MORSES CLUB PLC

Interim FY'20 results: steady core, deal upside

MCL's core HCC division once again delivered a strong performance. Market volumes remain subdued, but 11% underlying profit growth has been delivered, with efficiency gains and good credit (20% reported adjusted growth). The acquired businesses' performances required incremental investment, and initial lending appears slightly behind track, but these issues are short-term and management has reiterated its stretching guidance for FY'20 and FY'21. We also note the cash collected from CTL loans at acquisition is £11m, against an £8m consideration. Looking forward, management has outlined a clear, customer-demand-driven strategy in its area of competitive advantage.

- **1HFY'20 results:** HCC revenue was up 4%, despite credit issued and loan books being flat. Efficiency improved, as did impairment to revenue. HCC's adjusted PBT was up 20% (11% excluding an extra week of trading). The digital business saw adjusted pre-tax losses of £3.5m (statutory £5m), with heavy investment.
- **Outlook:** The management outlook statement was for trading in line with expectations, and we do not expect material changes in consensus numbers. Importantly, the stretching targets for the online business have been reiterated, with guidance of pre-tax, pre-interest profits in the range of £3m-£5m for FY'21
- **Valuation:** We detailed a range of valuation approaches and sensitivities in our initiation note, *Bringing home collect into the 21st century*, published on 2 February 2017. The range in absolute valuation methodologies is now 167p to 197p (previously 176.5p to 224.5p). We have adjusted our above-consensus estimates.
- **Risks:** Credit risk is high (albeit inflated by accounting rules), but MCL adopts the right approach to affordability and credit assessment. Regulatory risk is a factor, although high customer satisfaction suggests a limited need for change. MCL was the first major HCC company to receive full FCA authorisation.
- **Investment summary:** MCL is operating in an attractive market, and it has a dual-fold strategy that should deliver an improved performance from existing businesses and new growth options. It conservatively manages risk and compliance, especially in new areas. The self-employed agent network is the competitive advantage over remote lenders. The valuation appears an anomaly. We forecast a 7.1% FY'20 dividend yield, with cover of 1.6x (adjusted earnings).

Financial summary and valuation

Year-end Feb (£m)	2016	2017	2018*	2019*	2020E*	2021E*
Reported revenue	90.6	99.6	110.4	117.0	136.5	151.7
Total impairments	-18.8	-24.3	-24.7	-26.2	-30.0	-40.2
Total costs	-53.4	-56.7	-65.6	-67.1	-83.6	-85.1
EBITDA	19.3	19.9	20.1	23.7	22.9	26.4
Adjusted PBT	16.8	17.7	18.6	22.0	19.9	22.9
Statutory PBT	10.4	11.2	15.5	20.2	16.5	21.5
Statutory EPS (p)	6.1	6.6	9.7	12.5	10.3	13.6
Adj. EPS (p)	10.2	10.8	11.4	13.6	12.2	14.0
P/adj. earnings (x)	11.3	10.7	10.2	8.5	9.5	8.3
P/BV (x)	2.7	2.4	2.3	2.1	2.0	1.9
P/tangible book (x)	3.3	2.9	2.6	2.5	2.7	2.5
Dividend yield	N/M	5.5%	6.0%	6.7%	7.1%	8.6%

**IFRS9 basis (2018 pro-forma); Source: Hardman & Co Research*

Financials

Source: Refinitiv

Market data

EPIC/TKR	MCL
Price (p)	116.0
12m High (p)	174.0
12m Low (p)	123.0
Shares (m)	131.0
Mkt Cap (£m)	151.9
EV (£m)	176.1
Free Float*	60%
Market	AIM

**As defined by AIM Rule 26*

Description

Morses Club (MCL) is number two in UK home credit. It is growing this business organically and by acquisition, and is developing a range of related products, where it has a competitive advantage.

