TSB Banking Group plc

Q1 IMS 2015 Results

Wednesday 29 April 2015

Paul Pester - Chief Executive Officer

Good morning to everyone on the call and thanks for joining TSB Banking Group's 2015 Q1 results call. Darren and I are joined by Martin Adams, our Head of Investor Relations, and given we're in the middle of an offer period we're also joined by our corporate brokers. I'll start off by giving you a bit of an overview of the progress we've made in the quarter, I'll then hand over to Darren who will give you an update on the financials, and then we'll be happy to answer any questions you may have.

So, turning to the first slide and our key highlights for the quarter. As recently announced, the boards of TSB and Sabadell have reached an agreement on the terms for Sabadell to acquire TSB. The Sabadell transaction continues to progress and, as you know, the offer document was published on 17 April. However, whilst the transaction is ongoing, it is, of course, critical that we remain focused on the day job, so we have a discrete team working on the transaction itself, allowing the rest of the business to remain focused on achieving our strategy to grow TSB and to bring more competition to UK banking.

In the first quarter of 2015 we've continued to build on the strong start we made in 2014, reinforcing TSB's credentials as "Britain's Challenger Bank".

TSB has delivered a Q1 financial performance in line with expectations, achieving a management profit before tax in the quarter of £34 million, just under half of which was delivered by the Franchise business. We've also continued to make good strategic progress, particularly with regards to the roll-out of our mortgage intermediary channel. However, as we anticipated, we continue to experience a challenging interest rate environment, with the outlook for base rates remaining 'lower for longer', and the average five year swap rate during the first quarter remaining low at around 1.3%. This means that we will continue to focus on the way we manage our costs so that we can continue to deliver our strategy of achieving a 10% return on equity five years from our IPO.

So, turning to Slide 2 and the further strategic progress delivered during the quarter. As you will recall, our growth strategy has three key components. Firstly, providing great banking to more people. In the most recent quarter, TSB achieved 7.9% share of flow of all new and switching bank accounts, so obviously this marks the fifth consecutive quarter where the Group has now delivered above its 6% share of flow target, with the continued strong performance reflecting the strength of the TSB brand and our competitive bank account offering.

Secondly, helping more people to borrow well. As we reported at our Full Year results presentation in February, we got off to a flying start in the mortgage intermediary channel – receiving over £300 million worth of applications at the time of our full-year results. We've continued this flying start and I'm pleased to report that we received over £700 million of applications by the end of the first quarter, and we're continuing to develop what we offer to our customers through brokers, from mortgages for first time buyers and home movers in

January, to remortgages in March, and we're now piloting buy-to-let. The progress we're making through the intermediary channel is already being recognised. For example, we were named intermediary mortgage lender of the quarter by Mortgage Strategy magazine. So with more than 7,500 mortgage advisors now signed up to provide TSB mortgages, this channel is very much up and running and delivering.

The third component of our strategy is providing the type of banking people tell us they want. In Q1 we have continued to invest in our digital proposition, launching our new mobile banking app, making it easier and simpler for our customers to bank with us wherever they may be, delivering "local banking on demand".

In addition, we're doubling the size of our digital banking team to support the further improvement of our digital proposition. At the same time we're also continuing to refine our branch distribution channel. It's now about 18 months since we launched TSB back onto high streets right across Britain, and almost a year since the end of co-servicing with Lloyds Bank, during which both TSB and Lloyds Bank customers could service their accounts in TSB and Lloyds' branches. So we now have a much clearer picture of how our customers are using our branches, and we're responding to this.

So far this year we have extended the opening hours for almost 400 of our branches and the number of branches we open on a Saturday now stands at 328. We've also been looking at the 15 locations across the UK where we have two or more branches within around 500 metres of each other. Of course we can now see that customers tend to use a particular branch in these locations and we've developed plans to invest in the preferred branch before closing the other one or two that are nearby. So we will absorb 17 of the lesser used branches into the 15 branches that customers tell us they prefer.

The first location for this is Enfield in North London where we have just refurbished and re-launched the preferred branch, and will soon close the spare one which is only about 170 metres down the road. So the response from customers in Enfield and from our partners in Enfield has been overwhelmingly positive. If you look across the Bank as a whole, our Bank NPS, or net promoter score, improved a further 5 points during this quarter, again making it the fifth consecutive quarter where this score has increased. This certainly tells me that our customers continue to notice and appreciate the differences that we're making.

So now let's move to Slide 3 and over to Darren for more detail on the financial performance. Darren, over to you.

Darren Pope - Chief Finance Officer

Thank you very much Paul and good morning to everyone. As you can see from Slide 3, in the first quarter of 2015 deposits marginally grew by 0.4%, or £109 million. However, current account balances grew by £266 million in the quarter, reflecting the continued strong current account proposition. This more than offset the small reduction we saw in our savings deposits as we continued to re-price this book. As expected, these re-pricing actions have also benefitted our net interest margin, and we'll discuss this shortly.

Customer lending balances continued to reduce, but the rate of reduction has slowed considerably and overall balances are down only 1.2% quarter-on-quarter. The Franchise lending component only decreased by 0.7%. At the Full Year we said we would start growing our Franchise lending book by the half year, and we are very much on track to do this. This improvement reflected slower than expected mortgage back book attrition as well as the success of the new intermediary channel, which, as Paul said, has originated over £700 million of applications and £98 million of completions in the first quarter.

