Shawbrook Group PLC (LSE: SHAW)

Modest Upside for Next 12 Months; Possible Economic Headwinds Ahead

- **Mixed 1H15**: While Shawbrook reported lower-than-expected mortgage growth for the first half of the year, industry-wide growth rates were also down. However, the company’s NIM remained stable, its Cost-to-Income Ratio fell to 48.9%, and its CET 1 Ratio rose to 15.2% as a result of the successful IPO in April.

- **Financial Guidance**: The Company recently reaffirmed its long-term and short-term financial guidance, including £2 billion in gross originations by FY 17, NIM remaining stable at current levels, a Cost-to-Income Ratio of 40% by FY 17, a pre-tax ROA of 3.5% by FY 17, annualised cost of risk of 0.5-0.6%, and a CET 1 Ratio of at least 13%. We believe the Gross Origination and NIM targets may be on the high side, given market headwinds and increased competition. However, Shawbrook’s relatively diversified loan book (only ~22% BTL mortgages vs. 41% for ALD and 46% for OSB) may help it weather the storm of regulatory changes.

- **Catalysts**: 1) **Full-Year Results on 3 March**. The new CEO plans to address the market for the first time as well. 2) **Higher-Than-Expected Consumer Lending or Business Credit Growth**. These products are both relatively new with limited historical data, but early performance is promising. 3) **Declining Funding Costs**. Despite the expected rise in interest rates, the company could see lower funding costs in the future, given its 75% fixed-rate deposits and its Easy Access product. 4) **BTL Regulatory Changes Are Lighter Than Expected**. If the government reverses course on its recent tax and stamp duty proposals, country-wide mortgages and the BTL segment specifically could see higher-than-expected growth.

Our **358p** target price is based on the 75th percentile multiples from the comparable public companies (FY 15E and FY 16E P / E multiples of 14.9x and 11.1x and P / TBV multiples of 3.4x and 2.8x), as well as our multi-stage dividend discount model, which reflects Shawbrook’s plans for a maiden dividend in FY 16 and rapid growth thereafter. Given that Shawbrook’s Loan growth and Net Income growth are well above peer companies’ figures, we believe the 75th percentile multiples are justified.

### Financial and Valuation Metrics (Fiscal Year Ends 31 December)

<table>
<thead>
<tr>
<th>Year</th>
<th>FY 14A</th>
<th>FY 15E</th>
<th>FY 16E</th>
<th>FY 17E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported EPS (GBP)</td>
<td>20.88p</td>
<td>26.47p</td>
<td>30.48p</td>
<td>38.47p</td>
</tr>
<tr>
<td>Unadjusted P / E (x)</td>
<td>23.7x</td>
<td>14.2x</td>
<td>10.5x</td>
<td>8.0x</td>
</tr>
<tr>
<td>ROTCE (%)</td>
<td>24.4%</td>
<td>23.8%</td>
<td>21.3%</td>
<td>21.9%</td>
</tr>
<tr>
<td>CET 1 Ratio (%)</td>
<td>11.6%</td>
<td>15.8%</td>
<td>16.3%</td>
<td>15.7%</td>
</tr>
<tr>
<td>Tangible Book Value (GBP £ M)</td>
<td>169.2</td>
<td>315.0</td>
<td>417.3</td>
<td>520.0</td>
</tr>
<tr>
<td>P / TBV (x)</td>
<td>4.8x</td>
<td>2.6x</td>
<td>2.0x</td>
<td>1.6x</td>
</tr>
</tbody>
</table>

Number of shares (m) | 250.0  |
Market Cap (GBP £ M) | 818.5  |

Source: Company data, Goldman Stanley estimates.
Goldman Stanley

Operations

Figure 2 – Shawbrook Gross Loan and Commercial Mortgage Growth

- **UK GDP Growth**: In our Base Case scenario, represented above, we forecast UK nominal GDP growth of 2.5% over the next two years, declining to 2.0% through FY 19. We project all of Shawbrook’s addressable lending markets, including Commercial Mortgages, as percentages of GDP.

