Virgin Money Full Year 2016 Results Presentation

Transcript

Tuesday, 28th February 2017

Performance Review

Jayne-Anne Gadhia

Chief Executive Officer, Virgin Money

Welcome

Good morning everyone, and welcome here to the London Stock Exchange for the Virgin Money results presentation. There is no doubt that 2016 will be remembered as a year of political turbulence, with the Brexit vote and the election of President Trump. However, 2016 was also the best year we have ever had at Virgin Money; a year where we have met or exceeded plan in every material respect, and a year where we have once again delivered on the promises that we made back in 2014 at the time of IPO, despite the bank tax surcharge, the lower interest rate environment and other external shocks. That says to me that we have the brand, the business model and the executive team capable of navigating a path to sustainable returns regardless of sudden surprises, and an opportunity to continue our strong progress of growth, quality and returns.

Continued strong progress

First, let me highlight the annual results themselves, then explain how we have achieved them, and why we remain very confident as we look to the future. We drive the business to achieve our planned return on equity. A result of 12.4% for the year is especially pleasing, being as it is substantially ahead of our cost of capital. The disciplined capital management that this implies was enhanced by a robust focus on profitability, and the year-on-year growth in underlying profit before tax of 33% to over £213 million was a function of growth in every asset class and customer segment, as well as diligent cost control and a relentless drive for continuously improving asset quality.

We are pleased to report as a result, a 22% increase in earnings per share to 32.7 pence, and in particular to announce a total dividend for the year of 5.1 pence. That is 13% ahead of the amount we paid in 2015.

A track record of success

This result show just how far we have come since the acquisition of Northern Rock on 1st January 2012. During that time, we have more than doubled the size of the balance sheet without compromising asset quality, and whilst maintaining strong capital ratios. At the same time, the cost:income ratio has fallen from almost 150% to 57%.

We have achieved this without compulsory redundancy programmes. Indeed, the number of people we employ has grown only modestly at just over 2% a year, compared to the substantial growth in income and returns over the last five years. We have not closed a single branch, nor do we intend to. We have, however, invested substantially in product development, operational efficiency and digital distribution. As a result, we have turned a loss-making bank into one beating its cost of capital in less than five years.

However, we are never complacent. In fact, I recently heard Sir Alex Ferguson say that complacency is a disease, and it resonated loudly with me. We take nothing for granted, and the focus that has driven our results over the last five years will remain undiluted in the years ahead.

The basis of our continued progress

I think there are three main reasons for our continuing progress: customer loyalty and growth, operating leverage and asset quality. I would just like to take a moment now to focus on each of these three success factors.

Growth through a compelling customer proposition

For us, 2016 saw a real step change in customer growth and customer advocacy. Overall customer numbers grew by 15%, but even more pleasing was that customer numbers increased in each and every product segment. To top that off, the number of sales made to existing customers grew by almost 50%; clear evidence of the potential to sell more products into our existing and growing customer base.

Now, this is no accident, as you will imagine. At the beginning of 2016, we invested heavily in staff and processes to enhance our customer experience. We have been rewarded with a very material increase in our net promoter scores across the business, with an overall score now of +29, which is a significant increase from the +19 that we achieved last year.

We have also increased the strength of our relationships with mortgage intermediaries, who provide 90% of our mortgage business. We established a mortgage lab to deliver improvements, such as the introduction of a new web-based application and retention process, both of which have been developed with the help of our intermediary partners. This investment supported an increase in our intermediary NPS score to +55 during the year.

But it is not just intermediary distribution that we focus on. Customers tell us that they like the balance we offer of personal relationships in stores and lounges alongside our digital transactional capabilities. 82% of our business now comes to us online or through mobile technology. That is, of course, efficient for our customers and low cost for us.

Our lounges go from strength to strength, with an extraordinary NPS of +86 and receiving, on average, nearly 50,000 customers each month. Our Sheffield lounge opened in 2016, and its partner branch immediately shot to the top of the leader board for new business. We plan to open a new lounge in Cardiff soon.

The power of the Virgin brand remains undiminished, and forms a basis for future opportunities. For example, Virgin Money Giving continues to broaden the reach of our brand and our appeal. In 2017, we are launching text giving, and planning new partnerships to grow this part of the business and its halo effect even more strongly.

I am especially pleased to be able to announce today our new partnership with Virgin Red, Virgin Group's window of customers onto the broader Virgin world. From March, Virgin Money customers will be able to received discounted products from other Virgin companies, in a way that satisfies a real and pent-up customer demand.

This focus on customers has created efficient customer growth, but it has also paid dividends in terms of improving customer retention, which in the mortgage business alone increased by 10%, from 64% to 70% during the year. We continue to invest in customer relationships and see this as critical; a real USP in the future of banking competition.

Operating leverage

2016 also saw real benefits from our significant operating leverage. Costs grew by only 1% in a year when income increased by 12%. We have absolute focus on cost control which drives a culture of efficiency, and has driven our cost:income ratio down by six percentage points to 57.2%.

This has been achieved in a number of ways. In 2016, we built our award-winning mortgage lab. This research and development unit brings together teams from across the business to build efficient mortgage processes that work for intermediaries, customers and Virgin Money in equal part. We call that EBO[1].

Our focus on customer acquisition and retention has driven operational efficiencies. As an example of that increased efficiency, in mortgages we processed 18% more completions per team member this year than in 2015.

2016 was our first full year of running credit cards on our own operating platform, and the cost impact has been material, with a 24% reduction in unit costs year on year.

Operational efficiencies have been enhanced by our growing digital footprint, and our presence on social media. In fact, digital and social media have helped to drive a 22% reduction in the cost of acquisition per customer year on year.

I am particularly pleased that we have been able to achieve these results whilst, at the same time, continuing and increasing investment in our business-as-usual systems and processes. In 2016, we invested over £50 million in our current business. That is 14% up on the previous year, even before our commitment to our new digital programme with 10x.

All these investments have made our colleagues' lives demonstratively easier. Not only have they benefited from improved systems and processes, but also from our investment in training and cross-training. As a result, we have a stable, loyal and competent workforce with a very strong engagement score of 81%.

As I look forward, I am confident that we can sustain this operating efficiency and achieve our target of a 50% cost:income ratio by the end of 2017.

Asset quality

Let us now turn to asset quality, and to be clear: when I use those words 'asset quality', I mean much more than current credit experience might imply. Because of course, in today's benign interest rate environment, all banks are reporting low loan losses. However, we are pleased with the evidence that shows in both our mortgage and cards portfolios that we continue to enjoy arrears emergence which is both improving in absolute terms and better than market norms. Peter will talk more about this later.

However, we are not resting on our laurels, and our asset portfolios are built with a view to an uncertain future. Our credit risk appetite, to be clear, is low. When we make lending decisions, we set stringent hurdles to the quality of new customers, and we manage our existing book to maintain the performance of each and every customer cohort. That means we can be as confident as possible that customers can afford their loans today, and also if times get tougher.

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[1] http://uk.virginmoney.com/virgin/investor-relations/about-us/business-as-a-force-for-good/

In fact, my board challenges me from time to time on whether we are taking enough risk. My view is that, whilst there may appear to be opportunities that pass us by for now, we will be glad of that in the future. That is why 92% of our lending is in secured prime mortgages, with high affordability, low average LTVs and broad geographic distribution.