Company information

CEO	Paul Smith
CFO	Andrew Hayward
Non-ex. Ch.	Stephen Karle

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Key shareholders

Hay Wain	36.74%
Miton Asset Mgt.	10.13%
JO Hambro	6.93%
Majedie Asset Mgt.	4.66%
Artemis Inv. Mgt.	4.30%
Legal and General	4.04%
Canaccord Genuity WM	3.52%

Diary

End-Feb'20	Trading statement

Analyst

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1HFY'20 results (to end-August)

Group highlights

The key group highlights from the interim results were:

- Net loan book growth over 12 months of 6.2% to £72.2m (1HFY'19: £68.0m), driven by acquisitions. The HCC book was £68.2m, against £67.9m.
- Impairment as a percentage of revenue for the period was 19.0% (1HFY'19: 21.9%). IFRS9 is very sensitive to new sales and, in HCC, these were down 4% (a significantly smaller fall than peers).
- Customer numbers of ca.276,000 (1HFY'19: 230,000), which include around 52,000 (1HFY'19: 1,000) in the digital division.
- Efficiency improved in HCC (costs 57.5% of revenue, against 58.6%), but the acquired businesses are higher-cost, including integration expenses.
- Proposed interim dividend of 2.6p (1HFY'19: 2.6p).
- HCC adjusted PBT was up 20.2% to £13.1m (1HFY'19: £10.9m) – a good underlying performance, supplemented by £1m from an extra week's trading.
- Group adjusted PBT of £9.6m (1HFY'19: £10.5m), with a strong performance in the HCC division offset by the integration of new digital businesses. Statutory PBT was £6.7m (1HFY'19: £10.0m), impacted for the same reason.
- Adjusted EPS of 5.9p (1HFY'19: 6.6p) and basic EPS of 4.1p (1HFY'19: 6.3p).
- A review of current financing arrangements is under way with both existing and alternative providers. An update is expected with the results in May 2020.

KPIs

We detail below the key KPIs outlined by the company, and a couple of additional measures. The trends reflect the acquisition of higher-cost new businesses (the HCC efficiency is improving) and the investments being made to get them fully integrated into MCL's other businesses. We note stretching targets for FY'20 and FY'21 have been reiterated, and we do not expect a change in consensus estimates.

Company KPIs

	2015	2016	2017	2018	2018*	2019*	1HFY'19	1HFY'20
Adjusted PBT (£m)	13.0	16.8	17.7	19.2	18.6	22.0	10.5	9.6
Adjusted EPS (p)	8.1	10.2	10.8	11.7	11.4	13.6	6.6	5.9
Admin. cost to income ratio	36.5%	36.8%	33.1%	32.2%	59.4%	57.4%	58.5%	63.9%
RoE	21.5%	27.9%	27.2%	26.5%	N/A	29.6%	25.4%	22.6%
Tangible equity/avg. recs.	N/M	85.3%	93.5%	92.6%	N/A	85.9%	87.6%	84.5%
Number of customers (000s)	198	199	216	229	235	235	230	276
Number of agents	1,893	1,839	1,826	2,030	2,030	2,050	1,942	1,817
Credit issued (£m)	112.0	122.2	144.1	174.4	174.4	178.5	86.1	91.0
Impairment/revenue	25.5%	20.8%	24.4%	26.1%	22.5%	22.4%	21.9%	19.0%
Period-end receivables (£m)	55.6	56.8	61.2	72.8	68.9	73.0	68.0	72.2

**IFRS9 basis; Source: MCL, Hardman & Co Research*

Core HCC business

Highlights

Strong profit growth, despite market volumes being challenging. Key features included improving efficiency, lower impairment to revenue (but primarily mix-driven) and evolving technology opportunities.

The key highlights of the HCC division were:

- Adjusted PBT up 20.2% to £13.1m (1HFY'19: £10.9m). Reported PBT was £11.7m, up 12.5% on 1HFY'19's £10.4m.
- Following the introduction of the FCA's remedies to the High Cost Credit Review, which were introduced at the end of 2018, growth in credit issued has slowed. There has been a continued focus on quality business, which has helped to reduce impairment as a percentage of revenue to 18.5% (1HFY'19: 21.4%). We understand that, since the period-end, there has been modest sales growth.
- A small reduction in customer numbers (224k vs. 1HFY'19's 229k), but average balances increasing (August 2019 £607 vs. £590 in August 2018).
- Agent numbers down to 1,817, from 1,942 in 1HFY'19, but 97.5% of agent rounds are fully staffed. The average agent book has increased with technology-driven efficiency improvements. This has further reduced the cost/income ratio to 57.5% (1HFY'19: 58.6%).
- Successful launch of the customer portal, with 30,000 customers registered in the first six months, 40,000 by end-September.
- Morses Club Card (MCC) established as a core cashless product, with ca.33,000 customers and balances of £15.9m (1HFY'19: 27,000 customers and £13.1m of balances).

