EDISON

S&U

H122 update

Reduced impairments underpin increased profit

Financial services

S&U reports that growth in lending at Advantage and Aspen has been somewhat constrained by the supply of used vehicles and houses for sale, but collections have been strong. At Advantage the level of impairment has been lower than expected, more than offsetting lower loan growth and prompting increases in our earnings estimates.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/20	89.9	35.1	239.4	120.0	12.3	4.1
01/21	83.8	18.1	120.7	90.0	24.4	3.1
01/22e	84.4	30.6	204.2	100.0	14.4	3.4
01/23e	90.9	33.2	221.7	110.0	13.3	3.7

Note: *PBT and EPS are reported. EPS are diluted.

Trading update for May to July

S&U's trading update for the period from 20 May to 31 July indicated that it is trading well, with profitability, collections and book debt quality ahead of expectations. Advantage motor finance has seen strong levels of applications though transactions are slightly below an ambitious target (with cautious underwriting and limitations on supply of vehicles) leaving net receivables similar to the year-end level of £247m. This has been more than offset by strong collections with bad debt and impairment levels below expectation so the divisional H122 profit is expected to show a significant increase, ahead of budget. Advantage continues to work on improvements including refining its product offering, easing online payments and enhancing social media marketing. Aspen has benefited from a strong housing market (albeit with some supply constraints) and participation in the government-backed Coronavirus Business Interruption Loan Scheme (CBILS) and net receivables have reached nearly £58m (versus over £50m in the 20 May AGM update and £18.5m a year ago). Book quality and repayments remain good. Aspen has also refined its product offering and has strengthened its underwriting team to ensure delivery of a prompt and bespoke service.

Financial position, outlook and new estimates

The group reported current borrowing of £116m compared with £110m at the beginning of the period and total funding facilities of £180m. Looking ahead, Advantage should benefit from a gradual return to normal levels of business, subject to the evolution of the pandemic and UK economy. Aspen may see some further CBILS benefit in the current month and underlying growth in FY23, although replacing the CBILS lending as it matures may represent a challenge. Reflecting the trading update, our EPS estimates for FY22 and FY23 are increased by 28% and 5% respectively. For further detail see page 4.

Valuation

On our new forecasts the shares are trading on prospective P/Es of 14.4x and 13.3x for FY22 and FY23 respectively and a historic yield of 3.1%. Further potential recovery and growth are supportive factors.

11 August 2021

Price	**2,940p**
Market cap	**£357m**
Debt (£m) at 10 August 2021	116
Shares in issue	12.1m
Free float	28%
Code	SUS
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	14.9	6.6	82.6
Rel (local)	13.8	5.3	50.0
52-week high/low		2,930.00p	1,475.00p

Business description

S&U's Advantage motor finance business lends on a simple hire-purchase basis to lower- and middle-income groups who may have impaired credit records that restrict their access to mainstream products. It has c 63,000 customers. The Aspen property bridging business has been developing, following its launch in early 2017.

Next events

H122 results	28 September 2021

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Edison profile page

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Background

This section provides updates on some of the indicators we monitor when assessing trends in the markets for the Advantage and Aspen businesses.

Exhibit 1 shows independent forecasts for UK GDP and unemployment as collected by the UK Treasury in July. Compared with the May data shown in our last note, the average of new GDP forecasts has shown a further increase for 2021 and is marginally lower for 2022. The mitigation provided by the vaccination programme during the current wave of COVID-19 and the ability to push ahead with the easing of restrictions are likely to have been influential in the estimate increases. Unemployment expectations have been lowered further for both years and on all the measures shown. This should be positive for Advantage, if realised, as unemployment is a key sensitivity.

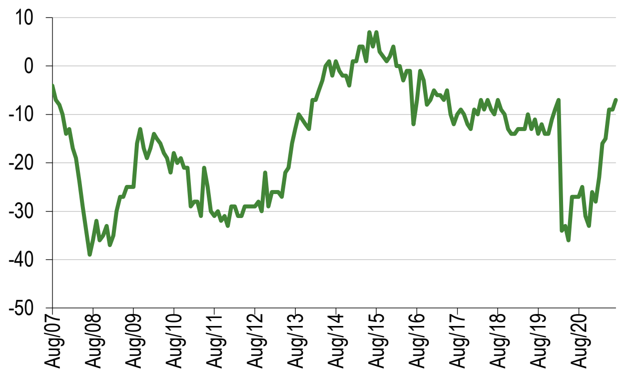
Exhibit 1: Comparison of independent economic forecasts for the UK (July)

