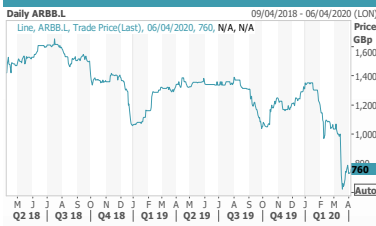




6 April 2020

Financials



Source: Refinitiv

Market data

EPIC/TKR	ARBB
Price (p)	735/705
12m High (p)	1,428
12m Low (p)	625
Shares (m)	15.4
Mkt Cap (£m)	112
Loan to Deposits 2021E	77%
Free Float*	42%
Market	AIM/NEX

*As defined by AIM Rule 26

Description

Arbuthnot Banking Group (ABG) has a well-funded and capitalised private bank, and has been growing commercial banking very strongly. It holds a 9.85% stake in Secure Trust Bank (STB).

Company information

Chair/CEO	Sir Henry Angest
COO/CEO Arb.	Andrew Salmon Latham
Group FD,	James Cobb
Deputy CEO	
Arb. Latham	

Tel: +44 207 012 2400

www.arbuthnotgroup.com

Key shareholders

Sir Henry Angest	56.1%
Liontrust	7.0%
Slater Investments	3.9%
Miton Asset Mgt.	3.6%
R Paston	3.6%
M&G IM	3.5%

Diary

To be confirmed when current restrictions allow (div. paid as second interim) AGM

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

ARBUTHNOT BANKING GROUP

2019 results: resilience into the storm

To be resilient in an economic storm, a bank needs three things – low risk assets, strong capital and surplus deposits. ABG has all three. At end-2019, 55% of loans were in the private bank (significantly secured on sub-60% LTV residential properties) or the acquired mortgage book. Just 1.5% of the commercial loan book was on 80%+ LTV. The equity-to-assets ratio was 8% and total capital ratio, 17.3%. The regulators have reduced capital buffers – we estimate ABG has ca.£60m of surplus capital. There is surplus liquidity: deposits £2.1bn, loans £1.6bn. ABG announced an increased dividend but withdrew it following PRA market guidance.

- ▶ **2019 results:** Underlying PBT was £5.8m vs. £4.4m (re-stated). Income was up 7%. Impairments saw a net release in 2H. The FY charge was £867k vs. £2.7m. Despite heavy investment, costs rose 8%, only 1% ahead of income. Loans were up 31% to £1.6bn. Deposits increased 22% to £2.1bn. Assets under management rose 12%.
- ▶ **Outlook:** There are too many moving parts to rely on single projections. We have introduced a range of scenarios. Our central case is zero profit in 2020, reflecting margin pressure following base rate cuts and COVID-related losses. The upside scenario profit is £6m. The extended economic-downturn scenario is a £15m loss.
- ▶ **Valuation:** Our forecast scenarios, and multiple valuation approaches, see a broad range of implied valuations. Our base case range is 871p to 1,912p, our upside scenario 1,183p to 2,377p, and our downside 782p to 1,424p. The share price is 54% of the 2019 NAV (1,364p), implying value destruction to perpetuity of £97m.
- ▶ **Risks:** As with any bank, the key risk is credit. ABG's existing business should see below-market volatility, and so the main risk lies in new lending. We believe management is cognizant of the risk and, historically, has been very conservative. Other risks include reputation, regulation and compliance.
- ▶ **Investment summary:** ABG offers strong-franchise and continuing-business (normalised) profit growth. Its balance sheet strength gives it a number of wide-ranging options to develop organic and inorganic opportunities. The latter are likely to increase in uncertain times. Management has been innovative, but also very conservative, in managing risk. Having a profitable, well-funded, well-capitalised and strongly growing bank priced at half book value is an anomaly.

Financial summary & valuation (see financial section for forecast scenarios)

Year-end Dec (£000)	2015	2016	2017	2018	2019*
Operating income	34,604	41,450	54,616	67,905	72,465
Total costs	-35,926	-46,111	-54,721	-64,982	-70,186
Cost:income ratio	104%	111%	100%	96%	97%
Total impairments	-1,284	-474	-394	-2,731	-867
Reported PBT	-2,606	179	2,534	6,780	7,011
Adjusted PBT	2,982	4,009	3,186	7,416	5,800
Statutory EPS (p)	86.3	1,127.2	43.9	-134.5	41.1
Adjusted EPS (p)	13.5	17.1	47.5	40.3	32.8
Loans/deposits	82%	76%	75%	71%	77%
Equity/assets	5.5%	18.5%	12.8%	9.0%	8.0%
P/adjusted earnings (x)	54.4	43.0	15.5	32.4	22.4
P/BV (x)	0.92	0.48	0.48	0.57	0.54

* IFRS9 basis; Source: Hardman & Co Research

2019 results summary

Financial highlights

Strong PBT growth at underlying level driven by improving credit and broadly in line cost and revenue growth

EPS growth on company underlying basis.

