ShawandPartners
Financial Services

Pioneer Credit Limited (PNC)

Rating: Buy | Risk: High | Price Target: $0.80

8 June 2024

Poised for Profit: Market Turns Favourable

Key Information

Current Price ($ps)	0.46
12m Target Price ($ps)	0.80
52 Week Range ($ps)	0.30 - 0.48
Target Price Upside (%)	73.9%
TSR (%)	73.9%
Reporting Currency	AUD
Market Cap ($m)	61.9
Sector	Information Technology
Avg Daily Volume (m)	0.0
ASX 200 Weight (%)	0%

Fundamentals

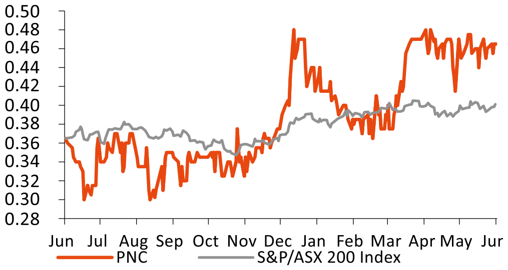
YE 30 Jun (AUD)	FY23A	FY24E	FY25E	FY26E
Sales ($m)	77.5	80.0	100.6	115.5
NPAT ($m)	0.3	(2.7)	11.1	18.1
EPS (cps)	0.1	(2.1)	7.3	11.9
EPS Growth (%)	100.3%	nm	441.9%	61.8%
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

Ratios

YE 30 Jun	FY23A	FY24E	FY25E	FY26E
P/E (x)	nm	(21.5)	6.3	3.9
EV/EBITDA (x)	3.4	3.5	3.2	2.9
Div Yield (%)	0.0%	0.0%	0.0%	0.0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	0.7%	(1.7%)	15.6%	17.5%
Absolute (%)	1.1%	(1.1%)	16.3%	27.4%
Benchmark (%)	0.4%	0.6%	0.7%	9.9%



Price performance indexed to 100 *Source: FactSet*

Major Shareholders

Samuel Terry Asset Management	15.5%
Keith Johns	12.9%
James Simpson	8.3%
Nomura Special Investments Singapore	6.6%

Event

We initiate research coverage on Pioneer Credit (PNC) with an A$0.80/shr Target Price and a BUY recommendation. PNC is the #2 participant in the Australian debt purchasing and collection industry.

We believe that the Australian debt purchasing industry is about to return to growth after about five years of contraction caused by increased regulation, more prudential lending standards, higher interest rates, and COVID raising the sensitivity to financial hardship among vendors of aged deb (banks, financial institutions). Stable and relatively high Australian employment makes the time right for lenders to sell significant inventory of aged debt to collectors. However, the debt collection industry has now consolidated leaving Pioneer Credit standing as one of two *major* participants.

Highlights

- **PNC has set an ambitious LTIP target of FY26 NPAT A$18mn (FY23A A$0.2mn.)** Implied in this target is the expectation for strong growth in purchased debt portfolios (PDP's) and a solid expected IRR (from cash collections.)
- **We believe PNC can grow its debt purchases to A$120mn over the next few years** from A$95mn (FY24 guidance.) This should drive an increase in cash collections to over A$200mn by FY26 (FY23A A$128mn.)
- **PNC is replacing its senior financing facility saving A$8mn-A$11mn per annum in interest expense**. It has appointed Nomura as exclusive arranger of the facility likely to open at start of FY25.
- **PNC is a high-risk investment.** 1) Pioneer is highly leveraged carrying about A$290mn of net debt. Leverage magnifies earnings and valuation volatility. 2) Pioneer needs to acquire PDP's to grow profitability. The availability of portfolios at appropriate prices are affected by factors outside PNC's control. 3) PNC's debt obligations are currently being refinanced and likely to impose financial covenants. If PNC's fails to roll its debt funding or if at some time breaches covenants, alternative sources of financing may be sought. 4) PNC operates in an industry with a strict legal and regulatory framework. Any failure to comply could result in reputational loss and substantial losses.

Recommendation

Our A$0.80 valuation suggests a TSR of 74% and warrants a BUY recommendation considering risk/return.

We believe DCF is the best approach to valuing PNC. The present value of PNC's estimated remaining collections (ERC) from existing ledgers is worth A$3.90/shr, in our view, and covers PNC's current net debt, lease liabilities and Opex to collect those ledgers.

On-top of that is the value we ascribe to PNC's *future business* underpinned by its people, contracts, systems and brand or reputation in a growing industry. We believe that is worth A$0.80/shr. It is derived from the present value of our *projected* debt purchases and collections.

NAV or NTA is an inferior valuation approach, in our view, because accounting standard AASB 9 –Financial Instruments dictates that PNC's debt ledgers be carried at amortized cost. This means that book values (NAV or NTA) reflect an arcane accounting rather than the present value of prospective cash flows. AASB 9 also impedes valuation comparisons across companies.

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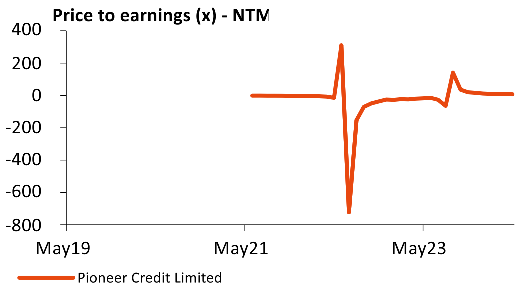
Pioneer Credit Limited
Information Technology

FactSet: PNC-AU / Bloomberg: PNC AU

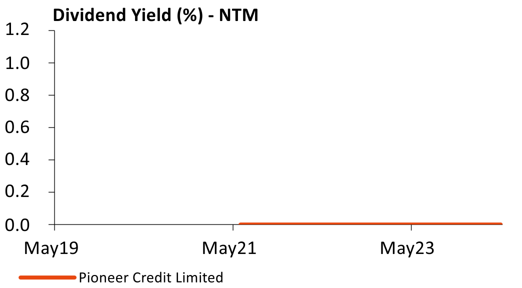
Key Items	Data
Recommendation	BUY
Risk	HIGH
Price ($ps)	0.46
Target Price ($ps)	0.80
52 Week Range ($ps)	0.30 - 0.48
Shares on Issue (m)	134.7
Market Cap ($m)	61.9
Enterprise Value ($m)	320.0
TSR (%)	73.9%

Valuation NPV	Data
Beta	1.40
Cost of Equity (%)	12.7%
Risk Free Rate (%)	4.3%
Terminal Growth (%)	3.0%
WACC (%)	8.2%

Pioneer Credit Ltd. engages in the provision of financial services specializing in acquiring and servicing unsecured retail debt portfolios. It also engages in the acquisition and servicing of unsecured retail debt portfolios comprised of personal loans and credit cards. The company was founded by Keith R. John in 1998 and is headquartered in Perth, Australia.



