EQUITY REPORT

September 9, 2021

SOLUTION FINANCIAL INC.
(TSX: SFI)

BUSINESS DESCRIPTION

Solution Financial Inc. was founded in 2004 and is headquartered in Richmond, British Columbia, Canada. The company specializes in sourcing and leasing luxury and exotic vehicles, yachts, and other high-cost assets that traditionally hold their value over time. Its target customer base consists of affluent immigrants, international students, and business owners who have limited credit histories in Canada and, thus, difficulty securing financing. This high-quality clientele has resulted in virtually no bad-debt charges nor the need for vehicle repossession.

The company established its market presence in British Columbia, and has initiated efforts to expand into Alberta and Ontario over the past two years. Importantly, Solution Financial has maintained profitability since going public in mid-2018, spanning 10 quarters through the second quarter of fiscal 2021 (ended April 30, 2021). Of note, the profitability was achieved despite significant headwinds caused by the COVID-19 pandemic.

In our view, Solution Financial is still at an early stage of its growth cycle, and we believe that its successful buildout in servicing the British Columbia market should help establish a presence in new markets. We note that Ontario represents a larger opportunity than British Columbia and Alberta combined, accounting for nearly 50% of Canada's international student population and roughly 45% of new immigrants each year.

Solution Financial was able to maintain solid monthly leasing volumes in fiscal 2020 (October 31), despite a more-than-50% decline in the number of international students enrolling and returning amid travel restrictions related to COVID-19. Prior to the pandemic, the trend of increasing student permit holders in Canada had been highly favorable, increasing from 110,000 in 2000 to over 640,000 in 2019. Importantly, nearly 75% of this total is covered under the company's current commercial footprint. As such, we expect the lifting of restrictions and resumption of normalized conditions over time to provide an additional tailwind to the company's growth trajectory.

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PRICE CHART

KEY STATISTICS

Key Stock Statistics	
Recent price (9/3/21), CAD	0.45
52 week high/low (CAD)	0.60 - 0.32
Shares outstanding (M)	89.7
Market cap (M, CAD)	40
Dividend	0.004
Yield	0.9%

Sector Overview	
Sector	Financials
Sector % of S&P 500	11.2%

Financials ($M, CAD)	
Cash & Mkt Securities	2.1
Debt	10.9
Working Capital ($M)	-8.9
Current Ratio	0.3
Total Debt/Equity (%)	122.0%
Payout ratio	NM
Revenue (M) TTM	17.7
Net Income (M) TTM	0.6
Net Margin	3.0%

Risk	
Beta	0.31
Inst. ownership	0%

Valuation	
P/E forward EPS	NA
Price/Sales (TTM)	2.3
Price/Book (TTM)	3.2

Top Holders
NA
NA

Management	
CEO	Mr. Bryan Pang
CFO	Mr. Sean Hodgins
VP - Operations	Mr. Vincent Lau
Company website	https://www.solution.financial

We view immigration as another favorable opportunity for Solution. Immigration accounts for nearly 80% of Canada's population growth and the volume of immigrants is expected to expand by more than 400,000 annually from 2021 to 2023. The company estimates an addressable market of more than 430,000 new immigrants and international students annually in its three current markets, representing potential lease-value capital opportunities in excess of C$70 million. Across all of Canada, Solution projects a C$100 million annual lease-capital opportunity for its target market, with white glove service and a focus on luxury products.

Solution Financial is focused on building an in-house portfolio of limited edition and high-demand luxury vehicles for lease brokering. As of the end of calendar 2020, the company had a 60% net equity position in its vehicle portfolio, which is well above its public peers, which tend to be more focused on traditional subprime automobiles. As of April 30, 2021, it had 293 vehicles in its portfolio, a net decrease of eight vehicles. More than 67% of its inventory held a residual value greater than C$55,000 and 14% of the total held a residual value above C$150,000. Over recent quarters, the company made the strategic decision to support top-line sales by selling certain vehicles at a premium, this due to higher demand amid a shortage of new vehicles (caused by the limited availability of certain microprocessor components).

As of the second fiscal quarter of 2021, the total value of the lease portfolio was C$23.4 million, which is below the peak of nearly C$25 million in fiscal 2020. As conditions begin to normalize post-pandemic, we expect the portfolio to expand in number and in gross transaction value, and view Solution Financial as well positioned to return to pre-pandemic growth rates above 18%. This growth should be driven by expansion into new markets, led by Ontario.

Given the favorable expansion prospects for immigration and student populations in the company's target markets, Solution expects to expand its portfolio to more than C$100 million by the end of calendar 2023. It anticipates this threshold will serve as validation of its business model and attract attention among banking industry participants as a potential acquisition target.

