Virgin Money

Full Year Results 2014

Thursday, 5th March 2015

Jayne-Anne Gadhia, Chief Executive

Thanks for coming. John did say to me yesterday that I ought to introduce the chairs, which as some of you will know, are from our Virgin money lounges that have been very successful for us for 2014, so we tend to take them with us everywhere. So we enjoy that anyway.

Thanks again for coming. When we came to speak with analysts and investors ahead of our listing we emphasised the fact that over many years we've always hit our targets. And of course when we did that we only had six weeks of the year left from listing to the year end, so I guess it was easier for us than usual to guide investors to our expected year-end out turn. But nevertheless that out turn was significantly ahead of our initial plans for 2014, and I'm really pleased to say that today we're reporting results which are ahead of plan in all key areas.

Now as a result we've delivered an underlying return on tangible equity for 2014 of 7.4%. And to be clear, that's having taken full account of FSCS and our AT1 coupon, and of course it is also taking into account the capital increase that we received in November of £150m as a result of listing. So this result, the 7.4% RoTE, stands us we think in very good stead to achieve our stated goal of mid-teens return on equity by the end of 2016.

So I'm now going to look at how we achieved these results and how things are progressing and then I'll hand over to Lee to talk about the finances in a bit more detail.

Now in 2014 we grew our mortgage book by 11.8%, and that was from £19.6bn to £21.9bn. That represents 10.2% share of net lending in a market which grew by 1.4%. That means that we took a market share of gross lending of 3.15% in the second half of 2014. Actually that made us the second largest net lender in the second half of the year, and that was despite not ramping up our activity until the middle of the year after we'd received our new ICG guidance from the PRA. And in fact our net lending share in Q4 2014 was over 20%. As a result of that we left the year with a well-stocked mortgage pipeline, and in January now that Bank of England data is out we can officially say that we took a 3.9% market share of completions. And so far this year we've received mortgage applications that are ahead of our initial estimates. So good performance in the mortgage growth.

In terms of our retail funding performance we grew total deposits by 5.9% to be precise last year, so in line with market, and that was to £22.4bn to support our lending. And at the same time we were able to carefully manage our cost of funds and we achieved very strong customer retention.

Our cards book also exceeded our expectations. We did second and final closing of the MBNA deal in November, and that saw us acquiring £359m of new balances in addition to that already acquired at first closing. So that took our year-end card balance to £1.1bn, that's 41% growth year-on-year to be clear, and that's somewhat ahead of our expectations, as a result of the acquisition but also as a result of retention and new customer acquisition slightly ahead of plan.

As expected our non-interest income remained largely flat; it was just over 16% of total income for the year. And we expect that income to grow, especially now that we've signed contracts, which we announced at the end of last year, with Friends Life, Ageas and Monitise to launch new life insurance, general insurance and digital initiatives respectively.

Now I'm pleased to report that we've been able to exceed our growth targets and at the same time maintain our conservative approach to risk. We continue to think that we've got one of the best quality mortgage books of any lender, and as a team we make it a continuing objective to keep it there. We executed a very successful cards debt sale in October, and the proceeds from this, as Lee will talk about in a bit more detail, are offset against our cost of risk. But excluding the impact of the debt sale our cost of risk anyway fell by 27% year-on-year and including the debt sale that reduction was 53%.

Putting that into perspective the cost of impairment charges on our mortgage book was only £1.2m in 2014, that compared with £2.1m the year before. I think that was really to do with our very diligent underwriting approach, but also the characteristics of the book that that drives, for example, our portfolio LTV is only 55.7%.

Now I'm also really pleased with the performance of the cards book where impairments fell to 2.43% excluding the impact of that debt sale. And actually that was materially lower than we expected when we did the original deal and acquired the book from MBNA in 2013.

Now on the quality front of course our business scorecard also includes quality measures, and I'm really pleased to say that all of these ended the year ahead of target. So just to give you a brief example of that: our net promoter score increased to +16 during the year, and that makes us a market leader in terms of financial services. The capital position remained really strong, the leverage ratio as you'll have seen at 4.1%. And our fully loaded CET1 ratio finished the year at 19%.

Now I'm really pleased too with our liquidity position. We've achieved real optimisation during the year, but without compromising our protection. And as a result we ended 2014 with a loan to deposit ratio of 102.8%.

And since listing I've been delighted to welcome Richard Hemsley as Chief Banking Officer, and Darrell Evans to lead our Current Account, Insurance and Investment business. They both bring deep experience to fully round out the executive team for the next stage of our growth, and for those of you here in London they'll both be available to chat after this presentation, as we all will.

Moving on to returns. Of course as a result of this strong performance our returns have exceeded plan. Statutory profit before tax of £34m has been really strong, and that's having taken into account the cost of listing, the additional consideration we paid to the government for the final acquisition tariff if you like for Northern Rock, share based payments to staff that crystallised on listing, and the continuing build of our credit card business.

Now our underlying profit before tax really does show the strength of our franchise I think, and at £121.2m for the year represents a whole 127% growth from 2013. Obviously we achieved that in a number of ways, in particular through careful management of our margin levers. And as a result of that we recorded an average NIM for the year of 150 basis points, which was again ahead of plan. We achieved this through a focus on mortgage spread, the development of our cards business and the successful repricing of our Retail deposit book, and Lee will discuss each of these components in more depth when he speaks.

Cost income ratio showed significant improvement too, despite the impact of higher bonuses being paid as a result of the material outperformance in the year. And we continue to demonstrate really strong operating leverage.

So taking together this improvement in our financial performance, increased our underlying return on tangible equity by 5.1%, and that's from 2.3% at the end of 2013 to 7.4% at the end of 2014, after the receipt of £150m of new capital, as I said earlier. And on a like-for-like basis if we hadn't raised the capital in November these results would have generated a RoTE of 8.1%.

So turning just lightly to the individual business lines: As I say, we took 3.15% share of the mortgage market in the second half of 2014. Momentum has really continued into 2015, and in the first two months of this year we've received £1.7bn worth of mortgage applications across all channels. As I said earlier, completions in January represented 3.9% of market share according to Bank of England data, and it looks like this performance level has continued into February, although of course the official figures haven't been published yet.

We've undoubtedly benefited from really strong relationships with intermediary partners, and those relationships have been built over very many years. Intermediaries have become much more important we think to mortgage customers and providers alike since the introduction of MMR, and our key competence in this channel underlines our confidence in continued growth.

