Metro Bank Full Year Results 2017

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

Presentation

Vernon Hill

Thank you all for coming. Welcome to the Metro Bank 2017 Results Webcast. As you know, Metro Bank is the revolution in UK banking. And we're going to report to you on another great year and what you can expect in the years going forward. With me are the two folks that you know, Craig Donaldson, who's been the Chief Executive of Metro Bank since I dreamt this idea up; and our Chief Financial Officer, Michael Brierley. This is his last round. This is your last chance to abuse Mike because he's going to retire in March. He's been the Chief Financial Officer since the bank started. And just when we get him trained, he's going to retire.

The Metro Bank revolution keeps getting bigger and stronger and better. The British consumer, the British corporate customer, the British business customer have embraced a completely new way of looking at business and retail banking. And they say to us, "Thank god we finally have a choice."

A quick summary of the results that we've released already. Assets this year are up 63% over last year. Deposits are up 47%. And I want to point out that our best deposits, our current accounts, where there's no cost of money, grew in 2017, 61%. People bank with us for the service, convenience and the experience, not about price. We had another great year of loans. Loans grew 64% and Craig and Mike will go through all that with you. We promised the market we would turn into a full-year profit. This was the first year it happened pretty much on course. And as we like to say about most things at Metro, the best is yet to come.

We recently received a report that surprised even us, our brand recognition in London with very little ad spend is 89%. That's just an unbelievable number. We would never see that in America. And it shows you the British public was waiting for a chance to embrace change. We have confirmed our 2020 growth targets that we announced previously. And for all of you who have to fill in all your blanks in your financial models, we've given you the 2023 targets. And we have confidence that we're going to make and hopefully exceed those targets. With that lead in, I will turn it over to Craig.

Craig Donaldson

Thank you, Vernon. So, as is normal Vernon has used all the best lines. You never know what you're going to follow, but you do know that the best lines will have been used. We have gone from strength to strength, like Vernon said. We've delivered a great year. And we said we'd deliver our first full year of profit and we did. And that was the key to what we said. Customer deposits £11.7 billion, on target. £6.3 million deposit growth per store per month; a superb number.

Net customer loans are up. Loan to deposit ratio 82% and obviously we'll talk more about these as we go through, but another very strong performance. And our profit swing of over £30 million. But actually it's this slide. This tells you what happened last year but this is the start of what will happen this year, because of the culture and the model that builds the future and what we've just said is the past. For the second year running, we were the most trusted financial provider – second year running. It's all about trust we know that.

We also won the best mobile app provider. And actually it's gone from strength to strength. Again more about that later. We said we'd lend over £1 billion to business customers. We did. And we won several awards for what we do with our business customers. One of them was we were the best business lenders of the year by Corporate LiveWire. Our Voice of the Colleague, our culture which is key, every single metric in the Voice of the Colleague went up. I think that's the one I'm probably most proud of. Because if we create FANS amongst our colleagues, we know that they will create FANS amongst our customers.

And actually we created another 600 jobs for those colleagues and promoted over 600 people. And in the communities we serve, because we are part of the community – that's why we have stores so we can be in the communities. Over 27,000 schoolchildren went through our education programme. It's part of the national curriculum. We go in and teach it. We built fantastic relationships with the schools and actually just creates a fantastic environment. Because every one of those 27,000 schoolchildren for the last hour of the course comes into our stores. And it just brings to life what Metro Bank is about and that is genuinely creating FANS. And by creating FANS, by focusing on our model and by focusing on our culture, the profit increases every quarter. As I said earlier, we had an over £30 million swing from 2016 into 2017. We will have a bigger swing than that this year. 2018, the profit will grow more than that again this year.

And it will continue to grow as we go and deliver our 2020 targets, and then deliver our 2023 targets. And whilst increasing our profit – and as I said the trajectory on our profit will increase quarter on quarter. Of that there is no doubt, as we started with our strongest pipelines we've ever had. We've continued to grow. But what I want to draw out is we've grown. We don't offer incentives to customers to join us. We don't offer teaser rates. And we do very little advertising. How we win our customers is because people are recommended to us.

Our brand recognition has gone from 66% to 89% in London. One of the numbers Vernon didn't mention – there's not many to be clear – is that our brand recognition nationally is now 48%. One in two people know Metro Bank nationally. And that's before we get there. So this tells you people are talking about us. The red box is our net promoter score which is across the whole organisation. What that tells you is they are talking well about us because as we grow, we deliver better and better service. So they are talking well about us.

They are joining us because they're being recommended to us. And when you win customers who are recommended to you and then you deliver the very thing that they were recommended to you for, they stay. And that is how you create a high-growth business. And in that high growth business, more and more of our FANS are trusting us with more and more of their deposits. More FANS are joining us and we're winning more deposits. The trajectory is pretty clear. I think the things I'd draw out, I've already mentioned £6.3 million per store per month and very strong.

I have to mention the dollar number. Otherwise you will definitely hear Vernon say it –

Vernon Hill
So our stores last year in US dollars grew $103 million a store. The average branch in America – we all know the UK numbers – grows $1-2 million a year in deposits. We're 50 to 100 times faster growing than an American bank branch.

Craig Donaldson
And as Vernon said the best is still yet to come of course. But that was all achieved with cost of deposits that came down from 79 bps in 2016 to 54 in 2017. We finished the year in Q4 at 52 bps, a slight increase on the back of the rate increase in November. What we're winning is low-cost sticky deposits. And we're winning more and more of them as more customers join us and more of our existing customers bring their business to us.

And the stickiness, when you look at our current accounts, 32% of our deposits now are what we call non-interest bearing liabilities or current accounts. 61% growth. And we get those at 0%, and it's that 0% that we can treat like a natural hedge. We know it lasts over five years, six years, seven years because we've proven that now with how long we've been trading. It allows us to lend into the markets at low risk. Our structural advantage of our low-cost sticky deposits means we can be high-growth lenders at low risk; hugely important.

