Manx Financial Group

Record PBT driven by niche growth strategy

FY22 results

Banking

Manx Financial Group (MFG) has delivered impressive growth in a weak economy through its strategy of investing in niche markets. PBT rose 71% to a record £5.2m and net attributable profit rose 55% to £4.3m due to a combination of organic growth and an initial contribution from 50%-owned Payment Assist (PAL). Return on equity (ROE) expanded to 15.9% from 11.8% in 2021. PAL was consolidated for just over three months and contributed 13.5% of PBT in FY22. Hence, we calculate a pro-forma PBT run-rate of c £6–7m in FY22. Furthermore, MFG continues to enjoy positive momentum within its chosen scalable and economically resilient high-return businesses.

Year end	Operating income (£m)	PBT (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/19	16.5	3.0	1.66	0.00	14.5	N/A
12/20	16.4	2.0	1.37	0.00	17.5	N/A
12/21	20.0	3.0	1.97	0.24	12.2	1.0
12/22	26.1	5.2	3.15	0.38	7.6	1.6

Note: *EPS is fully diluted.

Growth unhindered by macro environment

Despite an uncertain macroeconomic environment, MFG continues to grow both organically and through acquisitions that fit its strict criteria. Total loan balances for the group increased £62.2m to £291.5m. Despite absorbing additional staff from the acquisition of PAL and hiring in anticipation of being granted a UK deposit-taking licence, the group's PBT reached a record £5.2m. Net attributable profit for the year increased to £4.3m versus £2.8m in FY21 and a dividend of 0.3764p/share has been recommended for shareholder approval (FY21: 0.2443p/share). Credit risk appears well under control as gross loans 30 days' overdue remain in line with FY21 at 10.8% of the book (FY21: 10.7%).

PAL to boost earnings and ROE in 2023

MFG completed its purchase of a 50.1% stake in PAL on 21 September 2022. PAL contributed £3.4m in revenues and £0.7m in pre-tax profit to the group in FY22. Using either MFG's disclosed full year PBT for PAL of £1.5m or the actual three months' annualised profit would imply a pro-forma profit range for the group of £6–7m (15–35% above reported FY22 PBT). Moreover, MFG is experiencing good organic growth in its structured lending business as it continues to expand its operations in the UK. Approval of a UK deposit licence would provide the group with additional flexibility in funding its rapid growth.

Valuation: P/BV of 1.35x with ROE of 15.9%

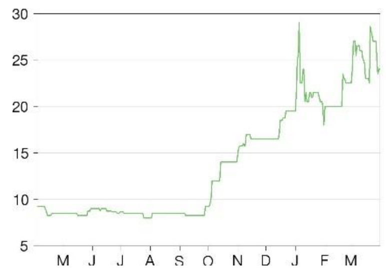
Using FY22 results, MFG currently trades at a price to book value (P/BV) ratio of 1.35x (1.01x using undiluted shares outstanding) and has an ROE of 16%, above the FY18–22 average of 12.5% and at the top end of our chosen peer group. Annualising the three-month run-rate profit for PAL would imply an ROE of 19% for FY22. We believe that MFG's premium rating to peers is justified due to its higher profitability.

3 April 2023

Price	**24p**
Market cap	**£28m**

Common Equity Tier 1 (CET1) ratio	12.4%
Shares in issue	115.1m
Free float	40.8%
Code	MFX
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	6.7	9.1	159.5
Rel (local)	10.4	6.9	161.3
52-week high/low		29p	8p

Business description

Manx Financial Group is an Isle of Man based diversified financial services group. Through its subsidiaries such as Conister Bank and Payment Assist, the group operates in resilient niche lending and financing markets in both the UK and the Isle of Man.

Next events

AGM	May 2023

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FY22 results

Exhibit 1 details the key profit and loss items over recent years and the half years for FY22.

During 2022, MFG grew its loan book by 27% to £291.5m (FY21: £229.3m), as the consolidation of PAL augmented the robust organic growth across the majority of the group; excluding the three-month contribution from PAL, PBT would have grown 48% y-o-y.

