Secure Trust Bank

Q319 trading update

A reassuring trading update

Banks

Secure Trust Bank's (STB's) trading update for Q319 had a reassuring tone. The business trends and 'overall results are in line with management expectations'. Management noted that demand slowed in September, but this is not a surprise given Brexit deadline concerns. STB has been in de-risking mode for several quarters and has been repositioning its loan book in anticipation of economic and political uncertainties. At the same time, the short duration of its loan book allows it to respond quickly as the lending environment changes. We are not making changes to forecasts or our fair value of 2,428p per share.

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	11.4	5.9
12/18	151.6	36.7	162.0	83.0	8.2	6.2
12/19e	170.9	42.1	179.5	87.2	7.4	6.6
12/20e	186.2	52.7	227.3	91.5	5.9	6.9

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

Brexit uncertainty

The Brexit uncertainty has led to some borrowers holding back ahead of the 31 October deadline. This has been mainly in the real estate finance division (representing 29% of STB's H119 lending revenue net of impairments). STB warned that political developments could have an impact on the economy and STB's Q419 results. However, this slowdown could lead to a pronounced catch-up in activity after the Brexit outcome becomes clearer. Retail demand has been little affected, as unemployment remains low and wage growth is good.

Unaffected by FCA motor fee changes

The Financial Conduct Authority (FCA) announced on 15 October it was planning to ban some commission arrangements between lenders and some car retailers and motor finance brokers. These are commissions that are linked to the interest rate the customer pays that the broker has the power to set or adjust. STB does not expect any negative impact from these proposed changes as it has never employed any of these commission structures across its business.

Valuation: Unchanged at 2,428p per share

We are not changing our forecasts but are reassured by the update. We are expecting a normalised return on equity of 14.4% in 2019 and see this reaching 18.7% by 2021. Our dividend discount model-derived fair value remains 2,428p implying a 2019 P/NAV of 1.8x. We forecast STB to continue to deliver returns considerably above its 10% cost of equity. As such, a significant premium to the current P/BV of 1.0x seems justified. STB is paying an attractive current year dividend yield of 6.6%, which is set to grow.

17 October 2019

Price	**1,330p**
Market cap	**£246m**

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	0.8	(8.9)	(4.8)
Rel (local)	2.4	(5.1)	(6.7)
52-week high/low		1,590p	1,157.5p

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 trading update	January 2019

Analysts

Pedro Fonseca +44 (0)20 3077 5700

Andrew Mitchell +44 (0)20 3681 2500

financials@edisongroup.com

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FCA planned motor changes

The consultation paper issued on 15 October followed the FCA's findings of its investigation into the motor finance commission practices published in March 2019. In the report, the FCA was concerned about commission models linked to motor finance interest rates that the brokers had a 'wide discretion to set or adjust'. This generated a conflict of interest (no pun intended) where the higher the interest rate set by the broker, the bigger the commission. The FCA estimated that this was costing customers as much as £300m a year when compared to flat fee models.

These discretionary commission models generally had three formats: (1) increasing difference in charges (DIC), (2) reducing DIC and (3) scaled commission models. In the first format, there is a minimum interest rate and the broker is paid according to how much higher than the minimum they are able to charge their customer. In the second, there is a maximum interest rate and what the broker receives is based on the difference between interest they are charging and the maximum allowed. In the last format, the fee paid varies directly with the interest rate within certain parameters.

The FCA made the point that the first two are more damaging than the scaled commission models, but all of them are unhealthy and the FCA is planning to ban these arrangements. It wants to sever the link between interest rates paid by customers and broker fees. The FCA proposal would allow for variable commission models for brokers, but not one based on customer interest rates. This would allow, for example, higher fees being charged for customers who required more work from the broker.

In addition, the FCA also found high levels of non-compliance in terms of disclosure requirements as described in its Consumer Credit sourcebook. The FCA is planning to make some minor changes to make compliance easier and with greater certainty.

The finalisation of these new rules is expected by the beginning of Q220.

Since STB does not operate with these discretionary commission models it does not expect to have any negative impact from these changes. STB expects that as a result of these changes, there may conceivably be some increase in new car prices, with a knock-on positive effect on the used car market. This would help STB as its V12 Vehicle Finance partnership with Aston Barclay is focused on working with dealers in the used car finance segment, including dealer stock funding.

Exhibit 1: Financial summary

Year end 31 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	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: Secure Trust Bank accounts, Edison Investment Research

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Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia