

Provident Financial PLC 2020 Half Year Results

Presentation

Malcolm Le May

Chief Executive Officer

Good morning, everybody. Thank you for dialling in to our 2020 interim results. I'm Malcolm Le May. It's been a half year that no one expected and I believe that Provident Financial has reacted to circumstances extremely well. We have delivered for our shareholders and customers whilst looking after our colleagues. All things considered, I believe our financial and operational performance has been both resilient and strong.

We have continued to make progress in transforming the group. We have navigated an evolving regulatory environment for the sector and are playing our part in helping shape the agenda. We have delivered on some of the strategic initiatives we set out in our Capital Markets Day last November. As we said at the Capital Markets Day our aim is to establish Provident as the leading provider of responsible credit to the underserved, producing attractive and sustainable return for shareholders.

This goal has not changed and now is even more important than ever for our customers whose importance is increasingly recognised by the government and the regulators. Nor, indeed, has the strategy that we step out of the Capital Markets Day changed to achieve our aim. In relation to today's presentation Neeraj will be presenting the interim numbers and I'll be reporting on the operation progress and financial highlights.

Then I'll talk a little bit about our strategy and outlook before hosting question and answers. As Neeraj joined us in the lockdown no one has really had the chance to meet him yet properly but hopefully we can address this during the interim roadshows. I am delighted that he is on our team.

Turning to slide 3 now. When I last spoke to you at the prelims in late February, COVID-19 had just arrived in the UK but no one quite knew what was going to happen next. Throughout March we ramped up our planning for potential outcomes which put us in a good position to help our customers and look after our colleagues when the lockdown actually kicked off. Our focus throughout this phase was to manage what we could control.

We cannot control the macroeconomic environment but we could ensure our customers, colleagues, and our balance sheet were prepared for the upcoming pandemic challenges. In relation to customers, we made the decision to keep lending responsibly to them though we did, obviously, tighten underwriting as you would expect. We implemented

customer payment holidays for some ahead of the FCA guidance. For colleagues we moved to remote working prior to the lockdown.

Though as some of our colleagues qualify as keyworkers they therefore have been working from our offices helping our customers throughout the pandemic. We also rolled out wellbeing support for our colleagues and ensured that everyone working from home had the right equipment to work efficiently and comfortably.

Turning to capital and liquidity having a banking licence in the group was a significant advantage when improving our capital and liquidity position. Many in our sector have struggled to access capital. The banking licence has made it considerably easier for us and we now have a very strong CET1 ratio of 35.4% with liquidity of about £1.2 billion.

During this period we also had Vanquis' VREQ removed and we successfully tendered £75 million of senior bonds in a capital and PL efficient way. We also renegotiated an interest covenant waiver for our revolving credit facility. We also, as you know, withheld last year's dividends and all of these actions helped make us more financial robust.

Now, the outcomes of all these actions that we performed much better than we modelled in March but enough those our financial performance was resilient, as you can see, we reported a group adjusted loss of some £32.6 million. Now, a loss is a loss and clearly we would like it not to have been. But I think it is also fair to point that during this period both Vanquis Bank and Moneybarn were profitable.

Our social purpose, as you've heard me say before, is to help put people on the path to a better everyday life. Now, this doesn't only equate to customers and colleagues but in our view to helping the wider society in general. Therefore, we believe as we have performed so robustly in the first half we've decided to repay all furlough support we've received back to the government because we just feel it's the right thing to do.

Now, I hope you find this new slide useful and interesting. It sets out products we're in, the size of the market, our current loan book, the customer numbers in the market, and the cost of risk revenue yield, et cetera. It shows in a snapshot that in addition to the robust balance sheet and liquidity we have, we hold a dominant market position in the subprime space which in and of itself is very underbanked.

Now, as the slide clearly shows, putting COVID-19 to one side, all of our divisions have the opportunity to grow their loan books and customer numbers. It also shows, not surprisingly, that COVID-19 has negatively impacted the loan book and customer number growth in the first half. Except, of course, in Moneybarn where there is an interest trend developing. Therefore when the pandemic ends and our loan book returns to growth and the metrics of revenue yield, [impairment], et cetera, will start improving.

They will be moving in the right direction which is clearly very positive for long term sustainable shareholder returns. Numbers on a slide can sometimes look a bit stark and not always tell the whole story. In this case though, I do feel all divisions have performed resiliently so far during the pandemic. Importantly, even though lending and collection volumes dropped significantly when the lockdown started they have improved steadily month on month through April trending continuing to July and what we can see so far in August. This is clearly positive for our customers, Provident, and also the UK economy.

The next three slides focus on how the divisions, Vanquis, Moneybarn, and Consumer Credit Division responded to the operational challenges of lockdown help their customers and our colleagues, and also delivered on our social purpose. There is a lot of data on these slides. I don't plan to call out each point but I will flag some of the key ones. Turning to Vanquis Bank first on slide 5, call centre colleagues were able to work remotely from day one, Now 80% do. Customers always could talk to someone if they wanted to.

This is no mean operational feat when you have well over 1.5 million customers and the pandemic has arrived and an operational call centre had over 1000 people prior to lockdown. Also with its customer champion hat on, the bank did not apply any credit line increases to its customers as a result of COVID-19. New customer acquisition at the bank was down at 147,000 versus 190,000 for the equivalent period in 2019.

A good performance because there was absolutely no activity at the start of lockdown and customer spend was down some 40% year on year in April. Though by the end of July it was back down to only 15% lower than the prior year. The bank has also now restarted its phased reintroduction of credit line increases. Just like the other divisions the bank also implemented the brand new payment holiday procedures for customers. They did this over a very short period of time.

Take up of payment holidays when introduced was around 3% of customers but by the end of July it was down to about 1%. This was much lower than our initial estimates and despite the FCA extending the payment holiday we continue to see a decline in trend of uptake. Importantly, as the first phase of payment holidays roll off we're seeing a greater than anticipated percentage of customers returning to normal payment patterns.

For slide 6, Moneybarn made payment holidays available to its customers marginally before the FCA recommended it. It remained open for new business from day one in a market where a number of the competitors were closed for business. This was very well received from customers and brokers alike and put Moneybarn in a strong position when the lockdown began to ease enabling it to increase its market share.

As flagged earlier, Moneybarn's loan book grew in the first half to some £529 million and so did its customers numbers. Also in July, Moneybarn had a record month for new car loans of around 4500 in the month with about 40% of the new car loans going to customers who we would classify as keyworkers. But at present it does appear that car demand has increased in our market driven potentially by the desire of people not to use public transport and to get to and from work.

Payment holidays in Moneybarn were high and peaked at around 23,000 or some 27% of the workforce when first introduced. I don't think that's surprising when you think it's probably the largest monthly outgoing for our customers. But just like Vanquis, as lockdown eased and the economy appears to be slowly improving the take up has dropped and now only about 3.5% of customers are on payment holidays and that's as of the end of July.

Like Vanquis, Moneybarn customers rolling off payment holidays have exhibited similar characteristics with the majority of returning to normal payment patterns. Equally, the uptake of new payment holidays has been at a fraction of the initial rate.

Turning to slide 7, the Consumer Credit Division was on track to break even before COVID-19 but now, perhaps not surprisingly, that has been delayed. With the onset of the pandemic CCD had to completely revolutionise its operating model as its customer engagement managers, we call them CEMs, could no longer go and visit customers. The CCD response to this problem, among other responses, was to roll out Provident Direct, its digital collection customer model which was completed in just two weeks and embraced by customers and CEMs alike

For those customers who couldn't pay remotely we provided the [AltPay] cards so they could pay through the Post Office. Through this new customer servicing model we were very successful and by July collections were running at some 90% plus of pre-COVID levels. Lending also had been re-established and we were lending to levels with existing customers of circa 90% of pre-COVID-19 levels.

We were lending, perhaps interestingly, to new customers and that's a definition for us, customers we hadn't lent to in the previous six months, at around 40%. It's probably fair to point out that lending to customers was temporarily suspended when lockdown started in line to our stricter approach to underwriting. Other changes that CCD made in the first half like re-introducing the 78 week and 104 week lending products and reducing its cost base have, I believe, put the division in a strong position for the second half.

That said, the impact of lockdown could not be avoided by the division and Satsuma was temporarily closed for new business although their lending – for new business lending although their collections remain robust. Also in relation to high cost short term credit, we'll need to see what the [inaudible] expects us to do differently following their recent paper. Once we understand that change we will adapt our model accordingly.

The CCD forbearance is built into the product and roughly only 2.7% of customers took the benefit of payment holidays as at the end of July. So to conclude, CCD has been collecting very well in the pandemic and has adapted well to the issue of new loans to existing and new customers. However, in this traditionally low period of the year of loan issuance we have seen the book shrink. Despite this the changes we have made and, I believe, the business is well placed for the traditional busy run up to the Christmas period.

So moving to slide 8, to sum up our half year performance I think we have performed better than we expected when the lockdown happened in March. This is because I believe we took actions. We managed the factors that we could control. We focused on our customers and our colleagues and ensured we have the strongest possible capital and funding entering into the pandemic.

We also implemented payment holidays successfully and have done a good job managing their run off and the demand for the extension, so far, has been low. So in my view, we've managed the knowns and positioned ourselves well for the second half of the year. It is though the macroeconomic environment which we cannot control which perhaps concerns us.

We don't have a crystal ball and therefore we do not know what will happen to unemployment or the economy when furloughing ends. Therefore, though we are well positioned business wise for the second half we are cautious for the group's outlook for the second half and the first half of next year due to the macroeconomic environment. So I will now hand over to Neeraj, our new CFO, who as I mentioned earlier joined us

during lockdown from Secure Trust Bank. He will run you through our interim numbers before I wrap up with strategy and outlook and then we'll take some questions and answers. Neeraj, over to you.

