Metro Bank Full-Year Results 2016

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

Presentation

Vernon Hill

Good afternoon, everybody, and good morning to our friends in America. This is a combination live meeting, webcast and a phone call also. So, we're talking to our fans in every media we can find. Again, my welcome to all of you. This is the end of our first year as a publicly listed firm, and we're just ending our sixth and a half year, as Metro Bank started and launched in 2010.

Joining me today is the Chief Executive Officer of the bank, Craig Donaldson; and the Chief Financial Officer, Mike Brierley. Both have been with me since before the bank started, as we had the dream to build an idea from Britain to completely change British banking. I'd like to introduce my wife right here in the front, who is the keeper of the Metro Bank brand, and the thing that you all came to really see is my puppy Sir Duffield; more people know him than they know me!

We're pleased to report on our results for the year and our results for the fourth quarter. Momentum grows and grows and grows; we had a great year and a great quarter. As of the end of the year, our assets grew 64% to £10 billion; our loans grew 66% to £5.8 billion; and we're pleased to report that our loan-to-deposit ratio grew to 74%. First thing to note is deposits are the core of our service and convenience model, and we're pleased to report we had another great year and a great quarter; at the end of the year, our deposits had grown to £8 billion, a growth rate over the year of 56%.

One of the numbers you see us report, because we think it's important, is our deposit growth per store per month, and in this past year we set a record of growing £5.7 million in deposits per month. That's £63 million a year; converted to American dollars, that's $79 million a year in deposit growth per store. The average deposit growth in an average American bank is $1 million; we're growing 79 times the American average.

We're proud that all this happened as we managed to reduce our cost of deposits from 0.87, when the year began, to 0.63 in the last month of the year. Customers bank with us for service and convenience, not for price. We're certainly fair about our price, but we're delivering a unique service and convenience model. We are also proud to say that our deposit accounts today total over 940,000 accounts, in a country where the press loves to say, 'You Brits won't switch banks.' Almost one million of you have switched to us already. Thank you. The other number we're very proud of, in our very short life: our brand recognition in Greater London is 84%. Everybody in London knows the Metro Bank brand.

As to income, the fourth quarter was our second quarter of turning into a profit. We reported a £1.5 million underlying profit before tax, and you're going to see our profit numbers grow as the banks grow. We've announced our growth targets for 2020; we remain confident in those targets. This is a dynamic growth model that happens to be a bank. We encourage you to look at it not through the eyes of bankers, but how we have and will build a very unique worldwide brand as a growth retailer.

With those comments, I'm pleased to turn it over to Craig.

Craig Donaldson

As I'm now used to, after eight years, following Vernon, he's now presented the speech that I'm going to give. Some things do not change, you'll be happy to know. I wanted to start very quickly: the key thing we said at the half year, the key thing we said when we would lift was that we would grow into profit on a month-by-month basis in 2016. I'm being subtle, I know, but this subtle graph is just to show you that we achieved that, and we're very proud of it at a time when we invested over £100 million in store development, colleague training and technology, that we turned into profit at the same time as that investment in our growth.

When we look – and you will see a lot of the slides are very similar to what we presented at the half year, because actually what you're seeing is that consistency in our delivery, and our consistency of what we're talking about. Vernon mentioned the £8 billion of deposits; definitely the £5.7 million per store per month is a very strong number. The best number we've delivered, and we continue to grow year on year.

And the record deposit growth was followed by record loan growth. And actually, our loan/deposit ratio going into 74% is an absolutely key number. We talked about, by 2020, getting to 80%; that's 5% improvement. A lot of the questions we've had previously are: can you lend? Can you actually get up to the 80% loan-to-deposit ratio? I think this is telling you yes: record deposit growth, record lending growth, and that record lending growth improving the loan-to-deposit ratio by 5%; that is very strong.

Vernon talked about the brand recognition: key for us. We do not pay incentives for people to join us, we do not go out and spend fortunes on advertising; we win our customers because our fans tell their friends and colleagues they should bank with us, and the recognition is the key to doing that, followed by the net promoter score which is consistent. And that's a consistency of delivery as we grow the bank significantly. Some of the questions we get asked: what about if you get big, will you be as bad as others that I won't mention? Well, I think the fact that we are consistently delivering a 75–80% net promoter score shows you that, as we grow, we will continue to deliver unparalleled service and convenience, because that's what this model is about.

And then for me, the one I really want to draw out: I am so proud that we won in 2016 the most trusted financial provider from Moneywise. The last five years that has been won by First Direct; the two years before that, it had been won by Nationwide. So, I'm really proud that we are the most trusted financial provider in the UK. When you add that to the net promoter score and the brand recognition, it's a great set of results for 2016.

So, we continue to grow. Vernon mentioned our cost of deposits: we started 2016 with 87bps, we finished the year at 63bps. The 24-bp reduction in cost of deposits, 12bps of that was through the reduction in the base rate, 12bps of that was due to management actions taken to reduce the cost of deposits. That reduction in the cost of deposits was done at the time we delivered the £5.7 million per store per month in growth, showing you how we manage the book, we keep winning the fans and keep building the deposits.

