VIRGIN MONEY UK

06 February 2024

Virgin Money UK PLC: First Quarter 2024 Trading Update

David Duffy, Chief Executive Officer:

“We have made a positive start to the year, with strong Q1 results in line with our guidance. We’ve delivered growth in new accounts, deposits and target lending segments, at stable margins and with ongoing cost efficiencies. We are encouraged by both our customers' resilience and improving sentiment in the mortgage market as interest rates have peaked. We carry good momentum into 2024 as we continue to successfully execute our strategy."

Summary financials	Q1 2024	FY 2023	Change	Q1 2023	Change
Key growth metrics (£’m)					
Mortgages	57,112	57,497	(0.7)%	58,402	(2.2)%
Business	9,017	8,738	3.2%	8,449	6.7%
Unsecured	6,703	6,519	2.8%	6,219	7.8%
Customer lending	**72,832**	**72,754**	**0.1%**	**73,071**	**(0.3)%**
Customer deposits	**67,308**	**66,609**	**1.0%**	**66,153**	**1.7%**
Key performance metrics					
Net interest margin (NIM)	1.89%	1.91%	(0.02)%	1.89%	-
Cost:income ratio excluding notable items (CIR)	52%	52%	-	53%	1%
Cost of risk (CoR)	35bps	42bps	7bps	36bps	1bp
Transitional Common Equity Tier 1 (CET1) ratio	14.0%	14.7%	(0.7)%	15.0%	(1.0)%

Q1 Summary: Good business momentum, in-line with FY24 guidance

Targeted growth in customer lending; deposit mix remains stable

- Mortgages 0.7% lower in Q1 at £57.1bn, reflecting disciplined approach to trading in subdued market; early signs that market activity has improved in January, increasing back to 2019 levels
- Business lending growth of 3.2%, driven by strong demand at good margins in our sector specialisms
- Unsecured lending increased 2.8% in Q1 to £6.7bn, driven by 4.1% growth in credit card lending, with growth in retail spend year-on-year and stable repayment rates
- Deposits 1.0% higher in Q1 at £67.3bn, with overall deposit mix stable relative to Q4 23
- Further growth in total active relationship customer accounts (+27k net during Q1) to 3.8m
- Successfully migrated all existing Virgin Money Investments (VMI) customers onto new digital platform; launched new pension proposition with good initial customer reaction

Stable Net Interest Margin (NIM); FY24 NIM guidance of 190-195bps unchanged

- NIM stable in Q1 at 189bps (Q4 23: 189bps), with benefits from structural hedge reinvestment rate and ongoing cards EIR outperformance offset by mortgage spread pressure and deposit competition
- Expect NIM to be resilient over remainder of year, including reduced rate expectations

Cost:income ratio (CIR) stable as execution of our savings programme absorbed ongoing inflation

- Q1 CIR of 52% (excluding notable items); continue to expect broadly stable CIR in FY24
- Closed 39 stores and reduced office property footprint by c.35% in Q1, supporting gross savings
- Good progress towards making increasing use of cost-effective geographies for outsourced activities
- Further drive towards digital customer engagement, including withdrawal of passbooks from savings

Credit quality remains solid; provision coverage modestly higher

- Overall arrears trends remain broadly consistent with FY23; credit card arrears continue to gradually increase in line with expectations, reflecting ongoing maturation and diversification
- Provisions up to £639m (Q4 23: £617m) given change in loan mix; coverage 3bps higher to 87bps
- £64m impairment charge in Q1, equivalent to 35bps CoR; continue to expect 30-35bps for FY24

Strong capital position supports ongoing shareholder distributions and growth opportunities

- £150m share buyback announced in November 2023 was 34% complete at end of January
- CET1 ratio lower at 14.0%, reflecting ongoing profitability offset by full c.60bps impact of £150m buyback and £0.3bn higher RWAs; fully loaded CET1 ratio now 13.8%
- Continue to expect 13-13.5% CET1 in FY24, with FY24 distributions around the FY23 nominal level, including further buybacks to be announced during H2, subject to Board and regulatory approval
- Issued new £350m AT1 and £500m RMBS; reduced TFSME by £1.2bn in Q1

Overview

The Group delivered good business momentum in Q1, supported by accelerated strategic execution, including growth in target lending segments, stable margins despite rates peaking and robust credit quality. Ongoing delivery against our restructuring programme is supporting our stable cost performance, despite inflation, and we are proceeding with our new FCPP[1], as announced at FY23 results. The £150m share buyback programme announced in November is progressing well and we anticipate announcing further distributions this year, given our resilient capital position, as we normalise our CET1 to 13-13.5% by FY24.

