20th October 2017

Morses Club

Building a profitable and sustainable franchise

The key message from the H1FY18 results is that it confirms MCL's fundamental approach to business. It is building a long-term franchise, carefully assessing risk and returns and prioritising resource to the most value-added area. In this period, the unique opportunity in home collect credit (HCC) was clearly the priority. Book acquisitions and some other new product areas were temporarily less of a management focus although we expect growth from them in due course. The modest online lending pilot is still in pilot stage and will be rolled out carefully. FY19 estimates are broadly unchanged (EPS up 24% on FY17).

- **HCC agent opportunity:** MCL confirmed that nearly 600 agents and managers joined (filling vacancies and replacing some underperforming agents the net territory builds was c400). Critically these agents have been added without disruption to the existing HCC business and are performing ahead of plan.
- **Other growth plans:** There were no acquisitions in the period. This partially reflected market conditions and also the management focus on new agents which provide a longer-term revenue stream. H1FY18 was primarily a period of developing and integrating IT and risk model testing in the online loan area.
- **Valuation:** Our range of absolute valuation approaches indicate a fair value would be around 178p (previously 177p) with the Gordon's Growth Model (which capture both value added and growth) having the highest valuation at 198p. Both have increased sharply with the higher earnings and equity forecast.
- **Risks:** Credit risk is high (albeit inflated by accounting rules) but MCL adopts the right approach. Regulatory risk is a factor. HCC has already been reviewed and high customer satisfaction suggests limited need for change. MCL was the first major HCC company to get a full FCA authorisation.
- **Investment summary:** We believe MCL is operating in an attractive market and has a dual-fold strategy which should deliver an improved performance from existing businesses and over time deliver new growth options. MCL conservatively manages risk and compliance, especially in new business areas. The agent network is the competitive advantage over remote lenders. The valuation has material upside. Our 2018E dividend yield is 5.2% with cover of. 1.9x (adj. EPS).

Financial summary and valuation

Year end Feb (£m)	2015	2016	2017	2018E	2019E
Reported revenue	89.9	90.6	99.6	114.1	125.8
Total impairments	-22.9	-18.8	-24.3	-31.4	-34.0
Total costs	-51.4	-53.4	-56.7	-63.4	-68.5
EBITDA	16.5	19.3	19.9	20.7	24.9
Adjusted pre tax	13.0	16.8	17.7	18.1	21.6
Statutory pre tax	58.5	21.2	11.2	13.4	14.8
Statutory EPS (p)	46.5	6.1	6.6	8.3	9.2
Adj EPS (p)	8.1	10.2	10.8	11.2	13.3
P/ Adj Earnings (x)	16.5	13.1	12.4	12.0	10.0
P/BV (x)	1.8	3.1	2.8	2.7	2.7
P/tangible book	2.0	3.9	3.4	3.1	2.9
Yield	n/m	n/m	4.8%	5.2%	5.7%

Source: Hardman & Co Research

Financial Services

Source: Eikon Thomson Reuters

Market data

EPIC/TKR	MCL
Price (p)	134.0
12m High (p)	154.8
12m Low (p)	84.6
Shares (m)	129.5
Mkt Cap (£m)	173.5
EV (£m)	159.5
Free Float*	44%
Market	AIM

**As defined by AIM Rule 26*

Description

MCL is number two in UK home credit. It is growing this business organically and by acquisition, and is developing a range of related products where it has competitive advantage.

Company information

CEO	Paul Smith
CFO	Andy Thomson
Non Exec Chair	Stephen Karle

Tel number +44 (0)330 045 0719
www.morsesclubplc.com

Key shareholders

Perpignon Limited	51.00%
Schroder Investment Mgt	10.03%
Miton Asst Mgt	6.72%
JO Hambro	5.16%
Andy Thomson	4.38%
Soros Fund Mgt	4.03%
Blackrock	3.51%

