Virgin Money
Q1 Trading Update
Transcript

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Virgin Money Q1 Trading Update

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Introduction

Morning everyone. Thanks very much for joining the call. Hopefully, as you will have seen in the trading statement this morning, we are very pleased with Virgin Money's performance during Q1 this year. It has met our expectations in every respect. It was a quarter in which we were really delighted to see our net promoter score increase by ten points to reach +39. As you will probably know, that is one of the best scores for a UK retail bank.

Mortgages

However, I know you will want me to turn first to mortgages, so let us just talk a little bit about that. As you will have seen, the Council of Mortgage Lenders has estimated that mortgage gross lending in Q1 was £49.1bn. That is a 6.2% fall on 2016. There should be no surprises in that, of course, because it is largely to do with the accelerated lending which took place in advance of the increase in stamp duty on buy-to-let last year. Overall, we outperformed the market in Q1, with £2bn worth of gross lending which, representing a 3.44% market share for the first quarter, is right at the top of our target range and represents an improvement on our equivalent share for Q1 last year. To be clear, we do expect that the gross lending market in the UK will grow from here for the rest of the year.

We were particularly pleased with our retention figures and our net lending outcome. Retention has continued to perform strongly; we are achieving just over 71% at the moment. We took a 12.3% share of the net lending market, which demonstrates our continued strong growth in UK mortgages, and is in fact one of our strongest quarters in terms of our share of net lending.

As far as the shape of the business is concerned, almost 80% of it was residential and the remainder was buy-to-let. We lent 18% of new business to first-time buyers, which we were particularly pleased about, and 36% went into residential re-mortgages. We continue to see this as a really strong profile for Virgin Money in the UK mortgage market, and certainly one which allows us to manage our mortgage spreads effectively. Spreads for the quarter met our expectations. Hugh is here with me and will talk a little bit more about that if you like. I think he felt it was the most stable quarter we have had for mortgage spreads. That is largely to do with our nimble approach to pricing in the segments that we operate in.

The book continued to perform really well in terms of asset quality, with mortgage cost of risk remaining low and stable compared to 2016. We are pleased that we continued to benefit from such strong relationships with mortgage intermediaries, and we are particularly pleased that they helped to vote us Best Mortgage Lender at the Mortgage Strategy Awards in March.

Credit cards

We are very aware of the focus that there has been on the FCA's consultation on credit cards, and on concerns around the level of unsecured consumer indebtedness in the UK at the moment. I would just like to assure you that we take both of these very seriously.

FCA consultation paper

First of all, let me turn to the FCA consultation paper. I just wanted to remind everyone that we have been working with the FCA, as have other credit card providers of course, for some months since their initial Credit Card Market Review came out. There were no surprises for us in the last consultation paper and, given that we built our credit card business so recently, and it is less than two years since we put that live, there is almost no change for us to make in order to be fully compliant very quickly. We can also see that none of the proposed remedies coming out of the FCA will affect the underlying economics of our card book in any material way.

Consumer indebtedness

Secondly, as far as consumer indebtedness is concerned I think we have always told you, and told the whole market, that we always put asset quality before asset growth. We have always been very focused and diligent in terms of our credit standards. As you will remember, we tightened our underwriting criteria immediately following the referendum last year; not because we had any problems, but simply because we wanted to make sure that we never do, and that we are always taking top-quality customers through to the Virgin Money balance sheet. We have continued to do that. We have continued to tighten and we have continued to lend responsibly, and we are pleased throughout the cycle that that is going to give us a good outcome.

In fact, because of the fame of our brand and our effective distribution, we have been able to further tighten credit criteria in the quarter. As a result, we have been able to take good volume in the market, with credit card balances growing by about £200m, but certainly not in a way that means we have had to be top of the table in the 0% balance transfer world, nor in any way that means we have been weakening our rigorous credit standards.

Altogether, that means that we are still confident of hitting our £3bn target for credit card balances at the end of this year, but actually we will achieve that with even higher credit standards than we had initially envisaged. We keep that under regular review.

As we review the credit card business, we can see that customer behaviour continues to be very solid. In fact, we can actually see that the average level of indebtedness for customers in our book is lower than that for the market as a whole. You may want to ask a little bit more of that later. We continue to write a higher proportion of retail cards in our new business than we did last year, and the split in the first quarter of the credit card portfolio was 60% balance transfer business and 40% retail cards. Despite the fact we are never complacent, I hope, we really do believe that we have built and continue to build a book which is well positioned to behave in a very stable way, even in a potentially uncertain future.

Savings

As far as savings are concerned, we have had a particularly strong quarter. Our cash ISA business has continued to grow very strongly, with inflows up 39% on the same quarter last year. Overall, our savings franchise continues to thrive. We have also repriced a further £5bn of retail deposits. That is down by about 20bps during the quarter. We have also given notice of another reprice on around a further £5bn, which will take effect in the second quarter. As we told the market we would at the end of last year, we have drawn further on TFS, and obviously altogether this has really helped our overall cost of funds.

Now, I know that you are always interested in net interest margin, and you will remember we do not disclose it specifically in Q1. What I would say is that it is in line with the full-year results of 2016, and any pressure coming through on mortgage asset spreads has been offset by improvements in the cost of funding through retail deposits and TFS. A number of people this morning have asked us whether our flat NIM is flat with a hint of up or flat with a hint of down; I think the answer is it is flat with a hint of flat.

