UK mortgage banks

The trend is not your friend: look at the lending multiples!

Neutral

Stock selection

Preferred
Credit Agricole
Least preferred
Lloyds TSB

Sector data

MSCI weighting			
SG weighting			
Average beta (5 years)			
Current beta (2 years)			
1m IBES EPS change			
Performance (%)	**1m**	**3m**	**12m**
MSCI sector			
Rel. MSCI Europe			

■ **Fact** We believe the current spurt of loan growth in the mortgage market (Q1 net lending up 30% on last year) is based on some disturbing lending policies. We tried a ‘‘mystery shopping’’ exercise last week and phoned a couple of IFAs to see how much lenders would allow us to borrow. One IFA said that several banks were prepared to lend 6x gross income, as long as LTV was no greater than 75%. Though banks often talk about decisions based on affordability, in our mystery shopping exercise, the size of the deposit appeared to be the key determinant (equating to 75% LTV).

■ **Impact** This has two effects: 1) we expect mortgage banks to report strong trading statements and impressive H1 results, and, 2) we should also see a rapid slowdown at some point, if banks really are using affordability models. Affordability assumptions are becoming increasingly stretched as non-mortgage costs (council tax, utility bills) rise ahead of inflation. A further brake on demand could be the movement in the 2-year fixed rate, (more than 70% of UK gross mortgage lending has been fixed rate in the last 6 months), which has risen by 50 basis points from the February 2006. If the market does not slow, we raise the possibility that the impact of reduced mortgage risk weightings under BIS II could be driving increasingly bold lending assumptions. If banks continue to lend at a time of deteriorating affordability, this also raises questions about potential misselling.

■ **Recent performance** UK mortgage banks (Alliance & Leicester, Bradford and Bingley and Northern Rock) have all jumped over 30% and outperformed the EU banks index by 10% over in the last six months. The UK mortgage banks are now trading at an 16% P/E premium to European banks, versus a an average 40% discount in 2005.This can partly be attributed to consolidation speculation, but also to a stronger mortgage market. We prefer HSBC (Buy, 950p FV 1,140p) which should benefit from positive trends outside the UK.

■ **Next events** UK banks will release trading updates in late May and June. We believe the market should be anticipating positive statements, given the strong industry data. However, we also believe that banks should voice caution on the outlook, given the deteriorating affordability trends.

Key recommendations

	Reco	Price 12/5/06	Fair val. 12m	P/E 06 (x)	P/E 07 (x)	Div. yld 06 (%)	Comments
Alliance & Leicester	SELL	1,147	900	14.4	13.8	4.4	At risk from PPI investigation
Bradford & Bingley	SELL	489	400	13.6	12.9	4.1	Not interesting at these levels, buy to let untested TTC
Northern Rock	SELL	1,055	950	12.3	10.7	3.1	High volume model unproven in slowing market
Sector average	-	-	-				


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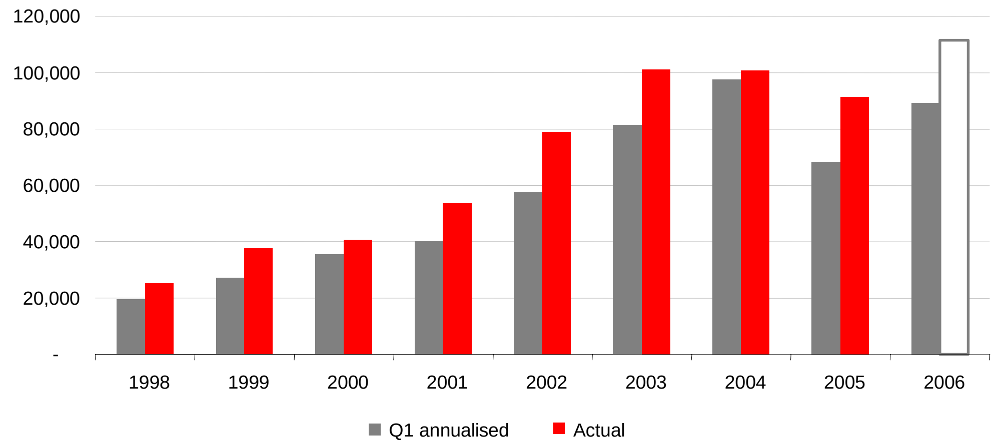
Concerns

Yet another fantastic year?

The UK mortgage market has had a strong start to the year. Net lending was £22.3bn for Q1 this year (up 30% on last year) according to the Bank of England. Annualising this figure would suggest an outcome for the year of £90bn. However, history shows that annualising Q1 tends to *understate* the full amount, applying the 10 year average 'seasonality factor' would get us to net lending of £111bn, 10% above the record years of 2003 and 2004.

