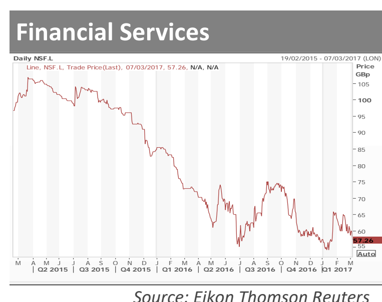
Financial Services



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	NSF
Price (p)	58.125
12m High (p)	99.25
12m Low (p)	56.0
Shares (m)	317
Mkt Cap (£m)	184
EV (£m)	266
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, is number three in home credit, and a scalable platform in the growing guaranteed loans market.

Company information

CEO	John van Kuffeler
CFO	Nick Teunon
Exec Dir	Miles Cresswell-Turner

Tel: +44 (0)2038699026
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Key shareholders

Invesco	26.69%
Woodford Investment	22.02%
Marathon Asset Mgt	10.18%
Secure Trust Bank	7.42%
Toscafund Asset Mgt	3.71%
Jupiter Asset Mgt	2.99%

Next event

9 May 2017	AGM
Early July	Trading stmt
Early August	H117 res

Analysts

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Non-Standard Finance

Branching Out Investment accelerated

NSF is accelerating the investment in its branch network, doubling the rate of new office openings 2017/2018 compared with previous expectations. We believe the company's plans to staff these offices by experienced managers are credible. In home collect (HCC) NSF now has a model to fully exploit the opportunity from the market leader's re-focus. 19% of Trusttwo new loans in December were from intra-group referrals, up from zero in June. Our estimates have been cut to reflect investment and a more measured risk appetite in HCC through 2018. We believe there is significant opportunity from switching PFG agents and will review forecasts once the scale of the transfers is clearer.

- **Strategy**: We outlined in our note Carpe Diem, the profitability generated by NSF's strategy of growing its lending rapidly, widening spreads, gaining efficiencies of scale and having these positive profitability factors only partially offset by higher impairments.

- **2016 results:** 2016 pre-tax results were slightly ahead of our numbers and broadly in line with consensus. Tightened lending criteria in H2 saw slower than expected loan growth in HCC but the revenue impact was offset by lower impairments. The H2 cost performance in the branch network was excellent.

- **Valuation:** The benefit of rolling forward our methodologies to our 2018 numbers is offset by our estimate reductions (now 97p was 101p). Given the expected growth profile moving to 2019 should see a material uplift. As the 2018 dividend is closer to peers we have also introduced a yield comparative.

- **Risks:** Credit risk remains the biggest issue and part of NSF's model is to accept higher credit risk where a higher yield justifies it. NSF is also innovative and has incurred losses trialling different routes to customers. Regulation is also a potential issue noting management take appropriate action to mitigate this risk.

- **Investment summary:** Substantial value should be created as: (i) competitors have withdrawn; (ii) NSF is well-capitalised with access to significant debt funding; (iii) positive macro-economic drivers, and (iv) NSF has an experienced management team delivering technological efficiency without compromising the key F2F model. Targets of 20% loan book growth and 20% EBIT ROA appear credible and investors are paying just 8x 2018 PE and getting a 5%+ yield.

Financial summary and valuation (pro forma normalised)

Year end Dec (£000)	2016	2017E	2018E
Revenue	94,674	110,285	135,612
Imprmnts (exc FRS9)	(25,705)	(26,254)	(32,504)
Total costs (exc dep)	(49,600)	(57,434)	(65,986)
EBITDA	19,369	26,596	37,122
Pre-tax	13,056	19,435	26,993
Statutory pre-tax	(9,342)	1,401	12,439
Pro-for norm EPS (p)	3.37	4.94	7.19
Dividend (p)	1.20	2.25	3.25
P/ Adj Earnings (x)	17.2	11.8	8.4
P/BV (x)	0.7	0.8	0.7
P/tangible book	1.9	1.8	1.7
Yield	2.1%	3.9%	5.6%

Source: Hardman & Co Research

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FY16 Results

Outlook and estimate changes

Our estimates have been cut to reflect investment and continued lower risk appetite in HCC through 2018.

2016 delivered a small beat at the normalised pro-forma pre-tax level against our forecasts. Within this, group revenue, impairments, and costs were all below our forecasts primarily as management tightened lending criteria in the HCC business in H216 and so this high-margin business did not meet our volume forecasts. Cost control in the branch business was excellent and funding costs were also below our estimates. These trends have been carried forward in to 2017 where we have also included a £1m additional cost for the accelerated branch opening programme announced with the results. Our 2018 pre-tax numbers also reflect lower risk appetite in HCC (average total value of loans per agent £43k end 2018 and end 2016 v £53k end 2015, however this will also result in lower impairment as a percentage of revenue). At this stage, we have not included a material benefit from PFG agents switching and will do so once a visible trend is clear. In line with our treatment at MCL, we now include FRS9 effect only in statutory numbers (FRS9 has no impact on total profitability per loan or on cash flow). We are not yet forecasting 2019 when we expect the full payback from the investment in branch openings in 2017/ 2018.

