Metro Bank Q2 1H Results 2017

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

Presentation

Vernon Hill

Good afternoon in London and welcome to the Metro Bank's Second Quarter Performance Results. I'm pleased to be with all our friends here in London, our friends on the phone, and friends on the web, and those of you on the web can see Sir Duffield opening the event. Whatever bank Chairman bring his dog to the first half results? So that is obviously the most important thing here, but thank you all for coming.

The second quarter and the first half was another great period of our bank, the machine just keeps on rolling. Before I say a few words, let me introduce the people that actually make it happen, our Chief Financial Officer, Mike Brierley, and our Chief Executive, Craig Donaldson, who you all know.

Mike and Craig have both been with me since before Metro opened, and are largely responsible for building what has become Metro Bank. By chance, this Friday is the seventh anniversary of the launch of Metro Bank in 2010: the beginning of the revolution in British banking, a revolution that creates fans, fans that join our brand, fans that remain loyal, and fans that bring their friends.

Thank all of you here and those on the phone and on the web, who are our Metro Bank friends. Our sincere thanks to our customers, our fans, our tremendous staff, and the British public that has overwhelmingly embraced the revolution in banking, which is Metro Bank.

The second quarter was another unbelievable quarter for Metro. Assets are £13 billion, up 57%. Deposits ended the quarter at £9.8 billion, up 49%, and loans ended the quarter at £7.7 billion up 67%. And Craig and Mike are going to describe to you in some length the financial results. We're also pleased to announce that last night, we completed a capital fund raising of £280 million. This is a growth capital fund raise. As this bank grows, we need to raise capital to keep up with the growth. And the shareholders have responded overwhelmingly. We raised £280 million at the market price, and the order book was £200 million plus.

We're also pleased to report that the stock is up 5% from the beginning trade this morning as the response to our offering has been strong in the offering and in the aftermarket. This has left Metro Bank with a risk capital ratio of 19.4%, probably the highest capital ratio of any bank in the world, and continues to build our foundation for tremendous growth. Metro Bank is a true growth bank. It's not another 'me too' bank, it's not a better bank, it's a revolution in banking in Britain, and it's becoming a worldwide brand.

At this time, I'll turn it over to Craig and Mike.

Craig Donaldson

Good afternoon, good morning, everybody. Thank you for dialling in, viewing, or coming along today, and thank you, Vernon. I could normally go straight to questions, but Vernon has left me a little bit to talk about today, which is good, so thank you.

I'm going to go straight into it. The revolution goes and sounds exactly like Vernon said. We went through over 1 million customer accounts in May, and continue to grow. Yesterday alone, we had over 1,100 people open accounts with us, who walked in to be with us, no advertising, they called their friends, their family, their colleagues had said we're where they should be.

Actually, one thing I'm most proud of in the last quarter is the awards we won. We won most trusted financial provider for the second year running. For a bank of our scale, to win the largest independent review for the second year running I think it's a real validation of how we are viewed, the most trusted financial provider. And, to also then win the best mobile banking app, tells you just about how you integrate everything together. The stores are a massive engine for our organisation, as is every channel.

I will say as well, along the bottom there, they are the awards we won this quarter, there was a few more that we didn't put on, but there are a few there. Our Voice of the Colleague is our internal surveys, we went up in or stayed the same in every metric, and they are bloody good results.

And then I come on to the one that we buried, the simple thing of doubling profitability quarter on quarter. We're doing what we said we would do, we're doing what we said we would do, and we will keep doing it. We bought the £600 million mortgage book, more about that from Mike later, but it's fair to say, we've looked at over 30 books now, we've bought two, we'll keep looking for the right risk return, got to be the right risk, and if it's got the right risk, we'll then look at the returns. If it's not the right risk, we never worry about the return, we just don't go near it.

And Vernon mentioned last night, and we'll talk a little bit about that later on, but you can see on every metric, on target or outperform. And I'm very proud of how the British public and British business continues to come to us and bank with us.

And just in case you missed it, in my normal subtle way, our profit goes from strength to strength. You know, we talked about the J-curve, we are well into that now. And you know, we doubled our profit like we said. And we're going to continue to invest in the business. We will invest over £100 million in building this business this year, and we'll continue to have the profit go in the right direction. We could be far more profitable today if we didn't invest in the growth, but what we're spending today is about driving 2020, and that's why we're investing – because it's all about the growth in the long term. And it is long term when you think about the model we are offering.

This is a slide I've slightly changed to what you've normally seen and we pull it forward, because, look, we're a retailer, and the future of retail is about how you integrate service through every channel. And those retailers, the Amazons, the Apples, of the world, are focused on integration through every channel, and so are we.

And we're starting to win the awards improving that with best branch service, best mobile app, we were second in telephony, fair play to First Direct, and we will become better than them over time. It's about how you integrate every channel, because what consumers in businesses want, is the ability to choose how they engage with the services they want. And that's what Metro Bank is building, that's what we are, we are a retailer of now, and the future. And that's the bank, as well as retailers, they got to get with this, and it's our lack of legacy that allows us to do it, it's how we integrate our technology which is real time processing, which allows us to move data in a way that anybody with legacy just cannot do and to fulfil through every channel, every time, at a time when the customer chooses, which allows us then, when we look at PSD 2, which is one of the hot topics, to be ready, good to go, we're early. We're not sure how many of the people will be ready, but we are, and we'll build on our architecture, we'll build out that architecture.

