Secure Trust Bank: The undervalued specialist lender

Company:	Secure Trust Bank (STB LN)	**Market Cap:**	£117mio
Industry:	Specialist lender	**Subordinated Debt:**	£90mio (@13%)
Country:	UK	**Revenue:**	£203mio
Date:	31st May 2023	**Net Income:**	£33.7mio (16.6%)
Dividend:	£8.4mio (7.2%)	**CET1 ratio:**	14% (21.4%)
Entry:	£117mio	**Target:**	£200mio

Why Secure Trust Bank?

- Valuation at the lowest point since the depth of the Covid crisis (3.5 P/E)
- Strong capital ratios, further enhanced by larger subordinated issuance
- Well hedged duration, with 7% sight deposits covered 3x with cash balances
- 96% of deposits are guaranteed by the government deposit protection scheme

A bank that lends in a secure way

Secure Trust Bank is a specialist lender focused on consumer financing, namely retail finance and vehicle finance, and business financing, namely commercial finance and real estate finance, with half of their lending balances allocated to retail finance. The bank is an online bank only and their loans are 125% covered by deposits, of which half are received via term deposits, 20% via notice deposits, over 15% via ISA deposits and only 7% via sight deposits, hence matching the duration of the portfolio with its deposits. This is reflected in the lending, as retail has an average duration of 18-24 months, car financing 48 months, real estate 5 years and commercial financing generally 2-3 years. Their sight deposits are 3x covered by cash. One example of retail financing is a season ticket for Arsenal football club, for which Secure Trust Bank is receiving a discount by the club of at least 7% to finance the ticket over the 10 months duration.

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Secure Trust Bank New Business Lending

Category in mio £	FY 2019	FY 2020	FY 2021	FY 2022
Retail Finance	726	614.5	771.5	1,124
Vehicle Finance	183.3	78.6	199.8	401.7
Commercial Finance	162.2	126.1	93.7	157.3
Real Estate Finance	316.1	189.5	376.1	384.5
Total lending	1,388	1,009	1,441	2,068

Source: Secure Trust Bank

Secure Trust Bank Deposits

Category	FY 2019	FY 2020	FY 2021	FY 2022
Term deposits	64%	54%	46%	56%
Notice deposits	33%	35%	37%	20%
ISA deposits	2%	7%	12%	17%
Sight deposits	1%	4%	5%	7%

Category in mio £	FY 2019	FY 2020	FY 2021	FY 2022
Term deposits	1,296	1,076	967	1,408
Notice deposits	664	697	778	503
ISA deposits	38	139	252	428
Sight deposits	23	80	105	176
Total deposits	2,020	1,992	2,103	2,515

Source: Secure Trust Bank

Good margins, low impairments

FY 2022 has seen a decline in net interest margins from 6.1% to 5.7%. While this is overall negative, the new business lending balances have meanwhile increased by over 43%, therefore leading to higher profits overall. Impairments have climbed year-on-year due to exceptionally low impairments during Covid, but the impairments remain below pre-pandemic levels. However, if we were to apply 2019 impairment levels to 2022 new lending balances, profitability would remain high with a price/earnings ratio of just below 10 vs. 3.5 at the moment.

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Margins remain at a healthy level

Category	FY 2019	FY 2020	FY 2021	FY 2022	Target FY 23
Lending book CAGR			12.2%	15.6%	15%+
Net interest margin	6.5%	6.3%	6.1%	5.7%	>5.5%
Cost income ratio	56.9%	55.1%	60.0%	55.0%	<50%
Return on average equity	12.8%	6.1%	15.9%	10.7%	14%-16%

Source: Secure Trust Bank

Impairment charges on new lending balances remain low

Category	Impairment charge FY 19	Cost of risk FY 19	Impairment charge FY 20	Cost of risk FY 20	Impairment charge FY 21	Cost of risk FY 21	Impairment charge FY 22	Cost of risk FY 22	FY 19 impairment on FY 22 balance
Retail Finance	19.5	2.7%	15.9	2.6%	4.6	0.6%	14.6	1.3%	30.2
Vehicle Finance	12.5	6.8%	25.2	32.1%	-1	-0.5%	20.5	5.1%	27.4
Commercial Finance	0.1	0.1%	5.2	4.1%	0.1	0.1%	1.3	0.8%	0.1
Real Estate Finance	0.1	0.0%	1.1	0.6%	-0.2	-0.1%	0.8	0.2%	0.1
Subtotal	32.2	1.6%	47.4	2%	3.5	0.2%	37.2	1.4%	57.8

