EDISON

S&U

Interim results

Growth opportunities and delivery

Financial services

S&U Group is fundamentally changing following the sale of its home collect business (£50.5m profit on disposal and a £1.25 special dividend). Resources (S&U currently has net cash) will be devoted to accelerated growth in motor finance and SME specialist lending. The special dividend was below our forecast, but reflects management confidence in its opportunities. H116 motor division profits (£9.7m, £7.7m in H115) were ahead of the run rate of our estimates, primarily due to better impairments.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/14	60.8	17.3	112.0	54.0	22.1	2.2
01/15	36.1	14.8	99.0	66.0	25.1	2.7
01/16e	43.5	18.8	124.8	197.5	19.9	8.0
01/17e	57.0	23.9	159.2	90.0	15.6	3.6

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

H116 results

With a year end of January 2016, we refer to the interim results to end July 2015 as comprising H115). The ongoing motor business saw revenue up 20% on H115 at £20.4m. New business written was down 3% H116 on a record H115 with a slow Q116, but the book grew from £106m at end January 2015 to £122m at end July. Management has refined its already effective processing, including streamlining the product range. Faster growth was seen in Q216, with the number of loans in August 2015 up 21% on August 2014. Management's full year plans have been increased. The slower new business saw cost of sales rise 1% and administration expenses by 3%. Impairments rose from £2.4m to £3.2m (up 33%) reflecting the maturing of historic lending. Through-the-life credit losses of c 15% are still expected. This level of loss, and the recent modest deterioration, were both fully expected and built into initial pricing. The rolling 12-month impairment to revenue remained at 17%. Credit quality remained excellent, with 92.3% of loans up to date (H115: 93.5%). Only 0.38% of accounts were more than six months in arrears (H115: 0.55%).

Outlook

The motor business has already started to accelerate its growth from a slow Q116. Management advises that this is driven by service improvements rather than compromising margin or lending criteria. It cites product line streamlining (eg it no longer sells breakdown insurance), extended same-day settlement (funds can now be sent until 4pm from 1pm) and decisions within 10 seconds for 97% of applications. The SME initiative detailed below is expected to launch early in 2016 and management is exploring a range of niche, high-margin specialist areas.

Valuation: c 20% upside

The average of our approaches is £29.9. Our peer valuation approach is £35.3. Our Gordon's growth model is higher at £40.3, with 25% ROE forecast over the long term. Our dividend discount model is £14.0, but this approach does not capture FY17 growth or the potential re-gearing of the group.

1 October 2015

Price	**2,480p**
Market cap	**£295m**

Net cash (£m) at H116 (adjusted for sale proceeds and £17m div)	4
Shares in issue	11.9m
Free float	46%
Code	SUS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	2.2	10.2	29.0
Rel (local)	5.2	18.0	36.7
52-week high/low		2,529.0p	1,890.0p

Business description

Post-disposal, S&U is a niche motor finance provider to the non-standard UK market. It has more than 27,500 customers, having made more than 12,000 new loans in FY15.

Next events

Trading update	Early December 2015

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Edison profile page

S&U is a research client of Edison Investment Research Limited

Investment summary

Company description: Specialist lender

S&U provides finance to non-standard retail customers through auto finance. It originates business through brokers (85%), refinances for previous customers (5%) and dealers (10%). The auto finance business has seen exceptional growth generated through traditional and internet brokers. The group is undergeared (debt to equity just 45% at H116, now cash-positive post receipt of sale proceeds), allowing for significant expansion. Management has already started to accelerate motor finance lending with a focus on better service delivery of a streamlined product range rather than competing on price or credit quality. It expects to launch SME vehicle finance, targeted at smaller businesses and extending existing relationships, in Q116. Other opportunities, both organic and inorganic, are being explored and we detail below the criteria that management is considering. We believe the group will continue to be conservatively managed and that we will see evolutionary rather than revolutionary growth. S&U's advanced application for a banking licence has now been deferred, probably until 2017.

Valuation: Upside c 20%

We use a range of peer comparators, dividend discount and Gordon's growth approaches. The range of valuations is wide, but on average indicates c 20% upside. Gordon's growth model shows an increased valuation with the higher forecast equity base, as management has retained more equity than we had expected. This reflects its confidence in the opportunities currently available and our model assumes good returns on retained capital (see details below). There has been a modest reduction in our dividend discount model as the special dividend payout was below forecast. We note that our forecast period (2016-17) does not fully capture the deployment of the cash proceeds, nor does it give credit for a balance sheet that could see significant capital repatriations and remains less geared than peers. The peer valuation methodology is largely unchanged.