Source: FactSet



Source: FactSet

Financial Year End: 30 June

Investment Summary (AUD)	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (Reported) (cps)	**(40.3)**	**0.2**	**(7.5)**	**8.0**	**13.0**
EPS (Underlying) (cps)	**(40.3)**	**0.1**	**(2.1)**	**7.3**	**11.9**
EPS (Underlying) Growth (%)	n/a	100.3%	nm	441.9%	61.8%
PE (Underlying) (x)	**(1.0)**	**nm**	**(21.5)**	**6.3**	**3.9**
EV / EBIT (x)	**10.2**	**8.7**	**8.6**	**8.8**	**7.9**
EV / EBITDA (x)	**1.0**	**3.4**	**3.5**	**3.2**	**2.9**
DPS (cps) (AUD)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Free Cash Flow Yield (%)	(124.2%)	(42.3%)	(91.1%)	(30.7%)	2.3%

Profit and Loss (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
Sales	53.7	77.5	80.0	100.6	115.5
Sales Growth (%)	*n/a*	*44.3%*	*3.2%*	*25.8%*	*14.8%*
Other Operating Income	0.7	5.3	8.0	1.0	1.1
EBITDA	**60.6**	**86.1**	**92.6**	**111.0**	**129.1**
EBITDA Margin (%)	*nm*	*nm*	*nm*	*nm*	*nm*
Depreciation & Amortisation	(54.5)	(52.1)	(55.5)	(70.4)	(81.1)
EBIT	**6.1**	**34.0**	**37.1**	**40.5**	**47.9**
EBIT Margin (%)	*11.4%*	*43.9%*	*46.4%*	*40.3%*	*41.5%*
Net Interest	(39.1)	(33.7)	(39.8)	(29.4)	(29.8)
Pretax Profit	(33.0)	0.3	(2.7)	11.1	18.1
Tax	(0.1)	0.0	0.0	0.0	0.0
Tax Rate (%)	*0.2%*	*(1.2%)*	*0.0%*	*0.0%*	*0.0%*
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	**(33.1)**	**0.3**	**(2.7)**	**11.1**	**18.1**
Significant Items	0.0	(0.2)	(6.0)	0.0	0.0
NPAT Reported	**(33.1)**	**0.2**	**(8.7)**	**11.1**	**18.1**

Cashflow (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
EBIT	6.1	34.0	37.1	40.5	47.9
Tax Paid	0.0	0.0	0.0	0.0	2.0
Net Interest	(25.7)	(29.9)	(39.8)	(29.4)	(29.8)
Change in Working Capital	(0.1)	6.2	(3.0)	0.2	0.1
Depreciation & Amortisation	55.3	58.5	55.5	70.4	81.1
Other	(75.8)	(81.5)	(95.0)	(100.0)	(100.0)
Operating Cashflow	**(46.8)**	**(20.0)**	**(46.9)**	**(17.8)**	**3.3**
Capex	(0.7)	(0.3)	0.0	0.0	0.0
Acquisitions and Investments	0.0	0.0	0.0	0.0	0.0
Disposal of Fixed Assets/Investments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	**(0.7)**	**(0.3)**	**0.0**	**0.0**	**0.0**
Free Cashflow	**(42.4)**	**(14.2)**	**(48.5)**	**(19.5)**	**1.5**
Equity Raised / Bought Back	12.5	0.0	10.1	2.7	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Change in Debt	52.3	7.4	44.0	15.0	(2.0)
Other	(4.6)	(1.6)	(1.7)	(4.4)	(1.8)
Financing Cashflow	**60.3**	**5.8**	**52.4**	**13.3**	**(3.8)**
Exchange Rate Effect	0.0	0.0	0.0	0.0	0.0
Net Change in Cash	**12.8**	**(14.4)**	**5.6**	**(4.5)**	**(0.5)**

Balance Sheet (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash	23.1	8.4	13.6	9.0	8.5
Accounts Receivable	6.2	1.5	1.5	1.6	1.7
Inventory	96.3	106.1	106.1	116.0	122.6
Other Current Assets	1.0	0.7	1.0	1.0	1.0
PPE	0.8	0.7	(0.3)	(1.3)	(2.3)
Other Non Current Assets	211.2	208.9	277.8	300.2	313.7
Total Assets	**339.5**	**326.8**	**400.1**	**427.0**	**445.7**
Accounts Payable	28.7	6.1	1.1	1.4	1.6
Short Term Debt	20.4	11.3	15.0	0.0	0.0
Long Term Debt	236.3	255.1	295.0	325.0	323.0
Income Taxes Payable	0.0	0.0	0.0	0.0	0.0
Other	13.0	12.2	14.7	15.3	17.7
Total Liabilities	**298.4**	**284.8**	**325.8**	**341.6**	**342.2**
Total Shareholder Equity	**41.1**	**41.9**	**74.3**	**85.4**	**103.5**

Ratios	FY22A	FY23A	FY24E	FY25E	FY26E
ROE (%)	n/a	0.4%	(4.7%)	13.9%	19.2%
Gearing (%)	85.0%	86.0%	80.0%	78.7%	75.2%
Net Debt / EBITDA (x)	3.9	3.0	3.2	2.8	2.4

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About Pioneer and Valuation Summary

We initiate research coverage of Pioneer Credit with a BUY recommendation and an A$0.80 Target Price.

Pioneer Buys Aged Debt

Pioneer Credit buys aged debt – primarily personal loans and credit card balances -- from the major Australian banks and other large financial institutions. PNC has 12 vendor/suppliers currently, including a 5-year supply (flow) agreement with CBA to 2027. PNC does not purchase pay day loans. PNC does not purchase utility or telecommunications debt. PNC does not offer further credit to its debtor customers, unlike its major competitor, Credit Corp. PNC has opted not to extend credit to avoid being in competition with its vendors.

PNC tends to purchase aged debt at under 20c on the dollar and recovers about 1.8x to 2.5x the purchased value over 10 years with 100% payback usually within the first 2.5 years. Pioneer's operating cost – locating and managing debtors -- mainly consists of staff.

PNC has an active customer/debtor base of about 246,000 people with A$2.2bn in receivables due to PNC of which A$459mn are on committed paying arrangements.

Pioneer Has Solid Compliance Record

PNC also has a solid compliance record as measured by reported complaints to the Australian Financial Complaints Authority (AFCA) (See **Error! Reference source not found.**). Complaints recorded have remained broadly stable over the last 3 years. PNC's customers, meaning debtors or payers, regard the company favourably with a net promoter score (NPS) of 19. The rating of the company's approach to financial hardship is about industry average and stable since 2017, according to the Association of Financial Counsellors.

We Think PNC is Undervalued

We think PNC's share price is undervalued. The present value of collections from PNC's existing inventory of debt ledgers, net of collection costs -- covers the company's liabilities. (See Figure 1, items 1 to 4.)

