CYBG PLC FY18 Preliminary Results Transcript

David Duffy

Okay, we'll get started. Good morning to everyone in London, and good evening to those of you joining our webcast from Australia, and welcome to CYBG's full-year results presentation for 2018. I'll briefly take you through the progress we've made in our strategic execution, Ian will then talk to our performance for 2018, I'll return with some thoughts on the opportunities ahead, and Ian will close with some guidance for 2019. So, our presentation is a little longer today because we're trying to do the standalone performance and our initial thoughts on the combination, so if you bear with us, I'm sure we'll get everything covered for you.

Okay. So, on strategic execution, before Ian talks about the specifics of FY18 in detail, and given we have new shareholders and analysts at today's presentation, I thought it'd be useful to provide you with some context around our strategic delivery since the IPO. Following our IPO in 2016, we outlined a three-year plan, which you're all familiar with, where we promised to deliver sustainable customer growth; secondly, to reduce our cost base; and thirdly, to optimise capital, all the while transforming our digital capabilities.

Turning first to customer growth, we have delivered an above-market 6 percent CAGR in our mortgage lending over the past three years, and this demonstrates our ability to take market share consistently from other players. At the same time, we're continuing to develop our core SME franchise with an above-market 6 percent CAGR growth rate and are on track to beat our goal of £6 billion of lending over the three years to the end of 2019. So, we're delivering against the promise.

Our prudent balance sheet model means that we have funded the majority of this growth through customer deposits, building on our strong current account base across both retail and SME and utilising our diversity of funding sources. All of this growth has been delivered in line with our mid-single digit guidance following our capital markets day in 2016.

And if I turn to efficiency next, we've committed to delivering over £100 million of net reductions in our total cost base by year end 2019, and we are running ahead of that target.

Our cost-to-income ratio has therefore reduced from 75 to 63 percent over the past three years, and importantly, we expect this trend to continue going forward. The success of the combined initiatives means that we've delivered a total return on tangible equity of 10.6 percent in 2018, and this is in line with the target we published for double-digit returns. We have also begun our journey of providing sustainable return on equity to our shareholders with our first two years of dividend payments.

In October, we also announced the successful receipt of IRB accreditation for both our mortgage and SME portfolios, and we still remain focused on further optimising our capital position, and we will continue with the IRB application for our unsecured personal lending portfolio as well.

From a performance perspective, I'm actually really quite pleased. We've managed to deliver on the majority of our targets that we published ahead of schedule, and our successful completion of this standalone plan has enabled us now to take our next strategic step of creating the first true national competitor.

Back in 2016, we made the strategic decision to invest £350 million in our platforms. We've already migrated around two million retail customers onto the platform, and we've had no migration issues. We expect our 200,000 SME customers to be on the platform by September 2019. This platform is open banking-ready, has full open-API capability, and will enable us to be the first in the market to deliver a current account aggregator service.

We've also launched a B store, which will in time contain a full range of products and services to support our customers, and we'll be seeking to leverage the much broader Virgin Group companies as part of that proposition. We've already launched B currency, the only live augmented reality app by a UK bank, which enables customers to instantly convert currencies when purchasing items abroad. Our B Smart app is coming next, and that's a utility price comparison app, and that will be launched quite soon.

And if you look at B, in just over two years, it has grown to in excess of 190,000 accounts with over £2.1 billion deposits and a very strong NPS score. We've also signed strategic partnerships with large tech players such as PayPal on cards and FinTech such as Ezbob on SME, and just last week, Salary Finance. And I think what's important is these partnerships demonstrate both our willingness to collaborate with third parties and the attractiveness of our digital platform in the marketplace.

So when I look at the franchise in simple terms, we now have a national brand; a full suite of products; an integrated open-API platform for six million retail customers and SME customers; and a proven partnership capability. We also intend to deploy a proposition which I think will be unique, using other Virgin Group companies through our marketplace, and we're confident that we'll be able to drive growth across all of our segments and are going to take market share as we have in the past.

Frankly, when you look at this franchise, I think that our advantage is that we are more innovative and agile than our large competitors and more capable of competing effectively than our smaller competitors. And I'll talk further about our growth ambitions in detail towards the end of the presentation, but before that, let me hand you over to Ian, who will talk you through our standalone performance.

Ian Smith

Thank you, David. Good morning. It's a pleasure to see you here this morning, and good evening to our friends in Australia. I'm going to run through the standalone results for 2018, but I'll keep it brisk, because I'm sure, like us, you're much more interested in looking forward than looking back.

Now, before I get into the specifics of the 2018 performance, I first just wanted to highlight how the strategic execution that David spoke about has translated into improved financial performance over the past three years.

Sustainable customer growth has been a consistent feature, and while the income environment has been tough, we've outperformed on costs, delivering a 14 percent reduction in underlying expenses. Taken together, our actions have driven a significant increase in underlying ROTE, hitting our double-digit target a year early.

Now, I'm very pleased to be able to report a 13 percent increase in underlying PBT this year, and we continue to deliver improved business performance. Key contributors to the profit growth were increased net interest income commensurate with growth in our balance sheet; costs, which were 6 percent lower year on year; and once again, a very low cost of risk. Now, in terms of KPIs, our net interest margin was 217 basis points, in line with our guidance of circa 220. We continue to improve the cost/income ratio, which now stands at 63 percent, with positive jaws of 5 percent in the year, and our underlying return on tangible equity was 10.6 percent.

The strong underlying performance has enabled the board to recommend an increased dividend of 3.1 pence per share, payable to all shareholders.

Now, before I move off this page, a few words on non-interest income, as we don't cover it elsewhere. After stripping out fair-value movements, most of which are non-recurring, and the £6 million cost of the PCA campaign in October 2017, non-interest income is broadly flat year on year. I think the key takeaway from this slide is that our core business performance remains solid.

Now, turning to statutory earnings. After conduct charges and other items, we recorded a loss of £145 million. The charge for legacy conduct of £396 million includes the £220 million we took in the first half, with a further £176 million charge in the second half. £150 million of that relates to PPI, and I'll talk you through the assumptions behind this in detail shortly. The core message on PPI though, is that we believe the endgame is playing out largely as expected back in May, but we've topped up our volumes to cover us out to the time-bar in August 2019.

The additional £26 million charge for other conduct matters in the second half relates to further costs in relation to the small basket of non-PPI issues we've been managing. We do not expect to incur further substantial costs in relation to these matters and I can deal with any other items on this slide in the Q&A as required.

We continue to see the benefits of our broad funding base and lower cost liability mix. We increased our deposits in line with lending growth in the year, and after stripping out the impact of base rate increases in November '17 and August '18, we actually saw the underlying cost of deposits come down fractionally year on year. That's a great testament to our management of mix and pricing when you consider that we saw strongest growth in our savings products. Our all-in cost of funds last year was around 80 basis points, up five bps year on year, and the net increase was driven by base and other rate hikes.

In line with our strategy to deliver sustainable customer growth, we've seen good asset growth in the year across all three of our asset classes. In delivering this growth, we have not compromised on our underwriting standards, as evidenced by our origination KPIs.

In mortgages, our origination LTVs and LTI multiples have held steady or improved slightly, and in SME, our internal eCRS risk rating on new business is consistent year on year.

Now, as you know, mortgages started the year with a great tailwind from a healthy pipeline, but things slowed a little bit in the third quarter due to the impact of the changes we made to our broker-servicing model. Now, these have been addressed, I'm pleased to report the Q4 volumes did bounce back as expected and, if anything, were a bit ahead of what we were expecting. The result is we've delivered 4.5 percent growth in mortgages, getting on for double the market in 2018 while maintaining our discipline on margin.

In terms of mix, the home mover market has been flat, with growth primarily stemming from first-time buyers and remortgaging. The buy-to-let market remain subdued, and the business being written in that space is predominantly remortgage. With base rate having increased, it remains very much a fixed-rate market, and we're seeing five-year fixes growing in popularity.

In SME, we had a slightly stronger second half given the pipeline coming into the period, with above-market growth of 6 percent in core balances for the year, and this is due to our consistent and disciplined focus on serving the SME market, and our specialist sector offerings resonate particularly strongly with customers. Now drawdowns were ever so slightly down on last year at £2 billion versus £2.1 billion in 2017, and we think this reflects just that slightly lower confidence amongst our SME clients given the economic uncertainty relating to Brexit.

