morsesclub

# 2020 Full Year Results and current trading

Paul Smith – CEO
Andy Thomson – Interim CFO

27 November 2020

# Highlights

# Group Operational Highlights

## Increased digitalisation, moving towards a more comprehensive financial services offering

### HCC

Launch of Customer Portal - **78,000 customers** in FY20

Currently **117,000** customers registered

Enabling of virtually **paperless** loan documentation process

**c.58%** lending now completed **digitally**

**79% cash** collections now made **digitally**

Positive response to **digital Refer-a-Friend** scheme launched in September, prior year referral scheme – **37,000** new customers

**£43.3m** sales executed **digitally** in 8 months to October 2020

**Customer payment performance 96%** of FY20 in October 2020

### Digital

CURO Transatlantic acquisition - **online lender**, with c. **37,000 customers**, now operating under the **Dot Dot Loans** brand

U Holdings acquisition, an **e-money current account** provider, with **18,000 customers**

Appointment of Gary Marshall as **COO** of Shelby Finance

**Re-engineering** of online businesses

**Banking** and **credit** offering due to be launched in **H2 2021**

**Break-even** forecast during **FY22**

Growing levels of lending and encouraging uplift in demand for **longer-term** lending products evident

**Digital focus and capabilities enabled Morses Club to react quickly and effectively to changing customer needs during Covid-19 pandemic**

# Impact of Covid-19

Rapid response, stabilising business and accelerated progress in ongoing strategy

## Rapid and comprehensive response

Quickly leveraged existing technology and expertise

Remote lending to existing customers recommenced just 3 weeks after March lockdown

Remote lending to new customers launched in July 2020

Focused on collections and maintaining customer service

No staff furloughed

No government assistance sought

£30m funding arrangements in place until end November 2021

All employees and agents successfully continuing to work from home

Transformative rationalisation of property portfolio – 94 properties reduced to 32 currently

## Resilient performance

**HCC** lending at **73%** of FY19 levels in 3 months to October 2020, a **sharp improvement** compared to April 2020

FY21 **HCC sales** YTD* total **65%** of FY20

**HCC repayments at 77%** of FY19 levels in 3 months to October 2020

**Quality** of loan book approaching pre-Covid-19 levels

Continued **improvement** in digital division

Digital sales and collections in Q2 FY21 significantly **improved**, sales **15%** ahead of FY19

**Deleveraging** plan progressing, **strong funding position**

## Acceleration of ongoing strategy

**Acceleration** of digital strategy within HCC

Development of new brand identity, U Money, to **link** current account and credit services

Move to Modulr for **enhanced** account and payments services

## Key stats (HCC)

| | Current | Pre-Covid-19 |
|---|---|---|
| Customers signed up to online customer portal | 117,000 | 78,000 |
| Loans delivered digitally | 55% | 17% |
| Customer satisfaction | 97% | 97% |
| Cash collected remotely | 78% | 40% |

Note: * 8 months to October

# Financial Highlights

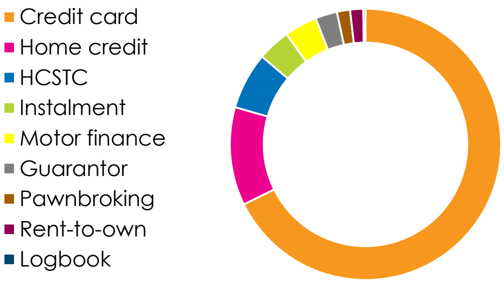
Resilient Group financial performance in FY20, with underlying results impacted by £1.7m Covid-19 adjustment

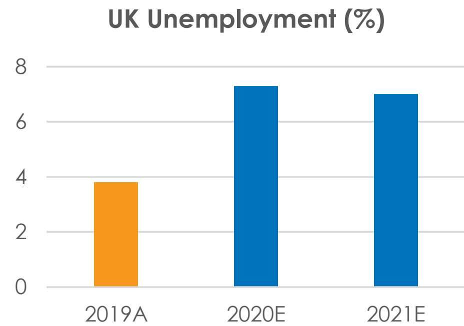
| | Group | HCC | Digital |
|---|---|---|---|
| **NORMALISED ADJUSTED PBT (£m)** | | | |
| | 15.5 (FY19: 22.0) | 24.5 (FY19: 22.5) | (9.0) (FY19: (0.5)) |
| **STATUTORY PBT (£m)** | | | |
| | 11.5 (FY19: 20.2) | 21.2 (FY19: 20.7) | (9.7) (FY19: (0.5)) |
| **RETURN ON EQUITY** | | | |
| | 17.2% (FY19: 27.2%) | 30.1% (FY19: 27.2%) | n/a |
| **CUSTOMER NUMBERS ('000s)** | | | |
| | 255 (FY19: 235) | 221 (FY19: 234) | 34 (FY19: 0) |
| **NET LOAN BOOK (£m)** | | | |
| | 72.8 (FY19: 73.0m) | 67.9 (FY19: 73.0) | 4.9 (FY19: 0.0) |

