



## **IOU FINANCIAL INC.**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **INTRODUCTION**

The following management's discussion and analysis ("MD&A") of IOU Financial Inc. ("IOU Financial" or the "Company"), prepared as of May 24, 2018, should be read in conjunction with, and is qualified in its entirety by reference to, the condensed interim consolidated financial statements as at and for the three-month period ended March 31, 2018 and 2017 and related notes which have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting ("IAS 34"), as issued by the International Accounting Standards Board ("IASB").

All amounts are expressed in Canadian dollars unless otherwise indicated.

#### **OVERVIEW**

IOU Financial provides small businesses throughout the US and Canada access to the capital they need to seize growth opportunities quickly. Typical customers include medical and dental practices, grocery and retail stores, salons, gas stations, auto repair shops, and restaurants. In a unique approach to lending, IOU Financial's advanced, automated application and approval system accurately assesses applicants' financial realities, with an emphasis on day-to-day cash flow trends. IOU Financial allows these businesses to apply for six, nine, twelve, fifteen and eighteen-month term loans of up to US\$300,000 to qualified US applicants (\$100,000 in Canada) within a few business days, with affordable charges favorable to cash-flow management. Its speed and transparency make IOU Financial a trusted alternative to banks. To learn more visit: [IOUFinancial.com](http://IOUFinancial.com).

As at March 31, 2018, IOU Financial's customers had been in business an average 11.5 years (based on their incorporation date) at the time of application. These businesses borrowed on average US\$62,304 for a weighted average term of 11.8 months and generally used the funds to purchase new equipment, invest in an increased workforce, attend to repairs, expand their business, purchase more inventory or increase marketing efforts.

IOU Financial finances its lending activities in part by selling some of its commercial loans receivable to third party purchasers on a non-recourse basis and retaining the servicing rights for these loans in exchange for a service fee.

As a lender, IOU Financial earns revenue from fees it charges to its borrowers, interest payments it receives on loans it has funded, gains on the sale of loans it has sold as well as servicing fees it charges third-party purchasers for servicing the loans. A referral fee is earned on loans that are referred to and funded by other third-party lenders.

IOU Financial's common shares trade on the TSX Venture Exchange ("TSX-V") under the symbol "IOU". Since commencing commercial lending operations in December of 2009 until March 31, 2018, the Company has originated approximately US\$533.4 million. IOU Financial had 37 full-time employees as at March 31, 2018.

## **CORPORATE HISTORY**

IOU Financial is the continuation of Matco Ravary Inc. ("Matco Ravary"), a Company founded in 1977, which specialized for over 40 years in the retailing of home improvement and building materials. On November 1, 2002, Matco Ravary sold its operating assets to a company involved in the same sector, thereby ceasing all operations in the home improvement and building materials retailing sector. On May 14, 2004, substantially all of its issued and paid-up capital was distributed to its shareholders.

On April 29, 2005, Matco Ravary changed its corporate name to MCO Capital Inc. ("MCO"). During the following fiscal years, the main business and objective of MCO was to identify and evaluate businesses and assets with a view to a potential acquisition.

On February 28, 2011, MCO completed a reverse acquisition and acquired all of the issued and outstanding shares of IOU Central Inc. ("IOU Central"), a Canadian corporation incorporated in August 2006. On the same day, MCO also acquired all of the issued and outstanding shares of IOU USA, other than the shares of IOU USA already held by IOU Central. IOU USA was incorporated in Delaware in August 2006. In connection with the completion of the reverse acquisition, MCO effected a share consolidation and changed its name from "MCO Capital Inc." to "IOU Financial Inc."

## **FORWARD-LOOKING STATEMENTS**

Statements made in this MD&A that describe IOU Financial's or management's budgets, estimates, expectations, forecasts, objectives, predictions or projections of the future may be "forward-looking statements". Forward-looking statements are statements, other than statements of historical fact, that address or discuss activities, events or developments that IOU Financial expects or anticipates may occur in the future. The forward-looking statements can be identified by the use of the conditional or forward-looking terminology such as "anticipates", "believes", "estimates", "expects", "may", "plans", "projects", "should", "will", or the negative thereof or other variations thereon.

IOU Financial cautions that, by their nature, forward-looking statements involve risks and uncertainties. A number of factors could cause actual results, performance or developments to differ materially from those expressed or implied by such forward-looking statements, including but not limited to, risks inherent in growing a new business, dependence on third-party service providers, competition, regulatory risk, dependence on key personnel, risks related to rapid growth of the Company, security and confidentiality risk, risk related to inability to attract borrowers and lenders, technological development risk, IT disruptions, maintenance of client relationships, litigation risk, volatility of stock price, and other factors that are beyond its control. IOU Financial cautions that the foregoing list of factors is not exhaustive. For more information on risks and uncertainties and assumptions that would cause the company's actual results to differ from current expectations, please refer to the section "Risks and Uncertainties" of this MD&A.

The forward-looking statements in this MD&A reflect IOU Financial's views as at the date of this MD&A and are based on certain assumptions including assumptions as to future economic conditions and courses of action, as well as other factors management believes are appropriate in the circumstances. IOU Financial does not undertake any obligation to update publicly or to revise any such forward-looking statements, unless required by applicable legislation or regulation.

## **OVERALL PERFORMANCE AND SELECTED FINANCIAL INFORMATION**

The following table summarizes key financial data for each of the respective periods. The financial information presented below has been presented in Canadian dollars (except where otherwise noted) and has been prepared in accordance with International Financial Reporting Standards (IFRS).

