

## 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)	314
Mkt Cap (£m)	197
EV (£m)	385
Free Float	99%
Market	Main

## 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

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## 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

Early August	Interim results
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## Analysts

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## Non-Standard Finance plc

## 1H'18 preview: costs 1H-weighted, revenue 2H

We preview the 1H'18 results due in early August. The 18 June trading update confirmed trading was consistent with FY guidance, but we think investors should recognise the split between 1H and 2H. We forecast that NSF will deliver 46% of FY'18 revenue in 1H'18 and 46% of impairments, but 50% of costs and 49% of finance costs; thus, we estimate 18% of group 2018 PBT in 1H'18 and 82% in 2H'18. The revenue split reflects business seasonality and payback for investment. Impairments reflect IFRS9 taking more provisions upfront when loans are added. Costs reflect the timing of investments in each division, operational normalisation in EL, and guarantor loans synergies. We make no changes to 2018 estimates.

- **FY guidance unchanged:** We note that the trading statement on 18 June and the 14 May AGM reiterated comfort with FY'18 consensus. Management should have good visibility on the FY, given pipelines and year-to-date actuals.
- **1H'18E below 2H'18E:** With 1H'18 forecast to show below half of FY'18 revenue but around half of costs and financing, the balance of profits is more 2H-skewed. As we explain in this note, investors should not be concerned about this and, on the back of the recent trading statement, we do not expect consensus 2019 estimates to change. Our 2019E £24.8m PBT is 5% above 2H'18E annualised.
- **Valuation:** Our absolute valuation measures for NSF range from 100p-103p per share. Until consensus adopts a uniform IFRS9 approach across all companies, peer comparisons have limited value.
- **Risks:** For all lenders, credit risk is key. For the past decade, EL has shown strong growth and controlled impairments. NSF is innovative and may incur losses in piloting products, but these risks are kept proportionate. Regulation is an issue in home credit; 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	95,124	121,682	166,098	197,000
Impairments (incl. IFRS9)	-26,155	-28,795	-39,728	-46,208
Total costs (excl. dep.)	-49,600	-67,706	-85,596	-93,760
EBITDA	19,369	25,181	35,443	50,638
PBT	13,056	13,203	14,424	24,798
Stat. PBT (co. basis)	-9,342	-13,021	-4,196	11,348
Pro-forma norm. EPS (p)	3.37	3.44	3.72	6.40
DPS (p)	1.20	2.20	2.50	3.15
P/adj. earnings (x)	18.7	18.3	16.9	9.8
P/B (x)	0.8	0.9	0.9	0.9
P/tangible book	2.0	2.6	2.6	2.5
Yield	1.9%	3.5%	4.0%	5.0%

Source: Hardman &amp; Co Research

## Everyday Loans

<b>Figure 1: Everyday Loans (EL)</b>			
<b>(£000)</b>	<b>1H'18E</b>	<b>2H'18E</b>	<b>% in 1H</b>
Business revenue	35,000	41,305	46%
Impairments	-6,845	-8,035	46%
FRS9 impairment	-684	-803	46%
Revenue less impairments	27,471	32,466	46%
Administration expenses	-17,601	-16,910	51%
Operating profit	9,870	15,556	39%
Net finance costs	-6,364	-6,624	49%
Profit before tax	3,506	8,932	28%
Income tax	-666	-1,697	28%
Segment profit (loss) post-tax	2,840	7,235	28%

Source: Hardman & Co Research

We forecast that EL will deliver 46% of FY'18 revenue in 1H'18, with the 11 branches opened in 1H'18 only really starting to deliver meaningful revenue in 2H. The network has 20 more branches open now than a year ago, and we assume that 2H revenue will be up 18% on 1H. Impairments under IFRS9 will follow a similar trend, with 2H seeing a greater hit, as IFRS9 takes more provisions – as loans are added to the books. We assume costs will be 51% of the FY total, given that the timing of the branch openings was largely in 1Q (thus significant ongoing costs in 1H), but the additional one-off costs will all be in 1H. These include factors such as legal work, recruitment and training of new staff, and some fit-out costs. Given loan growth, we have assumed a slight bias in funding costs to 2H.

