DF CAPITAL

BANKS

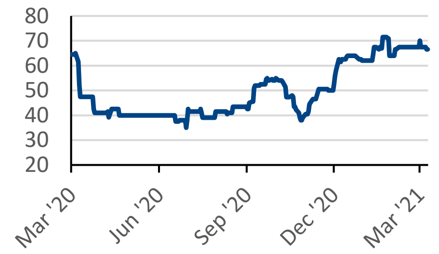
18 March 2021

DFCH.L

66.5p

Market Cap: £119.3m

SHARE PRICE (p)



12m high/low	72p/35p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£17.6m *(at 30/06/20)*
Enterprise value	£101.7m
Index/market	AIM
Next news	FY 20 results - Apr 21
Shares in Issue (m)	179.4
Chairman	John Baines
Chief Executive	Carl D'Ammassa
Finance Director	Gavin Morris

COMPANY DESCRIPTION

Specialist commercial lending and personal savings bank

www.dfcapital.co.uk

DF CAPITAL IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Positioned for efficient growth

DF Capital (DFC) is a specialist SME (Small and Medium sized Enterprise) lender and personal savings bank operating in the UK. It secured permission to commence deposit taking at the end of September 2020 which has allowed it to successfully replace more costly wholesale funding with retail deposits. Having navigated the impact of COVID-19 with aplomb so far, the Group's recent capital raise doubled its lending capacity and we expect it to grow its loan book at pace. With an efficient business model, DFC is initially concentrating on its inventory finance product to secure run-rate profitability during Q4 2021, but holds the promise of supporting a poorly served market with the addition of new, longer term loan products in adjacent segments. Our scenario analysis suggests that one additional product could add at least 12% to our FY 2023E earnings estimate.

- With access to deposit funding, DFC raised £145m of deposits in the 12 weeks to December 2020 allowing it to repay all its other forms of more expensive borrowings. This should see its net interest rate margin increase significantly, from c2% to 6%. Its recent £40m capital raise supports a loan book of c. £550m.
- DFC has significant growth prospects in inventory finance lending from its current position (its loan book was £125m in mid-Jan 2021). The Group outlined a potential pipeline of c£850m which should easily support the Group towards its current capacity of £550m.
- While our current growth estimates are based on its existing loan product, our broad scenario analysis of adding a new product during FY 2022E would add around 12% to our FY 2023E adjusted diluted EPS estimate. This would produce a base for accelerated growth. Longer term, DFC is targeting high-teens ROE.
- Credit quality has remained well controlled and the Group now has experience of testing its approach to risk management and systems during a very difficult year but, unlike many peers, it started 2021 with no COVID related legacy in its loan book.
- DFC uses online digital processes to reduce the cost of underwriting, onboarding, administering and auditing its lending customers. These systems support management and staff with specific sector knowledge of lending and savings products.

DFC has a highly experienced management team which is focused on delivering swift growth from its existing inventory finance product to run-rate profitability in Q4 2021. Thereafter, its deposit base and digital processes are set to add further impetus by supporting the addition of new products.

FYE DEC (£M)	2019	2020E	2021E	2022E	2023E
Net interest income	4.0	1.8	12.9	26.4	39.0
Pre-impairment op. inc.	4.4	2.0	13.3	26.9	39.5
Profit before tax	-13.5	-14.2	-4.9	4.1	13.0
Adj. Diluted EPS (p)	-15.1	-13.3	-2.9	2.3	6.8
Price/NTAV	1.1x	1.4x	1.4x	1.3x	1.2x
Post-tax ROTE	-22.7%	-24.7%	-7.2%	4.7%	12.5%
PER (x)	-4.4x	-5.0x	-22.7x	28.8x	9.8x

Source: Company Information and Progressive Equity Research estimates.

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DFC at a glance

Brief company history

Distribution Finance Capital Holdings plc (DFCH) was founded in 2016 and incorporated in England. Currently, its main country of operation is the United Kingdom. Its subsidiary, DF Capital Bank Limited (DFC) is a specialist SME (Small and Medium sized Enterprise) lender and personal savings bank. The Group has provided over £1bn of cumulative funding to dealers and manufacturers since it started lending activities in 2017. It received permission to become a deposit taker (usually referred to as a 'banking licence') at the end of September 2020.

Board and senior management

DFC has significant experience among its senior staff of running lending businesses in the UK which includes appointments across key operating functions.

Current position

The granting of a banking licence brought the opportunity to realise the potential of an operating model which had been developed to run as a deposit-taking institution. The group currently has regulatory capital which will support a loan book of up to £550m. DFC will concentrate on providing inventory finance lending to manufacturers' dealers. Essentially, it is a niche lender to SMEs which establishes relationships with manufacturers and then provides working capital solutions to the customers (dealers) which sell their products. To date, the Group has navigated the impact of COVID-19 on its operating environment with good control of costs and credit quality. It ended 2020 with a loan book of £113m (which had subsequently reached £125m by 22 January 2021) and deposits of £145m.

Market

The overall level of lending to UK SMEs totalled £212.7bn at the end of December 2020 according to Bank of England's statistics. Within that, DFC estimates that inventory finance lending across the sectors in which it operates accounts for around £20bn. Another potential market for future products such as asset finance and leasing is judged to be around £38bn while the market for short term working capital funding is put at £40bn; significant opportunities for the Group in the medium term.

Process

To maintain an efficient business model, DFC is using third party software which it has tailored to provide a unique user experience for its customers. The Group operates digital processes for onboarding and auditing dealers and will introduce online banking for depositors during 2021.

Lending products

DFC offers inventory finance and supply chain products which provide working capital solutions. The Company effectively purchases assets from manufacturers and these are then delivered to those selling the products (for instance, a caravan dealer) for onward sale to the final consumer. DFC's loans are repaid when the dealer sells the asset to the final consumer and accordingly the lending product is known as "pay-as-sold". Its current target sectors comprise motorhomes and caravans, lodges and holiday homes, marine, motorsports, transport (inc commercial vehicles), agriculture, and industrial (inc plant and machinery). DFC does not currently lend to the motor trade or car dealerships. As at 30 June 2020, DFC had 77 active agreements with manufacturers and 779 dealer customers. Following the COVID-19 pandemic the Group has carried out a review of its entire dealer network and we would expect the number of dealers to have reduced given the Group's focus on credit quality.

Savings products

Having received permission to take deposits at the end of September 2020, DFC has rapidly established a deposit base; the Group raised deposits totalling £145m in the c12 weeks to the end of 2020 following the launch of its deposit taking operations. We estimate that this has reduced the funding cost of the business from c. 6% to less than 1.5% and the Group has repaid all of its wholesale funding and other loans. Management expects to fund all its near-term growth in the loan book (comprising solely the inventory finance product) through deposits.

Estimates

Our estimates can be seen up to FY 2023E in the table at the end of this document. They reflect the evolution of DFC into a profitable business – but they only include our views on what we believe that the current pay-as-sold product will contribute. We include assumptions for an aggregate raise of £15m of new capital during FY 2023E which serves to keep our CET 1 ratio estimates, conservatively, above 18% over our forecast horizon.

Summary financial estimates

	2020E	2021E	2022E	2023E
Total income (£m)	2.4	13.6	27.4	39.5
Profit before tax (£m)	-13.8	-4.9	4.1	13.0
Adj. Diluted EPS before exc. Items (p)	-12.9	-2.9	2.3	6.8
Customer loans (£m)	113.0	310.0	540.0	725.0
Core tier 1 capital ratio (%)	51.2%	32.0%	19.2%	18.8%

Source: Progressive Equity Research estimates

Growth opportunity

- Over time, it is the intention of the business to expand its product range to operate in additional sectors and further up and down the value chain. DFC expects to reach a breakeven monthly run-rate during Q4 21, following which it is likely to launch further products and expand into other SME sectors. Our estimates to FY 23E currently reflect the single product offering but we look at the potential impact of new products on growth prospects and earnings enhancement. The central case of our scenario analysis suggests that launching a new product in FY 2022E could, conservatively, improve our FY 2023E adjusted diluted EPS estimate by 12%.

In summary

DFC has an excellent opportunity to grow its loan book swiftly, combining its low-cost funding with a robust business model. It has plenty of scope for lending in its initial target market and the additional prospect of investigating broader ways of growing the loan book through new products or entering new geographies. As we discuss in this note, the upside to earnings from that is potentially significant. The Group is digitalised, with no legacy systems, and has a scalable business model with controlled costs which should support growth in its loan book up to £550m initially. We expect DFC's highly credible management team to produce the anticipated growth in a poorly served SME lending market while maintaining strict control of credit quality and governance. Longer term, management has aspirations to build a multi-billion pound loan book.

The operating environment

Clearly, the underlying operating environment for all but the first three months of 2020 was influenced by COVID-19 and the attendant constraints on people and businesses. This has required lenders (not just authorised banks) to proactively support customers and the communities in which they operate. For DFC, the initial lockdown in the UK meant disruption to its business on two fronts: firstly, there was minimal stock of new assets available to support its lending products and, secondly, there were considerable constraints put on Group by of its then wholesale funders.

On the loan demand side, dealers were forced to close meaning that, with a few exceptions, most were unable to realistically sell any product. On the funding side, wholesale lenders at the time were particularly risk-averse which significantly reduced DFC's ability to satisfy any demand for new lending.

As restrictions were lifted, there were two noticeable trends:

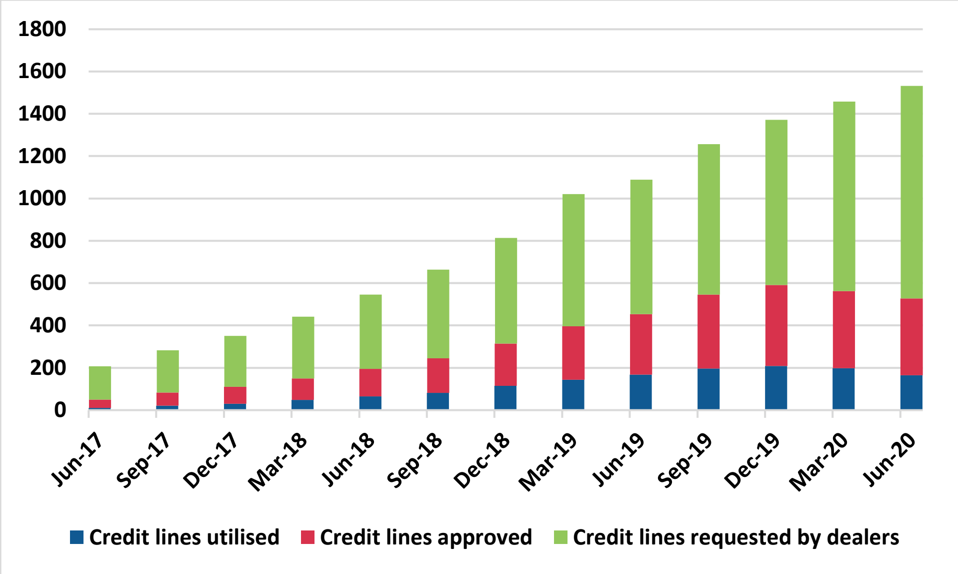
Firstly, there was significant pent-up demand for DFC's dealers' products - particularly those benefitting from the trend toward staycation. In addition, motorcycles were also in high demand due to the move away from using public transport.

Secondly, supply chains had been heavily disrupted during the lockdown so there was minimal availability of new stock. Consequently, as that occurred when DFC had a reduced ability to lend, there was no damage to its business relationships or reputation. In fact, the Group was able to deepen relationships through maintaining a helpful, responsive service to its customers.

During the first half of 2020, DFC provided forbearance to certain of its dealer customers, although this represented less than 2% of the value of the loan book at the time. As the first lockdown restrictions were eased, many of DFC's customers experienced a significant improvement in sales. That led to loan repayments, reflecting the fact that DFC's loans are mainly repaid as assets are sold.

Crucially, DFC also received its deposit taking licence as asset stocks started to flow again. The Group supplied a useful indication of the size of demand for its inventory finance product, once new asset availability increased, in its interim results presentation which continued to increase over the period of lockdown.

Pent-up demand for inventory finance loans (£m)

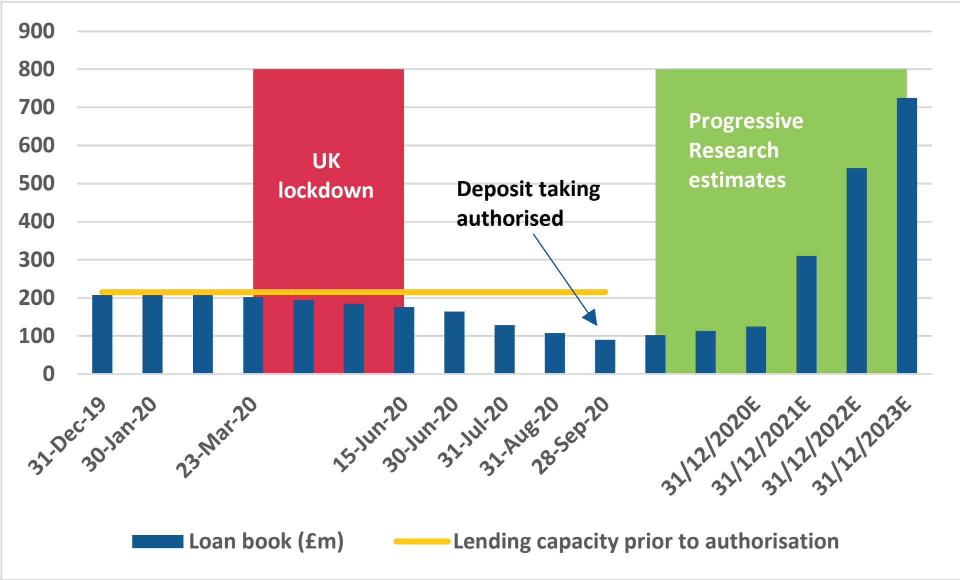


Source: Company information

Despite that demand, the impact on the Group's loan book can be seen in the chart below as it reduced in size from £208m as at 31 December 2019 to £164m as at 30 June 2020, reaching a low point of £83m in October 2020. Subsequently, DFC has resumed growth in its lending with its book standing at £125m at the time of its 22 January 2021 trading update.

When looking at the Group's 'runway' for loan book growth up to £550m, the path includes around £225m capacity in existing facilities and some £50m increase in existing facilities. Another £50m of new facilities are in progress, a further £250m of potential new facilities and around £150m of new leads which are being qualified. Thus, including the £125m loan book, the potential facility pipeline totals around £850m. Generally speaking, typical facility utilisation is 60-70% - hence the view on the feasibility on reaching a £550m loan book from one product.

Loan book (£m) control and estimated growth



Source: Company information, Progressive Equity Research estimates

Despite further current COVID-related restrictions, we expect the Group to take advantage of its success in taking deposits and to grow the loan book strongly over our forecast horizon – those expectations are also shown in the chart. This reflects the increased demand for loan facilities and the availability of cheaper retail deposit funding.

