

# S&U

## Positive trend in quantity and quality of lending

**S&U's trading update for the period since its half-year end confirmed that it is trading in line with expectations and our estimates are unchanged. Transactions and receivables outstanding continue to grow even though underwriting criteria have been tightened. Impairment rates have edged up further but should stabilise and reverse as the loan book mix evolves.**

| Year end | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|---------|---------|-----------|
| 01/16    | 45.2         | 19.5      | 132.4    | 76.0    | 17.4    | 3.3       |
| 01/17    | 60.5         | 25.2      | 169.1    | 91.0    | 13.6    | 4.0       |
| 01/18e   | 80.0         | 30.3      | 201.9    | 105.0   | 11.4    | 4.6       |
| 01/19e   | 95.6         | 35.5      | 235.8    | 117.4   | 9.8     | 5.1       |

Note: \*PBT and EPS are reported from continuing operations. FY16 DPS excludes exceptional payment of 125p.

## Motor finance continues growth

Advantage reports that applications for motor finance have been strong and, even though underwriting refinements have meant a slight reduction in the rate of approvals, transaction growth has been maintained and receivables stand at over £240m, up nearly 6% in the period since the end of July or c 24% since the end of January. A new e-signature system that guides customers through terms and conditions and verifies their digital sign-off is being well-received and is contributing to a higher rate of conversion from approvals to transactions (c 10% in recent years). Tighter lending criteria mean the quality metrics on new loans have risen but the legacy effect of the previous move towards higher-risk customers means the impairment rate relative to revenue has ticked up modestly (23.4% vs 22.9% H118). Given the recent announcement from Provident Financial that its non-prime motor finance subsidiary, Moneybarn, is the subject of an FCA investigation relating to customer affordability and treatment of customers in financial difficulty, it is worth mentioning that Advantage was authorised by the FCA in December 2016 and has not been involved in any ongoing FCA discussions since that point. Management stresses its commitment to responsible lending and use of a sophisticated affordability process.

## Aspen Bridging pilot builds its loan book

The Aspen property bridging finance pilot has increased its loan book significantly, from £2m at the half year stage to £9m, with loan to value and pricing in line with budgets. The intention remains to build this to c £20m and the trial period is set to end in H218. The early signs are promising but the business is still nascent.

## Valuation

Our, unchanged valuation of 2,700p is based on consideration of an ROE/COE model and peer group valuations (see overleaf). This suggests upside of c 18% from the current share price. On our estimates, the yield for FY18 is 4.6%.

## December trading update

### Financial services

8 December 2017

**Price** **2,302.5p**  
**Market cap** **£276m**

|                                |       |
|--------------------------------|-------|
| Net debt (£m) at end July 2017 | 80.7  |
| Shares in issue                | 12.0m |
| Free float                     | 26%   |
| Code                           | SUS   |
| Primary exchange               | LSE   |
| Secondary exchange             | N/A   |

### Share price performance



|                  |         |         |      |
|------------------|---------|---------|------|
| %                | 1m      | 3m      | 12m  |
| Abs              | 9.6     | 17.1    | 15.3 |
| Rel (local)      | 12.5    | 17.9    | 7.4  |
| 52-week high/low | 2420.0p | 1883.5p |      |

### 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 c 53,000 customers currently. The pilot Aspen Bridging finance business is expanding its loan book (c £9m).

### Next events

|                    |                 |
|--------------------|-----------------|
| Q4 and FY18 update | 9 February 2017 |
|--------------------|-----------------|

### Analysts

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## Valuation

We have updated our usual peer comparison table below. Even after a relatively strong period for the S&U share price over the last two months the shares trade only modestly above the average P/E valuation and offer a yield of 4%.

**Exhibit 1: Peer comparison**

|                                | Price (p) | Market cap (£m) | 2017 P/E (x) | Yield (%)  | ROE (%)     | Price to book (x) |
|--------------------------------|-----------|-----------------|--------------|------------|-------------|-------------------|
| <b>S&amp;U</b>                 | 2,270.0   | 272.2           | 11.4         | 4.0        | 15.2        | 1.9               |
| 1PM                            | 48.5      | 41.8            | 6.2          | 0.0        | 12.5        | 0.9               |
| Close Brothers                 | 1,389.0   | 2,104.6         | 10.4         | 4.3        | 16.4        | 1.7               |
| Private and Commercial Finance | 28.5      | 60.5            | 10.6         | 0.0        | 11.4        | 1.8               |
| Provident Financial            | 810.0     | 1,200.7         | 14.5         | N/A        | N/A         | 1.6               |
| Secure Trust Bank              | 1,812.0   | 334.8           | 13.2         | 4.1        | 11.9        | 1.4               |
| <b>Average</b>                 |           |                 | <b>11.1</b>  | <b>2.5</b> | <b>13.5</b> | <b>1.6</b>        |

Source: Bloomberg, Edison Investment Research. Note: P/Es adjusted to CY17. Priced at 7 December 2017.

Exhibit 2 shows how a stronger recent performance has left the shares as one of the better performers over the periods shown. Provident Financial remains an outlier on the downside, reflecting its stock-specific difficulties, which have been compounded, as noted above, by the announcement of regulatory investigation of Moneybarn.

