

# Banking on London

## Decoding UK Retail Banking: Buy Barclays & HSBC

- **What's New?** — In December 2013 the major UK lenders published details, for the first time, of retail lending at individual postcode level. We have collated & analyzed this new regional data. By using the “branch finder” search tool on each individual lenders website we also believe we have been able to capture (almost) all of the postcode locations of each of the individual branches of the six largest lenders. This enables us to draw new conclusion on the strengths and weaknesses of each bank.
- **Best Placed For Growth: Barclays & HSBC** — In recent years funding and capital constraints have been the main driver of mortgage market share changes: Barclays has captured share, while Lloyds has lost share. In future we expect pricing, service quality and strategic positioning, to include regional positioning, to be bigger drivers. In the long-term we see Barclays & HSBC as best placed for loan growth, helped by a strong market position in London, which is expected to show some of the fastest population growth and contributes a disproportionately large share of UK GDP.
- **Best Cost Take-Out Potential: RBS, HSBC & Barclays** — The success of digital banking has resulted in a marked behavioral shift: RBS has seen a 30% drop in branch transactions since 2010, while half of all consumer lending at Barclays is now transacted without the customer ever visiting a branch. The traditional branch model is set to come under review, with the possibility of large cost-savings. Based on outstanding mortgage loans per branch, RBS, HSBC & Barclays appear to have the largest cost take-out potential, with the greatest opportunities in Wales, North East (Barclays), South West (HSBC) and across a wide range of regions for RBS.
- **Best Positioned In The Event Of A Downturn: Barclays** — The regions where we believe the greatest asset quality risks reside are those with above-average unemployment and house prices still well below the previous 2007 peak. There are five regions which fit both categories – North East, North West, Wales, Yorkshire & Humberside and West Midlands. Barclays has the lowest exposure to these five regions. Lloyds has greatest exposure. What about a London house price bubble? We do not subscribe to this, as mortgage affordability still looks attractive vs history.
- **4Q13 Results Previews** — Barclays (Buy) and HSBC (Buy) both screen well in our regional analysis on growth, cost take-out potential and asset quality. Barclays is also on [Citi Focus List](#). We expect investor concerns on leverage, asset shrinkage and costs to be addressed with the 4Q13 results. Our other Buy rated UK bank is StanChart, where downside risks are more than adequately reflected in the lowly valuation in our view. We have a Neutral rating on Lloyds and Sell (3H) rating on RBS. Our target price and earnings changes are summarized below. Industry trends can be located in our accompanying report [UK Banks Big Picture: Winter 2013/14](#).

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Company	Ticker	Rating		Target Price		Current Year Earnings Estimates	
		Old	New	Old	New	Old	New
Barclays	BARC.L	1	1	£3.20	£3.30	p26.4	p24.4
HSBC	HSBA.L	1	1	£7.70	£7.70	US\$95	US\$93
Lloyds Banking Grp	LLOY.L	2	2	£0.83	£0.85	p6.1	p6.1
RBS	RBS.L	3H	3H	£2.75	£2.90	p-19.1	p-19.1
Standard Chartered	STAN.L	1	1	£16.50	£16.50	US\$212	US\$212

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

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# Decoding UK Retail Banking

## Key Findings

- In the long-term we see Barclays and HSBC as best placed for loan growth, helped by a strong market position in London: 33% of Barclays mortgage portfolio is derived from London and 31% of HSBC's portfolio (Figure 17).
- Based on the current mortgage market share positions, we believe Barclays should consider targeting market share gains in East Midlands, HSBC looks to be well-balanced, Lloyds needs to gain exposure to South East, East of England and London and RBS should aim to invest more in London (Figure 19).
- RBS, HSBC and Barclays appear to have the poorest productivity, with outstanding mortgage loans per branch of £49m, £62m and £76m respectively. This compares to £108m at Lloyds for example (Figure 32). This productivity metric concurs with current cost-income ratios, where Lloyds is already 'best in class' at 47% (Figure 26). This seems to suggest the greatest branch, and therefore cost take-out potential could be at RBS, HSBC and Barclays.
- Retail operations in Wales screen as 'inefficient' for all three of the banks above. Other regions which screen as 'inefficient' include North East for Barclays, South West for HSBC and a wide range of regions across the UK for RBS (Figure 33)
- The regions where we believe the greatest asset quality risks reside are those with above-average unemployment and house prices still well below the previous 2007 peak - North East, North West, Wales, Yorkshire & Humberside and West Midlands (Figure 46, Figure 51). Barclays has the lowest exposure, at 23%, and Lloyds the greatest exposure, at 31%, to these five regions (Figure 52).
- We do not see sufficient evidence to suggest there is a house price "bubble" in London. Mortgage affordability in London, relative to the rest of the UK, is broadly in-line with historic levels (Figure 56), positive for asset quality in the region.

## What's New?

In December 2013 the major UK lenders published details, for the first time, of lending at individual postcode level

In December 2013 the major UK lenders published details, for the first time, on their total outstanding mortgage, personal and SME lending balances split by postcodes across Great Britain. Going forward this data will be published quarterly by the CML (Council of Mortgage Lenders) and BBA (British Banking Authority), with the CML responsible for publishing data on residential mortgage lending and the BBA responsible for publishing data on SME lending and unsecured personal loans.

This is a major development in terms of transparency and enhanced disclosure. So what conclusions can we draw from this wealth of new data? Which banks have the greatest exposure to which regions? Where do the largest gaps and growth opportunities exist? Are some banks more productive in certain local regions than others? We set out to address all of these questions (and more) within this report.

At first glance the breakdown of the six largest UK lenders' outstanding loan portfolios by region broadly maps to the split of UK GDP and disposable income

Figure 1. Largest Six Lenders - Breakdown of Key Branch and Lending Statistics by Region

Region	Bank Branches	Mortgage Lending	Personal Loans	SME Loans
East Midlands	7%	5%	6%	6%
East of England	9%	7%	7%	7%
London	13%	26%	17%	20%
North East	4%	3%	4%	3%
North West	11%	9%	12%	11%
Scotland	8%	7%	8%	7%
South East	14%	18%	15%	13%
South West	8%	9%	9%	12%
Wales	5%	3%	5%	5%
West Midlands	9%	7%	9%	10%
Yorkshire & The Humber	8%	6%	8%	7%

Source: Company Reports, Company Websites, CML, BBA and Citi Research  
Note: Includes Barclays, HSBC, Lloyds, Nationwide, RBS and Santander UK

Figure 2. Great Britain - Breakdown of Key Demographics by Region

Region	Population	GVA	Disposable Income	SME Turnover
East Midlands	7%	6%	7%	6%
East of England	10%	9%	10%	9%
London	13%	23%	17%	29%
North East	4%	3%	4%	2%
North West	11%	10%	10%	10%
Scotland	9%	8%	8%	6%
South East	14%	15%	16%	15%
South West	9%	8%	9%	7%
Wales	5%	4%	4%	3%
West Midlands	9%	7%	8%	7%
Yorkshire & The Humber	9%	7%	8%	7%

Source: ONS, BIS and Citi Research

Our collated data captures 69% of total UK mortgage lending, 58% of personal lending and 46% of SME lending

Out of the 10,834 sector postcodes in Great Britain data has been published on 8,260 - 9,030 postcodes (Figure 3). In addition, there are 1,770 postcodes where nobody lives. Our collated data on the six largest lenders regional exposures, built on a bottom-up basis, using data at individual sector postcode level, captures 69% of total UK mortgage lending (£873bn), 58% of personal lending (£29bn) and 46% of SME lending (£78bn). However we note that the individual bank data that we have used includes some redaction in order to strike a balance between the desire for transparency and the need to protect customer confidentiality.

For example borrowing for a sector postcode cannot be disclosed where there are fewer than 10 borrowers or where borrowing is highly concentrated in a small number of the largest borrowers in the sector. Furthermore for some lending data, especially within the SME space, it is impossible to allocate this to an individual sector postcode. The full BBA/CML statistics also include Clydesdale & Yorkshire Banks and incorporates data at an area level (which cannot be allocated to individual postcodes). This therefore captures 73% of total UK mortgage lending (£898bn), 60% of personal lending (£30bn) and 60% of SME lending (£104bn).

Figure 3. Great Britain - Market Coverage of Initiative

	Mortgages	Personal Loans	SME Borrowing
Total industry level, UK (£ bn)	1,266.0	50.0	170.4
<b>Scope of this initiative, GB (£ bn)</b>	<b>898.1</b>	<b>30.3</b>	<b>103.6</b>
<b>Publishable at sector postcode level</b>			
: (£ bn)	<b>884.6</b>	<b>29.5</b>	<b>82.8</b>
: number of sector postcodes	9,030	8,940	8,260
Sectors redacted to preserve confidentiality			
: (£ bn)	3.5	0.1	4.4
: number of sector postcodes	800	410	1,300
Other lending which cannot be allocated at sector, but available at Area level (£ bn)	3.3	0.3	14.5
Lending which cannot be allocated to geographies (£ bn)	6.5	0.4	1.8

Source: BBA. Note: Scope of initiative includes the six largest lenders (Barclays, HSBC, Lloyds, Nationwide, RBS and Santander UK) and Clydesdale & Yorkshire Banks

Any conclusions drawn from this report could be subject to possible caveats

When interpreting the figures in this report, it is also important to bear in mind that we have only collated data on the six largest lenders. As the CML points out, local markets may display very different market share characteristics. Furthermore there is significant variation in house price values, population size and tenure patterns at a local level, which could distort any conclusions.

# Growth & Market Share Opportunities

## Barclays Gaining Share; Lloyds Losing Share

**The six largest lenders dominate the UK retail banking market**

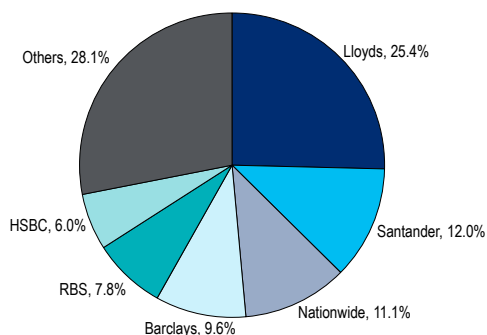
The six largest lenders dominate the UK mortgage, personal unsecured and SME markets. For example the six largest lenders account for a combined 72% of total mortgage loans, of which the largest three account for 48%, and the largest lender, Lloyds, 25% (see Figure 4). However the period post the financial crisis has seen some of the largest market share shifts in recent history (see Figure 5), due to a combination of M&A, revised risk assessment and tighter regulatory constraints on capital and liquidity. This has enabled some lenders to capture significant mortgage market share (eg. Barclays). Meanwhile others have recorded sharp declines (eg. Lloyds, Santander). New entrants have made little headway.

**In recent years Barclays has captured the most mortgage market share, while Lloyds has lost the most market share**

At Lloyds the decline in mortgage loans outstanding was primarily due to balance sheet management, with an aim to better match loans to deposits, thereby reducing the Group's reliance on wholesale funding. In particular Lloyds decided to actively step back from intermediary remortgages, where they felt the brand damage would be less pronounced. Instead Lloyds remained focused on first-time buyers. Lloyds reached the desired Group LDR target (120%) in 1Q13 and its mortgage market share has since started to stabilize. We forecast a return to loan growth in 2014 (+3% yoy). Santander made an active decision to focus on quality, rather than quantity. Lending criteria were tightened on a range of higher LTV and interest only mortgages in early 2012 which limited gross mortgage lending. For example Santander has introduced a 50% LTV cap on new interest only mortgages.

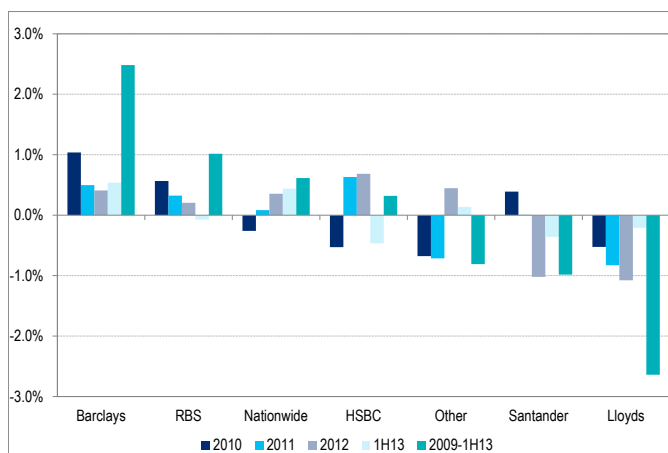
**New entrants have made little headway**

Figure 4. Market Share of UK Mortgages Outstanding, end-June 2013



Source: Company Reports, BoE and Citi Research  
Note: 'Others' based on BoE industry total less six largest lenders

Figure 5. Change in UK Mortgage Market Share, end-2009 to end-June 2013

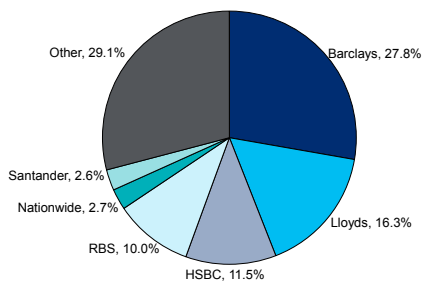


Source: Company Reports, BoE and Citi Research  
Note: 'Others' based on BoE industry total less six largest lenders

**Barclays has also captured market share in credit cards, through a combination of M&A and organic growth**

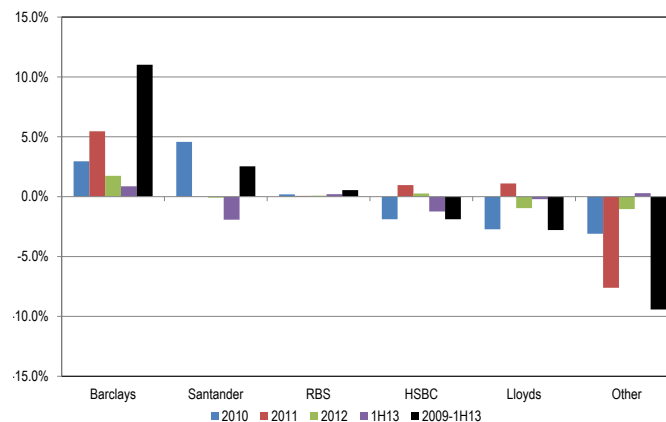
Each bank provides inconsistent disclosure on unsecured personal loans – some banks include overdrafts, others do not – making market share analysis somewhat more complicated. However all of the banks do provide data on outstanding credit card balances. While this does not track to the unsecured lending captured in the postcode data, it nonetheless gives an indication on which banks have been more active. Overall Barclays, the largest credit card lender in the UK (Figure 6), is the only bank to have captured significant market share in recent years, through a combination of M&A (the Egg acquisition) and organic growth (Figure 7). This has been at the expense of some of the international and smaller lenders in the market.

Figure 6. Market Share of UK Credit Cards Outstanding, end-June 2013



Source: Company Reports, BBA and Citi Research  
Note: 'Others' based on BBA industry total less six largest lenders

Figure 7. Change in UK Credit Card Market Share, end-2009 to end-June 2013

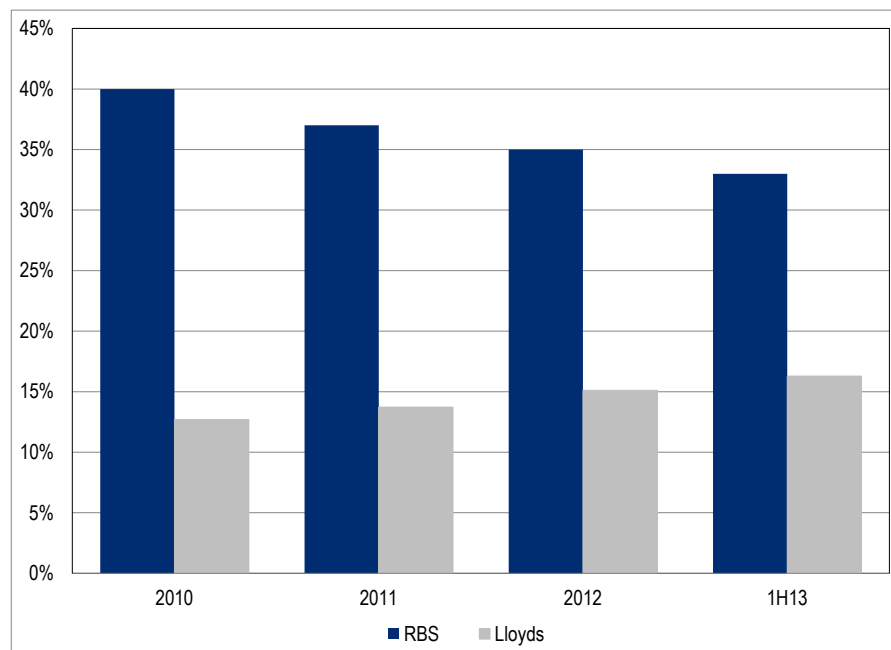


Source: Company Reports, BBA and Citi Research  
Note: 'Others' based on BBA industry total less six largest lenders. Barclays includes acquisition of Egg in 2011 (+2.6% m/share). Santander includes acquisition of Santander Cards in 2010 and disposal of Cahoot credit cards in 2H13.

### RBS has lost notable market share in SME lending

Individual bank disclosure on SME lending also tends to be either inconsistent (based on different turnover thresholds used to define an "SME"), or absent entirely. RBS is the largest lender in this market, followed by Barclays, and then Lloyds. The recent report by Sir Andrew Large into RBS' SME lending practices does provide some useful data on RBS' recent market share progression in SME lending as we illustrate below. Overall RBS has lost a substantial 7ppt in just two and a half years, following a decline in its share of the flow of gross new lending and a rise in the rate of repayments. In contrast Lloyds has made small gains in market share.

Figure 8. UK Banks – SME Market Share, end-2009 to end-June 2013



Source: RBS Independent Lending Review, Company Reports and Citi Research Estimates

**We expect pricing, service quality and strategic positioning to be the key drivers of growth going forward**

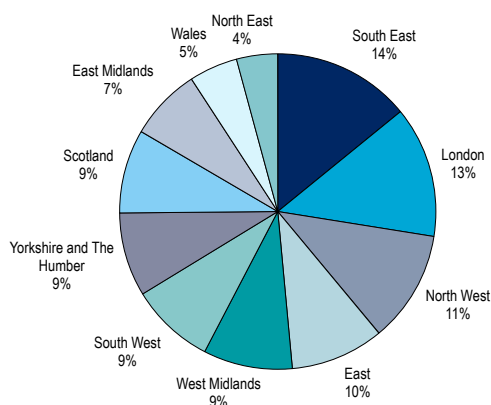
**27% of the population of Great Britain resides in London and South East. These two regions have also seen some of the fastest population growth**

## Best Regional Focus For Growth: Barclays & HSBC

While M&A and balance sheet constraints have been the primary driver of market share in recent years, we believe we have now reached an inflection point. With further consolidation unlikely and balance sheets now far healthier, we expect market share to instead be driven by more traditional factors – namely pricing, service quality and strategic positioning. One key strategic factor is each lenders regional strengths and weaknesses. This is evident through the postcode data we have collated, which enable us to observe which banks have the greatest exposure to which regions. In turn, we can derive where the largest market share gaps and growth opportunities exist for each bank, on a long-term basis.

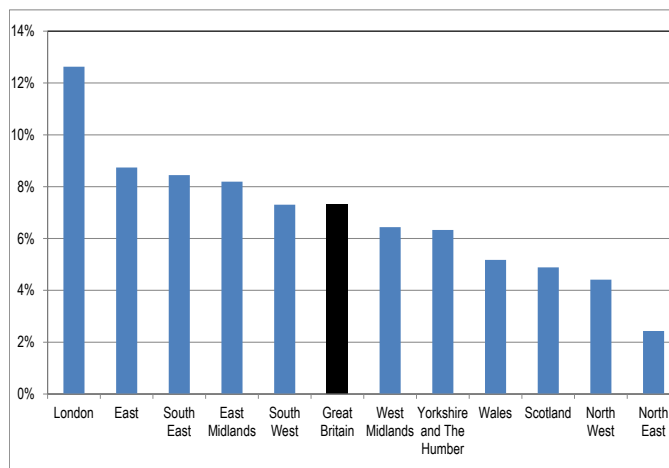
First we consider the demographics. A combined 27% of the population of Great Britain resides in London and South East. These two regions have also seen some of the fastest population growth during the past 10 years, with a CAGR of 1.2% and 0.8% respectively. In sharp contrast the North East and Wales have seen much slower growth and now constitute the two smallest regions by population.

Figure 9. Great Britain Population By Region



Source: ONS and Citi Research

Figure 10. Great Britain Population Growth In Past 10 Years



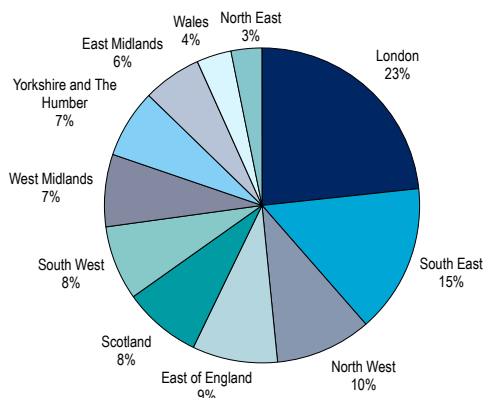
Source: ONS and Citi Research

**London and South East make an even more prominent contribution to Gross Value Added (GVA) and household disposable income**

London and South East make an even more prominent contribution to Gross Value Added (GVA) and household disposable income, accounting for 38% and 33% of the GB total respectively. While the growth trends of both economic indicators over the past ten years do not necessarily map to population growth, London has seen the strongest growth in GVA (+4.8% CAGR) and in disposal income (+4.3% CAGR) far outpacing the wider country. In contrast the West Midlands and Yorkshire and Humber have seen some of the slowest growth in GVA and disposable income.

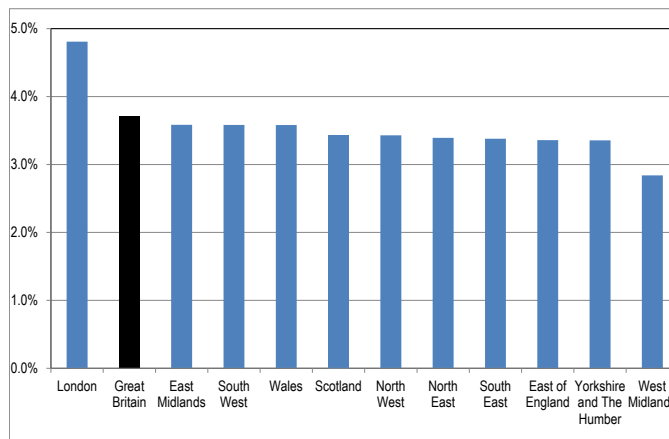


Figure 11. Great Britain Gross Value Added (GVA) By Region



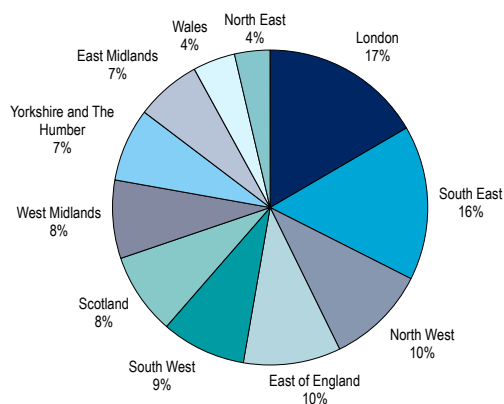
Source: ONS and Citi Research. Note: Workplace based estimates of economic output, based on the incomes of individuals allocated to their place of work.

