NATWEST GROUP

Fund Analyst: Rohan Bahl

Fund Chairman: James Tate

FINANCE FOCUSED

BUY: ROBUST CAPITAL POSITION, PROFITABLE STRATEGY AND PROSPECT OF STOCK BUY BACK

Company Overview: NatWest Group

Company Name:	NatWest Group plc
Exchange:	LSE
Ticker:	NWG
Country:	United Kingdom
Sub Industry:	Banking

Company Data:

Price Rating:	Buy
Price Target:	£1.88
Current Price:	£1.50
Upside:	25.1%
Price Date:	11/12/20
52 Week Average:	£1.46
Market Cap:	£18.17 (bn)

Company Overview

- A leading UK bank that covers a variety of services: retail, private, commercial and investment banking.
- NatWest Group was formerly known as RBS group, it rebranded in July 2020 for reputational purposes.
- Following a bailout during the 2008 financial crisis, the UK government owns 62% of NatWest in ordinary shares.
- Undergoing a simplification of its lines of business, NatWest has since returned to profit.
- Majority of profits come from their retail and commercial line.
- Their investment banking arm (NatWest Markets) is a consistent loss maker, despite making 11% of group revenue.
- Has fared well through Covid-19, with lower than expected loan impairment costs, and most mortgages resuming payments despite being on mortgage holidays.

Figure 1: Revenue Breakdown by Business (YE2019)

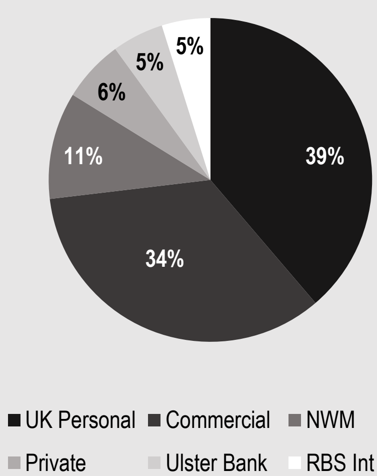
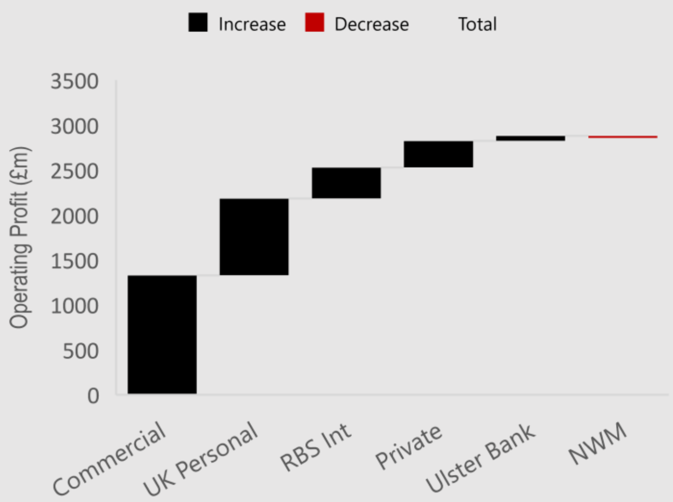


Figure 2: Profit Breakdown by Business (YE2019)



FINANCE FOCUSED

Reasons to Invest in NatWest Group

NatWest Group has seen a complete transformation over the last decade, bouncing back from a reputation in tatters, consistent losses and intense public scrutiny. This has been led by a much-needed shift in strategy, which puts shareholders and profitability first.

Firstly, NatWest has focus on cutting operational costs, with a preference for gains in efficiency rather than reducing their business. This has been effective and has seen NatWest return to profits. Through acting on digitalisation trends in retail banking, NatWest target cutting operational costs by over a third (£3 bn.) over the next 5 years. This also includes scaling back their loss-making NatWest Markets division.

Secondly, with such a robust capital position, strong performance will allow NatWest to buyback the UK government's stake.

1. Able to Absorb Economic Headwinds with Capital to Spare:

- Tier 1 Capital Equity Ratio (CET1), a measure of a bank's financial strength and solvency, stands at 18.2% putting it as the strongest UK bank by capital - £62bn surplus liquidity.
- Solvent position can absorb unexpectedly high impairment losses as the economic effects from Covid-19 deepen.
- NatWest is organised to run at a CET1 of c.14% over the medium to long term, giving a £7.2 - 9bn headroom over this period.
- Spare capital gives the opportunity to partially buy back Government owned shares, which would relieve public scrutiny.

