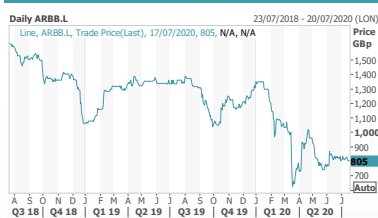


20 July 2020

## Financials



Source: Refinitiv

## Market data

EPIC/TKR	ARBB
Price (p)	795/790
12m High (p)	1,428
12m Low (p)	625
Shares (m)	15.4
Mkt Cap (£m)	123
Loan to Deposits 2021E	76%
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](http://www.arbuthnotgroup.com)

## Key shareholders

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

## Diary

Oct'20	Trading statement (TBC)
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## Analyst

Mark Thomas	020 7194 7622
	<a href="mailto:mt@hardmanandco.com">mt@hardmanandco.com</a>

# ARBUTHNOT BANKING GROUP

## 2020 interim results: credit robust, rate sensitivity

To be resilient, a bank needs three things – low risk assets, strong capital and surplus deposits. ABG has all three. The low-risk assets are reflected by the small percentage (and falling) Stage 2 and Stage 3 loans in the private bank as well as low loan to values. Surplus capital is now £66m and deposits exceed loans by £0.6bn. Profits before tax, though, fell from £2.9m to £0.2m as the decline in base rate squeezed margins (£2.7m cost) and with a £1m incremental COVID-19-related impairment. Our 2020 base-case scenario is now for a small loss (previously breakeven). The shares trade at 64% of NAV, implying value destruction to perpetuity.

- **1H'20 results:** Gross interest income rose from £35.2m in 1H'19 to £39.0m while interest expense rose from £6.5m to £9.3m. Fee income was flat. Costs rose from £33.8m to £35.1m; net impairments increased from £1.3m to £1.7m, including £1m incremental COVID-19-related effects. As expected, there was no dividend.
- **Outlook:** There are too many moving parts to rely on single projections. We have introduced a range of scenarios. Our central case is a £1.5m pre-tax loss in 2020. Given news flow, we have narrowed our expectations, so the upside scenario profit is now £3m (was £6m) and the downturn scenario is a £10m (was £15m) loss.
- **Valuation:** Our forecast scenarios, and multiple valuation approaches, see a broad range of valuations. Our base-case range is 871p to 1,658p, the higher end down with the fall in STB value. Our upside scenario is 1,044p to 1,918p, and our downside 783p to 1,412p. The share price is 64% of the 1H'20 NAV (1,248p).
- **Risks:** Short term, the impact of lower base rates is critical. Going forward, the key risk is credit. Historically, ABG has been very conservative in lending criteria and security taken. Its financial strength means that ABG can take time to optimise recoveries. 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 below book value is an anomaly.

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

Year-end Dec (£000)	2015	2016	2017	2018	2019*	2020* central
Operating income	34,604	41,450	54,616	67,905	72,465	70,293
Total costs	-35,926	-46,111	-54,721	-64,982	-70,186	-68,973
Cost:income ratio	104%	111%	100%	96%	97%	98%
Total impairments	-1,284	-474	-394	-2,731	-867	-4,400
Reported PBT	-2,606	179	2,534	6,780	7,011	-1,500
Adjusted PBT	2,982	4,009	3,186	7,416	5,800	500
Statutory EPS (p)	86.3	1,127.2	43.9	-134.5	41.1	-8.2
Adjusted EPS (p)	13.5	17.1	47.5	40.3	32.8	2.3
Loans/deposits	82%	76%	75%	71%	77%	76%
Equity/assets	5.5%	18.5%	12.8%	9.0%	8.0%	7.2%
P/adjusted earnings (x)	58.9	46.5	16.7	35.0	24.2	338.4
P/BV (x)	0.99	0.52	0.52	0.62	0.59	0.64

