VIRGIN MONEY UK

*02 August 2023*

**Virgin Money UK PLC: Third Quarter 2023 Trading Update**

***David Duffy, Chief Executive Officer:***

"We have delivered another quarter of good progress against our strategy, with growth in both deposits and our target lending segments. Given our strong capital position, we anticipate a total of c.£175m of buybacks for FY23 with more to follow as we normalise our surplus capital position by the end of next year.

Our overall credit quality remains stable and we are fully committed to doing the right thing by our customers, through competitive rates, innovative products and proactive communication, as well as supporting government initiatives to help people through the current challenging environment."

| Summary financials | Q3 2023 | H1 2023 | Change | Q3 2022 | Change |
|---|---|---|---|---|---|
| **Key growth metrics (£'m)** | | | | | |
| Mortgages | 57,544 | 57,687 | (0.2)% | 57,761 | (0.4)% |
| Business | 8,730 | 8,596 | 1.6% | 8,288 | 5.3% |
| Unsecured | 6,300 | 6,152 | 2.4% | 6,014 | 4.8% |
| **Customer lending** | **72,574** | **72,435** | **0.2%** | **72,062** | **0.7%** |
| **Customer deposits** | **67,266** | **67,030** | **0.4%** | **64,080** | **5.0%** |
| **Key performance metrics** | | | | | |
| Net interest margin (NIM) | 1.93% | 1.91% | 0.02% | 1.87% | 0.06% |
| Underlying cost:income ratio | 51% | 51% | - | 52% | (1)% |
| Cost of risk (CoR) | 30bps | 40bps | (10)bps | 12bps | 18bps |
| Transitional Common Equity Tier 1 (CET1) ratio | 14.9% | 14.7% | 0.2% | 14.8% | 0.1% |

**Q3 Summary: Solid financial performance, FY23 guidance maintained; resumed share buyback**

**Growing in target lending segments; continued deposits inflows**

- Further growth in total active relationship customer accounts (+51k during Q3) to 3.7m
- Mortgages broadly stable in Q3 at £57.5bn, in a subdued market
- Business lending was up 1.6% in Q3 to £8.7bn, driven by 2.6% growth in BAU balances
- Unsecured lending increased 2.4% in Q3 to £6.3bn, driven by 3.9% growth in card balances
- Deposits 0.4% higher in Q3 at £67.3bn, with further growth in term deposits at competitive rates

**Stable NIM despite tighter new mortgage spreads & deposit migration; FY23 guidance unchanged**

- NIM remained stable in Q3 at 193bps (Q2: 194bps), supported by higher rates, including from reinvestment of structural hedge, balanced by mortgage spread pressure and deposit migration
- Continue to expect FY23 NIM of c.190bps, with stability across H2 compared to H1 (191bps)

**Costs performing in line with expectations**

- Continue to expect cost:income of 51-52% in FY23, with broadly stable costs in H2 vs. H1
- Costs in Q3 in line with H1 run-rate, supported by reduction in temporary costs flagged at H1 given service improvement, offset by higher regulatory investment and inflation
- Following recovery in service levels and in line with digital strategy, now accelerating restructuring activity, including 30% reduction in store network, supporting gross savings earning into FY24

**Broadly stable credit quality; coverage further strengthened**

- Overall credit quality remains broadly stable, supported by consistent underwriting criteria. Credit card arrears continue to gradually increase from low levels, in line with expectations at H1
- Provisions increased to £547m (Q2: £526m), driven mainly by higher modelled ECL in cards; coverage now 75bps (Q2: 72bps)
- £55m impairment charge in Q3; 30bps CoR (H1: 40bps); continue to expect c.35-40bps for FY23
- The Group is providing support for customers dealing with rising living costs, including the Mortgage Charter package of measures agreed with HM Treasury and other tailored solutions

**Strong capital & funding position; now anticipate c.£175m of share buybacks for FY23**

- Following second strong stress test result, expect c.£175m of share buybacks for FY23; comprising £50m today and c.£125m alongside FY23, subject to Board and regulatory approval
- Continue to expect to normalise CET1 ratio to 13-13.5% by FY24, supported by further buybacks
- CET1 ratio improved to 14.9% in Q3; c.(20)bps impact of £50m buyback will be recognised in Q4
- Robust funding and liquidity position; 12-month average LCR 143% and NSFR 136%
- Fitch updated VMUK's outlook to positive; issued £500m RMBS at pricing in line with Tier 1 peers

## Overview

The Group delivered a solid financial performance in Q3, with growth in net lending and deposits, robust margin and broadly stable credit quality. We were pleased with our positive performance in the 2022 ACS Stress Test, with our ongoing capital strength supporting further shareholder distributions, including an anticipated c.£175m total share buyback for FY23, as we normalise our CET1 ratio to 13-13.5% by the end of FY24. We continue to make good progress on our digital transformation, with renewed momentum on restructuring activity, while continuing to safeguard service and support our customers.

