LLOYDS BANKING GROUP PLC – Q1 2013 INTERIM MANAGEMENT STATEMENT

TUESDAY 30 APRIL 2013

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us for our Q1 results call. I will begin by giving an overview of the further strong progress we have made on our strategy.

Turning to slide 1, for those of you who are following the website presentation. We have delivered a strong performance in the first quarter, with significant progress in many key areas despite a challenging environment. Profits, both at Group level and in the core business, have improved substantially. At the same time our net interest margin increased as we expected, and costs and impairments continue to fall.

Importantly, our core loan book returned to growth in the first quarter, earlier than we expected. This was driven by growth in lending to business clients, providing further evidence of our support for the UK economic recovery.

So the momentum we built in 2012 has continued and increased into the first quarter, and in a number of areas we now expect to deliver ahead of the guidance we set at the year-end results, as you will hear soon.

I have spoken before about our very strong core franchise and we further increased profitability in the core, driven by increased cost efficiencies and a further reduction in impairments. Our core returns remain substantially above the cost of equity.

We have also continued to make substantial reductions to our non-core portfolio, with a £9 billion reduction on a constant currency basis for the first quarter, or £6 billion after currency effects.

And, as you have seen, we have made further progress since the quarter end, with the agreement to sell our Spanish retail operations to Banco Sabadell, which we announced yesterday, reducing non-core assets by a further £1.5 billion.

As regards to capital, we remain confident in our capital position as we have a strongly capital generative business and have further strengthened our capital generation, driven by our core underlying profitability and also the sale of a 20 per cent stake in St James's Place.

We continue to address legacy issues, as you will hear from George, and on PPI we have seen a substantial fall in complaint volumes, as expected.

On Verde, we are disappointed that The Co-operative Group decided that they can no longer proceed with the purchase of the business given their view of regulatory and economic circumstances. As a result we are now progressing towards an IPO, our Plan B, and an option we have maintained from the outset.

Turning now to an overview of financial performance on slide 2. Compared to the first quarter of last year, we delivered a substantial increase in underlying profit from £500 million to £1.5 billion which includes a gain of around £400 million from the sale of a 20 per cent stake in St James's Place. Similarly, statutory profit increased from £280 million to £2 billion, including around £780 million of gains on further gilts sales.

We saw a further increase in the net interest margin of 2 basis points to 1.96 per cent in the quarter, and we remain on track to reach our target of around 1.98 per cent for the full year.

We have reduced Group costs by 6 per cent compared to last year and we saw run-rate savings from Simplification increase to over £1 billion by the end of the quarter.

Group impairments fell by 40 per cent and non-core impairments fell by 59 per cent. These significant improvements have been primarily driven by our progress in reducing the non-core book ahead of plan.

Group returns improved substantially as a result, and core returns remain significantly above our cost of equity.

Turning now to the balance sheet on slide 3. Our customer deposits continue to grow, with our Group loan to deposit ratio falling 2 percentage points to 119 per cent, now below the 2014 target set out at the strategic review, and the core ratio has now reached our revised target of 100 per cent as set out last year.

On non-core assets, with the progress we have seen in the quarter, we remain confident of achieving our target of a reduction of at least £20 billion in 2013 and now expect to comfortably meet our target of £70 billion or less by the end of 2014, with less than £35 billion in non retail assets and done in a capital accretive way.

We remain a strongly capital generative business. In the first quarter our core tier 1 ratio improved to 12.5 per cent, and on a fully loaded basis we generated 60 basis points of capital, offsetting the impact in January this year from the change in pension accounting rules, leaving our fully loaded ratio unchanged at 8.1 per cent.

Turning now to slide 4 and the support we are giving to our customers and the UK economy. I highlighted earlier that we grew our core loan book in the first quarter, ahead of expectations, and that this growth was primarily driven by lending to our business clients.

We continue to support the UK economy through a number of Government schemes and were pleased with the Government's decision to extend the Funding for Lending by a year to January 2015. The Government see Funding for Lending as a key way to help small and medium sized businesses which are at the heart of the British economy and our strategy is aligned to this.

One specific example is our support of small and mid-sized clients in the Manufacturing sector where having achieved £700 million in total in the last six months, we now expect to exceed our target of £1 billion of lending by September, as we are running ahead of plan.

In SMEs, over the last 12 months our lending has grown 4 per cent against a market which contracted 4 per cent, and so far this year we have supported more than 32,000 start-ups.

In Retail, we continue to be the UK's largest lender to first-time buyers, providing one in four with mortgages. We remain committed to helping 60,000 customers buy their first home in 2013 and made good progress towards this goal in the first quarter.

We also announced recently that we will further support customers through our participation in the Help to Buy scheme that was outlined in the 2013 Budget, which we believe will be an important stimulus for the housing market and the construction sector.

In summary, we remain committed to going further to help our customers, and to help Britain prosper. We delivered on this in both 2011 and 2012, and the initiatives I have just outlined show that we are continuing to do so, and more, in 2013.

And now I will hand you over to George to consider the financials in more detail.

George Culmer, Group Finance Director

Thank you António and good morning everyone. As already mentioned and as shown on slide 5, we delivered a substantial improvement in performance in the first three months of 2013, with a £1 billion increase in Group underlying profit to £1.5 billion. This reflects a 19 per cent increase in core profits to £1.9 billion, including £0.4 billion from the partial sale of St James's Place, and a 64 per cent reduction in non-core losses to £392 million.

