CITY INSIGHTS

PRIVATE & COMMERCIAL FINANCE GROUP

www.pcfg.co.uk

COMPANY UPDATE

5 JULY 2016

Private & Commercial Finance

The second interim results from Private & Commercial Finance Group (PCFG), for the 12 months to 31 March, announced on the 9 June, comfortably exceeded market expectations. Scalability of the vehicle and asset finance business and the attendant operational gearing are behind rising profitability on a low cost base. Credit quality continues to improve with falling loan default provisions. The model can take PCFG much further, but an application for bank status has now been submitted (13 May) and, once obtained, should accelerate the Group's growth by enabling entry to new markets.

KEY INFORMATION

EPIC	PCF.L
Market	AIM
Sector	Financial Services
Share price (p)	24.22
12m high/low (p)	35.00/16.50
Issued shares (m)	154.16
Market cap (£m)	38.39
NOMAD/Broker	Panmure Gordon
Joint broker	Stockdale Securities

SHARE PRICE GRAPH

GROUP DESCRIPTION

PCFG is a specialist finance Group providing instalment credit for consumer motor vehicle purchase and HP/finance leases for vehicles, plant and equipment for the small businesses. The focus is on portfolio growth, increased profitability and credit quality. Business is largely broker originated with proposals evaluated by in-house underwriters. PCFG is currently in the process of seeking approval from the FCA/PRA.for a banking licence in order to accelerate its growth.

FINANCIAL CALENDAR

AGM & Trading Update (tbc)	23 Sep '16
Final results - 18 mths to 30 Sep	6 Dec '16

- Adjusted pre-tax profits, after adding back the preliminary costs of applying for the bank licence, increased by 67% to £3.5m. Very good increases were achieved on the profitability metrics: 41% uplift on the return on average assets (ROAA) to 3.1% (2015: 2.2%) and 36% on the fully diluted return on equity (ROE) to 13.9% (2015: 10.2%). Rising profitability has been achieved through business growth rather than an improvement in the net interest margin, currently around 6%.
- A 13% increase in new business volumes underpinned portfolio growth of 12% to £112m on which there was a record low level of impairments (now down to 1.1%). Business finance lending increased by 24% as SMEs increasingly use specialist asset finance companies in place of the high street banks. Consumer loans, primarily for car purchase, rose 5%..
- Over the short term, PCFG has committed facilities of £117m with £89m utilised leaving adequate headroom for loan expansion through to the receipt of a banking licence. By year end, bank status should be achieved and will be followed by a six to nine months mobilisation period to establish the appropriate banking infrastructure, compliance and staffing requirements. PCFG will seek to attract retail deposits in H2 of 2017 to reduce its cost of funds, enabling it to offer finance facilities at lower cost as well as entering new markets.
- Bank status would have the short term effect of raising the cost base by c.£1m in PCFG's F17 (year to 30 September) and c.£1.3m in F18, temporarily lowering PCFG's ROAA and ROE. Despite these one-off costs, underlying profitability remains strong and PBT is only slightly down on F16. The ROE will also be affected by a probable capital-raising in early 2017 (£10m is suggested by both house brokers) to bolster the balance sheet and increase liquidity as part of the mobilisation process.
- A possibly slower environment faces the banking sector after the Referendum vote with attendant lower interest rates and increased default risks. None of this is guaranteed and PCFG's prospects remain sound, both on an 'as is' basis and with bank status. The Company's tight market focus, diverse, well spread collateral-backed portfolio, low costs and strong capital base are all positive factors in a potentially weaker economy. In that scenario, and on a three year horizon, a loan book of £200m with recalibrated ROAA of 2.5% and ROE of 12.5% are all achievable targets.
- PCFG has stated that it will recommence paying dividends with the first being paid on the final results for the period ending 30 September 2016.

Year end 30 Sept	Turnover (£m)	PBT (£m)	Dil EPS (p)	PER (x)	DPS (p)	Yield (%)
2015A#	45.3	2.1	1.3	18.6	-	-
2016E>2	54.8	3.7	1.6	15.1	0.1	0.4
2017E2	63.4	4.1	1.3	18.6	0.2	0.8
2018E2	78.4	6.7	2.1	11.5	0.3	1.2

 # Year to 31 March. 1 Fully diluted 2 Average of Panmure Gordon & Stockdale forecasts
~ Pre-tax profit and EPS estimates are adjusted to exclude all bank set-up costs
> Estimates for the year are for H2 plus the third interim period H3 rather than the full 18 months from the 31 March 2015.

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OPERATIONAL HIGHLIGHTS

Expansion without any loss of quality

PCFG produced a strong set of results comfortably exceeding market expectations. The key points in terms of expansion and performance metrics were:

- **Originations**: New business originations increased by 13% to £63m (2015: £56m), a slightly faster rate of growth than the prior year.
- **Portfolio**: Growth of 12% to £112m (2015: £100m). The figure excludes unearned finance charges of £26.5m (2015: £23.6m) which contribute to future earnings.
- **Credit quality**: The loan loss provisioning charge declined by 20% to £1.2m (2015: £1.5m) and the level of impairments declined to 1.1% (2015: 1.6%).
- **Operating profit**: Excluding bank costs, operating profit increased by 26% to £8.5m (2015: £6.8m), with a corresponding 170 bps margin enhancement.
- **ROAA**: The return on average assets increased by 41% to 3.1% (2015: 2.2%).
- **ROE**: The fully diluted return on equity increased 36% to 13.9% (2015: 10.2%).

