ARBUTHNOT BANKING GROUP PLC

Interim Report 2023

The importance of history and Sun Tzu

The importance of previous experience cannot be overstated. "Those who are not willing to learn from history are doomed to repeat the mistakes of previous generations".

A good place to start, therefore, is with the famous Chinese General, Sun Tzu and his writings in "The Art of War" ca. 2500 years ago. He established some basic truths such as:

"He whose ranks are united in purpose will be victorious."

"The commander will surely choose those who are most fortunate."

"The traits of a true commander are: courage, wisdom, humanity and integrity."

Origins of Arbuthnot Latham

George Arbuthnot (1772 – 1843) was a son of the Edinburgh banker Robert Arbuthnot. He started in 1803 as a partner in Latour & Co. in Madras (today Chennai), Southern India. Latour & Co. had been set up in 1780 by Count Francis Joseph Louis Latour de Quercy, who died in 1808. In 1807 Latour & Co. became Arbuthnot & Co. and George Arbuthnot became the leading partner until he retired in 1824. In his farewell letter to the partners he said:

"…not only give the constituent (client) the assurance that his money is safe, but also give him the feeling that he is benefitting himself by dealing with the House."

In 1826 John Alves Arbuthnot started as a clerk at Arbuthnot & Co. and in 1831 became a partner. He married the daughter of George Arbuthnot. Upon his return to London he established, together with Alfred Latham, the trading house Arbuthnot & Latham on 13 March 1833.

(For more details, read the book: Arbuthnot Latham 1833 – 2013 by David Lascelles)

Directors

Sir Henry Angest
Chairman and Chief Executive

The Hon Sir Nigel Boardman
Independent Non-Executive Director

James Cobb FCA
Group Finance Director

Ian Dewar FCA
Independent Non-Executive Director

Andrew Salmon FCA
Group Chief Operating Officer

Sir Alan Yarrow FCSI (Hons)
Independent Non-Executive Director

Frederick Angest
Non-Executive Director

Secretary

Nicholas Jennings FCA

Arbuthnot Banking Group PLC

The Seven Principles

Ever since George Arbuthnot first gave guidance about corporate behaviour, it has been the culture of Arbuthnot to follow his advice. The Seven Principles summarise Arbuthnot's corporate philosophy and ethics.

During the 190 year history of serving its customers, Arbuthnot has proven its ability to adopt and grow by applying such principles with pragmatism and common sense.

1. Arbuthnot serves its **shareholders**, its **customers** and its **employees** with **integrity** and **high ethical standards.** This is demonstrated in a **progressive dividend** policy, in **fair pricing** and in **pay for performance.**

2. Arbuthnot attaches great importance to **good relations** with customers and business partners, and treating them **fairly and promptly**. Arbuthnot believes in **reciprocity.**

3. Arbuthnot is **independent**, and **profit and growth oriented** while maintaining a **controlled risk profile.**

4. Arbuthnot's business is conducted in an **innovative, flexible** and **entrepreneurial** manner, with an **opportunistic** and **counter-cyclical attitude.**

5. Arbuthnot's approach is based on **diversification** to spread the risk, a **long-term view** to further growth, **empowerment of management** and a culture of **rewards for achievements** to engender loyalty.

6. Arbuthnot does not sacrifice **long term prospects** for short term gains – nor sacrifice **stability** for quick profits, and it will never put the whole company at **risk.**

7. Ultimately, the success of Arbuthnot depends on the **teamwork**, **commitment**, and **performance** of its employees, combined with the **determination** to win.

The continued application of these principles will allow the business to pursue growth in a controlled manner, providing a high quality service to its customers whilst delivering good returns to shareholders and securing the well-being of its employees.
To this end, an inclusive and balanced work environment will provide a rewarding as well as challenging multiformity.

Sir Henry Angest
Chairman & CEO

17 July 2023

Chairman's Statement

I am pleased to report that the Group continues to make good progress. The profit before tax for the first six months of the year is £26.4m compared to £3.4m in the same period last year.

The Group remains focused on delivering the strategic aims in the new "future state 2" presented earlier this year along with the 2022 full year results. With greater diversity in the lending balances being provided by the specialist divisions, the overall profitability has benefited from the upward moves in the Bank of England Base Rate.

As previously noted, the upward shifts in the base rate create a lag effect in the Group's net interest margins, as it takes time for the cost of customer deposits to reprice to current market levels as they mature. Thus, we expect net interest margins to narrow as this repricing of deposits takes place.

The deposit market continues to remain extremely competitive, with many offers for term deposits of one year now well in excess of the base rate. Our bank, Arbuthnot Latham has been swift to adjust its rates in these markets, offering new and existing customers attractive rates.

However, with the strength of our deposit base, which is diversified between transactional and term accounts, the average cost of deposits stood at 2.2% for the month of June and averaged 1.9% for the first six months of the year. If base rates remains unchanged for the next 12 – 18 months, the cost of deposits is expected to rise to a peak of 2.9% over time.

I have previously explained that I believe that the strength of a bank should be measured against the quality of its deposit base rather than only capital or lending based measures. This I feel was never more clearly demonstrated than during the recent period of market uncertainty caused by the collapse of Silicon Valley Bank. I was pleased to note that the relationship banking model that we have established proved to be powerful and we saw the confidence that our clients have in us, demonstrated by the fact that we had net inflows of deposits during that time.

I was also pleased that during the first half of the year, Arbuthnot Banking Group carried out a successful capital raise. With the demand for the new equity being heavily oversubscribed, we were able to raise £12m rather than the initial target of £10m to help to satisfy this demand. This equity raise was designed to allow the lending businesses to continue to build their pipelines of new lending opportunities while at the same time having sufficient capital to allow for the second tranche of the Countercyclical Capital Buffer and to position us to be able to take advantage of opportunities that are expected to arise given the current market conditions.

This expectation proved correct as our specialist lending business, Asset Alliance was able to acquire a £42m portfolio of operating leases at a discount in May.

Given the rapid rise in interest rates, we are aware that the outlook for credit risk has worsened. At this time we have not yet seen a significant deterioration in our lending portfolios, however there is early evidence of pressure on affordability to cover interest payments becoming problematic as it takes time for the rental market to reprice. In response we have tightened our credit appetite, with LTVs on residential investment lending now being targeted at around 50% rather the previous 60%.

The specialist lending divisions continue to monitor their portfolios closely but as yet they continue to perform well.

Given its confidence in the prospects of the Group, the Board has decided to increase the interim dividend to 19p, being an increase of 2p over the interim dividend paid in 2022. This interim dividend will be paid on 22 September 2023 to shareholders on the register on 25 August 2023.

Banking

The Banking division reported a profit before tax of £31.1m for the first six months (30 June 2022: £6.6m), with lending balances totalling £1.45bn and deposits of £3.25bn (30 June 2022: lending of £1.46bn; deposits of £2.61bn).

Against the backdrop of ongoing economic uncertainty, the Bank has continued to stay focused on client service, which has led to net growth in client acquisition. The Bank's long term approach and cautious banking model resonates well with criteria clients looking for a bank where they can build a long term relationship.

Chairman's Statement *continued*

Deposits grew by £165.8m in the first half of 2023 despite a number of high profile banking failures and turbulence across the banking sector. The Bank's strategy to hold high levels of liquidity, with no reliance on wholesale funding meant that the Bank operated with a consistently strong liquidity position in the period, reassuring clients of the Bank's robustness and resilience.

The Bank has continued to pursue its strategy to focus on more capital efficient lending and allowing capital intensive lending to mature and refinance away in addition to tightening its credit criteria. The loan book fell marginally by 1% in the six months to finish the half year at £1.45bn.

The impact of the changing macroeconomic environment is resulting in some signs of stress in the loan book, however given the Bank's cautious underwriting approach with low LTV ratios, the Bank is well positioned to exit any defaults with little or no loss.

Wealth Management

Assets Under Management ("AUM") closed the half-year mark at £1.38bn with positive net funds flow for the first half of 2023. The rising interest rate environment has resulted in an increase in client withdrawals compared to prior periods, where clients are opting to pay down their debt.

Arbuthnot Commercial Asset Based Lending ("ACABL")

ACABL has reported a profit before tax of £4.0m (30 June 2022: £2.9m) an increase of 38% for the same period in the prior year. The loan book was £241.1m as at the half year compared to £238.8m in the prior year and £268.8m at the previous year end.

