

Virgin Money UK PLC Investor Update 30 September 2021 – Call Transcript

Hosted by David Duffy (CEO), Clifford Abrahams (CFO), Richard Smith (Head of Investor Relations) and Ed Henning (CLSA)

Operator

Good morning, and welcome to the Virgin Money U.K. call. I will now hand you over to your host, Ed Henning, to begin. Ed, please go ahead.

Ed Henning, CLSA

Thank you very much. And look, firstly, thank you, David and Clifford, for your time today. As always, it's very much appreciated. Look, what I thought we'd do -- David, maybe, if we can start with just a quick overview of what you're seeing in the U.K. economy and the business, and then we'll throw it out open to questions. But I'll pass it onto you, David.

David Duffy, CEO, Virgin Money UK PLC

That's great. Thanks, Ed. And I appreciate you hosting this, as usual. And good evening everyone, and thank you all for joining. You hopefully, by now, had the chance to read our short announcement, which we put out a while ago. So, I think I'll just quickly kick off by talking that through, and then discuss the broader themes we're seeing in the business, and obviously open up to Q&A and we'll have plenty of time for that.

As you know from our previous discussions, we've been working hard to evaluate the opportunity to accelerate our digital strategy, and today's announcement is really marking the first step towards our ambition of becoming the U.K.'s best digital bank. And we specifically have announced changes to our store network, which is probably not a surprise, and we are closing 31 stores. And also, the evolution of our operating model at our head office sites we've communicated on, because we're becoming more flexible and digitally enabled in terms of space.

As we've come to the end of our Integration and Transformation, this acceleration of the digital strategy means that we will have to book an extra £45 million of restructuring charges this year. £25 million of that is for stores and £20 million for non-branch property and operating model changes. And that takes the total restructuring costs, for the year, to £145 million, with savings then reinvested into the business. We also continue to look at the opportunity to simplify the IT estate and deliver efficiency benefits and growth over time.

In terms of what's driving those changes, it's a continuation of the three themes we've talked about before, customer practices shifting to digital channels, which I'm sure you've seen; our colleagues' desire for more flexible working arrangements and the implications that has for our office space requirements; and lastly, the opportunities we see for greater automation and use of technology.

Now, as we've largely delivered Integration, we're aiming to move towards greater automation with a cloud-based infrastructure and that will drive and improve customer experience, and also a faster deployment of change. As we accelerate these digital initiatives, we're targeting further productivity and efficiency gains, and to create capacity for further reinvestment, driving further digitalisation and growth.

As the group looks to the future and targets stronger growth, we're focused on leveraging the enhanced capabilities delivered by these digital initiatives, and also strategic partners -- which you've seen us developing -- such as the announcement of Global Payments recently, and then Capita and these will help us to build unique customer experiences and propositions.

And alongside our compelling loyalty and rewards programme, our investments, I think, it will leave Virgin Money extremely well-placed to deepen the customer relationships that we have and to drive profitable growth over time. And we will provide, you know, a good deal more detail on our digital strategy, including how it supports our growth ambitions and the associated efficiency benefits we expect, as well as the investment opportunities alongside our full-year results.

Before opening with Q&A, I just want to make a few comments on trading, what we're seeing in the market at present. And so, if you think of the U.K. economic backdrop, we've continued to see an improving picture over the past few months, and the economy is demonstrating greater resiliency as restrictions have been lifted. We've seen continued positive revisions to the outlook for GDP recently, with the Bank of England now expecting greater than 7 percent growth this year, and a recovery to pre-pandemic levels in Q4 '21.

We also have expectations for unemployment which also has improved markedly, with some commentators now suggesting we're past the peak of 5 percent, with a declining trajectory through 2022.

Consumer spending levels have recovered through June and July, as lockdown restrictions were eased, and are back above pre-pandemic levels and the recent easing of some restrictions on travel will also see some improvement in a sector that has lacked a recovery so far, obviously.

And you might have also seen some commentary on supply shortages in the U.K, particularly petrol, driving up inflation expectations, with bond yields responding in recent days as well. And the Bank of England now expects inflation to rise to near 4 percent before falling back, slowly, to 2 percent.

With the removal of the government support that I just mentioned, we will remain watchful of the economy as well. We're not complacent about the potential implications for the backdrop, but we do have greater confidence, given recent trends and the improving outlook.

In terms of volumes, let me make a couple comments on that. In Mortgages, activity levels in the housing market have remained really strong in the run-up to the stamp duty holiday deadlines, with volumes pulled forward to meet those dates. Although pleasingly, when we look at August, the most recent approvals data -- or most of the recent approvals data -- shows some underlying strength. So, there is no doubt that competition has increased, as we thought it would, over the course of the year. And some major players had continued to target growth aspirations and deploy the excess liquidity generated in this lockdown. For our part, we're continuing to be selective. And as you know, our goal is to balance volumes and pricing carefully, as we have done historically, through these competitive periods.