Figure 12. Great Britain Gross Value Added CAGR In Past 10 Years



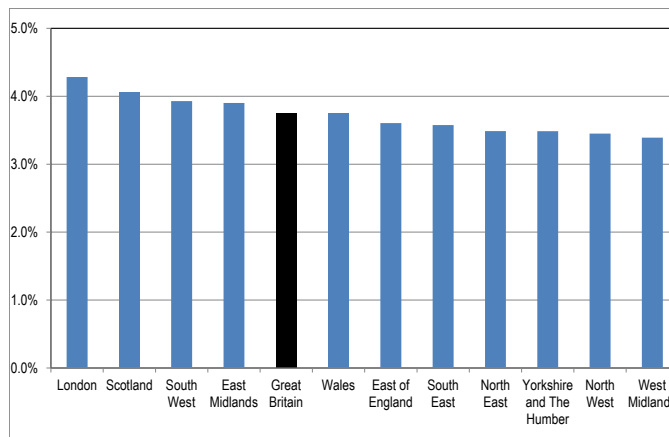
Source: ONS and Citi Research. Note: Workplace based estimates of economic output, based on the incomes of individuals allocated to their place of work.

Figure 13. Great Britain Gross Disposable Income By Region



Source: ONS and Citi Research. Note: Income received by households net of tax payments, social security contributions and benefits

Figure 14. GB Gross Disposable Income CAGR In Past 10 Years



Source: ONS and Citi Research. Note: Income received by households net of tax payments, social security contributions and benefits

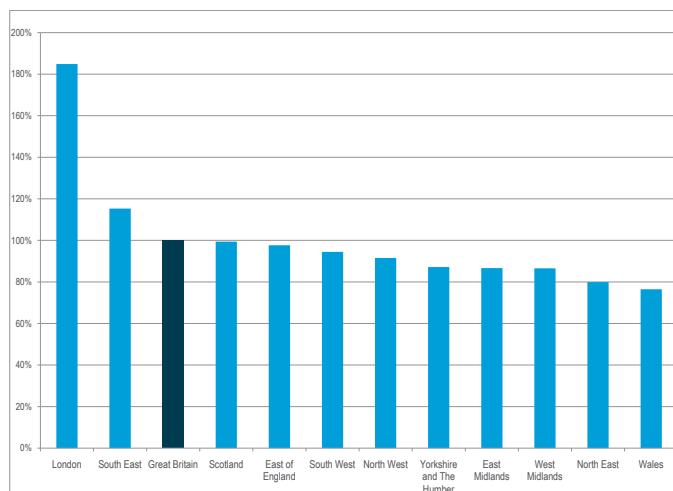
GVA per head in London is now almost double the national average (Figure 15). Furthermore the range in economic output per head between sub-regions is far wider in the UK than in any other European country, largely due to London's decoupling with the rest of the country (Figure 16). The UK lenders should therefore not underestimate the strategic importance of investing in the country's capital in our view.

**A number of economic indicators suggest the London population boom, together with faster growth in GVA and disposable income, is set to continue**

A number of economic indicators also suggest that the London population boom, together with faster growth in GVA and disposable income, is set to continue. For example, London's age profile is younger than that of the UK as a whole, with a median age of 34.0 years, compared with 39.7 years for the UK. Life expectancy at birth in 2009 to 2011 was 79.3 years for males and 83.6 years for females, above the England averages (78.9 and 82.9 years respectively). International migration to London is another factor to consider. The interim 2011-based population projections from the ONS suggest the population could increase by a further 14.2% between 2011-21 to 9.4 million. The rate of business creation in London is also the highest in the UK, at 14.6% in 2011, compared with 11.2% for the UK as a whole.

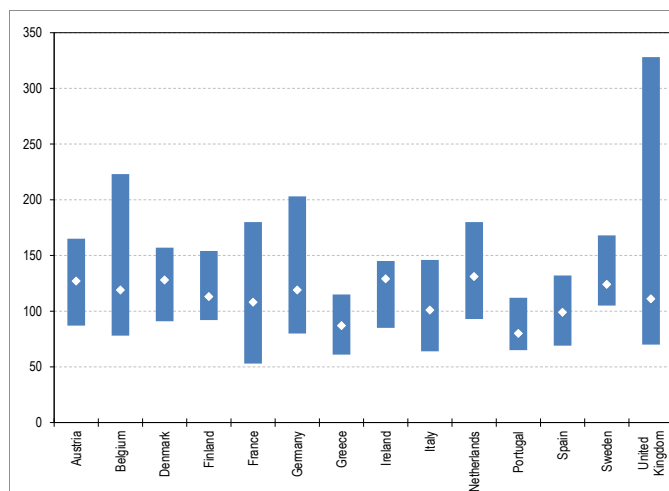


Figure 15. Gross Value Added Per Head as % of GB Average



Source: ONS and Citi Research. Note: Workplace based estimates of economic output, based on the incomes of individuals allocated to their place of work.

Figure 16. Range in GVA Per Head Between Sub-Regions as % of EU Average



Source: Eurostat and Citi Research. Note: PPP adjusted.  
◇ = National Average. Range for UK is for Inner London to West Wales.

#### Lenders need to be positioned to benefit from London's growth prospects

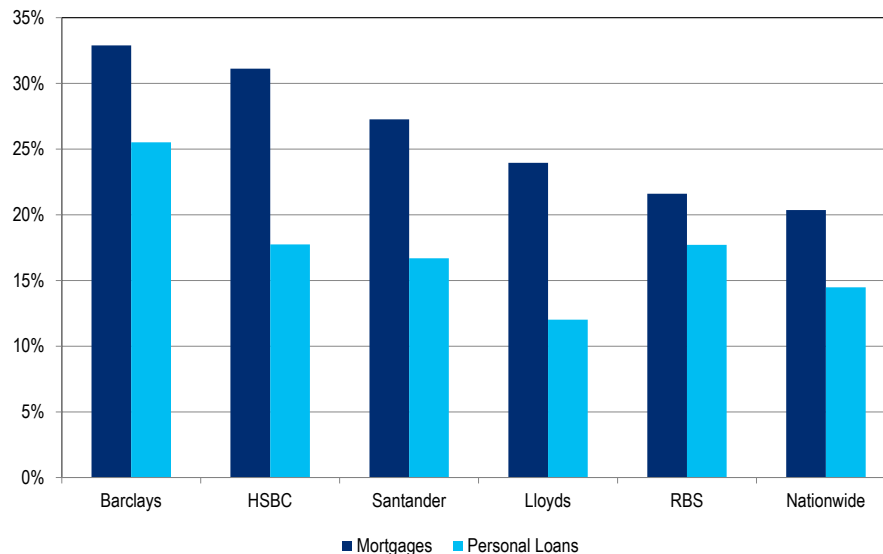
This long-term growth potential in London, relative to the rest of the UK, has not been lost on senior bank executives. For example in March 2013 Ross McEwan, then head of retail banking and now CEO of RBS, stated:

*"We have got a very big customer base that is poorly penetrated right across the whole business, but thinking about London in particular, where there is still growth and the incomes are pretty good. I see it as both using the customer base that we have to actually do better things with it and then also see if we can't pick up a little bit more market share without being absolutely aggressive in the marketplace. I'll give you a quick example using mortgages; we're completely underscored on mortgage advisers in the London marketplace, the biggest growth place. I think at the bottom end there were about 63 people that were qualified to do a mortgage. I mean, we should have twice that number in this marketplace. So it's those sort of opportunities, because the opportunities are there for us we just haven't been working hard enough on them and focusing on the growth opportunities in London."*

#### Barclays & HSBC have the greatest exposure to London and look best placed

So which of the listed UK lenders has the greatest exposure to London? Barclays has the largest allocation, with 33% of its mortgage portfolio and 26% of its personal loan portfolio (by value) derived from London. HSBC has the second largest mix towards London. In contrast Lloyds only derives 24% of its mortgage portfolio and 12% of its personal loan portfolio from London, while for RBS the comparable figures are 22% and 18%. We would argue that Barclays and HSBC therefore look better placed to benefit from London's strong future growth demographics.

Figure 17. UK Lenders – Proportion of Lending Portfolio Derived From London

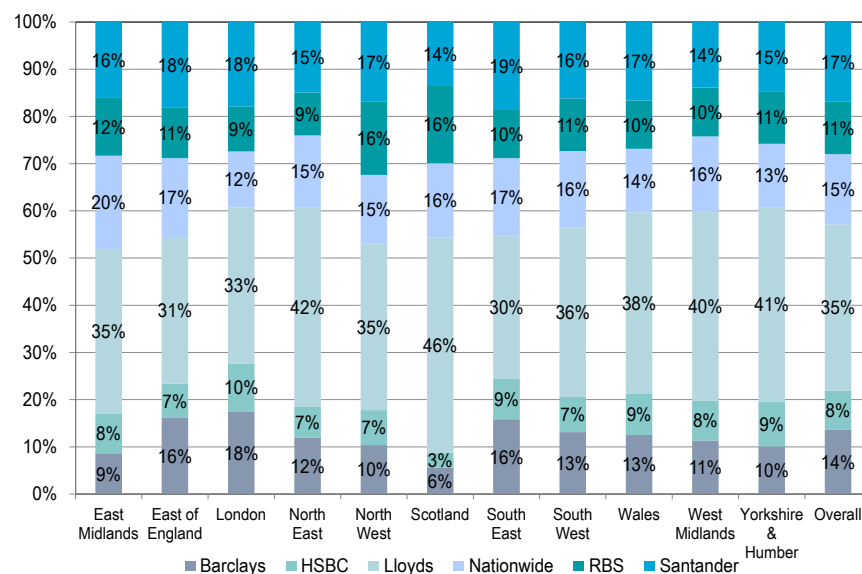


Source: Company Reports and Citi Research

**We compare lenders' market share positions in each region**

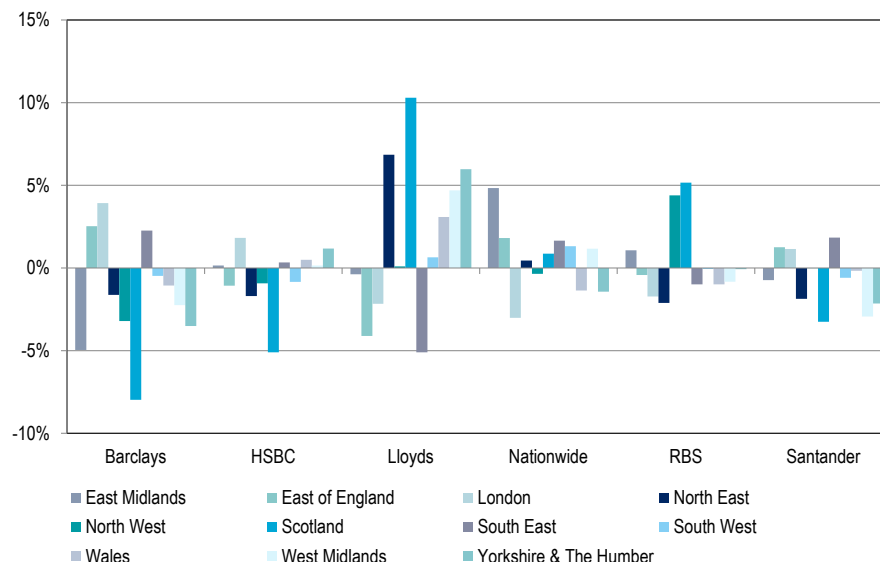
What about missed market share opportunities? Below we outline the split of total mortgage loans outstanding between the six largest lenders in each individual region. Of course this analysis fails to take into account other competitors, albeit as we illustrated in Figure 4 these only account for c28% of the overall mortgage market. The second chart then demonstrates each lenders' excess / shortfall in each individual region relative to their position across the country as a whole.

Figure 18. UK Lenders – Split of Regional Mortgage Loans Between Six Largest Lenders



Source: Company Reports and Citi Research

Figure 19. UK Lenders – Mortgage Share Excess/(Shortfall) vs National Market Share Position



Source: Company Reports and Citi Research

Note: Market share defined as market share amongst six largest lenders

Barclays (Figure 20) appears to have the best overall regional focus to benefit from future population and economic growth in the UK, buoyed by its significant market presence in London, where Barclays has its largest market share excess relative to its overall market share position across the country (c4ppt ahead of its national average). Barclays is also overweight in the South East and East of England.

**Barclays should target market share gains in East Midlands**

Barclays' largest market share shortfall is understandably in Scotland (c8ppt below), which is dominated by Lloyds, via the Bank of Scotland brand, and RBS and where it would be difficult to compete. However Barclays is also surprisingly weak in the East Midlands, a region which has seen respectable economic growth over the past ten years. However on closer inspection this mainly appears to be attributable to a smaller presence in the north of the region (Derby, Nottingham), which arguably is less complementary to Barclays' existing regional focus on London and South East.

**HSBC appears to be well balanced**

Interestingly HSBC (Figure 21) has a broadly similar geographic split to Barclays with a market share excess in London and shortfall in Scotland. It therefore also looks well positioned to benefit from different future regional growth trends, in our view. The remainder of the portfolio is also relatively well balanced between the various regions, with no obvious market share shortfalls outside of Scotland.

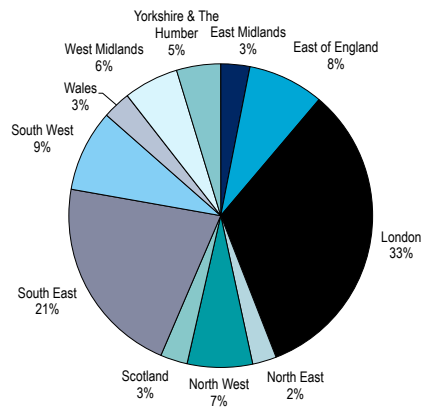
**Lloyds needs to gain exposure to South East, East of England and London**

As well as Scotland, Lloyds (Figure 22) is overweight in North East, Yorkshire and West Midlands, relative to peers – all regions which have reported some of the slowest population and economic growth in the past ten years. In contrast it is underweight in the South East, East of England and London – which together have recorded strong growth over the past ten years. The geographical mix of Lloyds' business therefore looks far from ideal. Centralized pricing makes it difficult to compete on price in individual regions, so greater investment on staff, services and marketing may be required to improve market share in these three regions.

**RBS needs to invest in London**

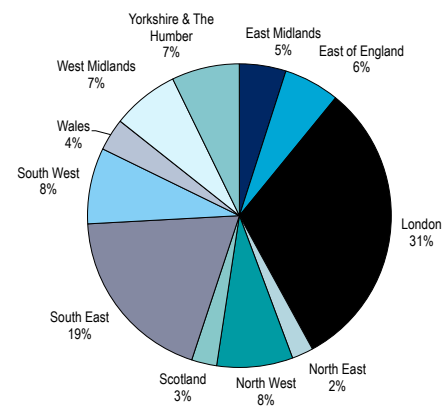
RBS (Figure 24) has a heavy weighting towards Scotland and the North West, with market share shortfalls in the North East and London. As Ross McEwan has himself alluded to one of the priorities for RBS has to be renewed focus and investment in London, such as the aforementioned example of hiring more mortgage advisors.

Figure 20. Barclays – Breakdown of Mortgage Portfolio by Region



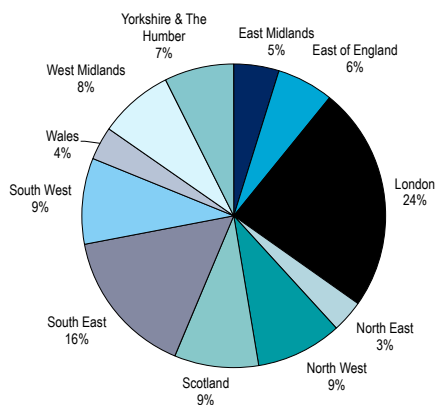
Source: Company Reports and Citi Research

Figure 21. HSBC – Breakdown of Mortgage Portfolio by Region



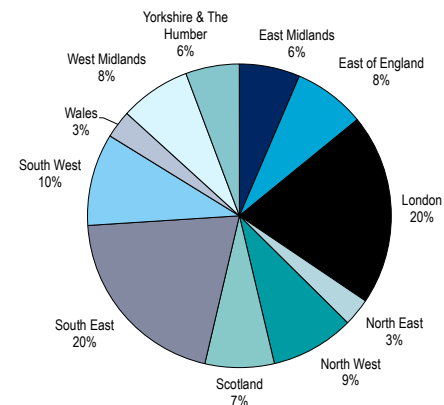
Source: Company Reports and Citi Research

Figure 22. Lloyds – Breakdown of Mortgage Portfolio by Region



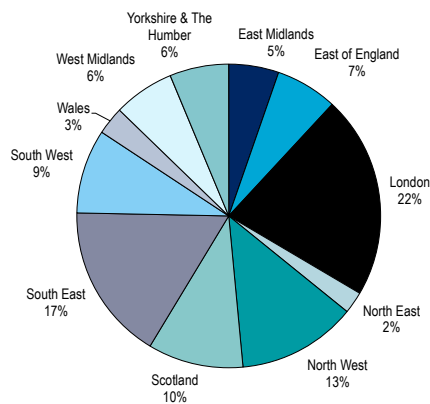
Source: Company Reports and Citi Research

Figure 23. Nationwide – Breakdown of Mortgage Portfolio by Region



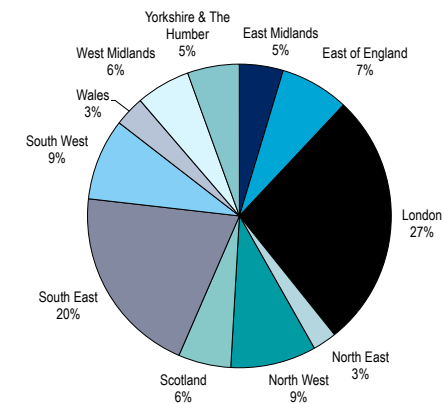
Source: Company Reports and Citi Research

Figure 24. RBS – Breakdown of Mortgage Portfolio by Region



Source: Company Reports and Citi Research

Figure 25. Santander – Breakdown of Mortgage Portfolio by Region



Source: Company Reports and Citi Research

# Operational Productivity

## Do Banks Need Branches?

Retail banks are businesses with high operational leverage

Banks are businesses with high operational leverage, especially in the retail segment, due to the high fixed costs associated with branch and other sales and service network infrastructure. Furthermore only a small proportion of retail banking staff costs are truly variable, since bonus payments are only a small proportion of overall compensation packages and branches require minimum staffing levels.

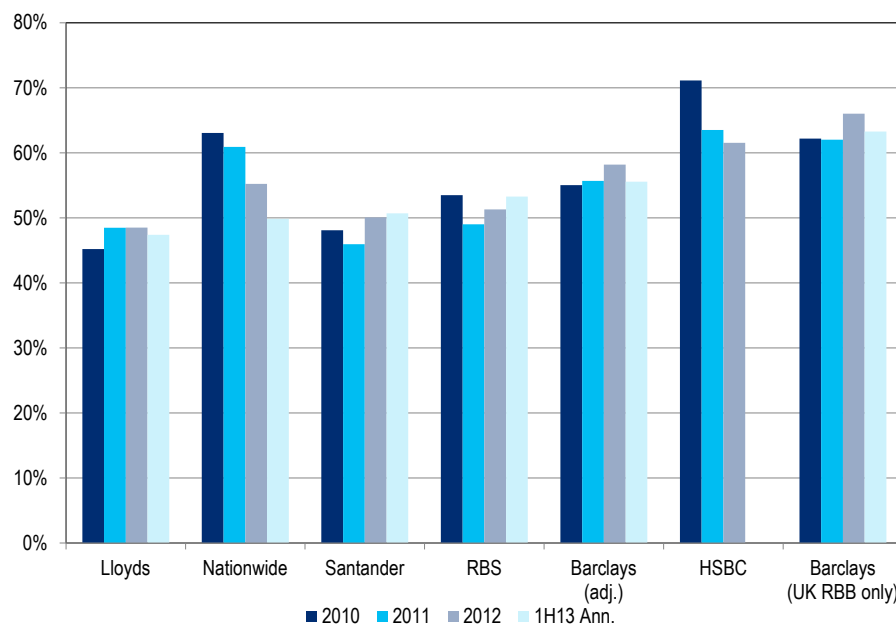
There are still some 'low hanging fruit' opportunities to reduce the cost base, such as simplifying the product range, manage distribution channels, improve sourcing, flattening the organization structure, moving to paperless statements, and so on, but ultimately a reduction in the size of the branch network and associated costs is likely to drive the largest cost saves in future years. A rationalization of the branch network, as well as telephony and support functions, should become increasingly feasible as customers resort to increased automation via online and mobile banking.

Lloyds has the best cost-income ratio, while Barclays & HSBC still have elevated cost-income ratios

In recent years there has been a renewed focus on cost discipline given the challenging top-line outlook. Lloyds and RBS have made the largest absolute cost reductions within their UK retail divisions, with expenses declining by 12% and 11% respectively since 2010, driven by a range of integration and simplification initiatives. All of the UK banks have therefore been able to broadly maintain and/or improve their existing cost-income ratios within a c45-65% range (Figure 26).

Lloyds remains the 'low cost producer' helped by its scale in UK retail banking, followed by Nationwide and Santander, albeit these two lenders have recently seen diverging trends. In contrast Barclays and HSBC have slightly more elevated cost-income ratios due to: (i) service-led propositions (over pricing); (ii) high-end asset quality bias (lower average LTVs), with the offset then usually coming from lower loan loss ratios relative to peers (see next chapter); (iii) slightly lower LDRs and; (iv) business mix, as both banks have a higher proportion of unsecured lending.

Figure 26. UK Retail Banking – Comparison of Cost-Income Ratios



Source: Company Reports and Citi Research

Notes: Barclays Adjusted based on UK RBB and 50% of BarclayCard in order to make it more comparable to the UK Retail divisions reported at peers. HSBC based on UK retail at HSBC Bank plc (the principal UK subsidiary). All ratios exclude 'one-off' items such as conduct charges for PPI, etc.

**Half of all consumer lending at Barclays is now transacted without the customer ever visiting a branch**

The success of digital banking presents significant cost-save opportunities, together with an ability to improve customer service and response times. Antony Jenkins, Barclays CEO, recently confirmed that almost half of all consumer lending at Barclays is now transacted without the customer ever visiting a branch and acknowledged that the traditional branch model and other points of contact will become less important to customers as part of the service mix over time:

*"The second macro challenge and something that I've described as the strategic battleground for banks over the next 20 years is cost ... We are working on ways to automate systems which have traditionally been performed manually, all but removing the risk of human error, and simultaneously driving down costs. Huge swaths of activity have the potential to be automated.*

*The rapidly growing use of technology by customers and clients is a trend which clearly indicates how banking services will increasingly be accessed in the future. By way of illustration, UK retail banking today now has over 2 million individuals who regularly use our mobile banking service. We have already seen this lead to an 8.4% reduction in call center volumes. Almost half of all consumer lending in Barclays last month was transacted by customers without visiting a branch.*

**The success of digital banking has resulted in a marked behavioral shift...**

*This change in how people want to engage with banks can make a customer's experience quicker, more responsive, and more satisfying. And to be clear, this behavioral shift is not a future trend. It's happening now. The implication of this shift is that the traditional branch model and other points of contact will become less important to customers as part of the service mix over time. And that in turn represents a significant opportunity to better serve customers and save cost."*

**... with traditional branch models (and associated costs) coming under review**

The other UK banks are taking similar steps. For example, at RBS increased use of online banking and an enhanced mobile banking application (used by >2 million customers within 15 months of launching) has enabled the bank to rationalize branch, phone and support functions, reducing related annual costs by 22%. Among RBS' digital customers 89% have also adopted paperless statements. At Lloyds, over 10 million customers now use internet banking and a further 3.7 million are mobile banking users, with mobile payment transactions doubling in the past year.

