

Secure Trust Bank

FY19 trading update

Positive pre-close

Secure Trust Bank's (STB) pre-close trading update indicates that FY19 results should be in line with expectations, despite the economic slowdown dampening loan demand in the second half of 2019. STB highlighted its strong control over risk while interest margins have been stable. The bank is cautiously optimistic about 2020 and is well positioned, with healthy capital, good liquidity and new business pipelines. STB does not envisage material changes to 2020 guidance, and we are maintaining our estimates and 2,428p per share valuation.

Year end	Operating income (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/17	129.5	27.0	116.4	79.0	13.8	4.9
12/18	151.6	36.7	162.0	83.0	9.9	5.2
12/19e	170.9	42.1	179.5	87.2	9.0	5.4
12/20e	186.2	52.7	227.3	91.5	7.1	5.7
12/21e	205.0	60.8	257.7	92.6	6.2	5.7

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Careful navigation bearing fruit

We believe that STB's cautious lending stance and business repositioning has helped it deliver solid 2019 numbers (we forecast 2019 pre-tax earnings +16% year-on-year, ROTE of 14.8%) and it is well positioned to adjust if business picks up following the UK general election. The positive tone regarding risk control is reassuring given that the economy was sluggish during the second half of the year. The bank has indicated that impairment rates are running lower than at mid-2019.

Ready for growth

We continue to forecast 17% and 14% growth in loans for STB in 2020 and 2021, respectively. This should help drive underlying pre-tax earnings from the forecast £42.1m in 2019 to £60.8m in 2021. There are still some question marks regarding the UK economy in the short and medium term but, if the economic backdrop is supportive, STB should conceivably be able to deliver on these forecasts.

Valuation: 2,428p unchanged

We make no changes to our forecasts and maintain our fair value at 2,428p per share (based on a dividend discount model), equivalent to a 2020 P/NTA of 1.6x. The bank's shares are up 33% over the last 12 months, but our fair value estimate is still 51% above the current share price, offering attractive upside potential. The dividend yield of 5.7% (2020e) is above the average of STB's peers.

Banks

15 January 2020

Price 1,610p
Market cap £298m

Net debt/cash (£m)	N/M
Shares in issue	18.5m
Free float	84.5%
Code	STB
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.0	33.1	33.1
Rel (local)	(3.2)	25.0	18.4
52-week high/low		1,660p	1,158p

Business description

Secure Trust Bank is a well-established specialist bank addressing niche markets within consumer and commercial banking. It is launching a non-standard mortgage business. Former parent Arbuthnot Banking Group's shareholding is now less than 20%.

Next events

FY19 results	March 2020
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Valuation

STB's share price is up 38% since its 9 October 2019 trough of 1,200p. It is not the only stock to have benefited from the UK general election rebound, but it has been an outperformer. Over the last 12 months, it is the top performer among peers (see Exhibit 1). Clearly, STB's shares have benefited from the bank's solid results, the reassuring updates and a cautious, flexible strategy.

Our fair value for STB is unchanged at 2,428p, 51% above the current share price of 1,610p. Our fair value is derived using a dividend discount model. The fair value is equal to 1.6x 2020e P/NTA. We forecast an ROTE of 18.0% in 2020 and 19.8% in 2021, hence a fair value well in excess of tangible book value is fully justified, in our view.

Exhibit 1: Challenger/specialist lender share price performance, %

	One month	Three months	One year	Ytd	From 12m high
Secure Trust Bank	0.0	33.1	33.1	0.6	-6.9
1PM	7.1	28.2	-12.8	8.7	-27.2
Close Brothers	-1.6	20.3	5.7	0.1	-3.8
CYBG	-19.0	38.4	-6.9	-7.0	-21.0
Metrobank	0.6	-4.8	-89.3	-3.9	-91.1
OneSavings Bank	-6.3	16.0	11.4	-3.8	-9.6
Paragon	-7.4	1.9	20.7	-8.1	-10.9
PCF Group	-2.8	27.8	-2.6	-1.4	-12.0
S&U	1.0	1.9	3.4	0.5	-13.8
Average	-3.6	16.2	-8.8	-1.9	-23.7
Average ex-Metro	-4.2	19.2	2.7	-1.6	-14.0

Source: Refinitiv, Edison Investment Research. Note: Prices as at 14 January 2020.

Exhibit 2: Challenger/specialist lender comparative table

	Price (p)	Market cap (£m)	P/E (x) CY0e	P/E (x) CY1e	Dividend yield (%)	ROE last reported	P/BV last reported
Secure Trust Bank	1,610	297.5	9.9	9.0	5.2	11.6	1.24
1PM	37.5	33.4	5.7	5.1	2.2	13.0	1.00
Close Brothers	1,599	2419.4	11.9	11.7	4.1	14.9	1.72
CYBG	175.35	2518.4	7.4	7.4	0.0	9.8	0.50
Metrobank	198.1	341.6	66.3	-31.0	0.0	2.9	0.14
OneSavings Bank	416.8	1856.6	7.2	6.7	3.5	22.3	1.50
Paragon	495.2	1269.8	9.8	9.2	4.3	10.3	1.17
PCF Group	34.5	86.3	11.5	9.0	1.2	11.0	1.47
S&U	2120	256.9	7.0	6.3	3.2	17.6	1.64
Average			15.9	3.0	2.3	12.7	
Average ex-Metro			8.7	7.9	2.6	14.1	
STB vs average ex-Metro			15%	11%	95%	-31%	

Source: Refinitiv, Edison Investment Research. Note: Prices as at 14 January 2020.

