Morses Club PLC (MCL)

Opportunities abound

Having completed a major integration, and a good FY17 management can focus on carefully controlled growth. In the Home Collect (HCC) business, management reports the expected increase in agents looking to join the group. MCL will be very selective about new agents, but this is a material, if at present unquantifiable, opportunity. Management is also using technology to improve efficiency and distribution. In related areas, where MCL has existing competitive advantages, new products are being carefully rolled out. New relationships and partner agreements add to the potential down the line. We see 32% valuation upside.

- **Strategy:** HCC is an attractive, established market. MCL is improving efficiency, raising yields and focussing on lower-risk customers. MCL is conservative and exploits new business opportunities in a risk averse way. New products are extensively tested and introduced only where MCL has a competitive advantage.
- **HCC Outlook:** More agents have applied to join MCL in spring 2017. These are being reviewed and we expect to upgrade our FY19 numbers with the interim results when there is greater clarity how many actually join. Given incentives, there will be little impact on the bottom line in FY18.
- **Valuation:** Our range of absolute valuation approaches indicate a fair value would be around 177p with the Gordons growth model (which capture both value added and growth) having the highest valuation at 199p. We have rolled forward our valuation base year increasing both prices from prior estimates.
- **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 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 1.7x (adj.)

Financial summary and valuation

Year end Feb (£ms)	2015	2016E	2017E	2018E	2019E
Reported revenue	89.9	90.6	99.6	107.3	115.3
Total impairments	-22.9	-18.8	-24.3	-27.9	-30.9
Total costs	-51.4	-53.4	-56.7	-59.6	-61.9
EBITDA	16.5	19.3	19.9	21.2	24.1
Adjusted pre tax	13.0	16.8	17.7	18.8	21.4
Statutory pre tax	58.5	21.2	11.2	14.1	14.6
Statutory EPS (p)	46.5	6.1	6.6	8.7	9.1
Adj EPS (p)	8.1	10.2	10.8	11.6	13.2
P/ Adj Earnings (x)	16.5	13.1	12.4	11.5	10.1
P/BV (x)	1.8	3.1	2.8	2.7	2.6
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

Financials

Source: Eikon Thomson Reuters

Market data

EPIC/TKR	MCL
Price (p)	134.0
12m High (p)	136.1
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 Chr	Stephen Karle

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www.morsesclubplc.com

Key shareholders

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

Next event

Early Sept	Trading Update
Early Oct	Interim Results

Analysts

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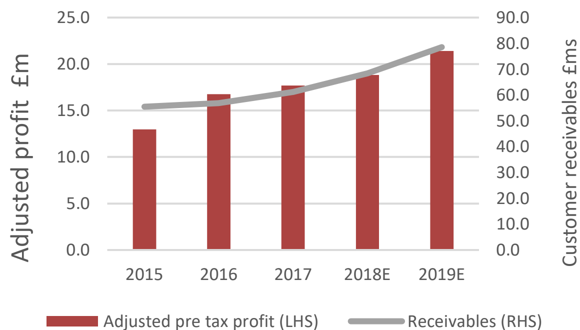
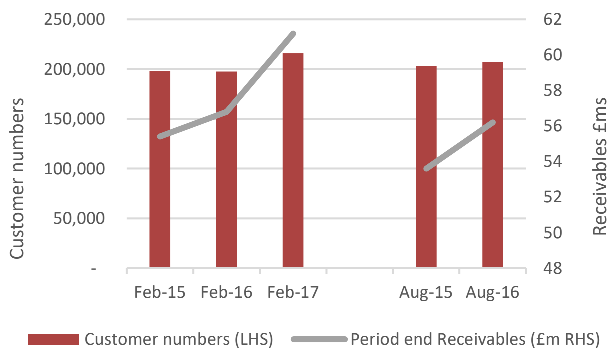
Adjusted pre-tax profits and customer receivables (£ms) 2015-2019e