Hardman & Co comment

Profit growth payback for historical investment

Profit growth in challenging markets is a highly credible performance, and reflects, we believe, payback for historical investments in technology and the integration of self-employed agents.

Sales down, but by materially less than peers

New sales in HCC were down 4% on 1HFY'19, driven primarily by market-wide adoption of new regulatory practices (group credit issued was broadly flat, including acquisitions and digital). This drop is materially less than that experienced by peers, and management believes this is due to the technology it has put in place. By way of direct example, management used amended ONS data to establish likely customer non-discretionary expenditure needs. If the actual customer input was at a lower system, the system overrode the customer input and adopted the ONS-driven level. This was sound from both an affordability and regulatory perspective, but it also meant MCL was ready for the regulatory changes. The management explanation of the lower-than-peer sales fall is intuitively credible, although we are unable to verify the exact procedural differences.

£1m profit assistance from extra week of trading, plus lower sales impacting on upfront IFRS9 impairments

The £2.2m rise in HCC profits was assisted by a 27-week period (vs. 26 weeks in prior year), which the company advises contributed £1m to profit and a small benefit to the cost ratio. Part of the residual growth was also due to a lower impairment rate, which is expected to reverse in 2H. The technicalities of IFRS9 penalise a growing business (as impairments are taken upfront) but are positive for a business that is not adding new business. The 4% drop in sales thus helped the impairment rate fall to an unsustainable level, which will not recur when the business has returned to sales growth.

Outlook for HCC

Three opportunities to increase annual profits– technology-driven efficiency, differentiated commission rates and first price rise in four years

Management outlined three programmes/initiatives to improve profitability over the near term.

- Technology has meant that there is an increasing proportion of business (both loans and collections) that is non-cash-driven. In 1HFY'20, the majority of customers have made cashless payments (either by phone, portal, or chip and PIN on doorstop). The time spent between the agent and customer is falling, allowing each agent to service more customers. Technology also improves processing, and reduces errors – both these factors mean that each manager can service more agents. Overall, the number of customers per agent and manager has been rising, driving efficiency gains – which are expected to continue.

- The same technology changes have allowed MCL to introduce differentiated commission rates. Previously, all collections were paid the same agent commissions, but this is now lower for non-cash collections. As each agent is able to serve more customers (and average customer borrowing is rising), each agent can earn greater income for the same hours worked. We note that total agent commissions posted a marginal rise, while the number of agents fell 6.4%. Importantly, the agents have been brought along in this process and encouraged to adopt the new best practices, rather than having them imposed from above.

- For the first time in four years, there has been an increase in pricing. The rise has been implemented by extending the payment period, rather than increasing each weekly payment, so as to lessen the impact on borrowers. Management notes the significant increase over the past four years in areas like compliance costs and IT. Peers have introduced price increases at an earlier stage, and this does not seem to have had any material impact on volume growth.

Additional opportunities if digital initiatives see increased retention

On top of these programmes, there is incremental upside from MCL's strategic initiatives in digital, which we detail below. Around 20% of MCL customers leave each year, and its exit surveys suggest that most are seeking alternative finance. Approximately 8% return to MCL later, but slowing the net attrition, to ca.24k customers per year, could have dramatic impacts on profitability. This could be achieved by better service propositions, loyalty built from non-financial services offered competitively on the portal, or a broader product range. Some of this incremental profit is likely to be retained in the HCC business.

Morses Club Card (MCC) important step

MCL has seen three key benefits from MCC: i) distribution of a loan via a card is easier than by cash; ii) it means customers who could not otherwise access (cheap) deals online can now do so; and iii) it provides invaluable data on customer behaviour, which can then be monetised through the customer portal. We do not see MCC as transformational for MCL. It is part of the overall efficiency improvement programme, and it is helpful, but not necessary, to the portal development. It is thus a "nice" incremental option.