\* IFRS9 basis; Source: Hardman &amp; Co Research

# 1H'20 results summary

## Financial highlights

*Profits down as base rate cuts squeezed margins, no STB dividend*

*Impairments included £1m of COVID-19-related effects*

*Capital surplus £66m*

- ▶ Profit before tax came in at £0.2m (1H'19: £2.9m). The primary reduction came from Bank of England base rate reductions (cost £2.7m) where variable loans were re-priced down, reducing spread. Despite 27% volume growth, interest income rose from £35.3m to just £39.0m. Many deposits were already at the pricing floors and so 21% volume increases and higher-cost capital instruments saw the total interest expense climb from £6.5m to £9.4m. Additionally, the group did not receive in 1H'20 the anticipated ca.£1m dividend from its investment in Secure Trust Bank. Costs increased from £33.8m to £35.1m, well below volume growth. Earnings per share was 0.9p (1H'19: 16.6p)
- ▶ Net impairments increased by 19% to £1.7m. Commercial division impairments fell; there was continued zero impairment in the mortgage division and increases elsewhere. We give a more detailed credit review later in this report. COVID-19-related issues saw gross impairments rise by £1m, from £5.2m to £6.2m.
- ▶ The capital surplus was £66m (31 December 2019: £72m), 147% of required capital with a Core Equity Tier 1 ratio of 13.9% (31 December 2019: 14.4%) and total capital ratio of 17% (31 December 2019: 17.3%). The liquidity surplus is in excess of £400m, with deposits £0.6bn above loans.
- ▶ Net assets per share stood at £12.48 (1H'19: £13.21; 31 December 2019: £13.64) with a fall in the value of the STB stake (this does not materially affect regulatory capital as it is already largely a capital deduction).

## Operational highlights

*Loans up 27% including mortgage book acquisition*

*Deposits up 21% with growth in commercial and Arbuthnot Direct*

*AUM up 4% with gross inflows up 77%*

- ▶ Customer loans were £1,620m (1H'19: £1,275m), an increase of 27%. The growth reflects acquired mortgage portfolios and growth in commercial banking (up £88m). Private bank loans saw a 2% rise in loan balances in 1H'20 (ABG has not been willing to compete on price for low loan-to-value mortgages, which have continued to re-finance elsewhere) after originating new loans of £193m (1H'19: £206m). Forbearance in the largest acquired mortgage book has fallen from 26% of customers to 8%. The asset finance division, in line with market trends, experienced a much higher level of request (63%).
- ▶ Customer deposits increased by 21% to £2,207m (1H'19: £1,829m) with strong growth in commercial banking and Arbuthnot Direct.
- ▶ Assets Under Management came in at £1,074m (1H'19: £1,029m), rising 4% despite the market turmoil. AUM growth reflected £58.3m of gross inflows, 77% ahead of the same period last year and also with increased new client numbers.
- ▶ ABG remained fully operational by implementing remote working plans and was accredited in June to provide Government supported Business Interruption Loans "CBILs" and "BBLs".

## Secure Trust Bank (STB)

*STB share price falls affect equity but not regulatory capital*

STB has been de-recognised as an associated undertaking, due to a loss of significant influence (ABG directors left the board). It showed a sharp mark-to-market fall in 1H'20, with the end-June share price (724p) at lows not seen since 2012. The fall in the value of the stake (£15.9m) is taken directly to equity but has limited impact on regulatory capital as the investment is a supervisory deduction.

## Low-risk portfolio

IFRS9 classifies loans into three stages, with Stage 1 being the best quality and Stage 3 the worst. The table below shows the trends in the three largest divisions, which show:

### *Private bank asset quality improving*

- In the private bank, in 1H'20, Stage 2 and Stage 3 loans have fallen by £5.5m (12%) and £1.5m (5%), respectively. There are fewer problem accounts than at the start of the year. We understand there has also been a ca.£1.1m re-classification of a stage 3 loan to the commercial division but the trend is still down.

### *Commercial bank driven by one account with significant surplus security*

- In commercial lending, there has been an increase in Stage 3 accounts, primarily reflecting one loan of £9.5m where property security valued at £15m is held and no loss is expected from this situation. As noted above, there was a re-classification increasing Stage 3 balances.

