

Lloyds Banking Group

2Q23 – in line earnings, lower TNAV

Reiterate Rating: BUY | PO: 58.00 GBp | Price: 46.10 GBp

Flows and margin key

An in line underlying performance despite higher provisions for economic scenarios capturing higher rates is reassuring, we think. However, we expect the market to focus on deposit mix and flows which were negative in the quarter, and the implications for the size of the structural hedge and margin sustainability. We see this as far outweighed by higher rates (discussed in [Lloyds Banking Group: Near-term moderation](#) report link). Similarly, the 8% QoQ reduction in tangible book value from higher rates will flow back over time. While we expect short term weakness in the shares, a 5.7x PE substantially undervalues sustained mid teens profitability and capital distribution yield.

In line Q2 and FY23 guidance

£1,821m underlying profit before tax is in line with consensus but higher volatility & other items result in a 3% post tax miss (Exhibit 1). Income and costs are both 1% better than consensus, offset by higher provisions which include an £84m charge for economic scenario changes (higher interest rates) with underlying asset quality stable. Management now guide for FY23 net interest margin above 3.10% and RoTE over 14%. At 3.12% and 14.3%, consensus is there already. Higher rates also weighed on tangible book value, down 8% QoQ to 45.7p, CET1 increased 10bp QoQ to 14.2%.

Watch the flow

Deposits fell 1% QoQ but included a 2% reduction in retail current accounts and a corresponding increase in savings accounts. This reduces 'hedgeable' deposits, and the company indicates some reduction in the size of the structural hedge in 2H23. Although included in our forecasts (see UK Banks: Attractive returns, unappealing backdrop, 23 June 2023), we expect this to be an area of concern for the market. Deposit outflows came from commercial and wealth. Given similar yields on hedge reinvestment and liquidity, we see the volume of deposits as more important than hedge size.

Estimates (Dec) (GBp)	2021A	2022A	2023E	2024E	2025E
Net Profit (£m)	5,355	5,021	4,760	4,876	5,436
EPS (Adjusted)	8.38	7.89	7.57	8.21	9.85
Dividend / Share	2.00	2.40	2.90	3.20	3.40
Adjusted NAV PS	56.4	51.0	52.1	58.9	68.0
ADR EPS (Adjusted - US\$)	0.46	0.39	0.39	0.42	0.51
ADR Dividend / Shares (US\$)	0.11	0.12	0.15	0.16	0.17
Valuation (Dec)					
P/E	5.57	5.91	6.16	5.69	4.75
EPS Change (YoY)	243%	-5.80%	-4.08%	8.36%	20.1%
Price / BV	0.70x	0.74x	0.71x	0.63x	0.55x
Price / NAV	0.82x	0.90x	0.88x	0.78x	0.68x
Net Yield	4.34%	5.21%	6.29%	6.94%	7.38%
DPS Change (YoY)	251%	20.0%	20.8%	10.3%	6.25%
Price / GOP	5.38x	3.59x	3.55x	3.20x	2.70x

26 July 2023

Equity

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Stock Data

Price (Common / ADR)	46.10 GBp / 2.35 USD
Price Objective	58.00 GBp / 2.94 USD
Date Established	23-Jun-2023 / 5-Jul-2023
Investment Opinion	B-1-7 / B-1-7
52-Week Range	38.51 GBp-54.33 GBp
Market Value (mn)	33,163 GBP
Shares Outstanding (mn)	71,944.0 / 17,986.0
Average Daily Value (mn)	75.59 USD
Free Float	99.9%
BofA Ticker / Exchange	LLDTF / LSE
BofA Ticker / Exchange	LYG / NYS
Bloomberg / Reuters	LLOY LN / LLOY.L
ROE (2023E)	11.4%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "[BofA ESGMeter Methodology](#)".