UK mortgages net lending



Source: Bank of England, SG Equity Research

Yet, we believe affordability should now be acting as a constraint on the UK mortgage market. Mortgage costs (interest charge and loan repayment) are around 50% of take home pay for the average new borrower (average approval for house purchase £134K according to BBA). Add to this the substantial increases in utility bills and above inflation council tax rises and this will put pressure on the average homeowner's finances (which HBOS suggests has increased by 14% over the last three years).

Mystery shopping exercise

Averages can hide a wide distribution, so we decided to try a mystery shopping exercise, asking two IFAs how much banks were prepared to lend. We asked for a standard repayment mortgage, for someone earning £100K a year, who had a £200K deposit. We were surprised when the intermediary told us that several lenders are prepared to lend money to someone earning £100K at an income multiple of 6.0x gross income (this did not include a multiple of any bonus). Assuming a 25 year repayment mortgage (75% LTV base rate tracker), this equates to 2/3 of Take Home Pay (gross income less income tax and national insurance). Assuming a 20 year repayment mortgage, not unreasonable considering the average age of a First Time Buyer is currently 34, this rises to three quarters of Take Home Pay. If interest rates rise by 50bp, (as the market is currently anticipating) this results in a rise of mortgage costs by £2,200 per annum.

Annual repayment costs of a mortgage on 6x income

Assumptions		2006 25 yr	2006 20 yr	
Gross Income (Yr)	£	100,000	100,000	A
Take Home Pay (THP)	£	64,466	64,466	B
Mortgage Rate	(%)	5.05	5.05	C
House price	£	800,000	800,000	D
P/E ratio	(x)	8.0	8.0	=D/A
LTV		0.75	0.75	=E/D
Loan Amount	£	600,000	600,001	E
Income multiple		6.0	6.0	=E/A
Mortgage payments (Yr)	£	-42,785	-48,350	F
Mortgage as % of THP	(%)	66%	75%	=F/B

Source: SG Equity Research

This was the maximum rate on a standard mortgage, but the intermediary did email us to say that some lenders would be prepared to go higher. To be fair to the intermediary, they did want to meet us in person to discuss upfront costs and give us and idea of what our mortgage payments would be, and make sure they fit with our anticipated budget. Also, the second adviser we spoke to said that 4.0x was the normal maximum, but more ‘flexible’ products were available.

Interestingly though, the fact that the shopper said he was prepared to put down a large deposit seems to have been the key determinant. Although banks claim to use sophisticated affordability models, we believe our experience of talking to intermediaries who broke mortgages shows that Loan To Values (LTVs) are the real driver of lending decisions. From the banks perspective, this may make sense, as Loss Given Default is likely to be lower if buyers has put in a substantial amount of equity themselves. However, it raises questions about the sustainability of loan growth, and the potential for misselling.

Affordability models

When we asked banks about maximum income multiples they were prepared to lend at, many said that they no longer used income models, instead preferring to focus on affordability. This should mean that the models take into account the essential costs of owning a house.

The regulator has encouraged the banks to adopt this approach. Sir Howard Davis, at the time he was Chairman of the FSA, stressed the importance of reviewing overall income and expenditure. In 2004, the FSA took over the regulation of UK mortgage lending, with rules explicitly stating that mortgage providers must assess a customer’s ability to repay.

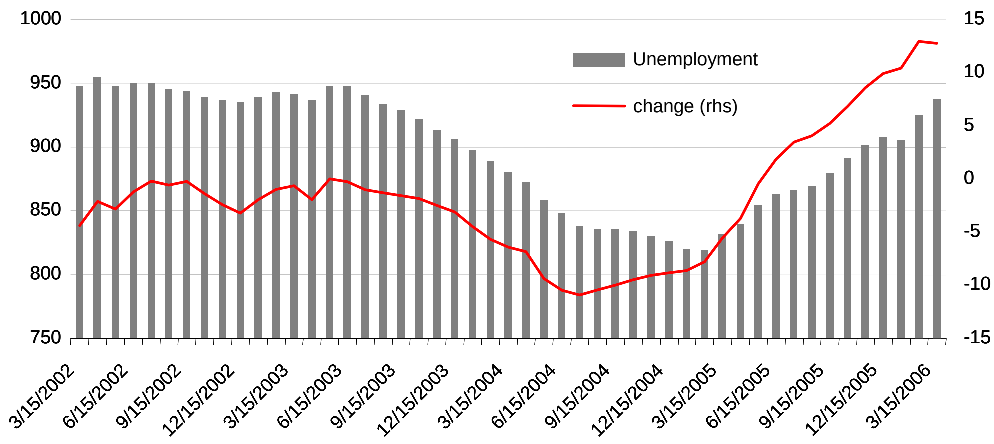
Yet, council tax and fuel bills are growing well ahead of inflation, and will more than offset the effects of a single base rate cut in 2005, according to HBOS. This suggests to us that, if these models are being used correctly by lenders, mortgage lending should be slowing. So far, this has not happened, and we think investors should be asking themselves at what point it should.