<b>Summarized Financial Data</b>		
	Three-Month	
	<b>2018</b>	2017
	\$	\$
For the period ended March 31		
Loan originations (\$US)	<b>24,530,275</b>	22,056,943
Principal balance of loan portfolio	<b>32,163,142</b>	43,803,726
Principal balance of servicing portfolio	<b>32,043,018</b>	23,022,100
Total loans under management	<b>64,206,160</b>	66,825,826
Gross revenue	<b>4,437,977</b>	4,293,217
Net revenue	<b>2,671,113</b>	1,442,660
Net earnings (loss)	<b>797,198</b>	(995,085)
Net earnings (loss) per share <sup>(1)</sup>	<b>0.01</b>	(0.01)
Adjusted net earnings (loss)	<b>804,088</b>	(690,400)
Total assets	<b>39,206,205</b>	47,441,099
Total liabilities	<b>30,290,153</b>	38,040,044

<sup>(1)</sup> The net earnings (loss) per share has been calculated using the weighted average number of shares outstanding during each period. Diluted earnings per share were not presented as the effect would be anti-dilutive.

IOU Financial's innovative lending platform continues to emerge as a viable solution to the challenges small businesses face when trying to obtain financing. IOU Financial believes that a large opportunity exists to expand its presence in what it believes is a significantly underserved market.

During the three-month period ended March 31, 2018, IOU Financial originated (funded) approximately US\$24.5 million in loans (2017: US\$22.1 million), representing an increase of 11.2%.

For the three-month period ended March 31, 2018, loans originated through the retail channel, where borrowers are sourced directly, increased 210.6%, year over year, to US\$2.8 million. The increase in originations through the retail channel is principally due to referrals received from strategic partnerships entered into during 2017 with entities such as banks and small business suppliers. Loans originated through our wholesale channel, where borrowers are sourced via relationships with third-party business loan brokers, increased 2.9% year over year to US\$21.8.

As at March 31, 2018, total loans under management amounted to approximately \$64.2 million (2017: \$66.8 million), representing a decrease of 3.9% over the same period in 2017. As at March 31, 2018, the principal balance of the loan portfolio amounted to \$32.2 million (2017: \$43.8 million), representing a decrease of 26.6% over the previous year. Through a series of debt assignment agreements concluded during the three-month period ended March 31, 2018, IOU Financial sold some of its commercial loans receivable to third-party purchasers on a non-recourse basis for total

proceeds of \$15.4 million (2017: \$6.8 million). IOU Financial retained the servicing rights (payment collections) for these loans in exchange for a servicing fee. As at March 31, 2018, the principal balance of IOU Financial's servicing portfolio (loans being serviced on behalf of third-parties and one related-party) amounted to approximately \$32.0 million (2017: \$23.0 million), representing an increase of 39.2%.

Gross revenues, comprised of interest revenue, net gains recognized on loan sales as well as fees and servicing income, totaled \$4,437,977 for the three-month period ended March 31, 2018 (2017: \$4,293,217), representing an increase of 3.4% over the previous year. Interest income decreased to \$3,369,970 for the three-month ended March 31, 2018 (2017: \$3,711,044), representing a decrease of 9.2% over the previous year, as a result of a decrease in the size of the loan portfolio.

Net revenue totaled \$2,671,113 for the three-month period ended March 31, 2018 (2017: \$1,442,660), representing an increase of 85.2% over the previous year, primarily driven by the decrease of 50.6% in the provision for loan losses (net of recoveries).

Interest expense during the three-month period ended March 31, 2018 decreased by 11.6% to \$812,535, compared to \$918,658 the previous year. The decrease is attributable to a decrease in borrowings under the credit facility.

Provision for loan losses (net of recoveries) decreased by 50.6% to \$954,329 for the three-month period ended March 31, 2018 (2017: \$1,931,889). This decrease is primarily attributable to lower defaults by borrowers as well as by the smaller size of the loan portfolio. The improvement in the provision for loan losses (net of recoveries) is a result of changes made in 2017 in the Company's lending policies and in the loan servicing and collection process, which includes an aggressive litigation strategy against businesses who default on their loan obligations.

Operating expenses decreased 23.1% to \$1.87 million for the three-month period ended March 31, 2018 (2017: \$2.44 million). The decrease is attributable to the Company's plan to reduce operating expenses initially introduced in the third quarter of 2016. The plan resulted in reduced headcount thereby lowering employee compensation costs, a decrease in marketing costs and reduced professional fee expenses due to vendor contract re-negotiations.

For the three-month period ended March 31, 2018, IOU Financial had positive net earnings of \$797,198 or \$0.01 per share compared to a net loss of \$995,085 or \$(0.01) per share in 2017.

Adjusted net earnings for the three-month period ended March 31, 2018 was \$804,088 compared to an adjusted net loss of \$690,400 in 2017. The \$1.5 million improvement in adjusted net earnings is principally due to the \$1 million decrease in the provision for loan losses as well as to the \$0.6 million in reduced operating expenses in the quarter compared to the same period last year and the \$0.1 million increase in gross revenue.

## **RESULTS OF OPERATIONS FOR THE PERIOD ENDED MARCH 31, 2018**

The following table presents IOU Financial's condensed interim consolidated statement of comprehensive income for the three-month period ended March 31, 2018 and 2017. The financial information is presented in Canadian dollars (except where otherwise noted) and was prepared in accordance with IFRS.