Unsecured lending grew by 4 percent, which is about £40 million absolute, and that was driven by growth in personal loans following the improvements we made to our capability that I talked about at the half-year; basically, enhancement of our smart search capability for aggregators and the launch of preapproved in-app functionality. Looking into 2019, the pipeline is solid for both mortgages and SME, and I would expect us to continue to take market share going forward.

So, we grew net interest income off the back of sensible asset growth, albeit at a lower margin year on year. The NIM, at 217 basis points, was in line with guidance and consistent with the margin compression we'd flagged in the mortgage book. In mortgages, the average portfolio yield was down 18 basis points year on year, and that was really reflecting front-book pricing pressure and also mix changes. The shift in focus from buy-to-let origination to residential and the attrition in SVR balances that are now 9 percent of the book compared to 11 percent a year ago, have all contributed to this.

SME continues to do well. Stripping out the impact of rate increases, and most of the SME book is tied to LIBOR, we've seen a few basis points of real improvement in average book yield over the last 12 months. Our SME business continues to be a good counterbalance to margin pressure on retail lending. It brings better asset pricing and importantly, a source of low-cost deposits.

Retail unsecured is still a competitive space, and we've seen the average portfolio yield come down from almost 900 basis points to 835, although this is slightly less than the decay we experienced last year.

So, to summarise, retail pricing was disappointing, and that drove margin compression that we've offset with good performance in SME and some great work on the deposit side, allowing us to manage to our NIM guidance for the year.

We delivered underlying operating expenses of £635 million last year ahead of market guidance. I'm pleased to say that Project Sustain has been completed, delivering the promised run rate savings of more than £100 million, a year ahead of schedule.

I'm also pleased that because we overdelivered on gross savings, we've been able to reinvest a good chunk of money into improving our customer and colleague proposition along the way. We'll see the full-year benefit of the run rate from this year's Sustain initiatives flow into next year's expense base, but now that Sustain has closed, our focus moves on to integration.

Cost of risk ticked lower this year, down to 12 basis points, and all key balance sheet asset quality metrics are improved compared to 2017. The key driver of the reduction year on year is that we saw lower specific provisions in our SME business. Now, SME is always a little bit lumpy, and we'd expect to see next year's SME bad debt charge return to more normal levels, although given this is the point to which we say a fond farewell to IAS39 and welcome in IFRS9 from the first of October, we may need to recalibrate what we think of as normal.

We've been soft-guiding on the impact of IFRS9 for the last couple of years, and today we've published our estimate of the day one position. The details are given in the preliminary announcement on page 43, but the headline is that we estimate an increase in provisions on day one of £21 million after tax, well within the previously indicated impact. The effect on capital is negligible, as we will benefit from the transitional relief offered by the PRA.

Now, looking ahead, we can't ignore Brexit. We've done as much work as we can to identify and mitigate areas of risk in our portfolio that might arise in an orderly Brexit. We focused on customers in EU-exposed sectors such as agriculture and those in all sectors that are exposed to the risk from supply chain disruption or other impacts from leaving the European Union, and we consider that we're well prepared to manage an orderly outcome, but the risk posed by a hard or disorderly Brexit is much more difficult to plan for.

We're taking another substantial top-up to the PPI provision today, largely reflecting revised assumptions on complaints volumes out to the time bar. While PPI has disappointed once again, as I said at the beginning of my remarks, it does feel like the endgame is getting easier to call. When we discussed the provision six months ago, I talked about the key assumptions that drove the numbers: complaints volumes; uphold rates; the redress amount; and cost to do. Over the last six months, volumes, uphold rates, and redress were pretty much exactly as we modeled. We said we *expected to see 60,000 complaints; well we saw 63,000.*

So, what's driving the £150 million additional provision top-up is extra volume between now and the time bar and some additional cost to do. Starting with volumes, we'd assumed that we would see complaints run at 10,000 per month on average to the end of the financial year and then step down once the CMC fee cap began to bite. We actually saw complaints tick up in our third quarter, with a weekly average of 2,600 and a peak in the month of May of 12,000, and we saw that as CMCs accelerating before the fee cap in July. Since then, we've seen the weekly average come down, and the October monthly run rate dipped below 8,000 for the first time since 2017.

We've seen this reducing trend despite further advertising bursts from the FCA and the fee cap only having been in place for a short time. However, we've had another go at projecting how complaints run from here, and we think it sensible to allow for higher volumes than we modeled back in April, so we've topped up to create capacity for 83,000 new complaints in the 11 months to time bar, compared to our projection of around 50,000 six months ago, and in effect, this more or less flatlines our latest experience.

We've also seen some unforeseen increases in overhead and indirect costs. There has been a couple of things that contributed to that. We had some quality assurance rework in relation to the PBR and closed-case remediation exercises, and we plan to do that over a longer period of time, utilising spare capacity in our Glasgow site. But the FCA wanted us to deal with these cases quicker, and so we kept one of our third-party sites open for a few months longer than originally budgeted. And in addition, the introduction of GDPR this year has added extra steps and costs to what we have to do to process complaints. So, the £150 million top-up takes the provision level to £275 million as at the end of September. Now, I'm going to do something I've never done before on PPI and go a little way out on a limb. I think this is the last material provision we'll be required to take on PPI, and I know you all want me to be right.

Underlying capital generation of 63 basis points compares with 13 basis points last year, with improved gross generation combined with lower drag from investment and asset growth. However, the key impact on capital and the capital ratio has been legacy conduct costs, which absorbed 182 basis points of CET1 and reduced the CET1 ratio on a standardised basis to 10.5 percent at the end of the year.

As you're aware, shortly after the end of the financial year the group received IRB accreditation from the PRA in respect of its mortgage portfolio and ahead of schedule also for the SME book. IRB accreditation delivered a reduction of over £5 billion in risk-weighted assets and resulted in a CET1 ratio on a pro forma basis at 30 September 2018 of 14 percent. Now, as we've consistently stated, attaining IRB is a critical strategic benefit for the group. It puts us on a level playing field against our peers and eliminates a competitive and capital disadvantage. We're extremely pleased to have delivered on our promises here. And I guess that's a good point for me now to hand back to David to talk about the future.

David Duffy

Thanks, Ian. So, before I speak a little bit about the ambitious future, I suppose I should acknowledge the current environment. It is a tough one. There's a huge amount of political uncertainty as we all know, and the outcome remains hard to call. We talk about "no deal" as being a very bad outcome. I don't think we can say much more illuminating things than that. Clearly, we're seeing it having an impact on the economic performance and outlook for the bank, and that's really a broad macro-UK theme, and at the same time, on a positive note, credit performance has remained benign.

Now having said that, and looking past the doom and gloom to the medium-term opportunities for us, I'm going to move on to slides like this rather than Brexit slides/ I think is going to be the way we go. If we look at the acquisition of Virgin Money, I think what we have is generally a best-of-both leadership team in terms of experience and a proven track record of complex multi-year transformation. We've also added tremendous bench strength from Virgin Money to our business at all levels.

Peter Bole, formerly the Virgin Money CFO, has joined as our group integration director and will lead the group-wide integration program covering every aspect of the bank and will also cover the delivery of the RBS alternative remedies package schemes. Hugh Chater, the commercial director from VM, has also joined our LT in his current capacity and has day-to-day oversight of the VM leadership team alongside myself. Hugh, importantly, will also lead our commercial planning around the combined mortgage business as we move towards full integration.

I'm also, given the circumstances, particularly delighted that Fraser Ingram has taken on the role of COO on an interim basis. Fraser and his team were the executives that built out our digital capability, and I look forward to working with Fraser and our new Virgin colleagues, who also have great expertise, to build on the great achievements of recent years. The combination of the expertise and the cultural similarities of both banks gives me a lot of confidence in our ability to deliver the integration plan over the next few years, and we're already working jointly on quite a number of initiatives, and frankly I think we're making a lot quicker progress than I would have expected at this stage.

