

S&U

Trading broadly in line

S&U's latest trading update indicates it is on track to deliver results close to expectations for the current year. Motor finance receivables growth slowed in the second half, which prompted a reduction in our estimates, primarily for FY20. We still look for a return on equity (ROE) of above 17% and believe the discipline shown in holding to pricing and credit criteria at Advantage is a positive sign for investors. Our expectations for Aspen Property Bridging are unchanged and it should provide a valuable diversifying contribution to profits.

Year end	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
01/17	60.5	25.2	169.1	91.0	12.7	4.2
01/18	79.8	30.2	202.4	105.0	10.6	4.9
01/19e	91.1	34.5	231.4	118.0	9.3	5.5
01/20e	100.1	38.3	256.6	130.5	8.4	6.1

Note: PBT and EPS are reported.

Trading update signals in line for FY19

S&U's December trading update indicates it is trading broadly in line with expectations for the current year. The used car finance market has been resilient but S&U reports a slight reduction in loan applications and an increase in competitive pressure for Advantage (something that has been seen previously on occasion). This, and tighter credit criteria, has meant the number of new loans year to date is down 7% versus last year. Growth in the loan book has therefore slowed noticeably (receivables stand at £267m vs £263.5m end-July). As expected, the risk-adjusted yield has fallen slightly since July at 25.0% vs 25.4%, reflecting the worse than expected quality of some loans taken on last year. Positively, cash collections from newer customers indicate moves to increase credit quality are paying off. The Aspen property bridging finance business, no longer a pilot project, continues to make progress and is looking to expand its loan book to c £30m during calendar year 2019.

Background and outlook: Tempering FY20e growth

Advantage's in-house expertise in customising credit rating metrics facilitates refinement of credit criteria and its experience in adjusting to changing markets is evident in its discipline when competitors offer what it sees as unattractive terms to win business. This has reduced the growth in receivables and, with the reduced risk-adjusted yield, has led to a tempering in our estimates. For the current year this is only marginal (-1.5% for EPS) whereas for FY20e our assumption of lower receivables growth results in an 8% reduction in estimated EPS.

Valuation: Still looks conservative on lower estimates

S&U shares trade on an FY20 P/E multiple of below 9x on our revised estimates with a historical yield of nearly 5%. On a calendarised basis it trades close to peer average P/Es for this year and next and generates an above-average ROE while only commanding a slightly above average price to book multiple. Our ROE/COE valuation stands at 2,800p (previously 3,060p).

December trading update

Financial services

10 December 2018

Price 2,150p
Market cap £257m

Net debt (£m) end July 2018	121.4
Shares in issue	12.0m
Free float	26%
Code	SUS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(0.5)	(14.9)	(6.8)
Rel (local)	4.9	(7.7)	1.1
52-week high/low	2,790p	1,920p	

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 that restrict their access to mainstream products. It has 59,000 customers. The Aspen property bridging business has moved beyond the pilot stage and is expanding its loan book (c £18m December 2018).

Next events

Q4 and FY19 trading update 6 February 2019

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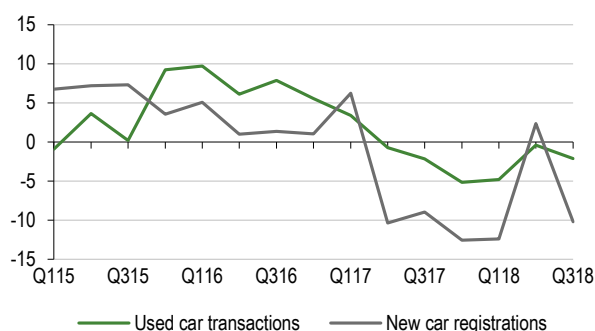
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Car market trends and Aspen investment to increase

Industry data for the used-car market demonstrate its greater recent stability compared with the new car market (Exhibit 1 shows trends in SMMT data for registrations and used-car transactions). The number of point-of-sale car financing transactions has continued to grow but has also shown a disparity between new and used cars, with new car financing down 5% in the 12 months to end September compared with the rise of 8% for used cars. For September alone the number of used-car finance transactions was up 3%, suggesting some tapering in growth compared with compound annual growth of 10% between 2009 and 2017 (quarterly trend shown in Exhibit 2).

