Financial review

"Once again, we have delivered a strong set of results in 2023, through a disciplined approach to growth and tight cost control. We continue to make good progress towards our financial model targets."

Gary Thompson
Chief Financial Officer

I am pleased to report that the Group delivered a strong financial performance in 2023. We continued to make good progress on executing our strategy, improving cost efficiency, diversifying our funding position and we maintain a very conservatively capitalised balance sheet to mitigate any further potential deterioration in the challenging macroeconomic environment.

Financial model

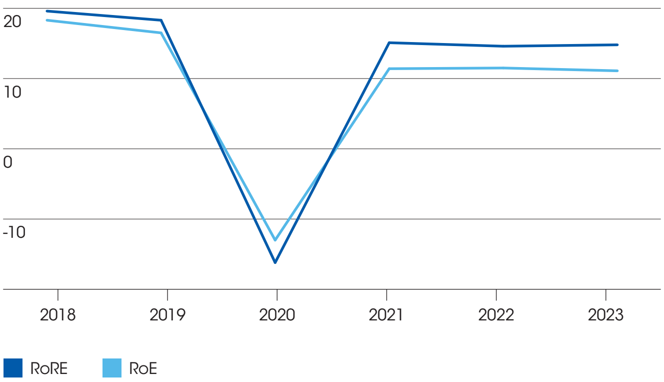
Our business is well managed and operates with strong ethical and financial disciplines. As we navigate our future growth opportunities and business choices, we have a formal financial model which underpins our Next Gen strategy and balances the needs of our various stakeholders including customers, colleagues, regulators, shareholders and debt providers. It sets out the target returns we need to deliver sustainable earnings, support our progressive dividend policy, invest in the future growth of the business and ensure we maintain a strong balance sheet.

Our financial model, details of which can also be found on page 6, focuses on the following:

1. Return on required equity (RoRE)

The first, most integral part of our model is to deliver a target RoRE of between 15% and 20%. We believe that returns materially above this range would not balance the needs of all of our stakeholders in delivering our purpose of building a better world through financial inclusion. We calculate RoRE as profit after tax over the average required equity of 40% of receivables. This allows us to ensure comparability between divisions and is more consistent with the financial model which assumes a 40% equity to receivables ratio. We will also continue to disclose our return on equity (RoE) on a Group basis. We target each of our divisions to deliver a return of at least 20% to ensure that we can deliver the Group RoRE, after taking account of central costs.

Group pre-exceptional returns %



Group pre-exceptional returns %

The pre-exceptional annualised RoRE for the year of 14.8% is broadly in line with 14.6% at the end of 2022. We continued to operate close to the lower end of our target range of 15% to 20% as we rebuild scale and transition the Polish business to the new regulatory landscape. The Group's pre-exceptional RoE, based on actual equity, reduced by 0.4 ppts to 11.1% at the end of 2023 as a result of favourable exchange rate movements which increased equity. We expect our Group returns to moderate in 2024 as we continue the transition of our Polish businesses in the evolving regulatory landscape, refinance the Group's fixed rate debt and accelerate receivables growth elsewhere in the Group. We would then expect returns to improve in 2025.

We firmly believe each of our businesses is capable of delivering a 20% RoRE and the RoRE by division is set out below:

	2023	2022
European home credit	**20.5%**	21.3%
Mexico home credit	**20.7%**	19.2%
IPF Digital	**7.6%**	6.9%

European and Mexico home credit are already delivering a RoRE slightly above the 20% threshold we set for each division. IPF Digital's RoRE improved by 0.7 ppts year on year to 7.7% (2022: 6.9%) reflecting good growth and strong operational discipline notwithstanding the adverse impact of the reduction in returns within Poland. Although IPF Digital has lower scale than we would wish following Covid-19 and the closure of Finland and Spain, there are strong organic growth opportunities in our existing markets as we rebuild the business, particularly in Mexico, Australia and Poland. We will also continue to consider inorganic opportunities to deliver scale and increase returns to our target levels at the lower end of the Group's target range in 2025.

2. Distribution of earnings

The delivery of a RoRE of 15% supports the distribution of a minimum of 40% of our post-tax earnings. A RoRE of nearer 20% would allow us to either distribute more than 40% of our earnings to shareholders and/or deliver additional receivables growth (see 3. Receivables growth below).

