Chief Financial Officer's Operational and Financial Review

"The Group has continued to make good progress on all fronts with profits, returns on assets and equity and dividends all showing a favourable trajectory. We continue to make great strides in our core UK Home Collected Credit business whilst making significant progress towards diversifying our product portfolio."

Andy Thomson
Chief Financial Officer

Overview

The results for the Group for the 52 weeks ended 23 February 2019 reflected the growth in earnings from the expansion in HCC territories during the last year. Whilst credit issued increased by a modest 2.4%, reflecting our continued focus on quality in a stable market place, adjusted profit before tax increased by 14.6% as the cost of the new territory build subsidies declined from £4.5m to £1.7m. Statutory reported profit before tax increased by 25.5%.

Over the two years covering the period of above average territory build growth (FY17 to FY19), credit issued grew by 24% (FY19: £178.5m v FY17: £144.1m) and adjusted profit before tax also by 24% (FY19: £22.0m v FY17: £17.7m).

Impairments remained broadly stable at 22.4% of revenue from 22.5%. Write-offs during the year fell to 21.2% of revenue from 22.4% last year (on a pro forma IFRS9 like-for-like basis). Impairment provisions at the close of the period did increase proportionally to gross receivables, which was a result of the quantum of top tier* customers falling from 69.6% to 68.4% as the new territories trended towards the long-term mix of good customers. This still compares very favourably to the 66.2% top tier we had in February 2017, prior to the significant territories expansion.

Shareholders' funds increased by 6.8% to £71.0m compared to the prior year, however after taking into account the £3.2m reduction to opening shareholders' funds due to the implementation of IFRS9 which was effective for the Group from 25 February 2018, on a like-for-like basis the increase was 12.2%. The net loan book increased by 0.3% to £73.0m, however after taking into account the IFRS9 adjustment above, the like-for-like increase was 6%.

* A top tier customer is a customer who has made 9 or more payments by value in the last 13 weeks.

Trading summary

£'m (unless otherwise stated)	IFRS 9 52-week period ended 23 February 2019	IAS 39 52-week period ended 24 February 2018	Pro forma IFRS 9 52-week period ended 24 February 2018
Customer numbers ('000s)	**235**	229	229
Period end receivables	**73.0**	72.8	68.8
Average receivables	**69.3**	66.4	n/a[1]
Revenue	**117.0**	116.6	110.4
Impairment	**(26.2)**	(30.4)	(24.8)
Agent Commission	**(28.3)**	(28.0)	(28.0)
Gross Profit	**62.5**	58.2	57.6
Administration expenses (pre-exceptional)	**(37.1)**	(36.1)	(36.1)
Depreciation	**(1.7)**	(1.5)	(1.5)
Operating Profit before exceptional costs and amortisation of acquisition intangibles	**23.7**	20.6	20.0
Amortisation of acquisition intangibles	**(1.0)**	(2.1)	(2.1)
Acquistion, restructuring and non-recurring costs	**(0.8)**	(1.0)	(1.0)
Exceptional costs	**–**	0.1	0.1
Operating profit	**21.9**	17.6	17.0
Funding costs	**(1.7)**	(1.5)	(1.5)
Statutory Profit Before Tax	**20.2**	16.1	15.5
Tax	**(4.0)**	(3.0)	(3.0)
Statutory Profit After Tax	**16.2**	13.1	12.5
Basic EPS	**12.5p**	10.1p	9.6p

1 Metric not quoted as it includes data points which precede the date of IFRS 9 transition.

Reconciliation of Statutory profit before tax to Adjusted profit before tax and explanation of Adjusted EPS

£'m (unless otherwise stated)	IFRS 9 52-week period ended 23 February 2019	IAS 39 52-week period ended 24 February 2018	Increase
Statutory Profit Before Tax	**20.2**	16.1	25.5%
Acquisition, restructuring and non-recurring costs	**0.8**	1.0	
Exceptional costs[2]	**–**	(0.1)	
Amortisation of acquired intangibles[3]	**1.0**	2.1	
Adjusted Profit Before Tax[1]	**22.0**	19.2	
Tax on Adjusted Profit Before Tax	**(4.4)**	(4.0)	
Adjusted Profit After Tax	**17.6**	15.2	
Adjusted EPS[1]	**13.6p**	11.7p	
Adjusted Return on Assets[1]	**25.4%**	22.9%	
Adjusted Return on Equity[1]	**29.6%**	26.5%	

1 Definitions are set out in the Glossary of Alternative Performance Measures.
2 Costs incurred in relation to the Company's IPO and AIM listing.
3 Amortisation of acquired customer lists and agent networks.

