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New Rec: **Resource America** (REXI-$29.13) August 23, 1998

Position: Sell Target: $5 Timing: 2 (1=aggressive, 5=cautious)

$M	Q3 98	Q4 98e	Q1 99e	Q2 99e	F1998e	F1999e
REVS	25,122	25,342	21,868	22,619	86,846	92,096
EPS $	0.45	0.48	0.36	0.38	1.63	1.56
Y/Y %	221%	124%	32%	-12.3%	100%	-4.3%
PE					17.9x	18.7x
PSR					6.7x	6.4x
Consen		$0.49	$0.57	NA	$1.64	$2.60

Shares Out: 20.2 M Market Cap: $588M FYE: Sept

Summary: Resource America is a specialty finance company principally engaged in the "mortgage loan acquisition and resolution" business. The company acquires troubled loans and restructures and refinances these loans.

Along the way the company books profits from a variety of sources. This is where Resource America shows extraordinary resourcefulness. The company records income from interest, which is normal, but then books income in more unusual ways. It books gains on sales when it sells senior liens on the loans in its portfolio. It books " accretion of discount" revenue, which is the difference between the cost of the loan and the estimated value of the loan resulting from an "independent" appraisal and management's

estimate of future cash flow improvements. These accounting practices seem unusual. Indeed, we have been unable to find a basis for these practices in GAAP, although the company's accountants, Grant Thornton LLP, may be able to explain how these practices conform to accepted accounting practices.

Most important, the majority of the company's earnings and earnings growth come from these two non-cash revenue items. Indeed, if we remove the reported gains on sale and the accretion of discount items from REXI's operating income for the last twelve months, operating income falls from $31.6 million to just $1.6 million. The magic of gain on sales and accretion of discount accounting is especially powerful because these gains fall right to the bottom line, with little or no associated cost. Thus, if we remove these two revenue items from the last twelve months results, EPS falls from a reported $1.37 to just $0.08 per share. To the extent that these items are questionable as true revenue, and we think that the vast majority if not all of these revenues should not be considered as true income, then the stock market is overvaluing REXI shares by accepting reported earnings as economic.

Evidence of true earnings power is lacking. The company has not generated cash flow from operations either in F1997 or in the first nine months of F1998.

Moreover, a high percentage of the reported gains on sales, as well as many fee income items that we have not eliminated, come from transactions with related parties. Remarkably, over the last five quarters about 25% of the company's total reported operating income and 26% of reported earnings was from transactions with affiliated entities. In the recent March quarter, over 50% of operating income was from transactions with affiliates. The high prevalence of related party transactions casts further doubt on the true value of the company's earnings and assets.

Below, we examine the accounting practices, the related party transactions, and the recent developments in REXI's business. We conclude that even under REXI's questionable accounting practices earnings growth should slow. REXI is quickly spending its ability to use its pool of existing loans as a source of gains by selling an increasing proportion of liens. New loans that REXI is buying are larger, and competition for these loans is much greater. REXI is now paying top dollar for loans, as we shall demonstrate, where, earlier in its existence it might be argued that REXI was getting good deals because of a weak market and a lack of competition.

REXI is also engaged in small ticket leasing operations, and has interests in oil and gas, which we discuss, below.

REXI appears to be a seriously overvalued and little understood security. When the investment community fully realizes what REXI management is doing from an accounting point of view to boost reported earnings, we think the reaction could be severe. Ultimately, this may be a lawsuit waiting to happen.

We estimate that REXI will report earnings of $1.60 in F 1998, versus

consensus $1.61, but will earn only $0.18 without the gains on sales and accrual of discounts. In F 1999, we expect REXI to report $1.56, versus a consensus $2.60, but it will only earn $0.57 without gains on sales and accrual of discounts. Some day, and it may not be very far away, the company may have to restate its numbers. Thus, our $5 target.

Discussion:

1. Although Resource America has been around for over 25 years, the excitement began in 1991 when the company broadened its business activities from the mundane oil and gas business to the flashier specialty finance business. Its specialty finance activities include involvement with mortgages, leases, and 125% loan to value transactions, known as "125s". Of these activities, the mortgage loan acquisition and resolution business has grown the most, generating revenues of $18.5 million in the June '98 quarter, up from $4.5 million on the June '97 quarter, for a stellar 317% gain.

What exactly is the mortgage loan acquisition and resolution business? Resource America describes this activity in its 10-K as involving "the purchase at a discount of troubled commercial real estate mortgage loans at prices generally ranging from $1 million to $10 million and the restructuring and refinancing of those loans." The concept is simple: buy mortgages from distressed sellers, work out the problems, and profit from resolving the troubled situations. The notion conjures up images of RTC fire sale stories, where distressed owners sold properties for pennies on the dollar, while savvy buyers made millions. Indeed, REXI cites the RTC and FDIC auctions as the catalyst for the emergence of its business.

Resource America claims it has exceptional expertise in acquiring and resolving troubled loans from private sellers, due to its ability to move discreetly and quickly. After making its initial investment and resolving the major problems, REXI either sells a senior lien against the mortgage or refinances the loan in order to reduce the amount of cash tied up in the loan. Typically, REXI will then retain a subordinated position in the mortgage, so that cash flow from its mortgages will first service senior claims and additional cash received will be retained by the Company. REXI benefits from this transaction because it allows the company to free up cash to acquire other mortgages, and also allows REXI to remain an active participant with the mortgage and to receive interest, to book advisory and refinancing fees and to recognize accounting gains when it sells liens against the mortgages. Indeed, including ancillary fees, REXI states that its total annualized loan yield is consistently in excess of 35%, as we show, below.

Table 1. Real Estate Finance Revenue and Yield Breakdown by Quarter:

	12/96	3/97	6/97	9/97	12/97	3/98	6/98
Interest	634	1,500	1,454	1,313	2,722	2,009	3,446
Accreted discount	793	710	1,100	1,497	1,666	1,931	2,275
Fees	1,407	7	7	1,135	1,775	1,880	1,430
Gains on refin, sale	385	1,561	1,890	3,751	1,528	7,935	9,461
Total	3,219	3,778	4,451	7,696	7,691	13,755	16,612
Book Value of Real Estate Loans*	49,693	55,574	59,302	88,816	128,884	182,624	188,996
Average Book Value	35,746	52,634	57,438	74,059	108,850	155,754	185,810
Annualized BV yield	36.0%	28.7%	31.0%	41.6%	28.3%	35.3%	35.8%

* Book Value includes accreted discount and allocation of gains from sales & refinancings.