## Pioneering Growth

Mortgage balances of £57.5bn were broadly stable in the quarter, against a subdued market backdrop, as the Group traded well to preserve profitability in a competitive environment. Front book application spreads remained tight and below back book levels in Q3, as mortgage pricing continued to lag the sharp rise in swaps. The Group expects housing activity to remain muted in the near term, given the implications of higher rates, and will continue to focus on supporting existing customers and managing mortgage profitability considering the current challenging trading conditions.

Business lending increased by 1.6% in Q3 to £8.7bn as a reduction in Government-scheme balances was more than offset by 2.6% growth in BAU balances to £8.0bn, reflecting a good performance in a subdued market. Our performance was supported by the strength of our franchise and sector specialisms in our target market segments. Government-scheme balances declined 9.4% to £0.7bn as expected, as borrowers made contractual repayments. The Group expects a modest level of growth in business lending during the remainder of the financial year.

Unsecured lending increased 2.4% in Q3, driven mainly by credit card growth, as the Group benefited from resilient demand from existing customers. 136k new accounts were opened in Q3, stable on Q2, reflective of our disciplined approach to profitability. Customer spending remained strong across all categories and repayment rates remain broadly consistent. Our Virgin Atlantic card portfolio performed particularly strongly in Q3, with balances c.10% higher, following a bonus points campaign between May and June. Personal Loans and Overdraft balances reduced modestly during Q3 in line with expectations. The Group expects Unsecured lending to grow at a moderate pace during the rest of the financial year.

Deposit performance was strong in Q3, as overall deposits increased 0.4% to £67.3bn. The Group continued to deliver growth in term deposits at competitive rates, with front book spreads tighter vs. H1, reflecting increased competition. Non-linked savings balances further reduced during the period, given higher attrition and churn from the back book. Relationship deposits reduced modestly in Q3 due mainly to lower current account balances, though remained stable as a percentage of total deposits at 53%.

NIM remained stable in Q3, reducing 1bp vs. Q2 to 193bps, as benefits from higher rates, including from reinvestment of the structural hedge, balanced spread pressure in mortgages and ongoing deposit migration. Looking ahead, we expect similar trends to continue, with an ongoing benefit from higher rates and reinvestment of the structural hedge, offset by persistent mortgage spread pressure given lower activity levels, as well as further deposit migration and competition. As a result of these factors, the Group continues to expect stable NIM across H2 compared to H1 (191bps), and FY23 to be c.190bps.

Non-interest income was modestly lower in Q3 vs. Q2, as the Group made changes to packaged account benefits and reduced associated fees, aligned with Consumer Duty regulations. In addition, the Group continues to face short term headwinds from lower merchant services income following a strategic change in its payments partner. Excluding these impacts, non-interest income was stable, as a result of continued good card spending and robust business activity levels.

## Delighted Customers and Colleagues

The Group has continued to attract new customers during the quarter, with a 51k growth in total active relationship customer accounts to 3.7m. We remain committed to providing good value to customers, while improving overall customer service and experience.

The Group has made important steps to embed Consumer Duty requirements, which came into effect in July, including enhancing customer communications, customer journey improvements and some pricing changes. The new regulations, designed to help drive good customer outcomes, align to our Purpose of “Making you happier about money”. Furthermore, we have continued to see positive trends in customer experience following recent investment, including a marked improvement in call waiting times, significantly lower complaints volumes and an improved Group Smile[1] score from 46% at Q2 to 49% at Q3.

We continued to attract new current account customers in Q3, in line with the Group's strategy. During the quarter, we opened c.22k new PCAs, with our latest campaign featuring 3.55% interest on linked savings, exclusive ISA products and a compelling cashback programme. Our Business Current Account (BCA) also continued to perform strongly, as we opened c.10k new BCAs during Q3 and continued to grow accounts on a net basis for the nineteenth consecutive month, increasing our market share.