Guaranteed service levels are really important to intermediaries, and a considerable part of our success has been driven by our improving service offering. That service received the coveted 5-star award for Service to Intermediaries at the end of 2014. And of course that's an award that is voted for by intermediaries themselves.

Of course pricing has also been key to driving volume, and during 2014 mortgage spreads on new business averaged above 200 basis points. And despite increasing market competition, which we do feel, we expect to maintain spread at around this level for 2015, and we'll manage that within our agreed risk appetite but adjusting our business mix.

Our Retail deposit business has also performed very strongly in fact exceptionally well. We grew total deposits by 5.9% during the year, in line with market growth and entirely in line with our own funding plans. And those plans we feel we successfully optimised during the year to reduce the high levels of liquidity that you may remember we carried in to 2014.

Throughout the year we reduced our cost of funds in various ways. Our front book variable rate deposit pricing has fallen from about 140 basis points down to 120 basis points. This makes us an effective and fair competitor but of course compared to the market it also gives us continuing opportunities for further cost reduction.

Equally pleasing for us is the success of the second deposit reprice of the year which we executed in November. That means that we gave our customers notice of it in November, the full financial impact actually comes through in 2015. We applied a 22 basis point reduction to the price of around £10bn worth of back book customers, and we've experienced customer retention that's currently estimated to be over 95%. The full net interest margin benefit of this repricing will be recorded in 2015, as I say. And we also optimise the cost of our wholesale funding, which Lee will talk about a bit later.

So I turn to credit cards now. I'm also pleased to report excellent progress with the build of our own credit card business. The real focus of 2014 was building our own credit card manufacturing capability in partnership with TSYS who, as you know, are the leading credit card systems provider globally. The business was launched initially to staff in November 2014 and was delivered, of course, on time and on budget. On 26th February this year we opened the business to all customers directly through our website.

The final step is to migrate the accounts currently processed on MBNA's systems to our own platform, and we confidently expect to have completed this project by the time we next see you. Moving on to our own systems it will give us a really significant cost benefit over our service agreement with MBNA, and it does provide us with a platform really prime for growth.

So as a result we see the financial results achieved in 2014 from cards as really only the beginning of what we can achieve now that we're fully in control of our own business. Don't forget to enable us to execute a successful systems migration we closed the new cards business in October 2014, and of course that inevitably reduced the income received from new sales. Nevertheless, with a retention profile that ran somewhat better than planned in 2014, we ended the year with cards' balances of about £1.1bn following the successful transfer of the second tranche of balances from the MBNA deal which, as I said earlier, brought a further £359m of cards onto our balance sheet.

During the year cards' NIM grew from 9.14% to 9.6%. And as with our mortgage assets we focus really hard on the credit quality of our cards, and we were rewarded during the year with a cost of risk of only 2.43%, excluding the card debt sale that I mentioned earlier.

So the message is that we’ve not yet started to realise in full the potential of our cards business, and with our own capability now live we continue to expect to grow cards balances to £3bn of outstandings by the end of 2018, which is fully in-line with our initial plans.

During 2014 we started selling our Essential Current Account in Scotland and Northern Ireland, and since the beginning of the year we have been offering this product in England and Wales. As a fee free basic bank account, this product gives us strategic options around current accounts, but we've limited volume to around 10,000 a year in order to manage costs. The product has performed really well, it's been well received in the market, and it's exceeded our expectations in terms of customer demand and average balances. And of course our cautious entry into the current account market means that we're not weighed down by the fixed operating costs that support a traditional current account book, nor are we challenged by structural hedges which may have become costly to some providers in the current interest rate environment.

During the year we began the development of a new digital account that will sit alongside the Essential Current Account, and I'll tell you more about that when we get together again later in the year. Together, the traditional and digital capability we have, gives us flexibility to take advantage of the findings of the CMA following their review into the current account market, which, as you know, is due to report in 2016.

We've also invested in our insurance capability, and contracts have been signed with both Friends Life and Ageas to offer life insurance and general insurance respectively. Our new life products went live only last week, and we expect home and motor products to be on sale during the second half of this year. These products will add to our very successful travel insurance capability which delivered almost 400,000 sales during 2014.

Now it's hard for me personally to believe this, but it's 20 years tomorrow since we launched Virgin in financial services offering investments direct to customers, and 19 years since we launched our first pension product. In both businesses over that number of years we've experienced very strong customer retention. And we've further developed our investment and pension capability recently by launching three new funds with State Street. These will add to our very successful equity products, which in total grew balances to over £3bn by the end of 2014. So together these product lines, along with card fees, contributed 16% of our total income for the year.

So 2014 has been a very successful year where we've grown our mortgage and savings business strongly, built our cards capability, and developed value adding partnerships across quite a wide range of products. Commercially we're in a stronger position than ever to grow in multiple areas. As a reminder, since IPO we've publicly launched new cards on our own manufacturing platform, rolled out our current account capability throughout the UK, concluded new deals with Friends Life, Ageas and Monitise, and continued to grow our mortgage business strongly.

Now of course we're mindful of a number of headwinds, and in particular the flat base rate environment and the competitive dynamic that continues to put pressure on mortgage spreads. So I'm pleased to say that whilst never complacent, we believe we're well protected against these challenges for two key reasons. Firstly, our variable rate retail deposit book remains on average about 40 basis points ahead of market averages. If we need to re-price we've demonstrated our capability and our readiness to do so. Secondly, our operational leverage means that we can hold our costs whilst growing our business. We're not changing our guidance on a 50% cost income ratio by 2015, but what I really mean is that our confidence in achieving that remains very strong.

So as a result, I'm pleased to say that we don't rely on an increase in base rates to meet this year's financial targets. In fact, we are assuming there are no base rate increases this year. We will maintain disciplined cost management and we remain confident of meeting our target net interest margin for the year, because we've got room to manage deposit pricing to offset mortgage pricing if it becomes necessary to do that.

2015 started very strongly for Virgin Money, building on the successful foundations of last year so now I'm going to ask Lee to share more of that financial detail with you.

Lee Rochford, Chief Financial Officer

Thank you Jayne-Anne, and good morning everyone. In the next few minutes I will set out Virgin Money's strong performance in 2014 that Jayne-Anne has touched on, and that's continued to build on our track record of delivering high growth without compromising quality to drive substantially higher and sustainable returns to shareholders.

