Stockdale

05 December 2017

Buy

Current price
31p

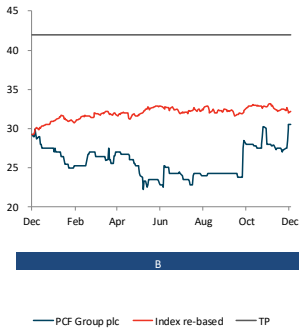
Target price
42p

Market cap
£65m

Enterprise value
£65m

Price performance

	Stock	All-Share
1 month:	8.9%	-2.8%
3 month:	25.8%	-0.5%
12 month:	4.4%	10.2%



Last results
Finals, 05 Dec 17

Next results
Interims, Jun 18

Next event
AGM, Mar 18

Reuters / BBG
PCF.L / PCF LN

Index
FTSE AIM

Priced at close
04 December 2017

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PCF Group*

New bank has started strongly

PCF's FY2017 final results beat expectations as adj. PBT of £5.0m added back only £1.37m banking costs vs our £1.5m forecast. The portfolio of receivables grew to £146m (SSL forecast £145m) from £122m and the quality was reflected by the record low impairment charge of 0.5%. Most importantly, PCF bank was launched in July and received £53m in deposits by 30 September. In our view, this access to lower cost of capital will enable PCF to achieve its FY2020 targets of a £350m portfolio and 12.5% RoE. We retain our 42p TP and Buy rating.

Key forecasts

Year to Sept	Net Interest £m	PBT £m	EPS* P	EPS growth %	DPS p	Dividend yield %	P/E x	P/NAV X	ROE %
2017A	11.1	5.0	2.0	nm	0.2	0.6	15.5	0.8	12.1
2018E	14.7	5.2	1.9	-5.0	0.3	1.0	16.3	0.7	10.1
2019E	20.5	8.5	3.2	68.4	0.4	1.3	9.7	0.6	14.7
2020E	22.1	10.0	3.7	15.6	0.5	1.6	8.4	0.5	14.9

Source: Stockdale estimates, company data. NB: * based on underlying PBT and fully-diluted EPS excluding banking costs

Transformational year as PCF Bank successfully launched in July 2017

To enable it to meet the PRA/FCA capital requirements PCF successfully raised £10.5m in April via a placing (£10m) and an over-subscribed open offer at 25p per share. PCF then completed its banking mobilisation process and received its first deposits in July, which had reached £53m by end September. We have argued for the last two years that we believe becoming a bank will be transformational for PCF as it will enable the group to have a substantially lower cost of capital. This means PCF should have access to larger and more prime addressable markets in order to achieve its £350m loan portfolio target by FY2020. Our forecasts assume that this target will be achieved organically but the £750m portfolio target by FY2022 will require acquisitions. As expected the expanded equity base impacted the RoE (8.7% in FY2017 vs 13.0% in FY2016) but the reaffirmation of the 12.5% target shows the operational gearing of profits as the business scales.

Strong underlying trading led by Business Finance Division

PCF delivered a 25% increase in adj. PBT (before £1.37m of banking set-up costs vs £1.5m SSL forecast) to £5.0m (£4.0m in FY2016) on a portfolio of loan receivables that grew 20% to £146m (vs £122m). While a record low impairment charge of 0.5% (1%) contributed to some of the profit growth, new business volumes up 24% to £84.6m (£68.4m) suggest that profit growth is set to continue. This was led by Business Finance Division's 45% increase in SME lending. We make no changes to our adj. PBT forecasts for FY2018 and FY2019 and introduce a £10.0m forecast for FY2020.

Valuation remains undemanding in our view

In our view, with the lower cost of capital from retail deposits enabling PCF to address more prime markets in Consumer Finance Division by end Q1 2018, both divisions will contribute to the £350m target portfolio for FY2020. Our target price is based on PCF's market capitalisation as a percentage of receivables compared to a peer group. Our 42p target price represents 0.6x the £146m portfolio PCF reported for September 2017. Obviously, if PCF achieves or exceeds its medium/long-term targets there is scope to deliver significant shareholder value. The 90% increase in the dividend to 0.19p shows management will also continue to pursue a progressive dividend policy. We retain our Buy rating.

