

Lloyds Banking Group

Q4 preview – motor finance and margin

Maintain Rating: NEUTRAL | PO: 52.00 GBp | Price: 41.50 GBp

Uncertainty weighs

A managed margin decline, before recovery from later this year, continued momentum in non-interest income and the prospect of a 15% RoTE with a mid-high teens annual yield (Exhibit 10) should be enough for Lloyds to rerate from its 6x PE (Exhibit 15). Even if there's additional disclosure on motor finance lending, we'd expect investors to be wary. Neutral ([Downgrade to Neutral – more uncertainty](#)), PO 41.5p, ADR \$2.64 from \$2.62.

Q4 earnings down 17% QoQ

We expect a 17% QoQ fall in earnings with margin erosion continuing at a similar pace to Q3, a seasonal increase in costs and a net provision release after the repayment of a sizeable defaulted corporate loan (Exhibit 1). This recovery could be used to build a motor finance provision – we've factored £0.5bn into our estimates, assuming that Lloyds would want to be prudent, but the lack of detail on the regulatory review outcome means that there's no obligation to raise a provision now. It looks like consensus assumes a similar provision, but spreads it over 2024E-25E (Exhibit 4).

Motor finance uncertainty

The motor finance review won't complete before September. Until then, we see potential remediation costs for Lloyds of £0.8 - 3.6bn (Exhibit 2), with investor concerns that estimates will rise reinforced by recent comments from the regulator ([More motor finance risk](#) report link). Some disclosure on historical motor finance lending under discretionary commission contracts would help but the confirmation of any remediation framework is what's really needed to restore investor confidence, we think.

Managed margin decline, recovery to 15% RoTE

Having cut our margin estimates on lower rates at the beginning of the year, we expect a 2.90% FY24 net interest margin, with a Q3 trough (Exhibit 7), and recovery from 2025E. Our 2024E net interest income is 3% below consensus, but 6% above in 2026E (Exhibit 8) when we expect a 15% RoTE (Exhibit 9).

Estimates (Dec) (GBp)	2021A	2022A	2023E	2024E	2025E
Net Profit (£m)	5,355	5,021	4,828	4,249	4,618
EPS (Adjusted)	8.38	7.89	7.89	7.15	8.16
Dividend / Share	2.00	2.40	2.90	3.20	3.50
Adjusted NAV PS	56.4	51.0	49.1	54.4	61.5
ADR EPS (Adjusted - US\$)	0.46	0.39	0.40	0.36	0.41
ADR Dividend / Shares (US\$)	0.11	0.12	0.15	0.16	0.18
Valuation (Dec)					
P/E	5.01	5.32	5.33	5.88	5.16
EPS Change (YoY)	243%	-5.80%	-0.07%	-9.35%	14.1%
Price / BV	0.63x	0.66x	0.67x	0.60x	0.54x
Price / NAV	0.74x	0.81x	0.85x	0.76x	0.67x
Net Yield	4.82%	5.78%	6.99%	7.71%	8.43%
DPS Change (YoY)	251%	20.0%	20.8%	10.3%	9.38%
Price / GOP	4.84x	3.23x	3.30x	3.26x	2.83x

09 February 2024

Equity

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Stock Data

Price (Common / ADR)	41.50 GBp / 2.05 USD
Price Objective	52.00 GBp / 2.62 USD
Date Established	15-Jan-2024 / 9-Feb-2024
Investment Opinion	B-2-7 / B-2-7
52-Week Range	39.55 GBp-54.33 GBp
Market Value (mn)	29,857 GBp
Shares Outstanding (mn)	71,944.0 / 17,986.0
Average Daily Value (mn)	47.60 USD
Free Float	99.9%
BofA Ticker / Exchange	LLDTF / LSE
BofA Ticker / Exchange	LYG / NYS
Bloomberg / Reuters	LLOY LN / LLOY.L
ROE (2023E)	11.9%
ESGMeter™	High

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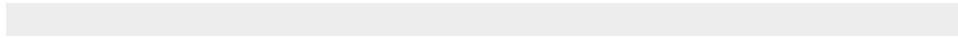
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Refer to important disclosures on page 11 to 14. Analyst Certification on page 9. Price Objective Basis/Risk on page 9.

