Arbuthnot Banking Group PLC

INTERIM REPORT 2010

ARBUTHNOT BANKING GROUP PLC

Group Directors & Secretary

Directors

Henry Angest
Chairman and Chief Executive

James Cobb ACA
Group Finance Director

Neil Kirton
Director

Ruth Lea
Independent non-executive director

Sir Christopher Meyer
Independent non-executive director

Dean Proctor
Director

Andrew Salmon ACA
Chief Operating Officer

Atholl Turrell ACA
Director

Robert Wickham
Deputy Chairman and senior independent non-executive director

Secretary

Jeremy Robin Kaye FCIS

Corporate Philosophy

Arbuthnot has a 177 year history of serving its customers, as well as a long track record of profitability against the background of a continually changing environment. The ability of Arbuthnot to adapt and grow has come from managing the business through seven key principles developed over time. These principles, always applied with pragmatism and common sense, govern the activities of the Group, ranging from major strategic issues to smaller day-to-day operational matters.

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

Sun Tzu
The Art of War
circa 500 BC

1. Arbuthnot serves its **shareholders**, its **customers** and its **employees** with **integrity** and **high ethical standards.** This is expressed in a **progressive dividend** policy, in **fair pricing** and **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 approach is based on **diversification**, a **long-term view, empowerment of management** and a culture of **rewards for achievements.**

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

6. Arbuthnot does not sacrifice **long term prospects** for short term gains – nor sacrifice **stability** for quick profits**.**

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.

Henry Angest
Chairman & CEO
4 August 2010

Chairman’s statement

Arbuthnot Banking Group recorded a profit before tax of £2.3m for the six months ended 30 June 2010 (2009: £0.7m). This result reflects a continuation of the improving trend in the Group’s underlying earnings. All of the Group’s core businesses traded profitably in the first half.

The Group’s banking subsidiaries, Arbuthnot Latham and Secure Trust Bank, have both seen rapid growth in deposits during the first half of 2010. The Group’s total customer deposit base expanded from £386m at 31 December 2009 to £499m at 30 June 2010. Although this puts our two banks in a strong position to take advantage of the attractive lending opportunities currently available, deposit growth has outpaced the growth in the lending book, negatively impacting earnings in the first half. Loan losses remain at satisfactorily low levels.

The Group is committed to returning to a progressive dividend policy as trading conditions improve. Accordingly, the interim dividend will be increased by 0.5p to 11p, and will be paid on 1 October 2010 to shareholders on the register at 3 September 2010.

Retail Banking Division

Pre-tax profits for Secure Trust Bank increased by 13% to £4.6m (2009: £4.1m) compared with the first half of last year.

The portfolios of loans acquired in 2009 continue to perform in line with expectations, and the company is actively seeking opportunities to buy further loan books if they can be acquired at attractive prices. Our motor finance business began cautiously in the first half of 2009 and is now seeing strong growth with advances totalling £16.7m at 30 June 2010. The market opportunity for this product remains compelling and we intend to continue to grow our motor finance book whilst maintaining credit quality.

A new lending initiative in the first half of 2010 involved the expansion of our existing niche business in musical instrument finance into other niche point-of-sale financing. We have made a good start in lending for the purchase of bicycles, and other products are being actively considered.

The prepaid current account launched last year is now progressing well. The number of accounts opened tripled during the first half of 2010 to 6,000, and we are actively trialling new distribution channels for this product to accelerate its expansion still further.

The overall customer base of the bank has increased significantly despite the continuing decline in OneBill customer numbers, and now stands at approximately 82,000.

In the absence of adverse economic developments we remain optimistic about the remainder of 2010 and beyond.

Henry Angest, Chairman, Arbuthnot Banking Group

Private Banking Division

Arbuthnot Latham's pre-tax profits were £0.1m (2009: £0.7m). The emphasis remains on strong liquidity and maintaining a customer loan/deposit ratio of approximately 60%. With money market rates for surplus funds remaining at historic lows, Arbuthnot Latham's prudent balance sheet management currently represents a significant sacrifice of profit in favour of liquidity and long term stability.