**In the past ten years 16% of high street branches have closed**

In the ten years to end-2012 the 'Campaign for Community Banking Services' calculates that the four listed UK banks have closed a net 1,084 branches, or 16% of the total (Figure 27). This includes 172 closures in 2011 and a further 155 branch closures in 2012. Closures have then continued into 2013: "HSBC has closed more than 200 branches in the UK over the last three years, but only four so far in 2013 ... Royal Bank of Scotland has closed 60 branches this year ... Santander will close a total of 48 this year, but has opened three new branches, making a net loss of 45 ... Barclays has closed 16 branches since the start of 2013 ... Lloyds has promised not to close any branches before February 2015" (BBC, 19 August 2013).

Figure 27. UK Branch Net Closures, 2002-12

	2002-12 (absolute)	2002-12 (%)
Lloyds	286 (incl. 189 o/laps)	18% (6% ex-o/laps)
Natwest	188	11%
Barclays	186	10%
HSBC	424	26%
<b>Subtotal</b>	<b>1,084</b>	<b>16% (14% ex-o/laps)</b>
Santander	253 (151 o/laps)	20% (8% ex-o/laps)
<b>Total</b>	<b>1,337</b>	<b>17% (13% ex-o/laps)</b>

Source: Campaign for Community Banking Services

Note: Overlaps refer to branch closures post mergers/acquisitions

## Greatest Cost Saving Potential: RBS, HSBC & Barclays

**We expect branch closures will continue for the foreseeable future**

Branch closures remain a highly sensitive political topic. At present a mandatory 12-week notice period is required for all branch closures and three of the four listed UK banks have signed up to a voluntary pledge protection against closure of over 400 (70%) of 'last bank in town' where the nearest alternative bank would be more than 1 mile away. Nonetheless we expect branch closures will continue for the foreseeable future, as banks adapt to the emergence and success of internet and mobile banking and the subsequent behavioral shift among the customer base. We expect they will also continue to come under pressure to reign in expenses.

**In Europe the Dutch, German and Nordic banks all operate with fewer branches than the UK banks**

A global comparison of bank branch density (branches per 100,000 population) places the UK in the middle of the pack. In Europe the Dutch, German and Nordic banks all operate with fewer branches than the UK banks. In contrast Southern Europe generally screens poorly with a very branch intensive model, especially in Spain and Italy, albeit often these retail branches can be relatively small. Branch density patterns often reflect the level of adoption of digital and electronic banking in a country. For instance the Nordic markets have the lowest number of cheques issued per capita among the developed markets, with Germany not far behind. The same markets also have some of the highest debit card usage.

Figure 28. Bank Branch Density For Selected Countries Worldwide (commercial bank branches per 100,000 population)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	% Chg
Spain	98.2	100.1	102.7	105.2	104.9	100.3	97.1	89.6	85.1	-13.3%
Italy	63.5	64.1	65.4	66.7	70.3	67.6	66.5	66.0	64.4	1.4%
Switzerland	57.4	56.8	55.6	55.3	53.9	52.7	51.8	50.2	48.8	-14.9%
Belgium	57.2	53.7	53.4	51.4	49.7	47.9	45.0	43.4	42.4	-25.9%
France	21.5	22.0	45.9	44.8	44.5	41.9	41.5	41.2	38.8	80.4%
United States	32.5	33.1	33.8	34.6	35.0	35.8	35.4	35.2	35.3	8.4%
Denmark	50.1	50.2	50.5	51.9	50.5	45.8	40.9	38.7	34.3	-31.5%
Japan	34.6	34.4	34.1	34.0	33.9	33.9	34.0	33.9	33.9	-2.0%
Australia	30.7	30.6	31.2	31.4	31.6	31.5	31.3	30.9	31.8	3.7%
Ireland	35.9	34.6	34.0	33.4	34.1	34.9	28.7	27.7	25.0	-30.2%
<b>United Kingdom</b>	<b>29.1</b>	<b>28.4</b>	<b>26.5</b>	<b>26.5</b>	<b>26.2</b>	<b>25.6</b>	<b>24.9</b>	<b>24.2</b>		<b>-16.7%</b>
Canada	-	-	24.6	24.6	24.5	24.1	24.0	24.1	24.4	-0.5%
Hong Kong	23.6	23.2	23.0	23.3	23.6	23.3	23.6	23.7	23.5	-0.4%
Sweden	23.6	23.6	23.7	23.6	24.0	23.0	22.5	21.7	21.8	-7.4%
Netherlands	33.7	28.1	27.7	28.6	27.6	25.2	23.0	21.3	19.6	-41.8%
Germany	21.3	20.2	16.7	16.3	16.3	15.8	15.7	15.5	13.9	-34.7%
Finland	13.2	14.4	16.9	16.1	16.1	15.0	15.5	15.1	13.6	3.2%
Singapore	11.7	11.5	11.1	10.7	10.3	10.2	10.2	10.0	9.8	-16.8%
Norway	13.1	12.1	12.0	12.3	11.6	10.9	11.0	10.7	9.9	-24.7%

Source: IMF

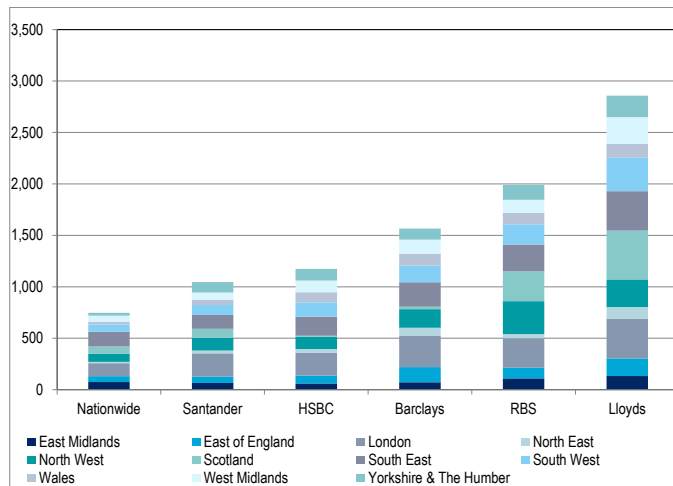
**We compare outstanding loans that each lender has issued in each region to the number of branches in the same location**

By using the "branch finder" search tool on each individual lenders website and cross-referencing the results against sites such as 'www.bankopeningtimes.co.uk' we believe we have been able to capture (almost) all of the postcode locations of each of the individual branches of the six largest lenders, to the best of our ability. In turn we can then compare outstanding loans that each lender has issued in each region to the number of branches in the same location. While this is an admittedly simplistic analysis – it doesn't take into account the size of each branch, different opening hours, different rental and staff costs between regions – it nonetheless serves as an interesting measure of operational productivity of each lender.



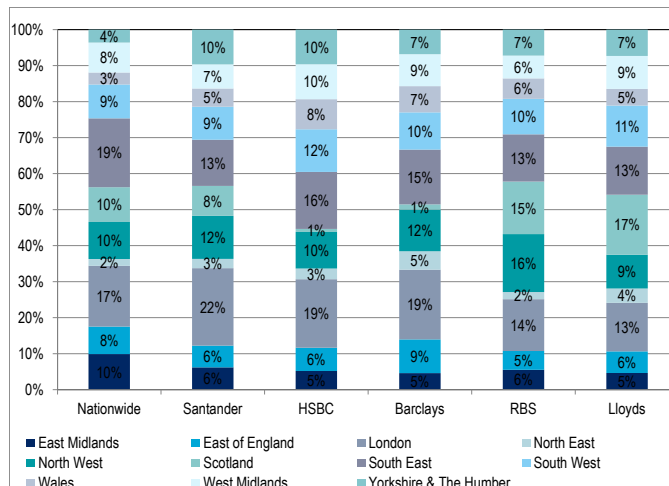
As one would expect, Lloyds has the largest number of branches in Great Britain, totaling close to 3,000, split between the Lloyds, Halifax, Bank of Scotland and TSB brands. This mirrors its dominant market share position in UK retail loans and deposits. Interestingly Santander (post the integration of A&L, Abbey and B&B) and Nationwide (including the Cheshire, Derbyshire and Dunfermline brands, which are all set to be integrated), the second and third largest UK mortgage lenders respectively, operate with the fewest branches.

Figure 29. UK Lenders – Total Branches in Great Britain



Source: Company Reports, Company Websites and Citi Research  
Note: Excludes branches in Isle of Man and Channel Islands. Also this includes branches in Great Britain only, so excludes Northern Ireland.

Figure 30. UK Lenders – Split of Total Branches in Great Britain



Source: Company Reports, Company Websites and Citi Research  
Note: Excludes branches in Isle of Man and Channel Islands. Also this includes branches in Great Britain only, so excludes Northern Ireland.

**Nationwide and Santander screen as most 'efficient'. Lloyds also screens well**

The proportion of branches in each region broadly maps to the breakdown of each lenders' mortgage portfolio, but there are some notable discrepancies: outstanding mortgage loans per branch are higher in London, South East and East of England and lower in Wales, Scotland and the North West (Figure 31). If one were to assume similar aggregate income on each mortgage loan, as mortgage pricing tends to be set on a centralized basis, and broadly similar costs at each individual branch, then this would imply that branches in the former three regions are more productive and/or cost efficient than branches in the latter three regions.

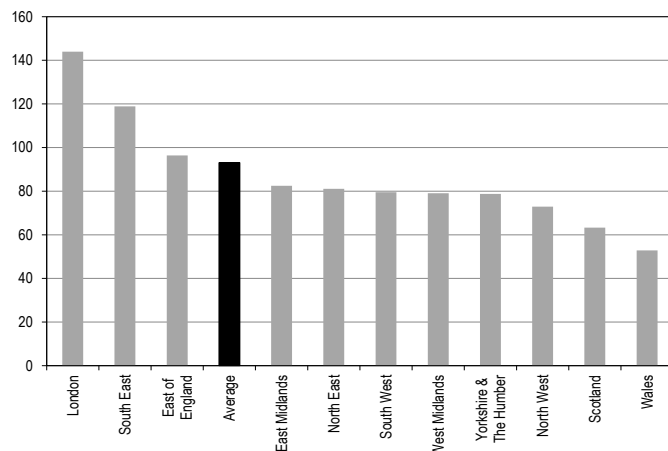
Of course these are large assumptions to make. Average LTVs, and therefore mortgage rates, will likely vary by region, while the cost of each branch will no doubt show some regional differentiation. For example, Lloyds and RBS have a disproportionately large number of branches in Scotland (Barclays and HSBC have very few branches in Scotland), but a number of these are smaller branches with fewer staff and reduced opening hours. Some of the Scotland branches are only open for 3 days a week, while others still revert to the old definition of 'mobile banking' – a mobile branch that drives from location to location<sup>1</sup>.

**We see the greatest cost take-out potential at Barclays, HSBC and RBS**

By lender Nationwide and Santander screen as most 'productive' on our simple metric of mortgage loans per branch (Figure 32). Lloyds also screens well. These three banks also have the best cost-income ratios in the industry (Figure 26), suggesting that while our productivity metric may be simplistic, it does appear to have some validity. The banks which screen as least productive – and therefore where the greatest cost take-out potential may reside – are Barclays, HSBC & RBS.

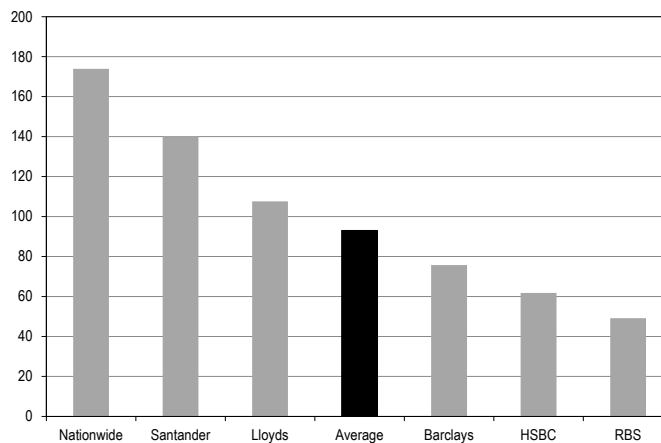
<sup>1</sup> See <http://www.bankofscotland.co.uk/accessibility/banking-options/mobile-branch/> and <http://personal.rbs.co.uk/personal/ways-to-bank-with-us/mobile-branch.html>

Figure 31. UK Regions – Outstanding Mortgage Loans Per Branch (£m)



Source: Company Reports, Company Websites and Citi Research  
Note: Based on six largest UK lenders only

Figure 32. UK Lenders – Outstanding Mortgage Loans Per Branch (£m)



Source: Company Reports, Company Websites and Citi Research

**Barclays and RBS have both indicated that they already have plans to reduce branch headcount and/or close more branches in the near future**

This analysis also fits with the strategic steps currently underway at each bank. In February 2012 Lloyds announced a three-year moratorium on branch closures. However Lloyds is the exception, rather than the rule, which we would argue is because it already operates on a more efficient basis compared to listed peers. In sharp contrast Barclays and RBS have both indicated that they have plans to reduce branch headcount and/or close more branches in the near future.

In November 2013 Barclays announced that 1,700 staff will be made redundant in 2014 from its UK retail banking operations, ranging from cashiers, personal bankers and operational specialists to branch managers and assistant manager roles. This is on top of the recent closures of its Coventry and Dartford call centers which places a further c600 staff at risk (source: Unite, 14 November 2013). Barclays has added that it will try to achieve the cuts through a voluntary redundancy scheme.

By 2015 Barclays target a UK Retail & Business Banking cost-income ratio in the mid-50s versus 66% in 2012. In an interview with the FT (17 November 2013) the head of retail and business banking at Barclays, Ashok Vaswani, said he was planning a significant overhaul of the size, location and functionality of the bank's branches, as swaths of customer transactions are moving online: *"I'm a firm believer that branches will survive but the format – where they are located and what happens in them – will change. There is no question there will be shrinkage."*

Meanwhile in April 2013 Ross McEwan commented in interviews that RBS has "probably still got too many branches" and stated that the proportion of RBS' branches which might be closed is "probably around 10%". In the same interview Mr McEwan also cited the potential to move existing branches to much smaller premises because far less administrative work and fewer transactions were now done on these sites. He also warned that RBS's UK retail banking workforce would fall further from its current level of c38,000 (source: Herald Scotland, 25 April 2013).

**RBS has seen a 30% drop in branch transactions since 2010**

At the annual Business in the Parliament conference, Mr McEwan announced that there would be a fundamental change in the bank's customer service in response to a "seismic shift" in the way people use services, with a 30% drop in the number of branch transactions since 2010. Rather than a focus on the traditional branch network RBS will invest in technology and in more 'points of presence' including "new generation cash machines" which offer a broad range of everyday banking facilities, as well as 24-hour self-service centres. This echoes previous comments:

*"We constantly think about points of presence as ATMs and branches. We need to stop thinking about that, we need to start thinking about where, as a point of presence, that the customer actually has an interaction with us, do it themselves, or come into a branch, for things like kiosks and the likes, where they can just do it for themselves in a public space, if they want to do it, or they can have access 24/7 online, or through mobile. But the old days of points of presence being a branch I think are well and truly over and done with."* (Ross McEwan, Investor Seminar on UK Retail Banking, 18 March 2013).

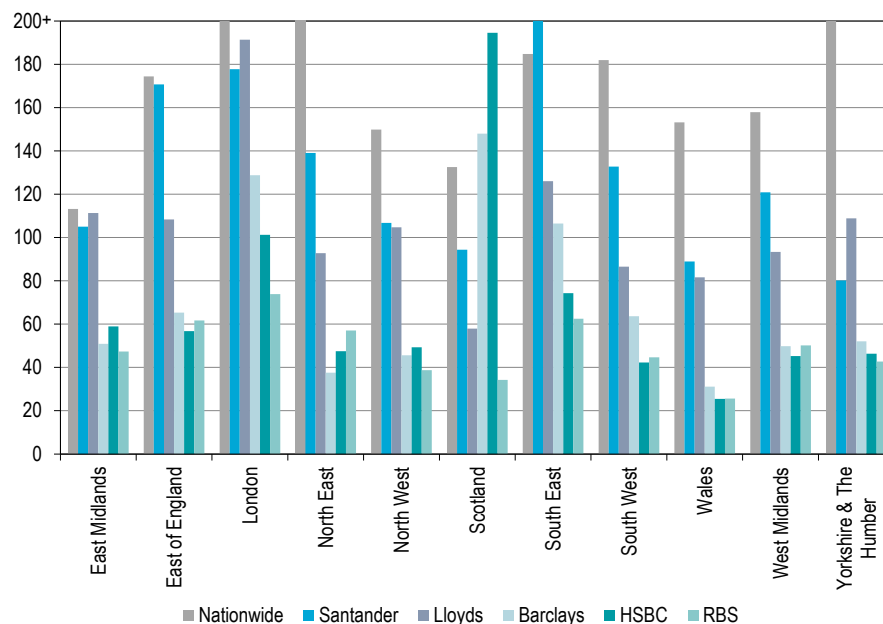
**Retail operations in Wales screen as 'inefficient' for all three banks**

The next stage of this process is to establish in which regions Barclays, HSBC and RBS can reduce branch and associated costs, with the smallest potential revenue attrition. A comparison of our 'productivity' metric - mortgage loans per branch – indicates that Wales could receive the greatest attention at each bank. Clearly this is a simplistic metric, and is subject to all of the aforementioned caveats, but it is worth noting that in Llandudno, for example, RBS and HSBC appear to have double the number of branches as Lloyds, yet less than half of Lloyds' outstanding mortgage loans in the area. Of course there may be justifiable social responsibility reasons for maintaining branches in these communities, as well as the risk of brand damage from any withdrawal, which needs to be taken into account.

**Other regions which screen as having 'inefficient' operations include North East for Barclays, South West for HSBC and a wide range of regions for RBS**

Aside from Wales, other regions which screen as having 'inefficient' operations at each lender include the North East for Barclays (including Darlington, Sunderland, Cleveland), the South West for HSBC (including Bournemouth, Dorchester, Taunton, Torquay, Truro) and a wide range of regions across the country for RBS.

Figure 33. UK Lenders – Outstanding Regional Mortgage Loans Per Branch (£m)



Source: Company Reports, Company Websites and Citi Research

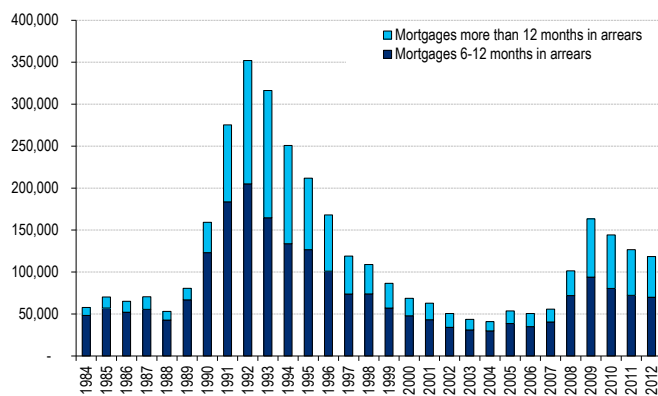
# Asset Quality

## Benign Loan Loss Environment (For Now)

The mortgage loss experience in the UK has thus far proved to be muted during the latest credit cycle. After peaking in 2009, at half the level of the 1992 peak, arrears (and possessions) have trended downwards ever since. In 2012 the number of mortgages in arrears declined 6% in 2012, to 118,400, a trend which has continued into 2013. The muted losses during the latest economic downturn can be attributed to two primary factors: (i) lower rates have improved mortgage affordability; (ii) unemployment has remained low and stable among the adult population aged 25+.

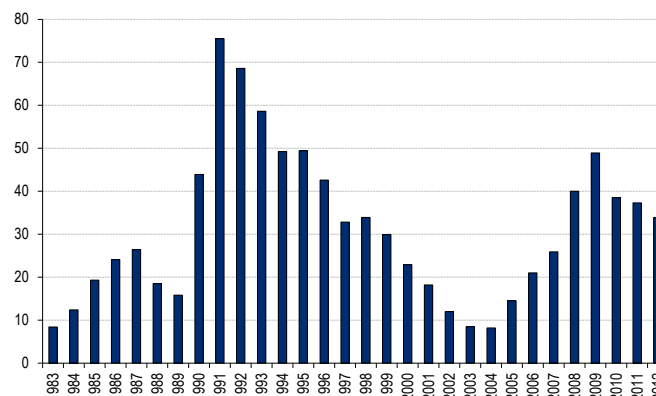
To a lesser extent lenders have also been willing to restructure existing mortgages.