In Business, demand continues to be relatively muted given the volume of the government scheme lending that has been made available. But business demand is likely to improve a bit as the backdrop normalises and we previously viewed this as likely towards the end of the calendar year, and that continues to be our thinking. With our ongoing proposition development in the backdrop, we feel quite well-placed to participate in that growth when it comes through.

On Personal lending, our performance has been more resilient than our peers throughout the pandemic, and with our balance transfer skew holding up better than the more transactional card balances of our peers. With new propositions being launched -- a buy-now, pay-later offer is being tested, and a good early start to our cash-back propositions, we're well-placed to pick up, pretty much across the piece, volumes of consumer spending translating into additional balances later in the year. You know, as the U.S. lifted the restrictions on travel, we saw a very big pickup in our cards, just for travel, which seems to be an indication of how travel latency will start to improve.

And finally, PCA volumes remain an area of focus for us. As you recall, we've seen a good performance through Q3 with 110,000 new accounts opened at that stage. That's leaving us second in the switching tables in the latest reported quarter. And we continue to focus on being competitive, despite a number of alternative cash offers coming back into the market in Q4.

In terms of our broader underlying trends and the backdrop, many of the themes we highlighted in July have pretty much remained consistent based on recent sector data. And as a reminder, we now expect NIM to finish the year modestly ahead of 160 basis points, with a stabilising trajectory into Q4 from the Q3 levels, which were 168 basis points.

And in terms of the drivers, we highlighted increasing competition as a headwind, alongside wholesale funding costs from issuance and tailwinds from ongoing positive deposit re-pricing. And we'll guide to the full-year FY22 NIM at the full-year results.

The asset quality backdrop has continued to be supported by the economic recovery, and we know that in July, that we saw there was an opportunity for a further reduction in credit provisions in Q4, if the strengthening in the outlook persisted. And we're working through our normal process and we'll update on this matter alongside our full-year results.

We remain very well-capitalised. We're reporting a CET1 of 14.8 percent, including the software benefit. Risk-asset inflation continues to be pushed out by the stronger backdrop throughout the year so far. The SST outcome remains a key factor for us in our thinking around capital returns, and we expect to provide a further update on our capital framework after the December results.

We'll give a more detailed view on the outlook we see across all of our products at the full-year, but we thought it would be helpful just to give you an insight into some of the themes that we're seeing in the U.K. And overall, we continue to drive towards a double-digit statutory return in the medium-term, targeting strong and profitable growth over time. So, no change there.

Okay, Ed. I think that's probably all I just wanted to make as comments, to allow for as much question time as possible. So, let me hand back to you for Q&A.

Ed Henning

Thank you David, and look, I'll kick off with a few questions, and then we'll open it up to anyone that jumps in. And I know a number of you have emailed me questions, and I'll try to get through those as we go.

But maybe just touching on today's announcement, I know you are going to give your medium term or your 3 year cost out plan at the full-year results. But with what you've announced today -- some closures of branches, and also looking at property -- those kinds of things, you know, should they have reasonably quick pay-off?

David Duffy

Yes, Clifford, you want to cover that topic?

Clifford Abrahams, CFO, Virgin Money UK PLC

Yes. You'd expect so. So, we are taking those measures. It reduces costs, but it's adapting our business and our people to the new digital reality. So, there'll be some cost savings associated with that and as you can see, we're pointing also to our further investment, further digitising and growth. So, we'll give that balanced picture at the full year.

Ed Henning

No worries -- and the other way of thinking about this as you touch on is the growth side, and I'll go through asset growth in a minute, but with your investment in digital and what you're doing, do you think this will start to drive you back to system growth, or even allow you to grow above system in certain categories going forward? How should we think about the investment in digital and then your growth outlook going forward?

David Duffy

Maybe I'll make one comment, and then -- and Clifford, you and I've talked about this. I think where we've shaped the growth expectation in our minds around this post-lockdown period, we thought that we'd have a relatively flat balance sheet this year, as we were conservative, but also, we thought that the economy would begin to step up growth in the first half of next year, and we'll be participating in that and probably by the second half of next year, we would expect normalised growth levels. And what we're trying to do is focus on building out the products, and the propositions, and the digital capability very strongly now, so that's why we have PCAs, and BCAs being rolled out now following the PCAs. We're trying to build the customer volume and then we should expect to grow across all of our products comfortably at or above the market in the second half of '22. I think that's just an outline, Ed, it's not absolute because we will adapt to the market, but that's the intent.

Ed Henning

Okay. No, that's really good, just to kind of understand the thinking behind that.