**Final Dividend proposed of 1.0p (FY19: 5.2p)**

# The Non-Standard Credit Market

## New lending by non-prime segment (2018)[5]




**9m** people have no savings at all[6] and 7m people have savings of less than £100[7]

**10-12m** customers have difficulty accessing credit from mainstream financial institutions

**£10.7bn** total loan receivables across UK non-prime consumer credit[2]

## Non-Standard Credit Market expected to grow as supply contracts

Economic conditions likely to push some prime borrowers into non-standard market. Currently circa **2m** people move between standard and non-standard markets due to credit scores[2]

**3 million** consumers use high cost credit (excluding overdrafts) including rent-to-own, catalogue credit, store cards and HCC[2]

Gross loan receivables for the largest active firms up by **41%** in two years to 2017/18, and net receivables (after impairments) up **32%**

The availability of unsecured consumer credit fell for a **12th** successive quarter in the fourth quarter of 2019[5]

Lenders also further tightened their lending standards for unsecured consumer credit for a **13th** successive quarter[5]

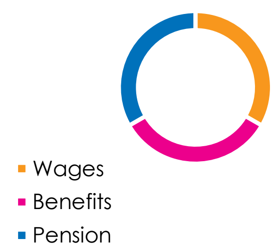
Reduced number of non-standard credit market providers presents opportunities for **market share gains** in online lending and wider market

Economic impact of Covid-19 anticipated to **increase customer numbers** within sub-prime market

## HCC

**£1.1bn market** | **1.6m users[3]**

**Typical HCC customer income sources**




**Typical HCC customer personal debt**


(1) High Cost Credit Review ANNEX 1 - July 2017
(2) Source: Company accounts, Apex insights analysis, FCA market statistics
(3) FCA High Cost Credit Review Technical Annex 1: CRA data analysis of UK personal debt – July 2017
(4) FS17/2: High-cost credit and review of the high-cost short-term credit price cap
(5) Apex Insight - Non-Prime Consumer Credit: UK Market Insight Report - September 2019
(6) Scottish Widows Savings Report 2014
(7) BBC - Millions have less than £100 in savings, study finds
(8) ONS data and HM Treasury forecasts for the UK economy (October 2020)

# Key strategic drivers

## Mature HCC market

Robust performance during FY20

Mature sector with market share gains possible

Current economic situation likely to result in more people entering the non-standard finance market

Morses Club can maximise market position as regional providers exit

Majority of HCC customers adapted well to remote service and lending model

Willingness to interact digitally opens up opportunities for broader offering

Lending to existing customers has resulted in increased quality of loan book

## Increasing Digital Appetite

Strong progress in development of digital offering to meet changing customers' needs

Strong demand from HCC customers for additional digital products

Number of well-known providers have exited the market due to legacy Pay Day regulation issues

Additional demand for loans from e-banking customers as part of vision of integrated offering

Robust lending, with increase in 6-month and 9-month products during Covid-19 pandemic

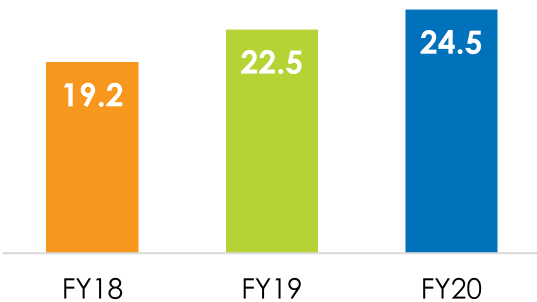
Digital division key to delivering medium-term growth for the Group

Established provider with strong track record and sufficient funding to address wider market opportunities

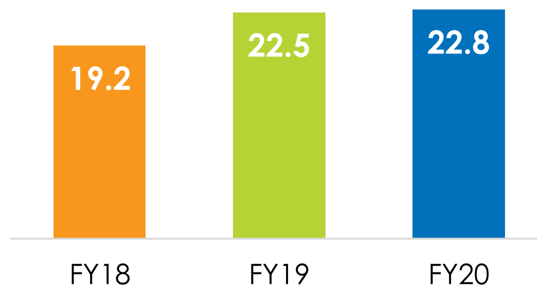
# Financial Review

# HCC Division

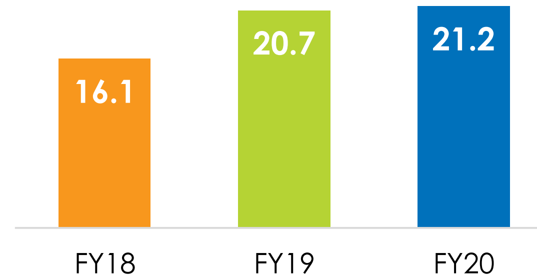
### Normalised Adjusted PBT (£m)