So you'll be surprised to know there's more strong momentum, more strong growth. Of course it was. Our loan to deposit ratio grew to 82%. We grew across all areas. The one area I've consistently pulled back from is consumer finance, consumer lending, where we still have circa £200 million of lending altogether, a very small number across the whole book. That's a conscious decision we made nearly two years ago. We could drive the yield up by lending more here. But I don't believe the risk return is right. And we've got to manage that. The cost of risk is the key number for long-term growth.

And the reason we've pulled out of consumer lending is because I do not believe the risk return is right. I've been saying that for two years. And that is why that number has remained pretty static. But what that's allowed us to do is keep this number pretty static because we're lending at the right risk for the right returns. We will not chase yield at the cost of risk. That way fools go. This is a long-term growth business built on strong risk principles.

So non-performing loans slightly up to be honest. Nothing there to worry about at all. This is still an unbelievably low number as the business matures. I wouldn't read anything into it. Cost of risk 11 bps, up from 10 bps. Again lost in the roundings, in truth. We said we'd be below 20 bps for our cost of risk, I think we've achieved that. And more importantly as well, as we go forward, our debt to value, our loan to value continues to be around circa 60%. And it's very important that we continue to lend to a circa 60% loan to value, debt to value, because that gives you the comfort about happens as you move forward. We have that coverage. We have that buffer. And as I said, our low-cost sticky deposits that we win from our FANS enables us to lend high-growth low-risk, because we can play in markets that others just simply can't. We can play in very, very aggressive yield markets because of the core deposit pricing and structure.

Michael?

Mike Brierley

Thanks, Craig. I am pleased that Vernon has finally decided that I am in fact fully trained. I've been semi trained I think for quite some time, I'm quite buoyed up by that, and that should carry me through the rest of presentation I think. So we remain a deposit-led, low-risk business. And the balance sheet continues to reflect that. One, Craig has dealt with the loans, but it's probably worth just dwelling on treasury assets just briefly. What do we do with the money that we raise in deposits but actually don't lend out? And the answer is of course that we keep it in a very liquid and very strong instruments. 91% of the liquidity investment portfolio are in cash or gilts or AAA rated RMBS and covered bonds.

One number on the balance sheet I think probably worth drawing attention to is here, the Bank of England funding schemes drawings, previously the Funding for Lending Scheme and latterly the Term Funding Scheme, the TFS. You can see that there is a significant increase in the year. There, that's the biggest percentage, 512% growth. It sounds huge, doesn't it? And with total drawings at the end of the year at £3.3 billion, I think it's important at this point to remind everybody in the room and on the webcast that we don't use that money to fund lending. But rather we buy treasury instruments, the aforementioned gilts and RMBS in order to provide a boost to net interest income. Although I think, as I've said previously, that also had an adverse effect on NIM because the return is relatively low on those low-risk treasury instruments. The TFS scheme actually closes at the end of this month. And we will repay those TFS drawings over the course of the next four years. The previous drawings that we had drawn down on the FLS scheme have all been repaid.

Turning to capital. Clearly post the £280 million raise in the middle of the year, clearly we have a healthy, CET1 risk capital ratio of 15.3% at the end of the year. But of course we are growing fast. Those advances are up 64%, as both Craig and Vernon have said. Total assets up 63%. That's the £16 billion number in red. And therefore we do need additional capital in order to fund future growth.

We actually don't need any capital this year, but we will need some early next year, and the intention is to raise some loss absorbing debt capital before we get to the point next year where we need to raise it. We're very conservative. We tend to raise capital ahead of need. But it is going to be loss-absorbing debt capital, for sure, because that will help boost returns and fuel us into the next phase of our growth.

No presentation, I suspect, in this season of announcements for banks, can get away with not mentioning IFRS 9. Which I think I'll spare those who don't need the technical briefing. It is in fact a change to the way financial instruments are looked at on the balance sheet. It affects banks particularly and it also impacts on impairments. We have adopted IFRS 9 from 1st January, but there is an impact on reserves. Moving from the previous regulations to IFRS 9 has an impact on reserves. I said last time in the mid-year that it would be immaterial. And indeed it is very immaterial indeed. There is no material impact, particularly after the transitional relief that we received from the regulator because clearly it affects the reserves and therefore the CET1 ratio.

MREL too is a fact of life for banks as well. Minimum requirements for own funds and eligible liabilities is what MREL stands for. What a mouthful that is. And broadly speaking it's part of the regulators in the UK and wider, their response to the previous banking crisis and nationalisations and stuff like that. And therefore new regulation requires banks to hold MREL capital, such that were the worst to happen to any bank, that it could be recapitalised and effectively reconstituted.

It will impact on Metro because we are growing. And we are growing into that regulation. It doesn't affect small banks. It does affect big banks and that's where we are going. And therefore we're going to have to raise some £750 million of MREL eligible debt by the 1st January 2020 because that's when the transition arrangements kick in. And we're planning to start doing that next year.

The P&L. Now I'm not really going to make any apology for repeating the next line, which is, we've achieved our first full-year of profitability. I am the CFO and I've waited a very, very long while to say that, a long, long while, as we've invested through the last nine or so years. The P&L I think sort of stands for itself. Craig referred to that £32.5 million positive move. And I think that's critical because that shows the momentum that we have now in the P&L. And that's certainly going to be carried forward into 2018.

The positive jaws, as we call them, the growth differential between the revenue at 51% and the operating costs at 31% will continue to subsist. And that will produce a curve. By definition that produces a curve. You saw that in the earlier slide, the quarter slides of profit that Craig put up. And that will play through 2018 and indeed beyond.

One line worth picking out I think in particular is the depreciation and amortisation line. You look at the operating expenses up 29%, but the depreciation and amortisation is up 49%. What's going on there? And the answer is of course we continue to invest in the business. This is a long-term play, as Craig said. We're building a franchise here. And we continue to invest. That investment will manifest itself in new stores, but also in investing in our digital stack. Last year of course we had a new mobile app, award-winning mobile app, and of course current account online, which will Craig will talk about I suspect, in a minute.

