PCF Group plc

PCF BANK

Simple banking. At your service.

Interim Report 2020

PCF GROUP

Simple banking. At your service.

PCF Group plc is the AIM-listed parent company of the specialist bank, PCF Bank.

PCF Bank offers retail savings products for individuals and lending products for consumers and businesses to finance motor vehicles, equipment and property.

Our commitment is to provide great customer service through expertise and simplicity.

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PCF GROUP

Company Information

Directors

Tim Franklin *Non-executive Chairman*
Mark Brown *Non-executive*
Christine Higgins *Non-executive*
Marian Martin *Non-executive*
David Morgan *Non-executive*
David Titmuss *Non-executive*
Scott Maybury *Chief Executive*
Robert Murray *Managing Director*
David Bull *Finance Director*

Company Secretary

Robert Murray

Registered Office

Pinners Hall
105-108 Old Broad Street
London EC2N 1ER

Registered Number

02863246

Auditors

Ernst & Young LLP
25 Churchill Place
Canary Wharf
London E14 4SY

Nominated Adviser & Broker

Panmure Gordon (UK) Limited
One New Change
London EC4M 9AF

Joint Broker

Shore Capital Limited
Cassini House
57 St. James's Street
London SW1A 1LD

Registrars

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 7NH

Media & Investor Relations

Tavistock Communications Limited
1 Cornhill
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PCF Bank Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, FRN number 747017. The Bank is registered in England and Wales, registration number 02794633, and is wholly owned by PCF Group plc, a company registered in England and Wales, registration number 02863246 and listed on the Alternative Investment Market. Certain subsidiaries of the Bank are authorised and regulated by the Financial Conduct Authority for consumer credit activities. Registered offices are at Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

PCF GROUP

Chairman's Statement

for the six months ended 31 March 2020

I am pleased to report a strong trading performance in the first half of the current financial year, although it was affected in its final weeks by the Covid-19 crisis. As highlighted in our trading update of 8 April 2020, the crisis took hold too late in this reporting period to have a significant impact on new business performance, but it has had a material effect on the outlook for the remainder of this financial year and, in particular, loan loss provisioning at 31 March 2020. Impairment provisioning under IFRS 9 includes an element of unrealised loss against potential future defaults based on portfolio behaviours and the economic outlook at 31 March 2020.

Profitability and Covid-19 effect

Statutory profit before tax for the six months ended 31 March 2020 was £2.6 million (2019 – £3.3 million), a fall of 21%. The results include an incremental impairment charge of £1.6 million in the period for our expectation of the effect Covid-19 will have on the collectability of our portfolio. On an annualised basis, this represents an 80 basis points increase in the relative cost of risk. The impairment charge, together with the judgements used to assess the effects of Covid-19, are further detailed in the Notes to the Accounts.

Covid-19 related impairment aside, the underlying profit before tax increased by 27% from £3.3 million to £4.2 million. This is a satisfactory performance which was tracking towards our previous market expectation. It also reflects the underlying quality of the portfolio and a lending policy which has increasingly focussed on the prime segments of the credit spectrum.

As a result of the increased impairment charge, earnings per share fell to 0.8p (2019 – 1.2p) and return on equity reduced from 11.4% to 6.8%.

The net interest margin ('NIM') in the period was 6.8% (2019 – 8.0%) as we actively manage the move up the credit quality spectrum. This decrease in NIM was offset by operational gearing through continued growth of our portfolio. We have seen the cost-to-income ratio in the period fall to 52.4% (2019 – 54.3%). This operational efficiency is supported by the continued investment in technology and infrastructure to build scalable, customer-facing systems to support our business model.

The Group's total funding cost fell to 2.1% (2019 - 2.4%) as we continue to improve the efficiency of the Bank's treasury model and replace higher cost wholesale funding with cheaper retail deposits. The lending portfolio is now, in the main, funded by retail deposits of £340 million (September 2019 – £267 million) and the support of over 7,800 (September 2019 – 6,250) savings customers.

Our staff are currently working remotely. They have adapted well to this new environment, continue to offer unwavering support to customers and remain open across all business lines for new lending. Our existing customers have required our assistance, with forbearance granted to £138 million of balances at 29 May 2020, with the majority of requests falling after the period end. The prevalence of requests is greater in business finance, where many SMEs have felt the full force of the UK lockdown.

Business lines, current trading and the portfolio

New business originations increased by 26% in the period to £153 million (2019 – £121 million). Prior to any Covid-19 related events, the business had operated in line with the Board's expectations and we were making excellent progress towards our ambitious targets for portfolio growth and

increased profitability. The crisis caused an immediate decrease in demand for our products and our lending volumes reduced by 52% against target in April and May 2020, with the business finance division being most affected. In particular, the segment of SME lending in which our subsidiary Azule operates, finance for broadcast and media equipment, has seen the sharpest decline.

New business volumes were strong across all business lines. The largest contributor was the business finance division where lending to SMEs increased by 16% to £66 million (2019 – £56 million). The consumer finance division also showed strong progress with an increase of 48% to £43 million (2019 – £29 million). At this time last year, our bridging property finance operation had only just commenced trading. Originations for this division in the period totalled £18 million (2019 – £2 million), exceptional progress from a start-up position. Finally, Azule, our specialist broadcast and media equipment finance division, originated £26 million of business (2019 – £33 million), of which £11 million was for our own portfolio, the remainder being placed with other funders.

While the current demand for lending is uncertain, the markets in which we operate have continued to grow over the past year and we expect the opportunity to remain for volume growth once the economy begins to show signs of a recovery. The business asset finance market increased 7% in 2019 and the consumer motor finance market for used vehicles showed similar growth of 6%. Despite competitive pressures, we have continued to grow market share and presence in all our markets. While the appetite for SMEs to recommence borrowing is currently unknown, consumer motor finance has proved more resilient. This experience supports market commentary that, post-crisis, a change in travel preferences will lead to a bounce in vehicle sales through the recovery phase. As a predominantly used car lender, we should be well placed to take advantage of that trend. Our bridging property finance division is also showing strong activity as non-bank lenders have withdrawn from that market due to liquidity issues.

The portfolio has grown by 18% in the period to £401 million (September 2019 – £339 million). The quality of the portfolio is being actively managed and, in the period, 80% (2019 – 76%) of new business originations were in our prime credit grades. A focus on prime quality in recent years has resulted in the overall portfolio now containing 74% prime customers, up from 68% at the interim stage last year. We expect this to continue. The continual increase in portfolio quality is borne out by the impairment charge which, ignoring the additional charge as a result of Covid-19, would have reduced in the period from 0.9% to 0.8%. The incremental impairment charge of £1.6 million for Covid-19 increased Expected Credit Loss provisions held on the balance sheet at 31 March 2020 to 2.8% (September 2019 – 2.2%), an increase of 27%. The collection environment is likely to be extremely challenging in the coming months, but we have highly experienced management and staff who steered the business through previous downturns.

The Group's lending policy as a collateral-backed lender to prime customers provides resilience in times of economic stress. We have increased our prime quality origination targets in business finance and consumer motor finance from 75% to 90% in the light of the crisis. This is a prudent measure but is likely to result in downward pressure on lending margins in those divisions and we expect our NIM to fall further in the short-term.

PCF GROUP

Chairman's Statement

The portfolio is reported net of unearned finance charges of £69 million (September 2019 – £63 million). This unearned finance income will be attributed to future accounting periods and will help to support future earnings performance against the short-term effects of a business slow down, such as the one we are experiencing at the current time.

