Virgin Money

Half Year Results 2015

Tuesday, 28th July 2015

Jayne-Anne Gadhia, Chief Executive Officer

Good morning everyone. It's great to see so many people here. Thanks very much for coming to the beautiful Ham Yard Hotel. We have chosen to come here to have the presentation this morning because we're really hopeful that all of you will come down on the way out of here to our new Haymarket Lounge and have a look round. We think it's quite special and we'd love to show you round before it opens to the public.

I'm also particularly pleased that Glen Moreno is here, our new Chairman, as we report our first results since he became Chairman I think back in June, so welcome. It's going to take 40 minutes for me to go through our results this morning. I know you'll all have seen them already. Mike has just said to me he needs to leave promptly and he knows I can talk, so I promise you that we will actually get through it before or on 10.30.

As I say, we are inviting people to come and see the Haymarket Lounge. As we looked at setting up that site some time ago, Caroline who is our wonderful Culture Director and I were walking down the Haymarket and we knew that it had quite a dingy basement in this particular store, but we wanted to turn it into a lounge, and I said to her, "Caroline, do you think we could have an aeroplane in the lounge?", and of course because she is brilliant she said, "I should think we probably can", and then she found a brilliant team and you will see that we do indeed have an aeroplane in our bank.

In a sense that just demonstrates the difference that we're able to show at Virgin Money, and it's really that difference I think that's helped us to deliver some really strong financial results for the year, which resulted in a return on tangible equity of 10.2%. For many people of course that's ahead of our cost of capital, and we are delighted to have got to that place so soon after listing. That's up from 7.6% on a like-for-like basis in the first half of 2014, and we've done that through a really diligent focus on growth, quality and returns. When Lee and I have been out on the road I remember a couple of investors asking us do you really focus on mortgage volumes for example monthly, to which I said no, not monthly, daily. So anyway, to cut to the chase I just wanted to give you our high level results for the half-year and an update on our business performance, and then Lee's going to go through the more detailed financials.

You won't be surprised to know that we are particularly pleased with the progress that we've made on NIM. That's up 22 basis points to 165 basis points at the half-year. Obviously we've had to focus really hard on mortgage asset spreads in order to achieve that. I'll talk a little bit more about that in a moment. We have re-priced our retail deposit book and that's compensated for a squeeze in spreads, and of course we have had a mixed benefit as a result of being able to launch our cards business on our new platform.

Actually, looking ahead we're taking action to re-price the retail deposit book further, and that'll continue to offset asset pricing pressure in the second half, we think. But at that point, and following the next re-price that we're currently undertaking, you should be clear that we think that deposits then will be priced at roughly the market average, so maybe a little bit more room for manoeuvre but we're close to market average once we've undertaken our next re-price.

So overall we expect average NIM for this year in total to moderate from 165 basis points that we currently are, because of the fact that we will have taken deposit pricing down and because mortgage asset spreads will have been squeezed, and we now expect over the course of this year in total to beat our original guidance for NIM but probably by a couple of basis points of the guidance that we gave of around 160 basis points for the year.

But regardless of any pressure on NIM, one of the great things about the Virgin Money business model I think is that we do have flexibility to compensate in our financial management for pressures in different parts of the business. Firstly, I'm pleased to say that costs have been kept well under control, and I'm sure you will all be pleased to see, as we are, that there's been absolutely no cost growth at all between the second half of 2014 and the first half of 2015, despite the fact that we've grown volumes very quickly and very significantly during that period. That's enabled us to get to a cost income ratio of 62.2%, and that's well on our way to achieving a cost income ratio of about 50%, no more than 50% as we've planned and shared with the market, we expect to be there by 2017.

Let's get onto volumes then. I'm pleased to report that our gross mortgage lending increased by 44% to £3.6bn in the half-year. The numbers that I give you are based on May formal numbers, because the official numbers for June aren't or weren't out yet as of last night, but we think that May is a pretty strong guide to where we'll end up in June. Those May numbers show that at that point we'd taken a 3.8% share of the gross mortgage market as at the end of May. Asset quality remains really strong, and at 12 basis points cost of risk is well below our guidance. Remember that we said we thought that our cost of risk would be between 15-20 basis points, it's come out at 12 for the half-year. Even with the successful growth of the credit card book, which I'll talk a little bit more about in a moment.

All of that has meant that we've grown our underlying profit for the half-year by 37%, and our actual profit number is £81.8m for the half-year. Further good news during the half is that the PRA agreed some of the model changes that we'd shared with the market that Marian and her team have been working on, around the way in which we calculate our risk weighted assets. During the period we had that model change approved and we ended the half with a common equity tier 1 ratio of 18.7%, and then a 4.1% leverage ratio.

Really exciting for me is that as a result of the strong performance and our outlook for the year, last night after close of business the Virgin Money Board were delighted to declare an interim dividend of 1.4p a share, which will be paid in October. That's completely in line with the dividend policy that we set out in our prospectus. Perhaps I shouldn't say that I'm so especially delighted about it because we knew that that's what we would be delivering, but for us we believe that being able to declare this dividend now so soon into listed life is a real sign of the Board's confidence in our quality of earnings and our future outlook.

We can be confident in announcing that dividend mainly because of the flexibility that I talked about earlier. We've got real flexibility in our business to drive value through continuing to utilise the operating leverage that the acquisition of Northern Rock brought to us, and also building on a number of product initiatives that I'll talk about in a moment.