What is not reflected in the share price is the value of PNC's future/potential business. (See Figure 1, item 5.) PNC's well-established systems and relationships should generate future positive free cash flow and therefore, have value.

Figure 1: Pioneer Credit – Shaw and Partners Valuation Components

Valuation Component	FY 25 Value A$mn	Per Share
1) PV of Estimated Remaining Collections(ERC) of current ledgers	470.1	$3.36
2) Net Debt	(308.7)	-$2.21
3) Lease Liabilities	(9.3)	-$0.07
Cash NTA	152.2	$1.09
4) PV of Opex to Run Down Current Book	(155.0)	-$1.11
5) PV of Future Business	114.3	$ 0.82
PNC Valuation	111.4	$0.80
Current M'cap	62.9	$ 0.45
Potential Upside	51.3	$0.37
Total Shareholder Return	82%	82%

Source: Shaw and Partners

Investing in the Debt Collection Industry: Why Now?

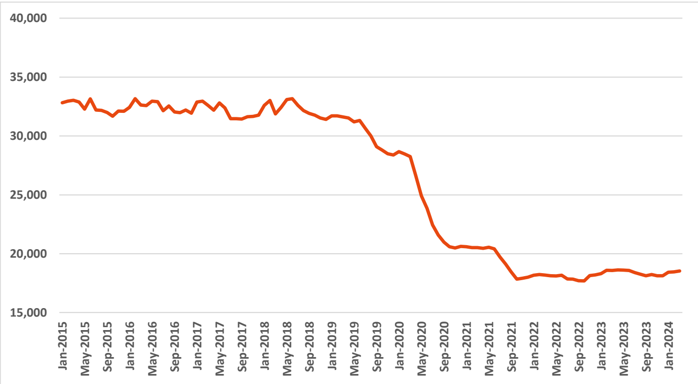
The debt collection industry is emerging from a five-year period of contraction caused by increased regulation, more prudent bank lending, and COVID.

Increased regulatory oversight and negative publicity scurried capital from the industry. That, in turn, induced consolidation. Government oversight, improved bank lending standards reduced the supply of aged debt. COVID sensitized banks to financial hardship which inhibited them from selling aged debt to collectors.

Now, there is less competition for purchased debt and more automation. Credit card balances are extending and personal loans in arrears are ticking up. New technology is reducing cost of debt collection. Banks are prepared to sell aged debt again but are selective in choosing their debt management service providers, emphasizing compliance and automation.

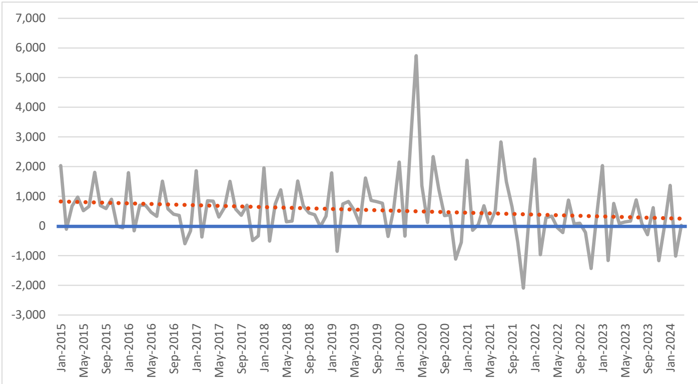
Figure 2 below, shows credit card balances accruing interest have slightly ticked up since 2021. Figure 3 below, shows that Australia monthly credit card repayments are dipping below purchases more frequently. In other words, people are becoming more likely to not pay their full credit card balance.

Figure 2: Australia Credit Card Balances Accruing Interest A$mn



Source: RBA

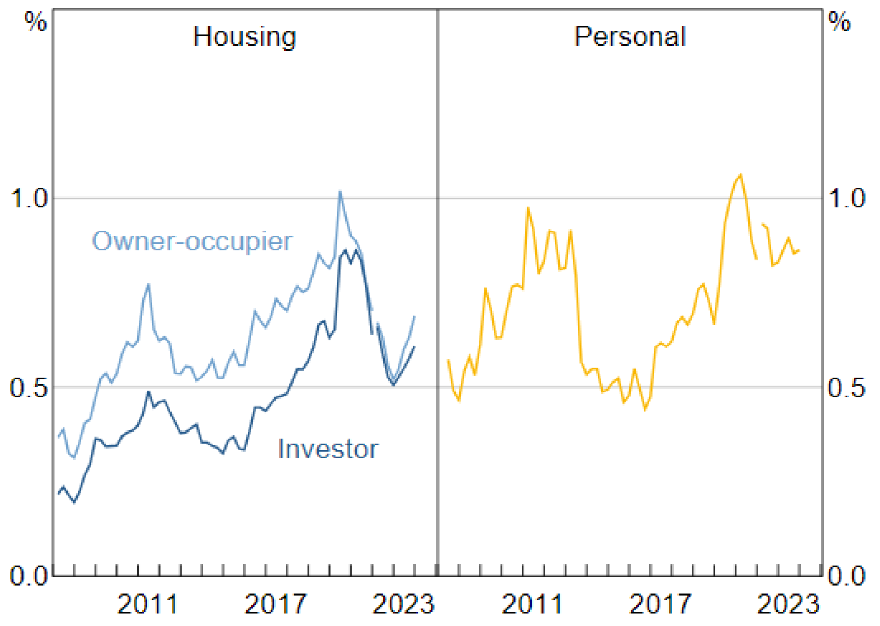
Figure 3: Australia Credit Repayments Minus Purchases A$mn



Source: RBA

Figure 4 reflects the RBA's view that a small but growing proportion of borrowers are experiencing stress. According to the RBA, banks expect loans in arrears to increase a bit further but remain relatively low historically.

Figure 4: Bank Loans 90+ Days Past Due



Source: RBA Financial Stability Report Mar Qtr 2024

Employment is key to enabling debtors to meet their commitments and employment in Australia has remained stable. Although Australia's *unemployment rate* ticked up 0.2pts in April relative to March, this was due to more people registered as looking for work rather than more people put out of work.

Against this backdrop PNC has emerged having long established relationships with the major banks in the business of debt purchasing and collection. With fewer competitors, PNC is in a better market position to procure aged debt. Although, PNC experienced its own form turbulence – accounting issues causing volatility in its stock price -- its operations remained sound.

The recovery has already started with PNC guiding investors to expect growth in debt purchases in FY24 to A$95mn, an increase of over 50% vs FY23. With improving industry conditions, we envision PNC reaching its FY26 LTIP hurdle of A$18mn NPAT putting the stock on a deep-value PE of 5.2x FY26 EPS.

PNC Likely to Gain Market Share

PNC's FY24 debt purchase guidance calls for 50% growth vs FY23 to A$95mn. Credit Corp has issued FY24 debt purchase guidance of A$100mn-A$110mn – about flat with the pcp.

