Metro Bank Full Year 2018 Results Preview and Trading Update

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Craig Donaldson (CEO) and David Arden (CFO)

Presentation

Craig Donaldson

Good morning, everybody and thank you for joining the call. Let me say happy New Year as well, as I haven't spoken to many of you this year so far.

As you can see from our trading preview, 2018 was a very strong year for us in terms of growth. We had record customer account growth, of over 400,000 customers, a 33% increase on last year. And most pleasing, we're seeing over 1,000 business customers join us every week, which shows the strength of Metro Bank in the business community. Alongside that, our deposit growth of 34%, £5.9 million per store per month on average, and loan growth of 48% shows the underlying strength of what we have built at Metro Bank. And all that's achieved with the long-term view of strong credit. And our credit quality has remained robust. Last year, we opened ten stores, with six in Quarter 4. And actually, we opened our first store in 2019 last week, when we opened Moorgate last Thursday. And the pipeline for future growth continues to be strong. We have seven further stores at advanced planning stage or currently under construction, and we expect to open in Birmingham, our first new area of 2019, during the first half of this year. Year-on-year, underlying profit before tax increased 138% to £50 million – a very strong growth of 138%, which continues to show the underlying strength in the organisation. However, profit in quarter 4 of £11 million was somewhat softer than we had anticipated, and we will discuss that more when we get together on 27th February.

So overall, very strong growth. We continue to deliver for our customers. But we are operating in a very competitive environment and, as we've discussed before, we continue to see that come through. And obviously, we are in somewhat unchartered territory and we're seeing capital markets and associated funding costs change, and these are headwinds that we will discuss more on 27th February as well. So, with that, please may I hand over to David? David.

David Arden

Thank you, Craig. Morning, everybody. You'll see in our announcement that we expect risk-weighted assets to be £8.9 billion at the year-end, partly due to loan growth and partly due to an adjustment in the risk weighting of certain commercial loans secured on property and certain specialist buy-to-let loans. These changes in the commercial loans and the specialist buy-to-let came to light following an internal review in preparation for our year-end. I'm sure you've done the maths, but the one-off adjustments will be around £900 million.

Metro Bank remains comfortably above its regulatory minima and the fundamentals of the business remain unchanged. We remain well positioned to continue attracting deposits and to prudently grow our lending, and we look forward to providing you with an update on the outlook at our prelims on 27th February.

Craig Donaldson

Thanks, Dave. So, we felt it was important to update the market on the recent trading and the expected adjustments that Dave's just talked to you about on the RWAs. Notwithstanding that, and the challenging quarter and the uncertain economic environment, the bank continues to do well. We set ourselves up to win customers and create FANS, and win their low-cost sticky deposits and then do low-risk lending into the market. And that's what we're doing. And that doesn't change. Uncertain times don't change what we're achieving for the long term here. We're continuing to innovate and we're continuing to focus on our long-term, low credit-risk, high-growth, great customer service.

So, we do look forward to providing further details on our 2018 performance, together with an update on the outlook, on 27th February. But for now, I'd like to open the call to questions. Please, please bear in mind that we may only be able to provide limited information at this stage, as we are still in the process of preparing our 2018 full-year results.

Q&A

Joseph Dickerson
Hi. Good morning, guys. Just a quick one. Obviously, you're on a standardised risk model, so you could – could you please explain a little bit what's changed here, particularly vis-à-vis say professional buy-to-let and commercial property and, you know, exactly what's happened? That would be quite helpful. And also, if you could just comment on the way in which flowing activity impacted Q4. Was it, you know, was it fees and margin, etc? Just a little bit more flavour there. And I presume you probably can't comment on it, but whether you've seen a pick-up in the first few weeks of this year.

