

Equities

11 August 2011 | 24 pages

Royal Bank of Scotland Group PLC (RBS.L)

Irish Woes

- Company Update
- Target Price Change
- Estimate Change

■ **Results Disappoint on Credit Quality** — RBS reported a weak set of 1H11 results. Although revenues were better than expected, this was mainly driven by non-recurring trading income from the non-core division, reflecting gains on a number of securities arising from restructured assets. Meanwhile, GBM revenues saw a sharp decline qoq and provisions were much heavier than anticipated, driven by higher impairments in UK Corporate (core) and Ulster Commercial Real Estate (non-core).

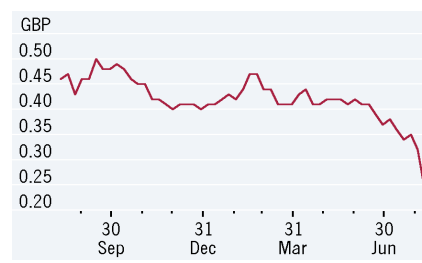
■ **Non-Core Run-Off** — Total third-party assets are down to £113bn, from £138bn at end-2010. Disposal losses on these assets have been small, partly in our opinion because RBS has been able to focus on 'low hanging fruit' from the markets, corporate & retail divisions. In contrast, CRE assets have proved more 'sticky'. We expect losses to increase going forward, as portfolio divestments become increasingly challenging.

■ **Ireland** — Ulster remains the key driver of non-core impairments. At end-June, Ulster had £52bn of loans outstanding, including £18bn CRE. In 2Q11, the large increase in Ulster provisions was attributed to a 'deep-dive' region-by-region analysis performed on Irish land exposure. CRE is likely to remain the primary driver of loan defaults in the Ulster book, in our opinion, with NPL formation still climbing. That said, RBS coverage ratios (52% CRE, 54% corporate, 38% mortgages) are either in-line or superior to peers.

■ **Buy Rating** — We lower our operating profit forecasts by 19% in 2011, 17% 2012, 9% 2013 and 7% 2014, due to a lower revenue contribution from GBM and the assumption that provisions remain elevated for longer. Correspondingly, we reduce our target price to 46p (from 50p). We believe that complexities at RBS are reducing, and although the economic outlook remains uncertain, the company does appear to be gradually turning the corner in terms of operating performance. We reiterate our Buy rating.

Buy/Medium Risk	1M
Price (11 Aug 11)	£0.24
Target price	£0.46
	from £0.50
Expected share price return	92.3%
Expected dividend yield	0.0%
Expected total return	92.3%
Market Cap	£26,526M
	US\$42,795M

Price Performance (RIC: RBS.L, BB: RBS LN)



Royal Bank of Scotland Group PLC (GBP)

Year to 31 Dec	2009A	2010A	2011E	2012E	2013E
Net Income (£M)	-6,551.2	76.0	932.8	3,620.3	5,881.1
Diluted EPS (p)	-11.9	0.1	0.9	3.4	5.4
Diluted EPS (Old) (p)	-11.9	0.1	2.0	4.1	6.0
PE (x)	-2.0	341.0	27.8	7.2	4.4
P/BV (x)	0.4	0.4	0.4	0.4	0.3
DPS (p)	0.0	0.0	0.0	1.0	2.0
Net Div Yield (%)	0.0	0.0	0.0	4.2	8.3
ROE (%)	-6.3	-1.6	-2.2	3.8	7.6

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	-2.0	nm	27.8	7.2	4.4
P/E reported (x)	-3.8	nm	-16.7	9.5	4.6
P/BV (x)	0.4	0.4	0.4	0.4	0.3
P/Adjusted BV diluted (x)	0.4	0.4	0.4	0.4	0.3
Dividend yield (%)	0.0	0.0	0.0	4.2	8.3
Per Share Data (p)					
EPS adjusted	-11.9	0.1	0.9	3.4	5.4
EPS reported	-6.4	-1.0	-1.4	2.5	5.2
BVPS	65.1	65.5	65.0	67.5	71.4
Tangible BVPS	51.3	52.0	51.4	53.9	57.9
Adjusted BVPS diluted	64.8	65.2	64.7	67.2	71.1
DPS	0.0	0.0	0.0	1.0	2.0
Profit & Loss (£M)					
Net interest income	13,567	14,200	13,166	12,977	13,359
Fees and commissions	5,948	5,983	5,755	5,778	6,237
Other operating Income	5,695	7,696	7,907	7,387	7,777
Total operating income	25,210	27,879	26,827	26,142	27,374
Total operating expenses	-17,401	-16,712	-15,681	-15,060	-15,118
Oper. profit bef. provisions	7,809	11,167	11,146	11,082	12,256
Bad debt provisions	-13,899	-9,256	-8,013	-5,004	-2,930
Non-operating/exceptionals	3,799	-2,162	-4,128	-1,835	-910
Pre-tax profit	-2,291	-251	-995	4,242	8,416
Tax	339	-663	-566	-1,123	-2,112
Extraord./Min. Int./Pref. Div.	-1,655	-213	7	-400	-647
Attributable profit	-3,607	-1,127	-1,554	2,720	5,656
Adjusted earnings	-6,551	76	933	3,620	5,881
Growth Rates (%)					
EPS adjusted	43.9	100.6	nm	288.1	62.4
Oper. profit bef. prov.	nm	43.0	-0.2	-0.6	10.6
Balance Sheet (£M)					
Total assets	1,522,481	1,452,634	1,432,948	1,324,881	1,291,175
Avg interest earning assets	753,036	689,958	669,195	639,567	606,689
Customer loans	554,654	502,748	477,186	429,714	417,577
Gross NPLs	34,989	38,598	42,458	36,089	27,067
Liab. & shar. funds	1,522,481	1,452,634	1,432,948	1,324,881	1,291,175
Total customer deposits	414,251	428,599	440,425	439,498	460,702
Reserve for loan losses	15,173	18,182	20,000	17,000	12,750
Shareholders' equity	77,736	75,132	74,615	77,326	81,549
Profitability/Solvency Ratios (%)					
ROE adjusted	-11.4	0.1	1.3	5.1	7.9
Net interest margin	1.80	2.06	1.97	2.03	2.20
Cost/income ratio	69.0	59.9	58.5	57.6	55.2
Cash cost/average assets	0.9	1.1	1.1	1.1	1.2
NPLs/customer loans	6.3	7.7	8.9	8.4	6.5
Reserve for loan losses/NPLs	43.4	47.1	47.1	47.1	47.1
Bad debt prov./avg. cust. loans	2.2	1.8	1.6	1.1	0.7
Loans/deposit ratio	133.9	117.3	108.3	97.8	90.6
Tier 1 capital ratio	14.4	12.9	14.0	14.5	16.5
Total capital ratio	16.3	14.0	14.6	13.6	15.4

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Irish Woes

1H11 Results and 2H11 Forecasts

RBS reported a weak set of 1H11 results. While total income was better than expected, this was mainly driven by non-core trading income, reflecting gains on a number of securities arising from restructured assets. We do not expect this to recur. Meanwhile, provisions were much heavier than anticipated (Figure 1), mainly driven by further impairments at Ulster. We elaborate further on asset quality in the following sections.

Figure 1. RBS – Group Quarterly P&L , 1Q10-2Q11 (£m)

£m	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	% QoQ	% YoY	% vs CIRA	% vs Cons
Income (pre claims)	9,123	8,163	7,917	7,459	8,033	7,767	-3%	-5%	5%	5%
Claims	(1,136)	(1,323)	(1,142)	(1,182)	(912)	(793)	-13%	-40%	-12%	-12%
Income net of claims	7,987	6,840	6,775	6,277	7,121	6,974	-2%	2%	7%	7%
Operational expenses	(4,430)	(4,103)	(4,096)	(4,081)	(4,121)	(3,892)	-6%	-5%	0%	0%
Gross operating profit	3,557	2,737	2,679	2,196	3,000	3,082	3%	13%	17%	19%
Impairments	(2,675)	(2,487)	(1,953)	(2,141)	(1,947)	(2,264)	16%	-9%	28%	19%
PBT pre FVO	882	250	726	55	1,053	818	-22%	227%	-5%	2%
FVO	(169)	619	(858)	582	(480)	339	-171%	-45%		
PBT inc FVO	713	869	(132)	637	573	1,157	102%	33%		
Other items	(734)	288	(1,247)	(643)	(692)	(1,835)				
PBT as-reported	(21)	1,157	(1,379)	(6)	(119)	(678)	470%	-159%		
Tax	(107)	(825)	261	3	(423)	(222)				
Minorities, pref div & discontinued	(120)	(75)	(28)	15	14	3				
Attributable Profit	(248)	257	(1,146)	12	(528)	(897)	70%	-449%		

Source: Company Reports, CIRA Estimates and Company Collected Consensus

We forecast a second half pre-tax profit (pre FVO) of £1,262m vs £1,871m in 1H11. We outline our key assumptions below.

We expect to see a decline in revenues and assume provisions remain elevated for longer.

- **Revenues.** We forecast 2H11 total income, net of claims of £14.8bn, down 9% HoH. This is almost entirely driven by an assumption of weaker non-core and GBM revenues. In non-core, we forecast 2H11 revenues of £0.5bn vs £1.2bn in 1H11. This is driven by disposal losses of c£250m per quarter, compared to gains in the first half (including a £505m recovery in 2Q11). In GBM, we assume the subdued trading environment continues (July performance has been described as “poor”), with 2H11 revenues of c£3.2bn per quarter, compared to £3.9bn in 1H11. We expect to see broadly stable net interest margins in core retail & commercial.
- **Costs.** We forecast total expenses of £7.7bn in 2H11 vs £8.0bn in 1H11, mainly driven by lower costs in GBM (£1.6bn vs £1.9bn). On the post-results call management confirmed that there was some flexibility in the annual reward projection, which has already been lowered, and that headcount would also be reviewed. Media reports (Telegraph, 10 August) have suggested a headcount reduction of 2,000 in GBM over the next 18 months, from the current 19,000 (13% of group).
- **Provisions.** We expect a small improvement in provisions in the second half (£3.8bn vs £4.2bn). However, following the 2Q11 disappointment, we have increased our provision forecast, to £8.0bn for the full-year.

Asset Quality Concerns

Provisions increase driven by CRE

Similar to Lloyds, the main disappointment to arise from RBS' 1H11 results was an uptick in provisions, driven by the non-core business (Figure 2). While Lloyds' provisions were mainly attributable to the wholesale portfolio, UK Corporate and especially Irish CRE were the main culprits at RBS. More specifically, UK Corporate suffered from "individual corporate cases and lower releases", while the increase in non-core impairments was "due primarily to Irish land value provision and some individual corporate cases". However, at the same time management commented "we are hopeful that the corner has [in Ireland] has turned ... there are the first signs in economic statistic terms of that".

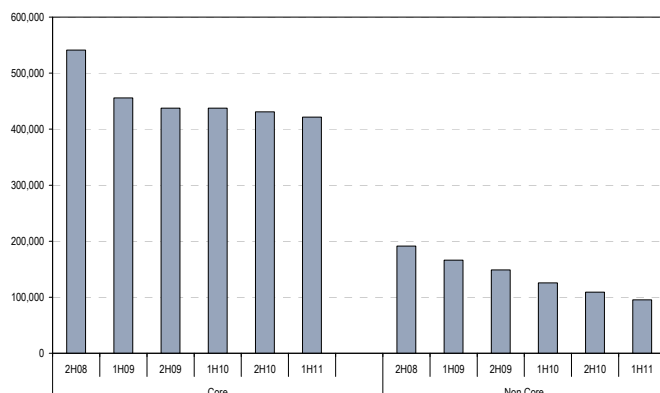
Asset quality trends remain unconvincing. After some signs of stabilisation towards the end of 2010, NPL formation has again accelerated in 1H11, both in core and non-core (Figure 5). Meanwhile, although the non-core coverage ratio continues to improve, the opposite is true of the core business (Figure 6).