Downsides include subdued overall market, fewer acquisitions, and reversion to normal impairment losses

On the downside: i) we do not believe there will be significant market growth in HCC; ii) the most recent experience has been that sellers of the HCC business expect very full valuations; acquisition-driven growth may return if there is further alignment on price expectations, but the business message is that such opportunities, at present, are fewer than we had expected; and iii) there will be a reversion to more normal levels of impairments to revenue, as the business has some sales growth.

Digital

Highlights

Early stages of integration of businesses into customer-driven strategic focus

The key highlights of the Digital division were:

- Acquisition of two digital businesses, offering online lending and current account services.
- Knowledge transfer, by in-house resource of the CURO Transatlantic decision engine into Shelby Finance Loan Management platform.
- Acquired customer base of 49,000 customers in online lending, which has reduced to ca.36,000, due to the withdrawal of payday-type products.
- Customer base of 16,000 engaged in online current account product.
- Relocation of contact centre to support online lending business.
- Engaged in full integration plan into the Group structure.

Hardman & Co comment

One-offs include £1.2m of over-accrued interest at date of acquisition not identified until full ownership taken, customer numbers down – largely expected – and intensive integration work

The scale of pre-tax losses in 1HFY'20 (adjusted £3.5m, statutory £5m) was higher than we had expected, driven by a number of factors, primarily in the online business.

- £1.2m of interest, which had been incorrectly accrued ahead of acquisition, was only identified once MCL was able to get into the books in detail. The incorrect accrual was not picked up in the due diligence exercise. We believe that buying a business from an administrator is likely to carry incremental risks and, while such a loss is disappointing, investors should bear in mind that the cash collected, even adjusting for this, is still well in excess of the consideration.
- We expected a loss of customers during the period when systems were being migrated to the MCL platform and it was unable to offer the full service. In the presentation, there was also a focus on the nature of product and the loss of customers, who, on acquisition, had very short facilities.
- The integration appears to have taken more work than we had expected. For example, we note that, on acquisition, we understood the call centre to be fit for purpose, but it has subsequently been relocated. There is clearly considerable effort being made in integrating all the systems.

Issues either historical or short-term. Guidance unchanged.

It is, however, important to put these experiences into perspective. They are either historical or short-term and, while the 1HFY'20 performance may have been disappointing, it is crucially important that management has reiterated its goals, including monthly run-rate profitability by February 2020, 200k new loans p.a. by end-February 2021 and FY'21 profits of £3m-£5m (pre-interest).

Online lending

As we detailed in our note, *Home collect and online lending acquisitions*, published on 15 March 2019, MCL's online lending operations were transformed by the acquisition of CURO Transatlantic (CTL) for a consideration of ca.£8m. MCL acquired:

£8m consideration is discount to cash collected of £11m

- Gross receivables that, to date, have seen cash collections of £11m, against the consideration of £8m.

MCL very selective on which customers it has bought

- All the existing infrastructure of CTL, including its decision platform. Management advises that the decision engine was a significant enhancement to the one in MCL's subsidiary, Dot Dot Loans (CTL has much more data and a longer history). The output from this engine has been reviewed by MCL staff and external due diligence advisers, and, we understand, produces better results than Dot Dot Loans' current system.

- A call centre and online lending capabilities. All of CTL's current employees (ca.200) have become employees of Shelby Finance Ltd, part of the MCL Group, including customer services, analytics, marketing and IT teams. Those staff currently working on redress (ca.10% total) have been freed up to work on more revenue-generating activity.

Not included in the purchase were: i) more than 90% of customers who could be considered higher-risk; ii) any mis-selling liability for historical business activity; iii) the potentially toxic brand, Wage Day Advance; and iv) Juo Loans (set up in 2017 to offer guarantor loans – but very few were written).

Migration of systems initially limited new business written to ca.10% of level at which expected to be once systems are live

We believe the key considerations for whether the renewed platform can deliver the growth in loans (as noted, MCL targets 200k loans p.a. by end-February 2021, vs. 50k customers on acquisition in February 2019) and profits are as follows:

- Historically, CTL did deliver very strong growth in this area – so there is a track record (see our note, *Home collect and online lending acquisitions*, published on 15 March 2019).

- The acquired analytics have been based on huge datasets of customers, and especially identifying where affordability was an issue. While MCL has not acquired the customers, it has acquired the analytical tools.