Financials: H116 Good growth from motor business

H116 saw strong growth in profits in the motor business. Since then the volume growth has accelerated.

- Profit before taxation from continuing operations is up 32% to £8.8m (H115: £6.7m), with record profits at Advantage Finance (AF) at £9.7m (H115: £7.7m). Revenue from continuing operations was up 20% to £20.4m (H115: £17.0m). Additionally, there was an exceptional profit on disposal of the Home Credit division of £50.5m (cash proceeds of £82.5m).
- Basic earnings per share from continuing operations are up 32% to 58.3p (H115: 44.3p).
- The first interim dividend increased by 18% to 20p per ordinary share (2015: 17p), with an exceptional additional dividend of £1.25 per share.
- Continued excellent collections and debt quality at Advantage Finance.
- Strong net cash position for organic expansion and acquisitions.

Sensitivities: Credit is critical and conservatively managed

Credit is the main sensitivity for any lender and we detail below how the group is conservatively positioned with a strong stock of provisions. Other, less important sensitivities include improved returns from leveraging an underutilised balance sheet; regulation, which may be a net positive; and stock illiquidity – the family and one charity own more than 70% of the shares in issue.

Company description: Accelerated targeted growth is now the focus of this specialist lender

S&U undertook a transformational deal in August 2015, selling the group's historic core home collect business. The proceeds (£82.5m) mean the group is now cash positive (when most peers have debt at 3-4x their equity). The group booked a gain on disposal of £50.5m (minimal tax leakage of £80k), increasing the equity base to £137m (£120m after a £15m special dividend and £2m ordinary dividend to be paid in November 2015). This low debt and high capital base gives S&U considerable freedom to accelerate organic growth in its motor finance business, explore adjacent lending areas such as SME vehicle finance and consider inorganic opportunities to further accelerate these growth options. August 2015 has already seen a pick-up in new lending activity, driven by better service and a streamlined product range rather than aggressive pricing or changes in risk appetite. SME lending is expected by management to commence in CY Q116 and will focus on the smaller SMEs typified by the example of lending on a contractor's van, having already lent on his car. We believe any inorganic activity will be very measured, and again is likely to be in specialist finance areas with good risk-adjusted returns.

Non-prime auto finance

Business overview

S&U conducts its non-standard, auto finance business through the AF brand. It sources the business primarily through brokers (85%), refinancing previous customers (5%) and direct from dealers (10%). There are over 40 brokers, with the largest 10 accounting for c 50% of new business (the top three c 25%). The brokers source their business from dealer relationships (c two-thirds covering the whole span of dealerships from small to large, with business from more than 400 different dealers per month) and over the internet (c one-third). Having been focused on broker distribution since 2005, S&U believes its systems and procedures deliver good service (98% of applications are now via online processing), giving AF a competitive advantage with this group. It typically pays an average commission and, importantly, is certain in its payments as it does not have clawbacks (see section on credit). Management also believes that low staff turnover (the majority of the management team has been with the company since inception) and a strong focus on reward and recognition are fundamental to AF's 15 consecutive years of record profits.

AF has seen monthly applications rise steadily from c 13k per month in the summer of 2011 to c 16k in summer 2012 and more than 20k per month in 2013 to over 22k in H115 and c 40k in H116. This growth has primarily been driven by market growth (more customers in the non-standard space) and market share gains (primarily from mainstream funders, which have now largely exited the non-standard market). AF approves around 28% of its applications (H115: 25%), of which just a tenth are actually drawn down (ie around 3% of all applications turn into loans). The non-drawings have been increasing with more internet brokers, where the customer arranges finance first and then may not find the car they want, or the dealer could provide alternative finance at point of sale. The average loan is c £6k (H115: c £6k, H114: £5.5k) repayable over 48 months (H115: 47, H114: 45). The total amount repayable is c £10.8k with an interest rate of typically 15-20%. Risk control and collections are all managed centrally from one office. The typical customer is middle-aged, may be in full-time employment with earnings close to the national average wage and may be a home owner. AF is targeting those who have had good credit for the past year or so after having had a negative credit event before that. The credit assessments of mainstream lenders will usually decline such a customer because of their historic impairment. The cars financed tend to be used (less immediate depreciation than new cars), family models and at an average loan-to-value of 95%.