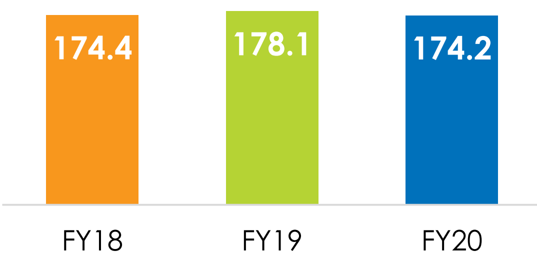

### Adjusted PBT (£m)



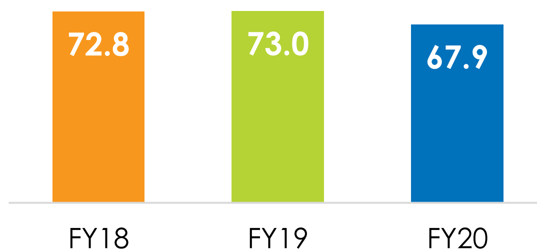

### Statutory PBT (£m)



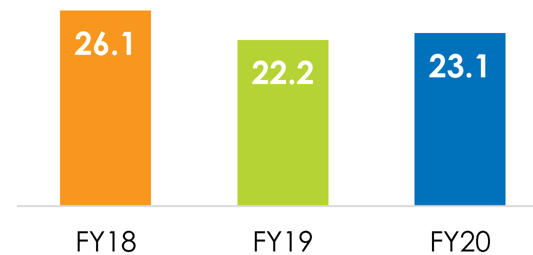

### Credit Issued (£m)




### Loan Book (£m)




### Impairments as a % of revenue




### Commentary

FY20 was a strong year for HCC, with revenues up 2.3%, higher gross margins and stable costs

Normalised Adjusted Profit, being the Adjusted Profit prior to an IFRS9 Covid-19 overlay of £1.7m, increased by 8.9%

Even after taking into consideration the Covid-19 overlay, Adjusted Profit slightly increased

Whilst Credit issued declined by 2.2% we are well-placed for a post Covid-19 recovery in consumer borrowing

There was a slight increase in underlying Impairments from 22.2% to 23.1%, however this is still well within our target range of 21% - 26%

# Digital Division

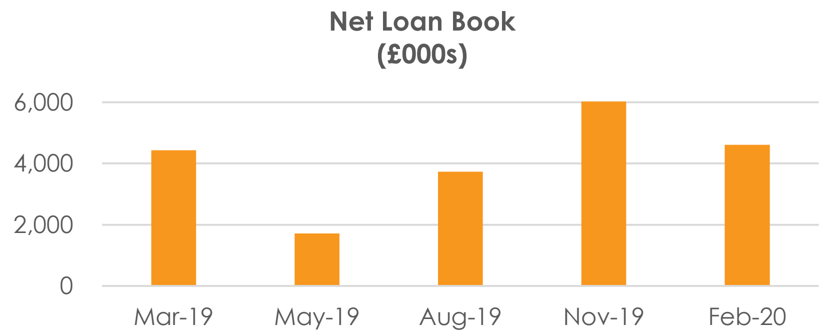
## Commentary

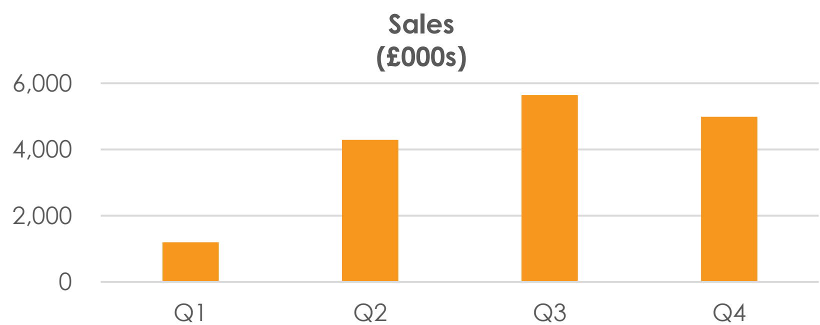
Customer numbers and loan book declined in H1 FY20 as we transitioned platforms and processes, but rebuilt in H2 FY20 prior to Covid-19 impact

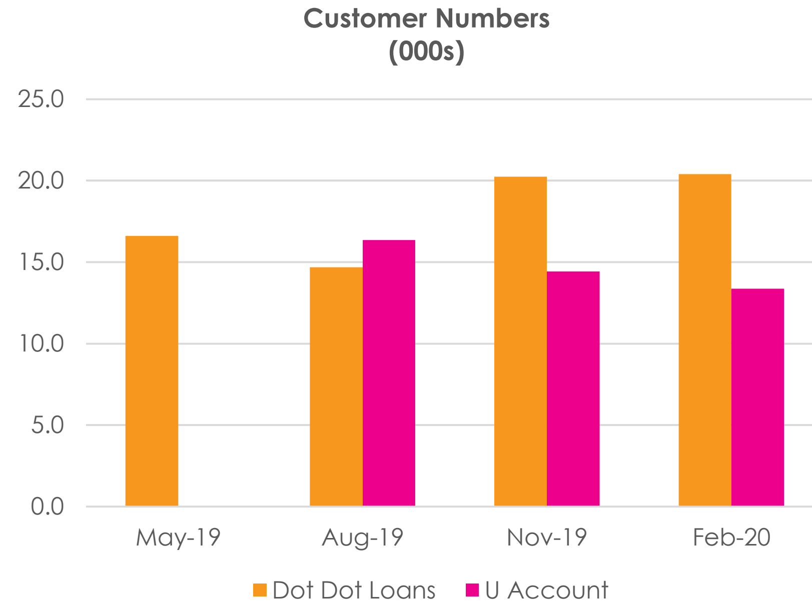
Right-sized cost base to more appropriate levels

