continue to be supportive of overall returns. In addition, reputational damage to the sector from the Northern Rock PLC bailout should ultimately be repairable (for a full list of U.K. credit institutions rated by Standard & Poor's see table 2).

Table 2

U.K. Credit Institutions Rated By Standard & Poor's

	Long-term rating	Outlook	Short-term rating
Retail banks			
Abbey National PLC* (subsidiary of Banco Santander, S.A.)	AA	Stable	A-1+
AIB Group (UK) PLC (subsidiary of Allied Irish Banks PLC)	A+	Positive	A-1
Alliance & Leicester PLC*	A+	Negative	A-1
Barclays Bank PLC	AA	Stable	A-1+
Bradford & Bingley PLC*	NR	N/A	A-1
Clydesdale Bank PLC (subsidiary of National Australia Bank Ltd.)	AA-	Stable	A-1+
Bank of Scotland PLC	AA	Stable	A-1+
HSBC Bank PLC (subsidiary of HSBC Holdings PLC)	AA	Stable	A-1+
Lloyds TSB Bank PLC	AA	Stable	A-1+
Northern Rock PLC*	A-	Watch Dev	A-1
National Westminster Bank PLC	AA	Negative	A-1+
The Royal Bank of Scotland PLC	AA	Negative	A-1+
Ulster Bank Ltd.	AA	Negative	A-1+
Standard Life Bank Ltd. (subsidiary of Standard Life Assurance Co.)	A-	Stable	A-2
U.K. banks primarily operating overseas			
Standard Chartered Bank	A+	Stable	A-1
U.K. bank holding companies			
Barclays PLC	AA-	Stable	A-1+
HBOS PLC	AA-	Stable	A-1+
HSBC Holdings PLC	AA-	Stable	A-1+
Lloyds TSB Group PLC	AA-	Stable	A-1+
Standard Chartered PLC	A	Stable	N.R.
The Royal Bank of Scotland Group PLC	AA-	Negative	A-1+
Building societies			
Britannia Building Society	A	Stable	A-1
Nationwide Building Society	A+	Stable	A-1
Yorkshire Building Society	A	Stable	A-1
Foreign banks incorporated in the U.K.			
Citibank International PLC (subsidiary of Citigroup Inc.)	AA+	Watch Neg	A-1+
Credit Suisse International (subsidiary of Credit Suisse)	AA-	Positive	A-1+
Morgan Stanley Bank International Limited	AA-	Negative	A-1+
Nomura Bank International PLC (subsidiary of Nomura Holdings Inc.)	A	Stable	A-1
Sumitomo Mitsui Banking Corp. Europe Ltd. (subsidiary of Sumitomo Mitsui Banking Corp.)	A+	Stable	A-1
UBS Ltd. (subsidiary of UBS AG)	AA	Stable	A-1+
Europe Arab Bank PLC (subsidiary of Arab Banking Group)	A-	Stable	A-2

Table 2

U.K. Credit Institutions Rated By Standard & Poor's (cont.)			
FCE Bank PLC (subsidiary of Ford Motor Co.)	B+	Stable	B-3
JPMorgan Securities Ltd.	AA	Stable	A-1+
Westpac Europe Ltd. (subsidiary of Westpac Banking Corp.)	AA	Stable	A-1+
Securities firms			
Banc of America Securities Ltd.	AA+	Stable	A-1+
Lehman Brothers Holdings PLC (subsidiary of Lehman Brothers Holdings Inc.)	A+	Stable	A-1
Morgan Stanley Group (Europe) PLC (subsidiary of Morgan Stanley)	N.R.	N/A	A-1+
Morgan Stanley & Co. International PLC	AA	Negative	A-1+
Asset managers			
F&C Asset Management PLC	BBB+	Watch Neg	A-2
Fidelity International Ltd. (incorporated in Bermuda)	A	Stable	A-1
Gartmore Investment Management Ltd.	BB+	Stable	B
Schroders PLC	A	Stable	A-1
Invesco PLC	BBB+	Stable	N.R.
Investment trusts			
3i Group PLC	A+	Stable	A-1
Edinburgh Investment Trust PLC	AA	Stable	A-1+
JPMorgan European Investment Trust PLC	AA-	Stable	A-1+
JPMorgan Fleming Mercantile Investment Trust PLC	AA	Stable	A-1+
Scottish American Investment Co. PLC	A+	Positive	A-1
Witan Investment Trust PLC	AA+	Stable	A-1+

Ratings at Dec. 18, 2007. *Converted from building society status to bank. N/A--Not applicable. N.R.--Not rated.

London: a global marketplace home to global players

London plays a vital role as an international financial center and is therefore host to a large number of foreign banks. These banks accounted for more than 50% of total U.K. banking assets at end-2006, the highest proportion of any major country. These banks are mainly engaged in interbank funding activity, corporate and investment banking, and, with a few exceptions, play little part in the domestic scene.

The strength and breadth of the U.K. economy, the size of its banking markets, the relatively high historical rate of growth, and the growing overseas earnings of U.K. banks have combined to create some of the most highly valued banking franchises in Europe and the world. Five of the largest 20 European financial companies by market capitalization are based in the U.K., and two of the 10 largest banking groups in the world are U.K. based.

Relatively high concentration

The U.K. retail banking landscape is dominated by the five biggest U.K. banks, listed below in order of total group balance sheet size. Between them they account for three-quarters of personal current accounts, 45% of outstanding residential mortgage advances, and 80% of ATMs. Their dominance is such that the Competition Commission has effectively barred them from making any further major in-market mergers or acquisitions. These are closely followed by two players with strong retail presences, Abbey National PLC and Nationwide Building Society.

- HSBC Holdings PLC, which owns HSBC Bank PLC in the U.K.;
- The Royal Bank of Scotland Group PLC, which owns The Royal Bank of Scotland PLC and National

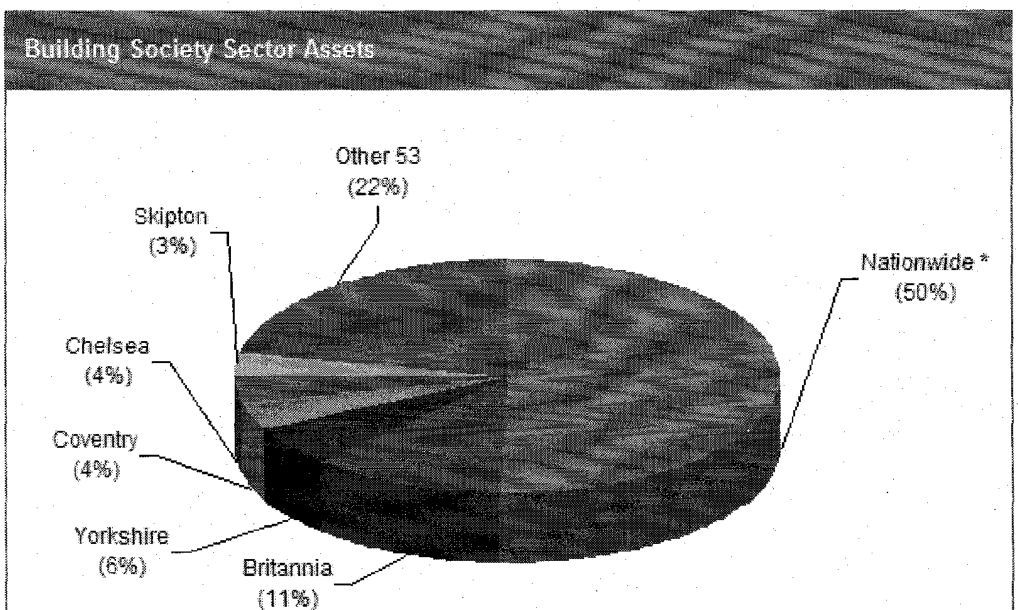
Westminster Bank PLC;
- Barclays PLC, which owns Barclays Bank PLC;
- HBOS PLC, which owns Bank of Scotland PLC (BoS);
- Lloyds TSB Group PLC, which owns Lloyds TSB Bank PLC.

Despite the dominance of the Big Five, the U.K. banking system remains open to new entrants. Recent examples include ING Bank N.V. (ING; AA/Stable/A-1+), which has built a useful deposit-taking franchise through its ING Direct brand, and Banco Santander S.A. (Santander; AA/Stable/A-1+), which has been working hard to rejuvenate Abbey National PLC since its acquisition in 2004. Niche opportunities also remain, particularly in business banking, where Bank of Ireland (BoI; A+/Positive/A-1), Allied Irish Banks PLC (A+/Positive/A-1), and Clydesdale Bank PLC have made inroads, and private banking, where the marketplace remains fragmented and small domestic banks vie with the Big Five and the large global wealth managers.

Building societies occupy a small, but important, niche

A further niche in the market is occupied by the building societies, mutual credit institutions akin to U.S. savings and loans. This sector is relatively small by most measures (the sector holds under 6% of U.K. banking assets), but punches above its weight in its core areas of expertise--the savings and residential mortgage markets, where it has historically maintained an 18%-20% market share. The sector has consolidated hugely in the past 20 years--from 273 societies in 1980, to 59 in September 2007. It has always been, and remains, a highly concentrated sector, and is dominated by Nationwide Building Society, which expanded further in 2007 through its merger with the Portman Building Society. The three largest societies, all rated by Standard & Poor's, together hold two-thirds of sector assets (see chart 15).

Chart 15



*Post merger with Portman Building Society. Source: Standard & Poor's, Building Societies Association, and company accounts; latest available data. Total assets=£313 billion.

The sector's raison d'etre is to provide value to its members. Societies usually do this through more attractive product pricing, displaying weaker reported profitability as a result, and some also pay members a quasi dividend. The "lost" profit arising from the former is hard to quantify precisely, but, given the partial flexibility that societies have here, Standard & Poor's takes this implicit subsidy into account when analyzing performance.

Abbey National became the first society to go down the demutualization route in 1989. Many others have since followed, for example, Halifax PLC in 1997, Alliance & Leicester PLC (A&L) in 1997, Northern Rock PLC in 1997, Bradford & Bingley PLC (B&B) in 2000--leaving commentators ready to write the sector's obituary a few years ago. However, while the societies tend to lack the diversification from which higher rated banks benefit, the sector's cultural differentiation remains its strength and, with more cautiously managed institutions having returned to fashion in the current market climate, its franchise appears stronger now than it has been for some time.

Strong competition in retail banking to continue, but growth set to slow

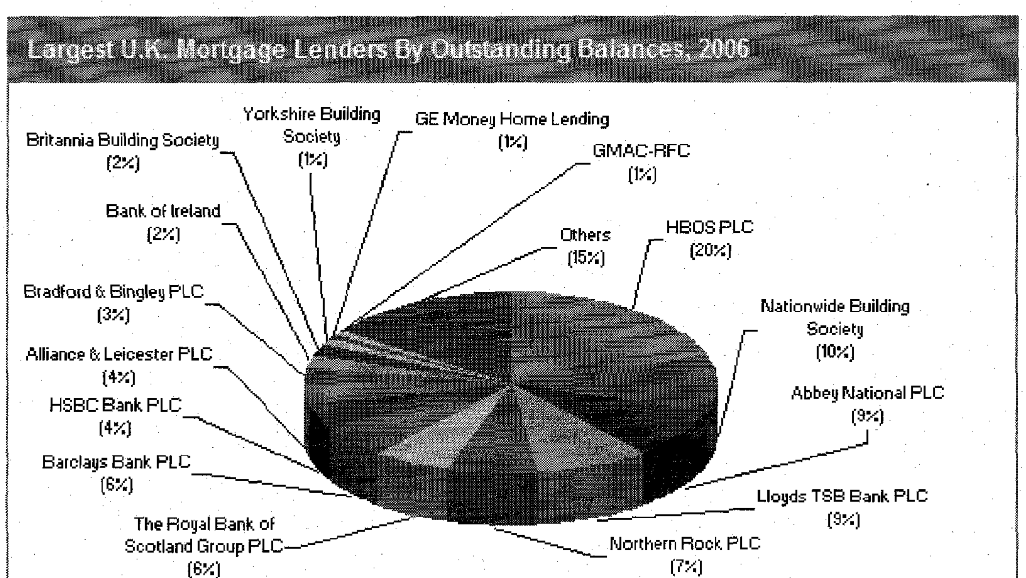
The U.K. retail sector continues to generate a significant part of banks' earnings and balance sheet exposures. Competition in the domestic banking market remains intense, but the banks have managed to maintain this as a high growth, high return business. Faced with a lack of acquisition opportunities, they have focused instead on customer acquisition--often achieved through initially weakly profitable or even loss-making rates--and cross selling to achieve organic growth. However, there are few barriers to customers' freedom to shop around, which has diminished customer loyalty for some products, such as credit cards and mortgages. These factors have led to margin squeezing, but given strong historical volume growth and still quite widespread customer inertia in some product lines, overall profitability has, to date, remained ample for funding organic growth, and many banks have run significant share buyback programs.

The outlook is less positive. The slowing economy and the mortgage market, and tighter credit conditions will all dampen revenue growth and rising loan loss provisions will similarly impact profit growth. While the U.K. banking market is mature, the degree of saturation remains unclear. The banks have started to leverage cross selling, but white-labeling opportunities remain, which allow them to bring in revenues from outside their own franchise. We expect to see more joint ventures, such as those already in place with many supermarkets. In addition, it should be remembered that unlike in many continental European countries, the broker and advisor channel is very strong in the U.K., meaning that the banks currently only see a small part of total U.K. nonbanking business. While the demise of this channel is hard to foresee, there is scope for the banks to wrest more market share, and fee income, into their own direct distribution channels. This would be tough to do, however, and would require a longer term project of engineering a fundamental shift in the customer's psyche, from product provider to trusted advisor--differentiation perhaps most easily achieved through customer segmentation and branding. In the meantime, the banks can be expected to plough the existing furrows--cost efficiency, further geographical expansion, product diversification, and capital efficiency.

The mortgage market pauses for breath...

Between 1999 and 2007, the U.K. mortgage market grew by 140%, with outstanding balances at end October 2007 of £1.17 trillion. This huge expansion is indicative of the rise in house prices, but equally reflects the increase over that period in lending activity generated from remortgaging, which accounts for about 40% of gross lending. The market is a far more dynamic and competitive one than it used to be. It has also become more concentrated as the scale economies of the largest players have enabled them to price more competitively--the top-five lenders hold a collective market share of about 55% (see chart 16).

Chart 16



Source: Standard & Poor's, Council of Mortgage Lenders, and company data.

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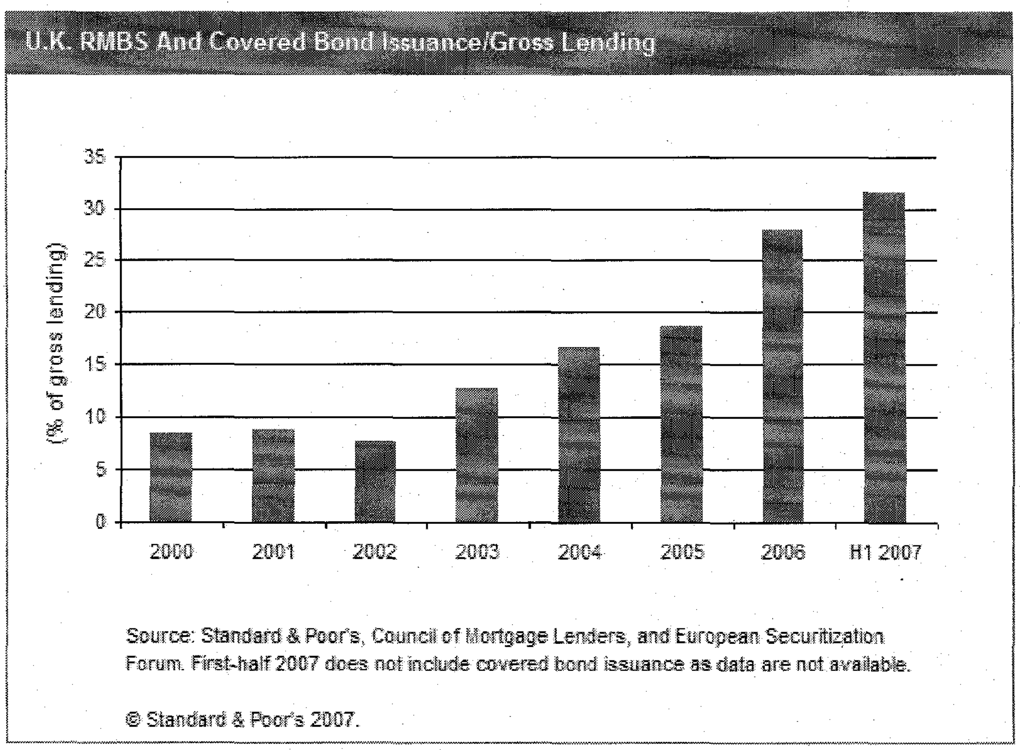
The growth in the market has been enabled by the flourishing of the RMBS, and latterly covered bond, markets, which have allowed banks to grow assets faster than they can attract deposits and to reduce their need for additional capital. RMBS issuance has grown rapidly and was equivalent to approximately one-third of gross mortgage lending in the first half of 2007, more than any other country in Europe (see chart 17). The current closure of this market therefore represents a real problem for the mortgage lenders, even if it proves to be temporary.