Claimant count rising

Unemployment has been trending up recently, and now stands at the highest level in three years. This has coincided with arrears ticking up as well (HBOS, the UK's largest mortgage lender reported cases in arrears up 24% in mainstream lending and 53% in specialised lending).

Naturally, there is still a significant cushion in the average LTVs. However, Northern Rock has said 30% of new lending was at or above 90% LTV, which leaves no margin for error, as banks suggest they can only recoup around 70% of the properties' value once repossessed and auctioned off. Given that house prices are so far above average earnings, any lender writing high gross market share is likely to be lending at high LTVs and income multiples.

UK unemployment: absolute (000's) and change rhs (%)

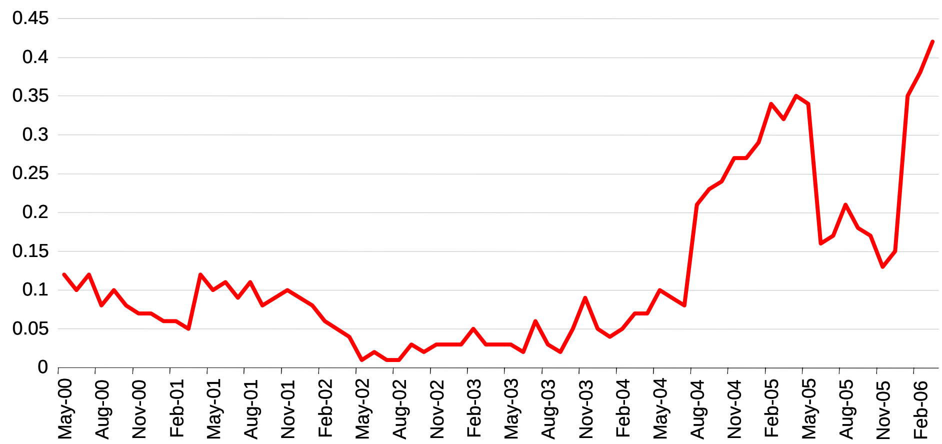


Source: Datastream

Spreads on 95% LTV lending widening

We notice that the spread between 95% and 75% Loan To Value (LTV) base rate tracker mortgages has widened to 40 basis points in the last few months. The Bank of England reports that the rate on a 95% LTV base rate tracker is 5.62% versus 5.20% for a 75% LTV mortgage. We believe this could be an early indication that banks are seeing an increased threat of default, and are attempting to price loans by taking into account the amount of cash they will receive if default does occur.

Spread between 95% and 75% base



Source: SG Equity Research, Bank of England

Interestingly, the spread between 95% versus 75% LTV two-year fixed mortgages has remained relatively constant, at around 25 basis points. This suggests that banks do view even a small rise in base rates as having implications for arrears, for those customers on a floating rate.

UK interest rates

According to our strategists, capital markets are now pricing in two rate rises before December this year. However, given that, over the last six months, more than 70% of UK gross mortgage lending has been fixed rate according to the Council of Mortgage Lenders, and the two-year fixed rate has risen by 50 basis points from the February 2006, the expectation of rising rates may in itself be enough to choke off demand. Clearly existing customers are less sensitive to rising interest rates is reduced by the recent popularity of fixed rate lending, however in the UK fixed rate tends to mean loans fixed for between two and five years, which will have to be refinanced at the prevailing market rates. From a demand perspective, UK rates are clearly important, especially given our concern about deteriorating affordability from non-mortgage costs.

Deposits

If the LTV metric is the key determinant of lending, the outlook does not look good either, given the low UK savings (currently 4.8%), so, we question how long borrowers will be able to fund purchases with large cash deposits. In 1995, under 10% of First Time Buyers (FTBs) aged under 30 needed funds over and above their plausible savings to fund a deposit. But, by 2005, this had risen to nearly 50%, according to the Council of Mortgage Lenders (CML). The CML noticed that, in 2002, 38% of mortgage equity withdrawals were used for unspecified purposes – which it suggests was a significant source of deposits for First Time Buyers. At the very least, we suggest the 'wealth effect' of rising house prices has given parents more confidence in gifting offspring money for a deposit. As an illustration of this, one bank has told us they could afford to lend more money, because the value of equity people have in their homes has increased.

Overseas property

We also notice the social trend of increased investment in property overseas. The Office of Deputy Prime Minister (ODPM) estimated this at £23bn in investment overseas in 2004. Not large in the context of the UK mortgage market, but potentially increasingly significant in the context of net lending.