Dividend up 5%

- ▶ Profit before tax (PBT) came in at £7.0m (2019: £6.8m; 2017: £2.5m). Underlying PBT was £5.8m (2018 restated: £4.4m). Operating income increased by 7% while expenses grew by 8%. Impairments saw a net recovery in 2H'19 after a £1.1m release following a review of collateral assumptions initially used on the adoption of IFRS9. The full-year charge was £0.8m (2018: £2.7m; 2017: £0.4m).
- ▶ Earnings per share came in at 41.2p (2018: -134.5p, including a £25.7m net loss on de-recognition of STB associate, recorded in discontinued operations). Underlying earnings per share were 32.8p (2018: 22.7p).
- ▶ A second interim dividend was declared in lieu of a final dividend, so it does not need AGM approval (21p per share against 20p, an increase of 5%). The total full-year dividend per share would have been 37p (2018: 35p; 2017: 33p). Given PRA market-wide guidance, the second interim dividend was withdrawn on 2 April.
- ▶ Net assets were £208m (2018: £196m; 2017: £236m) and net assets per share were 1,364p (2018: 1,283p; 2017: 1,547p).

Operational highlights

Loans up 31% or £370m, two thirds acquired, one third organic

Margins down on mix effects and deposit competition

Deposits up 22%, nearly £500m over loans

AUM up 12%

New business streams coming online

- ▶ Customer loans increased 31% to £1,599m (2018: £1,225m; 2017: £1,049m) including the acquisition of a £265m mortgage book for £258m. Commercial division loans rose to £527m (2018: £443m; 2017: £305m). Group-wide written loan volume fell 8% to £430m (2018: £469m; 2017: £466m), with a continued focus on higher-margin business, especially in the private bank.
- ▶ The Arbuthnot Latham margin fell slightly (4.7% vs. 4.5%) amid competitive pressure, on deposits and a mix effect with the mortgage portfolio average yield slightly lower than the group.
- ▶ Customer deposits increased 22% to £2,085m (2018: £1,714m; 2017: £1,391m), with growth in the commercial division (£824m vs. 2018: £567m; 2017: £308m).
- ▶ Assets under management (AUM) rose 12% to £1,107m (2018: £985m; 2017: £1,044m). Management had promised a re-invigoration of this business and, for six consecutive months, the Investment Management division has recorded positive net inflows of client monies.
- ▶ Asset-based lending business issued facilities of £76m with payments of £450m and processed £485m of invoice volumes, with the fourth quarter being double the volume of the first quarter. In 2020, ABG expects it to be profitable in each month, having reached breakeven in 2019.
- ▶ Arbuthnot Direct raised £83m of deposits.

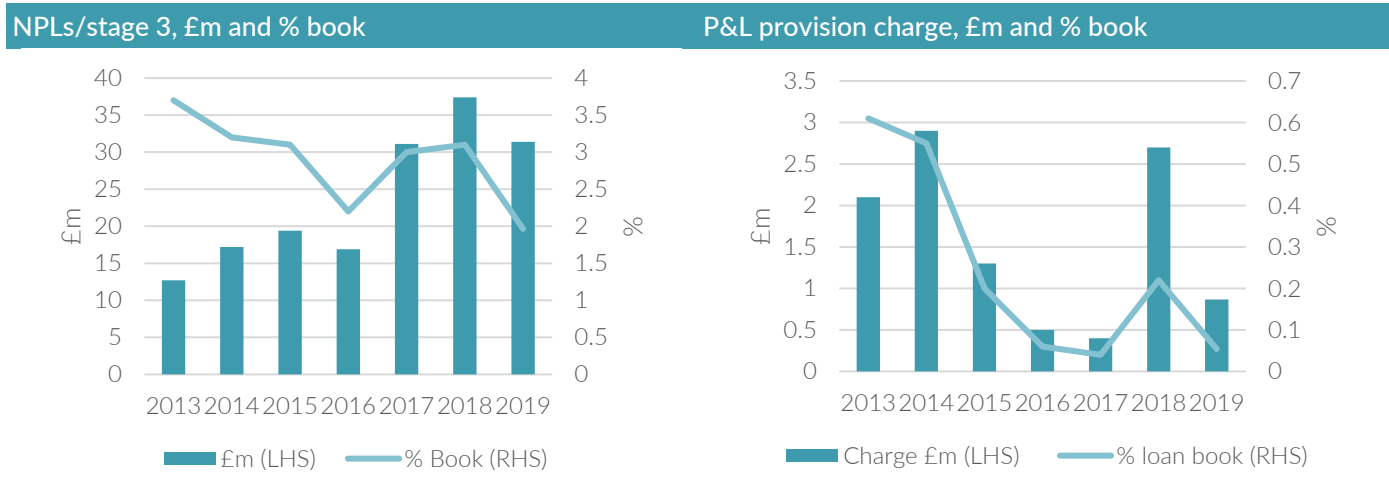
Secure Trust Bank (STB)

STB has been de-recognised as an associated undertaking, due to a loss of significant influence (ABG directors left the board). It showed a positive mark-to-market gain in FY'19, but this will have reversed subsequently. These movements are taken directly to equity.