Despite the cost of deposits increasing to 2.4% (FY21: 1.5%), as the Bank of England raised interest rates, the group's net interest margin (NIM or NII/average assets) improved to 7.1% (6.2% in FY21). This is the result of the consolidation of PAL (which has higher margins) and higher utilisation of the deposit base underlined by the loan-to-deposit ratio increasing to 95.8% from 90.4%.

Net fee income decreased 10% y-o-y to £1.2m, although this made a small 4.5% contribution to overall core operating income. Commissions in the Edgewater Associates Independent Financial Advisory (IFA) business declined due to weak investor sentiment and activity. Commission expense was also affected by the acquisition of PAL, accounting for 11.7% of interest income, roughly in line with the 11.5% in H122. Commission income growth at subsidiaries Conister Bank (+15.7%) and MFX (+14.1%) was not enough to offset the above factors.

Exhibit 1: Selected figures, FY18–22

£'000s	H122	H222	FY18	FY19	FY20	FY21	FY22
Net interest income (NII)	10,532	13,820	15,568	17,929	15,470	17,980	24,352
Net fee income	986	164	(2,738)	(1,630)	384	1,282	1,150
Depreciation on leasing assets	(16)	0	0	(333)	(406)	(269)	(16)
Core operating income	11,502	13,984	12,830	15,966	15,448	18,993	25,486
Other operating income	275	39	131	388	200	365	314
Gains on securities and asset revaluations	(113)	386	205	178	757	689	273
Total operating income	11,664	14,409	13,166	16,532	16,405	20,047	26,073
Operating expenses	(7,059)	(9,831)	(9,748)	(11,632)	(11,394)	(12,789)	(16,890)
Operating profit before impairments	4,605	4,578	3,418	4,900	5,011	7,258	9,183
Impairment on loans and advances to customers	(2,268)	(1,722)	(857)	(1,900)	(3,950)	(4,360)	(3,990)
Associates profit	0	18	30	124	54	32	18
VAT recovery	0	0	119	(101)	906	113	0
Profit before tax	2,337	2,874	2,710	3,023	2,021	3,043	5,211
Income tax expense	(160)	(377)	(243)	(350)	(53)	(234)	(537)
Net profit	2,177	2,497	2,467	2,673	1,968	2,809	4,674
Minority interests	(16)	(327)	0	0	(33)	(16)	(343)
Net attributable profit	2,161	2,170	2,467	2,673	1,935	2,793	4,331
Key ratios (%, else stated)							
NIM (NII/average assets)	6.7	7.9	8.4	8.0	5.9	6.2	7.1
Impairment provision % average loans	1.9	1.3	0.6	1.2	2.1	2.1	1.5
Cost income ratio	60.5	68.2	74.0	70.4	69.5	63.8	64.8
ROE	16.7	15.4	13.3	12.7	8.7	11.8	15.9
Loan as % deposits	96.6	95.8	93.6	85.4	88.5	90.4	95.8
Total capital ratio (%)	17.7	17.7	18.1	16.9	19.1	19.1	15.3
Stage 3 loans as % of net loans	4.4	5.1	0.7	3.5	7.2	4.4	4.5
Stage 3 loans as % of gross loans	7.7	8.2	2.7	5.7	10.2	7.7	8.8
Loans (£'000s)	244,923	291,475	148,278	179,370	193,143	229,251	291,475
Equity (£'000s)	26,987	29,770	19,723	22,319	22,435	24,985	29,770

Source: Manx Financial Group, Edison Investment Research

Total operating expenses for the business increased 32% to £16.9m (£12.8m), mainly from an increase in personnel costs (including an additional one-off £200 per employee to provide support during the cost-of-living crisis) following the acquisition of PAL and hiring in readiness for expected approval of a UK deposit-taking licence. Expenses were also affected by IT investments to improve operational efficiency.

Looking at H2 versus H1, operating profits before impairments were roughly flat at £4.6m mostly as a result of the notable cost items above.

Profit before tax for the company reached a record £5.2m (FY21: £3m) and post minority interest (nearly all the 49.9% that MFG does not own of PAL) net income attributable to shareholders for the year totalled £4.3m, up from £2.8m in the previous year.

