Financial Times

December 10, 2015 5:13 pm

# Questions over Clydesdale as float looms

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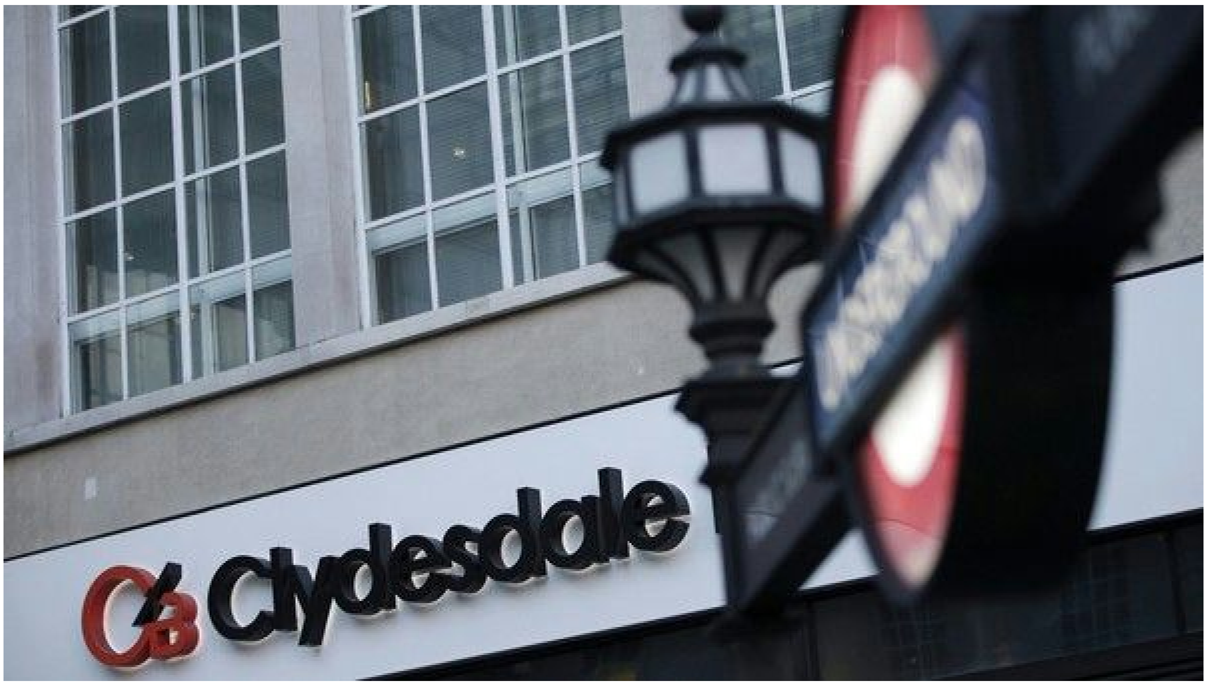


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For the first time in almost 100 years, Clydesdale and Yorkshire is on the cusp of becoming an independent bank.

The lender owned by National Australia Bank is due to float in London in February, making it the latest in a series of challenger banks to launch initial public offerings this year.

But after years of poor performance from the UK division — which has been embroiled in mis-selling, hit with regulatory fines and exposed to bad property loans — analysts are questioning whether Clydesdale will appeal to investors.

The flotation of Clydesdale, formed in 1838 in Scotland, is the culmination of NAB's strategy to withdraw from the UK.

NAB's other British subsidiary, Yorkshire Bank, operates as a division of Clydesdale under its licence, and is part of the sale. The Australian group aims to float 25 per cent of the UK business and demerge the remaining 75 per cent to existing NAB shareholders.

"The interesting thing will be how they can differentiate themselves and compete," says Jonathan Goslin, an analyst at Numis. "Size will be beneficial."

He adds that "there's still demand there for challengers, with TSB being taken out" following its acquisition by Spanish bank Sabadell.

£2.1bn

Amount earmarked for misconduct issues

Clydesdale and Yorkshire is positioning itself as a turnround story, pointing to efforts to draw a line under former misdemeanours and poor lending practices.

David Ellis, an analyst at Morningstar, says: "In the past, the Clydesdale and Yorkshire banks suffered badly from commercial real estate loans that went bad and massive losses on mis-selling and conduct issues."

Conduct problems cost the bank £1.51bn between March 2013 and the end of September 2015. The lender was among the banks that mis-sold payment protection insurance — a form of cover to protect credit repayments. It was fined £21m this year for poor PPI complaints handling.

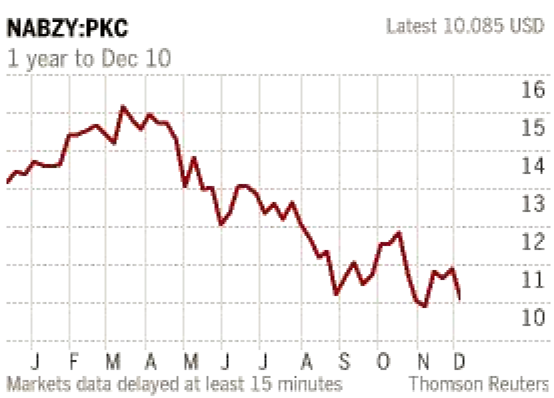
As part of NAB's sale, the UK's financial watchdog instructed it to set aside £1.7bn to cover potential redress claims against Clydesdale in the future. This forms part of a total £2.1bn pot earmarked to deal with misconduct issues — including mis-selling of interest rate hedging instruments to businesses.

Bad commercial real estate loans, stretching back to before the financial crisis, have hit performance in the UK division, and ultimately NAB. The UK bank has offloaded £5.6bn of commercial real estate loans, accounting for the bulk of its exposure, to NAB, in order to focus on retail and small business lending.

Mr Ellis says: "National Australia Bank presents a rosy future for Clydesdale, but the test will be how well new management execute on the turnround strategy and whether the UK economic recovery continues to gain momentum."

David Duffy, who is credited with turning round Irish bank AIB, took over as chief executive of Clydesdale and Yorkshire in June. He is targeting a double-digit return on equity over the next five years, up from about 5 per cent.

Analysts at Deutsche Bank say the key to hitting this target is a reduction in the bank's cost-to-income ratio to 60 per cent, down from 75 per cent.




Mr Duffy recently told the Financial Times that digital services and branch enhancements would be areas of focus to help improve shareholder value. The bank has about 275 retail branches and 40 business and private banking centres.

Buy-to-let has spurred Clydesdale's mortgage growth substantially in recent years. About 42 per cent of the bank's gross new lending in 2015 has come from buy-to-let loans, compared with 17 per cent in 2012.

But government measures to cool the market, including a 3 percentage-point increase in stamp duty rates for buy-to-let properties, could stymie Clydesdale and Yorkshire's future growth.

As one of the biggest challengers coming to market, analysts say there are positives for prospective investors, including its heritage and scale. In its investor presentation ahead of the IPO, the bank says it has "175 years of regional presence — two trusted brands, recognised service quality, leading regional market shares".

It notes that Clydesdale is the "largest of the midsized banks", with 2.8m customers, and £29bn loans.

Nonetheless, some investors remain sceptical of buying the shares when the bank floats. Jan Luthman, a fund manager at Liontrust Asset Management, says there could be an attractive buying opportunity at a later date if NAB shareholders sell their shares in the UK business.

NAB investors receive one Clydesdale share for every four NAB shares held, under the terms of the proposed demerger, which is still subject to a shareholder vote at the start of next year.

"We probably will go back and have a look, but with a view to what price we'd like to see post IPO," Mr Luthman says.