- **Addressable Loan Markets**: We expect modest growth in Shawbrook’s addressable markets over the next five years, including 5-10% growth in Asset Finance and Consumer Lending. Commercial Mortgages are expected to decline by 10-15%, but the BTL segment that Shawbrook focuses on should continue to grow at ~10%+, driven by supply/demand and changing home ownership dynamics.

- **Shawbrook Market Share**: We forecast the greatest market-share gains in Commercial Mortgages (increasing from 0.27% to 1.00%), Secured Lending (increasing from 7.33% to 17.00%), and Consumer Lending (rising from 0.66% to 1.35%). Asset Finance and Business Credit should also see more modest gains.

Figure 3 – Percentage of Gross Loans by Segment

- **Diversification**: Although Shawbrook focuses on Commercial Mortgages, it is more diversified than peer banks such as Aldermore and OneSavings Bank, given that only 22% of its total loan portfolio consists of BTL mortgages. By contrast, 41% of Aldermore’s portfolio consists of BTL mortgages and 46% of OneSavings’ portfolio is BTL mortgages.
**Outlook:** Although Shawbrook plans to develop its other segments, we expect Commercial Mortgages to represent a greater percentage of total Gross Loans by FY 19, given the relative growth rates of each market.

**Charge-Offs and Provisions:** We have estimated Net Charge-Offs at 0.11% of Average Gross Loans, rising to 0.13% by FY 19, compared to historical figures ranging from 0.05% to 0.09%. Provisions for Credit Losses vary by segment but represent between 0.15% and 0.20% of Gross Commercial Mortgages and 2.3% to 2.5% of Consumer Loans.

**Figure 4 – Shawbrook Interest Rate and NIM Development**

![Average Interest Rates and Net Interest Margin, Historical and Projected](image)

Source: Company data, Goldman Stanley estimates.

**Historical Performance:** Shawbrook’s NIM has risen substantially in the past several years and remained stable in 1H15, driven mostly by declining funding costs on retail deposits.

**Outlook:** Although we expect LIBOR spreads on the company’s assets to decline, gross asset yields should remain in the same range due to rising LIBOR rates. We also expect the cost of funding for the company’s fixed-rate deposits (75% of total) to decline from 2.6% to 2.1%.

**Assumptions:** We assumed the following LIBOR spreads and gross asset yields:

- **Commercial Mortgages:** L + 600 bps declining to L + 510 bps; yield of 6.3% rising to 6.5%
- **Asset Finance:** L + 970 bps declining to L + 900 bps; yield of 9.9% rising to 10.4%
- **Business Credit:** L + 670 bps declining to L + 620 bps; yield of 6.9% rising to 7.6%
- **Secured Lending:** L + 980 bps declining to L + 930 bps; yield of 10.0% rising to 10.7%
- **Consumer Lending:** L + 1140 bps declining to L + 1040 bps; yield of 11.6% rising to 11.8%
Revenue Mix: Net Interest Income / Revenue was at 91.5% in the past fiscal year, and is expected to increase to 93.1% by FY 19, driven by a relatively stable Net Loans / Total Assets ratio. Net Fee and Commission Income and Net Income from Operating Leases contributed approximately £10 million in revenue in the last fiscal year.

Growth Rates: Interest Income grew at a CAGR of 224% since FY 10; we expect a 22% CAGR through FY 19.

Percentage Contributions: We expect Interest Income from Commercial Mortgages to increase from 31% of the total to 43% by FY 19, driven by similar asset yields and an increasing proportion of Commercial Mortgages.

Company Targets: Shawbrook management have targeted a 40% Cost-to-Income Ratio by FY 17; as shown above, we believe this figure is overly optimistic, but attainable by FY 19.

Staff Costs: These represent the company’s primary non-interest and non-provision expense; we used the following assumptions:

  - Employee Count: This increases from 414 in FY 14 to 901 by FY 19, implying that revenue per employee will rise from ~£271,000 to £420,000 over those five years.
- **Staff Costs per Employee**: The fully-loaded costs, including benefits and IT/infrastructure, will rise from ~£75,000 in FY 14 to £90,000 by FY 19 (CAGR of 3.6%, just above inflation).

