Creating the First True National Competitor to the Status Quo

Recommended All-Share Offer for Virgin Money

18 June 2018
Welcome
Jim Pettigrew
Chairman of the Board of Directors, CYBG PLC

Good morning, everyone in London here and everyone listening via phones and indeed on the webcast medium and, indeed, an early good evening to everyone listening in from Australia.

It is an absolute pleasure to welcome you to the investor presentation of CYBG’s recommended all-share offer for Virgin Money, so thank you very much for coming.

The plan for this morning is that our Chief Executive, David Duffy, will lead the presentation. You will hear also from our CFO, Ian Smith and our COO, Debbie Crosbie. Then, after that, David will return for Q&A.

I would just very simply like to introduce this morning by saying how excited we all are here at CYBG for this combination of CYBG and Virgin Money. It offers strategic and financial benefits for shareholders on both sides and a tremendous opportunity for all stakeholders including and most importantly, of course, our customers.

Thank you once again for joining us. Without any further ado, I will hand you over to David.

Transaction Terms and Vision for the Future
David Duffy
CEO, CYBG PLC

Introductory remarks
Good morning, everyone. Thanks Jim. I have to say today is a pretty historic day for both Virgin Money and CYBG. I know bankers are not supposed to be very excitable. I will admit to being very excited, but I will not do anything odd, so relax everyone.

However, let me just, before we start, say when I look at this, Jayne-Anne and her team have built Virgin Money into a great business with a national brand which is very attractive and has a huge affinity with customers. CYBG has also transformed as a business, with a great heritage on the one hand and a passion for technology and customers.

With this combination we are also bringing together two fantastic pools of talent. This talent is of a really high quality, great leadership with strong cultures and values. I am therefore absolutely thrilled to be presenting this transaction to you today.

Agenda
In terms of our agenda for the day, I will begin, as Jim says, with an overview and an explanation of our vision, Ian will take you through the financial rationale, Debbie will address the technology aspects and then I will return and close out the presentation before we move to Q&A.

Transaction terms
As you can see, the key terms of the transaction are shown here on the slide with further details available in the 2.7 Market Announcement. This transaction is now a recommended all-share offer, with around 62% of the combined group owned by CYBG shareholders and 38% owned by Virgin Money shareholders. The transaction has the recommendation of both boards and an irrevocable undertaking from the Virgin Group. As you can see, the exchange ratio represents an attractive upfront premium for Virgin Money shareholders.
The compelling strategic and financial rationale of this transaction will enable us to deliver material earnings per share accretion to all shareholders and enhanced capital generation, which of course will allow us to accelerate our progressive dividend ambition. I am pleased to report that there will also be management continuity with our chairman Jim Pettigrew, our CFO Ian Smith and myself continuing in our roles for the combined group.

Two new executive directors will also be joining the board from Virgin Money and one nominated by Virgin Enterprises.

We are reaching an inflection point in the banking industry

As you know, customers are changing how they are using banks and also how they access services in general, with many new entrants to the market emerging both small and large. I have talked about this a lot. The technology being deployed is rapidly changing; it is ground-breaking in some cases. Regulatory change is also intensifying competition and at the same time seeking to protect consumer choice.

We concluded that if we were to remain competitive we would have to build an industry-leading open banking digital capability and this capability we have built and it is live in the marketplace today. The next step we considered as a board was an objective to move to a single brand as we believed that the combination of our digital platform and a nationally-recognised brand would be required to remain competitive in the medium-to-long term.

In our view therefore the future winners, when you look at this business, would need to have sufficient scale. They have to have a powerful brand and the ability to deliver a best-in-class digital customer experience for both retail and very importantly SME.

This transaction combined complementary businesses and delivers scale

When we consider the acquisition of Virgin Money we realised that this transaction above all other would bring together the complementary strengths of the two businesses and would also leverage CYBG's digital platform and Virgin's iconic brand.

We know that we will be able to, in addition, achieve significant cost synergies and we also believe that the combination of 6 million customers and a much broader product profile offers enhanced revenue opportunities.

If we break that down further, CYBG has a retail and SME product range, critically, with deep customer loyalty and a digital platform that is operating live today, as I have mentioned. Virgin Money benefits from an iconic brand and a national distribution capability. They also have strong propositions in mortgages, credit cards and retail investment products.

Two UK challengers become a true national competitor

The combined franchise offers us the chance to operate with a single brand in the future and importantly for me, a brand that has a leading NPS of +37 with the wider Virgin brand having a UK brand awareness score of 99%.

To be clear, our intention with this transaction is to transition to the Virgin Money brand across our entire business in time and to fully leverage this iconic brand, with further testing in the SME market to be undertaken.

Delivering an enhanced retail customer proposition...

The combination therefore offers us the opportunity to deliver a compelling retail proposition to around 6 million customers. It will bring together in one place a product set built around a core current account offering supplemented with a retail investment proposition. In addition, as part of the wider Virgin Group ecosystem, we will explore the opportunity to develop partnerships with the other Virgin Group companies.
...With a strong regional SME franchise and ambition to compete nationally
In addition to a compelling retail proposition we strongly believe that this combination can enhance our differentiated SME proposition as well. The Virgin brand itself is synonymous with the entrepreneurial spirit of its founder and subject to further research it is our ambition to rebrand the SME business in time.

You will also be aware that we are keen to leverage the RBS Alternative Remedies Package to scale our franchise nationally. I believe that this transaction will help make us a more compelling applicant.

Bringing together two highly compatible cultures
As we seek to create a truly national competitor to the status quo, our culture will be a critical driver of our success, in my mind. Virgin Money has a strong reputation for employee engagement and similarly one of the greatest strengths of CYBG is its people and its focus on the customer. As part of the due diligence process we are able to confirm that we have a highly-compatible internal culture focused on customers and a true disruptive mentality in both organisations.