Low-risk portfolio

Measured against book, NPLs and provisions are around 2016 levels

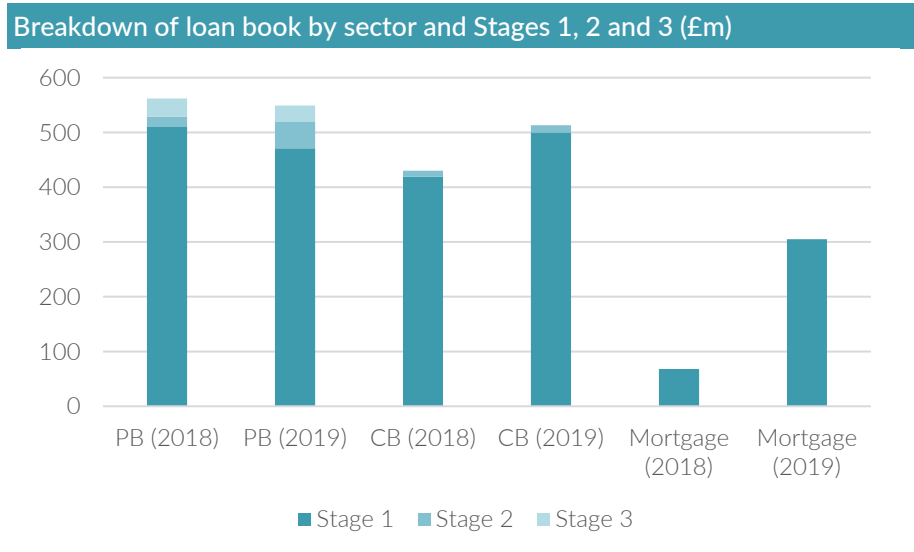
As can be seen in the charts below, non-performing loans (NPLs) and provisions, both improved in 2019. Measured against book, both are around 2016 levels and well below the levels of 2013-14. It should be noted that IFRS9 distorts historical trends and, in 2019, ABG reviewed its initial assumptions, especially with regard to collateral. This led to a net release of £1.1m in 2H'19. Even excluding this assumption change, the charge was down on 2018.



Source: ABG, Hardman & Co Research

Vast majority of book is on Stage 1 with no Stage 2 or 3 advances in mortgage portfolio

IFRS9 classifies loans into three stages, with Stage 1 being the best quality and Stage 3 the worst. The Report and Accounts show ABG has just £31m of its £1.6bn (2018: £37m of its £1.2bn loans) in Stage 3. There has been a ca.£30m increase in Stage 2 loans in the private bank, most of which are now more than 90 days in arrears. Of this increase, £9m is where physical security LTV is under 60% and a further £9m where the LTV is between 60% and 80%. At end-2019, there was £13m of level 2 exposure with an LTV of over 80% (total property collateral against these positions of £11m) and there are further security provisions, including personal guarantees.



Note: PB is private bank, CB is commercial bank. Source: ABG, Hardman & Co Research

Loans and collateral by LTV buckets (£000)						
	Private bank		Commercial bank		Mortgages	
	Loans	Collateral	Loans	Collateral	Loans	Collateral
Less than 60%						
Stage 1	266,706	620,496	299,642	631,792	93,454	318,010
Stage 2	17,785	35,150	868	3,120	0	0
Stage 3	9,527	22,405	0	0	0	0
60%-80%						
Stage 1	178,117	273,038	194,442	304,127	46,333	67,372
Stage 2	18,132	26,565	10,356	16,560	0	0
Stage 3	1,658	2,599	0	0	0	0
80%-100%						
Stage 1	20,670	23,340	4,871	4,920	56,967	66,421
Stage 2	8,434	9,800	1,428	1,750	0	0
Stage 3	3,105	3,295	0	0	0	0
Greater than 100%*						
Stage 1	5,133	2,410	1,250	740	108,276	69,235
Stage 2	4,775	2,000	0	0	0	0
Stage 3	15,242	8,102	0	0	0	0

Source: ABG, Hardman & Co Research

In addition to property, other security is taken, including charges over Arbuthnot Latham Investment Management portfolios, other chattels and personal guarantees. The increase in LTV greater than 100% is due to an increase in exposures collateralised by other assets.

