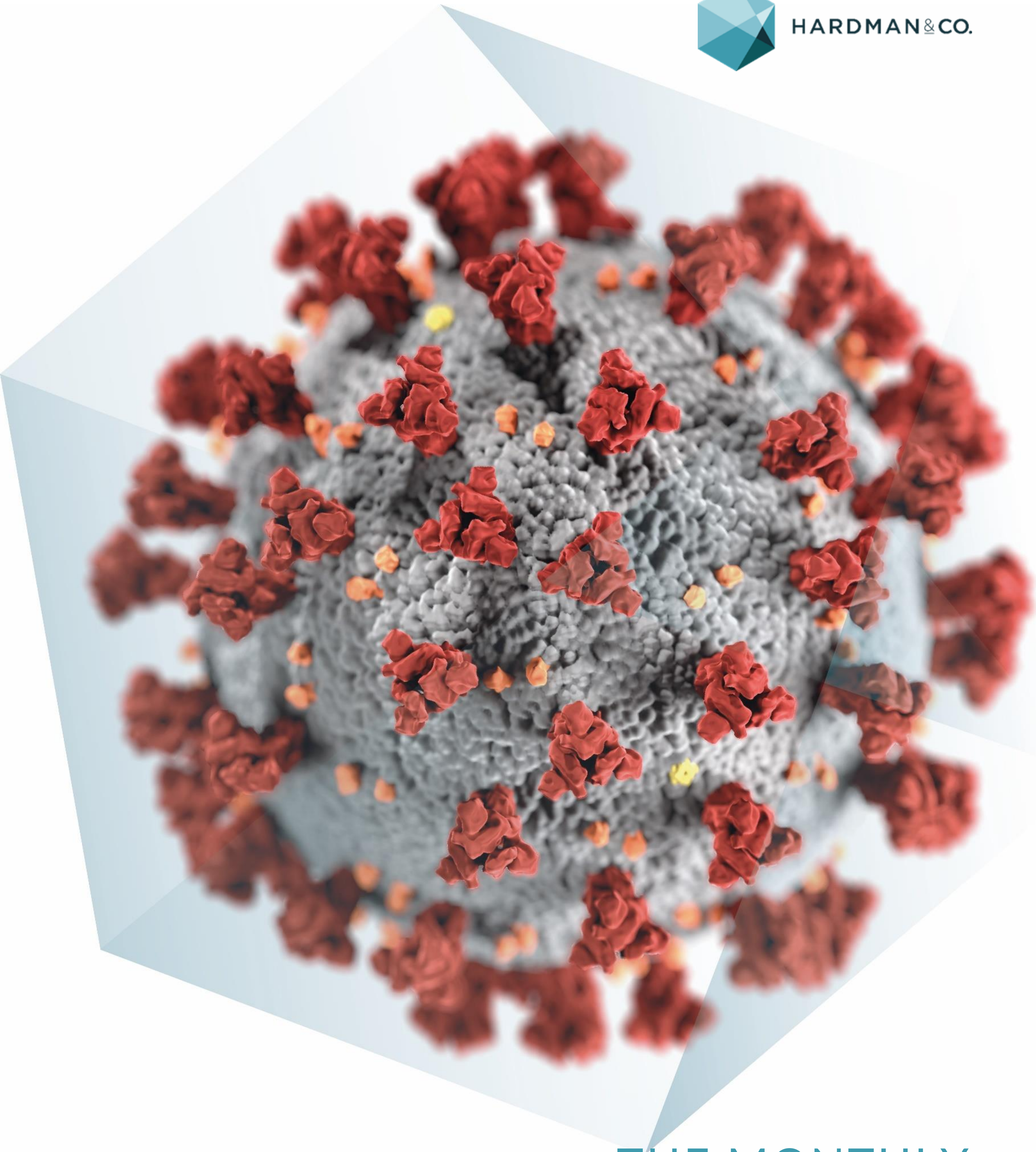

HARDMAN & CO.

THE MONTHLY

June 2020

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Feature article

Investing in a pandemic

Changes post COVID-19

This article focuses on two main impacts: effect on companies and the broader macro picture

Much has been written about the effects of the virus on the world and on the stock market. Here is one analyst's take on some of the likely impacts on the way we should look at companies. This article was originally produced as a blog, "10 Changes Post Virus", which was published a few weeks ago.

I have discussed the impacts in two areas – the broader macro picture and what this means for companies. Under macro effects, I discuss financial repression and capital controls, why interest rates will stay low for some time, and what this means, some potential ripple effects, including the potential for inflation, and the need for balance sheet restoration by both corporate and personal sectors.

I then discuss the implications for companies and equity investors, looking at the consequent likely greater desire for stronger balance sheets by the corporate sector, the need to onshore elements of the supply chain and the implications for equity valuation, working capital and income funds. Finally, I discuss how this will lead to corporates 'kitchen-sinking' reserves, and why we believe one result will be that more fraud is exposed.

The macro picture

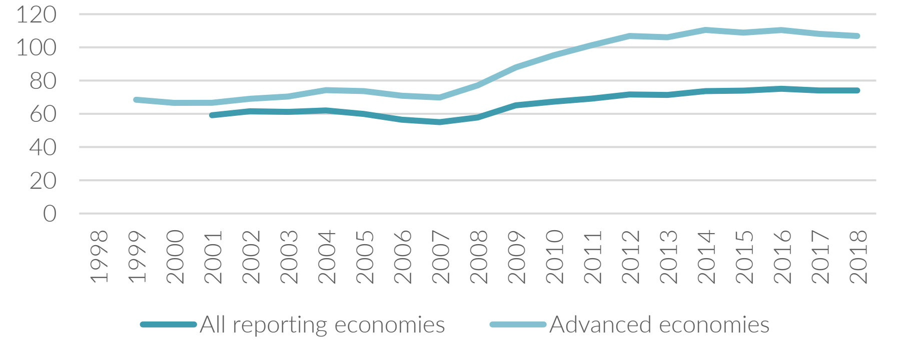
The COVID-19 pandemic has obviously been a massive shock to the financial system, and one clear effect is that almost every government on the planet is likely to have a lot more debt in June 2020 than it did in January – and likely even more by the end of the year. Add to this that the situation at the start of 2020 was not looking particularly attractive, in any case.

Higher debt

Debt larger than GDP not a great situation, and needs to come down

Advanced economies saw a significant increase in debt, above 100%, post the global financial crisis of 2008-09. Reinhart and Rogoff, in their famous book, *This Time Is Different: Eight Centuries of Financial Folly*, advocated caution that debt above 90% of GDP would slow economic growth. Their statistics and conclusions were then undermined, when it was found that there was a mistake in their spreadsheet. It was always unlikely that two academics could predict future economic events on the basis of historical trends.

Government debt as a percentage of GDP (%)



Source: BIS, Hardman & Co Research

Higher growth best way to reduce debt…

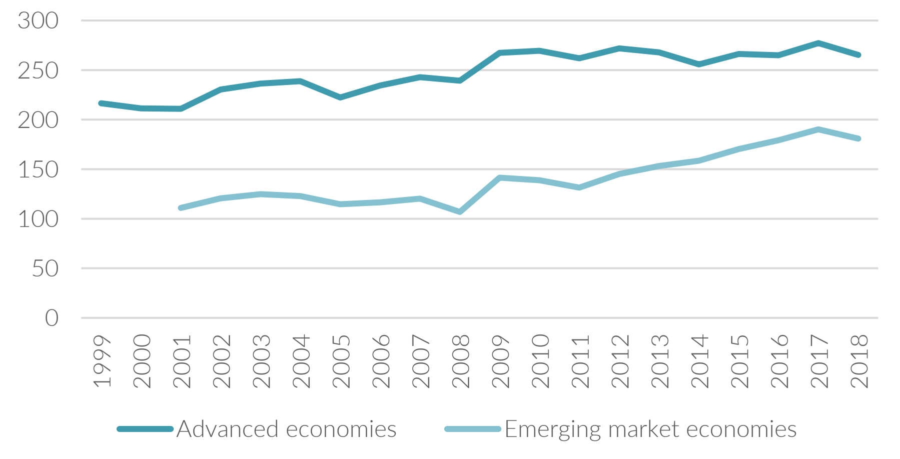
But simple common sense says that when debt is larger than GDP, it's probably not great, and you should think about getting it down. It's certain that, when this chart is drawn again, as of the end of 2020, there will be another huge increase. That surely is a cause for concern. One way this might not be a problem is that, if every government has huge debts, there will be no relative disadvantage, and hence perhaps no real risk that they cannot be financed. I am a simple stock analyst, and this is above my pay grade. My guess is that governments will, at some point, feel constrained in what they can spend and they will seek to reduce their debt burdens. Most will surely be forced to (continue to) engage in a policy of financial repression, so that their interest rates are below inflation. This could be required for decades, rather than years, and I think it has important implications for equity investors.

It's worth noting that this is not just a governmental problem; the corporate sector is also highly levered. So total debt, excluding financial institutions, is over 250% of GDP in advanced economies – it will certainly be a lot higher at the end of 2020, irrespective of a V-, W-, U-, or L-shaped recovery – or indeed any other type of recovery.

…and timely fiscal stimulus should be priority for all governments…

The best way of reducing debt to GDP is higher growth – a timely fiscal stimulus should be a priority for all governments, and – correctly delivered – it will get us all out of a mess.

Total debt as percentage of GDP (%)



Source: BIS, Hardman & Co Research

Higher taxes

…with other options being higher corporate and personal taxes

Other options for governments will presumably, at some point, be higher corporate and personal taxes, although there is an economic impact. US hedge fund manager Jim Chanos has opined[1] that if government is to bail out businesses, then businesses will be forced to pay higher taxes as an insurance premium going forward. He calculates that S&P 2021 consensus earnings of $170 (too high an estimate, in my opinion) will need to be revised down to $135, if the US returns to tax rates of the pre-Trump era.

[1] Podcast interview with Barry Ritholz: https://www.bloomberg.com/news/audio/2020-05-02/jim-chanos-on-financial-fraud-podcast-k9pvdxqs

Other options, cited by eminent financial historian, Russell Napier, include an unpalatable menu for investors:

- wealth taxes;
- dividend controls;
- restrictions on investment;
- restrictions on ownership of gold (this happened in the 1930s); and
- capital controls.

The last one is the most interesting, in our view, and raises all sorts of issues that a simple analyst like myself is unable to answer. It seems unimaginable in a global inter-connected financial environment. But what would you do if you were President of, say, Turkey?

The solution for governments must be to engineer higher growth – let's hope they can achieve this, as the alternatives are unpalatable.

Interest rates may stay low

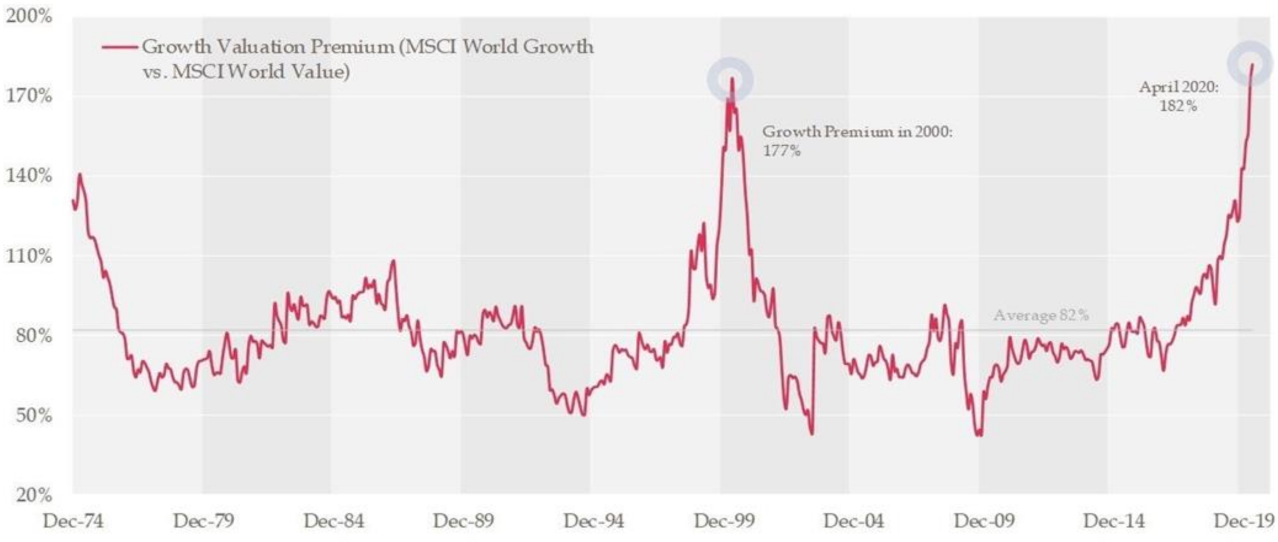
Low interest rates and subdued inflation will affect pension deficits

It seems highly likely that interest rates will stay low for an extended period. My base-case assumption is that, as with the situation post the GFC, inflation will remain subdued (this may well be the surprise of the decade, as inflation eventually returns, as in the mid-1960s).

This will affect pension deficits, which we discuss below, but should, in theory, continue to fuel the valuation of growth stocks. With growth scarcer, this becomes an even more attractive feature, which would suggest that the last decade's winners – tech – should remain winners. I would point out two caveats.

- Firstly, can these valuations grow forever? Trees to the sky? Probably not. And relative valuations have already increased significantly – as of mid-May 2020, the growth vs. value relationship had already surpassed the prior peak.

