Metro Bank Q3 Results Call

26.10.2016

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

Presentation

Vernon Hill

Good morning in America, and good afternoon in Britain, to our Fans on both sides of the Atlantic. We're pleased to report on and discuss our results for the third quarter. Most of you know that Metro Bank celebrated its sixth anniversary during this quarter. The highlights are: loans are up 73%, deposits are up 66%, revenue is up 78% and, as we promised, we reported an underlying profit before tax of approximately £600,000. Our customer count is now 850,000, and we're quickly growing to the one million count. In the prior months we have issued guidance for the company going forward, and one of our guidance numbers was that our deposit growth per store per month would be £5.25 million. We're pleased to report that our deposit growth in the third quarter per month per store was £5.6 million, despite the fact that we aggressively reduced deposit rates, which reduced our cost of money and raised our margin. As most of you know, Metro is traded on the London Stock Exchange. Our symbol is MTRO and our market cap at this minute is approximately £2.2 billion.

I'm now turning it over to Craig Donaldson, our Chief Executive, and Mike Brierley, our Chief Financial Officer.

Craig Donaldson

Thank you, Vernon. Just to reiterate what Vernon said, I think we had a very good quarter. We're very proud of what we've continued to deliver. I just wanted to draw really on the record growth in customer accounts. We actually have six stores opening in quarter four, so one would expect that to continue, and I'm so proud that we have 80% brand recognition. We have a significantly higher NPS than anybody else in the UK, and that's undoubtedly driving customer growth as we continue to create Fans. The model is about creating Fans. We focus on creating Fans, and those Fans are telling their friends, families and colleagues they should bank with us. And those 68,000 customer accounts that have come to us are evidence that this is working quarter in, quarter out, day in, day out. And I'm very, very proud of that.

Vernon Hill

I just want to add one thing before I turn it over to Mike Brierley. Our assets at the end of September were £9 billion which, even at the reduced value of the pound, is – what Michael, about $10 billion? So, for you Americans, this is a US$10 billion bank with 43 stores. Michael.

Mike Brierley

I think the only comment I'd add really is that the positive jaws on the P&L that we've seen in previous quarters, with growth in income significantly exceeding cost, continued in the third quarter, and we anticipate that continuing in the fourth quarter. It is that that is driving us to profitability, and it's that which will drive us on to higher profitability in 2017 as previously guided.

Craig Donaldson

Thank you, Mike. Could I ask that we go to questions now and open it up? Please feel free to ask away.

Q&A

Peter Lenardos
Good afternoon gentlemen. It's Peter at RBC in London. Just a question on your NIM. I know it came up two basis points in Q3, and you anticipate your deposits re-pricing at lower still in Q4 because of the BOE base rate cut in August. Do you have any commentary on the quantum? Do you expect deposits to continue to re-price down and the impact on the NIM in Q4? Thank you.

Craig Donaldson
Hi, Peter. It's Craig. So, the cost of deposit drops you've seen in quarter three over previous quarters had nothing to do with the base rate moves at this point. The base rate changes were passed on on 13th October. We anticipated that would reduce our cost of deposits by a further 12–14 bps, and as it turned out that is exactly what happened. That in its entirety will not play through to the NIM, but a large portion of it will play through to the NIM, and therefore I do expect us to see a significant improvement in the NIM towards two, and around two by the year end.

Peter Lenardos
Great. Thanks Craig. Very clear.

Vernon Hill
Thank you, Peter.

Joseph Dickerson
Hi, good morning. Just before I ask my question, I would like to say I drove past the new Wimbledon branch on Saturday and it's fantastic. I think it's one of your best branches.

Vernon Hill
Thank you, Joe, I agree. It's our best site and our best store. Thank you. I'm glad you went by to see it.

Joseph Dickerson
Absolutely fabulous. I basically had two questions, but Peter asked one of them. Could you just go through any plans for usage of the TFS and how that would work for you, and what the impact on your profitability could be?

Vernon Hill
Craig?

Craig Donaldson
So, we've applied TFS and we have been accepted into it.

