Provident Financial plc
Interim Management Statement
22 October 2010

Provident Financial plc, the leading UK non-standard lender, made the following Interim Management Statement today covering the period from 1 July 2010 to 21 October 2010.

Overview

Tight control over the quality of lending and the effectiveness of collections has resulted in a good collections performance through the third quarter of the year.

Whilst Home Credit experienced subdued customer demand over the summer months, it is encouraging that recent weeks have seen a pick-up in sales which are now running ahead of the same period last year.

Vanquis Bank is performing strongly and enjoyed its best trading period to date in the third quarter. The business achieved key milestones for scale and profitability during September, passing 500,000 customers, £300m of receivables and achieving its post-tax return on equity target of 30%.

Although management expect the direct impact of the Government's spending review on the group's customer base to be modest, continued tight underwriting and close attention to margins and costs will remain in place over the coming months until there is evidence of a sustained economic recovery.

Market conditions

Home Credit customers are typically lower income households with many deriving the majority of their income from hourly paid, part-time or casual employment. Whilst unemployment levels in the economy have remained relatively stable, some Home Credit customers continue to be affected by the growth in underemployment characterised by reduced working hours and having to accept part-time or temporary work. As a result, demand for credit was subdued during the summer months as some existing customers continued to display cautious behaviour. Encouragingly, in recent weeks there has been a pick-up in sales which are now running ahead of the same period last year.

Vanquis Bank customers are typically in regular employment earning between £12,000 and £25,000 per annum but with a thin or impaired credit record. With better visibility on future earnings, demand for credit from this segment has been maintained and, as the main participant in the non-standard credit card market, Vanquis Bank has experienced both a strong flow of new applications and good utilisation of credit lines.

Business performance

The year-on-year rate of new customer growth in Home Credit was maintained at between 4% and 5% during the third quarter of 2010. This is likely to moderate during the remainder of the year as the business is now placing greater emphasis on issuing credit to existing good quality customers.

Demand for credit over the summer months was relatively subdued and average receivables for the nine months ended 30 September 2010 were 1.3% below the comparative period in 2009. The annualised yield on the receivables book edged up during the third quarter and the collections performance was robust throughout the period. Overall, the impact of subdued demand on receivables has left Home Credit's trading performance modestly short of plan at the end of the third quarter. However, as the business approaches its peak trading period, there has been an increase in loan sales with credit issued in recent weeks running ahead of the same period last year.

Home Credit successfully completed its move this month to a new head office building in Bradford, consolidating split operations into a single purpose-built facility that will accommodate the future growth of the business. The year-end accounts will reflect an exceptional write down of residual fixed assets of £2.5m.

Vanquis Bank has continued to receive a strong flow of card applications. Underwriting standards have remained unchanged resulting in a year to date acceptance rate of 18% compared to 19% at the half year. Customer numbers stood at 501,000 at the end of September, representing year-on-year growth of 20.4%. Receivables passed the £300m milestone during September and average receivables for the nine months ended 30 September showed growth of 22.7% over the corresponding period in 2009.

The favourable trend in delinquency rates that developed during the second quarter of the year continued through the third quarter, providing further evidence that the consistent application of tight underwriting and credit line increases have underpinned a further improvement in the quality of the receivables book. This has supported a further expansion in the annualised risk-adjusted margin to around 32% at 30 September 2010. Overall, Vanquis Bank's trading performance is running ahead of plan at the end of the third quarter due to the combined effect of strong growth and favourable delinquency trends.

Overall, group performance for the nine months to 30 September 2010 is in line with plan.

<u>Government Spending Review</u>

On 20 October 2010, the Chancellor announced details of the Government's Spending Review, including cuts to public spending and reforms to welfare benefits.

The total welfare benefits savings included in the Spending Review and June 2010 Budget are to be phased in over the next four years, rising from £2.3bn in 2011/2012 to £18.1bn by 2014/2015.