Second homes abroad

	2000	2004	CAGR
Spain	47,650	69,284	
France	35,296	51,322	
Portugal	3,530	5,132	
Italy	1,765	2,566	
Other European	26,472	38,491	
All Europe	**114,713**	**166,795**	**9.8**
US	10,589	15,397	
Other non-Europe	51,180	74,417	
All non-Europe	**61,769**	**89,814**	**9.8**
Total	**176,482**	**256,609**	**9.8**

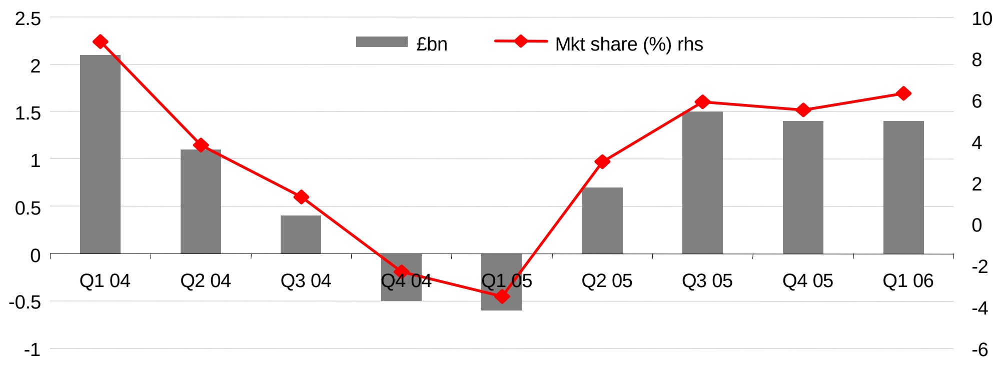
Source: ODPM

The data from the ODPM is only available up to 2004, and is rather suspect given that second homes abroad seem to have grown at the same rate across all countries. Nevertheless, anecdotal evidence suggests that the trend of UK homeowners buying property overseas is becoming increasingly common. This means that the UK housing market is not a closed system, and gains made from the sale of a UK property, which have traditionally been ploughed back into the UK market in the form of higher deposits, may increasingly be used to fund property overseas.

Two (too?) aggressive competitors

These trends are also occurring with the entrance of two new competitors. Abbey's net mortgage market share fell sharply in the second half of 2004, probably as a result of the integration with Santander, but since then has recovered. Given that the bank has launched a high profile advertising campaign, for base rate tracker mortgages, we would expect the bank to write higher market shares.

Abbey market share trends

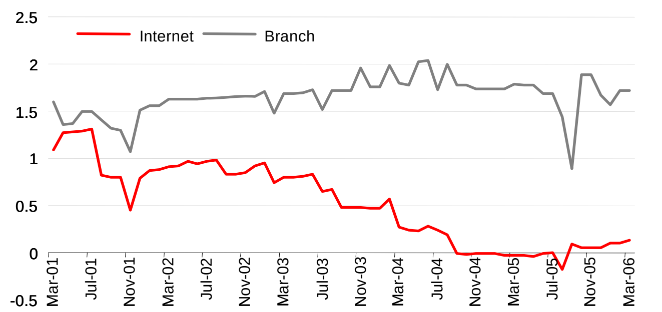


Source: SG Equity Research

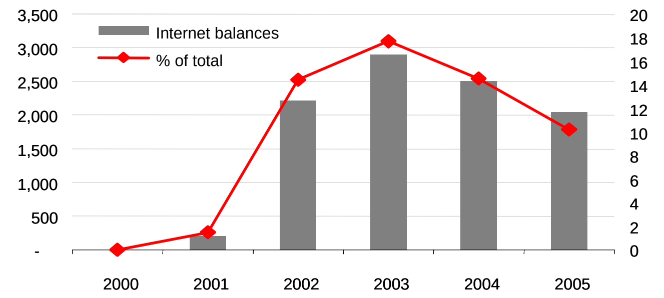
ING entered the UK internet deposit market in mid 2003 with a deposit rate above the level of base rates. The bank beat its internal targets and had a devastating effect on deposit spreads on UK internet balances. In the only bank that reports deposit balances by type, Northern Rock saw a dramatic net outflow.

The Dutch bancassurer has announced that it intends to enter the mortgage market. Our concern is that this may lead to another round of margin compression, at precisely the time that banks should be attempting to tighten lending criteria.

UK deposit spreads: internet and branches



Northern Rock internet deposits



Source: SG Equity Research

Recommendations

We are leaving our recommendations and earnings unchanged. For Alliance & Leicester and Bradford & Bingley, we forecast loan growth of 9% (consistent with that achieved in 2005). For Northern Rock, we see growth in average interest-earning assets falling from 27% (which is above the company's strategic target) to 22%. This rate of loan growth translates to -3% EPS growth for Alliance & Leicester (driven by unsecured lending provisions continuing to increase), +3% EPS growth for Bradford & Bingley, and 14% EPS growth for Northern Rock.