New UK-incorporated banks

There have been a number of new banks which have entered the UK market over the last few years as authorised entities which are incorporated in the UK. In addition, banks incorporated outside the UK may become authorised to establish branches and/or accept deposits. The former are, perhaps, of more interest in terms of new entities entering the UK banking market. The British Business Bank's (BBB) Small Business Finance Markets 2019/20 publication noted that 'the range of products and services available to SMEs has been increased by challenger and specialist banks' and also said that 'challenger and specialist banks have been a great source of diversity within SME finance markets in recent years'.

In 2020, DFC appears to be one of only two SME focused banks that joined the Bank of England's list of new UK incorporated firms with authorisation during the period (see chart below). Importantly, DFC received full authorisation and did not pursue the mobilisation route to obtain its licence, which would have seen it authorised with restrictions.

Amendments to list of banks incorporated in the UK

Month	New firms with authorisation		Firms with authorisation cancelled		Name change
	New Firm	Type of lending of new firm	Cancelled (or applied to cancel*)	Type of lending of cancelling firm	
Jan-20	GKBK Limited Oxbury FS Plc	Trading as Vive: Retail lending and deposit taking delivered digitally Deposit taking. Lending only to British farmers			
Feb-20					
Mar-20	Castle Trust Capital PLC	Deposit taking, mortgages and development finance			
Apr-20					
May-20					
Jun-20			Revver Limited	Property based commercial lending	Oxbury FS Plc to Oxbury Bank PLC
Jul-20			R. Raphael & Sons Plc	Retail savings and lending	GKBK Limited to GH Bank Limited
Aug-20			The Commonwealth Trade Bank Plc	International trade finance	CIBC World Markets Plc to CIBC World Markets Limited
Sep-20	**Distribution Finance Capital Limted**	**SME lending, deposit taking**	ADIB	Bankng services to hgh net worth and corporate customers	Sumitomo Mitsui Banking Corporation Europe Limited to SMBC Bank International plc
Oct-20	Monument Corporation	Digital only, serving the mass affluent	Virgin Money (*)	Retail banking and business accounts	**Distribution Finance Capital Limited to DF Capital Bank Limited**
Nov-20	Recognise Financial Services	Bridging and commercial property finance, working capital loans			Monument Corporation to Monument Bank Limited
Dec-20					

Source: Progressive Equity Research, Bank of England monthly PRA-regulated bank lists

The BBB report also reflects on the new challenger and specialist banks that received authorisation between 2013 and 2019, noting a mix of full-service, digital-only and specialist banks (including micro banks). It also comments that, in recent years, 'new digital-only and specialist banks including micro banks have been more common'.

Interestingly, there appears to be little data on the level of lending by new banks to SMEs and an observation that business lending was weighted towards commercial mortgages at the time its publication was published in January 2020.

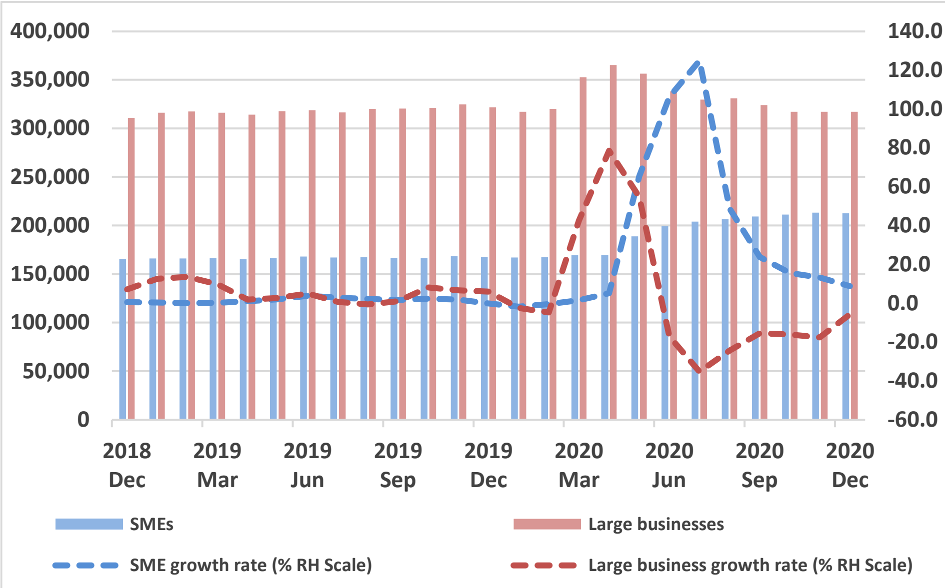
What seems to be generally accepted is that lending to SMEs remains a relatively underserved market, particularly the area of asset finance where incumbent lenders seem less willing to lend against the range of assets that new banks will consider.

There are also the efficiency benefits that new banks can derive from digitalisation of processes to help reduce cost:income ratios and aid more competitive pricing of loans and savings products, although, we feel that there is often a balance to be struck between the level of staff input compared to complete digitalisation.

Lending to UK SMEs

The overall level of lending to UK SMEs totalled £212.7bn at the end of December 2020 according the Bank of England's statistics. DFC has previously estimated that inventory finance lending accounts for around £20bn in the sectors in which it operates. The chart below shows how lending to UK businesses has changed during 2020. In particular, the stock of lending to large businesses in the UK picked up almost immediately as the UK went into lockdown. SME lending followed suit a couple of months later and the dotted lines show that the stock of SME lending continued to grow on a monthly basis into December 2020 while lending to large businesses declined.

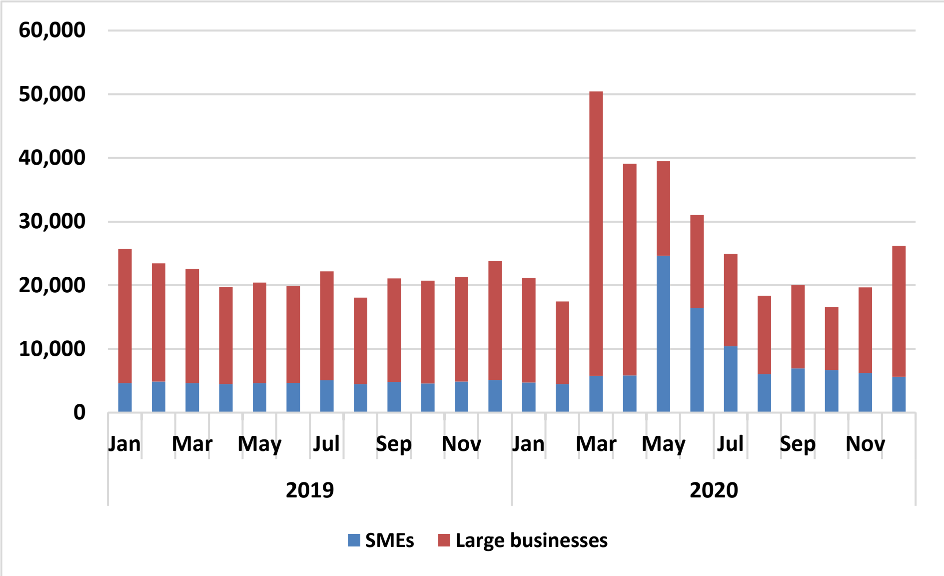
Monetary financial institutions' stock of loans to UK non-financial businesses (Non-Seasonally Adjusted) (£m) and growth rates (RH Scale %)



Source: Bank of England

It is, perhaps, easier to see the monthly pattern of gross new lending in the chart below which shows how the level of new lending to SMEs lagged that of lending to large businesses. This possibly reflected the speed with which the latter moved to draw down unused portions of their existing facilities to bolster their cash positions whereas SMEs had to make particular arrangements to access new lending alongside the timing of the launch of government supported schemes such as Coronavirus Business Interruption Loans (CBILS) and Bounce Back Loans (BBLS). Lending volumes to large businesses started to pick up again during Q4 2020.

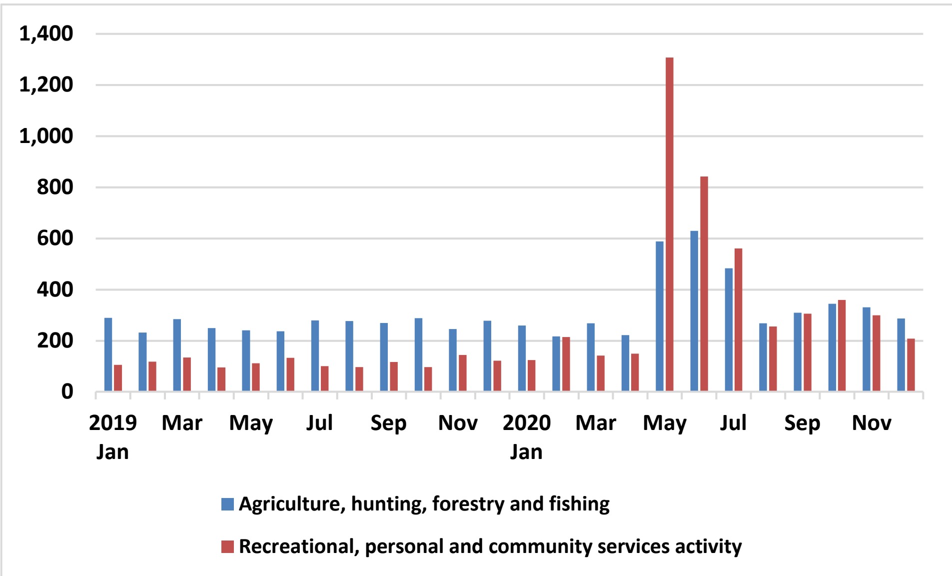
Monetary financial institutions' monthly loans to UK non-financial businesses (Non-Seasonally Adjusted) (£m)



Source: Bank of England

DFC lends to specific market segments and, although it is difficult to discern the niche lending products in the wider data, the chart below shows the spikes in lending which occurred in the wider agricultural and recreational segments of lending to UK businesses.

Gross lending by financial institutions to SMEs in agricultural and recreational industries (£m)



Source: Bank of England

Mind the gap

On 18 November 2020, Andy Haldane, the Chief Economist of the Bank of England and a Member of the Monetary Policy Committee gave a speech entitled "Seizing the Opportunities from Digital Finance". In it, he noted that '*for many decades, the market for SME lending has misfired, constraining the quantity and raising the price of SME financing in ways which have hindered economic growth*'. He highlighted two pieces of 'information asymmetry' which compounded the problem: Firstly, SMEs know more about their businesses than a lender ever could. Secondly, existing lenders to SMEs know more about their SME customers than prospective new lenders.

Mr Haldane notes that it has been estimated that UK SMEs face an annual funding gap of over £20 billion citing the previous finding of the National Audit Office of a possible need by SMEs by 2017 for an additional £22 billion over and above the finance available to them at the time of a 2014 survey. Clearly, times have moved on but it is worth noting his point that corporate lending as a fraction of UK banks' balance sheets has fallen from over 60% in the 1950s to around 15% currently.

Part of a mooted solution is the suggestion of an Open Data platform for SMEs on which the Bank of England has already set out some design ideas. It would provide a standardised means of permissioned sharing of data about businesses and could include data from multiple relevant sources, not just banks. There would be no central data repository, physical credit file or central infrastructure. An SME could allow the providers to share data with potential lenders to help shorten application processes and allow access to a broader set of lenders through digital identification and verification.

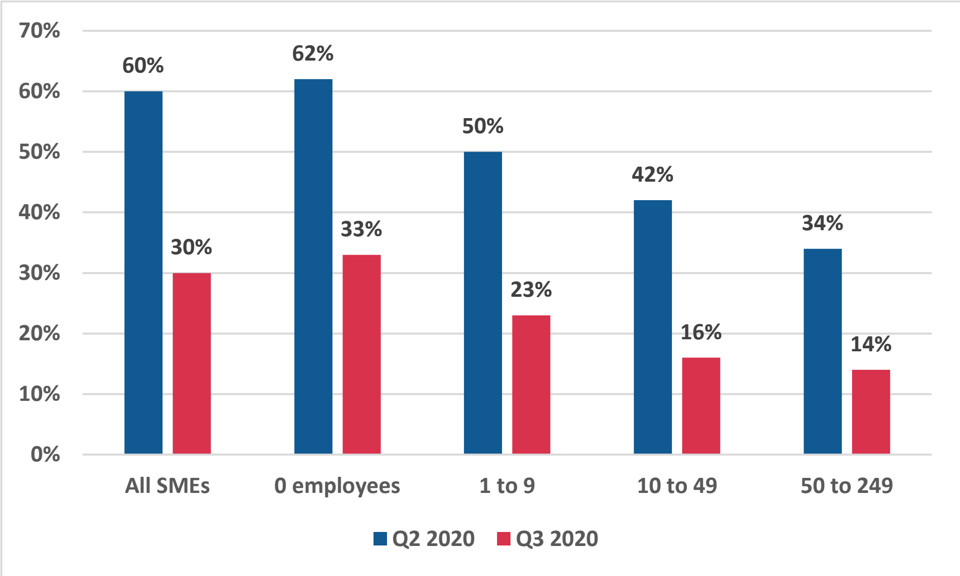
Before that happens, however, it seems to us that the ability of lenders to offer digital solutions through flexible platforms must put them at the forefront of reducing the funding gap to SMEs. COVID-19 has clearly had an impact on the availability of credit and has produced a necessary requirement for agility in terms of assessing potential customers and confirming new lending. The willingness and ability of SMEs to borrow new funds has been affected greatly as surveys from UK Finance confirm.

UK Finance survey of SMEs for Q3 2020

The BVA BDRC survey report for UK Finance for Q3 2020 found that only a minority of SMEs expected no income at all in the coming months. Overall, some 30% of respondents expected turnover to be down by more than 50% or non-existent. However, the proportion of SMEs who were expecting to see that harshest of outcomes had halved since the survey was conducted for Q2 2020 – although only slightly fewer respondents in Q3 felt that the worst was still to come compared to Q2.

Within the survey, the response to COVID-19 by sector shows unsurprising trends with all sectors having been affected, especially those in Hospitality and Transport, with Agriculture less so. Apart from Health, all sectors saw an increase in redundancies between Q2 and Q3, with Hospitality the worst hit. The Service sector and Construction were the sectors most likely to be planning for the future while, again unsurprisingly, Hospitality, Health and Transport were more likely to be still focused on COVID.

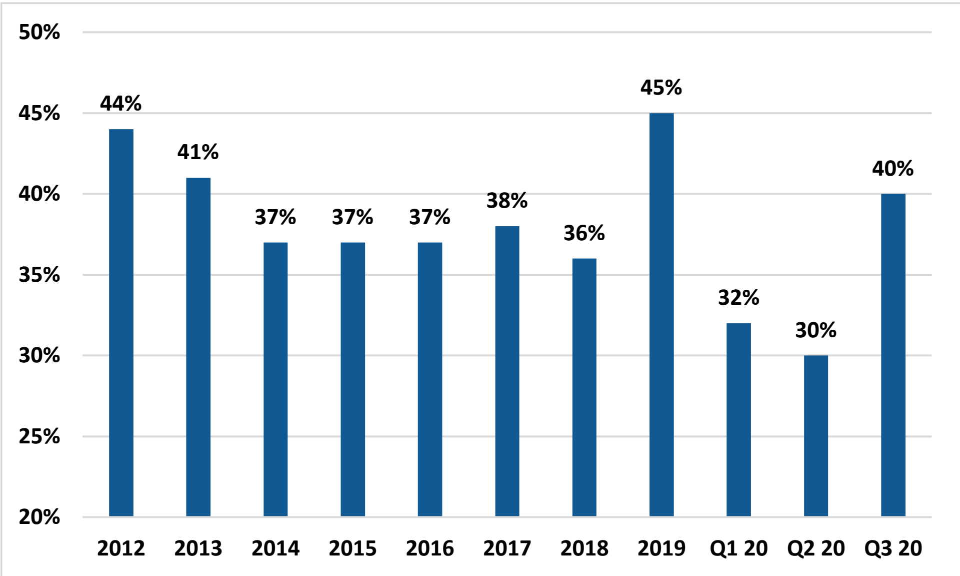
The proportion of SMEs expecting revenue to be down by more than 50% or non-existent in the coming months



Source: BVA BDRC survey report for UK Finance

In terms of their views on the future, 4 in 10 SMEs were directing more of their focus in that direction. The smallest SMEs were slightly more likely to still be entirely focussed on the pandemic, however. About one third of respondents saw the future as predominantly offering threats, rather than opportunities, to their businesses. That declined slightly as the size of the SME increased. That is, perhaps, reflected in the return to borrowing in Q3 that the Bank of England data showed and the results of the survey below.

Proportion of SMEs using finance

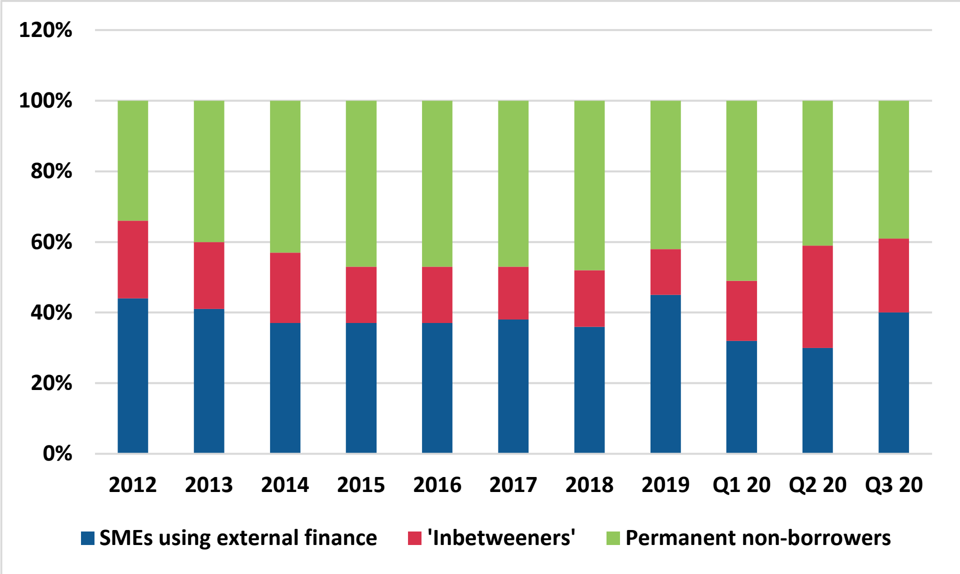


Source: BVA BDRC survey report for UK Finance

The use of finance was 40% in Q3 2020, which was more in line with most previous years compared to the unusually low levels in Q1 and Q2 of this year. The survey notes that the use of loans/commercial mortgages doubled compared to 2019. There was obviously an increase in the forms of finance supported by grants and government guarantees. This meant that there were as many SMEs using finance as there were 'Permanent non-borrowers' who were not using finance and showed no inclination to do so.

Overall, the survey suggests that the general mood amongst SMEs in Q3 had improved from Q2 with more SMEs expecting some income and starting to think about the future. Interestingly, when looking at the three major concerns of economic climate, political uncertainty and cash flow/late payment, the latter had reduced from the Q2 high point while the economic climate continued to be the main concern.

The gap between SMEs who borrowed and those who didn't narrowed in Q3 2020



Source: BVA BDRC survey report for UK Finance

Interestingly, of those using external finance, around one third were said to be concerned about whether they have the right funding in place for their businesses. Overall, though, as growth aspirations increased in Q3, the proportion of SMEs happy to borrow to grow increased to 34% from 29% and 31% in Q1 20 and Q2 20 respectively. The survey found that 11% of SMEs reported a need for funding in the previous twelve months and most acted on that. That compared to 3% in 2019. Of all applications made from Q3 2019, 82% were successful compared to 71% in the 18 months to Q4 2019. This comparison is affected by the Government backed loan schemes for which 91% of applications were successful.

The appetite for finance increased in Q2 20 and it remained higher in Q3 with 12% of those surveyed planning to apply and 23% expecting to seek finance in the future. This latter group of continued to be focused on the current economic climate to a greater degree than previously seen (81%, up from 62% in 2019).

In all, the operating environment still seems to contain good demand for new lending from SMEs – although this will clearly be influenced by future developments in the wider economy.

Lloyds Banking Group

As a brief example of the experience of one of the larger UK banks, Lloyds saw a mix of effects across its retail and commercial lending books. The Group reported £3bn net growth in mortgages in Q3 2020 with a £3.5bn increase in its open mortgage book. Its consumer finance balances were 2% below the level at the end of Q2 2020 while SME borrowing included around £11bn of Government-backed scheme lending. Lloyds estimated that around 50% of that remained on deposit. Conversely, there was a reduction in corporate and institutional balances which included repayment of RCFs and other facilities.

Many banks are expected to face back-book challenges or have their focus drawn to Government-backed products which may impact their appetite for future lending. In the following section, we look at DFC's loan book and its prospects for growth in its chosen markets.

Lending

Current loan product details

DFC currently offers its "pay as sold" inventory finance products across six, related, product segments. The purpose of inventory finance products is to support DFC's customers' growth aspirations by allowing them to match their cash cycle to the lending term, releasing working capital. A typical average loan duration is around 150 days but the actual duration varies with individual agreements.

Loan product

Inventory Finance 'Pay as sold'

Working capital finance provided to dealers for their forecourt inventory - for specific assets or wider asset groupings.

PRODUCT DESCRIPTION
DFC purchases finished goods from the manufacturer and these are delivered to the dealer. Loans take two forms:
Unit Stocking **loans for assets supplied to a dealer**
Floorplan **loans for assets supplied under a manufacturer program.**

Gross yield p.a.: 7% to 8%

TARGET CUSTOMER SEGMENTS

- Agricultural equipment
- Marine
- Motorhomes and caravans
- Industrial equipment
- Motor vehicles
- Lodges and holiday homes

CLIENT TYPE
Example Original Equipment Manufacturers:

- Willerby
- Swift
- Triumph Motorcycles
- Fairline Yachts
- Terex
- Maxus
- Erwin Hymer Group

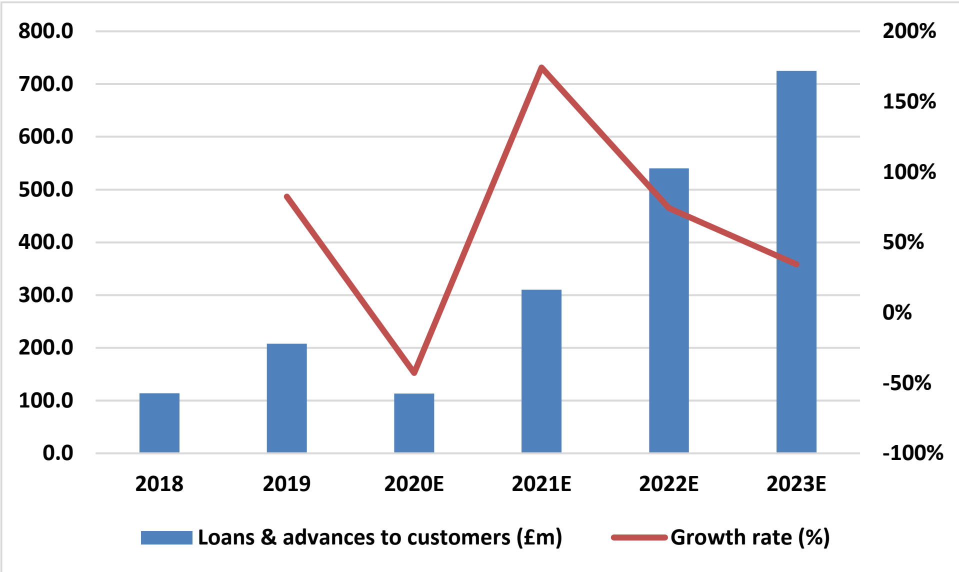
Source: Progressive Equity Research

DFC offers unit specific finance on predominately new inventory which allows dealerships to stock the financed assets and display them to their customers. The loan amount is repaid in full upon asset sale or repaid in full at the end of the contractual term if the asset is not sold in this time. Once repaid, the facility remains available for further drawdown against specific assets during the agreed life of the facility. This revolving facility generally averages over £100,000 but the Group will currently consider providing facilities between £30,000 and £9m, although we understand that this limit is a function of its limits set by the PRA for all banks as a percentage of their regulatory capital. The recent capital raise should theoretically allow DFC to offer larger facility sizes up to c.£18m.

Loan book assumptions

Our estimates are based on the assumptions of growth in the loan book as shown in the chart below. Clearly, the fluctuations in 2020 reflect the impact of COVID-19. It is also worth noting that, until DFC received authorisation in September 2020, the Group did not have the flexibility of funding through its wholesale funding arrangements. Since the Group re-started lending, following its authorisation and having put the required liquidity buffers in place as a new bank, DFC's loan book started to grow from a low point of £83m in October 2020. The control over its loan book during 2020 should be viewed in tandem with the levels of arrears and overall credit quality which we examine in subsequent sections of this document. DFC ended 2020 with a loan book of £113m and this had grown to £125m by 22 January 2021.

Loan book growth assumptions



Source: Company information, Progressive Equity Research estimates

Other lenders had varying experiences during 2020 which were influenced by, *inter alia*, the type and size of loans, customer profiles and maturity profiles and funding of their loan books. For instance, in its financial year to the end of September 2020, PCF Bank saw Consumer Finance lending up 26% while Business Finance was down 34% and its Azule Finance (broadcast equipment finance) reduced by 43%. Its Property Bridging Finance was up 328%, however. In terms of new business finance in areas most relevant to DFC, the 80% fall in Business Finance in PCF Bank's financial H2 compared to its H1 reflected SMEs holding back on investment plans and making use of CBILS and BBILS products. Azule Finance was down 50% as the broadcast industry was hit and customers made use of those same products.

Paragon Bank has given a trading update for the final quarter of calendar 2020 (its financial Q1) in which it noted that SME lending had shown growth from the final quarter of its FY 2020 financial year to the end of September, aided by a further £13.6 million of lending as part of the CBILS and BBLS schemes. However, it remained below the levels seen pre-COVID-19.

Sourcing new business

Around half of DFC's lending is gained through programmes with manufacturers. DFC's Commercial Team either has existing relationships with those manufacturers or will look to add to them by approaching new leads. The manufacturers then open up their dealer networks to DFC and these dealers are then digitally onboarded and underwritten to establish them as customers with lines of credit. Once a dealer is onboard, the process is almost entirely automated, creating a very efficient business model. Consequently, for the sectors which the Group currently serves, there is little need for more business development or management staff to grow the loan book and there appears to be significant headroom for growth at current staffing levels. Should DFC move into new sectors, though, we would expect further investment in staff with appropriate knowledge of those sectors/product areas.

The rest of the Group's lending is sourced from relationships or direct approaches to potential customers within the same sector verticals to which the Group lends through its programmes.

How does the process of lending work from enquiry to grant of a loan?

Courting the manufacturer takes time when trying to establish a new relationship, but the rest of the process can be relatively quick. Often, the manufacturer will recommend some dealers for the initial programme with others following. DFC underwrites each dealer and they receive individual credit limits and may be asked for additional security depending upon their circumstances.

One of the changes that the COVID-19 pandemic brought was the reduced ability to audit assets in person. DFC has developed a smartphone self-audit app which dealers can use to perform a self-audit; the dealer uses the app to take a picture of the asset so that checks can be performed on the condition of the asset and verification of the asset can be made through serial number checks. Importantly, the app geo-tags the location at which the picture was taken so that DFC is able to confirm the asset is actually in the location it is expected to be.

The Group also monitors credit bureau data on a monthly basis and will assess the behavioural performance of the dealers to watch for anything that may be detrimental to future credit quality.

Beyond inventory finance

At previous investor presentations, management has indicated that once the existing inventory finance product has reached a breakeven run-rate (expected Q4 2020 and achieved at a loan book size of approximately £270m), that it would consider the introduction of new products. As a result, we could potentially see further details of new product launches as the Group moves closer towards profitability. New products likely to be considered include other working capital products such as asset backed lending and invoice finance, short term loans, commercial lending, asset finance and hire purchase.

There is also the possibility that DFC could acquire existing lending businesses to accelerate expansion in its loan book into new product areas – that would bring the advantage of potentially acquiring expertise in new products and sectors at the same time.

We look at the opportunities for DFC to grow its business at a faster rate through the addition of a new product in a later section.

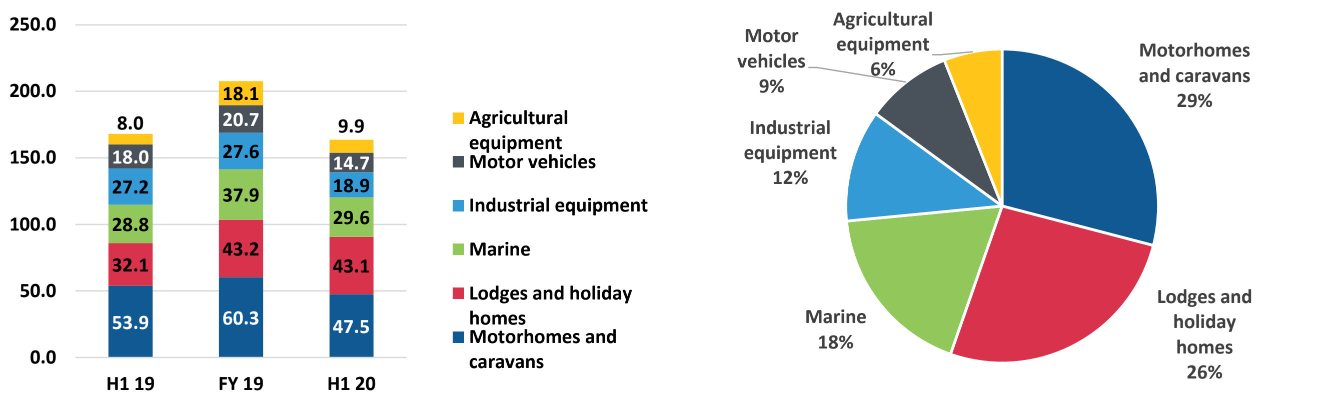
Credit quality

The onset of the COVID-19 pandemic has allowed DFC to rigorously test the Group's approach to credit management, operations, business plan and assumptions. This operating environment effectively stress tested the Group's ability to manage its loan book and to control impairments, even before it was granted its banking licence. Having ended 2019 with a loan book of £208m, by the end of September 2020, it had fallen to £90m. As we note in the previous section, during that time, we saw a period during lockdown when dealerships were completely closed. After that, from mid-June 2020, DFC had to manage increasing demand from customers that saw loans repaid, set against the diminished availability of replacement of new assets to fund and on-going constraint of wholesale funding.