Statutory profit before tax increased by £1.8 billion to £2 billion, driven by the increase in underlying profit, and asset sales and volatile items of £1.1 billion.

Asset sales include gains on sales of Government securities of £776 million, and we have now completed the repositioning of our Gilt portfolio, and don't expect a material level of gilt sales going forward.

Volatile items include the positive effect of insurance volatility, caused by movements in financial markets. This totalled £462 million, largely reflecting the rise in equity markets in the period.

Also included in statutory profit were Verde and Simplification costs of £409 million. Verde costs in the first quarter were £195 million, while Simplification spend was £214 million. We have now realised run-rate savings of over £1 billion from Simplification, with a ratio of spend to savings achieved of almost one to one.

Looking at the drivers of underlying profit on slide 6. Core income in the first quarter was £4.6 billion, up 7 per cent year-on-year. This includes the £394 million gain from St. James's Place, which also drove the 15 per cent increase in core other income. Excluding St. James's Place gain, core other income was 6 per cent lower than in Q1 last year, although down just 3 per cent on Q4 2012 excluding the insurance claims, the continued growth in Commercial Banking offset by the Q4 benefit of Insurance assumption changes.

Core net interest income was stable compared with Q1 2012 as the impact of the 3 per cent reduction in average interest earning assets over the year was mostly offset by the 2 basis point improvement in net interest margin, which was 2.34 per cent for the core, and, when combined with 44 basis points for the non-core, gives 1.96 per cent for the Group as a whole.

On slide 7 we've set out the drivers of margin in more detail. The positive trend in Group and core reflects the benefits of improved deposit margin, primarily driven by the repricing of Retail deposits, and of online deposits in Wealth, as well as Asset Finance and International.

This more than offset lower asset margins, and the expected lower returns on our structural hedge and from lower income as a result of government bond sales. As I said at the year end, we expect the structural hedge and the gilts to have a negative effect on Group margin of around 6 basis points and 8 basis points respectively in the 2013 full year.

Looking briefly at costs on slide 8. We have delivered a reduction of 6 per cent in total costs driven by savings from our Simplification programme where run rate savings have now passed the £1 billion mark, an increase of £160 million since the start of the year.

We are updating our full year cost guidance and now expect costs to be around £9.6 billion for 2013, compared with previous guidance of £9.8 billion, driven by further cost savings and the effect of the deconsolidation of St. James's Place, which will reduce costs by around £0.1 billion.

We are now also targeting a further cost reduction to around £9.15 billion in 2014, reflecting Simplification and other savings, and assuming, subject to regulatory approvals, a mid-year IPO of Verde.

On impairments on slide 9, as in 2012, our prudent risk appetite and strong management controls continue to drive an improvement in portfolio and asset quality. Group impairments of £1 billion were down 40 per cent year on year. This was mainly driven by the 59 per cent decrease in non-core impairment, with substantial reductions in the Commercial Banking and International portfolios.

For the core, we saw a 14 per cent reduction compared to the fourth quarter of last year, while the increase compared with Q1 2012 was primarily attributable to a provision release in Commercial Banking in the first quarter of last year.

In terms of AQR, for the Group this reduced to 80 basis points, while for the Core it remains low at around 50 basis points, at the lower end of our long-term target for the Group.

On PPI on slide 10, we have taken no further provision in the first quarter. The volume of PPI complaints has continued to fall in line with expectations with average weekly complaints now running at approximately 15,000. This is down 28 per cent on Q4, and has more than halved from Q2 last year.

Total costs incurred in Q1 were £586 million, including approximately £180 million of related expenses. We now expect costs in the first half to be marginally higher than thought at the year end. This is due to the acceleration on our initiative of the settlement of cases currently held with the Financial Ombudsman Service, and some one-off VAT payments. As previously said, we continue to expect monthly costs to decline in the second half of the year.

Moving on to the balance sheet on slide 11. We continue to hold a strong balance sheet. During the quarter, we continued to grow deposits, reduce our non-core assets and utilise surplus liquidity to further reduce wholesale funding by £8 billion, and repay £8 billion of our LTRO funding from the European Central Bank.

Looking at the non-core reduction in more detail on slide 12. During Q1, as you heard, we delivered a further reduction in non-core assets of £9 billion at constant exchange, or £6 billion after FX, of which only half a billion was from impairment. And this reduction was again achieved in a capital accretive manner.

This decrease was primarily driven by the disposal of non-retail assets, and comprised reductions of £3 billion in treasury assets, £2 billion in UK commercial real estate and around half a billion each in our Irish, asset finance, acquisition finance, and shipping portfolios.

We continue to reduce the risk profile of the non-core portfolio, and the 16 per cent reduction in non-retail RWAs exceeded the 10 per cent reduction in assets, and, for the non-core portfolio as a whole, the fall in RWAs was 10 per cent, again in excess of the 6 per cent fall in assets.

We remain on track to achieve a non-core reduction of at least £20 billion in 2013, and our target of a non-core asset portfolio of £70 billion or less by the end of 2014, with less than £35 billion of that being non-retail assets.

And that brings us to capital, on slide 13. During the first quarter our core tier 1 capital ratio increased by 50 basis points to 12.5 per cent, while the fully loaded ratio was stable at 8.1 per cent. This is a strong performance given that both of these ratios were impacted by the implementation of IAS19, as we flagged at the year end.

And both ratios benefited from our improved profitability, as well as from the reduction in risk-weighted assets, mostly from the non-core, and the St. James's Place share sale.