Figure 2. RBS – Core and Non Core P&L Impairments, 1Q10-2Q11 (£'m)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	%QoQ	%YoY
Core	971	1,097	782	930	872	853	-2%	-22%
Non Core	1,704	1,390	1,171	1,211	1,075	1,411	31%	2%
Total	2,675	2,487	1,953	2,141	1,947	2,264	16%	-9%

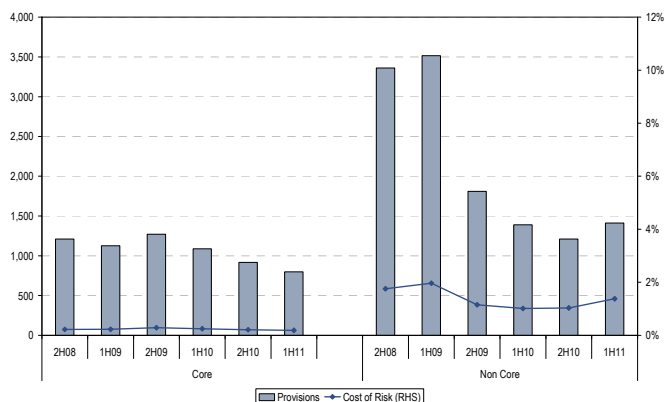
Source: Company Reports

Figure 3. RBS Core vs Non Core –Loans by Division (£m)



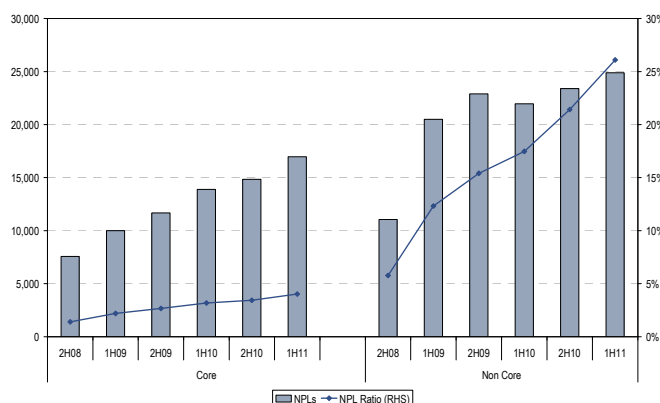
Source: Company Reports and CIRA Estimates

Figure 4. RBS Core vs Non Core – P&L Provs (£m) and Cost of Risk



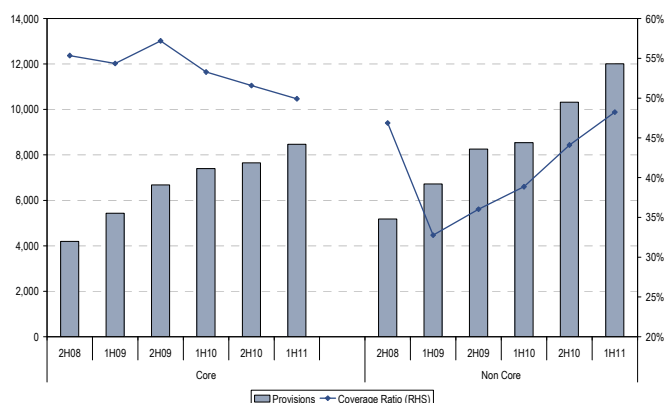
Source: Company Reports and CIRA Estimates

Figure 5. RBS Core vs Non Core – NPLs (£m) and NPL Ratio



Source: Company Reports and CIRA Estimates

Figure 6. RBS Core vs Non Core – B/S Provs (£m) and Coverage Ratio



Source: Company Reports and CIRA Estimates

Stable Core Provisions

Stable core provisions but NPLs at Ulster and in UK Corporate are climbing

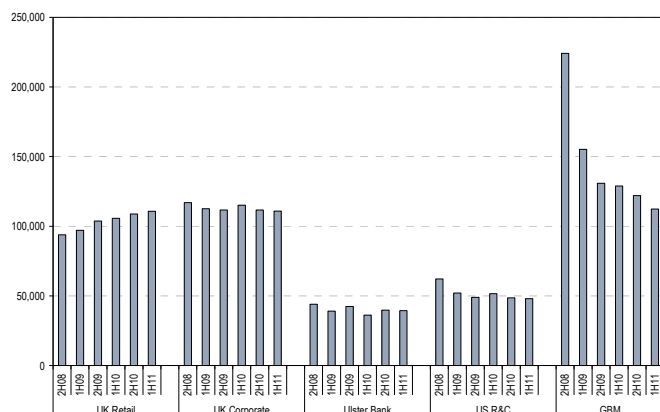
While overall provisions were stable in the core business qoq, this was mainly a reflection of lower impairments in Ulster and US R&C, offsetting higher impairments in GTS and UK Corporate (Figure 7). More alarming is the large increase in NPLs in Ulster bank and UK Corporate (Figure 10), combined with the decline in coverage ratios at the latter (Figure 11).

Figure 7. RBS – Core P&L Impairments, 1Q10-2Q11 (£'m)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	%QoQ	%YoY
UK Retail	387	300	251	222	194	208	7%	-31%
UK Corporate	186	198	158	219	105	218	+108%	10%
Wealth	4	7	1	6	5	3	-40%	-57%
GTS	0	3	3	3	20	54	170%	1700%
Ulster Bank	218	281	286	376	461	269	-42%	-4%
US R&C	143	144	125	105	110	66	-40%	-54%
GBM	32	164	-40	-5	-24	37	na	-77%
Central Items	1	0	-2	4	1	-2	na	na
Total	971	1097	782	930	872	853	-2%	-22%

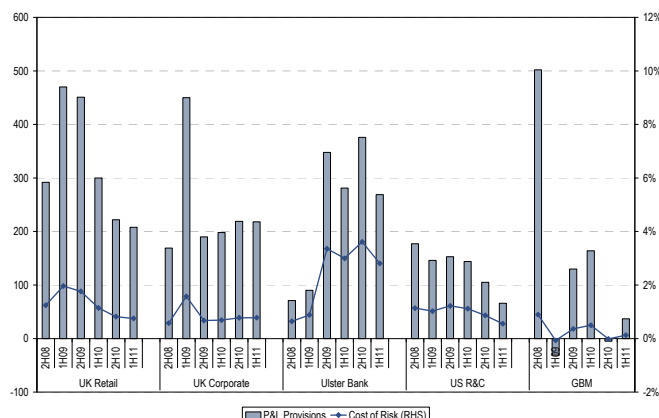
Source: Company Reports

Figure 8. RBS Core – Gross Loans by Division (£m)



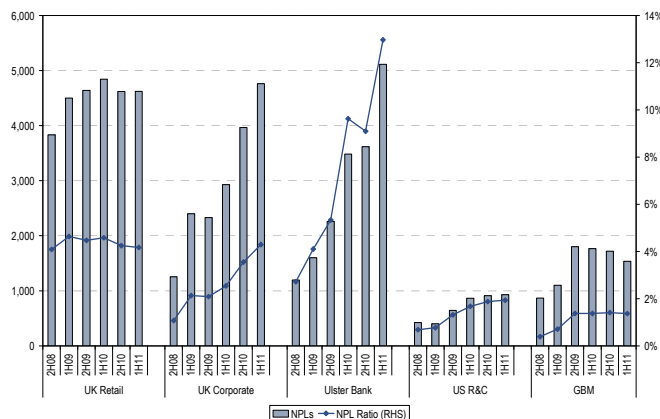
Source: Company Reports and CIRA Estimates

Figure 9. RBS Core – P&L Provisions by Division (£m) and Cost of Risk



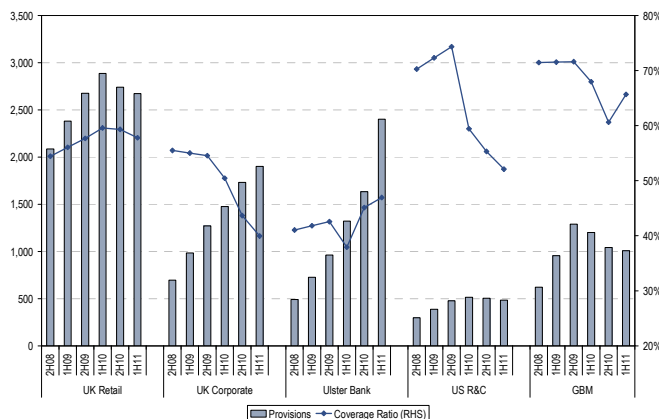
Source: Company Reports and CIRA Estimates

Figure 10. RBS Core – NPLs by Division (£m) and NPL Ratio



Source: Company Reports and CIRA Estimates

Figure 11. RBS Core – B/S Provs by Division (£m) and Coverage Ratio



Source: Company Reports and CIRA Estimates

UK Corporate

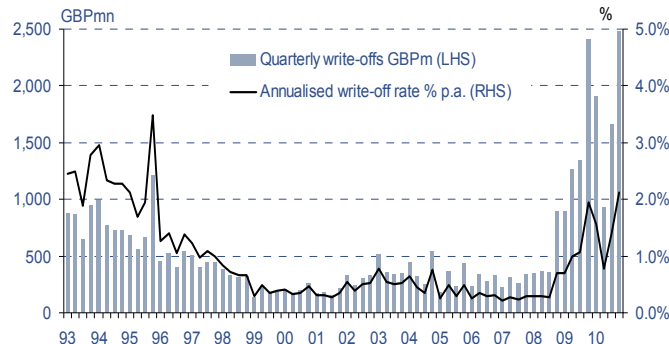
Evidence of recent deterioration in UK corporate credit quality

The pattern of loan losses on UK books has been very different in this recession, in terms of timing, than in previous downturns. We suspect that the drivers of this have been a combination of the following:

- The corporate sector entered the current downturn with a higher level of return on capital than at any time in the past 40 years, with net returns on capital employed of around 14% in aggregate in 2007, compared with 11-12% before the 1990s recession and only 8% before the early 1980s recession.
- A higher service-sector bias in the economy, which has a lower proportion of fixed costs and hence less operating leverage. Combined with a more flexible labour force and rewards structure, this has helped to keep the UK's rate of unemployment at only 7.8%.

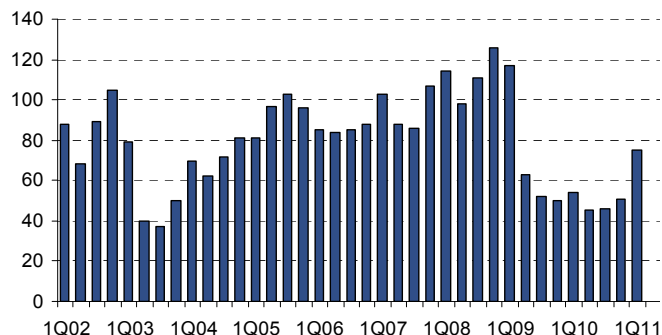
Notwithstanding these general comments, there is evidence of a recent deterioration in credit quality within the company sector (especially retail). The BoE data on bank write-offs of company loans has risen again recently, perhaps foreshadowing a rise in the official liquidation statistics. A quarterly survey from Ernst & Young on profit warnings among quoted sector companies showed something of a jump recently (Figure 13).