Chart 17



The RMBS market has also allowed a fundamental shift to take place in the nature of the lender/borrower relationship and a transition from the old "take and hold" model to one of "underwrite and distribute". This brought in new players, increased competition, compressed margins and, over time, has led the banks to increase their focus on higher margin (and higher risk) market segments. Most banks have dabbled in these segments, but a few, such as B&B, refocused their offering entirely.

The changed dynamic of the market has bought with it attendant risks, some realized in the U.K., some not. Securitization has been a useful tool for better aligning maturities of assets and liabilities, but high reliance on wholesale funding has clearly proven to be a weakness. However, there has been little evidence of other risks crystallizing, such as materially weaker underwriting standards or widespread cases of misconduct or fraud by intermediaries, with their highly commission-based incomes.

While the turn in the market has led to a widespread rethinking of approach by lenders and investors alike, the model itself is not broken. Securitization continues to provide an effective tool for banks' risk transfer and funding and as a portfolio diversification tool for investors. Standard & Poor's therefore expects the market to reopen to the banks, albeit perhaps with higher overcollateralization requirements and initially only for the best quality mortgages. This will logically first be seen in the covered bond market, which offers greater security than RMBS, and which will soon be underpinned by legislative framework in the U.K.

Chart 18
The Funding Crisis At Northern Rock PLC

Northern Rock PLC was a building society until 1997, when it demutualized. From 1999, it embarked on an aggressive growth strategy in its core sector, the U.K. residential mortgage market. This was facilitated by the development of the securitization markets, the bank's expertise in leveraging its highly efficient operational model, and its consequent ability to pass on attractive pricing to borrowers. It was so successful in this regard that it accounted for an exceptionally high 19% share of total new lending in the first half of 2007, and was the U.K.'s fifth-largest mortgage lender with 7% of stock. However, this model brought with it a key weakness--a high reliance on wholesale funding.

While the bank's credit quality has remained strong, it was undone by the rapid deterioration in the credit and money markets from July 2007, which ultimately saw the term funding markets--securitization and covered bonds--closed off. The bank's financing options became increasingly limited, so much so that by mid September it was compelled to seek backup liquidity support from the Bank of England, which it anticipated it would not need to draw on. Due to the perceived risk of contagion, the Government authorized the BOE to provide the facility, collateralized with Northern Rock mortgages. However, this frightened depositors and led to the first run on a U.K. bank since 1866. The Government stemmed this by guaranteeing all wholesale funding existing on Sept. 20, 2007, and all deposits.

At the time of writing, Northern Rock is undertaking minimal new mortgage lending. The BOE facility, which is open-ended to the extent that collateral is available, is thought to have grown to about £25 billion. A bidding process is underway for the bank, and is expected to be concluded by February 2008. If a sale does not proceed, alternatives include nationalization.

...but opportunities remain for the fittest

The supply of credit to the mortgage market has fallen markedly since August 2007 due to the, perhaps temporary, curtailment of Northern Rock's lending activity (see chart 18) and the scaling down of activity by those other lenders hit hardest by funding constraints (see chart 16). Those now most constrained have typically been the more aggressive and often highly wholesale funded, nonbank financial institutions such as Paragon (not rated) and Kensington (not rated).

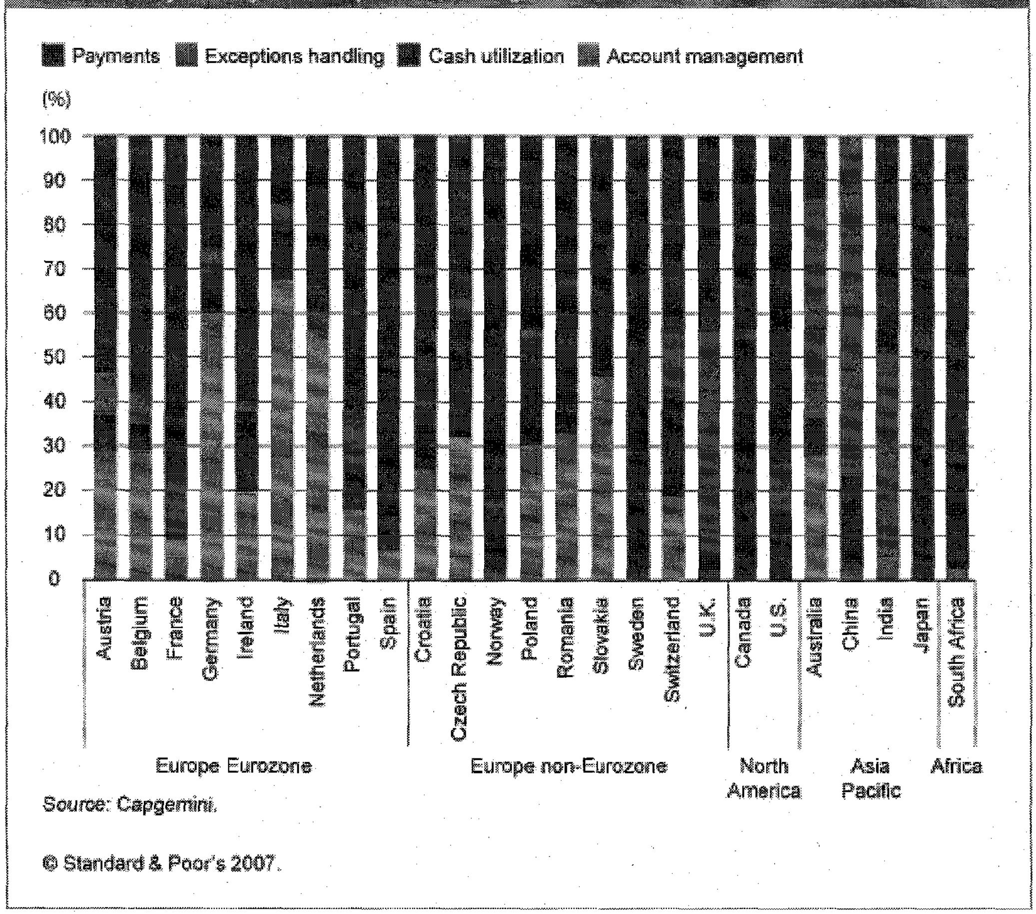
The rethinking of risk appetite by lenders can be expected to reduce supply further, particularly in the riskier segments. While greater mortgage persistency will support profitability for lenders, many are having to rethink their mortgage and funding strategies as a result of current market conditions, potentially leading some to take a seat on the sidelines until funding conditions improve. The fall in house market activity means that lenders will be fishing from a smaller pool going forward, but there will still be profitable and/or higher quality opportunities for those who have been able to establish a substantial degree of prefunding for 2008, and who also have the capital base and franchise to support it. Against a background of increasing household financial stress, lenders will require strong risk management to avoid adverse selection, but reduced competition should allow greater scope to cherry pick customers.

The end of "free" banking?

As margin contraction has pressurized interest income, U.K. banks have sought to offset this through growing noninterest income. This has included efforts to make additional product sales and the imposition of additional or higher penalty fees and charges on some products. The latter is also the function of a consumer base that appears to have an aversion to paying upfront fees for financial services. This results in markets in the U.K. such those for credit cards and current accounts, the latter being characterized by the dominance of the "free" banking model, that is, no standing charges. Aside from the striking difference across the various national banking markets, chart 19 shows the predominance of transaction charges and penalty fees as sources of income for U.K. banks. It is a small minority of the customer base that accounts for the majority of these fees.

Chart 19

U.K. Banks Rely Heavily On Exceptions Handling Fees

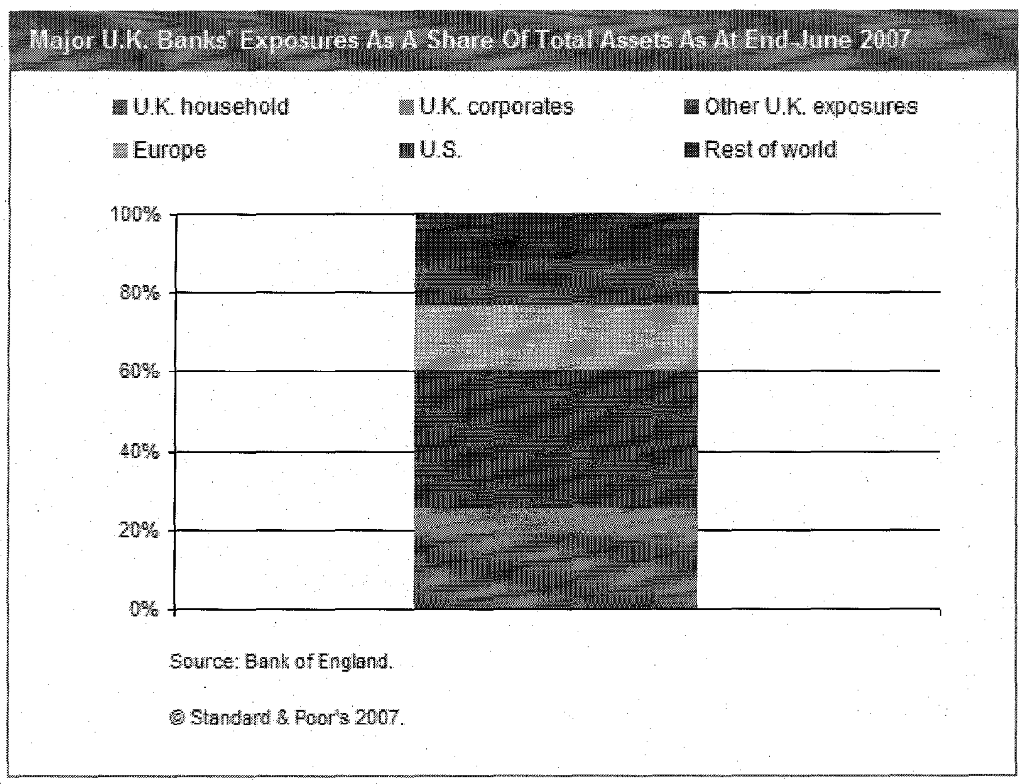


As noted below, the perceived excessiveness of banks' overdraft charges is an area of increased regulatory scrutiny at present, and a legal challenge to the charges is due to be heard in 2008. If the judgment goes against the banks, it could result in millions of pounds of additional reimbursements to customers. This could be expected to dent earnings in the period, but the banks can be expected to react and raise fees elsewhere. Of greater fundamental importance is the related, but separate, ongoing market study by the Office for Fair Trading (OFT) into personal current accounts, which addresses wider questions about competition and price transparency. Whatever the result, the principal value of current accounts, as a source of valuable credit quality information and enhanced cross-selling opportunities, is unlikely to change. However, one possible outcome is that standing charges on current accounts, which currently tend to appear only where additional services are provided, could become widespread. Other banks will have been studying closely the February 2007 move by HSBC's telephone and Internet banking subsidiary, First Direct, to introduce a monthly fee from for sole current account holders who keep average monthly balances below a certain limit.

Overseas expansion a continuing theme

The generally solid returns available from the domestic market led the U.K. banks to have a predominantly domestic focus in years gone by. The main exceptions have always been HSBC and Standard Chartered Bank (A+/Stable/A-1), both of which are international groups generating the majority of their earnings outside the U.K. Taking the large banking groups as a whole, their aggregate balance sheet is split 60%/40% domestic to overseas exposure (see chart 20).

Chart 20



The other large U.K. banks have a mixed history of overseas activity. Lloyds TSB Group is now essentially a domestic focused institution, having sold its principal remaining overseas operations in 2003/2004. By contrast, the others have been actively pursuing overseas expansion strategies for many years, mainly through acquisitions.

- HBOS acquired full control of BankWest in Australia in 2003, and also has an expanding presence in Ireland.
- RBS's $10.5 billion acquisition of Charter One in the U.S. in 2004 was the culmination of a string of smaller

acquisitions, starting from its purchase of RBS Citizens NA (AA-/Negative/A-1+) in 1988. It also has a material interest in Ireland (through Ulster Bank Ltd.; AA/Negative/A-1+) and is now in the process of acquiring part of ABN AMRO Bank N.V. (AA-/Positive/A-1+).

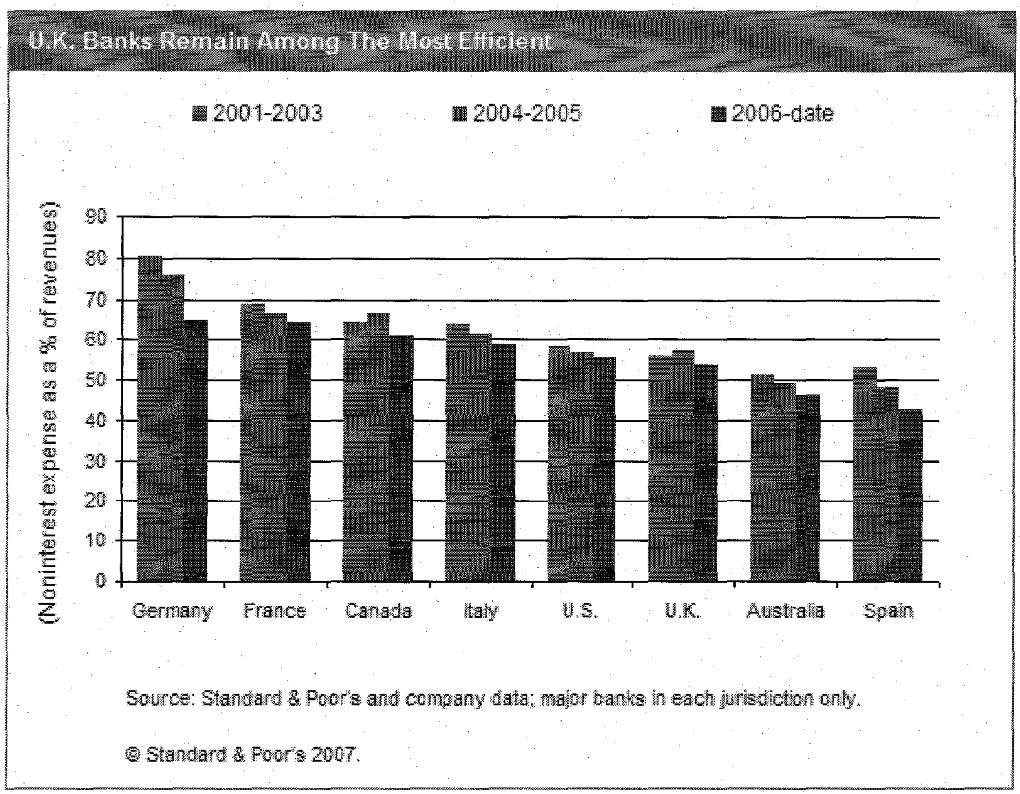
- Barclays international expansion has been more organic (in investment banking, asset management, and credit cards), but also by acquisition, notably the Spanish bank, Banco Zaragozano (not rated), in 2003 and the South African group ABSA (Absa Bank Ltd. is rated Api; unsolicited rating) in 2005.

Overseas expansion has been well managed so far in Standard & Poor's view, and should continue to provide significant diversification benefits and more attractive growth prospects than in the U.K. Therefore, while Standard & Poor's does not consider a wave of cross-border activity to be imminent, a continuation of the current trend of selective expansion can be expected. Other smaller U.K. institutions (Nationwide and A&L) are expected to continue to gradually increase their non-U.K. commercial assets on the fringes.