Whilst the Financial Policy Committee has stated that major UK banks and building societies had an aggregate capital shortfall at end 2012 of around £25 billion, we are awaiting the outcome of the consideration of the FPC's recommendations by the Prudential Regulatory Authority Board. Given our strongly capital generative core business and continued progress in increasing capital and reducing risk through non-core asset disposals, we however continue to be confident in our capital position.

And with this strong capital generation, we are now guiding to a fully loaded core tier 1 ratio in excess of 9 per cent by the end of 2013 and in excess of 10 per cent by the end of 2014, and so meeting regulatory requirements well ahead of time.

That completes my review of the financials and I would now like to hand back to António.

António Horta-Osório, Group Chief Executive

Summary

Thank you George. So in summary. The Group's underlying performance in the first 3 months improved substantially and we continue to deliver ahead of plan in a number of key areas.

The progress we have made on the non-core reduction, in this and previous periods has meant that our Group results increasingly reflect the strong profitability of our core franchise, where returns remain above the Group's cost of equity.

And I remain confident in our capital position, given the strongly capital generative nature of our business and of our strategy.

Overall, the momentum we built in 2012 has continued, and indeed accelerated, in the first quarter of 2013.

So what does this mean for our guidance? We are on track to meet our existing guidance for 2013, and due to significant progress in three key areas, as George already mentioned, we are today strengthening guidance.

Firstly, and as you have heard already, our core loan book returned to growth in quarter one, 6 months ahead of plan. This was driven by continued positive SME lending and growth in lending to mid-sized and larger corporates, which more than offset an expected decrease in the mortgage book. I expect this to continue and also expect mortgage lending to turn positive in quarter three as previously announced.

With regards to capital, we are now targeting a fully loaded core tier 1 ratio of above 9 per cent by the end of the year and of above 10 per cent by the end of next year.

Our guidance on total costs for 2013 is now £9.6 billion, driven by further cost savings and the deconsolidation of St. James's Place.

We are also giving new guidance for costs in the full year 2014 which we now expect to be around £9.15 billion assuming an IPO of Verde at the mid year. Overall, this means that we will deliver nearly £2 billion of cost savings by the end of 2014, versus our total costs in 2010. £1 billion more than we outlined at the time of our strategic review.

And together, these three areas of new guidance further underline my confidence in delivering on our medium-term financial targets.

Thank you, this concludes our presentation, and I would like to open the line up to any questions.

Question and Answer Session

Question 1: Michael Helsby, Bank of America

Morning gents. Just one question from me actually. Just a bit of a confirmation on your cost guidance. I am just conscious that it includes a half year contribution from Verde and that we all, I think, stripped Verde out from the whole of 2014. So I was wondering if you could tell us what the cost number would be relative to your 9.15 if we exclude Verde altogether? That gives me a base for 2015. Thank you.

Answer: George Culmer

Hi Mark, it's George here. You know, you are right, we assume that that £9.15 billion, there is a mid-year IPO from the presentation. And the answer is to strip Verde out entirely you would be round about the nine number.

Michael Helsby

Okay, thank you.

Answer: António Horta-Osório

Michael we should add that as you say so and as George has said, we have considered Verde by mid-year which just to complement your question has an impact on both costs and income. So in the same way that it would represent £150 million of costs for the total, for the whole of 2014, it would represent as well £300 million of additional revenues versus the previous scenario. So that is more or less what we have said about Verde. That Verde on the full 2014 year would have revenues of around £600 million and costs of around £300 million. And impairments I believe around the £100 million.

Question 2: Chris Manners, Morgan Stanley

Good morning guys. I had just a couple of questions for you. The first one was on the impairment charge, looked to be a lot better than I guess some people were anticipating. I was just wondering which areas did well in the quarter?

And as I look to your guidance, the £1 billion charge was around 80 basis points, you are saying 50-60 basis points for next year. So would that mean we would be expecting in absolute terms, an impairment charge number of less than £3 billion? Is that round about what your guidance means?

And the second one was on the FPC capital exercise. Obviously Andrew Bailey is saying that UK Banks still had a capital gap of about £12.5 billion on the plans that he had seen when he had the press conference. I was just wondering, do you guys think you have a capital gap on your current plans? And are there things that you have come up with since that announcement that would mean that you could close that gap?

Answer: George Culmer

Hi Chris, it's George here. To deal with your first part, in terms of impairments, it is pretty good across the board actually. When I look across the divisions and I look at Q1 on Q1, Retail is there or thereabouts in terms of absolute amounts. Commercial Banking, as we called out in the presentation, is up Q1 versus Q1 but that was because in Q1 of last year we had a collective release of about £79 million. So that sort of flattered Commercial Banking's ratio. But we are seeing good trends right across the business in terms of the core book and on the non-core, Juan, do you want to comment on them?

Further answer: Juan Colombás

It's Juan Colombás here, Chief Risk Officer. The way we look at it is the core book is performing in a flattish strength around the 40-50 basis points if you look at the AQRs in the last quarters. The non-core performance is a combination of two things. One is the fact that the type of sales we have been prioritising in the last year have been focused on the risk in the portfolio as far as possible, this is now showing a lower AQR quarter after quarter. And the second thing you are seeing is a fast reduction in the non-core book. So all combined means that the total AQR of the Bank is dropping every quarter.

Further answer: George Culmer
And on the full year outlook, I think we haven't given any explicit guidance in terms of impairments and in terms of absolute numbers, but I certainly would say that I would expect to see a continuation of the good trends we have seen in Q1. So we haven't given it explicitly.