Assessing credit quality

As the loan book grows, DFC can control its exposure to reduce counterparty risk to minimise the impact should that counterparty fail. The average exposure to any one business segment has obviously varied with the movement in the loan book over the last eighteen months. The latest update as at the end of June 2020 showed that the two largest segments - Motor Homes & Caravans and Lodges & Holiday Homes - accounted for just over 55% of the loan book compared to 50% and 51% at the end of the two respective half years.

Concentration of credit risk (£m) – last three reports **Percentage concentration as at 30 June 2020**



Source: Company information, Progressive Equity Research

DFC builds its own credit score for counterparties which includes utilising third party credit ratings which is supported by the loans being secured on the assets. DFC takes effective ownership of the asset direct from the manufacturer at a discount to the wholesale price.

The loan-to-value ratio is a mathematical calculation which expresses the amount of a loan balance outstanding as a percentage of the total appraised value of the asset. A high LTV indicates that there is less value to protect the lender against default. There are two loan-to-value measures to which DFC refers when looking at risk:

- Loan to wholesale value – where the wholesale price is the invoice value paid by the dealer to the manufacturer.
- Loan to retail value – where the retail price is the invoice value paid by the end user or purchaser of the asset

The recent progression of those two measures reflects the continuing management of the loan book by the Group during the initial period of the pandemic. DFC's Wholesale and Retail LTVs of new lending are around 85% and 70% respectively.

Loan to value ratios (%)

	30/06/2019	31/12/2019	30/06/2020	31/08/2020
Loan to wholesale value	84%	85%	79%	75%
Loan to retail value	70%	70%	66%	63%

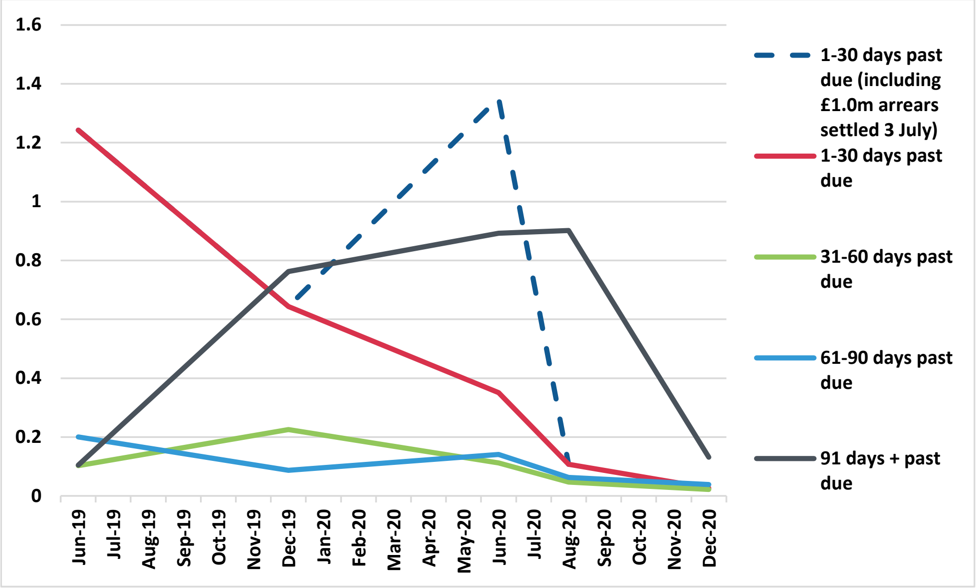
Source: Company information

The highly secured nature of DFC's lending is an important point to note here, in our view. In the event of a loss, the Group has a substantial buffer between the value of the loan and the retail price of the asset. There is also a degree of added comfort with around half of DFC's lending related to programmes with manufacturers whereby if a dealer hits an issue, the manufacturer will help to redistribute assets to other dealers in the network.

Arrears

In conjunction with this, we note that the arrears experience of the Group also pointed to the Group's resilient performance in terms of the quality of the loan book, albeit one which was declining in size.

Arrears as % of loan book

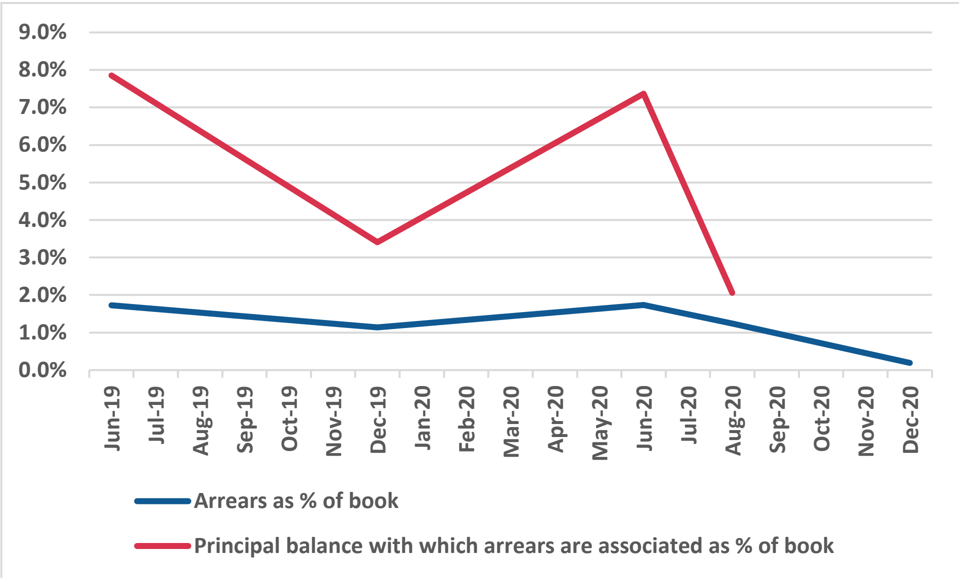


Source: Company information, Progressive Equity Research

This chart shows the arrears numbers and the associated principal balance of the loans in arrears as percentages of the loan book. Again, we can see the significant control exerted by management on the credit quality of the loan book during the initial period of the pandemic. In its January 2021 trading update, management noted that arrears were sitting "significantly lower" than the levels seen in periods prior to the onset of the global pandemic.

By way of comparison, the experience of Virgin Money's business lending book showed that, at the time of its September 2020 year-end, arrears measures were stable to improving, with 90+ DPD of 0.27% compared to 0.47% a year earlier. During the year, the proportion of business customer accounts classed as categorised (watch, default and impaired), by value, increased from 8.13% to 8.61% of the total business book.

Arrears and balance associated with those arrears as % of book



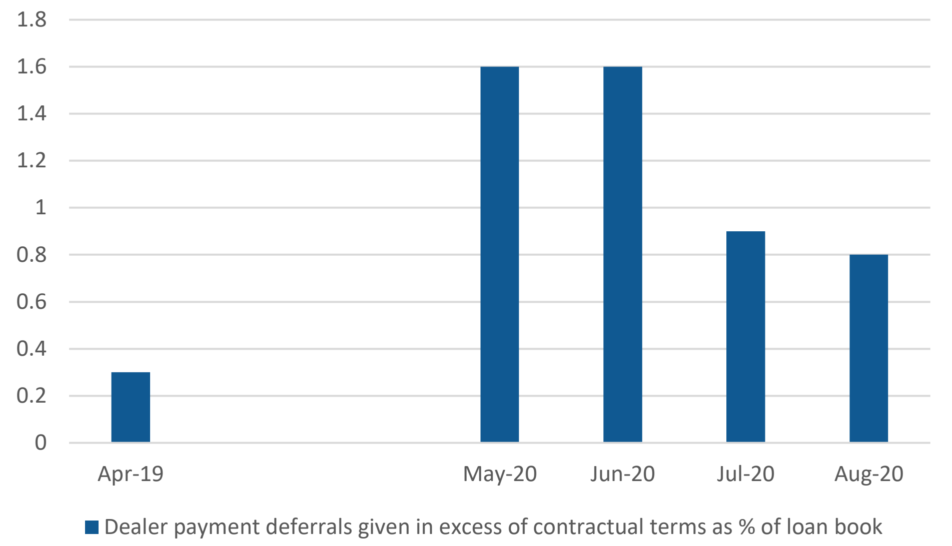
Source: Company information, Progressive Equity Research

Forbearance

We mentioned earlier that, during the first half of FY 2020E, DFC provided forbearance to certain of its dealer customers representing less than 2% of the value of the loan book at the time. DFC also noted lower arrears and forbearance at 31 August 2020 than it had reported as at 30 June 2020.

The following chart shows the levels of forbearance which DFC granted and it is worth looking at the percentage of the loan book that deferrals represented. We give some comparative data for several competitors below which show DFC's experience in a favourable light.

DFC forbearance granted (%)



Source: Company information,

By contrast, Virgin Money's full year to the end of September 2020 obviously contained a longer period of the COVID pandemic and its business portfolio forbearance increased from £509m (368 customers) at 30 September 2019 to £539m (368 customers) at 30 September 2020. Moves in forbearance reflected the proportion of business customers requiring support on non-standard terms and evidencing financial difficulty. As a percentage of the business portfolio, forborne balances reduced to 5.92% (2019: 6.38%) while impairment coverage increased to 14.3% (2019: 10.87%).

Similarly, PCF Bank has the same financial year end of September and, in its FY 2020, it saw a "constant increase in requests from customers" during the first lockdown, many for precautionary reasons, which resulted in a peak in May 2020 of £139.4 million representing 37.8% of its loan portfolio. There was a gradual reduction during the summer months as customers resumed payments after a 3 month payment holiday – after which forbearance levels reduced to £40 million (10.9% of portfolio) by 30 September 2020. By the end of November 2020, PCF reported that there had been a further reduction to £23 million (6.3% of portfolio). With the lowest forbearance rates at that stage in its Consumer Finance Division (2.3% of the portfolio), the level in its Business Finance Division was 9.1%; and within its Azule portfolio it was 15.0%.

In its financial Q1 trading update for the three months to the end of December 2020, Paragon Bank stated that the take up of new payment holidays remained low. Overall, Paragon has given payment holidays on approximately £2.6 billion of balances since March 2020, but as at 31 December 2020, the remaining balance was substantially lower at £104.6 million, of which £93.4 million represented extensions "due to mature over the coming few months."

IFRS9

Under IAS 39 accounting standards, credit losses were taken into account when the loss occurred. With the new IFRS 9 standards, impairment recognition will follow a forward-looking "expected credit loss" model. Effectively, IFRS9 brings forward the recognition of impairments from when the loan becomes distressed to when it is originated and changes recognition from an incurred-loss basis to one of an expected loss. We expect there to be considerable room for interpretation but the key seems to be to continually assess the credit quality of a loan book and to update assumptions accordingly. It could lead to assumption changes across the sector in times of uncertainty and the impact on earnings could be quite marked even in the absence of overt changes in customer credit quality.

Under IFRS 9, credit exposures will be categorised into one of three stages, depending on the increase in credit risk since initial recognition. When there is a significant increase in credit risk, loans must be moved from a 12-month expected loss to a lifetime expected loss. That will be judged by comparing the initial credit risk of a financial instrument with its current credit risk, taking into consideration its remaining life. In stages one and two, the interest revenue will be the effective interest on gross carrying amount; in stage three it will be the effective interest on amortized cost.

In summary:

- Stage 1 assets comprise clean, newly originated assets as well as those which have not experienced a significant increase in credit risk. These assets carry an expected credit loss allowance equivalent to the expected credit losses deemed possible within 12 months.
- Stage 2 assets are those which have experienced a significant increase in credit risk since origination. These assets carry a lifetime expected credit loss.
- Stage 3 assets have either defaulted or are otherwise considered to be credit impaired. These assets also carry a lifetime expected credit loss.

The table below shows the movements in DFC's exposures during the first half of 2020. The totals as at 30 June 2020 reflect DFC's careful management of the credit quality of the loan book and the low levels of Stage 3 assets even with the influence of COVID on the economy.

Gross loan receivables in accordance with impairment losses (£m)

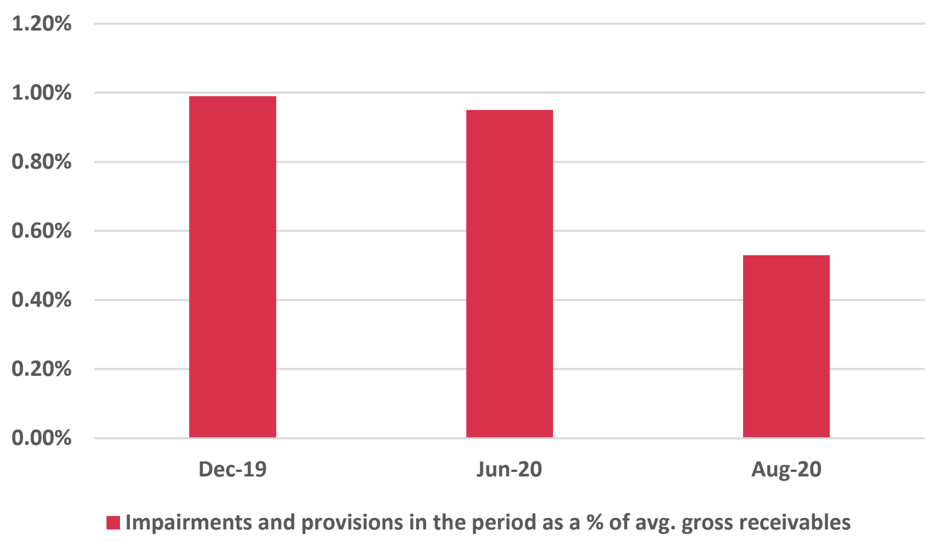
	Stage 1	Stage 2	Stage 3	Total
As at 1 January 2020	202.0	4.6	2.9	209.4
Changes in IFRS 9 model & parameters				
Transfer to Stage 1	29.5	-28.8	-0.7	0.0
Transfer to Stage 2	-55.4	57.5	-2.1	0.0
Transfer to Stage 3	-2.5	-2.4	5.0	0.0
New financial assets originated	117.6	2.9	0.0	120.5
Repayments	-148.6	-13.4	-1.9	-163.9
Write-offs	0.0	0.0	-0.1	-0.1
As at 30 June 2020	**142.6**	**20.3**	**3.0**	**165.9**
Loss allowance coverage at 30 June 2020	**0.7**	**0.2**	**1.3**	**2.2**
Loss allowance coverage at 30 June 2020 (%)	**0.47%**	**0.81%**	**44.66%**	**1.31%**

Source: Company information

Cost of risk

DFC's management of arrears and the highly secured nature of its lending meant that the Group saw only modest write-offs (£76k) through to 30 June 2020. The cost of risk decreased slightly to 0.95% from 0.99% at the end of 2019 but continued to reflect the influence of COVID-19 on DFC's IFRS9 provision assumptions. In its September presentation, DFC noted that it had fallen further to 0.53% by the end of August 2020.