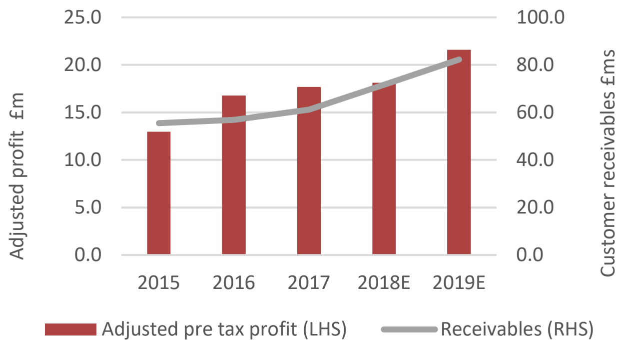
Next event

Early March 2018	Trading update
End April	FY results

Analysts

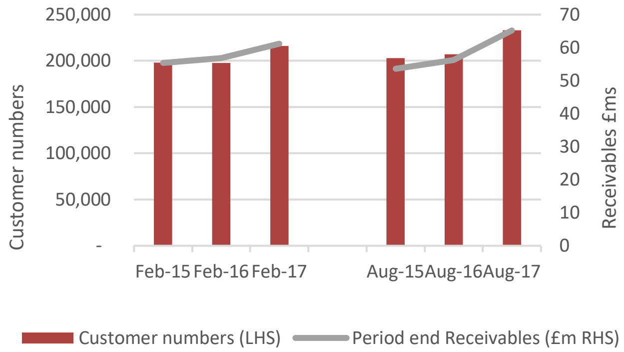
Mark Thomas 020 7194 7622
mt@hardmanandco.com
Dr Brian Moretta 020 7194 7622
bm@hardmanandco.com

Adjusted pre-tax profits and customer receivables (£ms) 2015-2019e



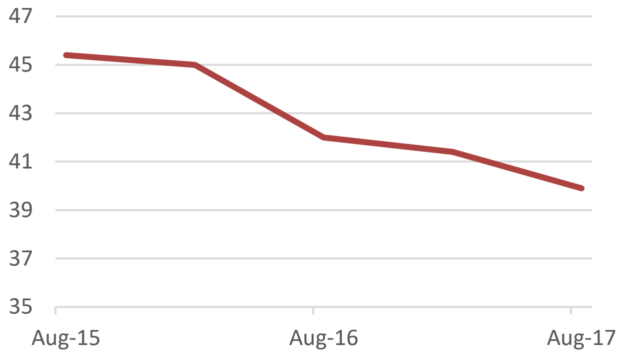
- 2018e reflects partial benefit from new agents offset by less acquisition and new product growth. Management had previously built capacity which managed new hires without operational disruption in core HCC business.
- 2019e profits up as new agents deliver full period revenue benefits and with payback from other initiatives.
- 2019 also sees benefits from technology and economies of scale: admin cost growth c2/3rds of income growth.
- Accelerated growth in receivables through 2018 and 2019. We still see upside to our numbers from additional customer acquisition over the Christmas season.

Growth in customer numbers and receivables



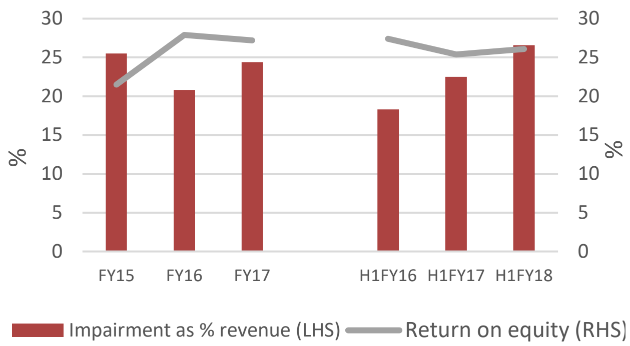
- Seasonal business with peak at Christmas, so this chart shows like for like growth for each accounting period end.
- The six months to August 2017 mainly business as usual growth with the major benefit from PFG hiring still to come.
- Acquisition of books down in H1FY17 but these are likely to be a continuing feature of the business over the medium term.
- New product initiatives being carefully piloted and rolled out. In H1FY18 they added relatively little growth.

Average duration of loans



- Average duration is being managed down – new customers limited to 20/33-week products, the 78-week product only now available to customers who already have this product.
- Falling duration helps increase yield.
- Increase in yield despite reducing higher risk accounts.
- Management expect average duration to stabilise around 40 weeks, so the process is now largely complete.

Returns on Equity and impairments as a percentage of revenue



- MCL is a high ROE business with an average 26% FY15-17 and over 27% over past two years.
- ROE in H1FY18 small uplift on FY17 at 26.1% (25.4%). We expect a sharp increase in ROE in 2019E with the full benefit of FY18 hiring and operational leverage.
- Impairments as a proportion of revenue in H1FY18 increased on the prior year. In this business, growing new customers typically increases initial impairments to revenue. The underlying trend is stable.

Source: Company data; Hardman & Co Research

H1FY18 results (to end August)

Key messages

For us the key message from these results is not the financial performance in the period but rather what it tells us about the business model and management culture. Management has historically made a number of promises as to how it would run the business, each of which was visibly demonstrated in the period.

- **Growth would be carefully controlled**. It is no accident that the growth in territory builds (c20%) was less than the surplus operational capacity that MCL reported end FY17 (28% more customers could be managed). Not all new agents that applied to MCL were accepted (e.g. minimum two years of HCC experience required) and the total growth was such that the core HCC business did not face operational disruption.

