



Thursday 18th September 2008

DAILY COMPANY NOTE — HBOS See page 2 for full details

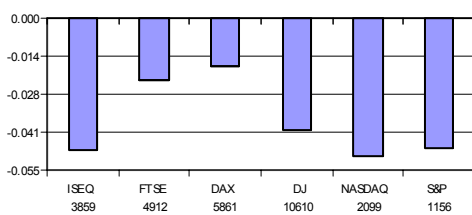
Daily Market Comment

Yesterday's Summary : Tumbling financials continued to lead markets lower yesterday. In early morning trading yesterday HBOs was the catalyst sparking off yet another broad sell off as it entered merger talks with Lloyds TSB. Banks accounted for 80% of volume traded on the ISEQ as it followed suit with Bank of Ireland issuing a trading statement in which it said that the bank would be cutting its dividend and warned that profits would be down on the six months to September. Yesterday also saw a considerable flight to safety as investors sought a haven in bullion, cash and short dated bonds. This saw the price of gold break through the \$860 level while US 3 month T-Bill yields plummeted to 0.02%, the lowest since 1941.

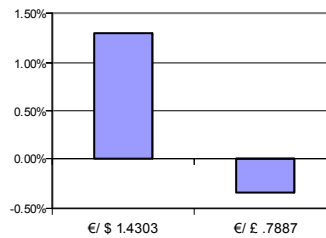
Overnight News: In the US, markets took little comfort in the government's rescue of AIG as very negative market sentiment prevailed, and investors turned their focus to the vulnerability of the two remaining US investment banks – Morgan Stanley and Goldman Sachs. The Dow and S&P 500 closed at fresh YTD lows at 10609 (-449) & 1156 (-57) respectively.

Breaking News : **Ryanair** released its AGM statement this morning, raising its profit forecast and sees itself breaking even for 2008, having previously forecast a full year result of between breakeven and a loss of €60 million. The change in forecast is a direct result from the sudden decline in oil prices. Shares have rallied c.6% this morning. **Kingfisher** released its interim results, posting pre-tax profits of £206 million, beating analyst's expectations of £205 million. It forecasts "very tough times ahead" for the sector, "especially in the UK" noting that the UK home improvement market has declined by 2%. **Pernod-Ricard** announced its full year results, posting net profits of €840 million undershooting analyst's expectations at €899 million. However, it lifted its dividend 5% to €1.32 per share.

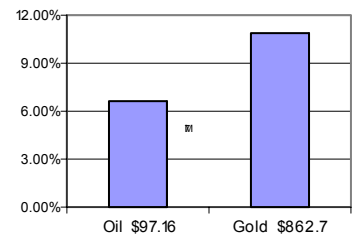
Equity Indices change on day



Currency daily % change



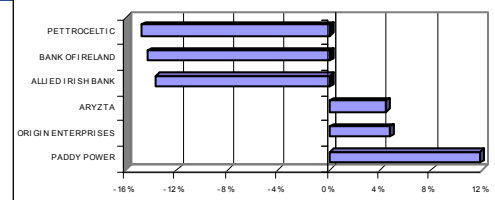
Oil/Gold daily % change



News

- "Regulator steps up scrutiny of financial institutions"-(The Irish Times)
- "Lloyds TSB agrees £15bn rescue of lender **HBOS**"-(The Irish Times)
- "**Morgan Stanley** contemplates merger with Wachovia"-(The Irish Times)
- "**Bol** halves dividend to weather the storm as bad debts spiral"-(Irish independent)
- "Gatwick likely to sell for €3.8bn as Bransen hovers"-(Irish Independent)

ISEQ Performers/Losers 17/09/08



Market Themes and Movers

Global Central Bank Action : The major Central Banks in the world have announced an injection of \$180Bn into financial markets. The Central Banks included are the ECB, BOE, Federal Reserve and Swiss National Bank and the aim of the injection is to reduce the pressures in USD money markets and to increase liquidity available to the banks. The funds have been injected to the financial system through Repo transactions with banks posting eligible collateral such as government bonds in return for cash. In a separate transaction the ECB have also announced a further injection of Euro funds on special 1-day tender providing extra liquidity into the Euro-Zone financial system. This has helped reduce the overnight rate in Euros.