Vernon Hill
Stop for a minute. Craig, we have Americans on. Explain what this means.

Craig Donaldson
I'm sure they all know, but for those that don't: it's the Term Funding Scheme, it's the new baby brother of the Funding for Lending Scheme. The difference is, on the Term Funding Scheme we would put our security in and we would be given liquidity at base rate, and it would be cash that would be given. Under the Funding for Lending Scheme, we would put our security in, we would be given T-bills at base rate and then we'd have to repo them. So, because we get the cash, we save the repo costs.

Vernon Hill
So this is cheaper funding costs for us.

Craig Donaldson
We currently have around about £1 billion drawn from the FLS, and we've been given 5% of our lending as an initial entry to TFS, which is around about £228 million, he says specifically, that we are able to draw down. And we will draw that down, either to use appropriately or to repay FLS and get the 25bps improvement.

Because we are growing, and net lending significantly, and we'll continue to do that as is the model, we anticipate that we will increasingly every quarter get a significant further allowance on TFS; whether we draw that down or not will depend upon the market and the opportunity around that. Mike, do you want to add anything?

Mike Brierley
Yes. Our initial allowance was £228 million, you're quite right Craig. And the additional allowance we got from the lending, particularly to SMEs in the third quarter, is an extra £500 million. So, our intention is, as Craig has said, to draw down on that through the remainder of this year and next year, and to repay the FLS money, which is more expensive.

Vernon Hill
So, this is lower cost of funding.

Mike Brierley
Absolutely, and therefore this is ultimately going to be beneficial to net interest income, although the impact on NIM is much more muted.

Craig Donaldson
The reason, Joe, as well, just to be clear: this obviously is to be used for lending. Therefore, one could say, 'Will we see a further compression into yields, both commercial lending and mortgage lending?' We haven't seen further compression post Brexit. Will we see it going forward? It's been interesting watching hedging costs, and how hedging costs have significantly increased. They dropped to almost zero post Brexit, and have obviously gone back up. And one would say that would hold the yields up on mortgage lending. But my view would be at the moment that TFS is an offset for yield compression. However, will yield compression happen? Question mark. We'll definitely be taking the TFS.

Vernon Hill
Joe, your second question?

Joseph Dickerson
No, no, Peter asked the first of my two questions. I had the question on where could the cost of deposits go just on a static basis, given the lagged effect that you mentioned in the press release. So that was the first question.

Vernon Hill
We told you the lag effect would be a one-time negative charge, and that went through in September.

Joseph Dickerson
Thanks.

Vernon Hill
Thank you, Joseph.

Nick Grant
Hey, good afternoon guys.

Vernon Hill
Afternoon.

Nick Grant
I just want to see if you could give some commentary on what you're seeing in the high-end housing market and buy-to-let. Are you seeing any additional softness there post Brexit?

Craig Donaldson
It's Craig here. So, two different markets. We have definitely seen a softening in large property purchases in London, so £3 million-plus property purchases in central London have definitely slowed. I don't believe it's Brexit-related; I believe it's stamp duty-related from the changes that occurred in stamp duty in April, and it's just that they've been conflated together with Brexit. We don't do much in that market, so it's had little to no impact on Metro Bank, but I know, from speaking to people, it's had significant impact into certain areas of the economy. What we have seen off the back of that, though, interestingly, is speaking to a number of builders that we bank and who we do a lot of business with: they've never been busier, because the money that's not being spent on stamp duty is being spent by people to do up the houses that they'd rather stay in than give the money in tax.

Your second point then about buy-to-let, what are we seeing? Buy-to-let definitely slowed in quarter two, and about 23% of the book that was drawn in quarter three was buy-to-let, which was slightly lower than the 25% average on the book. That was down to a slowdown in quarter two in applications, which came into drawdowns in quarter three. I think the market's back. We've definitely seen it pick up in applications in quarter three, and it feels like it's starting to run as it did before.

Nick Grant
Okay, thanks.

Vernon Hill
Anything else, Nick?

Nick Grant
Yes, one more question please. So, you guys have deposit rates coming down a bit in the fourth quarter, from what you guys saw in 3Q. How would you say that lines up proportionally with what you're seeing from your competition in the market?