Losses greater than originally expected

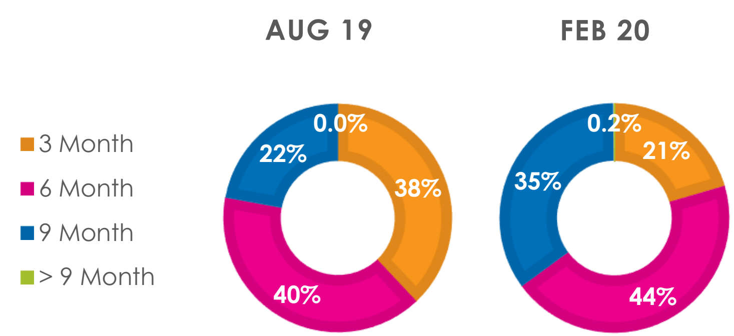
Break-even expected by FY22, through a combination of strong online lending and integrated banking and loan products




### Dot Dot Loans Product Mix – focus on longer term lending



# Income Statement

| £'m unless otherwise stated | HCC | Feb-20 Digital | Total | HCC | Feb-19 Digital | Total |
|---|---|---|---|---|---|---|
| Customer numbers ('000's) | 221 | 34 | 255 | 234 | 0 | 234 |
| Period end receivables | 67.9 | 4.9 | 72.8 | 73.0 | 0.0 | 73.0 |
| Average receivables | 69.4 | 5.0 | 74.4 | 69.2 | 0.0 | 69.2 |
| Average tangible equity | 63.4 | (8.1) | 55.3 | 59.5 | 0.0 | 59.5 |
| Revenue | 119.3 | 14.4 | 133.7 | 116.6 | 0.4 | 117.0 |
| Impairment | (27.6) | (7.1) | (34.7) | (25.9) | (0.3) | (26.2) |
| Agent commission | (27.0) | (0.6) | (27.6) | (28.3) | 0.0 | (28.3) |
| Gross profit | 64.7 | 6.7 | 71.4 | 62.4 | 0.1 | 62.5 |
| Admin expenses | (34.5) | (13.8) | (48.3) | (36.6) | (0.6) | (37.2) |
| Depreciation | (3.6) | (0.7) | (4.3) | (1.6) | 0.0 | (1.6) |
| Normalised operating profit | 26.6 | (7.8) | 18.8 | 24.2 | (0.5) | 23.7 |
| Financing costs | (2.1) | (1.2) | (3.3) | (1.7) | 0.0 | (1.7) |
| **Normalised adjusted PBT** | **24.5** | **(9.0)** | **15.5** | **22.5** | **(0.5)** | **22.0** |
| Covid-19 IFRS9 overlay | (1.7) | 0.0 | (1.7) | 0.0 | 0.0 | 0.0 |
| **Adjusted profit** | **22.8** | **(9.0)** | **13.8** | **22.5** | **(0.5)** | **22.0** |
| Impairment/revenue | 23.1% | 49.3% | 26.0% | 22.2% | 75.0% | 22.4% |
| Agent commission/revenue | 22.6% | 4.2% | 20.6% | 24.3% | 0.0% | 24.2% |
| Admin (inc Depr) exp/revenue | 31.9% | 100.7% | 39.3% | 32.8% | 150.0% | 33.2% |
| Normalised return on assets | 31.0% | n/a | 16.6% | 26.2% | n/a | 25.3% |
| Normalised return on equity | 33.9% | n/a | 22.3% | 30.4% | n/a | 29.4% |

## Commentary

### HCC

Credit issued declined by 2.2% to £174.2m (FY19: £178.1m) reflecting maturity of market

2.3% increase in revenue due to slightly higher income yields

Agent commission costs reduced from 24.3% of revenue to 22.6%

Increased profit even after IFRS9 Covid-19 overlay

### Digital

Credit issued increased by £15.7m to £16.1m (FY19: £0.4m) due to acquisitions

Revenue increased to £14.4m (FY19: £0.4m) due to acquisitions

Adverse impact on profits due to re-platform, improved processes and rebuilding customer base

# Balance Sheet

| £'m | Feb-20 (IFRS9) | Feb-19 (IFRS9) | Feb-18 (IAS39) |
|---|---|---|---|
| **Non current assets** | | | |
| Goodwill | 13.0 | 3.5 | 2.9 |
| Acquisition intangibles | 0.8 | 1.6 | 2.1 |
| Software and licences | 6.6 | 4.6 | 3.4 |
| Plant and equipment | 0.8 | 0.4 | 0.8 |
| Right of use asset (IFRS16) | 2.8 | 0.0 | 0.0 |
| Deferred tax | 0.6 | 1.0 | 0.0 |
| Total fixed assets | 24.6 | 11.1 | 9.2 |
| **Current assets** | | | |
| Trade receivables inc>12 mths | 72.8 | 73.0 | 72.8 |
| Cash and cash equivalents | 11.9 | 7.9 | 4.9 |
| Other current assets | 4.8 | 2.4 | 2.0 |
| Total current assets | 89.5 | 83.3 | 79.7 |
| **Total assets** | **114.1** | **94.4** | **88.9** |
| **Liabilities** | | | |
| Loan facility | (34.0) | (14.5) | (16.0) |
| Lease liabilities (IFRS16) | (2.8) | 0.0 | 0.0 |
| Trade and other liabilities | (6.6) | (8.9) | (6.4) |
| Total liabilities | (43.4) | (23.4) | (22.4) |
| **Net assets** | **70.7** | **71.0** | **66.5** |
| **Net tangible assets inc software** | **56.9** | **65.9** | **61.5** |
| **Trade receivables/net assets** | **103.0%** | **102.8%** | **109.5%** |

