17 June 2019

NON-STANDARD FINANCE PLC

Back to basics

While there has been deafening noise around the lapsed Provident Financial (PFG) bid, the fundamental outlook for NSF is unchanged. It still has the market-leading network in unsecured branch-based lending and is number two in guarantor loans, both growing strongly. It is number three in home credit. The direct costs of the bid were ca.5% of NSF's market capitalisation and we estimate a further disruption/ extra finance effect of 2%-3%. This may be compared with a share price fall of 28%. Delivery of consensus earnings and franchise growth expectations will be the key to restoring management credibility and reducing the discount to the peer group.

- **Strategy:** With the lapsing of the PFG bid, NSF is expected to focus on the operational delivery of the franchise growth in both Everyday Loans (ELD) and Guarantor Loans (GLD) divisions. In home collect (HCC), we expect profit growth to come from improving impairments and operational efficiency.

- **Post-deal effects:** We see minimal disruption to ELD or GLD. Earnings delivery and dividend payments may restore the share price rating. NSF may itself become a bid target until such time. The Woodford holding is unclear, but NSF doesn't seem a priority sale. Multiple directors have been buying recently.

- **Valuation:** We roll forward our valuation base year to 2020. The strong profit growth forecasts see a material uplift in valuation with this change. Our approaches now indicate a 96p to 109p range. The highest valuation is from the dividend discount model; we detail below NSF's actions on its dividend.

- **Risks:** Credit risk remains the biggest threat to profitability. 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 acting to mitigate this risk.

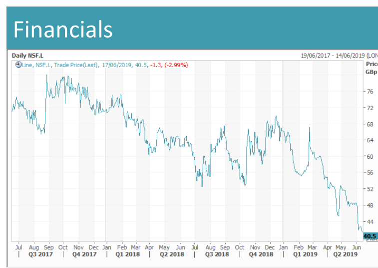
- **Investment summary:** Substantial value should be created, as: i) competitors have withdrawn; ii) NSF is well capitalised, with committed debt funding; iii) macro drivers are positive; and iv) NSF's experienced management delivers operational efficiency without compromising the key face-to-face model. Targets of 20% loan book growth and 20% EBIT RoA appear credible, and investors are paying ca.7.3x 2019E P/E and getting a ca.7.7% yield.

Financial summary and valuation

Year-end Dec (£000)	2016	2017	2018	2019E	2020E	2021E
Reported revenue	94,674	119,756	166,502	192,108	219,634	251,183
Total impairments	-26,155	-28,795	-42,688	-48,221	-53,359	-59,316
Total costs	-49,600	-67,706	-87,792	-92,806	-101,785	-112,969
EBITDA	19,369	25,181	37,648	51,081	64,490	78,898
Adjusted PBT	13,056	13,203	14,769	21,762	30,248	38,859
Statutory PBT	-9,342	-13,021	-1,590	-1,121	27,119	37,328
Pro-forma EPS (p)	3.37	3.44	3.70	5.65	8.00	10.34
DPS (p)	1.20	2.20	2.60	3.20	4.00	5.00
P/adjusted earnings (x)	12.3	12.0	11.2	7.3	5.2	4.0
P/BV (x)	0.5	0.6	0.6	0.6	0.6	0.6
P/tangible book (x)	1.3	1.7	2.3	2.4	1.8	1.4
Dividend yield	2.9%	5.3%	6.3%	7.7%	9.7%	12.1%

Source: Hardman & Co Research

Financials



Source: Refinitiv

Market data

EPIC/TKR	NSF
Price (p)	41.4
12m High (p)	70.0
12m Low (p)	41.4
Shares (m)	312.0
Mkt Cap (£m)	129
EV (£m)	382
Free Float	99%
Market	Main

Description

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

Company information

CEO	John van Kuffeler
CFO	Nick Teunon
Exec Director	Miles Cresswell-Turner

+44 20 38699026
www.nonstandardfinance.com

Key shareholders

Invesco	28.7%
Woodford Inv. Mgt. (04/09/18)	25.7%
Aberforth Partners	13.0%
Marathon Asset Mgt.	12.7%
ToscaFund	3.85%

Diary

Mid-Jul	Trading update
Mid-Aug	Interim results

Analysts

Mark Thomas 020 7194 7622
mt@hardmanandco.com

Disclaimer: Attention of readers is drawn to important disclaimers printed at the end of this document

Executive summary

Opportunity from PFG was very attractive but management credibility and share price dented. Fundamental outlook unchanged despite share price fall.

Enterprise is embedded in NSF management's DNA and it will try to seize market opportunities as they arise. We detail below how the PFG share price reaction implies that the pre-synergy value to NSF shareholders of the deal was nearly the same as NSF's market capitalisation pre-deal. Against this had to be weighed the direct costs from attempting the deal, which, given most were success-related, we know are just 5% of the market capitalisation. While launching the bid appears justified, the result of it would appear to be that management credibility and the share price rating have both been dented. The structure of NSF, whereby each of the operating companies is largely self-standing, means that we see only a small amount of business disruption, if any, and an incremental finance cost of £1m p.a. (ca.2.5% of forecast 2021 profits). As a result, the fundamental outlook for the group is unchanged, in our view. It still has the market-leading network in unsecured branch-based lending and is number two in guarantor loans, both of which are expected to continue to grow strongly over the forecast period. It is number three in home credit. The strong growth expected as a standalone entity is unaffected by the lapsed deal and we believe investors should now focus on that.

Strong growth from franchise expansion in Everyday Loans and Guarantor Loans, payback from historical investments, and improving credit experience in Home Collect

We forecast the pro-forma normalised EPS to increase from 3.7p in 2018 to 5.7p in 2019, 8.0p in 2020 and 10.3p in 2021. The key drivers to this profit growth are: i) strong volumes in ELD and GLD; ii) slower incremental investment, especially in ELD with the payback from historical expenditure becoming much more visible; iii) steady improvements in HCC credit experience and efficiency (while volume growth is expected to be minimal, profits in this business can still increase through further progress on impairment and cost management).

Acquisition effects reducing so numbers will be "clean"

As the impact of historical acquisitions drops out, the pro-forma normalised graduates increasingly towards to the statutory profit number (2021E difference 4%). We believe having "clean" numbers will be welcomed by investors.

ELD opportunities from economies of scale with limited regulatory risk. We expect further use of technology, better conversion of leads and further branch expansion.

We reviewed ELD in our reports *Reading the runes: strong controlled growth*, published on 5 December 2018 and *Everyday Loans: a heart of gold*, published om 14 May 2018. In summary, we believe there is a long-term growth opportunity from a business with an excellent, sustainable market position. In particular, for the foreseeable future, the company can: i) use technology to deliver an enhanced customer experience and operational efficiency (the opportunities from the latter are designed to enhance the branch face-to-face business model, not replace it); ii) generate better leads from deeper, broader broker relationships, focused marketing and improving conversion rates; and iii) expand its branch network, with a long-term potential optimal size of the network of 100-120 branches (compared with 65 at the end of 2018, the network has already added eight new branches with 73 now open). As a standalone business, it offers: i) operational leverage allowing economies of scale, best practice cross-fertilisation, and better control of risk; ii) earnings stability in macroeconomic downturn as rate increases and increased non-standard demand offset higher impairments; and iii) limited regulatory risk. As part of the NSF group, it has incremental opportunity from cross-sales.