Liquidity and capital management

The Group has a Liquidity Coverage Ratio of 1,181% (September 2019 – 553%) which is well in excess of the minimum requirement of 100%. With access to both the retail deposit market and the Treasury's new Term Funding Scheme for SMEs, the Group retains a strong liquidity position. The Group has a CET1 capital ratio of 17.0% (September 2019 – 18.0%). This exceeds our regulatory requirement and, with the UK lockdown resulting in a contraction of new lending volumes and bridging property finance offering capital efficiency, we expect only a modest increase in risk weighted assets in the near future. Alongside the available headroom on our Tier 2 capital facility, this will maintain a comfortable surplus capital position.

Outlook

Our current strategic focus is to safeguard our staff, portfolio, capital and liquidity. The UK economy is experiencing great uncertainty and, since the end of our reporting period, the current economic forecasts show a steep fall in economic activity, alongside high levels of unemployment and business failure. In the second half of our financial year, IFRS 9 impairment modelling will continue to adjust as the economic outlook becomes clearer. We will continue to evaluate the impact on our lending portfolio as this economic data emerges and update the market accordingly. It is difficult to estimate at this time how damaging the effects of this pandemic will be to our performance, but we will remain disciplined in our risk appetite and continue to limit the operational impact. Market guidance will return once there is greater clarity.

We entered this crisis in a strong position, made even stronger by the experienced PCF team. We have a diversified balance sheet in terms of both lending and funding which is based on a prudent business model. In the short-term we will focus on supporting staff and customers but, once this crisis passes, we will refocus our strategic objectives and reset our targets for growth. The objective is to emerge from this period of disruption in the best possible financial position and to take advantage of the opportunities that may present themselves in the form of fewer market participants, further portfolio diversification and sector consolidation.

The business has demonstrated strong operational resilience during this period, successfully servicing customers with empathy and professionalism. This efficiency and flexibility are strong endorsements of the culture and values of PCF, and I am hugely grateful to our staff for their determination and dedication during this very disruptive period. At the current time we are well positioned to navigate the crisis.

T A Franklin
Chairman

3 June 2020

PCF GROUP

Consolidated Income Statement
for the six months ended 31 March 2020

	Note	Six months ended 31 March 2020 unaudited £'000	Six months ended 31 March 2019 unaudited £'000	Year ended 30 September 2019 audited £'000
Interest revenue calculated using the effective interest method	7	**20,364**	16,248	**34,499**
Interest and similar expense calculated using the effective interest method	8	**(7,717)**	(6,230)	**(12,884)**
Net interest income		**12,647**	10,018	**21,615**
Fees and commission income		**890**	605	**1,815**
Fees and commission expense		**(813)**	(501)	**(1,154)**
Net fees and commission income		**77**	104	**661**
Net loss on financial instruments mandatorily at fair value through profit or loss		**(25)**	–	**(63)**
Net operating income		**12,699**	10,122	**22,213**
Personnel expenses		**(4,331)**	(3,800)	**(7,640)**
Depreciation of office equipment, fixtures, fittings and motor vehicles		**(122)**	(67)	**(137)**
Amortisation of intangible assets		**(268)**	(196)	**(416)**
Other operating expenses		**(2,280)**	(1,644)	**(3,827)**
Impairment losses on financial assets	9	**(3,146)**	(1,164)	**(2,175)**
Total operating expenses		**(10,147)**	(6,871)	**(14,195)**
Profit before tax		**2,552**	3,251	**8,018**
Income tax charge	10	**(509)**	(658)	**(1,624)**
Profit after tax		**2,043**	2,593	**6,394**
Earnings per 5p ordinary share - basic and diluted	17	**0.8p**	1.2p	**2.7p**

Consolidated Statement of Comprehensive Income

for the six months ended 31 March 2020

	Six months ended 31 March 2020 unaudited £'000	Six months ended 31 March 2019 unaudited £'000	Year ended 30 September 2019 audited £'000
Profit after taxation	**2,043**	2,593	**6,394**
Other comprehensive income that will be reclassified to the income statement			
Fair value loss on FVOCI financial instruments	**(460)**	(87)	**(10)**
Deferred tax income	**–**	–	**2**
Total items that will be reclassified to the income statement	**(460)**	(87)	**(8)**
Total comprehensive income, net of tax	**1,583**	2,506	**6,386**

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Consolidated Balance Sheet

at 31 March 2020

	Note	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Assets				
Cash and balances at central banks		**12,246**	2,882	**7,371**
Debt instruments at FVOCI	14	**20,128**	27,491	**19,638**
Loans and advances to customers	11	**400,856**	275,710	**338,503**
Office equipment, fixtures, fittings and motor vehicles		**3,168**	292	**579**
Deferred tax assets		**1,138**	1,287	**1,105**
Other assets		**3,258**	5,856	**4,932**
Goodwill and other intangible assets		**5,968**	5,437	**5,941**
Total assets		**446,762**	318,955	**378,069**
Liabilities				
Due to banks		**30,483**	52,028	**44,412**
Due to customers		**339,853**	203,754	**267,070**
Subordinated debt	15	**5,000**	–	**-**
Derivative financial instruments		**56**	–	**63**
Current tax liabilities		**242**	528	**1,521**
Other liabilities		**10,869**	7,065	**6,248**
Total liabilities		**386,503**	263,375	**319,314**
Equity				
Issued capital	16	**12,510**	12,510	**12,510**
Share premium	16	**17,619**	17,653	**17,619**
Other reserves		**(453)**	(72)	**7**
Own shares		**(355)**	(355)	**(355)**
Retained earnings		**30,938**	25,844	**28,974**
Total		**60,259**	55,580	**58,755**
Total equity and liabilities		**446,762**	318,955	**378,069**

Consolidated Statement of Changes in Equity

for the six months ended 31 March 2020

	Attributable to equity holders of the Group					
	Non-distributable			Distributable		
	Issued capital £'000	Share premium £'000	Own shares £'000	Other reserves £'000	Retained earnings £'000	Total equity £'000
Balance at 1 October 2019	12,510	17,619	(355)	7	28,974	58,755
Profit for the period	–	–	–	–	2,043	2,043
Issuance of new shares	–	–	–	–	–	–
Fair value loss on FVOCI financial instruments	–	–	–	(460)	–	(460)
Share-based payments	–	–	–	–	(79)	(79)
Cash dividends	–	–	–	–	–	–
Balance at 31 March 2020	12,510	17,619	(355)	(453)	30,938	60,259

	Attributable to equity holders of the Group					
	Non-distributable			Distributable		
	Issued capital £'000	Share premium £'000	Own shares £'000	Other reserves £'000	Retained earnings £'000	Total equity £'000
Balance at 1 October 2018	10,611	8,527	(355)	15	23,753	42,551
Impact on transition to IFRS 9	–	–	–	–	(502)	(502)
Restated balance at 1 October 2018	10,611	8,527	(355)	15	23,251	42,049
Profit for the period	–	–	–	–	2,593	2,593
Issuance of new shares	1,898	9,087	–	–	–	10,985
Fair value loss on FVOCI financial instruments	–	–	–	(87)	–	(87)
Share-based payments	–	–	–	–	40	40
Cash dividends	–	–	–	–	–	–
Balance at 31 March 2019	12,509	17,614	(355)	(72)	25,884	55,580

	Attributable to equity holders of the Group					
	Non-distributable			Distributable		
	Issued capital £'000	Share premium £'000	Own shares £'000	Other reserves £'000	Retained earnings £'000	Total equity £'000
Balance at 1 October 2018	10,611	8,527	(355)	15	23,753	42,551
Impact on transition to IFRS 9	–	–	–	–	(502)	(502)
Restated balance at 1 October 2018	10,611	8,527	(355)	15	23,251	42,049
Profit for the year	–	–	–	–	6,394	6,394
Issuance of new shares	1,899	9,092	–	–	–	10,991
Fair value loss on FVOCI financial instruments	–	–	–	(8)	–	(8)
Share-based payments	–	–	–	–	79	79
Cash dividends	–	–	–	–	(750)	(750)
Balance at 30 September 2019	12,510	17,619	(355)	7	28,974	58,755