Source: Secure Trust Bank

Strong capital ratios

Despite the growth in lending balances, Secure Trust Bank has been able to increase their capital ratios, or at least kept it relatively stable over the last few years. The new Tier 2 subordinated bond of £90mio (£40mio more than the expired bond) will further boost the capital ratios and enable more growth. Although the interest rate on the new subordinated bond is very high at 13% and increase the interest expense by around £8.325mio, this will be more than offset by higher lending balances at above 5.5% net interest margins (£13.75mio extra income as £40mio extra capital is equivalent to £250mio extra lending at 16% capital ratio applied).

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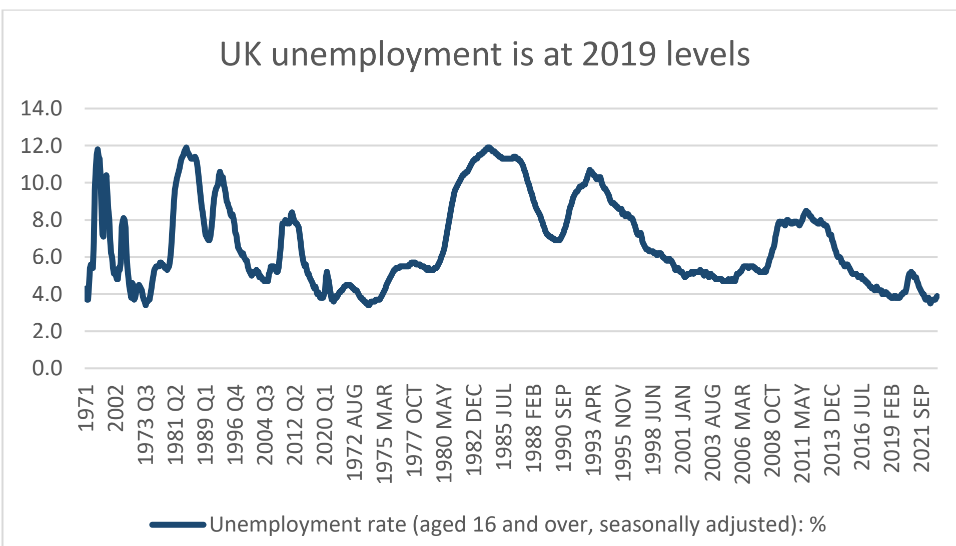
Strong capital ratios well above the requirements

Category	FY 2019	FY 2020	FY 2021	FY 2022	Requirement
CET1 ratio	12.7%	14.2%	14.5%	14%	8.6%
Total Capital ratio	15%	16.4%	16.8%	16.2%	12.5%
Elibigle Tier 2	£50mio	£45.1mio	£47mio	£49.9mio	
Total Capital ratio	£318mio	£328.8mio	£350.6mio	£377.3mio	
Leverage ratio	9.8%	10.4%	10.3%	11%	3.25%
RWAs	£2.1bn	£2bn	£2.1bn	£2.3bn	

Source: Secure Trust Bank

Low unemployment

In order for impairments to significantly increase, the unemployment rate needs to increase substantially. During Covid there have been higher impairment charges (in 2020), which were quickly reversed. Monzo increased their consumer lending aggressively over the last year, leading to a doubling of revenue to £355.6mio according to the FT. This has led their impairment charges to increase from £14mio to £104mio on £759.7mio lending balances. Secure Trust Bank has consumer lending balances of £1,427.6mio and revenues of only £135.4mio, which shows the much stronger credit quality Secure Trust Bank is lending to. Metro Bank, a competitor of Secure Trust Bank, has much lower capital ratios and therefore is unable to increase their lending, which enables Secure Trust Bank to capture more market share. Overall, the current market valuation of Secure Trust Bank is near its all-time low during the Covid crisis. This does not seem justified, even if we face climbing unemployment and a potential recession.



Source: ONS

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