

**Buy****Braemar Shipping Services**

Reaping the benefits of diversification

Current price 420p**Target price** 500p

Market cap: £90.1m
Shares in issue: 21.5m
NAV (FY1): £57.1m
Gearing (FY1): -31.3%
Interest cover (FY1): -91.8x

[Full valuation data on back page](#)**Performance**

	Stock	All-Share
1 month:	9.1%	-1.9%
3 month:	25.4%	12.6%
12 month:	44.3%	32.4%
High/low:		
12 months:	420.0p / 200.0p	

Last results: Interims, Oct 09
Next results: Finals, May 10
Next event: IMS, Jan 10

Reuters/BBG: BMS.L / BMS LN**Analyst:**

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Priced at close, 28 October 2009

The recent interim results reassured us that the group remains resilient despite the extraordinary upheaval in the shipping market. Although profits were sharply lower YoY, there were signs of stabilisation compared with H2 2008/09 and the non-broking earnings streams provided further cushioning. In our view, the February 2010E P/E of 8.3x and dividend yield of 5.9% make little allowance for a potential recovery in broking earnings. Our recommendation remains Buy, with a target price of 500p (increased from 450p).

Year to	Sales	PBT	EPS	EPS	DPS	Yield	P/E	EV/EBITDA	VORR
Feb	£m	£m	p	growth %	p	%	x	x	x
2009A	127.1	17.3	62.0	21.0	24.0	5.7	6.8	3.6	0.3
2010E	110.0	14.4	50.6	-18.5	24.8	5.9	8.3	4.7	0.4
2011E	117.1	16.0	54.9	8.6	25.5	6.1	7.6	3.9	0.3
2012E	127.2	18.0	60.6	10.3	28.0	6.7	6.9	3.0	0.3

Source: Arbuthnot estimates, company data

- **Forecasts increased:** At the EPS level, our estimates have increased by 13% for 2010E and by 12% for each of 2011E and 2012E. The main driver of the upgrade is a better-than-expected performance in the non-broking divisions (Technical, Logistics and Environment). Our estimates for the shipbroking division are largely unchanged.
- **Non-broking activities proving their worth:** As with other shipbrokers, Braemar is somewhat cushioned from the fall in shipping rates by its forward order book (struck at higher charter rates and asset values than at present) and its flexible cost base (lower bonuses act as an automatic stabiliser). However, the group has also made significant progress in building profit streams from more stable non-broking activities. This diversification has proved its worth in H1; operating profit from these divisions grew by 18% YoY, compared with broking operating profit which fell by 37% YoY.
- **An attractive and lower-risk route to shipping market exposure:** We consider the shipbroking groups to be the best way to gain exposure to a potential recovery in the shipping market. Although the market as a whole remains over-supplied with capacity, which is highly likely to keep charter rates in check while the market digests the consequences of the recent binge of newbuild orders, we believe higher volumes will offset the impact on the shipbrokers. Both Braemar and Clarkson have commented that their volume trends are favourable. The shipbrokers also benefit from being asset-light (no need to raise capital, refinance debt or time asset purchases) and diversified (exposure to multiple industry segments, all ship sizes and broad client bases), with support from flexible cost bases and strong balance sheets (net cash).
- **Buy, target price increased to 500p:** We view the group's valuation as highly attractive. In our opinion, a February 2010E P/E of 8.3x allows nothing for the potential for a shipping market recovery to lift broking earnings and overlooks the growing importance of the group's more stable non-broking activities. The dividend yield (2010E: 5.9%) is also highly attractive and the payout is well covered (2010E: 2.0x). Our recommendation remains Buy, with a target price of 500p (based on a 10.0x P/E, below the five-year average), increased from 450p.

Overview

Company activities

Braemar Shipping Services is a leading shipbroker and maritime services provider. It has exposure to all key shipping market segments. Its maritime services divisions offer a variety of niche services that provide more stable fee-based revenue to complement the commission-driven broking earnings stream.

Key issues on which investors must take a view

The outlook for the world economy and international trade are the key macro drivers for the group. At the micro level, can the group maintain market-leading positions in its key markets? To what extent will shipping rates recover as trade activity recovers? How secure is the forward order book?

Likely direction of consensus revisions

Unclear. Forecasts remain sensitive to the US dollar exchange rate (all shipbroking revenue is in US dollars), underlying shipping rates, and the overall level of shipping activity. The outlook for all these is uncertain and sensitive to the outlook for the global economy and international trade. Tough market conditions, falling asset prices and tight credit markets mean that some of the forward order book may be at risk.

Valuation and reason behind target price

Our recommendation is Buy, with a target price of 500p based on a P/E of 10.0x, slightly below the five-year average. We view Braemar Shipping Services as an attractive play on an eventual recovery in world trade and the shipping market. In our view, the shares are also highly attractive on a dividend yield basis.

Risks to our view

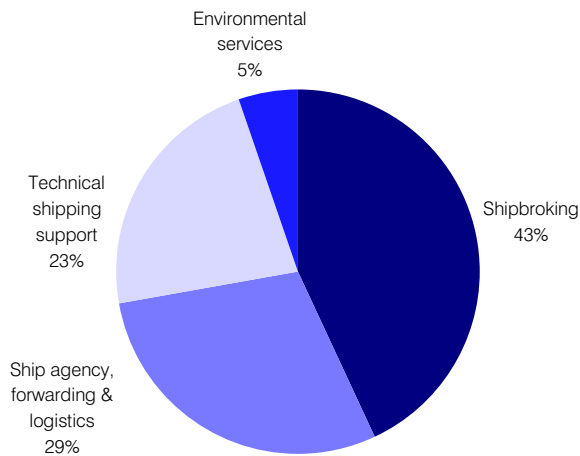
We perceive the key risks as being a further deterioration in the world economy and international trade, depressed shipping rates, and potential cancellations in the forward order book.

Diversification is not always a dirty word

Braemar Shipping Services has successfully pursued a strategy of acquiring and growing services businesses that are related to its core shipping industry expertise, but which have fee-based revenue or conventional trading profit streams. The objective has been to accumulate a portfolio of businesses that are related to the group's core activities, but which have more stable earnings streams than shipbroking commission.

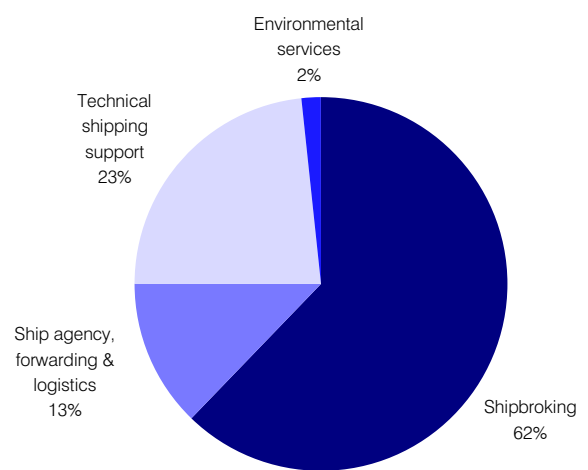
Figures 1 and 2 show the extent to which the group has grown its non-broking activities, from a base of almost zero seven years ago. Our estimates suggest these activities will account for 57% of revenue and 38% of operating profit this financial year.