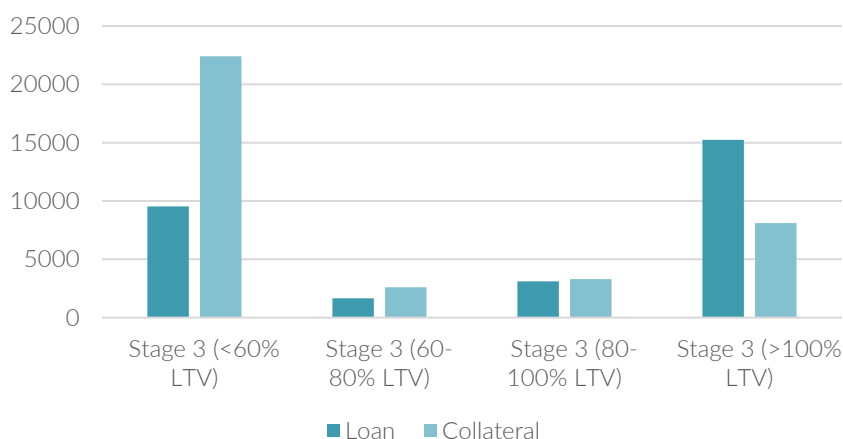
Customer cashflow is key. Three quarters of the acquired book has longer than 10-year record of repayments. Such a track record gives considerable comfort with about half of the book on high LTVs.

Customer cashflow, we believe, is the key to good credit. Of the £265m loans acquired in 2019, £201m were originated between 2005 and 2008. With such an extended track record of good payments, there is reasonable hope that if the customer were to miss a few monthly instalments due to COVID, they would quickly revert to being a good payer. £65m was originated in 2018/19 by Magellan Homeloans with 462 loans at an average balance of £140k and average LTV of 70%. This level of debt (and implied house value of ca.£200k) suggests mainstream borrowers. Investors will note that the distribution of LTV in the mortgage book is very wide, including £108m of debt in LTVs over 100%. We emphasise our initial point that cashflow is king and a customer with a 10-year track record of paying is likely to be a relatively low risk, even on a high LTV.

Looking at the private bank, Stage 3 accounts, the vast majority have significant real-estate security cover. There is often a personal guarantee on top (and not included in LTV data).

Looking forward, we believe the greatest risk lies in those who are already late in payment (Stage 3) and where LTVs are high. There are no such loans in the mortgage book or the commercial bank. In the private bank, the breakdown by loan to value is below. It is worth re-emphasising that this is only property security and ABG also holds other types of security which may be realised over the long term.

Breakdown of private bank Stage 3 loans by LTV (£m)



Note: PB is private bank, CB is commercial bank. Source: ABG, Hardman & Co Research

By sector, residential mortgages are about two thirds and a growing proportion of the book

Most of the private bank loans (£579m) were residential mortgages on low LTV. In addition, there is a further £306m of residential mortgages in mortgage divisions. With further residential mortgages in the commercial division (buy to let) the total residential mortgage book is £1.035bn out of total loans of £1.6bn (i.e., 64% of the total book, up from 58% at end-2018). The mortgage acquisition was more geographically diversified and the proportion of total lending in London has fallen by a couple of percentage points to 35%.

Customers in difficulties managed over long term. ABG has balance sheet strength to hold re-possessed assets for many years to sell into more favourable markets.

In 2019, forbearance measures were in place for 3.1% of the book (2018: 2.2%). One third of the increase came from covenant waivers (new feature with business mix), one third by term extension and one third had payment holidays. We do not view this as a major concern. A significant part of ultimate losses is in how a business manages recoveries and, in turn, this is dependent on whether management can take time to realise positions, or is likely to want to eliminate “problems” as quickly as possible. We believe that ABG is in the former camp and will initially work with the borrower pre-enforcement of security and, when security is taken, will take as much time as is required to optimise its realisation value. We have already seen a modest pick-up in forbearance situations in 2019 and such an approach reflects a conservative culture, but also a strong capital base. While there may be multi-year work outs, ABG is not a seller into distressed markets.

Impairments based off 50% chance of modest house price declines; slightly more conservative end-2019 than 2018

In its Report and Accounts, ABG provides both the detail of its assumptions in its expected loss calculation and a sensitivity analysis to it. The key driver is house prices and, in the table below, we detail the assumptions ABG used. In 2019, there was a 50% weighting applied to the scenario with a modest overall house price decline and a reduction in the weighting which assumed any price growth. In terms of sensitivity, if the collateral valuations decreased by 10% across all Stage 3 client exposures, this would lead to a £2.1m adverse (2018: £1.9m adverse) impact on profit or loss.

