S&U

Year-end trading update

Trading remains strong

Financial services

In its year-end update, S&U confirmed FY17 finished strongly and in line with market expectations. Advantage motor finance recorded a 32% increase in customer numbers and the impairment ratio is running in line with expectations. Funding remains in place for further growth at Advantage and the bridging finance pilot, which is now open for business.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/15	36.1	14.8	99.0	66.0	22.5	3.0
01/16	45.2	19.5	132.4	76.0	16.8	3.4
01/17e	61.2	25.8	171.0	90.0	13.0	4.0
01/18e	77.9	31.0	206.0	109.8	10.8	4.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. FY16 DPS ex-exceptional payment of 125p.

Strong finish to year

Advantage has continued to grow strongly with the number of live customers reaching 43,000: the second year of growth of over 30%. Customer transactions at 20,000 grew at a similar rate. In its January trading update Provident Financial reported a quieter Q4 for its Moneybarn business but S&U has sustained growth through this period helped by a focus on service and within its non-prime sweet spot in the credit risk spectrum. While impairments increased in FY17, this reflected a move to a slightly higher risk-reward profile on loans, and is in line with management expectations. Our estimates are unchanged from our last note published in December.

Funding in place and bridging pilot open

S&U invested £33m in the motor finance business in FY17 (compared with £27m in FY16). It has total bank facilities of £85m and had net debt of £49m at the end of January. The group sees this as sufficient to fund growth at Advantage this year and the launch of the bridging finance pilot. Further facilities will be negotiated as required. Aspen Bridging is now open for business and up to £20m may be invested over 15 months; management will take a prudent approach to developing this opportunity.

Valuation: Growth and yield appeal

S&U shares trade on a yield of 4% based on our estimated full-year dividend of 90p (first two interims total 52p versus 43p last year). On our forecasts, earnings growth for FY17 would be nearly 29% and 20% for FY18. Reflecting unchanged estimates and assumptions, our ROE-/COE-based valuation is also unchanged at c 2,650p. Further sustained growth at Advantage and success with the bridging pilot would be likely to drive returns and the rating (on a price to book basis) higher on a medium-term view.

13 February 2017

Price	**2,225p**
Market cap	**£267m**
Net debt (£m) at end January 2017	49
Shares in issue	12.0m
Free float	26%
Code	SUS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	1.5	(1.3)	8.0
Rel (local)	1.3	(7.2)	(14.7)
52-week high/low		2,610.00p	1,997.00p

Business description

S&U's Advantage motor finance business lends on a simple hire purchase basis to lower and middle income groups that may have impaired credit records which restrict their access to mainstream products. It has 43,000 customers currently. The pilot Aspen Bridging finance business is now open.

Next events

FY17 results	28 March 2017

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Edison profile page

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Valuation

We have updated our valuation comparison table, which includes peers involved in non-standard lending or that have motor finance as one of their activities. Within this group S&U trades close to the average P/E and an above-average yield. Its return on equity is below average but the group does include Provident Financial, earning a return of over 38%, so in this context it can be viewed as mid-range. Mirroring this positioning, it trades on a below-average price to book ratio.

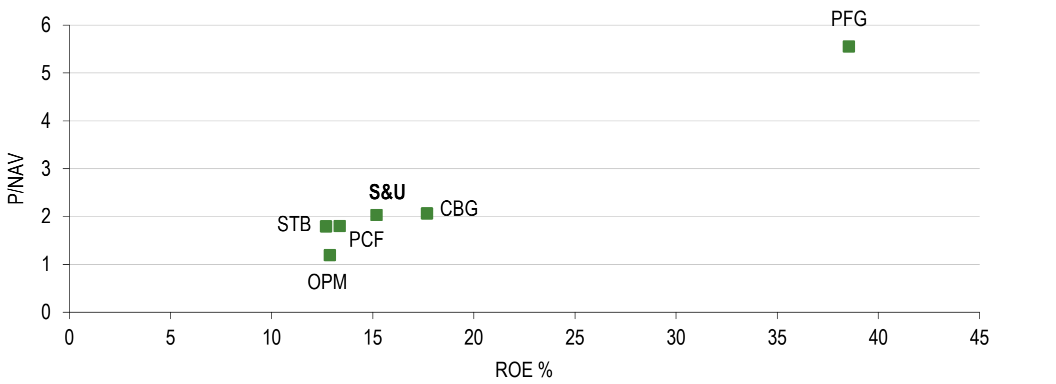
Exhibit 1: Peer comparison

	Price (p)	Market cap (£m)	2016 P/E (x)	Yield (%)	ROE (%)	Price to book (x)
S&U	**2,225.0**	**266.2**	**13.3**	**3.4**	**15.2**	**2.0**
1PM	58.5	31.9	9.0	0.9	12.9	1.2
Close Brothers	1,500.0	2,252.3	11.9	3.8	17.7	2.1
Private and Commercial Finance	25.3	43.0	13.3	0.0	13.4	1.8
Provident Financial	2,761.0	4,080.0	16.0	4.3	38.6	5.6
Secure Trust Bank	230.2	415.7	16.0	3.2	12.7	1.8
Average			**13.2**	**2.6**	**18.4**	**2.4**

Source: Bloomberg, Edison Investment Research. Note: P/Es adjusted to CY16. Priced at 13 February 2017.