- Intermediaries are always looking for new suppliers of credit and, in particular, are looking for those with strong balance sheets and who may be reasonably expected to stay the course through economically difficult conditions. MCL's balance sheet is thus a competitive advantage and is attracting new business in this space, especially when combined with the intermediary service proposition of CTL. Its history and culture as a non-standard UK lender also stand it in good stead with brokers.

- The potential market is huge, with many of the 8.5m non-standard customers who do not use home collect being a potential target. MCL noted that the top-eight lenders in high-cost, short-term credit had revenues of £453m in 2016 (five times MCL's own revenue for that year). Against this market-wide goal, MCL's share would be just 3%. We believe the real target audience is smaller but highly credible for a well-funded, technologically-advanced business with strong analytics to take its target share.

- We believe that, if economic conditions weaken, a number of peripheral players will withdraw, creating acquisition opportunities. In such economic and market conditions, the potential demand could rise significantly, allowing additional re-pricing.

- We also see regulatory pressure on some of the peripheral products.

- The redress for historical mis-selling is likely to put pressure on some other lenders in the same way as it did on CTL. An ongoing business that is profitable can be dragged down by the cost of a historical business. MCL noted several

players with complaints to the FSCS at nine times its own level (at an incremental cost in FSCS fees in excess of £1m p.a. per company), who also faced "lost" cases requiring compensation at rates of three to five times MCL's level (14% of cases upheld against it), with the associated compensation claims, and, of course, the sheer administration associated with such redress (10% of CTL's staff).

Target pre-interest profit of £3-£5m in FY'21 reiterated

Delivering MCL's targets will be challenging. The conservative nature of the company is such that we do not believe it would put into the market expectations for 200k new loans p.a. and FY'21 profits of £3m-£5m (pre-interest) without having a high degree of confidence that it would achieve them.

U Holdings Limited (acquisition announced 24 June 2019)

On *24 June,* MCL announced the acquisition of U Holdings Limited (which trades as U Account) for an initial cash consideration of £5.8m, financed from existing MCL cash and debt facilities, and a deferred consideration of up to £5m, payable in cash over the next four years to February 2023, conditional upon certain net profit criteria having been met.

Based in Sheffield, U Account is a leading digital current account provider. As well as providing card services with its current accounts through contactless Mastercard debit cards, U Account also offers in-app features and functionality to help customers manage their finances more effectively. U Account focuses on customers who are underserved by traditional banks. MCL has acquired U Account's technology and e-money banking platform, as well as its 20,000 current active customers.

U Holdings on track. Losses were expected this year, before earnings accretion expected thereafter.

While U Account has historically been loss-making (in the year-ended 28 February 2019, U Account – then trading under the ownership of Ffrees Family Finance Ltd – generated unaudited revenue of £1.7m and an unaudited operating loss of £4.0m), in its June announcement, management said it expected that, post-integration and restructuring, the losses incurred in the remainder of FY20 would be in the range of £1.4m to £1.7m. Management was confident that the acquisition would be earnings-accretive thereafter.

Strategic vision for digital

Vision driven by what customers have told MCL that they want. Potential to now provide products to 59% of customer wallet, up from 27%.

MCL's strategic vision is driven by customer-driven demand. From its dozens of customer surveys, it has identified how customers want to be served (primarily mobile, in addition to agent), which products they want and what they are willing to pay. With the development of online lending products, current account overdrafts and, in due course, credit cards, MCL believes it can address 59% of the customer wallet, compared with just 27% from HCC alone. This has required investment, but the pace of investment has been proportionate to the business. It has not incurred the losses seen by, say, Satsuma, and its acquisition of CTL has already seen more cash collected than consideration paid.

Customer portal will see whole opportunity and key development. Being sold by agents whose buy-in is shown by rapid growth in portal user numbers.

The customer portal is an important part of this. It currently i) provides customers with information regarding their account balance, payment history and MCC account, ii) enables customers to see their eligibility for further credit at any time, and iii) it offers content and rewards from third parties. The e-money product is being rolled out this year, and the plan is to fully integrate this into the customer portal. It will thus offer customer ease of administration, credit products, banking products and access to discounts they would not otherwise be able to see. MCL plans to monetise the business primarily through the credit products. It expects to earn some income from third parties for hosting their products, but these may be regarded as covering costs, rather than profits.

