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November 8, 2010

Industry View
**In-Line**

# Banks

## Irish Loan Exposure: Stress Testing Danske, Lloyds, RBS and KBC

**Stress testing Danske, Lloyds, RBS & KBC we find:** i) For Danske (OW) the EPS impact is -18%, but the stock would after this still only be trading at 8.2x 2013 EPS, in line with the sector at ~8x. ii) For RBS (EW) and Lloyds (UW) the impact would be an EPS cut of ~27% putting LLOY on 12.5x 13e (50% premium to sector) and RBS on 8.4x (in line). iii) For KBC (EW), we find a limited impact of 60bp on the core tier 1 ratio, taking it to 7.5% and a 2011 P/TBV of 1.1x vs. the sector at 1.3x.

**What's new:** Over the last 10 days Irish banks' CDS spreads widened by 20%-25% taking them to levels only seen by the Greek banks. Behind this is the German proposal on a sovereign debt resolution mechanism at the EU summit. Funding remains a key issue in Ireland.

**Why we did our stress test:** Clearly, widening CDS spreads is not the whole story. We have seen it before and the only thing that has happened is that they have come down again. However, Ireland's dependence on ECB funding has over the last three months increased by 2% points to 7%, indicating that the funding situation is deteriorating. The implications of this are unclear, but in this report we examine the impact of a) a haircut on government debt and b) deteriorating credit quality caused by a further hit to the economy.

**How we did our stress test:** In our stressed scenario we take a 30% haircut on all government bonds and a 30%, 40%, 25% and 8% write-off of the December 2008 loan book for Danske, Lloyds, RBS and KBC (difference due to loan book mix). Since the visibility is so low we have built an interactive model, where investors can insert their own loss assumptions – please contact your sales representative for a copy.

Note: widening of Irish bank CDS does not necessarily herald an economic double-dip, and hence these stress outcomes are just a calibration of our bear cases.

### Overview of Irish loan exposure for select banks

| Ireland sensitivity | RBS | Lloyds | Danske | KBC |
|---|---|---|---|---|
| **Ireland 1H10** | £bn | £bn | DKKbn | €bn |
| Commercial Real Estate | 17.4 | 11.1 | 25.9 | 0.8 |
| Mortgages | 20.5 | 7.5 | 33.9 | 13.3 |
| Other | 14.0 | 8.1 | 22.8 | 3.7 |
| **Gross Loans** | **51.9** | **26.7** | **82.6** | **17.8** |
| % group 1H10 loans | 9% | 4% | 4% | 11% |
| % CRE | 34% | 42% | 31% | 4% |
| % Mortgages | 39% | 28% | 41% | 75% |
| Net loans (net of all prov.) | 47.4 | 21.8 | 71.9 | 17.4 |
| **Net loans / group tang. equity** | **82%** | **53%** | **89%** | **240%** |
| Ireland Impaired Loans | 10.6 | 11.7 | 21.7 | 2.6 |
| % total loans | **21%** | **44%** | **26%** | **15%** |
| Ireland B/S provision | 4.5 | 4.9 | 10.7 | 0.4 |
| Coverage, impaired loans | **43%** | **42%** | **50%** | **15%** |
| **Group 1H10** | | | | |
| Loans | 555 | 646 | 2,330 | 167 |
| Tangible equity | 57.6 | 41.0 | 80.4 | 7.3 |
| **Cumulative losses taken so far** | | | | |
| Dec 08 Ireland Loans | 60.7 | 31.4 | 79.4 | 18.8 |
| 1H08 impairment charge | 0.10 | 0.06 | 0.19 | 0.03 |
| 2H08 impairment charge | 0.43 | 0.48 | 1.51 | 0.03 |
| 1H09 impairment charge | 0.64 | 1.03 | 2.82 | 0.09 |
| 2H09 impairment charge | 1.39 | 1.92 | 2.42 | 0.09 |
| 1H10 impairment charge | 1.76 | 1.56 | 2.74 | 0.17 |
| Q310 impairment charge * | 0.98 | 0.78 | 1.02 | 0.04 |
| **cumulative loss 08-Q310** | **5.29** | **5.83** | **10.69** | **0.44** |
| % Dec 08 loans | **9%** | **19%** | **13%** | **2%** |
| **Base case on future Ireland losses** | | | | |
| Impaired loans % of Dec 08 | 30% | 55% | 40% | 20% |
| Total impaired loans | 18.3 | 17.2 | 31.8 | 3.8 |
| Loss severity on impaired loans | 46% | 50% | 45% | 21% |
| Total losses | 8.5 | 8.6 | 15.9 | 0.8 |
| Loss / Dec 08 loans | 14% | 28% | 20% | 4% |
| Further losses to take 4Q10-13e | 3.2 | 2.8 | 5.2 | 0.3 |
| **% 1H10 TNAV** | **6%** | **7%** | **6%** | **5%** |
| **Stress case on future Ireland losses** | | | | |
| Impaired loans % of Dec 08 | 46% | 65% | 55% | 25% |
| Total impaired loans | 27.9 | 20.4 | 43.7 | 4.7 |
| Loss severity on impaired loans | 53% | 62% | 55% | 30% |
| Total losses | 14.9 | 12.6 | 24.0 | 1.4 |
| Loss / Dec 08 loans | 25% | 40% | 30% | 8% |
| Further losses to take 4Q10-13e vs. ba | 6.4 | 4.0 | 8.1 | 0.6 |
| **% 1H10 TNAV** | **11%** | **10%** | **10%** | **9%** |