And on your third bit, on FPC, as we said in the press release and in my presentation Chris, yes we await the outcome. You know we know that the FPC came up with, or rather the FSA came up with, the recommendation of around £25 billion in terms of 2012. We know that I think some of the projections in terms of the 2013 are being relooked at, I think is the best way of describing it by the PRA. So they came up with that £25 billion. I think the PRA Board is working through each of the individual companies as we speak. But I'm afraid I can't give to you any line of sight in terms of you know what specific numbers might be or when we actually would receive that information. That is the current situation.

What it means for us though, is that we carry on and we carry on delivering the capital generative strategy. So as you have seen from the stats today in terms of the growth of the core tier 1 and in terms of the fully loaded, having capital action that offsets that 60 basis points impact of IAS19 coming off. So the Group continues to throw off significant capital and I think it is quite important the guidance we have given out today that we expect to move on that fully loaded basis from 8.1 per cent to an excess of 9 per cent by the end of this year and we have also said we expect to be in excess of 10 per cent by the end of 2014. So you know, as we understand it, the PRA are working through the numbers and what it means and I think they are reviewing some of that 2013 outlook. But what matters for us, as I said, is that we continue to throw off and we continue to be capital generative.

Chris Manners
Perfect. Thank you very much.

<u>Question 3: Andrew Coombs, Citigroup</u>
Good morning, I have three questions on the core revenues please. Firstly just looking at the core NII, the average interest earning assets were down 1 per cent Q on Q there, resulting in another decline in core NII despite the better margin. But given the core loan growth in Q1 the one basis point improvement in the core NIM, presumably we should see a return to core NII growth from Q2 onwards?

My second question was just with regards to the core OOI, £1.9 billion if you exclude the gain on St. James's Place. I think you mentioned that was down Q on Q due to insurance assumption changes. And down year-on-year due to lower bancassurance income. Perhaps you could elaborate a bit more there?

And in the final question, I just wanted to ask, you mentioned 'Help to Buy'. I know it is early days, but interested to know your thoughts on the potential impact and perhaps the trade off between volumes and margins by that scheme? Thank you.

Answer: George Culmer
Hi Andrew. I will do the first couple. Yes as you said on core, well where shall I start? As you know, we haven't given explicit guidance in terms of overall income for the full year and it remains a sort of relatively challenging environment etc as you know. But certainly as you say in core NII, whilst we had average interest earning assets down a percent, we have got the margin offsetting that and you have seen as you have said a pickup in core loans and advances. So we are feeling pretty good about the core NII trends.

In terms of OOI, particularly when I look at that Q4 versus Q1, as you said, if we strip out insurance claims which had a sort of light Q4 because there were some write-backs and things like that for some of the weather provisions that we took mid-year last year, it was down about 3 per cent. Insurance assumption changes benefited Q4 by about £40 million and then also if I look at St. James's Place, not the gain here Andrew, but just in terms of the run-rate, St. James's Place was up about £20 million, £25 million or so in Q4 versus Q1. And so they have had an impact on the overall Q4/Q1. Commercial Banking was up about 5 per cent Q1 on Q4 which is encouraging, and I think that now represents about the fourth quarter or so in a row that we have seen growth in the Commercial Banking OOI, which obviously we talked a lot about a couple of weeks ago and it is an encouraging sign. So that is sort of the trends and that is what we are seeing.

And the third question was on the 'Help to Buy'.

Answer: António Horta-Osório
Yes I will take that one Andrew. Well what I think is that this scheme like the FLS is a very thoughtful scheme, and I think it will have a very relevant impact. And I have to say, I think the impact will be more than what I saw in some research notes that I have read. Why do I believe this? Because number one, it is a very, very wide scheme. So contrary to the other schemes targeted to the mortgage market, this is targeted at all the first time buyers and also movers in the market. So potentially we have the very, very big impact. Number one. Second, the biggest factor, in my opinion, that is restricting the housing market at the moment and first time buyers is the deposit that people have to put up front, given the tightening of credit criteria in banks, given uncertainty on capital and FPC. So if you take a 95 per cent LTV mortgage the difference in price to a 75 per cent one is around 150 basis points, while we believe the cost of credit per year plus administrative costs that the Government may have should be on the range of 40-50 basis points. And therefore, this guarantee will provide much bigger potential volumes with reasonable margins, as is the case now in the mortgage market. And can have, I repeat, a significant impact on first time buyers and as a consequence on the construction sector. So we see this scheme as potentially very impactful, like the FLS and Lloyds being the largest mortgage player will do its best, as we did in FLS to make it work.

Further question
Thank you. Just playing devil's advocate to that, how much of your SVR book do you think could be subject to cannibalisation is the wrong word, but perhaps remortgaging with the assistance of this scheme onto new fixed rate?

Answer: António Horta-Osório
Well I think that is a valid point Andrew, but if you look at the SVRs, we being the largest lender to have our SVR pricing in the middle to the low side of the pack given that for example, the second largest lender has a much higher SVR and therefore we think, and we have assessed this in depth, that our net position should be quite neutral in that regard.

Andrew Coombs
Okay, thank you.

<u>Question 4: Jason Napier, Deutsche Bank</u>
Good morning, three please if I may. Quick ones I promise. The first was just on non interest income coming back on the first quarter figure in core, excluding St James's Place. George the deconsolidation of that, presumably that happened on sale date. So I just want to confirm you were saying that Q1 revenues were down 20-25 versus Q4 as a consequence of St. James's Place but presumably for two-thirds of the quarter the revenues are still left in. So I am just trying to get a sense as to what the base number is for Q1 to take into Q2?