GLD market growth and market share opportunities

GLD offers exposure to a structurally growing market and the potential opportunity to continue to take share from the market leader. Guarantor loans offer the potential borrower a much lower cost of finance, which is both more affordable and creates the opportunity to re-build a credit record. The strong growth in recent years is evidence of real demand for such a product. The regulatory and reputational risks of involving a third party in the loan have been known about for many years. On p23 of *Carpe Diem*, our initiation on Non-Standard Finance published on 11 November 2016, we noted: "From multiple aspects, including treating customers fairly, good business practice and limiting potential mis-selling compensation claims, the guarantor's responsibility has to be very clearly outlined before the loan is issued." We believe this has been firmly embedded in NSF practices.

HCC taken PFG restructuring opportunity and from here cash generating rather than growth

HCC has opportunities in improving credit and efficiency. Having grown significantly under NSF's ownership, we view this division as having shifted to become a cash-generating machine, rather than significant growth business.

2018 results

Summary

Key highlights are normalised revenue up 39%, improving credit, higher funding costs (full-year effect of long-term committed facility)

While the evolution of the PFG deal has been a key driver to NSF's share price, investors should not lose track of what it achieved in 2018. To recap, the key highlights were as follows.

- Underlying results were ahead of consensus forecasts with strong growth in operating profit in all three divisions.
- Normalised revenue was up 39% to £166.5m (2017: £119.8m) while reported revenue was £158.8m (2017: £107.8m).
- Rate of group impairment was lower at 25.6% of normalised revenue (2017: 27.1%).
- Normalised operating profit (including a charge of £1.4m for deferred consideration on the acquisition of George Banco) was up 51% to £35.9m (2017: £23.7m). Reported operating profit was £19.5m (2017: £3.8m).
- Normalised profit before tax was up 12% to £14.8m (2017: £13.2m), with a full-year impact of higher cost, but committed long-term funding that was put in place in the second half of 2017. Reported loss before tax of £1.6m (2017: loss before tax of £13.0m) is after fair-value adjustments, amortisation of acquired intangibles and exceptional items.
- Normalised EPS was up 8% to 3.7p (2017: 3.4p). Reported loss per share of 0.5p (2017: loss per share of 3.3p) is after fair-value adjustments, amortisation of acquired intangibles and exceptional items.
- Recommended final dividend of 2.0p per share (2017: 1.7p) making a total dividend for the year of 2.6p per share (2017: 2.2p), up 18% compared with the prior year.
- Current trading: NSF reported a good start to the year and in line with management's expectations.
- Investors should note that the 2018 and 2017 results are not strictly comparable as the group acquired George Banco on 17 August 2017 and from 1 January 2018 the group adopted IFRS 9.
- Total net loan book on a consistent IFRS 9 basis was up 29% to £310.3m with growth in all three divisions.

Key performance indicators			
IFRS 9 key performance indicators Year-end Dec 2018	Branch-based lending	Guarantor loans	Home credit
Loan book growth	24.7%	61.0%	2.0%
Revenue yield	46.8%	32.2%	171.5%
Risk adjusted margin	36.7%	25.8%	115.6%
Impairments/revenue	21.5%	20.0%	32.6%
Impairments/average net loan book	10.1%	6.4%	55.9%
Operating profit margin	33.8%	35.2%	10.3%
Return on assets	15.8%	11.3%	17.7%

Source: NSF results release dated 8 March 2019

Changes to estimates

2018 was a beat

2019 trimmed HCC profit for some disruption and impact of funding the bid expenses. 2019 sees payback for historical investments.

New 2020 and 2021 estimates continuing 2019 growth trends

Against our previous forecasts, the main changes have been in the HCC division. We have reduced volume and income growth – with the former now 2%, in line with the bottom end of the company's pre-bid guidance and partially reflecting some disruption to the business, which was expected to be demerged as part of the bid process. While there is a possibility that the business may face a reinvigorated PFG, it is worth noting that the market leader remains under special supervision from the FCA and is also expected to remain loss-making in 2019. We assume that revenue growth is expected to be more modest going forward, although profitability should continue to increase, driven by further progress on reducing impairment. (We note the group's comment in its recent trading update that the overall rate of impairment as a percentage of revenue has continued to fall.) There has been a small reduction in admin costs but an increase of £1m in interest costs (reflecting interest burden of the deal expenses that we expect will be £12m in the first half, including VAT). Forecast equity is reduced because of the statutory loss, including the £12.5m of exceptional costs (including VAT).

For the first time, we have introduced 2020 and 2021 estimates. The business messages from 2019 are continued with strong franchise and profit growth in both ELD and GLD, and stable volumes in HCC but with an improving credit profile and lower impairment as a percentage of revenue.

Estimate changes								
		2018			2019E		2020E	2021E
Year-end Dec	Estimate	Actual	change	Old	New	change	First est.	First est.
Profit and loss (£m)								
Revenue	167,852	168,128	0%	200,978	192,108	-4%	219,634	251,183
Impairments (inc. FRS 9)	-39,252	-42,688	9%	-53,650	-48,221	-10%	-53,359	-59,316
Total costs (exc. Dep.)	-87,246	-87,792	1%	-94,135	-92,806	-1%	-101,785	-112,969
EBITDA	37,132	37,648	1%	53,192	51,081	-4%	64,490	78,898
Pre-tax	14,660	14,769	1%	24,725	21,762	-12%	30,248	38,859
Pro-forma norm. EPS	3.78	3.70	-2%	6.42	5.65	-12%	8.00	10.34
Dividend	2.6	2.60	0%	3.20	3.20	0%	4.00	5.00
Balance sheet (£m)								
Amounts receivable	293.6	314.6	7%	360.6	381.8	6%	456.9	548.7
Borrowings	228.8	266.3	16%	288.8	326.3	13%	382.3	454.3
Equity	221.7	210.5	-5%	222.1	202.3	-9%	215.3	234.6

Source: Hardman & Co Research

Divisional summary

Normalised divisional results					
Year-end Dec'18 (£'000s)	Branch-based lending	Guarantor loans	Home credit	Central costs	NSF plc
Revenue	79,579	21,748	65,175	-	166,502
Other operating income	1,397	229	-	-	1,626
Modification loss	-482	-	-	-	-482
Impairments	-17,099	-4,342	-21,247	-	-42,688
Revenue less impairments	**63,395**	**17,635**	**43,928**	**-**	**124,958**
Admin expenses	-36,488	-9,983	-37,214	-5,397	-89,082
Operating profit	**26,907**	**7,652**	**6,714**	**-5,397**	**35,876**
Finance cost	-12,778)	-5,833	-2,461	-35	-21,107
Profit before tax	**14,129**	**1,819**	**4,253**	**-5,432**	**14,769**
Taxation	-2,612	-645	-774	834	-3,197
Profit after tax	**11,517**	**1,174**	**3,479**	**-4,598**	**11,572**
Normalised earnings per share					3.70p
Dividend per share					2.60p

Source: NSF results release dated 8 March 2019

ELD

ELD financials

Strong growth in new originations, improved conversion rate and so loan book growth. Stable impairment. Costs rising faster than revenue given pace of investment and finance costs reflect long-term committed facility.