Arbuthnot Latham continues to see excellent opportunities both for good quality lending and for deposit raising, and has expanded its balance sheet size by approximately £46 million in the first half of 2010, to a footing of £416m at 30 June 2010. It has also been able to take advantage of a more benign hiring environment selectively to upgrade staff in key client-facing roles.

Despite operating in challenging markets, revenues in Arbuthnot Latham's wealth management and financial planning businesses have grown steadily in 2010.

The structured product business, Gilliat Financial Solutions, has experienced slow sales, but is now reaching break-even level having contributed a first-half loss. The result was also affected by an impairment charge of £0.2m relating to an equity investment.

Investment Banking Division

Arbuthnot Securities recorded a profit before tax of £0.5m (2009: loss of £1.3m). Secondary revenues for the six months were £3.6m up from £2.9m in the equivalent period last year. Corporate Finance revenue, at £4.4m, was also significantly ahead.

New hires continue to make a positive difference in all areas of the Securities business. Sectoral coverage has been added in Real Estate and more recently in Business Services and Strategy. During the first half, Sales and Sales Trading saw quality additions (particularly in larger companies) and more recently, the Securities business has hired two Directors in Corporate Finance. Costs continue to be managed actively. Head count at June was 72 (2009: 75).

In April 2010, the business announced that it had entered into an agreement with Anand Rathi, a leading Indian investment bank. The agreement covers the cross referral of corporate work between UK, Europe and India, and the distribution by Arbuthnot Securities of an Indian equity product into the UK and Europe. Corporate and analyst roadshows have already taken place in the UK and several initiatives are being planned for the coming months.

Outlook

Our investment banking business will naturally be affected by fluctuating market confidence but is focussed on improving the quality of its franchise. Our retail and private banking businesses are liquid, well-capitalised and prudently managed. We have several promising initiatives underway across the Group to take advantage of market opportunities. Any outlook statement made at this time must recognise that economic recovery remains fragile and vulnerable to shocks. However, in the absence of adverse economic developments we remain optimistic about the remainder of 2010 and beyond.

Henry Angest
Chairman & CEO
4 August 2010

Consolidated statement of comprehensive income

	Six months ended 30 June 2010 £000	Six months ended 30 June 2009 £000
Interest and similar income	12,521	8,512
Interest expense and similar charges	(3,226)	(3,026)
Net interest income	**9,295**	**5,486**
Fee and commission income	15,053	15,119
Fee and commission expense	(667)	(474)
Net fee and commission income	**14,386**	**14,645**
Gains less losses from dealing in securities	2,008	1,386
Operating income	**25,689**	**21,517**
Net impairment loss on financial assets	(1,321)	(749)
Operating expenses	(22,033)	(20,066)
Profit before income tax	**2,335**	**702**
Income tax expense	(470)	(428)
Profit for the period	**1,865**	**274**
Foreign currency translation reserve	(63)	168
Revaluation reserve		
– Revaluation of freehold premises	(112)	–
Other comprehensive income for the period, net of income tax	(175)	168
Total comprehensive income for the period	**1,690**	**442**
Profit attributable to:		
Equity holders of the Company	1,890	682
Non-controlling interests	(25)	(408)
	1,865	**274**
Total comprehensive income attributable to:		
Equity holders of the Company	1,715	850
Non-controlling interests	(25)	(408)
	1,690	**442**
Earnings per share for profit attributable to the equity holders of the Company during the year		
(expressed in pence per share)		
– basic and fully diluted	12.6p	4.5p

