LLOYDS BANKING GROUP PLC– 2023 Q3 IMS – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

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LBG:
William Chalmers, Chief Financial Officer

WILLIAM CHALMERS
Good morning, everybody and thank you for joining our Q3 results call. Let me start with an overview of our key messages on slide 2.

SLIDE 2 – CONSISTENT DELIVERY
We continue to focus on supporting customers as they navigate what remains an uncertain economic environment. In this context, our purpose-driven business model remains central to how we operate as we continue to help Britain prosper.

We are delivering against our strategic ambitions. You saw this in our recent Consumer seminar and will hear more about it in the remaining three seminars, including that of the Corporate and Institutional business next month. Strategic execution is key to realising our ambition of higher, more sustainable returns.

In Q3, the Group, again, delivered a robust financial performance, with a solid income trajectory and capital generation. This allows us to reaffirm our 2023 guidance, and to improve it for the asset quality ratio. Together with our strategic progress, it makes us well positioned to deliver for all our stakeholders.

Let’s turn to the financials on slide 3.

SLIDE 3– CONTINUED ROBUST FINANCIAL PERFORMANCE
As said, Lloyds Banking Group delivered a robust financial performance in the first 9 months of the year.

Statutory profit after tax was £4.3 billion. This is 46 per cent higher than the previous year, however, we should note that the 2022 comparative included an exceptional charge relating to the implementation of IFRS17. Return on tangible equity meanwhile year to date is 16.6 per cent.

Net income of £13.7 billion is up 7 per cent on the prior year. This was supported by a net interest margin of 315 basis points and growth in other income, partly offset by a higher operating lease depreciation charge.

Total costs of £6.8 billion were up 6 per cent, or 5 per cent excluding remediation. This is in line with expectations and reflects our continued strategic investment, as well as the effects of inflation on the cost base.

Asset quality remains resilient. The impairment charge of £849 million is equivalent to an asset quality ratio of 25 basis points year to date. Excluding all MES impacts year to date, the asset quality ratio is 27 basis points.

TNAV per share is up 1.5 pence compared to Q2 at 47.2 pence. Alongside, the Group delivered strong capital generation of 165 basis points, or 129 basis points after regulatory headwinds. We have also substantially agreed the triennial pension valuation, recognising a £250 million remaining deficit.

I will now turn to slide 4, to look at our customer franchise.

SLIDE 4 – ONGOING RESILIENCE IN CUSTOMER FRANCHISE
The customer franchise remains resilient. Total lending balances stand at £452 billion, up £1.4 billion in the quarter. This was driven by a £1.2 billion increase in Retail lending, including growth in the open mortgage book, as well as continued momentum in cards, loans and motor.

The growth in mortgages was driven by strong retention activity as we support customers in refinancing their mortgages in the higher rate environment. The back-book meanwhile continues to rundown and is now £36 billion. We continue to see competitive mortgage pricing. Completion margins are around 50 basis points and we expect that to remain the case in the short-term, exerting margin pressure on refinancing business. That said, mortgage lending remains attractive from a returns and an economic value perspective.

Commercial balances were down slightly by £0.6 billion in the quarter. This includes the effect of FX in the Corporate and Institutional business, offset by ongoing repayments of the Government support scheme loans and limited new lending demand in SME.

On the liability side, total deposits are up £0.5 billion in the third quarter. This includes an increase of £0.7 billion in Retail and stable Commercial deposits.

The Retail deposit performance saw an outflow of £3.2 billion in current accounts, slightly higher than the second quarter.

Importantly, the reduction in current accounts was more than offset by the £3.9 billion inflow in Retail Savings. We continue to recapture a high proportion of current account outflows within our own savings proposition, as well as gaining new customers through our attractive offerings.

Overall, Retail depositor behaviour continues to reflect the higher rate and inflationary environments, as well as the evolving competitive situation, including our own savings offers.

In Commercial Banking, we saw a small reduction in SME deposits, again, focused on non-interest bearing accounts. This was more than offset by growth in targeted sectors within Corporate and Institutional.

Looking forward, we continue to expect total deposits to be broadly stable for the year. However, the mix shift from current accounts to term savings is likely to continue. Whilst difficult to predict with certainty, the rate of this shift is likely to slow over time, albeit remaining a headwind for the margin.

Moving on to slide 5 and Group income.

SLIDE 5 –SOLID INCOME PERFORMANCE

The Group saw solid income growth in the first 9 months of the year. Net income of £13.7 billion is up 7 per cent year on year, supported by net interest income of £10.4 billion, up 10 per cent.

The margin for the first 9 months of the year is 315 basis points. This includes a Q3 margin of 308 basis points, down 6 points from Q2. This is playing out in line with our guidance, given the expected headwinds from mortgage and deposit pricing, partly offset by reinvestment of the structural hedge.

Looking forward, we expect the margin to decline again in Q4, however, again as guided, to remain just above 300 basis points. Based on this we continue to expect a full year margin in excess of 310 basis points.

In the context of the deposit trends that I described earlier, the structural hedge nominal balance reduced to £251 billion. The £4 billion reduction, along with any subsequent reduction in the fourth quarter, is in line with our expectation of a modest reduction in the hedge notional balance over the second half of this year.

Given an average yield of around 1.4 per cent and the current prevailing swap rates, the hedge refinancing continues to provide a material income tailwind. Looking forward we continue to expect hedge income to be around £0.8 billion higher in 2023 than 2022.

Non-banking NII was £76 million in Q3, broadly in-line with the H1 run-rate. From here we expect non-banking NII funding costs to increase further, reflecting the impact of refinancing longer dated funding instruments, as well as increasing levels of activity in a higher rate environment.

Average interest earning assets of £453.5 billion year to date were broadly stable in the quarter. We continue to expect AIEAs for the full year to be slightly down compared to Q4 2022.

Turning briefly to other income. OOI of £3.8 billion in the year to date is up 8 per cent year on year, with broad based growth across all of our divisions.

