S&U

AGM and Q124 trading update

Results on track to meet FY24 expectations

Insurance

S&U, the specialist motor and property finance lender, reported a good start to the financial year with profit before tax (PBT) up £0.3m in the period to 24 May despite group borrowing costs increasing by £3m versus the same period last year. A new £230m funding facility has increased total funding facilities to £280m, giving the group just under £100m to fund its growth plans over the next two years. Although rising interest rates are a headwind, credit quality remains strong, and S&U expects growth to continue in FY24. Our estimates remain unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/22	87.9	47.0	312.7	126.0	8.0	5.0
01/23	102.7	41.4	277.5	133.0	9.0	5.3
01/24e	119.3	42.9	268.4	133.0	9.3	5.3
01/25e	131.9	48.7	300.3	150.0	8.3	6.0

Note: *PBT and EPS are reported. EPS is diluted.

Advantage motor finance

Against a backdrop of limited supply in the new car market, the used car market remains robust with transactions up 4% in Q123 versus Q122 and used car values remaining above pre-pandemic levels (see Exhibits 5 to 8). Net receivables for Advantage have reached a record £311m versus £306m at end FY23 and £268m on 25 May 2022. Credit quality remains strong with above budget collections of 94%, while contractual payment arrears have fallen 25% compared to the same period last year. Although growth has paused while the group prepares for the Consumer Duty framework implementation due in July, management remains confident that current run rates and increases in transaction sizes to higher scoring customers should support a pick-up in growth for the rest of the year.

Aspen property bridging

Although higher interest rates have strained the residential property market, Aspen has grown considerably year-on-year. Net receivables for Aspen are £107m compared to £114m at end FY23 and £72m on 25 May 2022. PBT for Aspen is up 20.6% versus the same period last year. S&U reported total collection receipts of £22.3m (FY22: £20.2m). As the UK refinancing market slowed due to market conditions, the group experienced lower than anticipated extension and recovery receipts. Credit quality is good with 10 of the c 140 loans (c 7%) in default at the end of the quarter; S&U expects the defaulted loans to be recovered by the end of June.

Valuation: Trading below implied ROE for FY24

The shares are trading on an FY24e P/E multiple of 9.3x and dividend yield of 5.3%. Inputting our FY24 estimates of a 14% return on equity (ROE), 10% cost of equity (COE) and 2% growth rate into the ROE/COE model, we value S&U at 2,980p. At its current share price, keeping the COE and growth rate constant, the market is pricing in a ROE of 12.1%, which is below the historic average of 16% (between FY16 and FY23) and our respective estimates for FY24 and FY25 of 14% and 14.5%.

26 May 2023

Price	**2,500p**
Market cap	**£304m**

Net debt (£m) at end January 2023	193
Shares in issue	12.2m
Free float	16.8%
Code	SUS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	7.1	12.2	9.4
Rel (local)	11.2	16.9	9.9
52-week high/low		2,570p	1,905p

Business description

S&U's Advantage motor finance business lends on a simple HP basis to lower- and middle-income groups that may have impaired credit records restricting access to mainstream products. It has c 65,000 customers. The Aspen property bridging business has been developing since its launch in 2017.

Next events

Q223 update	10 August 2023

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Market background

The current macroeconomic environment remains challenging, although key economic indicators are showing broad optimism in the outlook.

Economic forecasts for the UK have been upgraded, with Treasury data showing that expectations for GDP growth in the UK is now -0.1%, an improvement on the -0.2% expected in March. Meanwhile, the International Monetary Fund (IMF) upgraded its UK GDP growth forecast to 0.4% on 23 May. Consumer confidence appears to be slowly recovering as private and public wages continue to grow and unemployment remains low at 3.9%. The market for second hand cars remains robust, with prices still above pre-pandemic levels and monthly transactions higher in Q123 compared to Q122. The number of residential property transactions and monthly mortgage approvals has begun to cool off as a higher interest rate environment sweeps through the economy, squeezing incomes and increasing the cost of borrowing.

