VIRGIN MONEY UK

01 February 2022

Virgin Money UK PLC: First Quarter 2022 Trading Update

Virgin Money UK PLC ("VMUK" or the "Group") confirms that trading in the three months to 31 December 2021 was in line with the Board's expectations.

David Duffy, Chief Executive Officer:

"Virgin Money's performance in the first quarter has been strong. Our balance sheet is performing well, asset quality remains robust and we have increased guidance on net interest margin for 2022. We are optimistic about the pace of recovery of the UK economy based on growing consumer and business confidence, underpinned by lower unemployment."

"We've continued our strong delivery of new digital propositions, including the launch of our fee-free digital business current account and innovative new unsecured lending products, with more to come later this year. We've also launched our new working model, 'A Life More Virgin', offering full remote-working flexibility, which is leading the industry in providing a digital-led and future-proof work environment that delivers for our customers."

Q1 Summary – Delivering the digital strategy with improving financial performance

Continued deposit mix optimisation and broadly stable lending balances

- The Group continues to successfully improve its deposit mix and funding costs as relationship deposits grew 1.2% to £31.0bn, whilst overall deposits reduced (2.0)% to £65.5bn
- Unsecured lending grew 3.0% to £5.6bn driven by growth in credit cards from increased activity and compelling new digital propositions
- Mortgages decreased (0.5)% to £57.8bn as the Group broadly maintained market share while continuing to prioritise margin in a competitive environment
- Business lending reduced (2.2)% to £8.3bn as anticipated, driven by BAU activity remaining subdued given weaker market demand, seasonality and lower Government-backed lending

Further Net Interest Margin (NIM) improvement; FY22 outlook increased

- NIM improved in Q1 to 177bps (Q421: 170bps) benefitting from higher hedge contributions, lower cost of funds and a higher yielding lending mix
- Now expect NIM to be c.175bps for FY22, with growth in higher-yielding lending offset by mortgage competition and normalisation of the savings market over the remainder of the year

Delivering our digital strategy; strong pipeline of proposition launches

- Costs in line with expectations; expect underlying costs to be broadly stable in FY22
- Flexible, instalment lending launched in app, and will soon be available to all credit card customers; the Group's new fee-based propositions will launch later this year
- Improved Brighter Money Bundles PCA proposition, now including PCA debit card cashback
- Fee-free digital M Account for Business launched with digital on-boarding and cashback; innovative M Track for Business also launched in Q1, Marketplace launching later this year
- Reduction to store network announced in September in progress, with 28 closures now completed since Q421, reducing the store footprint from 162 to 134 as at end-January
- Digitising key customer journeys including deployment of self-service chatbot and automated ID and verification for account opening; cloud migration programme initiated
- Introduced A Life More Virgin flexible working model including access to modern digital tools

Stable credit provisions; robust asset quality

- Robust credit quality maintained across key portfolios, balance sheet credit provisions of £501m (Q421: £504m); stable coverage of 70bps (Q421: 70bps)
- Low impairment charge of £16m in Q1, equivalent to 9bps cost of risk; maintained economic scenarios from Q421 given no significant change to the economic outlook

Strong CET1 ratio improved further driven by strong profitability

- CET1 ratio increased c.30bps to 15.2% (including c.40bps of software benefit); benefitting from strong profitability and lower RWAs; fully loaded CET1 ratio now 14.8%
- Performed resiliently in inaugural Solvency Stress Test (SST); expect to provide a further update on capital framework and distribution policy alongside H1 in May, as previously guided

Pioneering Growth

(£mn)	30 Sep-21	31 Dec-21	Q1 growth	YTD annualised
Mortgages	*58,104*	*57,785*	*(0.5)%*	*(2.2)%*
Business	*8,477*	*8,287*	*(2.2)%*	*(9.0)%*
o/w Govt lending	*1,318*	*1,255*	*(4.8)%*	*(19.1)%*
o/w BAU Business lending	*7,159*	*7,032*	*(1.8)%*	*(7.1)%*
Unsecured	*5,415*	*5,580*	*3.0%*	*12.2%*
Customer lending	71,996	71,652	*(0.5)%*	*(1.9)%*
Customer deposits	66,870	65,503	*(2.0)%*	*(8.2)%*
o/w relationship deposits	*30,596*	*30,956*	*1.2%*	*4.7%*

The Group further reduced the cost of deposits in Q1 with an improvement in mix, as relationship deposit balances grew 1.2%. Overall deposits reduced (2.0)% with more expensive term deposit balances declining (12)% in the period.

Unsecured balances increased 3.0% in Q1 driven by a pick-up in demand and compelling new digital propositions. Aggregate credit card spending has recovered to pre-COVID levels and the number of new accounts opened exceeded 132k in the quarter, the highest level since the start of the pandemic. Overall, this led to 4.7% growth in the cards book. The Salary Finance portfolio performed well during the period, whilst Personal Loans and Overdraft balances reduced as expected. The Group continues to expect good momentum in Unsecured balance growth through the remainder of FY22, supported by new digital propositions and an ongoing recovery in the economic backdrop.

