Provident Financial plc
Interim Management Statement
18 October 2013

Provident Financial plc, the leading UK non-standard lender, made the following Interim Management Statement today covering the period from 1 July 2013 to 17 October 2013.

Overview

The group overall has performed in line with its internal plan through the nine months ended 30 September 2013.

Vanquis Bank has continued to trade ahead of its internal plan, delivering strong growth and robust margins, supported by stable, record low delinquency levels. The pilot credit card operation in Poland continues to support the potential for developing a business capable of delivering the group's target returns. Further sound progress has been made in refining the credit tools relevant to the target customer segments, which should allow a firm business plan for Poland to be established during the first quarter of 2014.

The Consumer Credit Division (CCD) has seen no change to the weak pattern of demand reported in the first half of the year. Whilst the trading result for the third quarter remained behind the prior year, the benefit of the cost savings implemented at the end of July and some improvement in collections performance in September narrowed the shortfall in the quarter. Strategic plans to reposition CCD over the next 18 months are now well advanced, with the main thrusts being to focus on driving returns within the core home credit business whilst investing in broadening the customer and product proposition through the roll-out of online direct repayment lending.

The group's funding position remains very robust and the group's committed debt facilities, together with the retail deposits programme at Vanquis Bank, are sufficient to fund contractual maturities and projected growth in the business until the seasonal peak in 2016.

CCD

Business performance

The competitive landscape for CCD remains unchanged. As anticipated at the interim results, CCD has not seen any improvement in the trading environment during the third quarter. Home credit customers tend to be hourly paid with a bias towards more casual, temporary and part-time employment with any recovery in their income levels typically lagging the broader economy.

Home credit customer confidence remains very low and household disposable incomes and living standards continue to suffer from the persistent rise in food, fuel and utility bills. Tight underwriting standards remain in place and customer behaviour has remained cautious, especially demand from better quality customers who are typically eligible for higher value, longer duration loans that are often used for more discretionary items of expenditure. As a result, sales during the seasonally quiet third quarter trading period were subdued and continued to track below the prior year. At the end of September, customer numbers and average receivables showed year-on-year reductions of 8.7% and 5.5% respectively, compared with 5.8% and 3.6% reported at the half year.

The annualised revenue yield strengthened further during the third quarter, ending September at 94.3% compared with 92.4% at June 2013. This reflects the continued shift in the mix of lending, including a reduction in demand for longer duration loans which carry a lower yield than shorter term products.

Credit standards have remained unchanged and there has been no further deterioration in the arrears profile or collections performance during the third quarter. Nonetheless, the increase in the annualised revenue yield and the year-on-year deterioration in the arrears profile resulted in the annualised ratio of impairment to revenue increasing to 38.1% at the end of September, from 36.8% at June. The year-on-year deterioration in the arrears profile is closely linked to weaker demand over the last 12 months, as those existing customers not wishing to take further credit have less incentive to bring their accounts up to date and remain in mild arrears. There is a heavy focus on arrears activity throughout the field organisation in the run up to the peak Christmas trading period which has produced some improvement in collections performance during September.

The cost reduction programme announced at the interim results was fully implemented by the end of July and gross cost savings of approximately £10m will be delivered in the second half of the year, with the full year benefit increasing to £18m in 2014.

With regard to ongoing product initiatives, the trial of the ‘24/7’ prepaid reloadable MasterCard, together with an online customer portal which allows customers to top-up their card against agent pre-approved limits, continues to progress well across approximately 20% of the business. Full roll-out is expected through the first quarter of 2014. The smart phone collections app for agents which was developed in the first half of the year has now been rolled-out to 1,000 agents. The app replaces the paper-based capture and processing of transactional data and has been very well received by agents. Roll-out across the agency force is planned for 2014.

Whilst CCD’s trading result for the third quarter remained behind the prior year, the benefit of the cost savings implemented at the end of July and some improvement in collections performance in September narrowed the shortfall in the quarter.

Business development

The strategic plan to reposition CCD over the next two years is now well advanced, with the main thrusts being to focus on driving returns within the core home credit business whilst investing in broadening the customer and product proposition through the roll-out of online direct repayment lending.

The core home credit business will continue to address those customers who can only be served responsibly through the weekly interaction with a Provident agent. However, operational effectiveness and significant cost efficiencies will be secured through the roll-out of smart phone and tablet technology across the agent force and branch-based field operations. Major benefits will be realised from:

- the implementation of standardised best practices across the agent force and field operations;
- the elimination of the significant cost associated with paper driven processes that exist throughout the business today; and
- enhanced evidence of compliance as the regulation of the business transitions from the Office of Fair Trading (OFT) to the more exacting Financial Conduct Authority (FCA) regime from 1 April 2014.

