

S & U plc

Reaction Note

4th October 2018

Price 2605p

TDIM

SUS

Market Cap

£312.0m

Net Debt (F)

£128.7m

Free Float

32.4%

Average Daily Volume

3.2k

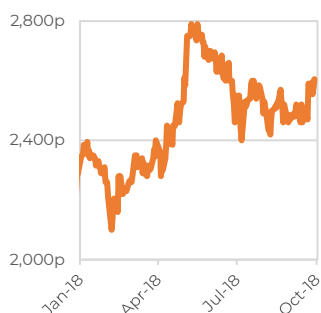
Broker

Peel Hunt

Listing

Main

Share Price Performance



S & U is one of the UK's leading non-prime motor finance lenders. It operates exclusively within the second-hand car market and provides finance via hire purchase agreements.

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Stronger and More Stable

S & U's interim results broadly confirmed our forecasts and the strength of the business model. The company is deliberately increasing its underwriting criteria in motor lending (Advantage) in the face of still rising demand. We believe that this will result in declining impairment charges, relative to revenue, from the latter half of (calendar year) 2019 onwards. Together with the prospect of a positive decision on the Aspen Bridging Finance pilot, we are now more confident of the medium-term outlook for S & U. In the short term, loan growth is likely to continue to be slow while impairment may still rise as a function of the complexion of the historic loan book. However, we don't believe this will be material, so are content to leave our forecasts unchanged across the timeframe. On value, the company's peer group has experienced share price weakness of late, reducing the comparative ratios, while S & U has seen its market value rise. However, despite these movements, theoretical value remains over 20.0% above the current share price level.

Year to	PBT	EPS	DPS	PER	PEG	Yield
January	£m	P	P	x	X	%
FY18a	30.2	203.8	105.0	12.8	0.7	4.0
FY19e	36.0	241.4	120.7	10.8	0.6	4.6
FY20e	41.0	274.8	137.4	9.5	0.7	5.3
FY21e	46.0	314.4	157.2	8.3	0.6	6.0

Interim Results

S & U reported under IFRS 9 and IFRS 16 for the first time: as required, it did not restate prior periods. However, the changes were not significant and, at PBT and EPS, did not materially impact "real" growth rates. Allowing for the changes, revenue grew by 23% but impairment by 54%, leaving EBITDA growth at 21.7% and the margin up by 110bps. The key growth driver remained the expansion of the motor book through 2016 and 2017 although there was an important first-time contribution (£0.3m at EBIT) from Aspen. Reflecting historic loan growth, finance charges were higher but PBT and EPS growth was still 17.0% and 17.3% respectively. On balance sheet, total receivables increased by 22.0% to £279.8m while gearing rose from 56.0% to 78.0%.

Motor loan applications reached a record level of 510,000; an increase of 16% year on year. At the same time the company has strengthened its underwriting criteria such that the approval ratio has fallen from 31% to 25% (year-on-year). The company is taking advantage of market growth to improve the quality of its lending book without compromising overall customer growth, which in the half was up 18.4% to 58,000 Advantage customers.

Forecasts

While we have not changed our PBT and EPS forecasts through the timeframe, we have altered the composition of the current year's income statement and cash flow. On the former, we have reduced revenue by more than impairment to reflect IFRS changes. The impact on EBITDA is mitigated by lower other COGS such that our previous forecast remains. Further out, we have made no changes to our income statement forecasts.

In cash flow terms, we have reduced the outflow from Advantage to reflect slower loan growth but relatively stable collections. This is carried forward into 2020 and 2021 such that our gearing estimates remain largely unchanged. We have made no allowance for Aspen beyond the current loan book, preferring to wait for the result of the board's decision in November 2018

