Stockdale

9 June 2016

Buy

Private & Commercial Finance Group*

Strong results and banking licence in sight

Current price
31p

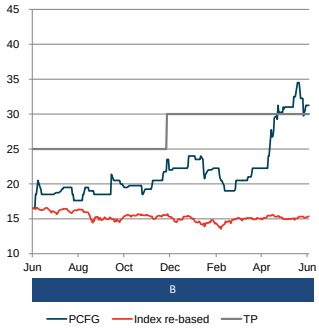
Target price
42p (from 30p)

Market cap
£49.7m

PCFG has delivered adj. PBT of £3.5m in the 12 months to end March 2016, in line with our upgraded forecast following the trading update. With the change of year-end and the banking licence application submitted last month, we have moved the basis of our forecasts to pro forma 12 month periods to September 2016 and are no longer treating banking costs as exceptional. We have also moved the basis of our target price to a ratio of 0.6x our forecast FY2016 loans portfolio equal to 42p per share (from 30p). Buy rating retained.

Price performance

	Stock	All-Share
1 month:	0.8%	2.5%
3 month:	52.4%	1.3%
12 month:	89.4%	-7.1%



Key forecasts

Year to Sep	Sales £m	PBT £m	EPS p	EPS growth %	DPS p	Dividend yield %	P/E x	EV/EBITDA x	ROE %
2015A#	48.2	2.8	1.3	62.2	0.0	0.0	23.2	2.1	10.7
2016E#	54.5	3.6	1.6	21.2	0.1	0.3	19.1	5.2	11.0
2017E	62.7	3.7	1.4	-11.4	0.2	0.6	21.6	5.7	7.3
2018E	78.4	6.0	2.3	55.7	0.3	1.0	13.9	4.5	10.7

Source: Stockdale, # estimates for the 12 months to 2015 and 2016 as year-end changed to September from March

Results to end March 2016 continue to show strong progress

Following the change of year end to September to bring it in line with its 72% shareholder, Bermuda Commercial Bank (BCB), PCFG will be reporting an 18-month period to September 2016. The results for the 12 months to March 2016 show a 67% increase in adj. PBT to £3.5m on a portfolio of £112m (up 12%). The portfolio quality is demonstrated by the record low level of impairments at 1.1% (1.6% a year ago).

Exceeding key targets

An indication of how strong the business has performed is that both the key targets of a 2.0 % return on average assets and a 10% return on equity were significantly beaten, with the former hitting 3.1% and the latter 13.9% for the reported period. This compares to 2.2% and 10.2% respectively in the prior year and has led to PCFG increasing the targets for the shorter-term to 2.5% and 12.5%.

Banking licence will open up much larger addressable market

Although PCFG has committed facilities to continue to grow its business in order to achieve its medium-term target of a £250m loans portfolio, it needs to access cheaper capital. To do this PCFG has been progressing through the banking licence application process over the last 12-18 months, which culminated in the application being submitted on 13 May 2016. With the regulatory authorities expected to respond within six months we no longer treat the costs associated with becoming a bank as "exceptional" and thus our adjusted PBT and reported PBT are the same. We forecast £1m of mobilisation costs in FY2017 but little benefit to the portfolio, but then a significant increase in both portfolio size and PBT in FY2018.

Changed basis of valuation has led to increased 42p target price

From September 2014, we had based our target price on an earnings-based multiple and, while this has been sensible given the strong earnings progression over the last two years, we now believe a target price based on the market capitalisation as a percentage of receivables better reflects the growth opportunity. Our 42p target price (previously 30p) represents 0.6x the £120m portfolio we forecast for September 2016. With our forecast of significant portfolio growth in the next two years, there is scope to increase our target price further in due course. We view the intention to re-introduce a dividend as an additional attraction for investors.

Last results
Interims, 9 Jun 16

Next results
Finals, Dec 16

Next event
Trading update, Oct 16

Reuters / BBG
PCF.L / PCF LN

Index
FTSE AIM

Priced at close
8 June 2016

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*Stockdale acts as broker and/or advisor to this company and has agreed to publish research on it at least annually.

