



Tuesday 17th June 2008

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

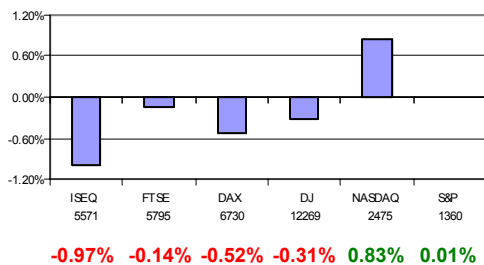
**Daily Market Comment**

**Yesterday's Summary :** With euro-zone May CPI being revised up to 3.7% year on year and the US Empire manufacturing index coming in weaker than expected, the ISEQ finished in negative territory yesterday, closing down 0.97% at 5,571.30. Despite Barclays announcing that its profit before tax in May was well ahead of the monthly run rate for 2007, it was a mixed day for the financials. Bank of Ireland lost 3.2% to €6.81, while Anglo Irish Bank and AIB were slightly stronger, adding 1.6% to €7.06 and 0.1% to €11.23 respectively. Ryanair shed 4.6% to €3.10 as record high oil prices and broker downgrades hurt the stock.

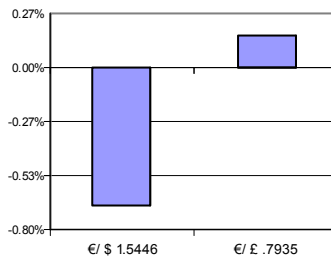
**Overnight News :** Australia's S&P/ASX 200 ended up 1.0% at 5,422.7, reversing early losses as investors selectively picked up financial services stocks which had been under pressure in recent sell-offs. The Chinese benchmark Shanghai Composite Index closed down 2.76% at 2,794.75, dragged down by large caps, while Japan's Nikkei ended mostly flat, down 0.04% at 14,348.37.

**Breaking News :** Cemex, the world's third largest cement maker has cut its 2008 forecast for pre tax earnings to \$5.3bn from \$5.6bn, citing the weak US housing market, and slowdowns in key European markets. However Cemex still predicted strong second quarter earnings due to its purchase of Australia's Rinker in June last year. Diageo has said that its Diageo-Guinness USA unit is suing California's Board of equalization in response to its regulations that would raise taxes on flavoured beer by 1,600 percent. Elan and Wyeth's have announced that the key new drug bapineuzumab helped a proportion of patients with Alzheimer' disease in an intermediate clinical trial, which supports their decision to start final Phase III tests. John O'Donovan , Chief Financial Officer of Bank of Ireland, has bought 10,000 more shares in the bank at a price of €6.75 per share.

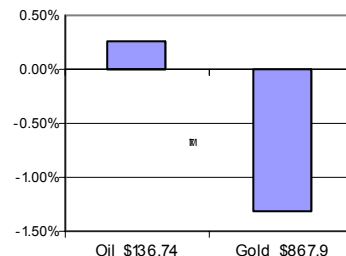
**Equity Indices change on day**



**Currency daily % change**



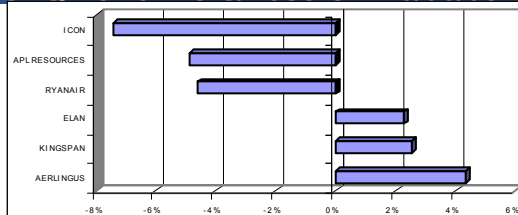
**Oil/Gold daily % change**



**News**

- "Battle for control of IN&M sees company's free float fall by 8%" - **IN&M**-(I.T)
- "Euro-zone inflation hits 3.7%"-(The Irish Times)
- "Barclays planning to sell billions in new shares" - **Barclays**-(Irish Independent)
- "US bank slashes mortgage holdings by one-fifth" - **Lehman Brothers**-(I.I)
- "Elan's Alzheimer drug trial data due" - **Elan**-(Irish Examiner)

**ISEQ Performers/Losers 16/06/08**



**Market Themes and Movers**

**EU to make guarantees to Irish voters:** EU officials yesterday announced their intentions to preserve the Lisbon treaty in its current form. Following on from last week's rejection of the Lisbon treaty, EU officials are proposing explicit protocols relating to Ireland's sovereignty. Ireland will have guarantees on its independent ability to set its own tax policy, the ability to maintain its neutrality and control over its abortion policy. The EU is in an awkward position, the prospect of amending the treaty as a whole is seen as unfavourable, as it is unlikely that a revised treaty would be ratified in all 27 member states. Therefore appeasing Irish voters may be seen as offering a greater chance of salvaging the treaty.