Weighting to range of economic outturns and collateral/property price impact for each					
% Scenario	Probability 2019	Weighting 2018	Change London	in Property Rest of UK	Price Overseas
Severe decline	1	1	-40	-40	-40
Moderate decline	3	3	-20	-20	-20
Decline	50	50	-2	-1.5	-1
No change	26	21	0	0	0
Growth	20	25	0.5	0.5	2.3

Source: ABG, Hardman & Co Research

£1.1m release in 2019 driven by use of market default statistics rather than a small sample of in-house situations; methodological change only

We noted above that an assumption change had seen a release of provisions in 2H'19 of £1.1m. When ABG adopted IFRS9, it applied a probability of loss assumption driven by historical experience in relatively small sections of its own book across all its book. In 2019, this was changed to using more market-wide statistics collated by the Bank of Bank of England. £0.8m of the gain was on changing assumptions in the Commercial Division where ABG's specific data was relatively limited. We do not believe this means ABG had a worse-than-market experience but rather, in the samples previously used, did not appropriately reflect the much larger books now in place. It is simply applying a different method of calculation leading to a different number.

Capital

Group well capitalised, with core Tier 1 ratio of 14.4%

The key message on capital is that ABG is well capitalised, with a core Tier 1 ratio of 14.4%.

Capital structure			
Year-end Dec (£000)	2017	2018	2019
Share capital	153	153	154
Retained earnings*	237,171	209,083	209,171
Fair value/available-for-sale reserve	162	-12,169	205
Treasury shares	-1,131	-1,131	-1,214
Capital redemption reserve	20	20	19
IFRS9, transitional add-back	-	1,986	1,109
Core Tier 1	236,375	197,942	209,444
Deduction for (non)/significant investment*	-61,766	-16,082	-10,183
Deduction for goodwill	-5,202	-5,202	-5,202
Deduction for other intangibles	-10,793	-11,336	-14,880
Prudent valuation deduction/others	-	-38	-1,535
Total Tier 1 capital resources	158,614	165,284	177,644
Tier 2			
Tier 2 debt securities in issue	13,104	13,283	36,837
Total Tier 1 & Tier 2 capital resources	171,718	178,567	214,481
Core Tier 1 capital ratio (net core Tier 1 capital/Basel III total risk exposure)	17.3%	15.9%	14.4%
Total capital ratio (capital/Basel III total risk exposure)	18.8%	17.2%	17.3%

*Deduction for significant investment. The portion of the investment representing up to 10% of ABG's Tier 1 is added back to capital resources and then risk-weighted at 250%, while anything above the 10% is deducted. The STB stake is a deduction and, hence, even though there was an accounting writedown on the transition from associate accounting, this did not have a material impact on capital ratios.

Source: ABG, Hardman & Co Research

Surplus capital of over £40m at end-2021E, even after our downside scenario

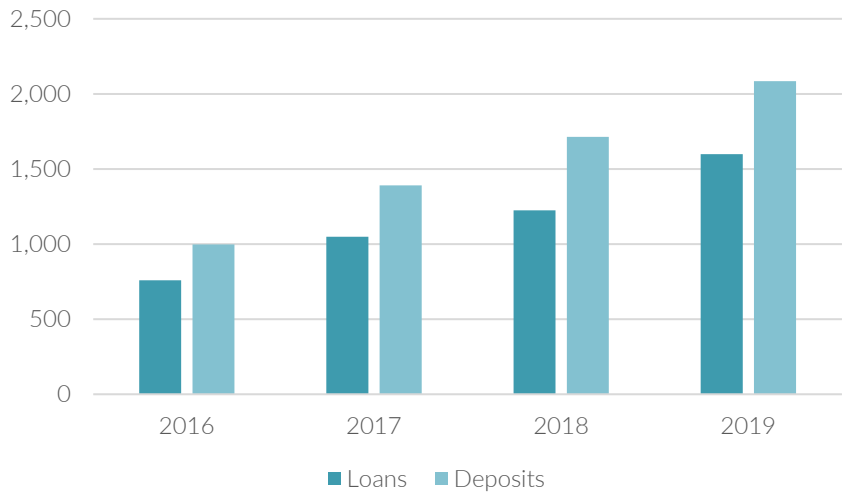
Capital is of course the second line of defence against downside scenarios (the first is existing profitability). We detail in the section on financials below a range of scenarios. The downside scenario would use approximately half the surplus capital currently available still leaving the group with more than £40m of surplus capital by the end of 2021. In that scenario, loan balances may be expected to fall, which would increase this surplus further.

Strong liquidity

Surplus deposits have been a long-term feature. At end-2019, ABG had nearly £0.5bn surplus deposits over lending.

