06 February 2019

CYBG PLC: First Quarter 2019 Trading Update

CYBG PLC ("CYBG" or the "Group") confirms that trading in the three months to 31 December 2018 was in line with the Board's expectations and that good progress has been made with the Virgin Money integration programme. The acquisition of Virgin Money completed on 15 October 2018; the financial performance and business commentary in this trading update has been prepared on the basis that the combination with Virgin Money had been in effect since 01 October 2017 (see basis of preparation for more details).

Q1 customer lending growth of 1.4% to £71.9bn

- Q1 mortgage growth of 1.5% to £60.0bn benefitting from a strong pipeline coming into the quarter and good customer retention
- Q1 SME growth of 1.2% to £7.6bn with c.£600m of drawdowns underlining the strength of the Group's SME strategy and strong demand from our customers
- Net cost of risk of 22bps (3 months annualised) with asset quality remaining resilient

Q1 NIM of 172bps (3 months annualised) with FY19 guidance range narrowed to 165-170bps

- As expected, NIM is lower than FY18 due to sustained pricing pressure in the UK mortgage market
- Now expect to deliver a NIM of 165-170bps for FY19, at the upper end of previous guidance range

Initial integration work reaffirms transaction benefits; annual run-rate cost synergies now £150m

- Our integration programme is well underway and we are pleased with the progress we have made in achieving our initial milestones. The Group's underlying cost:income ratio in Q1 was below 60%.
- Having confirmed our initial synergy plan assumptions, the Group now expects to deliver a minimum £150m of annual net run-rate cost synergies by the end of FY21, vs. £120m previously announced

Group remains strongly capitalised with a CET1 ratio of 14.5%

- CET1 ratio of 14.5%; c.60bps lower than the pro forma 30-Sep-18 ratio primarily due to ordinary dividend and AT1 distributions, and exceptional charges
- IFRS 3 accounting adjustments had a negligible impact on capital
- Q1 PPI complaint volumes of c.1,800 per week, in line with our provision assumption

David Duffy, Chief Executive Officer of CYBG PLC, commented:

"The Group has made a good start to the year and we are making encouraging progress on the initial stages of the three-year Virgin Money integration programme.

In a highly competitive environment, we have delivered ahead-of-market lending growth for our customers and improved our NIM guidance for 2019. We have also made good progress on cost reductions and have now increased our integration synergy target to £150m.

I am particularly encouraged by our performance in SME. We are well prepared for the start of the RBS Incentivised Switching Scheme and we hope to attract a large proportion of the 120,000 SME customers that RBS are required to switch. We have also recently submitted our application for a grant from the RBS Capability and Innovation Fund, where we believe we offer the strongest case for delivering a genuine boost to competition in the SME market.

Market conditions remain uncertain while we await the outcome of the Brexit negotiations, but we remain focussed on supporting our customers and delivering against the factors within our control."

Customer balances

(£bn)	at 31 Dec 18	at 30 Sep 18[1]	% growth
Mortgages	*60.0*	*59.1*	*1.5%*
SME[2]	*7.6*	*7.5*	*1.2%*
Retail Unsecured	*4.3*	*4.3*	*0.4%*
Customer lending	71.9	70.9	1.4%
Customer deposits	61.1	61.0	0.2%

We started FY19 with a strong mortgage pipeline which, together with a focus on customer retention, delivered balance growth of 1.5% in the first quarter.

We sustained momentum in SME origination during Q1 backed by strong demand from our SME customer base, with drawdowns of c.£600m (at attractive margins) and net lending growth of 1.2%. We therefore remain on track to deliver our commitment to lend £6 billion to our SME customers over 3 years by the end of FY19.

Retail unsecured lending increased by 0.4% reflecting modest credit card balance growth in the period.

The Group's deposit gathering continues to perform well. We started the quarter with high levels of liquidity following the wholesale funding raised at the end of Q4 18, which, together with good deposit origination at cost-effective rates, enabled us to fund the strong growth in lending in the quarter as well as meet scheduled maturities for savings and term deposits.

Asset quality remained resilient with an annualised net cost of risk of 22bps in the first three months, in line with management's expectations and reflecting higher cost of risk in SME and Retail Unsecured. Impairment charges in Mortgages remain very low. The increase in SME reflects a cost of risk more reflective of historical norms following the very low levels of impairment experienced in FY18. Retail Unsecured cost of risk has increased largely due to portfolio mix changes.