- **Other Administrative Expenses**: These represent the second-biggest non-interest and non-provision expense. As these consist primarily of fixed expenses, we have assumed that they decline from 23% of revenue in FY 14 to 18% by FY 19.

**Figure 7 – Shawbrook Regulatory Capital Ratios**

[Diagram showing regulatory capital ratios, historical and projected.]

**Source**: Company data, Goldman Stanley estimates.

- **Targeted Capital Levels**: We have used the company's targeted 13% CET 1 Ratio to drive dividends and the other capital ratios. Given the Basel III and CRD IV requirements, this level implies an 8.5% discretionary buffer in FY 15, which declines to 3.5% in FY 19 as a result of the 2.5% capital conservation buffer and 2.5% countercyclical buffer. The SIFI buffer would not apply to Shawbrook.

- **Forecasts**: The company stays well above its targeted CET 1 Ratio over the next five years, primarily because it continues to issue additional shares even as its dividend issuances begin; Tier 1 and Total Capital both remain in healthy ranges.

- **Leverage Ratio and Tangible Common Equity Ratio**: These remain between 8% and 11% over the next five years (both were between 6% and 7% in the past two years). The company stays far above the 3% minimum levels even in more pessimistic scenarios.

- **New Ratios Under Basel III and CRD IV**: These new regulations introduce the Liquidity Coverage Ratio and the Net Stable Funding Ratio; the LCR requirement begins in FY 15 at 60%, rising to 100% by FY 19, while the 100% NSFR requirement begins in FY 18.
  - **Liquidity Coverage Ratio**: The company does not disclose the calculations for this ratio, but we estimated it at 224% in FY 14 based on the company’s Liquid Assets and Net Cash Outflows (vs. the official figure of 326%). It remains above 200% all through the next five years, far above the 60-100% requirements.
  - **Net Stable Funding Ratio**: Once again, the company discloses the percentage (156%) but not the calculations. We estimated it at 160% based on the Loans, Deposits, and Net Inflows, and we expect it to remain between 160% and 180% over the next five years, far above the 100% requirement.

**Valuation Summary**

Our target price of **358p** is based on a combination of:

- **Multiples**: The median FY 15E and FY 16E P / E multiples for the public comps are 13.8x and 10.5x, respectively, and the median FY 15E and FY 16E P / TBV multiples are 2.8x and 2.3x. Given that Shawbrook’s Net Income growth exceeds the median growth rate of the set and that its regulatory capital ratios and loan growth rates are also higher, we believe it deserves a value closer to the 75th percentile of the set (which implies a share price of 364p).
Goldman Stanley

- **Dividend Discount Model**: Our Base Case analysis, with a Cost of Equity of 12% declining to 11% and a Long-Term Asset Growth Rate of 7% and a Long-Term ROTCE of 13.5%, produced an implied share price of 358p.

- **Residual Income Model**: Our Base Case analysis, with the same Cost of Equity and Asset Growth assumptions but a Long-Term ROCE of 13.0%, produced an implied share price of 340p.

**Figure 8 – Shawbrook Valuation Summary (Base Case) and Current Share Price**

![Shawbrook Valuation Summary](image)

- **Current Share Price**: At 327p, Shawbrook appears slightly undervalued relative to its peer companies as well as to the implied intrinsic value from our dividend discount model (DDM). As shown above, we believe a share price closer to 350p – 360p would be more in-line with the DDM and Residual Income Model and the 75th percentile multiples from the comps.

- **Other Methodologies**: We do not view Precedent Transactions as meaningful due to the lack of truly comparable deals and the low number of recently acquired UK-based banks (~4 in the past four years). The Regression Analysis based on ROTCE and P / TBV produces implied share prices higher than the others, but that is also because the set of banks is so broad.