Growth premium to value exceeds tech boom levels

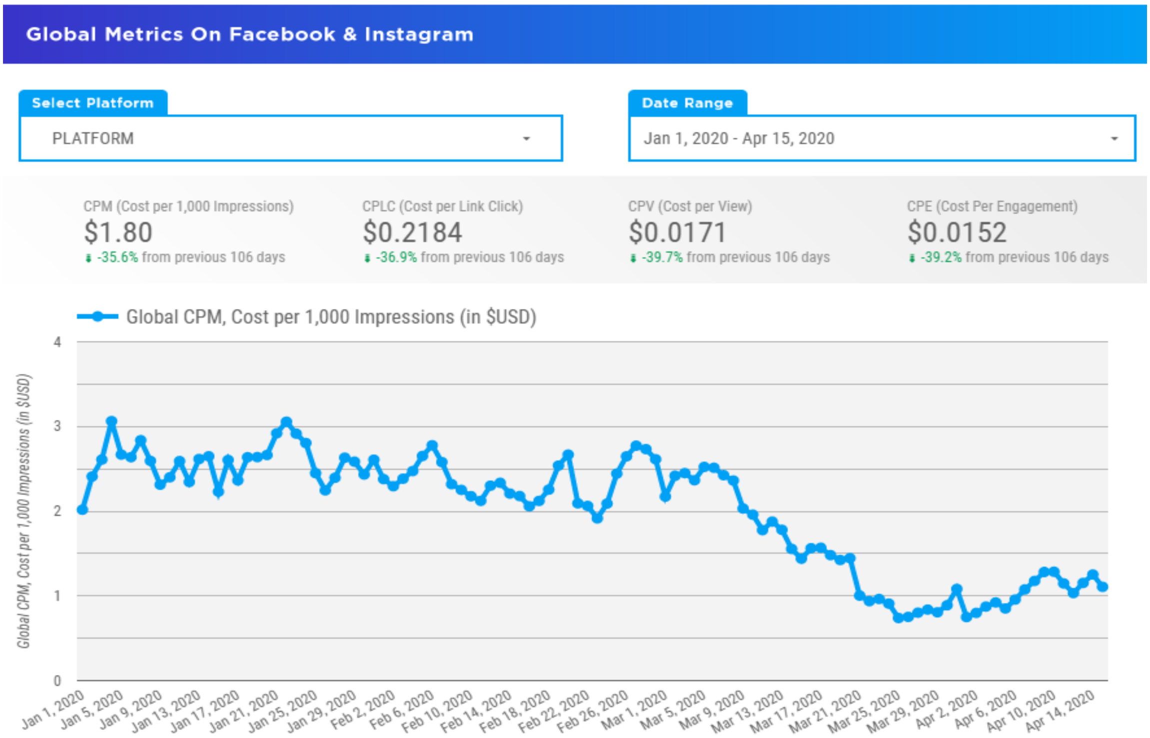


This chart shows the overvaluation of the MSCI World Growth Index compared to the MSCI World Value index since 1974. The overvaluation is measured by a composite factor of PE, PC, PB and Dividend Yield. Source: StarCapital, Thomson Reuters Datastream and MSCI as of 30/04/2020.

Source: Star Capital

- Secondly, even growth stocks are not immune to the general economic malaise. Internet advertising rates have collapsed, which will – for a period – hurt Alphabet and Facebook, for example.

Internet advertising costs have collapsed



Source: Gupta Media

Ripple effects and inflation

Direct effects of coronavirus crisis across all sectors…

The coronavirus crisis has created huge survivability issues for a number of sectors, notably airlines, travel and hospitality. The duration may be variable – for example, as long as the threat of virus transmission remains, cruise lines may face a long struggle to persuade holidaymakers to take such vacations, but the risk of short-haul air travel may be perceived as lower (although Carnival noted strong bookings for late summer in May 2020, so, somewhat surprisingly perhaps, cruising may recover more quickly).

There has obviously been an indirect effect across all sectors, even internet advertising, as was discussed earlier. A primary impact has been felt in the oil industry, where there initially appeared to be an almost existential crisis, as Saudi and Russia co-operated, possibly to undermine US shale.

…but what will be indirect impacts beyond general economic decline?

These were fairly obvious and direct initial impacts. What we have yet to understand, at this early stage of the crisis, is the indirect impacts beyond the general economic decline. This could be manifested in food shortages, a break in manufacturing supply chains, an inability to pay footballers' wages, the collapse of secondary Formula 1 teams, leading to a death of the sport, or many other potentially more serious impacts, which we have not yet thought of.

My candidate for the most impactful would be an increased propensity to save, which would slow economic growth. Second would be the potential for the imposition of a police state, as track and trace measures are implemented, with the loss of personal privacy, as foreshadowed in Yuval Noah Harari's piece for the FT on 20 March 2020.

Inflation could return in short term…

I alluded earlier to the prospect of a return to inflation. It seems impossible, given the depressed state of demand, but it also looked unlikely in the mid-1960s – yet inflation returned, leading to a dramatic wealth destruction in the following 15 years. This would be the one surprise that would really help governments; could it happen again? There may, after all, be some consequences of freely printing money.

Inflation did not resume in the last decade, in spite of huge bouts of quantitative easing. It could happen this time, however, for two reasons:

- The system has been flooded with more money, on top of its already liquid state.
- Last time around, demand growth was anaemic, and the allowed continued existence of zombie companies meant that the supply impact was lower than it would otherwise be. This time, it's highly likely that there will be multiple bankruptcies and some interruption to supply.

Inflation could well return in the short term, as oil demand returns, causing a sharp increase in oil prices, feeding through to plastic and chemicals, and as sectors of the economy that are hardest-hit see supply shrinkage:

- Airline seats will be scarcer, at least temporarily, as airlines fail, and carriers are slow to re-introduce capacity.
- The restaurant industry will see a sharp reduction in capacity, as demand to eat out returns close to pre-crisis levels (pent-up demand offset by lower affordability).
- Hotels, another mom-and-pop industry, like restaurants, will see a capacity reduction and an ability to push prices.

…probably driven by supply shortage

We will not have cost-push inflation, as labour will be in plentiful supply, nor will it be demand-led. A new form of supply shortage-driven inflation is possible, however, at least in certain sectors, and the problem with inflation is that it's difficult to make it disappear. It should be positive for equities, as long as it is contained to a limited number of sectors, but should inflation return in the medium term (not my central case), levels above 4% could severely impact valuation multiples.

Balance sheet restoration

Balance sheet restoration likely to weigh on economic growth for number of years…

Personal and corporate balance sheets need to be restored. This is likely to weigh on economic growth for a number of years. I pondered whether, in our new caring society "on the other side", bling might become unfashionable, but after reading an article in an Asian edition of *Tatler* that the Chinese bought a record $2.7m of Hermes Birkins and assorted goods in one day post lockdown, I initially wondered if the world would be that different.

…with most people needing to reduce their spending

My takeaway is that there may be two sorts of consumers immediately post lockdown. Those wealthy employees who have seen no impact on their earnings may well have pent-up demand to spend, in spite of the hit to their savings. They may go out and buy big-ticket items, and trade up in their restaurant choice – they cannot eat the lost meals out, but they can upgrade. My guess is that these will be in the minority, and will be outweighed by the self-employed, the furloughed and the unemployed, all of whom will need to reduce their spending.

Even if luxury is partly immune (and I wonder), large swathes of the lower end of the income distribution and the middle class will be, and will feel, much poorer. If stock markets stabilise at higher levels, the rich won't feel as bad, but many will have suffered losses as business owners and, if markets fall, there will also be a further reverse wealth effect.

Note that this will affect both corporate and personal balance sheets. Companies seem likely to rein in capex and discretionary spending for the 2020-22 period. Consumers will buy fewer and cheaper big-ticket items. This seems inevitable, although the impact is hard to model on corporate earnings at this point – we do know, however, that earnings will be lower than formerly forecast.

The one slightly odd exception to the big-ticket expense may be the leisure sector, where there will be a massive pent-up demand for holidays. Certain "exhausted" people will demand holidays, and this is the one luxury item that many middle-class households, at least, will be loath to sacrifice.

The picture for companies

Fortress balance sheets

One legacy from pandemic may be culture of conservatism and risk aversion

Andrew Smith, former KPMG Chief Economist, told me at the outset of UK lockdown that he was "quite shocked at how limited a financial cushion many businesses seem to have." This is perhaps not so surprising, given that, for the last 40-odd years, investors and speculators have enjoyed a tailwind from falling interest rates. So long as you had the stomach for debt, you basically made money. This culminated in a veritable orgy of buybacks in the last decade.

One legacy of the pandemic may be a culture of greater conservatism and risk aversion. Boards are likely to adopt a more conservative approach – the shock we have just experienced will make even the less risk-averse director appreciate having more cash and more facilities, *just in case*. Boards will likely want some security against another pandemic. This has two important implications for equity investors:

- Corporations have been the single-largest buyer of equities in the 2010s: buybacks may be much less fashionable, even after balance sheets have been restored post the pandemic.
- Return on Equity (RoE) will fall as a consequence: buybacks, even at high prices, usually boosted RoE, as money has been so cheap. It will remain cheap, but more conservative balance sheets will be one factor in lowering RoE.

As Michael Pettis, notable China commentator, put it in a series of tweets in April 2020:

"*When an economy goes through many years of rising real estate and asset prices, surging debt, and loose monetary conditions, business balance sheets tend to get structured in highly speculative ways that effectively "bet" on more of the same – 'inverted balance sheets'.*

Over time the whole economy 'shifts' towards riskier balance sheets. This is likely to be a problem nearly everywhere, and especially in China, where decades of artificially high growth, soaring real estate prices, excess liquidity and surging debt have transformed the balance sheet structures of nearly all businesses.

Inverted balance sheets are highly pro-cyclical. Economies and businesses with highly inverted balance sheets tend to surprise on the upside when conditions are good, often developing a reputation for smart management, and then destroy this reputation when conditions reverse".

China may not have seen the last effects of the pandemic. And if investors in developed markets seek safer balance sheets, companies will be forced to respond. Some investor reaction was under way, even before this crisis. Grant's Interest Rate Observer of 7 February 2020, opened with: "The lowest interest rates, the most accommodating Fed, the shortest junk-bond durations, the highest corporate leverage and the longest business expansion frame the value proposition for junk bonds and the speculative-grade, tradable bank debt styled 'leveraged loans.' 'Hold on to your hats!' is the investment conclusion".

Onshoring supply chains

Companies will want higher stocks and more diversity of supply

ING economist, Mark Cliffe, has suggested that "businesses are likely to shift from lean 'just in time' to bigger 'just in case' inventories. Businesses will be warier of single sources of supply or demand, allowing for a greater ability to switch activities or locations." Clearly, there is an associated cost.

Similarly, Tim Harford wrote in the *Financial Times* on 18 April 2020 that "It is tempting to fight the last war: we built up reserves in banking after the financial crisis, but we did not pay attention to reserve capacity in health...." The risk inherent in just-in-time and diverse supply chains has become more apparent, and companies will surely want higher stocks and more diversity of supply, and will onshore more production as a protection against a recurrence. Again, this will have two implications:

- production costs will rise; and
- returns will fall as inventory and working capital increase.

Pension deficits to increase significantly

Assets down and liabilities up in many cases significantly

The good news is that bonds have increased in value, and, given the growth in deficits, governments have huge incentives to keep yields low. However, the pension deficit (perhaps there is a surplus in the S&P 500 or the FTSE 100, but I haven't seen one for a long time) is the difference between two large numbers:

- Assets have gone down significantly for those with a higher exposure to equity, but less so for those funds with a larger exposure to bonds. Funds with heavy exposure to alternatives may find that the lack of a mark-to-market doesn't help if the private equity portfolio companies sink under the weight of their debt.

- Liabilities have gone up significantly, because the liabilities are discounted to present value, based on bond yields that have collapsed. This means that pension deficits will have increased significantly for most quoted companies. This is almost a straight subtraction from equity values. I looked at one UK retailer whose equity valuation would theoretically halve if bonds were 2% lower at the date of the next accounts. Many companies with large workforces have a high sensitivity to lower rates through the pension exposure.

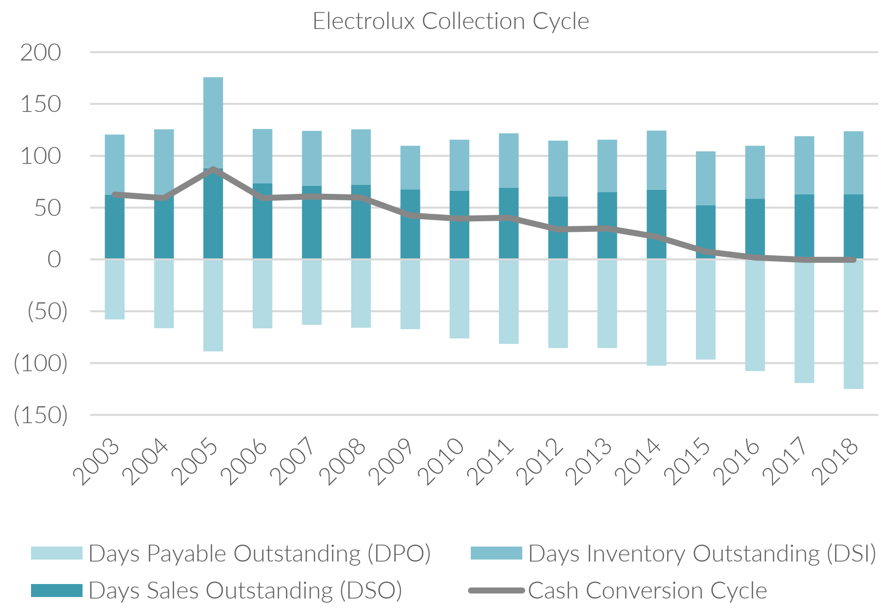
Working capital unwind

Unwind will occur on both sides of balance sheet

An unwind of working capital will occur on both sides of the balance sheet. I have observed a number of industrial companies that have improved working capital tremendously over the last 10-15 years. Many have done this predominantly by failing to pay suppliers on time – unless their supply chains are extraordinarily robust, these companies will be hit by the need for increased inventory and by the need to start paying suppliers more quickly.

The following chart illustrates Electrolux's working capital over the last 15 years or so.

Electrolux – working capital, 2003-18



Source: Hardman & Co Research

The collection cycle (number of days sales tied up in working capital) looks to have achieved a marvellous improvement, from 63 days 15 years earlier, and a peak of 87 days, to zero. But look at how this has been achieved – debtor days have been flat, at 60-ish. Inventory days have actually increased slightly to ca.60 days, while payables days have doubled from ca.60 to ca.120.

Perhaps Electrolux's suppliers are all robust companies in great health, after Electrolux has been so bountiful with its custom. But I doubt it; rather, I suspect many of its suppliers will have been significantly impacted by the lockdown. Unless Electrolux not only pays its bills but pays them in advance, they may be unable to supply – cue a potentially massive working capital unwind for Electrolux; that's assuming that housebuilders are back building houses, or homeowners are refurbishing and making big-ticket expenditure.

I have singled out Electrolux, but this would apply to any of a large number of quoted industrials that have been engaging in this type of financial engineering (spoiler – it's not uncommon).

Where now for income funds?

Recent dividend cuts by major companies may lead to a perception that no company is safe

For many companies, the priority will be rebuilding balance sheets. Dividends will be a secondary issue. For those companies subject to government rescue, dividends are likely to be capped or forbidden until debts are repaid. Income fund managers will have an increasingly narrow repertoire. This is quite an important issue for many UK pensioners (not to mention fund managers).

That British Telecom would use this as an opportunity to rebase dividend expectations was somewhat predictable; less so for Royal Dutch Shell, which was seen as a stalwart in dividend payments, and was perceived by many as the most secure dividend in the FTSE 100. Now that it has cut its dividend, a perception may develop that no company is safe.