ABG has always been conservatively run in terms of liquidity. This has continued in recent years with deposits in 2019 of 1.3x the level of loans and the nominal surplus remaining at ca.£0.5bn.

Loans and deposits since sale of Secure Trust Bank in 2016 (£m)

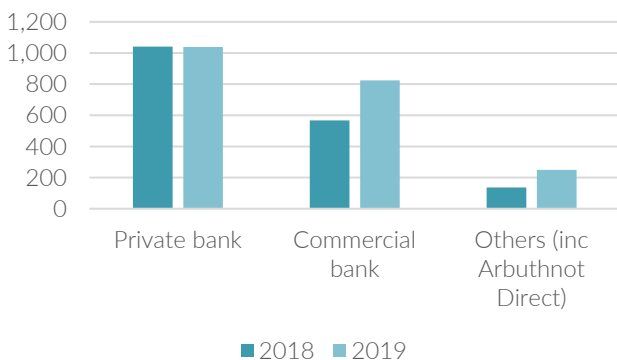


Source: ABG, Hardman & Co Research

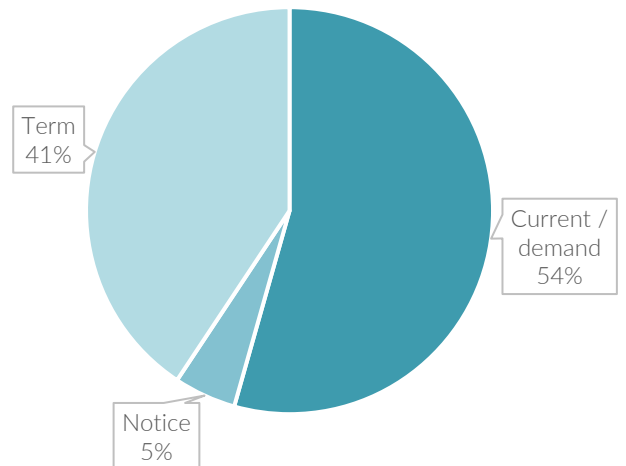
Broadly diversified by type and source. £500m of term deposits mature 2Q'19 to 4Q'19 and only re-price on maturity

We believe investors should not only focus on the quantum of deposits, but their diversity and maturity profile. As can be seen in the chart below, ABG raises deposits across a whole range of customers and can dip in and out of whichever market gives it the prices, volumes and terms required (a capability enhanced by the Arbuthnot Direct launch). While it still has a majority of deposits in current and demand accounts, the fixed-term element is now 41% of deposits. Of the £848m term accounts, £550m will mature in 2Q'19-4Q'19, but they will allow an element of smoothing of the recent base rate fall as they do not immediately re-price.

Deposits by division (£m)



Deposits by type (%)



Source: ABG Hardman & Co Research

Financials

Introducing range of scenarios given current market uncertainty

Given market uncertainty, we no longer believe that a single forecast is appropriate but instead provide investors with a range of scenarios. There are a number of sensitivities which need to be considered and, in many cases, which provide offsets across the different scenarios. For example, a downside scenario will see a bigger hit to loan volumes, but is likely to see better pricing potentially on both loans and deposits. Our upside scenario is marginally better than our previous forecast.

Summary of impact on 2020 profits of different scenarios against 2019			
£m	Downside scenario	Central case	Upside scenario
Net interest income			
Hitting savings floors	-10	-10	-3
Widening asset prices	3	1	0
Deposit competition	2	2	1
Volume	-5	0	13
Fees and commissions			
Fees lending	-1	0	1
Fees AUM	-2	-1	1
Other income			
STB dividend	-1	-1	0
Acquisition adjustments	2	1	0
Lower rent	-3	-3	-3
Costs			
Ongoing costs	10	5	-10
Investment spend	4	2	0
Impairments	-21	-3	-1
Change in P&L against 2019	-22	-7	-1
Reported profit in 2020	-15	0	6
Other considerations			
Investment property	-12	0	2
MTM STB stake (in reserves)	-10	0	+20

Source: Hardman & Co Research

Looking at some of these issues in more detail:

Deposits will hit pricing floors with base rate cut, potentially putting £10m pressure on income...

▶ In 2019, the private bank incurred interest expense of £2.3m on just over £1bn of deposits (i.e., just over 20bp cost) while in the commercial bank the costs were £2.8m against a closing deposit book of £824m (average cost just over 30bp). With the base rate now cut from 65bp to 10bp, ABG will not be able to pass the full reduction on to its savers. Indeed, it is likely to see 50bp-60bp of pressure on deposit margins. As most of the asset side is variable, creating a hit to earnings of ca.£10m appears reasonable. Further reductions are likely to have a modest effect, so the downside scenario is the same as our base case. In our upside scenario, there is a relatively rapid recovery and so the base rate could rise in three-four months.

