

## Financials



Source: Eikon Thomson Reuters

## Market data

|              |       |
|--------------|-------|
| EPIC/TKR     | NSF   |
| Price (p)    | 63.0  |
| 12m High (p) | 78.75 |
| 12m Low (p)  | 50.5  |
| Shares (m)   | 313   |
| Mkt Cap (£m) | 197   |
| EV (£m)      | 385   |
| Free Float*  | 99%   |
| Market       | Main  |

\*As defined by AIM Rule 26

## Description

In the UK non-standard lending market, NSF has the market-leading network in unsecured branch-based lending, and is number two in guarantor loans and number three in home credit.

## Company information

|          |                   |
|----------|-------------------|
| CEO      | John van Kuffeler |
| CFO      | Nick Teunon       |
| Chairman | Charles Gregson   |

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[www.nonstandardfinance.com](http://www.nonstandardfinance.com)

## Key shareholders

|                     |       |
|---------------------|-------|
| Invesco             | 28.7% |
| Woodford Investment | 26.8% |
| Marathon Asset Mgt. | 10.3% |
| Aberforth Partners  | 10.2% |
| Quilter Cheviot AM  | 4.1%  |
| ToscaFund           | 3.8%  |

## Diary

|          |                     |
|----------|---------------------|
| November | Capital Markets Day |
|----------|---------------------|

## Analysts

|             |  |
|-------------|--|
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## NON-STANDARD FINANCE

## 1H'18 results: jam today, more tomorrow

NSF invested heavily in 2016 to 1H'18, deferring the delivery of greater bottom-line profits. The 1H'18 results delivered tangible payback on this investment, with normalised operating profits up 79% (statutory operating profit moved from a loss of £1.1m to a profit of £7.0m). Pre-tax profits were held back by the group locking in long-term, more expensive, funding (finance costs £9.6m vs. £3.1m) but, as these funds are deployed, pre-tax profits are expected to rise. We reviewed Everyday Loans (EL) in *"A heart of gold"*. We believe the re-pricing and volume opportunities that NSF have in a downturn provide it with counter-cyclicality.

- **1H'18 results:** The key takeaway from the results was that credit quality was ahead of expectations, especially in the branch and guarantor loan (GLD) businesses. Customer numbers and volumes for those divisions were ahead of our forecasts; Home Collect (HC) agent and customer numbers were a little below our expectations but HC remains the group's smallest division.
- **Outlook:** In recent trading statements, management has confirmed that full-year trading is in line with expectations. Despite credit being better than expected, we understand management plans to maintain scorecards, rather than chase incremental volume; indeed, we see an easing in HC volume targets after a period of rapid YoY growth.
- **Valuation:** Our absolute valuation measures for NSF range from 91p-103p per share. With the IPO of Amigo, there is now a market comparator for the GLD business, and so we are introducing a sum-of-the-parts model (implied valuation 89p). Peer comparators reach up to 91p.
- **Risks:** Credit risk remains the biggest threat to profitability, and NSF's model accepts higher credit risk where a higher yield justifies it. NSF is innovative, and may incur losses piloting new products, customers and distribution. Regulation is a market issue; management is taking appropriate action to mitigate this risk.
- **Investment summary:** Substantial value should be created, as i) competitors have withdrawn, ii) NSF is well capitalised, with committed six-year debt funding, iii) macro drivers are positive, and iv) NSF has a highly experienced management team, delivering operational efficiency without compromising the key F2F model. Targets of 20% loan book growth and 20% EBIT RoA appear credible, and investors are paying 9.8x 2019E P/E and getting a 5.0% yield.

## Financial summary and valuation

| Year-end Dec (£000)          | 2016    | 2017    | 2018E   | 2019E   |
|------------------------------|---------|---------|---------|---------|
| Revenue                      | 94,674  | 119,756 | 167,852 | 200,978 |
| Impairments (incl. IFRS9)    | -26,155 | -28,795 | -39,252 | -47,259 |
| Total costs (excl. dep.)     | -49,600 | -67,706 | -87,246 | -94,135 |
| EBITDA                       | 19,369  | 25,181  | 37,132  | 53,192  |
| PBT                          | 13,056  | 13,203  | 14,660  | 24,725  |
| Statutory PBT (co. basis)    | -9,342  | -13,021 | -4,850  | 11,275  |
| Pro-forma normalised EPS (p) | 3.37    | 3.44    | 3.78    | 6.41    |
| DPS (p)                      | 1.20    | 2.20    | 2.60    | 3.20    |
| P/adjusted earnings (x)      | 18.7    | 18.3    | 16.7    | 9.8     |
| P/BV (x)                     | 0.8     | 0.9     | 0.9     | 0.9     |
| P/tangible book              | 2.0     | 2.6     | 3.2     | 2.9     |
| Yield                        | 1.9%    | 3.5%    | 4.1%    | 5.1%    |

Source: Hardman &amp; Co Research

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# 1H'18 results summary

## Positive trends in most KPIs

We detail the group's 1H'18 KPIs below and, for information, the same for FY17, although investors should note that the 1H'17 reported figures have not been restated. The key messages are (i) accelerated loan growth compared with end-2017, (ii) stable/improving yields, and (ii) impairments to revenue better than guidance in the branch and GLD businesses. For its KPIs, NSF has presented on a like-for-like basis – so, for example, the loan book growth is not distorted by accounting.

## KPIs (rolling 12 months to June 2017 and June 2018)

| %                        | EL*            |       | George Banco/TrustTwo (GLD**) |       | Loans at Home (LAH***) |       |
|--------------------------|----------------|-------|-------------------------------|-------|------------------------|-------|
|                          | (branch-based) |       |                               |       |                        |       |
|                          | 1H'17          | 1H'18 | 1H'17                         | 1H'18 | 1H'17                  | 1H'18 |
| Loan book growth         | 15.9           | 28.3  | 43.2                          | 56.1  | 10.3                   | 53.0  |
| Normalised revenue yield | 45.7           | 46.5  | 31.0                          | 36.6  | 178.1                  | 174.9 |
| Risk-adjusted margin     | 35.2           | 37.8  | 26.5                          | 30.4  | 111.0                  | 110.9 |
| Impairments/revenue      | 23.0           | 18.8  | 14.5                          | 17    | 37.7                   | 36.6  |
| Operating profit margin  | 37.6           | 35.4  | 12.6                          | 35.9  | 4.8                    | 6.0   |
| RoA                      | 17.2           | 16.5  | 3.9                           | 13.3  | 8.5                    | 10.5  |

Source: NSF, Hardman & Co Research; \* Everyday Loans; \*\* Guarantor Loans \*\*\* Home Collect;

Group profit estimates broadly unchanged: EV up, GLD stable, LAH modest fall

At this stage, we have not changed our FY18 group estimates materially. We characterise 1H'18 as a small beat (see each division below for more details), but we will treat this as a cushion against any future market uncertainties, rather than increase estimates at this stage. The transition to IFRS9 has also meant that the accounting has made certain business trends less visible. Divisionally, we have increased estimates in EV and the GLD business, while we have trimmed them in HC.