PCF GROUP

Consolidated Statement of Cash Flows

for the six months ended 31 March 2020

	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Operating activities			
Profit before tax	**2,552**	3,251	**8,018**
Other non-cash items included in profit/(loss) before tax			
Depreciation of property, plant and equipment	**122**	67	**137**
Amortisation of other intangible assets	**268**	196	**416**
Net change in FVOCI financial instruments	**(460)**	(87)	**(8)**
Share-based payments	**(79)**	–	**79**
Impairment losses on financial assets	**3,146**	1,164	**2,175**
Income tax (paid)/due	**(1,788)**	(650)	**(633)**
Adjustment for change in operating assets			
Net change in loans and advances	**(65,499)**	(42,383)	**(106,348)**
Net change in other assets	**1,641**	(3,366)	**(2,231)**
Change in operating liabilities			
Net change in derivative financial instruments	**(7)**	–	**63**
Net change in amounts due to customers	**72,783**	12,615	**75,931**
Net change in other liabilities	**4,621**	(196)	**(1,492)**
Net cash flows from/(used in) operating activities	**17,300**	(29,389)	**(23,893)**
Investing activities			
Cash paid for investment in subsidiary	**-**	(2,283)	**(2,283)**
Proceeds from financial instruments	**-**	12,411	**-**
Net sale of debt instruments at FVOCI	**(490)**	–	**20,264**
Purchase of office equipment, fixtures, fittings and motor vehicles	**(2,711)**	(27)	**(384)**
Purchase of intangible assets	**(295)**	(148)	**(900)**
Net cash flows from/(used in) investing activities	**(3,496)**	**9,953**	**16,697**
Financing activities			
Repayment of borrowings	**-**	10,275	**10,991**
Proceeds from share issue during the period	**5,000**	–	**-**
Net proceeds from borrowings	**(13,929)**	(9,295)	**(17,012)**
Dividends paid to equity holders	**-**	–	**(750)**
Net cash flows from/(used in) financing activities	**(8,929)**	980	**(6,771)**
Net increase/(decrease) in cash and cash equivalents	**4,875**	(18,456)	**(13,967)**
Cash and cash equivalents brought forward	**7,371**	21,338	**21,338**
Cash and cash equivalents carried forward	**12,246**	2,882	**7,371**

Notes to the Interim Report

1 Basis of preparation

The interim results are unaudited and do not constitute statutory accounts as defined by section 434 of the Companies Act 2006. The Group balance sheet comparative figures for the year ended 30 September 2019 are based on the statutory accounts of the Group for that year and have been reported on by the Group's auditor and delivered to the Registrar of Companies. The comparative figures for the Group income statement and statement of other comprehensive income are based on the unaudited interim report for the six months ended 31 March 2019. The report of the auditors was unqualified and did not contain a statement under section 498 of the Companies Act 2006.

2 Statement of compliance

These interim consolidated financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting', as adopted by the European Union.

The interim results have been prepared based on the accounting policies set out in the Annual Report and Financial Statements for the year ended 30 September 2019, except for the adoption of new standards effective as of 1 October 2019.

3 New standards, interpretations and amendments adopted by the Group

The Group applies, for the first time, IFRS 16 'Leases'. As required by IAS 34, the nature and effect of these changes are disclosed below.

Several other amendments and interpretations apply for the first time in 2020, but do not have an impact on the interim consolidated financial statements of the Group. All other accounting policies are unchanged from the last annual financial statements.

4 Changes in accounting policies and disclosures

The accounting policies applied by the Group differ from those in the 2019 Annual Report due to new standards and interpretations becoming effective. The following amendments to standards have been illustrated as they were applied for the first time in the 2020 interim financial period, resulting in consequential changes to the accounting policies and other note disclosures, where applicable.

4.1 IFRS 16 'Leases'

On 1 October 2019, the Group adopted the requirements of IFRS 16. The new standard replaces IAS 17 'Leases' and related interpretations. The standard applies to all leasing arrangements and sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessor and lessee accounting.

The Group has adopted IFRS 16 using the modified retrospective approach, with practical expedients. As such, the standard is applied as of 1 October 2019, with the cumulative effect recognised as an adjustment to the opening balance of retained earnings. Comparative information for 2019 is not restated.

The key changes and impacts are outlined below.

(i) Definition of a lease

Under IFRS 16, a contract is, or contains, a lease, if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

Transition

On transition to IFRS 16, the Group elected to apply the practical expedient set out in IFRS 16, which states that an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. As such, the Group only applies the new requirements of IFRS 16 to contracts previously identified as leases under IAS 17 and to contracts entered into or changed on or after 1 October 2019 that meet the definition of a lease under IFRS 16. Contracts that were not previously identified as leases under IAS 17 were not reassessed.

(ii) Lessor accounting

Lessor accounting under IFRS 16 is largely unchanged from IAS 17. Lessors continue to classify leases as either operating or finance leases using similar principles as set out in IAS 17.

Transition

On adoption of IFRS 16, the accounting policies applied by the Group for leases in which it acts as a lessor are unchanged and there are no other impacts.

(iii) Lessee accounting

Previously under IAS 17, the Group classified each of its leases at inception date as either a finance lease or an operating lease. A lease was classified as a finance lease if it transferred substantially all of the risks and rewards of ownership of the leased asset to the Group; otherwise it was classified as an operating lease. Finance leases were capitalised at the commencement of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments were apportioned between finance charges and a reduction of the lease liability. In an operating lease, the leased asset was not capitalised and the lease payments were charged to administrative expenses in the income statement on a straight-line basis over the lease term. Any prepaid or accrued lease payments were recognised in other assets or other liabilities respectively.

Upon adoption of IFRS 16, the Group introduced a single lessee accounting model for all leases, except for short-term leases and leases of low value items. All leases are now recognised on-balance sheet whereby a right-of-use asset is recognised to represent the right to use the underlying asset and a lease liability is recognised to represent the obligation to make lease payments.

New accounting policies

A summary of the new accounting policies applied by the Group upon adoption of IFRS 16 for leases in which it acts as a lessee is as follows.

Right-of-use assets

The Group recognises a right-of-use asset at the lease commencement date. The right-of-use asset is measured at cost, less any accumulated depreciation and impairment losses, and is adjusted for any remeasurement of the lease liability. The cost of the right-of-use asset includes the amount of the lease liability recognised, initial direct costs incurred, and lease payments made at or before the commencement date, less any lease incentives received.

The Group presents right-of-use assets in office equipment, fixtures, fittings and motor vehicles in the balance sheet, classified in the right-of-use leasehold property category.

Right-of-use assets are depreciated on a straight-line basis over the shorter of the estimated useful life and the lease term. Right-of-use assets are subject to impairment. Depreciation and impairment losses are charged to administrative expenses in the income statement.

Lease liabilities

At the lease commencement date, the Group recognises a lease liability measured at the present value of the lease payments to be made over the lease term. The lease payments include fixed payments, including in-substance fixed payments, less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating a lease, if the lease term reflects the Group exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as an administrative expense in the income statement in the period in which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date, unless the interest rate implicit in the lease is readily determinable. After the commencement date, the lease liability is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments, or a change in the assessment to purchase the underlying asset.

Lease liabilities are presented as a line item in the balance sheet.

