

# SECURE TRUST BANK PLC (STB:LSE)

**Sector: Financial Banks (Small-Cap)**

<b>Current Price (£ pence):</b>	2156
<b>1 YR Change:</b>	-22.35%
<b>Incorporation:</b>	1954
<b>Beta (Public Source):</b>	0.5924
<b>Valuation Type:</b>	Value

Revenues 2015	£ m	%
<b>Real Estate Finance:</b>	20,3	13%
<b>Asset Finance:</b>	2,4	2%
<b>Commercial Finance:</b>	1,6	1%
<b>Personal Lending:</b>	57,9	37%
<b>Motor Finance:</b>	33,3	21%
<b>Retail Finance:</b>	24,2	15%
<b>Other:</b>	18,4	12%
<b>Total</b>	<b>158,1</b>	<b>100%</b>

## Company Description

Secure Trust Bank PLC is low risk-appetite-having "pure" bank engaged in providing banking and financial services. The Company's principal activity is banking, including deposit taking, and secured and unsecured lending. The Company's segments include Business finance, including Real Estate Finance, which offers buy-to-let and development loans secured by the United Kingdom real estate; Asset Finance, which offers loans to small and medium sized enterprises to acquire commercial assets, and Commercial Finance, which includes invoice discounting and invoice financing; Consumer finance, including Personal lending, which provides unsecured consumer loans sold to customers through brokers and affinity partners. The bank has a long history of prudent banking and opted for an IPO in 2011.

## SWOT

Strength	Weaknesses
<ul style="list-style-type: none"> <li>- Subprime unsecured lending sold out at a profit.</li> <li>- Short average life of total loan book &lt; 30 months.</li> <li>- CET1 of 20.1% as of 30 June 2016.</li> <li>- The bank has little/no debt.</li> </ul>	<ul style="list-style-type: none"> <li>- A small bank that will stay small.</li> <li>- Impairment charges totaling ~ £13 m</li> <li>- Limited appetite to grow to mid-tier size bank.</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>- Cash on balance sheet £ 141 m as of 30/6/16, plenty to lend and M&amp;A is marked as priority.</li> <li>- Personalized banking still relevant even with new online businesses popping up.</li> <li>- Asset finance started in 2015 generating good revenues.</li> <li>- Retail Financing (Online e-commerce consumer) is growing more rapidly and has lower impairments than motor or personal lending in consumer finance.</li> </ul>	<ul style="list-style-type: none"> <li>- Low interest rates may persist.</li> <li>- Threat from online loan portals like Lending Club.</li> </ul>

## Investment Summary

The bank is relatively safe cheap when considering growth potential. After the sale of unsecured Every Day loans portfolio -which did command significant risks but also great profitability-, the bank sits with a large cash pile of ~ £ 140 m whereas the market demands £ 400 m for the entire company. So, if I buy the shop for £400m and get a register along with £140m cash, actual market valuation of earnings potential stood at £260 m. The company treats customers well, has no wild ambitions, lending is measured and controlled and if profits continue to climb at previous pace, the future Earnings to current Price come at around 10. Considering the net equity worth of ~£ 260 m being priced by the market, the judgement of the analyst rests on determining if the equity is worth more than that, which in my view is. Current earnings (accounting) give a net equity market cap/earnings of 9 which is not expensive for a safe-playing bank like Secure Trust Plc. Not outstandingly cheap but still a good enterprising bank for a diversified portfolio.

## CHEAP

Average volume	11.70k
Shares outstanding (m)	18.48
Free float (m)	13.48
Market cap (m)	402.94 GBP
EPS (TTM)	0.9955 GBP
P/E (TTM)	21.91

## FINANCIALS

Debt/ Equity	0%
EPS 5Yr Avg.Growth	25,36%
Net Income 5Yr Avg Growth	35,64%
Op. Income 5Yr Avg Growth	23,35%
ROE 5 Yr Avg	25,80%