Cost of Risk (%)



Source: Company information

To provide some context, we note the experience of Virgin Money's business lending book. Although we refer to its financial year to the end of September, it encompasses almost the same period of influence of COVID-19 to which DFC is referring.

Virgin Money's business lending increased by £1.1bn to £8.7bn as at 30 September 2020 (2019: £7.6bn) which included lending under government-backed loan schemes, which contributed to £1.2bn of portfolio growth in the year. It experienced little significant deterioration in underlying asset quality measures and had positioned its portfolio towards more resilient sectors, such as Agriculture and Health & Social Care.

The business lending portfolio impairment provision increased by £156m to £303m as at 30 September due to the expectation of greater pressures on the portfolio in 2021 from COVID-19 and Brexit. The impairment charge for the year to 30 September 2020 was £183m giving a cost of risk of 212bps. The resultant coverage ratio of provisions to customer loans of 391bps increased by 198bps from 2019 which reflected the composition of its generally sub-investment grade SME portfolio. Nonetheless, prudent economic forecasts applied caused the probability of default assumptions to worsen with the impact of that including further migrations from 12-month to lifetime loss coverage.

Fact Box

When looking at the reporting of a bank's credit quality, it is worth bearing in mind the following broad definitions:

- *Impaired loans - loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.*
- *Impairment allowances - provisions held on the balance sheet reflecting a charge against profit for the incurred loss inherent in the lending book.*
- *Impairment losses - the reduction in value following an impairment review of an asset that determines that its value is lower than its carrying value.*

And, additionally, the 'jargon' that can surround the condition of the loan book:

- *Loans past due - when a counterparty has failed to make a payment when contractually due.*
- *Loss emergence period - the estimated period between impairment occurring and the establishment of an appropriate impairment allowance.*
- *Probability of default - the likelihood that a customer will default on their obligation within the next year.*
- *Loss Given Default - the estimated loss that will arise if a customer defaults.*
- *Exposure at Default - an estimate of the amount expected to be owed by a customer at the time of the customer's default.*
- *Expected loss - the amount of loss that can be expected which is calculated by multiplying the Default Frequency by the Loss Given Default by the Exposure at Default.*

Our assumption on impairment

In establishing our estimates, we have taken a view on the likely longer term prospects for annual impairment charges. We obviously do not have access to management views on how its assessment model is managed so our estimate of a charge of 1% of the average loan book in any year, represents our best view on the charge.

Lessons from 2020

In what was a very difficult operating environment, DFC has demonstrated good control of its loan book and credit metrics. This should provide a great deal of comfort on the systems which the Group uses to monitor credit quality in our view. Given that the Group is at an early stage of its development, one might reasonably ask how much the experience of managing a loan book of sub £200m applicable to the management of the book going forward in a fast growth phase.

A highly experienced management team

Importantly, on that latter point, we note that there is already a great deal of experience in the management team, including experience of a harsh business cycle and the financial crisis of 2008 and its subsequent impact. In addition, the influence of the COVID-19 pandemic on DFC's operating environment has helped road test the ability of the Group's people and systems in managing the business through difficult circumstances. As we note elsewhere, part of the group's audit system has been developed to work remotely through automation. This obviously included the constraint of a lack of available wholesale funding during the first period of lockdown in the UK. The result was that DFC managed a book that had seen significant growth without seeing arrears levels take off. Indeed, it ended up with a loan book that had been managed down in size at the point when it was able to start taking deposits to reduce its funding costs and to support a return to growth in the book without any legacy impact from the COVID-19 operating environment.

Continuous monitoring of credit quality

This also means that the Group has been able to reconsider its relationships with its borrowers. Clearly, some sectors to which it has been lending have been more affected by the pandemic than others. We would expect, for instance, that the proportion of the book that Marine assets form in the near future will be somewhat lower than in the pre-COVID-19 book. Conversely, transportation may well move in the opposite direction. Overall, we feel that DFC is likely to kick off its next growth phase with, potentially, fewer – but better quality – dealer relationships. We also note that this higher quality may lead to a slight reduction in gross yields over time, reflecting better credit risk.

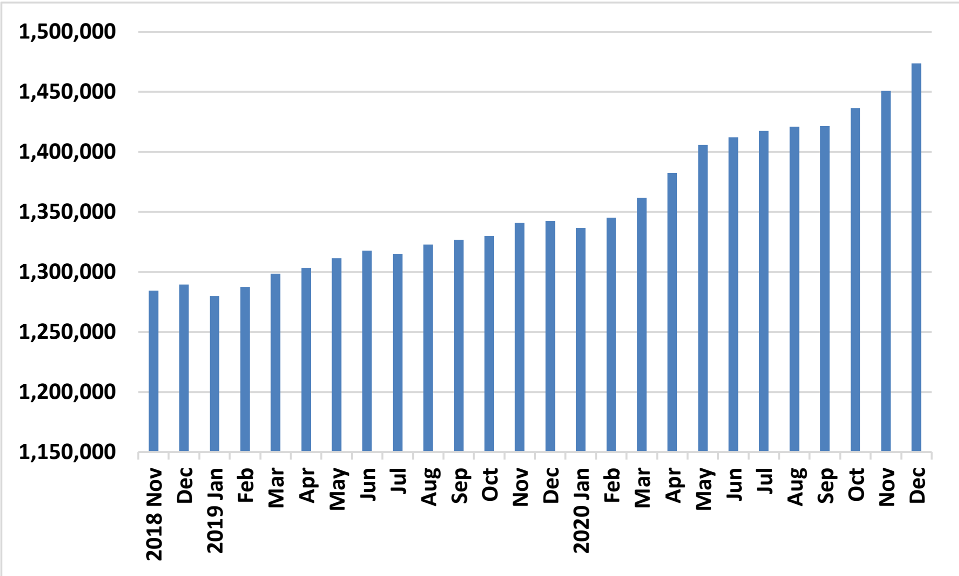
Funding the loan book

Reducing funding costs in one fell swoop

By the end of 2020, DFC had raised retail deposits in excess of £145m following the launch of its savings products on 14 October 2020. The rapid inflows of cheaper deposits allowed the Group to repay its wholesale funding facilities of £30m to its senior and senior mezzanine lenders, Citibank and funds affiliated with Ares Management Corporation. On 9 December 2020, it also announced that it had repaid its outstanding £9.5m loan to TruFin plc. At that stage, the Group's loan book was (and remains) entirely supported by retail deposits, which in turn transforms its net interest margin projections from historically low levels of c2% to in excess of 6%. DFC has not needed to pay for its profile to be promoted to achieve that level of deposits and has generally positioned itself in the “best buy” tables for the requisite period to achieve its requirements. The Group has also been awarded feefo's "Trusted Service Award 2021" following the ratings and reviews received from its personal savings customers.

Bank of England data adds context to this and shows how the level of deposits in the UK evolved during 2020.

Financial institutions' deposits from UK residents (£m)



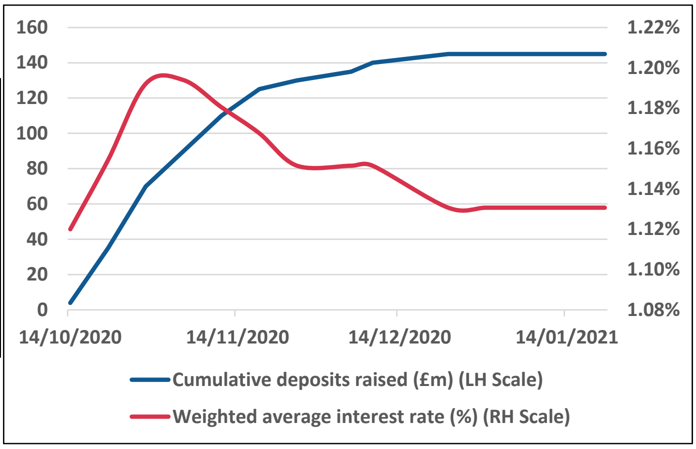
Source: Bank of England

DFC launched several deposit products over the period from 14 October to the end of 2020 to achieve a total of £145m as at 31 December 2020. It now has 90 day, 1 year fixed, 15 month fixed, 18 month fixed and 2 year fixed products. This diverse profile of product maturity will smooth out future deposit raising requirements as products mature and depositors consider alternative saving strategies. This table shows the various issues and the periods in which they were open. From that, we have extrapolated the rough cumulative path of the build-up of deposits and our associated estimate of the resulting impact on the Group’s average funding rate following each subsequent issue.

DFC deposit issues

Product	Issue	Launch date	Date closed	AER
90 day notice	Issue 1	14/10/2020	21/10/2020	1.12%
1 year fixed	Issue 1	14/10/2020	16/10/2020	1.18%
2 year fixed	Issue 1	16/10/2020	27/10/2020	1.23%
2 year fixed	Issue 2	02/11/2020	06/11/2020	1.20%
18 month fixed	Issue 1	02/11/2020	19/11/2020	1.10%
15 month fixed	Issue 1	04/11/2020	17/11/2020	1.10%
18 month fixed	Issue 2	19/11/2020	27/11/2020	0.95%
18 month fixed	Issue 3	27/11/2020	17/12/2020	0.85%

DFC deposits raised (£m) and estimated funding rates (%)

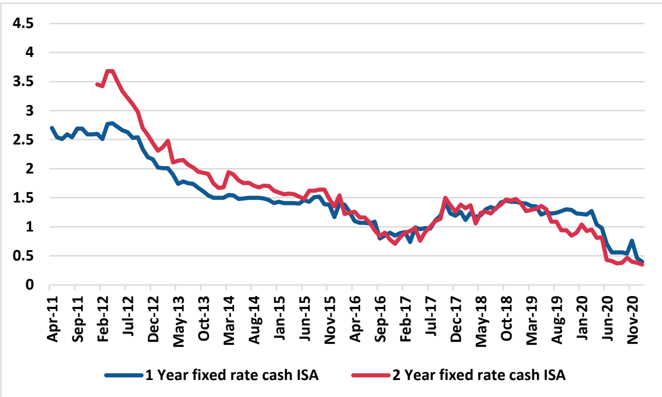


Source: Company information, Progressive Equity Research graph

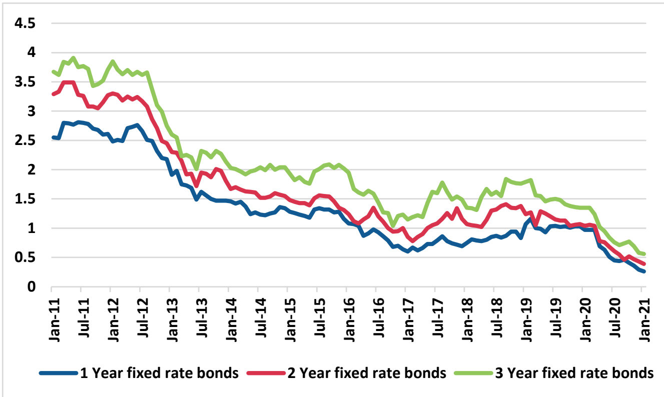
As the chart below shows, market deposit rates for fixed rate bonds and cash ISAs have fallen significantly. This means that, on our estimates, DFC's current average funding cost is below 1.2%. That compares to around 6% for the wholesale funding available to the Group prior to the granting of its banking licence. The Group expects to complement its deposit products with the launch of online self-service banking capabilities in 2021. It may also consider launching an instant access account to reduce funding costs further.

Currently, DFC enjoys a positive funding mismatch, in that its deposits are longer term than the average 150 days duration of its loans.

Deposit rates for cash ISAs (%)



Deposit rates for fixed rate bonds (%)

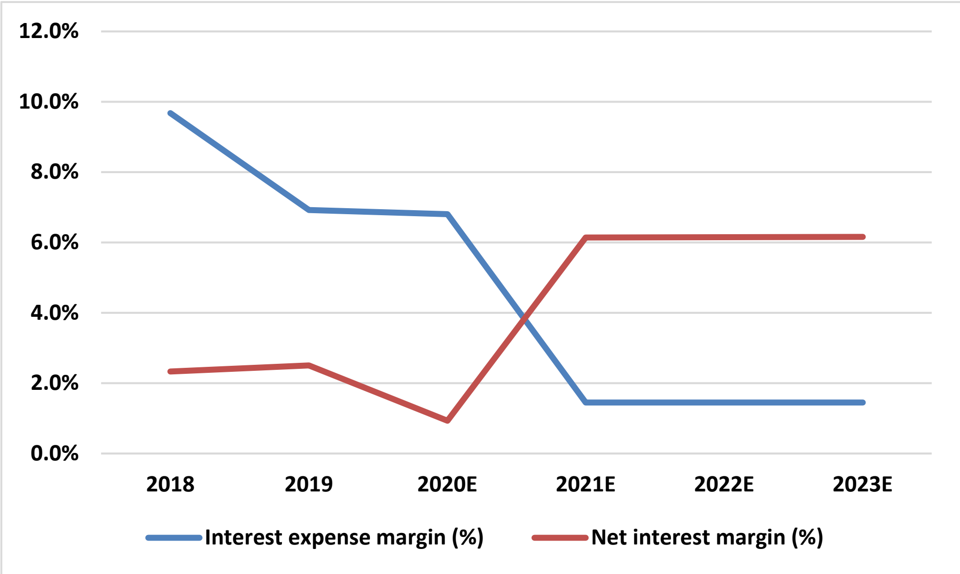


Source: Bank of England

At some point, the group may wish to revisit wholesale funding and we note that Ares Management Corporation retains a right of first refusal until June 2022 in respect of the on-going provision of wholesale funding, should it be required. The Group has also placed its ENABLE Funding application with the British Business Bank on hold. We believe, given the size of the retail deposit market, that DFC is unlikely to need to consider diversifying its funding sources for some time to come, certainly no earlier than 2022.

At that point, as well as the sources noted above, it would have the option of considering SME deposits, other government and Bank of England schemes and wholesale funding providers. At that time, seeking wholesale funds as a bank ought to present a more appropriately priced selection of wholesale funding, in our view. There is also the medium term prospect of considering forms of securitisation of loans – although that would be subject to the types of products which the Group has in its loan book at the time.