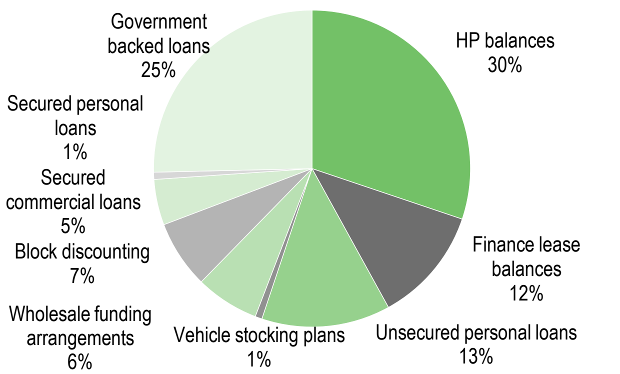
Improved profitability had a positive impact on average ROE, which increased to 15.9% versus 11.8% the prior year.

MFG's subsidiary Conister Bank remains well capitalised with a CET1 ratio of 12.4% (FY21: 15.2%), well above the minimum requirement of 8.5%. The fall in CET1 is a result of the PAL acquisition and we would expect this to rebuild rapidly due to the group's high ROE and low dividend payout. Consistent with the board's policy to reward shareholders with 10% of group profit in cash and shares, a dividend of 0.3764p/share has been recommended to shareholders (FY21: 0.2443p/share).

Stable credit risk trends

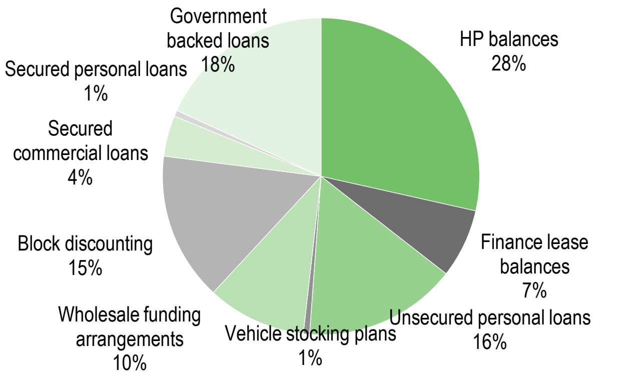
The group has taken a conservative approach to credit risk in recent years, moving away from unsecured lending towards secured. Currently only 16% of the book is in unsecured personal loans (albeit this slightly increased with the acquisition of PAL). Hire purchase (HP), finance leases, vehicle stocking plans, block discounting, secured commercial, personal loans and wholesale funding arrangements are all secured.

Exhibit 2: Gross loan breakdown FY21



Source: Manx Financial Group, Edison Investment Research

Exhibit 3: Gross loan breakdown FY22



Source: Manx Financial Group, Edison Investment Research

Exhibits 2 and 3 illustrate the change in loan mix over the year. Following the PAL acquisition, unsecured personal loans have risen somewhat from 13% to 16% of the loan book. However, in the context of a highly secured book overall, this is not very significant and we note the impairment allowance has increased to 4.7% of gross loans (FY21: 3.7%).

Total gross loans and advances in FY22 were £305.7m. Of those loans, £27.0m are in stage 3 (the highest risk of default) and overdue 30 days, representing 8.8% of total gross loans (see Exhibit 4) and up from 7.7% the previous year. Stage 3 loans are 52% covered by impairment reserves, which rises to 100% including £12.9m collateral held (FY21: 108%). Total gross loans overdue 30 days amount to £31.4m or 10.3% of total gross loans, remaining in line with FY21 (see Exhibits 5 and 6). Overall, we conclude asset quality remains well managed and stable and consistent with 2021.

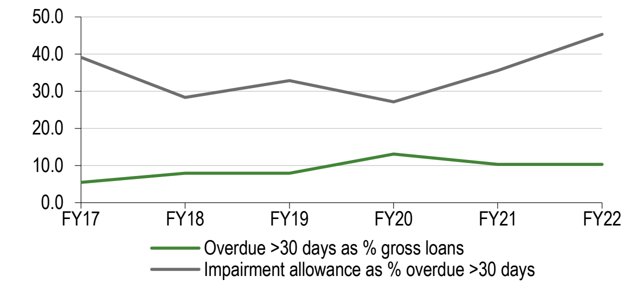
Note: Stage 1 loans are not deemed credit impaired with payments up to date to 30 days. Stage 2 loans are not deemed credit impaired but payments are over 30 days overdue. Stage 3 loans are deemed credit impaired and payments are more than 90 days overdue. Grade A loans are the lowest risk within each stage, while Grade C are the highest risk.