I'm not going to go through every bullet point; you don't need me to. Just to say that we start the year on our deposits in a very strong position, and that strong position on our deposits – 63bps into 2017 with strong growth – means we can continue to lend at low risk. The deposits are the absolute foundation of this model, but it allows us then to lend. So, as you can see, it's been a little bit repetitive: we've continued to grow our loan-to-deposit ratio to 74%. And for me, the key thing is, with this lending that we've done, our risk has continued to be exceptionally strong. I draw out the cost of risk being 10bps. I know that's something that has agitated one of two people, that we said by 2020 our cost of risk would be below 20bps; we continue to give out.

And for me, if you look at the early parts, the early calls, it's actually the debt-to-value. Our debt-to-value is lower now, which means that actually, the risk of the book is even stronger. So, our debt-to-value on the residential mortgage lending is down to 58%; the debt-to-value on our commercial lending is down to 57%; and our buy-to-let lending down on debt-to-value to 56%, meaning a significant amount of equity in our lending to cover any risks that we carry.

One thing that's not on there that I will say is commercial and resi development: we've got less than £10 million of resi development; it's significantly less than £10 million, but we have less than £10 million. So, out of a £6 billion lending book, I'll let you do the maths. I think we will technically say it's small. So, I'm very proud; at the moment, we're running around 36% commercial lending. Now, 2020, we still want to drive up the commercial lending to 40%, and we will do that. We'll continue to do that. Mike?

Michael Brierley

Afternoon, everybody. Good morning if you're in the US. So, now I'm following Vernon and Craig, so they've definitely stolen all of the best numbers, there's no doubt about that. Let's look at the balance sheet, there's a few things I think worth saying here. Clearly, you're looking at an intrinsically liquid balance sheet; we had a liquidity coverage ratio of 138% at December. Two reasons, really: one, that we're conservative; and secondly, of course, we need it to fuel the growth. We haven't changed our conservative approach to investing surplus deposits in our investment portfolio: 84% of it is AAA rated RMBS and covered bonds, gilts, treasury bills and, of course, cash. One new line up there in the middle of the balance sheet, deposits from Central Bank. What is that? That is the term funding scheme, that's the new Bank of England term funding scheme. We drew just over £500 million by the end of the year, and we will continue to increase that throughout the year. We're paying our drawings from the previous funding for lending scheme. Why would we do that? Because the new scheme is even cheaper funding.

Our capital ratios remain strong, well above regulatory minimums. And, of course, we still have the opportunity of moving to AIRB; we're currently on the standardised approach to measuring credit risk, as most of you know. The work on that project is progressing well, we have a very good dialogue with the PRA and the regulator. We're certainly aiming on submitting our waiver application by the end of the year for residential mortgages, but the timing of AIRB, of course, is then – we're not the only ones in that particular conversation.

Turning to the P&L, we made a profit in the second half of the year. I've waited a long time to be able to say that, and I'm really pleased to have got there. And what drove us to that was, of course, the strong positive jaws in the P&L that we've seen in previous quarters. The revenue, we've already talked about it: 62% up year on year, and the operating expenses up 26%, and I'm including the depreciation and amortisation there. And it's those jaws that have driven the profit, and they will drive us on to our first full year of profitability in 2017, as both Vernon and Craig have said.

Its worth, I think, pausing on two other numbers: the net interest margin down in the bottom, 2% on average in 2015 and 1.97% in 2016, a slight slip back. A lot of that was to do with the lag effect of the base rate change, the move down in the Bank of England base rate in August; that knocked a few basis points off, otherwise I think we would have been flat. A very good signposting to where we're going, however, is the fourth quarter NIM of 2.03%, and that will continue to go up driven by rises in the loan-to-deposit ratio, and also some of the moves in the funding, particularly the move toward the term funding scheme.

Cost of risk is low, as Craig has said, and it's stable. These are Craig and my favourite two graphs; we fight over who gets to present these. We've decided to call it a draw today, and I get one and he gets one. The top slide: again, we've shown it before, it's quarter on quarter. The blue is stores making a profit. We think like a retailer, therefore we measure the profitability in each and every store. And the red are those stores, new stores, who are still loss-making but moving towards profit. You can see the clear trend from quarter four 2015 down to quarter three, the shrinking red and the rising graph. Notice a small tick-up in fourth quarter 2016; we opened a number of very good new stores towards the end of the year, and that explains the tick-up. They will move towards profitability through 2017. But the key, of course, is that all stores that have been more than 18 months are in positive contribution and are continuing to grow. I can't but want to point out the third bullet point here, which is to say deposit boxes: we've put that metric up before, it's very, very stable. Stores open more than 12 months, more than 80% of the rent is covered by safe deposit box rental. It comes in every month, God bless it.