Q3 saw continued improvement quarter on quarter, in line with our expectations for other income to build gradually. This is supported by customer activity, our ongoing strategic investments and the release of the store of insurance earnings within our CSM liability. Looking forward we expect the fourth quarter outcome to be much like the third.

Operating lease depreciation of £585 million includes £229 million in Q3, up from Q2, reflecting continued normalisation. This is driven by the higher value of new vehicles, lower gains on sale, growth in the Motor business, including from Tusker, and an adjustment to take account of recent price declines in electric vehicles. This normalisation is an ongoing process, meaning we expect to see a further increase in Q4.

Now looking at costs on slide 6.

SLIDE 6 – COSTS IN LINE WITH EXPECTATIONS

Cost management continues to be a critical discipline. Operating costs of £6.7billion are up 5 per cent, driven by planned strategic investments, the costs associated with new business and the impacts of inflation.

The cost income ratio of 49.5 per cent for the first 9 months of the year continues to be highly competitive. Looking forward we stay focused, as always, on efficiency and mitigating the impact of persistent inflation. We remain on track to deliver operating costs of circa £9.1 billion in 2023.

The remediation charge remains low at £134 million for the year to date, largely in relation to pre-existing programmes.

Let me now move on to asset quality on slide 7.

SLIDE 7 – RESILIENT OBSERVED ASSET QUALITY

Asset quality remains very resilient across the Group. The impairment charge of £849 million for the year to date equates to an AQR of 25 basis points. Pre economic forecast adjustments for the year to date, the impairment charge was £918 million, or 27 basis points.

The Q3 charge was £187 million. This includes a release due to updated economic forecasts of £74 million. Excluding this, the observed charge of £261 million reflects the stable credit trends of our prime customer base and our prudent approach to risk.

It also reflects a net calibration benefit of about £70 million from the more resilient than expected performance in the unsecured portfolio. This net benefit in the period should not be seen as part of the underlying run-rate.

The stock of ECL on the balance sheet stands at £5.4 billion, still close to £700 million above our base case and driving strong coverage levels across the portfolio. Given the ongoing resilience of the portfolio, we now expect the asset quality ratio to be less than 30 basis points in 2023. This represents a slight improvement on previous guidance.

Let me now turn to slide 8 to look at the performance across our lending portfolios.

SLIDE 8 – REASSURING PERFORMANCE ACROSS PORTFOLIOS

The performance across our portfolios continues to be reassuring. Importantly, UK mortgages remain resilient. New to arrears increased slightly in the first half, largely within the variable rate legacy book, originated between 2006 to 2008. It is a little too early to call the trend, but new to arrears were then stable in this book in the third quarter.

The unsecured and commercial books meanwhile continue to exhibit very stable arrears and default rates that are broadly at or below pre-pandemic levels. In both cases these are inside of our expectations.

Customer behaviours are similarly reassuring. In retail cards minimum payers are stable. In the Commercial business, we continue to see stable levels of SME overdrafts, and RCF utilisation trends remaining more than 30 per cent below pre-pandemic levels.

Our Commercial portfolio is high quality. Around 90 per cent of SME lending is secured whilst circa 80 per cent of Corporate and Institutional exposure is to investment grade clients.

Within the Commercial business, our net CRE exposure is only £11 billion. The portfolio remains robust and is well diversified, with circa 42 per cent of lending relating to residential investment. The average LTV of the portfolio is 43 per cent, while circa 90 per cent have an LTV below 70.

Let me briefly look at our updated economic assumptions on slide 9.

SLIDE 9 – UPDATED MACROECONOMIC OUTLOOK

The macro outlook has improved a little since Q2. Overall GDP is proving more resilient than expected. We now expect growth in 2023 of 0.4 per cent, compared to our forecast of 0.2 per cent at the half year. We have also reduced our base rate forecast with 5.25 per cent now expected to be the peak.

Our unemployment expectations continue to assume only a gradual build. The peak unemployment rate is revised down to 5.1 per cent. We have also slightly improved our HPI assumptions, now modelling a decline of 5 per cent in 2023 and a peak to trough decline of around 11 per cent.

Let me now move onto slide 10 and address the below the line items and TNAV.

SLIDE 10 – UNDERLYING AND STATUTORY PROFIT CONVERGE, TNAV BUILDING

Underlying and statutory profit continues to converge. Restructuring costs were £69 million for the year to date. The volatility line of £266 million includes £215 million of negative insurance volatility, largely in the second quarter given the increase in rates.

Statutory profit after tax of £4.3 billion resulted in a return on tangible equity of 16.6 per cent for the first 9 months of the year, including 16.9 per cent in Q3. We continue to expect a return on tangible equity greater than 14 per cent for the full year 2023.

Tangible net assets per share at 47.2 pence are up 1.5 pence in the quarter. The increase in the quarter was due to profit accumulation, the lower share count and a reduction in the cash flow hedge reserve, partially offset by the impact of higher long-term gilt yields on the pension accounting surplus.

Turning now to capital generation on slide 11.

SLIDE 11 – CONTINUED STRONG CAPITAL GENERATION

We delivered strong capital generation in the first 9 months of 2023.

Within this, risk weighted assets at £218 billion are £6.8 billion higher, including £2.4 billion in Q3. The increase year to date includes an adjustment for part of the anticipated impact of CRD IV model updates, taken at Q2. Excluding this, lending increases and credit and model calibrations were partly offset by our continued optimisation efforts.

Capital generation was 129 basis points after regulatory headwinds, or 165 basis points before these. This results in a CET1 capital ratio of 14.6 per cent, which includes 65 basis points of dividend accrual and remains well ahead of our ongoing target of around 13.5 per cent.

Going forward, we continue to expect 2023 capital generation, post regulatory headwinds, to be circa 175 basis points.

I am pleased to update that we have now substantially agreed the triennial pensions review. After around £5 billion of contributions, alongside asset performance and rates changes the funding deficit stands at circa £250 million.

Following a closing contribution of this amount by March 2024, there will be no further contributions in this triennial period. This represents a considerable achievement from the 2019 deficit position of £7.3 billion.

Let me finish on slide 12.

SLIDE 12 – CONSISTENT DELIVERY

In summary, the Group delivered a robust financial performance over the first 9 months of the year, with income growth, disciplined cost management and a resilient asset quality, together driving strong capital generation.

Looking forward, we are maintaining our 2023 guidance, and slightly improving it for the asset quality ratio:

- We continue to expect a net interest margin of greater than 310 basis points;
- Operating costs of circa £9.1 billion;
- The Asset quality ratio is now expected to be less than 30 basis points;
- Return on tangible equity of greater than 14 per cent; and
- Capital generation of about 175 basis points.

The Group consistently delivers a robust financial performance, whilst making progress against our strategic ambitions and most importantly, supporting our customers.

That concludes my remarks for this morning. Thank you for listening. I will now hand back to the operator for Q&A.

QUESTION AND ANSWER SESSION

Question 1 – Guy Stebbings, Exane BNP
Morning, William thanks for taking the questions. A couple on deposits and NIM.

So, for NIM trajectory next year, I appreciate you won't want to guide the number at this stage but as you sit here today and you weigh up the tailwinds from the hedge, the headwind from mortgage spreads and the headwinds presumably still from deposit mix shift, how do you think about those factors in the extent to which they could net off or is it more likely that NIM declines sequentially next year?

And then a question specifically on deposits. You alluded to the deposit mix shift slowing. I appreciate forecasting is very challenging on that line but are you seeing any signs at this stage that it is slowing or are you really talking about 2024 and beyond before we can start to think about things improving that. Thank you.

William Chalmers
Thanks very much indeed Guy and obviously both important questions, and so each of those in turn, first of all on the NIM trajectory.

As you rightly said we won't be giving guidance for 2024 but just a step back for a moment in respect of what we have given for 2023. As you know the guidance for 2023 is in excess of 310 basis points, the year as a whole. We are now operating or rather the third quarter is operating at 308 and I mentioned in my comments just now that we expect to see it decline a little again by a similar sort of level really for Q4, but to stay above the 300 level importantly for that quarter.

As we look forward Guy I think it is probably safe to say the headwinds in terms of deposit churn and mortgages pressure from the relatively tight mortgage spreads that we are seeing continue to play themselves out perhaps a little bit further.

I expect over time this will gradually slow down and alongside of that as we get into 2024 the tailwinds in the form of the structural hedge in particular will most probably strengthen a little bit through the course of the year.

So that gives you a bit of insight I hope Guy in terms of the picture that we expect to see in specifically 2023 but then in terms of the way in which the headwinds and the tailwinds play themselves out over the course of 2024. All of that of course will depend upon the rates, upon depositor behaviour upon mortgage margins and the like. But we will fill you in more precisely at year end as to how we expect that to develop.

On deposits Guy we have seen deposits move a little bit during the course of the quarter. Most pleasingly we have seen deposits go up over the course of the third quarter. So, while we have PCA outflows of £3.2 billion those have been more than matched by savings inflows of £3.9 billion in retail for example leading to an increase of £0.7 billion and in commercial banking leading to an increase of £0.1 billion. So, we are really pleased to see that deposit performance, looking at the deposit book as a whole.

Having said that, as you say there have been some churn within the deposit book and so there has been, not surprisingly, and very much as we guided I hope through the course of this year, but not surprisingly in the interest rate environment, some movement from current accounts into savings and indeed within the savings book from instant access where customers are prepared to give up access in exchange for a higher rate in locking up the money into fixed term deposits.

That is in the current rate environment as we said, likely to continue during the course of quarter four. As just said I think it may play itself out a little bit further during a part of 2024 looking forward. And at the moment at least Guy there are ups and downs in the given quarter. I think it would be premature to call a trend at this point. I think we just have to see how things develop and you know as said, what we are focused on is making sure the overall deposit picture remains as strong as it has done during the quarter three.

Guy Stebbings
In terms of the experience going into Q4, I know we are very early in the quarter but has it been sort of similar to what you saw in Q3 in terms of those mix on deposits then?

William Chalmers
I think so, Guy. Again, we don't really want to call a trend based on any particular month during the quarter but you see some months during the quarter perform better. You see some months during the quarter, perhaps because of competitor offers for example, be a little weaker and kind of ebbs and flows during the quarter.

I do think over time what are we going to see? We are going to see a combination of fewer bank base rate changes and therefore fewer prompts to the savers. We are going to see hot money that is going to move, already having moved. We are going to see a forward curve dip down and therefore competitor offers if you like probably dip down with it and therefore less incentive to move. We are going to see most probably the convergence between instant access rates and those on fixed term deposit rates partly for that reason.

And so all of these things Guy I think lead us to believe that over time this churn that we are seeing a little bit of right now is likely to slow. Whether it slows in Q4 or whether it slows in 2024, I think it's difficult right now to be overly precise on this point, but you can get a sense as to kind of how we expect things to develop.

And then to the extent your question is kind of how that influences the margin going forward as said, I suspect the headwinds have a little bit to playout in the first half of 2024. I suspect the tailwind gathers strength during the second half of 2024, principally off the back of the structural hedge. So those are the kind of ingredients that I look out for Guy.

Guy Stebbings
That's great, thank you.

William Chalmers
Thank you.

Question 2 – Jason Napier, UBS
Good morning William, thank you for taking my questions.

The first one was just on capital generation that the firm is clearly producing in line with plan and looking like it is going to be strongly distributable. I wonder could you just talk please about the ongoing work that you are doing with the PRA on hybrid mortgage models and what the sort of standard deviations there are around capital requirements and how that might impact I guess next year's RWAs.

And then secondly other operating income you know for a long while has been an area of sort of some disappointment and it is looking like it's performing really well, but heard you guided for flat in Q4. I just wondered if there is any colour you might add on what sort of natural growth you get into next year from the investments, the acquisitions or maybe some sense as to at what rate the overall market in which you operate you know is growing at the moment and whether we could bank on reasonable sustained momentum into next year in that line item? Thank you.