A number of people have been asking us about our non-interest income products, and I have been really pleased with their performance during the quarter. We are still clear that we expect these lines of business to produce about 10% of our total income by the end of this year. Savings and investment business has been strong, and I am pleased to tell you that we have signed a new contract with the BGL Group to offer a new life insurance product later in the year. Our other insurance lines have also continued to grow.

Financial dynamics

As you would imagine given the strength of our commercial performance, financial dynamics have been very strong in all respects. I am particularly pleased, as always, with cost control. The cost:income ratio in the first quarter has been stronger than on average in 2016, and we continue to really concentrate on managing the cost line in the knowledge that it is the one line that is always in our management control. So far, so good, in terms of hitting a 50% cost:income ratio by the end of this year.

Equally important, of course, is the impairment line. What I can tell you is that not only do we have no issues in that line at all, but that mortgage cost of risk was low and stable, and that credit card cost of risk has actually slightly improved since the end of last year. That is because we continue to lend responsibly. We have always said that we manage our underwriting carefully and consistently, and once customers are with us, we work with them to keep them in good financial health.

Overall then, the performance of the P&L and balance sheet is entirely in line with our plans for the year. Our capital ratios continue to be well in excess of regulatory requirements and we continue to be confident of delivering on all elements of our guidance for the year ahead. There are a couple of reasons for this level of confidence. As far as the economic outlook is concerned, I continue to be pleased that the economy is performing better than my expectations and possibly better than market expectations post Brexit, or certainly post referendum. There are a number of areas where that is particularly good for us at Virgin Money, notably the slight reduction in unemployment that we have seen recently and the steady increase in house price growth, both of which are good for our business. Although we agree with the Bank of England in terms of the increase in consumer indebtedness, as I have said previously, the way in which we acquire our customers allows us to be confident that we are not stoking that fire, nor are we taking on customers who are overly indebted.

Competition in the markets is strong, but we continue to be able to deliver on our plans. To remind you, that means that we remain confident of delivering our result of between 3–3.5% market share of gross lending in mortgages, and £3bn worth of credit card balances, despite the fact that we will continue to put asset quality before volume.

Digital bank plans

Now, I know that a number of people will be keen to understand where we have got to with our plans for the digital bank. Again, we have had very positive progress during Q1. So far 10x have delivered everything they have promised. We now have an initial system that will be subject to testing as part of the next steps for the programme, a full team up and running and a clear vision on how the Virgin Money digital bank will compete in the digital world of the future. I am still very clear that we have got a unique place in this digital market. What we are not doing is putting a digital front end on our existing systems; rather, we are building a full new digital capability that is much more likely to compete with the neo-banks and fintechs. However, the difference between us and them is that we have a significant asset base and a material number of customers to build from. That is what I think will mean that we are the real winner. We are still on track to deliver something to customers before the end of 2018 and our current expectation is to update the market more fully and formally on our digital bank proposition before the end of this year.

Co-op Bank

Before many of you ask me about the Co-op Bank, with which we have been associated, as you know, in the press in the last few weeks, I just want to remind you that it has been five years since we bought Northern Rock. Since then, we have looked at every possible acquisition in the UK retail financial services sector, but all we have actually done is to buy our credit card book and a small mortgage book. The fact that we look at everything, and we do look at everything, should not be taken to mean that we will do anything that is not consistent with our low-risk plans and our safety-first approach for Virgin Money.

We look forward to updating you again on our performance at the half-year, but now Peter and Hugh are with me and we all look forward to taking your questions. Thank you very much.

Q&A

Rohith Chandra-Rajan (Barclays): Hi, good morning there. Thank you very much for addressing the FCA and the indebtedness issue head on. I wonder if I could ask you to elaborate a little bit, particularly in terms of your own risk appetite and how you see that as differing to the market as a whole? What are the key indicators that you would like us to consider when we think about the Virgin Money credit card book and risk appetite and indebtedness, and how do those compare to the broader market?

The second one, as you finished off with, in terms of potential acquisitions: I do not expect you to comment on specific acquisitions, but it would be really interesting to hear the metrics that you consider when you are looking at acquisitions in terms of size and scale and strategic fit/product group. What are the key metrics that you look at? Thank you.

Jayne-Anne Gadhia: Thank you very much, Rohith. Let me give two quick answers myself if I may, Hugh, without stealing your thunder too much, on the credit card position. Then I will ask Hugh to comment on it and then I will come back to you and talk about acquisitions, if I may Rohith. The two pieces of information that you may find helpful in terms of how our risk appetite, or at least our outcomes, differ from the market as a whole is that we can see that customers in our book are actually less indebted than customers are across the market. Now, there was a piece of work that came out in the last few weeks that showed that average customer indebtedness as a percentage of household income was about 27%. Ours is just over 20%, just to give you an example of why we feel that we are in good shape in terms of that indebtedness index, if you like. Obviously, that is very powerful and very valuable for us.

Then the second thing is, as we disclosed to the market last year, we have customers whose average profile is they are about 42 years old, and I remember we talked to you about them having, on average, free income of around £750 a month. Now, as we tighten our credit criteria, we have actually increased the free income that we require of our customers. As part of the credit tightening, we have increased that from £700 a month previously. Both of those are very strong qualitative indicators of why our credit performance is as good as it is. Hugh, may I ask you to say any more, having stolen your thunder?