Secondly, likewise for the non-core losses. I appreciate that you have mentioned the trend should continue. Where we are now, non-core is showing an impairment rate that is pretty much in line with core, exceptionally good relative to our expectations. I just wanted to check there weren't any large recoveries in the first quarter and that is an underlying number?

And then thirdly, to do with the disposal that was announced yesterday. I am afraid I may be being dense here, but if you have got £600 million of RWAs against a book of £1.5 billion, but a loss of £250 million on £72 million of consideration, that implies a book value of at least £300 million, I think, for that unit. And I am struggling to understand why you would have had £300 million of book against £1.5 billion of assets? Thank you.

Answer: George Culmer
Hi Jason, it's George here. So I will pick up the first one. In terms of St. James's Place, now what's actually happened, because it was disposed of so close to the quarter end, we actually took a full quarter's earnings. So three months worth of earnings comes through the P&L. And just so you know, just for numbers and stuff, so within the income line, this is St. James's Place of run-rate rather than gains or anything like that, we took in about £86 million of income. That, for example, compared to a number that was north of, I think it was about £110 million or something like that in Q4. But it was £86 million of income and about £44 million of operating expenses. So those are the numbers that we had in for Q1. And just to let you know, for the full year 2012 those equivalents were about £330 million and £170 million in terms of income and expenses.

Further answer: Juan Colombás
On the non-core AQR, on page 9, you can see the non-core AQR in quarter one was 200 basis points roughly and it is higher than the core book. The core book is in the 50s and the non-core is at 200. So this is what we think. These trends of improvement is a result of the actions we are taking in the non-core book. So we could see this positive trend in the coming quarters as well.

Answer: George Culmer
Turning to your third question in terms of sort of working back, trying to back solve to the loss, you have got to remember the Spanish operation, this is a business that has been losing money for, I think, the last three or four years, and was a weak position in obviously a weak market. The loss actually comes about as there is just some additional restructuring type charges that we will actually be putting to that business ahead of the disposal. So there is nothing wrong with your maths in terms of back solve, except it misses out there will be a number of restructurings that take place ahead of disposal that gets you to that £250 million. But those numbers have to be borne in mind in terms of the track record of this business. And I think what for us is a hugely beneficial move in terms of containing our exposure to that economy and taking a billion and a half of non-core away.

Further question
Thank you. So if it is not intangible, so it is a restructuring provision, the impact on core capital is the £250 million loss, right?

Answer: George Culmer
That is correct, yes.

James Napier
Perfect. Thank you.

Question 5: Rohith Chandra, Barclays
Hi thank you. I wonder if I could follow up on impairments and then also ask a quick one on the fair value unwind. Just on the impairments, can I just check the answer actually to Jason's question, that the non-core charge of about 200 basis points in the quarter, is my understanding correct, that you expect that to come down a bit as the year progresses?

And then also on your 50-60 basis points guidance for next year, if we assume that core stays around 50 that would imply non-core coming down to somewhere south of 100 basis points. Again I just wanted to check that was in line with your expectations?

And then secondly, on fair value unwind. £1.3 billion unwind relating to asset disposals. I just wanted to check how much is left in the pot to offset future disposals? That's it thank you.

Answer: Juan Colombás
I will answer the first one. Our expectation in impairments, as you can see the trends in the core book are quite stable. So and this is what we think you can expect in our core book in the coming quarters. The non-core as I say, we think you could see positive improvement in the AQRs. At the same time the size of the book is shrinking. So the combination of both things is what is making us to think that we can achieve the targets in AQR for next year.

Further question
And could you give some indication in terms of is that less than 100 basis points on the non-core, is that a sensible assumption for next year?

Answer: António Horta-Osório
In terms of the non-core we don't give guidance on that because it may be quite lumpy, but I think the point here is as you have seen last year, there were several quarters where the AQR of the core book has been below 50 basis points in a difficult economic environment. So we are very comfortable with the 50 basis points guidance for the core that we have given. Because when we said 50 to 60, we said with the core on the lower end, so we now are very comfortable with the core being really on the lower end and it has even been lower last year, while the economic environment is still not great. And given as Juan said, that the non-core is shedding quite quickly, the impact on the total AQR should not exceed the 60 basis points. You can derive from that depending on your assumptions on volumes, what the AQR would be for the non-core.

Answer: George Culmer
On the fair value stuff, I don't have the figure to hand, but I want to say on the asset side of things, it is not a huge number, I want to say like £1 billion to £2 billion or that, but we will come back to you. It is not a huge number.

Further question
So in the text today it says £1,262 million asset disposal losses offset by I think just over £1.3 billion fair value unwind. So all I was wanting to understand is as you dispose of more assets, your expectation is you will continue to have fair value unwind to offset any losses?

Answer: George Culmer

Yeah, I mean the extent to which there is fair value unwind, all we are doing actually is as we dispose of them, we are actually accelerating the recognition of that credit. It is just, as you know, it is just a timing thing. And as I said, in terms of how much is left in the Bank, I want to say it is about £1 billion to £2 billion, but we will check that number. But I think what matches in all of this, is actually that we continue to do it in a capital accretive fashion. From the Q1 disposals, I think it has added something like about £450 million to the capital base. So we will get back to you on the precise number. All we are doing is dragging forward because there would have been an original time pattern and time frame in terms of that fair value and how it was spread. And when we thought that the pools and piles would occur. But as we actually fell forward of that we accelerate the timing. But I will come back to you on what the number actually is.