Exhibit 2 shows the price to book values against ROEs for the same companies. The small sample means we cannot draw any strong conclusions, but S&U can be seen as being broadly centrally placed, with Provident Financial valued at a level that arguably fully reflects its high ROE. Prospectively, continuation of S&U's growth in motor finance and success with its bridging finance pilot could deliver higher returns and valuation. Our valuation, based on a ROE/COE model, remains unchanged at c 2,650p (assumptions, as before, include a return on equity of 17%, cost of equity of 10% and growth of 5%).

Exhibit 2: Return on equity and price/NAV for S&U and selected peers



Source: Bloomberg. Note: OPM (1PM), PCF (Private and Commercial Finance), CBG (Close Brothers), PFG (Provident Financial). Based on historical numbers for ROE and NAV. As at 13 February 2017.

Finally, Exhibit 3 shows recent share price performance for the peer group. Here performance is quite widely dispersed over the different periods although S&U has been modestly ahead or close to the average: an improvement since we last wrote in December, probably reflecting the reassuring nature of the latest trading updates.

Exhibit 3: Share price performance comparison

	One month	Three months	One year	Ytd	From 12-month high
S&U	**2.3**	**0.5**	**1.1**	**1.0**	**(14.8)**
1PM	(8.6)	(9.3)	(10.0)	(9.3)	(19.9)
Close Brothers	3.4	12.4	24.2	3.8	(1.1)
Private and Commercial Finance	(4.7)	(11.4)	23.2	(8.2)	(27.9)
Provident Financial	(2.9)	(0.6)	(8.5)	(3.1)	(18.8)
Secure Trust Bank	(4.3)	2.8	(15.5)	4.6	(18.3)
Average (unweighted)	**(2.5)**	**(0.9)**	**2.4**	**(1.9)**	**(16.8)**

Source: Bloomberg. Note: As at 13 February 2017.

Exhibit 4: Financial summary

£'000s	2014	2015	2016	2017e	2018e
Year end 31 January					
PROFIT & LOSS					
Revenue	60,823	36,102	45,182	61,232	77,924
Impairments	(12,847)	(5,863)	(7,611)	(11,349)	(14,224)
Other cost of sales	(6,866)	(6,674)	(8,980)	(13,387)	(17,115)
Administration expenses	(22,519)	(6,957)	(7,131)	(8,620)	(11,260)
EBITDA	18,591	16,608	21,460	27,876	35,325
Depreciation	(577)	(163)	(209)	(241)	(294)
Op. profit (incl. share-based payouts pre-except.)	18,014	16,445	21,251	27,635	35,030
Exceptionals	0	0	0	0	0
Non-recurring items	0	0	0	0	0
Investment revenues / finance expense	(727)	(1,680)	(1,782)	(1,863)	(4,024)
Profit before tax (FRS 3)	17,287	14,765	19,469	25,772	31,006
Profit before tax (norm)	17,287	14,765	19,469	25,772	31,006
Tax	(3,955)	(2,920)	(3,583)	(5,184)	(6,201)
Discontinued business after tax		6,615	53,299		
Profit after tax (FRS 3)	13,332	18,460	69,185	20,589	24,805
Profit after tax (norm)	13,332	11,845	15,886	20,589	24,805
Average Number of Shares Outstanding (m)	11.9	12.0	12.0	12.0	12.0
EPS - normalised (p)	112.0	99.0	132.4	171.0	206.0
Dividend per share (p)	54.0	66.0	201.0	90.0	109.8
EBITDA margin (%)	30.6%	46.0%	47.5%	45.5%	45.3%
Operating margin (before GW and except.) (%)	29.6%	45.6%	47.0%	45.1%	45.0%
Return on equity	20.5%	15.7%	15.2%	15.4%	16.9%
BALANCE SHEET					
Non-current assets	52,212	76,781	103,653	140,714	187,466
Current assets	57,739	68,578	61,903	67,310	81,138
Total assets	109,951	145,359	165,556	208,024	268,604
Current liabilities	(10,091)	(8,945)	(6,850)	(8,860)	(9,516)
Non-current liabilities inc prefs	(30,650)	(55,150)	(30,650)	(59,650)	(105,650)
Net assets	69,210	81,264	128,056	139,514	153,438
NAV per share (p)	588	689	1,084	1,179	1,297
CASH FLOW					
Operating cash flow	(5,407)	(13,404)	(16,017)	(30,586)	(39,829)
Net cash from investing activities	(736)	(1,096)	80,716	(392)	(580)
Dividends paid	(5,664)	(6,734)	(23,090)	(9,558)	(11,289)
Other financing (excluding change in borrowing)	33	8	55	20	0
Net cash flow	(11,774)	(21,226)	41,664	(40,517)	(51,699)
Opening net (debt)/cash	(21,015)	(32,789)	(54,015)	(12,351)	(52,868)
Closing net (debt)/cash	(32,789)	(54,015)	(12,351)	(52,868)	(104,567)

Source: S&U accounts, Edison Investment Research. Note: Net debt includes £0.45m preference shares. FY16 DPS includes an exceptional payment of 125p. FY14 P&L figures include the discontinued home credit business and are therefore not comparable with subsequent years.

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