Our total dividend of 10.3 pence per share in 2023 represents a pre-exceptional payout ratio of 44%. We anticipate our payout ratio to be in excess of 40% of earning in 2024 as we continue to transition our Polish businesses in the evolving regulatory landscape.

3. Receivables growth

Returning capital of 40% of post-tax earnings allows us to fund receivables growth in the following year by up to 10%. If we grow in excess of 10% we will utilise any additional capital resources over our target capital base. If we expect to grow at less than 10% we will either retain capital or increase the capital return to shareholders above our 40% minimum threshold.

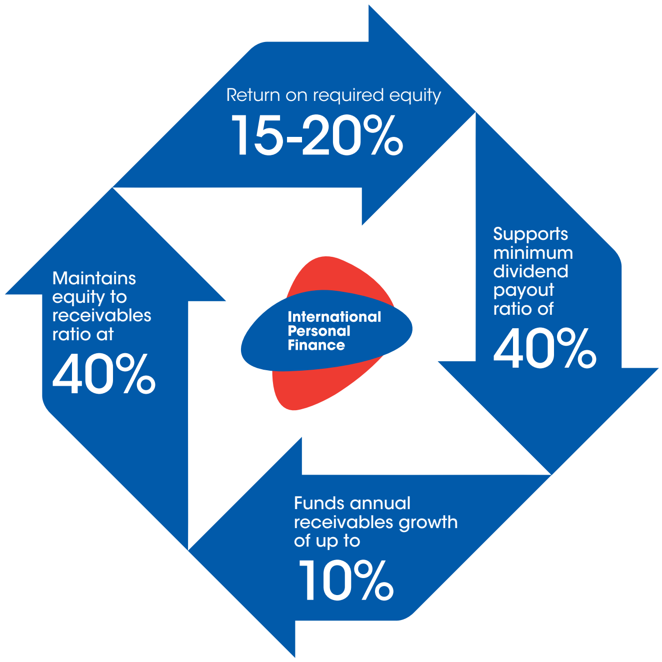
In 2023, receivables remained broadly in line with 2022, as the expected reduction in Poland was offset by receivables growth in all other markets. This growth is less than 10% and, as a result, we generated additional capital over and above our financial model during 2023 (see 4. Equity to receivables ratio below).

4. Equity to receivables ratio

A target equity to receivables ratio of 40% is our current view of an appropriate balance sheet, offering plenty of security in both good and more difficult times. At the end of 2023, the Group's equity to receivables ratio was 56% (2022: 51%), higher than our target of 40%.

We anticipate a reduction in the equity to receivables ratio in 2024 (subject to foreign exchange movements) as we invest in growth, continue to deliver our progressive dividend policy and deliver returns below our target threshold as we continue to transition our businesses in Poland.

Our financial model



Changes to financial model KPIs

Our financial model is underpinned by a stringent focus on revenue yield, impairment rate and cost-income ratio. It is also dictated by the cost of funding and the tax rate. We set targets for each of these metrics at the half year in 2022 and, in light of strong operational performance since then together with the global rise in interest rates due to cost-of-living pressures, we have re-evaluated and subsequently reset the targets for each of these metrics in 2023 as follows:

Group KPI	Previous target range	New, medium-term target range
Annualised revenue yield	53% – 56%	56% – 58%
Annualised impairment rate	14% – 16%	14% – 16%
Annualised cost-income ratio	52% – 54%	49% – 51%

The revised targets are supported by our financial forecasts and ongoing initiatives that are well progressed. They support the delivery of our target returns of between 15% and 20% after taking account of increasing funding costs and an ongoing tax rate of approximately 40%.

Revenue yield – Our target range for revenue yield is 56% to 58% which is based on our current product structure and today's regulatory landscape.

The Group revenue yield continued to strengthen, increasing by 3.4 ppts to 55.3% year on year, reflecting the positive impacts of lower levels of promotional activity introduced during the second half of 2022 and price increases in some of our markets. It is now just below our target range of 56% to 58%, and we expect it to increase further in the medium term as: (i) Mexico home credit, which carries a higher yield, grows and represents a larger proportion of the Group's receivables portfolio; and (ii) continued lower promotional activity in the receivables portfolio take greater effect.

Impairment rate – We have a target range of between 14% and 16% for our impairment rate.