2. This reported high yield is impressive, especially since the RTC wound down at the end of 1995, and the real estate market has rebounded sharply in recent years, eliminating most of the distressed fire sale prices of the early 1990s. While REXI's portfolio has benefited from properties acquired after the collapse of the 1980s real estate bubble, the portfolio size has increased over five fold just since December 1996, suggesting that the company is able to find distressed sellers even in strong market conditions.

These reported high returns so impressed us that we thought to study the sources of these revenues, hoping to learn more. What we found was a highly valued company using unusually aggressive accounting practices, combined with reliance on insider dealings, to generate its "extraordinary" reported returns.

3. Most notable about the company's real estate finance business is the large component of revenue from "Accreted discount" and "Gains on Sale". These two revenue items together accounted for 65.7% of revenues in the last twelve months, and 77.7% of revenues in the June '98 quarter:

Table 2:

	12/96	3/97	6/97	9/97	12/97	3/98	6/98
Interest	19.7%	39.7%	32.7%	17.1%	35.4%	14.6%	20.7%
Accreted discount	24.6%	18.8%	24.7%	19.5%	21.7%	14.0%	13.7%
Fees	43.7%	0.2%	0.2%	14.7%	23.1%	13.7%	8.6%
Gains on refin sale	12.0%	41.3%	42.5%	48.7%	19.9%	57.7%	57.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

We think, as is discussed at length below, that accreted discounts and gains on sales and refinancings should be excluded from revenues in order to get a true picture of REXI's value. Since these two revenue streams have minimal associated costs, the totals flow right to the operating income line. The exclusion of this revenue dramatically lowers net income, and earnings per share. Indeed, the removal of just these two items reduces REXI's earnings per share for the last twelve months to just $0.08 from the

reported $1.37.

Table 3:

As Reported:	12/96	3/97	6/97	9/97	12/97	3/98	6/98
Operating Income	2,786	3,326	4,073	4,647	5,723	9,194	12,109
Net Income	2,299	2,534	2,930	3,163	3,951	6,319	8,367
Net EPS - Diluted	0.22	0.18	0.21	0.22	0.27	0.43	0.45
As Adjusted:							
Operating Income	1,608	1,055	1,083	(601)	2,529	(672)	373
Net Income	1,085	740	748	(350)	1,816	(435)	245
Net EPS - Diluted	0.10	0.05	0.05	(0.02)	0.12	(0.03)	0.01

4. The reported income from REXI's investment portfolio includes four components: interest, accreted discount, fees, and gains on the sales and refinancings of mortgages. From Table 1, the fastest growing component of real estate finance income is "Gain on sales of liens and refinancings". This revenue source has been growing rapidly despite the fact that few mortgages have actually left the company's portfolio. How, a curious investor may ask, is it possible to sell, yet still own, a loan?

After REXI completes a loan acquisition, it seeks to either refinance or sell a senior lien against the mortgage. In both instances an accounting gain may be booked. When a senior lien is sold, the gain reported is calculated by taking the amount of the lien and dividing by the appraised value of the property. This ratio is multiplied by the carrying value of the loan, to calculate the cost of the piece of loan sold. Finally, this cost of the sale is subtracted from the amount of the lien sold to calculate the "gain" on the financing.

Cost of partial note sold =
((Senior lien amount)/(Appraised value of property))*(Book value of note)

Amount of gain on Sale =
(Senior lien amount) - (Cost of partial note sold)

For instance, if a loan on a property with an appraised value of $1,000 had been acquired for a purchase price of $800, and a senior lien was sold for $500:

Cost of note sold: (500/1000)*800 = 400
Amount of Gain on Sale: 500 - 400 = 100

One obvious flaw in this accounting treatment is that it assumes that both pieces of the loan are worth the same, despite the fact that the buyer of the senior lien now holds a senior position, while REXI retains the second, subordinated position. REXI retains the majority of the risk of the mortgage, even though it claims to have "sold down" its position. Here it is important to distinguish between the sale of a participating interest, and a senior lien. A participating interest would imply that the purchaser would be sharing the risk pro rata with its ownership percentage, whereas a senior lien holder would be risking capital only after the subordinated position had

been wiped out.

The gain on sale treatment of selling senior liens appears to be aggressive. The risk of ownership has not been transferred, and there is doubt as to the ability of REXI to ever realize the recorded gain. Any downturn in the real estate market would devastate REXI's carrying value of loans on the balance sheet.

It is also not at all clear that these transactions are actually sales. A more conservative accounting treatment would view the sale of a senior lien as a financing, and would add a liability to the balance sheet instead of subtracting an asset. Indeed, in the footnotes, REXI reports that as of the quarter ended June 30, 1998 there were $521 million in aggregate face value of mortgages with $ 92.4 million in senior liens, but there were only $189.0 million in real estate mortgages on the balance sheet.

Several of the transactions where REXI has booked gains appear to be repurchase agreements, in reality. Reading through the footnotes of the mortgage portfolio we note that REXI has the obligation to repurchase, or to substitute performing loans, if the loans default.

Item: Loan "13" has a senior lien interest sold subject to the right of the holder, upon default, to require the company to substitute a performing loan.

Item: Loans 22 and 27 have senior lien interests sold to Commerce Bank, N.A. The company has the obligation to repurchase these senior lien interests, at Commerce's option, on or after June 27, 2002 and September 29, 2002, if the senior lien interest is not repaid in accordance with its terms.

