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ATLANTIC CAPITAL MARKETS

UK BANKING REPORT

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The financial crisis seems all, but a distant memory and banking stocks have come to be seen as dull and a long way away from their pre-crisis personas. But with global issues mounting again, whether its Brexit or trade wars, there is something seemingly always around the corner for the UK banking stocks. But this won't be the backdrop forever, just the foreseeable future. For the income investor out there, well at least some have started paying dividends and if you can see beyond the Brexit noise (and god only knows we all want to) then long-term prospects look good....... or do they?

Barclays Plc (BARC)

Net Asset Value (exc intangibles) 318.58p
Discount to NAV (as of 25th Sept@145p) = 54.49%

Barclays really needs very little in the way of an introduction, they are a British multinational investment bank and financial services company, headquartered in London. Apart from investment banking, Barclays is organised into four core businesses: personal banking, corporate banking, wealth management, and investment management. Barclays was originally a goldsmith banking business established in the City of London in 1690. James Barclay became a partner in the business in 1736. In 1896, several banks in London and the English provinces, including Backhouse's Bank and Gurney's Bank, united as a joint-stock bank under the name Barclays and Co. Over the following decades, Barclays expanded to become a nationwide bank. In 1967, Barclays deployed the world's first cash dispenser.

One thing that sets Barclays apart from the UK's other big four banks is its large and sometimes successful investment bank.

Investment banking

Investment banking is generally 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 Stanley.

Becoming a major player has not come easy or cheap, so it's understandable why Barclays is reluctant to part with one of its best assets, even if it is unfashionable. While investment banking adds extra volatility to earnings it can also generate mega-money in good times – on a scale that retail banking can never do and those worried about another financial crisis should note that Barclays has been the first of the major British banks to successfully ring-fence its UK retail operations.

The Revolving Door

Shareholders like stable leadership and a clear strategy, which is fair enough. But in the last decade, Barclays has provided neither.

Since 2011, Barclays has had four different CEOs. While there are no guarantees the present CEO will be around for the long-term, the hope is that the Board of Directors understands that the share price has been hampered by the lack of continuity, so will endeavour to create more stable leadership. Even if it has yet to be rewarded, the new strategy for Barclays seems a lot less complicated. A focus on transatlantic operations will be much easier to understand and manage.

We've noted that Barclays is now taking a leaf out of Lloyd's book and continuously using the words simple and straightforward. I don't think Barclays will ever be a simple as Lloyds, but nor should it try to be. It's got a better spread of assets and products. You can't be simple and diversified at the same time.

Summary

Barclays has a lot of catching up to do. Its costs are way too high, and its capital could do with a boost. Both points are being addressed. The recent dividend increases are now appealing to the income investor, but this has weighed on the company's overall dividend cover. The biggest attraction of Barclays is its deep discount to net assets. The dividend cover does also offer investors the comfort. There's a lot of potential upside that could be unlocked if the management team can run the business in a cohesive and consistent manner. For investors prepared to take a longer view, Barclays is a bargain.

Technical Data

Key Fundamentals	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18
Revenue (£ m)	32278	31803	27747	27056	28768
Pre-Tax (£ m)	2220	2026	3160	3471	3425
EPS	-0.70p	-1.90p	10.40p	-10.30p	9.40p
PE	n/a	n/a	24.03	58.11	16.01
PEG	n/a	n/a	n/a	n/a	n/a
EPS Growth	n/a	n/a	n/a	n/a	n/a
Dividend Cover	-0.11	-0.29	3.1	1.17	1.45
Dividend Yield	2.67%	2.97%	1.34%	1.47%	4.32%

Broker Ratings

Date	Broker name	Rating	New view	New target	Previous target
10-Sep-19	Jefferies	Reiteration	Buy	209.00p	280.00p
10-Sep-19	Barclays	Reiteration	Overweight	226.00p	215.00p
06-Sep-19	Deutsche	Reiteration	Buy	175.00p	212.00p
29-Aug-19	RBC Capital	Reiteration	Sector perform	180.00p	-
05-Aug-19	UBS	Reiteration	Buy	200.00p	200.00p
22-Jul-19	Jefferies	Reiteration	Buy	280.00p	280.00p

Lloyds Banking Group (LLOY)

Net Asset Value (exc intangibles) 55.51p
Discount to NAV (as of 25th Sept@52.93p) = 4.65%

Lloyds was initially founded in 1695 by the Parliament of Scotland of the Bank of Scotland, which is the second oldest bank in the United Kingdom. The Group's headquarters is located at 25 Gresham Street in the City of London. Lloyds Banking Group's activities are organised into: Retail Banking (including Mortgages and Sole Traders); Commercial; Life, Pensions & Insurance; and Wealth & International. Lloyds' has extensive overseas operations in the US, Europe, the Middle East and Asia. Following the takeover, the Group stopped using the name HBOS publicly. The Halifax brand, products and pricing were discontinued in Scotland until it was re-established in 2013. The Halifax and Lloyds Bank brands are used in England and Wales and the Bank of Scotland and Halifax brand is used in Scotland, each offering different products and pricing.