- **Resources would be prioritised in areas of optimal return**. The opportunity from the PFG fall-out enhances the agent network and should produce revenue and profit streams that recur over many years. This is clearly a higher priority than building new, untested, product lines or acquiring books of business, some of which is likely to be non-recurring as it does not meet MCLs credit policies.

- **Pilots of new products would be small** until operational experience was gained.

- **Funding risk would be conservatively managed** with facilities arranged well in advance of their being needed. MCL announced on 18th August that it had secured the addition of one of the UK's leading high street lenders to its existing loan facility. Sitting alongside the existing funder, Shawbrook Bank, this increased the overall revolving facility from £25m to £40m. The facility was extended from March 2019 to expire in August 2020.

Financial Highlights

Steady growth with well controlled risk and expenses.

- Revenue up 15% to £54.2m (H1FY17: £47.2m). Total credit issued increased 25% to £82.2m) with the gross loan book up 12%. 12% annual increase in customer numbers to 233k (an increase of 8% on FY16 - 216k). The proportion of loans attributable to the Company's highest tier customers increased by 7% compared to 27 August 2016, reflecting a focus on improving the quality of the book. Net loan book growth of 16% to £65.2m (H1FY17: £56.2m).

- Impairments as a percentage of revenue for the period were 26.6% (FY17: 24.4%), within the target range of 22-27%. A growing business is likely to see higher impairments to revenue and we note that MCL is applying historic experience assumptions to new lending in its new territory builds. Actual customer behaviour indicates this is likely to prove a conservative assumption. Accounting requirements also inflate the charge relative to cash losses and again the effect increases with a growing book. There is no sign of underlying credit strain.

- Costs as a percentage of income declining to 56.4% (FY17: 56.9%, H1FY17 58.3%) an 8% efficiency improvement on the prior year.

- Adjusted profit before tax increased to £8.7 (H1FY17: £8.6m). Excluding temporary agent costs and the Dot Dot investments, there was an 18% growth in adjusted PBT to £10.9m (from £9.2m). The reported profit before tax £6.7m (H1FY17: £4.6m). Adjusted EPS 5.3p (H1FY17: 5.3p); Basic EPS 3.9p (H1FY17: 2.7p). Proposed dividend of 2.2p (H1FY17: 2.1p).

Company KPI'S and targets

We detail below the key KPI's outlined by the company and a couple of additional measures. We highlight a strong profitability (ROA c 20%) which we believe will be improved with operational efficiency, economies of scale and potentially more debt gearing.

Figure 1: Company KPIs and targets

KPI	2015	2016	2017	H1FY18	Comment
Adjusted profit before tax (£m)	13.0	16.8	17.7	8.7	Impairments revert to norm
Adjusted EPS (p)	8.1	10.2	10.8	5.3	As above
Admin Cost Income ratio (%)	36.5%	36.8% *	33.1%*	32.5%	Productivity improvement and economies of scale
Return on assets (%)	15.5%	20.2% *	19.5%	19.4%	Should increase with operational efficiency
Return on equity (%)	21.5%	27.9% *	27.2%	26.1%	Should increase with improving operational efficiency and potentially more debt gearing in due course
Tangible equity / avg recs (%)	n/m	85.3%	93.5%	90.0%	Should reduce with more debt gearing
Number of customers	198,171	198,727	216,000	233,000	Includes growth in 18-35 yr olds
Number of agents	1,893	1,839	1,826	2,124	Management focus is on attracting high quality agents.
Credit Issued (£ms)	112.0	122.2	144.1	82.3	Up 25% (was 18% for FY 17)
Impairment / revenue (%)	25.5%	20.8%	24.4%	26.6	Target range 22-27%
Period end receivables (£m)	55.6	56.8	61.2	65.2	12% growth in year over what is normally quiet period

Source: MCL, Hardman & Co Research

Impact on estimates

The major driver to estimate revisions is the inclusion of the c400 territory builds associated with the recent hires offset by higher funding costs (with new lending debt financed), lower acquisition growth and a deferral of new product stream income. We have not included incremental customer numbers gained through PFG's focus on collections over sales over Christmas although we expect upside from this.