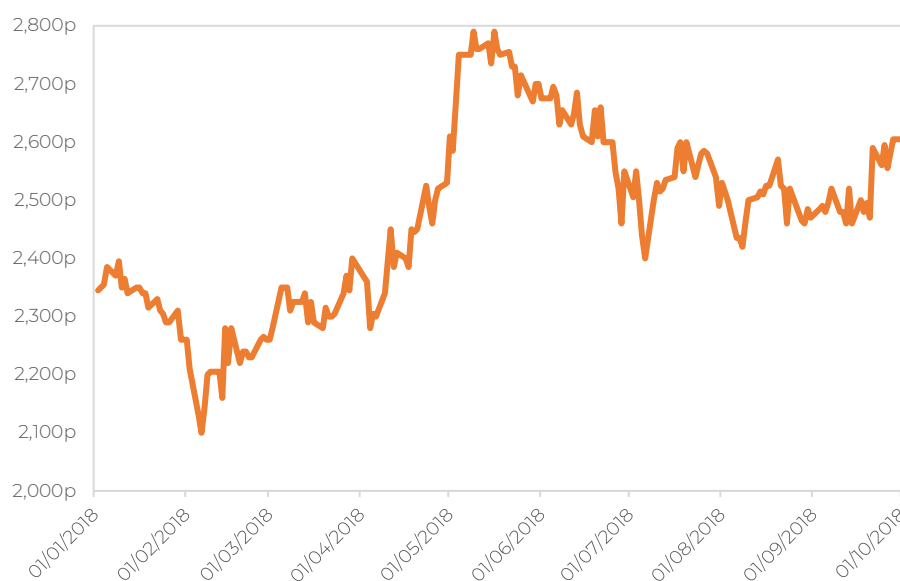
Theoretical Value

S & U has outperformed our wider peer group by a considerable margin over the last month. Over this timeframe, the peers have experienced a 5.7% average share price fall compared to S & U's 4.5% gain. Simultaneously, forecasts for KPIs within the peer group (EPS and DPS) have come under pressure. We believe that this is due to emerging caution over the UK speciality finance market in general, and motor lending in particular, in the immediate aftermath of Brexit in March 2019.

Our previous report (*Cautiously Positive Trading Update*, 8th August 2018) suggested 3110p as "fair". Despite the movements within the comparative group's values, this rises slightly to 3178p, 22.0% higher than the current share price. S & U's apparent wide discount at PEG between it and the sector is the principle driver of this value.

Data Bank

Figure 1: S&U Share Price (January 2018 to date)



Source: Bloomberg

Figure 2: Share Price Performances (comparative group)

	1 Month	3 Months	12 Months
S & U Plc	4.5	3.0	23.4
International Personal Finance Plc	(7.1)	6.5	1.1
Paypoint Plc	(2.2)	(5.5)	1.1
Morses Club Plc	2.5	(7.9)	(0.3)
Close Brothers Group Plc	(3.6)	5.3	4.8
Non-Standard Finance Plc	(15.3)	(5.4)	(31.3)
OneSavings Bank Plc	(2.8)	(5.5)	0.1
Paragon Banking Group Plc	(0.7)	(9.3)	5.1
Provident Financial Plc	(14.3)	(1.1)	(12.2)
Secure Trust Bank Plc	(7.5)	(9.8)	(8.6)
Lookers Plc	1.9	0.6	(4.9)
Marshalls Plc	(6.2)	3.0	(3.0)
BCA Marketplace Plc	(12.3)	(9.8)	(7.4)
Motorpoint Group Plc	(10.3)	(10.3)	49.3
Auto Trader Group Plc	(0.7)	5.9	15.2
AVERAGE (FINANCE)	(5.7)	(3.6)	(4.5)
AVERAGE (MOTOR DEALERS)	(5.5)	(2.1)	9.8
AVERAGE (TOTAL)	(5.6)	(3.1)	0.6

Source: Bloomberg

Figure 3: Comparative Valuation Analysis (prices as @ 1st October 2018)