Craig Donaldson

Following Mike now, you can see the handover is smoothly done. The thing I want to draw out was, then, the annual cohorts at the bottom. You'll have seen this before, many of you. The cohorts continue to start faster, start bigger and to continue to grow. Whether you're looking at 2010 through 2015, they are all growing. And this is not about the new stores driving profitability; the existing stores are the powerhouse for the organisation. Our stores make more, grow more year on year on year, but the actual unit cost that goes into them does not. And I know one of you in the room talks about the unit metrics, and it's absolutely spot on. That is the key to this. Why does it get better? Why do stores start bigger and grow faster? The network effect: as you saw earlier, the 84% brand recognition, that plays massively. And also, the fact that we are getting better; we are learning, and we'll continue to get better and we'll continue to learn as we go forward. Obviously, I can't go without speaking about 2016: well, it's started bigger and it's growing faster. Some of the stores won some very good, big commercial relationships on the back of some of the things we're doing, kind of what we said the model would be.

I love this chart, it is my favourite chart: we just keep growing, and we will keep growing, and we'll keep expanding. We have 48 stores open now. We opened – I believe it was six in around a ten-week period, proving that we can do it and we'll continue to do it. We'll open between 10 and 12 this year, depending on planning and builders; I'm sure the builders will work as hard as they can, but depending planning and building. And we've just put a list down here of some of them that will open over the next definite 12 months, and if not this 12 months, definitely the next 24. My joke is normally I've promised my dad we'll get to Sunderland at some point; it won't be within this time horizon, but we will be as north by the end of next year as Birmingham, as far west as Bristol. And actually, I think we're going out to Cardiff in April to have a look at sites there as well.

And the reason we're doing that is so we grow in the right way. We have two stores in Milton Keynes today, we're looking to open a site in Northampton later this year, and we'll take colleagues from Milton Keynes, our great colleagues who live the culture and create fans every day, and they'll be part of the store when we open in Northampton. And in that way, we ensure that we always deliver the model, and that's the key to the growth: deliver the model. But it's got to be integrated, and it's got to be across every channel. It's not just about face-to-face and it's not just about technology, because that's not the way customers think. Customers don't think like that. Customers think about what they want and how they can get it, and therefore for us it's how we integrate all of the channels together to create the experience that customers tell us what they want. And so, we said we'd deliver on best in class, the Apple Pay, the Android: everything we said we'd deliver has been delivered. A few weeks ago, we were trending on the App Store for Apple; I don't know how many banks trend on the App Store. My son told me: he's nine, he was very excited. So was his dad when he told him, to be clear. We actually, at the moment, when I checked just before I came in here, have the highest-scoring bank app in the UK on the App Store as well. That's what we said we'd do: we said we'd invest, we said we'd improve and we'll keep doing it and we'll keep growing.

On the right-hand side, I've got what's coming this year. So, we are going to be opening accounts online before the end of half one, is the plan, with a state of the art 'selfie' Again, I did have that explained to me, obviously. We're going to be talking about personalisation and how we can bring banking to life through the mobile app and through other channels, more to the customer, and using behaviour metrics to drive our fraud management and to make life easy for customers again. The things below that, our API layer, looking at open banking; PSD2 coming in 1st January 2018, doing a lot of work in that area, as we will be on our packaged account offering and also on our unsecured lending platform. But we'll talk to you more about those at the half year.

Last year, we invested over £100 million in driving the investment in the growth, and we went into profit. This year we will be profitable across the full year, but we'll continue to invest circa £100 million, because it's a long-term model and we want to better every day, every week, every month, every year. And that will get better as well, because of the long-term investment and the culture and model; that's the key.

So, as far as we can see at this point in time, we have absolutely no reason to change our guidance. We're very happy with where the business is. We start 2017 in fine fettle. In fact, I'm quite chuffed with where we are. Sorry, a Northern vernacular for those in America, from where I live. It means I'm very happy; I'm very happy, I'm chuffed! And we see no reason to move away from our 2020 guidance. We will go into full-year profitability; that is our plan, and we expect to do it this year. And we will grow and deliver the 2020 targets that you see on the screen. We're going to do what we said. We've done what we said we'd do last year, we'll do what we said we're going to do this year, and we'll do it again next year. Because this model has a stability about it and a reliability about it, and that's what we will continue to build on. Thank you.

Vernon Hill

Just talk for a moment about how you have the parts of our delivery channels united – online, in-store, mobile – and how we have a big advantage there.

Craig Donaldson

Well, it's interesting; I keep being asked about face-to-face or technology, and surely it's just all about technology because people are closing stores: to be honest, if my stores were like theirs, I'd shut them as well. You know, it's very simple.

Vernon Hill

You sound more like an American, correct?

Craig Donaldson

Eight years Vernon, eight years! It has to rub off a little bit. But the point is, to me, what customers want is technology that's integrated to make their lives easier. Since we opened our doors, we've printed off over a million debit and credit cards now in-store; it takes about three minutes. Now, the people who came in to get those cards, of course could have waited seven days for it to be popped in the post, but they wanted it now. And the way people live and work and play these days, it's about instant fulfilment, and everything can't be instantly fulfilled through a mobile app.

You know, it's interesting; I live in North London and I use Deliveroo. It's a great mobile app, but it's not much good unless the food turns up hot. I use Uber, which is a great mobile app, but it ain't much good if the car doesn't work when it turns up. And it's the integration of the technology with a physical delivery that actually sets them apart. Amazon opening stores, Sainsbury's buying Argos for click-and-collect; all integrations of technical and physical delivery to create instant fulfilment, or fulfilment at the time of choice for the customer. That's what Metro Bank's doing, and we're the only bank in the UK that can do it. It's not about face-to-face and it's not about technology; it's about the integration of it to fulfil customer needs, and that's what we're doing.