Our strong underwriting and diligent application of our lending standards means that I see minimal risk to our business of any material change in mortgage impairment, even as rates rise as one day, surely, they must. This same risk management approach is applied to our cards business, which comprises only 8% of our total lending.

When I said at the half year that we were tightening the credit criteria on our cards book, some of you thought that this implied a problem with that book. I want to emphasise now that this is simply not the case. Our cards are in high demand, and we were able to manage our path to £3 billion of balances by the end of the year at the same time as tightening our credit criteria. If we did not do this, then we would overshoot that target. Even as the Bank of England is reporting a decline in credit standards for unsecured lending, the credit quality of our credit card lending is increasing. We have tightened credit cut-offs, we stick by strong affordability criteria and we never down-sell.

As a result, our book is demonstrating lower arrears emergence that even we had forecast, and my message is that our asset quality sound through a low credit risk appetite and a diligent focus on underwriting and affordability. We believe in delivering superior asset quality throughout the cycle; we always have and we always will. It is what allows me to sleep at night.

Strong track record of growth

Mortgages

Turning now to product growth in 2016, I am very pleased to report gross mortgage lending of £8.4 billion, an increase of 12% on the previous year, compared with market growth in gross lending of just over 10%. This represents a 3.44% market share, right at the top of our guidance. Our market share of net lending also grew to 10.5%.

The market was competitive, and flourished despite the shock of the EU referendum. We do not expect that momentum to reverse in 2017, especially given this government's housing policies. Indeed, we expect to diversify our business into the shared ownership and custom build end of the market, to grow and to give us more options for margin management.

Mortgage asset spread certainly fell at the market level during 2016, we think by up to 30 basis point towards the end of the year, as higher swap costs were not passed on in higher pricing, and we expect pricing to be pretty flat in the months ahead.

Deposits

This spread compression was offset more than we expected, though, during the year, as the cost of retail deposits also fell following the base rate reduction in August and helped by the introduction of the Term Funding Scheme. That meant that we were able to reprice £14 billion of our retail deposit book on the base rate reduction, an additional £5.5 billion during the year, while still continuing to provide customers with competitive rates. That we got the pricing right seems to be borne out by the 12% growth in our retail book against market growth of 3%, and we continue to be a major provider of cash ISAs, with 33% market share of net inflows in 2016. I think we have proven beyond doubt that our ability to grow our business into a vibrant retail deposit franchise is unfettered.

I also wanted to mention the outstanding progress we made in current accounts during the year, where we more than doubled new business acquisitions year on year. Although the absolute numbers remain quite small, in accordance with our plans, it is really pleasing that average balances have been higher than we expected, and this has helped us to grow account numbers without an unpalatable profit drag.

Credit cards

Credit card growth in 2016 was exceptional, and we ended the year with balances of £2.4 billion. Year-on-year percentage comparisons are bit misleading, because 2015 was not a full year of sales for us. For us, slowing credit card volumes to meet planned levels has been more of a challenge than it has been to compete for them. That has meant we have not been compelled to offer products priced at the top end of the best-buy tables. In fact, we had settled in about sixth position. We also benefited from the introduction of new product offerings during the year. We achieved a 70/30 split between balance transfer and retail cards for the full year, and indeed the mix of our business has been positively different to our expectations. We saw new business, for example, at 60% balance transfer and 40% retail in January this year.

I personally review customer behaviours on a weekly basis, and everything continues to be absolutely stable and in line with the assumptions underlying both the EIR and our impairments estimates. As a result, we remain confident in meeting our target of £3 billion of credit card balances by the end of this year, even as we tighten lending criteria.

Financial services

Finally, I am pleased with the progress of our financial services business this year. Funds under management increased by 12%, to close the year at £3.4 billion, and travel insurance continued to exceed expectations with over 450,000 policies sold in 2016.

In summary: in all key areas, our growth outperformed that of the market.

Uncompromising commitment to quality

Asset quality

The quality of our business continues to be of prime importance to me and the whole Virgin Money team. I have already spoken about our attention to asset quality, which remains uncompromising, and resulted in a continued low and stable cost of risk of 13 basis points for 2016. Even more importantly, asset quality for me means having built a book with through-the-cycle resilience, and this is what we focus on every day.

Funding

Turning to our funding base, I am pleased to report a stable portfolio increasingly diversified, and with lower funding costs than in previous years. We were particularly pleased with customer loyalty through another phase of repricing of our retail deposit portfolio and, indeed, retention from our last repricing exercise was over 97%. We continue to extend our wholesale funding, and to take advantage of the Term Funding Scheme while it is available. Taken together, this has reduced our weighted average cost of funds for 2016 to 130 basis points. That is down from 143 basis points in 2015.

Capital

During the year, we reinforced the quality of our capital stack, with a successful and well-priced issuance of £230 million of AT1 capital. That enabled us to plan confidently for growth, as well as ending the year with our leverage ratio at 4.4% and our CET1 ratio of 15.2%. Of course, coupon costs are built into our returns guidance for the years ahead.

'EBO' culture

The key to driving quality throughout Virgin Money is our continued focus on our corporate ambition to make 'Everyone Better Off', or for as we call it, EBO. EBO empowers everyone in the business to make balanced decisions, and reinforces our approach to our customers, colleagues, corporate partners and communities. In our latest colleague opinion survey, 93% of all colleagues said that they understand how EBO applies to their role. For me, that is the fundamental basis of our business's quality, and of our overall progress and success.

Sustainable returns

Margin

Finally from me, to returns. I am pleased to report a net interest margin of 160 basis points for the year, as a result of daily management of every basis point on both side of the balance sheet. That NIM outcome was supported by our deposit repricing and access to TFS, together with stable mortgage front-book pricing which we achieved despite the competitive market.

Returns

This margin performance, taken together with the operating leverage and high asset quality I have spoken about, allowed us to deliver a return on tangible equity of 12.4%. We are particularly pleased to have achieved this in the first year of the bank tax surcharge, because without that we would have been reporting a RoTE of 13.5%, entirely in line with our initial IPO guidance.

Dividends

Our confidence in the sustainability of solid double-digit returns allows us to recommend a final dividend of 3.5 pence per share, resulting in a total dividend of 5.1 pence for the year; an increase of 13% compared to 2015.

Concluding remarks

All of this in a year which demonstrates to me that Virgin Money has many levers with which to drive long-term sustainable returns in excess of our cost of capital. But, I will come back to talk a little more on the outlook later. For now, I would like to introduce you to Peter Bole, who took over as CFO on 1st January this year. Peter joined us from Tesco Bank in November, and it is great to have him as part of the team. Over to Peter.

Financial Review

Peter Bole

Chief Financial Officer, Virgin Money

Introduction

Thanks, Jayne-Anne, and good morning everyone. I am delighted to be here this morning, and delighted to have joined the Virgin Money team at the start of November. For the first two months, I had the benefit of a thorough handover, before taking over formally on

1st January. I would like to thank Dave Dyer, who was incredibly helpful during that period; as you will see from today's results, he has helped drive excellent performance in the business.

One of the great things about arriving in the final quarter has been my involvement in the annual planning process, and obviously being at the heart of the year-end process. This has confirmed me the great strength of the business I joined.

I will now provide some further colour on the results Jayne-Anne has outlined, and I will spend some time on the drivers of our performance, particularly on the asset quality.

Balance sheet progress

The 2016 results demonstrate our strong and continuing growth profile across all product lines. Mortgage gross lending grew by 12%, and with strong retention performance, net lending was even better at 20% growth year on year. Cards growth was also strong. We are well placed to achieve £3 billion of prime balances by the end of 2017, and expect to continue to grow safely from that point.