<b>Condensed Interim Consolidated Statement of Comprehensive Loss</b>		
	Three-Month	
For the period ended March 31	2018	2017
	\$	\$
Gross revenue	4,437,977	4,293,217
Cost of revenue	1,766,864	2,850,557
Net revenue	2,671,113	1,442,660
Operating expenses	1,873,915	2,436,057
Earnings (loss) before income taxes	797,198	(993,397)
Income tax expense	-	1,688
Net earnings (loss)	797,198	(995,085)
Currency translation differences	521,276	(44,849)
Total comprehensive income (loss)	1,368,474	(1,039,934)
Net earnings (loss) per share	0.01	(0.01)
Adjusted net earnings (loss)	804,088	(690,400)

### Gross Revenue

IOU Financial's gross revenue consists of interest revenue earned on loans it has funded and servicing fees on loans sold to loan purchasers. Gross revenue also includes net gains recognized on the sale of loans.

The following table summarizes revenues by category.

<b>Total Revenue by Category</b>		
	Three-Month	
For the period ended March 31	2018	2017
	\$	\$
<b>Gross Revenue</b>		
Interest revenue	3,369,970	3,711,044
Other fees and servicing income	354,646	288,578
Net gain recognized on sale of loans	713,361	293,595
<b>Gross Revenue</b>	<b>4,437,977</b>	<b>4,293,217</b>

Gross revenue for the three-month period ended March 31, 2018 was \$4,437,977 (2017: \$4,293,217). The increase of \$144,760 is attributable to the following: Interest revenue decreased by \$341,074 from \$3,711,044 earned during the 2017 period to \$3,369,970 in 2018 due to a lower average principal balance of the loan portfolio at March 31, 2018 compared to the prior year; other fees and servicing income increased by \$66,068 from \$288,578 in 2017 to \$354,646 in 2018. Net gains recognized on loan sales increased by \$419,766 during the 2018 period from \$293,595 to \$713,361. This increase is due to an increase in the number of loans sold.

#### Cost of revenue

IOU Financial's cost of revenue consists primarily of interest costs incurred in connection with the financing of its lending activities and provisions for loan losses (net of recoveries). The following table summarizes cost of revenue by category.

Cost of Revenue by Category		Three-Month	
For the period ended September 30		2018	2017
		\$	\$
<b>Cost of revenue</b>			
Interest expense		812,535	918,658
Provision for loan losses, net of recoveries		954,329	1,931,899
<b>Total cost of revenue</b>		<b>1,766,864</b>	<b>2,850,557</b>

Cost of revenue for the three-month period ended March 31, 2018, compared to the same period in 2017, decreased by \$1,083,693, from \$2,850,557 in 2017 to \$1,766,864 in 2018. This decrease is attributable to a decrease of \$106,123 in interest expense, from \$918,658 in 2017 to \$812,535 and a decrease in the provision for loan losses, net of recoveries, of \$977,570, from \$1,931,899 in 2017 to \$954,329 in 2018. The decrease in interest expense is attributable to a decrease in borrowings under the credit facility.

The provision for loan losses, net of recoveries, decreased as a result of a decrease in defaults by borrowers as well as by the smaller size of the loan portfolio. The improvement in the provision for loan losses (net of recoveries) is a result of changes made in 2017 in the Company's lending policies and in the loan servicing and collection process, which includes an aggressive litigation strategy against businesses who default on their loan obligations.

#### Operating Expenses:

IOU Financial's operating expenses consist primarily of compensation costs and professional service fees, including consulting services, legal, audit and accounting fees as well as stock-based compensation and other operating costs.

Operating expenses decreased by \$0.6 million to \$1.9 million during the three-month period ended March 31, 2018 compared to \$2.4 million in the same period in 2017. This decrease can be attributed to the following:

- a decrease of \$205,789 in employee compensation costs and \$60,520 in rental expense following the cost reduction plan implemented in the quarter ended September 30, 2016;
- a decrease of \$184,935 in professional fees following vendor contract cancellations in 2017;
- a decrease of \$117,481 in data services due to a renegotiation of existing vendor agreements
- a decrease of \$61,616 in advertising and promotion due to a decrease in marketing efforts;
- a decrease of \$42,379 in other costs;

offset by:

- an increase of \$117,774 in legal and accounting fees due to increased loan collection efforts;

The above decreases are attributable to the Company's plan to reduce operating expenses initially introduced in the third quarter of 2016. The plan resulted in reduced headcount thereby lowering employee compensation costs, a decrease in marketing costs and reduced professional fee expenses due to vendor contract re-negotiations.

The increase in loan collection efforts is mainly a result of the aggressive litigation strategy introduced in 2017 against businesses who intentionally default on their loan obligations.

Adjusted Earnings (Net Loss):

Adjusted earnings (net loss) represents earnings (net loss) excluding certain non-cash items such as amortization and depreciation, stock-based compensation, net gain recognized on sale of loans, amortization of servicing asset, income tax recoveries and excluding certain non-recurring expenses. The Company uses Adjusted Earnings (Net Loss) as a measure of financial performance.

	<b>Adjusted Net Loss</b>	Three-Month	
		<b>2018</b>	<b>2017</b>
		\$	\$
<b>Net earnings (loss)</b>	<b>797,198</b>	(995,085)	
Depreciation and amortization	35,326	56,746	
Amortization of transaction costs	81,119	88,506	
Stock-based compensation	16,505	17,994	
Gain on servicing asset	(629,649)	(249,505)	
Amortization of servicing asset	503,589	389,256	
Income tax expense (recovery)	-	1,688	
<b>Adjusted net earnings (loss)</b>	<b>804,088</b>	(690,400)	

Adjusted net earnings for the three-month period ended March 31, 2018 was \$804,088 compared to an adjusted net loss of \$690,400 in 2017. The \$1.5 million improvement in adjusted net earnings is principally due to the \$1 million decrease in the provision for loan losses as well as to the \$0.6 million in reduced operating expenses in the quarter compared to the same period last year and to the \$0.1 million increase in gross revenue.

