

We invest in winners. That means we invest in strong companies that create value for their shareholders with sustainable business models, solid balance sheets and high margins. We keep the risks low and invest when our position is fuelled by a positive event. We refer to that as the combination of value and event.

Lloyds Bank plc Bond 2009 (29/unb.)

The history of the British Lloyds Banking Group reaches back to the year 1765, when John Taylor and Sampson Lloyd founded a private bank by the name of Taylor & Lloyd. Through the centuries, the institution grew with takeovers and mergers, and established a reputation as a solid bank and insurance company in the mass client business. But then the company bought crisis-riddled mortgage bank HBOS in the autumn of 2008 for GBP 12 billion. Just a few months later, the group had to be bailed out. From then on, the state owned 43% of the company. A majority takeover and participation in the rescue fund was prevented with the issue of new shares (GBP 13.5 billion) and subordinate instruments (GBP 7.5 billion).

Today, Lloyds is profitable and the bestcapitalised bank in England. The government is in the process of selling its remaining shares at a profit. The purchase of HBOS turned out to be a blessing in disguise: Without the financial crisis, regulators would not have consented to the purchase, and Lloyds would not control more than a third of all savings/current accounts and mortgage transactions in its home market. As at 30 September 2014, Lloyds is reporting GBP 250 billion in risk-weighted assets (RWA). They are accompanied by GBP 52 billion in capital instruments. Of these, only the tier 1 capital (CET1) of GBP 30 billion is of relevance. It is followed by GBP 5 billion

in tier 2 capital (AT1), consisting of CoCo bonds, i.e. contingent convertible bonds, which are converted into tier 1 capital if a CET1 ratio of 7% (the minimum ratio set by the British regulatory authority for large institutions) is not reached. Therefore, the economic CET1 ratio is 14%. This situation directed our interest to the GBP 4 billion in tier 1 capital, which follows in terms of ranking, and, in particular, to a bond not eligible under Basel III (BB), which was issued at a volume of GBP 700 million in 2009. The coupon is 13% p.a. The coupon increases by 40 basis points plus an additional margin if repayment does not take place at the regular termination date in the year 2029. Two delayed coupons from the year 2010 and 2011 will become due at the latest upon redemption.

The terms of the bond exclude the possibility of loss sharing ("contractual trigger"). Therefore, we would have to see a loss of GBP 18 billion or 7% of RWA, with no possibility of subsequent going concern-related measures that would put our bond at risk. A so-called "make-whole" provision allows the bank to terminate the bond at any time. To do so, it would have to compensate all coupons going up to 2029 at a discount. We are expecting such a step, because the bond loses 10% of capital eligibility every year as a result of its coupon structure, and thus becomes more and more useless, not to mention expensive, for Lloyds. At the current price level, the current interest rate until the termination date is 7% p.a. This rate would be increased on a time weighted basis with a premature termination.

Sincerely yours



J. Henrik Muhle



Dr. Uwe Rathausky