Rohith

That would be great, thank you.

Question 6: Chintan Joshi, Nomura

Hi good morning. Can I start with capital please. If I look at your Basel 3 core tier progression at 8.1 including IAS19, and also including the gilt sales, St. James's Place and the share issuance of about £1.5 billion, what I am thinking is how do we get to 9 per cent by the end of the year? Obviously there will be a lot of moving parts through the year, but if you could help us with the big moves? Because if I look at underlying, then there was about a maybe a 10 bps improvement quarter on quarter, if I exclude these sales. So just trying to think about progression here.

Answer: George Culmer

Okay, I am not going to give you a sort of item by item. It is worth calling out again, I know you have just been through these numbers, but in staying flat we have basically offset a 60 basis point drag in that first quarter. And as you have seen from the slides and you know yourself, that is a combination of that accretive non-core run down and the profitability, the increased profitability of the core franchise and things like the sale of St. James's Place, all core parts. And as we move into the next nine months or so, we will continue with that accretive non-core run-down. What you are seeing in terms of underlying profitability in the business in Q1, you will see stretch out through the rest of the year. So in terms of the trends on impairments and trends on expenses, we spent a long time this morning talking about income, but what you will see is a continued strong underlying profit which obviously drives the sort of best form of capital and that will play a key part. But I am sorry I am not going to sit down and give you an itemised breakdown. What I think matters most is the guidance we have given that we do expect to above 9 per cent by the end of the year.

Further question

Fair enough. If I can just continue on Scottish Widows. Even the Danish compromise, will come to that when we come to that, but currently it is a £5.1 billion deduction, what optimisation can we have on this £5.1 billion? I noticed you have done about £1.5 billion of sub-debt in Scottish Widows. I am just wondering even without the Danish compromise, what is the potential to reduce this £5.1 billion number?

Answer: George Culmer

Okay, it is a good point and it is worth emphasising to people that when we say about 9 per cent, that is assuming Article 45. So thanks for that question actually. So it is a sort of pretty conservative worse case. So when we say above 9 per cent that is on an Article 45 basis. And in terms of optimisation, well first off you have got fundamental underlying profitability of the business. And Scottish Widows is a good business, has been profitable and will continue to be profitable. That is the start of everything if you like. Then there is a looking around to be a capital efficient as you can be and we are spending a lot of time working with the insurance team in terms of looking at that capital requirement, in terms of looking at that capital position. And looking at, if there are things we can do which would basically hedge out some of the tail risks for example in some of those requirements would enable us to actually upstream the capital into the Bank and therefore count on an Article 45 basis. So we were successful last year, last year I think we took out something like, this was in 2012, £700 million from the insurance business in terms of capital up streaming. I would expect to exceed that number, I am not going to give you a precise amount, but I would expect to materially exceed that number in 2013 but it is around generating profits and working with the business to see how we can actually reduce that capital requirement.

Further question:

Thank you and finally if I can just follow up on the 'Help to Buy' commencement. I am thinking about that you are very active in the first time buyer market currently and that tends to be a good margin business, the 'Help to Buy' will have some margin compression, So are you saying that the volume will offset the margin pressure that you may have in that area?

Answer: António Horta-Osório

That is absolutely my impression because I strongly feel that there is a sort of market failure on the high LTVs given the capital uncertainty as I mentioned to you. And therefore the trade-off between margins that those high LTVs and demand which is being withheld from the market in my opinion should be positive. And I also think that it is very likely that the beginning of the scheme which is effectively as you know, January 1st, will be the beginning in terms of completions which means that we will be able to start marketing for applications by the end of quarter 3 which, should be positive as well.

Chintan Joshi

Thank you.

<u>Question 7: Tom Rayner, Exane BNP Paribas</u>

Yes good morning everyone. Can I have a couple of questions please on the core business trends and then maybe one on the dividend outlook. Just back on sort of core non interest income, excluding the gain from St James's Place the year on year trend of sort of down almost 6 per cent, looks perhaps a little bit weak. But if I strip out the revenue numbers I think George gave in response to an earlier question, the £86 million and the £330 million, it looks as if the underlying trend is more like plus 7 per cent year on year. Is that, does that feel right to you that sort of growth? And I am interested in, as the core loan book starts growing again, is that a driver of this line? Could you explain if I am on the right lines on that one please? And I have another two questions.

Answer: George Culmer

Plus 7 sounds a bit rich to me. When I look Q1 on Q1 last year there are things like, we are a slightly different business in terms of balance sheet size and there are things like lower levels of Bancassurance investment sales that have come through. So when I look at Q1 on Q1, I would have to go back through your maths, but stripping out and coming out a positive 7, sounds a bit rich to me.

Further question

Okay, is it growing underlying and is the growth in the loan book a driver of that line do you think?

Answer: George Culmer

It will be yes. It is going to take time to come through, but it will be. But again thinking back to Q1 last year, there is some volatility again, thinking back to last year. I think Commercial Banking had a good OOI last year; there was good Trading and Markets activity actually in Q1 last year. But the loans and advances should drive the OOI activity as well, but it is going to take time to come through.

Further question

Okay, also secondly on the impairments, I think at the full year you talked about the sort of trends in the core sort of credit quality having stabilised and sort of 50 basis points was the level it was at which is where it is again roughly in Q1. I think Juan Columbas then mentioned a range of 40 to 50. So just trying to get a sense, is 40 to 50 still within that sort of stable guidance? Because obviously 50 to 40 is a reasonably…

Answer: Juan Columbas

I think so, a 40 to 50 range on the core book.