Figure 12. Quarterly write-offs by UK banks of loans to private non-financial corporations



Source: Bank of England

Figure 13. UK quoted company profit warnings per quarter

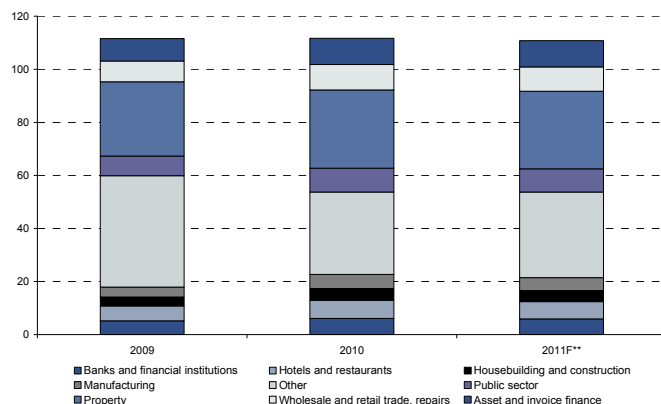


Source: Ernst & Young

Until 2Q11, RBS' Core UK Corporate impairments were trending down despite a recent uptick in company profit warnings and write offs by banks. We believe the deterioration has instead mainly been reflected in the non core division where UK Corporate impairments have shown a more notable increase. We also believe that it reflects the 'lumpy' nature of corporate exposures where individual credits can materially affect the impairment line in the quarter. Although, as RBS pointed out in a recent investor seminar on UK Corporate, single name concentrations have been reduced by almost half over the 2009/10 period.

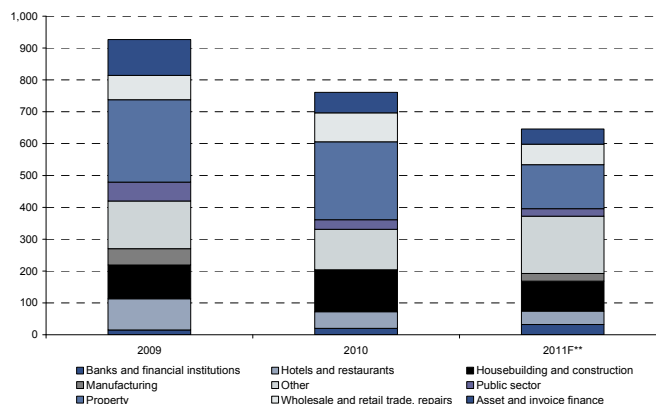
We believe current problems in credit quality will appear in certain sectors, specifically SME and retail. We therefore expect UK Corporate impairments to remain elevated in the coming quarters.

Figure 14. RBS – UK Corporate Gross Loans by Sector, 2009-11F (£'bn)



Source: Company Reports and CIRA Estimates, Note: 2011F is same as 1H11

Figure 15. RBS – UK Corporate Impairments by Sector, 2009-11F (£'bn)



Source: Company Reports and CIRA Estimates, Note: 2011F is 1H11 annualised

Elevated Provisions in Non-Core

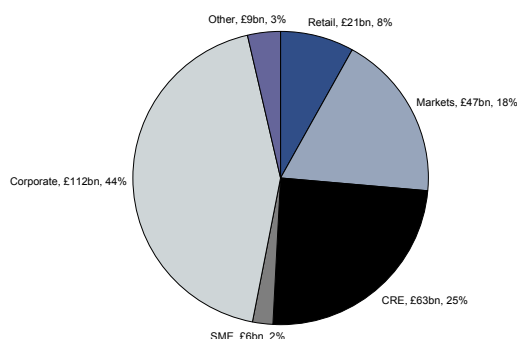
Good progress on non-core run-off but disposal losses likely to increase

Progress continues on the non-core run-off, with total third-party assets (ex derivatives) now down to £113bn, from £125bn at end-March and £138bn at end-2010. Management target c£96bn by the end of the year and £20-40bn by end-2013. The aim of the division is to preserve capital, weighing up the potential RWA reduction from disposal against the impact on the P&L.

So far, disposal losses on these assets have been small, partly, in our opinion, because RBS has been able to focus on 'low hanging fruit' from the markets, corporate & retail divisions. In contrast, CRE assets have proved more 'sticky' and harder to dispose of given the lack of liquidity. These assets now account for 33% of non-core assets, up from 25% at end-2008. We expect disposal losses to increase going forward, as portfolio divestments become increasingly challenging.

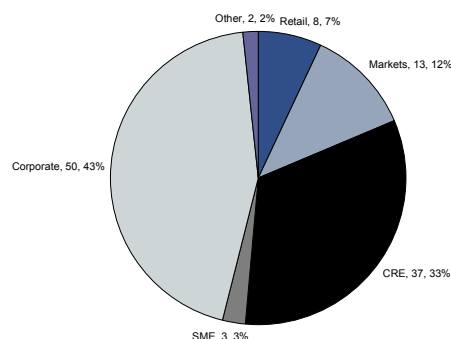
In the meantime, we also expect provisions in the non-core division to remain elevated. In the second quarter, provisions increased by 31% qoq (Figure 18) driven by CRE exposures in Ulster (and to a lesser extent GBM). We now forecast total non-core provisions of £22.9bn from 2009-13E, still well within RBS' prudent guidance of c£20-30bn.

Figure 16. RBS Non-Core – £258bn Assets Split by Type, end-2008



Source: Company Reports

Figure 17. RBS Non-Core – £113bn Assets Split by Type, June 2011



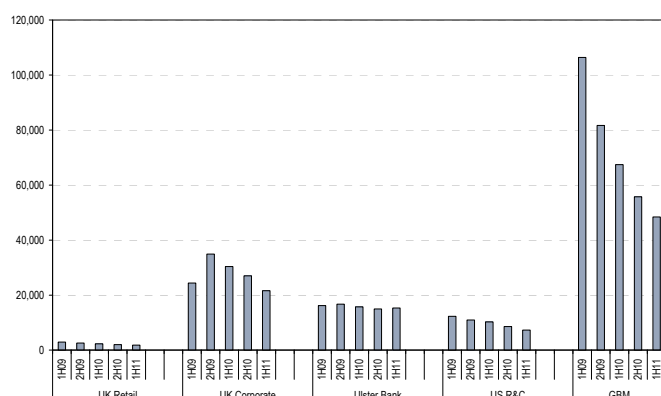
Source: Company Reports

Figure 18. RBS – Non Core P&L Impairments, 1Q10-2Q11 (£'m)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	%QoQ	%YoY
UK Retail	5	-	5	3	-	4	na	na
UK Corporate	155	263	173	239	65	181	+178%	-31%
Ulster Bank	552	704	689	789	839	982	+17%	39%
US R&C	208	141	116	123	91	78	-14%	-45%
GBM	753	266	191	48	79	169	+114%	-36%
Other	31	16	(3)	9	1	(3)	-400%	-119%
Total	1,704	1,390	1,171	1,211	1,075	1,411	+31%	2%

Source: Company Reports

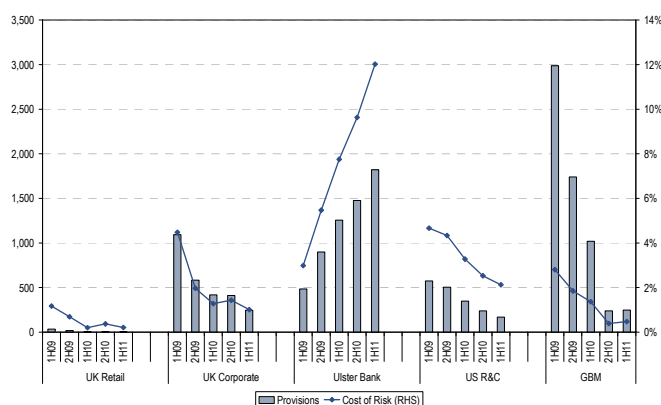
Figure 19. RBS Non-Core – Gross Loans by Division (£m)



Source: Company Reports and CIRA Estimates

*Please note

Figure 20. RBS Non-Core – P&L Provs by Divs (£m) and Cost of Risk



Source: Company Reports and CIRA Estimates

Irish Credit Quality

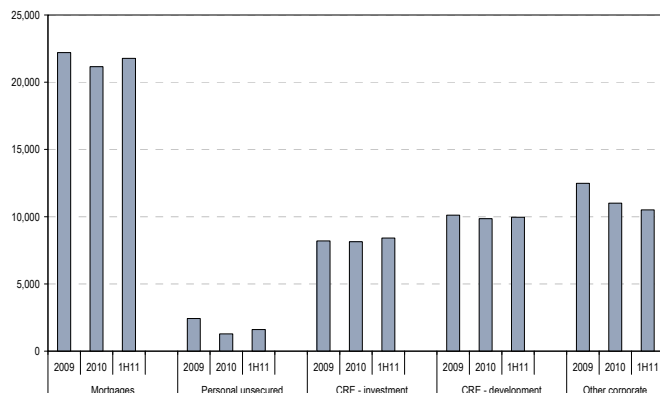
Irish NPLs continue to climb, but coverage ratios are in-line or better than peers.

As illustrated in Figure 20, Ulster remains the key driver of non-core impairments. At end-June, Ulster had £52.3bn of loans outstanding, broadly flat since end-2010, split £37.4bn core (mainly mortgages, corporate) and £14.9bn non-core (mainly CRE). We outline the overall breakdown in Figure 21 and Figure 22. Of the total Ulster CRE portfolio, 25% relates to Northern Ireland, 63% to the Republic of Ireland and 12% to the rest of the UK.

Of concern is that Ulster mortgages, corporate and CRE have all continued to see an increase in NPLs (Figure 23), with little sign of stabilisation. RBS has, however, provisioned prudently with coverage ratios improving over the past two years, as property prices continue to decline. We calculate that RBS now has an aggregate coverage ratio of 52% on CRE (broadly in-line with Lloyds and KBC at 55%), 54% on corporate (versus Lloyds 54%, KBC 38%) and 38% on mortgages (KBC 30%).

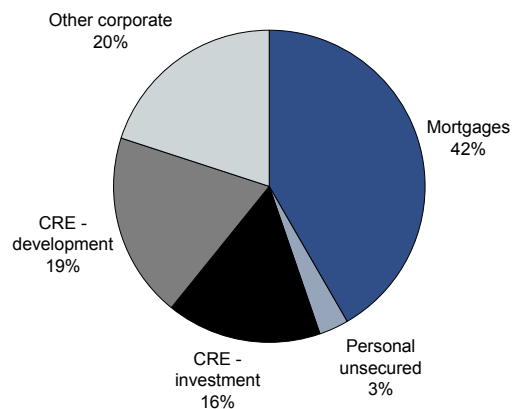
In 2Q11, the large increase in Ulster CRE provisions was attributed to a 'deep-dive' region-by-region analysis performed on Irish land exposures. CRE is likely to remain the primary driver of loan defaults in the Ulster book, in our opinion. Ongoing reviews of the portfolio have already led RBS to re-allocate a greater portion of the portfolio to specialised management in the Global Restructuring Group. RBS states that "the outlook remains challenging with limited liquidity in the marketplace to support re-financing".

