

## Building scale in the right places

To say there have been some ups and downs for FlexiGroup (ASX, FXL) since the stock arrived on the ASX a decade ago, is something of an understatement. The leasing and finance group listed with some fanfare around a year before the GFC, after which reality set in rather abruptly.

A strong recovery of the shares (which rose tenfold) from the financial crisis lows was underpinned by a robust earnings performance, with organic revenue growth augmented by acquisitions. The last two and a half years though have seen a significant share price de-rating, with the business unit in particular seeing increased competition from banks, which have impacted earnings forecasts. Investors have also been unsettled by disruption to senior management.

We however believe the tide is turning with an improved earnings outlook following a series of recently implemented restructuring initiatives. This has seen the divestment of non-core, low margin businesses, while core operations have been boosted by a meaningful acquisition, whose integration is progressing well. The company's management team is also in much better shape, and with strategic direction also being steered by the company's Chairman and co-founder.

Technically the charting picture has also picked up, in line with an improving fundamental story, and this provides us with some confidence that a key inflection point has been reached.

From a valuation perspective the shares are modestly priced in our view, at around 9 times FY17 earnings, with a dividend yield approaching 7 percent.

**We therefore recommend FlexiGroup as a buy to all Members with a medium to long term horizon.**

Turning to the technicals, on the daily chart, support is currently being tested at the 50-day moving average (red line) at the \$2.19 mark. Should prices lift from current levels, then a short-term advance towards a zone of resistance located between \$2.46 and \$2.58 could follow. This consists of the 38.2% Fibonacci retracement and the 31<sup>st</sup> August high (thin red line). A sustained break above the topside of this range would likely lead to a strengthening of the overall technical outlook.



With reference to the weekly chart, structural support was respected at the \$1.73 region in July (horizontal blue line). This is an important level, as it has been a focal point of resistance in September 2009, and support on a number of occasions in March, August and December 2011. The significance of this price region has resulted in a firm recovery in share price. Over the near term, resistance is expected at the 50-week moving average (red line) at \$2.40. Therefore, a decisive break above this indicator would likely result in medium-term momentum to swing in favour of the bulls. In-turn, this could lead to a broader term rise towards the 38.2% Fibonacci retracement of \$2.91.



## Company History

The beginnings of FlexiGroup date back to 1988 when the company's founders David Berkman and Andrew Abercrombie (the current Chairman and 24 percent shareholder), identified a gap in the market with few options available for small and medium-sized businesses requiring simple finance for office equipment.

Fast forward to the present day and the company has a network of over 20,000 merchant, vendor and retail partners, with business and consumer clients across a host of sectors. The company has operations in Australia, and New Zealand, as well as a fledging business in Ireland. Finance solutions include 'no interest ever', leading, vendor finance, interest free and credit cards, as well as lay-by products.

The company's units includes commercial and consumer leasing which is provided through five specialised brands FlexiRent, FlexiWay, FlexiCommercial (for SMEs) , FlexiEnterprise, and SmartWay (channelled through JB Hi-Fi stores).

The company's Interest free finance business operates through the Lombard and Once brands, while the 'No Interest Ever!' Unit operates under the banner of Certegy Ezi-Pay.

## Recent Developments

After delivering several years of robust underlying revenue and earnings growth, the last couple of years have proven more of a challenge for FlexiGroup. This is also as margin pressures within the banking sector have led participants there to also look for a slice of the action in the SME space.

Investor sentiment was further knocked with the abrupt departure of the company's CEO Tarek Robbiati in the middle of last year. The company's management team though has been strengthened significantly in our view through the appointment of Symon Brexis-Weston as the CEO at the end of last year. Mr Brexis Weston boasts an excellent pedigree having been CEO of Sovereign Assurance Company (owned by CBA), the largest life insurance provider in New Zealand.

The management of the company's New Zealand operations were meanwhile also bolstered by the elevation of David Stevens to the CEO position there. The New Zealand business is now one of significant scale for FlexiGroup following the \$315 million acquisition of Fisher & Paykel Finance. The business has over 430,000 cardholders (including the Q card and Farmers credit card). As a result the kiwi business now accounts for around 44% of business volumes.

## Strategic Initiatives

Looking at the share price chart in recent years, it is apparent that FlexiGroup has lost some of its lustre as far as the market is concerned. Worries that the company has lost its way, and focus, along with increasing competition from the banks have been primary concerns.

However, new management have sought to bring focus back to the operations with a host of initiatives. This has included discontinuing non-core, low ROE offerings, and focussing on core business units Cards, Certegy and Leasing. These areas account for 90% of the company's volumes, with an addressable market estimated at around \$250 billion.