Figure 1: Divisional revenue (February 2010E)



Source: Arbutnot estimates

Figure 2: Divisional operating profit (February 2010E)



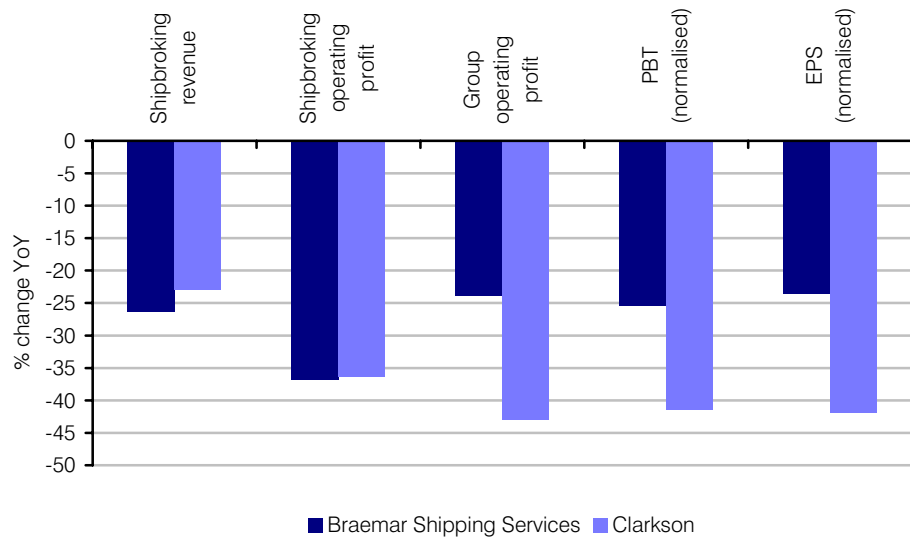
Source: Arbutnot estimates

Contrary to conventional investment wisdom, the presence of non-broking businesses in the group had a significant cushioning effect in H1

Conventional investment wisdom plays down the value of diversification within groups by emphasising the importance of focusing on core activities and the ability of portfolio investors to gain better diversification by directly investing in other quoted companies with different activities. Although we are not challenging this proposition, we note that the presence of non-broking businesses in the group did have a significant cushioning effect in H1.

Figure 3 compares the first-half performance of Braemar Shipping Services and Clarkson on a number of key measures. We accept that time periods under consideration are not identical, and that there are other distorting factors at work, but we believe these shortcomings do not compromise our overall argument. The shipbroking divisions of each group delivered similar performances in terms of declines in revenue (in sterling terms) and operating profit. However, Braemar outperformed Clarkson significantly when the overall group performances are considered, due to Braemar's non-broking divisions growing profits YoY.

Figure 3: H1 performance, Braemar Shipping Services vs. Clarkson



Source: Company data

NB: Braemar Shipping Services: half year to August 2009, Clarkson half year to June 2009

Valuation

Target price increased to 500p from 450p

As a result of the increase in our EPS estimates, we have raised our target price to 500p from 450p. We continue to base our target price on a February 2010E P/E of 10.0x, which is slightly below the five-year average for the group (10.9x). However, we note that this average is depressed by the extremely low P/E the shares have traded on during the past year.

Figure 4: Five-year FY1 P/E chart (consensus estimates)



Source: Datastream

Financials

Changes to estimates

Changes to our headline estimates are summarised in Table 1 below.

The main driver of our estimate revisions was the performance of the group's non-broking divisions. These exceeded our expectations at the interim stage, collectively growing operating profit by 18% YoY compared with shipbroking operating profit, which fell by 37% YoY in the half-year to August 2009. We have rolled forward the better performance into H2 and beyond, and left our Shipbroking estimates largely unchanged.

Other changes to our estimates include a slightly lower number of shares (which accounts for the larger percentage upgrade at the EPS level compared with the PBT level) and a higher dividend forecast, reflecting the 3% increase in the interim dividend and our assumption that dividend cover of around 2x will be targeted.