And on this slide here, we have some of the things that we're in the middle of building, we're actually live at the moment, live testing with real customers opening accounts online. We'll call it click and collect, you can open an account sitting here now, and then just pop downstairs and collect the card, click and collect. Or of course, we'll post it to you, because it is about choice. The customer has to have the ability to decide how to engage, banks have to give up that to customers, otherwise customers will go elsewhere. We're the only bank that can do that.

We're also obviously developing our mobile app out. More of that as we go through into the third quarter and the fourth quarter. Other stuff that we are doing that I am very excited about: our 'Create Beneficiary' will be going live any week now on the mobile app. And some of the personalisation stuff that we're developing around personal financial management, which will go live towards the end of the year, is very exciting. So, we're investing in that development. We've just won best mobile banking app, you got to keep moving forward. You've got to keep investing to be better.

And of course, we're looking at machine learning. We're also looking at augmented intelligence. Not artificial intelligence, augmented intelligence because it's about how can we use augmented intelligence to support people, not to replace people. And that's what we're building at the moment, in both the front office and the back office, to drive productivity and efficiency, so that when a customer wants to do something, it happens in real time, there and then, every time.

And it's working. You know, we've talked about the customers, we've talked about the service we're offering, we've talked about the awards we've won. But actually by creating fans, we win more low-cost sticky deposits. We averaged 6.4 million per store per month in the first half – growth in deposits is always, always net.

The point I want to draw out, obviously, our cost of deposits came down from an average of 61bp in the first quarter to 53bp in the second quarter. Will the cost of deposits continue to drop in that way over the over the coming months? No, it won't be that precipitous. There's no doubt about that. Please don't forecast that in your models, but it will drop a little bit. There will be further reductions but nowhere near the precipitous drops we've had in the past.

The key thing I want to draw out from this is the non interest bearing liabilities. We call them current accounts. And the current accounts are transacting accounts are both personal and business. We've seen 71% year-on-year growth in our non interest bearing liabilities, and that is the engine of the organisation. That's what we want to win. Because if you win the transaction banking, you not only win the non interest bearing liabilities, but you win the fee income that comes along with it. And this is the engine that's driving faster and faster now. And you will see over the coming months and quarters how that will pick up and take the business forward.

Vernon Hill
Craig, can I interrupt?

Craig Donaldson
Please do.

Vernon Hill
This last chart shows you deposit growth per store per month. And because the banks in Britain don't report that, we have to compare our performance to the American banks who do have to report it. So, the average American bank grows its deposits per branch $1 to $2 million a year. Metro Bank converted into dollars is growing $100 million a store a year. In other words, a hundred times the American average. And we want to reflect on that number to show the magnitude of growth.

Craig Donaldson
And the beauty of it is like I said, the non interest bearing liability. It's your current account. The business' current account. The very thing by which you live on every second of every day, is what we are winning. And because we win the sticky low-cost deposits, we can do our lending at low risk. That is the key to the model. As you can see, we've now increased our loan deposit ratio to 79%. You know that we –and I'm sure it's no surprise for you –we don't like surprises normally apart from last night, although a few of you had worked it out.

We moved the loan deposit ratio, we will talk more that, in 2020 up to 85% because of our confidence in the growth and the momentum of the business that we're going to do it. In the last quarter, if you strip out the book purchase, we delivered 85% loan to deposit ratio in the quarter. And you got to remember, we were sat here last summer where I said we were pulling back on consumer finance because I wasn't happy with the risk return. Well that's what we did. We pulled back circa £127 million, it is a bit precise for a circa, but there you go. Circa £127 million of our lending out of £7.8 billion is consumer finance. Now, we could do more but as a conscious decision, we will only lend at the right risk and the right return. Will we do more consumer finance going forward? Absolutely, yes, but only when the market returns to a more normalised position.

So, I know we can do 85% without consumer finance and I know when consumer finance comes back, we'll go back into the market or actually, the market will come back to us in truth. We never moved; it was the market that moved. We know the risk we will take. We know the returns we want, and that's what we hold for.

Our buy-to-let on the back of the £600 million purchase is now 30%. That will trend down back 25% by the end of next year. That's just the natural dynamics that we have in the book. There's no doubt the buy-to-let as a sector has slowed a little and that's naturally going to bring our buy-to-let performance back to 25%.

The cost of risk, the NPLs, is all very low. It continues, I see no stress or pressure in that all. So, I know we talked a lot if 20bps is the right number – well, at the moment, I see no reason at all why I will be questioning it because, absolutely, we are running a low-risk book. And, as I forecast forward, that's what I see.

And just to bring that life, at the very bottom there, our average debt to values, on residential lending, 58%, on commercial, lending 57%, on buy to let 60%. The biggest peak to trough reduction in the last few downturns, shall we say, was 27% peak to trough on residential mortgages. It's sitting today at 58%. This is a low-risk, long-term, high-growth model. And we're delivering every quarter.

