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BARCLAYS Vs LLOYDS

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Barclays and Lloyds are the key banks in the UK sector and despite some similarities there's also glaring differences. I often get asked by clients which is the better of the two. One is the "boring" but steady and the other is "exciting" but can also be unstable. In this report I have looked at the pair and what has been said recently. Both have caused investors huge frustrations over recent years but both for very different reasons.

There's an old saying in the stock market, when the tide goes out you get to see who's swimming without the shorts on! And with the last 6 months hitting the UK and global economies hard this year's half year figures will reveal more than usual.

Barclays Plc (BARC)

Identity Crisis

There's no doubting that Barclays has some great businesses when you scratch the surface.

It is of course one of the UK's big four banks with over 23 million customers, a leading wealth manager and has a leading investment bank, but it is fair to say that Barclays is not the global bank it once was. With the exception of the US, it has largely retreated from foreign markets. Only a few years ago it had major operations in Europe and Africa in particular, but these have been sold off. What we have left is a UK-US focused bank. Expansion is no longer the name of the game. Today it's all about profits and dividends.

Prized Asset

One thing that sets Barclays apart from the UK's other big four banks is its large and sometimes successful investment bank, and it is this arm of the business that has helped the company over the last 6 months. Investment banking is seen as the riskier but more lucrative cousin of retail banking. Instead of mortgages and current accounts, it involves things like advice on takeovers, raising debt and equity for large corporations and trading of bonds and shares.

Barclays is the only British bank to make serious headway in investment banking, boosted by its opportunistic buy of Lehman Brothers core business during the financial crisis. This gave Barclays a leg up to compete with Wall Street's titans such as Goldman Sachs and Morgan StanleyThis was similar to 2015, when it earned £0.03mn from a scientific fee for service work for AstraZeneca, which is also a FTSE 100 stock. This followed from an exclusive license agreement it had entered into earlier with the pharmaceutical company for £4.3mn.

Barclays Recent Market Update

Key Takeaways

· H1 Profit Before Tax £1.3Bn

· H1 Credit Impairment and Provision Charges Of £3.7Bn

· H1 Cet1 Ratio 14.2%

· Q2 Credit Impairment and Provision Charges Of £1.6Bn

· H1 Group Income Up 8% To £11.6Bn

· H1 Costs Fall 4%

· Q2 Corporate and Investment Bank Rote 9.6%

· Q2 Markets Income Up 49% To £2.1Bn

· Q2 Ficc Income Up 60% To £1.4Bn

· No Dividend Payment In H1

· Q2 Cib Income Up 19% To £3.3Bn

· H1 Cards and Payments Income Down 21% To £1.7Bn

· H1 Group Rote Of 2.9%

· H2 is Expected to Continue to Be Challenging

· Income in Barclays UK And Cc&p Is Expected to Gradually Recover from Q2 Levels

· H2 Impairment Is Expected to Remain Above Level Experienced in Recent Years

· As At 30 June 2020, Group Held A Provision Of £774m Relating To PPI.

· H2 may Be Headwinds to Cet1 Ratio from Procyclical Effects on Rwas

· Board Will Decide on Future Dividends and Its Capital Returns Policy at Fy20

· Operating Expenses Decreased 5% To £4,405m

· Loans and Advances Increased £5.3bn to £138.1bn Due to Increased Lending Within Cib, Partially Offset by Lower Card Balances in Cc&p

· TNAV per share increased to 284p (December 2019: 262p) reflecting 4.0p of statutory EPS and positive reserve movements, including retirement benefit re-measurements and currency translation reserves

There's a few obvious reasons for the drop in Barclays share price despite what some might interpret as positive, anything from the fear of a second wave to the continued restrictions on dividend payments to them also setting aside a higher than expected amount to cover the potential for a rise in loan losses.

Barclays have set aside a higher than expected £1.6bn to cover a possible rise in loan losses in the second quarter of the year, there was expectations to report credit impairment charges and loan loss provisions totalling £1.42bn for the April-June period, according to an average of analyst forecasts compiled by the bank. That increase takes total provisions to £3.7bn for the half-year and analysts predict that sum to rise to 5.79bn for the full year.

