

Lloyds Banking Group

1Q23 – Strong earnings and capital generation

Maintain Rating: BUY | PO: 63.00 GBp | Price: 47.68 GBp

Strong earnings and capital generation

After an 11% Q1 beat, we expect higher rates and improving mortgage spreads to provide more margin support later in the year. Strong other operating income and 52bp capital generation are also encouraging. We see attractive earnings growth and capital distribution and maintain Buy.

Earnings 11% above consensus, 27% YoY growth

Underlying profit before tax of £2,220m includes costs and provisions 5% and 32% better than consensus, while income is in line with market expectations. Less remediation expenses are the primary driver of better costs and robust credit quality and slightly improved economic assumptions kept the provision charge low. A CET1 ratio of 14.1% and 52bp capital generation in the quarter is after a final £800m pension fund contribution, 49.6p tangible book per share is up 7% QoQ.

Revenue focus

Net interest income 1% below consensus is compensated by stronger other operating income. Management has reiterated previous guidance for a step down in the net interest margin in Q2 and > 3.05% for FY23 and flat average interest earning assets for the year. A 50bp Q1 mortgage completion spread is an offset to higher rates, but market spreads are improving and we see volumes recovering. Underlying business activity driving 6% YoY growth in other operating income is encouraging.

Mixed volumes

Lloyds had only modest deposit outflows in Q1 but mortgages shrank a little more than we had expected. Deposits are relatively stable, down £2.2bn in the quarter, with commercial inflows helping to offset retail, and wealth outflows. This looks largely as anticipated and management has previously indicated structural hedge headroom for changes in deposit volume and mix. Were the hedge notional reduced, we'd expect a near term earnings pick up with policy rates currently above swap rates.

Estimates (Dec) (GBp)	2021A	2022A	2023E	2024E	2025E
Net Profit (£m)	5,355	5,021	4,918	4,980	5,218
EPS (Adjusted)	8.38	7.89	7.81	8.34	9.35
Dividend / Share	2.00	2.40	2.90	3.20	3.40
Adjusted NAV PS	56.4	51.0	52.9	59.8	68.4
ADR EPS (Adjusted - US\$)	0.46	0.39	0.39	0.42	0.47
ADR Dividend / Shares (US\$)	0.11	0.12	0.14	0.16	0.17
Valuation (Dec)					
P/E	5.76	6.11	6.18	5.79	5.18
EPS Change (YoY)	243%	-5.80%	-1.01%	6.73%	12.1%
Price / BV	0.72x	0.76x	0.72x	0.64x	0.57x
Price / NAV	0.85x	0.94x	0.90x	0.80x	0.70x
Net Yield	4.19%	5.03%	6.08%	6.71%	7.13%
DPS Change (YoY)	251%	20.0%	20.8%	10.3%	6.25%
Price / GOP	5.56x	3.71x	3.54x	3.26x	2.91x

03 May 2023

Equity

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Stock Data

Price (Common / ADR)	47.68 GBp / 2.36 USD
Price Objective	63.00 GBp / 3.13 USD
Date Established	9-Sep-2022 / 20-Apr-2023
Investment Opinion	B-1-7 / B-1-7
52-Week Range	38.51 GBp-54.33 GBp
Market Value (mn)	34,303 GBp
Shares Outstanding (mn)	71,944.0 / 17,986.0
Average Daily Value (mn)	80.13 USD
Free Float	99.9%
BofA Ticker / Exchange	LLDTF / LSE
BofA Ticker / Exchange	LYG / NYS
Bloomberg / Reuters	LLOY LN / LLOY.L
ROE (2023E)	11.7%

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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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	14,039	14,330	14,931
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	3,318	3,410	3,449
Total Non-Interest Income	5,060	5,249	4,851	4,973	5,044
Total Operating Income	16,223	18,421	18,890	19,304	19,975
Operating Expenses	(10,072)	(9,463)	(9,966)	(10,153)	(10,375)
Pre-Provision Profit	6,151	8,958	8,924	9,150	9,599
Provisions Expense	1,385	(1,510)	(1,311)	(1,377)	(1,500)
Operating Profit	7,536	7,448	7,613	7,773	8,100
Non-Operating Items	(634)	(520)	(245)	(220)	(220)
Pre-Tax Income	6,902	6,928	7,368	7,553	7,880
Net Income to sh/holders	5,355	5,021	4,918	4,980	5,218
Adjusted Cash Earnings	5,945	5,435	5,111	5,154	5,392