In essence, what we have here is the opportunity to build a best-of-both model that draws on the talent of both CYBG and Virgin Money. I passionately believe that the combination of the two franchises will offer our colleagues the opportunity to build their careers at one of the most innovative and entrepreneurial banks in the market.

We will create the first true national competitor to the status quo
In summary, this new franchise combines an iconic national brand, a full-service retail and SME proposition, with scale and on top of that a leading digital capability. I am absolutely certain we will deliver a better bank for our 6 million customers. We will also be a more effective competitor due to our scale. In addition, we will be very well positioned for the open banking environment.

I will now hand over to Ian to explain the financial benefits of our strategy. Thank you.

Financial Rationale
Ian Smith
CFO, CYBG PLC

Welcome
Thanks David and good morning. It is nice to see some of the usual friendly faces out there today and g’day to everyone following this from Australia. David has explained the clear strategic rationale that underpins this transaction and I will now set out the financial logic.

What we are doing here is bringing together two businesses with complementary portfolios and different competitive advantages that, by and large, operate in very similar ways. It was extraordinary how often during the due diligence process that one side or the other would say, ‘Yeah, we do it the same way.’

There is a unique opportunity here to realise the benefits of scale and eliminate duplication to deliver cost synergies. We also expect to deliver substantial benefits for customers and shareholders by making the most of both businesses’ core capabilities, enhanced product sets and enlarged customer base.
Financial highlights of the transaction

This slide sets out the financial highlights of the deal, focused on five key elements that I will talk through in detail: significant annual cost synergies of around £120 million; a diversified, customer-led funding model; the strength of a broad-based, low-risk asset portfolio and a strong pro forma day one capital position with further upside potential.

These elements combine to deliver material value creation and EPS accretion for all shareholders.

Significant cost synergies expected

We have identified significant annual run rate cost synergies of around £120 million to be delivered by the end of financial year 2021. By that I mean that financial year 2022 will see the full benefit of the total synergy run rate amount. Our approach to synergies is very much in line with our successful Sustain cost efficiency programme that CYBG investors and equity analysts know well. However, I appreciate that our new prospective shareholders may be less familiar with this programme. I will therefore cover each area as I go. By way of comparison, at our recent interim results we reported that Project Sustain had successfully delivered £120 million of gross annual run rate savings within two years.

Turning to the four categories of expected synergies, the first area is network efficiency. As most of you know, this is how we deal with the branch network. We continue to see a strong future for the branch in our omnichannel model but there is scope to optimise the branch network. We consider that this will yield annual savings of approximately £15 million.

Next, it is organisational design. That is reshaping the senior leadership structure of the group to unlock the benefits of scale. We have identified annual cost synergies here of around £35 million. We expect to see little overlap in our customer-facing roles and so this is primarily focused on removing the duplication of roles among senior management.

The third area is operational efficiency, which also delivers around £35 million of the annual synergies. This is achieved through integrating customer service operations, driving efficiencies through digitisation and automation and by combining the functions that support our respective businesses.

We will deliver the last £35 million of cost savings from central cost management. This is where we reduce third-party spend, cut overheads, make savings on the combined annual investment budget and deal with office buildings. This category is net of the incremental trademark licence fees in relation to the brand.

In total, across all of the programmes we are expecting a reduction in the combined group’s FTE of around 16%, reflecting the significant overlap across management and operations. We expect to complete around 30% of the initiatives by the end of financial year 2019 and get us to around 70% complete by the end of 2020, finishing the work in 2021.

Remember, I am talking here about delivering initiatives and the associated run rate savings, not the in-year expense impact.

As you would expect, we have done a great deal of work on synergy planning. We have spent time discussing and validating aspects of our plans with Virgin Money Management during the due diligence process. In addition, as required by the UK Takeover Code, our quantified financial benefits statement has been independently reviewed and reported on by Deloitte and our banking advisors. This provides independent validation of the commitments that we have made.

Finally, I wanted to draw your attention to an important point. In addition to the £120 million of validated cost synergies, the combination provides the opportunity for Virgin Money to avoid incurring incremental operating costs
in the future relating to their digital banking operation, which is currently in development. We have not quantified this amount for the purposes of reporting under the Takeover Code and therefore it is not included in the synergies. However, we do understand that there are estimates of those incremental costs in the public domain.

**Conservative costs to achieve**

The cost synergies will be delivered as we integrate the two businesses and Debbie will take you through that shortly. The cost of delivering our integration plan is estimated at around £240 million, pre-tax. We have erred on the side of conservatism in assessing this. We have, for example, based our severance cost estimates on the application of the more generous of the two redundancy policies.

As you can see, the phasing is split broadly evenly across a three-year period, again consistent with Debbie’s integration plan. I do not want to steal her thunder because, trust me, that is never a good move. However, I will say a few words about the plan, principally how it manifests in the financials.

Our plan is to ensure that we minimise disruption for our customers and reduce migration risk. That is what drives the pace of delivery on synergies and to some extent makes it perhaps a little more costly than previous industry transactions. We make no apology for that; we are going to get it right and that takes time and money.

**Upside potential from revenue synergies**

As David outlined, the Virgin Money brand is a key strategic attraction of this transaction, with its national recognition and strong brand awareness. We have therefore negotiated an agreement with Virgin Enterprises Limited for the exclusive right to use the Virgin Money brand for financial services in respect of retail, SME and corporate customers in the UK in perpetuity. The brand plays very well with consumers and we are committed to moving all of our retail customer business to the Virgin Money brand. This will take some time as it is a complex process.

We also believe that the Virgin Money brand will be successful in the SME space. As David says, we are doing some work to validate that. If, as we expect, it is well-received then we would also expect to rebrand our SME business.

The trademark licence fee will be £12 million in year one, with scaled increases thereafter. The all-in annual cost of the licence fee once the rebranding is complete will be lower than the 1% of revenue currently paid by Virgin Money. As part of the trademark licence agreement, Virgin will be permitted to nominate one non-executive director to join our board.

Our estimate of rebrand costs is approximately £60 million, expected to be largely incurred in the first two years, with the majority of the spend relating to products, IT and property. The way to think about the rebrand spend is twofold. Firstly, it pretty much substitutes what we would otherwise have had to spend to scale our B brand more nationally. Secondly, we believe there are significant revenue synergies to be achieved through adopting a single brand with national recognition.

We believe that deploying the Virgin Money brand and the CYBG product set across the 6 million customers of the combined group will deliver incremental growth in revenues. Virgin Money has not had the product range to broaden and deepen the offering to its 3.4 million customers over its relatively short life. The combination also gives us better geographical coverage that will help drive growth. The two businesses also enjoy strong customer loyalty and an enhanced product set that will enable us to increase the number of products per customer in the combined group. Finally, the combined group will also be better placed to partner with other Virgin-branded businesses, with enhanced revenue opportunities available.

We have done detailed work to estimate these revenue synergies. However, they have not been quantified for the purposes of reporting under the Takeover Code.
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Diversified, customer-led funding model

CYBG has always adopted a prudent deposit-first strategy to fund its lending growth and Virgin Money has followed a similar path. The combination allows us to build on our successful deposit franchises, with the benefits of an iconic national brand to help attract new customers.

The combined group will benefit from a diversified customer-led funding model, with around 77% of sticky customer deposit funding. 30% of the funding base comprises of core relationship balances and we expect to increase that over time. Retail savings balances make up about 44% of the total combined deposit book. What is really pleasing is that both banks enjoy high renewal rates across their fixed-term savings products, approximately 80% on a combined basis. Virgin Money's renewal rate is especially strong.

The combination will also allow us to reinforce our relationship model, combining the Virgin Money brand with the CYBG current account offering. We believe this will drive deposit growth opportunities across current accounts and linked savings. Finally, TFS outstandings are around £8.7 billion, which is very manageable within the context of our funding plan. We anticipate refinancing in advance of contractual maturity.

We are confident that we will deliver deposit growth across all products and attract substantial SME deposits through the RBS Incentivised Switching scheme, for which we are currently well placed. We also have a clear plan for wholesale issuance to meet our MREL requirements.

Finally, we expect that this combination will be looked on favourably by the ratings agencies. Only Moody's have commented publicly so far, saying that in their initial view they expect the transaction to be credit-positive.

Complementary models create a low-risk combined portfolio

Moving on to the asset side of the balance sheet, the complementary businesses being brought together in this combination work really well. CYBG brings a mortgage portfolio balanced between owner-occupier and buy-to-let customers, a growing SME franchise and a small unsecured lending book. Virgin Money contributes a strong mainstream mortgage book and is a material and effective player in the credit card market. The combination creates a broad-based low-risk loan book: 83% of the combined portfolio comprises high-quality mortgages, with a 57% average loan-to-value and a 60-basis point non-performing loan ratio.

Virgin Money has a strong reputation among brokers for its mainstream products. This can be added to our own more tailored mortgage broker proposition, allowing the combined group to access a broader distribution channel. The combined group also continues to benefit from a strong SME franchise. You will be very familiar with our ambition to scale this regional franchise nationally via the RBS alternative remedies package.

Finally, Virgin Money brings a strong credit card capability that fills a gap in CYBG's unsecured lending proposition. I will talk about that in more detail now.

Prime credit card portfolio underpins unsecured lending growth opportunities

Virgin Money has a super-prime credit card portfolio, concentrated in low-risk segments and compares favourably in this regard to the wider industry in the UK. Impairment charges have been coming down over the past three years and the charge-off rates are lower than the industry average.

Some of this is about the benign macro and the mix of the book. However, it is also very much a reflection of book quality. Our due diligence had validated the quality of the portfolio and our growth strategy in this space.

Balance growth will be less focused on balance transfer products going forward. Virgin Money is already seeing increased retail spend among its cardholder base and initiatives such as the relaunched Virgin Atlantic partnership are expected to drive volumes. The Virgin Money credit card portfolio provides opportunity for sustainable lending
growth as we offer that superior product capability to the CYBG customer base, which is currently under-penetrated from a cards perspective.

**Credit card EIR accounting to be reviewed on completion**

There has been a fair amount of commentary by analysts and other stakeholders regarding the way in which firms recognise income on certain products under the effective interest rate method of accounting. We are also aware that the PRA has become increasingly interested in the topic.

I will start by reminding everyone that CYBG does not bring forward the recognition of income on any of its core retail products. EIR is most relevant for us in our SME portfolio, where we treat certain fees paid by customers as integral to the lending yield and recognise those fees over the life of the loan. We therefore have an EIR liability on our balance sheet.

EIR income recognition in the credit card portfolio is currently a material item for Virgin Money. This is because a significant proportion of the book was acquired on 0% balance transfer terms. On that part of the book Virgin Money estimates the income it expects to earn over the life of a card product and recognises that income rateably over that life. Of course, this requires a degree of judgement and brings with it some estimation risk. At 31st December 2017 Virgin Money had a receivable of around £160 million relating to EIR income.

This practice is industry standard for those banks with material cards portfolios. The key parameters, or metrics, will vary between cards books depending on the nature of the portfolio. We have discussed this topic at some length with Virgin Money during due diligence and management presented a robust explanation of the approach, along with supporting data. We also note that the methodology used by Virgin Money has been signed off by two different audit firms.

On acquisition, we will bring the credit card portfolio, including the EIR receivable, onto our books at fair value. That is really the appropriate juncture for us to put our foot on the ball, if you like and test the approach and we will reset it if necessary. It is too early to say what the outcome of the fair value exercise will be or to guide on EIR in the combined group. However, as ever, you can expect us to be appropriately prudent.