Exhibit 1: Estimate changes

	2016			2017e			2018e		
	Old	Actual	% change	Old	New	% change	Old *	New	% change
Profit and Loss (£'000s)									
Reported revenue	96,394	94,674	-2%	114,814	110,285	-4%	144,560	135,612	-6%
Total impairments (ex FRS9)	(26,154)	(25,705)	-2%	(30,046)	(26,254)	-13%	(42,158)	(32,504)	-12%
Total cost (exc dep)	(50,290)	(49,600)	-1%	(55,594)	(57,434)	3%	(64,864)	(65,986)	2%
EBITDA	19,950	19,369	-3%	29,174	26,596	-9%	42,666	37,122	-13%
Pre-tax	12,732	13,056	3%	20,327	19,435	-4%	30,917	26,993	-13%
Pro for norm EPS (p)	3.3	3.4	1%	5.2	4.9	-4%	8.15	7.19	-12%
Dividend (p)	1.3	1.2	-8%	2.3	2.3	0%	3.0	3.25	8%
Balance Sheet (£ms)									
Amounts Receivable	180.0	180.4	0%	205.8	208.0	1%	247.3	259.3	5%
Borrowings	87.3	87.3	0%	114.3	117.3	3%	147.8	162.8	10%
Equity	252.1	248.8	-1%	248.1	245.5	-1%	253.6	247.7	-2%

*Source: Hardman & Co Research * prior year re-stated to exclude FRS9*

FY16 pro forma Group KPIs

Figure 2 shows the company's performance against its KPIs in 2016. Other than credit in the home collect business (which we explore in more detail below) it was on target in all other areas except for the return on assets target in Trusttwo which reflects its current, sub-optimal scale (although it is expected to grow quickly from here).

Exhibit 2: 2016 pro forma KPIs

	Everyday Loans (EL)		Loans At Home (LAH)		TrustTwo (TT)	
	Rate (%)	V target	Rate (%)	V target	Rate (%)	V target
Loan book growth	18.0	Y	19.3	Y	18.9	Y
Revenue Yield	44.2	Y	152.8	Y	31.9	Y
Risk adjusted Margins	35.3	Y	97.3	Y	26.7	Y
Impairments / revenue	20.0	Y	36.3	N	14.8	Y
Operating profit margin	38.8	Y	4.4	N	27.2	Y
Return on assets	17.1	Y	6.7	N	8.5	N

Source: NSF, Hardman & Co Research, Excludes FV adjustments

Everyday Loans (EL)

Everyday Loans is NSF's largest business representing c74% of the group total loan book and 82% of pro forma normalised operating profit. NSF completed the acquisition of EL on 13 April 2016. Since then loan volumes have been increasing on a higher yield, and management is expanding the branch network rapidly.

Change in outlook with these results

Growth Opportunities

Growth opportunities accelerated to 20 branches over 2017/2018 instead of 10

With these results, management has announced a material acceleration in its branch opening programme. Previous guidance had been for an additional c5 branches each year in 2017 / 2018. Management is now indicating 12 branches in 2017 (of which 10 sites are already identified) and up to a further 8 probable locations for 2018. The EBIT impact is likely to be around negative £1m in 2017 (NSF indicated it expected branches to break even around month 11 with the opening losses fully recouped by around month 25). In 2018 the EBIT impact is likely to be modest as the branches opened in 2017 should be moving to profitability and offsetting the further investment made in 2018. Significant increases in 2019 profitability should be seen (although we do not forecast that year currently).

Broadening product range

We also note that within its branch network, NSF is expanding its product range and for example, has a new product targeted at the self-employed. Socio demographic trends in the UK are strongly supportive of this and from personal experience, this analyst knows that standard credit assessments do not capture the recently self-employed well. We also note that higher risk customers to whom EL lent prior to its acquisition by Secure Trust, are once again viewed as an acceptable risk with higher rates being charged.

Multiple actions to manage risk from accelerated growth including using experienced senior managers from own network, taking managers from branch business in run down, hiring externally managers with prior experience

To avoid unacceptable risk, the experience of front line managers is critical. NSF has several initiatives in hand to deliver this accelerated growth using well-trained and experienced staff.

- Firstly, NSF has indicated that the managers of new branches will typically be managers from existing branches (where their deputies would then be promoted to branch manager). We believe new entrants in lending (not just in branches) initially incur higher risk and so it is appropriate that the more senior staff are taken from the existing network to run new branches.
- Second, we believe that some of the competitor branch businesses which closed to new lending in 2011/2012 will now be in their final stages of run off. We believe they will have retained the best staff to manage the run-down period and so these experienced staff will only now be looking for new positions.
- Third we understand that external recruitment programmes have identified potential staff with direct prior experience of this business. While they may have been out of the market for a while, there are still several hundred managers of previous branches that are no longer employed by competitors.
- Fourth, with the new self-employed product, NSF is overlaying branch management with a centralised resource that has specific experience in analysing income flows for self-employed and so can support the branches in assessing variable income. Managers who have knowledge of credit impaired or

variable income borrowers, are being supported in assessing this different risk profile.