Craig Donaldson
That's a great question. You've got two very different, obviously, markets. You have the retail market, which is heavily publicised and very easy to see what's going on. I think we have passed on pretty much the full 25bps. Not all of the competition has been able to do that, because they'd already – I think Vernon would use the word 'milked and pillaged' the back books, and we wouldn't have done that. So, I think some people have struggled to pass on the full 25. Because we have our savings promise, where we reward loyalty rather than penalise it, we didn't have a problem on that.

In commercial and SME deposits, you've got a very mixed bag. Some people move their deposits very quickly in line with ourselves, and some people have kept their deposits out there higher for longer. And I actually believe that what we're seeing is it takes time for certain organisations to play through rate changes. It's the first rate change for eight years, and I think certain organisations have faster mechanisms than others. But we're watching it very closely.

Nick Grant

Excellent. Thank you, gentlemen.

Vernon Hill

Thank you, Nick.

Nick Baker

Good afternoon, gentlemen. Thanks for taking my questions. Just two for me. The first one was on the net gains on securities. Obviously that was a favourable tailwind for you in the third quarter. Just sort of keen to understand what drove that, and to what extent that's a crystallisation of high-yielding assets that may drag on NIM further out, or whether that's not really relevant?

The second question is really just if you could provide us some more colour around costs, and how you expect to see that trending. Obviously, you've flagged that you expect to bring on a further four stores before the year end. Can we take it, then, that you'd be looking for a number north of ten for new stores openings in 2017? What's the general cost growth you'd expect for 2017 relative to 2016 as a whole? Thanks.

Vernon Hill

Well, I'll answer the question about the store count: our model that we've given you is ten to twelve stores. As to the cost in revenue, Michael?

Mike Brierley

Ten to twelve stores is pretty consistent with what we've seen in previous years. I think that the cost growth is going to track very much as we've seen quarter on quarter. I think as far as Q4 is concerned, we may see a small uptick in costs consistent with the number of stores that we're opening there.

Vernon Hill

Yes, but Nick, the bigger picture is not that granular question. In the quarter, revenue went up 78% and costs went up 25%, and that margin is widening over time and that's what's driving the profit and the profit we expect. You can continue to expect revenue growth to substantially outgrow cost growth.

Craig Donaldson

Michael, do you want to answer on the gains on sales?

Mike Brierley

I mean, gains on sales are a natural part of banking, and we've seen gains on sale in just about every quarter that we've been operating. But as to gains in sale in the third quarter specifically, we deliberately took some gains on sale as a result of yield movements post the referendum and the base rate move, and of course those offset or more than offset the lag effect of the base rate re-pricing.

But also, gains on sale arise because of the actions of third parties, and we saw a number of RMBS being called in the market at early repayment, and we were holding them below 100 cents in the dollar and therefore we actually saw a gain. There is an impact. I think you alluded to the fact that there is an impact on the yield going forward, but it is immaterial, quite frankly. It is part of banking.

Craig Donaldson

Nick, if I may just go back on the cost question as well, though. Undoubtedly, opening six stores creates extra cost. But we always planned that, and we'd always given the guidance that we'd go into profitability on a month-to-month basis later in this year. We knew we were opening six stores, and we were very confident that, even with that opening, we'd still deliver the profitability month on month this year. And we've said that we'll deliver full-year profitability next year, and that includes opening ten to twelve stores. The growth, the investment in the growth, is built into this plan, and the growth that we're delivering shows it's working. If you look at how much we've invested in our technology, in our stores and in our training of our people – and we've taken the losses down quarter on quarter and gone into profit significantly on the back of that investment – that's what we'll keep doing, and we'll keep driving the jaws exactly like Vernon said.

Nick Baker
That's helpful. Can I just ask Mike a quick follow-up on gains on securities? Obviously, you've said that it's something which you've seen for a number of quarters. Do you have a sense of backlog or any sort of expectation as to what that line could register in future? Are you expecting it to trend down or is it very much a sort of quarter-to-quarter volatility number?