Exhibit 4: Credit quality analysis

	2022				2021			
£'000	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Grade A	273,332	-	-	**273,332**	213,102	-	-	**213,102**
Grade B	-	5,006	9,347	**14,353**	-	5,735	5,594	**11,329**
Grade C	391	-	17,622	**18,013**	342	541	12,656	**13,539**
Allowance for impairment	**(303)**	**(3)**	**(13,917)**	**(14,223)**	**(503)**	**(124)**	**(8,092)**	**(8,719)**
Carrying value	273,420	5,003	13,052	**291,475**	212,941	6,152	10,158	**229,251**
Impairment coverage	0%	0%	52%	**5%**	0%	2%	44%	**4%**
Current	269,130	-	-	**269,130**	210,491	-	-	**210,491**
Overdue < 30 days	4,593	604	-	**5,197**	2,953	-	-	**2,953**
Overdue > 30 days	-	4,402	26,969	**31,371**	-	6,276	18,250	**24,526**
Total	273,723	5,006	26,969	**305,698**	213,444	6,276	18,250	**237,970**
Collateral	-	-	12,927	-	-	-	11,625	-
Collateral coverage	-	-	48%	-	-	-	64%	-
Total impairment and collateral coverage	-	-	100%	-	-	-	108%	-

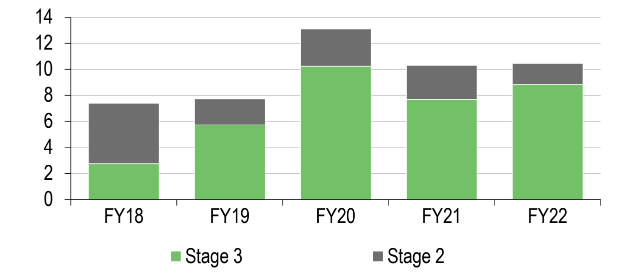
Source: Manx Financial Group, Edison Investment Research

Exhibit 5: Overdue loans and impairment allowance



Source: Manx Financial Group, Edison Investment Research

Exhibit 6: Stage 2 and 3 as a % of gross loans



Source: Manx Financial Group, Edison Investment Research

Conservative interest rate risk

The recent failure of Silicon Valley Bank (SVB) has focused investor attention more acutely on liquidity and interest risk management in financial institutions. MFG maintains a very conservative risk profile compared to peers, with a mostly fixed-term deposit book matching its fixed-term loan book (ie no material mismatch).

Exhibit 7 shows the maturity profile of the assets and liabilities is well matched with a short aggregate duration. 40% of assets and 32% of liabilities reprice within six months. 54% of assets and 65% of liabilities reprice within one year.

Exhibit 7: Maturity of assets and liabilities at the reporting date (£'000)

Maturity of assets and liabilities at the reporting date	**Sight – 1 month**	**>1 month – 3 months**	**>3 months – 6 months**	**>6 months – 1 year**	**>1 year – 3 years**	**>3 years – 5 years**	**>5 years**	**Total**
Assets	53,715	48,698	48,647	53,599	106,755	51,316	16,531	**379,261**
Liabilities	17,908	28,052	67,537	115,960	99,611	19,833	590	**349,491**
Coverage								
Asset/Liabilities	200%	74%	-28%	-54%	7%	159%	2702%	
Asset/Total Assets	14%	13%	13%	14%	28%	14%	4%	**100%**
Liabilities/Total Liabilities	5%	8%	19%	33%	29%	6%	0%	**100%**

Source: Manx Financial Group, Edison Investment Research

Exhibit 8 shows that on a cumulative basis the group is slightly liability sensitive up to three years by just over £12m or only 3% of total assets. Conister Bank has a significant proportion of term deposit funding compared to a typical high-street bank. The bank's interest rate disclosure in accordance with FSA reporting standards shows that an instantaneous 2% increase in interest rates benefits net interest income by £1.08m or only 3% of revenues.