If one looks at the underlying cost to income ratio, clearly we made a profit. So guess what? It dropped below 100%. It's 90%. And of course it will continue to fall and we will talk about future guidance in a couple of slides' time. But actually the measure I really look at is up here. It's this annual operating cost per million pound of deposit because we're a deposit-led business. And so clearly deploying those efficiently is what we're all about. And that actually shows us an improvement of 11% year on year. And that is a sign of the economies of scale that we're getting in the business. And again, that is definitely going to continue.

So NIM. Customer NIM. We introduced the Customer NIM measure recently midyear because the TFS drawings that I referred to earlier, £3.3 billion at the end of the year, remember, distorts pure NIM. Pure NIM is up there. In fact, actually the measure of that distortion can be seen both by actually the differential between Customer NIM and pure NIM, but also actually the movement between 2016 and 2017. They move in opposite directions. Why is that? Because the drawings on TFS, we invest them in AAA rated RMBS, gilt and indeed hold in some cash, actually, at the Bank of England for liquidity purposes.
And clearly the return on that is at the lower rate of NIM. It boosts NII, but it's a lower rate of NIM. So customer net interest margin is a much more accurate measure of how we are deploying our deposits that we have, the sticky low cost deposits that we get, and the return that we earn on them. And as we repay the TFS monies, that we have drawn down, over the next four years, pure NIM and Customer NIM will move together. NIM will rise towards Customer NIM.

These are my favourite slides.

So the top of slide is store contribution, of course there are fixed cost at the centre, but contribution. The blue lines is the total of all the stores making a positive contribution. And the red line there – and always this is going to be red, immature stores, are stores that are actually making a negative contribution. So clearly the net is in the yellow bubble above. And I think the trend line is reasonably clear. And, of course, all stores open eighteen months or more are making a positive contribution.

It's a very powerful slide and we will come and look at a particular store in a minute. But this graph down here is the annual cohorts of stores, deposits on this axis, the length of time the stores have been opened here. And each of these lines is a year with the brown one there being 2010 although it excludes actually Holborn here. And the stubby red line here, tracking here, of course is the stores that were open in 2017.

And the message on that graph is clear. New stores open bigger and they grow faster. So why would that be? And the answer is clear. As Craig said we're getting better, there's no doubt about that. But it is also the brand recognition score plays into that. And of course the network effect, the network effect as we build out stores in geographies. And Craig will talk about that a little bit more.

It isn't new stores alone that is driving the growth because we think like a retailer. And therefore we use the retailer-like measures. Comp store growth, same store growth is absolutely a key measure for us. And the figures are up there. For stores that have been opened more than twelve months, the comp store growth is 43% which is a phenomenal number. And you go, yeah, but as they get older that's going to fall. Well, yeah that is true. But actually more than 36 months it's 35% which is an incredible number as well. And those comp store numbers and the vintages here are saying the same stores, they open bigger and they grow faster.

So we've looked at the macro level. Let's have a look at a particular store. Ealing, which used to be a former pub actually, which I used to drink in. But anyway, a story for another day I think. So what we've got here is the P&L, down to the contribution line. The P&L for Ealing, Ealing's actual cost, Ealing's actual deposits, customer accounts and the actual cost of its own deposits, the fees it generates. And then an allocation from the centre in terms of the net interest income that's generated on the deposits. It's not a calendar year. This is the first twelve months, second twelve months. So it was opened in June 2013. It made a positive contribution within fourteen months. And you can see the figures yourself. It made a loss, after fourteen months a small profit – and that profit continues to grow.

But what I will point out to you on this is a few things. The costs are relatively static of course. They don't change. They do go up, of course, but they don't change a great deal. As it moves into profit, it generates more deposits, more fees, more customers and it falls to the bottom line. We're creating an annuity income stream. And this is Ealing, add them all up and you get the previous slide. And that's what's driving profitability; the maturation of the stores.

So why did we choose Ealing? Because there are some cynics in the room, I can feel it. And why did we choose Ealing? Did we choose Ealing because it moved into a positive contribution so quickly? Well no. Quite a few stores moved more quickly than fourteen months actually. So that's not it. Did we choose it because it had lots of safe deposit boxes sold? Well no, because actually there are a fair few stores that have sold 100% of their boxes and have a waiting list and that's not true. Did we choose it because the deposits still increasing? Well, no, because they are increasing in all of the stores.

Because this is, it's representative. And that's why it's been chosen. It's not special, I don't think. It's absolutely representative. And all the trends that I picked out pretty much apply to every store to a greater or lesser extent. But it isn't all about the stores. It’s more than that. I think Craig is going to talk to that now.

Craig Donaldson

Thank you, Mike. I'm still in training so... The thing is that of course, it is about the stores, they’re massively important. And that’s how we think about and grow the business, because the consistent delivery from the stores allows us to plan and to look forward. But the key is how you bring it all together and how you, as a high-growth retailer, you think about customer experience through every channel. And that's what we have to focus on. And that's what we do focus on. With our technology stack we, just up here, we're talking about – we've just launched our current account online, we call it CAO.

It's funny, we had our Board meeting yesterday when we were signing off everything. And Monique, who’s just joined our Board last year, was telling me how she sat with somebody and had gone through the whole process in less than ten minutes. And then they popped in the store to collect the card, click and collect. John Lewis, Argos have been doing it for years. We’re the only bank that can do it. Nobody else can do it. And it's about bringing retail thinking to how we fulfil for customers through every channel is the key.

And we're doing that by having our own technology stack that allows us to be very adaptable, to be able to move at a pace that others just simply can’t, whilst also working with the best fintechs out there. We’ve now integrated with 14 fintech companies. Actually we use something called selfie ID&V to fulfil our financial crime requirements. It's a fantastic fintech company that we’re using. And what we'll continue to do is work with the best in the market to create the best experience through every channel for our customers.