The good news is that we are equally confident in our ability to fund that growth. Retail deposits have grown by 12%, ahead of the market which grew at 3%. For all three of these product categories, we have significant room for growth before stock levels mature to match our flow market share, as you can see from the stock and flow statistic here.

Our wholesale funding programme has also supported growth. As you may recall, we successfully issued £1.3 billion of RMBS in the first half. By issuing in dollars for the first time, this extended our accessible pool of investors. The Term Funding Scheme has given us further opportunity to reduce the cost of funding, and will also support the repayment of our outstanding FLS balances, which stood at £2.7 billion at the end of year. Our strong net lending position gives us access to material sums of TFS, and we aim to draw between £5 to £6 billion of low-cost term funding from this source.

As Jayne-Anne has noted, this will take our loan-to-deposit ratio temporarily to around 120% this year, tailing back down from 2018 onwards. Our capital strength is also supportive of our growth plans. All our capital ratios leave us well positioned for future growth, and I will return to capital later.

P&L – further growth in profitability

Turning to the P&L: we were very pleased with net interest income growth of 14%, especially in another year of strong mortgage market competition. We work every day to maximise margin through dynamic pricing and by optimising funding costs, asset volume and mix. As Chair of the weekly pricing committee, I can tell you that every tranche of business we write is priced to be value accretive. Overall, asset growth drove our net interest income, and diligent margin management maintained our NIM at the 160 basis points.

At a headline level, other income grew by 1%. This increase was achieved despite the average FTSE being lower in the year, a material reduction in cards interchange fees and the removal of mortgage admin fees. As a result of continued focus on driving efficiency in the business, costs grew by just 1%. Set against total income growth of 12%, this resulted in our cost/income ratio improving by over 6 percentage points.

Income growth did not come at the expense of quality. You will see that the impairment charge increased to £37.6 million. This was entirely due to the credit card book, where although loss rates improved, this was more than offset by the balance growth. This volume effect resulted in the one basis point increase in the Group cost of risk at 13 basis points.

As a result of the combination of income growth, together with continued operating leverage and a controlled cost of risk, underlying profit grew by one third to £213 million. I will now step through the drivers of this performance in more detail, starting with NIM.

Net interest margin evolution

In a year when the Bank base rate was reduced by 25 basis points, net interest margin performed more strongly than we expected. The volume of new mortgages written during the year diluted the net interest margin by only 17 basis points. In part, this benefited from completion spread at 187 basis points for the year, an increase of one basis point from 2015 despite the increasing market competition.

Much of this dilution in mortgage spreads was addressed by our strong management of funding costs, which increased margin by ten basis points. This was achieved largely by significant repricing of the back book of retail deposits. In fact, taking account of base-rate-related changes, almost £20 billion of balances were repriced during the year. To be clear, there is still more to go: we have executed a further reprice of £5 billion of balances already in 2017, and a further tranche of a similar size is planned later in the year.

The effective interest rates on cards written since we started originating in our own platform has remained at around 7%. As you would expect, we focus hard in ensuring our EIR assumptions are fully supported by data analytics and stable customer behaviour. These cards, including those written during the year, diluted back-book margins and reduced overall spread by ten basis points. This was more than offset by growth in card balances, which increased the total margin by 12 basis points.

Taken together, these movements resulted in an average net interest margin for the year of 160 basis points. That is down year on year by only five basis points; a result slightly ahead of our previous guidance, and benefiting from our constant and focused commercial management.

Further demonstration of operating leverage

Moving on to operational leverage, 2016 saw an impressive improvement in operating efficiency in every area of our business, as well as a sustained level of investment in our operation. The improvement in the cost:income ratio in each segment contributed to a 6 percentage point improvement in our overall cost:income ratio. Our core mortgage and savings operation saw income growth of £24 million, against an increase in direct overhead of just £4.7 million.

Our cards operation is now realising the significant benefits of our in-house platform. Not only did we deliver service improvements for customers, but cost growth of less than £1 million supported income growth of £38 million. While some of this delta arose from waving goodbye to MBNA in early 2015, the cards cost base can certainly support much more growth on a marginal basis.

Our financial services business recorded a cost reduction of 6.6% against an income increase of 2.5%. This reflects the benefit we gain from leveraging the infrastructure of a number of partners in this area of the business.

Central costs have actually fallen, despite supporting a total increase in income of £63 million. This is the clearest indication to me that we can drive much more scale without increasing this overhead. I am confident that we have enough accountants, risk managers and lawyers to support us as we become a much bigger business. Taken together, the structure of our cost base and our focus on cost management give us great confidence in improving our cost/income ratio in the years ahead, and in an exit run rate for 2017 of 50%.

This would not be possible, however, without continued investments in our systems, processes and infrastructure. The revenue investments in these essential developments grew by nearly 14%, ahead of growth in total income, with total cash spent of over £50 million excluded the new digital developments. This underlines our commitment to investing in improved business processes, today and in the future.

Strong asset quality

The 2016 results give us great confidence in our outlook for both growth and costs, and I am happy to say that our outlook for asset quality is equally robust, even given some of the macroeconomic uncertainties that lie ahead. I would like to take the next few slides to explain why.

First, let me update you with an overview of the portfolio. Our lending activity continues to be dominated by the secured assets that accounted for 92% of the book. These are all secured on prime UK properties, with 82% in residential mortgages and 18% in buy-to-let. We operate rigorous underwriting standards and portfolio level limits that ensure a high quality of security for our mortgages. The average loan-to-value of the residential portfolio is 56%. Three quarters of this portfolio has a loan-to-value of less than 70%.

On buy-to-let, the position is even stronger. The average loan-to-value of the buy-to-let portfolio is 55%, and 85% of the portfolio has a loan-to-value of less than 70%. This reflects the tighter underwriting rules, and the absence of any lending above a 75% loan-to-value.

Unsecured lending consists of our prime credit card book, and represents just 8% of overall customer lending. So, as you can see, we have a very clean lending portfolio with no unsecured personal loans, SME or commercial real estate lending. This helps position the portfolio well for any uncertainty ahead.

That gives you a sense of the overall shape of our lending portfolio. As everyone is aware, at this point in the economic cycle we see very low levels of arrears. Therefore, when we are thinking about credit risk, we are very focused on ensuring the resilience of our portfolios should the economy deteriorate.

Strong and improving credit metrics for mortgages

When I look at the mortgage portfolio, everyone is aware of the fantastic quality of the book that we bought with Northern Rock. This has performed exceptional well in our hands. The assets underwritten since then have seen improving performance. When we look at the arrears data by lending vintage, we can see that since 2012 the performance of each vintage of mortgages has demonstrated successively better performance than earlier vintages; each new year’s trend line is below the last. Indeed, older vintages have shown an improving trend over the last 24 months.

This performance reflects our rigorous underwriting approach. We limit our maximum loan size, and have lower loan-to-value limits on larger loans. The result is improved quality of the security in higher-risk areas that have seen the most significant house price inflation; specifically, lending in London and the Southeast has a lower than average loan-to-value. Over half our mortgages in London have a loan-to-value of less than 50%. There are then three separate affordability tests that we use to identify the upper limits of lending we are willing to provide.

It is the combination of strict criteria for both the lending security and the customer affordability that we use to create a resilient portfolio. When we look at the arrears level this approach is generating, we see a steady improving trend, set against the growth in total mortgage book.