## Commentary

Total equity decreased reflecting the final dividend paid for FY19

Continued investment in technology platform reflected in software and licenses

Christmas lending peaked at £40.0m (FY19: £21.5m)

### Fair value balance sheet

| | |
|---|---|
| Reported net assets | 70.7 |
| Fair value loan assets | 26.1 |
| Other fair value adjusts | (0.3) |
| Fair value net assets | 96.5 |

### Covid-19

As a result of Covid-19, post year-end lending has been reduced through both demand and risk appetite

At the end of April 2020, the debt facility was extended from August 2020 to end of November 2021 at a reduced level of £40m compared to £55m

As at the end of October 2020, borrowing was £12.0m against our Covid-19 plan of £18.5m and £23.0m in October 2019

# Cash Flow

| | Feb-20 | Feb-19 |
|---|---|---|
| **Cash from operations ex invest in loan book** | 25.7 | 24.7 |
| Cash from funding | 19.5 | (1.5) |
| Total Cash Sources | 45.2 | 23.2 |
| | | |
| Decrease/(increase) in net loan book | 0.2 | (0.2) |
| Acquisitions | (15.9) | (2.2) |
| Purchase of intangibles | (4.3) | 0.0 |
| Capital expenditure | (2.2) | (2.4) |
| Principal paid under lease liabilities | (1.4) | 0.0 |
| | | |
| Corporation tax | (4.2) | (3.6) |
| Interest paid and arrangement fee | (3.2) | (2.2) |
| | | |
| Dividends paid | (10.2) | (9.6) |
| | | |
| Total Cash Uses | (41.2) | (20.2) |
| | | |
| Cash Movement | **4.0** | **3.0** |

## Commentary

Cash inflow from operations ex-investment in the loan book of £25.7m was up by 4.0% (FY19: £24.7m)

Increased borrowings of £19.5m largely reflected the acquisitions and purchase / investment in intangibles (£20.2m)

A final dividend is proposed of 1.0p per share bringing the full year dividend to 3.6p (FY19: 7.8p)

# Post balance sheet event – impact of Covid-19

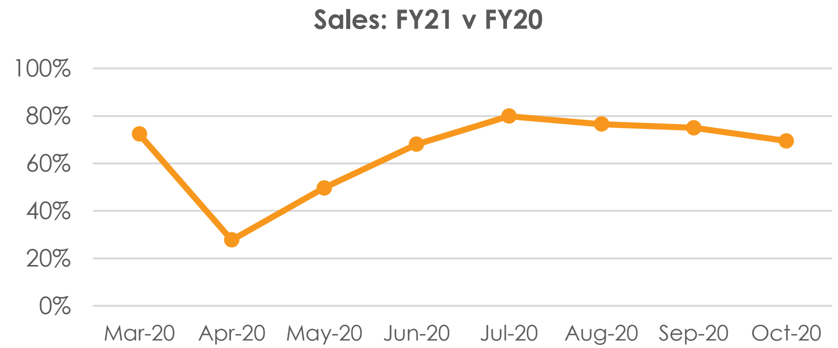
**Accounting treatment**

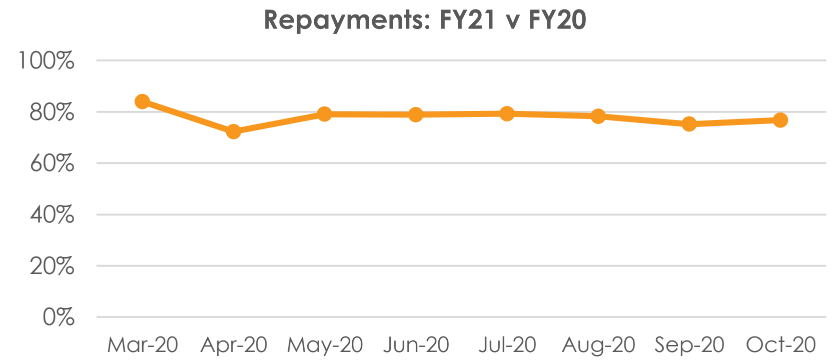
- The Covid-19 pandemic was fast evolving on a daily basis throughout February and March 2020, resulting in the full UK lockdown in late March 2020
- The IFRS9 accounting treatment required us to make an assessment of a Covid-19 scenario, calculate the impact of that scenario to our normal expected credit loss calculations and then apply a probability weighting of that scenario occurring, as at 29 February 2020
- This resulted in a probability weighted impact of £1.7m which was charged to the FY20 accounts
- Post year-end, we are able to rely on empirical information to establish the impact of Covid-19 on the closing February 2020 loan book assets and expected credit losses
- In addition, we also looked at how customer repayment behaviour would affect revenue recognition
- The table below summarises the expected impacts, most of which will crystallise in the first half of FY21
- These numbers do not estimate the impacts of Covid-19 as a result of lower sales volumes or possible subsequent impacts if the UK were to go into further stringent lockdowns