Exhibit 3: Financial summary

Year end December	2016	2017	2018	2019e	2020e	2021e
£m except where stated						
Profit and loss						
Net interest income	92.5	114.6	133.7	148.8	162.1	177.8
Net commission income	14.5	14.9	17.9	22.1	24.0	27.2
Total operating income	107.0	129.5	151.6	170.9	186.2	205.0
Total G&A expenses (exc non-recurring items below)	(64.3)	(71.3)	(84.5)	(97.4)	(104.2)	(111.7)
Operating profit pre impairments & exceptionals	42.7	58.2	67.1	73.5	82.0	93.3
Impairment charges on loans	(23.3)	(33.5)	(32.4)	(33.2)	(31.2)	(32.5)
Other income	0.0	0.3	0.0	0.0	0.0	0.0
Operating profit post impairments	19.4	25.0	34.7	40.3	50.8	60.8
Non-recurring items	0.0	0.0	0.0	0.0	0.0	0.0
Pre tax profit - continuing basis	19.4	25.0	34.7	40.3	50.8	60.8
Corporation Tax	(5.2)	(5.1)	(6.4)	(7.8)	(8.6)	(10.3)
Tax rate	26.8%	20.4%	18.4%	19.3%	17.0%	17.0%
Bank tax surcharge	0.0	0.0	0.0	(1.0)	(2.1)	(2.9)
Profit after tax - continuing basis	14.2	19.9	28.3	31.5	40.1	47.6
Discontinued business	123.3	3.9	0.0	0.0	0.0	0.0
(Loss)/profit for year	137.5	23.8	28.3	31.5	40.1	47.6
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Net income attributable to equity shareholders	137.5	23.8	28.3	31.5	40.1	47.6
Company reported pre-tax earnings adjustments	7.9	2.0	2.0	1.8	1.9	0.0
Reported underlying pre-tax earnings (ex discontinued 2015/16)	27.3	27.0	36.7	42.1	52.7	60.8
Reported underlying earnings after tax	20.6	21.5	29.9	33.2	42.0	47.6
Average basic number of shares in issue (m)	18.5	18.5	18.5	18.5	18.5	18.5
Average diluted number of shares in issue (m)	18.6	18.6	18.6	18.6	18.6	18.6
Reported diluted EPS (p)	77.3	107.0	152.2	169.5	215.8	256.1
Underlying diluted EPS (p)	113.0	116.4	162.0	179.5	227.3	257.7
Ordinary DPS (p)	75.0	79.0	83.0	87.2	91.5	92.6
Special DPS (p)	165.0	0.0	0.0	0.0	0.0	0.0
Net interest/average loans	8.15%	7.72%	7.37%	6.68%	6.15%	5.84%
Impairments/average loans	2.04%	2.30%	1.79%	1.49%	1.18%	1.07%
Cost income ratio	60.1%	55.1%	55.7%	57.0%	56.0%	54.5%
Balance sheet						
Net customer loans	1,321.0	1,598.3	2,028.9	2,428.5	2,841.4	3,249.6
Other assets	189.0	293.3	415.4	428.6	443.5	485.6
Total assets	1,510.0	1,891.6	2,444.3	2,857.0	3,284.9	3,735.2
Total customer deposits	1,151.8	1,483.2	1,847.7	2,248.6	2,583.1	3,008.9
Other liabilities	122.2	159.3	359.5	345.3	361.8	379.4
Total liabilities	1,274.0	1,642.5	2,207.2	2,603.3	3,007.4	3,419.6
Net assets	236.0	249.1	237.1	253.7	277.5	315.6
Minorities	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	236.0	249.1	237.1	253.7	277.5	315.6
Reconciliation of movement in equity						
Opening shareholders' equity	141.2	236.0	249.1	237.1	253.7	277.5
Profit in period	137.5	23.8	28.1	31.5	40.1	55.1
Other comprehensive income	(1.8)	2.9	(25.8)	0.0	0.0	0.0
Ordinary dividends	(13.1)	(14.0)	(14.8)	(15.5)	(16.3)	(17.1)
Special dividend	(30.0)	0.0	0.0	0.0	0.0	0.0
Share based payments	0.2	0.4	0.5	0.6	0.0	0.0
Issue of shares	2.0	0.0	0.0	0.0	0.0	0.0
Share issuance costs	0.0	0.0	0.0	0.0	0.0	0.0
Closing shareholders' equity	236.0	249.1	237.1	253.7	277.5	315.6
Other selected data and ratios						
Period end shares in issue (m)	18.5	18.5	18.5	18.5	18.5	18.5
NAV per share (p)	1,277	1,348	1,283	1,424	1,840	1,878
Tangible NAV per share (p)	1,229	1,292	1,230	1,364	1,779	1,828
Return on average equity	72.9%	9.8%	11.6%	12.6%	13.3%	13.9%
Normalised return on average equity	9.9%	8.9%	12.8%	14.1%	17.3%	18.9%
Return on average TNAV	10.3%	9.3%	13.4%	14.8%	18.0%	19.8%
Average loans	1,134.6	1,484.6	1,826.4	2,253.5	2,442.5	2,635.0
Average deposits	1,067.5	1,321.7	1,655.4	2,024.8	2,234.6	2,427.8
Loans/deposits	114.7%	107.8%	109.8%	108.0%	110.0%	108.0%
Risk exposure	1,264.0	1,446.1	1,824.6	2,175.8	2,522.0	2,878.9
Common equity tier 1 ratio	18.0%	16.5%	13.8%	12.1%	11.2%	11.1%

Source: Company accounts, Edison Investment Research

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