Despite the general reaction to the figures and the sharp drop in the share price there was a few positives to cling onto, firstly the bank has confirmed it is in a strong enough position to handle the impact of loan defaults caused by the pandemic, Capital buffers are strong with provisions in place far superior to what was seen in 2008.

Jes Staley, Barclays chief executive, told his investors “the board will decide on future dividends and capital returns at the year-end 2020”.

Despite the weight on the consumer banking side due to the obvious concerns and lower demand for credit cards and personal loans, its investment bank came to the rescue for the group. The fixed income, currencies and commodities division was the top performer in the corporate and investment banking unit with a 60% increase in income to £1.4bn during the second quarter. The markets division posted a 49% rise in income to £2.1bn. The strong investment bank performance supports Chief Executive Jes Staley’s strategy of maintaining the bank’s diversified business model, contrary to the wishes of activist investor and top shareholder Edward Bramson, who wants Barclays to shrink the business to slash costs.

The British lender booked pre-tax profit for the first half of the year of £1.3bn, down from £3bn a year ago as provisions against potential bad debts outweighed improved revenues from its investment bank. Barclays’ capital ratio came in at 14.2%, up from 13.1% at the end of March as recent regulatory changes boosted its reserves for the lender which has in recent years skated close to the lower threshold acceptable to authorities.

Barclays Outlook

· Given the uncertain economic outlook and low interest rate environment, the second half of the year is expected to continue to be challenging.

– Income in Barclays UK and CC&P is expected to gradually recover from Q220 levels, but certain headwinds including from the low interest rate environment, are likely to persist into 2021.

– The CIB performance in the first half benefitted from increased issuance activity and trading volumes, with the franchise well positioned for the future.

– Impairment in H220 is expected to remain above the level experienced in recent years, but to be below the H120 credit impairment charge assuming no change in macroeconomic forecasts.

· Continued focus on cost discipline, but short-term headwinds remain from spend on COVID-19 initiatives.

· In H220 there may be headwinds to the Group’s CET1 ratio from procyclical effects on RWAs, and reduced benefit from transitional relief on IFRS 9 impairment. However, the Group’s CET1 ratio will continue to be managed to maintain an appropriate headroom above the MDA hurdle.

· The Group continues to target a RoTE1 of >10% and cost: income ratio of <60% over time, but targets remain subject to change depending on the evolution of the COVID-19 pandemic.

Lloyds Bank (LLOY)

Lloyds has been back to doing what it does best – current accounts, mortgages, personal and business loans, life insurance...sound dull? Thank goodness. Fund managers in the City used to mockingly call Lloyds “the world’s most boring bank”, who knew that would become a compliment. It’s taken many years for Lloyds to recover from the financial crisis, not only financially but also on a reputational level. As we know, Lloyds made a near fatal error when it bought HBOS in the thick of the fog back in 2008. In the four years that followed, the HBOS side of the business would incur a mammoth £45bn of loan impairments in addition to £10bn from the Lloyds side.

Lloyds Recent Market Updates

Key Takeaways

· Net income of £7.4bn, down 16%.

· Lower net interest margin of 2.59% reflecting lower rates,

· Total costs of £3.9bn, 4% lower, with business as usual costs down 6%,

· Trading surplus of £3.5bn, a reduction of 26% compared to the first six months of 2019, providing still significant capacity to absorb impairment impacts of the coronavirus crisis

· Impairment charge of £3.8bn, including £2.4bn in the second quarter

· Statutory loss before tax of £602mn and statutory profit after tax of £19mn,

· Balance sheet remains strong and well positioned to absorb coronavirus impacts

· Loans and advances at £440bn were stable compared to the year-end but reduced by £3bn in the second quarter

· Customer deposits increased by £29bn in the half and £13bn in the second quarter

· Loan to deposit ratio now 100%, providing significant potential to lend into recovery, with a strong liquidity position

· CET1 ratio of 14.6 per cent and 13.4 per cent pre IFRS 9 transitional relief, along with lower Pillar 2A requirement