It appears Resource America did, in fact, book a gain in connection with at least one of these loans. In the first quarter of 1997 only one loan was sold, for a gain of $385,000 and it was to a financial institution. The December 96 10-Q reads, "The financial institution has certain recourse rights against the company should the loan not perform under the terms of the participation agreement." A second loan was sold to the same financial institution in the fourth quarter, under similar terms. In total, only two loans were sold in the fourth quarter but a gain of $3.8 million was booked, suggesting that gains were booked on both of these loans.

Repurchase Agreements, or "repos", may look like sales, but they are not sales. Both formal and informal repurchase agreements are accounted for by the seller as a financing, and no sale should be recorded, according to FAS-65. (par. 8) As of December 31, 1997, senior lien positions aggregating $12 million, in seven commercial mortgage loans have been sold with terms that require the company to replace defaulted loans with performing loans.

5. Understanding REXI's use of "accreted discount" is also critical for assessing REXI's true earnings. Appraised value and an assessment by management of its ability to increase cash flows from the property in the future are the key elements of the "accreted discount." The accounting is complicated, and aggressive, in our opinion. It is not at all clear that the

company is using correct accounting under GAAP.

The accounting works like this: Resource America acquires a distressed mortgage loan for what it believes to be a below market price. The company then has the property underlying the mortgage appraised by an independent party. The independent party or parties used are not named, The appraisals are consistently higher than what the company paid. The fact that the company can consistently buy below the newly appraised market value of the property is in itself suspicious, but we will not dwell on that issue.

Management then reviews the projected cash flows, to determine whether it will be able to improve these cash flows in the future. Management accrues the difference between the purchase price and the sum of projected increased cash flows plus the amount of the appraisal in excess of the loan cost. The accrual appears to be added to income on a straight line over the life of the loan.

" The difference between the company's cost basis in a loan and the sum of projected cash flows from, and the appraised value of, the underlying property (up to the amount of the loan) is accreted into interest income over the estimated life of the loans using a method which approximates the level yield method. The projected cash flows from the property are reviewed on a quarterly basis and changes to the projected amounts reduce or increase the amounts accreted into interest income over the remaining life of the loan on a method approximating the level yield method." (April 23 1998 prospectus)

As a result, non-cash "accreted discount" is included in current revenue. However, the accreted discount number is the result of estimates of the future value to be received from the mortgage, one by an independent appraiser, and another by management. Current period reported revenues and earnings are based upon a future sales price and future cash flow improvements that may never be realized.

We also think that if this were at all a legitimate way to look at these loans, the "level yield" method, which we suppose means a straight line would also be inappropriate, since it discounts events that will happen for out in the future too quickly.

"Accreted discount" is a wonderful thing because it flows right to the bottom line, since it costs nothing, and even though no cash is received when the revenue is recorded. It also seems almost "fantastic," in the literal sense, because it seems mostly "made up." Perhaps others will find what we have been unable to find in GAAP. So far, at least, we have been unable to find a justification for this type of accounting treatment for mortgage securities in our accounting books.

FAS-65 governs the treatment of mortgage securities, and our reading is that if mortgages are to be held to maturity they are to be recorded at the lower of cost or market. If the mortgages are to be traded, they are to be carried at market value. The company does not trade its mortgages. In addition, during the period that mortgages are held for sale any related

purchase discounts may not be amortized as interest revenue. Since Resource America holds the securities to maturity, even while selling senior liens against them, FAS-65 would seem to require that the loans be on the books at cost or market, whichever is lower, which would not allow for an "accreted discount."

In the June '98 quarter, accreted discount totaled $2.3 million, up from $1.1 million in the year ago period, or up 150%. In the last twelve months, accreted discount has risen to $7.4 million, or 16% of real estate revenues.

In addition, it is difficult to confirm that the company's commissioned appraisals reflect reality. REXI has not yet sold a loan outright to an independent party. The ten loans that it has clearly sold were sold to its affiliated Resource Asset Investment Trust ("RAIT"), a REIT that Resource America sponsored.

In total, on January 23, 1998, Resource America sold 10 of its mortgage loans and two senior liens in two additional loans for a total sales price of $20.2 million. REXI booked a $3.1 million gain on the sale. We estimate the total appraised value of the ten loans sold (assuming that one loan is appraised at its cost because no appraisal was available) is $21.0 million, yet these same ten loans were sold for $18.1 million, a 14% discount to what Resource America claimed the mortgages were worth.

Nearly 70% of the loans sold were acquired prior to 1995, and would have the greatest appreciation potential. Many of these loans were also scheduled to mature within the next year, which would have allowed investors to see the actual returns on the mortgages. Resource America purchased 500,000 shares of RAIT at the time of the IPO and an additional 335,937 shares as part of a secondary, and effectively controls 14%. We assume the sale of the loans and the IPO investment were easy to transact, because Betsy Cohen, the Chairman and CEO of Resource Asset Investment Trust, is the wife of Edward Cohen, the Chairman and CEO of Resource America. Jonathan Cohen, Edward's son, is serving on the board of RAIT as the representative from Resource America. No conflicts of interest here.

The one loan that we have found that might be considered a sale appears to have contingencies. In the second quarter of fiscal 1997 a borrower defaulted on an existing forbearance agreement. The company then sold its ownership interest for cash, and a note with a $3.6 million face value, and booked a $837,000 gain. However, the terms of the note were never revealed, and it is not clear that the note has been repaid.

6. After examining REXI's accounting related to gains on sales and accreted income, it should come as no surprise that its treatment of fee income is also aggressive.

What the company actually does to earn fee income is vague, but seems predominantly related to services rendered related to the existing mortgage portfolio. In the March '98 quarter REXI booked $1.9 million in fees from a borrower whose loan the company later acquired for $78.6 million. In the quarter ended June '98 the company booked $525,000 for

services to a borrower whose loan REXI later acquired. This implies that borrowers hired Resource America as an advisor, then decided to sell their loans to the company, and in exchange paid a fee, before getting cash for the loan sold.

This accounting treatment appears designed to accelerate fee income, which arguably should be recognized over the term of the financing.

Another unnamed borrower paid a one-time $850,000 fee "in connection with the operation, leasing and supervision of a property securing one of the company's loans". Yet Resource America, itself, is not a property management company and this type of work is supposedly done by an affiliated company, Brandywine Construction & Management. Since these fees flow to the bottom line with perhaps little incremental expenses, the nature of these fees, and who is paying them, is an important consideration.