So, while we have a lot to do to obtain our combined group license under Part VII, I'm very excited about the future of the combined group and in particular the potential relationship with Virgin Group companies. We have an iconic national consumer champion brand in Virgin Money. It has a high awareness; 99 percent across the UK. When you take that brand, and you combine it with the technology platform and the capability we have built, I think you get a genuinely differentiated proposition in the marketplace. In addition, we'll be now able to offer a full range of products, as we've discussed before, and services to all six million of our customers.

I mean, for a practical example, we can offer a strong current account proposition which didn't exist before with an exciting digital capability to the Virgin customer base and significantly increased product penetration as well as benefit from associated low-cost funding. We can also leverage the Virgin Money network, which doesn't do sales, as you know, to increase our overall sales ambitions on a national basis. Our SME franchise, as Ian has described, is prime to be scaled nationally through *utilising the RBS alternative remedies package schemes and the capability and innovation award at a Pool A level.*

And as I said, I think we're the only realistic challenger if you define that by someone who can break through the critical 5 percent market share threshold to provide a real challenge. I think we're the only credible challenger in that space. I think, when I look at it, the expansion of our SME franchise, both in scale and geographically, is a key part of our strategic development over the next few years, and I think this will bring a lot of diversification and, in particular, funding benefits. And this RBS package - I look at this as really the first step in in our strategy before we develop a national technology-driven strategy for SME for the combined group.

So, when I stand back from what we've developed here with this acquisition, I think we have a unique advantage. We have a national iconic brand that has ubiquitous recognition and does not have importantly for me, a legacy banking connotation. We have sufficient scale and products and services to be competitive, and we'll deliver those to the six million customers as I said, and all of that through a national distribution platform. We have a brilliant digital platform and data-mining capability which will be deployed across our entire retail and customer and SME base.

We have an opportunity, as I said, to develop the whole SME platform nationally, a scaled national competitor with a great digital offering. We'll also be able to offer many of the benefits of the other Virgin Group products when we're developing our proposition model. What does that translate into? It gives us a low-cost customer acquisition capability, and uniquely we'll be able to acquire customers by tying all of this together with a Virgin Group loyalty program which is under development.

This banking-as-a-platform, as it's referred to, model, will all be delivered uniquely through a single brand, an integrated brand, of Virgin, so unlike others who have friends and family that they have to get together, we'll do it through all one brand association. I don't think any other bank can replicate the innovation, the diversity of product, and proposition delivery that we can create through this combination. Effectively, when we stand back, we will deliver a technology-driven, integrated bank with a single brand around open banking, and that's unique.

So when I stand back, we're extremely well positioned to deliver on our ambition to become the first true national competitor to the status quo, and I think that's real and tangible, and we'll demonstrate it in the next year. I'll now hand you back to Ian, who will talk you through our 2019 guidance for the combined group.

Ian Smith

So, I know you're all aware that we only took control of Virgin Money five weeks ago, and being reasonable people, you won't expect us to have had enough time to develop detailed guidance by now. So, we're going to come back to you in 2019 with comprehensive medium-term guidance. However, I'm sure you'll be delighted I'm going to say a little bit now about how we expect the group to perform in 2019.

Before I start on the outlook for the enlarged group, I'll say a few words about Virgin Money's third quarter, which concluded just before we took control on 15th of October. VM had a solid Q3 with asset growth, margin and profits in line with expectations and the guidance given at the half-year. The margin compression that had been well flagged continued, and we see that coming through in the plan for the year ahead.

We're pleased to reaffirm the integration plan, cost synergies, and cost to achieve that we outlined on the 18th of June. Everything we've seen since the 15th of October has increased our confidence in the delivery of our plans.

In addition to the announced synergies, David has spoken about the focus on growth initiatives as we bring the two businesses together. I won't repeat those here, but I'll underline our confidence that this affords us a truly unique opportunity to deliver growth over the medium term in what may be a more challenging operating environment. I want to remind you about the sequencing of the integration process that will determine the pace at which we build out the growth opportunities and realise cost savings from the combination.

A key gating item is the approval of the Part VII transfer. Before Part VII, we need to maintain the separate integrity of the two banks with some regulatory restrictions on our ability to approach things on a combined basis. Our target is to get the Part VII approved towards the end of calendar 2019. And Part VII approval allows us to bring all our customers products and business under a single banking license.

From that point, we'll be able to rebrand and progressively offer our full product range to all our six million customers on a single platform and through a unified branch network. We planned the integration with Part VII in mind, and our guidance on cost synergies reflects this. Our integration effort in 2019 will be focused on planning and preparation, which will be considerable, and on securing cost savings focused on third-party contracts, property efficiencies, and senior management headcount reductions.

The group starts life with a robust capital position. The CET1 ratio is 15.2 percent, more than three and a half percentage points above the fully loaded CRD4 requirement of 11.6 percent, and you can do the maths: that's about a billion pounds and a pretty strong starting point, which I hope you'll agree.

Now, what's not included is the impact of the IFRS3 acquisition accounting adjustments, as that work is ongoing. Now, this is important because it helps us deal with an issue that has been a matter of some interest and comment: the EIR accounting in the Virgin Money credit card book and the capital impact of any adjustments we might be expected to make to the accumulated cards' EIR asset, which stood at circa £190 million at 30th of June this year. IFRS3 requires us to bring the assets and liabilities, all of the assets and liabilities, of Virgin Money onto our balance sheet at fair value.

As part of that process, we'll eliminate the EIR asset completely and reset it to zero, and we recognise the cards portfolio on our balance sheet at its fair value based on the NPV of the contractual cash *flows in the book without the requirement to estimate the benefit of material forward income and include that on the balance sheet today. So, the key thing to understand about the VM card book is that going forward in our hands, the book should not be as sensitive to the risks of EIR accounting in the way that Virgin Money was on a standalone basis.*

We've acquired a more seasoned back book where customer behavior is much better understood, and over time, front book origination will be less reliant on interest-free balance transfer offers, and we can set the income recognition assumptions on a suitably prudent basis.

Now, coming back to IFRS3 and the acquisition accounting, the work is not complete, and we won't have a final answer until early 2019, but we expect that the net outcome of all of the puts and takes on the assets and liabilities, including the cards book, will not have a material impact on the group's capital position.

So, how do we feel about capital? Well, as you know, we expect the group to be capital generative over time, so I guess the key questions will be, where do we expect to operate from a capital perspective, and does that result in excess capital, and if so, what do we intend to do with it? So, the board likes where we are right now from a capital perspective. 2019 looks like an interesting year, both at a macro level and also for our business. We hope to get a sensible resolution on Brexit, but some uncertainty remains, and that's casting a shadow over economic growth prospects in the UK, and CYBG is sensitive to UK macro, as you might expect.

In our own business in 2019, we'll see the unveiling of an updated strategic plan; the commencement of our integration; the outcomes of the Williams & Glyn RBS alternative remedies process; and we'll see the closure of PPI. And that's really just to name a handful of key strategic developments in the months ahead. Facing into that from a position of capital strength seems to be the right thing to do.

Importantly, the PRA wants us to undertake an ICAAP assessment for the enlarged group, which we'll do in the first half of next year. We don't expect that to throw up new risks for which we will need to hold capital, but it is a key determinant of our capital requirements, so, unfortunately, we're not going to try to answer those three questions definitively today. That will be determined over the coming 12 months. Regarding the capital operating level, we'll target holding a sensible buffer over the regulatory minimum, and I wouldn't expect us to be out of line with our larger peers. The answer to the other questions will be much clearer towards the end of this financial year.

And finally, a signal of the board's confidence in the strength of the business and its prospects, notwithstanding the macro uncertainty, is the decision to propose an increased dividend this year of 3.1 pence per share and to reaffirm our commitment to progressive increases in payout over time. You will recall that we paid an inaugural dividend of 1p per share last year, and so that's a fairly material increase year on year.

Before I guide specifically on NIM, I need to do a bit of recalibration with you. The new group NIM is quite different from what you're used to seeing. We've shown on the slide here the two heritage NIMs on a standalone and comparable basis, and so let me be clear about the basis of the Virgin

Money margin figures. Firstly, they've been converted to a September year-end, and most importantly, they show the real NIM rather than the banking NIM convention that was used. You can see the difference between the two heritage business models come through quite clearly.