- **Other Cases**: Our Upside Case, with higher figures for loan growth and market share gains, Long-Term ROTCE (14.0% vs. 13.5%), and Long-Term Asset Growth (8.0% vs. 7.0%) yields an implied share price of **452p** in the DDM; our Downside Case, with lower figures for all of those and a Long-Term ROTCE of 12.0% and Asset Growth Rate of 6.0%, yields an implied share price of **230p**.

**Comparable Public Companies**

To value Shawbrook, we used a set of comparable public companies with a focus on adjusted, normalised P / E and P / TBV multiples (we explain the adjustments below):
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Figure 9 – Shawbrook Comparable Public Companies and Valuation Output
### Metrics and Multiples:
We view forward P/E multiples and P/TBV multiples as the most meaningful ones, even though Net Income Growth and forward P/E multiples are not highly correlated. There is a high degree of correlation between ROTCE and the forward P/TBV multiples.

### Adjustments and Normalizations:
We have adjusted each comparable company for Excess or Deficit Capital under the assumption that these peer banks, like Shawbrook, are targeting 13% CET 1 Ratios. We have therefore subtracted Excess Capital from the numerator and denominator in multiples such as P/TBV; we have also adjusted each company’s Net Income by subtracting Excess Capital * Risk-Free Rate of 1.94% * (1 – Tax Rate) and adjusted the P/E multiples by using these new Net Income figures and Equity Value less Excess Capital.

We have also added back non-recurring charges such as IPO listing fees when calculating each company’s Adjusted, Normalised Net Income. None of these adjustments makes a huge difference; the multiples and implied values differ by ~5% without these changes.

### Target P/E and P/TBV Multiples:
The median FY 15E and FY 16E P/E multiples are 13.8x and 10.5x, respectively, and the median FY 15E and FY 16E P/TBV multiples are 2.8x and 2.3x. Shawbrook trades at almost exactly these multiples, but we believe that a premium valuation closer to the 75th percentile of the range is justified given that its projected Net Income growth, Loan growth, and regulatory capital ratios are above most of the peer banks.

### Target Price:
As a result, we examined implied values based on the 75th percentile P/E and P/TBV multiples. The median implied share price based on P/TBV multiples was 370p, and the median based on P/E multiples was 343p. Our target price of 358p is almost exactly in between these two figures.
Precedent Transactions

We do not view Precedent Transactions as a meaningful methodology for Shawbrook, but the selected set of M&A deals is shown below:

Figure 10 – Shawbrook Precedent Transactions

<table>
<thead>
<tr>
<th>Acquirer Name</th>
<th>Target Name</th>
<th>Date Announced</th>
<th>Percent Acquired</th>
<th>Equity Purchase Price</th>
<th>Total Assets</th>
<th>Book Value</th>
<th>Tangible Book Value</th>
<th>LTM Net Income</th>
<th>P / BV</th>
<th>P / TBV(5)</th>
<th>LTM P / E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco de Sabadell, S.A.</td>
<td>TSB Banking Group plc</td>
<td>2015-03-12</td>
<td>100.0%</td>
<td>£ 1,700.0</td>
<td>£ 22,171.4</td>
<td>£ 1,634.4</td>
<td>£ 1,634.4</td>
<td>£ 134.5</td>
<td>1.0x</td>
<td>1.0x</td>
<td>12.6x</td>
</tr>
<tr>
<td>Industrial and Commercial Bank of China</td>
<td>ICBC Standard Bank Plc</td>
<td>2014-01-28</td>
<td>50.0%</td>
<td>£ 770.2</td>
<td>£ 11,216.1</td>
<td>£ 835.2</td>
<td>£ 818.7</td>
<td>(24.6)</td>
<td>0.5x</td>
<td>0.5x</td>
<td>NM</td>
</tr>
<tr>
<td>J Sainsbury plc</td>
<td>Sainsbury's Bank plc</td>
<td>2013-05-30</td>
<td>100.0%</td>
<td>£ 358.0</td>
<td>£ 4,593.0</td>
<td>£ 395.0</td>
<td>£ 391.0</td>
<td>40.6</td>
<td>1.3x</td>
<td>1.3x</td>
<td>7.7x</td>
</tr>
<tr>
<td>Virgin Money Holdings (UK) plc</td>
<td>Northern Rock Plc</td>
<td>2011-11-17</td>
<td>100.0%</td>
<td>£ 657.0</td>
<td>£ 19,929.6</td>
<td>£ 1,121.7</td>
<td>£ 1,114.2</td>
<td>(149.4)</td>
<td>0.8x</td>
<td>0.8x</td>
<td>NM</td>
</tr>
</tbody>
</table>

Source: Company data, Goldman Stanley estimates.

