Metro Bank Q1 2017 Results Call

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Vernon Hill (Chairman), Craig Donaldson (CEO) and Mike Brierley (CFO)

Presentation

Vernon Hill

Good afternoon, Vernon Hill. Good afternoon in Britain, good morning in America. We're pleased to report to you on our Q1 results, which are great, and I will turn over to Craig.

Craig Donaldson

I've been caught out by the shortness! Vernon's a little under the weather today. So, thank you, Vernon. I am very pleased with our first quarter's results. I think to report record customer account growth, record deposit growth and our second strongest lending growth in a quarter is a superb quarter overall. I am also really, really looking forward to the second quarter. We enter the second quarter with the strongest lending pipeline we've ever had, and have some fantastic technology deliveries that we'll be dropping in over the coming weeks and months, that we can talk you through as we go through the call today.

So, overall – you know, this is only a month or six weeks after we did our full-year. We are in a very good position after a very good quarter, and a very good start to 2017.

Vernon Hill

Mike, do you want to say anything?

Mike Brierley

No, Craig's stolen all the best lines as usual.

Vernon Hill

No, I steal them all. So, with that, you all have a copy of the press release; we'll open the floor now.

Q&A

Peter Lenardos

Good afternoon gentlemen, it's Peter Lenardos from RBC in London. I have three questions for you. I was hoping you could give us further clarity on, firstly, the minor one basis point drop in the NIM during the quarter?

Two, the two-percentage-point decline in the loan to deposit ratio.

Three, if you could just update us: I know you said you were going to do ten store openings this year; how do you expect those to phase in as we progress throughout 2017? Thank you.

Craig Donaldson

So, shall I start on this and then I'll hand over to Mike? Good afternoon, Peter, by the way. So, let me start with stores, I'll start in reverse order. On the stores, they will be back-loaded in the year. We will start opening stores in the second half; August, September, October, November and currently we've planned for a couple in December. They have been back-loaded purely because when we get our stores, it's often after the Christmas period because they're retail stores we're taking over, and people obviously do not like to come out in their peak periods.

Looking forward though, if I may, we are seeing a very strong pipeline grow from 2017 onwards. We have some fantastic sites we're currently negotiating on and in legals in across Birmingham and Bristol, moving into Cardiff. And actually, if anything the pipeline is strengthening. So, I am confident into next year we should be opening stores in the first half, which I'll be looking forward to as well.

Vernon Hill

And Peter, it's a good question. Another point is that we're getting this tremendous growth in deposits with no new stores opening in the first part of this year.

Peter Lenardos

That's a good point, thank you.

Craig Donaldson

The two-percentage-point decline on the loan to deposit ratio: it will go up and down sometimes quarter to quarter, and if you look year on year it's gone from 69 up to 72. It did drop I believe in one of the quarters a little bit last year, so therefore this is consistent with what we've seen. We had a strong lending quarter; what we had was an exceptionally good deposit quarter. And my view is, when we have customers who want to bring their relationships to us, I'd like to win them and build those relationships because that's how we'll build the bank long term.

So, for me, the other thing therefore when you look at it: to look at our cost of deposits dropping from a 66 average in Q4 to 61 on average in Q1, whilst delivering £1 billion growth for the first time, I think it's just exceptionally strong. I fully expect as we go through the rest of this year that we will finish the year above the loan to deposit ratio that we started the year. And I see no reason when I look into the pipeline and the growth for the rest of the year to have anything that will say anything otherwise.

Vernon Hill

Peter, on that subject I just want to make the point again: we grew this tremendous growth in deposits, and our cost of funds went down. That's very important. And as you saw, the growth per store for this quarter was £7.4 million a month a store. Converted today to American dollars, that's US$113 million a year for growth. I want to remind everyone on the call: the average in America today is US$1–2 million a year, versus our US$113 million.

Craig Donaldson

To come onto your –

Mike Brierley

Yeah, you asked about the one-basis-point fall in the NIM, Peter, and of course the answer is actually linked to what Craig has already said, which is that we had an exceptional quarter in terms of deposit growth, and often there is a lag between the generation of deposits and the lending or the investment of those deposits to generate return. A lot of those deposits were raised actually quite late in the quarter, and therefore they were sitting on the balance sheet in cash and therefore had a short-term detrimental impact on the NIM. Long term, of course, we'll invest them for value, and certainly we're confident that NIM will continue to rise throughout the year as it's done in the last few years.

