

Europe

RBS

Restarting Discretionary Coupons- remain Buyers of Tier 1

Event: RBS announced today that it will resume discretionary coupons and dividend payments on hybrid capital debt. Discretionary dividends as well as the discretionary distributions on the RBSG/RBS innovative securities will be paid on their scheduled payment dates in June 2012 (RBS Capital Trust A, RBS Capital Trust B, RBS Capital Trust D, RBS Capital Trust I, RBS Capital Trust II and RBS Capital Trust IV). Future coupons and dividends on the hybrid securities will be paid in accordance with their relevant terms. Funding to cover the £350m cost will come from the sale of surplus shares held by the Employee Benefit Trust (~£250m) and from the issue of new ordinary shares (~£100m). There will have no impact on the firms' Core Tier 1 capital.

How to trade it: Buy RBS Tier 1. We advised clients to buy RBS Tier 1 in our note of 24 Feb 12 [RBS Q4 '11: Losing Money to Gain Advantage](#). We have also noted to clients that money is fungible and RBS could follow Lloyds' lead in issuing shares to pay the hybrid coupons. These bonds retained their value as the market softened in March. We believe some investors are long these bonds on the expectation of gaining the interest accrual. Prices may appear to soften slightly following the accrual turn-on and the Trust Preferred Tier 1 securities have 'capital-stoppers' that inhibit the buy-back of these securities until 12 months of coupons are accrued. In the Q4 '12 results teleconference with fixed income investors, RBS management confirmed that these securities may not be subject to a LME until 2013; nonetheless, we maintain our buy recommendation on these securities. We believe that if investors wait until 2013, they risk missing the opportunity to capture potential LME upside and the potential for RBS to engineer any solution to this issue in advance of 2013. Our top picks are the innovative RBS Tier 1. These bonds were issued with coupons that step to levels that were approximately 100bps higher than asset swap spreads at their time of issuance. This signalled to investors that they would be called at first call date as the bonds have an incentive to be redeemed. We believe that they will lose all regulatory value under Basel III once they are past their effective maturity, which is at first call date for these bonds. Our top picks are the RBS 6.467 12/49-12, RBS 5.512 09/49-14 (\$US) and RBS 4.243 12/49-16. We recommend taking profits on the RBS 6.467 and RBS 4.243 at €75 and €70, respectively, the RBS5.512 at \$80. We recommend stop losses on the RBS 6.467 and RBS 4.243 at €50 and €45, respectively, and the RBS5.512 at \$50.

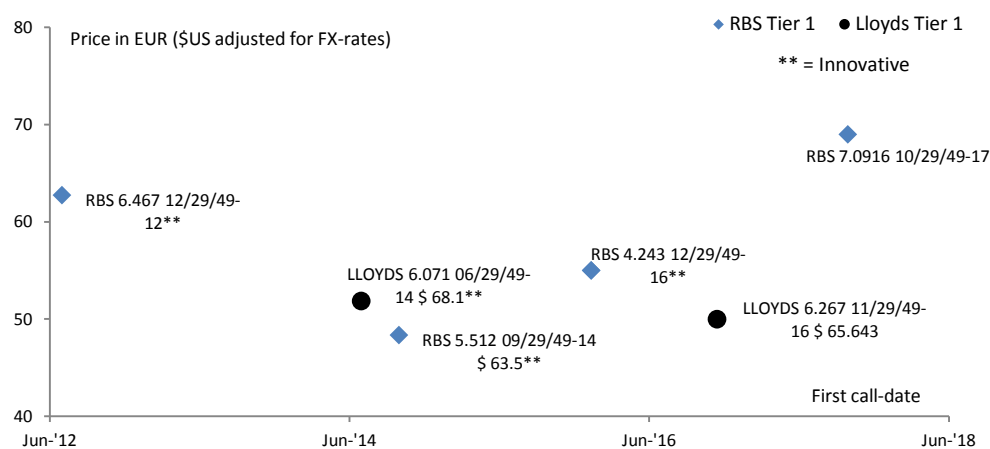
RBS Innovative Debt may see an LME once Capital Stoppers are Removed

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Source: SG Cross Asset Research, Bloomberg.