Mike Brierley
Good afternoon, everybody. Good morning to the US.

The balance sheet remains intrinsically liquid because of the business model. As to remind new viewers, we don't have wholesale funding. We're funded by deposits from our commercial and business customers and from our retail customers. Of course, that's reflected in an LCR ratio of 114% at the end of June.

We continue to swap out of our FLS funding, government funding, into TFS, because it is cheaper. There is a little wrinkle with that. We've swapped out about half a billion in the first half of the year. There's a little wrinkle with that because much of the FLS drawings are off balance sheet whereas the TFS drawings are on balance sheet. And therefore, although it's cheaper by swapping out our FLS to TFS, we are having a little bit of a drag on the NIM. Vernon has already talked about the pro forma ratios, capital ratios, post the capital raised at CET1 19.4% and a leverage of 7%. And, of course, they position us well for the next phase of our growth.

If we look at the CET1 ratio, however, from Q1 to Q2, you see that's declined from 15.9% to 13.5%. That's due in the main to the strong organic loan growth that Craig was talking about earlier. Of course, the portfolio purchase that crystallised on 2nd June, the buy to let portfolio that we purchased from Cerberus. There is one technical issue in there that's probably worth drawing out as well, which is, most of you know that the Bank is on a standardised method for determining credit risk, but it's also on the standardised method for operational risk as well. Once a year, that operational risk quotient resets, and it resets in the second quarter. And clearly, we're a fast growing bank and, therefore, it resets up because it is based on averages of past years' revenue, and, of course, that's going up quite a lot.

Craig Donaldson

So Mike, we can talk to anybody through that in detail later if they wish to go through it.

Mike Brierley

Of course, endlessly, I can see the appetite in the room as we speak. Vernon and Craig have talked about the successful capital raise that completed yesterday / today. And clearly, what that does is it gives a lot of flexibility when we look forward.

We're a fast growing bank and we do need capital in order to continue to fuel that growth which will carry on for many years ahead. We tend to raise capital ahead of needs. We don't tend to wait until the last minute, we raise ahead of , and by completing this capital raise, as I say, gives us flexibility as to when to enter the debt market, because, over time, clearly, the intention is to have a fully mature bank capital stack. At the moment, we just have common equity. But, clearly, we are destined to raise debt, be that a tier 1 or tier 2 or, of course, MREL then. And the capital raise really positions us well to do that but also to deal with future regulatory developments, including MREL.

One of the impacts of that capital raise is a function of maths, really, which is if you raise equity, then, clearly, there has to be some impact on ROE. And there is. Our guidance was that we would be circa 18% ROE by 2020. This capital raise pushes back the point on which we get to 18% by a couple of years, a couple of years max., I think, and by 2020, our guidance now will say that we will be at circa 14%.

The right-hand side of the slide deals with some moving parts. We're making good progress towards making our AIRB waiver application for residential mortgages by the end of the year. And we're also looking forward to seeing the outcome of the PRA's consultation paper on Pillar 2 offset, which should finish, I think, in January next year. And, clearly, that could be a very useful bridge for us between where we are now on a standardised approach to credit risk and, clearly, where we're going, AIRB, and that could be a very useful bridge.

I think, to forestall the question that inevitably we're going to get later is about future capital raises, and I think the answer to that is that we don't see any needs to raise capital through – obviously the remainder of this year or 2018.

The P&L – it is obviously a CFO's dream to be able to say that profitability doubled in the quarter, I quite enjoyed that. And they repeated again at some point quite soon. And, of course, that's driven by the reduction and the cost of deposits, which Craig has talked about earlier. And, of course, what that leads to is the positive P&L jaws that we've got, with income increasing a lot of faster than expenses, and you get the kind of curve that you saw in the earlier slide.

Costs – we are a growth company, as Vernon has said, and costs are very much under control. But we continue to invest heavily in our IT, particularly digital, as Craig outlined earlier, in our stores, and I think Craig will talk about stores in a minute and, of course, and our colleagues too. So, costs are under control but we continue to invest. We are building a franchise here.

NIM – the NIM dropped slightly from quarter 1 to quarter 2. A couple of things going on there, one of which I've already referred to, but the other is the build-up of cash in order to purchase the buy-to-let portfolio that crystallised on 2nd June, £600 million sitting at the Bank of England, earning 25 basis points, definitely cramps your style slightly as far as the ROE is concerned. And I alluded earlier to the swapping out from FLS into TFS, which is now boosting the P&L, actually, has also had a little drag effect on NIM.

What's the outlook for NIM? Well, certainly the cash won't be weighing next quarter, so I expect it to go up. And I think that, as the loan-to-deposit ratio rises towards our initial guidance of 80% in 2020, but now, 85%, and again, you will see that feed through to the NIM.

Cost of risk, as Craig alluded to, remains benign. All the leading indicators say to me that this is likely to remain so at least over the next few quarters, for sure.