Back to boring

Lloyds have received a lot of praise recent years, mainly due to a return to boring comfortable banking. Lloyds is back to doing what it does best – current accounts, mortgages, personal and business loans, life insurance...sound dull? Thank goodness.

First half 2019 figures

The group reported weaker-than-expected figures at the end of July, as a further £550m was set aside to meet claims for mis-sold insurance to consumers. This number was above the market expectations and whilst not the main catalyst for the drop lower, certainly a contributing factor. That all being said, surely with the PPI claim window now closing it would be good to think that "the peoples cash machine" will soon be closing.

Lloyds announced pre-tax profits of £2.9bn for the first half of the year. This number came in below analyst's forecasts of £3.45bn. The figure was down from £3.12bn for the same period the previous year. Lloyds have said exceptional one-off charges, including PPI, would knock its capital build for 2019 to the lower end of its range, but without the one-off costs they matched analyst forecasts for underlying profits, at £4.2bn.

Competition in the UK's mortgage market has also weighed on Lloyds' net interest margin to 2.9% from 2.91% the previous quarter and 2.93% a year ago. Despite the deterioration, both the impairments and net interest margin figures were in line with analyst expectations.

The bank's core capital ratio, a key measure of financial strength was 14.6%, down from the previous quarter, but above analysts' consensus estimate of 14.2%.

The bank said it would increase its interim dividend by 5% to 1.12 pence per share.

Lloyds also has a £15bn motor finance business and with weakness in the used car prices this has also led to a 27% jump in impairments to £579m over the six months to the end of June 2019.

Brexit Concerns

Lloyds has been the only one of Britain's four biggest lenders not to have taken a provision against a potential Brexit-related increase in bad loans, and its recent commentaries do conflict with other banks.

Chief Executive Antonio Horta-Osorio said Lloyds had seen business confidence deteriorate, but little impact on consumers as the chances of a more disorderly exit from the European Union increase and economic surveys paint an increasingly gloomy picture.

Pressure in key market

They are facing headwinds in their key mortgage market and in a recent report from BofA Merrill Lynch there is an expectation that Lloyds will see £2bn revenue headwind from competition in the mortgage market. Their key competitor in this arena, Nationwide has a 14.5% share of the market and is stronger than Lloyds's at 13.1%.

Lloyds are currently trying to manage the trade-off between growing its mortgage volumes and sustaining its net interest margin in the face of increased competition and a lack of UK interest rate rises.

New dividend policy

Lloyds also recently announced they are to start paying quarterly dividends! With everything else the bank has said recently they are keen to remain in a good light with investors. It will begin paying quarterly dividends to investors from 2020.

Lloyds support this move in a recent statement, saying “it will provide a more regular flow of dividend income to all shareholders whilst accelerating the receipt of payments.” But this all seems like a bit smoke and mirrors to me. Does it really make a difference if dividends are received quarterly or bi-annually? I think one of the key drivers is to keep investors happy and divert the focus away from the Chief exec pay. Despite everything that has gone on, Lloyds are convinced the recent move on dividend distribution will help attract the income buyers. The shares have always been popular with income buyers and in reflection of all the work the business has done key shareholders have continued to back the generous dividend policy, for 2019 and 2020 the yield does remain respectable, but hardly dazzling.

Key Fundamentals	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18
Revenue (£ m)	39845	30889	48313	40713	26430
Pre-Tax (£ m)	1762	979	3888	5275	5960
EPS	1.70p	0.80p	2.40p	4.40p	5.50p
PE	44.6	91.34	26.05	15.36	9.43
PEG	n/a	-1.73	0.13	0.18	0.38
EPS Growth	n/a	-52.94%	199.18%	83.84%	25.00%
Dividend Cover	2.27	0.29	0.79	1.44	1.71
Dividend Yield	0.99%	3.76%	4.88%	4.51%	6.19%