The Group remains confident in its medium-term outlook and is focused on delivering double-digit statutory returns to drive value for shareholders. This will be supported through the execution of our strategy and leveraging the power of the brand, including growth in return accretive segments, greater cost-efficiency through digitisation, ongoing balance sheet resilience and sustainable capital distributions to shareholders. We look forward to communicating the next phase of our strategy at a Capital Markets Day later this year.

Pioneering Growth

Mortgage balances reduced by 0.7% in Q1 to £57.1bn, as we maintained discipline in a subdued market, with our c.3.5% market share unchanged. Application spreads improved during Q1, despite customer pricing trending lower, but remained below the spread of maturing balances. The Group is trading nimbly to optimise performance, including the launch of our innovative new 'Fix and Switch' range, along with our new premium broker service, delivering an enhanced experience and a larger pipeline of recommended cases. There are early signs in January that market activity has improved, including market applications volumes more in line with 2019 levels within both residential lending and more recently buy-to-let. Looking ahead, the Group expects customer sentiment in mortgages to continue to improve, given the emergence of more positive trends at lower customer rates.

Business lending increased by 3.2% in Q1 to £9.0bn, as the Group maintained good momentum in BAU balances, which increased 4.2% to £8.5bn, more than offsetting a 10.5% reduction in Government-scheme balances to £0.6bn. This performance was supported by strong demand at good margins in our resilient national sector specialisms and market segments, and our relationship manager-led approach. We maintain a robust lending pipeline and expect to continue to grow balances and market share during FY24.

Unsecured lending increased 2.8% in Q1, driven mainly by measured credit card growth, reflecting strong demand from existing customers, and further new account acquisition in a resilient market. New credit card accounts opened in Q1 totalled 122k, lower than 147k in Q4 23, reflecting a disciplined approach to credit and profitability. Our customers are demonstrating resilience, with higher year-on-year spend and stable repayment rates and we have continued to observe customer behavioural activity outperforming our prudent assumptions across spend, repayment and retention, resulting in card EIR performance remaining persistently better than expected. Personal Loans and Overdrafts reduced in line with expectations, ahead of the Group's re-entry into the market for new Personal Loans in H2 with a fully digitised end-to-end proposition. The Group continues to expect moderate growth in Unsecured balances during the rest of the financial year, in line with its strategy.

The Group traded well during Q1 to maintain its customer deposit mix and manage ongoing deposit migration. Overall deposits increased 1.0% to £67.3bn, including 1.7% growth in relationship deposits, which remained stable as a percentage of total deposits at 53%. In the secondary savings market, the Group prioritised variable savings for new funding during Q1, given the beneficial pricing available relative to term deposits. Non-linked savings therefore increased by 0.7% to £9.8bn as growth from new variable savings offset ongoing attrition from the back book. Term deposits remained stable during Q1 at £21.5bn. Our deposit book remains defensively positioned, reflecting our existing, higher proportion of term deposits and the attractive rates we offer to our customers, which as at FY23, remained above larger UK peers.

NIM of 189bps in Q1 was stable relative to Q4 23 (189bps), as benefits from the reinvestment rate of the structural hedge and ongoing credit card EIR outperformance offset spread pressure in mortgages and further deposit competition and migration. The path for base rate expectations and swaps has reduced further since our FY23 results, reflecting a headwind to NIM from lower hedge reinvestment and potential delays in deposit pass-through. Subject to macroeconomic uncertainties, we expect NIM to be resilient over the remainder of the year, with FY24 NIM guidance of 190-195bps unchanged, as benefits from reinvestment of the structural hedge, albeit with a lower rate outlook, and growth in higher-yielding lending segments mitigate headwinds from mortgage spreads and ongoing deposit migration and competition.

Non-interest income (excluding notable items and one-off gains) was stable during Q1 vs. Q4 23, supported by resilient credit card spending and robust business activity levels. There were c.£(12)m of notable charges within non-interest income due to hedge ineffectiveness and rate volatility in the period.

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[1] Financial crime prevention programme

Delighted Customers and Colleagues

The Group continued to attract new customers in Q1, with 27k growth in net active relationship customer accounts to 3.8m. We remain committed to consistently improving the customer experience over time. In Q1, the Group delivered an improvement in call waiting times and launched new products and services, while remaining on track to implement the second phase of the Consumer Duty regime in July 2024.