In early May, ACABL celebrated its 5th year anniversary. Since launch, the business has grown its loan book with facility limits in excess of £500m and built a team of 31 highly experienced staff.

The business has continued to onboard new clients and support the growth of existing clients, however demand for transactional funding was seen to reduce towards the end of 2022 following the 'mini budget' and this has carried over into early 2023. This has resulted in a higher level of refinance opportunities that have and are being carefully considered in light of the market challenges. This has impacted the level of funds in use when compared to the previous year end, which also takes into account some expected client attrition given the book's maturity.

It is expected activity from Private Equity sponsors and the wider Corporate Finance community will result in an increase in transactional flow in the second half. Given the opportunities that will come from more realistic enterprise values, ACABL is well placed to fund these future transactions.

In the first quarter, ACABL renewed its accreditation to provide loans under the Recovery Loan Scheme as a continued additional source of funding for deal structures where appropriate.

Renaissance Asset Finance ("RAF")

RAF has reported a profit before tax of £0.7m (30 June 2022: £0.2m), with customer loan balances of £156.7m (30 June 2022: £102.6m).

New business levels have remained positive and the balance sheet continues to grow in line with the Group's Future State plan, with improved margins achieved on new business despite the current economic environment.

Whilst some pressure is expected, particularly in the SME customer base, the book continues to perform in the current economic climate with problem debts marginally lower than expected.

Asset Alliance Group ("AAG")

AAG continues to trade well with leased assets and hire purchase loans totalling £258.8m at the end of June 2023 compared to £128.6m as at 30 June 2022, equating to year-on-year growth of 101%, and 37% year to date. Included in the result is £42m of operating leases which AAG acquired at a discount to face value, to provide buses for contracted operations in London.

Despite the portfolio acquisition, supply chain issues continue, however with signs of improvement beginning to appear. Where in prior periods, supply chain issues have led to a buoyant used truck market, the business expects this market to weaken, but margins currently remain stronger than expected.

Mortgage Portfolios

The Group's acquired mortgage portfolio is currently operating in line with expectations with a carrying value of £135.0m compared to £166.2m as at 30 June 2022 and £148.5m as at 31 December 2022.

Chairman's Statement *continued*

Operations

The Bank continues to see significant growth in client activity with non-card related payment volumes increasing by 15% year on year, with over 500,000 payments processed in the first half of 2023. Card transactions have also seen significant growth with volumes in the first six months of 2023, approximately 45% higher than the same period last year.

Having completed the core banking platform upgrade at the end of 2022, the Bank has commenced a review of its future digital strategy that will focus on further developing the client digital channels and streamlining a number of operational processes. The outputs of this review will underpin the roadmap for further technology investment over the coming 2-3 years with delivery expected to commence later in 2023.

Outlook

The continued stubbornness of inflation has led to increased interest rate rises which has had a positive effect on the profitability of the Group. The outlook for the economy looks increasingly uncertain and we remain alert to potential increases in credit risk that may result from an economic downturn. However, given the improved profitability and robust financial strength, the Group remains well positioned.

Sir Henry Angest
Chairman & CEO

17 July 2023

Consolidated Statement of Comprehensive Income

	Note	Six months ended 30 June 2023 £000	Six months ended 30 June 2022 £000
Income from banking activities			
Interest income		100,320	49,088
Interest expense		(31,950)	(6,552)
Net interest income		**68,370**	**42,536**
Fee and commission income		11,275	10,099
Fee and commission expense		(105)	(59)
Net fee and commission income		**11,170**	**10,040**
Operating income from banking activities		**79,540**	**52,576**
Income from leasing activities			
Revenue		49,895	48,851
Cost of goods sold		(41,821)	(40,538)
Gross profit from leasing activities		**8,074**	**8,313**
Total group operating income		**87,614**	**60,889**
Net impairment loss on financial assets		(2,453)	(1,201)
Other income	7	2,326	610
Operating expenses		(61,079)	(56,923)
Profit before income tax		**26,408**	**3,375**
Income tax expense		(6,440)	(705)
Profit for the period		**19,968**	**2,670**
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Changes in fair value of equity investments at fair value through other comprehensive income		174	462
Tax on other comprehensive income		(43)	(88)
Other comprehensive income for the period, net of tax		**131**	**374**
Total comprehensive income for the period		**20,099**	**3,044**
Earnings per share for profit attributable to the equity holders of the Company during the period (expressed in pence per share):			
Basic earnings per share	8	**129.4**	**17.8**
Diluted earnings per share	8	**129.4**	**17.8**

The notes on pages 9 to 27 are an integral part of these consolidated financial statements

Consolidated Statement of Financial Position

	At 30 June 2023 £000	At 30 June 2022 £000	At 31 December 2022 £000
ASSETS			
Cash and balances at central banks	646,016	512,837	732,729
Loans and advances to banks	148,970	125,839	115,787
Debt securities at amortised cost	597,473	386,880	439,753
Assets classified as held for sale	3,232	3,220	3,279
Derivative financial instruments	7,427	4,165	6,322
Loans and advances to customers	2,034,897	1,989,867	2,036,077
Other assets	66,267	110,188	52,185
Financial investments	3,684	2,970	3,404
Deferred tax asset	1,706	3,233	2,425
Intangible assets	30,535	30,853	32,549
Property, plant and equipment	220,539	118,551	175,273
Right-of-use assets	7,314	14,663	7,714
Investment properties	6,550	6,550	6,550
Total assets	**3,774,610**	**3,309,816**	**3,614,047**
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital and share premium	11,773	154	154
Retained earnings	228,250	200,785	212,037
Other reserves	(82)	(321)	(213)
Total equity	**239,941**	**200,618**	**211,978**
LIABILITIES			
Deposits from banks	197,384	230,110	236,027
Derivative financial instruments	58	162	135
Deposits from customers	3,253,890	2,801,530	3,092,549
Current tax liability	6,059	1,877	1,748
Other liabilities	32,573	23,092	26,144
Lease liabilities	7,415	15,269	7,872
Debt securities in issue	37,290	37,158	37,594
Total liabilities	**3,534,669**	**3,109,198**	**3,402,069**
Total equity and liabilities	**3,774,610**	**3,309,816**	**3,614,047**

The notes on pages 9 to 27 are an integral part of these consolidated financial statements

Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Group					
	Share capital and share premium £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 1 January 2023	**154**	**19**	**1,067**	**(1,299)**	**212,037**	**211,978**
Total comprehensive income for the period						
Profit for the six months ended 30 June 2023	–	–	–	–	19,968	19,968
Other comprehensive income, net of income tax						
Changes in the fair value of financial assets at FVOCI	–	–	174	–	–	174
Tax on other comprehensive income	–	–	(43)	–	–	(43)
Total other comprehensive income	**–**	**–**	**131**	**–**	**–**	**131**
Total comprehensive income for the period	**–**	**–**	**131**	**–**	**19,968**	**20,099**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Issue of new ordinary shares	11,619	–	–	–	–	11,619
Final dividend relating to 2022	–	–	–	–	(3,755)	(3,755)
Total contributions by and distributions to owners	**11,619**	**–**	**–**	**–**	**(3,755)**	**7,864**
Balance at 30 June 2023	**11,773**	**19**	**1,198**	**(1,299)**	**228,250**	**239,941**

	Attributable to equity holders of the Group					
	Share capital £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 1 January 2022	**154**	**19**	**979**	**(1,299)**	**201,026**	**200,879**
Total comprehensive income for the period						
Profit for the six months ended 30 June 2022	–	–	–	–	2,670	2,670
Other comprehensive income, net of income tax						
Changes in the fair value of financial assets at FVOCI	–	–	462	–	–	462
Tax on other comprehensive income	–	–	(88)	–	–	(88)
Total other comprehensive income	**–**	**–**	**374**	**–**	**–**	**374**
Total comprehensive income for the period	**–**	**–**	**374**	**–**	**2,670**	**3,044**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Sale of financial assets carried at FVOCI	–	–	(394)	–	394	–
Final dividend relating to 2021	–	–	–	–	(3,305)	(3,305)
Total contributions by and distributions to owners	**–**	**–**	**(394)**	**–**	**(2,911)**	**(3,305)**
Balance at 30 June 2022	**154**	**19**	**959**	**(1,299)**	**200,785**	**200,618**