(1) Equity Purchase Price is based on the amount offered for 100% of the target’s common shares on the announcement date. Price includes 50% of earn-out values.
(2) Tangible Book Value is defined as Equity less Preferred Stock and Additional AT1 Securities, Noncontrolling Interests, and Goodwill & Other Intangible Assets.

Dividend Discount Model (DDM)

Given that Shawbrook plans to start issuing dividends only in FY 16, we used a 15-year Dividend Discount Model with support for three phases: Rapid Dividend Growth in Phase 1, Slowing Dividend Growth in Phase 2, and Payout Ratio Stabilization in Phase 3.

In addition to a changing dividend payout ratio in each phase and a Cost of Equity that gradually declines from 12% to 11%, Return on Tangible Common Equity and Total Asset Growth also decline over the 15 years in the projections.

Additionally, stock issuances stop after five years, Risk-Weighted Assets as a % of Total Assets stabilize and remain constant in the last five years, and Goodwill & Other Intangibles as a % of Total Assets do the same.
Figure 11 – Shawbrook Projected Net Income and Dividends

<table>
<thead>
<tr>
<th>Historical/Projected</th>
<th>FY18</th>
<th>FY19</th>
<th>FY20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income Before Common</td>
<td>£M</td>
<td>£M</td>
<td>£M</td>
</tr>
<tr>
<td>Full Year Dividends</td>
<td>£M</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>% Growth:</td>
<td>N/A</td>
<td>11.3%</td>
<td>10.8%</td>
</tr>
<tr>
<td>Projected:</td>
<td>10.5%</td>
<td>10.3%</td>
<td></td>
</tr>
<tr>
<td>Dividends Per Share</td>
<td>£M</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>- Shareholders Equity</td>
<td>£M</td>
<td>320.7</td>
<td>386.3</td>
</tr>
<tr>
<td>Ending Common Shareholders’ Equity</td>
<td>£M</td>
<td>386.3</td>
<td>474.5</td>
</tr>
<tr>
<td>+ Goodwill &amp; Other Intangibles</td>
<td>£M</td>
<td>474.5</td>
<td>584.4</td>
</tr>
<tr>
<td>Total Assets</td>
<td>£M</td>
<td>584.4</td>
<td>706.5</td>
</tr>
<tr>
<td>Risk-Weighted Assets (RWA)</td>
<td>£M</td>
<td>706.5</td>
<td>835.5</td>
</tr>
<tr>
<td>% Growth:</td>
<td>9.6%</td>
<td>11.7%</td>
<td></td>
</tr>
<tr>
<td>Total Equity</td>
<td>£M</td>
<td>474.5</td>
<td>584.4</td>
</tr>
<tr>
<td>Return on Average Total Equity</td>
<td>13.5%</td>
<td>14.8%</td>
<td></td>
</tr>
<tr>
<td>Discount Period (With Stipulated):</td>
<td>1.0%</td>
<td>2.0%</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>1.0%</td>
<td>2.0%</td>
<td></td>
</tr>
<tr>
<td>PV of Dividend(s)</td>
<td>£M</td>
<td>320.7</td>
<td>386.3</td>
</tr>
<tr>
<td>Cost of Equity</td>
<td>%</td>
<td>13.5%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Cumulative Discount Factor</td>
<td>£M</td>
<td>0.20</td>
<td>0.14</td>
</tr>
<tr>
<td>PV of Future Share Issuance</td>
<td>£M</td>
<td>9.0</td>
<td>9.0</td>
</tr>
</tbody>
</table>

Source: Company data, Goldman Stanley estimates.