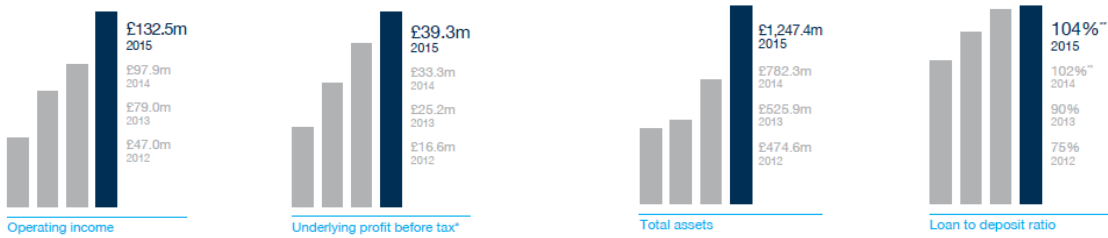
## VALUATION

Terminal value	333
PV T.Value	166
Current Book V.	228
Sum PV of 5yr Ex. Returns	113
<b>TOTAL</b>	<b>507</b>
Shares Outstanding (m)	18,48
Share Price	27,4
Current Price	21,6
Upside	27%
<b>PE Based</b>	
Current P/E	21
Current Earnings (m)	28,7
2021 Expected Earnings (m)	40
Current P/E to future N.P	10
Price Derived w. Current P/E	45
Potential	111%



# Total & Segments Source: Annual Report/Company Website

## Total Financial Highlights

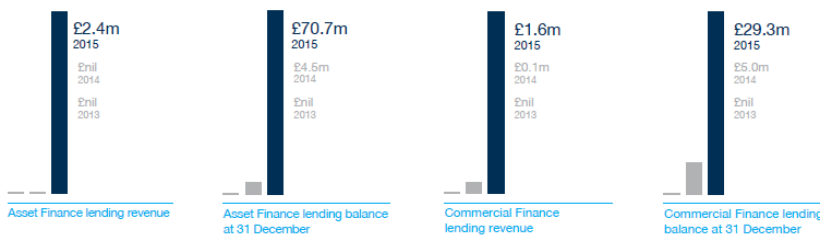


- Number of customers increased by 33% from 2014 till 2015
- Number of customers increased over 35% from half year 2015 (449949) till 30 June 2016 (608891).

## Business Finance (Total Business Lending: £ 468 m, Increase from 2014: 227%)

- **Real Estate Finance:** Increased book by 175% in 2015. No credit losses till end year 2015.
- **Asset Finance:** Gross new lending (£ 72 m) exceeded target in 2015. No credit losses, revenue grew to £ 2.4m in 2015 from £ 0 in 2014.
- **Commercial Finance:** Top 20 providers of asset based lending facilities in UK. No credit losses in 2015.

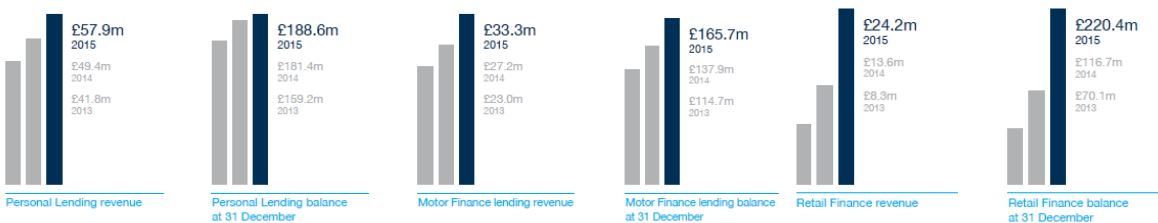
Revenue and lending performance vs prior years



## Consumer Finance (Total Consumer lending £ 574 m, Increase from 2014: 32%)

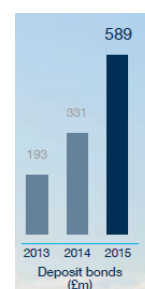
- **Personal Lending:** Increase of 6% in lending activity 2015, the segment faced major disposal of ELG unsecured loan portfolio giving a gain on disposal. Impairment losses increased 45% to £ 4.8m (~6.4% of total lending compared to 3.7% of lending in 2014).
- **Motor Finance:** New business increased 20% YoY, income increase by 22% in 2015. Impairment losses increased from 3.9 m (2.8% of lending balance) to £ 7.3 m (4.4% of lending balance).
- **Retail Finance:** For purchase of sports stuff, furniture and electronics, the business helps consumers borrow money to pay immediately online for a commodity. Requires good relationship management with retailers and new lending volume increased 90% to £ 293 m. Impairments were £ 5.2 m which were 2.3% of total lending assets by end of 2015, significantly lower than Personal & Motor Financing.