...but may see some offset on both asset spreads and, in due course, deposit competition

▶ Asset spreads are likely to widen, reflecting both higher risk and a market reduction in bank lending appetite. Deposit competition has been intense in recent weeks and, in tumultuous market conditions, is likely to continue. However, as banks are not lending in the downside scenario, we assume this competition will moderate allowing wider deposit spreads.

- Central assumption is flat balance sheet**

 - ▶ Our volume assumption is a flat balance sheet in the central case, an upside in line with our previous forecasts and a shrinking balance on the downside. This will free up capital, although is clearly adverse for earnings.

- Some pressure on other income in all scenarios**

 - ▶ Other income reflects a cancelled STB dividend (a *suspension was announced* on 24 March, lower lending-related fees and marginally lower investment manager fees. In 2019, investment manager fees were changed from primarily ad valorem, to a more service-based, annual, pricing structure while wealth planning fees of £1m are time-based. In all scenarios, there will be lower rent from the investment property being refurbished. There is the potential for further RAF acquisition adjustments, which have a final payout in 2022 and current goodwill of £3.5m (indicative of the maximum adjustment available to ABG).

- Main offset is opportunity to reduce both investment and ongoing spend**

 - ▶ We have split the costs into investment spend and ongoing. There is an element of ongoing cost which is fixed, but we do not expect management to do nothing while income reduces. The upside scenario reflects our previous forecast.

- Provisions will rise but scale of increase is unclear. Downside scenario assumes 30bp on residential and 300bp across rest of book.**

 - ▶ The starting point for impairments is the non-recurrence of the assumption change, adding £1m to provisions. For our downside, we have assumed a 30bp loss on residential mortgages and 300bp on the rest of the portfolio. How IFRS9 will be implemented remains uncertain and we note the joining Bank of England/Prudential Regulation Authority *20 March 2020 statement*, which seems to imply a lower than may otherwise be expected charge.
 - ▶ Other potential impacts on statutory equity include:
 - The main investment property is King Street in London's West End. As this is now being re-developed for sale, it is accounted for on the lower of cost or net realisable value with the latter being based off assumptions once it has been developed – i.e. in 18 months to two years, at which stage more of a recovery may be expected. There remains £6.7m of investment property (Crescent Office Park, Bath), which is marked to market.
 - The holding in STB is now marked to market with any change in fair value being taken directly to reserves (both up and down).

- Main investment property valued off expected market conditions in two years and so has some time to recover from current shock**

- STB holding is marked to market, directly to reserves**

Profit and loss – Central case

Profit and loss – Central case					
Year-end Dec (£000)	2017	2018	2019*	2020E*	2021E*
Interest income	47,427	65,290	76,870	95,000	95,000
Interest expense	-6,334	-10,107	-18,233	-43,344	-42,464
Net interest income	41,093	55,183	58,637	51,656	52,536
Fees and comms. income	13,805	12,956	13,935	12,793	12,793
Fees and comms. expense	-282	-234	-107	-100	-100
Net fees and comms.	13,523	12,722	13,828	12,693	12,693
Operating income	54,616	67,905	72,465	64,349	65,229
Net impairment on financial assets	-394	-2,731	-867	-3,840	-4,640
STB dividend income	0	0	1,500	0	1,000
Other income	3,033	6,588	4,099	2,064	2,064
Operating expenses	-54,721	-64,982	-70,186	-62,573	-62,422
Profit before tax from continuing operations	2,534	6,780	7,011	0	1,231
Income tax	-448	-1,121	-835	0	-209
Profit after tax from continuing operations	2,086	5,659	6,176	0	1,022
Profit from discontinued operations after tax	4,437	-25,692	0	0	0
Profit for year	6,523	-20,033	6,176	0	1,022