William Chalmers
Thanks Jason. Two questions there, CRD IV and other operating income Jason. CRD IV as said the discussions with the PRA are ongoing in respect of principally the mortgage models and how those develop looking forward.

We are doing currently further analysis and indeed model development. As you know we took £3 billion of CRD IV RWAs in H1. It is likely as we said in our public documents today that that discussion will develop and therefore off the back of that, I think quite likely that further CRD IV or RWA impacts come to pass over the course of the current, of the future periods.

It is also likely there is a phase over time and so as a result Jason we will aim to manage them. We will also aim to offset them to the extent that we can. As you know we have got guidance out there in respect of 2024 RWAs – 220-225. Now I very much hope that we are able to manage CRD IV pressures within that existing time frame. So you know we will update that more fully at year end as we always do. But hopefully that gives you an impression as to where we are with CRD IV, dialogue with the PRA. The fact that we hope over time to be able to manage the CRD IV RWA pressures within our existing guidance.

On the topic of OOI Jason, as you say it's pleasing to see some growth in respect of OOI. A couple of points really to make there. One is we are seeing it across all of our different business areas. So for example if you look at retail you will see it in the context of current account development. You will see it in the context of cards. You will see it in the context of transport.

If you look at the commercial business you will see it in the context of the growth within corporate institutional financing of bond issues and the like along with market trends as well. And if you look at the insurance business for example you will see some developments in terms of not just net new money but also propositions like the work based proposition there too.

So, brilliant across the board strength in terms of OOI which is good to see. What is driving that? I think it is a combination of organic customer activity which is you know still rebuilding to an extent, post pandemic. And some of the propositions that we are putting out there we hope are very competitive and that is what is being brought out by the numbers if you like.

Alongside of that Jason what is driving it is our organic and inorganic investments. The organic ones being very much consistent with the strategy that Charlie and I laid out in 2022 and the inorganic ones you are familiar with, Tusker is a good example at the beginning of this year which is performing very well in terms of building that business.

As we look forward Jason those same trends we believe are going to inform OOI growth over the course of not just this year 2023, but also going into 2024. And so you know I don't want to put a number on it clearly for 2024 at the moment but the growth that we have seen of eight or nine per cent in 2023 feels reasonably solid and I would expect to make further progress during the course of 2024 looking forward.

Final caveat there Jason, it is of course as ever activity dependent, it always is with other operating income. But I think the foundations feel pretty solid.

Jason Napier
Thank you, that's helpful.

William Chalmers
Thanks Jason.

Question 3 – Jonathan Pierce, Numis
Good morning William. Thanks for taking the questions, I have got two again.

The first is on the capital position because based on your guidance for generation in the full year, less a little bit of the dividend accrual in the fourth quarter, I think you will land at about 14.8 or 14.9 on CET1 ratio. So this is obviously significant excess to the target.

So wondering where you feel comfortable operating that in the medium term. We came into this year I think pro-forma for the buybacks 14.1 per cent, which again is ahead of your target. But I am also thinking about this in the context of, if the target if 13.5 per cent, the low point if you like is when you announced the buybacks at the start of the year and for the remaining twelve months you operate considerably in excess of that target.

I suppose the question is how quickly can we expect you to get down to 13.5 per cent pro-forma for the buybacks. Could it happen in February 2024?

The second question is on deposit margin and clearly there's a huge debate at the moment raging on the headwinds and the tailwinds. But if I just step back from it, you produced good disclosure at the interim results, the deposit margin including the impact of the hedge costs which is effectively what it is.

I think your number at H1 was 1.34 per cent. So accepting that it is not quite clear whether it goes up a bit, goes down a bit in the next six to twelve months depending on deposit migration. In the medium term is it your view that earning 130 basis points on deposits in an environment where base rate is 4 or 5 per cent, is too low and that number will go up. And is it a core part of the RoTE target by the time we get into 2026? Thanks a lot.

William Chalmers
Thank you Jonathan, again important questions. The capital guidance first of all as you commented on, the capital guidance that we have out there is 13.5 per cent. That is the target capital ratio for the bank. When we look at the capital ratio today, as you know 14.6 per cent is the print that is coming off of Q3. And as you alluded to that is likely to lead to a decent capital position at year end.

A couple of points on that, one is we are very committed to capital repatriation. The two components of that as you know Jonathan have been a progressive and sustainable dividend. We increased it by 15 per cent at the interim. I would be confident in expecting that to continue at the full year and I look forward to continued progressive and sustainable dividend growth thereafter.

Alongside of that at the end of every year we will consider the excess capital position above and beyond our target capital ratios and taking account of you know all kinds of external and internal factors. And it is really for the Board to decide at that point, but you have seen the commitment that we have in the context of buybacks in previous years. And you know not wanting to in any sense pre-empt that debate, I am sure we will have a debate over what to do with excess capital at the end of this year.

So that is point one, you asked specifically within capital guidance how we see if you like coming down closer to our target of 13.5 per cent and I think it is a relevant point. In short we have committed to get to 13.5 per cent by the end of 2024. Now at the beginning of this year we were 14 per cent. I think we would aim to deliver a relatively smooth capital trajectory down to 13.5 by the end of 2024 which in turn probably means chipping away a little below 14 per cent by the end of this year, you know we will see, but that would be my broad expectation, and then arriving in a kind of fairly linear fashion at 13.5 per cent by the end of 2024. So hopefully that gives you some idea of how we think about it.

The deposit margin point, it is an important one. You know as said we are seeing a bit of churn in terms of the book over the course of this year. It is entirely consistent with the expectations that we had of this interest rate environment and indeed I hope the guidance we have given to the market through the course of the year. Likely as said we see that continue a little bit during the course of Q4. And then I expect over time it is hard to be too precise on when, that comes to slow down if you like and at some point presumably comes to an end.

Now within that context as you say we have the structural hedge refinancing going on and that remains no matter what the deposit churn really does and no matter whether or not there is any modest reduction in the structural hedge. A very strong tailwind for the income profile of the business. You gave a number there in terms of the structural hedge yield as an example of that and how it's strengthening Jonathan.