The key divisional highlights from 2018 were:

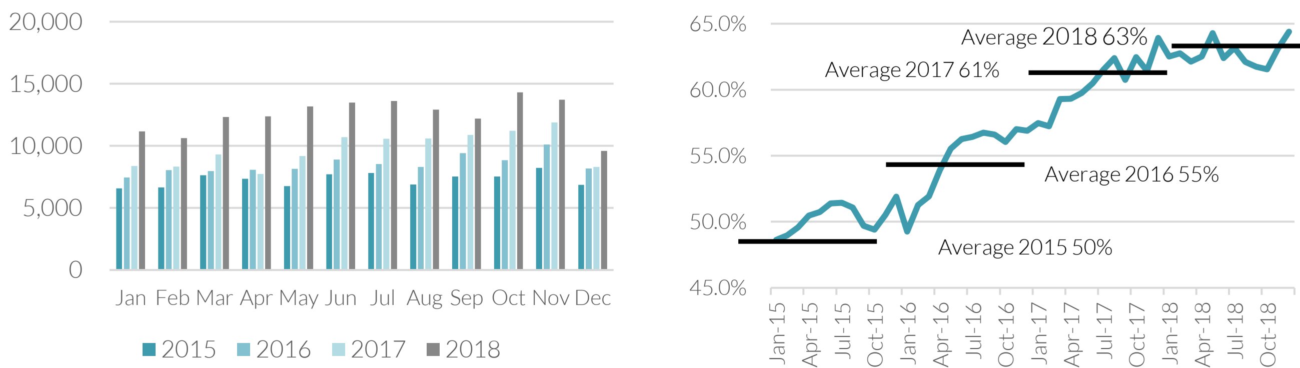
- The net loan book was up 25% to £186.2m. New originations rose by 28% to £149.5m with the branch network having processed 401,000 new and existing borrower applications (up 18%). A slight shift in mix meant that average revenue yields also increased to 46.8% (2017: 44.0%). Overall revenue grew 31% to £80m.
- Over 1.6m loan applications were processed, up 59%. The number of new borrower applications sent to branch ('ATBs') increased by 17% to 366,000 (2017: 313,700). An improved conversion rate on new borrower applications to branch of 9.0% (2017: 7.3%) saw ca.33k new borrower loans and a further ca.12k loans were written to existing customers.
- Impairment was stable at 21.5% of revenue. This is despite the accelerated rate of loan growth, which under IFRS 9 (which requires expected losses to be accounted for on origination of each loan), may have been expected to see impairments rise. Risk adjusted revenue increased by 24%.
- Costs rose 28% to £36.5m with heavy investment continuing. 12 new branches opened in 2018 taking the total to 65 (three in FY'19 up to results date) and 99 new staff were added in 2018. This prompted an £8m increase in costs.
- Finance costs rose £5.7m, 81% to £12.8m reflecting strong volume growth and the full-period effect of the higher-cost but committed, long-term financing lines.

Customer numbers up 30;. yields increased again, but at slower rate

ELD franchise growth

ELD now has more than 61,000 active customers, up 30%. This has fuelled strong lending growth and, as can be seen in the table below, the 2018 monthly average new business volume was ca.£12.5m (£9.8m in 2017). We expect further growth in 2019 and beyond as the branches opened in 2017 and 2018 mature. The rate of increase in gross yields has slowed, but 2018 was still above 2017 (63% and 61%, respectively). Looking forward, we expect the increase to moderate further unless there is an economic downturn, in which case, we might expect a further increase in pricing to mitigate any increase in impairment and protect risk-adjusted margins.

ELD new business volumes (£'000s) and average gross yield (%)



Source: NSF, Hardman & Co Research

Cost growth halves and, with payback for historical investments, ELD delivers strong profit growth. Finance costs rise with volumes as effect of higher-cost locked-in funding fully in 2018.

ELD forecasts

We detail in the table below our revised forecasts. We have slowed the rate of branch openings to just over half the level seen in 2017 and 2018. Consequently, the rate of cost increase is expected to slow from ca.£8m p.a. in 2018 to £4-£5m p.a. As we expect the new branches added in 2017/2018 to deliver increased lending as they mature, the revenue growth is expected to be broadly in line with historical averages, creating positive gearing and strong profit growth. This is in line with management's comments that, by slowing branch openings, it would expect operating profit growth to accelerate. The rate of increase in finance costs slows to be more in line with volume growth as the impact of the high-cost but long-term committed facilities was fully included in the 2018 numbers. 2021 still shows strong profit growth (pre-tax profit +22%) but at a slower rate than 2020 (+54%) and 2019 (51%). This trend reflects the slower rate of increase in branches in 2019, which results in fewer branches growing into full profit maturity in 2021.

Normalised ELD results

Year-end Dec (£'000s)	2016	2017	2018	2019E	2020E	2021E
Business revenue	50,088	60,937	79,579	93,217	108,290	124,099
Other operating income	450	1,926	1,397	1,000	1,000	1,000
Revenue	**50,538**	**62,863**	**80,976**	**94,217**	**109,290**	**125,099**
Impairments	-10,484	-11,654	-17,099	-20,257	-23,716	-27,272
Modification loss			-482	-482	-482	-482
Revenue less impairments	40,054	51,209	63,395	73,479	85,092	97,345
Administration expenses	-20,631	-28,555	-36,488	-39,487	-43,316	-48,500
Operating profit	**19,423**	**22,654**	**26,907**	**33,992**	**41,776**	**48,845**
Net finance costs	-4,720	-7,051	-12,778	-15,874	-18,015	-19,933
Profit before tax	**14,703**	**15,603**	**14,129**	**18,118**	**23,761**	**28,912**
Income tax	-2,941	-3,146	-2,612	-3,442	-4,158	-4,915
Segment profit (loss) post tax	**11,762**	**12,457**	**11,517**	**14,676**	**19,603**	**23,997**
Number of branches	41	53	65	73	80	87
Period-end customer numbers	39,600	47,000	61,200	68,000	78,200	89,930
Period-end loan book (exc. FV adjustments)	122,400	148,500	186,200	223,440	256,956	292,930
Average loans	113,400	133,000	170,000	204,820	240,198	274,943

Source: NSF, Hardman and Co Research

GLD

Strong volume growth with significant gains in market share; impairments worsened, but still well below market leader; costs growth below income growth; finance costs up again with long-term committed funding

GLD financials

The key divisional highlights in 2018 were:

- The net loan book was up 61% to £83.1m. While the revenue yield fell to 32.2% (from 34.7%) reflecting a change in business mix, with full-period income effects from prior year lending and acquisitions, revenue increased by 169% to £21.7m.
- The rate of impairment as a percentage of revenue in 2018 was 20.0% (15.5% in 2017), although still well below the market leader (23.7% in 2018/19 and 21.3% in 2017/18) and also reflecting the impact of IFRS9 provisions on origination. With impairments up a nominal 218%, the risk-adjusted revenue rose by 163% (and risk adjustment margin fell from 34.7% to 32.2%).
- Costs increased by 117%, leading to a pre-deferred consideration operating profit growth of 228% (including the deferred consideration charge, profits grew 178%).