Further question

Okay, perfect. And just finally on dividend, António, and I read this in the Sunday Telegraph anyway, so correct me if any of this is incorrect, but you mentioned that there are no alternative uses for the capital, therefore Lloyds will be a high dividend paying company once again. Now I know there are all sorts of things to get through with the FPC and everything. I am trying to get a sense about when you are at the right capital ratio, whatever that is, will the payout ratio then be the only variable that moves or is there some sort of natural cap on how high the payout ratio may go? Can you give me any colour on that?

Answer: António Horta-Osório
Yes, I think Tom you read correctly. I mean the way I see it is the following. So as we complete the FPC exercise in 2013, 2014 will be very likely a very normal year. And as we have inflected the growth on the core loan book and we will be rising, given that the market is shrinking as a whole, we may increase our loans by, I imagine 2-3 per cent, that does not require a lot of capital. And given that we are generating 50-60 basis points of core tier 1 ratio per quarter now, given that our legacy issues are decreasing significantly as you saw, obviously Lloyds will come back to a high dividend bank stock in the future. And I think you are right when you mention that the payout is the only variable because we are completely committed, as you know, to getting this bank back on its feet, profitable, lending to the economy and getting taxpayers' money back. So we are absolutely focused on that. Being a UK focused retail and SME bank with two competitive advantages: the lowest cost structure of the sector which will be critical for us to increasingly offer better value for money for our customers which I think is the only strategy compatible with the present regulatory environment; and second, we want to have the lowest cost of equity in the sector because given we are in a AAA rated country, we have SME and retail businesses which are low volatility, we will have the lowest cost structure, we have much less wholesale funding, much more capital, much less non-core assets. Every of these factors should contribute to a lower beta and therefore a lower cost of equity. And therefore all the capital we are going to generate through lower costs and lower impairments will accrete to capital and will be available in the future for dividends. And our purpose is to go back to a high dividend bank stock.

Further question
Okay, thank you very much for that. And I guess the other variable which has been feature just in recent years has been PPI and other sort of redress. Is that an issue now that we can finally put behind us do you think?

Answer: George Culmer
Hi Tom, it's George again. Well you have seen the trends we put out this morning. In terms of complaints, on PPI they are trending where we expected them to be. Cash out the door is slightly higher than we expected and that's partly due to, as I said in the presentation, we have got to settle some cases or will be settling some cases within FOS and some VAT one offs etc. But certainly the complaints trend is moving as we expected, which is obviously an encouraging sign. So you know that is you know what I would say on PPI. Obviously we haven't changed any of the other legacy provisions in terms of interest rates stuff etc. So they are still out there. I am never going to say never, but it is just a question of working your way through these.

Tom Rayner
Lovely, Thanks very much.

Question 8: Raul Sinha, JPMorgan
Hi, morning gents. Could I have one point of clarification and then a couple of questions please. Just on the point of clarification, I was wondering if there was a currency impact on core loans as well. You very kindly stripped it out of non-core and I was just wanting to make sure that the core loan growth is not distorted by any currency moves?

Answer: George Culmer
Hi Raul. Yeah, it's George here. There is a very small currency impact on the WAFI bit. So on one of the slides we break out where the core loans advances comes from and I think WAFI is up, I forget the precise number, but there is a small element of FX, but it is a tiny amount.

Further question
Right thanks. Just in terms of my other two questions then. Firstly I was wondering if you might be able to comment a bit on any pipeline of disposals outside of non-core and Verde? Are there any areas that you might be willing to flag to us that could deliver another nice gain, like St. James's Place did, just thinking about the FPC?

And my second question is on the impact of retail, picking up loan growth in the second half of the year. What do you think the impact of that might be on the asset margin and mix? Obviously it was 4 basis points negative in the core in this quarter. Do you anticipate that gets worse as we go through the rest of the year and what sort of magnitude do you think that might be currently?

Answer: António Horta-Osório
Raul, on your first question, and George will take the second one. I am sorry to disappoint you, but you know this is relating to that question is like in football you know, prognosis only after the game finishes. We like to do things and then communicate them and I am sure you understand about that, so we cannot comment any further. George.

Answer: George Culmer
Sorry, the second question was again?

Further question:
It was on the impact of Retail loan growth pipeline, obviously you are flagging that it is going to pick up and I was wondering what you think it might have an impact on the asset margin?

Answer: António Horta-Osório
We have said since June last year that our plan was if you remember, as we would be getting to 100 per cent core loan to deposit ratio, we said then by March, which we did, that during the first half like in the past two years, mid corps and large corporates would start to grow which has now happened a quarter earlier than we thought. And we said that the whole core book would grow in the third quarter because in the second one we would reach the market share in mortgages of around 25 per cent. And from then onwards we would start growing with the market which is now growing less than 1 per cent. So fortunately the growth in quarter 1 which as I said I now expect to continue, has more than offset the mortgage decrease. That is why the total core loan book increased as a whole in quarter 1, so six months ahead of the previous plan. And the action that we have been taking already, because don't forget that applications take place at least four month before actual completions. All the actions we have been taking in terms of management, are absolutely in line for our mortgage book to start growing with the market in quarter 3. So I do not expect to see, I don't expect you to see, any change in terms of present competitive behaviour because those are actions we are already taking, implementing in the market ahead of completions as we do the applications.