A corollary may be that some perennial dividend payers may be rerated, as these funds are forced into a narrower group of stocks. I think this is more likely to happen in the US, where dividends are often paid quarterly and where companies may sacrifice buybacks but continue to pay dividends (which are generally much smaller) – dividend-paying stocks like Apple and Microsoft have seen a strong performance for a long time; less so the Johnson and Johnsons and Proctor & Gambles. These types of stocks may be perceived as safer bets for income investors.

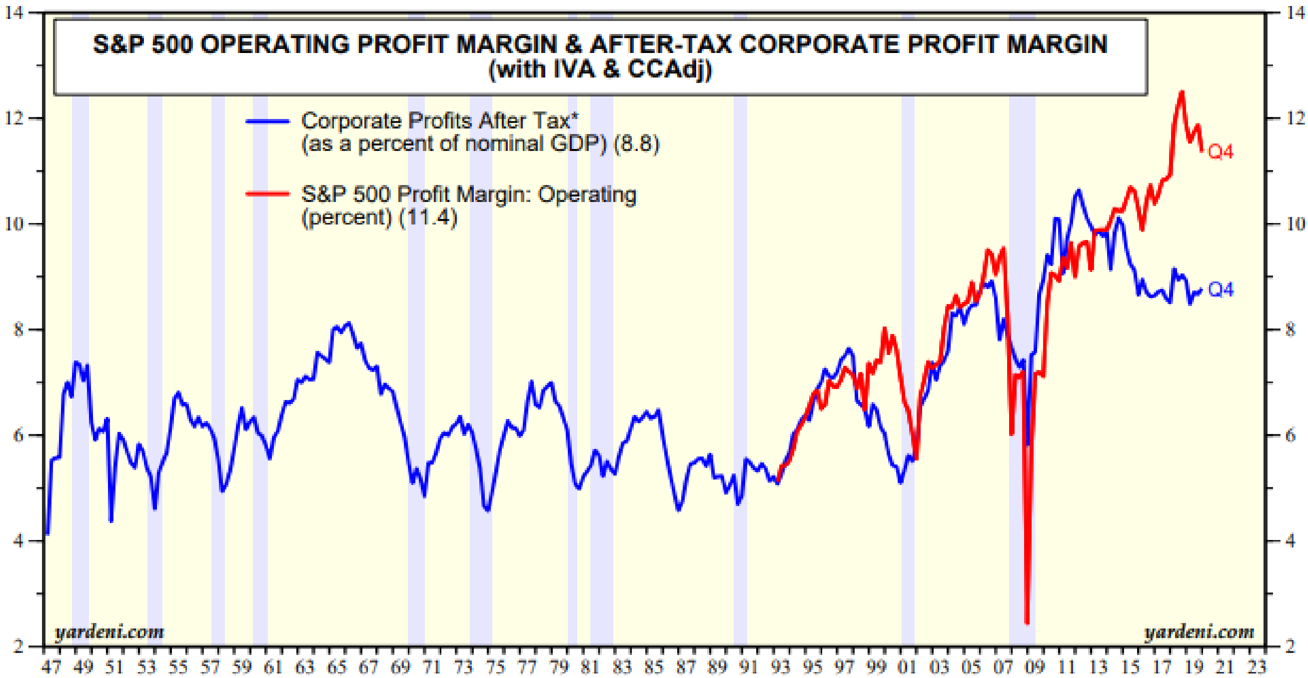
The “bezzle” and the great reset

JK Galbraith coined the term the “bezzle” in his book *The Great Crash, 1929*.

“In many ways the effect of the crash on embezzlement was more significant than on suicide. To the economist embezzlement is the most interesting of crimes. Alone among the various forms of larceny it has a time parameter. Weeks, months or years may elapse between the commission of the crime and its discovery. (This is a period, incidentally, when the embezzler has his gain and the man who has been embezzled, oddly enough, feels no loss. There is a net increase in psychic wealth.) At any given time there exists an inventory of undiscovered embezzlement in – or more precisely not in – the country’s business and banks. This inventory – it should perhaps be called the bezzle – amounts at any moment to many millions of dollars. It also varies in size with the business cycle. In good times people are relaxed, trusting, and money is plentiful. But even though money is plentiful, there are always many people who need more. Under these circumstances the rate of embezzlement grows, the rate of discovery falls off, and the bezzle increases rapidly. In depression all this is reversed. Money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise. Audits are penetrating and meticulous. Commercial morality is enormously improved. The bezzle shrinks.”

I have been preaching for the last 18 months that too many companies were cooking the books. This has been the “bezzle”.

Reported corporate profits looked inflated



Source: yardeni.com

The chart above shows the gap between the S&P profit margins and the NIPA (National Income and Product Accounts) margins, an economic measure. The S&P number has been moving straight up, while the economic margins have been in steady decline. This is exactly what happened in the late 1990s, and it indicates that margins are being goosed – back then, it corrected, when S&P margins fell back to the economic margin level, and this will happen again. (There are some technical reasons why the S&P should be somewhat higher, but not to this degree.)

Earnings for most quoted companies will be reset down

Now finance chiefs have an opportunity, presented by the virus, to engage in the 'Great Reset' – earnings will be reset, and the virus will be the excuse. Even if there were no lasting effects from the virus, earnings for the vast majority of quoted companies would be reset down. They have been stretching the elastic of earnings for some years, and now they have the opportunity to get their books in order. Forecasts will go down, even before you factor in the virus effects.

One final point regarding company profits – the Japanese earthquake in 2011 is the best analogy for an economic halt such as we are currently experiencing. It took industry there a long time to restart the supply chain and return to normal. We are told that China is already nearly there, but that process may take longer in other economies.

Conclusions

Main conclusion: assess resilience of your portfolio to every eventuality

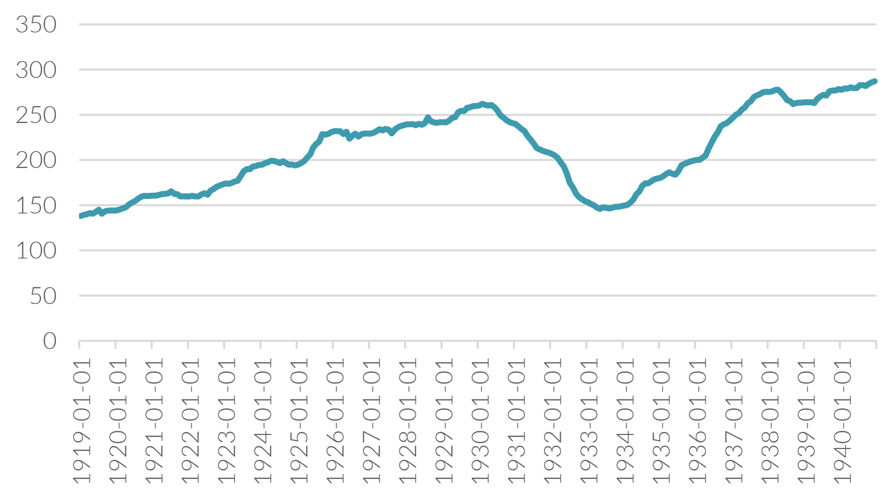
I confess that I don't know where the market will end up. Even doing a forecast for an individual company is incredibly difficult at this point; more difficult than it has ever been in my (long) career, and as difficult as it was post 9/11, when I was researching airline stocks, for example. The good news is that I think there are a lot of great opportunities in current markets on both the long and short sides – rarely does such an opportunity set present itself.

Structural trends will continue, regardless:

- climate change;
- ageing population; and
- an emerging middle class

But we may also see impacts that we don't expect – for example, ice cream sales collapsed by 44% in the 1930s depression, as the chart below illustrates. It took a further 4¼ years to surpass the 1930 peak.

US ice cream production – 12-monthly, m gallons



Source: St Louis FRED, Hardman & Co Research

What we now know, however, is that the impossible can happen – who would have thought that forward oil could trade at a negative price? The single conclusion to take away from this article is that you should assess the resilience of your portfolio to every eventuality – probabilities may be low, but look at the impact that those extreme events at the left tail of the normal distribution can have. Analyst teams should sit down and brainstorm what they think could happen, assign a probability, and assess the impact on portfolios.

One simple example: let's assume that this is indeed a point like 1965, and we see a return to inflation. Interest rates reached 15% in 1982. Now it may not reach that quantum, especially starting from effectively 0. But what would happen to your portfolio if rates reached 10% in 2030 or 2035? Most young investors probably cannot imagine a world in which rates are 15%. Thinking the unthinkable is one of the lessons I am trying to take away from this crisis.

About the author

Steve Clapham is an equity analyst at Hardman & Co.

Steve is the founder of Behind the Balance Sheet, an investor training consultancy. He has been an investment analyst for the last 25 years, working on the sell side for a number of investment banks covering the transport, utilities and conglomerates sectors. In 2005, he moved to the buy side, where he was a partner at Toscafund Asset Management LLP, and then Head of Research at Altima Partners LLP.

Steve was part of the group of investors that acquired Hardman & Co in late 2012. He holds a degree in Technology and Business Studies, and is a member of the Institute of Chartered Accountants of Scotland.

Company research

Priced at 26 May 2020 (unless otherwise stated).

Pharmaceuticals & Biotechnology

Source: Refinitiv

Market data	
EPIC/TKR	**AGY**
Price (p)	**11.1**
12m High (p)	15.8
12m Low (p)	7.3
Shares (m)	636.2
Mkt Cap (£m)	70.6
EV (£m)	42.0
Free Float*	41%
Market	AIM

**As defined by AIM Rule 26*

Description

Allergy Therapeutics (AGY) provides information to professionals related to prevention, diagnosis and treatment of allergic conditions, with a special focus on allergy vaccination. The emphasis is on treating the underlying cause and not just the symptoms.

Company information	
CEO	Manuel Llobet
CFO	Nick Wykeman
Chairman	Peter Jensen

+44 1903 845 820
www.allergytherapeutics.com

Key shareholders	
Directors	0.7%
Abbott Labs	37.8%
Southern Fox	20.3%
SkyGem	19.5%
River & Mercantile	4.8%

Diary	
Jun'20	Trading statement
1H'21	Ph. I peanut vaccine trial

Analyst
Martin Hall 020 7194 7622
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ALLERGY THERAPEUTICS

Business as usual

AGY is a long-established specialist in the prevention, diagnosis and treatment of allergies. Pollinex Quattro (PQ) is an ultra-short-course subcutaneous allergy immunotherapy (SCIT) platform, which continues to make strong market share gains in a competitive environment. Several products using the PQ platform are in late-stage development in order to move them to full registration under new EU and US regulations. Although the global lockdown related to COVID-19 is affecting some parts of the company's operations, manufacturing is still running at full capacity and cross-border pharmaceutical distribution remains unaffected.

- **Strategy:** AGY is a fully integrated pharmaceutical company focused on the treatment of allergies. There are three parts to its strategy: i) continued development of its European business via investment or opportunistic acquisitions; ii) the US PQ opportunity; and iii) further development of its pipeline.

- **COVID-19:** Last month, we highlighted that manufacturing is performed in the UK and Spain and, in line with guidance on pharmaceutical products, production is still running at full capacity. Employees in marketing, mostly in Germany, are working remotely, as are the HQ and administrative staff in the UK.

- **Role of adjuvants:** In the search for a COVID-19 vaccine, using the most appropriate adjuvant is important. AGY has made clear to the large vaccine players that it has proven biodegradable adjuvants available. This strength was reinforced by a recent scientific review article published in *Allergy*.

- **Business update:** AGY's business is biased to the first half of each fiscal year, with ca.70% of sales generated in this period, as reported recently. The company is also in the fortunate position of having few clinical trials running, so is not being affected by the global lockdown in the same way as reported by many others.

- **Investment summary:** While adhering to government advice, AGY is well positioned with respect to COVID-19. Manufacturing and distribution of pharmaceutical products can, and is, continuing. No significant clinical trials are being run, and the company has a strong balance sheet, with ca.£40m gross cash in the bank. AGY usually issues a trading statement at the end of June.

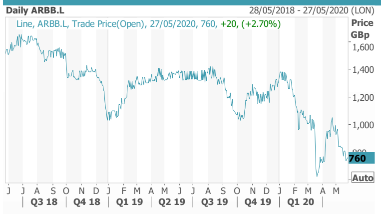
Financial summary and valuation

Year-end Jun (£m)	2017	2018	2019	2020E	2021E	2022E
Sales	64.1	68.3	73.7	80.0	86.0	92.0
R&D investment	-9.3	-16.0	-13.0	-13.0	-18.0	-26.0
Underlying EBIT	-3.6	-7.4	-2.2	-1.2	-5.6	-13.3
Reported EBIT	-2.6	-7.4	3.8	2.0	-5.6	-13.3
Underlying PBT	-3.7	-7.5	-2.3	-1.4	-6.1	-13.8
Statutory PBT	-2.7	-7.5	3.7	1.8	-6.1	-13.8
Underlying EPS (p)	-0.6	-1.3	-0.4	-0.3	-1.1	-2.3
Statutory EPS (p)	-0.4	-1.3	0.5	0.3	-1.0	-2.1
Net (debt)/cash	18.8	12.5	25.0	15.9	9.9	-4.4
Equity issues	0.0	0.0	10.2	0.3	0.3	0.3
P/E (x)	-14.0	-6.5	-20.3	-24.0	-7.6	-3.6
EV/sales (x)	0.82	0.77	0.71	0.65	0.61	0.57

Source: Hardman & Co Life Sciences Research

HARDMAN&CO.

Financials



Source: Refinitiv

Market data

EPIC/TKR	ARBB/ARBN
Price (p)	740/747.5
12m High (p)	1,390
12m Low (p)	625
Shares (m)	15.4
Mkt Cap (£m)	114
Loans to deposits, 2019	77%
Free Float*	42%
Market	AIM/Aquis

**As defined by AIM Rule 26*

Description

Arbuthnot Banking Group (ABG) has a well-funded and capitalised private bank, and has been growing commercial banking very strongly. It holds a 9.85% stake in Secure Trust Bank (STB).

Company information

Chair/CEO	Sir Henry Angest
COO/CEO Arb. Latham	Andrew Salmon
Group FD, Deputy CEO Arb. Latham	James Cobb

+44 20 7012 2400
www.arbuthnotgroup.com

Key shareholders

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

Diary

To be confirmed when current restrictions allow	AGM

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

ARBUTHNOT BANKING GROUP

Strong capital, low-risk assets and surplus deposits

We reviewed ABG's results in our 6 April note, *2019 results: resilience into the storm*. We noted that three things make ABG more resilient to the forthcoming economic storm: low-risk assets, strong capital and surplus deposits. ABG's 14 May *trading statement* confirmed these points, reporting 4% loan book growth in 1Q (origination up 38% on 1Q'19) and net investment management inflows. As previously announced, and detailed in our note, in the near term, the impact of lower interest rates squeezing margins will affect profitability significantly. Trading at half of NAV, however, implies permanent value destruction.