Table 1: Summary of changes to estimates

Year end February (£m)	2010E	2011E	2012E
New PBT (normalised)	14.4	16.0	18.0
Old PBT (normalised)	13.2	14.9	16.7
<i>% change</i>	<i>8.9</i>	<i>7.4</i>	<i>8.2</i>
New EPS (normalised) (p)	50.6	54.9	60.6
Old EPS (normalised) (p)	44.8	49.3	54.0
<i>% change</i>	<i>12.7</i>	<i>11.5</i>	<i>12.2</i>
New DPS (p)	24.8	25.5	28.0
Old DPS (p)	24.0	24.0	24.0
<i>% change</i>	<i>3.1</i>	<i>6.2</i>	<i>16.7</i>

Source: Arbutnot estimates

Main driver of our estimate revisions was the performance of the group's non-broking divisions

Table 2: Income statement

Year end February (£m)	2008	2009	2010E	2011E	2012E	Growth (%)		
						2010E	2011E	2012E
Revenue								
Shipbroking	52.8	60.4	47.5	49.9	54.9	(21.4)	5.0	10.0
Ship agency, forwarding & logistics	27.9	40.8	31.8	35.0	38.5	(22.0)	10.0	10.0
Technical shipping support	9.5	21.2	25.0	26.3	27.6	18.0	5.0	5.0
Environmental services	10.8	4.7	5.7	6.0	6.3	20.0	5.0	5.0
Group revenue	101.0	127.1	110.0	117.1	127.2	(13.5)	6.4	8.6
Operating margin (%)								
Shipbroking	24.8	24.8	22.5	24.0	25.0			
Ship agency, forwarding & logistics	4.1	2.8	7.0	7.0	7.0			
Technical shipping support	8.9	19.6	16.0	16.0	16.0			
Environmental services	17.3	(3.5)	5.0	5.0	5.0			
Group operating margin	14.3	13.2	12.9	13.5	14.0			
Operating profit								
Shipbroking	13.1	15.0	10.7	12.0	13.7	(28.7)	12.0	14.6
Ship agency, forwarding & logistics	1.2	1.1	2.2	2.5	2.7	97.1	10.0	10.0
Technical shipping support	0.8	4.2	4.0	4.2	4.4	(3.7)	5.0	5.0
Environmental services	1.9	(0.2)	0.3	0.3	0.3	272.5	5.0	5.0
Group operating profit	14.4	16.8	14.2	15.8	17.8	(15.4)	11.1	13.1
Net finance income	0.4	0.3	0.2	0.2	0.2	(46.9)	0.0	0.0
JVs & associates	0.4	0.2	0.1	0.1	0.1	(70.0)	5.0	5.0
PBT (normalised)	15.2	17.3	14.4	16.0	18.0	(16.7)	10.9	12.9
Exceptional items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit on disposal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PBT	14.7	16.2	13.1	14.6	16.7	(19.5)	12.0	14.1
Tax	(4.8)	(4.7)	(3.9)	(4.4)	(5.0)	rate 30.2	30.0	30.0
Profit after tax	9.9	11.5	9.1	10.2	11.7	(20.9)	12.4	14.1
Minority interests	(0.1)	(0.1)	(0.0)	(0.0)	(0.1)	(20.0)	5.0	5.0
Attributable profit	9.8	11.5	9.1	10.2	11.6	(20.9)	12.4	14.1
EPS (normalised) (p)	51.2	62.0	50.6	54.9	60.6	(18.5)	8.6	10.3
EPS (p)	49.0	56.7	44.0	48.5	54.2	(22.5)	10.2	11.9
EPS (fully diluted, normalised) (p)	50.9	60.9	49.7	54.0	59.5	(18.5)	8.6	10.3
EPS (fully diluted) (p)	48.7	55.7	43.2	47.6	53.3	(22.5)	10.2	11.9
DPS (p)	23.0	24.0	24.8	25.5	28.0	3.1	3.0	9.8