Clearly, there will be upward pressure on our estimates if the strong first quarter is extrapolated for the rest of the year. However, given our arguments about deteriorating affordability and the movement in the two-year fixed rate choking off demand, we feel comfortable sticking with our numbers and reiterating our Sell recommendations.

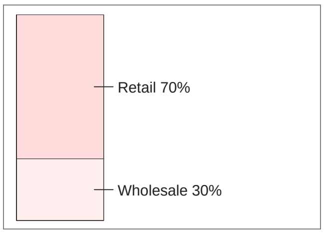
Valuation

	Rec.	Current price (12/05/06)	Fair value	Upside/ (Down)	P/E06	P/B06	DY06*	P/E07	P/B07	DY07*
Alliance & Leicester	Sell	1,147p	900p	(24.0%)	14.4x	2.6x	4.7%	13.8x	2.4x	4.9%
Bradford & Bingley	Sell	489p	400p	(21.7%)	13.6x	2.2x	4.1%	12.9x	2.0x	4.1%
Northern Rock	Sell	1,055p	950p	(13.9%)	12.3x	2.7x	3.1%	10.7x	2.3x	3.1%

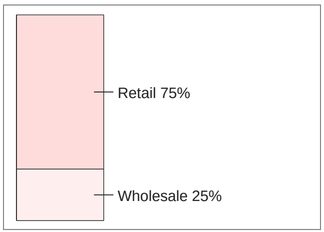
* dividend yield
Source: SG Equity Research

Though we and the market should be anticipating positive statements, given the strong industry data, we also believe that banks should voice caution on the outlook. This does not appear to be priced in given that, at present, the UK mortgage banks are trading at an 16% premium to European banks (versus a 40% discount in 2005) and a 23% premium versus UK universal banks (versus a 24% discount).

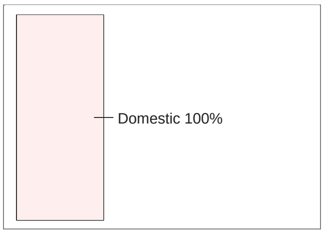
Allocated capital/division 05



PBT/division 05



Revenues/region 05



Normalised data

Normalised growth (%)	8.8
Cost/inc ratio (%)	55.0
FV 3 years (p)	1,131

Large premium versus sector

Exposed to deterioration in unsecured lending

Commercial Banks (United Kingdom)

Alliance & Leicester

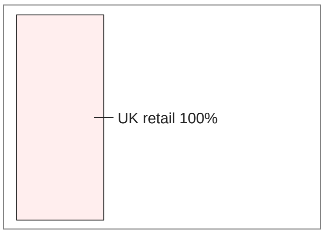
SELL | Price (12/05/06) 1,147p | Fair value 900p