The Group has made significant improvements to its investment proposition, Virgin Money Investments (VMI). During Q1, VMI launched its new pension product, giving customers a straightforward way to save for later life, with positive early customer engagement. In January, we also successfully migrated over 150k existing VMI customers onto a new digital platform with FNZ, allowing all VMI customers to service their pension and investment accounts digitally and manage their products more effectively.

Our insurance proposition is performing well, with c.50k new digital travel insurance sales in Q1, supported by a cashback promotion to existing current account and credit card holders. We are on track to launch our new digital home insurance product this year, as we grow our fee earning capabilities over time.

In our credit cards business, we successfully upgraded our new conversational banking virtual assistant, Redi during Q1. Redi is now connected to the credit card core systems, enabling complete servicing activity and real-time changes to a customer's account. The service continues to attract favourable Smile scores and is driving lower call volumes. We are delighted to have won 'Best Application of AI or ML in Financial Services' with IBM, at the 2024 Cards and Payments Awards for the introduction of Redi. We will be adding additional functionality to PCAs shortly as we introduce a more personal approach to digital banking.

We are making good progress on our integrated app for key Virgin Money products, incorporating features from our digital wallet, including rewards and insights, alongside new components including open banking aggregation, instant card issuance and conversational banking. We are well placed to launch the first iteration of this integrated app during the year.

Despite a competitive market for PCAs, we opened c.27k new PCAs in Q1. This performance was supported by our linked saver product and access to exclusive ISA products, with our ISA proposition recently winning three categories at the '2024 Savings Champion' Awards. Our BCA proposition also continues to perform well, despite a challenging market, as we grew our stock of BCAs to over 250k in Q1.

Recognising the challenging environment and our Purpose of 'Making You Happier About Money', we rewarded 97% of colleagues with a salary increase in January, while also increasing our starting salary. We are on track to fully open our new Glasgow head office in February, which will offer a modern, employee-led, state of the art facility as part of our A Life More Virgin colleague proposition. We were also pleased to announce the appointment of Lucinda Charles-Jones as a non-executive Director in January.

Super Straightforward Efficiency

The Group remains highly focussed on managing its cost base and driving improved efficiency. During the quarter, operating expenses (excluding notable items) remained stable year-on-year, in line with expectations, as savings from our cost savings programme absorbed ongoing inflation. The Group continues to expect to deliver a broadly stable cost:income ratio (excluding notable items) in FY24.

The Group is on track to deliver c.£200m of annualised savings from its existing restructuring programme after accelerating restructuring and digitisation activity. The Group finalised the closure of 39 stores in Q1, thereby reducing its store network by 30% to 91 stores, while also reducing its office property footprint by a further c.35%, with further opportunities for office property rationalisation identified following the success of the Glasgow head office consolidation. As a result of our restructuring programme, we reduced the number of FTEs in Q1 on a gross basis by c.150, with total FTEs now at a similar level as they were at CYBG around the time of its initial public offering, and expect further reductions in FTEs during the year. We are also looking to make increasing use of other more cost-effective geographies for outsourced activities. We continue to drive digital customer engagement, including the withdrawal of passbook savings accounts for customers and have made further progress in modernising our technology infrastructure, with the ongoing adoption of Microsoft Azure, scaling the use of cloud services across the Bank.

The Group continues to expect the majority of the remaining c.£60m of restructuring costs of the c.£275m total to be incurred during FY24, reflecting the costs of delivering IT improvement, severance and further changes to the property footprint. We are also making good early progress delivering against the new c.£130m financial crime prevention programme, as we improve our financial crime prevention capabilities and protect our customers. We have signed a contract with our new fraud detection partner as we upgrade to a market leading fraud system and have signed an agreement with a leading behavioural detection solutions partner, which will allow the Bank to add additional capabilities into its strategic solutions for disrupting fraud and money mule activity. We continue to expect to incur c.£40m of investment in FY24.

Discipline and Sustainability

The UK economic outlook is improving with inflation, while still elevated, starting to normalise, leading to increased market expectations for rate cuts in 2024. Unemployment expectations remain low, though the BoE expects GDP growth to remain challenged in the coming quarters. We are well positioned against this backdrop with strong capital, robust provision coverage and consistent underwriting criteria.

Credit quality remained solid during the quarter with the portfolio continuing to perform well. Overall arrears trends were consistent with FY23. We have continued to see a gradual increase in credit card arrears, as expected, mainly reflecting the ongoing portfolio maturation and diversification of our cards book.