Faster growth in new loans for business

The results plus a favourable economic background provided an encouraging base for PCFG's plan to gain its banking licence by the year end following the application made on the 13 May. Those plans remain intact despite the economic and political uncertainties engendered by the leave vote in the EU referendum. The Business Finance division grew more rapidly than Consumer with originations up 24% to £28m, as SMEs have increasingly used specialist lenders rather than the high street banks. Consumer Finance had a 5% growth in new business to £35m. Importantly, both divisions show substantial improvements to their operating margins as shown in the table below. Pre-tax profits are after the allocation of central costs.

Divisional revenue and profit performance

12 months ended 31 March #	2015	2016	Change (%)
Fig's in £'000			
Consumer Finance			
Total turnover ~	33,343	35,064	5
Turnover for the year	24,270	26,939	11
Pre-tax profit	1,257	2,209	76
Margin (%)	*5.2*	*8.2*	300 bps
Business Finance			
Total turnover	22,615	28,140	24
Turnover for the year	21,023	24,323	16
Pre-tax profit	842	1,083	29
Margin (%)	*4.0*	*4.5*	50 bps
Total for Group			
Total turnover	**55,958**	**63,204**	
Turnover for the year	45,293	51,262	13
Pre-tax -profit	**2,099**	**3,292**	57
Loan loss provisioning charge	(1,546)	(1,210)	(22)
Consumer finance	(1,060)		
Business finance	(486)		

2016 results are for a second interim period ended 31 March in the 18 month accounting period to 30 September 2016.

~ Incudes revenue from previous years' originations. Turnover for the year includes only amounts collected from agreements w ritten in the year.

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INTERIM RESULTS DETAILS

Profitability increased through scale...

The Income Statement shows several positive features compared with the corresponding period :

- **Adjusted pre-tax profit**: Excluding banking costs, increased by 68% to £3.5m (2015: £2.1m).
- **Gross margin**: Broadly maintained at 29.5%.
- **Administrative expenses**: These increased by 3% despite the inclusion of £224,000 banking costs. Excluding those costs, administrative expenses would have declined by 0.5%, helped by a 22% decline in loan loss provisions.
- **Tax charge**: The effective rate was 20%, 23% in the prior year, as the tax rate normalises.
- **EPS**: The reported decline in the basic earnings per share was due to increases in the number of shares following the conversion of the CULS. The shares in issue increased by 101.04m in the 12 month period.

...and a tightly managed cost base

The key element in PCFG's business model is to grow the business while tightly managing the cost base. That was achieved despite incurring £224,000 of additional costs in preparing and submitting the bank application to the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA).

Income Statement			
12 months ended 31 March (Fig's in £'000s)	2015	2016	Change (%)
Consumer Finance	24,270	26,939	11
Business Finance	21,023	24,323	16
Turnover	**45,293**	**51,262**	13
Cost of sales	(31,846)	(36,123)	13
Gross profit	**13,447**	**15,139**	13
GP margin (%)	*29.7*	*29.5*	(20 bps)
Loan loss provisioning charge	(1,546)	(1,210)	(22)
Depreciation and amort. of other intangibles	(349)	(358)	3
Banking costs	-	(224)	-
Other administration expenses	(4,791)	(5,083)	6
Administrative expenses	**(6,686)**	**(6,875)**	3
Profit from operations	**6,761**	**8,264**	22
Operating margin (%)	*14.9*	*16.1*	120 bps
Net finance costs	(4,662)	(4,972)	7
Adjusted profit before tax #	**2,099**	**3,516**	68
Profit before tax	2,099	3,292	57
Tax	(485)	(659)	36
Profit after tax	**1,614**	**2,633**	63
EPS basic (p)	3.0	2.5	(17)
EPS diluted (p)	1.3	1.8	38
# Excluding banking costs.			

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BALANCE SHEET

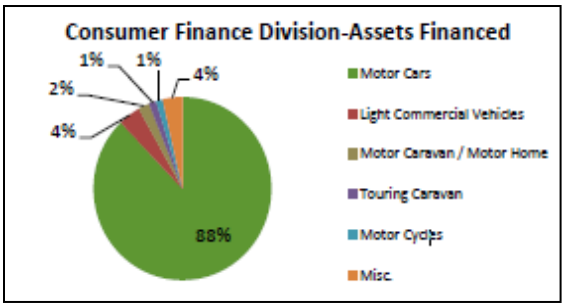
Portfolio expansion with continuing improvement in quality

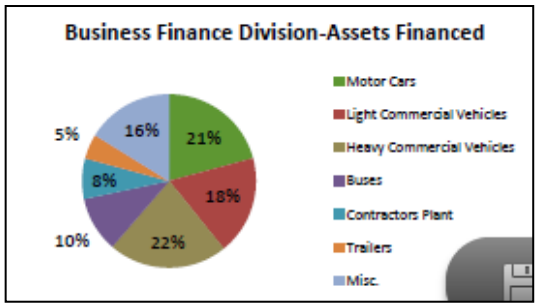
On the asset side, the key points are:

- **Gross loans and receivables**: Inclusive of the portion relating to future unearned income, the gross portfolio increased 12% or by £14.9m to £142.6m.
- **Loan portfolio**: After excluding unearned future finance income and the loan loss provision, the portfolio showed 12% growth to £112.3m (2015: £99.8m) of which 59% were loans to consumers and 41% business loans to SMEs.
- **Future finance income**: Loan agreements are structured so that 50% of income is received after the first year. Last year, £26.5m is shown as future income, up from £23.6m in 2015.
- **Impaired loans**: These amounted to 6.5% of gross loans and have reduced to £9.3m (2015: £10.6m), covered by a loan loss provision of £3.8m. The uncovered portion is supported by charging orders or revised payment arrangements.

PCFG's niche is vehicle loans

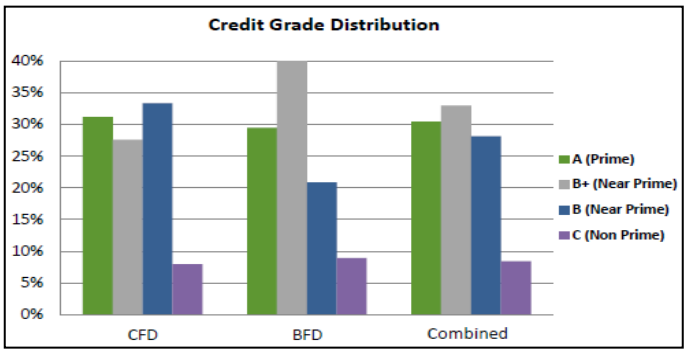
Currently, 61% of business loans are for cars or commercial vehicles; in the case of consumers, 92% of loans are obtained to purchase cars, vans or light commercial vehicles. The distribution of asset types financed by PCFG is as shown below. Vehicles have the advantage of offering good collateral as well as having readily available market values from sources such as, for example, Glass's Guide. This enables PCFG to price risk more accurately, first on the consumer and, secondly, on the vehicle itself. Values of specialised business plant are obtained from professional third parties.





Over 60% of loan agreements are prime or near prime...

On the Company's risk assessment criteria, of the loan agreements now in place, nearly 60% of consumer loans are in PCFG's A or B+ categories (i.e. prime or near prime) and nearly 70% of business loans. At the other end of the scale, and priced accordingly for their greater risk, 8% of consumer and 9% of business loans are classed as non-prime. The distribution of loan categories is as shown in the chart below.



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...with improved credit quality

PCFG set outs the latest credit quality data in the table below which supports the claim that there has been an improvement in the overall quality primarily stemming from prudent underwriting and a reduction in the percentage of impaired loans.

Credit quality breakdown			
12 months ended 31 March (Fig's in £m)	2015	2016	Change (%)
Neither past due nor impaired	114.3	128.3	12
As % of gross loans & receivables	*89.5*	*90.0*	
Past due but not impaired	2.9	4.9	69
As % of gross loans & receivables	*2.3*	*3.4*	
Impaired	10.5	9.3	(11)
As % of gross loans & receivables	*8.2*	*6.5*	
Gross loans and receivables	**127.7**	**142.5**	12
Impaired	10.5	9.3	(11)
Loan loss provision	4.2	3.8	(10)
Impaired net of loan loss provision	**6.3**	**5.5**	(13)

...and no reasons for expecting this to change

As it stands now, there is no reason to expect any sharp deterioration in credit quality arising from the EU referendum leave vote and its potentially adverse economic consequences. The main risks are of a gradual slowdown in the demand for loans both from consumers and SMEs in a weaker climate. What is not expected is a reduced volume of business resulting from PCFG adopting more stringent loans criteria. They would not be warranted. Revenues are more likely to rise from new business opportunities taken up following the grant of a banking licence.

A reshaped and strengthened balance sheet...

- **Debt**: As at the 31 March, total debt finance amounts to £89.6m of which the non-current portion was £18.1m inclusive of the remaining £1m nominal of 6% CULS due to be converted in September. The debt figure also includes £0.4m of derivatives for hedging against changes in interest rates.
- **Net assets**: Increased 93% to £22.9m (2015: £11.9m) from £11.9m due to the following:
  - i. Conversion of £8.6m of CULS into 101.04m of ordinary shares with a nominal value of £5.0m. This increased the issued share capital from £2.7m to £7.7m;
  - ii. Transfer of £7.9m from the share premium account and £3.9m from capital reserves totalling £11.8m to the Profit and Loss account.
  - iii. The P&L account also benefited from the profit for the year of £2.6m. Hence the P&L account shows an increase of £14.4m from £1.4m to £15.8m.

...with reduced gearing...

- **Gearing**: Measured as debt to net assets, PCFG's balance sheet gearing has declined from 7.5x to 3.9x as a result of the increase in the denominator.

...and distributable reserves for dividend resumption

The purpose of gaining court approval for the conversion of the share premium account and capital reserves into distributable reserves was for the resumption of dividend payments, and this has been signalled by the Company. The first of these is forecast by the house brokers at 0.1p as a final dividend for the year ended 30 September 2016, with reasonable progression thereafter. The balance sheet is as shown overleaf.