**Combined group to be strongly capitalised**

The combined group will be strongly capitalised from day one, with an expected pro forma CET1 ratio in excess of 12%. That includes a significant buffer to the combined regulatory capital requirement. It is important to note that this pro forma capital position is prior to recognising the potential beneficial impact of CYBG’s IRB accreditation and Virgin Money’s expectation for a reduction in its mortgage risk weightings. Each of these is currently subject to review by the PRA.

Both of these workstreams are expected to continue unaffected by the combination, with a high confidence of a positive outcome and a material potential benefit from each. Finally, it should be clear that the combined group will be significantly below the total assets threshold, of £175 billion, that attracts a systemic risk buffer. We do not expect any additional capital requirements relating to our increased scale.

**Enhanced capital generation**

We expect the combined group to deliver strong net capital generation. This will create capacity to fund healthy dividends for shareholders. The expected one-time benefits from CYBG’s IRB approval and the potential mortgage risk weight reduction for Virgin Money will reduce the capital requirement for the combined group. The combined group’s earnings will benefit from cost synergies net of cost to achieve and a relatively lower drag from investment spend.
When you bring these two businesses together and deliver on the financial opportunities available, we believe that it will deliver enhanced net capital generation and provide the capacity to accelerate the progressive dividend ambitions expressed by both CYBG and Virgin Money.

What does accelerate mean exactly? While it is too early for us to commit to any firm numbers today, we are confident that the pace at which we can increase the dividend per share is enhanced by this transaction.

Reinforces delivery of existing financial targets

What does all of this mean for CYBG’s financial targets and shareholders more broadly. Let me be clear to our CYBG shareholders. We expect to deliver on our original targets for financial year 2019. The combination will reinforce the group’s performance against those targets and deliver value for all shareholders.

In terms of loan growth and loan-to-deposit ratio, both metrics remain appropriate for the combined group. You will see us continue to target sustainable growth supported by a diversified funding model.

The combined group’s cost-income ratio is expected to be at the lower end of our target range in financial year 2019, with further benefits coming in 2020 and beyond from the significant cost synergies I set out earlier.

Our double-digit return on tangible equity target is strengthened by this transaction. However, you will forgive me if I keep my powder dry for just a little bit longer before committing to any firm numbers on this one. We expect to come back with more guidance at our full year results in November.

As I have discussed, the enhanced capital generation expected will provide capacity to accelerate our progressive dividend ambitions. Finally, the transaction will deliver material earnings per share accretion for all shareholders through improved operating performance as the result of the delivery of cost synergies and other benefits.

Expected transaction timeline

Before I hand over to Debbie, I shall provide a quick overview of the next steps in the process.

We expect to publish the key shareholder documentation quite soon. That is the scheme documents, as well as a CYBG prospectus and circular. These will provide more details as to the transaction and issuance of CYBG shares and seek to provide shareholders with the key information they need to make an informed decision. In due course both CYBG and Virgin Money will arrange meetings for each group of shareholders to approve the transaction and the necessary documents to implement it.

If shareholders do vote to approve, we receive the necessary regulatory approvals and the offer conditions are satisfied then we would hope for completion in calendar Q4.

With that, I will hand you over to Debbie Crosbie, our Chief Operating Officer. She will talk you through the technology platform and our integration approach.

Technology Platform and Integration

Debbie Crosbie

COO, CYBG PLC

Thank you, Ian. Good morning to everyone in London and good evening to everyone in Australia.
Established technology platform and integration capabilities

I thought I would kick off this morning, for the benefit of Virgin Money customers and shareholders, by explaining what we have live today for our customers on our leading digital iB platform. I will also explain, importantly, why we think it is fantastic that the Virgin Money customers will be able to join the millions of our customers already using it.

Over the last three years we have been investing significantly in our new digital proprietary banking platform. This sits above our core systems. This construct means that however our retail or SME customers choose to interact, whether that is on the phone, branch, mobile, the iB platform delivers a leading real-time experience covering our full product range for all our brands.

The iB platform already has a number of market leading functionalities; I will give some examples. We have fully-digital current account opening for all of our retail customers that takes less than 15 minutes. We have a number of in-app smart features, like customer-defined saving pots and innovative budgeting tools. We have fully-digital faster clearing live, face ID in our mobile apps etc. It has also enabled us to launch our current account aggregation tool in May. We are one of the first banks in the UK with live open banking enabled technology, despite not being one of the CMA 9.

Just to be clear, all of this functionality is live today. There is no need for us to develop a parallel system or lots of new technology.

We have an established track record of successfully migrating our Clydesdale and Yorkshire Bank customers onto the platform. My team and I have already migrated over 2 million current accounts very successfully.

As a result of all of that, the platform is now handling a tenfold increase since the start of migration. That is why I am very confident that we have a scalable and resilient platform.

In summary, all of the customers of the combined group, once migrated, will not only benefit from the full product offering that our retail and SME customers enjoy today. They will benefit from all of the market-leading functionality and omnichannel digital experience that our iB platform already delivers.

Low-complexity integration plan

You will not be surprised that we are very alive to the fact that we are putting forward a proposed integration when there is a heightened interest in banking integrations right now. Let me therefore bring to life for you why this is much less complex than other integrations and how we are very confident that we can manage the risks.

Firstly, as I have said before, there is no new technology build. Secondly, we are in control of the schedule: it is a phased migration. The large majority of mortgages and many of the savings accounts will be transferred at the customer’s renewal of their fixed term. Finally, but very importantly, Virgin Money has a small number of current accounts which will be much more straightforward to migrate because these accounts do not currently have online or mobile banking.

There is therefore no big bang migration. We will be taking a phased approach over 36 months. That will allow us to maintain an absolute focus on delivering, throughout the process, excellent customer experiences. The biggest change for CB and YB customers is that they will experience the rebrand, which from our perspective is a much lower technology risk.