We think that the UK economy is also pretty good for developing and growing the Virgin Money business. It continues to recover. Economic growth, higher employment, and improved consumer confidence are all helping to underpin the housing market. When you look at the size of mortgages/the mortgage world during the year, the CML had actually estimated I think at the beginning of the year that the mortgage market would be around £220bn. We're seeing it likely to be down from there, at around £209bn. And actually, that's why we've exceeded our top end 3.5% market share target for the first half-year. We plan, as you may know, to manage our mortgage business on a number of applications per day basis, and we based that on the market of £220bn, and we're able to take the number of applications and process them through our ops centre even though the market were down a little. We do see that market growing, we'd expect to still continue to process roughly the same number of apps every day; and over the course of 2016 we see the market growing to about £230bn, which is the CML's current guidance.

The key issue for the mortgage market of course continues to be tighter asset spreads, and that's something that we do see as the biggest area that we've managed effectively during the first half and need to continue to focus on hard in the second. We're really pleased to say that despite competitive pressure in half one we achieved average spreads of 198 basis points, but we do see continuing pressure in half two.

As we look forward, our plans assume that there'll be no base rate for the rest of this year, and we are seeing or at least we're planning for a single rate rise in the middle of next year and no more in 2016. Given Mark Carney's recent comments and the comments of other people, we think that might be a prudent assumption, and we do think that if base rates rise then NIM will also be widened in the market by our competitors.

Turning to other products, we see further potential opportunities for us in the findings of the CMA and their investigation into current accounts, and as you know, those findings are due in the second half of the year. Our Essential Current Account sold really well during the first half of the year. You will remember that because of the 3 if in credit model we felt that we needed to constrain volume, and we've been able to do that, but hit the volumes that we've wanted and we've had really good quality customers buying our products at the volume that we've wanted, which has been excellent. So any opportunities that come out of the CMA review to level the playing field in current accounts will certainly fuel additional profitable growth.

Then of course there's the 8% surcharge on bank profit that was a surprise when it was announced in the Budget. Clearly a lot of people have commented on that in the press. We have spoken to HMT about it, but we actually think that it's a conversation that we should do privately and not a discussion to have in the media. Once the Finance Bill has become a Finance Act we'll all know exactly what we're dealing with. Until then of course we're assuming that the full 8% will be a surcharge on profits over £25m. If that is the case then we think that that will delay us in delivering our mid-teens returns, but probably by up to 12 months, no more than that.

Let me look now at our mortgage business in a little bit more detail. I said earlier 3.8% share of the gross mortgage market. Because of our good retention experience and the speed in which we're growing, as at the end of May that was a 20.5% share of the net mortgage market, and we feel very pleased with that position. That means that we've put on £3.6bn of new mortgages during the half-year, and grew balances by a net £1.7bn. We think that achieving that sort of growth at an average completion spread of 198 basis points is a really strong performance in such a competitive market at the moment, and really that success has been driven by our ever strengthening intermediary relationships, and that’s been recognised by a number of high profile awards that we’ve been pleased to receive from the sector.

We also managed to get the spreads to where they’ve got to obviously by focusing hard on business mix, and Anth and Peter who managed that are here today to answer any questions you have in a bit more detail. But we have managed mix, and just to be really clear, we’ve done that absolutely within our risk appetite, so we’ve not gone up the risk curve in order to manage margins in the way that we have. Just a very simple way of looking at that at the moment in terms of LTVs, our portfolio Loan to Value has remained flat at the end of the first half of this year compared to the end of last year at 56%. Our New Business LTV is also flat in those comparative periods at around 67%.

Really the way in which we’ve managed the margin is to have moved the low LTV two year fixed residential product into low LTV buy-to-let two year product. We’ve done that because obviously competition’s at it most fierce in the residential space, and we’ve done that extremely well, and just to reiterate again absolutely within our risk appetite. We had the headroom in our risk appetite to do it. We increased our share of flow of buy-to-let during the half-year to about 28% of new business. Just to put that into context, of course that's less than 1% of the total buy-to-let market. Our portfolio exposure remains at, to be precise, 16.2%, which is pretty close to market norms. As we look forward, we think we will continue to grow our buy-to-let business, but we only intend to do that in line with market growth. We’re not certainly going to become a leading buy-to-let lender, but we’ll continue to support the market roughly as we do now.

Of course, a number of you will ask us I’m sure what the new tax regulations will do to our ability to grow our buy-to-let business. Our own view quite close to that that PwC talked about a few days ago, where they said that given the supply of housing and the cost of property they would anticipate that by 2020 up to 50% of people under the age of 40 will be renting properties. Now I suggest that that means that the buy-to-let market, therefore, will remain vibrant and that the sort of the interventions around policy and taxation will be there to make sure that risk and financial management are appropriate, not that the market won’t exist.

From our own perspective at the moment, as you know, we offer buy-to-let properties to private individuals, not to professional landlords. And given the way in which the tax regime is moving on, we will be changing that, such that we can offer buy-to-let sales to individuals who incorporate themselves, as it were, in order to take on buy-to-let properties. And to be clear, we don’t expect at all to be moving into the commercial mortgage business, but we do expect to protect our ability to sell buy-to-let mortgages in that way.

So in short, we’ve been able to control mortgage spreads by managing the mix of business between buy-to-let and residential and through the LTV distribution and we’ve done it very well.

So, if holding asset spreads at around 200 basis points has been a really key achievement for us, I’m also really pleased by the way in which we’ve been able to reduce our weighted average cost of funds during the period. It fell from 160 basis points, in H2 last year, to 146 basis points in H1 2015. And during the period, we were particularly pleased to be able to prove our ability to fund asset growth and manage price and volume of retail deposits really precisely, and we do that on a very focused basis.