	IPF	Paypoint	Morses Club	Close Bros	NSF	OneSavings	Paragon	Provident Fin	Secure Trust	Average
Share Price	218	913	144	1552	55	396	464	584	1630	
Market Capitalisation	485.1	605.3	188.6	2,351.3	170.7	961.2	1,222.6	877.7	301.6	
Enterprise Value	1,115.1	576.3	202.4	1,588.3	376.7	811.2	13,296.6	1,964.2	81.6	
EV/Revenue	1.3	4.8	1.6	1.9	2.3	3.0	48.2	1.7	0.5	
EV/EBITDA	-	9.4	-	-	12.0	-	-	-	-	
PER	7.0	14.6	10.8	11.3	13.9	7.4	9.5	11.4	10.9	10.8
PEG	-	-	0.2	2.9	1.0	1.5	0.6	0.9	-	1.2
Yield	5.7%	6.4%	5.4%	4.1%	4.4%	3.5%	4.0%	1.5%	5.1%	4.5%

Source: Bloomberg & Capital Access Group

Figure 4: Theoretical Value

2018/19	Comparative Ratio	Implied Value	Movement against Current Price (2605p)
PER	10.8	2601	na
Yield	4.5%	2704	3.0%
PEG	1.2	4229	62.4%
Average/Theoretical Value		3178	22.0%

Source: Capital Access Group Forecasts

Figure 5: Implied Value at Theoretical Level (3178p)

Year to January	2019F	2020F	2021F
PER	13.2	11.6	10.1
Yield	3.8%	4.3%	4.9%
PEG	0.7	0.8	0.7

Source: Capital Access Group Forecasts

Figure 6: Interim Income Statement Analysis

Year to January	H2 2018A	H1 2019A	H2 2019E	Growth	
				H1/H1	H2/H2
Revenue	42.2	44.5	50.2	18.5%	18.9%
Impairment	(11.0)	(11.4)	(13.2)	32.7%	20.2%
Other COGS	(8.6)	(8.6)	(9.0)	-0.4%	4.1%
COGS	(19.7)	(20.0)	(22.4)	16.1%	14.1%
Impairment/Revenue	26%	26%	26%		
Gross Profit	22.6	24.5	27.8	20.5%	23.1%
Gross Margin	53%	55%	55%		
EBITDA	17.7	18.9	21.4	21.7%	20.6%
D&A	(0.2)	(0.1)	(0.2)	0.0%	3.7%
EBITDA Margin	42%	43%	43%		
Administrative Expenses	(5.0)	(5.7)	(6.3)	16.3%	25.5%
Operating Profit	17.6	18.8	21.5	21.9%	22.4%
Operating Margin	42%	42%	43%		
Net Finance Costs	(1.7)	(2.1)	(1.9)	82.3%	14.0%
PBT	15.9	16.7	19.3	17.0%	21.4%
ETR	19%	19%	20%		
Tax Charge	(3.0)	(3.2)	(3.8)	14.6%	29.2%
Attributable Earnings	12.9	13.5	15.5	17.6%	19.6%
Average No. Shares	12.0	12.0	12.0		
EPS (p)	107.8	112.6	128.8	17.3%	19.5%
DPS (p)	77.0	32.0	88.7	14.3%	15.2%
Dividend Cover	1.4	3.5	1.5		

