Fixed Interest

PFG | Provident Financial Group

Provident Financial 7% 04/10/2017 - Buy

28th March 2012

Price	100
Credit Rating	BBB
Risk Rating	Medium
Coupon	7%

The Issuer:

Established in 1880, Provident Financial Plc ("PF") is one of the UK's leading suppliers of personal credit products to the non-standard lending market through their Consumer Credit Division (Home Credit) and Vanquis Bank (Credit Cards). The company is listed on the London Stock Exchange and valued at £1.6 billion. It serves over 2.5 million customers through a network of more than 400 branches, 3,500 employees and 10,500 agents offering small loans (typically £300-£650 over one year) to their customers, typically lower-income families that have limited access to credit from mainstream providers maybe due to limited or impaired credit histories. The Annual Percentage Rate (APR) on the most popular home credit loans is currently 254%. As at year end 2011, customer satisfaction in Home Credit was 91%.

The agent is at the heart of the home credit service who typically calls every week to collect the repayments. 69% of the agents are women and usually come from the same communities as their customers. Agents are paid commission based on what they collect, not what they lend, so it is in their interest to lend only as much as customers can afford to repay. The agent's weekly visit is not only convenient; it's a useful reminder to put the money aside for the repayment too.

The company weathered the storms of the credit crunch well generating consistent profits and last month saw the company report record turnover and record profits. Tight underwriting standards, a focus on existing good-quality customers and a strong collections performance also saw delinquency rates stabilise at an all-time low for the business. Gearing is stable at 3.2x and with a significant surplus of regulatory capital the group is fully funded into 2015.

As with any lender, PF is also reliant on credit lines-typically bank loans. Since the credit crunch, such loans have been drying up. Accordingly PF has been diversifying its source of funding through its Vanquis Bank, where £140m of retail deposits (at interest rates of between 3.15% and 4.65%) have been gained on fixed 1-5 year terms. The bank should achieve its target of funding 80% of its receivables book with deposits by the end of 2012.

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Credit Analysts View:

The issue carries a BBB rating from Fitch, making the bond "investment grade". An obligor rated 'BBB' has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.

Terms of the bond:

Denomination

The bond has a face value of just £100, although it is not possible to subscribe for less than £2,000. Thereafter, the bonds can be bought and sold in multiples of just £100.

Coupon

The bond pays a 7% coupon in two semi-annual instalments in arrears in April and October. Interest will begin to accrue from the 4th of April 2012.

Redemption

Subject to credit risk, the bonds will be repaid on the maturity date, 4th October 2017.

Dealing

The bonds will be traded on the London Stock Exchange's electronic Order Book for Retail Bonds (ORB), which was launched in response to private investor demand for easier access to trading bonds with the aim of providing a transparent and efficient mechanism for UK retail investors to access the bond markets. The bonds are tradeable instruments and prices will be quoted in the market during trading hours. The bonds can be sold before maturity on the ORB and the prices are supported by Barclays Bank Plc and Investec Bank Plc in a market-making capacity.

Stamp Duty

No UK stamp duty is payable on the issue or transfer of the bond or on its redemption.

Security

The bond is senior, unsecured, unsubordinated debt of PF. This means that if PF becomes insolvent, you may recover your investment in priority to subordinated debt holders and shareholders of PF. However, you could still lose some or all of the money you have invested.

Summary:

The bond looks good value against the 1.1% offered by the benchmark gilt and the 3% offered by average corporate sterling bonds for the same maturity. The continued forecast of a low interest rate environment provides added attraction. The relatively short maturity of the bond will also mean less volatility in secondary market prices. The senior ranking of the bond combined with the steady course steered by PF's management through the credit crunch suggests that the new bond offers a good risk/return ratio. The Provident Financial 7% April 2020 is priced at 105.7, indicating a 6.1% yield to maturity. Considering the 7% 4th October 2017 bond is shorter, we believe the bond should trade at a premium to par upon admittance to trading in the secondary market.

Gibraltar Asset Management

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Fixed Interest (cont)

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