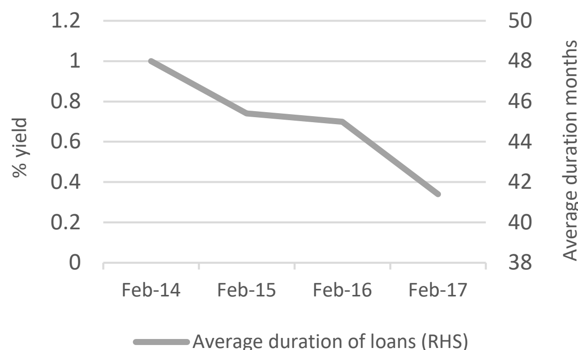
- 2017e profit growth was impacted by impairments rising to more normal levels and rising temporary commissions paid to attract new agents.
- 2018e / 2019e profit growth (7% and 13% respectively) as a drag from these issues.
- Technology seeing steady improvement in cost income ratio with admin cost growth c three quarters income growth
- Much more stable growth (consistently mid-single digit) expected in receivables. This should be a conservative assumption and will be reviewed at the interim stage.

Growth in customer numbers and receivables



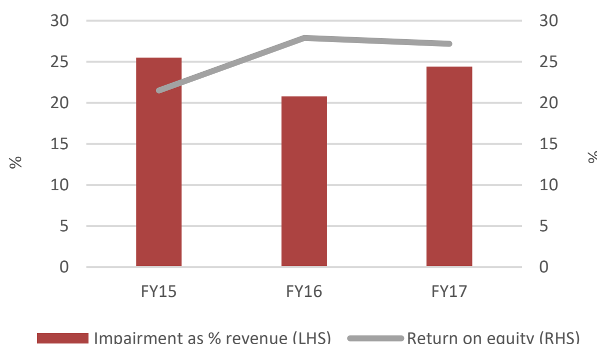
- Seasonal business with peak at Xmas, so this chart shows like for like growth for each accounting period end.
- The year to February 2017 saw the tail end of the SFS acquisition clean-up exercise reducing numbers of lower quality credits.
- Acquisition of books down in FY17 but a continuing feature of the business. Morses Club has also seen "organic" growth and new agents.
- This growth is before any benefits from the new product initiatives outlined below.

Revenue yield and 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 it.
- Falling duration helps increase yield. The theoretical revenue yield (see definition later) up a tenth (from 1.63% February 2014 to 1.71% February 2017).
- Increase in yield despite reducing higher risk accounts.
- Management expect average duration to stabilise around 40 weeks.

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 FY17 broadly stable on FY16 with rising impairments offset by operational efficiency improved.
- Impairments in FY17 reverting back to the normal levels and similar to FY15. FY16 saw a focus on managing integration not new business and the latter typically incurs higher impairments.

Source: Company data; Hardman & Co Research

FY17 results

Financial Highlights

Steady growth with well controlled risk and expenses.

- Revenue up 10% to £99.6m (FY16: £90.6m).
- Net loan book growth of 8% to £61.2m (FY16: £56.8m).
- Impairments as a percentage of revenue for the period was 24.4% (FY16: 20.8%), comfortably within the target range of 22-27%.
- 9% increase in customer numbers to c216k (FY16: 198k).
- Costs as a percentage of income declining to 56.9% (FY16: 58.9%).
- Adjusted profit before tax increased to £17.7m (FY16: £16.8m); reported profit before tax £11.2m (FY16: £10.4m).
- Adjusted EPS 10.8p (FY16: 10.2p); Basic EPS 6.6p (FY16: 6.1p).
- Proposed final dividend of 4.3p (FY16: N/A).

Operational Highlights

Using technology and delivering new product lines

- Technological efficiencies capable of delivering 28% capacity increase in customer/manager ratio.
- New products developed and introduced including Morses Club Card (cashless lending) in April 2016 and Dot Dot Loans (online lending) launched in March 2017. The strategic acquisition of Shelby Finance Limited in January 2017 providing FCA approved platform for the launch of Dot Dot Loans at a fraction of the cost of a bespoke IT build.
- Completed 7 acquisitions with total gross receivables of £6.8m.
- Core HCC business had added 105 new agent territory builds (FY16: 91).