And obviously all the channels are up here. Our API gateway was ready. I know that's an unusual thing for a bank to say. But it was ready. I'm really excited about the opportunities that open banking, PSD2, the API gateway, will bring. I know a lot of people are talking about where was the fireworks when it happened. Well, I think when we look back it'll be a seminal moment but it will take time to grow into. And I think that for business customers is where the biggest opportunity lies. We are a business and personal bank. We look after business and personal customers. Business customers are the most underserved. And I'm genuinely excited about what open banking and our API layer will allow us to do for those customers. And we will talk more about that as we move through the year.

But it's about being adaptable and working with the best in the market and that's what we do. So we're also, of course, we are building more stores. We’ve got 55 now. We only opened seven last year. We wanted to open ten. But we actually have five in build at the moment. We're building in Southampton. We’re building in Oxford. We're building in Bristol. We're building in Watford and we're building in Putney. So to have five stores in build this early in the year tells me that the 12 we’re forecasting to hit this year is more than achievable. I'm expecting when we stand here for the half year, we'll be telling you about the great store openings that we’ve had.

So our plan hasn’t changed though. We're going to look to have 200 to 250 stores nationally. We are entering new markets as we speak. I mentioned we're building in Bristol now, a fantastic market. And if we haven't signed – I think we’re through planning in Cardiff, so we will be getting ready to take on that building. We've got several sites in the Birmingham conurbation and we’ll be opening Northampton and further into Birmingham later this year. We're growing into new markets, whilst growing in the markets where we are. At the moment this covers about 34% of the business banking market in the UK, 34%. We've got 66% to grow into. But in that 34%, we're taking 17% of the business switchers in London and southeast, huge numbers. So we’re going to keep growing in the markets where we are. And we're going to open up new markets over the coming years. The stores are massively important to be a part of the mix of how we fulfil through every channel for our customers.

Let's come onto the refinements of the 2020 targets. I've just talked to you about stores. We're now, with the planning that we've got, say we’re going to open 100 stores. We opened three less stores than we wanted to last year. We’re taking that number down looking forward and confident we’ll get to 100. You and I know that’s a staging post. We want to get to the 200 to 250. It'll be 100 by the end of 2020. But we’ve continually over-performed on our deposit performance per store. As we just said, we did £6.3 million per store a month last year. So we're increasing that from £5.25 million to a range of £5.5-6.5 million. We’re very confident we can do that as we go forward.

And even though we're increasing our deposits, our sticky low cost deposits at a fantastic rate of knots as we win more customers. Our loan to deposit ratio continues to increase. And we’re very confident that we can get up to the 85-90%. The reason why we're putting 85-90% is because we'll make decisions as we go forward. I mentioned earlier we made the decision 18 months to two years ago to pull back on consumer lending because we weren't happy with the risk return. We'll be faced with more decisions like that because we're running a business and we're running it for the long term. And it'll be the right thing for us to do. But we're confident that 90% is the upper limit. Fundamentally we don't want to have wholesale funding. When the TFS is ready to pay back, we'll pay it back. And we can run a high growth low-risk business at 90% loan to deposit ratio without needing wholesale funding. And that's what we'll look to do.

And then finally Customer NIM, I think Mike explained that very well. Customer NIM is the franchise NIM. It's the NIM that we are actually earning on the deposits that we win. I don't let TFS touch the business because what I want is to focus on our customers. And this is the NIM we earn in the long term by winning more customers and lending the sticky deposits we get, out. And we'll continue to do that. And that's why the NIM will trend towards the Customer NIM as we pay the TFS back, and as we grow the business without drawing down anymore TFS. So it's refinement to our targets, if you look at them you know we're very comfortable we're going to hit them – we're very confident that this translates into very strong earnings that will be delivered. Earnings that I'm sure you've worked out before and will work out again.

But we're growing. Only £100 billion in deposits is only 4% of the market we serve. £100 billion is only 4%. So when we're talking about 2020 its simply in the foothills of where we can take Metro Bank. So we're showing you 2023 here, but please don't think that that is anything other than the next set of foothills that we're walking up. I'm surprised Vernon hasn't said it yet. £100 billion is the minimum you'd expect from me; 4% should be easily achievable for an organisation like ourselves. But 2023 therefore is the logical step. We work on five to seven year plans. What we're basically saying is therefore between 2020 and 2023 we're going to double our deposits. We're going to be opening 15 to 20 stores every year. We'll have the same deposit growth. We'll have the same loan to deposit because that gives us the flexibility that we want to make the right long-term decision. And that the Customer NIM and fees, the NIM will trend to that and then it'll all be one.

Cost to income ratio will come down simply because Mike talked about the curve. If you look at the quarter on quarter growth that will accelerate. Q1 is looking exceptionally strong at the moment. We started with the best pipelines we've ever had. And I'm very confident about that curve will continue significantly as we trend to our 2020 and beyond targets. And then cost of risk, we've gone from 15 to 30 bps as we look through the cycle. And manage the business to the cost of risk. I do not want the cost of risk to be higher than the 30 bps we put there. We make decisions on our lending yields and our volume against the cost of risk because we are a high-growth business and must manage the risk properly.

Then finally ROE. This is not us backing away from our 2020 and our 2022 numbers. At the half year we said we'd deliver 14% in 2020. We said we'd deliver 18% in 2022 and we will. In our modelling, in our planning, we're planning to have another capital raise in 2023. Now if that is debt, we'll be higher up on the ROE. If it's equity, we'll be towards the lower end. I don't know what it'll be yet and I want to have the flexibility to make the right decision at the right time. But what we're trying to share with you, obviously I plan out where my capital raises are going to be. We're currently considering one in 2023 and that's what would impact on the ROE, depending on whether it's debt or equity. But we are absolutely standing by 2020 it will be 14, 2022 it will be 18.