Clifford Abrahams

Just coming in on that a little bit, I think, building on that answer, I mean, clearly there's rightly a focus on short-term growth, and we're seeing that come through on the deposit side and particularly on the credit card side, as David indicated. So, into next year, I mean, I can see that those will be growth drivers. I think in terms of tying back to the investments we're making, that's about feeding the medium and longer-term pipeline for growth. So, we're halfway through a big investment on our mortgage re-platform and that will make us more agile, more able to adapt to market conditions and we see that as a growth driver as that programme completes, so that will be next year driving growth thereafter. So, I think we're actively trading and benefitting from the recovery that we're seeing in the U.K. but there's clearly a pipeline of investment, so the growth we're seeing now reflects the investment of the past few years and so we're laying the platform for medium-term growth through this digital strategy now.

Ed Henning

No, that makes sense. And just one further I guess on the mortgage platform. When do you think the first iteration of that will drop and drive some more efficiency in the mortgage growth?

Clifford Abrahams

So, that's in the next financial year. So, we've made good progress. I mean, the nature of these things, you're not done until you're done, but that should actually land in full year '22 and deliver the benefits I indicated. There'll be some efficiency benefits and cost benefits, but also our ability to connect digitally and provide a sort of end-to-end digital journey, both to brokers and our staff, will facilitate speed and agility in the marketplace and over time should give us trading benefits in the mortgage market. Alongside that also -- we're also flexing our, you know, call it our risk appetite, which segments we're targeting, so we're not just shrugging our shoulders as spreads come under pressure. We're actively trading in different segments to optimise our margin in these more difficult circumstances.

Ed Henning

No, that makes sense and that's consistent with some of the feedback I've got from mortgage brokers. But maybe if I can push my luck just on the mortgage platform, should we hopefully see that finished by, early in FY22, or is it more the back end of '22?

Clifford Abrahams

Well, you can imagine we're pushing the teams hard and we need to get it right and not going to announce a deadline on this call. But, you know, we're confident we can deliver and over time will give us those benefits.

Ed Henning

Okay. No, worries. No, that's good. I might move onto, hopefully, a quick one, you know, we've seen questions around energy, especially in the U.K. Do you guys have any exposures to U.K. energy companies more broadly or any that have gone or failed recently?

David Duffy

No. We don't have any exposure to that sector. I mean, we'll look for downstream impacts, if they occur, but we're in a good position, we're not exposed to that brewing crisis.

Ed Henning

Okay. So, that's a positive. The next one from me is, and you touched on it, David. BoE, and potentially seeing rate increases coming through for the U.K. Can you just run us through, maybe how we should think about rate increases given your book is predominantly fixed rate on the mortgage side and do you see impact flowing through early or how it translates into NIM -- or how we should think about the rate increase for you guys and any impact on earnings?

David Duffy

Sure, Clifford will probably cover that.

Clifford Abrahams

I'll pick that up. So, you know, not an unexpected question given the environment. And we disclosed that at the half year, so back in May our rate sensitivity, and I'll guide you guys to page 17 in that deck, and what that shows is for a 25 basis point uptick in rates, a parallel uptick, the NII impact would be £25 million. So, we disclosed that when we put in place the hedging programme, when we reintroduced it. And we showed an outlook around NII contribution from the hedge which indicated, sort of actually flattish to up going into full year 2022. So, we're sort of rounding the corner of the downswing in interest rates. We actually showed the yield curve at the time and if you compare it to where we are today, we've seen a 25 basis points uptick, roughly 25 to 30 basis points uptick, particularly in that sort of two-year to four-year slot, which is where we're focused. So, that will give you a feel for -- I mean, rates going up is good from our point of view, we would like more PCAs in relationship deposits, but that rate uptick is helpful in that respect. So, we're pleased with that effect, if it lasts. And I think on mortgages, as you know, rates tend to be sticky on their way down and perhaps sticky on the way up, so that may be contributing to some of the tough market conditions we're seeing on the mortgage side, but broadly speaking, £25 million NII for 25 basis points uptick.

Ed Henning

No worries, that's good -- and that's assuming everything passed on, so -- you know, that's the benefit of having your current accounts essentially at zero, right?

Clifford Abrahams

Yeah, that's a sort of one year -- exactly, yeah and we will update on sensitivities at the full year, given it's a point of focus because there are other things going on. Fine tuning our hedge, for example, and shifting mix in our deposit base where we're really pleased with the growth in our PCA and relationship deposit base which has been fairly sticky despite the recovery we're seeing in the economy. So, we'll update further on sensitivity at the full year.

Ed Henning

Yeah, no worries. And there's no timing impact because of the fixed-rate nature of lending and, you know, do the deposits go up earlier than the rates, or it really doesn't matter because you've fixed the funding to the mortgages so when they go up it rolls through?

