

Manx Financial Group

FY22 interims

Strong H122, well positioned for macro headwinds

Manx Financial Group (MFG) had a strong H122, with a PBT of £2.3m more than doubling and a return on average equity (ROE) of 16.8%. Loans grew 16% as the group continues to reposition itself into prime lending segment ahead of the more challenging macroeconomic environment. The net interest margin improved to 8.9% (8.5% in H121) and impairments remain under control with an annualised charge of 1.9% (2.1% in H121). Conister Bank (MFG's bank) has formally applied for a UK branch deposit-taking licence on 25 October. This will give this Isle of Man bank a greater foothold in the UK for growth. The balance sheet is well capitalised (total capital 17.7%, CET1 of 14.2%) and still carries surplus liquidity to fund expansion plans. The bank is trading at an FY21 P/BV of only 0.8x despite its track record of ROE being above its cost of equity (COE, which we estimate at 10–11%) and ability to expand its balance sheet.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/18	13.2	2.7	1.5	0.00	9.3	N/A
12/19	16.5	3.0	1.5	0.00	9.3	N/A
12/20	16.4	2.0	1.2	0.00	11.7	N/A
12/21	20.0	3.0	1.9	0.17	7.4	1.2

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

Good momentum

The bank has positioned itself well to take advantage of recession resilient markets both in the UK and the Isle of Man. It has also been accredited by the British Business Bank to support UK SMEs through their government guaranteed loan schemes. And while the volatile markets have hurt MFG's financial advisory business, its foreign exchange segment has done quite well. In September the group completed its acquisition of Payment Assist, the UK's leading provider of auto repair point-of-sale finance, with a fast-growing loan book of £21.3m (9% of MFG).

Positioned for growth

Management has been moving into more prime, recession-proof sectors since the 2016 Brexit vote to both protect and allow for future loan growth. At the same time, the bank remains confident in its strategy mix of organic growth and acquisitions. A UK deposit banking licence will open greater avenues for growth, both in terms of business opportunities and funding.

Valuation: P/BV of 0.8x, with ROEs well above COE

There are no consensus forecasts for MFG, but its strong loan book and track record of growth bodes well for future revenue. MFG is trading at a P/BV of only 0.8x, which seems low given its track record of delivering ROEs above its COE (we estimate this at 10–11%). Its trailing FY21 P/E of 7.8x does not seem demanding, given the bank's strong growth profile and potential. UK bank valuations are being affected by market concerns regarding macroeconomic and political uncertainty.

Banking

1 November 2022

Price **14p**
Market cap **£16m**

Core Equity Tier I (CET1) ratio* 14.2%

*As at 30 June 2022

Shares in issue 115.0m

Free float 50%

Code MFX

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	51.4	75.0	64.7
Rel (local)	50.0	84.3	76.7
52-week high/low		14p	8p

Business description

Manx Financial Group PLC is the holding company of a diversified financial services group which includes Conister Bank Limited, Conister Finance & Leasing Limited, MFX Limited, Blue Star Business Solutions Limited and Edgewater Associates Limited.

Next events

Trading update November 2022

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H122: PBT doubled

16% loan growth

MFG loan balances grew 16% y-o-y as MFG continued its strategy of repositioning towards the prime lending segment. The group reported that prime lending as a percentage of the total rose from 78.5% at the end of FY21 to 85%.

A key driver for loan growth has been the COVID-19 related government business support loans. Conister Bank has applied to continue participating in the government's extension of the Recovery Loan Scheme, although it is likely that growth in this segment will slow down; additionally, it is dependent on government plans and policies. Wholesale funding arrangements and block discounting (structured product that allows companies to release money tied in commercial agreements with clients) have also been growing strongly.

Conversely, hire purchase and financial leases have continued to decline – they fell 9% and 32% y-o-y. This trend was expected and reflects the repositioning.

Despite the de-risking, the net interest margin has remained resilient and increased from 8.5% at end-June 2021 to 8.9% as a percentage of average loans.

Asset quality stable

Asset quality seems to be remaining under control. Impairment charges as a percentage of loans were 1.9% in H122; this compares with 2.1% in H121. Stage 3 loans as a percentage of net loans were 10.8% in H122, similar to end-June 2021 (10.4%). Impairments were 41% of stage 3 gross loans. This compared with 36% a year ago and 48% recorded at the end of FY21. About 76% of loans are collateralised.

Loans more than 30 days overdue were 10.7% of net loans, and this figure has been relatively stable over the last 12 months.

