VIRGIN MONEY UK

02 August 2022

Virgin Money UK PLC: Third Quarter 2022 Trading Update

David Duffy, Chief Executive Officer:

"Virgin Money has had another positive quarter, financially and strategically. We've grown our balance sheet across all target areas, grown our customer base with innovative and compelling products, and recently announced Slyce, our responsible buy now pay later product. I was also pleased to commence our buyback programme in the quarter."

"Looking out into an uncertain economic environment, while our asset quality remains resilient and customers aren't yet showing signs of financial stress, we are helping our customers and colleagues navigate what will be a more difficult period for many."

Q3 Summary: Strong profitability and robust balance sheet; commenced inaugural buyback

Delivering on our digitally led strategy with innovative new customer propositions

- 45% YoY increase in digital personal and business current accounts sales (c.45k total in Q3); voted 'Best Current Account Provider of the Year' by customers at Moneyfacts Awards 2022
- 160k new credit cards opened in Q3, following record Q2 (175k); retail spend remains strong
- 'Slyce' waitlist launched for our innovative Buy Now Pay Later product
- Launched 'Marketplace' proposition for businesses, alongside 'M-Track'; helping customers manage money digitally and access fintech-enabled business and lending solutions
- Continued progress in automation with 43% of customer journeys digitised (FY21: 27%)

Growing in target segments, with continued optimisation of deposit mix

- Unsecured lending grew 3.8% in Q3 to £6.0bn driven by growth in high-quality credit card balances from strong new account growth, higher retail spending & new digital propositions
- Mortgages remained stable at £57.8bn, with the Group targeting growth in mortgage balances in the medium term
- Business lending was up 0.3% to £8.3bn, driven by 1.6% growth in BAU balances, despite a subdued market and lower Government-backed lending which reduced (7.5%)
- The Group continues to successfully improve its deposit mix as relationship deposits grew further to 52% of total deposits (Q2: 50%), while overall deposits reduced (0.5)% to £64.1bn

Robust asset quality, stable provisions and coverage maintained

- Continued resilient credit quality, with low arrears across key segments and limited signs of stress. Underwriting criteria tightened across the portfolios to reflect higher cost of living
- Stable credit provisions at £476m (Q2: £479m); prudent IFRS 9 economic scenarios from Q2 maintained, supplemented by PMAs. Aggregate coverage stable at 66bps (Q2: 66bps)
- Impairment charge of £23m in Q3, 12bps cost of risk in the quarter, 8bps YTD
- Now expect a single digit cost of risk for FY22

Resilient Net Interest Margin and lower impairment drives strong Return on Tangible Equity

- NIM remained strong in Q3 at 187bps (H1: 183bps; YTD: 184bps) supported by higher rates, deposit spreads and higher yielding lending mix, offset by ongoing mortgage spread pressure
- The Group now expects NIM of around 185bps for FY22, stabilising as we exit the year
- Continue to expect costs to remain broadly stable compared to FY21
- Delivered 9.6% statutory Return on Tangible Equity Q3 YTD (H1: 9.1%)

CET1 ratio improved further, driven by ongoing profitability; maintained robust funding

- Commenced inaugural share buyback programme with an initial repurchase of £75m following resilient performance in Solvency Stress Test (SST), supplementing 2.5p interim dividend
- CET1 ratio increased c.10bps to 14.8% (including full c.30bps impact of £75m buyback); benefitting from ongoing profitability and lower RWAs; fully loaded CET1 ratio now 14.5%
- Moody's upgraded VMUK's long term issuer rating to Baa1 from Baa2; outlook remains stable
- Maintained robust funding and liquidity position with LCR of 142% (Q2: 139%) and LDR of 112% (Q2: 112%); successful AT1 bond issue in June further optimised the capital stack

Pioneering Growth

(£m)	31 Mar-22	30 Jun-22	Q3 growth	Q3 annualised
Mortgages	*57,798*	*57,761*	*(0.1)%*	*(0.3)%*
Business	*8,263*	*8,288*	*0.3%*	*1.2%*
o/w Govt lending	*1,148*	*1,061*	*(7.5)%*	*(30.2)%*
o/w BAU Business lending	*7,115*	*7,226*	*1.6%*	*6.3%*
Unsecured	*5,793*	*6,014*	*3.8%*	*15.3%*
Customer lending	71,854	72,062	0.3%	1.2%
Customer deposits	64,386	64,080	(0.5)%	(1.9)%
o/w relationship deposits	*31,887*	*33,274*	*4.3%*	*17.4%*

We are pleased with our performance in the quarter as we delivered growth in our target segments of Unsecured and BAU Business lending, while growing relationship deposits further, and as we continued to build good financial momentum with strong margins and ongoing profitability.