Figure 2: Estimate changes

	2018e			2019e		
	Old	New	% change	Old *	New	% change
Profit and Loss (£'000s)						
Reported revenue	107.3	114.1	6%	115.3	125.8	9%
Total impairments	(27.9)	(31.4)	13%	(30.9)	(34.0)	10%
Total costs	(59.6)	(63.4)	6%	(61.9)	(68.5)	11%
EBITDA	21.2	20.7	-2%	24.1	24.9	3%
Adjusted pre tax	18.8	18.1	-4%	21.4	21.6	1%
Statutory pre tax	14.1	13.4	-5%	14.6	14.8	1%
Statutory EPS (p)	8.7	8.3	-5%	9.1	9.2	1%
Adj EPS (p)	11.6	11.2	-4%	13.2	13.3	1%
Div (p)	7.0	7.0	0%	7.7	7.7	0%
Balance Sheet (£ms)						
Amounts Receivable	68.1	71.7	5%	78.4	82.3	5%
Borrowings	11.5	13.5	17%	17.5	20.0	14%
Equity	63.7	63.2	-1%	65.7	65.3	-1%

Source: Hardman & Co Research Equity change reflects timing of dividend which we had incorrectly included in FY17

Outlook

Opportunity from market changes

There have already been incremental agent and field manager hiring increasing the franchise by c20%.

Provident Financial Group (PFG) has inflicted two distinct, but compounding, stages of self-harm. Firstly, they tried to change over a hundred years of culture and replace self-employed, often part-time agents with an employed, largely full-time, model. This has resulted in significant numbers of dis-satisfied staff leaving PFG, with MCL cherry picking those with the best cultural / economic fit. The benefit of this has already been seen, with MCL reporting nearly 600 agent and manager hires and a net 411 territory builds adding c20% to its franchise. It is worth noting that this is twice the highest sensitivity analysis we built into our review on MCL in May (Opportunities Abound).

It is also worth noting that the new agents are already performing ahead of plan. Our base assumption had been that there would need to be carry cost of new incentives for their first year. This now appears to be offset by greater than expected performance with the net effect that the impact on FY18 earnings from the new agents is neutral. MCL had previously reported an infrastructure capacity headroom of close to 30% which means the extra staff have been incorporated with no material disruption to the ongoing business, again helping protect 2018 earnings.

With PFG's second profit warning we see a further opportunity (not in current numbers) from customers who may otherwise have stayed with PFG now coming over to MCL. We will only build this into estimates when there is greater transparency on actual movements (probably with the first trading update in 2019).

The second leg of PFG's problems arose when implementing the change in strategy. The IT systems did not work well and inexperienced customer relationship managers proved much less effective than expected (although the read across from NSF should have given fair warning that this could happen). This creates an incremental and compounding opportunity for MCL over and above the agent hires reported with these results. Critically over Christmas PFG appears likely to be focussed on collections and not sales which means that many customers who may otherwise have stayed with PFG may now have to find an alternative loan provider. It is also probable that further agents will become dissatisfied especially, if their customers are unable to get critical Christmas finance. MCL has the agent network, funding in place and infrastructure to effectively manage this growth. There is the potential for further economies of scale with more customers served by the fixed-cost infrastructure. We detail below a range of sensitivities and will include this upside when there is greater visibility.

Figure 3: Scenarios of incremental agents on 2019 estimates (adjusted profit basis)

No of additional agents	**Base**	**+10,000**	**+20,000**	**+30,000**
No customers	280,000	290,000	300,000	310,000
Loan book (£ms)	82.3	85.2	88.1	91.1
Total revenue	125.8	130.3	134.8	139.3
Impairment charge (exc FRS9)	(34.0)	(35.5)	(37.1)	(38.7)
Agent commission	(28.9)	(30.3)	(31.3)	(32.4)
Gross profit	62.9	64.5	66.3	68.2
Administration expenses pre excep and intang amortisation	(38.0)	(38.4)	(38.6)	(38.8)
Depreciation (inc goodwill impairment, amortis of IT)	(1.6)	(1.6)	(1.6)	(1.6)
Operating profit pre excep and amortisation	23.3	24.5	26.2	27.8
Adjusted financing costs	(1.7)	(1.9)	(2.2)	(2.4)
Adjusted profit before tax	**21.6**	**22.6**	**24.0**	**25.4**
Income tax	(4.3)	(4.5)	(4.8)	(5.1)
Adjusted post tax profit	**17.3**	**18.0**	**19.2**	**20.3**
V base		**4%**	**11%**	**18%**

Source: Hardman & Co Research

To add to the fog of uncertainty, it is unclear what PFG will, and can, do about its own issues. Management there is clearly committed to stabilising and re-building its business and has already made senior management appointments. It has all the data to carefully target its historic agents / managers to pick off the best ones and entice them back with financial incentives. An extra £10m-£20m in PFG's costs may prevent a much larger franchise loss but it would reduce MCL's opportunity to take share.