We've delivered a very strong set of results in 2014 with key business indicators ahead of consensus. Relative to 2013, we've delivered strong net interest income growth of 27%. This has been driven by a 24 basis point uplift in net interest margin, and delivery of a share of mortgage market net lending of 10.2%. We've continued to demonstrate operational leverage with our cost income ratio falling from 77.2% in 2013 to 68.7% in 2014.

The benefit of a high quality asset portfolio that reflects our prudent risk appetite is clearly demonstrated in our impairment performance. We've recorded an impairment charge of just £15.8m on a book of over £23bn. It is important to note that this impairment charge for 2014 is reduced by the £8.9m that Jayne-Anne mentioned, which is the impact of the sale of those charged off card balances. Taken together, these factors have led to a significant improvement in our underlying profit before tax, which has increased by 127% year-on-year, from £53.4m to £121.2m. As a result, we've achieved an increase in our RoTE from 2.3% to 7.4%, and I'm happy to confirm that we remain on track to achieve a mid-teens RoTE by the end of 2016.

So turning now to net interest margin. We delivered strong growth in NIM during 2014 adding 24 basis points, moving from 126 basis points in 2013 to 150 basis points for the full year. This NIM enhancement was driven by the performance in both our mortgage and card businesses together with balance sheet optimisation, and all underpinned by successful cost of funds management. Delivering new mortgage lending spreads at above 200 basis points, coupled with successful management of our funding costs, took mortgage NIM from 115 basis points to 142 basis points. This increased group NIM by 22 basis points.

Our 10.2% share of net mortgage lending increased the proportion of mortgages on our balance sheet. This shift in mix towards mortgages, while we successfully completed the cards platform build, only cost 1 basis point of group NIM. Strong customer retention on the mature cards book, coupled with that same successful cost-to-funds management, took card NIM from 9.14% in 2013 to 9.6% in 2014. This contributed to group NIM by 2 basis points.

We had set out during the IPO process that we fully expected a reduce in cards balance until Q4 2014, and as you've heard, in November 2014 we successfully acquired £359m of Virgin Money account balances that had been written to MBNA's balance sheet. This expected reduction in our average card balances reduced group NIM in 2014 by 3 basis points. However, the successful completion of our card platform means we're now able to grow the card portfolio from here. This makes that 3 basis point cost a one-off impact. During the year we've optimised our treasury and liquidity positions further, which has both added 4 basis points to group NIM and at the same time supported a very strong liquidity position.

Now I look at the year ahead. As Jayne-Anne has said, we've already taken action to re-price retail deposits further, and it's important to note that after this re-pricing our rates remain top quartile, which continues to offer us flexibility in future. Our cards platform has been successfully built, tested and launched to the public, that will mean a benefit to NIM from cards mix into the future; though, as we have set out in our previous guidance, we see that benefit offset somewhat in the short-term at least as we invest to build the book. And there continue to be opportunities to optimise the composition and the cost of our funding further, and manage our overall balance sheet shape. All of these factors together lead me to reaffirm our guidance of a progression towards our target NIM of around 170 basis points, and delivery of that NIM growth, as you've heard, in 2015 is not reliant on base rate rises.

So looking now at other operating income. As expected income is flat year-on-year at £72m, with significant potential for growth. This is predominantly made up of fee income from our credit card book and our Current Account, Insurance and Investment business. Credit card fee income reduced £3.1m to £25.2m as the end of our agreement with MBNA means that we now write the cards to our own balance sheet. As a result of that we received commission payments from MBNA for only 10 months of the year, and the level of that commission per card reduced somewhat during the year. But the ability to sell new cards on our own platform, including the NII benefits of the balance transfer fees, and the enhanced profitability from having the additional acquired assets on our balance sheet, will more than offset the loss of that commission income. Looking forward, we expect credit card fee income to decline slightly in the short-term until the new business matures and starts to generate increased transactional fees.

Within our Current Account, Insurance and Investments business, income from funds under management increased slightly during the year to £29m as we continue to derive the benefit from a very stable book. That increase was offset by lower insurance income while we reposition our offerings in this area, and as Jayne-Anne has said, we've already launched new products and will continue to launch new products later in the year. This will feed through into our income as the year's progress. I expect the growth in other income in this business to be in-line with the growth in our NII.

Moving on now to look at costs. We continued our strong focus on operational leverage and cost control throughout 2014. This meant that we achieved a reduction in cost income ratio, from 77.2% to 68.7%. Our operating leverage is particularly evident in the Mortgage and Savings business. The costs have increased by £7.8m or 9.8%, compared to income growth of 39.4%. Despite the necessary development of our Cards team, the growth in costs in the cards segment has been constrained to £2.2m, only 5.7% up on the previous year. And as we replace our MBNA servicing agreement with our in-house model, supported by TSYS, we have additional cost benefits that will come through later this year and beyond.

In terms of central costs, they've increased by £12.6m or 8.5%. This increase remains consistent with our IPO guidance. £3.1m was driven by increased depreciation as our run rate catches up with our capital investment spend, and £8.3m came through higher bonuses as a result of the material outperformance in the year. We continue to expect future cost increases to be on a marginal cost basis primarily in our operating segments, and as a result of all of the above we remain on track to deliver our target cost income ratio of 50% by 2017 as we continue to drive operational leverage and invest in our business.

So turning now to our asset quality. When we bought Northern Rock we bought one of the highest quality books in the UK, and we do not intend to compromise on that position. As we set out during the IPO, we are committed to maintaining our strong asset quality in all of our business lines. The total impairment charge for 2014 was £24.7m. Gross of the cards debt sale, this amounts to an 11 basis point cost of risk. Only £1.2m of this charge came from our mortgage portfolio.

Cards impairment did benefit from that debt sale but that included balances from 2013 and 2014 and that reduced our overall cost of risk for the entire business to 7 basis points. Actually such debt sales may form a part of our business as usual as required in the future.

Excluding the benefit though of that debt sale the cost of risk on the cards portfolio is only 2.4% compared to 2.9% last year.

So looking forward we continue to expect the cost of risk to trend upwards towards the guidance we gave previously of around 15 – 20 basis points per annum and that reflects the mix of our growing Cards business as we go forward.

So if I turn now to the balance sheet elements of asset quality, during the year we held mortgage arrears at low levels, with loans over three months in arrears of 31 basis points compared to the latest industry average of 133 basis points.