ROE of 16.8%

The doubling of net earnings in H122 resulted from a combination of strong revenue growth of 30%, while operating expenses rose 20% and impairment charges 6%. The reported ROE of 16.8% followed the 14.9% for the second half of FY21. In previous years, ROE has been relatively resilient and robust, at between 9% and 13%.

The market volatility adversely affected MFG independent financial advisory business and this has hurt fee income. Conversely, foreign exchange advisory business has benefited from the same. Manx FX's revenue grew 6% and PBT by 5% y-o-y.

Healthy balance sheet

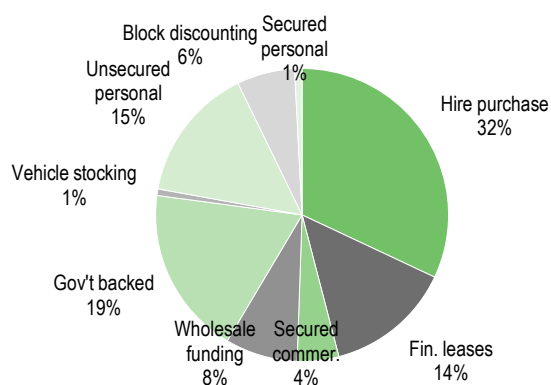
MFG's balance sheet remains robust, and this is helped by the bank's good profitability and capital headroom. The group can afford the 10% pay-out ratio started in 2021 without it materially interfering in MFG's ability to grow and seize opportunities. MFG's total capital ratio was 17.7% as at 30 June 2022 (it was 17.8% a year ago), while the regulator requires 14%. MFG's CET1 ratio of 14.2% is also comfortable and higher than a year ago (13.7%) despite the balance sheet expansion.

Balance sheet liquidity remains fine and MFG benefits from a good retail deposit base in the Isle of Man and will be further bolstered by the ability to market for UK deposits assuming their branch banking licence is approved. Its loan to deposit ratio was 99% at the end of H122.

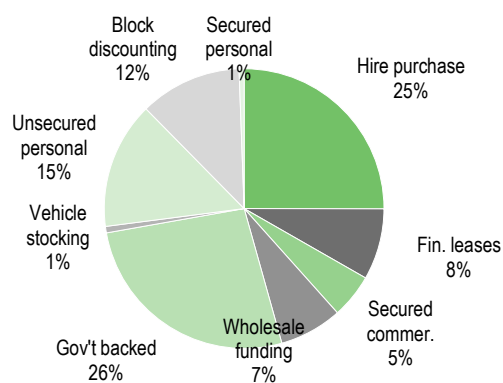
Exhibit 1: H122 vs previous interims – selected numbers

	H119	H120	H121	H122	H122 vs H121 (%)
Net interest income	8,877	7,811	8,555	10,532	23.1
Net fee income	(1,118)	287	478	986	106.3
Fee and commission expense	(2,934)	(1,870)	(1,878)	(1,517)	(19.2)
Depreciation on leasing assets	0	(203)	(173)	(16)	(90.8)
Core operating income	7,759	7,895	8,860	11,502	29.8
Other operating income	139	111	129	275	
Gains on securities and asset revaluations	104	455	(1)	(113)	
Total operating income	8,002	8,461	8,988	11,664	29.8
Operating expenses	(5,211)	(5,503)	(5,879)	(7,059)	20.1
Operating profit before impairments	2,791	2,958	3,109	4,605	48.1
Impairment on loans and advances to customers	(1,469)	(1,895)	(2,142)	(2,268)	5.9
Associates profit	46	(91)	59	0	
VAT recovery	52	36	113	0	
Profit before tax	1,420	1,008	1,139	2,337	105.2
Income tax expense	(184)	(16)	(122)	(160)	
Net profit	1,236	992	1,017	2,177	114.1
Minority interests	0	5	12	(16)	
Net attributable profit	1,236	997	1,029	2,161	110.0
Key ratios and balance sheet					
NIM (NII as % average loans)	11.2	8.7	8.5	8.9	
Impairment charge % average loans	1.8	2.1	2.1	1.9	
Cost income ratio (%)	65.1	65.0	65.4	60.5	
ROE (%)	12.1	9.0	8.9	16.8	
Loan as % deposits	95.8	83.4	91.5	96.6	
Total capital ratio (%)	17.0	16.0	17.8	17.7	
Stage 3 loans as % net loans	5.2	7.2	8.3	8.5	
Stage 3 loans as % gross loans	5.0	12.7	10.4	10.8	
Impairments % stage 3 loans (net)	85.1	85.9	52.6	67.7	
Impairments % stage 3 loans (gross)	53.1	26.7	28.5	32.4	
Loans (£ thou)	170,035	181,581	211,445	244,923	15.8
Equity (£ thou)	20,986	21,870	23,133	26,987	16.7