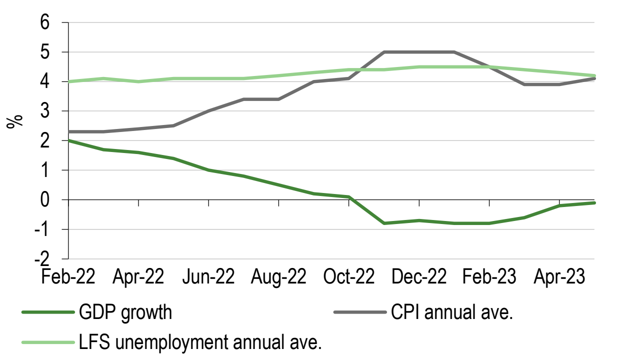
Both Advantage and Aspen are well positioned to benefit from this environment as demand for lending remains solid and credit quality is strong.

Key economic indicators

Between February and December 2022, UK GDP forecasts for 2023, collected by HM Treasury, trended downwards (see Exhibit 1). Since then, GDP forecasts have edged up, with the latest average showing a marginal reduction of 0.1% (see Exhibit 2). Most recently, the IMF projected that the UK GDP will expand 0.4% on the back of stronger wage growth, easing energy prices and the resolution of supply chain issues. According to the Office for National Statistics, average regular pay growth jumped 7.0% for the private sector and 4.8% for the public sector, between November 2022 and January 2023.

Having peaked at 5%, annual inflation (CPI) expectations have decreased to 4.1% a marginal bounce from estimates of 3.9% in April. CPI estimates for FY24 remain flat with previous estimates of 2.5%. Market estimates for unemployment slightly improved to 4.2% (4.3% in April), affirming the market assumption of a stronger-than-expected economy in the UK.

Exhibit 1: Evolution of UK economic forecasts for 2023



Source: Collected by HM Treasury (last reading May 2023)

Exhibit 2: Independent forecasts for 2023 and 2024

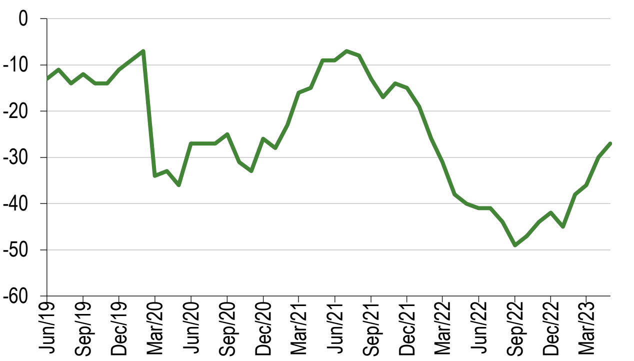
%	Average	Average of new forecasts
GDP growth		
2023	-0.1	0.2
2024	0.8	1.0
Labour Force Survey unemployment rate Q4		
2023	4.2	4.2
2024	4.4	4.3
Inflation Q4 (CPI)		
2023	4.1	3.9
2024	2.5	2.5

Source: Collected by HM Treasury (May 2023)

Exhibit 3 shows the consumer confidence about personal finances and the economic outlook between now and the next 12 months. The start of the Russia-Ukraine war on 24 February 2022 drove consumer confidence down as energy and food price hikes rippled through the economy, followed on by sequential interest rate increases that have almost levelled with the rates experienced during the 2008 financial crisis. However, most recently, the UK economy has seen strong growth in private and public sector wages and the outlook remains more positive than previously, supported by the upgrade in GDP forecasts by the IMF. Headline inflation is trending downwards into single digits (currently reported at 8.7% despite forecasts of 8.4%), as energy prices continue to slide, allowing the consumer to be more optimistic about the UK economic outlook.

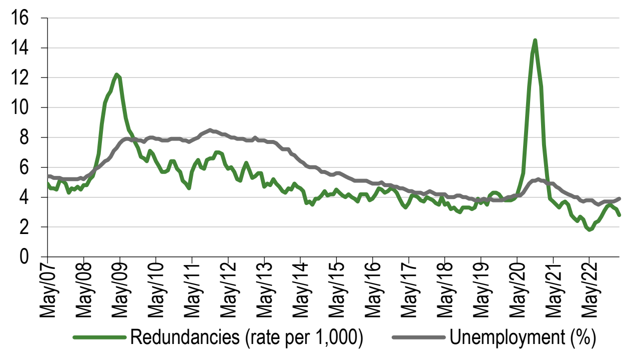
In Exhibit 4, we observe the relationship between redundancies and unemployment. After the abnormal spike in 2020 due to COVID-19, redundancies returned to a normalised level shortly after. While redundancies retraced upwards in the second half of 2022, they have ticked lower in the past two months of reporting (February and March) as the UK economy has proven to be more resilient. Although unemployment remained stable in the last quarter of 2022, there are signs that it is rising and is currently 3.9% versus 3.7% in March 2022. We note that the labour market remains tight.