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Refer to important disclosures on page 6 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 26 July 2023 03:38AM EDT

iQprofileSM Lloyds Banking Group

Key Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(£ Millions)	IFRS	IFRS	IFRS	IFRS	IFRS
Net Interest Income	11,163	13,172	13,558	14,002	15,048
Net Fee Income	1,423	1,503	1,533	1,564	1,595
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Other Income	3,637	3,746	3,483	3,559	3,586
Total Non-Interest Income	5,060	5,249	5,016	5,123	5,181
Total Operating Income	16,223	18,421	18,574	19,125	20,229
Operating Expenses	(10,072)	(9,463)	(9,966)	(10,153)	(10,375)
Pre-Provision Profit	6,151	8,958	8,608	8,972	9,854
Provisions Expense	1,385	(1,510)	(1,209)	(1,341)	(1,456)
Operating Profit	7,536	7,448	7,399	7,631	8,398
Non-Operating Items	(634)	(520)	(245)	(220)	(220)
Pre-Tax Income	6,902	6,928	7,154	7,411	8,178
Net Income to sh/holders	5,355	5,021	4,760	4,876	5,436
Adjusted Cash Earnings	5,945	5,435	4,952	5,050	5,610

Key Balance Sheet Data	2021A	2022A	2023E	2024E	2025E
Total Assets	886,525	877,829	865,881	870,366	880,266
Average Interest Earning Assets	439,800	448,300	452,417	450,824	452,041
Risk Weighted Assets	195,967	210,859	212,946	217,984	222,573
Total Gross Customer Loans	507,140	504,282	496,066	499,311	509,091
Total Customer Deposits	507,469	523,927	500,197	482,322	488,177
Tier 1 Capital	36,594	34,036	32,971	33,431	35,809
Tangible Equity	40,495	34,539	33,700	35,389	37,742
Common Shareholders' Equity	47,011	41,980	41,501	43,430	45,903

Key Metrics	2021A	2022A	2023E	2024E	2025E
Net Interest Margin	2.51%	2.91%	2.99%	3.12%	3.31%
Tier 1 Ratio	18.7%	16.1%	15.5%	15.3%	16.1%
Effective Tax Rate	14.7%	19.8%	26.0%	27.0%	27.0%
Loan / Assets Ratio	56.8%	56.9%	56.7%	56.9%	57.4%
Loan / Deposit Ratio	99.2%	95.4%	98.2%	103%	103%
Oper Leverage (Inc Growth - Cost Growth)	-7.72%	19.6%	-4.49%	1.09%	3.59%
Gearing (Assets / Equity)	18.9x	20.9x	20.9x	20.0x	19.2x
Tangible Equity / Assets	4.57%	3.93%	3.89%	4.07%	4.29%
Tangible Equity / RWAs	20.7%	16.4%	15.8%	16.2%	17.0%

Business Performance	2021A	2022A	2023E	2024E	2025E
Revenue Growth	6.12%	13.5%	0.83%	2.97%	5.77%
Operating Expense Growth	13.8%	-6.05%	5.31%	1.88%	2.19%
Provisions Expense Growth	-133%	-209%	-19.9%	10.9%	8.56%
Operating Revenue / Average Assets	0.86%	0.84%	0.85%	0.88%	0.96%
Operating Expenses / Average Assets	-1.15%	-1.07%	-1.14%	-1.17%	-1.19%
Pre-Provision ROA	0.70%	1.02%	0.99%	1.03%	1.13%
ROA	0.61%	0.57%	0.55%	0.56%	0.62%
Pre-Provision ROE	13.6%	20.1%	20.6%	21.1%	22.1%
ROE	11.9%	11.3%	11.4%	11.5%	12.2%
RoTE	15.4%	14.5%	14.5%	14.6%	15.3%
RoRWAs	2.98%	2.67%	2.34%	2.34%	2.55%
Dividend Payout Ratio	23.9%	30.4%	38.3%	39.0%	34.5%
Efficiency Ratio (Cost / Income Ratio)	62.1%	51.4%	53.7%	53.1%	51.3%