Source: Company Data, Morgan Stanley Research * estimated for LLOY and KBC

# Investment Case

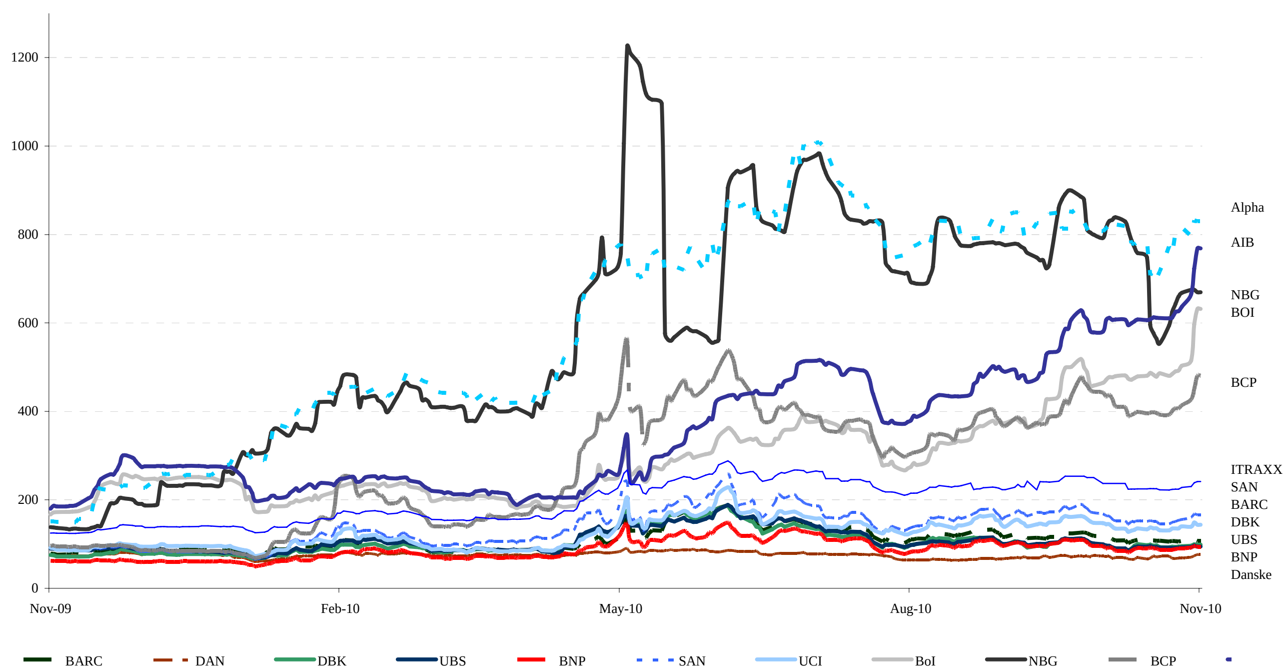
**At this point, it looks increasingly possible that the Irish situation could worsen. The outcome of this is more difficult to determine. In our stress test we take into account a haircut on government debt (which we still view as fairly unlikely, but possible) and also examine what the impact would be on capital and earnings if losses were to increase to 30%, 40%, 25% and 8% of the loan book for Danske, Lloyds, RBS and KBC (difference due to loan book mix). Even in this severe scenario we are comfortable with our Overweight rating on Danske bank, as it would still be trading in-line with the sector. We also continue to see value at RBS (Equal-weight). Lloyds BG would, post our stress test, trade at a 50% premium to the sector, hence we feel comfortable with our Underweight rating on the stock. In the case of KBC where our stress test has a rather limited impact, reducing the core tier 1 by 60bp to 7.5%, we remain Equal-weight.**

**Irish banks 5y CDS spread increase by ~25%**

Germany proposed a sovereign debt resolution mechanism at the EU summit 10 days ago. As a consequence, the funding situation for the Irish banks has deteriorated further. Irish bank assets funded by ECB now stand at 7% up from 5% in July. At this point in time it is only a proposal, but it opens up the possibility that Ireland could enter the EFSF program (see text box on next page).