- **COVID-19 impact on ABG:** ABG funded £26m of new loans during lockdown to mid-May. Conservative IM saw assets fall 6% to end-April. 25% of mortgage and 67% of asset finance borrowers are on payment holidays. Given lower capital buffers, ABG will have greater surplus capital (end-2020) than originally planned.

- **COVID-19 impact on peers**. *Close Brothers'* nine-month bad debt ratio was 2.1% (0.9% prior year). *Barclays UK's* 1Q'20 impairment charge was £481m (£191m 1Q'19); *Lloyds'* was £1,311m (£275m). *Virgin Money's* COVID-19 effect was 40bps (u/l 23bps). *OneSavingsBank's* payment holidays on 27% mortgages.

- **Valuation:** Our forecast scenarios and multiple valuation approaches see a broad range of implied valuations. Our base-case range is 871p to 1,912p, our upside scenario 1,183p to 2,377p, and our downside 782p to 1,424p. The share price is 54% of the 2019 NAV (1,364p), implying significant value destruction to perpetuity.

- **Risks:** As with any bank, the key risk from here is credit. ABG's existing business should see below-market volatility, and so the main risk lies in new lending. We believe management is cognizant of the risk and, historically, has been very conservative. Other risks include reputation, regulation and compliance.

- **Investment summary:** ABG offers strong-franchise and continuing-business (normalised) profit growth. Its balance sheet strength gives it wide-ranging options to develop organic and inorganic opportunities. The latter are likely to increase in uncertain times. Management has been innovative, but also very conservative, in managing risk. Having a profitable, well-funded, well-capitalised and strongly growing bank priced well below book value appears anomalous.

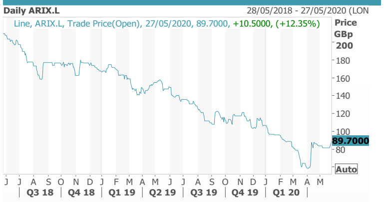
Financial summary and valuation (see our note, *2019 results: resilience into the storm*, for range of scenario forecasts)

Year-end Dec (£000)	2015	2016	2017	2018*	2019*
Operating income	34,604	41,450	54,616	67,905	72,465
Total costs	-35,926	-46,111	-54,721	-64,982	-70,186
Cost:income ratio	104%	111%	100%	96%	97%
Total impairments	-1,284	-474	-394	-2,731	-867
Reported PBT	-2,606	-1,966	2,534	6,780	7,011
Adjusted PBT	2,982	1,864	3,186	4,388	5,800
Statutory EPS (p)	86.3	1,127.3	43.9	-134.5	41.1
Adjusted EPS (p)	13.5	17.1	47.5	22.7	32.8
Loans/deposits	82%	76%	75%	71%	77%
Equity/assets	5.5%	18.5%	12.8%	9.0%	8.0%
P/adjusted earnings (x)	54.8	43.3	15.6	32.6	22.6
P/BV (x)	0.92	0.49	0.48	0.58	0.55

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

HARDMAN&CO.

Pharmaceuticals & Biotechnology



Source: Refinitiv

Market data

EPIC/TKR	**ARIX**
Price (p)	**85**
12m High (p)	158
12m Low (p)	58
Shares (m)	135.6
Mkt Cap (£m)	115.3
NAV/share (p)	171.1
Premium/discount to NAV	-50%
Free Float	70%
Market	Main

Description

Arix Bioscience (ARIX) is a publicly listed biotechnology venture capital (VC) company. It provides an opportunity for all investors to participate in a balanced portfolio of diverse biotech innovation via a single stock. With a global portfolio of 16 companies and five IPOs achieved since launch in 2016, ARIX is a dynamic and modern approach to life sciences VC investing.

Company information

Executive Chairman	Naseem Amin
MD	Jonathan Tobin
COO	Robert Lyne
Finance Director	Marcus Karia

+44 20 7290 1050
www.arixbioscience.com

Key shareholders

Directors	0.1%
Link Fund Solutions	19.8%
Fosun	8.2%
Ruffer	6.1%
Takeda Ventures	5.5%

Diary

3 Jun	AGM
Aug'20	Interim results

Analyst

Martin Hall 020 7194 7622
mh@hardmanandco.com

ARIX BIOSCIENCE

News from Iterum is imminent

ARIX is a listed global VC company that presents an opportunity for institutional and retail investors to participate in the high risk-reward profile of early-stage biotech investing. ARIX minimises risk through its expert investment team and portfolio diversification. At 31 December 2019, its published NAV was £202m, compared with £138m investment into its portfolio – currently 16 companies. With a cash position of £54m (31 December 2019), ARIX is well positioned to support its portfolio of investments. Strong gains have been registered by portfolio companies recently, which has not been reflected in the ARIX share price.

- **Strategy:** ARIX sources benefits from an established network and a strong scientific reputation. The portfolio is diversified by therapeutic area, treatment modality, stage of discovery/development and geography to balance the risk-reward profile. Value is realised when ARIX successfully exits its investments.

- **Iterum:** Portfolio company, Iterum, is expected to announce results from its Phase III trial with sulopenem in complicated urinary tract infections (UTIs) imminently, with data from uncomplicated UTIs by the end of 2Q'20. In the event of positive outcomes, Iterum is likely to strengthen its balance sheet with an equity raise.

- **Harpoon:** The stock price of another portfolio company, Harpoon, has responded very positively to the announcement that the first patient has been dosed with HPN217 in a Phase I/II trial focused on relapsed refractory multiple myeloma. HPN217 becomes Harpoon's third product in clinical trials.

- **Amplyx:** Unlisted portfolio company, Amplyx, which is developing treatments for life-threatening fungal infections, has announced the closing of a $53.0m extension to its Series C funding round, bringing the total to $90.0m. ARIX invested $6.0m in Amplyx in two tranches during 2017, and retains a 3.0% stake.

- **Investment summary:** Global macroeconomics, affected by COVID-19, resulted in initial share price volatility among some of ARIX's listed portfolio companies. However, reiteration of solid cash runways in the 1Q'20 reports of its listed investee companies, coupled with some positive trial news, have seen a strong rebound in some of the share prices, notably Imara (IMRA.OQ) and Harpoon (HARP.OQ), and associated unrealised valuation gains, which have not been reflected in ARIX's share price. The current NAV discount has widened to 50%.

Financial summary and valuation

Year-end Dec (£m)	2017	2018	2019	2020E	2021E	2022E
Change in FV of investments	5.5	51.2	-58.6	*40.9	-	-
Operating income	1.9	1.3	0.5	0.2	0.2	0.0
Administrative expenses	-11.0	-11.7	-9.7	-7.0	-5.5	-5.6
Operating profit/(loss)	-7.2	37.5	-70.6	-12.7	-7.2	-7.6
Profit/(loss) before tax	-7.2	37.5	-70.6	-12.2	-6.9	-7.3
Underlying EPS (p)	-9.5	27.2	-49.9	-8.3	-4.7	-5.0
Net cash/(debt)	74.9	91.2	53.7	37.4	25.8	14.0
Capital increase	105.1	83.5	0.0	0.0	0.0	0.0
NAV/share (p)	152.3	200.4	149.1	171.1	-	-

**Based on share prices and forex at close of business on 26 May 2020*
Source: Hardman & Co Life Sciences Research

Market data

EPIC/TKR	Private
Price (p)	n/a

Description

B-North is being developed to serve the sizeable UK SME lending market. It has state-of-the-art technology, a regional hub model and experienced managers to deliver a best-in-class service to SMEs and commercial brokers. It will be funded through best-buy retail deposit comparison websites. The model should have a material cost advantage over competitors, and credit risk is being tightly managed.

Company information

Chairman	Ron Emerson CBE
CEO	Jonathan Thompson
CFO	David Broadbent

investor@b-north.co.uk
b-north.co.uk

Key shareholders

Directors/management	£1m+
Greater Manchester Combined Authority	Six-figure sum
HNWI	Balance

Diary

2Q'20	Banking licence (tbc)
2Q'20	£20m capital raise (tbc)
2Q'20	Start lending (tbc)
4Q'20	Start retail deposit-taking

The target seed round top-up capital raise of £2m was over-subscribed (£2.7m raised). The group targets raising £20m from institutional investors, conditional on getting its banking licence.

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

B-NORTH

Working towards launch

B-North published its *1Q overview* on 17 April. With no back-book to worry about, increased SME funding needs, and mainstream banks diverted by operational constraints, the fundamental reason for B-North's existence is, if anything, stronger. The timing of the equity issue has, not unsurprisingly, been affected by current equity markets, and the final material condition to getting the banking licence is raising these committed funds. B-North continues to engage closely with the regulator and potential investors, so as to raise funds quickly when markets improve. It has managed cashflow – so existing funds will see it through to 4Q'20.

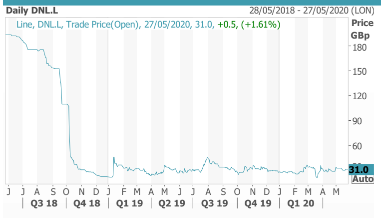
- **COVID-19 impact on B-North:** The procedural elements of getting the banking licence have not been impacted, and are well advanced, but the required £20m equity raise is more challenging. Cash outgoings have been reduced (salaries cut, supplier arrangements reviewed), so that existing cash will last into 4Q'20**.**
- **COVID-19 impact on peers**. *Close Brothers'* nine-month bad debt ratio was 2.1% (0.9% prior year). *Barclays UK's* 1Q'20 impairment charge was £481m (£191m 1Q'19); *Lloyds'* was £1,311m (£275m). *Virgin Money's* COVID-19 effect was 40bps (u/l 23bps). *OneSavingsBank's* payment holidays on 27% mortgages.
- **Valuation:** Given the growth profile of the company and associated uncertainties, any valuation must be treated with extreme caution. In our *initiation*, we gave a range of approaches, indicating that, on average, B-North's value in 2027 could be treble the amount of equity raised, and we provided a range of sensitivities.
- **Risks:** Credit risk is key for any bank. B-North will establish independent credit functions, and its technology brings it close to customers interfacing with their internal information. It has multiple options to address any loan growth shortfall. The economic cycle is important. The model is yet to be tested, and capital raised.
- **Investment summary:** B-North is still at the pre-revenue stage. Its model should be low-cost, and deliver a superior service to customers and intermediaries. It has a conservative credit culture and uses state-of-the-art technology, written from scratch, to originate, service and manage its business. Funding will be via the deep best-buy retail deposit comparison sites. The potential market is huge, profitable and under-served, and major incumbents have selectively become uncompetitive.

Financial summary and valuation – eight-pod scenario

Year-end Sep (£m)	2019	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
Net interest income	0.0	0.5	3.9	14.5	37.4	72.7	116.2	160.7	203.6
Costs	-2.9	-7.0	-18.0	-28.3	-36.0	-41.3	-45.5	-47.8	-52.0
Impairments	0.0	0.0	-0.2	-1.0	-3.1	-7.4	-8.9	-10.1	-10.7
Pre-tax profit	-2.9	-6.5	-14.2	-14.3	-0.6	25.9	64.7	106.5	145.4
Net interest margin	n/m	1.4%	4.0%	4.3%	4.1%	4.2%	4.2%	4.3%	4.3%
Cost:income ratio	n/m	n/m	n/m	n/m	-93%	-55%	-38%	-29%	-25%
RoE	n/m	-14%	-15%	-12%	0%	11%	20%	23%	24%
Loans	0	15	100	470	1,100	1,925	2,850	3,700	4,550
Deposits	0	0	12	329	770	1,424	2,098	2,745	3,393
Equity	1	72	86	102	154	217	298	393	502
Value at 12x P/E*	n/m	n/m	n/m	n/m	n/m	252	629	962	1,303
Value vs. cum. equity issued	n/m	n/m	n/m	n/m	n/m	1.1	2.3	2.9	3.4

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

Pharmaceuticals & Biotechnology



Source: Refinitiv

Market data

EPIC/TKR	**DNL**
Price (p)	**31.0**
12m High (p)	47.0
12m Low (p)	21.0
Shares (m)	121.6
Mkt Cap (£m)	37.7
EV (£m)	20.6
Free Float*	49%
Market	AIM

**As defined by AIM Rule 26*

Description

Diurnal (DNL) is a European, UK-headquartered, specialty pharma company targeting patient needs in chronic, potentially life-threatening, endocrine (hormonal) diseases. Alkindi is approved in Europe and has been filed in the US. Chronocort completed the largest and only Phase III trial in CAH and is awaiting EMA approval.

Company information

CEO	Martin Whitaker
CFO	Richard Bungay
Chairman	Peter Allen

+44 29 2068 2069
www.diurnal.co.uk

Key shareholders

Directors	2.9%
IP Group	36.2%
Finance Wales	9.5%
Polar Capital	8.1%
Amati VCT	7.8%
Richard Griffiths	5.1%

Diary

Sep'20	Final results
29 Sep	Alkindi PDUFA date
4Q'20	Alkindi FDA approval

Analyst

Martin Hall 020 7194 7622
mh@hardmanandco.com

DIURNAL GROUP

Business as usual

DNL is a commercial-stage specialty pharmaceutical company focused on diseases of the endocrine system. Its two lead products target rare conditions where medical needs are currently unmet, with the aim of building a long-term "Adrenal Franchise". 2020 is expected to be a busy year, with market authorisations and a US commercial partnership for Alkindi. DNL is well positioned with respect to the manufacture and distribution of Alkindi, although COVID-19 has introduced some uncertainty regarding launch in some countries, such as Italy. The US licensing deal with Eton Pharmaceuticals has strengthened the group's financial position.

- **Strategy:** DNL aims to create a valuable "Adrenal Franchise" that can treat patients with chronic cortisol deficiency diseases from birth through to old age. Once Alkindi and Chronocort are established in Europe and the US, the long-term vision is to expand DNL's product offering to other related conditions.

- **Chairman:** On 5 March 2020, the non-executive chairman of DNL, Peter Allen, announced his intention to step down after five years in the post, effective 30 June 2020. Sam Williams, current NED and representative of major shareholder, IP Group, will fulfil the role on an interim basis until a new chairman is appointed.

- **Operations:** In readiness for potential launches, DNL had already built up stock levels of Alkindi. This has left the company well positioned in the unlikely event that any movement across borders becomes difficult during the lockdown, and it has enough stock available to meet foreseeable demand across Europe.