Vernon Hill

Thank you, Craig. We're going to open the floor up for some comments or questions. We're going to take some on the webcast or on the phone, but we'll start here on the floor. Who would like to ask something? Yes, sir. Peter, RBC.

Peter Lenardos

Hi, good afternoon. It's Peter from RBC. I have two questions, one about investment. Craig, you said £100 million in investment in 2016 and £100 million in 2017. I guess I was just curious of the breakout between the capitalised and expensed amounts?

And the second would be the growth outside of London: do you anticipate growing stores in Birmingham, or is it just a one-off? Will you similarly expand there like you've done in London? Thanks.

Craig Donaldson

Can I answer the store question? And I'll leave Mike to answer the capitalisation versus the OpEx. On the stores, I expect us to fill out. You know, there're some great cities, towns; you've got Solihull, you've got other places. And we want to be in all of the major places where customers live, work and play. And so, why wouldn't we want to fill out in Birmingham, in Bristol, Taunton, Cardiff, Bath, Swindon, Oxford, Gloucester?

These are major conurbations where people want to get their banking done now, and we'll be the answer to that. Michael, I can see you're writing numbers, so –

Michael Brierley
Yeah, I can. Thanks for that.

Vernon Hill
Maybe we should mail you the answer!

Michael Brierley
No, not at all. I mean, the £100 million is made up of – it's mainly CapEx: CapEx on stores, about £45 million, and also capitalisation of software development. A lot of the digital stuff that Craig was talking about clearly was developed recently, and has been capitalised; it will last us for a few years yet. So, that's the majority of it. Also thrown into that £100 million is about £5 million on training as well; we very much recruit for attitude and then train people up for skill. And then there is a smattering of OpEx as well. But mainly, it's intangibles.

Peter Lenardos
Great, thank you.

Vernon Hill
From Ireland.

John Cronin
Thank you, it's John Cronin from Goodbody. Just a couple of questions. As you continue to grow your in-store deposits at an increasing rate, in many of the branches at least, does that provide – and as you expand into other territories, does that provide you with an opportunity from a lending perspective to increase the penetration of direct lending as opposed to intermediaries? And I say that coupled with your reference to the 84% brand recognition here in London.

And my second question then is around – actually, you talk about the stores generating increasing deposits growth over time, but what I'm trying to get a picture of is the inflection point, because there is one presumably where you can't keep going at an increasing rate, and it does begin to tail off.

Vernon Hill
Well, that was not our American experience on the deposit growth. Craig can answer the other question. The more stores you build, the stronger your brand gets. I built about 100 of these in American multiple markets. And the more stores I put in the market, the better they all did. The joke was, in America the stores only stop growing when there's no place left to park when they get overrun. So, what we're seeing is our deposit growth per store is going up as we get bigger and our brands get stronger.

Craig Donaldson
And if I may just support what Vernon just said: we're six and half years in, we've seen no evidence of that inflection point you spoke about. They're all continuing to grow. When we see it, let's talk about it. But after six and a half years, it goes from strength to strength. So, I can't answer that question because I have no evidence of what it will be. But I know it's not in the hundreds of millions that we've already got in several of our stores.

On your other point about direct versus intermediary: as we grow our commercial business, a lot more of that is direct; the local business managers, the local directors, the commercial managers. Boots on the ground, getting to know and building the relationships, and that will grow as part of the business. But we won't slow down the work we do with intermediaries. Intermediaries are – we bank them, they're part of our business customer base and we've got their cash management, and we want to work with them. So, we will do more direct, but I'd expect to do more intermediary as well, because they're our customers as well, and why wouldn't we want to work with all of our customers?

John Cronin
Thank you, so they're mutually exclusive, effectively. And then if I just might add one further question? On the safe deposit boxes, do you anticipate that declining as a percentage of cost coverage for the branches as you expand into other regions?

Vernon Hill
No.

Craig Donaldson
No.

Vernon Hill
Safe deposit boxes are that unique service where all the British banks have withdrawn from the market. We're essentially the only provider in Britain. Isn't it nice to have a position like that? Alright, yes?

Ian Gordon
Hi, it's Ian Gordon, Investec. You've been filling your boots with TFS even though you don't need it, because it makes you a turn. Any early thoughts on how you may get your hands in some of the Williams & Glyn dowry and/or the customers?

Michael Brierley
I'm going to let Craig answer that one.

Craig Donaldson
We obviously are waiting to see some detail. We have had very early conversations with Treasury, and I think they're still working through the detail. And we are very interested. We want to win customers, and if there are Williams & Glyn customers, we'd love them to come and bank with us now. And many of them have, and many of them will continue to do so. But of course we're interested, but I've only seen what you've seen; we need more detail first.

Vernon Hill
You know, both of these questions, or three of them, have a theme that I'd like to make: even as well as we are doing, we only have 0.8% of the deposit market in Greater London, and less than that in Britain. The upside here: the area to grow is so large. While all these points are interesting, in the big picture, the upside here is unlimited.