%	Average	Average of new forecasts	Low	High
GDP growth				
2021	6.9	7.1	5.7	8.1
2022	5.5	5.4	4.5	8.2
Labour Force Survey unemployment rate Q4				
2021	5.6	5.4	4.9	6.5
2022	4.9	4.7	4.3	5.9

Source: HM Treasury

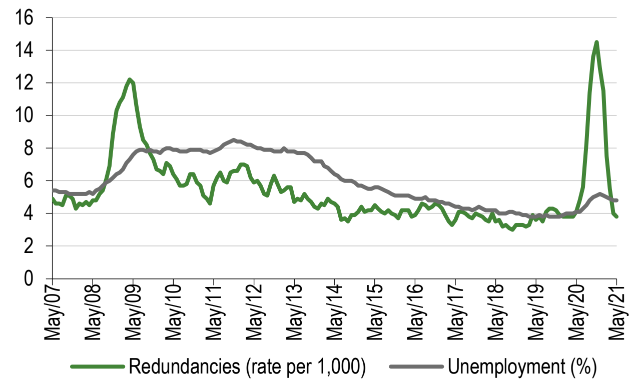
Exhibit 2 shows a continued improvement in consumer confidence in recent months, despite the emergence of a further wave of COVID-19. Uncertainties remain and the further impact of COVID-19 is likely to fluctuate, but for the moment confidence in a progressive normalisation in economic activity seems to be growing. Exhibit 3 shows that the unemployment rate has moved up since early 2020 but appears to be flat or slightly lower on the latest, provisional, readings. Government job protection measures are still moderating the level of unemployment to some extent, leading to the expectation of a slightly higher rate by the end of December this year at 5.6% versus the May level of 4.8%. Redundancies, a more immediate measure, saw a very sharp spike as the pandemic took hold, but fell rapidly and have remained on a downward trend on recent figures.

Exhibit 2: GfK UK consumer confidence indicator



Source: Refinitiv (last value July 2021)

Exhibit 3: UK redundancies and unemployment

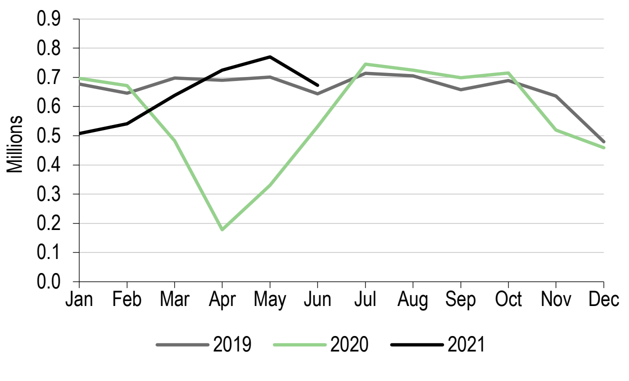


Source: ONS (last value May 2021)

We now turn to data on used car transactions and used car finance. Exhibit 4 shows the sharp drop in used car transactions in April 2020. Volume recovered very well following the initial lockdown, albeit with a further dip following subsequent lockdowns. April to June 2021 saw a return to activity levels close to pre-pandemic levels as represented here by the 2019 monthly figures, although the

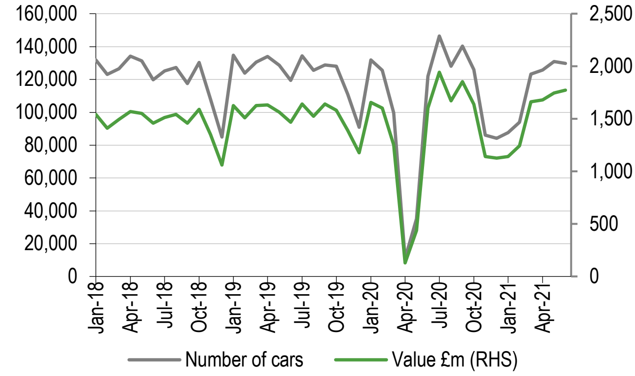
April bounce was smaller than industry participants had thought possible. Exhibit 5 shows a similar pattern in used car finance.

Exhibit 4: Monthly used car transactions 2019–21



Source: SMMT. Note: Last value June 2021.