Figure 21. RBS – Core & Non-Core Ulster Gross Loans by Type (£m)



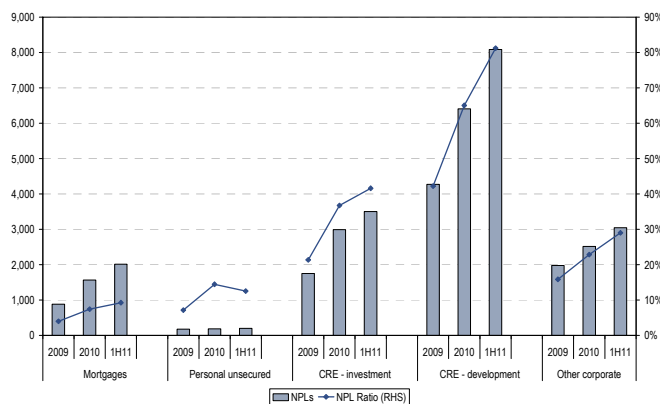
Source: Company Reports and CIRA

Figure 22. RBS – Breakdown of Ulster Portfolio (Core & Non-Core)



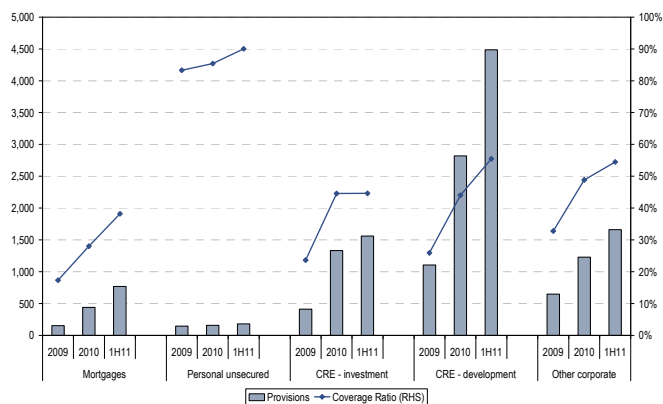
Source: Company Reports and CIRA

Figure 23. RBS – Ulster NPLs by Type (£m) and NPL Ratio



Source: Company Reports and CIRA

Figure 24. RBS – Ulster B/S Provisions by Type (£m) & Coverage Ratio



Source: Company Reports and CIRA

Valuation

We value RBS using a combined dividend discount model and capital-adjusted warranted equity valuation approach. This points to a target price of 46p (from 50p).

Figure 25. Royal Bank of Scotland – DDM & Capital-Adjusted WEV Valuation

1. Dividend Discount Model (DDM)	2011e	2012e	2013e	2014e
PV of dividend (by quarter received)	0.0	0.8	1.5	2.0
Total dividend PV (GB pence)	4			
2. Terminal value (WEV)	2014e			
RoE	8.7%			
Long-term growth	2.0%			
CoE	11.3%			
Theoretical BVM	0.72x			
End of 2014 BVPS	75			
Terminal value	54			
End 2014 core equity tier 1 ratio (B3)	11.5%			
Capital surplus/(deficit) per share vs 10%	7			
Capital-adjusted terminal value	61			
PV of adj TV (GB pence)	42			
3. Final DDM & WEV valuation				
Total PV (1 + 2) (GB pence)	46			

Source: Citi Investment Research and Analysis

Figure 26. CIRA Estimate Changes, 2011-14E (£m)

	2011E			2012E			2013E			2014E		
	Old	New	% Diff	Old	New	% Diff	Old	New	% Diff	Old	New	% Diff
RBS Total Income pre FVO	30,081	30,027	0%	29,668	29,102	-2%	31,074	30,321	-2%	32,296	31,508	-2%
Total Operating Costs	-15,689	-15,681	0%	-14,967	-15,060	1%	-15,054	-15,118	0%	-15,327	-15,365	0%
General Insurance Net Income	929	1,118	20%	1,215	1,208	-1%	1,394	1,386	-1%	1,450	1,442	-1%
Gross Op Profit pre FVO & Impairment	10,866	11,146	3%	11,728	11,082	-6%	13,058	12,256	-6%	13,889	13,077	-6%
Impairment losses	-6,795	-8,013	18%	-4,494	-5,004	11%	-2,800	-2,930	5%	-2,439	-2,446	0%
Operating PBT pre FVO	4,071	3,133	-23%	7,234	6,077	-16%	10,258	9,326	-9%	11,450	10,631	-7%
FV gains	- 939	- 591	-37%	- 525	- 525	0%	-	-	0%	-	-	0%
Operating Profit inc FVO	3,133	2,542	-19%	6,709	5,552	-17%	10,258	9,326	-9%	11,450	10,631	-7%

Source: Citi Investment Research and Analysis

Figure 27. Royal Bank of Scotland - Group Profit and Loss Account 2008-14E (Pounds in Millions)

	2008	2009	%chg	2010	%chg	2011E	%chg	2012E	%chg	2013E	%chg	2014E	%chg
Net Interest Income	15,764	13,567	-14%	14,200	5%	13,166	-7%	12,977	-1%	13,359	3%	13,805	3%
Net Fee Income	6,434	5,948	-8%	5,983	1%	5,755	-4%	5,778	0%	6,237	8%	6,571	5%
Income from trading activities (ex FVO)	(8,829)	3,999	-145%	6,138	53%	4,687	-24%	5,013	7%	5,216	4%	5,441	4%
Other Operating Income	289	787	172%	1,213	54%	2,102	73%	1,167	-44%	1,175	1%	1,184	1%
Total Operating Revenue	13,658	24,301	78%	27,534	13%	25,709	-7%	24,934	-3%	25,987	4%	27,000	4%
Staff Costs	(7,990)	(9,081)	14%	(8,956)	-1%	(8,556)	-4%	(8,209)	-4%	(8,263)	1%	(8,378)	1%
Other operating costs	(6,366)	(6,447)	1%	(5,994)	-7%	(5,605)	-6%	(5,392)	-4%	(5,390)	0%	(5,498)	2%
Depreciation	(1,832)	(1,873)	2%	(1,762)	-6%	(1,520)	-14%	(1,460)	-4%	(1,465)	0%	(1,489)	2%
Total Operating Costs	(16,188)	(17,401)	7%	(16,712)	-4%	(15,681)	-6%	(15,060)	-4%	(15,118)	0%	(15,365)	2%
Insurance premium net income	1,792	909	-49%	345	-62%	1,118	224%	1,208	8%	1,386	15%	1,442	4%
Gross Operating Profit	(738)	7,809	-1158%	11,167	43%	11,146	0%	11,082	-1%	12,256	11%	13,077	7%
Impairment losses	(7,432)	(13,899)	87%	(9,256)	-33%	(8,013)	-13%	(5,004)	-38%	(2,930)	-41%	(2,446)	-17%
FVO gains	1,232	(142)	-112%	174	-223%	(591)	-440%	(525)	-11%	0	-100%	0	nm
Operating Profit inc FVO	(6,938)	(6,232)	-10%	2,085	-133%	2,542	22%	5,552	118%	9,326	68%	10,631	14%
Restructuring costs & other	(1,357)	(1,286)	-5%	(1,032)	-20%	(2,561)	148%	(700)	-73%	(300)	-57%	0	-100%
Amortisation of purchased intangibles	(443)	(272)	-39%	(369)	36%	(210)	-43%	(210)	0%	(210)	0%	(210)	0%
Bonus tax/bank levy	0	(208)	nm	(99)	-52%	(411)	315%	(400)	-3%	(400)	0%	(400)	0%
APS CDS - FV change	0	0	nm	(1,550)	nm	(637)	-59%	0	-100%	0	nm	0	nm
Redemption of own debt	0	3,790	nm	553	-85%	255	-54%	0	nm	0	nm	0	nm
Other items (incl disposal gains & losses)	442	132	-70%	171	30%	27	-84%	0	-100%	0	nm	0	nm
Goodwill write-down	(16,196)	(363)	-98%	(10)	-97%	0	-100%	0	n.m.	0	nm	0	nm
Pretax Profit (reported)	(24,492)	(2,291)	-91%	(251)	-89%	(995)	297%	4,242	nm	8,416	98%	10,021	19%
Tax	1,280	339	-74%	(663)	-296%	(566)	-15%	(1,123)	98%	(2,112)	88%	(2,404)	14%
Post-tax profit from continuing ops	(23,212)	(1,952)	-92%	(914)	-53%	(1,561)	71%	3,120	nm	6,304	102%	7,617	21%
Profit / loss from disc ops (net of tax)	(86)	(72)	-16%	(28)	-61%	31	-211%	0	-100%	0	nm	0	nm
Minority Interests (Incl. Non-Equity)	(412)	(648)	57%	(61)	-91%	(24)	-61%	(24)	0%	(207)	764%	(311)	50%
Preference dividends	(596)	(935)	57%	(124)	-87%	0	-100%	(376)	n.m.	(440)	17%	(440)	0%
Net Attributable Profit	(24,306)	(3,607)	-85%	(1,127)	-69%	(1,554)	38%	2,720	nm	5,656	108%	6,866	21%
Ordinary Dividend	(2,312)	0	-100%	0	n.m.	0	n.m.	(358)	nm	(1,434)	300%	(2,509)	75%
Retained Earnings	(26,618)	(3,607)	-86%	(1,127)	-69%	(1,554)	38%	2,361	nm	4,223	79%	4,357	3%
Per share data													
Basic, Core EPS	-	8.7p		4.7p	-46%	5.3p	14%	6.1p	13%	6.6p	9%	7.2p	9%
Basic Core + Non-Core EPS	-	(12.4)p		0.1p	-101%	0.9p	1127%	3.4p	288%	5.5p	62%	6.4p	17%
Diluted EPS Reported	(146.7)p	(6.8)p	-95%	(1.0)p	-85%	(1.4)p	38%	2.5p	nm	5.2p	108%	6.4p	21%
Dividend per share, reported	0.0p	0.0p	nm	0.0p	nm	0.0p	nm	1.0p	nm	2.0p	100%	3.0p	50%
Payout ratio	0%	0%		0%		0%		40%		38%		47%	
Diluted BVPS	115.4p	64.8p	-44%	65.2p	1%	64.7p	-1%	67.2p	4%	71.1p	6%	75.2p	6%
Tangible diluted BVPS	73.8p	51.1p	-31%	51.8p	1%	51.2p	-1%	53.7p	5%	57.6p	7%	61.7p	7%
Operating ratios													
Reported NIM	2.1%	1.8%		2.0%		1.9%		2.0%		2.2%		2.3%	
Cost-income ratio, adjusted	104.8%	69.0%		59.9%		58.5%		57.6%		55.2%		54.0%	
NPL ratio	2.7%	6.1%		7.4%		8.5%		8.1%		6.3%		4.7%	
Coverage ratio (Provision / NPL)	50.3%	43.4%		47.1%		47.1%		47.1%		47.1%		47.1%	
Adj. ROE (ex FVOD, APS FV, res, etc.)	-18.4%	-11.4%		0.2%		1.3%		5.1%		7.9%		8.7%	
Adj RoA	-0.44%	-0.35%		0.01%		0.06%		0.26%		0.45%		0.54%	
Balance sheet summary													
Total assets	2,218,693	1,522,481	-31%	1,452,634	-5%	1,432,948	-1%	1,324,881	-8%	1,291,175	-3%	1,273,003	-1%
Net loans and advances to customers	691,976	554,654	-20%	502,748	-9%	477,186	-5%	429,714	-10%	417,577	-3%	418,164	0%
Customer accounts	518,461	482,604	-7%	510,693	6%	529,247	4%	522,991	-1%	540,020	3%	558,633	3%
Loan to deposit ratio	133%	115%		98%		90%		82%		77%		75%	
Total shareholders funds	45,525	69,890	54%	70,388	1%	69,871	-1%	72,582	4%	76,805	6%	81,162	6%
Capital position													
Core tier 1 capital (Basel 2)	34,041	48,151	41%	49,309	2%	49,904	1%	56,633	13%	61,867	9%	66,715	8%
Core tier 1 capital (Basel 3)	-	-	nm	36,064	nm	37,899	5%	48,941	29%	54,701	12%	60,421	10%
Tier 1 capital (Basel 2)	57,124	62,898	10%	59,829	-5%	60,424	1%	67,153	11%	72,387	8%	77,235	7%
Risk weighted assets (Basel 2)	577,800	438,200	-24%	462,600	6%	431,845	-7%	463,082	7%	440,023	-5%	433,813	-1%
Risk weighted assets (Basel 3)	-	-	nm	621,989	nm	559,702	-10%	565,999	1%	538,357	-5%	527,563	-2%
Basel 2 Core Tier 1 Ratio (%)	5.9%	11.0%		10.7%		11.6%		12.2%		14.1%		15.4%	
Basel 3 Core Tier 1 Ratio (%)	-	-		5.8%		6.8%		8.6%		10.2%		11.5%	
Basel 2 Tier 1 ratio (%)	9.9%	14.4%		12.9%		14.0%		14.5%		16.5%		17.8%	

