Escher Marwick PLC, Just Cash Flow PLC – Secured Fixed Rate Notes

INTRODUCTION

ARC Ratings, S.A. (ARC) has affirmed the final, long-term public ratings of 'A(sf)' to the Series 2016-7 Secured Notes and the Series 2016-8 Secured Notes issued by Escher Marwick PLC, both with stable outlook.

Just Cash Flow PLC (the 'Borrower') has drawn from the Series 2016-7 and 2016-8 Secured Fixed Rate Notes. The Series 2016-7 Notes are due 21 October 2019 with a 7.25% fixed rate coupon, whilst the Series 2016-8 notes are due 21 October 2021 with an 8.5% fixed rate coupon, both paid semi-annually (together are the "Secured Notes").

The proceeds of the Note subscriptions have been loaned to Just Cash Flow ('JCF') by Escher Marwick PLC (the 'Lender' and the 'Issuer') pursuant to a Facility Agreement dated 27 January 2017. JCF will use the proceeds to provide Revolving Credit Facilities ('RCFs') to Small and Medium-Sized Enterprises ('SMEs') as an alternative to traditional bank funding.

RATING HIGHLIGHTS

KEY RATING DRIVERS

- ARC applied conservative stresses to the Collateral Yield, Monthly Payment Rate and the Principal Charge Offs to find that the Credit Enhancement provision within this portfolio was sufficient to support an 'A(sf)' rating scenario according to ARC's bespoke model.
- ARC drew comfort from the asset coverage available to the transaction, given the Total Collateral balance is greater than the Total Facility Balance. ARC also analysed the asset coverage ratios of the RCFs in the portfolio by assuming a worst-case scenario of the Net Asset Value ('NAV') of the collateral (which secures the RCFs) based on JCF's Credit Policy.
- ARC draws comfort from JCF's Credit Policy as it focuses on underwriting processes that depend on the equity provided by the SME and any prior credit or debt which the SME may hold (part of JCF's NAV to Loan ratio calculation).

SUMMARY OF RATING METHODOLOGIES

ARC has applied the ARC Ratings' Global Structured Finance Rating Criteria (updated September 2019). This methodology is available from www.arcratings.com.

RATING

Security Class	Issue Rating	Outlook
Series 2016-7 Secured Notes	A(sf)	Stable
Series 2016-8 Secured Notes	A(sf)	Stable

ISSUER AND LENDER
Escher Marwick PLC

BORROWER AND SELLER
Just Cash Flow PLC

SECURITY TRUSTEE
GRM Law Trustees

REGISTRAR
Avenir Registrars Limited

RATING DATE
11 October 2019

INITIAL RATING
22 December 2016

LAST REVIEW
11 October 2018

NEXT REVIEW DATE
12 October 2020

METHODOLOGY APPLIED
ARC Ratings' Global Structured Finance Rating Criteria available at www.arcratings.com

ARC CONTACT DETAILS
Mark Vrdoljak
Lead Analyst
mark.vrdoljak@arcratings.com
Ayub Khan
Back-up Analyst
ayub.khan@arcratings.com
Emma-Jane Fulcher
Chief Ratings Officer & Panel Chairperson
emma.fulcher@arcratings.com

11 Hollingworth Court
Turkey Mill, Ashford Road
Maidstone, Kent ME14 5PP
Tel: +44 (0)1622 397350
Website: www.arcratings.com

COMPANY OVERVIEW

JCF provides RCFs to UK SME businesses that struggle to obtain traditional bank funding. This may be because the company is in its infancy or due to its business strategy. Consequently, given the higher risk, JCF can achieve a higher rate of return, c. 20%. The RCFs range from GBP 10,000 to GBP 500,000, with the average RCF being around GBP 50,000. Customers have the flexibility to draw down only on the amount required and repay at a non-fixed date; this enables JCF's return on interest to be lower than the Annual Percentage Rate ('APR') figures, which is a regulatory requirement to be classed as a responsible lender.