Valuation*	12/02	12/03	12/04	12/05	12/06e	12/07e	12/08e
P/E (x)	10.0	10.0	10.9	10.8	14.4	13.8	13.3
Price/book value (x)	2.4	2.3	2.2	2.1	2.6	2.4	2.2
Price/tangible book value (x)	2.4	2.3	2.2	2.1	2.6	2.5	2.2
Net yield (%)	4.7	5.2	5.6	5.8	4.7	4.9	5.1
Per share data (p)							
EPS (adj.)	84.0	83.8	79.8	81.6	79.5	82.9	86.1
Goodwill amortisation	na	na	na	na	na	na	na
Tangible book value	355.8	366.6	388.4	419.3	437.7	465.3	512.6
Book value	355.8	366.6	390.3	423.4	441.9	469.4	516.7
Net dividend	39.9	43.9	48.3	51.5	53.6	55.7	57.9
Income statement (£m)							
Net interest income	757	738	736	751	776	809	848
Net fees & commissions							
Trading income (inc. forex)							
Other income	0	0	0	0	0	0	0
Total income	1,305	1,317	1,328	1,353	1,391	1,453	1,506
Total expenses	-752	-769	-770	-766	-770	-781	-793
Gross operating income	553	548	558	587	622	672	713
Net provisions	0	0	-46	-74	-98	-111	-127
Operating income after provisions	553	548	512	513	524	561	586
Goodwill amortisation							
Other	0	0	80	34	2	21	21
Pre-tax income (after GW)	553	548	592	547	526	582	607
Taxation	-133	-146	-159	-140	-139	-157	-164
Other							
Minority interests	-1	-1	-14	-18	-29	-38	-38
Reported net income	420	401	419	389	357	387	405
Net income excl. exceptionals & GW	420	401	365	366	356	372	391
Balance sheet (£m)							
Total assets	41,249	48,424	50,084	58,982	61,931	65,028	68,279
Net customer loans	27,301	29,802	33,741	40,094	42,098	44,203	46,414
Non-performing loans (NPLs)	5	5	6	6	6	6	6
Customer deposits			25,072	26,438	26,438	26,438	26,438
Intangible assets			8	19	19	19	19
Shareholders' equity	1,722	1,694	1,752	1,901	1,974	2,118	2,355
Tier I capital	1,704	1,675	2,068	2,196	2,569	2,713	2,950
Risk weighted assets (RWAs)	20,034	22,629	24,430	29,062	32,840	35,467	37,950
Accounting ratios							
Profitability							
ROE (adj.) (%)	24.1	23.5	21.2	20.0	18.4	18.2	17.5
Return on RWAs (%)	2.13	1.89	1.61	1.43	1.24	1.20	1.17
Ratios							
Net interest margin (%)	na	na	na	na	na	na	na
Cost income ratio (%)	57.6	58.4	58.0	56.6	55.3	53.7	52.6
Provision charge GOI (%)	0.0	0.0	8.2	12.6	15.8	16.5	17.8
Provision charge RWAs (bp)	0	0	20	28	32	33	35
Tax rate (%)	28.1	27.7	26.8	25.6	26.5	27.0	27.0
Growth rate							
Net interest income yoy growth (%)	-1.4	-2.6	-0.3	2.0	3.4	4.2	4.9
Non-interest income yoy growth (%)	10.6	5.7	2.3	1.7	2.2	4.8	2.0
Total income yoy growth (%)	3.3	0.9	0.9	1.9	2.8	4.5	3.6
Total expenses yoy growth (%)	2.7	2.3	0.1	-0.5	0.5	1.5	1.5
Gross operating income yoy growth (%)	4.1	-1.0	1.9	5.2	5.9	8.1	6.1
Operating income after prov. yoy growth (%)	18.1	-1.0	-6.5	0.2	2.1	7.2	4.4
Pre-tax income (after GW) yoy growth (%)	39.9	-1.0	8.1	-7.6	-3.9	10.8	4.3
Reported net income yoy growth (%)	46.5	-4.4	4.5	-7.2	-8.2	8.3	4.7
EPS (adj.) yoy growth (%)	25.2	-0.3	-4.8	2.3	-2.6	4.3	3.8
Solvency, asset quality and others							
NPLs/loans (%)	na	na	na	na	na	na	na
Provisions outstanding/NPLs (%)	na	na	0.0	0.0	0.0	0.0	0.0
Tier I capital ratio (%)	8.5	7.4	8.5	7.6	7.8	7.6	7.8
Core Tier I ratio (%)	8.6	7.5	6.7	6.5	6.0	6.0	6.2
Total solvency ratio (%)	na	na	na	na	na	na	na
Payout ratio (%)	46.3	51.4	48.8	59.4	65.5	62.9	41.6

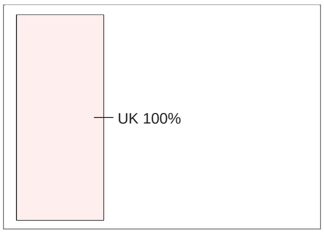
* Valuation ratios for past years are based on average historical prices and market capitalisations

Allocated capital/division 05

PBT/division 05



Revenues/region 05



Normalised data

Normalised growth (%)	5.0
Cost/inc ratio (%)	45.0
FV 3 years (p)	474

Premium to the sector

Unexciting growth prospects

Thrifts & Mortgage Finance (United Kingdom)