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

Overview

Company activities

PCF Group 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). PCF has c.12,000 agreements in place and a total loan portfolio of c.£146m. With a diverse customer base, no single customer accounts for more than 0.6% of the portfolio. 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. The use of improved IT systems will deliver efficiencies in both the lending and savings operations as FY2018 progresses.

Key issues on which investors must take a view

At the heart of PCF'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. Focused on near-prime and now prime customers, PCF generates attractive yields and has low bad debt charges. A key issue in recent years has been the sourcing of new finance. While there have been significant mobilisation costs to achieve its deposit-taking licence PCF will now be able to execute its growth strategy by accessing capital at a much lower rate than provided by wholesale funders.

Likely direction of consensus revisions

PCF's experienced and dedicated management team is now in a stronger position to deliver profit uplifts longer-term given its improved funding and initiatives for growth. While we expect a much-increased portfolio size following the attainment of the deposit-taking licence as the group benefits from a lower cost of capital and greater scope of offerings, it is FY2019 before we forecast any significant earnings progression as it takes time to put the new capital and infrastructure to work.

Valuation and reason behind target price

Our target price is based on the market capitalisation as a percentage of receivables. Our 42p target price represents 0.6x the £145m portfolio PCF reported for September 2017. 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.

Risks to our view

We believe that PCF is well placed to deliver strong growth in its receivables portfolio now it can access cheaper funding through its banking licence. PCF does not offer PCPs (personal contract plans) but could be impacted by the FCA review into these products. Obviously, further reductions in UK economic growth forecasts and/or a negative Brexit could make it more difficult for PCF to achieve its FY2020 targets and impact our forecasts and view. Mitigating against this is that PCF currently has less than 0.5% shares in its addressable markets and is now very well capitalised so could potentially use M&A more aggressively.

Assumptions

Our FY2019E forecasts reflect more fully the benefits to PCF of the lower cost of capital on both its adj. PBT and portfolio size

PCF has reported its first set of full year results as a bank which essentially reduces the disclosure in the segmental analysis to adjusted PBT. In Table 1 below we have shown the results for the 12 months to September 2016 and 2017 as well as our forecasts for each of the next three years. We have treated the historical costs of becoming a bank (FY2016 and FY2017) as exceptional in order to show the underlying profit progress in each of these years. From FY2018 onwards, the £2m+ annual banking costs have been absorbed into our forecasts of operating costs hence the relatively flat adj. PBT. Our FY2019E forecasts begin to reflect more fully the benefits to PCF of the lower cost of capital on its adj. PBT and portfolio size.

Table 1: Segmental breakdown

£000's	FY16A	FY17A	FY18E	FY19E	FY20E
Consumer finance	1,795	1,617	2,319	3,809	4,501
% group	*49.8*	*44.5*	*45.0*	*45.0*	*45.0*
Business finance	1,807	2,016	2,835	4,655	5,502
% group	*50.2*	*55.5*	*55.0*	*55.0*	*55.0*
Add back banking costs	439	1,367	0	0	0
Total underlying PBT	**4,041**	**5,000**	**5,154**	**8,464**	**10,003**
Portfolio at end of period (£'m)	122	146	215	305	370
RoAA (%)	3.2	2.5	2.9	3.3	3.0

Source: Company data, Stockdale estimates

For the first time in the group's history the business finance portfolio was larger than the consumer motor portfolio

The segmental breakdown shows that the consumer finance and business finance split was 45:55. This compared to our forecast of a 51:49 split in favour of consumer finance for FY2017. As shown in Table 1 above, profitability was also more weighted towards the business finance division where PCF launched its new competitive prime terms towards the year end. Over half of the £84.6m new business originations was for business-critical assets for sole traders, partnerships and small companies. SME lending increased 45% over the year whereas consumer motor finance advances fell 3% (FY2016: 8% increase), and for the first time in the group's history the business finance portfolio was larger than the consumer motor portfolio. This, in our view, is also a reflection of declining vehicle sales and the competitiveness of the consumer market space and PCF's reluctance to sacrifice the net yield in return for an increase in market share. PCF expects growth to be restored in Q1 2018 once it has implemented the planned changes to its IT platforms and can target, through the lower costs of its funding, the more prime consumer motor finance market.

