

EQUITY RESEARCH

TSB PLC – IPO- NEUTRAL



COLLINS SARRI STATHAM
INVESTMENTS

Research Report

ADVISORY SERVICES

Report Date

16th JUNE 2014

Analyst

Ravi Lockyer MSc Lib

Collins Sarri Statham
Investments Ltd

Stock Rating:
NEUTRAL

Target Price..... 260p
IPO Offer Price: 220p-290p
Yr Hi/Low:.....NA
Shares o/s.....0.5bn
Mkt Cap(mid).....£1.28bn
Avg Daily Vol.....NA
Dividend Yield.....NA
Fiscal Year31Mar.2015
Website: www.tsb.co.uk

Key Risks to Price

Target

TSB is exposed to mortgage risks, and risks relating to the adequacy of reserves to cover impairment losses

TSB has no track record as an independent company

The board of TSB has confirmed it is unable to pay a cash dividend until 2018.

Lloyds Banking will retain 75% post IPO which results in a significant overhang

TSB is a UK bank offering financial services including current accounts, savings, loans, mortgages, insurance and credit card products.

TSB IPO background

As a condition of the Treasury's financial assistance in 2009, Lloyds is obliged by the European Commission to fully divest itself of TSB by 31 December 2015. Lloyds had considered the disposal of the TSB's 631 branch network "Project Verde" via a sale to a competitor. However advanced talks with NBNK and Co-Op Bank fell through, leaving Lloyds with only the IPO option. The IPO is a rather inelegant solution and reliant on retail shareholders who should expect further stock sales in 2014/15. Those further share disposals are likely to be to UK institutions.

TSB holds a 6% UK market share (as measured by branch network) drawn from former C&G / Lloyds branches. The network is high quality and covers 89% of UK retail centres (its main strength). However the sale of a bank hived out of a branch network is unusual and carries operating risks, not least that TSB clients could view the mandatory switch over of their accounts negatively.

IPO valuation is on the high side

The TSB have indicated a price range for the IPO of 220p to 290p suggesting a valuation of £1.1bn to £1.45bn. This range suggests Lloyds is attempting to value TSB at a maximum discount of 25.7% to a minimum discount of 2.09% to TSB CET1 capital of £1.481bn. This is a key metric for bank valuations. It is core to the decision as to whether or not to invest, yet by using a price range it is unclear what discount will apply. We view this pricing approach negatively and the price should have been fixed.

Advanced acquisition talks with Co-Op in early 2013 centred on a price of £750m. Lloyds is now attempting to realise at least £350m more for TSB apparently on the basis of management accounts showing PBT for 2013 of £67m against £39m in 2012. This indicates a pro-forma EPS of c 10.3p (P/E 21.3x- 28.1x) for FY2013 another pointer to an expensive valuation.

TSB cost/ income ratios of 66% have trended down c.3% since 2011 but the surprise is ultra- low potentially unsustainable impairments of £27m (15bps) in a mortgage book of £17.4bn. This could be the best it gets for UK mortgage impairments. On the mortgage book itself (87% residential / 13% BTL) with an average indexed LTV ratio of 46% with only 7.7% (£1.33bn) of higher risk mortgage loans with LTV >90%, this should be considered high quality with the caveat that TSB faces a challenge in that a high proportion of the mortgage book (45.3%) are interest only mortgages (more problematic post the April Mortgage Market Review). The TSB is very dependent on the UK mortgage NIM for EPS growth over the 2015-18 period, as other areas such as cards (£2.1bn portfolio)/ insurance are relatively small divisions.

Conclusion

The Offer closes on the 17th June with pricing and admission on 20th June – in our view the pricing uncertainties and lack of cash dividend are negatives. Overall there is little incentive to "fly blind" on TSB. NEUTRAL

Collins Sarri Statham Investments Ltd. 6th Floor 5 Lloyds Avenue London EC3N 3AE

Telephone: +44 (0)20 7264 2360 Facsimile: +44 (0)20 7264 2361 www.css-investments.com Email: info@css-investments.com

Collins Sarri Statham Investments Ltd. is authorised and regulated by the Financial Conduct Authority (Registration No 483868).
Registered in England and Wales (Company No 6539190).