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Balance sheet			
12 mths ended 31 March # (Fig's in £'000)	2015	2016	Change
Goodwill	397	397	-
Other intangible assets	514	414	(100)
Property, plant and equipment	105	108	3
Loans and receivables	63,680	73,529	9,849
Deferred tax assets	1,694	1,326	(368)
Non-current assets	**66,390**	**75,774**	9,384
Loans and receivables	36,149	38,741	2,592
Trade and other receivables	1,134	171	(963)
Corporation tax	-	-	
Cash and cash equivalents	139	84	(55)
Current assets	**37,422**	**38,996**	1,574
TOTAL ASSETS	**103,812**	**114,770**	10,958
Interest-bearing loans and borrowings	10,733	71,204	60,471
Trade and other payables	1,643	1,475	(168)
Derivative financial instruments	22	51	29
Corporation tax	176	-	
Bank overdrafts	703	675	(28)
Current liabilities	**13,277**	**73,405**	60,128
Derivative financial instruments	156	353	197
Interest-bearing loans and borrowings	78,521	18,089	(60,432)
Non-current liabilities	**78,677**	**18,442**	(60,235)
TOTAL LIABILITIES	**91,954**	**91,847**	(107)
NET ASSETS	**11,858**	**22,923**	11,065
Share capital	2,656	7,708	5,052
Share premium	4,398	-	
Reserves	3,746	(303)	(4,049)
Own shares	(305)	(305)	0
Profit and loss account	1,363	15,823	14,460
SHAREHOLDERS' FUNDS	**11,858**	**22,923**	11,065

Results are for the second interim period ended 31 March 2016 in the 18 months accounting period to 30 September 2016.

Wholesale bank funding facilities remain important...

With the focus on gaining a banking licence, there is still scope to for continued growth of the business as currently organised and with adequate headroom available within its existing bank facilities. PCFG currently has committed banking facilities of £117m of which only £89m have been utilised so it can still finance its current business and consumer credit business for the next two to three years provided there is no significant change in the ability of its banks to provide funds.

...with one key term loan due for refinancing

PCFG's bank funding is a mixture of term loans and block discounting facilities from a group of banks. The term loans have a fixed date for repayment and a fixed interest rate based on LIBOR plus margin. Block discounting is also at fixed rates. The largest of the term loans outstanding is for £50m and due for repayment on 30 September.

This explains the large increase shown in current bank borrowings from £10.7m to £71.2m and due for refinancing. Renewal of this term loan is currently being negotiated and documented for three year renewal after which PCFG's balance sheet will show a more normal time distribution between current and non-current liabilities, broadly matching the pattern of asset maturities.

Cost of bank debt shaded below 6%...

Given the mix of term loans and block funding, currently around 75% of PCFG's debt is at fixed rates. On the smaller portion of floating rate debt, the risk of rate changes is hedged using interest rate swaps so the effective proportion of fixed rate finance is increased. The overall cost of bank funding has now shaded to less than 6%, but may not fall further given the current phase of the credit cycle. That has been the rationale for application for a banking licence enabling lower cost fund sources to be tapped in the form of retail deposits.

...but cost is not the only factor

Cost is not the only reason for seeking a diversification of fund sources. Under the terms of its bank borrowings, either term loans or block discounting, PCFG is restricted to providing loan agreements for up to five years, and for which matching bank funds are required. This restriction precludes entry to some asset finance markets where longer maturities are the norm.

All except c.£1m of CULS now converted

Within the liabilities section, the remaining CULS is around £1m nominal and the final maturity date is 30 September 2016. The majority shareholder, Bermuda Commercial Bank (BCB), has converted all its CULS holdings and now accounts for 72% of PCFG's issued share capital. This will reduce to 68% upon conversion of the remainder. As a prospective bank, PCFG sees the possibility of achieving synergies by co-sourcing with BCB some key functional areas such as internal auditing.

CASH FLOW STATEMENT

Main focus is on expansion of the loan portfolio covered by financing

As shown overleaf, the cash flow statement reveals only an increase in loans and receivables of £12.4m (2015: £11.2m) reflecting the growth in business and this was largely financed from two primary sources:

1. Internally generated profit of £3.3m from operating activities
2. In the financing section, net proceeds from new borrowing amounting to £8.5m.

Very little investment has taken place either in fixed assets (property, plant and equipment) or in intangibles such as business software. Any new infrastructure investment expenditure awaits conversion to bank status and PCFG will not anticipate it. Required expenditure of this type would be more likely to fall in the second half of F17.

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Cash Flow			
12 mths ended 31 March (Fig's in £'000s)	2015	2016	Change
Profit before taxation	**2,099**	**3,292**	**1,193**
Depreciation and amortisation of other intangible assets	349	358	9
Increase in loans and receivables	(11,174)	(12,441)	(1,267)
Decrease/(increase) in trade and other receivables	(203)	963	1,166
(Decrease)/increase in trade and other payables	331	(160)	(491)
Other cash movements	(4)	16	20
Cash flows used in operating activities	**(8,602)**	**(7,972)**	**630**
Tax paid	35	(422)	(457)
Net cash flows from operating activities	**(8,567)**	**(8,394)**	173
Purchases less sales of property, plant & equipment	(50)	(38)	12
Purchase of other intangible assets	(52)	(87)	(35)
Net cash flows used in investing activities	**(102)**	**(125)**	**(23)**
Issue of own convertible debt	50	-	
Proceeds from borrowings less repayments	8,101	8,492	**391**
Net cash flows used in financing activities	**8,151**	**8,492**	**341**
Net (decrease)/increase in cash and cash equivalents	**(518)**	**(27)**	**491**
Cash and equivalents at beginning of period	(46)	(564)	(518)
Cash and cash equivalents at end of period	(564)	(591)	(27)
Cash at bank	139	84	(55)
Bank overdrafts	(703)	(675)	28
Net cash	**(564)**	**(591)**	**(27)**

BUSINESS MODEL

Routes to market diversifying...