Consolidated statement of financial position

	At 30 June 2010 £000	2009 £000
ASSETS		
Cash	1,517	260
Derivative financial instruments	501	280
Loans and advances to banks	48,657	19,348
Loans and advances to customers	253,223	189,494
Trading securities - long positions	4,464	2,805
Debt securities held-to-maturity	222,199	168,222
Current tax asset	–	45
Other assets	16,284	17,454
Financial investments	4,712	3,627
Intangible assets	2,767	2,750
Property, plant and equipment	6,585	9,323
Deferred tax assets	1,039	59
Total assets	**561,948**	**413,667**
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	150	150
Share premium account	21,085	21,085
Retained earnings	11,893	10,445
Other reserves	(1,252)	(701)
Non-controlling interests	**2,119**	**1,872**
Total equity	**33,995**	**32,851**
LIABILITIES		
Deposits from banks	3,725	2,509
Trading securities – short positions	1,072	1,592
Deposits from customers	498,776	351,119
Current tax liability	662	–
Other liabilities	11,693	13,118
Deferred tax liabilities	65	–
Debt securities in issue	11,960	12,478
Total liabilities	**527,953**	**380,816**
Total equity and liabilities	**561,948**	**413,667**

Consolidated statement of changes in equity

	Attributable to equity holders of the Company								
	Share capital £000	Share premium account £000	Foreign currency translation reserve £000	Revaluation reserve £000	Capital redemption reserve £000	Treasury shares £000	Retained earnings £000	Non-controlling interests £000	Total £000
Balance at 1 January 2010	150	21,085	(258)	258	20	(940)	11,684	2,144	34,143
Total comprehensive income for the period									
Profit/(loss) for the six months ended 30 June 2010	–	–	–	–	–	–	1,890	(25)	1,865
Other comprehensive income, net of income tax									
Foreign currency translation reserve	–	–	(63)	–	–	–	–	–	(63)
Revaluation reserve									
– Revaluation of freehold premises	–	–	–	(112)	–	–	–	–	(112)
Total other comprehensive income	–	–	(63)	(112)	–	–	–	–	(175)
Total comprehensive income for the period	–	–	(63)	(112)	–	–	1,890	(25)	1,690
Transactions with owners, recorded directly in equity									
Contributions by and distributions to owners									
Purchase of own shares	–	–	–	–	–	(157)	–	–	(157)
Final dividend relating to 2009	–	–	–	–	–	–	(1,681)	–	(1,681)
Total contributions by and distributions to owners	–	–	–	–	–	(157)	(1,681)	–	(1,838)
Balance at 30 June 2010	150	21,085	(321)	146	20	(1,097)	11,893	2,119	33,995

Consolidated statement of changes in equity continued

	Share capital £000	Share premium account £000	Foreign currency translation reserve £000	Revaluation reserve £000	Capital redemption reserve £000	Treasury shares £000	Retained earnings £000	Non-controlling interests £000	Total £000
	Attributable to equity holders of the Company								
Balance at 1 January 2009	150	21,085	(299)	366	20	(445)	11,257	2,280	34,414
Total comprehensive income for the period									
Profit/(loss) for the six months ended 30 June 2009	–	–	–	–	–	–	682	(408)	274
Other comprehensive income, net of income tax									
Foreign currency translation reserve	–	–	168	–	–	–	–	–	168
Revaluation reserve – Amount transferred to profit and loss on sale	–	–	–	(47)	–	–	47	–	–
Total other comprehensive income	–	–	168	(47)	–	–	47	–	168
Total comprehensive income for the period	–	–	168	(47)	–	–	729	(408)	442
Transactions with owners, recorded directly in equity									
Contributions by and distributions to owners									
Purchase of own shares	–	–	–	–	–	(464)	–	–	(464)
Final dividend relating to 2008	–	–	–	–	–	–	(1,541)	–	(1,541)
Total contributions by and distributions to owners	–	–	–	–	–	(464)	(1,541)	–	(2,005)
Balance at 30 June 2009	150	21,085	(131)	319	20	(909)	10,445	1,872	32,851

