EQUITY REPORT

October 12, 2022

SOLUTION FINANCIAL INC.
(TSX: SFI, OTCQX: SLNFF)

BUSINESS DESCRIPTION

Solution Financial Inc. was founded in 2004 and is headquartered in Richmond, British Columbia, Canada. Solution specializes in sourcing and leasing luxury and exotic vehicles, yachts, and other high-cost assets that traditionally hold their value over time. The company deploys an innovative leasing program that established Metro Vancouver as a model for North America, and currently is being rolled out across Canada.

Solution utilizes a unique lease agreement that contains elements of both a rental and loan, giving consumers flexibility to upgrade or downgrade their vehicles more quickly than traditional automobile leases. This leasing alternative has proven extremely popular with affluent immigrants, international students, and business owners who may have limited credit histories in Canada and prefer more-flexible vehicle-ownership options. This high-quality clientele and Solution's focus on luxury and ultra-luxury assets has resulted in virtually no bad debts. Unlike most traditional leasing companies who routinely see significant credit losses, Solution consistently has profited on end-of-lease or early-termination vehicle sales.

The company established its market presence in British Columbia, and expanded into Alberta in 2020 and Ontario in 2021. Importantly, Solution Financial has maintained profitability since going public in mid-2018, spanning 15 quarters through the third quarter of 2022 (ended July 31, 2022). Of note, profitability has been maintained despite significant headwinds caused by the COVID-19 pandemic and supply chain and semiconductor issues that have negatively impacted the automotive industry.

In our view, Solution Financial has been successfully navigating these challenges, as it has focused on supporting luxury dealerships across its network to finance vehicle sales, through its core leasing services, as customers face higher borrowing costs and more-restrictive lending requirements imposed by Canadian banks.

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PRICE CHART

KEY STATISTICS

Key Stock Statistics	
Recent price (10/10/22, CAD)	0.30
52 week high/low (CAD)	0.55 - 0.27
Shares outstanding (M)	88.1
Market cap (M, CAD)	26.4
Dividend	0.004
Yield	1.3%

Sector Overview	
Sector	Financial
Sector % of S&P 500	10.9%

Financials ($M, CAD, as of 7/31/22)	
Cash & Mkt Securities	0.2
Debt	10.6
Working Capital ($M)	-6.9
Current Ratio	0.4
Total Debt/Equity (%)	77.7%
Payout ratio	36.8%
Revenue (M) TTM	19.0
Net Income (M) TTM	1.0
Net Margin	5.3%

Risk	
Beta	0.43
Inst. ownership	0%

Valuation	
P/E forward EPS	NA
Price/Sales (TTM)	1.4
Price/Book (TTM)	1.9

Top Holders
NA
NA

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

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 it to 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 has been able to maintain solid monthly leasing volumes throughout the COVID-19 pandemic, despite a more-than-50% decline in the number of international students enrolling and returning amid travel restrictions related to COVID-19 since its global spread in early 2020. 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.

We view immigration as another favorable opportunity for Solution Financial. Immigration accounts for nearly 80% of Canada's population growth and the volume of immigrants is expected to continue to expand in the coming years. The company has estimated an addressable market of more than 430,000 new immigrants and international students annually in its three current markets. Under a normalized market environment scenario, Solution Financial has valued its potential lease-value capital opportunity in excess of C$70 million. Across all of Canada, Solution Financial has projected a C$100 million annual lease-capital opportunity for its target market, with white glove service and a focus on luxury products. Although we see the opportunity being slowed by macro-economic challenges, we see its growth thesis remaining intact.

Solution Financial is focused on building an in-house portfolio of limited edition and high-demand luxury vehicles for lease brokering. As of July 31, 2022, it had 323 vehicles in its portfolio, with a total portfolio lease value of C$27.3 million, up from C$26.0 million in the prior quarter. As of the end of its last fiscal year on October 31, 2021, the company had a 57% net equity position in its vehicle portfolio, which is well above its public peers, which tend to be more focused on traditional subprime automobiles. More than two-thirds of its operating lease portfolio were in an original retail price range greater than C$55,000 and 15% were in an original retail price range above C$150,000.

In recent quarters, the company made a strategic decision to support top-line revenues by selling certain vehicles at a premium due to higher resale demand coupled with a shortage of new vehicles (caused by the limited availability of certain microprocessor components).
Recently, Solution Financial has cited dealership partners beginning to see the arrival of some new vehicles that had been backlogged. We are encouraged by the resumption of leasing activity, as it was a primary revenue driver in the quarter ended July 31, 2022. While revenue from vehicle sales declined to C$1.16 million in the quarter ended July 31, 2022, from C$3.7 million in the prior year, gross margins improved to 36% from 26%, respectively.