The one thing I think I probably just need to really nail down is, the other reason that the NIM is going to go up in the next quarter, of course, is the portfolio purchase, which is definitely NIM accretive. We didn't get very much of that accretion in the last quarter but we're going to get a whole quarter of it next quarter.

Vernon Hill
This is the fun part.

Craig Donaldson
Who thinks I'll get through this slide without Vernon? Yeah, the betting is low on than that.

My second favourite slide when I talk to people, our chart is here at the bottom, the annual cohort growth. Our stores continue to open bigger, and grow faster, and they're all growing. And that's down to us getting better at what we do. And as I said earlier, it's all about just being better tomorrow than we are today. That's how you keep growing, is to improve.

Vernon Hill
And all the stores have continued now with pretty much the same rate.

Craig Donaldson
The older stores continue to power through, and you know that's the strength of this model. Today, we opened with the same number that we finished with last night and we add to it. And it's the continual addition of customers of deposit and lending in the existing stores and drives the profit even stronger. And that actually is the key up here, if you look. Let me shout some numbers now. In quarter 1, the profitable stores made£41.8 million. In quarter 2, the profitable stores made £48.7 million. And that growth in income was not all down to the one store that flipped out of loss into profit. It was down in continual increase in positive contribution from those stores.

The power of this organisation are the stores that have been trading now for three years plus. They are the real power of the organisation. And that's why I said the investment that we're making today is the power of 2020, plus all the stores that are all opened already. That's the power of this reliable model. This model it delivers month-by-month, quarter-by-quarter, year-by-year. And that's why it's a long-term growth model.

Just a couple of few things of – yes, safe deposit boxes continued to cover 80% of the rent after 12 months. Yes, we're very confident that will continue. Yes, it does actually work. Who would guess? But it does work. And we've got some great stores coming up in the second half of the year. At least eight will be opening later this year. We've got 8 in build at the moment. We're not going to do the 12, I will come on to that in the moment, but we're hoping to do 10, but at least 8 that will definitely open. Next year will be bigger, much bigger. But safe deposit boxes continue to deliver regular fee income every month. You don't pay us, you don't get access. It's rather lovely, really.

Vernon Hill
Go back to that slide there, retailers report their comparable sales growth per store and a retailer today would love to have a 5% or 6% comp store growth, we report deposit comp store growth per store. Last quarter was 45%, and a lot of these stores are getting large, so they're on a large base. There is no retail model in the world that can grow store sales like this can.

Craig Donaldson
I'm sure I said this before, on our Board, we have a chap called Roger Farah. Roger was CEO of Foot Locker then Macy's, and then he ran Ralph Lauren. So I think we can agree he knows a little bit about retail. This is the number when he gets the board pack that he rings me up on and goes, 'Oh my God' every month. He just loves this number. Because he remembers when he used to look out at Ralph Lauren globally, these retail like-for-like sales, he loves that number.

Vernon Hill
Go back one more time. We encourage everyone who follows the Metro Bank story to use this slide as a guide, by thinking of us as a growth retailer that happens to be a bank. One of the reasons our bank in America was trading on such a high multiple, and

one of the reasons Metro is trading on such a high multiple is because this is not a bank, this is a high growth retailer with an almost unlimited growth path.

Craig Donaldson

Thank you. And this is how we're filling it out. We've changed the map, and I hope you can see that. I'm rather disappointed. I'm going to have words with the guide – Sunderland still isn't on there, which I take as a slight.

Vernon Hill

Is it still there?

Craig Donaldson

No, it still isn't on there.

Vernon Hill

No I don't mean the map, I mean is it still there?

Craig Donaldson

It's still there. How very dare you? But you can see how we are radiating out from Central London and we'll continue to do that. We'll be opening later this year in Swindon. We'll be opening later this year in Peterborough, in Northhampton, in Canterbury, and we'll in fill in what we've already opened as well as opening new markets moving out.

So next year, we'll be looking to open Leicester and several stores, probably four or five in Birmingham. We've got a couple of stores in Bristol. We've got a couple a stores we're looking at in Cardiff. And we'll be opening. So we'll be moving out. This model works. It's working in every socio demographic. It's working in working class towns, in upper class towns, everywhere because why wouldn't people want service and convenience? Service and convenience is not about money, it's about expectations for treating people with respect. And everybody wants to be treated with respect and that's why this model works.

So we're finally getting it out. Next time you see this map, it'll just show a little bit further north. But it'll take a few years. You know, we've got to grow properly. We've got to keep the brand and we've got to keep the culture and the model tight. And we've got to create fans every day. And to do that, we've got to make sure we have the right support and the right oversight. And that's why we're growing in this way.

So I come on to our 2020 targets. Mike covered the ROE, where we said it was a function of maths. There is a return and an equity part. If you have more equity, then the return is spread a little bit, the ROE goes down. I've been helping some of our colleagues in the press to understand that. And the loan-to-deposit ratio going up from 80% to 85%, that's all about our confidence in the business. We are very confident this business is going well. We are very, very confident this business is going well and very confident with our refinements in the 2020 model. Vernon, back to you.