Source: Company data, Arbutnot estimates

Table 3: Balance sheet

As at end February (£m)	2008	2009	2010E	2011E	2012E
Non-current assets	36.8	41.6	40.2	38.8	37.2
Current assets	52.6	63.4	58.0	67.7	81.0
Total assets	89.3	105.0	98.2	106.5	118.3
Current liabilities	46.6	49.6	38.7	42.2	48.2
Non-current liabilities	1.2	2.4	2.4	2.4	2.4
Total liabilities	47.8	52.0	41.1	44.6	50.6
Net assets	41.5	52.9	57.1	61.9	67.7
Equity shareholders' funds	41.2	52.8	56.9	61.8	67.6
Minority interests	0.3	0.1	0.1	0.1	0.1
Total shareholders' funds	41.5	52.9	57.1	61.9	67.7
Net debt (cash)	(21.2)	(25.2)	(17.8)	(25.6)	(36.8)

Source: Company data, Arbutnot estimates

Table 4: Cash flow statement

Year end February (£m)	2008	2009	2010E	2011E	2012E
Operating activities					
Group operating profit	14.0	15.7	12.8	14.4	16.5
Depreciation & amortisation	1.1	2.0	2.4	2.5	2.5
Movement in working capital	5.8	2.7	(11.0)	1.5	3.0
Other	0.4	0.6	0.6	0.6	0.7
Cash generated by operations	21.2	21.0	4.9	19.0	22.6
Tax	(4.6)	(6.2)	(4.7)	(4.0)	(4.7)
Interest paid	0.4	0.3	0.2	0.2	0.2
Net cash flow from operating activities	17.0	15.0	0.3	15.1	18.1
Investing activities					
Investments	0.1	(0.0)	0.4	0.0	0.0
Capex	(1.0)	(1.2)	(1.0)	(1.0)	(1.0)
Acquisitions and disposals	(4.3)	(5.1)	(1.7)	(1.0)	0.0
Net cash flow from investing activities	(5.2)	(6.4)	(2.3)	(2.0)	(1.0)
Financing activities					
Issue/repurchase of shares	(0.7)	(0.8)	0.0	0.0	0.0
Movement in debt & leases	0.0	0.0	0.0	0.0	0.0
Dividends paid to minorities	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)
Equity dividends paid	(4.1)	(4.9)	(5.0)	(5.3)	(5.8)
Cash flow from financing	(4.9)	(5.7)	(5.0)	(5.4)	(5.8)
Change in cash for the period	6.9	2.9	(7.0)	7.8	11.2

Source: Company data, Arbutnot estimates

Ratios

Table 5: Key valuation ratios

Year end February (x)	2010E	2011E	2012E
P/E (normalised)	8.3	7.6	6.9
P/CF (gross)	123.8	5.8	5.0
P/CF (free)	(288.0)	6.3	5.3
P/Sales	0.8	0.8	0.7
P/Book	1.6	1.5	1.4
EV/EBITDA	4.6	4.2	3.7
EV/EBITA	5.0	4.5	4.0
EV/Sales	0.6	0.6	0.6
EV/CF (gross)	129.4	4.7	3.9
EV/CF (free)	(154.9)	5.0	4.2
FCF yield (%)	(0.6)	19.8	24.0
FCF yield to equity (%)	(0.3)	16.0	19.3
Dividend yield (%)	5.9	6.1	6.7
Dividend cover (normalised)	2.0	2.2	2.2
Dividend cover	1.8	1.9	1.9

Source: Arbutnot estimates

Table 6: Profit margins

Year end February (%)	2008	2009	2010E	2011E	2012E
Operating margin	14.3	13.2	12.9	13.5	14.0
EBITDA margin	15.0	13.9	13.8	14.4	14.9
Pre-tax margin	15.0	13.6	13.1	13.7	14.2
Net margin	10.1	9.9	9.5	9.9	10.2