Broker Ratings

Date	Broker name	Rating	New view	New target	Previous target
13-Sep-19	Shore Capital	Reiteration	Buy	-	-
10-Sep-19	Deutsche	Reiteration	Hold	53.00p	55.00p
06-Sep-19	Deutsche	Downgrade	Hold	55.00p	74.00p
29-Aug-19	RBC Capital	Reiteration	Outperform	70.00p	-
15-Aug-19	HSBC	Reiteration	Hold	52.00p	58.00p
31-Jul-19	Berenberg	Reiteration	Hold	55.00p	60.00p
31-Jul-19	Jefferies	Reiteration	Buy	99.00p	99.00p
16-Jul-19	JP Morgan	Downgrade	Neutral	70.00p	80.00p

Summary

The share price will always gather attentions especially after a pullback. At the moment the biggest and most obvious weight on the share price is the prospect of a No-deal Brexit rearing up again with Boris’ approach to the negotiations. The market never likes uncertainty and in the current political climate uncertainty is rife, especially for domestic UK stocks. Once clarity has been gained and the reality of a No-deal firmly put to bed, this will be the trigger for Lloyds share price to start running. That is a big when, and a big if, and until such a time I see the share price remaining rangebound.

Royal Bank of Scotland (RBS)

Net Asset Value (exc intangibles) 324.68p
Discount to NAV (as of 25th Sept@202.3p) = 37.7%

The Royal Bank of Scotland commonly abbreviated as RBS was established in 1724 and is one of the retail banking subsidiaries of The Royal Bank of Scotland Group plc, together with NatWest and Ulster Bank. The Royal Bank of Scotland has around 700 branches, mainly in Scotland, though there are branches in many larger towns and cities throughout England and Wales. Both the bank and its parent, The Royal Bank of Scotland Group, are completely separate from the fellow Edinburgh-based bank, the Bank of Scotland, which pre-dates The Royal Bank of Scotland by 32 years.

Following ring-fencing of the Group's core domestic business, the bank is expected to become a direct subsidiary of NatWest Holdings. NatWest Markets comprises the Group's investment banking arm. To give it legal form, the former RBS entity was renamed NatWest Markets in 2018. Economic conditions before Brexit are still a drain on profitability and cost targets despite a robust announcement on the first half years trading. including a £1.7bn dividend. RBS are certainly on a surer financial footing, but the business still has a lot to do to navigate the Brexit backdrop.

Recent Figures

RBS said its overall lending business remained healthy, but it reported an increase in bad loans of £182m for the first half compared with the previous year. They have also seen default rates increase among personal banking customers, a decline in property valuations in the retail sector and large companies delaying financing due to Brexit uncertainty.

Being the most embattled UK bank and the one that is still largely held by the UK Government. The state currently owns just over 62%, valuing its holding at about £18.4bn and plan to exit its shareholding by 2024. A consensus of City analysts is forecasting the bank will see bottom line profits nearly double when it reports and there is a general view that the government will look to sell off more of its stake after the figures. There are also suggestions it could offer them at a discount to counteract any Brexit uncertainty, making for an interesting proposition. That is if the figures read right. The key numbers to look for in these figures are the continuation of sustainable growth and obviously any words on contingency plans with Brexit.

"The subdued outlook for interest rates is affecting all banks, global economic growth prospects are less favourable, trade tensions between China and the U.S. continue to be strained ... and that's also affecting market confidence." RBS announced the £1.7bn windfall for investors after the sale of a stake in Saudi bank Alawwal helped to support a 48% increase in first-half pre-tax profits to £2.7bn.

Key Fundamentals	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18
Revenue (£ m)	19846	16890	15945	16063	16656
Pre-Tax (£ m)	2643	-2703	-4082	2239	3359
EPS	-30.10p	-17.20p	-59.50p	6.30p	13.50p
PE	788.8	n/a	n/a	43.84	16.05
PEG	n/a	n/a	n/a	n/a	0.14
EPS Growth	n/a	n/a	n/a	n/a	114.29%
Dividend Cover	n/a	n/a	n/a	n/a	6.76
Dividend Yield	n/a	n/a	n/a	n/a	0.92%

Broker Ratings

Date	Broker name	Rating	New view	New target	Previous target
13-Sep-19	Shore Capital	Reiteration	Buy	-	-
06-Sep-19	Deutsche	Downgrade	Hold	215.00p	290.00p
29-Aug-19	RBC Capital	Reiteration	Sector perform	230.00p	-
15-Aug-19	HSBC	Downgrade	Hold	210.00p	260.00p
15-Aug-19	UBS	Reiteration	Buy	265.00p	285.00p
20-Jun-19	RBC Capital	Reiteration	Sector perform	230.00p	260.00p

Standard Chartered (STAN)

Net Asset Value (exc intangibles) 324.68p
Discount to NAV (as of 25th Sept@202.3p) = 37.7%

Standard Chartered PLC is a British multinational banking and financial services company headquartered in London, England. It operates a network of more than 1,200 branches and outlets across more than 70 countries and employs around 87,000 people. It is a universal bank with operations in consumer, corporate and institutional banking, and treasury services. Despite its UK base, it does not conduct retail banking in the UK, and around 90% of its profits come from Asia, Africa and the Middle East.