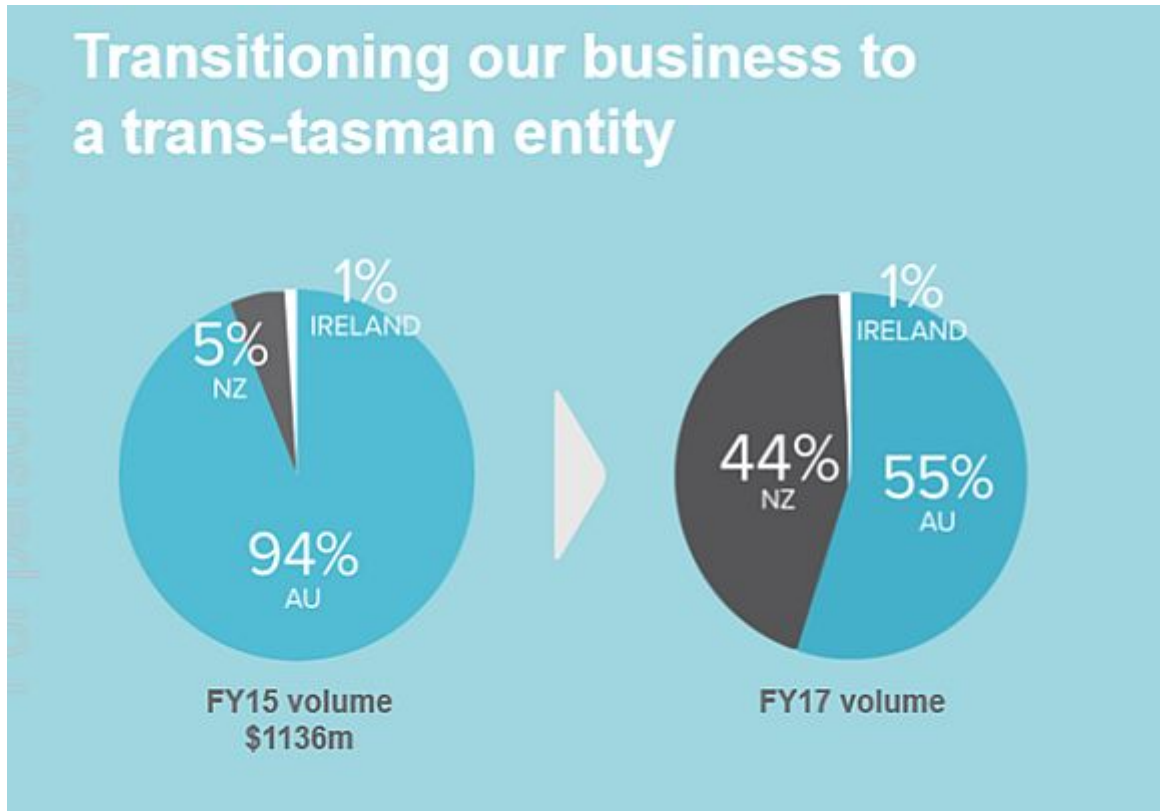
Management have also sought to bring back a sales culture and customer focus which they acknowledge had 'fallen away.' IT spend is being refocussed on core business units and with the specific aim of improving processes, rather than just 'spend for spend's sake'.

**Key initiatives to return FXL to profitable organic growth** FLEXIGROUP™

- 1 Upscaling AU Cards business through leveraging strategic contracts
- 2 Oxipay launched to market targeting millennials spend
- 3 Investing in Ireland business to capture market opportunity
- 4 Rebuild of Commercial Finance business
- 5 Roll out scheme card in NZ and improve cost to income ratio
- 6 Driving sales and marketing culture
- 7 Exiting non-core business units

Source: Company Presentation

The company has also sought to diversify its geographical reach, a process which has been supercharged by the acquisition of Fisher and Paykel Finance. In FY15 Australia accounted for around 94% of volumes, with this to be diluted to 55% for FY17. Management also have strong ambitions for the company's Irish business which they expect to account for between 8 and 10% of group profit (from less than 2% now) over the next three to four years.



Source: Company Presentation

The company are also looking to other avenues for growth, having taken a minority stake in fintech lender Kikka Capital for \$2 million in May. Kikka's proprietary credit model provides growth capital to small businesses and has the fastest origination process currently in the market.

Management are also well aware that existing product offerings need to move with the times. FlexiGroup plans to unveil a new product next month specifically designed to appeal to 'millennial' consumers who are likely to be more open to leasing household items.

Such a nimble and technologically aware approach is also delivering significant new business wins. Last month the company announced that it has won a deal with Flight Centre to offer the travel agency's customers interest-free loans. FlexiGroup will make an investment of around \$3 million as part of the mandate, which it believes could more than double the Group's card business' revenue over the next several years.