In that regard, REXI also booked a $1.6 million fee from Resource Asset Investment Trust in January 1998, in addition to booking gains on loans sold to the REIT.

7. The lack of an arms-length relationship between Resource America and Resource Asset Investment Trust should deeply trouble investors. REXI recorded a $840,000 fee for advising RAIT, and also books gains when mortgage loans are sold to RAIT. In the quarter ended March 31, 1998, REXI booked a $3.1 million gain from loans and liens sold to RAIT.

Our reading of the mortgage accounting rules is that when mortgage loans are sold to affiliated enterprises, "the selling affiliate must first adjust the carrying amount of the mortgage loans... to the lower of cost or market before computing gain or loss on the sale..." If a mortgage maker is seen to be an agent for an affiliate, and if the mortgage banker "will originate certain specified types of loans for, and authorized by, the affiliated company...." then "the mortgage banker may charge an origination fee for services rendered in acquiring the loans. The affiliated company should record the loans acquired at the mortgage banker's acquisition cost." FAS-65 par. 13.

We do not know if there is sufficient evidence to establish a principal-agency relationship between RAIT and REXI. Should it be determined that REXI is originating loans destined for RAIT, and is acting as an agent, which could be the case, then the booking of gains from sales to RAIT might not be considered correct under GAAP rules.

8. Resource America's reliance on an affiliated company to generate over 50% of operating income in the March 1998 quarter may not be a surprise for investors who know REXI's past. The company has generated about 25% of operating income and 26% of reported earnings from affiliated transactions in the last five quarters. The company has a history of relying on affiliated enterprises to generate revenue. The "Related Party Transactions" section of the 10-K is three pages long, and depicts an organization rife with insider relationships.

A few of the highlights from the related party transactions include:

Edward Cohen, Resource America's CEO, is an approximately 8% owner of Brandywine Construction & Management, the property manager for borrowers whose mortgages REXI owns.

Edward Cohen is also an officer, director and with his wife, principal owner of JeffBanks. A subsidiary of JeffBanks is Jefferson Bank, a business that has both sold mortgages to, and purchased mortgages from, Resource America. The Bank is also a tenant in a building whose mortgage is owned by REXI.

Betsy Cohen is Edward Cohen's wife. Betsy is CEO of Resource Asset Investment Trust, and CEO of Jefferson Bank

In June 1997, Resource America purchased two loans from a partnership where the LP's are the Mr. & Mrs. Edward Cohen, and another REXI officer. $804,000 in gains were recorded when these loans were sold.

Also in June 1997, Resource America sold two senior liens to two partnerships where officers and directors hold approximately 20% positions.

We went back five quarters and calculated how much revenue was booked as a result of these related party transactions. Not only are the amounts substantial, but they have also been increasing. In the five quarters , transactions with affiliated entities have provided about 25% of operating income and 26% of earnings.

Table 4.

	6/97	9/97	12/97	3/98	6/98
Loan acq. from Jefferson Bank		224			
Loans acq. from officer p'ship		804			
Officer p'ship acquired liens	1,121				
Sale to RAIT				3,100	
Loan acq. by affiliated p'ship					
Advice related to RAIT			830		
RAIT dividend income				135	240
Fee from RAIT				1,600	
Expense reimb. from CEO					513
Total benefit	1,121	1,028	830	4,835	753
Total operating income	4,073	4,647	5,723	9,194	12,109
Percent from affiliated cos	28%	22%	15%	53%	6%
EPS Benefit	$0.06	$0.05	$0.04	$0.23	$0.03

The reliance on insider transactions to improve the public company's earnings was remarkable in the June '98 quarter. The REIT paid $240,000 in dividend income, and an affiliated partnership involving the REIT will pay a $840,000 fee in Q4. The CEO lowered REXI's expenses by "reimbursing" REXI for a business deal he was working on for the company, and which involved a property that was then transferred to a partnership controlled 1% by a REXI subsidiary, 95% by REXI officers, and 5% by an unrelated party. The purpose of the transfer was to "protect" REXI from being the tax

owner on the underlying property, and to protect it from having to report the property's operations, including depreciation, and revenues as a part of the company. The question is, was this transaction in the best interest of REXI shareholders?

9. Even if investors are willing to accept REXI's accounting as reflecting true earnings, for how much longer can management continue to meet Wall Street expectations? The company must continue to acquire and sell more liens to keep gains on sales increasing. The quarterly trend suggests that REXI has been refinancing or selling liens in a greater number of loans than the company is originating. This may mean a slowdown ahead, as REXI runs out of "inventory."

Table 5.

	12/96	3/97	6/97	9/97	12/97	3/98	6/98
Loans originated.	4	2	3	9	4	1	4
Liens/refin. completed	1	2	3	2	6	7	7
Excess (deficit)	3	0	0	7	(2)	(6)	(3)

Additionally, the reported gains are becoming more concentrated in fewer properties. For instance, in the June '98 quarter total sales gains of $9.5 million were recognized on the sale of seven loans. Two of the loans resulted in gains of $3.3 million and $4.9 million, leaving $1.3 million in gains to be divided among the remaining 5 loans. Resource America needs to acquire more loans quickly for the company to continue to book increasing gains from the sale of liens.

As of December 31, 1997, the portfolio consisted of 43 loans, and the company had already given up a senior position in 30 of the loans. It appears that all of the mortgages sold to the REIT already had a lien sold, so that leaves 13 loans available for refinancing or for the sale of a senior lien. Since December, five loans have been acquired and 14 loans/refinancings have been completed, leaving only four loans currently available for sale. In the June '98 quarter the Company quickly sold liens against its two large acquisitions, diminishing the prospect for gains in future quarters. This lack of inventory holds dim prospects for future "gains on sales" and fees in connection with sales and refinancings.