Because of vehicle sales, Solution Financial has decreased its financial leverage ratio as of July 31, 2022, to 1.15:1, as compared to 1.48:1 at the end of fiscal 2021. The company's credit facility and loan balance stood at C$7.5 million, down from C$10 million at October 31, 2021. Total liabilities declined to C$15.7 million from C$19.9 million over the same period.

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. 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 Financial targeted a long-term portfolio value exceeding C$100 million. 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 Financial also has a significant understanding of the premium and limited brands

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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**	**0.30***	**0.55***	**0.27***	**26***	**-33**	**43**	**NM**	**30.0**	**0.43**	**1.3**
AXIS AUTO FINANCE INC.	TSXV: AXIS	0.54*	0.73*	0.44*	66*	4	10	NM	42.2	0.68	NA
ELEMENT FLEET MANAGEMENT CORP.	TSX: EFN	16.46*	17.87*	10.99*	6492*	24	3	35	19.2	0.92	1.9
ACCORD FINANCIAL CORP.	TSX: ACD	8.15*	9.50*	8.02*	70*	1	57	2680	7.4	1.80	3.7

* Statistics in Canadian Dollars (CAD)

that are in high 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 time.

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 a customer's credit history and the liquidation value at auction or scrap, which can result in significant reserves and credit losses. In addition, the company has established relationships with luxury vehicle dealerships in its target markets, and those dealerships direct customers directly to the company. 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 July 31, 2022, the average remaining lease term for the portfolio was 1.9 years, weighted by net book value for each vehicle, which is below industry averages. At July 31, 2022, Solutions' 323 leases were generating annualized gross rental and lease revenue of approximately C$7.5 million. 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 one has expired. Customers are also incentivized to maintain the vehicles in order to build customer equity. The equity can be used towards a future lease and building customer loyalty while maintaining a high-quality and reliable clientele.

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 an employment and earnings history in Canada. The company also charges an above-industry-average deposit when a customer takes possession of a leased vehicle, which helps ensure the leased assets are appropriately secured. Finally, Solution Financial protects itself financially by basing its leasing terms higher than the vehicle's expected depreciation and residual value to ensure a healthy rate of return. At the end of a vehicle's lease cycle history, the company is typically able to sell a vehicle for a profit 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 it 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 anticipated accretive contribution to an acquiring company's earnings.

ANALYST COMMENTARY: EARNINGS

For the year ended October 31, 2021, net revenues increased 43% to C$20.5 million, boosted by a favorable comparison over the prior-year, during which the COVID-19 pandemic took hold. Although we expect revenues to decline modestly in fiscal 2022, we are encouraged by Solution Financial continuing to generate positive adjusted net income, as it has done for 15 consecutive quarters, despite pandemic-related disruptions to vehicle sales, the in-person closures of universities and a global semiconductor shortage (which has contributed to above-average variability in the size of the total lease and finance portfolio).

Despite these challenges, Solution Financial has improved its gross margins across fiscal 2022, recording margins of 36% for the fiscal third quarter ended July 31, 2022, on increased higher-margin leasing activity, compared with lower-margin vehicle sales. We see the company's leasing of vehicles at a higher financing rate than their expected depreciation as an attractive component of Solution's business model that should contribute to continued profitability, above-industry-average gross margins and effective rates of return.

The company has also increased its operating income at a higher rate than operating expenses, driving expanded operating margins. We also anticipate that the company's expansion into new markets in Alberta and Ontario will drive top-line growth in a low-overhead environment, with penetration among a small number of luxury dealerships requiring minimal marketing spend. Despite these challenges, the company maintained positive cash flow from operations of C$6.2 million for fiscal 2021, compared with C$6.9 million for the prior-year. Between the beginning of fiscal 2019 and the end of fiscal 2021, Solution financial more than doubled operating income, while only increasing operating expenses by approximately 30%.

For the first nine months of fiscal 2022, operating cash flow has been flat. The company has disposed of certain operating lease assets and is using surplus cash to pay down its financing line of credit (amid increasing prime interest rates) to minimize interest costs.

Over the past several years, the company has shown tight controls over its share count. Since the first quarter of fiscal 2019, shares outstanding have risen by a modest 12%, to 88.1 million shares, approximately 65% of which are held by company insiders, from 78.9 million. That should provide earnings leverage, as the company ultimately returns to 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 over 1%, based on a recent stock price and a market capitalization of C$0.30 and C$26 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.