Cards book metrics also trending positively

Turning to credit cards, we are well aware of the concerns from the Bank of England that underwriting standards in the industry have been weakened to support growth in unsecured lending. Let me be clear: we have not relaxed underwriting standards at Virgin Money at all. As you can see, the quality of new customers has continued to improve since 2013, with an increasing majority at high or very high quality.

The overall impairment trend has been improving since we established our own operation. The book originated prior to 2015, representing 35% of lending, demonstrates an excellent impairment level of just 2.3%. This includes the poorer quality 2013/14 vintage written under our transition arrangement with MBNA, and we have spoken about that previously.

Cards originated in 2015/16 represent 65% of the book; comparing the early performance of these cards with the pre-2013 vintage at the same stage of maturity gives us confidence that 2015 and 2016 lending should mature to perform as well as, if not better than, the earlier vintages.

A key driver of this performance is the severity of our affordability tests. We test a customer's ability to repay their entire balance, assuming that they have fully drawn their credit line and are paying the highest contractual interest rate. The typical customer can then afford a further 6% increase in APR and still be able to repay our debt, as well as any borrowings with other lenders. To confirm, we never down-sell; that is, selling a risk-adjusted product to a customer who does not meet our stringent underwriting criteria.

Let me give you a sense of what this leads to in practice. Our average customer is 42, owns their own home, has an income of £39,000 and has around £700 of monthly income after living expenses and existing credit commitments, all pointing to a distinctive level of resilience. As with mortgages, despite the growing book you can see the improving trend of our credit card arrears performance, despite the very strong asset growth.

The message in our cards book is that we are targeting a portfolio at the upper end of prime. It is performing well, and is designed to be resilient in uncertain times.

Credit performance reflects high quality assets

This careful management of credit risk is reflected in our 2016 performance, with the total impairment charge increasing by just £7.3 million to £37.6 million. This charge resulted in a cost of risk of 13 basis points, just one basis point higher than 2015.

The mortgage cost of risk remained at one basis point, with the impairment charge £200,000 lower than 2015. In cards, the cost of risk fell by 30 basis points to 170 basis points, reflecting both in improving quality in the book and the less-seasoned newer lending.

Impaired loans, as a percentage of loans and advances, was stable in the mortgage portfolio, demonstrating continued high quality of the book. In the cards portfolio, this metric improved by 40 basis points to 1.3%, as higher-quality recent originations continued to dilute the impact of the bounty book.

Our provision coverage ratio for impaired balances increased for both lending products. The level of provision coverage in the mortgage book was 11.4%, and this reflected both the extremely low level of arrears in the book and the high level of security.

In credit cards, we treat all balances as impaired if payment is more than one day overdue. In addition, we provide for losses on fully paid-up balances based on a statistical assessment of arrears that we expect to emerge. The result is provision coverage in excess of 100%, and this is increased in the year as the book has grown relative to arrears balances.

All in all, then, for asset quality we have a picture of high quality, stability in performance, and increased coverage in provisioning.

P&L – sustainable and improving returns

Returning to the overall P&L, we can see the strength of this model, with high-quality asset growth and continuing operational leverage driving improved returns. Return on assets grew by two basis points to 44 basis points and return on tangible equity grew 1.5 percentage points to 12.4%. As a consequence, earnings per share improved by 5.9 pence to 32.7 pence. This period represents our best performance since the acquisition of Northern Rock, and a continuation of the improving trend in every period since.

Statutory profit and tax

The strong underlying performance I have outlined is flowing through to statutory profit this year, with only two categories of adjustment. The first category, non-trading items, has fallen by more than 50%. The most significant reduction was in share grants associated with the IPO, which fell to £2 million and will be next to nothing in 2017.

Strategic items include a couple of things. The first is the exploratory work in respect to potential SME developments, and the second is the initial research work undertaken to shape our digital strategy and choose the appropriate delivery partner. Our contract with 10x will be amortised upon the implementation of our digital bank.

The simplification costs refer primarily to the costs associated with reorganisation of our senior management structure, and these are non-recurrent. Fair-value gains relate to the final unwind of fair-value adjustments made in the acquisition of Northern Rock.

Excluding the second transitory category of adjustment, that is the hedge volatility, statutory profit before tax grew by 47%, and our post-tax number would have been near £146 million. This £8.9 million mark-down on derivative will reverse over the life of the relevant instruments. The implementation of the bank tax surcharge meant that we incurred an extra £12.5 million of tax, taking the effective rate to 28%, so our statutory profit after tax increased by 26% to £140 million.

Robust capital position supports strong growth trajectory

I will now turn to capital, which has benefited from this strong profit performance. Our success in 2016 meant that the core equity tier one capital resources increased by almost 10%. Thanks to the increase in profitability, after distributions and regulatory adjustments we retained £103 million of earnings, and this increase in resources added 1.3 percentage points to CET1 in the year, and made a substantial contribution to the resources required to support asset growth.

Risk-weighted assets grew as expected for three reasons: first, our continued growth in mortgage lending; secondly, the growth in credit card balances, which attract a 75% risk weight; and finally, the increase in risk-weighted assets from operational risk, which simply reflects the strength of business growth.

This increase was partly offset by the improving quality of the mortgage book, driven by the impact of rising HPI and lower arrears. This resulted in a reduction in risk-weighted assets of £357-million. Taken together, these factors resulted in a 25.9% increase in risk-weighted assets to £7.7 billion.

This growth in RWAs, together with the increase in capital resources, resulted in a CET1 ratio at the end of 2016 of 15.2%. When combined with the increase in retained earnings, the £230 million AT1 issuance in November resulted in total capital ratio of 20.4%, and a leverage ratio at year end of 4.4%. Clearly, capital ratios at these levels are supportive of our future growth plans.

Of course, the current regulatory environment means that we, like all banks, continue to focus hard on potential changes to our capital requirements. The key things we are focused on are IFRS 9, the advance modelling on cards and risk weight floors. We are well advanced in planning for the impact of IFRS 9 and advance modelling for cards, and for risk weight floors we think we are relatively well positioned, given our through-the-cycle modelling approach and the existing average mortgage risk weight density.

In summary, we are pleased with the capital generation in the year, and our capital strength as we enter 2017. Given our view of regulatory developments, which we have made an allowance for in our forecasts, we believe we are well positioned to continue to deliver on our ambitious growth plans.

Doing what we said we would do

To conclude, we believe the 2016 results represent another year of significant progress for Virgin Money, and we have continued to deliver on all of our targets. Our strategy of growth, quality and returns resulted in underlying profit before tax increasing to £213 million. Return on tangible equity increased by 1.5 percentage points to 12.4%.

I hope I have shown that we have room to build further on our demonstrable operating leverage to deliver ongoing profitable growth and increased shareholder value, and that shareholder value to be delivered in part through an increasing dividend. The 13% increase in our total dividend for this year reaffirms our confidence in our future plans. We expect to increase this dividend progressively in absolute terms. To be clear, this means the pence per share will steadily increase but the pay-out ratio will reduce, as we deploy capital to take advantage of our clear growth opportunities. So with that I will hand you back to Jayne-Anne. Thank you very much.

Looking Ahead

Jayne-Anne Gadhia

Chief Executive Officer, Virgin Money

Outlook

I hope you now have a good understanding of our results for 2016, and why we believe that we have the brand, the team and the business model to deliver growth, quality and returns on a sustainable basis for the years ahead. But, before we look much further ahead, I did want to reiterate our guidance for the end of 2017, which is largely unchanged from our previous updates.