Short-term leases and leases of low value assets

The Group applies the recognition exemption to any short-term leases (i.e. those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). The Group also applies the recognition exemption to leases that are considered of low value. Lease payments under such contracts continue to be charged to administrative expenses in the income statement on a straight-line basis over the lease term.

Lease term

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease if it is reasonably certain not to be exercised.

Transition

Leases previously classified as finance leases

At the date of transition, 1 October 2019, the Group had no lease contracts that had previously been classified as finance leases in which it acts as the lessee.

Leases previously classified as operating leases

At the date of transition, 1 October 2019, the Group had a number of lease contracts for properties that had previously been classified as operating leases in which it acts as the lessee and a franking machine. For such leases, upon transition the Group recognised right-of-use assets and lease liabilities, except for short-term leases (see practical expedients below). Lease liabilities were recognised at the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application. Right-of-use assets were recognised at an amount equal to the lease liability, adjusted for any related prepaid and accrued lease payments previously recognised.

The Group elected to apply the following practical expedients set out in IFRS 16, whereby it

- used a single discount rate for portfolios of leases with reasonably similar characteristics;
- relied on its previous assessment of whether leases were onerous immediately before the date of initial application;
- applied the short-term lease exemption to leases with a remaining lease term of less than 12 months at the date of initial application;
- excluded initial direct costs from the measurement of the right-of-use asset at the date of initial application; and
- used hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

Impacts on transition

The effects of adopting IFRS 16 as of 1 October 2019 were as follows.

- Right-of-use assets of £2.3 million were recognised and are presented in a new right-of-use leasehold property category within property, plant and equipment in the balance sheet.
- Lease liabilities of £2.2 million were recognised and are presented as a new line item in the balance sheet.
- Prepayments of £nil and accruals of £0.3 million (included within other assets and other liabilities respectively) related to contracts previously classified as operating leases were derecognised.
- The net effect of these adjustments had no impact on opening retained earnings.

Impacts for the period

The table below sets out the carrying amounts of the Group's right-of-use assets and lease liabilities and the movements during the six months ended 31 March 2020.

	Right-of-use leasehold assets unaudited £'000	Lease liabilities unaudited £'000
Six months ended 31 March 2020		
At 1 October 2019	2,300	2,200
Additions	–	–
Depreciation expense	(300)	–
Interest expense	–	–
Payments	–	(300)
At 31 March 2020	2,000	1,900

The table below sets out the amounts recognised in the income statement.

	Administrative expenses unaudited £'000	Interest expenses unaudited £'000	Total unaudited £'000
Six months ended 31 March 2020			
Depreciation expense of right-of-use assets	300	–	300
Interest expense on lease liabilities	–	–	–
Rental expense on short-term leases	–	–	–
Total recognised in the income statement	300	–	300

The right-of-use assets is shown in 'Office equipment, fixtures, fittings and motor vehicles' on the balance sheet and lease liabilities are included within 'Other liabilities.'

5 Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires the directors to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are as follows.

5.1 Effective interest rate (estimate)

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate method. Management must use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. Management reviews the expected lives on a segmental basis, whereby products of a similar nature are grouped into cohorts that exhibit homogenous behavioural attributes. The key assumptions applied by management in the effective interest rate methodology is the behavioural life of the assets. The expected life behaviours are subjected to changes in internal and external factors and may result in adjustments to the carrying amount of loans which must be recognised in the income statement. The effective interest rate behavioural models are based on market trends and experience.

5.2 Impairment losses on financial assets (judgement and estimate)

The measurement of impairment losses under both IFRS 9 and IAS 39 across all categories of financial assets in scope requires judgement, in particular the estimation of the amount and timing of future cash flows and collateral values, when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, the changes in which can result in different levels of allowances.

Covid-19

Due to the macro-economic downturn caused by the Covid-19 pandemic, the Group's Expected Credit Loss ('ECL') method was further enhanced by separating forborne exposures and adversely affected industrial sectors and providing a Post Model Adjustment ('PMA') to increase the ECL based on a harsher economic outlook, as detailed below.

The actions taken by the UK Government and central bank provide an indication of the potential severity of the downturn and post-recovery environment, which, from a commercial, regulatory and risk perspective, could be significantly different to past crises and persist for a prolonged period. An immediate financial impact of the outbreak is an increase in ECL, driven by a change in the economic scenarios used to calculate ECL. The outbreak has led to a weakening in GDP and used car prices together with a predicted sharp rise in unemployment rates, all of which are key inputs used for calculating ECL, and the probability of a more adverse economic scenario for at least the short-term is substantially higher than at 30 September 2019. The impact of the outbreak on the long-term prospects of businesses, particularly those customers in the Azule division, and individuals is uncertain and may lead to significant ECL charges

on specific exposures, which may not be fully captured by ECL modelling techniques. Where not captured, reduced recovery rates and sectors in the Azule division have been added to the PMA. Forborne loans do not routinely move to Stage 2, however, it is acknowledged that there is an increase in credit risk and a PMA has been put in place. These adjustments are continually under review as more information on the effects of Covid-19 come to light.

The Group's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include

- the Group's internal credit grading model, which assigns Probability of Default ('PD') to the individual grades;
- the Group's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a Lifetime Expected Credit Loss ('LTECL') basis and the qualitative assessment;
- the segmentation of financial assets when their ECL is assessed on a collective basis;
- the development of ECL models, including the various formulas and the choice of inputs;
- the determination of associations between macroeconomic scenarios and economic inputs, such as unemployment levels and collateral values, and the effect on PDs, Exposure At Default ('EAD') and Loss Given Default ('LGD'); and
- the selection of forward-looking macroeconomic scenarios and their probability weightings to derive the economic inputs into the ECL models.

It has been the Group's policy to review its models regularly in the context of actual loss experience and to adjust when necessary.

5.3 Impairment testing of investment in subsidiaries (judgement)

The Group assesses, at each reporting date, whether there is an indication that goodwill acquired through acquisitions may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. In light of the impact of Covid-19 on the Group's investments, the Board will perform semi-annual assessments of goodwill for impairment, as described below.

The review of goodwill for impairment reflects the Board's best estimate of future cash flows of the Group's cash generating units ('CGU') and the rates used to discount these cash flows. Both these variables are subject to judgement and estimation uncertainty as follows.

- The future cash flows of the CGUs are sensitive to projected cash flows based on the forecasts and assumptions regarding the projected periods and the long-term pattern of sustainable cash flows thereafter; and
- The rates used to discount future expected cash flows can have a significant effect on their valuations and are based on the price-to-book ratio method which incorporates inputs reflecting several variables.

An impairment is recognised if impairment testing finds that the carrying amount of a CGU exceeds its recoverable amount. The recoverable amount of the CGU is calculated based on its value-in-use, determined by discounting the future cash flows (pre-tax profits) to be generated from its continuing use. Forecast cash flows are reduced by any earnings retained to support the growth in the underlying CGUs loan books through higher regulatory capital requirements. Forecasted post-tax profits are based on expectations of future outcomes, considering past experience and adjusted for anticipated revenue growth.

The key assumptions used in the calculation of value-in-use are as follows.

Discount rate
The pre-tax discount rate is an estimate of the return that investors would require if they were to choose an investment that would generate cash flows of amount, timing and risk profile equivalent to those that the entity expects to derive from the asset. The Group calculates discount rates using the price-to-book ratio method which incorporates target return on equity, growth rate and price-to-book ratio. The discount rate for each CGU is adjusted to reflect the risks inherent to the individual CGU.

Discount rates used were as follows.

PCF Credit Limited - 13.98%
Azule Limited - 13.98%

Cash flow period
PCF Credit Limited Five years of cash flows (pre-tax profits) are included in the discounted cash flow model based on the Bank's business plan.