Exhibit 1

**5 year CDS spreads**




Source: Morgan Stanley Research, Datastream

Figures are 5Y SENIOR prices where available, but NBG is 5Y SUB.

Exhibit 2

### How does the EFSF work?

### Backstop in the background: The EFSF

There is still the EFSF that Ireland could turn to (see *EuroTower Insights: Stress Testing Europe*, June 30, 2010). Our understanding is that, in principle, the EFSF could help to fund the recapitalisation of the banking system if a sovereign in the euro area were to find itself unable to raise the necessary funds in the market. However, it is unlikely, in our view, that the EFSF will take direct exposure to the banking sector. In fact, the Greek loan agreement explicitly stresses that it does not involve direct exposure to the Greek banking system. Under the framework agreement signed on June 7 by all euro area finance ministers, the EFSF would lend to the government in question. This means that the government would need to meet the strict conditionality attached to such loans, including a fiscal austerity programme and further structural reforms. Based on the most recent assessments of the Irish economy, the European Commission and the IMF would probably demand some modest fiscal tightening measures from the Irish government over and above the 2% per annum the government committed to in its Stability Programme. But the imposed adjustment is unlikely to be anywhere near the demands made on Greece. On the structural reforms, there is not that much to do in Ireland. A change in the tax treatment of housing could be part of the mix, but the Irish government is working on this anyway.

### Main features of the European stabilisation mechanism

| | European Stabilisation Mechanism | European Financial Stabilisation Facility |
|---|---|---|
| **Characteristics** | | |
| Size | €60 billion | €440 billion |
| Guarantee structure for debt | EU budget | Cash buffer plus 120% guarantee of each euro area countries' pro rata share of issued bond |
| Approval required from national parliaments | No | Yes |
| **Loan characteristics** | | |
| Eligibility for loans | EU countries | Euro area countries |
| Conditionality for borrower | Economic and fiscal adjustment programme required | Economic and fiscal adjustment programme required |

Source: Morgan Stanley and BIS

### Using NAMA Haircuts as an indicator

Irish banks are transferring loans to NAMA, comprising property and associated loans. The average haircut for Bank of Ireland has been 36% and the Minister's Statement on 30 September 2010 suggests a haircut on the remaining tranche of 42%. For AIB, the haircut on its transfers so far was 45% and the remaining tranche is set at 60%. This may provide a guide on potential losses for the UK banks with Irish exposure, although the losses will depend on the mix of the book (high for CRE, lower for Irish mortgages). For the CRE component of the Irish books, this suggests potential losses of 50-60%.

Exhibit 3

### Details of 2nd tranche transferred to NAMA

| Participating institution | Nominal value of loans acquired | Value of securities exchanged for loans | Discount | Discount % |
|---|---|---|---|---|
| Allied Irish Banks | €2.73 billion | €1.40 billion | €1.32 billion | 48.5% |
| Bank of Ireland | €1.82 billion | €1.13 billion | €686 million | 37.8% |
| EBS Building Society | €35.9 million | €19.3 million | €16.6 million | 46.4% |
| Irish Nationwide Building Society | €591 million | €163 million | €428 million | 72.4% |
| Anglo Irish Bank | €6.75 billion | €2.57 billion | €4.18 billion | 61.9% |
| Total Tranche 2 | €11.9 billion | € 5.28 billion | €6.63 billion | 55.6% |
| Total Tranches 1 & 2 | €27.2 billion | € 13 billion | €14.2 billion | 52.3% |

Source: NAMA

### Lloyds Banking Group

In its recent 3Q10 IMS, LLOY suggested the Irish impairment may be similar in 2H10 to 1H10 (it took £1.6bn impairment 1H10, implying an annual loss rate over 12% in FY10 on its book) and that the deterioration in economic conditions is keeping impairment levels high, particularly in CRE. At 1H10, the gross book was £26.7bn, with £11.7bn of impaired loans (44% impaired) and an impairment provision of £4.9bn (42% covered). Its Irish CRE book was £11.1bn of which 54% was Property Investment (45% impaired) and 46% was Property Development (90% impaired). The amount of impaired loans on its Irish book increased from 33% end 2009 to 44% 1H10.

### RBS

Royal Bank of Scotland: RBS has significant exposure to Ireland via its Ulster Bank division. In the 3Q10 IMS, RBS suggested Irish asset default levels and loss rates in both the retail and corporate portfolios were to remain elevated and RBS expected this to continue into Q4 before beginning to stabilise. RBS took £2.7bn impairment 9M10, or ~410bps of annualised losses. At 1H10, the gross Irish loan book was £51.9bn, we estimate ~£10bn of impaired loans (20% impaired) and an impairment provision of ~£4.5bn (~45% covered). The Irish CRE book of £17.4bn at 1H10 was 34% of the total.

