



CHANGES TO PRICE TARGETS AND RATINGS

The ultimate aim of updating changes to our price targets and ratings should, in our view, be to try to help clients make better risk-reward bets. To this end, given that the sector has fallen so much in recent weeks, we do not simply make wholesale reductions in price targets while maintaining the same ratings. Rather, we try and evaluate on a stock by stock basis whether the current price is one where we are comfortable justifying our valuation and rating.

The key changes are as follows.

- We **upgrade Lloyds from Reduce to Hold** but **maintain our price target of 49p**. The share price has fallen to our target and we believe that this price is in our long-term expectation of an eventual sale of investments in other financial institutions (primarily Scottish Widows).

We rationalise this as follows. Our model indicates 2012 EPS of 7.7p, which is 8% below the consensus estimate. Our own estimate is unadjusted for Basel III. If, as is our expectation, Lloyds is forced to sell its investments in other financial institutions because its Basel III Core Tier 1 ratio is too low, then this would solve its lack of capital adequacy, but would mean that group earnings would be negatively impacted by some 15%. This would result in our 2012 EPS estimate falling to 6.5p. Putting this on a 10x multiple, then discounting back at 10% for three years, results in a simple price target of 49p today.

- In contrast to Lloyds, **we reduce our price targets for the Spanish banks BBVA and Santander but maintain our Hold recommendations on both**. We reduce our price target for BBVA to €11.60 from €14.25, and our price target for Santander to €11.30 from €13.00. This provides approximately 14% upside from the current share price for both stocks, which is not insignificant, but far less than the upside seen at the Nordic banks, our favoured stocks.

The risk of higher funding costs, arising from contagion from higher Spanish sovereign CDS spreads to bank CDS spreads, has increased materially in our view. This clearly increases the risk of higher long term funding costs for the Spanish banks in our opinion.

Additionally, the potential need to reign in the large fiscal deficit in Spain would translate into lower GDP growth and higher loan losses.

Indeed, the recent 4Q09 results for BBVA and Santander were already incrementally negative in our opinion, leading us to believe that credit quality deterioration will be a lot worse than expected in the next few quarters.

- **We reduce our price target to €3.10 from €3.55 for Intesa but maintain our Hold rating. We maintain our price target for Unicredit at €2.00 and maintain our Reduce rating**. These price targets point to upside of 18% and 0% for Intesa and Unicredit respectively, which is less than the upside seen at the Nordic banks, our favoured stocks.

Italy is also suffering from increased sovereign CDS spreads, given the perception of being highly indebted. We do not believe that the indebtedness of Italy should give rise to the same concerns as at Greece, Portugal or Spain given that its fiscal deficit as a percentage of GDP is much lower and its economy is nowhere near as dependent on construction as the Spanish economy. Additionally, the increase in CDS spreads for Intesa and Unicredit should not significantly affect funding costs, in our view, since both have LTD ratios of about 100%. However, our concern is that the heightened perception of economic weakness for the peripheral European countries (which we believe is valid) will lead to a higher long-term cost of equity, resulting in lower target prices.

Research

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Additionally, we still believe that Intesa and Unicredit are structurally low ROE banks. Robustness in the Italian banking sector for loans and deposits means that neither has been able to make much headway in improving relative asset pricing (as at BBVA and Santander) or increasing deposit bases (as at HSBC, Standard Chartered or Handelsbanken).

We believe relative outperformance for Intesa and Unicredit will occur when the EURIBOR base rate starts to increase. However, we do not anticipate increases for a long while yet (at least until after the end of 2010). If anything, the next change by the ECB might be down.

- **For HSBC and Standard Chartered, we maintain our Hold ratings and price targets of 800p and 1500p respectively.** This indicates upside from current share prices of 18% for HSBC and 2% for Standard Chartered, still lower than at the Nordic banks.

Our thesis on the banks has not fundamentally changed. At HSBC, we are positive on the earnings trajectory, geographic footprint and loan-to-deposit ratio of ~80%. However, we see the Core Tier 1 ratio at only 6.0% at year-end 2012 under Basel III. We believe management may feel the need to raise capital raise at some point to regain parity with peers (perhaps a \$10bn raising at its expected Shanghai listing?). We would be very comfortable raising our rating to Buy and accumulating shares into such a capital raise.

Our thesis for Standard Chartered has not changed either. We see the bank as very high quality in many respects. Attractive growth prospects in Asia should be funded by a surplus deposit base (as with HSBC, the loan-to-deposit ratio is now 80%). We anticipate weakness in trading income in the near term, but offset by an expected recovery in profits from the Consumer Banking division. What prevents us from having a Buy rating is valuation. Standard Chartered trades at a premium P/TNAV and we do not foresee any catalysts that would make that premium expand.

