

**Market data**

EPIC/TKR	ARBB
Price (p)	1,445
12m High (p *)	1,717
12m Low (p *)	1,265
Shares (m)	15.3
Mkt Cap (£m)	£221m
Loans to deposits (2016E)	70%
Equity Leverage ratio (2016E)	18%
Free Float** (%)	43.4%
Market	AIM

*Not adjusted for £3 special dividend **As defined by AIM Rule 26

Description

ABG now has three legs to its business. Its private bank is well funded and capitalised and has been growing very strongly. It holds an 18.9% stake in Secure Trust Bank. It has c£85m to invest in new organic or acquired businesses.

Company information

Chair / CEO	Sir Henry Angest
COO	Andrew Salmon
Group FD	James Cobb

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<http://www.arbuthnotgroup.com>

Key shareholders

Sir Henry Angest	55.1%
Liontrust Inv Ptnrs LLP	5.2%
Unicorn Asset Mgmt	4.8%
Prudential plc	5.7%
R Paston	3.5%

Next event

Trading statement	February 2017
FY16 results	March 2017

Analysts

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Arbuthnot Banking Group**New group taking shape with strong momentum**

In the past week ABG has announced the acquisition of a private-bank loan portfolio and a specialist asset backed finance business (subject to regulatory approval). Prior to these deals we believed ABG had nearly £100m of surplus capital and these deals will utilise £15m of this. ABG is now evolving into a more diversified banking group with both deposit and targeted lending businesses. It is establishing clear momentum across the group. We had expected loan acquisitions and will build the asset-backed deal into our numbers and valuation once the completion of the deal is more certain.

- ▶ **Loan book acquisition:** On 19th December ABG announced it had completed the purchase of a £45m private banking loan portfolio (83 accounts), mainly secured against residential property, from Duncan Lawrie. The average loan to value of the portfolio is 43% and the client yield is 5.21%. The consideration was £42.7m.
- ▶ **Asset backed acquisition:** On 20th December ABG announced the intended acquisition of Renaissance Asset Finance (completion likely Q217). RAF finances a range of specialist assets. On 30 November 2016 RAF's assets were £68m and net assets £1.6m. We believe the final PE multiple will be mid-single digit.
- ▶ **Other momentum:** In the recent trading statement, management advised that it was accelerating investment as "the disruption in the larger UK banks has led to a number of direct approaches from experienced bankers". We expect the organic momentum to also be strong.
- ▶ **Valuation:** Our base case valuation is now 1629p (formerly 1920p) an upside of 13%. The fall is primarily due to a £3 special dividend paid since our last report. Our capital fully deployed models indicate £19.56, an upside of 35%. With momentum building in ABG, the latter scenario appears increasingly likely.
- ▶ **Investment summary:** ABG offers strong franchise and continuing-business profit growth. Its balance sheet strength means it has wide ranging strategic options to develop organic and inorganic opportunities. The latter are likely to increase in uncertain times. Management has been both innovative but also very conservative in managing risk. Our base case valuation has 13% upside, rising to 35% on the full deployment of capital.

Financial summary and valuation

Year end Dec (£000)	2013 *	2014 *	2015	2016E	2017E	2018E
Operating income	100,020	92,049	34,815	40,865	50,719	66,143
Total costs	(76,231)	(66,165)	(35,926)	(44,163)	(47,630)	(56,472)
Cost income ratio	76%	72%	103%	108%	94%	85%
Total impairments	(18,807)	(11,953)	(1,284)	(846)	(1,072)	(1,425)
Reported pre-tax	15,713	13,931	(2,395)	(298)	7,095	14,086
Adj pre-tax	18,528	15,327	3,187	5,952	9,595	15,586
Statutory EPS (p)	77.3	58.0	86.3	1,120.3	41.5	84.7
Adj EPS (p)	92.1	78.2	20.5	24.4	55.4	93.2
Loans / deposits (%)	76%	97%	82%	70%	78%	83%
Equity / assets (%)	6.1%	7.8%	5.5%	17.6%	15.3%	13.1%
P/Adj Earnings (x)	15.7	18.5	70.6	59.2	26.1	15.5
P/BV (x)	3.3	1.9	1.8	1.0	0.9	0.9

Source: Hardman & Co Research * Includes fully consolidated STB **NAV increased with STB share sales

Renaissance Asset Finance Limited

Asset finance business focused on luxury cars and SME equipment

ABG has reached an agreement to acquire 100% of Renaissance Asset Finance Limited ("RAF", <http://www.renaissanceaf.com/>) from its founders. RAF is a provider of finance for a range of specialist assets including executive, specialist and vintage cars, commercial vehicles, coaches, agricultural equipment, plant & machinery and taxis. It is primarily based in the South East but also has an office in Wilmslow (Cheshire, opened May 2016). Distribution is via premium brokers and direct with customers all over the UK.