### *No losses in mortgage book. Increase in Stage 2 and 3 accounts is technical issue post acquisition.*

- In the mortgage book, ca.4% of the book is now in those stages (having been zero previously). ABG has taken no impairments, though, as customer cashflow is the key to good credit, we believe. 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-19, 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 loan to value (LTV) of 70%. The reported increase in Stage 2 and Stage 3 is an accounting issue reflecting the fact that, on acquisition, all the accounts are technically up to date with payments to ABG. The current numbers are more reflective of the real position and, given security values and long customer payment track record, no provisions are deemed necessary.

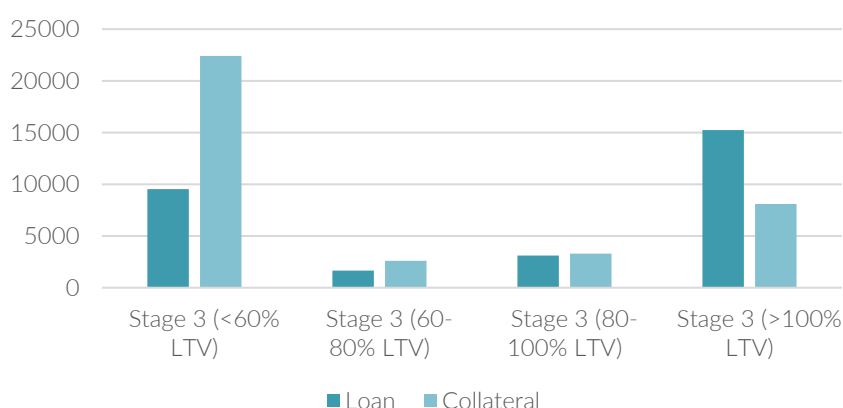
Loans and collateral by LTV buckets (£000)						
	Private bank		Commercial bank		Mortgages	
	Loans	Impairment allowance	Loans	Impairment allowance	Loans	Impairment allowance
<b>Stage 1</b>						
June 2020	529,247	288	525,628	236	279,963	0
December 2019	509,865	145	505,692	174	306,044	0
June 2019	513,879	807	465,202	817	61,267	0
<b>Stage 2</b>						
June 2020	38,094	24	25,000	0	6,314	0
December 2019	43,525	34	22,090	11	0	0
June 2019	40,543	98	9,931	7	0	0
<b>Stage 3</b>						
June 2020	28,063	3,299	12,960	1,593	5,681	0
December 2019	29,549	3,493	375	352	0	0
June 2019	30,801	4,732	5,420	827	0	0

Source: ABG, Hardman & Co Research

In the smaller RAF book, there has been an increase in Stage 3 accounts (from £1.5m to £2.2m) while Stage 2 accounts have risen from £756k to £792k. Provisions against these balances have risen from £372k to £447k.

*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. Disclosure from the year-end has not been updated, so the breakdown by loan to value at that time is given 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

Again, the December disclosure highlighted that most of the private bank loans (£579m) were residential mortgages on low LTV. In addition, there were at that time 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 was £1.035bn out of total loans of £1.6bn (i.e., 64% of the total book). The mortgage acquisition was more geographically diversified and the proportion of total lending in London fell in 2019 by a couple of percentage points to 35%.

Impairments based off 92% chance of downside scenarios, up from 54% end-2019

ABG has provided 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. As can be seen, there has been a material increase in downside weightings. In terms of sensitivity, moving to a 100% assumption on the "moderate decline" (which is not that moderate as it assumes 20% drops in house prices) would adversely reduce profits by £3.1m. It is important to measure this credit sensitivity against the much higher impact of base rates cuts.