Credit quality

Credit reverted to normal levels after unusually depressed FY16. Underlying credit mix (as evidenced by impaired % of book) an improving trend

We note that the reported impairment as a percentage of revenue rose to a more normal level in FY17 (24.4%) from 20.8% in FY16 (when the focus of the group was on integration and so there were fewer new business sales which typically incur higher provisions. This level is still (just) in the lower half of management's target range (22-27%). We note that the proportion of accounts which are neither past due nor impaired is increasing (to 71% of net receivables from 68% Feb 16 and 66% Feb 2015 - see figure 1).

Figure 1: Analysis of overdue loans and write offs

Category of loan (£'000s)	Feb 14	Feb 15	Feb 16	Feb 17
Neither past due nor impaired	9,423	35.959	38,568	42,990
Past due not impaired	304	488	277	224
Impaired	4,184	19,036	17,986	18,014
Impaired as % total	30%	34%	32%	29%
Write off in period	5,097	24,664	21,710	22,526

Source: MCL, Hardman & Co Research

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 2: Company KPIs and targets

KPI	2015	2016	2017	Comment
Adjusted profit before tax (£m)	13.0	16.8	17.7	FY17 impairments revert to norm and temp agent comms.
Adjusted EPS (p)	8.1	10.2	10.8	As above.
Cost Income ratio (%)	36.5%	36.8% *	33.1%*	Productivity improvement and economies of scale
Return on assets (%)	15.5%	20.2% *	19.5%	Should increase with operational efficiency
Return on equity (%)	21.5%	27.9% *	27.2%	Should increase with improving operational efficiency and potentially more debt gearing in due course
Tangible equity / avg reces (%)	n/m	85.3%	93.5%	Should reduce with more debt gearing
Number of customers	198,171	198,727	216,000	Includes 5% growth in 18-35 yr olds
Number of agents	1,893	1,839	1,826	Management focus is on attracting high quality agents.
Credit Issued (£ms)	112.0	122.2	144.1	Up 17% in H1FY17, 18% for FY
Impairment / revenue (%)	25.5%	20.8%	24.4%	Target range 22-27%
Other important indicators				
Dividend cover (x) / policy	n/m	n/m	1.7x	Distribute majority of adjusted earnings over medium term
Period end receivables (£m)	55.6	56.8	61.2	8% growth in year
Agent Commissions as % revenue	17.7	18.0	23.1	Increase in H1FY17 due to new agent subsidiaries rising to £0.7m with greater number of new agents.

*Source: MCL, Hardman & Co Research * Includes acquisition costs*

Impact on estimates

2017 in line so no major changes from that. Expect to upgrade numbers at interims when there is clarity on core business opportunity.

We have not at this stage included any change in our forecasts for the number of new agents joining MCL. We believe the opportunities are significantly higher than in previous years but there remain considerable uncertainties as to how many will convert. We discuss this below. Should more agents join, it will incur higher incentive costs which are likely to limit any material impact in FY18. The benefit will be seen in FY19 and we expect to upgrade our estimates with the interim results when there is much more clarity. The 2017 profit and loss numbers were in line with overall expectations and so the changes to estimates bottom line are very modest. Equity has increased as we had incorrectly deducted the final FY17 dividend from the equity base at the year end when it will have effect in the following year.

Figure 3: Estimate changes

	2017			2018e			2019e		
	Old	Actual	% change	Old	New	% change	Old *	New	% change
Profit and Loss (£'000s)									
Reported revenue	98.5	99.6	1%	104.2	107.3	3%	113.2	115.3	2%
Total impairments	(23.1)	(24.3)	5%	(25.0)	(27.9)	12%	(28.3)	(30.9)	9%
Total costs	(56.9)	(56.7)	0%	(59.6)	(59.6)	0%	(63.5)	(61.9)	-2%
EBITDA	19.7	19.9	1%	20.9	21.2	1%	23.2	24.1	4%
Adjusted pre tax	17.5	17.7	1%	18.5	18.8	2%	20.4	21.4	5%
Statutory pre tax	11.3	11.2	-1%	14.1	14.1	0%	13.7	14.6	6%
Statutory EPS (p)	6.9	6.6	-3%	8.7	8.7	0%	8.6	9.1	6%
Adj EPS (p)	10.7	10.8	1%	11.4	11.6	2%	12.6	13.2	5%
Div (p)	6.3	6.4	2%	6.9	7.0	1%	7.5	7.7	3%
Balance Sheet (£ms)									
Amounts Receivable	61.8	60.8	-2%	69.2	68.1	-2%	79.6	78.4	-2%
Borrowings	9.0	10.0	11%	11.5	11.5	0%	17.5	17.5	0%
Equity	56.2	61.4	9%	58.7	63.7	9%	60.2	65.7	9%

