Metro Bank Q3 Results 2018

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Vernon Hill (Chairman), Craig Donaldson (CEO) and David Arden (CFO)

Presentation

Vernon Hill

Thank you. Good afternoon to the Metro Bank Q3 call. Good morning in America and good afternoon in Europe. Just a few comments, then I'll turn it over to our chief executive Craig Donaldson and our chief financial officer David Arden.

Quarter three is the beginning of year nine as we've ended the first eight years of the Metro Bank quest. We passed £20 billion in assets, 1.5 million people have switched their accounts to us and we're taking massive market share every day and every month. We're always proud to say that our growth—we're always proud to report our deposit growth per store where we compare it to the American deposit growth per branches and, again, this quarter our deposits converted to American dollars were approximately $100 million per store per year compared to the American average of $1 to $2 million. For the third quarter, our net income grew 200 percent. And with that, I'll turn it over to Craig.

Craig Donaldson

Thank you, Vernon. Hello everybody, welcome to the call. Let me just start by saying, you know, the model continues to go from success to success. We continue to be focused on creating FANS. And, for us it's all about acquiring our FANS and retaining them through the service that we offer across every channel. We've actually welcomed over 300,000 more customers to us this year, over 100,000 in the last quarter, and currently are opening over 1,000 retail accounts a day and almost 1,000 business accounts a week, a fantastic performance.

This is being driven by the service that we deliver, as I said earlier, and I'm proud. Just to bring it to life, the Competition Markets Authority independent review that was done that showed us coming second in both personal and business for overall quality of service. We're the only organisation in the top two across personal and business, and the only organisation in the top five on every single metric, showing that we're delivering for both our personal and business customers and showing that we are creating FANS.

To talk some numbers, our deposits were £14.8 billion up 38 percent year on year; over a billion in the quarter and £6.2 million per store per month in the quarter. A very strong performance again. Also, that was across our non-interest bearing liabilities, our variable deposits, and our fixed rate deposits, showing growth across personal and business and all of the types of liabilities.

Our lending engine really is delivering. We grew 52 percent year on year and delivered over a billion in organic net lending again. This drove our loan to deposit ratio to 89 percent. Year to date, we've trebled our profit from the same period last year where we made £13.2 million last year with £39.2 million so far this year. And that's as well as absorbing the £3 million of Tier 2 debt costs, which obviously were not there in quarter 2 this year.

Our capital ratios remain robust with a total capital ratio of 19.1 percent and a CET1 ratio of 15.7 percent and we continue to invest in building the bank. I'm very excited about what we're working with. We're working currently with 19 FinTech companies across a number of different API integrations, and we've just launched our new artificial intelligence-led money management tool on our mobile app for personal customers. It's been unbelievably positively accepted. We've currently only turned on about a quarter of the opportunities that are in there. And as we build this out, we'll launch it next year for business customers as well. And this forms the beachhead for how we'll interact and service our customers and be able to bring a number of new service offerings to our customers as we move forward.

Finally, we continue to build out our stores. We've opened our 60th store in Bath last week with great sunshine. We currently have nine more in build from Ashford to Birmingham. But we continue to build on our low-risk focus. We continue to build by winning customers, winning their low cost sticky deposits, and then lending that out to high-quality, low-risk opportunities. And we're making sure that we stick to that as we build the bank for the long term. David?

David Arden

Thank you, Craig. Hello, everybody. If I may, I'll add some colour to our key metrics. Customer NIM showed a slight increase to 2.21 percent. That's a one basis point increase quarter on quarter and three bps year on year, largely due to the increase in the loan to deposit ratio to 89 percent. Our cost of deposits increased 2 basis points to 61 bps, reflecting one month of the August base rate rise. We've passed on between 5 and 15 basis points to our variable rate savings customers. We are, though, seeing yield compression across asset classes and we see that most acutely in residential mortgages. Competitive pressures has lowered yields, even in the face of the base rate rise, and swap costs are at 2-year highs. Right now there is no sign of that pressure abating.

For clarity, the quarter on quarter reduction in overall NIM was entirely due to our Tier 2 debt servicing costs, which shouldn't be a surprise given the raise in June. Without Tier 2 interest costs, overall NIM would have moved in line with Customer NIM, i.e., a one basis point increase. And actually, we think that's a good result given the market backdrop.