Regulation

Ongoing issue but management taking appropriate action

EL received its full FCA licence on 21 June 2016. The thematic review which was most likely to have had an impact on EL was the one on early stage collection (review published December 2016) but EL processes had already been changed in this area.

EL is applying for a high cost short-term credit licence in order to offer one year loans (its current product ranges require a different licence). The rates it charges are well below the cap on High-Cost Short-Term Credit (0.8% per day, equivalent to c1,200% APR) and while extending the HCSTC cap to other products is one option being considered by the FCA review, we believe it is unlikely. We expect that the main area of focus is likely to be the charges levied by the banks on unauthorised overdrafts and Rent-to-Own providers.

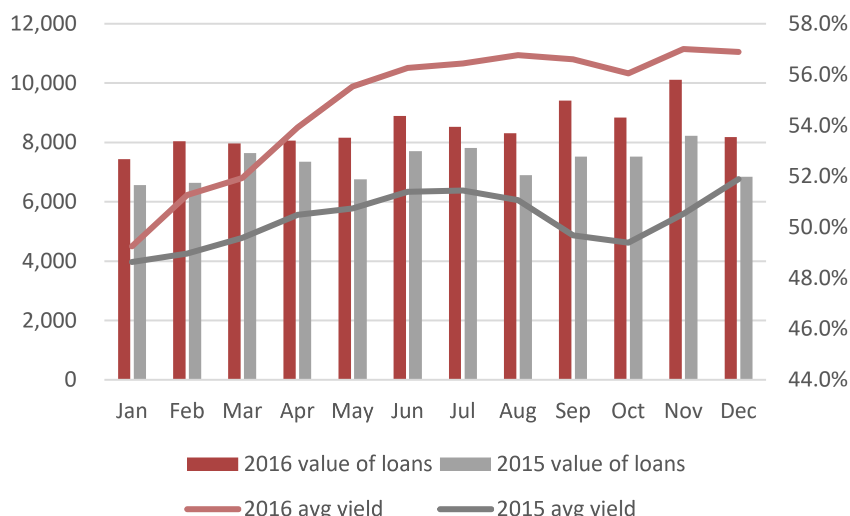
Key Features from 2016 results

2016 delivered as promised – accelerated loan growth, wider margin

Cost control was excellent

2016 delivered exactly what had been promised – strong loan growth combined with a widening of margin. The latter reflects both increased risk appetite (EL is lending once again to customers to which it used to lend before its acquisition by the more conservative Secure Trust Bank) and to compensate for a higher average cost of funding under NSF's ownership. 2016 lending, revenues and impairments were marginally ahead of forecasts while costs were lower than expected with H216 pro forma costs below H116 (£10.2m v £10.4m). Funding costs also fell somewhat more than expected (H116 £2.8m, H216 £1.9m) while we had expected a modest rise.

Figure 3: EL new loans issued and average yield by month 2015 and 2016



Source NSF, Hardman & Co Research

Net effect that our normalised 2017 profit is now £16.7m (previously £17.2m). Assuming payback for this investment the 2018 forecast is now £20.7m (previosuly£21.5m).

Compared with our previous forecasts we have increased branch numbers in line with the company's guidance. The tick up in customer numbers, loans, revenue and impairments lags this growth and is somewhat more visible in 2018 although the main benefit will be seen in 2019. As specific costs in any period can be volatile, and given the further investment announced, our 2017 estimated costs have been increased modestly despite the strong H216 performance. The dip in impairments in 2017 and then small rise in 2018 reflects the growth and relative maturity of the

book. The finance costs drops further in 2017 with a full year benefit from the lower rates seen in H216 although it picks up again in 2018 due to mix effects (greater proportion of borrowing rather than equity funding). We have assumed a small drop in average loan size as we expect newer branches and newer products to initially have a smaller balance following the Low and Growth approach to new lending.