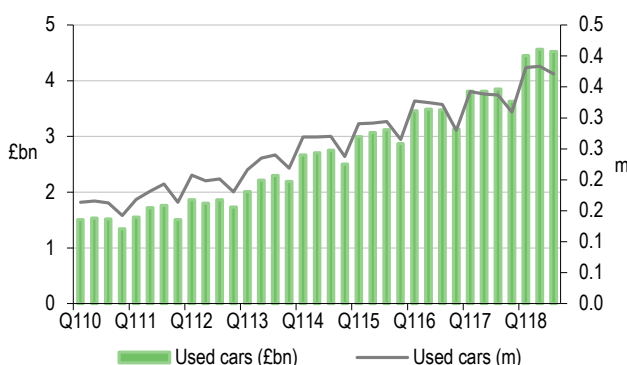
Within the used car market, Advantage addresses the lower to middle income segment with an average loan size of c £6,200, where vehicles are most commonly used for transport to work: features that tend to mitigate the risk of default and exposure to potential weakness in used car prices. Loans are straightforward hire-purchase contracts and Advantage does not offer personal purchase contract loans.

Exhibit 1: UK car market trends (% change y-o-y)



Source: SMMT

Exhibit 2: Used-car finance through dealerships



Source: Finance and Leasing Association

In November S&U announced it will develop its Aspen property bridging finance business beyond the pilot stage. The loan book is c £18m (£16.3m at the half year) and for 2019 investment will be increased to £30m, a significant step up but still small in the context of the market and the group.

The average loan size at Aspen is c £380,000, with an interest rate of just over 1% per month and an original term of between six and 12 months. In its trading update S&U noted that stepped loans have been popular and profitable. As an illustration, these may offer a lower interest rate over four months at 0.65%, followed by a step up to 1.25% for the balance of the period. Aspen loans are made for refurbishment rather than rebuilding (avoiding risks related to timing and collateral value). The business was in profit at the half year (£0.28m profit in the period to end July). Aspen expects a return on capital of around 12% and, while this is lower than the figure of c 15% earned by Advantage, it is still attractive taking into account the different characteristics of the businesses.

The business should provide a welcome diversification for the group and (subject to credit experience) further loan book growth from £30m to £50m could see it generating a pre-tax profit of c £5m.

Financials: Estimate changes

The main figures from our segmental forecasts are shown in Exhibit 3. We have not changed our estimates for bridging finance and the main change in motor finance, as noted earlier, is a lower

rate of receivables growth assumed for both forecast years. The risk-adjusted yield is slightly lower than previously, but we still assume a small improvement in FY20 as the tightening of criteria progressively feeds into the loan book.

Exhibit 3: Segmental analysis					
£000s	2016	2017	2018	2019e	2020e
Motor					
Net accounts receivable	145,141	193,529	251,215	268,724	296,268
Revenue	45,182	60,521	78,882	88,239	95,427
Impairments	(7,611)	(12,194)	(19,434)	(23,012)	(23,899)
Ratios					
Net receivables growth	36%	33%	30%	7%	10%
Revenue as % avg receivables	35.9%	35.7%	35.5%	33.9%	33.8%
P&L loan loss provision as % revenue	(16.8%)	(20.1%)	(24.6%)	(26.1%)	(25.0%)
Risk adjusted yield on average receivables	29.9%	28.5%	26.7%	25.1%	25.3%
P&L loan loss provision as % avg receivables	(6.1%)	(7.2%)	(8.7%)	(8.9%)	(8.5%)
Bridging finance					
Net loans end of period			10,841	20,000	30,000
Interest/fee revenue			899	2,870	4,625
Loan loss provision			(162)	(241)	(393)
Ratios					
Interest/fee revenue % of average receivables			24.9%	18.1%	18.5%
P&L loan loss provision % ave receivables			(4.5%)	(1.5%)	(1.6%)
Group					
Accounts receivable	145,141	193,529	262,056	288,724	326,268
Revenue	45,182	60,521	79,781	91,109	100,052
Source: S&U, Edison Investment Research					

The changes in the headline numbers of our estimates flowing from the revised segmental assumptions are summarised in Exhibit 4 and further details are included in Exhibit 6.

Exhibit 4: Changes to estimates												
Year end	Revenue (£m)			PBT (£m)			EPS (p)			DPS (p)		
January	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
2019e	92.4	91.1	-1.4	35.0	34.5	-1.5	235.0	231.4	-1.5	118.0	118.0	0.0
2020e	106.7	100.1	-6.2	41.8	38.3	-8.3	280.0	256.6	-8.3	140.0	130.5	-6.8
Source: Edison Investment Research												

Valuation

We have updated our peer comparison table (Exhibit 5), which includes a number of companies involved in non-standard lending or have motor finance as one of their activities. S&U trades on calendar year 2018 and 2019 P/Es close to the averages and on an above-average yield. The ROE is above the group average, whereas the price-to-book is only modestly higher than average.