10. In order for the gains to continue, Resource America needs to demonstrate that it can continue to acquire distressed mortgages at attractive prices. Either the company must acquire more properties, or it must increase the size of its deals. The numbers of loans originated on a quarterly basis suggests that the company is simply increasing deal size, most likely because it takes almost as much time to close a small transaction as it does to close a large transaction.

While Wall Street believes the company can continue its winning streak, a close look at recent deals suggests that the strong real estate market and the need to compete for larger deals is undermining Resource America's strategy. REXI no longer seems able to do small deals at bargain prices that are below the radar screen of other sophisticates buyers. As a result, it is doubtful that REXI can realistically continue to book even the kinds of gains that it has booked on properties in the past.

An analysis of two recent deals makes the point. Instead of competing at the low end of the market, two recent transactions completed at $85 million, and $57 million, demonstrate that the deal size has increased dramatically. The transaction size is clearly large enough to attract competition from top real estate managers, which, combined with a much healthier real-estate market, may mean that "profits" even the way that REXI accounts for them, may be harder to come by.

The Evening Star building, located at 1101 Pennsylvania Ave is one of the most desirable addresses in Washington D.C. The building was put into bankruptcy to avoid foreclosure in August 1997. Dai-Ichi Kangyo was the lender, and due to a ruling from the Japanese Finance Ministry, the bank is prohibited from making new loans, so the lender was not able to refinance due to legal constraints. At the time of the filing, real estate experts doubted that the loan could be refinanced due to the high debt obligations. The face amount of the loan was about $367 per square foot, and some experts suggested that this was twice what the building was worth. At the time, the highest recent price in the DC area was $302 per square foot, paid in April 1996.

The building was sold in a competition among several bidders, with Resource America the high bidder, at $85 million, or $392 per square foot. The price per square foot was the highest price paid in recent years for a downtown office building. One lawyer familiar with the transaction called the price "eye-popping". Phrases like, "one of a kind" were being used to describe the property, and to justify the price.

Now, then, instead of buying distressed properties, Resource America is competing with real estate speculators for acquisitions. Although the loan was distressed, the property is not, and market participants do not appear to be discounting the price just because the owner is in bankruptcy. This property is also significantly different from the $1-$10 million transactions that management claims as its expertise. We are skeptical of the value added of Resource America's deal makers at this level. This purchase could "top-tick" the Washington D.C. real estate market.

Despite the high price paid, REXI's management found an appraiser who immediately put a nearly $100 million valuation on the property, or $458 per square foot. Management took this opportunity to sell a senior lien and to book a $4.9 million gain related to this property.

A second recent transaction, involving the Philadelphia Stock Exchange building, also distinguishes itself as being different from the company's stated investment strategy. The building was acquired for $56.5 million by a partnership called OSEB Associates, and Resource America provided the funding. The loan will pay 10% on its stated face value of $65 million. Of course, REXI recorded a $840,000 fee for the transaction. The partnership is 89% owned by Resource Asset Investment Trust, and 11% owned by Brandywine Construction & Management, the management company responsible for managing the properties underlying REXI's mortgages.

A news release related to the transaction states that OSEB beat out about two dozen other bidders for the 17 year old property. The seller was Clarion Partners, a sophisticated seller who manages over $5.3 billion in real estate assets for pension plans. Clarion describes itself as providing, "the capabilities for more market-attuned portfolio management". The property was put on the market in April 1998 to take advantage of the strong property market. In Philadelphia, rents are up approximately 10% in the last year alone, and even in early 1997 brokers were quoted saying, "This is the hottest market I've seen in my lifetime. It's sizzling." It is doubtful that REXI got any bargains for OSEB in this highly competitive deal.

Of the 456,000 square feet of the building, Cozen & O'Connor, a law firm, has a minimum commitment for 145,000 square feet, and has options for growth up to 175,000 square feet, or 32% to 38% of the space. The Philadelphia Stock exchange currently occupies 40% of the space, but could move out of half the space within 5 years in connection with its merger with the American Stock Exchange. That is, there is significant uncertainty regarding the future rents of up to 40% of the property. Although we do not know the current rents being paid on the property, Clarion Partners certainly does, and they have decided to sell. There is no indication that this is a distressed situation, a fire sale price, or that this is a timely acquisition.

We don't think that REXI booked a gain on the transaction with OSEB, although we cannot be sure at this time. If it did, this would seem to be a clear instance where REXI acted as agent and would not be entitled to any gains.

11. The origination and resale of leases is the second important segment of specialty finance activities, and accounted for about $3.4 million in revenue in the June quarter, FQ3. The business was started in 1995 when the company acquired an equipment leasing subsidiary of a regional insurance firm. The company focuses on "small ticket" leases that generally range from $5,000 to $100,000 in equipment costs, and management targets an average transaction size of $10,000. The strategy is to offer leasing services through vendor programs, and to focus on the low end of the market, where management believes a significant growth opportunity to exist.

Resource America's strategy is to originate the leases, and then sell them in bulk, on a servicing retained basis. During fiscal 1997, 3,214 lease transactions were completed, with equipment totaling $34.6 million in cost. In the June '98 quarter, 2,580 lease transactions were completed, with equipment totaling $26.5 million in cost, up from 931 leases with a cost of $21.2 million in the June '97 quarter. These leases are then sold to a special purpose financing entity ("SPE"), who resells the leases to financial institutions. The resale of the leases generates "Gain in sales in leases" revenues, and the lease finance placement also generates advisory fees.

Lease accounting is more of an art than a science. A leasing company receives its return in two components, revenue from the payments on the lease, and revenue from the sale of the equipment, or the "residual" at the end of the lease term. An expected return is calculated when the lease is originated, and part of the return is based upon the estimated value of the

residual. Hence, if the residual is ultimately worth more than originally anticipated the residual will add to the economic profit of the lease. Likewise, if the residual is worth less than anticipated, the economics of the lease will be lower than originally anticipated.

The value of the residual is important because the sales that REXI has made to SPEs have been sales for cash and notes, with the value of the notes based upon the residuals in the leases. That is, while REXI has booked profits on the sale of its leases in the quarter in which the leases where sold, the profit is tied up in a note receivable whose value may or may not be ultimately realized. Does this sound familiar? In fiscal 1997, the majority of the improvement in leasing revenues was due to the gain on sales of leases.