Hugh Chater: Thank you very much Jayne-Anne, and good morning. In addition to those data points, which are critical in terms of understanding the type of customers we are acquiring and their characteristics, I would take you back to some of the structural facets of how we lend. It is vital to remember that we do not down-sell, so there is basically a binary choice that we take: we either acquire the customer because we think they meet our, as Jayne-Anne has said, ever-tightened credit criteria, or we do not. We do not have a book which has high-quality customers on the one side, and slightly lower-quality customers paying a higher APR on the other side; we have a book that is entirely comprised of high-quality customers, because we simply do not book them if they do not meet our criteria.

The other thing which is very important is that we have been successful in attracting better-quality customers in the last six months, because of the development we have made to our eligibility checker at the front end of the process. This has actually meant that, although we have had slightly less competitive pricing than we have enjoyed previously in the market, the quality of the customer we have acquired, as Jayne-Anne has talked about, has actually improved because 75% of all new customers that we have acquired in the last quarter have come to us with the comfort and understanding that they are pre-approved for our offer. That allows us to select the very best quality customers in the market.

Jayne-Anne Gadhia: Thank you, Hugh. Shall I go on to acquisitions then, Rohith, if I may?

Rohith Chandra-Rajan: Could I just very quickly check? That last comment I found particularly interesting: it is this pre-approval that is enabling you to improve credit quality without competing on price. Do you think that is a key differentiator?

Hugh Chater: It is. It is the combination of that, together with the knowledge that the customer has that they are not going to get down-sold.

Rohith Chandra-Rajan: Okay, thank you.

Jayne-Anne Gadhia: On acquisitions, I should point out that I am not referring to anything specific at this point in time. We have looked at a number of things over five years, and broadly look at the same sort of metrics in all of them. One of the key areas that we would look at of course, is credit quality. We focus so hard on making sure that we have got a super-clean book, and the thing that I absolutely do not want to do is to ever acquire anything which would deteriorate credit quality beyond a prime position, if that is the right way of putting it. I remember some time ago we looked at a mortgage book and the team had done a lot of work on it. When it came to me, it was very easy to say we are not going to do it, because it had a high percentage of self-certified mortgage business, for example. It is something that we just would not do. Credit quality is of primary importance.

In terms of the strategic fit, the two areas of our business that we will be building out with our digital bank, and we are very excited about that, and also hopefully we have an opportunity to look at what might come from the new shape of Williams & Glyn with this, is current accounts and SME. Clearly, the Virgin franchise, the Virgin brand, would perform extremely well in both of those markets and they are of interest to us. However, we have a very strong organic plan for building out both of those products which we are very committed to.

We would look very hard with any deal at execution risk. The Northern Rock deal was obviously something that was well executed. We thought about that a lot before we did it, and we would not ever do anything that we felt was too risky to execute. All of that together comes down to a place where we would always look at what sort of capital consumption any sort of acquisition might mean for us. At the moment, we are very pleased with where we are from a capital perspective, because we have got a low-risk, well performing bank with low operational risk too. Our capital position is, I like to think, very clean, if that is the right way of putting it, and I would want to make sure that whatever we do in the future, whether that would be in terms of acquisition or organic growth, then we would be in a similar position.

Finally, culture and ethics are important to us. You all know I think that we want to make everyone better off in banking and we don’t ever want to dilute that positive outlook and that way of doing business. I would say those are five key things to consider for us, Rohith, in terms of our organic growth or non-organic growth. I should make the point at this point that organic growth is very much our planned strategic direction, but we would never say never to anything, as you know.

Robert Noble (RBC): I was just looking at the recent Financial Stability Review from the Bank of England, and they seem to be, not just the FCA on persistent debtors, but they seem to be concerned about the balance transfer market, the use of effective interest rate accounting. I was wondering if you had noticed a change at all from the attitude of the regulator with your discussions with them.

Secondly, just on costs: you are saying you are on target to hit 50% cost:income ratio. Just piecing together all your other guidance of a flat margin, your growth targets etc., I think it implies costs are around about flat for the year. Does that sound about where you are headed, or should I expect more inflation? Thanks.

Jayne-Anne Gadhia: Okay. Peter, why don’t you answer that one first while you think about the Financial Stability Review, Hugh?

Peter Bole: On costs, Robert, the 50% number that we have spoken about is an exit run rate. We do envisage a little bit of inflation, as we saw last year, in underlying cost, but it is relatively modest; our expectation is it will be comfortably outstripped by the income growth. So, it is that positive jaws that we are forecasting across the course of the year. I will let Hugh talk about the card piece, but one thing I would say on effective interest rate accounting: we continue to monitor that very closely. We have got detailed analytics happening on a monthly basis, and we continue to see that very, very stable behaviour within that. I will let Hugh add some colour to that.

Hugh Chater: That was going to be my line, but anyway, thank you very much. I think the direct answer is: we have not seen any change from the regulator in terms of their approach with and comfort with the things that Peter has just talked about. As Peter said, we pay very, very close attention to how the customer base is performing; particularly, obviously, the existing base of customers as opposed to new. As Jayne-Anne mentioned, we see consistency and stability in that. So, all in all we are very confident that the way we account for the income associated with the book is entirely appropriate.

Robert Noble: Okay, thank you.

