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Patience runneth dry

Consumer credit company FlexiGroup (ASX, FXL) has certainly not taken part in the revival witnessed in the broader markets this year. Indeed, the shares have continued their downward trajectory from the highs seen last August. Investors have been unnerved by a change of CEO, and headwinds on a number of fronts. Already fragile sentiment has been exacerbated by the company warning on profits today, ahead of half year results at the end of the month.

The shares have recovered from their lows in the session, but are now trading at a very modest earnings valuation of around 8 times. This leaves a low bar for outperformance arguably, but **we are also concerned that today's warning may not be the last.**

The growth in the company's underlying businesses is slowing quicker than anticipated, and could well falter further as the economy loses steam, and also given the prospect of ongoing 'balance sheet' pain for consumers. The fact that the final Hayne report hasn't seen any severely negative consequences for the big banks, also means that the 'competition' for credit could tighten further. All this may only frustrate a company specific turnaround under a new, but relatively unproven CEO.

FlexiGroup has been a disappointing recommendation, but we are concerned that the outlook may become worse before it gets better. The first profit warning for 2019 is unlikely to be the last, in our view. **Accordingly, we are recommending Members sell their holdings in FlexiGroup, to avert further downside.**

Revised Guidance

We covered in our previous note how overall, FY18 was a solid year for FlexiGroup with marked improvements across key metrics, supported by the prudent retirement of legacy brands. We were encouraged also by the tilt towards a younger market segment, setting the platform for earnings growth.

The share price picture however tells a different story, with uncertainties lingering over the company's turnaround plan, and under a new CEO. This is also whilst the underlying trading environment has remained challenging.

The latter was underlined by today's profit warning, with FlexiGroup downwardly revising FY2019 cash net profit after tax (NPAT) to be in the range of $76 - $80 million. This compares to previous guidance of $95-$100 million, and follows a $12 million after-tax impairment in the Commercial Leasing business. Driving the impairment is the company's exposure to the voluntary liquidation of one of its equipment finance vendor program partners.

The company also reported that the AU cards business total receivables grew by 18% year-on-year, outperforming a 'negative trend' across the industry category. Still the level of growth was below budget expectations, and the previously flagged improvements were occurring at a slower than forecast rate, also impacting Group NPAT.

Management did report that the Group's 'Buy now Pay later' product Certegy EziPay continues to grow strongly, with volumes up 7% year-on-year. Given the stellar share price performance of Afterpay Touch, the group would likely wish it had a bigger exposure, as it remains a relatively small slice of the revenue pie.

There may also be some interruption coming to the sector in the form of tighter regulation, and particularly given that the final report from Ken Hayne is out. The consumer leasing market was not caught by the RC but following a Senate Inquiry the company's CEO, Rebecca James, was amongst those who responded that they supported the implementation of the Small Amount Credit Contract (SACC) and Consumer Lease reforms. ASIC is also seeking to 'improve' standard of practice in the sector. Further oversight here may only add to the list of issues currently facing new management.

We will no doubt hear more from management on the group's strategy at the end of the month when interim results are announced. On the face of it the underlying numbers should be reasonable, with a NPAT forecast of $32 million, 3% higher than the prior comparable period, with 272,000 new customers added and 2,800 sellers onboarded in the last six months. However, we are more concerned about what more is to come down the track.

Turning to the charts, on the daily chart, the technical picture has deteriorated further, with prices falling further below dynamic support at the 200-day (green line) and 50 day (red line) moving averages. Resistance at the 50% Fibonacci retracement at $1.79 has given way, as has that at the 61.8% Fib at $1.67. A bearish moving average (where the 50-day moving average crosses beneath the 200-day moving average) has reinforced the bearish picture.

With reference to the monthly chart, near-term support at the November low of $1.44 (horizontal thin-blue line) has given way. An additional layer between $1.08 and $1.20 is now under threat. The dominant long-term downtrend remains in play, and therefore, the climb north could be slow in coming.

FlexiGroup Limited - FXL (ASX) - 1 Month CandleStick Chart - AUD

Summary

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Disclosure: FlexiGroup is held within the Small & Mid-cap managed account portfolio.

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Snapshot FXL

Flexigroup

Latest Closing Price: $1.18

The foundations 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 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.

Market Capitalisation:$664.34m

	FY1	FY2
Price to Earnings	4.9	4.7
Dividend Yield (%)	7.1	7.8
Price to Book	0.68	0.63
Return on Equity (%)	14.6	13.9
EV/EBITDA	10.0	10.6

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