Mortgage balances reduced in Q1 by (0.5)% reflecting lower market demand post-SDLT changes and a continuing competitive environment. New business spreads remained below back book levels throughout the period and we remained selective, balancing volumes and pricing carefully to maintain profitability. The Group continues to invest in technology to expand its digital straight-through processing capability to support its goal to maintain market share in the medium term.

Business lending declined (2.2)% in Q1 as anticipated with a reduction in BAU and Government-scheme volumes. The BAU book declined (1.8)% given a seasonal contraction in working capital demand from farming customers, and generally subdued market activity which is expected to improve later in the year in line with the broader economic recovery and improved business confidence. Government backed balances declined (4.8)% to £1.3bn as expected, as borrowers continue to repay balances following the expiry of the 1-year interest free period.

NIM improved 7bps in Q1 to 177bps reflecting the benefit of higher structural hedging contributions from the expanded hedge, a further reduction in the overall cost of funds and growth in higher yielding unsecured lending, partly offset by ongoing strong competition in mortgages. The Group now expects NIM to be c.175bps for FY22, including the benefit of the latest bank base rate rise, as the trends seen in Q1 continue and as the savings market normalises over the remainder of the year.

Non-interest income performance, excluding fair value movements, improved in the period, supported by a recovery in card spending and business activity levels. The Group continues to expect non-interest income to recover, and to rise as a proportion of total income over time.

The UK economic outlook remains positive, including expectations for a continued recovery in GDP growth and lower unemployment, despite the recent spike in COVID case numbers driven by the Omicron variant. Following the MPC's decision to increase rates in December, the Group also notes market expectations that further rate rises could follow in 2022 given higher inflation. Overall, despite the uncertainty posed by new variants and concerns over inflation, the strengthening backdrop and easing of government restrictions give some scope for greater optimism about the pace of the recovery.

Delighted Customers and Colleagues

The Group remains focused on delivering new propositions to target digital-driven growth in key segments.

Credit card cashback signs-ups continued at pace, as total registrations reached c.295k during Q1 (Q421: c.230k). Towards the end of the quarter, we launched instalment payments on credit cards, allowing customers to pay off card purchases over a fixed term. We have had a positive initial response from customers using the Cards mobile app to take advantage of this new option, and the Group is focused on extending the availability of instalment plans in the coming months. We will also develop the unsecured product-set further during Q2 with the launch of subscription-based finance, which will expand our offering to a younger, underserved demographic who favour this style of product.

Our Brighter Money Bundles (BMB) campaign continued to attract new PCA customers, despite a more competitive market backdrop. There have now been over 140k new accounts opened since the start of the initial BMB campaign in Q121. Our most recent BMB campaign features £100 of Virgin experience days vouchers and up to 5% credit interest on balances up to £1,000. All PCA customers will also be able to earn compelling cashback rewards at participating merchants on their debit card spend, as we continue to offer a differentiated proposition to support new sales and switching in the coming months.

We extended our BCA proposition during Q1 with the launch of our digital fee-free M-Account, including digital on-boarding and debit card cashback. We also launched the M Track proposition which provides businesses with a mix of market-leading tools and data-driven insight to help manage their financial health. Over the coming months, further developments will include expansion of digital on-boarding journeys, the ongoing development of the M Track proposition, and the addition of the Marketplace, enabling us to provide further solutions for customers' needs as they develop their businesses.

Towards the end of the quarter, the Group signed an agreement with Virgin Red, as our market defining loyalty proposition gathers momentum. Over the coming months, the Group will continue exploring the potential to reward new and existing customers with Virgin Red points across different products, giving customers over 200 ways to earn and spend Virgin Red points across Virgin Group companies and other retailers.

VMUK is transforming its colleague operating model, building on the capabilities introduced over the last year, to fully embed the new A Life More Virgin (ALMV) flexible working model and digital-first colleague experience. In order to drive productivity, we continue to implement a new agile IT infrastructure and have begun accessing the full power of Microsoft's cloud computing product-suite, enhancing the way we work and supporting collaboration. Early colleague and industry feedback on the A Life More Virgin working model has been very positive.

Over the course of Q1 the Group has continued to make progress on its ESG agenda, including the ongoing rollout of our Sustainable Business coach as we build momentum in Sustainability linked Loans to support businesses that are leading environmental and social change. After signing up to the Net Zero Banking Alliance, the Group is focussed on developing its targets and roadmaps to deliver net zero as well as further green propositions across Mortgages and Business to support customers in reducing their carbon footprint. We also remain focused on tackling the Poverty Premium; the Group has introduced a benefits calculator to help individuals identify where they could be eligible for further support.