Mike Brierley
We never budget for gains on sale, we never assume that they're going to be there. Sometimes they're tactical, sometimes they're more strategic. Our aim is to maintain those positive jaws on the P&L. It's that that's driving us the profitability, with or without gains on sale. We don't rely on them; sometimes they're there, and sometimes they're not and our guidance does not take account of gains on sale.

Craig Donaldson
Correct.

Nick Baker
Okay. Crystal clear. Thanks a lot.

Vernon Hill
Thank you.

Mike Brierley
Cheers, Nick.

Craig Donaldson
Cheers, Nick.

Jim McCormick
Hi all. Great quarter. Craig, just picking up on what you mentioned on technology. Can you give us some highlights of how technology has affected you positively, say, in the quarter and what you're looking at going forward in terms of new features or functionality that would reduce cost coming on board?

Craig Donaldson
Yeah, of course, Jim. That would be my pleasure. So, in the last quarter we actually launched our new internet, and we went live with 500 customers on our commercial internet. We also had a number of straight – our workflow is a CRM package, it's Microsoft Dynamics. We've put a number of processes into that in our commercial end, which has significantly helped us speed up the process on how we work with customers. It was already very good; it's now even better.

So basically, you break it down into supporting customers; that would be commercial online banking, which we are rolling out now to all customers. And our plan is, by the end of the year, that all 16,000 customers on the commercial online banking will be on our new offering. It is spectacular. It's so much better than much of the competition out there, if not all. We've had customers we've recruited from all of the competition; we've put them all on there, we've had their feedback, we've adapted it because we can really move at pace on this, and I'm very, very excited about the customers joining us on the back of this superb technology when it's aligned with our model.

Later this quarter, possibly early next quarter, we'll go live on Faster Payments. We will be a direct member; we'll be leaving agency banking and we'll be clearing as a direct member of Faster Payments. We said we'd do that. We are actually live and dual running, and that's a huge step forward for any growing bank, to go as a direct clearer into the payment system, and shows the confidence in our growth that we really have.

We are currently in alpha testing on our new personal and business mobile app. The team won't let me play with it; they're worried I'll break it in the alpha testing. We will be going into beta testing in November. I'm very excited about that. We'll be giving it to all 2,500 colleagues and certain invited customers, who we know will give us good feedback on how we can make it better, in November. Depending on how that goes, we'll go live either in December or in January, depending where we are around the change freeze window.

We are currently building out online account opening, with the plan that that will go live in quarter two next year, so customers will be able to open straight through with some really whizzy kit. More on that next year, if you don't mind, about how we'll be opening accounts straight through. It will be a step change to what anybody offers in the UK.

Vernon Hill
I want to remind everybody on Jim's question: we have a big advantage at Metro Bank. We have, without a doubt, the most modern single client view IT system in banks in Britain, and it gives us tremendous advantage on adding new bells and whistles. And frankly, most of the new fintech ideas, Jim, come here first, because if we like it we can actually make it work.

Craig Donaldson
I think for me, Jim, as well, it's the way we think. You know, we've recruited a great guy, Martyn Atkinson, who's leading a lot of the digital work and working with David Young in our IT, really driving things forward. It's an exciting time. But to me, it's the way you think about this. This is a cultural way of thinking. We're thinking, how can we use technology to make our customers' lives easier? Yes, you drive out cost in it, but it's the thought process about how can we make our customers' lives easier rather than how do we drive people on the cheaper channels. And that thinking, we're thinking about how we can align technical with physical delivery. Because actually, what people want these days is not everything in a mobile; what they want is it delivered now. And using our store estate aligned with our technology, we can fulfil in a way that no other bank can, and that's what customers want. They want fulfilment now. That's the key, and that's how we think.

Vernon Hill
Jim, anything else?

Jim McCormick
Great on that. How about on the contact centre or the call centre? Anything going on there?