Costs and transaction synergies

The Group has made good progress in reducing its underlying operating costs in the period and remains on track to deliver its FY19 guidance of <£950m. The run-rate savings from the final year of the Group's Project Sustain cost efficiency programme are being delivered as expected. The Group is also confident that it will realise Year 1 integration synergy benefits as planned. The rationalisation of the top two layers of senior management is now largely complete and the VM Digital Bank project has also been closed down with no future operating costs to be incurred. The Group's underlying cost:income ratio in Q1 was below 60%.

Having confirmed the initial cost synergy assumptions, the Group now expects to deliver a minimum £150m of annual net run-rate cost synergies by the end of FY21, vs. £120m announced previously.

Exceptional items

The Group incurred £161m of exceptional charges in Q1 including £48m of costs incurred by Virgin Money in relation to the transaction, £8m of acquisition associated stamp duty, £77m in relation to the closure of the VMDB project (including a £70m capital-neutral asset write-off) and £17m of initial integration spend. During the remainder of FY19 the Group expects to incur a further c.£100m of integration, rebranding, and restructuring costs.

PPI complaint variables are all tracking as expected with complaint volumes in the first quarter of c.1,800 per week, in line with our provision assumption. The Group therefore remains comfortable with its current level of PPI provisioning.

[1] 30 Sep 18 balances are on a pro forma basis.
[2] The Group has largely completed the run-down of its non-core SME portfolio and therefore the small remaining balance has now been re-integrated into a single SME portfolio for reporting purposes.

IFRS 3 accounting adjustments

The Group has completed its preliminary assessment of the IFRS 3 accounting adjustments required upon consolidation and, as guided, the net impact on Day 1 capital is immaterial with goodwill relating to the acquisition of £12m – see appendix 1 for details.

Capital

The Group remains strongly capitalised with a CET1 ratio of 14.5% at 31 December 2018. In line with expectations, this is c.60bps lower than the pro forma 30 September 2018 ratio of 15.1%, primarily due to dividends and AT1 distributions (c.30bps) and exceptional charges (c.20bps).

Strategic joint venture with Aberdeen Standard Investments (ASI)

The Group confirmed in January that it had signed a conditional agreement in relation to the strategic joint venture with ASI. This will enable the Group to offer market-leading investment solutions through the Virgin Money brand, enabled by ASI's asset management technology. Under the terms of the sale and purchase agreement, with ASI acquiring 50% (less one share) of Virgin Money Unit Trust Managers Limited ("VMUTM"), the Group will receive cash consideration of c.£40m upon completion (expected in calendar Q2 2019). Once completed, the strategic partnership will be accounted for using the equity accounting method. In 2018, VMUTM recorded[3] non-interest income of c.£35m and operating costs of c.£20m. The accounting reallocation of the VMUTM operating costs is not included in the annual run-rate cost synergies of £150m by FY21.

Outlook

The political situation in the UK remains highly uncertain and the potential impact on the UK economy remains unclear, but the Group remains focused on unlocking the opportunities from the Virgin Money acquisition and delivering our FY19 margin and cost guidance.

Assuming a broadly stable pricing environment, the Group's NIM is now expected to be 165-170bps for FY19. This includes the impact of the Group's review of its credit card EIR accounting approach and reflects adjustments made to the key assumptions which are now in line with market norms, reflecting a more conservative basis.

The Group remains on track to deliver its FY19 cost target of <£950m and, having confirmed its initial cost synergy assumptions, now expects to deliver a minimum £150m of annual net run-rate cost synergies by the end of FY21 vs. £120m previously announced.

In terms of asset growth, mortgage market dynamics remain consistent with those experienced over the last 12 months and pricing in that market remains highly competitive. In light of this, net mortgage lending growth for the full year will be lower as we focus on optimisation of volume and value. SME and unsecured lending growth are expected to remain robust.

The Group will be hosting a Capital Markets Day for investors and analysts on Wednesday 19th June in London at which the Group's updated strategy and medium-term targets will be communicated. More details on the event will be provided in due course.

[3] Unaudited figures for the financial year ending 31 December 2018

Appendix 1 - Acquisition of Virgin Money

On 15 October 2018, the Company acquired all the voting rights in Virgin Money by means of a scheme of arrangement under Part 26 of the UK Companies Act 2006 for a purchase consideration of £1.6bn. This comprised the fair value of approximately 541m new CYBG PLC ordinary shares in exchange for all Virgin Money shares at a ratio of 1.2125 CYBG shares for each Virgin Money share. Following completion, Virgin Money shareholders owned approximately 38% of the Combined Group (on a fully diluted basis).