AF historically sold a limited range amount of insurance (including breakdown) to around a fifth of its new customers (it stopped selling PPI in 2009, having changed procedures in 2007, thus limiting compensation risk). The average fee to S&U was c £100 per case (c £12k per month in revenue). By streamlining the product range, processing has become even more efficient (97% of applications get an in principle agreement within 10 seconds). Speed and certainty of service are important elements of the total package to brokers and management ascribes some of the recent acceleration in new loan growth to service improvement.

The outlook

We expect continued strong growth for specialist, non-standard auto financers.

- Market growth: greater consumer confidence is likely to see increased appetite for major spend such as car renewals/upgrades. Looking at its low market share, we do not believe S&U is dependent on market growth to deliver good franchise growth.
- Market share gain from tiny market share: the Finance and Lease Association (FLA) members provided more than 1m consumer motor finance contracts in 2014, indicating market share by S&U of c 1%. In its chosen niche of non-standard motor financing, the share will be much larger, but there is considerable scope for market share gains.
- Greater share of broker wallet: S&U has generated market share gains by effectively servicing brokers and taking an increasing share of their business. We believe brokers will have valued the continued presence of specialist lenders through the financial crisis, and a return by mainstream lenders will take time to have an effect. S&U does not believe it is yet approaching caps in terms of its allocation by any material broker.
- Increasing numbers of brokers: while the greater part of growth has come from existing relationships, S&U is continually broadening the range of its distribution. We note, for example, that a relatively modest increase in its average loan size would make it more appealing to a range of mainstream garage networks and their broker financing.

Financial performance

The inherent conservatism in AF is visible in Exhibit 1 below. The group did not ramp up its lending ahead of the financial crisis and waited for some years before aggressively growing the book. Credit costs have remained very stable in absolute terms and have fallen significantly as a proportion of revenue or lending. Most recent data show a further improvement, with 99% of live receivables making their first payment on time (2006-07 average c 95%).

Exhibit 1: Motor division key financials and performance ratios (£000s)

Year end 31 January	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017e
Profit and loss												
Revenue	11,176	11,675	12,858	14,175	14,195	16,049	17,782	20,801	26,147	36,102	43,500	57,000
Impairments	(3,756)	(4,105)	(4,087)	(4,785)	(5,538)	(5,883)	(5,750)	(5,291)	(5,096)	(5,863)	(6,650)	(9,500)
Other costs (inc finance)	(5,183)	(5,258)	(6,158)	(6,378)	(5,530)	(5,939)	(6,126)	(7,430)	(9,582)	(13,524)	(16,250)	(21,750)
Profit	2,237	2,312	2,613	3,012	3,127	4,227	5,906	8,080	11,469	16,715	20,600	25,750
Balance sheet												
Accounts receivable	37,920	40,894	46,435	50,850	51,793	55,564	60,338	71,778	93,217	127,740	159,000	193,000
Provisions	(7,934)	(9,036)	(10,431)	(11,474)	(12,781)	(16,275)	(18,083)	(19,279)	(20,248)	(21,353)	(23,000)	(23,000)
Net accounts receivable	29,986	31,858	36,004	39,376	39,012	39,289	42,255	52,499	72,969	106,387	136,000	170,000
Total assets	30,415	32,166	36,222	39,729	39,374	39,953	42,662	53,037	73,760	108,477	130,699	149,205
Ratios												
Cost income ratio (%)	(46)	(45)	(48)	(45)	(39)	(37)	(34)	(36)	(37)	(37)	(37)	(38)
Annual impairments as % rev	(34)	(35)	(32)	(34)	(39)	(37)	(32)	(25)	(19)	(16)	(15)	(17)
Provisions as % gross lending	(21)	(22)	(22)	(23)	(25)	(29)	(30)	(27)	(22)	(17)	(14)	(12)
Revenue as % avg reces		37.8	37.9	37.6	36.2	41.0	43.6	43.9	41.7	40.3	35.9	37.3

Source: S&U, Edison Investment Research

Competition

S&U's key competitor, Moneybarn, estimates that approximately half a million cars are purchased annually by UK non-standard borrowers, of which about 10% were funded through secured car finance products and the remainder funded through cash, loans from friends and family or alternative forms of credit such as personal and guarantor loans. The biggest competition is thus these other sources of funding. Guarantor loans appear to be an area of interest to regulators for potential mis-selling/new disclosure being required.

In the secured car finance providers market, competition has increasingly intensified, with Provident Financial's takeover of Moneybarn (14 August 2014) being particularly important in S&U's space. This has allowed Moneybarn to be more active because it has access to Provident's broader and cheaper funding. Moneybarn has been more aggressive in the core space, but has also broadened its product range. It is also trialling financing light commercial vehicles.