- **We maintain our price targets and Buy ratings for the Nordic banks DNB NOR, Handelsbanken and Nordea.** All the Nordic banks should, in our view, have relatively robust earnings, supported by Norway and Sweden having the strongest GDP growth rates in developed Europe in 2010, according to consensus forecasts. Indeed, we have seen in the recent 4Q09 results the common theme of lower than expected loan losses. We also see all three banks as being very well capitalised under Basel III. Revenue growth has varied somewhat among the Nordic banks, and this is one of the factors by which we differentiate between them.

DNB NOR is our top pick among the Nordic banks that we cover. The target price remains at NOK86.00, pointing to 33% upside from the current price. Its greater exposure to Norway, where the base rate is already on an upwards trend, should benefit net interest income growth. It is also rather cheap compared to the peer group, trading at only 1.1x 2010e TNAV.

Handelsbanken is our second favourite Buy. The target price remains at SEK250.00, pointing to 31% upside from the current price. It is relatively expensive on P/TNAV, but this reflects its lower cost of equity and its 'best-in-class' status within the group of lending banks. It has demonstrated in recent quarters an improvement in its loan-to-deposit ratio, reflecting the relative strengthening of its deposit franchise as the credit crisis has unfolded. We believe the strength in its net interest income will surprise consensus.

Nordea, meanwhile, is a stock that we expect to outperform the peer group of lending banks, despite being not as attractive in our opinion as DNB NOR or Handelsbanken. The target price remains at SEK86.60, pointing to 28% upside from the current price. We do not expect the development of net interest income to be quite as strong as its Nordic peers given the modest deterioration in its loan-to-deposit ratio. Indeed, we have seen evidence of this in the recent 4Q09 results relative to DNB NOR.

Figure 1: Matrix DCF Valuation Table for Large Cap Lending Banks

Stock name	Matrix Rating	Mcap (€bn)	Curr	Price (local)	DCF FV	DCF P/FV	DCF Upside/Downside	Cost of Equity Assumptions					Terminal Value % FV	
								Risk-Free Rate	LT Market Return	Market risk premium	Equity Beta*	LT Growth Rate		COE
BBVA	HOLD	38.0	EUR	10.14	14.11	72%	39%	3.96%	8.50%	4.55%	1.49	5.00%	10.73%	34%
DNB NOR ASA	BUY	13.1	NOK	64.90	82.84	78%	28%	3.93%	8.50%	4.58%	1.24	5.00%	9.59%	43%
HSBC HLDGS PLC	HOLD	134.9	GBP	675	942	72%	39%	3.93%	8.50%	4.57%	1.15	5.00%	9.19%	46%
INTESA SANPAOLO	HOLD	33.2	EUR	2.64	3.55	74%	34%	3.96%	8.50%	4.55%	1.29	5.00%	9.84%	41%
LLOYDS BANKING	HOLD	36.4	GBP	49.76	48.73	102%	-2%	3.96%	8.50%	4.55%	1.66	5.00%	11.48%	32%
NORDEA BANK AB	BUY	27.7	SEK	67.55	81.18	83%	20%	3.93%	8.50%	4.57%	1.30	5.00%	9.87%	40%
BANCO SANTANDER	HOLD	81.2	EUR	9.87	12.29	80%	25%	3.93%	8.50%	4.58%	1.49	5.00%	10.74%	34%
SVENSKA HAN-A	BUY	12.1	SEK	191.50	242.83	79%	27%	3.93%	8.50%	4.57%	1.15	5.00%	9.17%	46%
STANDARD CHARTER	HOLD	34.2	GBP	1474	1523	97%	3%	3.96%	8.50%	4.55%	1.56	5.00%	11.03%	32%
UNICREDIT SPA	REDUCE	38.6	EUR	2.00	1.85	108%	-8%	3.93%	8.50%	4.57%	1.67	5.00%	11.56%	30%