**Exhibit 2: Share price performance comparison**

|                                | One month  | Three months | One year      | Ytd           | From 12-month high |
|--------------------------------|------------|--------------|---------------|---------------|--------------------|
| <b>S&amp;U</b>                 | <b>8.1</b> | <b>15.4</b>  | <b>13.7</b>   | <b>3.1</b>    | <b>(7.1)</b>       |
| 1PM                            | 2.1        | (1.0)        | (20.7)        | (23.2)        | (23.8)             |
| Close Brothers                 | 3.5        | (8.9)        | 0.2           | (3.9)         | (19.0)             |
| Private and Commercial Finance | 2.7        | 17.5         | (4.9)         | 3.8           | (10.9)             |
| Provident Financial            | (9.5)      | 2.7          | (71.4)        | (71.6)        | (75.3)             |
| Secure Trust Bank              | (1.7)      | 4.7          | (16.3)        | (15.8)        | (27.5)             |
| <b>Average (unweighted)</b>    | <b>0.9</b> | <b>5.1</b>   | <b>(16.6)</b> | <b>(17.9)</b> | <b>(27.3)</b>      |

Source: Bloomberg

With unchanged estimates we maintain our valuation at 2,700p, reflecting consideration of an ROE/COE model and peer valuations. See our [last note](#), published in October, for further details of this and a discussion of the market background and outlook.

**Exhibit 3: Financial summary**

| £'000s   | 2015     | 2016     | 2017     | 2018e     | 2019e     |
|--|----------|----------|----------|-----------|-----------|
| Year end 31 January                                | IFRS     | IFRS     | IFRS     | IFRS      | IFRS      |
| <b>PROFIT &amp; LOSS</b>                           |          |          |          |           |           |
| Revenue  | 36,102   | 45,182   | 60,521   | 80,014    | 95,623    |
| Impairments  | (5,863)  | (7,611)  | (12,194) | (18,252)  | (21,366)  |
| Other cost of sales                                | (6,674)  | (8,980)  | (12,871) | (17,763)  | (20,559)  |
| Administration expenses                            | (6,957)  | (7,131)  | (8,332)  | (10,162)  | (12,144)  |
| EBITDA   | 16,608   | 21,460   | 27,124   | 33,836    | 41,554    |
| Depreciation                                       | (163)    | (209)    | (253)    | (348)     | (626)     |
| Op. profit (incl. share-based payouts pre-except.) | 16,445   | 21,251   | 26,871   | 33,489    | 40,928    |
| Exceptionals                                       | 0        | 0        | 0        | 0         | 0         |
| Non-recurring items                                | 0        | 0        | 0        | 0         | 0         |
| Investment revenues / finance expense              | (1,680)  | (1,782)  | (1,668)  | (3,146)   | (5,384)   |
| Profit before tax (FRS 3)                          | 14,765   | 19,469   | 25,203   | 30,343    | 35,544    |
| Profit before tax (norm)                           | 14,765   | 19,469   | 25,203   | 30,343    | 35,544    |
| Tax  | (2,920)  | (3,583)  | (4,861)  | (5,997)   | (7,109)   |
| Discontinued business after tax                    | 6,615    | 53,299   |          |           |           |
| Profit after tax (FRS 3)                           | 18,460   | 69,185   | 20,342   | 24,346    | 28,435    |
| Profit after tax (norm)                            | 11,845   | 15,886   | 20,342   | 24,346    | 28,435    |
| Average Number of Shares Outstanding (m)           | 12.0     | 12.0     | 12.0     | 12.1      | 12.1      |
| Diluted EPS (p)                                    | 154.3    | 576.5    | 169.1    | 201.9     | 235.8     |
| EPS - normalised (p)                               | 99.0     | 132.4    | 169.1    | 201.9     | 235.8     |
| Dividend per share (p)                             | 66.0     | 201.0    | 91.0     | 105.0     | 117.4     |
| EBITDA margin (%)                                  | 46.0%    | 47.5%    | 44.8%    | 42.3%     | 43.5%     |
| Operating margin (before GW and except.) (%)       | 45.6%    | 47.0%    | 44.4%    | 41.9%     | 42.8%     |
| Return on equity                                   | 15.7%    | 15.2%    | 15.2%    | 16.7%     | 17.7%     |
| <b>BALANCE SHEET</b>                               |          |          |          |           |           |
| Non-current assets                                 | 76,781   | 103,653  | 138,004  | 182,253   | 219,322   |
| Current assets                                     | 68,578   | 61,903   | 57,763   | 79,351    | 97,837    |
| Total assets                                       | 145,359  | 165,556  | 195,767  | 261,604   | 317,159   |
| Current liabilities                                | (8,945)  | (6,850)  | (17,850) | (8,401)   | (23,180)  |
| Non-current liabilities inc pref                   | (54,950) | (30,450) | (38,450) | (100,450) | (125,450) |
| Net assets   | 81,464   | 128,256  | 139,467  | 152,753   | 168,529   |
| NAV per share (p)                                  | 689      | 1,084    | 1,177    | 1,275     | 1,407     |
| <b>CASH FLOW</b>                                   |          |          |          |           |           |
| Operating cash flow                                | (13,404) | (16,017) | (27,431) | (34,873)  | (21,543)  |
| Net cash from investing activities                 | (1,096)  | 80,716   | (308)    | (1,618)   | (1,618)   |
| Dividends paid                                     | (6,734)  | (23,090) | (9,548)  | (11,380)  | (12,977)  |
| Other financing (excluding change in borrowing)    | 8        | 55       | 21       | 2         | 0         |
| Net cash flow                                      | (21,226) | 41,664   | (37,266) | (47,869)  | (36,138)  |
| Opening net (debt)/cash                            | (32,339) | (53,565) | (11,901) | (49,167)  | (97,036)  |
| Closing net (debt)/cash                            | (53,565) | (11,901) | (49,167) | (97,036)  | (133,174) |

Source: S&U accounts, Edison Investment Research. Note: FY16 DPS includes an exceptional payment of 125p.

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