The fair value of the shares issued was calculated using the market price of 286.4 pence per share, on the London Stock Exchange at its close of business on 12 October 2018.

The table below sets out the provisional fair values of the identifiable net assets and liabilities acquired. In accordance with IFRS 3 'Business Combinations', the acquisition accounting will be finalised within 12 months of the acquisition date.

	Book value at 15 October 2018 £m	Fair value adjustments £m	Fair value as at 15 October 2018 £m
Assets			
Cash and balances with central banks	4,146	-	4,146
Due from other banks	598	-	598
Financial instruments at fair value through other comprehensive income[1] [2]	2,028	-	2,028
Other financial assets at fair value through profit or loss	1	-	1
Derivative financial instruments	71	-	71
Loans and advances to customers[3]	37,843	34	37,877
Property, plant and equipment	73	(7)	66
Intangible assets	172	6	178
Deferred tax assets	23	6	29
Other assets	93	-	93
Total assets	45,048	39	45,087
Liabilities			
Due to other banks[3]	7,171	(114)	7,057
Derivative financial instruments	41	-	41
Due to customers	32,111	10	32,121
Debt securities in issue	3,548	8	3,556
Other liabilities	337	28	365
Total liabilities	43,208	(68)	43,140
Net assets	1,840	107	1,947
Fair value of net assets acquired			1,947
Fair value of non-controlling interests[4]			422
Goodwill arising on acquisition			12
Total consideration[2] [5]			1,537

[1]) Under IFRS 9 'Financial Instruments', debt investments which would previously have been classified in the available-for-sale category are reclassified to the new fair value through other comprehensive income category.
[2] Adjusted to remove the CYBG debt securities held by Virgin Money.

[3] Included within Loans and advances to customers and Due to other banks is c£300m of fair value assets which will unwind through the income statement over the next 3 to 5 years.

[4] At the acquisition date, Virgin Money Holdings (UK) plc had in issue Fixed Rate Resettable Additional Tier 1 (AT1) securities issued on the Luxembourg Stock Exchange. In accordance with IAS 32 these are classified as equity instruments. The Group has not acquired the AT1 securities which remain in issue to third parties, consequently these represent a non-controlling interest. As the AT1 instruments are actively traded, the fair value of £422m was calculated based on the market price on the Luxembourg Stock Exchange at its close of business on 12 October 2018.
[5] Includes 'shares to be issued' in the future relating to employee share plans in regard to the settlement of the outstanding Virgin Money share awards.

Appendix 2 - Pro forma comparative financial information

Pro forma CYBG consolidated balance sheet

	As at 30 September 2018				As at 31 March 2018			As at 30 September 2017		
	CYBG Group as reported Statutory basis £m	Virgin Money [1] £m	Fair value adjustments £m	Pro forma basis £m	CYBG Group as reported at Statutory basis £m	Virgin Money [1] £m	Pro forma basis £m	CYBG Group as reported Statutory basis £m	Virgin Money [1] £m	Pro forma basis £m
Assets										
Cash and balances with central banks	6,573	4,177	-	10,750	6,150	4,791	10,941	6,937	2,507	9,444
Due from other banks	836	423	-	1,259	830	430	1,260	1,174	513	1,687
Financial assets available for sale [2] [3]	1,562	2,153	-	3,715	1,352	1,176	2,528	2,076	874	2,950
Other financial assets at fair value	362	-	-	362	421	-	421	477	-	477
Derivative financial instruments	262	79	-	341	334	70	404	282	81	363
Loans and advances to customers	32,744	37,848	34	70,626	32,137	36,784	68,921	31,293	35,841	67,134
Due from customers on acceptances	4	-	-	4	4	-	4	4	-	4
Property, plant and equipment	88	72	(7)	153	86	74	160	86	74	160
Investment properties	7	-	-	7	8	-	8	14	-	14
Intangible assets	412	170	6	588	371	142	513	339	112	451
Deferred tax assets	206	22	6	234	204	22	226	154	13	167
Defined benefit pension assets	212	-	-	212	222	-	222	207	-	207
Other assets	188	101	-	289	234	117	351	188	89	277
Disposal group assets held for sale	-	11	-	11	-	-	-	-	-	-
Total assets	43,456	45,056	39	88,551	42,353	43,606	85,959	43,231	40,104	83,335
Liabilities										
Due to other banks	3,122	7,170	(114)	10,178	2,683	7,537	10,220	3,817	5,030	8,847
Other financial liabilities at fair value	15	-	-	15	20	-	20	26	-	26
Derivative financial instruments	361	39	-	400	388	66	454	376	104	480
Due to customers	28,904	32,101	10	61,015	28,463	31,118	59,581	27,718	30,031	57,749
Liabilities on acceptances	4	-	-	4	4	-	4	4	-	4
Provisions for liabilities and charges	331	8	-	339	458	7	465	554	9	563
Debt securities in issue [3]	4,937	3,560	8	8,505	4,409	2,738	7,147	4,785	2,894	7,679
Retirement benefit obligations	3	-	-	3	3	-	3	3	-	3
Deferred tax liabilities	77	-	28	105	81	-	81	75	-	75
Other liabilities	2,480	318	-	2,798	2,536	332	2,868	2,471	256	2,727
Disposal group liabilities held for sale	-	2	-	2	-	-	-	-	-	-
Total liabilities	40,234	43,198	(68)	83,364	39,045	41,798	80,843	39,829	38,324	78,153