## Estimate changes

| Year-end Dec                         | 2018E   |         |        | 2019E   |         |        |
|--------------------------------------|---------|---------|--------|---------|---------|--------|
|                                      | Old     | New     | % chg. | Old     | New     | % chg. |
| <b>Profit and loss (£000)</b>        |         |         |        |         |         |        |
| Reported revenue                     | 166,098 | 167,852 | 1%     | 197,000 | 200,978 | 2%     |
| Total impairments (including IFRS9)  | -39,728 | -39,252 | -1%    | -46,208 | -47,259 | 2%     |
| Total costs (excluding depreciation) | -85,596 | -87,246 | 2%     | -93,760 | -94,135 | 0%     |
| EBITDA                               | 35,443  | 37,132  | 5%     | 50,638  | 53,192  | 5%     |
| PBT                                  | 14,424  | 14,660  | 2%     | 24,798  | 24,725  | 0%     |
| Pro-forma normalised EPS (p)         | 3.72    | 3.78    | 2%     | 6.40    | 6.41    | 0%     |
| DPS (p)                              | 2.50    | 2.60    | 4%     | 3.15    | 3.20    | 2%     |
| <b>Balance sheet (£m)</b>            |         |         |        |         |         |        |
| Amounts receivable                   | 293.6   | 306.4   | 4%     | 361     | 376.5   | 4%     |
| Borrowings                           | 228.8   | 242.8   | 6%     | 289     | 307.8   | 7%     |
| Shareholders' equity                 | 221.7   | 209.1   | -6%    | 222     | 209.3   | -6%    |

Source: Hardman & Co Research

Real like-for-like revenue and operating profit growth above reported levels unding robust

The statutory accounts mean that 1H'18 is on an IFRS9 basis, while 1H'17 was on the old IAS39 standard. This distorts growth rates, so investors need to treat revenue growth (reported at 51%), normalised operating and pre-tax profit increases (79% and 4%, respectively) with caution. The strong loan book growth means more provisions are taken upfront, so the real like-for-like growth numbers would be higher. The group remains well-funded, with existing committed lines more than covering expected growth through to mid-2020 (with covenants on an IAS39 basis).

## Everyday Loans (EL)

EL (branch-based lender) is NSF's largest business, representing ca.62% of the group's total loan book, 45% of revenue and 75% of pro-forma normalised operating profit (60%, 51% and 86%, respectively, in FY'17). NSF completed the acquisition of EL on 13 April 2016.

### Key features from results

*More branches*

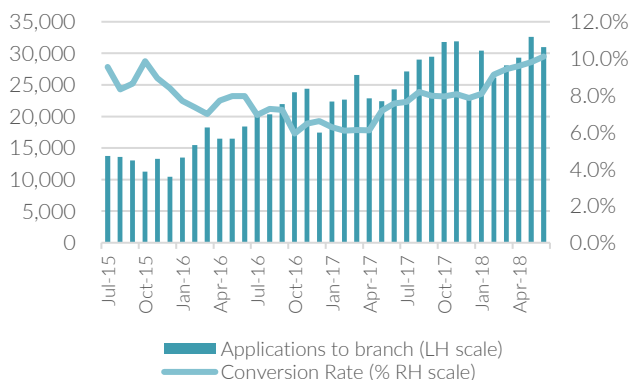
*More applications*

*Improving conversion rates*

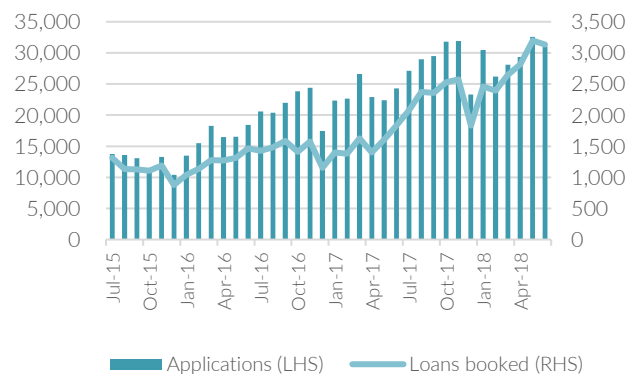
*All helping strong loan growth*

- ▶ Since the acquisition of EL, NSF has invested heavily in expanding the branch footprint (11 branches opened in 1H'18, now 64; up 78% on when NSF acquired the business). With this, and a strengthening of broker relationships, there has been an increase in the volume of applications. Sharing of best practice (inter alia taking ideas from branches with high conversion and applying these across the network), together with an improved quality of leads received from brokers, have increased the conversion rate of the higher number of applications.

Number of applications to branch/conversion rate



Loan applications and loans booked



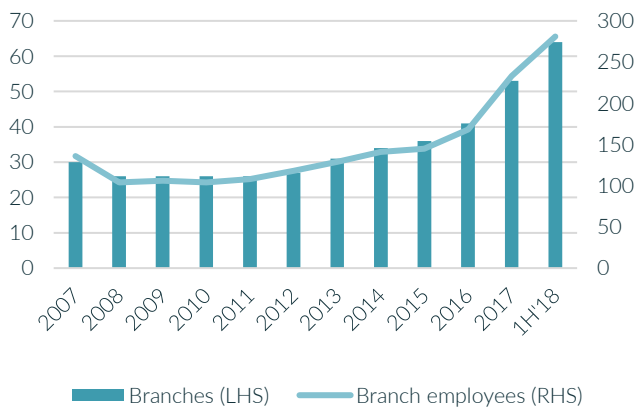
Source: Hardman & Co Research

*Consistent branch model being adopted*

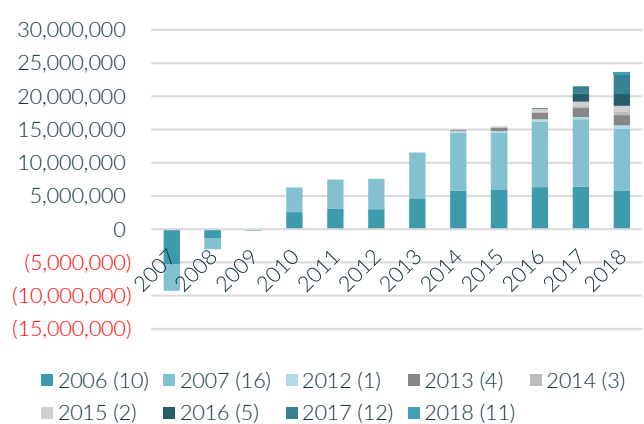
*Material embedded value in branches not yet at maturity*