Figure 4: Financial summary and ratios Everyday Loans

	Pro forma normalised		
Year end Dec (£000)	**2016**	**2017E**	**2018E**
Reported Revenue	50,088	59,780	75,597
Impairments	(10,034)	(11,657)	(15,497)
FRS9 impairment	-	-	-
Revenue less Impairments	40,054	48,123	60,100
Administration expenses	(20,631)	(26,303)	(31,751)
Operating profit	19,423	21,820	28,349
Net Finance Costs	(4,720)	(5,151)	(7,578)
Profit before tax	14,703	16,669	20,771
Number of branches	41	53	60
Period end customer numbers (000s)	39,600	52,000	63,000
Period end Loan book (exc FV adjustments)	122,400	149,328	186,660
Average loans	113,400	135,864	167,994
Ratios			
Revenue (pre FV) as % average loans	44.2%	44.0%	45.0%
Impairments as % pre FV revenue	-20.0%	-19.5%	-20.5%
Risk adjusted margin	35.3%	35.4%	35.8%
Pre-tax return (exc FV) on avg loans	13.0%	12.3%	12.4%
Cost as % pre FV revenue	-41.19%	-44.00%	-42.00%
Operating % pre FV revenue	38.78%	36.50%	37.50%
Net Finance costs as % pre FV revenue	-9.42%	-8.62%	-10.02%
Impairment as % average loans	-8.85%	-8.58%	-9.23%
Costs as % average loans	-18.19%	-19.36%	-18.90%
Net Finance cost as % average loans	-4.16%	-3.79%	-4.51%
Average loan per customer (£)	3,091	2,872	2,963
Pre FV revenue per customer (£)	1,264.8	1,149.6	1,200.0

Source: Hardman & Co Research

Loans at Home (LAH)

LAH is NSF's second largest business with c20% of the Group's total loan book and 15% of pro-forma, normalised 2016 operating profit. NSF completed the acquisition of SD Taylor (legal owner of LAH) on 4th August 2015.

Change in outlook with these results

Organic growth

Our forecast for normalised divisional profits in 2017 is down from £7.2m to £6.7m We still forecast strong growth in 2018 (now £9.2m from £12.1m).

In 2016 management experimented with several channels to access the significant pool of potential customers released by the market leader's refocussing of their business. Two approaches attracted customers who ultimately proved unprofitable and LAH is now focussed on attracting established agents that are then able to attract clients that have previous experience of home credit. By closing down the other channels, and tightening overall credit LAH is unlikely to see the same degree of loan growth, revenue, costs or the impairments that we had previously expected. We now assume average loans will grow 11% against a previous 17% (year-end spot balance growth is ahead of this as some of the non-repeated business had worked out by the year end 2016 but was in the average for the year). The slower loan volume is significantly offset by more stable margins and a faster decline in impairments (from 34% of revenue to 30%) and marginally slower cost growth.

Opportunity from PFG further restructuring

For PFG's Consumer Credit Division, retaining 90% of revenue at 84% of costs, would see profits rise and use less capital…..

10% of CCD's revenue is roughly the same as LAH's revenue

With its results on 28 February, PFG announced a major restructuring of its agent network. It will move from employing 4,500 full and part time agents to having a network of 2,500 fully employed staff with the objective of serving the same customer base. PFG believe this will enhance efficiency, improve control and with advanced technology ensure better customer service. We note that if PFG retains 90% of the risk-adjusted revenue, but incurs 84% of the costs, it will improve its nominal profits and use less capital. PFG is currently in discussions with staff but expects the new structure to be in place by late summer 2017.

Agents paid on commissions based off collections have incentive to only make good loans

While Provident believes that by having employed staff they will be able to improve operational control, the remuneration structure will need to be carefully managed. Self-employed agents, paid from commissions based on their collections, have a direct interest in only lending to what they perceive to be good customers; an important issue for both credit but also regulatory risk. Salaried staff whose remuneration is less linked to cash collected have less incentive to take such an interest in the quality of lending they make. We believe one reason banks have suffered from mis-selling losses is having salaried staff incentivised by sales.

Increasingly good agents may be dis-illusioned as PFG halves its agent network again.

PFG has already shrunk from c10,000 agents to its current 4,500. We believe the weakest agents will have been lost first and those remaining will increasingly be the more effective agents. We note not all agents want full time work (many being housewives who work and value flexibility for things like child care). If good agents become disillusioned there is likely to be a opportunity for competitors like NSF to pick up agents and their customer base over time. We also note that supervision time in the field is driven by customer numbers (especially delinquent ones) rather than agent numbers. The marginal cost of 2 part-time agents compared with one full time one is modest and mainly training and compliance time. NSF very quickly put out an announcement stating it was committed to sticking with its model of self-employed agents, many of whom like to work part-time.

Regulation

HCC already been reviewed many times and does not appear to be the main target for the Nov 2016 FCA review of high cost credit.

On 29th November 2016 the FCA announced it was reviewing high-cost credit including HCC. This market has been subject to previous reviews and procedural remedies introduced included a website with price comparability. This, and NSF's high customer satisfaction should limit any potential adverse impact from the announced review and we note NSF's share price barely reacted on the day. However, there will be further news around this issue. The Citizens Advice Bureau's input, reported in the FT on 15 February 2017, highlighted procedural abuses by unnamed, door step lenders. NSF firmly rebutted that it was at fault, highlighting how its procedures would prevent such practices. The shares rose 4% on that day. While we do not discount regulatory risk, improved IT should ensure better compliance and NSF has introduced groupwide a programme to advance understanding of appropriate behaviour and culture. Compliance with any further remedies would also be likely to impact to a greater extent on smaller players and may see further opportunities to attract experienced agents.