Clifford Abrahams

Exactly, so we hedge our book and that nets out, and then we put in place that structural hedge relating to the behavioural balances, so, you know, we're not taking that kind of risk. I think the one-year outlook gives you that normalised or post-adjustment effect. I mean, it's typical that the deposit prices takes a little bit of time on the way up, you know, that's how the market's behaved in the past, but that one-year outlook will give you a feel for it. And clearly, part of the benefit is on the structural hedge where we can lock in, you know, as the hedge rolls off, we

can lock in the higher rate we're seeing, 50, 60 basis points or so at the three year end now, and we can lock that in as the hedge rolls forward.

Ed Henning

Yeah, no, right. And just to clarify for everyone on the call, you know, when you get the benefit of this, it's not the two and the four year going up, unless you're locking in those rates, it's really when the cash rate goes up from the current 10 basis points.

Clifford Abrahams

Yeah, that's right -- that's right.

Ed Henning

Yeah, no worries. I might just keep going before I open up and just move onto more broadly, NIM, you see a lot of market commentary, we see some prices coming down on the front book with mortgage pricing there. And, you know, you've talked about how you manage volume and margin. But can you just touch on the front book pressure? Firstly is it worse than expectations on the mortgages and how we should think about that in relation to your NIM looking forward?

Clifford Abrahams

I think I'll pick that up. I think we had been anticipating some tightening of spreads in the mortgage market. So, I'm just picking up your point about expectations. So we took advantage of spreads that were strong in the early part of this year, but a bit more cautious of spreads that have come in. I think until -- well, until this quarter, we've seen spreads still well in excess on the front book compared to the back book or the total book. I think you know, we'll obviously report at Q4, but it's -- front book is more in line with the total book at this stage. I would say for the industry as a whole, so we're still seeing decent returns but not something we want to grow aggressively at this stage. Where we have the advantage, I think, perhaps versus some other banks, is that we're still seeing repricing benefit on the deposit side, we're benefitting from lower spreads on wholesale, and that gives us the confidence to indicate modestly higher than 1.60% for the full year. So, as David said, we're seeing that uptick in NIM stabilise into Q4, and we'll update at the full year for guidance into next year on NIM.

Ed Henning

No worries, that's helpful. And look, appreciate, you know, we can't get guidance for '22, but feel free to give it if you'd like to? But in thinking about some of the moving parts, you know, mortgage competition, you just touched on there that the front book rates are basically in line with where your back book is, so unless they get worse that shouldn't be a big headwind. Is that fair?

Clifford Abrahams

I don't want to get into elements of guidance into next year. I think that what you're saying is logical, right. I think the things that will drive NIM next year will be the outlook for mortgages, and you've touched upon that, as well as the remaining repricing benefits that we're seeing on deposits. So, we're still paying, you know, one percent

plus on term deposits, and we have over £10 billion personal term deposits for example, it gives a feel for the remaining tailwind from deposits even before you get into rate increases that we alluded to earlier.

Ed Henning

Yeah. So, you've still got some natural flow down from the term deposits that are rolling off the current rates which will flow into next year, and then, you know, whatever happens on mortgage pricing, you know, there may be a headwind, there may not be a headwind, but you do have some tailwind still on the deposit going through.

Clifford Abrahams

Yeah, I think that's a good summary -- a good summary.

Ed Henning

Is that fair?

Clifford Abrahams

Yep, a good summary.

Ed Henning

Yeah, okay. No, that's good. Look, I've got more questions on email that have come through, but I might just pause to see if anyone on the line wants to ask a question before I keep going. Operator, do you want to check the line, please?

Operator

So we have a question from Kapilan Pillai, from Millennium. Your line is open.

Kapilan Pillai, Millennium

Yeah. Morning guys, thanks for doing the call. Can I just ask just how you're thinking about capital return, if there's been any change in thoughts there ahead of the stress test later in the year, just given how strong, I guess, you know, even the fully loaded capital ratio is?

David Duffy

Yeah, sure. Clifford, do you want to make some comments on that?

Clifford Abrahams

Yeah, so no specific updates, I think. We are feeling good about our capital position, at 14.8%, and we're clearly well provided, and David flagged -- you know, we see risks on the release side, on provisions. The stress testing result is really quite important to us since this is the first time we've gone through that formal process. So, I think

we're feeling good about where we are at this stage and we'll update, as David indicated, after we get those results on capital return. Yeah, I think that's pretty much all to say at this stage.

Kapilan Pillai

Got it, thank you.

Operator

We have no further questions.

Ed Henning

Okay. No worries. Please interrupt if someone else lodges a question. Just continuing on the capital return for a minute. If I think about where you are, obviously you've talked about, you know, you've got heaps of capital there and, you know, if you wait and see the stress test and how it unfolds. But all your models are relatively new, pushing toward IRB, that the PRAs approved - does that give you a lot of comfort going into the stress test?