Stockdale

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Overview

Company activities

Private & Commercial Finance Group (PCFG) specialises in the provision of finance through two divisions, Consumer Finance (providing finance to consumers mainly for used vehicles) and Business Finance (providing finance to SMEs for vehicles, plant and equipment). PCFG has c.12,000 agreements in place and a total loan portfolio of c.£112m. From its offices in London, management operates an efficient and scalable business model, with scope for enhanced returns through the expansion of its receivables portfolio. With 45 employees, the company has short lines of communication that enable fast decision-making. This is bolstered further by its internet-based proposals system, eQuote. Focused on prime customers, PCFG generates attractive yields and has low bad debt charges. With a diverse customer base, no single customer accounts for more than 0.6% of the portfolio.

Key issues on which investors must take a view

At the heart of PCFG's business model is the ability to generate a margin by borrowing from providers of finance at one rate and then lending this on to consumers and SMEs at a higher rate. A key issue in recent years had been the sourcing of new finance as banks cut lending. In the last year, PCFG has negotiated new and improved funding agreements and currently has committed headroom of over £25m, so we are confident that this position has improved. As a collateral-backed lender of good-quality liquid assets with new initiatives for growth, we believe PCFG is well-placed to grow its receivables portfolio and profitability. A further catalyst to this will be achieved when PCFG gets its banking licence which is progressing following the submission of the application in May 2016.

Likely direction of consensus revisions

PCFG has an experienced and dedicated management team and is now in a stronger position given its improved funding and initiatives for growth. Given the progress with the banking licence we have adjusted our PBT forecasts to reflect the costs of this and the benefits to come in due course. While we expect a much increased portfolio size following the attainment of the deposit-taking licence, it will be FY2018 before we forecast earnings progression given the costs involved ahead of mobilisation.

Valuation and reason behind target price

From September 2014 we based our target price on an earnings-based multiple rather than an NAV-based one. While this has been sensible given the strong earnings progression over the last two years we are now moving to a target price based on the market capitalisation as a percentage of receivables. As a consequence we now have a 42p target price which represents 0.6x the £120m portfolio we forecast for September 2016. Obviously, with our forecast of significant portfolio growth in the next two years there is scope to increase our target price further in due course. We view the intention to re-introduce a dividend as an additional attraction for investors.

Risks to our view

We believe that PCFG is well placed to deliver a progressive rise in its receivables portfolio now it has secured additional funding and the banking licence is progressing. A significant increase in competitive pressures or economic upheaval could pose a risk to our positive view. Any problems or delays in the banking licence process could impact management's ability to grow the portfolio and/or the return on average assets in the medium-term.

Assumptions

We now include the costs of becoming a bank and the benefits of future deposits in our forecasts

As previously announced, PCFG is moving its year end to September to coincide with the year-end of its 72% shareholder BCB and will therefore be reporting on an 18-month period to end September 2016. In Table 1 below we show our breakdown of the last three reported six-monthly periods and our forecast for the six months to end September 2016 to try to show the underlying profit progress that PCFG has been making. We have then created pro forma results for the 12 months to end September 2015 and 2016. PCFG has previously broken out central costs in the periods up to September 2015 but has now restated these results by allocating them to the two divisions. In addition, now that the banking licence application has been submitted, we are including the costs associated with becoming a bank (which we have previously shown as exceptional and added back to get our adjusted PBT - these amounted to £224k in the 12 months to March 2016), as part of the operating expenses. This means that our adjusted and reported PBT will be the same for our pro forma 12 months to end September 2016 and future years. As Table 1 shows the full benefit of taking deposits will initially start to come through in FY2018.