Financials

Impact on estimates

Little change to bottom-line estimates but CTL introduces potential volatility

We have reduced our revenue and impairment expectations, reflecting the performance in the digital business and, more importantly, the delay to our previously assumed acquisitions. Additionally, our earnings estimates have been reduced by ca.1%, with the issue of 1.2m shares pursuant to the vesting of awards under the company's deferred share bonus scheme (see *announcement, dated 25 July*). Overall, our adjusted EPS and profit estimates are broadly unchanged in FY'20 and see a modest reduction in FY'21. Given that management outlook comments are in line with expectations, we do not believe there will be a material change in consensus estimates.

Estimate changes

Year-end Feb	2020E			2021E		
	Old	New	% change	Old	New	% change
Profit and loss (£m)						
Reported revenue	143.0	136.5	-5%	158.8	151.7	-5%
Total impairments	-37.3	-30.0	-19%	-46.6	-40.2	-14%
Total costs (incl. temp. comm.)	-83.6	-83.6	0%	-85.5	-85.1	0%
EBITDA	22.1	22.9	3%	26.7	26.4	-1%
Adjusted PBT	20.0	19.9	-1%	24.1	22.9	-5%
Adjusted EPS (p)	12.4	12.2	-1%	14.9	14.0	-6%
Statutory PBT	17.6	16.5	-7%	21.7	21.5	-1%
Statutory EPS (p)	11.2	10.3	-9%	13.7	13.6	-1%
Dividend (p)	8.2	8.2	0%	10.0	10.0	0%
Balance sheet, @ end-Feb (£m)						
Amounts receivable	90.4	85.1	-6%	104.4	98.6	-6%
Borrowings	26.0	26.0	0%	31.0	31.0	0%
Equity	76.0	74.8	-2%	80.8	79.5	-2%

Source: Hardman & Co Research

Balance sheet

@ end-Feb (£000)	2015	2016	2017	2018	2019*	2020E*	2021E*
Goodwill	294	1,326	2,834	2,834	3,501	13,281	13,947
Intangible assets	10,391	9,052	7,058	5,520	6,221	6,148	5,079
Property, plant and equipment	936	1,182	763	822	378	4,377	4,377
Amounts receivable from customers	1,507	679	395	265	206	100	100
Deferred tax	0	0	0	0	958	920	920
Total non-current assets	13,128	12,239	11,050	9,441	11,264	24,826	24,423
Current assets							
Receivables	53,976	56,152	60,833	72,563	72,840	85,000	98,500
Trade/other receivables, incl. stock	26,216	1,554	2,019	2,039	2,369	3,000	3,000
Cash and cash equivalents	8,650	3,755	3,985	4,868	7,893	1,777	3,444
Total current assets	88,842	61,461	66,837	79,470	83,102	89,777	104,944
Total assets	101,970	73,700	77,887	88,911	94,366	114,604	129,367
Current liabilities							
Trade and other payables	-3,274	-7,452	-5,892	-6,695	-1,830	-2,830	-3,830
Tax payable					-7,482	-7,482	-7,482
Lease liabilities						-3,519	-3,519
Total current liabilities	-3,274	-7,452	-5,892	-6,695	-9,312	-13,831	-14,831
Net current (liabilities)/assets	85,568	54,009	60,945	72,775	73,790	75,946	90,113
Non-current liabilities							
Financial liabilities – borrowings	0	-9,000	-10,000	-15,552	-14,075	-26,000	-35,000
Deferred tax	-2,614	-1,879	-617	-144	0	0	0
Total non-current liabilities	-2,614	-10,879	-10,617	-15,696	-14,075	-26,000	-35,000
Total liabilities	-5,888	-18,331	-16,509	-22,391	-23,387	-39,831	-49,831
Net assets	96,082	55,369	61,378	66,520	70,979	74,773	79,536