So what we had within Q3 was a yield on the structural hedge of about 1.35 per cent or thereabouts. What we expect to have for the remainder of this year is a building of that yield into more like 1.4 or 1.5 per cent territory and then it builds again during the course of 2024 into kind of above 1.6 territory. I won't be more precise beyond that but it is a kind of you know 1.6 plus type territory going forward.

That is off the back of some £40 billion of hedge refinancing that comes due during the course of 2024 which you know as I said earlier on provides quite a strong tailwind particularly in the second half of the year in the overall margins of the business.

So you know I am pretty confident as we sit here today that the strength of that structural hedge refinancing tailwind is likely in due course to outweigh the effect of any headwinds that we may get in the meantime from the deposit turn that we are seeing. And that's the balance of things and I think Jonathan over time for the final point, that is going to deliver the type of income and ultimately operating leverage that allows us to deliver a stronger RoTE and in turn a stronger capital return in the period looking forward, particularly looking forward 2025, 2026 time frame.

Jonathan Pierce
Okay that's really helpful and sorry just one supplementary, the hedge maturities next year, is that evenly spread across the four quarters or is there a lumpy profile again?

William Chalmers
It is, there is a bit of a backend weighting Jonathan, it is not terribly acute but I think there is a bit of a skew towards the backend. So that is partly what is informing my comments around the margins in the questions earlier on.

Jonathan Pierce
Okay, thanks William.

Question 4 – Ben Toms, RBC
Morning William, thank you for taking my questions. Firstly on the structural hedge, you reiterated your modest single digit reduction in the hedge notional in H2 2023. Do you believe that you can hold onto your non interest bearing deposits better than peers and therefore should we be modelling less of a reduction in the Lloyds structural hedge notional going forward relative to our views in the sector as a whole. I guess the buffer you have over the balance sheet notional might also play a role here.

And then secondly in relation to your pension deficit funding, a reduction that you announced today, with only a £250 million contribution expected in Q1 2024. Will that have a bearing on your capital generation guidance of a 175 basis points for FY24? Just trying to get a feeling of how baked in this good news is to the existing financial plan. Thank you.

William Chalmers
Thank you Ben, again both important questions.

In terms of the structural hedge, maybe I will just start with 2023, the structural hedge guidance that we gave at the half year is for a modest reduction and that continues to be the case if you like. I don't think there is any change to the guidance we gave at the half year in respect to that. You have seen the nominal balance come down about £4 billion during the course of quarter three. It might come down by something similar during the course of quarter four, you know let's see. But I think something broadly similar would be expected and indeed the combination of those two added together, that is what led us to our modest notional reduction that we gave at the half year guidance.

I think looking forward it won't surprise you to know Ben we are not going to be specific today at least on guidance for the structural hedge going forward. We certainly will be at the tail end of the year as we always are. But looking forward what do we expect to see?

I think if you see a continuation of the churn albeit at some point no doubt a slowing. Then off the back of that, that is what drives the structural hedge behaviour and so it would be reasonable to expect I guess some similar type of activity in the context of 2024. But you know let's see how rates play out, let's see how customer behaviours play out. And that in turn will inform how we manage the structural hedge looking forward.

You asked about our performance versus others and how we see the stickiness of our deposit base. Obviously I can't comment on a relative basis but I can comment in terms of how we see the deposit base at Lloyds Banking Group develop, and maybe a couple of points to make there.

I think one is we have invested heavily in terms of customer contact strategies and so we do work hard to identify where customers might move, how they might move, what it is they are looking for in terms of interest versus access trade offs, that sort of thing.

A lot of it is digitised and I hope that that allows us to manage the deposit performance as best we can. Nothing is ever going to be perfect to be clear but nonetheless I think those types of investment are important.

Alongside of that we have a variety of different products with hopefully competitive offers out there. Some of them are structural hedge eligible even though they are savings offers and so not just instant access but we have developed other products that are not fixed term, so called limited withdrawal products that in turn our structural hedge eligible that gives customers a choice if they want to go for a compromise between higher rates number one, but also some degree of access number two, that type of product allows them to do it and in turn that also allows us to keep the balances on the structural hedge, as it is predictable and so forth.

So that combined with the customer contacts strategies that we have, i.e., offers and products, means we hope it allows us to manage the deposit base successfully.

I think final point Ben is you know we have got a very broad based customer profile across the UK. It is a very broad franchise, great diversified franchise. In that sense you know our deposit base and the behaviour of the deposit base is driven by that type of characteristic. So you know maybe there is something in that. Hopefully that addresses the structural hedge deposit questions.

On the capital question Ben it is a good question. When we look at the position on capital we have given very clear guidance in respect to 2023 and even respect to 2024.

I am not going to comment today specifically on 2024 beyond what I have just said, but I think on capital guidance as always in all years we just try to be clear and consistent. We don’t typically disclose all the moving pieces of capital, indeed it is quite a complex picture.

At the same time you are aware of the income and the P&L trends that we have given and discussed in part again this morning. It is very clear that the pension deficit reduction is a positive for capital, certainly for the remainder of this year, certainly for next year and indeed looking forward.

At the same time there are some uncertainties in the context of the capital position and they will play themselves out. So for example we have made an allotment for CRD IV for RWA increases next year. But there is some uncertainty about whether the PRA will increase RWA’s more than we expect.

We don’t expect that clearly because our base case we have allowed for, but there is some uncertainly there. Likewise there is some possible capital refinancing that we will consider over the course of 2024.

And then finally there is some share based payments where in the past we have been able to issue shares. We are now coming up against some of the limits to those and those will require purchasing shares on the market in exchange for compensation plans and the like. And so these are examples really of the types of uncertainties that we look into in the capital build. And that is why Ben when we set back what we want to do is just to provide something that is clear and predictable from your perspective of a hundred and seventy-five basis points for this year and for next.