Jayne-Anne Gadhia: Thank you Robert.

Raul Sinha (JP Morgan): Morning, it is Raul here. Can I have two please? The first one, Jayne-Anne, is on the £3bn cards balances. The reiteration of that after a very strong first quarter implies some slowdown in the pace of growth, which I think you have talked about a little bit. Could you touch upon the shape of the expiry of the promo offers within your cards balances, and how that might impact some of the net growth in your cards book as we get to the second half this year?

Jayne-Anne Gadhia: Yes. Your second question?

Raul Sinha: The second one was on deposits, the £5bn repricing; if you could give us maybe some colour on that in terms of what magnitude of impact that might have? If not, maybe you could talk a little bit about how much competition you have seen from the industry around the ISA season on term deposits and savings deposits? Where is the industry heading in terms of deposit costs relative to your expectations? Thanks.

Jayne-Anne Gadhia: Okay. You are certainly right in terms of the £3bn being affected by the run-off of the promo offers. Hugh, why do we not start with that? Perhaps you could go straight into deposits?

Hugh Chater: Yes, I will do that. Thank you, Jayne-Anne. We are this year starting to see material cohorts of business that we expect to attrite within credit cards. It is entirely within our plan and assumptions, and the run-off we are expecting from those portfolios will be around 60% of balances as they mature fully. We continue to see that as a solid assumption, based on the data that we have from some small cohorts of business that were acquired under the MBNA partnership rolling off. You are right, the trajectory of credit card balances is now starting to be shaped by this dual effect of the new growth, which drives over 100% of the total growth on the portfolio, which then is balanced by or offset by the attrition. However, just to restate: the performance we have seen to date suggests that our assumptions around attrition on cohorts as they roll off are entirely in line with what we have seen in the very early days.

Raul Sinha: Sorry, if I could just follow up on that? The 40% stick rate that you assume, do you think that the extension of the balance transfer periods across the industry could materially impact that?

Hugh Chater: No, that is something that we have allowed for, because frankly, the extension of balance transfer periods have been quite stable for about the last six or seven months. The other point to make is that we do have a very sophisticated programme of working with existing customers, as Jayne-Anne has mentioned. Part of that, of course, is to ensure that we stimulate that book of existing customers to retain the balance, rather than just sit back and wait and see what happens.

Moving on to savings, if I may? The £5bn of repricing that you were talking about: the average price impact of that is equivalent to the previous one that was mentioned in Jayne-Anne's remarks earlier. It is circa 20bps of rate reduction that we are seeing. We are seeing very strong balance retention on the repricing that we are doing, so again, our estimates for the effect on balances and the effect on the overall payment rate on the book, we believe our assumptions around there are very solid.

In terms of the market overall, the movements in the savings market are definitely in the secondary market. Again, we are seeing tactical pricing there. I do not expect that the move by NS&I, for instance, with their three-year-term product that has just come out at 2.2%, will have any substantial effect on our base. We are confident in our ability to continue to manage the balance of funding between retail and wholesale at the rates that we anticipated at the beginning of the year, and do not therefore suggest any change in the guidance that we gave at that point.

Peter Bole: Just reiterating that point: the deposit repricing is entirely embedded within the guidance for full-year NIM that Jayne-Anne referenced earlier.

Raul Sinha: Thanks, that is really helpful. Jayne-Anne, could I have one follow-up please, a broader question on the cards? The Bank of England Credit Conditions Survey shows that there is likely to be quite a big contraction in the availability of unsecured credit to households. Is that something that you are seeing in your data as well? It does not seem to me to gel with the comments you made about increasing competition. Do you think that if everybody started to withdraw a little bit from the unsecured market in general, that might have negative implications for asset quality going forward?

Hugh Chater: So, maybe I will try and answer that one as well.

Jayne-Anne Gadhia: So nice to have you here, Hugh. Yes, thanks.

Hugh Chater: The competition that we have seen in probably the last six to nine months, in terms of increase in lending, has almost entirely been at the lower credit risk end of the spectrum. So, the increase in what the industry calls credit-builder products has been substantial.

Raul Sinha: Okay.

Hugh Chater: And my sense is that that is where the squeeze will come, and that lenders will decide that they cannot achieve the right risk-adjusted margin in the event that impairments start to increase. Just to reiterate: we are seeing nothing that suggests that the guidance we have given around the £3bn, at the rate that we have within our plan, cannot be achieved, so we are very confident of that, even allowing for the additional tightening that we have made.

Raul Sinha: That is really helpful guys, thanks so much.

Jayne-Anne Gadhia: Thank you very much.

Michael Helsby (Bank of America Merrill Lynch): Morning everyone. I think one of the key things for me this morning was that the redemption profile in the mortgage book looks to have actually improved in Q1; you referenced that the retentions are very strong. Can you give us a little bit more colour in terms of what you are doing differently, if anything, or why you think that is improving? Whether you think the sense of that is a sustainable position for the rest of year? Because it is quite at odds with the market when re-mortgaging, as you say, has been the biggest driver in the market. Thank you.

Jayne-Anne Gadhia: Thanks, Mike. Well, this is clearly turning into the Hugh Chater show this morning, and that is good; one of the things I would say is that one of the reasons I think that our results are so strong is that, over the course of the last year or so, we have consolidated all of our commercial activity under Hugh, and we have been able to see real growth, performance and stability as a consequence. So Hugh, over to you.