Craig Donaldson
Joe, good morning. Thank you for the question. It's Craig. Let me answer the comment on the P&L, if I may, and then I'll hand over to David to discuss the risk-weighted assets. So, as we've already discussed when we were together at Q3, we've definitely seen a softening of the mortgage margins and margins wider. We subsequently, having had HSBC and other banks come out and say that was ringfencing, assumed that was being driven by locked-in liquidity, and we haven't seen that change. And there's no doubt as we went through Q4, margins continued to be under pressure and that did play through into the P&L. We also obviously have a number of stores under build, where we're carrying the cost of that in Q4, and we did open six stores and that did impact. With regard to the wider macro-economic environment, as has been said by many commentators, it definitely did play through into, as we went through Q4, and we did see a slight change in customer behaviour towards the end of Q4. It's very early doors. It's too early to say whether that's changed. It certainly feels like Q1 has started with people back on the pitch, shall we say, but it's too early to draw any conclusions, and we will discuss that more on 27th February. But the margins have been well forecast, I'm afraid are playing through and we also were carrying the costs of new stores that were being built. Can I have a –

Joseph Dickerson
Sorry, can I just ask – were you effectively carrying the cost of 13 stores in the fourth quarter that were not generating any profits?

Craig Donaldson
Yes, we would be generating costs. The costs were when we had the seven stores that we discussed. When you open a store, it takes several months for a store to move into profit, and therefore obviously you're carrying the training costs, the development costs, the running costs of new stores, and you're also carrying the cost of the stores that aren't yet open of the construction and the rent that you have to be paying. So, there are a number of costs that are absolutely long-term value-add and you know that they will play through and add to the long-term profitability of the organisation. But for the several months leading up to the store openings, and for the several months post a store opening, they are negative impacts. But they're well worth it when you look at the cohort analysis that we've gone through before. They genuinely drive through the profit then over the long term. David, may I hand over to you for RWAs?

David Arden
Of course. On RWAs, as I said, we identified the need for making the adjustment following an internal review in preparation for our year-end. That review has been augmented by, with support from a big-four audit firm and the review was comprehensive of our commercial portfolio and we've discussed our findings with the PRA. We've communicated this as soon as we possibly can, hence the call this morning. The two elements of the changes– one relates to regulatory interpretation, and given the review we've done, we think it's appropriate that we change our regulatory interpretation. That means that for exposures secured on commercial property we're moving our risk weight from 50% to 100%. On elements of our professional buy-to-let portfolio, we're moving from 35% risk weight on certain assets up to 100%. And, where appropriate, bringing that down to 76% when supported by the SME supporting factor. Just to stress, Joe, that this is a fully comprehensive view and we're not expecting any further changes following the review that we've undertaken.

Joseph Dickerson
Okay. Thanks.

Robert Sage
Yes, thank you very much. If I could just sort of follow up, if I could please, on the risk-weighted asset question, because the sort of risk weighting movements you've just outlined – 50% or 35% up to 100% - are clearly quite major and I would imagine that that would significantly shift the expected profitability on new business written, given the sort of the greater capital

requirements. And I was wondering sort of whether that will actually sort of inform a different view in terms of your appetite to be lending into these particular sectors, and whether that might have an impact in terms of future growth prospects.

Craig Donaldson

Morning Robert. Thank you for the question. It's Craig here. As you'd expect, we are constantly reviewing our return on equity as part of our internal pricing positions. And therefore, where you change the capital weightings against a product such as this, it does play through into the pricing that we would want to place into the market. Of course though, we are in a competitive environment and you can only move pricing so much, so therefore you need to make decisions. What we are doing though is, you know, our work – we're winning, as I said earlier, over 1,000 businesses a week are joining us, and what we've been focusing on and what we continue to focus on more and more will be winning trading businesses. And what we want to do is continue to pivot and drive into winning more trading businesses, doing the lending to those trading businesses, and also winning the fee income opportunities as we discussed in the Q3 results, that that brings. That's where we want to focus the business. So, from my point of view, when you change the capital weightings, does it change your pricing? Yes. Does it change where you would look to focus somewhat? Yes, it does in part, but it doesn't change the long-term strategy of the organisation. And the long-term strategy of the organisation is to win trading businesses and to win retail customers through our great service, and by creating FANS. That will not change and does not change, according to this piece of work. David, is there anything you'd like to add?

David Arden

No, I'd echo everything you've said, Craig, clearly – we'll be looking at – we've got – we look at our capital allocation and what assets we're investing in all the time. This will enable us – this will allow us or this will lead us into pivoting that, but that plays squarely into Craig's comments around winning trading businesses and winning the holistic business of our customers.

Craig Donaldson

And what I'd also add is, you know, and Robert, as a growing bank, as we've always said, we take action to maximise shareholder return. And therefore, for me this is just one of the levers you would look to pull. You take the information and you look to manage your risk-weighted assets, you look to manage your densities, and there are a number of levers we can look to optimise as we move forward, and this just plays into our normal planning rounds.