The table below shows branch employees rising in line with branch numbers. The aggregate profitability of the branches by the year they opened is shown in the right-hand graph (new branches are often seeded with loans and staff from existing ones). The key message is that the 43% of branches opened since 2015 generated under a third of profits. There is an embedded value that has yet to become visible. The large losses in the early years are a significant barrier to entry to setting up a branch network.

## Number of employees and branch locations



## Aggregate profitability (£) by year of branch opening



Source: Hardman & Co Research

## Performance of EL against Hardman & Co expectations (£m)

|       | Revenue        | Impairments | Costs | Finance | Pre-tax |
|-------|----------------|-------------|-------|---------|---------|
| 1H'18 | 1.7 B (0.8 B*) | 0.5B        | 0.1W  | 0.8B    | 2.9B    |

Source: Hardman & Co Research; "B" better than forecast; "W" worse than forecast; \* excl. loan sales

As noted above, 1H'18 saw a beat on revenue (customer numbers and loans ahead of our forecasts), an improved credit performance (18.8% of revenue vs. our forecast 19.6% and previous company guidance of 20%-22%) and costs broadly in line.

## Change in outlook for EL with these results

Looking forward, we have increased our expectation for customer numbers (2018E was 56k, now 59k, 2019E was 64.6k, now 68k) and average loans by £5m. We have trimmed the yield, to be consistent with 1H'18, and so our forecast reported revenue is now £77.7m (was £76.5m) for 2018 and £94.9m (was £91.9m) for 2019. We have included the gain on the sale of a portfolio of non-performing loans (£890k) as a one-off. We have carried forward the improved credit (as a percentage of revenue) and, despite the loan growth, this leads to reduced impairments by £0.1m in 2018 and a small increase in 2019. We have cut 2018 finance costs by £0.9m, leaving 2019 unchanged.

2018 revenue estimates increased by £2.1m  
(£1.2m excluding loan sale)

## Non-Standard Finance

### Financial summary and ratios, EL

| Year-end Dec (£000)                    | Pro-forma normalised |               |               |               |
|--|----------------------|---------------|---------------|---------------|
|  | 2016                 | 2017          | 2018E         | 2019E         |
| Reported revenue                       | 50,088               | 60,937        | 77,684        | 94,947        |
| Other income                           | 450                  | 1,926         | 890           | -             |
| <b>Total revenue</b>                   | <b>50,538</b>        | <b>62,863</b> | <b>78,574</b> | <b>94,947</b> |
| Impairments                            | -10,484              | -11,654       | -14,760       | -18,515       |
| IFRS9 impairments                      | 0                    | 0             | -1,476        | -1,851        |
| Revenue less impairments               | 40,054               | 51,209        | 62,338        | 74,581        |
| Administration expenses                | -20,631              | -28,555       | -35,104       | -40,179       |
| <b>Operating profit</b>                | <b>19,423</b>        | <b>22,654</b> | <b>27,234</b> | <b>34,402</b> |
| Net finance costs                      | -4,720               | -7,051        | -12,029       | -16,335       |
| <b>Profit before tax</b>               | <b>14,703</b>        | <b>15,603</b> | <b>15,205</b> | <b>18,067</b> |
| Number of branches                     | 41                   | 53            | 65            | 70            |
| Period-end customer numbers (000s)     | 39,600               | 47,000        | 59,000        | 68,000        |
| Period-end loan book (excluding FV)    | 122,400              | 148,500       | 185,625       | 222,750       |
| Average loans                          | 113,400              | 133,000       | 167,063       | 204,188       |
| <b>Ratios</b>                          |                      |               |               |               |
| Revenue (pre-FV) as % of average loans | 44.2%                | 45.8%         | 46.5%         | 46.5%         |
| Impairments as % of pre-FV revenue     | -20.9%               | -19.1%        | -19.0%        | -19.5%        |
| Risk-adjusted margin                   | 35.3%                | 37.1%         | 37.7%         | 37.4%         |
| Cost as % of pre-FV revenue            | -41.19%              | -46.86%       | -45.19%       | -42.32%       |
| Operating pft % of pre-FV revenue      | 38.80%               | 37.20%        | 34.66%        | 36.23%        |
| Net finance costs as % of pre-FV       | -9.42%               | -11.57%       | -15.48%       | -17.20%       |
| Impairments as % of average loans      | -9.25%               | -8.76%        | -8.84%        | -9.07%        |
| Costs as % of average loans            | -18.19%              | -21.47%       | -21.01%       | -19.68%       |
| Net finance cost as % of average loans | -4.16%               | -5.30%        | -7.20%        | -8.00%        |
| Average loan per customer (£)          | 3,091                | 3,160         | 3,146         | 3,276         |
| Pre-FV revenue per customer (£)        | 1,264.8              | 1,296.5       | 1,316.7       | 1,396.3       |

Source: Hardman & Co Research

#### Macroeconomic downside protected by volume and re-pricing opportunities

We see significant long-term potential from this business (see our note "[A heart of gold](#)"). Investors should note that, in a downturn scenario, we believe that the potential number of customers is likely to rise materially, as more consumers will be pushed down into the non-standard arena, (near prime lenders will likely tighten their lending criteria). With the average revenue yield close to 50%, the ability to re-price is also much greater than the mainstream market. One reason NSF locked in financing (albeit at a higher cost) was to ensure that it had secure, long-term funding. These factors suggest that EL's performance should be robust if, and when, there is a UK recession.

## Guarantor Loans (GLD):

In 1H'18, GLD was the second-largest of NSF's three businesses and represented 24% of the group's loan book, 13% of revenue and 15% of pro-forma normalised operating profit (19%, 7% and 4%, respectively, in FY'17). It offers loans to non-standard customers who are able to get someone else, often a family member with a good credit rating, to guarantee their loan. With the guarantee, the interest rate that the borrowers have to pay is significantly lower than if they were to borrow on their own, making the loan much more affordable. TrustTwo (TT) was acquired as part of EL on 13 April 2016. The acquisition of George Banco (GB) was completed on 17 August 2017.

