

On Deck Capital, Inc. (ONDK, Buy, \$4.25 PT)

Soft 2Q19 Offset by \$50M Share Repurchase Plan & Desire to Pursue Bank Charter – Weakness Creates Opportunity; Upgrading to Buy

WHAT YOU SHOULD KNOW: This morning before the market open, OnDeck Capital (ONDK) reported 2Q19 adjusted earnings per share of \$0.09 below our estimate of \$0.13 and the consensus estimate of \$0.11. The miss was driven by higher-than-expected credit costs in the quarter and the impact of consolidating Evolocity during the period. During the quarter, ONDK announced a \$50M share repurchase program and the intent to pursue a bank charter. We believe the sharp decline in ONDK's share price post earnings is overly punitive and creates an attractive entry point into the stock as the company should begin to see margin and earnings improvement over the next few quarters, in our view. We are upgrading ONDK to Buy (from Neutral) with a price target of \$4.25 based on 1.0X our FY20 TBV estimate of \$4.22.

- Credit performance** – The provision rate during the quarter increased to 7.3% in 2Q19 vs. 6.8% in 1Q19. This was driven by a higher charge-off ratio of 15.1% driven by the write-off of loans originated during 2H18. Management notes improving trends in early FY19 vintages and a 50 bp decrease in 15 to 89 days past due balances to 4.9%. This should reduce inflows into 90+ over the next couple quarters reducing the provision rate.
- Capital return** – During the quarter, ONDK announced a new \$50M share repurchase program valid through August 31, 2020. The capital return is a positive development and allows the company to rightsize its capital base and will increase leverage to ~3.4X in our model. Over time, a leverage ratio in the 3.5X to 4.0X is reasonable and would increase the company's ROE significantly.
- Pursuing a bank charter** – ONDK announced that after analyzing the pros and cons of becoming a bank, the company determined the benefits outweigh the costs and would consider either a de novo charter application or an acquisition. We note that Marlin Business Services (MRLN, Not Rated) has a bank charter and during 1Q19, deposits accounted for 87% of funding at an average cost of 2.25%, ~321 bps below ONDK's 5.46% funding cost during the same period. As an example, if we assume a 321 bp improvement on 87% of ONDK's funding during FY20E, our \$0.59 estimate would increase to \$0.89.
- Guidance** – Reduction in FY19 guidance was driven by an increase to the provision rate, ODX and updated forecasts for the company's international businesses. ONDK expects FY19 revenue of \$438M-\$448M, Net Income of \$12M-\$20M and Adj. Net income of \$22M-\$30M.
- Valuation** – Our \$4.25 price target is based on 1.0X our FY20 TBV per share estimate of \$4.22. We believe this is an appropriate multiple for a business we expect to generate a 13.7% ROTCE during FY20. Our valuation equates to a 7.2X multiple of our FY20E Adj. earnings per share of \$0.59.



July 29, 2019

Giuliano Bologna

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COMPANY DATA	
Closing Price:	\$3.04
Price Target:	\$4.25
Market Cap (\$M):	301.51
Shares Out (M):	76.1
Avg Daily Vol - 3 Months (M):	0.44
Dividend/Yield:	\$0.00/0.0%

REVISIONS		
	Previous	Current
Rating	Neutral	Buy
Price Target	-	\$4.25
FY19E EPS	\$0.43	\$0.37
FY20E EPS	\$0.55	\$0.59
FY19E Rev. (M)	\$446.15	\$448.68

Diluted EPS (Adjusted)			
FY Dec	2018A	2019E	2020E
Q1	0.08	0.10	0.14
Q2	0.13	0.09	0.18
Q3	0.17	0.08	0.13
Q4	0.20	0.09	0.14
Calendar EPS	0.58	0.37	0.59
Calendar P/E	6.8x	10.8x	6.7x

REVENUE (\$M)			
FY Dec	2018A	2019E	2020E
Q1	90.28	110.17	118.54
Q2	95.62	110.25	119.43
Q3	103.00	112.26	120.73
Q4	109.53	116.01	125.88
FY	398.43	448.68	484.58

Source: IDC, BTIG Estimates and Company Documents (\$ in millions, except per share amount)

Investment Thesis

We have a Buy rating and a \$4.25 price target on OnDeck Capital. We believe ONDK has a differentiated business model with an impressive return profile and the company is undertaking the right initiatives to drive future profitability and earnings growth during FY20. And, we believe the market is discounting the company's ability to achieve those goals.