The Debt Recovery Industry

There is scant hard market data on the debt recovery industry, but indications are that the industry had diminished in size, until now.

Figure 5: Australia Debt Collection Industry Measures

2014	Current	
8,550	6,178	Employees
A$1.4bn	A$1.2bn	Revenue
A$2.2bn	A$1.4bn	Collections

Source: IBISWorld, ACCC, Australia Debt Buyers and Collectors Association

We think the industry manages debt under collection A$35bn excluding, perhaps the aged receivables owed to the Australian Taxation Office (ATO.) The Australia Debt Buyers and Collectors Association (ADBCA) reports that in 2022 its members managed A$20.8bn under collection. However, not all debt collectors are members of ADBCA and that sum excludes New Zealand.

Of that A$35bn, we estimated Credit Corp has an Ausralia/New Zealand receivables of A$8bn and PNC has about A$2bn.

In terms of collections shown in Figure 5 above (A$1.4bn FY22,) PNC collected about A$100mn in FY22 and Credit Corp about A$340mn. Over half of all collections are made by contingent debt collectors – see below.

The debt recovery industry is segmented into two main business models:

1) Debt Purchasing – whereby the debt collector acquires the debt outright from a 'vendor' or 'client'. The debt purchaser carries inventory risk but retains the cash it collects.
2) Contingent Collection – whereby the debt collector is assigned aged debt and earns a fee for successful collection.

Some debt recovery organizations in the industry offer mercantile or outsourced services whereby they manage the receivables and debt collection functions of businesses. This business model is *generally* confined to smaller institutions although there are instances of larger companies using outsourced accounts receivable managers.

As discussed above, we believe that the value of aged debt to be sold by major financial institutions is now primed for growth.

Decade of Regulation 2010-2020 Raising Barriers to Entry

The debt collection industry, indeed, banking in general, encountered increased regulation to protect consumers and debtors during 2010-2020. Capping off the decade was the influential Australian Royal Commission Report into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Commission.) Since then, Australian banks have become more prudent in their lending enabling riskier credits to be serviced by the shadow banking industry, such as private credit and buy-now-pay-later lenders. These phenomena raised costs and barriers to the debt collection industry as well as reduced supply of available debt sold/outsourced for collection.

Figure 6: Key Debt Collection Industry Regulation

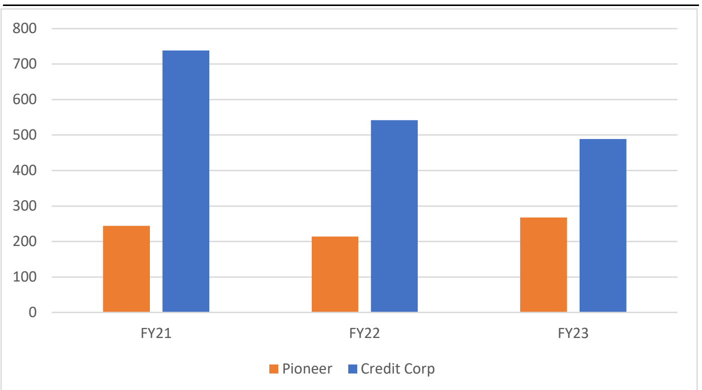
Australian Consumer Law, Competition and Consumer Act 2010	Harassment and coercion provisions, false and misleading conduct enforced by ACCC. Generally, requires an Australian Credit Licence for engaging in credit activity
National Consumer Credit Protection Act 2009 (Updated July 2021)	Updated to require debt management service providers, i.e. contingent debt collectors, hold an Australian Credit Licence.
Australian Consumer Law and Fair-Trading Act 2012 (VIC)	Permits debtors to seek compensation for humiliation and distress caused by non-compliant debt collectors.
Privacy Credit Reporting Code 2014	Enforced under the Privacy Act 1988. A breach of the Code is a breach of the Privacy Act.
ACCC/ASIC Debt Collection Guideline (2014)	Practical guidance on what creditors and collectors should and should not do to minimise their risk of breaching the Commonwealth consumer protection laws. The guideline points out, a creditor may be responsible for their agent's collection activities.

Source: ACCC May 2015 Research Into the Australian Debt Collection Industry

Debt management service providers are required to hold an Australian Credit Licence when managing 'credit regulated' debt. The Australian Credit Licence places additional obligations on debt purchasers including enhanced standards of conduct, internal and external dispute resolution schemes e.g. the Australia Financial Complaints Authority (AFCA), publication of a guide how to register complaints and details of external dispute resolutions.

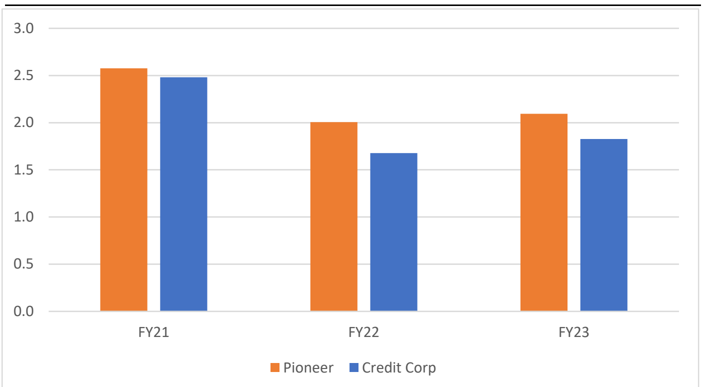
Error! Reference source not found. shows the number of complaints made to AFCA. PNC receives about 200-250 complaints per annum has remained broadly constant and is comparable to comlaints about Credit Corp's collection entities on a per A$mn of cash collected (Figure 9.)

Figure 7: Complaints to AFCA PNC and Credit Corp by Fiscal Year



Source: AFCA – For FY23 Shaw and Partners includes complaints about the following Credit Corp entities: Baycorp, Collection House, Lion, Credit Corp Recoveries, Credit Corp Collections, Credit Corp Services, and BC

Figure 8: Complaints to AFCA per A$mn Australia Collections



Source: AFCA, Shaw and Partners Estimates

Financial Hardship

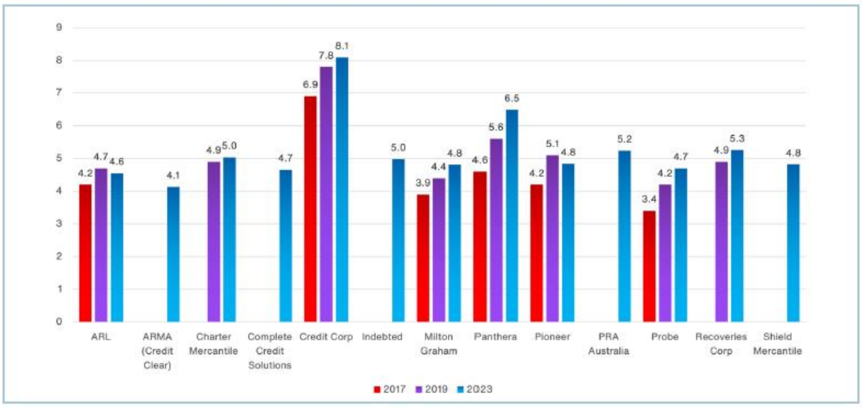
Under section 72 of the National Credit Code, if a consumer notifies their lender that they are or will be unable to meet their credit obligations, lenders must consider varying the customer's credit contract and advise them of the decision within specified timeframes. Variations to the credit contract can include payment deferrals, reduced payment arrangements, interest-only periods, term extensions, capitalisation of arrears or interest-rate reductions.