Robert Sage

Very clear, thank you.

Ed Firth

Morning, everybody. Just two questions. I guess one was just on the detail. In terms of the £50 million that you're highlighting, can you tell me what the consensus was on that? It seems to be huge variations of numbers kicking around, including and excluding exceptionals. So, it would be good just to get some clarity on what the consensus was on the equivalent of the £50 million. And then secondly, in terms of your disappointment, can I just clarify that? I think in your first comment, in your opening comments, you said it was a funding environment, but then I guess in the answer to the question earlier, you said it was mortgage margins and costs of branch openings. So, I'm just trying to get clear, which of those is the sort of key one? Or are we looking like just a bit of disappointment across all lines?

David Arden

If I could just pick up on the consensus, consensus for full year was £59 million.

Ed Firth

So, that is equivalent to the 50, effectively?

David Arden

It is.

Craig Donaldson

And as for disappointment, I'm not disappointed, Ed. I think gross 138% in your underlying profit is a very strong performance as we continue to invest in growing out the bank. You know, we've continued to invest in our colleagues and their development. We continue to invest in our store roll-out. We've continued to invest in our digital. You know we have our five-star digital – our app on the app store. We have launched our Insights. We're doing a number of things across the organisation, because we focus on the long term. My apologies – I didn't mean to discuss funding. If that came across, my apologies. For me, there are some well-trodden things that have been discussed in Q3 and I'm afraid the trends that we saw, that were being discussed, I think across the whole of the industry, we saw play through into Q4.

Ed Firth
Okay.

Craig Donaldson
And that's what I was saying around –

Ed Firth
Did it - it is mainly just – it's mortgage – it's mortgage pricing and costs, rather than – I mean there's been a lot of talk in the market about costs of funding, particularly the capital markets being very difficult, etc. But that's not really been a big driver for you?

Craig Donaldson
Well, we didn't raise any capital in Quarter 4, so therefore that wouldn't play through into any of our funding costs. Obviously, it's one we'll discuss on 27th February though, as we look forward.

Ed Firth
Fantastic. Thanks very much.

Colin Jackson
Hi guys. Just one question from me. I'm just curious as to when do you expect that you need to raise more capital?

David Arden
We're not going to get into that today, I think. As Craig articulated, we'll give a full update of the outlook into '19, '20 and beyond, at our full-year prelims on 27th February.

Craig Donaldson
So, if I may Colin, good morning as well. As I said, look, we're a growing bank and we will take action to maximise shareholder return and therefore we look at how we manage our capital base across all of our options. And look, we have a number of options. And we take into account the RWAs, we take into account the wider market as we look forward. But we have a number of levers we can pull to support our capital position and we would look across that. So, I don't think people should be reading in and assume what you've just said. We have a number of levers to pull. We will manage this to maximise our shareholder return, and we'll take the opportunities that we have and we'll discuss them more on 27th February.

David Arden
Yeah, and that's the key point, we'll discuss more on 27th February.

Craig Donaldson
Thank you, Colin.

Christopher Cant
Good morning. Thanks for taking my questions. If I could just ask, your CET1 number I think is now down to about 13%, if I back out the 250 of tier two from your reported total capital ratio. So, if I could just come back on the previous question, I'm afraid, David on the recent roadshow, you said to investors you don't expect a need to raise equity until 2021. That doesn't really look realistic, given your growth expectations. So Craig, you're talking about pulling levers. Could you give us some more information about what levers you are actually going to pull to adjust your CET1 trajectory? I can only see seriously stepping back on growth aspirations as the only viable option at this point, ahead of IRB accreditation coming in. And then, to also follow up an earlier question on returns, if I think about what this means for your ROE target, you've cut your ROE target twice in the past due to raising equity. Whether or not you do go through a further capital raise or not, you are going to have to run with higher equity levels than you expected. This is about a 12%, 13% increase, if I take your £900 million one-off adjustment, relative to your 3Q RWAs. So, implicitly, does that shave your ROE target down to the sort of 10% level, just because of higher capital levels than you were expecting, all else equal? Thank you.

