VIRGIN MONEY UK

***01 February 2023***

**Virgin Money UK PLC: First Quarter 2023 Trading Update**

***David Duffy, Chief Executive Officer:***

"We've had a positive first quarter with continued good progress on digitisation and growth in lending across the business as more customers choose Virgin Money. Arrears remain broadly stable but we've increased the support available to those who need it and remain prudently provisioned for an uncertain economic outlook. Looking ahead, we have good financial momentum and a number of exciting digital product launches to come which will support our continued growth"

**Q1 Summary: Prudent, profitable growth in customer lending; broadly stable credit quality**

**Targeted growth across customer lending, up 0.7% in Q1; further optimisation of deposit mix**

- Mortgages grew 0.4% in Q1 to £58.4bn as a strong pipeline drove completions
- Business lending was up 2.4% in Q1 to £8.4bn, with BAU balances 4.0% higher due to good quality growth in our defensive specialist sectors, offsetting Government scheme run-off
- Unsecured lending increased 0.9% to £6.2bn; more moderate pace of growth in Q1 reflecting a disciplined approach to credit and profitability
- Overall deposits grew 1.2% to £66.2bn, with strong growth in new term deposits at attractive pricing offsetting lower savings balances; relationship deposits +1.2% and 53% of total deposits

**Delivering on our digitally led strategy; growing our relationship customer accounts**

- Further growth in total active relationship customer accounts (+34k during Q1)
- Fully launched 'Slyce', our innovative Buy Now Pay Later product
- Finalising new digital mortgage platform, which will transform our mortgage proposition and improve service to customers and brokers; launching to Direct customers in the coming months
- New digital investing and pensions platform in final stages of testing; full launch of investment solutions and new funds via new mobile app anticipated in Q2
- Digital self-service customers in cards and PCAs increased from 56% at Q422 to 58% at Q1

**Credit provisions and coverage increased; asset quality remains broadly stable**

- Overall arrears remain broadly stable across key lending segments
- Provisions increased to £485m (Q422: £457m) driven by higher modelled ECL in cards, reflecting prudent new business staging & the expectation arrears will normalise from low levels
- PMAs maintained, taking overall coverage higher to 66bps (Q422: 62bps)
- £66m impairment charge in Q1, equivalent to 36bps cost of risk (CoR)
- Continue to expect FY23 CoR around through the cycle level of c.30-35bps
- Providing support for customers dealing with rising living costs, including tailored forbearance solutions as required; online Cost of Living hub established

**Further improvement in Net Interest Margin (NIM)**

- NIM improved in Q1 to 189bps (Q422: 186bps) as benefits from higher rates, structural hedge contributions and deposit margins offset ongoing mortgage spread pressure
- The Group expects NIM to remain in the 185-190bps range for FY23

**Continue to expect a c.50% cost:income ratio in FY23 as gross savings are delivered**

- Expect H2 to benefit from lower costs related to the completion of our investment in mortgage digitisation, reduced temporary costs to support service and delivery of cost saving measures
- As we continue to improve service levels, we have paused some restructuring activity in H1 but continue to expect majority of remaining c.£190m of restructuring costs to be incurred in FY23

**Capital position remains strong; maintained robust funding**

- Completed inaugural £75m share buyback; £50m buyback extension c.63% complete in Q1
- CET1 ratio stable at 15.0% (including full c.20bps impact of £50m buyback); benefitting from ongoing profitability and stable RWAs; fully loaded CET1 ratio now 14.7%
- Mortgage hybrid implementation in Q2 expected to increase RWAs by c.£1bn (at the lower end of previously guided range) and modestly increase excess expected loss (EEL) capital deduction
- Basel 3.1 implementation on 1 Jan 2025 currently expected to have no material day 1 impact on the capital position; no constraint from output floor expected until late in the transition period
- Robust funding and liquidity position; LCR at 144% (Q422: 138%) and LDR stable at 110%