A lender may disagree with a hardship notice. In that case, the lender must notify the debtor of disagreement, provide the reasons, and inform of the right to complain along with the contact details for AFCA.

PNC generally attempts to avoid purchasing debt from banks or other lenders that are classified as hardship cases. Such balances, if discovered, are returned to the vendor.

Should a debtor notify PNC of financial hardship, PNC has a dedicated hardship program. Figure 9 shows how financial counsellors rated various debt collectors in their approach to hardship cases.

Figure 9: Ratings of Debt Collectors in Approach to Financial Hardship



Source: Association of Financial Counsellors -- Dec 2023 Survey

Consolidation – Another Australian Duopoly Emerges

PNC's area of concentration is acquiring large tranches of personal debt from vendors, i.e. financial institutions. This market is now being served primarily by: Credit Corp and PNC. There are two smaller participants in this segment of the debt purchasing market. PRA Australia – an Australian subsidiary of the global PRA Group operating in USA, Europe and Australia (Nasdaq: PRAA.) PRA began purchasing debt in Australia in 2021. Complete Credit Solutions is another market participant.

A shrinking market, intense competition and increased regulatory oversight has resulted in numerous departures from the industry:

- Baycorp Holdings Pty Ltd acquired by Credit Corp A$65mn August 2019.
- Collection House Limited acquired out of administration for A$11mn August 2022.
- Recoveries Corp, acquired by Transaction Capital in 2016, has vacated debt purchases and now focusses upon contingent debt collection.
- The AFR reports that Panthera has mandated Grant Samuel to launch a sale of debt ledgers. [1] The Federal Court ordered that Panthera Finance Pty Ltd pay $500,000 in penalties for unduly harassing three consumers in 17 March 2020[2] That court finding may have damaged Panthera's reputation and its ability to win tenders for debt ledgers.

[1] https://www.afr.com/street-talk/panthera-mandates-grant-samuel-to-test-buyer-appetite-20240208-p5f3jh

[2] https://www.accc.gov.au/media-release/debt-collector-panthera-to-pay-500000-in-penalties-for-undue-harassment

Note: There are numerous smaller companies that purchase aged receivables from SME's and other smaller financial institutions. PNC does not compete in that area of the market.

Shaw and Partners Financial Modelling of Pioneer Credit

Cash Collection Curve Modelling

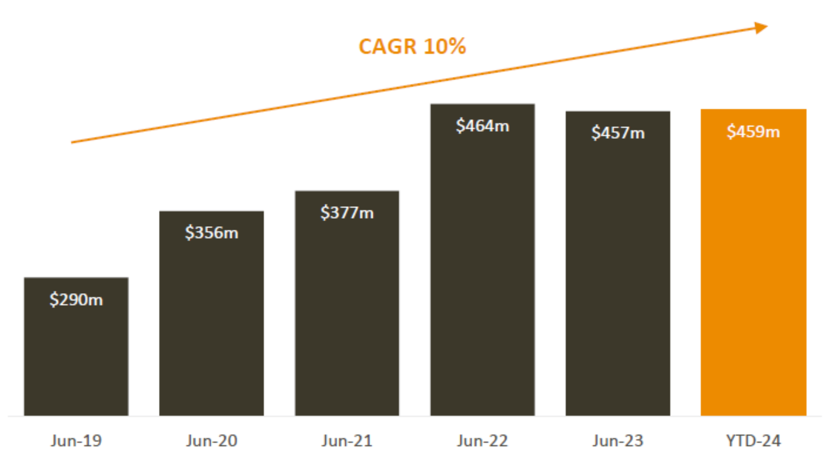
Looking backward, we have incorporated the last ten years of PNC's financial accounts and investor presentations into financial modelling to map annual collections against prior period ledger purchases. We believe we can reasonably estimate the rate of debt recovery and quantify remaining collections. By our estimates, PNC's historic collection curve has yielded an ROI of 2.0x and an effective interest rate of return (EIR) of about 30%.

Looking forward, PNC will continue to implement an improved approach to managing debt ledgers that it adopted a couple of years ago. PNC has undertaken to engage debtors/customers under longer-term, steady "arrangements" rather than encouraging upfront payment. This should have the effects of 1) extending the duration of the collection period and 2) increasing overall collections over time 3) stabilizing income and cash flow over time. Arrangements tend to run for 3-4 years.

We have incorporated the new debt collection curve into our financial modelling. The prospective debt collection curve used in our model manifests in an ROI of 2.35x and EIR of 33.5%.

Figure 10, below, shows PNC customers under arrangement stepped up in FY22. These customers make regular payments to retire their debts. The increase was a manifestation of PNC's changed approach and also debt ledgers purchased by PNC included payers that were already under arrangement.

Figure 10: PNC Payers Under Arrangements (aka Performing Portfolio)



Source: PNC 1H 24 Investor Presentation

Figure 11, below, shows Shaw and Partners modelling of PNC key operating metrics. The collection curve described above is reflected in the Cash Collections line shown in Figure 11 and is projected to grow 81% above FY23 to A$227.7 by 2030. In the near term, although the cash collections are likely to exceed debt purchases, net operating cash flow remains negative until FY26 because interest expense and opex would not yet be fully covered.

Also, we can estimate PNC's remaining collections if we can reasonably profile the collection curve. Figure 11 shows two lines for estimated remaining collections (ERC) – the first is a Shaw and Partners calculation (FY24E A$464.3mn) and the second is PNC's disclosure for the respective year. Shaw and Partners estimate is lower than PNC's as our model has the capability to look back only 10 years, but PNC's calculation may anticipate collections from debt ledgers purchased more than 10 years ago. This is important because Shaw and Partners' approach results in a more conservative company valuation. Our valuation, incorporates the present value of Shaw and Partners ERC (See Figure 1.)