Relatively strong efficiency...

U.K. banks are among the most efficient in the world, as measured by cost-to-income ratios (see chart 21). The efficiency improvements have been enabled through substantial organizational and technological changes. These have seen the rapid growth of Internet and telephone banking to the partial detriment of the branch network, which is now focused more on sales and advice than account servicing. This has been facilitated for some by the establishment of centers of excellence for certain functions, such as call centers and transaction processing, often in locations such as India, where there is a large pool of cheap, but skilled, and English-speaking labor. Overall, U.K. staff numbers have reduced as a result, a task made simpler by the relatively flexible labor laws and the lack of government interference in private sector staffing decisions.

Chart 21



The scope for further significant reductions in the cost-to-income ratio appears limited in the medium term, as the quick wins for cost reduction have already been leveraged and provisioning requirements are expected to continue to rise as asset quality weakens. Nevertheless, there is likely to be renewed focus on cost control as banks seek to maintain current profitability.

...but regulatory pressures continue to rise

The deregulation of the banking sector was largely completed in the 1980s. Since then, State intervention has been quite limited, although attitudes have changed markedly in recent years. The government has also extended the reach of the Financial Services Authority's (FSA) regulation to include the conduct of mortgage and general insurance intermediation. Political reaction to banks' announcements of record profits and previous cases of misselling by the financial services industry have more recently led to increasing focus on the banks' sources of income.

Aside from the rule making around mortgage and general insurance sales, the FSA's pressure has typically been at a high level--encouraging banks to design products and processes that align shareholder and customer interests, and make banks take a closer interest in the actions of intermediaries. By contrast, the Competition Commission and OFT have focused on specific products and services. This has resulted in a litany of investigations in recent years which have variously identified the misselling of payment protection insurance, excessive profits on small and midsize enterprise (SME) business banking accounts, excessive mortgage exit fees, hidden costs to the customer in check clearing, and excessive default charges on credit cards and current accounts. Price controls on SME bank accounts (since rescinded) and credit card fees, fines, and enforced redress payments have followed.

This consumer-led agenda looks set to continue to occupy a significant amount of management time. To date, the impact on profitability has been relatively limited as compensation payments have not been hugely punitive and banks have been able to offset specific fee reductions by varying their overall fee structure, known as the "waterbed effect". While Standard & Poor's expects this resourcefulness to continue and does not expect a major long-term impact on bank earnings, continued pressure could lead banks to more fundamentally reappraise their retail business models.

Ownership: Strong Culture Of Shareholder Value

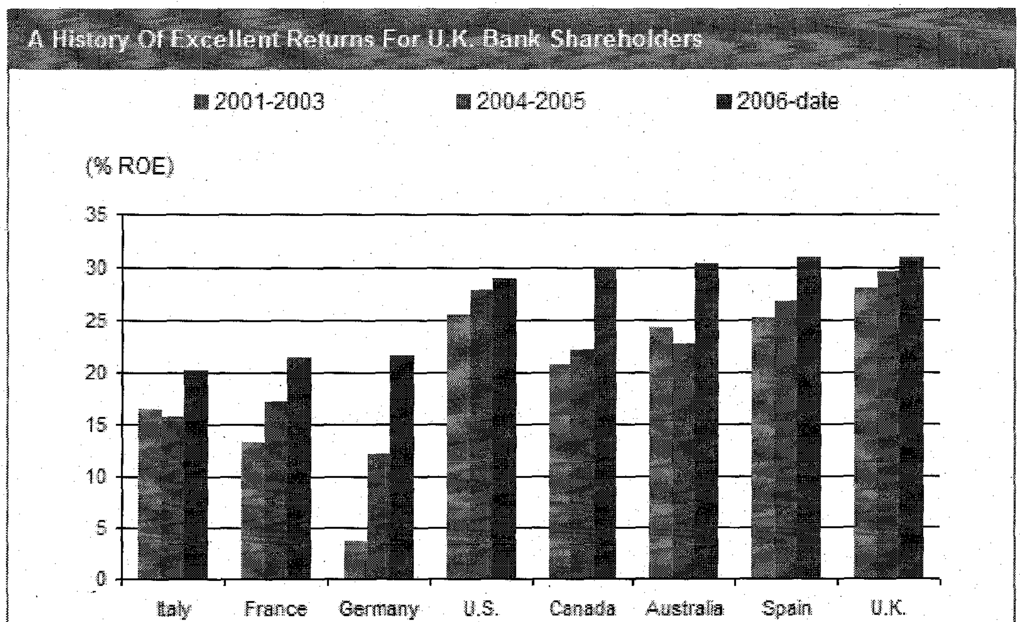
Unlike many European banking sectors, much of the U.K. banking system is publicly quoted. Government involvement is limited to the Post Office and National Savings, both of which have adopted a more commercial stance in recent years. The Post Office distributes a broad range of third-party financial products (via a joint venture with BoI) including loans, while National Savings now offers equity-linked products. The mutual sector remains significant, but is comparatively fragmented. Owing to the predominantly commercial nature of the U.K. banking sector, a strong culture of shareholder value has developed, which helps to explain the focus on profitability.

Bank shares are listed on the London Stock Exchange, where liquidity is usually very good, ownership well distributed among institutional investors, and disclosure requirements strong. Building societies are mutually owned, and the bulk of their customers are members, although they also issue a publicly traded form of capital known as permanent interest-bearing shares.

Financial Trends

The absolute profitability of the U.K. banking sector has been strong and resilient for several years, thanks in large part to the benign credit environment. Opportunities for profit growth have become harder to come by in the past few years, however, as a result of weaker retail demand, although this has been offset by a high degree of revenue diversity, expanded corporate and investment banking operations for some, increased operational efficiency, and still relatively high margins on some products. Share buyback schemes and hybrid debt issues have been employed widely to assure shareholder value, with the result that the largest U.K. banks still have the highest average ROE of their international peer group (see chart 22).

Chart 22



ROE defined defined as core earnings/average adjusted common equity. Source: Standard & Poor's and company accounts.

However, the credit cycle has turned abruptly since August 2007. Higher funding costs may be offset by widened asset spreads to a significant degree, but some banks are recording significant impairment losses on their investments, and lower volumes and rising bad-debt charges can be expected to constrain future profit growth. Unexpected balance sheet expansion, due to the longer warehousing of risk and funding off balance sheet commitments to structured investment vehicles (SIVs) and conduits, is a further constraint for some. However, the impact here is primarily on funding, rather than capital, and it appears manageable.

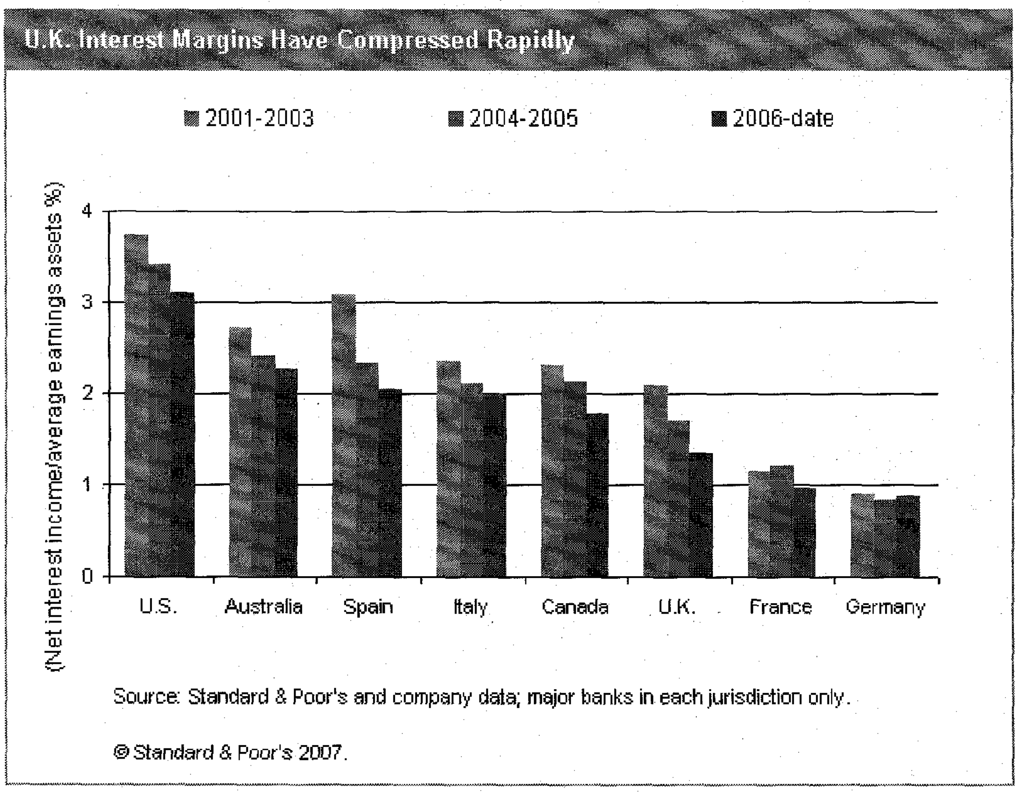
Overall, Standard & Poor's expects the downturn to remain manageable for most of the rated sector within current rating levels, but we do expect to see a greater dispersion in reported performance. Painful though it will be, the repricing of credit risk will ultimately benefit the banking sector and the broader economy, leading to a more differentiated and more adequate pricing of the risk in the medium to long term. This will mean that lenders and investors will be more appropriately compensated for, and better protected against, credit risk on new business.

Overall profitability strong, despite margin compression

In absolute terms, the rate of domestic earnings growth for the U.K. banking sector has slowed in recent years. Nevertheless, overall profitability continues to compare well with that of international peers', largely due to good cost control and business diversification. The comparatively wide range of business and geographic diversity of most U.K. banks should continue to provide a buffer against the current cyclical downturns in the credit markets.

Slowing domestic earnings are due to the margin squeezing seen in the past few years (see chart 23). While margins have declined among international peers too, they were already tighter in the U.K. and the compression has been more acute. This has resulted in asset growth outpacing income growth and a drive toward higher margin--and higher risk--segments and fee-based income. Standard & Poor's expects the decline in margins to moderate, but, while the repricing of assets is already underway, liability spreads look set to decline. The probability of a material improvement in interest margins is therefore low.

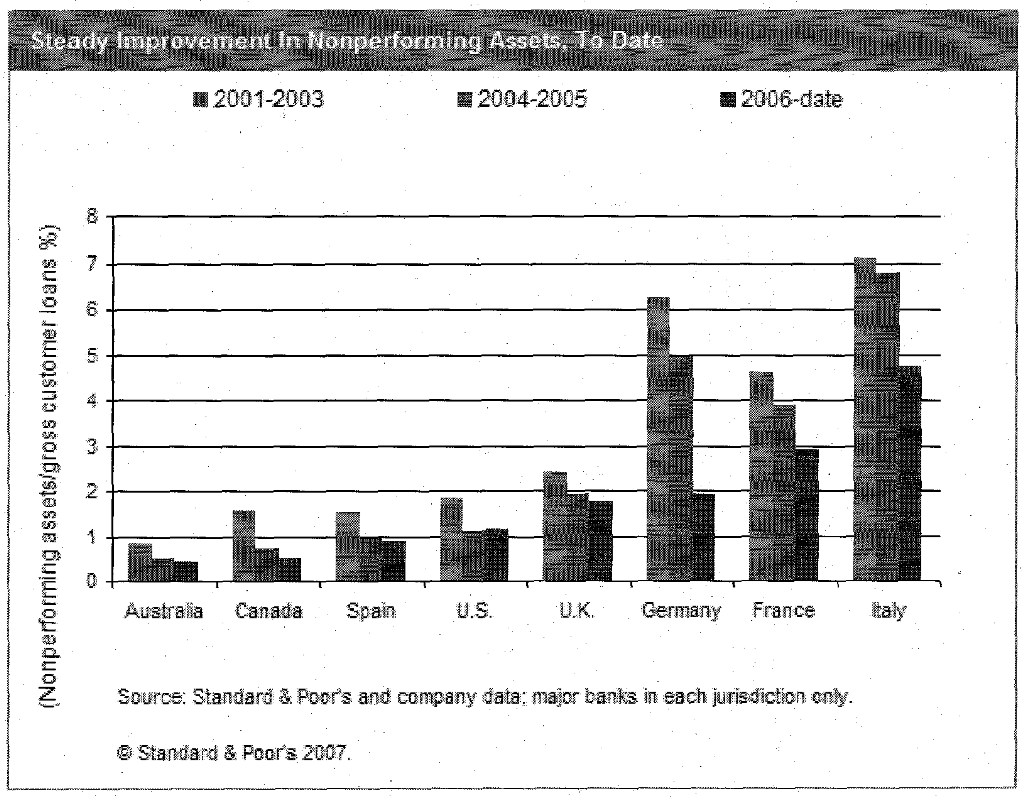
Chart 23



Specific credit quality concerns emerging, but still a healthy overall picture

Credit quality is robust for corporate loans and residential mortgage borrowers, with loan loss provisions and nonperforming assets remaining consistently low by historical standards and satisfactory when compared with international peers (see chart 24). However, the household sector continues to weaken and write-off rates in unsecured lending have already spiked. This is echoed, albeit to a lesser degree, in the corporate world, where leverage has increased. Bad-debt charges are therefore likely to continue to rise into 2008 from the current levels. Standard & Poor's considers, however, that provisioning growth is likely to be gradual and measured, so that the impact on banks' profitability will be relatively muted.

Chart 24



In addition, U.K. banks have not been immune from the problems in the U.S. and the broader turn in market sentiment. While direct exposures to U.S. subprime have been modest, many banks have taken hits to reserves due to write-downs on their investment portfolios and/or impairment losses on their exposures to SIVs. In addition, some of the larger banks--Barclays and HBOS in particular--have been big players in the leveraged finance market and are now having to warehouse underwritten loans for longer and take, as yet modest, markdowns to some of them. While the underlying credit quality is typically still sound, these tend to be quite concentrated exposures. It is as yet unclear whether further write-downs will be needed.

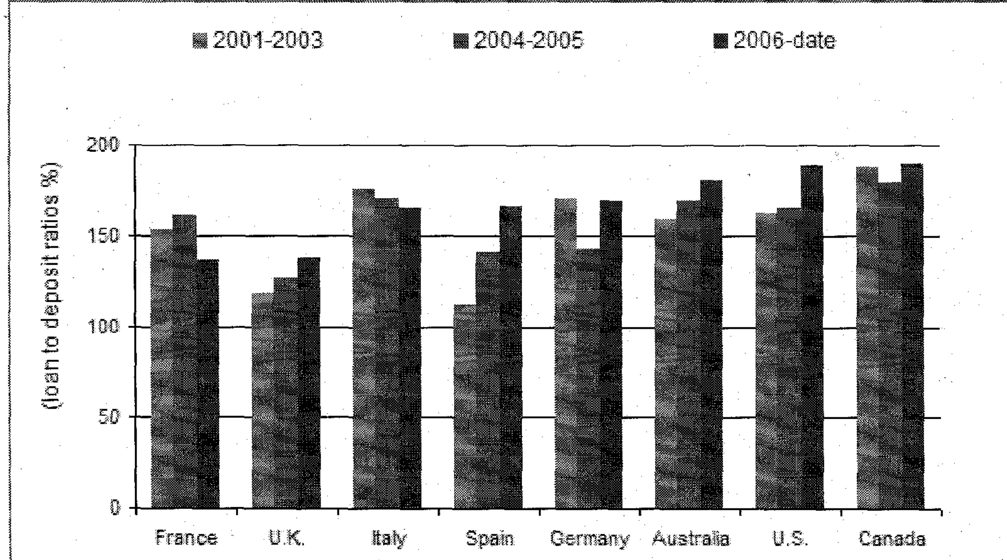
Generally moderate levels of wholesale funding in the global context...

U.K. banks and building societies were traditionally largely funded by customer deposits. This remains the case for most building societies, including Nationwide and Yorkshire Building Society, who typically have wholesale funding ratios of less than 25%. Although societies now have increased legal freedom to take on more wholesale funding (for more information, see "U.K. Parliament Proposed Legislation Will Not Affect Building Society Ratings," published on Aug. 23, 2007, on RatingsDirect), they are unlikely to do so in a material way, particularly in the current environment.