Source: Company data, Arbutnot estimates

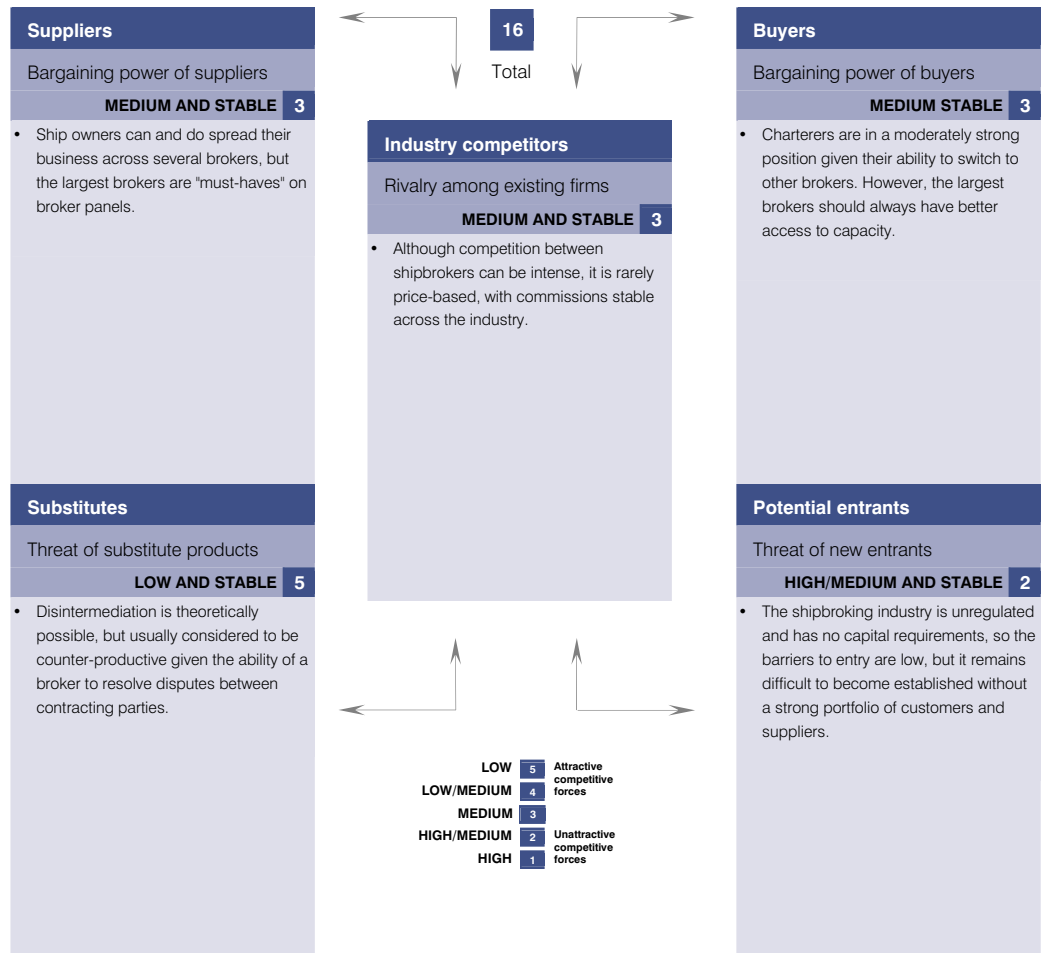
Table 7: Return on capital measures

Year end February (%)	2008	2009	2010E	2011E	2012E
ROE (closing)	24.8	23.7	18.3	18.7	19.2
ROE (average)	26.5	26.7	19.0	19.5	20.1
ROCE (closing)	70.9	60.4	36.2	43.4	57.6
ROCE (average)	68.8	69.7	42.4	41.7	53.0

Source: Company data, Arbutnot estimates

Analysis of the strategic environment

Porter's five competitive forces model



Source: Arbutnot (adapted from Porter 1980 p.4); 'Total box' represents sum of five forces: 25 = attractive industry, 5 = competitive industry

SWOT analysis

<p>Strengths</p> <ul style="list-style-type: none"> A well-diversified shipbroking business with exposure to all key markets. Strong balance sheet with no debt. 	<p>Weaknesses</p> <ul style="list-style-type: none"> Slightly less well diversified in shipbroking than Clarkson.
<p>Threats</p> <ul style="list-style-type: none"> Excessive diversification away from the core shipbroking activities may lead to management distraction. 	<p>Opportunities</p> <ul style="list-style-type: none"> Weak markets offer opportunities to make acquisitions at more reasonable prices. Further acquisitions in maritime services.