## **CONSOLIDATED FINANCIAL POSITION**

The following table presents IOU Financial's condensed interim consolidated statement of financial position as at March 31, 2018 and December 31, 2017. The financial information is presented in Canadian dollars (except where noted) and was prepared in accordance with IFRS.

### **Condensed Interim Consolidated Statement of Financial Position**

As at:	<b>March 31, 2018</b>	<b>December 31, 2017</b>
	\$	\$
<b>Assets</b>		
Commercial loans receivable	<b>33,049,076</b>	33,980,711
Allowance for loan losses	<b>(2,925,395)</b>	(2,750,844)
Commercial loans receivable – net	<b>30,123,681</b>	31,229,867
Non-portfolio assets	<b>9,082,524</b>	7,788,695
<b>Total assets</b>	<b>39,206,205</b>	39,018,562
<b>Liabilities</b>		
Credit facility	<b>18,509,667</b>	19,652,382
Convertible debentures – liability component	<b>10,324,222</b>	10,298,267
Other liabilities	<b>1,456,264</b>	838,501
<b>Total liabilities</b>	<b>30,290,153</b>	30,789,150
<b>Shareholders' equity</b>	<b>8,916,052</b>	8,229,412

#### Total Assets

Total assets decreased by 0.5% from \$39,018,562 at December 31, 2017 to \$39,206,205 at March 31, 2018. This decrease is attributable to a decrease of \$1,106,186 in net commercial loans receivable. Cash reserves increased by \$1,080,429 (see "flow of funds" section below for an explanation of the variance) and servicing asset by \$211,470.

#### Total Liabilities

IOU Financial's total liabilities decreased 1.6% from \$30,789,150 at December 31, 2017 to \$30,290,153 at March 31, 2018. The decrease is due to a reimbursement of US\$1 million of the financing credit facility during the quarter, offset by an increase of \$617,763 in accounts payable and accrued liabilities.

#### Shareholders' Equity

Shareholders' Equity increased 8.3% from \$8,229,412 at December 31, 2017 to \$8,916,052 at March 31, 2018. This increase is attributable to current period comprehensive income, partially offset by the impact of IFRS 9 adoption.

## **LIQUIDITY AND CAPITAL RESOURCES**

IOU Financial's primary sources of liquidity and capital resources are cash-on-hand, cash provided by operations and cash provided by financing through the issuance of equity and/or debt securities as well as the sale of loans.

The Company continues to review the current terms of its credit facility in order to best meet its liquidity needs. During the quarter ended March 31, 2018, the Company paid down US\$1 million of its financing credit facility. In February 2018, the Company modified and extended until December 31, 2020 its credit facility. The amount of the extended credit facility is US\$20.0 million including a currently available US\$5.0 million revolver amount as well as a US\$15.0 million term portion.

During the three-month period ended March 31, 2018, the Company sold \$15.4 million (2017: \$6.8 million) of commercial loans receivable. The loan sales program continues to provide the Company with additional liquidity to meet its growing loan demand and increase its presence in the marketplace.

### **Operating lease commitments**

The Company leases offices under non-cancellable operating lease agreements. The lease terms are between 3 and 12 years and are renewable at the end of the lease term.

The future aggregate minimum lease payments under the non-cancellable operating lease are as follows:

	<b>Mach 31, 2018</b>
No later than 1 year	352,520
Later than 1 year and no later than 4 years	1,493,247
Later than 5 years	101,815
<b>Total</b>	<b>1,947,582</b>

### **Flow of funds**

The following table presents a summary of cash flows for the nine-month period ended March 31, 2018 and 2017.

#### **Condensed Interim Consolidated Statement of Cash Flows**

For the three-month period ended March 31	<b>2018</b>	2017
	\$	\$
Cash generated by (used in) in operating activities	3,223,421	(2,045,106)
Cash used in financing activities	(2,278,801)	(895,686)
Cash used in investing activities	(13,742)	(6,547)
Increase (decrease) in cash	930,878	(2,947,339)
Exchange rate difference on cash	149,551	(59,571)
<b>Net increase (decrease) in cash</b>	<b>1,080,429</b>	(3,006,910)

#### Cash generated by operating activities

The \$5.3 million improvement in cash generated by operating activities for the three-month period ended March 31, 2018, compared to the same period in 2017, was primarily related to an increase of \$8.6 million in cash inflow from the sale of commercial loans (2018: \$15.4 million compared to \$6.8 million in 2017) and an improvement of \$1.8 million in net earnings, offset by an increase in commercial loans receivable funded in excess of amounts collected (2018: \$14.0 million compared to 2017: \$9.5 million).

#### Cash used in financing activities

The \$1.4 million increase in cash used in financing activities for the three-month period ended March 31, 2018, compared to the same period in 2017, is primarily due to the repayment of funds of the financing credit facility in 2018 for US\$1.0 million.

#### Cash used in investing activities

The \$7,195 increase in cash used by investing activities for the three-month period ended March 31, 2018, compared to the same period in 2017, is due to an increase in cash outflows for the purchase of intangible assets and equipment.