By contrast, U.K. banks have seen strong asset growth outstrip that of deposits in recent years, requiring them to increase their wholesale funding. This has been facilitated by the emergence of the covered bond market in the U.K., which has developed since 2003, despite there being no specific legal regime for covered bonds in the U.K. Despite this trend, U.K. banks have remained relatively deposit funded by global standards (see chart 25).

Chart 25

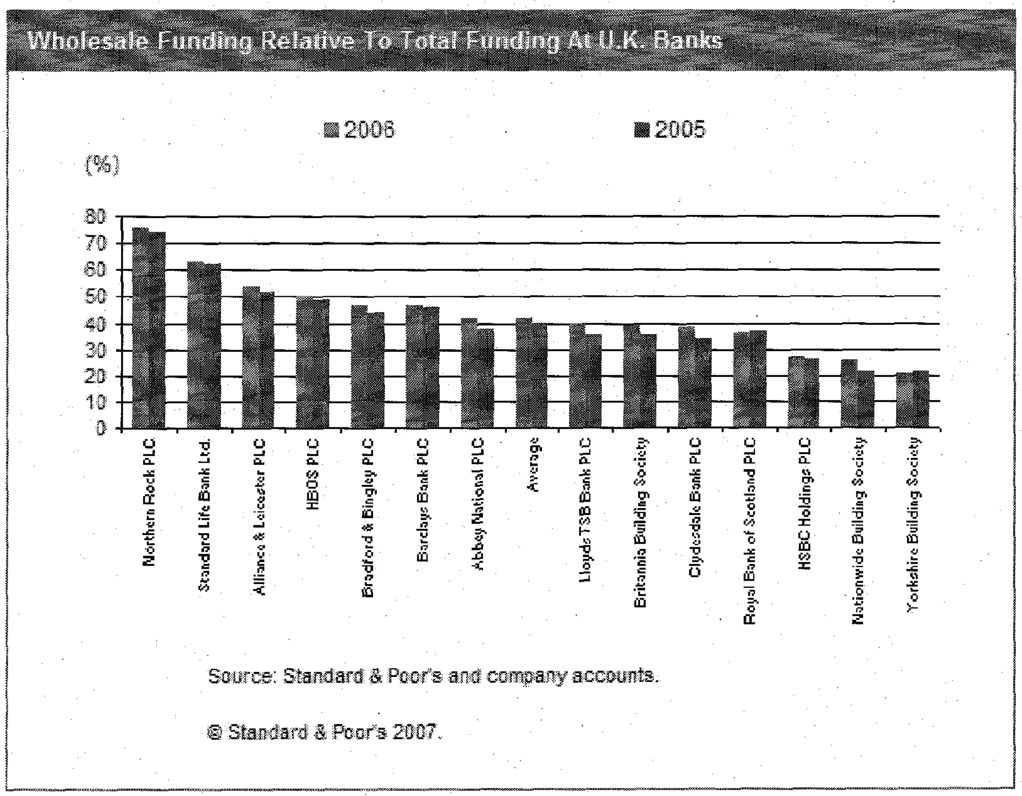
U.K. Banks' Funding Relatively Sound In The Global Context



Source: Standard & Poor's and company data; major banks in each jurisdiction only.

However, as it has been well documented, there are outliers within this U.K. peer group--notably Northern Rock (see chart 26).

Chart 26

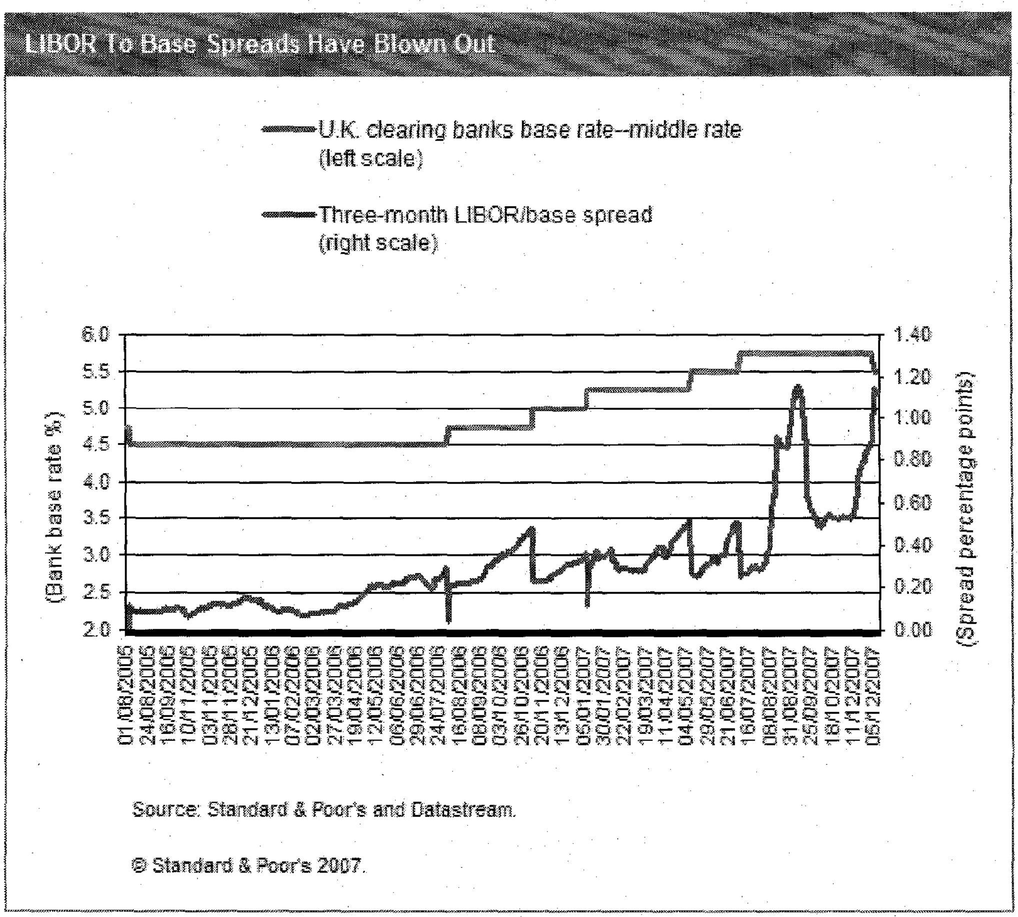


..but that is of scant comfort when the term lending market closes

Until recently, wholesale funding has been a cost efficient and predictable way of growing the balance sheet--competition for term retail deposits remains fierce and has led to the increased prevalence of "hot money" that moves with the best available rates.

The market dislocation that has occurred since August has exceeded the expectations of all but the most pessimistic stress tests--the secured lending market has almost entirely dried up, some SIVs and conduits are having to be funded or their assets brought on balance sheet, the door to the U.S. (and other) CP markets has been shut for many U.K. banks, and the LIBOR spread over BoE base rates has mushroomed, hitting 152 bps on Sept. 12, 2007. While the latter then retrenched somewhat, it has moved out again (see chart 27). This is the result of continued negative market sentiment, mutual distrust, and cash hoarding, particularly as banks move into the traditionally illiquid Christmas and New Year period.

Chart 27



Most U.K. banks went into this period quite well placed, having spent the past year actively diversifying their funding sources and extending the maturity profile of their debt. However, while a few cash-rich institutions have since fared reasonably well--typically those with a very strong retail funding base or who had prefunded their expected lending--the majority has been hit hard, albeit to varying degrees. Although regulatory liquidity ratios have not been seriously under threat, the inability to borrow beyond three months in the wholesale markets at anything other than the most punitive rates, even on a secured basis, has led to a steady diminution of average funding tenor for many institutions.

The banks have deployed a mixture of strategies in response--renewing attempts to attract retail deposits, curtailing loan growth, selling noncore assets. A handful has even managed private placements of securitized loans, albeit at more elevated prices. In doing so, U.K. banks have been at a notable disadvantage when compared with Eurozone banks in that, unlike the European Central Bank (ECB; AAA/Stable/A-1+), the BOE has had a longstanding policy of not accepting securitized residential mortgages as collateral. Although the BOE has since changed its stance, accepting these notes at its special auctions, this route remains somewhat stigmatized. Some banks have instead pledged the notes from their internally securitized mortgages directly with the ECB--possible if they have a branch in the Eurozone--or repoed the notes through friendly third parties.

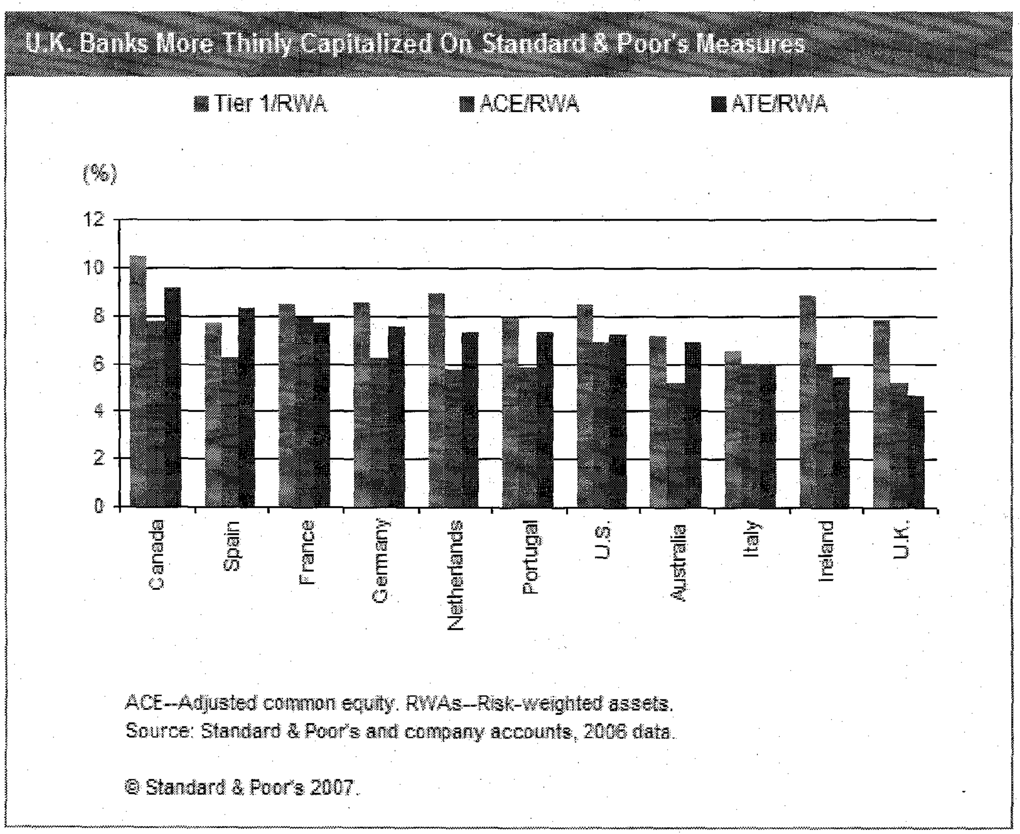
Standard & Poor's continues to be in regular contact with all of its issuers regarding their liquidity, and expects funding conditions to start to normalize in the New Year--although this could certainly be as late as the second quarter. When the smoke finally clears, some banks can be expected to fundamentally rethink their funding and liquidity policies and the regulatory requirements may also change--both of which could have wider implications for business strategy and interest margin. Although as Northern Rock has shown, retail deposits can be subject to flight in extremis, Standard & Poor's continues to regard retail deposits as the most stable and least risk-sensitive form of funding, and therefore from a liquidity perspective regards those banks with proven retail deposit franchises favorably. This is not to say, however, that wholesale funding does not have its place--particularly where it is well diversified by tenor and source, and it serves to match the maturities of an institution's assets and liabilities more closely.

Some institutions have benefited from a one-off inflow from the reported "£10" billion of former Northern Rock deposits since withdrawn. Competition for retail money, which is already quite strong, can be expected to pick up further, with predictable consequences for interest margin. However, even though economic growth should grow the deposit pool and the weaker market outlook will bring in money from other investment types, how much extra money is out there is unclear. It is certainly conceivable that some banks will be unable to hit their deposit targets and may have to constrain asset growth as a result.

Relatively weak capitalization, despite strong earnings generation

Standard & Poor's considers the capitalization of the major U.K. banking groups to be quite weak. This is the result of the banks' strong culture of shareholder value, which has led capitalization to be tightly managed and, in the event of the buildup of "excess" capital, share buybacks to be regularly deployed. In addition, U.K. banks have been at the forefront of the shift toward the greater use of nonequity Tier 1 capital and securitization.

Chart 28



Capital ratios for U.K. banks, when analyzed by Standard & Poor's preferred capital measures do not compare well internationally (see chart 28). Standard & Poor's capital measures now differ markedly from regulatory capital for several reasons. First, this reflects the significant role for nonequity capital within Tier 1 (typically more than 25% of the total), which is excluded from Standard & Poor's adjusted common equity (ACE) measure. Second, following the introduction of IFRS, the FSA took a lenient approach because it only partially deducts pension deficits and proposed dividends. Both of these are material for U.K. banks because they have tended to have relatively high pension deficits and dividend payout ratios. Standard & Poor's considers these should be fully deducted from equity capital.

Third, the FSA only deducts from total regulatory capital the embedded value of life insurance subsidiaries, net assets of general insurance subsidiaries, investments in other banks' capital, and retained equity in securitization vehicles. Standard & Poor's takes a more conservative view by analyzing adjusted total equity (ATE), which further adjusts for these factors. The above, combined with the U.K. banks' emphasis on origination and distribution of credit risk in recent years, have created material and growing differences between regulatory ratios and Standard & Poor's preferred capitalization measures to an extent not seen in most other countries.

Capital outlook uncertain

There are currently a number of opposing forces on U.K. bank capitalization, which will likely lead banks to plot different courses to maintain the status quo. On the upside, Standard & Poor's expects bank earnings to continue to support capital generation and for many banks to benefit from reduced capital requirements under Basel II. Slower asset growth should also result in less capital strain. This is counterbalanced, however, by a number of headwinds. Market conditions have forced a return, perhaps temporarily, from the distribution and securitization-led model of loan origination adopted by many institutions to the old one of "take and hold". The resultant asset growth will be exacerbated for those banks being forced to bring conduit funding and SIVs back on balance sheet. Additional pressures include impairment charges on some investment portfolio assets and the further expected rise (from a low base) of NPLs.

Standard & Poor's expects U.K. banks and building societies to continue to have the means to fairly comfortably exceed their capital requirements. However, the above factors will weigh differently on individual banks and the implications could range from capital releases for those with the least risky profiles, to restricted asset growth, sales of noncore assets, or even dividend cuts. What is certain is that share buybacks will not be as ubiquitous as they have been until now.

Basel II implications unclear for overall bank capitalization

By Jan. 1, 2008, all U.K. banks and building societies will have moved to the Basel II capital regime. Regulatory approval of their capital models continues apace, but it seems likely that, as in many other European countries, the larger, more complex institutions will typically be on internal-ratings based approaches for credit risk and standardized or advanced approaches for operational risk. The FSA is less usual in that it has both the power and the intent to make an additional Pillar 2 charge where it considers capital to be an appropriate mitigant of risks not captured by Pillar 1. As in other countries, the FSA will impose a floor, limiting any capital release in 2008 to 10% of the capital requirement under Basel I.

Some trends are already clear. Institutions with a large proportion of residential mortgages on their books will see their credit risk charges fall materially below current requirements--in many cases they could more than halve--to the extent that they will be nowhere near offset by the new operational risk and Pillar 2 charge. Institutions will have an even greater focus on efficient capital usage, leading to exits from business lines or asset disposals where risk-adjusted returns have become less attractive. Indeed, this was the primary driver behind the recent loan book disposals by B&B and RBS. Finally, as Standard & Poor's is already seeing, the quality and effectiveness of enterprise risk management and disciplines such as stress testing is generally rising, particularly at smaller U.K. institutions.

While Standard & Poor's broadly welcomes Basel II and expects any changes in bank capitalization to be gradual, we are concerned that some banks might seek to 'spend' the regulatory benefits of Basel II through asset growth or capital releases. We will assess such changes in capital policy closely as, in our view, Basel II merely changes the measurement of risk, not the underlying economic risk itself. In addition, the variety of approaches permissible under Basel II will make meaningful international comparison of banks' capitalization levels very difficult. As a result, our new risk-adjusted capital measure (see related articles listed in table 3) will become our benchmark to assess banks' risk-adjusted capital and risk-adjusted profitability. Standard & Poor's continues to press for enhanced and consistent disclosures under Pillar 3 (see table 3).

An internationally respected regulatory regime has lost some of its luster

The high-level approach to financial services regulation is laid down in a Memorandum of Understanding (MoU) between Her Majesty's Treasury (the finance ministry), the BoE, and the FSA--collectively known as the Tripartite Authorities. Its purpose is to specify each party's responsibilities to avoid gaps or duplication in their work programs. The Treasury is responsible for the overall structure of regulation and the legislation that governs it. The BoE is responsible for the overall stability of the financial system and its infrastructure, particularly the payment systems. The FSA authorizes and supervises individual firms and regulates the conduct of financial markets. The MoU sets out a framework for regular information exchange between the three bodies.

The FSA has a broad remit as the single regulator of the U.K. financial services sector. A key driver behind its establishment in 1997 was the number of financial services conglomerates in the U.K., and the blurring of traditional product boundaries. Most financial groups are now supervised on an integrated basis by the FSA.

The FSA assumed its full powers in 2001, following the enactment of the Financial Services and Markets Act 2000 (FSMA). The FSA's responsibilities are governed by four statutory objectives included in the FSMA:

- Maintaining confidence in the U.K. financial system;
- Promoting public understanding of the financial system;
- Securing the right degree of protection for consumers; and
- Helping to reduce financial crime.

In addition to inheriting the supervisory roles of its predecessor bodies, the FSA has since been allocated a number of new responsibilities. It has been given a much stronger consumer education remit than any previous regulator, for example, and its supervisory net has also been widened to capture activities such as the Lloyd's insurance market and wholesale market abuse. A further extension of its powers in 2005 was the introduction of mortgage and general insurance regulation. This regime focuses on the sales and administration processes for these products, which used to be subject to a voluntary code of conduct. The FSA is a major contributor to developments in international banking supervisory standards, and strictly applies them to U.K. institutions. In several cases, its rules are more stringent than those required by the Bank for International Settlements (BIS). It routinely sets minimum total regulatory capital ratios that exceed, often by a considerable margin, the 8% level prescribed by the BIS, for example.

Overall, Standard & Poor's regards the FSA as a well-managed organization that capably carries out its supervisory responsibilities. Indeed, its integrated and proportionate approach and principles-based regime have arguably helped to underpin the attractiveness of London as a global financial center. However, it remains an organization of finite resources, which has been asked to expand its remit into new areas while simultaneously implementing new capital (Basel II, Solvency II) and conduct of business (MiFID) regimes, monitoring the health of the entire U.K. financial system, and trying to attract experienced professionals in a hot labor market. While the FSA has always been clear that it operates a nonzero failure regime, the near failure of Northern Rock PLC, one of the country's biggest banks, is not consistent with this principle. However, lessons will be learned and the reputational damage to the FSA, and that of London as a whole, should be repairable.

Crisis management: changes afoot in the light of Northern Rock

In the event of a problem arising, the Tripartite Authorities' are required to work closely together to coordinate their response, including possible support operations. The combined business continuity working group that would take the lead in managing an operational disruption caused by, for example, widespread system failures or a terror incident. While the arrangement appeared sound in principle, the Northern Rock case--which was its first major test--highlighted certain disagreements and differences in approach that arose from the differing objectives of each constituent body. Although there will no doubt be lessons learned from the episode, the model appears likely to remain substantially unchanged.

Like most mature market economies, the U.K. is classified as "supportive" by Standard & Poor's. The Tripartite Authorities make no forward commitment to intervene in the event of a bank failure--consistent with the FSA's nonzero failure regime of supervision. However, where a bank failure would be of systemic importance, such that it would have financial stability implications, intervention appears much more likely. This is the scenario that led to their extraordinary support of Northern Rock. Where this support occurs, the implications are factored into the ratings on that institution. While the Northern Rock case sets a precedent, Standard & Poor's considers that potential extraordinary future external government support in the U.K. for individual institutions remains uncertain. The credit ratings of U.K. banks will therefore continue to receive no routine uplift for this to their stand-alone rating.

Bank depositors are protected under the Financial Services Compensation Scheme (FSCS). Independent from the FSA, but accountable to it, the FSCS covers deposits, investments, and insurance in the event that an FSA-authorized, U.K-incorporated company is unable to pay its obligations. If an overseas bank with a U.K. branch became insolvent, the deposit protection arrangements and legislation of the relevant home country would determine the recovery potential of U.K. depositors.

Until recently, the FSCS provided substantial, but not full coverage of deposits up to a £35,000 threshold, with any payment above this amount depending on the proportion of the bank's assets that could be recovered. Although this level of coverage is relatively generous when compared with some other EU countries, the queues outside Northern Rock branches highlighted some retail depositors' ignorance of the scheme, as well as broader concerns about its partial coverage and the timeliness of any compensation. The coverage of the scheme has since been extended to 100% of the first £35,000 that depositors have with each institution. To date, this move has had limited immediate financial implications for the banks who fund the scheme. However, since the scheme remains only partially prefunded, a contingent liability remains in the form of a future call on the banking sector up to £1.8 billion if a bank failure triggers a large compensation payout. Despite the change to coverage noted above, concerns remain around the timeliness of payments, the coverage levels, and other aspects of the scheme. The Tripartite Authorities are therefore undertaking a root and branch review of the FSCS, the outcome of which is due to be announced in 2008.

Accounting

Comparability improving following transition to IFRS

With effect from 2005, for listed companies U.K. GAAP was replaced by IFRS--a common accounting framework implemented across all EU countries. The principal advantage of IFRS is that it allows better cross-border comparisons of company accounts, thanks to greater standardization, although the extent of harmonization is still unclear.

The major U.K. banks restated their 2004 GAAP accounts under IFRS, taking advantage of the option not to apply the new accounting standards IAS32, IAS39, or IFRS4 to their 2004 comparatives. Financial statements from 2005 include the effect of these standards, and are therefore not directly comparable with 2004 IFRS restatements--although many banks attempted to quantify the difference. This transitional loss of time series comparability is being remedied over time with the publication of more recent full-year accounts, which are consistent with those in 2005.

Pensions deficits falling, for now

Until quite recently, U.K. banks have tended to have relatively large pension deficits as a result of the emphasis on final salary occupational schemes in the U.K. and the significant falls in stock markets in 2000-2003. There are also other postretirement benefit obligations (principally medical schemes), but these are relatively small.

IFRS requires either full recognition of a net deficit or surplus on balance sheet or, under the "corridor approach", to defer certain actuarial gains and losses. This has the effect of reducing equity at most U.K. banks, given that most schemes are in deficit. It also increases the volatility of shareholders' equity, because deficits can move significantly with market performance and assumptions underlying the actuarial valuation of the pension liability. This volatility has been mitigated for the purposes of regulatory capital, however, because the FSA allows an institution to deduct from Tier 1 an actuarial estimate of the next five years' of employer contributions into the funds if this is lower than the full deficit. This approach is likely to be reviewed in the coming 12 months-18 months.

Although Standard & Poor's considers these deficits to be manageable, they are, nevertheless, a real--if long term--liability and therefore need to be taken into account in an assessment of capital. We therefore adjust ACE and ATE for institutions that do not fully reflect these deficits in their net assets. This includes Barclays and Lloyds TSB, who both report under the corridor approach to IAS19. (For more information, see "Defined-Benefit Pension Obligations: Massive Reductions In Deficits For Western European Banks Mask Underlying Risk," published on July 26, 2007.)

A mix of higher pension contributions from some banks during 2006 and, more importantly, favorable market conditions that lifted asset returns, resulted in a huge reduction in the deficits reported under IAS19 by U.K. and other Western European banks. In addition, even though the benefits payable in the future increased due to the revision of assumptions regarding longevity, salary growth, and inflation rates, these were typically offset to a significant extent by the change in the discount rate on these obligations.

For the largest six U.K. banks, the aggregate deficit plummeted from £20.3 billion at end 2005 to £11.9 billion at end 2006. This equates to 6% of the total reported equity of these banks, against an average of 5% for Western European banks as a whole. However, aggregate obligations still stood at 47% of the total reported equity of these banks. This highlights that such liabilities still represent a significant risk to the banks' balance sheet and that their management is an important part of a bank's overall financial and risk management strategy.

Furthermore, as we noted in the article cited above, Standard & Poor's does not consider the recent improvements in deficits to be permanent--deficits could deteriorate in the future depending on the application of asset-liability management strategies, bond yields, and other market movements. Indeed, while the banks' end-2007 accounts may see further reductions in their reported pension deficits, the prospect of further increases in life expectancy, weaker equity returns, and lower interest/discount rates seems to place upward pressure on pension fund deficits from 2007 onwards.

Appendix 1: Basic Data On The U.K. Banking System

Sovereign credit ratings

Table 3

Sovereign Ratings On The U.K.	Local currency	Foreign currency
Long-term rating	AAA	AAA
Short-term rating	A-1+	A-1+
Outlook	Stable	Stable

The long-term sovereign rating on the U.K. has been maintained at 'AAA' since it was first assigned in 1978. The most recent analysis of the U.K. was published on Jan. 25, 2007.

Number of banks

At the end of October 2007, there were 339 authorized banks in the U.K. Of these, 156 were U.K. incorporated, 100 were incorporated elsewhere in the European Economic Area (EEA) and operated in the U.K. on a branch or cross-border basis, and 83 were incorporated outside the EEA. In addition, there were 59 building societies.

System deposits

At Sept. 30, 2007, the U.K. banking sector's balance sheet included £6,157 billion of deposits, of which £2,649 billion were held by U.K. financial institutions, and £3,509 billion by overseas financial institutions. About £2,886 billion of the total came from outside the U.K.

Deposits per capita

Deposits with banks and building societies by U.K. residents totaled £27,075 per capita at Sept. 30, 2007.

Form of regulation

The FSA became the single regulator for financial services in the U.K. in December 2001, and supervises banks and building societies under the FSMA. The BoE retains responsibility for the oversight of payment systems.

Bank superintendent

The Chairman of the FSA is Sir Callum McCarthy, who was appointed in September 2003. The Chief Executive is Mr. Hector Sants, who succeeded Mr. John Tiner in July 2007.

Appendix 2

Table 4

Related Articles	
Major European Banks Show Resilience In Difficult Market	Nov. 15, 2007
Lessons From The U.S. For U.K. Nonconforming Mortgages—Six Months On	Nov. 5, 2007
European Economic Forecast: Europe's Central Banks Weigh Inflation Against The Fallout From The U.S. Slowdown	Oct. 31, 2007
Northern Rock And The Liquidity Squeeze: Implications For U.K. Banks In The Longer Term	Oct. 11, 2007
Payment Shock Approaching For Borrowers In U.K. Nonconforming RMBS	Sept. 27, 2007
What Are The Implications Of Northern Rock's Bailout For Other U.K. Banks?	Sept. 18, 2007
Defined-Benefit Pension Obligations: Massive Reductions In Deficits For Western European Banks Mask Underlying Risk	July 26, 2007
Greater Basel II Pillar 3 Disclosure Would Enhance Transparency And Comparability In The Global Banking Sector	July 10, 2007
Growth And Returns Lure Lenders To The U.K. Specialist Mortgage Market	June 6, 2007
Building Standard & Poor's Risk-Adjusted Capital Framework	June 4, 2007
European Credit Card Index Report Q3 2007	Nov. 19, 2007

Table 4

Related Articles(cont.)	
U.K. Prime RMBS Index Report Q3 2007	Nov. 26, 2007
U.K. Nonconforming RMBS Index Report Q3 2007	Nov. 16, 2007

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com

Europe | United Kingdom
Diversified Banks (GICS) | Banks (Citi)

Company Focus

20 February 2008 | 20 pages

Barclays PLC (BARC.L)

Estimate change ☑

Relief Rally Overdone

- **No new black holes discovered** — New disclosure and the apparent absence of new problem areas has injected a degree of confidence that further credit market related losses will remain manageable. Although this may yet prove optimistic, with significant 'Alt A' and other US subprime-related exposures remaining on balance sheet, we do not view this as the single most pressing issue facing the group.

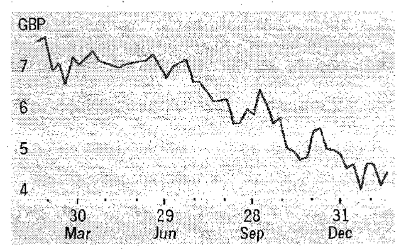
- **Lack of revenue growth drivers a major concern** — We estimate that underlying revenue growth in 2H07 at Barclays Capital fell to c2% yoy and would not expect conditions to significantly ease in 2008, despite an expectation of lower credit related write-downs overall. We struggle to see where the lost ground can be meaningfully recovered, with both domestic and international businesses currently facing headwinds elsewhere in the group.

- **Balance sheet leverage unresolved** — While raising additional non equity capital has increased the Tier 1 ratio to 7.8%, well ahead of the company's targeted 7.25%, has also increased balance sheet gearing with non-equity instruments now constituting 35% of Tier 1 capital. In addition we expect organic capital rebuild to be limited with the Equity Tier 1 ratio rising from 5.1% to only 5.3% by 2010E, a factor we expect to remain a drag on the group's rating.

- **400p target price unchanged, retain Sell** — We have cut underlying EPS by 1% to 64.5p in 2008E. Our new estimates for both tNAV (259p) and EPS lead us to maintain our target price at 400p and we retain our Sell (3M) recommendation.

Sell/Medium Risk	**3M**
Price (19 Feb 08)	£4.77
Target price	£4.00
Expected share price return	-16.1%
Expected dividend yield	7.7%
Expected total return	**-8.4%**
Market Cap	£31,367M
	US$61,237M

Price Performance (RIC: BARC.L, BB: BARC LN)



	2008E			2009E			2010E		
£m, unless stated	**Old**	**New**	**% Chg**	**Old**	**New**	**% Chg**	**Old**	**New**	**% Chg**
Revenue	24,467	24,037	-2%	26,050	25,445	-2%	27,855	26,934	-3%
Costs	(14,635)	(14,277)	-2%	(16,063)	(15,607)	-3%	(17,172)	(16,680)	-3%
Operating Profit	9,831	9,759	-1%	9,987	9,837	-2%	10,683	10,254	-4%
Impairment losses	(2,812)	(2,747)	-2%	(2,463)	(2,674)	9%	(2,611)	(2,754)	5%
Pre-Tax Profit	7,038	7,055	0%	7,544	7,208	-4%	8,093	7,546	-7%
EPS (p) Reported	67.3p	66.7p	-1%	72.2p	67.5p	-7%	77.1p	70.3p	-9%
EPS (p) Underlying	**65.1p**	**64.5p**	**-1%**	**69.9p**	**65.3p**	**-7%**	**74.7p**	**68.0p**	**-9%**
DPS (p)	38.0p	36.5p	-4%	41.0p	39.0p	-5%	44.0p	42.0p	-5%
Cost Income Ratio (%)	59.8%	59.4%	-42bp	61.7%	61.3%	-32bp	61.6%	61.9%	28bp
Equity Tier 1 Ratio(%)	5.4%	5.1%	-33bp	5.7%	5.2%	-52bp	6.1%	5.3%	-73bp
Tier 1 Ratio (%)	7.8%	7.5%	-25bp	8.0%	7.5%	-51bp	8.3%	7.5%	-77bp