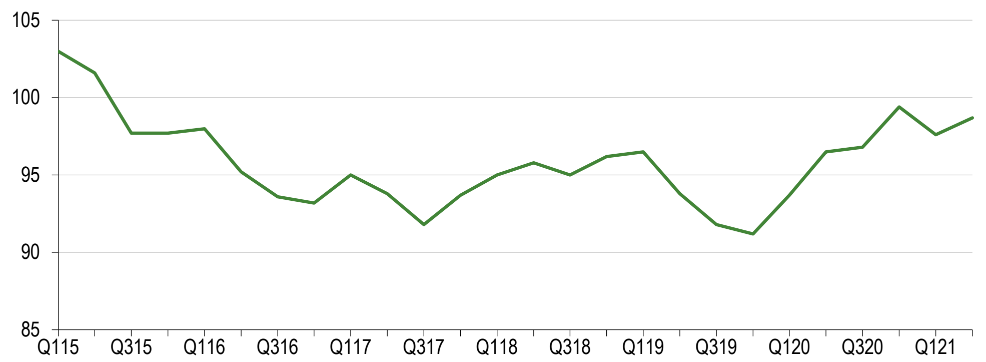
Exhibit 5: Used car finance through dealerships



Source: Finance and Leasing Association. Note: Last value June.

Used car prices (see Exhibit 6), were buoyant in 2020 and have remained so in 2021 to date, with strong consumer demand and reduced supply pushing prices up. The ONS data is supported by reports from auctioneer Aston Barclay and marked strength in the Autotrader retail price index. While Advantage's exposure to auction prices for repossessed cars is moderated by the relatively low value of vehicles it finances, the strength in prices is a positive factor.

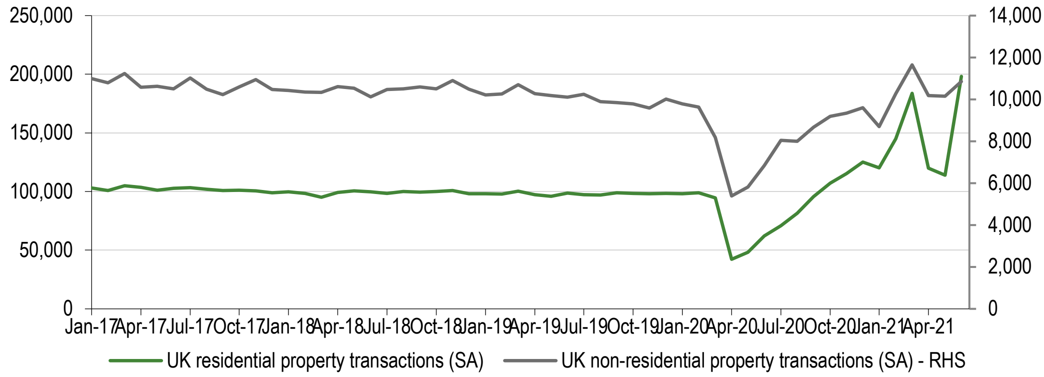
Exhibit 6: Second-hand car prices (CPI index)



Source: ONS (last value Q221)

Looking at the background for Aspen Bridging, Exhibit 7 shows the number of UK non-residential and residential transactions, with residential being most relevant for Aspen. Both have seen sustained improvement following the initial lockdown in 2020 with the latest residential data boosted as buyers sought to take advantage of the temporary increase in the stamp duty land tax nil rate band. On a longer view, S&U sees an imbalance between supply and demand for good-quality homes as a favourable backdrop for its customers who are refurbishing and developing properties. As a small business, Aspen should also have significant scope for expansion now that it is more established in the market. The CBILS lending mentioned earlier has given useful access to larger and more established developer customers as well as expanding the loan book in the short term.

Exhibit 7: UK property transactions (seasonally adjusted)



Source: HM Revenue & Customs. Note: Figures for April to June 2021 are provisional. SA = seasonally adjusted.

Estimate changes

Following the trading update we have adjusted our estimates with the key figures shown below and further details given in the Financial summary (Exhibit 9). The main changes we have made in our assumptions are as follows:

- Reduced net receivables and loan book growth assumptions for Aspen and Advantage respectively to reflect the levels reported in the update. This results in the reductions in revenue shown below.
- Reduced assumed impairment rate for Advantage to a level closer to pre-pandemic levels. This has a substantial positive impact on estimated profit for FY22 as shown and results in an increase in EPS for the year of 28%. The change for FY23 is more modest because we had already allowed for a significant normalisation of impairment levels.

We have not allowed for a 'macro' write back of the significant provisions made during FY21 at Advantage (a profit and loss charge of £36.0m versus £16.5m in FY20 resulting in end-year balance-sheet provisions of £92.6m). With the government furlough scheme still to fully unwind, there could be a need to use some of these provisions. Nevertheless, the year-end review of provisions could generate a one-off release.