Table 2 below shows the segmental split of the loan provisioning charge. This is largely in line with the PBT split across the two divisions in the forecast years. We have assumed that the impairment charge will increase as a percentage of the overall portfolio in FY2019 and FY2020 as a consequence of a number of factors including Brexit and slower economic growth.

Table 2: Loan provisioning charge split

£000's	FY16A	FY17A	FY18E	FY19E	FY20E
Consumer finance	- 609	- 384	- 447	- 952	- 1,458
%	*62*	*57*	*40*	*40*	*40*
Business finance	-381	-294	-671	- 1,427	- 2,187
%	*38*	*43*	*60*	*60*	*60*
Loan provisioning charge	**- 990**	**- 679**	**- 1,118**	**- 2,379**	**- 3,645**
% portfolio	*0.9*	*0.5*	*0.5*	*0.8*	*1.0*

Source: Company data, Stockdale estimates

Sensitivity analysis

We can apply the matrix of implied RoAA on the various average portfolio sizes for FY2020 to get a gauge of how our FY2020 £10.0m adj. PBT could be achieved

Although PCF has withdrawn its formal targets for Return on Average Assets (RoAA) we have reconciled our adj. PBT forecasts by the implied RoAA on our portfolio of receivables forecasts at the end of each of the forecast years. We believe that we can apply the matrix of implied RoAA on the various average portfolio sizes for FY2020 to get a gauge of how our FY2020 £10.0m adj. PBT could be achieved.

We forecast a relatively flat adj. PBT of £5.2m for FY2018 as the £2m+ of banking costs are absorbed in operating costs so, in our view, the full benefit of the cheaper cost of capital will be felt in the years from FY2019E onwards. This is because the enlarged portfolio will begin to mature and PCF will be able to swap out more of its expensive wholesale funding with cheaper retail deposits. In Table 3 below, we show a sensitivity analysis on our FY2020E forecasts on a range of return on average assets from 2.5% to 3.3% on an average portfolio size of £300m to £400m. As can be seen in Table 3 our adj. PBT forecast can be delivered by assuming a 3.10% RoAA on a portfolio of £22m, a 2.85% RoAA on a portfolio of £350m, a 2.70% RoAA on a portfolio of £370m or a 2.50% RoAA on a portfolio of £400m.

Table 3: FY2020 adj. PBT sensitivity analysis to portfolio size and RoAA

	Return on average assets				
Average portfolio size (£m)	2.50%	2.70%	2.85%	3.10%	3.30%
300	7.5	8.1	8.6	9.3	9.9
322	8.1	8.7	9.2	**10.0**	10.6
350	8.8	9.5	**10.0**	10.9	11.6
370	9.3	**10.0**	10.5	11.5	12.2
400	**10.0**	10.8	11.4	12.4	13.2

Source: Stockdale estimates

PCF has retained its 12.5% return on equity (RoE) target for FY2020, which we forecast to be exceeded

PCF has retained its 12.5% return on equity (RoE) target for FY2020, which we also forecast to be exceeded, as shown in Table 4 below. We have used the average of the opening and closing equity balances as a proxy for the monthly average equity which PCF uses in its calculation. This would have delivered an 8.8% RoE for FY2017 vs PCF's reported 8.7%. We have also used the adj. PAT rather than the reported PAT that PCF uses, which has depressed its RoE for FY2016 and FY2017 but will be the same as ours in future years.