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

Underlying net asset value

Sensible discount rate on impaired loans sees c20% uplift to NAV compared with accounting whose rules are appropriate to mainstream lenders but not MCL

In our initiation note, we highlighted how the accounting for impairments under-valued the real net assets of the business because cashflows associated with non-performing loans were discounted at an unreasonably high rate. With the results, management highlighted that using a return on equity rate rather than customer rate for discounting would see net assets £11.6m higher, a material increase on the £61.4m reported on the accounting basis. We also note that for a growing company the effect is more than one which is being managed down.

Figure 4: Analysis of impact of discount rate

£ms	Feb 2017	Comment
Gross contracted receivables	122.9	This is the amount customers are legally due to pay (includes interest)
Cash projection	93.9	Using historic experience this is the amount MCL actually expects them to pay.
Discounted at customer EIR	(32.7)	Depending on product, the discount rate can be between 200-400% p.a. on those accounts which non-performing. Most cash flows are very short term so the effect averages at 35% discount to total nominal cash projected (performing loans are not affected)
IFRS Balance sheet	61.2	As reported in the statutory accounts
Discount at ROE target	(£21.1m)	Discount effect drops by two thirds using a lower discount rate
Balance sheet using ROE discount rate	£72.8	Lower discount increases net assets
Uplift in net assets	£11.6m	Impact is nearly 20% increase in NAV

Source: MCL, Hardman & Co Research

Funding

Headroom for growth but expect facilities to be increased

Management noted the peak utilisation of facilities was £21.5m (December 2016) against their facility of £25m. By the accounting year end of end February the utilisation had already dropped to £10m. New facilities to take account of incremental growth are being negotiated and we expect announcements in due course.

Opportunity from market changes

PFG believes the change will see cost savings and in due course better sales and collections

With its results on 28 February, PFG announced a major restructuring of its agent network and they provided more details in their April 4th Investor seminar (slides 112 -124 PFG CM day presentation). 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. PFG advise that it expects its annual profits in the medium term to increase by at least £30m to over £150m, with approximately half of the increase derived from cost savings and half derived from sales and collections. 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 so there is logic in their approach. PFG is currently in discussions with staff but expects the new structure to be in place by late summer 2017. In its 12 May IMS conference call PFG indicated it had filled c250 more jobs from its own agents than it had originally planned to do.

Small changes in PFG's business could have big effect on MCL

In 2016 PFG's consumer credit division revenue was £519m, impairments were £120m and costs were £257m. This was on a base of 862k customers and average receivables of £508m. CCD also includes PFG's online and guarantor business which total £24m receivables, c5% of the business and which are unaffected by the change. By way of comparison, MCL's Fy17 revenue was c£100m and its receivables £61m so if MCL was to gain 5% in PFG's revenue it would increase its revenue by a quarter.

Agents paid on commissions based on 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 not directly 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. We note that MCL has restructured its own 100+ employed agents (who came with acquired businesses) so that they are now on a self-employed basis.

Increasingly good agents may be disillusioned 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 have other part-time jobs or small businesses, or have caring responsibilities).). If good agents become disillusioned there is likely to be an opportunity for competitors like MCL to pick up agents and their customer base over time.

Technology has given MCL management span to manage incremental agent and customers

Critically managing the new agents takes resource to ensure risk is effectively controlled and compliance with regulatory standards. We note productivity improvements using technology mean that MCL see an increase of 28% in customers each manager can oversee as credible. On the current customers / agent ratio, this would mean an additional 511 agents could be managed on the existing infrastructure.

Uncertainty over how many agents will meet MCL's standards

MCL advised that the number of agents in its pipeline for new territory builds is up materially. However, the direct effect of this increase in agents is currently unclear.