- The net result was that normalised operating profit increased more than twofold to £7.7m (2017: £2.7m).

- Finance costs rose by 187%, reflecting full-period effects, volume growth and the higher-cost long-term committed funding. As a consequence, pre-tax profits rose 153%.

GLD franchise growth

Leads up 39% with rising proportion passing scorecard led to 62% increase in number of loans

Leads rose by 39% to over 2.3m, of which 32% passed through the scorecard (2017: 27%) with more than 758,000 loan applications processed, up 66%. Conversion at 2.3% (2017: 2.4%) saw a 62% increase in number of loans written. Operationally, the move to a single loan management platform for new loans completed on time and on budget. GLD added 31 new staff and moved to larger premises in Trowbridge, and now has more than 25,000 active customers, up 44%.

NSF reports its GLD had seen loan CAGR of 55% from end-2015 to end-2018 (this number actually understates the growth as 2015 is on IAS 39 and 2018 is under IFRS9, which reduces the loan balance). This number is assuming that George Banco was owned for the whole period and so is not distorted by acquisition effects. In 2018, the book grew from £52m to £83m, up 61% on a like-for-like basis.

Growth from market demand, gaining share from brokers and unique opportunity from cross-sales

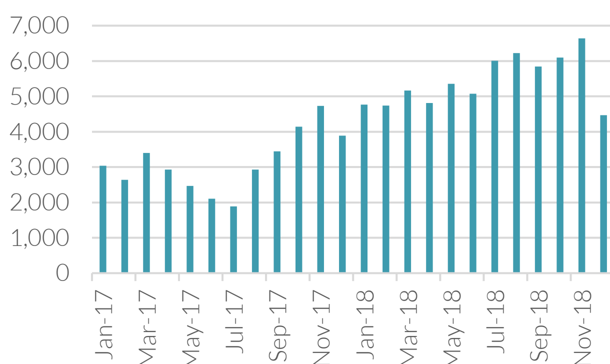
We believe it is important to understand how NSF generates such growth.

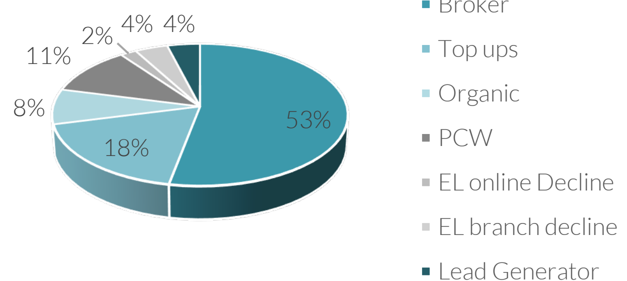
- Strong market demand: We note that the market leader reported 17% loan growth in its results on 28 May, albeit on a significantly larger loan book. The presence of the guarantor reduces the interest rate to such a level that the loan can become affordable to the borrower, creating real demand for the product.

- Attractiveness to brokers: NSF generates just over half its new business from brokers and to report the growth it does, GLD must be taking share in this market. We believe one structural issue here is that brokers want a panel of providers and not be over-reliant on a single provider. From the broker perspective, having a large, well-funded provider such as NSF is a highly attractive diversification opportunity away from the market leader.

- Cross-sales: We note that 6% of new sales were to ELD declines (both online and branch). While this is still a relatively modest number, we expect further growth from this NSF-unique opportunity over time.

GLD new business volumes (£'000s) and value of new loans by channel (%)





Source: NSF, Hardman & Co Research

GLD forecasts

Positive trends continue in our forecasts

The strong business momentum seen in 2018 is expected to continue with strong customer number growth in 2019-20 and further increases into 2021 benefitting from the delivery of technology improvements. While the rate of growth is expected to slow over the forecast period, it will still require a material increase in investment/costs.

Normalised GLD results						
Year-end Dec (£'000s)	2016	2017	2018	2019E	2020E	2021E
Business revenue	2,416	8,078	21,748	29,916	41,010	55,363
Other operating income			229			
Revenue	**2,416**	**8,078**	**21,977**	**29,916**	**41,010**	**55,363**
Impairments	-358	-1,365	-4,342	-5,662	-8,188	-11,053
Revenue less impairments	2,058	6,713	17,635	24,254	32,822	44,310
Administration expenses	-1,402	-3,965	-9,983	-12,000	-17,000	-23,000
Operating profit	**656**	**2,748**	**7,652**	**12,254**	**15,822**	**21,310**
Exceptional items						
Net finance costs	-316	-2,029	-5,833	-8,605	-10,936	-14,764
Profit before tax	**340**	**719**	**1,819**	**3,649**	**4,886**	**6,546**
Income tax	-68	-130	-645	-693	-855	-1,113
Segment profit (loss) post tax	**272**	**589**	**1,174**	**2,956**	**4,031**	**5,434**
Period-end customer numbers	3,300	17,400	25,100	33,885	45,745	61,755
Period-end loan book (exc. FV adjustments)	8,800	48,200	83,100	116,340	157,059	212,030
Average loans	7,700	40,400	67,600	99,720	136,700	184,544

Source: NSF, Hardman and Co Research

Home credit:

HCC financials

Modest loan book growth as PFG opportunity now embedded. Profit growth is expected from improvement in impairments and increasing efficiency.

The key divisional highlights in 2018 were:

- The net loan book was up 2% to £41.0m, after 49% growth in 2017. A small shift in business mix towards larger, long-term loans meant that average revenue yield fell slightly. However, this shift is expected by management to be temporary and it has already begun efforts to shorten the book with the result that yields should start to recover during 2019 and into 2020.
- Impairments were down from 37.6% to 32.6% of revenue, reflecting the benefit of new management controls and oversight.
- The net effect was that normalised operating profit was up 116% to £6.7m (2017: £3.1m).
- Finance costs doubled primarily due to the full-period effect of the higher cost but long-term committed funding.

HCC franchise growth

Volume growth now limited

HCC delivered 14% loan book CAGR from end-2015 to end-2018 as it exploited the opportunity from PFG's restructuring of its businesses. This opportunity is now largely embedded with the growth in 2018 a more pedestrian 2%. Looking forward, we are not forecasting any material market share gains and a broadly flat overall HCC market. Given the process to demerge the business as part of the group's proposed acquisition of Provident Financial, after previous disruptions, discussed later in this report, we have assumed a broadly flat book from here.