RISKS

Risks to an investment in Solution Financial include credit risk, should the company incur losses or should any counter party fail to perform its obligations; interest-rate risk, as fair values, future cash flows, and customer financing appetites vary due to changes in market interest rates; competitive risk, as Solution's proven business model could attract competitors with enhanced capital resources, which could hamper Solution's ability to compete; and lastly, risks that exist because volumes and margins on brokered transactions vary due to the timing of new luxury model release dates, macro-economic conditions, and Solution's working-capital position.

RECENT DEVELOPMENTS

Despite challenges to Solution Financial's business since the onset of the COVID-19 pandemic, which slowed the expansion of its target vehicle-leasing demographic, we remain encouraged by the company's ability to maintain capital to support its long-term growth goals. In September 2022, Solution closed on a $15 million credit facility with ATB Financial, replacing a previous $12.5 million facility. We see the new facility, which adds $2.5 million of available credit, as supporting future growth financing arrangements with non-dilutive and low-interest capital. We view this as important, providing Solution Financial with the flexibility to access resources and support more dealerships across its network as operating conditions improve over the coming years.

In July 2022, the company closed the non-brokered financing of unsecured convertible debentures with a principal amount of C$3,175,400, after raising approximately C$8.2 million in similar financings across 2021.

With these proceeds, Solution has been able to expand its network of luxury vehicle dealers, which we expect to support a wider footprint for its portfolio of in-house leases, and penetration of new markets in Canada, primarily in Ontario. The company has completed licensing from Ontario's Vehicle Sales Regulator (OMVIC) and initiated expansion into the province during calendar 2021.

In addition, the company graduated from the TSX Venture Exchange to the Toronto Stock Exchange in September 2021, and began trading on the OTCQX in November 2021, which we think will enhance the market liquidity for the stock and the company's access to capital over time.

Steve Silver,
Argus Research Analyst

INCOME STATEMENT

Growth Analysis ($MIL, CAD)	2019	2020	2021	Q1 2022	Q2 2022	Q3 2022
Revenue	9.6	14.3	20.5	5.1	5.6	3.4
Gross Profit	3.0	3.4	9.7	2.5	1.2	1.2
G&A	2.1	1.9	2.8	0.8	0.9	0.6
R&D	0.0	0.0	0.0	0.0	0.0	0.0
Operating Income	0.7	1.5	1.6	0.4	0.4	0.6
Interest Expense	0.4	0.7	0.4	0.1	0.1	0.2
Pretax Income	0.3	0.8	1.2	0.2	0.2	0.5
Tax Rate (%)	45	49	21.0	17.0	18.0	18.0
Net income	0.2	0.4	0.9	0.2	0.2	0.4
Diluted Shares	80.5	81.1	84.2	89.4	88.8	88.3
EPS	0.00	0.01	0.01	0.00	0.00	0.00
Dividend	0.001	0.004	0.004	0.001	0.001	0.001
Growth Rates (%)						
Revenue	NA	49%	43%	NA	NA	NA
Operating Income	NA	114%	7%	NA	NA	NA
Net Income	NA	100%	125%	NA	NA	NA
EPS	NM	NM	NM	NA	NA	NA
Valuation Analysis						
Price ($): High	NA	NA	NA	NA	NA	NA
Price ($):Low	NA	NA	NA	NA	NA	NA
PE: High	NA	NA	NA	NA	NA	NA
PE: Low	NA	NA	NA	NA	NA	NA
PS: High	NA	NA	NA	NA	NA	NA
PS: Low	NA	NA	NA	NA	NA	NA
Yield: High	NA	NA	NA	NA	NA	NA
Yield: Low	NA	NA	NA	NA	NA	NA
Financial & Risk Analysis ($MIL, CAD)						
Cash	0.6	2.5	3.4	2.8	0.6	0.2
Working Capital	-5.6	-10.6	-13.2	-5.2	-6.9	-6.9
Current Ratio	0.3	0.3	0.5	0.5	0.4	0.4
LTDebt/Equity (%)	NM	NM	24	24	0	1
Total Debt/Equity (%)	102	122	98	92	79	78
Ratio Analysis						
Gross Profit Margin	31%	24%	47%	48%	22%	36%
Operating Margin	7%	10%	8%	8%	6%	18%
Net Margin	2%	3%	4%	4%	4%	12%
Return on Assets (%)	2.3	3.4	3.2	NA	NA	NA
Return on Equity (%)	2.0	4.0	7.6	NA	NA	NA
Op Inc/Int Exp	175%	214%	400%	400%	400%	300%
Div Payout	44%	79%	37%	39%	44%	24%

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