Table 6.

	9 Months		Year Ended	
Small ticket leasing	6/97	6/98	9/96	9/97
Gain in sale of leases	2,131	5,514	--	3,711
Interest and fees	620	2,373	7	1,081
Partnership management	1,338	1,398	3,809	1,713
Lease placement, advisory	654	700	650	657
Total	4,743	9,985	4,466	7,162
Revenue w/o gains	2,612	4,471	4,466	3,451

In fiscal 1997 leases were sold for total gains on sale of $3.7 million, calculated by subtracting the book value of $30.2 million from the cash received of $20.6 million plus notes with face value of $13.3 million. The company collected $8.5 million in principal payments during fiscal 1997 on these notes, leaving $4.8 million still outstanding. That is, the profit on the sale is in the notes. Payment on the notes is subject to the level of lease delinquencies and subject to the ultimate sales price of the residuals.

In the quarter ending June '98, REXI began to retain residuals for its own account. Leases with a book value of $21.1 million were sold to an SPE for cash of $22.7 million, resulting in a $1.6 million gain in the quarter, and resulting in unrealized residuals of $2.9 million, carried on the company's books. While the decision to retain lease residuals improves the quality of current period lease earnings, REXI is still at risk for recourse for lease delinquencies on leases sold. To the extent that the company is originating "full-payout" leases, that recover the entire value of the equipment by the end of the lease term, the risk of recourse is lessened.

We question the wisdom of retaining residuals on small ticket items such as copy machines and computer equipment. In the 10-K the Company also stated it enhances lease yields by lengthening the term of the leases it originates. A longer lease term makes residual values harder to estimate. There is no reason to believe that the company has a distribution channel to maximize the value of equipment at the end of the lease term.

Bulls expect leasing to be a key component of REXI's growth going forward. However, we wonder what type of assumptions and promises the company is making in order to grow the leasing business. Recently, Resource America won a contract to run Tech Data's lease finance division.

Although no details were released regarding how much business the contract will generate, the deal was won away from GE Capital, one of the largest financiers of leases in the country. Commenting on GE's response, CEO Edward Cohen was quoted in the Philadelphia Business Journal as saying: "They never heard of us, even when they told them our name." REXI also beat out 40 other companies who were invited to bid on Tech Data's lease finance subsidiary.

The significant competition raises the issue of how profitable the business will be for Resource America. Although Cohen would not disclose any terms of the contract, we think that as an unknown he must have used price in order to win the business. In leasing, better lease rates can be offered by either having a lower cost of capital than competitors, or by having more aggressive assumptions regarding the ultimate value of the residuals. Since we doubt that Resource America has a lower cost of capital than GE, it must be willing to take a lower return on the leases, or have higher residual estimates built into its lease pricing.

12. Although REXI is involved in the oil and gas business this business segment has shown limited growth. Energy production revenues totaled only $3.9 million in fiscal 1997, up 15% from 1996 levels, while the energy services business declined by 4% to 1.7 million. Gross margin on this business was 51%, before depletion and operating expenses.

The company presents the standardized measure of discounted future net cash flow related to proved developed oil and gas reserves, based upon year end results. Using a 10% discount factor, the discounted future cash flow is $10 million. We do not quarrel with this valuation, but instead rely upon it to show that the oil & gas business is not a significant component of the current valuation of the stock.

REXI does seem to be taking advantage of the current high multiple of the stock to purchase additional oil and gas properties. Specifically, Resource America announced it would acquire Atlas Energy, a privately held energy company, for a total purchase price of $70 million, comprised of $47 million in stock and the assumption of approximately $20 million in debt. Atlas has interests in about 1,400 wells in the Appalachian Basin, and operates more than 650 miles of gas pipelines. While we can hardly argue with the company for using its high-priced stock to acquire natural resources, we do not think current momentum investors will have the same enthusiasm. With natural gas prices currently depressed we do not believe Atlas will be a near term earnings driver.

13. A better measure of REXI's true earnings might be its cash flow from operations. Despite reporting net income of $18.6 million and $1.15 EPS in the last nine months, REXI has not generated any cash from operations in the last nine months. $34 million of non-cash gains from accretion of discount and gain on asset dispositions are the reason. The company has not demonstrated its ability to turn these gains into money. Investors in REXI shares might do well to wait until the company can show them the money to prove these gains are real.

Table 7.

Quarterly Cash Flow from Operations	12/97	3/98	6/98
Net income	3,951	6,319	8,367
Reconciling adjustments			
Depreciation and amortization	508	708	732
Property impairments		63	199
Amortization	208	236	1,006
Provision for possible losses	318	623	263
Collection of interest income		2,769	1,494
Accretion of discount	(1,666)	(1,931)	(2,275)
Deferred income taxes	826	(464)	(54)
Gain on asset dispositions	(4,740)	(11,247)	(12,136)
Change in operating assets and liabilities:			
(Increase) decrease in accounts receivable	(3,086)	856	1,624
Increase in prepaid exp., other assets	(372)	(1,076)	(192)
Increase (decrease) in accounts payable	367	(547)	1,800
Increase (decrease) in other liabilities	1,043	(3,938)	5,135
Net Cash Provided by (Used in) Operations	(2,643)	(7,629)	5,963

14. Financial projections. $000.

INCOME STATEMENT	9/97	12/97	3/98	6/98
Real Estate Finance	7,697	9,392	15,875	18,541
Equipment Leasing	2,419	3,172	3,452	3,361
Energy: Production	1,014	1,232	1,048	1,014
Services	503	583	487	507
Interest & Other	667	698	443	1,699
	12,299	15,077	21,305	25,122
COSTS AND EXPENSES				
Real Estate Finance	477	1,523	2,985	3,120
Equipment Leasing	1,071	1,325	1,465	1,113
EE&P	527	574	571	767
Services	256	309	299	274
G&A	967	927	1,289	1,059
DD&A	453	508	708	732
Interest	3,551	3,870	4,171	5,685
Other - Net	350	318	623	263
	7,652	9,354	12,111	13,013
Income from Operations	4,647	5,723	9,194	12,109
OTHER INCOME (EXPENSE)				
Gain (Loss) on Sale	2	3	0	8
Inc. Before Taxes	4,649	5,726	9,194	12,117
Income Taxes	1,486	1,775	2,875	3,750
Net Income	3,163	3,951	6,319	8,367
Net EPS - Primary	0.22	0.28	0.44	0.46
Weighted Avg Shares Out.	14,550	14,199	14,247	18,189
Net EPS - Fully Diluted	0.22	0.27	0.43	0.45
Weighted Avg Shares Out.	14,487	14,718	14,748	18,794