### **FY16 Results**

FlexiGroup released full year results a few weeks ago, which were strong given that the business has been undergoing much change over the past year. We believe these lay the foundations for a significant improvement in earnings in FY18 and beyond.

The company saw revenues rise by 16% to \$396.4 million in FY17, and delivered an 8% increase in Underlying or 'Cash' NPAT to \$97 million, in line with guidance. The performance was underpinned by a 19% jump in new business volumes, and 47% lift in receivables to \$2.094 billion, boosted by the acquisition in NZ. Management also reaffirmed that (despite disposals) cash NPAT for FY17 would be in the range of \$90 million to \$97 million.

FlexiGroup (\$m)	FY15	FY16	Growth v PCP
Cash NPAT <sup>1</sup>	90.1	97.0	8%
Statutory NPAT	82.7	50.2	(39%)
Volume	1,136	1,350	19%
Closing Receivables	1,428	2,094	47%
Cash Flow from Operating Activities	121.2	147.4	22%
ROE % <sup>2</sup>	23%	19%	(4%)
Cash Earnings per Share (cents) <sup>2</sup>	28.7	28.0	(2%)

Source: Company Presentation

At the bottom line the company's statutory earnings fell some 39% to \$50.2 million due to previously flagged impairments on exited businesses. Costs were also lifted by acquisitions, as well higher investment in IT software. As a result the dividend declared was lowered to 15 cents per share from 17.75 cents previously. Going forward the company intends to keep the payout at 50-60% of Cash NPAT

Looking ahead we believe that a significant lift in receivables (up 47% on FY15) affords FXL significant operating leverage and will underwrite earnings growth in the years ahead. Management foresee a return to double-digit profit growth in FY18.

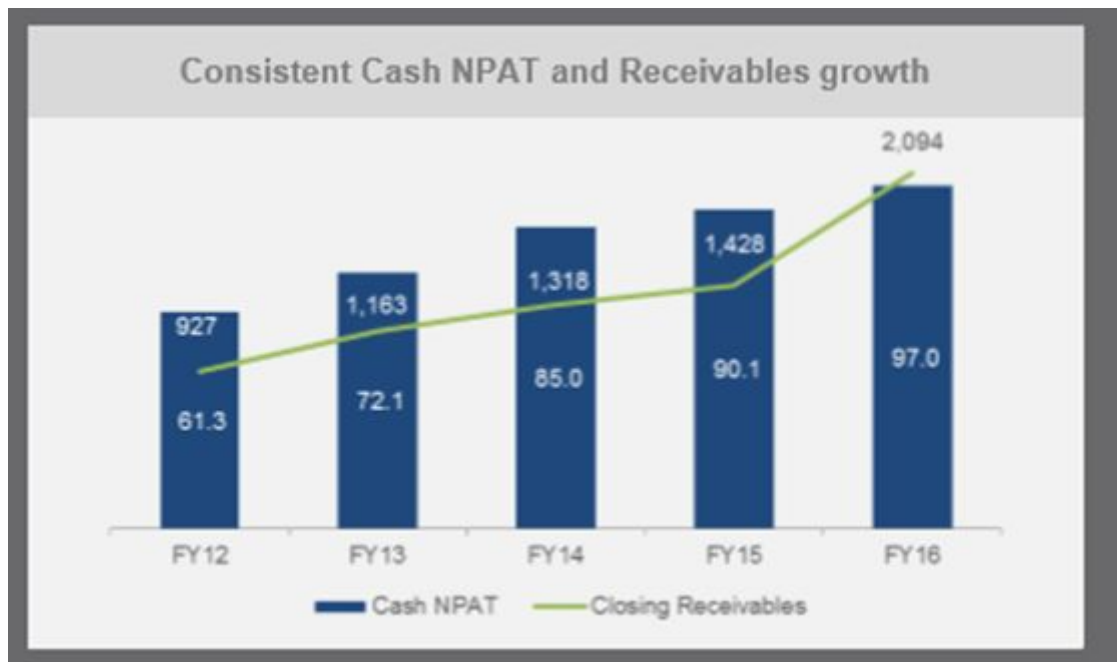


	Cards – NZ	Cards – AU *	Certegy	Leasing – NZ	Leasing – AU	
FY17 Volume growth	8-10%	15+%	1-3%	8-10%	1-3%	Cash NPAT growth  <b>&gt;10%</b>
FY18 Volume growth	10-12%	15+%	8-10%	10%	5-10%	

\* Cards AU volume outlook upgraded from 10% growth per Strategy Day presentation 31 May 2016 following announcement of partnership with Flight Centre on 8 August 2016

Source: Company Presentation

And strong NPAT growth in line with higher levels of receivables is something that FlexiGroup has been able to consistently deliver on in recent years.