The rate of inflation in our markets has remained elevated, and, whilst it is now reducing, there continues to be pressure on our customers' disposable incomes. Our disciplined approach to granting credit to our customers in a responsible, affordable way continues to be reflected in our good portfolio quality and robust customer repayments. I am very pleased to report that to date we have not seen any discernible impact from the cost-of-living crisis on customer repayment performance. The Group delivered an impairment rate of 12.2% in 2023 (2022: 8.6%), in line with our expectations as impairment rates continue to normalise towards our target levels. We expect the Group impairment rate to rise closer to our target range of 14% to 16% in 2024 as we continue to grow the business and Mexico home credit, which carries a higher impairment rate, represents a larger proportion of receivables.

Cost-income ratio – A key focus of our strategy is to become a smarter and more efficient organisation through process improvement and the deployment of technology. Our very strong cost control, combined with the excellent growth in revenue, delivered a significant 3.9 ppt improvement in the Group's cost-income ratio from 60.9% to 57.0% year on year. Our actions, together with ongoing growth, will continue to drive down this ratio to our target of 49% to 51% over the next two years.

Funding rate – After taking account of the cost of hedging, our funding rate was around 10% prior to the very volatile market conditions we have seen since 2022. The funding rate of 14% in 2023 is significantly higher than this rate, due to increased interest rates in our markets as a result of the cost-of-living crisis and higher hedging costs. We expect this elevated cost of funding to persist in the short to medium term as we refinance fixed-rate, fixed term debt and, as a result, we have been focused heavily on bolstering the revenue yield and maintaining tight control of costs to mitigate the impact of higher funding costs. As noted earlier, we have revised our targets for revenue yield and cost-income ratio to accommodate the increased funding costs we are incurring.

Tax rate – We consider a tax rate of around 40% to be reflective of the Group's structure and we consider this to be our normalised rate, albeit we continue to ensure that we are as tax efficient as possible. Our tax rate in 2023 was 38%, modestly lower than our target but we expect it to return to around 40% in 2024.

The target KPIs, taken together, will deliver our target RoRE of 15% to 20%. Each of our countries has a different income statement composition reflecting their credit risk and their respective regulatory, funding and tax environments. As mentioned earlier, we believe that each of our businesses is capable of delivering a target RoRE of 20%, and we have established similar KPI targets for each territory. We will manage each business to deliver these targets in order to deliver the target Group financial model.

"Maintaining tight control of costs and delivering process efficiency improvements through the deployment of technology are key to mitigating the inflationary environment and driving up our returns."

Taxation

The pre-exceptional taxation charge on the profit for 2023 is £31.9m, which represents an effective rate for the year of approximately 38% (2022: 40%). The lower tax rate in 2023 reflects a number of disparate elements, including a positive tax ruling in Poland which secured an element of bad debt tax relief arising on loans issued since our Polish business changed its regulatory status at the start of 2022. We expect the effective tax rate to return to around 40% in 2024.

Consistent with 2022, the 2023 results reflect an exceptional tax charge of £4m (2022: exceptional tax credit of £10.5m, which was stated net of a £5.1m tax charge in respect of Hungary) relating to the "extra profit special tax" implemented by the Hungarian government in 2022 and chargeable on the financial sector including non-bank financial institutions. The tax has been extended by one further year, and a further tax charge of £2m is expected to arise in 2024.

Earnings per share (EPS)

Statutory EPS was 21.5 pence in 2023, compared with 25.6 pence per share in 2022. The 16% reduction wholly reflects the benefit of an exceptional tax credit of £10.5m in 2022 compared with an exceptional tax charge of £4.0m in 2023 (see note 10 to the financial statements).

Excluding the impact of the exceptional items, pre-exceptional EPS was 23.2p per share (2022: 20.8p), up 2.4p (11.5%) year on year, at a higher rate than profit growth due to a lower effective tax rate of 38% compared with 40% last year.

Dividend

Reflecting our confidence in executing the Group's strategy and realising the long-term growth potential of the business, the Board is pleased to declare a 10.8% increase in the final dividend to 7.2p per share (2022: 6.5 pence). This is in line with our progressive dividend policy and brings the full-year dividend to 10.3p per share (2022: 9.2p), an increase of 12.0% on 2022 and representing a pre-exceptional payout rate of 44% (2022: 44%). As we previously communicated, the payout rate is modestly above our target of 40% as we utilise our strong capital base whilst rebuilding our RoRE to our target level of 15% as the transition of our Polish business is completed. Subject to shareholder approval, the final dividend will be paid on 10 May 2024 to shareholders on the register at the close of business on 12 April 2024. The shares will be marked ex-dividend on 11 April 2024.