Both businesses have been exposed to NIM compression over the past 12 months, largely due to the mortgage market dynamics of competitive pricing and reducing SVR balances. The compression has been less severe in the CYBG heritage, where NIM has been more resilient given our lower cost funding base, our slightly richer mix in mortgages, and critically, the benefit of SME. Going forward, we'll focus on the combined NIM, and in FY19, we're guiding to a range of between 160 and 170 basis points.

Margin compression in the mortgage portfolio is expected to continue, and along with some upward pressure on savings rates, that will drive the reduction in the net interest margin. This is offset by growth in current account funding, helped by the RBS remedy package, which I'll talk about in a moment, and a positive contribution from non-mortgage lending yields. Now, the reason we're expressing guidance as a range this year is because we've owned the business for five weeks, and in addition to the overall economic uncertainty, there are a number of upside opportunities and downside risks that may impact our ability to land NIM on the head of a pin.

These risks and opportunities mirror what we're already seeing in our plans. We've baked in some competition impacts, but we can't rule out further pressure. On the other side though, we may see stronger results from Williams & Glyn switching than we have in the plan, and we will find opportunities for managing the combined balance sheet that are not yet baked into the guidance. Initially, we've put together two heritage plans that have been devised separately, and we're confident that integrating the balance sheet management of the enlarged group will yield income opportunities.

Of course, the big unknown is what happens to interest rates, which no doubt will depend on the political outcome. So, an important point to make is we're facing the current period of political and economic uncertainty with higher levels of liquidity than we might hold in different circumstances, and that in turn dilutes the margin. Now, we think that's the right thing to do for now, and if we get a little more stability in due course, then we'll look at that again.

Before I move off NIM, there's a very specific point I need to address, which is MREL. There is a wide range of estimates out there as to how much MREL we'll need to raise and its impact on the margin. Now, we've got a slide in the appendix that talks to this in a bit more detail, but here are the headlines. Today, we already hold more MREL than our 2020 interim requirement. The end-state MREL requirement will be set by reference to our Pillar 2A buffer in 2021, and that's likely to be lower than it is today.

We're planning on senior unsecured issuance of around £2 billion to £2.8 billion over the next three years at a rate of one or two trades per year, and this issuance is factored into our funding and margin plans at prudent spread levels and doesn't present any concerns.

Turning now to one of our strongest core competencies: costs. Now, we expect to make good *progress in managing down costs in 2019. We'll see the full-year benefit of the final Project Sustain initiatives coming through, and we'll begin posting the initial synergy benefits from the Virgin Money transaction. So as ever, that demands that we set a target for the year.*

Now, in trying to establish a starting point for the group's cost base, I guess there are three components to consider. The £635 million we've reported today, the Virgin Money core cost base, and the last publicly available consensus estimate of that for 2018 was circa £350 million, and then also the cost of running the Virgin Money digital bank, which was expected to launch in 2019, and running costs were estimated at circa £35 million incremental. The VMDB project is being shut down, and so that is no longer a factor. From the start point, I've outlined that, having avoided incremental cost relating to VMDB, and focused on integration, we expect to deliver a combined cost base of less than £950 million in 2019.

So, after a bit of a wait and a number of false dawns, the process for delivering the RBS alternative remedies package is about to begin. Now it's worth recapping what the European Commission and UK Treasury are seeking to do here. It's all about competition, finding a way to move meaningful market share away from the incumbents, and create additional investment capacity for banks such as CYBG to strengthen their competitive threat in SME banking, and all applications will be looked at through that competition lens. And that's why it's necessary to focus on both material elements of the remedies package: incentivised switching and capability.

I think all too often people focus on the free money part, the capability grants. Incentivised switching delivers on the competition objective because it is designed to cause at least 120,000 SME customers to leave RBS and go to another provider amongst a limited field. We expect to be a major winner in the incentivised switching scheme, which kicks off pretty soon, and you can see the key dates on the slide. We've invested heavily to ensure we're ready to seamlessly onboard a substantial proportion of the 120,000 customers that are expected to move.

We've built a dedicated switching factory in Leeds and recruited close to 50 new relationship managers, many directly from Williams & Glyn. We have both a compelling proposition and the capability to give these longstanding customers of RBS exactly what they need. And as we said before, we think of incentivised switching as a really important source of low-cost funding at scale. The pool of customers from which the switchers will be drawn contains around £11 billion of deposits.

Now, this is a number you weren't familiar with, but RBS have allowed us to talk about, and RBS have been fantastic throughout this process in helping us get ready for the switching process. We therefore expect this part of the package to yield a couple of billion of low-cost liabilities for CYBG over the two years the scheme is expected to operate. Of course, what's hard to predict is the pace and scale of customer acquisition, given it's all driven by customer choice.

Now Part Two of the package is the capability and innovation fund. As David said, we're a Pool A applicant, eligible for the largest grants, and the key dates in the application timetable, again, are shown on the slide. Coming back to competition, the authority's key objective -we think it's pretty *clear that we're best placed to invest the capability money for the most beneficial impact on competition in SME banking. The Competition and Markets Authority are clear that a 5 percent market share is the minimum requirement to disrupt incumbents and therefore to have that meaningful beneficial impact on competition.*

Santander and the big four banks are already well above that level, and then there's us. At 3 1/2 percent market share of business current accounts today, with the other potential applicants a long way behind, we are the only bank that can credibly break through the CMA's 5 percent threshold and deliver the necessary impact on competition, and we're ready to go on this, too. We've worked through in some detail how we expect to invest the money and the growth that it will help deliver, and our application is ready to submit. However, there is the small matter of convincing the judges, and so we haven't yet baked this element into our financial plans for 2019.

So, there's a lot going on for CYBG in 2019, and so you'd expect a busy schedule for substantive market updates. In the first half, we'll get some clarity, we hope, on Brexit; we'll learn the outcome of the RBS alternative remedies process; we'll build out our integration planning, including the Part VII and the rebranding; we'll do an ICAAP; and we'll complete our strategic planning for the enlarged group. And that will enable us to deliver a Capital Markets Day in June 2019 to share the medium-term performance targets for our business, and thereafter, things should settle down into a more regular reporting cycle, and we can all have weekends off again. Currently, we've no plans to move from a September year-end.

So, taking a step back, here's how I'd summarise how we feel about the road ahead. There are lots of positive things to work on as we bring these businesses together, but they're going to take patient, focused execution, and that's something that we've been quite good at in the last three years. We're very focused on what's in our control, and we have prepared as best we can for what's not, and quite frankly, we're really looking forward to getting stuck in. So, having provided a detailed update today and the promise of lots more to come, I'll end there and hand over to Q&A.

David Duffy

Okay, thanks, Ian. We're going to handle questions in the room, and then we're going to go to the people who are on the phone. So, starting with the room first, I think we have some mics here.

Q&A

Aman Rakkar: *Good morning. It's Aman Rakkar from Barclays. First question, on net interest margin. Sorry. You alluded to the guidance that you've given for next year. Can I just ask how many base rate hikes, if any, you have in your capital plans? Sorry, in your guidance. And on that theme as well, could you give us any colour about what benefit the combined group had from the most recent base rate hike?*

Can you talk about what kind of deposit beta you pass through and any kind of numbers you can kind of give us on the benefit you enjoyed there?

And then the second question was about the mortgage market. I'm just interested in, clearly, a key source of margin pressure for the combined group going forward, and both CYBG and Virgin Money have basically lowered their market share of gross lending this year. Kind of interested in whether you see that materially recovering from here?

You know, just the kind of back of the envelope calculation I've done, I think you were somewhere probably about 5 1/2 percent market share last year of gross lending. I think that's probably come down 1 percent, something like that, this year. Do you see that materially recovering from here? And I guess what I'm trying to unpick is basically what kind of growth rate can we expect from that business going forward?

Ian Smith: *Sure. So, we have no base rate hikes in our plan for FY19. I think the first one we see next happens sometime in the following financial year. In terms of deposit beta, we're pretty much in line with the other banks, and I think they've broadly talked about, passing on about 60 percent of the last rate increase to depositors. We wouldn't be out of line with the rest of the industry there.*

In terms of mortgage share and therefore how that translates into growth, you're right, and that reduction, I guess, through 2018 largely came from the Virgin Money side. They grew very strongly through 2017 and then, in 2018, took a bit of a step back, so that's where, CYBG broadly maintained its share of flow and a gradual tick up in stock by the end of the year. So, as I say, it came from the Virgin Money side.