Just to bring a bit more colour to that, let me take each of the products in turn. As I said, when migrating the personal current accounts that Virgin Money has we will use the automated switching service, the CASS service, which is tried and tested technology. I am sure it is familiar to you all.
Just to give you a bit more context to the 100,000 current accounts for us, in our most recent switching campaign, in approximately just under two weeks we migrated just under 20,000 accounts. That should give you some comfort.

For the transfer of the savings accounts, we will use the proven industry-standard bulk redirection service, that has recently been used very successfully by the ringfenced banks, but at a much lower scale.

We expect a significant majority of the products with fixed terms, like mortgages and savings, to move on to the iB platform at renewal. This means that Virgin Money customers will move onto the new platform just through their normal customer processes. That will be seamless to them.

Finally, for CYBG's credit card customers, who represent the minority of the combined group, we will migrate them onto Virgin Money's modern TSYS platform. This is a process that TSYS have done many times before. Once done, we will of course integrate it securely into our iB platform over time.

We have a very conservative phased plan to migrate a low volume of low-complexity products onto our platform. As Ian has already covered, what is very important about all of this is that all of the integration plans are the basis that have driven both the cost-to-achieve numbers and the synergy numbers that you have heard Ian cover earlier.

However, despite all of this, we are very still very alive to the challenge of managing executive risk. I will remind you that we will benefit not only from our experience but the significant experience and added bandwidth that our new colleagues in Virgin Money bring. We have successfully executed the NAB separation. This, combined with the success of our recent digital and customer migrations, means that I and my team feel very confident, but not complacent, that this programme of work is very manageable.

I will now hand back to David, who will close and summarise.

**Summary**

David Duffy

*CEO, CYBG PLC*

*Creating the first true national competitor to the status quo*

Thanks Debbie. Just to summarise: we absolutely believe that this is a unique opportunity to create the first true national competitor to the status quo. The combination does deliver a full-service retail and SME bank. However, it has an iconic brand, national coverage and scale and a leading technology platform that is live today. The expected financial outcomes are also compelling, with significant cost synergies, as Ian has said. We have a low risk balance sheet and a strong capital position, reinforcing the delivery of our existing financial targets, as well as being earnings accretive for all shareholders. We also see a great opportunity to acquire new customers. This will be on a national platform as a result of the scale that we will achieve through the combination and we will become a true national competitor to the big five banks.

As I said earlier, Jayne-Anne and her team have built a fantastic business and have also created a deep-bench of talent. We in CYBG have been delivering a similar transformation and we see a huge opportunity as we bring the best talent of both organisations together.

As I have said, it is rare to be able to speak in these excitable terms about banking. However, I believe that this new combined franchise will deliver the biggest challenge to the status quo for a very long time in the UK.
That concludes our presentation on Virgin Money acquisition. Thank you for your time and we will now take your questions. We will start in the room, then go to phones and finish with the webcast. I will coordinate the questions and my colleagues here, including the Chairman, will answer those as well. If I go to the room first, are there any questions here?

**Q&A**

**Charmsol Yoon (UBS):** Hello. I have two questions. One is on your capital. I believe your P2A is perhaps higher than some of the large banks in the UK. I appreciate that it is probably early stages. However, have you discussed with PRA regarding the direction of your P2A, whether it will go higher or lower?

My second question is on the Virgin Money digital bank. I believe they still have £70 million to spend on their digital bank and I believe they made an exclusive agreement with 10x Technologies. Do you understand whether this deal will include any break clause?

**David Duffy:** Thank you. Ian, I will refer this to you.

**Ian Smith:** Okay, thanks Charmsol. Regarding our Pillar 2A requirements, we are in the middle of a SREP process with the PRA on our standalone capital position. One of the bigger components in there is pension risk. The Pillar 2A requirement was last set when our scheme was open to future accrual and we were exposed to higher pension risk. I think broadly the direction of travel there should be lower. However, that is obviously subject to agreement with PRA.

On your second question, about the VMDB spend, I think that project is reasonably far advanced; certainly in terms of the initial build and related spend. We have taken account of any sort of contractual conditions if we were to change our mind about anything that VM do when the businesses come together. That is therefore included in the cost to achieve.

**Edward Firth (KBW):** Hi. I just had a couple of questions. One is, I noticed there was a £60 million rebranding cost included in the presentation; is that part of the £240 million or is that in addition to the £240 million in terms of restructuring charges?

**Ian Smith:** That is in addition to the £240 million, yeah.

**Edward Firth:** Great. The second question was regarding the EIR assumptions and all the excitement around Virgin’s accounting. The key question for my mind is not so much the accounting, but you have obviously done a lot of due diligence on that book. Could you just give us some idea? I suppose the key issue is: is that book performing in line with the expectations that are built into the models that they are using for EIR or not? I guess that is the key question.

**Ian Smith:** I guess I would point you to some of the statements made by Virgin Money, in particular at their recent first quarter results call. There they confirmed that, indeed, the book was performing in line with the expectations that were driving the model. However, as I said in my remarks, there is a lot of judgement around this and it is something we are going to look at very carefully for day one purposes.

**Edward Firth:** Okay, thanks.
Christopher Cant (Autonomous Research): Good morning, thanks for the presentation. Could I just come back to your cost synergies, please, the £120 million run rate savings? Could you confirm what base you are using as the jumping-off point for that £120 million, please? Is that gross or net of any inflationary pressures?

Then there is a broader point. It does, if I am right in thinking this is jumping off from 2018 Virgin cost base, ex-digital bank, it does seem to imply very, very substantial cost take-out. If I think back to 2016, Virgin used to disclose divisional costs. The bank’s approach was to allocate just the costs required to run the individual business divisions. The combined cost-income ratio for the divisions at that point was about 25%. At least based on my quick maths this morning, this level of cost take-out would take the business down to about a 30% cost-income ratio within Clydesdale. It therefore seems like you are taking out the entirety of the head office, pretty much. Is that realistic?

Ian Smith: Chris, thank you. When you say the jumping off point, you mean what is the baseline?

