HARDMAN&CO.

13 July 2020

Financials

Source: Refinitiv

Market data

EPIC/TKR	**NSF**
Price (p)	**5.15**
12m High (p)	70.0
12m Low (p)	5.14
Shares (m)	312.4
Mkt Cap (£m)	16
EV (£m)	319
Free Float	99%
Market	Main

Description

In the UK non-standard lending market, Non-Standard Finance (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	Jono Gillespie

+44 20 38699026
www.nsfgroupplc.com

Key shareholders (31 March '20)

Alchemy	29.95%
Aberforth Partners	17.78%
Marathon Asset Mgt.	11.03%
Neil Utley	7.00%
Tosca Fund	4.75%
Basswood	3.25%

Diary

Jul'20	Announcement re discussions with shareholders on potential equity raise

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

NON-STANDARD FINANCE PLC

FY'19 solid; outlook – broad range of outcomes

Key takeaways from NSF's *results* and *presentation* were: i) solid underlying 2019 with normalised operating profits up 20% and lower impairments to revenue; ii) £60m cash now – April and May cash-generative; and iii) current collections 86% of pre-lockdown levels. NSF is a going concern and is considering an equity raise to help fund additional growth. Downside includes: i) statutory loss with further goodwill impairments; ii) material uncertainty arising from COVID-19 effects and so possibly its going-concern status; and iii) operating performance improvement needed for further securitisation-line drawings (waiver *extended on 29 June*).

- **Opportunities:** We have emphasised before how higher demand for non-standard lending in a downturn, combined with wider spreads, can more than offset increased impairments. NSF's current balance sheet means that an equity raise to support credit lines is necessary to take advantage of this opportunity.

- **Uncertainties:** COVID-19 creates uncertainty on loan volumes (and so income) as well as impairment. NSF is solvent and liquid in its base-case scenario, and so the business is a "going concern". However, a materially more severe downturn could see further financing covenants breached and a risk to this status.

- **Valuation:** Near-term earnings, and dividend progression, do not reflect the long-term business outlook and are likely to be highly variable. The Gordon Growth Model implies for a long-term profitable growing business, a value above book (2019 tangible book value £40m, market capitalisation £16m).

- **Risks:** Credit risk remains the biggest threat to profitability (this is mitigated through high risk-adjusted margins and good customer relationships), and NSF's model accepts higher credit risk where a higher yield justifies it. As noted above, COVID-19 also presents short-term threats to income.

- **Investment summary:** Short-term uncertainty aside, substantial medium- and long-term value should be created, as i) demand for, and pricing of, non-standard finance is likely to be strong for at least the next few years following the fallout from the COVID-19 crisis, ii) NSF has substantial committed medium-term debt funding, iii) competitors have withdrawn (and potentially more may do so), and iv) it has a highly experienced management team.

Financial summary and valuation (2020 and 2021 base case, no equity raise – see later section for range of other scenarios)

Year-end Dec (£000)	2017	2018	2019E	2020E	2021E
Reported rev./other inc.	121,682	168,128	184,611	163,457	176,144
Total impairments	-28,795	-43,738	-46,660	-64,181	-49,797
Total costs	-69,203	-89,082	-95,786	-91,946	-90,303
Normalised EBIT	23,684	35,101	42,165	7,331	36,044
Adjusted PBT	13,203	13,994	14,707	-22,886	5,928
Statutory PBT	-13,021	-2,365	-75,976	-27,133	1,697
Pro-forma EPS (p)	3.44	3.50	3.66	(6.04)	1.64
DPS (p)	2.20	2.60	0.70	-	1.00
P/adjusted earnings (x)	1.5	1.5	1.4	-0.9	3.1
P/BV (x)	0.1	0.1	0.1	0.2	0.2
P/tangible book (x)	0.2	0.3	0.4	0.8	0.7
Dividend yield	42.7%	50.5%	13.6%	0.0%	19.4%

Source: NSF, Hardman & Co Research; all years are on IFRS 9 basis

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2019 results

Group summary

As noted on the front page, there were positives and negatives in the results.

Normalised revenue rose 10%, credit and efficiency improvements led to strong operating profit growth, volume- and mix-driven rise in funding costs saw normalised operating profit up 20%

- Normalised revenue was up 10% to £184m (reported revenue +14% to £181m). Credit impairments rose by £1m to £45m. Normalised costs rose by £7m to £96m (reported by £5m to £103m). Normalised operating profit was up 20% to £42m (reported operating profit by 71% to £32m). Normalised PBT was up 5% to £14.7m as finance costs increased by £6m to £27m (driven primarily by loan book growth and a mix change, with lower proportionate equity funding at 54% of receivables, against 77% in 1H'18).