Craig Donaldson
Ian, to your point, I think with business banking – and I'm stealing from Vernon again – it is the most underserved market. And we do do business banking: we've just launched, as you saw, the commercial online banking; we've just launched the business app which is getting the rave reviews on the App Store; we've just recruited 30% more local business managers in our stores starting in January. We are investing in our business offering, because we want to do more and more with business customers. So, the Williams & Glyn thing is just a natural thing we'd be doing, but of course we'll look to take advantage of it if there is an opportunity.

Ian Gordon
I guess that's really pitching on the free money aspect more than the customer recruitment aspect?

Craig Donaldson
I'm a boy from the North East, I'm more than happy to take free money. Sir?

Shailesh Raikundlia

Good afternoon, Shailesh Raikundlia from Panmure Gordon. I have a couple of questions if I may? If I come back to the cost of deposits, obviously it's come down quite dramatically. The 12 basis points that you talk about management action, I was wondering whether you can elaborate on that, as to how you managed to achieve that? And also, how low in terms of the cost of deposit do you see it going? Obviously, you're going to get benefit from the TFS and other parts in the net interest margin overall.

Secondly, just on the cost of risk. We have seen a bit of an edge up in terms of the impairments quarter on quarter. I'm just wondering if you could elaborate in which parts of the business that comes through?

Craig Donaldson

So, let me answer the deposit one first. The numbers we talk about are not our cost of funds; our cost of funds is below the numbers you see there. But we've managed cost of deposits because it's the important metric for the long term of the company. The cost of deposits came down by the 12bps, as said, because we cut our rates. But I mean, it's as simple as that. But what we have is we have a savings promise. And our savings promise is that our existing customers will always be on the same or more than our new customers, because we want to treat people who've been loyal to us well. So, we absolutely continue to follow through on that, but we have brought the rates down. But we're making sure that our existing customers always have better rates or the same rates. And that's really important that we do that, because that's about being the most trusted, and we will continue to be the most trusted because we treat customers in the right way.

Vernon Hill

And the bigger point here is: people don't bank with us for price. No one buys an iPhone 7 because it's cheap; they're buying the Apple world. That's what Metro Bank is: people join us and become fans because they're joining the Metro Bank world. An idea that is somewhat difficult for us to get across to some of the British press.

Craig Donaldson

I think also, if I may, is – I'm jumping in quick! Well can they come down more, you ask? I do not think we'll see the drops that we saw last year. But there are actions that can be taken, and there has been a step change for fixed rates that were set, say, 18 months ago or two years ago, will be rolling into a different pricing market now, and that will have an impact, but nothing like –

Vernon Hill

Okay, a couple more here – I'm sorry.

Michael Brierley

Hang on, you mentioned impairments, I think, and quarter-on-quarter moves in impairments. I mean, arrears remain very low across the whole book, and actually any change from quarter three to quarter four is we're starting to build in to IFRS 9; we have the models in place and we know increasingly where we're going, and therefore we're starting to build into IFRS 9. IFRS 9, I think, is an improvement on the previous accounting standard. It does cause a change in the level of impairments; it front-loads them, in essence, in the life of a loan, and we're already starting to build into that. So, that's already in the ten basis points.

Vernon Hill

Thank you. A couple more here. Joe: what's your price? What's your target price?

Joseph Dickerson

£45

Vernon Hill

Thank you, Joe. Go ahead.

Joseph Dickerson
Joseph Dickerson from Jeffries. So, you've got your 110-store target; can you give us an update on how many sites have been identified to get to that 110? So, what's effectively the pipeline there?

And could you also give us a sense of how you plan to grow, if at all, in unsecured, and how you see the competitive environment in unsecured, given it's a fairly small part of the portfolio at this point?

Vernon Hill
So, I'll talk about sites. As you know, I've built hundreds of these in America, so I'm fairly confident in building sites. We know where the next 20 to 30 are going to go, and we have target towns probably up to the 110 number. So, it's two points: identifying the town, and then identify at acquiring the best corner in the best site at each town. We're never going to have the same number we had in America, because there's no suburban sprawl here like you would see in New York. But we're pretty far along on where we expect to be.

Craig Donaldson
Could I come back on unsecured, if I may? You saw, Joe, on one of slides I showed that we are developing now – we're in selection mode for our new unsecured lending platform provider, for both business and personal customers. That will go into build this year; hopefully finish before the year end, might be early part of next year. Therefore, we'll have more functionality in which to drive our lending forward.

However, we have pulled back a little bit, not because of the risk per se but because of the return on risk. When you've got people out offering 2.8% unsecured, where you hold 100% capital, and you can be getting 2.79% on up to 85% loan-to-value mortgages and holding 35% capital, the risk/reward I think is out of kilter at the moment and I'd rather let that just settle down. I don't need it, I don't chase it.

Vernon Hill
Thank you, Joe. Who else? Sir.

Nick Baker
Good afternoon, it's Nick Baker from Goldman's. Just two quickly from me. So, the first really on gross mortgage lending. So, you grew net mortgage –

Vernon Hill
Can you speak up a little bit, Nick? We can't hear you very well.

