United States and continues to steal market share from the brick-and-mortar competition. In the last 5 years the business has compounded assets at a rate of 18% and core earnings at a rate in excess of 60%. During this same time period the business has been gaining efficiencies by leveraging the fixed costs associated with the digital banking platform across a larger asset base. This operating leverage is accelerating core earnings at a rate in excess of asset growth. We believe that this leverage will continue into the future and further gains in efficiency will be passed along to customers in the form of lower fees on banking transactions and higher interest on deposits. We effectively paid 12x earnings for a rapidly growing business with a strong competitive position. This compares favorably to the average P/E multiple of 14x earnings for an S&P 500 constituent.

Key Metrics

The key metrics for BofI are Assets Under Management, Return on Average Assets, Core Earnings, Net Interest Margin, and Non-Performing Loans to Total Loans. Each driver of success is described in greater detail below.

AUM

Assets under management is the terminology used to describe the total amount of money that is being managed by the bank. As new customers deposit funds at BofI the total AUM for the bank increases. As a branchless bank BofI has been able to attract additional deposits by charging lower fees on banking transactions and offering higher interest rates. AUM is important because the size of the bank is a primary driver of core earnings. The larger the bank the higher the earning power.

Return on Average Assets

ROAA is an important measure of a banks efficiency and profitability. The higher the ROAA the more profitable the business. An average bank typically has a ROAA of 0.75% and in the last 3 years BofI has been able to nearly double this national average. ROAA is calculated by dividing TTM core earnings by TTM average assets.

Example

TTM core earnings = $30 million

TTM average assets = (Beginning of period assets + End of period assets) / 2 = ($1.9B+ $2.4B) / 2 = $2.15B

ROAA = $30,000,000 / $2,150,000,000 = 1.4%

This metric is important because it is a clear indicator of how well BofI is competing relative to its peers. If ROAA is significantly higher than the competition it is a demonstration of superior performance and execution.

Core Earnings

We define core earnings as the net income without the after-tax impact of realized and unrealized securities gains and losses. In plain English, this metric is a measure of how much money the bank would earn excluding special one-time items, such as the gain on sale from investments. Core earnings are important because it ultimately determines the value of the company. The more the business earns the more the business is worth.

Net Interest Margin

The net interest margin is defined as the interest rate spread between interest earnings assets and interest bearing liabilities. If a customer receives 0.5% interest in their checking account and the bank loans those funds as a home mortgage at 4.5% the net interest margin is equal to 4.0% (4.5% - 0.5%). The net interest margin is typically dictated by market forces and is can only be slightly improved by outstanding management. This metric is important because it is a major contributor to core earnings.

Non-Performing Loans to Total Loans

Non-performing loans occur when a bank extends credit to a borrower that does not repay. It is essential that all banking institutions minimize the number of loans that end up non-performing. Historically a value less than 1% is expected for a high quality bank during normal economic conditions. During the financial crisis this number climbed as high as 5% for some banks and many were forced to declare insolvency. BofI was a notable exception during this time period. The company has consistently had one of the lowest non-performing loans to total loan ratios in the nation indicating high quality underwriting standards. Due to the rapid growth of BofI it is imperative that underwriting remains a priority. This metric is important because a bank that extends low quality loans will eventually face insolvency.

Historical Performance of Key Metrics

Year	'08	'09	'10	'11	'12
Total Assets	$1,194,245,000	$1,302,208,000	$1,421,081,000	$1,940,087,000	$2,386,845,000
Net Interest Margin	1.72%	3.04%	3.83%	3.67%	3.70%
Efficiency Ratio	52.40%	43.46%	29.33%	39.90%	39.72%
Core Earnings	$3,800,000	$12,200,000	$17,618,000	$19,658,000	$30,677,000
EPS	$0.46	$0.77	$2.22	$1.87	$2.33
Return On Assets	0.39%	0.57%	1.55%	1.22%	1.36%
Return On Equity	5.39%	8.30%	19.32%	14.83%	16.63%

AUM

Assets under management have increased from $405 million in 2004 to more than $2.3 billion in 2012. This represents total annualized growth of 24.8% or 12.7% annualized growth per share when factoring in dilution. The historical performance is largely attributed to a secular shift to branchless banking combined with attractive rates on deposits that has allowed BofI to capture market share. BofI has created an engine for new business through affinity channels, online advertising, print advertising, direct mailers, and more. This distribution engine is firing on all cylinders.

ROAA

Return on average assets has been steadily increasing as BofI has been able to leverage more assets across the company's digital platform. For the years spanning 2005 to 2009 ROAA averaged 0.5% due to the limited size of the bank and the fixed costs associated with running the banks technology platforms. As assets have increased the fixed costs have remained relatively stable allowing for strong operational leverage to lift ROAA. In the last 3 years ROAA has averaged 1.4% which is approximately double the national average.

Core Earnings

Core earnings have benefited from both the increase in AUM and the operational leverage inherent in BofI's business model. These two elements have increased core earnings from $2.8 million in 2005 to $30.6 million in 2012 representing a 40% annualized increase or 28.6% when calculated on a per share basis. The circumstances, competitive position, secular tailwinds, and outstanding execution that contributed to this phenomenal growth remain intact today.