Exhibit 8: Changes to estimates

Year-end January	Revenue (£m)			PBT (£m)			EPS (p)			DPS (p)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
FY22e	88.6	84.4	-4.8%	23.9	30.6	28.3%	159.2	204.2	28.3%	100.0	100.0	0.0%
FY23e	94.5	90.9	-3.8%	31.8	33.2	4.6%	211.9	221.7	4.6%	110.0	110.0	0.0%

Source: Edison Investment Research

Valuation

P/E comparisons with peers remain difficult given the impact of forward-looking provisioning as a result of the COVID-19 pandemic. On our revised numbers, S&U trades on prospective multiples of 14.4x and 13.3x for FY22 and FY23 respectively. Given the five-year duration of Advantage loans and our assumptions on loan growth, even the FY23 forecast is unlikely to reflect a full recovery from the pandemic. At a share price of 2,940p, an ROE/COE model with an assumed cost of equity (COE) of 10% and long-term growth of 2% suggests the market is assuming a return on equity (ROE) of c 18%. This is above the 13.2% and 13.4% generated in our forecasts for FY22 and

FY23, but the potential for further recovery and growth in both businesses are supportive factors here.

Exhibit 9: Financial summary

£'000s	2017	2018	2019	2020	2021	2022e	2023e
Year end 31 January							
PROFIT & LOSS							
Revenue	60,521	79,781	82,970	89,939	83,761	84,360	90,893
Impairments	(12,194)	(19,596)	(16,941)	(17,220)	(36,705)	(19,135)	(19,168)
Other cost of sales	(12,871)	(17,284)	(15,751)	(19,872)	(14,264)	(18,688)	(20,808)
Administration expenses	(8,332)	(9,629)	(10,763)	(12,413)	(10,576)	(11,642)	(12,543)
EBITDA	27,124	33,272	39,515	40,434	22,216	34,895	38,374
Depreciation	(253)	(294)	(414)	(450)	(520)	(528)	(475)
Op. profit (incl. share-based pay-outs pre-except.)	26,871	32,978	39,101	39,984	21,696	34,367	37,898
Exceptionals	0	0	0	0	0	0	0
Non recurring items	0	0	0	0	0	0	0
Investment revenues / finance expense	(1,668)	(2,818)	(4,541)	(4,850)	(3,568)	(3,769)	(4,690)
Profit before tax	25,203	30,160	34,560	35,134	18,128	30,599	33,208
Tax	(4,861)	(5,746)	(6,571)	(6,252)	(3,482)	(5,814)	(6,310)
Profit after tax	20,342	24,414	27,989	28,882	14,646	24,785	26,899
Average Number of Shares Outstanding (m)	12.0	12.1	12.1	12.1	12.1	12.1	12.1
Diluted EPS (p)	169.1	202.4	232.0	239.4	120.7	204.2	221.7
EPS - basic (p)	170.7	203.8	233.2	239.6	120.7	204.3	221.7
Dividend per share (p)	91.0	105.0	118.0	120.0	90.0	100.0	110.0
EBITDA margin (%)	44.8%	41.7%	47.6%	45.0%	26.5%	41.4%	42.2%
Operating margin (before GW and except.) (%)	44.4%	41.3%	47.1%	44.5%	25.9%	40.7%	41.7%
Return on equity	15.2%	16.7%	17.6%	16.8%	8.1%	13.2%	13.4%
BALANCE SHEET							
Non-current assets	138,004	181,015	185,383	197,806	173,413	210,660	234,004
Current assets	57,763	84,178	95,430	108,275	111,426	110,397	122,044
Total assets	195,767	265,193	280,813	306,081	284,839	321,057	356,048
Current liabilities	(17,850)	(7,927)	(6,722)	(7,424)	(5,309)	(4,151)	(4,396)
Non current liabilities inc pref	(38,450)	(104,450)	(108,724)	(119,183)	(98,501)	(122,923)	(142,845)
Net assets	139,467	152,816	165,367	179,474	181,029	193,982	208,807
NAV per share (p)	1,177	1,276	1,375	1,493	1,490	1,597	1,719
CASH FLOW							
Operating cash flow	(27,431)	(43,418)	10,530	4,946	32,940	(10,226)	(8,273)
Net cash from investing activities	(308)	(1,040)	(785)	(265)	(1,112)	(250)	(250)
Dividends paid	(9,548)	(11,377)	(13,080)	(14,461)	(13,098)	(11,892)	(12,134)
Other financing (excluding change in borrowing)	21	12	14	14	2	0	0
Net cash flow	(37,266)	(55,823)	(3,321)	(9,766)	18,732	(22,368)	(20,657)
Opening net (debt)/cash	(11,901)	(49,167)	(104,990)	(108,311)	(118,077)	(99,345)	(121,713)
Closing net (debt)/cash	(49,167)	(104,990)	(108,311)	(118,077)	(99,345)	(121,713)	(142,370)

Source: S&U accounts, Edison Investment Research

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