Interest expense margin (%) and Net interest margin (%)



Source: Progressive Equity Research estimates

Future opportunities to support growth

Overall, we take the view that, in the near term, DFC needs to take advantage of the time and money spent on getting its banking licence through maintaining a sustained period of efficient growth. That implies a period of consolidating its loan book with its current invoice finance product before adding additional complexity by launching new products.

However, over time, as DFC expands, there are a range of opportunities available to the Group, including financing to other parts of the supply chain such as distributors and consumers and, potentially, expanding into Europe. We would expect the abundance of opportunities in the UK to take precedence over expansion into other countries. However, that will depend on the products that are most attractive to management at the time that it looks to accelerate growth by considering options beyond the current product type. In addition, the Group could look at acquiring lenders with an existing book of business and relevant management expertise. Again, that will depend on the cost of acquiring a business if that option arises.

Capacity

Clearly, expansion of the business after a period of slowdown and cost control (including redundancies) begs the question as to how the leaner DFC will balance the cost of people and systems development as the loan book growth accelerates.

We expect DFC to continue to benefit from the digital application process for deposits and the online-self management tools which will become available to depositors. The systems have also been built to cater for significantly higher loan volumes – although they are obviously subject to ongoing upgrading and investment over time. We would surmise that the current level of people in the business can support growth in the loan book to £270m with relatively few additions. Our estimates include growth in operating expenses which take into account the levels of lending which we anticipate, and we note that that the Group's current level of regulatory capital can support a loan book of around £550m. Thereafter, as well as looking at raising further equity, DFC would need to consider recruiting further staff to support growth – particularly if that involved the greater complexity of launching a new product – at management level and within the sales account management team. The current mooted further investment in digitalisation should help limit that cost. For instance, the Retail Deposits Team is unlikely to grow much following the launch of the online account management product. However, we would not expect the cost of such recruitment to be in direct relation to the prospective additional growth which means that the Group's cost:income ratio should benefit from growth in the loan book as it matures over time reaching sub 45%, through the benefits of scaling the business while absorbing additional staff costs.

Paths to accelerated growth

As we note above, new products look likely to provide the initial opportunity to accelerate growth once the Group has hit a profitable run rate from its Inventory Finance product. Management has previously highlighted the following areas:

- Asset finance and leasing
- Short term working capital
- Asset based lending
- Commercial lending

- Invoice finance

Longer term there is the opportunity for DFC to consider geographic expansion into Europe. Many of the manufacturers the Group has relationships with supply products into Europe not just the UK so a considerable opportunity exists. However, in the medium term, the Group is focused on expansion in the UK; first through growing its existing inventory finance product and then through the launch of new additional products.

As previously mentioned, the existing Inventory finance market presents the Group with a £20bn opportunity in DFC's existing sectors; DFC believe that a loan book of in excess of £0.5bn in this product should be achievable. Beyond this, we believe the first two products which are the most likely areas into which DFC might expand its products are asset finance & leasing and short term working capital funding, including asset backed lending and invoice financing. These markets are estimated to be worth £38bn and £40bn respectively. We include some summary data of the potential products in this chart.

New product examples

Asset Finance & Leasing

Lending against existing assets or finance for additional assets. Leasing of assets for a specific period.

PRODUCT DESCRIPTION
Leases consist of a primary rental period under which payments reflect the cost of the asset plus interest. Under a Hire Purchase contract the lessee obtains title to the asset at end of this term. Under a finance lease, at the end of the primary period the lessee may continue to use the asset on a secondary term or return the asset to the lessor.
Gross yield p.a.: 7% to 8%

Short-term working capital finance

Finance to ensure that working capital needs are met.

PRODUCT DESCRIPTION
A working capital loan finances a customer's everyday operations. They are not used to buy long-term assets or investments but provide the working capital to cover a company's short-term operational needs.

Gross yield p.a.: 7% to 8%

Source: Progressive Equity Research

Additional growth – new products

To give an idea of the potential enhancement to earnings that a new product might bring, we show below a ready-reckoner which contains some basic assumptions around the revenue, costs and capital requirements that might be associated with the addition of a new product. It is generic and reflects our subjective assumptions (not management's) but shows that earnings can be improved by further working DFC's position and sector expertise in the UK. We have assumed that Year 1 contains set up costs for the new product which produces a significantly higher cost:income ratio than is seen in the later years. We have assumed that there may be a reintroduction of wholesale funding which is why our weighted cost of funding is 2.00% in this example – but this is not a certainty and we believe that this is therefore a conservative view on funding costs. The first table includes any fee assumptions within the interest line.

New product example

New product	Year1	Year2	Year3	Year4	Year5
Period end loans	125	275	375	475	575
Average loan book	62.5	200.0	325.0	425.0	525.0
RWAs @ 85%	106.25	233.75	318.75	403.75	488.75
Assumed CET1 ratio	17.5%	17.5%	17.5%	17.5%	17.5%
New capital required	18.6	22.3	14.9	14.9	14.9

Assumptions	Year1	Year2	Year3	Year4	Year5
Product yield	7.50%	7.50%	7.50%	7.50%	7.50%
Cost of deposits	1.50%	1.50%	1.50%	1.50%	1.50%
Cost of wholesale funding	3.50%	3.50%	3.50%	3.50%	3.50%
Weighted cost of funding	2.00%	2.00%	2.00%	2.00%	2.00%
Average funding = average loans	62.5	200.0	325.0	425.0	525.0
Impairment charge	1.00%	1.00%	1.00%	1.00%	1.00%
Share price - nominal	66.5	66.5	66.5	66.5	66.5

	Year1	Year2	Year3	Year4	Year5
Interest receivable	4.7	15.0	24.4	31.9	39.4
Interest payable	-1.3	-4.0	-6.5	-8.5	-10.5
Net interest income	**3.4**	**11.0**	**17.9**	**23.4**	**28.9**
Net interest margin (%)	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*
Total income	**3.4**	**11.0**	**17.9**	**23.4**	**28.9**
Impairment charge	-0.6	-2.0	-3.3	-4.3	-5.3
D&A (nominal)	-0.2	-0.2	-0.2	-0.2	-0.2
Costs	-2.4	-4.9	-7.9	-10.3	-12.6
Cost/income ratio (%)	*75.6%*	*45.9%*	*45.0%*	*44.7%*	*44.3%*
PBT	**0.2**	**4.0**	**6.6**	**8.7**	**10.8**
Tax	0.0	0.0	0.0	0.0	0.0
PAT	**0.2**	**4.0**	**6.6**	**8.7**	**10.8**
Period end shares in issue (m)	179.4	232.3	265.9	288.3	310.6
Average shares in issue (m)	179.4	205.8	249.1	277.1	299.4
New shares issued (m)	28.0	33.6	22.4	22.4	22.4
Average new shares (m)	14.0	16.8	11.2	11.2	11.2
Total average shares (m)	193.3	222.6	260.3	288.3	310.6
Addition to adj. Diluted EPS before exc. items (p)	**0.1**	**1.8**	**2.5**	**3.0**	**3.5**

Source: Progressive Equity Research

To give a more practical example, if we combine Year 1 and Year 2 with our FY 2022E and FY 2023E estimates, we can see the effect in the table below. Capital and shares in issue reflect a CET1 ratio assumption for this new lending of 17.5%.

Given the set-up costs which we have assumed, our first year EPS estimate is reduced, although this is clearly from a small positive number in the first place. FY 2023E shows an 12.4% uplift, bearing in mind that this includes all Group earnings being based on the new total of assumed shares in issue.

New product impact on published forecasts

New product	FY 2022E	FY 2023E
Period end loans	665.0	1000.0
Average loan book	487.5	832.5
RWAs @ 85% plus operational RWAs	567.4	854.0
Total Tier 1 capital (£m)	107.1	161.3
CET1 ratio	18.9%	18.9%

Assumptions	FY 2022E	FY 2023E
Product yield	7.50%	7.50%
Cost of deposits	1.50%	1.50%
Cost of wholesale funding	3.50%	3.50%
Weighted cost of funding	2.00%	2.00%
Average funding = average loans	487.5	832.5
Impairment charge	1.00%	1.00%
Share price - nominal for new capital raise	66.5	66.5

	FY 2022E	FY 2023E
Interest receivable	36.3	61.8
Interest payable	-6.5	-11.8
Net interest income	**29.8**	**50.0**
Net interest margin (%)	*6.1%*	*6.0%*
Fees & Commission	0.5	0.5
Total income	30.3	50.5
Impairment charge	-4.7	-8.3
D&A	-1.3	-1.6
Costs	-20.0	-23.6
Cost/income ratio (%)	*70.3%*	*50.0%*
PBT	4.3	16.9
Tax	0	0
PAT	4.3	16.9
Period end shares in issue (m)	179.4	232.3
Average shares in issue (m)	179.4	205.8
New shares issued (m)	28.0	33.6
Average new shares (m)	14.0	16.8
Total average shares (m)	193.3	222.6
Adj. Diluted EPS before exc. items (p)	2.2	7.6
Current estimate (p)	2.3	6.8
Change from base case	**-2.5%**	**12.4%**

Source: Progressive Equity Research

Sensitivity to impairment and interest rates

As well as being sensitive to the additional costs necessary to establish a new product, the rate of impairments and the cost of funds assumptions can make a considerable difference. The table below shows the sensitivity of the addition to Progressive FY 2023E EPS estimate to the assumed impairment rate and weighted cost of funds. The central case of the above example is highlighted in blue. We would emphasise that we believe that we have been conservative. For instance, it is worth bearing in mind that the Group may continue to fund solely from deposits, in which case, the average cost of funding could be 1.25% in the above example and the uplift to EPS would be 22.3% (shaded orange) at the same rate of impairment assumption. Should that latter rate fall to, say, 0.75% as well, the uplift would be 25.6% (shaded green).

Sensitivity analysis

		Weighted average cost of funding					
		1.00%	**1.25%**	**1.50%**	**1.75%**	**2.00%**	**2.25%**
Impairment charge	**0.25%**	35.6%	32.3%	29.0%	25.6%	22.3%	19.0%
	0.50%	32.3%	29.0%	25.6%	22.3%	19.0%	15.7%
	0.75%	29.0%	25.6%	22.3%	19.0%	15.7%	12.4%
	1.00%	25.6%	22.3%	19.0%	15.7%	12.4%	9.1%
	1.25%	22.3%	19.0%	15.7%	12.4%	9.1%	5.7%
	1.50%	19.0%	15.7%	12.4%	9.1%	5.7%	2.4%

Source: Progressive Equity Research

Regulatory capital

Capital Requirements Directive IV (CRD IV)

In 2013, the European Commission published its legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), which together form the CRD IV package. It implemented the Basel III reforms in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. CRD IV rules applied from 1 January 2014 onwards. The main element which we tend to take note of is the requirement to hold regulatory capital.

Regulatory capital

This represents the amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies. The PRA expects the most significant part of a firm’s capital to be ordinary shares and reserves. These are the highest-quality form of capital, as they allow firms to absorb losses unambiguously on a going concern basis. The PRA also expects firms to comply with the clearly stated internationally agreed criteria around the definition of capital.

Risk-weighted assets

This is a measure of a bank’s assets adjusted for their associated risks. Risk weightings are established in accordance with the Basel Capital Accord as implemented by the PRA. Risk-weighted assets (RWAs) are used to link the minimum amount of capital that banks must have, with the risk profile of their lending activities (and other assets). The more risk a bank takes, the more capital is needed to protect depositors. RWAs are the loans and other assets of a bank, weighted by a percentage factor to reflect their respective level of risk of loss to the bank. For example, mortgages (which are secured by residential property) are generally considered to be lower risk than unsecured credit card lending to individuals. Lending to corporates will be weighted according taking into account the level of risk and security involved in the lending book. The greater the amount of higher risk assets and loans that a bank has, the higher its risk-weighted assets, and therefore, the higher the amount of capital the bank must have in order to meet its minimum capital adequacy ratios.

Common equity tier 1 capital (CET 1)

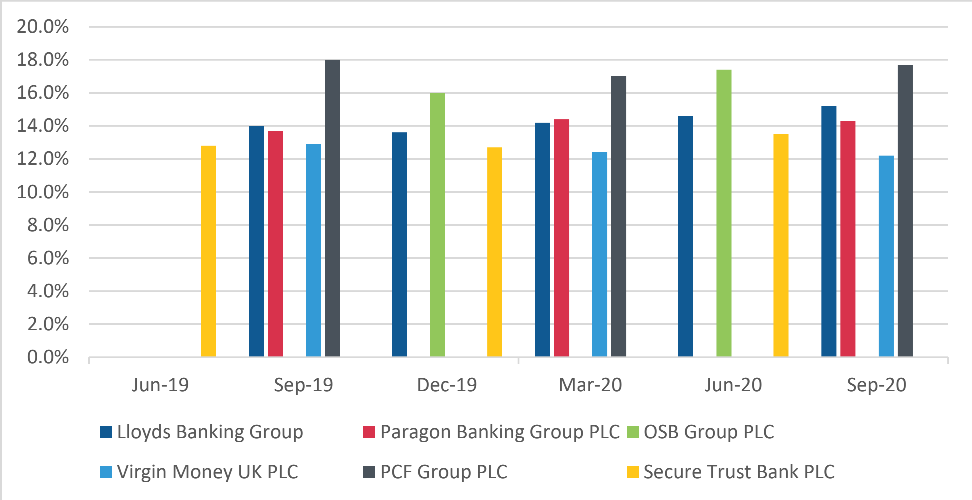
Common equity tier 1 capital is the highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.

The CET 1 ratio is the percentage that CET 1 capital represents of the period-end RWAs.

Companies reporting their capital positions may be granted transitional relief on the adoption of IFRS 9, with the impact on capital of additional impairments being phased in over a five-year period. However, firms are also required to disclose capital measures as if the relief has not been given (referred to as the ‘fully loaded’ basis).

We publish our estimates for CET 1 in this document and base our views on capital required to support the business on maintaining a ratio of above 17%. This may well prove to be conservative but, given that DFC only received its authorisation as a deposit-taker in September 2020, we believe that it is prudent to do so at present. The table below shows a selection of CET 1 ratios for comparator companies over their varying reporting cycles.