## Key features from results

### Business integration on track

1H'18 was partially about integrating the two GLD businesses. Management has indicated that this should be largely complete by the end of 2018. The combination has created one division with one set of key business processes, although, as the two brands serve slightly different parts of the guarantor segment, they have been kept separate (TT gets most of its business from price comparison websites and direct, while GB sees most of its business coming from financial brokers).

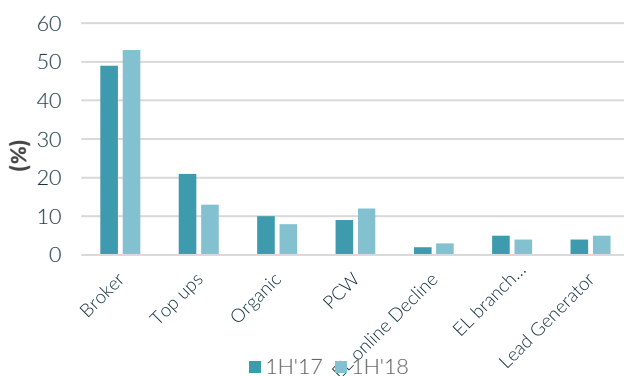
### Increasing broker penetration and referrals from branch network

Additionally, in 1H'18, the group has been seeking to exploit the strong market growth and, in particular, to leverage two distinct competitive advantages: firstly, brokers are looking for a credible alternative to the market leader (Amigo) to limit their concentration risk; secondly, NSF is looking to exploit the group synergies from referring EL declines to the GLD business. Over the past year, accepted leads have increased from just over 60k per month to nearly 200k (a 180% increase), with strong growth across both brands.

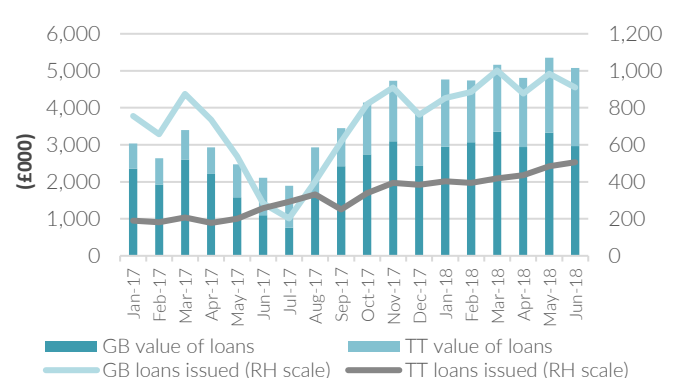
### Good recovery in volumes at GB; TT steady increases since acquisition

As can be seen in the right-hand chart below, there has been a strong recovery by GB from the low point seen ahead of the acquisition last year. TT, which has been under NSF ownership for a longer period, has been showing steady improvements throughout (from ca.£450k of lending per month in April 2016 to ca.£2m per month in June 2018). Overall, on a like-for-like basis (i.e. assuming GB had been owned for the full period), the loan book grew by an impressive 56%.

Source of new business by distribution channel



Value of loans and loans issued by GB and TT



Source: Hardman & Co Research

## Non-Standard Finance

*Growth comes with broadly stable credit, unlike Amigo loans*

In H1'18, customer growth was above our expectations (20.9k vs. 19.1k), and consequently the loan book and revenue were above forecasts. This did not come at the cost of credit. Impairments were 17% of revenue against previous guidance of 20%-22%. The impairments LFL at NSF have been broadly stable while, at Amigo, there has been a sharp increase (from 6.8% to 21.3% of revenue, IAS39 basis). The better-than-expected credit performance has also fed through to an improvement in the like-for-like risk-adjusted margin (30.4% against 26.5% in 1H'17), as well as an increase in the operating profit margin to 35.9% and return on assets to 13.2%.

### Performance of GLD against Hardman & Co expectations (£m)

|       | Revenue | Impairments | Costs | Finance | Pre-tax |
|-------|---------|-------------|-------|---------|---------|
| 1H'18 | 1.2B    | 0.4B        | 0.8W  | 0.3W    | 0.5B    |

Source: Hardman & Co Research; "B" better than forecast; "W" worse than forecast

## Change in outlook for GDL with these results

*Raised revenue, expenditure and finance cost expectations. Net effect is profits in line with previous forecasts.*

We have increased customer numbers, average loan book and average yield forecasts to reflect the 1H'18 levels. These drive an increase in revenue from the £18.9m previously forecast to £21.6m for 2018, and from £28.0m to £29.4m for 2019). An improvement in the ratio of impairments to revenue is partially offset by the higher revenue (£0.3m net improvement). Costs have been increased by £2m and finance costs by £0.8m, leaving the divisional profit largely unchanged.

### Financial summary and ratios, GLD

|  | Pro-forma normalised |              |              |               |
|--|----------------------|--------------|--------------|---------------|
| Year-end Dec (£000)                      | 2016                 | 2017         | 2018E        | 2019E         |
| Reported revenue                         | 2,416                | 8,078        | 21,610       | 29,354        |
| Impairments                              | -358                 | -1,365       | -2,553       | -4,208        |
| IFRS9 impairments                        | 0                    | 0            | -894         | -1,473        |
| Revenue less impairments                 | 2,058                | 6,713        | 18,164       | 23,673        |
| Administration expenses                  | -1,402               | -3,965       | -9,500       | -10,600       |
| <b>Operating profit</b>                  | <b>656</b>           | <b>2,748</b> | <b>8,664</b> | <b>13,073</b> |
| Net finance costs                        | -316                 | -2,029       | -5,500       | -6,500        |
| <b>Profit before tax</b>                 | <b>340</b>           | <b>719</b>   | <b>3,164</b> | <b>6,573</b>  |
| Period-end customer numbers (000s)       | 3,300                | 17,400       | 24,360       | 32,886        |
| Period-end loan book (excluding FV)      | 8,800                | 48,200       | 69,890       | 97,846        |
| Average loans                            | 7,700                | 40,400       | 59,045       | 83,868        |
| <b>Ratios</b>                            |                      |              |              |               |
| Revenue (pre-FV) as % of average loans   | 31.9%                | 35.8%        | 36.6%        | 35.0%         |
| Impairments as % of pre-FV revenue       | -14.8%               | -15.3%       | -16.0%       | -19.4%        |
| Risk-adjusted margin                     | 26.7%                | 30.3%        | 32.3%        | 30.0%         |
| Pre-tax return (excluding FV) average    | 4.4%                 | 1.8%         | 5.4%         | 7.8%          |
| Cost to % pre-FV revenue                 | -58.0%               | -49.1%       | -44.0%       | -36.1%        |
| Operating % pre-FV revenue               | 27.2%                | 34.0%        | 40.1%        | 44.5%         |
| Net finance costs as % of pre-FV revenue | -13.1%               | -25.1%       | -25.5%       | -22.1%        |
| Impairments as % of average loans        | -4.6%                | -5.5%        | -4.3%        | -5.0%         |
| Costs as % of average loans              | -18.2%               | -9.8%        | -16.1%       | -12.6%        |
| Net finance cost as % of average loans   | -4.1%                | -5.0%        | -9.3%        | -7.8%         |
| Average loan per customer (£)            | 2,667                | 2,770        | 2,869        | 2,975         |
| Pre-FV revenue per customer (£)          | 732                  | 464          | 887          | 893           |

