



Orchard Bond Finance plc

Ticker: ORCHLN

Isin	Issue Size	Rating M / S&P	Coupon	Min Piece	Maturity	Details	Offer	Govt Spread
GB00BMBV8F68	£10mn	n/a	6.25% s/a	£2k	June 2027	£100 increments; long first coupon to Dec	100	+488

Orchard Bond Finance plc is a funding entity established for Orchard Funding Group plc (OFG), which provides loans for insurance premiums, professional fees, and other service fees. Bond proceeds will be used to fund both (or either) the existing business and strategic expansion, and we expect the bond will be listed on the LSE's order book for fixed income securities (OFIS; ORB). The group has two decades of profitable operations, strong and consistent interest income margins, a sensible approach to growth, and opportunities to conservatively lever its longstanding relationships and proprietary software into new areas. The coupon is attractive given the reliable income generated by OFG's longstanding repeat lending businesses.

Bond

- **Senior secured.** Security includes a **first lien charge** over floating assets of the issuer, which can include any combination of newly originated loans, loans to other group companies for existing and new markets lending, and loan portfolios purchased from group operating companies.
- There is also a **partial senior unsecured guarantee** from group parent OFG that will cover any shortfall in coupon or principal up to a total maximum claim of 10% of the bond, i.e. £1mn. The guarantee is structurally subordinated to third party loans provided directly to operating companies.
- **Covenants** include a consolidated interest cover covenant of at least 1.5x and timely financial reporting of half yearly and annual accounts. The issuer is providing a negative pledge on the granting further security ahead of bondholders. Dividends and other distributions will be stopped in any event of default or potential default.
- Events of default include non-payment of interest or principal (14 days grace period); breach of other obligations (30d); enforcement proceedings (30d); insolvency (£50k minimum demand); change of control; lack of authorisation & consents (includes necessary licences); security or guarantee not in full force & effect.
- Any member of the OFG group may repurchase the bonds on the open market or otherwise at any time, and may retain, resell or surrender them for cancellation. Early redemption is only possible in the event of tax changes.
- Governed by English law.

Business

Orchard Funding Group plc has been providing short term loans in the fee funding market for 20 years. It listed on the AIM market in 2015 (ticker: ORCH) and has a market capitalisation of £12.9mn. CEO Ravi Takhar retains 53.66% of the listed company directly. OFG has lent more than £680mn over 20 years, including £61mn in the year to July 2021. It is authorised and regulated by the FCA for consumer lending.

The UK general insurance market is estimated at c.£30bn, with around £10bn being fee finance. OFG estimates that market leaders Close Brothers and Premium Credit have around £5-6bn of that £10bn, leaving plenty of room for OFG as the third main player despite its relatively small size. A number of large insurance brokers also have finance companies.

The group started with insurance premium financing via Bexhill UK in 2002, which also provides loans for static caravan site fees. The group expanded into professional fee financing via Orchard Funding in 2010. Both spread these important professional expenses over 3-12 monthly payments (average 10 months). Orchard Finance does the same for gap insurance policies sold to Toyota vehicle buyers. Cherry Orchard Funding has been established for bridging property finance lending.

All business is sourced via partners: insurance brokers, accounting firms, Toyota, and static caravan park managers.

	Insurance Premium Finance	Professional Fee Finance	Site Fee Finance
Business Description	Lending to clients of insurance brokers for insurance premiums	Lending to clients of professional practices for fees	Lending to clients of park operators for annual static caravan fees
Key Trading Partners	Insurance Brokers	Professional Firms	Park Operators
No of Trading Partners	Circa 100	Circa 400	Circa 10
No of Borrower Agreements	Circa 35,000	Circa 1,500	Circa 2,000
Average Advance Length	10 months	10 months	10 months
Average Advance Size	£619	£3,366	£2,307
Advances/Revenue of Market Leader	£3.5bn/£120m	£300m/NA	NA
Recourse to provider	Full guarantee	Full guarantee	Full guarantee

There are four distinct routes to the consumers at the end of the loans:

- **Premium finance company funding** (45% of current loan book) – OFG operating company lends to an insurance broker premium finance company, which lends funds on to the end customer and provides a guarantee to OFG.
- **Direct financing** (37%) – OFG operating company lends directly to the end customer, but still has a guarantee from the referring business (insurance broker, accounting firm, park operator, service provider).
- **Static caravan HP lending** – OFG operating company pays the park operator for the caravan and receives a guarantee in return. The end customer pays the OFG operating company.
- **Secured property finance** – OFG operating company lends directly to the end customer and takes first lien security over the residential property.

