SUPPORTING OUR CUSTOMERS AND HELPING BRITAIN PROSPER

Lloyds Banking Group
Half-year update
2016

António Horta-Osório
Group Chief Executive

0.85p
increased interim dividend per ordinary share

£2.5bn
statutory profit before tax more than doubled

Dear Shareholder

We have delivered a good financial performance in the first half of 2016, with robust underlying profit, a doubling of statutory profit and strong capital generation, along with continued progress on our strategic initiatives.

Our differentiated, UK focused, retail and commercial business model continues to deliver, and our financial strength, coupled with our cost leadership and low risk approach, position us well in the face of current market uncertainty. Our strategy of becoming the best bank for customers and shareholders remains unchanged and we will continue to support the economy and help Britain prosper in the months and years ahead.

Market positioning

Following the EU referendum the outlook for the UK economy is uncertain and, while the precise impact is dependent upon a number of factors, including EU negotiations and political and economic events, a deceleration of growth seems likely. Given the sustainable recovery in recent years, the UK economy enters this period of uncertainty from a position of strength and is well positioned to face any economic headwinds. The simplification and transformation of the business in recent years and our prudent approach to risk position us well to continue to deliver strong returns to our shareholders.

As a simple, UK focused bank we have benefited from the sustainable nature of the recovery in the UK economy. In recent years house prices have increased, businesses and consumers have been deleveraging, more people are in work with unemployment at a record low, and wages have been growing.

These improvements in the economy and our low risk approach are reflected in the quality of our lending portfolios and we continue to de-risk the business. In Buy-to-let mortgages we have grown significantly below the market, and in London we have restricted our share of mortgage flow through loan-to-income caps. In Commercial Banking we have reduced our exposure to higher risk segments through a selective participation strategy.

Our market-leading cost position also continues to provide competitive advantage in a challenging environment, and our cost:income ratio further improved to 47.8 per cent in the first half of this year. In addition, we have one of the strongest capital and funding positions amongst the major banks worldwide, as demonstrated by our continued successful issuance of wholesale funding post-referendum. Our low cost, low risk, differentiated capital generative business model is structured to be resilient through the economic cycle.

The regulatory environment continues to evolve and there remain a number of areas on which we expect clarity soon, including the Financial Conduct Authority's (FCA) consultation into a proposed time-bar for PPI complaints, the final outcome of the Competition and Market Authority (CMA) review and some of the consultation papers on the capital framework. Clarity on these areas will build on the good progress made by global regulators in finalising their overall approach to capital, liquidity and solvency. Given the strength of our balance sheet and our underlying capital generation, we are well placed to meet these evolving regulatory requirements.

Financial performance

Underlying profit of £4.2 billion was 5 per cent lower than the same period last year (or 2 per cent lower excluding TSB), driven by a slight decrease in income and an increase in the impairment charge from historically low levels. This was partly offset by a 3 per cent reduction in operating costs as we continue to simplify the business. Underlying return on required equity was strong at 14.0 per cent. Statutory profit before tax of £2.5 billion was more than double that of the same period in 2015, driven by a significant reduction in conduct charges and the gain on sale of our stake in Visa Europe. Statutory return on required equity has improved to 8.3 per cent.

Our financial strength coupled with our cost leadership and low risk approach position us well in the face of current market uncertainty

We have again demonstrated the capital generative nature of the business, generating 50 basis points of common equity tier 1 (CET1) capital in the second quarter, despite a 30 basis point impact from the EU referendum. Our balance sheet remains strong with a CET1 ratio of 13.0 per cent post-dividend and a leverage ratio of 4.7 per cent.

Dividend

In 2015 the Group paid its first significant dividend since the financial crisis. In line with our progressive and sustainable ordinary dividend policy, we are pleased to be announcing a 13 per cent increase in the interim ordinary dividend to 0.85 pence per share. As previously indicated the Board will assess the capital position, the level of final dividend and whether the distribution of surplus capital is appropriate with the full year results.

Strategic progress

We have continued to make significant progress on each of our three strategic priorities: creating the best customer experience; becoming simpler and more efficient; and delivering sustainable growth.