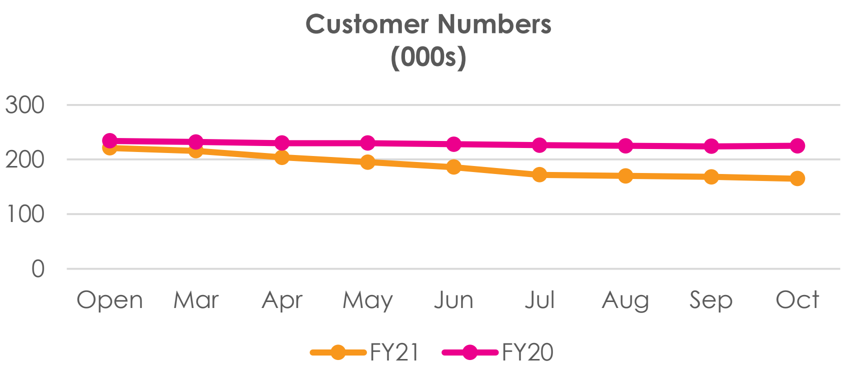
| **Post balance sheet event - Covid-19** | **£'m** |
|---|---|
| Increased expected credit losses | 5.8 |
| Loss of forward flow income | 0.3 |
| Extended loan lives | 0.8 |
| **Total** | **6.9** |
| Less: IFRS9 provision recognised in FY20 | (1.7) |
| **Net post balance sheet event** | **5.2** |

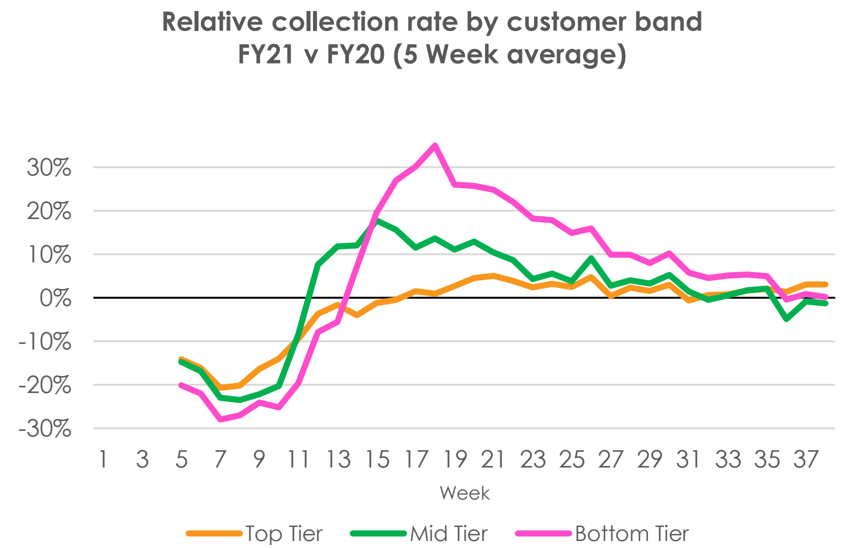
# Trading Update

# HCC in FY21




Unable to lend in first month of lockdown but quickly recovered with July 2020 particularly strong. FY21 sales for eight months to date total 65% of FY20

Remote sales continue at over 50% of the total compared to nil in FY19

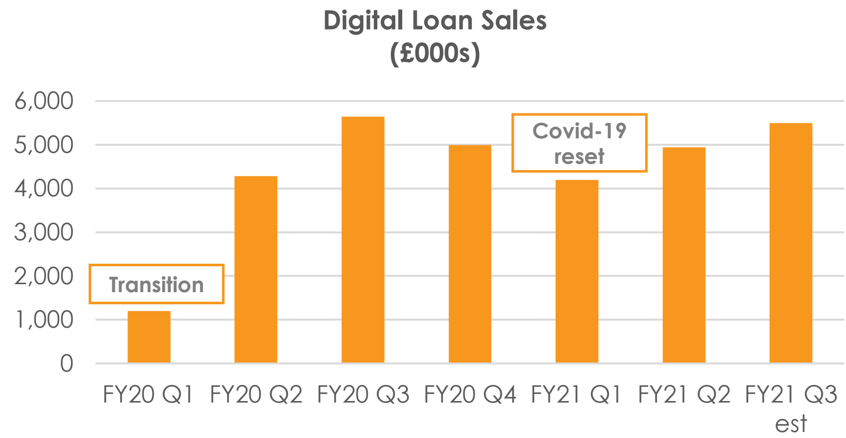
Since May 2020, collections stabilised, with YOY decline mostly reflecting the loan book / customers decline. FY21 collections (8 months to date) total 78% of FY20