Our view on where we expect to go from here, I think we're going to stay is as flexible as we can. In what is quite a difficult market we've demonstrated our ability to take share; I would expect that unless pricing was absolutely crazy - and it still makes sense from a return on equity basis - we would continue to grow ahead of market.

The key question is what's the market going to grow at? And I think that's what we've all got to guess. So what I'm saying is that Virgin Money have taken a bit of a step back from their previous strong growth in mortgages. We've held our own, and I think we'll continue to take market share in 2019. I just don't know what that is yet.

David Duffy: *Okay, I think we have one over here at the front.*

Robert Sage: *Yes, it's Robert Sage from Macquarie. Just one quick question. Looking at the expected margin decline next year to 1.6% to 1.7%, down from 1.78%. If you were to look in terms of the primary driver, is it correct to assume that it's largely mortgage market pressure on the asset spread side that would be causing your view that this will fall? To what extent might it be also be attributable to other factors? I think you referenced the sort of upward pressure on the deposit spreads, but is it largely mortgages that we should be looking at there?*

Ian Smith: *Certainly, on the VM side, and- I'm looking forward to getting to a point where I don't talk about heritages, but it's early days. So, certainly, the bulk of the net interest margin compression* *from the VM heritage comes from the mortgage market. Our own is much more balanced. We've got a broader business that allows some puts and takes that help us to manage the overall net position. But, yes, a lot of that pressure comes from mortgages.*

The other opportunity we have coming into this is really to start working on the liability mix. Virgin Money, without a current account base and without SME, has focused heavily on the savings market. We have the opportunity over time to drive a more balanced position. And the other thing is liquidity. Liquidity is an important part of this. We talk about liquidity drag in our business, and the group is in a strong liquidity position at the moment, which I think you'd expect given market conditions.

Now, just, again, to reinforce our guidance today is base case. I can't emphasise enough that, having been in charge of our new business of Virgin Money for five weeks, our ability to influence that is something that we'll work through overtime.

David Duffy: Any more questions from the room? We have one up front here, and we'll come back in a second.

Shailesh Raikundlia (Panmure Gordon): Good morning, guys. Just to follow up on NIM again. Just in terms of your assumptions on the EIR on the credit card book, is your NIM guidance particularly for Virgin Money on its own predicated on the fact that there is going to be quite a lot of compression on the credit card margins as well. because of the way you're going to account for it going forward? So, has that had a bit of an impact, or is it mainly still the margin side of things?

And secondly, on the SVR book, have you any idea at what rate the SVR book contracts further from here - it's obviously gone down from 11 percent to 9 percent, so that will obviously have another impact on NIM as well going forward.

Ian Smith: Sure. So, the group net interest margin is not particularly sensitive to EIR assumptions. You know, what we're talking about is over a much bigger income base in the enlarged group, so, not a huge impact there, and I think that gives us the opportunity to be a bit more prudent on EIR. And then, sorry, the second part of your question?

Shailesh Raikundlia: On the SVR.

Ian Smith: Yeah. So, it's hard to call because it's so much driven by customer and competitive behavior. Our base case is probably for that to settle around about where it is now, but, who knows? And I think you have to go back into history to see that, certainly in our case, something sort of sub-10 percent was a steady state.

David Duffy: Okay, we have one over here.

Guillaume Desqueyroux: Good morning. Guillaume Desqueyroux from Tideway Investments, two questions, if I may. The first one is on the comment you made on the broker services adjustment that you had to go through in Q3 that you were expecting a slowdown in the volume, but actually *it was quite a positive. So, if you can comment a little bit further on that.*

And the second question is on the IRB applications that you have in front of you.

So, you said the next one is the unsecured lending activity for CYBG, so it should happen within the next 12 months, I guess, something like that? But the next one after the Part VII, you said the end of FY19. So, is it a three-year program for you to have an aggregated IRB application for the overall group and to have a meaningful impact on your RWA in 2022? Is it the way we have to think about your RWA reduction going forward? Thank you.

Ian Smith: *The first part of the question? Sorry, it was a long one.*

Guillaume Desqueyroux: *You made a comment on the broker arrangements. Thank you.*

Ian Smith: *We talked about at the half-year that we had brought our broker mortgage processing on shore from India, and we'd experienced some operational problems in bringing that on board, which meant that our applications through the broker channel were much reduced. So, we worked hard to fix those problems and to partner with our brokers to solve those, and we flagged at the time that we thought we would see a difficult third quarter and return to growth in the fourth quarter.*

We actually expected our mortgage balances to go backwards in Q3. They were, I think, £13 million up, so that was better than expected, and then we're back to normal in the fourth quarter. So, we really put that behind us. It was a frustrating episode, but we've put that behind us.

Unsecured IRB and the relationship between that and integration. So, unsecured IRB; we now have to factor in our book the general expectation is that we would see, an increase of a few hundred million in respect of risk-weighted assets, but nothing more than that.

We also have the unsecured book in Virgin Money, which is also where we have an IRB application in process; that's on standardised, and we expect to see a beneficial impact on RWAs from that application. We're going to bring those two together, because, you know making sure that we've got a coordinated and cohesive approach to the PRA on those, and I suspect that the process of putting a foot on the ball means that we're probably later in the year in terms of submission of the application. I'm hoping that we're not going to see a big impact on net RWAs as a result, and it's not dependent on Part VII.

For the IRB modeling process, we've got 19 mortgage models, and those really look at particular segments of the portfolio. An easy example is a buy-to-let or current account mortgage or something of that nature. So, they're much more segment-specific than entity-related. I don't know how many mortgage models Virgin Money have but I would expect that we can bring some of those together where they make sense, and that's not dependent on a regulatory process in any way. But I think we'll continue to operate a range of mortgage models that manage the different parts of our book. So, Part VII and integration is not a barrier to getting on with the IRB process.

David Duffy: We have one here in the middle, and then we'll come back to you afterwards. Thank you.

David Wong: Good morning. It's David Wong from Credit Suisse. I had two questions. The first is just a quick follow-up to your comment about the degree of control you've got over the Virgin Money business. So, should we expect that, basically for the large part of 2019 before all these Part VII transfers get effected, that Virgin Money still remains slightly on its own as part of the combined group, and you don't have full control – you haven't got as tight a control over the business as you would expect to have post-integration?

The second question I just had was on the mortgage distribution. I guess you'll probably still primarily rely on brokers, third-party brokers, to distribute mortgages, but if I wonder if you would hope to do more direct distribution over time rather than relying on that third-party channel? Many thanks.

David Duffy: Great. Maybe I'll pick up on the control issue. Just to be clear, the Part VII requires you to run two separate entities for a period of time, but there will be levels of integration that we will negotiate along the path with the regulator. But in terms of specific control, I am the CEO of both legal entities, with full regulatory responsibility; the same for Ian as the CFO, and our CRO is now becoming the same. What that means is that you should think of it as having full control. So, we have full control of two separate entities that we're running in parallel, if that makes sense Although that sounds a bit like an oxymoron.

And then at the group board level, we run a Virgin Money board and a group board, but we bring it together, and so our chairman and myself and the rest of the board members manage the entity as one. So, that's the way to think of it: one group entity being managed; two run separately but with full control at the key executive level.

Ian Smith: Yes and David, the only impediment that gives us into Part VII is. Well, I'll give you a couple of live examples. A Virgin Money customer can't walk into a Yorkshire Bank branch and transact business until we get to Part VII and we get onto a common platform. It's the customer side that we can't integrate. We can do all of the functions, and as David says, we have absolute control over the business.

For mortgage distribution, at the moment, CYBG is about 80 percent broker, 20 percent branch; Virgin Money is close to 100 percent broker. Both heritage businesses were developing a direct proposition through digital channels, and we're now able to combine our efforts on that. I think that's key to a better customer experience and also to reducing cost to serve.

David Duffy: And just a subtlety to add there. When you think of the Virgin Money network, it wasn't a sales network. So, they gathered deposits, but didn't have a sales capability. So, across all the products suite, we will deploy a full product capability through the full national network.