**Weighting to range of economic outturns and collateral/property price impact for each**

% Scenario	1H'20	Probability 2019	Weighting 2018	Impact at 100% weighting (£m)	Change London	in Property rest of UK	Price overseas
Severe decline	2	1	1	-31.8	-40	-40	-40
Moderate decline	20	3	3	-3.1	-20	-20	-20
Decline	70	50	50	+0.7	-2	-1.5	-1
No change	4	26	21	+1.3	0	0	0
Growth	4	20	25	+1.4	0.5	0.5	2.3

Source: ABG, Hardman & Co Research

**COVID-19 commentary**

ABG commented that:

"The significant business risks that may arise from the economic shock in addition to the reduction in interest rates as detailed in the Chairman's statement are:

a) Increased credit risk as borrowers are unable to continue to meet their interest obligations as they fall due. It is also currently unclear precisely how the Government's announced package of measures will interact with this clear risk. The mortgage payment holiday for three months, which was subsequently extended by a further three months for retail mortgage customers, will allow borrowers some grace to return to normal payments. Additionally, the introduction of CBILs and

Company identifies, as expected, credit risk, less new business, investment property values and investment management income as key exposures over and above base rate effect

BBLs, which include Government guarantees, provide additional support to customers which may potentially reduce some of this risk to the Group.

b) The uncertainty in the economy could result in a significant fall in the collateral values of our security held against the loans..... However, the average loan to value of our property backed lending book is 53.5%, so to have any material impact, this fall in collateral values would have to be severe and prolonged.

c) A prolonged reduction in business activity will affect our ability to generate new business opportunities and it is highly likely that repayments in our current lending portfolios will be greater than new originations, which could lead to an overall fall in the Group's customer lending balances and the associated revenue that this generates.

d) The economic shock could also lead to a fall in valuations in the Groups investment properties and those properties held in inventory.

e) As the revenues earned by the Group's Investment Management business are directly linked to the balances managed on behalf of our customers, any reduction in these values due to market movements will have a corresponding impact on these revenues."

*Hardman & Co analysis is scenario section below*

*Hardman & Co comment: We do not believe that any of the issues identified above will surprise investors. Indeed, they were all in our scenario tests in our 6 April note [2019 results: resilience into the storm](#) and updated in the section below. The key sensitivity in the short term is the impact of lower interest rates, which was built into our previous forecasts. The main variability/risk to our forecasts will come from credit. We note the sensitivity to different assumptions gives a relatively modest increase in the "expected loss" element of IFRS9, so the risk comes from actual arrears rather than IFRS9 cyclicality. As detailed above, we expect individual loans should see mitigated effects from the high levels and quality of security undertaken by ABG.*

*Group well capitalised, with core equity tier 1 ratio of 13.9%*

*Surplus capital of over £50m at end-2021E, even after our downside scenario*

## Capital

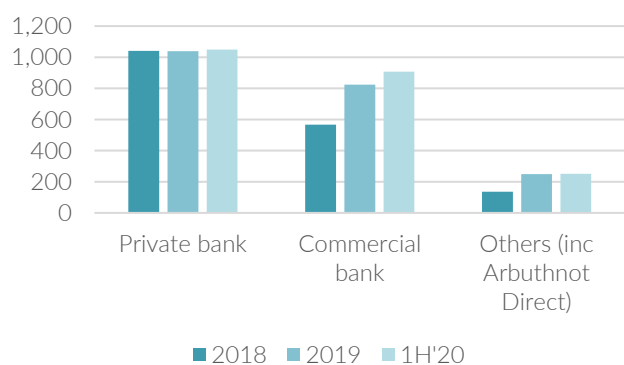
Capital is of course the second line of defence against downside scenarios (the first is existing profitability). The group starts from a strong position with the core Equity Tier 1 ratio of 13.9%. We detail in the section on financials below a range of scenarios. The downside scenario would use less than a third of the surplus capital currently available, still leaving the group with more than £50m of surplus capital by the end of 2021. In that scenario, loan balances may be expected to fall, which could increase this surplus further.