In our credit cards business, we've now deployed Redi, our new virtual assistant chatbot that will link to our core systems, enabling real-time changes to a customer's account. The chatbot has been very well received by customers, attracting favourable Smile scores, and resulting in a containment rate of around 50%, which in turn has supported 20% lower call volumes in the first month of deployment. Following the successful release to credit card customers, we will be adding the new functionality to PCA customers shortly as we work to introduce a more personal approach to digital banking.

We are making good progress with the development of our Digital Wallet. During Q3, the first iteration of the Wallet was launched to Virgin Atlantic credit card holders, allowing them to access spend insights and earn rewards. Early feedback has been positive with customers demonstrating strong engagement with the app. We will continue to build the Wallet's capability over the coming months.

During Q3, we relaunched our investment proposition, Virgin Money Investments, alongside our joint venture partner abrdn. The proposition includes a Stocks and Shares ISA and a General Investing Account, enabling customers to select from a portfolio of Virgin Money managed funds, underpinned by a digital platform, seamless customer journey and with integrated Virgin Red rewards. Growth in investments is a key strategic ambition for Virgin Money and we are pleased with early trading performance.

We recognise the impact that persistent inflation and higher rates are having on some of our customers, including higher living costs and we are supporting them in managing their finances, including through our online Cost of Living hub. We remain committed to offering competitive savings rates to new and existing customers and have increased our proactive communication to help them get better rates. For customers that we lend to, we are providing tailored support, including the ability to restructure facilities or make reduced payments, and we have fully implemented additional measures as part of the new Mortgage Charter. In addition to direct support for customers, we are working with the industry and third parties to provide assistance to those most in need, including fully embedding the Turn2Us benefits calculator on our website, helping users to confirm or uplift £3m in government funded benefits since launch.

Colleague engagement remains at record highs, demonstrating the success of the A Life More Virgin flexible working model. The Group was pleased to reward most colleagues with a 5% salary increase in July, following an initial 5% increase in January. We recently announced the appointment of Allegra Patrizi as MD of Business and Commercial, subject to regulatory approval. Upon conclusion of the regulatory process and a handover period, she will assume leadership of the Commercial function from Hugh Chater.

The Group has continued to make progress against its Sustainability agenda and is on track to disclose net zero roadmaps and targets at FY23 for our remaining business sectors and operational emissions. Sectors have been selected in line with the Net Zero Banking Alliance and TCFD guidance; we anticipate this will cover emissions and transition plans for c.85% of our lending.

## Super Straightforward Efficiency

The Group remains highly focussed on managing its cost base and driving improved efficiency across the organisation. During the quarter, underlying operating expenses were equivalent to the run rate in the first half, in line with expectations. This performance was supported by lower external resource costs that had previously been required to safeguard service in the first half, following an improvement in customer experience metrics. This was offset by inflation and higher regulatory investment, particularly relating to fraud and financial crime. Overall, the Group remains on track to deliver a cost:income ratio of 51-52% for FY23, with broadly stable costs in H2 relative to H1.

During Q3, the Group has continued to build momentum in digitising the Bank, which will drive further cost savings over time. The number of fully digitised customer journeys increased to 49% (Q2:44%). This

[1] Key customer experience metric. For full definition, please see p351: https://www.virginmoneyukplc.com/downloads/pdf/virgin-money-uk-plc-2022-annual-report-and-accounts.pdf

contributed to the improvement in digital primacy to 60% (Q2: 59%), which measures the proportion of active PCA and Card customers who are digital only in their engagement with the Bank. Furthermore, the Group recently announced it will be closing an additional 39 stores, as it adapts to changing customer demand. Following these latest changes, which will take effect later this year, VMUK will have reduced its store network by 30% to 91 stores. We continue to expect the majority of the remaining c.£140m of restructuring costs out of the c.£275m total to be incurred in H2, including the costs of reducing our property footprint, severance and ongoing delivery of IT changes, which will drive further savings into FY24.

## Discipline and Sustainability

The UK economic outlook remains mixed, with high inflation persisting, driving market expectations that further rate rises are likely in 2023. This has played through to the housing market, with the higher interest burden contributing to subdued activity. Despite this, expectations for unemployment remain low and the BoE expects GDP to grow modestly. Against this backdrop, we are confident that we are well positioned given our strong capital, high quality customer base, consistent risk appetite and robust coverage.