Quality of Earnings	2021A	2022A	2023E	2024E	2025E
Total Non-Interest Inc / Operating Inc	31.2%	28.5%	27.0%	26.8%	25.6%
Market-Related Revenue / Total Revenues	0%	0%	0%	0%	0%
Provisioning Burden as % of PPP	-22.5%	16.9%	14.0%	15.0%	14.8%
NPLs plus Foreclosed Real Estate / Loans	1.28%	1.53%	1.63%	1.62%	1.58%
Loan Loss Reserves / NPLs	59.3%	59.1%	62.5%	50.0%	50.0%
Loan Loss Reserves / Total Loans	0.76%	0.90%	1.02%	0.81%	0.79%
Provisions Expense / Average Loans	-0.28%	0.30%	0.24%	0.27%	0.29%

Company Sector

Banks-Retail

Company Description

A wide range of banking activities including personal and corporate lending, life assurance, general insurance, private banking and investment management. The majority of the group's assets and profits are located in and earned in the UK.

Investment Rationale

Rising interest rates and a strategic focus on increasing customer wallet share are positives and should sustain a solid mid teens RoTE even with significant mortgage pricing pressure. A combination of strong profitability and limited capital consumption from volume growth should support an ongoing capital distribution yield in the mid teens too. The current stock price undervalues this level of profitability and capital return, in our view.

Stock Data

Shares / ADR	4.00
Price to Book Value	0.7x

Exhibit 1: Lloyds 2Q23 performance

Underlying profit before tax in line with consensus, 3% post tax miss

	2Q22	3Q22	4Q22	1Q23	2Q23			2Q23 vs			
					Act	Cons	BofA	Cons	BofA	2Q22	1Q23
P&L (£m)											
Net interest income	3,190	3,394	3,643	3,535	3,469	3,429	3,450	1%	1%	9%	-2%
Other income	1,185	1,171	1,128	1,257	1,281	1,231	1,250	4%	2%	8%	2%
Operating lease depreciation	(119)	(82)	(78)	(140)	(216)	(150)	(150)	44%	44%	82%	54%
Total income	4,256	4,483	4,693	4,652	4,534	4,510	4,550	1%	0%	7%	-3%
Operating costs	(2,087)	(2,128)	(2,512)	(2,023)	(2,243)	(2,241)	(2,175)	0%	3%	7%	11%
Remediation	(52)	(27)	(10)	(166)	(51)	(80)	(75)	-36%	-32%	-2%	-69%
Total costs	(2,139)	(2,155)	(2,522)	(2,189)	(2,294)	(2,321)	(2,250)	-1%	2%	7%	5%
Gross operating profit	2,117	2,328	2,171	2,463	2,240	2,189	2,300	2%	-3%	6%	-9%
Impairment	(200)	(668)	(465)	(243)	(419)	(371)	(343)	13%	22%	110%	72%
Underlying PBT	1,917	1,660	1,706	2,220	1,821	1,818	1,957	0%	-7%	-5%	-18%
Restructuring	(23)	(22)	(11)	(12)	(13)	(24)	(15)	-	-	-	-
Volatility and other items	(289)	(1,062)	(638)	52	(198)	(72)	(100)	-	-	-	-
Statutory PBT	1,605	576	1,057	2,260	1,610	1,722	1,842	-7%	-13%	0%	-29%
Tax	(303)	(82)	(75)	(619)	(387)	(467)	(497)	-	-	-	-
Profit after tax	1,302	494	982	1,641	1,223	1,255	1,345	-3%	-9%	-6%	-25%
Key metrics											
Ordinary dividend (p)	0.80	0.00	1.60	0.00	0.92	0.92	1.00	0%	-8%	-	-
Share buyback (£bn)	0	0	2,000	0	0	-	0	-	-	-	-
Banking net interest margin	2.87%	2.98%	3.22%	3.22%	3.14%	3.10%	3.12%	0.04%	0.02%	0.27%	-0.08%
Average interest earning banking assets (£bn)	451	455	454	454	453	453	453	0%	0%	0%	0%
Cost: income ratio	50.3%	48.1%	53.7%	47.1%	50.6%	51.5%	49.5%	-0.9%	1.1%	0.3%	3.5%
Asset quality ratio	0.15%	0.52%	0.40%	0.21%	0.36%	0.30%	0.30%	0.06%	0.06%	0.21%	0.15%
CET1 ratio	14.7%	15.0%	14.2%	14.1%	14.2%	14.2%	14.4%	0.0%	-0.2%	-0.5%	0.1%
Risk weighted assets	210	211	211	211	215	212	212	2%	2%	3%	2%
TNAV per share (p)	51.4	44.5	46.5	49.5	45.7	49.7	49.5	-8%	-8%	-11%	-8%