Source: MFG

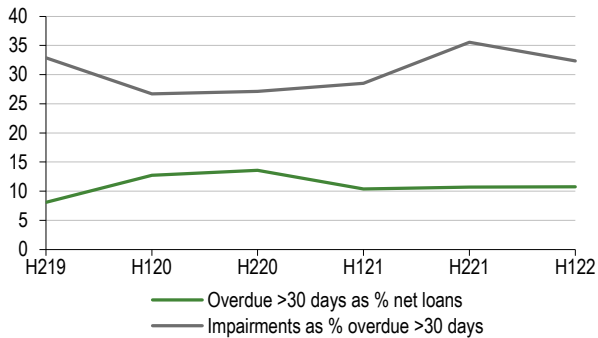
Exhibit 2: Loan breakdown (H121)


Source: MFG

Exhibit 3: Loan breakdown (H122)


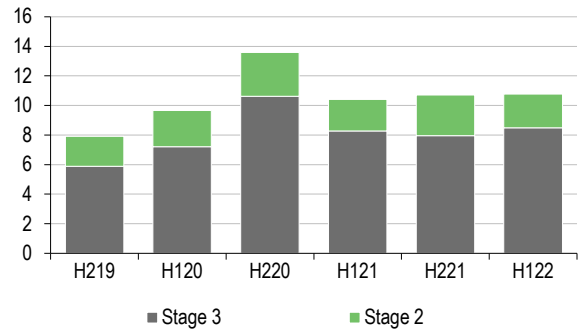
Source: MFG

Exhibit 4: Overdue loans and impairments



Source: MFG

Exhibit 5: Stage 2 and stage 3 loans as % of net loans



Source: MFG

Payment Assist acquisition completed

MFG completed the acquisition of a 50.1% stake in Payment Assist in September 2022, after announcing the deal in [May 2022](#). Payment Assist is a leading auto repair point-of-sale finance provider with a loan book of £21.3m and EBITDA of £2.5m in FY21. It is a fast-growing business (loans grew 72% and EBITDA doubled since 2019). It is a company with which MFG has worked with over the years, it knows the management well and sees both the growth opportunity and the leverage it provides as an entry to the UK.

UK deposit-taking licence via Conister Bank

Conister Bank has started the process of becoming the next deposit-taking institution in the UK and formally applied for a UK branch licence on 25 October. The bank has been expanding year-on-year, with total assets compounding over 20% per year in recent years. Obtaining a UK banking licence will allow the Isle of Man-based bank to extend its footprint in the UK. It intends to further disrupt the structured finance market and a UK branch licence, if granted, will give it a foothold in the UK deposit-taking market. In addition, it will allow the bank to gain greater access to the UK payments infrastructure as it opens up discussions with other service providers. Finally, there is the opportunity to explore more significant financial resources via government bodies such as the British Business Bank, which will only deal with UK corporations and non-financial resources, such as the UK employment market, with a specialist and diverse talent pool in the financial services industry.

2023 likely to be a challenging year

2023 is shaping up to be a challenging year. The economic slowdown is now a reality, as is the higher interest rate outlook. There is still much uncertainty to the extent of the downturn and how much rates will rise. Currently the overnight index swaps are pricing in a Bank of England policy rate of close to 5%, which would represent quite a considerable series of rate hikes in a very short period were this to happen.

Interest rate increases are often good for banks as they tend to boost interest margins. However, excessive rate hikes, especially when coupled with other issues such as a cost of living squeeze, can raise asset quality concerns for banks.

We draw comfort from the fact that MFG has been bracing itself for a recession for a couple of years, has a robust balance sheet, good interest margins and a strong franchise in the Isle of Man.

Valuation: Undemanding multiples

There are currently no consensus forecasts for MFG. However, MFG is currently trading at an FY21 P/BV of 0.8x, which is broadly comparable to banks in our peer sample that have similar resilient ROEs during the lockdown period. We note that MFG usually delivers ROEs that are above its COE (we estimate this at 10–11%). MFG P/E trailing ratios are not demanding if we factor the growth potential of a small bank such as MFG. In general, the valuations of the UK banking sector in general are currently depressed by the current macroeconomic and political uncertainty.