Key Balance Sheet Data					
Total Assets	886,525	877,829	873,586	883,602	898,442
Average Interest Earning Assets	439,800	448,300	452,419	456,083	465,152
Risk Weighted Assets	195,967	210,859	215,943	223,285	229,982
Total Gross Customer Loans	507,140	504,282	503,771	512,547	527,267
Total Customer Deposits	507,469	523,927	503,473	503,473	509,603
Tier 1 Capital	36,594	34,036	33,739	34,538	36,914
Tangible Equity	40,495	34,539	34,218	36,256	38,620
Common Shareholders' Equity	47,011	41,980	42,019	44,297	46,781

Key Metrics					
Net Interest Margin	2.51%	2.91%	3.10%	3.12%	3.17%
Tier 1 Ratio	18.7%	16.1%	15.6%	15.5%	16.1%
Effective Tax Rate	14.7%	19.8%	26.0%	27.0%	27.0%
Loan / Assets Ratio	56.8%	56.9%	57.1%	57.6%	58.2%
Loan / Deposit Ratio	99.2%	95.4%	99.1%	101%	103%
Oper Leverage (Inc Growth - Cost Growth)	-7.72%	19.6%	-2.77%	0.31%	1.29%
Gearing (Assets / Equity)	18.9x	20.9x	20.8x	19.9x	19.2x
Tangible Equity / Assets	4.57%	3.93%	3.92%	4.10%	4.30%
Tangible Equity / RWAs	20.7%	16.4%	15.8%	16.2%	16.8%

Business Performance					
Revenue Growth	6.12%	13.5%	2.55%	2.19%	3.48%
Operating Expense Growth	13.8%	-6.05%	5.31%	1.88%	2.19%
Provisions Expense Growth	-133%	-209%	-13.2%	4.99%	8.92%
Operating Revenue / Average Assets	0.86%	0.84%	0.87%	0.88%	0.91%
Operating Expenses / Average Assets	-1.15%	-1.07%	-1.14%	-1.16%	-1.16%
Pre-Provision ROA	0.70%	1.02%	1.02%	1.04%	1.08%
ROA	0.61%	0.57%	0.56%	0.57%	0.59%
Pre-Provision ROE	13.6%	20.1%	21.2%	21.2%	21.1%
ROE	11.9%	11.3%	11.7%	11.5%	11.5%
RoTE	15.4%	14.5%	14.9%	14.6%	14.4%
RoRWAs	2.98%	2.67%	2.39%	2.35%	2.38%
Dividend Payout Ratio	23.9%	30.4%	37.1%	38.4%	36.4%
Efficiency Ratio (Cost / Income Ratio)	62.1%	51.4%	52.8%	52.6%	51.9%

Quality of Earnings					
Total Non-Interest Inc / Operating Inc	31.2%	28.5%	25.7%	25.8%	25.3%
Market-Related Revenue / Total Revenues	0%	0%	0%	0%	0%
Provisioning Burden as % of PPP	-22.5%	16.9%	14.7%	15.0%	15.6%
NPLs plus Foreclosed Real Estate / Loans	1.28%	1.53%	1.60%	1.57%	1.53%
Loan Loss Reserves / NPLs	59.3%	59.1%	62.5%	50.0%	50.0%
Loan Loss Reserves / Total Loans	0.76%	0.90%	1.00%	0.79%	0.76%
Provisions Expense / Average Loans	-0.28%	0.30%	0.26%	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 double digit RoTE even with significant mortgage pricing pressure. Capital distributions look set to decline but are still attractive. 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