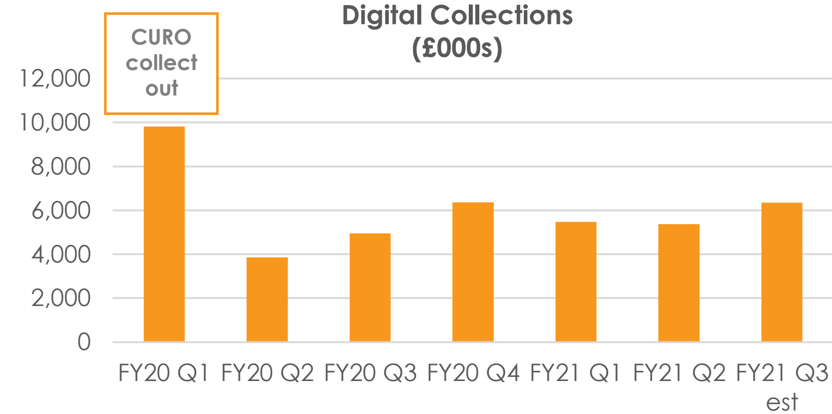
Remote cash collections 79% for the three months to October 2020 compared to 41% for the same period last year

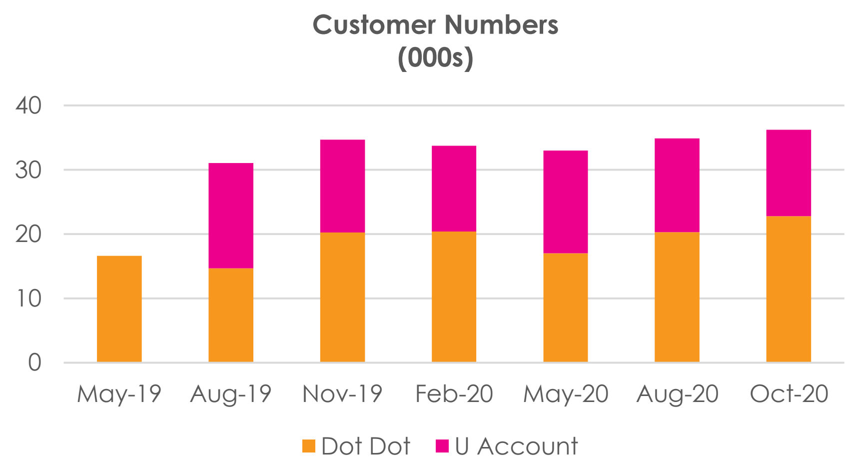
Customer payment performance dipped to 79% of last year in April 2020 but had recovered to 97% in August 2020

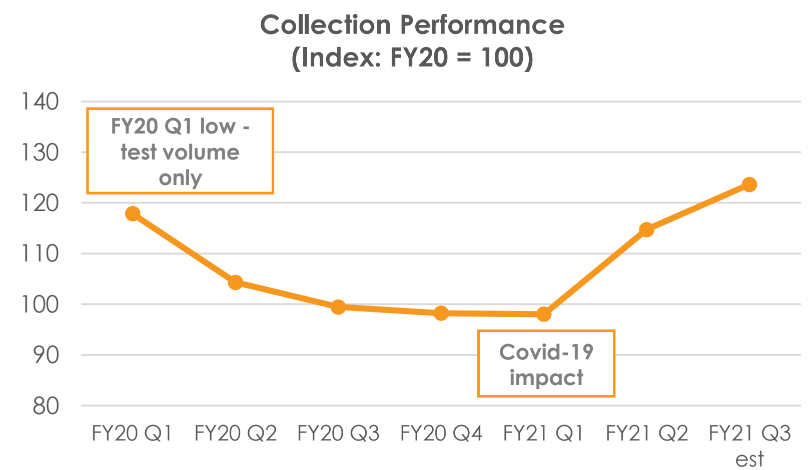
This dipped slightly with regional lockdowns to 93% in September but recovered back to 96% in October 2020

# Digital in FY21




Sales trend rebased in FY21 Q1 as both demand dropped and credit scoring tightened

Dot Dot Loans customer numbers recovered to pre-Covid-19 levels by August 2020

Digital collections in Q2 FY21 up 39% on last year driven by stronger sales volumes and an improvement in debt quality

Collection performance improved in the last two quarters

# Strategy

# Meeting customer demand for additional products

## Feedback from HCC customers:

Up to **65%** of customers **interested in Morses Club current account**

Up to **72%** interested in **using account for money transfers**

Up to **63%** interested in **credit limit current account**

Up to **79%** of customers **aware of portal**

Up to **73%** interested in **having income paid into account**

Up to **32%** of customers **have a credit card**

Up to **73%** interested in **having bills paid from account**

Up to **43%** **use their card for emergency cash**, with up to 36% using it for cash withdrawals