## Pioneering Growth

| (£m) | 30 Sep-22 | 31 Dec-22 | Q1 growth | Q1 annualised |
|---|---|---|---|---|
| *Mortgages* | *58,155* | *58,402* | *0.4%* | *1.7%* |
| *Business* | *8,247* | *8,449* | *2.4%* | *9.7%* |
| *o/w Govt lending* | *963* | *872* | *(9.4%)* | *(37.3%)* |
| *o/w BAU Business lending* | *7,285* | *7,577* | *4.0%* | *15.9%* |
| *Unsecured* | *6,163* | *6,219* | *0.9%* | *3.6%* |
| Customer lending | 72,565 | 73,071 | 0.7% | 2.8% |
| Customer deposits | 65,360 | 66,153 | 1.2% | 4.9% |
| *o/w relationship deposits* | *34,649* | *35,054* | *1.2%* | *4.6%* |

We are pleased with our progress in the quarter as we continue to deliver on our strategy, despite the uncertain economic backdrop. We have continued to digitise the Bank, and we are also seeing positive customer reaction to our digital propositions, with further exciting launches to come. Alongside this, we have good financial momentum, including stronger margins and profitable, well-managed growth, while controlling costs, maintaining robust capital and safeguarding and supporting our customers.

Mortgage balances increased during the quarter by 0.4% supported by the strong pipeline of business established last year, and despite the slower housing market in Q1. Completion spreads remained below back book levels throughout the period. Front book application spreads improved through the quarter, but there are signs of competition returning to the market this year. In the near term, the Group expects more muted mortgage volumes, in line with the subdued market backdrop. The Group is currently finalising its investment in a new mortgage platform, which will be launched for Direct customers in the coming months, and Intermediaries soon after. This will create a smooth end-to-end digital process for both direct customers and mortgage brokers, improving both efficiency and customer service. This will extend our market reach and enable us to compete better over the medium term.

Business lending increased by 2.4% in Q1 to £8.4bn as a reduction in Government-scheme balances was more than offset by 4.0% growth in BAU balances in a subdued market. BAU performance was supported by the conversion of a strong pipeline of new business, reflecting the strength of our franchise and sector specialisms in resilient market segments, as well as a phasing impact from the timing of drawdowns. Government-scheme balances declined (9.4%) to £0.9bn as expected, as borrowers made contractual repayments. The Group expects a more moderate pace of growth in Business lending through the remainder of FY23.

Unsecured balances increased 0.9% in Q1 as we moderated credit card growth, given the weaker credit environment. New accounts opened in Q1 totalled 121k, which was a reduction from Q422 (159k) as the Bank increased product pricing, driving improved profitability, while further tightening affordability criteria. Aggregate customer spending has remained strong across all categories and repayment rates remain broadly consistent, with no indication that current spending levels are increasing repayment risk. Personal Loans and Overdraft balances reduced modestly during the period in line with expectations. The Group continues to expect Unsecured balances to grow at a more moderate pace relative to FY22, reflective of our disciplined approach to credit and profitability.

The Group continued to improve its mix of deposits, as relationship deposit balances grew 1.2%, supported by strong customer propositions and competitive rates. Overall deposits increased 1.2% in the period as the Group acquired new term deposits at attractive spreads. Non-linked savings balances reduced during the period, given higher attrition and churn from the back book and as the Group prioritised the current good value opportunities available in the term deposit market.

NIM improved 3bps in Q1 vs. Q422 to 189bps, as the benefit of higher rates, increased structural hedge contributions and better deposit margins offset ongoing competitive pressure in mortgages and higher liquidity-related average interest earning assets as anticipated. As these trends continue, the Group expects NIM to remain in the 185-190bps range for FY23.

Non-interest income, excluding fair value movements, was resilient, supported by card spending and business activity levels. During the quarter, there was a c.£13m adverse impact from fair value movements due to hedge ineffectiveness and rate volatility in the period.

## Delighted Customers and Colleagues

During the quarter, the Group has made further progress in enhancing its digitally led propositions and attracting new customers, with a 34k growth in total active relationship customer accounts to 3.6m.

