

S&U

Lending discipline tempers pace of growth

S&U's year-end trading statement indicated that FY19 results would be in line with expectations. Motor finance new business has slowed recently reflecting a combination of more intense competition and S&U's maintenance of tighter credit criteria. As a result, FY20 starts with lower receivables than we had assumed, and it also seems prudent to allow for lower growth than previously. Our FY20e EPS is reduced by 4.7% but the prospective ROE remains above 17%.

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	90.7	34.3	230.1	116.0	9.3	5.4
01/20e	95.9	36.5	244.6	122.5	8.8	5.7

Note: PBT and EPS are reported.

Broadly in line for FY19

Overall trading was reported as satisfactory and FY19 results are expected to be in line with consensus. The main business, Advantage motor finance, has continued to see a high level of loan applications, but the combination of increased competition and adherence to previously tightened credit criteria has reduced new transactions, and the level of receivables at c £261m was modestly below the £267m reported in the last [update](#) on 7 December and our estimate of £268m. Positively, there is evidence that loan quality is improving as underwriting changes start to feed into the loan book. The Aspen property bridging business ended the year with a loan book just above £18m compared with £11.2m at the end of January 2018. The gross margin on new loans has been running ahead of Aspen's budget. S&U has declared a second interim dividend of 35p (+9.4%), giving a dividend so far for FY18 of 67p versus 60p. The board intends to restore dividend cover to 2x when setting the final payment.

Competition and credit discipline trim FY20e

There is only a marginal reduction in our FY19 estimates reflecting the indicated level of year-end receivables (EPS -0.5%). For FY20, we have assumed a more modest level of motor finance receivables growth (6% versus 10%), noting both upside and downside risk subject to the ebb and flow of competitive pressures, in addition to the macroeconomic background. We still look for the Aspen loan book to expand to £30m.

Valuation: Still implies caution on future returns

Although our estimates are reduced, we still project returns on equity of over 17% for FY19 and FY20 and note that an ROE/COE model suggests the current share price is discounting a return of 13.8% given a cost of equity of 10% and growth of 4% (see further discussion on pages 2–3).

Q419 trading update

Financial services

7 February 2019

Price **2,150.00p**
Market cap **£258m**

Net debt (£m) at end July 2018	121.4
Shares in issue	120m
Free float	26%
Code	SUS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.4	2.4	2.4
Rel (local)	(3.6)	0.9	2.3
52-week high/low	2790.00p	1920.00p	

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 just over 59,000 customers. The Aspen property bridging business has moved beyond the pilot stage and is expanding its loan book (just over £18m at end-January 2019).

Next events

FY19 results	26 March 2019
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Estimate changes

The key figures from our adjusted segmental forecasts are shown below, with the main changes since our [last note](#) in December being the lower assumed levels of receivables for motor finance referred to earlier. Aspen property bridging is in the early stages of its development, having moved out of the pilot stage towards the end of calendar 2018. The year-end loan book was somewhat lower than we had assumed at just over £18.1m versus £20m, but we do not see this as particularly significant given the potentially lumpy incidence of loans which have an average size of c £380,000. As noted earlier, we have kept in place the assumption of a year-end loan book of £30m for FY20. Further details of our forecasts can be found in the financial summary (Exhibit 4).

Exhibit 1: Segmental analysis					
£000s	2016	2017	2018	2019e	2020e
Motor					
Net accounts receivable	145,141	193,529	251,215	261,347	277,263
Revenue	45,182	60,521	78,882	87,878	91,275
Impairments	(7,611)	(12,194)	(19,434)	(22,918)	(22,861)
Ratios					
Net receivables growth	36%	33%	30%	4%	6%
Revenue as % average receivables	35.9%	35.7%	35.5%	34.3%	33.9%
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%	25.3%	25.4%
P&L loan loss provision as % avg receivables	(6.1%)	(7.2%)	(8.7%)	(8.8%)	(8.5%)
Bridging Finance					
Net loans end of period			10,841	18,100	30,000
Interest/fee revenue			899	2,825	4,660
Loan loss provision			(162)	(237)	(396)
Ratios					
Interest/fee revenue % of average receivables			24.9%	18.3%	19.0%
P&L loan loss provision % avg receivables			(4.5%)	(1.5%)	(1.6%)
Group					
Accounts receivable	145,141	193,529	262,056	279,447	307,263
Revenue	45,182	60,521	79,781	90,703	95,934
Source: S&U, Edison Investment Research					

Exhibit 2 summarises the headline numbers from our estimates. In addition to the P&L items, we have changed our dividend assumptions to align them with earnings and the company's indication that it will return to a twice-covered dividend for the full year (FY19).