Figure 11: Shaw and Partners Model of PNC Key Operating Metrics

Key Operating Metrics	FY22A	FY23A	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Cash Collections A$mn	106.7	128.0	132.8	168.3	193.9	208.6	223.6	234.0	234.2
Amoritized Interest Income A$mn	62.6	73.7	80.0	100.6	115.5	120.9	127.7	132.0	135.3
Cash Debt Purchases A$mn	(99.5)	(59.2)	(95.0)	(100.0)	(100.0)	(105.0)	(105.0)	(105.0)	(102.5)
Estimated/Projected ROI	214%	258%	215%	259%	228%	243%	238%	238%	238%
Estimated Remaining Collectons Shaw Calc (1) A$mn	452.2	489.5	566.3	662.6	692.0	739.3	770.2	795.8	814.6
Estimated Remaining Collections Company Calc A$mn	572.2	567.0	661.0						
Employee Costs A$mn	(33.2)	(34.4)	(36.1)	(44.1)	(50.3)	(54.2)	(57.9)	(59.8)	(61.0)
Other Opex A$mn	(13.0)	(12.1)	(6.1)	(14.3)	(15.7)	(16.6)	(17.4)	(18.0)	(18.2)
Total Opex A$mn	(46.2)	(46.5)	(42.2)	(58.4)	(66.0)	(70.8)	(75.3)	(77.8)	(79.2)
Cost to Serve Ratio (Opex/Cash Collections)	42.9%	36.6%	38.0%	34.7%	34.0%	34.0%	33.7%	33.2%	33.8%
EBITDA A$mn (Cash Collects + Other Inc - Opex)	60.6	86.1	92.6	111.0	129.1	139.0	149.5	157.5	156.4
D&A A$mn	(2.8)	(2.2)	(2.7)	(2.7)	(2.8)	(2.8)	(2.9)	(3.0)	(3.0)
PDP Amortization A$mn	(51.7)	(49.9)	(52.8)	(67.7)	(78.4)	(87.6)	(95.9)	(102.0)	(99.0)
% of Collections	-48.4%	-39.0%	-39.8%	-40.2%	-40.4%	-42.0%	-42.9%	-43.6%	-42.3%
EBIT A$mn	6.1	34.0	37.1	40.5	47.9	48.5	50.7	52.5	54.4
Net Finance Costs A$mn	(39.1)	(33.7)	(39.8)	(29.4)	(29.8)	(28.3)	(26.8)	(25.9)	(22.3)
NPAT A$mn	(33.1)	0.2	(8.7)	11.1	18.1	18.2	20.3	21.3	24.1
EPS fully diluted (AUD c/shr)	(40.29c)	0.13c	(2.14c)	7.33c	11.86c	11.90c	13.30c	13.95c	15.75c
Operating Cash Flow After Debt Purchases A$mn	(46.8)	(20.0)	(46.9)	(17.8)	3.3	4.0	14.5	21.5	23.7
Net Debt Ex Leases A$mn	233.6	258.0	296.4	316.0	314.5	312.3	299.7	280.2	258.6

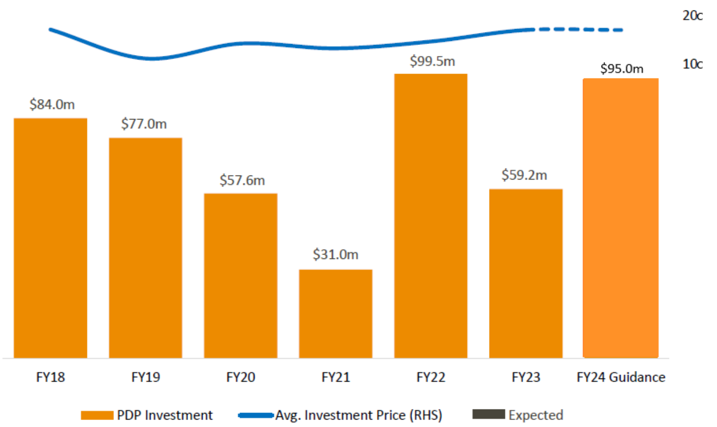
Source: Shaw and Partners Projections, PNC Financial Reports to FY23A
(1) Shaw and Partners ERC calculation differs from PNC in that Shaw and Partners considers only 10 years of collection per debt ledger.

Growth in PDP (Purchased Debt Portfolios) Modelled

We believe that from FY24 to FY25, PNC should grow its debt purchases (PDP's) to A$105mn from guidance of A$95 in FY24 (See box in Figure 11.)

As discussed earlier in this report, the banking industry seems primed to sell larger quantities of aged debt and PNC is in an improved market position to procure that debt. PNC historically paid for debt priced at less than 20c on the dollar. In other words, for A$95mn, PNC might acquire about A$600mn in receivables to be collected.

Figure 12: PNC Historical Debt Purchases and FY25 Guidance



Source: PNC, Shaw and Partners

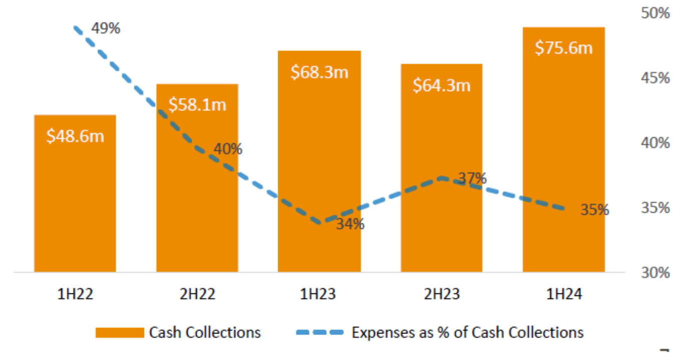
Opex and Cost to Serve

Management's guidance for FY24 cost to serve is 35%-37% of cash collected.[3] Wages are the single biggest cost element accounting for about 75% of costs. The most labour-intensive function is locating debtors, informally known as 'skip tracing.' As PNC's collection book grows it requires more staff to locate debtors. PNC has a low-cost team in the Philippines which it can engage for some vendors. Not all of PNC's vendors permit offshore interaction with Australian debtors.

PNC is currently implementing a new CRM system which is targeted for completion end of FY24 and to deliver efficiencies from FY25. Also, PNC's emphasis on encouraging debtors into arrangements enables more automation. Debtors can make payments via PNC's online portal.

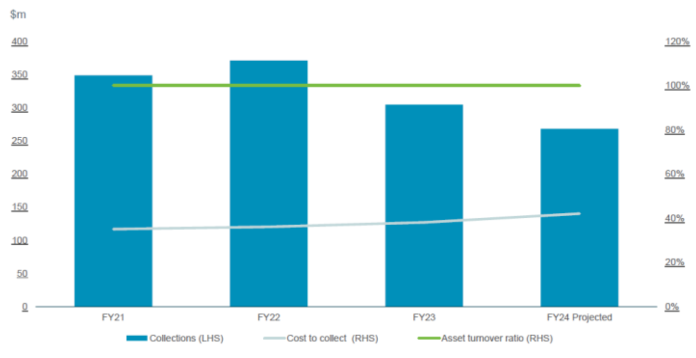
Ultimately, we conclude about 50% of PNC's opex is fixed. That means there is indeed operating leverage, and we expect the cost to serve ratio to fall below 35% as cash collections grow.