Exhibit 2 shows a number of comparisons between S&U and Moneybarn. It is not surprising that Moneybarn shows strong new business growth given its access to lower-cost funding and the desire to prove the acquisition successful. We believe the relatively slow volumes seen by S&U in Q415 and Q116 were significantly due to this factor. We note that in Q216 and Q316 S&U has accelerated its growth by improving its service levels to counter the competitive threat. At the results meeting management emphasised that it had not changed pricing or risk limits to take on the competition. Given the lower gearing, the lower funding cost is also noticeable.

Exhibit 2: KPI comparison S&U with Moneybarn

	Moneybarn	S&U
Customer profile		
Average customer loan (£s)	9,000	6,000
Average customer age (years)	40	Mid-40s
Average customer income (£k)	25	25
Franchise growth (Moneybarn June; S&U July 15 on previous year)		
Customer numbers	26,000	27,500
Period end receivables (%)	43	25
New loans (%)	88	(3)
Financial ratios (%)		
Annualised revenue to average receivables	28	36
Annualised impairment to average receivables	4	3
Impairment as % revenue	14	17
Cost as % revenue	29	37
Interest cost as % revenue	18	5

Source: S&U, Provident Financial interim 2015 results announcement, Edison Investment Research

Funding

The H116 balance sheet (end July) was before S&U received the £82.5m of disposal proceeds for its home collect business and £17m of dividend payments (£15m special, £2m 'normal') due for payment in November. Adjusting the period-end balance sheet debt of £61.6m for these items leaves S&U with net cash of c £4m. It has decided to repay the revolving credit facility with HSBC/Allied Irish Bank (although it will keep the same facility for a small unutilised fee), but will keep the £30m of M&G finance due in 2012/2022. The group will thus have a gross cash position £30m higher than the net and will incur a funding cost as a consequence. Management believes that the growth opportunity will see its cash balances quickly deployed and that the carry cost is less than cancelling facilities and trying to renegotiate them later. It also gives flexibility to move quickly should an inorganic opportunity arise.

Deploying the cash proceeds – inorganic growth

The disposal proceeds were only received in August and the completion accounts are yet to be finalised. Management has made it clear that it will consider carefully all the organic and inorganic options to deploy cash and thus improve EPS. In terms of inorganic options, at this stage it has highlighted the criteria it would consider, namely:

- It does not wish to dilute sustainable ROCE, which is likely to mean that any new business will be in speciality finance rather than prime lending.
- It has no appetite for long-term commitments/capital-intensive lending, which we interpret as meaning it would not consider areas such as sub-prime mortgages.
- It will not be rushed into mega transactions, meaning that any deals are likely to be small and evolutionary rather than transformational and revolutionary.
- Any market must show good growth potential.
- It is interested in finding the right business model rather than a business that is simply driven by targets.

Managing credit

Summary

For any lender, especially a specialist one, managing credit is absolutely key to delivering profitable growth. The motor book is highly diversified by customer numbers, economic sectoral exposure and geography, which provides diversification benefits. We detail below S&U's overall approach and the specific measures it has taken to ensure impairments are both managed and more than priced into lending decisions. The motor business has seen its rolling 12-month impairments as a percentage of revenue remain at 17%, well under half the level seen as recently as 2011. Management attributes this low number to ongoing refinement of lending scorecards including both internal and external factors. There has been a very modest tick-up on the level seen at end January 2015, which reflects the maturing of the book with lower growth seen in Q415 and Q116. Accelerated loan growth would see this number continue at well below the levels of five years ago.

Approach to lending

In the consumer credit business we note that all lending decisions are sanctioned centrally, with the agent having discretion to decline applications that meet central criteria, but not to approve applications that do not; lending is driven by the agent's assessment of the cash flow affordability of the loan and the likelihood of the customer making repayments, with minimum income and maximum repayment requirements subject to regular review; agent commission is almost entirely based on collections and not the amount lent; and there are extensive audit checks on agents.

In the ongoing motor business we note that 92% of accounts are up to date (H115: 94%, H114: 91%); only 28% of applications are approved (of which just 10% then convert); all customers pay by direct debit; tranches of lending are back tested to prove statistical models are delivering the expected credit quality; external data are used in addition to internal and bespoke underwriting and scoring; management describes its collections/customer relations and monitoring systems as state of the art, a view supported by a 2013 FLA review of its collections systems, which received the highest rating; the CEO receives daily delinquency data and weekly reviews from the risk director, and management information systems allow the interrogation of the book by numerous matrices; 97% of applications are dealt with by automated systems and the rest manually by eight underwriters; and through repossessions AF has good knowledge of the real value of its security, although it does introduce a modest sensitivity to the price of second-hand cars.