To calculate Terminal Value, we used both the Perpetuity Growth Rate method and the Multiples Method and selected assumptions that footed with each other (Terminal Net Income Growth was 7.0%, Terminal Cost of Equity was 11.0%, and Terminal ROTCE was 13.5%).

Figure 12 – Shawbrook Terminal Value Calculations

<table>
<thead>
<tr>
<th>Terminal Value - Perpetuity Growth Rate Method</th>
<th>Terminal Value - Multiples Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terminal P / TVB Multiple by ROTCE:</td>
<td>1.62x</td>
</tr>
<tr>
<td>Terminal Value:</td>
<td>2,724.0</td>
</tr>
<tr>
<td>(+) PV of Terminal Value:</td>
<td>613.4</td>
</tr>
<tr>
<td>(+) Excess / (-) Deficit Capital:</td>
<td>-</td>
</tr>
<tr>
<td>(+) Sum of PV of Dividends:</td>
<td>418.2</td>
</tr>
<tr>
<td>Implied Equity Value:</td>
<td>1,031.6</td>
</tr>
<tr>
<td>% of implied Value from PV of TV:</td>
<td>95.9%</td>
</tr>
<tr>
<td>Implied Share Price:</td>
<td>£ 3.58</td>
</tr>
<tr>
<td>Bank’s Current Share Price:</td>
<td>£ 3.27</td>
</tr>
</tbody>
</table>

Source: Company data, Goldman Stanley estimates.

With these assumptions and the Dividend projections above, the DDM produced the following output in the Base Case of our analysis.
Residual Income (Excess Returns) Model

The Residual Income, or Excess Returns, Model is a variation of the Dividend Discount Model where the bank’s implied value depends on its Common Book Value plus the Present Value of “Excess Returns,” i.e. Return on Common Equity * Average Common Equity – Cost of Equity * Average Common Equity in each future period.

This analysis can be useful for fast-growing banks that are not currently issuing dividends since banks need only a positive ROCE for this model to work. It can also be useful for large, mature banks where most of the intrinsic value is in their current Balance Sheet.

Running this analysis for Shawbrook produced similar results to the Dividend Discount Model (i.e., the company seems slightly undervalued), despite the use of ROCE less Cost of Equity rather than Dividends to measure the company’s value:

The other cases closely matched this output as well: just as in the Dividend Discount Model, the company appeared overvalued by ~30% in the Downside Case and undervalued by 30-40% in the Upside Case.
Regression Analysis

As a final valuation check, we also examined the output of a Regression Analysis that compared each UK-based bank’s FY 16E ROTCE and FY 16E P / TBV multiple and established a relationship between them, with ROTCE as the explanatory variable.

- **Set of Banks**: We examined 15 publicly traded UK-based and UK-headquartered banks, ranging from Barclays and HSBC to Shawbrook’s peer banks.

- **Adjustments**: We did NOT adjust any of these banks for Excess or Deficit Capital; the set was so broad that it was not reasonable to use the same targeted CET 1 Ratio for all the companies.

As shown above, Shawbrook seems **significantly undervalued** when measured this way: in the **Base Case**, its implied share price is 430p compared with its current price of 327p. Given that $R^2$ is 0.81, the correlation is fairly strong.

While this is an interesting result, we do not view it as terribly meaningful because many of the larger banks have much lower P / TBV multiples and ROTCE figures and because of outliers such as Paragon Financial [PFG]. Regression Analysis is useful for cross-checking other methods, but is less useful as a strict valuation methodology itself.

Investment Thesis, Catalysts, and Risks

We believe that Shawbrook is modestly undervalued but that share price appreciation in the next 12 months is limited, resulting in our “Neutral” recommendation:

- **UK Mortgage Market**: Channel checks indicate a possible slowdown in BTL lending, prompted by falling home prices and stricter regulation and tax treatment; we could see Shawbrook growing from 0.27% to ~1.00% market share in the next five years, but the BTL market itself may grow by less than expected.