Christopher Cant: Yeah, exactly.

Ian Smith: The baseline is historical, the equivalent 2017 numbers for both businesses.

To your point, we think that there are substantial cost synergies available and that they come from the combined cost base. This is not just focusing on it as a proportion of the Virgin Money cost base standalone. We have very similar operations, there is a great deal of duplication. I think, on your critical point about how realistic it is to entirely duplicate functions, operations etc., we think that over three years, using our scalable platform, it is absolutely achievable. That is why the cost synergies in this deal are so strong.

Christopher Cant: To be clear, if I have understood what you have just said correctly, is part of the £120 million essentially incremental sort of CYBG standalone efficiency savings that you might have made above and beyond your existing plan? Is that how to think about it?

Ian Smith: What we have done is look at the combined cost base of the new group, figure out what we think it takes to run it and that is what drives the £120 million. It is looking at the aggregate cost base.

Christopher Cant: Okay, thank you.

Kinner Lakhani (Deutsche Bank): Maybe a holistic question first and then I will come up with a financial-type question. Combining the challenger banks, the two banks, what is the challenger proposition for the next 2–3 years that you will be implementing? Is there a risk that maybe there is too much internal focus during the merger process? I was thinking of specific areas that you planned to challenge the market.

Then, separately, on capital, especially taking into account the optimisation that you can do with both mortgage books, where do you see your hurdle rate? What is your management buffer that you plan to run with? Would you look to keep your capital ratios close to that hurdle rate or could it get beyond that hurdle rate?

David Duffy: Maybe I will just jump in at the high level to your question: where are we in the broader spectrum here? I think our first starting point was if we put these two businesses together, it is complementary. There is synergy, there is a real scale. In my mind, there is a minimum scale requirement to be effective as a competitor in this landscape. I have therefore moved us out of challenger space into competitor space. I think challengers are niche players, being a scale competitor in this country is what I mean we have now done. That is our ambition to create that effective competitor.

The second space is SME; it is a particular focus. Yes, we will play in all the other spaces, on prices and all the rest, in retail. However, in this country SME is poorly served by bigger banks. We have really first-class technology being developed in that space, 180 years of history and are growing at £2 billion a year already. We expect to be very
successful in the Williams & Glyn process; we would expect that with the business being a franchise growth story, both physically and digitally. When you ask about where we would place an emphasis, that is probably it. Competition nationally in all but we see a unique advantage with our size, agility, technology and the brand, frankly, versus the other banks. That is therefore where our emphasis will be and that is where we would position ourselves. We are moving out of the challenger space, that is lots of niche players, into really a credible competitor to the bigger banks.

The last thing I would say is scale is not meaning that you have to get bigger to be better and to be a better competitor. I think the next generation model of banking, including open banking, which is where we are leading, is going to be about partnerships, alliances and at an efficient scale. That is the model we will be applying. You will see us very much in the open banking marketplace offering a range of other services and competing effectively there.

Debbie?

Debbie Crosbie: Just to build on that, I think that what we have is a very integrated model to deliver a joined-up experience. It is anchored in the current account proposition. We are very well through the build and delivery of all of that and are very confident that we can really exercise a great customer experience in pulling that together.

We see ourselves as a very real competitor to the big five banks in delivering quite a different experience. Frankly, a lot of the build and heavy lifting of all of that is behind us. We are fully separated from NAB and very confident that we are ready for the next set of challenges.

Ian Smith: Just before I get onto capital, just my own contribution is that I think we will institute a £5 contribution to charity any time someone says ‘challenger’ in one of these sessions now. We are bored of that.

David Duffy: We are all grown up now.

Ian Smith: In terms of capital and capital hurdle rate, this is a business which, in combination, we expect to generate substantial capital. We do not expect to hoard that capital. We have a fair bit going on, but the capital generation is expected to be very strong, alongside the material up sides that we see from both Virgin Money’s model recalibration and our own IRB accreditation.

In terms of where we expect to be, we have always been pretty consistent when talking to you guys that IRB and achieving IRB accreditation is an important threshold for us in recalibrating our RWAs and then thinking about the level of capital that we would run at. That accreditation is expected, as we have always said, by 1st October 2018. We always said we would have a conversation with you guys once that had been achieved so we will stick with that.

I guess from day one we are comfortably over 12% in terms of CET1 ratio. However, that is over 12% with a big chunk of the book on standardised risk weights. I think there will then be a settling down process that has us calibrating our level of capital, commensurate with what we see elsewhere in the market and appropriate for our risks. We are not a DCIB or anything of that nature, so we will not carry the same burden that the other national competitors have. We will be able to say more about this, I think, in November. However, we are in a pretty strong position compared to the PRA’s capital requirement from day one with material upside.

David Duffy: Just to close out on your last point, you referenced a little bit capacity, perhaps and distraction, we have been very focused on this. I think one thing to recognise is we are ending the first three-year phase of a strategy. Within that, as Debbie has talked about, 28 of the 29 separation initiatives are completed. Most of the other big initiatives are coming off with deadlines that you all know: building out our entire digital platform and launching it in the market, building out for PPI for 3,000 people. We are therefore releasing tremendous capacity.

Secondly, the capacity that is available in the actual acquisition of Virgin Money and putting the two resources will be added to the mix as well. They have a very talented group of people.
We therefore feel, actually, pretty comfortable. As we have said, it is not a massive high-tech integration of technology or anything like that so this is about managing smart and integrating but primarily focusing on growth to that larger customer base.

Jim Pettigrew: I would just echo David’s points. From a board perspective, we are really focused on getting that right balance between the internal, just executing on the transactional side but at the same being very cognisant of the external perspective as well. That is a real focus of the board over the next couple of years, to be perfectly frank.

