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Barclays business model under pressure after 'messy' Q4

Filippo Alloatti, Senior Analyst at Hermes Credit, reacts to today's Barclays results:

Key points:

- Profit before tax misses expectations
- Long-term business model issues remain
- Maligned investment bank dominates profits
- Retail banking needs refining

Barclays was yesterday forced to partially announce its 2013 full year results, after it leaked to the media ahead of today's official release.

The group has announced 2013 adjusted profit before tax of £5.2bn – statutory of £2.9bn – which was lower than consensus expectations of £5.4bn.

In terms of capital, the CET1 is surprisingly down 30bps QoQ as they are paying a big dividend, 40% payout ratio. Sticking to the guidance of 10.5% CET1 ratio by 2015 is rather disappointing. The PRA leverage ratio is much better at 2.97%.

Aside from the quarterly number, long-term strategic issues regarding its universal banking model remain. We have entered a new world of ring-fencing for UK banks, and more onerous leverage ratio requirements.

Barclays management faces a conundrum. The much-maligned investment bank is still generating more than 60% of group profits, helping to slowly expand its capital base – and pay a dividend. However, the very same investment bank is, considering Basel requirements and The Financial Stability Board's mandate, limiting the strategic options for Barclays.

Cutting the balance sheet more aggressively and reducing assets counting in the leverage ratio, to the tune of £150bn as speculated by the Sunday Times, is similar to the route to be taken by Deutsche Bank.

Exiting a few product lines where it does not have critical mass, and further reducing the investment bank workforce will help, but allocating 3% or more equity on the investment banking assets risks delivery of returns below the group's cost of equity.

Unless the above cuts are massive, which would likely result in significant lost revenues.

Barclays' geographically sparse retail banking operations (UK, Continental Europe and South Africa) needs more rationalising and a refined narrative, as its relative weight in the group could be set to increase.

We expect increased guidance on its CRD IV (Capital Requirements Directive) common equity target and perhaps clarification on how the maximum distributable amount (MDA), as per article 141 CRD IV, is interpreted at the bank. We fear the PRA will be more assertive and could force Barclays to skip the coupon on the recently issued CoCo in AT1 host at some point in time in the future. Therefore, potentially making the AT1 junior to common shares.

-ENDS-

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Notes to Editors:

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