PCFG's proven business model has worked well in terms of scalability and the improved quality of its loan book. The legacy impairments are now down to single figure millions and the actual loan loss provisioning charge to the income statement has declined to 1.1% (against 1.5% a year ago) of the loan portfolio. Currently, 75% of business is funnelled through a network of brokers, providing national coverage and a reliable route to market. PCFG has given no indications that any adjustments to its business model will be required should the economy weaken significantly. The current modus operandi is robust.

...with a higher proportion of direct and returning business

An increased proportion of originations, now 14%, is direct or from returning customers while another 11% is obtained from joint ventures set up with key brokers who share the profits and default risks in lieu of taking a commission. PCFG anticipates an increasing volume of business from direct channels as the Company's profile is raised and a possible 10% could come from the internet, directly accessed from the website.

Well spread customer base with low transaction size

PCFG has avoided growth at the expense of lower quality loan agreements, and overall risk has been minimised by low transaction size, a large and diverse customer base, and avoiding too high a commitment to any single borrower. PCFG has approaching 11,000 loan agreements in place. SME business loans are larger averaging £26,000 at inception while, for the consumer, the average loan at inception is £11,700.

Repossessed assets do not mean losses are sustained	PCFG's risk appraisal takes account both of customer and asset quality. For business assets as well as car loans, an agreement to fund the purchase price may represent a loan to assessed market value in excess of 100%. In the event of a default, repossession of the asset may result in recovering proceeds less than the loan. However, this will have been taken into account in pricing the risk at the outset with the quality and credit status of the customer securing the shortfall. It should be added that, post the Referendum vote, PCFG does not expect a decline in asset prices and thus reduced collateral values. They should therefore continue to provide solid backing for loans, an essential feature and source of comfort in PCFG's business model.

OBJECTIVES

A strong business already	PCFG's effective and successful business model is well able to provide a platform for profitable growth even without the bank option. Previous indications suggested that monthly new business originations of £7m - 8m were feasible to drive the portfolio to £250m, albeit over a longer period. This remains a valid option under current conditions and the continued availability of bank finance.
Bank functions entail higher annual operating costs of £1m plus in F17...	The costs of gaining the bank licence amounted to £224,000 in the year to 31 March, and they are likely to be the same amount again when PCFG reports results for the accounting period of 18 months to the 30 September 2016. For the full year 2017, PCFG indicated £1m will be added to administrative costs by virtue of additional staffing costs for treasury, audit, compliance and other bank functions. Other costs will be incurred for changes to systems, IT, additional depreciation and amortisation of start up costs. F18 full year costs are likely to increase to c.£1.3m. Eventually there will also be fees payable to the PRA for the Financial Services Compensation Scheme.
...so profitability targets are temporarily lowered...	PCFG's business objective for the calendar year 2016 have been reset as follows: 1. Growth of the net loan portfolio to £120m from the current £112m. 2. Revised profitability targets of 2.5% for ROAA (from 3.1%) and 12.5% for ROE (from 13.9%). These targets were in place before the outcome of the EU referendum vote but they are realistic and achievable even in a less favourable climate. The profitability outcomes are mainly based on the scale of operations, and PCFG is still starting from a relatively low base.
New capital-raising in prospect in the regulatory mobilisation phase	Going beyond the year end and with bank status secured early in 2017, PCFG will organise a fund-raising of £5m - £20m (both house brokers suggest £10m) for regulatory purposes, primarily to boost its capital base, add liquidity and provide a platform for planned growth. The fund-raising will be at an early stage of the six months mobilisation phase. In this phase, PCFG will modify its business structure and model to comply with regulatory requirements, establish the internal audit functions and also begin the process of attracting retail deposits.

Costs now, benefits later along with reduced funding risk

Tapping the pool of retail deposits should begin from the summer of 2017 but the benefits of lower cost funding are unlikely to accrue until F18, i.e. PCFG's financial year ended 30 September 2018. Having access to retail deposits cuts the risk of any curtailment or reduction in bank funding if the banking sector as a whole comes under pressure or is subjected to tighter regulatory constraints.

More cost-effective funding can be achieved...

In practical terms, what is outlined by PCFG is:

1. A shift in the balance of funding with a mooted 75% from retail deposits, bank wholesale facilities providing the other 25%. Current thinking is to attract 3-5 year deposits with a typical c.£40,000 average balance and 100-day notice period.
2. A weighted average cost of funds lower by 200 bps to c.4%, all other things remaining equal. That qualification is needed post the referendum vote as expectations relating to the path of interest rates, both from the demand and supply sides, have become more uncertain.

Penetration of prime markets will lower portfolio yield...

On the yield side, PCFG will be targeting lower risk markets which are currently unavailable to it due to its existing funding model. The Finance Leasing Association (FLA) indicated that in 2015 its members provided £110bn of finance, £81bn to consumers and £29bn to business. A large proportion of this substantial market is unavailable to PCFG as its credit facilities are too expensive for prime borrowers; consumers and businesses in these prime markets would not be willing to pay the higher interest rates that PCFG would need to charge. Currently, for loans across both divisions, PCFG charges an average interest rate of 12% (APR), but the effective yield is lower after taking account of loan loss provisions.