CET 1 ratios – fully loaded where supplied



Source: Company information

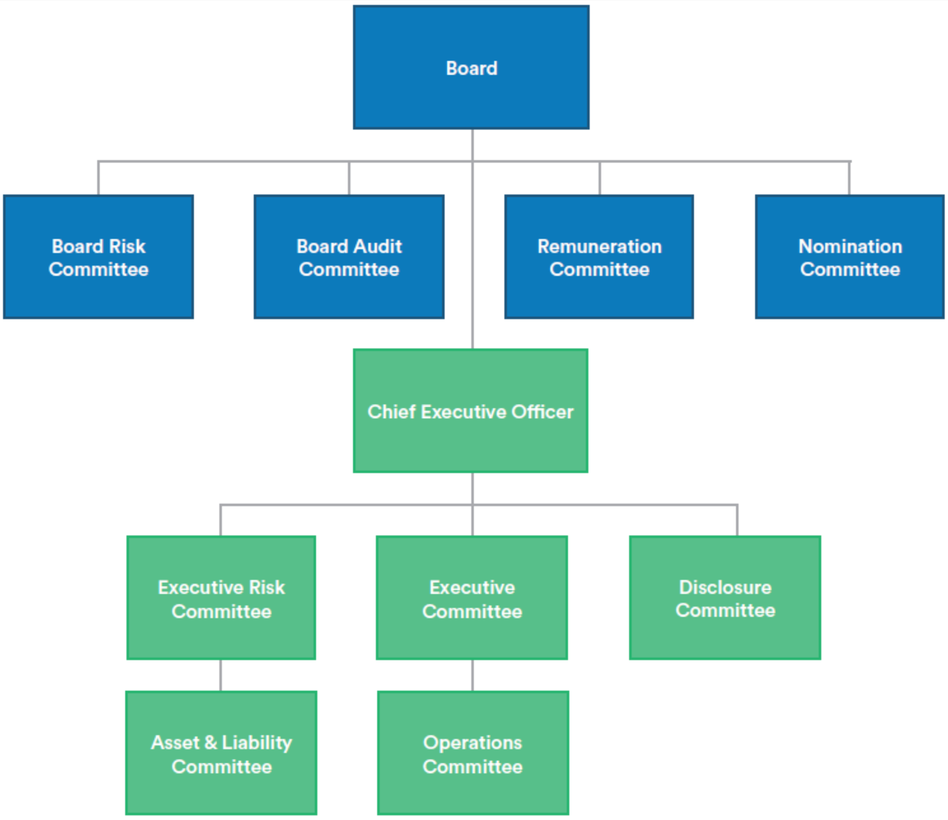
Corporate governance and ESG

As a bank, DFC has particular governance standards to uphold. It has statutory, legal and regulatory frameworks, under UK and European law, enacted by the UK regulatory authorities, the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"). DFC therefore needs suitably qualified and authorised personnel, "under the overall governance of an experienced and diverse Board of Directors ("Board")". In this last respect, it is worth looking at the biographies of the Board members and Executive Management on page (45) to see the level of experience which is at the Group's disposal. Clearly, it also needs to have a strong customer focus which includes the values of Treating Customers Fairly ("TCF") and Conduct Risk.

The Board's focus is on maintaining a suitable and sustainable business model which balances the long term growth of the business with near term objectives and regulatory requirements.

The Board and management committees are shown in the chart below.

Board sub-committees and Management committees



Source: Company information

We think that a successful application process for deposit-taking authorisation goes a long way to comforting all stakeholders as to the associated strong governance that comes with the responsibility of operating with a banking licence.

The Group did not provide any specific commentary on ESG in its 2019 Report & Accounts other than the detail of its Corporate Governance approach. It did provide more detail on the business functions of the Group and their key roles and responsibilities. It also provided a Section 172 statement which detailed the Group's considerations on the impact of its decision making and strategy on stakeholders in the Group: Customers, Employees, Regulators and Shareholders.

With corporate governance already a significant part of its business life as a bank, DFC is also looking at ESG in the context of sustainability. As we understand it, this would mean looking at the impact of environmental and societal considerations on its lending and people in particular. This would include diversity of recruitment, career development and charitable work. We believe that the Group will look to produce a consolidated ESG report towards the middle of 2021. Obviously, it already has reporting responsibilities as a bank which include carbon emissions, for instance. We expect that there will be some commentary on the impact on the environment of the classes of assets on which it offers funding within that. The PRA also requires extra reporting on ESG matters.

Estimate assumptions

Our estimates can be seen up to FY 2023E in the table at the end of this document. They reflect the evolution of DFC into a profitable business – but they only include our views on what we think that the current pay-as-sold product will contribute. A summary of some main items can be seen in the table below:

Selected financial estimates

Income Statement (£m)	**2020E**	**2021E**	**2022E**	**2023E**
Net interest income	1.8	12.9	26.4	39.0
Other operating income	0.2	0.4	0.5	0.5
Pre-impairment operating income	2.0	13.3	26.9	39.5
Impairments	-1.2	-2.1	-4.0	-6.3
Expenses	-15.1	-16.1	-18.7	-20.2
Operating income	-14.2	-4.9	4.1	13.0
Profit before tax	**-14.2**	**-4.9**	**4.1**	**13.0**
Tax	0.0	0.0	0.0	0.0
Profit after tax	**-14.2**	**-4.9**	**4.1**	**13.0**
Per share data (p)				
Basic EPS	-13.4	-2.9	2.3	6.8
Diluted EPS	-13.4	-2.9	2.3	6.8
Adj. Diluted EPS before exc. Items	-13.4	-2.9	2.3	6.8
NAV/share	47.7	47.9	50.2	57.8
NTAV/share	46.7	47.2	49.5	57.2
Balance Sheet				
Customer loans (£m)	113.0	310.0	540.0	725.0
RWAs (£m)	97.1	264.5	461.2	620.2
Core tier 1 capital ratio (%)	**50.7%**	**31.8%**	**19.1%**	**18.8%**

Source: Progressive Equity Research estimates

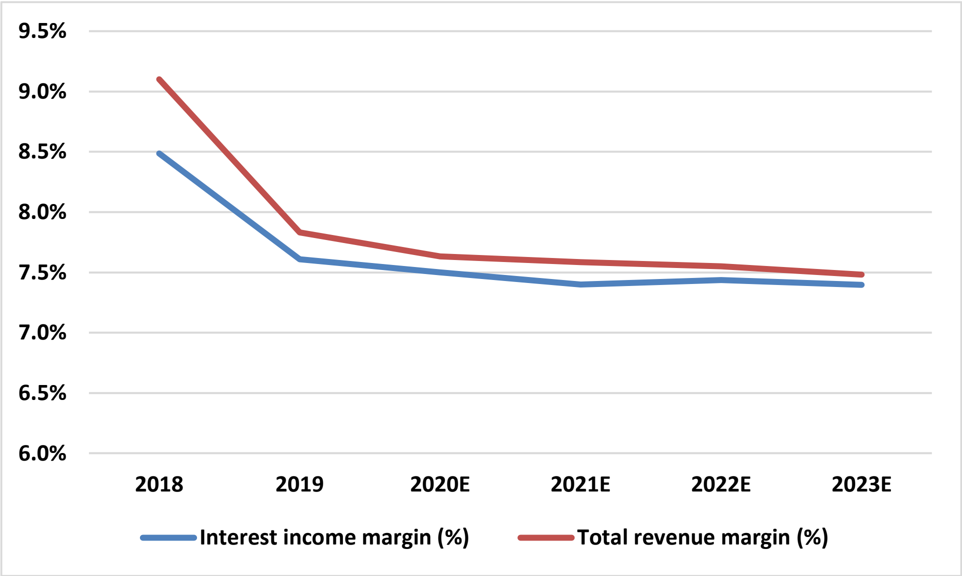
Over our forecast horizon, we have assumed that:

- DFC grows its loan book at a fast pace of between 34% to 174% per annum (the percentage growth rate reduces as the book size increases). We expect DFC to have a significant opportunity to grow its lending quickly given the level of pent-up demand which the Group has seen.
- The total income margin is 7.5% to 7.7%. This is consistent with the experience of DFC so far in lending to its chosen market segments and, given the level of demand which is apparent, we think that this remains a reasonable assumption.
- The cost of funds (deposits only) is 1.5% (which is currently a conservative estimate, in our view). Again, the recent experience of DFC in the deposit market has been one of decreasing cost of funds for the Group. Given the outlook for interest rates at the moment, we feel that this remains a realistic view for us to take in the medium term,
- The net interest margin is 6.1% to 6.2% - a function of the two previous assumptions.
- The impairment charge is up to 1% per annum. This is the predominant that we include in our estimates and reflects the level of control which the Group has demonstrated during the pandemic. We shall keep this under review as the loan book grows and we see empirical evidence of the Group's management of a larger loan book.
- The cost:income ratio reduces over time. This is really a function of the economies of scale which we expect to emerge as the Group grows its loan book and as it rolls out

various digital offerings to enable greater efficiencies in its management of deposits. We think that costs should only show higher rate of increase with the added complexity associated with the introduction of new products or a significant change to the Group's operating model.

- The CET 1 ratio remains above 17%. This is a subjective view but one which we think reflects a reasonable degree of conservatism as we look at the early stage of a faster growth phase for DFC.

Total revenue and Interest income margins (%)



Source: Company information, Progressive Equity Research estimates

We include assumptions for a further raise of £15m of new capital which serves to keep our estimated CET 1 ratios above 18% over our forecast horizon. This is based on our current view of one product and does not take into account any accelerated growth in earnings (and accompanying capital requirements) which would be added by the launch of new loan products, as discussed in our scenario analysis. Please note, our assumptions on the share price at which this capital is raised do not represent a forecast of where the share price will be at the time that DFC may choose to issue new equity but simply the basis for the number of new shares that we use to form our EPS estimates.

Valuation

Peer comparisons

Peer Group comparisons are useful in terms of setting a wide context but can be somewhat difficult to apply in a meaningful manner when the subject company is at the start of its growth journey. In addition, it is difficult to find exact matches in terms of loan book or purity of business lines, growth rates, market segments etc. Nonetheless, we include a selection of companies in the table below which give a broad view on average P/Es and book values. We have included the descriptions of those businesses (mostly their own) to show where their respective business focuses lie. It is challenging to compare the average result to DFC at present because, as we note above, given the age of the business, it would be more appropriate to look at years beyond our current forecast horizon. It is likely that we would be including the influence of additional loan products on our estimates by then as well.

Peer company data

	P/E FY1E	P/E FY2E	Price/BV	Financial year end	Company description
Paragon Banking Group PLC	9.9	8.6	1.0	30/09/2021	Specialist mortgage, savings and business finance provider
OSB Group PLC	7.2	7.2	1.2	31/12/2020	"OneSavings Bank (OSB) is a leading specialist mortgage lender, primarily focused on carefully selected segments of the mortgage market. Our specialist lending is supported by our Kent Reliance and Charter Savings Bank retail savings franchises. Diversification of funding is provided by sophisticated securitisation platforms."
Virgin Money UK PLC	11.8	7.9	0.5	30/09/2021	"We serve 6.4 million customers across the UK through a digital-first approach that offers leading online and mobile services, supported by telephone and branch banking, including a national network of branches and business banking centres."
PCF Group PLC	7.3	5.8	1.0	30/09/2021	"Established in 1994, PCF Group plc is the AIM-quoted parent of the specialist bank, PCF Bank Limited. Since commencing operations as a bank in 2017, the Group has increased its lending portfolio from £140 million to over £425 million. The Group will retain its focus on portfolio quality and lending to the prime segments of its existing financial services markets. The Group will continue to identify opportunities to diversify its lending products and asset classes through acquisition and by setting up new organic operations."
Intermediate Capital Group PLC	18.4	18.0	4.2	31/03/2021	"Specialise in private debt, equity and credit, providing financing solutions across the capital structure, and pioneering new strategies where we can deliver value to our investors."
Secure Trust Bank PLC	9.2	9.2	0.7	31/12/2020	"UK retail bank, providing savings accounts and lending services to over a million customers. Born in 1952 in the West Midlands, we've had plenty of time to hone our craft. We're a bank you can trust. After all, it's in our name. Our approachable, straight-talking teams are based at our Solihull headquarters and offices in Cardiff, London, Manchester and Rotherham. We're all working hard to build the best bank in Britain."
Average		**9.5**	**1.4**		

Source: Company websites, Refinitiv EIKON, Progressive Equity Research

The average current price to book valuation in the table above is difficult to compare to that of DFC given the latter's position at the start of its growth journey. Apart from the lack of comparability of the businesses in the peer group, there is also a huge impact from the capital raisings which the Group has already undertaken and that which we have included in our estimates. In line with management guidance, we have assumed that DFC moves into its first full year of profitability in FY 2022E. For FY 2020E, DFC's current Price/Book is 1.4x and this diminishes to 1.2x based on our FY 2023E numbers.

Bearing the point on capital in mind, the table below shows a range of valuations for the Group's market capitalisation that would be implied from applying a commonly used version of the Gordon Growth Model (RoTE-g/CoE-g) to our FY 2023E estimates. This provides Price/Book multiples which are applied to our FY 2023E book value estimate. For instance, applying a cost of equity of 11% and our estimated return on equity of 12.5% for that year would produce a market capitalisation of £148.5m in the area shaded blue in the table below. The contents of the table clearly vary with those assumptions but would also change with any additional loan products and the addition to profitability and capital which they would entail.

Crucially, it is important to note that DFC is targeting high-teens RoTE in the longer term whereas our estimates up to FY 2023E are clearly still in the build-up phase. Consequently, our estimates reflect additions to capital through fundraisings with contributions to capital from retained earnings only starting to show through in FY 2023E. A return of 15% with an 11% cost of equity implies a valuation of £196.7m, for instance (shaded green).

Scenario analysis of FY 2023E estimate driven valuations for market cap (£m)

		Cost of Equity						
		8%	**9%**	**10%**	**11%**	**12%**	**13%**	**14%**
RoTE	**8%**	118.0	88.5	70.8	59.0	50.6	44.3	39.3
	9%	157.4	118.0	94.4	78.7	67.4	59.0	52.5
	10%	196.7	147.5	118.0	98.4	84.3	73.8	65.6
	11%	236.0	177.0	141.6	118.0	101.2	88.5	78.7
	12%	275.4	206.5	165.2	137.7	118.0	103.3	91.8
	13%	314.7	236.0	188.8	157.4	134.9	118.0	104.9
	14%	354.1	265.6	212.4	177.0	151.7	132.8	118.0
	15%	393.4	295.1	236.0	196.7	168.6	147.5	131.1
	16%	432.7	324.6	259.6	216.4	185.5	162.3	144.2
	17%	472.1	354.1	283.3	236.0	202.3	177.0	157.4
	18%	511.4	383.6	306.9	255.7	219.2	191.8	170.5
	19%	550.8	413.1	330.5	275.4	236.0	206.5	183.6
	20%	590.1	442.6	354.1	295.1	252.9	221.3	196.7

Source: Refinitiv EIKON

As we note above, we would expect the Group's RoTE to improve as the business matures. We also remind investors that this is one of many outcomes and that they should use their own views of the relevant risks when assessing any valuation criteria.