- **Interest Rates and Spreads**: With LIBOR expected to rise by a modest amount over the next several years (we have forecast 0.85% by FY 17), we see gross asset yields staying in the same range as spreads decline by 0.5% – 1.0%, prompted by increased competition and Shawbrook’s above-market rates. On the other hand, funding costs could decline, particularly on the 75% of Shawbrook’s deposits with fixed rates (the average rate was 2.6% in FY 14, and we have forecast 2.4% for FY 15 declining to 2.1% in FY 19).

- **Long-Term ROTCE and Asset Growth**: We view Virgin Money and Paragon as the most comparable “mature” specialty lenders, and both have ROTCEs between 12% and 13% for FY 16. Given Shawbrook’s age and market focus, we see its Long-Term ROTCE as slightly higher at 13.5%, with Asset Growth of 7.0%.
Goldman Stanley

Our targeted share prices are as follows:

- **Bull Case**: 452p, based on Commercial Mortgages of £3.9 billion GBP by FY 19 and Total Loans of £6.9 billion, with a Long-Term ROTCE of 14.0%, Asset Growth of 8.0%, and Cost of Equity of 11.0%.

- **Base Case**: 358p, based on Commercial Mortgages of £3.5 billion GBP by FY 19 and Total Loans of £6.3 billion, with a Long-Term ROTCE of 13.5%, Asset Growth of 7.0%, and Cost of Equity of 11.0%.

- **Bear Case**: 230p, based on Commercial Mortgages of £2.5 billion GBP by FY 19 and Total Loans of £4.7 billion, with a Long-Term ROTCE of 12.0%, Asset Growth of 6.0%, and Cost of Equity of 11.0%.

**Potential Catalysts**

- **Full-Year Results on 3 March**. The new CEO plans to address the market for the first time as well.

- **Higher-Than-Expected Consumer Lending or Business Credit Growth**. These products are both relatively new with limited historical data, but early performance is promising.

- **Declining Funding Costs**. Despite the expected rise in interest rates, the company could see lower funding costs in the future, given its 75% fixed-rate deposits and its Easy Access product.

- **BTL Regulatory Changes Are Lighter Than Expected**. If the government reverses course on its recent tax and stamp duty proposals, country-wide mortgages and the BTL segment specifically could see higher-than-expected growth.

**Investment Risks**

The following represent the greatest risks to our investment thesis:

- **Slowdown in Commercial Mortgage Growth**. While this segment has grown quickly historically, 1H15 results came in below expectations and channel checks have indicated a sluggish real estate market. Declining home prices and lengthier sales processes may also result in lower growth.

- **Interest Rate Compression**. While we continue to believe that funding costs will decline, increased competition in mortgages, asset finance, secured lending, and other areas may push down LIBOR spreads and gross asset yields. Shawbrook already charges rates above Aldermore and OneSavings Bank on its mortgages, and this trend may not be sustainable.

- **Risk Weightings on BTL Mortgages Changing**. The Basel Committee has proposed changing the risk weights on BTL mortgages from 35% to 90%, and UK regulators are considering this proposal. While the additional capital required as a result of this change would not make a huge difference in Shawbrook’s implied value, it could result in lower loan growth in all segments.

- **Expiration of the Lockup Period on Pollen Street Capital’s 45% Stake on 10 February**. While a sale of the entire stake is unlikely, the investment firm may choose to sell at least part of its stake (given the last placement price of 335p), triggering a wider sell-off in the stock.

Other company-specific and industry-specific risks include (1) Growing competition in the specialty lending and BTL mortgage markets; (2) the ability of management to expand into new lending segments (3) the ability to keep growing deposits via online and postal sources; (4) potential regulatory changes, especially ones related to risk weightings and IFRS 9; (5) macroeconomic slowdown and a potential recession or stagnation in the UK economy; (6) ability to reduce costs as planned and achieve a 40% Cost-to-Income Ratio by FY 17; and (7) failure to execute on new product launches.