Collins Sarri Statham Investments Ltd - Analyst Rating Definitions:

BUY: A “buy” rating is applied to companies with established businesses that are profitable and where there is further profit growth expected. A “buy” recommendation means the analyst expects the share to reach the share price target on the note.

HOLD: The company’s valuation appears to reflect investor expectations in the short-term. Alternatively the company is awaiting key developments that will impact on the share price. Investors are advised to await the resolution of these key developments.

SELL: The company’s valuation appears too high having regard to material uncertainties, declining profit prospects or has sizeable funding requirements. A sell recommendation may also be applied where the board have failed in key objectives or appear to be frequently changing strategy. A sell recommendation means the analyst expects the share to fall to the price target on the note.

NEUTRAL (Not Rated): The analyst does not maintain a view in either direction.

Key to Material Interests:

Please be aware that the following disclosures of Material Interests are relevant to this research note:

TSB **Relevant disclosures: NA**

1. The analyst has a personal holding in the securities issued by the company or of derivatives linked to the price of the company’s securities.

2. Collins Sarri Statham Investments Ltd has clients who hold either shares or CFD positions in this security.

ANALYST CERTIFICATION:

The report’s author certifies that this research report accurately states his personal views about the subject security, which is reflected in the ratings as well as the substance of the report.

RECOMMENDATIONS:

Collins Sarri Statham Investments Ltd (CSS) does not in any of its publications take into account any particular recipient's investment objectives, financial situation, and specific needs and demands. Therefore, all CSS publications are, unless otherwise specifically stated, intended for informational and/or marketing purposes only. **CSS shall not be responsible for any loss arising from any investment based on a perceived recommendation.**

No publication (including recommendations) shall be construed as a representation or warranty that the recipient will profit, nor avoid sustaining losses, from trading in accordance with a trading strategy set forth in a publication.

This research is non-independent and is classified as a Marketing Communication under FCA rules detailed in their Conduct of Business Rulebook (COBS). As such it has not been prepared in accordance with legal requirements designed to promote independence of investment research and it is not subject to the prohibition of dealing ahead of the dissemination of investment research outlined in COBS 12.2.5.

RISK WARNING:

Trading in the products and services offered by Collins Sarri Statham Investments Ltd (CSS) may, result in losses as well as profits as the value of investments may go down as well as up. You may not get back the full amount you have invested.

Any reference to past performance should not be viewed as an indication of any future performance.

Leveraged products such as Contracts for Difference (CFDs) carry a higher risk to your capital. They can lose their value rapidly and you may lose substantially more than your initial investment.

SPECULATIVE TRADING IS NOT SUITABLE FOR ALL INVESTORS.

The information contained herein is based on materials and sources that we believe to be reliable however we make no representation or warranty, either express or implied, in relation to the accuracy, completeness or reliability of the information contained herein. Please note that the figures shown may, in some instances, be rounded to the nearest penny. Prices can move sharply from those quoted in this document. Current prices can be verified by calling one of our brokers. CSS is under no obligation to update the information contained herein. Neither CSS, nor its affiliates, nor its employees shall have any liability whatsoever for any indirect or consequential loss or damage arising from the use of this document.

Collins Sarri Statham Investments Ltd. 6th Floor 5 Lloyds Avenue London EC3N 3AE

Telephone: +44 (0)20 7264 2360 Facsimile: +44 (0)20 7264 2361 www.css-investments.com Email: info@css-investments.com

Collins Sarri Statham Investments Ltd. is authorised and regulated by the Financial Conduct Authority (Registration No 483868).
Registered in England and Wales (Company No 6539190).