Hugh Chater: Thank you Jayne-Anne, and good morning Mike. So, as you have said, we have seen lower redemptions than we had budgeted, and that is actually something which you may remember we also talked about when we did our full-year results, because we saw it then as well. I think there are two things that particularly help us in this area, maybe three actually. One is: you all know that, like pretty much everybody else in the industry, we did introduce a proc [uration] fee for brokers around redemption and re-mortgaging performance, and so we are in line with the rest of the industry and I think that was important. If we had been an outlier, I think it would have proved difficult to maintain this performance.

Second thing is we have historically had a reputation for re-mortgage, and I think that is something that we built on the strength of. For instance, we have invested in the online re-mortgage journey for our direct customers, and that definitely is helping us.

Then the third thing is that we have a product range that I think is straightforward and transparent for customers to understand. Of course, I would say that our brand is really helpful here, because it is a brand customers trust. You can see from our NPS, and the improvements in that, how customers are reacting to our brand; frankly, whether they are coming direct or through a broker.

Michael Helsby: Okay, thank you.

Jayne-Anne Gadhia: In a nutshell, Mike and others, I think part of the answer is we work on it as hard as we work on new business and years ago that probably was not quite the case.

Michael Helsby: Okay, good. No, it is working. Thank you.

Jayne-Anne Gadhia: Yeah. Thanks, Mike.

Emer Lang (Davy): Good morning. Just another one on the mortgage point. Your strong pipeline of £2.3bn at the end of Q1; typically, what would you expect to see in terms of conversion of that £2.3bn, and over what timescale?

Jayne-Anne Gadhia: The conversion profile is strong; I would say we are in the high 70s% on average, and on balance that comes through the pipeline in about a three-month period.

Emer Lang: Thank you.

Jayne-Anne Gadhia: Thank you very much.

Ian Gordon (Investec): Yes, morning. Well done on another great quarter. I have just got three pretty dull questions on detail, if I may? Firstly, could you spoon-feed me on the average cost of funds, what it has come down to in the first quarter?

Secondly, again on the volumes pipeline, up 14% quarter on quarter: is there any colour or comment to add on the composition of that pipeline in terms of owner-occupier/buy-to-let split, and/or the proportion which is re-mortgage?

Then thirdly, we have already had some discussion on the Credit Conditions Survey. The impairment performance you have reported within your cards portfolio may not be consistent with consensus, but it seems to be exactly consistent with what the Credit Conditions Survey said for Q1. The survey also anticipates a fall in Q2 for losses given default. Can you comment as to whether that expectation is consistent with your own book? Thank you.

Jayne-Anne Gadhia: Hugh, how about you start on volumes, because I can see Peter looking through the numbers.

Hugh Chater: Yes, thank you, Jayne-Anne. So, in terms of the composition of the pipeline, Ian, frankly I think we would say that it is going to mirror the business that we have done in probably the last month. So, essentially, very similar to what you would be used to from us, with maybe slightly more in terms of first-time buyers and slightly more in terms of new build specifically. The purchase to re-mortgage split: we have seen, because of the first-time buyer move, actually slightly stronger purchase, so just over 50% of new business in the last couple of weeks has been purchase. So, I think those are the two that I would mention, but otherwise very stable in terms of what you would have seen from us in the last year.

Ian Gordon: Great.

Jayne-Anne Gadhia: Thank you, Hugh. Now, Peter, you are going to answer the other two, I think. First of all, average cost of funds.

Peter Bole: Yeah. The average cost of funds in the quarter was down just over 100bps; it is about 1.03%, down from 130bps for 2016. So, that just reflects the flow-through of the impact of TFS into the funding mix, and also some of the repricing activity flowing through that Hugh has referenced. Again, Ian, I just reiterate: that is reflected through in the guidance that we are giving on total margin for the full year.

Ian Gordon: Of course.

Peter Bole: On the credit outlook and credit conditions, I think we have said in the announcement, Ian, that the credit performance we saw on mortgages was very stable in the quarter relative to 2016, and we saw a slight improvement actually in terms of cost of risk on the credit card book in the first quarter. We have reiterated that we are reaffirming the guidance for the full-year outlook. I think the only thing I would add to that is that we are not seeing anything in any of the indicators, either lag or lead, that would suggest anything other than a fairly stable performance as we look forward, certainly into Q2. So, I think that is probably as far as I would go at this stage, certainly reaffirming the guidance for the full year.

Jayne-Anne Gadhia: Yeah.

Ian Gordon: Nice one, thanks very much.

Jayne-Anne Gadhia: Thank you very much, Ian.

Edward Firth (KBW): Yes. Good morning everybody. I just have two questions, if that is alright? Firstly, just bringing you back to the EIR accounting: could you just tell us, both in terms of run-rate and balance sheet, what the difference is between what you are accruing and what you are actually receiving in terms of net interest income as of today? Because I guess as the balances grow, it becomes somewhat more material? That was the first question.

Then the second question: I was looking on your website the other day, and I think I am right that your SVR rate is now between 4.5–4.7%, which by any stretch of the imagination is a pretty extraordinary rate for secured lending. It must make that one of your biggest revenue contributors, even though it is only 11% of the book, if you are making a spread of 400bps or something. So, I guess the question there is: how sustainable do you think that is? That is particularly in the light of both your branding but also your plans to take £5–6bn of government-subsidised funding.