Source: Arbutnot

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Chief executive		Sales and trading	
Neil Kirton	020 7012 2108	Sales	
Research		Simon Wickham (Head of sales)	020 7012 2038
Head of research		David George	020 7012 2039
Xavier Gunner	020 7012 2083	Melanie Sharp	020 7012 2092
Alternative energy & technology		Nicholas Feldman	020 7012 2045
David Cunningham	020 7012 2082	Jonathan Clements	020 7012 2044
Emerging companies		Darren Winter	020 7012 2042
Robert Sanders	020 7012 2084	Matt Hasson (Natural resources)	020 7012 2037
Oliver Cummings	020 7012 2078	Sales trading	
Engineering; electronics; tech hardware; aerospace & defence		Paul Kersey (Head of sales trading)	020 7012 2030
Michael Blogg	020 7012 2091	David Llewellyn	020 7012 2031
Housebuilders & contractors		Lisa Letham	020 7012 2029
Kate Moy	020 7012 2074	Mark Barnes	020 7012 2019
Mining		Trading	
John McGloin	020 7012 2090	Bobby Tipping (Head of trading)	020 7012 2017
Tim Dudley	020 7012 2097	Andy Lewis	020 7012 2028
Oil & Gas		Edward Malone	020 7012 2027
Dougie Youngson	020 7012 2098	Investment funds	
Real estate		Sales	
Nan Rogers	020 7012 2096	Rupert Stevenson (Head of investment funds)	020 7012 2014
Support services: recruitment, automotive & related tech		Matthew Kinkead	020 7012 2013
Xavier Gunner	020 7012 2083	Adam Gill	020 7012 2025
Support services: consultancy, managed services		Trading	
David Brockton	020 7012 2093	Calum Summers (Market making)	020 7012 2009
Transport		Darren Papper	020 7012 2015
Gerald Khoo	020 7012 2089	Research	
Special situations		Chris Young	020 7012 2016
Sneha Shah	020 7012 2081		

Explanation of recommendations

Our analysts award a Strong Buy rating in those cases where they believe there will be total shareholder return - defined as the absolute rise in share prices plus dividend payment - in excess of 20% over a 12-month period. We assign a stock a Buy recommendation where our analysts believe there will be a total shareholder return of 10% or more over a 12-month period. We apply a Neutral recommendation where we anticipate a shareholder return of between plus 10% and minus 10%. We assign a Reduce recommendation where we anticipate a shareholder return of between minus 10% and minus 20%. Our Sell recommendation implies an expected shareholder loss over a 12-month period of 20% or more. Analysts have assigned a 'trading view' to stocks that they think might move materially within the following ten trading days; possibly in response to a move in currency, sentiment, or a specific event. The trading view is a short-term suggestion and does not contradict the 'recommendation'.

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Arbuthnot recommendation proportions in last quarter

All stocks excluding AIM		Corporate stocks excluding AIM	
Strong Buy	16.1%	Strong Buy	55.8%
Buy	38.0%	Buy	41.9%
Neutral	40.4%	Neutral	2.3%
Reduce	5.5%	Reduce	0.0%
Sell	0.0%	Sell	0.0%