23.2p
Pre-exceptional earnings per share

10.3p
Dividend per share

Balance sheet, treasury risk management and funding

Balance sheet

We continue to maintain a very conservatively capitalised balance sheet, a strong funding position and robust financial risk management.

At the end of 2023, the Group's equity to receivables ratio was 56% (2022: 51%) and this compares with our target of 40%. Notwithstanding the Group's returns being below the lower target threshold of 15% and the dividend pay-out ratio in excess of 40%, the ratio has increased during the year due to: (i) foreign exchange gains of £23m (2022: £42m) being credited to reserves in the year; and (ii) minimal receivables growth of 2.8% compared with up to 10% in the financial model. Excluding the benefit from exchange gains of £65m over the last two years, the equity to receivables ratio would have been around 49% at the end of 2023. We anticipate a reduction in the equity to receivables ratio in 2024 (subject to foreign exchange movements) as we invest in growth, continue to deliver our progressive dividend policy and deliver returns below our target threshold as we continue the two-year transition of our Polish businesses.

The gearing ratio was 1.0 times (2022: 1.2 times), comfortably within our covenant limit of 3.75 times.

Closing receivables in 2023 were £893m, which is a contraction of 0.2% (at CER) compared with 2022. Excluding Poland which saw an expected year-on-year reduction of 25%, closing receivables showed good year-on-year growth of 12%. The average period of receivables outstanding at the end of 2023 was 13.2 months (2022: 13.0 months) with 77% of year-end receivables due within one year (2022: 76%). Reflecting the continued caution in respect of the inflationary environment, our balance sheet remains very robust with an impairment coverage ratio of 36.3% at the end of the year, which is in line with 2022 and compares with a pre-Covid-19 ratio of 33.5% at the end of 2019. The Group's impairment provision includes £23.2m of post-model adjustments in respect of the cost-of-living crisis and the moratorium in Hungary compared with £24.9m held at the end of 2022 in respect of Covid-19 and the cost-of-living crisis. The gross contractual cashflows supporting the receivables valuation amounts to £1.7bn at the end of 2023 (2022: £1.7bn).

"We continue to maintain a very well capitalised balance sheet and robust funding position to support our ambitious future growth plans."

The business has a strong track record of cash generation, even during adverse market and regulatory conditions. During the outbreak of Covid-19 in 2020, the business restricted lending to customers and had a strong focus on customer repayments. Due to the short-term nature of the receivables book, this action generated cash from operating activities of £330m, which enabled the Group to reduce borrowings by £184m and increase cash by £80m. In addition, when a decision has been taken to withdraw from a territory due to inadequate returns being available (e.g. Slovakia in European home credit in 2015 and more recently Finland in IPF Digital in 2020), we have demonstrated that the collect-out takes around 2 to 3 years and the cash recoveries (net of any costs) have typically been close to the value of the net receivables from the time of the decision to cease the operations. This represents 1.7 times to 2.0 times the value of the debt funding supporting those receivables.

The strong cash generation of the Group has again been highlighted in 2023. With receivables growth at a relatively low level in 2023 due to the expected reduction in Polish receivables, the Group generated cash of £193m compared with £59m in 2022.

Treasury risk management

The Group has Board-approved policies to address the key treasury risks that the business faces – funding and liquidity risk, financial market risk (currency and interest rate risk), and counterparty risk. The policies are designed to provide robust risk management, even in more volatile financial markets and economic conditions within our planning horizon.

Compliance with these policies is monitored monthly by the Treasury Committee chaired by the Chief Financial Officer and the Board receives a comprehensive funding and liquidity overview through monthly reporting. Funding and liquidity of the Group are managed centrally by the Group Treasurer and qualified treasury personnel. The Group sets cash management controls for operating markets that are subject to independent annual testing.

Our funding policy requires us to maintain a resilient funding position for our existing business and for future growth. We aim to maintain a prudent level of headroom on undrawn bank facilities. Our currency policy addresses economic currency exposures and requires us to fund our receivables portfolios with local currency borrowings (directly or indirectly) to achieve a high level of balance sheet hedging. We do not hedge the translational risk of foreign currency movements on accounting profits and losses. Our interest rate policy requires us to hedge interest rate risk in each currency to a relatively high level. Our counterparty policy requires exposures to financial counterparties to be limited to BBB-rated entities as a minimum except as approved, or delegated for approval, by the Board. In addition to these policies, our operational procedures and controls ensure that funds are available in the right currency at the right time to serve our customers throughout the Group.

