CYBG PLC – Preliminary Results 2017

Presentation

David Duffy

Good morning to everyone in London and good evening to those of you who are joining our webcast in Australia. Welcome to our full year results.

As you can see, 2017 has been a very busy year for all of us. Our objective today though is to limit the presentation to 30 minutes. So, I will take it through the strategic process and then Ian will talk through the detailed financial performance and then I'll come back and conclude on our direction going forward and then we will take some questions obviously at that point.

So, if you look at 2017, it's been a very successful year for the transformation of the business. We have a clear strategic direction. It's simple. It's working. It remains unchanged from the beginning.

We're relentlessly focused on our three strategic priorities: growth, efficiency, and capital optimisation and it is all we talk about at the bank. Our focus on those has enabled us to increase our income while at the same time reducing our costs. And the positive jaws as you can see, have generated a seven percentage point reduction in our cost-income ratio. This in turn has contributed to a 33 per cent improvement in our underlying profit before tax and a 40 per cent improvement in our RoTE to 7.5 per cent. And I think that's been a terrific dynamic in this business.

Due to the strong performance and our return to a statutory profit, I'm very pleased to announce that the board is recommending the payment of our inaugural dividend of one pence per share to our shareholders. And I'm confident that we are on track, as are the board, to deliver on our target of achieving double digit returns for shareholders in 2019.

If you look at the business, a key driver of the growth and the financial performance, obviously, has been our ability to combine the digital transformation strategy with material improvements in processes that drive the customer experience. So, it's those two working together that really drive performance.

For example, we have driven customer growth in both assets and the liabilities by expanding the product suite. We launched our B credit card and on the opposite side we launched award-winning and innovative digital bonds.

Our digital brand B, is gaining a lot of traction with customers. We'll be using it as our growth brand going forward in the Midlands and the North West. We opened a B brand for retail and SME in Birmingham, for example, both sides of the business: retail and SME. It is an operational branch and also a showcase for customers to demonstrate our digital innovations.

The iB platform enables us to integrate the FinTech collaborations we're exploring. And we have recently launched our innovative digital SME lending facility, and this is quite unique. It allows SME's to apply for between £10 and £50,000 in just 10 minutes.

So we think it's a huge step forward for SMEs in an under-served sector. So, we've targeted that sector, making sure that we can deliver for them. We've also made significant improvement and progress in our key customer journeys. For example, in mortgages we have delivered a 50 per cent reduction in the time from application to offer for all of our customers and that's now down to less than 10 days, which is industry-leading. We can now offer the brokers, when they bring business to us, a decision in principal in just 10 minutes.

We can now offer SMEs account opening on a same-day basis. And our credit process enhancements have delivered a 40 per cent increase in same day credit decisions.

In terms of efficiency, we've reduced our network by 50 per cent in about four years. We've also made good progress in eliminating third party excess costs. And we are now harnessing robotics to drive out any further inefficiencies in the business.

So, in summary if you look at this combination of enhanced digital capabilities and improved customer journeys, they're delivering a much better customer experience and critically at a much lower cost to serve. That's how we're delivering the transformation. Before I get into some of the other elements let me hand you over to Ian to take you through the numbers.

Ian Smith

Thanks, David. And good morning everyone and good evening to our friends that are following this in Australia. It's great to have this opportunity to showcase the performance of our business in 2017.

As David said, we've delivered a 33 per cent increase in underlying profits and EPS off the back of solid asset growth at stable margins, a strong performance on costs, and a low cost of risk.

We've bridged half of the gap to double digit RoTE in the first year of our three-year plan to 2019. And we're also pleased to be able to recommend an inaugural dividend. Starting small as we signalled we would, but really good to get some runs on the board. And that's my one and only Ashes reference for today.

You are very familiar with our story and I've been asked not to drone on about it for too long, so I'll keep it brisk and leave plenty of time for Q&A.

This is the first statutory profit our group has reported for more than five years which feels like an important milestone. Shareholders regularly remind me that underlying profits make us all feel good, but statutory profits are what count.

As you're aware, we exclude certain items from underlying profit. As in previous periods, we've incurred conduct charges and at £58 million these are at a similar level to 2016. We also incurred restructuring costs of £67 million this year in relation to Project Sustain, our cost-reduction programme. We also have a substantial gain of £88 million before tax in relation to the pension scheme reforms that we concluded this year.

We delivered on our guidance for asset growth in mortgages and SME. Actually, it's fair to say we outperformed with a particularly strong second half. In mortgages, we saw record levels of new business flows alongside well-managed attrition. And I flagged at the half year that we were facing high levels of product maturities in the second half. And I'm pleased to say that our proactive retention measures meant that we were able to mitigate the attrition risk.

Over the full year, core SME lending attrition was in line with prior periods although a little lumpy especially in the first quarter and our growth was underpinned by strong levels of origination that we maintained throughout the year.

Our unsecured book, after shrinking a little in the first half, saw a modest growth in H2 entirely attributable to the personal loan portfolio. Now, you're familiar with our position here: we have modest growth plans in this space for now and that still feels right given the continuing competitive price environment, the levels of consumer indebtedness in the U.K., and the resultant increase in regulatory scrutiny in that space.

Our modest growth in personal loans has come via the online channel, following action taken to enhance and simplify the application process rather than from any pricing or other campaign activity. Now, just to rule that off, we wrote £213 million of PLs in the second half, compared to £171 million in the first. And our blended front book pricing over the year was 7.2 per cent compared to 7.8 per cent last year.

New business flows in mortgages were 13 per cent higher than 2016. You're familiar with our strategy by now: to focus on owner occupied ahead of buy-to-let.

And in 2017, we held our proportion of new purchase business at around 30 per cent of flow. And we did a high proportion of first time buyer and remortgage business to fill the gap left by lower buy-to-let origination.

Our owner occupied new business flow was very good across the LTV spectrum and an expanded range of products. We also benefited from continuing improvements in our processes. We talked about this at length back in May and David referenced some of the statistics in that space. Basically, when we're easier to deal with, we do more business.