** IFRS9 basis; Source: MCL, Hardman & Co Research*

Profit & Loss							
Year-end Feb (£m)	**2015**	**2016**	**2017**	**2018***	**2019***	**2020E***	**2021E***
Existing operations	22.5	84.7	96.2	110.4	116.8	118.0	150.7
Acquisitions during period	67.4	5.8	3.3		0.2	18.5	1.0
Total revenue	**89.9**	**90.6**	**99.6**	**110.4**	**117.0**	**136.5**	**151.7**
Impairment charge	-22.9	-18.8	-24.3	-24.7	-26.2	-30.0	-40.2
Ongoing agent commission	-17.7	-18.5	-21.2	-23.6	-26.6	-27.6	-27.6
Temporary agent commissions		-0.7	-1.2	-4.4	-1.7	-0.5	-0.3
Gross profit	**49.3**	**52.6**	**52.9**	**57.7**	**62.5**	**78.4**	**83.6**
Administration expenses (pre-excep. and intang. amort.)	-32.8	-33.3	-33.0	-37.6	-38.8	-55.5	-57.2
Depreciation (incl. goodwill impairment, amort. of IT)	-0.9	-0.9	-1.3				
Operating profit (pre-excep. and amort.)	15.6	18.4	18.6	20.1	23.7	22.9	26.4
Adjusted financing costs	-2.6	-1.6	-0.9	-1.5	-1.7	-3.0	-3.5
Adjusted PBT	**13.0**	**16.8**	**17.7**	**18.6**	**22.0**	**19.9**	**22.9**
Income tax	-2.7	-3.5	-3.7	-3.9	-4.4	-4.0	-4.6
Adjusted PAT	**10.3**	**13.3**	**14.0**	**14.7**	**17.6**	**15.9**	**18.3**

**IFRS9 basis (2018 pro-forma basis); Source: MCL, Hardman & Co Research*

Cashflow

Cashflow statement							
Year-end Feb (£000)	**2015**	**2016**	**2017**	**2018**	**2019***	**2020E***	**2021 E***
Statutory PBT	58,565	10,374	11,219	16,133	20,217	16,470	21,531
Depreciation	596	736	544	563	475	265	3,064
Impairment of goodwill	56	42	0	0	0	0	0
Amortisation of intangibles	8,574	5,683	4,412	2,950	2,209	1,000	1,332
Share-based payment expenses	0	0	126	431	1,107	1,107	1,107
Gain on acquisitions	-51,961	-32	0	0	0	0	0
Loss on disposal of plant, property and equipment	40	146	134	0	0	0	0
(Increase)/decrease in debtors	-14,803	27,532	-1,918	-11,604	-3,901	1,416	-12,478
Dividend *in specie* to Perpignon	0	-31,129	0	0	0	0	0
Increase/decrease in creditors	4,768	2,548	-1,640	1,846	2,170	1,500	1,500
Interest paid	1	647	927	1,456	1,745	3,000	3,500
Taxation paid	-800	-1,737	-4,078	-4,536	-3,555	-4,250	-5,250
Net cash inflow/(outflow) from op. activities	**5,036**	**14,810**	**9,726**	**7,239**	**20,467**	**20,508**	**14,306**
Cashflow from investing activities							
Purchase of intangibles	-416	-2,523	-1,029	-1,412	-2,411	-7,211	-1,445
Purchase of property, plant and equipment	-343	-1,152	-125	-622	-31	-600	-600
Disposal of assets	0	501	0	0	0	0	0
Purchase of subsidiaries	0	-7,383	-5,695	0	-2,187	-17,000	-3,000
Cash acquired on acquisitions	5,120	0	0	0	0	0	0
Net cash outflow from investing activities	**4,361**	**-10,558**	**-6,849**	**-2,034**	**-4,629**	**-24,811**	**-5,045**
Cashflow from financing activities							
Net borrowing	0	9,000	1,000	6,000	-1,052	11,925	9,000
Interest paid	-1	-647	-927	-1,904	-2,170	-3,000	-3,500
Dividends	-2,000	-17,500	-2,720	-8,418	-9,591	-10,738	-13,095
Net cash inflow from financing activities	**-2,001**	**-9,147**	**-2,647**	**-4,322**	**-12,813**	**-1,813**	**-7,595**
Net increase in cash and cash equivalents	7,396	-4,895	230	883	3,025	-6,116	1,666
Opening cash and cash equivalents	1,253	8,650	3,755	3,985	4,868	7,893	1,777
Closing cash and cash equivalents	8,650	3,755	3,985	4,868	7,893	1,777	3,444

**IFRS 9 basis; Source: MCL, Hardman & Co Research*

Valuation

Average valuation upside potential on absolute measures 57%

We detailed all the assumptions used in our valuation methodologies in our note, *Bringing home collect into the 21st century*, published on 2 February 2017. Post these changes, our absolute valuation techniques now imply an average of 182p. The falls from our previous forecasts (range was 176.5p to 224.5p) are driven by: i) lower tangible equity in the Gordon Growth Model (GGM), with a higher amount on intangibles than we had been forecasting following the deals; and ii) adjusted FY'21 forecasts seeing a lower ongoing dividend in the Dividend Discount Model (DDM).