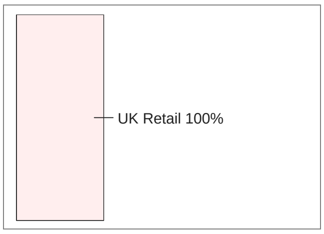
Bradford & Bingley

SELL | Price (12/05/06): 489p | Fair value: 400p

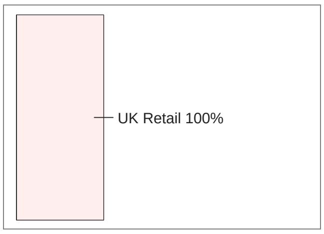
Valuation*	12/02	12/03	12/04	12/05	12/06e	12/07e	12/08e
P/E (x)	9.9	9.9	9.2	9.7	13.6	12.9	10.4
Price/book value (x)	1.6	1.5	1.5	1.6	2.2	2.0	1.9
Price/tangible book value (x)	1.8	1.7	1.5	1.7	2.2	2.1	2.0
Net yield (%)	4.7	5.4	5.9	5.5	3.9	4.1	4.3
Per share data (p)							
EPS (adj.)	31.7	31.1	31.8	34.4	35.9	37.8	47.2
Goodwill amortisation	2.4	2.3	0.0	0.0	0.0	0.0	0.0
Tangible book value	176.2	184.9	190.2	200.5	218.8	238.0	249.6
Book value	193.1	199.9	194.8	208.0	226.3	245.5	263.7
Net dividend	14.8	16.5	17.1	18.3	19.2	20.2	21.2
Income statement (£m)							
Net interest income	441	436	446	469	488	510	529
Net fees & commissions							
Trading income (inc. forex)							
Other income	287	132	116	103	109	115	118
Total income	728	567	562	572	596	625	647
Total expenses	-431	-280	-285	-265	-271	-278	-285
Gross operating income	298	287	277	308	325	346	362
Net provisions	-6	-7	1	-6	-9	-13	-19
Operating income after provisions	291	280	278	302	317	333	343
Goodwill amortisation	-16	-15	0	0	0	0	0
Other	-35	8	-170	-38	10	10	0
Pre-tax income (after GW)	241	274	108	264	327	343	343
Taxation	-63	-53	-69	-75	-95	-100	-47
Other							
Minority interests	-6	-10	0	0	0	0	0
Reported net income	172	212	39	189	232	244	296
Net income excl. exceptionals & GW	210	198	198	216	225	237	296
Balance sheet (£m)							
Total assets	0	0	0	0	0	0	0
Net customer loans	19,326	0	28,968	29,982	31,481	32,425	32,603
Non-performing loans (NPLs)	203	139	139	139	139	139	139
Customer deposits							
Intangible assets	110	95	29	48	48	48	48
Shareholders' equity	1,262	1,268	1,235	1,320	1,435	1,557	1,631
Tier I capital	1,267	1,252	1,413	1,499	1,615	1,737	1,811
Risk weighted assets (RWAs)	13,228	16,928	18,800	19,100	21,010	22,586	23,150
Accounting ratios							
Profitability							
ROE (adj.) (%)	16.6	15.6	15.8	16.9	16.3	15.8	18.5
Return on RWAs (%)	1.63	1.38	1.11	1.14	1.12	1.09	1.29
Ratios							
Net interest margin (%)	na	na	na	na	na	na	na
Cost income ratio (%)	59.1	49.4	50.7	46.3	45.5	44.6	44.1
Provision charge GOI (%)	2.1	2.3	-0.4	1.9	2.6	3.7	5.3
Provision charge RWAs (bp)	5	4	nm	3	4	6	8
Tax rate (%)	26.3	19.2	64.1	28.3	29.0	29.0	29.0
Growth rate							
Net interest income yoy growth (%)	-0.3	-1.3	2.5	5.2	3.9	4.6	3.7
Non-interest income yoy growth (%)	6.0	-54.1	-12.1	-10.9	5.4	5.4	3.2
Total income yoy growth (%)	2.1	-22.1	-0.9	1.9	4.1	4.8	3.6
Total expenses yoy growth (%)	-0.8	-34.9	1.7	-7.1	2.3	2.7	2.5
Gross operating income yoy growth (%)	6.6	-3.5	-3.4	11.0	5.7	6.5	4.6
Operating income after prov. yoy growth (%)	6.7	-3.7	-0.8	8.6	4.9	5.3	2.8
Pre-tax income (after GW) yoy growth (%)	2.7	13.8	-60.4	nm	24.0	5.1	-0.2
Reported net income yoy growth (%)	5.3	23.2	-81.6	nm	22.8	5.1	4.9
EPS (adj.) yoy growth (%)	10.8	-1.9	2.4	8.2	4.3	5.3	4.9
Solvency, asset quality and others							
NPLs/loans (%)	na	na	na	na	na	na	na
Provisions outstanding/NPLs (%)	na	na	na	na	na	na	na
Tier I capital ratio (%)	9.6	7.4	7.5	7.8	7.7	7.7	7.8
Core Tier I ratio (%)	8.4	6.7	6.2	7.0	6.9	6.9	7.1
Total solvency ratio (%)	na	na	na	na	na	na	na
Payout ratio (%)	56.2	48.2	275.0	58.5	50.9	50.8	44.0

Valuation ratios for past years are based on average historical prices and market capitalisations