Peter Lenardos

Great, thanks Vernon, Craig and Mike.

Craig Donaldson
Thanks, Peter.

Mike Brierley
Thanks, Peter.

Joseph Dickerson
Hi, good afternoon guys, thanks for taking my question – two, if I may? So, just on the unit economics, the £7.4 million of net deposit growth per store per month. I believe that's up about 12%, that metric, on Q1 last year, appreciating that there's some seasonality. Do you see for this year, particularly given that we'll have in the back end of the year some new stores online, and given that some of the stores that came online, such as Clapham Junction and Wimbledon last year, are in the commuter belts, do you see a slightly higher run rate now to net deposit growth per store per month? That's the first question.

The second question is: 2020 is somewhat in the distant future but not that far away, so could give us a road map as to how we get to the 3% NIM plus fees target that you have for 2020? Thanks.

Craig Donaldson
So, if I start on the performance on deposits to start: it was an exceptional –

Vernon Hill
Remember Joe, our target is £5.2 million a month. We're very, very comfortable with that. You're going to get some quarters where we do better. It's the commercial side that's driving it more than even our targets.

Craig Donaldson
So, to just build on that, it was exceptional. We had a great quarter one last year as well. I don't wish to change the guidance we've given at this point in time: it's £5.25 million. You won't be surprised to hear me say we're very confident about delivering the £5.25 million across the year, but we're sticking to that. It is great. We have seen from the stores that we did open last year, as we've always said in the cohort analysis that we've talked people through with the half-years and the full-years, our stores are opening bigger and growing faster in every cohort, and we've certainly seen that continue with the cohorts that we opened in 2016. And that's such a powerful reliable engine that continues to deliver.

Vernon Hill
And on that subject, Joe, I know you know this but for the rest of the people on the call: our basic model is about building fans. Fans join our brand, they remain loyal and they bring their friends, and we're seeing that fan effect multiply even more here than I saw in America.

Craig Donaldson
And I think if I may, to build on that again: if you look at it, one thing that's – it's the last bullet point in the Q1 highlights, but to me it's one of the most outstanding numbers: it's the record number again in the number of customer accounts we've opened. And that's the power for – because those accounts obviously bring deposits in when they open, but then of course they continue to grow, and so that's the model again, just playing through and playing through.

With regard to building into 2020, Mike, do you want to cover that?

Mike Brierley
Yeah, absolutely. I mean, I think the road map is the same as we outlined at listing, which is the increase in the loan to deposit ratio to circa 80% is our guidance for 2020. And also increased fees, particularly because we're seeing a lot of success in attracting trading businesses, and trading businesses generate lots of fees. Accounts are up 38% year on year, but fee income is actually up 50%, and the reason is because we're attracting trading businesses and the fees that they generate. There are also, I think, some technical aspects to the road mapping

around retiring some of our FLS and TFS funding, which serves to suppress NIM a little bit at the moment. But the real answer is success in attracting trading businesses, and increasing the loan to deposit ratio.

Joseph Dickerson
Great. Can I just have one more, just to elaborate on the first element of the question? Vernon, you mentioned the commercial growth, or Craig you mentioned the commercial growth, but I think a lot of people have a perception of Metro as this retail bank. What's the value proposition that's attracting the commercial customer, and why is it unique at Metro Bank?

Vernon Hill
It's the same thing we do for the entire bank: it's a unique service and convenience model that builds fans. A commercial client wants an old-fashioned banker who can handle his multi-million-pound loan, his mortgage loan, his kid's car loan and, as you know, Joe, that's what the Metro model brings back: old-fashioned banking. And it leads to a full relationship in lending and depositing. And of course, as we've grown the size of lending we can do on a per-loan basis, and all of that is working together. I think in the release we say our deposits are 50% commercial and 50% retail. I expect commercial to be higher than consumer over time.

Craig Donaldson
Joe, it's Craig here. The other thing I'd say is our technology, and the integration of that with the physical delivery, obviously underpins – it's the model, like Vernon said. But if you look at the SME market, we are opening thousands and thousands of accounts every month for business customers. And we don't offer incentives to them to do that, like many players, because we want to build long-term relationships. And what's happening is though, if you walk in: 63% of our accounts are typically opened for business customers for SMEs within 60 minutes. We did some research into other banks, and we haven't been able to use it because it returned six to eight weeks on average to open the same accounts in other banks, and it just wasn't credible for marketing. But the fact that we can fulfil the customers in the SMEs, the fact that we can do it with them there and then, and the fact that we're open seven days a week, early and late, with the technology offerings we've got, really attract these customers. Our busiest day for business is a Sunday.

Joseph Dickerson
Really?

Craig Donaldson
Absolutely. And why? I mean, people say, 'Why is that?' And the answer is because, if you are a painter and decorator, an electrician, a builder, you're on the job 09.00 to 17.00, Monday to Friday, and mostly you're working on a Saturday morning. Therefore, you do your banking on a Saturday afternoon or a Sunday, and we're open to be there for our customers, whether they're retail or business. And we win so much custom because we're there for our customers at times that suit them, or through the channels that suit them.

Joseph Dickerson
Thanks, guys.

Vernon Hill
Thank you, Joe.

Nick Baker
Good morning, gents. Thanks for taking my questions. I've got three, if that's alright? Firstly, just on the deposit gathering: clearly, you took a significant amount of volume in the three-month period. I am just looking for an update around the contribution of pensions deposits to your deposit base? I remember at the back end of 2015 that was around 11%, so just curious if you can give an update on whether that's moved?

The second one was just on other income quickly. I think, just looking at the release, the quarterly growth in other income was a tad slower than that in NII, so just sort of any colour you can give around the outlook for the step up in fees and other income would be helpful.

And then more broadly on the consumer credit environment in the UK: clearly, that's still a relatively small part of your book. I'm just curious to see: do you intend to increase that mix over time? And how is your risk appetite, given the pricing in that market at the moment? Thank you.

Craig Donaldson

So Nick, it's Craig here. Good afternoon, good morning by the way; whichever one it is, forgive me. Let me try and answer that to the start. So, on the deposit gathering in partnerships: partnerships was running slightly higher than 11% in the first quarter, but nothing significant. I'd call it within sensitivities either way, so slightly higher than 11% but it was very positive across the whole bank. Every area had a very good quarter one, and what was most pleasing was it was genuinely very, very well mixed and well balanced. Current accounts: one of the things that helped drive the cost of deposits down was the continued relationships that are being built through the current accounts, across both retail and business, and that's hugely positive for us. So no, very well mixed; slightly more partnerships, but that's a lot to do with tax.

Next one then was fees.

Mike Brierley

Do you want me to pick that up? I mean, I think it's important to remember that the fee income is up 50% year on year, quarter to quarter, but fee growth in quarter one was relatively muted at 4%. It's mainly seasonality, because overdraft fees and card transactions are down quarter on quarter. I mean, as I think it's very easy to understand, retail customers tend to utilise overdrafts in the run up to Christmas and repay after Christmas. And of course, card usage is inevitably higher over the Christmas period too. It's a little bit difficult to say, but I think also the lower day count quarter one versus quarter four also will have played through here, though it's a little bit difficult to say how much. I think if you take account of all of those items, you end up with underlying growth in high single digits, and I think that's what we'll see over the remainder of the year.

Craig Donaldson

But Nick, if I was you, I'd very much focus on quarter one to quarter one, and a 50% increase with a 38% increase in customer accounts; that's the key number for me, and that's the power of the model coming through. And, as Mike has said before, as we win more trading businesses we get more effects, we get more fee income. And also, we get more customers who introduce more customers to us, and that's so powerful.

With regard to consumer, could you just ask the question again for me, Nick? I do apologise.

Nick Baker

Well, I was keen to get your views on the proportion of your book that's in the consumer space. So, it's 3% currently, and you've talked before about increasing that mix over time, but I was just curious if, given the pricing environment in UK consumer credit, that's something you might defer, or if that's still your intention?

Craig Donaldson

So Nick, my intention is absolutely to grow consumer book from 3%, as I've said. However, in the short term I'm not willing to do lending at the prices where you've got unsecured lending at 2.7–2.8% up to £25,000. In our models, it just doesn't make economic sense across the cycle, so a conscious decision there. Also, in credit cards I'm not willing to do 40 months, 41 months, 42 months, 43 months – and I'm sure we'll have an innovation soon and go to 44 months – interest free. It's not our model. We don't offer incentives to win these customers. Of course, we offer credit cards, but what they are is to support the relationships we have with customers; they are not to win customers through incentives. So, conscious decisions made, but of course as it returns back to more normalised positions, I would like us to build our consumer lending to our customers, but not at the rate of 2.8%.

What's interesting is, in our AIRB modelling that we've been doing, as we build our models out further, we can get a higher yield on 90% loan to value lending in mortgages, with much lower losses and much lower capital requirements, than you can on the unsecured lending. It makes no sense to me therefore, to do the unsecured lending.

Nick Baker

Thanks guys. Can I just follow up on the pension point, by the way? The 11% you said, was that a stock number or was that the new business in the quarter?

Craig Donaldson

Oh sorry, that was the new business. So, the new business was slightly higher than the stock position, but what we find with partnerships and pensions is they do have big ups and downs just because of where the tax years are, and the investments. So, quarter one is normally – February and into March are normally very powerful for partnerships, simply because people are building up their reserves in advance of the tax and investments.

Nick Baker

Brilliant. Okay, thanks a lot guys.

Ian Sealey

Hi guys, it's Ian Sealey from Citigroup. Just two quick ones, first on the CET1 ratio: I'm just wondering if there's any sort of seasonal impact? Because it's down a little bit in the first quarter. Any seasonal impact from operational risk there, and if you could quantify that? And the second part of that question is how we should think about the CET1 ratio trending from here.

And then the second question is just if you could give us the number of how much TFS you took at the end of the quarter that would be great. Thank you very much.

Mike Brierley

Yeah, hi Ian, how are you doing? Yeah, the CET1 ratio fell from 18.1% at the end of the year to 15.9%. Generally that's driven by growth in risk-weighted assets. There was, however, a one-off impact as we included the 2016 audited revenues into the bank's basic indicator approach for operational risk. I think the impact of that was something in the region of 24–25 basis points; I just tapped on my calculator and came up with that figure.

So, where are we going with that? Well clearly, we're intending to continue to grow risk assets, the deposit and asset growth in the first quarter; we're intending to continue that, and therefore the CET1 ratio will continue to fall. But more gently, given the profitability that we're now achieving quarter on quarter.

Ian Sealey

Thank you. And on TFS?

Mike Brierley

On TFS: right towards the end of the quarter we took £350 million worth of TFS, and actually used most of it to repay more expensive FLS. But clearly, most of the FLS was off balance sheet, being held as Treasury bills, primary liquidity, whereas TFS, of course, arrives in cash and therefore is on balance sheet.

Ian Sealey

Perfect, thanks very much. Very useful.

Mike Brierley

Cheers, thank you.

Anna Brunetti

Hi. Yeah, I was just wondering: obviously, you partner with Zopa, so a peer-to-peer consumer platform. That was announced in 2015. I was wondering how is that line of business going, especially now that Zopa has announced they will obtain a banking licence, so they will become a little bit more a bank model? Are you still making business with them, and how much has that contributed to performance?

Craig Donaldson

Hi, it's Craig here. So, we have a very good relationship with Zopa. We actually have a lot of cultural alignment, I guess is the way I'd describe it. And yes, we expect to continue to work with Zopa. We find their service to be very good and, as I said, we work well together. However, the actual contribution into the first quarter was very small, because obviously the rates have drifted down significantly and, as I said earlier, we're not willing to lend at the rates that others are willing to lend. So, a good relationship, one we'll continue to build, but unless the risk return is right we won't do the lending. And at the moment in the consumer unsecured lending market, I don't believe the risk return is right.

Anna Brunetti

Sure, great. Do you think that it's going to change soon?

Craig Donaldson

You know, the Bank of England have come out and I think applied their calming, stabilising comment of, 'People should be aware that this is a little hot.' I think they announced 9% growth year on year. So, I don't know. I don't know what's going to go on, but undoubtedly the Bank of England are looking at it. It's not something that for me is particularly concerning, as we don't play in that market and we won't.

Anna Brunetti

Sure. Can I just clarify: with Zopa, would you lend to unsecured or secured?

Craig Donaldson

Unsecured, we lend unsecured with them.

Anna Brunetti

Unsecured, yeah?

Craig Donaldson

It's just CCA agreement, it's very simple, and we leverage their distribution and our brands together.

Anna Brunetti

Okay, no problem. Thank you very much.

Vernon Hill

Thank you all for being on the call. Please feel free to call us if you need anything else. Thank you all.

Craig Donaldson

Thank you, everybody.

Mike Brierley

Cheers, thank you.