Craig Donaldson

Morning, Chris. Thank you and happy new year. Look, as we've already said, we are a growing bank and we don't anticipate that that will change. We will continue to grow. We grew through a double-dip recession when we started the bank and there's no doubt we have established ourselves into the hearts and minds of the British public and British businesses, and we'll continue to support them. When we've discussed our capital and our CET1 before, my view is that as we trend towards AIRB, we will run below the 12% and we'll run between 11% and 12%. I think that's been a well-trodden path. I think Clydesdale Bank did that before. So, I believe, as we said before, we said at the last quarterly update that once we get AIRB, 12% is our long-run management expectation. But as we run towards AIRB, we're happy to run between 11% and 12%. So, we have space there, which should be taken into account with what you've said. Also, you know, we have a number of levers to pull. We have a number of levers to pull that will allow us to efficiently run our capital in this organisation, because we are very focused on our customers and our shareholders and we will look to maximise our shareholder return in the long term and we will take action to make sure that is what we do. Because it's the right thing to do and we've always said that. So, let us talk to you more on 27th February about the levers we will pull, but I fundamentally expect us to continue to grow this organisation. I do expect us to pivot to ensure that we are maximising that shareholder return and that we're managing our capital base efficiently. And I do think as we run towards our AIRB, you will see our CET1 run around 11%, which still has significant buffers over the regulatory minimum that we can carry. But let's talk more on 27th.

Christopher Cant

In terms of growing to 11% though, I mean practically speaking, that gives you capacity for a little under 20% growth from here. If you grew your balance sheet 20%, you would drop below 11%. So, that's a significantly slower pace of growth than you've been delivering in recent years. Is that – you know, when you're saying you're going to continue growing, obviously 20% is still rapid, although I think it would be below where market expectations are. Is that what you're expecting to do – just slow down growth to a still high but much slower than you've been running at level of growth?

Craig Donaldson

Chris, there are a number of levers that we can pull, which will protect the growth as well. So, I know you work out the 20%, but with levers, we have ways forward to protect our capital base whilst also growing the organisation efficiently for our capital. Let's discuss it more on 27th.

Christopher Cant

Okay. Thank you –

Craig Donaldson

And thank you, Chris. Sorry…

Christopher Cant

– ROE target for your 2020 numbers? Obviously, –

Craig Donaldson

Again, Chris, we're very focused on the capital efficiency and maximising that shareholder return, so we will take action to drive what we've already said. And my view is that with this information around RWAs, you will see the organisation pivot, but you'll see the organisation continue to grow and continue to win customers and continue to build the franchise for the long term.

Robert Noble

Morning, guys. I just wanted to ask – so, you've been focused on IRB approval for your mortgages. Does this kind of reinvigorate you to look at the corporate side as well? Have you started the process of applying for IRB approval on the corporate book and do you think you will going forward? And if you could just comment on deposit flows in the quarter as well and how you changed, actively changed pricing and flow dynamics of deposits in the quarter, because it was a little bit weaker than I think I was expecting. Thanks.

David Arden

On AIRB, Rob – excuse me – we fully expect to have all our portfolios through an AIRB process in due course. Our primary focus today is on AIRB for residential mortgages, but all portfolios will be through that process in due course.

Craig Donaldson

It's fair to say as well, Rob, we genuinely couldn't be more focused on AIRB. That doesn't change. Good morning, good sir. As to deposits, you know, the fact that we delivered the £5.9 million per store per month, as I said earlier, I think it's a very strong performance in the wider environment. The model is working. It continues to win customers and actually, it's continuing to strengthen day on day in the business market. We did take actions to manage our deposit base in Quarter 4 and we always would. And actually, I was pleased overall with our performance across the whole year. And some things came forward into Q3. Some things slip out of Q4. Overall though, it was a strong performance and one that I'm very pleased with. We continue to grow month-on-month our deposit base, at a low cost. And it's sticky, which allows us then to lend that safely into the market. And as we look forward into the wider macro-economic environment, I think that the core of our model, that low-cost sticky deposits that we can lend at low risk will absolutely be the strength of this organisation as we go through bumpy times, absolutely will be the key. And I think you're spot on, Rob. Thank you very much.

Robert Noble

Thanks.