In November, the Group finalised the launch of Slyce, our Buy Now Pay Later functionality with market-leading terms, in a regulated credit environment that will support customers in building and improving their credit score. There has been a strong level of customer interest to date, and we expect to build new accounts responsibly over the coming months as we expand marketing and refine the customer journey. This exciting new capability has further enhanced the overall cards proposition, adding to our compelling cashback programme. At the end of Q1, there were more than 700k participating customers in the cashback programme (Q422: c.650k), driving additional engagement across PCAs and credit cards. The programme has expanded further in Q1, and now gives customers access to more than 250 offers across 80 retailers.

We are making good progress with the development of our Digital Wallet. Having tested the functionality with a closed user group, we will soon invite Virgin Atlantic credit card holders to download the app, which will allow these customers to create instalment plans and earn rewards. This is an important milestone and we will continue to build the Wallet's capability over the coming months.

We are in the final stages of testing our new digital investing and pensions platform and app to help build our fee-earning capability. The new platform incorporates new, responsibly-invested (ESG) funds, a seamless customer journey and offers customers Virgin Red Rewards, with a public launch anticipated in Q2. The new digital platform will enable customers to access digital and telephony servicing while offering a rich mobile app experience.

We continued to attract new current account customers during the quarter, supporting the Bank's strategy to build a lower cost, stable funding base. There were c.27k new personal current accounts opened in the period (+44% YoY), which reflected a strong performance in a competitive environment. We were particularly pleased with our Business Current Account (BCA) performance as we opened c.9k new BCAs (+92% YoY) and continued to grow accounts on a net basis for the thirteenth consecutive month, increasing our market share despite a challenging market. This performance reflects the strength of the proposition and ongoing improvements to the digital customer experience.

We are committed to supporting our customers to manage the wider cost of living crisis. We have established an online Cost of Living hub, which offers free advice and support to customers who are seeking guidance on managing their finances. Where customers require tailored support, we are providing assistance, including the ability to restructure facilities or make reduced payments. During the quarter, we also partnered with Youtility, giving customers the ability to save money on their bills, accessible via the Virgin Money Banking App.

Having fully embedded the A Life More Virgin colleague proposition last year, the Group recorded its highest ever sustainable engagement score of 83% in Q1. This was up 4%pts from the previous survey undertaken in the summer of 2022 and reflects the success of our approach to operating a truly flexible working model. In January, we were pleased to welcome Sarah Wilkinson as Chief Operating Officer, bringing together the Group's Customer Experience and Digital & Innovation functions.

The Group has continued to make progress against its Sustainability agenda. Following the disclosure of our initial roadmaps and targets towards net zero at our FY22 annual results, we have continued our work on calculations and targets for remaining business sectors, operational emissions and supplier emissions. We will provide a further update on progress alongside our annual results. The Group also launched its Green Rewards Mortgage proposition in Q1, incentivising energy efficient homes and streamlined its Sustainable Business Coach app, helping businesses improve their ESG credentials.

### Super Straightforward Efficiency

The Group has continued to build momentum in implementing its Digital strategy, which will drive improved efficiency and cost reduction over time. In Q1, the Group further optimised digital journeys and introduced new initiatives enabling customers to self-serve, contributing to the improvement in digital primacy, which measures the proportion of active PCA and Card customers who are digital only in their engagement with the Bank, to 58% (Q422: 56%). These initiatives included the introduction of Live Chat capability for credit card customers, following the successful deployment to PCA customers last year. The Group will continue to improve digital journeys and is also developing new tools to create a more conversational form of online banking, including a new virtual assistant chatbot linked to our core systems, which will be able to make real-time changes to a customer's account.

The Group remains on track to deliver a c.50% cost:income ratio for FY23 as it delivers planned cost saving measures. While we continue to take costs out of the business, there are some short-term drivers of cost inflation. These include the finalisation of our investment in mortgage end-to-end digitisation and temporary additional measures to safeguard service, including strengthened call centre resourcing during a period of elevated customer demand, driven by the multiple base rate changes and further rate volatility post the mini-Budget in September. In order to further underpin service levels, we have also paused some restructuring activity. Consequently, we expect underlying costs in H2 to benefit as shorter-term cost headwinds abate and as cost saving initiatives earn through. We continue to anticipate the majority of the remaining c.£190m of restructuring costs to be incurred in FY23, weighted to H2.