### **SUMMARY OF QUARTERLY RESULTS**

#### **Quarterly Results**

<b>For the quarters ended</b>	<b>Mar 31/18</b>	<b>Dec 31/17</b>	<b>Sept 30/17</b>	<b>Jun 30/17</b>
	\$	\$	\$	\$
Gross revenue	<b>4,437,977</b>	4,216,586	4,541,659	4,363,634
Net revenue	<b>2,671,113</b>	1,887,487	1,134,786	1,037,002
Earnings (net loss)	<b>797,198</b>	52,589	(1,432,439)	(2,080,347)
Earnings (net loss) per share <sup>(1)</sup>	<b>0.01</b>	0.01	(0.02)	(0.03)
<b>For the quarters ended</b>	<b>Mar 31/17</b>	<b>Dec 31/16</b>	<b>Sept 30/16</b>	<b>Jun 30/16</b>
	\$	\$	\$	\$
Gross revenue	4,293,217	4,917,746	5,665,437	3,504,489
Net revenue	1,442,660	789,983	2,615,150	1,628,700
Net loss	(995,085)	(1,669,856)	(350,033)	(1,479,997)
Net loss per share <sup>(1)</sup>	(0.01)	(0.03)	(0.01)	(0.02)

(1) Earnings (net loss) per share has been calculated using the weighted average number of shares outstanding during each period. Diluted earnings per share were not presented as the effect would be anti-dilutive.

### **OFF-BALANCE SHEET ARRANGEMENTS**

IOU Financial does not engage in any off-balance sheet financing activities. IOU Financial does not have any interest in non-consolidated entities referred to as variable interest entities, which include special purpose entities and other structured finance entities.

### **PROPOSED TRANSACTIONS**

There were no proposed transactions as at the date of the Company's financial statements.

### **TRANSACTIONS BETWEEN RELATED PARTIES**

a) The CEO and director of IOU Financial is a shareholder in a company that owns a significant stake in Palos Capital Corporation, the parent company of Palos Management Inc ("Palos"). During the three-month period ended March 31, 2018, a fund managed by Palos purchased no amount (2017: \$1.8 million) of commercial loans receivable from the Company for which the Company has retained the servicing rights. Servicing fees, amounting to \$10,920 have been earned by the Company on these loans during the three-month period ended March 31, 2018 (2017: \$286,571). Palos also received agency fees of \$402 (2017: \$410) relating to the outstanding servicing portfolio balance during the period related to a third-party purchaser.

b) IOU Financial rents its Canadian office space to Palos. The lease may be cancelled after October 2021 upon the payment of a termination fee. The terms of this operating lease are similar to those that would have been present for an arm's length transaction. The amount expensed as rent for the period relating to this lease amounts to \$51,721 excluding applicable taxes (2017: \$55,741). Future non-cancellable lease commitments under this agreement amount to \$1,238,493.

c) Key Management Compensation

Key management includes directors (executive and non-executive) and officers. The compensation paid or payable to key management for employee services for the three-month period ended March 31, 2018 and 2017 is shown below:

	<b>Key Management Compensation</b>		Three-Month
For the period ended March 31	<b>2018</b>	<b>2017</b>	
	\$	\$	
Salaries and other short-term employee benefits	<b>227,925</b>	194,893	
Share-based payments	<b>9,093</b>	65,976	
	<b>237,018</b>	260,869	

## **COMMERCIAL LOANS RECEIVABLE**

IOU Financial's commercial loan receivable portfolio is composed of a large number of loans, and as such, no individual loan comprises a significant portion of the portfolio. As at March 31, 2018, the average loan balance in the portfolio was approximately US\$47,069. In addition to limiting its exposure to any single loan, IOU Financial maintains a geographically and industry diversified loan portfolio which reduces the risk of loss arising from adverse regional or industrial economic conditions.

The following tables present the portfolio by industry as at March 31, 2018.

<b>Industry Category</b>	<b>Portfolio %</b>
Specialty trade contractors and home building renovation	15
Casual, fine dining and full service restaurants	10
Automotive garage	7
Other store or online retailers and wholesalers	4
Medical services	3
Other professional services	3
Automotive parts, accessories and tire stores	3
Dentists	2
Insurance companies	2
Towing services	2
Other	49
<b>Total</b>	<b>100</b>

The following tables present the portfolio by geography as at March 31, 2018.

<b>State</b>	<b>Portfolio %</b>
California	20
Florida	11
Texas	9
New York	8
Illinois	4
Georgia	4
Ohio	3
Pennsylvania	3
North Carolina	3
Maryland	3
Virginia	3
New Jersey	3
Missouri	3
Other	23
<b>Total</b>	<b>100</b>

## **OUTSTANDING SHARE DATA**

The following table presents IOU Financial's outstanding share data as at May 24, 2018:

<b>Outstanding Share data</b>	
<b>Ordinary shares issued and outstanding:</b>	<b>Number of shares issued</b>
December 31, 2017	87,825,309
Shares issued during the period	-
<b>Shares outstanding on May 24, 2018</b>	<b>87,825,309</b>
<b>Warrants issued and Outstanding:</b>	<b>Number of warrants issued</b>
December 31, 2017	811,148
Warrants expired during the period	(332,023)
<b>Warrants outstanding on May 24, 2018</b>	<b>479,125</b>
<b>Options issued and outstanding:</b>	<b>Number of Options issued</b>
December 31, 2017	6,386,500
Options forfeited between January 1, 2018 and March 31, 2018	(233,333)
Options forfeited after March 31, 2018	(1,303,000)
<b>Options outstanding on May 24, 2018</b>	<b>4,850,167</b>

## **BUSINESS OUTLOOK**

IOU Financial remains well placed at the forefront of the fintech revolution that is democratizing access to capital for small businesses. IOU expects to continue to grow loan originations and generate profits throughout 2018.

The Company will continue to enhance its proprietary, next-generation technology and algorithms that evaluate and price credit risk.

IOU Financial will also continue to closely monitor the performance of its loan portfolio, capture operational efficiencies and keep costs under control.

The Company intends to grow loan originations by:

- Continuing to identify, recruit and partner with business loan brokers;
- Forming new strategic partnerships with entities such as banks and small business suppliers and leveraging their relationships with small businesses to add new customers;
- Expanding its product offering to allow it to serve small businesses whose needs are not met by its current products;
- Investing in direct marketing and sales; and
- Continuing its expansion into Canada.