Exceptional bid costs and goodwill writedown

- There was an exceptional charge of £80.6m (2018: £nil), which included fees and costs associated with the offer for PFG of £12.7m (2018: £nil) and restructuring charge of £1.9m. In 1H'19, there was a Loans at Home goodwill impairment of £12.5m. In 2H'19, there were further impairments across all three acquisitions £53.3m (FY'19 £65.8m) as the peer ratings in non-standard lending collapsed.

- A non-cash, prior-year corrected error in loan provisions of £4.0m reduced the group's net assets by £3.5m after accounting for deferred tax. This related to the use of incomplete data to calculate loss given default on the adoption of IFRS9 and has now been corrected.

KPI's generally positive trends

- As can be seen in the Key Performance Indictors (KPI) in the table below for the different businesses, loan growth has been slowing, yields are broadly stable, while impairments, profit margins and returns on assets are a mixed story.

KPI (%)

2019 (2018 restated)	ELD	GLD	HCC
Loan book growth	17.6 (24.7)	27.7 (61.0)	-2.7 (2.1)
Revenue yield	46.4 (47.8)	31.7 (32.5)	167.5 (171.5)
Risk-adjusted margin	36.1 (37.0)	23.2 (25.8)	122.2 (115.6)
Impairments/revenue	22.2 (22.7)	26.8 (20.5)	27.0 (32.6)
Impairments/average net loan book	10.3 (10.8)	8.5 (6.6)	45.2 (55.9)
Cost income ratio	45.4 (45.9)	43.2 (45.9)	58.0 (57.1)
Operating profit margin	31.9 (33.0)	29.4 (34.5)	15.0 (10.3)
RoA	14.8 (15.8)	9.3 (11.2)	25.1 (17.7)

Source: NSF results release and presentation, dated 26 June 2020

Cash currently £60m

- There is currently £60m cash in bank (gross borrowings of £345m). When the group was not lending, it was strongly cash-generative (April £7.4m, May £17.2m).

Lending restarted; collections at 86% pre-lockdown level

- Lending restarted in May 2020 and basic collections have been averaging 86% of pre-lockdown levels (better than average performance in branch-based lending).

Going concern today and in base-case scenario. Stress downsides could see pressure on funding.

- The group is currently a going concern and the group's base-case scenario, which has some limited loan growth, does not require any additional equity. However, COVID-19 creates uncertainty over income and impairments and a stress downside scenario would be likely to see funding issues and hence the uncertainty as the ongoing concern status. We believe this will be the key bear consideration.

Accelerated growth would require equity support to secure debt financing

- NSF is currently unable to draw additional funds from its securitisation facility due to a technical breach in its operational covenants. Consequently, the board is considering options on capital structure, including equity, that would allow NSF to pursue a more ambitious strategy given the expected increase in demand for its services as mainstream lenders tighten credit.

Range of outlook scenarios

Upside scenario

Downturns see increased demand for non-standard lending, less competition and wider spreads to offset higher impairments

Current conditions present multiple upside opportunities (as they have demonstrably done in past downturns). In particular, there is:

- increased demand as more mainstream borrowers are pushed into the non-standard space – this reflects increased unemployment, more financial strain, fewer hours worked by casual workers and all the other pressure on consumers as well as tighter lending criteria by mainstream lenders;
- less competition – on the margin, mainstream banks have lower appetite to lend, non-bank lenders can have difficulties accessing finance themselves, international operators withdraw to their home countries, some competitors will undoubtedly fail (Sunny Loans was the latest to announce that it had appointed administrators on 29 June 2020 – it had 50,000 UK customers); and
- increased lending spreads, reflecting more demand and less competition.

These factors have been flagged for many years

These factors combined could see an increase in profit, which more than offsets higher impairments on loans written before COVID-19 that move into arrears. Such a trend is not new. Indeed, on p6 of our November 2016 initiation Carpe Diem, we noted "At times of economic distress, the number of customers who drop out of prime status increases thus expanding the pool of potential customers in the non-standard market. Additionally, a non-standard lender's ability to re-price is significantly higher – it is easier to add 5% to a loan with an APR of 50% than a mortgage charging 3%. Impairments rise, as does the funding cost, but the bottom line resilience of well-run businesses such as PFG (2007 profit £115m, 2009 profit £130m) or S&U (2007 profit £6m, 2009 £6m) is high."