But I don't want us to forget it is – there's a lot of analysts in the room, there is a lot of shareholders in the room and on the calls. It's about creating FANS. The UK market has five, six massive banks that are a cartel. And what customers, we believe, a large number of customers want the service and convenience. They want to be looked after. And what we want to do is we want to look after them. We want to create FANS. And this is what our FANS are saying, and fundamentally this is what differentiates us. This is what makes us the Metro Bank because this is what we care about.

Vernon Hill

Thank you Craig and Mike. And before we go and answer questions from the floor and from outside, there's a couple of simple points that I've made before. But I want to make again, since we have some new people. Metro Bank is a power retailer that happens to be a bank. If you look at it through British bank eyes, you miss the entire message. Look at it as a high growth power retailer or a tech company. Most of you know I've been doing this for a long time. And in America we built this model from one branch to 500 stores.

And we learned a few things. Here we learned that everything we did in America works better here. Craig says it's because of him. You could say it's because of the bank competition. We showed a slide about growth. We showed you a typical store profit and loss statement. And it shows you the growth in the deposits per store. I often get asked, when are they going to stop? When is the growth per store going to slow down? I'm happy to say in the States I never had a store that stopped growing unless there was no place to park.

And while the percentage may come down as the stores get larger, we really don't expect them to slow down. Because of that it's very simple to understand and predict the financial results of the Metro Bank. If you tell us the deposit growth per store and the NIM, we can pretty much tell you what the results are going to be. And in the States and in Metro, our predictability on growth in earnings was very robust because this is a very simple model without all the normal mumbo jumbo that we hear at bank things. So with that, I would like to open up the floor.

Q&A

Vernon Hill

On the phone Nick Adams from Wellington. Nick has been an investor in Metro almost since the beginning, and he understands this as well as most.
"With Metro's growth at 50 times industry average, Metro is a difficult stock for most bank analysts to handle."
The analysts tend to look at us, particularly in Britain, as banks instead of what we are.
As an alternative way looking at this value issue, Nick asks, "what is the implied return on capital now of your first branch?"

Holborn was our first branch. The return on capital in Holborn is so high, I don't know what the number is. It's like off the charts Nick. But if you take a normal branch like we've shown you at Ealing, at the store contribution level they're getting 50-100% return on capital when they get maturity. It's almost so high that it doesn't – it's hard to believe.
But Nick's question makes the point. This is where the value is being created as a retailer at the store level. Thank you Nick. Next? Floor, yes. And you are? Sure. John Cronin from where?

John Cronin

John Cronin from Goodbody. Thank you for the presentation. And just a few questions. Look, first of all, very impressive loan growth and deposit growth consistently quarter on quarter, over many quarters at this point. But looking at your 2020-2023 targets, so just very crudely back of the envelope, it appears as if you are broadly pencilling in loan growth of approximately 35% per annum out to 2020 and then 25% per annum out to 2023. And focusing in on loans particularly, I guess, as the loan book grows in size and as you target more commercial, what kind of challenges do you perceive there to be to continue growing at that rate on the six year timeframe, yeah?

Vernon Hill

Of course you have all the issues of growth. And in credit you particularly have issues. This is not my first time I've done this. So I believe we know how to do it. Our experience has been very good here. But my last 15-year loss ratio in America at Commerce was 0.11. Craig said we have to hire people. We have to recruit and we have to train them. But Craig made a very strong point. When your cost of money is so low that you don't have to reach for risk and yield. So I'm completely confident that we can make those loan targets.

Craig Donaldson

Could I answer that as well? Just to build on what Vernon said. What we're doing is building engines. And in the mortgage market we're building engines through technology and distribution, working with the brokers and internally. You know, the market at the moment – John, you'll know better than I – £230 billion, I don't know. We take 1% to 1.5-2% of that, we're still a hugely small part. We have massive growth. And therefore it's about how we keep the customers as we grow as well, but which we are proving we can do.

So we play in the mass markets. We don't play in special niches. We play in places like mortgages, getting the right technology with the right service offering. Because of our low cost of deposits we can play in those markets where others can't. And then we attack the cartel who have in the mortgage market, if you include Nationwide in there, they are 80+%. And therefore what we're doing is attacking their back books while winning new customers as well.

That will always be ripe. Lloyd's has 48% of their lending. I might be wrong, you'll know better. I am sure you've just come from there. But you've got – Lloyds's have got over 40% of their back books on their standard variable rates. That's our opportunity. That's where we go. There's huge growth opportunities there. And then in commercial, well you heard us mentioned before, 17% of all business switches in London and in the southeast are coming to us. And we're only playing in 34% of the market. So as we continue to infill in the markets we play and enter the other 66% of the market and support Mark and Ian with more teams and more people, more specialisms, the market is there for us take. As long as we are the mass market, we are not a specialist lender. We play in the large pools of customer bases, both personal and business and that's how we'll grow.

Vernon Hill
And the bigger issue is when Metro Bank started, would this model work? Would the customers accept it? We’ve now proven that. It's always our challenge not to mess this up. As we get bigger, we have to deal with all the issues in all parts of the bank. We’ll go to the next question.

Craig Donaldson
Sorry, before – The other opportunity is consumer lending, John. You know, we're not even scratching that because we backed off, we weren’t happy with the risk reward. When the credit card market normalises we’re starting to see the consumer finance market normalise. That will open markets to us as well. But we’ll only go back into them at the point at which we're happy with the risk return. And it will normalise. I think John had one more question, sorry.

Vernon Hill
We’re going to be here all day with John. Go ahead, John, quickly.

John Cronin
Yeah just a couple of other quick ones. And one is just I saw on the accounts you submitted your IRB waiver request.

Vernon Hill
Okay and let me take it from another call to on this point. We got a call from Adam at Glenville Capital. If you are granted AIRB-related capital relief, will you raise your long-term ROE target, Craig?