**Danske Bank**
Danske bank's Irish operations make up 3% (DKK 65mn) of total credit exposure. Of this 41% are mortgages, 2% other personal loans, 3% government debt, 30% commercial real estate and construction and 24% corporate loans. At the end of Q3, 29% of the total loan book was non-performing loans (NPLs). Of the NPLs 31% were provisioned and of the total loan book Danske had booked provisions for 14% of the book.

Of the CRE loans, Danske has already taken provisions for 36% of the loans and 50% of the non-performing loans. At this point 66% of the CRE loans are NPLs.

In our (modelled) base case scenario we are forecasting that NPLs increase to 80% for the CRE portfolio with a loss given default of 55%, while for the corporate book we are forecasting a NPL of 60% and LGD of 45%. For details on the whole book, see Exhibit 6.

Danske Bank holds only DKK 3.3bn of Irish bonds, of this DKK2.9bn is central and local government bonds and the reminder is made up by covered bonds, CPs and credit bonds. We believe that the last DKK 400mn is held in the trading portfolio, where losses would be booked in the P&L while potential losses related to the DKK 3.3bn would be booked against equity. Hence, our stress test is somewhat misleading as we take all losses against the P&L for comparison reasons. Danske also holds DKK22 bn of loans to financial customers in Ireland.

After Q3, we have written off 13% of the accumulated loan book, which will increase to 20% by end of 2013. At the Q3 conference call Danske banks management stated that loan losses in Ireland would remain around DKK 1bn per quarter for the next couple of quarters, which we have in our model. The key is really over how long time the losses will be recognised.

**KBC**
KBC has a lower risk loan book than the other banks mentioned in this report as we believe as KBC has a much higher mortgage content (~75%) and the mortgages have experienced a lower default rate and lower loss severity in Ireland than the other loan categories. At 1H10, KBC had €17.8bn of gross loans in Ireland of which 15% or €2.6bn were high risk. Given the higher quality of the book the balance sheet provision taken was ~15% of the impaired loans. The exposure to commercial property lending which remains stressed is small at €0.8bn or 4% of the Irish loan book and so is less of a concern than at RBS/LLOY.

**Stress test**
In our stress test we have increased our loan losses significantly. For Danske we have increased our losses from 20% to 30% of the total loan book, for RBS from 14% to 25%, Lloyds BG from 28% to 40% and KBC from 4% to 8%. The additional losses, above our base case, we spread evenly over 2011-2013 (for KBC until 2012). Clearly, this could vary much more in reality. We assume haircuts on the bond portfolios of 30% loss, which will impact the P&L in 2011. Depending on whether these bonds are trading book or held-to-maturity, this may prove to be incorrect. However, the impact on the capital should be the same even though the P&L impact may vary. We assume losses are not tax deductible.

Methodology for our stress test:

- The levels of loan impairment and loss severity we have used are based on the specific loan book of each company. With a much higher loss severity applied on corporate loans, commercial real estate lending and unsecured personal loans than retail mortgages, which typically have lower loss given default given the collateral.
- We take into account the loan impairment experience to date and the loss severity expected by the banks as shown by the coverage ratio they use.

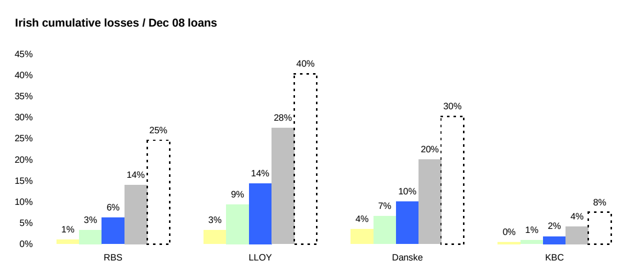
Clearly, at this stage the ultimate cumulative losses to be taken are difficult to judge and dependent on the eventual economic outcome in Ireland. We acknowledge that the widening of Irish bank CDS does not necessarily herald a double dip economic outcome and hence these stress outcomes are not our base case assumptions but rather a calibration of our bear case.

Exhibit 4
**Overview of stress case potential outcomes**

| 2013e (Local Curr) | RBS | Lloyds | Danske | KBC (2012e) |
|---|---|---|---|---|
| Base Case EPS | 7.3 | 7.6 | 22.1 | 5.2 |
| Stress Case EPS | 5.3 | 5.7 | 18.2 | 4.3 |
| % EPS change | -27% | -26% | -18% | -18% |
| Current P/E | 6.1 | 9.3 | 6.8 | 6.0 |
| Stress Case P/E | 8.4 | 12.5 | 8.2 | 7.3 |

