Time Finance plc

16 June 2021

Fair value 50p/share as *'Fantastic opportunities lie ahead'*

Time has confirmed the permanent appointment of the highly experienced Ed Rimmer as CEO. He has described an updated strategy as 'evolution not revolution'. The key elements are a primary focus on organic growth to double the net lending book to more than £200m over four years, with a priority placed on building the 'own-book' business over 'broked on' business. Time pursued a buy and build strategy to grow from £4m revenue in 2014 to £29m in 2020. Own book originations made up 37% of new business in FY20, growing to 46% in FY21. **Our fair value is >60% above the current share price.**

Ed has 20 years of commercial finance experience, was previously Time's COO (after being MD of the Commercial Finance Division), and UK CEO and main board Director of Bibby Financial Services Limited. Also of significance is the March appointment of Tanya Raynes as non-exec Director. Tanya is a chartered accountant, spent 10 years at GE Capital and was CEO of aviation business Centreline until 2019. She is non-executive Chair of Centreline's parent, Pula Aviation Services.

Time's trading update highlighted **the solidity of the foundations the re-shaped team have on which to build.** While business volumes in FY21 were unsurprisingly depressed as a result of the pandemic (£103m originations vs £147m in FY20), **the business has remained profitable with £3.0m adjusted PBT in FY21 (also £3.0m in FY20) and has a solid balance sheet. Net tangible assets stood at £28.3m on 31 May 21 (31 May 20: £26.5m) with cash and equivalents at £8.3m (£1.3m).** The loan repayment environment continued to improve with forbearance levels falling from £24.9m on 31 May 20 to £0.8m on 31 May 21 and deal arrears falling by 40% over FY21.

Market conditions are rapidly improving and we expect a return to growth. The Finance & Leasing association has reported a strong recovery in new lending business in March and April 21, and the May 21 HM Treasury *Forecasts for the UK economy* (a survey of 23 independent economic forecasts) showed upgraded average UK GDP growth forecasts of 6.4% for 2021 and 5.4% for 2022.

Based on Time delivering on its growth ambitions by FY25 and returning to pre-Covid adj. PBT margins of around 25% by then (translating to adj. PBT of around £10m), **we believe its fundamental value to be 50p per share**. **In addition, we highlight that compared to peers Time looks undervalued. Its price-to-book ratio of 0.5 is under half the 1.0 of a peer group median.**

Key Financials

Year-end 31 May	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E	FY 23E
Loan originations, £m	143	161	147	103	106	131
Net lending book*, £m	125	124	108	99	106	124
Revenue, £m	30.0	31.8	29.2	24.1	25.2	29.1
Admin exp, £m	12.0	13.3	12.8	11.8	13.2	13.9
Bad debt provisions,£m	2.2	2.4	5.1	5.1	5.2	5.0
adj PBT**, £m	7.8	8.1	3.0	3.0	3.3	5.5
EPS basic, p	7.6	7.3	1.8	1.4	2.7	4.7
Price Earnings Ratio	4.0	4.2	17.4	22.3	11.4	6.5
Price to Book Ratio	0.59	0.52	0.51	0.50	0.48	0.44
Net tangible assets***, £m	19.8	25.9	27.0	28.3	30.7	35.2
Net assets, £m	47.7	53.8	55.2	56.7	59.3	63.8

Source: Company Historic Data, ED estimates. PER & Price to Book based on share price of 30.5p
*excluding unearned interest, ** profit before tax, exceptional items & share-based payments ***excl. goodwill

Company Data

EPIC	TIME
Price (last close)	30.5p
52 weeks Hi / Lo	32p / 16p
Market cap	£28.2m
Net tangible assets	£29m
Avg. daily volume	131k
ED fair value / share	50p

Share Price, p

Source: ADVFN

Description

Time Finance, established in 1998, is a non-bank lender and broker. It has four operating divisions:

Asset finance: for SMEs to purchase hard and soft assets;

Invoice finance: for SMEs to borrow against debtors books;

Loans*:* commercial SME loans and consumer property loans;

Vehicle finance: for SMEs and consumers to purchase commercial or private vehicles.