Business as usual trends

Profit growth options in core HCC

No book acquisitions, but this is temporary issue. Over medium term we expect significant reduction in number of providers

In H1FY18 MCL made no loan book acquisitions (H1FY17 there were three, with receivables of £3.3m c6% of total book). The market had slowed in FY17 and it is likely that some smaller players will be waiting to see the fall-out from PFG before deciding to sell. They could reasonably be expecting more business and so a higher value. Additionally, MCL management has been more focussed on effectively managing the short-term opportunity from the released PFG agents. Looking forward, as the regulator moves to more intensive supervision (rather than approval) there may be more opportunities probably in FY19 /FY20. We do not expect there to be 400 HCC providers over the medium term.

New product areas

Morses Club card growth continuing at c5k per six months.

We note that Morses Club Card sales (H1FY18 - 11k cards in issue, H1FY17 c5k) have been steady. It now accounts for £4.6m of lending and has proved especially popular with the 18-35 year old age bracket.

Online lending now launched and in trial period to gather data before accelerating growth in due course

Online lending activities were accelerated with the Shelby acquisition in January 2017. The low-cost, low-risk, soft launch (branded Dot Dot Loans in March) saw activity primarily around building the right IT infrastructure, linkages and risk models. Over time the build-up of data and experience is likely to see an acceleration of lending, as the online brand attracts leads based on its own compelling offer in the market, rather than being reliant on the MCL website and branding which has a different customer demographic. Management is reviewing how to optimise the online business but with management focus on the HCC in H1FY18 the timing of our previous assumptions may now be somewhat delayed.

Looking at range of products to sell to customer base and likely to involve partnerships who have the product but not the customer base

With the FY17 results management advised it was advancing new products which may be directly related to its customer base but which are not HCC related. In particular, there was commentary about products offering discounts, rewards schemes, banking services and price comparisons. With these results, this opportunity was again mentioned but we believe it will not be actively pursued until FY19.

Customer, agent and staff satisfaction

Management highlighted the importance of motivated staff as well as customers (97% are either very or quite satisfied with the service). In particular there has been an improving trend in all aspects of engagement with an overall agent satisfaction rate of 77% (up from c70% two years ago). Interestingly, the first poll of territory builds indicated a 92% overall satisfaction level suggesting the new agents are likely to prove sticky to MCL should PFG attempt to lure them back.

Financials

Profit & Loss

Figure 5: Profit and Loss (£ms)

Year ended February	2015	2016	2017	2018E	2019E
Existing operations	22.5	84.7	96.2	114.1	122.5
Acquisitions during period	67.4	5.8	3.3	0	3.3
Total revenue	**89.9**	**90.6**	**99.6**	**114.1**	**125.8**
Impairment charge	(22.9)	(18.8)	(24.3)	(31.4)	(34.0)
Agent commission	(17.7)	(19.2)	(22.4)	(28.0)	(28.9)
Gross profit	**49.3**	**52.6**	**52.9**	**54.7**	**62.9**
Administration expenses pre excep and intang amortisation	(32.8)	(33.3)	(33.0)	(34.0)	(38.0)
Depreciation (inc goodwill impairment, amortis of IT)	(0.9)	(0.9)	(1.3)	(1.4)	(1.6)
Operating profit pre excep and amortisation	**15.6**	**18.4**	**18.6**	**19.3**	**23.3**
Adjusted financing costs	(2.6)	(1.6)	(0.9)	(1.2)	(1.7)
Adjusted profit before tax	**13.0**	**16.8**	**17.7**	**18.1**	**21.6**
Income tax	(2.7)	(3.5)	(3.7)	(3.6)	(4.3)
Adjusted post tax profit	**10.3**	**13.3**	**14.0**	**14.5**	**17.3**
Impairments as % revenue	-25%	-21%	-24%	-28%	-27%
Agent cost as % revenue	-20%	-21%	-23%	-25%	-23%
Admin cost as % revenue	-36.5%	-36.8%	-33.1%	-29.8%	-30.2%
Total costs as % revenue	-56%	-58%	-56%	-54%	-53%
Finance costs as % average debt	n/m	n/m	9.5%	10.2%	10.1%
Revenue yield (revenue as % average receivables)	n/m	164%	170%	173%	164%
Number of clients	198,171	198,727	216,000	260,000	280,000
No agents	1,893	1,839	1,826	2,200	2,250
Adj Profit per client	66	84	82	70	77
Receivables per agent	29,310	30,903	33,531	32,570	36,558

Source: MCL, Hardman & Co Research

Impact of gross up

Management has previously highlighted that the accounting requirement to gross up income and then provide against it (in situations where the customer has missed a payment but is still expected to repay) distorts the balance sheet and profit and loss. As can be noted in the figure below, with a growing book, the distortion increases.