Vernon Hill

Thank you, Craig. We'll take some questions from the phone from, from online, but we'll start here in London. Who'd like to be first? No one wants to ask everything. Peter from RBC.

Q&A

Peter Lenardos

Hi, good afternoon, it's Peter Lenardos from RBC. I just had a question maybe for you Mike on the non-performing loan percentage increasing. Was that because of the acquisition or was that just because the book is maturing?

Vernon Hill

It's because we're bouncing along the bottom.

Mike Brierley

Yes. I mean – so, yes, it is a very low number anyway and a couple of loans dropped in there at the end of the period. However, when we look at the security against those loans, there's no real danger of loss. And in fact actually – they are cured subsequently. Thanks.

Vernon Hill

Anything else? Okay, who else?

Nick Baker
Thanks. It's Nick Baker from Goldman. Just a few on capital, if that's okay? I think in the placing release that you put out yesterday, you talked about an 11% minimum CET1. So, I'm just curious to get your thoughts around, as you think about CET1 leverage, the 11% and the 4%, do you see those as guardrails or are those reflective of a level where you actually intend to run the bank going forward?

Mike Brierley
This is a very conservative bank and in fact we've never gone near either of those two numbers. It's definitely certain that the Board, Vernon, Craig, and I, want to go nowhere near that. We raise capital well ahead of needs. So, if it was a red, amber, green, if we were there, that would be red for us, for sure.

Vernon Hill
And Nick, as a probably know, when you're growing at these rates, even on scale, it's not the capital you need now, it's the capital you need a couple of years out. I think this is our fifth capital raise, sixth capital raise, we've always raised capital in advance when we need it and you can expect to see the same.

Nick Baker
Understood. And then just quickly to make sure I'm calculating things correctly. What was the risk rate on the portfolio purchase? Was that just a standardised mortgage portfolio? And then the operational risk that you mentioned had reset, if you could give us your operational risk calculation, that'd be helpful.

Mike Brierley
Yeah. Our standardised operational risk is 15% as an average three-year revenue, isn't it? And so that's a standardised calculation. It's a very broad brushed calculation. And, clearly, with our P&L doing this, every year as a reset and, clearly, it goes up and quite rightly so, and there's no problem there. As far as the portfolio is concerned, portfolio of purchase is concerned, they were buy to let mortgages, residential and the risk weight followed that, so there was nothing out of line with that, standardised stuff.

Craig Donaldson
On the operational risk one as well if I may just to support – what we see is we're growing the revenue in the way Mike spoke. You've got the third year dropping off things being replaced by the growth. That's why you'll see that step. And that's why we've started the transition and our application for residential and buy to let mortgages will be going later in this year a waiver.

Mike Brierley
And it all happens once in the quarter because when you've had your years accounts and they are audited and you have filed them with the regulator at that point, you then – you then do that calculation and drop it into your capital calculation.

Nick Baker
Okay, so that's why it wasn't in the first quarter?

Mike Brierley
Yes,

Vernon Hill
Nick, doesn't Goldman want to ask me what our growth targets are after year 2020? Are you going to ask me that?

Nick Baker
More than 1%.

Vernon
25% a year minimum, not 4%.

Craig Donaldson
Keep going, Nick. Do you have anything else?

Nick Baker
That was all. Thank you, guys.

Craig Donaldson
Thank you, Nick.

Vernon Hill
Who else in this group? Yes, sir from Jefferies.

Kapilan Pillai
Yes, guys, on the AIRB, is 20% mortgage risk rate still the planning assumption? And, once you've submitted that waiver, will it 15 to 16 months for approval that we've heard from other banks? And then once you do get that capital release, presumably that will go into re-investing for loan growth, again, getting to the LDR 85%? And the second question is the 71% current account numbers are obviously very strong. Could you then in light of that, update us on interest rate sensitivity?

Mike Brierley
As far as the AIRB waiver, I certainly think that it will take that kind of timescale. Clearly, we're not in control of that but that is the indication that the PRA have given everybody and I don't see us deviating strongly from that. Our planning assumption is recently conservative. Clearly, we have run the numbers as part of the AIRB, and we think our residential mortgage portfolio is very, very safe, and therefore we should get benefit from an AIRB waiver. Conservatively, yes, we're still at 20%.

Vernon Hill
For the Americans on the phone, we're talking about advanced risk management numbers. I think Mike answered it.

Craig Donaldson
It should go in later this year. Let me be lazy there and say 1st January, just because it's an easy day to work from. Therefore, 15, 16 months, I think the regulator came out and said in the consultation they thought would take 18 months, that is what they've come out and formally said. So if you add 18 months on, it should be somewhere in 2019. Will it be early 2019? Will it be later 2019? It definitely won't be 2018. And I certainly hope it's not 2020 when I would expect it to happen.

As for where it will come out, I think the regulator has been talking about bringing in floors. So there's been talk about 15%, there's been talk around 20%. I wouldn't imagine a bank that's moving from standardised onto advanced would be allowed to drop below where they think the floors are going to be. So, so that's probably a safe assumption for everybody to be thinking about. Wherever they talk about floors, probably assume it will go. And yes, this is a growth - you know, all of our capital is about growth capital. So, if we get capital relief from our very safe mortgage book, we will reinvest that in continuing the growth of this organisation.

