Provident Financial plc
Trading Statement
13 October 2017

Provident Financial plc, the leading UK non-standard lender, makes the following Trading Statement today covering the period from 1 July 2017 to 12 October 2017.

Summary

- A home credit business recovery plan has been developed under new leadership to re-establish relationships with customers, stabilise the operation of the business and improve collections performance. Progress to date is in line with the recovery plan and is consistent with the guidance provided on 22 August 2017 of a pre-exceptional loss for the Consumer Credit Division (CCD) in a range of between £80m and £120m for 2017 as a whole.

- Vanquis Bank has delivered further good growth through the third quarter of the year against credit standards that have recently been tightened, recognising the uncertainties faced by the UK economy.

- Satsuma has continued to make further good progress.

- Moneybarn has continued to enjoy a good flow of new business volumes with margins continuing to reflect the additional impairment on business written prior to the tightening of underwriting in the second quarter.

- Cash resources and funding capacity amounted to £236m following repayment of the 2012 retail bonds on the maturity date of 4 October 2017.

- Vanquis Bank continues to work with the Financial Conduct Authority (FCA) in relation to the investigation into the Repayment Option Plan (ROP).

- The Board confirms that a full-year dividend will not be paid.

- The search for a new Chief Executive is underway.

Commenting on the group's performance, Manjit Wolstenholme, Executive Chairman, said:

"Since the last update, we have moved quickly to appoint new leadership in home credit who have a deep understanding of the business and recognise the importance of the relationship between our front-line staff and our customers. A recovery plan has been developed and a number of actions have already been implemented to restructure the field organisation in order to provide the foundation for delivering the necessary improvement in customer service and financial performance.

Vanquis Bank continues to work with the FCA in relation to the investigation into ROP.

The board has appointed an independent agency to conduct a search for a new Chief Executive."

CCD

<u>Home credit</u>

The home credit business, which currently has approximately 500,000 active field customers, implemented a new operating model on 6 July 2017. The new model involved employing 2,500 full-time Customer Experience Managers (CEMs) in place of 4,500 self-employed agents, streamlining field management from 800 to 400 employees and introducing additional technology, including routing and scheduling software.

As reported on 22 August 2017, the implementation of the new operating model resulted in a significant amount of unforeseen disruption. The implementation of the new model proved too prescriptive in the way the workforce was managed, removing the ability of local management to prioritise and allocate resources. In addition, the re-design of territories and CEM rounds resulted in both discontinuity and disruption to customer relationships. There were also problems with the operation and flexibility of the routing and scheduling software due to data integrity issues which adversely impacted customer relationships. This combination of factors resulted in the significant deterioration in trading performance reported in our trading statement on 22 August.

The leadership team in CCD was changed in late August. Chris Gillespie returned to the group as Managing Director of the home credit business having previously held this role until 2013. He has a deep understanding of the home credit business and is familiar with many of the people that work for Provident. He is being supported by Luke Enock, who, as well as continuing to lead Satsuma, has been appointed Deputy Managing Director of the home credit business where his strong analytical and credit skills are highly relevant to the recovery of the business.

A recovery plan has now been developed which retains the employed operating model in the UK which in due course should allow the business to own and manage all aspects of the customer journey and exercise greater control over customer interactions. The primary focus of the recovery plan is to re-establish relationships with customers, stabilise the operation of the business and improve collections performance. A number of important actions have already been implemented to support these objectives. These involve moving away from the overly prescriptive routing and scheduling of customer interactions which were embedded in the new operating model and restoring the ability of local management to prioritise and allocate resources to meet customer needs. A key feature of this is increasing field management resource in order to restore appropriate spans of control which had been heavily diluted on implementation of the new operating model. The specific measures include:

- Moving from two UK divisions to four through the recruitment of two additional general managers and increasing the number of regional managers from 12 to 24;
- Appointing assistant area managers to support compliance, administration and arrears in order to free up the 160 area managers to focus on local resource allocation and management of individual CEM activity in the field;
- Recruiting at least 300 part-time employed CEMs, primarily from the previously self-employed agent workforce to accelerate the reconnection with customers;
- Providing additional training for new and underperforming CEMs, including extending the shadowing period and reintroducing a 'buddy' system;
- Increasing contact centre resource to handle significantly higher call volumes, undertake a customer contact programme and assist customers making their regular payments; and
- Management of the field organisation is being supported by the extensive use of analytics including tools that allow field management and CEMs to view and manage activity on a real-time basis via handheld technology.

The changes made by management over recent weeks have prevented any further deterioration in performance and should provide the foundation for delivering the necessary improvement in customer service. Collections performance in September was 65%, up from 57% in August, whilst sales were approximately £6m per week lower than the prior year compared with £9m during August. Home credit receivables ended September at £316.3m, down 33% from June 2017 (June 2017: £471.7m, September 2016: £489.2m).

Current performance is consistent with the recovery plan developed by management and the guidance provided on 22 August 2017 of a pre-exceptional loss for CCD in a range of between £80m and £120m for 2017 as a whole. This plan assumes a continuous improvement in customer service, collections and sales performance as the business trades through the seasonal peak in the weeks leading up to Christmas.

Satsuma

The development trajectory of Satsuma continues to be encouraging and customer numbers have increased from 66,000 at June 2017 to 71,000 at September 2017 (September 2016: 49,000) and receivables increased from £25m to £32m over the same period (September 2016: £14m). The business is expected to report a small loss for the year as a whole, modestly below previous guidance due to a lower inflow of potential customers from home credit following the recent disruption. However, the business is expected to generate a small profit during the second half of the year.

Vanquis Bank

Vanquis Bank has delivered further good growth. New account bookings through the third quarter were 5% higher than last year, and continued to benefit from the actions put in place in the second half of last year to develop the credit card proposition and enhance distribution, including the launch of the Chrome nearer prime credit card. Year-on-year customer growth of 13% and receivables growth of 14% have been delivered against credit standards that have recently been tightened, recognising the uncertainties faced by the UK economy. The recently introduced Vanquis Bank app has been well received and over 300,000 customers have now registered.

Delinquency levels have remained stable through the third quarter of the year reflecting the sound quality of the receivables book and the stable UK employment market. In line with previous guidance, the annualised risk-adjusted margin has moderated from 31.4% to June 2017 to 30.7% to September 2017 (September 2016: 32.2%), reflecting a reduction in the revenue yield due to a further decline in the penetration of ROP within the customer base and some moderation in the interest yield from the changing mix of business.

The Vanquis Bank loans pilot, currently focused on loans to existing credit card customers, continues to make steady progress. Following the deployment of a loan specific scorecard, the product range has been expanded and an online distribution channel has been launched.

Moneybarn

Moneybarn has continued to enjoy a good flow of new business volumes during the third quarter of the year, despite the tightening of underwriting on higher risk categories of business during the second quarter and some softness in customer demand. Continued development of its best in class customer platform together with extension of the product offering has enabled the business to generate new business volumes 10% higher than the third quarter of last year. Customer numbers and receivables ended September at 49,000 (June 2017: 46,000, September 2016: 39,000) and £362m (June 2017: £344m, September 2016: £286m) respectively, representing year-on-year growth of around 25%.

The annualised risk-adjusted margin has moderated from 23.4% to June 2017 to 22.7% to September 2017 (September 2016: 23.9%) largely reflecting additional impairment associated with the step-up in new business volumes over the last year and the flow through of impairment from higher risk categories of business prior to the tightening of underwriting in the second quarter.

Funding and capital

The group continues to actively monitor its capital and liquidity positions in the context of the uncertainties surrounding the home credit recovery plan and the ongoing FCA investigation into ROP. The group‘s common equity tier one ratio as at 30 September 2017 was 21.2% (June 2017: 21.5%) and gearing at the end of September was 3.0 times (June 2017: 2.7 times).

Vanquis Bank continues to build its retail deposits portfolio, with retail deposits increasing from £1,065m at June 2017 to £1,207m at September 2017.

At 30 September 2017, the group had cash resources of £194m, excluding the liquid asset buffer held by Vanquis Bank, and headroom on the group's committed debt facilities amounted to £70m. The additional capacity for Vanquis Bank to take retail deposits amounted to £92m, giving total funding capacity of £356m. Cash resources and funding capacity were reduced by £120m to £74m and £236m respectively following the repayment of the 2012 retail bonds on the maturity date of 4 October 2017. Maturities in 2018 comprise the third instalment of the M&G term loan of £15m due in January 2018 and £20m of private placement loan notes due in March 2018.

The group’s credit rating from Fitch Ratings was downgraded from BBB to BBB- and placed on negative watch following the group's announcement on 22 August 2017.

Regulation

Vanquis Bank continues to work with the FCA in relation to the investigation into ROP. As previously reported on 22 August 2017, the FCA has indicated that it has concerns about ROP and is investigating the period from 1 April 2014 to 19 April 2016. The voluntary requirement agreed with the FCA to suspend all new sales of ROP in April 2016 remains in place. In addition, the agreement with the PRA not to pay dividends to, or enter into certain transactions outside the normal course of business with, the Provident Financial Group without the PRA's consent remains in place pending the outcome of the FCA investigation.

CCD continues to operate under an interim permission whilst the home credit business implements its recovery plan.

In April 2017 the FCA published a consultation paper (CP17/10) as part of its ongoing Credit Card Market Study relating to persistent debt and earlier intervention remedies. The overall objective of the package of proposed remedies is to reduce the number of customers in problem credit card debt and put borrowers in greater control of their borrowing. The consultation closed on 3 July 2017 and the FCA expects to publish final rules in a policy statement later this year.

Dividends

The Board confirms that a full-year dividend will not be paid.

IFRS 9

IFRS 9 ‘Financial instruments’ is effective from 1 January 2018 and replaces IAS 39 ‘Financial instruments: Recognition and measurement’. IFRS 9 significantly changes the recognition of impairment on customer receivables by introducing an expected loss model. Under this approach, impairment provisions are recognised on inception of a loan based on the probability of default and the typical loss arising on default. This differs from the current incurred loss model under IAS 39 whereby impairment provisions are only reflected when there is objective evidence of impairment, typically a missed payment. The resulting effect is that impairment provisions under IFRS 9 are recognised earlier. This will result in a one-off adjustment to receivables and reserves on adoption and will result in delayed recognition of profits in growing businesses such as Vanquis Bank, Moneybarn and Satsuma.

The group has made good progress with its IFRS 9 implementation project and has now finalised the methodology and accounting policies to be used. Accordingly, to illustrate the impact of IFRS 9, the group estimates that reported receivables at the end of 2016 would have been approximately 6%-8% lower under IFRS 9 and the group’s reported net assets at the same date, after taking account of the deferred tax impact of the receivables adjustment, would be approximately 15%-17% lower.

Despite the adjustments required to receivables, net assets and earnings, it is important to note that IFRS 9 only changes the timing of profits made on a loan. The group’s underwriting and scorecards will be unaffected by the change in accounting, the ultimate profitability of loan is the same under both IAS 39 and IFRS 9 and more fundamentally the cash flows and capital generation over the life of a loan remain unchanged. The calculation of the group’s bank covenants are unaffected by IFRS 9, as they are based on accounting standards in place at the time they were set. Based on latest draft guidance, the regulatory capital impact of IFRS 9 is expected to be phased in on a transitional basis over five years.

This announcement contains inside information.

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