COMPETITIVE ADVANTAGE

Solution Financial's business model is based on a proprietary online technology platform. It is designed to generate leasing quotes more quickly and efficiently for a network of partnered luxury/ultra-luxury automotive dealerships, as compared with traditional third-party lease-quoting platforms. That, in turn, is intended to drive business to Solution Financial. Under this model, the company does not take on significant marketing expense for customer acquisition.

The business model is unique because the company is built upon an expertise and passion for luxury vehicles, as opposed to the more-traditional banking foundation. Solution also has a significant understanding of the premium and limited brands that are in highest demand and that are multi-generation vehicles (which carry value long after traditional vehicles have depreciated beyond a lease life cycle). By knowing this after-market inventory, Solution Financial is able to get a premium value from the vehicles and maintain residual value over an extended period.

We view the above as a barrier to entry, as Solution Financial's ecosystem, which focuses on flexibility and has taken years to develop, is atypical for current leasing industry participants. Most traditional subprime automobile lenders primarily focus on the customer's credit history and the liquidation value at auction or scrap, which can result in significant reserves and credit losses. In addition, Solution has established relationships with luxury vehicle dealerships in its target markets, and those dealerships direct customers directly to Solution. That process cannot be easily or quickly replicated by competitors. Lastly, the company takes on customers that traditional banks and insurance companies may not (such as high-deductible insurance leasees).

Another key differentiator in Solution Financial's business model is its ability to provide customers with short-term flexibility in their leasing options. The company proactively reaches out to clients to allow for regular upgrades without assessing penalties for early termination, which is uncommon in traditional leasing arrangements. As of April 30, 2021, the average remaining lease term for the portfolio was 1.6 years, weighted by net book value for each vehicle, which is below industry averages. Solution Financial is able to provide such flexibility because it uses its expertise to focus on luxury brands that have high demand and can easily be re-leased.

Given its expertise in the luxury vehicle market, Solution Financial is able to maintain an extremely low inventory of unleased vehicles. Its average turnover time between leases is less than one month, with a new leasing agreement often in place before the current lease has expired. Further, customers are incentivized to maintain the vehicles in order to build customer equity. The equity can be used towards a future lease, building customer loyalty while maintaining a high-quality and reliable clientele.

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PEER COMPARISON

Company	Ticker	Recent Price ($)	52-Week High ($)	52-Week Low ($)	Mkt. Cap ($MIL)	1-yr Price Change (%)	1-yr Rev Growth (%)	1 YR EPS Growth (%)	P/E Ratio	Beta	Yield (%)
SOLUTION FINANCIAL INC.	**TSX: SFI**	**0.45***	**0.60***	**0.32***	**40***	**0**	**48**	**NM**	**NM**	**0.3**	**0.9**
AXIS AUTO FINANCE INC.	TSXV: AXIS	0.53*	0.57*	0.25*	52*	38	9	NM	NM	0.5	NA
ELEMENT FLEET MANAGEMENT CORP.	TSX: EFN	14.20*	15.28*	10.40*	6005*	36	-5	365	22	1.0	1.8
ACCORD FINANCIAL CORP.	TSX: ACD	8.51*	9.20*	5.11*	73*	48	-17	-94	9.6	2.2	2.4

** Statistics in Canadian Dollars (CAD)*

Solution Financial is also well positioned to maintain minimal levels of bad debt among its customers. All of its portfolio vehicles have GPS trackers installed so that a vehicle can be located and recovered, if needed. In addition, its customers typically have other assets, such as real estate, that support their ability to meet lease obligations; they are only lacking employment and earnings history in Canada. Solution also charges an above-industry-average deposit when a customer takes possession of a leased vehicle; this helps ensure the leased assets are appropriately secured. And finally, Solution protects itself financially by basing its leasing terms higher than the vehicle's expected depreciation and residual value, this to ensure a healthy rate of return. At the end of a vehicle's lease cycle history, Solution Financial is typically able to sell a vehicle for a gain that is typically about 7% over residual value.

Historically, leasing company comparables have been acquired at an average valuation of around four-times price-to-book multiple. While Solution Financial recently traded at a multiple close to three-times, we would expect Solution to warrant a significant premium upon pursuing an exit strategy, given its proprietary system that is focused on luxury vehicles, minimal bad debt exposure, and the high net equity position in its vehicle portfolio. Further, we think that any M&A would likely leave Solution Financial's management in place, given that team's vehicle-focused expertise, ability to execute on its business model, and instantly accretive contribution to an acquiring company's earnings.

ANALYST COMMENTARY: EARNINGS

For the quarter ended April 30, 2021, net revenues increased 103% to C$5.6 million, boosted by a favorable comparison over the prior-year period, during which the COVID-19 pandemic took hold. Adjusted net income for the former period was C$239,094, and the quarter represented the tenth consecutive profitable quarter, despite pandemic-related disruptions to vehicle sales and the in-person closures of universities (which contributed to a 4% decrease in the total lease and finance portfolio, to C$23.4 million year-over-year). Despite these challenges, the company maintained positive cash flow from operations of C$2.6 million for the six months ended April 30, 2021, compared with C$2.8 million for the prior-year period.