Most asset, invoice, and SME loans are written to 'own-book'. Consumer and vehicle loans are 'broked-on'.

Paul Bryant (Analyst)
0207 065 2690
paul.bryant@equitydevelopment.co.uk
Andy Edmond
0207 065 2691
andy@equitydevelopment.co.uk

Strategy update

Time pursues a hybrid model of underwriting some loans on its own balance sheet ('own-book' lending) and acting as a broker for some loans underwritten by others ('broked-on' business).

Its core business is providing secured finance to smaller UK SMEs and its core products are the provision of asset, invoice and loan finance to these SMEs – written mostly as own-book business.

Asset finance made up 53% of group revenue in the 6m to 30 Nov 20, invoice finance 28%, and loan finance 8% (figures include some broked-on business in asset and loan finance, invoice finance is written entirely to own book).

Time sources lending capital for these loans primarily from institutions with a blended cost of funds of around 4% and lends-on to clients at an average rate of around 16% resulting in a net interest margin of around 12%. It is not subject to any regulatory minimum capital requirements as a bank would be, but it does use some equity capital to underwrite a share of 'own book' loans (typically 15-20%).

Adding an ability to broke-on business in some cases allows Time to present a wide multi-product offering to its core target market which allows it to deepen relationships with brokers (by placing the deal for them) and end clients by providing a one-stop-shop for their financing needs (the most common broked-on line of business for SME clients is car finance). At the same time, this strategy provides Time with the ability to maintain a clearly defined credit policy for its own-book business - sticking to core competencies and risk tolerance levels – while broking on business which falls outside of this scope.

While this logic remains valid, and the hybrid model is not disappearing, **the evolutionary change announced by Rimmer places a priority on building the higher-margin own-book business and hence focussing management resources and capital on this area of the business.**

Time is targeting growing its loan book from £99m as at 31 May 2021 to over £200m by 31 May 2025 (values exclude unearned interest; gross loan book target including unearned interest would be around £250m).

Management have also identified an opportunity that exists at the moment to recruit additional experienced and skilled sales staff (as a result of other lenders contracting) to help drive this growth. It is actively recruiting at the moment. This will depress margins slightly in FY22 and FY23 but the revenue and margin benefits of this move should come to the fore thereafter as sales from these new hires grows.

Time will continued to focus on diversification of its lending book, and has announced that the largest sector exposure now makes up 5% of the book, with the top ten sectors making up less than 25%. Diversification has in fact improved quite substantially over the last year. As at 31 May 20, the largest sector exposure was 6.5% (freight transport by road) and the top ten sector exposures totalled 35%.

In a further tweak to Time's SME stratgey, it has announced that it will be targeting a shift to ever more robust lending by looking to increase security requirements and increase average deal size. It will be raising minimum deal size levels from £1,000 to £5,000.

With a renewed focus on own-book lending comes additional capital requirements to underwrite these loans. While Time sources the bulk of its lending capital from institutions it does underwrite a proportion of its book using its own capital. **Time has therefore decided to stop paying dividends and use this capital to fuel growth by deploying the funds towards underwriting capital, technology and human resources.**

From a shareholders' perspective, Time is unequivocably pitching itself as a 'growth stock'.

Also noteworthy is that Time has played an active role over the last year in providing loans to SMEs under the government-backed Coronavirus Business Interruption Loan Scheme (CBILS) and is now also accredited by The British Business Bank to provide Recovery Loan Scheme (RLS) finance.

Outside of its SME business, Time also has a consumer vehicle finance business and a consumer property loans business, which combined make up around 10% of group revenue and comprise only broked-on loans. Under the new strategy, these businesses are likely to make up a smaller part of the group going forward and could probably be considered non-core. We wouldn't be surprised if at some point they considered divesting from these non-core areas if an attractive opportunity to do so arises.