Level of upside will be dependent on equity support from shareholders

The issue for NSF today is how to exploit the opportunity and lend more but to maintain a tight grip on impairment and costs. NSF's decision to pay a little more for multi-year commitment to funding lines has been justified but, in a COVID-19 environment, its operational performance means that, for the time being, it can no longer draw on this new line of funding. Access to this line of credit could be unlocked by further equity support and hence the group has commenced discussions with shareholders as to their appetite to fund a more ambitious plan than the current modest-growth base-case scenario. Not unsurprisingly, they can say nothing at this stage. The level of equity support, and so growth, will be dependent on investor appetite. We note that the largest shareholders have chosen to join the register after the PFG bid (e.g. Alchemy, Neil Utley, Marathon ca.50% combined). Additionally, Alchemy was the owner of Everyday Loans through the last recession and so knows the opportunity well. In our view, the scale of support that the major shareholders are willing to provide is wide.

Downside risk

Summary

Bears will focus on board's comments about potential uncertainty to going-concern basis. Not a problem in base-case scenario.

We believe the bears will focus on the uncertainty over the going-concern basis and, accordingly, investors need to understand the risks. The eye-catching risk relates to going concern. It is important to recognise that NSF's base-case scenario, where there is some muted lending and a "reasonable" macroeconomic downside scenario, the group would not breach any further covenants in the next 12 months and would not need to draw down further from the securitisation facility. As a result, no further covenant waivers would be required from its lenders in order to remain viable. The group has considered a stress to the base case where it is required to repay the £15m currently drawn under the securitisation facility. Under this stressed scenario, the group still does not expect to breach any further covenants over the next 12 months.

Range of uncertainties is very wide

However, the directors felt that the range of assumptions made in both the base-case and downside scenario were such that, given the uncertainties around the idiosyncratic impact of COVID-19, there remained a material level of uncertainty around the impact on the group's ability to meet its covenants and if they weren't met, the likelihood of a further waiver being granted by the lenders as well as the full impact on the group's balance sheet. NSF noted that current negotiations with lenders suggest that, whilst it is likely that waivers would be given, at a cost, to cover reasonable deviations from the base-case scenario, waivers which would be required to fully cover the downside scenario are beyond what is currently envisaged in the negotiations.

Financial

COVID-19 affects income and impairments, although to date about half those seeking forbearance are making full or partial payments

It is important, therefore, to consider how COVID-19 could affect the group. Government policy has seen a marked increase in those seeking forbearance, although NSF's experience has been that of those seeking assistance a quarter are making full payments, a further quarter make some payments and only half make no payments at all. Less positively, NSF notes that collections from guarantors when a borrower is on a payment freeze is one procedure that the regulator has prohibited with the result that the guarantor loans performance has been weaker than in the other divisions. Accounting for this in terms of both income and impairments is challenging. We believe an increase in impairments is inevitable, the only question is by how much. The effect on income is less clear but is directly linked to the size of the loan book.

IFRS9 could see expected loss increase from higher weighting assigned to downside scenarios. NSF gives sensitivity – at 50% base, 50% stress downside impact would be £3m.

- Impairments could be affected by both more customers moving into later arrears stages and so falling into higher impairment provisioning buckets, but also by anticipated losses rising as macroeconomic downside scenarios have an increased weighting in the calculations (IFRS9 provisioning is known to have pro-cyclical effects). NSF details its assumptions on p141 of its *Annual Accounts* where we note that, at the end of 2019, its weightings were downside scenario 30%, severe downside scenario 15%, and positive 5%. The two downside scenarios have increased from 2018 (when they were 0% and 10%, respectively) but there is the risk these will have to be increased further. A sensitivity to this was given on p145 of the accounts – at 50% base, 50% severe downside, the expected credit loss increases by £3m.

1Q'20 reporting by financials is seeing material increases…

- In their 2020 performances to date, many lenders have taken significant increases in charges (Barclays UK Personal Banking's 1Q'20 impairment charge was £134m (£52m 1Q'19); Lloyds Retail's underlying charge was £325m with a COVID-19 charge of £564m).

…but regulators seem to be playing it down

- However, there have been regulatory statements, which effectively "advise" that impairment policies should look through increases in COVID-19-related arrears and there has been unprecedented government support.

Deferring payments has an impact on income

- Deferring payments will lead to income deferral and associated modification and derecognition losses. The calculation is rather technical but at its heart is a discounted cashflow, so, if payments are made over a longer period, the DCF is lower. The outlook for future forbearance is unclear but it seems reasonable to assume that it will increase, at least for a period.
- We expect new business pricing to increase potentially quite sharply. The greatest effect will be felt in the short-term books (especially home collect).

Potential further non-cash goodwill impairments. NSF remains solvent if all goodwill written off.