Source: Company Reports and CIRA Estimates

Figure 28. Royal Bank of Scotland - Group Profit and Loss Account 1Q09-4Q11E (Pounds in Millions)

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11E	4Q11E
Net Interest Income	3,538	3,322	3,261	3,446	3,534	3,684	3,404	3,578	3,302	3,233	3,311	3,320
Net Fee Income	1,585	1,530	1,374	1,459	1,479	1,467	1,433	1,604	1,382	1,377	1,480	1,516
Income from trading activities (ex FVO)	1,370	542	1,297	790	2,225	1,502	1,432	979	1,490	1,204	962	1,030
Other Operating Income	(210)	386	344	267	596	232	359	26	710	863	285	244
Total Operating Revenue	6,283	5,780	6,276	5,962	7,834	6,885	6,628	6,187	6,884	6,677	6,038	6,110
Staff Costs	(2,510)	(2,150)	(2,175)	(2,246)	(2,553)	(2,178)	(2,166)	(2,059)	(2,320)	(2,099)	(2,056)	(2,081)
Other operating costs	(1,690)	(1,502)	(1,562)	(1,693)	(1,463)	(1,490)	(1,465)	(1,574)	(1,421)	(1,397)	(1,420)	(1,367)
Depreciation	(467)	(414)	(458)	(534)	(414)	(435)	(465)	(448)	(380)	(396)	(353)	(391)
Total Operating Costs	(4,667)	(4,066)	(4,195)	(4,473)	(4,430)	(4,103)	(4,096)	(4,081)	(4,121)	(3,892)	(3,830)	(3,839)
Insurance premium net income	390	376	156	(13)	153	(45)	147	90	237	297	280	304
Gross Operating Profit	2,006	2,090	2,237	1,476	3,557	2,737	2,679	2,196	3,000	3,082	2,488	2,576
Impairment losses	(2,858)	(4,663)	(3,279)	(3,099)	(2,675)	(2,487)	(1,953)	(2,141)	(1,947)	(2,264)	(1,990)	(1,811)
FVO gains	1,031	(960)	(483)	270	(169)	619	(858)	582	(480)	339	(225)	(225)
Operating Profit inc FVO	179	(3,533)	(1,525)	(1,353)	713	869	(132)	637	573	1,157	273	540
Restructuring costs & other	(379)	(355)	(324)	(228)	(168)	(254)	(311)	(299)	(145)	(1,916)	(250)	(250)
Amortisation of purchased intangibles	(85)	(55)	(73)	(59)	(65)	(85)	(123)	(96)	(44)	(56)	(55)	(55)
Bonus tax/bank levy	0	0	0	(208)	(54)	(15)	(15)	(15)	(11)	0	0	(400)
APS CDS - FV change	0	0	0	0	(500)	500	(825)	(725)	(469)	(168)	0	0
Redemption of own debt	0	3,790	0	0	0	553	0	0	0	255	0	0
Other items (incl disposal gains & losses)	241	212	(155)	(166)	53	(411)	27	502	(23)	50	0	0
Goodwill write-down	0	(311)	0	(52)	0	0	0	(10)	0	0	0	0
Pretax Profit (reported)	(44)	(252)	(2,077)	82	(21)	1,157	(1,379)	(6)	(119)	(678)	(32)	(165)
Tax	(228)	640	576	(649)	(106)	(825)	261	7	(423)	(222)	13	66
Post-tax profit from continuing ops	(272)	388	(1,501)	(567)	(127)	332	(1,118)	1	(542)	(900)	(19)	(99)
Profit / loss from disc ops (net of tax)	(45)	(13)	(7)	(7)	(4)	(26)	2	0	10	21	0	0
Minority Interests (Incl. Non-Equity)	(471)	(83)	(47)	(47)	(12)	(30)	(30)	11	4	(18)	(5)	(5)
Preference dividends	(114)	(432)	(245)	(144)	(105)	(19)	0	0	0	0	0	0
Net Attributable Profit	(902)	(140)	(1,800)	(765)	(248)	257	(1,146)	12	(528)	(897)	(24)	(104)
Ordinary Dividend	0	0	0	0	0	0	0	0	0	0	0	0
Retained Earnings	(902)	(140)	(1,800)	(765)	(248)	257	(1,146)	12	(528)	(897)	(24)	(104)
Per share data												
Basic, Core EPS					1.6p	0.6p	1.7p	0.7p	1.7p	0.9p	1.3p	1.4p
Basic Core + Non-Core EPS					0.3p	(0.3)p	0.2p	(0.2)p	0.3p	0.1p	0.3p	0.2p
Diluted EPS Reported					(0.2)p	0.2p	(1.1)p	0.0p	(0.5)p	(0.8)p	(0.0)p	(0.1)p
Diluted BVPS					65.8p	66.8p	65.9p	65.4p	64.4p	64.8p	64.8p	64.7p
Tangible diluted BVPS					52.1p	53.4p	52.5p	52.0p	51.0p	51.3p	51.3p	51.2p
Operating ratios												
Reported NIM	1.8%	1.7%	1.8%	1.8%	1.9%	2.0%	2.1%	2.0%	2.0%	2.0%	2.0%	2.1%
Cost-income ratio, adjusted	69.9%	66.0%	65.2%	75.2%	55.5%	60.0%	60.5%	65.0%	57.9%	55.8%	60.6%	59.8%
NPL ratio	3.5%	5.1%	5.8%	6.1%	6.4%	6.5%	7.0%	7.4%	8.0%	8.3%	8.4%	8.5%
Coverage ratio (Provision / NPL)	0.0%	0.0%	0.0%	43.4%	46.1%	44.6%	46.3%	47.1%	46.9%	49.0%	48.1%	47.1%
Balance sheet summary												
Total assets	2,060,488	1,644,445	1,680,316	1,522,481	1,582,898	1,580,853	1,628,663	1,452,634	1,413,253	1,445,969	1,439,459	1,432,948
Net loans and advances to customers	671,077	593,277	587,996	554,654	553,872	539,340	528,049	502,748	494,148	489,572	483,379	477,186
Customer accounts	514,844	490,282	493,234	482,604	506,246	491,545	507,926	511,957	518,906	517,525	525,264	529,247
Loan to deposit ratio	130%	121%	119%	115%	109%	110%	104%	98%	95%	95%	92%	90%
Total shareholders funds				69,890	70,830	72,058	70,856	70,388	69,332	70,000	69,976	69,871
Capital position												
Core tier 1 capital (Basel 2)		35,200	33,000	48,151	48,683	49,744	48,311	49,309	49,038	48,001	48,311	49,904
Tier 1 capital (Basel 2)		49,400	47,600	62,898	62,975	60,630	59,175	59,829	59,548	58,387	59,175	60,424
Risk weighted assets (Basel 2)	575,700	547,300	594,700	438,200	460,700	473,900	475,000	462,600	439,700	433,500	430,189	431,845
Basel 2 Core Tier 1 Ratio (%)		6.4%	5.5%	11.0%	10.6%	10.5%	10.2%	10.7%	11.2%	11.1%	11.2%	11.6%
Basel 2 Tier 1 ratio (%)		9.0%	8.0%	14.4%	13.7%	12.8%	12.5%	12.9%	13.5%	13.5%	13.8%	14.0%

Source: Company Reports and CIRA Estimates

Figure 29. Royal Bank of Scotland – Divisional Profit and Loss Account 2008-2014E (Pounds in Millions)