Figure 6: Underlying asset value

£m	Feb 16	Aug 16	Feb 17	Aug 17
Gross balances *	117.6	114.3	122.9	127.8
Gross cash projection **	**87.8**	**86.6**	**93.9**	**99.1**
Impact of discounting	(31.0)	(30.4)	(32.7)	(34.0)
IFRS bal. sheet value	**56.8**	**56.2**	**61.2**	**65.1**
Marginal impact on P/L of discounting		0.6	-2.3	-1.3

*Source: Hardman & Co Research * cash amount contractually due, ** cash actually expected to be received*

IFRS9 impact

Will impact on 2019 statutory earnings

IFRS 9 will replace IAS 39 as the accounting standard governing the classification, measurement, impairment and hedge accounting of financial instruments, including loan assets. IFRS 9 will take effect for accounting periods commencing 1 January 2018 (MCL's relevant year end will commence on 1 March 2018 and so the effect will be on results reported as FY19). MCL does not intend to adopt any changes in respect of IFRS 9 prior to this time. There has been some market commentary on IFRS 9 and the impact it may have on MCL.

- Neither we, nor the company nor its auditors, yet have a clear vision as to its impact. Any numerical estimates are thus highly speculative.

- The accounting does not impact on actual cash flow or losses. IFRS 9 is likely to bring forward impairments, and thus defer profit recognition, but it does not change ultimate losses.

- There remains significant discretion in timing of taking provisions. Taking a much oversimplified example Figure 6 gives an example where a company is expected to lose £10 on its portfolio of £100. In all scenarios, the ultimate loss of £10 is recognised so each approach may be argued as being fair. However, one company could take provisions when customers have early arrears while another when the loss is much closer to being crystallised.

Figure 7: Discretion remains re timing of provisions

	Period 1	Period 2	Period 3	Period 4
Performing book	60	70	80	90
Book in arrears	40	30	20	10
Provision required	10	10	10	10
Provision rate of arrears book	25%	33%	50%	100%

Source: Hardman & Co Research

- There is an argument that for a constantly growing business under IFRS 9 the amount of accelerated provision will always exceed the unwind of previously accelerated provisions and so profits will permanently be impaired. Figure 7 gives a simplified example where the extra provisions associated with growth impact on each year's profit and loss. This argument though is intellectually flawed because the actual cashflows and losses are unchanged. At some stage in the future the accelerated provisions would have been recognised.

Figure 8: Impact of IFRS9 is negative if book grows

	Period 1	Period 2	Period 3	Period 4
Accelerated provisions	-20	-25	-30	-35
Provisions that would have been recognised in period	0	20	25	30
Net impact on P/L	-20 *	-5	-5	-5

*Source: Hardman & Co Research * in practice this is likely to be taken as a prior year balance sheet re-statement*

Taking a slightly more practical example of a business growing at 10% per annum which under the current accounting policy would over the next three years would be required to take provisions of £20.0m, £22.0m and£24.2m respectively. If IFRS9 increased the provisioning by 5%, the new charges would be £21.0m-£23.1m-£25.4m. For this growing business, the <u>incremental</u> P&L charges also increase from £2.0m (£20m year 1 to £22m in year 2) and £2.2m (£22m in year 2 to £24.2m in year 3) to £2.1m (£21m to £23.1m) and £2.3m (£23.1m to £25.4m).

Balance Sheet

Figure 9: Balance sheet (£000s)

Year ended February	2015	2016	2017	2018E	2019E
Non-current					
Goodwill	294	1,326	2,834	2,834	3,500
Intangible assets	10,391	9,052	7,058	4,209	1,481
Property Plant and equipment	936	1,182	763	882	941
Amounts receivable from customers	1,507	679	395	300	200
Total Non-current assets	**13,128**	**12,239**	**11,050**	**8,224**	**6,122**
Current assets					
Receivables	**53,976**	**56,152**	**60,833**	**71,353**	**82,056**
Trade / other receivables	26,216	1,554	2,019	1,554	1,554
Cash and cash equivalent	8,650	3,755	3,985	3,076	4,099
Total current assets	88,842	61,461	66,837	75,983	87,708
Total assets	**101,970**	**73,700**	**77,887**	84,207	93,830
Current liabilities					
Trade and other payables	(3,274)	(7,452)	(5,892)	(6,892)	(7,892)
Total current liabilities	**(3,274)**	**(7,452)**	**(5,892)**	**(6,892)**	**(7,892)**
Net Current (liabilities) / assets	85,568	54,009	60,945	69,091	79,816
Non-current liabilities					
Financial Liabilities – borrowings	-	(9,000)	(10,000)	(13,500)	(20,000)
Deferred tax	(2,614)	(1,879)	(617)	(617)	(617)
Total non-current liabilities	(2,614)	(10,879)	(10,617)	(14,117)	(20,617)
Total liabilities	**(5,888)**	**(18,331)**	**(16,509)**	**(21,009)**	**(28,509)**
Net assets	**96,082**	**55,369**	**61,378**	**63,198**	**65,321**

Source: MCL, Hardman & Co Research

Figure 9 details the expected balance sheet. Compared with our last 2018 estimates we have increased receivables by c£10m to reflect new agent loans (this equates to £25k per agent against a stock of £33.5k per existing agent at end FY17). Receivables though have been reduced by £7m for lower book acquisitions and online lending growth.