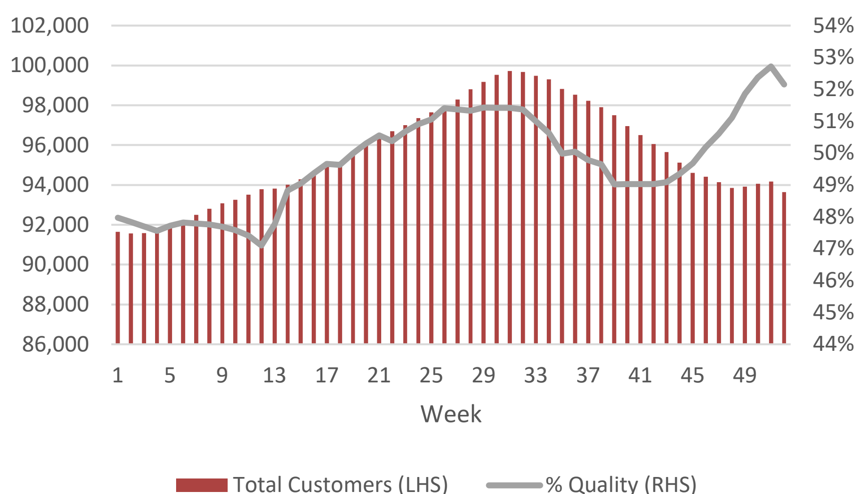
Whilst Loans at Home (along with the other major HCC firms) continues to operate under temporary permission from the FCA, we believe that the fact that the FCA has already licensed over 400 HCC firms provides comfort that they don't have an issue with HCC per se (it is also worth noting that CONC14 - the part of the regulations dedicated to HCC - doesn't highlight any particular issues of concern). We believe that the receipt of a full FCA licence could prove to be a healthy catalyst for the share price and would expect this to take place during 2017.

Key Features from 2016 results

Over-expansion in H116 saw material losses (Hardman e c£4-5m). Problems quickly identified and lending criteria tightened.

Activity in LAH in 2016 can be broken into two discrete periods (as evidenced by Figure 5 below). For just over six months the group expanded rapidly using a variety of alternate strategies to access new customers. As some of these pilots proved uneconomic they were closed and credit criteria tightened. This saw customer numbers fall by 6% in H216 but also a pick-up in their quality. Bottom line, LAH over-expanded the agent network in H116 by taking on less experienced agents and less experienced customers resulting in credit losses, operational strains on field management and on collection processes. The tighter credit scorecard meant that temporary agent commissions paid to newly recruited agents were greater than expected as it took these agents longer to reach their "normal" customer levels. We believe that management did not rush blindly into this area, unaware of the risks, but rather that the scale of known risks proved to be materially greater than had been anticipated in highly favourable economic conditions. The scale of potential loss was quickly identified and corrective action taken. We also note the divisional CEO left in January 2017.

Figure 5: LAH customer numbers and customer quality



Source NSF, Hardman & Co Research Quality measured as % customers over prior 13 weeks who paid 70% or more of due payments

Tighter risk criteria has reduced our loan forecast with partial offset by lower provisions. Our estimates do not include a material benefit from accelerated switching by PFG agents. We will do this once the trend is clear.

Against our forecasts average lending was materially below our estimate in H216 as the company tightened credit. This led to lower revenue and impairments (which, although a higher than expected as a proportion of revenue, were in nominal terms c£0.6m better than our forecast). Costs were above expectations associated with higher incentives and collections. The LAH branch network was also increased (to 47 from our forecast end 2016 44) partially we believe to ensure greater local control. Looking forward we have reduced the growth in average loan book sharply for 2017 and in 2018. We believe that the lower risk appetite will continue over the forecast period keeping average loans per agent at their 2016 level of £43k and below that historically seen. This is also expected to improve the rate at which credit losses trend to a more acceptable level (impairments as a percentage of revenue in 2017 down to 30% from 34% previously forecast). Part of the growth in "normal" costs (H216 £12.2m v £11m in H115) reflects collections on higher balances and part is associated with non-recurring businesses. Accordingly, our 2017 cost estimate is now £26m, 3% up on 2017. The net result is that we forecast that operating profit will increase sharply to £7.0m (2015: £1.9m) reflecting the high level of operational gearing and the impact of a return to more normalised level of impairment as a percentage of revenue.