First and foremost, we expect to continue to grow our mortgage business strongly through intermediaries and the direct channels, and to a market share towards the top end of our 3–3.5% target range. As a guide, we agree with CML estimates of a UK mortgage market of some £248 billion this year.

Next, and as I have previously said, we remain confident of achieving high-quality credit card balances of £3 billion by the end of the year. We expect to write a higher proportion of retail cards in that balance than we had planned originally.

We continue to be confident of the progress and potential of our financial services business. Our new plans are starting to bear fruit: travel insurance delivered 450,000 sales, home insurance grew to over 17,000 cases from a standing start, and we identified our new life insurance partner. Travel money is also growing well, as is as our international money transfer business. There is much to go on each of these lines, even before we consider additional income from new sources, as we grow our current account business and develop our relationship with Virgin Red. Prudently, we expect other operating income to be around 10% of total income this year, but we expect it to grow from there in the years ahead.

We expect to see continued solid growth in retail deposits, as well as utilising TFS to keep our funding costs as efficient as possible. As a result, you might expect to see our loan to deposit ratio increase up to 120%.

We remain very confident in asset quality from mortgages and cards. And unless there is a fast and material uptick in unemployment, we do not expect our cost of risk to exceed 20 basis points in 2017.

Our capital ratios also remain strong. We expect to maintain a total capital ratio of at least 15%, with CET1 being at least 12%. We further expect our leverage ratio to remain at around 4%, well ahead of our minimum risk appetite of 3.6%.

We have assumed that the Bank base rate remains flat during 2017. As a result, it is our view that market expectations for our NIM, at around 157 basis points in 2017, are about right with some potential upside. Our guidance today is for NIM of up to 160 basis points.

With that margin guidance, we will be delighted to end the year with an exit cost:income ratio of 50%, which we will achieve through our diligent focus on costs. We expect all of this to result in solid double-digit returns somewhat ahead of the 2016 outcome, where we had of course a return on tangible equity of 12.4%.

Strategic opportunities in the future

I hope that this update has given you real clarity and confidence in our ability and plans to grow Virgin Money organically. That is our current preference and intention.

What of other strategic opportunities? Firstly, the build of our digital bank in partnership with Antony Jenkins' 10x is progressing well. Let me be clear: our vision for this business is truly transformational. Using data analytics to personalise each customer's financial needs and transactional requirements, from their own preferred mobile device, will create for us a new place in banking. We will neither be the digital front end of a traditional banking platform, nor the new entrant with an unknown brand and no customers.

The Virgin brand gives us the credibility and cut-through that we need into the digital world of banking. We know that this is a service for which there is a demand from our 3.3 million customers and beyond. The experience gained from building our credit card platform from scratch gives us the expertise, unique data analytics capability and proven execution ability which we will leverage in building our digital bank. We look forward to providing the market with a strategic update on the Virgin Money digital bank when appropriate. However, for now, my message is: so far, so good.

We have confidence in our organic plans and in our exciting digital developments which lie ahead. In addition, we have always said that we will look at each and every opportunity ahead of us, and this year is no exception. We will continue to investigate SME opportunities and other small financial service businesses, perhaps in the asset management or insurance space, and other strategic opportunities, and the possibilities evolving from RBS's potential new agreement with Europe.

Yes, there are opportunities, and yes, we may look at them, but we do not need to do any of these things.

Our focus is squarely on running a safe bank and delivering sustainable growth in shareholder value. I hope that you agree that we have made progress in this respect in 2016.

Thank you for your time today. Now, Peter and I and the rest of the management team would be delighted to answer your questions.

Q&A

Ian Gordon (Investec): Good morning. Can I have three please? Clearly, the funding costs give you a material tailwind into 2017. I think I know the H2 average cost of funds, I do not know the Q4 average cost of funds, so can you help me with that and quantify the basis-point repricing of the two dollops of £5 billion, the one you have done and the one you are looking at?

Secondly: net mortgage growth of £4.3 billion in 2016; clearly, the significant improvement in retentions played a big part of that. I know you guide more explicitly on gross appetite, but when I see implied consensus expectations anticipating a 30% drop in net mortgage lending, I find that a little bit hard to rationalise. Is there anything you can see in your retentions experience or outlook which provides any rationale for that?

Thirdly, you alluded to it in your closing comments: any early thoughts on how you might sensibly access some of the Williams & Glyn slush fund?

Jayne-Anne Gadhia: I am going to ask Peter to talk about margins, Hugh to talk about mortgage retention and I will try and talk about Willy Glyn. From our point of view, as you know, we had not participated for many years in the Williams & Glyn sales process; indeed, we had also, post the referendum vote, concluded that now was not the right time to get into SME lending. However, I think we always said that we know the brand is right for that sort of market entry at the right time for the right price.

To the extent that the future of the Willy Glyn's transaction or whatever it becomes in the new European Commission enables us to do that, then we would be delighted to participate in whatever process comes next. I have no idea what that process might look like, and I do not know what the timescales are, but it seems to us something that is quite interesting for all of the challenger banks. It could bring real competition into the market. We will look at that seriously when the time comes, but definitely the time is not here yet.

Peter, would like to talk about some margin point, please?

Peter Bole: Yes. The point I would make on margin is if you look at our full-year margin of 160 basis points, it is pretty much flat first half/second half, so consistency there. As Jayne-Anne highlighted in her speech, there is a bit of pressure on mortgage spreads in the back half of the year, just reflecting some of these lower funding costs coming through. So, it is pretty much washing through at the moment, would be our view on that.

In terms of the repricing going forward, roughly 25 basis points on these amounts.

Jayne-Anne Gadhia: Thank you very much. Hugh, would you like to talk about mortgage retention?

Hugh Chater: In terms of mortgage retention, there are a few things to say. First of all, we have a fairly sophisticated segmentation-based approach to determining which customers we are looking to retain, which ones we think we will naturally retain, and which ones we are now looking for our intermediary partners to help us retain. Last year, we introduced a proc fee for intermediaries on retention; the vast majority of the market is now in the same place.

Take that together with the fact that, unlike the majority of the market, we have 35% of our new business written on five-year terms, so it is quite an extended term that we have for new business, which put us in a better position relative to the rest of the market. What we are seeing there is that the combination of those things has driven, as Jayne-Anne mentioned, our position where at the end of last year we were retaining 70% of business. What we have seen so far this year suggests that the volumes are there, and that we are continuing to see that loyalty to the brand.

Jayne-Anne Gadhia: Thanks.

Ian Gordon: Some £3 billion of net mortgage lending looks fairly nuts in 2017, which is where current consensus expectations are.

Jayne-Anne Gadhia: I would not comment on that.

Hugh Chater: I will not comment.

Ian Gordon: Thank you.

Rohith Chandra-Rajan (Barclays): Thank you. I have got two, please. Just to come back on the margin; thank you for the details on the deposit repricing. TFS, I guess, depends on when you draw it, but that looks like maybe a 10–20 basis points benefit. I just wondered if that was roughly the right ball-park.

Then I would be interested to know what your expectations are in terms of asset spread compression, both on the mortgage and the card book going forward into this year; particularly on mortgages, do you expect it to ease at all?