Super Straightforward Efficiency

As outlined at the full year trading update in November, the Group is accelerating its digital growth strategy in order to deliver an enhanced digital customer experience while driving improved efficiency and cost reduction over time.

In line with the Group's digital strategy and property changes announced in September 2021, the Group has completed the closure of a further 28 stores since FY21, taking the total number of stores to 134 as at the end of January 2022 while also reducing its back office footprint as planned. During Q1, the Group also reduced FTE numbers further as it transitions towards its target digital-first operating model. This was supported by ongoing progress in the end-to-end digitisation of customer journeys, including the delivery of a suite of self-service chatbots, in-app account opening journeys and automated identification and verification across Personal and Business products. We are also making good progress in mobilising the delivery of IT architecture in the cloud as we look to drive productivity improvements.

The Group continues to expect to incur £275m of restructuring charges across FY22 - FY24, with around half in FY22. Underlying operating expenses are expected to be broadly stable in FY22, in line with the outlook at FY21 results. This reflects higher costs from inflation, including agreed pay rises for staff and the costs of harmonised working terms as part of ALMV, targeted growth and digital development. This is expected to be broadly offset by gross savings from ongoing digital transformation and restructuring.

Discipline & Sustainability

Credit quality remained strong with no material deterioration in arrears performance and no significant specific provisions. Given the absence of a significant change to the economic outlook, in Q1, the Group applied the same economic scenarios to drive the ECL provision as those set out in the 2021 Full Year Results, resulting in stable credit provisions of £501m (Q421: £504m). Modelled and individually assessed ECL increased to £306m in the period (Q421: £297m), driven mainly by growth in unsecured lending. The Group decided to modestly reduce its Post Model Adjustments (PMAs), taking the overall PMAs held to £195m (Q421: £207m), with the reduction in the quarter associated with PMAs linked to payment holidays. Overall coverage remains robust at 70bps (Q421: 70bps)[1].

The Q1 impairment charge of £16m equates to a net Q1 cost of risk of 9bps. The Group continues to expect the cost of risk to rise towards the through the cycle range through FY22 and will fully refresh the economic scenarios used in IFRS9 modelling alongside the interim results in May.

The Group remains strongly capitalised and CET1 improved c.30bps to 15.2% on an IFRS9 transitional basis in the quarter, including c.40bps of benefit from the treatment of software intangible assets. Fully loaded CET1 also remained robust in the period, improving to 14.8% (Q421: 14.4%). The Group therefore retained a significant CET1 buffer of c.£1.5bn (6.5%) in excess of its CRD IV regulatory requirement of 8.7% as at 31st December 2021. The Group's total capital ratio improved to 22.3% (Q421: 22.0%) and UK Leverage Ratio was 5.3% (Q421: 5.2%).

Underlying capital generation was driven by ongoing profitability and lower RWAs, which reduced by £0.1bn to £24.1bn. The removal of the c.40bps CET1 benefit from software intangible treatment will take place in Q2 with hybrid mortgage model implementation currently anticipated in FY23.

The Group is engaging with the PRA on capital requirements and continues to expect to update its capital framework and distribution policy alongside Interim Results in May. VMUK performed resiliently in the 2021 Solvency Stress Test (SST) published in December, remaining above its reference rates on both a transitional and non-transitional basis. The Group is capital generative and is focused on growth of the balance sheet in key segments, maintaining capital strength and delivering sustainable shareholder distributions over the medium term, either in the form of dividends or buybacks, subject to regulatory considerations. As previously indicated, the Group would currently only consider bolt-on acquisitions that complement its existing organic strategy.

Funding and liquidity remain strong, with the LCR ratio increasing to 152% as a further reduction in more expensive term deposits and the repayment of the last of the Group's TFS borrowings were offset by final TFSME drawings ahead of the scheme closure in October 2021. This delivered a reduced overall cost of funds, supporting NIM, while striking a prudent balance between supporting additional lending to the real economy and not increasing refinancing risk. LDR in the period was broadly stable at 109%. There are no changes to any of the issuance plans communicated in the Group's FY21 results with capital issuance expected to be broadly limited to refinancing and £2-3bn of secured issuance (subject to deposit flows and relative cost) during 2022.

During Q1, the Bank of England confirmed that it expects the Group to meet an end-state MREL requirement (plus buffers) equivalent to 24.7% of RWAs in 2022 (based on end December P2A Total Capital requirement of 3.1%). The Group's IFRS 9 transitional MREL ratio of 32.2% (FY21: 31.9%) represents a prudent buffer of 7.5% or c.£1.8bn over this end-state requirement.

[1] Government guaranteed lending balances excluded for purpose of coverage ratio calculation

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Announcement authorised for release by Lorna McMillan, Group Company Secretary.

Forward looking statements

Virgin Money UK PLC is registered in England and Wales (company number: 09595911) and as a foreign company in Australia (ARBN 609 948 281) and has its registered office at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL