

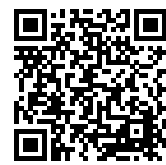


Together Q2 2019 Results - Still Concerned About Loan Book & Liquidity Risk

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Rupesh Tailor, Everest Research, 22 February 2019

- **Key observation #1 – Q2 2019 results, at face value, are consistent with bulls' thesis.** What's not to like about a business with: (1) high nominal rates (weighted average 9.2% at Q2 2019) on secured loans backed by property on low LTVs (weighted average 55.6%) with generally negligible cost of risk (0.1% of customer loans on an LTM basis at Q2 2019) and a low cost-income ratio of c. 37%; (2) strong through the cycle risk-adjusted margin of between 2% and 6% (pre-provision operating profits less impairment, divided by average customer loans); and (3) benefitting from structural growth in underserved segments of the UK specialist mortgage market – Together's loan book increased c. 8% qoq and c. 28% yoy at Q2 2019 and its CAGR over the past 5 years has been c. 23%
- **Key observation # 2 – Our concern with the bulls' thesis remains that: (1) Together's loan book composition today is significantly higher risk than that which it has carried through previous housing downturns; and (2) the loan putback feature in its revolving private securitisation facilities creates an automated liquidity run and liquidity shortfall in our stress scenario over 2019 – 2021 triggered by credit risk in Together's loan book if UK house prices fall 20%+, the likelihood of which we believe is increasing.**
See <https://www.everestresearch.co.uk/product/together-memo-070219/>
- Together's loan book is more exposed to commercial bridge loans (27% of loans) and buy-to-let (BTL) (21%) than 5 years ago (both 14%). Bridge loans are inherently risky in a property downturn as borrower ability to repay typically relies on refinancing into a term BTL mortgage or selling the property
- We also question how much retail bridge lending Together has over and above the 27% of the loan book in commercial bridge loans. Together's 1st lien retail bridge lending is not separately disclosed and is contained within the growing c. 14% of its loan book now in retail 1st lien loans



- Together is the market leader in a much larger, more speculative bridging market than existed pre-crisis and where the risk is arguably more akin to the fast track and self-certified mortgages of pre-crisis times. Tiuta Plc was the market leader in the bridging market of 2007 – 2010, experienced a peak year impairment charge of c. 23% of loans, used bridge to term/let as a way of hiding hung bridges and filed for administration in 2012. Bridge lending looks great when property markets are booming – it is easy for borrowers to sell or refinance – but impairment charges spike in a downturn
- As Together's Q2 2019 financial statements footnote 6 states, "The Group may modify the terms of customer loans either for commercial reasons or because of the financial distress of the customer. **It is not unusual for borrowers to transfer from a bridging loan to a term loan, which the Group treats as a derecognition of the original loan and the recognition of a new loan**". We believe such "bridge-to-term" (potentially hung bridges) has been a significant growth driver in Together's BTL loan book
- Whilst Together disclosed c. £820m of liquidity headroom at Q2 2019 (across its RCF, securitisation facilities and unrestricted cash), almost all of this comes from its securitisation facilities, availability of which depends on Together having sufficient unencumbered, facility-eligible collateral. The key risk we see is that, **in a scenario where UK house prices fall 20%+, Together's 3 month plus non-performing arrears would peak at c. 20% on our estimates, triggering c. £700m of loan putbacks to the Borrower Group over 2019 – 2020 and rendering Together's unencumbered loans ineligible for the securitisation facilities, creating a liquidity shortfall.**
See <https://www.everestresearch.co.uk/product/together-memo-070219/> for further details
- Liquidity risk could be further increased in a stress scenario by the Borrower Group losing access to the surplus income from the securitisation facilities (c. 21% of Borrower Group cash receipts), behavioural maturity extension of the securitised loans beyond the short maturities of Together's securitisation facilities (maturities between 2021 and 2023) and the contingent liability of Together's outstanding loan offer pipeline (size not disclosed).
See <https://www.everestresearch.co.uk/product/together-memo-070219/>
- **Key observation #3 – Whilst Together's loan book grew c. 28% yoy in Q2 2019, EBITDA was up only c. 12% on an LTM basis as net interest margin continues to compress to 7.4% on an LTM basis (-0.8pp yoy).** Together commented that recent competitor exits present it with increased lending opportunities. We note that failed bridge lenders in the last downturn, Tiuta and Cheval thought the same



- **Key observation #4 – UK house prices are starting to come under pressure as a potential hard (no deal) Brexit looms.** As measured by Halifax, UK house prices were -2.9% in January 2019 on the prior month (albeit still +0.8% yoy). Equivalent figures measured by Nationwide for January 2019 were +0.3% mom and +0.1% yoy, with a trend down over the course of 2018
- **Recommendation – We maintain our Short Sell recommendation on the Bracken Midco 1 £ BRACKN 8.875% 2023 Senior PIK-Toggle, initiated at 95.67 (10.1% cash-pay yield) on 7/2/19, where we see zero recovery value across our various stress scenarios. For investors who prefer to minimise negative carry, we recommend pairing this short with a long in the £ JERRGB 6.25% 2021 Senior Secured where we see recovery as at least 67% in most scenarios. See <https://www.everestresearch.co.uk/product/together-memo-070219/>**

Results Highlights

METRIC (GBP M)	Q2 2019	Q2 2018	% CHANGE	COMMENT
Net interest income	56	49	+13%	<ul style="list-style-type: none"> • LTM net interest income +15% yoy at Q2 2019, up to £213m
Net interest margin	7.4%	8.2%	-0.8pp	<ul style="list-style-type: none"> • Stated on LTM basis
EBITDA	61	54	+11%	<ul style="list-style-type: none"> • LTM EBITDA +12% yoy at Q2 2019, up to £232m
Net debt / EBITDA	10.7x	8.9x	+1.8x	<ul style="list-style-type: none"> • Stated on LTM basis, excluding Bracken Midco 1 PIK-Toggle
Loan book	3,248	2,546	+28%	<ul style="list-style-type: none"> • Loan book growth substantially outpacing growth in net interest income and EBITDA
Loan originations	1,810	1,410	+28%	<ul style="list-style-type: none"> • Stated on



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