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RBS: Group full quarter P&L (in GBP millions)

	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Net Interest Income	3,676	3,411	3,580	3,301	3,227	3,077	3,074	2,999
Net Fees	2,053	2,037	2,052	1,642	1,700	1,452	1,590	1,487
Net Trading Income	2,110	277	860	835	1,147	957	-59	212
Other Operating Income	301	147	1,049	628	1,439	2,686	731	-458
Total Revenues	8,140	5,872	7,541	6,406	7,513	8,172	5,336	4,240
Operating Expenses	-4,686	-4,868	-3,148	-4,315	-3,521	-5,864	-2,726	-4,617
Pre-Provision Profits	2,875	393	3,944	1,831	3,669	2,004	2,037	-377
Loan Loss Reserves	-2,487	-1,953	-2,141	-1,947	-3,106	-1,738	-1,918	-1,314
Operating Profits	388	-1,560	1,803	-116	563	266	119	-1,691
Pre-Tax Profit	1,174	-1,524	2,029	-96	-678	2,004	-1,976	-1,394
Taxes	-825	295	3	-423	-222	-791	186	-139
Net Income	276	-1,146	2,049	-528	-897	1,226	-1,798	-1,524

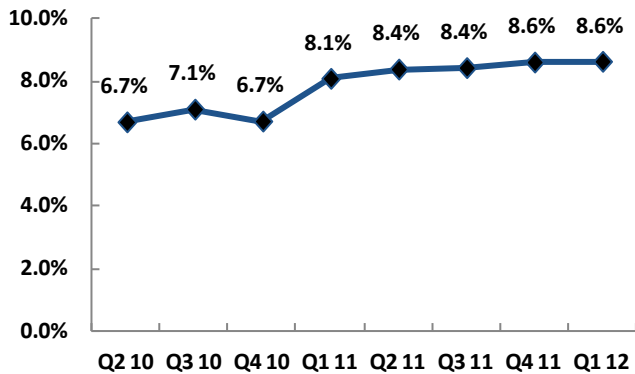
Source: SG Cross Asset Research, Bloomberg, Company Release.

RBS: Balance Sheet Data & Regulatory Ratios (in GBP millions)

	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Cash	29,591	61,416	57,014	59,591	64,351	78,445	79,269	82,363
Trading Securities	103,780	248,165	231,184	253,596	260,739	237,023	216,783	213,534
Intangible Assets	14,482	14,369	14,448	14,409	14,592	14,744	14,858	14,771
Net Fixed Assets	17,608	17,398	16,543	15,846	17,357	17,060	11,868	11,442
Total Assets	1,582,053	1,629,587	1,453,576	1,413,253	1,445,969	1,607,728	1,506,867	1,403,021
Total Deposits	420,890	420,639	510,693	428,474	428,703	433,660	502,955	497,510
Total Long Term Liabilities	679,849	735,230	542,687	523,418	606,334	758,415	592,301	693,815
Core Tier 1 Capital	50,275	48,311	49,309	49,038	48,001	47,830	46,341	46,802
Tier 1 Capital	61,161	59,175	60,124	59,548	58,387	58,336	56,990	57,342
Total Regulatory Capital	66,484	64,355	65,289	63,928	62,321	62,228	60,708	60,804
Core tier one Ratio	10.5%	10.2%	10.6%	11.2%	11.1%	11.3%	10.6%	10.8%
Tier one ratio	12.8%	12.5%	12.9%	13.5%	13.5%	13.8%	13.0%	13.2%
Capital Ratio	13.9%	13.5%	14.0%	14.5%	14.4%	14.7%	13.8%	14.0%

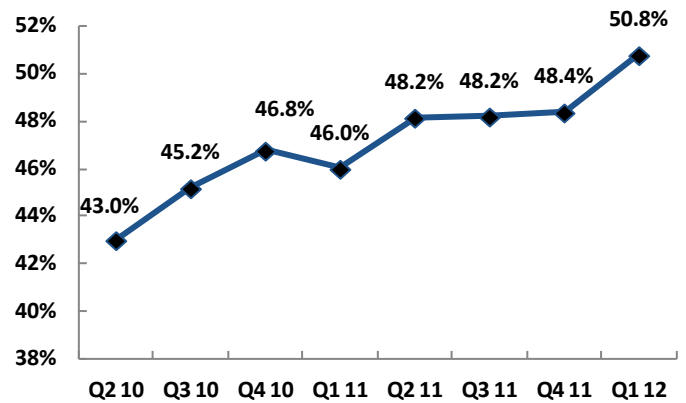
Source: SG Cross Asset Research, Bloomberg, Company Release.