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Group results

Credit issued to customers increased by 2.4% to £178.5m (FY18: £174.4m) and demonstrated that the majority of the benefits anticipated from the expansion in territories during last year had been achieved. The second half year growth was 0.5% to £92.5m (Second half FY18: £92.0m) compared to the first half growth of 4.5% to £86.0m (First half FY18: £82.3m). We expect that further growth in HCC sales will primarily come from acquisitions, however the two small acquisitions made in February 2019 had negligible impact on earnings in the year.

As a result of the implementation of IFRS9 in FY19, revenue and gross profit comparisons are more meaningful against the pro forma IFRS9 numbers for last year. The table below provides the comparative numbers against both the pro forma IFRS9 numbers and the actual numbers reported for last year under IAS39.

	FY19		Pro forma IFRS9 FY18		FY18 (reported)	
	£'m	% of rev	£'m	% of rev	£'m	% of rev
Revenue	117.0		110.4		116.6	
Agent commission	(26.6)	22.7%	(23.5)	21.3%	(23.5)	20.2%
Impairment	(26.2)	22.4%	(24.8)	22.5%	(30.4)	26.1%
Gross profit before territory build subsidy	64.2	54.9%	62.1	56.3%	62.7	53.8%
Territory build subsidy	(1.7)	1.5%	(4.5)	4.1%	(4.5)	3.9%
Reported gross profit	62.5	53.4%	57.6	52.2%	58.2	49.9%

Note: The reduction of revenue under IFRS9 is due to revenue being capped at the contractual amount whereas under IAS39 we were required to recognise revenue as if interest charges continued beyond the contract term. We then had to impair the excess revenue recognised over and above what we were contractually entitled to. Since we do not make any charges for late payments on any of our products the IFRS9 treatment of revenue is more appropriate.

On a comparable IFRS9 basis, revenue increased by 6.0% to £117.0m (FY18: £110.4m), with reported gross profit increasing by 8.5% to £62.5m (FY18: £57.6m). Compared to the reported numbers for FY18, revenue increased by 0.3% and reported gross profit increased by 7.4%.

Agent commission increased to 22.7% of revenue from 21.3% in the prior year. This was due to a minor revision of our agent commission schemes which although not fully approved by the FCA, were made with their full knowledge. In implementing this change, we standardised our scheme and were very careful to ensure no individual agents were materially adversely affected, which slightly increased total costs.

The impairment charge as a percentage of revenue was 22.4% for FY19, compared to 26.1% reported for in FY18 . The figure for the 2018 financial year was reported under IAS39, whilst FY19 is reported under IFRS9, and we had previously provided guidance that we expected this number to decrease as a percentage of revenue because of this change in the accounting regulations. FY18's pro forma income statement consistent with IFRS9 gives an impairment rate of 22.5%.

The ratio of impairment to revenue for FY19's outcome is in line with FY18. The actual debt write-off was only 3.5% lower than the prior year, compared to a revenue increase of 0.3%, the adverse movement in overall impairment relating to provision movements for future expected losses. This reflects a decline in top tier customers to 68.4% of gross balances from 69.6% in FY18 as the new territory build customer base trended closer to a long-term normal level of quality. A top tier of 68.4% of gross balances still compares very favourably with the 66.2% level in February 2017, prior to the territory build expansion.

Having reviewed all of the relevant factors that make up the calculation of the impairment provision (including the change in the accounting regulations), and in particular recognising that the impact of the improvements in debt quality over recent years has gone as far as is achievable, we are now issuing new guidance that we see impairment being in the range of 21% to 26% of revenue (previously 22% to 27%).

The gross margin benefitted significantly from the reduction in the cost of territory build subsidies, which fell to £1.7m from £4.5m in FY18, as the territory builds that largely commenced by the late Summer 2017 reached their target customer levels by late Summer 2018. Further, the split of this cost in FY19 was £1.3m in the first half and just £0.4m in the second half year, demonstrating the drop-off in the cost of subsidies.