Source: Company Information and Citi Investment Research

See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	8.0	7.5	7.4	7.3	7.0
P/E reported (x)	6.8	7.2	7.4	7.3	7.0
P/BV (x)	1.6	1.4	1.3	1.2	1.1
P/Adjusted BV diluted (x)	1.6	1.4	1.3	1.2	1.1
Dividend yield (%)	6.5	7.1	7.7	8.2	8.8
Per Share Data (p)					
EPS adjusted	60.0	64.0	64.5	65.3	68.0
EPS reported	69.8	66.7	64.5	65.3	68.0
BVPS	303.0	352.9	380.2	405.6	430.8
Tangible BVPS	191.4	242.2	255.8	285.4	314.7
Adjusted BVPS diluted	296.2	343.7	370.2	395.1	419.6
DPS	31.0	34.0	36.5	39.0	42.0
Profit & Loss (£M)					
Net interest income	9,143	9,610	10,313	10,802	11,307
Fees and commissions	7,177	7,824	8,215	8,790	9,406
Other operating Income	5,275	5,682	5,509	5,852	6,221
Total operating income	**21,595**	**23,116**	**24,037**	**25,445**	**26,934**
Total operating expenses	-12,949	-13,322	-14,075	-15,405	-16,478
Oper. profit bef. provisions	**8,646**	**9,794**	**9,961**	**10,039**	**10,456**
Bad debt provisions	-2,154	-2,795	-2,747	-2,674	-2,754
Non-operating/exceptionals	644	77	-159	-157	-156
Pre-tax profit	**7,136**	**7,076**	**7,055**	**7,208**	**7,546**
Tax	-1,941	-1,981	-1,975	-2,018	-2,113
Extraord./Min. Int./Pref. Div.	-624	-678	-763	-776	-793
Attributable profit	**4,571**	**4,417**	**4,317**	**4,414**	**4,640**
Adjusted earnings	3,934	4,239	4,317	4,414	4,640
Growth Rates (%)					
EPS adjusted	11.9	6.6	0.8	1.3	4.2
Oper. profit bef. prov.	23.9	13.3	1.7	0.8	4.1
Balance Sheet (£M)					
Total assets	**996,787**	**1,227,361**	**1,318,778**	**1,422,474**	**1,506,763**
Avg interest earning assets	347,374	380,284	423,130	465,696	495,929
Customer loans	285,631	349,167	375,174	398,293	421,894
Gross NPLs	5,849	11,438	8,479	9,001	9,535
Liab. & shar. funds	**996,787**	**1,227,361**	**1,318,778**	**1,422,474**	**1,506,763**
Total customer deposits	256,754	294,987	316,958	336,490	356,429
Reserve for loan losses	3,069	3,265	3,467	3,681	3,908
Shareholders' equity	**19,799**	**23,291**	**25,347**	**27,309**	**29,291**
Profitability/Solvency Ratios (%)					
ROE adjusted	21.1	19.7	17.8	16.8	16.4
Net interest margin	2.63	2.53	2.44	2.32	2.28
Cost/income ratio	60.0	57.6	58.6	60.5	61.2
Cash cost/average assets	1.3	1.2	1.1	1.1	1.1
NPLs/customer loans	2.0	3.3	2.3	2.3	2.3
Reserve for loan losses/NPLs	52.5	28.5	40.9	40.9	41.0
Bad debt prov./avg. cust. loans	0.8	0.9	0.8	0.7	0.7
Loans/deposit ratio	111.2	118.4	118.4	118.4	118.4
Tier 1 capital ratio	7.7	7.8	7.5	7.5	7.5
Total capital ratio	11.7	12.1	11.4	11.1	10.9

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Barclays' full-year 2007 results provided additional disclosure on a range of financial exposures and increased its write-downs from £1.7bn to £2.3bn. We estimate additional losses of £1.5bn to be taken through the course of 2008. A more pressing issue appears to be the lack of revenue momentum across the group. With Barclays Capital's revenue boosted by a number of 'one-off' items in 2H07, we would expect any further write-downs in 2008 to represent a big drag on growth. It would also appear unlikely that the same degree of cost control can be maintained with the prospect of further headcount expansion into 2008. With BarCap needing to overcome weaker operating conditions and headwinds apparent in other business lines, we believe Barclays group will struggle to deliver meaningful earnings growth in 2008. On broadly unchanged estimates we retain our 400p target price and Sell (3M) recommendation.

The BarCap engine splutters

Figure 1 shows our estimated revenue breakdown for BarCap on a product-by-product basis, excluding £658m of fair value gains in 2H07. It can be seen that the 2H07 performance was particularly weak in Credit Products and Mortgages & ABS, where financial write-downs have been taken. This was partly off-set by stronger performance in Interest Rate Products, Currency Products and Emerging Markets.

Figure 1. Barclays Capital Composition of Revenues

£m, unless stated	1H06	2H06	FY06	1H07	2H07	FY07	1H07 vs. 1H06	2H07 vs. 2H06	2H07 vs. 1H07
Credit Products	975	765	1,740	1,160	-280	880	19%	-137%	-124%
Interest Rate Products	715	300	1,015	765	1,020	1,785	7%	240%	33%
Equity Products	575	385	960	675	545	1,220	17%	42%	-19%
Commodities	285	435	720	570	355	925	100%	-18%	-38%
Currency Products	340	180	520	395	455	850	16%	153%	15%
Emerging Markets	250	250	500	320	360	680	28%	44%	13%
Private Equity	155	330	485	95	430	525	-39%	30%	353%
Mortgages & ABS	140	185	325	175	-575	-400	25%	-411%	-429%
TOTAL	3,437	2,830	6,267	4,153	2,308	6,461	21%	-18%	-44%

Source: Company information and Citi Investment Research estimates

Figure 2 shows that we believe there are a number of other adjustments that can be made to derive a better measure of underlying revenue growth. The adjustments we make are subjective and the rationale is explained below.

Figure 2. Reconciling underlying estimates for Barclays Capital

£m, unless stated	1H06	2H06	2006	1H07	2H07	2007
Reported revenue	**3,437**	**2,830**	**6,267**	**4,153**	**2,966**	**7,119**
Write-downs taken to revenue	-	-	-	-	*1,453*	*1,453*
Gains on own debt	-	-	-	-	*(658)*	*(658)*
Net write downs to revenue	-	-	-	-	795	795
Net investment income	(277)	(296)	(573)	(206)	(747)	(953)
Fair value adjustment of financial instruments	-	(85)	(85)	-	(514)	(514)
Underlying revenue	**3,160**	**2,449**	**5,609**	**3,947**	**2,500**	**6,447**
yoy growth	56.4%	18.3%	37.1%	24.9%	2.1%	14.9%

Source: Citi Investment Research

- **Write-downs taken to revenue**

These reflect a variety of write-downs against the credit market portfolio. Of the £1.5bn, £690m is against ABS CDO exposure, with the remainder against a range of other exposures. We have added these back to revenue for comparison purposes, although note that we assume further hits to revenue will occur in 2008 in relation to the residual exposures shown in Figure 4.

- **Gains on own debt**

This reflects the IFRS accounting treatment where a company's own debt is revalued and if found to have fallen in value generates a gain that is taken in the P&L. We believe it is fair to net these gains against other losses as it is arguably the result of the same weak conditions in the marketplace.

- **Net investment income**

We have fully deducted this line for comparison purposes, although note that in recent times there has been a consistent £200-300m of such gains. In 2H07 this jumped to a surprisingly high level of £747m on the back of private equity realisations, disposal gains in Asia, and structured credit transactions. Although we do not deduct this from our estimate of underlying EPS, we believe that 2H07 was significantly flattered by these gains.

- **Fair value adjustment on financial instruments**

These gains arise when financial assets or liabilities, primarily derivatives contracts, have to be initially valued at the transaction price as there are not enough observable inputs to use other fair value techniques. When such inputs do arise, the unrealised gain can be recognised as revenue. In 2007 BarCap recognised £514m of such gains compared to £85m in 2006. Assuming no significant further additions the end 2007 unrecognised figure of £154m implies a significant drop in the level of such revenue contributions.

Cost growth falls sharply but difficult to sustain

Figure 3 shows that costs were tightly controlled in 2H07, helping offset the weaker underlying revenue performance. We note that performance-related costs fell by 78% in 2H07, suggesting that this bore the brunt of the sizeable write-downs. We believe that the cost income ratio was flattered by the fact that a large chunk of the 'one-off' revenue gains will have generated little in the way of extra cost.

Figure 3. Barclays Capital Composition of Costs

£m, unless stated	1H05	2H05	1H06	2H06	1H07	2H07	FY05	FY06	FY07
New Investment	55	93	85	116	99	99	148	200	199
Performance Related	524	572	997	647	1,167	144	1,096	1,644	1,311
Contractors	55	63	64	97	74	84	119	160	159
Core Costs	745	855	976	1,029	1,142	1,162	1,600	2,005	2,304
Total Costs	**1,379**	**1,584**	**2,121**	**1,888**	**2,483**	**1,490**	**2,963**	**4,009**	**3,973**

	YoY (%)				YoY (%)	
	1H06	2H06	1H07	2H07	FY06	FY07
New Investment	54%	24%	17%	-14%	35%	-1%
Performance Related	**90%**	**13%**	**17%**	**-78%**	**50%**	**-20%**
Contractors	15%	53%	17%	-13%	35%	-1%
Core Costs	31%	20%	17%	13%	25%	15%
Total Costs	**54%**	**19%**	**17%**	**-21%**	**35%**	**-1%**

Source: Company information and Citi Investment Research estimates

We question whether this performance can be maintained in 2008 when the management guidance is that it is preparing to increase investment and headcount in different parts of the business. Figure 14 gives a full breakdown of our divisional forecasts, showing that we expect BarCap PBT to fall in 2008E.

Further credit market write-downs expected

Figure 4 shows Barclays latest disclosure of its trading exposure, which includes 'Alt A', Monoline Insurers and Commercial Mortgages. Although necessarily subjective, we show the extent of write-downs we expect to be incurred in 2008E.

Figure 4. Credit Market Write-Downs

	Dec 07 Pre	2007 Write-downs			Dec 07 Post	% Write-	2008E Cumulative Write-downs			
Barclays (£m)	Write-Down	Revenue	Impairment	Total	Write-Down	Down	Revenue	Impairment	Total	
ABS CDO (net of hedging)	**6,083**	**(690)**	**(722)**	**(1,412)**	**4,671**	**-23%**	**(892)**	**(933)**	**(1,825)**	**-30%**
Other US sub prime[1]	-	-	-	-	5,037	-	-	-	-	-
Alt A	-	-	-	-	4,916	-	-	-	-	-
Monoline Insurers	-	-	-	-	1,335	-	-	-	-	-
Commercial Mortgages	-	-	-	-	12,399	-	-	-	-	-
SIVs & SIV Lites	-	-	-	-	742	-	-	-	-	-
Other Structured Credit	**25,252**	**(763)**	**(60)**	**(823)**	**24,429**	**-3%**	**(1,639)**	**(129)**	**(1,768)**	**-7%**
Leveraged Loans	7,296	0	(58)	(58)	7,238	-1%	0	(219)	(219)	-3%
Credit Market positions	***38,631***	***(1,453)***	***(840)***	***(2,293)***	***36,338***	***-6%***	***(2,531)***	***(1,281)***	***(3,811)***	***-10%***
Annual movement	-	(1,453)	(840)	(2,293)	-	-	(1,078)	(441)	(1,518)	-

[1] Whole loan and trading positions

Source: Company reports and Citi Investment Research

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Forecast Changes

We have reduced our 2008E and 2009E underlying EPS estimates by 1% and 7% respectively. Stronger volume growth, particularly in UK Retail Banking and IRCB is largely offset by weaker margins, resulting in a 1% increase in net interest income in 2008E and 2% in 2009E. However, this is more than offset at the total income level where we have reduced forecasts by 2% in both years primarily as a result of increased fair value adjustments in BarCap's Credit Markets portfolio, which further depresses trading income. We expect Barclays to continue to focus on cost control, although this is limited by expansion plans in BarCap and IRCB. Although we anticipate a more rapid deterioration in credit quality in a number of divisions, we have reduced our 2008E impairment charge forecast by 2% reflecting a changing mix in BarCap write-downs with the majority expected to be accounted as fair value adjustments through the revenue line. We have amended our dividend forecasts to approximate growth of 7% given management's medium-term expectation of 5%-10% growth in economic profit.

Figure 5. Summary Forecast Changes — Barclays

	2008E			2009E			2010E		
£m, unless stated	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
PROFIT & LOSS ITEMS									
Customer Advances	330,938	375,174	13%	349,483	398,293	14%	370,079	421,894	14%
AIEA	424,957	450,106	6%	448,085	481,285	7%	473,969	510,573	8%
Net Interest Margin	**2.39%**	**2.29%**	**-4%**	**2.37%**	**2.24%**	**-5%**	**2.36%**	**2.21%**	**-6%**
Net Interest Income	10,162	10,313	1%	10,639	10,802	2%	11,198	11,307	1%
Non Interest Income	14,305	13,724	-4%	15,411	14,643	-5%	16,656	15,626	-6%
o/w Trading Income	4,444	3,571	-20%	4,844	3,857	-20%	5,328	4,165	-22%
Total Income	**24,467**	**24,037**	**-2%**	**26,050**	**25,445**	**-2%**	**27,855**	**26,934**	**-3%**
Total Costs	(14,635)	(14,277)	-2%	(16,063)	(15,607)	-3%	(17,172)	(16,680)	-3%
Cost Income Ratio (%)	59.8%	59.4%	-0.4%	61.7%	61.3%	-0.3%	61.6%	61.9%	0.3%
Operating Profit	**9,831**	**9,759**	**-1%**	**9,987**	**9,837**	**-2%**	**10,683**	**10,254**	**-4%**
Impairment Losses	(2,812)	(2,747)	-2%	(2,463)	(2,674)	9%	(2,611)	(2,754)	5%
- o/w UK Banking	(855)	(957)	12%	(923)	(1,039)	13%	(941)	(1,041)	11%
- o/w International Retail & Commercial Banking	(326)	(440)	35%	(402)	(554)	38%	(475)	(596)	26%
- o/w Barclaycard	(877)	(896)	2%	(872)	(955)	9%	(915)	(984)	7%
- o/w Barclays Capital	(750)	(440)	-41%	(262)	(110)	-58%	(276)	(115)	-58%
- o/w Other	(5)	(15)	223%	(4)	(16)	273%	(5)	(17)	243%
Impairments as % Average Loans & Advances	1.20%	1.11%	-9bp	1.00%	1.01%	1bp	1.00%	0.98%	-2bp
- o/w UK Banking	0.61%	0.67%	6bp	0.63%	0.69%	6bp	0.61%	0.66%	5bp
- Retail Banking	0.65%	0.65%	-	0.65%	0.62%	-3bp	0.62%	0.60%	-2bp
- Business Banking	0.55%	0.70%	15bp	0.60%	0.80%	20bp	0.60%	0.75%	15bp
- o/w International Retail & Commercial Banking	0.50%	0.61%	12bp	0.57%	0.71%	14bp	0.63%	0.72%	9bp
- o/w Barclaycard	4.50%	3.75%	-75bp	4.30%	3.60%	-70bp	4.30%	3.50%	-80bp
Pre-Tax Profit Underlying	**7,038**	**7,055**	**0%**	**7,544**	**7,208**	**-4%**	**8,093**	**7,546**	**-7%**
EPS (p) Underlying (fully diluted)	**65.1p**	**64.5p**	**-1%**	**69.9p**	**65.3p**	**-7%**	**74.7p**	**68.0p**	**-9%**
DPS (p)	**38.0p**	**36.5p**	**-4%**	**41.0p**	**39.0p**	**-5%**	**44.0p**	**42.0p**	**-5%**
GROWTH RATES (% yoy)									
Loan Growth	5.2%	7.4%		5.6%	6.2%		5.9%	5.9%	
AIEA Growth	7.7%	13.6%		5.4%	6.9%		5.8%	6.1%	
Net Interest Income	5.5%	7.3%		4.7%	4.7%		5.3%	4.7%	
Non Interest Income	5.5%	1.6%		7.7%	6.7%		8.1%	6.7%	
Total Income	5.5%	4.0%		6.5%	5.9%		6.9%	5.9%	
Total Costs	6.1%	5.6%		9.8%	9.3%		6.9%	6.9%	
Operating Profit	4.6%	1.7%		1.6%	0.8%		7.0%	4.2%	
Impairment Losses	5.4%	-1.7%		-12.4%	-2.7%		6.0%	3.0%	
Pre-Tax Profit Underlying	4.3%	3.2%		7.2%	2.2%		7.3%	4.7%	
EPS (p) Underlying (fully diluted)	3.2%	0.8%		7.4%	1.3%		6.8%	4.2%	
DPS (p)	8.6%	7.4%		7.9%	6.8%		7.3%	7.7%	

Source: Citi Investment Research

'Underlyingitis' Monitor

Total revenues (net of insurance claims) in 2007 were reported as £23,000m, a 6.5% increase vs. 2006 (Figure 6). We adjust the 2007 reported revenues by adding back the pensions mis-selling provision in Barclays Wealth (£19m in 2007, £67m in 2006), the settlements on overdraft fees (£116m in 2007, £nil in 2006), the loss on disposal of part of the monument card portfolio (£27m in 2007, £nil in 2006) and also the write-downs related to credit market exposures (£1,453m in 2007, £nil in 2006). We deduct the fair value measurement of financial instruments (£514m in 2007, £85m in 2006) and also the gains arising from the fair valuation of notes issued by Barclay Capital (£658m in 2007, £nil in 2006). We do not adjust for net investment income within BarCap, although note that in 2H07 this appeared to be c£450m ahead of normal run-rate. Following these adjustments, we estimate underlying revenue growth on a Citi basis to be +8.6% in 2007 vs. 2006. The company makes no adjustments to reported revenues.