Clifford Abrahams

Yeah. we've been preparing for the stress test for some time, you know, the good thing about being new to it is there's plenty that we can learn from the industry, so we've been well prepared going in. I think, as you say, our models -- I think you're making the point, our models are quite resilient under stress given we have more reliance on standardised approaches, so that's a good thing from a stress point of view. I think the book itself is well diversified and there's a big mortgage component which is pretty resilient given our LTVs. So, I think we feel good about going into that process. You can't anticipate where the regulator will come and have a view, but we understand our book well and, they know us well, and the dialogue is good. So, there's nothing untoward around the stress test, other than say look, it is important to calibrate, you know, what our true level of excess capital might be. We feel good about capital, we recognise the importance of dividends, and the importance of restarting the dividends and we want to be clear on a framework so that, you know, you guys understand how we're thinking about capital return. Our ambition isn't having an enormous payout that will constrain the growth of the business, we want a sustainable payout, and also be in a position to support the growth as we see opportunity for profitable growth in the short- to medium-term.

Ed Henning

No, that's helpful. So -- and in thinking about it with excess capital, so beyond a modest dividend or a dividend as we move forward, where your focus is right now is using that excess capital for growth as opposed to returning it to shareholders. Is that fair?

Clifford Abrahams

Yes, I mean, we want to restart the dividend on a sustainable basis because we recognise its importance. And we want to grow the business profitably given our franchise and our ambitions. So, those are the priorities and given our confirmation of our ambition around double-digit ROE, we see the ability to do both of those things.

Ed Henning

Yeah that's good. More, it was more so saying, growth over potential buyback, which I think you flagged where growth is your priority for use of capital.

Clifford Abrahams

Yeah. And clearly if we're sitting on excess capital for a period of time, we'll have to consider return possibilities, but we're feeling good about the medium-term growth outlook, particularly for our franchise and wouldn't wish to constrain it.

Ed Henning

Okay. No that's great thank you. Maybe going -- just one more question on NIM before I want to go to asset growth, you know, we talked about deposit tailwinds, we talked about where the mortgages are at. As you see growth coming back into the credit card market and potentially on the SME side, hopefully, you know --David talked about fourth quarter -- those businesses are higher NIM. If you do see, as you're seeing now, credit card activity picking up now, balances; from hearing one of your competitors talk, balances are starting to pick up in the credit card market. Is that another tailwind for NIM as we think about it next year if that does come through on the growth side?

Clifford Abrahams

Yeah, agreed. And you saw a little bit of growth at Q3 for us in unsecured, even though the lockdowns really ended completely in July, so, after the end of that quarter, so as David says, we're feeling good about unsecured. I think the other thing here is we've restored some of the risk appetite tightening that we put in place through the pandemic as things have normalised, and that itself will support NIM on the unsecured side. So, we're feeling good about unsecured. That would be a tailwind for NIM in and of itself, you know, it's a modest part of our overall book, but one where we have pretty strong market position actually, we're 7 percent market share given the resilience of that book and we've also got some good ideas to grow that in the short to medium term.

Ed Henning

Okay. No, that's very helpful. Thank you.

Operator

We have another question from the phone line, if you would like to answer that one?

Ed Henning

That would be great, please open up the line.

Operator

Excellent, so we have a question from Andrew Hokin from Smallco Investment Management, Andrew, your line is open.

Andrew Hokin, Smallco Investment Management

Great, thanks guys. Look just a question, sorry changing the topic, to get onto costs. You previously flagged these operating model changes with potential branch closures and just, you know, reduced office requirements at least a couple of times. And I thought in the past, you flagged them as potential opportunities to drive medium term costs below the previously stated £780 million target, but it sort of sounds like today you're suggesting those savings would be reinvested in digital. Could you just give us a feel for, I guess, how you're thinking about that?

David Duffy

Maybe I'll make one comment Clifford, and then you should obviously talk through it, but the question here is one of balance. We're looking at absolutely generating; we're committed to generating a reduced cost profile for this business, that's not changing. What we're looking at is the opportunity post lockdown to double down on the digital profile, to put us in a competitively advantaged position, acquiring new customers, looking at the new products like Buy Now, Pay Later, those kinds of things with the new partners we've signed up with. And we're trying to balance the dynamic here between, yes, a commitment to long term cost out, a commitment to our double-digit returns, but keeping some funds available to invest in those growth options so we can take advantage of the return to growth in the economy.

So, as we said earlier, we'd like to generate really strong growth, profitable, strong growth for the business, which obviously feeds into our distributions and dividends. And we'll have to have some funds to invest in that as opposed to just perpetually cutting the cost. So, it's a balance, but still underpinned by the commitment to cost reduction over time.

Andrew Hokin

Thank you.

Operator

We have no further questions on the line currently.

Ed Henning

No worries. Thank you. Just going back to overall credit growth, can you just give us a feel where you guys think system growth will be across mortgages, SME lending and credit cards in '22? I think that would be useful for the group here that are sitting a little while away from U.K.