Net Interest Margin

Net interest margin has been steadily improving during the last 5 years as BofI has been focused on lowering the cost of deposits. In 2008 the bank had approximately 35% of liabilities in the form of higher cost Federal Home Loan Borrowings. By attracting additional retail clients the percentage of liabilities represented by Federal Home Loan Borrowings has decreased to 19% and lowered the overall cost of funding for the bank. In turn net interest margin has seen a dramatic improvement. We would anticipate BofI to continue to find new channels to attract low cost deposits and further improve (or maintain) the company's healthy NIM.

Non-Performing Loans to Total Loans

Non-performing loans reached their peak in 2010 at 1.48% which was significantly less than competing financial institutions during the financial crisis. During the last 10 years BofI has consistently had one of the lowest Non-Performing Loan ratios in the industry due to strong underwriting standards and large down payments on residential property. It is our expectation that BofI will maintain a ratio of less than 1%, but during times of economic recession this ratio may exceed 2% or 3%. During such turbulent times we would expect Core Earnings to drop significantly and the price of the stock to decline.

Summary of Key Metrics

Metric	Expectations
Assets Under Management	Growth ranging from 8% to 30% per year Average of 15%-20% over 5 years
Return On Average Assets	Fluctuating between 1% and 2% Average of 1.5% over 5 years
Core Earnings	Growth proportional to AUM
Net Interest Margin	Fluctuating between 2% and 4% Average slightly less than brick-and-mortar competitors
Non-Performing Loans to Total Loans	Fluctuating between 0% and 1% with an average less than 1% >2% during a recession accompanied by a large price decline in the stock price

The Moat Around The Metrics

Low Cost Provider

BofI's primary competitive advantage is the low cost structure of the bank. As a branchless bank the company has lower operating expenses than the brick-and-mortar competition. This branchless business model is a 'self-serve' model as opposed to a 'relationship' model. Many individuals in the United States are willing to bank online and perform all necessary banking transactions themselves, such as depositing checks using a mobile app and setting up electronic payments. These individuals are willing to bank with BofI because of lower costs (such as free check books, zero ATM fees nationwide, etc.) and higher interest rates on savings. These consumers are willing to sacrifice the 'relationship' at a branch location for cost savings. As a low cost provider BofI has created an extensive moat around the business. Below is a snapshot of the operating costs of the company relative to banking peers:

Operating Cost Comparison As % of Assets[1]

Bank	Salaries	Occupancy Costs	IT Costs	Advertising	Administrative	Total
BofI Holding	0.58%	0.04%	0.07%	0.06%	0.15%	1.15%
BB&T	1.60%	0.37%	-	-	0.11%	3.06%
Wells Fargo	1.98%	0.23%	-	-	-	3.59%
Bank of America	1.38%	0.21%	0.19%	0.11%	0.59%	2.91%
Penns Woods Bancorp	1.41%	0.18%	-	0.05%	-	2.68%
Bank of Hawaii	1.54%	0.34%	0.10%	-	-	2.84%

For every $100 million dollars in assets the average bank has $3.01 million in expenses compared to $1.14 million for BofI. Operating expenses at BofI are 62% less than the competition and these cost savings are passed along to customers by offering many free services and paying higher interest rates on checking and savings accounts. Many customers are attracted to this type of banking service and BofI has been rapidly gaining market share.

[1] Data calculated from 10-K filings for each respective bank.

Risks

All banks carry risk due to the highly leverage nature of the business. As such, we intend to limit this position size to 10% of portfolio assets based on cost. Below are the primary risks we've assumed as owners of BofI.

Short-Term Risks

- Interest rates increase sharply. This would reduce BofI's income for 1 to 3 years due to the negative interest rate gap of the asset portfolio. A decline in income during a rising rate period would stabilize over time and management's decision to manage the asset portfolio with a negative gap is one we believe is prudent.

Long-Term Risks

- Poor Underwriting Standards. If BofI compromises underwriting standards for more rapid growth it could create a dangerous situation for stockholders. We have analyzed the underwriting processes for a few channels through which BofI originates loans with a primary focus on the warehouse lending lines that third-parties access for loan origination. After conducting our analysis we believe the requirements for borrowers are rigorous and intelligent. We have assumed that this sample research is consistent across all loan origination lines. Further evidence of strong underwriting standards at BofI include complaints from customers for being rejected when applying for loans (a good sign), down payments ranging from 30% to 45% on residential properties, and industry leading non-performing loan ratios for 10 straight years. If we detect that underwriting standards have deteriorated we would intend to exit the position.
- Regulatory changes. BofI continues to automate many processes that historically were done using manual documentation and inputs. If regulators force BofI to change the company's business processes to a less efficient model the company's competitive position could be negatively impacted.

Conclusion

In conclusion we believe that we paid a fair price at 12x earnings to acquire a rapidly expanding bank run by a talented management team. We fully anticipate outstanding growth through numerous channels that the bank uses to attract new deposits and originate loans. As the company continues to grow we expect the key metrics to continue to improve as additional assets are leveraged across the company's technology platforms. This operating leverage will further reduce BofI's cost structure as a percentage of assets and widen the competitive moat that surrounds the business. Through a superior business model and outstanding execution we anticipate BofI to steal market share from the brick-and-mortar competition for years to come.

Works Cited

1) *BOFI Annual Report - SEC Filing 10-K.* EDGAR, 2012.

Disclaimer