Source: Hardman & Co Research

Looking forward, the strong growth in guarantor loans is expected to continue. There is anecdotal evidence that the regulator sees this business line as a solution for poor-credit-history borrowers. By using a guarantor, such customers can get access to finance at rates that become affordable, rather than having no access at all to credit, thereby allowing them to rebuild their credit history. Again, we would expect volumes to be a key driver in a recessionary environment, and having guarantors who are significantly prime means the volatility in impairments may also be more moderate than most non-standard lending.



## Home Credit: Loans at Home (LAH)

Based on 1H'18 results, LAH is NSF's third-largest business, with ca.14% of the group's total loan book. While it does generate 42% of group revenue, it makes a smaller (9%) contribution to normalised operating profit (21%, 42% and 10%, respectively, in FY'17). LAH is the UK's third-largest HC credit business in terms of numbers of customers. NSF completed the acquisition of SD Taylor (which trades as LAH) on 4 August 2015, and it received its full FCA permissions on 16 May 2017.

### Key features from results

*Most affected by IFRS9. Further impact of new agents/customers from PFG.*

The HC business was the most affected division by the shift to IFRS9 accounting, as taking provisions earlier had a marked effect on the stock of provisions (so reducing receivables), driven by rapid growth. This volatility was compounded by the effect of bringing on board large numbers of Provident Financial agents who were paid temporary commissions, and bringing across a customer base that typically had larger loans taken over a longer period at lower yields.

#### Performance of LAH against Hardman & Co expectations (£m)

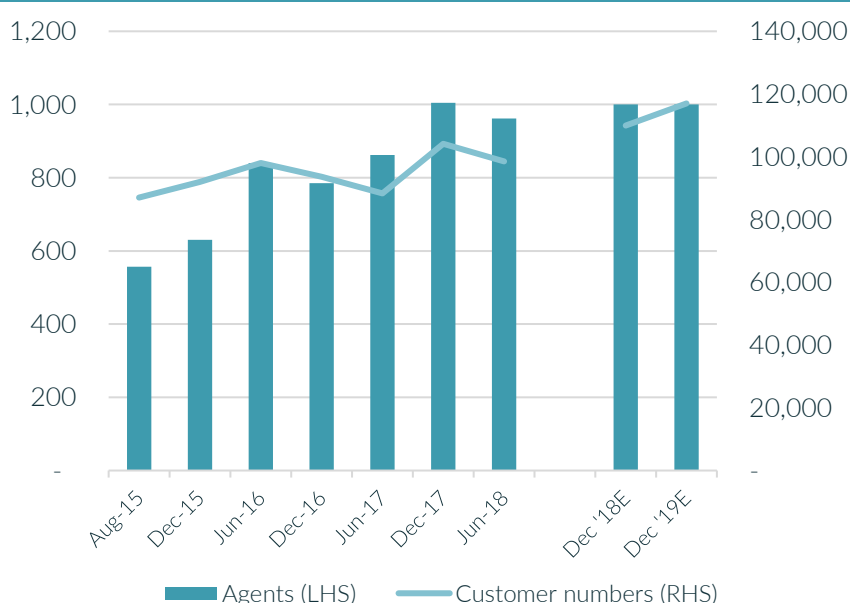
|       | Revenue | Impairments | Costs   | Finance | Pre-tax |
|-------|---------|-------------|---------|---------|---------|
| 1H'18 | 0.7B    | 0.6W        | In Line | 0.3W    | 0.2W    |

Source: Hardman & Co Research; "B" better than forecast; "W" worse than forecast

*1H'18 underlying broadly in line, with slight revenue beat offset by impairments*

Bearing in mind the complexity in forecasting future performance that this created, the business performed largely in line with expectations. We saw slightly faster-than-expected customer and agent attrition (but, given the number of PFG agents, this was to be expected), and impairments were towards the higher end of guidance.

#### Agent and customer numbers from August 2015



Source: NSF, Hardman & Co Research

We also note that management appears to be targeting a more normalised level of loan book growth than historically. Historical guidance had been for ca.20% p.a. growth, but this is now ca.20% p.a. over the medium to long term since acquisition. Given that the compound growth from acquisition to date has been 33% (and 53%

## Non-Standard Finance

*Volume growth target reduced. Mid to high single-digit growth going forward.*

*Now about operational delivery and PFG opportunity embedded in business*

in 1H'18), looking forward, a mid to high single-digit annual increase would deliver the target. Such a growth rate can be achieved by modest market growth and some fall-out of smaller providers who are getting squeezed by regulatory constraints.

Management commentary focused more on the operational delivery than strategic changes. This includes the roll-out of technology (improving efficiency while keeping the core customer/agent relationship) and maintaining good spans of control (around six agents per manager).

## Change in outlook for LAH with these results

*Yields trimmed, volumes unchanged, credit marginally worse*

Agent and customer numbers were below expectations. Looking forward, we have reduced our expectations for both (agents: 2018E was 1,050, now 1,000, 2019E was 1,100, now 1,000; customers: 2018E was 125k, now 110k, 2019E was 130k, now 117k). The loan book growth was ahead of expectations, but the revenue yield somewhat below (reflecting larger average loans). Given management commentary, we have left our loan book growth estimates unchanged, but we have trimmed the forecast yield to be more in line with 1H'18. This reduces 2018 revenue by £2m. Impairments were at the higher end of management guidance, and we have increased these a little going forward. We have also increased net finance costs.