Revenue down, profit stable, balance sheet strong

We knew the pandemic had severely depressed activity in Time's SME and consumer lending markets. Indeed, new business originations for FY21 were £103m, down from £147m in FY20, with revenue subsequently dropping from £29.2m to £24.1m, and the net lending book (net of unearned interest) ending the year at £99m, down from £106m.

The relative shift to own-book lending continued with around £47m of originations (46%; FY20: 37%) written to own book and £56m broked on (54%; FY20: 63%). Around 85% of revenue (FY20: 80%) was generated from own book lending and 15% from broking (FY20: 20%).

Time remained profitable for the year, reporting that profit before tax, exceptional items and share-based payments were expected to be approximately £3.0m (the same as FY20). We estimate net profit after tax to be around £1.2m (FY20: £1.6m).

Most encouraging was the strengthened balance sheet and cash position of the group, with net tangible assets rising from £26.5m on 31 May 20 to £28.3m on 31 May 21, and cash and equivalents rising from £1.3m to £8.3m – illustrative of prudent credit provisioning at the height of the pandemic and cash conservation measures undertaken by management through the year.

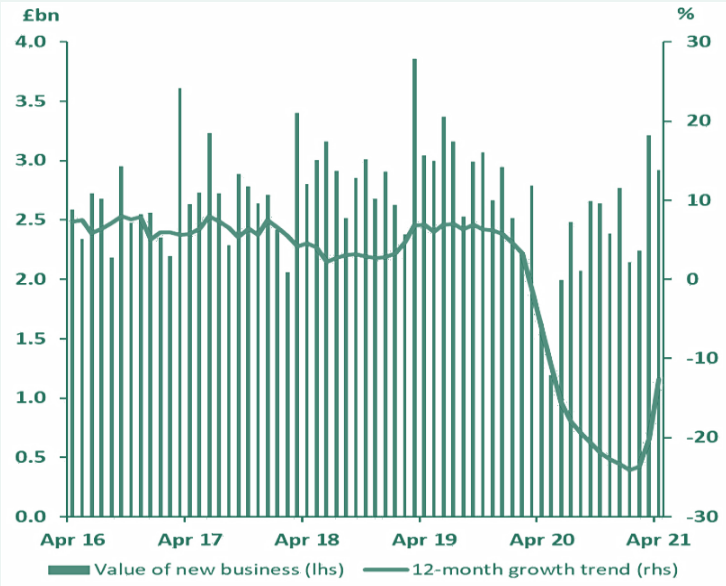
It is also worth highlighting that the balance sheet as at 31 May 21 includes around £15m of 'unearned income' which provides some good visibility towards future earnings.

Net portfolio write-offs (gross write-offs less recoveries) were around 1.5% of the gross lending portfolio compared to 1.0% for FY20, but credit risk provisions have only changed marginally and are still around 5.0% of the portfolio at £5.3m (31 May 20: 4.8% or £5.1m).

Outlook brightening

Overall market tailwinds appear to be building. The Finance & Leasing Association (FLA) has reported strong recoveries in asset finance (Time's largest division) in March and April 2021 and highlighted a positive outlook.

FLA asset finance new business trends



Source: Finance and Leasing Association (FLA)

Geraldine Kilkelly, Director of Research and Chief Economist at the FLA, added to the asset finance statistics: "*FLA's most recent research (March 21) suggests that asset finance providers are increasingly optimistic about the outlook for the rest of 2021. While mindful of the possibility of higher unemployment and a dip in confidence once the Government support schemes come to an end, 93% of respondents to our latest industry outlook survey expect new business growth over the next twelve months … If the industry maintains the performance we have seen in recent months, it would be on course to reach its pre-pandemic annual new business total by the end of 2021*."

The FLA numbers appear to be early indicators of a more bullish general economic growth outlook. The May 2021 HM Treasury *Forecasts for the UK economy* (a survey of 23 independent economic forecasts) showed that the average UK GDP growth forecast for 2021 was 6.4% (increased from 5.3% in April) and for 2022, 5.4%.

When it comes to credit losses, the outlook is also improving. Macro-economic indicators such as GDP and unemployment are key inputs into the statistical models which determine a large part of Time's credit loss provisions (unemployment forecasts also improved between April and May in the HM Treasury survey, from 6.3% to 5.9% for 2021 and from 5.5% to 5.2% for 2022). Furthermore, Time's forebearance levels have continued to drop (from £24.9m in May 20 to £0.8m in May 21), as have deal arrears (reduced by £9.3m between May 20 and May 21). We note that of the £5.3m credit loss provision (largely unchanged from 31 May 20), around £3m is driven by statistical modelling techniques (which assess the likelihood of deals falling into arrears) and £2m by a 'management overlay' where the Directors have taken the view that Covid-19 will, over time, likely have an adverse impact on the viability of some UK SME businesses and, in turn, the recovery of some receivables.

With the brightening outlook and increasingly robust economic recovery (albeit early days), we think that the balance of probability leans towards current credit provisioning being conservative.

Valuation: fundamental and peer comparison

Like a bank, Time's 'raw material' is cash which it borrows from institutional investors (mostly) and then lends on to borrowers, with the difference between these borrowing and lending costs (net interest margin) being its largest source of income. In addition, it earns income from fees and commissions where it acts as a broker. Because debt is its raw material, the notions of cost of capital and enterprise value are relatively meaningless. **Therefore, an equity valuation model, rather than an enterprise valuation model, is more appropriate to Time.**

Its business model - and particularly in light of the decision to focus more on own-book business - leads us to conclude that the free cash flows 'available' to equity holders (which could theoretically be paid out as potential dividends or reinvested in the business as Time has decided to do) is the 'surplus' capital on its balance sheet at the end of each year after maintaining sufficient equity levels to support growth (this is primarily driven by debt covenants – see below). It is these free cash flows we have estimated over an explicit 5-year period and discounted back to get a net present value of the business, our fundamental valuation.

Unlike a bank, Time has no minimum regulatory capital requirements, so it does not have the intensity of equity capital demands associated with growth that banks do. However, it does still need to meet explicit minimum equity requirements to stay within debt covenants, the most onerous of which is that it must not exceed a gearing ratio (debt to net tangible assets or NTA) of 6x. On 31 May 2020 its gearing ratio stood at 3.4x and on 31 May 2021 we estimated this to be approximately 2.5x, so Time is well capitalised in this regard.

But as it grows, minimum covenant requirements must be maintained (i.e. some profits need to be allocated to 'debt-covenant capital') and only after that, is any additional capital available to equity holders.

Our fundamental valuation is therefore based on the following methodology:

- forecasting the future minimum NTA requirements based on the loan book growth profile – growing the book to £200m by 31 May 2025 - assuming that Time maintains a gearing ratio of around 5x (a conservative assumption given that its actual gearing maximum is 6x);
- forecasting the actual NTA levels based on the current starting NTA level and adding forecast net income;
- calculating the difference between actual NTA and minimum NTA to give a 'free cash flow' available to equity holders (which could also be thought of as surplus capital);
- calculating a terminal value following year five, assuming 2.5% growth in perpetuity after year five;
- discounting the above free cash flows at the cost of equity which we have calculated to be 11.5%, based on a risk-free rate of 0.3%, an equity market risk premium of 5.5%, and a beta of 2.1.