Exhibit 3: GfK UK consumer confidence indicator



Source: Refinitiv (last value May 2023)

Exhibit 4: UK redundancies and unemployment



Source: ONS (last value March 2023)

Indicators for Advantage motor finance

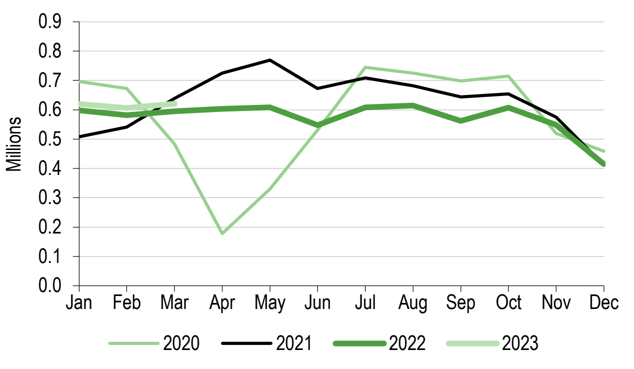
In Exhibit 5, we observe the monthly transactions between 2020 and the first three months of 2023. Volume recovered in a V-like fashion in the second half of 2020 following the initial impact of COVID-19 and subsequent lockdowns. Monthly transactions recovered in 2021 but supply issues, a result of constraints on new car production, moderated volumes. This trend continued into 2022. We note the seasonal nature of the market, with monthly transactions declining significantly at the end of the year.

In the first three months of 2023, volumes remained resilient, above the levels seen in 2022 and only below transactions experienced in 2020. However, the average number of transactions between January and March 2023 remains below the historical average (FY14–FY22) by around 26,623 transactions each month, or 4% of the average transactions between January and March 2023 (642,340).

Exhibit 6 displays both the value of advances and the number of cars that were bought on finance through dealerships. In the most recent March data, the value of advances remained above pre-pandemic levels but was 10% lower year-on-year. Similarly, the number of used cars bought in March was 8% lower than in March 2022.

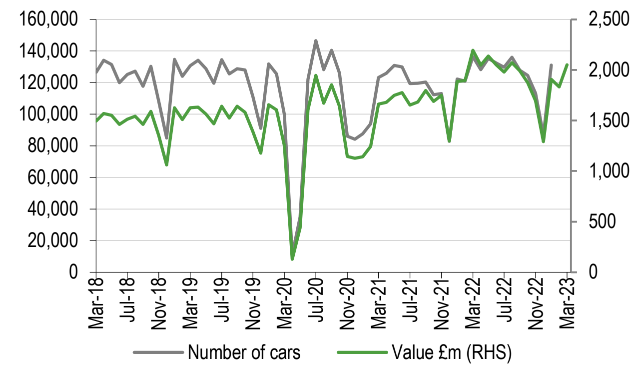
In March the Finance and Leasing Association said that its research indicated that the value of new loans to consumers for used car purchases in 2023 may fall by 12%. However, S&U remains optimistic in the growth of its Advantage business as new car supply constraints are a persistent factor in keeping value and demand robust in the market for used car finance. Coupled with high collection rates, improved rates of arrears and increasing transaction sizes to higher scoring customers, Advantage remains well positioned to continue growing sustainably throughout the year.

Exhibit 5: Monthly used car transactions 2020–22



Source: SMMT (last value March 2023)

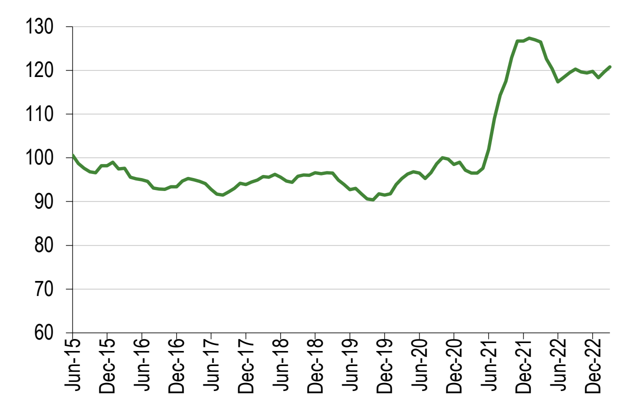
Exhibit 6: Used car finance through dealerships