Craig Donaldson
No, we’ve just come out with our targets. And we make an assumption on AIRB.

Vernon Hill
Adam, we assume that we get predictable relief from AIRB.

Craig Donaldson
Yeah, John, can I just see specifically on AIRB what you wanted to ask, though?

John Cronin
Really just in terms of expectations or in timeframes actually.

Craig Donaldson
So the application has gone in. I would expect us to get some way forward in 2019. I would certainly not be betting on it in early 2019. I’d certainly hope we get it before the end of 2019. We are currently looking at a 35% risk weight on residential mortgages with all of the add-ons. You look at the big banks that are sitting between 7% and 11%. I don't believe we’ll go that low.

Vernon Hill
Everybody in America understand what he's saying? Let me repeat it. On risk weightings, on residential mortgages we're working with disadvantage. Go ahead, Craig. Give the numbers again.

Craig Donaldson
So like I said, we’re sitting at 35% plus all of the add-ons, the big banks are sitting between 7% and 11%. I don't think we'll get down to 7% to 11%. We should do it if you look at all of our models to say we should be. But I think that we'll see us getting down – they talked about the floor at 15% to 20%. I think we'll head to the floor. And I think we’ll see others head to the floor the other way. And I think that will create a more level playing field and competition. We’ll come back to John. Let us ask other people and we’ll come back to him.

Vernon Hill
Yeah go ahead. Somebody here, sir, you in the back. Ian, you are from where?

Ian Gordon
Investec. Can I have two please? The first one is kind of the opposite to John’s first question. I'm very pleased that you are taking the loan deposit ratio up to 82%. I know you have only done a couple of inorganic portfolio acquisition since you started. It’s entirely possible another suitable opportunity might fall into your lap maybe this year. I would welcome it if you went to 85% this year. And just pursuing that slightly further, no one’s ever going to suggest you going to be anything other than the retail deposit

led bank. But should you not be a little bit more flexible, if you like, about pursuing or accepting other long-term secure funding if market opportunities arise?

Vernon Hill
I don't believe in wholesale funding in a bank. Our model says the value is in core deposits. So we may take some short term opportunity in long-term funding, but we're not a wholesale funding business. You might see it for a short period of time. But that's not our core value that we have.

Craig Donaldson
I'm worrying about wholesale funding when it freezes and what happens. And my view is have the right capital with the right risk and the right liquidity and then you can manage to do anything. And I worry when I look at organisations who at 120, 130 and 140, they become more and more beholden to the markets. And the markets can do strange things at strange times, and I don't want to be beholden to the markets.

Ian Gordon
You'd be happy to go through 85%?

Craig Donaldson
Yes, definitely.

Ian Gordon
And can I have a second one as well, please?

Craig Donaldson
Sure, go ahead.

Ian Gordon
So open banking, you've already talked about it very positively. Surprisingly enough, Lloyd's were quite positive about it this morning. I wondered if you could talk about the losers and you'd better not mention RBS or you might offend them again. If you wouldn't mind just talking in broad terms where the opportunity comes from.

Craig Donaldson
Yeah, I don't think you are a loser when you haven't done it yet. So I think the losers will be those that don't have the ability to adapt. Those that are not willing to look at themselves if they are large and take advantage of the opportunities, even if it has a way of eating themselves. I think for people like ourselves the opportunities are all in front of us. The opportunity is to create a customer experience using our technology stack at a pace that others would struggle to do to make customers' lives easier. And my view is open banking will allow us to do things for mortgage customers, for business customers, where we can do things for them to make their lives easier that they value.

Vernon Hill
Again, it's about your brand value not just the mechanics. If you have a net promoter score that we have 82% and RBS has a net promoter score of minus six. Which way do we think open banking is going to move? Well, it's pretty obvious.

Craig Donaldson
So I think the losers will be those that do not have the technology stacks that are adaptable and do not have the flexibility in how they manage themselves to go for opportunities even if in the short term they maybe seem to be negligible.

Vernon Hill
They do not have a brand customer's trust. Right, thank you.

Nick Baker
Thank you very much. It's Nick Baker from Goldman Sachs. My first question is – so thank you for slide 10 about Ealing. And the first question is really what is the operating expense in year zero? Because clearly investment process is always going to be a part of what you're about. So it would be a good time to understand how much of your current operating expenses relates to stores which aren't yet up and running?

Vernon Hill
So that's a good question. So let me answer it in a slightly different way. We have a negative in Britain; we have to expense rent when we start to build. When you compare it to American numbers we don't expense rent until we actually open the store. So

our biggest expenses is pre-opening, our rent and training and all that. This profit and loss statement talks about your operating expenses once you've opened. These guys will give you a number of how much a year we're losing on new stores, that's it. And we usually disclose that number. Do we have it? Our net losses on new stores last year?

Nick Baker

It's actually the slide before – it's the red line there, so its £1.3 million in quarter four.

Vernon Hill

But it's not a real true story because we only charge the direct expenses. You've invested in people to train, you are over building. It's funny you'll bring that. There's a lot of written about us in America on that number, adjusting for that number. It's a relatively small number here because you're doing relatively fewer new stores and they're going into profit in a much shorter time. But if you ask these guys again, they'll probably give you a real number.

Craig Donaldson

Could I? – Because what I would tell you is so what happens is obviously before we open the stores, we have to start paying from the point at which we do the work. So we do have, depending on the store, sort of a four months to six months cost of rent because you got to pay that even when you're working on the stores. So zero, you are right. But that does get caught up in the property cost are amortised, the rent we have to pay. There is a zero to it.

Vernon Hill

But, what's the big number? We'll get back to you on that.

Craig Donaldson

You know but and also you got to hire staff. You've got hire colleagues to be trained before you open the door.

Vernon Hill

And on that question, that's all baked into the expenses. And retailers tend to capitalise the expenses pre-opening. We do not. Go ahead, Nick you are doing good.