- **US licensing deal:** At the end of March 2020, DNL announced an exclusive US licensing agreement with Eton Pharmaceuticals (Eton) for the commercialisation of Alkindi Sprinkle. Eton has paid DNL $5m upfront, in cash and shares, and has pre-set milestones worth up to $47.5m in total, plus royalties on net sales.

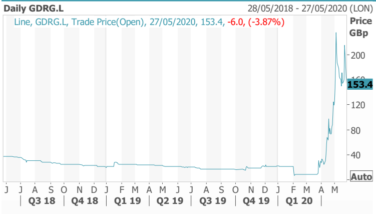
- **Investment summary:** The company is well positioned to withstand a long period of lockdown, with sufficient supplies of its commercially available drugs. New funding via the March Placing of shares to raise £10.7m (net), together with the upfront receipt from Eton, leave the company with sufficient cash to take it through to profitability, based on current forecasts.

Financial summary and valuation

Year-end Jun (£m)	2017	2018	2019	2020E	2021E	2022E
Sales	0.00	0.07	1.04	2.41	5.76	16.16
SG&A	-3.23	-6.21	-5.83	-5.50	-6.15	-7.53
R&D	-8.34	-10.02	-8.69	-4.78	-4.54	-5.90
EBITDA	-12.07	-16.97	-14.50	-5.16	-6.56	0.19
Underlying EBIT	-12.08	-16.98	-14.53	-5.18	-6.58	0.17
Statutory EBIT	-12.08	-16.98	-14.53	-5.18	-6.58	0.17
Underlying PBT	-12.16	-17.11	-14.40	-5.13	-6.50	0.21
Statutory PBT	-12.16	-16.91	-14.40	-5.13	-6.50	0.21
Underlying EPS (p)	-18.04	-27.16	-14.54	-4.24	-4.44	1.35
Statutory EPS (p)	-18.04	-26.78	-19.70	-4.24	-4.44	1.35
Net (debt)/cash	16.37	17.28	9.15	15.82	8.48	7.76
Equity issues	0.05	13.40	5.53	10.70	0.00	0.00

Source: Hardman & Co Life Sciences Research

Pharmaceuticals & Biotechnology



Source: Refinitiv

Market data

EPIC/TKR	**GDR**
Price (p)	**155.0**
12m High (p)	220.0
12m Low (p)	7.0
Shares (m)	44.9
Mkt Cap (£m)	69.5
EV (£m)	61.0
Free Float*	54%
Market	AIM

**As defined by AIM Rule 26*

Description

Genedrive plc (GDR) is a disruptive platform designed to bring the power of central laboratory molecular diagnostics to point-of-care/near-patient settings with a low-cost device offering fast and accurate results. It focuses on diagnostics for acute hospital settings and for serious infectious diseases, such as COVID-19, hepatitis C and tuberculosis.

Company information

CEO	David Budd
CFO	Matthew Fowler
Chairman	Ian Gilham

+44 1619 890 245
www.genedriveplc.com

Key shareholders

Directors	1.8%
Calculus	18.9%
BGF	12.8%
Spreadex	5.8%
River & Merc.	5.4%
Odey	4.1%

Diary (calendar year)

2H'20	WHO decision on HCV-ID pre-qualification

Analyst

Martin Hall 020 7194 7622
mh@hardmanandco.com

GENEDRIVE PLC

CE certification of high-throughput COVID-19 assay

GDR is a commercial-stage diagnostics focused on point-of-care (POC) molecular diagnostics. Its Genedrive® molecular diagnostic platform offers low-cost, simple-to-use devices for highly sensitive and specific testing. Rapid analysis of samples aids real-time decision-making, whether in clinical, public health or biothreat applications. Prospects have changed considerably over the last two months, with the development and commercialisation of two SARS-COV-2 assays, a rapid machine agnostic test that has just received its CE marking, and a POC test that will run on the Genedrive platform, due to be launched around the end of 2020.

- **Strategy:** With CE marking for its Genedrive technology platform, management has been focusing on a commercialisation pathway for gene-based diagnostics in biothreat pathogen detection, including hepatitis C, tuberculosis (TB) and, more recently, COVID-19 and Antibiotic-Induced Hearing Loss (AIHL).
- **Rapid test:** GDR has partnered with Cytiva (formerly GE Healthcare) for the development and commercialisation of a SARS-CoV-2 Polymerase Chain Reaction (PCR) assay. This one-step, high-throughput test to detect active infection in COVID-19 received its CE certification on 22 May.
- **POC test:** For the longer term, GDR is also developing a SARS-CoV-2 test that will be run on its mobile Genedrive platform. Following regulatory approval of the rapid test, the focus will now turn to validation trials for this convenient POC test that is expected to be available towards the end of this year.
- **New funding:** On the back of the COVID-19 test news and subsequent share price performance, management took the opportunity to raise gross new capital of £8.0m via a Placing of shares at 80p to provide the funds needed to complete the development of these new tests and advance its commercial programme.
- **Investment summary:** At the time of going to press, GDR was about to hold the general meeting with shareholders to approve the capital increase. GDR is well positioned in the competitive landscape for providing both high-throughput and POC tests for the detection of active coronavirus. These new tests have the potential to significantly improve the financial performance of the group. Until the potential is better understood, our forecasts remain under review.

Financial summary and valuation

Year-end Jun (£000)	2017	2018	2019	2020E	2021E	2022E
Group sales	5,785	1,938	2,362			
Underlying EBIT	-4,913	-5,264	-4,449			
Reported EBIT	-7,292	-7,375	-4,010			
Underlying PBT	-5,417	-5,782	-5,002			
Statutory PBT	-7,487	-7,788	-4,518		Forecasts under review	
Underlying EPS (p)	-23.6	-26.9	-15.8			
Statutory EPS (p)	-34.9	-31.9	-14.0			
DPS (p)	0.0	0.0	0.0			
Net (debt)/cash	-70	-2,096	-3,334			
Equity issues	6,023	0	3,243			
P/E (x)	-1.2	-1.1	-1.9			
EV/sales (x)	2.8	8.3	6.8			

Source: Hardman & Co Life Sciences Research

Financials

Source: Refinitiv

Market data

EPIC/TKR	**NSF**
Price (p)	**13.8**
12m High (p)	48.6
12m Low (p)	8.35
Shares (m)	312.0
Mkt Cap (£m)	43
EV (£m)	295
Free Float	99%
Market	Main

Description

In the UK non-standard lending market, Non-Standard Finance (NSF) has the market-leading network in unsecured branch-based lending, is number two in guarantor loans and number three in home credit.

Company information

CEO	John van Kuffeler
CFO	Jono Gillespie
Non-Exec. Chair	Charles Gregson

+44 20 386 99026
www.nonstandardfinance.com

Key shareholders

Alchemy	29.95%
Aberforth Partners	17.64%
Marathon Asset Mgt.	11.24%

Diary

Early Jun	FY'19 results

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

NON-STANDARD FINANCE

Results due shortly

On 23 April, NSF issued a *Timing of 2019 full year results & trading update*. Key for shareholders is that collections are running at high levels – branch-based business 90%, guarantor loans 90%, albeit most collections are month-end, so may be early, and home collect 75%, with broad adoption of remote payment options, rather than agent visits. With limited lending, NSF is now cashflow-positive (£3m first three weeks of April), significantly de-risking the book. In addition to £39m of cash (21 April), NSF has a £185m undrawn securitisation facility, earmarked to fund future growth and refinance a proportion of the more expensive £285m term loan facility.

- **Other news:** The change of manager at the Invesco Income and Growth Fund and Mark Barnett's departure have no impact on NSF, as their holding has been sold. Jono Gillespie, who worked with the CEO at Provident and has 20 years' sector experience, has taken over as CFO.
- **Peer news:** Provident Financial's 27 May *Trading update* noted signs of a recovery in new lending in May, modest payment holidays in Vanquis, and home collect at 80% of pre-COVID-19 expectations. Amigo's General meeting (*requisitioned* by Richmond Group) is on 17 June. There is no news from Morses Club this month.
- **Valuation:** Near-term earnings, and dividend progression, are unlikely to be reflective of the long-term business outlook and are likely to be highly variable. The long-term Gordon Growth Model has, on our assumptions, a value of 79p. The 2019E P/E is 3.4x. The price to tangible 2019E book is 0.9x.
- **Risks:** Credit risk remains the biggest threat to profitability (this is mitigated through high risk-adjusted margins and good customer relationships), and NSF's model accepts higher credit risk where a higher yield justifies it. Regulation is a market issue; management is taking appropriate action to mitigate this risk.
- **Investment summary:** Notwithstanding short-term uncertainty, substantial medium- and long-term value should be created, as i) demand for, and pricing of, non-standard finance is likely to be strong for at least the next couple of years following the fall-out from the COVID-19 crisis, ii) NSF has substantial committed medium-term debt funding, iii) competitors have withdrawn (and potentially more may do so), and iv) NSF has a highly experienced management team. As noted, investors are paying 3.4x 2019E earnings and 0.9x 2019E book value.

Financial summary and valuation (we will be introducing a range of forecast scenarios for 2020/2021 with the results, due early June)

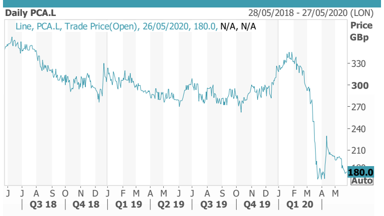
Year-end Dec (£000)	2017	2018	2019E*
Reported revenue	121,682	168,128	184,249
Total impairments	-28,795	-42,688	-45,658
Total costs	-69,203	-89,564	-95,000
EBITDA	23,684	35,876	43,590
Adjusted PBT	13,203	14,769	15,878
Statutory PBT	-13,021	-1,590	-19,779
Pro-forma EPS (p)	3.44	3.70	4.12
DPS (p)	2.20	2.60	0.7
P/E (adjusted, x)	4.0	3.7	3.4
P/BV (x)	0.2	0.2	0.2
P/tangible book (x)	0.6	0.8	0.9
Dividend yield	15.9%	18.8%	5.1%

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

PALACE CAPITAL

Above-average performance, with upside

Real Estate



Source: Refinitiv

Market data

EPIC/TKR	**PCA**
Price (p)	**181**
12m High (p)	350
12m Low (p)	170
Shares (m)	45.9
Mkt Cap (£m)	83
EV (£m)	191
Market	Main, LSE

Description

Palace Capital is a real estate investor, diversified by location, but with no London exposure and with minimal exposure to retail. There is an emphasis on city-centre locations. The York development site comprises 6% of assets.

Company information

Chairman	Stanley Davis
CEO	Neil Sinclair
CFO	Stephen Silvester
Executive director	Richard Starr

+44 20 3301 8330
www.palacecapitalplc.com

Key shareholders

AXA	7.7%
Miton	7.4%
J.O. Hambro	7.3%
Stanley Davis (Chairman)	3.6%

Diary

Jul'20	Final results
Aug'20	AGM
Nov'20	Interim results

Analyst

Mike Foster 020 7194 7622
mf@hardmanandco.com

Palace Capital is 50% in the robust sector of regional offices, with minimal retail and decent exposure to the strong industrials sector. It has a residential development site within the City walls at York, which is selling well, pre- and post-lockdown; this site will bring a welcome boost to profits early in FY'22. However, the largest profit driver is regional offices. Given good parking (even in central Manchester), generally very central locations and value-for-money rents, this is the type of stock to attract tenants looking for more space, maybe less densely laid-out, on attractive terms. In the medium term, we forecast dividends resuming growth above 19p.

- **Rent collection 80% end-April, and rising:** The-end March update confirmed quarter rents 70% up to date. At 23 April, this was 80%. Rents due end-June will be affected, but the outcome so far is encouraging, allied to end-1H20's position of £26.5m undrawn debt for development and a £20m revolving credit facility.

- **End-June quarter another challenge:** The end-June quarter will be another challenge for the real estate sector, but offices should be better placed, as this will cover post-lockdown. With regard to the leisure sector (see below), the outlook so far is reassuring, and 2021 is encouraging.

- **Some leisure exposure**: Leisure is Palace's second-largest sector. Predominantly, assets have large floorprints, e.g. cinema and allied pub in Halifax, and cinema and fitness destinations at Sol Northampton. Large sizes mean distancing is a practical option. Clearly, this is not plain sailing, but it is possible to overcome issues.

- **Strategy**: At reasonable worst, we anticipate 2022 rental income equals £15m. We paint at this stage with a rather broad brush, but it is constructed from "ground-up". York will spin off cash of ca.£20m, which, if half reinvested, would make up a good income stream to set against incentives to tenants in areas like leisure.

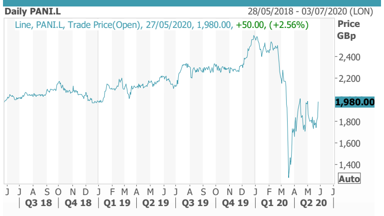
- **Risks:** The two large leisure sites comprise 20% asset value. The fact that they are large helps operational flexibility. Retail is minimal. The 4Q'20 dividend looks under threat. 3Q'20 was passed. Finances are secure (we gave detail last month) and, post the York development, LTV reduces to mid-20% levels. 2020 is difficult, but we believe there is every reason to see a much better 2021, given Palace Capital's strong set of assets, balance sheet and team.

Financial summary and valuation

Year-end Mar (£m)	FY17	FY18	FY19	FY20E	FY21E
Net income	12.2	14.9	16.4	19.0	
Finance cost	-3.0	-3.4	-4.6	-4.0	
Declared profit	12.6	13.3	6.4	3.6	
EPRA PBT	6.4	7.5	8.6	11.0	Await
EPS reported (diluted, p)	36.5	35.8	11.3	25.4	FY'20
EPRA EPS (p)	21.2	18.7	16.5	7.1	results
DPS (p)	18.5	19.0	19.0	14.3	announcement
Net cash/debt	-68.6	-82.4	-96.5	-108.6	
Dividend yield	10.2%	10.5%	10.5%	7.9%	
Price/EPRA NAV	40.8%	43.6%	44.0%	45.6%	
EPRA NAV (p)	443.0	414.8	406.6	396.8	
LTV	37.3%	29.9%	33.8%	37.2%	

Source: Hardman & Co Research

Closed-Ended Investments Funds



Source: Refinitiv

Market data

EPIC/TKR	**PIN**
Price (p)	**1,950**
12m High (p)	2,620
12m Low (p)	1,274
Shares (m)	54.089
Mkt Cap (£m)	1,055
NAV p/sh (p)*	2,729.9
Discount to NAV*	29%
Market	Premium equity closed-ended investment funds

Manager valuations: 86% Dec'19, 14% more recent; cut by 226.3p for "Manager's Provision"

Description

The investment objective of Pantheon International Plc (PIP) is to maximise capital growth by investing in a diversified portfolio of private equity (PE) assets and directly in private companies.