### Financial summary and ratios, LAH

|  | Pro-forma normalised |              |              |              |
|--|----------------------|--------------|--------------|--------------|
| Year-end Dec (£000)                      | 2016                 | 2017         | 2018E        | 2019E        |
| Reported revenue                         | 42,170               | 50,741       | 68,557       | 76,677       |
| Impairments                              | -15,313              | -15,776      | -21,938      | -24,537      |
| IFRS9 impairments                        |                      |              | -2,742       | -3,067       |
| Revenue less impairments                 | 26,857               | 34,965       | 43,876       | 49,073       |
| Administration expenses                  | -23,229              | -28,679      | -40,000      | -41,000      |
| Temporary agent commission               | -1,771               | -3,184       | 0            | 0            |
| Total expenses                           | -25,000              | -31,863      | -40,000      | -41,000      |
| <b>Operating profit</b>                  | <b>1,857</b>         | <b>3,102</b> | <b>3,876</b> | <b>8,073</b> |
| Net finance costs                        | -323                 | -1,299       | -2,585       | -2,738       |
| <b>Profit before tax</b>                 | <b>1,534</b>         | <b>1,803</b> | <b>1,291</b> | <b>5,335</b> |
| Number of offices                        | 47                   | 69           | 70           | 70           |
| Number of agents                         | 785                  | 1,005        | 1,000        | 1,000        |
| Period-end customer numbers (000s)       | 93,600               | 104,100      | 110,000      | 117,000      |
| Period-end loan book (excluding FV)      | 33,400               | 51,200       | 50,840       | 55,924       |
| Average loans                            | 27,600               | 34,500       | 38,300       | 42,130       |
| <b>Ratios</b>                            |                      |              |              |              |
| Revenue (pre-FV) as % of average loans   | 153%                 | 147%         | 179%         | 182%         |
| Impairments as % of pre-FV revenue       | -36.3%               | -31.1%       | -36.0%       | -36.0%       |
| Risk-adjusted margin                     | 97.3%                | 101.3%       | 121.7%       | 123.8%       |
| Pre-tax return (excluding FV) on average | 5.6%                 | 5.2%         | 3.4%         | 12.7%        |
| Cost to % pre-FV revenue                 | -59.3%               | -62.8%       | -58.3%       | -53.5%       |
| Operating % pre-FV revenue               | 4.4%                 | 6.1%         | 5.7%         | 10.5%        |
| Net finance costs as % of pre-FV revenue | -0.8%                | -2.6%        | -3.8%        | -3.6%        |
| Impairment as % of average loans         | -55.48%              | -45.73%      | -57.28%      | -58.24%      |
| Costs as % of average loans              | -90.58%              | -92.36%      | -104.44%     | -97.32%      |
| Net finance cost as % of average loans   | -1.17%               | -3.77%       | -6.75%       | -6.50%       |
| Average loan per customer (£)            | 357                  | 492          | 462          | 478          |
| Pre-FV revenue per customer (£)          | 451                  | 487          | 623          | 655          |

Source: Hardman & Co Research

As we have noted in previous reports, a well-managed HC business can deliver rising profits in a recession, as re-priced lending and volume opportunities offset higher impairments. This was delivered by the NSF management in their previous roles.

# Financials

| Statutory profit and loss (£000)           |                |               |                |                |                |
|--|----------------|---------------|----------------|----------------|----------------|
| Year-ended 31 December                     | 2015           | 2016          | 2017           | 2018E          | 2019E          |
| Business interest income                   | 14,657         | 81,099        | 119,756        | 167,852        | 200,978        |
| Other operating income                     | 0              | 450           | 1,926          | 0              | 0              |
| Fair value unwind on acquired portfolios   | -5,456         | -8,342        | -11,985        | -8,292         | -8,292         |
| <b>Total revenue</b>                       | <b>9,201</b>   | <b>73,207</b> | <b>109,697</b> | <b>159,560</b> | <b>192,686</b> |
| Underlying business impairments            | -1,885         | -21,162       | -28,054        | -38,511        | -46,518        |
| Unwind of provision discount               | -1,973         | -2,489        | -741           | -741           | -741           |
| Business impairments                       | -3,858         | -23,651       | -28,795        | -39,252        | -47,259        |
| IFRS9 impairments                          |                |               |                | -5,112         | -6,391         |
| <b>Gross profit</b>                        | <b>5,343</b>   | <b>49,556</b> | <b>80,902</b>  | <b>115,196</b> | <b>139,035</b> |
| Administration expenses                    | -11,340        | -44,074       | -69,203        | -89,604        | -97,029        |
| Amortisation of intangibles                | -4,030         | -10,714       | -7,897         | -10,328        | -5,158         |
| <b>Operating profit</b>                    | <b>-10,027</b> | <b>-5,232</b> | <b>3,802</b>   | <b>15,264</b>  | <b>36,848</b>  |
| EBITDA                                     | -5,799         | 6,172         | 12,518         | 27,007         | 43,734         |
| Exceptional Items                          | -6,135         | -626          | -6,342         | 0              | 0              |
| Net finance (cost)/income                  | 70             | -3,484        | -10,481        | -20,114        | -25,573        |
| <b>Profit before tax</b>                   | <b>-16,092</b> | <b>-9,342</b> | <b>-13,021</b> | <b>-4,850</b>  | <b>11,275</b>  |
| Income tax                                 | 3,022          | 1,344         | 2,686          | 752            | -3,084         |
| <b>Profit after tax</b>                    | <b>-13,070</b> | <b>-7,998</b> | <b>-10,335</b> | <b>-4,097</b>  | <b>8,190</b>   |
| Average no. shares for EPS calculation (m) | 61.50          | 307.32        | 316.90         | 313.95         | 312.67         |
| Statutory EPS (p)                          | -21.25         | -2.60         | -3.26          | -1.31          | 2.62           |
| Adjusted EPS (p)                           |                | 3.37          | 3.44           | 3.78           | 6.41           |
| DPS (p)                                    | -              | 1.20          | 2.20           | 2.60           | 3.20           |