TRANSACTION OVERVIEW

Transaction Overview

- Escher Marwick PLC has a GBP 500,000,000 Secured Medium Term Note Programme. Under the Programme, Escher Marwick PLC has issued Series 2016-7 and Series 2016-8 Secured Notes, both with a maximum subscription amount of GBP 25,000,000.
- The issue date of the Series 2016-7 Notes was 21 October 2016. The Series 2016-7 Notes are due 14 November 2019, and have a 7.25% fixed interest rate, paid semi-annually on 21 October and 21 April. The issue date of the Series 2016-8 Notes was 21 October 2017. The Series 2016-8 Notes are due 14 November 2021, and have an 8.5% fixed interest rate, paid semi-annually on 21 October and 21 April.
- The Notes rank pari-passu amongst each other and have been listed for trading on the Channel Islands Securities Exchange.
- JCF will use the loan to provide RCFs to SMEs as an alternative to traditional bank funding.
- Escher Marwick will from time to time issue securities and shall, at least 2 business days prior to any such issue notify JCF of the notional amount of securities to be issued and any accrued interest payment to be received by the Lender in relation to the series subscription amount. Upon receipt of a series drawdown notice, the borrower shall be deemed to have given the Lender notice of a request to draw, on the series issue date, a facility loan in an amount equal to the aggregate of the series subscription amount and accrued interest amount specified in that series drawdown notice.
- If the Borrower fails to make any payment due under the agreement on the due date for payment, interest on the unpaid amount shall accrue daily at 2% above the rate specified.

PERFORMANCE ANALYSIS

Underwriting Process

JCF has developed an in-house credit vetting and scoring system called PropensityPlus, which declines around 85% of RCF applications within 6 minutes. Successful applications are then forwarded to experienced underwriters; JCF believes human interaction is key to ensuring minimum defaults. On average, 8-10% of applications are granted, which indicates a conservative lending approach.

JCF lends to SMEs which are often in the infancy of business and thus their future cashflows are uncertain. Therefore, the PropensityPlus system utilises rules-based lending, which continuously monitors the Borrowers and Directors of the companies to assess any change in their credit profile from the onset of each application.

JCF's credit policy ensures a maximum concentration across one industry of 30%. Furthermore, JCF will only lend to specific use classes, such as general working capital, asset or stock purchases, new staff, funding new contracts or customers and supporting inherent seasonality. JCF's credit policy is reviewed every 6 months.

ONSITE REVIEW

ARC conducted an onsite review in Glasgow with the senior management of JCF on 25 April 2019. The review covered changes in staffing, technology, administration processes, management structure and internal systems and procedures.

ARC discussed JCF's BRAG (Black/Red/Amber/Green) system, whereby 'black' represents an adverse credit event (a CCJ, insolvency or loan arrears) occurring within the previous 3 months, 'red' represents personal credit profile issues, 'amber' represents new personal credit taken out such as a credit card and 'green' represents a new mortgage taken out by the customer. In the case of an 'amber' event occurring, JCF will further examine what the purpose for the additional credit line is and in the case of a 'green' event occurring, JCF will check whether the customer's mortgage payments have increased or whether they have simply changed mortgage providers. JCF will then take the appropriate action.

Subsequent to the April onsite, ARC conducted an onsite review on 4 October 2019. In this onsite, JCF discussed implementations to keep their customer growth rate high. JCF discussed implementations such as a no cost advisory package for existing customers, bank cards for easier borrowing and foreign exchange services.

JCF also made note of their growth in workforce with a focus on ensuring members of the underwriting team have years of underwriting and lending experience. Since the last review, JCF have taken on board:

- Nick Riley (Chief Credit Officer): formerly Chief Credit Officer at Honeycomb (another fintech company but for personal loans).
- Rob Hulse (Chief Commercial Officer): formerly Head of Channel Development at White Oak (a Fintech company which also provides loans for SMEs).
- Stuart Hodgson (Chief Technical Officer): formerly Group IT Director at First Names Group (a provider of real estate and corporate services, founded 1975).

ARC is of the view that JCF is capable of managing the transaction and underlying assets sufficiently due to their current procedures of recruiting very experienced staff and training newer members to a standard which allows for improved underwriting of SME loans. JCF's plans for 2020 include incorporation of a behavioural learning system within their lending process which assure ARC that JCF aim to improve their quality of loan servicing and underwriting by means which streamline the process and increase their customer base.