In buy-to-let, we've been facing into a weaker market, as you know. But we're quite pleased with the level and quality of the business we've captured especially in re-mortgage which is about 70 per cent of our buy-to-let flow. With more owner occupied in the mix, I guess you'd expect to see a slight uptick in average LTV and LTI.

But both of those measures have held up pretty well in 2017. In SME, we maintained the pace of origination with just over £2 billion of approvals in the year, well-spread by industry sector and all at solid risk ratings and we saw record drawdowns in 2017, up 13 per cent year on year.

Over the year we saw continued pressure on mortgage pricing. And I think we all understand that had an impact on front book yields. Now, some of the reduction in our average front book pricing from 277 basis points to 246 basis points is mix related, mainly about lower buy-to-let volumes.

But around 20 to 25 basis points of the compression relates to price reductions in a competitive market. I

guess it's interesting to see that mortgage pricing is still not responding proportionately to swap rate movements. We'll have to see how that changes going forward and also what the funding environment in 2018 will do to mortgage pricing.

By contrast, SME pricing has held up well and they're still 10 to 15 points better than the average back book rate.

Asset yields in mortgages and unsecured will add to margin pressure in FY18. I don't think that's going to come as a surprise to anyone, but SME yields helped to mitigate that pressure on the bank. And it's great to have that balance in our book that we've talked about so often.

As you know, we've undertaken a major overhaul of deposits this year. Looking back over the whole year, it's pleased to see a good performance on what we might call the three R's, restructure, reprice, and rebuild. And I don't want to labour the analogy, but I think we do the basics really well in our deposit franchise with our focus on relationship customers, I guess franchise funding if you will, supplemented by building new capability.

David spoke briefly about our success in recruiting deposits through our omni-channel platform in 2017. And we've taken in more than a billion of deposits through these channels in the last four months. Over 2017, we reduced our funding costs and improved our mix. Our net deposit growth for the year was led by SME, up almost £1 billion year on year and fairly evenly split between business current account and notice account balances.

These deposits constitute solid relationship funding at very low cost. Our retail deposit performance featured solid growth in personal current account balances offset by lower savings and that savings proposition very much refreshed by our digital and omni-channel offerings.

And in connection with digital, I just want to say how proud we are of the B performance. More than 100,000 customers are now on B. At the end of September, we had £1.1 billion of deposit money with a big chunk of that new to bank. So, B is turning out to be a vibrant highly rated brand that is absolutely key to our deposit franchise.

Going forward, deposit gathering for us is all about volume and mix. I think we've demonstrated that we're adept at raising deposits to fund our growth centred on franchise funding and delivered at a reasonable cost.

While 2017 saw extensive repricing of deposits by all banks including ourselves, we're confident that our diversity of deposit sources means that we'll fund in 2018 at a similar blended rate to 2017. Before I close, just a brief word about wholesale funding. We didn't take any more TFS in the second half of 2017. Instead, we focused on getting away a high quality RMBS trade and our inaugural bail-in debt issuance which was seven times oversubscribed allowing us to tighten pricing considerably on issue.

We're really pleased with our cost performance in 2017, coming in slightly ahead of the revised guidance that we gave in our third quarter update. In Q3 we were very clear that at this stage we're going faster rather than further. And we did a fair amount of heavy lifting in the first half of the year. So, one third of the way into our three-year cost programme, we've delivered around two thirds of the Sustain initiatives, that's £90 million of gross run rate savings. And we also delivered just over half of our commitment to reduce operating

expenses by more than £100 million.

Moving into 2018, we're focused on landing the remaining Project Sustain initiatives, mainly around central cost management, especially procurement, and organisational efficiencies. Key to this is our progress towards building a fully-fledged digital business. We'll take our successful and now largely complete customer journey work and leverage our iB technology to transform the customer experience and critically reduce cost to serve.

We've already digitised most of our customer on-boarding processes and we'll go further next year with significant investment in our contact centre and customer service capabilities delivering smarter and more efficient outcomes. We're already using robotics in a number of areas and we'll extend this deeper and broader into our business.

Now, this thought process also extends to how we run the business away from the front end. We're progressively rolling out new digital tools for our staff, cloud-based solutions that drive self-service and collaboration right across the business. We're confident that this will contribute to our efficiency gains in 2018 and beyond.

Our net cost of risk is stable half on half at 14 basis points, a little up on an all-time low last year. Our key asset classes continue to perform well in asset quality terms. We're not seeing any particular signs of stress either in the actuals or the lead indicators. We're trying to be a little bit more helpful this year and indicate the gross cost of risk, i.e., you know those provision charges for the year without the noise of recoveries and debt sale proceeds, et cetera, both at the group and the asset class level.

Now, I'm sure that is creating a rod for my own back and it's going to open up a whole new source of questions, but we think it's helpful to understand the underlying costs of risk and the contribution of each of our asset classes to the overall impairment charge. And before I move on in terms of credit performance, just a wee reminder on IFRS 9, we don't implement the standard until first of October 2018. So, we get to watch everyone else go first. We'll update you indue course on the impact. But I can confirm that we will be taking advantage of the transitional reliefs on capital. All we need now is for the regulators to confirm what they are.

So, turning to capital generation, a familiar picture slightly redrawn, again just trying to be helpful, we split out the absorption by business growth between RWA and investment spend. And that's really because we're still in the heavy lifting phase of our transformation. So, while we've seen a good improvement in capital generated by the business in 2017, off the back of strong profit growth, back capital continues to be absorbed by substantial investment spending. Particularly in relation to digital, IRB, and separation. And also, the exceptional charges, the below the line stuff.

I guess one of the things I'd like to point out though is that if you did a side by side of this sort of analysis for the two halves of FY17, it would show that the bulk of that capital generation was in the second half, again, more evidence of that momentum building in our business.

Continuing that theme, 2018 should present an inflection point in that capital generation. The surge in investment spend that we saw in 2016 and 2017 will abate and begin to normalise, and when we get to the end of 2018, we expect to be able to signal the reduced burden from exceptional charges. The bulk of the

fundamental restructuring of our business will be behind us.