Vernon Hill
Okay, anybody else here?

Kapilan Pillai
On interest rate sensitivity?

Mike Brierley
On interest rate sensitivity. I mean, you know, we've a very conservative bank and we don't run very much interest rate risk. And, clearly, it would be lovely if interest rates moved in the right direction, i.e. up, and that will be beneficial for us and indeed beneficial for others. But we're not running very much interest rates risks, and so speaking of the yield curve a rise in base rates would feed through to us over time but not in a material way at all.

Vernon Hill
Our targets do not assume any change in the shape of the yield curve and of course, if the yield curve steepen, it would help us, yes.

Mike Brierley
Not materially in the short term but over time, it would definitely help.

Vernon Hill
Thank you. Anybody else here? I'm sorry we have one more here before we go.

Ian Sealy Ian Sealey from Citigroup. Just two quick ones.

Vernon Hill
You're from where?

Ian Sealey
Citigroup. The distribution of branch openings to 2020, you talked obviously a big number in 2018, but perhaps you can just give us a bit more guidance as to the opening plans?

Second question, we talk about readiness for PSD 2, perhaps you just talk about some of the risks and opportunities there that would be very helpful. Thank you.

Vernon Hill
Craig, start out by explaining to the people on the web and the phone what it is exactly.

Craig Donaldson
So let me do the distribution first then I'll do the PSD 2 which is API lays. Please don't ask me to say what API means because I genuinely have forgotten. Application Program Interfaces, I think, or Platform Interfaces. But, the distribution, if you think about it, you know, on a cultural level, how we can grow the organisation out.

Vernon Hill
What is it? Explain to our viewers and listeners. What is it? What is PSD2?

Craig Donaldson
No. Let me come to that secondly.

Vernon Hill
Okay, sorry.

Craig Donaldson
So on distribution, on how we grow our stores, culturally we can grow this bank 20% to 25% typically, I think, on store openings a year. Now, obviously, I've given you a percentage there. So once we build the base, we can do more stores as an absolute number but the percentages stay the same. If you take the number where we are now and think forward 20% to 25% a year, you get your number between 100 and 110. And that's why we say circa 110 because we're very confident that's the way we'll grow. Sometimes we might be slightly lower in the 20% to 25%, sometimes we might be slightly higher. But that's where we're going to be running and that's why we're very confident around our ability to deliver the 100, 110 stores that we've always said we would.

Does that give you enough to work on? If you do the maths, it works pretty perfectly. And that's why post then, I think we can grow, you know, we should be 200, 250 stores like I've always said, and then we'll have Sunderland on the map. I keep coming back to that, my apology. You got to be proud of where you come from.

On PSD 2 which is the Personal Services Directive 2, it's about creating open architectural organisations and enabling customers to get the movement of data between different players easier. I'm paraphrasing to within an inch of my life here to simplify what is about 2,500 pages. It still haven't come out formally with the full regulation yet which I think is one of the dangers, where you haven't looked down on full legislation, but expect it to be implemented six months later with this huge technology that must be held by legacy organisations. That must be a problem. Not for us, our API gateway, our application platform interface, is there. We're very happy with the company we're working with, and we see that, because of our lack of legacy, because of our great real time technology, that gives us an opportunity to think about how we can offer services to our customers in a way that other organisations with legacy that they have to integrate with, just won't be able to do.

So PSD 2 is being seen as both a blessing and a curse by many. I do believe for us, it's a blessing. I do believe for us allow us, it will allow us to move in to product structures and service structures for customers with which they struggle with more. I do believe it gives us an opportunity to work with partners in a much more collegiate, intuitive, way for customers. And I do believe it gives us an opportunity to do things for customers that previously we've not been able to do because of the API layers being integrated – like the tax man, or into land security - you know, there's different ways we can use this to really make a difference and make peoples lives easier. And that's what we're thinking about at the moment. Is that okay?

Ian Sealey
Thank you very much.

Vernon Hill
Okay. Do we have anybody else here? If not, there's a web question for you Craig. Our target net interest margins for 2020 is 3%. Would you explain that? Is that still your target?

Craig Donaldson
Yes. So we say NIM plus fees will be around 3%. At the moment, it's around 2.4% in the last quarter. So as we said, we had a NIM reducing opportunity by holding £600 million of liquidity, and now we have a NIM accretive opportunity because we have spent £600 million and have the book on balance sheet. So that helps move that forward.

We also have the fact that we moved up to an 85% loan deposit ratio which will help take us there as well. Now, yes, there has been some compression of yield on mortgages. We are seeing that slowly, but we've been able to offset the vast majority, if not all of that, through the management of the cost of deposits. If you look at the compression in mortgages compared to the movement in cost of deposit, it's really washed that through.

So we'll bridge it by getting to the 85% loan to deposit ratio. We'll bridge it by seeing an increasing percentage of our lending in commercial banking and business banking, we'll bridge it by winning more transaction banking from commercial customers. We launched our commercial online banking platform last year, in November, and it's been hugely successful, and therefore, it takes time to get these people on to the platform. We had our best months ever in June, I only expect that to be beaten by us next month, probably next month. And that will continue as we go.