Figure 3: CET1 Ratio vs Competitors 2015-2020

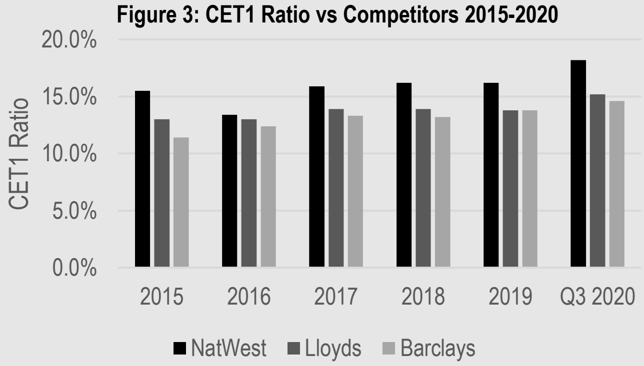
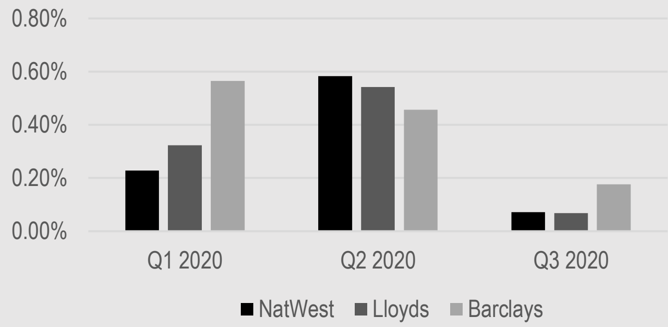


Figure 4: 2020 Loan Impairment to Customer Loans ratio



2. Effective Cost Cutting Strategy Seeing Results:

- Focused on generating shareholder value, targeting an operational cost reduction by £250m by year end.
- Simplifying the group to focus its strengths through scaling back NWM and bolstering its Commercial and Personal lines. This is reflected by a £10bn reduction in NWM's risk weighted assets (RWA) over the medium term, a third of what it is now.
- Reductions in RWA will reduce the scale of the loss making NWM, thus increasing the medium-term profitability.
- Income disposal losses due to NWM scale back set to be £0.6bn over two years, adding to the case of medium-term profitability.

Figure 5: Operating Costs and Net Income (2016-2020)

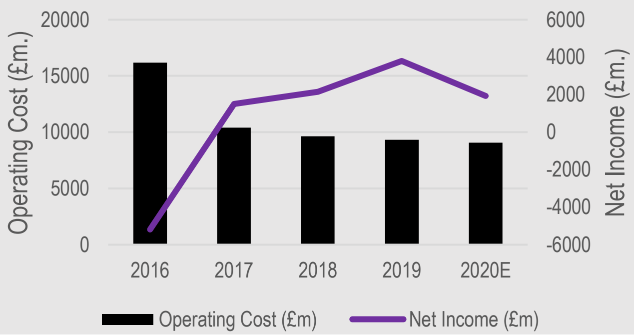
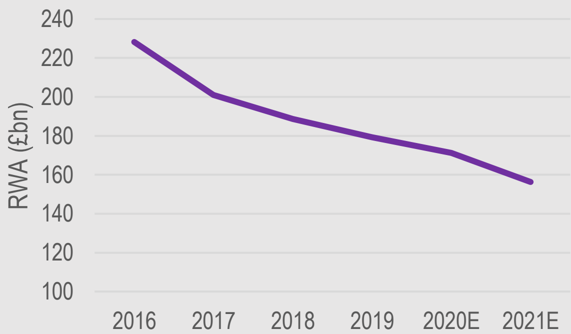


Figure 6: Total RWA Reductions (2016-2021)



FINANCE FOCUSED

NatWest Group Valuation Methodology

We made usage of a comparable analysis to reach our valuation and price target on NatWest Group. This was done for the following reasons:

- Dividends have been frozen for 2020 under a Bank of England ban, therefore a dividend discount model would be inaccurate.
- The price to book ratio is a key valuation metric for banks, as most of their balance sheet is securitised and can be valued according to market prices. Due to the risky nature of some of these assets, banks tend to trade at a discounted price to book value to account for this risk. Since NatWest group is looking to cut back risk from its business, there is a strong case that the extent of this discount is unwarranted, especially considering the 62% government stake.
- NatWest is undervalued compared to its main competitors, despite being in a better position financially, and is set for increased profits, thus justifying its target price.

Figure 7: NatWest Group Comparable Model

Company	P/E (TTM)	P/B (MRQ)
NatWest Group	23.7x	0.4x
Lloyds Bank	32.6x	0.6x
Standard Chartered	26.7x	0.5x
ABN AMRO	41.7x	0.4x
Mean	33.2x	0.48x
Median	29.7x	0.45x
Min	23.7x	0.40x
Max	41.7x	0.60x
Selected Multiple	31.2x	0.48x
NatWest	23.7x	0.4x
Valuation	£1.97	£1.78
Target Price	£1.88	
Upside	25.1%	

Future Catalysts:

- **Q4 Results:** focus on lower than expected impairment costs due to Covid-19, would give a boost in profitability.
- **Stock Buyback from Government:** potential for bolder business strategy following a reduction in public scrutiny.
- **Resumption of Dividends:** regulatory relaxation on dividend payments could see attractive yields.

Investment Risks:

- **Covid-19**: exposure to defaults following the widespread economic effects of Covid-19.
- **Negative Interest Rates:** would severely impact interest income, which has already taken a hit throughout 2020.