

# Mercantile Investment Company Limited

ABN 15 121 415 576  
Level 5, 139 Macquarie Street  
Sydney NSW 2000  
Tel 02 8014 1188 Fax 02 8084 9918

15 October 2018

The Manager  
Company Announcements  
ASX Limited

## ASX ANNOUNCEMENT

### Off-market bid for Yellow Brick Road Holdings Limited by Mercantile OFM Pty Limited

We refer to the off-market takeover bid for the shares in Yellow Brick Road Holdings Limited (ACN 119 436 083) (**YBR**) by Mercantile OFM Pty Ltd (ACN 120 221 623) (**Mercantile OFM**), a wholly owned subsidiary of Mercantile Investment Company Limited, the terms of which are contained in a bidder's statement dated 20 August 2018 (and amended by a supplementary bidder's statement dated 14 September 2018) (**Bidder's Statement**).

**Attached**, in accordance with section 647(3)(c) of the Corporations Act 2001 (Cth), is a copy of a supplementary bidder's statement dated 15 October 2018 (**Second Supplementary Bidder's Statement**) issued by Mercantile OFM. The Supplementary Bidder's Statement was lodged with ASIC earlier today and will be sent to YBR today.

The Offer has been declared best and final and will not be extended. The Offer will close on 19 October 2018.



**Gabriel Radzynski**  
Director

**Second Supplementary Bidder's Statement**  
**for the Offer by**  
**Mercantile OFM Pty Ltd (ACN 120 221 623) (Mercantile OFM)**  
**to acquire all the ordinary shares in Yellow Brick Road Holdings Limited (ACN**  
**119 436 083) (YBR)**

**Introduction**

This document is a Supplementary Bidder's Statement given pursuant to Division 4 of Part 6.5 of the Corporations Act 2001 in compliance with the requirements of Section 645 of the Corporations Act.

It is the second Supplementary Bidder's Statement prepared by Mercantile OFM (**Second Supplementary Bidder's Statement**) in relation to the Offer from Mercantile OFM to acquire all the YBR Shares that Mercantile OFM and its Associates do not already own, contained in the bidder's statement issued by Mercantile OFM and dated 20 August 2018, as amended by the first supplementary bidder's statement issued by Mercantile OFM and dated 14 September 2018 (**Bidder's Statement**).

This Second Supplementary Bidder's Statement supplements, and should be read together with, the Bidder's Statement (as amended by the first supplementary bidder's statement). Defined terms used in this Second Supplementary Bidder's Statement are capitalised and have the meaning given to them in Section 10 of the Original Bidder's Statement.

**CASH OFFER**

YBR Directors have recommended YBR shareholders reject a bona fide **CASH OFFER** for YBR shares at 9 cents per YBR Share. No other offer is currently available to YBR shareholders.

YBR shareholders are basically being asked to continue to support a strategy that has so far failed to deliver any returns to YBR shareholders.

**CRITICALLY CONSIDER YBR'S STATEMENTS**

Mercantile OFM has a number of material concerns regarding the information your YBR Directors provided in the Target's Statement. Not the least of which is that many of the statements in the Target's Statement, including forward looking statements, are not, in Mercantile OFM's view, based on reasonable grounds.

Mercantile OFM's concerns were not resolved by the supplementary target's statement dated 12 October 2018 (issued within the last 7 days of the Offer Period).

Mercantile OFM invites YBR shareholders to critically consider the story of growth and potential that has been the focus of the Target's Statement (as amended by the supplementary target's statement) and recent ASX announcements. To assist YBR shareholders, Mercantile OFM highlights the following 4 points:

**1. Poor financial and share price performance: CHANGE IS NECESSARY**

YBR has a track record of poor financial performance, years of persistent losses<sup>1</sup>, coupled with poor share price performance<sup>2</sup>.

---

<sup>1</sup> YBR has reported losses in 6 of the past 7 years and has accumulated losses totalling \$39.3 million to 30 June 2018.

<sup>2</sup> YBR first raised capital at \$0.40 per share in April 2011. It raised further capital later in 2011 and 2012 again at \$0.40 per share. It raised additional capital at \$0.70 per share in 2013 and 2014. YBR shares have traded below \$0.40 since October 2015 and have traded below \$0.20 since May 2016.