Consolidated Statement of Cash Flows

	Six months ended 30 June 2023 £000	Six months ended 30 June 2022[1] £000
Cash flows from operating activities		
Profit before tax	26,408	3,375
Adjustments for:		
- Depreciation and amortisation	5,489	3,764
- Impairment loss on loans and advances	(667)	(3,749)
- Net interest income	72	73
- Elimination of exchange differences on debt securities	8,064	(9,812)
- Other non-cash or non-operating items included in profit before tax	(57)	475
- Tax expense	(6,440)	(705)
Cash flows from operating profits/(losses) before changes in operating assets and liabilities	32,869	(6,579)
Changes in operating assets and liabilities:		
- net increase in derivative financial instruments	(1,182)	(2,421)
- net decrease/(increase) in loans and advances to customers	1,847	(115,156)
- net (increase)/decrease in assets held for leasing	(44,758)	6,674
- net increase in other assets	(13,316)	(824)
- net increase/(decrease) in amounts due to customers	161,341	(36,339)
- net increase/(decrease) in other liabilities	10,741	(1,660)
Net cash inflow/(outflow) from operating activities	**147,542**	**(156,305)**
Cash flows from investing activities		
Acquisition of financial investments	(106)	(4)
Disposal of financial investments	–	536
Purchase of computer software	(418)	(2,840)
Purchase of property, plant and equipment	(2,067)	(171)
Purchases of debt securities	(654,605)	(286,424)
Proceeds from redemption of debt securities	488,459	210,408
Net cash outflow from investing activities	**(168,737)**	**(78,495)**
Cash flows from financing activities		
Issue of new ordinary shares	11,619	–
Decrease in borrowings	(38,643)	(9,949)
Lease payments	(1,555)	(1,406)
Dividends paid	(3,756)	(3,305)
Net cash used in financing activities	**(32,335)**	**(14,660)**
Net decrease in cash and cash equivalents	(53,530)	(249,460)
Cash and cash equivalents at 1 January	848,516	888,136
Cash and cash equivalents at 30 June	**794,986**	**638,676**

[1] Prior year values have been represented using the indirect method in accordance with IAS 7.

The notes on pages 9 to 27 are an integral part of these consolidated financial statements

Notes to the Consolidated Financial Statements

1. Basis of preparation

The interim financial statements have been prepared on the basis of accounting policies set out in the Group's 2022 statutory accounts as amended by UK-adopted standards and interpretations effective during 2023 as set out below and in accordance with IAS 34 "Interim Financial Reporting" as adopted for use in the UK. The directors do not consider the fair value of the assets and liabilities presented in these financial statements to be materially different from their carrying value.

The statements were approved by the Board of Directors on 17 July 2023 and are unaudited. The interim financial statements will be available on the Group website (www.arbuthnotgroup.com) from 19 July 2023.

2. Risks and uncertainties

The Group regards the monitoring and controlling of risks and uncertainties as a fundamental part of the management process. Consequently, senior management are involved in the development of risk management policies and in monitoring their application. A detailed description of the risk management framework and associated policies is set out in note 4.

The principal risks inherent in the Group's business are reputational, macroeconomic and competitive environment, strategic, credit, market, liquidity, operational, cyber, conduct and, regulatory and capital.

Reputational risk

Reputational risk is the risk to the Group from a failure to meet reasonable stakeholder expectations as a result of any event, behaviour, action or inaction by ABG itself, its employees or those with whom it is associated. This includes the associated risk to earnings, capital or liquidity.

ABG seeks to ensure that all of it businesses act consistently with the seven corporate principles as laid out on page 3 of the Annual Report and Accounts. This is achieved through a central Risk Management framework and supporting policies, the application of a three-lines of defence model across the Group and oversight by various committees. Employees are supported in training, studies and other ways and encouraged to live out the cultural values within the Group of integrity, energy and drive, respect, collaboration and empowerment. In applying the seven corporate principles, the risk of reputational damage is minimised as the Group serves its shareholders, customers and employees with integrity and high ethical standards.

Macroeconomic and competitive environment

The Group is exposed to indirect risk that may arise for the macroeconomic and competitive environment.

In recent years there have been a number of global and domestic events which have had significant implications on the Group's operating environment, namely: Russia's War in the Ukraine, Coronavirus and Brexit. The culmination of these events has led to significant turmoil in both global and domestic markets. The most significant economic effect from these events includes record inflation driven by high fuel costs, leading to sharp and significant increases in the cost of borrowing. Conditions have improved since the year end however there still remains significant uncertainty around the recovery of the UK economy which may have an impact on the group's customers and assets.

Climate change

Climate change presents financial and reputational risks for the banking industry. The Board consider Climate change a material risk as per the Board approved risk appetite framework which provides a structured approach to risk taking within agreed boundaries. The assessment is proportional at present but will develop over time as the Group generates further resources and industry consensus emerges. The assessment is maintained by the Chief Risk officer and has been informed by the ICAAP review and numerous workshops for staff.

Whilst it is difficult to assess how climate change will unfold, the Group is continually assessing various risk exposures. The UK has a legally binding target to cut its greenhouse gas emissions to "net-zero" by 2050. There is growing consensus that an orderly transition to a low-carbon economy will bring substantial adjustments to the global economy which will have financial implications while bringing risks and opportunities.

The risk assessment process has been integrated into existing risk frameworks and will be governed through the various risk governance structures including review and recommendations by the AL Risk Committee. Arbuthnot Latham governance has been assessed against the Task Force on Climate-related Financial Disclosures' ("TCFD") recommended governance disclosures and where appropriate the FCA/PRA guidance as per the Supervisory statements.

Notes to the Consolidated Financial Statements *continued*

2. Risks and uncertainties (continued)

In accordance with the requirements of the PRA's Supervisory Statement 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change', the Group has allocated responsibility for identifying and managing the risks from climate change to the relevant existing Senior Management Function. The Bank is continuously developing a suitable strategic approach to climate change and the unique challenges it poses.

The FCA have issued 'Climate Change and Green Finance: summary of responses and next steps'. In addition to the modelling of various scenarios and various governance reviews, Arbuthnot Latham will continue to monitor requirements through the relationship with UK Finance.

Strategic risk

Strategic risk is the risk that the Group's ability to achieve its corporate and strategic objectives may be compromised. This risk is particularly important to the Group as it continues its growth strategy. However, the Group seeks to mitigate strategic risk by focusing on a sustainable business model which is aligned to the Group's business strategy. Also, the Directors normally meet once a year outside a formal Board setting to ensure that the Group's strategy is appropriate for the market and economy.

Credit risk

Credit risk is the risk that a counterparty (borrower) will be unable to pay amounts in full when due. This risk exists in Arbuthnot Latham, which currently has a loan book of £2.2bn (30 June 2022: £2.1bn). The lending portfolio in Arbuthnot Latham is extended to clients, the majority of which is secured against cash, property or other high quality assets. Credit risk is managed through the Credit Committee of Arbuthnot Latham.

Market risk

Market risk arises in relation to movements in interest rates, currencies, property and equity markets. The Group's treasury function operates mainly to provide a service to clients and does not take significant unmatched positions in any market for its own account. As a result, the Group's exposure to adverse movements in interest rates and currencies is limited to interest earnings on its free cash and interest rate re-pricing mismatches. The Group actively monitors its exposure to future changes in interest rates.

The Group is exposed to changes in the market value of its properties. The current carrying value of Investment Property is £6.6m (31 December 2022: £6.6m) and properties classified as inventory are carried at £10.5m (31 December 2022: £19.6m). Any changes in the market value of the property will be accounted for in the Income Statement for the Investment Property and could also impact the carrying value of inventory, which is at the lower of cost and net realisable value. As a result, it could have a significant impact on the profit or loss of the Group.