And so those of you that have said previously, to what extent are we concerned about our ability to drive the right volume of retail deposits at the right price to fund our asset growth, absolutely it remains the case that we manage our retail deposit volumes down and we do not have to really struggle to get them and we're managing them to absolutely the right place to be able to support our growth. And that meant that the deposit book grew by 3%, even though we reduced average front book pricing in H1.

We were particularly strong in cash ISAs during the period and we took a 10% share of the net inflows of the cash ISA market to the end of May. And just a milestone to tell everybody about: since we bought Northern Rock in January 2012, we've opened now over one million new savings accounts, which feels like a big milestone for everyone.

Now at the same time of managing the front book like that, as I mentioned earlier, we've been able to really reduce the cost of our back book of retail deposits. We talked last time we were together about a re-price that we'd notified customers of before the year-end, and that completed in February. It was a £9.8bn worth of back book, which we re-priced down by 22 basis points; and we experienced customer retention levels of as high as 95%, so, excellent. As a result, further price reductions are currently underway. We've notified customers of a price reduction and retentions are again better than expected.

But as well as optimising our retail pricing during the half, we've also looked at the efficiency of our liquidity position. We did a new ILAA, which was signed off by the PRA during the period, and so this is entirely within our risk appetite. And implementation of that policy has reduced the level of treasury assets that we hold on our balance sheet, and obviously contributed to the improvement in our overall cost of funds.

And then we've also enjoyed during the half, and we've talked about some of this earlier, another successful RMBS issuance of £750mn in May. And then we issued our first medium-term note during the period too. Both of those were at attractive rates that surpassed our initial expectations and Lee will talk a little bit more about that afterwards.

So that really tight focus on funding costs and the efficiency of our liquidity has been a key driver in driving our net interest margin and therefore our financial success during the period.

So if we look now at cards. You'll remember that in March, we migrated 675,000 customers from MBNA to our own operating and collections platform, and that was with overwhelming success; it surpassed my own pretty high expectations. We had no issues with customers, we had no problems with regulators, and we achieved all of that within our financial disciplines. And we're particularly pleased that despite such a major upheaval, we managed cards balances flat at £1.1bn, both pre and then post-migration, and that represents a 1.8% share of the £60bn cards market.

Now since migration, and of course it's only three months, but new business has been really strong across a range of cards, and when I say a range, just to be clear, we no longer just have a zero per cent balance transfer card, at the moment we have seven products in the market, and we now, on our own systems, have the flexibility to nimbly move between any of those products, as we need to, to meet market conditions and our own financial targets. So we're well on track now to meet our target of £3bn of credit card balances by the end of 2018.

Now the financial performance of our credit card book has also been very strong. The effective interest rate on the new cards range was 7.2% at the end of H1 '15. Total revenues have been flat and our impairment performance has been really good. Charge-offs are looking to settle it around 3%, which is what we expected.

Now, of course, the big issue during the period is that in Q4 the FCA will produce the first findings of their Credit Card Market Study. Our team have been well involved with the regulators during this period, and of course we have put in detailed thinking about the subject, and we believe that a 0% credit card is very good from a customer perspective. Whatever the findings, we know that our platform, our capability and our scale means that we're sufficiently nimble to respond to any changes pretty easily and with limited economic impact. So I'm very excited about the potential for the future of our credit card business for sure.

If we look at Other Operating Income now. As at the 30th June, Other Operating Income represented 13.5% of total income. Now that includes cards fee income and treasury asset sales, as well as our current account insurance and investment products. So Lee is going to obviously talk about the financial movements in those lines, but I'll just give you a brief update on where we're getting to from a business point of view.

So, the performance of our Funds under Management, it was great, it increased to £3.1bn in H1, and that was due to strong customer retention, as well as the successful launch of three new funds. And of this, almost 40% of the Funds under Management support customer pensions. Sales of pensions grew by 19% over H1 2014. And of course, new pension rules came in during the period and we were fully compliant with them well before the implementation date of April this year. And, as you know, we've always believed that it's important to put subject matter experts into business lines and we've recently appointed a new senior leader, with over 25 years of industry experience, to lead our new progress, future progress, and drive potential returns, more returns, on our Funds under Management business.

The insurance business has performed really well, as well. Income is up 5% half-on-half. Most of that increase came from our travel insurance business, where we put on 178,000 new policies, just in H1 2015 alone. And we launched our new life insurance business with Friends Life, which I think I flagged last time we were together, and have recently started a partnership with Amazon where the Virgin life product is marketed on Amazon's family site. We're very pleased with the initial findings there.

And we are in full user testing on our new home and motor proposition with Ageas and that's going to be launched in the second-half of this year, so really good progress in terms of our insurance business.

So, we've been pleased to be able to deliver such a strong set of results in the first half year of being listed, despite such a highly competitive and perhaps sometimes uncertain external environment. There's no doubt that there are an increasing number of new entrants in UK retail banking, and I think the introduction of the retail ring-fence is likely to give us more competition, to be honest. But I do think that's good for customers, definitely good for the economy, and I think it's good for us. Because, you see, I think that the three things that we have, that our competitors don't, are brand, flexibility and capability, and I think that those three things enable us to deal with external shocks and factors probably better than any other bank.

And our brand position has been reinforced during the period by a strong set of marketing campaigns, some of which you'll have seen, and of course, they've increased the level of spontaneous awareness of Virgin Money by 4%. That means that we now have 23% spontaneous awareness, so if you stop people in the street and ask them what financial services company comes to mind, 23% of them will say Virgin Money. And that increase in the first half of the year, up 4%, was in the market where the challenger bank average fell by 2.5%.