Azule Limited Five years of cash flows (pre-tax profits) are included in the discounted cash flow model based on the Bank's business plan.

Terminal value growth rate
A terminal value growth rate is applied in perpetuity to extrapolate cash flows beyond the cash flow period. The terminal value growth rate of 4.0% (reduced from 5%) per annum is estimated by the Board.

6 Segment information

The Group operates in the principal areas of consumer finance for motor vehicles, business finance for vehicles, plant and equipment, specialist funding in the broadcast and media industry and bridging property finance.

For management purposes, the Group has been organised into four operating segments based on products and services.

Consumer finance
Consumer hire purchase, personal loan and conditional sale finance for motor vehicles.

Business finance
Business hire purchase and lease finance for vehicles, plant and equipment.

Azule finance
Specialist funding and leasing services direct to individuals and businesses in the broadcast and media industry.

Bridging finance
Bridging property finance for residential, semi-commercial and commercial properties.

The Group's Executive Committee monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profits or losses and is measured consistently with operating profits or losses in the consolidated financial statements. However, income taxes are managed on a Group basis and are not allocated to operating segments.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Group's total revenue for the six month periods ended 31 March 2019 and 31 March 2020.

Segment assets include cash and balances at central banks, loans and advances to customers, financial instruments and tax assets. Segment liabilities comprise of amounts due to banks, amounts due to customers, derivative financial instruments and tax liabilities, but exclude certain borrowings that are for general corporate purposes.

The following table presents income and expense and certain asset and liability information for the Group's operating segments.

	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
Six months ended 31 March 2020					
Interest and similar revenue calculated using the effective interest method	8,297	10,231	905	931	20,364
Interest and similar expense calculated using the effective interest method	(3,089)	(4,119)	(304)	(205)	(7,717)
Net interest income	5,208	6,112	601	726	12,647
Fee and commission income	106	231	553	–	890
Fee and commission expense	(481)	(323)	(9)	–	(813)
Net fees and commission income/(expense)	(375)	(92)	544	–	77
Net loss on financial instruments mandatorily at fair value through profit or loss	(15)	(10)	–	–	(25)
Net operating income	4,818	6,010	1,145	726	12,699
Personnel expense	(1,489)	(1,880)	(700)	(262)	(4,331)
Depreciation of office equipment, fixtures, fittings and motor vehicles	(44)	(52)	(20)	(6)	(122)
Amortisation of intangible assets	(116)	(135)	–	(17)	(268)
Other operating expenses	(936)	(949)	(154)	(241)	(2,280)
Impairment loss on financial instruments	(956)	(1,981)	(201)	(8)	(3,146)
Total operating expenses	(3,541)	(4,997)	(1,075)	(534)	(10,147)
Segment profit before tax	1,277	1,013	70	192	2,552
Income tax charge	(255)	(203)	(14)	(37)	(509)
Profit for the period	1,022	810	56	155	2,043
Assets					
Additions to office equipment, fixtures, fittings and motor vehicles	1,039	1,484	–	188	2,711
Additions to other intangibles assets	113	161	–	21	295
Loans and advances to customers	147,326	210,328	16,539	26,663	400,856
Total assets	164,358	234,644	18,014	29,746	446,762
Total liabilities	142,085	202,845	15,859	25,714	386,503

	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
Six months ended 31 March 2019					
Interest and similar revenue calculated using the effective interest method	7,505	7,958	771	14	16,248
Interest and similar expense calculated using the effective interest method	(2,766)	(3,223)	(238)	(3)	(6,230)
Net interest income	4,739	4,735	533	11	10,018
Fee and commission income	51	119	435	–	605
Fee and commission expense	(236)	(257)	(8)	–	(501)
Net fees and commission income/(expense)	(185)	(138)	427	–	104
Net loss on financial instruments mandatorily at fair value through profit or loss	–	–	–	–	–
Net operating income	4,554	4,597	960	11	10,122
Personnel expense	(1,553)	(1,507)	(525)	(215)	(3,800)
Depreciation of office equipment, fixtures, fittings and motor vehicles	(18)	(27)	(22)	–	(67)
Amortisation of intangible assets	(81)	(113)	–	(2)	(196)
Other operating expenses	(726)	(714)	(112)	(92)	(1,644)
Impairment loss on financial instruments	(602)	(530)	(18)	(14)	(1,164)
Total operating expenses	(2,980)	(2,891)	(677)	(323)	(6,871)
Segment profit/(loss) before tax	1,574	1,706	283	(312)	3,251
Income tax charge	(308)	(356)	(53)	59	(658)
Profit for the period	1,266	1,350	230	(253)	2,593
Assets					
Additions to office equipment, fixtures, fittings and motor vehicles	11	16	–	–	27
Additions to other intangibles assets	61	86	–	1	148
Loans and advances to customers	105,763	147,667	19,725	2,555	275,710
Total assets	122,312	171,178	22,495	2,970	318,955
Total liabilities	104,344	146,030	10,468	2,533	263,375

7 Interest and similar revenue calculated using the effective interest method

	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Cash and short-term funds	**42**	45	**67**
Loans and advances to customers	**20,195**	15,897	**33,954**
Financial instruments – FVOCI	**127**	306	**478**
Total interest and similar income	**20,364**	16,248	**34,499**

8 Interest and similar expense calculated using the effective interest method

	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Due to banks	**576**	610	**836**
Due to customers	**7,141**	5,620	**12,048**
Total interest and similar income	**7,717**	6,230	**12,884**

9 Impairment losses on financial assets

	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
31 March 2020 - Unaudited					
Impairment charge for the six month period on loans and advances to customers	956	1,981	201	8	3,146
30 September 2019 - Audited					
Impairment charge for the year on loans and advances to customers	778	1,345	46	6	2,175
31 March 2019 - Unaudited					
Impairment charge for the six month period on loans and advances to customers	602	530	18	14	1,164

10 Income tax

The income tax rate is 20%, representing the best estimate of the annual effective tax rate applied to operating profit before tax for the six month period.

11 Loans and advances to customers

	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Consumer lending – gross	**151,200**	108,450	**131,902**
Business lending – gross	**217,662**	150,965	**191,460**
Azule lending – gross	**16,854**	19,923	**9,834**
Bridging lending – gross	**26,676**	2,569	**12,954**
	412,392	281,907	**346,150**
Allowance for impairment losses	**(11,536)**	(6,197)	**(7,647)**
	400,856	275,710	**338,503**

A reconciliation of the allowance for impairment losses for loans and advances, by class, is as follows.

Audited	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
At 1 October 2018	2,286	2,084	–	–	4,370
Adoption of IFRS 9	91	513	–	–	604
	2,377	2,597	–	–	4,974
Charge for the year (note 9)	778	1,345	46	6	2,175
(Recoveries)/write-offs	(107)	529	76	–	498
At 30 September 2019	3,048	4,471	122	6	7,647
Made up of					
Individual impairment	724	1,163	–	–	1,887
Collective impairment	2,324	3,308	122	6	5,760
Total impairment	3,048	4,471	122	6	7,647

Unaudited	Consumer finance £'000	Business finance £'000	Azule finance £'000	Bridging finance £'000	Total £'000
At 1 October 2019	3,048	4,471	122	6	7,647
Charge for the year (note 9)	956	1,981	201	8	3,146
(Recoveries)/write-offs	109	542	92	–	743
At 31 March 2020	4,113	6,994	415	14	11,536
Made up of					
Individual impairment	1,136	1,563	360	14	3,073
Collective impairment	2,977	5,431	55	–	8,463
Total impairment	4,113	6,994	415	14	11,536

Total impairment at 31 March 2020 reflects Expected Credit Losses calculated in accordance with IFRS 9. Loans and advances at company level relate to subsidiary undertakings and are eliminated at group level. These balances arose mainly from daily operations, payments on behalf of and subordinated loans to subsidiary undertakings. Loans and advances to subsidiary undertakings are unsecured, interest-free and repayable on demand. Due from 'Group companies' is entirely allocated to Stage 1 and based on materiality considerations and no provision has been recorded.