- Conversion rates are uncertain. It is not clear how many of the new agents will fit MCL's culture and financial requirements. MCL are very clear that they want to work with agents who are compatible with their ethos and culture of responsible lending, and that any individual who joins must deliver the quality customer service that is at the heart of MCL's business model. They are not looking to work with agents who lack experience, are overly sales driven (at any cost), or who are not willing to grow their business steadily over time (hence MCL's approach to territory builds being supported over a 12 month period). We note keeping control of this means that MCL is also not hiring super-agents (those with large books where business is sub-contracted out to other agents).

And over how many of those that meet MCL's requirements will choose to join MCL

- Agents may choose not to join MCL. It is not the only alternative HCC employer and NSF very rapidly put out announcements effectively saying it was open to dissatisfied agents. In the cold light of day, some agents who were initially unsettled by changes in their current business may become more comfortable with it over time. We would also expect PFG to pro-actively respond should its loss of agents be materially above its own internal plans and this could see more incentives to stay.

Some will cover existing rounds and some will be incremental

- New agents will be used to fill a limited number of existing vacancies (c40-50), replace some under-performing agents and to grow new customer rolls. Only the latter will see uplifts to estimates.

We will build into forecasts when we have clarity. In meantime sensitivity given below. Little impact in FY18 with upside in FY19

Given these uncertainties, we believe it is inappropriate to build a step change into agent forecasts. Greater clarity will be available with the interim results and we expect to upgrade numbers at that time. To give investors a flavour of the potential we detail below a range of scenarios. The higher cost of new joiner incentives means that there is minimal impact on FY18 with any benefits being seen in FY19. Incremental agents should see economies of scale although this is offset by higher funding costs (all new lending would be debt financed rather than primarily equity financed as at present).

Figure 5: Scenarios of incremental agents

Scenario	2018E				2019E			
No of additional agents	**Base**	**+100**	**150**	**+200**	**Base**	**+100**	**150**	**+200**
No agents	1,825	1,925	1,975	2,025	1,850	1950	2000	2050
Loan book (£ms)	68	72	74	76	78	83	85	87
Total revenue	107.3	110.4	113.2	116.1	115.3	120.3	123.4	126.5
Impairment charge (exc FRS9)	(27.9)	(29.4)	(30.5)	(31.6)	(30.9)	(32.9)	(34.1)	(35.3)
Agent commission	(24.7)	(26.5)	(28.2)	(29.7)	(26.5)	(28.0)	(28.7)	(29.4)
Gross profit	54.7	54.4	54.5	54.8	57.9	59.5	60.6	61.8
Administration expenses pre excep and intang amortisation	(33.5)	(33.8)	(34.2)	(34.5)	(33.8)	(34.1)	(34.5)	(34.8)
Depreciation (inc goodwill impairment, amortis of IT)	(1.4)	(1.4)	(1.4)	(1.4)	(1.6)	(1.6)	(1.6)	(1.6)
Operating profit pre excep and amortisation	19.8	19.2	19.0	18.9	22.5	23.7	24.6	25.4
Adjusted financing costs	(1.0)	(1.1)	(1.2)	(1.3)	(1.1)	(1.4)	(1.6)	(1.8)
Adjusted profit before tax	18.8	18.0	17.7	17.6	21.4	22.3	23.0	23.6
Income tax	(3.8)	(3.6)	(3.5)	(3.5)	(4.3)	(4.5)	(4.6)	(4.7)
Adjusted post tax profit	15.1	14.4	14.2	14.1	17.1	17.8	18.4	18.9
V base		**-4%**	**-6%**	**-6%**		**4%**	**7%**	**10%**
Agent comm as % revenue	-23.0%	-24.0%	-24.9%	-25.6%	-23.0%	-23.3%	-23.3%	-23.3%
Cost Income Ratio	-31.2%	-30.7%	-30.2%	-29.7%	-29.3%	-28.4%	-27.9%	-27.5%
Funding cost as % revenue	-0.93%	-1.04%	-1.08%	-1.12%	-0.95%	-1.20%	-1.30%	-1.41%

Source: Hardman & Co Research

Business as Usual Outlook

In our initiation (Bringing home collect into the 21st century) we outlined a number of options for profit growth for MCL.