Upcoming Catalysts

- 3Q19 earnings.
- Conference appearances.

Base Case Assumptions

- We currently model ONDK achieving adjusted net income in the middle of the company's FY19 guidance range.
- Adj. efficiency ratio falls in FY20 as the company completes its current investment spending initiative.
- Funding costs remain stable to slightly higher.

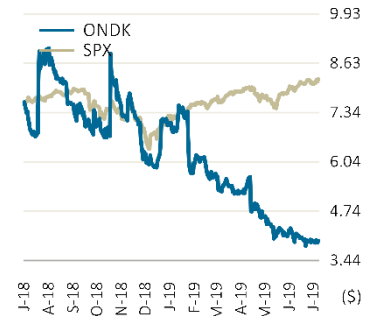
Upside Scenario

- The company increases growth and profitability in the near term.
- ONDK signs up new partners and has near-term visibility to achieving profitability.

Downside Scenario

- Credit performance deteriorates, and NCOs increase reducing profitability.
- Funding costs increase, reducing the company's NIM.

Price Performance



Source: IDC

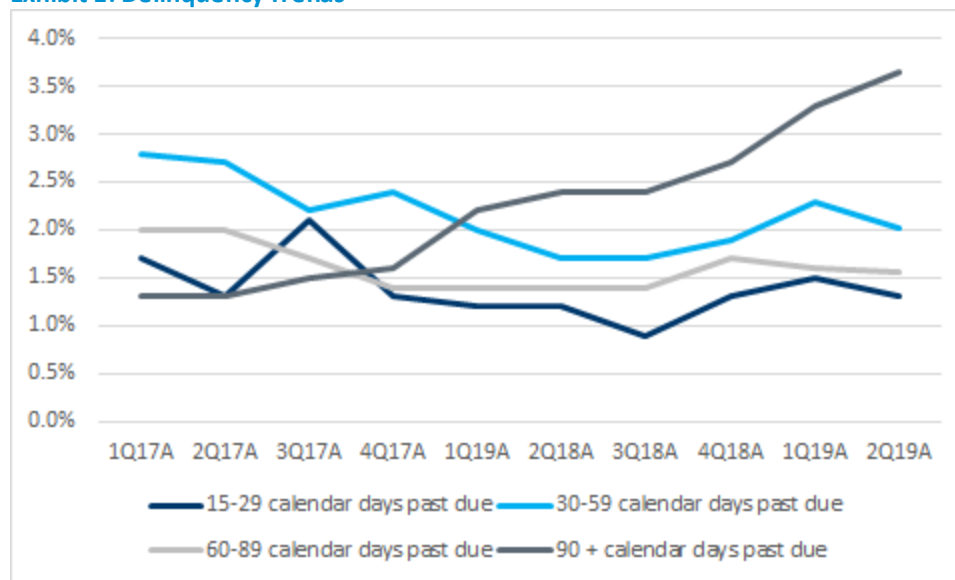
Company Description

On Deck Capital, Inc. provides capital financing services to businesses. The Company offers online tools and resources including data aggregation and electronic payment technology, and to evaluate the health of small businesses. On Deck Capital serves small and medium sized businesses in the United States.

International Segment Impact – The international segment generated a larger-than-expected loss during the period but the company continues to believe they will achieve profitability. During the call, management noted the Canadian operations had \$23M of funding debt at a blended cost of ~10% that ONDK intends to refinance. If the company is successful, this would reduce annualized interest cost by \$1M on a \$23M balance which is likely to increase further as the Canadian operations scale over the next few quarters.

Credit and delinquency trends – The weak 2Q19 performance was driven by worse-than-expected credit performance and higher up-front provisions. Going forward, ONDK expects credit trends to improve over the next few quarters noting better performance of early-2019 vintages and a 50 bp sequential decrease in 15-89 days delinquent balances to 4.9% from 5.4%. As these delinquencies roll through over the next couple quarters, the inflows of 90+ delinquencies should slow and reduce the credit headwind in the company's results.