Aman Rakkar (Barclays): Just one question on TFS, please. Thanks for your initial comments on that. Could you give us some indication on how much of the circa £9 billion you would be looking to replace from your retail deposit base versus wholesale? Perhaps, within that retail, how much is coming from current accounts, savings and others? Virgin Money historically have been quite helpful there. I think they talked about two-thirds from the retail book, one-third from wholesale issuance.

More broadly, when you think about replacing that funding going forward, do you envisage a scenario where you could potentially have to pay up for current accounts, for example? That is quite a significant chunk of funding that is coming out of the market over the next couple of years. Some people think that is a key headwind for UK retail banking. I would be interested to have your thoughts on that more broadly as well.

Ian Smith: Sure. Thanks for that and it is an important question.

The way we think about this is always having regard to our loan-to-deposit ratio. We have capped that ratio at 120% while TFS is in operation. Our normal operating level is about 115%. That said we see value in diversity of a funding base, both deposits and wholesale.

If we think about how we expect to fill this, first of all we are very focused on our requirement to go out and build around £3–3.5 billion of MREL over the next few years. That is concurrent with TFS refinancing. Both companies have started off on that path with inaugural issues and we have plans to fill that. We expect to continue to source the wholesale funding markets.

Our digital capability and in particular the opportunity that comes from the RBS Incentivised Switching process for SMEs we think will help drive low-cost deposit growth. However, as ever, we have consistently said that this is a question of managing the mix. We will go to both our SME current account base and our SME deposit base. Our blended average cost of funds in SME deposits is 25 bps. We have access to retail markets, so if we manage the mix we think it is entirely manageable across what is a substantial deposit franchise with strong loyalty.

David Duffy: We have national acquisition capability in that respect now, plus the digital enhanced version of it. We therefore have a broader reach in the space as well.

Debbie Crosbie: Just finally, we will be adding the full capability that we have in the CYBG branches into the Virgin Money branches, which will extend that deposit-taking capability for retail and SME right throughout the geographies.

Richard Smith (KBW): Hi there. Just two, please. The first one is just in terms of the end-state branch network once you have done the optimisation. How big do you think that will be, please? Sorry if I have missed that somewhere.

Then, secondly, in terms of some of the costs that you have been flagging this morning, how much of that do you expect to be capitalising, please?
Ian Smith: Okay, thanks Richard. In terms of branches, you have not missed anything; we have not given numbers. That is deliberate. We have a good sense of where it makes sense to retain branches and not. I guess what I would point you to is: in terms of synergies the network optimisation is the smallest part of what we have set out to do. I am sorry, your second question has just popped out of my head and I cannot read my writing.

Richard Smith: I am just thinking about the flow-through of intangibles and goodwill and how we should think about capitalised –

David Duffy: It is an intangible question.

Ian Smith: Yeah. I do not have a particular proportion of how much I would expect that to be capitalised. Broadly speaking, I think a good deal of it will be expensed through the P&L. If we think about the make up of synergy cost to achieve, it tends to be severance costs, lease breaks, contract break fees and other things. Debbie has said we are not expecting to build a lot of new technology here; we have the capability already. That therefore argues for a substantial P&L treatment.

Richard Smith: Thanks.

Guy Stebbings (Exane BNP Paribas): My first question was on capital. I appreciate you want to come back to the go-to target once, hopefully, you have IRB approval on the mortgage book. However, specifically on this transaction alone, do you think it should increase or decrease your go-to? On the one hand, perhaps, Pillar 2A could calm down because of the diversification benefits; I do not know if you can share any thoughts around that. On the other hand, maybe you want to have a bigger management buffer as you see how the credit card book performs as it seasons more. That was the first question.

The second question is: can I just check, the £120 million of cost savings excludes potential benefits in terms of the digital bank at Virgin Money; does the £240 million exclude any potential write-off costs associated with that?

Ian Smith: Okay, thanks Guy and good morning. In terms of go-to capital requirements, I think we will see a bunch of puts and takes as we work through the position with the PRA. What we have talked about is some of the things in our Pillar 2A that we would expect to see come down. We think that perhaps holding some additional capital to manage execution risk is something that the PRA would support. However, I think where we have gone to is, that we have talked about the capital requirement and the buffer from day one in the slide. That is how we are thinking about things on a standardised basis. However, as we say, we are going to come back very deliberately once we have that level playing field of capital requirements and be very clear about where we should be. That will be commensurate with our risks.

In terms of the £120 million, we are absolutely clear what is not in there, because it is not in the current cost base, are any run costs associated with Virgin Money digital bank. As I said in my presentation, I think there are estimates in the public domain. We have not made any assumptions about what happens to anything that is carried on the Virgin Money balance sheet in relation to their digital bank operation because of, a couple of things. It does not have a capital impact to the extent that it would not be carried on the balance sheet. Secondly, once we get in there and we understand capability and all those sorts of things, we will make the right decisions at that point.

Shailesh Raikundlia (Panmure Gordon): Hi, good morning. I have just one point of clarification on costs and then another question on revenue synergies. On the rebranding cost, £60 million, I am just trying to work out whether
that is a one-off cost or you are going to use it as a business-as-usual? Obviously the other £240 million is CTAs. Could you clarify that please?

Secondly, on revenue synergies, I am just trying to work out whether you envisage any clear, or very short-term, revenue synergies coming through, particular in terms of the funding side of things? We realise there is a lot of margin pressure coming through but with your current accounts that could be very beneficial to the likes of Virgin Money. Thanks.

Ian Smith: Okay, thanks Shailesh. To your first question, the £60 million is one off. That is, as I talked about, making changes that we need to products, to IT and to the physical infrastructure.

In terms of ongoing costs, cost of marketing and things like that, if Helen Page, our Innovation and Marketing Director, were up here she would be talking with great excitement about the brand and the benefits of the brand. Actually, you get quite a lot of halo impact from everything that Virgin does into the Virgin Money business. We are not seeing an ongoing cost from brand other than the trademark licence fee, which is already in our synergy calculations.

