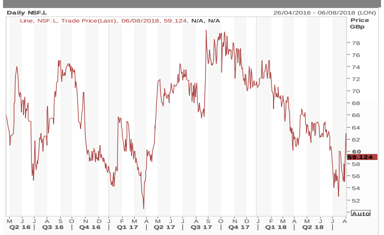
Non-Standard Finance

1H'18 results: jam today, more tomorrow

Financials



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**NSF**
Price (p)	63.0
12m High (p)	78.75
12m Low (p)	50.5
Shares (m)	313
Mkt Cap (£m)	197
EV (£m)	385
Free Float*	99%
Market	Main

**As defined by AIM Rule 26*

Description

In the UK non-standard lending market, NSF has the market-leading network in unsecured branch-based lending, and is number two in guarantor loans and number three in home credit.

Company information

CEO	John van Kuffeler
CFO	Nick Teunon
Chairman	Charles Gregson

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Key shareholders

Invesco	28.7%
Woodford Investment	26.8%
Marathon Asset Mgt.	10.3%
Aberforth Partners	10.2%
Quilter Cheviot AM	4.1%
ToscaFund	3.8%

Diary

November	Capital Markets Day

Analyst

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NSF invested heavily in 2016 to 1H'18, deferring the delivery of greater bottom-line profits. The 1H'18 results delivered tangible payback on this investment, with normalised operating profits up 79% (statutory operating profit moved from a loss of £1.1m to a profit of £7.0m). Pre-tax profits were held back by the group locking in long-term, more expensive, funding (finance costs £9.6m vs. £3.1m) but, as these funds are deployed, pre-tax profits are expected to rise. We reviewed Everyday Loans (EL) in "A heart of gold". We believe the re-pricing and volume opportunities that NSF have in a downturn provide it with counter-cyclicality.

- **1H'18 results:** The key takeaway from the results was that credit quality was ahead of expectations, especially in the branch and guarantor loan (GLD) businesses. Customer numbers and volumes for those divisions were ahead of our forecasts; Home Collect (HC) agent and customer numbers were a little below our expectations but HC remains the group's smallest division.
- **Outlook:** In recent trading statements, management has confirmed that full-year trading is in line with expectations. Despite credit being better than expected, we understand management plans to maintain scorecards, rather than chase incremental volume; indeed, we see an easing in HC volume targets after a period of rapid YoY growth.
- **Valuation:** Our absolute valuation measures for NSF range from 91p-103p per share. With the IPO of Amigo, there is now a market comparator for the GLD business, and so we are introducing a sum-of-the-parts model (implied valuation 89p). Peer comparators reach up to 91p.
- **Risks:** Credit risk remains the biggest threat to profitability, and NSF's model accepts higher credit risk where a higher yield justifies it. NSF is innovative, and may incur losses piloting new products, customers and distribution. Regulation is a market issue; management is taking appropriate action to mitigate this risk.
- **Investment summary:** Substantial value should be created, as i) competitors have withdrawn, ii) NSF is well capitalised, with committed six-year debt funding, iii) macro drivers are positive, and iv) NSF has a highly experienced management team, delivering operational efficiency without compromising the key F2F model. Targets of 20% loan book growth and 20% EBIT RoA appear credible, and investors are paying 9.8x 2019E P/E and getting a 5.0% yield.

Financial summary and valuation

Year-end Dec (£000)	2016	2017	2018E	2019E
Revenue	94,674	119,756	167,852	200,978
Impairments (incl. IFRS9)	-26,155	-28,795	-39,252	-47,259
Total costs (excl. dep.)	-49,600	-67,706	-87,246	-94,135
EBITDA	19,369	25,181	37,132	53,192
PBT	13,056	13,203	14,660	24,725
Statutory PBT (co. basis)	-9,342	-13,021	-4,850	11,275
Pro-forma normalised EPS (p)	3.37	3.44	3.78	6.41
DPS (p)	1.20	2.20	2.60	3.20
P/adjusted earnings (x)	18.7	18.3	16.7	9.8
P/BV (x)	0.8	0.9	0.9	0.9
P/tangible book	2.0	2.6	3.2	2.9
Yield	1.9%	3.5%	4.1%	5.1%

Source: Hardman & Co Research

1H'18 results summary

Positive trends in most KPIs

We detail the group's 1H'18 KPIs below and, for information, the same for FY17, although investors should note that the 1H'17 reported figures have not been restated. The key messages are (i) accelerated loan growth compared with end-2017, (ii) stable/improving yields, and (ii) impairments to revenue better than guidance in the branch and GLD businesses. For its KPIs, NSF has presented on a like-for-like basis – so, for example, the loan book growth is not distorted by accounting.

KPIs (rolling 12 months to June 2017 and June 2018)

%	EL* (branch-based)		George Banco/TrustTwo (GLD**)		Loans at Home (LAH***)	
	1H'17	1H'18	1H'17	1H'18	1H'17	1H'18
Loan book growth	15.9	28.3	43.2	56.1	10.3	53.0
Normalised revenue yield	45.7	46.5	31.0	36.6	178.1	174.9
Risk-adjusted margin	35.2	37.8	26.5	30.4	111.0	110.9
Impairments/revenue	23.0	18.8	14.5	17	37.7	36.6
Operating profit margin	37.6	35.4	12.6	35.9	4.8	6.0
RoA	17.2	16.5	3.9	13.3	8.5	10.5

*Source: NSF, Hardman & Co Research; * Everyday Loans; ** Guarantor Loans *** Home Collect;*

Group profit estimates broadly unchanged: EV up, GLD stable, LAH modest fall

At this stage, we have not changed our FY18 group estimates materially. We characterise 1H'18 as a small beat (see each division below for more details), but we will treat this as a cushion against any future market uncertainties, rather than increase estimates at this stage. The transition to IFRS9 has also meant that the accounting has made certain business trends less visible. Divisionally, we have increased estimates in EV and the GLD business, while we have trimmed them in HC.

Estimate changes

Year-end Dec	2018E			2019E		
	Old	New	% chg.	Old	New	% chg.
Profit and loss (£000)						
Reported revenue	166,098	167,852	1%	197,000	200,978	2%
Total impairments (including IFRS9)	-39,728	-39,252	-1%	-46,208	-47,259	2%
Total costs (excluding depreciation)	-85,596	-87,246	2%	-93,760	-94,135	0%
EBITDA	35,443	37,132	5%	50,638	53,192	5%
PBT	14,424	14,660	2%	24,798	24,725	0%
Pro-forma normalised EPS (p)	3.72	3.78	2%	6.40	6.41	0%
DPS (p)	2.50	2.60	4%	3.15	3.20	2%
Balance sheet (£m)						
Amounts receivable	293.6	306.4	4%	361	376.5	4%
Borrowings	228.8	242.8	6%	289	307.8	7%
Shareholders' equity	221.7	209.1	-6%	222	209.3	-6%

Source: Hardman & Co Research

Real like-for-like revenue and operating profit growth above reported levelsunding robust

The statutory accounts mean that 1H'18 is on an IFRS9 basis, while 1H'17 was on the old IAS39 standard. This distorts growth rates, so investors need to treat revenue growth (reported at 51%), normalised operating and pre-tax profit increases (79% and 4%, respectively) with caution. The strong loan book growth means more provisions are taken upfront, so the real like-for-like growth numbers would be higher. The group remains well-funded, with existing committed lines more than covering expected growth through to mid-2020 (with covenants on an IAS39 basis).

Everyday Loans (EL)

EL (branch-based lender) is NSF's largest business, representing ca.62% of the group's total loan book, 45% of revenue and 75% of pro-forma normalised operating profit (60%, 51% and 86%, respectively, in FY'17). NSF completed the acquisition of EL on 13 April 2016.

Key features from results

More branches

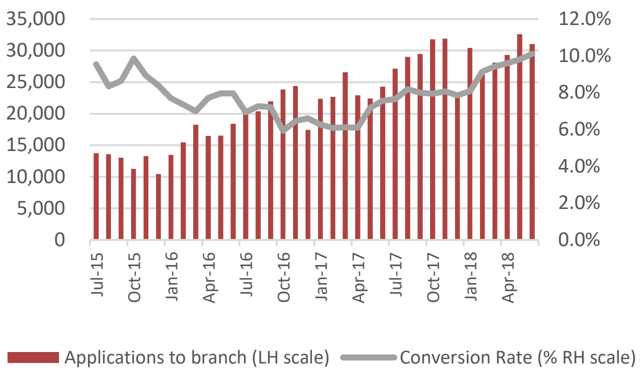
More applications

Improving conversion rates

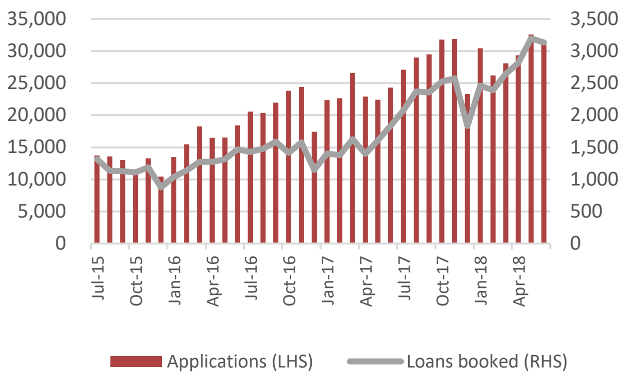
All helping strong loan growth

- Since the acquisition of EL, NSF has invested heavily in expanding the branch footprint (11 branches opened in 1H'18, now 64; up 78% on when NSF acquired the business). With this, and a strengthening of broker relationships, there has been an increase in the volume of applications. Sharing of best practice (*inter alia* taking ideas from branches with high conversion and applying these across the network), together with an improved quality of leads received from brokers, have increased the conversion rate of the higher number of applications.