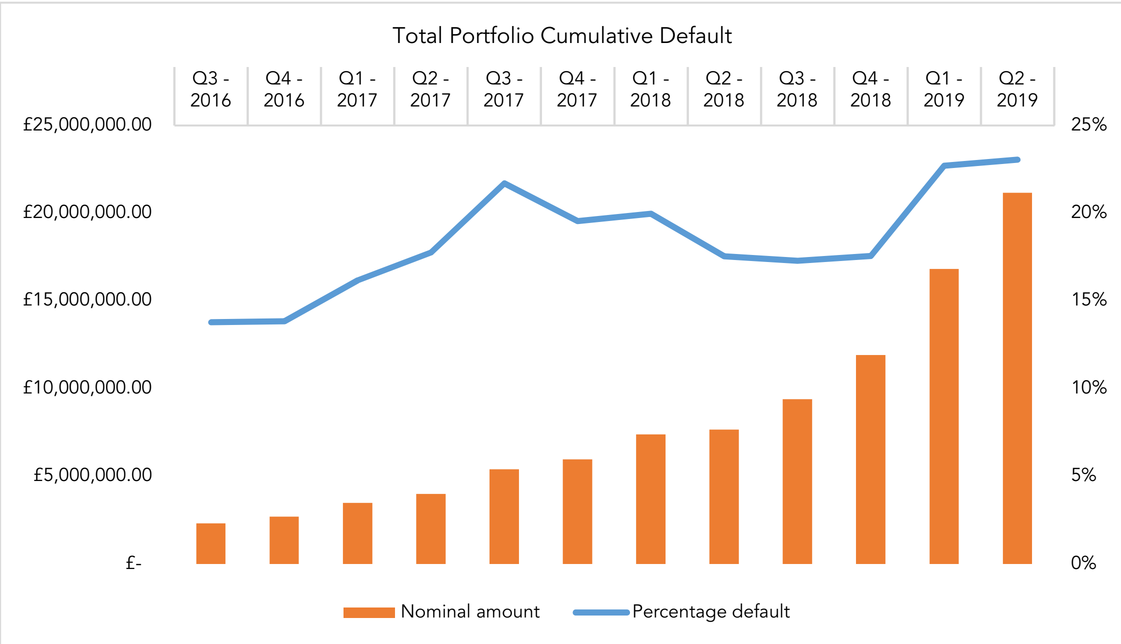
ASSET ANALYSIS

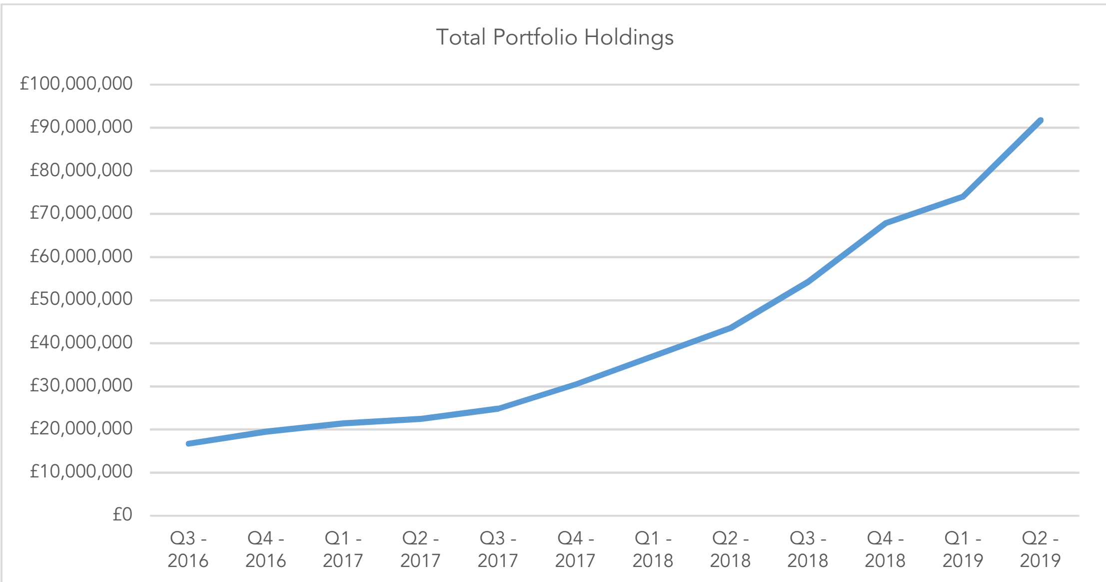
ARC received Note subscription amounts, drawdown notices of the Loan between the Lender and the Borrower and data on the underlying portfolio, as well as the overall JCF loan book. The Note subscription amounts to date are as follows:

Date	Nominal Amount for 2016-7 Notes	Nominal Amount for 2016-8 Notes
31/08/2019	20,149,287.00	32,851,374.00

ARC has calculated the over-collateralisation available to the transaction as 3.78% which is the RCF balance (GBP 55m) divided by the total amount drawn (GBP 53m) by the Borrower.

