EDISON

Manx Financial Group

H123 results

Rapid growth tempered by margin pressure

Banks

Manx Financial Group (MFX) posted record PBT of £3m supported by record new lending of £183m in H123. Conister Bank experienced margin compression of 6% as rising interest rates were passed on to savers more quickly than borrowers. However, group net interest margin (NIM) rose 1.5 percentage points y-o-y to 8.2% as Payment Assist (PAL, currently 50.1% owned) grew rapidly. Altogether, EPS fell to 1.67p/share from 1.89p/share, and net attributable profit declined by 11% y-o-y to £1.9m. The outlook for volume growth remains positive. The anticipated approval of a UK banking licence before year-end will add further funding flexibility into FY24 and the company continues to look for synergistic acquisitions, with general insurance an area of interest.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/19	16.5	3.0	1.66	0.00	11.4	N/A
12/20	16.4	2.0	1.37	0.00	12.8	N/A
12/21	20.0	3.0	1.97	0.24	9.6	1.3
12/22	26.1	5.2	3.15	0.38	6.0	2.0

Note: *EPS is fully diluted.

Impressive loan growth expected to continue

Manx grew its loan book 40% in H123 to £343m (H122: £245m), with a loan-to-deposit ratio of 103% (H122: 97%). Net interest income (NII) grew by 56% y-o-y to £16.4m, underpinned by stronger loan volume and higher rates passed through to borrowers. Positively, asset quality remains robust, with group cost of risk (CoR) moderately increasing to 4.9% while the CoR for Conister Bank remained flat at 0.1%. Management expects total loans to reach £400m by end-FY23, 17% above H123, from organic share gains in large addressable markets, but margins will remain challenged until rates begin to fall.

Eyeing up the general insurance market

Historically, Manx has supplemented organic growth with acquisitions intended to gain exposure to niche lending markets that present opportunities of high growth. For example, its 50.1% acquisition of PAL in September 2022 has already proven to be highly accretive and is on track to adding c £1.23m in annualised earnings. Management continues to express an acquisitive appetite, noting its desire – in the chairman's statement – to enter the general insurance market. A general insurance subsidiary would not only diversify Manx's earning stream, but would also potentially provide cross-selling opportunities.

Valuation: Implied growth of c 7%

Based on a UK bank peer comparison, plotting return on equity (ROE) against price-to-book value (P/BV), and using annualised H123 figures for Manx, we estimate that Manx should be trading at c 0.75x P/BV compared to its current multiple of 0.7x P/BV. This implies an upside of 7% to c 20p.

5 October 2023

Price	**19p**
Market cap	**£21m**
CET1 ratio (December 2022)	12.4%
Shares in issue	115.1m
Free float	39.4%
Code	MFX
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(11.9)	(14.0)	80.5
Rel (local)	(10.8)	(12.1)	74.3
52-week high/low		29p	12p

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

FY23 results	March 2024

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Manx Financial GroupManx Financial Group is a research client of Edison Investment Research Limited

H123: PAL contributions offset bank's margin erosion

In H123, the group lent a record £182.6m, a 65% uplift (H122: £110.9m). Subsequently, this pushed NII up by 56% to £16.4m. Group NIM increased 1.5 percentage points to 8.2% due to the contribution from PAL. Conister Bank, however, experienced margin erosion of 6% as the bank continued to grow its deposits (to fund lending) and passed on rates to savers. The cost of funds for Conister Bank jumped to 3.38% in H123, more than double the 1.59% in H122. Although the majority of lending activities occur through the bank, its subsidiary PAL helped boost margins at the consolidated group level. PAL's short-term lending structure, highlighted in our April Update note, means that yields are far higher than Manx's conventional lending activities. PAL is able to turn over one-year funding from Conister Bank c 1.2 times, which provides a useful counterbalance since PAL's lending reprices faster than Conister Bank's traditional lending. The combination of faster repricing on the lending side and the faster turnover on the loans allowed group NIM to increase respectably.

The group attempted to soften some of the margin pressure through expanding the loan-to-deposit ratio, which stood at 103% in H123 (H122: 97%). Notably, the loan book was up 40% y-o-y to £343m and this volume growth drove core operating income up 36% to £15.6m.

The group continued to focus on restraining fee and commission expenses. In H123, fee and commission expenses represented less than 1.4%, or £3m, of advances compared to 1.2% in H122. However, weak investor sentiment persisted. As a result, commissions earned in its financial advisory business – £2.2m – were not enough to overcome the expenses, leading to a net fee loss of £0.8m. Operating expenses rose 41% to £10m, predominantly in the form of personnel costs as Manx continued hiring staff to facilitate the opening of its UK deposit-taking branch. As is the case with other lenders, the group also bore the cost of underlying inflation. Furthermore, Manx has embarked on a multi-year, multi-million-pound IT investment programme as it focuses on scaling up the business, improving customer-facing technology and obtaining the infrastructure to continue adhering to compliance policies. This will increase efficiency in the medium to longer term but act as a headwind to profit during the implementation period.

Relatively in line with loan book growth, impairment charges increased 45% to £3.3m. Common with other UK lenders, Manx has increasingly placed emphasis on prime lending. This has allowed moderation in its CoR. Group CoR rose 1.5 percentage points to 4.9%, partly due to front loading stage 1 provisions due to loan growth. Notably, CoR for Conister Bank remained in line at 0.1%.

With a combination of strong operating performance and CoR, PBT rose 30% to £3.0m. However, net attributable profit fell 11% to £1.9m as the minority interest from the six-month contribution from PAL was removed from the consolidated accounts (see Minority interest explanation and Exhibit 2 below for further explanation). Resultantly, EPS fell to 1.67p/share, down 11% from 1.89p/share in H122. However, positively, Manx has maintained a strong ROE with an annualised 17.1% (FY22: 17.4%) according to its own definition. Manx uses net profit – before minority interest is deducted – to calculate its ROE whereas Edison uses net attributable profit to shareholders (after the minority interest has been deducted). Edison's annualised H123 ROE is 12.7%

Exhibit 1: Profit and loss account – selected numbers

£'000s unless stated otherwise	H121	H221	H122	H222	H123	y-o-y
Net interest income	8,555	9,425	10,532	13,820	16,384	56%
Net fee income	478	804	986	164	(798)	(181%)
Depreciation on leasing assets	(173)	(96)	(16)	0	0	(100%)
Core operating income	**8,860**	**10,133**	**11,502**	**13,984**	**15,586**	36%
Other operating income	129	236	275	39	62	(77%)
Gains on securities and asset revaluations	(1)	690	(113)	386	664	(688%)
Total operating income	**8,988**	**11,059**	**11,664**	**14,409**	**16,312**	40%
Operating expenses	(5,879)	(6,910)	(7,059)	(9,831)	(9,986)	41%
Operating profit before impairments	**3,109**	**4,149**	**4,605**	**4,578**	**6,326**	37%
Impairment on loans and advances	(2,142)	(2,218)	(2,268)	(1,722)	(3,294)	45%
Associates profit	59	(27)	0	18	0	N/A
VAT recovery	113	0	0	0	0	N/A
Profit before tax	**1,139**	**1,904**	**2,337**	**2,874**	**3,032**	30%
Income tax expense	(122)	(112)	(160)	(377)	(493)	208%
Net profit	**1,017**	**1,792**	**2,177**	**2,497**	**2,539**	17%
Minority interests	12	(28)	(16)	(327)	(612)	3725%
Net attributable profit	**1,029**	**1,764**	**2,161**	**2,170**	**1,927**	(11%)
Key ratios						
EPS (p)	0.89	1.57	1.89	1.88	1.67	
Diluted EPS (p)	0.73	1.24	1.48	1.45	1.30	
NIM (NII/average assets)	6.2	6.4	6.7	7.9	8.2	
NIM (NII/average interest earning assets)	6.6	6.7	7.1	8.4	8.8	
Group cost of risk (%)	2.9	3.7	3.4	4.7	4.9	
Cost income ratio (%)	65.4	62.5	60.5	68.2	61.2	
Annualised ROE* (%)	9.1	14.7	16.7	15.4	12.7	
Loan-to-deposit ratio (%)	91.5	90.4	96.6	95.8	103.2	

Source: Manx Financial Group, Edison Investment Research. Note: *Edison uses net attributable profit and average shareholder equity in our calculation.

Minority interest and PAL explained

In September 2022, Manx announced its 50.1% acquisition of PAL for £4.2m. Manx has the option to buy the remaining 49.9% for a variable cash consideration of two times average net profit of PAL, capped at £5m, by FY26 (see our last note in the 'Further upside optionality of Payment Assist' section for more detail). Under IAS 27, since Manx owns the majority of PAL, it must consolidate all of PAL's revenues, costs and profit in the group accounts and then deduct the 49.9% of net profit attributable to minority interest after taxes.

As virtually all the group £0.6m minority interest charge relates to PAL, an acquisition of the minority interest would be highly accretive on current run rates and PAL is on track to deliver an annualised c £2.5m in profit in FY23 (or c £1.23m in profits attributable to Manx shareholders). Should Manx acquire the other half of PAL, the minority interest will be expunged, and all profits would accrue to Manx shareholders. We show this effect in Exhibit 2 where, if Manx had owned PAL wholly (and ignoring any additional after-tax financing cost), EPS would have appreciated 32% to 2.21p/share from its actual earnings of 1.67p/share. This is also 17% higher than H122 EPS.