Figure 6: Financial summary and ratios Loans at Home

	Pro forma normalised		
Year end Dec (£000)	**2016E**	**2017E**	**2018E**
Reported Revenue	42,170	46,809	53,362
Impairments	(15,313)	(14,043)	(16,009)
FRS9 impairment			
Revenue less Impairments	26,857	32,766	37,353
Administration expenses	(25,000)	(25,750)	(27,681)
Operating profit	1,857	7,016	9,672
Net Finance Costs	(323)	(400)	(450)
Profit before tax	1,534	6,616	9,222
Number of branches	47	49	52
Number of agents	785	850	1,000
Period end customer numbers (000s)	93,600	105,000	120,000
Period end Loan book (exc FV adjustments)	33,400	38,076	43,407
Average loans	27,600	30,636	34,925
Ratios			
Revenue (pre FV) as % average loans	153%	153%	153%
Impairments as % pre FV revenue	-36.3%	-30.0%	-30.0%
Risk adjusted margin	97.3%	107.0%	107.0%
Pre-tax return (exc FV) on avg loans	5.6%	21.6%	26.4%
Cost to % pre FV revenue	-59.3%	-55.0%	-51.9%
Operating % pre FV revenue	4.4%	15.0%	18.1%
Net Finance costs as % pre FV revenue	-0.8%	-0.9%	-0.8%
Impairment as % average loans	-55.48%	-45.84%	-45.84%
Costs as % average loans	-90.58%	-84.05%	-79.26%
Net Finance cost as % average loans	-1.17%	-1.31%	-1.29%
Average loan per customer (£)	357	363	362
Pre FV revenue per customer (£)	451	446	445

Source: Hardman & Co Research

Trusttwo

Trusttwo is the smallest of NSF's three business and represents c5% of the Group's loan book and 3% of pro forma normalised operating profit. It offers loans to non-standard customers who are able to get someone else with a good credit rating to guarantee their loan. With the guarantee, the interest rate the borrower has to pay is significantly reduced, making the loan much more affordable for the borrower. Trusttwo was acquired as part of EL on 13 April 2016.

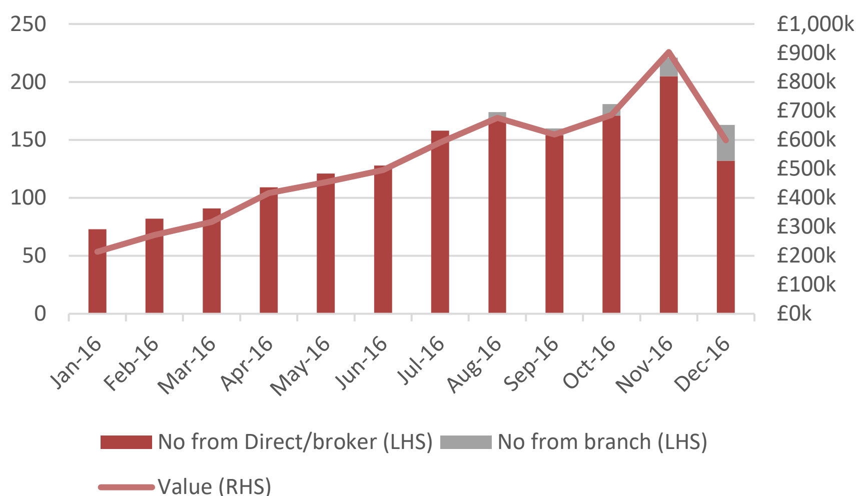
Change in outlook with these results

Growth

Referrals from EL branches accounted for 19% of new loans in December from zero in June

Management had previously highlighted the opportunity of effective cross referral from the EL branch network. To us, the most interesting impact on the outlook for Trusttwo from 2016 results is the initial stages of delivery of such lending. While it is still early days, Figure 7 shows how by December it had already become a material source of new loans accounting for 19% of new loans from zero in July. The drop in December new loans reflects the seasonal nature of the business – borrowers do not approach potential guarantors just before Christmas!

Figure 7: TrustTwo numbers of loans and total amount lent per month



Source NSF, Hardman & Co Research

Regulation

Regulatory developments a (small) positive for TT with more sensible recognition of when guarantors may be approached

On 25 October 2016 the FCA announced a consultation on guarantor loans. This guidance was finalised on 19 January 2017. As a result, the FCA has confirmed that there is no requirement for a statutory default notice to be issued where payment is requested of (not demanded), or volunteered by a guarantor and continuous payment authority (CPA) can be taken from the guarantor, provided notice is given sufficiently in advance (five working days is suggested) so as to afford them the opportunity to object/cancel the CPA. This is important as it means guarantors can be approached earlier in the arrears process and they are then able to encourage borrowers to get back on track. This results in payments being made at this stage when they might otherwise be missed.

Key Features from 2016 results

Against our forecasts the revenue and impairments were in line and costs marginally ahead. Given the opportunity from cross referrals we have accelerated all aspects of growth.