Credit quality remained broadly stable during the quarter, despite economic uncertainty, with the portfolio continuing to perform well. While overall arrears, excluding government guaranteed loans, remained modest during the period, we continued to see a gradual increase in credit card arrears, as expected, from the low pandemic levels and reflecting the credit cycle.

The Group applied the same prudent macroeconomic assumptions and scenario weightings for IFRS9 modelling as at Q2. Overall credit provisions increased to £547m (Q2: £526m), mainly due to a higher modelled ECL in credit cards, taking coverage higher to 75bps (Q2: 72bps). Modelled and individually assessed ECL therefore increased to £475m in Q3 (Q2: £455m), while management adjustments (MAs) were stable at £72m. These factors resulted in an impairment charge of £55m during Q3, equivalent to an annualised cost of risk of 30bps for the quarter. The Group will continue to monitor and fully refresh the economic assumptions used in its IFRS9 modelling and will update MAs alongside the annual results. Based on these factors, the Group continues to expect cost of risk to be in the range of c.35-40bps for FY23, assuming no further changes in the macroeconomic outlook.

We continued to generate capital during Q3 as CET1 improved c.20bps to 14.9%[2] on an IFRS9 transitional basis, underpinned by ongoing profitability. RWAs were c.£0.2bn higher at £24.9bn, given loan growth. Fully loaded CET1 also remained robust in the period, improving to 14.5%[2] (Q2: 14.4%). VMUK's total capital ratio was 21.3%[2] (Q2: 21.2%) and the UK Leverage Ratio was 5.1%[2] (Q2: 5.0%).

We were pleased with our resilient performance in the BoE's 2022 ACS stress test, where the Group remained significantly in excess of its reference rates on both a transitional and non-transitional basis. Following this strong performance, we continue to target normalising our CET1 ratio to 13-13.5% by the end of FY24, while remaining above 14% this financial year. For FY23, we anticipate announcing total share buybacks of c.£175m, including an initial £50m announced today, which is expected to consume c.20bps of CET1 in Q4. We currently anticipate announcing a further c.£125m buyback alongside FY23 results, subject to Board and regulatory approval. This further buyback would supplement the 30% dividend payout and impact regulatory capital in Q1 24. The Group expects to announce additional buybacks through FY24, with further details on our approach to be provided alongside FY23 results.

The Group maintains a robust funding and liquidity position. With broadly stable lending and modest growth in deposits, the Group's LDR was stable at 108%. The 12-month average NSFR[3] remains strong at 136% while 73% of the deposit book remains insured via the Financial Services Compensation Scheme. During Q3, we issued £500m of secured issuance via our Lanark RMBS programme at attractive pricing, demonstrating the Group's well-established wholesale funding programmes and market access. Following this, the Group still expects to issue towards the lower end of £1.5-2.5bn of secured issuance this year (£0.9bn issued FY23 YTD), subject to ongoing deposit flows and relative cost. The Group holds prudent liquidity, with the 12-month average LCR at 143% as at the end of June[3], comfortably in excess of both regulatory requirements and the Group's more prudent internal risk appetite metrics. The Group's IFRS9 transitional MREL ratio remained stable at 31.0%[2] of RWAs (Q2: 31.0%), still comfortably exceeding its loss-absorbing capacity requirement of 25.4% of RWAs. Capital and MREL issuance during FY23 is still expected to be broadly limited to refinancing and maintaining the current surplus to regulatory requirements. During the period, we were also pleased that Fitch upgraded the outlook on the Group's long term issuer rating from Stable to Positive.

[2] Includes unverified profits for Q3
[3] Spot NSFR as at the end of June (Q3) 137% (Q2: 136%); Spot LCR as at the end of June (Q3) 157% (Q2: 153%)

*The Company further announces that a copy of the Q3 Pillar 3 Disclosures 2023 will shortly be available to view on the Company's website at: https://www.virginmoneyukplc.com/investor-relations/results-and-reporting/financial-results/. A copy of the document has been submitted to the National Storage Mechanism and will shortly be available for inspection at: https://data.fca.org.uk/#/nsm/nationalstoragemechanism*

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Announcement authorised for release by Lorna McMillan, Group Company Secretary.

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