And the reason for that is that on social media, more than 6 million people have clicked on a Virgin Money advert during the half, and, amazingly – and I shouldn't say that, but amazingly – more than three quarters of the UK population have seen one of our ads six or more times since the new year. And, of course, when we look at our financial results, the benefit of that marketing success has driven down our cost of acquisition and that's also helped at a time of squeeze to asset spreads.

And then I'll talk about the flexibility point. We've got a number of key strategic options that are available to us to broaden our product range and our overall business franchise. Simply growing current accounts is an obvious opportunity and we continue to explore options there. And as I said, certainly at the time of the IPO, research shows that our brand is very appealing to SME business owners. And so, as a result, we're taking first steps into that area, just by putting in a small team of subject matter experts, who can help us to build our plans to enter the SME market when the time is right and our business plans properly allow.

And we've also begun a programme to extend our digital capability. Again a small step, but by the end of this year we will be in the user testing with our colleagues of a new digital spending product, which we'll pilot in the second half of the year and which we intend to launch at the beginning of next year.

And then, of course, again in terms of flexibility, we continue to have operating leverage which we can utilise in order to manage our financial returns.

And I've talked about how successful our cards migration was. On time and on budget for a project like that is unusual in our experience of banking, but it was also fit for purpose from day one. And I hope that demonstrates to you that we've got the capability to build and grow new businesses whenever the opportunity arises.

So, there's a long way to go to build out everything that we've got available to us. I was saying to Daryl last week that now it feels like during the course of this year all of our non-interest income lines are there and built, and they haven't even started yet and we've got real opportunities there. We've got opportunities to grow the current account franchise, opportunities in digital, toe in the water with SME, a really significant mortgage franchise, and we're funding that asset growth very successfully. And so we're in a great place now and there's a lot of room to go for the future. So I'll hand over to Lee now and he can talk about the numbers in a bit more detail.

Lee Rochford, Chief Financial Officer

Thank you Jayne-Anne and good morning everyone.

I'm pleased to say we've delivered a strong set of results for the first half of 2015 with underlying profit before tax up 37%, having managed the business to offset asset spread pressure and still deliver really good progress towards our targets.

Let's start with the balance sheet and two key features: strong growth and increased efficiency. The 7% growth in loans and advances, predominantly in the mortgage business, drove the income line of the P&L, which I will come on to in a moment, as well as 4% growth in our TNAV.

The increased efficiency has been driven by two actions. In the first we've substituted increased wholesale funding for retail funding; as you can see in the marked 47% increase in debt securities in issue. And with spreads on these deals of gilts plus 118 basis points for the MTN, and LIBOR plus 37 basis points for the RMBS, wholesale funding costs were lower than retail funding of equivalent tenure, and that contributed to lowering our average costs of funds.

The substitution of retail funding for wholesale funding is also visible in lower growth in customer deposits than in loans and advances at 3% and 7% respectively. As a result, the loan-to-deposit ratio has moved further into our target range of 100% to 110%.

As a second action, as Jayne-Anne mentioned actually, we've then managed the size and the mix of the liquidity portfolio to optimise efficiency, which you can see in the 12% reduction in Treasury assets.

Relative to the first half of 2014 we've delivered strong net interest income growth of 27%, driven by a 22 basis points uplift in net interest margin compared to a 15% growth in total assets.

We've continued to demonstrate good operational leverage, with our cost-to-income ratio falling from 66.7% a year ago to 62.2% in the first half of this year. And I'll come onto costs in more detail in a few moments.

The benefit of our high-quality asset portfolio is clearly demonstrated in our impairment charge of just £14.3m on a book of over £24bn, giving a cost of risk of just 12 basis points. Taken together these factors have led to a 37% increase in underlying profit before tax, and an improvement in our return on tangible equity to over 10%.

As we've described previously we think about the business in terms of return on assets which, combined with our targeted leverage ratio, leads to a mid-teens return on tangible equity. So now let me take you through the drivers of our return on assets, what we've achieved in the first half of the year, including increasing our return on assets to 40 basis points, and update you on the outlook.

So turning first to net interest margin. We're very pleased to have delivered strong growth in NIM, moving from 156 basis points in the second half of 2014 to 165 basis points for the first half of 2015. You can clearly see the impact of asset spread compression in the mortgage market, and how we address that through successful management of deposit pricing, which added 15 basis points to NIM, more than offsetting the asset spread pressure.

We also saw a 5 basis points benefit from the actions we took to increase the efficiency of the balance sheet, which I referred to just now. Asset spread pressure has been pronounced since we updated the market at the end of the first quarter, and as we set out then we've increased our share of buy-to-let business to 28% of flow in the first half to help offset that asset spread pressure, which was most pronounced in the low loan-to-value in the residential mortgage part of the market.

Looking ahead, we're taking action to re-price retail deposits further, and this will help partially offset expected asset price pressure in the second half of this year. Following that re-price our deposits will be priced at a level approaching the market average.

In the future the key external drivers will be the timing and amount of base rate rises, and the evolution of the competitive pressures which are currently present in mortgage pricing. We believe our planning assumptions remain conservative, with one base rate rise in mid-2016. All the indications are that base rate rises could come sooner, and that will actually help support our NIM progression.

In addition, the growth in cards balances will be a driver of NIM expansion. And we have the opportunity to add to our asset mix, for example through a move to SME lending as Jayne-Anne described. So overall we expect asset spread headwinds to mean that the average NIM for this year will moderate from its current level to a modest peak of a couple of basis points to our previous guidance of up to 160 basis points for the year, and then stabilise at that level before making further progress towards our medium-term target of 170 basis points.

Looking now at Other Operating Income. As expected, Other Operating income decreased half-on-half at £34.1m, but encouragingly it showed an increase in the second half of 2014, underlying the significant potential for growth. The main future driver of growth in this line is expected to be our current account, insurance and investments business. Encouragingly total income from this business grew by £1.5m or 9% from year-end, driven by growth in funds under management and in pension sales. All the foundations are now in place for the planned product launches in CII, but they will take time after launch to grow to scale.

Looking at the other major components of Other Operating Income. Credit card fee income reduced by £4.8m half-on-half as we expected, following the end of our agreement with MBNA, since we no longer receive commission from new card originations. But looking forward we expect credit card fee income to be stable in the short term until new business matures, and then starts to generate increased transactional fees.

The reduction in income from central functions is explained by a reduction in one-off asset sales in Treasury. So compared to the target of 15% in the medium term, other operating income came to just over 13% of total income in the first half of this year. We continue to expect growth in other operating income so that it will return to around 15% of total income over time, albeit not in a straight line.

So if I move on now to look at costs, where we have a 50% cost income ratio target in 2017. We continue to reap the benefits of the operational leverage of the business. This meant that we achieved a reduction in the cost income ratio from 66.7% in the first half of last year to 62.2% in the first half of this year.

Despite the necessary duplication of costs in paying MBNA to service our cards whilst we built and staffed our own platform prior to migration at the end of March, the growth in costs in the card segment was limited to £2.8m from the first half of 2014. While that is an increase on the first half of 2014, it represents an 18% reduction in cost compared to the second half as we stopped paying MBNA to service cards following migration in March.

Now we have replaced the MBNA servicing agreement with our own in-house model supported by TSYS we will see the forecast benefits of that arrangement come through later this year and beyond.

We continue to expect future cost increases to be on a purely marginal cost basis, primarily in our operating segments, and we are increasingly confident of delivering costs well within the growth rates seen over the last three years.

In the second half of last year we were completing the build-out of our platform, while in the first half of 2015 we've been maximising the benefits of writing an increased volume of business from a tightly controlled cost base. This has led to withdrawals of 13% between income growth and cost growth.

So as a result of all of the above we remain on track to deliver a cost-to-income ratio of no more than 50% by 2017.

So if we turn now to look our continued strong asset quality. We've guided to a cost of risk of 15 to 20 basis points in the medium term. In fact asset quality continues to be better than that, with a low and stable cost of risk of just 12 basis points in the first half of the year. The total impairment charge for the first half of 2015 was £14.3m, and only £1.6m of this charge came from our mortgage portfolio as we continued to see arrears improvement.

Cards impairment grew by 5% from the first half of 2014, while balances grew by 47%, resulting in a declining cost of risk to 2.3% from 3.1% a year earlier. This is due to the expected effect of new cards balances purchased last November experiencing low impairment during the 0% period.

Coverage ratios remain strong with 64.1% coverage of impaired mortgage balances, taking into account the provisions plus the excess expected loss.

So looking forward we continue to expect the cost of risk to remain within our previous guidance of 15 to 20 basis points in the medium term, reflecting the mixed impact of growing the credit card business. Our continued strong underwriting capabilities, high coverage ratios and the benefit of the lower for longer interest rate environment means that although impairments may not go much lower they will continue to remain supportive of our profitability and help offset pressures on returns.

Moving on to statutory profit. As expected underlying and statutory profit before tax is much more closely aligned in the first half of 2015 than it was in 2014 as the number of exceptional items has reduced significantly. In addition to a charge for the FSCS levy of £15.5m there were just two exceptional items in the first half of this year: a charge for IPO related share based payments of £6.5m, including national insurance contributions; and strategic development costs, as expected, were £4.8m, which predominantly related to the continued build out of the credit card platform.

Consistent with prior treatment we continue to show the costs of the FSCS levy below underlying profit before tax, but we do include it in our RoTE calculation.

In contrast to 2014 our £12.1m tax charge for the year was much more closely aligned to the statutory corporation tax rate, with an effective tax rate of 22%. We would expect the tax charge to continue to normalise in the future at around the prevailing corporation tax before the new surcharge of 8% from 2016 onwards. And that unexpected surcharge does of course have an impact on returns, which we estimate at less than 7% of earnings or approximately 100 basis points of RoTE in 2016.

Finally I would like to give some context with respect to our capital position. As I said earlier, we continue to have a strong balance sheet and strong capital ratios. The capital build from retained earnings this year at 0.8% was close to self-supporting asset growth in the first half of the year. In addition we adopted a change to our IRB model to take account of growth in the house price index beyond the 2007 peak. This provides a benefit in this year and is likely to be more material in years to come.

In the first half that change was partially offset by the effect of the change in new lending profile, resulting in a net benefit CET1 of 0.2%.

Overall, despite a 7% growth in loans and advances our CET1 ratio reduced by just 0.3% to 18.7% at 30th June. Our leverage ratio remains stable at 4.1%. And the headroom between our current capital and our target capital levels demonstrates our continued very significant capacity to support growth.

With retail deposits of less than £50bn the recent PRA leverage framework consultation does not apply to us. It is clear that our minimum requirement remains at 3%, and we wouldn't expect any additional regulatory requirement before 2017, when we do expect a follow-up consultation. This highlights the very conservative position we'd taken in our previous guidance of a 3.75% minimum leverage ratio. As such this is a positive development for us, and provides us with the opportunity to consider strategically optimising our capital structure over time. This would clearly help drive returns as we grow into our capital in a more leverage efficient manner.

As Jayne-Anne has said, SME is one option, and growing our cards business would clearly benefit our leverage efficiency as well.