Summary of different valuation techniques

	Implied price (p)	Upside potential
GGM	196.6	69%
DDM	166.7	44%
Average absolute measures	**181.6**	**57%**

Source: Hardman & Co Research

GGM

We have advanced our base year to February 2020, which sees an uplift of ca.20p per share in the valuation, as the forecast equity level is that much higher.

GGM and sensitivities

	Base	+1% RoE	+1% CoE	+0.5% G
RoE	25%	26%	25%	25%
CoE	11%	11%	12%	11%
Growth	5.5%	5.5%	5.5%	6.0%
Price/book value (x)	3.5	3.7	3.0	3.8
Premium for near-term outperformance	20%	20%	20%	20%
Adjusted price/book value (x)	4.3	4.5	3.6	4.6
Book value 2020E (£m)	60.5	60.5	60.5	60.5
Valuation (£m)	257.4	270.6	217.8	275.9
Valuation per share (p)	**198.8**	**209.0**	**168.2**	**213.1**
Variance (per share) (p)		10.2	-30.6	14.3

Source: Hardman & Co Research

Other issues

Change in directors

Two execs. now NEDs, but board balance still to independent directors

On 3 July, MCL announced that Leslie ("Les") Easson would be a non-executive director. Les joined the Board of MCL on 1 September 2019, when he retired from his role as the company's Operations Director on 31 August 2019. This followed the 2 May announcement that Andrew Thomson would retire from his role as CFO on 1 July 2019 but remain as a non-executive director. He was replaced as CFO by Andrew Hayward; Andrew joined MCL from eServGlobal, the ASX- and AIM-listed digital financial transactions technology company, where he had been CFO for more than two and a half years. Prior to this position, Andrew held the role of Head of Finance for Hurricane Energy PLC for almost five years and spent six years at PwC in various roles across audit and corporate finance, latterly working in its TMT (Technology, Media, Telecoms) corporate finance team.

Following these changes, the board consists of Stephen Karle (Chairman and NED), three independent NEDs (Baroness Simone Finn, Joanne Lake and Sir Nigel Knowles), two executives (Paul Smith and Andrew Hayward), two NEDs who were former executives (Andy Thompson and Les Easson), and Peter Ward, who was a cofounder of RCapital.

Directors/PMDR dealings

1.3m shares vested under the deferred share bonus scheme (DSBS) on 29 July 2019. We note that the majority of directors and PMDR (person discharging managerial responsibilities) with the largest entitlement sold only enough shares to meet their tax liabilities.

PMDR dealings

PDMR	Shares awarded under DSBS	Shares exercised	Shares sold to satisfy tax & NICs	Additional shares sold	Total number of shares sold	Net shares retained
Paul Smith	240,686	240,686	113,693	-	113,693	126,993
Andrew Thomson	181,853	181,853	85,903	-	85,903	95,950
Tracey Mulligan	147,086	147,086	69,480	-	69,480	77,606
Les Easson	160,457	160,457	75,796	-	75,796	84,661
Myron Burlak	133,715	133,715	63,164	70,551	133,715	0
Barrie Grimshaw	147,086	147,086	69,480	77,606	147,086	0
Ian Cooper	147,086	147,086	69,480	77,606	147,086	0

Source: MCL announcement dated 2 August 2019

Woodford read-across

Stake sold and no fundamental read-across

Historically, Woodford Investment Management had a holding of just under 10% in MCL. This was sold progressively through 2019, with the announcement that it was under 5% on 11 July. We understand the holding today is minimal. We note that one consequence of the Woodford situation is that compliance departments, especially in large multi-managers, have imposed restrictions on investments that may be considered illiquid. We do not believe this will be a material constraint should Hay Wain wish to sell down, given the liquidity in recent periods (ca.55m shares traded in 2018 and 2017).

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