Exhibit 8: Interest rate risk (£'000)

	Sight – 1 month	>1 month – 3 months	>3 months – 6 months	>6 months – 1 year	>1 year – 3 years	>3 years – 5 years	>5 years	Non-interest bearing	Total
Assets	53,593	48,698	48,647	47,813	106,755	46,176	3,098	24,481	**379,261**
Liabilities and equity	17,908	28,052	67,537	104,466	99,611	19,833	237	41,617	**379,261**
Interest rate sensitivity gap	**35,685**	**20,646**	**(18,890)**	**(56,653)**	**7,144**	**26,343**	**2,861**	**(17,136)**	
Cumulative	**35,685**	**56,331**	**37,441**	**(19,212)**	**(12,068)**	**14,275**	**17,136**		

Source: Manx Financial Group, Edison Investment Research

Looking ahead into 2023

The end of 2021 marked the beginning of global interest rate rises. In the UK, rates rose from 0.1% to 3.5% by the end of 2022. Given recent events in the banking sector and the lagged impact of monetary policy on the economy, there is continued potential for additional economic and market turbulence. On the other hand, the most bearish economic forecasts for the UK are moderating and the Office for Budget Responsibility (OBR) currently expects the UK to avoid a technical recession (two successive quarters of negative GDP growth) in 2023, with GDP growth for the year as a whole of -0.5%.

MFG has been growing its business despite the uncertain backdrop, through a strategy of operating in niche or underserved markets, but which are large in relation to the size of MFG and have demonstrated the ability to generate high returns through varying economic cycles. This strategy appears to have been validated considering the growth the company has achieved in the past several years, during which markets and economies have endured a series of disruptive events (Brexit, COVID-19, Ukraine war, rapid reversal of monetary policy, the UK 'fiscal event' fallout, accelerating inflation and interest rates, etc).

MFG's management sees ample scope to continue to pursue its growth strategy on an organic basis and through selective acquisitions.

Further upside optionality of Payment Assist

The recent acquisition of PAL is a good example of how MFG is rapidly building out its franchise without taking excessive risk. MFG has been familiar with PAL for some years as it has been providing finance to it through Conister bank. This has allowed MFG management to gain a good understanding of the business.

PAL is the UK's leading automotive repair point-of-sale finance provider and distributes through prominent national organisations such as Halfords and Formula One. There are additional organic growth opportunities in insured products (eg warranties) and retail as well as the core market, which is still quite fragmented, according to management. Expansion into new areas will take advantage of using trusted partners to mitigate risk.

PAL helps customers spread one-off or larger costs over relatively short time frames. Thus, the loan book is short duration and granular, and problems with individual customers can be identified early and action taken. The short duration loan book enhances the credit management process through fast identification of potential payment problems and subsequent loss mitigation. PAL performed well during the COVID-19 pandemic and, with a similar current squeeze on household incomes from persistent inflation, we would expect a similar resilient demand for PAL's financing services.

PAL has an attractive business model. The average loan duration is c 10 months. This means PAL is able to turn its loan book over 1.2 times on attractive one-year funding from Conister Bank.

Management maintains strict risk management policies, writing off debt over three months past due. Currently, write-off volumes remain low as vehicles remain an essential means of transport for many households.

The economics of the deal appear highly favourable: the initial 50.1% stake cost £4.2m in cash, which compares with an annualised attributable profit contribution of c £1.1m based on the three months of PAL contribution in FY22. This represents an annualised 26% return on investment and immediate earnings accretion.

Rather than buy out the whole of PAL in one transaction, MFG has retained an option to buy the remaining 49.9% stake for a variable cash consideration of only two times average net profit, capped at £5m. The option can be exercised before PAL declares a dividend for FY26, which gives MFG time to rebuild the capital required to finance the deal through retained earnings.

The acquisition of the remaining 49.9% looks to be a potentially attractive option that could provide the company with further upside in earnings.

We outline below how the other two main business areas within MFG are similarly performing strongly during the current difficult economic environment.

Conister Bank: Anticipating a UK deposit-taking branch

During FY22, Conister Bank continued to grow its lending, adding £57.7m to its loan book totalling £292.1m (FY21: £234.4m). The bank retains a strong customer base in the Isle of Man (IOM). Lending to customers and small and medium enterprises (SMEs) reached a record £50.5m (FY21: £42.9m) with over 65% originating from the online portal (FY21: 60%).