In a normalized operating environment, Solution Financial's business model has several inherently favorable characteristics that we expect will contribute to growth. First, the company leases vehicles at a higher financing rate than the expected depreciation in its portfolio. This supports an above-industry-average gross margin of 26%-35% and effective rate of return of approximately 14%. As well, the company has increased operating income at a higher rate than operating expenses, driving expanded operating margins. Since the first quarter of fiscal 2019 (January 31, 2019), operating income has increased roughly 80% (to C$1.88 million in the quarter ended April 30, 2021), while operating expenses have increased by only 35% over the same period (to C$676,000).

Further, the company's expansion into new markets in Alberta and Ontario should drive top-line growth in a low-overhead environment, with penetration among a small number of luxury dealerships requiring minimal marketing spend. Lastly, the company has shown tight controls over its share count. Since the first quarter of fiscal 2019, shares outstanding rose by a modest 14%, to 90.3 million shares from 78.9 million. That should provide earnings leverage, as the company resumes a normalized net-income growth trajectory.

Recently, the company has been distributing C$0.001 per share on a quarterly basis, which equates to an annual dividend yield of 1%, based on a recent stock price and market capitalization of C$0.43 and C$39 million, respectively.

MANAGEMENT

Mr. Bryan Pang founded Solution Financial in 2004 and has served as chief executive officer, president and a director since the company went public in June 2018. Mr. Pang has over 20 years of experience as an innovative financial service provider, particularly in the automotive industry, where he developed the unique leasing solution focused on immigrants and international students in Canada.

Solution Financial's board consists of seven directors, four of whom are independent, including Chairman Randy Smyth, who provides vehicle-leasing expertise to the company. Mr. Smyth is a successful entrepreneur with experience within the Financial Services sector. He has built several successful national leasing companies (both organically and through M&A activities) in Canada.

RECENT DEVELOPMENTS

To date in 2021, Solution Financial has raised approximately C$8.2 million from a series of non-brokered financings of unsecured convertible debentures and a short-form prospectus offering of common share units at C$0.40 (representing 1 common share and one common share warrant exercisable at C$0.50 for up to 12 months). The unsecured convertible debentures will mature in March 2023 and bear interest at an annual rate of 5%, paid semi-annually. With the proceeds, Solution is executing on its plan to expand its portfolio of in-house leases and enter new markets in Canada, primarily in Ontario. The company received its license to operate from Ontario's Vehicle Sales Regulator (OMVIC) during calendar 2021.

In addition, in September 2021, the company announced the successful graduation from the TSX Venture Exchange to the Toronto Stock Exchange, which we think will enhance the market liquidity for the stock and the company's access to capital over time.

Steve Silver

INCOME STATEMENT

Growth Analysis ($MIL, CAD)	2019	2020	Q1 2021	Q2 2021
Revenue	9.6	13.9	3.7	5.6
Gross Profit	3.0	3.4	1.0	1.2
G&A	2.1	1.9	0.6	0.7
R&D	0.0	0.0	0.0	0.0
Operating Income	0.7	1.5	0.3	0.4
Interest Expense	0.4	0.7	0.1	0.1
Pretax Income	0.3	0.8	0.2	0.4
Tax Rate (%)	45	49	45.0	29.0
Net income	0.2	0.4	0.1	0.2
Diluted Shares	80.5	81.1	83.7	89.7
EPS	0.00	0.01	0.00	0.00
Dividend	NM	NM	NA	NA
Growth Rates (%)				
Revenue	NA	45%	NA	NA
Operating Income	NA	114%	NA	NA
Net Income	NA	100%	NA	NA
EPS	NM	NM	NA	NA
Valuation Analysis				
Price ($): High	NA	NA	NA	NA
Price ($):Low	NA	NA	NA	NA
PE: High	NA	NA	NA	NA
PE: Low	NA	NA	NA	NA
PS: High	NA	NA	NA	NA
PS: Low	NA	NA	NA	NA
Yield: High	NA	NA	NA	NA
Yield: Low	NA	NA	NA	NA
Financial & Risk Analysis ($MIL, CAD)				
Cash	0.6	2.5	2.4	2.1
Working Capital	-5.6	-10.6	-9.9	-8.9
Current Ratio	0.3	0.3	0.3	0.3
LTDebt/Equity (%)	NM	NM	NM	NM
Total Debt/Equity (%)	102	122	114	102
Ratio Analysis				
Gross Profit Margin	31%	24%	27%	21%
Operating Margin	7%	11%	8%	7%
Net Margin	2%	3%	3%	4%
Return on Assets (%)	2.3	3.4	2.4	3.6
Return on Equity (%)	2.0	4.0	3.6	7.5
Op Inc/Int Exp	175%	214%	300%	400%
Div Payout	44%	79%	86%	41%

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