Source: Matrix Corporate Capital Research

Figure 2: Conventional Valuation Table - Matrix Estimates

Stock name	Matrix Rating	Mcap (€bn)	Curr	Price (local)	Target Price	Upside/Downside	Matrix EPS			Matrix P/E			Matrix BVPS		Matrix P/BV		Matrix ROE	
							FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
BBVA	HOLD	38.0	EUR	10.14	11.60	14%	1.13	1.10	1.44	8.95	9.20	7.03	8.39	9.25	1.21	1.10	13.5%	16.2%
DNB NOR ASA	BUY	13.1	NOK	64.90	86.00	33%	6.04	6.11	6.84	10.74	10.62	9.49	64.93	70.03	1.00	0.93	9.7%	10.1%
HSBC HLDGS PLC	HOLD	134.9	GBP	675	800	18%	0.483	0.697	1.028	22.09	15.31	10.38	7.39	8.01	1.44	1.33	9.9%	13.6%
INTESA SANPAOLO	HOLD	33.2	EUR	2.64	3.10	18%	0.249	0.231	0.286	10.60	11.40	9.21	4.69	4.93	0.56	0.54	5.4%	6.4%
LLOYDS BANKING	HOLD	36.4	GBP	49.76	49.00	-2%	-10.34	-2.22	3.60	-4.81	-22.37	13.82	60.61	64.82	0.82	0.77	-3.6%	5.7%
NORDEA BANK AB	BUY	27.7	SEK	67.55	86.60	28%	0.573	0.645	0.774	11.96	10.64	8.86	6.19	6.76	1.11	1.02	10.8%	12.0%
BANCO SANTANDER	HOLD	81.2	EUR	9.87	11.30	14%	1.09	1.14	1.33	9.02	8.69	7.45	9.03	9.82	1.09	1.01	13.1%	14.1%
SVENSKA HAN-A	BUY	12.1	SEK	191.50	250.00	31%	16.46	17.25	19.77	11.64	11.10	9.68	144.17	158.96	1.33	1.20	12.5%	13.0%
STANDARD CHARTER	HOLD	34.2	GBP	1474	1500	2%	1.91	2.25	2.71	12.19	10.36	8.60	15.60	18.41	1.49	1.26	17.2%	17.5%
UNICREDIT SPA	REDUCE	38.6	EUR	2.00	2.00	0%	0.078	0.069	0.160	25.50	28.98	12.51	3.42	3.59	0.58	0.56	2.0%	4.6%
AVERAGE						16%				11.8	9.4	9.7			1.06	0.97	9.1%	11.3%

Source: Matrix Corporate Capital Research

Figure 3: Conventional Valuation Table - Consensus Estimates

Stock name	Matrix Rating	Mcap (€bn)	Curr	Price (local)	Target Price	Upside/Downside	Cons. EPS			Cons. P/E			Cons. BVPS		Cons. P/BV		Cons. ROE	
							FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
BBVA	HOLD	38.0	EUR	10.14	11.60	14%	1.36	1.26	1.47	7.48	8.03	6.90	8.70	9.47	1.17	1.07	15.5%	16.4%
DNB NOR ASA	BUY	13.1	NOK	64.90	86.00	33%	5.91	5.76	7.24	10.99	11.28	8.97	63.81	67.98	1.02	0.95	8.9%	10.7%
HSBC HLDGS PLC	HOLD	134.9	GBP	675	800	18%	0.496	0.683	0.959	21.52	15.62	11.13	7.35	7.95	1.45	1.34	10.4%	13.5%
INTESA SANPAOLO	HOLD	33.2	EUR	2.64	3.10	18%	0.212	0.238	0.327	12.44	11.08	8.07	4.24	4.44	0.62	0.59	6.0%	8.0%
LLOYDS BANKING	HOLD	36.4	GBP	49.76	49.00	-2%	-12.40	-2.10	5.00	-4.01	-23.69	9.95	65.70	70.30	0.76	0.71	-3.1%	8.2%
NORDEA BANK AB	BUY	27.7	SEK	67.55	86.60	28%	0.617	0.488	0.632	11.12	14.05	10.85	5.76	6.16	11.72	10.97	8.7%	10.5%
BANCO SANTANDER	HOLD	81.2	EUR	9.87	11.30	14%	1.06	1.08	1.32	9.29	9.18	7.48	8.77	9.50	1.13	1.04	13.1%	15.3%
SVENSKA HAN-A	BUY	12.1	SEK	191.50	250.00	31%	16.18	15.24	18.01	11.84	12.57	10.63	140.23	150.32	1.37	1.27	11.3%	12.5%
STANDARD CHARTER	HOLD	34.2	GBP	1474	1500	2%	1.71	1.96	2.34	13.65	11.87	9.95	14.16	15.82	1.64	1.47	15.4%	16.4%
UNICREDIT SPA	REDUCE	38.6	EUR	2.00	2.00	0%	0.098	0.125	0.249	20.41	16.00	8.03	3.18	3.36	0.63	0.60	4.1%	7.6%
AVERAGE						16%				11.5	8.6	9.2			2.15	2.00	9.0%	11.9%

Source: Matrix Corporate Capital Research

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Company	Disclosure
Lloyds Banking	None
BBVA	None
Intesa Sanpaolo	None
HSBC	None
DNB NOR	None
Nordea Bank	None
Banco Santander	None
Svenska Han-A	None
Standard Charter	None
Unicredit	None

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