The Group has now moved to a quarterly cycle of updating the economic assumptions used within its IFRS 9 models, as provided by our third-party provider Oxford Economics. Relative to Q4 23, the weighted average macroeconomic scenario at Q1 includes GDP and unemployment assumptions that are largely unchanged, an improved, although still reducing outlook for HPI in the near and mid-term, and a modestly lower Bank of England base rate. During Q1, overall credit provisions increased to £639m (Q4 23: £617m), mainly reflecting growth in Unsecured and Business lending, contributing to modestly higher provision coverage of 87bps (Q4 23: 84bps). Within this, modelled and individually assessed ECL increased to £578m in Q1 (Q4 23: £540m), while management adjustments (MAs) reduced to £61m (Q4 23: £76m). These factors resulted in an impairment charge of £64m during Q1, equivalent to an annualised cost of risk of 35bps for the quarter. The Group continues to expect cost of risk to be in the range of 30-35bps for FY24, assuming no further material changes in the macroeconomic outlook and incorporating refinements to the application of SICR[2] on the Group's credit card portfolio, expected to be finalised later in the year.

The Group remains strongly capitalised with a CET1 ratio of 14.0%[3] on an IFRS9 transitional basis (Q4 23: 14.7%) or 13.8%[3] on a fully loaded basis (Q4 23: 14.3%), well above its MDA threshold of 10.9%. VMUK's total capital ratio was 20.4%[3] (Q4 23: 21.2%) and the UK Leverage Ratio was 5.1%[3] (Q4 23: 5.0%). We were pleased to commence our £150m share buyback programme in November, which was 34% complete at the end of January. The £150m buyback was fully recognised from a regulatory capital perspective in Q1 and consumed c.60bps of CET1. Alongside this, the Group generated capital through ongoing profitability, while RWAs increased to £25.5bn (Q4 23: £25.2bn), mainly reflecting loan growth and mix. The Group continues to expect to be operating in its target CET1 range of 13-13.5% in FY24, supported by nominal shareholder distributions in FY24 around the same level as FY23. The BoE has confirmed it will not conduct the Annual Cyclical Scenario stress test for 2024 and the Group currently expects further buybacks to be announced during H2, subject to Board and regulatory approval. We now expect some modest upside to our capital position from Basel 3.1 implementation on day 1 (1 July 2025), subject to regulatory approval. The Group has negligible exposure to the FCAs review of historical motor finance commission arrangements. The Group's closed Consumer Asset Finance proposition was direct to consumer only from 2012, with less than £2m of gross commissions paid on broker-originated agreements between 2007 and 2012. TNAV per share of 337p was 23p lower in Q1 as a reduction in the cash flow hedge reserve to £137m (Q4 23: £495m), primarily due to rate changes, offset the impact of ongoing profitability and a lower share count from buybacks executed in Q1.

Funding and liquidity remain strong, including 12-month average LCR of 150% and LDR broadly stable at 108%. The 12-month average NSFR remains strong at 135% while 72% of the deposit book is insured via the Financial Services Compensation Scheme. The strong funding position and deposit franchise enabled the Group to further reduce its TFSME outstanding by £1.2bn in Q1 to £5.1bn, resulting in the Group having now repaid all of its TFSME maturities due in 2024. In January, we publicly issued £500m of RMBS and the Group still expects £1.5bn - £2.0bn of secured issuance this year in total, subject to ongoing deposit flows and relative cost. The Group's IFRS9 transitional MREL ratio was 31.0%[3] of RWAs at Q1 (Q4 23: 31.9%), comfortably exceeding its loss-absorbing capacity requirement of 27.3% of RWAs. During Q1, the Group redeemed its £250m Tier 2 note as planned, pre-funded by the £300m senior MREL note issued in August 2023. The Group also issued a new £350m AT1 instrument and simultaneously tendered 42% of its £250m AT1 instrument, first callable in June 2024. Following these transactions, the Group is not currently expecting any further capital issuance during FY24, with any further MREL issuance in FY24 to be broadly limited to maintaining a prudent management buffer above regulatory requirements.

From a sustainability perspective during Q1, we have continued to focus on developing enhanced customer propositions to support a low-carbon transition while further refining our climate related credit appetite. Through our partnership with Good Things Foundation, all our stores are now Databanks offering free data to customers and we have launched the first phase of the Vulnerable Customer disclosure tool.

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[2] Significant increase in credit risk

[3] Includes unverified profits for Q1

The Company further announces that a copy of the Q1 Pillar 3 Disclosures 2024 will shortly be available to view on the Company's website at: https://www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/. A copy of the document has been submitted to the National Storage Mechanism and will shortly be available for inspection at: https://data.fca.org.uk/#/nsm/nationalstoragemechanism
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Announcement authorised for release by Lorna McMillan, Group Company Secretary.

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