Unsecured balances increased 3.8% in Q3 driven by strong new credit card sales and retail spend, supported by our new digital propositions. New accounts opened in Q3 totalled c.160k, continuing the strong trend from Q2 (c.175k), underpinned by prudent underwriting standards. Aggregate credit card spending remains above pre-COVID levels and improved relative to Q2 across all retail spend categories, led by resurgent travel spending. Personal Loans and Overdraft balances reduced modestly during the period in line with expectations. The Group continues to expect Unsecured balances to grow through the remainder of FY22, supported by new digital propositions and strong activity levels, and will maintain strong underwriting standards, particularly given the current high level of inflation and increased cost of living.

Mortgage balances remained stable in Q3 at £57.8bn, reflecting continuing competitive market conditions. New business spreads remained significantly below back book levels meaning we remained selective, balancing volumes and pricing carefully to maintain profitability. Towards the end of the quarter, we saw front book application spreads begin to improve as increases in front book pricing outpaced swaps. The Group expects to maintain its mortgage market share in the medium term, supported by the finalisation of its investment in technology to expand and optimise its digital straight-though processing capability. This investment will deliver a unified digital platform for customers and intermediaries with automated case tracking, improved turnaround times and extended market reach.

Business lending was stable in Q3 at £8.3bn as a reduction in Government-scheme balances was offset by growth in BAU balances. BAU balances increased 1.6%, supported by the conversion of a strong pipeline of new business and an improved overall proposition, against a subdued market backdrop. Government-scheme balances declined (7.5%) to £1.1bn as expected, as borrowers repay balances in line with their repayment schedule, while fraud cases remain minimal.

The Group continued to improve its mix of deposits, as relationship deposit balances grew 4.3%, supported by strong customer propositions, while overall deposits reduced (0.5%) in the period, driven by a (9.7%) reduction in Non-linked savings balances. Non-linked term deposits increased 2.8% during the period as the Group participated selectively in acquiring new volumes at attractive spreads, as front book pricing remained below the rate of swaps throughout the period.

NIM of 187bps in Q3 reduced vs. Q2 (189 bps) (H1: 183bps), reflecting ongoing competitive pressure in the mortgage market, largely offset by growth in higher yielding unsecured lending and the benefit of higher rates, which increased structural hedging contributions and supported deposit spreads, with continuing lower levels of aggregate pass through to depositors. As these trends continue, the Group now expects NIM of around 185bps in FY22, stabilising as we exit the year.

Non-interest income, excluding fair value movements, improved in the period relative to Q2, supported by resilient card spending and business activity levels. During the quarter, there was a c.£15m adverse impact from fair value movements due to hedge ineffectiveness.

Delighted Customers and Colleagues

During the quarter, the Group continued to roll-out new and improved, digitally-led propositions. Total gross credit and debit card cashback registrations reached c.590k during Q3 (Q2: 470k), and the two programmes will soon be merged, enabling customers to see total cashback earned in their Credit card and banking apps. Early engagement from card customers using the new instalment repayment capability have been positive, with the feature driving retail transactions and higher balances. The Group has now launched the waitlist for its innovative new proposition, Virgin Money Slyce. Slyce will give a younger demographic a differentiated way to access and better manage their credit, flexibly and simply. Slyce will offer full Buy Now Pay Later functionality with market-leading terms, in a regulated credit environment that will support these customers in building and improving their credit score.