Loan quality

We believe the long-term track record of S&U is helpful to understanding its risk appetite. While the business has obviously changed with the sale of the home credit operation, we believe that Exhibit 3 shows how conservative management has been in the past.

Exhibit 3: Summary of group loan book quality January 2007-15 (£000s)

Year end 31 January	2007	2008	2009	2010	2011	2012	2013	2014	2015
Neither past due nor impaired	40,851	41,395	44,181	46,271	49,432	54,272	63,808	85,921	117,487
Past due up to three months but not impaired	14,576	15,621	14,898	14,567	9,228	9,137	8,971	7,497	7,977
Past due over three months but not impaired	7,972	8,262	8,005	6,998	7,197	7,029	6,900	6,872	6,312
Total not impaired	**63,399**	**65,278**	**67,084**	**67,836**	**65,857**	**70,438**	**79,679**	**100,290**	**131,776**
Past due up to three months	4,224	4,818	4,971	3,648	4,255	3,568	3,529	4,195	7,318
Past due three to six months	1,794	1,823	2,117	2,007	1,959	1,297	1,159	974	1,182
Past due six months + or in default	2,604	2,975	3,280	2,945	2,647	2,197	1,953	1,552	1,633
Total impaired	**8,622**	**9,616**	**10,368**	**8,600**	**8,861**	**7,062**	**6,641**	**6,721**	**10,133**
Total	**72,021**	**74,894**	**77,452**	**76,436**	**74,718**	**77,500**	**86,320**	**107,011**	**141,909**
% neither past due nor impaired	56.7	55.3	57.0	60.5	66.2	70.0	73.9	80.3	82.8%
% impaired	12.0	12.8	13.4	11.3	11.9	9.1	7.7	6.3	7.1

Source: S&U, Edison Investment Research

Stock of provisions: Prudent, but note the write-off policy

Exhibit 4 details the movement in the provisions account by division. We note the stock of provisions is nearly four times the annual charge and rising rapidly. We believe provisioning is prudent bearing in mind the falling trend in impaired loans above. However, the write-off policy increases the stock of provisions. In auto, write-off occurs where there has been no payment for a year or AF repossesses the car, takes legal action, or assessed capital loss is >£1k. These policies ensure provisions remain on the balance sheet for some time.

Exhibit 4: Motor Division key credit metrics (£000s)

January	2007	2008	2009	2010	2011	2012	2013	2014	2015
Opening provisions	7,934	9,036	10,431	11,474	12,779	16,275	18,083	19,279	20,248
Charge for year	4,105	4,087	4,785	5,538	5,883	5,750	5,291	5,087	5,863
Amount written off	(1,833)	(1,448)	(2,438)	(2,863)	(976)	(2,126)	(2,433)	(2,092)	(1,915)
Unwind of discount	(1,170)	(1,244)	(1,304)	(1,370)	(1,411)	(1,816)	(1,662)	(2,026)	(2,843)
Closing provision	9,036	10,431	11,474	12,779	16,275	18,083	19,279	20,248	21,353
Provisions as % gross lending	(22)	(22)	(23)	(25)	(29)	(30)	(27)	(22)	(17)
Stock of provisions as % charge	220	255	240	231	277	314	364	398	364

Source: S&U, Edison Investment Research

Accounting – unwind of the discount

The accounting for impairments grosses up both revenue and provisions (net impact on profit zero). S&U fixes the interest its customers pay and does not vary it if they fall into arrears. IFRS accounting requires a notional interest to be generated and provided for, inflating both interest income and provisions above their 'real level' by c 10% and 50% respectively.

Management

The team has been working together for a considerable time – all the executive directors joined the business in 1999 or before. This has the advantage of consistency and a strong corporate culture, with conservatism deeply embedded in the company. We believe this culture was an important factor in S&U not getting carried away before the financial crisis, and in the consistency of results it subsequently delivered. We provide management biographies on page 11.

Sensitivities

Equity gearing and funding

S&U funding has been very conservatively managed (see Exhibit 5). It is currently net cash positive, while most peers work on multiples of 3-4x debt to equity. Its gross debt position remains very low and is all long duration.