Consolidated statement of cash flows

	Six months ended 30 June 2010 £000	Six months ended 30 June 2009 £000
Cash flows from operating activities		
Interest and similar income received	12,893	9,740
Interest and similar charges paid	(3,125)	(3,032)
Fees and commissions received	14,386	14,645
Net trading and other income	2,008	1,386
Cash payments to employees and suppliers	(22,902)	(22,086)
Taxation (paid)/received	(883)	1,253
Cash flows from operating profits before changes in operating assets and liabilities	2,377	1,906
Changes in operating assets and liabilities:		
– net (increase)/decrease in trading securities	(1,692)	1,274
– net increase in loans and advances to customers	(24,822)	(26,894)
– net decrease in other assets	2,470	715
– net increase/(decrease) in deposits from other banks	839	(389)
– net increase in amounts due to customers	112,777	59,377
– net decrease in other liabilities	(1,524)	(2,855)
Net cash inflow from operating activities	90,425	33,134
Cash flows from investing activities		
Purchase of computer software	(90)	(87)
Purchase of property, plant and equipment	(210)	(569)
Proceeds from sale of property, plant and equipment	1,645	142
Purchases of debt securities	(249,685)	(148,662)
Proceeds from sale of debt securities	155,083	173,543
Net cash from investing activities	(93,257)	24,367
Cash flows from financing activities		
Purchase of treasury shares	(157)	(464)
Dividends paid	(1,681)	(1,541)
Net cash used in financing activities	(1,838)	(2,005)
Net increase in cash and cash equivalents	(4,670)	55,496
Cash and cash equivalents at beginning of period	54,844	27,299
Cash and cash equivalents at end of period	50,174	82,795

Notes to the consolidated financial statements

1. Operating segments

The group is organised into four main operating segments, arranged over four separate companies with each having its own specialised banking service, as disclosed below:

1) Retail banking — incorporating household cash management, personal lending and banking and insurance services.
2) International Private banking — incorporating private banking and wealth management outside the UK.
3) UK Private banking — incorporating private banking and wealth management.
4) Investment banking — incorporating institutional stockbroking, equity trading and corporate finance advice.

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 operating assets and liabilities, being the majority of the statement of financial position.

Six months ended 30 June 2010	Retail banking £000	International Private banking £000	UK Private banking £000	Investment banking £000	Group (reconciling items) £000	Group total £000
Interest revenue	7,089	–	5,630	–	141	12,860
Inter-segment revenue	(126)	–	(72)	–	(141)	(339)
Interest revenue from external customers	6,963	–	5,558	–	–	12,521
Fee and commission income	5,706	–	2,997	6,350	–	15,053
Revenue from external customers	**12,669**	–	**8,555**	**6,350**	–	**27,574**
Interest expense	(1,325)	–	(1,595)	(35)	(34)	(2,989)
Subordinated loan note interest	–	–	–	–	(237)	(237)
Segment operating income	11,469	–	6,561	7,996	(337)	25,689
Impairment losses	(811)	–	(510)	–	–	(1,321)
Segment profit/(loss) before tax	4,599	(60)	78	451	(2,733)	2,335
Income tax (expense)/income	(1,042)	–	113	(33)	492	(470)
Segment profit/(loss) after tax	**3,557**	**(60)**	**191**	**418**	**(2,241)**	**1,865**
Segment total assets	182,710	102	416,401	12,143	(49,408)	561,948
Segment total liabilities	167,374	2,129	392,644	5,751	(39,945)	527,953
Other segment items:						
Capital expenditure	(55)	–	(204)	(28)	(13)	(300)
Depreciation and amortisation	(367)	(36)	(314)	(41)	(3)	(761)