*Initial consideration at NAV.
Deferred consideration based off profitability*

Consideration will be paid in four staged amounts, all of which will be in cash. The first amount will be paid at completion and will equal the net assets of RAF at that time. On 30 November 2016 customer assets were £68m (having only been in business for just over two years) and RAF's net assets were £1.6m. The remaining amounts will be made annually based on the profitability of the business in each of the following three years. The maximum amount payable for the performance based payments is limited to no more than £6.5m. The multiples for deferred consideration have not been disclosed. The accounting is likely to recognise all the deferred payment up-front with a commensurate amount of goodwill.

Assets yielding c9% after broker commissions

The unaudited accounts of RAF for the twelve months ended 30 June 2016 show a profit before tax of £2.4m (which included a one-off income amount of £1.75m) with the average gross customer yield being 8.9%, which is after allowing for 3% of broker's commissions.

After lower financing costs, acquisition PE multiple likely to be in mid-single digits

Excluding the one-off, the pre-tax profit of £0.65m would imply existing business earnings of c£0.5m and a maximum consideration earnings multiple of c16x. However, this will be reduced by lower funding costs (currently 4-5%). We note that historically RAF was financed by BLME (Bank of London and The Middle East) and this will be replaced by cheaper bank deposits raised by Arbuthnot Latham. We believe the end PE multiple is likely to be mid-single digits.

Both consideration and the refinancing of RAF's funding liabilities (approximately £66m) will be satisfied from the Group's current cash resources. The existing management team will continue to run the business.

Goodwill c£6.5m plus £6-7m of equity support. With loan portfolio using c£15m of the £100m surplus capital

In terms of capital the acquisition will see an immediate goodwill deduction (£6.5m). Although the lending is secured both on the underlying assets and by the high net worth borrower, we have assumed a further £6-7m of equity will be required to support the business. The Duncan Lawrie loan book is primarily secured on property so we assume it will require £2-3m of equity support. In total these deals may be expected to utilise c£15m of the previous c£100m surplus capital leaving scope for further deals as well as strong organic momentum.

Valuation and Financials

Valuation

ABG paid £3 special dividend since our last report reducing our target prices.

Our valuations reflect (i) the payment of a £3 special dividend since our last report (ii) a small drop in the Secure Trust share price reducing the value of the sum of the parts model (iii) a small reduction in our Gordon's growth discount to reflect the positive momentum in the business. Overall this reduces our base case valuation from 1920p to 1629p.

Our capital fully deployed model has a valuation of £19.56 (previously £20.39). To achieve the forecast incremental loan growth will, after the special dividend paid in 2016, require further gains (£22.5m) to be realised from the inherent profit within the residual STB stake. Strategically we believe this is the direction of travel although the precise timing is unclear.

No change in estimates at this stage

No change in estimates. Loan portfolio acquisitions expected. RAF will be included once deal concludes.

We have not changed our base estimates at this stage. As we outlined in our initiation note some of the expected growth was expected to come from loan acquisitions. The corporate acquisition has yet to receive regulatory approval and so the timing is unclear. We will review our numbers with the trading statement expected in February and the FY16 results in March 2017.