...and net interest margin may remain constant assuming no Brexit effects

Penetration of more prime markets on a substantial scale will result in the average yield declining. KPMG reported in its survey of smaller challenger banks that gross yields had edged down 10 bps to 5.7% in 2015. For PCFG, a reduction in yield post bank from the current level may be broadly of the same magnitude as the expected reduction in funding costs, leaving the net interest margin (NIM) broadly unchanged. Post the Referendum vote, there is the possibility of lower interest rates across the board to head off a now anticipated economic downturn. If so, this would lead to some squeeze on net interest margins for the banks. For PCFG, the NIM is less important than a change in scale as the Company attracts more business, allowing the favourable effects of operational gearing to kick in.

New platforms for growth with a bank licence...

Beyond a three year time horizon during which PCFG as a bank will have increased its market presence, the longer term objective is to grow the loan portfolio to a significant multiple of its current scale. The Company sets out its strategy clearly as follows:

i. Continue the focus on existing sectors of the asset/vehicle consumer and SME prime and near-prime markets.

ii. Move into new prime and super-prime sectors of the asset/vehicle finance markets.

iii. Diversify into new areas of asset finance, new asset classes and forms of finance such as factoring, stock finance, secured loans and even commercial mortgages.

...but PCFG is not a challenger

In the latter context, extending the range of profitable activities may entail PCFG acquiring complementary bolt-on businesses and recruiting specialist personnel. This said, PCFG has also indicated that while expansion in its range of activities is anticipated, it does not see itself becoming one of the new breed of so-called challenger banks. It will not primarily offer products and services now offered by the High Street banks and it does not see them as its real competition. In fact, it is because SMEs and consumers have turned to other specialist loan providers that the term challenger is something of a misnomer.

Scale is the key to increased profitability...

An increase in the portfolio to c.£750m (which may require acquisitions to achieve) would still represent only 0.7% of the FLA's 2015 lending total. PCFG further considers that a return on assets of 3.5% and an after tax ROE of 17.5% could be achievable on that scale of business, always assuming a continuation of current benign conditions and no adverse changes in the regulatory environment. The latter ROE figure is broadly in line with the average 17% achieved in 2015 by KPMG's smaller challenger banks. PCFG has already commented that its profitability targets are more geared to the amount of business it can attract and not on interest rates and margins.

...and a lower cost base, assuming other things remain equal

KPMG's smaller challengers include among others Aldermore, Close Brothers, Metro Bank, OneSavings Bank and Secure Trust Bank, but they are far from being a homogeneous group. While there are some commonalities, the point about their superior performance on average is that all are generally focused on niche lending. PCFG will be similar. Apart from their narrower focus, the other key factor in the superior performance of these smaller lenders is cost. The latest KPMG figure given for the smaller challengers in 2015 showed a further reduction in the average cost to income (CTI) ratio to below 49% with asset growth outstripping the cost base being the key. PCFG stands favourably on this metric with, on the house brokers' estimates for F18, a CTI of 34.4% (Panmure) and 46.8% (Stockdale). Income is taken as gross profit in this ratio.

BROKER ESTIMATES

Forecasts assume no changes in PCFG's own model, nor in the external environment...

Both Stockdale Securities and Panmure Gordon raised their estimates for PCFG on the strength of these results. Importantly, both sets of estimates are derived from PCFG's business model and transition to bank status. This status is assumed not to lead to changes in PCFG's business plans or direction within the three year forecast time horizon. Importantly, the new status gives access to retail deposits and the means to expand its loan book. There are no references to external factors such as the growth in competition, bank capital regulatory requirements yet to be set or any other significant factor.

...and anticipate F18 being the first year of real advance...

For both brokers, growth accelerates in F18, although the impact of bank costs will affect reported results in the earlier periods. The caveat, of course, is that the business climate becomes less favourable post Brexit, and reduced estimates of growth would then be warranted. Any such adjustments might be marginal. For the present we can only report on the brokers' current estimates based on status quo assumptions about the business environment.

Good underlying growth trajectory...	For Stockdale, bank costs are deducted of £387,000 in F16, £1.0m in F17 and £1.3m in F18. On an adjusted basis (for comparability with Panmure's numbers) Stockdale's pre- tax profit estimates are F16: £3.6m, F17 £3.7m and F18 £6.0m.
but regulatory capital retirements will dilute ROE	The projected loans portfolio is estimated to grow to nearly £200m by the end of F18 of which 80% is still financed by bank debt. On the adjusted PBT estimate of £6.0m for F18, the ROAA emerges at 3.5% and the post-tax ROE (on year end equity) 10.7%. As previously noted, the latter figure is affected by the £10m capital-raising anticipated by both brokers in early 2017s. What cannot be anticipated are any other regulatory capital requirements not yet determined.
Similar estimates for both PBT and returns	Panmure Gordon's pre-tax profit figures are presented before deducting bank costs and the adjusted PBT estimates are as follows: F16 £3.8m, F17 £4.5m and F18 £7.3m. After deducting the bank costs to arrive at reported F18 pre-tax profit of £6.0m, the ROAA emerges at 3.3% on average assets of £180m and the post tax ROAE (average equity) is 11.8%. Recalculating to a pre-exceptional bank cost basis for comparability with Stockdale, the ROAA is 4.0% and ROAE 14.3%. Bank borrowings are £167m which fund approximately 80% of a £210m year end loans portfolio.
Brokers' share price targets are pre-Brexit so have been adjusted...	Share price targets set prior to the Referendum now look too optimistic in the light of the declines experienced by the banking sector since the leave vote. In place of its previously earnings-based multiple, Stockdale uses market capitalisation as a percentage of the F16 year end receivables total (£120m) to set a revised share price target of 42p. This is raised from 30p set on the old earnings basis. Stockdale considers that the new approach better reflects PCFG's post-bank growth opportunity, albeit that might now be optimistic. Taking the 14% average downward price adjustment across PCF's peer group (eight companies selected) and applying it to the Stockdale number gives an adjusted 36p.
...but still provide a substantial premium to the current price	For Panmure Gordon, the share price target is 38p. This is based on 2.5x fully diluted book value of 15p as estimated for September 2016. The 2.5 times multiple incorporated a 20% premium to PCFG's peer group in recognition both of its long term track record and post-bank growth opportunity. If the same 14% average adjustment is applied as in the Stockdale case, this makes the target price 33p. In fact, for PCFG, the share price movement was larger at 20% for no obvious reasons, which may mean a potentially greater uplift when markets stabilise.