Profit growth opportunities from credit, improving efficiency, managing the loan book

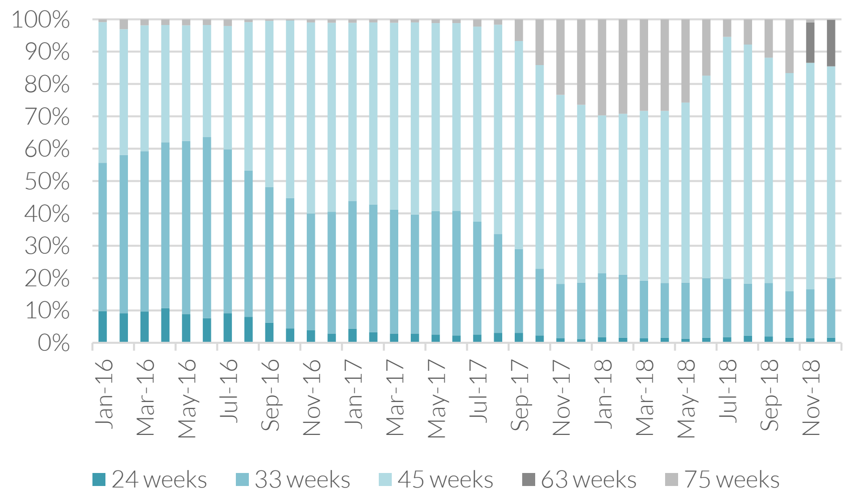
This does not mean that profit growth is anaemic as LAH can benefit from:

- Improving credit: We forecast a further reduction in impairment from the 2018 32.6% of revenue to 29% by 2021. This improvement reflects: i) fewer new customers who typically are at above-average loss rates; ii) a reduced IFRS9 impact as a consequence of slower loan growth; and iii) improved management control through the operational changes made in late 2018. We note this is a trend down towards a more normalised industry level (while PFG remains higher than this, MCL's HCC target range is 21%-26%).

- Improving efficiency with 93% of 2018 loans on the app (2017: 25%): This allows each agent to be more productive and service more customers and also provides managers with more timely data to manage their agents. Following the losses from its pilot with less experienced agents, we believe that LAH had been very prudent in managing the inflow of agents from PFG and thus starts from a position where it has more managers than it may need over the long term. Technology allows this process to be accelerated and a new streamlined management structure was put in place from January 2019.

- Loan book mix: As can be seen in the chart below, LAH's core product was primarily 45-week duration loans (June 2017: ca.60% of the book) with a very short tail of longer-duration loans. However, many of the former PFG customer base were used to having longer loans and so this product had to be offered (mid-2018, ca.30% of gross lending was on 63 weeks). Managing down this proportion should see an increase in yield and gives greater flexibility to re-price in the event of a downturn.

Gross lending product mix (%) by length of product in weeks



Source: NSF, Hardman & Co Research

HCC forecasts

As can be seen in the table below, the main driver to the £2m profit growth in the HCC business is improving credit (2021E: 29% revenue vs. 32.6% in 2018). We see further opportunities for efficiency to be improved but will build them into forecasts when there is greater visibility on them.

Normalised HCC results

Year-end Dec (£'000s)	2016	2017	2018	2019E	2020E	2021E
Revenue	**42,170**	**50,741**	**65,175**	**67,975**	**69,334**	**70,721**
Impairments	-15,313	-15,776	-21,247	-21,820	-20,974	-20,509
Revenue less impairments	26,857	34,965	43,928	46,155	48,361	50,212
Administration expenses	-23,229	-28,679	-37,214	-38,000	-38,000	-38,000
One-off temporary commission	-1,771	-3,184	0	0	0	0
Total admin costs	-25,000	-31,863	-37,214	-38,000	-38,000	-38,000
Operating profit	**1,857**	**3,102**	**6,714**	**8,155**	**10,361**	**12,212**
Net finance costs	-323	-1,299	-2,461	-2,510	-2,560	-2,612
Profit before tax	**1,534**	**1,803**	**4,253**	**5,645**	**7,800**	**9,600**
Income tax	-54	88	-774	-1,072	-1,365	-1,632
Segment profit (loss) post tax	**1,480**	**1,891**	**3,479**	**4,572**	**6,435**	**7,968**
No branches	47	69	66	70	70	70
No agents	785	1,005	897	900	900	900
Period-end customer numbers	93,600	104,100	93,800	95,676	97,590	99,541
Period-end loan book (exc. FV adjustments)	33,400	51,200	41,200	42,024	42,864	43,722
Average loans	27,600	34,500	38,300	39,066	39,847	40,644

Source: NSF, Hardman and Co Research

Post-deal issues

Operational disruption

We see limited operational impact. There will be cost of funding the deal expenses, but this is just 2.5% of forecast 2021 profits.

The disruption to the ELD and GLD businesses is expected to be minimal. Indeed, the emphasis given to these businesses could be seen as a positive encouragement for staff. In contrast, the effect on LAH may be more material as the staff and agents in that business are likely to have been more concerned about their job prospects and outlook. However, this needs to be put into context. LAH has been in a state of flux for some years with several major significant events (inter alia acquisition by NSF in 2015, an over-expansion with inexperienced agents and subsequent control tightening in 2016, implementation of new technologies in 2017 and the arrival of many PFG agents and their subsequent embedding during 2017 and 2018). For some businesses, the impact of a major acquisition and a proposed demerger may have been significant; for LAH, however, we believe that it is just "another day at the office". We believe that to the extent there is any impact, this may manifest itself through an increase in agent turnover at the interim results. At this stage, though, the long-term effect is unlikely to be material, in our view.

We also note that the cash payments to the PFG deal advisers (ca.£10m before VAT) will have increased borrowings and so incur an incremental funding cost. Given NSF's average funding in 2018 was ca.9%, this implies an incremental cost of £0.9m in the current year as we assume many of the costs will have already been incurred in the run-up to the bid. It also utilises facilities, which means that NSF will in due course have to arrange additional lines of credit and a little earlier than it would otherwise have had to do. However, we note that Amigo has recently expanded its securitisation facility to £300m and this may well be an option for NSF. While it seems unlikely that NSF would be able to secure the 500bps saving that Amigo was able to achieve, with a £330m facility from the credit funds already in place, any savings on new funding lines would be positive for NSF earnings.

Restoring the share price rating

Announcing a deal, focussing resources on it and potentially disrupting the day-to-day operations of the existing businesses and not winning over a significant number of shareholders has clearly had an impact on management credibility and the share price rating. We make the following observations:

- The direct costs of the deal are ca.5% of the market capitalisation. Since the 21 February (the day before the announcement of the offer), the share price has fallen from 57.6p to 41.4p (i.e. down 28%).

Rise in PFG's share price when deal lapsed implies market view was £170m of value to NSF shareholders before any synergy benefit

- It is worth considering how big the opportunity was for NSF shareholders. It is a crude measure, but we note that, on announcement, PFG rose by 15%, ca.£170m on the day the deal lapsed. This could be seen as the value the market had been attributing as going to NSF shareholders before any synergy benefits. It is a multiple of 20x the post-tax direct cost incurred and nearly the same market capitalisation as NSF had before it launched its offer.