Then the second one was just on credit quality, the 13 basis points to up to 20. I am interested to know what that means for mortgages, which were just one basis point this year, in cards which improved to 170 bps, and what the key economic assumptions underlying that are, please.

Jayne-Anne Gadhia: On the credit quality, I think the 20-basis-point position that we talk about, Rohith, is simply to do with uncertainty of outlook rather than certainty of our credit quality, if you see what I mean. We are giving ourselves some room to expand if needs be, to the extent that there is any deterioration in the macro environment. We do not see that, we do not see that generally, we do not see that in our book, but Article 50 has not been triggered yet. We would expect in more normal times to see a more gentle progress towards the cost of risk outcome for next year, but that does give us, we think, plenty of headroom to cope with an uncertain few months ahead.

Peter Bole: The point I would make on the TFS funding, and it is kind of restating the point we have made, is that what we have seen in the final quarter of the year is that asset spreads have been coming down, really reflecting the benefit of TFS in the market and the impact that is having on funding costs. We are not seeing that as a specific benefit coming through, which is why we are guiding towards that 157–160 basis points of margin going forward, because we see then coming down, broadly compensating.

Rohith Chandra-Rajan: Which would suggest there is some easing in the asset spread compression this year, if my rough maths on TFS is broadly right, 10 to 20 bps, because I think we had 27 bps of asset spread compression in 2016.

Jayne-Anne Gadhia: So far, that would appear to be about right.

Peter Bole: Yes.

Rohith Chandra-Rajan: Okay, thank you.

Guy Stebbings (Exane BNP Paribas): Thank you. Firstly, on mortgages: another very strong year in terms of gross mortgage spending, 3.4–3.5% market share. I know pricing is obviously important, but one of the other things you have talked around in the past is speed of offer, especially in the broker channel. A lot of competitors have talked about bringing down their speed of offer: is that still a competitive advantage for Virgin Money? Is it a case improving even further? That was the first question.

Jayne-Anne Gadhia: We continue to hold our average speed to offer to around 12–13 days. That has been very powerful. However, intermediaries are more keen, interestingly, that an organisation tells their customer when they are going to get their offer and they get it out then, if you see what I mean? So, it is not so much 12 days absolutely that is key; it is if you say it is going to be 15, do it in 15. If you say it is going to be ten, do it in ten. We have done that well, and we continue to offer our £100 to intermediary customers where we miss that target. We rarely pay out on it, because it has driven the efficiency of our operation as well as the response from our customers and our intermediaries. As far as we are aware, no other organisation does that, and it has definitely been very powerful for us.

Guy Stebbings: Thanks. Moving on to the credit card book: you have the £3 billion target for the end of this year, and credit quality performance continues to be very strong, but as you have continually suggested, there is a lot of uncertainty there. Post full-year 2017, where should we be thinking about the credit card book as a percentage of total loan book going forward?

Jayne-Anne Gadhia: We are not guiding beyond 2017. All I would say is, conceptually in my own mind, we would expect to see that the proportion of secured and unsecured in the book would not tilt towards unsecured, if you see what I mean. I would say that if you are anticipating the balance to be much as it is today, that is roughly what we are expecting.

Fahed Kunwar (Redburn): Hi, I just had a question on the credit card book. You had a really interesting chart about the old book and new book, so the new book sitting sub 50 bps on an impairment charge, and the old book 250 bps. How much of that is due to the fact that the new book is mainly interest-free balance transfer customers, so they do not pay any impairments?

Then if I think about the P&L for the credit card book, obviously the NII is accrued and amortised for the interest-free balances. How does the impairment charge work for those interest-free balances? Is that amortised in the same way, or will that come through once that book seasons and becomes non-interest free? Thanks.

Peter Bole: So, it is IAS 39 incurred loss modelling. So, we treat all balances one day down and beyond as being impaired, and we run the modelling to assess what recovery we might expect on those, including the sale of debt at 180 days. At the point that that has gone one day down, that is when we make a provision for it.

In addition to that, we use emergence period modelling to statistically model a component of the good book that we would assess to be likely to go bad, just based on stats, without any indicator of impairment having arisen, and that is why you end up with the impairment conversation north of 100%.

Fahed: Is there any kind of matching between the way you accrue the revenue and the way that you accrue the impairments then? I am just wondering how mismatched the P&L is right now?

Peter Bole: I mean, it is consistent with most retail lending products, where you take income as the borrowing is there evenly, but the provisions emerge as the book seasons.

Fahed: Thank you.

Nick Baker (Goldman Sachs): Thanks very much. Just two quickly, one on the TFS and then one on the dividend. So, on the TFS you mentioned you are going to draw about £5 to £6 billion. Is the £2.7 billion of FLS being refinanced inclusive within that? That is the first question?

Then, secondly, what is your strategy going forward, once the TFS starts to roll off – I appreciate that is quite far in the distance – to avoid a pick-up in funding costs at that moment in time? Given that you are taking quite a large slug of that.

Then, just around the dividend as well, what is your thinking around why you want to lower the pay-out ratio slightly? Given that you are 4.4 today, you think you are going to run at four, and even then, that is quite a bit above the 3.6 or 3.8 level that you have signalled in the past. Thanks.

Jayne-Anne Gadhia: I will start, if I may with dividends and the future, and you remember the first question, Peter, which I have forgotten.

Peter Bole: I will remember.

Jayne-Anne Gadhia: On the dividend thought, Nick, it is no more clever than: at the moment, our growth opportunities are significant. We see ourselves as a growth stock, although, we have always committed to making a dividend payment to the extent that we are able to, within our models. We do see dividends growing year on year, but in absolute terms rather than through the pay-out ratio. So, it is no more than that; it is the balance between capital and income benefit for shareholders that we are thinking of.

Just to be really clear, I hope you enjoyed that slide on the five-year progress since we bought Northern Rock. The future is bright. I think we have gone through a bit of a tipping point in terms of our ability to grow. We have the capital availability, we have the funding availability, we have the quality of assets that will enable us to, if you like, cherry pick that, and to take share from the incumbent banks. I would not want to limit that ability for ROE growth by paying out dividends when people are really investing in us as a growth stock at this point, is the logic at the moment.

As far as TFS is concerned, at the £5 to £6 billion level: as you say, it is a long time until the TFS has to be repaid, I think more than four years on average. Over that period of time, we would expect to grow current account balances, particularly through the development of our digital bank; not necessarily the whole lot being refinanced in that way, but it is a nice strategic benefit for us to be able to offset what could be otherwise a profit drag on the growth in liquidity from current accounts and bring a relatively similar cost of funds in through our own devices, as it were.

Peter Bole: FLS clearly matures well before TFS, so part of it is to just refinance through the TFS drawings. I think there is a slight overlap, when we will have a little bit of FLS and probably be fully drawn on TFS during 2018, but it will phase out beyond that.

Robert Noble (RBC Capital Markets): Given your focus on growing the digital bank, I was just wondering if you would see a large branch-based component of an acquisition positively or negatively?

Secondly, you have always sort of stayed away from the current account market to a certain extent. Can you give us any numbers on the cost/benefit analysis you have done on that, and how the partnership with 10x changes the cost/benefit analysis to make you more positive on the growth going forward?

Lastly, on retention rates: you say they are going up and mortgage spreads are coming down, but I am seeing mortgage rates which are broadly flat off your website, from everyone else's website. Does that mean the renegotiated rates that I cannot see are lower than your website rates, or not?