Liquidity risk

Liquidity risk is the risk that the Group, although solvent, either does not have sufficient financial resources to enable it to meet its obligations as they fall due, or can only secure such resources at an excessive cost. The Group takes a conservative approach to managing its liquidity profile. Retail client deposits and drawings from the Bank of England Term Funding Scheme fund the Bank. The loan to deposit ratio is maintained at a prudent level, and consequently the Group maintains a high level of liquidity. The Arbuthnot Latham Board annually approves the Internal Liquidity Adequacy Assessment Process ("ILAAP"). The Directors model various stress scenarios and assess the resultant cash flows in order to evaluate the Group's potential liquidity requirements. The Directors firmly believe that sufficient liquid assets are held to enable the Group to meet its liabilities in a stressed environment.

Operational risk

Operational risk is the risk that the Group may be exposed to financial losses from conducting its business. The Group's exposures to operational risk include its Information Technology ("IT") and Operations platforms. There are additional internal controls in these processes that are designed to protect the Group from these risks. The Group's overall approach to managing internal control and financial reporting is described in the Corporate Governance section of the Annual Report.

In line with further guidance issued by the Regulator, the Bank has continued to focus on ensuring that the design of systems and operational plans are robust to maintain operational resilience in the face of unexpected incidents.

Cyber risk

Cyber risk is an increasing risk for the Group within its operational processes. It is the risk that the Group is subject to some form of disruption arising from an interruption to its IT and data infrastructure. The Group regularly tests the infrastructure to ensure that it remains robust to a range of threats and has continuity of business plans in place including a disaster recovery plan.

Notes to the Consolidated Financial Statements *continued*

2. Risks and uncertainties (continued)

Conduct risk

As a financial services provider we face conduct risk, including selling products to customers which do not meet their needs, failing to deal with clients' complaints effectively, not meeting clients' expectations, and exhibiting behaviours which do not meet market or regulatory standards.

The Group adopts a low risk appetite for any unfair customer outcomes. It maintains clear compliance guidelines and provides ongoing training to all employees. Periodic spot checks, compliance monitoring and internal audits are performed to ensure these guidelines are followed. The Group also has insurance policies in place to provide some cover for any claims that may arise.

Regulatory and capital risk

Regulatory and capital risk includes the risk that the Group will have insufficient capital resources to support the business and/or does not comply with regulatory requirements. The Group adopts a conservative approach to managing its capital. The Board of Arbuthnot Latham approves an ICAAP annually, which includes the performance of stringent stress tests to ensure that capital resources are adequate over a three year horizon. Capital and liquidity ratios are regularly monitored against the Board's approved risk appetite as part of the risk management framework.

Regulatory change also exists as a risk to the Group's business. Notwithstanding the assessments carried out by the Group to manage regulatory risk, it is not possible to predict how regulatory and legislative changes may alter and impact the business. Significant and unforeseen regulatory changes may reduce the Group's competitive situation and lower its profitability.

3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. For a full list of critical accounting estimates and judgements, please refer back to the Annual Report and Accounts for 2022. Assumptions surrounding credit losses are discussed in more detail below, while other critical accounting estimates and judgements have remained unchanged from what was previously reported.

Estimation uncertainty - Expected credit losses ("ECL") on financial assets

The Group reviews its loan portfolios and debt security investments to assess impairment at least on a quarterly basis. The measurement of ECL required by IFRS 9, necessitates a number of significant judgements. Specifically, judgements and estimation uncertainties relate to assessment of whether credit risk on the financial asset has increased significantly since initial recognition, incorporation of forward-looking information ("FLI") in the measurement of ECLs and key assumptions used in estimating recoverable cash flows. These estimates are driven by a number of factors that are subject to change which may result in different levels of ECL allowances.

The Group incorporates FLI into the assessment of whether there has been a significant increase in credit risk. Forecasts for key macroeconomic variables that most closely correlate with the Bank's portfolio are used to produce five economic scenarios, comprising of a Baseline, which is the central scenario, developed internally based on public consensus forecasts, and four less likely scenarios, one upside and three downside scenarios (Downside 1, Downside 2 and Extreme Downside), and the impacts of these scenarios are then probability weighted. The estimation and application of this FLI will require significant judgement supported by the use of external information.

12-month ECLs on loans and advances (loans within Stage 1) are calculated using a statistical model on a collective basis, grouped together by product and geographical location. The key assumptions are the probability of default, the economic scenarios and loss given default ("LGD") having consideration for collateral. Lifetime ECLs on loans and advances (loans within Stage 2 and 3) are calculated based on an individual valuation of the underlying asset and other expected cash flows.

For financial assets in Stage 2 and 3, ECL is calculated on an individual basis and all relevant factors that have a bearing on the expected future cash flows are taken into account. These factors can be subjective and can include the individual circumstances of the borrower, the realisable value of collateral, the Group's position relative to other claimants, and the likely cost to sell and duration of the time to collect. The level of ECL is the difference between the value of the recoverable amount (which is equal to the expected future cash flows discounted at the loan's original effective interest rate), and its carrying amount.

Notes to the Consolidated Financial Statements *continued*

3. Critical accounting estimates and judgements in applying accounting policies (continued)

The Group considered the impact of various assumptions on the calculation of ECL (changes in GDP, unemployment rates, inflation, exchange rates, equity prices, wages and collateral values/property prices) and concluded that collateral values/property prices, UK GDP and UK unemployment rate are key drivers of credit risk and credit losses for each portfolio of financial instruments.

The five macroeconomic scenarios modelled on future property prices were as follows:

- Baseline
- Upside
- Downside 1
- Downside 2
- Extreme downside

The tables below therefore reflect the expected probability weightings applied for each macroeconomic scenario:

	Probability weighting	
	June 2023	December 2022
Economic Scenarios		
Baseline	42.0%	53.0%
Upside	21.0%	13.0%
Downside 1	18.0%	12.0%
Downside 2	12.0%	11.0%
Extreme downside	7.0%	11.0%

The tables below show the five-year forecasted average for property prices growth, UK unemployment rate and UK real GDP growth:

	30 June 2023				
	Base	Upside	Downside 1	Downside 2	Extreme downside
Five-year summary					
UK House price index - average growth	0.3%	4.0%	(1.6%)	(3.5%)	(5.5%)
UK Commercial real estate price - average growth	(0.8%)	2.4%	(2.8%)	(4.8%)	(6.8%)
UK Unemployment rate - average	4.2%	2.8%	5.1%	6.1%	7.0%
UK GDP - average growth	1.4%	2.0%	0.9%	0.4%	(0.1%)

	31 December 2022				
	Base	Upside	Downside 1	Downside 2	Extreme downside
Five-year summary					
UK House price index - average growth	(0.8%)	1.7%	(1.9%)	(3.0%)	(4.2%)
UK Commercial real estate price - average growth	(2.6%)	0.2%	(3.4%)	(4.1%)	(4.9%)
UK Unemployment rate - average	4.3%	2.8%	5.3%	6.3%	7.3%
UK GDP - average growth	1.2%	2.1%	0.8%	0.4%	0.0%

Notes to the Consolidated Financial Statements *continued*

3. Critical accounting estimates and judgements in applying accounting policies (continued)

The tables below list the macroeconomic assumptions at 30 June 2023 used in the base, upside and downside scenarios over the five-year forecast period. The assumptions represent the absolute percentage unemployment rates and year-on-year percentage change for GDP and property prices.