Number of applications to branch/conversion rate



Loan applications and loans booked



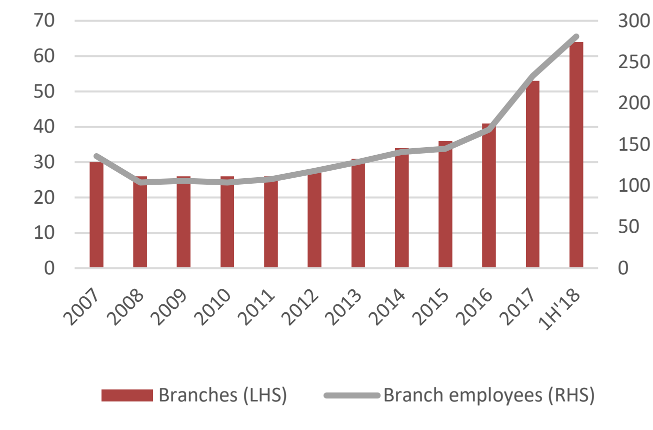
Source: Hardman & Co Research

Consistent branch model being adopted

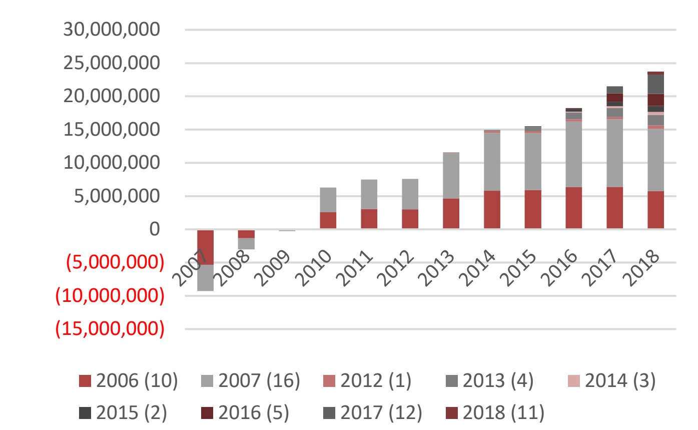
Material embedded value in branches not yet at maturity

The table below shows branch employees rising in line with branch numbers. The aggregate profitability of the branches by the year they opened is shown in the right-hand graph (new branches are often seeded with loans and staff from existing ones). he key message is that the 43% of branches opened since 2015 generated under a third of profits. There is an embedded value that has yet to become visible. The large losses in the early years are a significant barrier to entry to setting up a branch network.

Number of employees and branch locations



Aggregate profitability (£) by year of branch opening



Source: Hardman & Co Research

Performance of EL against Hardman & Co expectations (£m)

	Revenue	Impairments	Costs	Finance	Pre-tax
1H'18	1.7 B (0.8 B*)	0.5B	0.1W	0.8B	2.9B

*Source: Hardman & Co Research; "B" better than forecast; "W" worse than forecast; * excl. loan sales*

As noted above, 1H'18 saw a beat on revenue (customer numbers and loans ahead of our forecasts), an improved credit performance (18.8% of revenue vs. our forecast 19.6% and previous company guidance of 20%-22%) and costs broadly in line.

Change in outlook for EL with these results

2018 revenue estimates increased by £2.1m (£1.2m excluding loan sale)

Looking forward, we have increased our expectation for customer numbers (2018E was 56k, now 59k, 2019E was 64.6k, now 68k) and average loans by £5m. We have trimmed the yield, to be consistent with 1H'18, and so our forecast reported revenue is now £77.7m (was £76.5m) for 2018 and £94.9m (was £91.9m) for 2019. We have included the gain on the sale of a portfolio of non-performing loans (£890k) as a one-off. We have carried forward the improved credit (as a percentage of revenue) and, despite the loan growth, this leads to reduced impairments by £0.1m in 2018 and a small increase in 2019. We have cut 2018 finance costs by £0.9m, leaving 2019 unchanged.

Financial summary and ratios, EL

	Pro-forma normalised			
Year-end Dec (£000)	**2016**	**2017**	**2018E**	**2019E**
Reported revenue	50,088	60,937	77,684	94,947
Other income	450	1,926	890	-
Total revenue	**50,538**	**62,863**	**78,574**	**94,947**
Impairments	-10,484	-11,654	-14,760	-18,515
IFRS9 impairments	0	0	-1,476	-1,851
Revenue less impairments	40,054	51,209	62,338	74,581
Administration expenses	-20,631	-28,555	-35,104	-40,179
Operating profit	**19,423**	**22,654**	**27,234**	**34,402**
Net finance costs	-4,720	-7,051	-12,029	-16,335
Profit before tax	**14,703**	**15,603**	**15,205**	**18,067**
Number of branches	41	53	65	70
Period-end customer numbers (000s)	39,600	47,000	59,000	68,000
Period-end loan book (excluding FV)	122,400	148,500	185,625	222,750
Average loans	113,400	133,000	167,063	204,188
Ratios				
Revenue (pre-FV) as % of average loans	44.2%	45.8%	46.5%	46.5%
Impairments as % of pre-FV revenue	-20.9%	-19.1%	-19.0%	-19.5%
Risk-adjusted margin	35.3%	37.1%	37.7%	37.4%
Cost as % of pre-FV revenue	-41.19%	-46.86%	-45.19%	-42.32%
Operating pft % of pre-FV revenue	38.80%	37.20%	34.66%	36.23%
Net finance costs as % of pre-FV revenue	-9.42%	-11.57%	-15.48%	-17.20%
Impairments as % of average loans	-9.25%	-8.76%	-8.84%	-9.07%
Costs as % of average loans	-18.19%	-21.47%	-21.01%	-19.68%
Net finance cost as % of average loans	-4.16%	-5.30%	-7.20%	-8.00%
Average loan per customer (£)	3,091	3,160	3,146	3,276
Pre-FV revenue per customer (£)	1,264.8	1,296.5	1,316.7	1,396.3

Source: Hardman & Co Research

Macroeconomic downside protected by volume and re-pricing opportunities

We see significant long-term potential from this business (see our note "A heart of gold"). Investors should note that, in a downturn scenario, we believe that the potential number of customers is likely to rise materially, as more consumers will be pushed down into the non-standard arena, (near prime lenders will likely tighten their lending criteria). With the average revenue yield close to 50%, the ability to re-price is also much greater than the mainstream market. One reason NSF locked in financing (albeit at a higher cost) was to ensure that it had secure, long-term funding. These factors suggest that EL's performance should be robust if, and when, there is a UK recession.