The franchise unsecured book was marginally down, reflecting both seasonality of spend and the extremely competitive environment. Finally, the Mortgage Enhancement portfolio continued to re-pay as we expected, decreasing by 4.4% in the period. The combination of reducing franchise customer lending and growth in deposits has resulted in the Franchise loan-to-deposit ratio reducing 0.9 percentage points to 75.6%.

Looking towards the bottom of the slide, we can see that the Group's capital position remains very strong. Our pro forma common equity tier one ratio increased 0.1 percentage points to 19.8%, or 20.1% if you include the unaudited retained profits generated over the quarter. Both capital and liquidity clearly position us well for the balance sheet growth to come.

Let's move to Slide 4 and the P&L. As you can see half way down the slide, TSB generated Franchise management profit of £16.8 million in the first quarter, and that's broadly in line with our expectations. This is significantly higher than the previous quarter primarily as a result of the previously reported skew of our marketing and investment spend in 2014 towards the fourth quarter, and slightly lower marketing costs incurred by TSB in the first quarter.

Moving down the table from the top, Franchise net interest income was marginally lower given the expected further reduction in our lending volumes. However, as previously guided, Franchise net interest margin expanded in the first quarter, increasing by 6bps to 3.71%. That's primarily driven by the deposit re-pricing. For the rest of the year we expect this figure to trend down as we grow the balance sheet and as asset margin compression and lower interest rates work their way through.

Franchise Other Income was also down, primarily reflecting the effect of the previously reported market reforms to interchange fee income, and the fact that Added Value current accounts remain available only through the digital channel. Operating expenses were 12.8% lower given the marketing and investment spend trends noted earlier, but also reflecting the continued and successful business focus on managing our costs in the current low interest rate environment.

In the second quarter of 2015 I'd expect costs to step up somewhat as marketing spend increases and we recognise the FSCS charge, which is expected to be in the region of about £15 million. The impairment charge decreased by 20%, reflecting the continued effect of the favourable UK economic environment, the one-off charges in Q4 which included, if you remember, an increase in the unsecured loss emergence period, and a £1m benefit from net releases in Q1.

Management profit from the Mortgage Enhancement portfolio reduced by 9.5%, again as expected, and driven by the continued attrition and ongoing refinancing from customers in this portfolio onto lower 'new business' rates. In the current rate environment we expect this rate of reduction to remain broadly stable. So at a statutory level, Group Statutory Profit before Tax was £34.3 million.

What does this all tell us about expectations for 2015? Let's move on to Slide 5.

We continue to expect the Franchise margin to be broadly flat for the full 2015 compared to 2014's 3.62%. We are seeing margin expansion in early 2015, but continue to expect this to be offset by negative factors in the rest of the year, namely the balance sheet mix as our mortgage book starts to grow, asset margin compression coming through, and structural hedge returns as the interest rate environment continues to disappoint and this means that the expected 2015 exit rate for NIM will be noticeably lower than the average for the year.

For Franchise Lending we now expect intermediary mortgages to drive growth of over £1.5 billion, but at the same time, we will remain focused on attracting deposits and more current account customers to fund our longer-term growth and grow our customer base. We therefore continue to target consistently taking more than 6% of the market flow of current accounts each quarter. We expect other income to come under modest pressure given the early implementation of reduced interchange fees, and this contributes to the previously guided £15 million year-on-year reduction in Franchise Other Income. And finally, we expect no more than £720 million of costs in 2015 as a result of careful cost management, while at the same time ensuring we meet our growth targets.

So overall, Q1 has been another decent quarter of financial delivery against a very challenging interest rate and competitive environment. Thanks very much, and I'll now hand you back to Paul to summarise on Slide 6.

Paul Pester

Great thanks Darren. So just to recap, whilst the Sabadell transaction continues to progress, we remain resolutely focused on delivering our growth strategy and continuing to establish TSB's credentials as Britain's Challenger Bank. Our Q1 financial performance was in line with expectations and we're continuing to make good progress with our strategic delivery, particularly with regards to the mortgage intermediary channel. Of course, the interest rate environment does remain challenging and we continue to focus on cost management to mitigate the effect this may have.

With that I'm very happy to open up for any questions – if there are any – you might have on our performance or on our strategy. Of course, I can't really say any more than is already in the public domain regarding the Sabadell offer. So with that, I will hand back to Tyler and open up for questions.

<u>Question 1</u>

Richard Smith - KBW

Just one very quick question from me – and thank you for doing the call – which is just on the cost management that you were alluding to upfront, Paul. Just in terms of the 17 branches that you've identified, how much of that contributes to that cost management versus other cost saving initiatives that you're looking at?

Paul Pester

Thanks for your question. I have to say, what was driving us on the branch co-locations wasn't really cost reduction we are managing across the business. What was really driving us was the realisation that we ended up with a branch network where we, in some locations, had three branches within spitting distance of each other, so it just doesn't make sense for us to keep those branches open. So it's not a major driver of our cost programme, we didn't do it for the cost, we did it because it doesn't make sense to keep branches open where customers just frankly aren't coming into them. So across the business, as Darren said, we'll continue to focus on management of costs down and there's a whole raft of things we're doing to make that happen.

CLOSING REMARKS

Paul Pester

I have to say, I'm not surprised we don't have many questions given where we are in the current process with Sabadell etc, so I just want to say thanks to everyone for dialling in for this call. If there are any further questions obviously please come into our Investor Relations' Team, into Martin, and he'll do his best to answer them. With that I think we're done, so thank you very much Tyler.