Jayne-Anne Gadhia: I think the first thing that I would say on EIR accounting: you are asking for the difference between cash accounting and the appropriate accounting treatment that we have to take, do not forget, as a result of all of the international accounting standards. As you know, the average yield on the book is 7%. The gap between that 7% and what we actually earn in cash is not quite as significant as you would imagine, not least because we have a fee of up to 4% upfront, and people spend on their cards. So, I do think that sometimes there is a view that a 0% balance transfer has no cash at the beginning, and of course that is entirely incorrect. So, if we were to account on a cash basis, the difference between a 7% yield and the cash yield, as I say, would be nowhere near as material as that simple equation would imply.

We haven't disclosed, I do not think, in Michele's spotlight session, what that gap is. However, it is funny: when Dave Dyer became CFO around 18 months ago, and then when Peter joined us in November, the first thing both of them did was to work out the exposure on the EIR accounting side. Both felt very comforted as a result of looking at the cash compared to the accounting position. Peter, you might want to pick that up.

Peter Bole: I think I will just reiterate what I said earlier: it is something that is borne out from a lot of data we monitor very actively and will continue to do so.

Edward Firth: Apologies if you have already told us this, but what are your interest-free balances today, roughly?

Hugh Chater: Interest free, do you mean customers on the promo rate?

Edward Firth: Yes, exactly.

Hugh Chater: On a 0% promo rate?

Edward Firth: Yes, or near zero. Whatever you look upon as your promo rate. Whatever you apply the 3% or 4% to.

Jayne-Anne Gadhia: So, we have not disclosed that, Edward. I think we shouldn't pluck that out of the air.

Edward Firth: No, sure.

Jayne-Anne Gadhia: Maybe that is something that we will be disclosing at the half-year. That would be good.

Edward Firth: Okay, yes, that would be very helpful.

Jayne-Anne Gadhia: On SVR, I do not have any concerns about the rate, to be absolutely honest. It has remained stable since we acquired Northern Rock. We think about it as interest rates move. We reduced the SVR when interest rates did come down. As you rightly say, 11% of our book is on SVR, so you can work out the contribution of that rate to our overall net interest income, in the knowledge that there are very few customers that are on the SVR rate long term. So, although 11% of the book at any point in time is on SVR, sometimes that is just because customers are either waiting to go onto a new front-book product with us or elsewhere. I think you will find that the average amount of time that customers spend on SVR with us is between two and three months.

Edward Firth: Okay. Does it not jar a little bit with the branding of Virgin and the 'everybody better off' stuff and trying to be different to the existing banks, to then be charging a rate that is even higher than everybody else?

Jayne-Anne Gadhia: Do not forget, this is a contract term position for a 25-year mortgage, when we know that the market actually operates on a two-, three- or five-year position. So, to be absolutely honest, this probably enables us – to Mike's question earlier – to drive some of the retention, because we can talk to customers about their ability to sustain a lower rate by moving to a new front-book product with us. So, no, we feel perfectly happy that we are treating customers fairly as a result of that.

Edward Firth: Okay, thanks very much.

Jayne-Anne Gadhia: Thank you very much.

Jayne-Anne Gadhia: Morning, Guy.

Guy Stebbings (Exane BNP Paribas): I will refrain from asking another question on EIR, as much as I was tempted to. So, I will ask a question on mortgage pricing. In the past few weeks, we have seen some very competitive offers come to the market, albeit not the largest players. Is it a question of them being too small to significantly impact the competitive dynamics, or are we seeing a bit of a step up? I mean just in the last few weeks, really. It sounds as if you do not think it is a big step up, but I would be interested to get your thoughts.

Jayne-Anne Gadhia: I will start, Hugh, and perhaps you could add to it. If we are particularly mentioning the Yorkshire pricing recently; what was it, 88bps?

Hugh Chater: 89.

Jayne-Anne Gadhia: 89bps. Do not forget, they are not offering that through intermediaries; they are offering that through their localised branches, through broadly the North of England. So, it is limited distribution. We were discussing it earlier. Even when HSBC introduced their 99bps mortgage 12–18 months ago, that had no impact on us either, because it tended to be such low LTV, which I think this one is as well, that very few people were actually able to benefit from it. So, Hugh, any more to add to that?

Hugh Chater: Jayne-Anne, I think that is exactly it, to be frank. I would just reiterate that we have seen quite a lot of tactical pricing through the quarter, but as you mentioned earlier, it has probably been our most stable quarter for a very long time in terms of our pricing. I do think that our mix is a critical issue here, as I have mentioned already.

Jayne-Anne Gadhia: Yes.

Guy Stebbings: Okay, thanks a lot.

Jayne-Anne Gadhia: Thanks, Guy.

John Cronin (Goodbody): Morning, thanks for the call. Just a couple of questions. One is a follow-on question on the mortgage pricing. I just noted your guidance at the year-end stage, that there would be a further downward re-pricing in that book of about 25bps over the course of 2017. Is any update on that guidance, or how you feel about that now? I suppose that is a reference to just tracking your press releases, and noting that you have not moved since 3rd January.

The second question is just to come back to one of the points on the credit card arrears. Noticing the improvement in cost of risk in Q1, would it be fair to contend that that's likely to improve further, given the proportion of balance transfer balances in the book over the coming quarters, before reaching an inflection point? Any comments you would have to say about that would be useful.