Clifford Abrahams

Yeah. Maybe I'll comment. I mean, I think we see various sources of outlook and system growth. And we're kind of more, probably more focused on our own growth prospects because we take profitability into account, but I think the system growth has low single digit growth in mortgages, the unsecured picking up and business picking up a little bit later than that. I think we're living in uncertain times, of course, but I think the general direction is more positive.

I think from our point of view per David's remarks earlier, I mean, we will trade for value in the mortgage market. So, we won't necessarily grow in line with the market if we see spreads too tight for us and we'll try and maintain volumes selectively in segments where we see margins more attractive, so we've always been optimisers in the mortgage market. I think on the unsecured side there's opportunity for us to, I think, grow quicker than the market. Our customer base has been more affluent, more resilient, you see that looking back. They're excited that the possibility of trans-Atlantic travel for example with our connection with Virgin Atlantic and you wouldn't be surprised to hear that bookings are going well in that space, so even something like that will benefit the business, but also, we've been very focused on an upscale customer base and I think as we come out of the pandemic, we're somewhat broadening our risk appetite - still high quality - but we can normalise that a bit, that will fuel growth.

I think on the business side, it'll take a bit longer. I think the business sector, you know, has been flush with cash through government schemes and I think it'll take a little bit longer for sort of business-as-usual volumes to pick up. At the same time, we're seeing decent spreads on the business side where we are lending, so, we're managing that carefully. Where we can grow over time we will clearly take those opportunities.

Ed Henning

No worries. And then on the business side, do you see much payback of the bounce back loans or are people now starting to pay those or pay the interest bills on them?

Clifford Abrahams

It's early days...you know some of those schemes enabled people to refinance over a longer period - I think it's really early days on those schemes.

Ed Henning

Okay. No worries. That's helpful. And just one last one on unsecured and credit cards, you talked about the pick up in travel and stuff like that. You talked about generally the pickup in spend and the third quarter you saw a little bit of growth in credit cards, has that trend continued as people have opened up and started spending more, on your book?

Clifford Abrahams

Yeah, I won't comment specifically on our book, but I think the trends have been solid. The summer has been more normalised, travel, travel patterns, and we've seen some knock to that behaviour only in the last few days with petrol shortages, you see that in the media, I'm sure you guys have picked that up, but I think big picture, people's behaviour is normalising and that's coming through. Clearly, we'll give updates at the full year of where

we are while we're pretty much at the end of our reporting period and we'll update you with our full year figures very shortly.

Ed Henning

Okay. That's good. Maybe moving onto expenses and I know we've touched a little bit on the outlook. Initially going through Covid, there was a little bit of impact on delay on getting some expenses out. Have you seen any further delays from COVID or have you guys, as you've opened up, you've kind of been as you expected on the cost front?

Clifford Abrahams

Yeah, I mean on costs, at Q3 we guided to 890 as you know, so we stepped down in costs in the second half of the year. On cost programmes, we did pause and that takes some time to sort of restart and you've seen some of that evidenced right now. I mean, we closed a handful of branches in the full year '21, you know, low single digits and I think that reflects, the environment we're in and also making sure that we were available for communities during the crisis. As it's clear that digital usage is more permanent and we're adjusting our store network, you see this, I think, quite material movement, which is around 30 branches from a network of 160 and that takes quite a considerable amount of planning, working with staff and ensuring that the customers are safeguarded. So that's an example where we've restarted our efforts and the announcement points to digitising initiatives, which is -- we're finalising the planning stage of those programmes to be announced later, but that gives you a sense of how we have restarted those cost saving programmes now that the -- really most of the Covid disruption is behind us.

Ed Henning

And I just got a question through just asking about the costs plan in '22, and while we would love to get some numbers, are you going to give us like you've given us in the past, an absolute cost target or are you guys thinking cost-to-income targets or both?

Clifford Abrahams

Yeah, I think let's keep some powder dry for the full year. What's clear and you've heard this from both of us on this call that we do feel good about the growth potential of the franchise, Ed. Don't want to constrain it by excessive distribution, which we hinted at, but also we need to manage our costs and guide on costs to ensure that we can grow the franchise and deliver those returns that we all want. So we'll finalise how we communicate that shortly and give you full details at the full year.

Ed Henning

No, no worries. Maybe going on to non-interest income, you know, we saw some headwinds in the first half around fair value adjustment, how should we think about one, that going forward, and then as activity has picked up is there a direct correlation towards non-interest income fees coming through? So should we see a natural pick up in the fourth quarter and then in '22 as activity picks up?