Additionally, should market conditions continue to see de-rating of non-standard financials, there is a chance of further goodwill impairments. NSF identified the sensitivity to this issue as being a potential further 1% drop in price earnings multiples would result in ca.£0.8m of additional impairment of goodwill at the branch-based lending division, and reduce the level of existing headroom in relation to the carrying value of the home credit goodwill asset by £0.6m. The residual goodwill is £47.1m and £27.7m, respectively, (see p153 Annual Report); so, there is a potential for a further large non-cash, exceptional charge reducing statutory profits. There is of course no impact on tangible assets and the Directors note that under both its base and stress test scenarios, NSF remained in a net asset position and, upon adding a further stress to write off all remaining goodwill on the balance sheet as at 31 December 2019, the group and company remained solvent.

Financing and solvency

Main risk is around financing lines and unclear what support would be provided in stress downside scenarios

The main reason for a caveat to potential going-concern basis relates to what would happen to financing, noting the 29 June facilities update detailing the extension to waivers agreed by NSF's securitisation line provider. As noted above, discussions with financiers suggested there should no liquidity problem in the base-case scenario, but the waivers that would be required in a downside scenario were not under current discussion. We believe the main sensitivities here are as follows.

Collection rates an important factor. Major fall from here required for NSF to be illiquid but drawing new lines is problematic

- The rate of impairment is the performance trigger, which means that new facilities cannot currently be drawn under the securitisation line. The group additionally ran a liquidity reverse stress test on the base case to identify the level expected collections would have to fall by to cause the group to deplete all cash reserves. This assumes no further lending and a corresponding fall in collections with no change to operating expenses. The result of this showed that collections would have to fall by a further 65% from expected forecast levels in the base case for the group to become illiquid, assuming no access to further funding. Such a reduction in collections, based on evidence to date, was thought by the Directors to be an unlikely event. We also note the securitisation facility provider has a further waiver for COVID-19-related forbearance.
- Solvency: NSF's tangible net assets at end-2019 were £40.2m. 2019 impairments would need to increase by £51.6m, i.e. increase by 114% to eliminate the 2019 profit and net assets completely.

Divisional summary

Normalised divisional results

2019 (£000)	ELD	GLD	HCC	Central costs	NSF total	Change on 2018
Revenue	93,002	29,820	60,835	0	183,657	+10%
Other operating income	954	0	0	0	954	-41%
Modification loss	-951	-230	0	0	-1,181	n/m
De-recognition (loss)/gain	-482	69	0	0	-413	+220%
Impairments	-20,635	-7996	-16,435	0	-45,066	+3%
Revenue less impairments	**71,888**	**22,663**	**44,400**	**0**	**137,951**	**+11%**
Admin. expenses	-42,235	-12895	-35,298	-5358	-95,786	+8%
Operating profit	**29,653**	**8,768**	**9,102**	**-5,358**	**42,165**	**+20%**
Finance costs	-17,355	-7338	-2,166	-649	-27458	+30%
PBT	**12,298**	**1,430**	**6,986**	**-6,007**	**14,707**	**+5%**
Taxation	-2,711	-113	-1474	1,141	-3,216	+7%
PAT	**9,483**	**1,317**	**5,512**	**-4,866**	**11,446**	**+5%**

Source: NSF results presentation slide 11

ELD

Strong growth in 2019

The key divisional highlights from 2019 were: i) net loan book up 18% to £214.8m continuing a long-term growth trend (2016-19 CAGR 21%); ii) impairment lower at 22.2% of revenue (2018 22.7%). Impairment also improved against average net receivables (10.3% vs. 10.8%); iii) eight new branches opened taking the total to 73, iv) 17% increase in the number of staff to 476,; v) over 2.5m loan applications processed, up 52%; and vi) 75,400 active customers, up 23%.

Outlook

The collections rate in ELD had been among the best in the group (94% pre-lockdown level in May versus group average 86%). However, lending in April was close to zero and only restarted on 11 May. With the end-June results, NSF advised its book was down 7% (ca.£15m) on 31 December. We expect growth to resume but only carefully as NSF learns from new scorecards and there is greater clarity on potential unemployment. We expect a material increase in potential demand and the pace of growth will therefore be driven by NSF's lending appetite and access to funding. With continued repayments, for end-2020, we expect the loan book to still be down on 2019 and a drop in the average loans (to £198m vs. £200m in 2019). Strategically, we expect COVID-19 will lead to a pause in the branch opening plans in 2020 (there is capacity to grow lending in existing branches) before growth in the number of branches starts again. While like-for-like spreads are likely to improve, we believe there will be two adverse mix effects – NSF focusing on lower-risk customers and the impact of rescheduling some loans to lower rates with a net effect of slightly lower yields and divisional margins. In 2021, we expect impairments to nearly double from 22.2% of revenue to 41.5% with a nominal charge of £37.0m against £20.6m in 2019. With the headwind of the full-year effect of prior investments, we see costs being broadly flat. Divisional profits are thus forecast to fall from £12m in 2019 to a loss of £10m in 2020 before recovering strongly in 2021 to a profit of £6m (which benefits from 5% loan growth, a small spread improvement and a reversion of impairments to 27.5% of revenue). We expect cost control to kick in more effectively and so costs to be down compared with 2020. Under these assumptions, the loan book and profits would still be smaller than end-2019.