Source: Capital Access Group Forecasts

Figure 7: S & U Income Statement Analysis

Year to January					Growth		
	2018A	2019F	2020F	2021F	2019F	2020F	2021F
Revenue	79.8	94.7	110.0	121.0	18.7%	16.1%	10.0%
Impairment (Motor)	(19.4)	(24.6)	(28.6)	(30.9)	26.9%	16.1%	8.0%
Impairment (Aspen)	(0.2)	(0.2)	0.0	0.0			
Other Costs	(17.3)	(17.6)	(21.2)	(23.5)	1.9%	20.5%	10.9%
Total COGS	(36.9)	(42.4)	(49.8)	(54.4)	15.0%	17.4%	9.2%
Impairment/Revenue	24.3%	26.0%	26.0%	25.5%			
Gross Profit	42.9	52.3	60.2	66.6	21.9%	15.1%	10.7%
Gross Margin	53.8%	55.2%	54.7%	55.1%			
EBITDA	33.3	40.3	46.9	52.3	21.1%	16.3%	11.6%
D&A	(0.3)	(0.3)	(0.3)	(0.3)	2.0%	0.0%	0.0%
EBITDA Margin	41.7%	42.8%	43.5%	43.5%			
Administrative Expenses	(9.9)	(12.0)	(13.3)	(14.3)	20.9%	10.8%	7.5%
Operating Profit	33.0	40.0	46.6	52.0	21.2%	16.4%	11.7%
Operating Margin	41.3%	42.2%	42.3%	43.0%			
Net Finance Costs	(2.8)	(4.0)	(5.6)	(6.0)	41.9%	40.0%	7.1%
PBT	30.2	36.0	41.0	46.0	19.3%	13.8%	12.3%
ETR	19.1%	19.5%	19.5%	18.0%			
Tax Charge	(5.7)	(7.0)	(8.0)	(8.3)	22.1%	13.7%	3.8%
Attributable Earnings	24.4	29.0	33.0	37.7	18.7%	13.8%	14.4%
Average Number of Shares	12.0	12.0	12.0	12.0			
EPS (p)	203.8	241.4	274.8	314.4	18.4%	13.8%	14.4%
DPS (p)	105.0	120.7	137.4	157.2	15.0%	13.8%	14.4%
Dividend Cover	1.9	2.0	2.0	2.0	0.0%	0.0%	0.0%

Source: Capital Access Group

Figure 8: Advantage Cash Flow

Year to January	2018A	2019F	2020F	2021F
Balance Brought Forward	(130.0)	(171.9)	(184.8)	(187.2)
Advances	(152.2)	(150.0)	(165.0)	(185.0)
Collections	118.8	141.0	168.0	180.0
Settlements/re-loans	24.6	30.0	33.0	37.0
Debt Recovery	9.9	15.0	14.9	16.7
Overheads/Interest	(29.4)	(31.0)	(31.4)	(35.2)
Tax Paid	(5.4)	(5.9)	(8.0)	(8.3)
Dividend (to S&U plc)	(8.2)	(12.0)	(14.0)	(16.4)
Balance Carried Forward	(171.9)	(184.8)	(187.2)	(198.4)

Source: Capital Access Group

Figure 9: S & U plc Statutory Cash Flow

Year to January	2018A	2019F	2020F	2021F
Operating Profit	33.0	40.0	46.6	52.0
Net Finance (Cost)/Income	(2.8)	(4.0)	(5.6)	(6.0)
Tax Paid	(5.3)	(6.0)	(8.0)	(13.6)
Depreciation	0.3	0.3	0.3	0.3
Loss on Disposal	0.1	0.0	0.0	0.0
Receivables (Customers)	(68.5)	(41.0)	(24.3)	(29.8)
Receivables (Trade)	(0.1)	(0.4)	(0.4)	(0.4)
Payables	0.5	1.0	1.0	1.0
Accruals and Deferred Income	(0.8)	0.0	0.0	0.0
Share-Based Payments	0.3	0.4	0.4	0.4
Other	(0.0)	0.0	0.0	0.0
Operating Cash Flow	(43.4)	(9.7)	10.0	3.9
Disposal Proceeds	0.0	0.0	0.0	0.0
Capex	(1.1)	(1.0)	(0.5)	(0.5)
Investing Activities	(1.0)	(1.0)	(0.5)	(0.5)
Dividends	(11.4)	(13.1)	(14.9)	(17.0)
Issue of New Shares	0.0	0.0	0.0	0.0
Movement in Borrowings	0.0	0.0	0.0	0.0
Financing Activities	(11.4)	(13.1)	(14.9)	(17.0)
Net Cash Flow	(55.8)	(23.8)	(5.4)	(13.6)
Opening Net Debt	(49.2)	(104.9)	(128.7)	(134.1)
Closing Net Debt	(104.9)	(128.7)	(134.1)	(147.8)
Shareholders' Funds	152.8	167.3	183.8	202.6
Gearing	69%	77%	73%	73%

Source: Capital Access Group

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