That said, as a consequence of market yield pressures, management are focusing on other levers. What we won't do—and I'm being categoric—what we won't do is chase risk to drive NIM. We are a long-term growth business and so won't compromise long-term success by chasing short-term metrics. Our cost of risk remains low and stable at 6 basis points. That's 14 basis points below our 2020 target. What we are doing is focusing on fee generation and we are pleased with our fee performance in Q3. We have optimised some of our fee structures, developed new services, and are starting to see the benefits of our deepened customer relationships deliver. These initiatives should continue to slowly feed through to the P&L.

Finally, from me, cost:income ratio remained flat quarter on quarter. As you'd expect, we continue to face into the growing cost of regulation and continued investment in IT infrastructure and resilience, as well as the investment in our physical footprint, where we have nine stores currently in build. As we open these stores, they will start to make a positive contribution to our results. And without labouring the point too much, we also absorbed the full quarter of Tier 2 servicing costs, without which our cost:income ratio would have been 81 percent. Thank you, Craig.

Craig Donaldson

Thank you, David. So, I think what we're trying to show here is that our results genuinely demonstrate momentum in the business, and that we're actually winning our customers on service and convenience, and not price and not risk. If you look at that, just to bring that to life, our cost of deposits are now below base rate. People talk about our cost of deposits being between—below a 3-month LIBOR but they're actually below base rate now. And that shows you that we're winning as we offer our service integrated across all channels.

So, it's working. We're winning FANS every day across the U.K., we're doing it profitably, and we're doing it for the long term. And we're making the best investment and lending decisions at the right risk to maximise future returns. So, may I hand it over to Vernon?

Vernon Hill

Yes. And we'll begin taking questions now, please.

Q&A

Nicholas Herman

Two questions, please. Firstly, on deposit costs, so deposit betas have been very low since the recent rise in base rates. I just wanted to ask you about how you see the outlook for competition for funds evolving—I mean, obviously, since Marcus launched in the U.K.? So that'd be the first question. And then, secondly, commercial loan growth was a little bit slower than I was expecting this quarter, given your ongoing emphasis on how you're pivoting toward commercial. So, I'd be interested to hear about your comments about your outlook for that, please. Thank you.

Vernon Hill

Nick, Craig's going to answer the second part but I'll answer the first part. Marcus has no affect on the Metro Bank model. It's a model driven totally by rate. It's a company that can acquire business only by being a high rate payer. We acquire our deposits with service and convenience. We see no impact from Marcus at all. Craig?

Craig Donaldson
No, just to strengthen that, you know, our instant access account is running at 0.55%. Now, we put up by 15 bps in the last base rate move. Therefore, we attract customers who want the service and convenience that we offer across all of the channels integrated. There are a number of players out there currently offering 1.3-1.4 percent and I would suggest to you that customers that wanted the 1.3 or 1.4 percent previously would be the customers that were there and are the type of customers that will go to Marcus, not the type of customers that would've come to us.

Vernon Hill
And on this subject of deposit costs, I want to remind everybody that we have a very high percentage of non-interest bearing current accounts. And commercial accounts are 54 percent of our deposits. Is that correct on that?

Craig Donaldson
Yes.

Vernon Hill
Those are very big and great numbers.

Craig Donaldson
With regard to the commercial comment, Nick, actually we are seeing a pivot to commercial but actually it's been much stronger in current accounts, in NIBLs, as Vernon said, and in the fee income that we're earning. We're winning a large number of customers, which is great, and that's what we want to do is build the relationship. And we're also looking to do their lending but we're doing it at the right risk and we're focused in the right way for the long term. But that's it, really.

Vernon Hill
Okay, thank you, Nick. Next.

Nicholas Herman
Thanks a lot.

Rob Noble
Morning. Just on the mortgage markets and compression that you highlight, can you talk about your hedging policy and how it differs from the large banks and whether we should be worried about the recent—particularly going into Q4, the movement in the swap rates and should we be worried about that? If spreads stay at the current levels, which you've highlighted, is a pressure you don't see abating, how big an impact would that have on your 2020 guidance of circa 3 percent Customer NIM plus fees? And what levers are you pulling on the fee side to kind of offset this pressure? Thanks.

David Arden
Thanks, Rob, it's David here. On swap cost, it's not something—whilst the market focuses on and prices off swap cost, we don't. We're naturally hedged. So, as Vernon said there, we've got 30 percent of our deposits in NIBLs and that allows us to naturally hedge the balance sheet. So we're not playing in that part of the market.

On yields going forward, as we rightly point out, we're focusing very heavily on fees and fee accretion and optimising our fee structure. We've done various things in terms of delivering new services, forex in particular for our customers. And the lag effects on deepening customer relationships is now starting to play through. And so we're reasonably optimistic around fees going forward.

Craig Donaldson
And if I may Rob, as well, it's quite interesting. You know, when we look at quarter 2 this year, you know, so you had the base rate move towards the end of the last year; we then saw the base rate, sorry mortgage rate, start to move up in quarter 2. We saw a 12-18 bps increase across all the businesses we were doing. We anticipated that continuing, as we entered quarter 3 we continued to see that. We then had a base rate move in August, as you know, and we did not anticipate that rates would move down in September.

Now, is that a short-term move, is that a long-term move? I think the next 8-12 weeks are going to be very, very interesting. But what we'll be doing is focusing on fees and managing our risk-return in mortgages. But we have lots of opportunities on fees as we leverage our technology stack, leverage things like Insights, which I mentioned before. But we are watching the market very carefully whilst making sure that we put in place things that will drive this business forward for the long term.

David Arden
And just to close that out, I would remind everyone that our cost of risk remains very, very low at 6 basis points.

Craig Donaldson
Which is below our guidance that was 20, obviously.

Vernon Hill
Thank you, Rob.

Rob Noble
Great. Thanks.

Joseph Dickerson
Thanks for taking the question. I guess a couple of things. If I landed from Mars and I looked at the net interest income growth in the quarter, it doesn't really lag that much behind the asset growth. I mean, I know the LDRs moved up. But on the fee side, the year on year growth was 26 percent. I'll just ask the question—the prior question a slightly different way. Do you think through the steps that you're taking to optimise fees in the backend of the year here that, you know, on a 12-month view, that that fee income growth could get closer to the asset growth that the bank is seeing? Number one.

And then, number two, as you look at your new branches, obviously income from safe deposit boxes has been a big part of the story in terms of how it covers the rent and utilisation rates. Are you doing anything new with that strategy in the new stores? Are you putting more in? Less in? What are you seeing in the existing utilisation rates—

Vernon Hill
Yeah, hi, Joe. I'll answer the safe deposit—

Joseph Dickerson
I'm not asking anything on Marcus, Vernon. Don't worry. I get it.

Vernon Hill
No one ask anything on Marcus. Yeah, the safe deposit boxes are still strong. We put them in—the number we put in depends on the area the store is in and to some extent the size of the store. So, we maximise them where the market is there, where we have the space.

Craig Donaldson
What we have learned, though, Joe—you know, I'm sitting above the Holborn store today and we have 1,254 boxes all sold out. So nowadays, you know, and Cheapside have 1,252 boxes all sold out. We do put in more boxes now on average just because we now know the market and we know how the market performs. So we have learned as we've built and that definitely will be driving fee income. But, David, do you want to comment on the first question?

David Arden
Yeah, absolutely. Hi, Joe. You're quite right to point out that the fee growth has lagged asset growth, and that's part of the model really. As we deepen our relationships with customers, that creates a natural lag effect. But we are starting to see that catch up and point into the initiatives I highlighted earlier. We would hope that gap closes into 2019.

Vernon Hill
And also, Joe, the more commercial business we have, as you know, the more fee revenue we generate. That's another reason why a high percentage of commercial business is important.

Joseph Dickerson
Great. Thank you.

Craig Donaldson
Thank you, Joe.

Ian Gordon
Both in relation to the effect of store openings on other metrics, clearly we can see that you're accelerating the pace of store openings and we can see the fairly linear correlation with customer deposit gathering running at 6.2 million per store per month. In relation to loans, obviously the last quarter was a new record but can you just talk a little bit more about how you see loans developing? Are they as directly linked to store openings or is it a slightly less correlated relationship given the direct sales? And then, secondly, a similar theme. Obviously, as the network expands we can see a constant quarter on quarter improvement in cost to assets, cost to loans, the cost:income ratio. Again, can you just provide a little bit of commentary on how you expect maybe the absolute cost number to evolve over the coming quarters driven in part by the current pace of store build-out? Thank you.

Craig Donaldson
I'll take the first question Ian, and I'll let David take the second. So, there's no doubt when we're looking at consumer lending and when we're looking at commercial lending, stores play a very large part in how we grow those, and they are linked. Commercial lending is also linked to regional entry. So next year when we enter Birmingham, we'll be creating a new marketplace in which we can work. So it's not just stores; it's markets. And I think the U.K. has a number of very vibrant markets that we'll be looking to enter over the growing periods.

Within mortgages, obviously our direct offering is strengthened by our store footprint but we do deal with brokers. We have very good working relationships with a number of brokers who we like to bank as business customers as well and, therefore, that's less dependent on the stores. But what we do see is where we have a store close to brokers, because our brand plays through so strongly, we do actually see a pickup in broker business as well. Because I think the brand resonates and the service delivery resonates.

So stores absolutely correlate in commercial and in consumer. Less so in mortgages. But the brand is the thing that plays through across every channel. And our stores are the physical representation of our brand.

Vernon Hill
And just one comment on the brand. We can remember the first four or five stores. We'd open, people would come in and say who are you, what are you, what's different? As we saw in our store that opened in Bath, everybody knows the Metro Bank brand and all we get is thank God you're finally here.

Craig Donaldson
David?

David Arden
Just on the stores. So, clearly, the pace of growth—and there's a significant cost of growth through the P&L right now. That will continue. But as the business grows, the absolute proportion number of that store growth will lessen as an overall proportion of the cost base and, therefore, you should expect over time for the absolute level of growth in cost to slow, which will drive ultimately, as the P&L gears, in an improved cost:income ratio.

Craig Donaldson
And on the other side what you have is you have more mature stores. And as older stores have been coming and gathering maturity all the time—and I know lots of people who have seen the Ealing page that we have in the deck we present, it's actually the maturing stores that drive the revenue line, and the new stores that drive the cost line. And as we have more maturing stores, that's what creates that—

Vernon Hill
Let me just say one last thing. I'll translate for the Americans what David Arden said about store costs. The losses in the new stores become a decreasing percentage of our cost base as the stores, as the number of stores, get bigger.

Ian Gordon
Yeah, that's great. Thank you.

Robert Sage
Thank you for taking the questions. I've got one sort of bigger picture question, then a couple of sort of really quite fine detailed points, if I could. The first question is just sort of listening to your commentary surrounding deposit costs going up a little bit, presumably they're running slightly above that in the fourth quarter to date and the continuing asset pressure and then sort of looking in terms of your 2020 sort of customer margin target. I was wondering in sort of principle whether we should expect to see probably most of the actuals sort of ramp up, sort of coming towards the end of that period rather than a progressive increase in terms of margin enhancements, sort of over the course of the next couple of years or so.

And the second and third points—just really small points. First of all, there's quite a large net gain in sale of assets coming through in Q3—are sort of slightly bigger than you've seen in recent periods. I think it's about £4 million. I was just sort of wondering whether there's any particular commentary around that.

Craig Donaldson
Let me take the starter on the deposits. I mean, we finished the quarter at 61 bps. I think it's fair to say that only had one month of a base rate move in. We only passed on the base rate move at the beginning of September. So, if you were to use a straight line, that would tell you what you would expect from our cost to deposits in Q4. I wouldn't anticipate it being much more than that, if at all, so a very stable cost to deposits as we continue to grow significantly, which is the basis of the model that we're building.

I think your question around how we then trend forward, I think David said and I would support it, as we drive deepening relationships with business and personal customers, as we win more business customers—as I said, you know, almost 1,000 a week at the moment—and as we launch new services for our customers, I would expect to see the fee income pick up. And on the margin, my view would be—it's going to be, you know, the next 6-8 weeks is going to be very interesting as to how that moves forward, but I would expect as we continue, you know, the loan to deposit ratio is at 89, I expect it to oscillate around 90 as we go forward, so there's a little bit of play in there. And there's also a little bit more play to play through from the rate moves we had that should play through into the margin as well.

So I think that you'll see some move up during next year. I think fees is the place where we're pushing harder and we can control fees more. We can launch services more. There'll be a little move in the margin but it'll be interesting to see what happens in the mortgage market, I'm afraid.

Vernon Hill
But isn't it true, Craig, that we've had sort of a funny blip here where the base rates have gone up and the mortgage rates have gone down?

Craig Donaldson
It's not normal, that's for sure.

Vernon Hill
Right. And we shouldn't expect it to be normal. It's very unusual.

David Arden
Just to close out Robert - on gains, there's no particular commentary to point out. We see gains on sales as a normal part of our business, and the gains themselves are relatively small in the context of our overall balance sheet. So, no particular insight.

Vernon Hill
Thank you, Robert.

Robert Sage
Thank you.

John Cronin
Thanks for taking my call. Firstly, just on the net interest margin, would you look at, and Craig, taking into account your comment just made around the loan to deposit ratio hovering around 90 percent—would you look at turning off deposit growth next year potentially for a period of time to recycle excess liquidity, which would provide a dual benefit in the form of improved NIM from

having lower treasury assets, but also higher NIM by virtue of slowing down deposit growth—or higher net interest income, in fact?

Vernon Hill
All right, John, let me answer that. John?

John Cronin
Just from a profitability perspective and to give you the background on it, it's because—I'm getting to 12.1 percent CET1 ratio before today, by the end of next year. So my numbers are telling me now, given this third quarter development, that I can't see how without AIRB you will be able to manage without another equity raise next year unless you do something like this.

Vernon Hill
We're in the customer acquisition business — the value of a customer is just not their banking relationship with us but the relationship with the client. So, we always gather deposits on service and convenience. We're not the high-cost deposit payer, and I don't see any plans in our future to change that plan.

David Arden
On AIRB, John, as you've seen from our release this morning, there's no new news. I'll point you towards our half two guidance. We expect AIRB in H1 2019—sorry, H2 2019, and we are very comfortable with our capital plans for 2019.

John Cronin
Okay. A follow-on question just on the fees. So, you mentioned safe deposit boxes as one of the sources of strong fee income growth. Just so I get a complete understanding here, safety deposit box income was 9 million in FY '17 which was up 30 percent year on year versus loan growth of 64 percent and effectively it represented 3 percent of total income. So, you know, it's now jumped by £2m in FY '17. You know, to try and match that up with the growth rates you're recording and fee income, it seems to me that most of the growth is coming through bank fees levied on your customers. Is that correct or am I missing something?

Craig Donaldson
No, I think that we are seeing good growth in the safe deposit boxes and, obviously, as we open our stores at the backend of the year, we see a kick-up in that fee income. I would say you're absolutely right, we are winning, like we said—we are winning so many more business customers. We're deepening the relationship with the customers we've got and, therefore, earning fees on the transactions that we have with them.

And, you know, as we build out the service fees for the business customers using our APIs as well, we expect that to continue. So I actually see it as a very positive—it is about bank transactions, it is about FX, and it is about us fulfilling services for our businesses and deepening that relationship for the long term. Thank you, John. Appreciate that.

Christopher Cant
Thank you for taking my questions. Craig, if I go back to the 1Q call, you stated that you expected the gap between Customer NIM and headline NIM to be significantly, significantly closed by the end of 2021. But, obviously, we've seen the gap open up a further 8 bps this quarter due to that 250 million Tier 2 issuance. And it's now the widest gap that it's been, despite the fact you didn't do any further TFS drawings in the last couple of quarters.

On my numbers you're going to need more than £2.5 billion of combined AT1, Tier 2, and MREL senior issuance to meet the final MREL rules by the end of 2021. And so I don't see how you're going to get that gap much lower than about 30 bps in 2021, which I don't think is consistent with your earlier statement. Am I missing anything there, please? And in addition, you've issued the Tier 2 from your operating entity but you're almost certainly going to become a full bail-in firm over the next couple of years. Now, I think you're going to be required to set up a holding company as a consequence, meaning, you have to reissue that debt from the new entity. Your Tier 2 bond documents say that the bonds can be redeemed at par on a capital disqualification event unless the change in rules was reasonably foreseeable. I would say that a Holdco is reasonably foreseeable, but given that you've decided to issue from an Opco I can only assume you disagree with that. Could I therefore please ask in the event that the regulator requires you to move to a Holdco structure in the future, would you consider that to be a capital disqualification event enabling you to par call the existing Tier 2 and any future bonds you might issue with equivalent clauses?

Craig Donaldson
Thank you, Chris. I'll hand you over to David.

David Arden
Thank you, Craig. Chris, just on Holdco, you know, we're currently in consultation. I think there's a consultation going across the market on the requirement for a Holdco. We'd like to keep things simple. We are a simple bank. We don't want to put any complexity into our operating structure. That said, if we need from a regulatory perspective to have a holding company, then whilst that would be an inconvenience for us, it's something we can manage through.

On the convergence between NIM and Customer NIM, over the long term they will converge. You're right, though, to point out that MREL will continue to play into NIM, however, that will become a lesser portion as the business grows and they will naturally converge over time.

Craig Donaldson
And I would say I don't—I think our capital planning, we didn't come back to John either. I think our capital planning we're very comfortable with for next year. And we're very comfortable that the £2.5 billion you've raised are not numbers that we would recognise over a course of our growth. So, our view is very simple. That, one, we are anticipating fulfilling, of course, all of our regulatory requirements next year, our capital planning and scenario planning says we can do that and we will. And I do perceive that by the end of 2021, we will have started to see a closing because we won't be needing to raise £2.5 billion of CET1, AT1, and MREL. That's not the numbers we have in our long-term planning horizon. Thank you, Chris.

Christopher Cant
In terms of your—

Craig Donaldson
Oh, sorry, Chris. Go ahead.

Christopher Cant
In terms of your issuance plans, though, I know you've said that you're going to do 1 billion by 1 Jan 2020, I think from memory, in total, including the 250 you've done. But my understanding was that that was just to meet the interim rules, and the final MREL rules are obviously more onerous. So when you say that you don't recognise the number, are you comparing to what you think you need to issue to 2020 or what you're going to need by 1 Jan 2022? Obviously, 1 Jan 2022 is what I'm referring to here.

David Arden
We're getting into a slightly technical point here, Chris, but the difference between the interim and full MREL for us, given our very low pillar 2A is not that material.

Craig Donaldson
Yeah, so by the time we fulfil the interim, actually we've already climbed sort of the mountain on that one, because the actual addition on top of, the full transition for us is fundamentally a smaller amount.

Christopher Cant
I guess the issue is, though, given your pace of growth—you know, you're saying you need 1 billion by 1 Jan 2020 if you're balance sheet's growing 20 percent plus compound from full year '19 to full year '20, to full year '21, obviously that increases the requirement in addition to needing to meet the higher percentage requirement of the final rules. Hence, why the bigger number.

Craig Donaldson
Yeah, but perversely, actually it's a smaller number as you look forward than we've got to do next year. So we're forecasting, I think we put at half year, circa £700 million. And that's a very big number as we look forward to full transition we don't need to do again. Is that okay, Chris? Happy to take it offline, but thank you very much for the questions.

Christopher Cant
Thanks.

Michael Perito
Good afternoon. Thanks for taking the questions.

Craig Donaldson
Hi, Mike.

Michael Perito
I had just a couple I wanted to hit. A lot of my questions have been answered. But, obviously, as you guys think about your longer term targets, especially on the ROE, it doesn't sound like there's been any real change. But I'm curious, if you could maybe give us a little bit more insight on to where you think is realistic more near term. Like, as we look out, obviously 2018 is coming to a close in a couple months here and we look out to next year—I mean, in the current margin environment, what do you guys perceive with the growth you're seeing, as kind of a realistic profitability improvement figure that we should be expecting from you guys next year at this point?

Craig Donaldson
Mike, I really can't answer that because we don't give forward guidance at this point. And, you know, we are focused on our 2020 numbers. It's never linear, but we're seeing, you know, we are winning customers, winning their fees and doing the lending. It'll certainly be higher if the mortgage market moves up but, as I said, you know, we are very focused and driving towards our 2020 and 2023 targets, and that's where we are.

David Arden
Yeah. I would reiterate that, Mike. We're deeply committed to our 2020 targets but we are also very, very focused on building a long-term successful bank here.

Craig Donaldson
Do you have another question, Mike?

Michael Perito
Yeah. I understand you don't want to give the guidance, so I apologise for asking the question that way. Maybe let me rephrase. I mean, I guess in the current mortgage environment is it realistic to assume that you guys can drive ROE improvement? Or, I mean, is this something where, you know, it could have more—I guess to use a U.S. phrase—more of like a hockey stick look where it's going to really take getting to a certain point of scale later in the outlook to really start seeing material improvement?

David Arden
Yeah, I think that's absolutely the way to think about it. As we build scale, both on the balance sheet and through the cost base, then you will see returns that accelerate through time. But the harsh reality for us right now is that we are subjected to the theory of small numbers. You know, I gave you the example of our Tier 2 debt costs and they were relatively small in the quarter but they had a 3 percent impact on cost:income ratio. And that's - as the P&L, the balance sheet, and customer number scale, those things will become less important for us.

Craig Donaldson
And as our existing stores continue to power through with their maturity, that plays in very, very heavily as well, Mike. And I will say, of course, we keep banging on about it, I think is the technical term, is that, you know, the beauty is, as we continue to win more of our business customers, we continue to be able to offer more services to them and therefore, yes, there is, of course always a hockey stick, but we're well into maturing that hockey stick on the fee side as well. Is that okay, Mike?

Michael Perito
Okay, great. Yes, that is helpful, thank you. And then just, you know, as it relates to, you know, I didn't see a slide deck, I might have missed it for this quarter, but I remember last quarter you had the investor deck and you had the Ealing store and, you know, if you did the quick math I think it was fairly easy to see that that store was producing over a 20 percent ROE individually if you made some capital assumptions around what the store required.
I guess my second question here is, are you guys able to kind of tell us how many stores today are kind of at that level of production?

Craig Donaldson
The honest answer is I'm sure we can do it, I couldn't tell you off the top of my head. Let us take that away as something we can factor into thinking about for the full year results and how we may be able to bring that to life for you, Mike. And forgive me, I don't know the answer off the top of my head simply because it's not something I've looked at. I look at the growth and the contribution. But let us back into that and see what we can do for you.

Michael Perito
All right, perfect. Thanks for taking my question.

David Arden
Ealing's an average store and we've got a handful of stores that are making a negative contribution, as they've only just opened today. The vast majority of our stores are positive contribution.

Craig Donaldson
Thanks, Mike.

Michael Perito
Thank you guys. Appreciate it.

Kamran Ali
Hi, just one question for Vernon. Do you think PEG ratios are important for Metro? I'm looking at Amazon's PEG ratio and it's 1.6 and Metro is at about 0.6, which seems to be quite cheap.

Craig Donaldson
Vernon's not here. He had to leave the room. All I would say, if I may, is I think that's a very fair challenge and I wouldn't disagree with you. Thank you very, very much.

Kamran Ali
Thank you.

Aman Rakkar
Craig, you really helpfully gave us an illustration last quarter, you know, plugging the gap on your Customer NIM plus fees getting to three percent from the current level. Basically another 10 percent to go from here. I think you really helpfully provided an illustration. I think you said about a third would come from an increase in the LDR, tilt to SME, a third from the rate hike benefit, a third from increased fee penetration.

I mean, given another quarter has passed and we had delivery of the rate hike and the benefit come through and obviously the yield environment in U.K. mortgages is tough. Could you update us on that? Is that still your thinking or have we actually—are we requiring a bit more from the other levers that you're talking about?

Craig Donaldson
I think as we see the continued challenge into the mortgage market I think that we continue to have to push into fees. We can see our way to doing it and, what I want to make clear is, when we say our push into fees, I'm talking about our push into offering other services. You know, we want to create FANS. This is about us widening out and deepening the relationship with our FANS. So, therefore it is about what we're launching to our FANS, but there's no doubt with the mortgage environment the way it is, not just because I think it's been well covered by most banks that have spoken in the last few weeks, there's no doubt that we need to pivot more towards driving our service delivery to our customers and that's what we're doing.

Aman Rakkar
Thanks for that. Has the rate hike benefit come through to the extent that you were thinking and hoping for when you gave that update a couple of months ago?

Craig Donaldson
Not fully yet. Let's talk in a little bit of time. It takes a little bit of time for these things to come through. We've only seen 30 days of it.

David Arden
And to be honest, the reality is base rates went up and mortgage yields went down, which is slightly perverse so we're facing into that new reality.

Aman Rakkar
Okay, thank you very much.

Craig Donaldson

So, could I just say thank you to everybody who has joined the call. We do appreciate your time and we also appreciate your continued support. Thank you to everybody who asked questions as well. We do appreciate it, ensuring that we've got clarity out into the wider market.

I just want to finish by saying, you know, we are building something for the long-term. I sit above our Holborn store where 67 of us were in the bank when we opened the doors downstairs with no customers at half past seven on 29th of July 2010. Today we have over 1.5 million customer accounts. We have over 3,700 colleagues who work hard every day to build a bank that creates FANS and that's what we're doing and we're doing it profitably and we're also doing it for the long-term. So thank you for your support. Thank you very much.