## Loans at Home

<b>Figure 2: Loans at Home (LAH)</b>			
<b>(£000)</b>	<b>1H'18E</b>	<b>2H'18E</b>	<b>% in 1H</b>
Business revenue	32,593	38,262	46%
Impairments	-9,884	-12,081	45%
FRS9 impairment	-1,275	-1,559	45%
Revenue less impairments	21,434	24,622	47%
Administration expenses	-19,500	-20,500	49%
Operating profit	1,934	4,122	32%
Net finance costs	-977	-938	51%
Profit before tax	957	3,184	23%
Income tax	-191	-595	24%
Segment profit (loss) post-tax	766	2,588	23%

Source: Hardman & Co Research

The drivers for the home collect business are somewhat different. While we again expect revenue growth to reflect business growth, 1H impairments will have a smaller proportion of the FY total than in 2017. With the move to IFRS9, the charge for the key lending in December each year is now taken that year in 2H, whereas, previously (under IAS39), impairment was only taken when there was clear evidence that a loan might not be repaid (i.e. after a series of missed payments). Thus, December 2018 will see the hit for lending in Christmas this year, even though customers may not go into arrears until 2019. We believe management prudently over-resourced support functions as the business took on large numbers of PFG agents in 2H'17. We expect this to be slowly and carefully managed down, as the agents become more embedded and the integration risk moderates. Accordingly, we expect 2H costs in LAH to be only slightly above those in 1H. The funding cost reflects

the timing of when loans are added to the books, as well as the share of set-up fees that are amortised over the life of the new loan facility.

## Guarantor Loans business

**Figure 3: Guarantor loans business**

(£000)	1H'18E	2H'18E	% in 1H
Business revenue	8,712	10,227	46%
Impairments	-1,413	-1,471	49%
FRS9 impairment	-495	-515	49%
Revenue less impairments	6,804	8,241	45%
Administration expenses	-3,850	-3,650	51%
Operating profit	2,954	4,591	39%
Net finance costs	-2,350	-2,350	50%
Profit before tax	604	2,241	21%
Income tax	-115	-426	21%
Segment profit (loss) post-tax	489	1,815	21%

Source: Hardman & Co Research

Chart 21 of NSF's [FY17 results presentation](#) shows the strong growth in the guarantor loans business that was transformed by the acquisition of George Banco on 17 August 2017. We assume that this growth will continue and that revenue will therefore be biased to 2H. However, we assume a slightly higher proportion of the year in impairments in 1H, given the timing of loan book additions and the fact that IFRS9 takes more of these when the loan is first made (revenue, of course, being spread over the life of the loan). December is usually a quiet month for guarantor loans, so we have assumed a 49%:51% split in impairments. We assume that more synergy benefits will come through in 2H to offset the natural 2H bias in costs, creating a broadly even split over the year.

## Central costs

We have assumed an even split of central costs, taking them to £2.5m in each half.

## Group summary

**Figure 4: Group summary**

(£000)	1H'18E	2H'18E	% in 1H
Business revenue	76,305	89,793	46%
Impairments	-18,142	-21,586	46%
FRS9 impairment	-2,454	-2,877	46%
Revenue less impairments	55,709	65,330	46%
Administration expenses	-43,451	-43,560	50%
Operating profit	12,258	21,769	36%
Net finance costs	-9,691	-9,912	49%
Profit before tax	2,567	11,857	18%
Income tax	-497	-2,243	18%
Segment profit (loss) post-tax	2,070	9,614	18%

Source: Hardman & Co Research

## Financials and valuation

Our FY forecasts are unchanged from the trading statement on 18 June. A detailed statutory profit and loss and cashflow statement are available in our recent [FY17 Results Note](#), as are the valuation parameters and assumptions.