Creating the best customer experience

As a customer focused business, we are committed to meeting our customers' evolving needs and preferences through our multi-brand and multi-channel approach. We operate the UK's largest branch network and the largest digital bank with over 12 million online users and more than 7 million users of our top-rated mobile banking app. 60 per cent of customer needs are now being met digitally, and the digital channel is now the number one choice for customers taking out new loans or credit cards. At the same time we continue to invest in the branch network and new propositions to improve how customers interact with us. In Commercial Banking we have continued to invest to enhance client propositions and improve key processes, including improvements in the online banking platform and reduced new account opening times. In Consumer Finance, Black Horse has been recognised with several awards for its innovative new funding platform, Sign-IT, which reduced processing times for new

Our success in recent years has been based on a focus on and commitment to doing the right thing for customers

>12 million

digital banking customers

£4.2bn

robust underlying profit

50%

increase in customer service scores since 2011

47.8%

market-leading cost:income ratio

£1.2bn

lending to small and medium-sized enterprises

loans, while increasing security and protection for customers. In Insurance we have introduced an online tool allowing customers to consolidate their workplace pension assets, enabling them to make informed decisions about their pension plans.

Our progress in creating the best customer experience is reflected in the Group's customer satisfaction metrics, with the net promoter score over 50 per cent higher than at the end of 2011. In addition, Group reportable banking complaints remain significantly lower than our major peer group average.

Becoming simpler and more efficient

Our cost leadership position is a significant source of competitive advantage and remains a strategic priority. Within the 2015 full year results we announced we were actively responding to lower rates by accelerating cost delivery and targeting further savings. We are consequently now ahead of target in delivering the planned £1.0 billion of run-rate savings under the current Simplification programme, having already achieved £0.6 billion. In response to evolving customer behaviours we are extending the scope of the Simplification programme to include an additional c.200 branch closures, and a further c.3,000 role reductions. This will generate significant additional cost savings and, as a result, we have increased the Simplification run-rate savings target for the end of 2017 from £1.0 billion to £1.4 billion. In addition, we are targeting a c.30 per cent reduction in our non-branch property portfolio by the end of 2018.

Delivering sustainable growth

The Group aims to deliver sustainable growth across its key customer segments, consistent with its low risk business model. We have continued to make good progress in growing market share in areas where we are underrepresented, including our lending to SME customers, motor finance and credit card balances. In addition, we remain committed to supporting first-time buyers and continue to be the largest lender to this customer group. However, across the broader mortgage market, we continue to balance margin and risk considerations with volume growth. This approach, which has meant that we have grown below the market in the past 12 months, positions us well, ahead of any potential slowdown in the UK economy. In Insurance we have built on our recent success in bulk annuities by completing another three deals in the second quarter, demonstrating how our insurance capabilities and expertise can benefit Commercial Banking clients.

Guidance

Following the good financial performance in the first half of the year, we have reaffirmed our 2016 guidance for net interest margin and cost:income ratio. We continue to expect net interest margin for the full year to be around 2.70 per cent and for the cost:income ratio to be lower than the 49.3 per cent reported in 2015. Given the strong credit environment, we have improved our asset quality ratio guidance and now expect the full year ratio to be less than 20 basis points.

The impact on the Group of the EU referendum is dependent on economic and political outcomes, which remain uncertain. However, in 2016 we now expect to generate around 160 basis points of CET1 capital pre dividend, due to the impact of the EU referendum, in particular the effect of FX rates on risk-weighted assets.

Given the uncertainty, it is too early to determine the impact on our formal longer term guidance at this stage. However, while the business will remain highly capital generative, it is possible that this capital generation may be somewhat lower in future years than previously guided. We will formally update guidance when we have a clearer view of likely outcomes.

Outlook

As a result of the continued successful delivery of our strategy in recent years, we are in a strong position to withstand the uncertainty in our sector and the wider market, both now and in the future. This gives me great confidence that we will continue to support the UK economy, help Britain prosper and become the best bank for customers and shareholders.

António Horta-Osório
Group Chief Executive

Our Helping Britain Prosper Plan

Launched in 2014, our Helping Britain Prosper Plan focuses on the social and economic issues we are best placed to address. In 2016 we reviewed the Plan to make it simpler, more ambitious and measurable. The Plan consists of 24 targets across three themes, which we are measuring our performance against. Please refer to our website for further information on the Plan. We will provide a full update at the end of the year.

People

We'll help individuals and families by giving them more support – whether they're buying a home or saving for a better future.

Businesses

We'll help businesses of all types and sizes to prosper, by offering them the funding, the support and the encouragement they need to grow at home and abroad.

Communities

We'll help communities to prosper, by addressing inequality, supporting disadvantaged people and by championing Britain's diversity.

Dividend

Key dates for the payment of the dividends are:

11 August 2016
Shares quoted ex-dividend

12 August 2016
Record date

2 September 2016
Final date for joining or leaving the dividend reinvestment plan

28 September 2016
Interim dividend paid

Other dates for your diary

26 October 2016
Q3 interim management statement

Statements to note

This 2016 half-year update should be read in conjunction with Lloyds Banking Group's 2016 half-year results. This 2016 half-year update is provided for information purposes only, and is not intended to be a substitute for reading the 2016 half-year results.

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