"Despite the difficult macroeconomic backdrop, we successfully extended around £146m in 2023 and have a very solid financial foundation to support our growth plans."

The currency structure of our debt facilities broadly matches the asset and cash flow profile of our business. We have multiple local currency bank facilities, and our main €341m Eurobond provides direct funding to our markets using the euro currency and to markets using other currencies via foreign exchange transactions. For this reason, we do not expect fluctuations in the value of sterling to have a major impact on our funding position.

Debt funding is provided through a diversified debt portfolio with acceptable terms and conditions. We have wholesale and retail bonds denominated in euro, sterling, Swedish krona and Polish zloty, with varying maturities, together with facilities from a group of 18 banks that have a good strategic and geographic fit with our business. The Group's debt is senior unsecured debt, with all lenders substantially in the same structural position. We maintain our Euro Medium Term Note programme as the platform for bond issuance across a range of currencies.

Funding

At the end of December, the Group had total debt facilities of £629m, comprising £433m of bonds and £196m of bank facilities. Our borrowings stood at £516m and, together with undrawn facilities and non-operational cash balances, the Group's headroom on debt facilities amounted to £126m at the end of 2023. The Group's current funding capacity, together with strong business cash generation, is expected to meet our funding requirements into the first half of 2025. We note the improvement in market conditions as we actively explore options to refinance the Eurobond due in November 2025 together with our advisors. A range of debt refinancing options are available to the Group and we expect to continue to engage with fixed income investors in 2024.

Despite the difficult macroeconomic backdrop, we successfully extended around £146m of debt facilities in 2023, including £84m of bank facilities and the issue of £62m of bonds, including:

- a PLN 72m (£14.4m) 3-year floating rate Polish bond issued in October;
- an €11.6m (£10.1m) 3-year Hungarian bond at a fixed coupon of 11.5%;
- a £25.5m 4-year UK retail bond at a coupon of 12% issued in December; and
- the issue of £11.8of retail bonds held in treasury. The debt maturity profile of the Group stands at 2.0 years.

A full analysis of the maturity profile of the debt facilities is set out in note 21 to the Financial Statements and is summarised below:

Maturity profile of debt facilities

Group KPI	Previous target range	New, medium-term target range
Eurobond	November 2025	295.9
Swedish krona bond	October 2024	35.1
Sterling bond	December 2027	77.4
Polish bond	November 2026	14.4
Hungarian bond	December 2026	10.1
Total bonds		**432.9**
Bank facilities	2024 to 2026	195.8
Total debt facilities		**628.7**
Total borrowings		516.5
Headroom against debt facilities		112.2
Non-operational cash balances		13.8
Headroom and non-operational cash balances		126.0

Our blended cost of funding in 2023 was 14.0%, up from 13.3% in 2022. This increase was due to a significant step-up in interest rates across our markets which resulted in higher costs of bank funding and the cost of hedging. Our hedging policy is to match our local currency receivables with borrowings in the same denomination to provide certainty of cashflows and avoid significant volatility in the income statement from movements in exchange rates. Accordingly, our borrowings denominated in sterling and euro are swapped through forward contracts into local currency when we onward lend to our markets. As a result, the margin on the sterling/euro bond is effectively added to the local base rate for determining the cost of funding for that market. We anticipate an increase in the overall Group cost of funding in 2024 as we refinance maturing fixed interest rate funding. An analysis of our interest cost and funding rate is set out below:

	2023 £m	2022 £m
Bond costs	**44.4**	40.7
Bank funding cost	**12.7**	8.2
Hedging costs	**16.8**	16.7
Other	**3.0**	2.5
Total interest	**76.9**	68.1
Average gross borrowings	**548.9**	509.3
Cost of funding %	**14.0%**	13.3%

Our credit ratings remained unchanged in 2023. We have a long-term credit rating of BB- (Outlook Stable) from Fitch Ratings and Ba3 (Outlook Stable) from Moody's Investors Services.