Profit & Loss

Exhibit 1: Profit and Loss (£000s)							
Year Ended 31 December	2012	2013	2014 *	2015 E**	2016E	2017E	2018E
Interest Income	62,300	93,329	87,398	32,801	38,752	49,133	65,377
Interest expense	(17,514)	(20,279)	(19,371)	(7,779)	(8,886)	(10,888)	(13,183)
Net Interest income	44,786	73,050	68,027	25,022	29,866	38,245	52,194
Fees and Comm income	24,116	31,816	25,841	9,999	11,249	12,749	14,249
Fees and Comms expense	(3,347)	(4,846)	(1,819)	(206)	(250)	(275)	(300)
Net Fees and Comms	20,769	26,970	24,022	9,793	10,999	12,474	13,949
Operating income	65,555	100,020	92,049	34,815	40,865	50,719	66,143
Net impairment on Financial assets	(10,984)	(18,807)	(11,953)	(1,284)	(846)	(1,072)	(1,425)
Other income	11,065	10,731	-	-	1,665	-	-
Associate Income (Post tax)					2,181	5,078	5,840
Operating expenses	(53,043)	(76,231)	(66,165)	(35,926)	(44,163)	(47,630)	(56,472)
Profit before tax from continuing operations	12,593	15,713	13,931	(2,395)	(298)	7,095	14,086
Income tax	(1,128)	(4,198)	(3,444)	121	(1,263)	(973)	(1,596)
Profit after tax from continuing operations	11,465	11,515	10,487	(2,274)	(1,561)	6,123	12,490
Profit from discontinued operations after tax	(347)	-	6,529	28,798	228,110	-	-
Profit for year	11,118	11,515	17,016	26,524	226,549	6,123	12,490
Attributable to non-controlling interests	-	-	(8,382)	(13,798)	(61,426)	-	-
Attributable to equity shareholders	11,118	11,515	8,634	12,726	165,123	6,123	12,490

Source: Hardman & Co Research* ELL discontinued in 2014, ** STB discontinued in 2015

Exhibit 2: Divisional forecasts (£000s)							
Year Ended 31 December	2012	2013	2014	2015	2016E	2017E	2018E
Operating Income							
Private Banking	18,730	21,651	28,895	35,076	41,163	51,430	66,854
Group centre	(62)	(613)	(506)	(472)	(299)	(711)	(711)
STB	46,887	78,982	63,660	92,089	-	-	-
ABG Total	65,555	100,020	92,049	126,693	40,865	50,719	66,143
STB stand-alone (exc ELL 2014/2015)	46,887	78,982	63,660	92,089	129,864	164,038	208,139
Statutory pre-tax profit							
Private Banking	2,058	7,728	3,628	5,998	7,719	9,728	15,957
Group centre	(6,718)	(9,208)	(7,452)	(8,604)	(10,199)	(7,711)	(7,711)
STB	17,253	17,193	17,755	25,174	2,181	5,078	5,840
ABG Total	12,593	15,713	13,931	22,568	(298)	7,095	14,086
STB stand-alone (exc ELL 2014/2015)	17,253	17,193	17,755	25,174	29,864	34,538	40,139
Adjusted pre-tax profit (co basis)							
Private Banking	2,358	2,072	4,826	7,872	9,404	12,228	17,457
Group centre	(7,557)	(8,772)	(7,452)	(8,604)	(7,895)	(7,711)	(7,711)
STB	16,754	25,228	20,388	26,733	4,442	5,078	5,840
ABG Total	11,555	18,528	17,762	26,001	5,952	9,595	15,586
STB stand-alone (exc ELL 2014/2015)	16,754	25,228	20,388	26,733	29,864	34,538	40,139

Source: Hardman & Co Research

Exhibit 3: EPS calculation and dividends (p)							
Year Ended 31 December	2012	2013	2014	2015	2016E	2017E	2018E
Average No shares (m)	15.28	15.28	15.28	15.28	15.28	15.28	15.28
Less treasury	0.39	0.39	0.39	0.39	0.39	0.39	0.39
Less ESOP	-	-	-	0.15	0.15	0.15	0.15
Avg no shares for EPS calculation	14.89	14.89	14.89	14.74	14.74	14.74	14.74
Diluted no shares	-	-	0.19	0.20	0.05	0.05	0.05
Statutory EPS (p)	74.7	77.3	58.0	86.3	1,120.3	41.5	84.7
Diluted EPS (p)	74.7	77.3	57.3	85.2	1,116.6	41.4	84.5
Adjusted EPS (co basis)	60.8	92.1	78.2	20.5	24.4	55.4	93.2
Interim dividend (p)	11	11	11	12	13	14	15
Final dividend (p)	14	15	16	17	18	19	20
Special dividend (p)	-	18	-	-	325	-	-
Total dividend (p)	25	44	27	29	356	33	35

Source: Hardman & Co Research

Exhibit 4: Adjusted Profit and Loss (£000s)