NSF management DNA is to take opportunities with both upside and risk

- We believe this bid was entirely in-keeping with the management DNA of NSF. On the front page of every major note and in each of our monthly book entries, we have advised investors: "NSF is innovative, and may incur losses piloting new products, customers and distribution." We had not predicted this specific opportunity, but investors are buying an entrepreneurial team with both the upsides and the risk that brings.

Delivery of returns is key to restoring management credibility and share price rating

- Ultimately, we believe that the delivery of returns will be the thing to restore management credibility and share price rating. Investors will then see the payback for the enterprise culture and not just the risk. As we detail in the financial section below, we are forecasting earnings in 2021 of 10.84p vs. 3.70p in 2018. These earnings will be clean with statutory numbers the same as normalised, as accounting adjustments will have dropped out by then. Importantly, we expect steady progression of growth (normalised pre-tax 2018 £15m, 2019 £22m, 2020 £32m and 2021 £41m) so that with each set of results should generate greater confidence in the forecast growth.

Attractions of the guarantor loans sector

Claim

Part of the PFG defence was that the GLD division was under threat, most notably from regulatory intervention following the FCA's dear CEO letter dated 6 March:

"Additional focus for firms providing guarantor lending. As well as the areas of focus above, we will also prioritise our supervisory work with firms that provide guarantor loans in the following areas:

FCA focus on guarantors

Payments made by guarantor: Our diagnostic work on guarantor lending showed that many guarantors make at least one repayment and the proportion of guarantors making payments is growing. We want to understand the root causes for this increase, and whether firms are conducting adequate affordability assessments. We are also concerned that guarantors may not fully understand how likely it is that they will be called upon to make a payment. So, as well as our broad portfolio-wide work on relending, we will start a piece of complementary work on guarantor lending. This will establish whether potential guarantors have enough information to understand the likelihood and implications of the guarantee being enforced."

On 21 March, Jonathan Davidson of the FCA made comments at the Credit Summit held in London, which reinforced the view that guarantor loans could come under further regulatory scrutiny.

NSF response

NSF response was that it believes its model is robust

"We believe that our Guarantor Loans Division business model is robust: i) highly confident in our processes on assessing affordability and modest levels of repeat borrowing; ii) increased profitability whilst continuing to focus on the delivery of good customer outcomes; and iii) well-placed to take advantage of strong demand opportunities."[1]

"NSF is not the subject of any FCA investigation. The FCA has announced a portfolio review of the entire guarantor lending sector and NSF looks forward to participating in that review and sharing its expertise with the FCA."[2]

Hardman & Co view

These risks are not new. Treating guarantors fairly should have been a core approach for several years.

The risks in the guarantor loan market are not new, nor were they unknown. In our initiation note on NSF, *Carpe Diem*, published on 11 November 2016, we noted "From multiple aspects, including treating customers fairly, good business practice and limiting potential mis-selling compensation claims, the guarantor's responsibility has to be very clearly outlined before the loan is issued." As the "problem" has been known about for many years, we believe it will have been embedded in GLD practices. Unlike some others, the acquisition of the two businesses and their movement onto a single

[1] NSF presentation 29 April p7
[2] NSF presentation 13 May p5

platform is likely to mean that the most current practices will have been adopted, in our view.

Amigo's share price does not suggest the market is over worried by the risk

We note that Amigo Group, the benchmark provider of guarantor loans, is currently trading on 15x 2018 earnings (market capitalisation £1.3bn, earnings to March 2019, £88.6m), which is indicative that the market is not unduly concerned about that the market leader's prospects.

Share price rose above pre-announcement level within weeks

It is also worth noting how Amigo's share price has evolved over the period in question. On 5 March, it was 227p. It fell to 217p on 7 March (i.e. after the publication of the FCA letter) but then fell significantly more through the month, reaching a low of 155p on 26 March. However, it subsequently rose back to 257p on 18 April. Part of the fall may have been attributed to speculation that Amigo could have been a counter-bidder for PFG (denied in an RNS on 22 March). However, just weeks after the FCA letter and speech, Amigo's share price was higher than before it. Another point to consider regarding Amigo's valuation is that it may be somewhat depressed by the recent press speculation that the main shareholder has been looking to sell his 62% stake and uncertainty over management as the CEO designate has yet to be approved but the old CEO has resigned on health grounds.

NSF dividend payments

Legality of dividend payments/buybacks questioned over which legal entity had the distributable reserve. Historical payments addressed by AGM resolutions.

On 2 April, PFG questioned whether NSF had the distributable reserves under Companies ACT 2006 to make its dividend payments and buybacks. On 12 April, NSF acknowledged the technical breach, a situation that has arisen at a number of other UK-listed companies,[3] including Hargreaves Lansdown, Next, Morrisons, Betfair, esure, Dunelm and Intertek and announced the requisite AGM resolutions to address the issues. It subsequently rectified all issues through the resolutions agreed at the AGM.

Looking forward, management also put in place a series of steps to avoid any such issues in the future and has said:

- Commencing with the 2019 financial year, NSF will include in: i) its annual financial statements; and ii) its half-year results, a note setting out the quantum of reserves of the company which, as at the relevant accounts date, represent realised profits for the purposes of the Act. These statements will be covered, respectively, by the audit or review opinion (as applicable) provided by NSF's retained auditor from time to time.
- Each future distribution made by NSF or one of its group companies, whether by way of dividend, share buyback or otherwise, will be reviewed by external legal counsel and external accounting advisers from time to time to ensure it is in compliance with IFRS, the ICAEW technical guidance and the Act and to confirm that the appropriate administrative actions (such as the filing of relevant accounts with Companies House) have been carried out in a prompt and fully compliant manner. Any future corporate actions by NSF or other companies within the NSF Group, which may have an effect on its equity and/or distributable reserves position, will also be subject to external review.
- Effective immediately, NSF will maintain a rolling forecast of its distributable reserves position and track actual reserves as part of its ongoing dividend planning activities, ensuring that any variances from plan are managed within reasonable levels of tolerance and highlighted to the NSF Board accordingly.

[3] https://www.nonstandardfinance.com/~/media/files/n/non-standard-finance-v3/documents/disclaimer-documents/shareholder-distributions-recent-examples-of-other-uk-companies.pdf

Hardman & Co view

Historical payments raise questions on expertise and choice of advisers

We believe the issue was not "did NSF have distributable reserves, to pay its dividend?", but rather "were the reserves in the right legal entity to make the distribution and how they were transferred between group companies?". While clearly unfortunate, prompting questions on: i) the extent management appreciated the risks; and ii) the process by which they chose advisers in the past and the quality of advice received, we believe that every regulated entity faces the potential risk that reserves are in a less than optimal company and, as there was no shareholder loss, we view all of this as a highly technical and procedural issue that has now been rectified..

Is NSF now a target?