Figure 34. Number of Mortgage Arrears, 1984-2012



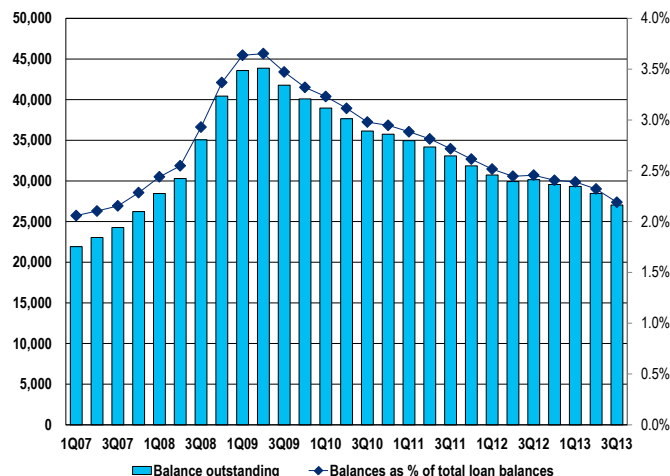
Source: Datastream, Citi Research

Figure 35. Mortgage Possessions, 1983-2012



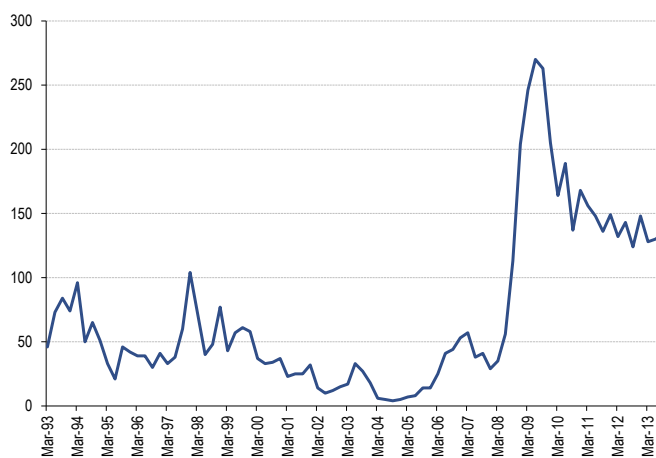
Source: Datastream, Citi Research

Figure 36. UK Mortgage Arrears, 1Q07-3Q13 (£m)



Source: MLAR

Figure 37. UK Mortgage Write-Offs, 1993-2013 (£m)



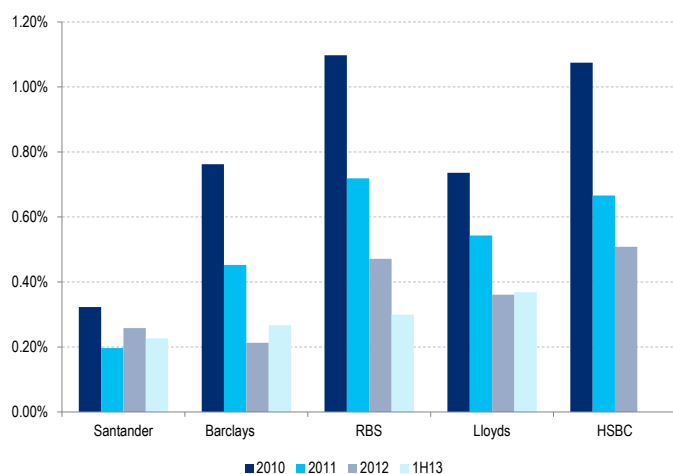
Source: Bank of England. Note: Includes Banks and Building Societies

**Barclays and HSBC have the lowest mortgage NPL ratios, while Lloyds and RBS have the highest**

A direct comparison of asset quality trends between the UK banks' retail divisions is difficult, based on different segmental definitions and business mix. For example Barclays, HSBC and RBS have a larger proportion of UK retail loans derived from unsecured business, at c8-10% of total retail loans, versus Lloyds, Santander and Nationwide, at c3-5%. We believe a better point of comparison is therefore between each banks' mortgage portfolios. Mortgage loan losses have been minimal for all of the UK banks in recent years, due to the benign environment – see Figure 39.

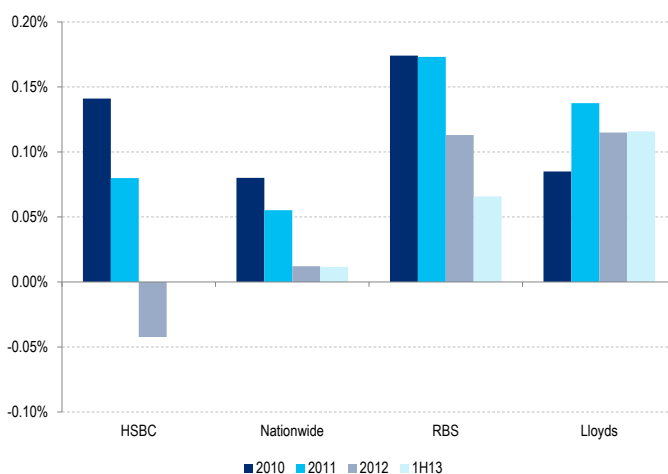
A comparison of mortgage NPL ratios (on as consistent a basis as possible) illustrates that Barclays and HSBC have the lowest proportion of non-performing loans, which we attribute to geographical mix and lower aggregate LTVs. In contrast Lloyds and RBS have the highest level of NPLs.

Figure 38. UK Retail Banking Divisions – Comparison of Loan Loss Ratios



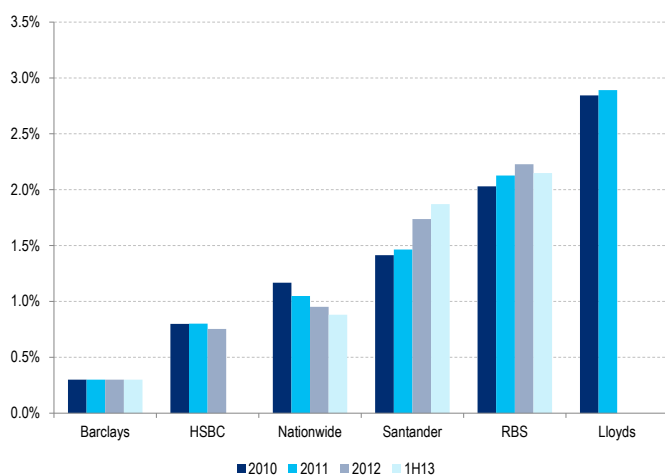
Source: Company Reports

Figure 39. UK Mortgage Lending – Comparison of Loan Loss Ratios



Source: Company Reports

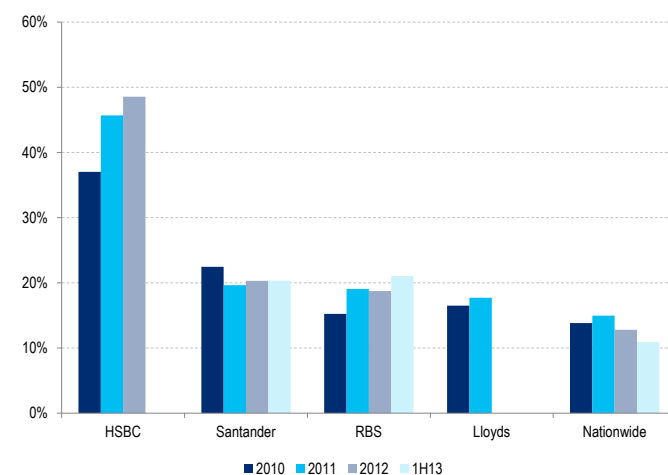
Figure 40. UK Mortgages – Comparison of NPL Ratios



Source: Company Reports and Citi Research

Note: Lloyds NPLs based on mortgage cases >90 days in arrears, rather than the company definition (> 180days) in order to be consistent with peers. Barclays based on mortgages which are over 90+ days past due only.

Figure 41. UK Mortgages – Comparison of Coverage Ratios



Source: Company Reports and Citi Research

Note: Lloyds NPLs based on mortgage cases >90 days in arrears, rather than the company definition (> 180days) in order to be consistent with peers. Barclays based on mortgages which are over 90+ days past due only.

**In the past higher base rates have led to an increase in impairments**

**21% of borrowers do not have enough savings to cover even one month of mortgage payments**

## Regional Asset Quality: Barclays Best Placed

Although the loan loss environment has been benign in recent years, this may be set to change. Why? Our economists expect UK base rates to start rising in early-2015 (perhaps late-2014). In the past higher base rates have inevitably led to an increase in impairments, partly offsetting any improvement in net interest margins. We expect the same this time around, albeit the pace of deterioration in asset quality, relative to the speed at which interest margins improve, may well differ.

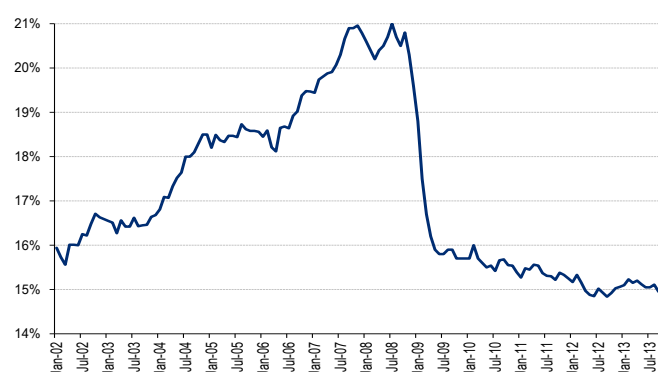
UK base rates have been low for an extraordinarily long period of time. While the affordability indices that we track look reassuring - mortgage payments as a percentage of disposable income is near record lows (Figure 43) - we worry that this could deteriorate quickly, especially as a larger proportion of borrowers are now on variable rates relative to history. A recent BoE survey indicated that 21% of mortgage borrowers do not have enough savings to cover even one mortgage payment. 38% do not have enough savings to cover three monthly payments.

Figure 42. UK House Price to Earnings Ratio, 2002-13



Source: DataStream, Halifax

Figure 43. UK Mortgage Payments as % of Post-Tax Income, 2002-2013

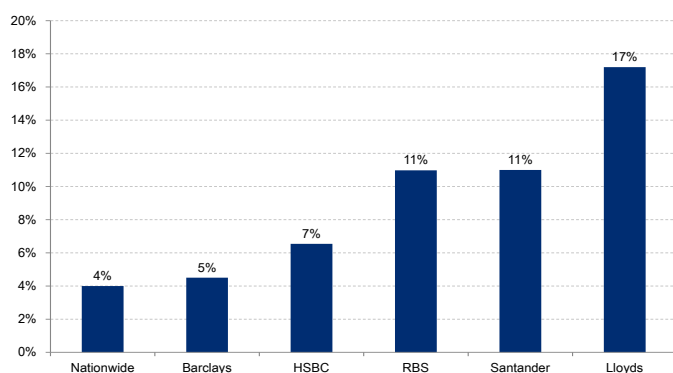


Source: DataStream, Barclays/Woolwich. Note: Principal + Interest.

**Lloyds is most exposed to this risk, in our view, due to its greater exposure to higher-risk variable mortgages**

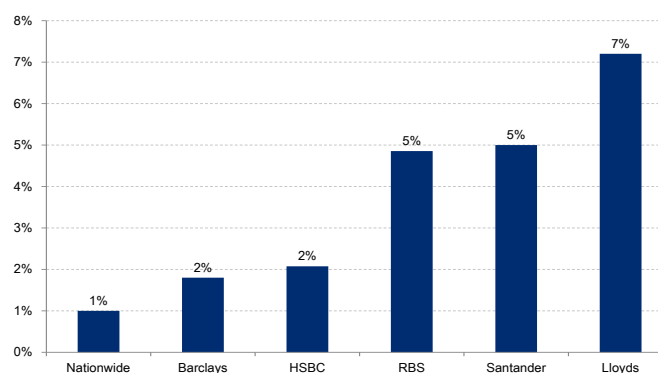
We have previously stated our belief that Lloyds is most exposed to this risk, due to its greater exposure to higher-risk variable mortgages. Approximately 60% of Lloyds' mortgage balance relates to variable mortgages, a third of which relate to Halifax SVR mortgages, where the rate already stands at 3.99%, even prior to any rise in short-term rates. Furthermore 17% of Lloyds' mortgage balance have an LTV of >90%, of which 7% relate to mortgages with LTV >100%, considerably higher than any of the other listed UK banks.

Figure 44. UK Banks – Exposure To Mortgages With LTVs >90%



Source: Company Reports. Note: Based on UK-only mortgages, except Lloyds and HSBC Bank Plc (UK subsidiary). Data as of end-1H13, except HSBC end-2012.

Figure 45. UK Banks – Exposure To Mortgages With LTVs >100%



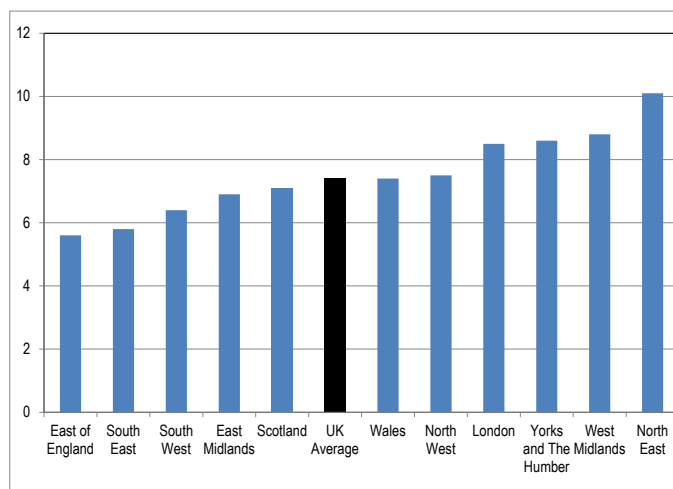
Source: Company Reports. Note: Based on UK-only mortgages, except Lloyds and HSBC Bank Plc (UK subsidiary). Data as of end-1H13, except HSBC end-2012.

**There are five regions which have above-average unemployment...**

The regional postcode data now enables us to perform a complimentary layer of analysis on the asset quality risks at each lender. The level of loan losses at each lender, and within each region, is ultimately decided by two key factors – the likelihood of default and the loss given default. The former is closely correlated to unemployment levels (although divorce and illness are other common causes of default), with the latter is closely correlated to LTV lending criteria and house price movements. For example, a combination of high and rising unemployment, together with a large proportion of borrowers ‘trapped’ in negative equity, is likely to result in heavier loan losses, than regions with low unemployment and low LTVs.

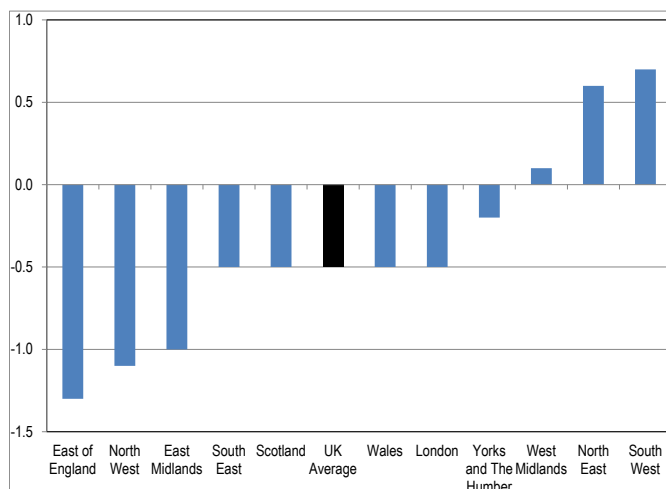
While the overall unemployment rate continues to trend downwards towards 7%, there are exceptions to this. For example unemployment in the North East has continued to rise in the past year, and now stands at 10.1%, substantially ahead of the UK average. In sharp contrast the East of England has seen the largest decline in unemployment and now stands at 5.6%, the lowest unemployment in the UK.

Figure 46. UK Unemployment Rate (%)



Source: ONS and Citi Research

Figure 47. UK Unemployment Rate, Change YoY (%)



Source: ONS and Citi Research

**...and still have average house prices which are still well below the 2007 peak...**

What about the risk of high LTVs and/or negative equity? The CML estimates that c719,000 UK households are currently in negative equity, down from c827,000 in 1Q12, with customers in negative equity largely determined by loan vintage and regional location<sup>2</sup>. This is hardly surprising given the wide range of house price movements in the past five years (see Figure 48 - Figure 51). For example London house prices have recovered sharply in the past two years and are now 8% higher than the previous peak in 2007. In contrast house prices in the North East are recovering at a slower rate and still remain 14% below their 2007 peak.

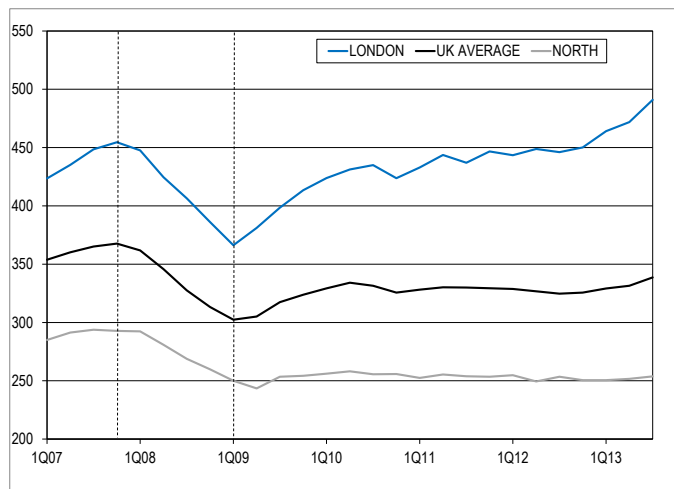
**...namely North East, North West, Wales, Yorkshire & Humberside and West Midlands**

The regions where we perceive there is currently the greatest asset quality risk, and which may initially see the largest increase in loan loss impairments in a rising rate environment, are those with above-average unemployment and house prices still well below the previous 2007 peak. There are five regions which fit both categories – North East, North West, Wales, Yorkshire & Humberside and West Midlands.

<sup>2</sup> See <http://www.cml.org.uk/cml/publications/newsandviews/125/470> for more detail.

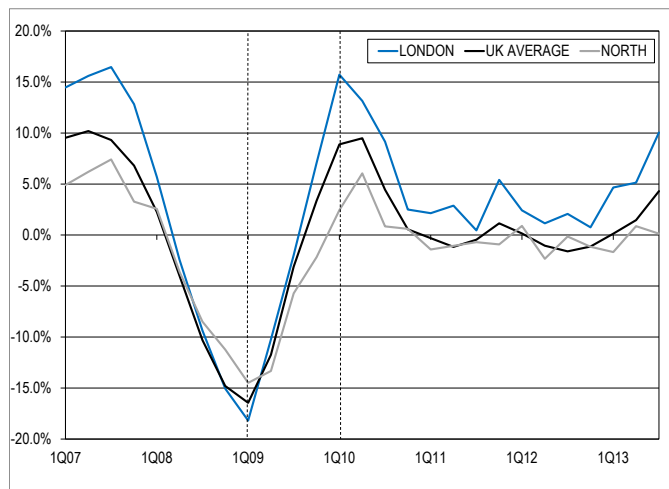


Figure 48. UK House Price Development, 2007-13 (Adjusted Index)



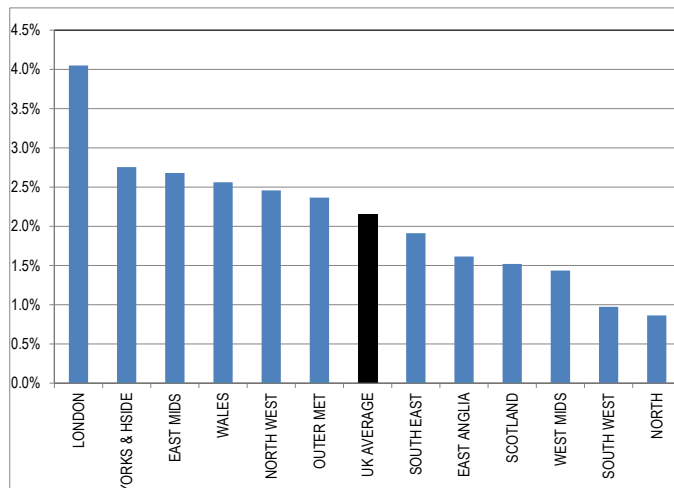
Source: Nationwide and Citi Research

Figure 49. UK House Price Development, 2007-13 (% YoY)



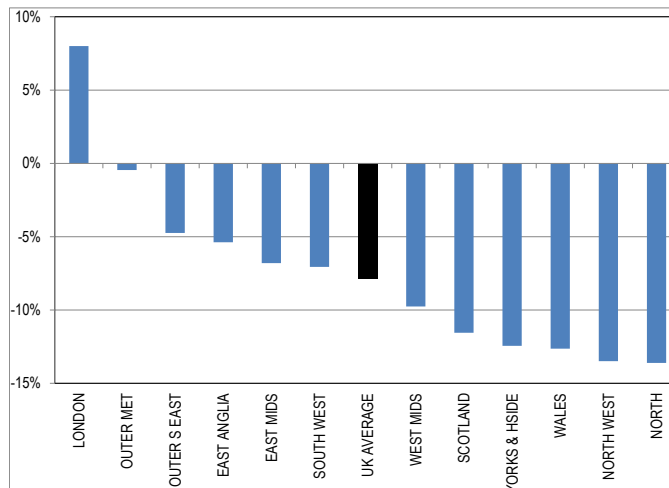
Source: Nationwide and Citi Research

Figure 50. UK House Price Development 2013



Source: Nationwide and Citi Research

Figure 51. UK House Prices vs Previous Peak

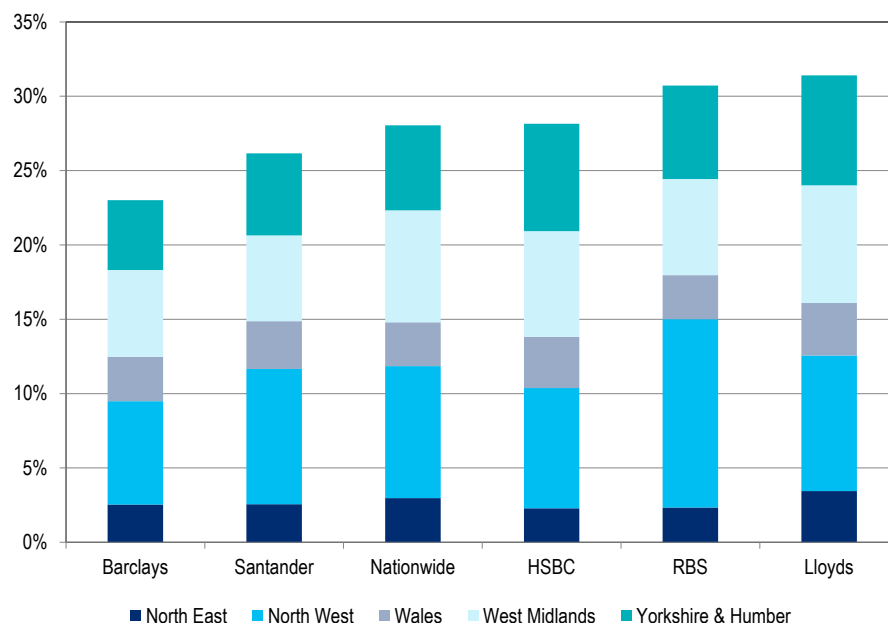


Source: Nationwide and Citi Research

**Barclays has the lowest exposure to these five regions, while Lloyds has the greatest exposure**

Lloyds has the greatest exposure to these five regions, which represent a combined 31.4% of its outstanding mortgage portfolio. RBS has the second largest exposure, at 30.7%, driven by a heavy presence in the North West. This reinforces our view that Lloyds, followed by RBS, is most at risk from any downturn in retail asset quality. In contrast Barclays appears to be best placed, with only 23.0% of its mortgage portfolio derived from these five regions (Figure 52).

