



Tuesday 13th May 2008

**DAILY COMPANY NOTE — HBOS** See page 2 for full details

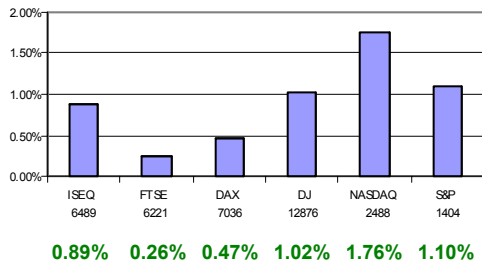
**Daily Market Comment**

**Yesterday's Summary :** With financial giant HSBC reporting first quarter results ahead of expectations and oil coming down from its recent record highs, the ISEQ finished in positive territory yesterday, albeit on low trading volumes, closing 0.89% higher at 6,488.72. Benefiting from further broker upgrades and improving investor confidence, C&C soared 10% to end the days trading at €5.38. Among the financials AIB was the best performer, adding 1.4% to €13.94. Bank of Ireland rose 1.1% to €9.20, while Anglo Irish Bank fell 1% to €9.50 on profit taking. Smurfit Kappa continued its freefall since results, shedding 7.1% to finish at €7.20.

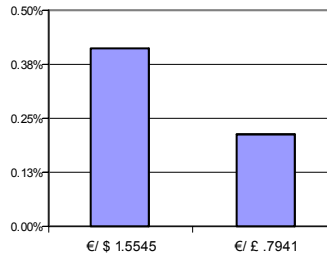
**Overnight News :** In China, the benchmark Shanghai Composite Index closed down 1.84% at 3,560.24, after yesterday's massive earthquake in the south-western province of Sichuan, as well as a 50 basis-point reserve requirement hike by the central bank. In Japan, the Nikkei 225 Stock Average tracked wall-street's gains, ending up 1.5% at 13,953.73.

**Breaking News :** Alliance & Leicester has said that it wrote down £391m on treasury assets, but that it has funding into the second quarter of 2009 and arrears were significantly better than the industry average. Tullow Oil has announced that the Taitai-1 exploration well has encountered five metres of net gas pay and at least eight metres of net oil pay. Travis Perkins, the British building materials group, has reported a 6.8% rise in fourth month sales and it warned that markets continue to slow. Travis Perkins said total turnover in the merchandising division rose 8.2%, while the retail division's sales climbed 3.3%. Redrow, the UK housebuilder, has reported that at the end of April their order book in the homes operations was 26.5% down on last year and that lending criteria is continuing to tighten. Meanwhile, Societe Generale has posted a 23% drop in first quarter net profit.

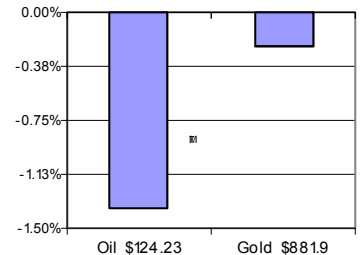
**Equity Indices change on day**



**Currency daily % change**



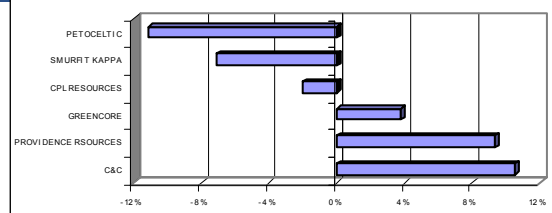
**Oil/Gold daily % change**



**News**

- "Qualceram first-half profits down on last year"-**Qualceram Shares**-(I.T)
- "Short-term borrowing rates show an easing of credit crisis"-(I.I)
- "C&C shares hit four-month high"-**C&C**-(Irish Examiner)
- "Asia growth helps offset home loan debts"-**HSBC**-(I.E)
- "Shoppers positive on Tesco US stores"-**Tesco**-(Financial Times)

**ISEQ Performers/Losers 12/05/08**



**Market Themes and Movers**

**UK inflation rises :** Britain's inflation rate has jumped the most since 2002, to its highest level in more than a year, the Office for National Statistics has said. The Consumer Price Index came in at 3%, compared with 2.5% in March and well ahead of economists forecasts of 2.6%. This latest data will cause some distress for the UK's Monetary Policy Committee as inflation is now just 0.1 percentage point away from their upper limit and as a result, it may not be plausible for them to continue their interest rate cutting policy. The Bank of England have reduced interest rates from 5.75% in December to 5% last month. The pound rose as much as 0.3% against the dollar after the report and traded as high as \$1.9529.

**US April Retail Sales & Wal-Mart Q1 :** The US Commerce Department will issue a report on US retail sales today and forecasts range between a decline of 0.9% and a rise of 0.6%. Predictions of a decline in US retail sales comes as the worst US housing recession for a quarter of a century and record oil prices have significantly damaged the real purchasing power of the US consumer. Meanwhile, Wall-Mart Stores, the worlds largest retailer, is due to report first quarter results today and expectations are for an increase in profit as consumers struggling with the economic downturn, switch their shopping preferences to discount stores.