Nick Baker
You grew net mortgage balances by more than £1 billion in a year, so that's more than a lot of the large banks in the UK. I'm curious: what was your share of new business that you took, or what was the total number? That would be helpful.

And also, if you could expand a bit on what you see is your differentiator in the mortgage space, which I think a lot of people would argue is one of the more commoditised areas of UK banking.

And then just a quick one on net deposit per store per month growth. I'm not sure – I know it's an important number; if you guys said it, I didn't catch the number for the fourth quarter discrete. So, if you have that as well, that would be helpful.

Craig Donaldson
So, let me answer that one first: we did £5.1 million per store per month in the fourth quarter. And we did £5.7 million across the year; that's the key. Quarters go up and down; I mean, that was still £5.1 million growth per store per month. We don't anticipate doing £5.25 million every quarter. You do have tax bills, you do have other things, and therefore it trends up. So, that's what we normally see: some quarters were £6 million-plus last year, some were £5.1 million. So, that's that point.

On the other point, around our share of the mortgage market: last year, I believe the mortgage market was around £248 billion. We did just over £1 billion. I'm sure you can do maths there for the size of the market that we took. Therefore, to put Vernon's point earlier, the big point would be that we are just a small part of it, we've got all of that to grow into, and that's what we'll continue to do with the infrastructure we've put in.

With regards to what's our differential, it's how we work with intermediaries. It's how we – to the point I think John asked earlier around direct intermediaries: we see them genuinely as partners. We don't compete with them, we work with them. And the way we've built our technology is to make the intermediaries' lives easier, because if we can make the intermediaries' lives easier, it's easier for them and their customers. And to do that, we've specifically built the retention approach. And the retention approach – it's no good just winning customers in the front end if you don't keep them. Long-term growth is powered by retention. And therefore, what we've done is spend a lot of time and energy building a genuinely step change in our retention approach to the rest of the industry. And I know the industry is moving, because they've seen what we're doing and the plaudits we've got. We will keep doing that because retention is the place to focus, and working with the brokers and engaging them as partners is the way to do it. And that's how we stand apart from a lot of the other organisations.

Michael Brierley
Service and convenience again.

Craig Donaldson
Exactly right.

Vernon Hill
Next, we've got a couple more here. This gentleman back here; you are…?

Ian Sealy
Ian Sealy from Citigroup. Can I ask about deposit mix going forward, just how you see that changing and the impact on the NIM?

And then related to that, the tier two that you mentioned, potential tier two issuance. Maybe you can just give us your thinking around that.

Thirdly, could you possibly just give us some sort of idea about the distribution of store openings, and therefore costs, in 2017? Thank you.

Michael Brierley
Let me pick up the tier two, and perhaps Vernon will pick up the stores. As far as the tier two is concerned – I mean, I think we've said previously that, given the growth rates we're seeing in assets, despite the fact that 2017 will be profitable, we won't be self-supporting in a capital sense until post 2020. And therefore, we will need to add capital in order to continue to fuel that growth. Given that we have the simplest capital base known to mankind, i.e. equity, and one class of equity at that, it seems to make sense to look to add just some debt to that mix in order to drive investor returns.

Clearly, looking at the capital ratios, they're currently strong. We have more than enough capital to support growth for quite some time to come, but nevertheless I suspect that might be our next step.

Craig Donaldson
I also think that – we're expecting a consultation paper to come out on Friday, 24th of this month from the PRA around bridging, I guess is the way I'd describe it, between standardised and advanced. That could be very interesting for us. I don't know what the detail is, but I think for organisations of our scale, and the low risk we run against the standardised risk-weighted assets, it could be a very, very interesting day. So, I shall be reading that on Friday.

Vernon Hill
And your other question was about store opening times. I've been doing this for a long time, and no matter what I do, it's always quarter three and quarter four that get the balance of the store openings, despite everything we try to spread it out, and I'm sure that's going to happen this year again.

Craig Donaldson
Could I ask, Ian, what was your first question? I do apologise.

Ian Sealy
In terms of the mix of deposits.

Craig Donaldson
Oh, okay. So, on the mix of deposits, it's running around 50/50 at the moment.

Vernon Hill
Commercial/consumer.

Craig Donaldson
Commercial/consumer. It sometimes changes, but it seems to right-size back to that. I'd expect that to continue at the moment.

Ian Sealy
And in terms of the current accounts, zero interest rates?

Craig Donaldson
It runs around 25% or 30%; sometimes it's up at 29%, 30%, sometimes it's down at 25%, 26%. Again, that seems to be the level that it's running at. We are launching current accounts online in the end of half one. Will that impact on it? We'll see. I expect it to run between 25% and 30%.

Vernon Hill
Okay. You had your – yes, sir?

Arun Melmane
Thank you. Arun Melmane, Macquarie. I have two. I think one was on – I wonder whether you were able – you talked a lot about Metro's advantage in terms of the funding side of things. I wonder whether you're able to give us a breakdown of the deposit rate you charge on retail versus SME, so we can cross-compare across the sector to be able to…?

Craig Donaldson
I think they're all published. I'll email them, but if you go on the website, they're all there.