COMPANY UPDATE

5 JULY 2016

SUMMARY AND CONCLUSIONS

Solid platform for growth with or without bank status...

PCFG has built an effective business model well adjusted for further progress whether or not banking status is achieved. The investment case is not predicated purely on the on the latter. The key points are:

...based on a sound model...

- **Business model**: Simple and effective with scalability providing substantial operational gearing benefits and good future earnings visibility. Latest results demonstrate this with profitability metrics well ahead of targets. This provides a cushion for the temporary downswing expected in the regulatory mobilisation phase.

...and retaining an asset finance-house base...

- **Bank prospects**: PCFG expects a result by year end given the six month statutory requirement for the PRA/FCA to reach a decision from the date an application is made. A favourable result will not lead to PCFG offering a full range of bank activities. It will remain essentially a finance house offering a wider range of business solutions. It will be able to expand into new asset finance markets.

Growth should accelerate...

- **Portfolio growth**: With access to retail deposits, PCFG should achieve a faster growth of its loans portfolio (last year 12%) with penetration of prime and super–prime market segments.

...with performance scale, not interest rate driven

- **Performance**: PCFG's has outperformed its own target returns both pre-tax on average assets and also post-tax on equity, albeit from a low base. The impact of bank costs and regulatory capital increase creates a temporary dip.
- **Operational gearing**: This should continue the enhancement process, even with a flat net interest margin, and the cost income ratio is likely to remain at the lower end of the market spectrum.

Peer group challengers perform better on simplified, low cost models

- **Peer group**: Latest survey evidence from KPMG covering the banking sector in 2015 and including the so-called 'challenger' banks is encouraging. The superior performance metrics of new bank entrants compared to their larger peers is ascribed to factors that that are highly relevant to PCFG, basically simpler product offerings, targeted lending and a much lower cost base.

Recession risks have increased but the time scale is unclear...

- **Caveats**: The uncertainty element has now increased after the referendum vote. The risks of recession for the banks and finance houses are for slower business growth, reduced interest rates and increased customer defaults. The pessimism may be overdone and the time scale is unclear. On the positive side, PCFG is well structured to cope with a weaker climate and should enjoy potential synergies with its major shareholder, BCB.

...and regulatory burdens may get tighter as markets weaken

- **Regulatory issues**: In addition to the above, capital requirements and other safety measures, as determined by the PRA and FCA, may increase. Banks must contribute a levy to the Financial Services Compensation Scheme (FSCS), although only when reaching a certain level of profit.

COMPANY UPDATE

5 JULY 2016

BOARD OF DIRECTORS

CHAIRMAN

David Anthony (appointed July 2011)

David is a Chartered Accountant and was previously Chief Executive of Hitachi Capital (UK) PLC and Chairman of Hitachi Capital Vehicle Solutions. In these roles he built Hitachi Capital (UK) PLC into one of the UK's leading finance groups with assets of over £1.5 billion and the largest overseas operation of the Japanese parent company. He was also a NED of Secure Trust Bank in 2007-10.

NON-EXECUTIVE DIRECTOR

Anthony Nelson (appointed NED October 2008)

Tony is one of the founding directors of PCFG and a member of The Association of Corporate Treasurers. After qualifying as a solicitor, he held senior management positions with various multi-nationals, including Chief Executive of McDonnell Douglas Bank Limited from 1981 to 1993 and Chief Executive of PCFG from 1994 to 2008.

NON-EXECUTIVE DIRECTOR

David Morgan (appointed July 2012)

David has over thirty-five years' experience in international banking, starting his career at Standard Chartered Bank in Europe and the Far East and becoming Chief Executive for the UK and Europe in 1998. He left Standard Chartered in 2003 and has been involved in various business advisory and non-executive roles. David is currently a NED of Somers Limited, Bermuda Commercial Bank Limited, Waverton Investment Management Limited and Ascot Lloyd Financial Services Limited.

NON-EXECUTIVE DIRECTOR

Mark Brown (appointed December 2015)

Mark has been Chairman of Westhouse Securities since November 2014. He was previously Chief Executive of Collins Stewart Hawkpoint. He was Global Head of Research for ABN AMRO and HSBC and Chief Executive of ABN's UK equities business. Mark led the turnaround of Arbuthnot Securities followed by Collins Stewart Hawkpoint.