Similarly in credit cards balances two or more payments in arrears were 146 basis points compared with the latest industry average of 264 basis points.

The credit metrics for our mortgage book at the year-end 2014 demonstrate that our asset quality remains very high. Its improving HPI increases our equity coverage and that reduces our impaired loans. The weighted average LTV on our mortgage book has reduced from 59.8% to 55.7% in 2014. The distribution of our LTV bandings is clear evidence of the quality of our sales and underwriting processes with more than 80% of the book at less than 70%

LTV and less than 1% above 90%. The average LTV of loans in arrears of one month or more is less than 60%, that's against 66.5% in 2013.

So all of that together has contributed to a reduction in total gross impaired loans from £138.3m to £103.9m.

And with respect to our impaired balance coverage ratio our position continues to be strong, increasing by four percentage points year-on-year. From a capital perspective including our excess expected loss we have above 50% coverage on our impaired loans which we believe is very prudent given the underlying credit quality of our book.

So if I move on now to the performance by business unit: Our Mortgage and Savings business has increased its underlying contribution by £76.3m or 59% year-on-year. We've achieved this contribution by managing the asset yield in competitive markets and through improved cost of funds management, while at the same time controlling costs to optimise operational leverage.

Turning to Cards: In a year when our focus was on building the new credit card capabilities and with constraints on our new card origination underlying contribution still improved by 4% to £44.9m. This is a very strong result particularly in the context of the expected reduction in average balances that took income lower and given that the benefits of the new platform are yet to come.

In respect of Current Account, Insurance and Investments the majority of our underlying contribution comes from our funds under management and income from these products was 4% higher in 2014 at £29m. As expected underlying contribution in this segment was flat year-on-year and as we've both emphasised we see strong potential in the business going forward. The other income you can see in central functions was primarily driven by the result of asset sales by Treasury.

So the strong performance across all units has contributed to the results we're reporting today and importantly we believe we have strong momentum going into 2015.

So moving on now to statutory profit: to reconcile our underlying performance to statutory PBT we must take into account that we incurred a number of one-off costs in the year, the largest element of which was related to the IPO.

Even after accounting for these items, and the related non-deductible costs from a tax perspective, we posted a statutory profit before tax for the year of £34m. The completion of the IPO in November triggered a payment to the Treasury which had been agreed when we acquired Northern Rock. An amount of £50m was crystallised and paid and £36m of this amount was recognised during the year, the balance having been charged in prior years.

Additionally we incurred £23.9m of IPO-related costs during the year. That included £12.6m of execution costs, fees and expenses, £10.7m of share-based payments to staff and £0.6m of one-off payments to project staff on listing.

Other exceptional items included £4.5m of premium on the repurchase of our NCT1 notes; £9m of investment in our credit card and digital platforms; a £3.5m net gain on sale following the disposal of Church House Trust; and £0.9m of fair value adjustments.

Consistent with prior treatment we continue to show the cost of the FSCS Levy below underlying profit before tax but we do include it in our RoTE calculation as Jayne-Anne has mentioned.

Our £25.3m tax charge for the year was inflated due to the majority of the IPO cost being non-deductible as well as a prior year tax adjustment. However, we would expect the tax charge going forward to normalise around the prevailing corporate tax rate.

So now to the balance sheet: As we've discussed we've grown total loans and advances very strongly at 14%, primarily driven by mortgage lending but at the same time carefully optimising our deposit growth at almost 6%.

Treasury assets have reduced reflecting further optimisation while supporting a very strong liquidity position.

The growth in customer deposits represents a 1.49% share of total market inflows as well as a strong share of ISA business at 7.6%.

Our debt securities have increased over the year as we launched the latest of our successful securitisations from our Gosforth platform issuing £1bn into the market in September 2014. And our risk-weighted assets ended the year broadly flat whilst our balance sheet increased by 8%; I'll come on to this in a minute, but the outturn was achieved through the changes to our IRB modelling approved by the PRA at the end of the first half of 2014.

The loan to deposit ratios increased to 102.8%, this reflects initiatives implemented to improve the efficiency of the balance sheet, increasing the loan to deposit ratio towards our target range of 100% - 110%.

And all of this is underpinned by the strength of our funding, liquidity and capital positions which I'll come on to now.

So I'll start with the detail of our funding and liquidity profile, I've already talked about the strength of the retail funding franchise and the key objectives for developing our wholesale funding franchise, a broader diversification of funding, supporting our balance sheet tenor and enhancing refinancing capacity for growth.

Importantly we have negligible short-term wholesale funding and we have significant capacity to broaden our entire wholesale funding franchise. We have established our RMBS programme with a strong reputation and in September we priced our transaction at a 45 basis point growth. In addition the £160m AT1 transaction that we carried out earlier in the year was also multiple times oversubscribed.

Those successful deals demonstrate there is significant demand for Virgin Money paper in the market.

We have taken the opportunity to draw further on up the FLS scheme during 2014, we drew £1.1bn to take the closing position to £2.26bn. This diversifies our funding base, supports balance sheet tenor and enhances our liquidity efficiency. The cost of refinancing FLS in the future is fully built into our NIM and our RoTE guidance.

So turning to liquidity, on liquidity we maintain a conservative approach to the composition of our liquid asset portfolio; we hold 85% of the portfolio in either the Bank of England reserve or in UK Government Bonds. And at the end of the year more than 98% of the portfolio was rated AA+ or better.

So now if we look at the drivers of the movement in our risk-weighted assets, our RWA is reduced slightly from £5.21bn in 2013 to £5.16bn at the end of last year. That's a 0.9% reduction in RWAs against a 14% growth in loans and advances to customers and an 8% growth in total assets.

Lending growth and loan would have increased RWAs by a total of £681m but that was more than offset by model changes. The primary driver of our overall flat RWA position was the PRA approval for an enhancement to our mortgage IRB modelling. That reduced RWAs by over £1bn. However our IRB modelling remains very prudent. Our models were constructed using data from the entire Northern Rock book which in general terms had significantly worse asset quality than the good book that we purchased. This means that our models overestimate the probability of default and the risk weight. Also as we explained at the IPO we use a through-the-cycle methodology to calculate our mortgage risk weights, not a point-in-time method that is used by many of our peers. Our methodology is more conservative and there is less volatility of outcome particularly under stress. As a result our RWAs are £205m higher than our arrears behaviour would suggest is strictly required.