## **CRITICAL ACCOUNTING ESTIMATES**

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

### **1. Valuation of commercial loans**

Management exercises judgement to determine whether indicators of loan impairment exist based on historical loss experience, and if so, management must estimate the timing and amount of future cash flows from loans receivable. Specifically, management must assess at which point a loan is deemed to be uncollectible in order to write it off. The payment performance of customers could be different from the assumptions used to determine the impairment and there can be no assurance that expected future cash flows will be realized. As such, the measurement of impairment of loans receivable is subject to a high level of uncertainty and changes in estimates, assumptions, or circumstances may cause future assessments to be significantly different than current assessments and may require an increase or decrease in the allowance.

### **2. Servicing assets**

The initial recognition of servicing assets requires the Company to make estimates of the fair value of the service to be provided which is based on market expectations at the time of the loan sale and may vary from the actual cash flows serviced.

### **3. Deferred Tax Estimation**

Deferred tax assets and liabilities recognition involves making a series of assumptions. For instance, the Company must estimate the timing of the reversal of temporary differences or if it is probable that temporary differences will not reverse in the foreseeable future or the tax rates expected to apply to the period when the asset is realized or the liability is settled.

With respect to deferred tax assets, their realization ultimately depends on taxable profits being available in the future. Deferred tax assets should be recognized when it is probable that taxable profits will be available against which the deferred tax asset can be utilized and it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments. This involves the Company making assumptions within its overall tax-planning activities and periodically reassessing them in order to reflect changed circumstances as well as tax regulations. Moreover, the measurement of a deferred tax asset or liability reflects the manner in which the entity expects to recover the asset's carrying value or settle the liability.

### **4. Stock-based compensation**

The Company measures the cost of equity-settled transactions with employees of the Company and share warrants by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option or share warrant, volatility and dividend yield and making assumptions about them.

## **CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION**

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after January 1, 2018 and have not been applied in preparing the Company's condensed interim consolidated financial statements. None of these is expected to have a significant effect on the condensed interim consolidated financial statements of the Company, except the following set out below:

### **IFRS 16, Leases**

In January 2016, the IASB released IFRS 16, which supersedes IAS 17, Leases and the related interpretations on leases: IFRS Interpretations Committee (IFRIC) 4, Determining Whether an Arrangement Contains a Lease; Standard Interpretations Committee (SIC) 15, Operating Leases – Incentives; and SIC 27, Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier application permitted for companies that also apply IFRS 15. The Company is currently evaluating the impact of the standard on its consolidated financial statements.

### **IFRIC 23, Uncertainty over Income Tax Treatments**

This new Interpretation was issued by the IASB in September 2017. It provides guidance on when the recognition of a current tax asset is appropriate if tax laws require an entity to make an immediate payment in respect of a disputed amount. The Interpretation is effective for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of the standard on its consolidated financial statements.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

Under IFRS 7, Financial instruments: Disclosures, financial assets must be classified into one of four categories: financial assets at fair value through profit or loss, held to maturity investments, loans and receivables and available for sale. Financial liabilities must be classified into one of two categories: at fair value through profit or loss or amortized cost. Cash, restricted cash, commercial loans receivable, certain other assets and sales tax receivable have been classified as loans and receivables. Loans and receivables are accounted for at amortized cost using the effective interest rate method. Accounts payable and accrued liabilities, and financing credit facility are classified as financial liabilities and are accounted for at amortized cost using the effective interest rate method.

The carrying values of cash, accounts receivable, loans receivable, credit facility and accounts payable approximate their fair values due to the relatively short period to maturity of these items.

Loan investment receivables are due from customers in the United States. The maximum credit risk associated with the company's financial assets is the carrying value of those assets.

### *Foreign exchange risk*

The Company operates internationally and is exposed to foreign exchange risk arising from currency exposure with respect to the US dollar. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities.

The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results.

Listed below are the relevant instruments and the amount of foreign currencies included in their balances (in US dollars) as at March 31, 2018:

	<u>US\$ '000</u>
Cash	3,663
Restricted cash	1,052
Certain other assets	1,396
Net loan investment receivable	23,363
Accounts payable and accrued liabilities	902
Credit facility	14,355

The exchange rate applied as at March 31, 2018 was 1.2894 (December 2017: 1.2545).

Based on the Company's foreign currency exposure noted above, varying the above foreign exchange rates to reflect a one (1) percent strengthening of the Canadian dollar would have increased the net loss by approximately \$380,318 (December 31, 2017: \$348,330), assuming that all other variables remained constant. An assumed one (1) percent weakening of the Canadian dollar would have had an equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

#### *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach in managing liquidity is to ensure, as much as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company manages liquidity risk through the management of its capital structure.

#### *Credit risk*

Credit risk is managed on a Company basis and results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract. The Company regularly monitors the credit risk exposure and takes steps to mitigate the likelihood of these exposures from resulting in actual loss.

The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit risk history of each customer. These policies cover the approval of credit applications, attribution of risk ratings, management of impaired loans, establishment of provisions and risk-based pricing. The Company does not believe it is exposed to an unusual level of customer credit risk. The Company's maximum credit risk is the carrying value of the cash, restricted cash and commercial loans receivable. In response to increased delinquency levels, the Company made changes to its lending policies. The allowance for loan losses is maintained at a level considered sufficient to cover all potential losses.

In addition, financial instruments that potentially subject the Company to significant concentrations of credit risk consist of deposits in the form of cash and restricted cash. The Company invests with major North American financial institutions. The Company has investment policies that are designed to provide for the safety and preservation of principal, the Company's liquidity needs and appropriate yields. The Company has no exposure to any asset-backed securities.