Exhibit 1: Delinquency Trends



Source: Company Reports

Profitability Improvement – As we move closer to FY20, we expect ONDK's efficiency ratio will begin to improve materially. During FY18, the company's efficiency ratio was 39.8% and we are modeling an increase to 41.9% during FY19 due to increased investment spending. As the investment spending slows down and the international segment generates smaller losses and achieves profitability during FY20, we are modeling an efficiency ratio of 39.5% during FY20 which represents a 30 bp improvement over FY18.

ODX – During the quarter, JP Morgan (JPM, Not Rated) informed ONDK it no longer intends to continue originating loans using ODX. While the loss of the company's first ODX customer is a negative development, the relationship allowed the company to prove it could enable a bank partner to originate small business loans and likely made it possible for the PNC Financial Services (PNC, Not Rated) and other potential future partnerships at ODX. During the conference call, management noted the pipeline of potential partners continues to expand and they still expect to announce additional new programs during 2019.

We don't assign any standalone value to ODX in our valuation and believe it could be a source of upside down the line once more bank partners are added, and we have increased visibility into the revenue and profit potential.



New Valuation – We are upgrading ONDK to Buy (from Neutral) with a price target of \$4.25 based on 1.0X our FY20E TBV per share of \$4.22 which supports a price target of \$4.25. We believe this is a fair multiple for a company we expect will generate a 13.7% ROTCE during FY20. On an earnings basis, our \$4.25 valuation equates to a 7.2X multiple of our FY20E Adj. EPS of \$0.59.

Going into FY20, the company has a few tailwinds that should drive earnings and ROE higher: completing the investment spending program, achieving profitability in the international segment and reduced credit headwinds. As the company begins to achieve these goals, we believe the multiple will rerate higher.