Company information

Chairman	Sir Laurie Magnus
Aud. Cte. Chr.	David Melvin
Sen. Ind. Dir.	Susannah Nicklin
Inv. Mgr.	Pantheon
Managers	Helen Steers
Contact	Vicki Bradley
	+44 20 3356 1800
	www.piplc.com

Key shareholders (31 May'19)

USS	8.2%
Merian	7.0%
Esperides SA SICAV- SIF	5.7%
East Riding of Yorkshire	4.7%
APG Asset Mgt.	4.4%
Investec Wealth	4.4%
Private Syndicate pty.	3.8%
Brewin Dolphin	3.4%

Diary

Early Jul	May performance update

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

PANTHEON INTERNATIONAL

THE INFORMATION CONTAINED IN THIS REPORT IS INTENDED ONLY FOR , AND MAY BE ACCESSED ONLY BY, PERSONS IN THE UNITED KINGDOM, PROFESSIONAL INVESTORS IN DENMARK, FINLAND, GERMANY, THE NETHERLANDS, SPAIN AND SWEDEN, PERSONS WHO ARE BOTH WHOLESALE CLIENTS AND PROFESSIONAL OR SOPHISTICATED INVESTORS IN AUSTRALIA AND PERSONS IN ANY OTHER JURISDICTION TO WHOM SUCH INFORMATION CAN BE LAWFULLY COMMUNICATED WITHOUT ANY APPROVAL BEING OBTAINED OR ANY OTHER ACTION BEING TAKEN TO PERMIT SUCH COMMUNICATION WHERE APPROVAL OR OTHER ACTION FOR SUCH PURPOSE IS REQUIRED. THE INFORMATION IN THIS REPORT IS NOT DIRECTED AT AND IS NOT FOR USE BY ANY OTHER PERSON AND IT MAY NOT BE LAWFUL TO ACCESS THE INFORMATION IN OTHER JURISDICTIONS.

PIP is an investment trust that invests in a diversified portfolio of PE assets managed by third-party managers across the world. PIP is the longest-established PE fund-of-funds on the London Stock Exchange, and has outperformed the FTSE All-Share and MSCI World indices since its inception in 1987.

PIP is managed by Pantheon, one of the world's foremost PE specialists. Founded in 1982, with assets under management (AUM) of $47.1bn (as at 30 September 2019), and a team of 99 investment professionals globally (total staff 330 as at March 2020), Pantheon is a recognised investment leader, with a strong track record of investing in PE funds over various market cycles in both the primary and secondary markets, as well as a track record of co-investments.

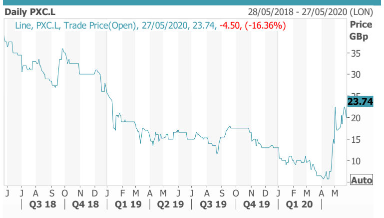
PIP actively manages risk by the careful selection and purchase of high-quality PE assets in a diversified and balanced portfolio, across different investment stages and vintages, by investing in carefully selected funds operating in different regions of the world.

PIP, like all private equity investors, is reliant on calculating its NAV on underlying manager valuations. This can see a delay in market rating changes feeding through to PIP's NAV. It has tried to eliminate this distortion and, in its 30 April monthly performance report, PIP noted NAV of 2,794.9p, based off 94% of December valuations, which were then adjusted down by £122m (226.3p per share), to reflect underlying manager feedback and market movements since. That report detailed the methodology used in assessing the manager's provision. The 26 May performance update reported that the provision had been left unchanged to end-April.

Given the regulatory restrictions on distributing research on this company, the monthly book entry for Pantheon can be accessed through our website, Hardman and Co Research. Our initiation report, published on 6 September 2019, and our reports, History of value added to portfolio by holding Pantheon, published on 26 November 2019, and 2020 interim results consistency in delivery, published on 2 March 2020, can be found on the same site.

HARDMAN&CO.

Mining



Source: Refinitiv

Market data

EPIC/TKR	**PXC**
Price (p)	**27.50**
12m High (p)	28.75
12m Low (p)	5.00
Shares (m)	52.68
Mkt Cap (£m)	14.49
EV (£m)	15.18
Free Float*	84.30%
Market	AIM

**As defined by AIM Rule 26*

Description

Phoenix Copper (PXC) is developing the former Empire deposit and the surrounding area in central Idaho into a potentially world-class copper and polymetallic mine. First production is expected in late 2021.

Company information

Chairman	M. Edwards-Jones
CEO	Ryan McDermott
CFO	Richard Wilkins
CTO	Roger Turner

+44 7590 216 657
www.phoenixcopperlimited.com

Key shareholders

Martin Hughes (Cheviot)	22.40%
JIM Nominees	8.30%
Directors & mgt.	9.44%
Lynchwood Nominees Ltd	5.62%

Diary

Jun'20	Assay drilling results
3Q'20	Updated resources

Analyst

Paul Mylchreest 020 7194 7622
pm@hardmanandco.com

PHOENIX COPPER LTD

A potentially world-class copper-silver-gold mine

PXC continues to advance its strategy for the staged development of the potentially world-class polymetallic mine in mining-friendly Idaho, US. In a change to planned mine scheduling, the initial Red Star silver mine will provide cashflow to develop the Empire near-surface copper (oxide ore) mine and explore the much larger sulphide ore body at depth. Only ca.1% of the deposit has been explored so far. Our current estimated DCF valuation of 31p/share is based on the initial silver mine only.

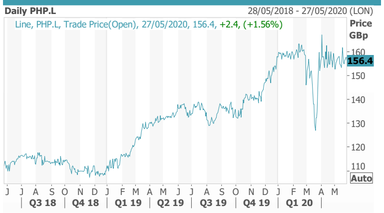
- **Strategy:** PXC focuses on near-term cashflow, and will maximise returns/ minimise risk to shareholders by developing a potentially world-class copper-gold-silver deposit in stages. Empire was formerly a very high-grade underground copper mine (recovering 3.64% Cu), shut down due to World War II.
- **Recent announcements:** On 4 May 2020, a new NI43-101 resource for Empire was announced by re-evaluating the existing ore body. This increased the gold and silver resources by 87% and 29%, respectively. The notional gold value, at $1,600/oz, is $547.6m, and the silver value, at $19.00/oz, is $180.5m.
- **Red Star update:** The Red Star mine development is being fast-tracked, with production possible by end-2021. This year's drilling programme will see a further 20 drill holes to upgrade/enlarge the existing resource. The initial three holes led to an inferred resource of 103,500 tonnes of ore and 0.58m oz of silver.
- **Risks:** PXC is subject to normal risks for a junior mining company. These include volatility in copper and zinc prices, operational risks in executing the mining plan, running downstream processing facilities and funding risks. We believe that jurisdictional risk is significantly reduced in PXC's case, due to the Idaho location.
- **Investment summary:** Our DCF valuation is 31p/share, based solely on the silver mine, a cautious (for now) 15% discount rate and a long-term silver price of $19.00/oz. PXC's share price is highly geared to the upside thesis for silver (and copper), with each $1.00/oz adding an estimated 6.2p-6.3p/share.

Financial summary and valuation

Year end Dec ($m)	2017	2018	2019	2020E	2021E	2022E
Sales	0	0	0	0	0	48,800
Underlying EBIT	-1.058	-1.654	-1.105	-1.282	-2.082	0.787
Reported EBIT	-1.058	-1.654	-1.105	-1.282	-2.082	0.787
Underlying PTP	-1.056	-1.652	-1.128	-1.380	-5.069	-2.708
Statutory PTP	-1.056	-1.652	-1.128	-1.380	-5.069	-2.708
Underlying EPS (c)	-8.20	-5.82	-2.76	-2.44	-3.30	7.15
Statutory EPS (c)	-8.20	-5.82	-2.76	-2.44	-3.30	7.15
Net (debt)/cash	1.904	0.113	-0.589	-0.953	-26.530	-8.895
Average shares (m)	16.498	28.273	40.862	56.436	82.086	82.086
P/E (x)	n/a	n/a	n/a	n/a	n/a	4.7
Dividend yield (%)	n/a	n/a	n/a	n/a	n/a	n/a
FCF yield (%)	n/a	n/a	n/a	n/a	n/a	73.1%

Source: Hardman & Co Research

Real Estate



Source: Refinitiv

Market data

EPIC/TKR	**PHP**
Price (p)	**153**
12m High (p)	161
12m Low (p)	115
Shares (m)	1,220
Mkt Cap (£m)	1,866
EV (£m)	3,000
Market	Premium, LSE

Description

Primary Health Properties (PHP) is a REIT acquiring and owning modern primary medical properties in the UK, and is expanding into the Republic of Ireland (RoI), now 7% of assets.

Company information

CEO	Harry Hyman
CFO	Richard Howell
Chairman	Steven Owen

+44 20 7451 7050
www.phpgroup.co.uk

Key shareholders

Directors	1.0%
Blackrock	6.7%
CCLA	5.3%
Investec Wealth	5.0%
Vanguard Group	2.7%
Troy Asset	2.3%

Diary

Jul'20	Interim results
Feb'21	Final results

Analyst

Mike Foster 020 7194 7622
mf@hardmanandco.com

PRIMARY HEALTH PROPERTIES

Gilt-edged stock on a near 4% dividend yield

The search for income will continue to point investors towards stocks that generate reliable income. PHP has paid a rising dividend in each year of its existence, a total now of 23 years. Such a record is, of course, all the more impressive given that it encompasses the global financial crisis and subsequent problems. We are of the view that the length of unbroken rises is hardly credited by the market. Further, PHP has several drivers to EPS growth, namely cost ratios and expansion into Republic of Ireland (RoI), on which we expand below. In addition, the level of market rents is rising.

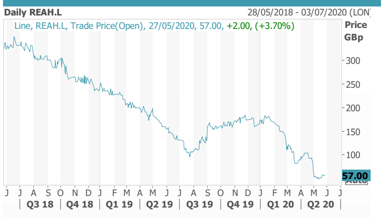
- **A stand-out performer**: There are a number of factors driving growth in EPS. These include costs, higher returns in RoI and a rising quantum of rental increases. This is a market where the trend in rent rises is actually accelerating. This has been confirmed by the Assura results last month.
- **Expansion**: Another, principal, driver of EPS growth is the benefit of the significant expansion since 2019. In March last year, PHP merged with MedicX, a quality investor, but one with somewhat expensive debt. As this gets diluted with new debt, EPS will rise.
- **Valuation:** The rating last year reacted positively to strategy execution, including the MedicX merger, and the debt and equity funding for growth. COVID-19 has illustrated PHP's index-linked, gilt-style character. The dividend yield is at a large premium to gilts. The 1.475p 2Q dividend represents an annualised yield of 3.8%.
- **Risks:** Rents are upwards-only, and effectively paid by the government. There is over £340m of undrawn loan facilities added to cash on deposit. Interest cover is 2.7x. We estimate a 46.8% end-2020 LTV. No development risk is taken, and some larger development sites have recently delivered faultlessly.
- **Investment summary:** As noted, this is a stand-out stock, where fundamentals would logically propel it upwards, as a result of its track record and of macro conditions that have reduced medium-term interest rates even further. The merger and ongoing debt refinancing have significantly enhanced EPS, but the benefits so far are only partly reflected in the numbers. There is a clear road ahead for EPS growth.

Financial summary and valuation

Year-end Dec (£m)	2017	2018	2019	2020E	2021E
Income	71.3	76.4	115.7	134.0	143.0
Finance costs	-31.6	-29.7	-43.7	-46.5	-48.8
Declared profit	91.9	74.3	-70.2	112.4	133.7
EPRA PBT	31.0	36.8	59.7	72.4	78.7
EPS reported (p)	15.3	10.5	-6.4	9.2	10.9
EPRA EPS (diluted, p)	5.1	5.2	5.4	5.9	6.4
DPS (p)	5.25	5.40	5.60	5.90	6.12
Net debt	-726.6	-670.2	-1,120.8	-1,249.3	-1,382.9
Dividend yield	3.4%	3.6%	3.7%	3.8%	4.0%
Price/EPRA NAV (x)	1.52	1.45	1.41	1.39	1.32
IFRS NAV per share (p)	94.7	102.6	101.0	103.7	108.7
EPRA NAV per share (p)	100.7	105.1	107.9	110.3	115.3

EPRA EPS and EPRA NAV adjusted as per PHP definition
Source: Hardman & Co Research

Food Producers



Source: Refinitiv

Market data

EPIC/TKR	**RE./RE.B**
Price (p)	**54/58.5**
12m High (p)	199.0
12m Low (p)	48.0
Shares Ord (m)	44.0
Shares Prefs (m)	72.0
Mkt Cap Ord (£m)	23.7
Mkt Cap Prefs (£m)	41.9
EV (£m)	303.6
Free Float	27.6%
Market	MAIN

Description

R.E.A. Holdings (REA) is engaged in the operation and further development of palm oil plantations in East Kalimantan, Indonesia. The group also owns stone quarrying rights and concessions, and coal mining concessions that are being contracted out to third-party operators.

Company information

Managing Director	Carol Gysin
Chairman	David Blackett

+44 207 436 7877
www.rea.co.uk

Key shareholders

Directors	31.4%
M&G Investment	20.0%
Nokia Bell Pensioenfonds	9.3%
Aberforth Partners	6.7%
Artemis	5.6%

Diary

11 Jun	AGM
Sep'20	Interim results

Analyst

Yingheng Chen 020 7194 7622
yc@hardmanandco.com

R.E.A. Holdings

FY'19 results

2019 was described by the Chairman as a "difficult trading period", with the average received price for its CPO (FOB basis Samarinda) $453 per MT, vs. a 25-year average price per MT CPO of ca.$535 (like-for-like). REA reported "a second record year" for FFB production, at 800,666 MT (800,050 MT FY'18), well below its start-of-year target, due, in part, to biotic stress (after the 2018 bumper crop) and unusually low rainfall in the second half of the year. EBITDA improved to $18.2m ($12.3m). REA recorded a pre-tax loss of $43.7m ($5.5m loss) after finance costs of $31.9m ($5.4m), including $8.6m of adverse currency effects on the loan portfolio.

- **Production:** FFB per hectare rose to 24 mt/ha (23 mt/ha FY'18) (notwithstanding a sector-wide decline in FFB production due to biotic stress), and oil extraction rates (OER) strengthened to 23% (22.5%). Both metrics place the group's efficiency in the top quartile for the plantation sector.