Nick Baker

The other one was actually on fee income so NII and loan growth kind of broadly up in step in the year. Fee income somewhat lower, and the trends we see across the sector I guess it would be good to get your view on kind of exactly why that is and whether that's in line with where you have expected it to track.

Mike Brierley

So, that is in line with where we expected it to be. I mean, that fee growth is waxing strong. And as we penetrate commercial customers, SMEs more deeply, larger SMEs, we get more fee income from them, including FX income as well. So there's a lag effect there as we penetrate. As we get bigger and we access more, we get SMEs who are larger. Then we get more fees. And that is definitely a trend we saw last year. And that resulted in a lot of strong momentum in that area. On the retail side, of course –

Vernon Hill

On that question a lot of the community misses the fact as we get bigger, the size of our commercial relationships and commercial credit gets bigger, which means we have commercial fees. And when you guys write about it, it's hard to fit that into your model. And so sometimes you are surprised about the growth that you're expecting because the commercial's becoming a bigger, more important part all the time.

Mike Brierley

I mean, the SMEs are the most under-served part of the UK market without a shadow of doubt. And the charging structures and the fee structures from our largest competitors are byzantine in their complexity. And we have always sought to keep things simple and transparent, and have always attracted lots of SMEs right from the word go from that perspective. But larger SMEs generate more fees and we're accessing them. We are getting them on board. And in some cases of course it takes time because we sometimes have to swim upstream in relationships. They already have banking relationships. And sometimes we join as the second bank and then have to swim upstream to the first bank. That tends to happen but there is a time.

Craig Donaldson

Can I also add of course, we mentioned open banking, Ian's question about who'll be the winners. For me a huge opportunity around fees. As we create more services we're able to do more customers using the API layers, I think we'll see more fee income opportunities. And so we've almost held back on some things, waiting for the API layers to be there because it'll open opportunities at a better cost and a better service to fulfil more and earn more fee income.

So I think you're going to see new fee lines growing, which will be on top of the natural growth you see in the businesses as we win more business customers. And actually open banking is the key to that, the API layers and the opportunities that creates. That's where it's really exciting for me.

Joe Dickerson

It's Joe Dickerson from Jefferies. Could you all talk through the store target of moving from 110 to 100? I mean, obviously the unit economics are very strong. And on the last earnings call I remember I challenged your then guidance because you were surpassing it. So the unit economics is strong. But why the less stores, number one? Number two, just on the store point 2023 you're growing in parts outside of the southeast. Do you now have a national scale ambition in terms of the deposit footprint?

And then I guess, secondly how do you think about the share price? I'm sure you all have your ideas about the valuation of the share price. And having covered Commerce Bank in America I remember it traded consistently. So the best indicator of share price was the market cap relative to the core sticky deposits. And do you see that as a prospect in the UK at Metro?

Vernon Hill

We know why you have the highest target price for Metro out there now, Joe. First of all, on the stock price the Commerce's historic experience was roughly speaking our market cap was 20% of our deposits. And actually we're not too far off in Britain. And over a period of time, that's one of the shorthand rules that I use to give me a range of where the market cap should be. Store acquisitions, what I do – and it's different in Britain than America since you don't have suburban sprawl, particularly in Greater London. You're going to get less stores but they're going to be much higher deposits per store. When I look back at the 450 to 500 stores in America – and New York was our largest market – I often think the mistakes I made. When I want to go into an area so bad that instead of waiting for the A plus site, I waited for the A – I took the A minus site, we did okay but not as good as we should have done in that market. And I swore to myself I'm not going to do that again. So our theory is the best site in the best town is always worth the money. And it's always worth waiting.

So in some ways it's less predictable on store openings here because they are more complicated downtown sites. And we're sort of giving you a range. And what's your third question?

Joe Dickerson

National scale ambition?

Vernon Hill

Well, Craig said we're going west. We're going north. We're going to Manchester.

Craig Donaldson

We can go to Sunderland at some point, yes.

Vernon Hill

Sunderland, we're never going to. We should be, over time, in every major UK market. But if you look at it this way, as Craig said, if we only get 10% of the deposit market in Britain that's approximately a £200 billion bank. And based on the shorthand version I gave you, you could say that that could produce a £40 billion market cap versus our £3 billion market cap now. And it's our job to make that come true. Next.

Robert Noble

Morning, afternoon. Your TFS drawings, are they – are you maxed out on those now or –?

Vernon Hill

The whole thing's done with. It's over. You can't draw any more after the end of this month and we're done.

Robert Noble

And so the number I see at Q4 is the number that will be at Q1 as well?

Michael Brierley

No, we have drawn additional TFS funds in the first quarter.

Robert Noble

Substantially more or?

Michael Brierley
No, not substantially more.

Robert Noble
Okay. So I just want to get an idea of the difference between NIM and Customer NIM as we go through 2018. Because I think some people were worried at these results because of the move in actual NIM and ignoring the stability in Customer NIM. And I just want to know where you think the difference will be this year rather than 2020?

Michael Brierley
We are looking at the average numbers there for 2016 and 2017. And the differential throughout the year opened up.

Vernon Hill
You mean widened?

Michael Brierley
Widened, absolutely. And I think that clearly I think that that will certainly continue in the first quarter. So there will be a striking difference between the two numbers. Repayment is not going to be a material figure in 2018. And therefore I think that you know they are going to stay quite wide apart thereafter in 2019 onwards. NIM will rise towards customer NIM as we repay the TFS.

Nicholas Herman
Would you expect Customer NIM to rise in the next four quarters?

Michael Brierley
Yes absolutely. Yes absolutely, driven by the rise in the loan to deposit ratio and the strength of the fee generation, absolutely.

Vernon Hill
And we suggest you to use that Customer NIM plus fees as the predictability of our NIM targets in 2020 and 2023.