	2008	2009	%chg	2010	%chg	2011E	%chg	2012E	%chg	2013E	%chg	2014E	%chg
GBM													
Rates	3,027	4,856	60%	2,050	-58%	1,688	-18%	1,772	5%	1,843	4%	1,917	4%
Currencies & Commods	1,539	1,277	-17%	870	-32%	949	9%	978	3%	1,007	3%	1,048	4%
Equities	368	1,474	301%	933	-37%	965	3%	1,013	5%	1,064	5%	1,106	4%
Credit markets	(3,435)	2,255	-166%	2,215	-2%	2,173	-2%	2,238	3%	2,305	3%	2,398	4%
Asset and portfolio management	858	1,196	39%	1,844	54%	1,403	-24%	1,445	3%	1,488	3%	1,548	4%
Total Income ex FVO	2,357	11,058	369%	7,912	-28%	7,178	-9%	7,446	4%	7,707	4%	8,016	4%
Total Direct Expenses	(3,325)	(3,895)	17%	(3,535)	-9%	(3,552)	0%	(3,587)	1%	(3,659)	2%	(3,732)	2%
Indirect Expenses	(663)	(765)	15%	(862)	13%	(914)	6%	(923)	1%	(941)	2%	(960)	2%
Operating Profit Before Imp losses	(1,631)	6,398	-492%	3,515	-45%	2,712	-23%	2,936	8%	3,107	6%	3,323	7%
Impairment losses	(521)	(640)	23%	(151)	-76%	(68)	-55%	(102)	52%	(98)	-5%	(96)	-2%
Pretax Contribution ex FVO	(2,152)	5,758	-368%	3,364	-42%	2,644	-21%	2,833	7%	3,009	6%	3,227	7%
Total third party assets (exc deriv mtm'd)	498,700	412,200	-17%	396,700	-4%	414,752	5%	408,425	-2%	405,451	-1%	405,451	0%
Risk Weighted Assets	151,800	123,700	-19%	146,900	19%	133,496	-9%	125,486	-6%	121,721	-3%	121,721	0%
Cost/income ex FVO	169%	42%		56%		62%		61%		60%		59%	
Impairment charge / advs (bp) - Non-APS	29	59		20		6		10		10		10	
GTS													
Net interest income	937	912	-3%	974	7%	1,043	7%	1,361	30%	1,474	8%	1,569	6%
Non-interest income	1,494	1,575	5%	1,587	1%	1,207	-24%	1,011	-16%	1,036	2%	1,085	5%
Total income	2,431	2,487	2%	2,561	3%	2,250	-12%	2,372	5%	2,509	6%	2,654	6%
Total direct expenses	-511	-532	4%	-570	7%	-512	-10%	-525	2%	-541	3%	-562	4%
Indirect Expenses	(864)	(943)	9%	(894)	-5%	(845)	-5%	(866)	2%	(892)	3%	(928)	4%
Operating Profit Before Imp losses	1,056	1,012	-4%	1,097	8%	893	-19%	981	10%	1,077	10%	1,164	8%
Impairment losses	(54)	(39)	-28%	(9)	-77%	(94)	944%	(20)	-79%	(20)	5%	(21)	5%
Pretax Contribution	1,002	973	-3%	1,088	12%	799	-27%	962	20%	1,056	10%	1,143	8%
Total third party assets	21,000	18,400	-12%	25,200	37%	30,200	20%	31,408	4%	32,978	5%	34,627	5%
Risk Weighted Assets	3,100	19,100	516%	18,300	-4%	18,800	3%	19,552	4%	20,530	5%	21,556	5%
Net interest margin, reported	8.3%	9.2%		6.7%		5.8%		6.5%		6.7%		6.8%	
Cost/income	57%	59%		57%		60%		59%		57%		56%	
UK Corp and Commercial													
Net Interest Income	2,448	2,292	-6%	2,572	12%	2,651	3%	2,513	-5%	2,616	4%	2,734	5%
Fees and commissions	829	858	3%	952	11%	981	3%	921	-6%	967	5%	1,015	5%
Non-Interest Income	460	432	-6%	371	-14%	375	1%	349	-7%	366	5%	384	5%
Total Income	3,737	3,582	-4%	3,895	9%	4,006	3%	3,782	-6%	3,949	4%	4,134	5%
Total Direct Expenses	(1,119)	(1,021)	-9%	(1,137)	11%	(1,125)	-1%	(1,040)	-7%	(1,072)	3%	(1,104)	3%
Indirect Expenses	(518)	(509)	-2%	(534)	5%	(523)	-2%	(484)	-7%	(499)	3%	(514)	3%
Operating Profit Before Imp losses	2,100	2,052	-2%	2,224	8%	2,358	6%	2,258	-4%	2,379	5%	2,517	6%
Impairment losses	(319)	(927)	191%	(761)	-18%	(677)	-11%	(544)	-20%	(523)	-4%	(547)	5%
Pretax Contribution	1,781	1,125	-37%	1,463	30%	1,682	15%	1,713	2%	1,856	8%	1,970	6%
Gross Loans & Advances To Customers	103,100	111,600	8%	111,700	0%	113,934	2%	106,880	-6%	111,155	4%	116,713	5%
Risk Weighted Assets	91,000	90,200	-1%	81,400	-10%	78,958	-3%	73,329	-7%	76,262	4%	80,075	5%
Net interest margin, reported	2.40%	2.22%		2.51%		2.56%		2.62%		2.62%		2.62%	
Cost income ratio	44%	43%		43%		41%		40%		40%		39%	
Impairment charge / advances (bp)	30	86		68		60		52		48		48	
UK Retail													
Net Interest Income	3,187	3,452	8%	4,078	18%	4,384	8%	4,206	-4%	4,460	6%	4,723	6%
Fees and commissions	1,524	1,244	-18%	1,100	-12%	1,122	2%	1,054	-6%	1,106	5%	1,162	5%
Other non-interest income	227	251	11%	227	-10%	204	-10%	192	-6%	201	5%	212	5%
Total Income	4,938	4,947	0%	5,405	9%	5,710	6%	5,452	-5%	5,768	6%	6,096	6%
Total Direct Expenses	(1,345)	(1,266)	-6%	(1,252)	-1%	(1,332)	6%	(1,232)	-7%	(1,269)	3%	(1,307)	3%
Indirect Expenses	(1,851)	(1,773)	-4%	(1,621)	-9%	(1,434)	-12%	(1,314)	-8%	(1,340)	2%	(1,380)	3%
Operating Profit Before Imp losses	1,742	1,908	10%	2,532	33%	2,944	16%	2,906	-1%	3,158	9%	3,409	8%
Impairment losses	(1,019)	(1,679)	65%	(1,160)	-31%	(809)	-30%	(670)	-17%	(696)	4%	(742)	7%
Pretax Contribution	723	229	-68%	1,372	499%	2,135	56%	2,236	5%	2,463	10%	2,667	8%
Gross Loans & Advances To Customers	93,800	103,000	10%	108,400	5%	112,696	4%	107,291	-5%	113,239	6%	118,733	5%
Risk Weighted Assets	45,700	51,300	12%	48,800	-5%	50,734	4%	47,818	-6%	50,469	6%	52,917	5%
Net interest margin, reported	3.58%	3.59%		3.91%		4.02%		4.08%		4.10%		4.12%	
Cost income ratio	65%	61%		53%		48%		47%		45%		44%	
Impairment charge / advances (bp)	110	171		110		73		64		63		64	

Source: Company Reports and CIRA Estimates

Figure 30. Royal Bank of Scotland – Divisional Profit and Loss Account 1Q09-4Q11E (Pounds in Millions)

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11E	4Q11E
GBM												
Rates	2,150	1,002	981	723	787	475	440	348	659	316	348	365
Currencies & Commods	539	416	147	175	295	179	218	178	224	234	246	246
Equities	371	364	282	457	314	238	198	183	275	234	222	233
Credit markets	858	690	475	232	959	474	349	433	885	437	415	436
Asset and portfolio management	527	113	180	376	469	581	349	445	337	329	367	370
Total Income ex FVO	4,445	2,585	2,065	1,963	2,824	1,947	1,554	1,587	2,380	1,550	1,597	1,650
Total Direct Expenses	(1,162)	(884)	(961)	(888)	(1,071)	(831)	(787)	(846)	(1,079)	(834)	(810)	(829)
Indirect Expenses	(193)	(201)	(191)	(180)	(223)	(202)	(218)	(219)	(227)	(233)	(227)	(227)
Operating Profit Before Impairment losses	3,090	1,500	913	895	1,530	914	549	522	1,074	483	560	595
Impairment losses	(269)	31	(272)	(130)	(32)	(164)	40	5	24	(37)	(30)	(25)
Pretax Contribution ex FVO	2,821	1,531	641	765	1,498	750	589	527	1,098	446	530	570
Total third party assets (ex derivs mtm'd)	476,200	437,900	459,100	412,200	443,700	400,000	420,700	396,700	423,300	419,100	416,904	414,752
Risk Weighted Assets	137,900	112,500	121,500	123,700	141,800	141,300	143,700	146,900	146,500	139,000	136,220	133,496
Cost/income ex FVO	30%	42%	56%	54%	46%	53%	65%	67%	55%	69%	65%	64%
Imp charge / advances (bp) - Non-APS	59	-10	78	55	11	75	-13	-2	-9	20	11	7
GTS												
Net interest income	220	225	234	233	217	237	257	263	260	263	260	260
Non-interest income	385	398	388	404	390	411	411	375	282	297	307	320
Total income	605	623	622	637	607	648	668	638	542	560	567	580
Total direct expenses	-130	-125	-124	-153	-137	-139	-138	-156	-125	-127	-130	-130
Indirect Expenses	(235)	(229)	(223)	(256)	(237)	(227)	(218)	(212)	(210)	(215)	(210)	(210)
Operating Profit Before Imp losses	240	269	275	228	233	282	312	270	207	218	227	240
Impairment losses	(9)	(4)	(22)	(4)	0	(3)	(3)	(3)	(20)	(54)	(10)	(10)
Pretax Contribution	231	265	253	224	233	279	309	267	187	164	217	230
Total third party assets	20,200	20,400	20,200	18,400	25,600	25,700	24,200	25,200	27,100	30,200	30,200	30,200
Risk Weighted Assets	3,500	3,700	3,900	19,100	20,400	19,400	18,600	18,300	18,200	18,800	18,800	18,800
Net interest margin, reported	8.3%	9.2%	9.6%	9.8%	8.0%	6.5%	6.7%	6.2%	8.0%	6.5%	6.7%	6.2%
Cost/income	60%	57%	56%	64%	62%	56%	53%	58%	62%	61%	60%	59%
UK Corp and Commercial												
Net Interest Income	499	560	607	626	610	647	662	653	689	641	655	666
Fees and commissions	194	219	223	222	224	233	244	251	244	231	245	261
Non-Interest Income	117	109	106	100	105	107	80	79	88	94	95	98
Total Income	810	888	936	948	939	987	986	983	1,021	966	995	1,024
Total Direct Expenses	(259)	(228)	(245)	(289)	(305)	(271)	(267)	(294)	(292)	(270)	(281)	(282)
Indirect Expenses	(130)	(125)	(125)	(129)	(130)	(128)	(139)	(137)	(131)	(133)	(130)	(129)
Operating Profit Before Imp losses	421	535	566	530	504	588	580	552	598	563	584	613
Impairment losses	(100)	(450)	(187)	(190)	(186)	(198)	(158)	(219)	(105)	(218)	(175)	(179)
Pretax Contribution	321	85	379	340	318	390	422	333	493	345	409	435
Gross Loans & Advances To Customers	115,700	112,600	113,900	111,600	114,300	115,200	113,500	111,700	112,500	110,800	112,367	113,934
Risk Weighted Assets	86,200	89,500	91,000	90,200	91,300	87,600	84,700	81,400	79,300	77,900	78,429	78,958
Net interest margin, reported	1.88%	2.17%	2.38%	2.47%	2.38%	2.50%	2.58%	2.57%	2.73%	2.55%	2.61%	2.62%
Cost income ratio	48%	40%	40%	44%	46%	40%	41%	44%	41%	42%	41%	40%
Impairment charge / advances (bp)	17	79	33	34	33	35	28	39	19	39	31	32
UK Retail												
Net Interest Income	797	868	848	939	933	1,001	1,056	1,088	1,076	1,086	1,100	1,122
Fees and commissions	337	321	303	283	259	263	262	316	270	295	280	277
Other non-interest income	53	69	69	60	56	56	64	51	34	38	64	68
Total Income	1,187	1,258	1,220	1,282	1,248	1,320	1,382	1,455	1,380	1,419	1,444	1,467
Total Direct Expenses	(329)	(316)	(305)	(316)	(330)	(343)	(331)	(248)	(328)	(324)	(340)	(340)
Indirect Expenses	(487)	(452)	(447)	(387)	(391)	(401)	(402)	(427)	(350)	(364)	(360)	(360)
Operating Profit Before Imp losses	371	490	468	579	527	576	649	780	702	731	744	767
Impairment losses	(354)	(470)	(404)	(451)	(387)	(300)	(251)	(222)	(194)	(208)	(205)	(202)
Pretax Contribution	17	20	64	128	140	276	398	558	508	523	539	565
Gross Loans & Advances To Customers	94,300	97,100	100,900	103,000	104,000	105,700	107,600	108,400	110,000	110,400	111,548	112,696
Risk Weighted Assets	49,600	54,000	51,600	51,300	49,800	49,100	49,300	48,800	50,300	50,445	50,589	50,734
Net interest margin, reported	3.46%	3.69%	3.47%	3.74%	3.66%	3.88%	4.02%	4.08%	4.04%	4.00%	4.02%	4.06%
Cost income ratio	69%	61%	62%	55%	58%	56%	53%	46%	49%	48%	48%	48%
Impairment charge / advances (bp)	151	196	163	177	150	114	94	82	71	75	0	0

Source: Company Reports and CIRA Estimates

Figure 31. Royal Bank of Scotland – Divisional Profit and Loss Account 2008-2014e (Pounds in Millions) cont