In terms of revenue synergies, we expect to see a build over time as we deploy products to the customer. In terms of funding synergies, I guess our blended marginal cost of deposits is lower than Virgin Money because of the benefits of our current account base. You might therefore expect to see some short-term benefits from that. However, we are really focused on the three-year synergy picture.

Shailesh Raikundlia: Thanks.

Ebrahim Saeed (Deutsche Bank): Morning, three if I may? In your presentation you disclose your Pillar 2A requirement pro forma at 2.4%, if I understand that correctly. I would just appreciate if you could provide some sensitivities around that. Then, taking that 2.4% as a static number, it seems that the combined entity would have excess AT1. What would your plans be about that?

Then, finally, what happens with the Virgin Money Group Holdings box? Will that be held as a subsidiary or over time will that disappear?

Ian Smith: Okay. In terms of sensitivities around the 2.4%, can you ask the question in a different way? I do not entirely understand that.

Ebrahim Saeed: The number could go up or down. What levels of confidence do you have on that 2.4% number?

Ian Smith: Okay. We have talked about some of the things that might help from a Pillar 2A perspective, not least the lower pension risk that CYBG faces, having undertaken significant reform of its DB scheme. I have also spoken about the fact that we will hold some additional capital in relation to the transaction and the execution associated with that.

Broadly speaking, we will not know until we have finally sorted things out as part of the change of control process with the PRA. However, I would expect, net-net, there to be no significant changes there.

In terms of just other elements in the capital structure, the group structure, what we do with the different entities and the two banking licences, we have a plan. That plan will be tested through the change of control process with the PRA. We are pretty comfortable that we will organise ourselves appropriately.
Ed Henning (CLSA): Hi guys, a couple from me. Firstly, just on the rebranding and the £60 million. I imagine that is just for the retail arm as you said you are only testing SME at the moment. If you were to rebrand all the SME, how much are you looking for on top of that?

Also, just a second one on the EIR accounting, can you give any more colour just on what kind of impact per year that would have if you did change the accounting there?

Ian Smith: Ed, on your first question, we are anticipating a rebrand of SME and therefore those costs are included in the £60 million, so keep that nice and simple.

In terms of the EIR, Virgin Money have provided the necessary disclosures around sensitivities to key assumptions in their disclosures. I think the main thing for us will be a valuation of the asset on acquisition that then will drive the effective interest rate going forward, once that is set, because that will determine it.

I think you can look to Virgin Money’s accounts for some of that sensitivity. I beg your pardon, we can point you in the right direction after this. However, it gives an order of magnitude of what would happen if the assumptions change. I think for us the key consideration is what rate do we recognise income at going forward? As I say, that is a product of the fair value exercise. I cannot really be more helpful at this stage, Ed.

Ed Henning: No, that is fine. Thank you, Ian.

David Duffy: Going to the webcast, I think Owen has one question.

Owen Price: Yes, we have two questions from John Cronin at Goodbody. They are: can you speak a little bit about the strategy for the combined group? Are there further acquisitions or partnerships with technology companies on the agenda? The second question is: can you give an indication as to your up-to-date expectation for migration to IRB credit risk models in the case of mortgages?

David Duffy: I think, just to be very clear, we are not sitting here considering another acquisition. I am a little bit tired with this one but thanks, John, for voting for our stamina in such a way. However, seriously, the view, as I mentioned a little earlier, is we are not driven by scale acquisitions. We have a view on reaching a minimum scale, or a sufficient scale and then we will be focused on the second part of the question, which is around partnerships. I think the way this world works in open banking will be a slow development for 12-18 months. However, what Debbie and I are spending a lot of time thinking about are the appropriate partners, not for scale, but for delivering the best and most unique customer experience in the country. That is the battleground, winning on that space. We think partnerships with the technology and the scale we have will be sufficient. From John’s perspective, it will not be driven by further acquisitions as a mentality. It will be very much focused on the partnerships, but we are not ready to speak to specific partnerships at this time.

Ian Smith: John, the second part of your questions was about expectations for IRB for mortgages. We reiterate our confidence in delivering for 1st October. We continue to make progress through the PRA’s evaluation. The latest position is that our confidence continues to increase.

Edward Firth: In terms of the £120 million of cost synergies that you are talking, just to be absolutely clear, that is based on today’s cost base for both companies, is that right? Therefore, effectively your existing cost programme that you have already announced and you have already targeted on is included in the £120 million. Am I right on that?

Then, I guess, secondly, the additional spend that people might be expecting from Virgin is not included. Is that absolutely right?
Ian Smith: Yes, you are absolutely right, Ed. For the purposes of our synergy statement under the Takeover Code, we have to adopt a baseline of historical numbers that are out there. That £120 million, in terms of a validated number is against that historical baseline.

And yes, to be clear, any incremental OPEX that relates to the running costs of VM digital bank are not there because they are not in the historical cost base. However, they will not be incurred.

Edward Firth: Equally, any cost programme that you have previously announced is included in that £120 million.

Ian Smith: No because essentially the synergies are off the £675 million of costs that we reported in our P&L through 30th September 2017. When we think about planning this, we have the trajectory that you all know and understand about our standalone cost base, we have the synergies that have announced today.

Edward Firth: Okay.

Ian Smith: It has to be anchored in historical fact, if you like. However, of course you guys know what we have said about where we are heading in terms of cost base, that sort of thing.

Edward Firth: I just remember I think you were already targeting £640 million, something like that. I suppose my question is: is the £35 million that you were already targeting included in the £120 million or is it separate to that?

Ian Smith: It is separate to the £120 million.

Edward Firth: Okay, great. Thanks for that.

David Duffy: Okay. Sometimes it is harder to get there.

I think we have to close there, given other commitments today. I just want to thank you all, at short notice given the announcement this morning, for getting here and for your questions. To those of you in Australia, thank you also. We will obviously be meeting with you and others during this week and then in Australia next week. Thank you all very much.

[END OF TRANSCRIPT]