Figure 52. UK Lenders – Proportion of Mortgage Lending Portfolio Derived From North East, North West, Wales, Yorkshire & Humberside and West Midlands

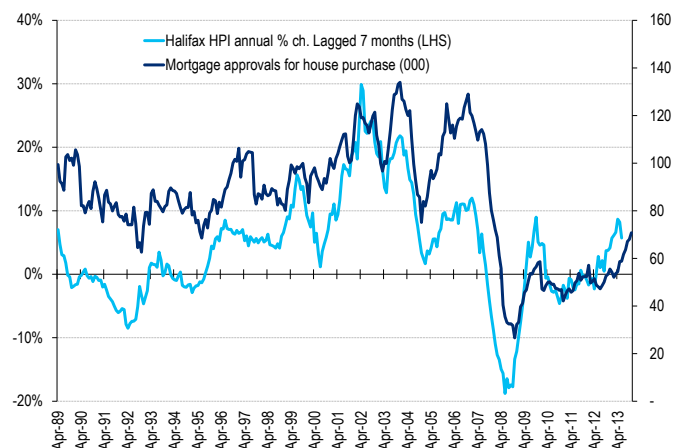


Source: Company Reports and Citi Research

### Is London currently in the middle of a house price “bubble”?

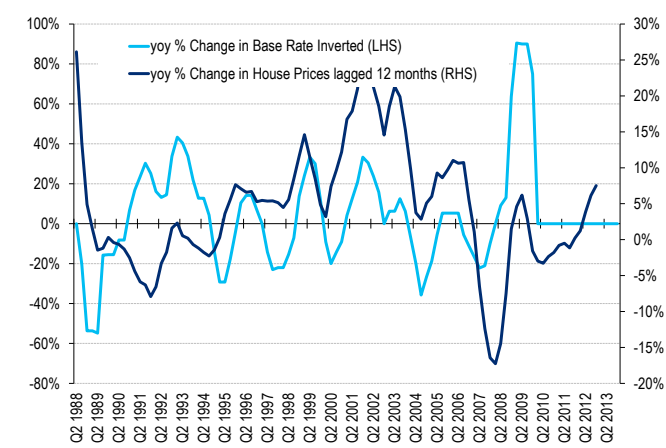
Historically UK house prices have been predominantly driven by two factors – mortgage approvals (high correlation with a c7-month lag) and UK interest rates (high inverse correlation with a c12-month lag). So a rising rate environment initially serves to increase the probability of default, as mortgage affordability deteriorates, but over time this also tends to result in lower house prices, increasing the loss given default. So while the five regions above might be where the initial risk resides in a rising rate environment, what about a couple of years down the line? Are some regions likely to see house prices correct more than others? Is London currently in the middle of a house price “bubble” as the media might have us believe?

Figure 53. Mortgage Approvals for House Purchase vs House Price Inflation (Lagged Seven Months), 1989-2013 (%)



Source: Datastream, Citi Research

Figure 54. Annual Change in UK Interest Rates vs House Price Inflation (Lagged 12 Months), 1988-2013 (%)

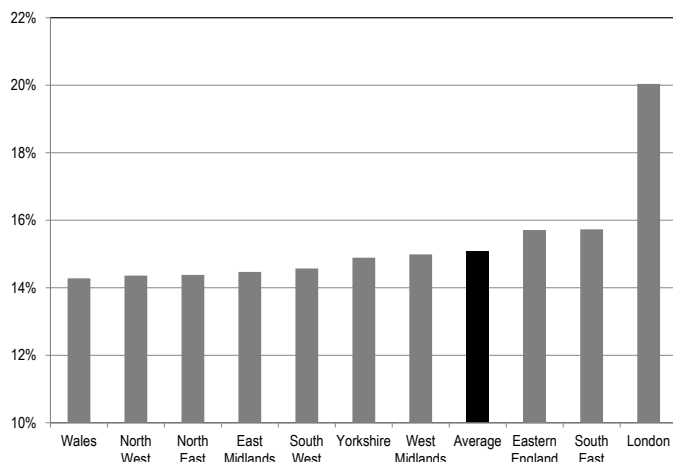


Source: Datastream, Citi Research

**London mortgage affordability is still well below historic levels and only slightly above UK average levels**

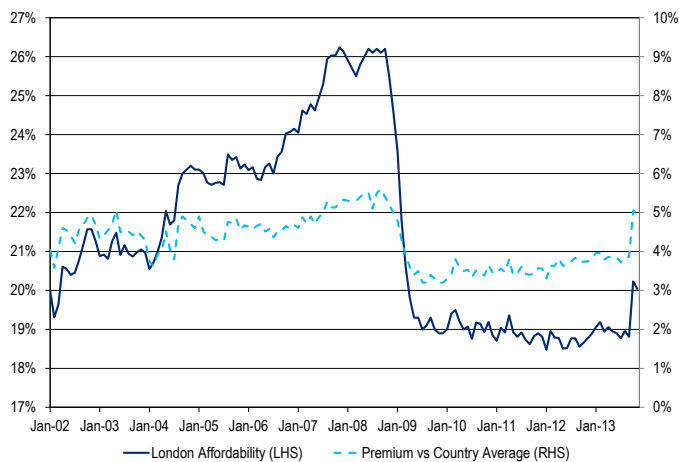
In Figure 43 we illustrated that UK mortgage payments, as a percentage of disposable income – our chosen measure of mortgage affordability - are still close to record lows. What about at a regional level? There is very little discrepancy between regions, with the exception of one – London – but even London is not substantially higher than the rest of the country. The London 'premium', at c5%, is not too dissimilar to 2003-05, while London mortgage affordability itself is still very attractive versus historic levels, even with the step-up in late-2013, reflecting the rise in house prices. We therefore do not subscribe to the argument that London could see a much larger house price correction than other regions.

**Figure 55. UK Mortgage Affordability By Region - Mortgage Payments as % of Post-Tax Income**



Source: DataStream, Barclays/Woolwich. Note: Principal + Interest.

**Figure 56. London Mortgage Affordability - Mortgage Payments as % of Post-Tax Income Versus The Country Average**

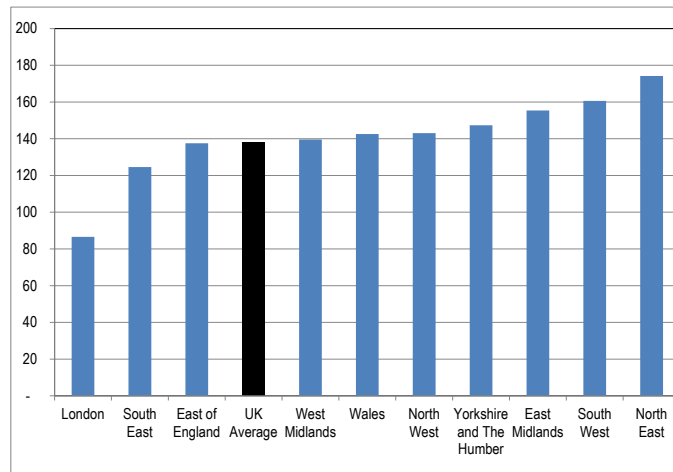


Source: DataStream, Barclays/Woolwich. Note: Principal + Interest.

**London also screens well on personal insolvency metrics and on net business birth rates**

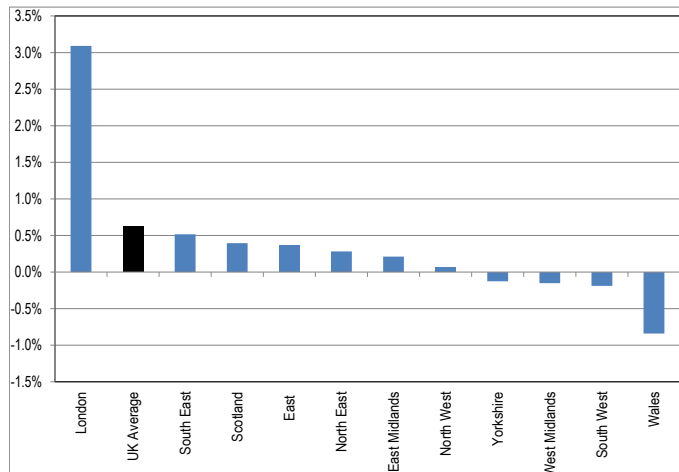
For completeness we also consider the regional asset quality risks surrounding unsecured personal and SME lending. From 2008-12 personal insolvencies were highest in the five aforementioned regions, plus the South West. They were lowest in London and South East. The net business birth rates also show similar trends. Again Barclays appears well placed to benefit based on the high proportion of unsecured and SME lending derived from London. See Appendix for more detail.

**Figure 57. Personal Insolvencies - Number of New Cases Per 10,000 Adult Population in Five Years From 2008-12**



Source: The Insolvency Service and Citi Research

**Figure 58. Net Business Birth Rate by Region, 2012**



Source: ONS and Citi Research. Note: Based on business birth rates less death rates

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# Company Results Previews

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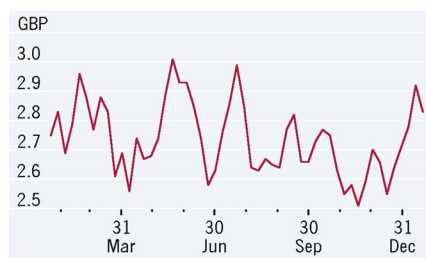
For Group and Divisional financial models for each company please refer to the accompanying report: [UK Banks Big Picture: Winter 2013/14](#)

## Company Focus

- Estimate Change
- Target Price Change

<b>Buy</b>	<b>1</b>
Price (21 Jan 14)	£2.81
Target price	£3.30
from £3.20	
Expected share price return	17.5%
Expected dividend yield	2.1%
<b>Expected total return</b>	<b>19.7%</b>
Market Cap	£45,238M
	US\$74,333M

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



## Barclays PLC (BARC.L)

### 11 Feb: New CFO To Announce Leverage Plans

■ **4Q13 Results Due 11 February** — Barclays is set to release 4Q13 results on Tuesday 11 February at 07:00 GMT. We forecast adjusted Group PBT of £1.2bn, -21% qoq and -16% yoy. This is driven by the bank levy and a weak investment bank result on subdued FICC revenues, albeit this is already widely anticipated after Deutsche Bank's recent profit warning. Instead we expect focus will be on the outlook statement, on any update on the TRANSFORM program and on any new announcements on deleveraging and cost take-out from the new CFO. We forecast a BIII CET1 ratio of 10.0% and a PRA leverage ratio of 2.7% (or under alternative definitions: CRD IV leverage ratio 3.0%, BCBS leverage ratio 2.7%).

■ **Weak FICC Revenues** — The US banks, on aggregate, have reported 4Q13 FICC revenues -4% yoy, or -8% yoy excluding BAC. However European banks are likely to have underperformed in our view. Closest peer Deutsche Bank has reported 4Q13 FICC revenues down -31% yoy (estimated -24% yoy underlying), due to weak core rates and credit solutions. We forecast Barclays FICC revenues down -30% yoy, or -20% yoy excluding exit quadrant assets. Barclays may also take a FVA adjustment below the line, albeit this is a non-cash item.

■ **Capital & Deleveraging** — At end-3Q13 Barclays reported a PRA leverage ratio of 2.2%. The £6bn rights issue (+40bps) and \$2bn CoCo issuance (+10bps) should lift this to 2.7% at end-2013. We forecast a further improvement to 3.0% by mid-2014 mainly driven by retained earnings. Additional deleveraging and/or CoCo issuance could provide an additional buffer above and beyond this. As previously discussed (see ['Is Barclays Losing Market Share in FICC?' 23 Sep](#)) we believe Barclays could identify another c£150bn of asset deleveraging from mid-2014 to end-2015. Importantly the recent ruling on the leverage ratio (see ['Amendments to Leverage Ratio' 13 Jan](#)) has retained netting of repos and cash collateral on derivatives, which means that Barclays should predominantly be able to achieve any future asset shrinkage via balance sheet optimization, resulting in less revenue attrition, in our view. We would also highlight that the PRA calculation already makes a deduction for future legal/conduct risks.

■ **Cost Saving Potential** — The target underlying cost base of £17.5bn in 2014 and £16.8bn in 2015 is impressive, but we note cost-saves are back-end loaded. We believe the 2014 target is within reach, but are skeptical on the 2015 target without further evidence of the steps that are being taken. More granular detail on cost saves – by source and division – could provide some encouragement.

■ **Buy Rating** — Barclays is our top-pick among the UK banks. We believe the capital position is satisfactory and do not see sufficient evidence to suggest Barclays is losing market share in its core FICC franchise. Meanwhile greater granularity on cost saves could drive consensus upgrades over time, while ongoing asset shrinkage should improve confidence in Barclays' leverage ratio. We lower 2013 underlying earnings due to an adjustment in our definition of "normalized" tax. We also trim 2014-15E EPS by 1-4% on lower IB revenues. We reiterate our Buy rating, new target price 330p (from 320p) as we roll-forward our valuation methodology to 2016. Excess capital would add a further 40p.

#### Barclays PLC (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (£M)	3,238.3	4,599.4	4,016.9	5,609.5	6,428.9
Diluted EPS (p)	23.9	33.7	24.4	34.0	39.0
Diluted EPS (Old) (p)	23.4	35.0	26.4	35.3	39.5
PE (x)	11.8	8.3	11.5	8.3	7.2
P/BV (x)	0.7	0.7	0.8	0.8	0.7
DPS (p)	5.4	6.0	6.0	12.0	17.0
Net Div Yield (%)	1.9	2.1	2.2	4.3	6.0
ROE (%)	5.6	-1.2	2.8	8.5	9.6

## 11 Feb: New CFO To Announce Leverage Plans

Figure 59. Barclays – Summary Group and Divisional P&L by Quarter (£m)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13E	1Q14E	2Q14E	3Q14E	4Q14E
<b>Group</b>																
Revenues	7,399	7,549	7,001	6,213	8,108	7,384	7,002	6,867	7,734	7,337	6,445	6,680	7,645	7,500	7,161	6,981
Expenses	-4,842	-4,967	-4,686	-4,766	-4,965	-4,555	-4,353	-4,690	-4,782	-4,359	-4,262	-4,733	-4,420	-4,337	-4,184	-4,635
<b>Gross Operating Profit</b>	<b>2,881</b>	<b>2,582</b>	<b>2,315</b>	<b>1,447</b>	<b>3,143</b>	<b>2,829</b>	<b>2,649</b>	<b>2,177</b>	<b>2,952</b>	<b>2,978</b>	<b>2,183</b>	<b>1,948</b>	<b>3,226</b>	<b>3,163</b>	<b>2,977</b>	<b>2,346</b>
Impairments	-921	-907	-1,023	-951	-784	-926	-805	-825	-706	-925	-722	-783	-759	-759	-768	-768
JVs & Associates	17	19	18	5	36	41	21	43	54	-122	25	11	19	19	20	20
<b>Operating Profit</b>	<b>1,977</b>	<b>1,694</b>	<b>1,310</b>	<b>501</b>	<b>2,395</b>	<b>1,944</b>	<b>1,865</b>	<b>1,395</b>	<b>2,300</b>	<b>1,931</b>	<b>1,486</b>	<b>1,176</b>	<b>2,486</b>	<b>2,423</b>	<b>2,229</b>	<b>1,598</b>
FVOD gains/losses	-351	440	2,882	-263	-2,620	-325	-1,074	-560	-251	337	-211	0	0	0	0	0
Disposal gains/Losses & Exceptionals	2	-1,172	-1,797	548	-300	-223	-700	-1,000	-514	-2,126	-101	-441	-250	-250	-250	-250
<b>Pre-Tax Profit</b>	<b>1,628</b>	<b>962</b>	<b>2,395</b>	<b>786</b>	<b>-525</b>	<b>1,396</b>	<b>91</b>	<b>-165</b>	<b>1,535</b>	<b>142</b>	<b>1,174</b>	<b>735</b>	<b>2,236</b>	<b>2,173</b>	<b>1,979</b>	<b>1,348</b>
Tax on continuing operations	-408	-241	-1,050	-205	140	-453	-104	-199	-491	-103	-446	-195	-593	-560	-505	-344
<b>Profit After Tax</b>	<b>1,220</b>	<b>721</b>	<b>1,345</b>	<b>581</b>	<b>-385</b>	<b>943</b>	<b>-13</b>	<b>-364</b>	<b>1,044</b>	<b>39</b>	<b>728</b>	<b>540</b>	<b>1,643</b>	<b>1,614</b>	<b>1,475</b>	<b>1,004</b>
<b>Barclays Capital</b>																
Fixed Income, Currency & Commodities	2,211	1,623	1,299	933	2,319	1,761	1,675	1,494	2,190	1,378	940	1,044	1,865	1,585	1,347	1,078
Equities and Prime Services	546	615	346	300	591	615	523	454	706	825	645	613	777	761	685	630
Investment Banking	664	533	402	518	515	509	493	620	558	528	525	604	558	658	599	683
Principal Investments	8	99	89	36	11	139	30	26	9	279	1	30	10	10	10	10
<b>Total revenue</b>	<b>3,429</b>	<b>2,870</b>	<b>2,136</b>	<b>1,787</b>	<b>3,436</b>	<b>3,024</b>	<b>2,721</b>	<b>2,594</b>	<b>3,463</b>	<b>3,010</b>	<b>2,111</b>	<b>2,291</b>	<b>3,209</b>	<b>3,015</b>	<b>2,641</b>	<b>2,401</b>
Operating Costs	-2,114	-2,068	-1,818	-1,726	-2,195	-1,849	-1,737	-1,850	-2,054	-1,697	-1,622	-2,114	-1,787	-1,705	-1,557	-2,008
<b>Gross Operating Profit</b>	<b>1,315</b>	<b>802</b>	<b>318</b>	<b>61</b>	<b>1,241</b>	<b>1,175</b>	<b>984</b>	<b>744</b>	<b>1,409</b>	<b>1,313</b>	<b>489</b>	<b>176</b>	<b>1,422</b>	<b>1,309</b>	<b>1,084</b>	<b>393</b>
Total impairments	31	79	-114	-89	-81	-121	-3	1	14	-195	-25	-50	-50	-50	-50	-50
Other Net Income	3	7	6	-4	22	6	7	15	8	9	5	9	8	8	8	8
<b>Operating Profit</b>	<b>1,349</b>	<b>888</b>	<b>210</b>	<b>-32</b>	<b>1,182</b>	<b>1,060</b>	<b>988</b>	<b>760</b>	<b>1,431</b>	<b>1,127</b>	<b>469</b>	<b>135</b>	<b>1,380</b>	<b>1,267</b>	<b>1,042</b>	<b>351</b>
<b>Divisional Operating Profit</b>																
UK Retail	253	378	429	162	232	360	358	275	299	360	380	398	411	431	443	453
BarclayCard	311	273	367	261	347	404	396	336	363	417	403	418	432	442	441	461
Europe Retail	-76	-109	21	-176	-72	-76	-81	-114	-106	-247	-105	-112	-81	-91	-65	-65
Africa Retail	130	178	191	231	132	51	34	105	81	140	134	116	125	125	134	134
<b>Retail &amp; Business Banking</b>	<b>618</b>	<b>720</b>	<b>1,008</b>	<b>478</b>	<b>639</b>	<b>739</b>	<b>707</b>	<b>602</b>	<b>637</b>	<b>670</b>	<b>812</b>	<b>821</b>	<b>888</b>	<b>908</b>	<b>952</b>	<b>982</b>
Investment Bank	1,349	888	210	-32	1,182	1,060	988	760	1,431	1,127	469	135	1,380	1,267	1,042	351
Corporate	24	37	140	-10	203	108	88	61	220	223	289	243	262	282	268	288
Wealth	41	34	70	43	50	49	70	105	60	20	51	101	84	94	94	104
<b>IB, Corporate &amp; Wealth</b>	<b>1,414</b>	<b>959</b>	<b>420</b>	<b>1</b>	<b>1,435</b>	<b>1,217</b>	<b>1,146</b>	<b>926</b>	<b>1,711</b>	<b>1,370</b>	<b>809</b>	<b>480</b>	<b>1,726</b>	<b>1,643</b>	<b>1,404</b>	<b>743</b>
Head Office & Other	-55	15	-116	21	320	-11	12	-113	-48	-109	-135	-125	-128	-128	-128	-128
<b>Total</b>	<b>1,977</b>	<b>1,694</b>	<b>1,312</b>	<b>500</b>	<b>2,394</b>	<b>1,945</b>	<b>1,865</b>	<b>1,415</b>	<b>2,300</b>	<b>1,931</b>	<b>1,486</b>	<b>1,176</b>	<b>2,486</b>	<b>2,423</b>	<b>2,229</b>	<b>1,598</b>

Source: Company Reports and Citi Research Estimates

Figure 60. Barclays – Dividend Discount Model & Warranted Equity Valuation

<b>Dividend Discount Model (DDM)</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
PV of dividend (by quarter received)	6.4	10.7	13.6	13.7
<b>Total dividend PV (GB pence)</b>	<b>44</b>			
<b>Terminal value (WEV)</b>	<b>2016e</b>			
RoTE	12.1%			
Long-term growth	2.0%			
CoE	11.2%			
Theoretical TBVM	1.10x			
TBVPS	362			
Terminal value	397			
<b>PV of TV (GB pence)</b>	<b>287</b>			
<b>Total PV (GB pence)</b>	<b>330</b>			
<b>Capital Adjusted</b>	<b>2016e</b>			
Basel 3 CET1 ratio	12.7%			
Capital surplus/(deficit) per share vs 10.5% [A]	56			
PRA leverage ratio (ex legacy AT1)	4.3%			
Capital surplus/(deficit) per share vs 3.0% [B]	100			
Minimum [A,B]	56			
<b>PV of Capital Surplus (GB pence)</b>	<b>40</b>			
<b>Total Adj PV (GB pence)</b>	<b>370</b>			

Source: Citi Research

## Company Focus

### ■ Estimate Change

<b>Buy</b>	<b>1</b>
Price (21 Jan 14)	£6.75
Target price	£7.70
Expected share price return	14.1%
Expected dividend yield	4.9%
<b>Expected total return</b>	<b>19.0%</b>
Market Cap	£127,083M
	US\$208,816M

### Price Performance

(RIC: HSBA.L, BB: HSBA LN)



## HSBC Holdings PLC (HSBA.L)

### 27 Feb: Better Balance Sheet Trends

■ **4Q13 Results Due 24 February** — 4Q13 results will be released on Monday 24 February. We expect solid results. Our 4Q13 reported pre-tax profit forecast is \$5.9bn, excluding any FVOD charge, compared to an underlying pre-tax profit of \$5.5bn in 3Q13. We forecast a 2% qoq increase in TBVPS to \$7.82 and a stable core tier 1 ratio of 13.3% (Basel 2.5). At a divisional level, we forecast flattish GBM numbers and relatively stronger RBWM and CMB trends.

■ **GBM Benefits From Base Effects** — We expect HSBC's FICC and corporate banking driven GBM division to report flattish qoq numbers in 4Q13, while all yoy numbers should benefit from relatively low comps in 4Q12. We forecast total GBM revenues of \$4.3bn, +3% qoq, +20% yoy, with Global Markets income remaining stable (+3% qoq, +84% yoy). Within Global Markets, rates revenues are expected to be lower (-26% qoq), while FX should be relatively robust (+31% qoq). We forecast overall GBM PBT of \$1.9bn, +3% qoq, +56% yoy.

■ **Flattish HK & RoAP; LatAm One-Offs** — We forecast HK PBT of \$2.1bn, flat qoq, but still accounting for over a quarter of HSBC's underlying group profits and up 2% yoy. We forecast Rest of Asia Pacific PBT of \$1.5bn, flat qoq and accounting for a third of our underlying group profit estimate. We expect Asia-Pac revenues to remain resilient, driven by CMB strength, but offsetting this, we forecast a small uptick in costs in this region. LatAm should benefit from the 'one-off' gain from the sale of Panama operations.

■ **Asset Quality Mixed** — We expect loan loss provisions to go up slightly to c69bps annualised in 4Q13, vs 63bps for 3Q13. We expect impairment charges to decline in Europe and Middle-East in 4Q vs 3Q, though up significantly in North America. LatAm, HK and Rest of AP could be up slightly qoq. We forecast a decline in absolute NPL levels, though NPL ratio could be up slightly qoq.