**Figure 6: Normalised profit and loss (£000)**

Year-end 31 December	2016	2017	2018E	2019E
Business interest income	94,674	119,756	166,098	197,000
Other operating income	450	1,926	0	0
Fair value unwind on acquired portfolios	0	0	0	0
<b>Total revenue</b>	<b>95,124</b>	<b>121,682</b>	<b>166,098</b>	<b>197,000</b>
Underlying business impairments	-23,155	-28,054	-38,987	-45,467
Unwind of provision discount	-3,000	-741	-741	-741
Business impairments	-26,155	-28,795	-39,728	-46,208
IFRS9 impairments			-5,331	-6,393
<b>Gross profit</b>	<b>68,969</b>	<b>92,887</b>	<b>121,038</b>	<b>144,399</b>
Administration expenses	-50,290	-69,203	-87,011	-95,488
Amortisation of intangibles	0	0	0	0
<b>Operating profit</b>	<b>18,679</b>	<b>23,684</b>	<b>34,027</b>	<b>48,910</b>
EBITDA	19,369	25,181	35,443	50,638
Exceptional items				
Net finance (cost)/income	-5,623	-10,481	-19,603	-24,112
<b>Profit before tax</b>	<b>13,056</b>	<b>13,203</b>	<b>14,424</b>	<b>24,798</b>
Income tax	-2,688	-2,313	-2,741	-4,712
<b>Profit after tax</b>	<b>10,368</b>	<b>10,890</b>	<b>11,684</b>	<b>20,087</b>

Source: NSF, Hardman & Co Research

**Figure 7: Balance sheet (£000)**

@ 31 December	2015	2016	2017	2018E	2019E
<b>Non-current assets</b>					
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	11,519	11,519
<b>Total non-current assets</b>	<b>56,013</b>	<b>154,941</b>	<b>167,307</b>	<b>159,064</b>	<b>153,906</b>
<b>Current assets</b>					
Inventories	3	-	-	-	-
<b>Amounts receivable from customers</b>	<b>28,412</b>	<b>180,413</b>	<b>259,836</b>	<b>293,620</b>	<b>357,247</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	2,599	1,036
Total current assets	46,010	196,381	280,601	306,521	372,429
<b>Total assets</b>	<b>102,023</b>	<b>351,322</b>	<b>447,908</b>	<b>465,584</b>	<b>526,335</b>
<b>Current liabilities</b>					
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>294,168</i>	<i>358,076</i>
<b>Non-current liabilities</b>					
Financial liabilities – borrowings	-	87,300	199,316	228,816	288,816
Deferred tax	-	6,793	4,996	2,479	852
<b>Total non-current liabilities</b>	<b>-</b>	<b>94,093</b>	<b>204,312</b>	<b>231,295</b>	<b>289,668</b>
Total liabilities	16,860	102,239	214,665	243,648	304,021
<b>Net assets*</b>	<b>85,163</b>	<b>249,083</b>	<b>233,243</b>	<b>221,937</b>	<b>222,314</b>

Source: NSF, Hardman & Co Research \* incl. £255k of non-controlling Interests

## Valuation

*Average valuation potential upside on absolute measures 61%*

Our absolute valuation techniques imply average upside potential of 61%. At present, we do not believe peer valuations are helpful, as it is unclear to what extent consensus is consistently applying IFRS9 across all companies. We note that the profit growth profile of both EL and the guarantor loans businesses is materially faster than the consensus forecasts for the quoted non-standard consumer credit companies as a whole, and investors should consider the appropriate rating for such growth once a consistent approach to accounting has been adopted.

**Figure 8: Summary of different valuation techniques**

	Implied price (p)	Upside potential (%)
Gordon Growth Model (GGM)	102.5	63%
Discounted Dividend Model (DDM)	100.4	59%
Average absolute measures	101.4	61%

*Source: Hardman & Co Research*

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