For all of these scenarios¹, OFG's proprietary Lend XP software is used to originate and administer the loan, including reminders for the premium/service fee when approaching renewal time. It includes all the necessary credit checks and affordability assessments with external reference agencies as required by FCA regulations. In addition, OFG has its own Open Banking platform, trustloop, which enables permissioned visibility to customer bank accounts and is used for underwriting all HP business. Lend XP and trustloop give OFG and its partners excellent insights during the assessment and ongoing administration of its loans.

Defaults are consistently low, at <1% of the loan book outstanding. Accounting firms and insurance brokers rarely fail. If end customers miss a payment, OFG tries again. If a second payment fails, OFG alerts the relevant referring partner, who then takes action, which includes cancelling the insurance policy/service if necessary. The guarantees from partners provide very strong incentive for arrears to be satisfactorily resolved and the risk to OFG therefore remains low. In FY 2021 almost 99% of customer receivables were subject to recourse to the introducing partner. OFG will be sticking to its conservative approach, which limits any one finance company loan to £1mn. The limit is £500k for a limited company/partnership/consumer and also applies to any property bridging finance loans written.

Premium finance company lending is already a key part of the book, but with the FCA's regulatory move away from commission-based broking income, there is additional scope to grow this area by assisting brokers in establishing their own finance companies, for which OFG provides the Lend XP software to manage the onlending process.

¹ Additionally, other small streams of business are originated the same way: pitch fees are around 7% of OFG's loan book. Other fees include professional fees (7%), leisure (2%), and school (1%). Working capital loans are around 1%.

OFG saw revenue growth from £3.4mn in FY 2015 to £5.48mn in FY 2019, before the impact of Covid-19 saw a drop in demand for its lending products. It has remained profitable throughout the pandemic, however, with net interest income in the past two financial years of £3.9mn and £3.2mn respectively. Additional income is earned on software, collection, and other fees. The crucial net interest income margin is over 85%, reflecting the group's total external funding costs of c.6.0% versus the weighted average rates of 11-12% charged to borrowers.

The balance sheet is dominated by loan receivables that were already starting to rise again in FY 2021. We expect this to continue building back to the £32.1mn 2019 peak and beyond. Cash has been stable over £2mn for the past two years. Lending operations are conservatively funded with a mix of almost £16mn in equity and £12.3mn outstanding debt. Adding the £10mn new bond issue will increase flexibility and provides certainty around medium-term funding to underpin sensible growth without the at-call nature and annual reviews of third party funding. It will bring debt to equity up from 78% to something like 140%, but given OFG's track record of adding c.£1m of equity annually after dividends under pre-covid conditions, and conservative expansion of the business, we think gearing can reduce back to c.100% within term of the bond.

Cash flow clearly follows the ebbs and flows of lending, particularly as the loan book shrank in FY 2020 and grew again in FY 2021. Net cash outflows arising from growth, along with £614k p.a. of dividends, have been well covered by cash and equivalents on hand. Modest growth leads to modest cash outflows, and as the pandemic demonstrated, in times of lower demand a good quality book self-liquidates profitably.