The net increase is thus c£3m (5%). In FY19 we have carried these trends forward generating a net increase of £4m in lending in that year. We have assumed all the net new lending is largely debt financed, thus increasing borrowings. The proportionate increase in debt is much higher (14% v 5% increase in loans) as it starts at a lower nominal base. The cost from this incremental funding partially offsets the operational leverage noted in the profit and loss section.

Cashflow

The strong lending requires funding but, as can be seen, the strong profitability of the business largely covers this.

Figure 10: Cashflow (£000s)

Year ended February	2015	2016	2017	2018E	2019E
Profit (loss) before tax	58,565	10,374	11,219	13,450	14,775
Depreciation,	596	736	544	382	441
Impairment of goodwill	56	42	-	-	-
Amortisation of intangibles	8,574	5,683	4,412	3,946	3,825
Share based payment expense	-	-	126	126	126
Gain on acquisition	(51,961)	(32)	-	-	-
Loss on disposal of plant property and equipment	40	146	134	-	-
(Increase)/decrease in debtors	(14,803)	27,532	(1,918)	(6,258)	(7,517)
Dividend in Specie to Perpignon	-	(31,129)	-	-	-
Increase / decrease in creditors	4,768	2,548	(1,640)	(1,000)	(1,000)
Interest paid	1	647	927	1,200	1,700
Taxation paid	(800)	(1,737)	(4,078)	(4)	(4)
Net cash inflow / (outflow) from operating activities	**5,036**	**14,810**	**9,726**	**11,841**	**12,345**
Cashflows from investing activities					
Purchase of intangibles	(416)	(2,523)	(1,029)	(759)	(1,425)
Purchase of property, plant and equipment	(343)	(1,152)	(125)	(500)	(500)
Disposals of assets	-	501	-	-	-
Purchase of subsidiaries	-	(7,383)	(5,695)	(5,000)	(5,000)
Cash acquired on acquisitions	5,120	-	-	-	-
Net cash outflow from investing activities	**4,361**	**(10,558)**	**(6,849)**	**(6,259)**	**(6,925)**
Cashflows from financing activities					
Net borrowing	-	9,000	1,000	3,500	6,500
Interest Paid	(1)	(647)	(927)	(927)	(927)
Dividends	(2,000)	(17,500)	(2,720)	(9,065)	(9,972)
Net cash inflow from financing activities	**(2,001)**	**(9,147)**	**(2,647)**	**(6,492)**	**(4,399)**
Net increase in cash and cash equivalents	7,396	(4,895)	230	(909)	1,022
Opening cash and cash equivalents	1,253	8,650	3,755	3,985	3,076
Closing cash and cash equivalents	8,650	3,755	3,985	3,076	4,099

Source: MCL, Hardman & Co Research

Valuation

Average valuation upside on absolute measures 32%

We detailed all the assumptions used in our valuation methodologies in our note Bringing home collect into the 21st century. Post these results' changes, our absolute valuation techniques now imply an average of 178p (previously 177p). The peer valuations indicate c157p (previously 165p) with the decrease driven by the collapse in PFG's share price and ratings exceeding the cuts to estimates.

Figure 11: Summary of different valuation techniques

	Implied Price (p)	Upside (%)
Gordon's Growth	198.2	48%
DDM	156.7	17%
Average absolute measures	**177.5**	**32%**
Peer 2017 PE	133.8	0%
Peer 2017 yield	180.1	34%
Average of peers	**156.9**	**17%**

Source: Hardman & Co Research

Gordon's Growth Model

Figure 12: Gordon's Growth model and sensitivities

	Base	+1% ROE	+1% COE	+0.5% G
Return on Equity (%)	25	26	25	25
Cost of Equity (%)	11	11	12	11
Growth (%)	5.5	5.5	5.5	6
Price/Book Value (x)	3.5	3.7	3.0	3.8
Premium for near term out-performance (%)	20%	20%	20%	20%
P/BV (x)	4.3	4.5	3.6	4.6
BV 2019 (£m)	60.3	60.3	60.3	60.3
Valuation (£m)	256.7	269.9	217.2	275.1
Valuation per share (p)	198	208	168	212
Variance (per share)		10.2	-30.5	14.2