Figure 6. Barclays – Underlying Revenue Growth, FY06 – FY07

£m	FY06	FY07	% Change
Reported Revenues	**21,595**	**23,000**	**+6.5%**
add back mis-selling provision	67	19	
add back settlements on overdraft fees	-	116	
add back loss on disposal of Monument card portfolio	-	27	
add back write-downs related to credit market exposures	-	1,453	
less fair value measurement of financial instruments	-85	-514	
less gains arising from fair valuation of own debt	-	- 658	
Citi Underlying Revenue Growth	**21,577**	**23,443**	**+8.6%**

Source: Company Reports and Citi Investment Research

Figure 7 shows the reconciliation between reported and underlying cost growth. We deduct the benefit of the £267m Sale & Leaseback gain in 2007 (£432m in 2006) and the £58m break fee relating to the ABN Amro transaction (£nil in 2006). These adjustments reduce statutory cost growth of 4.1% to an underlying 3.2% (Citi basis). The company makes no adjustments to the costs.

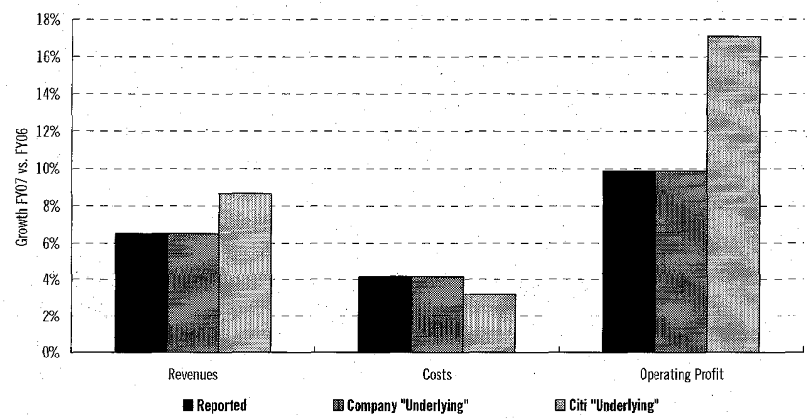
Figure 7. Barclays – Underlying Cost Growth, FY06 – FY07

£m	FY06	FY07	% Change
Reported Costs	**12,674**	**13,199**	**+4.1%**
less Sale & Leaseback Disposals	432	267	
less break fee relating to ABN Amro transaction	-	58	
Citi Underlying Cost Growth	**13,106**	**13,524**	**+3.2%**

Source: Company Reports and Citi Investment Research

Figure 8 shows that on a Citi basis, the growth in pre-provision profit growth was 17.1%. This compares to 9.9% on a statutory (and company) basis.

Figure 8. Barclays — Underlyingitis (Growth), FY06 – FY07



Source: Company Reports and Citi Investment Research

Figure 9. Underlyingitis Monitor — FY07 Results to Date

Year-on-Year Growth (CIR basis)	Results Date	Underlying Income	Underlying Cost	Underlying Operating Profit
Barclays	**19th February 2008**	**+8.6%**	+3.2%	+17.1%
Bradford & Bingley	13th February 2008	-1.7%	+3.2%	-5.5%

Source: Citi Investment Research

Valuation

Price to book target range

Figure 10 shows the theoretical price-to-book valuation based on a range of RoE and long-term growth assumptions and a 12.0% cost of equity. Figure 11 shows the implied target price based on these multiples and our 2008E tNAV per share estimate of 259p. We have indicated the range that we believe to be most applicable for Barclays in the current environment.

Figure 10. Theoretical Price to Book Multiple based on range of RoE and Growth assumptions (Cost of Equity 12.0%)

	Return on Equity										
Long term growth	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%	20.0%	21.0%	22.0%	23.0%	24.0%
0.0%	1.17	1.25	1.34	1.42	1.50	1.59	1.67	1.75	1.84	1.92	2.00
0.5%	1.18	1.26	1.35	1.44	1.52	1.61	1.70	1.79	1.87	1.96	2.05
1.0%	1.18	1.28	1.37	1.46	1.55	1.64	1.73	1.82	1.91	2.00	2.10
1.5%	1.19	1.29	1.38	1.48	1.57	1.67	1.77	1.86	1.96	2.05	2.15
2.0%	1.20	1.30	1.40	**1.50**	1.60	1.70	1.80	1.90	2.00	2.10	2.20
2.5%	1.21	1.32	1.42	1.53	1.64	1.74	1.85	1.95	2.06	2.16	2.27
3.0%	1.23	1.34	1.45	1.56	1.67	1.78	1.89	2.00	2.12	2.23	2.34
3.5%	1.24	1.36	1.47	1.59	1.71	1.83	1.95	2.06	2.18	2.30	2.42
4.0%	1.25	1.38	1.50	1.63	1.75	1.88	2.01	2.13	2.26	2.38	2.51
4.5%	1.27	1.40	1.54	1.67	1.81	1.94	2.07	2.21	2.34	2.47	2.61
5.0%	1.29	1.43	1.58	1.72	1.86	2.01	2.15	2.29	2.44	2.58	2.72

Source: Citi Investment Research

Figure 11. Barclays Target Price based on Theoretical Price to Book Multiple (2008E tNAV per share 259p)

	Return on Equity										
Long term growth	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%	20.0%	21.0%	22.0%	23.0%	24.0%
0.0%	303	324	346	367	389	411	432	454	475	497	519
0.5%	304	327	350	372	395	417	440	462	485	507	530
1.0%	306	330	354	377	401	424	448	472	495	519	542
1.5%	309	333	358	383	408	432	457	482	506	531	556
2.0%	311	337	363	**389**	415	441	467	493	519	545	571
2.5%	314	341	369	396	423	451	478	505	532	560	587
3.0%	317	346	375	404	432	461	490	519	548	577	605
3.5%	321	351	382	412	443	473	504	534	565	595	626
4.0%	324	357	389	422	454	487	519	551	584	616	649
4.5%	329	363	398	433	467	502	536	571	606	640	675
5.0%	334	371	408	445	482	519	556	593	631	668	705

Source: Citi Investment Research

Figure 12. Barclays — Profit and Loss Account, 2006A-10E (Pounds in Millions)

	2006		2007		2007		2008E		2009E		2010E	
	1H	FY	1H	% Chg	FY	% Chg	FY	% Chg	FY	% Chg	FY	% Chg
Net Interest Income	**4,404**	**9,143**	**4,589**	**4.2%**	**9,610**	**5.1%**	**10,313**	**7.3%**	**10,802**	**4.7%**	**11,307**	**4.7%**
Net fees and commissions	3,652	7,177	3,899	6.8%	7,824	9.0%	8,215	5.0%	8,790	7.0%	9,406	7.0%
Net trading income	2,201	3,614	2,811	27.7%	3,759	4.0%	3,571	(5.0%)	3,857	8.0%	4,165	8.0%
Net insurance income	651	1,447	590	(9.4%)	1,735	19.9%	1,787	3.0%	1,841	3.0%	1,896	3.0%
Other	61	214	127	108.2%	188	(12.1%)	150	(20.0%)	155	3.0%	160	3.0%
Total Other Income	6,565	12,452	7,427	13.1%	13,506	8.5%	13,724	1.6%	14,643	6.7%	15,626	6.7%
Total Income	**10,969**	**21,595**	**12,016**	**9.5%**	**23,116**	**7.0%**	**24,037**	**4.0%**	**25,445**	**5.9%**	**26,934**	**5.9%**
Staff Costs	4,147	8,169	4,581	10.5%	8,405	2.9%	8,993	7.0%	10,071	12.0%	10,876	8.0%
Other Administrative	1,916	3,980	1,893	(1.2%)	4,036	1.4%	4,157	3.0%	4,363	5.0%	4,581	5.0%
Depreciation	207	455	227	9.7%	467	2.6%	490	5.0%	515	5.0%	541	5.0%
Amortisation of intangibles	69	157	89		202		202					
Operating Lease rental	168	345	204		414		435		457		479	
Total Costs	**6,507**	**13,106**	**6,994**	**7.5%**	**13,524**	**3.2%**	**14,277**	**5.6%**	**15,607**	**9.3%**	**16,680**	**6.9%**
Operating Profit	**4,462**	**8,489**	**5,022**	**12.6%**	**9,592**	**13.0%**	**9,759**	**1.7%**	**9,837**	**0.8%**	**10,254**	**4.2%**
Impairment loss	1,057	2,154	959	(9.3%)	2,795	29.8%	2,747	(1.7%)	2,674	(2.7%)	2,754	3.0%
Exceptionals	238	755	38		237		0		0		0	
Associates	30	46	0		42		43		45	3.0%	46	3.0%
PBT	**3,673**	**7,136**	**4,101**	**11.7%**	**7,076**	**(0.8%)**	**7,055**	**(0.3%)**	**7,208**	**2.2%**	**7,546**	**4.7%**
Taxation	(1,072)	(1,941)	(1,158)		(1,981)		(1,975)		(2,018)		(2,113)	
Minorities - equity	(155)	(342)	(167)		(377)		(380)		(393)		(409)	
Minorities - non equity	(139)	(282)	(142)		(301)		(383)		(383)		(383)	
Attributable Profit	**2,307**	**4,571**	**2,634**	**14.2%**	**4,417**	**(3.4%)**	**4,317**	**(2.3%)**	**4,414**	**2.2%**	**4,640**	**5.1%**
Dividends	1,105	1,771	1,311	18.6%	2,079	17.4%	2,325	11.8%	2,516	8.2%	2,723	8.2%
Retained Profit	**1,202**	**2,800**	**1,323**		**2,338**		**1,992**		**1,897**	**0.0%**	**1,917**	**0.0%**
EPS (Reported)	36.3p	71.9p	41.4p	14.1%	68.9p	(4.2%)	66.7p	(3.2%)	67.5p	1.2%	70.3p	4.1%
EPS (Fully Diluted Basis)	35.1p	69.8p	40.1p	14.4%	66.7p	(4.5%)	64.5p	(3.3%)	65.3p	1.3%	68.0p	4.2%
Dividend per share	**10.5p**	**31.0p**	**11.5p**	**9.5%**	**34.0p**	**9.7%**	**36.5p**	**7.4%**	**39.0p**	**6.8%**	**42.0p**	**7.7%**
Underlying Adjustments												
PBT	3,673	7,136	4,101	11.7%	7,076	(0.8%)	7,055	(0.3%)	7,208	2.2%	7,546	4.7%
minus exceptional items	(238)	(323)	109		30		0		0		0	
minus Sale & Leaseback Gain	0	(432)	(147)		(267)		0		0		0	
Underlying cash PBT	**3,435**	**6,381**	**4,063**	**18.3%**	**6,839**	**7.2%**	**7,055**	**3.2%**	**7,208**	**2.2%**	**7,546**	**4.7%**
EPS (Fully Diluted Basis)	35.1p	69.8p	40.1p		66.7p		64.5p		65.3p		68.0p	
less exceptional items	(2.6p)	(9.8p)	(0.4p)		(2.7p)		0.0p		0.0p		0.0p	
Underlying Cash EPS (Fully Diluted Basis)	**32.5p**	**60.0p**	**39.7p**	**22.2%**	**64.0p**	**6.6%**	**64.5p**	**0.8%**	**65.3p**	**1.3%**	**68.0p**	**4.2%**
Summary Balance Sheet (£m)												
Customer Advances	285,497	285,631	324,517	13.7%	349,167	22.2%	375,174	7.4%	398,293	6.2%	421,894	5.9%
RWA	290,924	297,833	318,043	9.3%	353,476	18.7%	390,806	10.6%	419,256	7.3%	444,098	5.9%
Intangible Assets	7,093	7,307	7,863	10.9%	8,296	13.5%	8,094	-2.4%	7,892	-2.5%	7,690	-2.6%
Balance Sheet Assets	986,124	996,787	1,158,262	17.5%	1,227,361	23.1%	1,318,778	7.4%	1,422,474	7.9%	1,506,763	5.9%
Customer Deposits	253,200	256,754	292,444	15.5%	294,987	14.9%	316,958	7.4%	336,490	6.2%	356,429	5.9%
Equity	17,988	19,799	20,973	16.6%	23,291	17.6%	25,347	8.8%	27,309	7.7%	29,291	7.3%
Tier 1 Capital	21,017	23,005	24,469	16.4%	27,408	19.1%	29,428	7.4%	31,325	6.4%	33,242	6.1%
Loan to Deposit Ratio	113%	111%	111%		118%		118%		118%		118%	
Tangible Equity/Assets Ratio	1.82%	1.25%	1.13%		1.22%		1.31%		1.36%		1.43%	
Reported NAV (p)	**276p**	**303p**	**321p**	**16.1%**	**353p**	**16.5%**	**380p**	**7.7%**	**406p**	**6.7%**	**431p**	**6.2%**
Tangible NAV (p)	**167p**	**191p**	**201p**	**19.9%**	**227p**	**18.9%**	**259p**	**13.9%**	**288p**	**11.4%**	**318p**	**10.1%**
Equity Tier 1 Ratio	**4.9%**	**5.3%**	**5.3%**		**5.1%**		**5.1%**		**5.2%**		**5.3%**	
Tier 1 Ratio	7.2%	7.7%	7.7%		7.8%		7.5%		7.5%		7.5%	
Total Capital Ratio	11.1%	11.7%	11.8%		12.1%		11.4%		11.1%		10.9%	

Please note profit and loss account continues overleaf.

Source: Company reports and Citi Investment Research estimates.

Figure 13. Barclays — Profit and Loss Account, 2006A-10E (Pounds in Millions)

Performance Ratios	2006 1H	2006 FY	2007 1H	2007 FY	2008E FY	2009E FY	20010E FY
Margin (Divisional Basis)							
UK Retail Banking	3.74%	3.76%	3.70%	3.64%	3.50%	3.45%	3.40%
UK Business Banking	3.24%	3.27%	3.33%	3.24%	3.05%	3.00%	3.00%
UK Banking	3.54%	3.56%	3.55%	3.48%	3.32%	3.27%	3.24%
Wealth Management	7.35%	7.07%	6.40%	5.82%	5.00%	4.75%	4.60%
Barclaycard	7.85%	7.72%	7.52%	7.26%	6.75%	6.60%	6.50%
International ex Absa	2.27%	2.22%	2.18%	2.26%	2.20%	2.20%	2.20%
International	3.39%	3.20%	3.05%	3.18%	3.19%	3.10%	3.08%
Dealing Income as % of Total Income	20.1%	16.7%	23.4%	16.3%	14.9%	15.2%	15.5%
Non Interest Income/Total Income	59.9%	57.7%	61.8%	58.4%	57.1%	57.5%	58.0%
Cost Measures							
Cost/Income ratio	59.3%	60.7%	58.2%	58.5%	59.4%	61.3%	61.9%
Provision as % average balances							
UK Retail Banking	0.84%	0.86%	0.73%	0.71%	0.65%	0.62%	0.60%
UK Business Banking	0.39%	0.48%	0.47%	0.54%	0.70%	0.80%	0.75%
UK Banking	0.66%	0.71%	0.62%	0.64%	0.67%	0.69%	0.66%
Wealth Management	0.04%	0.04%	0.06%	0.09%	0.15%	0.15%	0.15%
Barclaycard	5.65%	5.95%	4.76%	4.37%	3.75%	3.60%	3.50%
International ex Absa	0.12%	0.15%	0.16%	0.24%	0.40%	0.50%	0.50%
International	0.27%	0.32%	0.34%	0.42%	0.61%	0.71%	0.72%
Total	**1.08%**	**1.07%**	**0.92%**	**1.28%**	**1.11%**	**1.01%**	**0.98%**
Tax Rate	**29.2%**	**27.2%**	**28.2%**	**28.0%**	**28.0%**	**28.0%**	**28.0%**
Returns							
Return on Equity (reported)	27.9%	25.2%	28.0%	21.0%	18.2%	17.2%	16.8%
Return on Equity (underlying)	24.4%	20.5%	26.1%	19.0%	18.2%	17.2%	16.8%
Return on RWA	1.55%	1.35%	1.66%	1.26%	1.12%	1.05%	1.04%
Dividends							
Conventional Dividend Cover	2.1x	2.6x	2.0x	2.1x	1.9x	1.8x	1.7x
Underlying Dividend Cover	3.1x	1.9x	3.5x	1.9x	1.8x	1.7x	1.6x

Please note profit and loss account continues overleaf.