The effect of specific measures relating to welfare benefits included in the Spending Review and the June Budget which are most relevant to Home Credit customers are set out below:

- It is estimated that the capping of benefits that family households can receive at around £500 a week from 2013, equivalent to £26,000 a year, will affect under 1% of households served by Home Credit. The average household income of a Home Credit customer is approximately £12,000 a year and typically includes income from employment. Furthermore, less than half of Home Credit customers are in receipt of any benefits (other than child benefit and pensions).
- The cutting of child benefits to families where at least one parent earns more than approximately £44,000 a year will not affect Home Credit customers.
- The capping of the Local Housing Allowance used to determine Housing Benefit due to take effect from April 2011 will not have a significant impact on the Home Credit customer base. It is estimated that 8% of Home Credit customers live in private rented accommodation and are in receipt of benefits. Only a small proportion of these customers live in four or five bedroom houses or areas of high cost housing and will experience a reduction in Housing Benefit. Importantly, the Spending Review confirmed that there is to be no change to Social Housing rents for existing tenants.
- It is estimated that the restriction on the Employment Support Allowance paid to those who are unable to work because of a disability or a health condition to one year from 2012 will impact less than 5% of households served by Home Credit.
- The headline benefit savings of £18.1bn in 2014/2015 include £6.2bn in relation to switching indexation of benefits from RPI to CPI. This does not reduce the level of benefits but serves to moderate the rate of future increases.

The transition from the current welfare benefits system to the Universal Credit will be phased in over the next 10 years. Given the short duration of the Home Credit loan book, this timescale will allow any impact on customers' circumstances to be comfortably accommodated within the normal loan renewal process. Accordingly, this transition does not present any increased exposure to credit risk.

The Office of Budget Responsibility has forecast that the measures included in the Spending Review and June Budget will reduce public sector employment by 490,000 over four years through a combination of natural attrition and redundancies. The majority of the reduction is forecast to take place from 2013/2014. The majority of Home Credit households derive their income from hourly paid, part-time or casual work and are therefore not typically employed in administrative roles within Central or Local Government. Vanquis Bank customers are in more regular employment and will therefore have some representation within this public sector population. It is estimated that the direct impact of the reduction in public sector employment will affect around 1% of Vanquis Bank's customer base.

In summary, the phased introduction of the changes to welfare benefits does not increase the exposure to credit risk in Home Credit due to the short duration of its loan book. In addition, the impact of the changes on the typical household income of a Home Credit customer is expected to be modest. Whilst the direct impact of the reduction over the next four years in administrative roles within Central and Local Government is not expected to have a significant impact on the Home Credit or Vanquis Bank customer base, at present the potential impact of public sector spending cuts on the broader economy is difficult to estimate. It is also possible that changes in the labour market may increase the size of the non-standard credit market. In view of the uncertainty over the future direction of the employment market, in the near term, management will continue to impose tight control over the issue of credit.

Funding and capital

The group's funding and liquidity position remains strong with an average duration of 3.8 years. Balance sheet gearing at the end of September was modest at 3.1 times compared with a covenant limit of 5 times.

Headroom on the group's committed debt facilities at 30 September 2010 amounted to £325m and the group has sufficient committed debt facilities to fund planned growth through to the end of 2011.

Regulation

In conjunction with the rest of the credit industry, the group is working towards implementation of those parts of the Irresponsible Lending Guidance to Creditors not already in force by February 2011 together with the EU Directive on Consumer Credit.

The group also continues to work with the UK Cards Association to implement the findings of the Department for Business Innovation and Skills consultation on credit and store card regulation by the end of the year.

More recently, the Government has issued a call for evidence in connection with a review of consumer credit and insolvency. It is clear that the new administration will wish to assess the situation for itself and the group welcomes the fact that an evidence-based approach is being pursued.

Outlook

The receivables books in both businesses are in good condition and the strong performance of Vanquis Bank and the pick-up in Home Credit sales in recent weeks have added to management's confidence of delivering a good result for the year.

Commenting on the group's performance, Peter Crook, Chief Executive, said:

"I am encouraged by recent business performance as we enter the peak trading period. We expect the direct impact of the Government's spending review on the group's customer base to be modest but continued tight underwriting and close attention to margins and costs will remain in place over the coming months until there is evidence of a sustained economic recovery."

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