[1] The figures for the pre-acquisition period have been extracted from the management accounts of Virgin Money.

[2] Due to non-coterminous year ends, the effective dates for the adoption of IFRS 9 differ between the CYBG Group (which adopted IFRS 9 on 1 October 2018) and Virgin Money (which adopted IFRS 9 on 1 January 2018). This disclosure reflects the pre IFRS 9 ‘Financial Instruments’, adoption and therefore debt investments are classified in the available-for-sale category. Following IFRS 9 adoption these are reclassified to the new fair value through other comprehensive income category.

[3] Adjusted to remove the CYBG debt securities held by Virgin Money.

Pro forma CYBG consolidated income statement and KPI's [(1)]

	Year to 30 September 2018			Half year to 31 March 2018			Year to 30 September 2017		
	CYBG Group as reported £m	Virgin Money [(2)] £m	Pro forma basis £m	CYBG Group as reported £m	Virgin Money [(2)] £m	Pro forma basis £m	CYBG Group as reported £m	Virgin Money [(2)] £m	Pro forma basis £m
Net interest income	851	606	1,457	426	312	738	844	575	1,419
Non-interest income [(3)]	156	72	228	77	27	104	172	63	235
Total operating income	1,007	678	1,685	503	339	842	1,016	638	1,654
Underlying operating and administrative expenses	(635)	(363)	(998)	(323)	(170)	(493)	(675)	(348)	(1,023)
Operating profit before impairment losses	372	315	687	180	169	349	341	290	631
Impairment losses on credit exposures	(41)	(62)	(103)	(22)	(26)	(48)	(48)	(42)	(90)
Underlying profit on ordinary activities before tax	331	253	584	158	143	301	293	248	541
Restructuring and related expense	(38)	-	(38)	(24)	-	(24)	(67)	-	(67)
Virgin Money acquisition costs	(37)	(2)	(39)	-	-	-	-	-	-
RBS alternative remedies package spend	(16)	-	(16)	(5)	-	(5)	-	-	-
Separation costs	(8)	-	(8)	(4)	-	(4)	(8)	-	(8)
Legacy conduct costs	(396)	-	(396)	(220)	-	(220)	(58)	-	(58)
VM digital bank [(4)]	-	(3)	(3)	-	(2)	(2)	-	(9)	(9)
Gain on disposal of Visa C shares [(4)]	-	3	3	-	-	-	-	-	-
Gain on defined benefit pension scheme reforms	-	-	-	-	-	-	88	-	88
Gain on disposal of VocaLink share [(5)]	-	-	-	-	-	-	20	6	26
Statutory (loss)/profit on ordinary activities before tax	(164)	251	87	(95)	141	46	268	245	513
Profitability KPI's:									
Net interest margin (NIM)			1.78%			1.84%			1.92%
Average interest earning assets			£81,867m			£80,404m			£74,211m
Statutory return on tangible equity (RoTE)			(0.4)%			0.0%			8.4%
Statutory cost to income ratio (CIR)			89%			89%			66%
Statutory basic (loss)/earnings per share (EPS) [(6)]			(1.1)p			0.1p			21.9p
Underlying RoTE			11.1%			11.8%			9.4%
Underlying CIR			59%			59%			62%
Underlying basic EPS [(6)]			29.7p			16.1p			24.7p
Asset Quality KPI's:									
Impairment charge to average customer loans (cost of risk)			0.14%			0.14%			0.13%
Regulatory Capital ratios:									
CET1 ratio [(7)]			15.1%			n/a			n/a
Risk weighted assets (RWAs) [(7)]			£22.9bn			n/a			n/a
Tangible net asset value (TNAV) per share [(8)]			260.0p			263.0p			271.9p