Source: Morgan Stanley Research estimates

Exhibit 5
**Base and bear case Irish cumulative loss scenarios**




Source: Morgan Stanley Research estimates

Exhibit 6

## Irish exposure and potential losses

| Ireland sensitivity | non-core | core | RBS | Lloyds | Danske | KBC |
|---|---|---|---|---|---|---|
| **Ireland 1H10** | | | £bn | £bn | DKKbn | €bn |
| Commercial Real Estate | 7.9 | 9.5 | 17.4 | 11.1 | 25.9 | 0.8 |
| Mortgages | 5.6 | 14.9 | 20.5 | 7.5 | 33.9 | 13.3 |
| Other | 2.2 | 11.8 | 14.0 | 8.1 | 22.8 | 3.7 |
| **Gross Loans** | **15.7** | **36.2** | **51.9** | **26.7** | **82.6** | **17.8** |
| % group 1H10 loans | 3% | 7% | 9% | 4% | 4% | 11% |
| % CRE | 50% | 26% | 34% | 42% | 31% | 4% |
| % Mortgages | 36% | 41% | 39% | 28% | 41% | 75% |
| Net loans (net of all prov.) | 12.5 | 34.9 | 47.4 | 21.8 | 71.9 | 17.4 |
| **Net loans / group tang. equity** | **22%** | **61%** | **82%** | **53%** | **89%** | **240%** |
| Ireland Impaired Loans | 7.1 | 3.5 | 10.6 | 11.7 | 21.7 | 2.6 |
| % total loans | 46% | 10% | **21%** | **44%** | **26%** | **15%** |
| Ireland B/S provision | 3.2 | 1.3 | 4.5 | 4.9 | 10.7 | 0.4 |
| Coverage, impaired loans | 45% | 38% | **43%** | **42%** | **50%** | **15%** |
| **Group 1H10** | | | | | | |
| Loans | 555.4 | 555.4 | 555 | 646 | 2,330 | 167 |
| Tangible equity | 57.6 | 57.6 | 57.6 | 41.0 | 80.4 | 7.3 |
| **Cumulative losses taken so far** | | | | | | |
| Dec 08 Ireland Loans | 16.7 | 44.0 | 60.7 | 31.4 | 79.4 | 18.8 |
| 1H08 impairment charge | 0.08 | 0.02 | 0.10 | 0.06 | 0.19 | 0.03 |
| 2H08 impairment charge | 0.34 | 0.09 | 0.43 | 0.48 | 1.51 | 0.03 |
| 1H09 impairment charge | 0.48 | 0.16 | 0.64 | 1.03 | 2.82 | 0.09 |
| 2H09 impairment charge | 0.90 | 0.49 | 1.39 | 1.92 | 2.42 | 0.09 |
| 1H10 impairment charge | 1.26 | 0.50 | 1.76 | 1.56 | 2.74 | 0.17 |
| Q310 impairment charge * | 0.69 | 0.29 | 0.98 | 0.78 | 1.02 | 0.04 |
| **cumulative loss 08-Q310** | **3.75** | **1.54** | **5.29** | **5.83** | **10.69** | **0.44** |
| % Dec 08 loans | 22% | 4% | **9%** | **19%** | **13%** | **2%** |
| **Base case on future Ireland losses** | | | | | | |
| Impaired loans % of Dec 08 | 70% | 15% | 30% | 55% | 40% | 20% |
| Total impaired loans | 11.7 | 6.6 | 18.3 | 17.2 | 31.8 | 3.8 |
| Loss severity on impaired loans | 50% | 40% | 46% | 50% | 45% | 21% |
| Total losses | 5.8 | 2.6 | 8.5 | 8.6 | 15.9 | 0.8 |
| Loss / Dec 08 loans | 35% | 6% | 14% | 28% | 20% | 4% |
| Further losses to take 4Q10-13e | 2.1 | 1.1 | 3.2 | 2.8 | 5.2 | 0.3 |
| **% 1H10 TNAV** | **4%** | **2%** | **6%** | **7%** | **6%** | **5%** |
| **Stress case on future Ireland losses** | | | | | | |
| Impaired loans % of Dec 08 | 75% | 35% | 46% | 65% | 55% | 25% |
| Total impaired loans | 12.5 | 15.4 | 27.9 | 20.4 | 43.7 | 4.7 |
| Loss severity on impaired loans | 70% | 40% | 53% | 62% | 55% | 30% |
| Total losses | 8.8 | 6.2 | 14.9 | 12.6 | 24.0 | 1.4 |
| Loss / Dec 08 loans | 53% | 14% | 25% | 40% | 30% | 8% |
| Further losses to take 4Q10-13e vs. base case | 5.0 | 4.6 | 6.4 | 4.0 | 8.1 | 0.6 |
| **% 1H10 TNAV** | **9%** | **8%** | **11%** | **10%** | **10%** | **9%** |
| Group loan loss forecast 2H10-2013e | | | 20.3 | 24.6 | 19.5 | 2.1 |
| Base case Ireland losses % group losses | | | 16% | 11% | 27% | 16% |
| Extra losses on stress case | | | 3.2 | 1.2 | 3.0 | 0.3 |
| **Stress case extra losses vs 1H10 TNAV** | | | **6%** | **3%** | **4%** | **4%** |