Table 4: RoE calculation

£000's	FY16A	FY17A	FY18E	FY19E	FY20E
Underlying PBT	4,041	5,000	5,154	8,464	10,003
Tax charge (20%)	- 899	- 1,166	- 1,031	- 1,693	- 2,001
Underlying PAT	**3,142**	**3,834**	**4,123**	**6,771**	**8,003**
Equity	**24,707**	**38,661**	**42,784**	**49,555**	**57,558**
*RoE (%)**	*12.7*	*12.1*	*10.1*	*14.7*	*14.9*

Source: Company data, Stockdale estimates *RoE has been calculated using the adjusted PAT over the average opening and closing equity balances.

As highlighted earlier we believe that the FY2020 targets will be achieved or exceeded organically, but that the FY2022 targets will require acquisitions. With its strong capital position PCF is well-placed to buy companies, portfolios, teams or indeed all three in the coming years.

Valuation

Our target price is derived from assuming a ratio of 0.6x the £146m receivables portfolio that we PCF reported to end-September 2017

Our target price is derived from assuming a ratio of 0.6x the £146m receivables portfolio that PCF reported to end-September 2017. We then divide the implied £89.1m market capitalisation by the 212.2m fully-diluted shares in issue to derive our 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 1.6x multiple relative to Every Day Loans's last–reported £146m receivables. NSF itself, trades on a multiple of more than three times that of PCF and more than double the implied 0.6x multiple at our 42p target price

Table 5: Ratio of market capitalisation to receivables

Company	Market cap (£m)	Last reported receivables (£m)	Ratio (x)
PCF	65	146	0.4
Provident Financial	1317	1,477	0.9
1PM	40	71	0.6
Manx Financial Group	11	123	0.1
Non-Standard Finance	230	147	1.3
S&U	282	162	1.7
Secure Trust Bank	328	1,509	0.2
Average			**0.8**

Source: Company data, Stockdale estimates

Continuation of progressive dividend policy is positive although we expect the bulk of the shareholder returns will come through capital growth

Table 6 below shows the valuation metrics (where available) of the above companies. For the price/NAV multiple we have used our numbers for PCF and the last reported price/tangible book value from Factset for the comparator companies. However, given the different year-ends this is more of a guide than a like-for-like comparison. We view the 90% increase in the proposed final dividend to 0.19p as a continuation of the progressive dividend policy, which PCF introduced in FY2016, as an added attraction to investors. Nevertheless, we expect the bulk of the shareholder returns will come through capital growth.

Table 6: Peer group valuation

Company	Ticker	Price	Mkt Cap	NAV	P/NAV	Dividend Yield		PE	
		p	£m	£m	x	%		x	
						FY+1	FY+2	FY+1	FY+2
PCF	**PCF-GB**	**31**	**65**	**39**	**0.8**	**1.0**	**1.3**	**16.3**	**9.7**
Provident Financial	PFG-GB	880	1,304	731	1.8	-	3.3	16.1	9.6
1PM	OPM-GB	46	39	28	1.4	1.4	1.9	6.1	5.7
Manx Financial Group	MFX-GB	9	11	14	0.8	n/a	n/a	n/a	n/a
Non-Standard Finance	NSF-GB	71	224	243	0.9	3.3	4.7	15.0	10.5
S&U	SUS-GB	2,376	285	143	2.0	4.3	5.0	11.7	10.0
Secure Trust Bank	STB-GB	1,798	332	239	1.4	4.4	4.7	13.1	10.2
Peer group average					**1.3**	**2.7**	**3.9**	**12.4**	**9.2**

Source: Company data, Stockdale estimates, Factset. Priced at close 04 December 2017, historic most recently reported NAVs used,