Table 1: Assumptions

Year end September (£'000)	2015H1A#	2015H2A#	2015A#	2016H1A#	2016H2E	2016E#	2017E	2018E
Consumer Finance								
Revenues	12,580	13,104	25,684	13,835	14,417	28,252	32,490	40,613
% increase	*7.7*	*12.1*	*9.9*	*10.0*	*10.0*	*10.0*	*15.0*	*25.0*
PBT	751	980	1,731	1,367	1,402	2,769	3,184	4,061
PBT margin	*6.0*	*7.5*	*6.7*	*9.9*	*9.7*	*9.8*	*9.8*	*10.0*
Business Finance								
Revenues	10,719	11,836	22,555	12,487	13,790	26,277	30,218	37,773
% increase	*8.8*	*14.9*	*11.9*	*16.5*	*16.5*	*16.5*	*15.0*	*25.0*
PBT	500	612	1,112	557	636	1,193	1,511	3,211
PBT margin	*4.7*	*5.2*	*4.9*	*4.5*	*4.6*	*4.5*	*5.0*	*8.5*
Total								
Revenue	23,299	24,940	48,239	26,322	28,207	54,529	62,708	78,385
% increase	*8.2*	*13.4*	*10.8*	*13.0*	*13.1*	*13.0*	*15.0*	*25.0*
Segmental PBT	1,251	1,592	2,843	1,924	2,038	3,962	4,695	7,272
PBT margin	*5.4*	*6.4*	*5.9*	*7.3*	*7.2*	*7.3*	*7.5*	*9.3*
Central Costs	0	0	0	0	0	0	0	0
Bank		(67)	(67)	(157)	(230)	(387)	(1,000)	(1,300)
Adjusted PBT	**1,251**	**1,659**	**2,910**	**1,767**	**1,808**	**3,575**	**3,695**	**5,972**
PBT margin	*5.4*	*6.7*	*6.0*	*6.7*	*6.4*	*6.6*	*5.9*	*7.6*
Reported PBT	1,251	1,525	2,776	1,767	1,808	3,575	3,695	5,972
End year portfolio size	**99,829**	**108,000**	**108,000**	**112,000**	**119,732**	**119,732**	**139,969**	**198,475**
% margin on average portfolio	*2.5*	*2.8*	*2.7*	*3.1*	*3.0*	*3.1*	*2.8*	*3.5*

Source: Stockdale # we have shown our estimates for the 6 and 12 month periods to end September 2015 and 2016 as company has changed its year-end to September from March. It will thus report on an 18 month period to September 2016.

Banking Licence

Table 2 below shows the timetable of events since PCFG considered applying for a deposit-taking licence at the beginning of 2015 and the various stages of the application process it has gone through up to submitting its application on 13 May 2016. There is now a period of up to six months before PCFG receives a response from the regulatory authorities, hence our expectation that this will occur around the time the final results for the 18 month period to September 2016 are released in December 2016.

Table 2: Timeline of banking application/licence

Date	
2015	
Q1	Banking licence project kicked off with system selection, Business plan production and exploratory conversations with the regulator
Q2	Business plan submitted for feedback sessions
Jul	First of three meetings with regulators occurred
2016	
Jan	Final feedback session meeting occurred
Mar	PRA/FCA invited PCFG to first challenge sessions to discuss the Capital and liquidity regulatory reviews (termed the Technical Challenge Session)
Apr	RA/FCA invited PCFG to second challenge sessions to discuss the Regulatory Business Plan
May	PRA/FCA invited PCFG to submitted application and this was duly submitted on 13 May 2016
Dec	Expected response from PRA/FCA
	Upon application approval the mobilisation of the business plan, including governance, systems, risks, compliance and control to take between 6 – 9 months
2017	
Jan	Stockdale expects PCFG will raise £10m of regulatory capital as part of the mobilisation process
Q3	First deposits will be taken

Source: Company data, Stockdale estimates

We have forecast that £10m of regulatory capital will be raised issuing 30 million shares at 33.5p by end January 2017

On the assumption that the banking licence application is approved PCFG has indicated it will take 6-9 months to mobilise the business plan. One of the initial elements of this will be to raise sufficient regulatory capital. We believe that this will range from a minimum of £5m up to £20m. In order to create our forecasts for FY2017 and FY2018 we have assumed that £10m of regulatory capital will be required. We have forecast that this will be achieved by issuing 30 million shares at 33.5p by end January 2017 so there will a weighted average of an additional 20 million shares in FY2017 and the full 30 million in FY2018. While there will be an additional £1m costs in the banking mobilisation in FY2017 there will be no real portfolio benefit as the first deposits are only likely to occur in the latter part of the financial year, hence our forecast of relatively flat group PBT for FY2017.