Arun Melmane
Okay, perfect. And then second bit is, I noticed you had a note on deferred tax and the losses carried forward; I think it's page 19. You talked about how that might not happen, were changes in regulation to go forward. What does that do? Do we just assume the tax rate goes back up to 26% in respect to the rest of the sector, or…?

Michael Brierley
I mean, I think that's a precautionary note; all accountants are very cautious, as you know. Tax rates change, they go up and down, and there's certainly proposals that indicate corporation tax rates may be going down, in which case the value of those carried-forward tax losses may also go down in the region of £1 million or £2

million impact. Accounting regulations don't allow us to front-run on tax rate changes, and therefore the note is a precaution on that.

Vernon Hill

Do you expect to use all your tax losses carried forward within the next few years?

Michael Brierley

Yeah, absolutely. Certainly very close to the guidance there is, yeah.

Vernon Hill

Okay, anybody else here? Thank you all. I'm going to go to the phones. Okay. Gentleman on the phone, we're going read your comment.

Raul Sinha

Good afternoon, gentlemen. Apologies, I couldn't be there in person. I think great job on the deposits, there's not much to talk about there as far as I'm concerned. But I just had a question on the loan book, the real estate part of it especially. So, maybe a couple of – I'd like to get your thoughts on the commercial book. I think the real estate part of it is now above £1 billion, and in the note it says it's rent, buy and sell. So, could you maybe talk a little bit about what exactly is within that lending segment, and how you're managing the risk there?

And related to that, maybe just your view on the London property market. Obviously, there are some signs of weakness; what's your outlook over there? Thanks.

Craig Donaldson

Yeah, of course. I mean, we do lend on property. We do not do development in any scale, as I said earlier. I think that's the key. I think where the key risk is where normally you'd see the cranes, I think the comment is you can see bad debt. We don't so that, we've got –

Vernon Hill

Craig, that's not quite true.

Craig Donaldson

Enough said.

Vernon Hill

Cranes are out!

Craig Donaldson

Moving on, so we have less than £10 million residential development, no commercial development. That's the key one, and I think that's the first place that you'd see the stresses come through.

The second point was, and it was actually up on the screen: I think 56% was the debt-to-value coverage on our commercial book. I think that's a very healthy coverage there. About 25% of it is buy-to-let; again, we do not lend above 75%. The average is down at – I think it was 57%

Vernon Hill

Mike, the annual report when it comes out, it has a detailed breakdown of our exposures?

Michael Brierley

It does. Actually, it's in the preliminary results.

Vernon Hill
It's in the results that they have now.

Craig Donaldson
So, my point is, though: we lend low risk, we lend very securely into it and we do not do the development side of it at any scale. The development we have done has been the people who we've built relationships with over six years, where we're happy that we have a broader relationship that covers any risk that we'd be facing into. And I think that's the key as well.

Vernon Hill
Okay. Next please.

Raul Sinha
Just your view on the London property market if you've got any, please.

Craig Donaldson
We're not seeing – we saw a slowdown, I said this at the half-year and at the quarter, on the back of the tax changes that came in at the end of March, beginning of April. But apart from that, we've seen really nothing, especially not in the commercial market actually at the moment. You know, if you look at the rental market in London on commercial property, it really is, from what we've seen, unbelievably still very strong. So, we're not seeing that stress and strain come through in any way, shape or form. In the mortgages up to circa £2 million, which is the vast majority of our business, again we're seeing a very strong market there. We've not seen any slowdown whatsoever. In the much bigger mortgages, I do think that's been hit by the tax and other things, and I think that's just slowed it down. And where you have little liquidity, you can get volatility, and I think people are seeing volatility at the moment rather than underlying stress.

Raul Sinha
Great. That's really helpful, thank you.

Vernon Hill
Thank you, JP Morgan. Let's do the next call, please.

Vernon Hill
Do you want me to read this? Jim McCormick from Manhattan; his question is: 'Other high street banks in Britain are shrinking their branches. Do you see that to continue, and how attractive is that for Metro in gaining market share?'

If I had the UK banks' branch network, I would shrink them to zero; that's about what they're worth. As they withdraw – as they have disinvested and shrunk and removed human beings from the branches, all of those things help our brand grow, and you can see it in the growth numbers. Yes, Jim, we do get certain opportunities to buy sites when the other banks have shut down, but that's not really an important factor in our niche.

Craig Donaldson
Sorry, may I? One of – Iain Kirkpatrick who runs regional banking for us, who's in the room here, was presenting at a conference on creating fans, talking about stores and technology and about the integration of it, and how you put them together to offer choice to create fans. And there was somebody from one of the banks we may be alluding to, a CEO of another bank, who was presenting on how to drive customers onto cheaper channels.

Vernon Hill
How to drive customers out.

Craig Donaldson
How to drive customers onto cheaper channels. Tells you all you need to know. And we're trying to create fans while they're driving them out. And yes, that is helpful.

Vernon Hill
Okay. Doug Schaller from North Carolina. Doug's question is: 'In reference to the £100 million capital spend in the last two years each, what would be the total spend on a normal growth for the no-growth UK banks?'

Craig, do you have any idea how to answer that?

Craig Donaldson
That's a great question. Well, probably less than we're spending. And even if they did spend that, I'm not sure you'd see the value. So actually, from a value perspective – legacy is a hard thing to keep investing in. And if you are spending hundreds and hundreds of millions of pounds on the legacy systems, so much of the money you spend is on keeping them alive rather than making things better. The beauty is, we have no legacy. What we have is investment in doing better things for our customers, whilst others are investing in putting veneers over the top of poor legacy. It's a huge advantage to us. I don't know how much they spend. I believe one of the large banks said they were going to spend £1 billion on their IT system in the next three years. And that was probably just for the electric pads to keep it going.

Vernon Hill
For those of you who've followed Metro since the launch, we have a tremendous advantage with a brand-new IT system where everything is linked together. We call it the single client view. Its brand new, it's fresh, all the IT and mobile stuff's all linked together. It's really the most advanced system in Britain, and it's a tremendous advantage; not only to serve our clients, but to support this growth.

Patrick O'Brien asks: 'The borrowings from the Bank of England may be cheap, but with all your excess deposits, why borrow at all?'

Michael Brierley
The answer is simple: because it is cheap funding from the Bank of England, and invest that for value we can make.

Vernon Hill
We make money.

Michael Brierley
We can make a turn on it, and that's a good enough reason I think.

Craig Donaldson
The way I would suggest it as well, is the way I think about it – and the way Mike and Vernon spoke about it is spot on. But what it has done: you know, the Bank of England launched this to try and drive the price of lending down, and it's worked. They have achieved their aim. So, what we've done is by taking the FLS and now the TFS, we're just offsetting some of that yield compression, so we take some of the good news as well as the bad news.

Michael Brierley
I think it's important to say that we do not rely on the FLS or the TFS. We're building a long-term franchise here: we are investing in our customer service, we are delivering service to our customers and driving the deposits up. That's what we're here to do, and that's what we are doing. The FLS and the TFS, they make sense at the macroeconomic level, but they're not here forever. We're not building the bank on the back of those, that's for sure.

Vernon Hill
And just a comment from me on that point: running a predictable high-growth business is fundamentally different from running large banks that are not growing, and in fact shrinking. We have the advantage of running a high-growth business, so we get to invest for growth. Unfortunately, they are running businesses that are being reduced, and they have no choice but to try to cost cut their way to prosperity. That's a fundamentally different view of life.

Are we done? That's all. I'll give you one or two more here if anybody has them. This is your last shot. Nobody has any? Goldman Sachs.

Speaker
Thank you. Second one from Goldman Sachs. Good afternoon, Vernon, how are you? I have a conceptual question, and then maybe a slightly off- piste question as well. So, the first one is: what is the end game?

Vernon Hill
Only a Brit would have asked that question.

Speaker
Well, I'm not British.

Vernon Hill
You've been here too long!

Speaker
Maybe. So, what's the end game, and what is the target where you want to get to – let's call it a steady state for Metro, and how long does it take to get there?

And then the second question – so, two questions additional. The second one is, you said the British banks are terrible, and I agree.

Vernon Hill
The customers say that.

Speaker
Right.

Vernon Hill
It's not me saying that.

Speaker
Yeah, I agree. European banks are worse. So, what's precluding you from expanding what you've built here in the UK to select markets on the Continent?

And then finally, I'm not a UK banks analyst, but the one thing that surprised me is there was no mention of Brexit. How does that change, if anything, your thinking about the future?

Vernon Hill
I'll go in reverse order. Brexit has no impact on us whatsoever. And right now, we have slightly less than 1% of the UK market. And our market is totally in Britain. If we got 5% of the UK deposit market, only 5%, that's a £100 billion deposit bank, which should have a market cap of £18–20 billion. We have an unlimited space to grow.

You asked me: do we have any thoughts of expanding outside Britain? When we brought this model from America, it was fairly easy to bring the model here. We speak a language that's somewhat similar. But the mechanics in the banking system in Britain are very similar to the American system. And most of you have heard me say before: we are running almost our exact model in Britain that we brought from America. And everything we did in New York works better here. So, we've got lots of room, and I'm not going to France.

And your third question was?

Speaker

Brexit, why don't you go outside of the UK and what is the target? What is the end game?

Vernon Hill

100% of the market is our target. 100% of the market, and this model will never stop growing, just like it did in America. There's no reason this model should ever stop growing. And it's our job to make it better as we get bigger and build more fans. Remember, the base of this model is: fans join your brand, they remain loyal and they bring their friends. That's the essence of what the Metro Bank model is. The more fans we get, the more friends they bring, and the growth rate keeps on going. Thank you all.

Wait a minute, I got one more question. I don't want to miss this one. John Tschol from America: 'Why do the UK analysts for banks not understand the value of high-growth businesses like Metro, Uber and Apple?'

And I'm going to answer this question: some of you get it, some of you don't get it. If you look at Metro Bank through the eyes of British banks and British banking, you'll never understand what a high-growth, high-value bank means. We're a high-growth retailer that happens to be a bank. And the market is putting a value on it as a high-growth retailer, not a shrinking bank. Thank you all.