Charmsol Yoon: Yeah, thank you. Charmsol Yoon from UBS. Do you have any expectation in terms of market share how much you target to take from the alternative remedies packages, the *switching ranging from 120K to 200K customers?*

And secondly, can I quickly follow-up on the NIM side? Do you understand what's driving the rapid decrease in Virgin Money's NIM in FY19? Is it front to back book? Thank you.

Ian Smith: *Good morning, Charmsol. Our expectation of share of 120,000 customers, I wanted to avoid us getting dragged into a league table discussion, so I haven't put a number up there, but you can expect us to take a significant proportion of the overall total. You think about how many meaningful banks are in that process: ourselves, Santander, and a couple of others. So, that should give you a bit of an indicator.*

The Virgin Money NIM. There's a lot of sort of that snowball effect of business written in 2017 in a very competitive part of the mortgage market then feeding through into FY18's and FY19's margin. So, it's that sort of snowball effect of back book. I think that some of taking the foot off the gas on front book in 2018 from VM will help a little bit in terms of stemming the decline, they did not grow as strongly in that competitive space, but it's back book-related.

David Duffy: *We have one just to the left here.*

Guy Stebbings: *Good morning. Thank you. Guy Stebbings from Exane BNP Paribas First question was just on how you think about the relative preference on growth between mortgages, unsecured, and SME as we stand here today with a very competitive mortgage market but given the economic uncertainty how that might play through to unsecured and SME. So, how would you rate growth between those three segments, if you like?*

And the second question, if I can push you on "material", because you used the term "not material" for two very important items: the capsule impact from IFRS3 and any further PPI top-up. People's views on what "not material" might be could be vastly different, so any color you can give whatsoever around that. Are we talking 100 basis points, nothing more than that, or anything else? That would be very helpful. Thank you.

Ian Smith: *The relative preference on growth is a really good question. So, without giving you precise numbers, because I'm going to fight shy of that, our emphasis - and again, this is all on a base case which says that people stop messing around and we get a sensible answer on Brexit, is that we would see much stronger growth or much more of a focus on growth in SME and unsecured and much less emphasis on growth in the mortgage market. Both SME and unsecured are better for the margin mix.*

And you know, if I think about both of those businesses from a heritage CYBG perspective. Though, clearly, heritage CYBG for SME, because Virgin Money didn't have it. We've made fantastic strides in SME from a place where, back in 2014, the business was mothballed. It's reinvigorated; it's got new people. We are taking market share from the likes of Lloyds and Barclays and others. The biggest competitor we see in SME in the regions is actually HSBC so we are taking share off the incumbents, and it's at good margins and good pricing.

Unsecured, you know us well, Guy. We've not been particularly relevant in that market because of a lack of capability primarily. We saw some decent growth in personal loans in 2018, and I think unsecured, through, our PL (personal loan) business and things like the salary finance joint venture and others, will just help underpin that, and again, earn much better margins in that space.

On the VM side, we talked about a bit of a step back from the mortgage market, and you'll continue to see growth in the cards business there. It's a really good business. We've got to make sure we get the income assumptions right, but they're still stronger than you're seeing in mortgages. So, hopefully, that gives you a bit of a sense of where we're placing our chips, but it is predicated on a sensible Brexit outcome.

Material. The way we think of material is it doesn't cause us to break our stride; it's just how we think about the business. We're strongly capitalised. PPI has been a very painful episode for this business and primarily our former shareholders, but currently, our shareholders today. It's something where we'll maybe have to deal with some last bits and pieces on closing out, but we don't see it causing an interruption in what we want to do, and similarly on IFRS3.

David Duffy: *We have one over here.*

David Lock: *Hi, it's David Lock from Deutsche. I just have a follow-up on PPI. Can you clarify a little bit? Because, of course, the deadline is in August, and you quote all the numbers about weekly customer complaints, but if I make a complaint, or I make a claim on the last week, presumably it's going to take a few months for me to actually get paid out? And if you have a sudden rush of people in the last week, how long will actually the cost take to come out of the business? So, can you just give a bit of clarity as to that provision? What exactly is that? Is that to the August deadline, or is it to a little bit beyond that? Thank you.*

Ian Smith: *So, the way we think about the provision, David, is until we're done. We have a regulatory obligation to deal with claims in 56 days, so it's a two-month process and unless there is a deluge, and I don't think any of us is expecting a deluge of complaints at the last minute, I mean, how many people are out there that need to find out about PPI in the world? So, unless we have a deluge we're well able to cope with those volumes within the 56 days. So, when we sit down in 12 months time, we would expect to be able to show that most people that we have on the pitch dealing with PPI are now doing other things.*

David Duffy: *Maybe it might be time to go to the phones, and we'll come back to the room if there's any at the end. So, Andrew, do we have calls coming in?*

Operator: *We have a question from Ed Henning of CLSA. Ed, please go ahead.*

Ed Henning: *Hi, guys, a couple of questions from me. Firstly, can you just confirm in your NIM guidance that the potential change in EIR is actually in the guidance?*

Ian Smith: Given that we stated a range, Ed, you can expect that any changes in income recognition on the cards book, we can absorb within that.

Ed Henning: Okay, that's great. And just a second one. David, you talked about building out and needing to invest in the business and technology. Firstly, why is it taking so long to get the SME customers across the iB platform? And how quickly can you roll out if you've built all of the tech around SME and also the current accounts around B to roll it out with the Virgin brand name on it?

David Duffy: Yes, Ed, it's really a question of prudence. So, we've moved across two million customers, and if you look at all the issues in the UK and sensitivities around that, we decided to do retail first and SME second. We've built out that capability and with 200,000 customers. We don't see that as a major complexity. We will have all of that done during the coming year; if you think about it, we can't really do integrated offerings with Virgin Money until the following year, until Part VII is done, so it allows us to complete our exercise, fully embed it, and then be ready to switch into offering this product to Virgin Money customers in the following year.

Equally, we were very cognisant of the fact that the timing was fluid on Williams & Glyn, and so the switching begins in 2019 before our Part VII is done, so we're having to move with another brand first. So, we have a major conversion, which we'll be completing during the year on our own SMEs but at a manageable population. We will then have a large switching incoming activity on SMEs, and then we'll be deploying significant new technologies further than those built today with the funding, if we get the right level of funding from the Category A. And then, as we agree the Part VII we'll be able to deploy that rapidly into the Virgin Money territory. So, it's a combination of a series of activities but underlying prudence, Ed.

Ed Henning: Yes, so that you basically for a Virgin Money-branded SME product release it's not until after the Part VII? And is that the same for current accounts?

David Duffy: That's the same. You know, basically what Part VII does is protects against customer detriment, and what you have to do is convince the regulators that you have done enough to protect the customer, and the processes that you've engaged in will guarantee that. So, what we have is Peter Bole, who is our integration director, is looking across the entire spectrum of activity in the bank, whether it's technology, or it's just communications with the customers - every aspect of that, and then the rebranding process being done in the right way and that the plans for that are robust and coherent for the regulator and that we have proved that we're not going to do a customer harm.

That takes usually 12 months, Ed. What we're hoping is that along the way we can make progress. So, think of it as a pyramid, we can start slicing things out of that pyramid and executing them ahead of that as long as we can demonstrate they are not directly impacting the customer. So, it's trying to get operational execution momentum, and then anything for the customer waits till post-Part VII, Ed.

Ed Henning: Okay, thank you.

Operator: Our next question today comes from John Cronin of Goodbody. John, please go ahead.

John Cronin: Hi, guys. Thanks for taking my questions. The first question I have is just to understand better your guidance on IFRS3 impact. I appreciate that that's preliminary and the work is ongoing and how that dovetails with the NIM guidance in Virgin Money's case. I note your comment to the effect that the denomination and margin on the credit card for Virgin isn't a major driver of the NIM dilution, but am just trying to understand better.

If you effectively eliminate the EIR asset at acquisition, then, does your NIM implicitly continue to assume significant margin deterioration in the credit card book for Virgin even though that's not the primary driver of overall group NIM compression, or indeed Virgin Money compression? So, I appreciate there's a lot going on there within that, but any more colour you could give to marry up the two on credit cards specifically would be helpful?