The business origins stem from the merger of the Chartered Bank of India, Australia and China. The Chartered Bank began when Queen Victoria granted a Royal Charter to Scotsman James Wilson in 1853. Chartered opened its first branches in Mumbai, Kolkata and Shanghai in 1858, followed by Hong Kong and Singapore in 1859. The Bank started issuing banknotes of the Hong Kong dollar in 1862. and standard bank Standard Bank which was a British bank founded in the Cape Province of South Africa in 1862 by Scot, John Paterson.

Standard Chartered has a primary listing on the London Stock Exchange and is a constituent of the FTSE 100 Index. It had a market capitalisation of approximately £24.4bn as of 4 April 2017, the 28th-largest of any company with a primary listing on the London Stock Exchange. It has secondary listings on the Hong Kong Stock Exchange and the National Stock Exchange of India. Its largest shareholder is the Government of Singapore-owned Temasek Holdings.

Listed in London and Hong Kong and with a stronger global presence you would be forgiven for thinking that growth and upside would be stronger. The Brexit uncertainty however weighs on all UK banks regardless of their overall operations. In previous figures Standard chartered have pointed towards increased US interest rates boosting revenue, but with rates being dropped in the US this is now being stunted as well. They have suffered a couple of high-profile legal cases over the last 12 months, from fixing the RAND to the investigation into the potential breach of sanctions for Iran controlled entities. Both faces potentially large fines, which could easily scupper the banks plans to return capital to investors. We feel there is a high probability of this being more detailed in the figures and having the potential to overshadow any positives.

Recent Announcements

Despite Brexit being the front of most investors' minds relating to banks interestingly enough for standard chartered the tit-for-tat tariff war between China and the United States and an easing monetary policy cycle is seen as more of a risk for the Asian facing bank, even as it managed to exceed first-half profit estimates. Pre-tax profit did increase 3% to $2.41bn for the first 6 months of 2019 from $2.35bn in the same period last year.

The trade war between the world's two largest economies has raised costs, roiled financial markets and has also triggered analyst concerns about its impact on global banks that handle the bulk of the trade finance related businesses.

"Concerns surrounding the potential escalation of trade tensions has affected sentiment and central banks' commentary is indicating a reversal of monetary policy normalisation," said StanChart Chief Financial Officer Andy Halford in a statement.

StanChart also said that "recent political protests have additionally elevated the risk" in Hong Kong, referring to a wave of protests in the financial hub against a now suspended extradition bill that would see people sent to mainland China for trial in Communist Party controlled courts.

"The Hong Kong situation obviously is more fragile at this particular point in time," Halford said. While the bank has not seen any direct impact of that on its business, sentiment has been impacted a little bit, he added.

Key Fundamentals	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18
Revenue ($ m)	25035	21168	19679	21377	24038
Pre-Tax ($ m)	3987	-1715	446	2147	2307
EPS	102.20¢	-91.90¢	-14.50¢	23.50¢	18.70¢
PE	14.7	n/a	n/a	44.12	41.71
PEG	-0.39	n/a	n/a	n/a	-2.04
EPS Growth	-37.83%	n/a	n/a	n/a	-20.43%
Dividend Cover	1.19	-6.71	n/a	2.14	0.89
Dividend Yield	5.72%	1.64%	n/a	1.06%	2.69%

Broker Ratings

Date	Broker name	Rating	New view	New target	Previous target
13-Sep-19	Shore Capital	Reiteration	Buy	-	-
06-Sep-19	Deutsche	Reiteration	Hold	630.00p	630.00p
13-Aug-19	JP Morgan	Reiteration	Overweight	850.00p	-
16-Jul-19	Berenberg	Reiteration	Buy	-	-
05-Jul-19	Barclays	Reiteration	Underweight	570.00p	570.00p

HSBC (HSBA)

Net Asset Value (exc intangibles) 649.91p
Discount to NAV (as of 25th Sept@609p) = 6.1 %

