

S&U

Trading remains strong

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.

Year-end trading update

Financial services

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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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

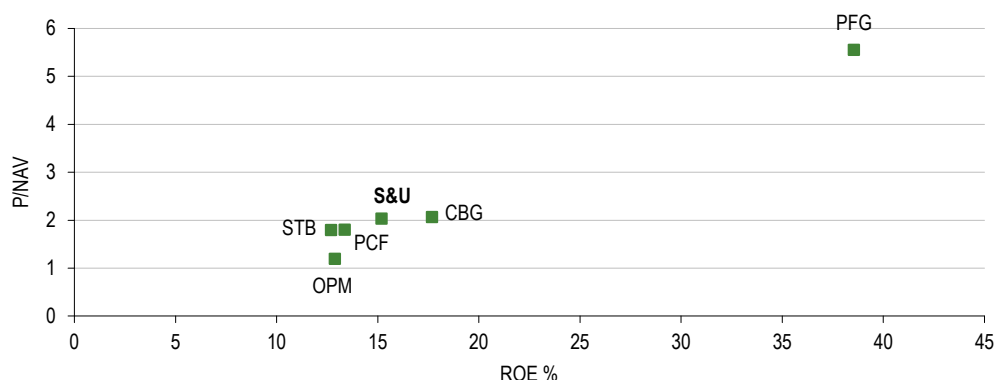
| | Price (p) | Market cap (£m) | 2016 P/E (x) | Yield (%) | ROE (%) | Price to book (x) |
|--------------------------------|----------------|-----------------|--------------|------------|-------------|-------------------|
| S&U | 2,225.0 | 266.2 | 13.3 | 3.4 | 15.2 | 2.0 |
| 1PM | 58.5 | 31.9 | 9.0 | 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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