UK House price index - four quarter growth

Year	Baseline	Upside	Downside 1	Downside 2	Extreme downside
2023	(6.2%)	(3.9%)	(7.0%)	(7.8%)	(8.6%)
2024	(2.0%)	5.2%	(6.0%)	(10.0%)	(13.9%)
2025	1.1%	4.0%	(3.2%)	(7.5%)	(11.8%)
2026	3.4%	4.9%	2.3%	1.3%	0.2%
2027	5.2%	9.6%	5.8%	6.3%	6.9%
5 year average	0.3%	4.0%	(1.6%)	(3.5%)	(5.5%)

UK Commercial real estate price - four quarter growth

Year	Baseline	Upside	Downside 1	Downside 2	Extreme downside
2023	(10.3%)	2.0%	(13.6%)	(16.9%)	(20.1%)
2024	0.5%	2.6%	(7.8%)	(16.0%)	(24.3%)
2025	1.8%	2.6%	(0.7%)	(3.2%)	(5.8%)
2026	1.9%	2.7%	3.8%	5.8%	7.8%
2027	2.1%	1.9%	4.3%	6.4%	8.6%
5 year average	(0.8%)	2.4%	(2.8%)	(4.8%)	(6.8%)

UK Unemployment rate - annual average

Year	Baseline	Upside	Downside 1	Downside 2	Extreme downside
2023	4.1%	3.2%	4.4%	4.7%	5.0%
2024	4.2%	2.8%	5.2%	6.2%	7.2%
2025	4.2%	2.8%	5.5%	6.9%	8.2%
2026	4.2%	2.5%	5.4%	6.5%	7.7%
2027	4.2%	2.5%	5.1%	6.1%	7.0%
5 year average	4.2%	2.8%	5.1%	6.1%	7.0%

UK GDP - annual growth

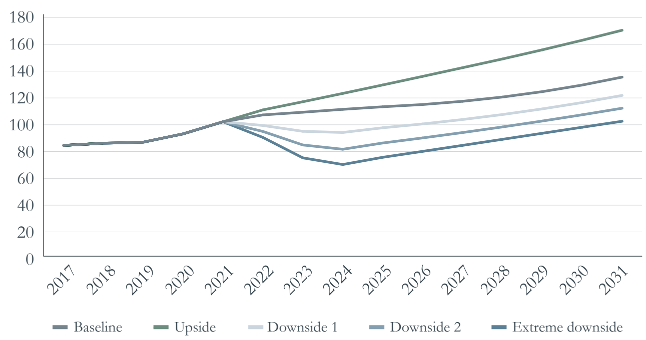
Year	Baseline	Upside	Downside 1	Downside 2	Extreme downside
2023	0.3%	0.6%	(0.6%)	(1.5%)	(2.4%)
2024	1.0%	2.0%	–	(0.9%)	(1.9%)
2025	1.7%	2.3%	1.5%	1.4%	1.2%
2026	1.9%	2.5%	1.7%	1.4%	1.2%
2027	1.9%	2.5%	1.7%	1.4%	1.2%
5 year average	1.4%	2.0%	0.9%	0.4%	(0.1%)

Notes to the Consolidated Financial Statements *continued*

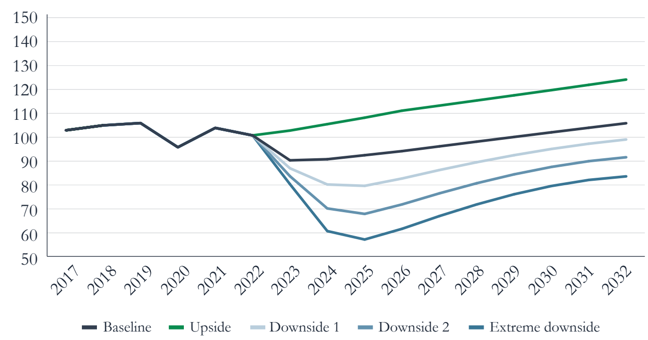
3. Critical accounting estimates and judgements in applying accounting policies (continued)

The graphs below plot the historical data for HPI, Commercial real estate price, unemployment rate and GDP growth rate in the UK as well as the forecasted data under each of the five scenarios.

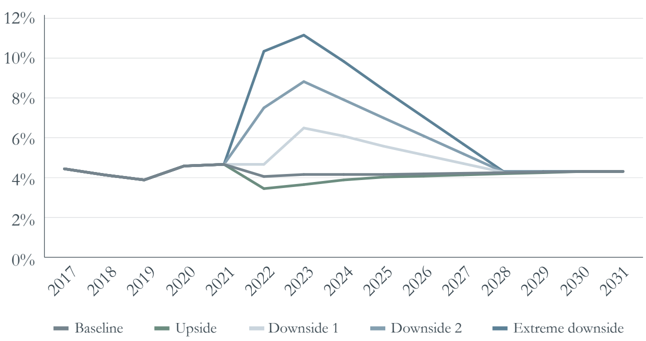
UK House Price Index



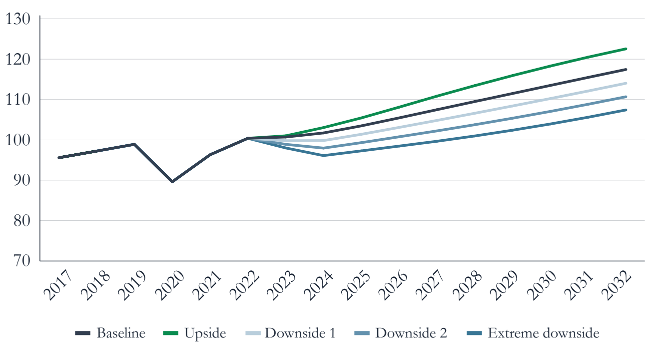
UK Commercial Real Estate Price



UK unemployment



UK GDP



Management have assessed the impact of assigning a 100% probability to each of the economic scenarios, which would have the following impact on the Profit or Loss of the Group:

	Arbuthnot Latham	
Impact of 100% scenario probability	June 2023 £m	December 2022 £m
Baseline	0.6	0.7
Upside	0.9	1.0
Downside 1	(2.4)	(2.0)
Downside 2	(8.3)	(7.5)
Extreme downside	(20.6)	(19.1)

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management

Strategy

By their nature, the Group's activities are principally related to the use of financial instruments. The Directors and senior management of the Group have formally adopted a Group Risk and Controls Policy which sets out the Board's attitude to risk and internal controls. Key risks identified by the Directors are formally reviewed and assessed at least once a year by the Board, in addition to which key business risks are identified, evaluated and managed by operating management on an ongoing basis by means of procedures such as physical controls, credit and other authorisation limits and segregation of duties. The Board also receives regular reports on any risk matters that need to be brought to its attention. Significant risks identified in connection with the development of new activities are subject to consideration by the Board. There are budgeting procedures in place and reports are presented regularly to the Board detailing the results of each principal business unit, variances against budget and prior year, and other performance data.

The principal non-operational risks inherent in the Group's business are credit, macroeconomic, market, liquidity and capital.

Credit risk

The Company and Group take on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Company and Group's portfolio, could result in losses that are different from those provided for at the balance sheet date. Credit risk is managed through the Credit Committee of the banking subsidiary.

The Committee regularly reviews the credit risk profile of the Group, with a clear focus on performance against risk appetite statements and risk metrics. The Committee considered credit conditions during the period.

The Company and Group structure the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to products, and one borrower or groups of borrowers. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. The limits are approved periodically by the Board of Directors and actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral, and corporate and personal guarantees.

The Group has attempted to leverage stress test modelling insights to inform ECL model refinements to enable reasonable estimates. Management review of modelling approaches and outcomes continues to inform any necessary adjustments to the ECL estimates through the form of in-model adjustments, based on expert judgement including the use of available information. Management considerations included the potential severity and duration of the economic shock, including the mitigating effects of government support actions, as well the potential trajectory of the subsequent recovery.

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of collateral to secure advances, which is common practice. The principal collateral types for loans and advances include, but are not limited to:

- Charges over residential and commercial properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities;
- Charges over other chattels; and
- Personal guarantees

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In order to minimise any potential credit loss the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances. Repossessed collateral, not readily convertible into cash, is made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness, or held as inventory where the Group intends to develop and sell in the future. Where excess funds are available after the debt has been repaid, they are available either for other secured lenders with lower priority or are returned to the customer.

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The key inputs into the measurement of the ECL are:

- assessment of significant increase in credit risk
- future economic scenarios
- probability of default
- loss given default
- exposure at default

The IFRS 9 impairment model adopts a three stage approach based on the extent of credit deterioration since origination.