Lastly there was an increase in RWAs for operational risk since these are calculated based on a three year rolling average of total income and that's growing strongly. So that's added a further £104.5m to our operational RWAs.

So finally I would like to give some context with respect to our capital position. As I said earlier we start 2015 with strong capital ratios and that reflects the high quality of our capital stack which was enhanced through the successful IPO.

We're fully compliant with CRD IV as currently implemented and we believe we're well positioned for the calibration of additional buffers which may be added to leverage ratio requirements.

Our strong capital ratios and our low risk business model position us well to deliver on our growth plans while remaining above the capital minima we've committed to, namely a 12% CET1 ratio, a 15% total capital ratio and a leverage ratio above 3.75% plus management buffers.

From the chart you can clearly see the benefit from capital raised at the IPO which added 2.9% to the CET1 ratio. The capital impact of IPO costs, the additional consideration for Northern Rock paid to the Treasury, and the increase in lending during the year combined to reduce our CET1 ratio by 3.1%.

And the impact on RWAs from the increase in operational risk is offset by a positive impact from other items.

The combined effect of the IRB model changes agreed with the PRA and the capital build from the strong retained earnings is an increase in the CET1 ratio of 3.7%.

So overall CET1 grew from 15.5% in 2013 to a robust 19% in 2014. And importantly the headroom between our current capital and our target capital levels demonstrates our very significant capacity to support growth.

So in summary building our track record of growth without compromising on quality to drive substantially higher returns to our shareholders has made good progress in 2014, and we start 2015 well positioned to continue the journey towards a mid-teens RoTE by the end of next year.

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

Jayne-Anne Gadhia

Thank you Lee. So where does all of that leave us in terms of our expectations for 2015? Well I hope that between us we've been able to demonstrate to you that we exceeded our initial targets for 2014 and delivered on the promises that we made for the year at the time that we listed in November.

It remains our intention and expectation to deliver on those same promises as we look ahead and so I'm pleased to reaffirm the guidance that we gave at the time of IPO in all material respects. Whilst stretching we believe that these targets are still achievable.

Firstly we continue to expect to take between 3% and 3.5% market share of mortgages each year. This year has started well in this respect and we continue to be confident of growing our funding capability to support asset growth and to manage our overall net interest margin.

The successful launch of our Cards capability and our historic acquisition and retention experience gives us confidence of delivering on our plans of building our cards' balances to at least £3 billion by the end of 2018.

As a result of our focus on mortgage spreads, options to reduce retail deposit pricing further, the growth of our credit card product and action to optimise funding and liquidity, we continue to target a net interest margin of around 170 basis points by the end of 2017.

Our cost flexibility remains a daily focus and opportunity and we continue to expect to deliver a cost income ratio of around 50% by the end of 2017. And putting all of this together, we continue to expect to deliver a mid-teens underlying return on tangible equity by the end of 2016.

We have all of our commercial building blocks in place now to support further growth. Our conservative risk appetite, unburdened by legacy issues and strong culture enable us to focus on future opportunities rather than past mistakes, and so we can deliver, we believe, a high quality result. And our structural cost advantages enable us to stand up to macro and market challenges with some confidence.

And I should point out that this outlook is all based on organic growth. We will look at potential acquisition opportunities to the extent that they don't compromise the quality of our franchise or materially exceed our risk profile, of course. So, to be clear, we do not need to make an acquisition to meet our stated targets.

In the immediate future, and following yesterday's announcement, we look forward to joining the FTSE 250 share index later this month.

And that I think concludes our review of 2014 and we look forward to answering any questions that you have. Thank you very much for listening.

Mike's going to pass the microphone around.

Q&A session

Question 1

Michael Helsby, Bank of America Merrill Lynch

I've got two questions, if I can, and thanks for the presentation, by the way, it was very clear.

There's a lot of focus, clearly, on mortgage competition and you're not blind to that, obviously, but you have ended the year very strongly from a margin point of view, so I was wondering if you could tell us what your exit Q4 NIM was in 2014. And then linked to that, clearly, you've already done with the repricing on the deposit book, a step towards that margin, so if you could quantify what that deposit improvement is already?

And then secondly, if you could just give us a little bit more colour on the Cards' business, because clearly you've already launched that, so should we expect to be seeing Richard on the telly with his credit card? What type of plans have you got for that initial ramp-up? So that would be good, thank you.

Jayne-Anne Gadhia

Thanks Mike. On the net interest margin point, as you rightly say, strong growth in NIM and we actually exited 2014 at 155 basis points. And the reason that we'd rather talk about averages than the exit rate, of course, is what we don't want is for you all to feel that that means that we're going to accelerate beyond our NIM guidance, which remains absolutely that we'd expect to get to around 170 basis points in two years' time. For us, the strong exit to 2014 gives us, if you like, some protection against a flat base rate environment in 2015, and we are expecting, in our plans, there to be no base rate increase in 2015, but nonetheless, to meet our net interest margin target. So I don't know if you want to add to that before I go back to credit cards?

Lee Rochford

I think that's right. I think we've been very clear about the rate of that progression as well, that we'd expect it to be around 10 basis points per annum, so I wouldn't get ahead of myself in expecting more than that. I think that the deposit reprice should underline some confidence that we can get to that level during the year.

Jayne-Anne Gadhia

I think actually, Mike, you asked specifically what's the impact of the deposit repricing?

Jayne-Anne Gadhia

So the 22 basis points on £10 billion starts coming through from February, I think, into the numbers, so you haven't seen it in the numbers that we've given you so far.

As far as the credit cards marketing position is concerned, as you can imagine, the build of our own credit card business and then the migration of data to the acquired business, and all its data too, that business has been a huge project for us so we're really thrilled with where we've got to, having launched to the public last week. We've done that in quite a low key way so far for Virgin. If you come to our website then you can now buy a credit card, but we haven't started marketing actively yet, and we'll get the migration plans done and get that behind us and then start really actively marketing for new business. And you can expect us to be investing in a marketing campaign, and I'm sorry to say to Richard, I don't think he will feature directly in it, but it will be a high profile campaign in the months ahead!

Question 2

Rohith Chandra-Rajan, Barclays

Good morning. I'd just like to follow up on the margin question, actually. You mentioned the 200 basis points spread on the mortgage book and you expect to maintain that in the face of what looks like some quite aggressive pricing down in the market overall. You mentioned a change in mix, so I'm curious to understand a little bit more about that, please, in terms of exactly how you're managing the mortgage book.