*Surplus deposits have been a long-term feature. At end-1H'20, ABG had nearly £0.6bn surplus deposits over lending and more than £400m surplus liquidity over regulatory requirements.*

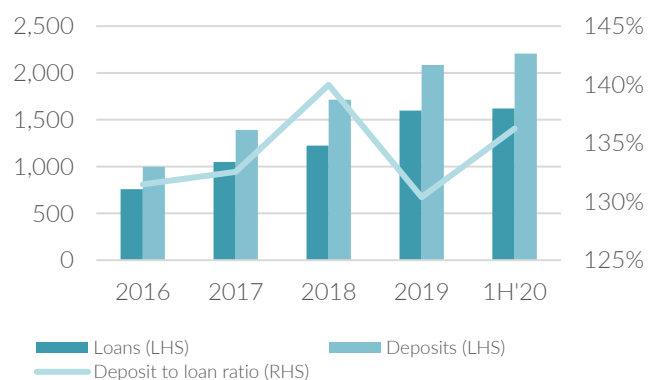
## Strong liquidity

ABG has always been conservatively run in terms of liquidity. This has continued in recent years with deposits in 1H'20 of £2.2bn against loans of £1.6bn and generating surplus liquidity over regulatory requirements in excess of £400m. This has been carefully managed growing from £300m at the end of March. Of course, this comes at a cost as typically the investment returns are lower than the deposit rate being paid, but it appears to us a prudent approach in such volatile times. 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 at end-2019 was 41% of deposits and we expect some modest re-pricing benefit as these deposits roll over (an offset to the higher liquidity cost noted above).

### Deposits by division (£m)



### Group loans and deposits (£m) and ratio



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 that 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. Given the impact of base rate cuts visible in 1H'20 (and the full period effect in 2H'20), an increased carry cost for higher surplus liquidity and the adoption of a new CRM system (incremental costs ca.£150k p.m.), we are now forecasting a base-case loss of £1.5m (previously breakeven). Given the uncertainties, we have limited our scenario discussion to the current year.

Summary of impact on 2020 profits of different scenarios against 2019			
£m	Downside scenario	Central case	Upside scenario
<b>Net interest income</b>			
Hitting savings floors	-10	-10	-3
Widening asset prices	3	1	0
Deposit competition	2	2	1
Volume	-3	6	10
<b>Fees and commissions</b>			
Fees lending	-1	0	1
Fees AUM	-2	-1	1
<b>Other income</b>			
STB dividend	-1	-1	0
Acquisition adjustments	2	0	0
Lower rent	-3	-3	-3
<b>Costs</b>			
Ongoing costs	7	3	-10
Investment spend	-2	-2	0
Impairments	-9	-4	-1
Change in P&L against 2019	-17	-8.5	-4
<b>Reported profit in 2020</b>	<b>-10</b>	<b>-1.5</b>	<b>3</b>
<b>Other considerations</b>			
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 material pressure on deposit margins. As most of the asset side is largely 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 to four months.

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

- ▶ Asset credit 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 broadly flat balance sheet in 2H'20 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).

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

- ▶ There is considerable uncertainty on provisions. The IFRS9 sensitivity disclosure is helpful in assessing the impact of the accounting treatment cyclicality. It is entirely credible to see, as we did in the commercial division in 1H'20, a sizeable loan going into arrears but requiring no provision. Our £9m increase on 2019 assumption in the downside scenario is very much finger in the air rather than scientific calculation and it also reflects that the full effect of provisions may not be felt until 2021.

*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.

*Other risks include property valuations and the STB share holding*

- ▶ 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). Given STB is now at 2012 lows, downside from here may be expected to be relatively modest.



## 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	76,000	79,175
Interest expense	-6,334	-10,107	-18,233	-18,900	-19,300
<b>Net interest income</b>	<b>41,093</b>	<b>55,183</b>	<b>58,637</b>	<b>57,100</b>	<b>59,875</b>
Fees and comms. income	13,805	12,956	13,935	13,293	14,043
Fees and comms. expense	-282	-234	-107	-100	-100
Net fees and comms.	13,523	12,722	13,828	13,193	13,943
<b>Operating income</b>	<b>54,616</b>	<b>67,905</b>	<b>72,465</b>	<b>70,293</b>	<b>73,818</b>
Net impairment on financial assets	-394	-2,731	-867	-4,400	-4,600
STB dividend income	0	0	1,500	0	1,000
Other income	3,033	6,588	4,099	1,580	2,000
<b>Operating expenses</b>	<b>-54,721</b>	<b>-64,982</b>	<b>-70,186</b>	<b>-68,973</b>	<b>-67,822</b>
<b>Profit before tax from continuing operations</b>	<b>2,534</b>	<b>6,780</b>	<b>7,011</b>	<b>-1,500</b>	<b>4,396</b>
Income tax	-448	-1,121	-835	255	-747
Profit after tax from continuing operations	2,086	5,659	6,176	-1,245	3,648
Profit from discontinued operations after tax	4,437	-25,692	0	0	0
<b>Profit for year</b>	<b>6,523</b>	<b>-20,033</b>	<b>6,176</b>	<b>-1,245</b>	<b>3,648</b>