So, expect us to continue to work within our stated operating range for CET1 in 2018 as we continue with our transformation and we'll revisit this topic with you in some detail I guess in 12 months' time.

Turning briefly to a progress report on two of the key matters that impact our capital position, pensions and IRB.

IRB remains on track. As you know, we submitted our waiver application in April this year. And we're in the midst of the PRA's evaluation process. We found the PRA to be constructive and helpful, whilst clearly looking for rigor in holding us to a high standard. And nothing we've learned so far causes us to change our previously stated guidance on timing or RWA impact of IRB transition.

Secondly, it's been an important year for managing pension risk. A key event was the agreement with the members and trustees to close the defined benefit scheme to future accrual of benefits. In addition, we saw the culmination of the work we've done over the last few years in de-risking the scheme come through in the 2016 triennial and the IAS19 year-end position. The reduction in scheme liabilities from the closure has a clear beneficial impact on the scheme deficit in the triennial and also on balance sheet where the IAS19 position has moved into a meaningful surplus.

Now, this is helpful. It should provide a good degree of insulation against short term volatility in our CET1 ratio from pension movements. The deficit improvement in the triennial evaluation, together with the journey plan that we've agreed with the trustee, would have supported a reduction in the requirement for deficit recovery contributions. However, the board has decided to stick with the level of contributions that are already in our capital plan – that's £50 million per annum – and revisit the position after the 2019 triennial. I think it's good to be dealing with the scheme from that position of strength.

Just a wee footnote to the capital modellers amongst you: at the request of the trustee, we paid the £50 million contribution that was due in October 2017 six months early, which shaved off 20 basis points of CET1, and we won't be making another contribution until October 2018.

Finally, we have yet to see the pension changes feed through into the assessment of capital requirements, but all other things being equal, we'd expect to see a reduction in Pillar 2A capital required for pension risk when the PRA come to look at this next time.

I do shake my head ruefully at the title on this slide. But unfortunately making progress, means spending a great deal of money. You'll be aware of our announcement on conduct provisions concurrent with the NAB results announcement three weeks ago. We provide a fair bit of detail in the announcement, so I'm going to focus on two things here: a brief summary of what happened during the year and then how we see things going forward.

We've broken out the provision utilisation in 2017 highlighting the heavy demand from our back book programmes: Remediation, and the Past Business Review, and that consumed over half a billion of provision in the year.

PBR is done and Remediation is almost done. And so now it's really all about walk-in complaints from now until the time bar in August 2019. In 2017, walk-ins were around 30 per cent of the spend against the provision. So, having narrowed the scope of PPI going forward to walk-in complaints, I guess what's our thought process about the next 22 months?

We saw very high levels of walk-in complaints in the second half of 2017. Driven by heightened CMC activity and I guess also the media attention around the FCA's advertising campaign. We think that that will be sustained for a while into next year. And then we expect to see complaints tail off as we head towards the time-bar deadline.

Now, there are very few authoritative benchmarks out there for PPI complaint levels. And we're also dealing with this matter a little later than some of the other banks. Our own profile is unique to us. However, one way of looking at it is what proportion of total PPI policies have either been complained about or redressed, book coverage if you like. Based on our assumptions if complaint levels pan out the way we've estimated, that'll leave us firmly in the pack of the rest of the UK banks in terms of book coverage.

So, finally, what happens if we're wrong? The remaining balance of the NAB conduct indemnity, around £150 million, allows us to be wrong by around 100 per cent, i.e. the remaining indemnity would allow us to meet the cost of almost twice what we have provided for in terms of walk-in complaints.

And of course, the conduct indemnity is there to cover all legacy conduct matters, not just PPI. However, while we continue to manage a series of legacy conduct issues, none of them has anything near the financial impact of PPI.

So, today, we're reiterating our medium term 2019 targets, I guess with added confidence and delivery. This feels well within our grasp. And I'm sure you would expect us to do that rather than come up with a new plan after the first year of the old one. We know the strength of our business and what it can deliver, notwithstanding that we've always been quite cautious about the outlook for growth since June last year.

So, turning to the near-term and the guidance for 2018, we focused from the outset on sustainable as opposed to heroic growth. Our guidance for 2018 is once again mid-single digit growth in mortgages and SME lending, and that's off the back of a bigger balance sheet.

So, supporting our income projections for next year we started the year with healthy pipelines in both of those asset classes. While market conditions might worsen, we think we're well-placed to deliver sustainable asset growth in 2018.

Our underlying operating expenses in 2018 will be below £650 million, continuing the progress we've made under Project Sustain. And we're well on track to deliver on our commitment of a sub £630 million OpEx base in 2019.

On net interest margin, based on what we see in our business today, and assuming no further base rate rises in the next financial year, we expect to see NIM soften a little compared to 2017 and coming around the 220 basis point mark, plus or minus.

Now this reflects some pressure on margins from asset yields and a modest increase in wholesale funding costs. While the blended average cost of deposits, we expect to stay stable at 2017 levels.

Now, just a word of warning. Our balance sheet size means that KPIs like NIM can be subject to quarterly fluctuations. For example, we're somewhat pre-funded at the moment. So, to reiterate our guidance on NIM is for the full year and not for every quarter.

We expect 2018 to be another year of clear progress on the road to delivering on our 2019 targets. I think the only other matter to comment on here is dividend. We got off the mark this year, but we're not giving specific guidance or what we might expect to get to next year. We intend to progressively build our dividend each year having regard to net capital generation and the demand for capital in our business. This year's announcement should be taken as a sign of confidence in the capital generation capacity of our business.

So, thank you for listening. Now, back to David for some closing remarks.

David Duffy

Thank you, Ian. I think as you've seen from Ian's presentation, our business transformation is delivering. We've made substantial progress since the IPO. And if you look at this slide, it's in both financial performance across the P&L and also the balance sheet, and we've executed, as Ian mentioned, on our customer growth targets at the same time as reducing our cost base.

Just as importantly though, the transformation we're undertaking is building a better bank for our customers and our colleagues and this provides the real building blocks for the next phase of our evolution. I won't go through all the points but just to mention a few, having a very clear focused strategy which is consistent and doesn't change, and then an expanded omni-channel product capability for the needs of our SME and retail customers, having those available as the core of what we do is fantastic.