■ **Buy Rating** — Although HSBC has made decent progress on costs savings and divestments, the stock has lagged the UK/Euro banks sector LTM (HSBC -2% vs UK Banks Avg +7%/Euro banks Avg: +16%). We see upside from normalizing NIMs over the next few years, as well as further restructuring. The shares also have an attractive dividend yield (2014E: 4.8%). We reiterate our Buy rating with an unchanged target price of 770p. We roll forward our forecasts to 2016 and also introduce the half-yearly/quarterly forecasts for 2014. We trim 2013E EPS by 2% on slightly higher expenses, but make minimal change to 2014-15E EPS.

### HSBC Holdings PLC (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (\$M)	16,224.0	13,454.0	17,341.0	18,533.4	20,811.3
Diluted EPS (¢)	91	74	93	98	108
Diluted EPS (Old) (¢)	91	74	95	98	109
PE (x)	12.3	15.1	12.0	11.3	10.2
P/BV (x)	1.3	1.2	1.2	1.1	1.1
DPS (¢)	39	41	48	53	58
Net Div Yield (%)	3.5	3.7	4.3	4.8	5.2
ROE (%)	11.1	8.4	10.1	10.2	10.8



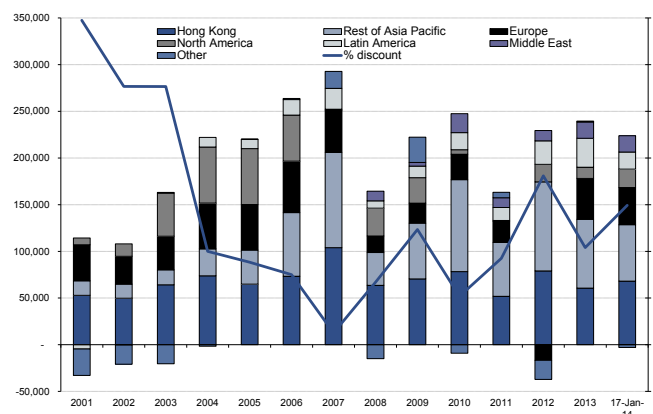
## 27 Feb: Better Balance Sheet Trends

Figure 61. HSBC – Summary Group P&L by Quarter (\$m)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13E	1Q14E	2Q14E	3Q14E	4Q14E
Total Income	17,040	18,654	19,947	16,639	16,201	20,696	14,566	16,867	18,416	15,956	15,078	17,227	17,317	17,317	16,930	16,930
Total Costs	-10,369	-10,141	-9,869	-11,166	-10,353	-10,851	-10,279	-11,444	-9,347	-9,052	-9,584	-10,229	-9,306	-9,306	-9,982	-9,982
<b>Operating Profit</b>	<b>6,671</b>	<b>8,513</b>	<b>10,078</b>	<b>5,473</b>	<b>5,848</b>	<b>9,845</b>	<b>4,287</b>	<b>5,423</b>	<b>9,069</b>	<b>6,904</b>	<b>5,494</b>	<b>6,999</b>	<b>8,011</b>	<b>8,011</b>	<b>6,948</b>	<b>6,948</b>
Loan Impairment Losses	-2,384	-2,882	-3,890	-2,971	-2,366	-2,433	-1,720	-1,792	-1,171	-1,945	-1,593	-1,726	-1,460	-1,460	-1,520	-1,520
Associates, JV & Other	619	937	967	741	840	1,003	914	800	536	678	629	621	650	650	670	670
<b>PBT</b>	<b>4,906</b>	<b>6,568</b>	<b>7,155</b>	<b>3,243</b>	<b>4,322</b>	<b>8,415</b>	<b>3,481</b>	<b>4,431</b>	<b>8,434</b>	<b>5,637</b>	<b>4,530</b>	<b>5,894</b>	<b>7,201</b>	<b>7,201</b>	<b>6,098</b>	<b>6,098</b>
Taxation	-491	-1,221	-1,634	-582	-1,385	-2,244	-658	-1,028	-1,324	-1,401	-1,045	-1,297	-1,584	-1,584	-1,342	-1,342
Minorities	-262	-285	-299	-301	-356	-314	-325	-312	-757	-305	-285	-200	-414	-414	-414	-414
<b>Post-tax profit</b>	<b>4,415</b>	<b>5,347</b>	<b>5,521</b>	<b>2,661</b>	<b>2,937</b>	<b>6,171</b>	<b>2,823</b>	<b>3,403</b>	<b>7,110</b>	<b>4,236</b>	<b>3,485</b>	<b>4,597</b>	<b>5,617</b>	<b>5,617</b>	<b>4,757</b>	<b>4,757</b>
Dividends		-1,860	-1,604	-1,604	-2,084	-2,084	-1,651	-1,651	-2,600	-2,600	-1,834	-1,834	-2,478	-2,478	-2,478	-2,478
Retained Profit		3,869	4,067	1,205	1,001	3,990	1,415	2,008	3,972	1,550	2,209	3,402	3,329	3,329	2,469	2,469
<b>Per share data</b>																
EPS (Reported)	23.0c	28.5c	29.0c	12.0c	13.0c	30.9c	13.0c	17.2c	34.0c	20.0c	16.0c	23.2c	26.9c	26.8c	22.2c	22.1c
EPS (Fully Diluted)	22.0c	28.4c	29.2c	13.2c	14.4c	30.5c	13.0c	15.7c	33.0c	20.8c	16.0c	23.0c	26.3c	26.2c	21.7c	21.6c
Dividend per share (paid out)	12.0c	9.0c	9.0c	9.0c	14.0c	9.0c	9.0c	9.0c	18.0c	10.0c	10.0c	10.0c	20.0c	11.0c	11.0c	11.0c
Dividend per share (declared)	9.0c	9.0c	9.0c	14.0c	9.0c	9.0c	9.0c	18.0c	10.0c	10.0c	10.0c	20.0c	11.0c	11.0c	11.0c	22.0c
BVPS	8.59	8.59	8.50	8.48	9.14	8.73	9.05	9.09	9.08	8.96	9.19	9.33	9.47	9.62	9.71	9.81
Tangible BVPS	6.91	6.79	8.50	6.69	7.44	7.14	7.45	7.47	7.51	7.43	7.66	7.81	7.96	8.11	8.21	8.31
<b>Operating Ratios</b>																
ROE	11.6%	13.3%	13.7%	6.2%	6.6%	13.8%	5.8%	7.1%	14.8%	9.1%	7.2%	9.8%	11.4%	11.2%	9.2%	9.1%
Net Interest margin (NII/ ATA)	1.57%	1.56%	1.53%	1.53%	1.55%	1.40%	1.36%	1.36%	1.34%	1.33%	1.30%	1.34%	1.39%	1.37%	1.35%	1.33%
Cost / income ratio	61%	54%	49%	67%	64%	52%	71%	68%	51%	57%	64%	59%	54%	54%	59%	59%
<b>Asset Quality</b>																
Provision charge (bps)	94	111	161	126	98	100	69	72	49	80	63	69	57	57	58	57
Non Performing Loan Ratio	2.5%	2.5%	3.5%	4.4%	4.3%	4.2%	4.0%	3.9%	4.0%	3.9%	3.7%	3.7%	3.6%	3.5%	3.5%	3.4%
Coverage	79%	72%	54%	42%	42%	42%	42%	42%	41%	41%	43%	46%	46%	47%	48%	49%
<b>Summary Balance Sheet</b>																
Common Equity	152,546	153,057	151,694	151,520	163,708	158,572	165,787	167,945	168,105	166,898	171,879	175,281	178,609	181,938	184,407	186,876
Loan to deposit ratio	80%	79%	76%	75%	75%	76%	76%	74%	73%	74%	74%	74%	74%	74%	74%	74%
Equity capital ratio (B3)				8.1%				9.5%		10.1%	10.6%	10.8%	11.0%	11.2%	11.5%	11.7%
Equity capital ratio (B2)	10.7%	10.8%	10.6%	10.1%	10.5%	11.3%	11.7%	12.3%	12.7%	12.8%	13.3%	13.4%	13.4%	13.4%	13.5%	13.6%
Tier 1 Ratio (B2)	12.2%	12.2%	12.1%	11.5%	11.9%	12.7%	13.1%	13.4%	13.6%	13.6%	14.1%	14.2%	14.2%	14.1%	14.3%	14.4%
Total Capital Ratio (B2)	15.1%	14.9%	14.6%	14.1%	14.4%	15.1%	15.6%	16.1%	16.7%	16.6%	17.4%	17.2%	17.2%	17.1%	17.3%	17.5%

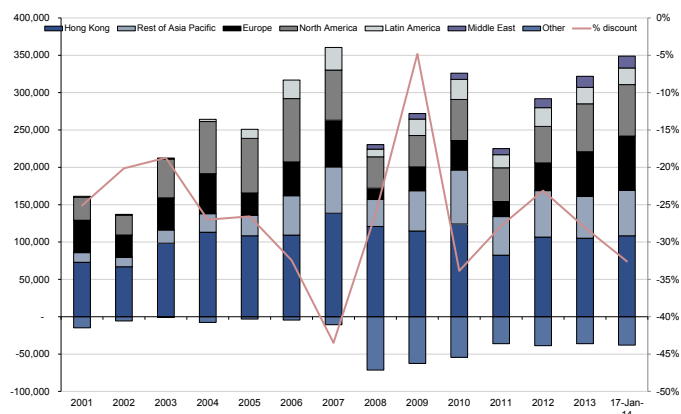
Source: Company Reports and Citi Research Estimates

Figure 62. HSBC – PE SOTP Valuation (\$m)



Source: Citi Research

Figure 63. HSBC – PB SOTP Valuation (\$m)



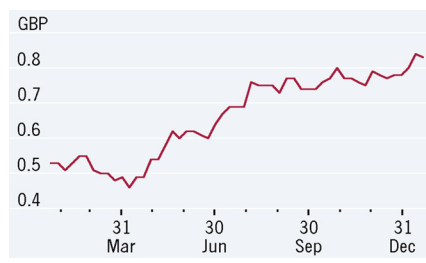
Source: Citi Research

## Company Focus

- Estimate Change
- Target Price Change

<b>Neutral</b>	<b>2</b>
Price (21 Jan 14)	£0.84
Target price	£0.85
from £0.83	
Expected share price return	1.3%
Expected dividend yield	0.6%
<b>Expected total return</b>	<b>1.8%</b>
Market Cap	£59,999M
	US\$98,588M

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



## Lloyds Banking Group PLC (LLOY.L)

### 13 Feb: All About The Dividend Policy

- **4Q13 Results Due 13 February** — 4Q13 results will be released on Thursday 13 February at 07:00 GMT. We forecast underlying PBT of £1.3bn, -12% qoq due to the bank levy, but +96% yoy. We see little room for surprise around the 4Q13 results themselves, given the explicit interest margin and cost guidance provided by the company. Instead we expect the focus to be on any 2014 outlook and guidance provided by the company, especially on dividends and interest margins.
- **Dividend Policy Is Key** — The BoE has announced plans to conduct an annual stress test of the UK banks – see [‘UK Bank Stress Tests’ \(1 October 2013\)](#) – which seems to indicate that UK banks may have to hold even more capital. While Lloyds is one of the better capitalized UK banks - we forecast a BIII CET1 ratio of 10.0% at end-2013, rising to 10.9% end-2014 - we fear the uncertainties surrounding this stress tests may prevent Lloyds from paying anything more than a token dividend in 2013 – we forecast 0.5p – and may limit any ability to discuss future dividend policy. We forecast a payout ratio of c44-50% in 2014-16.
- **Interest Margin Outlook** — Our interest margin forecasts – 211bps in 2013, 227bps in 2014 and 230bps in 2015 – are slightly ahead of consensus. However we believe the interest margin ‘story’ has largely played out, with deposit pricing now stabilizing and asset margins coming under some pressure. Furthermore we expect Group loan growth to be more moderate than consensus expectations, driven by a further reduction in loans in the Commercial Banking division. Our 2014 expenses forecast, of £8.9bn, is slightly below the target £9.15bn.
- **UKFI Follow-On Placing** — The UKFI confirmed the sale of a 6% stake in Lloyds on 17 September, reducing the total stake from 39% to 33%. The lock-up, post this sale, expired on 15 December 2013. Another placing in early-2014 to institutional (and possibly retail) investors therefore appears likely. We expect the overhang risk to be well managed, but nonetheless this will continue to limit share price upside in the near-term in our view.
- **Neutral Rating** — We trim underlying EPS estimates by 2% in 2014 and make modest cuts (<1%) to 2013 and 2015, driven by slightly lower other operating income. Lloyds was a successful turn-around story in 2013, but with the stock now trading on 1.5x P/TB for an underlying RoTE of 12-13%, we believe the shares looks fairly valued. We reiterate our Neutral rating, new target price 85p (from 83p) as we roll forward our valuation model to 2016.

#### Lloyds Banking Group PLC (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (£M)	397.5	1,839.8	4,340.0	5,229.4	5,399.2
Diluted EPS (p)	0.6	2.6	6.1	7.3	7.6
Diluted EPS (Old) (p)	0.6	2.6	6.1	7.5	7.6
PE (x)	144.7	31.9	13.7	11.5	11.1
P/BV (x)	1.3	1.3	1.4	1.3	1.2
DPS (p)	0.0	0.0	0.5	2.2	3.5
Net Div Yield (%)	0.0	0.0	0.6	2.6	4.2
ROE (%)	-6.1	-3.1	2.2	8.2	10.5

## 13 Feb: All About The Dividend Policy

Figure 64. Lloyds – Summary Group P&L by Quarter (£m)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13E	1Q14E	2Q14E	3Q14E	4Q14E
NII	3,298	3,057	3,052	2,803	2,633	2,582	2,575	2,545	2,553	2,653	2,761	2,796	2,801	2,801	2,712	2,712
OOI (net of insurance claims)	2,278	2,470	1,900	2,188	2,095	1,936	2,010	2,010	2,336	1,922	1,794	1,791	1,856	1,856	1,780	1,780
<b>Total Income (net of insurance claims)</b>	<b>5,576</b>	<b>5,527</b>	<b>4,952</b>	<b>4,991</b>	<b>4,728</b>	<b>4,518</b>	<b>4,585</b>	<b>4,555</b>	<b>4,889</b>	<b>4,575</b>	<b>4,555</b>	<b>4,587</b>	<b>4,657</b>	<b>4,657</b>	<b>4,492</b>	<b>4,492</b>
Operating Expenses	-2,751	-2,581	-2,577	-2,712	-2,564	-2,461	-2,483	-2,596	-2,408	-2,341	-2,361	-2,458	-2,290	-2,290	-2,166	-2,166
<b>Operating Profit Pre Impairments</b>	<b>2,825</b>	<b>2,946</b>	<b>2,375</b>	<b>2,279</b>	<b>2,164</b>	<b>2,057</b>	<b>2,102</b>	<b>1,959</b>	<b>2,481</b>	<b>2,234</b>	<b>2,194</b>	<b>2,129</b>	<b>2,367</b>	<b>2,367</b>	<b>2,326</b>	<b>2,326</b>
Impairments	-2,608	-2,814	-1,956	-2,409	-1,657	-1,500	-1,262	-1,278	-1,002	-811	-670	-791	-688	-688	-659	-659
<b>Underlying PBT</b>	<b>217</b>	<b>132</b>	<b>419</b>	<b>-130</b>	<b>507</b>	<b>557</b>	<b>840</b>	<b>681</b>	<b>1,479</b>	<b>1,423</b>	<b>1,524</b>	<b>1,338</b>	<b>1,679</b>	<b>1,679</b>	<b>1,667</b>	<b>1,667</b>
Fair Value Unwind	431	588	95	92	30	127	55	313	-5	41	-127	-23	-75	-75	-75	-75
LM, ECNs, volatile items and asset sales	-364	100	130	975	91	-147	189	2,147	616	-240	-734	0	-38	-38	-38	-38
Other (PPI, Simplification, etc.)	-3,754	-601	-1,251	-621	-340	-1,264	-1,228	-2,523	344	-1,511	-1,103	-386	107	-901	32	-314
<b>Statutory PBT</b>	<b>-3,470</b>	<b>219</b>	<b>-607</b>	<b>316</b>	<b>288</b>	<b>-727</b>	<b>-144</b>	<b>618</b>	<b>2,434</b>	<b>-300</b>	<b>-440</b>	<b>929</b>	<b>1,172</b>	<b>663</b>	<b>1,583</b>	<b>1,236</b>
<b>Margin (bps)</b>	<b>216</b>	<b>209</b>	<b>205</b>	<b>197</b>	<b>195</b>	<b>191</b>	<b>193</b>	<b>194</b>	<b>196</b>	<b>206</b>	<b>217</b>	<b>223</b>	<b>226</b>	<b>228</b>	<b>228</b>	<b>229</b>
Average Interest Earning Assets (£bn)	603.5	589.5	581.2	567.5	558.8	547.6	537.0	529.8	520.3	506.7	507.9	501.9	495.2	492.5	475.4	472.9

Source: Citi Research

Figure 65. Lloyds – Citi vs Consensus Estimates

	2013E			2014E			2015E		
£m	Cons	Citi	% Diff	Cons	Citi	% Diff	Cons	Citi	% Diff
NII	10,670	10,763	1%	10,766	11,026	2%	10,878	10,854	0%
OOI (net of insurance claims)	8,000	7,843	-2%	7,750	7,272	-6%	7,924	7,391	-7%
<b>Total Income (net of insurance claims)</b>	<b>18,670</b>	<b>18,606</b>	<b>0%</b>	<b>18,516</b>	<b>18,298</b>	<b>-1%</b>	<b>18,802</b>	<b>18,244</b>	<b>-3%</b>
Operating Expenses	-9,579	-9,568	0%	-9,196	-8,912	-3%	-9,104	-8,840	-3%
<b>Operating Profit Pre Impairments</b>	<b>9,091</b>	<b>9,038</b>	<b>-1%</b>	<b>9,320</b>	<b>9,386</b>	<b>1%</b>	<b>9,698</b>	<b>9,405</b>	<b>-3%</b>
Impairments	-3,554	-3,274	-8%	-2,755	-2,695	-2%	-2,476	-2,613	6%
<b>Underlying PBT</b>	<b>5,537</b>	<b>5,764</b>	<b>4%</b>	<b>6,565</b>	<b>6,691</b>	<b>2%</b>	<b>7,222</b>	<b>6,792</b>	<b>-6%</b>
Other (PPI, Restructuring Costs, etc.)	-1,612	-3,141	95%	-1,500	-2,037	36%	-535	-568	6%
<b>Statutory PBT</b>	<b>3,925</b>	<b>2,623</b>	<b>-33%</b>	<b>5,065</b>	<b>4,654</b>	<b>-8%</b>	<b>6,687</b>	<b>6,225</b>	<b>-7%</b>
<b>Margin (bps)</b>	<b>208</b>	<b>211</b>		<b>221</b>	<b>227</b>		<b>225</b>	<b>230</b>	
Average Interest Earning Assets (£bn)	512.0	509.2	-1%	489.7	484.0	-1%	492.4	471.0	-4%

Source: Company Collected Consensus (last available 9 October 2013) and Citi Research

Figure 66. Lloyds – Dividend Discount Model & Capital-Adjusted Warranted Equity Valuation

1. Dividend Discount Model (DDM)	2013e	2014e	2015e	2016e
Annually paid DPS	0.50	2.20	3.50	3.70
PV'd dividend	0.49	1.94	2.81	2.98
Total dividend PV (GB pence)	8			
2. Terminal value (WEV)	2016e			
RoTE	12.2%			
Long-term growth	2.0%			
CoE	10.0%			
Theoretical TBVM	1.28x			
TBVPS	68			
Terminal value	87			
Basel 3 CET1 ratio	14.3%			
Capital surplus/(deficit) per share vs 10%	16			
Capital-adjusted terminal value	102			
PV of TV (GB pence)	77			
3. Final DDM valuation				
Total PV (GB pence)	85			

Source: Citi Research

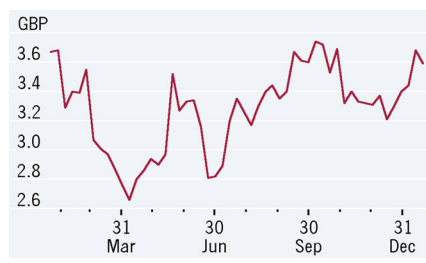
## Company Focus

- Estimate Change
- Target Price Change

<b>Sell/High Risk</b>	<b>3H</b>
Price (21 Jan 14)	£3.62
Target price	£2.90
from £2.75	
Expected share price return	-19.8%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>-19.8%</b>
Market Cap	£40,894M
	US\$67,196M

### Price Performance

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



## Royal Bank of Scotland Group PLC (RBS.L) 24 Feb: Challenges In Outlining A Credible Core Strategy

■ **4Q13 Results Due 27 February** - 4Q13 results will be released on Thursday 27 February at 07:00 GMT. We forecast an underlying pre-tax loss of £3.5bn, following RBS' plans to create an internal "bad bank". However this has been well-flagged so we instead expect the focus to be on any accompanying remarks and/or strategy day on how to improve profitability in the "good bank". For our full investment thesis see ['Bad Bank' Implications](#) (20 Nov 2013).

■ **Accelerated Asset Reduction Crystallizes Heavy Charges** — In preparation for the internal "bad bank" RBS booked a 3Q13 loss, after heavy provisions, and has flagged a further £4.0-4.5bn impairment charge in 4Q13, equivalent to a TNAV hit of c7%. In 2014-16 there will then be an incremental £1.0bn impairment charge, £1.5-2.0bn of disposal costs and £1.5bn of operating and funding costs, taking cumulative charges to c£8.0-9.0bn, or c12-14% of TNAV. The impact on capital should be more limited at -10bps 4Q13 and +40-50bps 2014-16, as these charges are offset by lower deductions for EL (-£5bn) and RWA release (-£6bn). We forecast an end-2013 BIII CET1 ratio of 9.0%, in-line with guidance.

■ **A Response To New Capital Requirements** — The major reason for taking these steps appears to be to mitigate the impact of proposed new capital demands from the PRA, as well as the BoE stress tests. RBS argue these losses would have been recognized in the long-term under the existing strategy anyway, but we question whether this is true in an improving macro environment. Once again short-term steps to appease the regulator have been taken in favor of long-term shareholder value in our view. RBS now target an 11% CET1 ratio by end-2015 rising to 12% by end-2016. We forecast 12.4% and 13.2% respectively.

■ **What's Left In The 'Good Bank'?** — The Government's review acknowledges that "the drag from legacy assets is not the main impediment to the Government selling down its stake ... a much more substantial impact on achieving this objective could be secured through delivery of further improvements in the return on equity in the 'good' bank". The report then looks at the strategic coherence and poor profitability of certain 'core' units and states that RBS will undertake a comprehensive review of Ulster Bank, continue to shrink investment banking and will exit from other areas deemed to have limited connectivity. This strategy appears to differ from the one proposed by former CEO, Hester. He had stated that it was better for RBS to have a "better business balance" otherwise it would simply become a "second best Lloyds." We await more detail from Mr McEwan.

■ **Sell The Shares** — We make no changes to our EPS estimates but update our capital forecasts, resulting in an increase in our target price to 290p (from 275p). We reiterate our Sell (3H) rating. RBS is our least favored UK bank.