Craig Donaldson
A lot. We implemented a new system in the fourth quarter last year. It's artificial intelligence, and we have what's called Unified Service Desktop, which is about how we can identify customers when they call in and then route them. It's improving itself all the time. That is the big area now. It's about how can we leverage the technology there to deliver better service, so when you call through you get straight through to the right person who can answer your questions first time, rather than having to press 1 for this and 7 for help.

Vernon Hill
Anything else, James?

Jim McCormick
Thanks a lot. Terrific.

Vernon Hill
Thank you, Jim.

Jonathan Goslin
Hey, guys. I hope all is well. Just a quick one following up on the call centre question. I understand you're planning to open another call centre, with around 250 people in the near future. Could you maybe provide a bit more detail on the potential costs associated with that, and maybe when you'd expect them to start accruing?

Craig Donaldson
So, we are already accruing for that now. We own the building in Slough. I like to have the contact centres on, above or behind stores, because you keep the culture tight then. It's really important that you don't have people floating away, and the closer you can have everybody to the customer, the more you focus on the customer. So, the contact centre we're building is a 250-seater contact centre in Slough. Actually, over time we're going to have a lot more people working there, but we'll start with a team of ten. And as the calls grow, we're just creating the capacity for the future so that we're always ahead of the growth curve, ensuring we can deliver for our customers, because that's really important.

So, we're paying the costs now. We already owned the building, so there was no cost. I think per square foot, the contact centre's cost us nothing, because we own it and we were already paying for it. The technology is our technology that we're putting in there, so actually it's about making sure we're ready for the growth. We will fill out that centre during next year and into 2018, so we're just making sure we're ahead of the curve and we can continue to deliver for our customers.

Vernon Hill
Your question was about cost, and I have to reiterate what I said: revenue grew 78%, cost grew 25%. You're going to see costs increasing in every part of the bank if we grow at these dynamic rates, but revenue will continue to grow at a much quicker rate.

Craig Donaldson
Jonathan, for me what this is about is, as Vernon said and I said, undoubtedly we are investing in the growth. But what the growth is doing is growing the top line far faster than the investment of the cost, and that's why the jaws have opened in the way they have. And the beauty is, of course, what we're doing is investing in where the customer gets benefit. We don't invest in things like incentives to try and win customers or rate teasers; we invest in things that make a difference long term. It's easy to drive growth in the short term by throwing money at it. We invest for the long term, in creating a service model and creating Fans, and that's what drives the jaws long-term and that's really important we continue to do that.

Vernon Hill
OK. Anything else?

Jonathan Goslin
No, no. That's fine, thanks.

Vernon Hill
Thank you.

Craig Donaldson
Thanks, Jonathan.

Ian Sealey
Hi. I've got a quick question on the net deposit growth per store per month. Clearly, very strong at £5.6 million. I was wondering if you could split this between stores that have been open more than one year and those less than one year? And maybe you can give us sort of an idea of how this should evolve going forward. Thank you.

Craig Donaldson
Let me come in on that first, Ian, if I may, and then I'll let Mike come over the top with any commentary he'd like to make. If you remember when we did the listing, the prospectus, we had the cohort analysis. And if you remember at the half-year, we upgraded that cohort analysis from 2010 across through 2015.

Vernon Hill
Describe how you did the cohorts.

Craig Donaldson
We do the cohorts by year, showing the deposit growth on average in the year of the stores that opened. What we've seen is, Ian, that's absolutely continued: the stores that we're opening are starting faster. I think King's Road, it's fair to say, had a stellar start earlier this year, but the stores are opening faster and they're growing faster and every cohort continues to grow. And that's just because the model powers us forward in the way I said earlier, because it's about creating Fans and then they bring their friends, family and colleagues in to bank with us. The number that I would use to evidence that most would be 61%.

Mike Brierley
I think the key number there is the comp store growth. I mean, we look at, effectively, same-store growth for stores that have been open more than 12 months, and comp store growth is 61%, which is a phenomenal figure. The growth in deposits is coming certainly from new stores, but it's absolutely coming from all the older stores as well. As Craig said all the cohorts continue to grow, but for the newer cohorts, we open bigger and they grow faster.

Ian Sealey
Okay. So, should we expect them to come down slightly towards the £5.25 million?