And then, just secondly, on the CET1 guidance, in terms of where you would like to be from a target ratio perspective, I note your comment around in line with the larger peers. You know, specifically, what should we be thinking in that respect? Is that 12% or is it 13% or potentially even higher, given the currently elevated P2A? Thank you.

Ian Smith: Okay, so IFRS3 and NIM - unfortunately, John, I'm not going to be particularly helpful. We're not done on IFRS3, so there will be a bunch of those fair value adjustments that do feed through into the net interest income line. We haven't yet included those in guidance, and we'll talk about them when we come back in the first quarter. I'm not particularly concerned about it.

And again, I think I'll just steer you away from worrying too much about EIR and its impact on margin. You know, we get a back book that is probably earning better today than the assumptions that were made early on in terms of cash, and therefore, the bridge to EIR is much shorter. So, you're going to have to be patient with that. We'll come back on the impact of all of those adjustments early next year.

On CET1 guidance, it's one thing to say where we expect to target; i.e., be above X percent. And as I say, I can only point towards some of our larger peers and obviously make any adjustments for the fact that we're not a SIB in terms of requirements. But we're going to come back on our Capital Markets Day and give much more clarity around capital and the capital trajectory. At the moment, we're going to sit on a big pile of capital, and we'll tell you what we're going to do with it in six months.

John Cronin: Thank you.

Operator: Our next question today comes from Victor German of Macquarie. Victor, please go ahead.

Victor German: Yes, good morning. I apologise in advance; you've had a lot of questions on margins, and I'm not going to break the trend here. I look at your CYBG guidance for margins, and I note that you issued MREL debt in September, which is obviously going to cost some additional money in

FY19 yet you're guiding to broadly flattish margins. In fact, it looks like margins are actually fairly stable in the brand, yet Virgin Money contraction is 17 basis points, which is higher than the previous year.

And the base impact (given the base is different) is effectively a 12 percentage points decline. I'm just hoping you can provide a little bit more colour in terms of why we're seeing that margin decline. And maybe some comments around the potential MREL impact, the potential TFS and any additional colour you can give us on the trajectory as we exit 2019? Where can that margin actually go?

Ian Smith: *Okay. So, Victor, I'm not going to tell anybody about where we expect to go after 2019. We're very clear that after owning the business for five weeks and given all the stuff that's going on in the outside world, you know, 2019 is as far as we're prepared to go today. Now all roads lead to Capital Markets Day. We'll have a much clearer perspective when we get to June. So, I know that's going to frustrate you.*

In terms of the CYBG heritage, we raised MREL at the back end of FY2018, but we are very confident about raising cost-effective funding throughout the year, so I wouldn't focus on a particular element of the funding mix in CYBG. We've proved ourselves pretty good at managing the different pressures in margin up until now, and I wouldn't expect that to change. TFS refinancing for the combined group - we'll probably aim to refinance about £1 billion of TFS in 2019, and we'll refinance that from a combination of deposit and wholesale funding, all factored into our plans.

The Virgin Money business and the impact on margin there. First of all, what I'd say is we knew that Virgin Money was facing into margin compression. We factored that into our planning when we were constructing the deal, so it's no surprise to us. Their business model is very different to the CYBG heritage. They competed in a much lower margin space in the market and competed fairly strongly there and grew their book strongly as a result, and therefore that has baked in some of the spread compression that we're seeing. The Virgin Money funding model is also different to CYBG and a bit more dependent on refinancing savings year after year and being pretty price-sensitive in that regard.

We're very confident that as we get to grips with the combined business, that we'll be able to drive through a broader liability mix, much more similar to what we have today over time, but it's going to take time. So, I see this as an FY19 challenge for the heritage Virgin Money business that we'll be able to work on through the year. I talked about what we might do on liquidity; I think some of the balance sheet management opportunities we have before us will deliver stronger income. I'm pretty optimistic that, as we put these businesses together, we will drive to a much stronger position. But at the moment, you know, what we're seeing in 2019 is as a result of how Virgin Money has built its business over the last couple of years; something that we were well aware of when planning the acquisition.

Victor German: *Okay, thank you.*

Operator: *Our next question today comes from Fahed Kunwar of Redburn. Fahed, please go ahead.*

Fahed Kunwar: Hi. Good morning, guys. Thanks for taking questions. I just have one question, really. It's following on from the comments you made there, which were, I thought, very important. Have you made any assumptions at all on any shift of the funding mix of Virgin towards the Clydesdale funding mix within that 2019 guidance? And following on from that, should we think of 2019 really as a transitory year in terms of what the margins look like thereafter? I'm not asking for guidance post-2019, just an idea of is this guidance really not the steady state of the combined entity but more a factor of the way the Part VII is working?

I ask the question, obviously, because the shares are down pretty significantly today, and I imagine most of it is to do with what is the cost of your growth. So, it'd be very useful if we could get some colour on if, in the FY19 guidance, are there are any revenue synergies or any kind of benefit from being a combined entity within that margin guidance. Or is this more going to be a 2020 story in terms of the strategic benefits coming through on revenue and particularly funding for Virgin Money? Thanks.

Ian Smith: So, Fahed, I think you're spot-on. Because we have to wait for Part VII to really bring the two customer businesses together and to start driving the revenue benefits from the combination, what you're seeing in 2019 is really how the two heritage businesses perform, and as I say, we reap what we saw in terms of the 2018 business feeds into the 2019 margin. So, that's what you're seeing come through. We think of 2019 very much as a transitional year.

We'll have the opportunity on the income side to get into optimising the balance sheet, and I keep saying that. One of the things we've been pretty good at in CYBG is making sure that we're very tight on managing our average interest earning assets and picking and choosing our spots to compete. We would expect to do the same across the enlarged group, and we're confident that'll have some benefit that's to come through.

The key focus of the integration effort for 2019 is on costs and some of the functions. The real opportunity revenue-wise and growth-wise we'll start to see come through after that. So, I think you're spot-on there.

Fahed Kunwar: Can I ask one quick follow-up question on CYBG? I think current accounts is a really key part of this whole merger. But in 2019, for CYBG, how much did (I think you talk about it briefly in the RNS), but how much did B contribute to the current account growth, and how much of the current account growth is from Clydesdale time deposits going into current accounts, as we've seen across the market? And the reason I ask the question is just to get a sense of how powerful a proposition B is when you do eventually pull it into the Virgin Money customers. Thanks.

Ian Smith: Yes. So, the bulk of our personal current account growth The current account growth includes business as well, but the bulk of our current account - personal current account growth came from B, and B has always been a mixture of retention of customer balances as well as delivering growth and what we have said consistently, and we'll repeat today, is that the majority of the deposit growth is new to bank. So, an important engine for growth that offsets some of the attrition we *might see in some of our older current account proposition products.*

Fahed Kunwar: Thank you very much.

David Duffy: I think we have more on the line.

Operator: We have a question from Chris Cant of Autonomous Research. Chris, please go ahead.

Chris Cant: Good morning. Thanks for taking my questions. I was going to have to come back to your NIM slide, I'm afraid, and I know you've taken a few questions on this, but it's obviously of significant interest to all of us. Could you could confirm what your exit NIM for Clydesdale standalone was for 4Q 2018? I think that was below the 215 you guide for 2019. And on the 125 bps NIM expectation for Virgin in 2019, can I be clear, is that post-expected EIR changes or not?

You've given us the specific NIM for Virgin within the group. I appreciate your comments about at a combined entity level, EIR change as not being a material driver. But is the 125 bps you're guiding us for Virgin 2019 inclusive or exclusive of any changes to EIR, please? And it would also be great if you could give an exit NIM there, although I can understand if you're reticent to do so.

And finally, you are flagging liquidity pressures on NIM. Some others have been flagging this with 3Q results; I guess this is a largely optical, or a denominator-driven impact on your NIM. Just to allow us to contextualise that, could you give us a sense of what the combined group NII was for the period covered on Slide 23 please, so we can get a better sense of how much liquidity drag there might be for the combined business? Thanks.

Ian Smith: Okay, thanks, Chris. So, the exit NIM for CYBG in, well, the fourth quarter NIM was 212 basis points. That was diluted by wholesale issuance and other non-customer related business in the fourth quarter. We'd planned for that, and it's not representative of the running yield, so that's why there's that apparent inconsistency, but, we were very comfortable with guidance versus exit NIM, because it was diluted by certain specific factors.