Risks

Business risks and management action

Risk	Risk/impact	Management action/comments
Credit risk	The risk of financial loss arising from a customer or counterparty failing to meet their financial obligations to DF Capital.	The Group takes a proactive approach to monitoring the credit risk of its commercial lending operations through regular contact and review of customers, including frequent asset audits to verify the collateral status throughout the life of the loan. Policies are in place to manage the Group's credit and counterparty risk.
Liquidity risk	The risk that DF Capital is not able to meet its financial obligations as they fall due or that it does not have the tenor and composition of funding and liquidity to support its commercial lending.	The Group has in place a policy and control framework for managing liquidity risk. The Group's Asset and Liability Management Committee (ALCO) is responsible for managing the liquidity risk via a combination of policy formation, review and governance, analysis, stress testing, limit setting and monitoring. The ALCO meets on a monthly basis to review the liquidity position and risks. Daily liquidity reports are produced and reviewed by the management team to track liquidity and pipeline. This is further supported by the Internal Liquidity Adequacy Assessment Process (ILAAP) document.
Capital & earnings risk	The risk that DF Capital has an insufficient amount or type of capital to support the regulatory requirements of its business activities through normal and stressed conditions. In addition, the risk that capital may be inefficiently deployed across the Group.	The Group's Asset and Liability Management Committee (ALCO) is responsible for managing capital risk including overseeing the utilisation of capital and monitoring of capital in line with the agreed strategy and appetite. This is further supported by the Internal Capital Adequacy Assessment Process (ICAAP) document.
Interest rate risk in the Banking Book (IRRBB)	The risk of financial loss through un-hedged or mismatched asset and liability positions due to changes in interest rates.	The Group's borrowings are both fixed and administered rates of interest. These borrowings fund existing loans and advances to customers at fixed rate. To help mitigate interest rate risk the Group may increase asset pricing accordingly on new assets funded at its discretion. Additionally, the limited asset average loan duration helps mitigate this interest rate risk.
Market risk	The financial risk deriving from exposures to movements in market prices of trading assets and liabilities.	The Group does not have any appetite to run market risk. DF Capital does not have trading books and any investments as part of liquidity buffer management are in sovereign bonds, held in the banking book, with the interest rate risk covered by. The Group has no exposure to foreign currencies.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems errors, or from external events.	DF Capital has a framework in place which sets out its approach to operational risk, with associated roles and responsibilities further defined in a number of policies and procedures covering the various types of operational risk.
Conduct risk	The risk of detriment caused to DF Capital or its customers due to inappropriate execution of business activities and processes, such as the sale of unsuitable products or the mismanagement of customer complaints.	Group policies outline the approach and processes followed for ensuring good customer conduct outcomes and compliance with conduct requirements. It is supported by several process documents which detail the specific steps and responsibilities across the firm for treating our customers fairly.

Source: Company information, Progressive Equity Research

Business risks and management action (continued)

Risk	Risk/impact	Management action/comments
Reputational risk	The risk of loss or imposition of penalties, damages, or fines from the failure of the firm to meet legal and regulatory obligations.	The Group has polices covering a number of requirements related to its AIM listing and ensuring adherence to regulatory requirements applicable to banks.
Economic risk	The risk that the current economic environment deteriorates further and that the UK undergoes a long term deep recession.	At least quarterly, the Board and management perform a review of current macroeconomic conditions and forecasts, an assessment of the key internal and external risks facing DF Capital, and a horizon scan for emerging risks. This exercise includes a review of the management actions required to mitigate the risks identified, providing a link between risk management, business strategy and financial planning, at a company-wide level.
Regulatory risk	The risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.	The Group abides by and uses as best practice, where applicable, the operating conditions and guidance set out for banks within the statutory, legal and regulatory frameworks, under UK and European law, enacted by the UK regulatory authorities, the Prudential Regulation Authority and the Financial Conduct Authority. To that end, the Group is managed and governed by suitably qualified and authorised personnel, under the governance of an experienced and diverse Board of Directors.
Cyber risk	A cyber-attack impacting its core operating and banking systems could have a number of implications such as inability to conduct business operations or loss of customer data. Cyber deficiencies also often give rise to severe reputational damage.	DF Capital aims to ensure best in class cyber defences. Live monitoring of systems and networks is in place, with cyber-specific risk indicators reviewed regularly by Management and the Board. DF Capital operates under an annual Cyber Security Plan, which includes tests performed internally and by third parties.
Climate risk	The global trend towards electric vehicles is impacting the industry segments to which DF Capital is exposed to, some at higher speed than others. In addition, climate events may result in greater risks of damage to the physical assets funded by DF Capital (e.g. flood risk	DFC monitors industry and regulatory developments with respect to climate change. It remains engaged with clients and manufacturers as products evolve. Whilst the risk to physical assets is covered by insurance on behalf of its customers, as required under lending terms, the initial and ongoing customer risk reviews take into account factors associated with the asset location, including exposure to climate events.
Governance risk	The risk that DF Capital's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.	The Group has governance arrangements that support the effective long-term operation of the business and meet regulatory and societal expectations.

Source: Company information, Progressive Equity Research

Shareholder register

The chart below shows the top 10 shareholders in DFC as they stand on the most up to date notifications of holdings following January's capital raise. They account for just shy of 73% of the outstanding shares. It seems to be commonly understood that 39.4% shareholder Arrowgrass will look to sell down its stake in the medium term while Watrium, which owns 13.2% is believed to be a long-term holder. The Group's IPO was conducted at 90p so, for Arrowgrass, we would surmise that its timetable for reducing its stake is likely to be driven by the share price performance. For the moment, though, a large proportion of the shares are held by a few institutions with the top five shareholdings currently accounting for nearly 72% of the issued share capital.

Top 10 shareholders in DF Capital Holdings (as at 9/12/20)

Investor name	% Outstanding
Arrowgrass Capital Partners (US) LP	39.4%
Watrium AS	13.2%
Liontrust Asset Management PLC	10.0%
Premier Miton Group	5.6%
UBS Group	4.2%
Canaccord Genuity Group Inc	3.0%
Directors, Employees & Related Parties	2.6%
Private Stakeholders (UK)	2.4%
BalckRock Inc	2.3%
Compagnie Odier SCA	2.3%

Source: Refinitiv EIKON

Board and senior management biographies

Board

John Baines - Independent Chairman

John has over 30 years of experience in the banking industry following qualification as a chartered accountant. John was formerly CFO of several UK banks, including Co-operative Bank, Aldermore and Coutts and Co. John has a wide variety of business experience in both UK and overseas businesses, including retail banking, SME, wealth management and investment banking.

Carl D'Ammassa - Chief Executive Officer

Carl has over 20 years' experience working in commercial and SME finance, with extensive divisional managing director and CEO experience built across a number of UK based businesses. Carl previously held the position of CEO at White Oak UK, a specialist lender to SMEs. Prior to this Carl was Group Managing Director at Aldermore Bank, leading its growing business lending franchise. He spent 10 years at GE Capital, and later took roles at Hitachi Capital and Hydrex Ltd. Carl has previously been Chairman and a Board Director of The Leasing Foundation and was a Non-Executive Director of AFS Group Holdings Ltd.

Gavin Morris - Chief Financial Officer

Gavin possesses over 20 years of financial services experience across banking, corporate lending and leasing. Gavin has deep finance expertise in a regulated environment from his time at GE Capital Bank in the role of Acting CFO and in a number of "Head of" finance roles including Treasury, Regulatory Reporting, Controllership, Pricing and FP&A. Gavin was involved in both the set up and dismantling of GE Capital Bank. Gavin is a qualified chartered accountant and spent 10 years with KPMG.

Mark Stephens - Senior Independent Non-Executive Director

Mark has 30 years of experience in UK banking across a wide range of functional areas. Mark was formerly the CEO of Harrods Bank and was previously the deputy CEO and one of the founders of Aldermore.

Carole Machell - Independent Non-Executive Director

Carole held a series of executive positions at Barclays until changing to a portfolio career in 2016. Prior to joining Barclays, she spent 8 years at JP Morgan in a range of Operations, Technology and strategic roles. She was also Managing Director of OMLX, The Swedish Derivatives Exchange and worked at Merrill Lynch. Carole is a qualified chartered accountant (ACA).

Thomas Grathwohl - Independent Non-Executive Director

Tom is a former GE Capital Senior Managing Director with 40 years of distribution finance industry experience. Tom assisted in the sale process of GE Capital Commercial Distribution Finance to Wells Fargo in 2016. During his tenure at Wells Fargo, Tom assisted in the global integration of the GE Capital Commercial Distribution Finance Business.

Stephen Greene - Non-Executive Director

Stephen has investment banking, investing and capital markets experience, previously holding positions at Keel Harbour Capital Limited, Arrowgrass Capital Partners, RMG Wealth Management, ACPI Investments and Deutsche Bank. Recently he has transitioned into more technology focused roles, specifically within financial services and artificial intelligence, and currently serves as a Non-Executive Director of Trufin plc and Coleura Labs Limited, Managing Director of Orsus Ventures Limited, and formerly served as Managing Director of Satalia. Stephen has a Money, Banking and Finance degree from the University of Birmingham and is a Chartered Financial Analyst (CFA) charterholder.

Haakon Stenrød - Non-Executive Director

Haakon is an Investment Director at Watrium AS. He was previously a partner with the leading Nordic investment banking group ABG Sundal Collier. He has broad transaction experience in M&A, equity capital markets, debt and restructuring advisory. He holds an M.Sc. in Industrial Economics and Technology Management from the Norwegian University of Science and Technology.

Senior management

Andrew Stafferton - Co-Founder and Chief Commercial Officer

Andrew co-founded DF Capital in 2016 and has over 20 years of financial services and distribution finance experience. Andrew is the former leader of the Global Business Development team at GE Commercial Distribution Finance ("CDF"), and held prior roles as General Manager – ANZ (CDF), European Head of Marine, Agriculture and Industrial divisions with CDF, Head of Strategy – Europe (CDF), as well as roles in Risk and Operations.

Tomas Oliveira da Silva - Chief Risk Officer (subject to regulatory approval)

Tomas joined DF Capital in 2019 as Head of Enterprise and Prudential Risk before taking on the position of CRO in 2021. He previously spent close to 6 years in banking supervision at the Bank of England (Prudential Regulation Authority). Prior to that Tomas worked as an economist at IHS Markit and the Portuguese Ministry of Economy.

Jonathan Biggin - Chief Operating Officer

Jonathan has more than 20 years of operational experience in banking and financial services, including being former COO of Hitachi Capital (UK). Jonathan defined and led the future strategy of the Customer Servicing, Operations, Technology and Data Management divisions whilst COO of MBNA, Bank of America.

Charlie Michael – Head of People

Charlie joined DF Capital in December 2020 from Aldermore Bank where she spent ten years in several senior HR roles. She has worked within the financial services industry for over 20 years – including roles at Merrill Lynch and Formation Asset Management.

Financial Summary: DF Capital

Year end: December (£m unless shown)

PROFIT & LOSS	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
Net interest income	4.0	1.8	12.9	26.4	39.0
Other operating income	0.4	0.2	0.4	0.5	0.5
Pre-impairment operating income	4.4	2.0	13.3	26.9	39.5
Impairments	(1.6)	(1.2)	(2.1)	(4.0)	(6.3)
Expenses	(14.2)	(15.1)	(16.1)	(18.7)	(20.2)
Operating income	(11.4)	(14.2)	(4.9)	4.1	13.0
Profit before tax	(13.5)	(14.2)	(4.9)	4.1	13.0
Tax	0.0	0.0	0.0	0.0	0.0
Profit after tax	(13.5)	(14.2)	(4.9)	4.1	13.0
PER SHARE ITEMS	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
No of shares (million)					
Undiluted, period-end	106.6	106.6	179.4	179.4	204.4
Undiluted, average	75.6	106.6	167.2	179.4	191.9
Fully diluted, average	75.6	106.6	167.2	179.4	191.9
Earnings per share (p)					
Basic EPS	(17.9)	(13.3)	(2.9)	2.3	6.8
Diluted EPS (p)	(17.9)	(13.3)	(2.9)	2.3	6.8
Adj. Diluted EPS before exc. items (p)	(15.1)	(13.3)	(2.9)	2.3	6.8
NAV	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
Net asset value	64.6	50.9	86.0	90.1	118.0
NAV/share (p)	60.5	47.7	47.9	50.2	57.8
Net Tangible Asset Value	63.7	49.8	84.8	88.9	116.9
NTAV/share (p)	59.7	46.7	47.2	49.5	57.2
Average equity	59.6	57.4	67.9	87.5	103.6
BALANCE SHEET	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
Customer loans	207.6	113.0	310.0	540.0	725.0
Customer deposits	0.0	(145.1)	(295.9)	(505.0)	(695.0)
Wholesale funding	(164.7)	0.0	0.0	0.0	0.0
Loan:deposit ratio	1.3	0.8	1.0	1.1	1.0
RWAs		97.1	264.5	461.2	620.2
Core tier 1 capital ratio (%)		50.8%	31.8%	19.1%	18.8%
VALUATION	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
Price/NTAV	1.1x	1.4x	1.4x	1.3x	1.2x
Post-tax ROTE	(22.7%)	(24.7%)	(7.2%)	4.7%	12.5%
PER (x)	-4.4x	-5.0x	-22.7x	28.8x	9.8x
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company information and Progressive Equity Research estimates

18 March 2021

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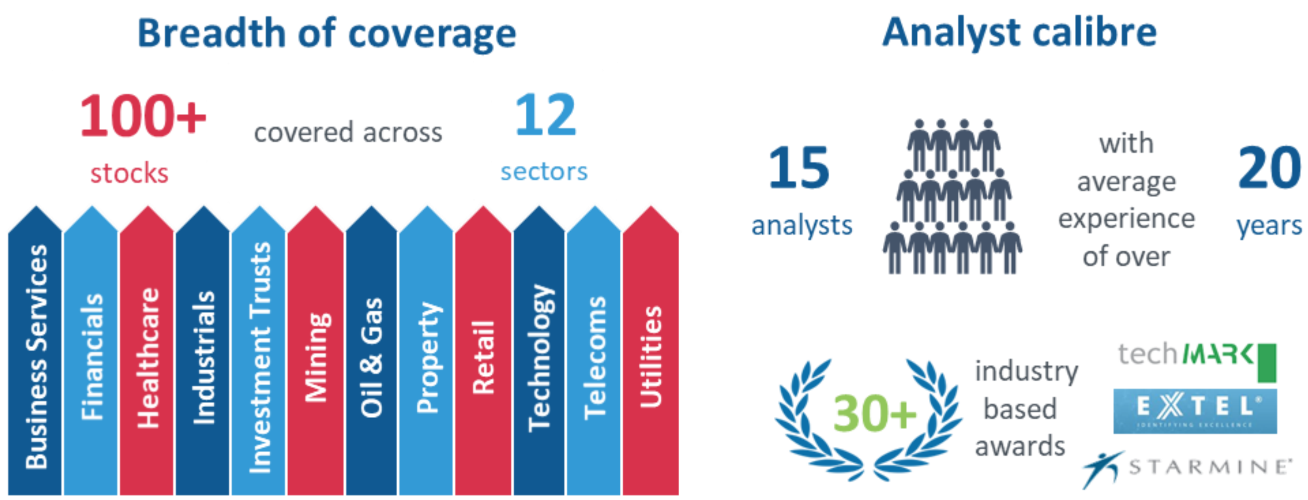

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