As we state in our Bidder's Statement, whilst past performance is no guarantee of future returns, YBR's historically poor financial and share price performance could indicate such performance may continue into the future **WITHOUT CHANGES AT YBR**.

Mercantile OFM made the Offer to seek greater influence regarding YBR's strategy and operations in order to facilitate **CHANGE**.

## 2. Explanation of YBR's value is confusing

The YBR Directors make a number of representations in the Target's Statement as to YBR's value. Mercantile OFM considers many of the explanations in the Target's Statement as to YBR's value to be confusing.

For example, the YBR Directors' "view" of YBR's equity value is based in part on the YBR Directors' own estimates<sup>3</sup>, **yet the basis of these estimates are not fully, nor are they clearly, explained**<sup>4</sup>.

YBR chose not to subject the YBR Directors' estimates or "view" of equity value to the scrutiny of an independent expert. **An independent expert's report could have provided YBR shareholders with clarity regarding value.**

The Target's Statement talks at length about a securitisation program, going so far as to quantify the potential financial benefits of such a program<sup>5</sup>. The YBR Directors highlight that these potential benefits have been excluded from their valuation (i.e. \$0.38 per YBR share)<sup>6</sup>. Clearly, this implies that YBR shares are potentially worth more than \$0.38 per share. **YBR SHAREHOLDERS SHOULD REMEMBER THESE ARE SHARES CURRENTLY TRADING AT \$0.11** (the closing price on 12 October 2018).

## 3. Aspirational statements but no path to profit

The Target's Statement focuses attention away from YBR's statutory losses. The Target's Statement suggests YBR shareholders should be encouraged by growth in revenues and gross profits. It appears to invite YBR shareholders to focus on what are uncertain future benefits from "potential" new business. This focus away from YBR's actual performance is only compounded by the supplementary Target's Statement dated 12 October 2018.

In Mercantile OFM's view, there appears to be little connection between apparently aspirational statements as to YBR's future business potential (and the value of new business) and a clear path to delivering profits to YBR shareholders.

## 4. YBR has for several years told shareholders that it is on the verge of implementing a securitisation strategy. Yet none has materialised.

In its Target Statement, YBR refers to a letter dated 29 August 2018 written by its chairman, which outlined "*a new strategic initiative – YBR's intention to pursue securitisation as a source of additional funds for mortgage lending...*"<sup>7</sup>

The securitisation strategy is described as a "*new strategic initiative*". It is not new. YBR has for several years told shareholders that it is on the verge of implementing a securitisation strategy. Yet none has ever materialised (see **Annexure** for details of past disclosures).

---

<sup>3</sup> Specifically the "Director's estimates" of certain businesses "*Potential future benefits of YBR's planned initiatives.*"

<sup>4</sup> No explanation was provided in the original Target's Statement and whilst the additional information provided in YBR's supplementary target statement, in Mercantile OFM view's, is confusing and seemingly incomplete.

<sup>5</sup> These are illustrated in the Target's Statement to more than double "*Divisional Mortgage Product Gross Profitability*" (YBR Target's Statement, Chart 10). In Mercantile OFM's view, YBR provides little objective, transparent evidence or justification for the potential financial benefits claimed. Nor have they provided any indication of the capital required to deliver such a program.

<sup>6</sup> Shown in Chart 11 of the Target's Statement.

<sup>7</sup> The letter, dated 29 August 2018, was contained in the ASX announcement entitled "*Preliminary Financial Report*".

There was no mention of securitisation in ASX releases from November 2015 until 27 August 2018<sup>8</sup>, only days after Mercantile OFM launched its takeover offer. It was then that YBR made an announcement entitled “*Exclusive Negotiations - \$300m RMBS Warehouse Facility*”. **Two days later**, YBR announced those “exclusive negotiations” had terminated.

The Target’s Statement states that “*the YBR Directors believe the market timing is now ripe* [for the new program].” Shareholders may recall similar statements were made back in 2015.

Mercantile OFM believes YBR has raised the possibility of securitisation once again, simply in an attempt to defend itself against Mercantile OFM’s Offer.

Tantalising as it might sound, Mercantile OFM does not believe YBR has the financial capacity to establish a warehouse facility, which is the precursor to a securitisation program. The main reason Mercantile OFM does not believe YBR can establish a warehouse is, based on YBR’s audited accounts, YBR does not have the necessary funds to provide the first loss capital required for a warehouse facility.