The trial of the Provident online direct repayment product has run since April and proved capable of delivering the group's target returns. It captures those applicants of sufficient credit quality whose preference is to access credit online and make weekly repayments direct from their bank account without the need for an agent visit. It can also appeal to those existing home credit customers whose credit status has improved and supports an online lending relationship. More broadly, online credit of up to 12 months in duration is relevant to a proportion of applicants declined a Vanquis Bank credit card as well as the significant audience of non-standard consumers that occupy the segment of the market between Vanquis Bank and home credit. To address these opportunities, a new separately branded online product will be launched shortly. It will draw on the highly effective distribution, underwriting and collections capabilities of both CCD and Vanquis Bank.

Vanquis Bank

Business performance

Vanquis Bank has continued to generate strong growth and margins through the third quarter of the year as it continues to experience strong demand from developing the under-served non-standard credit card market.

Consistent investment in the customer acquisition programme, particularly direct mail, has seen customer numbers rise to 1,051,000 at the end of September, representing year-on-year growth of 26.0%. Whilst the marketing activity of competitors has shown a further modest increase, it has had no discernible impact on overall new account bookings which for the current year are now expected to exceed the volume of 375,000 booked in 2012, against unchanged underwriting standards.

The growth in customer numbers together with the credit line increase programme has supported year-on-year growth in average receivables of approximately 39% at 30 September 2013, broadly in line with that reported at the half year.

Vanquis Bank customers are typically in more regular employment than home credit customers although the business has demonstrated that it is less sensitive to changes in the employment market than mainstream card issuers. The combination of the consistent application of tight credit standards and a benign UK employment market has seen delinquency levels remain stable at record lows for the business. As expected, the annualised risk-adjusted margin moderated from 34.4% at the half year to 34.0% at the end of September and will moderate further since it is no longer benefitting from the progressive reductions in delinquency experienced in prior periods.

Vanquis Bank has continued to outperform its internal plan through the third quarter of the year.

Business development

The progress of the pilot operation in Poland continues to support the development of a credit card business capable of delivering the group's target returns.

As set out in the interim results, a primary focus of the pilot is refining the credit tools relevant to the target customer segments. Sound progress is being made on this front, including the deployment in late September of significantly enhanced second generation scorecards drawing on credit data from multiple bureaus. In addition, the distribution of the product continues to be augmented through the appointment of further national brokers and major online affiliates and the detailed plans to establish in-country call centre and support functions are being firmed up.

It is anticipated that new account bookings will continue to run at around 3,000 per month through the final quarter of the year and provide the data necessary to develop a business plan based on a firm assessment of the addressable market segment during the first quarter of 2014.

At the end of September, the operation had 23,000 customers and a receivables book of £4.6m. As previously indicated, the cost in 2013 in respect of the Polish pilot operation will be approximately £7m.

Funding and capital

The group's funding and liquidity positions remain strong. Balance sheet gearing at the end of September was 2.8 times compared with a covenant limit of 5.0 times.

Headroom on the group's committed debt facilities at 30 September 2013 amounted to £301m, which, together with the retail deposits programme at Vanquis Bank, is sufficient to fund maturities and projected growth in the business until the seasonal peak in 2016.

Regulation

The FCA has recently published a consultation on its detailed proposals for the new regulatory regime for consumer credit, which will come into effect from 1 April 2014 when it supersedes the OFT. The consultation builds on responses to the high level FCA consultation exercise initiated in March 2013, and covers key features of the authorisation, supervision and enforcement regimes, as well as conduct rules and guidance including a new draft rule book. The consultation runs until 3 December 2013, and the FCA intends to publish its final rule book and guidance in the first quarter of 2014.

Outlook

The high quality of the receivables book, strong margins and continued investment by Vanquis Bank in developing its customer base, have delivered a third quarter performance ahead of internal plans and leaves the business in a position to deliver strong results for the year as a whole. The Polish pilot operation has made further sound progress and a firm business plan is expected to be completed in the first quarter of 2014.

Whilst CCD continues to face weak demand, its financial performance is benefitting from the cost reductions implemented in July and a heavy focus on arrears management which is yielding some improvement in collections performance. The plans to reposition the business over the next 18 months are well advanced. The agenda is to focus on driving returns within the core home credit business and invest in broadening the customer and product proposition to capture a larger share of the target non-standard audience through the roll-out of online lending.

The group overall has performed in line with its internal plan during the third quarter and expects to do so for the year as a whole.

The group has a strong funding position that allows it to meet its contractual debt maturities and execute in full on its growth plans into the seasonal peak in 2016.

Commenting on the group’s performance, Peter Crook, Chief Executive, said:

“I am pleased to report further strong growth at Vanquis Bank whilst the continuing weak conditions within CCD confirm the importance of the cost reductions implemented in July. The group overall has performed in line with its internal plan through the nine months ended 30 September and is expected to continue to do so for 2013 as a whole.

The group’s funding position remains strong and the sound progress made by the Vanquis Bank credit card pilot in Poland and in developing an online direct repayment product to capture a greater share of the non-standard UK market are exciting opportunities to augment the group’s medium-term growth prospects.”

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