We've also reinvigorated our SME business and are on track to meet our commitment of lending six billion by the end of 2019.

In addition, we've already built our market-leading iB platform. It's a real-time, integrated, omni-channel platform with a plug and play FinTech capability. And that really does provide us with the platform to be a lead innovator in the market. And I'll come back to that in a second.

So, with these foundations in place, where do we go next? Our strategy is to deliver growth through our three strong brands that are all run on that one platform called iB. As you know, our Clydesdale and Yorkshire brands, have a powerful history, they have a powerful heritage, but we also now have a third brand, B.

B is a very dynamic digital brand and we've managed to attract over 100,000 customers and over £1 billion in deposits in just 18 months. So, we see it as really strong and building real momentum.

All of our retail and SME customers are moving onto the iB platform in the coming months, not years. And this means that all of these customers will be able to access the same benefits of and capabilities of B. For those of you in London, after this presentation you can experience some of the technology that we're

delivering.

This B brand as I mentioned will be our growth catalyst and that'll help fulfil the ambition we have which is to be the key banking partner for both retail and SME across the Midlands and the Northern Powerhouse and you'll see further evidence of this expansion during 2018.

And going into 2018, we will be bidding for additional funds as part of the RBS alternative divestment scheme. And if successful this will be supportive of our ambition to expand our SME presence in the Midlands and the Northwest. And I think that's a very important part of our future.

As previously mentioned, we've already built our scalable digital platform iB and this means very importantly we are ready for the future of banking today. PSD2 and Open Banking both represent a sea change for retail banking in particular and we anticipate that the banking model will evolve into more of a lifestyle marketplace model which has a central location which would include the majority of your financial services. But, also your non-financial services for both retail and SME.

What are those things you use and where will they all be? Our digital platform, with its omni-channel capability, was actually designed for that future model. We have already built, as you can see here, some of the services which we believe our customers will want in that new marketplace.

To give you some examples, B aggregation is an application which we aim to implement in the early part of next year and that will position us as the lead innovator in the aggregation of financial services products for retail and SME. That means putting everything together through the one app for all the different accounts you may have as well as credit cards.

We plan to launch that in early 2018. And the objective here is to enable our customers, in all of these applications, to take more control of their finances and to make banking stress-free.

In addition, you can see on the slide some of the capabilities which are beyond the normal like: B @ Home which is for mortgages; B for Business, which will have the same capability as the B retail app; B @ Home, mortgage products; B Money, cheque scanning; B Traveller, for convenience, discounts on the road, access to lounges; B Connected, a new digital CRM tool; B Smart, helping you save money. And that's just if you are spending money, let's help you spend it smarter; B Secure for new customer selfie verification.

So, I think what we're really saying here is that we're building the bank of the future, but we've built it and it's here today.

So, in summary we have this clear strategic direction which is simple, it's delivering, and is fit for purpose in the current economic and competitive environment. We have three brands not just the two that you knew. All of those allow us to target different regions and demographics across the UK. We have the full retail and SME omni-channel capability and we offer the full suite of products across both assets and liabilities that our customers need.

As Ian mentioned, this business has a diverse range of funding sources from SME to corporate to retail and that's both in the branch and in digital formats. At the same time, we're reducing costs and delivering on the

investment profile not withstanding that. And we have appropriate medium-term targets as Ian described.

As a result, when I look at this bank I think we're incredibly well positioned to be the most credible challenger to the big five. We have a full retail and SME bank with a market leading omni-channel digital platform and we're now ready for the future evolution of banking.

And when I talk about that and what you see here, that is the bank of the future today and not in years to come.

So, with that, I want to thank you for listening. We can talk through all of these topics during questions which are coming up. I think what we'll do is take questions in the room, then we will go to telephone next and then we will go to the web.

Q&A

Gary Greenwood: Thanks. It's Gary Greenwood at Shore Capital. I've got two questions. First one, just in terms of your investment spend, I think you're spending £350 million on primarily developing your digital platform. Virgin said that they're spending £150 million, so, you're spending £200 million more, so I was wondering what you get for your extra £200 million?

Second question on the dividend: you mentioned that the capital is going to inflect in the coming year, so I'm just wondering how quickly you can get to that 50 per cent pay-out ratio?

Ian Smith: Gary the £350 million covers a range of things. It's growth investment which is primarily around digital, but it also includes things like separation and IRB. So, it's not all focused on digital. So that's not entirely comparable with the other bank you talked about.

A good chunk of that is, as David says, behind us. We've built the capability and that goes to support the point I was making about how that sort of a surge of investment spend will abate going forward. In terms of dividends, I'm not going to be drawn on how quickly we get to 50 per cent pay-out.

I would expect us to build gradually over the next two to three years. And I think as we become much more comfortable about generating excess capital we'll start to feel more able to talk about direction of travel there.

Gary Greenwood: Thank you.

Michael Helsby: Thanks, it's Michael Helsby from Bank of America Merrill Lynch. Just three quick ones if I can. Firstly, on the margin there is a lot going on, but you alluded to your guidance being the full year margin, which given where you ended was about 221, sounds like the margin might dip below the full year guidance before it comes back up. So, I was wondering if you could give us some more colour on how you see the margin developing next year?

Secondly, other income was flat. I was wondering if you could give us a bit more colour on that.

And then just to wrap up on Gary's point, what do you think the intangible growth will be in 2018 and then if

that's done, does it go up again in 2019? Thank you.

Ian Smith: Thanks Michael. So, on the net interest margin, as I said our exit NIM in quarter four of 2017 was 221 basis points. That really was impacted by our strong liquidity in that quarter as we were doing two things there: one was preparing for maturities of wholesale funding in the RMBS space and then secondly, we had a strong deposit build. That strength in building deposits has continued into the first quarter.

I would expect to see the Q1 NIM to be lower than full year guidance. Our practice generally is to prefund growth. We think that's the prudent way to handle it. As we iron out the balance between funding and lending, you'd expect to see the NIM come back stronger in the remainder of the year.