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Administration expenses increased from £37.6m in FY18 to £38.7m in FY19, reflecting greater customer acquisition costs that in part offset the reduction in territory build subsidy costs, as well as the continued increase in costs of compliance. However, the administration expenses as a percentage of revenue fell from 34.0% in FY18 (pro forma IFRS9) to 33.2% in FY19, an overall efficiency gain of 2.4%, driven by ongoing productivity improvements achieved through the operational IT improvements and lower management bonuses.

Adjusted profit before tax increased to £22.0m from £19.2m in the prior year, an improvement of 14.6%. The reported profit before tax increased from £16.1m to £20.2m, an improvement of 25.4%. The improvement in the reported profit before tax was boosted by reduced charges for the amortisation of acquisition intangibles, since only two small acquisitions were made at the end of FY19 and a reduction in acquisition, restructuring and non-recurring costs from £0.9m last year to £0.8m.

A table of adjustments between reported profit before tax and adjusted profit before tax is shown below.

For illustrative purposes the table below also shows the movement in the adjusted profit before tax when compared to the prior year on a like-for-like basis under IFRS9, which indicates a performance improvement of 18.3%.

£'m	FY19	FY18	Increase
Reported PBT	**20.2**	**16.1**	**25.5%**
Amortisation of acquisition intangibles	1.0	2.1	
Acquisition, restructuring and non-recurring costs	0.8	0.9	
Adjusted PBT	**22.0**	**19.2**	**14.6%**
Application of IFRS9 to FY18	n/a	(0.6)	
Pro forma IFRS 9 Adjusted PBT	**22.0**	**18.6**	**18.3%**

The amortisation of intangible assets reflects the unwinding of intangible assets in connection with acquisitions. This reduction reflects both the lack of material acquisitions in FY19 and reduced levels of amortisation in connection with prior year acquisitions. Intangible assets are amortised over the asset's useful economic life, which is based on the expected life of the acquired customer relationships. Due to the behavioural profile of our customers, this will naturally result in a greater amortisation charge in the early years with a corresponding reduction in later years. No intangible asset is recognised for acquired agents or new customers that these agents may identify subsequently, which management considers to be a conservative approach.

Other non-operating costs in FY19 largely related to legal and professional fees associated with acquisition activities. These were far lower than the other non-operating costs in FY18 which were largely as a result of restructuring costs in operations.

Earnings per share

The adjusted earnings per share for FY19 was 13.6p, an increase of 16.2% relative to the 11.7p for FY18. This represents an increase of 20.4% relative to the equivalent number of 11.3p for FY18.

The reported earnings per share for FY19 was 12.5p compared to 10.1p for FY18, an increase of 23.8%. This is 30.2% up on the equivalent pro forma IFRS9 number of 9.6p for FY18.

Dividend

Subject to shareholder approval at the Annual General Meeting on 25 June 2019, the Board proposes to pay a final dividend of 5.2p per Ordinary Share (FY18: 4.8p) payable on 26 July 2019 to shareholders on the register at the close of business on 28 June 2019.

This payment is in addition to the interim dividend already paid of 2.6p per Ordinary Share, making a total dividend for the year of 7.8p (FY18: 6.0p). The continued high level of the dividend payments reflects the Board's confidence in the business prospects and our commitment to provide a strong income yield to our shareholders.

Net margin

The adjusted net margin, which excludes amortisation of intangibles on acquisitions and other non-operating costs, increased to 18.6% from 16.8% in the prior year, due largely to the reduction in the cost of territory builds. This reduced cost of territory builds helped to improve margins by 2.4% in FY19.

The reported net margin for the period increased to 17.3% from 13.8% in the previous year, driven by several factors: the reduced territory build costs mentioned above, the reduction in the amortisation of intangibles on acquisitions charge which reduced to £1.0m from £2.1m in the prior year for the reasons described above and below.

Acquisitions and goodwill

The Group made two small HCC acquisitions towards the end of FY19 which had a negligible impact on the amortisation of acquisition intangibles in the period. The goodwill on acquisitions may be found in note 10 in the financial statements.

Following the year end, the Group acquired the business and certain assets of online lender CURO Transatlantic Limited for £8.5m. This acquisition was in line with our stated strategy to diversify the products and markets that we serve in the non-prime lending space. This acquisition gives us scale and expertise to take our own Dot Dot online product to a level where management are confident that it will be financially successful. We are currently going through a complex integration process of rebranding and replatforming the incumbent technology, which means that there will be initial losses, particularly in the first half of FY20, as we build it back up to a profitable scale. However, management are confident that the acquisition will make healthy returns on the investment.