Morgan Stanley : According to various media reports, Morgan Stanley has entered into preliminary merger talks with Wachovia group and other banks, as the seven straight decline in its share price sent the stock to its lowest level since 1998. The company is battling extraordinary market pressures that have already pushed Lehman Brothers and Merrill Lynch into bankruptcy protection or hasty merger deals. One of the perceptions hurting the investment bank shares is that they can no longer rely on deteriorating global markets to replenish the cash necessary to fund their trading and lending businesses. Morgan Stanley has said it believes it could stay independent because it doesn't need immediate funding, but it has recognised that confidence in an investment bank is a precious commodity, that can wither quickly and must be preserved at any cost.



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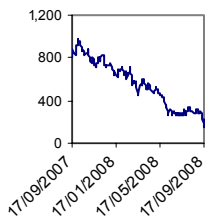
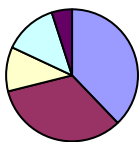
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HBOS

Oliver Gilvarry
Hold
Target
232p
Current
221p
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.

Statistics
Price Performance

Revenue by Division


- Corporate 38%
- Retail 34%
- Insurance & Investments 11%
- International 13%
- Treasury & Asset Mgt. 5%

Fundamental view

- This morning Lloyds TSB announced the take over of HBOS with the agreement of the HBOS Board and the deal is expected to be completed by December.
- The purchase will be a paper based deal with HBOS shareholders receiving 0.83 Lloyds shares for each HBOS share. Based on Lloyds TSB closing share price last night, the price paid per HBOS share is £2.32, valuing HBOS at £12.2Bn.
- The new merged bank will have a significant share of the UK mortgage market at 30% with a similar share of the deposit market. The combined entity will have a branch network of over 3,300 branches and rationalisation of the network is certain. The aim is to reduce the cost:income ratio below 40% for the new bank and achieve an additional £1Bn in pre-tax earnings by 2011.
- Lloyds CEO stated this morning that the disposal of non-core assets will happen. This could include the Australian and Irish operations due to their heavy reliance on wholesale funding. The final dividend will be paid in paper and Lloyds pre-merger high payout ratio will now drop to 40% going forward.

Valuation

- The price paid for HBOS by Lloyds, based on yesterday's closing prices, is at a 58% discount to Tangible Net Asset Value (TNAV). This discount will add to the TNAV of Lloyds, increasing it from £1.96 to circa £2.80.
- Reliance on wholesale funding was a concern about HBOS and its loan to deposit ratio was 1.77x, higher than the ratio at Lloyds of 1.45x. The new bank will now have a ratio 1.64x highlighting a significant reliance on wholesale funding in the new bank. To reduce this reliance, asset disposals will have to be undertaken.
- Lloyds has a higher credit rating than HBOS and the market expects it will retain its AA- rating post merger allowing the group to fund at cheaper levels than HBOS. The merger doesn't achieve any diversification in geographical exposure for the new bank and increases the exposure to a slowing UK economy.
- A 12-month price target for Lloyds post merger is £2.80. Due to the continued reliance of the new entity on wholesale markets and exposure to the UK economy, the price target is based on 1x TNBV.
- With Lloyds offering 0.83 shares for each HBOS share, a price target based on Lloyds 12-month price target results in a price target for HBOS of £2.32. Therefore, we are reducing our recommendation for HBOS from Buy to Hold.

Next catalyst

- Further up-dates are expected from both Boards over the next few days and this will hopefully clarify the future plans for the new bank.

Major Shareholders	%	Peer Group Multiples			
		Company name	P/E 08	P/E 09	EPS Growth 08-09
Private	10.81%	HBOS	3.9	N/a	N/a
Alliance Bertstein	10.78%	Barclays	6.2	7.0	-12.90%
Axa	10.30%	RBS	7.1	4.9	30.99%
Legal & General	4.60%	Lloyds	7.1	6.5	8.87%
Shares Outstanding		5269m			

Share Data	Financial Data	2007	2008e
Current Price (p)	PBT (£m)	5,474	4,082
Mkt Cap (£m)	EPS (p)	106	56
Reuters	P/E(x)	4.52	3.95
Bloomberg	DPS (p)	49	21
Sector	Div Yield	6.73%	9.41%
CEO			
CFO			
Website			


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