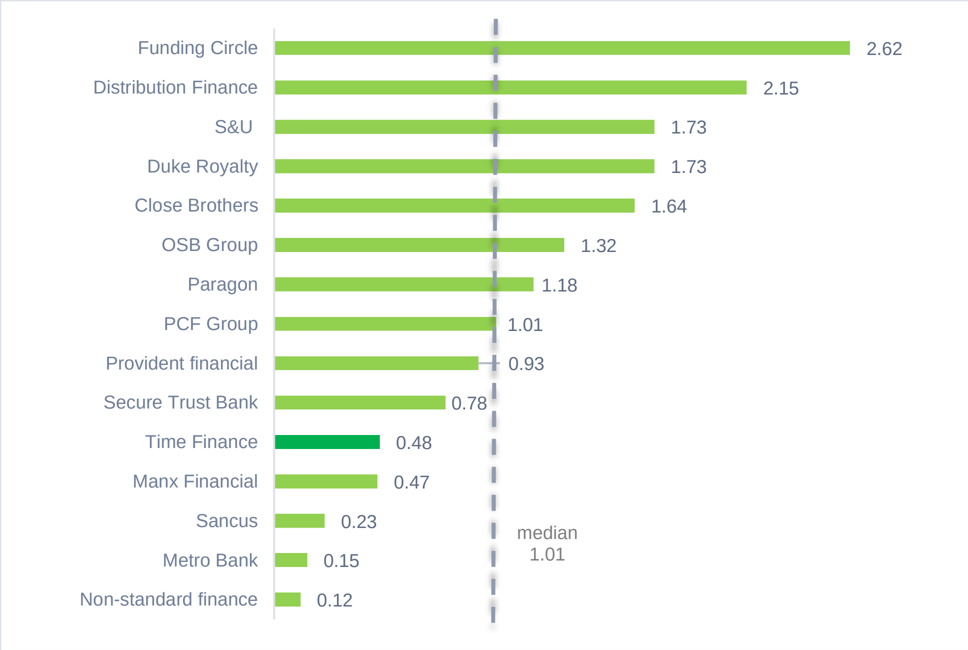
This methodology produces a per share fundamental value of 50p, roughly 65% above the current share price of 30.5p.

In addition, we have considered Time's market valuation on a relative basis to peers, and on this basis, it also appears to be undervalued.

Most notably, the median price-to-book ratio of the peer group of 1.01 is around double the 0.48 of Time, which backs up the conclusion from our fundamental analysis that Time appears undervalued.

The peer group selected for comparison all have significant parts of their businesses that overlap with Time's business activities. While it is a group that certainly has limitations in terms of direct comparisons (a mix of bank and non-bank lenders, a range of market capitalisations, and differing year-ends making Covid-impact comparisons difficult) the analysis does produce some telling insights:

Peer Comparison: price-to-book ratios



Source: ED, ADFVN as at 11 June 2021

It is worth pointing out that current PER comparisons are not parituculary meaningful, as many peers are making losses due to pandemic-related write-downs, and different reporting periods skew PE ratios because of the timing of these write-downs.

If the new strategy announced by Time produces the results targeted by management, we see scope for significant rerating of the company.

Operating Divisions

ASSET FINANCE

Time's asset finance division lends money to UK SMEs to purchase physical assets: 'hard' assets such as plant or machinery which typically have a relatively high and tangible value that makes the asset suitable for loan security; or 'soft' assets such as office furniture or shop fittings which have little residual value that makes these assets unsuitable for loan security (so alternative forms of security is required such as personal guarantees).

Most asset-backed loans are for 'business-critical' assets without which a small business would not be able to operate. Repayments are therefore usually prioritised by the borrower. Lending periods are typically around three years, average deal sizes are around £50k for hard assets (but up to £500k) and £10k for soft assets, with pricing varying between 8% and 18%. Business is mostly sourced through loan brokers, equipment suppliers and vendors.

INVOICE FINANCE

Time entered the invoice finance business in June 2017 with the acquisition of two entities specialising in invoice finance - Gener8 Finance Limited and Positive Cashflow Finance Limited. This division lends money to SMEs against their debtors' books under two different scenarios: 'disclosed' or 'confidential' financing. Disclosed invoice financing involves financing plus a credit control service managed by Time (usually more suitable for smaller businesses). Confidential invoice financing excludes the credit control service and is usually more suitable for larger businesses with a robust internal credit control function.