In FY19, Dot Dot loans made a start-up loss of £0.5m (FY18: £0.8m).

Funding

Following our increase in debt funding from £25m to £40m in August 2017, we were pleased to announce in November 2018 a further increase in our revolving credit facility to £50m plus a mezzanine facility of £5m with an option, subject to conditions and lender approval at the time, to increase the mezzanine facility up to £15m. The expiry date of the RCF facility remains August 2020, with the mezzanine facility expiring in February 2021.

The current facility is sufficient to meet our immediate strategic objectives, with the peak drawdown in FY19 being only £21.5m in December 2018 (FY18: December 2017 £28.0m). We remain focused on seeking to increase our gearing in order to maximise equity returns, but not to a degree that we would feel we were putting the Group at a significantly higher level of financial risk.

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Balance sheet

The total equity for the Group increased by 6.8% from £66.5m reported in FY18 to £71.0m, reflecting the proportion of profits that we retain for future expansion. This was a 12.2% increase relative to the pro forma IFRS9 total equity figure of £63.3m.

The main asset of the Group is our loan book, which on a net basis increased by 0.3% from £72.8m in FY18 to £73.0m in FY19. However, the opening loan book was reduced down by £3.9m to £68.9m as a result of adopting IFRS9, so the real increase on a comparable IFRS9 basis was 6.0%.

Summarised balance sheet

£'m	FY19 Reported	Pro forma IFRS9 FY18	FY18 Reported
Loan book	73.0	68.9	72.8
Bank loans	(14.5)	(16.0)	(16.0)
Other net assets	12.5	10.4	9.7
Total equity	71.0	63.3	66.5

Cash flow

The simplified cash flow statement below illustrates the cash generated by the business. Cash from operations excluding investment in the loan book increased by 6.1% to £24.3m (FY18: £22.9m).

Summary cash flow

£'m (unless otherwise stated)	52-week period ended 23 February 2019	52-week period ended 24 February 2018
Cash from operations excluding investment in loan book	**24.3**	22.9
Cash from funding	**(1.0)**	6.0
Total cash sources	**23.3**	28.9
Increase in net loan book	**(0.8)**	(11.6)
Acquisitions	**(2.2)**	–
Capital expenditure	**(2.4)**	(2.0)
Corporation tax	**(3.6)**	(4.6)
Interest paid	**(1.7)**	(1.4)
Dividends paid	**(9.6)**	(8.4)
Total cash uses	**(20.3)**	(28.0)
Cash movement	**3.0**	0.9

IFRS 9

The International Accounting Standards Board introduced a new accounting standard covering financial instruments which became effective for accounting periods beginning on or after 1 January 2018.

This standard replaces IAS 39: Financial Instruments: Recognition and Measurement.

The new standard requires that lenders (i) provide for the Expected Credit Loss ('ECL') from performing assets over the following year and (ii) provide for the ECL over the life of the asset where that asset has seen a significant increase in credit risk. As a result, whilst the underlying cash flows from the asset are unchanged, IFRS 9 has the effect of bringing forward provisions into earlier accounting periods. This resulted in a one-off adjustment to receivables, deferred tax and reserves on adoption.

To assist analysts and investors, the FY18 full year results included a separate disclosure detailing an estimate of the expected impact of IFRS 9 on the closing balance sheet for FY18 (and therefore the opening balance sheet for FY19). An analysis of impacts on the main areas of the opening balance sheet are:

	Closing Balance Sheet IAS39	IFRS9 estimated adjustment	Opening Balance Sheet IFRS9
Net Loan Book	72.8	(3.9)	68.9
Other (Deferred tax)	(0.1)	0.7	0.6
Net Assets	66.5	(3.2)	63.3

The adoption of IFRS9 saw a reduction in the net loan book of £3.9m, which net of deferred tax resulted in a reduction in net assets of £3.2m.

The fundamental cash flows of the business remain unchanged with the introduction of IFRS9 only changing the timing of the profits taken on the Group's products.

The introduction of IFRS9 has not resulted in any changes to the Group's lending policy.

By order of the board:

Andy Thomson
Chief Financial Officer
2 May 2019