Although our estimates have been reduced, we still look for the ROE to move to more than 17% for FY19 and FY20. Factoring an assumed cost of equity of 10%, long-term growth of 4% (5% previously) and an ROE of 17% to a ROE/COE model would give a value of 2,800p (3,060p previously) .

Exhibit 5: Peer comparison

	Price (p)	Market cap (£m)	P/E 2018 (x)	P/E 2019 (x)	Yield (%)	ROE (%)	P/BV (x)
S&U	2,150	257	9.4	8.4	5.5%	16.7	1.7
1PM	41	36	5.6	5.4	2.1%	13.0	0.7
Close Brothers	1,428	2,152	10.4	10.2	4.6%	16.3	1.6
OneSavings Bank	336	819	6.2	5.8	4.2%	25.5	1.4
PCF Group	36	77	16.3	10.8	1.1%	10.3	1.8
Provident Financial	608	1,533	11.9	9.4	1.8%	14.0	2.3
Secure Trust Bank	1,378	253	9.1	7.4	6.0%	8.9	1.0
Average			9.9	8.2	3.3%	14.6	1.5

Source: Thomson Reuters, Edison Investment Research. Note: P/Es are adjusted to calendar years. Priced at 7 December 2018.

Exhibit 6: Financial summary

£'000s	2016	2017	2018	2019e	2020e
Year end 31 January					
PROFIT & LOSS					
Revenue	45,182	60,521	79,781	91,109	100,052
Impairments	(7,611)	(12,194)	(19,596)	(23,253)	(24,292)
Other cost of sales	(8,980)	(12,871)	(17,284)	(17,450)	(19,310)
Administration expenses	(7,131)	(8,332)	(9,629)	(11,066)	(12,006)
EBITDA	21,460	27,124	33,272	39,340	44,444
Depreciation	(209)	(253)	(294)	(359)	(399)
Op. profit (incl. share-based payouts pre-except.)	21,251	26,871	32,978	38,981	44,045
Exceptionals	0	0	0	0	0
Non recurring items	0	0	0	0	0
Investment revenues / finance expense	(1,782)	(1,668)	(2,818)	(4,473)	(5,769)
Profit before tax (FRS 3)	19,469	25,203	30,160	34,508	38,276
Profit before tax (norm)	19,469	25,203	30,160	34,508	38,276
Tax	(3,583)	(4,861)	(5,746)	(6,556)	(7,272)
Discontinued business after tax	53,299				
Profit after tax (FRS 3)	69,185	20,342	24,414	27,953	31,003
Profit after tax (norm)	15,886	20,342	24,414	27,953	31,003
Average Number of Shares Outstanding (m)	12.0	12.0	12.1	12.1	12.1
Diluted EPS (p)	576.5	169.1	202.4	231.4	256.6
EPS - normalised (p)	132.4	169.1	202.4	231.4	256.6
Dividend per share (p)	201.0	91.0	105.0	118.0	130.5
EBITDA margin (%)	47.5%	44.8%	41.7%	43.2%	44.4%
Operating margin (before GW and except.) (%)	47.0%	44.4%	41.3%	42.8%	44.0%
Return on equity	15.2%	15.2%	16.7%	17.6%	17.9%
BALANCE SHEET					
Non-current assets	103,653	138,004	181,015	196,262	221,573
Current assets	61,903	57,763	84,178	107,597	130,101
Total assets	165,556	195,767	265,193	303,858	351,674
Current liabilities	(6,850)	(17,850)	(7,927)	(7,203)	(7,488)
Non-current liabilities inc pref	(30,450)	(38,450)	(104,450)	(131,202)	(162,086)
Net assets	128,256	139,467	152,816	165,453	182,101
NAV per share (p)	1,084	1,177	1,276	1,381	1,520
CASH FLOW					
Operating cash flow	(16,017)	(27,431)	(43,418)	(998)	(5,716)
Net cash from investing activities	80,716	(308)	(1,040)	(588)	(588)
Dividends paid	(23,090)	(9,548)	(11,377)	(13,084)	(14,576)
Other financing (excluding change in borrowing)	55	21	12	(3)	(16)
Net cash flow	41,664	(37,266)	(55,823)	(14,673)	(20,896)
Opening net (debt)/cash	(53,565)	(11,901)	(49,167)	(104,990)	(119,663)
Closing net (debt)/cash	(11,901)	(49,167)	(104,990)	(119,663)	(140,559)

Source: S&U Accounts, Edison Investment Research. Note: FY16 dividend per share includes exceptional payment of 125p.

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