Source: Company reports and Citi Investment Research estimates.

Figure 14. Barclays — Divisional Forecasts, 2006A-10E (Pounds in Millions)

	2006		2007		2007		2008E		2009E		2010E	
	1H	FY	1H	% Chg	FY	% Chg	FY	% Chg	FY	% Chg	FY	% Chg
UK Retail Banking												
Net Interest Income	1,358	2,765	1,407	4%	2,858	3%	2,964	4%	3,097	4%	3,235	4%
Other Income	751	1,581	801	7%	1,555	-2%	1,586	2%	1,618	2%	1,666	3%
Total Income	**2,109**	**4,346**	**2,208**	**5%**	**4,413**	**2%**	**4,550**	**3%**	**4,715**	**4%**	**4,902**	**4%**
Costs	(1,319)	(2,785)	(1,307)	-1%	(2,656)	-5%	(2,603)	-2%	(2,681)	3%	(2,761)	3%
Operating Profit	**790**	**1,561**	**901**	**14%**	**1,757**	**13%**	**1,947**	**11%**	**2,034**	**4%**	**2,140**	**5%**
Impairment Losses	(306)	(635)	(277)	-9%	(559)	-12%	(551)	-2%	(557)	1%	(571)	3%
Associates	0	2	1	0%	7	250%	7	3%	7	3%	8	3%
Trading Profit	**484**	**928**	**625**	**29%**	**1,205**	**30%**	**1,404**	**17%**	**1,485**	**6%**	**1,577**	**6%**
Loans & advances	72,200	74,700	77,500	7%	82,000	10%	86,920	6%	92,135	6%	97,663	6%
Average balances	73,128	73,593	76,747	5%	78,502	7%	84,693	8%	89,774	6%	95,161	6%
Margin (based on loans)	3.7%	3.8%	3.7%		3.6%		3.5%		3.5%		3.4%	
Impairment losses as % ave balances	0.8%	0.9%	0.7%		0.7%		0.7%		0.6%		0.6%	
Cost/Income Ratio	62.5%	64.1%	59.2%		60.2%		57.2%		56.9%		56.3%	
Barclays Commercial Bank												
Net Interest Income	822	1,702	863	5%	1,738	2%	1,769	2%	1,810	2%	1,882	4%
Other Income	332	693	388	17%	816	18%	873	7%	917	5%	963	5%
Total Income	**1,154**	**2,395**	**1,251**	**8%**	**2,554**	**7%**	**2,642**	**3%**	**2,727**	**3%**	**2,845**	**4%**
Costs	(432)	(917)	(441)	2%	(946)	3%	(965)	2%	(994)	3%	(1,024)	3%
Operating Profit	**722**	**1,478**	**810**	**12%**	**1,608**	**9%**	**1,677**	**4%**	**1,733**	**3%**	**1,821**	**5%**
Impairment Losses	(100)	(252)	(123)	23%	(290)	15%	(406)	40%	(483)	19%	(471)	-3%
Associates	2	3	0	0%	0	-100%	0	0%	0	0%	0	0%
Trading Profit	**624**	**1,229**	**687**	**10%**	**1,318**	**7%**	**1,271**	**-4%**	**1,250**	**-2%**	**1,351**	**8%**
Cost/Income Ratio	37.4%	38.3%	35.3%		37.0%		36.5%		36.5%		36.0%	
UK BANKING												
Net Interest Income	2,180	4,467	2,270	4%	4,596	3%	4,733	3%	4,907	4%	5,118	4%
Other Income	1,083	2,274	1,189	10%	2,371	4%	2,459	4%	2,535	3%	2,629	4%
Total Income	**3,263**	**6,741**	**3,459**	**6%**	**6,967**	**3%**	**7,193**	**3%**	**7,442**	**3%**	**7,747**	**4%**
Costs	(1,751)	(3,702)	(1,748)	0%	(3,602)	-3%	(3,568)	-1%	(3,675)	3%	(3,785)	3%
Operating Profit	**1,512**	**3,039**	**1,711**	**13%**	**3,365**	**11%**	**3,625**	**8%**	**3,767**	**4%**	**3,961**	**5%**
Impairment Losses	(406)	(887)	(400)	-1%	(849)	-4%	(957)	13%	(1,039)	9%	(1,041)	0%
Associates	2	5	1		7	40%	7	3%	7	3%	8	3%
Trading Profit	**1,108**	**2,157**	**1,312**	**18%**	**2,523**	**17%**	**2,675**	**6%**	**2,735**	**2%**	**2,928**	**7%**
Cost/Income Ratio	53.7%	54.9%	50.5%		51.7%		49.6%		49.4%		48.9%	
Cost/Income Ratio (including property gains)	49.2%	50.3%	46.5%		47.9%							
Wealth Management												
Net Interest Income	192	392	205	7%	431	10%	481	12%	515	7%	543	6%
Other Income	386	768	430	11%	856	11%	942	10%	1,017	8%	1,098	8%
Total Income	**578**	**1,160**	**635**	**10%**	**1,287**	**11%**	**1,423**	**11%**	**1,532**	**8%**	**1,641**	**7%**
Costs	(448)	(913)	(460)	3%	(973)	7%	(1,041)	7%	(1,114)	7%	(1,192)	7%
Operating Profit	**130**	**247**	**175**	**35%**	**314**	**27%**	**382**	**22%**	**418**	**9%**	**450**	**8%**
Impairment Losses	(1)	(2)	(2)	0%	(7)		(14)		(16)		(18)	
Trading Profit	**129**	**245**	**173**	**34%**	**307**	**25%**	**368**	**20%**	**401**	**9%**	**432**	**8%**
Cost/Income Ratio	77.5%	78.7%	72.4%		75.6%		73.2%		72.7%		72.6%	
International Retail and Commercial Banking (IRCB)												
Net Interest Income	844	1,653	844	0%	1,890	14%	2,283	21%	2,404	5%	2,569	7%
Other Income	767	1,596	802	5%	1,633	2%	1,733	6%	1,867	8%	1,998	7%
Total Income	**1,611**	**3,249**	**1,646**	**2%**	**3,523**	**8%**	**4,017**	**14%**	**4,271**	**6%**	**4,567**	**7%**
Costs	(1,113)	(2,217)	(1,116)	0%	(2,379)	7%	(2,669)	12%	(2,857)	7%	(3,083)	8%
Operating Profit	**498**	**1,032**	**530**	**6%**	**1,144**	**11%**	**1,348**	**18%**	**1,415**	**5%**	**1,484**	**5%**
Impairment Losses	(68)	(167)	(93)	37%	(252)	51%	(440)	75%	(554)	26%	(596)	8%
Associates	27	49	1		7	-86%	7	3%	7	3%	8	3%
Trading Profit	**457**	**914**	**438**	**-4%**	**899**	**-2%**	**915**	**2%**	**868**	**-5%**	**896**	**3%**
Cost/Income Ratio	69.1%	68.2%	67.8%		67.5%		66.4%		66.9%		67.5%	
IRCB - ex Absa												
Net Interest Income	293	604	334	14%	753	25%	900	20%	976	9%	1,045	7%
Other Income	225	442	268	19%	586	33%	674	15%	755	12%	830	10%
Total Income	518	1,046	602	16%	1,339	28%	1,574	18%	1,731	10%	1,875	8%
Costs	(383)	(829)	(449)	17%	(1,046)	26%	(1,203)	15%	(1,383)	15%	(1,522)	10%
Operating Profit	135	217	153	13%	293	35%	371	27%	348	-6%	353	2%
Impairment Losses	(16)	(41)	(24)	50%	(79)	93%	(164)	107%	(222)	36%	(237)	7%
Associates	21	40	(1)	-105%	(4)	-110%	(4)	-7%	(4)	9%	(4)	9%
Trading Profit	140	216	128	-9%	210	-3%	204	-3%	122	-40%	111	-9%
Cost/Income Ratio	73.9%	79.3%	74.6%		78.1%		76.4%		79.9%		81.2%	

Barclays — Divisional Forecasts, 2006A-10E (Pounds in Millions) cont...

	2006		2007		2007		2008E		2009E		2010E	
	1H	FY	1H	% Chg	FY	% Chg	FY	% Chg	FY	% Chg	FY	% Chg
ABSA £												
Net Interest Income	551	1,049	510	-7%	1,137	8%	1,383	22%	1,428	3%	1,524	7%
Other Income	542	1,154	534	-1%	1,047	-9%	1,059	1%	1,112	5%	1,168	5%
Total Income	**1,093**	**2,203**	**1,044**	**-4%**	**2,184**	**-1%**	**2,443**	**12%**	**2,540**	**4%**	**2,692**	**6%**
Costs	(730)	(1,388)	(667)	-9%	(1,333)	-4%	(1,466)	10%	(1,473)	1%	(1,561)	6%
Operating Profit	**363**	**815**	**377**	**4%**	**851**	**4%**	**977**	**15%**	**1,067**	**9%**	**1,131**	**6%**
Impairment Losses	(52)	(126)	(69)	33%	(173)	37%	(277)	60%	(332)	20%	(359)	8%
Associates	6	9	9		11		11		11		0	0
Trading Profit	**317**	**698**	**310**	**-2%**	**689**	**-1%**	**711**	**3%**	**746**	**5%**	**784**	**5%**
Cost/Income Ratio	66.8%	63.0%	63.9%		61.0%		60.0%		58.0%		58.0%	
£:Rand - period end	13.19	13.71			13.64	-1%	14.92	9%	14.92	0%	14.92	0%
£:Rand - average	11.31	12.47			14.11	13%	14.92	6%	14.92	0%	14.92	0%
ABSA Rm												
Net Interest Income	6,231	13,081	7,196	15%	16,043	23%	20,639	29%	21,300	3%	22,736	7%
Other Income	6,130	14,390	7,535	23%	14,773	20%	15,807	7%	16,598	5%	17,428	5%
Total Income	**12,361**	**27,471**	**14,731**	**19%**	**30,816**	**12%**	**36,447**	**18%**	**37,897**	**4%**	**40,164**	**6%**
Costs	(8,256)	(17,308)	(9,411)	14%	(18,809)	9%	(21,868)	16%	(21,981)	1%	(23,295)	6%
Operating Profit	**4,105**	**10,163**	**5,319**	**30%**	**12,008**	**18%**	**14,579**	**21%**	**15,917**	**9%**	**16,869**	**6%**
Impairment Losses	(588)	(1,571)	(974)	66%	(2,441)	55%	(4,128)	69%	(4,953)	20%	(5,350)	8%
Associates	68	112	28	-58%	155	-50%	163	5%	171	5%	180	5%
Trading Profit	**3,585**	**8,704**	**4,374**	**22%**	**9,722**	**12%**	**10,614**	**9%**	**11,135**	**5%**	**11,699**	**5%**
Cost/Income Ratio	66.8%	63.0%	63.9%		61.0%		60.0%		58.0%		58.0%	
Loans & advances	308,659	331,782	369,944	20%	420,112	27%	496,299	18%	536,003	8%	578,883	8%
Average balances	274,000	304,118	350,380	28%	368,723	21%	458,652	24%	495,344	8%	534,971	8%
RWAs	272,688	284,181	307,519	13%	321,931	13%	380,313	18%	410,738	8%	443,597	8%
Average RWAs	249,577	264,006	295,850	19%	147,925	-44%	351,122	137%	395,526	13%	427,168	8%
Margin (based on ave loans)	4.59%	4.30%	4.14%		4.35%		4.50%		4.30%		4.25%	
Margin (based on ave RWAs)	5.03%	4.95%	4.91%		10.85%		5.88%		5.39%		5.32%	
Impairment losses as % ave balances	0.43%	0.52%	0.56%		0.66%		0.90%		1.00%		1.00%	
Barclaycard												
Net Interest Income	678	1,383	700	3%	1,394	1%	1,612	16%	1,750	9%	1,827	4%
Other Income	580	1,131	560	-3%	1,092	-3%	1,103	1%	1,136	3%	1,170	3%
Total Income	**1,258**	**2,514**	**1,260**	**0%**	**2,486**	**-1%**	**2,715**	**9%**	**2,886**	**6%**	**2,997**	**4%**
Costs	(483)	(1,019)	(516)	7%	(1,101)	8%	(1,211)	10%	(1,272)	5%	(1,335)	5%
Operating Profit	**775**	**1,495**	**744**	**-4%**	**1,385**	**-7%**	**1,504**	**9%**	**1,614**	**7%**	**1,662**	**3%**
Impairment Losses	(488)	(1,067)	(443)	-9%	(838)	-21%	(896)	7%	(955)	7%	(984)	3%
Associates	1	(8)	(2)		(7)	-13%	(7)	3%	(7)	3%	(8)	
Trading Profit	**288**	**420**	**299**	**4%**	**540**	**29%**	**601**	**11%**	**652**	**9%**	**670**	**3%**
Cost/Income Ratio	38.4%	40.5%	41.0%		44.3%		44.6%		44.1%		44.6%	
Loans & advances	17,400	18,200	18,300	5%	20,100	10%	23,115	15%	24,733	7%	25,970	5%
Average Balances	17,408	17,918	18,761	8%	19,191	7%	23,886	24%	26,514	11%	28,105	6%
Margin (based on ave loans)	15,698	17,035	17,053	9%	19,929	17%	22,520	13%	23,646	5%	24,355	3%
Impairment losses as % ave balances	7.85%	7.72%	7.52%		7.26%		6.75%		6.60%		6.50%	
Barclays Capital												
Net Interest Income	495	1,158	567	15%	1,179	2%	1,203	2%	1,227	2%	1,251	2%
Other Income	2,942	5,109	3,586	22%	5,940	16%	5,465	-8%	5,902	8%	6,492	10%
Total Income	**3,437**	**6,267**	**4,153**	**21%**	**7,119**	**14%**	**6,667**	**-6%**	**7,129**	**7%**	**7,743**	**9%**
Costs	(2,121)	(4,009)	(2,483)	17%	(3,973)	-1%	(4,092)	3%	(4,835)	18%	(5,313)	10%
Operating Profit	**1,316**	**2,258**	**1,670**	**27%**	**3,146**	**39%**	**2,575**	**-18%**	**2,294**	**-11%**	**2,431**	**6%**
Impairment Losses	(70)	(42)	(10)	-86%	(846)	1914%	(440)	-48%	(110)	-75%	(115)	5%
Trading Profit	**1,246**	**2,216**	**1,660**	**33%**	**2,335**	**5%**	**2,171**	**-7%**	**2,221**	**2%**	**2,354**	**6%**
Cost/Income Ratio	62%	64%	60%		56%		61%		68%		69%	
Staff numbers	10,500	13,200	13,200	33%	16,200	23%	17,334	7%	18,201	5%	18,747	3%
Average headcount	10,200	11,025	11,850	30%	14,700	33%	16,767	14%	17,767	6%	18,474	4%
BGI												
Net Interest Income	7	10	(2)	-129%	(8)	-180%	0	0%	0	0%	0	0%
Other Income	838	1,655	945	13%	1,934	17%	2,031	5%	2,132	5%	2,239	5%
Total Income	**845**	**1,665**	**943**	**12%**	**1,926**	**16%**	**2,031**	**5%**	**2,132**	**5%**	**2,239**	**5%**
Costs	(481)	(951)	(555)	15%	(1,192)	25%	(1,371)	15%	(1,508)	10%	(1,613)	7%
Operating Profit	**364**	**714**	**388**	**7%**	**734**	**3%**	**660**	**-10%**	**624**	**-5%**	**625**	**0%**
Cost/Income Ratio	56.9%	57.1%	58.9%		61.9%		67.5%		70.7%		72.1%	

Source: Company reports and Citi Investment Research