RBS: NPL/GLNs are levelling off

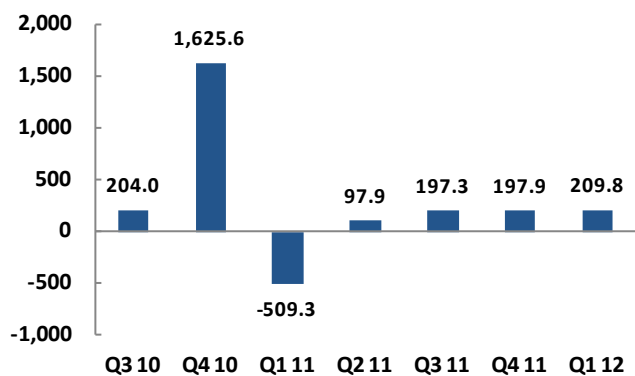


Source: SG Cross Asset Research, Bloomberg, Company Release.

RBS: Provisioning Ratios continue to improve

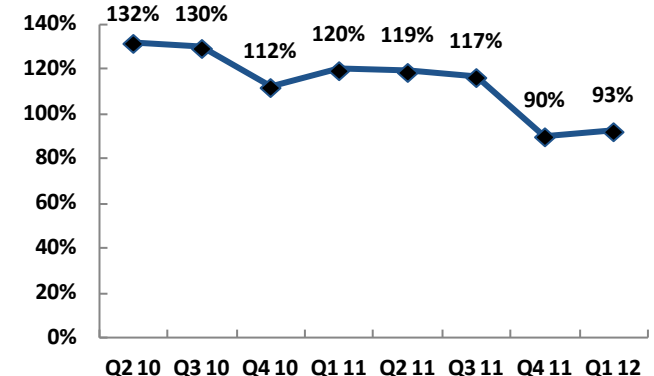


RBS: Liquidity Profile remains positive
(Liquidity Jaws: Growth in deposits – Growth in lending in bps)

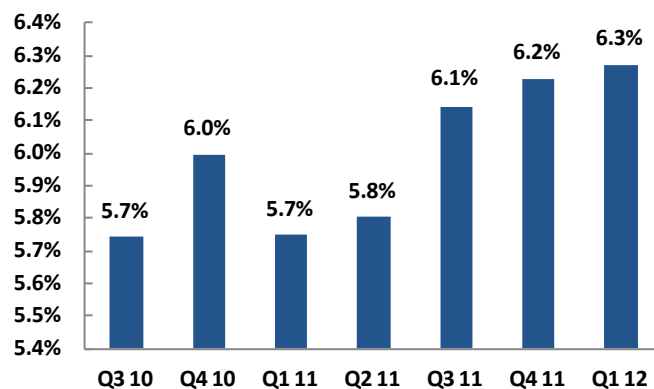


Source: SG Cross Asset Research, Bloomberg, Company Release.

RBS Loan to deposit ratio: slight marginal uptick

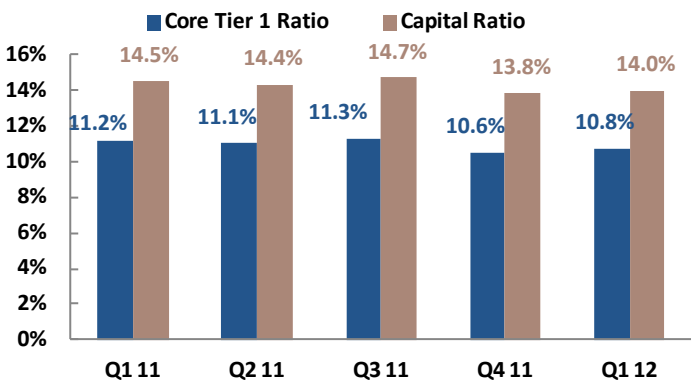


RBS: Leverage improving
(Tangible Equity / Tangible Assets – derivatives)



Source: SG Cross Asset Research, Bloomberg, Company Release.





RBS: Capital Ratios look good



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APPENDIX

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Positive: Indicates expectations of a general improvement of the issuer's credit quality over the next six to twelve months, with credit quality expected to be materially stronger by the end of the designated time horizon.

Stable: Indicates expectations of a generally stable trend in the issuer's credit quality over the next six to twelve months, with credit quality expected to be essentially unchanged by the end of the designated time horizon.

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Individual Bond recommendations:

Buy: Indicates likely to outperform its iBoxx subsector by 5% or more

Hold: Indicates likely to be within 5% of the performance of its iBoxx subsector

Sell: Indicates likely to underperform its iBoxx subsector by 5% or more

Individual CDS recommendations:

SG Credit research evaluates its expectation of how the 5 year CDS is going to perform vis-à-vis its sector.

Sell: CDS spreads should outperform its iTraxx sector performance

Neutral: CDS spreads should perform in line with its iTraxx sector performance

Buy: CDS spreads should underperform its iTraxx sector performance

Sector weightings:

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NEUTRAL: Sector spread should perform in line with its iBoxx corporate index

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