Source: NSF, Hardman &amp; Co Research

| Normalised profit and loss (£000)        |               |                |                |                |  |
|--|---------------|----------------|----------------|----------------|--|
| Year-ended 31 December                   | 2016          | 2017           | 2018E          | 2019E          |  |
| Business interest income                 | 94,674        | 119,756        | 167,852        | 200,978        |  |
| Other operating income                   | 450           | 1,926          | 890            | 0              |  |
| Fair value unwind on acquired portfolios | 0             | 0              | 0              | 0              |  |
| <b>Total revenue</b>                     | <b>95,124</b> | <b>121,682</b> | <b>168,742</b> | <b>200,978</b> |  |
| Underlying business impairments          | -23,155       | -28,054        | -38,511        | -46,518        |  |
| Unwind of provision discount             | -3,000        | -741           | -741           | -741           |  |
| Business impairments                     | -26,155       | -28,795        | -39,252        | -47,259        |  |
| IFRS9 impairments                        |               |                | -5,112         | -6,391         |  |
| <b>Gross profit</b>                      | <b>68,969</b> | <b>92,887</b>  | <b>124,378</b> | <b>147,327</b> |  |
| Administration expenses                  | -50,290       | -69,203        | -89,604        | -97,029        |  |
| Amortisation of intangibles              | 0             | 0              | 0              | 0              |  |
| <b>Operating profit</b>                  | <b>18,679</b> | <b>23,684</b>  | <b>34,774</b>  | <b>50,298</b>  |  |
| EBITDA                                   | 19,369        | 25,181         | 37,132         | 53,192         |  |
| Exceptional items                        |               |                |                |                |  |
| Net finance (cost)/income                | -5,623        | -10,481        | -20,114        | -25,573        |  |
| <b>Profit before tax</b>                 | <b>13,056</b> | <b>13,203</b>  | <b>14,660</b>  | <b>24,725</b>  |  |
| Income tax                               | -2,688        | -2,313         | -2,785         | -4,698         |  |
| <b>Profit after tax</b>                  | <b>10,368</b> | <b>10,890</b>  | <b>11,875</b>  | <b>20,027</b>  |  |

Source: NSF, Hardman &amp; Co Research

## Non-Standard Finance

| Balance sheet (£000)                     |                |                |                |                |                |
|--|----------------|----------------|----------------|----------------|----------------|
| @ 31 December                            | 2015           | 2016           | 2017           | 2018E          | 2019E          |
| Non-current                              |                |                |                |                |                |
| Goodwill                                 | 40,176         | 132,070        | 140,668        | 140,668        | 140,668        |
| Intangible assets                        | 14,119         | 17,412         | 17,205         | 6,877          | 1,719          |
| Property, plant and equipment            | 1,718          | 5,459          | 9,434          | 11,576         | 11,576         |
| <b>Total non-current assets</b>          | <b>56,013</b>  | <b>154,941</b> | <b>167,307</b> | <b>159,121</b> | <b>153,963</b> |
| Current assets                           |                |                |                |                |                |
| Inventories                              | 3              | -              | -              | -              | -              |
| <b>Amounts receivable from customers</b> | <b>28,412</b>  | <b>180,413</b> | <b>259,836</b> | <b>306,355</b> | <b>376,520</b> |
| Trade and other receivables              | 10,275         | 10,753         | 9,811          | 10,302         | 10,817         |
| Cash and cash equivalent                 | 7,320          | 5,215          | 10,954         | 1,768          | 2,156          |
| Total current assets                     | 46,010         | 196,381        | 280,601        | 318,425        | 389,493        |
| <b>Total assets</b>                      | <b>102,023</b> | <b>351,322</b> | <b>447,908</b> | <b>477,546</b> | <b>543,456</b> |
| Current liabilities                      |                |                |                |                |                |
| Trade and other payables                 | 9,490          | 8,146          | 10,353         | 12,353         | 14,353         |
| Deferred tax liability                   | 14,275         | -              | -              | -              | -              |
| Total current liabilities                | 23,765         | 8,146          | 10,353         | 12,353         | 14,353         |
| <i>Net current (liabilities)/assets</i>  | <i>29,150</i>  | <i>188,235</i> | <i>270,248</i> | <i>306,072</i> | <i>375,140</i> |
| Non-current liabilities                  |                |                |                |                |                |
| Financial liabilities – borrowings       | -              | 87,300         | 199,316        | 252,316        | 317,316        |
| Deferred tax                             | -              | 6,793          | 4,996          | 3,537          | 2,226          |
| <b>Total non-current liabilities</b>     | <b>-</b>       | <b>94,093</b>  | <b>204,312</b> | <b>255,853</b> | <b>319,542</b> |
| Total liabilities                        | 16,860         | 102,239        | 214,665        | 268,206        | 333,895        |
| <b>Net assets*</b>                       | <b>85,163</b>  | <b>249,083</b> | <b>233,243</b> | <b>209,339</b> | <b>209,560</b> |

Source: NSF, Hardman & Co Research; \* incl. £255k of NCI

| Cashflow statement (£000)                                 |                |                 |                |                |                |
|---|----------------|-----------------|----------------|----------------|----------------|
| Year-ended 31 December                                    | 2015           | 2016            | 2017           | 2018E          | 2019E          |
| Profit (loss) before tax                                  | -16,162        | -5,858          | -2,540         | 15,264         | 36,848         |
| Taxation paid   | -350           | -1,341          | -2,226         | -1,226         | -1,226         |
| Depreciation  | 198            | 690             | 1,497          | 2,359          | 2,894          |
| Share-based payments                                      | 0              | 0               | 291            | 473            | 473            |
| Amortisation of intangibles                               | 4,030          | 10,714          | 7,897          | 10,328         | 5,158          |
| FV unwind on acquired loan book                           | 5,456          | 8,342           | 11,985         | 8,292          | 8,292          |
| Loss on disposal of fixed assets                          | 51             | -363            | -416           | 0              | 0              |
| Decrease in inventories                                   | 6              | 3               | 0              | 0              | 0              |
| Increase in amounts receivable from customers (net of FV) | -5,394         | -21,039         | -54,437        | -64,811        | -78,457        |
| Increase in receivables                                   | -16,445        | -7,737          | -51            | -491           | -515           |
| Increase in payables                                      | 19,078         | -6,952          | 1,000          | 2,000          | 2,000          |
| <b>Net cash outflow from operating activities</b>         | <b>-9,532</b>  | <b>-23,541</b>  | <b>-37,000</b> | <b>-27,812</b> | <b>-24,533</b> |
| Cashflows from investing activities                       |                |                 |                |                |                |
| Purchase of property, plant and equipment                 | -341           | -3,514          | -4,931         | -4,500         | -4,500         |
| Purchase of subsidiaries                                  | -81,111        | -230,784        | -16,442        | 0              | 0              |
| <b>Net cash outflow – investing activities</b>            | <b>-81,452</b> | <b>-234,298</b> | <b>-21,373</b> | <b>-4,500</b>  | <b>-4,500</b>  |
| Cashflows from financing activities                       |                |                 |                |                |                |
| Net finance income  | 70             | -3,484          | -7,974         | -20,114        | -25,573        |
| Proceeds from issue of shares/share purchase              | 98,234         | 172,869         | -1,357         | -1,630         | 0              |
| Proceeds from borrowing                                   | 0              | 87,300          | 77,882         | 53,000         | 65,000         |
| Dividends   | 0              | -951            | -4,439         | -8,130         | -10,006        |
| <b>Net cash inflow – financing activities</b>             | <b>98,304</b>  | <b>255,734</b>  | <b>64,112</b>  | <b>23,127</b>  | <b>29,421</b>  |
| Net change in cash/cash equivalents                       | 7,320          | -2,105          | 5,739          | -9,185         | 388            |
| Opening cash and cash equivalents                         | 0              | 7,320           | 5,215          | 10,954         | 1,768          |
| Closing cash and cash equivalents                         | 7,320          | 5,215           | 10,954         | 1,768          | 2,156          |