Loan quality also remains stable as loans overdue by 30 days are in line with FY21 at 10.3% of gross loans and just above the five-year average of 9.9%.

The bank has shifted to secured lending over the past few years. Thus, Conister Bank was able to increase its structured lending in the UK by 34.8% to £150m (FY21: £114.1m), and at the same time hold lower loss provisions due to the collateral support.

To diversify funding and support its growth ambitions on the UK mainland, Conister Bank applied for a UK deposit-taking licence in October 2022. The regulator’s go-ahead is still pending, but the bank’s management has shown its confidence in the approval process by already staffing up operations and incurring an extra £1m in personnel expenses. The UK branch would give Conister Bank more flexible funding options and access to cheaper deposits to support its ambitions to grow in the UK, according to management.

The growth potential and relatively large addressable markets in its chosen lending segments have led management to guide to increased lending in H123 in comparison to H122. Through its structured finance lending in the UK and strong reputation in the Isle of Man, the group is well positioned to expand its activity in the UK in niche markets, be it organically or through acquisitions.

MFX

MFX Limited is the subsidiary of MFG that provides access to competitive foreign exchange and international processing facilities, serving predominantly SMEs in the IOM. Increases in global interest rates have resulted in increasing currency and interest rate volatility, on which MFX was able to capitalise. In FY22, MFX generated £1.74m in fee and commission income (FY21: £1.53m), generating a pre-tax return on assets of 260%, above the five-year average of 171%. This highly cash-generative business provides a useful counter-cyclical benefit to the group during periods of market and economic volatility.

Valuation

Currently, there are no consensus forecasts for MFG. Exhibit 9 shows the market's current relative valuation of the peer group based on 2022 figures. In our valuation we compare current price to FY22 book value (P/BV) against both reported ROE and an adjusted FY22 ROE figure using the three-month annualised contribution from PAL.

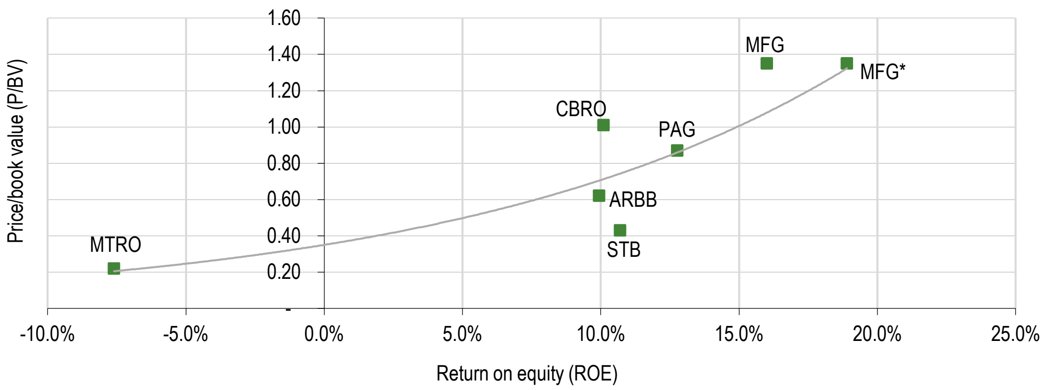
MFG shares trade at a P/BV ratio of 1.35x, calculated using a diluted share count. On a non-diluted basis, the P/BV for MFG is 1.01x. MFG trades at a premium to peers, which we believe is supported by a higher profitability on an ROE basis compared to the peer group (see Exhibit 9). Considering MFG's FY18–22 ROE averaged 12.5%, the group remains attractively priced at book value.

Using either MFG's disclosed full year PBT for PAL of £1.5m or the actual three months' annualised profit would imply a pro-forma profit range for the group of £6–7m (15–35% above reported FY22 PBT).

In Exhibit 9, MFG* is the pro-forma figure for FY22 based on the actual three-month profit contribution from PAL.

Based on these assumptions, the implied adjusted FY22 ROE for MFG is 19%. Using the current valuation of 1.35x P/BV, and the reported 2022 ROE of 15.9%, the market is currently pricing in a cost of equity (COE) of 11.8% (COE = ROE/PBV) with no implied growth. Conservatively assuming zero growth, the same COE of 11.8% and adjusted FY22 ROE of 19%, the implied P/BV would be 1.61x, which is 19% above the current P/BV ratio.