Other income; it remains a tough old fight out there to continue to generate fees and commissions. I think holding things roughly flat is a good performance. And our thought process for next year is again that we expect to hold things relatively flat on other income.

The intangible deduction from capital is almost entirely related to our investment spend. As I said, I expect that to reduce in 2018 and indeed 2019. The reason for that is there's been significant 'hump' in separation, in particular building our treasury platform which is the most expensive capital project that we have and IRB which is not too far behind. We talked about IRB spend being around about £50 million over the period.

Once we get past that hump, we're much more focused on a normalised level of investment that delivers growth and that's anything from £100 to 150 million a year.

Michael Helsby: Sorry. Do you mind if I come back on that? What level of intangible growth should we expect in the next 18 months?

Ian Smith: So, I'm giving a slightly different answer because I'm not guiding specifically to a number on intangibles, but I would expect to see a lower call on CET1 from investment spend next year.

Michael Helsby: And, sorry, I forgot to mention on the margin, other NII this year was quite strong relative to what it's been in the past. Can you just talk about that a little bit and then I'm done. Thank you.

Ian Smith: Sure. I mean I think that there is a slightly mixed bag in there, but a chunk of it relates to swap income. I'm happy to come back on the detail of that. It's a small part of our overall income picture, both in absolutes and in delta terms. But I'll come back to you on that one.

Nick Baker: Morning, it's Nick Baker from Goldman Sachs. Just two quickly for me. So, the first is just around your positioning and your appetite in terms of gross mortgage lending market share. Since the base rate rise, we haven't seen that step up in yields to the extent that swap rates have moved. And a number of players in the last week have said, essentially that their appetite is somewhat more limited at the current spread level. So, any kind of colour or commentary on how you see yourself positioned would be helpful.

And then the second one was around the deposit growth momentum in the final quarter. I think deposits are up six per cent quarter on quarter and you just mentioned that they've been very strong in the first quarter. It doesn't seem as if you've changed much on a pricing perspective. So, an idea of what is driving that and how

long you'd expect that to continue forward would be helpful as well. Thank you.

Ian Smith: Thanks, Nick. In terms of our appetite for mortgage growth, I'd underline that we've always been, I think, fairly moderated in our appetite for mortgage growth.

We haven't pursued some of the more aggressive growth appetite that others have. And I expect that to continue. We've talked about mid-single digit. I think we blipped over that from our strong second half this year. Mid-single digit feels about right. We called, I think, a cooling off in the market probably ahead of others in moderating our growth ambition back and our capital markets day following the Brexit votes. And we think being able to do mid-single digit sensible pricing is doable.

The deposit momentum is coming from two places. I don't want to repeat a lot of what we talked about at the half year, but we stood up then and said, having done a restructure of our product set, that we would then rebuild, and we've rebuilt by launching a couple of new products, particularly in the digital space, that have gained real traction and it is extraordinary now how those channels are overtaking the branch in terms of a source of deposit gathering.

And our business deposits have performed really, really strongly. What we've done is take advantage of a slight relaxation by the PRA in terms of allowing certain types of financial intermediaries to place money on notice accounts rather than in instant access. That's helped with liquidity value. We've got some strong relationships in that space.

We've also got a real bow wave of progress on business current account recruitment.

So, as I say almost half a billion of balance increases over the year on business current accounts.

Guy Stebbings: Thank you. Guy Stebbings, Exane BNP. Just circling back to capital – it sounds like you are increasingly confident that the inflection point is going to be in the next 12 months? Can you give us a bit more of a flavour there? It certainly feels like you're getting closer on that.

And if the dividend guidance is a gradual uptick towards 50 per cent, then it looks like you could be quite a bit above the 12 to 13 per cent range. So, how should we think about that? Is it to do with using RBS perhaps more than people are expecting? Any other colour you can give would be very helpful.

Ian Smith: Okay thanks, Guy. I'm very keen that we start thinking about what the world looks like after restructuring because I think that's quite important.

I wasn't just dancing around handbags and saying "let's talk about this in 12 months" but I think in 12 months we will have a chance to restart the conversation with our shareholders and you guys on capital.

So, what's our operating range for CET1? And I'm not flagging a significant change in this, but once we get to IRB, we will work out what the revised capital requirements is. I think that's the point at which to reset it. We still think that somewhere in the 12 to 13 per cent range feels about the right place and it's not too different from, say, Lloyds or others. Although I know there's a bit of upward pressure there.

So, I think we'll come back and have a good conversation about it. But I do think that somewhere in the mid-12 to 13 per cent range still feels right at the moment.

In terms of how we might deploy additional capital, I think RBS does present an interesting opportunity. It feels to us, first of all, that it's about liabilities, first and foremost, in terms of just the specific customer base that's being incentivised to switch.

But I think that the capability that we expect to be able to deploy on the back of the funding that we're bidding for will make our business better overall. And I think that will help us add to our lending capability, broaden our product set, those sorts of things. I think that's certainly a good use of capital. But I'm expecting that in the early stages this to be primarily about acquisition of liabilities.

John Cronin: Thank you, it's John Cronin from Goodbody. Three questions: my first one is in relation to the digital transformation project. We saw Virgin Money last week, articulate possible efficiencies over a period of time and you've been investing in this quite heavily for some time and the migration process to the digital bank looks to be in the relative of near-term and clearly concurrently delivering reasonable growth as well.

So I am trying to get a sense of what kind of benefits could emerge in an open banking context from, say, FY19. Should we be thinking about how we quantify that at this juncture? Presumably there is some expectation of benefit from increased switching over time. Anything you can help us on in that context would be great.

And the second point in that context is in relation to the trajectory of the group beyond the medium-term. I don't want to be referring back to Virgin all the time but they did set out a vision for becoming a platform-esque type bank where they would have a substantial level of revenue emanating from fee income. In time, could that be a strategy that may make sense for CYBG to pursue in the context of its own advanced investment? Anything you can say about that would be helpful.

And then I have some granular questions on the restructuring costs and the investment spend. Any specifics you could give us about how that should play out from a modelling perspective, on FY18 (both H1, H2) and beyond FY18 would be very helpful. Thank you.