Exhibit 5: Funding structure of S&U

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017e
Equity to accounts receivable (%)	58	56	56	57	61	67	71	71	65	58	95	82
Gross debt to equity (%)	75	79	74	72	60	44	34	34	47	67	23	22
% of debt >1 year	71	63	69	51	100	100	96	87	93	100	100	100

Source: S&U, Edison Investment Research

S&U has been working on a banking licence application (expense so far c £650k). It held its detailed challenge meetings before the opportunistic sale of the home collect business. S&U is now cash rich and so does not need the banking deposits, and the group profile has changed so dramatically that its historic submissions are no longer relevant. Management indicates that the banking licence is still a strategic objective, but its implementation has been deferred until 2016 or, more likely, 2017.

Regulation

Regulation is a permanent cost for businesses like S&U. The regulation of consumer credit has changed from the Office of Fair Trading to the Financial Conduct Authority (FCA). S&U expects a full authorisation of its motor finance business later this year.

Illiquidity in shares

The Coombs family continues to have a material interest in S&U (total family holdings 54%; major holdings are detailed on page 11). An independent charity (Wiseheights) holds more than 20% of the shares, which we understand is its sole equity investment. We expect the family to remain the major shareholders for the foreseeable future.

Valuation

We use a range of valuation approaches, the average of which is £29.89 (previously £28.31). Gordon's growth model shows an increased valuation with the higher equity base as management has retained more equity than we had expected. This reflects its confidence in the opportunities currently available and our model assumes good returns on retained capital (see details below). There has been a modest reduction in our dividend discount model as the dividend payout was below forecast. We note that our forecast period (2016-17) does not fully capture the deployment of the cash proceeds, nor does it give credit for a balance sheet that could see significant capital repatriations and still be less geared than peers. The peer valuation methodology is largely unchanged.

Peer valuations (3,533p previously 3,434p)

The different business models mean that peer valuations need to be treated with caution. In particular, S&U has net cash, while its peers have net debt typically c 4x their equity base. As S&U deploys its surplus funds, we might expect the price-to-book matrix (the current big positive outlier) to reduce and for it to be offset by higher earnings and yield-based measures. Once it progresses with its bank licence, we will include appropriate challenger banks (most notably Paragon: 2016e consensus P/E 10.4x) in the comparator table. Non-Standard Finance (NSF) was loss making in H116 and there are currently no public forecasts. Should the latter change, we will also include it in the comparator table. Since our last report, the net effect of peers share price movements and forecast changes leaves this valuation measure broadly unchanged.

Exhibit 6: Peer valuation metrics

	Price (p)	Market cap (£m)	P/E (x) 2015	P/E (x) 2016e	2016/15 growth	2016 yield	2016 payout ratio	Price/book value (x)	Equity to lending (%)
S&U	**2,480**	**293**	**19.9**	**15.6**	**26%**	**3.1%**	**67%**	**2.1**	**111%**
PFG	3,179	4,672	19.8	18.3	8%	4.1%	82%	8.0	32%
Secure Trust	2,850	518	17.4	15.8	10%	3.2%	56%	4.0	15%
Average PFG/STB			18.6	17.1	9%	3.7%	69%	6.0	23%
S&U at peer average (p)	**3,533**		**2,324**	**2,717**		**2,112**		**6,979**	

Source: Thompson Reuters. Note: *Our calculations are based on January of the following year (eg for year-end 2015 we use January 2016). Prices as at 30 September 2015.

Gordon's growth model and sensitivity (4,032p from 3,563p)

Establishing the long-term return on equity is complicated by the expected level of equity gearing. We believe that leverage will increase over the medium term and so assume a long-term sustained return on equity of 25% (ahead of our 2017 forecast of 13%). We have built in a cost of equity of 10.5%, given S&U's low gearing and long track record. As noted above, we have increased our growth assumption to 5.5%. Given the depressed ROE, we have introduced a 15% discount to reflect near-term performance below our long-term assumption. These assumptions suggest S&U should trade at 3.9x book value. We include the 125p special dividend as a one-off benefit. Our new valuation is £40.32, which has increased due to a lower capital distribution than in our previous estimate (£15m v £30m). 2017e equity is thus higher and we assume a 3.9x multiple on equity.