Source: Finance and Leasing Association (last value March 2023)

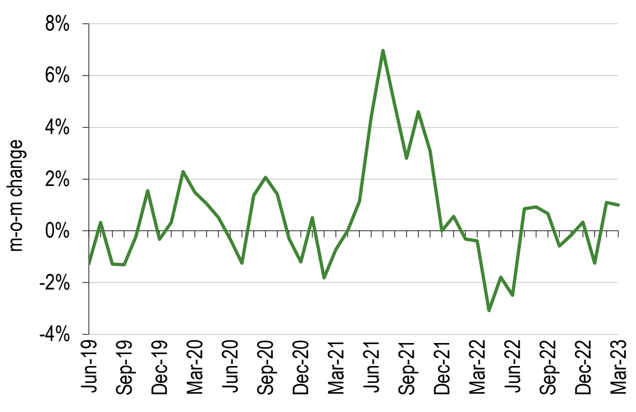
Reduced supply and strong consumer demand drove used car prices upwards in mid-2021 (see Exhibit 7). Since then, prices have remained c 20% above those in June 2021. In the second half of 2022, monthly changes in used car prices have been less volatile compared to previous periods and seem to be hovering closer to a zero-percentage change, insinuating less demand and/or greater supply. Although a fall in prices would be negative for Advantage, it is relatively protected by the low value vehicles it finances (average advance of £7,799 in FY23).

Exhibit 7: Used car price index



Source: ONS CPI Index (last value March 2023)

Exhibit 8: Monthly change in used car prices



Source: ONS CPI Index. Note: Month-on-month % change.

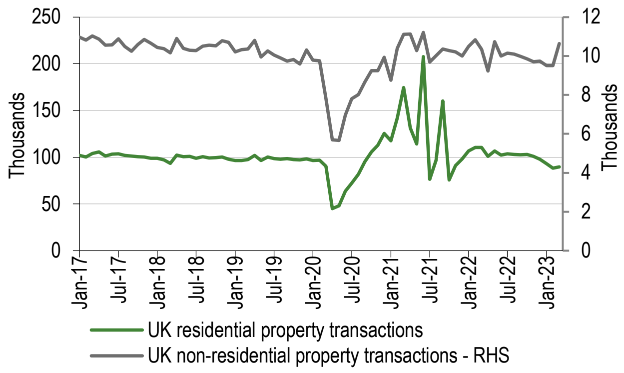
Indicators for Aspen property bridging

Exhibit 9 shows the number of UK non-residential and residential transactions, with residential being more relevant for Aspen. In 2020, a wave of lockdowns and the implementation of a stamp duty holiday caused volatility in monthly transactions. Most recently, residential property transactions have returned to pre-pandemic levels and there are signs of a slight decline as the cost of borrowing continues to rise.

Following sequential interest rate increases in 2022, the cost of borrowing has risen, credit standards have tightened and unemployment has edged upwards. Consequently, the monthly number of mortgage approvals has fallen below its normalised rate (see Exhibit 10). We expect this trend to continue as further anticipated interest rate increases will further squeeze incomes and tighten credit standards.

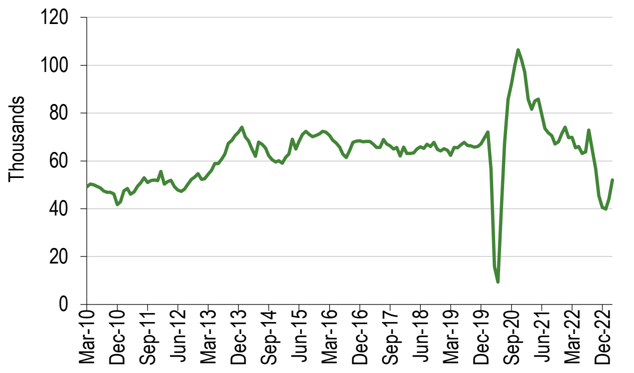
Aspen acknowledges that the residential property market has been depressed, but its continued lending behaviour of focusing on experienced property developers with good assets and a high net worth has allowed Aspen to increase its lending activity while maintaining good credit quality.