Average facility sizes are between £250k and £500k (but up to £2.5m). Interest rates are typically around 4% but this business does attract significant fee income (such as for managing credit control), so average revenue is actually around 13%. Business is mostly sourced through insolvency practitioners and professional firms.

LOANS

The loans division of Time provides: commercial loans to UK SMEs (mostly loans to fund working capital requirements backed by personal guarantees); CBILS loans to UK SMEs (which are 80% guaranteed by the UK government); and property loans to consumers (residential and commercial mortgages, bridging loans, buy-to-let loans).

Those commercial loans which meet Time's credit criteria are written to own-book with the balance broked-on; CBILS loans are written to own-book; and all property loans are broked-on.

VEHICLE FINANCE

Time's vehicle finance division offers loan finance to SMEs to purchase or lease commercial fleets and to consumers to purchase or lease new or second-hand cars.

It acts only as a broker for this business and writes no vehicle finance to its own book, which provides additional diversification to Time's income streams. Indeed, this was the original rationale for entering this market which was done via the acquisition of Academy in 2015. Business is sourced through vehicle dealerships and also via online direct channels.

Financials

Consolidated Income Statement					
12 months to end May, £'000s	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Revenue	**31,814**	**29,062**	**24,106**	**25,240**	**29,148**
Other income	-	182	-	-	-
Total Revenue	**31,814**	**29,244**	**24,106**	**25,240**	**29,148**
Cost of sales	(10,271)	(13,319)	(9,175)	(8,583)	(9,392)
Gross Profit	**21,543**	**15,925**	**14,932**	**16,658**	**19,756**
Administrative expenses	(13,292)	(12,793)	(11,783)	(13,168)	(13,871)
Exceptional items	(221)	(909)	(900)	(304)	(254)
Share-based payments	(3)	(31)	(575)	(49)	(57)
Operating profit	**8,027**	**2,192**	**1,673**	**3,136**	**5,573**
Finance costs	(218)	(181)	(149)	(156)	(350)
Finance income	67	9	7	8	9
Profit before tax	**7,876**	**2,020**	**1,532**	**2,988**	**5,232**
Income tax	(1,524)	(465)	(291)	(568)	(994)
Profit after tax	**6,352**	**1,555**	**1,241**	**2,420**	**4,238**
Adjusted earnings before interest, tax, exceptional items and share-based payments					
Statutory profit before tax	**7,876**	**2,020**	**1,532**	**2,988**	**5,232**
Add back:					
Exceptional items	(221)	(909)	(900)	(304)	(254)
Share-based payments	(3)	(31)	(575)	(49)	(57)
Adjusted profit before tax	**8,100**	**2,960**	**3,007**	**3,341**	**5,544**