Source: Morgan Stanley Research estimates
Note: estimated for RBS non-core. For Danske bank we have excluded loans to financial customers* estimated for LLOY and KBC

Exhibit 7

## Stress case potential impact

| Danske Bank | DKKmn | 2011E | 2012E | 2013E |
|---|---|---|---|---|
| | **Current Net profit** | 11,495 | 15,134 | 15,447 |
| | Current EPS | 16.45 | 21.66 | 22.10 |
| | Current TBV | 129 | 145 | 162 |
| | Current P/E | 9.1x | 6.9x | 6.8x |
| | Current P/TBV | 1.2x | 1.0x | 0.9x |
| | Current CT1 | 9.9% | 10.5% | 11.4% |
| | **Haircut on bonds** | **-990** | | |
| | New Net Profit | 10,505 | 15,134 | 15,447 |
| | Change in net profit | -9% | 0% | 0% |
| | New EPS | 15.03 | 21.66 | 22.10 |
| | New TBV | 128 | 144 | 161 |
| | **New P/E** | **10.0x** | **6.9x** | **6.8x** |
| | **New P/TBV** | **1.2x** | **1.0x** | **0.9x** |
| | Impact on CT1 bp | -0.11% | | |
| | **New CT1** | **9.8%** | **10.4%** | **11.3%** |
| | **Additional LLC, stressed scenario** | **-2,713** | **-2,713** | **-2,713** |
| | New Net Profit | 8,782 | 12,421 | 12,734 |
| | Change in net profit | -24% | -18% | -18% |
| | New EPS | 12.57 | 17.77 | 18.22 |
| | New TBV | 125 | 137 | 151 |
| | **New P/E** | **11.9x** | **8.4x** | **8.2x** |
| | **New P/TBV** | **1.2x** | **1.1x** | **1.0x** |
| | Impact on CT1 bp | -0.30% | -0.6% | -0.8% |
| | **New CT1** | **9.6%** | **10.0%** | **10.6%** |
| | **Haircut and additional losses** | **-3,703** | **-2,713** | **-2,713** |
| | New Net Profit | 7,792 | 12,421 | 12,734 |
| | Change in net profit | -32% | -18% | -18% |
| | New EPS | 11.15 | 17.77 | 18.22 |
| | New TBV | 124 | 136 | 149 |
| | **New P/E** | **13.4x** | **8.4x** | **8.2x** |
| | **New P/TBV** | **1.2x** | **1.1x** | **1.0x** |
| | Impact on CT1 bp | -0.41% | -0.7% | -0.9% |
| | **New CT1** | **9.5%** | **9.9%** | **10.5%** |

| KBC | EURmn | 2011E | 2012E | 2013E |
|---|---|---|---|---|
| | **Current Net profit** | 997 | 1,759 | |
| | Current EPS | 2.94 | 5.18 | |
| | Current TBV | 30 | 30 | |
| | Current P/E | 10.6x | 6.0x | |
| | Current P/TBV | 1.0x | 1.0x | |
| | Current CT1 | 7.6% | 8.1% | |
| | **Haircut on bonds** | **-115** | | |
| | New Net Profit | 882 | 1,759 | |
| | Change in net profit | -12% | 0% | |
| | New EPS | 2.60 | 5.18 | |
| | New TBV | 29.4 | 30.1 | |
| | **New P/E** | **11.9x** | **6.0x** | |
| | **New P/TBV** | **1.1x** | **1.0x** | |
| | Impact on CT1 bp | -0.09% | | |
| | **New CT1** | **7.5%** | **8.0%** | |
| | **Additional LLC, stressed scenario** | **-310** | **-310** | |
| | New Net Profit | 688 | 1,450 | |
| | Change in net profit | -31% | -18% | |
| | New EPS | 2.02 | 4.27 | |
| | New TBV | 28.5 | 28.3 | |
| | **New P/E** | **15.3x** | **7.3x** | |
| | **New P/TBV** | **1.1x** | **1.1x** | |
| | Impact on CT1 bp | -0.23% | -0.5% | |
| | **New CT1** | **7.4%** | **7.6%** | |
| | **Haircut and additional losses** | **-424** | **-310** | |
| | New Net Profit | 573 | 1,450 | |
| | Change in net profit | -43% | -18% | |
| | New EPS | 1.69 | 4.27 | |
| | New TBV | 28.5 | 28.0 | |
| | **New P/E** | **18.4x** | **7.3x** | |
| | **New P/TBV** | **1.1x** | **1.1x** | |
| | Impact on CT1 bp | -0.32% | -0.6% | |
| | **New CT1** | **7.3%** | **7.5%** | |