The Group's maximum exposure to credit risk before collateral held or other credit enhancements is as follows:

	30 June 2023							
Group Credit risk exposures (all stage 1, unless otherwise stated)	Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Total £000
On–balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	645,854	645,854
Loans and advances to banks	–	–	–	–	–	–	148,970	148,970
Debt securities at amortised cost	–	–	–	–	–	–	597,473	597,473
Derivative financial instruments	–	–	–	–	–	–	7,427	7,427
Loans and advances to customers (Gross of ECL)	1,450,674	136,014	157,972	241,255	12,472	42,444	–	2,040,831
Stage 1 - Gross amount outstanding	1,361,491	111,989	152,553	226,484	11,472	42,444	–	1,906,433
Stage 2 - Gross amount outstanding	54,071	11,011	2,531	12,654	1,000	–	–	81,267
Stage 3 - Gross amount outstanding	35,112	13,014	2,888	2,117	–	–	–	53,131
Other assets	–	–	–	–	–	–	25,118	25,118
Financial investments	–	–	–	–	–	–	3,684	3,684
Off-balance sheet:								
Guarantees	1,841	–	–	–	–	–	–	1,841
Loan commitments	225,901	–	–	284,290	665	–	–	510,856
At 30 June 2023	**1,678,416**	**136,014**	**157,972**	**525,545**	**13,137**	**42,444**	**1,428,526**	**3,982,054**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

Group Credit risk exposures (all stage 1, unless otherwise stated)	30 June 2022 Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Total £000
On–balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	512,663	512,663
Loans and advances to banks	–	–	–	–	–	–	125,839	125,839
Debt securities at amortised cost	–	–	–	–	–	–	386,880	386,880
Derivative financial instruments	–	–	–	–	–	–	4,165	4,165
Loans and advances to customers (Gross of ECL[1])	1,450,415	166,263	103,309	238,980	9,736	13,473	–	1,982,176
Stage 1 - Gross amount outstanding	1,359,839	140,170	87,420	238,980	9,053	13,473	–	1,848,935
Stage 2 - Gross amount outstanding	60,041	21,279	12,318	–	–	–	–	93,638
Stage 3 - Gross amount outstanding	30,535	4,814	3,571	–	683	–	–	39,603
Loans and advances to customers at fair value through profit or loss	–	–	–	–	–	–	10,330	10,330
Other assets	–	–	–	–	–	–	12,763	12,763
Financial investments	–	–	–	–	–	–	2,970	2,970
Off-balance sheet:								
Guarantees	3,427	–	–	–	–	–	–	3,427
Loan commitments	282,901	–	–	68,880	1,844	–	–	353,625
At 30 June 2022	**1,736,743**	**166,263**	**103,309**	**307,860**	**11,580**	**13,473**	**1,055,610**	**3,394,838**

[1] Prior year loans and advances to customers have been represented from net to gross of expected credit losses (ECL) in order to align the presentation to the annual report.

Group Credit risk exposures (all stage 1, unless otherwise stated)	31 December 2022 Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Total £000
On–balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	732,513	732,513
Loans and advances to banks	–	–	–	–	–	–	115,788	115,788
Debt securities at amortised cost	–	–	–	–	–	–	439,753	439,753
Derivative financial instruments	–	–	–	–	–	–	6,322	6,322
Loans and advances to customers (Gross of ECL[2])	1,455,607	148,957	134,724	270,999	14,950	17,442	–	2,042,679
Stage 1 - Gross amount outstanding	1,363,572	126,726	128,807	267,962	13,756	17,066	–	1,917,889
Stage 2 - Gross amount outstanding	59,904	10,777	2,454	–	1,001	376	–	74,512
Stage 3 - Gross amount outstanding	32,131	11,454	3,463	3,037	193	–	–	50,278
Other assets	–	–	–	–	–	–	14,160	14,160
Financial investments	–	–	–	–	–	–	3,404	3,404
Off–balance sheet:								
Guarantees	2,591	–	–	–	–	662	–	3,253
Loan commitments	219,490	–	–	250,276	1,312	–	–	471,078
At 31 December 2022	**1,677,688**	**148,957**	**134,724**	**521,275**	**16,262**	**18,104**	**1,311,940**	**3,828,950**

[2] Prior year loans and advances to customers have been represented from net to gross of expected credit losses (ECL) in order to align the presentation to the annual report.

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

The tables below show the Group's expected credit loss (ECL), by segment and stage:

Group ECL provisions	30 June 2023 Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Total £000
Stage 1	(574)	(7)	(223)	(121)	(96)	(108)	–	(1,129)
Stage 2	(12)	(21)	(45)	(14)	–	–	–	(91)
Stage 3	(2,712)	(995)	(956)	(50)	–	–	–	(4,714)
At 30 June 2023	**(3,298)**	**(1,023)**	**(1,224)**	**(185)**	**(96)**	**(108)**	**–**	**(5,934)**

Group ECL provisions	30 June 2022 Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Total £000
Stage 1	(229)	(15)	(90)	(137)	(42)	–	–	(513)
Stage 2	(4)	(10)	(114)	–	–	–	–	(128)
Stage 3	(1,331)	(70)	(493)	–	(104)	–	–	(1,998)
At 30 June 2022	**(1,564)**	**(95)**	**(697)**	**(137)**	**(146)**	**–**	**–**	**(2,639)**

Group ECL provisions	31 December 2022 Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Total £000
Stage 1	(622)	(13)	(214)	(167)	(81)	(50)	–	(1,146)
Stage 2	(60)	(10)	(60)	–	–	–	–	(130)
Stage 3	(2,276)	(417)	(625)	(2,007)	–	–	–	(5,325)
At 31 December 2022	**(2,958)**	**(440)**	**(899)**	**(2,174)**	**(81)**	**(50)**	**–**	**(6,601)**

Capital management

During the period all regulated entities have complied with all of the externally imposed capital requirements to which they are subject. The capital position of the Group remains strong. The Total Capital Requirement Ratio ("TCR") is 8.32% (31 December 2022: 8.32%), while the CET1 capital ratio is 12.2% (31 December 2022: 11.6%) and the total capital ratio is 14.5% (31 December 2022: 14.0%).

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

Valuation of financial instruments

The Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions. If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis. The objective of valuation techniques is to determine the fair value of the financial instrument at the reporting date as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. In the event that fair values of assets and liabilities cannot be reliably measured, they are carried at cost.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making measurements:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads assists in the judgement as to whether a market is active. If in the opinion of management, a significant proportion of the instrument's carrying amount is driven by unobservable inputs, the instrument in its entirety is classified as valued using significant unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

The tables below analyse financial instruments measured at fair value by the level in the fair value hierarchy into which the measurement is categorised:

At 30 June 2023	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	7,427	–	7,427
Financial investments	–	–	3,684	3,684
Investment properties	–	–	6,550	6,550
	–	**7,427**	**10,234**	**17,661**
LIABILITIES				
Derivative financial instruments	–	58	–	58
	–	**58**	**–**	**58**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

At 30 June 2022	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	4,165	–	4,165
Loans and advances to customers at fair value through profit or loss	–	–	10,330	10,330
Financial investments	–	–	2,970	2,970
Investment properties	–	–	6,550	6,550
	–	**4,165**	**19,850**	**24,015**
LIABILITIES				
Derivative financial instruments	–	162	–	162
	–	**162**	**–**	**162**

At 31 December 2022	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	6,322	–	6,322
Financial investments	–	–	3,404	3,404
Investment properties	–	–	6,550	6,550
	–	**6,322**	**9,954**	**16,276**
LIABILITIES				
Derivative financial instruments	–	135	–	135
	–	**135**	**–**	**135**

There were no transfers between level 1 and level 2 during the year.

The following table reconciles the movement in level 3 financial instruments measured at fair value (financial investments) during the year:

Movement in level 3	At 30 June 2023 £000	At 30 June 2022 £000	At 31 December 2022 £000
At 1 January	9,954	9,719	9,719
Acquisitions	106	10,334	53
Disposals	–	(536)	(640)
Movements recognised in Other Comprehensive Income	174	333	822
At 30 June / 31 December	**10,234**	**19,850**	**9,954**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

The tables below show the fair value of financial instruments carried at amortised cost by the level in the fair value hierarchy:

At 30 June 2023	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	646,016	–	646,016
Loans and advances to banks	–	148,970	–	148,970
Debt securities at amortised cost	–	597,294	–	597,294
Loans and advances to customers	–	–	1,995,048	1,995,048
Other assets	–	–	25,118	25,118
	–	**1,392,280**	**2,020,166**	**3,412,446**
LIABILITIES				
Deposits from banks	–	197,384	–	197,384
Deposits from customers	–	3,253,890	–	3,253,890
Other liabilities	–	–	32,573	32,573
Debt securities in issue	–	–	37,290	37,290
	–	**3,451,274**	**69,863**	**3,521,137**