Source: Hardman & Co Research

Broad peer comparisons

Figure 13: Peer valuation comparisons

	Shr price (p)	Market Cap (£m)	2018 PE (X)	2018 Yield (%)
Morses Club (Feb 18)	134	173.5	10.0	5.7%
NSF (Dec)	881	1306	8.6	3.2%
PFG (Dec)	78.75	250	10.5	4.6%
S&U (Jan 18)	1990	239	8.6	5.8%
H&T	327	122	12.4	3.5%
Peer average			10.0	4.3%
MCL at peer average (p)			133.8	180.1

Source: Hardman & Co Research

Disclaimer

Hardman & Co provides professional independent research services. Whilst every reasonable effort has been made to ensure that the information in the research is correct, this cannot be guaranteed.

The research reflects the objective views of the analysts named on the front page. However, the companies or funds covered in this research may pay us a fee, commission or other remuneration in order for this research to be made available. A full list of companies or funds that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/

Hardman & Co has a personal dealing policy which debars staff and consultants from dealing in shares, bonds or other related instruments of companies which pay Hardman for any services, including research. They may be allowed to hold such securities if they were owned prior to joining Hardman or if they were held before the company appointed Hardman. In such cases sales will only be allowed in limited circumstances, generally in the two weeks following publication of figures.

Hardman & Co does not buy or sell shares, either for its own account or for other parties and neither does it undertake investment business. We may provide investment banking services to corporate clients.

Hardman & Co does not make recommendations. Accordingly, we do not publish records of our past recommendations. Where a Fair Value price is given in a research note this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities/companies but has no scheduled commitment and may cease to follow these securities/companies without notice.

Nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell securities by us.

This information is not tailored to your individual situation and the investment(s) covered may not be suitable for you. You should not make any investment decision without consulting a fully qualified financial adviser.

This report may not be reproduced in whole or in part without prior permission from Hardman &Co.

Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the Financial Conduct Authority (FCA) under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259. However, the information in this research report is not FCA regulated because it does not constitute investment advice (as defined in the Financial Services and Markets Act 2000) and is provided for general information only.

Hardman & Co Research Limited (trading as Hardman & Co)
35 New Broad Street
London
EC2M 1NH
T +44 (0) 207 194 7622

Follow us on Twitter @HardmanandCo

(Disclaimer Version 2 – Effective from May 2017)

Hardman Team

Management Team			
+44 (0)20 7194 7622			
John Holmes	jh@hardmanandco.com	+44 (0)207 194 7629	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)207 194 7630	CEO

Marketing / Investor Engagement		
+44 (0)20 7194 7622		
Richard Angus	ra@hardmanandco.com	+44 (0)207 194 7635
Max Davey	md@hardmanandco.com	+44 (0)207 194 7622
Antony Gifford	ag@hardmanandco.com	+44 (0)207 194 7622
Vilma Pabilionyte	vp@hardmanandco.com	+44 (0)207 194 7637
Gavin Laidlaw	gl@hardmanandco.com	+44 (0)207 194 7627
Ann Hall	ah@hardmanandco.com	+44 (0)207 194 7622

Analysts

+44 (0)20 7194 7622

Agriculture		**Bonds**	
Doug Hawkins	dh@hardmanandco.com	Brian Moretta	bm@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com	Mark Thomas	mt@hardmanandco.com
Thomas Wigglesworth	tcw@hardmanandco.com		
Building & Construction		**Consumer & Leisure**	
Tony Williams	tw@hardmanandco.com	Mike Foster	mf@hardmanandco.com
Mike Foster	mf@hardmanandco.com	Steve Clapham	sc@hardmanandco.com
		Jason Streets	js@hardmanandco.com
Financials		**Life Sciences**	
Brian Moretta	bm@hardmanandco.com	Martin Hall	mh@hardmanandco.com
Mark Thomas	mt@hardmanandco.com	Gregoire Pave	gp@hardmanandco.com
		Dorothea Hill	dmh@hardmanandco.com
Media		**Mining**	
Derek Terrington	dt@hardmanandco.com	Paul Singer	if@hardmanandco.com
Oil & Gas		**Property**	
Angus McPhail	am@hardmanandco.com	Mike Foster	mf@hardmanandco.com
Services		**Special Situations**	
Mike Foster	mf@hardmanandco.com	Steve Clapham	sc@hardmanandco.com
		Paul Singer	ps@hardmanandco.com
Tax Enhanced Services		**Utilities**	
Brian Moretta	bm@hardmanandco.com	Nigel Hawkins	nh@hardmanandco.com
Chris Magennis	cm@hardmanandco.com		

Hardman & Co

35 New Broad Street
London
EC2M 1NH

Tel: +44(0)20 7194 7622

www.hardmanandco.com