#### *Interest rate risk*

The Company is subject to interest rate risk on its cash and restricted cash. Sensitivity to a 1% change in interest rates would not have a material effect on the Company's results.

None of the Company's current commercial lending is based on variable interest rates. The Company is also exposed to changes in the value of a loan when that loan's interest rate is at a rate other than current market rate. The Company mitigates this risk by lending for short terms, with terms at the inception of the loan generally varying from six to eighteen months.

The Company is exposed to cash flow interest rate risk on its credit facility issued at a variable rate. During 2017 and 2018, the borrowings at a variable rate were denominated in USD. The Company mitigates this risk by borrowing in the short term and therefore the Company does not believe that its exposure to interest rate risk is significant.

Interest income presented in the condensed interim consolidated statement of comprehensive loss represents interest income on financial assets that are classified as loans and receivables.

## **RISKS AND UNCERTAINTIES**

In addition to the risks mentioned above, IOU Financial is subject to a number of risks and uncertainties in carrying out its activities.

### ***IOU Financial is Subject to the Risks Inherent in Growing a New Business.***

IOU Financial's operations are subject to the general risks inherent in growing a new business, including, among others, hiring and retaining experienced and qualified employees. If IOU Financial cannot hire or retain qualified employees, or cannot effectively implement its business planned strategy, it will be hampered in its ability to grow its current market and to develop new markets, which would in turn have an adverse effect on its financial performance. Even if IOU Financial successfully implements its planned strategy, it may not achieve the favourable impact on its operations that it anticipates.

### ***Compliance with debt covenants***

IOU Financial entered into a loan agreement with a new lender in 2016. The loan agreement imposes covenants and obligations on the part of the Company. In particular, the agreement contains certain covenants and representations, the breach of which could result in a default and the acceleration of the maturity of the term credit facility. IOU Financial plans to address the risk of default by endeavoring to meet the financial covenants and other obligations in the loan agreement. There is no assurance, however, that IOU Financial will be in compliance with covenants in the future due to unforeseen events or circumstances and if IOU Financial was to default there is no assurance that an amendment or waiver will be granted by the lender.

### ***Dependence on Third Party Service Providers***

IOU Financial's service to its clients depends, in part, on its ability to attract and retain the services that are provided to it, by third party service providers. If some or all of IOU Financial's current third-party service providers were to interrupt or cancel their current services to IOU Financial, the company might be forced to curtail or cease its operations.

### ***Competition***

IOU Financial operates in an increasingly competitive environment. Both large and small competitors compete with IOU Financial. Some of these competitors may have longer operating histories, greater name recognition and greater financial and marketing resources than IOU Financial. IOU Financial believes that its ability to compete effectively is dependent upon the quality of its product and client service. There can be no assurance that IOU Financial will be able to compete effectively and retain its existing clients or attract and retain new clients. IOU Financial's current and potential competitors may develop and market new products or services that render IOU Financial's existing and future products and services less marketable or competitive.

### ***Regulatory Risk***

IOU Financial is subject to strict regulatory and licensing compliance standards, non-conformity with which may expose IOU Financial to adverse consequences. IOU Financial's business is dependent to a large extent on its ability to remain in good standing with all regulators. Some of these regulators impose minimum working capital or net equity requirements, amongst other, which in certain cases and under certain circumstances, IOU Financial may not be able to satisfy. Under such cases, the Company may not be able to operate its regular business until all such financial or regulatory requirements have been satisfied.

### ***Dependence on Key Personnel***

IOU Financial's future depends, in part, on its ability to attract and retain key personnel. IOU Financial's future also depends on the continued contributions of its executive officers and other key technical personnel, each of whom would be difficult to replace. The loss of the services of executive officers or key personnel, and the process to replace any of its key personnel could involve significant time and expense and may significantly delay or prevent the achievement of its business objectives.

### ***IOU Financial's growth could strain its personnel, resources and infrastructure***

IOU Financial's growth in headcount and operations may place a significant strain on its management and its administrative, operational and financial reporting infrastructure. Accordingly, IOU Financial's success will depend, in part, on the ability of its senior management to manage the growth it achieves effectively. To do so, it must continue to hire, train and manage new employees as needed. The addition of new employees and the system development that it anticipates will be necessary to manage its growth will increase its cost base, which will make it more difficult for it to offset any future revenue shortfalls by reducing expenses in the short term. If IOU Financial fails to successfully manage its growth, it will be unable to execute its business plan. If its new hires perform poorly, or if it is unsuccessful in hiring, training, managing and integrating these new employees, or if it is not successful in retaining its existing employees, IOU Financial's business may be harmed. To manage the growth of IOU Financial's operations and personnel, it will need to continue to improve its operational and financial controls and update its reporting procedures and systems. Given the complex nature of the accounting of the Company's operations and the limited number of staff resources, IOU Financial may not be able to address all accounting and reporting impacts of new transactions or agreements on a timely basis.

### ***Security and Confidentiality Risk***

IOU Financial stores users' bank information and other personally-identifiable sensitive data. Any accidental or willful security breaches or other unauthorized access could cause users' secure information to be stolen and used for criminal purposes. Security breaches or unauthorized access to secure information could also expose IOU Financial to liability related to the loss of the information, time-consuming and expensive litigation, and negative publicity. If security measures are breached because of third-party action, employee error, malfeasance or otherwise, or if design flaws in its software is exposed and exploited, and, as a result, a third party or disaffected employee obtains unauthorized access to any of its users' data, IOU Financial's relationships with its users will be severely damaged and it could incur significant liability. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until they are launched against a target, IOU Financial and its third-party hosting facilities may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, many states have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach are costly to implement and often lead to widespread negative publicity, which may cause IOU Financial's users to lose confidence in the effectiveness of its data security measures. Any security breach, whether actual or perceived, could harm IOU Financial's reputation and could result in the loss of users and future business.