Figure 13: PNC Cost to Collect Guidance 35%-37%



Source: Pioneer 1H 24 Investor Presentation

Figure 14: Credit Corp AU/NZ Cost to Collect Guidance > 40%



Source: Credit Corp 1H 24 Investor Presentation

Net Finance Costs Reduced with New Terms from Nomura

The outlook for PNC has enabled the company to negotiate better terms for its senior debt facilities with its exclusive arranger Nomura Australia Ltd. (Nomura holds 6.6% of PNC's equity.) PNC believes the new terms will afford a cost of debt between 9-10%. At that rate, PNC would save between A$8-11mn.

Shaw and Partners models an interest expense reduction of A$11mn for FY25 and anticipates positive EPS in that year.

FY26 Guidance and Potential for New Equity

PNC has issued an earnings target of A$18mn for FY26 statutory NPAT as part of its LTIP program (discussed in the next section.)

Critical to achieving this objective is large growth in PDP's and no expansion in interest expense, in our view. Given our assumption that free cash flow may not turn positive until FY26, it is possible that PNC may issue new equity.

We currently model A$30mn of injected capital in early FY26.

[3] (Our estimate in Figure 10 differs from PNC's guidance because PNC included in its calculation other income and timing differences related to cash collection. Adjusting for those one-offs, our cost estimate would be within guidance.)

Management Ownership and Incentives

Management and the Board own over 15% of PNC including Keith John, CEO, who owns 12.9%. PNC has options on issue -- listed and unlisted. On a fully diluted basis, Keith John's ownership would increase to 14.6%.

Figure 15: PNC Major Equity Owners

	Shares	Unlisted Warrants	Performance Righs	Listed Options	Total
Keith Johns Ownership	17,297,934	0	2,807,766	4,527,273	24,632,973
%	12.9%		21.8%	15.4%	14.6%
Samuel Terry Asset Mgmt	20,919,645				20,919,645
%	236.6%				236.6%
James Simpson	11,100,000				11,100,000
%	8.3%				6.6%
Nomura Special Investment	8,842,718				8,842,718
%	6.6%				5.2%
Total	134,255,446	5,566,808	12,884,841	29,361,726	169,183,980

Source: PNC Filings

Performance Rights, LTIP and FY26 Guidance A$18mn NPAT

PNC has 12.9mn Performance Rights outstanding of which 9.3mn were issued in November 2023 as part of the LTIP update. Keith John has been issued 2.8mn of these 2023 Performance Rights.

The final (fourth year, FY26) hurdle for the 9.3mn performance rights is for PNC to deliver at least A$18mn of statutory NPAT in FY26. Only upon this achievement can the rights vest.

Listed Options

PNC's 29.4mn listed options trade under the symbol PNCO. The options were issued on 18 May 2022, have an exercise price of A$0.80 and expire 31 March 2025. Shaw and Partners does not dilute its valuation for these securities as they are far out of the money. We do, however, reduce our equity valuation by the market value ascribed to these options or about A$2mn.

Unlisted Warrants

We expect PNC's unlisted warrants to convert in September 2024 as prescribed and dilute PNC's ordinary shares by an additional 5.6mn units. This should be a non-cash transaction as the shares will be issued from the Warrant Reserve.

PNC's Claim against PwC for Almost A$32mn (A$0.24/shr) Not Factored Into Our Valuation

In October 2023, Pioneer Credit commenced legal proceedings in the Supreme Court of WA against PricewaterhouseCoopers (PwC) for negligence, breach of retainer and misleading or deceptive conduct.

PwC was PNC's appointed auditors for the financial year ending 30 June 2014 until the financial year ending 30 June 2019. Pioneer's claim arises from PwC's opinion, first communicated to Pioneer in December 2017, that when Pioneer was required to adopt Accounting Standard AASB 9 ('AASB 9'), for the reporting period commencing 1 July 2018, it could continue to classify and report the value of its purchased debt portfolios (PDPs) at fair value (as opposed to amortized cost.)

It is alleged in the proceedings that PwC repeated and confirmed their opinion in this regard until February 2019. On or about April 2019, after the publication of the 31 Dec 2018 accounts, PwC advised Pioneer that, in PwC's opinion, Pioneer was required to classify and report the value of its PDPs under AASB 9 at amortised cost.

Pioneer claims that PwC's conduct caused Pioneer to breach its financial covenants and sustain significant loss and damage currently assessed by Pioneer to be approximately $27 million (and almost $32 million with interest.)

Valuation

Our A$0.80 valuation is based on a DCF after mapping PNC's prospective cash collections in accordance with a cash collection curve for each year's PDP.

DCF Best Approach

We feel that DCF is the best valuation approach because accounting standard AASB 9 – Financial Instruments dictates that PNC's debt ledgers be carried at amortized cost. This is not the same as the present value of the expected remaining collections. This means that book values (NAV or NTA) reflect an arcane accounting rather than the present value of prospective cash flows.

Our DCF approach comprises of a few components. Figure 16 lists the components. The PV of the estimated remaining collections (ERC) of the existing ledgers (Item 1) is worth A$3.90/shr and covers the current net debt, lease liabilities and Opex to collect the existing ledgers (Items 2,3,4). Note that our ERC estimate is more conservative than PNC's because PNC incorporates potential collections beyond a 10-year time frame.

Augmenting the valuation is the worth we ascribe to PNC's *future business* underpinned by its people, contracts, systems and brand or reputation in the market (Item 5). We believe that has value of A$0.80/shr. It is derived from the present value of our projections for PNC's future debt purchases and collections.

Figure 16: Pioneer Credit – Shaw and Partners Valuation Components

Valuation Component	FY 25 Value A$mn	Per Share
1) PV of Estimated Remaining Collections(ERC) of current ledgers	544.6	$3.90
2) Net Debt	(316.0)	-$2.26
3) Lease Liabilities	(9.3)	-$0.07
Cash NTA	219.3	$1.57
4) PV of Opex to Run Down Current Book	(200.0)	-$1.43
5) PV of Future Business	91.9	$ 0.66
PNC Valuation	111.2	$0.80
Current M'cap	64.3	$ 0.46
Potential Upside	27.6	$0.34
Total Shareholder Return	43%	73%

Source: Shaw and Partners

Our DCF incorporates the following factors shown in Figure 17 and has the following sensitivity shown in Figure 18.