· H1 half Pre-tax Loss Of £602mn

· Q2 Impairments Charge Of £2.4bn, Overall H1 Impairments Of £3.8bn

· H1 Post-tax Profit Of £19mn

· CET1 OF 14.6%

· H1 Net Income Of £7.4bn

· H1 Total Costs Of £3.9bn

· Net Interest Margin Of 2.59%

· Cost to Income Ratio Of 52.3%

· Tangible net assets per share increased by 0.8 pence to 51.6 pence at 30 June 2020 from 50.8 pence at 31 December 2019. This was largely due to an increase in the net pension asset driven by wider credit spreads in the first quarter and an increase in the Group's cash flow hedge reserve

Lloyds went into the red after recording a £3.8bn provision for bad loans arising from the coronavirus crisis - almost £1.8bn higher than financial analysts had expected. The results revealed a pre-tax loss of £602mn compared to profits of £2.9bn for the same period in 2019, on net income of £7.4bn, also 16% lower. Lloyds said it had set aside £2.4bn for possible loan losses in the three months to June alone as the UK economy became mired in the coronavirus lockdown.

The bank also pointed to a strong balance sheet, well positioned to absorb coronavirus impacts. This was in part due to a £29bn increase in customer deposits during the period as a result of reduced consumer spending and "inflows to the Group's trusted brands in an uncertain environment."

The group loan to deposit ratio now sits at 100%, "providing significant potential to lend into recovery, with a strong liquidity position." Lloyds said a CET1 ratio of 14.6 percent "provides significant headroom above lower regulatory requirements of c.11 per cent as a cushion against potential credit impairment."

There have been early signs of recovery in the Group's core markets, mainly in consumer spending and the housing market, but the outlook remains highly uncertain and the impact of lower rates and economic fragility will continue for at least the rest of the year. Looking forward, group operating costs are expected to be below £7.6bn, with impairments expected to be between £4.5bn and £5.5 bn.

Lloyds Outlook

· There have been early signs of recovery in the Group's core markets, mainly in consumer spending and the housing market, but the outlook remains highly uncertain and the impact of lower rates and economic fragility will continue for at least the rest of the year.

· The Group's updated 2020 guidance reflects a proactive response to the challenging economic environment and is based on the Group's recently revised current economic assumptions, which have deteriorated since the first quarter.

– Net interest margin expected to remain broadly stable on the second quarter level at c.240 basis points for the rest of the year resulting in a full year margin of c.250 basis points

– Operating costs to be below £7.6bn

– Impairment expected to be between £4.5bn and £5.5bn

– Risk-weighted assets expected to be flat to modestly up compared to the first half of 2020

· Although the economic outlook remains uncertain, the Group's financial strength and business model will ensure that it can continue to support its customers and help Britain recover. This is fully aligned with the Group's long-term strategic objectives, the position of the franchise and the interests of our shareholders

How They Compare

Barclays and Lloyds' UK retail banking divisions are direct competitors, selling mortgages, loans and credit cards. Barclays also has an investment arm which the CEO has been keen to develop despite opposition from some investors. Lloyds, however, is 100% focused on the real UK economy. Its business is built around mortgage lending, car finance, consumer lending and business banking.

Lloyds drop in income contrasted with Barclays who reported an increase in revenue, largely driven by higher investment banking income.

Barclays still trade at a deeper discount to NAV than Lloyds, highlighting that despite Lloyds share price being lower than Barclays, Barclays share price is more of a bargain....for now.

Lloyds Bank has a greater focus on retail and business banking such as mortgages, credit cards and loans which saw reduced activity during the coronavirus lockdown. However, the introduction of government schemes such as the Bounce Back Loan helped Lloyds maintain a relatively steady loan book as mortgage activity fell sharply.

Despite the sharp impact to share price's the latest figures from each bank suggest to me that they will be able to survive the Covid-19 pandemic without too many problems.

Dividends at both banks have been suspended by order of the regulator and despite the fundamental differences relating to performance the similarities in the share price movements are striking.

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