Guarantor Loans (GLD):

In 1H'18, GLD was the second-largest of NSF's three businesses and represented 24% of the group's loan book, 13% of revenue and 15% of pro-forma normalised operating profit (19%, 7% and 4%, respectively, in FY'17). It offers loans to non-standard customers who are able to get someone else, often a family member with a good credit rating, to guarantee their loan. With the guarantee, the interest rate that the borrowers have to pay is significantly lower than if they were to borrow on their own, making the loan much more affordable. TrustTwo (TT) was acquired as part of EL on 13 April 2016. The acquisition of George Banco (GB) was completed on 17 August 2017.

Key features from results

Business integration on track

1H'18 was partially about integrating the two GLD businesses. Management has indicated that this should be largely complete by the end of 2018. The combination has created one division with one set of key business processes, although, as the two brands serve slightly different parts of the guarantor segment, they have been kept separate (TT gets most of its business from price comparison websites and direct, while GB sees most of its business coming from financial brokers).

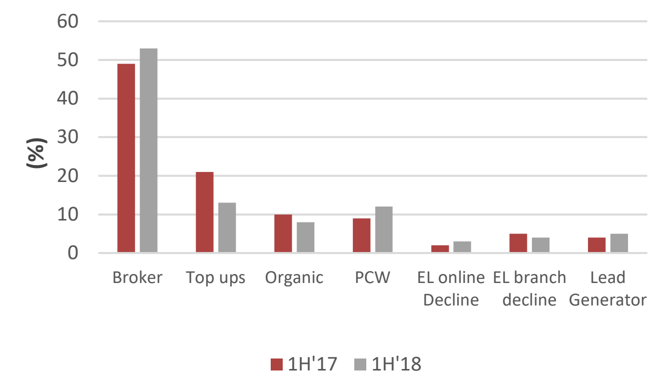
Increasing broker penetration and referrals from branch network

Additionally, in 1H'18, the group has been seeking to exploit the strong market growth and, in particular, to leverage two distinct competitive advantages: firstly, brokers are looking for a credible alternative to the market leader (Amigo) to limit their concentration risk; secondly, NSF is looking to exploit the group synergies from referring EL declines to the GLD business. Over the past year, accepted leads have increased from just over 60k per month to nearly 200k (a 180% increase), with strong growth across both brands.

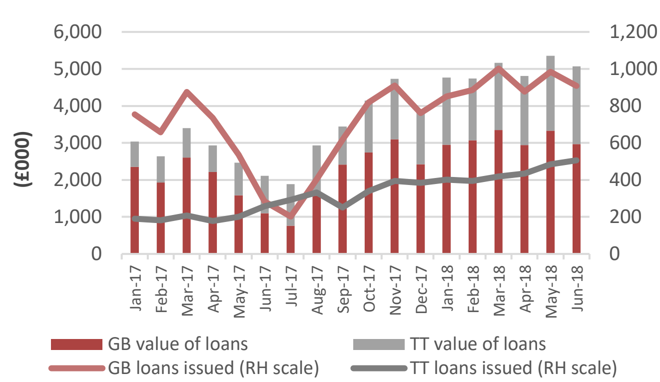
Good recovery in volumes at GB; TT steady increases since acquisition

As can be seen in the right-hand chart below, there has been a strong recovery by GB from the low point seen ahead of the acquisition last year. TT, which has been under NSF ownership for a longer period, has been showing steady improvements throughout (from ca.£450k of lending per month in April 2016 to ca.£2m per month in June 2018). Overall, on a like-for-like basis (i.e. assuming GB had been owned for the full period), the loan book grew by an impressive 56%.

Source of new business by distribution channel



Value of loans and loans issued by GB and TT



Source: Hardman & Co Research

Growth comes with broadly stable credit, unlike Amigo loans

In H1'18, customer growth was above our expectations (20.9k vs. 19.1k), and consequently the loan book and revenue were above forecasts. This did not come at the cost of credit. Impairments were 17% of revenue against previous guidance of 20%-22%. The impairments LFL at NSF have been broadly stable while, at Amigo, there has been a sharp increase (from 6.8% to 21.3% of revenue, IAS39 basis). The better-than-expected credit performance has also fed through to an improvement in the like-for-like risk-adjusted margin (30.4% against 26.5% in 1H'17), as well as an increase in the operating profit margin to 35.9% and return on assets to 13.2%.

Performance of GLD against Hardman & Co expectations (£m)

	Revenue	Impairments	Costs	Finance	Pre-tax
1H'18	1.2B	0.4B	0.8W	0.3W	0.5B

Source: Hardman & Co Research; "B" better than forecast; "W" worse than forecast

Change in outlook for GDL with these results

Raised revenue, expenditure and finance cost expectations. Net effect is profits in line with previous forecasts.