GLD

GLD financials

The key divisional highlights in 2019 were: i) net loan book up 28% to £105.5m continuing the long-term growth trends (2016 to 2019 CAGR 44%); ii) impairment increased to 26.8% of revenue from 20.5% (as a percentage of the average loan book 8.5% against 6.6%); iii) consolidation of the division's operations from two sites into one; iv) more than 520,000 loan applications processed, up 16%; and v) 32,600 active customers, up 30%. There were operational issues in the collections team earlier in the year, which should have been resolved by the consolidation into one site, but it contributed to the rise in impairments on 2018.

In terms of claims, a major issue at competitor Amigo, management commented that its experience was very different. Total complaints (including things like telephone mis-handling) were slightly lower in April/May than Jan/Feb. There has seen a slight increase in the number of Financial Ombudsman Service (FOS) complaints but the proportion reviewed in NSF's favour has risen from around a third to around a half, albeit on small volumes. NSF also said it was seeing some claims company activity but significantly less than that experienced by Amigo.

The government's moratorium on allowing collections from guarantors has temporarily taken away a key element of this type of lending with the result that the performance of higher-risk customers has become more visible. This is evident in lower collections rates than for branch-based lending (83% of pre-lockdown levels). Once collections are allowed to be made from guarantors, the benefit of having two counter-parties should become visible again and the fundamentally lower risk of this type of lending evident in better collection and arrears.

Outlook

The above-average duration of lending has seen the book fall slower than other divisions (down 4% end-June on 31 December). However, the high-profile problems and associated high numbers of complaints at the market leader may have an impact on sentiment to guarantor loans and we believe that NSF will be cautious over the next few months regarding the pace of loan book growth. In 2020, we are expecting a full-year loan decline of 16% (average down 1%). Again, like-for-like spreads are expected to widen but mix effects (especially a greater focus on higher-quality customers that tend to come through price comparison websites) should result in a modest fall in margin in 2020. Impairments again are expected to spike up to 35% revenue with a nominal charge of £10m vs. £8m. Slower new lending under IFRS9 sees less of the upfront hit that would otherwise have been incurred. Costs show only a modest rise, again primarily driven by full-year effects from prior investments and a small pick-up in the administration of claims broadly offset by short-term cost-control measures. Looking forward to 2021, we expect loan growth to recover more quickly (20% spot, average 4%), the market widening of spreads to feed through (32% vs. 31%), impairments to improve to around 2019 levels offset by costs growth. Overall, we therefore expect 2021 to be around breakeven/a small loss.

HCC

HCC financials

The key divisional highlights in 2019 were: i) the net loan book was down 3% to £39.9m; ii) impairments were down from 32.6% to 27.0% of revenue; iii) significant technology-driven enhancements were delivered during the year, including a new customer portal, automated income verification, card readers for agents enabling "chip and pin" on the doorstep and a bespoke scorecard for the most experienced and best-performing agents. Improving technology was an important factor when agents were no longer able to visit customer homes and, despite home collect being a core part of the model previously, post lockdown collections averaged 76% of pre-lockdown levels.

Volumes a temporary constraint in home collect as new delivery channels rolled out. Should be in place by critical 4Q, but revenue likely to fall

Home collect registered a seasonal decline in 1H and this was compounded by agents not making new loans from the end of March and during most of April. The home visit was fundamental to this and remote lending was only put in trial through April and May and will be rolled out fully in July. As a result, at the end of May, the loan book was thus down 32% versus December 2019, or down 26% from the beginning of March. We expect an element of recovery, especially by the critically important 4Q, but model a 10% drop in YoY balances (average down 20%). Again, a market-wide broadening in new business pricing is in the short term offset by mix effects (in this case, less new lending, which in 2019 was above-average margin, shorter duration) and a focus on quality. Together, these see a material fall in revenue (from £61m in 2019 to £45m in 2020). Impairment as a percentage of revenue rises but in nominal terms sees a modest reduction given the smaller book. Lower commissions drive a materially lower cost outlook and we forecast the division's pre-tax profit to fall from £7m in 2019 to pre-tax loss of £4m in 2020. Into 2021, we expect loan growth of 10%, the market pricing and new business feeding through to wider margins, an improvement in credit metrics driving pre-tax profits back to £5m.