At 30 June 2022	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	512,837	–	512,837
Loans and advances to banks	–	125,839	–	125,839
Debt securities at amortised cost	–	386,706	–	386,706
Loans and advances to customers	–	–	1,947,478	1,947,478
Other assets	–	–	12,989	12,989
	–	**1,025,382**	**1,960,467**	**2,985,849**
LIABILITIES				
Deposits from banks	–	230,110	–	230,110
Deposits from customers	–	2,801,530	–	2,801,530
Other liabilities	–	–	24,634	24,634
Debt securities in issue	–	–	37,158	37,158
	–	**3,031,640**	**61,792**	**3,093,432**

At 31 December 2022	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	732,729	–	732,729
Loans and advances to banks	–	115,788	–	115,788
Debt securities at amortised cost	–	439,389	–	439,389
Loans and advances to customers	–	–	1,996,966	1,996,966
Other assets	–	–	14,160	14,160
	–	**1,287,906**	**2,011,126**	**3,299,032**
LIABILITIES				
Deposits from banks	–	236,027	–	236,027
Deposits from customers	–	3,092,549	–	3,092,549
Other liabilities	–	–	4,954	4,954
Debt securities in issue	–	–	37,594	37,594
	–	**3,328,576**	**42,548**	**3,371,124**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

All above assets and liabilities are carried at amortised cost. Therefore for these assets, the fair value hierarchy noted above relates to the disclosure in this note only.

Cash and balances at central banks

The fair value of cash and balances at central banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

At the end of each year, the fair value of cash and balances at central banks was calculated to be equivalent to their carrying value.

Loans and advances to banks

The fair value of loans and advances to banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

Loans and advances to customers

The fair value of loans and advances to customers was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date, and the same assumptions regarding the risk of default were applied as those used to derive the carrying value.

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends and expected future cash flows.

For the acquired loan book, the discount on acquisition is used to determine the fair value in addition to the expected credit losses and expected future cash flows.

Debt securities

The fair value of debt securities is based on the quoted mid-market share price.

Derivatives

Where derivatives are traded on an exchange, the fair value is based on prices from the exchange.

Deposits from banks

The fair value of amounts due to banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

At the end of each year, the fair value of amounts due to banks was calculated to be equivalent to their carrying value due to the short maturity term of the amounts due.

Deposits from customers

The fair value of deposits from customers was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date for the notice deposits and deposit bonds. The fair value of instant access deposits is equal to book value as they are repayable on demand.

Financial liabilities

The fair value of other financial liabilities was calculated based upon the present value of the expected future principal cash flows.

At the end of each year, the fair value of other financial liabilities was calculated to be equivalent to their carrying value due to their short maturity. The other financial liabilities include all other liabilities other than non-interest accruals.

Subordinated liabilities

The fair value of subordinated liabilities was calculated based upon the present value of the expected future principal cash flows.

Notes to the Consolidated Financial Statements *continued*

5. Operating segments

The Group is organised into eight operating segments as disclosed below:

1) Banking – Includes Private and Commercial Banking. Private Banking – Provides traditional private banking services. Commercial Banking – Provides bespoke commercial banking services and tailored secured lending against property investments and other assets.

2) Wealth Management – Offering financial planning and investment management services.

3) Mortgage Portfolios – Acquired mortgage portfolios.

4) RAF – Specialist asset finance lender mainly in high value cars but also business assets.

5) ACABL – Provides finance secured on either invoices, assets or stock of the borrower.

6) ASFL – Provides short term secured lending solutions to professional and entrepreneurial property investors.

7) AAG – Provides vehicle finance and related services, predominantly in the truck & trailer and bus & coach markets.

8) All Other Divisions – All other smaller divisions and central costs in Arbuthnot Latham & Co., Ltd (Investment property and Central costs).

9) Group Centre – ABG Group management.

Transactions between the operating segments are on normal commercial terms. Centrally incurred expenses are charged to operating segments on an appropriate pro-rata basis. Segment assets and liabilities comprise loans and advances to customers and customer deposits, being the majority of the balance sheet.

Notes to the Consolidated Financial Statements *continued*

5. Operating segments (continued)

Six months ended 30 June 2023	Banking £000	Wealth Management £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Group Centre £000	Total £000
Interest revenue	51,527	–	5,125	5,500	11,253	661	778	25,476	3	**100,323**
Inter-segment revenue	–	–	–	–	–	–	–	–	(3)	**(3)**
Interest revenue from external customers	51,527	–	5,125	5,500	11,253	661	778	25,476	–	**100,320**
Fee and commission income	1,471	5,579	–	18	3,331	11	–	865	–	**11,275**
Revenue	–	–	–	–	–	–	49,895	–	–	**49,895**
Revenue from external customers	**52,998**	**5,579**	**5,125**	**5,518**	**14,584**	**672**	**50,673**	**26,341**	**–**	**161,490**
Interest expense	5,350	–	(4,166)	(1,997)	(7,125)	(215)	(4,224)	(17,475)	(2,101)	**(31,953)**
Cost of goods sold	–	–	–	–	–	–	(41,821)	–	–	**(41,821)**
Add back inter-segment revenue	–	–	–	–	–	–	–	–	3	**3**
Fee and commission expense	(20)	–	–	–	(85)	–	–	–	–	**(105)**
Segment operating income	58,328	5,579	959	3,521	7,374	457	4,628	8,866	(2,098)	**87,614**
Impairment losses	(1,375)	–	(630)	(303)	(17)	(15)	(113)	–	–	**(2,453)**
Other income	65	–	–	108	–	–	12	2,141	–	**2,326**
Operating expenses	(25,879)	(7,515)	(378)	(2,666)	(3,333)	(972)	(7,011)	(8,171)	(5,154)	**(61,079)**
Segment profit / (loss) before tax	31,139	(1,936)	(49)	660	4,024	(530)	(2,484)	2,836	(7,252)	**26,408**
Income tax (expense) / income	–	–	–	(159)	(950)	133	(220)	(3,925)	(1,319)	**(6,440)**
Segment profit / (loss) after tax	**31,139**	**(1,936)**	**(49)**	**501**	**3,074**	**(397)**	**(2,704)**	**(1,089)**	**(8,571)**	**19,968**
Loans and advances to customers	1,447,375	–	134,991	156,748	241,071	12,376	42,336	–	–	**2,034,897**
Assets available for lease	–	–	–	–	–	–	216,496	–	–	**216,496**
Other assets	–	–	–	–	–	–	–	1,526,231	(3,014)	**1,523,217**
Segment total assets	**1,447,375**	**–**	**134,991**	**156,748**	**241,071**	**12,376**	**258,832**	**1,526,231**	**(3,014)**	**3,774,610**
Customer deposits	3,254,761	–	–	–	–	–	–	–	(871)	**3,253,890**
Other liabilities	–	–	–	–	–	–	–	277,663	3,116	**280,779**
Segment total liabilities	**3,254,761**	**–**	**–**	**–**	**–**	**–**	**–**	**277,663**	**2,245**	**3,534,669**
Other segment items:										
Capital expenditure	–	–	–	(5)	–	–	(97,066)	(1,941)	–	**(99,012)**
Depreciation and amortisation	–	–	–	(1)	–	(296)	(18,429)	(3,230)	–	**(21,956)**

The "Group Centre" segment above includes the parent entity and all intercompany eliminations.