Exhibit 7: Gordon's growth model and sensitivity (p per share)

	Base	+1% ROE	-1% COE	+1% growth
Return on equity (%)	25.0	26.0	25.0	25.0
Cost of equity (%)	10.5	10.5	9.5	10.5
Growth (%)	5.5	5.5	5.5	6.5
Price/book value (x)	3.9	4.1	4.9	4.6
Book value per share, January 2017 (p) excl special dividend	1,178.5	1,178.5	1,178.5	1,178.5
Implied value pre near-term performance	**4,596**	**4,832**	**5,745**	**5,451**
Near-term performance discount/premium	-15%	-15%	-15%	-15%
Implied value ongoing business	**3,907**	**4,107**	**4,884**	**4,633**
One-off distribution	125	125	125	125
Implied total value	**4,032**	**4,232**	**5,009**	**4,758**
Variance from base		200	977	726

Source: Edison Investment Research

Dividend discount model (1,402p from 1,496p)

We take our explicit dividend forecasts for the years 2016-17. Beyond this, we grow earnings by 5.5% for 10 years and assume a pay-out ratio of 78% (retaining sufficient capital to fund growth of 5.5% while earning an ROE of 25%). We then assume a residual value of 10x this dividend, with all the cash flows discounted at the cost of equity (10.5%). We also assume a one-off distribution equivalent to £15m. This generates a value of 1,402p (previously 1,496p). The reduction is due to a lower special dividend than in our last forecast. We note the valuation is likely to be increased materially by rolling forward into 2018, when more of the proceeds are deployed. It could be argued that a fair comparison with peers would mean there should be debt at 3-4x equity. The lower end of this range would equate to debt of c £400m (£33 per share), although we do not believe there is any appetite for this level of implied risk.

Financials

We had previously included the home collect business in our 2016 forecasts (with a zero effect in 2017e). These have now been treated as discontinued businesses and so drop out of our estimates. As can be seen in the table below, we have not changed our 2017 estimates materially.

Exhibit 8: Estimate revisions

	Revenue (£m)			PBT (£m)			EPS (p)			Dividend (p)		
Year end 31 January	Old	New	% chg	Old	New	% chg	Old	New	% chg	Old	New	% chg
2016e	66.2	43.5	(34)	22.5	18.8	(17)	149.9	124.8	(17)	75.0	197.5	163
2017e	56.0	57.0	2	23.3	23.9	2	155.2	159.2	3	85.0	90.0	6

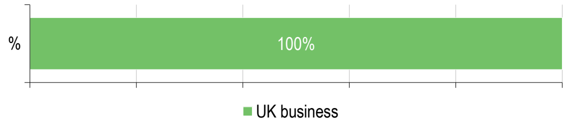
Source: Edison Investment Research

In Exhibit 9 below 2015 onwards is on the continuing business basis. 2007-14 has been included to show the group's longer-term performance.