Central and exceptional costs

Central costs – some savings in 2021 but, in 2020, higher finance costs

Central costs were down 1% despite further investment in governance and risk-management controls. Given the outlook, we expect further cost control in this area, particularly felt in 2021. However, in 2020, we see a cash drag from the group having drawn facilities but maintaining significant liquidity and so a higher central finance cost.

Exceptional items

In 2019, there was an exceptional charge of £80.6m (2018: £nil), which included fees and costs associated with the offer for PFG of £12.7m (2018: £nil) and restructuring charge of £1.9m. In 1H'19, there was a Loans at Home goodwill impairment of £12.5m. In 2H'19, there were further impairments across all three acquisitions £53.3m (FY'19 £65.8m) as the peer ratings in non-standard lending collapsed. As noted above, should market conditions continue to see de-rating of non-standard financials there is a chance of further goodwill impairments. NSF identified the sensitivity to this issue as being a further 1% drop in price earnings multiples resulting in ca.£0.8m of additional impairment of goodwill at the branch-based lending division, and reducing the level of existing headroom in relation to the carrying value of the home credit goodwill asset by £0.6m.

Financials

Base case

We have detailed the key drivers to our base case in the section above.

Reported profit and loss (base case)							
Year-end Dec (£000)	**2015**	**2016**	**2017**	**2018***	**2019***	**2020E***	**2021E***
Business interest income	14,657	81,099	119,756	166,502	183,657	162,957	175,144
Other operating income	0	450	1,926	1,626	954	500	1,000
Fair-value unwind on acquired portfolios	-5,456	-8,342	-11,985	-7,678	-2,873	0	0
Total revenue	**9,201**	**73,207**	**109,697**	**160,450**	**181,738**	**163,457**	**176,144**
Impairments	-3,858	-23,651	-28,795	-43,945	-46,660	-64,181	-50,978
Gross profit	**5,343**	**49,556**	**80,902**	**116,505**	**135,078**	**99,277**	**125,166**
Administration expenses	-11,340	-44,074	-69,203	-89,082	-95,786	-91,946	-90,303
O/W depreciation	-198	-690	-1,497	-1,772	-3,869	-4,500	-4,500
Amortisation of intangibles	-4,030	-10,714	-7,897	-8,681	-7,226	-4,247	-3,050
Operating profit	**-10,027**	**-5,232**	**3,802**	**18,742**	**32,066**	**3,084**	**31,813**
EBITDA	**-5,799**	**6,172**	**12,518**	**29,195**	**43,792**	**11,831**	**39,363**
Exceptional items	-6,135	-626	-6,342	0	-80,584	0	0
Net finance (cost)/income	70	-3,484	-10,481	-21,107	-27,458	-30,217	-30,116
PBT	**-16,092**	**-9,342**	**-13,021**	**-2,365**	**-75,976**	**-27,133**	**1,697**
Income tax	3,022	1,344	2,686	58	-332	4,748	-289
PAT from continuing operations	**-13,070**	**-7,998**	**-10,335**	**-2,307**	**-76,308**	**-22,385**	**1,409**
Average no. shares for EPS calculation (m)	61.50	307.32	316.90	312.71	312.40	312.44	312.44
Statutory EPS (p)	-21.25	-2.60	-3.26	-0.74	-24.43	-7.16	0.45
Adjusted EPS (p)		3.37	3.44	3.50	3.66	-6.04	1.64
DPS (p)		1.20	2.20	2.60	0.70	0.0	1.00

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

Normalised profit and loss (base case)						
Year-end Dec (£000)	**2016**	**2017**	**2018***	**2019***	**2020E ***	**2021E***
Business interest income	94,674	119,756	166,502	183,657	162,957	175,144
Other operating income	450	1,926	1,626	954	500	1,000
Fair-value unwind on acquired portfolios	0	0	0	0	0	0
Total revenue	**95,124**	**121,682**	**168,128**	**184,611**	**163,457**	**176,144**
Impairments	-26,155	-28,795	-43,738	-46,660	-64,181	-49,797
Gross profit	**68,969**	**92,887**	**124,183**	**137,951**	**99,277**	**126,347**
Administration expenses	-50,290	-69,203	-89,082	-95,786	-91,946	-90,303
Operating profit	**18,679**	**23,684**	**35,101**	**42,165**	**7,331**	**36,044**
EBITDA	**19,369**	**25,181**	**36,873**	**46,665**	**11,831**	**40,544**
Net finance (cost)/income	-5,623	-10,481	-21,107	-27,458	-30,217	-30,116
PBT	**13,056**	**13,203**	**13,994**	**14,707**	**-22,886**	**5,928**
Income tax	-2,688	-2,313	-3,050	-3,261	4,005	-807
PAT from continuing operations	10,368	10,890	10,944	11,446	-18,881	5,121