Final point then that I will make is that let’s not forget that it is a very strong capital build. That allows us to deliver both a progressive and sustainable dividend of 15 per cent up this year. I will be very, very hopeful of a decent increase in the dividends next year I will leave that to the board to decide at that point.

And alongside of that you have seen our performance on the buyback. So you know let’s make no mistake about that. 175 basis points, that is a very strong capital performance that allows us to deliver a decent yield for all of our investors.

Ben Toms
Thank you.

William Chalmers
Thanks Ben.

Question 5 – Chris Cant, Autonomous
Good morning. Thanks for taking my questions. Two on revenue related issues please. Just going back to your strategic plan guidance from a couple of years ago and conscious of comments you were making around the strength of the other income line looking into 2024. At that strategic update you said there would be about £0.7 billion of revenues generated incrementally from sort of organic, inorganic initiatives across

2022 to 2024. How much of that do you think is captured in the run rate that we are seeing today versus how much is still to come into 2024 please, just be interested to get an update on your thinking around that piece now that we are towards the end of that three year window.

And then on the NIM if I could just come back to that from what you have said you know the Q4 NIM is just going to be a shade above three and I guess if we were looking at that NIM ratio given the trends through the second half, the December NIM or the end of the year NIM I guess implicitly is going to be a bit below three. Looking into the first half of 2024 and you have indicated then that there maybe some net pressures through the initial portion of 2024, but potentially offset a little bit towards the back end of 2024.

So it feels like we should be thinking about a NIM for 2024 at least starting below three, is that the right influence to draw at the beginning of the year? And then we can sort of make our own mind up as to whether you managed to sort of pull back from that level. Thank you.

William Chalmers
Thanks Chris. In respect of OOI, as you say there has been a decent performance in OOI, I would say actually quite a strong performance in OOI so £1.29 billion during the course of Quarter three, so far year to date £3.8 billion.

That is an improvement of around 8 per cent year on year. I think if you scratched beneath the surface and say what are the kind of one offs and so forth so you see in OOI, which you sometimes do, for example, weather benefits, or for that matter weather costs in general insurance for example. You know likewise some lumpiness that you see from time. Actually the underlying is looking pretty similar so the underlying is probably also 8 or 9 per cent year on year the way that we look at it. Once you take out any kind of one off type effects there.

So on the whole we are pretty comfortable with the OOI performance, in fact I think you know we see it as reasonable and quite positive. We haven't disclosed exactly what the portion of that OOI performance is strategic initiatives that we have seen. We will clearly give full guidance on that delivery point for 2024 and maybe just two comments made on the way there.

One, is we feel very comfortable with the £0.7 billion that we have committed to deliver for 2024 so that is perhaps worth underlining, we feel comfortable with the guidance we have given, we expect to deliver on it when we get to the year end 2024 results.

Secondly it is not particularly linear and that is to say the reason why we are feeling comfortable with it, is we are already seeing signs of decent delivery, but on the other hand because the investments are relatively early and then those investments bear fruit if you like in the period thereafter, it is not strictly linear between where we are now and at the end of 2024.

But again I think the point to take away is we feel very comfortable about it and have got significant kind of runs on the board if you like in respect of that £0.7 billion. We won't be exactly half way Chris but it won't be terribly far off of that when we look at it.

In respect of NIM I will probably just repeat the comments that I made earlier on, which is to say we are not going to give guidance for 2024 and certainly not a kind of quarterly guidance. You have seen our run rate NIM which goes to just above three hundred as I said in my script comments for the final quarter of 2024. And then I think the evolution as said, you know we will see the headwinds play themselves out a little bit during the course of the first half. We will see the tailwinds strengthen a little bit during the course of the second half.

There is one more comment that I might make just to give you some illustration in terms of how those headwinds play themselves out. At the moment we our refinancing mortgage business at around 175 basis points versus mortgage business that we are putting on around 50 basis points. That is a gap of some 120-130 basis points for refinancing mortgages. By the time we get to the backend of 2024 that mortgage business is rolling off at more like 80 basis points. And let's say that mortgage spreads remain the same as they are today. The gap therefore is more like 30 basis points than 130 basis points. So that is just one example of how we see the headwinds play themselves out a little bit during the course of the latter half of 2024. And in exchange I made some comments if you like on the development on the hedge which as said will play itself in more and more during the course of the year.

Chris Cant
Okay, thank you.

William Chalmers
Thank you Chris.

Question 6 – Edward Firth, KBW
Thanks very much and good morning William. I just have two questions I guess. One was I think you mentioned in the script something about funding costs for non interest income going up and I just wanted to check I understood what that meant. Is that the sort of £70-80 million a quarter excluded from the NIM. Are you saying that we should expect that to increase from here or was it something different. Or maybe I misheard. So that was the first question.

And then the second question was about mortgage refinancing. So talking to some of the mortgage brokers they are telling me there is a huge theme at the moment is extension of the term of mortgages so people are managing to effectively keep their monthly bills under control by terming out their mortgages.

So I guess my question is firstly, is that right, so can you give me some sort of idea of what proportion of refinancing are seeing a terming out? And then finally does that come through in forbearance data or not, or do we just see that as a new product and therefore is not really related to the old one? Thanks very much.

William Chalmers
Thanks Ed, a couple of questions there and on NBNII and mortgage refinancing. On the non banking interest income the non banking income we saw in Q3 was about £76 million or so. I expect that to come up a little during the course of Q4 and indeed likely to tick up a little bit again during the course of 2024 I won't be overly precise on that. But what is going on there?

There are two things really going on there. One is around refinancing of existing activity Ed. So insurance, pensions and investments for example, transport for example, LDC for example, likewise commercial banking. These deals if you like are put on financing over a term and then when they come up for refinancing they then reflect the prevailing interest rates.

So for example we have a Motor book which has an average life for three years. Some of that stuff is coming up for refinancing during the course of this year and looking forward. So, that type of thing is an example of renewal of existing facilities into a higher rate environment.