## Discipline and Sustainability

We remain cautious on credit, given expectations for GDP growth to remain challenged and inflation to persist. Credit quality remained relatively stable in Q1 despite continued economic uncertainties, with the portfolio continuing to perform well. Overall arrears, excluding government guaranteed loans, remained broadly stable during the period and there were no significant changes in individually assessed provisions. Towards the end of the quarter, the Group implemented further tightening of credit criteria, to improve the resilience of returns.

In its IFRS9 modelling, the Group applied the same economic scenarios as at Q422, given the quarterly reporting period, including a 35% weighting to the downside scenario. Overall credit provisions increased to £485m (Q422: £457m), taking aggregate coverage higher to 66bps (Q422: 62bps). This was mainly due to higher modelled ECL, largely in credit cards, reflecting our prudent approach to the staging of new business and our expectation that arrears will continue to normalise from recent low levels. Accordingly, the modelled and individually assessed ECL increased to £406m in Q1 (Q422: £372m), while PMAs were maintained at £79m (Q422: £85m). The combination of these factors resulted in an impairment charge of £66m during Q1, equivalent to an annualised cost of risk of 36bps. The Group will continue to monitor and fully refresh the economic scenarios used in IFRS9 modelling and will update PMAs alongside the interim results. Based on these factors, the Group continues to expect FY23 cost of risk to remain around the through the cycle level of c.30-35bps.

The Group remains strongly capitalised with a CET1 ratio of 15.0% on an IFRS9 transitional basis in Q1 (Q422: 15.0%), including unverified profits for Q1. Fully loaded CET1 also remained robust in the period, improving to 14.7%[1] (Q422: 14.6%). VMUK's total capital ratio was 21.8%[1] (Q422: 22.0%); the UK Leverage Ratio was 5.0%[1] (Q422: 5.1%). We were pleased to commence our £50m extended share buyback programme in November, which was fully recognised from a regulatory capital perspective in Q1 and consumed c.20bps of CET1. The extended share buyback is c.63% complete and follows our inaugural £75m share buyback, which was completed during the quarter. The Group currently expects any further buybacks to take place after the results of the BoE's 2022 Annual Cyclical Scenario stress test are published in the summer, subject to regulatory approval. Capital generation during the period (net of the extended share buyback), was underpinned by ongoing profitability, while RWAs remained stable at £24.0bn (Q422: £24.1bn). The Group expects to operate above 14% CET1 in FY23, given the level of macroeconomic uncertainty, before returning to its 13-13.5% CET1 target range by FY24. This includes the anticipated impact of implementing mortgage hybrid models, currently expected to increase RWAs by c.£1bn and modestly increase the EEL regulatory capital deduction in Q2.

Following the BoE's recent consultation paper on implementation of the Basel 3.1 standards, the Group currently expects no material day 1 (1 Jan 2025) impact on the capital position. Given the Group's risk weight density, the output floor is not expected to constrain RWAs from the benefits of IRB methodology until late in the transition period.

Funding and liquidity remain strong, with the LCR ratio increasing to 144% (FY22: 138%) and LDR broadly stable at 110% (FY22: 111%). Following the increase in customer deposits in Q1, the Group now expects to issue towards the lower end of the £1.5-2.5bn of secured issuance communicated at FY22, subject to ongoing deposit flows and relative cost. Following the share buyback extension and redemption of the remaining £73m stub of one of its AT1 instruments in December, the Group's IFRS9 transitional MREL ratio reduced to 31.9%[1] (FY22: 32.1%), still comfortably exceeding its loss-absorbing capacity requirement of 25.9% of RWAs. Capital and MREL issuance during FY23 is still expected to be broadly limited to refinancing and maintaining the current surplus to regulatory requirements.

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[1] Includes unverified profits for Q1

*The Company further announces that a copy of the Q1 Pillar 3 Disclosures 2023 will shortly be available to view on the Company's website at: [https://www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/](https://www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/). A copy of the document has been submitted to the National Storage Mechanism and will shortly be available for inspection at: [https://data.fca.org.uk/#/nsm/nationalstoragemechanism](https://data.fca.org.uk/#/nsm/nationalstoragemechanism)*
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Announcement authorised for release by Lorna McMillan, Group Company Secretary.

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