David Duffy: Maybe I'll pick up on the first part of this in terms of the digital transformation.

I think you know we're not going to set new targets off the back of a third-party presentation, but when we look at the critical mass of people talking about this from your bank to others, there's a lot of promises and a lot of long-dated deliverables. So, I start from the point of view that I'm not actually referencing that, because we've already got this live and we're running it.

So, we've been building that for quite some time. So, we are there. What to do on an ongoing basis? You're seeing in some of our growth rates the benefits of this already. And so, without being precise about measuring that, if I give you some examples, when you look at a mortgage process and you can bring it down to below 10 days by changing the process and you can move to a decision in principle within 10 minutes, then you're creating a broker community link and you're creating convenience for the customer. So, efficiency of customer convenience. If you look at retail account opening, if you can do that straight through in a matter

of 10 minutes you're offering that. The acquisition of that customer is therefore much more efficient.

If you go to the SME side, and I think this is the important thing for us, we can have a long list on the retail side, but we're also powering ahead on the SME side. And many people who are challengers just don't have SME, they're all talking about it. So, if you look at our latest initiative in SME offering people £10-50,000 in 10 minutes is a very, very low-cost acquisition model. It's a great convenience model. It's when you want to access it. It could be Sunday night. And that digital transformation of the process and digital access to the loan is a huge step forward.

So, as you look at that, that's also going to inform further growth in SME. So, I think, when you look at SME and retail for us, growth in retail and SME is by change of process and by digitisation. So, I think where we stand now is very straightforward.

We have all the products. We have SME. Unlike a lot of others that have retail. We have the digital capability and that platform is the only omni-channel integrated one and we're launching this kind of marketplace concept that people are talking about and there are seven products on the screen behind me which are going to be there.

It's a little early to predict exactly how that growth will happen. You need to see customer behaviours change as well as growth. So, we will see over the next 12 to 18 months what this starts to generate and what we might be able to expect, and we can incorporate that into some of our more direct plans afterwards.

Ian Smith: As David says it's about the way we deliver to our customers. It isn't about building something brand new off to the side. And I think what it does for us, if you're look for something measurable, is that we started off the first half of the year with annualised growth in mortgages at four per cent. Then in the second half, growth was clearly a lot stronger than that. Some of that will be about pricing, but a lot of that has been about the improvements in processes (supported by digital) that allow brokers to do business with us much more easily.

I can't remember if we've talked about this, but we did a video for staff where our two key brokers participated in a pilot for these new processes and we had a 'before' and 'after'. 'Before' was some of the complaints about the traditional CYBG 'clunkiness', that sort of thing. And the 'after' was the brokers saying "we're going to give you more business", "you're much easier to work with".

And that's a lot to do with digital – there's a balance between the front end, which I think is fantastic for our customers and as David says, it's built. And then secondly, it's about the value that digital brings to cost to serve and our guidance for 2019 is 55 to 58 per cent in cost income ratio terms. We're really confident that that's closer to 55 than 58 and some of that comes from digital. And we will continue to see those benefits.

I think your last question was the granular one about restructuring investment spent, similar to what Michael was going after. We spent close to £200 million in 2017 across the range of our investment projects. We expect that to be somewhere down around about £150 next year and then returning (lower than that) to a more normalized level thereafter.

In terms of restructuring costs, we guided to about £200 million all in for the sustained programme. We spent

what you see through the P&L, £112m. And so we still think there's about £80 million or so to go in respect to that. We expect to do quite a lot of that work in FY18 with the tail spilling over into FY19.

David Duffy: The trajectory – just to talk a little bit about that – when we started this IPO we said we would be in Scotland and the Northeast. We wouldn't go down South building an SME business and we would earn the trust of our investors by delivering on the promises associated with that model.

As we talked about the Williams & Glynn bid for the funds through that cycle and that process, we're looking to do an expansion across the Midlands and the North West. We've already started in the Midlands with our Birmingham branch branded B for retail SME and that digital brand will grow across those fairly big geographies with plenty of economic potential.

And then the digital brand is on a national basis. Our SME product for example, and any of the other products, are available on a national basis. So that's how we're shaping the business to have a very powerful digital brand and bank of the future underpinned by significant geographical presence in the Northern Powerhouse and in Scotland.

Chris Cant: Chris Cant from Autonomous. Going back to your capital markets day, I think you gave us this £5 billion of RWA benefit from the IRB transition as of 1H-16 figure. But I'm pretty sure you said that was across books and I think your wording today has changed slightly to say it's just coming from the mortgage book. It implies about a 14 per cent risk weighting as of 1H-16 and I think you previously guided to a 20 per cent planning assumption. So, I was wondering if you could update us on your expected mortgage risk weight post IRB transition, please.

And then secondly, there's been quite a bit of press this year around a possible £1 billion lawsuit for fixed rate tailored business loans. I'm just wondering if you can comment on this in light of the reduced balance on the indemnity. Have you received this lawsuit or is it just posturing from the class? Thanks.

Ian Smith: So, thanks Chris. So herein lies the problem of trying to be helpful. The reason we're so confident about IRB is because we've been running models for quite some time and that estimate of £5 billion of risk weight reduction related to mortgages and was based on what we were seeing from those internal models, which were not approved by the PRA.

So, what I said at Capital Markets Day was for planning purposes working on the basis of a 20 per cent risk weight. So, all of our guidance, our ROTE guidance, all those sorts of things is off the back of a 20 per cent risk weight.

Our models continue to go through the process of approval. The indications from that process are that 20 per cent as a planning assumption still feels comfortable, but we still have to get to the end point before we can say precisely what our risk weight density will be in mortgages. So that was why I was trying to say "think about it as 20 per cent and we'll see where we end up".

I still think, based on what our modelling says, that £5 billion of reduction makes sense, but we have to factor in a bunch of things like output floors and others that were not necessarily that clear at the time and probably still aren't. So, we're planning, for guidance purposes, at 20 per cent, our models are saying that that feels

pretty comfortable in terms of where we expect to end up.