And then the final thing is probably - Michael?

Mike Brierley
Yes. There's one more element, there's one more element that's going to help us bridge between where we are now, which is actually 2.4% of the half year, is, we referred to earlier, which is both the FLS and the TFS and that acts as a boost to P&L. It helps generate net interest income but it actually acts as a drag, and therefore, repaying both of those elements overtime, you know, could add 15 to 20 basis points to the NIM. So that's also a factor in bridging between where we are now.

Craig Donaldson
That's a pretty comprehensive answer.

Vernon Hill
Thank you. The next question I have, is there an opportunity to take Metro outside of Britain? Sunderland is one option.

Craig Donaldson
He couldn't resist. Was that Matt Lindenbaum by any chance?

Vernon Hill
As most of you know Metro Bank is modelled after our American experience. And in many ways the British banking system and the American system are pretty much the same, but the American system was designed early on after the British system. So, it's fairly easy to transport our model to Britain where the words almost mean the same thing. So that's one reason we came to Britain and you do speak a language somewhat like the Americans.

Even when we meet our goal deposits on the 2020 target, that's less than 3% of the deposits in Britain. So, the upside here for us is so big and so strong that certainly I have no intent to taking Metro Bank outside of Britain. There's lots of people in Britain we need to free.

Craig Donaldson
This is a revolution therefore freedom is guaranteed. For me, look, we can build this organisation over a number of years; you know, if you look 10 years out, why shouldn't we be a 100 billion sterling bank and growing?

It's actually between 4% and 5%, you know, £ 2.3 trillion deposit market, say by 2020, that number will continue to grow. We get to 100 billion in ten years' time and I'm expecting us to do that. Then you can work out what that means. It still means 4% to 5% of the market with huge opportunity. We are a small island, it's densely populated and has a cartel of six organisations that we're winning business from.

Vernon Hill
Okay. Next, okay.

Vernon Hill
Hello. Are we getting anything, team? While we wait, is there anybody else here think of something clever?

John Cronin, Goodbody
Hi guys. On the substantial uplift in profitability in the first half. And just a few questions if I may. One is on the 2020 and the 2022 targets, and I'm just asking in respect of the 2022 target now, do those incorporate any further potential capital raisings? I noted a comment earlier, Vernon, around no further raisings anticipated on 2017 or 2018, but what about in the period up to 2022 because you have that specific ROE target?

The second question is on the liquid assets portfolio and particularly the held to maturity portfolio. Given the size of that portfolio, is there any prospects that Metro Bank would be required to comply with PRA ring fencing requirements? And then, the third question is on risk-rated assets intensity. What potential benefits do you think could come through?

Craig Donaldson
We have your questions.

Mike Brierley
The questions didn't come through very clearly but it's definitely a question about ringfencing and whether it was going to apply to apply to Metro Bank in the future. Well, I suppose my answer to that will be ringfencing is a little way off and we're certainly well outside the ring fencing regime at the moment. And clearly, we do have a significant portfolio of investment assets, which certainly could be an issue within ring fencing. But by the time ring fencing comes in, our loan to deposit ratio will be at 85%, circa 85%, or indeed higher. And therefore, we will have much less of an investment portfolio and therefore, frankly, not an issue with ring fencing.

Vernon Hill
Let me add to that, Mike. We don't expect to do ringfenced as we are ringfenced now. We also consider the ring fencing from the major banks to be a giant plus as the big banks have to ring fence, the customers have to change their accounts. They're going to be forced to make a choice. Do I stay with one of the big five? And that gives us an increased opportunity to convince them to switch. But we see ring fencing for the major banks as a big plus. I don't see ring fencing in the future for Metro.

Craig Donaldson
The other thing I'd say on that if I may, and John, obviously, forgive us, we are trying to answer the question we think you asked and I think we're pretty close, but Mike mentioned earlier about FLS and TFS. The TFS program comes to an end in February. I don't believe at this point that the Bank of England is looking to close it earlier.

At that point, you then have four years of which you got to pay back the money from the point of which you withdrew it. You know, if you look at the large part of our portfolio, actually, because of TFS when it pays us back, we pay the TFS back. And therefore, our assets will significantly drop, one as we go to the 85% loan to deposit, exactly like Mike said. And the other is, as TFS gets paid back, we get rid of the assets.

So, no, I don't see ring fencing as being an issue for us. I don't believe it's something we have an issue with. To use Vernon's point before, we see it as an opportunity, not a threat because as other people focused on the threat, we see the opportunity first to keep focusing on customers. And if you keep focusing on customers, you win.

Vernon Hill
Are you done with John, Craig? Can we get him off?

Craig Donaldson
No, there was still a question.

Vernon Hill
Give him one more.

Craig Donaldson
No, no. there was one more question, I believe, that he said in our 2020 ROE of 14%, then our ROE of 2022 of 18%, were there other company raises or debt raises in there and have we factored that in? I think is what I've picked up from what John said. And my view would be yes and yes. We plan forward, we planned it in, and therefore, yes, John, the answer to your question is about have we planned in any other subsequent capital raises? The answer would be yes.