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

Balance sheet							
@ 31 Dec (£000)	2015	2016	2017	2018*	2019*	2020E*	2021E*
Non-current							
Goodwill	40,176	132,070	140,668	140,668	74,832	74,832	74,832
Intangible assets	14,119	17,412	17,205	14,477	8,572	5,325	3,275
Other assets				241	1	443	326
Right of use asset					10,560	10,000	8,500
Property, plant and equipment	1,718	5,459	9,434	6,677	6,556	6,556	6,556
Deferred tax asset				230	1,677	4,768	1,677
Amounts receivable from customer				198,631	185,269	160,595	176,223
Current assets							
Amounts receivable from customer	**28,415**	**180,413**	**268,096**	**112,027**	**176,379**	**160,595**	**176,223**
Trade and other receivables	10,275	9,709	1,551	3,967	2,643	2,643	2,643
Cash and cash equivalent	7,320	5,215	10,954	13,894	14,192	34,264	14,503
Total current assets	46,010	195,337	280,601	129,888	193,214	197,502	193,369
Total assets	**102,023**	**350,278**	**447,908**	**490,812**	**480,681**	**460,020**	**464,758**
Current liabilities							
Trade and other payables	13,803	8,005	10,353	16,445	26,909	28,909	30,909
Provisions				589	1,466	1,466	1,466
Lease liability					1,830	1,830	1,830
Deferred tax liability	3,057	-	-	-	-	-	-
Total current liabilities	16,860	8,005	10,353	17,034	30,205	32,205	34,205
Net current (liabilities)/assets	29,150	187,332	270,248	112,854	163,009	165,297	159,164
Non-current liabilities							
Financial liabilities – borrowings	-	87,300	199,316	266,322	317,590	317,590	317,590
Lease liability					9,275	9,000	9,000
Deferred tax	-	5,890	4,996			(0)	1,328
Total non-current liabilities	-	93,190	204,312	266,322	326,865	326,590	327,918
Total liabilities	16,860	101,195	214,665	283,356	357,070	358,795	362,123
Net assets	**85,163**	**249,083**	**233,243**	**207,456**	**123,611**	**101,226**	**102,635**

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

Cashflow

Year-end Dec (£000)	2015	2016	2017	2018*	2019*	2020E*	2021E*
Profit/(loss) before and interest	-16,162	-5,858	-2,540	19,517	-48,518	3,084	31,813
Taxation paid	-350	-1,341	-2,226	-1,164	3,067	500	4,748
Depreciation	198	690	1,497	1,772	3,869	4,500	4,500
Share-based payments	0	0	291	1,157	1,183	0	0
Amortisation of intangibles	4,030	10,714	7,897	9,661	9,595	4,247	3,050
Fair-value unwind on acquired loan book	5,456	8,342	11,985	7,678	2,873	0	0
Goodwill impairment					65,837		
Loss on disposal of fixed assets	51	-363	-416	-35	-16	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	-54,367	40,459	-31,257
Increase in receivables	-16,445	-7,737	-51	5,844	-399	0	0
Increase in other assets				-241	240		
Increase in payables	19,078	-6,952	1,000	-4,132	709	2,000	2,000
Net cash inflow/(outflow) from op. activities	**-9,532**	**-23,541**	**-37,000**	**-35,116**	**-15,927**	**54,790**	**14,854**
Cashflow from investing activities							
Net purchase of fixed assets	-341	-3,514	-4,931	-5,915	-6,535	-4,500	-4,500
Purchase of subsidiaries	-81,111	-230,784	-16,442	0	62	0	0
Net cash outflow from investing activities	**-81,452**	**-234,298**	**-21,373**	**-5,915**	**-6,473**	**-4,500**	**-4,500**
Cashflows from financing activities							
Net finance income	70	-3,484	-7,974	-14,121	-19,277	-30,217	-30,116
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	50,400	0	0
Dividends	0	-951	-4,439	-7,177	-8,425	0	0
Net cash inflow from financing activities	**98,304**	**255,734**	**64,112**	**43,971**	**22,698**	**-30,217**	**-30,116**
Net increase in cash and cash equivalents	7,320	-2,105	5,739	2,940	298	20,073	-19,762
Opening cash and cash equivalents	0	7,320	5,215	10,954	13,894	14,192	34,264
Closing cash and cash equivalents	7,320	5,215	10,954	13,894	14,192	34,264	14,503