Craig Donaldson
I think that's something we're managing. We've been managing the cost of risk – sorry, the cost of deposits. I also manage the cost of risk, obviously. Which is ten bps, obviously. We manage the cost of deposits. My view is that we'll stay on guidance or above guidance. How much above will just depend, and I don't want to say we'll constantly be at £5.6 million or £6 million, but we'll definitely be on or above £5.25 million.

Vernon Hill
And you'll get variations quarter to quarter that sometimes are outside of our control, so I wouldn't put too much on that. I personally think deposit rates per branch are going up.

Craig Donaldson
That's feedback for me, by the way! All right?

Ian Sealey
That's very useful, thank you.

Craig Donaldson
Thanks, Ian. Cheers.

Arun Melmane
Afternoon, gentlemen. I have two. One was in terms of the corporate loan book: have you seen any significant changes in mix or sentiment or demand in terms of sector or geographies, you know, before and post Brexit?

And second one was: are you happy to know that I'm a customer of Metro? I opened an account. They made me wait 15 minutes, but I did get it done within 30 post that. The question was: what happens when you have, say, two million customers, and how do you then manage the wait time and not become something like HSBC, which probably would have taken me a week's wait time to get there?

Vernon Hill

You'd be lucky in a week. You know, Arun, let me – this is Vernon. Let me answer this question. I've been down this road before. When I was running Commerce in America, we were getting 21 million in-store customer visits every month. So, we know how to handle volume. Metro's learning how to handle volume. Our stores in America never stopped growing, except when there was no place to park. Then it was the volume was too high. And if you can't increase the flow-through in the store, then you build another store a couple of blocks or a mile away. So, it's a combination of more staffing, more efficiency and building more stores to support the ones you have.

Craig Donaldson

Arun, if I may come in as well: obviously, you have the application of technology. First of all, though, I should say, my apologies that you had to wait 15 minutes. Like you said, it is less than the average, I would suggest, but my apologies and thank you for becoming a customer. I hope everybody on the call is thinking that they should be becoming a customer today. However, my view is very simple: it's the application of technology and it's also forecasting. What we're looking at now, if you think about the discussion I said in March – sorry, in quarter two we'll be launching our new ability to open accounts online for personal customers. As part of that, we'll have the ability to start and finish in any channel, so click and collect if you wanted to call it. So, you could be sitting on this call now, applying for your account, going through the process very slickly, very easily, and then pop in and collect your card at the end of the call. It's that type of thing where we can work with our customers to give them the choice, give them the ability to make their own decisions, but then fulfil at point of sale if they wish, which will drive things and create capacity. And that's why our stores are going to be so, so much bigger: because we'll be able to fulfil so many more things through them for so many more customers, because of the different omni-channel approaches that we'll have. We're in the middle of building that out. That will continue, and actually it's something that makes me…I'm really excited about it. I'm genuinely excited about what's coming next year.

On your point about the corporate loan book, obviously we're sort of three months post. We looked to see if anybody had pulled any application forms, if we saw people… We've seen nothing, no real change in the discussions. We had one lady who owned two flower shops and is looking to buy a third: she decided not to purchase it, and then three weeks later came back and went ahead and bought it. I think so far, from what we've seen at the level at which we interact with customers, very, very little impact on the corporate loan book. The only thing I can tell you is we're winning more customers, and it's growing because we're doing the right things.

Vernon Hill

And one final comment on that. In the press release, we've broken out the deposits on page 3, which are roughly 50% retail and 50% business accounts. That is a very good mix for us, and I think the business is actually going quicker.

Craig Donaldson

The commercial online banking has so many customers who have been so impressed.

Vernon Hill

So, you're going to see a continued shift to more business deposits than consumer deposits, and that's what we want. Anybody else?

Arun Melmane

Perfect. I congratulate you on the 15-minute delay, because HSBC asked me to come in next week on a Tuesday to get an appointment.

Craig Donaldson

Thank you.

Vernon Hill

Thank you, all. We expect to hear all of you, you're all our Fans. Thank you.

Craig Donaldson

Thank you, everybody.