Table 7: Income Statement

12 months ended 30 September £'000s	FY16A	FY17A	FY18E	FY19E	FY20E
Interest income	15,231	19,970	25,431	33,800	40,500
% Portfolio	*14*	*15*	*14*	*13*	*12*
Interest expense	- 4,991	- 8,906	- 10,822	- 12,480	- 15,188
% Portfolio	*-5*	*-7*	*-6*	*-5*	*-5*
Net interest income	**10,240**	**11,064**	**14,609**	**21,320**	**25,313**
Net interest margin	*9%*	*8%*	*8%*	*8%*	*8%*
Fees and commission income	432	512	721	988	1,350
Fees and commission expense	- 580	- 702	- 812	- 1,040	- 1,283
Net fee and commission expense	**- 148**	**- 190**	**- 90**	**- 52**	**68**
Fair Value gain/(loss) on financial instruments	16	- 4	-	-	-
Net operating income	**10,108**	**10,870**	**14,519**	**21,268**	**25,380**
Administration expenses	- 5,516	- 6,558	- 8,247	- 10,425	- 11,732
% net interest income	*-54%*	*-59%*	*-56%*	*-49%*	*-46%*
Impairment losses on financial assets	- 990	- 679	- 1,118	- 2,379	- 3,645
% Portfolio	*0.9%*	*0.5%*	*0.5%*	*0.8%*	*1.0%*
Profit before tax	**3,602**	**3,633**	**5,154**	**8,464**	**10,003**
Banking costs	439	1,367	-	-	-
Underlying profit before tax	**4,041**	**5,000**	**5,154**	**8,464**	**10,003**
Income tax	- 899	- 1,166	- 1,031	- 1,693	- 2,001
Effective tax rate	-22%	-23%	-20%	-20%	-20%
Underlying net profit	**3,142**	**3,834**	**4,123**	**6,771**	**8,003**
Reported net profit	**2,703**	**2,467**	**4,123**	**6,771**	**8,003**
Weighted average no. of shares	156,655	190,409	212,220	212,220	212,220
Weighted average no. of shares including dilution	170,425	190,409	212,220	212,220	212,220
Statutory basic EPS (p)	**1.73**	**1.30**	**1.94**	**3.19**	**3.77**
Statutory diluted EPS (p)	**1.59**	**1.30**	**1.94**	**3.19**	**3.77**
Underlying basic EPS (p)	**2.01**	**2.01**	**1.94**	**3.19**	**3.77**
Underlying diluted EPS (p)	**1.84**	**2.01**	**1.94**	**3.19**	**3.77**
Dividend per share (p0	**0.10**	**0.19**	**0.30**	**0.40**	**0.50**

Source: Company data, Stockdale estimates

Table 8: Balance Sheet

As at 30 September £000's	FY16A	FY17A	FY18E	FY19E	FY20E
Assets					
Cash and balances at central banks	5,904	17,018	16,000	21,000	25,000
Loan and advances to customers	121,960	145,718	215,000	305,000	370,000
Growth		*19%*	*48%*	*42%*	*21%*
Debt securities	-	4,511	4,511	4,511	4,511
Property Plant and Equipment	147	271	312	343	377
Intangible assets	764	2,704	2,163	1,731	1,384
Deferred tax assets	1,424	1,205	844	675	540
Trade and other assets	503	1,041	566	679	747
Total Assets	**130,702**	**172,468**	**239,395**	**333,938**	**402,560**
Liabilities					
Due to banks	103,305	77,067	53,947	37,763	26,434
Due to customers	-	53,120	137,958	240,503	310,615
Derivative financial liabilities	491	-	-	-	-
Trade and other liabilities	2,199	3,620	4,706	6,118	7,953
Total Liabilities	**105,995**	**133,807**	**196,611**	**284,383**	**345,002**
Equity					
Share Capital	7,956	10,611	10,611	10,611	10,611
Share premium account	174	8,524	8,524	8,524	8,524
Other reserves	- 373	-	-	-	-
Own shares	- 305	- 355	- 355	- 355	- 355
Retained earnings	17,255	19,881	24,004	30,775	38,778
Total Equity	**24,707**	**38,661**	**42,784**	**49,555**	**57,558**
Total equity and liabilities	**130,702**	**172,468**	**239,395**	**333,938**	**402,560**

Source: Company data, Stockdale estimates

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	53.5%	Buy	100.0%
Add	+10% to +20%	Add	4.7%	Add	0.0%
Neutral	(+/-) 10%	Neutral	41.8%	Neutral	0.0%
Sell	-10% or more	Sell	0.0%	Sell	0.0%

Source: Stockdale

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