Finally, just on the credit cards again: in the presentation last year, you gave a very useful breakdown of the book at the end of 2015. I think at that stage, balance transfers constituted 63% of the book. Can you give an update on that figure?

Jayne-Anne Gadhia: Peter, do you want to start?

Peter Bole: If I touch on mortgage pricing. I think what you are referring to, John, when we spoke at the full-year results we spoke about how pricing had generally come off in the market at the back end of quarter four, in the last few weeks of quarter four, in terms of spreads. Our assessment of that was that it was really a rational market reaction to the lower cost of funding, partly driven by TFS and the knock-on impact that had on retail pricing. So, we certainly saw that at the back end of Q4. As you rightly point out, some of our pricing just around the turn of the year responded to that. However, I think the point that Hugh has made earlier is that throughout the quarter we have seen really remarkable stability. While we have had individual competitors coming in with the odd headline-grabbing rate in niches, we have not seen anything that would shift the rate from that price point that we went to towards the back end of Q4, early Q1. So, there has been a lot of stability there.

I will maybe just touch on credit card arrears. We have seen a slight improvement – it is slight – in the cost of risk in quarter one. As we go forward, for some of the reasons that Hugh has already highlighted, we will start seeing some of the cohorts of business put on the book in the last couple of years begin to roll off, and we will get more of a natural dynamic as the book is increasingly seasoned over the coming months and quarters and then years. We would just see that cost of risk stabilising and normalising. So, I would not be baking in improvements at this point.

Hugh Chater: Maybe just in terms of the final question, I think there are two different points to make here. One is that, as Jayne-Anne mentioned earlier, we have seen, deliberately, a quite material shift in terms of our acquisition, and the composition of that acquisition between cards which have a balance-transfer-led offer and cards which have a retail-led offer. So, through the whole of the quarter, we saw much more in terms of retail-led cards coming through. As we mentioned earlier, 40% of everything we acquired was on a retail-led card. That will definitely start to feed its way through into the portfolio. It is probably too soon just yet for it to change the dynamic that you referenced earlier, but over time, we are deliberately engineering more of a balance between cash-led or BT-led offers and retail-led offers.

John Cronin: Thank you.

David Wong (Credit Suisse): Good morning, all, just two questions from me. The first one: I just wanted to check if you could give any more comments on how your owner-occupier business, the buy-to-let business performed during the quarter? I am particularly interested in the buy-to-let lending target, how it has been performing in the face of the tax-deductibility regulation that took effect in April. That is the first question.

The second question is on net interest margin: could I just check that the stability that you referenced in the quarter was essentially the effect of the term funding reduction rolling off, which has allowed the market to acquire stability? I just wanted to check that.

If I could ask the question on full-year 2017 maybe in another way, I think at the full-year 2016 results you were comfortable with the consensus of 157bps at the time. Are you comfortable with that number, or you think that could tighten up further? Thank you.

Jayne-Anne Gadhia: I will say that what we are doing today is confirming our guidance on everything, and on net interest margin. We did say 157bps, I think we are sticking to that. Although at the time, I think I did say that we were hopeful that that would come in ahead, and our current performance implies that that is the case. That is, to be clear, not new guidance. It is just a bit of added confidence, if you see what I mean.

Peter Bole: I think there were points at year-end where we referenced up to 160bps.

Jayne-Anne Gadhia: We did.

Peter Bole: So, that 157–160bps range remains valid.

Jayne-Anne Gadhia: Yes, absolutely. Hugh, could you do the owner-occupied versus buy-to-let, please?

Hugh Chater: Yes, thank you, Jayne-Anne. So, as we have talked about, buy-to-let continues to be a strong area of new business for us, and also increasingly re-mortgage. So, there is about £20bn of buy-to-let that is due to re-mortgage in the market as a whole this year, and we are confident that we will get our par share of that. Nothing we have seen in the quarter suggests that any of the regulatory changes that came in at the end of last year impact either our new business or indeed our re-mortgage business on buy-to-let. We have not changed our risk appetite at all around that. So, we continue to see that as a material contributor, both to volume but also to our spreads.

David Wong: Many thanks.

Hugh Chater: Thank you.

Fahed Kunwar (Redburn): Hi, morning, a couple of questions. The first was on the cost of funds, this 103bps. That is still very high, even relative to not the bigger bank peers, some of the smaller bank peers. I am guessing the way that structurally comes down is via current account growth. So, could you give us an update on the size of the current account book, and how that growth came through in the first quarter 2017? I have got a couple of others. Shall I just go through them all?

Jayne-Anne Gadhia: Yes please, yes.

Fahed Kunwar: The second was on credit card accounting. The EIR is fair enough, but on the impairments, you are still seeing obviously, as a couple of questions earlier mentioned, that that impairment charge is going to be low and you talk about that book seasoning. How does IFRS 9 impact that? I guess that forces the impairments to move to a more expected loss basis, more in line with the revenue. So, when IFRS 9 comes in, should we expect quite a big tick-up in that impairment charge because of the proportion of interest-free balance transfer cards that you have?