Sensitivity analysis

While the full benefit of the cheaper cost of capital will be felt in years after FY2018 Table 2 below shows a sensitivity analysis on a range of return on average assets from the target of 2.5% up to 4.0% on an average portfolio size of £150m to the targeted £250m. This analysis becomes applicable in FY2018 as our £4.7m PBT forecast would be a 3.5% return on average assets on an average portfolio size of £170m. Obviously, if PCFG can beat the 3.5% RoAA forecast and/or the portfolio grows ahead of our forecast then there is upside potential to our FY2018 forecast.

Table 3: PBT sensitivity analysis to portfolio size and return on average assets (£m)

	Return on average assets				
Average portfolio size (£m)	2.5%	2.7%	3.0%	3.5%	4.0%
150	3.8	4.1	4.5	5.3	6.0
170	4.3	4.6	5.1	**6.0**	6.8
200	5.0	5.4	6.0	7.0	8.0
225	5.6	6.1	6.8	7.9	9.0
250	6.3	6.8	7.5	8.8	10.0

Source: Stockdale estimates

Asset finance market

Asset finance as an alternative source of funding has been a strong growth market

Asset finance as an alternative source of funding has achieved exceptional growth through 2014 and 2015 and PCFG expects strong growth to continue beyond 2016 hence its banking application to access more of this market. The Finance & Leasing Association (FLA) reported £29bn of new business in the asset finance market in 2015, up 13% on the previous years. The growth was broad-based across many asset finance sectors – the largest of which were cars (up 11% to £8.9bn), commercial vehicles (up14% to £6.9bn) and plant & machinery (up 7% to £5.8bn).

PCFG's share of the SME Asset & Vehicle Finance and Consumer Motor Finance markets is currently less than 0.5%. This is largely as a result of the group's current treasury model and pricing structure, which means it is unable to compete on a significant number of transactions. Indeed, PCFG believes that its current pricing structure prevents it from accessing 80% of each market. This section of the market consists of customers with a better credit profile than currently seen, who by definition expect to pay a lower interest rate.

PCFG will be able to address this barrier issue as a consequence of the banking licence and a new treasury model and, therefore, be able compete in grades higher up the credit spectrum. Indeed, there should be opportunity to grow both the amount of new business and, thus, market share in each of its divisions. Furthermore, the ability to offer lower rates should ensure that PCFG has better customer retention as currently it loses those customers which improve their credit profile sufficiently to access cheaper finance.

Valuation

We view the 0.6x ratio of market cap to receivables portfolio implied by our 42p target price as conservative in the light of some of the recent multiples paid

Our new target price is derived from assuming a ratio of 0.6x the £120m receivables portfolio that we forecast for end-September 2017. We then divide the implied £71.5m market capitalisation by the current 170.4m fully-diluted shares in issue to derive 42p per share. We view this multiple as realistic given Non-Standard Finance PLC has been consolidating in this market with the purchase of Every Day Loans from Secure Trust for which it paid £235m (£107m cash, repaying £108m of debt and £20m of NSF shares) implying a 2.3x multiple relative to the last–reported £102m receivables. Its earlier purchase of the Home Credit business, Loansathome4u, from S&U for £82.5m implied a 2.4x multiple of the January 2015 loan book of £34.6m. Provident Financial Group bought Money Barn in August 2014 for £120m, implying a multiple of 0.9x the £133m receivables at that time, it has subsequently grown this to a £243m portfolio in sub-prime car finance.

Table 4: Ratio of market cap to receivables

Company	Mkt Cap (£m)	Last reported receivables portfolio (£m)	Ratio (x)
PCFG	**49.7**	**112**	**0.5**
1pm	37	47.9	0.8
Manx Financial Group	9.2	101.4	0.1
Provident Financial	4313	2060	2.1
S&U	268	160	1.7
Secure Trust Bank	500	1074.9	0.5

Source: Company data, Stockdale estimates

The intention to return to the dividend list is positive in our view

Table 5 below shows the valuation metrics (where available) of the above companies. We view the intention to have a progressive dividend policy in place from September 2016 as an added attraction to investors.