We have increased customer numbers, average loan book and average yield forecasts to reflect the 1H'18 levels. These drive an increase in revenue from the £18.9m previously forecast to £21.6m for 2018, and from £28.0m to £29.4m for 2019). An improvement in the ratio of impairments to revenue is partially offset by the higher revenue (£0.3m net improvement). Costs have been increased by £2m and finance costs by £0.8m, leaving the divisional profit largely unchanged.

Financial summary and ratios, GLD

	Pro-forma normalised			
Year-end Dec (£000)	**2016**	**2017**	**2018E**	**2019E**
Reported revenue	2,416	8,078	21,610	29,354
Impairments	-358	-1,365	-2,553	-4,208
IFRS9 impairments	0	0	-894	-1,473
Revenue less impairments	2,058	6,713	18,164	23,673
Administration expenses	-1,402	-3,965	-9,500	-10,600
Operating profit	**656**	**2,748**	**8,664**	**13,073**
Net finance costs	-316	-2,029	-5,500	-6,500
Profit before tax	**340**	**719**	**3,164**	**6,573**
Period-end customer numbers (000s)	3,300	17,400	24,360	32,886
Period-end loan book (excluding FV)	8,800	48,200	69,890	97,846
Average loans	7,700	40,400	59,045	83,868
Ratios				
Revenue (pre-FV) as % of average loans	31.9%	35.8%	36.6%	35.0%
Impairments as % of pre-FV revenue	-14.8%	-15.3%	-16.0%	-19.4%
Risk-adjusted margin	26.7%	30.3%	32.3%	30.0%
Pre-tax return (excluding FV) average	4.4%	1.8%	5.4%	7.8%
Cost to % pre-FV revenue	-58.0%	-49.1%	-44.0%	-36.1%
Operating % pre-FV revenue	27.2%	34.0%	40.1%	44.5%
Net finance costs as % of pre-FV revenue	-13.1%	-25.1%	-25.5%	-22.1%
Impairments as % of average loans	-4.6%	-5.5%	-4.3%	-5.0%
Costs as % of average loans	-18.2%	-9.8%	-16.1%	-12.6%
Net finance cost as % of average loans	-4.1%	-5.0%	-9.3%	-7.8%
Average loan per customer (£)	2,667	2,770	2,869	2,975
Pre-FV revenue per customer (£)	732	464	887	893

Source: Hardman & Co Research

Looking forward, the strong growth in guarantor loans is expected to continue. There is anecdotal evidence that the regulator sees this business line as a solution for poor-credit-history borrowers. By using a guarantor, such customers can get access to finance at rates that become affordable, rather than having no access at all to credit, thereby allowing them to rebuild their credit history. Again, we would expect volumes to be a key driver in a recessionary environment, and having guarantors who are significantly prime means the volatility in impairments may also be more moderate than most non-standard lending.

Home Credit: Loans at Home (LAH)

Based on 1H'18 results, LAH is NSF's third-largest business, with ca.14% of the group's total loan book. While it does generate 42% of group revenue, it makes a smaller (9%) contribution to normalised operating profit (21%, 42% and 10%, respectively, in FY'17). LAH is the UK's third-largest HC credit business in terms of numbers of customers. NSF completed the acquisition of SD Taylor (which trades as LAH) on 4 August 2015, and it received its full FCA permissions on 16 May 2017.

Key features from results

Most affected by IFRS9. Further impact of new agents/customers from PFG.

The HC business was the most affected division by the shift to IFRS9 accounting, as taking provisions earlier had a marked effect on the stock of provisions (so reducing receivables), driven by rapid growth. This volatility was compounded by the effect of bringing on board large numbers of Provident Financial agents who were paid temporary commissions, and bringing across a customer base that typically had larger loans taken over a longer period at lower yields.

Performance of LAH against Hardman & Co expectations (£m)

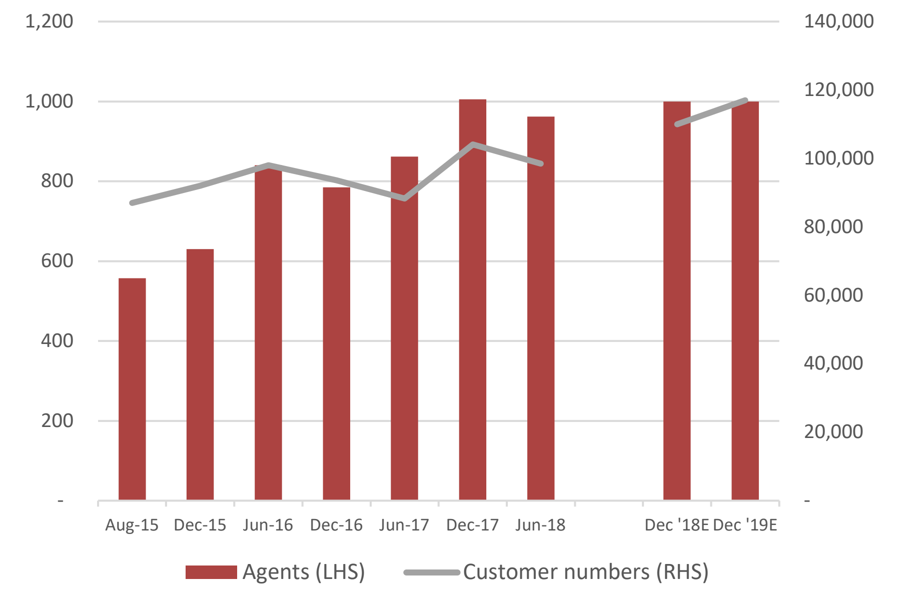
	Revenue	Impairments	Costs	Finance	Pre-tax
1H'18	0.7B	0.6W	In Line	0.3W	0.2W