So in summary we have delivered a strong set of results in the first half of 2015, despite the asset spread pressure in the mortgage market. Our track record of growth, without compromising on quality, to drive substantially higher returns to our shareholders has made really good progress in the first half of 2015. And we have the flexibility in our plan to continue the journey towards our medium-term goals.

So with that I'm going to hand back to Jayne-Anne.

Jayne-Anne Gadhia

Thank you Lee. So my summary would be that we've performed very strongly in the first half of the year. Mortgage growth, net interest margin, profit before tax and return on tangible equity all performing ahead of expectations. And the other key metrics are there too, including our cost-to-income ratio, excellent asset quality and the strong capital position that Lee has just talked about.

So I'll just finish then with a bit of an outlook for the rest of the year and a little bit beyond that. Although we've achieved 3.8% market share of gross lending in half one, asset spread compression in the competitive mortgage market that we all face does remain a potential headwind in the second half of this year. And as we said earlier and in Q1 we will aim to protect spread with a sharp focus on volume. So what that means is that we're likely to ease back on our market share in the second half of the year and probably come in for the year at the top end of the range we guided to of between 3% and 3.5% market share for the year.

Now just to be clear that doesn't mean that to say that we're going to shrink volumes we will still write absolutely greater mortgage volume in the second half of the year than the first, but we think the market will be bigger and therefore our relative share may be a little smaller and therefore fall as a function of market growth.

With everything that we've got now in place we remain on track to meet our target of £3bn of new credit card balances by the end of 2018 and as I said earlier current account, digital and SME development give us really significant potential to drive the growth of the business.

We're going to obviously continue to drive the efficiency of our balance sheet and always protect asset quality.

Cost flexibility remains an opportunity to offset potential headwinds and to continue to drive returns in the medium-term. And we continue to deliver on our cost efficiency targets, that's a huge focus for the management team and as a result we're well positioned to achieve our cost/income ratio target of no more than 50% as planned in 2017.

We remain confident and wouldn't want you to get ahead of yourselves, we remain confident that we will deliver annual NIM a couple of points ahead of our guidance of up to 160 basis points for the year, but we shouldn't get ahead of ourselves because of the asset spread headwinds.

The unexpected addition of the bank surcharge will slow our progress to mid-teens returns but let me be clear we do expect to achieve that level of return by the end of 2017. We think we're proving that we've got the brand, the capability and the flexibility to adapt to market conditions and to new opportunities and we've got the capital to support our growth ambitions. So, so far we think we've delivered on what we promised at IPO and we continue to guide as we did at IPO with the exception of the slight slowdown in the timing of achieving our mid-teens RoE. And we do think that the dividend that we've declared today is real evidence of our confidence in delivering our plans.

So now Lee and I and the rest of the management team are here for the next ten minutes or so to answer any questions that you may have.

Q&A

Question 1

Chintan Joshi, Nomura

A couple of questions. The first one is a rate hike is potentially expected in the first quarter next year and we've got the 8% surcharge, how do you think this might impact mortgage rates and savings products? How does the market play out in your view over the next six months as we head into that rate hike?

And then secondly you had £1.7bn net lending if I remember correctly, £3.6bn gross lending, even if I account for normal redemption of the book there are people moving away from Virgin Money in your mortgage book, can you explain the dynamics around that? I suspect it is normal but I just want to kind of get a sense of what's happening there? Thank you.

Jayne-Anne Gadhia

Sure well since I've talked for such a lot I'm going to ask Anth to answer all those questions. Can you remember all of that?

So Anth Mooney as many of you have met before is responsible for our mortgage and savings business.

Anthony Mooney, Director of Financial Services

Hi morning everyone. The first part of your question how will the mortgage and savings market play out. I think we would expect mortgage spreads to remain in the second half of the year broadly at the level they're at now. We have of course seen, over recent months, some significant tightening. We've managed by using our headroom on risk appetite managed through that period. We don't see any significant further deterioration to mortgage spreads in the second half as the market starts to strengthen slightly.

In terms of the savings market I think we don't see any material shift until we start to see that first base rate hit spreads over the last 12 to 18 months in the savings market have remained broadly constant, so we don't see any material short-term change in that dynamic.

In terms of our retention rates and in terms of our SVR book if you have a look at our attrition rates from our mortgage back book over the last six months they've remained broadly flat compared to previous periods. So if you look at our SVR book we're seeing attrition from about 15% which is similar to previous periods, we don't see significant change. If you look at our retention rates on maturing business we're still achieving a retention rate of 65% to 70% in that area – very consistent with previous performance. We don't see a significant change in that regard either.

Chintan Joshi

Just a quick follow-up do you think mortgage rates can go up because of rate hikes and 8% surcharge?

Anthony Mooney

I think it's possible we've seen significant competition this year particularly in Quarter 2 as the larger lenders have come back. I think with a base rate move we would expect to see remortgaging take off more strongly next year once that first base rate move happens, so we would expect to see a stronger mortgage market as we see play out in same forecast for the market next year. So if we see an easing of that competitive tension then you would expect spreads to ease slightly next year. But it's very competitive out there so we haven't factored that into our plans.

Jayne-Anne Gadhia

And I think that's the important point that for us we're assuming that with the exception of one base rate rise next year everything remains flat. Anything that's more than that is upside to our plan.

Question 2

Andrew Coombs, Citigroup

A couple of questions from me as well please – one on savings and one on cards. Just firstly you talked about communicating the cut on the easy access savings product to customers from the 7th September. Could you just clarify how much of the £22.8bn of savings does that relate to in absolute terms?

And also what are your budgeted retention rates there because I assume they'll be slightly less than the 95 you saw previously given your moving closer towards the industry norm?