Jayne-Anne Gadhia: No renegotiated rates that you cannot see, so no, if you know what I mean. I do not know whether there is more you wanted to add to that, Hugh? Just in terms of mortgage spreads and the stability of them.

Hugh Chater: Yeah, so I think, as we have talked about, that the whole market has moved down. We are probably seeing average application spread somewhere between 170–175 at the moment in the market, and I think that is a noticeable move down from where we were, particularly towards the end of last year, and I think that is almost entirely driven by swaps, even though obviously with TFS around, people are using that in different ways.

Our retention spreads: as Jayne-Anne said, what you see is what people are taking in terms of our product rates. The really important thing for us about retention is that it is a win-win both in terms of spread, because we are seeing people taking slightly longer product, but also in terms of product quality, because of course those are known customers to us. We are very confident about how they will perform, and that is true both on residential but also since last year on buy-to-let, when we introduced retention for buy-to-let as well.

Jayne-Anne Gadhia: On branch networks, to your point about whether we would consider an acquisition that included branches: it has not even crossed my mind what that might or might not look like.

As far as branches in our own hands are concerned, we have 75. We have always had 75 branches. We acquired that with Northern Rock. We have not closed any, as I said in my speech earlier. In fact, we have grown seven lounges, which we have done really well. For us, we do think that that balance between digital capability, and bricks and mortar where customers can get personal relationships which they definitely value, is a really good balance. It was interesting to see some of the publicity around Metro and their branches over the weekend. I think their model goes the other way around, more branches, less digital; we are more digital, less branches. However, I do think that the interaction is important.

As far as current accounts are concerned, and the modelling that we have done for the current account on the digital bank: at the moment, we are much more at the stage of systems build and customer proposition, and we will not get into disclosing the economic benefits until much later down the track. As I said earlier, we intend to have a market update on the digital bank, I hope before the end of this year, so that we can explain that entire business and commercial model. The way in which we are thinking about a brand-new type of digital current account should mean that it is very low cost for us to execute in our own hands, and that as a consequence, benefit can go to the customer, and we then benefit, of course, from the funding cost. That circle is what we are very focused on optimising.

I think you have seen us do that, really, in the credit card business: 24% reduction in costs in our own hands from MBNA. If we could achieve that in terms of the cost of a traditional system of current accounts and a digital system of current accounts, or better, then we would be delighted.

Michael Helsby (Bank of America Merrill Lynch): Thank you. Just two, please, Jayne-Anne. I think you mentioned in your remarks about how you are looking at credit quality in the credit card business every week. Thank you for the new information that you have given us. I was wondering if we could invite a little bit more colour on how you are monitoring the credit quality in that business on a real-time basis, so we can get more comfortable on the shift that is clearly going on between balance transfers and retail? That is the first question.

The second point is on slide 40, you give us the non-trading items, the below-the-line points. I was wondering if you would be comfortable giving us any guidance for what you expect in 2017? Thank you.

Jayne-Anne Gadhia: Yeah. Okay. I will leave Peter to think about whether we want to give any guidance on that or not, knowing the number myself.

Yes. Let me introduce Chris Taylor, for those that have not met him. As you know, Michele set up and established our credit card business – it feels like a long time ago now – which launched back in 2015. Michele has moved on to lead the launch of the digital bank, based on all of the experience that she and the team got from that. Hugh has therefore taken over the full commercial aspect of our business, and Chris runs the credit card business within that context. Chris was the Head of Credit and all sorts of things at MBNA, joined to be part of the team to set up our credit card business. Nobody better to answer your question, Mike; tell everybody about credit card credit please, Chris.

Chris Taylor: Thank you, Jayne-Anne. Maybe two parts to the answer, Mike. So, in terms of the management information that we look at and review, same as the information that Peter and Jayne-Anne shared in their review: we are looking at the performance of the portfolio day in and day out, week in and week out, particularly the new accounts that we are booking, and making sure that we like the quality that we are seeing. You saw in the spotlight review that we did that we have very clear targets for the performance in terms of the credit performance of the new accounts that we originate. We set early targets in terms of early arrears performance, so six months on book, nine months on books; we do not wait to get to year one or year two.

We monitor those every month, the different cohorts that mature throughout the working week and throughout the working month. As Jayne-Anne said, we are delighted to say that our 2016 and 2015 vintages are outperforming the targets that we have set in terms of credit quality. We do exactly the same terms of existing portfolio. We look at the performance of the different cohorts that we have within the book, and we look at how they are performing every month against our financial targets, and against the business plans that we have.

In terms of our customers, we are monitoring customers really closely, and we are looking for changes in behaviour that are more subtle than perhaps the performance changes that you would see in the early arrears. I think there has been a lot of focus, particularly at the end of the year, on unsecured lending, debt-to-income ratios. We spend a huge amount of time looking at the business that we are writing, the existing customers that we have, and how they compare to the areas of concern.

I think the big thing that we did last year, and Jayne-Anne talked about complacency and not being complacent: we do not just look about the characteristics within our existing customers that may cause us credit risk issues in the future based upon what we know, which is more the traditional asset mix; we also look at the concerns that may be raised in terms of future economic headwinds. We talked a lot about our past experience, and the fact that affluence was really important in understanding risk potentially through a downturn. That was the reason why last year, even though we were outperforming all of our credit targets, we took the decision to tighten; because that performance may not be sustained in the future, and it is far more prudent to make those changes now, rather than wait to see it realised.

Jayne-Anne Gadhia: Thank you. Does that answer all your question, Mike? Thank you very much, Chris.

David Wong (Credit Suisse): Good morning, I just had two questions. The first is: there have been changes and there are going to be changes in the mortgage buy-to-let market, so I just wanted to understand your thoughts here. Obviously, the stamp duty changes have happened, and in light of the new tax rules on 1st April, just how that may be affecting your thinking towards that market.

The second question is just on costs. I think you have managed to keep the cost base, as you pointed out, extremely stable. Obviously, you are having to do some of these investment spends; I think you referenced £50 million of cash spend in 2016 and so on. Do these start to get reflected in the cost line further down? Just thinking about how those investments get reflected there. Thank you.

Jayne-Anne Gadhia: Yeah, I will answer on cost because I did not answer you, Mike, on guidance for below-the-line spend. The answer is less than £10 million. There is probably a better way of putting it; my entire IR team cringe at that point.

Peter Bole: It is probably worth adding, Jayne-Anne, that the area we see this year is really on the internal spend on the digital bank.

Jayne-Anne Gadhia: Yeah, absolutely. Which comes back to your question, really. The year we acquired Northern Rock, we spent £40 million rebranding branches, et cetera. We always committed to spending, first of all, £40 million, then £50 million in investing in the infrastructure that we have, and developing our business capability. The credit card business was built within that rolling £50 million worth of cash spend.

What we will always do on a new programme, exactly as we did with credit cards, is to amortise that after the business goes live, over sensible accounting policies which are disclosed in the ARAs. You will see the depreciation coming through the top line.

Peter Bole: All I was going to add was, if you look at the depreciation charge year on year in 2016, it has actually ticked up a little bit. You will see that coming through, so a lot of the cash spend in the year has already started being amortised.

Jayne-Anne Gadhia: If you want to think about how I am thinking about the financial cost of our digital bank, we are basing it very much on the shape of our credit card investment, both in terms of scale and subsequent amortisation.

Hugh, would you like to talk buy-to-let, please? Thank you.