12 Investment in subsidiary undertakings

Company

The consolidated financial statements include the financial statements of the Company and its subsidiary undertakings. The Company does not have any joint ventures or associates. Significant subsidiaries of the Company were as follows.

Name of company	Incorporated	Nature of business	Percentage of equity interest 31 March 2020	Percentage of equity interest 31 March 2019	Percentage of equity interest 30 September 2019
PCF Bank Limited	UK	Banking, hire purchase, leasing & bridging	100	100	100
PCF Credit Limited	UK	Leasing & hire purchase	100*	100*	100*
PCF Equipment Leasing Limited	UK	Leasing & hire purchase	–	100*	100*
PCF Financial Leasing Limited	UK	Leasing & hire purchase	–	100*	100*
Azule Limited	UK	Leasing & hire purchase	100*	100*	100*
Azule Finance Limited	IE	Leasing & hire purchase	100*	100*	100*
Azule Finance GMBH	DE	Leasing & hire purchase	100*	100*	100*

*Held by a subsidiary of the Company

PCF Equipment Leasing Limited and PCF Financial Leasing Limited were dissolved on 26 November 2019.

The registered office of all subsidiaries incorporated in the United Kingdom is Pinners Hall, 105-108 Old Broad Street, London EC2N 1ER.

The registered office of Azule Finance Limited is Suite 104, 4/5 Burton Hall Road, Sandyford, Dublin 18.

The registered office of Azule Finance GmbH is Domgarten 12, 47877 Willich, Germany.

All companies have an accounting reference date of 30 September.

Azule Limited, which owns 100% of Azule Finance Limited and Azule Finance GmbH, was acquired by PCF Bank Limited on 5 November 2018.

13 Goodwill and other intangibles assets

Goodwill relates partly to the Group's Consumer Finance Division which arises from the acquisition of a subsidiary company, TMV Finance Limited ('TMV'), in November 2000, and the remainder for the acquisition of Azule Limited on 5 November 2018.

Subsequently, a corporate reorganisation resulted in the assets and business model of TMV being transferred to its related companies in the Group, PCF Credit and PCF Bank. Most new business in respect of the Azule franchise is written in PCF Bank.

The rationale for the TMV acquisition was to increase market share and adopt the business model for new business generation, which involved contractual relationships with broker introductory sources. As the business model was new to the Group at the

time of acquisition and has continued to be the primary source of new business for the Group, the directors believe that the underlying net assets of PCF Credit and PCF Bank are sufficient to cover the carrying amount against its recoverable amount, and there is no indication of impairment.

The rationale for the Azule acquisition was to diversify and it offers revenue synergies in a niche class of business-critical assets, with strong collateral characteristics, and lending to prime credit grade customers. The directors believe that the underlying net assets from Azule's business are enough to cover the carrying amount against its recoverable amount, and there is no indication of impairment.

In performing the semi-annual impairment test, the Group assesses the economic performance of each acquisition, the future of the business acquired and its useful economic life. The assessment ensures that growth and profitability are at least the same value as the amount that was paid 'over and above' the fair value of the assets and liabilities acquired. To assess this, the Board approved forecast (adjusted by the Board's current view of the impact of Covid-19 on the Group) has been used and discounted back to present value.

Both the CGUs acquired are expected to continue to perform, but forecasting is only over the next five years. There is, therefore, a requirement to capture expected growth and cashflows beyond these dates. In order to complete this, there is a terminal valuation that is required to be performed to assess whether goodwill has been impaired or not. Terminal value often comprises a large percentage of the total assessed value.

TMV CGU

The recoverable amount of the TMV CGU of £314 million at 31 March 2020 has been determined based on a value-in-use calculation using cash flow projections from financial budgets approved by the Board covering a five year period, and a terminal valuation based on the previous year's adjusted forecast. The projected cash flows have been updated to reflect the business over this period, which is aligned to future expected growth in its products and services. The pre-tax discount rate applied to cash flow projections is 13.98% per annum over a five year period and, for the period beyond, terminal growth rate of 4.0% is used, being the expected long-term average growth rate for the Group. It was concluded that the fair value less costs of disposal exceeded the value-in-use. In conclusion, there is no obvious impairment loss existing at balance sheet date and the current goodwill remains appropriate for the carrying value for the TMV acquisition.

Azule CGU

The recoverable amount of the Azule CGU of £10 million at 31 March 2020 has been determined based on a value-in-use calculation using cash flow projections from financial budgets approved by the Board covering a five year period, and a terminal valuation based on the previous year's adjusted forecast. The projected cash flows have been updated to reflect the business over this period, which is aligned to future expected growth in its products and services. The pre-tax discount rate applied to cash flow projections is 13.98% per annum over a five year period and, for the period beyond, terminal growth rate of 4.0% per annum is used, being the expected long-term average growth rate for the Group. It was concluded that the fair value less costs of disposal exceeded the value-in-use. In conclusion, there is no obvious impairment loss existing at balance sheet date and the current goodwill remains appropriate.

Key assumptions used in value-in-use calculations and sensitivity to changes in assumptions
The calculation of value-in-use for both TMV and Azule is most sensitive to the following assumptions.

- Terminal value
- Terminal growth rate
- Discount rates
- Free cash flow for the last forecasted year

Terminal value (using the perpetuity method) – Discounting is necessary because the time value of money creates a discrepancy between the current and future values of a given sum of money. In business valuation, free cash flow or dividends can be forecast for a definite period of time, but the performance of ongoing concerns becomes more challenging to estimate as the projections stretch further into the future. Moreover, it is difficult to determine the precise time when a company may cease operations.

To overcome these limitations, investors can assume that cash flows will grow at a stable rate forever, starting at some point in the future. This represents the terminal value.

Terminal value is calculated by dividing the last cash flow forecast by the difference between the discount rate and the terminal growth rate. The terminal value calculation estimates the value of the company after the forecast period.

Terminal growth rate – The terminal growth rate is the constant rate at which a company is expected to continue to grow. This growth rate starts at the end of the last forecasted cash flow period in a discounted cash flow model and goes into perpetuity.

Discounted rates – Discount rates represent the current market assessment of the risks specific to each CGU, taking into consideration the time value of money and individual risks of the underlying assets that have not been incorporated in the cash flow estimates. The discount rate calculation is based on the specific circumstances of the Group and its operating segments and is derived from its Weighted Average Cost of Capital ('WACC').

Growth rate estimates – Both the businesses acquired are expected to grow over the next five years taking into consideration a reduction in growth due to Covid-19 in the short-term.

Group	Six month period ended 31 March 2020 £'000	Six month period ended 31 March 2019 £'000	Year ended 30 September 2019 £'000
TMV Finance Limited acquisition	**397**	397	**397**
Azule Limited acquisition	**2,500**	2,500	**2,500**
	2,897	2,897	**2,897**

Group	Six month period ended 31 March 2020 £'000	Six month period ended 31 March 2019 £'000	Year ended 30 September 2019 £'000
Cost and net book value			
Opening balance	**2,897**	397	**397**
Additions during the year	**–**	2,500	**2,500**
Closing balance	**2,897**	2,897	**2,897**

Other intangible assets

The Group's other intangible assets consist solely of computer software and capitalised expenses incurred in the project of applying to become a bank.