Income Statement

OnDeck - Operating Model	Dec-15	Dec-16	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Dec-20	Dec-21
\$ millions	2015A	2016A	2017A	1Q18A	2Q18A	3Q18A	4Q18A	2018A	1Q19A	2Q19A	3Q19E	4Q19E	2019E	1Q20E	2Q20E	3Q20E	4Q20E	2020E	2021E
Interest income	195.05	264.84	334.58	86.37	92.37	99.48	105.36	383.58	105.99	105.64	107.86	111.22	430.71	113.95	114.02	115.66	120.49	464.12	493.77
Gain on sale of loans	53.35	14.41	2.49	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other revenue	6.37	12.06	13.89	3.91	3.25	3.52	4.17	14.85	4.18	4.61	4.40	4.79	17.98	4.59	5.41	5.06	5.39	20.46	23.02
Gross revenue	254.77	291.32	350.95	90.28	95.62	103.00	109.53	398.43	110.17	110.25	112.26	116.01	448.68	118.54	119.43	120.73	125.88	484.58	516.78
Provision for loan losses	74.86	149.96	152.93	36.29	33.29	39.10	39.85	148.54	43.29	42.95	46.50	49.55	182.29	47.40	42.87	49.47	53.47	193.21	202.31
Funding costs	20.24	32.45	45.44	11.82	12.20	11.67	11.23	46.92	11.33	11.38	13.42	13.66	49.79	13.39	13.15	13.33	13.87	53.74	58.70
Total cost of revenue	95.11	182.41	198.36	48.11	45.50	50.77	51.08	195.46	54.62	54.33	59.92	63.21	232.08	60.79	56.02	62.80	67.33	246.95	261.01
Net revenue	159.66	108.91	152.59	42.17	50.12	52.23	58.45	202.97	55.54	55.91	52.34	52.80	216.60	57.75	63.41	57.93	58.54	237.63	255.77
Sales and marketing	60.58	67.01	52.79	10.60	11.43	10.85	11.21	44.08	11.96	13.31	12.20	11.32	48.79	12.86	14.31	13.12	12.56	52.84	56.28
Technology and analytics	42.65	58.90	53.39	11.01	12.80	13.42	13.64	50.87	16.81	16.68	15.43	15.43	64.35	15.28	15.43	15.58	15.74	62.03	66.06
Processing and servicing	13.05	19.72	18.08	5.22	5.04	5.30	5.65	21.21	5.49	5.61	5.83	6.21	23.14	5.96	6.09	6.33	6.74	25.11	26.61
General and administrative	45.30	48.35	41.92	17.73	16.03	13.11	14.47	61.33	14.03	16.35	15.94	15.78	62.11	15.99	15.54	15.55	15.39	62.46	66.21
Total operating expenses	161.59	193.97	166.17	44.55	45.31	42.67	44.96	177.49	48.28	51.95	49.41	48.74	198.38	50.08	51.35	50.57	50.43	202.44	215.16
Income (loss) from operations	-1.93	-85.07	-13.58	-2.39	4.82	9.56	13.49	25.48	7.26	3.96	2.93	4.06	18.21	7.67	12.05	7.35	8.11	35.19	40.62
Interest expense	0.31	0.41	0.76	0.05	0.04	0.06	0.00	0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income (loss) before provision for income taxes	-2.23	-85.48	-14.35	-2.44	4.77	9.50	13.49	25.32	7.26	3.96	2.93	4.06	18.21	7.67	12.05	7.35	8.11	35.19	40.62
Provision for income taxes	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.74	1.80	1.03	1.22	5.78	1.92	3.01	1.84	2.03	8.80	10.15
Net income (loss)	-2.23	-85.48	-14.35	-2.44	4.77	9.50	13.49	25.32	5.52	2.17	1.91	2.84	12.43	5.75	9.04	5.52	6.09	26.39	30.46
Net income (loss) attributable to noncontrolling interest	-0.96	-2.52	-2.81	-0.52	-1.02	-0.27	-0.60	-2.41	-0.34	-2.13	-1.60	-1.20	-5.26	-0.78	-0.51	-0.33	0.00	-1.61	0.00
Net income (loss) attributable to On Deck Capital shareholders	-1.27	-82.96	-11.53	-1.92	5.79	9.77	14.09	27.73	5.86	4.30	3.50	4.04	17.69	6.53	9.54	5.84	6.09	28.01	30.46
Basic EPS - GAAP	-\$0.02	-\$1.17	-\$0.16	-\$0.03	\$0.08	\$0.13	\$0.19	\$0.37	\$0.08	\$0.06	\$0.05	\$0.06	\$0.24	\$0.10	\$0.15	\$0.09	\$0.10	\$0.44	\$0.52
Diluted EPS - GAAP	-\$0.02	-\$1.17	-\$0.16	-\$0.03	\$0.07	\$0.12	\$0.18	\$0.36	\$0.07	\$0.05	\$0.05	\$0.06	\$0.23	\$0.10	\$0.14	\$0.09	\$0.09	\$0.42	\$0.50
Diluted EPS - Adjusted	\$0.14	-\$0.95	\$0.06	\$0.08	\$0.13	\$0.17	\$0.20	\$0.58	\$0.10	\$0.09	\$0.08	\$0.09	\$0.37	\$0.14	\$0.18	\$0.13	\$0.14	\$0.59	\$0.69
Common shares outstanding	69.55	70.93	72.89	73.98	74.39	74.72	75.50	74.65	75.54	76.14	72.95	68.77	73.35	65.23	64.38	62.97	61.58	63.54	58.10
Diluted share outstanding	69.55	70.93	72.89	73.98	78.29	79.37	79.59	77.81	79.12	78.90	75.72	71.56	76.32	68.03	67.19	65.79	64.42	66.36	60.97
Diluted shares outstanding - Non-GAAP	75.35	70.73	72.89	77.35	78.29	79.37	79.59	78.65	79.12	78.90	75.72	71.56	76.32	68.03	67.19	65.79	64.42	66.36	60.97
Net income (loss) attributable to On Deck Capital shareholders	-1.27	-82.96	-11.53	-1.92	5.79	9.77	14.09	27.73	5.86	4.30	3.50	4.04	17.69	6.53	9.54	5.84	6.09	28.01	30.46
Stock-based compensation	11.58	15.92	12.52	3.21	2.79	2.85	2.97	11.82	2.44	2.58	2.64	2.73	10.38	2.73	2.75	2.78	2.90	11.15	11.89
Real estate disposition charges	0.00	0.00	0.00	4.19	0.00	0.00	0.00	4.19	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Severance and executive transition expenses	0.00	0.00	3.18	0.91	0.00	0.00	0.00	0.91	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt extinguishment costs	0.00	0.00	0.00	0.00	1.38	0.55	0.00	1.93	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Sales tax refund	0.00	0.00	0.00	0.00	0.00	0.00	-1.10	-1.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Adjusted net income (loss)	10.31	-67.04	4.16	6.39	9.97	13.17	15.96	45.48	8.29	6.88	6.14	6.76	28.07	9.26	12.29	8.62	8.98	39.15	42.35
Diluted shares outstanding - Non-GAAP	75.35	70.73	72.89	77.35	78.29	79.37	79.59	78.65	79.12	78.90	75.72	71.56	76.32	68.03	67.19	65.79	64.42	66.36	60.97
Tangible book value per share	\$4.62	\$3.63	\$3.40	\$3.41	\$3.47	\$3.59	\$3.77	\$3.77	\$3.91	\$3.82	\$3.86	\$3.90	\$3.90	\$3.98	\$4.09	\$4.16	\$4.22	\$4.22	\$4.62
Tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	24.0%	45.3%	35.0%	30.0%	31.7%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
ROA	1.4%	-7.4%	0.4%	2.5%	3.8%	4.8%	5.5%	4.2%	2.8%	2.2%	1.9%	2.1%	2.3%	2.8%	3.8%	2.6%	2.6%	3.0%	3.0%
ROE	3.3%	-22.5%	1.6%	9.7%	14.9%	18.9%	21.8%	16.4%	10.9%	8.6%	7.9%	9.1%	9.2%	12.9%	17.3%	12.1%	12.7%	13.7%	14.9%
NIM	23.8%	24.9%	26.0%	27.2%	28.0%	29.2%	30.1%	28.7%	29.4%	28.8%	28.2%	28.5%	28.7%	29.2%	29.5%	29.3%	29.4%	29.3%	28.9%
Tangible leverage ratio	1.2x	2.9x	2.6x	2.8x	2.8x	2.9x	2.7x	2.7x	2.7x	2.6x	2.8x	3.0x	3.0x	3.1x	3.0x	3.3x	3.4x	3.4x	3.7x
Adj. Efficiency ratio	58.9%	61.1%	42.9%	40.1%	43.0%	38.1%	38.3%	39.8%	41.6%	44.8%	41.7%	39.7%	41.9%	39.9%	40.7%	39.6%	37.8%	39.5%	39.3%