The YBR Chairman’s letter<sup>9</sup> accompanying the 2018 financial statements and the Target’s Statement are the first time (as far as Mercantile OFM can discern) YBR has made clear in its announcements regarding warehouses and securitisation that YBR will need to obtain equity and mezzanine funding for such a facility<sup>10</sup>. In other words, confirming Mercantile OFM’s view that YBR does not have the capital required to establish a warehouse and securitisation program.

## Authorisation

This Second Supplementary Bidder’s Statement is dated 15 October 2018, the date it was lodged with ASIC. This Second Supplementary Bidder’s Statement has been approved by a resolution of the Directors.

Dated: 15 October 2018

Signed for and on behalf of **Mercantile OFM Pty Ltd**



**Gabriel Radzynski**  
Director

---

<sup>8</sup> YBR’s Target’s Statement provides the first and only explanation for the hiatus in the establishment of the securitisation plans. In the letter to YBR shareholders appended to the Target’s Statement, YBR’s Chairman states that “*work was suspended on this major initiative during FYs 2017 and 2018 to wait for more favourable market conditions and allow YBR to implement other important internal projects.*” See YBR Target’s Statement, page 64.

<sup>9</sup> Chairman’s Letter dated 29 August 2018.

<sup>10</sup> Mercantile OFM notes that YBR described a number of pre-conditions to being able to obtain an RMBS facility, yet failed to make mention of what capital is required to establish such a facility.

## Annexure A

Below is a summary of the history of ASX announcements on the securitisation program.

In an August 2015 Strategy Update, YBR told shareholders “...*time is ripe to launch a [securitisation] program in Q2.*”<sup>11</sup> Shareholders were told that “*warehouse funding terms [were] well progressed.*”<sup>12</sup>

In the 2015 Annual Report, YBR’s Chairman wrote of the changing lending landscape. He cited “*out of cycle*” rate rises, regulator actions to “*cool*” investor lending and the bank’s increased regulatory capital requirements. In this context, he wrote “*we now have the size, scale and capability to establish a securitisation program.*” He also advised that “*the timing could not be better for us.*”<sup>13</sup>

By November 2015, the much vaunted Q2 launch had been pushed out to “*3<sup>rd</sup> quarter FY2016*” due to unspecified market conditions.<sup>14</sup> The same announcement also advised that YBR was in negotiations with four funding partners.

Two months later, in its 29 January 2016 Appendix 4C, YBR did not provide any commentary about its securitisation plans. Instead, it referred to “*a strategic decision to invest in a major market-share push, through increased Yellow Brick Road marketing activity.*”

In half year results announcements made on 26 February 2016 there was no update on YBR’s securitisation plans. There was no mention in either the half year report or the accompanying Investor Presentation of whether the plans were still afoot or whether they had been deferred or abandoned.

On 27 August 2018, only days after Mercantile OFM had launched its takeover offer, YBR made an announcement entitled “Exclusive Negotiations - \$300m RMBS Warehouse Facility.” YBR’s Chairman was quoted in this announcement as saying “*We have been building towards entering the securitisation market for a number of years – in fact it was always our intention to do so once we achieved a substantial distribution business...*”

Mercantile OFM notes that YBR described in that announcement a number of pre-conditions to being able to obtain an RMBS facility, yet failed to make mention of what capital is required to establish such a facility.

Two days later, YBR announced those “*exclusive negotiations*” had terminated.

The YBR Chairman, in his letter<sup>15</sup> accompanying the 2018 financial statements and the Target’s Statement, writes that “*discussions with potential warehouse providers are reasonably advanced and the Company has received a number of indicative detailed terms sheets, which we intend to progress.*” This is in stark conflict with YBR’s announcement made only days earlier, which stated that it had entered into “*a new exclusive negotiation arrangement with a new major Australian bank.*”<sup>16</sup>

---

<sup>11</sup> Strategy Update released on ASX on 17 August 2015, page 11. Q2 was described as being by the end of the second quarter of FY16, being December 2015.

<sup>12</sup> Ibid

<sup>13</sup> 2015 Annual Report

<sup>14</sup> Investor Update released on ASX on 11 November 2015, page 21

<sup>15</sup> Chairman’s Letter dated 29 August 2018.

<sup>16</sup> ASX announcement dated 12 September 2018.