- **Coal:** In 2019, a contractor was appointed to provide mining services. It will fund all further expenditure requirements in exchange for participation in profits that may be generated from the mine. The COVID-19 crisis has delayed commencement of coal mining, and this may now not commence until 2021.

- **Stone:** REA announced that it was finalising arrangements with a neighbouring coal company for the opening and quarrying of the andesite stone concession, on similar terms to those agreed for the Kota Bangun coal concession, with work expected to commence in 2H'20, depending on the progression of COVID-19.

- **Global palm oil consumption:** According to *Oil World*, world consumption of palm oil is expected to shrink in the 2019/20 season, for the first time in more than 30 years. A consumption decline forecast of ca.1.1m mt from the prior year, however, with global consumption of 76.5m mt, would still exceed expected production.

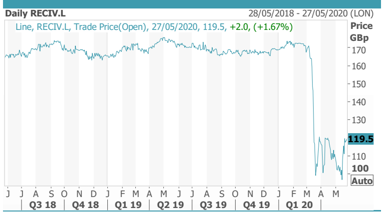
- **Summary:** COVID-19 has brought the world economy to a halt – first the slowdown in imports from India and China, and now Europe and the US. We now expect a gradual increase in demand from China, as the country emerges from the lockdown, and there should hopefully be a surge in imports from India, the biggest consumer country of palm oil.

Financial summary and valuation

Year-end Dec ($m)	2016	2017	2018	2019	2020E
Sales	79.3	100.2	105.5	125.0	
EBITDA	16.8	20.7	12.8	18.2	
Reported EBIT	-5.0	-2.2	-10.7	-9.1	
Adjusted PBT	-18.4	-18.3	-20.3	-35.1	Forecasts
EPS (c)	-48.2	-67.7	-54.4	-43.1	under
DPS (p)	0.0	0.0	0.0	0.0	review
Net (debt)/cash	-205.1	-211.7	-189.6	-207.9	
P/E (x)	-	-	-	-	
Total planted hectare (ha)	42,846	44,094	36,500	36,154	
Adj. EV/planted ha ($/ha)*	6,057	5,870	6,869	6,815	
CPO production (mt)	127,697	143,916	217,721	224,856	

**EV/planted ha includes mkt. cap. of 9% pref. shares; Source: Hardman & Co Research*

Diversified Financial Services



Source: Refinitiv

Market data

EPIC/TKR	**RECI**
Price (p)	**119.5**
12m High (p)	175.5
12m Low (p)	94.4
Shares (m)	229.3
Mkt Cap (£m)	274
NAV p/sh (p)	147
Disc. to NAV	19%
Market	Premium Equity Closed-Ended Inv. Funds

Description

Real Estate Credit Investments (RECI) is a closed-ended investment company that aims to deliver a stable quarterly dividend via a levered exposure to real estate credit investments, primarily in the UK, France and Germany.

Company information

Chairman	Bob Cowdell
NED	Susie Farnon
NED	John Hallam
NED	Graham Harrison
Inv. Mgr.	Cheyne Capital
Head of Team	Ravi Stickney
Main contact	Richard Lang
	+44 207 968 7328
	www.recreditinvest.com

Key shareholders (pre-placement)

Bank Leumi	8.6%
AXA SA	8.4%
Close Bros	8.2%
Premier AM	8.2%
Fidelity	8.0%
Canaccord Genuity Group	7.7%
Smith and Williamson	6.7%

Diary

Mid-Jun	May factsheet

Analysts

Mark Thomas	020 7194 7622
	mt@hardmanandco.com
Mike Foster	020 7194 7622
	mf@hardmanandco.com

REAL ESTATE CREDIT INVESTMENTS

RECI is a closed-ended investment company. To achieve the investment objective, the company invests, and will continue to invest, in real estate credit secured by commercial or residential properties in Western Europe, focusing primarily on the UK, France and Germany.

Investments may take different forms, but are likely to be:

- Secured real estate loans, debentures or any other forms of debt instruments (together "Secured Debt"). Secured real estate loans are typically secured by mortgages over the property or charges over the shares of the property-owning vehicle. Individual secured debt investments will have a weighted average life profile ranging from six months to 15 years. Investments in secured debt will also be directly or indirectly secured by one or more commercial or residential properties, and will not exceed an LTV of 85% at the time of investment.
- Listed debt securities and securitised tranches of real estate-related debt securities – for example, residential mortgage-backed securities and commercial mortgage-backed securities (together "MBS"). For the avoidance of doubt, this does not include equity residual positions in MBS.
- Other direct or indirect opportunities, including equity participations in real estate, save that no more than 20% of the total assets will be invested in positions with an LTV in excess of 85% or in equity positions that are uncollateralised. On specific transactions, the company may be granted equity positions as part of its loan terms. These positions will come as part of the company's overall return on its investments, and may or may not provide extra profit to the company, depending on market conditions and the performance of the loan. These positions are deemed collateralised equity positions. All other equity positions in which the company may invest are deemed uncollateralised equity positions.

RECI is externally managed by Cheyne Capital Management (UK) LLP, a UK investment manager authorised and regulated by the FCA. As at 29 February 2020, Cheyne had 161 employees, of which 32 were in the Real Estate Team, and AUM of $7.2bn, of which $3.4bn was managed by the Real Estate Team. It has offices in London, New York, Bermuda, Berlin, Dubai, Dublin and Zurich. Cheyne invests across the capital structure – from the senior debt to the equity positions. It has expertise in the structuring, execution and management of securitisation transactions, involving a broad range of assets, including portfolios comprised of traditional asset classes, such as commercial and residential mortgages, as well as mortgage-backed securities and the management of commercial real estate portfolios, focused on Europe and the UK.

RECI gave a market update (including a detailed review of COVID-19-related exposures) on 15 May and issued its end-April Factsheet on 12 May.

Given the regulatory restrictions on distributing research on this company, the monthly book entry for RECI can be accessed through our website, Hardman and Co Research. Our initiation report, published on 28 August 2019, and our notes, *Delivering on its promises*, published on 17 December 2019, and *Getting a balanced view on outlook*, published on 21 May 2020, can be found on the same site.

Pharmaceuticals & Biotechnology

Source: Refinitiv

Market data

EPIC/TKR	**STX**
Price (p)	**98.0**
12m High (p)	196.0
12m Low (p)	54.0
Shares (m)	117.2
Mkt Cap (£m)	114.8
EV (£m)	106.5
Free Float*	33%
Market	AIM

**As defined by AIM Rule 26*

Description

Shield Therapeutics (STX) is a commercial-stage pharmaceutical company delivering innovative specialty pharmaceuticals that address patients' unmet medical needs, with an initial focus on anaemia associated with renal and gastrointestinal disorders.

Company information

CEO	Tim Watts
CFO	tba
Chairman	Hans Peter Hasler

+44 207 186 8500
www.shieldtherapeutics.com

Key shareholders

Directors	8.9%
W. Health	47.8%
MaRu AG	10.7%
C. Schweiger	4.8%
USS	4.4%

Diary

18 Jun	AGM
Mid-2020	US Accrufer deal
3Q'20	Accrufer launch
4Q'20	Paediatric study to start

Analyst

Martin Hall 020 7194 7622
mh@hardmanandco.com

SHIELD THERAPEUTICS

Reassuring update

STX is a commercial-stage company delivering specialty products that address patients' unmet medical needs, with an initial focus on treating iron deficiency (ID) with ferric maltol. Its lead product, Feraccru/Accrufer, is approved with a broad label in the US and Europe. Positive sentiment is returning after some unexpected announcements. With the recent 2019 results, a clear vision was laid down by the new CEO, with reassurance that the company has a 12-month cash runway, excluding any upfront payments associated with a US licensing deal. Meanwhile, the effect of COVID-19 on STX has been minimal and could provide an opportunity.

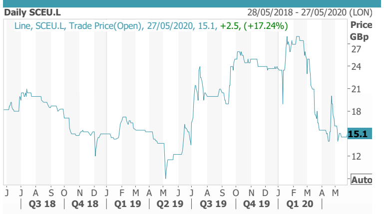
- **Strategy:** STX's strategy is to out-license the commercial rights to its products to partners with marketing and distribution expertise in target markets. These deals allow STX to retain its intellectual property (IP) and to keep investing in its R&D pipeline, while benefiting from immediate and long-term value.
- **2019 results:** Royalties on net Feraccru sales received from Norgine were £0.63m, derived mostly from Germany, with some from the UK. Net cash at 31 December 2019 was £4.1m, subsequently boosted by the $11.4m upfront from ASK Pharma, offset by the €2.5m milestone repayment to Norgine.
- **EU patent opposition:** Teva has raised opposition to two Feraccru patents (2,668,175 and 3,160,951) with the European Patent Office (EPO). In March 2019, the EPO decided in favour of STX on 2,668,175, which has gone to appeal. The first hearing on 3,160,951 had been set for 23 June 2020. However, as a result of the coronavirus pandemic, this case has been postponed.
- **Chairman:** On 21 May, James Karis, non-executive Chairman of STX, announced his intention to step down at the AGM on 18 June 2020, after five years in office. He will be replaced from that date by current NED, Hans Peter Hasler, an experienced pharmaceutical industry and investment executive.
- **Investment summary**: The publication of results provided new CEO, Tim Watts, with the opportunity to reinforce the strategy, provide a trading update, and to reiterate STX's cash runway into 2021. Feraccru is a new option to intravenous iron for patients reluctant to attend hospitals due to the risk of COVID-19. STX is working diligently towards signing a US commercial partner for Accrufer.

Financial summary and valuation

Year-end Dec (£m)	2017	2018	2019	2020E	2021E	2022E
Gross revenues	0.64	11.88	0.72	10.07	5.06	13.15
Sales	0.64	0.86	0.62	1.15	5.06	13.15
R&D	-4.71	-4.30	-2.50	-3.24	-3.81	-4.19
Other income	0.00	11.03	0.10	8.92	0.00	0.00
EBITDA	-18.48	-2.47	-6.41	1.56	-3.90	-0.11
Underlying EBIT	-18.90	-3.26	-9.04	-1.06	-6.53	-0.11
Reported EBIT	-20.95	-5.17	-9.04	-1.06	-6.53	-0.11
Underlying PBT	-18.91	-3.26	-9.07	-1.11	-6.58	-0.16
Statutory PBT	-20.99	-5.16	-9.07	-1.11	-6.58	-0.16
Underlying EPS (p)	-15.58	0.09	-7.52	-0.53	-5.13	0.40
Statutory EPS (p)	-17.43	-1.55	-7.52	-0.53	-5.13	0.40
Net (debt)/cash	13.30	9.63	4.12	3.07	-8.56	-18.77

Source: Hardman & Co Life Sciences Research

Automotive



Source: Refinitiv

Market data

EPIC/TKR	**SCE**
Price (p)	**16**
12m High (p)	28
12m Low (p)	12
Shares (m)	155
Mkt Cap (£m)	24.8
EV (£m)	21.8
Free Float*	86%
Market	AIM

As defined by AIM Rule 26

Description

Surface Transforms (ST) is 100% focused on the manufacture and sales of carbon ceramic brake discs. It has recently announced a number of OEM contracts.

Company information

Non-Exec. Chair.	David Bundred
CEO	Dr Kevin Johnson
Finance Director	Michael Cunningham

+ 44 151 356 2141
www.surfacetransforms.com

Key shareholders (pre recent fund raise)

Directors	14.0%
Canaccord	14.8%
Unicorn	12.3%
Richard Gledhill esq. (director)	9.9%
Richard Sneller esq.	8.2%
Hargreaves Lansdown	4.5%

Diary

30 Jun	AGM
20 Jul'20	Half year sales update
Late Sep'20	Interim results

Analyst

Mike Foster 020 7194 7622
mf@hardmanandco.com

SURFACE TRANSFORMS

Successful, oversubscribed fund raise

ST's strong position is not apparent in its current share price. It is understandable that early-growth companies should be vulnerable in terms of ratings, and ST remains loss-making this year. However, we strongly believe the order book already in the company's possession is only a down-payment to two things: it takes the company to profits and cashflow-positive trading, and it demonstrates that it has succeeded in its aim – to be a trusted partner of European OEMs (then globally) in a truly mission-critical component with a uniquely positive competitive landscape. The recent share issue was highly oversubscribed, and finances are strong.

- **Major orders achieved, and more to come:** As per its 10 January update: "the Company still expects to be able to make significant contract announcements during the new 2020 financial year." The market is currently tiny, at £100m. It is set to grow ca.20-fold, with ST one of only two manufacturers.
- **Major orders won last year:** We have enumerated these in past research, but we emphasise that our estimates include only firm original equipment (OEM) orders and the ongoing baseload of revenue from track cars and retro-fit. Pre COVID-19, these latter had been predictable and on a rising trend.
- **Capacity allocation model:** ST's capacity-in-place is £17m sales p.a. The production process, while extremely complex, is entirely repeatable; so expansion would consist of adding more of exactly the same bespoke kit as that being used already. There will be ongoing scope to adjust efficiencies.
- **Fund raise:** ST is set to be cashflow-positive by 2021. COVID-19 has not affected the OEM order time line, as this is set by the timing of model launches. These types of cars benefit from significant pre-orders. The 13p fund raise was oversubscribed and the open offer to shareholders subscribed 4.7 times over.
- **Investment case:** This is a large, growing market, 99%-supplied by one, highly profitable player. Lead times for new competition are multi-year (as in five or more), with none in sight. ST is the right side of high barriers to new competition in a high-growth market. The path to its discs being designed into many more models is clear.

Financial summary and valuation

Year-end May*/ December**(£m)	FY19*	*7-month 19E***	FY20E**	FY21E**	FY22E**
Sales	1.00	1.45	1.60	4.00	5.70
EBITDA	-2.60	-1.41	-1.55	-0.10	1.00
EBITA	-2.94	-1.70	-2.25	-0.80	0.30
PBT	-3.04	-1.76	-2.25	-0.80	0.30
PAT	-2.12	-0.90	-2.25	-0.25	0.85
EPS (adjusted, p)	-1.66	-0.97	-1.20	-0.16	0.55
Shareholders' funds	6.90	5.57	6.52	6.27	7.12
Net (debt)/cash	1.60	1.60	2.65	2.65	3.60
P/E (x)	loss	n/a	loss	loss	29.1
EV/sales (x)	21.8	n/a	13.6	5.4	3.8
EV/EBITDA (x)	loss	n/a	loss	loss	21.8
DPS (p)	nil	nil	nil	nil	nil

As this report goes to publication, the company's 2019 report is being published, with a statement
**May year-end; **Change of year-end to December*
Source: Hardman & Co Research

THE 600 GROUP

Reacting well and well-prepared for the future

Trading remains most challenging. The 600 Group is reacting accordingly. It remains well placed fundamentally and competitively, with a world-class reputation, and with its financial position recently strengthened. The shares, however, are likely to tread water in the near term.