Group	Six month period ended 31 March 2020 £'000	Six month period ended 31 March 2019 £'000	Year ended 30 September 2019 £'000
Cost			
Opening balance	**6,149**	5,249	**5,249**
Additions during the period	**295**	148	**900**
Closing balance	**6,444**	5,397	**6,149**
Accumulated depreciation			
Opening balance	**3,105**	2,689	**2,689**
Amortisation during the period	**268**	196	**416**
Closing balance	**3,373**	2,885	**3,105**
Net book value	**3,071**	2,512	**3,044**

Group	Six month period ended 31 March 2020 £'000	Six month period ended 31 March 2019 £'000	Year ended 30 September 2019 £'000
Net book value of combined goodwill and other intangible assets	**5,968**	5,437	**5,941**

14 Financial instruments

The Group invests in highly liquid financial instruments to support its liquid asset buffer and raises wholesale funding by issuing financial instruments. The Group also uses derivative financial instruments to manage the risks arising from its operations. The risks associated with financial instruments represents a significant component of the total risks faced by the Group and are analysed in more detail below.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 5.

14.1 Valuation techniques

Debt instruments at FVOCI

Covered bond debt securities are financial instruments issued by banks or building societies and collateralised against a pool of assets that, in case of failure of the issuer, can cover claims at any point in time. They are subject to specific legislation to protect bondholders. These instruments are generally highly liquid and traded in active markets, resulting in a Level 1 classification. When active market prices are not available, the Group uses discounted cash flow models with observable market inputs of similar instruments and bond prices to estimate future index levels and extrapolating yields outside the range of active market trading, in which instances the Group classifies those securities as Level 2.

Debt financial instruments

Fair values of derivatives are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flows.

14.2 Valuation principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price), regardless of whether that price is directly observable or estimated using a valuation technique.

In order to show how fair values have been derived, financial instruments are classified based on a hierarchy of valuation techniques, as explained in note 14.4.

14.3 Valuation governance

The Group's fair value methodology and the governance over its models includes a number of controls and other procedures to ensure appropriate safeguards are in place to ensure its quality and adequacy. All new product initiatives, including their valuation methodologies, are subject to approvals by various functions of the Group, Company and the Bank, including the Risk and Finance functions. The responsibility of ongoing measurement resides with the business and product line divisions.

Once submitted, fair value estimates are also reviewed and challenged by the Risk and Finance functions. The independent price verification process for financial reporting is ultimately the responsibility of the independent price verification team within the Treasury function, which reports to the Finance Director.

14.4 Assets and liabilities by classification, measurement and fair value hierarchy

The following table summarises the classification of the carrying amounts of the Group's financial assets and liabilities.

Group	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
31 March 2020 - unaudited				
Cash and balances at central banks	12,246	–	–	12,246
Loans and advances to customers	400,856	–	–	400,856
Debt instruments at FVOCI	–	–	20,128	20,128
Total financial assets	413,102	–	20,128	433,230
Office equipment, fixtures, fittings and motor vehicles				3,168
Other assets				3,258
Deferred tax assets				1,138
Goodwill and other intangible assets				5,968
Total assets				446,762
Due to banks	30,483	–	–	30,483
Due to customers	339,853	–	–	339,853
Subordinated debt	5,000	–	–	5,000
Derivative financial instruments	–	56	–	56
Total financial liabilities	375,336	56	–	375,392
Current tax liabilities				242
Other liabilities				7,593
Total liabilities				386,503

Group	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
31 March 2019 - unaudited				
Cash and balances at central banks	2,882	–	–	2,882
Loans and advances to customers	275,710	–	–	275,710
Debt instruments at FVOCI	–	–	27,491	27,491
Total financial assets	278,592	–	27,491	306,083
Office equipment, fixtures, fittings and motor vehicles				292
Other assets				5,856
Deferred tax assets				1,287
Goodwill and other intangible assets				5,437
Total assets				318,955
Due to banks	52,028	–	–	52,028
Due to customers	203,754	–	–	203,754
Subordinated debt	–	–	–	–
Derivative financial instruments	–	–	–	–
Total financial liabilities	255,782	–	–	255,782
Current tax liabilities				528
Other liabilities				7,065
Total liabilities				263,375

Group	Amortised cost £'000	FVTPL £'000	FVOCI £'000	Total £'000
30 September 2019				
Cash and balances at central banks	7,371	–	–	7,371
Loans and advances to customers	338,503	–	–	338,503
Debt instruments at FVOCI	–	–	19,638	19,638
Total financial assets	345,874	–	19,638	365,512
Office equipment, fixtures, fittings and motor vehicles				579
Other assets				4,932
Deferred tax assets				1,105
Goodwill and other intangible assets				5,941
Total assets				378,069
Due to banks	44,412	–	–	44,412
Due to customers	267,070	–	–	267,070
Derivative financial instruments	–	63	–	63
Total financial liabilities	311,482	63	–	311,545
Current tax liabilities				1,521
Other liabilities				6,248
Total liabilities				319,314

The Group holds certain financial assets at fair value grouped into Levels 1 to 3 of the fair value hierarchy, as explained below.

Level 1 – The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio mainly comprises gilts, fixed rate bonds and floating rate notes for which traded prices are readily available.

Level 2 – These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed when no active market exists, and quoted prices are available for similar instruments in active markets.

Level 3 – These are valuation techniques for which one or more significant inputs are not based on observable market data. Valuation techniques include net present value by way of discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, similar market products, foreign currency exchange rates and equity index prices. Critical judgement is applied by management in utilising unobservable inputs, including expected price volatilities and prepayment rates, based on industry practice or historical observation. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The following table shows an analysis of financial instruments recorded at amortised cost by level of the fair value hierarchy.

Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Carrying value £'000	Fair value £'000
Financial instruments held at amortised cost 31 March 2020					
Cash and balances at central banks	12,246	–	–	12,246	12,246
Loans and advances to customers	–	–	400,856	400,856	451,764
	12,246	–	400,856	413,102	464,010
Due to banks	30,483	–	–	30,483	30,483
Due to customers	–	–	339,853	339,853	339,853
Subordinated debt	–	–	339,853	339,853	339,853
	35,483	–	339,853	375,336	375,336

Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Carrying value £'000	Fair value £'000
Financial instruments held at amortised cost 31 March 2019					
Cash and balances at central banks	2,882	–	–	2,882	2,882
Loans and advances to customers	–	–	275,710	275,710	319,094
	2,882	–	275,710	278,592	321,976
Due to banks	52,028	–	–	52,028	52,028
Due to customers	–	203,754	–	203,754	203,754
	52,028	203,754	–	255,782	255,782

Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Carrying value £'000	Fair value £'000
Financial instruments held at amortised cost 30 September 2019					
Cash and balances at central banks	7,371	–	–	7,371	7,371
Loans and advances to customers	–	–	338,503	338,503	338,503
	7,371	–	338,503	345,874	383,714
Due to banks	44,412	–	–	44,412	44,412
Due to customers	–	–	267,070	267,070	267,070
	44,412	–	267,070	311,482	311,482

The following table shows an analysis of financial instruments recorded at FVOCI by level of the fair value hierarchy.

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair value £'000
Financial instruments held at fair value through other comprehensive income (FVOCI) 31 March 2020				
Covered bonds	20,128	–	–	20,128

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair value £'000
Financial instruments held at fair value through other comprehensive income (FVOCI) 31 March 2019				
Covered bonds	27,491	–	–	27,491

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Fair value £'000
Financial instruments held at fair value through other comprehensive income (FVOCI) 30 September 2019				
Covered bonds	19,638	–	–	19,638

	Notional Level 1 £'000	Notional Level 2 £'000	Notional Level 3 £'000	Carrying value £'000	Fair value £'000
Derivative financial instruments 31 March 2020					
Financial assets	–	5,000	–	–	–
Financial liabilities	–	5,000	–	(56)	(56)
31 March 2019					
Financial assets	–	–	–	–	–
Financial liabilities	–	–	–	–	–
30 September 2019					
Financial assets	–	10,000	–	–	–
Financial liabilities	–	10,000	–	(63)	(63)

14.5 Impairment allowance for loans and advances to customers

The table below shows the credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and year-end stage classification. The amounts presented are gross of impairment allowances.