Table 5: Peer group analysis

Calendarised data	Price	Market cap	P/E		EV/EBITDA		Yield (net) (%)	
to September year end	(p)	(£m)	2016E#	2017E	2016E#	2017E	2016E#	2017E
PCFG	**31.3**	**49.7**	**19.1**	**21.6**	**5.2**	**4.7**	**0.3**	**0.6**
1pm	69.5	36.5	na	na	na	na	na	na
Manx Financial Group	9.3	9.4	na	na	na	na	na	na
Provident Financial	2878.0	4,249.1	18.2	na	na	na	4.2	na
S&U	2350.0	280.8	14.9	15.0	na	na	3.0	3.2
Secure Trust Bank	2630.0	478.4	12.4	11.6	na	na	3.1	3.3
Linear average			16.1	16.1	5.2	4.7	2.7	2.4

Source: Stockdale estimates # we have shown our estimates for the 12 month period to end September 2016 as company has changed its year-end to September from March. It will thus report on an 18 month period to September 2016. Factset. Priced at close: 7 June 2016

Financials

Table 6: Income statement

Year end September (£ 000)	2015A#	2016E'#	2017E	2018E
Revenues	48,239	54,529	62,708	78,385
% increase	*13.1*	*13.0*	*15.0*	*25.0*
Cost of sales	-33,961	-38,170	-43,896	-54,870
% group revenues	*70.4*	*70.0*	*70.0*	*70.0*
% increase	*12.8*	*12.4*	*15.0*	*25.0*
Gross profit	14,278	16,359	18,812	23,516
% group revenues	*29.6*	*30.0*	*30.0*	*30.0*
Operating expenses	-6,598	-7,331	-8,847	-9,705
% group revenues	*13.7*	*13.4*	*14.1*	*12.4*
Operating profit (pre-x)	7,680	9,028	9,966	13,810
% group revenues	*15.9*	*16.6*	*15.9*	*17.6*
Exceptional/bank costs	-67	-387	-1,000	-1,300
Operating profit	7,680	9,028	9,966	13,810
% group revenues	*15.9*	*16.6*	*15.9*	*17.6*
Net interest inc/(chrg)	-4,904	-5,453	-6,271	-7,839
Other financial items	-	-	-	-
Net financial items	-4,904	-5,453	-6,271	-7,839
PBT	2,776	3,575	3,695	5,972
% group revenues	5.8	6.6	5.9	7.6
PBT (pre-x)	**2,776**	**3,575**	**3,695**	**5,972**
Tax	-485	-792	-939	-1,454
% PBT	*17.5*	*22.2*	*25.4*	*24.4*
% Pre-exceptional PBT	*20.0*	*20.0*	*20.0*	*20.0*
Total tax charge	-485	-792	-939	-1,454
Net profit	2,291	2,782	2,756	4,518
% group revenues	*4.7*	*5.1*	*4.4*	*5.8*
Net profit (pre-x)	2,291	2,782	2,756	4,518
% group revenues	*4.7*	*5.1*	*4.4*	*5.8*
RoE	*10.7*	*11.0*	*7.3*	*10.7*
Fully-diluted shares in issue (m)	170.0	170.4	190.4	200.4
EPS (pre-x) (p)	**1.3**	**1.6**	**1.4**	**2.3**
% increase	*62.2*	*21.2*	*-11.4*	*55.7*

Source: Stockdale # we have shown our estimates for the 12 month periods to end September 2015 and 2016 as company has changed its year-end to September from March. It will thus report on an 18 month period to September 2016.