### ***If IOU Financial is unable to increase transaction volumes, its business and results of operations will be affected adversely.***

To succeed, IOU Financial must increase transaction volumes on its lending platform by raising additional capital and attracting a large number of qualified borrowers in a cost-effective manner. The general tightening and other developments in the broader credit markets may impact IOU Financial's ability to attract capital to lend which, in turn, could limit its ability to increase transaction volumes. If IOU Financial is not able to attract qualified borrowers, IOU Financial will not be able to increase its transaction volumes. In addition, IOU Financial will rely on a variety of methods to drive traffic to its website and lending platform. If IOU Financial is unable to use any of its planned marketing initiatives or the cost of these initiatives was to significantly increase, IOU Financial may not be able to attract new qualified borrowers in a cost-effective manner. As a result, its revenue and results of operations could be affected adversely and could impair its ability to maintain its lending platform.

### ***As an online company constantly involved in the development of its online lending platform, IOU Financial faces increased risks, uncertainties, expenses and difficulties.***

If IOU Financial is successful, the volume of loans originated through its lending platform may increase beyond its current capacity, which will require IOU Financial to increase its facilities, personnel and infrastructure in order to accommodate the greater servicing requirements and demands of its lending platform. IOU Financial's lending platform is dependent upon its website.

IOU Financial will likely be required to constantly add new hardware and update its software and website, expand its customer support services and add new employees to maintain the operation of its lending platform, as well as satisfy its servicing requirements. If IOU Financial is unable to increase the capacity of its lending platform and maintain the necessary infrastructure, it might then suffer from a negatively impact on its revenue stream.

***Any significant disruption in service on IOU Financial's website or in its computer systems could reduce the attractiveness of its lending platform and result in a loss of users.***

If a catastrophic event resulted in a lending platform outage and physical data loss, IOU Financial's ability to service its loans would be materially and adversely affected. The satisfactory performance, reliability and availability of its technology and its underlying network infrastructure are critical to its operations, level of customer service, reputation and ability to attract and retain users. IOU Financial's system hardware is hosted in multiple hosting facilities. All of the data is stored in multiple geographic locations to ensure data availability in the event a particular data center fails. IOU Financial's service provider does not guarantee that access to IOU Financial's website will be uninterrupted, error-free or secure. IOU Financial's operations depend on its supplier's ability to protect their and its systems in their facilities against damage or interruption from natural disasters, power or telecommunications failures, air quality, temperature, humidity and other environmental concerns, computer viruses or other attempts to harm its systems, criminal acts and similar events. If its arrangement with this supplier is terminated, or there is a lapse of service or damage to the supplier's facilities, IOU Financial could experience interruptions in its service, as well as delays and additional expense in arranging new facilities. Any interruptions or delays in its service, whether as a result of its supplier or other third-party error, its own error, natural disasters or security breaches, whether accidental or willful, could harm its relationships with its users and its reputation. In addition, in the event of damage or interruption, IOU Financial's insurance policies may not adequately compensate it for any losses that it may incur. IOU Financial's disaster recovery plan has not been tested under actual disaster conditions, and it may not have sufficient capacity to recover all data and services in the event of an outage at a supplier facility. These factors could prevent it from processing or posting payments on the loans, damage its brand and reputation, divert its employees' attention, reduce its revenue, subject it to liability and cause users to abandon its lending platform, any of which could adversely affect its business, financial condition and results of operations.

***IOU Financial's ability to service loans or maintain accurate accounts may be adversely affected by computer viruses, physical or electronic break-ins and similar disruptions.***

The highly-automated nature of IOU Financial's lending platform may make it an attractive target and potentially vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. If a computer "hacker" were able to infiltrate IOU Financial's lending platform, users would be subject to an increased risk of fraud or identity theft, and IOU Financial may not receive the principal or interest payments that it expects to receive on any loans that it was fraudulently induced to make. Hackers might also disrupt the accurate processing and posting of payments to IOU Financial's accounts on its lending platform, or cause the destruction of data and thereby undermine IOU Financial's rights to repayment of the loans it has made. While IOU Financial has taken steps to prevent hackers from accessing its lending platform, if it is unable to prevent hacker access, its ability to receive the principal and interest payments that it expects to receive on loans it made and its ability to service its loans and to maintain its lending platform could be adversely affected.

***Maintenance of Client Relationships***

The ability of IOU Financial to attract and maintain clients requires that it provide a competitive offering of products and services that meet the needs and expectations of its clients. IOU Financial's ability to satisfy the needs or demands of its clients may be adversely affected by factors such as the inability or failure to identify changing client needs or expectations or the inability to adapt in a timely and cost-effective manner to innovative products and services offered by competitors.

***Litigation Risk***

IOU Financial's business may become susceptible from time to time to various legal claims, including class action claims, in the course of its operations or with respect to the interpretation of existing agreements. Any future claims or litigation could have a material adverse effect on IOU Financial's business and its profitability.

***Possible Volatility of Stock Price***

The market price of the common Shares could be subject to wide fluctuations in response to factors such as actual or anticipated variations in IOU Financial's results of operations, changes in financial estimates by securities analysts or by management, general market conditions and other factors. Market fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations may adversely affect the market price of the common shares.

**GENERAL**

The Company also discloses information related to its activities on SEDAR at [www.sedar.com](http://www.sedar.com) and on its website [www.ioufinancial.com](http://www.ioufinancial.com)