Source: Company reports, company compiled consensus, BofA Global Research estimates

BofA GLOBAL RESEARCH

Price objective basis & risk

Lloyds Banking Group (LLDTF / LYG)

We value Lloyds using a Gordon Growth methodology using 2025E as a base year and a 13% CoE. We add to this valuation the present value of our forecast dividends and share buybacks through to 2025E discounted at the cost of equity. This is then cross checked against sector PE multiples and our economic scenarios analysis to arrive at our PO of 58p (\$2.94).

Downside risks to our price objective are weaker earnings than anticipated from higher impairment losses if the UK economy performs worse than we presently expect, a weaker interest rate outlook, tougher regulation and/or increased competition. Upside risks are stronger UK growth and more interest rate hikes, and a more constructive pricing environment.

Analyst Certification

I, Rohith Chandra-Rajan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Allied Irish Banks	AIBRF	AIBG ID	Alastair Ryan
	Banco BPM	BNCZF	BAMI IM	Antonio Reale
	Bank Of Ireland Group	XBOIF	BIRG ID	Alastair Ryan
	BFF Banking Group	XBBZF	BFF IM	Antonio Reale
	BNP Paribas	BNPQF	BNP FP	Tarik El Mejjad
	BNP Paribas	BNPQY	BNPQY US	Tarik El Mejjad
	CaixaBank	CIXPF	CABK SQ	Antonio Reale
	Credit Agricole	CRARF	ACA FP	Tarik El Mejjad
	Danske Bank	DNSKF	DANSKE DC	David Taranto
	Erste Bank	EBKOF	EBS AV	Alastair Ryan
	Erste Bank	EBKDY	EBKDY US	Alastair Ryan
	HSBC	XHSBF	5 HK	Alastair Ryan
	HSBC	HBCYF	HSBA LN	Alastair Ryan
	HSBC -A	HSBC	HSBC US	Alastair Ryan
	ING Groep NV	ING	ING US	Tarik El Mejjad
	ING Groep NV	INGVF	INGA NA	Tarik El Mejjad
	Intesa Sanpaolo	IITSF	ISP IM	Antonio Reale
	Intesa Sanpaolo	ISNPY	ISNPY US	Antonio Reale
	KBC Group	KBCSF	KBC BB	Tarik El Mejjad
	KBC Group NV	KBCSY	KBCSY US	Tarik El Mejjad
	Lloyds Banking Group	LLDTF	LLOY LN	Rohith Chandra-Rajan
	Lloyds Banking Group	LYG	LYG US	Rohith Chandra-Rajan
	NatWest Group	RBSPF	NWLG LN	Rohith Chandra-Rajan
	Natwest Group PLC	NWG	NWG US	Rohith Chandra-Rajan
	Nordea	NBNKF	NDA FH	David Taranto
	Nordea	XSABF	NDA SS	David Taranto
	Nordea Bank Abp	NRDBY	NRDBY US	David Taranto
	Permanent TSB	ILPMF	PTSB ID	Alastair Ryan
	Santander	SAN	SAN US	Antonio Reale
	Santander	BCDRF	SAN SQ	Antonio Reale
	Societe Generale	SCGLF	GLE FP	Tarik El Mejjad
	Societe Generale	SCGLY	SCGLY US	Tarik El Mejjad
	StanChart	SCBFF	STAN LN	Alastair Ryan
	StanChart	XCHBF	2888 HK	Alastair Ryan
	UBS	XUJHF	UBSG SW	Alastair Ryan
	UBS	UBS	UBS US	Alastair Ryan
	Unicredit	UNCFF	UCG IM	Antonio Reale

EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Unicredit	UNCR	UNCR US	Antonio Reale
NEUTRAL				
	Banco Bilbao Vizcaya Argentaria	BBVA	BBVA US	Antonio Reale
	Bankinter	BKMF	BKT SQ	Antonio Reale
	Barclays	BCLYF	BARC LN	Rohith Chandra-Rajan
	Barclays	BCS	BCS US	Rohith Chandra-Rajan
	BBVA	BBVXF	BBVA SQ	Antonio Reale
	Handelsbanken	SVNLF	SHBA SS	David Taranto
	Monte dei Paschi	BMDPF	BMPS IM	Antonio Reale
	Svenska Handelsbanke	SVNLY	SVNLY US	David Taranto
UNDERPERFORM				
	ABN AMRO	ABMRF	ABN NA	Tarik El Mejjad
	Banco Sabadell	BNSF	SAB SQ	Antonio Reale
	Commerzbank	CRZBF	CBK GY	Rohith Chandra-Rajan
	Deutsche Bank	DB	DB US	Rohith Chandra-Rajan
	Deutsche Bank	XDUSF	DBK GY	Rohith Chandra-Rajan
	DNB	DNBBF	DNB NO	David Taranto
	DNB ASA	DNBBY	DNBBY US	David Taranto
	Mediobanca	MDIBF	MB IM	Antonio Reale
	Poste Italiane	PITAF	PST IM	Antonio Reale
	Raiffeisen Bank International	RAIFF	RBI AV	Alastair Ryan
	SEB	SVKEF	SEBA SS	David Taranto
	Swedbank	SWDBF	SWEDA SS	David Taranto
	Swedbank AB	SWDBY	SWDBY US	David Taranto
	Virgin Money UK PLC	CBBYF	VMUK LN	Rohith Chandra-Rajan
	Virgin Money UK PLC	CYBBF	VUK AU	Rohith Chandra-Rajan

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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Disclosures

Important Disclosures

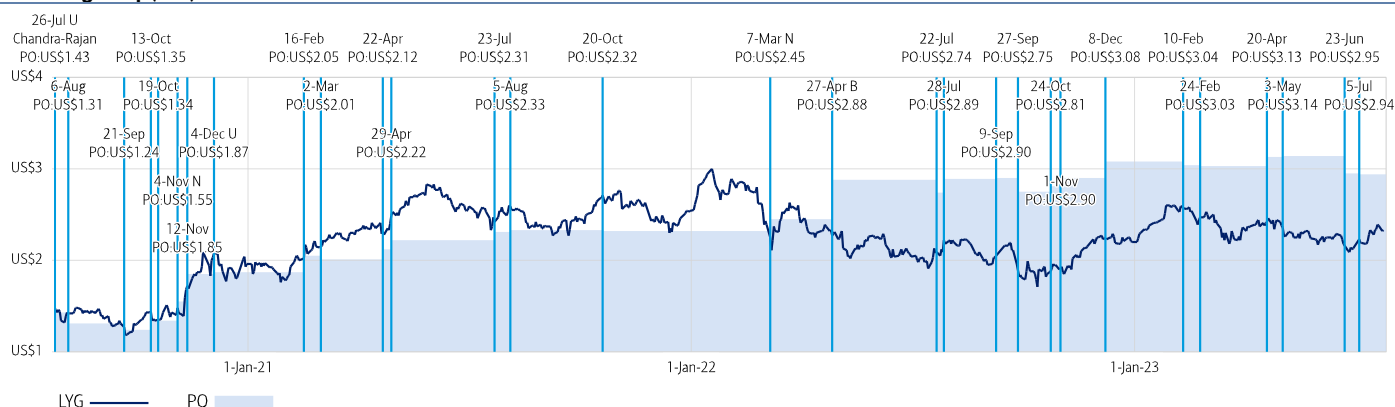
Lloyds Banking Group (LLDTF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Lloyds Banking Group (LYG) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Banks Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	98	50.52%	Buy	81	82.65%
Hold	45	23.20%	Hold	33	73.33%
Sell	51	26.29%	Sell	37	72.55%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

Price Charts for the securities referenced in this research report are available on the [Price Charts website](#), or call 1-800-MERRILL to have them mailed.

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