Further question
The reason I ask the question Antonio is obviously we can see you know declines in the asset margin in the credit conditions survey?

Answer: António Horta-Osório
That's right and relating to that point as you know, we, maybe differently from other banks, we always manage this retail margin as the asset margin minus the deposit margin, what we really manage is the difference between the two, especially now that we have 100 per cent core loan to deposit ratio. And as you see from our slide number 7, you are right about the asset margin, it has been going down given FLS for the same reason deposit margin has been going up because of FLS and again over the last quarter we were able to manage the difference between the two in a positive way. The increase in deposit margin more than offset the decrease in the asst margin which we continue to manage very tightly on a weekly basis, by the way, at the highest level of the organisation and we expect that picture to continue going forward.

Raul Sinha
Excellent. Thanks very much, that is very helpful.

<u>Question 9: Manus Costello, Autonomous</u>
Good morning everyone. Since we are on slide 7, actually I wanted to stay there for my question please. I wonder if you could give us an indication in the first quarter of what level of your mortgage book is currently on SVR and how that has changed in Q1 versus where we were at the end of Q4? Obviously following up on Raul's question about the potential for asset mix and margin changes going forward?

And secondly just on a point of detail. Can you give us an indication of how the gilt sales will impact in Q2 on Q1, what the headwind will be from that? And then I assume by Q3 we are done and the run rate of margin is not going to have any more impact from the gilt sales? Thank you.

Answer: George Culmer
I don't have to hand in terms of where the SVR has moved. I mean it is 60 per cent or so of the portfolio, I haven't looked to see where it has moved Q4 versus Q1, but I certainly wouldn't expect to have seen any material shift change in that percentage actually Manus, we will go back and check.

In terms of the gilts again in terms of Q2, I would imagine a similar type of performance, in terms of how the 8 basis points busts down, we will go back and check. But I imagine Q2 would be a similar amount and then as you say, I would start catching up on myself. So sorry that is a bit vague, but as I say we can come back in terms of the SVR.

Further answer: António Horta-Osório
If your question was related to the guidance we had given at year end, the 198, when we gave it we had already in our plan that we would sell these additional gilts, if that was the question.

Further question
Yes that was part of the question. And just back on the first question, sorry a more strategic point about any potential SVR switch, I think from a comment to an earlier question Antonio, you were suggesting you didn't think the drop in rates across the mortgage market was going to have any impact on SVR and that you think that sort of 60 per cent level will stay stable?

Answer: António Horta-Osório
Well what I said is that I think as per the question that it will have impact in the market as a whole, but I think on our specific position, given the positioning of our prices in SVR it should be neutral for us. That is what I said.

Manus Costello
Okay, thank you.

<u>Question 10: Arturo de Frias, Santander</u>
Hi good morning. I would like to ask you about RoE trends or RoTE trends particularly on core. I was running one quick number. If we exclude the gains of the sale of St James' Place and annualise what is going on in the core, we get to an RoTE of around 18 per cent for this year. And if I add to that all your comments during this call, all the guidance during this call, i.e., NIM still improving, volumes probably growing, partially thanks to the 'Help to Buy' programme, original Simplification costs coming through and impairments stable in the region of 40-50 bps, it looks increasingly clear to me that the RoTE in core is going to exceed the 20 per cent very soon, probably already in 2014. I know that is my view and not your view, but can I ask you if all those comments are more or less reasonable descriptions of reality in your view? Thank you.

António Horta-Osório
Arturo that is a very important question, so I will ask our Finance Director to answer it!

Answer: George Culmer
You should come and work for us Arturo! Look I am not going to comment on the specifics, but you are dead right in terms of it and it is a message we push out in terms of the earnings power and returns that we make within the core business. They have been consistent over the sort of last twelve months or so and you are right with the improving trends in terms of impairments, expenses, what we are seeing on the NIM, we remain very confident about the financial performance of the book. And you are right, if I strip out, I think we talked about you know return on risk weighted assets over 3 per cent, and are still up at about 253 if I strip out St. James's Place. This is a book that makes strong returns. I am not going to comment on your 18 per cent or 20 per cent. You know what our overall targets are. But that is part of the reason why we feel confident that we will actually meet those targets.

Answer: António Horta-Osório
And Arturo, I might add, because I think your point is quite a strategic one and quite relevant, that we should not underestimate the power of a leading brand. I mean this is the leading bank in this country in retail and SMEs, Lloyds is the leading high street brand, Halifax is the leading challenger brand. The power of a multi-brand strategy with top brands in a large market such as the UK, which has very interesting structure in terms of number of players and very interesting dynamics in terms of front book, back book. It has huge potential and you have leading brands and the right strategy. I am very optimistic about the potential going forward of the core book of Lloyds which as you said is emerging as we shed the non-core. And I repeat the power of leading brands is unparalleled to second tier brands.

Further question
Okay, thank you. Can I ask also something very quickly on the dividend. Assuming that the PRA lifts the uncertainty on capital soon, whenever that happens, could we expect you to give the market some guidance on payout ratios after that?

Answer: George Culmer
In time, yes.

Answer: António Horta-Osório
It is very likely Auturo. The fact that the FPC is now focusing on having the situation completely clear in terms of stress test for the end of 2013, I think by the same token leave 2014 as a total normal year and therefore with full clarity for 2014, what you are saying is very logical.

Arturo de Frias
Okay, thank you very much.

António Horta-Osório
Thank you Arturo, thank you everyone.

End of Q&A