Exhibit 2: Changes to estimates												
	Revenue (£m)			PBT (£m)			EPS (p)			DPS (p)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
2019e	91.1	90.7	-0.4%	34.5	34.3	-0.5%	231.4	230.1	-0.5%	118.0	116.0	-1.7%
2020e	100.1	95.9	-4.1%	38.3	36.5	-4.7%	256.6	244.6	-4.7%	130.5	122.5	-6.1%
Source: Edison Investment Research												

Valuation

Our peer comparison table (Exhibit 3) includes a number of companies that are involved in non-standard lending or have motor finance as one of their activities. S&U trades on calendar year 2018 and 2019 P/E's above the averages but within the range of values. It has an above-average yield. The ROE is above the group average, whereas the price-to-book is only slightly higher than average.

While our estimates have been reduced, we still expect the ROE to be above 17% for both FY19 and FY20. Factoring an assumed cost of equity of 10%, long-term growth of 4% and an ROE of

17% into an ROE/COE model would give a value of 2,800p (unchanged). We note that the current share price (2,110p at time of writing) would imply an ROE of 13.8%, all else equal, which is similar to S&U's recent low point, recorded in FY09.

Exhibit 3: Peer comparison

	Price (p)	Market cap (£m)	P/E 2018 (x)	P/E 2019 (x)	Yield (%)	ROE (%)	P/BV (x)
S&U	2,110	255	9.3	8.7	5.0	16.7	1.6
1PM	49	43	6.2	N/A	1.3	13.0	0.9
Close Brothers	1,451	2,211	10.4	10.0	4.3	16.3	1.6
OneSavings Bank	373	918	6.4	6.0	3.4	25.5	1.6
PCF Group	37	80	11.1	8.6	0.8	10.3	1.8
Provident Financial	520	1,326	9.6	7.8	0.0	14.0	2.0
Secure Trust Bank	1,395	260	7.7	6.5	5.7	8.9	1.0
Peer average			8.6	7.8	2.6	14.6	1.5

Source: Refinitiv, Edison Investment Research. Note: P/Es are adjusted to calendar years. Priced at 6 February 2019.

Exhibit 4: Financial summary

£'000s	2016	2017	2018	2019e	2020e
Year end 31 January	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	45,182	60,521	79,781	90,703	95,934
Impairments	(7,611)	(12,194)	(19,596)	(23,155)	(23,257)
Other cost of sales	(8,980)	(12,871)	(17,284)	(17,373)	(18,515)
Administration expenses	(7,131)	(8,332)	(9,629)	(11,017)	(11,512)
EBITDA	21,460	27,124	33,272	39,158	42,650
Depreciation	(209)	(253)	(294)	(359)	(399)
Op. profit (incl. share-based payouts pre-except.)	21,251	26,871	32,978	38,799	42,251
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	34,326	36,482
Profit before tax (norm)	19,469	25,203	30,160	34,326	36,482
Tax	(3,583)	(4,861)	(5,746)	(6,521)	(6,932)
Discontinued business after tax	53,299				
Profit after tax (FRS 3)	69,185	20,342	24,414	27,805	29,550
Profit after tax (norm)	15,886	20,342	24,414	27,805	29,550
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	230.1	244.6
EPS - normalised (p)	132.4	169.1	202.4	230.1	244.6
Dividend per share (p)	201.0	91.0	105.0	116.0	122.5
EBITDA margin (%)	47.5%	44.8%	41.7%	43.2%	44.5%
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%	17.5%	17.1%
BALANCE SHEET					
Non-current assets	103,653	138,004	181,015	190,049	208,845
Current assets	61,903	57,763	84,178	113,638	141,319
Total assets	165,556	195,767	265,193	303,686	350,165
Current liabilities	(6,850)	(17,850)	(7,927)	(7,179)	(7,339)
Non-current liabilities inc pref	(30,450)	(38,450)	(104,450)	(131,202)	(162,086)
Net assets	128,256	139,467	152,816	165,305	180,740
NAV per share (p)	1,084	1,177	1,276	1,380	1,509
CASH FLOW					
Operating cash flow	(16,017)	(27,431)	(43,418)	8,115	2,478
Net cash from investing activities	80,716	(308)	(1,040)	(588)	(588)
Dividends paid	(23,090)	(9,548)	(11,377)	(13,084)	(14,336)
Other financing (excluding change in borrowing)	55	21	12	(3)	(16)
Net cash flow	41,664	(37,266)	(55,823)	(5,559)	(12,462)
Opening net (debt)/cash	(53,565)	(11,901)	(49,167)	(104,990)	(110,549)
Closing net (debt)/cash	(11,901)	(49,167)	(104,990)	(110,549)	(123,011)

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

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