Exhibit 6: Challenger/specialist lender comparative table

	Price (p)	Market cap (£m)	P/E (x) FY20	P/E (x) FY21	Div. yield (%) FY 21	ROE (%) FY20	ROE (%) FY21	P/BV (x) last reported
MFX	14.37	16.5	11.6	7.8	1.2	8.8	11.8	0.80
Arbuthnot Financial	863	127	n.a	20.9	4.4	n.a.	3.2	0.64
Close Brothers	993	1473	7.7	8.6	0.0	10.0	12.4	0.90
Metro Bank	72	122	n.a	n.a	0.0	(17.9)	(16.3)	0.12
Secure Trust Bank	624	115	2.5	4.0	9.8	5.9	16.7	0.37
Paragon	427	994	12.6	8.1	6.1	9.1	12.7	0.86
Average ex-Metro & Arbuthnot			7.6	6.9	5.3	8.3	14.0	0.71
MFG versus average			53%	13%	(77%)	5%	(15%)	13%

Source: Refinitiv, Edison Investment Research. Note: Priced at 26 October 2022.

Exhibit 7: Financial summary

Year end December, £ unless stated	FY18	FY19	FY20	FY21
Profit and loss				
Net interest income	15,568	17,929	15,470	17,980
Net commission income	(2,738)	(1,630)	384	1,282
Other income	336	233	551	785
Total operating income	13,166	16,532	16,405	20,047
Total operating expenses	(9,748)	(11,632)	(11,394)	(12,789)
Operating profit pre impairments & exceptionals	3,418	4,900	5,011	7,258
Impairment charges on loans	(857)	(1,900)	(3,950)	(4,360)
Associates	30	124	54	32
VAT recovery	119	(101)	906	113
Profit before tax	2,710	3,023	2,021	3,044
Corporation Tax	(243)	(350)	(53)	(234)
Tax rate	9%	12%	3%	8%
Profit after tax	2,467	2,673	1,968	2,810
Minority interests	0	0	(33)	(16)
Net income attributable to equity shareholders	2,467	2,673	1,935	2,794
Reported underlying earnings after tax	2,467	2,673	1,935	2,794
Shares and per share ratios				
Average basic number of shares in issue (m)	131.1	131.1	119.0	114.3
Average diluted number of shares in issue (m)	172.8	172.8	155.5	150.8
Period end shares in issue (m)	131.1	131.1	114.1	114.3
Reported diluted EPS (p)	1.54	1.55	1.24	1.85
Underlying diluted EPS (p)	1.54	1.55	1.24	1.85
Ordinary DPS (p)	0.00	0.00	0.00	0.17
NAV per share (p)	11.4	12.9	14.4	16.6
Tangible NAV per share (p)	8.9	9.4	10.1	10.7
Income ratios and per share				
Net interest/average loans	11.5	10.9	8.3	8.5
Impairments /average loans	0.6	1.2	2.1	2.1
Cost income ratio	74.0	70.4	69.5	63.8
Return on average equity	13.3	12.7	8.8	11.8
Return on average TNAV	17.2	16.9	12.3	17.6
Balance sheet				
Net customer loans	148,278	179,370	193,143	229,251
Other assets	48,636	73,517	74,818	79,502
Total assets	196,914	252,887	267,961	308,753
Total customer deposits	158,500	209,933	218,285	253,459
Other liabilities	18,691	20,635	27,241	30,309
Total liabilities	177,191	230,568	245,526	283,768
Net assets	19,723	22,319	22,435	24,985
Minorities	0	0	84	56
Shareholders' equity	19,723	22,319	22,351	24,929
Reconciliation of movement in equity				
Opening shareholders' equity				
Profit in period	2,467	2,673	1,968	2,809
Other comprehensive income	(6)	(77)	(292)	236
Ordinary dividends	0	0	0	(185)
Minority changes from subsidiaries	0	0	(1,560)	(310)
Closing shareholders' equity	19,723	22,319	22,435	24,901
Balance sheet ratios				
Loans as % deposits	93.6	85.4	88.5	90.4
Loans to equity (x)	7.5	8.0	8.6	9.2
Stage 3 as % loans	2.8	5.9	10.6	8.0
Impairments as % stage 3 loans gross	81.5	45.3	34.7	47.8
Impairments as % stage 3 loans net	327.3	75.1	51.5	85.9
Total capital ratio (%)	18.1	16.9	19.1	19.1

Source: MFG

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