Hugh Chater: As you say, clearly the whole market now has certainly taken on board the first set of changes that the PRA introduced, or required us to introduce, at the end of last year. We have talked about the portfolio comprising 18% buy-to-let; what we have seen in the early part of this year is actually 20% of our new volume, including both purchase and re-mo, coming through on buy-to-let.

We are very pleased with that because the quality remains very high, so average LTVs are 60%. We have taken a decision that we are looking for a minimum interest coverage ratio of 145%, with a 5.5% stress. The quality of business we see, as I say, is very strong, so we are pleased with that.

I think what we have demonstrated is that, particularly through our connection and work with intermediaries, we remain a strong player in buy-to-let. The aspirations we have for that in terms of volume for this year, we are confident that we can deliver those, given we are looking for about 18–20%.

Arun Melmane (Macquarie): I had a question on what NIM would do when interest rate rises; I appreciate it is a couple of years away, but you gave a number in terms of the fixed that you write five-year, that is about 35% of new originations. I just wondered if you were to give me some breakdown on whether that was more or less than what the market wrote, and what the behavioural maturity of your book looks like? Especially mortgages, as we look out from here, and whether that was different from the back book?

Jayne-Anne Gadhia: The only thing that I would say in that respect is that obviously we test, from an earnings at risk perspective, interest rates both down and up. I think we disclosed last time that, on a 25-basis-point move on our balance sheet, the impact on the bottom line is about £12 million. Now, I know that is a less sophisticated answer than your question demands, but that is probably the best indication that I can give you. We do expect to see benefit, in other words.

Peter Bole: The only thing I might add is just in terms of the current book, clearly we are hedging the current five-year mortgages and bringing them back to a floating rate receivable today to protect the margin, so it is not as though there is a specific exposure there.

Vivek Gautam (JP Morgan Cazenove): Good morning, I have two questions. First one is on other income: your comments and guidance indicate that you are expecting a flattish other income in 2017, and growth thereafter. Can you please talk a bit about what the drivers are of that growth, in terms of product lines?

The second one is on IFRS 9. You said that you are in advanced stages: can you share your views on what you think the initial provision top-up should be? A ballpark range would be very helpful.

Jayne-Anne Gadhia: Okay, I will do other operating, and Peter, you can do IFRS 9, in the time-honoured way. I think that is the right way to think about other operating income: flattish, with a hint of up during 2017. I think the last time we got together, I said that we had brought together a team that was thinking about other operating income in a broader way than simply selling a unit product of insurance et cetera, because we are starting to develop a broader customer proposition. Those propositions are developed, they have started; the life insurance supplier and partner that stands behind the life part of that is selected. So, we definitely see growth in the insurance business.

Our savings and investment businesses, we have been focused on extremely hard, and we expect to see growth and strategic development continuing across that business line. It has actually grown quite well this year, not least given some of the choppier waters of the year, so we have been very pleased with that.

We have got two smallish product lines that we launched just over 12 months ago, travel money and international money transfer. As I have looked at the weekly update that I get, every week they have their best week ever. They are not huge, but they are definitely starting to grow.

As I indicated, there is obviously opportunity for the other income line, from the future of the digital bank – in particular the current account business – and our partnership with Virgin Red to create income that is different to the normal non-interest income line. As I say, flattish with a hint of up, with a really strong strategic outlook for the future.

Peter Bole: IFRS 9, I am going to disappoint you here. Like everyone else has reported so far, we are not giving out numbers at this stage. We have done a lot of work where we are building it into our own internal plans, where we think the impact is going to be. The two things to note are: clearly, it depends on where we are in the economy. By the time it comes in, in 2018, given our book is 92% secured lending today with relatively low LTVs, the impact is less significant there than it might be on unsecured lending.

In terms of our own internal capital plans, we have made an assessment. We have taken a view on that. We are not taking account of any transitional benefits that might come from the regulatory environment. We know that they are speaking, and indeed the PRA's pronouncement at the end of the week hinted at potential for that as well. However, we have not made any allowance for that in our internal plans at this point.

Vivek Gautam: That seems to indicate from here that you would be comfortable with –

Peter Bole: From a capital perspective.

John Cronin (Goodbody): Thank you. Just on the NIM guidance of up to 160 bps for 2017: what I am trying to get a sense of within that is isolating the potential NIM compression within the credit card book. I suppose the way I am thinking about that is, you had a mixed benefit in 2016, I think, of approximately 12 bps in that book, which presumably will taper off as the growth reduces. As well as that, as cost of risk becomes more prominent as the book seasons, that will have a consequent negative impact on the interest income. I am just trying to put all that together and get a sense of, taking your guidance on NIM, what kind of basis points compression you could see in the coming years owing to those drivers.

Then just continuing on the credit card theme, on the cost of risk. Appreciating your guidance of up to 20 bps in 2017 is very much related to the uncertainty with respect to macro conditions, but I suppose are there any more disclosures you could provide in terms of the arrears or impaired balances by vintage, just to get a sense of how the new credit card balances, so to speak, or those acquired in the last one to two years, may evolve in terms of eventual arrears/impairments.

Jayne-Anne Gadhia: We will not be giving more disclosure on the card book than we have already today, if you see what I mean. For the future, I tend to agree with you: when we were putting the ARAs together, I was saying to Marian that there is so much disclosure on mortgages, we should look to be doing the same on credit cards, and we will be giving that some thought for the future. I think what we have explained today, we hope is helpful, and that is as far as we will be going today.

The same is true, I think, in terms of the impact on NIM: we are pretty confident of the NIM guidance that we are giving, taking everything as a round. Understanding your point around the compression point, the way in which I think about it is that we expect to maintain an effective interest rate on the credit card book of 7%.

Shailesh Raikundlia (Panmure Gordon): Thanks for the time, it is just a slightly conceptual question. It is regarding your current account book, or the lack of. I am just trying to understand that; one of your main competitors seems to have done a pretty good job of trying to attract current accounts. You have been going for a while now, with a pretty sizeable branch network. I am just trying to understand why you have not managed to attract a significant share of current accounts so far, and why you need to move to a more digital channel? Because most of the inertia seems to be based on branch-based networks. Thanks.

Jayne-Anne Gadhia: What is the right way of answering that? Compared to the competitor you talk about, we think that we have delivered profitability on a more significant and sustainable basis. The drag of current account against profitability, when you have to do this fees-free, has always been something that we have seen as a concern. It is very expensive in order to administer and deliver a current account if you want to drive return targets like 12.4%. We have been very thoughtful about that.

In terms of whether or not we have been successful with current accounts: based on that particular view of the future, we have surpassed our own expectations around the current account that we have offered. As I say, we doubled volumes this year. That means that in a network of 75 branches – you can only buy it through a branch, because we know if we offered this current account online, the volumes would be a significant profit drag – we have sold over 12,000 current accounts in the last 12 months. It is small compared to the current account market overall, but it surpassed our expectations.

For us, we never managed to convince the competition authorities that free-if-in-credit banking is in fact a sham. We still think it is. The way in which we are going to be addressing that market is through the digital bank, and that is our conceptual and strategic outlook for the future. I think, therefore, we can do that in a way that grows our funding base, grows our economic benefit, does not become a profit drag, is positive for liquidity and gives customers a good deal. However, that will be a new-fashioned current account, not an old-fashioned one.

Thank you very much, indeed. Thank you all for coming and for your questions. It is always great to see you, and I look forward to seeing you again at the half year. Thanks very much.

[END OF TRANSCRIPT]