And then on volumes, you've highlighted a very strong start to the year in mortgages, and I'm just wondering if you can comment on the deposit growth in the year to date? Thank you.

Jayne-Anne Gadhia

So as far as deposit growth year-to-date is concerned, one of the really interesting features I think that many of you looked at in 2014 was that at the beginning of 2014 we were far ahead in terms of our retail deposit volume, if you recall, and as came to market we deliberately flattened that off. Interestingly, you'll see that deposit growth now has grown to meet asset growth in all respects and we are almost bang on our required and planned targets in order to fund the asset growth that we're currently seeing, so we absolutely see real strength in terms of our deposit franchise and it continues to come through.

As far as the mortgage mix is concerned, and perhaps, Anth, I'll ask you to speak in a little bit more detail, but the key area that we've really looked at, Rohith, in the last few months has been the balance between retail mortgages and buy-to-let mortgages. When we look at our buy-to-let portfolio, the buy-to-let business produces a very strong RARoRAC – Risk Adjusted Return on Risk Adjusted Capital – and as a consequence, we have accelerated the writing of buy-to-let business perhaps slightly ahead of Retail, but nonetheless, within our portfolio risk limits, and so that's enabled us at the highest level to manage the margin. Many of you know Anth Mooney who runs our mortgage business. Did you want to just add to that? Just step this way Anth and add to that.

Anth Mooney, Director of Financial Services

Good morning everyone. I wouldn't add a great deal, I think we've started to grow out our buy-to-let business. I its good quality business, low LTV business. Our risk appetite is around about 18% to 19% of our book on buy-to-let, we wouldn't expect at any point over our planning horizon to move beyond that risk appetite level, so we're doing it sensibly and cautiously and writing good quality business. But it does allow us to protect that overall mortgage spread without really feeling like we're moving up the risk curve.

Jayne-Anne Gadhia

And just to reinforce the point, I think I'm right in saying that the maximum LTV on our buy-to-let business is 75%?

Anth Mooney

Correct.

Question 3

Mike Trippitt, Numis

Can I just ask on the credit card about competition and margins, certainly looking at the Barclays' numbers it's quite a decline in quarterly NIM within Barclaycard and a lot of competition around and, clearly, you're creating some competition with balance transfer business. So is there any change there in your outlook on margins, or given, I guess, you look at this on a risk-adjusted basis, is the fact that if credit qualities are good you're prepared to take a little bit more margin pain in order to grow the business. So some thoughts around that please?

Jayne-Anne Gadhia

Yes, in a sense, I think you may have answered, from my perspective, your own question to a certain extent, which is that the quality of the credit card business and the risk-adjusted margin is very strong and that would always be actually our first focus. Obviously, we would never write a piece of business that doesn't have a positive net present value and we make sure that that's the case in pricing our credit card business. And in terms of the EIR modelling that we do on the credit card business, obviously we take account of the products that we're looking for going forward, as well as the ones we've got on the book. Lee, is there anything you want to add to that?

Lee Rochford

Yes, there's a key point in there. We obviously have a very mature book right now, which is largely off of its promotional period, so I think we've been very clear that you shouldn't expect the NIM on the card book to stay where it is right now that reflects the book that we've acquired. And as we write new balance transfer product, that will come on at an EIR of about 7.5% and we've no reason to change the guidance on that. So I think as Jayne-Anne says, we will balance risk and return. We take a very conservative approach, a top slice of the market, and that feeds through in these sorts of impairment numbers you're seeing coming through from us.

Mike Trippitt

Could I just ask a follow up on this point about new business mortgage pricing, because it surprised me as well. Buy-to-let, I think I may have just missed what you said in terms of the mix, so could you just say where buy-to-let is as a mix of gross this year? And maybe on those very strong apps coming into 2015, what the mix is?

Anth Mooney

Last year it was around 25% of new business. That mix is broadly stable and as we head into the New Year we may tune that up slightly, tune that down slightly, depending on the risk-adjusted returns we're seeing. But that's certainly allowing us to maintain our spread in the region of 200 basis points that Jayne-Anne has described. So no real material shift from last year into this.

Question 4

Martin Leitgeb, Goldman

Good morning, just three questions please.

The first one, you mentioned obviously very strong market share in terms of new mortgage lending in January the 3.9%, and it seems almost like you're managing this on a monthly basis. So I'm just wondering, could you give us a bit of a better understanding on how volatile this data point is, 3.9%, is that potentially because a lot of clients signed a mortgage in January and can it be 3.0% in February or March, or is that within a relatively narrow range typically?

The second question is in terms of statutory PBT and obviously the second half was impacted by all the transaction costs and so forth. Going forward, just in a way of thinking of your build of TNAV, are there any material costs still left for '15 and '16 or is it purely, I think, what you disclosed on the share base payments which are still due?

And lastly, in terms of cost, it seems like in the second half that the central function costs were a little bit lower, at least to what we forecast at. Is that because just where you came up, or could that be a timing impact, so maybe some of the build-up is coming a bit slower or hasn't been booked yet?

Jayne-Anne Gadhia

So let me try and answer the market share questions and then perhaps you can remember the other two!

So on market share, Martin, I think our guidance doesn't change, that we expect to be between 3% and 3.5% of the mortgage market for the course of the year. You're right, we do focus on it all the time, and therefore you would perhaps expect it to move. I don't think it will be all over the place, but we absolutely set ourselves monthly targets that we diligently follow through on and we have absolute focus on them all the time.

If behind your question is do we think that we will knock out of the park a 3.5% market share this year, we're not planning to that at all. The position that we're in at the moment is that the mortgage market, as you know, started the year off much slower in 2015 than 2014, I think 12% down or something. We were up. And from our perspective, we don't think that that's sustainable over time. I know that the CML have come out and said that they think that the mortgage market will be £220bn this year. We think it's going to be closer to £210bn, perhaps a little bit lower than that. And over the course of the 12-month period, we would expect to come out at the market share that we've guided to. The opportunity for us, of course, it's something else to do with managing margins, is that we're not in a place where we have to cut price to achieve our targets, we're exceeding our targets and therefore we can manage pricing a little bit more tightly, if you like, in order to get that balance right. So you'd expect to see that sort of movement I think over time.