Exhibit 9: UK property transactions



Source: HM Revenue & Customs. Note: Seasonally adjusted, to March 2023.

Exhibit 10: Monthly number of mortgage approvals



Source: Bank of England. Note: Seasonally adjusted, to March 2023.

Exhibit 11: Financial summary

£'000s	2019	2020	2021	2022	2023	2024e	2025e
Year end 31 January							
Profit & Loss							
Revenue	82,970	89,939	83,761	87,889	102,714	119,344	131,911
Impairments	(16,941)	(17,220)	(36,705)	(4,120)	(13,877)	(18,841)	(21,108)
Other cost of sales	(15,751)	(19,872)	(14,264)	(18,771)	(23,676)	(24,956)	(26,456)
Administration expenses	(10,763)	(12,413)	(10,576)	(13,679)	(15,731)	(16,708)	(18,468)
EBITDA	**39,515**	**40,434**	**22,216**	**51,319**	**49,430**	**58,839**	**65,880**
Depreciation	(414)	(450)	(520)	(529)	(525)	(551)	(652)
Op. profit (incl. share-based payouts pre-except.)	39,101	39,984	21,696	50,790	48,905	58,288	65,229
Exceptionals	0	0	0	0	0	0	0
Non-recurring items	0	0	0	0	0	0	0
Investment revenues / finance expense	(4,541)	(4,850)	(3,568)	(3,772)	(7,495)	(15,354)	(16,573)
Profit before tax	**34,560**	**35,134**	**18,128**	**47,018**	**41,410**	**42,934**	**48,656**
Tax	(6,571)	(6,252)	(3,482)	(9,036)	(7,692)	(10,327)	(12,164)
Profit after tax	**27,989**	**28,882**	**14,646**	**37,982**	**33,718**	**32,607**	**36,492**
Average Number of Shares Outstanding (m)	12.1	12.1	12.1	12.1	12.1	12.2	12.2
Diluted EPS (p)	232.0	239.4	120.7	312.7	277.5	268.4	300.3
EPS - basic (p)	233.2	239.6	120.7	312.8	277.5	268.4	300.3
Dividend per share (p)	118.0	120.0	90.0	126.0	133.0	133.0	150.0
EBITDA margin (%)	47.6%	45.0%	26.5%	58.4%	48.1%	49.3%	49.9%
Operating margin (before GW and except.) (%)	47.1%	44.5%	25.9%	57.8%	47.6%	48.8%	49.4%
Return on equity	17.6%	16.8%	8.1%	19.6%	15.6%	14.0%	14.5%
Balance sheet							
Non-current assets	185,383	197,806	173,413	184,189	222,031	244,786	267,645
Current assets	95,430	108,275	111,426	143,040	206,143	225,550	245,941
Total assets	280,813	306,081	284,839	327,229	428,174	470,336	513,586
Current liabilities	(6,722)	(7,424)	(5,309)	(8,789)	(6,918)	(7,605)	(8,118)
Non-current liabilities inc pref	(108,724)	(119,183)	(98,501)	(111,693)	(196,371)	(221,399)	(243,927)
Net assets	165,367	179,474	181,029	206,747	224,885	241,331	261,541
NAV per share (p)	1,375	1,493	1,490	1,702	1,852	1,987	2,153
Cash flow							
Operating cash flow	10,530	4,946	32,940	(2,094)	(62,760)	(9,031)	(5,552)
Net cash from investing activities	(785)	(265)	(1,112)	(284)	(660)	(1,080)	(1,080)
Dividends paid	(13,080)	(14,461)	(13,098)	(12,263)	(15,546)	(16,161)	(16,282)
Other financing (excluding change in borrowing)	14	14	2	1	1	0	0
Net cash flow	**(3,321)**	**(9,766)**	**18,732**	**(14,640)**	**(78,965)**	**(26,272)**	**(22,914)**
Opening net (debt)/cash	(104,990)	(108,311)	(118,077)	(99,345)	(113,985)	(192,950)	(219,222)
Closing net (debt)/cash	(108,311)	(118,077)	(99,345)	(113,985)	(192,950)	(219,222)	(242,136)

Source: S&U, Edison Investment Research. Note: EPS is on a reported basis.

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