The last question was on the mortgage market being stable in the first quarter; if I look at TFS coming through, the deposit rate cuts coming through and also the mix moving, as credit cards are still growing more than mortgages, that implies you are still expecting 5–10bps of mortgage margin compression over the next year. So, if mortgage rates stay stable, as they have in the first quarter, then there is optimism in terms of your margin outlook. Is that a fair conclusion? Thanks.

Jayne-Anne Gadhia: Let me answer the last one, and say yes.

Fahed Kunwar: Okay, cool, thank you.

Jayne-Anne Gadhia: To be honest, part of the reason that we are where we are in the recent answer to the question, the 157–160bps, is all to do with the uncertainty around mortgage asset spreads. As Hugh said, in Q1 we have been surprised on the upside, managed our way there very successfully. If we can continue to do that throughout the rest of the year, then you are right, there is some upside there. However, we are definitely not calling it out at the moment, because we manage that hard every day. You should not think that that is in any way a slam-dunk. Fingers-crossed, is the best way of putting that.

You are also correct about cost of funds and current accounts. Whilst you might be absolutely correct that a cost of funds of 103bps might look high, obviously it is entirely within our plans, and we are delighted to have brought it down to that level. As we grow current accounts, obviously that cost of funds will come down.

Now, our Essential Current Account is growing ahead of our plans, but compared to market volumes, it is still very low. I think we wrote 12,000 current accounts last year, we will do a little bit more than that this year. For us that is excellent, because we limit volume given the current product, because we sell everything at once through our 75 branches. So, to do that sort of volume through the branch network that we have, we are delighted by. What it does do of course is it proves incontrovertibly our capability to operate a very effective current account. It has been voted the best basic bank account in the country. So, it is a good solid product that we are operating extremely well from a customer satisfaction point of view and a cost of funds point of view.

The real opportunity for us, as I alluded to earlier, is to roll out that or preferably better through our digital bank. That will come next year. We are really excited, very positive about that, because that will be transformational for our ability to grow the business, manage net interest margin and further deliver improved financial results, I think. I should ask you, Peter, to speak about IFRS 9, please, as I know it is your favourite subject.

Peter Bole: Yes, it is certainly getting plenty of attention. If I step back, every credit book has an element of seasoning in it, so I would not necessarily draw out balance transfer as being particularly different from the retail product, or indeed, to an extent, mortgage products as well. They all have a degree of seasoning in them. So, as you rightly point out, the thing through IFRS 9 is that there is an acceleration of the recognition of credit losses. Clearly, it does not change the ultimate loss in any way, shape or form; it just brings that recognition forward. So, we have not come out and quantified that and given numbers on that at this point. The thing we have said – we said it at year-end, and just reiterate it – it is reflected in our assessment of capital and our guidance on minimum capital ratios that we have given to the market previously. That will be our day-one adjustment. It is in the tens of millions category, is our assessment at this point, rather than beyond that.

Then, in terms of how that influences profitability going forward: the extent to which you have got a flat book, actually it does not really alter your cost of risk charge. Where you are growing books, as we are, it will create a slight increase in the cost of risk as you are growing, just simply because you are recognising those losses faster, albeit it does not fundamentally change the cash flows and the economics of the product.

Fahed Kunwar: Okay, thank you. Just one quick follow-up to Jayne-Anne: in your mind, how big can the current account base be relative to the deposit base? I appreciate it might take some time. If you look at the big banks, it sits between 15–20%. As a percentage of your total deposit base, on a five-year view, where do you think current accounts can be?

Jayne-Anne Gadhia: I cannot answer the question in exactly the way you have asked it, Fahed. The way in which I look at it is, when you look at some of the challenger banks of our sort of scale, whether that is TSB, the Co-op or what would have been Williams & Glyn, they are all at somewhere between £5–6bn. We think that would be about the right sort of scale for us over time. Now, will we get there in five years? That might be pretty optimistic, but nevertheless, that would be the sort of target that we would be looking for.

Fahed Kunwar: Thank you very much, cheers.

Jayne-Anne Gadhia: Thank you.

Nick Baker (Goldman Sachs): Good morning, everyone. Thanks for the call. I think most of mine have been answered. I just wanted to ask quickly around SME. You mentioned it in response to the question around inorganic growth. It has been roughly ten months since your plans for an SME market entry were put on ice. I was just wondering if you had had any thoughts about when you might take those off ice, as it were? Thank you.

Jayne-Anne Gadhia: Thank you very much, Nick. So, the thing that has been interesting is in terms of prioritisation, having pulled back from the SME world, we have very squarely prioritised and launched ourselves into building digital capability. Now, of course, the benefit of that is that not only will we be building retail digital capability, but in the end, we hope to take that into SME land. So, you should expect us to get our digital bank up and running first, before we make any sort of comment on where we go with SME, unless the Williams & Glyn opportunity means that we cannot avoid making that a priority, because the value is significant for us.

So, there is nothing that means we think the franchise works any less well, as it were. There is still a very positive opportunity for the Virgin brand in the SME market. The question is simply: given all the work we are doing at the moment, particularly the digital development, when is the right time to do that? It seems better to develop digital capability and build off that, than to do it in parallel and build something old. We will look at Williams & Glyn and see whether that gives us another opportunity going forwards.

Laura, I think we are now through our hour of call. So, I know everybody will be wanting to get back to their desks. So, this is probably a time to say thank you to everyone. Thanks for your support and interest in what we have done in the quarter, and thank you for all of your questions.

[END OF TRANSCRIPT]