Vernon Hill
But equity raises would not be in for the foreseeable future if we had zero capital debt on our balance sheet and that would be our next choice depending on the market.

Mike Brierley
And therefore, we factored that into or P&L. We factored that into, etc, etc, etc. We've worked out obviously when we think that we have a seven-year capital plan and we've managed that very tightly.

Vernon Hill
Okay. The question I have online is, you're typically running above your targeted store deposit growth of 5.25 m a month, and yes, we are. Won't online accounts openings add to the pace of growth per store? 100%. Not the growth rate, but it absolutely will.

And the related question is, are you anticipating a decline in underlying bricks and mortar gross per store per month in the future?

The great retailers of the world have learned to seamlessly unite stores, digital and online. That is the Metro Bank story. So, because of the way London is built, we'll never get as many stores as we have in America, but we don't need as many stores because mobile takes a lot of the transactions out. So, we expect online account opening to increase our rate of growth rather than be a minus.

Craig Donaldson
And let's discuss that at the end of the full year. Let us get this launched. Let us get actual numbers. Let us get experience and then let us discuss it. I certainly don't see it as a negative.

Vernon Hill
Okay. Next, some more?

I see it here. It provides splits of retail and commercial deposits and loans in the disclosure. Can you provide a composition of your commercial book, from RBS? We have given you a breakdown in some of the information we released, I don't think it's really appropriate to do it here but it is true that our deposits are about 50% commercial, 50% consumer. That is a very good percentage and we talk about growth, we talk about commercial and consumer.

The split of our lending book between retail and commercial is, Craig?

Craig Donaldson
52% and 48%. It's on the bottom bullet point on the slide that I've just taken us to. On deposits.

Vernon Hill
On deposits.

Craig Donaldson
Yes, and do we break that out? Well, we've already said to you, it's around about 31% that is this transaction banking accounts. It's actually around about 31% on both sides, so it's about 31% of the deposits for current accounts for personal business and for business and commercial customers.

Vernon Hill
You should expect to see as we go forward, the commercial portion of our loan book could be an increasing percent. All right? Last question on the phone.

Michael Perito
Hey, good afternoon, guys.

Craig Donaldson
Hi, Michael.

Vernon Hill
Hi.

Michael Perito
Just a couple of questions that I have left here that I wanted to touch on, maybe a first one for Mike, just on the net interest margin. You know, at times in the quarter, there are a couple of things early on that impacted the 1.92%. Can you maybe give us a sense of where the NIM, you know, kind of ended the quarter just to get a better sense of work trend next quarter at one in rebounds?

Mike Brierley
It was much more reflective of quarter one than the average position for quarter two; definitely on an upward trend.

Vernon Hill
And what was the first quarter?

Mike Brierley
2.02%.

Vernon Hill
2.02%, Mike.

Mike Brierley
So it's much more reflective of that.

Michael Perito
Okay. Great. Thanks. And then just around the expenses and the store openings. Do you guys expected, you know, the 20% to 25% percentage was helpful Craig, but do you expect a lot of that to be back end loaded again next year? And I guess, the reason I'm asking is because, I mean, I would guess most of the stores coming on in the second half of this year, the expenses are pretty much already in the run rate but just trying to get a sense of where the next few quarters could trend here on the expense side of things with the pipeline building for next year already.

Vernon Hill
So, the question is, where we are on the pipeline for stores next year and are they openings back end loaded in the third and fourth quarter, and the answer is, one of the reasons we're down on store opens this year is several of them have been pushed in the next because of the issues of development. To be fair, I've been doing this for a long time and developed 600 bank sites, and no matter what I do, they always open predominantly in quarter three and quarter four. We'll try to do better.

Craig Donaldson
And we have to do better. Let's challenge ourselves.

Vernon Hill
Anybody else?

Michael Perito
Like I just said, Vernon -

Vernon Hill
Yes?

Michael Perito
But I guess the expenses as they trend here, I mean, I guess, what's the lead up time? So, I mean, are the expenses going to start coming next couple of quarters for those stores opening in 3Q, 4Q, or will they be more heavy in the first half of next year?

Mike Brierley
So, Michael, I mean, I think the answer is that with the stores back end loaded this year slightly, we will see the expenses take off in quarter three and quarter four. We have massive positive draws on the P&L, so I don't think we're going to necessary see that to be reflected in the bottom line. But, certainly, expenses will be a little heavier in quarter three and quarter four.

Vernon Hill

And Michael, you and I think about like we do in America that the rent on a new store doesn't begin until you open the store. The British accounting rules, we have to start expensing the rent when we start the build. That combined with the people we have to recruit mean a lot of the expenses on new stores start months before we open the store. Anything else?

Michael Perito

Perfect. Thank you. Thank you, guys. Appreciate it.

Vernon Hill

Anything else on the web? On the phone, here? Thank you all for coming. Thank you for being involved. If you haven't switched banks, today is a good day. Thank you, all.