We highlight that this is quite a simplified analysis. Should Manx acquire PAL for £5m in cash, its balance sheet equity would instantly decrease to £26m but rise to £29m by the end of the year as PAL's earnings feed into equity and partially offset the £5m reduction. Based on this calculation, annualised ROE would be 18%, above our current annualised ROE of 12.7%. Additionally, it is worth noting that the debt-to-equity ratio, ie leverage, would also increase to 1.4x (currently 1.3x).

Exhibit 2: H123 selected numbers profit and loss account – the PAL effect

£'000s unless stated otherwise	With 50.1% ownership of PAL	If Manx owned 100% of PAL
Profit before tax	3,032	3,032
Income Tax	(493)	(493)
Net profit	2,539	2,539
Minority interest	(612)	0
Net attributable profit	1,927	2,539
EPS (p)	1.67	2.21

Source: Edison Investment Research

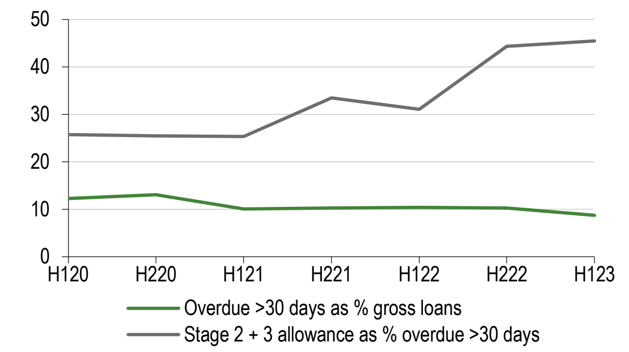
Credit analysis: Asset quality is robust

Over the past few years, as is a common theme with other UK lenders, Manx has shifted the loan book towards mostly prime lending. Although this implies a lower interest yield on assets, it means asset quality tends to be much better, resulting in attractive and less volatile risk-adjusted returns.

In Exhibit 3, we highlight that loans overdue 30 days as a percentage of gross loans have trended downwards over the last couple of years, and even dipped below 10% in H123 as the group grew prime lending rapidly. Coverage of stage 2 and 3 impairment allowances as a percentage of stage 2 and 3 overdue more than 30 days is robust at 46% (H122: 31%) and slightly above the 44% in FY22.

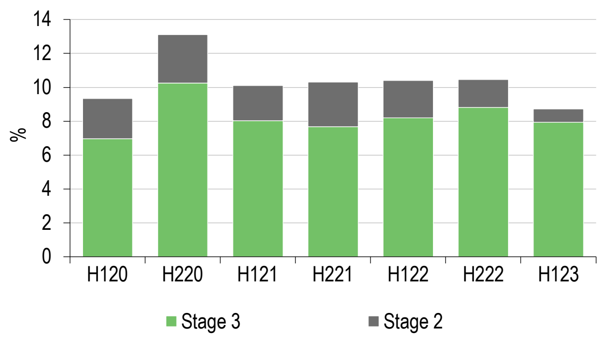
Additionally, total stage 2 and 3 loans in aggregate actually fell slightly in absolute terms in H123 versus H222. Exhibit 4 shows total stage 2 and 3 loans as a percentage of gross loans was 8.7%, significantly improved from 10.4% in H122 as Manx benefited from increased customer quality.

Exhibit 3: Overdue loans and impairment allowance



Source: Manx Financial Group, Edison Investment Research

Exhibit 4: Stage 2 and 3 as a percentage of gross loans



Source: Manx Financial Group, Edison Investment Research

Looking ahead: UK licence, acquisitions and margin pressure

Management stated that the process of obtaining a UK banking licence is on track and it expects a response from regulators before the end of the year. A UK licence would give additional funding flexibility for the group and help balance the geographic funding profile. From a lending point of view, and despite the competitive UK market, a UK branch has promising potential. Manx estimates the market size for small and medium-size enterprise lending to be £15.7bn. Currently, Manx holds about 1.8% of UK market share while non-bank lenders make up 36%. Although Manx already lends to the UK, a deposit-taking branch would help boost its operations and brand image.

Manx has employed acquisitions successfully as a means of achieving growth in strategically attractive segments of the market. The group will continue to look for acquisitions to supplement its already strong organic growth. One of these markets is general insurance. Entry into the general insurance market will further enhance the earnings diversity of the group alongside providing cross-selling opportunities with its other subsidiaries.

From a macroeconomic perspective, the environment remains difficult to predict. Management believes that market conditions will remain challenging until Q224 – assuming market expectations that the UK would have reached the peak of the interest rate cycle and possibly begun the trek downwards.