I'll hand over to Lee for the two other questions.

Lee Rochford

So the first one, I think, was on statutory profit and the impact of one-offs and exceptionals, and I think you're absolutely right, so we were very transparent in the prospectus about the fact there will be a trail of share-based payments to come through and we expect those to be exactly in line with that disclosure.

Beyond that, really not very much material. There will be some finalisation of the build costs for the credit card platform to come through. As we've talked about, we've just launched off that platform, but some of the bill costs did come into 2015, but nothing like the scale of last year, so it will be somewhat lower than what we disclosed last year around that business.

And then the other question I think was on costs as well, central function costs. We did talk about, last year, the fact that we had been building our capabilities and our bench strengths, particularly at and around central functions, to support the organisation as it went into the next phase of its growth, including being a listed company, so there obviously was some uplift in our central functions' costs. But I think you're absolutely right, we think we're very close to a point now where that's a critical mass and cost going forward will really be on a volume base basis within the segments rather than within the central costs. We think we've got a tight grip on that and they will grow at a slower rate than in the past.

Question 5

Chintan Joshi, Nomura

Good morning; a couple on market behaviour and a very quick couple on details.

You dropped your deposit pricing, you said, Feb 22 basis points. How has that experience on market share been? And I guess what I'm getting to is what kind of elasticity do you see in terms of pricing versus market share of deposits? I'm just trying to get a sense of how that is playing out.

And then the second one is on how much of your growth origination is from intermediaries? And that market, every bank is targeting intermediary related flows, even traditional banks that weren't in it are now getting in it, I'm just trying to understand, will there be fee pressure eventually from the intermediary market and would that impact yourselves and the industry generally?

Jayne-Anne Gadhia

Okay, so first of all in terms of retail deposit price, just to be really clear, there are two ways of looking at where we are in the market we repriced the back book down by the 22 basis points. The front book, there's a range of different prices, which average roughly at a reduction year-on-year from 140 basis points for new business to 120 basis points of new business.

As I think one of us said, that 120 basis points on the front book instant access still puts us top quartile in the market. And one of the things that over the course of the last 12 months I'm really pleased about, in terms of the commercial team, is that now, of course, we understand the behavioural aspects of our sales and marketing strategy for retail deposits, such that we are very, very clear on the price volume trade-off for the volume of business that we need. And so we look at it much more as optimising cost of funds than taking market share. We know that we can do market share and retail deposits and last year our own experience, our own growth was absolutely in line with the market. I think the market was 6% and we were 5.9%, so we know that we are able to access that market at the right price, at the right time in terms of our funding and our cost of funding. And I think it's something that we've got much, much more sophisticated at during the course of the three years that we've owned Northern Rock and that's performing very well for us this year. As I said, going into this year, we are much more tightly managed in terms of our plans, so we don't carry excess liquidity because we're able to manage that so confidently.

Chintan Joshi

If you went from, say, a first quartile to second quartile, would you be able to sustain your market share? I guess not. What would the drop be? Any feel you can give us there?

Jayne-Anne Gadhia

Can you give a feel for that?

Anth Mooney

I think it's a tough question, in a way. If we could go from first quartile to second quartile and maintain a market share, we would, that would be my answer. But I think the savings market is price sensitive, let's be honest. But I think in terms of managing our own flows, we manage our pricing at the front end within four or five basis points to drive variances in month of, say, plus or minus £100 million of flow, so that should give you an idea of the kind of sensitivity that's at a market level.

We've not at any point, since we acquired Northern Rock, struggled for retail funding and, indeed, we've been gently moving our pricing down, as we discussed this morning, whilst still delivering our flow targets for the year.

Just to echo what Jayne-Anne has said in terms of that price elasticity on the back book, our retention rates for maturing business remain very, very strong, almost 90% for ISA business and above 80% for other fixed rate bonds. And in terms of the recent repricing, we've seen 95% of those customers who have been repriced stay with us, so a good strong performance front and back book.

Jayne-Anne Gadhia

Thanks Anth. On the intermediary side of things, we said, I think at the time of listing, that more than 80% of our business comes from intermediaries and that we saw that that channel would become even stronger because of MMR. And you're right, we are seeing the strength and professionalisation of that channel, we think that they're doing a really good job.

I agree with you, competition will increase in that marketplace as more people start to use the intermediary channel, but I do think there's definitely been a perception that over the years that intermediaries are all about price and that is not our expectation. Of course you have to price products competitively, but there's much to it than that. And as I said earlier, the service promise, the service execution that we can give to intermediaries, the way in which we support their sales force to be able to market to their clients effectively, the sort of personal relationships and corporate relationships that we have go back a very long way. We don't expect to have to pay more for business, we've got agreements with all intermediaries set up and renewed recently, and so we'd expect to be able to continue to develop on our very strong relationships with those corporate relationships over the years to come.

Chintan Joshi

And just a quick detail question. Could you give us some sense of debt sale/asset sale that we can expect next year, what the volumes are that you're looking to sell and may sell, just to give us a feel of what we can expect?

Lee Rochford

I think the easiest way to maybe answer that is only roughly half of that book that we sold was from each of the two years of sales that we'd sold, so all the charged off balances over two years. Obviously as the book grows, though, the absolute amounts may change, but I think as a proportion that's probably about right. You can work out there was about £45 million of charged off total amount for that, so you can work out the price from there and figure out based on your view of cost of risk going forward and what that would be.

Question 6

Andrew Coombs, Citigroup

Good morning, two follow-up question and then one broader one, all relating to interest margins.

Firstly, coming back to your point about the broker channel more broadly, you have seen a number of new entrants over the past few months, including entrants now offering application to offer guarantee periods. So clearly the service does seem to improving across the board from a number of your peers as well. So bearing that in mind, I understand your service proposition has been there for some time, but perhaps you could elaborate on if everybody else is catching you up and what that then means for pricing on that channel?

The second question is just coming back to this business mix. Is it possible to quantify the difference in the yield or that average yield on buy-to-let versus homeowner, as well as the risk adjusted margin on buy-to-let versus homeowner?

And then the final question, a broader question, given your belief that base rates no longer rise until next year, and given where you are with the savings repricing, perhaps you could just comment on the trajectory of the path to the 170 basis points?