Until management credibility restored by delivery on earnings, the synergies NSF identified in its bid, make it a potential target

On our forecasts, NSF is trading on a 2020E PE of ca.5x. Its market capitalisation of £129m is a tenth of Amigo Holdings and the relatively weak position of NSF post deal may be perceived by a potential buyer as a unique opportunity. It would be hard, for example, for NSF management to argue against cross-sale synergies or lower funding costs as a justification for an incoming bid. We also note that NSF's own offer included the sale of businesses, so multiple potential buyers for the constituent elements could also be a potential outcome.

Director buying

Directors shown confidence

Director buying at NSF since the deal lapsed has included Nick Teunon (CFO 20,000 shares), Miles Cresswell-Turner and family (Executive Director 100,000 shares) and Professor Heather Jane McGregor (NED, 20,000 shares).

The Woodford effect

Resolution at Woodford is unclear, but given rating and public support for management, NSF may not be first asset for sale

As noted on the front page, Woodford Investment Management currently has a reported stake of 25% in NSF. There has been considerable speculation over what may happen to his holdings in order to meet mandate transfers and potential redemptions. This speculation has included the transfer to investors/managers (as appears to be the case with half the stake in Amigo Holdings), through to potential sale, especially for the most liquid holdings.

We note that, on 6 June, Woodford Investment Management Ltd reported it had reduced its shareholding in PFG from 23.44% to 18.43% with the residual stake now worth ca.£213m. In contrast, the 25% holding in NSF has a value of ca.£32m, may face less liquidity, the share rating is lower than a few months ago and it is in a business that Woodford IM had very publicly backed. The risk of a large forced seller, however, cannot be ruled out, and will depend on the ultimate future of Woodford Investment Management Ltd. However, given the size of the holding, it seems more likely that any potential sale would be conducted off-market.

Financials

We present below the results from 2015-21E. The 2015-17 results are not directly comparable with 2018 in that IFRS9 accelerates the recognition of losses and, for a growing business, reduces near-term profits. The ultimate cashflows are unchanged and later-period profits are correspondingly higher. They do, however, provide a perspective on the group's growth.

Reported profit and loss

Year-end Dec (£000)	2015	2016	2017	2018 *	2019E *	2020E *	2021E *
Business interest income	14,657	81,099	119,756	166,502	191,108	218,634	250,183
Other operating income	0	450	1,926	1,626	1,000	1,000	1,000
Fair-value unwind on acquired portfolios	-5,456	-8,342	-11,985	-7,678	-4,291	0	0
Total revenue	**9,201**	**73,207**	**109,697**	**160,450**	**187,817**	**219,634**	**251,183**
Impairments	-3,858	-23,651	-28,795	-42,688	-48,221	-53,359	-59,316
Gross profit	5,343	49,556	80,902	117,762	139,596	166,275	191,867
Administration expenses	-11,340	-44,074	-69,203	-89,564	-94,737	-103,716	-114,900
Amortisation of intangibles	-4,030	-10,714	-7,897	-8,681	-6,092	-3,129	-1,531
Operating profit	**-10,027**	**-5,232**	**3,802**	**19,517**	**38,767**	**59,430**	**75,436**
EBITDA	**-5,799**	**6,172**	**12,518**	**29,970**	**46,790**	**64,490**	**78,898**
Exceptional Items	-6,135	-626	-6,342	0	-12,500	0	0
Net finance (cost)/income	70	-3,484	-10,481	-21,107	-27,388	-32,311	-38,109
Profit before tax	**-16,092**	**-9,342**	**-13,021**	**-1,590**	**-1,121**	**27,119**	**37,328**
Income tax	3,022	1,344	2,686	-89	213	-4,746	-6,346
Profit after tax from continuing operations	**-13,070**	**-7,998**	**-10,335**	**-1,679**	**-908**	**22,373**	**30,982**
Average no. shares for EPS calculation (m)	61.50	307.32	316.90	312.71	312.05	312.05	312.05
Statutory EPS (p)	-21.25	-2.60	-3.26	-0.54	-0.29	7.17	9.93
Adjusted EPS (p)		3.37	3.44	3.70	5.65	8.07	10.07
DPS (p)		1.20	2.20	2.60	3.20	4.00	5.00

*Source: NSF, *IFRS9 basis Hardman & Co Research*

Normalised profit and loss

Year-end Dec (£000)	2016	2017	2018 *	2019E *	2020E *	2021E *
Business interest income	94,674	119,756	166,502	191,108	218,634	250,183
Other operating income	450	1,926	1,626	1,000	1,000	1,000
Fair-value unwind on acquired portfolios	0	0	0	0	0	0
Total revenue	**95,124**	**121,682**	**168,128**	**192,108**	**219,634**	**251,183**
Impairments	-26,155	-28,795	-42,688	-48,221	-53,359	-59,316
Gross profit	68,969	92,887	125,440	143,887	166,275	191,867
Administration expenses	-50,290	-69,203	-89,564	-94,737	-103,716	-114,900
Amortisation of intangibles	0	0	0	0	0	0
Operating profit	**18,679**	**23,684**	**35,876**	**49,150**	**62,559**	**76,967**
EBITDA	**19,369**	**25,181**	**37,648**	**51,081**	**64,490**	**78,898**
Exceptional Items						
Net finance (cost)/income	-5,623	-10,481	-21,107	-27,388	-32,311	-38,109
Profit before tax	**13,056**	**13,203**	**14,769**	**21,762**	**30,248**	**38,859**
Income tax	-2,688	-2,313	-3,197	-4,135	-5,293	-6,606
Profit after tax from continuing operations	**10,368**	**10,890**	**11,572**	**17,627**	**24,954**	**32,253**

*Source: NSF, *IFRS9 basis Hardman & Co Research*

Balance sheet

As at 31 Dec (£000)	2015	2016	2017	2018 *	2019E *	2020E *	2021E *
Non-current							
Goodwill	40,176	132,070	140,668	140,668	140,668	140,668	140,668
Intangible assets	14,119	17,412	17,205	13,431	7,339	4,210	2,679
Other assets				241			
Property plant and equipment	1,718	5,459	9,434	7,723	10,292	12,861	15,430
Total non-current assets	56,013	154,941	167,307	162,063	158,299	157,739	158,777
Current assets							
Amounts receivable from customer	**28,415**	**180,413**	**268,096**	**314,614**	**381,804**	**456,879**	**548,681**
Trade and other receivables	10,275	9,709	1,551	3,967	4,300	5,000	5,750
Cash and cash equivalent	7,320	5,215	10,954	13,894	3,707	4,086	5,363
Total current assets	46,010	195,337	280,601	332,475	389,811	465,965	559,794
Total assets	**102,023**	**350,278**	**447,908**	**494,538**	**548,110**	**623,704**	**718,571**
Current liabilities							
Trade and other payables	13,803	8,005	10,353	17,242	19,242	21,242	23,242
Deferred tax liability	3,057	-	-	-	-	-	-
Total current liabilities	16,860	8,005	10,353	17,242	19,242	21,242	23,242
Net current (liabilities)/assets	29,150	187,332	270,248	315,233	370,569	444,723	536,552
Non-current liabilities							
Financial liabilities - borrowings	**-**	**87,300**	**199,316**	**266,322**	**326,322**	**382,322**	**454,322**
Deferred tax	-	5,890	4,996	252	0	4,596	6,196
Total non-current liabilities	-	93,190	204,312	266,574	326,322	386,918	460,518
Total liabilities	16,860	101,195	214,665	283,816	345,564	408,160	483,760
Net assets	**85,163**	**249,083**	**233,243**	**210,723**	**202,547**	**215,545**	**234,812**