HSBC Holdings plc is a British multinational investment bank and financial services holding company. It was the 7th largest bank in the world by 2018, and the largest in Europe, with total assets of $2.558 tn (as of December 2018). HSBC traces its origin to Hong Kong, and its present form was established in London by the Hong Kong and Shanghai Banking Corporation to act as a new group holding company in 1991. The origins of the bank lie mainly in Hong Kong and to a lesser extent in Shanghai, where branches were first opened in 1865. The HSBC name is derived from the initials of the Hong Kong and Shanghai Banking Corporation. The company was first formally incorporated in 1866. HSBC has around 3,900 offices in 67 countries and territories across Africa, Asia, Oceania, Europe, North America, and South America, and around 38 million customers. They operate in four business groups: Commercial Banking, Global Banking and Markets (investment banking), Retail Banking and Wealth Management, and Global Private Banking.

HSBC, the worlds local bank, a marketing stroke of genius from the Hong Kong and Shanghai Banking Corporation. The company is well positioned globally, but that does not offer total immunity to the tempered view on UK banks over the last 12 months. They offer a good opportunity to have exposure to the growth expected in the Asian economies. This has fuelled them where the UK domestic banks have failed, but it will be interesting to see if the growth can be sustained, especially with the slowdown in Asian economies over the last 12 months. The last set of figures certainly impressed with the firm reporting pre-tax profit increase of 28% thanks to "strong revenue growth and lower operating expenses". They also offer the income investor a decent dividend yield, decent

for a bank anyway, however there has been a lot of concerns about slowdowns in china and the main concern here will be how it translates to the figures.

Recent figures for the first half of the year where quite robust with adjusted profit before tax $12,516m versus $11,723m for the same period last year, common equity tier 1 ratio up 30bps from 31 December 2018 to 14.3% and also intend to initiate a share buy-back of up to $1bn.

However, given the overall backdrop they were also cautious on the prevailing outlook for interest rates and revenue headwinds. Overall the first-half pre-tax profit rose 15.9% and the announcement of a further share buyback, has flown straight in the face of most analysts' expectations that they might pause its strategy of returning extra capital to investors.

We're looking at P/E of 11 based on current forecasts, and that might look scarily high to some banking investors. By comparison, Lloyds shares, together with those of RBS and Barclays, are on P/E multiples of around 7 or 8.

Key Fundamentals	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18
Revenue (£ m)	19846	16890	15945	16063	16656
Pre-Tax (£ m)	2643	-2703	-4082	2239	3359
EPS	-30.10p	-17.20p	-59.50p	6.30p	13.50p
PE	788.8	n/a	n/a	43.84	16.05
PEG	n/a	n/a	n/a	n/a	0.14
EPS Growth	n/a	n/a	n/a	n/a	114.29%
Dividend Cover	n/a	n/a	n/a	n/a	6.76
Dividend Yield	n/a	n/a	n/a	n/a	0.92%

Broker Ratings

Date	Broker name	Rating	New view	New target	Previous target
13-Sep-19	Shore Capital	Reiteration	Buy	-	-
06-Sep-19	Deutsche	Downgrade	Hold	215.00p	290.00p
29-Aug-19	RBC Capital	Reiteration	Sector perform	230.00p	-
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15-Aug-19	UBS	Reiteration	Buy	265.00p	285.00p
20-Jun-19	RBC Capital	Reiteration	Sector perform	230.00p	260.00p

Sector Summary

With the financial crisis long behind us, and investors having a cautiously negative attitude to bank stocks pretty much engrained it has been hard to see much optimism in the sector, and just when it started to look good, Brexit and trade wars exploded and given new reason for caution.

Collectively most banking shares do still trade at a significant discount compared to equity markets that have since recovered, largely due to the sector taking time to strengthen their overall offering to both investors and customers. They have been Suring up their capital positions and positioning themselves to be far more appealing and stable and far less vulnerable to the previous issues. This and appealing yields shouldn't turn investors off, even now with global issues rearing up, the changes put in place to create stability in the banking sector has meant that business' are far more robust than they were pre 2007. I feel there is justifiable cause to think they are far better positioned to weather the current backdrop.

Long term investors should really look to review the sector and take advantage of the yields on offer, whilst also analysing the long-term outlook. Short term traders need to be on their toes, trends can be strong and lucrative, but also fleeting and quickly dismissed. Fair reference should also be given to the sterling rate as well, which again is impacting shorter term appetite.

I am always reminded of one of the first things I was told when I came to the markets and that is, you make your profit on the price you buy...not the price you sell, and what I mean by that is timing is critical, more so on the entry than the exit. The current volatility in the market can offer up great entry levels for those looking over the longer and seeking to take advantage of short-term concerns.