Source: NSF, Hardman & Co Research

# Valuation

## Summary

**Average valuation upside potential on absolute measures 53%**

**New SoTP model implies 40% upside potential**

**Peer comparison (on P/BV) upside potential 44%**

Our absolute valuation techniques imply average upside potential of 53%. Peer valuations are now helpful, as we believe consensus is consistently applying IFRS9 across all companies. With the Amigo IPO, we have introduced a sum-of-the-parts (SoTP) model.

### Summary of different valuation techniques

|                                  | Implied price (p) | Upside (%) |
|----------------------------------|-------------------|------------|
| Gordon Growth Model (GGM)        | 91.4              | 45%        |
| Discounted Dividend Model (DDM)  | 101.3             | 61%        |
| <b>Average absolute measures</b> | <b>96.3</b>       | <b>53%</b> |
| Sum-of-the-parts (SoTP)          | 88.4              | 40%        |
| Peer P/E/yield                   | 66.8              | 6%         |
| Peer P/BV                        | 90.7              | 44%        |

Source: Hardman & Co Research

We detailed our assumptions in our initiation note, published on 11 November 2016, *Carpe Diem*.

GGM 91.4p

- **Gordon Growth Model:** Our assumptions are given in the table below. The only change since our last report has been to increase the RoE by 1.5% to 31.5% to reflect the reduction in equity under IFRS9. The book value has fallen primarily because of the IFRS9 adjustment, with a modest additional reduction from the higher dividend assumptions.

### GGM and sensitivities

|                                | Base         | +1% to RoE   | +1% to CoE   | +0.5% to G   |
|--------------------------------|--------------|--------------|--------------|--------------|
| RoE (%)                        | 31.5         | 32.5         | 31.5         | 31.5         |
| CoE (%)                        | 11           | 11           | 12           | 11           |
| Growth in equity (%)           | 5.5          | 5.5          | 5.5          | 6            |
| P/BV (RoE-G)/(CoE-G)           | 4.7          | 4.9          | 4.0          | 5.1          |
| Discount re near-term perf.    | -10%         | -10%         | -10%         | -10%         |
| P/BV (x)                       | 4.3          | 4.4          | 3.6          | 4.6          |
| BV 2019E (£m)                  | 67.2         | 67.2         | 67.2         | 67.2         |
| <b>Valuation (£m)</b>          | <b>285.8</b> | <b>296.8</b> | <b>241.8</b> | <b>308.3</b> |
| Variance (£m)                  |              | 11.0         | -44.0        | 22.5         |
| <b>Valuation per share (p)</b> | <b>91.4</b>  | <b>94.9</b>  | <b>77.3</b>  | <b>98.6</b>  |

Source: Hardman & Co Research

DDM 101.3p

- **Dividend Discount Model:** We have modestly increased our dividend assumptions, given the 20% increase announced with these results. Our DDM now indicates a value of 101.3p.

SoTP 88.4p

- **Sum-of-the-Parts:** With the IPO of Amigo, there are now direct comparators for two out of NSF's three businesses, although we note that there is not yet a clear public consensus for Amigo. To get to our 2019 calendar equivalent P/E, we have assumed 40% growth in normalised earnings from those announced in the prospectus for the year to March 2018. EL does not have a quoted peer. With many of the characteristics of Amigo (few competitors, strong market position, high risk-adjusted margins), we have ascribed it that rating too (see table below).

## Non-Standard Finance

| SoTP model          |                       |          |         |       |   |
|---------------------|-----------------------|----------|---------|-------|---|
|                     | 2019E earnings (£000) | Multiple | Value   |       | Comment   |
| EL                  | 14,634                | 13.3     | 194,913 |       | Same rating as Amigo                                    |
| LAH                 | 4,321                 | 10.3     | 44,506  |       | Morses Club 2019E (Hardman & Co estimates)              |
| GLD                 | 5,324                 | 13.3     | 70,911  | Amigo | (rating = market cap/1.4x March 2018 adjusted earnings) |
| Central             | -4,253                | 8.0      | -34,020 |       | Should show only moderate growth                        |
| Group               | 20,027                | 13.8     | 276,311 |       |   |
| Value per share (p) |                       |          | 88.4    |       |   |

Source: Hardman & Co Research

Peer comparators range from 65.2p to 90.7p

| Cashflow statement (£000) |                 |              |           |             |           |
|---------------------------|-----------------|--------------|-----------|-------------|-----------|
| Year-ended 31 December    | Share price (p) | Mkt cap (£m) | 2019E P/E | 2019E yield | P/last BV |
| NSF                       | 63              | 223          | 9.8       | 5.1%        | 2.1       |
| PFG                       | 680             | 1722         | 11.2      | 7.0%        | 2.5       |
| Morses Club (Feb'20)      | 168             | 218          | 10.3      | 5.1%        | 3.8       |
| Amigo (estimated)         | 283             | 1350         | 13.3      | n/a         | 6.7       |
| S&U (Jan'20)              | 2500            | 300          | 10.1      | 5.4%        | 2.0       |
| H&T                       | 314             | 117          | 9.6       | 3.9%        | 1.1       |
| Ramsdens                  | 156             | 48           | 9.5       | 4.9%        | 1.7       |
| Average peers             |                 |              | 10.67     | 5.3%        | 2.97      |
| NSF price at peer average |                 |              | 68.3      | 65.2        | 90.7      |

Source: NSF, Hardman & Co Research

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## Status of Hardman & Co's research under MiFID II

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In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public...'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: <http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf>

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.



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