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 31 March 2020				
Gross carrying amounts				
Performing				
High grade	136,728	5,116	–	141,844
Standard grade	176,366	23,727	401	200,494
Sub-standard grade	39,410	5,792	78	45,280
Non-performing				
Individually impaired	–	–	797	797
Collectively impaired	1,558	4,185	18,234	23,977
Total	354,062	38,820	19,510	412,392

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 31 March 2019				
Gross carrying amounts				
Performing				
High grade	64,914	–	–	64,914
Standard grade	157,265	12,670	60	169,995
Sub-standard grade	31,830	2,890	–	34,720
Non-performing				
Individually impaired	–	–	965	965
Collectively impaired	–	1,566	9,747	11,313
Total	254,009	17,126	10,772	281,907

	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 30 September 2019				
Gross carrying amounts				
Performing				
High grade	90,161	–	286	90,447
Standard grade	179,162	15,603	214	194,979
Sub-standard grade	37,430	4,190	29	41,649
Non-performing				
Individually impaired	–	–	4,945	4,945
Collectively impaired	541	2,632	10,957	14,130
Total	307,294	22,425	16,431	346,150

An analysis of changes in the gross carrying amount and the corresponding ECLs is as follows.

Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2019	307,294	22,425	16,431	346,150
New assets originated or purchased	138,923	–	–	138,923
Assets derecognised or matured	(68,025)	(2,242)	(798)	(71,065)
Transfers to Stage 1	1,615	(1,615)	–	–
Transfers to Stage 2	(23,857)	23,857	–	–
Transfers to Stage 3	(1,885)	(3,579)	5,464	–
Amounts written-off	(3)	(26)	(1,587)	(1,616)
At 31 March 2020	354,062	38,820	19,510	412,392

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2019	1,576	1,458	4,613	7,647
New assets originated or purchased	763	–	–	763
Assets derecognised or matured	1,911	803	1,569	4,283
Transfers to Stage 1	19	(19)	–	–
Transfers to Stage 2	(1,360)	1,360	–	–
Transfers to Stage 3	(509)	(1,067)	1,576	–
ECL transfers	–	–	–	–
Amounts written-off	(82)	(13)	(1,062)	(1,157)
At 31 March 2020	2,318	2,522	6,696	11,536

Gross carrying amounts	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2018	195,580	18,550	10,183	224,313
New assets originated or purchased	238,564	105	45	238,714
Assets derecognised or matured	(106,857)	(7,814)	(640)	(115,311)
Transfers to Stage 1	2,294	(2,294)	–	–
Transfers to Stage 2	(16,706)	16,706	–	–
Transfers to Stage 3	(5,581)	(2,829)	8,410	–
Amounts written-off	–	–	(1,566)	(1,566)
At 30 September 2019	307,294	22,424	16,432	346,150

ECL allowance	Stage 1 £'000	Stage 2 £'000	Stage 3 £'000	Total £'000
At 1 October 2018	757	765	3,452	4,974
New assets originated or purchased	1,223	7	13	1,243
Assets derecognised or matured	(339)	(72)	(281)	(692)
Transfers to Stage 1	136	(136)	–	–
Transfers to Stage 2	(64)	64	–	–
Transfers to Stage 3	(25)	(221)	246	–
ECL transfers	(112)	1,051	2,749	3,688
Amounts written-off	–	–	(1,566)	(1,566)
At 30 September 2019	1,576	1,458	4,613	7,647

15 Subordinated debt

The Group has a £15 million Tier 2 capital facility, with the ability to access this in tranches as required to support growth. At 31 March 2020, £5 million had been drawn down at an 8% fixed interest rate.

	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Brought forward	**-**	–	**-**
Drawn down 2029	**2,500**	–	**-**
Drawn down 2030	**2,500**	–	**-**
Carried forward	**5,000**	–	**-**

The subordinated liabilities are repayable in full on the dates stated or earlier, at the option of the Group and with the prior consent of the PRA. The interest expense for the six month period to 31 March 2020 was £105,205.

The rights of repayment of the holders of these liabilities are subordinated to the claims of all depositors and all creditors.

16 Issued capital and reserves

Share capital	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Ordinary shares issued and fully paid			
Brought forward	**12,510**	10,611	**10,611**
Issuance of new shares during the period	**-**	1,899	**1,899**
Carried forward	**12,510**	12,510	**12,510**

Share premium	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Brought forward	**17,619**	8,527	**8,527**
Issuance of new shares during the period	**-**	9,126	**9,092**
Carried forward	**17,619**	17,653	**17,619**

Date of issue	Number of shares	Issue price	Change in share capital at 5p per share £'000	Change in share premium £'000
30 October 2018				
Shares issued as part of the consideration on acquisition of Azule Limited	1,923,076	39.00p	96	654
11 March 2019				
Shares issued to support increased lending	35,833,333	30.00p	1,792	8,958
Fees relating to share issue				(556)
29 March 2019				
Shares issued pursuant to Employee Share Scheme – Exercise of Options	195,000	21.17p	10	31
12 April 2019				
Dividend reinvestment	15,703	34.5p	1	5
			1,899	9,092

17 Earnings per share

Basic earnings per share ('EPS') is calculated by dividing the net profit for the period attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the period.

The following table shows the income and share data used in the basic and diluted EPS calculations.

	31 March 2020 unaudited £'000	31 March 2019 unaudited £'000	30 September 2019 audited £'000
Net profit attributable to ordinary shareholders adjusted for the effect of dilution	**2,043**	2,593	**6,394**

	31 March 2020 '000 units	31 March 2019 '000 units	30 September 2019 '000 units
Share-based payments Basic and diluted weighted average number of shares	**250,197**	217,921	**234,107**
Basic and diluted earnings per 5p ordinary share	**0.8p**	1.2p	**2.7p**

18 Related parties

30 September 2019 – audited

Non-executive directors held a total of £186,756 in savings accounts in the Bank at 30 September 2019.

The Group had a borrowing arrangement from Bermuda Commercial Bank amounting to £83 million which was repaid in full during 2019. Such arrangement was at arm's length and the total interest expense recorded during the year was £214,342.

31 March 2020 – unaudited

Non-executive directors held a total of £126,507 in savings accounts in the Bank at 31 March 2020.

19 Events after the balance sheet date

30 September 2019 – audited

Subsequent to the year end, the Group made a payment of £750,000 in respect of Azule's contingent consideration which is a non-adjusting event.

31 March 2020 – unaudited

There have been no material post-balance sheet events.

PCF BANK

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Lending Consumer Finance 020 7227 7506 Business Finance 020 7227 7560
Azule Finance 01753 580 500 Bridging Finance 020 3848 7802

Savings 020 7227 7577 **Credit Control** 020 7227 7517 **Switchboard** 020 7222 2426

PCF Bank Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, FRN number 747017. The Bank is registered in England and Wales, registration number 02794633 and is wholly owned by PCF Group plc, a company registered in England and Wales, registration number 02863246 and listed on the Alternative Investment Market. Certain subsidiaries of the Bank are authorised and regulated by the Financial Conduct Authority for consumer credit activities. Registered offices are at Pinners Hall, 105-108 Old Street, London EC2N 1ER.