Key data

Exhibit 1: Lloyds 1Q23 performance

Underlying profit before tax 11% above consensus, 27% YoY growth

	1Q22	2Q22	3Q22	4Q22	1Q23			1Q23 vs			
					Act	Cons	BofA	Cons	BofA	1Q22	4Q22
P&L (£m)											
Net interest income	2,945	3,190	3,394	3,643	3,535	3,586	3,614	-1%	-2%	20%	-3%
Other income	1,182	1,185	1,171	1,128	1,257	1,208	1,200	4%	5%	6%	11%
Operating lease depreciation	(94)	(119)	(82)	(78)	(140)	(135)	(130)	4%	8%	49%	79%
Total income	4,033	4,256	4,483	4,693	4,652	4,659	4,684	0%	-1%	15%	-1%
Operating costs	(2,059)	(2,112)	(2,145)	(2,356)	(2,170)	(2,228)	(2,195)	-3%	-1%	5%	-8%
Remediation	(52)	(27)	(10)	(166)	(19)	(70)	(75)	-73%	-75%	-63%	-89%
Total costs	(2,111)	(2,139)	(2,155)	(2,522)	(2,189)	(2,298)	(2,270)	-5%	-4%	4%	-13%
Gross operating profit	1,922	2,117	2,328	2,171	2,463	2,361	2,414	4%	2%	28%	13%
Impairment	(177)	(200)	(668)	(465)	(243)	(355)	(310)	-32%	-22%	37%	-48%
Underlying PBT	1,745	1,917	1,660	1,706	2,220	2,006	2,104	11%	6%	27%	30%
Restructuring	(24)	(23)	(22)	(11)	(12)	(20)	(10)	-	-	-	-
Volatility and other items	(177)	(289)	(1,062)	(638)	52	(35)	0	-	-	-	-
Statutory PBT	1,544	1,605	576	1,057	2,260	1,951	2,094	16%	8%	46%	114%
Tax	(399)	(303)	(82)	(75)	(619)	(563)	(503)	-	-	-	-
Profit after tax	1,145	1,302	494	982	1,641	1,388	1,592	18%	3%	43%	67%
Key metrics											
Ordinary dividend (p)	0.00	0.80	0.00	1.60	0.00	0.00	0.00	-	-	-	-
Share buyback (£bn)	0	0	0	2,000	0	0	0	-	-	-	-
Banking net interest margin	2.68%	2.87%	2.98%	3.22%	3.22%	3.21%	3.26%	0.01%	-0.04%	0.54%	0.00%
Average interest earning banking assets (£bn)	448	451	455	454	452	453	453	0%	0%	1%	0%
Cost: income ratio	52.3%	50.3%	48.1%	53.7%	47.1%	49.3%	48.5%	-2.3%	-1.4%	-5.3%	-6.7%
Asset quality ratio	0.16%	0.15%	0.52%	0.40%	0.22%	0.31%	0.27%	-0.09%	-0.05%	0.06%	-0.18%
CET1 ratio	14.2%	14.7%	15.0%	14.2%	14.1%	14.1%	14.3%	0.0%	-0.2%	-0.1%	-0.1%
Risk weighted assets	210	210	211	211	211	212	211	-1%	0%	0%	0%
TNAV per share (p)	53.7	51.4	44.5	46.5	49.6	49.7	48.5	0%	2%	-8%	7%

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 12.5% 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 63p (\$3.13).

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
	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	NWG 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
	Societe Generale	SCGLF	GLE FP	Tarik El Mejjad
	Societe Generale	SCGLY	SCGLY US	Tarik El Mejjad
	UBS	XUJF	UBSG SW	Alastair Ryan
	UBS	UBS	UBS US	Alastair Ryan
	Unicredit	UNCFE	UCG IM	Antonio Reale
	Unicredit	UNCRY	UNCRY US	Antonio Reale
NEUTRAL				
	Barclays	BCLYF	BARCLN	Rohith Chandra-Rajan
	Barclays	BCS	BCS US	Rohith Chandra-Rajan
	Commerzbank	CRZBF	CBK GY	Rohith Chandra-Rajan

EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Handelsbanken	SVNLF	SHBA SS	David Taranto
	Mediobanca	MDIBF	MB IM	Antonio Reale
	StanChart	SCBFF	STAN LN	Alastair Ryan
	StanChart	XCHBF	2888 HK	Alastair Ryan
	Svenska Handelsbanke	SVNLY	SVNLY US	David Taranto