Up to **73%** interested in **setting up direct debits from account**

For HCC customers, **27%** of their credit need is met by HCC; a further **21%** is met by credit card, overdraft and HCSTC, and **11%** in 'other' unsecured personal loans – our multi-product offering means that we can now support an incremental **32%** of their debt requirements

morsesclub putting you first | | Dot Dot loans / LOANS
--- | --- | ---
Not working / benefits / part time and casual | **Income Source** | Full-time / salaried / 15-20% self-employed
Below national average (£10-15k) | **Income Levels** | Around national average (£20-30k)
Rented accommodation / social housing | **Housing** | Renters / c.20% mortgages
35-64 years >80%; 18-34 years 100% | **People with bank account by age** | 25-44 years 100%; 35-54 years 100%
Limited or no savings | **Savings** | Some savings for specific goals

| | Morses Club | Shelby Finance | | | |
|---|---|---|---|---|---|
| | | | U.MONEY | | |
| **Brand** | morsesclub putting you first | Dot Dot Loans | LOANS | E DRAFT | U ACCOUNT |
| **Market** | Short term | Short term | Long term | Revolving | Current Account |
| **Duration** | 22 – 53 weeks | 3 – 12 months | 18 – 48 months | Revolving | N/A |

# Targeting a large and underserved market

## Underserved 20.2 million adults

### Struggling
- 10.2m adults
- Working age
- Reliant on benefits
- Underserved / excluded

**Fintechs struggling with dormancy and fraud**

Pockit
0.4 million customers

SUITS ME.
0.6 million customers

### Squeezed
- 10.1m adults
- Working age
- Lower income
- Underserved / excluded

**There is space in our target market**

U ACCOUNT

cashplus
>2 million customers

thinkmoney
0.1 million customers

## Mainstream 31.7 million adults

### Millennials
- 11.2m adults
- Working age
- Mixed income range
- Tech savvy

**Established fintechs in this market – becoming saturated**

monzo
>13 million customers

Revolut
>10 million customers

STARLING BANK
>1 million customers

### Other
- 20.5m adults

**High street banks still have the mainstream majority**

HSBC

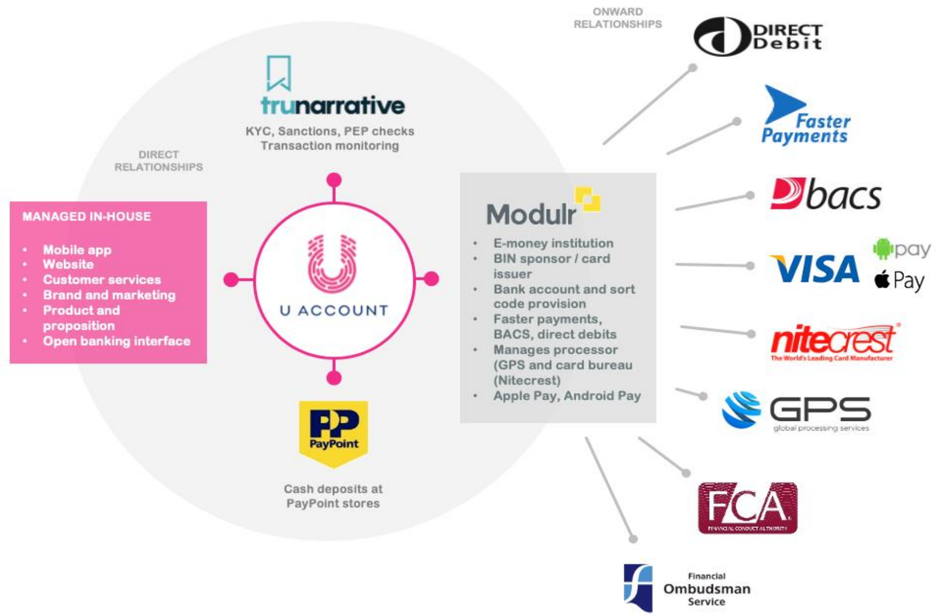
BARCLAYS

LLOYDS BANK

RBS

# Creating a competitive offering

## Partnering to improve upon competing products




### Strategy

- Customer needs at the heart of Morses Club's technology strategy
- Continued transformation of working practices - technology and service central to Agent model
- Create innovative, robust, compliant, secure and scalable digital products
- Expand service proposition linked to service model to build share of customer wallet

### Near-term deliverables

- Launch of rebranded credit suite for U Account customers at end H2 FY21 including revolving credit product and longer-term loans
- New loan management platform will integrate linked banking and credit products – H2 FY21
- U Account product to be offered to selected HCC customers
- Increased penetration of customer portal by development of wider financial services – pull marketing, rather than push
- Launch of new products and services via Portal to help customers manage their budget and access wider financial services

# Summary and Outlook

Our vision is to become a more complete financial services provider in the growing and fragmented non-standard finance credit market

**Clear strategy and recent acquisitions enabled a rapid and effective response to Covid-19**

**Introduced digital revolution in HCC sector which received a very positive customer response**

**Decline in HCC customer numbers and loan book but improving collections and digital engagement**

**Digital division experiencing continued improvement in sales, collections and debt quality - break-even position in FY22**

**Reengineering of business to support customers, employees and agents beyond direct requirements of Covid-19 response**

**Proven demand for additional products in a large and underserved market**

**High levels of customer service and deepening affordability assessments integral to new products and services to help customers manage their budget and access wider financial services**

**Current economic situation makes short-term outlook difficult to predict, but contracting credit supply expected to present opportunities**