Revenue and lending performance vs prior years



## Savings (Total Deposits £ 1033 m, Increase from 2014: 70%)

- **Notice Deposits:** Totalled £ 405 m in 2015 (£ 239 m 2014)
- **Term Deposits:** Term deposit bond balances equaled £ 589 m at the end of 2015.



## Model & Assumptions

Fiscal data as of Dec 31 2015	2014	2015	Jun 30 2016	2016	2017e	2018e	2019e	2020e	2021e
<b>Total equity</b>	<b>125</b>	<b>141</b>	<b>228</b>	<b>228</b>	<b>246</b>	<b>266</b>	<b>288</b>	<b>311</b>	<b>336</b>
	102%	13%	62%	0%					
<b>Retained Earnings</b>			<b>18,4</b>	<b>18,4</b>	<b>19,9</b>	<b>21,5</b>	<b>23,2</b>	<b>25,1</b>	<b>27,1</b>
	<b>% Change</b>				8%	8%	8%	8%	8%
<b>Exces Returns</b>			<b>27,1</b>	<b>27,1</b>	<b>29,3</b>	<b>31,7</b>	<b>34,2</b>	<b>37,0</b>	<b>40,0</b>
	<b>% Change</b>				8%	8%	8%	8%	8%
<b>PV Excess Returns</b>				<b>27,1</b>	<b>25,5</b>	<b>24,0</b>	<b>22,5</b>	<b>21,2</b>	<b>19,9</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>782</b>	<b>1,247</b>	<b>1,345</b>						
Total common shares outstanding	18	18	18						
Treasury shares - common primary issue	0	0	0						

<b>RORE</b>	<b>26,90%</b>	Current
<b>Payout</b>	<b>70%</b>	Current
<b>Cost of equity</b>	<b>15%</b>	Assumed
<b>Growth rate</b>	<b>3%</b>	Assumed

## Explanation

- > Assumed current Return on Required Equity (RORE) going forward. Company forecasts goal of achieving > 20% ROE at least.
- > Payout ratio also carried forward as per current situation.
- > Assumed Cost of equity considering the small cap nature of business. In practical terms, it is lower than 15% because risky loan portfolio has been sold out but I intend to be on safer side. If COE is too high, RORE may also seem too high too, therefore middle way is just to analyze on current situation going forward irrespective of bull or bearish scenario.
- > Growth rate is assumed 3% considering that M&A is a focus point for management after a recent disposal.

## Reporting Quality

Language in Annual Report	Standard.
Auditor's Opinion	KPMG Clear.
ESG & Sustainability reporting	Sufficient Governance Reporting; Share Options Reporting Significant to the Investment Case

## Explanation

- > Annual report is quite extensive and provides relevant information as per needed including governance reporting.
- > Auditor's opinion was clear.
- > Phantom Share Option (approved in 2015) is an interesting long term option scheme. With initial reference set at £ 25 share price, after four years, those granted options will be entitled to a payment by "reference to the increase in the value of ordinary shares". Apparently, at current stock price, none of the 326917 Phantom Share Option are set to make money. All in all, it does seem that the higher reference price of £ 25 will -most probably- be bullish for the stock too.

### Usefulness of ESG metrics in current scenario?

Governance is surely important but since IPO, interest rate environment has not been supportive for traditional banking institutions. With reporting for Phantom Share Options scheme available, the analyst surely can understand that the management or option holders don't stand to make any money since the reference price £ 25 is way higher than the current stock price. If the judgment going concern on bank is sound, management will surely work to get the price above £25 or what they believe is accurate worth of the enterprise giving further conviction to the bull case.