UNDERPERFORM

	ABN AMRO	ABMRF	ABN NA	Tarik El Mejjad
	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
	Monte dei Paschi	BMDPF	BMPS 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

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

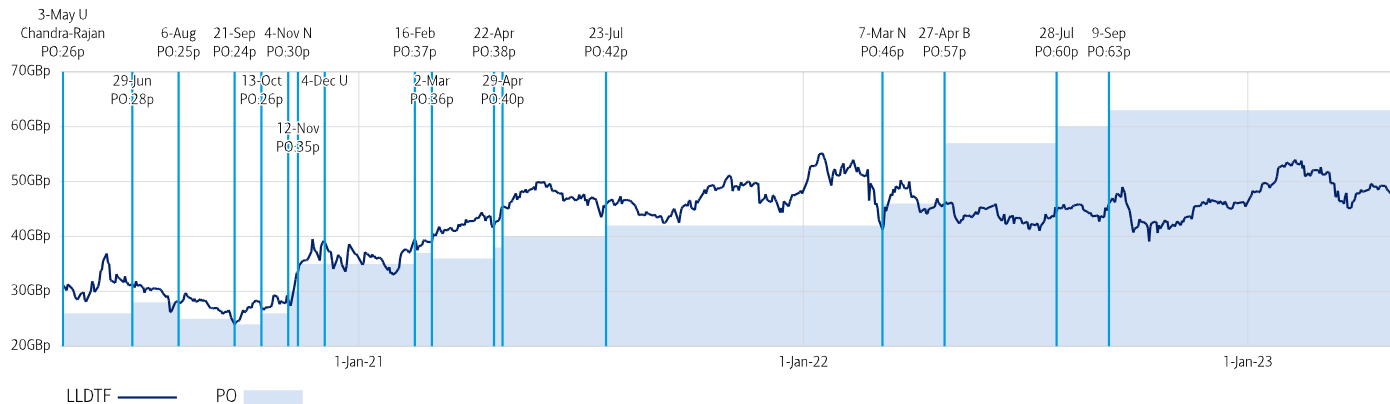
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Disclosures

Important Disclosures

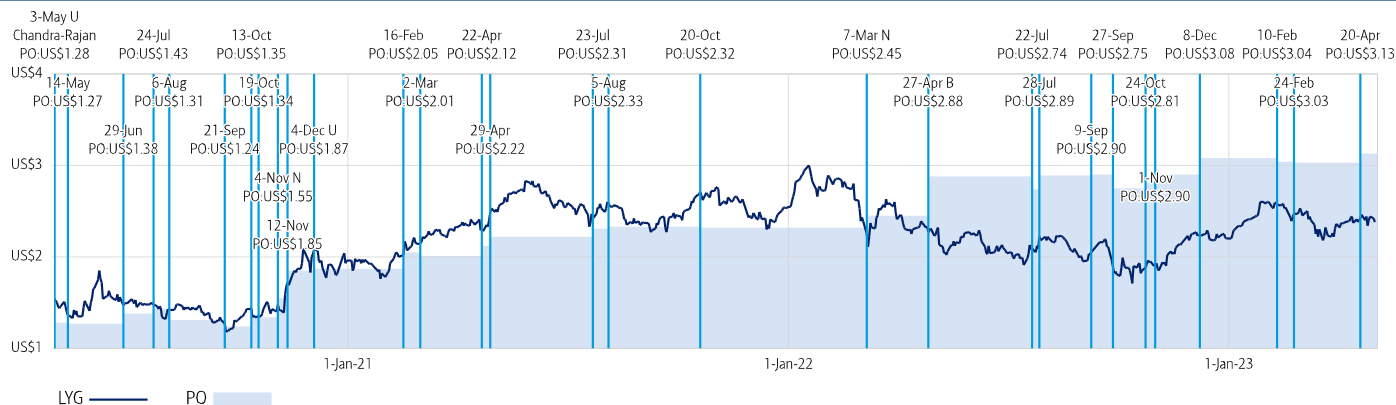
Lloyds Banking Group (LLDTF) Price Chart



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 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	88	50.87%	Buy	72	81.82%
Hold	40	23.12%	Hold	29	72.50%
Sell	45	26.01%	Sell	34	75.56%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

^{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}
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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