*Source: NSF, *IFRS9 basis Hardman & Co Research*

Cashflow

Year-end Dec (£000)	2015	2016	2017	2018 *	2019E *	2020E *	2021E *
Profit/(loss) before tax	-16,162	-5,858	-2,540	19,517	26,267	59,430	75,436
Taxation paid	-350	-1,341	-2,226	-1,164	-150	-150	-4,746
Depreciation	198	690	1,497	1,772	1,931	1,931	1,931
Share-based payments	0	0	291	1,157	1,157	1,157	1,157
Amortisation of intangibles	4,030	10,714	7,897	9,661	6,092	3,129	1,531
Fair-value unwind on acquired loan book	5,456	8,342	11,985	7,678	4,291	0	0
Loss on disposal of fixed assets	51	-363	-416	-35	0	0	0
Decrease in inventories	6	3	0	0	0	0	0
Increase in amounts receivable from customers (net of FV)	-5,394	-21,039	-54,437	-75,173	-71,481	-75,075	-91,802
Increase in receivables	-16,445	-7,737	-51	5,844	20	-700	-750
Increase in other assets				-241			
Increase in payables	19,078	-6,952	1,000	-4,132	2,000	2,000	2,000
Net cash inflow/(outflow) from op activities	**-9,532**	**-23,541**	**-37,000**	**-35,116**	**-29,873**	**-8,278**	**-15,242**
Cashflow from investing activities							
Net purchase of fixed assets	-341	-3,514	-4,931	-5,915	-4,500	-4,500	-4,500
Purchase of subsidiaries	-81,111	-230,784	-16,442	0	0	0	0
Net cash outflow from investing activities	**-81,452**	**-234,298**	**-21,373**	**-5,915**	**-4,500**	**-4,500**	**-4,500**
Cashflows from financing activities							
Net finance income	70	-3,484	-7,974	-14,121	-27,388	-32,311	-38,109
Share capital issues/purchases	98,234	172,869	-1,357	-2,102	0	0	0
Net proceeds from borrowing	0	87,300	77,882	67,371	60,000	56,000	72,000
Dividends	0	-951	-4,439	-7,177	-8,425	-10,532	-12,872
Net cash inflow from financing activities	**98,304**	**255,734**	**64,112**	**43,971**	**24,186**	**13,157**	**21,019**
Net increase in cash and cash equivalents	**7,320**	**-2,105**	**5,739**	**2,940**	**-10,187**	**379**	**1,277**
Opening cash and cash equivalents	**0**	**7,320**	**5,215**	**10,954**	**13,894**	**3,707**	**4,086**
Closing cash and cash equivalents	**7,320**	**5,215**	**10,954**	**13,894**	**3,707**	**4,086**	**5,363**

*Source: NSF, *IFRS9 basis Hardman & Co Research*

Valuation

Our absolute valuation techniques imply average upside potential of over 100%. This has increased sharply following the share price fall associated with the bid situation (down 28%) as well as moving forward our base valuation year from 2019 to 2020.

Summary of valuation approaches

	Implied price	Upside
Gordon Growth Model (GGM)	96.3	133%
Discounted Dividend Model (DDM)	109.1	163%
Average absolute measures	102.7	148%
Sum-of-the-parts (SOTP)	87.5	111%

Source: Hardman & Co Research

Gordon Growth Model

We detailed our assumptions in our initiation note, , Carpe Diem, published on 11 November 2016. Our assumptions are given in the table below. The only change has been to increase the RoE by 1.5% to 31.5% to reflect the reduction in equity under IFRS9.

GGM rises on rolling forward to 2020 with both earnings but also reduction in intangibles sees increasing tangible net asset value

The move from 2019 to 2020 as a base year has a dramatic effect on this valuation. Firstly, we expect retentions post dividend of £13m in 2020 against a reduction of ca.£7m expected in 2019. This reflects the growing statutory profitability of the group (from ca.£1m to ca.£25.8m). Additionally, the acquisition-related intangibles see further material reductions meaning that, in 2020, we expect the tangible book value to be £73.9m compared with £56.6m in 2019.

Gordon Growth Model assumptions

	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/NAV (x)	4.3	4.4	3.6	4.6
NAV 2020E (£m)	70.7	70.7	70.7	70.7
Valuation (£m)	300.7	312.2	254.4	324.4
Variance (£m)		11.6	-46.3	23.7
Valuation per share (p)	96.3	100.1	81.5	103.9

Source: Hardman & Co Research

Dividend Discount Model (DDM)

We have modestly increased our DDM as we roll forward our valuation year and thus include further earnings uplift. Our DDM now indicates a value of 109.1p.

Sum-of-the-parts (SOTP)

With the IPO of Amigo, there are now direct comparators for two out of NSF's three businesses.

Sum-of-parts approach

Division	2020E earnings (£000)	Multiple	Value (£000)	Comment
ELD	19,603	11.0	215,633	Small premium to Amigo with limited regulatory risk
GLD	4,031	10.0	40,312	Discount to market leader Amigo
LAH	6,435	9.0	57,917	Morses Club (Hardman & Co Est.)
Central	-5,115	8.0	-40,920	Should show only moderate growth
Group	24,954	10.9	272,942	
Value per share (p)			**87.5**	

Source: Hardman & Co Research

Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, no guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, except in the case of gross negligence, fraud or wilful misconduct. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co has been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fixed fee in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/legals/research-disclosures. Hardman may provide other investment banking services to the companies or legal entities mentioned in this report.

Hardman & Co has a personal dealing policy which restricts staff and consultants' dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. No Hardman & Co staff, consultants or officers are employed or engaged by the companies or legal entities covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for their own account or for other parties and neither do they undertake investment business. We may provide investment banking services to corporate clients. Hardman & Co does not make recommendations. Accordingly, they do not publish records of their past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities, companies and legal entities but has no scheduled commitment and may cease to follow these securities, companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors. Where this document refers to a particular tax treatment, the tax treatment will depend on each investor's particular circumstances and may be subject to future change. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make his or her own independent decisions and obtain their own independent advice regarding any information, projects, securities, tax treatment or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly has been approved by Capital Markets Strategy Ltd which is authorised and regulated by the Financial Conduct Authority (FCA).

No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission from Hardman & Co. By accepting this document, the recipient agrees to be bound by the limitations set out in this notice. This notice shall be governed and construed in accordance with English law. Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the FCA under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259.

(Disclaimer Version 8 – Effective from August 2018)

Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

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

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com