* IFRS9 basis; Source: ABG, Hardman & Co Research

Balance sheet – Central case

Balance sheet							
@ 31 Dec (£000)	2015	2016	2017	2018	2019*	2020E*	2021E*
Cash and balances at Central Bank	115,938	368,611	195,752	405,325	325,908	328,011	330,031
Loans and advances to banks	31,844	28,578	36,951	54,173	46,258	46,258	46,258
Debt securities held to maturity	91,683	87,728	107,300	342,691	442,960	442,960	442,960
Assets classified as held to sale	0	118,456	0	8,002	7,617	7,000	7,000
Derivative financial instruments	2,707	1,490	1,516	1,846	1,804	1,804	1,804
Loans and advances to customers	1,158,983	1,579,512	758,799	1,224,656	1,599,053	1,598,000	1,598,000
Other assets	16,866	16,894	11,939	12,716	86,443	86,443	86,443
Financial Investments	1,277	2,685	2,145	35,351	30,919	30,919	30,919
Deferred tax	2,588	1,784	1,665	1,490	1,815	1,815	1,815
Investment in associate	943	943	82,574	0	-	-	-
Intangible assets	11,318	10,874	8,522	16,538	20,082	19,582	19,082
Property, plant and equipment	12,475	14,004	4,782	5,304	5,813	5,813	5,813
Right of use property	0	0	0	0	19,944	20,559	20,559
Investment property	0	0	53,339	67,081	6,763	6,763	-
Total assets	1,446,622	2,231,559	1,265,284	2,175,173	2,595,379	2,595,927	2,590,684
Deposits from banks	27,657	55,305	3,200	232,675	230,421	230,421	230,421
Derivative financial instruments	1,067	135	227	188	319	319	319
Deposits from customers	1,194,285	1,929,838	997,649	1,714,286	2,084,903	2,085,000	2,085,000
Liabilities relating to assets classified as held for sale	0	8,700	0	0	-	-	-
Current tax liability	3,612	3,366	147	236	633	633	633
Other liabilities	34,984	31,977	17,082	18,549	13,500	13,500	13,500
Lease liabilities	0	0	0	0	20,431	20,882	20,882
Debt securities in issue	11,448	10,834	12,621	13,283	36,837	36,837	36,837
Total liabilities	1,273,053	2,040,155	1,030,926	1,979,217	2,387,044	2,387,592	2,387,592
Share capital	153	153	153	153	154	154	154
Retained earnings	114,641	123,330	235,567	209,083	209,171	209,171	203,928
Other reserves	-1,263	34	-1,362	-13,280	-990	-990	-990
Total to owners of the parent	113,531	123,517	234,358	195,956	208,335	208,335	203,092
Non-controlling interests	60,038	67,887	0	0	-	-	-
Total equity	173,569	191,404	234,358	195,956	208,335	208,335	203,092

*IFRS9 basis; Source: ABG, Hardman & Co Research

Valuation

Range of valuations broad – driven by both scenario of assumptions, but also methodology. Central balance sheet driven approach derives £19.12.

Following the cancellation of 2020 dividends and the cut to earnings, our Dividend Discount Model (DDM) central scenario is £8.71 while our Gordon Growth Model (GGM) £19.12. We do not believe that the implied price to book on the higher valuation is overly demanding, being 1.4x book value for a business which has delivered significant long-term value in the past.

Summary of different valuation techniques by scenario

£ per share	Downside	Central	Upside
GGM	13.74	19.12	23.77
DDM	7.82	8.71	11.83

Source: Hardman & Co Research

Gordon growth model down £6, primarily on assumption of bigger discount for near-term performance. 1.3x book value implied, which reflects value-added over long term

GGM

We have rolled forward our forecast year to 2021 for the GGM, which is actually adverse as we capture the reduction in equity from paying an uncovered dividend in 2021. Additionally, we have increased our short-term performance discount from 5% to 25%, reflecting the minimal earnings over these years (and so an actual performance which is well below the level assumed in the model). This approach now has a valuation using our assumptions of £17.94, compared with £23.27 previously with main driver (£5) coming from the increased discount assumption. The downside scenario (£14.24) reflects less equity and a further 10% discount and is close to book value. Put another way, the value destroyed over the next couple of years would be equivalent to the value then created to perpetuity!

GGM and sensitivities (central scenario)

	Base	+1% RoE	+1% CoE	+0.5% G
Return on Equity (RoE)	13.5	14.5	13.5	13.5
Cost of Equity (CoE)	10	10	11	10
Growth	5	5	5	5.5
Price/book value (x)	1.70	1.9	1.4	1.8
Premium for near-term outperformance	-25%	-25%	-25%	-25%
Adjusted price/book value (x)	1.3	1.4	1.1	1.3
Book value 2020E (£m)	206.8	206.8	206.8	206.8
Valuation (£m)	263.7	294.7	219.7	275.8
Valuation per share (p)	17.94	20.05	14.95	18.76
Variance (p per share)		31.0	-43.9	12.1

Source: Hardman & Co Research

Assumed uncovered dividend and then delayed previous dividend growth

DDM

In our central case, we assume ABG will pay 37p dividends in 2021 and 2022, even though it is uncovered. The dividend we had previously assumed for 2021 (65p) is now not paid until 2023. Overall, this produces a valuation of £8.71 (previously £11.83). In our downside scenario, we assume a 50% dividend cut for three years and then 65p, which results in a valuation of £7.82.

Earnings-driven SOTP model no longer useful given our forecasts are based off depressed 2021 level

SOTP

Our SOTP model was based on year 1 prospective earnings, which we do not believe accurately reflect ABG's long-term value creation and so we have withdrawn this model for the moment.

Notes

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research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com