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Timestamp: 09 February 2024 07:51AM EST



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	13,813	12,859	13,356
Net Fee Income	1,423	1,503	1,774	1,809	1,845
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Other Income	3,637	3,746	3,339	3,713	4,082
Total Non-Interest Income	5,060	5,249	5,113	5,522	5,927
Total Operating Income	16,223	18,421	18,926	18,381	19,283
Operating Expenses	(10,072)	(9,463)	(10,625)	(10,408)	(10,559)
Pre-Provision Profit	6,151	8,958	8,300	7,973	8,724
Provisions Expense	1,385	(1,510)	(633)	(1,178)	(1,424)
Operating Profit	7,536	7,448	7,667	6,794	7,300
Non-Operating Items	(634)	(520)	(400)	(220)	(220)
Pre-Tax Income	6,902	6,928	7,267	6,574	7,080
Net Income to sh/holders	5,355	5,021	4,828	4,249	4,618
Adjusted Cash Earnings	5,945	5,435	5,141	4,423	4,793

Key Balance Sheet Data

Total Assets	886,525	877,829	892,098	897,794	907,422
Average Interest Earning Assets	439,800	448,300	452,749	454,365	458,698
Risk Weighted Assets	195,967	210,859	217,957	222,168	226,214
Total Gross Customer Loans	507,140	504,282	501,288	505,745	515,252
Total Customer Deposits	507,469	523,927	518,537	518,537	524,868
Tier 1 Capital	36,594	34,036	36,451	36,952	37,369
Tangible Equity	40,495	34,539	31,516	33,276	35,691
Common Shareholders' Equity	47,011	41,980	39,450	41,451	43,985

Key Metrics

Net Interest Margin	2.51%	2.91%	3.05%	2.82%	2.89%
Tier 1 Ratio	18.7%	16.1%	16.7%	16.6%	16.5%
Effective Tax Rate	14.7%	19.8%	26.0%	27.0%	27.0%
Loan / Assets Ratio	56.8%	56.9%	55.6%	55.9%	56.3%
Loan / Deposit Ratio	99.2%	95.4%	95.7%	96.8%	97.4%
Oper Leverage (Inc Growth - Cost Growth)	-7.72%	19.6%	-9.54%	-0.84%	3.46%
Gearing (Assets / Equity)	18.9x	20.9x	22.6x	21.7x	20.6x
Tangible Equity / Assets	4.57%	3.93%	3.53%	3.71%	3.93%
Tangible Equity / RWAs	20.7%	16.4%	14.5%	15.0%	15.8%

Business Performance

Revenue Growth	6.12%	13.5%	2.74%	-2.88%	4.91%
Operating Expense Growth	13.8%	-6.05%	12.3%	-2.04%	1.45%
Provisions Expense Growth	-133%	-209%	-58.1%	86.2%	20.8%
Operating Revenue / Average Assets	0.86%	0.84%	0.87%	0.76%	0.81%
Operating Expenses / Average Assets	-1.15%	-1.07%	-1.20%	-1.16%	-1.17%
Pre-Provision ROA	0.70%	1.02%	0.94%	0.89%	0.97%
ROA	0.61%	0.57%	0.55%	0.47%	0.51%
Pre-Provision ROE	13.6%	20.1%	20.4%	19.7%	20.4%
ROE	11.9%	11.3%	11.9%	10.5%	10.8%
RoTE	15.4%	14.5%	15.6%	13.7%	13.9%
RoRWAs	2.98%	2.67%	2.40%	2.01%	2.14%
Dividend Payout Ratio	23.9%	30.4%	36.8%	44.7%	42.9%
Efficiency Ratio (Cost / Income Ratio)	62.1%	51.4%	56.1%	56.6%	54.8%

Quality of Earnings

Total Non-Interest Inc / Operating Inc	31.2%	28.5%	27.0%	30.0%	30.7%
Market-Related Revenue / Total Revenues	0%	0%	0%	0%	0%
Provisioning Burden as % of PPP	-22.5%	16.9%	7.62%	14.8%	16.3%
NPLs plus Foreclosed Real Estate / Loans	1.28%	1.53%	1.61%	1.59%	1.56%
Loan Loss Reserves / NPLs	59.3%	59.1%	62.5%	50.0%	50.0%
Loan Loss Reserves / Total Loans	0.76%	0.90%	1.01%	0.80%	0.78%
Provisions Expense / Average Loans	-0.28%	0.30%	0.13%	0.24%	0.28%

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

More normal interest rates and a strategic focus on increasing customer wallet share are positives and should sustain a low-mid teens RoTE even with significant mortgage and deposit pricing pressure. A combination of strong profitability and limited capital consumption from volume growth should support an ongoing capital distribution yield in the low-mid teens. This is an attractive combination but uncertainty on the scale of remediation costs likely holds back a re-rating.

Stock Data

Shares / ADR	4.00
Price to Book Value	0.7x

Half-yearly Earnings Estimates

	2022	2023
H1	3.78A	4.09A
H2	4.05A	3.74A

Key Changes

(US\$)	Previous	Current
Price Obj.	2.64	2.62



Key data

Exhibit 1: Lloyds 4Q23 preview

BoFAE 7% below consensus – we expect a large corporate loan provision writeback to more than offset a £0.5bn motor finance remediation provision

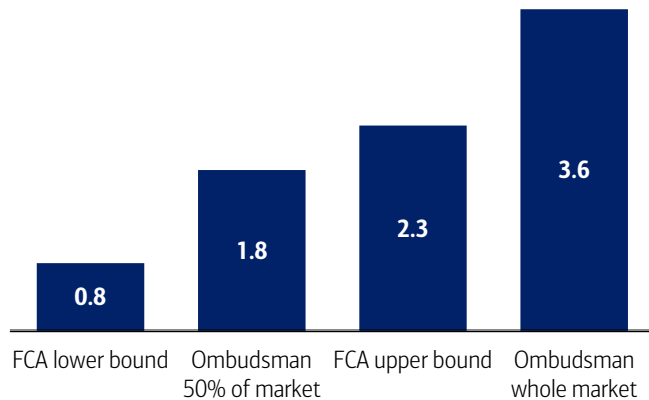
	4Q22	1Q23	2Q23	3Q23	BofA	YoY	4Q23E	Cons	YoY	QoQ
P&L (£m)										
Net interest income	3,643	3,535	3,469	3,444	3,365	-8%	-2%	3,368	-8%	-2%
Other income	1,128	1,257	1,281	1,299	1,276	13%	-2%	1,295	15%	0%
Operating lease depreciation	(78)	(140)	(216)	(229)	(245)	214%	7%	(234)	200%	2%
Total income	4,693	4,652	4,534	4,514	4,396	-6%	-3%	4,429	-6%	-2%
Operating costs	(2,495)	(2,179)	(2,128)	(2,254)	(2,457)	-2%	9%	(2,442)	-2%	8%
Remediation	(27)	(10)	(166)	(51)	(550)	1937%	978%	(152)	463%	198%
Total costs	(2,522)	(2,189)	(2,294)	(2,305)	(3,007)	19%	30%	(2,594)	3%	13%
Gross operating profit	2,171	2,463	2,240	2,209	1,388	-36%	-37%	1,835	-15%	-17%
Impairment	(465)	(243)	(419)	(187)	216	-146%	-216%	(126)	-73%	-33%
Underlying PBT	1,706	2,220	1,821	2,022	1,604	-6%	-21%	1,709	0%	-15%
Restructuring	(11)	(12)	(13)	(44)	(11)	-	-	(17)	-	-
Volatility and other items	(638)	52	(198)	(120)	(54)	-	-	(42)	-	-
Statutory PBT	1,057	2,260	1,610	1,858	1,539	46%	-17%	1,650	56%	-11%
Key metrics										
Banking net interest margin	3.22%	3.22%	3.14%	3.08%	3.02%	-0.20%	-0.06%	3.01%	-0.21%	-0.07%
Average interest earning banking assets	454	454	453	453	453	0%	0%	452	0%	0%
Cost: income ratio	53.7%	47.1%	50.6%	51.1%	68.4%	14.7%	17.4%	58.5%	4.8%	7.4%
Asset quality ratio	0.40%	0.21%	0.37%	0.16%	-0.19%	-0.59%	-0.35%	0.09%	-0.31%	-0.07%
CET1 ratio	14.2%	14.1%	14.2%	14.6%	14.1%	-0.1%	-0.5%	13.8%	-0.4%	-0.8%
Risk weighted assets	211	211	215	218	218	3%	0%	218	3%	0%
Dividend per share (p)	1.60	0.00	0.92	0.00	1.98	-	-	1.84	-	-
Share buyback (£m)	2,000	0	0	0	2,000	-	-	2,184	-	-
TNAV per share (p)	46.5	49.5	45.7	48.1	50.1	8%	4%	49.2	6%	2%

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

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Exhibit 2: Motor finance review could cost Lloyds £0.8-3.6bn

Cost to Lloyds (£bn)

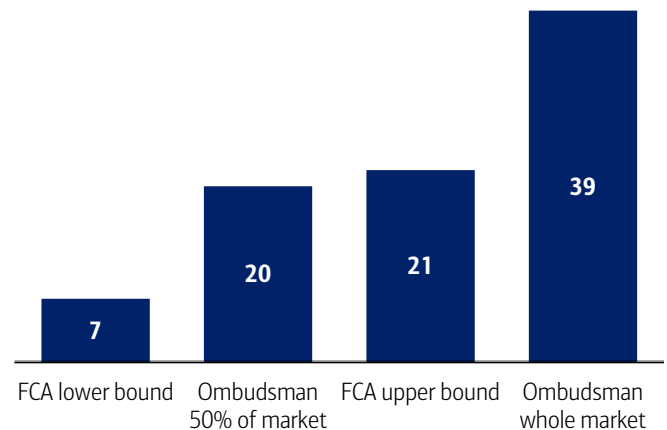


Source: BofA Global Research estimates

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Exhibit 3: Motor finance review could cost the industry £7-39bn

Cost to UK motor finance providers (£bn)

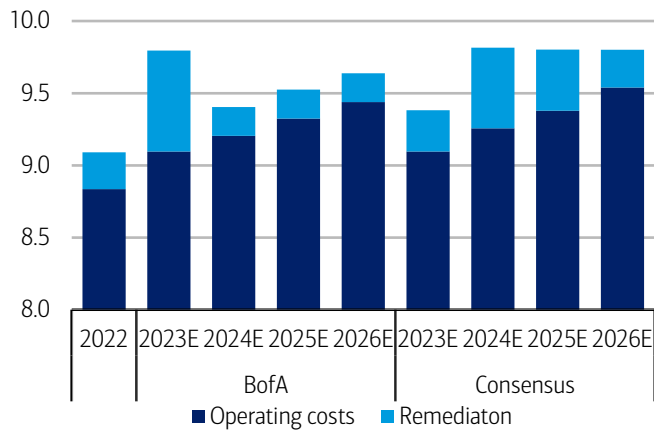


Source: BofA Global Research estimates

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Exhibit 4: Lloyds costs (£bn)

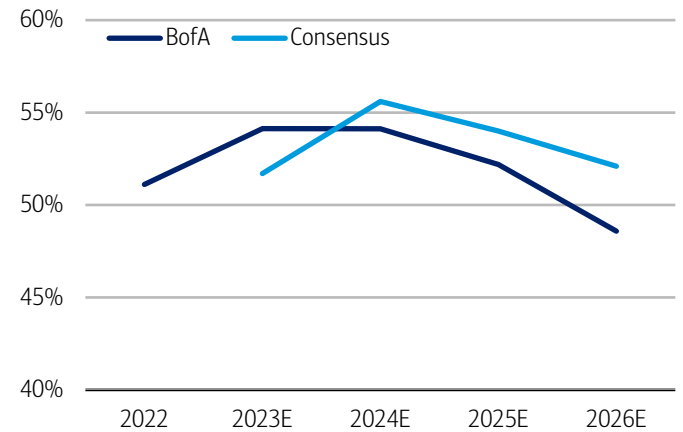
We factor in £0.5bn motor finance provision to 4Q23E, consensus spreads a similar amount over the coming years



Source: Company reports, company compiled consensus, BofA Global Research estimates
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Exhibit 5: Lloyds cost: income ratio

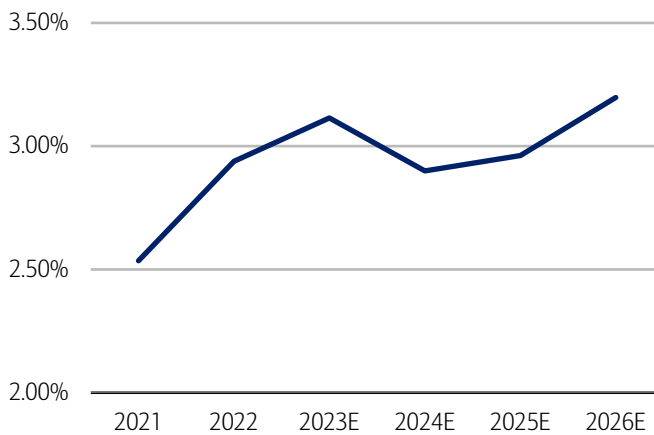
We expect <50% by 2026E, consensus stays higher



Source: Company reports, company compiled consensus, BofA Global Research estimates
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Exhibit 6: Margin recovering from 2025E as hedge continues building

Annual banking net interest margin

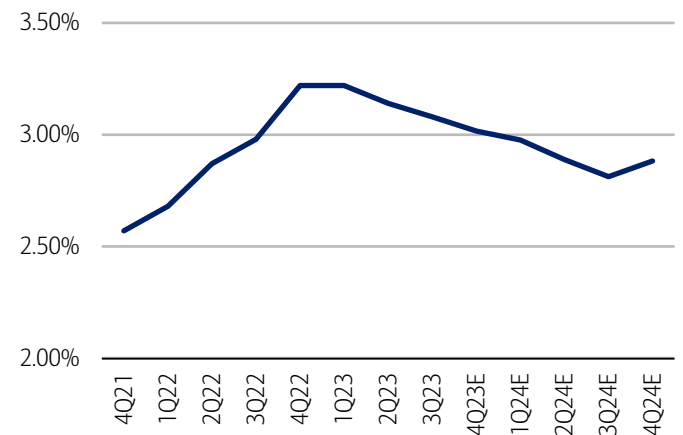


Source: Company data, BofA Global Research estimates

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Exhibit 7: Similar pace of decline to 3Q24E

Quarterly banking net interest margin

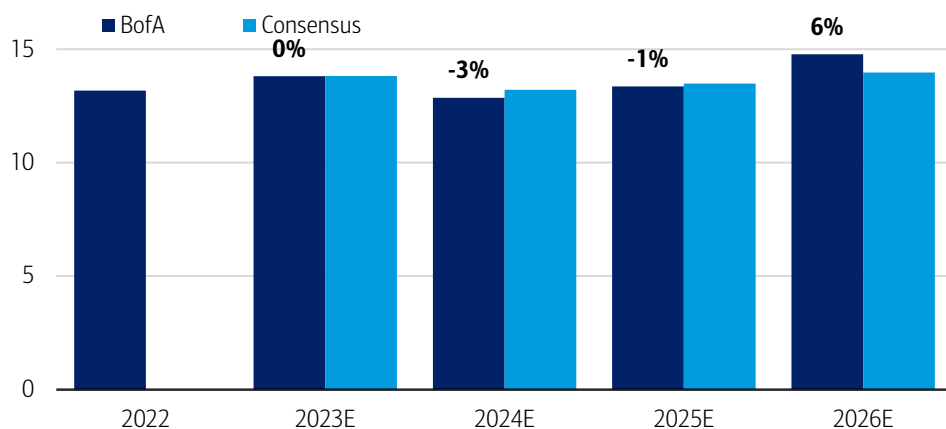


Source: Company data, BofA Global Research estimates

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Exhibit 8: Lloyds net interest income (£bn)

BofA 3% below 2024 consensus, 6% above 2026E

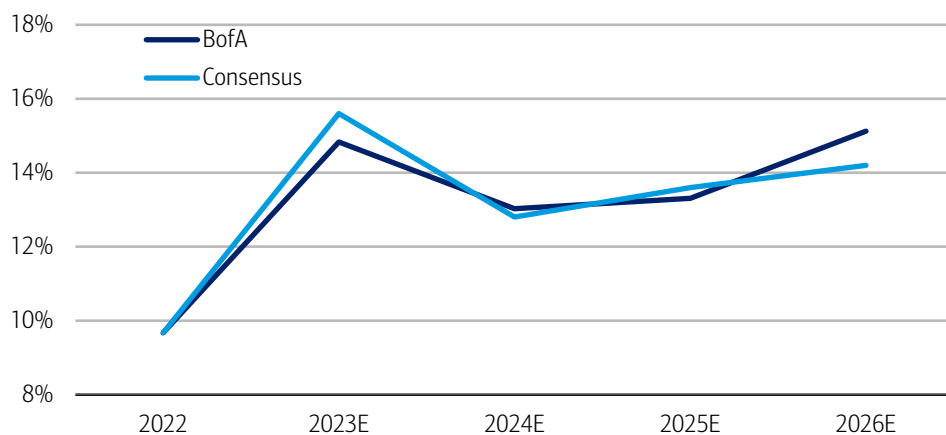


Source: Company reports, company compiled consensus, BofA Global Research estimates

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Exhibit 9: Lloyds RoTE

We expect 15% by 2026E, consensus 14%

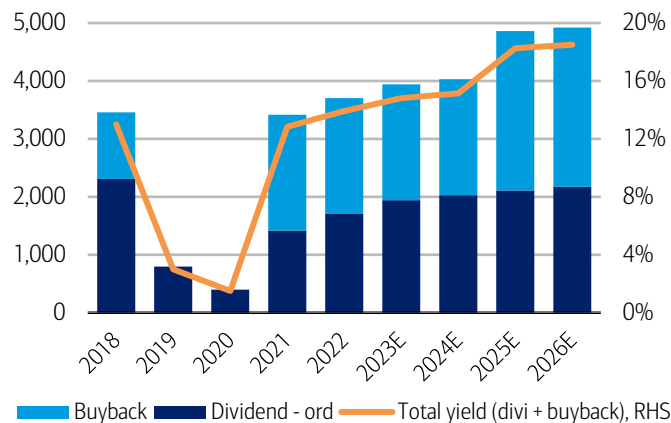


Source: Company reports, company compiled consensus, BofA Global Research estimates

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Exhibit 10: Annual yield 15% 2023E-24E then 19%

Capital distribution (£m) and yield

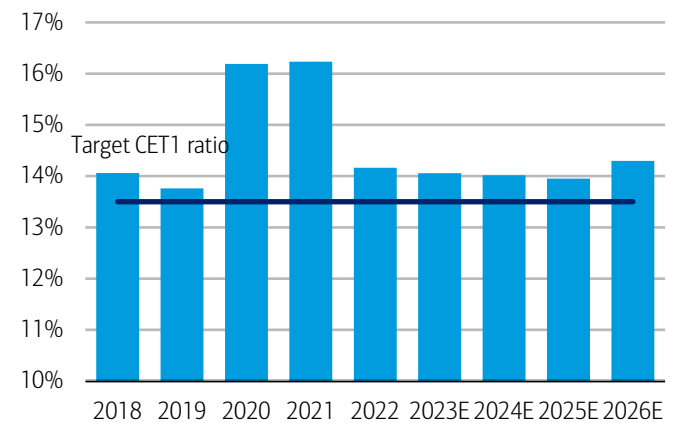


Source: BofA Global Research estimates, Bloomberg

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Exhibit 11: Operating above CET1 target, conserving capital for motor finance risk

Core Equity Tier 1 ratio



Source: Company data, BofA Global Research estimates

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Exhibit 12: 69p Gordon Growth model based valuation

Fundamental valuation

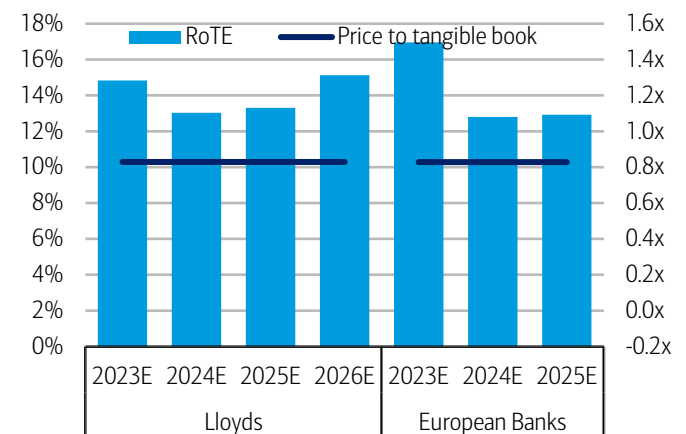
	Value per share (p)
2026E RoTE	15.1%
Cost of equity	13.0%
Growth	0%
Book multiple	1.2x
Book multiple discounted to 1 year from now	0.9x
2023E tangible book value	50
Value pre capital return	47
Present value of dividend	10
Present value of share buyback	12
Fair value	69

Source BofA Global Research estimates

BofA GLOBAL RESEARCH

Exhibit 13: Lloyds similar price to tangible book multiple and RoTE as European Bank sector

RoTE and price to tangible book value



Source: BofA Global Research estimates, Bloomberg

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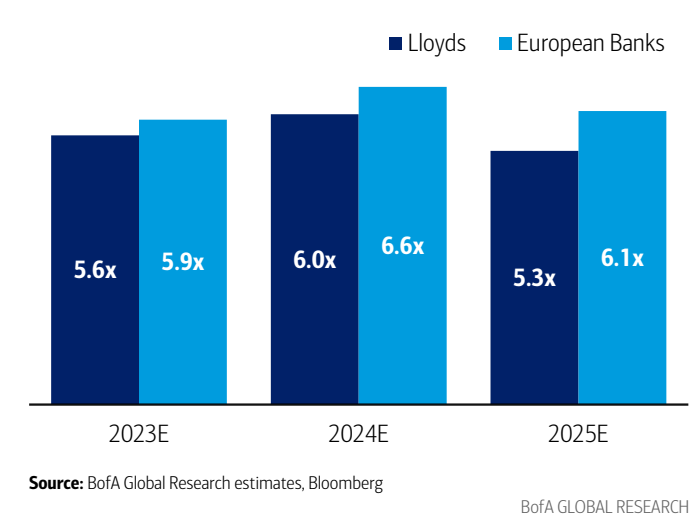
Exhibit 14: 46p valuation on European Bank sector 12M forward PE
European Bank sector relative PE valuation

	Value (p)
Lloyds 1 year forward EPS	7.0
European Bank sector 1 year forward PE	6.5x
Lloyds valued on sector multiple	46

Source: BofA Global Research estimates, Bloomberg

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Exhibit 15: Lloyds 9% PE discount to the European Bank sector
PE multiple



Price objective basis & risk

Lloyds Banking Group (LLDTF / LYG)

We value Lloyds using a Gordon Growth methodology using 2026E 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 2026E 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 52p (\$2.62).

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 fewer interest rate cuts, a more constructive pricing environment and lower conduct costs.

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
	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	Tarik El Mejjad
	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
	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
	NatWest Group	RBSPF	NWG LN	Rohith Chandra-Rajan
	Natwest Group PLC	NWG	NWG US	Rohith Chandra-Rajan
	Nordea	NBNKF	NDA FH	Tarik El Mejjad
	Nordea	XSABF	NDA SS	Tarik El Mejjad
	Nordea Bank Abp	NRDBY	NRDBY US	Tarik El Mejjad
	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
	Unicredit	UNCFF	UCG IM	Antonio Reale
	Unicredit	UNCRY	UNCRY US	Antonio Reale
NEUTRAL				
	ABN AMRO	ABMRF	ABN NA	Tarik El Mejjad
	Banco Bilbao Vizcaya Argentaria	BBVA	BBVA US	Antonio Reale
	Banco BPM	BNCZF	BAMI IM	Antonio Reale
	Bankinter	BKIMF	BKT SQ	Antonio Reale
	BBVA	BBVXF	BBVA SQ	Antonio Reale
	Handelsbanken	SVNLF	SHBA SS	Tarik El Mejjad
	ING Groep NV	ING	ING US	Tarik El Mejjad
	ING Groep NV	INGVF	INGA NA	Tarik El Mejjad



EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Lloyds Banking Group	LLDTF	LLOY LN	Rohith Chandra-Rajan
	Lloyds Banking Group	LYG	LYG US	Rohith Chandra-Rajan
	Monte dei Paschi	BMDPF	BMPS IM	Antonio Reale
	Raiffeisen Bank International	RAIFF	RBI AV	Alastair Ryan
	StanChart	SCBFF	STAN LN	Alastair Ryan
	StanChart	XCHBF	2888 HK	Alastair Ryan
	Svenska Handelsbanke	SVNLY	SVNLY US	Tarik El Mejjad
	UBS	XUHFJ	UBSG SW	Alastair Ryan
	UBS	UBS	UBS US	Alastair Ryan

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	Banco Sabadell	BNSF	SAB SQ	Antonio Reale
	Barclays	BCLYF	BARC LN	Rohith Chandra-Rajan
	Barclays	BCS	BCS US	Rohith Chandra-Rajan
	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	Tarik El Mejjad
	DNB ASA	DNBBY	DNBBY US	Tarik El Mejjad
	Mediobanca	MDIBF	MB IM	Antonio Reale
	Permanent TSB	ILPMF	PTSB ID	Alastair Ryan
	Poste Italiane	PITAF	PST IM	Antonio Reale
	SEB	SVKEF	SEBA SS	Tarik El Mejjad
	Swedbank	SWDBF	SWEDA SS	Tarik El Mejjad
	Swedbank AB	SWDBY	SWDBY US	Tarik El Mejjad
	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

EV / EBITDA

Basic EBIT + Depreciation + Amortization

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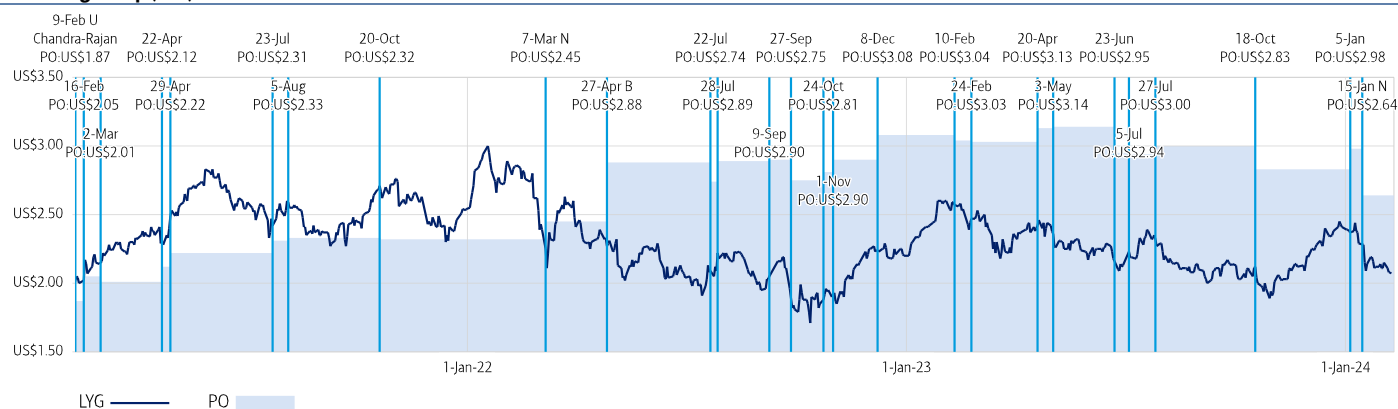
Lloyds Banking Group (LLDTF) Price Chart



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

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Equity Investment Rating Distribution: Banks Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	100	49.75%	Buy	84	84.00%
Hold	54	26.87%	Hold	41	75.93%
Sell	47	23.38%	Sell	35	74.47%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{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.



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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
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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.

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