However, as deposits are shorter-term products, they continue to reprice faster than loans and we expect to see further margin pressure. At the time of writing, Conister Bank is offering a 5.3% average savings rate on its fixed-term deposit accounts (with a maturity between six months and three years) and an average of 4.8% on its notice deposit accounts (maturities between 95 days and 180 days). Although we do not know the exact deposit mix, we can expect the cost of funding to increase from the current 3.38% as deposits are repriced to reflect updated rates. This will further put margin pressure on Manx as the longer duration loan book has a slower repricing cycle. Should rates rise, then one would project more margin erosion.

However, if rates come down as indicated by forward rate curves, Manx can expect its margins to expand favourably as deposits reprice faster to lower rates while it still collects interest on loans made at higher rates (and indeed some loans will still be repricing upwards). An additional offset to the current margin environment is PAL, which has a very short duration loan book. We highlight that for the year, management has guided to c £0.4bn in advances (FY22: £0.3bn), with a 20:80 split between the Isle of Man and the UK, which suggests it does not see a funding constraint for the business.

Valuation

Manx currently has no consensus forecasts. In Exhibit 5, we have selected a varied list of small and mid-cap UK banks and specialist lenders with similar operations to Manx. We highlight that Manx trades broadly in line with peers on a 2023e P/E and P/BV basis. However, Manx has a better ROE by 3.8pp (compared to average) and 2.5pp (compared to average excluding Metro Bank), respectively. Manx is a small company, especially when compared to peers, and hence yields less as it is still in its growth stage and therefore less inclined to focus on returning capital to shareholders through dividends. Nonetheless, a 2.1% yield looks respectable.

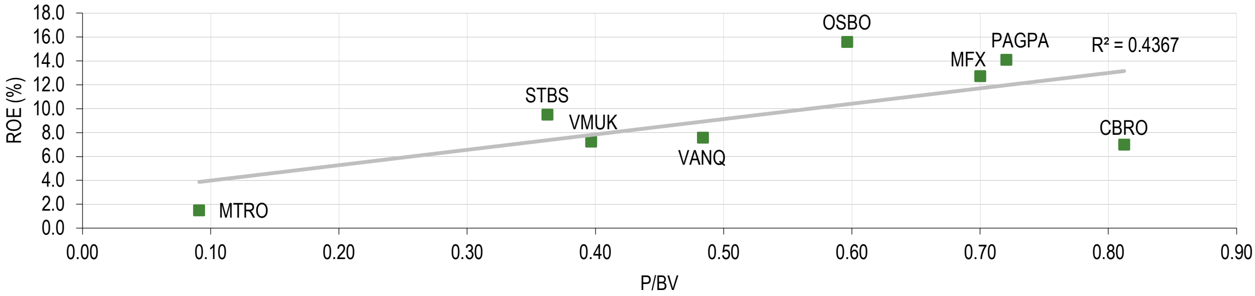
Exhibit 5: Peer comparison table

	Price (p)	Market cap (£m)	P/E 2022 (x)	P/E 2023e (x)	P/BV (CY1, x)	ROE (CY1, %)	Dividend yield (%)
Close Brothers	860	1,288	11.7	N/A	0.8	7.0	7.9
Virgin Money	154	2,057	5.0	5.0	0.4	7.2	6.5
Metrobank	51	87	10.0	10.0	0.1	1.5	N/A
OneSavings Bank	305	1,201	4.2	4.2	0.6	15.6	10.0
Paragon	473	1,029	5.5	5.5	0.7	14.1	6.1
Vanquis	116	297	8.1	8.1	0.5	7.6	13.2
Secure Trust Bank*	628	125	3.6	4.0	0.4	9.5	6.3
Manx Financial Group**	**19**	**21**	**5.2**	**6.4**	**0.7**	**12.7**	**2.1**
Average		**869**	**6.9**	**6.1**	**0.5**	**8.9**	**8.3**
Average ex-Metro		**999**	**6.4**	**5.4**	**0.6**	**10.2**	**8.3**

Source: Refinitiv, priced at 5 October. Note: *Edison estimates used for Secure Trust Bank. **Annualised H123 figures for Manx Financial Group.

In Exhibit 6, we graph ROE against P/BV for all peers and plot a line of best fit. We can see that in regard to the line of best fit, Manx is trading at a discount. To trade closer towards the line of best fit, Manx should be trading at a book value of c. 0.75x, or a price of c 20p, inciting a 7% uplift from the price at the time of writing.

Exhibit 6: ROE vs P/BV



Source: Refinitiv, priced at 5 October. Tickers: Metro Bank (MTRO), Secure Trust Bank (STBS), Virgin Money (VMUK), Vanquis (VANQ), Manx Financial Group (MFX), OneSavings Bank (OSBO), Paragon (PAGPA) and Close Brothers (CBRO).

Exhibit 7: 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 EPS (p)	1.88	2.04	1.65	2.46	4.07
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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