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

Scenarios

Given uncertainties, scenarios need to be treated with extreme caution and indicative of general direction only

Given the range of variables, we do not believe that investors should place too much emphasis on the details of individual scenarios. However, with the numbers below, we have attempted to highlight the key trends rather than a detailed forecast. There are some basic assumptions as follows:

Downside (ca.£17m greater loss) driven by lower volumes, materially higher impairments, some cost reduction

In the downside scenarios: i) lending volumes will fall and there is further short-term pressure on spreads from mix effects resulting in a 10% reduction in income; ii) impairments rise from 39% of revenue to 51%; iii) cost reductions take time, so costs fall less than revenue; and iv) there is a small reduction in funding costs (in home collect they are eliminated given the high proportion of equity funding already). This scenario would see losses ca.£17m higher than the base case, but there would still be positive net assets.

Equity raise (2020 profit impact small but material rise in 2021) driven by loan growth, efficiency improvements. 2021 profits back to 2019 levels with much enhanced outlook for 2022 and beyond.

In the equity raise scenario: i) Loan book growth increases faster than the base case and this is compounded as wider-margin new business is a greater proportion of the book – this drives revenue up 20% versus the base case. ii) Impairments rise given the IFRS9 new business charge. However, with increased lending volumes through the group's revised scorecards, there should be an improvement in delinquency and as there is spread widening contributing to revenue, so the rise in impairments is slower than revenue. iii) Costs rise slower than revenue with the usual economies of scale and capacity currently available in the branch network. iv) There is an increase in total funding cost but again slower than revenue as equity will be a higher proportion of the funding mix. v) In terms of EPS, it is probable that a proportion of any equity raise will be to fund growth through 2020 and 2021 and so there will be a drag from this factor. The normalised profit in this scenario is back to the 2019 levels with enhanced further potential for 2022.

Scenarios

FY'20 (£000)	Base	Downside	% base	Equity raise	% base
Total revenue	163,457	147,112	90%	166,726	102%
Impairments	-64,181	-73,808	115%	-64,260	100%
Revenue less impairments	99,277	73,304	74%	102,467	103%
Administration expenses	-91,946	-87,349	95%	-92,865	101%
Operating profit	7,331	-14,045	n/m	9,601	131%
Net finance (cost)/income	-30,217	-25,546	85%	-31,561	104%
Profit before tax	-22,886	-39,591	173%	-21,960	96%

Source: Hardman & Co Research

Scenarios

FY'21 (£000)	Base	Downside	% base	Equity raise	% base
Total revenue	176,144	158,530	90%	202,566	115%
Impairments	-49,797	-58,761	118%	-54,777	110%
Revenue less impairments	126,347	99,769	79%	147,789	117%
Administration expenses	-90,303	-85,788	95%	-94,818	105%
Operating profit	36,044	13,981	39%	52,971	147%
Net finance (cost)/income	-30,116	-25,599	85%	-37,645	125%
Profit before tax	5,928	-11,617	-196%	15,326	259%

Source: Hardman & Co Research

Valuation

Significant upside potential on our valuation assumptions and models

Our absolute valuation techniques imply significant average upside potential based off the base case that is of a going-concern business. We believe it is probable that any outturn will be binary – either the stress outturn develops in which case the shares are likely to be valued at nil or a base case in which case they will be a multiple of the current price.

Summary of valuation approaches		
	Implied price (p)	Upside potential
Gordon Growth Model (GGM)	22.3	333%
Discounted Dividend Model (DDM)	21.7	320%
Average absolute measures	22.0	327%

Source: Hardman & Co Research

GGM

We detailed our approach to the GGM in our initiation note, Carpe Diem, published on 11 November 2016. Our assumptions are given in the table below.

GGM 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.	-30%	-30%	-30%	-30%
P/NAV (x)	3.3	3.4	2.8	3.6
NAV 2020E (£m)	21.1	21.1	21.1	21.1
Valuation (£m)	69.7	72.4	59.0	75.2
Variance (£m)		2.7	-10.7	5.5
Valuation per share (p)	22.3	23.2	18.9	24.1

Source: Hardman & Co Research

DDM

We are forecasting a reduced 2021 dividend (to 1p, 1.6x covered by normalised earnings with growth to 2.4p by 2025 and 5.5% growth thereafter. On these assumptions, our DDM now indicates a value of 21.7p.

SOTP

The peer ratings that we have previously used in our SOTP model are extremely volatile and arguably of less use than normal. It is indisputable that they have fallen sharply since previous reports.

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research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com