Source: Hardman & Co Research; "B" better than forecast; "W" worse than forecast

1H'18 underlying broadly in line, with slight revenue beat offset by impairments

Bearing in mind the complexity in forecasting future performance that this created, the business performed largely in line with expectations. We saw slightly faster-than-expected customer and agent attrition (but, given the number of PFG agents, this was to be expected), and impairments were towards the higher end of guidance.

Agent and customer numbers from August 2015



Source: NSF, Hardman & Co Research

We also note that management appears to be targeting a more normalised level of loan book growth than historically. Historical guidance had been for ca.20% p.a. growth, but this is now ca.20% p.a. over the medium to long term since acquisition.

Volume growth target reduced. Mid to high single-digit growth going forward.

Given that the compound growth from acquisition to date has been 33% (and 53% in 1H'18), looking forward, a mid to high single-digit annual increase would deliver the target. Such a growth rate can be achieved by modest market growth and some fall-out of smaller providers who are getting squeezed by regulatory constraints.

Now about operational delivery and PFG opportunity embedded in business

Management commentary focused more on the operational delivery than strategic changes. This includes the roll-out of technology (improving efficiency while keeping the core customer/agent relationship) and maintaining good spans of control (around six agents per manager).

Change in outlook for LAH with these results

Yields trimmed, volumes unchanged, credit marginally worse

Agent and customer numbers were below expectations. Looking forward, we have reduced our expectations for both (agents: 2018E was 1,050, now 1,000, 2019E was 1,100, now 1,000; customers: 2018E was 125k, now 110k, 2019E was 130k, now 117k). The loan book growth was ahead of expectations, but the revenue yield somewhat below (reflecting larger average loans). Given management commentary, we have left our loan book growth estimates unchanged, but we have trimmed the forecast yield to be more in line with 1H'18. This reduces 2018 revenue by £2m. Impairments were at the higher end of management guidance, and we have increased these a little going forward. We have also increased net finance costs.

Financial summary and ratios, LAH

	Pro-forma normalised			
Year-end Dec (£000)	**2016**	**2017**	**2018E**	**2019E**
Reported revenue	42,170	50,741	68,557	76,677
Impairments	-15,313	-15,776	-21,938	-24,537
IFRS9 impairments			-2,742	-3,067
Revenue less impairments	26,857	34,965	43,876	49,073
Administration expenses	-23,229	-28,679	-40,000	-41,000
Temporary agent commission	-1,771	-3,184	0	0
Total expenses	-25,000	-31,863	-40,000	-41,000
Operating profit	**1,857**	**3,102**	**3,876**	**8,073**
Net finance costs	-323	-1,299	-2,585	-2,738
Profit before tax	**1,534**	**1,803**	**1,291**	**5,335**
Number of offices	47	69	70	70
Number of agents	785	1,005	1,000	1,000
Period-end customer numbers (000s)	93,600	104,100	110,000	117,000
Period-end loan book (excluding FV)	33,400	51,200	50,840	55,924
Average loans	27,600	34,500	38,300	42,130
Ratios				
Revenue (pre-FV) as % of average loans	153%	147%	179%	182%
Impairments as % of pre-FV revenue	-36.3%	-31.1%	-36.0%	-36.0%
Risk-adjusted margin	97.3%	101.3%	121.7%	123.8%
Pre-tax return (excluding FV) on average	5.6%	5.2%	3.4%	12.7%
Cost to % pre-FV revenue	-59.3%	-62.8%	-58.3%	-53.5%
Operating % pre-FV revenue	4.4%	6.1%	5.7%	10.5%
Net finance costs as % of pre-FV revenue	-0.8%	-2.6%	-3.8%	-3.6%
Impairment as % of average loans	-55.48%	-45.73%	-57.28%	-58.24%
Costs as % of average loans	-90.58%	-92.36%	-104.44%	-97.32%
Net finance cost as % of average loans	-1.17%	-3.77%	-6.75%	-6.50%
Average loan per customer (£)	357	492	462	478
Pre-FV revenue per customer (£)	451	487	623	655

Source: Hardman & Co Research

As we have noted in previous reports, a well-managed HC business can deliver rising profits in a recession, as re-priced lending and volume opportunities offset higher impairments. This was delivered by the NSF management in their previous roles.