And then circa half of the non banking interest income increase is related to growth within other operating income. So part of it as said related to the higher rate environment but also part of it is financing effectively volume growth within other operating income. And again that will be across the businesses, that will be across commercial, insurance, retail and the like.

So think about these non banking interest income steps if you like as two things. One is refinancing existing business and the second, about the same proportion, is refinancing volume growth in other operating income. And therefore driving if you like benefits within the other operating income lines. I think it is important to see that as a part of the picture here.

The mortgage refinancing Ed, the extension of term, there has been a little bit of that in the market but for us it is a pretty small, in fact I will go further actually and say a very small part of the overall business. It is not forbearance, to be very clear in response to your question, and it is overall, from our perspective, a very small part of the refinancing part of the business.

I would step back actually and say you know when we looked at the mortgage performance in terms of asset quality over the course of quarter three, we have scratched significantly beneath the surface if you like to really have a look at what is going on within the mortgage business. And it is that work that allows us to step back and say actually we have seen some really good signs of stability within the mortgage business. The vast bulk of the portfolios was always doing pretty well and continues to do pretty well despite economically slightly more challenging times. The area where we have been seeing an uptick in new to arrears is basically the 2006 to 2008 originations and within that a relatively small pocket of it. That has now been stable during the course of Q3.

As I said in my comment, perhaps it is a little early to call it a trend, but nonetheless we are pleased to see that stability in the context of what overall is a very well performing, very strongly performing mortgage book.

Edward Firth
Great, thanks very much.

William Chalmers
Thanks Ed.

Question 7 – Rohith Chandra-Rajan, Bank of America
Thank you, morning William. I just have a couple of quick follow-ups on NII if that's okay please. The first one was just on the deposits, you have done a very good job on retaining deposits in what has been a very competitive market. I was just wondering if there is any difference in the cost of those deposits than you were anticipating.

And then the second one is just on the margins. Just to clarify, really, your previous comments. I think based on what you have said to us so far you are indicating a similar sort of margin decline in Q4 as in Q3 and also with a similar mix of the drivers that you show in the NIM bridge in slide 5. I Just want to check if this is the case. Thank you.

William Chalmers
Thanks Rohith. I think two questions there, NII and particularly the relationship of deposits and then Q4 margin performance as a whole.

The NII in terms of deposits. When we set out the guidance earlier on this year and then went through the course of Q1 and Q2, we certainly anticipated the type of deposit movements that we have seen. I think that concept if you like, those flows in the context of the rate environment that we saw, were themselves, not terribly surprising. Your question was are we seeing a difference in the cost of deposits versus those expectations. I am not so sure we are terribly much Rohith. What you do see is obviously when a deposit moves from instant access to fixed term for example or for that matter from PCA into savings. That itself causes an increase in the cost of holding that deposit.

So it is less about the price of new offers that you put out to customers if you like. It is more about the flows within the book that you see and those driving differences in terms of costs of holding deposits. So that piece is going on but as said I think the overall flows are more or less in line with our expectations.

I would say within any given quarter as I mentioned earlier on, you are going to see ebbs and flows and they will depend upon competitive offers for example at any given point in time. But overall if you like I think the patterns that we are seeing I think the margin effect of those are more or less in line with our overall guidance at the beginning of the year and expectations in the context of the environment that we are in.

Your second question Rohith in terms of Q4. The Q4 margin reduction that we see, as said by quantum we think it is likely to be similar, give or take a few basis points or so, to the type of margin reduction that we saw in Q3. In terms of the sources of that margin reduction to your question, I think broadly similar would be my expectation. I mean I think as you look at the mortgage yields that we see in Q4 for example, the business that is rolling off, and let's say spreads remain the same for the moment, that looks pretty similar to me.

Likewise you know I think the deposit churn, I think it's got a little bit to play out as I mentioned earlier on, we expect to see a bit of that, again suggesting a similar pattern. And we have got about £12 billion of hedges for the remainder of this year Rohith. Those will be at different yields, however nonetheless we have about £12 billion of hedges. So again I think a broadly similar pattern we would expect to see driven by basically similar things Rohith.

Rohith Chandra-Rajan
Okay that's great, thank you.

William Chalmers
Thank you.

Question 8 – Andrew Coombs, Citi
Good morning thank you, I have a kind of simple numbers question and a bigger picture strategic question. And for the numbers question, you talked about the hedge being at a 1.4 per cent rate. So presumably the positions rolling off next year will be lower than that. So perhaps you could just provide some quantification of that.

My bigger picture question is you talked about your customer contact strategy. Clearly your retention has been very strong in the quarter. You have some unique models compared to the others. So I take your instant access savers, you have an advantage saver which offers up to 4 per cent subject to withdrawal restrictions.

So that then reverses after one year onto the standard saver which offers a max of 1.9 per cent. So to some extent you are more reliant on customer inertia then perhaps some of your peers. And I appreciate that these are both on sale products but given in the consumer duty review they had specifically talked about some on sale products having higher rates due to introduction, bonus rates and then reverting into a lower rate under different product names, and this specifically flags that, do you think that the business models that you have may come under review in the coming year? Thank you.

William Chalmers
Thanks Andrew. Just to take each of those in order. The Q3 yield I mentioned on the structural hedge is about 1.35 per cent. So that gives you an idea of the Q3 yield. I didn't give a precise number on the 2024 yield for the hedge but I said that it was above 1.6 per cent.

So you know safe to say that it is around kind of 1.6, 1.7 per cent type range. That combined with the fact that we have got about £40 billion of hedges rolling off during the course of next year Andrew, hopefully gives you enough to kind of work out the answer to your question. I'll leave you to do the maths as it were, but nonetheless that should give you some insight.

Andrew Coombs
Sorry the 1.6 is the blend across the whole portfolio including the new positions you are putting on now right?

William Chalmers
Yes I would stress above 1.6 Andrew so you know I haven't given you a number but I have said between 1.6 and 1.7 let's say. And so that is the average yield on the structural hedge portfolio during the year. And then as you will understand I am sure it then continues to pick up not just within the year but also then in subsequent years thereafter going back to our earlier conversation.