Anthony Mooney

So it's a little over £8bn. Jayne-Anne mentioned earlier that in February we moved the rates on around £9.8bn, this time around it's £8bn to £8.5bn.

In terms of retention rates we've factored into our planning an attrition rate of between 5% and 7.5%, we're about two or three weeks into that communication. Early indications, and I must stress it's early in that cycle, but we're performing better than plan at the moment, so signs are positive.

Jayne-Anne Gadhia

And cards? Andrew, Michelle's on holiday at the moment but Will's here so between us we'll do our very best.

Andrew Coombs

Perfect now on cards I mean obviously the volume growth has been subdued at the moment, that's because of all the platform changes you've had, you're now really in launch mode post that so I think there is a new marketing campaign that got pushed through in June. What are the initial signs from that? Have you seen an uptick in volumes? How successful has it been?

Jayne-Anne Gadhia

So I think that at the moment the marketing campaign's quite materially exceeding our expectations. However again I'd temper that because the reason for it is that Martin Lewis has been particularly positive about our products and so we've had coverage beyond our expectations. The team would say to me we should expect that to fall back to planned levels but at the moment we're exceeding planned levels.

<u>Question 3</u>

Nick Baker, Goldman Sachs

I have just one on Slide 15 on the NIM bridge, it's obviously a very strong performance on NIM all round, but on the 13bps compression in the mortgage business what would that have been on a constant mix if you hadn't taken the volume out of RESI and put it into Buy-to-Let?

Jayne-Anne Gadhia

I'm going to ask one or other of them but I don't know. Lee do you know that?

Lee Rochford

The yield benefit we had from changing the mix was around about 10 basis points.

Nick Baker

Then the second question really is on capital, so Quarter 1 an 18.7% [CET1 ratio] and leverage [ratio] of 4.1% - as you say you're only required to have 3 or above although it's applying at 3.75%, that leaves a lot of room to grow some high risk rate business, obviously you've got the card business coming online but if you could elaborate on the toe in the water that you say you have with looking at SMEs because obviously that's quite a broad spread, so the kind of business that is.

And I guess following on from that if, for whatever reason, you don't think that the SME proposition is something that you want to launch full scale near-term would you see room to majorly nudge up the capital return guidance that you have set out already? Thanks.

Jayne-Anne Gadhia

So I don't want to talk much more about the SME business until we've investigated it properly it would be foolish for me to do that I think, but it's real and it's at the very beginning, so when we've got something properly to inform the market on we will. I think for now all we're saying is we're looking at that and we know that our brand is right in that marketplace and we'll talk a little bit more about it later.

Could you answer the capital question, Lee?

Lee Rochford

Well I think on capital what we've indicated is we may have room but we've made no decisions at this stage to change our target levels, and therefore our guidance I think remains what it was and we'll see how things progress.

<u>Question 4</u>

Rohith Chandra-Rajan, Barclays

A couple please, one just on the Buy-to-Let market which you certainly addressed upfront and noted your comments on the ongoing demand. I was just wondering firstly on your risk appetite you talked before about having Buy-to-Let up to 18% or 19% of the book, currently it's 16.2%, I just want to check whether those parameters have changed at all?

And just in terms of pricing or competition in Buy-to-Let, given the tax changes are you anticipating any change in pricing going forward?

That was the first one.

Jayne-Anne Gadhia

I thought that was going to be a risk question for Marion but it's not really is it? So in terms of our risk appetite we haven't changed it so our current intention is to operate within our existing risk appetite. And so to be absolutely honest we had considered whether or not we should extend it earlier in the year but having looked at the market and looked at some of the regulatory intervention if you like we think that the risk appetite that we're currently operating is right and we're sticking to that.

Anth, do you want to comment on pricing?

Anthony Mooney

It's another crystal ball question right, but I think in the Buy-to-Let market we've seen spreads tighten a little but we're still seeing spreads of around 100 basis points higher in the Buy-to-Let space than we do on vanilla resi[dential lending]. I don't see that changing materially as a consequence of the announcement in the Budget.

Rohith Chandra-Rajan

The second one, and I might have missed it earlier, on the £8bn of deposit re-pricing you're putting through what's the price change?

Jayne-Anne Gadhia

20 basis points.

Question 5

Guy Stebbings, Exane

Just coming back on margin again, there's already been a few questions there, but just on the standard dynamics around 165 at the half-year, a couple of basis points above the 160 at full-year so suggesting exit rate's going to be perhaps below 160; and then a 170 sort of medium-term. So just understanding the dynamics there a little bit better.

And linked with that also the loan to deposit ratio just picking up towards the upper end of guidance I just want to understand if there's any changes there at all in terms of further support? I appreciate we've got further credit cards coming through, some deposit re-pricing but if there's any other dynamics which you're aware of?

Jayne-Anne Gadhia

Let me answer the loan to deposit one then Lee can perhaps answer the margin one that's more complicated.

The loan to deposit risk appetite remains at 110 and we're in that space and perhaps at the higher end of it now but it remains at 110.

Lee Rochford

I think on NIM guidance you shouldn't necessarily think actually that we exit the year at a rate below 160. So there's obviously a mixed dynamic going on where you've got some asset spread impact but then the impact of the retail re-price coming through later in the year. So actually we'd expect to exit the year in line with the average we're talking about for the year as a whole and that's without the full impact of the retail re-price coming through later next year or into next year.

Question 6

Tom Rayner, Exane

I was going to ask on capital but can I just follow up on Guy's question because you posted 165 for the first half and your full-year guidance is very clearly for 162, so mathematically doesn't that suggest you're going to be sub 160 in the second half of the year? And I just wondered when you say then you'll stabilise before then moving up to 170 in the medium-term, is that stabilising at the second half?