### Royal Bank of Scotland Group PLC (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (£M)	396.8	1,717.2	-2,123.1	2,639.2	3,301.9
Diluted EPS (p)	3.7	15.5	-19.1	23.6	29.6
Diluted EPS (Old) (p)	3.7	15.5	-19.1	23.6	29.6
PE (x)	98.7	23.3	-19.0	15.3	12.2
P/BV (x)	0.6	0.6	0.7	0.7	0.7
DPS (p)	0.0	0.0	0.0	5.0	10.0
Net Div Yield (%)	0.0	0.0	0.0	1.4	2.8
ROE (%)	-3.1	-9.1	-5.3	-1.5	5.0

## 24 Feb: Challenges In Outlining A Credible Core Strategy

Figure 67. RBS – Summary Group and Divisional P&L by quarter (£m)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13E
<b>Group</b>												
Revenues	6,906	6,644	5,021	4,853	6,165	5,520	5,558	4,842	5,161	5,447	4,770	4,889
Expenses & Claims	-3,961	-3,756	-3,683	-3,446	-3,799	-3,634	-3,473	-2,948	-3,381	-3,399	-3,228	-3,079
<b>Gross Operating Profit</b>	<b>2,945</b>	<b>2,888</b>	<b>1,338</b>	<b>1,407</b>	<b>2,366</b>	<b>1,886</b>	<b>2,085</b>	<b>1,894</b>	<b>1,780</b>	<b>2,048</b>	<b>1,542</b>	<b>1,811</b>
Impairments	-1,947	-2,264	-1,536	-1,692	-1,314	-1,335	-1,176	-1,454	-1,033	-1,117	-1,104	-5,283
<b>Operating Profit</b>	<b>998</b>	<b>624</b>	<b>-198</b>	<b>-285</b>	<b>1,052</b>	<b>551</b>	<b>909</b>	<b>440</b>	<b>747</b>	<b>931</b>	<b>438</b>	<b>-3,473</b>
FVOD, APS, PPI, Levy, Amort'n & Other	-1,245	-1,507	2,023	-1,808	-2,566	-719	-2,277	-2,667	79	-383	-1,072	-395
<b>Pre-Tax Profit from cont'g operations</b>	<b>-247</b>	<b>-883</b>	<b>1,825</b>	<b>-2,093</b>	<b>-1,514</b>	<b>-168</b>	<b>-1,368</b>	<b>-2,227</b>	<b>826</b>	<b>548</b>	<b>-634</b>	<b>-3,868</b>
Tax on continuing operations	-389	-168	-744	226	-138	-261	-3	-39	-350	-328	-81	1,044
<b>Profit After Tax from cont'g operations</b>	<b>-636</b>	<b>-1,051</b>	<b>1,081</b>	<b>-1,867</b>	<b>-1,652</b>	<b>-429</b>	<b>-1,371</b>	<b>-2,266</b>	<b>476</b>	<b>220</b>	<b>-715</b>	<b>-2,823</b>
Minorities, Prefs & Discontinued Items	70	115	107	28	107	-58	-34	-352	-83	-78	-113	-116
<b>Attributable Profit to Ord Shareholders</b>	<b>-566</b>	<b>-936</b>	<b>1,188</b>	<b>-1,839</b>	<b>-1,545</b>	<b>-487</b>	<b>-1,405</b>	<b>-2,618</b>	<b>393</b>	<b>142</b>	<b>-828</b>	<b>-2,939</b>
<b>Divisional Pre-Tax Profit</b>												
<b>Markets</b>	<b>1,029</b>	<b>327</b>	<b>-348</b>	<b>-109</b>	<b>824</b>	<b>251</b>	<b>295</b>	<b>139</b>	<b>278</b>	<b>93</b>	<b>210</b>	<b>18</b>
UK Retail & Commercial Banking - Total	1,203	1,066	982	936	1,012	1,010	895	1,013	891	928	999	150
- UK Retail	518	535	510	458	477	437	464	513	477	477	517	549
- UK Corporate	617	472	429	406	492	512	368	424	358	395	422	-469
- UK Wealth	68	59	43	72	43	61	63	76	56	56	60	70
US Retail & Commercial Banking	94	143	123	177	102	229	223	200	189	174	142	198
Ulster Bank	-365	-178	-208	-233	-310	-245	-242	-243	-164	-165	-132	-1,016
International Banking	226	149	228	152	97	167	175	155	94	42	83	119
<b>Regional Markets</b>	<b>1,158</b>	<b>1,180</b>	<b>1,125</b>	<b>1,032</b>	<b>901</b>	<b>1,161</b>	<b>1,051</b>	<b>1,125</b>	<b>1,010</b>	<b>979</b>	<b>1,092</b>	<b>-550</b>
Central Items & Other	-98	-12	0	74	-190	7	149	118	-36	140	-19	50
<b>Subtotal Core Divisions</b>	<b>2,089</b>	<b>1,495</b>	<b>777</b>	<b>997</b>	<b>1,535</b>	<b>1,419</b>	<b>1,495</b>	<b>1,382</b>	<b>1,252</b>	<b>1,212</b>	<b>1,283</b>	<b>-482</b>
Non-core	-1,091	-871	-975	-1,282	-483	-868	-586	-942	-505	-281	-845	-2,991
<b>Total Group</b>	<b>998</b>	<b>624</b>	<b>-198</b>	<b>-285</b>	<b>1,052</b>	<b>551</b>	<b>909</b>	<b>440</b>	<b>747</b>	<b>931</b>	<b>438</b>	<b>-3,473</b>

Source: Company Reports and Citi Research Estimates

Figure 68. RBS – Dividend Discount Model & Capital-Adjusted Warranted Equity Valuation

<b>1. Dividend Discount Model (DDM)</b>	<b>2013e</b>	<b>2014e</b>	<b>2015e</b>	<b>2016e</b>
PV of dividend (by quarter received)	0.0	4.5	8.2	11.1
<b>Total dividend PV (GB pence)</b>	<b>24</b>			
<b>2. Terminal value (WEV)</b>	<b>2016e</b>			
RoTE	7.4%			
Long-term growth	2.0%			
CoE	10.6%			
Theoretical TBVM	0.63x			
TBVPS	429			
Terminal value	269			
Basel 3 CET1 ratio	13.2%			
Capital surplus/(deficit) per share vs 10%	96			
<b>PV of adj TV (GB pence)</b>	<b>266</b>			
<b>3. DDM &amp; WEV valuation</b>				
<b>Total PV (1 + 2) (GB pence)</b>	<b>290</b>			

Source: Citi Research

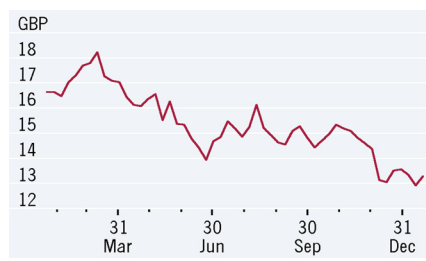
## Company Focus

### ■ Estimate Change

<b>Buy</b>	<b>1</b>
Price (21 Jan 14)	£13.60
Target price	£16.50
Expected share price return	21.3%
Expected dividend yield	4.3%
<b>Expected total return</b>	<b>25.6%</b>
Market Cap	£33,012M
	US\$54,244M

### Price Performance

(RIC: STAN.L, BB: STAN LN)



## Standard Chartered PLC (STAN.L)

### 5 Mar: Earnings Headwind; Attractive Valuation

■ **FY13 Results Due 5 March** — SC will release its FY13 results on Wednesday 5 March. For FY13, we are forecasting low single-digit revenue growth, +2% yoy and negative “jaws” of -1%. We therefore forecast pre-provision profit growth of +1% yoy, much lower than the +13% growth in 2012.

■ **Weak Pre-Close Trading Update** — SC’s pre-close trading update for FY13 on 4 December pointed towards weak overall earnings momentum in 2H13. The company said it expects FY13 revenue to be “broadly flat” with “low single digit growth” in Consumer Banking (CB) revenues and “flat” Wholesale Bank (WB) revenues for the year. SC pointed to weak EM currencies, Korea de-risking, higher Korean impairments and weakness in Wealth Management as factors behind the weak CB results. WB is expected to be impacted by weak “Own Account” results, stress in financial markets business and margin pressure.

■ **Stress In Both Major Segments** — Our forecast imply earnings stress in both major business segments. We forecast flat yoy revenue growth for WB and +3% growth for CB in 2013. Excluding US fines in 2012, we forecast flat trading profit for WB yoy while in CB we forecast a 12% yoy decline in profits, driven by a 52% rise in bad debt charges, due to Korea PDRS and other APAC. In WB the flat profit forecast is due to a 21% decline yoy in own account income for 2013 and poor performance in rates and capital markets business. However, SC’s gearing to FX revenues (c40% of its Financial Market income) should be a small positive.

■ **Company Re-Organisation Uncertain** — The company has announced a major re-organization of its businesses and a management shake-up. SC has reiterated intentions to work towards its Nov 11 investor day targets of “mid teen” ROEs, high single digit income growth and positive cost/income jaws. While the new segmentation may help focus on untapped growth opportunities and cost savings by removing duplication, no additional synergies from this reorganisation have been detailed and there has been some uncertainty raised by the management changes and new organogram. On capital, CEO Sands said contrary to “media noise” there are no plans to raise capital or dispute at the board level on the topic, and that there was no regulatory pressure to raise new equity.

■ **Remain Buyers** — SC shares are trading at attractive 2014E multiples: 10x PE, 1.2x P/TB and 4% dividend yield with an RoTE of 13%. The stock initially reacted negatively to the re-organization news, but has since rallied and is now up 5% vs price before the re-organization announcement. Near term possible catalysts include the continued recovery in DM Asia/Greater China and stability in asset quality issues in Korea. A key point: expectations are relatively low. We reiterate our Buy rating on STAN with a target price of 1650p. We roll forward our 2016 forecasts and also introduce the half-yearly forecasts for 2014.

### Standard Chartered PLC (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (\$M)	4,758.0	4,786.0	5,188.4	5,472.5	6,152.8
Diluted EPS (¢)	198	198	212	221	246
Diluted EPS (Old) (¢)	198	198	212	223	247
PE (x)	11.3	11.3	10.5	10.1	9.1
P/BV (x)	1.3	1.2	1.2	1.1	1.0
DPS (¢)	76	84	90	96	104
Net Div Yield (%)	3.4	3.8	4.0	4.3	4.7
ROE (%)	12.1	11.1	11.4	11.5	11.9



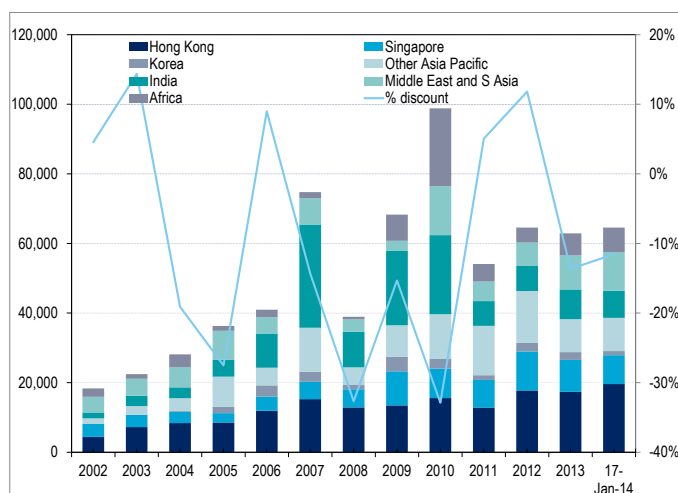
## 5 Mar: Earnings Headwinds; Attractive Valuation

Figure 69. Standard Chartered – Summary of Half-Year Estimates, 1H09-2H14E (\$m)

	1H10	2H10	1H11	2H11	1H12	2H12	1H13	2H13E	1H14E	2H14E
Net Interest Income	4,155	4,315	4,941	5,212	5,374	5,407	5,598	5,656	5,905	5,969
Fees, Trading & Other Income	3,769	3,823	3,823	3,661	3,997	4,005	4,390	3,519	4,384	3,866
<b>Total Income</b>	<b>7,924</b>	<b>8,138</b>	<b>8,764</b>	<b>8,873</b>	<b>9,371</b>	<b>9,412</b>	<b>9,988</b>	<b>9,175</b>	<b>10,289</b>	<b>9,834</b>
Total Expenses	-4,330	-4,693	-4,677	-5,240	-4,879	-5,176	-5,034	-5,323	-5,221	-5,460
<b>Operating Profit</b>	<b>3,594</b>	<b>3,445</b>	<b>4,087</b>	<b>3,633</b>	<b>4,492</b>	<b>4,236</b>	<b>4,954</b>	<b>3,852</b>	<b>5,068</b>	<b>4,374</b>
Loan Impairment Losses	-437	-446	-412	-487	-575	-621	-730	-861	-803	-944
Associates, JV & Other	-27	-7	-39	3	76	-757	101	19	98	16
<b>Pre-tax Profit</b>	<b>3,130</b>	<b>2,992</b>	<b>3,636</b>	<b>3,149</b>	<b>3,993</b>	<b>2,858</b>	<b>4,325</b>	<b>3,010</b>	<b>4,363</b>	<b>3,447</b>
Income Tax	-935	-773	-1,032	-810	-1,036	-830	-1,089	-843	-1,178	-931
Minorities & Other	-83	-100	-88	-97	-94	-105	-105	-112	-110	-118
<b>Attributable Profit</b>	<b>2,112</b>	<b>2,119</b>	<b>2,516</b>	<b>2,242</b>	<b>2,863</b>	<b>1,923</b>	<b>3,131</b>	<b>2,055</b>	<b>3,074</b>	<b>2,398</b>
<b>Per Share Data</b>										
<b>EPS (Reported)</b>	<b>99.4c</b>	<b>95.6c</b>	<b>106.5c</b>	<b>94.2c</b>	<b>119.9c</b>	<b>80.2c</b>	<b>129.5c</b>	<b>84.7c</b>	<b>126.0c</b>	<b>97.7c</b>
EPS (Fully diluted)	97.9c	94.0c	105.1c	92.9c	118.8c	79.3c	128.3c	83.9c	124.9c	96.8c
<b>DPS</b>	<b>23.4c</b>	<b>45.8c</b>	<b>24.8c</b>	<b>51.3c</b>	<b>27.2c</b>	<b>56.8c</b>	<b>28.8c</b>	<b>61.1c</b>	<b>54.2c</b>	<b>42.0c</b>
BVPS	1,369.0c	1,627.4c	1,720.6c	1,707.8c	1,768.6c	1,879.9c	1,846.9c	1,883.3c	1,961.7c	2,019.9c
TBVPs	1,066.3c	1,330.2c	1,409.7c	1,411.6c	1,473.6c	1,577.3c	1,595.2c	1,632.7c	1,712.9c	1,771.8c
<b>Operating Ratios</b>										
<b>ROE</b>	<b>14.9%</b>	<b>12.5%</b>	<b>12.7%</b>	<b>11.0%</b>	<b>13.8%</b>	<b>8.8%</b>	<b>13.9%</b>	<b>9.1%</b>	<b>13.1%</b>	<b>9.8%</b>
Net Interest margin (NII/ ATA)	1.81%	1.73%	1.82%	1.80%	1.78%	1.74%	1.75%	1.71%	1.72%	1.66%
Cost / income ratio	54.6%	57.7%	53.4%	59.1%	52.1%	55.0%	50.4%	58.0%	50.7%	55.5%
Provision charge / gross customer loans	0.42%	0.39%	0.33%	0.37%	0.43%	0.45%	0.52%	0.59%	0.52%	0.59%
NPL Ratio	2.0%	1.9%	1.7%	1.6%	1.9%	2.0%	2.0%	2.1%	2.2%	2.3%
Coverage	63.5%	57.8%	61.4%	64.0%	56.5%	56.2%	56.1%	57.8%	58.7%	59.7%
<b>Balance Sheet &amp; Capital Items</b>										
Customer Loans	215,005	240,358	262,126	266,790	272,453	279,638	285,353	301,047	314,006	329,888
Deposits	279,089	306,992	333,485	345,726	350,248	372,874	371,314	385,749	407,603	423,913
LDR	77%	78%	79%	77%	78%	75%	77%	78%	77%	78%
<b>Common Equity</b>	<b>29,458</b>	<b>38,212</b>	<b>40,933</b>	<b>40,714</b>	<b>42,305</b>	<b>45,362</b>	<b>44,768</b>	<b>45,835</b>	<b>48,088</b>	<b>49,660</b>
Equity Tier 1 Capital	20,787	28,799	30,893	31,818	33,072	35,339	36,774	37,841	40,094	41,666
Tier 1 Capital	26,251	34,313	36,443	37,012	38,267	40,600	42,000	43,015	45,268	46,840
RWAs (Basel II)	234,184	245,077	262,289	270,510	286,318	301,861	323,776	336,727	352,856	368,985
<b>Core Tier 1 Ratio (BII)</b>	<b>8.9%</b>	<b>11.8%</b>	<b>11.8%</b>	<b>11.8%</b>	<b>11.6%</b>	<b>11.7%</b>	<b>11.4%</b>	<b>11.2%</b>	<b>11.4%</b>	<b>11.3%</b>
Tier 1 Ratio (BII)	11.2%	14.0%	13.9%	13.7%	13.4%	13.4%	13.0%	12.8%	12.8%	12.7%

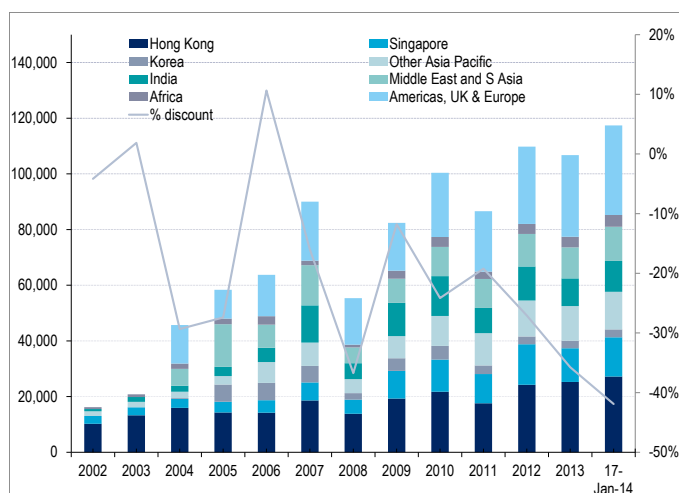
Source: Company Reports and Citi Research Estimates

Figure 70. STAN – PE SOTP Valuation (\$m)



Source: Citi Research

Figure 71. STAN – PB SOTP Valuation (\$m)



Source: Citi Research

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# Appendices

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## Appendix 1: Regional Statistics By Bank

### Barclays

Figure 72. Barclays – Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	#	£m	£m	£m
East Midlands	72	3,667	195	639
East of England	147	9,599	453	1,632
London	303	39,018	1,295	3,711
North East	80	3,007	287	517
North West	181	8,249	475	1,149
Scotland	23	3,403	41	217
South East	238	25,332	873	2,225
South West	162	10,311	439	1,188
Wales	114	3,548	278	1,079
West Midlands	139	6,923	438	1,191
Yorkshire & The Humber	107	5,566	299	868
<b>Total</b>	<b>1,566</b>	<b>118,622</b>	<b>5,073</b>	<b>14,416</b>

Source: Company Reports, Company Websites and Citi Research

Figure 73. Barclays – Split of Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	%	%	%	%
East Midlands	5%	3%	4%	4%
East of England	9%	8%	9%	11%
London	19%	33%	26%	26%
North East	5%	3%	6%	4%
North West	12%	7%	9%	8%
Scotland	1%	3%	1%	2%
South East	15%	21%	17%	15%
South West	10%	9%	9%	8%
Wales	7%	3%	5%	7%
West Midlands	9%	6%	9%	8%
Yorkshire & The Humber	7%	5%	6%	6%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Reports, Company Websites and Citi Research

Figure 74. Barclays – Loans Per Branch By Region

Region	Mortgages / Branch	Personal Loans / Branch	SME Loans / Branch
	£m	£m	£m
East Midlands	51	3	9
East of England	65	3	11
London	129	4	12
North East	38	4	6
North West	46	3	6
Scotland	148	2	9
South East	106	4	9
South West	64	3	7
Wales	31	2	9
West Midlands	50	3	9
Yorkshire & The Humber	52	3	8
<b>Total</b>	<b>76</b>	<b>3</b>	<b>9</b>

Source: Company Reports, Company Websites and Citi Research

## Lloyds

Figure 75. Lloyds – Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	#	£m	£m	£m
East Midlands	133	14,800	680	1,014
East of England	171	18,528	667	1,148
London	385	73,667	1,259	1,849
North East	114	10,576	555	741
North West	268	28,057	1,155	924
Scotland	476	27,586	1,161	1,346
South East	382	48,127	1,411	1,835
South West	326	28,203	1,007	3,345
Wales	133	10,851	544	946
West Midlands	261	24,353	1,129	2,335
Yorkshire & The Humber	209	22,749	901	829
<b>Total</b>	<b>2,858</b>	<b>307,497</b>	<b>10,469</b>	<b>16,311</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Lloyds, Halifax, Bank of Scotland and TSB brands

Figure 76. Lloyds – Split of Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	%	%	%	%
East Midlands	5%	5%	6%	6%
East of England	6%	6%	6%	7%
London	13%	24%	12%	11%
North East	4%	3%	5%	5%
North West	9%	9%	11%	6%
Scotland	17%	9%	11%	8%
South East	13%	16%	13%	11%
South West	11%	9%	10%	21%
Wales	5%	4%	5%	6%
West Midlands	9%	8%	11%	14%
Yorkshire & The Humber	7%	7%	9%	5%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Lloyds, Halifax, Bank of Scotland and TSB brands

Figure 77. Lloyds – Loans Per Branch By Region

Region	Mortgages / Branch	Personal Loans / Branch	SME Loans / Branch
	£m	£m	£m
East Midlands	111	5	8
East of England	108	4	7
London	191	3	5
North East	93	5	6
North West	105	4	3
Scotland	58	2	3
South East	126	4	5
South West	87	3	10
Wales	82	4	7
West Midlands	93	4	9
Yorkshire & The Humber	109	4	4
<b>Total</b>	<b>108</b>	<b>4</b>	<b>6</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Lloyds, Halifax, Bank of Scotland and TSB brands

## HSBC

Figure 78. HSBC – Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	#	£m	£m	£m
East Midlands	61	3,593	233	673
East of England	76	4,313	221	651
London	223	22,582	609	1,746
North East	35	1,662	133	322
North West	119	5,867	376	1,278
Scotland	10	1,946	117	288
South East	186	13,815	573	1,261
South West	139	5,877	314	1,127
Wales	98	2,495	199	800
West Midlands	114	5,160	326	1,176
Yorkshire & The Humber	113	5,239	327	1,170
<b>Total</b>	<b>1,174</b>	<b>72,549</b>	<b>3,429</b>	<b>10,492</b>

Source: Company Reports, Company Websites and Citi Research

Figure 79. HSBC – Split of Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	%	%	%	%
East Midlands	5%	5%	7%	6%
East of England	6%	6%	6%	6%
London	19%	31%	18%	17%
North East	3%	2%	4%	3%
North West	10%	8%	11%	12%
Scotland	1%	3%	3%	3%
South East	16%	19%	17%	12%
South West	12%	8%	9%	11%
Wales	8%	3%	6%	8%
West Midlands	10%	7%	10%	11%
Yorkshire & The Humber	10%	7%	10%	11%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Reports, Company Websites and Citi Research