Notes to the Consolidated Financial Statements *continued*

5. Operating segments (continued)

Six months ended 30 June 2022	Banking £000	Wealth Management £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	AAG £000	All Other Divisions £000	Group Centre £000	Total £000
Interest revenue	29,635	–	3,250	4,086	5,818	463	253	5,583	2	**49,090**
Inter-segment revenue	–	–	–	–	–	–	–	–	(2)	**(2)**
Interest revenue from external customers	29,635	–	3,250	4,086	5,818	463	253	5,583	–	**49,088**
Fee and commission income	1,564	5,332	–	138	2,670	5	–	390	–	**10,099**
Revenue	–	–	–	–	–	–	48,851	–	–	**48,851**
Revenue from external customers	**31,199**	**5,332**	**3,250**	**4,224**	**8,488**	**468**	**49,104**	**5,973**	**–**	**108,038**
Interest expense	(1,613)	–	(882)	(1,547)	(2,696)	(170)	(1,994)	3,746	(1,398)	**(6,554)**
Cost of goods sold	–	–	–	–	–	–	(40,538)	–	–	**(40,538)**
Add back inter-segment revenue	–	–	–	–	–	–	–	–	2	**2**
Fee and commission expense	14	–	–	–	(73)	–	–	–	–	**(59)**
Segment operating income	29,600	5,332	2,368	2,677	5,719	298	6,572	9,719	(1,396)	**60,889**
Impairment losses	(221)	–	(49)	(465)	(46)	(117)	(303)	–	–	**(1,201)**
Other income	–	–	–	69	–	–	(182)	723	–	**610**
Operating expenses	(22,804)	(7,171)	(481)	(2,124)	(2,790)	(751)	(7,155)	(9,198)	(4,449)	**(56,923)**
Segment profit / (loss) before tax	6,575	(1,839)	1,838	157	2,883	(570)	(1,068)	1,244	(5,845)	**3,375**
Income tax income / (expense)	–	–	–	–	–	–	–	624	(1,329)	**(705)**
Segment profit / (loss) after tax	**6,575**	**(1,839)**	**1,838**	**157**	**2,883**	**(570)**	**(1,068)**	**1,868**	**(7,174)**	**2,670**
Loans and advances to customers	1,459,182	–	166,168	102,612	238,843	9,590	13,473	11,500	(11,501)	**1,989,867**
Assets available for lease	–	–	–	–	–	–	115,133	–	–	**115,133**
Other assets	–	–	–	–	–	–	–	1,206,288	(1,472)	**1,204,816**
Segment total assets	**1,459,182**	**–**	**166,168**	**102,612**	**238,843**	**9,590**	**128,606**	**1,217,788**	**(12,973)**	**3,309,816**
Customer deposits	2,611,542	–	–	–	–	–	–	207,735	(17,747)	**2,801,530**
Other liabilities	–	–	–	–	–	–	–	292,414	15,254	**307,668**
Segment total liabilities	**2,611,542**	**–**	**–**	**–**	**–**	**–**	**–**	**500,149**	**(2,493)**	**3,109,198**
Other segment items:										
Capital expenditure	–	–	–	(5)	–	–	(35,612)	(205)	–	**(35,822)**
Depreciation and amortisation	–	–	–	(3)	–	(25)	(15,015)	(2,480)	(8)	**(17,531)**

Segment profit is shown prior to any intra-group eliminations.

Notes to the Consolidated Financial Statements *continued*

6. Underlying Profit

The Group has reported a profit before tax of £26.4m (2022 H1: £3.4m). The underlying profit before tax was £29.3m (2022 H1: profit of £10.7m). There are a number of specific one-off items which are included in the results that should be noted. These are detailed in the table below.

Underlying profit reconciliation	30 June 2023 £000	30 June 2022 £000
Profit before tax and group recharges	26,408	3,375
Profits earned on sale of trucks included in bargain purchase	2,940	3,328
Write down of King Street property	–	3,977
Underlying profit	**29,348**	**10,680**

During 2021 the Group acquired Asset Alliance Group Holdings Limited, which completed on 1 April 2021. The business was acquired at a discount to its fair valued net assets resulting in a bargain purchase of £8.6m in the first half of 2021.

The forgone profit on the sale of trucks generated by Asset Alliance was £2.9m in the period (30 June 2022: £3.3m), which is required from the acquisition accounting in 2021. The fair value adjustments to individual assets at acquisition are reversed through profit or loss at the point of sale.

In 2022 the net realisable value of the property in King Street was reduced by £4.0m, resulting from the agreement to sell it.

7. Other income

Included in other income is £0.9m recognised on a non-refundable deposit from a property owned by the Group and £0.4m in relation to a negligent property valuation.

Other items reflected in other income include rental income from the investment property of £0.2m (H1 2022: £0.7m).

8. Earnings per ordinary share

Basic

Basic earnings per ordinary share are calculated by dividing the profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares 15,431,170 (2022: 15,022,629) in issue during the period.

Diluted

Diluted earnings per ordinary share are calculated by dividing the dilutive profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the period, as well as the number of dilutive share options in issue during the period. There were no dilutive share options in issue at the end of June (2022: nil).

Profit attributable	Six months ended 30 June 2023 £000	Six months ended 30 June 2022 £000
Total profit after tax attributable to equity holders of the Company	19,968	2,670

Basic earnings per share	Six months ended 30 June 2023 p	Six months ended 30 June 2022 p
Total Basic Earnings per share	129.4	17.8

Notes to the Consolidated Financial Statements *continued*

9. Share capital and share premium

	30 June 2023 £000	30 June 2022 £000
Share capital	167	154
Share premium	11,606	–
Share capital and share premium	**11,773**	**154**

Ordinary share capital

	Number of shares	Share Capital £000
At 1 January 2023	15,279,322	153
Issue of shares	1,297,297	13
At 30 June 2023	**16,576,619**	**166**

Ordinary non-voting share capital

	Number of shares	Share Capital £000
At 1 January 2023	152,621	1
At 30 June 2023	**152,621**	**1**

Total share capital

	Number of shares	Share Capital £000
At 1 January 2023	15,431,943	154
Issue of shares	1,297,297	13
At 30 June 2023	**16,729,240**	**167**

a) **Share issue costs**
Incremental costs directly attributable to the issue of new shares or options by the Company are shown in equity as a deduction, net of tax, from the proceeds.

b) **Dividends on ordinary shares**
Dividends on ordinary shares are recognised in equity in the period in which they are approved.

c) **Share buybacks**
Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued.

The Ordinary shares have a par value of 1p per share (2022: 1p per share). At 30 June 2023 the Company held 409,314 shares (2022: 409,314) in treasury. This includes 390,274 (2022: 390,274) Ordinary shares and 19,040 (2022: 19,040) Ordinary Non-Voting shares.

d) **Share premium**
On 14 April 2023 the Group announced an oversubscribed conditional placing of and subscription for new voting ordinary shares in the Company at a price of 925 pence per share, raising approximately £12.0 million (before expenses). The Resolutions put to Shareholders at the General Meeting held at 4 May 2023 were duly passed. The Group received share premium of £11.6 million as a result of the share issuance.

10. Events after the balance sheet date

There were no material post balance sheet events to report.

Corporate Contacts and Advisers

Group Address and Registered Office

Arbuthnot Banking Group PLC
Arbuthnot House
7 Wilson Street
London EC2M 2SN
T 020 7012 2400
E info@arbuthnotgroup.co.uk
www.arbuthnotgroup.com

Corporate Contacts

London

Arbuthnot Latham & Co., Limited
Arbuthnot House
7 Wilson Street
London EC2M 2SN
T 020 7012 2500
E banking@arbuthnot.co.uk
www.arbuthnotlatham.co.uk

Bristol

St Brandon's House
27-29 Great George Street
Bristol BS1 5QT
T 01392 496061

Exeter

The Senate
Ground Floor
Southernhay Gardens
Exeter
Devon EX1 1UG
T 01392 496061

Manchester

8th Floor
82 King Street
Manchester M2 4WQ
T 0161 413 0030

Arbuthnot Commercial Asset Based Lending Limited

The Beehive
City Place
Gatwick RH6 0PA
E abl@arbuthnot.co.uk

Asset Alliance Group Holdings Limited

Edwin House
Boundary Industrial Estate
Stafford Road
Wolverhampton WV10 7EL
T 01902 625330
E enquiries@assetalliancegroup.co.uk
www.assetalliancegroup.co.uk

Renaissance Asset Finance Limited

3rd Floor
Phoenix Place
Christopher Martin Road
Basildon
Essex SS14 3GQ
T 01268 269500
E info@renaissanceaf.com
www.renaissanceaf.com

Advisers

Auditor

Mazars LLP

Principal Bankers

Barclays Bank PLC
Lloyds Bank PLC
National Westminster Bank PLC

Stockbroker

Shore Capital Stockbrokers Limited

Nominated Adviser and AQSE Corporate Adviser

Grant Thornton UK LLP

Registrars

Link Group
Central Square
29 Wellington Street
Leeds
Yorkshire LS1 4DL

Arbuthnot Banking Group PLC
Arbuthnot House
7 Wilson Street
London EC2M 2SN

T 020 7012 2400
E info@arbuthnotgroup.co.uk

www.arbuthnotgroup.com

Registration No. 1954085