Craig Donaldson
And as Mike said, the first quarter we've drawn a little bit more. And so therefore, there will be a little dilution on NIM itself, its dilution. It goes on the NII. Customer NIM should go up again. We did over £1 billion of net lending for the first time organically in Q4. Where it came in the quarter means we've got a very strong start to this quarter because you get a whole of that £1 billion on the balance sheet obviously late in the quarter. And we've got the best pipelines we've ever started with going into 2018. So you've got a great end to the year. On top of that you got a great start to the year. So I'd expect Customer NIM to be moving throughout this year.

Vernon Hill
In this model as the yield curve steepens, our NIM goes up substantially because we have such a large pool of no-cost current account deposits. In a steeper yield curve current accounts are worth more. All right next. Go ahead.

John Cronin
Yeah, one final one. It is on that. It's actually goes back to your point on capital. So the CET1 capital ratio stood at 15.3% at the end of the year, clearly a function of fast growth, with the 210 bps of reduction in the last quarter. But although you've now turned – although you are now turning in profitability on a full-year basis, on my numbers you don't have – you've not yet reached out inflection point where your profit generation is offsetting your RWA growth. So unless I'm missing something, I think you need a capital raise, an equity capital raise before the end of this financial year. So I'd like to know what I'm not thinking of, perhaps.

Michael Brierley
I mean, at the risk of repeating what I said, based on our current growth expectations and our current expectations of regulatory requirements, we do not believe we need a capital raise at all this year. We certainly do need additional capital to take us through our growth. You're quite right. We're not generating enough profit yet to the self-sustaining. That capital raise will be loss-absorbing debt capital. And we will raise it ahead of need, because we always do, because we manage our capital ratios conservatively. Our internal requirements are super equivalent to what the regulator asks us to hold. But we see no need for an equity rise this year certainly.

Craig Donaldson
And also I'd add two further points to that. One, we would expect the profits will be stepping up nicely. I expect Q1 to be a very strong quarter followed by another, that curve will pickup. I said the £30 million switch last year will be more, if not significantly more, this year on top of the £20 million we finished with. So it slows the descent down on the capital consumption. And then you have a Pillar 2a offset that was introduced on 1st January. If you look at that, I mean, that's literally written for a bank like Metro Bank. That has low risk, low LTV retail mortgages. And as we go through the ICAAP process I would expect there will be some benefits that should play through from that, John.

Michael Brierley
And I think that's probably the factor I think to take account of.

John Cronin
Thank you.

Vernon Hill
John, let me say one other thing on that question. Within the 2023 framework we gave you, we will reach the point where we are producing enough capital to support growth at this rate, within that target. I'm not sure we can tell you exactly where it is. But within that framework we should pass that point.

Alice Timperley
Alice Timperley from Morgan Stanley. First question just on IFRS 9, I realise that the day one impact is negligible. But just thinking further out, obviously we're going to a period of potential uncertainty over the next two to three years. Firstly, will you be publishing a transition document with the annual accounts as some of the other UK banks are doing? And secondly, if not, will you be able to give us any sense of, directionally where, how you think about macro parameters in the models and sort of sensitivities around that?

Michael Brierley
The annual report will contain a lot of disclosure around IFRS 9. I don't think we're on the skinny side as far as that's concerned. So that will be out relatively shortly. IFRS 9 has a more muted effect on us because of the highly secured loan book that Craig has described earlier with the loan to values at 60% and below, and the lack, relatively speaking, of an unsecured consumer lending portfolio which is, where I think the IFRS 9 is going to bite particularly. So the answer is yes, there will be a lot of disclosure in the annual report. To put it bluntly, it goes on for pages. And it's very exciting obviously but only for accountants and analysts. But IFRS 9 has a relatively muted effect for us. I mean, in the short term it's in the roundings.

Vernon Hill
Anybody else? I want to tell you how Metro Bank is different than everybody else, certainly all the banks. There's an article that came out in *Fintech* magazine, of all places. And it describes Metro Bank as the High Street heartthrob – the High Street heartthrob. I know that applies to me. But it really tells you about Metro is not a bank. It's an emotional brand, emotional brand, creating real value.

We have one coming in, Arun from Macquarie. What's the NIM impact from raising MREL?

Craig Donaldson
Can I answer? It's factored into the 2020 numbers that's in the model. And it's factored into the 2023 numbers. So actually the impact is factored into the Customer NIM plus 3%. And it's factored into our earnings which will be, as we've always alluded to for 2020 and for the new ones for 2023.

Vernon Hill
And fiscal 2016 disclosure implies slight negative gearing to rates rising –
Is that true, guys?

Craig Donaldson
Not as far as I am concerned.

Vernon Hill
I don't think that's right. But rather than the rates rising, as most of you know, it's the shape of the yield curve that's really important. To the extent the yield curve steepens, our zero cost current account deposits really add value. Thank you, Chris. Anybody else here? Those of you that haven't switched to bank account with us, you can now do it in store, on the mobile. And we're checking on each one of you after this. Thank you all for coming.

Craig Donaldson
And before we go could I just? As Mike said – Mike is retiring. Mike was the first person I hired, as he puts it, to do all the work. And it's genuinely with a heavy heart that I have to say Mike is leaving us. I tried to talk him out of it several times but Rachel told me – his wife, under no uncertain circumstances, that he was leaving. And I just want to put on the record for me personally and I'm sure from all Metro Bank people that there would not be a Metro Bank in the way we are if we hadn't had you, mate. And I'm genuinely sad to lose you, but you better be a customer still obviously. And I know you will be.

Vernon Hill
We're building a branch by your house.

Craig Donaldson
I know we are.

Michael Brierley
But you won't let me cut the ribbon.

Vernon Hill
Maybe I will.

Craig Donaldson
So, I just want to say on behalf of everybody at Metro Bank, Mike, good luck with your retirement, you lazy bugger. And I just want to say thank you from me personally because it wouldn't have been the same journey without you. And I am sure everybody will put their hands together –

Vernon Hill
And Michael, I agree also. You have done a great job. Thank you. And thank you all for coming.