% OF REVENUE	9/97	12/97	3/98	6/98
Real Estate Finance	62.6%	62.3%	74.5%	73.8%
Equipment Leasing	19.7%	21.0%	16.2%	13.4%
Energy: Production	8.2%	8.2%	4.9%	4.0%
Services	4.1%	3.9%	2.3%	2.0%
Interest & Other	5.4%	4.6%	2.1%	6.8%
	100.0%	100.0%	100.0%	100.0%
COSTS AND EXPENSES				
Real Estate Finance	3.9%	10.1%	14.0%	12.4%
Equipment Leasing	8.7%	8.8%	6.9%	4.4%
EE&P	4.3%	3.8%	2.7%	3.1%
Services	2.1%	2.0%	1.4%	1.1%
G&A	7.9%	6.1%	6.1%	4.2%
DD&A	3.7%	3.4%	3.3%	2.9%
Interest	28.9%	25.7%	19.6%	22.6%
Other - Net	2.8%	2.1%	2.9%	1.0%
	62.2%	62.0%	56.8%	51.8%
Income from Operations	37.8%	38.0%	43.2%	48.2%
OTHER INCOME (EXPENSE)				
Gain (Loss) on Sale	0.0%	0.0%	0.0%	0.0%
Inc. Before Taxes	37.8%	38.0%	43.2%	48.2%
Income Taxes	12.1%	11.8%	13.5%	14.9%
Net Income	25.7%	26.2%	29.7%	33.3%

YEAR/YEAR	12/97	3/98	6/98
Real Estate Finance	191.8%	320.2%	316.6%
Equipment Leasing	163.9%	106.2%	80.0%
Energy: Production	29.6%	10.7%	-1.0%
Services	50.0%	34.9%	20.8%
Interest & Other	609.3%	343.0%	2514.4%
	157.4%	210.6%	221.0%
COSTS AND EXPENSES			
Real Estate Finance	834.8%	1487.8%	1196.6%
Equipment Leasing	50.0%	61.7%	15.7%
EE&P	39.4%	34.4%	67.0%
Services	38.0%	34.1%	33.3%
G&A	56.6%	96.5%	66.4%
DD&A	33.9%	80.6%	87.7%
Interest	846.7%	583.8%	708.4%
Other - Net	3080.0%	358.1%	67.5%
	204.5%	242.7%	246.6%
Income from Operations	105.4%	176.4%	197.3%
OTHER INCOME (EXPENSE)			
Gain (Loss) on Sale	-96.6%	-100.0%	508.4%
Inc. Before Taxes	99.2%	177.8%	197.4%
Income Taxes	208.7%	271.0%	227.8%
Net Income	71.8%	149.4%	185.6%
Net EPS - Fully Diluted	-8.3%	87.4%	119.0%

INCOME STATEMENT	9/98 E	12/98 E	3/99 E	6/99 E
REVENUES				
Real Estate Finance	19,142	15,468	16,219	16,999
Equipment Leasing	3,500	3,600	3,600	3,600
Energy: Production	1,000	1,000	1,000	1,000
Services	500	500	500	500
Interest & Other	1,200	1,300	1,300	1,300
	25,342	21,868	22,619	23,399
COSTS AND EXPENSES				
Real Estate Finance	3,254	2,629	2,757	2,890
Equipment Leasing	1,400	1,440	1,440	1,440
EE&P	780	750	750	750
Services	275	275	275	275
G&A	1,460	1,544	1,596	1,648
DD&A	750	750	750	750
Interest	4,138	4,499	4,499	4,499
Other - Net	300	300	300	300
	12,357	12,188	12,367	12,551
Income from Operations	12,985	9,680	10,252	10,848
OTHER INCOME (EXPENSE)				
Gain (Loss) on Sale	5	5	5	5
Inc. Before Taxes	12,990	9,685	10,257	10,853
Income Taxes	4,027	3,002	3,180	3,364
Net Income	8,963	6,682	7,077	7,488
Net EPS - Primary	0.49	0.37	0.39	0.41
Weighted Avg Shares Out.	18,189	18,189	18,189	18,189
Net EPS - Fully Diluted	0.48	0.36	0.38	0.40
Weighted Avg Shares Out.	18,794	18,794	18,794	18,794

% OF REVENUE	9/98 E	12/98 E	3/99 E	6/99 E
Real Estate Finance	75.5%	70.7%	71.7%	72.6%
Equipment Leasing	13.8%	16.5%	15.9%	15.4%
Energy: Production	3.9%	4.6%	4.4%	4.3%
Services	2.0%	2.3%	2.2%	2.1%
Interest & Other	4.7%	5.9%	5.7%	5.6%
	100.0%	100.0%	100.0%	100.0%
COSTS AND EXPENSES				
Real Estate Finance	12.8%	12.0%	12.2%	12.4%
Equipment Leasing	5.5%	6.6%	6.4%	6.2%
EE&P	3.1%	3.4%	3.3%	3.2%
Services	1.1%	1.3%	1.2%	1.2%
G&A	5.8%	7.1%	7.1%	7.0%
DD&A	3.0%	3.4%	3.3%	3.2%
Interest	16.3%	20.6%	19.9%	19.2%
Other - Net	1.2%	1.4%	1.3%	1.3%
	48.8%	55.7%	54.7%	53.6%
Income from Operations	51.2%	44.3%	45.3%	46.4%
OTHER INCOME (EXPENSE)				
Gain (Loss) on Sale	0.0%	0.0%	0.0%	0.0%
Inc. Before Taxes	51.3%	44.3%	45.3%	46.4%
Income Taxes	15.9%	13.7%	14.1%	14.4%
Net Income	35.4%	30.6%	31.3%	32.0%