Exhibit 9: Financial summary

£'000s	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	2017e
Year end 31 January											
PROFIT & LOSS											
Revenue	42,795	45,978	46,182	45,795	48,016	51,919	54,990	60,823	36,102	43,500	57,000
Cost of Sales (excl. amortisation and depn)	(31,848)	(34,624)	(35,537)	(34,906)	(36,660)	(38,654)	(39,664)	(42,241)	(19,054)	(21,997)	(30,747)
EBITDA	10,947	11,354	10,645	10,889	11,356	13,265	15,326	18,582	17,048	21,503	26,253
Depreciation	(478)	(478)	(514)	(452)	(423)	(453)	(515)	(577)	(603)	(653)	(703)
Amortisation	0	0	0	0	0	0	0	0	0	0	0
Op. profit (incl. share-based pyts pre-except.)	10,469	10,876	10,131	10,437	10,933	12,812	14,811	18,005	16,445	20,850	25,550
Exceptionals	0	0	0	0	0	0	0	0	0	0	0
Non-recurring items	0	0	0	0	0	0	0	0	0	0	0
Investment revenues / finance expense	(1,539)	(2,298)	(1,868)	(1,434)	(1,074)	(596)	(581)	(727)	(1,680)	(2,100)	(1,700)
Profit before tax (FRS 3)	8,930	8,578	8,263	9,003	9,859	12,216	14,230	17,278	14,765	18,750	23,850
Profit before tax (norm)	8,930	8,578	8,263	9,003	9,859	12,216	14,230	17,278	14,765	18,750	23,850
Tax	(2,691)	(2,613)	(2,388)	(2,522)	(2,816)	(3,281)	(3,350)	(3,955)	(2,920)	(3,797)	(4,770)
Profit after tax (FRS 3)	6,239	5,965	5,875	6,481	7,043	8,935	10,880	13,323	11,845	14,953	19,080
Profit after tax (norm)	6,239	5,965	5,875	6,481	7,043	8,935	10,880	13,323	11,845	14,953	19,080
Minority Interests	0	0	0	0	0	0	0	0	0	0	0
Average Number of Shares Outstanding (m)	11.7	11.7	11.7	11.8	11.8	11.9	11.9	11.9	12.0	12.0	12.0
EPS - normalised fully diluted (p)	53.2	50.8	50.0	55.1	59.5	75.1	91.5	112.0	99.0	124.8	159.2
EPS – FRS3 (p)	53.2	50.8	50.0	55.1	59.5	75.1	91.5	112.0	100.1	126.1	160.7
Dividend per share (p)	32.0	32.0	32.0	34.0	36.0	41.0	46.0	54.0	66.0	197.5	90.0
EBITDA margin (%)	25.6%	24.7%	23.1%	23.8%	23.7%	25.5%	27.9%	30.6%	47.2%	49.4%	46.1%
Operating margin (before GW and except.) (%)	24.5%	23.7%	21.9%	22.8%	22.8%	24.7%	26.9%	29.6%	45.6%	47.9%	44.8%
BALANCE SHEET											
Non-current assets	24,908	27,057	28,505	27,163	27,169	29,435	36,741	52,212	76,781	99,531	126,958
Current assets	50,491	50,939	51,555	53,055	49,831	50,314	51,973	57,739	68,578	67,542	52,149
Total assets	75,399	77,996	80,060	80,218	77,000	79,749	88,714	109,951	145,359	167,073	179,107
Current liabilities	(14,715)	(13,546)	(19,507)	(4,948)	(4,483)	(6,437)	(9,198)	(10,091)	(8,945)	(7,829)	(9,015)
Minority interests	0	0	0	0	0	0	0	0	(55,150)	(30,650)	(30,650)
Net assets	39,904	42,083	43,582	46,620	49,867	54,662	60,866	69,210	81,264	128,594	139,442
CASH FLOW											
Operating cash flow	715	4,596	3,864	8,569	9,347	7,896	3,848	(5,407)	(13,404)	74,808	(12,650)
Net cash from investing activities	(504)	(458)	(142)	(104)	(360)	(660)	(718)	(736)	(1,096)	527	(1,030)
Net cash from (used in)	(217)	(4,132)	(3,721)	(7,086)	(10,086)	(7,511)	(3,138)	6,146	15,423	(47,373)	(8,713)
Net cash flow	(6)	6	1	1,379	(1,099)	(275)	(8)	3	923	27,962	(22,393)
Opening net cash	(28,653)	(32,092)	(31,722)	(31,768)	(27,071)	(22,158)	(19,239)	(21,015)	(32,789)	(54,015)	(1,553)
Closing net cash	(32,092)	(31,722)	(31,768)	(27,071)	(22,158)	(19,239)	(21,015)	(32,789)	(54,015)	(1,553)	(23,946)

Source: S&U, Edison Investment Research

Contact details	Revenue by geography
S&U, Royal House Princes Gate Homer Road Solihull B91 3QQ 0121 705 77 77 www.suplc.co.uk	

Management team

Chairman: Anthony Coombs	Deputy Chairman: Graham Coombs
Anthony Coombs joined S&U in 1975 and was appointed managing director in 1999 and chairman in 2008. Between 1987 and 1997 he served as an MP. He is a director of a number of companies and charities and is a trustee of the National Institute for Conductive Education and of Premier Christian Media.	Graham Coombs joined S&U after graduating from the London Business School in 1976. He is responsible for strategic matters.
Group Finance Director: Chris Redford	**MD, Advantage Finance: Guy Thompson**
Chris Redford is a chartered accountant with over 10 years' business experience in the fast-moving consumer goods, food and travel sectors. He was appointed as finance director of Advantage Finance in 1999 and as group finance director from 1 March 2004.	Guy Thompson joined the group in 1999 as managing director of Advantage Finance and has overseen the business growth and profit increases in the business. He has previous experience as a broker, bringing an understanding of the key distribution channel.

Principal shareholders	(%)
GDC Coombs	12.9
AMV Coombs	11.2
Grevayne	2.5
Mrs CMG Coombs	0.8
Total GDCC/AMVC group	28.6
DM Coombs	25.6
Wiseheights	20.4

Companies named in this report

Secure Trust (STB), Provident Financial (PFG),Non Standard Finance (NSF), Paragon (PAG)

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