	2008	2009	%chg	2010	%chg	2011E	%chg	2012E	%chg	2013E	%chg	2014E	%chg
UK Wealth													
Net Interest Income	578	663	15%	609	-8%	670	10%	723	8%	781	8%	820	5%
Fees and commissions	405	363	-10%	376	4%	394	5%	425	8%	458	8%	481	5%
Other non-interest income	76	83	9%	71	-14%	72	2%	75	3%	78	4%	81	4%
Total Income	1,059	1,109	5%	1,056	-5%	1,137	8%	1,223	8%	1,317	8%	1,382	5%
Total Direct Expenses	(533)	(496)	-7%	(524)	6%	(586)	12%	(604)	3%	(626)	4%	(655)	5%
Indirect Expenses	(162)	(160)	-1%	(210)	31%	(210)	0%	(214)	2%	(221)	3%	(229)	4%
Operating Profit Before Imp losses	364	453	24%	322	-29%	341	6%	405	19%	471	16%	497	6%
Impairment losses	(16)	(139)	769%	(18)	-87%	(25)	37%	(26)	5%	(27)	5%	(28)	5%
Pretax Contribution	348	314	-10%	304	-3%	316	4%	379	20%	443	17%	469	6%
Gross Loans & Advances To Customers	12,400	13,700	10%	16,100	18%	16,857	5%	17,667	5%	18,534	5%	19,443	5%
Risk Weighted Assets	10,800	11,200	4%	12,500	12%	13,088	5%	13,717	5%	14,390	5%	15,095	5%
Reported NIM	4.51%	4.38%		3.37%		3.35%		3.47%		3.60%		3.60%	
Fees as % of AUM	1.57%	1.11%		1.20%		1.21%		1.26%		1.30%		1.30%	
Cost income ratio	66%	59%		70%		70%		67%		64%		64%	
US Retail and Commercial Banking													
Net Interest Income	1,726	1,775	3%	1,917	8%	1,886	-2%	2,150	14%	2,314	8%	2,417	4%
Non-Interest Income	861	949	10%	1,029	8%	985	-4%	1,068	8%	1,121	5%	1,177	5%
Total Income	2,587	2,724	5%	2,946	8%	2,871	-3%	3,218	12%	3,435	7%	3,594	5%
Total Direct Expenses	(999)	(1,369)	37%	(1,353)	-1%	(1,311)	-3%	(1,366)	4%	(1,407)	3%	(1,450)	3%
Indirect Expenses	(623)	(766)	23%	(770)	1%	(736)	-4%	(768)	4%	(791)	3%	(814)	3%
Operating Profit Before Imp losses	965	589	-39%	823	40%	824	0%	1,084	32%	1,237	14%	1,329	7%
Impairment losses	(437)	(702)	61%	(517)	-26%	(386)	-25%	(344)	-11%	(316)	-8%	(330)	4%
Pretax Contribution	528	(113)	-121%	306	-371%	437	43%	740	69%	921	25%	1,000	9%
Gross Loans & Advances To Custs (£)	61,712	48,890	-21%	48,518	-1%	49,748	3%	51,451	3%	53,733	4%	56,116	4%
Risk Weighted Assets	63,836	59,741	-6%	56,959	-5%	58,403	3%	60,402	3%	63,080	4%	65,879	4%
Reported NIM (bps)	2.68%	2.37%		2.85%		3.02%		3.27%		3.42%		3.42%	
Cost/income	63%	78%		72%		71%		66%		64%		63%	
Impairment charge / advances (bp)	90	130		103		90		68		60		60	
Ulster Bank													
Net Interest Income	773	780	1%	761	-2%	650	-15%	630	-3%	643	2%	654	2%
Non-Interest Income	266	254	-5%	214	-16%	218	2%	223	2%	229	3%	238	4%
Total Income	1,039	1,034	0%	975	-6%	868	-11%	853	-2%	872	2%	893	2%
Total Direct Expenses	(423)	(410)	-3%	(311)	-24%	(292)	-6%	(286)	-2%	(289)	1%	(295)	2%
Indirect Expenses	(292)	(343)	17%	(264)	-23%	(248)	-6%	(243)	-2%	(246)	1%	(251)	2%
Operating Profit Before Imp losses	324	281	-13%	400	42%	327	-18%	323	-1%	337	4%	347	3%
Impairment losses	(106)	(649)	512%	(1,161)	79%	(1,230)	6%	(681)	-45%	(423)	-38%	(310)	-27%
Pretax Contribution	218	(368)	-269%	(761)	107%	(903)	19%	(358)	-60%	(86)	-76%	37	-143%
Gross Loans & Advances To Customers	44,000	39,700	-10%	36,900	-7%	34,493	-7%	33,638	-2%	34,032	1%	34,838	2%
Risk Weighted Assets	24,500	29,900	22%	31,600	6%	31,600	0%	30,816	-2%	31,178	1%	31,916	2%
Reported NIM (bps)	1.89%	1.87%		1.84%		0.00%		0.00%		0.00%		0.00%	
Cost/income	69%	73%		59%		62%		62%		61%		61%	
Impairment charge / advances (bp)	29	148		315		357		200		125		90	
Insurance													
Insurance Premium Net Income	4,306	4,354	1%	4,311	-1%	4,087	-5%	4,168	2%	4,335	4%	4,509	4%
Fees and commissions	(396)	(366)	-8%	(409)	12%	(352)	-14%	(359)	2%	(373)	4%	(388)	4%
Other Operating Income	520	472	-9%	467	-1%	467	0%	476	2%	495	4%	515	4%
Total Income	4,430	4,460	1%	4,369	-2%	4,202	-4%	4,286	2%	4,457	4%	4,636	4%
Net Claims	(3,032)	(3,635)	20%	(3,961)	9%	(2,983)	-25%	(2,960)	-1%	(2,948)	0%	(3,066)	4%
Net Insurance Income	1,398	825	-41%	408	-51%	1,219	199%	1,326	9%	1,510	14%	1,570	4%
Total Direct Expenses	(511)	(489)	-4%	(436)	-11%	(532)	22%	(532)	0%	(540)	2%	(554)	3%
Indirect Expenses	(261)	(270)	3%	(267)	-1%	(220)	-18%	(220)	0%	(224)	2%	(230)	3%
Operating Profit Before Imp losses	626	66	-89%	(295)	-547%	467	-258%	574	23%	745	30%	786	5%
Impairment losses	(42)	(8)	-81%	0	-100%	0	n.m.	0	n.m.	0	n.m.	0	n.m.
Pretax Contribution	584	58	-90%	(295)	-609%	467	-258%	574	23%	745	30%	786	5%
Total in-force policies ('000's)	17,156	21,235	24%	20,607	-3%	20,734	1%	21,356	3%	22,424	5%	23,545	5%
General insurance reserves	6,672	7,030	5%	7,559	8%	7,710	2%	7,941	3%	8,259	4%	8,590	4%
Combined ratio	-82%	-106%		-115%		-94%		-92%		-88%		-88%	
Cost/income	55%	92%		172%		62%		57%		51%		50%	

Source: Company Reports and CIRA Estimates

Figure 32. Royal Bank of Scotland – Divisional Profit and Loss Account 1Q09-4Q11E (Pounds in Millions) cont

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11E	4Q11E
Uk Wealth												
Net Interest Income	158	176	168	161	143	150	156	160	167	182	160	161
Fees and commissions	90	90	92	91	95	97	90	94	97	94	97	106
Other non-interest income	21	21	19	22	17	19	18	17	17	21	18	16
Total Income	269	287	279	274	255	266	264	271	281	297	275	284
Total Direct Expenses	(123)	(112)	(117)	(144)	(129)	(131)	(134)	(130)	(144)	(162)	(140)	(140)
Indirect Expenses	(46)	(41)	(42)	(31)	(60)	(47)	(55)	(48)	(52)	(58)	(52)	(48)
Operating Profit Before Imp losses	100	134	120	99	66	88	75	93	85	77	83	96
Impairment losses	(46)	(41)	(42)	(10)	(4)	(7)	(1)	(6)	(5)	(3)	(6)	(11)
Pretax Contribution	54	93	78	89	62	81	74	87	80	74	77	85
Gross Loans & Advances To Customers	12,300	12,400	13,400	13,700	14,500	14,900	15,500	16,100	16,500	16,800	16,829	16,857
Risk Weighted Assets	10,600	10,300	10,700	11,200	11,700	12,000	12,100	12,500	12,600	12,900	12,994	13,088
Reported NIM	4.47%	4.82%	4.34%	3.94%	3.38%	3.36%	3.44%	3.32%	3.45%	3.61%	3.14%	3.15%
Fees as % of AUM	1.15%	1.21%	1.16%	1.19%	1.20%	1.28%	1.16%	1.17%	1.13%	1.10%	1.15%	1.29%
Cost income ratio	63%	53%	57%	64%	74%	67%	72%	66%	70%	74%	70%	66%
US Retail and Commercial Banking												
Net Interest Income	494	448	410	423	468	502	480	467	451	469	480	487
Non-Interest Income	250	254	224	221	252	275	271	231	243	246	248	248
Total Income	744	702	634	644	720	777	751	698	694	715	727	735
Total Direct Expenses	(361)	(372)	(306)	(330)	(349)	(314)	(362)	(328)	(321)	(340)	(325)	(325)
Indirect Expenses	(201)	(194)	(191)	(180)	(188)	(190)	(191)	(200)	(183)	(182)	(186)	(186)
Operating Profit Before Imp losses	182	136	137	134	183	273	198	170	190	193	217	224
Impairment losses	(223)	(146)	(180)	(153)	(143)	(144)	(125)	(105)	(110)	(66)	(105)	(105)
Pretax Contribution	(41)	(10)	(43)	(19)	40	129	73	65	80	127	111	119
Gross Loans & Advances To Custs (£)	62,000	52,000	51,200	48,900	51,351	51,535	48,089	48,518	46,854	47,591	48,783	49,748
Risk Weighted Assets	64,300	55,600	62,800	59,741	63,810	65,487	64,140	56,959	53,583	54,523	56,796	58,403
Reported NIM (bps)	2.33%	2.32%	2.37%	2.45%	2.69%	2.78%	2.92%	3.02%	3.01%	3.01%	0.00%	0.00%
Cost/income	76%	81%	78%	79%	75%	65%	74%	76%	73%	73%	70%	69%
Impairment charge / advances (bp)	143	106	142	125	114	110	101	89	94	56	83	176
Ulster Bank												
Net Interest Income	202	208	176	194	188	194	192	187	169	171	160	150
Non-Interest Income	57	51	55	91	53	53	52	56	51	51	55	61
Total Income	259	259	231	285	241	247	244	243	220	222	215	211
Total Direct Expenses	(111)	(106)	(99)	(94)	(84)	(77)	(72)	(78)	(74)	(74)	(72)	(72)
Indirect Expenses	(77)	(75)	(73)	(118)	(76)	(66)	(62)	(60)	(62)	(68)	(62)	(56)
Operating Profit Before Imp losses	71	78	59	73	81	104	110	105	84	80	81	82
Impairment losses	(67)	(90)	(144)	(348)	(218)	(281)	(286)	(376)	(461)	(269)	(250)	(250)
Pretax Contribution	4	(12)	(85)	(275)	(137)	(177)	(176)	(271)	(377)	(189)	(169)	(168)
Gross Loans & Advances To Customers	42,200	39,000	40,600	39,700	38,800	36,200	37,800	36,900	37,200	37,400	35,947	34,493
Risk Weighted Assets	26,200	26,200	28,500	29,900	32,800	30,500	32,600	31,600	31,700	36,300	33,950	31,600
Reported NIM (bps)	1.87%	2.03%	1.74%	1.83%	1.77%	1.92%	1.90%	1.78%	1.72%	1.69%	1.61%	1.57%
Cost/income	73%	70%	74%	74%	66%	58%	55%	57%	62%	64%	62%	61%
Impairment charge / advances (bp)	64	92	142	351	225	310	303	408	496	288	278	290
Insurance												
Insurance Premium Net Income	1,061	1,079	1,102	1,112	1,096	1,080	1,075	1,060	1,011	996	1,030	1,050
Fees and commissions	(92)	(95)	(95)	(84)	(89)	(91)	(96)	(133)	(75)	(81)	(90)	(106)
Other Operating Income	108	104	112	148	92	116	112	147	134	131	110	92
Total Income	1,077	1,088	1,119	1,176	1,099	1,105	1,091	1,074	1,070	1,046	1,050	1,036
Net Claims	(793)	(758)	(928)	(1,156)	(974)	(1,132)	(949)	(906)	(784)	(704)	(750)	(745)
Net Insurance Income	284	330	191	20	125	(27)	142	168	286	342	300	291
Total Direct Expenses	(137)	(123)	(114)	(115)	(110)	(114)	(109)	(103)	(163)	(149)	(110)	(110)
Indirect Expenses	(66)	(65)	(64)	(75)	(65)	(62)	(66)	(74)	(56)	(54)	(55)	(55)
Operating Profit Before Imp losses	81	142	13	(170)	(50)	(203)	(33)	(9)	67	139	135	126
Impairment losses	(5)	(1)	(2)	0	0	0	0	0	0	0	0	0
Pretax Contribution	76	141	11	(170)	(50)	(203)	(33)	(9)	67	139	135	126
Total in-force policies ('000's)	17,205	17,498	17,627	17,710	17,678	17,089	20,152	20,607	20,822	0	0	0
General insurance reserves	6,630	6,601	6,839	7,030	7,101	7,326	7,552	7,559	7,541	0	0	0
Combined ratio	-96%	-90%	-103%	-128%	-107%	-123%	-110%	-114%	-100%	-93%	-95%	-100%
Cost/income	71%	57%	93%	950%	140%	-652%	123%	105%	77%	59%	55%	57%

Source: Company Reports and CIRA Estimates

Figure 33. Royal Bank of Scotland – Divisional Profit and Loss Account 2008-2014E (Pounds in Millions) cont

	2008	2009	%chg	2010	%chg	2011E	%chg	2012E	%chg	2013E	%chg	2014E	%chg
Central Items													
Pretax Contribution	150	491	227%	575	17%	(146)	-125%	(190)	30%	(57)	-70%	(97)	70%
Non-Core													
Net Interest Income	2,156	1,534	-29%	1,959	28%	1,120	-43%	728	-35%	437	-40%	262	-40%
Fees and commissions	912	510	-44%	471	-8%	182	-61%	118	-35%	71	-40%	43	-40%
Trading income	(7,739)	(5,161)	-33%	(31)	-99%	(68)	119%	0	-100%	0	n.m.	0	n.m.
Other operating income	653	32	-95%	(68)	-313%	517	-860%	(200)	-139%	(200)	0%	(200)	0%
Total Income	(4,018)	(3,085)	-23%	2,331	-176%	1,750	-25%	646	-63%	307	-52%	104	-66%
Total Direct Expenses	(2,144)	(1,895)	-12%	(1,825)	-4%	(1,041)	-43%	(677)	-35%	(406)	-40%	(244)	-40%
Indirect Expenses	(539)	(552)	2%	(500)	-9%	(297)	-41%	(163)	-45%	(98)	-40%	(59)	-40%
Total Expenses	(2,683)	(2,447)	-9%	(2,325)	-5%	(1,338)	-42%	(840)	-37%	(504)	-40%	(302)	-40%
General insurance net income	286	196	-31%	(35)	-118%	15	-143%	0	-100%	0	n.m.	0	n.m.
Operating Profit Before imp losses	(6,415)	(5,336)	-17%	(29)	-99%	427	-1573%	(194)	-145%	(197)	1%	(198)	1%
Impairment losses	(4,936)	(9,221)	87%	(5,476)	-41%	(4,725)	-14%	(2,618)	-45%	(828)	-68%	(372)	-55%
Pretax Contribution	(11,351)	(14,557)	28%	(5,505)	-62%	(4,298)	-22%	(2,812)	-35%	(1,024)	-64%	(570)	-44%

Source: Company Reports and CIRA Estimates

Figure 34. Royal Bank of Scotland – Divisional Profit and Loss Account 1Q09-4Q11E (Pounds in Millions) cont

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11E	4Q11E
Central Items												
Pretax Contribution	145	191	324	(169)	337	49	76	114	(43)	47	(75)	(75)
Non-Core												
Net Interest Income	395	274	287	578	568	534	438	419	303	285	276	256
Fees and commissions	172	79	130	129	104	158	43	166	47	47	46	42
Trading income	(2,617)	(1,184)	(579)	(781)	(131)	33	219	(152)	(298)	230	0	0
Other operating income	30	(52)	43	11	225	(25)	8	(276)	296	321	(50)	(50)
Total Income	(2,020)	(883)	(119)	(63)	749	700	708	157	348	883	272	248
Total Direct Expenses	(557)	(400)	(394)	(544)	(534)	(471)	(449)	(371)	(247)	(264)	(265)	(265)
Indirect Expenses	(142)	(137)	(132)	(141)	(122)	(121)	(130)	(127)	(76)	(71)	(75)	(75)
Total Expenses	(699)	(537)	(526)	(685)	(656)	(592)	(579)	(498)	(323)	(335)	(340)	(340)
General insurance net income	67	59	47	23	35	(42)	36	(64)	10	5	0	0
Operating Profit Before imp losses	(2,652)	(1,361)	(598)	(725)	128	66	165	(405)	35	553	(68)	(92)
Impairment losses	(1,828)	(3,516)	(2,066)	(1,811)	(1,704)	(1,390)	(1,171)	(1,211)	(1,075)	(1,411)	(1,209)	(1,030)
Pretax Contribution	(4,480)	(4,877)	(2,664)	(2,536)	(1,576)	(1,324)	(1,006)	(1,616)	(1,040)	(858)	(1,278)	(1,122)

Source: Company Reports and CIRA Estimates

Royal Bank of Scotland Group PLC

Company description

Royal Bank of Scotland (RBS) is a major UK-based, international universal banking group. The group provides banking services and structured financing to medium and large businesses in the UK, where it also offers banking to retail and SME customers, as well as internationally, most notably in the US via its Citizens subsidiary, and Ireland via Ulster Bank. RBS also sells insurance and investment products and provides private banking.

Investment strategy

We rate RBS Buy/Medium Risk (1M). We believe that the company remains poorly held by investors due to the perceived uncertainties surrounding the regulatory environment and, in particular, the perceived complexity of its balance sheet and earnings outlook as it restructures. However, we believe that these complexities and uncertainties are reducing, and the company is on-track to achieve large parts of its 2013 strategic targets, which the market valuation is not discounting.

Valuation

We set our target price at 46p based on a two-stage dividend discount approach combined with a capital-adjusted warranted-equity valuation to calculate a terminal value. This target price represents 0.86x multiple of 2012E TBV per share (in-line with the European banks sector average). RBS still has to execute on a relatively protracted balance sheet transformation program that may not be complete by end 2013, and the UK Government owns 84%. There is also regulatory uncertainty affecting the bank, in particular the Independent Commission on banking Review in the UK. This could result in near-term volatility in the share price. However, on a medium- to long-term view the size of the current discount is too much, in our opinion, and we believe there is now a good investment case for one of the few remaining 'value' or 'recovery' stories in the European banks sector.

Risks

We rate RBS as Medium Risk. RBS is still harder to model and forecast than the majority of European banks, but the forecast parameters are narrowing as the group's performance improves and we have a lengthening performance trend for the Non-Core division. Forecast risks now look evenly balanced, we believe. As well as downside risks associated with the Non-Core division balance sheet restructuring and Ireland, RBS has several potential upside surprise catalysts that could result in it materially outperforming our target, such as a turnaround in the US business and in Insurance, as well as margin improvements in the UK around rising interest rates. The regulatory risks surrounding UK bank capital requirements and what may be implemented in the UK following the recommendations of the ICB Review should be clearer by 4Q11.

Appendix A-1

Analyst Certification

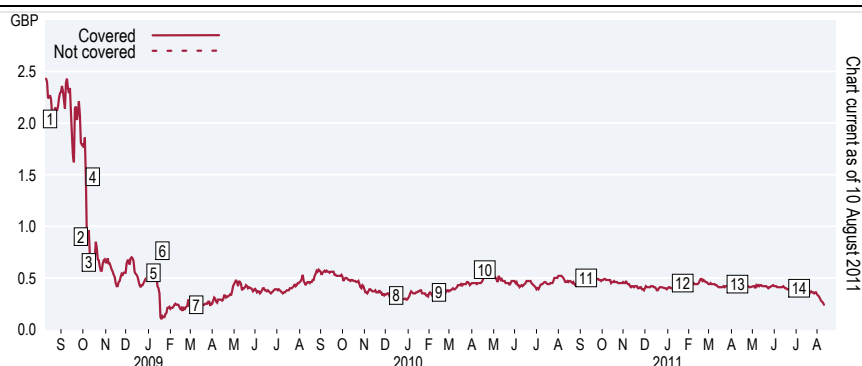
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IMPORTANT DISCLOSURES

Royal Bank of Scotland Group PLC (RBS.L)

Ratings and Target Price History Fundamental Research

Analyst: Andrew Coombs
Covered since July 6 2011



Date	Rating	Target Price	Closing Price
1 15-Aug-08	1M	*2.63	2.27
2 29-Sep-08	1M	*2.70	1.81
3 9-Oct-08	1M	*1.50	0.96
4 15-Oct-08	1M	*1.00	0.65
5 8-Jan-09	*1H	1.00	0.51

* Indicates change

Date	Rating	Target Price	Closing Price
6 21-Jan-09	*1S	*0.35	0.13
7 10-Mar-09	*2S	*0.20	0.21
8 16-Dec-09	*2H	*0.34	0.32
9 15-Feb-10	2H	*0.35	0.32
10 20-Apr-10	2H	*0.51	0.53

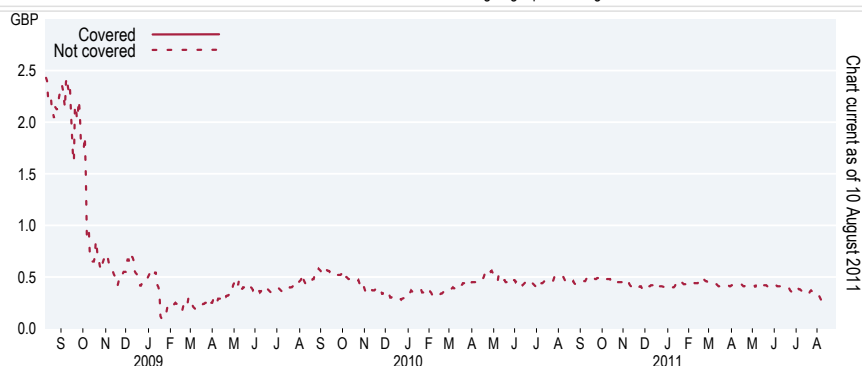
Date	Rating	Target Price	Closing Price
11 9-Sep-10	*1M	*0.57	0.48
12 24-Jan-11	1M	*0.56	0.44
13 11-Apr-11	1M	*0.61	0.44
14 6-Jul-11	1M	*0.50	0.38

Rating/target price changes above reflect Eastern Standard Time

Royal Bank of Scotland Group PLC (RBS.L)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Andrew Coombs
Covered since July 6 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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