YEAR /YEAR	9/98 E	12/98 E	3/99 E	6/99 E
Real Estate Finance	148.7%	64.7%	2.2%	-8.3%
Equipment Leasing	44.7%	13.5%	4.3%	7.1%
Energy: Production	-1.4%	-18.8%	-4.6%	-1.4%
Services	-0.5%	-14.2%	2.7%	-1.4%
Interest & Other	80.0%	86.2%	193.5%	-23.5%
	106.0%	45.0%	6.2%	-6.9%
COSTS AND EXPENSES				
Real Estate Finance	581.6%	72.7%	-7.6%	-7.4%
Equipment Leasing	30.7%	8.7%	-1.7%	29.4%
EE&P	48.0%	30.7%	31.3%	-2.2%
Services	7.2%	-11.0%	-8.0%	0.4%
G&A	51.0%	66.6%	23.8%	55.6%
DD&A	65.7%	47.6%	5.9%	2.5%
Interest	16.5%	16.3%	7.9%	-20.9%
Other - Net	-14.3%	-5.7%	-51.8%	14.1%
	61.5%	30.3%	2.1%	-3.5%
Income from Operations	179.4%	69.1%	11.5%	-10.4%
OTHER INCOME (EXPENSE)				
Gain (Loss) on Sale	196.7%	66.7%	NM	-37.5%
Inc. Before Taxes	179.4%	69.1%	11.6%	-10.4%
Income Taxes	171.0%	69.1%	10.6%	-10.3%
Net Income	183.4%	69.1%	12.0%	-10.5%
Net EPS - Fully Diluted	124.0%	32.0%	-12.3%	-10.5%

INCOME STATMENT	9/95	9/96	9//97	9/98 E
REVENUES	6,114	7,171	19,144	62,950
Real Estate Finance	0	4,466	7,162	13,485
Equipment Leasing	3,452	3,421	3,936	4,294
Energy: Production	1,879	1,736	1,672	2,077
Services	149	197	930	4,040
Interest & Other	11,594	16,991	32,844	86,846
COSTS AND EXPENSES	801	852	1,069	10,882
Real Estate Finance	0	2,339	3,822	5,303
Equipment Leasing	1,733	1,582	1,823	2,692
EE&P	1,026	869	909	1,157
Services	2,265	1,756	2,851	4,735
G&A	1,335	1,368	1,614	2,698
DD&A	1,091	872	5,273	17,864
Interest	0	7	653	1,504
Other - Net	8,251	9,645	18,014	46,835
	3,343	7,346	14,830	40,011
Income from Operations				
OTHER INCOME (EXPENSE)	(1)	7	74	16
Gain (Loss) on Sale	3,342	7,353	14,904	40,027
Inc. Before Taxes	630	2,206	3,980	12,427
Income Taxes	2,712	5,147	10,924	27,600
Net Income	0.40	0.62	0.84	1.67
Net EPS - Primary	6,706	8,271	13,075	16,482
Weighted Avg Shares Out.	0.39	0.62	0.83	1.63
Net EPS - Fully Diluted	6,878	8,289	13,156	13,156

% OF REVENUE	9/95	9/96	9/97	9/98 E
Real Estate Finance	52.7%	42.2%	58.3%	72.5%
Equipment Leasing	0.0%	26.3%	21.8%	15.5%
Energy: Production	29.8%	20.1%	12.0%	4.9%
Services	16.2%	10.2%	5.1%	2.4%
Interest & Other	1.3%	1.2%	2.8%	4.7%
	100.0%	100.0%	100.0%	100.0%
COSTS AND EXPENSES				
Real Estate Finance	6.9%	5.0%	3.3%	12.5%
Equipment Leasing	0.0%	13.8%	11.6%	6.1%
EE&P	14.9%	9.3%	5.6%	3.1%
Services	8.8%	5.1%	2.8%	1.3%
G&A	19.5%	10.3%	8.7%	5.5%
DD&A	11.5%	8.1%	4.9%	3.1%
Interest	9.4%	5.1%	16.1%	20.6%
Other - Net	0.0%	0.0%	2.0%	1.7%
	71.2%	56.8%	54.8%	53.9%
Income from Operations	28.8%	43.2%	45.2%	46.1%
OTHER INCOME (EXPENSE)				
Gain (Loss) on Sale	0.0%	0.0%	0.2%	0.0%
Inc. Before Taxes	28.8%	43.3%	45.4%	46.1%
Income Taxes	5.4%	13.0%	12.1%	14.3%
Net Income	23.4%	30.3%	33.3%	31.8%

YEAR /YEAR	9/96	9/97	9/98 E
Real Estate Finance	17.3%	167.0%	228.8%
Equipment Leasing	NM	60.4%	88.3%
Energy: Production	-0.9%	15.1%	9.1%
Services	-7.6%	-3.7%	24.2%
Interest & Other	32.2%	372.1%	334.4%
	46.5%	93.3%	164.4%
COSTS AND EXPENSES			
Real Estate Finance	6.4%	25.5%	918.0%
Equipment Leasing	NM	63.4%	38.7%
EE&P	-8.7%	15.2%	47.7%
Services	-15.3%	4.6%	27.3%
G&A	-22.5%	62.4%	66.1%
DD&A	2.5%	18.0%	67.2%
Interest	-20.1%	504.7%	238.8%
Other - Net	NM	9228.6%	130.3%
	16.9%	86.8%	160.0%
Income from Operations	119.7%	101.9%	169.8%
OTHER INCOME (EXPENSE)			
Gain (Loss) on Sale	-800.0%	957.1%	-78.4%
Inc. Before Taxes	120.0%	102.7%	168.6%
Income Taxes	250.2%	80.4%	212.2%
Net Income	89.8%	112.2%	152.7%
Net EPS - Fully Diluted	53.9%	34.3%	100.4%