| Lloyds | GBPmn | 2011E | 2012E | 2013E |
|---|---|---|---|---|
| | **Current Net profit** | 2,092 | 4,733 | 5,200 |
| | Current EPS | 3.1 | 6.9 | 7.6 |
| | Current TBV | 65.0 | 68.8 | 71.2 |
| | Current P/E | 14.7x | 6.5x | 5.9x |
| | Current P/TBV | 1.09x | 1.03x | 1.00x |
| | Current CT1 | 10.2% | 10.0% | 11.2% |
| | **Haircut on bonds** | **0** | | |
| | New Net Profit | 2,092 | 4,733 | 5,200 |
| | Change in net profit | 0% | 0% | 0% |
| | New EPS | 3.1 | 6.9 | 7.6 |
| | New TBV | 65.0 | 68.8 | 71.2 |
| | **New P/E** | **23.1x** | **10.2x** | **9.3x** |
| | **New P/TBV** | **1.09x** | **1.03x** | **1.00x** |
| | Impact on CT1 % | 0.00% | 0.00% | 0.00% |
| | **New CT1** | **10.2%** | **10.0%** | **11.2%** |
| | **Additional LLC, stressed scenario** | **-1,338** | **-1,338** | **-1,338** |
| | New Net Profit | 754 | 3,395 | 3,862 |
| | Change in net profit | -64% | -28% | -26% |
| | New EPS | 1.1 | 5.0 | 5.7 |
| | New TBV | 63.1 | 64.8 | 65.3 |
| | **New P/E** | **64.2x** | **14.2x** | **12.5x** |
| | **New P/TBV** | **1.13x** | **1.10x** | **1.09x** |
| | Impact on CT1 % | -0.31% | -0.57% | -0.93% |
| | **New CT1** | **9.9%** | **9.4%** | **10.3%** |
| | **Haircut and additional losses** | -1,338 | -1,338 | -1,338 |
| | New Net Profit | 754 | 3,395 | 3,862 |
| | Change in net profit | -64% | -28% | -26% |
| | New EPS | 1.11 | 4.98 | 5.67 |
| | New TBV | 63.1 | 64.8 | 65.3 |
| | **New P/E** | **64.2x** | **14.2x** | **12.5x** |
| | **New P/TBV** | **1.13x** | **1.10x** | **1.09x** |
| | Impact on CT1 % | -0.31% | -0.57% | -0.93% |
| | **New CT1** | **9.9%** | **9.4%** | **10.3%** |

| RBS | GBPmn | 2011E | 2012E | 2013E |
|---|---|---|---|---|
| | **Current Net profit** | 4,012 | 6,479 | 7,926 |
| | Current EPS (p) | 3.7 | 6.0 | 7.3 |
| | Current TBV (p) | 54.1 | 57.5 | 62.6 |
| | Current P/E | 12.1x | 7.5x | 6.1x |
| | Current P/TBV | 0.83x | 0.78x | 0.72x |
| | Current CT1 | 12.5% | 11.1% | 13.4% |
| | **Haircut on bonds** | **-230** | | |
| | New Net Profit | 3,782 | 6,479 | 7,926 |
| | Change in net profit | -6% | 0% | 0% |
| | New EPS (p) | 3.5 | 6.0 | 7.3 |
| | New TBV (p) | 53.8 | 57.3 | 62.4 |
| | **New P/E** | **12.9x** | **7.5x** | **6.1x** |
| | **New P/TBV** | **0.84x** | **0.78x** | **0.72x** |
| | Impact on CT1 % | -0.05% | -0.04% | -0.05% |
| | **New CT1** | **12.4%** | **11.1%** | **13.3%** |
| | **Additional LLC, stressed scenario** | **-2,148** | **-2,148** | **-2,148** |
| | New Net Profit | 1,865 | 4,331 | 5,778 |
| | Change in net profit | -54% | -33% | -27% |
| | New EPS (p) | 1.73 | 4.01 | 5.35 |
| | New TBV (p) | 52.1 | 53.6 | 56.7 |
| | **New P/E** | **26.1x** | **11.2x** | **8.4x** |
| | **New P/TBV** | **0.86x** | **0.84x** | **0.79x** |
| | Impact on CT1 % | -0.46% | -0.77% | -1.27% |
| | **New CT1** | **12.0%** | **10.4%** | **12.1%** |
| | **Haircut and additional losses** | -2,378 | -2,148 | -2,148 |
| | New Net Profit | 1,634 | 4,331 | 5,778 |
| | Change in net profit | -59% | -33% | -27% |
| | New EPS (p) | 1.51 | 4.01 | 5.35 |
| | New TBV (p) | 51.9 | 53.4 | 56.5 |
| | **New P/E** | **29.8x** | **11.2x** | **8.4x** |
| | **New P/TBV** | **0.87x** | **0.84x** | **0.80x** |
| | Impact on CT1 % | -0.51% | -0.81% | -1.32% |
| | **New CT1** | **12.0%** | **10.3%** | **12.1%** |