Source: Company Historic Data, ED estimates

Consolidated Balance Sheet

As at 31 May, £'000s	2019A	2020A	2021E	2022E	2023E
Assets					
Non-current assets	**81,413**	**77,063**	**72,845**	**75,525**	**83,486**
Goodwill	27,847	28,241	28,241	28,241	28,241
Intangible assets	493	526	327	327	327
Property, plant and equipment	1,418	767	485	485	485
Right of use property, plant and equipment	-	428	226	24	822
Trade and other receivables	50,710	46,157	42,622	45,504	52,667
Deferred tax	945	944	944	944	944
Current assets	**76,283**	**61,527**	**63,062**	**68,172**	**79,316**
Inventories	-	-	-	-	-
Trade and other receivables	74,432	60,038	54,735	59,058	69,803
Tax receivable	-	185	-	-	-
Cash and cash equivalents	1,851	1,304	8,327	9,114	9,513
Total assets	**157,696**	**138,590**	**135,907**	**143,697**	**162,802**
Liabilities			-	-	-
non-current liabilities	**31,075**	**28,877**	**28,878**	**30,682**	**36,199**
Trade and other payables	29,805	28,639	26,519	28,682	34,058
Financial liabiities - borrowings	469	-	2,230	1,980	1,730
Provisions	801	-	-	-	-
Lease liability	-	238	129	20	411
current liabilities	**72,841**	**54,490**	**50,324**	**53,737**	**62,618**
Trade and other payables	67,563	51,052	47,872	51,117	59,181
Financial liabiities - borrowings	3,278	2,407	2,407	2,407	2,407
Tax payable	1,309	287	(72)	205	631
Provisions	691	546	28	28	28
Lease liability	-	198	89	(20)	371
Total liabilities	**103,916**	**83,367**	**79,202**	**84,419**	**98,818**
			-	-	-
Equity			-	-	-
Called up share capital	8,760	8,899	9,037	9,037	9,037
Share premium	25,134	25,360	25,543	25,543	25,543
Employee shares	298	-	-	-	-
Treasury shares	(300)	(310)	(390)	(390)	(390)
Retained earnings	19,888	21,274	22,515	25,088	29,625
Total equity	**53,780**	**55,223**	**56,705**	**59,278**	**63,815**
Total equity and liabilities	**157,696**	**138,590**	**135,907**	**143,697**	**162,633**

Source: Company Historic Data, ED estimates

Consolidated Statement of Cash Flows					
12 months to end May, £'000s	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Cash generated from operations					
Profit before tax	7,876	2,020	1,532	2,988	5,232
Depreciation & amortisation	778	883	883	883	883
Finance costs	218	181	149	156	350
Finance income	(67)	(9)	(7)	(8)	(9)
(Gain) on disposal of property plant & equipment	-	-	-	-	-
Decrease/(increase) in inventory	365	-	-	-	-
Decrease in trade and other receivables	531	18,947	8,839	(7,206)	(17,908)
(Decrease) in trade and other payables	(5,286)	(17,677)	(5,300)	5,408	13,441
Movement in other non-cash items	(1,131)	612	-	-	-
Cash flows from operating activities					
Interest paid	(218)	(181)	(149)	(156)	(180)
Tax paid	(1,510)	(1,488)	(465)	(291)	(568)
Tax received	-	-	-	-	-
Net cash flows from / (used in) operating activities	**1,556**	**3,288**	**5,481**	**1,775**	**1,241**
Investing activities					
Acquisition of subsidiaries	-	(500)	-	-	-
Purchase of software, property, plant and equipment	(778)	(375)	(200)	(681)	(681)
Proceeds from sale of fixed assets	-	-	-	-	-
Contingent consideration paid	(533)	(565)	(197)	-	-
Interest received	67	9	7	8	9
Net cash flows from / (used in) investing activities	**(1,244)**	**(1,431)**	**(390)**	**(673)**	**(672)**
Financing activities					
Payment of lease liabilities	-	(218)	(218)	(218)	(218)
Loan repayments in the year	(1,237)	(991)	(870)	(250)	(250)
Loans issued in the year	756	-	3,100	-	-
Purchase of own shares in EBT	-	-	(80)	-	-
Proceeds from issue of share capital	-	-	-	-	-
Transactions costs related to share issue	-	-	-	-	-
Change in overdrafts (Invoice Finance)	-	(349)	-	-	-
Dividends paid to equity holders	(806)	(498)	-	153	299
Net cash flows from / (used in) financing activities	**(1,287)**	**(2,056)**	**1,932**	**(315)**	**(169)**
			-	-	-
Net incr/(decr) in cash & equivalents	(975)	(199)	7,023	787	400
Cash & equivalents brought forward	1,306	331	132	7,155	7,942
Cash & equivalents carried forward	**331**	**132**	**7,155**	**7,942**	**8,341**

Source: Company Historic Data, ED estimates

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD

Contact: info@equitydevelopment.co.uk | 020 7065 2690