Table 7: Cash flow

Year end September (£ 000)	2015A	2016E	2017E	2018E
PBT	2,776	3,575	3,695	5,972
Depreciation reversal	28	20	70	70
Amortisation	181	145	445	445
Amortisation -other	136	33	33	33
Non-recurring items	-	-	-	-
Change in core working capital	-11,046	-623	-3,412	-8,723
(Profit)/loss on sale of FA	-	-	-	-
Cash tax (paid)/received	-277	-792	-939	-1,454
Share based payments	4	-	-	-
Other items	-18	-	-	-
Gross cash flow (as stated)	-8,216	2,357	-109	-3,657
Net interest (paid)/received	-	-	-	-
Gross cash flow	-8,216	2,357	-109	-3,657
Gross TFA capex	-84	-20	-500	-20
Proceeds from TFA disposals	33	-	-	-
Net capex on TFA	-51	-20	-500	-20
Intangible fixed assets expenditure	-72	-175	-1,500	-175
Acquisitions of businesses	-	-	-	-
Hire purchases advances	-	-	-	-
Issue of ordinary shares	8,500	1,000	10,000	-
Issue of CULS	-	-	-	-
Debt	-8,500	-3,200	-7,800	4,000
Dividends paid	-	-	-	-190
Balancing item	-	-	-	-
CHANGE IN CASH	-8,339	-38	91	-42
Net cash	**51**	**13**	**105**	**62**

Source: Stockdale # we have shown our estimates for the 12 month periods to end September 2015 and 2016 as company has changed its year-end to September from March. It will thus report on an 18 month period to September 2016.

Table 8: Balance sheet

Year end September (£ 000)	2015A	2016E	2017E	2018E
Assets				
Tangible fixed assets	100	100	530	480
Goodwill/intangibles	869	866	1,888	1,585
Loans & receivables	69,079	79,500	93,703	144,874
Deferred tax assets	1,717	1,625	1,625	1,625
Non-current assets	**71,765**	**82,091**	**97,746**	**148,564**
Trade and other receivables (debtors)	1,043	1,179	1,356	1,695
Loans & receivables	38,427	40,232	46,266	53,601
Gross cash (and equivalents)	510	472	564	521
Current assets	**39,980**	**41,883**	**48,186**	**55,818**
Total assets	**111,745**	**123,975**	**145,932**	**204,381**
Liabilities				
Debt LT	-71,069	-78,591	-84,831	-135,156
Non-current liabilities	**-71,069**	**-78,591**	**-84,831**	**-135,156**
Provisions	-	-	-	-
Gross debt (and equivalents)	-459	-459	-459	-459
Trade and other payables (creditors)	-1,654	-1,870	-2,150	-2,688
Interest-bearing loans and borrowings	-17,073	-17,875	-20,556	-23,815
Tax liabilities	-	-	-	-
Current liabilities	**-19,186**	**-20,203**	**-23,165**	**-26,962**
Total liabilities	**-90,255**	**-98,794**	**-107,996**	**-162,118**
Equity				
Share capital	7,656	8,564	18,564	18,564
Share premium	7,898	7,898	7,898	7,898
Other reserve	3,349	3,349	3,349	3,349
Retained earnings	2,585	5,369	8,125	12,452
Shareholders' funds	21,488	25,180	37,936	42,263
Minority interests	-	-	-	-
Equity capital	**21,490**	**25,180**	**37,936**	**42,263**

Source: Stockdale # we have shown our estimates for the 12 month periods to end September 2015 and 2016 as company has changed its year-end to September from March. It will thus report on an 18 month period to September 2016.

Explanation of recommendations

Each structure below is based on total shareholder return defined as the absolute rise in share price plus dividend payment over a 12-month period

Stockdale recommendation structure		Stockdale recommendation proportions in last quarter			
		All stocks excluding AIM		Corporate stocks excluding AIM	
Buy	+20% or more	Buy	79.2%	Buy	94.1%
Add	+10% to +20%	Add	4.2%	Add	0.0%
Neutral	(+/-) 10%	Neutral	16.7%	Neutral	5.9%
Sell	-10% or more	Sell	0.0%	Sell	0.0%

Source: Stockdale

Stockdale acts as a market maker or liquidity provider for this company.

Stockdale has provided investment banking services to this company within the last 12 months.

The company has seen this research but no material changes have been made as a result.

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