Clifford Abrahams

The short answer is yes, I think the big drivers of fees in our business are on the payments, transactions, credit cards and also on the Business side and so I think to see fees fully normalise, you need to see both those cylinders firing. So the inter-charge income that we earn on payments, that's clearly recovering earlier than arrangement fees and other types of fees that we see on the Business side. So I think that's -- so the short answer is yes, but in my view it will take a few quarters to normalise and particularly until Business is back to where it was.

Ed Henning

Okay, that's helpful. Thank you for that. Next question, maybe going back a little bit to Virgin -- and you touched on some launch plans for the new mortgage platform. Can you just touch on maybe some of the products you've launched recently just to remind everyone in the audience and then what's going to come through in '22 to continue to help drive your growth going forward?

David Duffy

Sure. Maybe I'll start that and then you guys can jump in. So you'll recall that we did launch the PCA accounts, right, so that's been showing up great performance in terms of numbers of new accounts and in particular, we've seen in the last quarter switching as I mentioned, we moved up to number two in the table. And that's really showing the power of the brand and beginning to be demonstrated in 'live fire territory'. And we've been able to do that by bringing together the other group offerings, either wine or now experiences and we'll keep running new campaigns with new offers around that.

Equally, we've launched now our business current account, and that also has a five-star Moneyfacts kind of award, which is going to be the highest quality award of, you know, sort of rating your particular product. We're very happy with that. Both now have that award and that's now gathering steam out in the marketplace and offers going out with that. We are rolling out the business bank across the U.K. this year and into next year and over a this year and next year period, we'll put a lot of new software capabilities and tools in the hands of our customers with their balance sheet wealth tracker and health tracker. There is a lot of functionality with a bunch of Fintechs that we're actually executing on now and deploying and I think that will be very, very successful in the market. There's not many products like it, to be honest.

The mortgage book you've mentioned -- or the mortgage products you mentioned, and as we mentioned on the call earlier, that's definitely happening in '22 and as Clifford said we're pushing the team hard to keep driving that out there and I think that will be significant. This would be a first class product in the marketplace and really will help solidify the great relationships we have with the brokers.

Then we are looking at working on our operating platforms and moving as much of that into the cloud as possible. That's all activity we're working on with the likes of Microsoft. You've seen us announce the Global Payments partnership, and that's to explore a bunch of propositions, a whole load of ideas with them and that's early stages. I can't say too much, but, you know, the type of thing would be like the trial we have going on now on Buy Now, Pay Later. So that's quite an interesting area but you've got to be a little bit thoughtful about that, that's an area which regulators will jump on eventually. People aren't spending their money and saving the rest; they're just spending the money five times. So there's the question of how that all evolves, but still a long term and viable product and we certainly want to be thinking about whether we should participate in that.

And then there's functionality improvements which really help people like -- the debit and credit cards will both have cash back as well as loyalty. The Virgin Red programme, is the last one I'll mention, that is launched and building volume of customers in the marketplace now and we're working hard to bring that together with our payments capabilities and offer people real value. So you have a great experience with the technology and the app and then you get great value out of your activity through the app because you get rewards through that pretty unique programme.

So all of those are live or running very well, very happy with how they're going. So I think that's probably the main headlines. There will be more that we can talk about in November when we finish some of our work on propositions with the likes of Global Payments, but I'll pause there. I don't know if there's anything you want to add, Clifford?

Clifford Abrahams

Good summary. I think the thing I'm most excited about is actually on the Business side where there's, as you said, quite a lot happening this side of Christmas, I think, some exciting developments, so building on the success of our personal current account. And I think the other area is just fine tuning some of the propositions on the lending side, particularly on the unsecured side but also mortgages.

Ed Henning

Okay. No, no, that's good. And look, I've just got a couple of last questions because I know we're running a little bit of over time. I want to throw a bit more of a big, broader based question to David and/or Clifford. If we think about the business, what do you think the biggest threat or the biggest opportunity is for Virgin over the medium term?

David Duffy

That's a good question. I think the biggest threat is easy: it's the big tech firms, if they really go all in on and cross the regulatory inhibition and get into providing a full mainstream variety of services and by that, I would also include probably payment firms, you know, as they get into other products, the PayPal type sort of equation. So we keep a very close eye on that kind of evolution of those types of firms. I don't think -- people often say, "well, they don't want to be regulated, so it won't happen." I'm not so sure about that. I think that there is a blending of people in the marketplace, in that space into point-of-sale lending, and then suddenly it becomes something else.

So there's a real threat, I think, out there on that that we have to position well for. We try to meet that head on by having the unique brand with a great experience in the technology on the app and most importantly, real value creation for the individual through the loyalty programme. So that's how we battle that.

And the opportunity, I think, is exactly the flip side of that. I think we have a brand that is shown to be very strong and very powerful and attractive, both on the business and on the retail side. And I think that as we build out a technology sort of, position, we see ourselves literally having the ambition of becoming the best U.K. digital bank and that will present enormous opportunity if we can deliver that. And I'm really comfortable with our strategy and our approach and I know that the year end, we will talk a lot more about that as we finish all the thinking we're doing.

Just stepping into the double down on digital and becoming that best digital bank in the U.K., that's a real ambition and I think will provide a huge opportunity when combined with the brand in the future. So that'll be my take on it, Ed, but maybe, Clifford, you have other ideas as well?

Clifford Abrahams

No, I think a really good summary. I'm just reflecting on when I joined Virgin Money, it was announced in November, David -- I'm sure you remember -- where we are now. I think the business has delivered really well since that announcement, frankly -- I started in March. But if you think about last year where we think we'd be this year, I think I'm incredibly pleased not just with the resilience of the business, but also the early success of digital propositions and our delivery in that area. So I think the opportunity for us is quite unique at Virgin Money. So we, yeah, the overall market might be mature in the U.K. for financial services, but we see huge opportunity within that and the ability to move at pace in partnership with some of these businesses like Global Payments. So I think a huge amount of opportunity and I think, you know, you'll see steady execution against that in coming quarters.

Ed Henning

That was great. I had one other question come in from someone -- I've got a quick bit of time, so I'll ask and hopefully it's a reasonably easy question. The tax rate obviously, keeps moving around with some deferred tax assets and then you've had a change in the corporate tax rate over there. How should we think about the tax rate over medium term for you guys, Clifford?

Clifford Abrahams

Yeah, I'm going to ask Richard, actually, because there's a few dynamics into this year, which I think would be helpful to get right.

Richard Smith, Head of Investor Relations, Virgin Money UK PLC

Yeah, sure. Very happy to. I guess, in terms of sort of the medium-term effective tax rate, low 20s is still a reasonable place for people to be modelling in the outer years. As Clifford says, there are some moving parts in the near term which could see that move, but what we're effectively seeing this year has been the change in corporate tax rate has come in and that's therefore been or is being reflected through numbers this year and impacting the tax rate. Against that, the government has also flagged that it will be consulting on the banking surcharge, but that isn't going to happen within our financial year. So what you could see is that their aim to mitigate the headwinds of corporate tax rate changes for banks as offset by a change in the banking surcharge. So actually, you see a commensurate reversal going on next year, but they're still consulting on it, so we haven't got the final view on that yet but we'll keep everyone posted as and when we do get that. Longer term, though for now, you know, effective tax rate of low 20s is a reasonable starting point.

Clifford Abrahams

With the tax credit expected this year, just so everybody understands.

Ed Henning

No, that's very helpful, thank you. And then one last one to finish on. And, you know, I think we've been through a little bit of this during the call, but maybe you could both, David to you and to Clifford, you know, looking into '22, what are you guys most excited about?

David Duffy

Well, maybe I'll answer that first. I think taking into account our history, as well as looking at the market dynamics and our ambition, you know, we've had to deal with a lot of, you know, disruption, whether it's lockdowns or Brexit or PPI or all those things and any other legacy matters and I really feel that we now have a strong, capable balance sheet which can be deployed well. We will get past our last driving test, as it were, with the stress test at the year end and '22 offers us the potential to really deliver on digital and our growth ambitions and become that best digital bank. And there's an enormous opportunity out there for a powerful brand to provide that experience and that value to customers and I really think we can compete with the best in class on that and do very well, so I have a few new hires coming in as well, to strengthen the team, really talented people and I think that's giving us the, you know at all levels, not just the leadership team at other levels as well. And it gives me a lot of hope that we can, with a lot of hard chopping of wood to do every year, of course, but I think we'll be looking forward with optimism and excitement about building a business rather than constantly managing something that's been thrown at us. So good old, robust competition in the marketplace and winning. That's what's exciting.

Clifford Abrahams

Yeah, I'm pretty similar, David. I was going to say I think I might be excited about the stress testing, but it would be good to get that out of the way. You know, we're working towards the full year results so I think that's an important milestone. But in terms of the business, as David said, I mean, the history of PPI, of COVID, and then coming out through that, I mean I'm really proud of the resilience of the business from a capital balance sheet perspective, from a credit perspective, we're not completely out of COVID yet but I think the business -- the credit side has performed remarkably well. And at the same time, we've laid the foundations for digital growth, so the PCAs have done remarkably well in an environment where there's less switching because of the COVID environment. So I'm really excited about the launch of our business proposition, which will come before Christmas and we'll see, hopefully, further signs of Virgin's power in the SME market. So plenty of opportunity and hard work ahead of us to realise the potential of the franchise from the strong base we have now.

Ed Henning

No, that's great. And look, I know we've run a little bit over the time, but I'll stop it there and just say thank you for both for your time today and look forward to catching up at the full year results in November.

David Duffy

Great. And thanks again for hosting Ed, and thanks again to everybody for joining the call.

[ENDS]