Financials

Statutory profit and loss (£000)					
Year-ended 31 December	**2015**	**2016**	**2017**	**2018E**	**2019E**
Business interest income	14,657	81,099	119,756	167,852	200,978
Other operating income	0	450	1,926	0	0
Fair value unwind on acquired portfolios	-5,456	-8,342	-11,985	-8,292	-8,292
Total revenue	**9,201**	**73,207**	**109,697**	**159,560**	**192,686**
Underlying business impairments	-1,885	-21,162	-28,054	-38,511	-46,518
Unwind of provision discount	-1,973	-2,489	-741	-741	-741
Business impairments	-3,858	-23,651	-28,795	-39,252	-47,259
IFRS9 impairments				-5,112	-6,391
Gross profit	**5,343**	**49,556**	**80,902**	**115,196**	**139,035**
Administration expenses	-11,340	-44,074	-69,203	-89,604	-97,029
Amortisation of intangibles	-4,030	-10,714	-7,897	-10,328	-5,158
Operating profit	**-10,027**	**-5,232**	**3,802**	**15,264**	**36,848**
EBITDA	-5,799	6,172	12,518	27,007	43,734
Exceptional Items	-6,135	-626	-6,342	0	0
Net finance (cost)/income	70	-3,484	-10,481	-20,114	-25,573
Profit before tax	**-16,092**	**-9,342**	**-13,021**	**-4,850**	**11,275**
Income tax	3,022	1,344	2,686	752	-3,084
Profit after tax	**-13,070**	**-7,998**	**-10,335**	**-4,097**	**8,190**
Average no. shares for EPS calculation (m)	61.50	307.32	316.90	313.95	312.67
Statutory EPS (p)	-21.25	-2.60	-3.26	-1.31	2.62
Adjusted EPS (p)		3.37	3.44	3.78	6.41
DPS (p)	-	1.20	2.20	2.60	3.20

Source: NSF, Hardman & Co Research

Normalised profit and loss (£000)				
Year-ended 31 December	**2016**	**2017**	**2018E**	**2019E**
Business interest income	94,674	119,756	167,852	200,978
Other operating income	450	1,926	890	0
Fair value unwind on acquired portfolios	0	0	0	0
Total revenue	**95,124**	**121,682**	**168,742**	**200,978**
Underlying business impairments	-23,155	-28,054	-38,511	-46,518
Unwind of provision discount	-3,000	-741	-741	-741
Business impairments	-26,155	-28,795	-39,252	-47,259
IFRS9 impairments			-5,112	-6,391
Gross profit	**68,969**	**92,887**	**124,378**	**147,327**
Administration expenses	-50,290	-69,203	-89,604	-97,029
Amortisation of intangibles	0	0	0	0
Operating profit	**18,679**	**23,684**	**34,774**	**50,298**
EBITDA	19,369	25,181	37,132	53,192
Exceptional items				
Net finance (cost)/income	-5,623	-10,481	-20,114	-25,573
Profit before tax	**13,056**	**13,203**	**14,660**	**24,725**
Income tax	-2,688	-2,313	-2,785	-4,698
Profit after tax	**10,368**	**10,890**	**11,875**	**20,027**

Source: NSF, Hardman & Co Research

Balance sheet (£000)					
@ 31 December	**2015**	**2016**	**2017**	**2018E**	**2019E**
Non-current					
Goodwill	40,176	132,070	140,668	140,668	140,668
Intangible assets	14,119	17,412	17,205	6,877	1,719
Property, plant and equipment	1,718	5,459	9,434	11,576	11,576
Total non-current assets	**56,013**	**154,941**	**167,307**	**159,121**	**153,963**
Current assets					
Inventories	3	-	-	-	-
Amounts receivable from customers	**28,412**	**180,413**	**259,836**	**306,355**	**376,520**
Trade and other receivables	10,275	10,753	9,811	10,302	10,817
Cash and cash equivalent	7,320	5,215	10,954	1,768	2,156
Total current assets	46,010	196,381	280,601	318,425	389,493
Total assets	**102,023**	**351,322**	**447,908**	**477,546**	**543,456**
Current liabilities					
Trade and other payables	9,490	8,146	10,353	12,353	14,353
Deferred tax liability	14,275	-	-	-	-
Total current liabilities	23,765	8,146	10,353	12,353	14,353
Net current (liabilities)/assets	*29,150*	*188,235*	270,248	306,072	375,140
Non-current liabilities					
Financial liabilities – borrowings	-	87,300	199,316	252,316	317,316
Deferred tax	-	6,793	4,996	3,537	2,226
Total non-current liabilities	**-**	**94,093**	**204,312**	**255,853**	**319,542**
Total liabilities	16,860	102,239	214,665	268,206	333,895
Net assets*	**85,163**	**249,083**	**233,243**	**209,339**	**209,560**

*Source: NSF, Hardman & Co Research; * incl. £255k of NCI*

Cashflow statement (£000)					
Year-ended 31 December	**2015**	**2016**	**2017**	**2018E**	**2019E**
Profit (loss) before tax	-16,162	-5,858	-2,540	15,264	36,848
Taxation paid	-350	-1,341	-2,226	-1,226	-1,226
Depreciation	198	690	1,497	2,359	2,894
Share-based payments	0	0	291	473	473
Amortisation of intangibles	4,030	10,714	7,897	10,328	5,158
FV unwind on acquired loan book	5,456	8,342	11,985	8,292	8,292
Loss on disposal of fixed assets	51	-363	-416	0	0
Decrease in inventories	6	3	0	0	0
Increase in amounts receivable from customers (net of FV)	-5,394	-21,039	-54,437	-64,811	-78,457
Increase in receivables	-16,445	-7,737	-51	-491	-515
Increase in payables	19,078	-6,952	1,000	2,000	2,000
Net cash outflow from operating activities	**-9,532**	**-23,541**	**-37,000**	**-27,812**	**-24,533**
Cashflows from investing activities					
Purchase of property, plant and equipment	-341	-3,514	-4,931	-4,500	-4,500
Purchase of subsidiaries	-81,111	-230,784	-16,442	0	0
Net cash outflow – investing activities	**-81,452**	**-234,298**	**-21,373**	**-4,500**	**-4,500**
Cashflows from financing activities					
Net finance income	70	-3,484	-7,974	-20,114	-25,573
Proceeds from issue of shares/share purchase	98,234	172,869	-1,357	-1,630	0
Proceeds from borrowing	0	87,300	77,882	53,000	65,000
Dividends	0	-951	-4,439	-8,130	-10,006
Net cash inflow – financing activities	**98,304**	**255,734**	**64,112**	**23,127**	**29,421**
Net change in cash/cash equivalents	7,320	-2,105	5,739	-9,185	388
Opening cash and cash equivalents	0	7,320	5,215	10,954	1,768
Closing cash and cash equivalents	7,320	5,215	10,954	1,768	2,156