And in terms of what happens with the rest of the book, Chris, I'd expect to see some benefit in SME from collateralisation and some risk weight inflation going the other way from the unsecured book and our planning assumption again for that is that they broadly offset.

David Duffy: To be specific on the tailored business loans. No, we have not received any claim. These claims are being conducted in the media typically by firms who end up taking 40 to 60 per cent of what any customer would get. So, they drive this noise in the marketplace. We've received nothing. It's that simple.

Robert Noble: Morning, it's Robert Noble, RBC. Just three questions for me. On the deposit growth, you saw strong growth in H2. It mostly came from term deposits, I'm just wondering what gives you confidence that funding, deposit funding costs will be flat next year given we're seeing rising term deposit rates? They'll probably go up when TFS rolls up from specialty lenders as well. So, what gives you the confidence that you'll keep funding cost flats next year?

Second question is on the cost of growth. So, you're guiding to mid-single digit growth in loans, but you hit eight per cent in mortgages, for example, this year, and you've given an absolute cost number. So, if you came in at eight or ten per cent loan growth what's the incremental on the cost line relative to if you did five per cent? What sensitivity is there and I presume it's going down.

And then lastly on asset quality, the split that you've given on gross asset quality on consumer was going up, is there any sign of stress or is there any reason why? I know it's not a big part of your book but just generally what does asset quality outlook in the UK look like?

Ian Smith: Okay. Thanks, Robert. So just to clarify for you, our growth in the second half was not just about term deposits. Our term deposits are up £200 million over the year, we saw strong growth come from SME and the blended average cost of those SME deposits was some 30 basis points.

So, if you look at mix – and this is what I want to stress about the strength of our business – we're a real bank that has real current account customers and so the blended average cost of our deposits is not at the top of the best buy tables for retail.

We did more in SME over the course of the year in terms of growth than we did in retail. So, I'm really trying to emphasize managing that mix is both critical and beneficial.

Our costs are not particularly sensitive to growth. So, and I think that becomes increasingly important, as we reduce our cost to serve through digital and other means, I'm pretty confident that our cost guidance isn't under threat if we were to outperform a wee bit on growth.

And again, just to clarify, we've given a cost cap below £650 million rather than saying that will be bang on £650 million. But the important point is in our organic activity, we are not particularly sensitive to outperforming a little bit on growth.

It would be different if, for example, as part of gearing up for dealing with the RBS switching that we would

have to go and open new premises, build up teams all of those sorts of things, but that's a separate story and we'll ensure that that business case is absolutely compelling. But our core business is not sensitive to our performance on growth.

In terms of unsecured consumer, I think a 250 basis points gross cost of risk is about the right place. So, I would say that we probably saw slightly under in each of the last couple of years and as far as we can tell, backing into what some of our competitors, do that's inline with what they're seeing. So, I don't think we're out of line in that respect.

So, in terms of where we think cost of risk might go, I've talked before about a modest step up from here in each of the next couple of years. That's still what we're seeing. But, in terms of the overall gross cost from each of our three portfolios, certainly our central assumption is that next year will look a lot like this year.

Ed Firth: It's Ed Firth here from KBW. Can I just bring you back to your 2019 targets? I think you described it as your medium-term targets and in particular the double digit target which I guess you reiterated. The maths is reasonably simple: it looks like that must be somewhere around £400 million of PBT, something like that, and we know what cost number you're punting to and I guess you've been pretty clear about other income and provisions.

So, it seems you're looking at quite a big uptick in terms of net interest income which seems strange in an environment where you're guiding down in terms of the margin near term and you talk a lot about competition and you said how you're going to grow into 2019 when B is going to be facing more new players rather than less.

So, I guess my question is: what am I missing in that equation that gets me to the right number and makes you feel confident that you can reiterate that target?

Ian Smith: So, we're almost there. Right? As you say, it is predicated on something of the order of £350-400 million of profitability. And while we see a bit of softening on NIM, and let's be real here, this is not net interest margin falling off a cliff by any means, we're going to deliver growth. So, we expect interest income to continue to grow year over year.

You've seen our progress on costs and that will continue. I would just ensure that everybody understands that we're not deliberately being coy about this, we said we expect to be below £630 million in terms of OpEx in 2019.

I think that we will still see relatively benign credit conditions. And if you look at the bulk of our book which is in mortgages and the credit performance of that has been really strong. So my deadline feels quite good.

I'm worried I'm being drawn into profit forecast here. So, I'm keeping it as vague as I can, but that's the reason for our confidence. And we're almost at £300 million of profits at the moment, so I definitely think this is now well within reach.

Ed Firth: Can I just come back? In terms of when you look at those numbers, where are the areas that worry you? What do you think would push you off that track?

Ian Smith: I think that there is still a degree of macro risk that may make growth more difficult. If we're thinking about our principal risks to delivery that would be one of them. And there's no question that we're working hard to deliver the rest of the cost reductions. And while we remain confident there are some things we might choose to slow down because of market conditions or because of other particular features. It's not as simple as simply saying we'll close some branches. So, I think managing that is something we're very vigilant on. But broadly speaking there isn't anything because we're such a self-help story. We're not seeing anything out there that is going to derail CYBG.

David Duffy: Okay. I think we're just going to go to the phones now.

Ed Henning: Thanks, guys. Couple questions for me. First one on the NIM. Can you just talk about what your outlook for mortgage competition is? Are you assuming it continues at these levels or with the roll off of the TFS game, it improves a little bit?

Ian Smith: Okay. Do you want to give me a second one as well, Ed?

Ed Henning: Yes, second one, just on the customer journey, you talk about you're almost done, what's left there? And also, as you roll out into the iB platform does that include all the lending stuff for both mortgages and SME or is it just deposits?

Ian Smith: Okay. So, on outlook for net interest margin and particularly competition in mortgages, our central case is not for a further step down or step up in competitor activity over the coming year. And I think there'll be a number of factors that influence that. I think taking them in chronological order there is a school of thought that says TFS is going to make life a bit more difficult for challengers, or rather the ending of TFS.