We continued to attract new PCA customers through our Brighter Money Bundles (BMB) campaigns, now including a compelling rate of up to 1.71% on linked saver balances, with over 216k new accounts opened since the start of the initial BMB in Q121 (H1 2022: c.180k). We have continued to enhance the PCA onboarding and servicing experience, improving sales conversions and were delighted that customers voted us the 'Best Current Account Provider of the Year' at the Moneyfacts Awards 2022.

In our Business Bank, the Group is creating a digital customer experience that offers speed, simplicity and efficiency. Our new digital fee-free BCA continues to perform well, contributing to a c.10% increase in new BCA sales in Q3 vs. Q2. This performance was supported by the expansion of digital on-boarding, which has reduced the time to open an account and helped improve sales conversions by c.20% during the last quarter. The Group is also implementing significant improvements in the speed of loan application processing, enhancing the customer experience and enabling end-to-end digital borrowing, to support our future growth ambitions. Having launched M-Track, we've now rolled out the first phase of our Business Marketplace, providing innovative fintech solutions for our business customers, including expense and tax management, invoice financing and HR services.

We continue to make good progress developing our Digital Wallet, in partnership with Global Payments, which will combine product features, such as instalment credit, payment functionality and the Virgin Red loyalty scheme. We remain on track to share the first iteration of the wallet later in the year. Having trialled Virgin Red points with our PCA proposition, we recently added a points offer for customers purchasing our new digital travel insurance product via the Red app. Looking ahead, we will extend our customers' ability to earn points across a wider range of partner offers as we further develop this valuable customer proposition, enabling deeper relationships and rewarding customer loyalty.

The launch of our A Life More Virgin colleague proposition and our approach to a truly flexible working model has been positively received with colleague engagement scores improving to 78% at Q3 from 68% at FY21. Aligned to our digitally-led employment model, the Group is targeting implementation of 'Agile' ways of working to support the Bank's delivery of new digital propositions and improve the pace of innovation and our ability to respond to changing customer needs. To further support colleagues, the Group is pleased to be providing a £1k cost of living allowance in August for the majority of employees.

From a sustainability perspective, we have continued to focus on developing our Net Zero targets and roadmaps for disclosure at FY22, in line with our Net Zero Banking Alliance commitment. We launched a £200m Agri E-fund to support farmers adapting to environmental changes, the first green product specifically designed for UK farmers. Given our enhanced ESG disclosures, we were pleased to have received an upgraded rating from Sustainalytics, who now place us ahead of peers at 'low-risk'.

Super Straightforward Efficiency

The Group remains focused on progressing its digital strategy in order to deliver an enhanced digital customer experience while driving improved efficiency and cost reduction over time. We are working hard to take costs out of the business, despite increasing inflation and the impact of our colleague cost of living allowance. Consequently, we continue to expect underlying costs for FY22 to remain broadly stable compared to FY21. This reflects additional costs from higher inflation, our colleague cost of living allowance, targeted growth and digital development largely offset by gross savings from ongoing digital transformation and restructuring. We remain on track to deliver around £175m of gross cost savings by FY24, with around £275m of digital development and restructuring costs across the same period.

We have continued to make progress in the end-to-end digitisation of customer journeys, including an improved digital on-boarding and servicing experience across Personal and Business, as overall customer journeys digitised increased to 43% from 27% at FY21. Following delivery of a suite of self-service chatbots earlier in the year, the Group has now surpassed 1m chatbot conversations with retail customers, with the year to date resolution rate within the chatbot at 62%. As a result, the percentage of customer interactions through calls has reduced from c.70% at FY21 to c.50% as at the end of Q3.

Discipline and Sustainability

We remain cautious as the UK economic outlook has weakened, reflecting intensified global inflationary pressures. The BoE expects inflation to peak at 11% this year and GDP growth to slow sharply across 2023 and 2024, though expectations for unemployment remain low. Following the MPC's decision to increase rates in June, the Group notes market expectations that further rate rises are likely in 2022.

Across key portfolios, there are currently limited signs of credit concerns; overall arrears remained low and stable during the period and there were no significant changes in individually assessed provisions. However, the Group recognises the potential affordability issues that higher living costs will cause for households and is ready to support customers, as was the case throughout the pandemic. For prudence, VMUK has tightened its affordability and underwriting criteria for new customers across all lending categories to account for the higher levels of inflation and has retained the c.£25m affordability Post Model Adjustment (PMA) for any affordability impacts on existing customers.

In its IFRS9 modelling, the Group applied the same economic scenarios as at Q2, given the quarterly reporting period, and our prudent scenario weighting which includes a 35% weighting to the downside scenario. This resulted in credit provisions of £476m (Q2: £479m) and a Q3 impairment charge of £23m, equivalent to a cost of risk of 12bps. Modelled and individually assessed ECL was stable at £302m in the period (Q2: £300m), while PMAs reduced slightly as the Group released some Covid-linked PMAs, taking overall PMAs to £174m (Q2: £179m). Overall coverage remains strong at 66bps[1] (Q2: 66bps), as the Group remains well positioned for any deterioration in credit quality. The Group will continue to monitor and fully refresh the economic scenarios used in IFRS9 modelling and will update PMAs alongside the annual results. Based on these factors, the Group expects a single digit cost of risk for FY22.

Following the announcement of the Group's capital framework, we were pleased to commence our inaugural share buyback programme during the quarter, with an initial repurchase of up to £75m, given ongoing profitability and capital strength. Capital generation was strong during Q3 as CET1 improved c.10bps to 14.8% on an IFRS9 transitional basis (Q2: 14.7%), despite c.(30)bps CET1 impact from the announcement of the share buyback and c.(10)bps impact from the dividend accrual in line with the Company's dividend policy. Capital generation was underpinned by ongoing profitability and lower RWAs, which reduced by £0.2bn to £24.0bn, primarily reflecting strong HPI. Fully loaded CET1 also remained robust in the period, improving to 14.5% (Q2: 14.4%), well in excess of the Group's CRD IV regulatory requirement of 8.7% as at 30 June 2022 and the Group's long term target range of 13-13.5%. VMUK's total capital ratio improved to 21.9% (Q2: 21.8%); the UK Leverage Ratio was 5.0% (Q2: 5.1%).

The BoE recently announced that the delayed 2022 Annual Cyclical Scenario (ACS) will commence in September 2022 with the results published in Summer 2023. Given the change in timetable and the Group's strong capital position, the Board will consider further capital distributions this year as part of its regular ongoing assessment of surplus capital, subject to market conditions and regulatory approval.

Funding and liquidity remain strong, with LCR increasing to 142% (Q2: 139%) while LDR remained stable at 112% (Q2: 112%). In June, the Group successfully issued a new £350m AT1 bond, achieving significantly tighter pricing on a spread basis than prior issuances. Concurrently, the Group repurchased £377m of its existing AT1 bond that is callable later this year. After these transactions, the IFRS9 transitional MREL ratio improved to 31.9% (Q2: 31.7%), representing a prudent buffer over the Group's 2022 MREL (plus buffers) requirement of 24.7% of RWAs (based on June-22 Pillar 2A), with no further AT1, Tier 2 or Senior Unsecured issuance anticipated over the remainder of 2022**.** Of the £2bn to £3bn of secured issuance planned during 2022, the Group has made good progress despite challenging market conditions, having issued c.£1.7bn year to date. Any additional issuance this year will be subject to deposit flows and relative cost. During the period, we were pleased that Moody's upgraded the Group's long term issuer rating to Baa1 from Baa2, with the outlook on the rating remaining stable.

The Board has approved the appointment of PricewaterhouseCoopers LLP (PwC) as its external auditor, subject to shareholder approval, with effect from the year ending 30 September 2024. The change in auditor has been driven by mandatory rotation rules, with EY nearing the end of their allowable tenure following their appointment in 2005.

[1] Government guaranteed lending balances excluded for purpose of coverage ratio calculation

The Company further announces that a copy of the Q3 Pillar 3 Disclosures 2022 will shortly be available to view on the Company's website at: 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

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Announcement authorised for release by Lorna McMillan, Group Company Secretary.

Forward looking statements

Virgin Money UK PLC is registered in England and Wales (company number: 09595911) and as a foreign company in Australia (ARBN 609 948 281) and has its registered office at Jubilee House, Gosforth, Newcastle upon Tyne, NE3 4PL