Jayne-Anne Gadhia

Sure, so on the intermediary - I'm going to leave Marian and Anth to worry about what we can say on buy-to-let margins for a moment – but on the intermediary servicing proposition, you are right, we have also made an intermediary promise, so that we say to intermediaries that we will pay them £100 if we do not get their customer an offer within ten days of us receiving a fully packaged application. And so we have been the first, I think, provider, to put our money where our mouth is in terms of our service commitment, and actually that's been something that's very powerful in the intermediary channel.

Just to remind you, because we would have said this at IPO I'm almost certain, when we acquired Northern Rock the business was getting from application to offer in an average of 32 days. Mark, you'll correct me if I'm wrong, I think last week it was 11.2 days, and for fully packaged applications it's much lower than that, despite the fact that volume has ramped up so significantly.

So, Andrew, you're sort of right, I'm sure, that everybody ought to be able to get their service in order, but I'm relatively long in the tooth in the business now and it's something you have to focus on all the time and we diligently focus on it and understand it's a competitive advantage. I'm sure others can and will too, but at the moment I think we're in quite a leading place there.

As far as the trajectory for NIM is concerned, we expect, as we said at the guidance that we gave at listing that broadly we would move from our average position of 150 basis points at the end of 2014, through to 170 basis points in 2017, roughly 10 basis points a year. Now, as I say, that's why I don't want you all to get over-excited by the fact that we exited the year at 155. We're certainly not suggesting that we'll be 10 points higher than that, but on average a growth that's a nice smooth position between the average of 150-170 at the end would be something sensible to contemplate, I think.

In terms of your margin question, the answer is yes of course we know the difference between the margins that buy-to-let and residential mortgages create. Whether or not we can share that with the group? Marian, is there anything you would like to say about that just to give it a sort of relativity?

All I'd say is that they are materially stronger for the buy-to-let position, not least because impairments on buy-to-let are actually even stronger than they are on the residential book, and so when you look at the logic for our business development in the buy-to-let space it's entirely driven by financial metrics which continue to be materially strong.

Andrew Coombs

I guess my thought process would be that the yields are always going to be far superior on buy-to-let. The risk adjusted margins probably look superior today because of where we are in the cycle, but over the cycle I guess they look broadly similar. Is that fair?

Jayne-Anne Gadhia

Marian, do you want to come up and say something? Because Marian as our Risk Director has been very focused on this, as you'd imagine.

Marian Watson, Chief Risk Officer

Good morning everyone. I think there's a couple of things to think about here, both higher headline pricing and buy-to-let, and lower capital consumption. So like-for-like you get a much more attractive RARoRAC on the buy-to-let business. I think we would all concern ourselves about has buy-to-let really been through a crisis in recent times. But we write our buy-to-let business with a really good rental coverage ratio, and at low LTVs, so our average rental coverage on buy-to-let is about 170%, much higher than you'd see in the rest of the market. And this effect of arrears that Jayne-Anne's talking about is really supported by that, so we've got really good origination approaches, lower capital consumption, and a more attractive headline margin. Does that help?

Question 7

Chris Cant, Autonomous

I just wanted to follow up an earlier question actually. I think you mentioned your current pricing on variable rate deposits on the front book is 120bps. So should I take the fact that you've cut the back book by 22bps as an indication that you're now opening up a front book/back book pricing differential because I think previously you were aiming to keep pricing broadly harmonised.

Thinking about your loan-to-deposit ratio as a second question, 3 percentage points higher from the first half level, you're targeting 100-110. Just thinking about how that is likely to develop from here out to your 2017/18 target period, should we expect that to ramp up further during this year? Because I appreciate you said that you're very confident that you can fund your incremental growth, but just in terms of the type of funding for that, it feels like at the minute your deposits are lagging behind. And I think you made a comment that deposit growth has caught up with asset growth, but if I look at the second half it was still probably about 50% higher asset growth. Just if you could speak to that, thank you.

Jayne-Anne Gadhia

Just to be clear, I said we are very confident that the deposit growth that we are planning and can achieve enables us to drive the asset growth that we're seeing. Lee, would you like to do the RDR question?

Lee Rochford

I think on funding you shouldn't forget the point I made about wholesale funding as well, there's definitely some benefit to come through from the fact that we haven't yet diversified our wholesale funding like we can. We obviously look at the relative costs, we look at it within our risk appetite, and we look at the balance sheet shape we're targeting. So you're right, we have been deliberately growing deposits at a slower rate than we have the assets while we get the balance sheet to a place that we think is more efficient, including as well the amount of liquidity that we have to fund and carry on the balance sheet. So we're definitely looking at all the metrics, we think there's further to go with wholesale funding, we'll stay within the guidelines that we've set you, and that will give us some cost benefit as well as give us some volume benefit as well going forward.

Jayne-Anne Gadhia

And on the back book/front book pricing for deposits, I think simply because we have a range of products in front book and back book it's impossible to align all of them anyway, if you see what I mean. Broadly we would expect to align front and back book right, but it's not a sacred cow, and so as we manage our overall price of back book funding and our acquisition strategies going forwards we won't be slavishly tied to comparators, but we would expect them broadly to stay in-line.

Question 8

Ivan Jevremovic, UBS

Just a quick one on non-interest income please, particularly investments and insurance. As you mentioned yourself, investments are actually one of the oldest parts in continuity but has been reasonably stable. So just your outlook for growth from here given the new products you've launched and over the next few years how you see things feeding through?

Jayne-Anne Gadhia

I think that for us the overall statement for non-interest income, that we'd expect it keep pace with the growth of net interest income, remains the key guidance that we are giving at the moment. And part of the reason for that is that frankly we see the insurance business and the investment business as something that's a really untapped potential for future growth, if I'm honest. Darrell's here now, over time we have, as we said at the IPO, always discovered that bringing experts in to run business lines is something that's very important for us. We know that some of our competitors with big brands have achieved significant development in the insurance business, and that opportunity lies ahead for us we think we the partnerships that we have. Specifically on the investment side, it's where we've come from, it's a business that we haven't fully focused on over the course of the last few years because of the acquisition of Northern Rock and the focus that we've taken on putting that business into really great shape. So the focus that we're now putting on the investment business means that we certainly expect it to grow. We haven't put out the level of growth at the moment because it's quite nascent, but I think it's a big future opportunity for us.

Concluding comments: Jayne-Anne Gadhia

Thank you all so much for all of your questions, it's been really great to see you this morning. We look forward to seeing you again next time, whenever that is, half year results I presume. Thank you very much indeed.