Conversely there are plenty of big banks out there that, like us, have been sensible around TFS and therefore that's not going to be a feature particularly for them. But I think it will impact certain sectors of the market. I think we've also seen in recent news, two or three key players start to talk about protecting margin, moderating growth ambition, that sort of thing.

We moderated our growth ambition 15 months ago and so no surprise there for us. So, our central case is that we're not going to see a significant leg-down in pricing next year in mortgages.

In terms of the journey work, that's the nuts and bolts of what we're doing, and the key stuff is done. We've got a few bits and pieces still to complete but we accelerated that work to ensure we are done by the end of 2017. And I think focusing on cost to serve, ensuring that we can deliver for our customers right across the omni-channel spectrum, but increasingly digital.

So, deposits as you point out has been a good space for us. You'll see more digital-based lending both in terms of consumer but particularly importantly in SME as our micro SME online proposition that we've just launched starts to gather pace.

David Spotswood: Thanks. If you could just repeat what you just said in terms of return on tangible equity targets for 2019 that implies £350 to £400 million – that's a pretty high number. I assume that your returns

would target some sort of capital management but sounds like you're suggesting it doesn't? That's my first question.

The second question, if base rates go up by 100 basis points in the U.K., what's your feeling in terms of what that does to your NIM?

And my last question, when you're talking about B and talking about the growth environment, you're talking about your strong top line volume in the second half, your second half of growth was 4.2 per cent, or annualised 8.4 per cent, why is volume growth only going to be 5 per cent in FY18?

Ian Smith: Thanks, David. So, in terms of RoTE, there's a bunch of moving parts in there and my response to Ed Firth's question earlier was, when was proposing a hypothesis of what the numerator would be for that, is that there is a bunch of capital thoughts that go in there as well. Jarrod Martin called me out at Capital Markets Day last year in assuming that part of the RoTE improvement came from IRB and that's part of the capital action that we would take.

The fundamental though is that we're really focused on return. And we think that and the strength in business performance and therefore the numerator in the ROTE equation is one that gives us great confidence in bridging that gap. So, there's all sorts of things going on in there but it is just about fiddling with the capital base.

In terms of impact of base rates in the U.K., so just to be clear our guidance assumes no more increases, there are some market commentators out there that think we will see base rate increases and I think some people have predicted a couple in 2018. Broad rule of thumb: twenty-five point increase all other things being equal probably worth about £10 million of NIM over a full year. Obviously, there are some swings and roundabouts in terms of how much of that gets passed through and when but that's a good rule of thumb.

And then in terms of growth. Your challenge as to why our growth is lower than the second half of FY17: we did really well in the second half of 2017 and low mid-single digit is a range from four to six per cent. And we will use that range based on what we see in terms of market pricing and other things to ensure that we deliver profitability. So, I think it is four to six per cent and that's a prudent place to be.

Jarrod Martin: It's Jarrod Martin from Credit Suisse. Don't worry Ian, I'm not going to call you out on the RoTE target this evening. So, one question, or a couple of questions around the Williams & Glynn opportunity; there are substantial capability awards that are on offer, some in excess of £100 million for the successful applicants, so I'm wondering what you're targeting?

And then secondly once getting those awards, how quickly do you think you can execute on transitioning the customers across? Also considering one, their inertia and also the fact that RBS get a substantial penalty if they don't come across.

Ian Smith: Okay. So, we're a Pool A applicant in that process and the Pool A awards are £120 million, £100m and £60m. Clearly it will be competitive. I'm sure in some respects it'll be a pretty bloodthirsty competition for that level of award. But we're in that pool and we think that based on our track record of delivering new growth in the market which is really what this is all about, it's about promising that we have a strong case

compared to some of the others that might be in there. But it's certainly competitive.

In terms of being able to gear up and capture the customers that are proposing to switch, we'll be ready right from the get go. You know the capability money is, for us, is about, broadening our reach and our proposition. We're already geared up to handle significant volumes of customer growth because we do it every day. And 12 months ago when we were in serious discussions with RBS when they were thinking about selling Williams & Glynn, we were getting our heads around the basis of which we might be able to switch 100,000 customers a month.

So, we have that capability, we're really good at that, and if you look at some of the customer acquisition we've done over the last 12 months in business current accounts, then it underpins that doing the levels contemplated in Williams & Glynn is well within our reach.

I think in terms of how this drags on, RBS are incentivised to make this work. They said that to us when we we've been speaking to them. We get that sense from the Treasury and other officials overseeing this. And our general belief is that if customers are not moving, then RBS is going to be tasked with getting those customers across and if necessary expand the pool of available customers. This has to work. All of our discussions with the Treasury in the run up to this were about how they saw the scheme and that it was essential that RBS lose two and a half percentage points of market share.

Brett Le Mesurier: Thanks, this is Brett from Velocity Trade. The question is on deposits: your average balance sheet showed that the deposits fell by £1 billion from H2 to H2 so to what extent do you have to pay up to get the deposits to bounce back like that and where are you running for cost of deposits at the start of FY18?

Ian Smith: As we talked about, in restructuring the deposit portfolio, we did see liabilities and leave the bank in the first half. And we talked in our half year results about rebuilding those through the second half of the year. Where that rebuild has come from, as I said is a strong growth in SME and that that blend of deposits in terms of current account balances and business notice accounts from our SME customer base was priced at some 30 basis points.

Conversely, there's a fair bit of competition for term retail money out there so that's been a bit more expensive. But the volumes we've recruited are lower overall than historically. So, we've changed the mix in our savings book. As a consequence, in slide 11 I think you're referring to, is that the average cost of deposits was 47 basis points in 2017. We're guiding to stability in blended cost of deposits through 2018.

Brett Le Mesurier: My question was more about what happens at the end of the period? Did you have to pay up at the end of the period?

Ian Smith: I think I confirmed that in that the more expensive retail money was part of our mix in rebuilding the deposit base. But it's a much smaller proportion of our deposit base than historically.

David Duffy: Okay. I think that's all the questions we have. And there are none on the web. So, we're going to call to a close there. So, thank you all for coming. And there's toys to play with at the back if you want to look at the bank of the future on the way out. Thank you very much.