Source: Arbuthnot

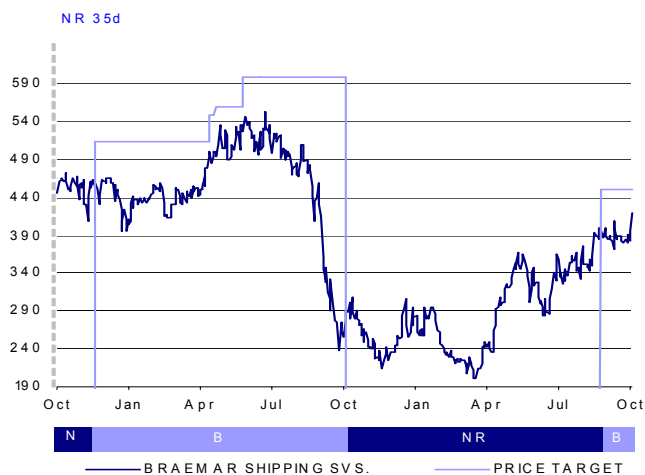
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Company valuation ratios (x)	2010E	2011E
EV/Sales	0.7	0.6
EV/EBITDA	4.7	3.9
EV/EBITDA REL	0.8	0.7
P/E	8.3	7.6
P/E rel	0.9	0.9
P/CEPS	-107.3	6.4
P/NAV	1.6	1.5
EV/IC	1.2	1.0
ROIC (%)	17.3	17.8
ROIC/WACC	2.9	3.0
VORR	0.4	0.3
3-year PEG	-8.5	
Trend PEG	1.1	
3-year CASH PEG	1.1	
Trend CASH PEG	1.1	
EV/Sales/G	28.1	
Industry attractiveness /25	16	

Source: Arbutnot estimates; growth rates from last actual

Share price and recommendation tracker graph (two years)



Source: Thomson Financial, Arbutnot

Summary financial data, year to Feb (£m)	2009A	2010E	2011E	2012E
Sales	127.1	110.0	117.1	127.2
EBITDA	17.7	15.2	16.9	19.0
Operating Margin (%)	12.3	11.7	12.3	12.9
EBIT	15.7	12.8	14.4	16.5
Interest charge	0.3	0.2	0.2	0.2
PBT	17.3	14.4	16.0	18.0
Tax rate (%)	29.0	30.2	30.0	30.0
Underlying tax rate	27.2	27.4	27.5	27.7
NOPLAT	12.2	10.3	11.4	12.9
Profit after tax	12.6	10.5	11.6	13.0
Reported EPS (p)	56.7	44.0	48.5	54.2
Underlying EPS (p)	62.0	50.6	54.9	60.6
Underlying EPS YoY growth (%)	21.0	-18.5	8.6	10.3
DPS (p)	24.0	24.8	25.5	28.0
Basic no. of shares (m)	21.0	21.5	21.9	22.3
Fully diluted no. of shares (m)	20.6	21.0	21.4	21.8
Operating cashflow	21.0	4.9	19.0	22.6
Depreciation	1.0	1.1	1.1	1.2
Provision utilisation	0.1	0.0	0.0	0.0
Change in working capital	2.7	-11.0	1.5	3.0
Cash tax paid	-6.2	-4.7	-4.0	-4.7
Capex	-1.2	-1.0	-1.0	-1.0
Asset disposals	0.0	0.0	0.0	0.0
Cash earnings	13.5	-0.8	14.0	16.9
CEPS (p)	65.7	-3.9	65.3	77.5
Fixed tangible assets	6.2	6.1	6.0	5.9
Goodwill	32.1	30.8	29.4	28.0
Other assets	66.7	61.3	71.0	84.4
Total assets	105.0	98.2	106.5	118.3
Current liabilities	49.6	38.7	42.2	48.2
Long-term liabilities	2.4	2.4	2.4	2.4
All liabilities	52.0	41.1	44.6	50.6
Net debt	-25.2	-17.8	-25.6	-36.8
Gearing (%)	-47.7	-31.3	-41.4	-54.5
Net asset value	52.9	57.1	61.9	67.7

Source: Company data, Arbutnot estimates