Andrew Coombs
Right got it, thank you.

William Chalmers
I will make one more comment about that, which I guess you probably expect from me, but that all delivers a very strong tailwind for income for the structural hedge. This year clearly, next year clearly and the year beyond that.

On the deposit front Andrew two comments to kick off with and I will give you a bit more detail. One is yes I feel very comfortable with our deposits model. In fact you know the proof is in the numbers. We have attracted £0.5 billion growth in deposits during the course of Quarter three. I think that says as much as anything actually about whether the depositors want to come to us or not. Not just within the retail business but also across the commercial business too.

Second Andrew before going into detail, I am pleased to hear that you have such a detailed knowledge of our investment accounts and savings offers. I hope that also means that you are a customer but I will leave you to answer that if you wish.

The reason why I feel comfortable with our model Andrew is because we have an incredibly extensive customer contact programme quite a long way, in fact a very long way from the customer inertia that you suggest there. We have actually contacted over ten million customers about savings options this year. We have increased rates nine times in our accounts this year.

We have a 192 per cent increase in savings accounts opened this year versus last year. We have had a 375 per cent growth in ISA's opened this year. I could go on Andrew but we have a very proactive customer contacts strategy in respect of our customers and delivering them with offers that make sense from their perspective for price and for access and bringing in other considerations that they may have.

So you know far from it being a model that arises from customer inertia, it is a pro-active outreach strategy. What it is, is a deposit strategy that was invested in consistently over time with that customer contact in mind. And as I say it is a deposit performance at the end of the day that reflects the strength of the franchise.

Andrew Coombs
Very clear thank you.

William Chalmers
Thanks Andrew.

Question 9 - Aman Rakkar, Bank of America
Hi William, I hope you can hear me okay. I have just two questions please, firstly on deposits. So thank you very much for the various bits of colour. But one thing that is missing is if you could tell us your proportion of deposits that are term deposits please.

I know that I have previously tried to ask you this question, and that you have kind of resisted in answering but I think it is a really, really important input into the analysis going forward and I think it is an important input to kind of really assess how impressive the deposit performance is in the course of the quarter.

The face value is a very resilient retail deposit print but I think we need to know the term deposit mix indeed, actually you know Lloyds might be the only bank in the UK that is not telling us what the mix of term deposits is. So what is your mix of term deposits and please could you let us know how that has changed sequentially? This is question one.

And then the second question is on mortgages, mortgage spreads in particular. And I was interested in your view around the near to medium term outlook for mortgage spreads. I guess this is a system that is repricing deposits quite meaningfully across the system and some competitors are pricing quicker than others.

You obviously also have some banks that are you know looking down the barrel of an increase in funding costs. I would have thought that this might be the kind of thing that could nudge assets both higher from here and asset pricing higher. So given your unique vantage point, I was interested if that is a reasonable assertion and is that something that you would be looking to kind of do? Thank you.

William Chalmers
Thank you Aman, thanks for both of your questions. As you say we haven't really given the split within our deposit working in the past. It is just not something that we necessarily disclose. You know others will do what suits them. We don't necessarily do the same, having said that your imploring has slightly got the better of me.

So I will give you some very rough insights if you like into the make-up of the book. But then I won't give you any more and you can kind of make of them what you will. But if you look at the fixed part of the overall retail savings book, just the retail savings component, knock off the PCA's instant access. If you are looking at term deposits there, somewhere between 20 to 25 per cent of that savings book. Now when you look at that analysis Aman and try to work with it don't forget that we also have a proportion of our savings book which is clearly instant access for sure. But we also have a portion of our savings book which is so called limited withdrawal which is a product that I mentioned earlier on.

So it may be in contrast to others, I don't know, but there are at least three components in our savings book that you have to think about when you think about the way in which the book is evolving and then the analysis that you get off the back of that. So I will give you that Aman, I don't think I am going to go any further but hopefully that is helpful.

On the mortgage pricing spreads point, I think your point is a very interesting one actually. In our view at least it doesn't necessarily seem to be the case that 50 basis points is the equilibrium state for mortgage pricing. Why do I say that, because that 50 basis points is driven by market conditions.

That is to say that product transfer is well below 50 basis points. New business is worth above 50 basis points. So any moment in time when you get a pick up in terms of volumes in the mortgage market, it is quite likely that it will drag the spread upwards in terms of the overall completions margins for the mortgage product as a whole.

So I think there is that gravitational pull that will depend upon the status of the market. In lean times like now you have got product transfers exerting a downward pressure on completions spreads. Clearly as the mortgage market picks up and it no doubt will do, that in turn will provide a different impetus.

The second point why I don't think 50 basis points is necessarily the equilibrium. Is there are just as you said Aman a lot of things going on not just in the deposit market but also in the macro.

So what is the effect of QT going to do overtime and how is that going to drive tightness in terms of the liabilities in the banking system. And off the back of that what does that do to mortgage spreads in an environment where, if you like, the cost of funding is going up reflecting that factor.

So I think there are some structural factors there which might drive spreads up over time. But having said that Aman being too precise as to exactly when that is likely to take place, I think that is challenging and that is why in turn for the margin guidance that we have given you for this year of greater than 310. We continue to plan on a fifty basis points spread or there abouts Aman and you know going forward when we are giving guidance at the year end, again we will be cautious about how this develops. So we don't get too far ahead of ourselves.

Aman Rakkar
Thank you so much William, I really appreciate you engaging with those questions. Is there any chance you could let us know how that make up of the 20 to 25 per cent has changed sequentially, does that move a lot Q2 versus Q3?

William Chalmers
No, Aman you've exhausted my generosity I'm afraid.

Aman Rakkar
Fair enough, thank you very much, appreciate it.

William Chalmers
Thank you very much indeed. Just to say thank you very much indeed to everybody for joining us this morning and have a good day.

END

FORWARD LOOKING STATEMENTS

This document contains certain forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Banking Group plc together with its subsidiaries (the Group) and its current goals and expectations. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. 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