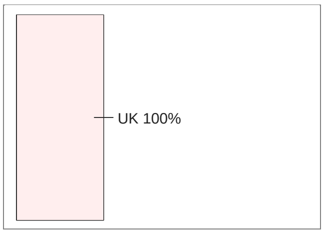
Allocated capital/division 05



PBT/division 05



Revenues/region 05



Normalised data

Normalised growth (%)	11.1
Cost/inc ratio (%)	32.5
FV 3 years (p)	1,418

Yield unlikely to provide support

Low cost model

Thrifts & Mortgage Finance (United Kingdom) — Price (12/05/06) — Fair value

Northern Rock — SELL — 1,055p — 950p

Valuation*	12/02	12/03	12/04	12/05	12/06e	12/07e	12/08e
P/E (x)	12.0	10.3	9.7	10.9	12.3	10.7	9.6
Price/book value (x)	2.4	2.1	2.2	2.2	2.7	2.3	2.0
Price/tangible book value (x)	2.4	2.1	2.2	2.2	2.5	2.2	1.9
Net yield (%)	3.0	3.4	3.3	3.4	2.9	3.1	3.5
Per share data (p)							
EPS (adj.)	56.5	67.2	76.0	74.2	85.5	98.5	109.8
Goodwill amortisation	0.4	0.9	0.0	0.0	0.0	0.0	0.0
Tangible book value	287.2	329.7	329.7	374.0	427.2	490.3	561.2
Book value	287.2	329.7	329.7	374.0	392.6	449.7	516.8
Net dividend	20.2	23.3	24.3	27.4	30.1	33.1	36.4
Income statement (£m)							
Net interest income	391	451	613	707	818	945	1,056
Net fees & commissions							
Trading income (inc. forex)							
Other income	0	0	0	0	0	0	0
Total income	561	652	724	836	967	1,116	1,244
Total expenses	-185	-213	-239	-275	-309	-349	-383
Gross operating income	376	439	486	561	657	767	862
Net provisions	-46	-50	-44	-57	-78	-103	-131
Operating income after provisions	330	389	442	505	579	664	730
Goodwill amortisation	-2	-4	0	0	0	0	0
Other	-2	1	0	-10	0	0	0
Pre-tax income (after GW)	326	387	442	494	579	664	730
Taxation	-96	-112	-128	-145	-171	-196	-215
Other							
Minority interests	0	0	-43	-49	-53	-59	-59
Reported net income	230	275	271	301	355	409	456
Net income excl. exceptionals & GW	233	277	314	308	355	409	456
Balance sheet (£m)							
Total assets	32,665	37,160	64,881	82,708	99,250	114,138	125,552
Net customer loans	24,951	28,202	54,769	70,240	88,073	103,582	118,393
Non-performing loans (NPLs)	190	187	203	239	275	275	275
Customer deposits							
Intangible assets							
Shareholders' equity	1,210	1,389	1,389	1,576	1,800	2,065	2,364
Tier I capital	1,618	1,833	1,833	2,033	2,257	2,522	2,821
Risk weighted assets (RWAs)	17,384	19,699	23,099	26,296	30,820	36,310	41,421
Accounting ratios							
Profitability							
ROE (adj.) (%)	20.5	21.3	22.6	20.8	21.0	21.2	20.6
Return on RWAs (%)	1.34	1.50	1.47	1.25	1.24	1.22	1.17
Ratios							
Net interest margin (%)	na	na	na	na	na	na	na
Cost income ratio (%)	33.0	32.7	33.0	32.9	32.0	31.3	30.8
Provision charge GOI (%)	12.2	11.4	9.1	10.1	11.9	13.4	15.3
Provision charge RWAs (bp)	26	27	21	23	27	31	34
Tax rate (%)	29.6	29.0	28.9	29.3	29.5	29.5	29.5
Growth rate							
Net interest income yoy growth (%)	14.1	15.2	35.9	15.4	15.8	15.5	11.8
Non-interest income yoy growth (%)	27.1	18.8	-44.6	15.4	15.0	15.0	10.0
Total income yoy growth (%)	17.8	16.3	11.1	15.4	15.7	15.4	11.5
Total expenses yoy growth (%)	13.1	15.1	12.0	14.9	12.7	12.8	9.7
Gross operating income yoy growth (%)	20.2	16.9	10.6	15.6	17.1	16.7	12.4
Operating income after prov. yoy growth (%)	19.3	17.9	13.5	14.3	14.8	14.6	10.0
Pre-tax income (after GW) yoy growth (%)	18.0	18.6	14.1	11.9	17.2	14.6	10.0
Reported net income yoy growth (%)	19.1	19.5	-1.2	10.9	18.1	15.3	11.4
EPS (adj.) yoy growth (%)	22.0	19.0	13.0	13.1	15.3	15.3	11.4
Solvency, asset quality and others							
NPLs/loans (%)	na	na	na	na	na	na	na
Provisions outstanding/NPLs (%)	na	na	na	na	na	na	na
Tier I capital ratio (%)	9.3	9.3	7.9	7.7	7.3	6.9	6.8
Core Tier I ratio (%)	7.0	6.6	5.1	5.1	5.1	5.0	5.1
Total solvency ratio (%)	na	na	na	na	na	na	na
Payout ratio (%)	36.3	35.1	37.1	38.0	36.8	35.1	34.5

* Valuation ratios for past years are based on average historical prices and market capitalisations

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	Ronald Wasylec	(33) 1 58 98 02 72
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