Source: BTIG Estimates and Company Documents



BTIG Covered Companies Mentioned in this Report

ON DECK CAPITAL, INC. (ONDK, Buy, \$4.25 PT; Current Price: \$3.96; Analyst: Giuliano.Bologna)

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Regulatory Disclosures

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Company Valuation and Risk Disclosures

On Deck Capital, Inc. (ONDK, Buy, \$4.25 PT)

Valuation: Our \$4.25 price target is based on 1.0X our FY20 TBV per share estimate of \$4.22. We believe this is an appropriate multiple for a business we expect to generate a 13.7% ROTCE during FY20. Our valuation equates to a 7.2X multiple of our FY20E Adj. earnings per share of \$0.59.

Risks: The primary risks to achieving our rating include slower-than-anticipated growth, worse-than-expected credit performance, a lack of new client additions at ODX, funding risks, the inability to expand margins, small business credit risk and macroeconomic risks.

On Deck Capital, Inc. (ONDK)

(\$)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
20-Jan-15	18.39	25	Mark Palmer	Buy
02-Nov-15	9.46	18	Mark Palmer	Buy
23-Feb-16	7.05	15	Mark Palmer	Buy
02-May-16	8.30	NA	Mark Palmer	Neutral
14-Aug-18	8.92	7	Mark Palmer	Sell
08-Oct-18	7.04	N/A	Mark Palmer	Neutral
16-Jul-19	3.99	N/A	Giuliano Bologna	Neutral

Company-Specific Regulatory Disclosures

BTIG LLC expects to receive or intends to seek compensation for investment banking services in the next 3 months from: On Deck Capital, Inc. (ONDK)

Other Disclosures

Additional Information Available Upon Request

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