Notes to the consolidated financial statements

1. Operating segments continued

Six months ended 30 June 2009	Retail banking £000	International Private banking £000	UK Private banking £000	Investment banking £000	Group (reconciling items) £000	Group total £000
Interest revenue	2,692	–	6,016	–	212	8,920
Inter-segment revenue	(81)	–	(115)	–	(212)	(408)
Interest revenue from external customers	2,611	–	5,901	–	–	8,512
Fee and commission income	7,773	–	2,539	4,800	7	15,119
Revenue from external customers	**10,384**	**–**	**8,440**	**4,800**	**7**	**23,631**
Interest expense	(430)	(12)	(2,016)	(179)	(32)	(2,669)
Subordinated loan note interest	–	–	–	–	(357)	(357)
Segment operating income	10,019	(12)	6,246	5,464	(200)	21,517
Impairment losses	(459)	–	(290)	–	–	(749)
Segment profit/(loss) before tax	4,061	(490)	731	(1,316)	(2,284)	702
Income tax (expense)/income	(1,153)	–	(174)	305	594	(428)
Segment profit/(loss) after tax	**2,908**	**(490)**	**557**	**(1,011)**	**(1,690)**	**274**
Segment total assets	96,131	193	349,777	12,808	(45,242)	413,667
Segment total liabilities	83,160	1,943	325,863	7,031	(37,181)	380,816
Other segment items:						
Capital expenditure	(166)	–	(474)	(15)	(1)	(656)
Depreciation and amortisation	(348)	(36)	(341)	(28)	(1)	(754)

The "Group" segment above includes the parent entity and all intercompany eliminations and fulfils the requirement of IFRS8.28.

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

Other than the international private banking operations which are in Switzerland, all the Group's other operations are conducted wholly within the United Kingdom and geographical information is therefore not presented.

2. Basic and fully diluted

Earnings per ordinary share are calculated on the net basis by dividing the profit attributable to the equity holders of the Company of £1,890,000 (2009: £682,000) by the weighted number of ordinary shares 14,999,619 (2009: 14,999,619) in issue during the period.

3. Basis of reporting

The interim financial statements have been prepared on the basis of accounting policies set out in the Group's 2009 statutory accounts as amended by standards and interpretations effective during 2010. The statements were approved by the Board of Directors on 4 August 2010 and are unaudited. The interim financial statements will be posted to shareholders and copies may be obtained from The Company Secretary, Arbuthnot Banking Group PLC, Arbuthnot House, 20 Ropemaker Street, London EC2Y 9AR.

Corporate contacts & advisers

Group Address
Arbuthnot Banking Group
Arbuthnot House
20 Ropemaker Street
London EC2Y 9AR
T 020 7012 2400
E info@arbuthnotgroup.com
www.arbuthnotgroup.com

Registered Office
One Arleston Way
Solihull B90 4LH
T 0121 693 9100
F 0121 693 9124

Corporate Contacts
Secure Trust Bank
One Arleston Way
Solihull B90 4LH
T 0121 693 9100
F 0121 693 9124
E banking@securetrustbank.com
www.securetrustbank.com

Arbuthnot Securities
Arbuthnot House
20 Ropemaker Street
London EC2Y 9AR
T 020 7012 2000
F 020 7012 2001
E investmentbanking@arbuthnot.co.uk
www.arbuthnot.co.uk

Arbuthnot Latham & Co
Arbuthnot House
20 Ropemaker Street
London EC2Y 9AR
T 020 7012 2500
F 020 7012 2501
E banking@arbuthnot.co.uk
www.arbuthnot.co.uk

Bartle House, Oxford Court
Manchester M2 3WQ
T 0161 236 4431
F 0161 236 4432

17 Southernhay West
Exeter EX1 1PJ
T 01392 496061
F 01392 495313

Advisers
Auditors:
KPMG Audit Plc

Principal Bankers:
Barclays Bank PLC
Lloyds TSB plc

Stockbrokers:
Numis Securities Limited

Nominated Advisor:
Hawkpoint Partners Limited

Registrars:
Capita Registrars
The Registry
34 Beckenham Road
Beckenham, Kent BR3 4TU

For your notes

Arbuthnot House
20 Ropemaker Street
London EC2Y 9AR

T 020 7012 2400
E info@arbuthnotgroup.com
www.arbuthnotgroup.com

Registration No. 1954085