Source: Morgan Stanley Research estimates

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|---|---|---|---|---|---|
| Stock Rating Category | Count | % of Total | Count | % of Total IBC | % of Rating Category |
| **Overweight/Buy** | **1122** | **40%** | **413** | **44%** | **37%** |
| **Equal-weight/Hold** | **1158** | **41%** | **411** | **43%** | **35%** |
| **Not-Rated/Hold** | **121** | **4%** | **22** | **2%** | **18%** |
| **Underweight/Sell** | **393** | **14%** | **103** | **11%** | **26%** |
| **Total** | **2,794** | | **949** | | |

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## Industry Coverage:Banks

| Company (Ticker) | Rating (as of) | Price* (11/05/2010) |
|---|---|---|
| **Steven Hayne** | | |
| Allied Irish Banks PLC (ALBK.I) | ++ | €.27 |
| Bank of Ireland Group (BKIR.I) | E (01/14/2010) | €.43 |
| HSBC (HSBA.L) | E (07/16/2009) | 683p |
| Lloyds Banking Group (LLOY.L) | U (06/11/2010) | 70p |
| Standard Chartered Bank (STAN.L) | E (10/26/2009) | 1,950p |
| **Maxence Le Gouvello du Timat** | | |
| BNP Paribas (BNPP.PA) | E (09/23/2010) | €53.8 |
| Credit Agricole S.A. (CAGR.PA) | O (07/27/2010) | €12.14 |
| DEXIA (DEXI.BR) | E (10/27/2010) | €3.25 |
| National Bank of Greece (NBGr.AT) | ++ | €7.4 |
| Natixis (CNAT.PA) | U (09/23/2010) | €4.42 |
| Societe Generale (SOGN.PA) | O (11/09/2009) | €44.02 |
| **Chris Manners, ACA** | | |
| Barclays Bank (BARC.L) | O (08/11/2009) | 290p |
| Royal Bank of Scotland (RBS.L) | E (08/09/2010) | 45p |
| **Thibault A Nardin** | | |
| KBC Group NV (KBC.BR) | E (04/27/2010) | €31 |
| **Morgan Stanley Research Europe** | | |
| Aareal Bank AG (ARLG.DE) | NA (06/18/2010) | €19.24 |
| Alpha Bank (ACBr.AT) | NA (09/07/2010) | €4.51 |
| BBVA (BBVA.MC) | ++ | €8.38 |
| Banco Popolare (BAPO.MI) | NA (03/19/2009) | €3.67 |
| Banco Popular (ES) (POP.MC) | NA (10/12/2010) | €4.32 |
| Banco Sabadell (SABE.MC) | NA (10/12/2010) | €3.22 |
| Banesto (BTO.MC) | NA (10/12/2010) | €6.99 |
| Bankinter (BKT.MC) | NA (10/12/2010) | €4.49 |
| EFG Eurobank (EFGr.AT) | NA (09/07/2010) | €4.13 |
| Piraeus Bank SA (BOPr.AT) | ++ | €3.3 |
| Santander (SAN.MC) | E (02/16/2010) | €8.5 |
| **Henrik H Schmidt** | | |
| Danske Bank (DANSKE.CO) | O (09/02/2010) | DKr149.9 |
| DnB NOR (DNBNOR.OL) | O (09/02/2010) | NKr79.75 |
| Nordea (NDA.ST) | U (09/02/2010) | SKr72.4 |
| SEB (SEBa.ST) | E (09/02/2010) | SKr52.55 |
| Svenska Handelsbanken (SHBa.ST) | E (09/02/2010) | SKr217.3 |
| Swedbank (SWEDa.ST) | E (09/02/2010) | SKr92.2 |
| **Hadrien de Belle** | | |
| Erste Bank (ERST.VI) | E (11/04/2008) | €33.45 |
| Raiffeisen Bank International (RBIV.VI) | NA (02/26/2010) | €41.6 |
| TT Hellenic Postbank S.A. (GPSr.AT) | O (02/01/2007) | €3.28 |
| **Huw van Steenis** | | |
| Commerzbank (CBKG.DE) | NA (08/13/2010) | €6.62 |
| Credit Suisse Group (CSGN.VX) | E (10/04/2010) | SFr41.9 |
| Deutsche Bank (DBKGn.DE) | E (10/11/2010) | €41.73 |
| Deutsche Postbank AG (DPBGn.DE) | U (11/03/2008) | €25.12 |
| Julius Baer (BAER.VX) | O (11/22/2005) | SFr41.52 |
| UBS (UBSN.VX) | O (05/11/2010) | SFr17.24 |

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.