And I think your comment, and correct me if I'm wrong, to a previous question was that you're expecting mortgage spreads to be stable in the second half, there's more deposit re-pricing in the second half, the cost of wholesale is cheaper than deposit so when I look at Slide 15 I am struggling to see why the second half would be... what you're implying by your full year.

Jayne-Anne Gadhia

In terms of our planning we've always tried to be prudent, we've always said that and we continue to be prudent, so from our perspective, as you rightly say, we're imagining that asset spreads remain low, we are looking at the balance of that against the later re-pricing. Don't forget we're only going to have, what, two months worth of the final deposit re-price coming through in this year, and we've done a lot already to make the balance sheet efficient, and indeed we're not expecting any other wholesale issuances during the course of this year. All of that taken together means that frankly, I'll be really honest, we just don't want you all to get ahead of yourselves in terms of the NIM guidance, so we just want to temper that back because we don't know what's going to happen with asset spreads.

On the other hand, if the press last weekend are right and asset spreads increase or base rates come through more quickly than we've planned, there's upsides. So we're frankly just trying to get to a place where we're saying let's be sensible about it and not get too carried away with what we've achieved in the first half because of the uncertainty that's out there. With a fair wind, great, but we can't rely on fair winds.

Further Question

Tom Rayner, Exane

I've just got a quick one on capital. Obviously 18.7% remains way more capital than you need. Again, on your slide the first two bars, if you assume that the rest of them are kind of not repeatable or not really fundamental, it's going to take I think 20 years before you get the capital ratio down to a level which most people would think was adequate. So I'm just wondering if you can give us any more colour on how, when, if that ratio starts to normalise?

Jayne-Anne Gadhia

No. In terms of our financial plans, as we look forward for the next three years we continue to have very strong and healthy capital ratios. We think that that's a really important place for this business to be. We can still deliver our mid-teens returns against those very strong ratios, as you've talked about, and I think safety and prudence is important. But it does give us the opportunity to invest further in new asset classes and growing the business faster if the opportunity arises. So I think it gives us strategic options and safety, and that means that we can all sleep well at night, I think.

Lee Rochford

I think a point I'd to that, don't forget the growth in the credit card business hasn't really kicked in yet, and that will feed through into capital into next year and beyond.

Question 7

Michael Helsby, Bank of America Merrill Lynch

Just two quick ones from me on costs. Clearly it was a really strong performance and, Lee, you mentioned that the card benefit has yet to come through. Should we think of you planning on costs to be not much more than flat second half versus first half, is that a good trajectory for you to be ending the year?

Then just on cards, Jayne-Anne, just to understand because when I look at the proposition it genuinely is market leading I think at the moment, clearly it's branded to hell and looks all very cool. You mention it started really, really good. Is there a break internally, i.e., if it carries on being really, really strong in terms of demand, do you temper that? Is there a limit in other words in terms of how quickly this can grow?

Jayne-Anne Gadhia

On cards, I don't want to sound gung-ho about it, but given the small place that we start from and the fact that we're on a TSYS system where we are 1% of their total capacity, we're not volume constrained, our operational capability is proven because we use TMS as well as our own people – that's a third party outsourcer, part of the TSYS Group – to support it, and we're very well capitalised, there's no sensible reason why we can't continue to grow if that volume's there in the market for us. As I say, I don't want to sound gung-ho about that, and I'm not suggesting we go and blow the lights out tomorrow, but there's no volume constraints on the growth of the credit card book of any materiality. Is that right, Will?

Lee Rochford

Costs I think was the other question. You're right, we do feel we have a really tight grip on costs I think in terms of what you should expect. As we've said before central functions we'd expect to hold really tight around the level they're at. We will see a benefit from cards cost continuing to come down going forward, but you'd expect to see some marginal costs in some of the other segments. So for the second half of the year I'd say a few single millions more than the first half, but not much more than that.

<u>Question 8</u>

Chris Cant, Autonomous

I have two please. On the cards business you've obviously talked a lot about volumes, but the EIR you give in the slide is now 7.2%, and I think from memory it was 8.5% at the time of IPO that you said was the gross yield on new cards.

Jayne-Anne Gadhia

7.5%, I think.

Chris Cant

Was it 7.5%? I think 7.5% was the NIM. I think 8.5% was the gross yield. So your EIR's come down effectively, I guess, by 130 basis points. First question is, what do you think that trend is going forward? Do you think yourselves and Barclaycard continue to just add an extra month to the balance transfer interest free period indefinitely? Where does that stop?

And following on from that, is the 7.2% a spot effective interest rate or was it an average for the half, and if it's an average, what was the spot at the end? Because obviously your interest free period has now gone out to 36 months so I guess if anything it's got worse, the effective interest rate on new business.

Lee Rochford

I think it's probably around the guidance. I'm not sure if you're confusing what we said around yield on the front book. We obviously have a back book with very mature yield and front book yield will be at a lower rate. But we were very clear that we expected the effective interest rate on new cards to be around 7.5%. So yes, we're off a little, durations have gone out a little bit, as you've mentioned the 36 months since the time we floated, but there have been offsets to that. We do expect the longer card life to lead to a better stick rate with customers, and we've got 10 years of rich data as we've seen balance transfer periods evolve over the last few years. So actually we think around about where we are now is a rate you can expect to see going forward.

Concluding comments: Jayne-Anne Gadhia

Thank you all very much indeed for coming. I really hope that some of you will be able to come down to see the Haymarket Lounge. Kirsty is over there with an umbrella, it's not very far down to the Haymarket. I really hope some of you can join us and come and see us. Thanks very much for your interest today. Bye for now.