Profit growth options in core HCC

Attracting more agents organically

In a normal year adding c100 new agents anyway

In FY17 MCL added 105 new agents (FY16 91). Management indicates that the supply of potential agents, even the best quality ones they are targeting, is such that the incentive per agent is unlikely to change materially.

Book acquisitions

6 book acquisitions, slightly down on FY16 but an ongoing feature of the business

In FY17 MCL made 6 loan book acquisitions with receivables of £6.7m, a consideration of £5.7m and generating intangibles and goodwill of £2.6m. This is somewhat slower than FY16 (consideration £7.9m, intangibles £2.8m) as the market slowed somewhat. Looking forward as the regulator moves to more intensive supervision (rather than approval) there may be more opportunities. Management believes that the level of opportunities probably bottomed out in FY17 providing further growth options going forward.

Use of technology to attract new customers

Increase in young customers with new technology delivery

We note that growth in 18-35 year customers was 5% in FY17 reflecting distribution using modern technology.

Use of technology to improve efficiency

Technology also saw 7% operational efficiency gain and increased management capacity

Management highlight that technology means the numbers of customer each manager can supervise has increased by 28% (from 700 to 900). This is important given the market opportunity currently available. We note the overheads to revenue ratio has fallen from 37.6% to 35.1%, an efficiency improvement of 6.8%.

Improving yield by shortening loan duration

Further shortening of loan duration seen uplift in yield

Shorter loans are on a higher yield. Management has reduced the average loan duration from 47.5 weeks (February 2015), to 44 weeks (February 2016) and down to 41.1 weeks (February 2017). This process is nearly complete as the target duration was 40 weeks.

New product areas

Figure 6: New initiatives timeline

	Roadmapped	Infrastructure in place	Internally Trialled	Expected launch
Morses Club Card	Y	Y	Y	Y
Remote Collect	Y	Y	Y	Y
Online Lending	Y	Y	Y	Y
E-Money	Y	Q418	Q119	Q219
Revolving Credit	TBC	TBC	TBC	TBC
Mobile Wallet	TBC	TBC	TBC	TBC

Source: MCL, Hardman & Co Research

Morses Club card growth continuing at c5k per six months.

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

We note that Morses Club Card sales (FY 10,228) ha been steady through the year (5k issued H1). It now accounts for c6% of lending and has proved especially popular with the 18-35 year old age bracket. Online lending activities were accelerated with the Shelby acquisition in January 2017. Management note that the cost of this deal was c15% of the quote to build an IT platform and they also got the relevant FCA licences. At this stage, it is a soft launch (branded Dot Dot Loans in March and currently running at c8k applications per month) as management tests its credit systems and scorecards. Over time the build-up of data is likely to see an acceleration of lending but we expect management to be conservative in this growth.

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

A new business message with these results was the indication that MCL is 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. These are likely to be politically attractive given the premiums that poorer customers often pay. Delivery would appear to be in conjunction with third parties who have the product but not the customer base. We expect more details to emerge over time on the potential monetary benefits and have not included any in our forecasts yet.

Natural attrition rates

Natural attrition from shortening book, applying MCL high credit standards, customers position and agent turnover.

The growth in receivables is offset by natural attrition from: (i) Bad debts written off; (PFG in recent announcement has attributed half to a third of its customer number reductions to the sale of delinquent low value customer balances to third party debt purchasers) (ii) Shortening loan durations mean that the book needs to churn more rapidly. This factor mirrors the improvement in yield and is largely complete. (iii) MCL credit standards typically see between a third and 40% of acquired customers not renewed. While the SFS clean-up is largely complete there will be drag from new book acquisitions made each year. (iv) Some acquired customers will have been given larger balances than MCL systems would support and so the individual borrowings will fall. (v) Good quality customers become eligible for cheaper forms of finance. (vi) Natural turnover of agents – as noted above agents can stop for a variety of reasons including moving house, their own employment prospects and life changes as well as moving to the competition. We note in FY17 that the total number of agents fell despite the territory builds and acquisitions. Management has emphasised that quality of agents is key and that numbers alone are not a key metric.

Financials

Profit & Loss

Figure 7: Profit and Loss (£ms)

Year ended February	2015	2016	2017	2018E	2019E
Existing operations	22.5	84.7	96.2	104.0	112.0
Acquisitions during period	67.4	5.8	3.3	3.3	3.3
Total revenue	**89.9**	**90.6**	**99.6**	**107.3**	**115.3**
Impairment charge	(22.9)	(18.8)	(24.3)	(27.9)	(30.9)
Agent commission	(17.7)	(19.2)	(22.4)	(24.7)	(26.5)
Gross profit	**49.3**	**52.6**	**52.9**	54.7	57.9
Administration expenses pre excep and intang amortisation	(32.8)	(33.3)	(33.0)	(33.5)	(33.8)
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**	**19.8**	**22.5**
Adjusted financing costs	(2.6)	(1.6)	(0.9)	(1.0)	(1.1)
Adjusted profit before tax	**13.0**	**16.8**	**17.7**	**18.8**	**21.4**
Income tax	(2.7)	(3.5)	(3.7)	(3.8)	(4.3)
Adjusted post tax profit	**10.3**	**13.3**	**14.0**	**15.1**	**17.1**
Average number of shares	126.70	129.50	129.50	129.50	129.50
Statutory EPS (p)	46.47	6.11	6.64	8.73	9.11
Diluted EPS (p)	46.47	6.11	6.61	8.69	9.07
Adjusted EPS (p)	**8.12**	**10.24**	**10.79**	**11.63**	**13.21**
Total dividend (p)	n/m	n/m	6.40	7.00	7.70
Dividend cover (adjusted EPS)	n/m	n/m	1.69	1.66	1.72
Ratios (%)					
Tangible ROE	n/m	20%	29%	28%	29%
Adjusted tangible ROE	n/m	12%	18%	21%	20%
Adjusted pre-tax ROA	n/m	30%	30%	29%	29%
Impairments as % revenue	-25%	-21%	-24%	-26%	-27%
Agent cost as % revenue	-20%	-21%	-23%	-23%	-23%
Admin cost as % revenue	-36%	-36.8%	-33.1%	-31.2%	-29.3%
Total costs as % revenue	-56%	-58%	-56%	-54%	-52%
Finance costs as % average debt	n/m	n/m	9.5%	9.3%	7.6%
Revenue yield (revenue as % average receivables)	n/m	164%	170%	166%	157%
Number of clients	198,171	198,727	216,000	225,000	245,000
No agents	1,893	1,839	1,826	1,825	1,850
Clients per agent	105	108	118	123	132
Revenue per client (£)	453	456	461	477	471
Revenue per agent (£s)	47,472	49,247	54,533	58,803	62,336
Agents comms per agent (£s)	9,350	10,440	12,270	13,525	14,337
Profit per client (£)	295	52	52	84	87
Profit per agent (£)	30,894	5,633	6,119	10,318	11,563
Receivables per client (£)	280	286	283	304	321

Source: MCL, Hardman & Co Research

Figure 8: Adjusted profits (£ms)					
Year ended February	**2015**	**2016**	**2017**	**2018E**	**2019E**
Adjusted pre-tax	**13.0**	**16.8**	**17.7**	**18.8**	**21.4**
Exceptional items inc IPO, Restructuring	(0.8)	(1.9)	(2.8)	(0.75)	(0.5)
Amortisation of intangibles	(8.3)	5.4	(3.7)	(3.9)	(3.8)
Parent interest charge adjustment	2.6	0.9	-	-	-
IFRS9 adjustment	-	-	-	-	(2.5)
Reported PBT on ordinary activities	**6.5**	**21.2**	**11.2**	**14.1**	**14.6**
Gains on acquisition	52.0	-	-	-	-
Statutory pre-tax profit	**58.5**	**21.2**	**11.2**	**14.1**	**14.6**
Adjusted tax	(2.7)	(3.5)	(3.7)	(3.8)	(4.3)
Tax effects of adjustments	3.1	1.1	1.1	0.9	1.5
Statutory post tax earnings	**58.9**	**7.9**	**8.6**	**11.3**	**11.8**

Source: MCL, Hardman & Co Research

Balance Sheet

Figure 9 details the expected balance sheet. The expected strong growth in lending is the key feature which as previously discussed does not include any benefit from accelerated agent hiring.

Figure 9: Balance sheet (£000s)					
Year ended February	**2015**	**2016**	**2017**	**2018E**	**2019E**
Non-current					
Goodwill	294	1,326	2,834	3,000	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**	**8,390**	**6,122**
Current assets					
Receivables	**53,976**	**56,152**	**60,833**	**68,133**	**78,353**
Trade / other receivables	26,216	1,554	2,019	1,554	1,554
Cash and cash equivalent	8,650	3,755	3,985	4,678	5,681
Total current assets	88,842	61,461	66,837	74,365	85,587
Total assets	**101,970**	**73,700**	**77,887**	**82,756**	**91,709**
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	67,473	77,695
Non-current liabilities					
Financial Liabilities – borrowings	-	(9,000)	(10,000)	(11,500)	(17,500)
Deferred tax	(2,614)	(1,879)	(617)	(617)	(617)
Total non-current liabilities	(2,614)	(10,879)	(10,617)	(12,117)	(18,117)
Total liabilities	**(5,888)**	**(18,331)**	**(16,509)**	**(19,009)**	**(26,009)**
Net assets	**96,082**	**55,369**	**61,378**	**63,747**	**65,700**
NAV per share (£)	0.74	0.43	0.47	0.49	0.51
Tangible NAV (£)	0.66	0.35	0.40	0.44	0.47
Total debt to NAV (%)	0%	16%	16%	18%	27%
Total debt to tangible NAV (%)	0%	20%	19%	20%	29%
Debt to loans (%)	0%	16%	16%	17%	22%

Source: MCL, Hardman & Co Research

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	14,135	14,566
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)	(2,975)	(6,395)
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	1,000	1,100
Taxation paid	(800)	(1,737)	(4,078)	(4)	(4)
Net cash inflow / (outflow) from operating activities	**5,036**	**14,810**	**9,726**	**15,610**	**12,659**
Cashflows from investing activities					
Purchase of intangibles	(416)	(2,523)	(1,029)	(925)	(1,259)
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)**	**(6,425)**	**(6,759)**
Cashflows from financing activities					
Net borrowing	-	9,000	1,000	1,500	6,000
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)**	**(8,492)**	**(4,899)**
Net increase in cash and cash equivalents	7,396	(4,895)	230	693	1,002
Opening cash and cash equivalents	1,253	8,650	3,755	3,985	4,678
Closing cash and cash equivalents	8,650	3,755	3,985	4,678	5,681

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 the February 2017 results changes our absolute valuation techniques now imply an average of 177.4p (previously 152.1p) with the increase largely driven by moving forward our valuation base year to 2019. The peer valuations indicate 165p (previously 142p) with the increase driven by a material increase in a couple of peers share prices.

Figure 11: Summary of different valuation techniques

	Implied Price (p)	Upside (%)
Gordon's Growth	199.5	49%
DDM	155.4	16%
Average absolute measures	**177.4**	**32%**
Peer 2017 PE	157.9	18%
Peer 2017 yield	171.8	28%
Average of peers	**164.8**	**23%**

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
Discount re near term (%)	20%	20%	20%	20%
P/BV (x)	4.3	4.5	3.6	4.6
BV 2019 (£m)	60.7	60.7	60.7	60.7
Valuation (£m)	258.3	271.6	218.6	276.9
Valuation per share (p)	**199**	**210**	**169**	**214**
Variance (p)		13.2	-39.7	18.5

Source: Hardman & Co Research

Broad peer comparisons

Figure 13: Peer valuation comparisons

	Shr price (p)	Market Cap (£m)	2017 PE (X)	2017 Yield (%)	P latest tangible BV
Morses Club (Feb 18)	**134**	**173.5**	**11.5**	**5.2%**	**3.4**
NSF (Dec)	3112	4612	17.1	4.5%	5.8
PFG (Dec)	68.75	218	13.9	3.3%	2.2
S&U (Jan 18)	2000	240	10.2	5.1%	1.7
H&T	295	109	13.1	3.4%	1.4
Peer average			**13.58**	**4.1%**	**2.77**
MCL at peer average (p)			**157.9**	**171.8**	

Source: Hardman & Co Research

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