\* 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	344,829	331,931
Loans and advances to banks	31,844	28,578	36,951	54,173	46,258	46,258	100,000
Debt securities held to maturity	91,683	87,728	107,300	342,691	442,960	442,960	400,000
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
<b>Loans and advances to customers</b>	<b>1,158,983</b>	<b>1,579,512</b>	<b>758,799</b>	<b>1,224,656</b>	<b>1,599,053</b>	<b>1,646,000</b>	<b>1,646,000</b>
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	6,763
<b>Total assets</b>	<b>1,446,622</b>	<b>2,231,559</b>	<b>1,265,284</b>	<b>2,175,173</b>	<b>2,595,379</b>	<b>2,660,745</b>	<b>2,658,129</b>
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
<b>Deposits from customers</b>	<b>1,194,285</b>	<b>1,929,838</b>	<b>997,649</b>	<b>1,714,286</b>	<b>2,084,903</b>	<b>2,167,000</b>	<b>2,167,000</b>
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
<b>Total liabilities</b>	<b>1,273,053</b>	<b>2,040,155</b>	<b>1,030,926</b>	<b>1,979,217</b>	<b>2,387,044</b>	<b>2,469,592</b>	<b>2,469,592</b>
Share capital	153	153	153	153	154	154	154
Retained earnings	114,641	123,330	235,567	209,083	209,171	207,926	205,310
Other reserves	-1,263	34	-1,362	-13,280	-990	-16,927	-16,927
Total to owners of the parent	113,531	123,517	234,358	195,956	208,335	191,153	188,537
Non-controlling interests	60,038	67,887	0	0	-	-	-
<b>Total equity</b>	<b>173,569</b>	<b>191,404</b>	<b>234,358</b>	<b>195,956</b>	<b>208,335</b>	<b>191,153</b>	<b>188,537</b>

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

## Valuation

*Range of valuations broad – driven by scenario of assumptions, but also methodology. Central balance sheet driven approach derives £16.58.*

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) is £16.58 (down with lower equity following the reduction in the STB stake). We do not believe that the implied price to book on the higher valuation is overly demanding, being 1.3x book value for a business that has delivered significant long-term value in the past. The range of valuations across our scenarios and models is given in the table below.

### Summary of different valuation techniques by scenario

£ per share	Downside	Central	Upside
GGM	14.12	16.58	19.18
DDM	7.83	8.71	10.44

*Source: Hardman & Co Research*

## GGM

*GGM down primarily due to lower statutory equity with fall in market value of STB stake*

The GGM has fallen to £16.58 as the NAV has fallen with the reduction in the value of the STB stake. This reduction is clearly dependent on market appetite for the shares.

### 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%
<b>Adjusted price/book value (x)</b>	<b>1.3</b>	<b>1.4</b>	<b>1.1</b>	<b>1.3</b>
Book value 2020E (£m)	191.2	191.2	191.2	191.2
Valuation (£m)	243.7	272.4	203.1	254.9
<b>Valuation per share (p)</b>	<b>16.58</b>	<b>18.53</b>	<b>13.82</b>	<b>17.34</b>
Variance (p per share)		28.7	-40.6	11.2

*Source: Hardman & Co Research*

## DDM

*Assumed uncovered dividend and then delayed previous dividend growth*

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 (unchanged on unchanged base-case forecasts). In our downside scenario, we assume a 50% dividend cut for three years and then 65p, which results in a valuation of £7.81.

## SOTP

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

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.

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