As a result of maintaining a strong financial profile, we operate with adequate headroom on the key financial covenants in our debt facilities, as set out in the table below:

	Covenant	2023	2022
Gearing[1]	Max 3.75x	1.1x	1.3x
Interest cover	Min 2x times	2.5x	2.3x

1. Borrowings adjusted for lease liabilities, unamortised arrangement fees and issue discount. Net assets adjusted for pension assets and derivative financial instruments, in accordance with the debt funding covenant definitions.

Foreign exchange on reserves

The majority of the Group's net assets are denominated in our operating currencies and, therefore, the sterling value fluctuates with changes in currency exchange rates. In accordance with accounting standards, we have restated the opening foreign currency net assets at the year-end exchange rate and this resulted in a £23m (2022: £42m) foreign exchange movement, which has been credited to the foreign exchange reserve.

Contingent liabilities – Poland regulatory communication

In February 2024, we received a letter from the KNF issued to all regulated lenders operating in the Polish credit card market setting out the KNF's views on how existing laws and regulations relating to lending activities should be interpreted by credit card issuers. The letter sets out the KNF's current expectations on how charging practices for credit cards should be subject to limits on non-interest costs, the need to differentiate between different costs charged by credit card issuers which are subject to caps and those fees which are not subject to a cap and lastly how issuers should approach more broadly the question of calculating and assessing fees which are not subject to specific legal limits.

The Group, following legal advice, had previously determined that non-interest cost caps did not apply to credit cards and is therefore reviewing, with the assistance of external counsel, what the impact of this communication might be and whether it constitutes a significant change to the existing approach taken by the Polish regulatory authorities.

It is currently not possible to predict the ultimate impacts of the letter, including the scope or nature of remediation requirements, if any, or any related challenges to the interpretation or validity of the Polish business's application of non-interest costs applied to its credit card portfolio since its launch in the third quarter of 2022.

The KNF's letter was not specific on when any changes would need to be implemented and did not indicate whether any retrospective application would be required. Considering this, alongside the legal advice obtained to date, the Group has not recognised a provision for this matter as at 31 December 2023.

The Group's Polish business has been issuing credit cards since late 2022. Polish credit cards receivables of £49m at 31 December 2023 represent just over 5% of the Group's receivables and approximately 25% of overall receivables in Poland.

Going concern

In considering whether the Group is a going concern, the Board has taken into account the Group's 2024 business plan and its principal risks (with particular reference to macroeconomic and regulatory risks). The forecasts have been prepared for the three years to 31 December 2026 and include projected profit and loss, balance sheet, cashflows, borrowings, headroom against debt facilities and funding requirements. These forecasts represent the best estimate of the Group's expected performance, and in particular the evolution of customer lending and repayments cashflows.

The financial forecasts have been stress tested in a range of downside scenarios to assess the impact on future profitability, funding requirements and covenant compliance. The scenarios reflect the crystallisation of the Group's principal risks, with particular reference to macroeconomic and regulatory risks, including crystallisation of the contingent liabilities disclosed in note 32. Consideration has also been given to multiple risks crystallising concurrently and the availability of mitigating actions that could be taken to reduce the impact of the identified risks. In addition, we examined a reverse stress test on the financial forecasts to assess the extent to which a macroeconomic scenario would need to impact our operational performance in order to breach a covenant. This showed that net revenue would need to deteriorate significantly from the financial forecast and the Directors have a reasonable expectation that it is unlikely to deteriorate to this extent.

At 31 December 2023, the Group had £126m of non-operational cash and headroom against its debt facilities (comprising a range of bonds and bank facilities), which have a weighted average maturity of 2.0 years. The total debt facilities as at 31 December 2023 amounted to £629m of which £98m (including £33m which is uncommitted) is due for renewal over the following 12 months. A combination of these debt facilities, the embedded business flexibility in respect of cash generation and a successful track record of accessing funding from debt capital markets over a long period (including periods with challenging macroeconomic conditions and a changing regulatory environment, tested in both 2020 and 2022), are expected to meet the Group's funding requirements for the foreseeable future (12 months from the date of approval of this report). Taking these factors into account, together with regulatory risks set out on page 80 of the Annual Report, the Board has a reasonable expectation that the Group has adequate resources to continue in operation for the foreseeable future. For this reason, the Board has adopted the going concern basis in preparing the Annual Report and Financial Statements.

Gary Thompson
Chief Financial Officer

14 March 2024