[(1)] The consolidated income statement is presented on a statutory and underlying basis. In addition, the financial key performance indicators (KPIs) presented above, and used by management in monitoring the Group's performance, are determined on a combination of bases (including statutory, regulatory and alternative performance measures), Further detail can be found in the Glossary on page 246 of the CYBG Annual Report and Accounts 2018, with an explanation of adjustments included on page 248 of the CYBG Annual Report and Accounts 2018, page 262 of the Virgin Money Group Annual Report and Accounts 2017, and page 66 of the Virgin Money Group 2018 Half-Year Results News Release.

[(2)] Assuming Virgin Money was acquired on 1 October 2016. The figures for the pre-acquisition period have been extracted from the management accounts of Virgin Money, due to the non-coterminous year ends which mean that the results for the pro forma periods are not specifically subject to audit. The pro forma financial results have been extracted from a combination of the audited 2016 and 2017 Annual Reports, and the 2018 Annual Report which is currently subject to audit.

[(3)] 'Fair value gains and losses on financial instruments' were previously treated as an adjustment to underlying profit within the Virgin Money accounts but have been reclassified to underlying non-interest income in line with the CYBG presentation.

[(4)] Previously classified as a 'Strategic item' within the Virgin Money accounts. This is consistent with CYBG Group policy for transactions of this nature, which are treated as adjustments to underlying profit.

[(5)] The gain on disposal of Virgin Money's VocaLink share has been reclassified from Other Income, and is now reported as an adjustment to underlying profit in line with the Group presentation.

[(6)] The weighted average number of ordinary shares in issue assumes that the 540,856,644 shares issued on the acquisition of Virgin Money, was done on 1 October 2016, and excludes own shares held. This has been applied across all periods for comparability purposes.

[(7)] The pro forma CET1 ratio and RWAs at 30 September 2018 reflect the impact of the acquisition of Virgin Money and IRB accreditation.

[(8)] The total number of ordinary shares in issue used in the TNAV per share calculation is the number of ordinary shares in issue on 15 October 2018 following the acquisition of Virgin Money (excluding own shares held). This has been applied across all periods for comparability purposes.

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Basis of preparation

CYBG's acquisition of Virgin Money completed on 15 October 2018. IFRS states that the financial performance of Virgin Money should be included within the results of CYBG from that date, referred to as the Reported basis.

To provide a more helpful set of historical comparators we have published pro forma results as if CYBG and Virgin Money had been a combined group since 01 October 2016. Pro forma results are provided below for the year to 30 September 2017, half year to 31 March 2018, and the year to 30 September 2018. The financial performance and business commentary provided in the trading update above have been prepared on the basis that the combination with Virgin Money had been in effect since 01 October 2017.

Because the acquisition was completed so close to the 30 September 2018 year end, the combined IFRS 3 position is only reflected in the pro forma balance sheet at 30 September 2018. This announcement is presented on a statutory and underlying basis.

The IFRS 9 accounting standard replaced IAS 39 ('Financial Instruments: Recognition and Measurement'), introducing changes to the classification and measurement of financial instruments and the impairment of financial assets. Virgin Money adopted IFRS 9 on 1 January 2018 and CYBG on 1 October 2018.

The pro forma results include key performance indicators (KPIs) that are used by management to monitor the Group's performance and are selected to meet a number of factors including statutory, regulatory, and alternative performance measure requirements. Further detail can be found in the Glossary on page 246 of the CYBG Annual Report and Accounts 2018, with an explanation of adjustments included on page 248 of the CYBG Annual Report and Accounts 2018, page 262 of the Virgin Money Group Annual Report and Accounts 2017, and page 66 of the Virgin Money Group 2018 Half-Year Results News Release.

Forward looking statements

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