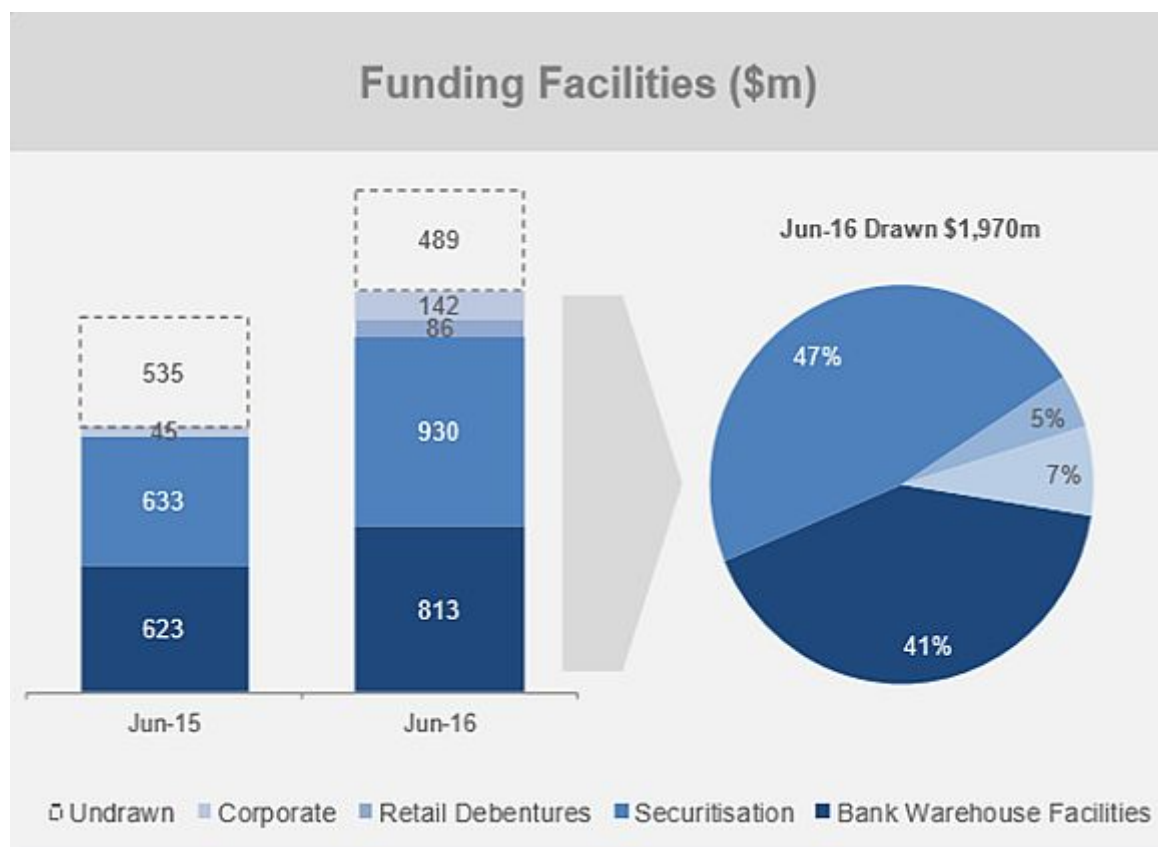
Source: Company Presentation

On the other side is the risk (and similar to the banking sector) that the Australian and New Zealand economies experience a downturn. Both nations remain heavily dependent on the outcome for the commodities sector (and particularly dairy in NZ's case). However with commodity prices ticking back up, and further tools at both central banks' disposal, there is cause for optimism in our view.

In terms of the impact of economic stress on FlexiGroup, a key yardstick is the level of impairments. This currently stands at around 3.5% of the portfolio (from 3.1% in FY15), and is one metric we will be monitoring

closely. Management though has sought to contain any further pressure here by implementing various changes to collections processes (including flexible payment options in line with income frequency).

From a balance sheet perspective FlexiGroup is appropriately geared in our view, with a recourse Debt/Equity of 67%. Borrowings are matched to customer contracts terms, and interest rates are fixed to match fixed income products. Holistically we also remain of the view that rates in Australia are going to remain low, at least in the medium term. On the funding side FXL also has substantial unused committed revolving facilities to facilitate growth of some \$489 million at the end of FY16.



Source: Company Presentation

### Summary

The last two and a half years have seen a significant share price de-rating for FlexiGroup from lofty levels, with the company seeing increased competition from banks, which has impacted consensus earnings forecasts. Investors have also been unsettled by disruption to senior management.

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## Snapshot FXL

### FlexiGroup

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### Market Capitalisation:\$809m

	FY1	FY2
Price to Earnings	8.6	7.9

Dividend Yield (%)	6.7	7.2
Price to Book	1.25	1.18
Return on Equity (%)	14.86	15.32

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