Summary Group Consolidated Financials table: FY2016 - FY2021

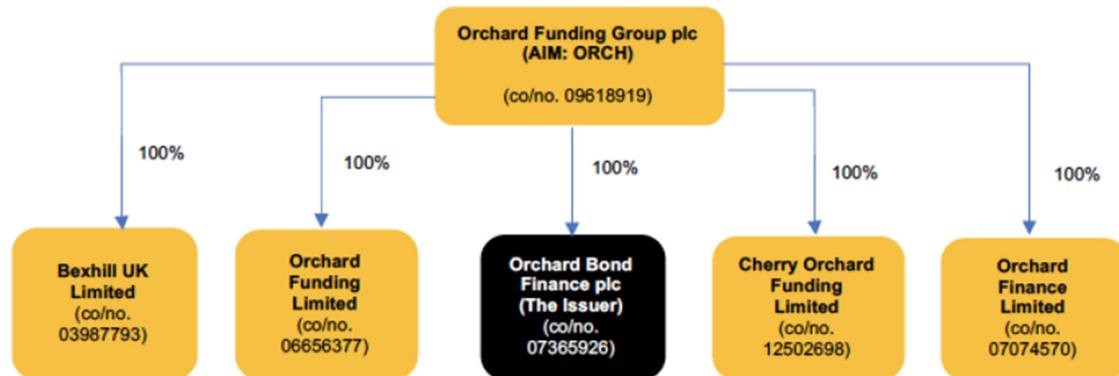
Key Performance Indicators (in £millions unless otherwise stated)	Full Year 2021	Full Year 2020	Full Year 2019	Full Year 2018	Full Year 2017	Full Year 2016
Lending volume	£61.02	£65.53	£72.99	£68.73	£63.35	£48.56
Average interest earning assets*	£28.59	£29.72	£31.54	£29.68	£25.11	£19.79
Total revenue	£4.60	£5.28	£5.48	£5.17	£4.55	£3.46
Average External Funding	£9.28	£12.82	£14.35	£13.16	£11.49	£8.11
Costs of external funds	£0.56	£0.62	£0.70	£0.63	£0.49	£0.43
Cost of funds/funds ratio	6.03%	4.84%	4.88%	4.79%	4.26%	5.30%
Operating costs	£2.52	£2.44	£2.20	£1.92	£2.01	£1.54
Return on average equity	5.35%	8.31%	11.24%	11.10%	10.51%	8.34%
Own resources (net current financial assets)	£14.15	£15.50	£14.82	£13.94	£13.03	£12.21

Funding

Existing facilities for the group total £27.5mn and are provided directly to operating companies. All are effectively at call and renegotiated annually and are secured by the respective operating company's assets. Total cost of funds has ranged between 4.30% and 6.03% of average funds outstanding over the past five years. That includes all interest and other charges, e.g. non-utilisation fees, etc. Cost of external funds has tended run at about 78% of total finance expenses.

- Bexhill – Toyota Financial Services – £15mn.
- Orchard Finance – Toyota Financial Services - £7.5mn.
- Orchard Funding – Natwest – £5mn.

The new bond will diversify funding sources, provide longer term funding to underpin the group, and better match the longer tenor financing needs of property bridging loans and static caravan HP agreements. This makes sense strategically and financially. The bond's Consolidated Interest Cover Ratio will be calculated using consolidated EBITDA versus the cost of external funds. We will need to see EBIT of around £1.6mn p.a. going forward to meet that covenant, which based on historic performance looks within the group's ability to produce as demand recovers and adds new products.



View

OFG has operated successfully for 20 years, including through the pandemic, and has the retained equity to show for it. The group has strong, longstanding relationship with reliable referring partners and a solid core of underlying repeat business by nature of its professional fees lending. The quality of the book is evidenced by low arrears and defaults and supported by introducing partner guarantees, as well as first lien charges where appropriate. The embedded nature of its software and open banking platform further strengthen partner relationships, portfolio management and compliance. Management has a sensible approach to underwriting and expansion, and ownership interests are well aligned with investing bondholders.

Half year results to December 2021 are expected in March.

Books are open until 12 noon on Wednesday 23rd February, although they may close early. Please contact the desk if you have any questions.

Penelope Fitzherbert

11 February 2022

Further information:

Orchard Funding Group: <https://www.orchardfundinggroupplc.com>

A six minute video introducing OFG is available on the homepage.

Open Banking: [trustloop - Instant Open Banking Solutions](#)

Toyota gap insurance: [TOYOTA GAP INSURANCE - GAP INSURANCE TODAY](#)

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