Figure 80. HSBC – Loans Per Branch By Region

Region	Mortgages / Branch	Personal Loans / Branch	SME Loans / Branch
	£m	£m	£m
East Midlands	59	4	11
East of England	57	3	9
London	101	3	8
North East	47	4	9
North West	49	3	11
Scotland	195	12	29
South East	74	3	7
South West	42	2	8
Wales	25	2	8
West Midlands	45	3	10
Yorkshire & The Humber	46	3	10
<b>Total</b>	<b>62</b>	<b>3</b>	<b>9</b>

Source: Company Reports, Company Websites and Citi Research

## Nationwide

Figure 81. Nationwide – Branches, Mortgages & Personal Loans by Region

Region	No. Bank Branches #	Mortgage Loans £m	Personal Loans £m
East Midlands	74	8,374	148
East of England	57	9,941	141
London	126	26,448	240
North East	14	3,853	56
North West	77	11,537	156
Scotland	72	9,543	128
South East	143	26,422	338
South West	70	12,735	144
Wales	25	3,829	63
West Midlands	62	9,789	136
Yorkshire & The Humber	27	7,424	109
<b>Total</b>	<b>747</b>	<b>129,895</b>	<b>1,658</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Nationwide, Cheshire, Derbyshire and Dunfermline Building Society brands

Figure 82. Nationwide – Split of Branches, Mortgages & Personal Loans by Region

Region	No. Bank Branches %	Mortgage Loans %	Personal Loans %
East Midlands	10%	6%	9%
East of England	8%	8%	9%
London	17%	20%	14%
North East	2%	3%	3%
North West	10%	9%	9%
Scotland	10%	7%	8%
South East	19%	20%	20%
South West	9%	10%	9%
Wales	3%	3%	4%
West Midlands	8%	8%	8%
Yorkshire & The Humber	4%	6%	7%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Nationwide, Cheshire, Derbyshire and Dunfermline Building Society brands

Figure 83. Nationwide – Loans Per Branch By Region

Region	Mortgages / Branch £m	Personal Loans / Branch £m
East Midlands	113	2
East of England	174	2
London	210	2
North East	275	4
North West	150	2
Scotland	133	2
South East	185	2
South West	182	2
Wales	153	3
West Midlands	158	2
Yorkshire & The Humber	275	4
<b>Total</b>	<b>174</b>	<b>2</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Nationwide, Cheshire, Derbyshire and Dunfermline Building Society brands

## RBS

Figure 84. RBS – Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	#	£m	£m	£m
East Midlands	110	5,209	407	1,963
East of England	104	6,416	355	2,011
London	286	21,113	1,129	7,743
North East	40	2,283	158	623
North West	320	12,385	1,093	5,046
Scotland	290	9,917	693	3,655
South East	261	16,307	886	4,548
South West	196	8,759	511	3,395
Wales	113	2,892	225	1,055
West Midlands	126	6,325	434	2,902
Yorkshire & The Humber	144	6,147	483	2,206
<b>Total</b>	<b>1,990</b>	<b>97,753</b>	<b>6,373</b>	<b>35,147</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Natwest and RBS brands

Figure 85. RBS – Split of Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	%	%	%	%
East Midlands	6%	5%	6%	6%
East of England	5%	7%	6%	6%
London	14%	22%	18%	22%
North East	2%	2%	2%	2%
North West	16%	13%	17%	14%
Scotland	15%	10%	11%	10%
South East	13%	17%	14%	13%
South West	10%	9%	8%	10%
Wales	6%	3%	4%	3%
West Midlands	6%	6%	7%	8%
Yorkshire & The Humber	7%	6%	8%	6%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Natwest and RBS brands

Figure 86. RBS – Loans Per Branch By Region

Region	Mortgages / Branch	Personal Loans / Branch	SME Loans / Branch
	£m	£m	£m
East Midlands	47	4	18
East of England	62	3	19
London	74	4	27
North East	57	4	16
North West	39	3	16
Scotland	34	2	13
South East	62	3	17
South West	45	3	17
Wales	26	2	9
West Midlands	50	3	23
Yorkshire & The Humber	43	3	15
<b>Total</b>	<b>49</b>	<b>3</b>	<b>18</b>

Source: Company Reports, Company Websites and Citi Research

Note: Includes Natwest and RBS brands

## Santander UK

Figure 87. Santander UK – Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	#	£m	£m	£m
East Midlands	65	6,826	123	37
East of England	63	10,753	137	42
London	225	39,997	335	658
North East	27	3,754	85	39
North West	125	13,343	263	175
Scotland	87	8,209	185	16
South East	134	29,783	302	61
South West	96	12,744	165	92
Wales	53	4,711	93	21
West Midlands	70	8,463	143	37
Yorkshire & The Humber	101	8,094	174	93
<b>Total</b>	<b>1,046</b>	<b>146,678</b>	<b>2,006</b>	<b>1,271</b>

Source: Company Reports, Company Websites and Citi Research

Figure 88. Santander UK – Split of Branches, Mortgages, Personal & SME Loans by Region

Region	No. Bank Branches	Mortgage Loans	Personal Loans	SME Loans
	%	%	%	%
East Midlands	6%	5%	6%	3%
East of England	6%	7%	7%	3%
London	22%	27%	17%	52%
North East	3%	3%	4%	3%
North West	12%	9%	13%	14%
Scotland	8%	6%	9%	1%
South East	13%	20%	15%	5%
South West	9%	9%	8%	7%
Wales	5%	3%	5%	2%
West Midlands	7%	6%	7%	3%
Yorkshire & The Humber	10%	6%	9%	7%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Reports, Company Websites and Citi Research

Figure 89. Santander UK – Loans Per Branch By Region

Region	Mortgages / Branch	Personal Loans / Branch	SME Loans / Branch
	£m	£m	£m
East Midlands	105	2	1
East of England	171	2	1
London	178	1	3
North East	139	3	1
North West	107	2	1
Scotland	94	2	0
South East	222	2	0
South West	133	2	1
Wales	89	2	0
West Midlands	121	2	1
Yorkshire & The Humber	80	2	1
<b>Total</b>	<b>140</b>	<b>2</b>	<b>1</b>

Source: Company Reports, Company Websites and Citi Research

## Appendix A-1: Stock Summaries

### Barclays PLC

#### Company description

Barclays is a UK-based financial services group with a significant international presence, particularly in Europe, the US and Africa. It is engaged in retail and commercial banking, investment banking and wealth management.

#### Investment strategy

We have a Buy rating. Barclays continues to face economic and regulatory risks in the UK, but we believe the recently announced rights issue should materially reduce future uncertainty. In our view Barclays can be a winner in the consolidating world of capital markets, based on its dominant position in FICC sales & trading, while its retail banking operations, especially the UK and BarclayCard, are already demonstrating respectable growth and returns. The increased payout ratio target, to 40-50%, should also provide a supportive dividend yield. Despite this, Barclays trades at a discount to the wider sector, on 0.9x P/TB vs the wider sector on 1.1x.

#### Valuation

We update our Barclays valuation to reflect that the shares are now trading ex-rights. We use a two-stage warranted equity valuation to value Barclays, using 2016 as a base year to compute a terminal value. We use a cost of equity of 11.2% and long-term growth of 2% to compute a fair value per share of 330p, which we set as our target price.

#### Risks

There are several risks that could cause the share price to deviate significantly from our target price, including the risks of adverse regulatory changes, a prolonged UK economic recovery, or a renewed bout of Eurozone sovereign concerns. If the impact of these risk factors is more negative than we anticipate, then the share price might fail to reach our target price.

### HSBC Holdings PLC

#### Company description

HSBC is a global bank. It has two effective home markets: UK and Hong Kong. It has a long-standing presence across the Asian region. More recently, it has expanded into the Americas. HSBC operates across all major business lines: retail, commercial and investment banking as well as insurance and wealth management.

#### Investment strategy

We have a Buy rating on HSBC. HSBC has made progress on costs (exceeding the upper end of the previous \$2.5-3.5bn cost saving target), divestments (exiting local or small businesses) and connectivity-driven revenue growth (re-focusing the business towards fast-growing GTS & FX). HSBC stock has lagged the UK banks sector YTD. With most of the concerns (like US AQ issues, AML fines etc) behind them, we foresee potential benefits once NIMs stabilizes. The shares have an attractive dividend yield, the balance sheet has been strengthened, and the stock looks attractive, especially for income investors.

## Valuation

We value HSBC using a combination of a two-stage dividend discount model (DDM), and peer group SOTPs. Our DDM uses our 2015 RoE forecast, a 9.4% CoE and 2-3% long-term growth. Our SOTP is derived using local peer-group valuation P/E and P/B multiples. The average of these methodologies points to a target price of £7.70.

## Risks

There are several risks that could cause the share to deviate from our target price including:

Economic and growth risks (HSBC's balance sheet has expanded rapidly in certain regions in recent years);

Competition and margin weakness (low interest rates put pressure on returns in deposit-heavy businesses, including cash management and BSM);

Political risks (HSBC operates in some countries which are considered higher risk political environments, such as South Asia);

Financial market volatility (HSBC's Global Banking & Markets division accounts for approximately a third of Group pre-tax profits) and;

Regulatory risks (regulatory pressures could lead HSBC to hold more capital and incur greater costs than necessary and depress future profitability).

Alternatively should any of these risks prove more benign than we anticipate then this could drive upside to our target price.

## Lloyds Banking Group PLC

### Company description

Lloyds Banking Group is a major UK-based financial services group, providing a wide range of retail and commercial banking and financial services products. Lloyds is the UK's largest retail financial services provider and its only sizeable 'bancassurer', providing life assurance, pensions and investment products, as well as general insurance underwriting and broking. The acquisition of HBOS in 2009 provided a significant increase in the group's market share in these areas.

### Investment strategy

We rate Lloyds Neutral. Lloyds' shares have outperformed in 2012 and in 2013 ytd following a sharp re-rating as it became increasingly apparent that Lloyds was making significant progress in reshaping & restructuring the business, improving both the liquidity and capital position. In the short-term we expect earnings to continue to improve, boosted by improving net interest margins, cost take-out and lower impairments albeit these drivers have now largely run their course. With the shares now trading on 1.5x TB, we believe the stock is already up with events.

## Valuation

We set our target price at 85p 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 1.5x multiple of 2014E TBV per share, a premium to the European banks sector average.

## Risks

Lloyds' risk profile has improved markedly over the past 18 months. However, the company is not without risk, not least in regard to the outlook for the UK economy, regulation, and global wholesale funding markets, in particular. The risk remains that economic conditions could deteriorate more severely, leading to reduced levels of activity and higher impairment losses. In addition, there is a degree of integration and restructuring risk as the group seeks to transform its balance sheet. Regulatory risks also continue in regard to the ICB's proposals over capital and ring-fencing requirements. If the impact of these risk factors is more negative than we anticipate, then the share price might fail to reach our target price.

# 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 and Ireland. RBS also sells insurance and investment products and provides private banking.

## Investment strategy

We rate RBS Sell/High Risk. We believe that RBS has made substantial progress in repairing the balance. However progress on profitability has not been as promising. RBS' remaining core business continues to be focused towards capital-intensive business areas, while in the UK it is more geared to Corporate, rather than Retail. We therefore struggle to see how RBS can generate a double-digit Group RoE in the medium-term. RBS also remains highly exposed to additional regulatory uncertainty in the UK. We rate the stock as Sell/High Risk.

## Valuation

We set our target price at 290p 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 0.7x 2014E TBV per share, a discount to the European banks sector average, which we believe is fair due to RBS's lower RoTE profile.

## Risks

We set a High Risk rating to reflect RBS' exposure to political and regulatory uncertainty. Specific downside risks include risks associated with shrinking the non-core balance sheet and restructuring the Markets division. RBS also has potential upside surprise catalysts, that could result in it outperforming our target, such as such as a sharper credit recovery in Ireland than we anticipate, a turnaround in the US, or further margin improvements in the UK following active central bank policy.

## Standard Chartered PLC

### Company description

Standard Chartered Bank (SC) is an unusual bank. It is listed in the UK but is an emerging market bank. Among EM-listed banks, Standard Chartered is unusual as it offers diversified exposure to multiple markets, including Hong Kong, Korea, India, Singapore, among others in Asia, as well as Africa and the Middle East. Asia (incl Middle-East) is by far the most important region for SC, in 2012 accounting for 80% of revenues and 85% of PBT.

### Investment strategy

We rate Standard Chartered Buy. We see the following key investment positives:

**Strong Growth Profile:** Most SC key markets are enjoying rapid growth. We forecast a high single-digit underlying revenue CAGR for SC from 2012 to 2015. This is still an attractive growth albeit not the double-digits growth rate achieved during 2004-2008.

**Solid Funding Base:** SC has a strong client funding franchise, reflecting its roots in Asian markets with high savings rates. SC client deposits have grown at a double-digit CAGR in the past few years. We forecast strong deposit growth going forward, similar to client loan growth. However, lendable deposit ratios are tighter in some markets due to reserve requirements (eg India, China, Indonesia).

**Network Banking:** SCB has an international network in over 70 countries, including over 40 countries in Asia, Africa and the Middle East. Only few other international banks have a comparable network in these emerging markets. Local banking champions often have a deeper presence in individual countries, but none has a comparable cross-border network. The network helps SC in Wholesale Banking, especially FX, trade finance and cash management.

### Valuation

Our Standard Chartered (SCB) target price is £16.50. We primarily value Standard Chartered using the average of two-stage dividend discount models (DDMs) and peer group SOTPs. We also reference to historical valuation multiples to verify our target price.

### Risks

We note the following risks to our forecasts and target price:

**Economic Risks and Growth Risks:** SC has grown its balance sheet rapidly in the 2000s, but in the past 12-18 months loan growth has slowed. We have an upbeat economic forecast for SC's key markets in 2013-14 but any deterioration in the economic environment could raise asset quality concerns.

**Competition and Margin Weakness:** Low interest rates put pressure on returns in deposit-heavy businesses, including cash management in WB and current accounts in CB. The group's low LDR is a drag on returns in a low rate environment and higher rates will help returns, in particular in CB. Many of the markets in which SC operates are a strategic growth priority for many banks, international and regional, and this is also placing pressure on product margins (eg trade finance) and staff and general costs.

Rising Rates and EM Valuation: Emerging market stocks often underperform when US\$ rates rise. Our analysis of banks' performance through rate cycles shows that UK international banks (HSBC, Standard Chartered) have underperformed the broader European equity market when \$ short rates increase faster than long rates and the yield curve. In other rate scenarios (long-end led flattening or steepening, or a short-end led steepening) UK international banks have typically outperformed or performed in-line with the broader market.

Political Risks: SC operates in many countries which are considered higher risk political environments, including South Asia and Africa.

# Appendix A-1

## Analyst Certification

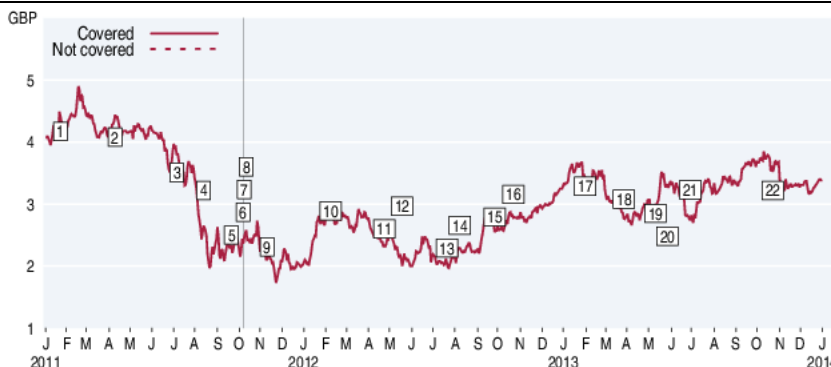
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

## 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 24-Jan-11	1M	*5.60	4.41
2 11-Apr-11	1M	*6.10	4.44
3 6-Jul-11	1M	*5.00	3.79
4 12-Aug-11	1M	*4.60	2.65
5 21-Sep-11	1M	*4.20	2.34
6 7-Oct-11	Stock rating system changed		
7 8-Oct-11	*1	4.20	2.36
8 12-Oct-11	1	*3.10	2.58

\* Indicates change

Date	Rating	Target Price	Closing Price
9 10-Nov-11	1	*3.00	2.11
10 8-Feb-12	*2	3.00	2.88
11 24-Apr-12	*2H	*2.80	2.33
12 18-May-12	2H	*2.50	2.00
13 20-Jul-12	2H	*2.35	2.05
14 8-Aug-12	2H	*2.30	2.29
15 26-Sep-12	2H	*2.70	2.55
16 23-Oct-12	2H	*2.85	2.78

Date	Rating	Target Price	Closing Price
17 31-Jan-13	2H	*3.60	3.43
18 27-Mar-13	2H	*3.00	2.77
19 10-May-13	2H	*2.90	3.00
20 28-May-13	*3H	2.90	3.32
21 28-Jun-13	3H	*2.70	2.74
22 23-Oct-13	3H	*2.75	3.52

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



Date	Rating	Target Price	Closing Price
1 2-Jul-12	*ADD LP	-	2.19

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

## HSBC Holdings PLC (HSBA.L)

### Ratings and Target Price History Fundamental Research

Analyst: Ronit Ghose



	Date	Rating	Target Price	Closing Price
1	7-Oct-11	Stock rating system changed		
2	8-Oct-11	*1	8.50	5.09
3	12-Oct-11	1	*7.25	5.29

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	14-Nov-11	1	*6.25	5.05
5	23-Feb-12	1	*6.50	5.75
6	23-Oct-12	1	*6.80	6.13

	Date	Rating	Target Price	Closing Price
7	31-Jan-13	*2	*7.70	7.17
8	17-Jun-13	*1	7.70	6.82

Rating/target price changes above reflect Eastern Standard Time

## HSBC Holdings PLC (HSBA.L)

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

Analyst: Ronit Ghose



	Date	Rating	Target Price	Closing Price
1	11-May-11	*ADD MP	-	6.46
2	1-Jul-11	*REM MP	-	6.29

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	10-Apr-12	*ADD MP	-	5.37
4	2-Jul-12	*REM MP	-	5.70

Rating/target price changes above reflect Eastern Standard Time

## Standard Chartered PLC (STAN.L)

### Ratings and Target Price History Fundamental Research

Analyst: Ronit Ghose



	Date	Rating	Target Price	Closing Price
1	21-Mar-11	1M	*22.00	16.22
2	23-Jun-11	1M	*20.00	15.34
3	7-Oct-11	Stock rating system changed		
4	8-Oct-11	*1	20.00	13.27
5	12-Oct-11	1	*18.00	14.35

\* Indicates change

	Date	Rating	Target Price	Closing Price
6	28-Nov-11	1	*17.50	13.40
7	2-Mar-12	1	*18.25	16.26
8	1-Jan-13	1	*18.50	15.74
9	31-Jan-13	1	*19.20	16.78
10	27-Feb-13	1	*20.00	17.75

	Date	Rating	Target Price	Closing Price
11	11-Apr-13	1	*19.00	16.55
12	13-May-13	1	*17.75	15.53
13	4-Dec-13	1	*16.50	13.39

Rating/target price changes above reflect Eastern Standard Time

## Standard Chartered PLC (STAN.L)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Ronit Ghose



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	16.70
2	11-May-11	*REM MP	-	15.88

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	1-Jul-11	*ADD MP	-	16.72
4	8-Feb-12	*REM MP	-	15.97

	Date	Rating	Target Price	Closing Price
5	15-Oct-12	*ADD MP	-	14.62
6	11-Apr-13	*REM MP	-	16.55

Rating/target price changes above reflect Eastern Standard Time

## Barclays PLC (BARC.L)

### Ratings and Target Price History

#### Fundamental Research

Analyst: Andrew Coombs

Covered since July 6 2011



	Date	Rating	Target Price	Closing Price
1	23-Feb-11	2M	*3.12	2.95
2	13-May-11	*1M	*2.99	2.53
3	6-Jul-11	1M	*2.86	2.31
4	21-Sep-11	1M	*2.68	1.42
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*1	2.68	1.52
7	12-Oct-11	1	*2.08	1.73

\* Indicates change

	Date	Rating	Target Price	Closing Price
8	1-Nov-11	1	*2.12	1.63
9	10-Jan-12	1	*2.26	1.74
10	7-Feb-12	1	*2.54	2.19
11	15-Feb-12	1	*2.77	2.23
12	30-Apr-12	1	*3.00	2.02
13	20-Jul-12	1	*2.77	1.47
14	8-Aug-12	1	*3.05	1.65

	Date	Rating	Target Price	Closing Price
15	26-Sep-12	1	*3.42	1.97
16	4-Jan-13	1	*3.69	2.56
17	13-Feb-13	1	*4.16	3.01
18	2-Aug-13	1	*3.19	2.64
19	24-Sep-13	1	*3.20	2.71

Rating/target price changes above reflect Eastern Standard Time

## Barclays PLC (BARC.L)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Andrew Coombs

Covered since July 6 2011



	Date	Rating	Target Price	Closing Price
1	9-Aug-11	*ADD MP	-	1.66

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

## Lloyds Banking Group PLC (LLOY.L)

### Ratings and Target Price History Fundamental Research

Analyst: Andrew Coombs

Covered since November 4 2011



	Date	Rating	Target Price	Closing Price
1	14-Apr-11	1M	*0.84	0.60
2	28-Jun-11	1M	*0.64	0.44
3	28-Jul-11	1M	*0.61	0.45
4	12-Aug-11	1M	*0.59	0.34
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*1	0.59	0.35

\* Indicates change

	Date	Rating	Target Price	Closing Price
7	12-Oct-11	1	*0.47	0.36
8	8-Feb-12	1	*0.45	0.36
9	2-May-12	1	*0.42	0.32
10	8-Aug-12	1	*0.45	0.32
11	23-Oct-12	1	*0.50	0.40
12	31-Jan-13	1	*0.62	0.52

	Date	Rating	Target Price	Closing Price
13	28-May-13	*2	0.62	0.61
14	28-Jun-13	2	*0.65	0.63
15	17-Jul-13	2	*0.70	0.70
16	2-Aug-13	2	*0.80	0.74
17	23-Oct-13	2	*0.83	0.78

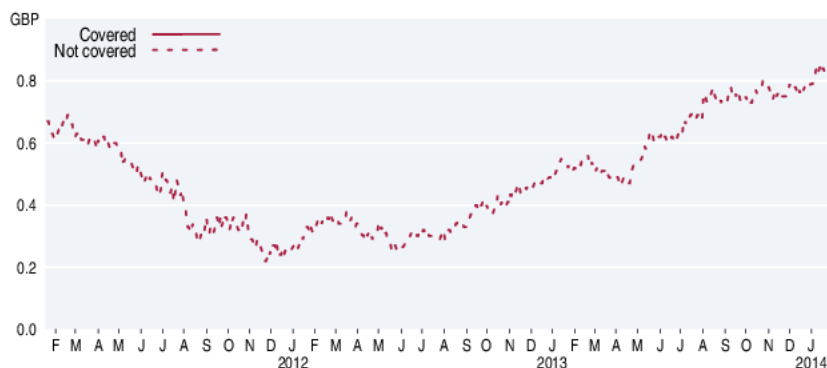
Rating/target price changes above reflect Eastern Standard Time

## Lloyds Banking Group PLC (LLOY.L)

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

Analyst: Andrew Coombs

Covered since November 4 2011



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Dec 2013

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