Exhibit 9: Peer group P/BV ratio versus ROE using 2022 financials



Source: Company accounts, Refinitiv, Edison Investment Research. Note: PAG using company underlying figure. MFG* includes annualised figures for PAL. Priced at 3 April 2023.

Exhibit 10: Financial summary

Year-end 31 December	FY18	FY19	FY20	FY21	FY22
£m except where stated					
Profit and loss					
Net interest income	15,568	17,929	15,470	17,980	24,352
Net commission income	(2,738)	(1,630)	384	1,282	1,150
Other income	336	233	551	785	571
Total operating income	**13,166**	**16,532**	**16,405**	**20,047**	**26,073**
Total operating expenses	(9,748)	(11,632)	(11,394)	(12,789)	(16,890)
Operating profit pre impairments & exceptionals	3,418	4,900	5,011	7,258	9,183
Impairment charges on loans	(857)	(1,900)	(3,950)	(4,360)	(3,990)
Associates	30	124	54	32	18
VAT recovery	119	(101)	906	113	0
Operating profit post impairments	**2,710**	**3,023**	**2,021**	**3,043**	**5,211**
Non-recurring items	0	0	0	1	0
Profit before tax	**2,710**	**3,023**	**2,021**	**3,044**	**5,211**
Corporation Tax	(243)	(350)	(53)	(234)	(537)
Tax rate	9%	12%	3%	8%	10%
Profit after tax	2,467	2,673	1,968	2,810	4,674
Minority interests	0	0	(33)	(16)	(443)
Net income attributable to equity shareholders	**2,467**	**2,673**	**1,935**	**2,794**	**4,331**
Shares and per share ratios					
Average basic number of shares in issue (m)	131.1	131.1	119.0	114.3	114.8
Average diluted number of shares in issue (m)	172.8	172.8	155.5	150.8	153.8
Period end shares in issue (m)	131.1	131.1	114.1	114.3	115.1
Reported diluted EPS (p)	1.54	1.66	1.37	1.97	3.15
Reported DPS (p)	0.00	0.00	0.00	0.24	0.38
NAV per share (p)	11.4	12.9	14.4	16.6	19.4
Tangible NAV per share (p)	8.9	9.4	10.1	10.7	10.7
Income ratios and per share					
Net interest/average loans	11.5	10.9	8.3	8.5	9.4
Impairments /average loans	0.6	1.2	2.1	2.1	1.5
Cost income ratio	74.0	70.4	69.5	63.8	64.8
Return on average equity	13.3	12.7	8.7	11.8	15.9
Return on average TNAV	17.2	16.9	12.3	17.6	28.6
Balance sheet					
Net customer loans	148,278	179,370	193,143	229,251	291,475
Other assets	48,636	73,517	74,818	79,502	87,786
Total assets	196,914	252,887	267,961	308,753	379,261
Total customer deposits	158,500	209,933	218,285	253,459	304,199
Other liabilities	18,691	20,635	27,241	30,309	45,292
Total liabilities	177,191	230,568	245,526	283,768	349,491
Net assets	19,723	22,319	22,435	24,985	29,770
Minorities	0	0	84	56	189
Shareholders' equity	19,723	22,319	22,351	24,929	29,581
Reconciliation of movement in equity					
Opening net assets					
Profit in period	2,467	2,673	1,968	2,809	4,674
Other comprehensive income	(6)	(77)	(292)	236	538
Ordinary dividends	0	0	0	(185)	(217)
Minority changes from subsidiaries	0	0	(1,560)	(310)	(210)
Closing net assets	19,723	22,319	22,435	24,985	29,770
Balance sheet ratios					
Loans as % deposits	93.6	85.4	88.5	90.4	95.8
Loans to equity (x)	7.5	8.0	8.6	9.2	9.7
Stage 3 as % loans	0.7	3.5	7.2	4.4	4.5
Impairments as % stage 3 loans gross	81.5	45.3	34.7	47.8	52.7
Total capital ratio (%)	18.1	16.9	19.1	19.1	15.3

Source: Manx Financial Group, Edison Investment Research

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