ARC has analysed historical default data of the overall JCF loan book from the period Q3 2016 to Q4 2018. The historical cumulative default rates of the overall JCF loan book are displayed in the graph below. Note that the percentage defaults represented below is the cumulative default amount against the nominal portfolio holdings. The decrease in percentages are due to the greater rate at which the portfolio has increased in comparison to the cumulative number of defaults.





JCF defines any payment which is not paid in 14 days as 'irregular activity'. If payment is still not made within 42 days from the first missed payment date, JCF considers this to be in default and the loan is sent to the risk department to find the best method for recovery of the amount in default. Default levels have fluctuated in the past 3 years with a total increase of 9.27%. This is fairly contained considering a growth of 210% only in the past year.

Historically, JCF have applied a 'New-for-Old' system where defaulted RCFs are removed from the portfolio, and as such do not secure the issued notes. However, JCF have no obligation to apply their New-for-Old system. Therefore, ARC has taken into consideration that at any time JCF may choose not to replace a defaulting loan which secures the Note and has included total charge offs and default rates in relation to the performance of this portfolio. ARC has also taken into consideration that since the last performance review, the default rate has increased in the wider loan book.

Currently, JCF shows an asset coverage ratio of 5.6x. However, ARC cannot distinguish exactly what proportion of the collateral JCF has claim over. As mentioned before, JCF considers the NAV to Loan ratio when originating RCFs which considers all equity and prior debt of the customer. In JCFs credit policy they measure the NAV based on what charge they have over the property. If JCF are the sole chargee, they will assume a 85% open market value, if a prior charge exists they will assume 85% of a restricted market value (and if two prior charges exist, they will prescribe a value of 65% to the restricted market value or 50% of the open market value. Therefore, ARC assumed a worst-case scenario haircut of 50% to the collateral value provided. Consequently, the asset coverage ratio calculated is 2.9x which, even after being stressed conservatively, is high.

Total Balance	Total Collateral
GBP 55.01m	GBP 307.83m

The top 5 largest RCFs represent around 26% of the entire portfolio and due to the size of the balance, JCF take special measures when underwriting large loans. As mentioned in the Lending Policy, any loan larger than GBP 50,000 are dealt with a loan by loan basis and to progress along JCF's underwriting process must show at least 3 forms of security. One example is a facility which is secured by a property valued at GBP 22m but JCF have charge over GBP 7m which covers the facility more than 3 times. JCF noted that any facility which is above GBP 50,000 must be secured in this fashion.

ARC analysed the underlying portfolio as a measure to analyse if it was still performing in line with an 'A(sf)' rating scenario.

Calculated Variable	Haircuts & Multiples for A Rating	Result (variable x haircut)
Collateral Yield	25% haircut	11.50%
Monthly Payment Rate	35% haircut	0.81%
Principal Charge Offs	2.75x	3.24%

The following haircuts were used (which was in consideration of the interest payments which needed to be met semi-annually) and along with an OC of 3.78%, the total Credit Enhancement is calculated by adding the Collateral Yield, Monthly Payment Rate and OC and taking away the Principal Charge Offs. This gave an overall Credit Enhancement of 12.48% for this transaction. This was more Credit Enhancement in comparison to last year's performance review, thus, not only showing that the underlying portfolio has maintained its performance but has also surpassed it. This also shows that the underlying assets are performing enough to cover all interest payments in a timely manner and still have a surplus.

RATING CONSIDERATIONS

Rating Meaning

The public rating affirms the accorded rating to the 'A(sf)' rated Secured Notes relate to the timely payment of interest and ultimate repayment of principal. The rating excludes an assessment of the ability of the Issuer to pay either any (early repayment) penalties or any default interest rate penalties.

The suffix code 'sf' means that the rating is of a structured finance nature. A rating outlook indicates the potential direction of a rating over the medium to long term, typically an 18 month to 2-year period.

ARC will perform regular surveillance on the transaction, and surveillance reports will be made available to subscribers to ARC's information services.

DATA RECEIVED FROM JUST CASH FLOW PLC

ARC received the following documentation from Just Cash Flow PLC:

- Drawdown notices for last 4 years
- Total subscription amounts
- Default and recovery data
- Current portfolio balance, collateral and monthly yield
- New-for-Old account data
- Details on RCFs which had defaulted

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ARC Ratings

11 Hollingworth Court

Turkey Mill, Ashford Road

Maidstone, Kent ME14 5PP

UNITED KINGDOM

Phone: +44 (0) 1622 397350

E-mail: arcratings@arcratings.com

Site: www.arcratings.com

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This Review Report should be read together with initial Rating Report and with the subsequent Review reports.

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