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# HBOS

**Stuart Draper BUY**

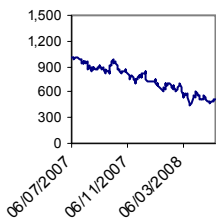
<b>Target</b>	<b>£6.00</b>
<b>Previous</b> (29/02/08)	<b>£8.50</b>
<b>Current</b>	<b>£5.05</b>

**FTSE**
**Bank**
**Company Profile**

The Group's principal activity is providing banking and other financial services in the United Kingdom and overseas. The Group has five divisions, Retail, Corporate, Insurance & Investment, International and Treasury & Asset Management. Retail includes customer bank accounts, consumer credit and advances.

**Fundamental view :** Last month, HBOS announced plans for a £4 bn rights issue, offering investors 2 new HBOS shares at £2.75 each for every 5 held. The £4.96 market price of the shares prior to the rights issue implies a theoretical ex-rights price (TERP) of £4.33. The EGM to approve the rights issue will take place in June, with the capital raising expected to be completed in time for the bank's H1 2008 results' announcement on 31st July. The primary reason for the rights issue was a further £3.6 bn pretax provision against risk assets, £970m of which is being charged to the profit and loss account and £2.6 bn of which is being charged directly to reserves. HBOS is also strengthening its capital position to maintain a tier 1 ratio in the range of 8% to 9% by reducing its target dividend payout ratio to 40% from 46%, and by paying its H1 2008 dividend in shares. However, HBOS also believes that all of the £4.4 bn of pre-tax provisions charged to date against its risk assets will reverse in due course, potentially leaving the bank in a surplus capital position of c.£1.5 bn by 2010, above the top of its new tier 1 range. Despite the potential for further writedowns in the group's asset-backed securities (ABS) portfolio further damaging NAV, our view is that solid group profitability should ensure that NAV growth resumes in 2009.

**Next catalyst :** As a result, we forecast that group NAV per share as at 31/12/09 will show 7.4% year on year growth to £4.35, from £4.05 as at 31/12/08. Given that management now expects to deliver 15% return on equity through the cycle, a price to tangible book multiple of 1.5x would still appear achievable, providing the basis for our new 12 month share price target of £6 (19% further upside), which is based on 1.5x year end 2008 NAV per share of £4.05. This new share price target is as a result of the major new share issuance from the £4 bn rights issue, as well as the implied return on equity dilution. At the TERP of £4.33, HBOS will be trading at 7.2x 2009 eps of 60p, a 15% discount to the current sector average of c.8.5x, and the shares will also be paying a dividend yield of c.5.1%. Another cut in UK interest rates next month could act as a positive catalyst for the share price. As a result, we would recommend clients to take up their entitlements under the rights issue at £2.75 per share.

**Statistics**
**Price Performance**

**Chart view: HBOS**

Support Primary: 491  
 Support Secondary: 457  
 Resistance Primary: 528  
 Resistance Secondary: 573

Medium-term chart trend is negative with a continuing pattern of bearish breakdowns. Stock needs to consolidate and form a solid support base before it can contemplate sustaining any significant gains. Trend resistance comes in at 528 and a move above here should provide some short-term respite. The more important 573 trend resistance level is likely to be difficult to overcome on the first attempt. On the downside a break of 491 would suggest that a move towards 457 is probable.

**Profit by Division**


- Retail 34%
- Corporate 38%
- Insurance Invt. 11%
- International 13%
- Treasury Asset Mgt. 6%

Major Shareholders	%	Peer Group Multiples.			
		Company name	P/E 08	P/E 09	EPS Growth 08-09
Alliancebernstein	8.96%	<b>HBOS</b>	9.0	8.4	7.14%
Legal & General Invt. Mgt.	5.05%	Lloyds	8.4	7.8	8.06%
Standard Life Invt.	2.41%	RBS	5.3	4.9	8.45%
M&G Invt. Mgt.	2.28%				
Blackrock Invt. Mgt.	2.16%				
<b>Shares Outstanding</b>		<b>3,749m</b>			

Share Data	Financial Data	2007	2008e	2009e	
Current Price (p)	Revenue (£m)	14,180	12,989	13,918	
Mkt Cap (£m)	PBT (£m)	5,708	4,897	5,365	
Reuters	HBOS.L	106	56	60	
Bloomberg	HBOS LN	4.76	9.03	8.43	
Sector	Bank	48.90	48.64	50.46	
Chairman	Denis Stevenson	Dividend Yield	9.67%	4.60%	9.98%
CEO	Andy Hornby				
Website	www.hbosplc.com				





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