Figure 8: Financial summary and ratios Trusttwo

	Pro forma normalised		
Year end Dec (£000)	**2016E**	**2017E**	**2018E**
Reported Revenue	2,416	3,696	6,653
Impairments	(358)	(554)	(998)
FRS9 impairment	-	-	(200)
Revenue less Impairments	2,058	3,142	5,455
Administration expenses	(1,402)	(2,200)	(3,750)
Operating profit	656	942	1,705
Net Finance Costs	(316)	(277)	(319)
Profit before tax	340	664	1,387
Period end customer numbers (000s)	3,300	4,455	5,792
Period end Loan book (exc FV adjustments)	8,800	15,840	28,512
Average loans	7,700	12,320	22,176
Ratios			
Revenue (pre FV) as % average loans	31.9%	30.0%	30.0%
Impairments as % pre FV revenue	-14.8%	-15.0%	-15.0%
Risk adjusted margin	26.7%	25.5%	25.5%
Pre-tax return (exc FV) avg loans	4.4%	5.4%	6.3%
Cost to % pre FV revenue	-58.0%	-59.5%	-56.4%
Operating % pre FV revenue	27.2%	25.5%	25.6%
Net Finance costs as % pre FV revenue	-13.1%	-7.5%	-4.8%
Impairment as % average loans	-4.6%	-4.5%	-4.5%
Costs as % average loans	-18.2%	-17.9%	-16.9%
Net Finance cost as % average loans	-4.1%	-2.3%	-1.4%
Average loan per customer (£)	2,667	3,556	4,923
Pre FV revenue per customer (£)	732	830	1,149

Source: Hardman & Co Research

Financials

We have outlined the detail of our forecasts in each divisional review. Non-exceptional central costs were slightly better than expected and from here are expected to show only a gentle increase. The pro-forma normalised numbers provide a clearer view of underlying business trends as the statutory numbers given below are impacted by the acquisitions and other accounting issues.

Figure 9: Profit and Loss (£000s)

Year ended 31 December	Statutory				Pro Forma normalised		
	2015	2016	2017e	2018e	2016	2017e	2018e
Business Interest Income	14,657	81,099	110,285	139,825	**94,674**	110,285	135,612
Fair value unwind on acquired portfolios	(5,456)	(8,342)	(11,074)	(4,000)	-	-	-
Total revenue	**9,201**	**72,757**	**99,211**	**135,825**	**94,674**	**110,285**	**135,612**
Underlying business impairments	(1,885)	(20,712)	(22,754)	(28,609)	(22,705)	(22,754)	(28,479)
Unwind of provision discount	(1,973)	(2,489)	(3,500)	(4,025)	(3,000) E	(3,500)	(4,025)
Total Impairments	**(3,858)**	**(23,201)**	**(26,254)**	**(32,634)**	**(25,705)**	**(26,254)**	**(32,504)**
FRS9 adjustment				**(5,090)**	-	-	-
Gross profit	**5,343**	**49,556**	**72,957**	**98,101**	**68,969**	**84,031**	**103,108**
Administration expenses	(11,340)	(44,074)	(58,253)	(67,182)	(50,290)	(58,253)	(67,432)
O/w Depreciation	(198)	(690)	(819)	(1,446)	(690)	(819)	(1,446)
Amortisation of intangibles	(4,030)	(10,714)	(6,960)	(5,603)	-	-	-
Operating profit	**(10,027)**	**(5,232)**	**7,743**	**25,315**	**18,679**	**25,777**	**35,676**
EBITDA	(5,799)	6,172	15,522	32,364	19,369	26,596	37,122
Exceptional Items	(6,135)	(626)	-	-		-	-
Net finance (cost)/income	70	(3,484)	(6,343)	(8,683)	(5,623)	(6,343)	(8,683)
Profit before tax	**(16,092)**	**(9,342)**	**1,401**	**16,632**	**13,056**	**19,435**	**26,993**
Income tax	3,022	1,344	(271)	(3,113)	(2,688)	(3,757)	(5,091)
Profit after tax	**(13,070)**	**(7,998)**	**1,130**	**13,270**	**10,368**	**15,677**	**21,902**
Avg no shares for EPS calculation	61.50	307.32	317.05	317.05	305.93	317.05	317.05
Statutory EPS (p)	(21.25)	(2.60)	0.36	4.19	n/a	n/a	n/a
Adjusted EPS (p)*	1.30	2.62	4.94	6.64	3.37	4.94	6.91
Total dividend (p)	-	1.20	2.25	3.25	1.20	2.25	3.25

Source: NSF Hardman & Co Research

NoNoteFigure 10: Balance Sheet (£000s)