NON-EXECUTIVE DIRECTOR

Andrew Brook (appointed December 2015)

Andrew is a chartered accountant with over 25 years financial services experience as a NED and previously a partner with PwC Bermuda. He is an independent NED of the company's parent Bermuda Commercial Bank and also sits on the board of a private equity Africa-focused advisory business, chairing its Investment Committee as an independent NED.

CHIEF EXECUTIVE OFFICER

Scott Maybury (appointed CEO October 2008)

Scott holds a degree in business studies and is a qualified accountant. He spent six years with BHP-Billiton, Australia's largest multi-national corporation, and five years with McDonnell Douglas Bank. He is one of the founding directors of PCFG and was previously Finance Director until October 2008.

MANAGING DIRECTOR

Robert Murray (appointed MD July 2012)

Robert holds the ACIB Banking Diploma and has over thirty-five years banking and finance experience. He heads both the Business and Consumer Finance Divisions and has extensive experience in lending to personal, corporate and international customers. He is one of the founding directors of PCFG.

FINANCE DIRECTOR

David Bull (appointed FD August 2015)

David is a chartered accountant and previously worked in the banking sector with appointments at KPMG, Deutsche Bank and the Bank of England where he was interim Chief Financial Accountant. Recently David worked as Director of Finance and Company Secretary at Hampshire Trust Bank, setting up the banking operations of that new bank. David joined PCFG in August 2015.

CITY INSIGHTS

PRIVATE & COMMERCIAL FINANCE GROUP

www.pcfg.co.uk

COMPANY UPDATE

5 JULY 2016

ADDRESS

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	105-108 Old Broad Street
	London
	EC2N 1ER
Telephone	020 7222 2426

LEADING SHAREHOLDERS

As at 9 June 2016	**%**
Bermuda Commercial Bank	72.0

INCOME STATEMENT			
12 months ended 31 March (£'000s)	2014	2015	2016
Consumer Finance	22,935	24,270	26,939
Business Finance	19,721	21,023	24,323
Revenue	**42,656**	**45,293**	**51,562**
Cost of sales	(30,098)	(31,846)	(36,123)
Gross profit	**12,558**	**13,447**	**15,139**
Loan loss provisioning charge	(2,024)	(1,546)	(1,210)
Deprec. and amort. of other intangibles	(359)	(349)	(358)
Other administration expenses	(4,552)	(4,791)	(5,307)
Profit from operations	**5,623**	**6,761**	**8,264**
Net finance costs	(4,378)	(4,662)	(4,972)
Profit before tax	**1,245**	**2,099**	**3,292**
Tax	(513)	(485)	(659)
Profit after tax	**732**	**1,614**	**2,633**
Basic EPS (p)	1.4	3.0	2.5
Diluted EPS (p)	0.8	1.3	1.8

BALANCE SHEET	2014	2015	2016
Goodwill and intangibles	1,043	911	811
Property, plant and equipment	84	105	108
Loans and receivables	53,134	63,680	73,529
Deferred tax assets and other	1,977	1,694	1,326
Non-current assets	**56,238**	**66,390**	**75,774**
Loans and receivables	35,521	36,149	38,741
Corporation tax	136	-	-
Trade and other receivables	930	1,134	171
Cash and cash equivalents	283	139	84
Current assets	**36,870**	**37,422**	**38,996**
TOTAL ASSETS	**93,108**	**103,812**	**114,770**
Interest-bearing debt and derivative fin. instruments	72,784	78,677	18,442
Non-current liabilities	**72,784**	**78,677**	**18,442**
Interest-bearing debt & derivative fin. instruments	8,281	10,755	71,255
Trade and other payables	1,302	1,643	1,475
Bank overdrafts	329	703	675
Corporation tax	-	176	-
Current liabilities	**9,912**	**13,277**	**73,405**
TOTAL LIABILITIES	**82,696**	**91,954**	**91,847**
NET ASSETS = TOTAL EQUITY	**10,412**	**11,858**	**22,923**

CASH FLOW	2014	2015	2016
Profit before taxation	**1,245**	**2,099**	3,292
(Incr.)/decr. in loans and receivables	(8,628)	(11,174)	(12,441)
Deprec. and amortisation of intangible assets	359	349	358
Net increase/decrease in payables less receivables	21	128	803
Other including loss/(profit) on asset disposals	32	(4)	16
Cash flows from operating activities	**(6,971)**	**(8,602)**	**(7,972)**
Tax paid	(55)	35	(422)
Net cash flows from operating activities	**(7,026)**	**(8,567)**	**(8,394)**
Purchases less sales of fixed assets	(8)	(50)	(38)
Purchase of other intangible assets	(172)	(52)	(87)
Net cash flows used in investing activities	**(180)**	**(102)**	**(125)**
Issue of own convertible debt	-	50	-
Borrowings less repayments & other adjustments	6,931	8,101	8,492
Net cash flows used in financing activities	**6,931**	**8,151**	**8,492**
Cash and equivalents at beginning of period	229	(46)	(564)
Net (decrease)/increase in cash and cash equivalents	(275)	(518)	(27)
Cash and cash equivalents at end of period	**(46)**	**(564)**	**(591)**

CONTACTS

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