Source: NSF, Hardman & Co Research

Valuation

Summary

Average valuation upside potential on absolute measures 53%

Our absolute valuation techniques imply average upside potential of 53%. Peer valuations are now helpful, as we believe consensus is consistently applying IFRS9 across all companies. With the Amigo IPO, we have introduced a sum-of-the-parts (SoTP) model.

New SoTP model implies 40% upside potential

Peer comparison (on P/BV) upside potential 44%

Summary of different valuation techniques

	Implied price (p)	Upside (%)
Gordon Growth Model (GGM)	91.4	45%
Discounted Dividend Model (DDM)	101.3	61%
Average absolute measures	**96.3**	**53%**
Sum-of-the-parts (SoTP)	88.4	40%
Peer P/E/yield	66.8	6%
Peer P/BV	90.7	44%

Source: Hardman & Co Research

We detailed our assumptions in our initiation note, published on 11 November 2016, Carpe Diem.

GGM 91.4p

► **Gordon Growth Model:** Our assumptions are given in the table below. The only change since our last report has been to increase the RoE by 1.5% to 31.5% to reflect the reduction in equity under IFRS9. The book value has fallen primarily because of the IFRS9 adjustment, with a modest additional reduction from the higher dividend assumptions.

GGM and sensitivities

	Base	+1% to RoE	+1% to CoE	+0.5% to G
RoE (%)	31.5	32.5	31.5	31.5
CoE (%)	11	11	12	11
Growth in equity (%)	5.5	5.5	5.5	6
P/BV (RoE-G)/(CoE-G)	4.7	4.9	4.0	5.1
Discount re near-term perf.	-10%	-10%	-10%	-10%
P/BV (x)	4.3	4.4	3.6	4.6
BV 2019E (£m)	67.2	67.2	67.2	67.2
Valuation (£m)	**285.8**	**296.8**	**241.8**	**308.3**
Variance (£m)		11.0	-44.0	22.5
Valuation per share (p)	**91.4**	**94.9**	**77.3**	**98.6**

Source: Hardman & Co Research

DDM 101.3p

► **Dividend Discount Model**: We have modestly increased our dividend assumptions, given the 20% increase announced with these results. Our DDM now indicates a value of 101.3p.

SoTP 88.4p

► **Sum-of-the-Parts:** With the IPO of Amigo, there are now direct comparators for two out of NSF's three businesses, although we note that there is not yet a clear public consensus for Amigo. To get to our 2019 calendar equivalent P/E, we have assumed 40% growth in normalised earnings from those announced in the prospectus for the year to March 2018. EL does not have a quoted peer. With many of the characteristics of Amigo (few competitors, strong market position, high risk-adjusted margins), we have ascribed it that rating too (see table below).

SoTP model

	2019E earnings (£000)	Multiple	Value	Comment
EL	14,634	13.3	194,913	Same rating as Amigo
LAH	4,321	10.3	44,506	Morses Club 2019E (Hardman & Co estimates)
GLD	5,324	13.3	70,911	Amigo (rating = market cap/1.4x March 2018 adjusted earnings)
Central	-4,253	8.0	-34,020	Should show only moderate growth
Group	**20,027**	**13.8**	**276,311**	
Value per share (p)			**88.4**	

Source: Hardman & Co Research

Peer comparators range from 65.2p to 90.7p

We detail below a comparison between NSF and a range of peers. We believe that there is now broad consistency in forecasts being on an IFRS9 accounting basis, and so a comparison appears valid. Amigo is clearly on a high P/BV – excluding it sees the average peer valuation on that measure at 68.2p.

Cashflow statement (£000)

Year-ended 31 December	Share price (p)	Mkt cap (£m)	2019E P/E	2019E yield	P/last BV
NSF	63	223	9.8	5.1%	2.1
PFG	680	1722	11.2	7.0%	2.5
Morses Club (Feb'20)	168	218	10.3	5.1%	3.8
Amigo (estimated)	283	1350	13.3	n/a	6.7
S&U (Jan'20)	2500	300	10.1	5.4%	2.0
H&T	314	117	9.6	3.9%	1.1
Ramsdens	156	48	9.5	4.9%	1.7
Average peers			10.67	5.3%	2.97
NSF price at peer average			**68.3**	**65.2**	**90.7**

Source: NSF, Hardman & Co Research

Notes

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(Disclaimer Version 8 – Effective from August 2018)

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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