Year ended 31 December	2015	2016e	2017e	2018e
Non-current				
Goodwill	40,176	132,070	132,070	132,070
Intangible assets	14,119	17,412	10,451	4,848
Property Plant and equipment	1,718	5,459	9,640	12,694
Total Non-current assets	**56,013**	**154,941**	**152,161**	**149,612**
Current assets				
Inventories	3	-	-	-
Amounts Receivable from customer	**28,412**	**180,413**	**208,003**	**259,338**
O/w FV adjustment	*426*	*15,833*	4,759	759
Trade and other receivables	10,275	10,753	11,828	13,011
Cash and cash equivalent	7,320	5,215	6,255	3,580
Total current assets	46,010	196,381	226,086	275,929
Total assets	**102,023**	**351,322**	**378,247**	**425,540**
Current liabilities				
Trade and other payables	9,490	8,146	9,146	10,146
Deferred tax liability	14,275	-	-	-
Total current liabilities	23,765	8,146	9,146	10,146
Net Current (liabilities) / assets	*29,150*	*188,235*	*216,940*	**265,783**
Non-current liabilities				
Financial Liabilities - borrowings	-	87,300	*117,300*	162,800
Deferred tax	-	6,793	*6,027*	4,671
Total non-current liabilities	**-**	**94,093**	***123,327***	**167,471**
Total liabilities	16,860	102,239	*132,473*	177,617
Net assets	**85,163**	**249,083**	***245,774***	**247,923**

Source: NSF, Hardman & Co Research

Figure 11: Cashflow statement (£000s)

Year ended 31 December	2015	2016e	2017e	2018e
Profit (loss) before tax	(16,162)	(5,858)	7,743	21,122
Taxation paid	(350)	(1,341)	(1,341)	(1,341)
Depreciation,	198	690	819	1,446
Amortisation of intangibles	4,030	10,714	6,960	5,603
FV unwind on acquired loan book	5,456	8,342	11,074	4,000
Loss on disposal of fixed assets	51	(363)	-	-
Decrease in inventories	6	3	-	-
Increase in amounts receivable from customers (net of FV)	(5,394)	(21,039)	(35,664)	(55,335)
Increase in receivables	(16,445)	(7,737)	(1,075)	(1,183)
Increase in payables	19,078	(6,952)	1,000	1,000
Net cash outflow from operating activities	**(9,532)**	**(23,541)**	**(10,484)**	**(24,688)**
Cashflow from investing activities				
Purchase of prop, plant and equipmt	(341)	(4,327)	(5,000)	(4,500)
Purchase of subsidiaries	(81,111)	(230,784)	-	-
Net cash outflow - investing activities	**(81,452)**	**(235,111)**	**(5,000)**	**(4,500)**
Cashflows from financing activities				
Net finance Income	70	(3,484)	(6,343)	(8,683)
Proceeds from issue of share capital	98,234	172,869	-	-
Proceeds from borrowing	-	87,300	30,000	45,500
Repayment of borrowing	-	-	-	-
Interest Paid	-	813	-	-
Dividends	-	(951)	(7,134)	(10,304)
Net cash inflow - financing activities	**98,304**	**256,547**	**16,524**	**26,513**
Net change in cash / cash equivalents	7,320	(2,105)	1,040	(2,675)
Opening cash and cash equivalents	-	7,320	5,215	6,255
Closing cash and cash equivalents	7,320	5,215	6,255	3,580

Source: NSF, Hardman & Co Research

Valuation

Summary

Average valuation upside on absolute measures 83%

Our absolute valuation techniques imply an average upside of 83%. The peer valuations are 19% upside but we believe the whole sector is under-valued.

Figure 12: Summary of different valuation techniques

	Implied Price (p)	Upside (%)
Gordon's Growth	111.7	92%
DDM	100.9	74%
Average absolute measures	106.3	83%
Peer 2018 PE	73.5	26%
Peer P/BV	81.6	40%
Peer 2018 Div Yield	53.0	-9%

Source: Hardman & Co Research Peer comparisons are against, PFG, MCL, S&U, H&T, STB Priced at 10/3/17

We detailed our assumptions in our initiation note Carpe Diem. The key changes are:

- Gordon Growth model: Rolling forward to the 2018e net assets value is more than offset by a slightly weaker statutory equity generation than expected in 2016 and the effect of our increased 2018 dividend forecast. This measure drops from 112.9p previously to 111.7p.
- Dividend discount model: Again rolling forward a year has a material effect (in this case largely due to the discounting factor on a larger dividend) compounded by the small 2018 dividend increase. This measure is now 100.9p (previously 88.8p).
- Peer 2017 PE: Price movements have been relatively modest since our last report but as we are forecasting 30% EPS growth at NSF, moving forward to 2018 sees a small increase in its valuation using peer PE relatives (now 73.5p v 69.1p).
- Peer Price to Book: There is little change in this relative measure (81.6 v 82.1p). NSF's payout ratio of statutory earnings in 2018 is in line with peers.
- Peer Dividend Yield: We are now introducing a yield comparator. Our forecast yield is ahead of the broad peers group (5.6% v 5.1%). Against a narrow group (PFG and Morses Club) NSF's 2018e yield is marginally lower although we would expect future earnings and so dividend growth to see it quickly catch up. Against the broad peers group the valuation would be 53.0p.

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