**New all time high for oil:** The price of a barrel of oil is now trading about \$134.60 after hitting another all time high yesterday. Oil spiked up to \$139.89, before pulling back in late trading. The spike is attributed to reports that Israel is seriously considering strikes on Iran. Apparently Israeli leadership is in consensus that strikes against Iranian nuclear facilities are necessary, and should be undertaken prior to the US election in November. On the other hand, Saudi Arabia is expected to announce an increase in production to 10 million barrels a day, which would represent a new peak in production for the kingdom. This increase in production could significantly ease the current market supply constraints.



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# HBOS

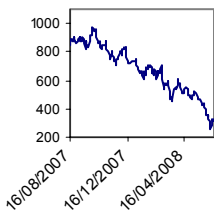
**Stuart Draper**
**BUY**
**Target**
**400p**
**Current**
**319p**
**FTSE**
**Bank**
**Company Profile**

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 :** Since HBOS announced its fully underwritten rights issue in April, the share price has come under pressure in the last four weeks. The share price has even dealt below the rights price of £2.75 which resulted in comparisons to the Bradford & Bingley rights issue. It should be noted that Bradford & Bingley had announced a profit warning and this could have been seen as an adverse change to the underwriting agreement allowing the underwriting banks to walk away from the transaction. Such a scenario doesn't exist in the case of HBOS and to emphasise this point HBOS, on the 11th of June, released a statement remarking that trading and mortgage arrears are in line with forecast. The recovery in the share price over the past number of days has been due to this statement and new rules regarding the short selling of shares in companies that are in the process of rights issues.

Management are confident in the strength of HBOS core market and stated they want to run a less levered balance sheet for 3 to 4-years and the fully underwritten £4Bn rights issue will allow HBOS to increase its core Tier 1 capital ratio to 7% from the current 5.7%. Andy Hornby, CEO of HBOS, also stated that HBOS will not grow the Balance Sheet until the securitisation market re-opens. The current deposit to loan ratio is 178% and an 1% growth in deposits will allow growth of 0.6% in lending. Based on a CAGR of 6.5% over the past 3-years in HBOS deposit book this would equate to an increase in the loan book of circa 4% in 2009 keeping the deposit to loan ratio constant. With HBOS management stating they want to lower the level of leverage on the Balance sheet, loan growth could be lower than 4% in 2009.

**Next catalyst:** The next up-date from HBOS will be on the week commencing the 16th of June when the prospectus for the rights issue will be released. Based on the aim of management to de-leverage the Balance Sheet and to reduce the deposit to loan ratio, loan growth in 2009 could be flat. Using this assumption, NAV in 2009 will remain flat at £4.05 from the estimated 2008 figure. Valuing the firm using a tangible book value of 1x, this results in a price target of £4.00 over the next 12-months.

**Statistics**
**Price Performance**


While dividend growth will be low or flat into 2009 and 2010, a risk does exist if the rights issue is not a success it will result in an over-hang of stock leading to further pressure on the share price. This may put pressure on the dividend payout ratio as the group would look to increase its capital base in ways other than equity issuance in the future. With the recent rally in the share price, the risk of the rights issue failing has recede, but it is still a risk that will weigh on the share until it is completed and should be considered.

**Chart View: HBOS**

Support Primary: 283  
Support Secondary: 249  
Resistance Primary: 398  
Resistance Secondary: 453

Chart outlook remains negative with a continuing pattern of bearish breakdowns. Given the size of recent losses and the oversold state of the stock some upward correction is not unlikely in the short term. However, the stock will need to consolidate and form a solid support base before it can contemplate sustaining any significant gains. Problems are not over and some sideways range trading may be in store for the near-term. Expect volatility to remain elevated.

**Profit by division**


- Retail 34%
- Corporate 38%
- Insurance Inv. 11%
- International 13%
- Treasury Asset Mgt. 4%

Major Shareholders	%	Peer Group Multiples.			
		Company name	P/E 08	P/E 09	EPS Growth 08-09
Alliancebernstein	10.50%	<b>HBOS</b>	<b>5.4</b>	<b>5.4</b>	<b>0.00%</b>
Legal & General Inv. Mgt.	5.05%	Lloyds	6.9	6.3	7.44%
Standard life Inv.	2.40%	RBS	5.8	5.3	10.00%
M&G Inv. Mgt.	2.29%				
Blacrock Inv. Mgt.	2.25%				
Shares Outstanding	3,749.12m				

Share Data	Financial Data	2007	2008	2009e
Current Price (p)	Revenue (£m)	14,180	12,947	13,947
Mkt Cap (£m)	PBT (£m)	5474	4897	5365
Reuters	EPS (p)	106	56	56
Bloomberg	P/E(x)	3.01	5.45	5.45
Sector	DPS(p)	49	22	22
Chairman	Dividend Yield	6.73%	7.34%	7.34%
CFO				
Website				





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