Figure 17: Base Case DCF Assumptions

Risk Free Rate(Rf)	4.3%
Market Risk Premium (Rm-Rf)	6.0%
Beta	1.4
Target debt to entity value	70%
Cost of debt (Kd)	9.0%
Cost of equity (Ke)	12.7%
Tax rate	30.0%
WACC	8.2%
Terminal Value/EV	42%

Source: Shaw and Partners

Figure 18: DCF Sensitivity to Growth and Cost of Capital

		WACC				
		7.7%	8.0%	8.2%	8.5%	8.7%
Terminal Growth	1.0%	$ 0.96	$ 0.85	$ 0.75	$ 0.66	$ 0.57
	2.0%	$ 0.99	$ 0.88	$ 0.77	$ 0.68	$ 0.58
	3.0%	$ 1.02	$ 0.91	$ 0.80	$ 0.69	$ 0.60
	4.0%	$ 1.05	$ 0.93	$ 0.81	$ 0.71	$ 0.61
	5.0%	$ 1.08	$ 0.95	$ 0.83	$ 0.72	$ 0.61

Source: Shaw and Partners

Is PNC Cheaper than Credit Corp?

PNC is trading on a similar EV/Cash Flow than Credit Corp. However, PNC is more levered, smaller in size and less diversified.

Figure 19: Pioneer vs Credit Corp Current Market Valuations

Company	EV	FY24E Cash Flow Before Investment, Interest and Tax	EV/Cash Flow	FY24 Net Debt	Net Debt/ Cash Flow
Pioneer	358	112	3.2x	296	2.7x
Credit Corp	1,280	409	3.1x	320	0.8x

Source: Shaw and Partners

We lack the data to determine whether the of Credit Corp share price reflects a discount to that company's estimated remaining collections plus its loan book. That is our preferred method of valuation.

Figure 20, below shows the NTA (Book Value) of selected ASX Financial Service providers. This is not our preferred method of valuation because accounting techniques blur cash valuations and they vary by company. Nevertheless, we present the table to readers out of interest.

Figure 20: NTA of Selected ASX-listed Financial Service Providers

Ticker	Company Name	Last close price AUD	Book Value (Last Reported	Price to Book	Mcap A$mn
PNC-AU	Pioneer Credit Ltd	$0.47	$0.41	1.2x	63.3
LFS-AU	Latitude Group Holdings Ltd.	$1.16	$0.39	3.0x	1,206.0
PLT-AU	Plenti Group Ltd.	$0.73	$0.32	2.3x	126.6
LFG-AU	Liberty Financial Group Ltd	$3.84	$2.99	1.3x	1,166.6
FSA-AU	FSA Group Limited	$0.85	$0.77	1.1x	103.1
CCP-AU	Credit Corp Group Limited	$14.61	$11.79	1.2x	994.5
EPY-AU	EarlyPay Limited	$0.17	$0.15	1.1x	49.2
HMY-AU	Harmoney Corp Ltd	$0.38	$0.42	0.9x	38.2
RMC-AU	Resimac Group Limited	$0.94	$0.97	1.0x	376.0
WZR-AU	Wisr Ltd.	$0.04	$0.04	0.8x	49.4
BTN-AU	Butn Limited	$0.05	$0.06	0.8x	13.4
B4P-AU	Beforepay Group Limited	$0.55	$0.63	0.9x	25.9
CCV-AU	Cash Converters International Limited	$0.20	$0.29	0.7x	125.5
PGL-AU	Prospa Group Ltd.	$0.41	$0.57	0.7x	66.7
MME-AU	MoneyMe Ltd.	$0.06	$0.13	0.5x	50.4
HUM-AU	Humm Group Limited	$0.43	$0.81	0.5x	217.3
ZIP-AU	Zip Co Ltd.	$1.18	-$0.28	-4.2x	1,332.3
Weighted average (ex Zip, Lattitude)				1.2x	
Weighted average under A$500mn m'cap				1.1x	

Source: Factset

Key Risks

- Pioneer needs to acquire debt portfolios in order to grow profitably. The availability of debt portfolios at appropriate prices are affected by factors outside Pioneer's control.
- Pioneer may not be able to collect on its debtor accounts in sufficient quantity or time to generate adequate returns on its investments in purchased debt portfolios.
- Pioneer is highly leveraged. Leverage magnifies earnings and valuation volatility.
- Pioneer has debt obligations maturing in 2025 and 2026. Pioneer has in principle agreements to extend maturities to 2029 and is awaiting noteholder approval. There is risk that PNC may not be able to extend its funding arrangements and alternative funding may be required.
- Pioneer creditors impose financial covenants on the company. Should Pioneer's performance deteriorate it may breach its financial covenants triggering the need for alternative funding.
- Pioneer operates in an industry with a strict legal and regulatory framework. Any failure by Pioneer to comply with applicable laws could adversely affect Pioneer's reputation, its business and result in substantial losses.
- Key personnel risk: CEO Keith Johns owns 12.9% of Pioneer and has an extensive industry network that is important in Pioneer's operating performance. If Mr Johns departs from Pioneer, performance of the company may be impacted.

Core Drivers and Catalysts

- The quantity of purchased debt securities drives current year and future year income/cash flows.
- The anticipated collections (total value and rate collection) as well as actual collections drive Pioneers income and cash flow.
- The cost of funding is a factor in Pioneer's profitability. Pioneer currently has funding arrangements in place with Nomura.
- Operating efficiency in collecting debts is a factor in Pioneer's financial performance.

Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

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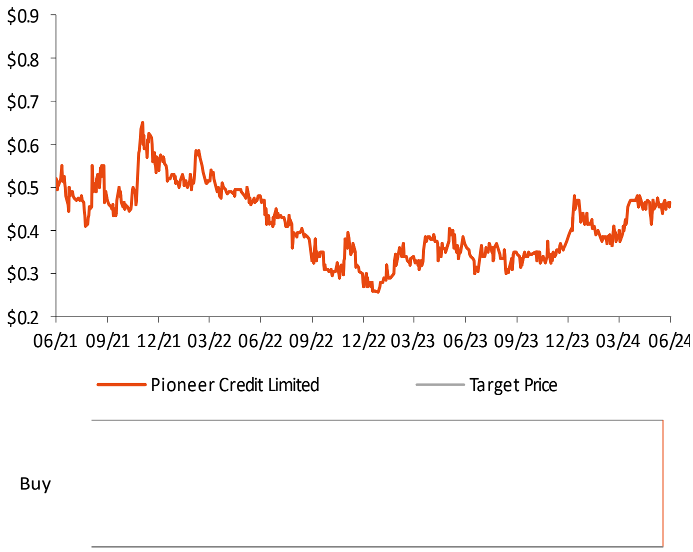
Distribution of Investment Ratings

Rating	Count	Recommendation Universe
Buy	70	91%
Hold	6	8%
Sell	1	1%

History of Investment Rating and Target Price - Pioneer Credit Limited

Date	Closing Price ($)	Target Price ($)	Rating
7-Jun-24	0.47	0.80	Buy



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