Year Ended 31 December	2012	2013	2014 *	2015 E**	2016E	2017E	2018E
Statutory pre-tax	12,593	15,713	13,931	(2,395)	(298)	7,095	14,086
Group adjustments							
Bonus payment in Group for ELL sale	-	-	-	-	2,304	-	-
Continuing income from associate for 6 mths ending June	-	-	-	3,708	2,261	-	-
180th anniversary	-	436	-	-	-	-	-
Arbuthnot Latham adjustments							
Cost of acquisition	-	-	-	418	200	200	200
Sale and leaseback	-	(6,535)	-	-	-	-	-
Gain on sale of Swiss subsidiary	(839)	-	-	-	-	-	-
Sale of Visa	-	-	-	-	(1,665)	-	-
Investment in operating system	-	-	-	1,123	600	-	-
Investment in AL commercial banking	-	-	-	333	1,250	1,000	-
Investment in new private bankers	300	-	-	-	-	-	-
Investment in regional offices / incremental office space	-	-	217	-	1,300	1,300	1,300
Investment in Dubai	-	879	981	-	-	-	-
STB adjustments							
Cost of option scheme	1,610	2,221	-	-	-	-	-
Gain on acquisition of Everyday Loans	(9,830)	-	-	-	-	-	-
ELL Fair value amortisation	3,056	4,066	-	-	-	-	-
Management incentives post acquisition	1,700	-	-	-	-	-	-
Excess funding prior to acquisition	1,900	-	-	-	-	-	-
Acquired portfolio	(363)	1	-	-	-	-	-
cost of acquisition	1428	854	198	-	0	0	0
V12 amortisation	-	893	-	-	-	-	-
Company adjusted basis	11,555	18,528	15,327	3,187	5,952	9,595	15,586

Source: Hardman & Co Research* ELL discontinued in 2014, ** STB discontinued in 2015

Balance sheet

Exhibit 5: Balance Sheet (£000s)

Year Ended 31 December	2012	2013	2014	2015	2016E	2017E	2018E
Cash and balances at Central Bank	203,683	193,046	115,938	368,611	304,892	257,548	250,503
Loans and advances to banks	144,391	105,061	31,844	28,578	18,578	18,578	18,578
Debt securities held to maturity	13,526	19,466	91,683	87,728	87,035	87,035	87,035
Assets classified as held to sale	-	-	-	118,456	-	-	-
Derivative financial instruments	648	508	2,707	1,490	1,490	1,490	1,490
Loans and advances to customers	586,968	732,009	1,158,983	1,579,512	735,000	980,000	1,300,000
Other assets	11,666	17,267	16,866	16,894	14,403	14,403	14,403
Financial Investments	3,257	1,975	1,277	2,685	2,685	2,685	2,685
Deferred tax	5,057	3,954	2,588	1,784	1,784	1,784	1,784
Investment in associate	-	943	943	943	89,030	94,108	99,948
Intangible assets	8,326	13,103	11,318	10,874	6,704	6,204	5,704
Property Plant and equipment	22,487	5,522	12,475	14,004	5,216	5,216	5,216
Investment Property	-	-	-	-	50,200	50,200	50,200
Total assets	1,000,009	1,092,854	1,446,622	2,231,559	1,317,017	1,519,251	1,837,546
Deposits from banks	373	2,003	27,657	55,305	1,986	1,986	1,986
Derivative financial instruments	462	371	1,067	135	-	-	-
Deposits from customers	894,545	957,791	1,194,285	1,929,838	1,050,000	1,250,000	1,560,000
Liabilities relating to assets classified as held for sale	-	-	-	8,700	-	-	-
Current tax liability	346	1,427	3,612	3,366	488	488	488
Other liabilities	23,655	32,116	34,984	31,977	20,000	20,000	20,000
Debt securities in issue	11,980	12,232	11,448	10,834	13,000	14,000	15,000
Total liabilities	931,361	1,005,940	1,273,053	2,040,155	1,085,474	1,286,474	1,597,474
Share capital	153	153	153	153	153	153	153
Retained earnings	53,372	67,901	114,641	123,330	232,710	233,944	241,239
Other reserves	(1,253)	(1,467)	(1,263)	34	(1,320)	(1,320)	(1,320)
Total to owners of the parent	52,272	66,587	113,531	123,517	231,543	232,777	240,072
Non-controlling interests	16,376	20,327	60,038	67,887	-	-	-
Total equity	68,648	86,914	173,569	191,404	231,543	232,777	240,072

Source: Hardman & Co Research

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