The Virgin Money guidance for 2019 does factor in some of the changes that Virgin Money have put through during 2018 and would have anticipated putting through in terms of adjustments to EIR. So taking some of the heat out of that. It doesn't reflect any further action that we might take, and I'm not saying anything about that today. It's a very important commercial decision; we're not going to rush our fences on that in terms of just how we think about it.

So, what I would say is be comfortable that Virgin Money, under its own steam, was trying to take some of the heat out of that, and therefore that is helpful and included in the 2019 guidance. But you know, it doesn't include anything we might do, but I'm pretty confident that we've got plenty of capacity at a group level to make necessary changes and stay within our guidance range. I'm not giving VM figures today, so I'm afraid I can't give you an exit NIM, and I can't also give you the combined NII. We're going to have to wait for that. One of the things we will do in early 2019 is provide some fairly detailed pro forma comparatives so they can be factored into people's *expectations. But we're not talking about VM numbers today.*

Chris Cant: *If I could just follow up on the comment you made in response to the first part of that question on the exit NIM, you were indicating that you don't consider that representative of the running NIM. Was there some kind of one-off adjustment in the quarter that impacted your NII, or is it to do with this liquidity drag that you're assuming goes away next year? Why is it exactly that you don't consider your 4Q NIM representative?*

Because I think for most peers, people tend to look at the exit NIM as a steer for the next year. Obviously, you're talking about a subdued or competitive environment in terms of mortgages in particular. So it does look like you're assuming an improvement there. Was it a specific one-off that you can call out, or why is it that you think that that wasn't representative?

Ian Smith: *This is the weakness in net interest margin, okay? In some respects, it's useful; in some respects, it's not. It can be heavily influenced by the denominator, so if you increase your denominator by raising money in wholesale markets, and then you go walk over the road and put it on deposit at the Bank of England, you get inflation in your average interest-earning assets, you don't grow your net interest income. So, that's really a big driver of that. I actually can't remember as I sit here what our third quarter net was, but it was higher than 217.*

I would resist focusing on a particular quarter's performance other than, as you quite rightly say, Chris, it is a bit of a steer, and you know, we're steering that we would expect to see our margin come down a bit over the next year or so. But it isn't representative of what we see as a whole year's performance. The CYBG net interest margin in the third quarter of FY18 was, a few basis points above the 217 reported for the year. So, it's puts and takes.

Chris Cant: *Okay, great. Thank you.*

David Duffy: *We've got one last one, I think, on the call, Andrew.*

Operator: *We do. We have a final question from Azib Khan of Morgan Financial. Please go ahead, Azib.*

Azib Khan: *Thank you very much. I've got two questions on PPI. Ian, you mentioned earlier that the second half 18 was in line with your 31 March provisioning assumptions but when I take a look at the data, about two thirds of that 31 March provision was utilised in the second half, which is a pretty high utilisation rate. So, can you please reconcile that higher utilisation rate with your statement? And the second question is, can you just clarify whether the 83,000 future walk-ins that you're assuming - are they the total number of walk-ins that you're assuming, or are they just the walk-ins where you expect claims to be upheld?*

Ian Smith: *Okay. So, utilisation rate was higher because we were managing a higher rate of claims across three different sites. We've now shut two of those sites and are processing claims entirely through our Glasgow operation, and we're also processing fewer claims. So, you know, it's really* *about the downward trajectory. I would focus on the 275 we have in the provision and how does that translate. We've actually allowed for a little higher cost per claim than we have up until now.*

The 83,000 is the number of people that walk through the door, and we have an uphold rate on those claims that has come down month after month in the last 12 to 15 months, indicating that the quality of claims walking through the door has been much lower, including people that don't bank with us or have never had PPI.

David Duffy: *Okay, I think we'll move to a question in the room now. And so, just up the back here.*

Jason Napier: *Good morning. Jason Napier, UBS. Two questions and I'm afraid the first one is on NIM once again. The product slide on 12 was particularly useful, giving us the yields on the CYBG books. Of course, they're annual numbers, and they've changed. And although I'm not a huge fan of quarterly anything, I just wonder whether you can give us an indication of front to back book apps just on mortgages for your business. So, the MLAR data suggests that the business done in the last quarter was at about 2.2 percent; the yield here is about 2.7. Presumably, your gap is narrower, and perhaps you could talk about whether there are any mix reasons why your portfolio might yield more than the market average that's on mortgages?*

And then, secondly, turning to Brexit. The decision that you've taken to run a liquid balance sheet in a well-capitalised bank into Brexit obviously makes perfect sense. I wonder whether you could talk to whether you're seeing any behavioral change or actions of that kind of nature amongst SME clients. Are they asking for bigger undrawn facilities to cushion themselves? Is there delayed capex? Anything you can say about the real economy would be helpful. Thank you.

David Duffy: *Sure, I'll pick up the real economy*

Ian Smith: *Sure.*

David Duffy: *The reality is, I think, interesting with the SMEs. If they see a hard Brexit, all bets are off just in terms of being able to invest and have clarity. It just puts a whole smorgasbord of uncertainty in the road of progress. So, they're all agitating very strongly for whatever we have today (it doesn't matter; it's infinitely better than no deal). So, they're starting with that premise, they're not expecting no deal.*

So, what they're doing right now is waiting for a decision, but that waiting is significant in terms of inertia. So, less in the credit or need to draw down cash flow territory, and more in the capital investment profile and I'm not just saying that statistically. We do a lot of engagement around the entire geography, and when you're talking to people, they're not really hiring, and they're not spending, but they're fine with running their day-to-day business across the location or locations they're in. So, that's why it's translating into a more benign credit outcome; it's because it's really about the investment or the hiring.

So, that's what's happening there, and I think what you're seeing around the consumer is no particular *stress as yet, but you're seeing again a consequent slowdown in spending and willingness to take on any more debt, given the fears that have been created. So, it's that inertia activity across all sectors that we look at that is driving most of this. The housing sector is the same. The number of houses available and retention is the big strategy right now, which I think is well flagged. So, again it is the same principle.*

So, I think what will be very interesting is when you pick out all the uncertainty and get some outcome, and when that outcome is there, and it's not a hard Brexit, I think there could be a relief rally and a little bit of a resettling of the economy. Certainly, some people are predicting strong shifts in sterling after that, all pointed towards general factors of more positivity, because we're into a really negative dip just now. So, Ian?

Ian Smith: *Sure. Yes, Jason, I'm not going to give any numbers here, but you're right to observe that our own portfolio is a slightly richer mix than the market average. I would say that Virgin Money tracks much more the market average or is probably slightly more diluted, and that what you see is the difference in the heritage business models coming through in margin planning. You know, our richer mix comes from certain factors that are probably going to be diluted over the next couple of years such as our buy-to-let premium, for example.*

When we focused on buy-to-let business particularly in 2014 or 15, that was at a significant premium to residential, and we've seen that mix gradually feed through. I think that's kind of baked in now. We've been very focused on the first-time buyer space, and again, for reasons of standardised capital weightings and others, we prefer the margin in that space. It's good business, but it's at a higher margin than others.

David Duffy: *We have just one more question here, and then we'll wrap up after this, and we can mingle a bit if you need. But everyone wants to get out I see too.*

David Wong: *Sorry, it's David from Credit Suisse again. Just a quick follow-up question on costs. If the income environment were less supportive than you thought, how prepared would you be to grip the cost base tighter for this year? That's my question. And is their pressure to reinvest any gross savings that you extract into either protecting the franchise or to counter things like wage inflation, which I guess in the UK is probably running around 2 1/2, 3 percent now. So, I'm just curious on how you're thinking about the flexibility to manage costs for 2019. Many thanks.*

Ian Smith: *Thanks, David. So, I think there's plenty to go for in the cost base. As ever, the art to this is making sure that you approach it at the right pace and in the right sequence. So, there are some things we just can't do until Part VII and until a bit later on, but we're definitely looking at opportunities to accelerate savings, and I think it's a good, helpful hedge against income weakness. So I think there are opportunities there, but we don't want to throw the baby out with the bathwater.*

David Duffy: *Okay, I think we're going to wrap it up there, but thank you to everybody on the phone for participating and in the room, and we'll end it there. Thank you very much.*