Industrial Engineering

Source: Refinitiv

Market data

EPIC/TKR	**SIXH**
Price (p)	**7.8**
12m High (p)	21.9
12m Low (p)	6.7
Shares (m)	117.1
Mkt Cap (£m)	9.1
EV (£m)	25.3
Free Float*	72.1%
Market	AIM

**As defined by AIM Rule 26*

Description

The 600 Group is a designer and manufacturer of industrial products active in machine tools, components and industrial laser systems. The US represents around 65% of group sales.

Company information

Executive Chairman	Paul Dupee
CFO	Neil Carrick

+44 1922 707110
www.600group.com

Key shareholders

Haddeo Partners	20.0%
Mr A Perloff and Maland	9.0%
Mr T Miller	3.8%
Miton Group	3.3%
Others	63.9%

Diary

Jul'20	Final results

- **Trading update:** The most recent trading update reveals that trading conditions remain most challenging, with volatile order intake in both business areas and many projects being delayed, with ongoing restrictions continuing to create supply challenges in general engineering sectors.

- **Trading results:** Trading results for the year to 28/03/20 are to be broadly in line with previous expectations. With trading visibility low, 2020/21 forecasts are suspended. Non-critical capital expenditure has been deferred. Debt levels remain as expected. The group is covenant-compliant, with adequate banking facilities.

- **Strategy:** The strategic objective is to grow the business into a global industrial concern. The US acquisition of CMS significantly strengthens the competitive position, being complementary and adding engineering expertise. The group is currently taking advantage of government schemes and stimulus packages.

- **Well-positioned competitively:** The 600 Group is regarded as well-positioned within highly competitive industries. It is undertaking a restructuring programme to reduce capex requirements and further improve margins. Opportunities are available for operational and distribution synergy benefits.

- **Investment summary:** The shares offer the opportunity to invest in a de-risked cyclical stock with good operational leverage, enhanced by new product launches and new market entry. Cyclicality has been de-risked through development of high-margin repeat/recurring business. The risk-reward profile is favourable, but the shares are likely to tread water until trading improvements become visible.

Financial summary and valuation

Year-end Mar ($m)	2018	2019	2020E	2021E
Sales	63.9	65.2	63.3	
Gross profit	21.6	23.6	24.4	
Underlying EBIT	1.8	5.2	2.6	
Underlying PTP	0.6	4.0	1.2	Forecasts
Underlying EPS (c)	1.0	3.5	0.9	suspended
Statutory EPS (c)	1.5	3.5	0.9	
Net (debt)/cash	-15.6	-14.5	-17.9	
DPS (p)	0.50	1.00	1.00	
P/E (x)	25.1	7.2	15.2	
Yield	2.5%	5.0%	9.1%	

Source: Hardman & Co Research

Analyst

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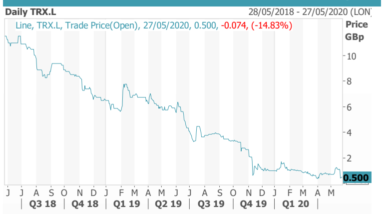
Pharmaceuticals & Biotechnology



Source: Refinitiv

Market data

EPIC/TKR	**TRX**
Price (p)	**0.45**
12m High (p)	6.37
12m Low (p)	0.35
Shares (m)	1,172.0
Mkt Cap (£m)	5.3
EV (£m)	7.3
Free Float*	62%
Market	AIM

**As defined by AIM Rule 26*

Description

Tissue Regenix (TRX) is a medical device company focused on regenerative medicine. Patented decellularisation technologies remove DNA, cells and other material from animal/human tissue and bone, leaving scaffolds that can be used to repair diseased or worn-out body parts. Its products have multiple applications.

Company information

CEO (interim)	Gareth Jones
Finance Director	Kirsten Lund
Chairman (interim)	Jonathan Glenn

+44 330 430 3052
www.tissueregenix.com

Key shareholders

Directors	4.3%
Link Fund Solutions	20.0%
IP Group	13.7%
Jupiter AM	8.5%

Diary

9 Jun	GM
Jun'20	2019 final results
1H'20	Potential EU approval of OrthoPure XT

Analyst

Martin Hall 020 7194 7622
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TISSUE REGENIX

Capital increase removes the shackles

TRX has a broad portfolio of regenerative medicine products for the biosurgery, orthopaedics, dental and cardiac markets. It has two proprietary decellularisation technology platforms for repair of soft tissue (dCELL) and bone (BioRinse). The company's commercial strategy has led to strong demand for its products, which it is looking to service through capacity expansion and optimisation of supply chain and operations. This left the company in a difficult position, requiring an injection of cash for working capital purposes in order to satisfy this demand. A US Government-backed loan gave TRX breathing space to sort out its funding needs.

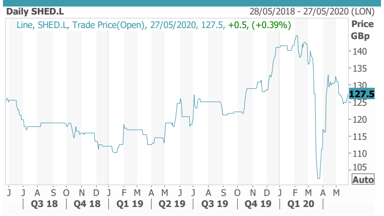
- **Strategy:** TRX is building an international regenerative medicine business with a product portfolio using proprietary dCELL and BioRinse technology platforms, underpinned by compelling clinical outcomes. It aims to expand its global distribution network, via strategic partnerships, to drive sales momentum.
- **Financing:** Historically, TRX appeared to be in an enviable position, with a strong shareholder base. However, the demise of Woodford funds and the contagion effect changed everything. Consequently, TRX has had to get potential new shareholders up to speed in order to satisfy its working capital needs.
- **Placing:** TRX has announced a conditional Placing, PrimaryBid offer (for retail investors) and Subscription (by certain directors) of 5,848m new Ordinary shares in the company at 0.25p per share, to raise gross new capital of £14.6m (£13.8m net), subject to shareholder approval at the GM on 9 June.
- **US operations:** Working within COVID-19 restrictions, TRX is still processing material for its commercialised DermaPure and BioRinse products. Although elective procedures in some hospitals have halted temporarily, this has enabled the company to build up levels of finished products, ready to meet future demand.
- **Investment summary:** Management has been operationally challenged in recent months, while it sought additional working and investment capital. Over £5m of the new capital is earmarked for expansion investment in the US to satisfy strong demand for its regulatory approved and commercialised products. With appropriate funds in place, management must now turn its attention to delivering on strategy in order to satisfy its new army of shareholders.

Financial summary and valuation

Year-end Dec (£m)	*2016	2017	2018	2019E	2020E	2021E
Sales	1.44	5.23	11.62	12.50		
EBITDA	-11.14	-9.01	-7.09	-7.82		
Underlying EBIT	-11.44	-9.72	-8.27	-9.00		
Reported EBIT	-11.44	-10.82	-8.69	-9.00		
Underlying PBT	-11.33	-9.67	-8.46	-9.29	Forecasts under review	
Statutory PBT	-11.33	-10.77	-8.88	-9.29		
Underlying EPS (p)	-1.35	-0.90	-0.67	-0.76		
Statutory EPS (p)	-1.35	-1.02	-0.70	-0.76		
Net (debt)/cash	8.17	16.42	7.82	-0.72		
Equity issues	0.00	37.99	0.00	0.00		
P/E (x)	-	-	-	-		
EV/sales (x)	-	2.3	1.1	1.0		

**11 months to December;*
Source: Hardman & Co Life Sciences Research

Real Estate



Source: Refinitiv

Market data

EPIC/TKR	SHED
Price (p)	128
12m High (p)	145
12m Low (p)	104
Shares (m)	188
Mkt Cap (£m)	241
EV (£m)	272
Market	AIM

Description

This strategically located REIT (e.g. urban "last-mile") deals with smaller (typically ca.70,000 sq. ft.), single-let industrial and logistics properties, servicing high-quality tenants. The market is in strategic undersupply.

Company information

CEO	Richard Moffitt
Chairman	Nigel Rich

+44 20 7591 1600
www.urbanlogisticsreit.com

Key shareholders

Directors	1.1%
Allianz	11.6%
Janus Henderson	10.7%
Rathbone I M	10.5%
Sir John Beckwith	8.0%
Premier	7.9%

Diary

Jul'20	AGM
Nov'20	Interim results

Analyst

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mf@hardmanandco.com

URBAN LOGISTICS

Well-placed and at a discount to NAV

Urban Logistics invests in "last-mile" distribution warehouses, the supply of which continues to fall in the face of internet-fuelled demand. The £130m equity fund raise, completed in March, is being put to work in a measured way. A strong further pipeline remains. The REIT is in exactly the right asset class, and its balance sheet is among the strongest in the sector. It is achieving NIYs well over 6%, and has a track record of raising rents well and, indeed, recycling some assets for good profits (typically 50%). With another good set of results and a confident forward statement achieved, the rating at below NAV is noteworthy. Results were reported on 29 May.

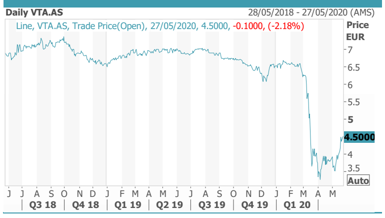
- **Results – year to March 2020:** Announced as we go to press, income and profits (pre LTIP) are in line with expectations and NAV within 1%. The acquisitions and trading update supports 2021E EPRA EPS ahead of the historical dividend. We expect equity fully invested pre-December with 25%-30% LTV March 2021E.
- **Deployment:** £50.4m has been deployed into a portfolio of nine single-let assets. On a net initial yield (NIY) of ca.6.5% average, this is a sensible continuation of the existing asset types, which have served so well so far. One site has extra development potential.
- **Valuation:** The UK is now in recession. This asset class is not. We reinstate estimates during June, with an initial EPS dilution from the expansion in shares in issue. We are confident deployment will enhance the potential for DPS growth, and we note good rises to date and the announcements on that deployment in strong locations.
- **Risks:** Sectoral exposure within the tenant base is biased towards food, pharmaceuticals, staple goods and large logistics firms, which are household names. At year-end, the balance sheet held £132m cash, with £151m loan facilities in place June 2020. Deployment affects 2021 profits, but is progressing very well.
- **Investment track record**: Since listing on the AIM in April 2016, Urban Logistics has generated annual NAV and dividend returns of 16.0%. Market rents are ca.9% above the REIT's current levels, as evidenced by two recent reviews. Market vacancies are only ca.5%, and Urban Logistics' vacancy is nil, so we expect that rental reviews will continue to enhance EPS.

Financial summary and valuation

Year-end Mar (£m)	2017	2018	2019	2020E	2021E	2022E
Rental income	2.28	5.56	10.80	12.20		
Finance costs	-0.60	-0.93	-2.20	-2.60		
EPRA operating profit	1.76	3.40	8.18	9.90		
Declared profit	4.89	9.86	18.88	18.40		
EPS reported (p)	46.80	19.54	22.12	19.60	Review post	
EPRA EPS (dil., post LTIP, p)	7.82	4.91	7.01	7.87	growth equity	
DPS (p)	6.23	6.32	7.00	7.60	raise	
Net debt	16.52	44.39	61.64	-66.00		
Dividend yield	6.0%	6.1%	6.8%	7.3%		
Price/EPRA NAV (x)	1.08	1.03	0.92	0.86		
NAV per share (p)	118.26	123.62	137.39	139.50		
EPRA NAV per share (p)	116.11	122.49	137.96	139.50		

Source: Hardman & Co Research

Financials



Source: Refinitiv

Market data

EPIC/TKR	**VTA .NA, VTA.LN, VTAS LN**
Price (€)	**4.50/4.25/390p**
12m High (€)	6.74/7.04/642p
12m Low (€)	3.20/3.38/285p
Shares (m)	36.6
Mkt Cap (€m)	164
Prop. 12-mth. yield	10.2%
Free Float	70%
Market	AEX, LSE

Description

Volta Finance (Volta) is a closed-ended, limited liability investment company with a diversified investment strategy across structured finance assets (primarily CLOs). It aims to provide a stable stream of income through quarterly dividends.

Company information

Ind. Chairman	Paul Meader
Ind. Non-Executive Directors	Graham Harrison Stephen Le Page Atosa Moini Paul Varotsis
Fund Managers AXA IM Paris	Serge Demay A Martin-Min François Touati
Co. sec. /Administrator	BNP Paribas Securities Services SCA, Guernsey Branch

BNP: +44 1481 750853
www.voltafinance.com

Key shareholders

Axa Group	30%
BBVA Madrid & BNP WM	7%
Ironside Partners & Deutsche	6%

Diary

Mid-Jun'20	May estimated NAV

Analyst

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VOLTA FINANCE

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Volta is a closed-ended, limited liability company registered in Guernsey. Its investment objectives are to seek to preserve capital across the credit cycle and to provide a stable stream of income to its shareholders through dividends that it expects to distribute on a quarterly basis. The current dividend policy (target 8% NAV) was outlined on *11 May 2020*. The assets in which Volta may invest, either directly or indirectly, include, but are not limited to, corporate credits, sovereign and quasi-sovereign debt, residential mortgage loans, commercial mortgage loans, automobile loans, student loans, credit card receivables, leases, and debt and equity interests in infrastructure projects. The current underlying portfolio risk is virtually all to corporate credit. The investment manager for Volta's assets is AXA Investment Managers Paris, which has a team of experts concentrating on the structured finance markets.

On 11 December 2018, Volta announced that, after due enquiry, it was the opinion of the Board that the company's shares qualified as an "excluded security" under the rules; the company, therefore, is excluded from the FCA's restrictions that apply to non-mainstream pooled investments (NMPIs).

In terms of COVID-19, Volta has made a number of announcements. The 11 March 2020 company *monthly report* included a detailed review of the February performance and the consequences of the COVID-19 crisis on the fund. A further *intra-month trading update* was issued on 24 March 2020. The *dividend was initially cancelled* on 2 April and *NAV announced* on 14 April, reporting a 32.4% monthly decline for March. On *11 May*, a (smaller) dividend was declared and a target 8% NAV payout announced. The *April NAV performance*, reported on 14 May, was +5.7%.

Given the regulatory restrictions on distributing research on this company, the monthly book entry for Volta Finance can be accessed through our website, *Hardman & Co Research*. Our *initiation report*, published on 5 September 2018, can be found on the same site, as can our notes, *Investment opportunities at this point of the cycle* (14 January 2019), *9%+ yield in uncertain times* (7 October 2019), *Follow the money* (3 February 2020), the manager's *March 2019* and *June 2019* presentations, and a *Q&A with Hardman analyst* (12 May 2020), as well as links to our Directors Talk interviews on the company.

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The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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