Gary Greenwood

Oh hi. Morning. I just had a couple of points of clarification. I think earlier on the call, you mentioned that customer behaviour changed towards the end of the quarter and then it sort of bounced back in Q1, 'they were back on the pitch' I think you said in Q1. I just wonder if you could sort of expand a bit on that comment, just to exactly, sort of, what changed in terms of their behaviour. And then the second question was just on the increase in the mortgage risk weightings. I just wanted to understand what the catalyst for that was – whether it's a sort of company-specific review or whether it's part of a sort of potentially a broader industry review by the PRA. Thank you.

David Arden

On the second part, Gary, it's firm-specific. We've undertaken the internal review. We've discussed with the PRA and we're making these changes today.

Craig Donaldson

So, something we found as we went through our end-of-year reviews, and like we said, we brought in our an external audit company to support us, to make sure it was done comprehensively, so we're not going to be discussing this again. As for the slowdown, I think there we all know, there was some broader macro-economic environment hits in Q4, and I think it's been well discussed. We did see that play through into some of our customer behaviours. We've only had a few weeks of this year. It's too early to comment on whether it's bounced back as much as we'd like or actually if it's bounced back totally. We just need to see. Our customers, we continue to grow, we continue to win more customers. And, you know, our income was up quarter-on-quarter and that will continue. I think for me the issue is we just need to do the work that we're doing and we'll discuss it more with you on 27th February.

Gary Greenwood

Okay. Was it any particular customer subsets that were behaving differently, or was it just across the board?

Craig Donaldson

It was pretty much across the board. I mean businesses, you know, let's face facts – December was a very strange month for the UK and I think a lot of people may have just put their foot on the ball to see what happened post some of the discussions that were going on in other parts of the British economy. And I think that was just playing through. I think it's a well – you know, I'm sure you've read it in across several industries and across several organisations. I'm afraid, you know, I think a number of people just put their foot on the ball, just drew breath and we'll see when that, you know, we'll discuss that more on 27th February. Because we'll actually just have more data then, and we'll actually hopefully have more information.

Gary Greenwood

Okay. That's great. Thank you very much.

Joseph Dickerson

Hi. I'm sorry to come back to you. I have a follow-up on I guess two things. I've got a follow-up on Rob Noble's question on the deposits. Would you be willing to disclose to us the movement in deposit costs in Q4 relative to Q3, or perhaps even the absolute level? Number one and number two. On what date do you expect to get the answer to your application for the RBS Remedies

Package? As that could be prospectively quite a meaningful benefit to you in terms of operating leverage? So, any colour on the date there would be quite welcome. Thanks.

Craig Donaldson

Joe, thank you. Topping and tailing the call – well done, good sir. I like it. On your first point around the cost of deposits, in Q3 we said that we expected it to go up on the back of the base-rate move that we'd seen. That played through exactly like we expected. We didn't see anything that wasn't forecast on our Q3 call. So, it was pretty consistent in the way it came through. So, nothing really different – nothing to call out. Our cost of deposits went up on the back of having a full quarter of impact at the base-rate move, in line with what we'd said on the Q3 call. And with regard to the Williams & Glyn fund, the Williams & Glyn – all of our bids have gone in. We were announced, as I'm sure you read, that we were one of the 11 organisations that were part of the switching programme, and we have been continuing to prepare ourselves for that. I'm led to believe that will start towards the end of February and we are expecting to hear where we are with regards to the funding. We are in pot A. We have applied for the money in pot A, which is either £120 million, £100 million or £60 million. We've applied for that money and we expect to hear, or it's been announced we should hear, the week commencing 18th February. Now, I don't know when in that week it'll be, but sometime between 18th and Friday 22nd, therefore. We believe we have an extremely strong case. We won, you know, we are winning a significant number of switchers from the larger organisations. We're winning over 1,000 business accounts every week and that's because people – our business customers, the most under-served part of the market, want the service and convenience that we offer and want the ability to act across business and personal. So, we think we're in a very good position. The bids are in and I'm afraid we're just waiting to hear, like your good self. But yes, very excited by the opportunities it presents. Thank you, Joe.

Craig Donaldson

Thank you very much. Thank you for everybody joining the call. I would just like to say, you know, we felt it was important to update the market on the recent trading and the expected adjustments that we are going to make to our RWAs. Notwithstanding that, you know, we are facing an uncertain macro-economic environment, but the bank continues to do well. And so, I just want to say thank you to everybody and I look forward to talking to you more on 27th February. Have a great day.

David Arden

Thank you, all.