Neeraj Kapur
Chief Financial Officer

Thank you, Malcolm. I'll take you to slide 10. As you've already heard we go into H2 this year with very strong capital and liquidity positions. At 35.4% seen through with one ration. With £215 million of surplus capital and 1.2 billion of liquidity with more than a billion of that as [inaudible]. This also shows the ability of Vanquis to raise deposits during a crisis which is also very important and is very effective.

The deposits were all priced below 200 basis points. Malcolm and I have driven these metrics from the beginning of the crisis to create optionality both from a defensive perspective during COVID-19 as well as in a growth scenario which we all hope will come sooner rather than later. Our objectives as set out in our Capital Markets Day last year are still as relevant to us as they were then, albeit now delayed.

Receivables growth will [drive our] IFRS 9 investment as will the improvements to the customers digital experience which will be supported by scalable and resilient [inaudible] resistance. Together with my treasury team I will be driving towards an optimised capital stack, as well as a more efficient and diverse funding structure for the group. During this crisis customers have shown an incredible drive to protect their credit and where possible reduce their debt burden.

The IFRS 9 impairment charge from H1 has therefore predominantly been driven by the very material deterioration in the macroeconomic outlook. We have also taken steps to tighten credit acceptance criteria significantly which I will come on to later.

I will now turn to slide 11. As you can see in this group results summary slide Vanquis and Moneybarn remain profitable even after the significant increase in IFRS 9 provision which is mainly due to the macro outlook deterioration. Our CCD division has been hit by the lack of new business during lockdown and the resultant impact on its receivables which by their nature are short maturity. This will inevitably delay the path to CCD's profitability.

However, if the macro outlook is to be believed and taken with the tightening of credit criteria by the big banks, the number of customers looking at our type of products is sure to increase significantly. At the same time we're seeing significant weaknesses in the business models of our competitor base during this time. The diversity of funding within our group and the capital strength bandaged from contrast to help our customers achieve a better everyday life.

I'll turn to slide 12 which gives you a divisional snapshot. What I would like to point out on this slide is that the most significant change in Vanquis and Moneybarn from H1'19 to this year is the impact of the macro outlook on impairments. Utilisation of credit cards issued to customers was hit significantly during the lockdown and not surprisingly.

Moneybarn which has actually been able to increase its receivables during H1 this year by remaining open during lockdown allowing those keyworkers that were looking to buy used cars to go to work has been a great example of our business model helping our customers to achieve a better everyday life. Our Provident business was nearly entirely impacted by the fast run off of receivables with no new business during lockdown. New business levels are now returning to pre-COVID levels.

Slide 13 sets out the key performance indicators. These are some of those that we use within the group to both understand and drive performance across our businesses. Cost of risk has increased unsurprisingly as I've already mentioned. There will be a strong focus on return on required equity going forwards as well as net interest margin and risk adjusted net interest margin. The capital liquidity net risk confirmed the points already made on capacity and preparedness.

Slide 14, which is interesting to see on this slide that the pre-impairment profit is only 15% down with net interest margin down by only 12%. This tells us that building receivables under tight underwriting criteria and improvements in the macro outlook over the medium term will return profit levels back to those that were pre-COVID.

The investment over the next three years in our business is digital customer offering will help improve efficiency of delivery as well as reduce operational risks as the business scales up in a post COVID environment. This will drive returns as more customers are helped in improving their everyday lives.

Slide 15 is an interesting slide and talks about the spend behaviour of our Vanquis customers. You will see here that initial fall in Vanquis customer spend was driven significantly by curtailment of holiday and recreation activities. Clearly unsurprising. It is interesting to see that in H1 retail spending by customers doesn't seem to have changed much.

At the more detailed level we saw that the high street spending that dropped significantly was replaced by a near equal and opposite increase in DIY spend. Unsurprisingly, spend on food increased. Spend levels are beginning to return back to their pre-COVID levels, generally.

Slide 16. Moneybarn has seen the fastest recovery to pre-COVID levels of all our businesses and our new business in collections are doing very well. This is after a significant tightening of credit acceptance criteria which has led to new business quality being more near prime in nature. It is also interesting to note that used car [volumes] have held up well since the crisis started.

Moneybarn is a wholly HP finance provider with a security of the car and an amortising loan profile over an average period of more three years. So whilst Moneybarn has no direct impact from car values as is the case with PPP providers, Moneybarn does have exposure on used car prices in the case of repossessed cars whose lost [inaudible] default.

CCD business has benefited from accelerated in production of Provident Direct, a collections method that was introduced UK wide. CCD loans are relatively short in duration therefore suffer run off more quickly than our businesses especially as was in the case in lockdown where customers are both unable to take new loans nor have as much need for spending on important items.

CCD's new business is seasonal and the most significant time of the year for new business flow is pre-Christmas. Quarter 4 with all its uncertainties will be an even more important period for CCD this year.

Slide 17 looks at the impact of payment holidays on our businesses. It was interesting to see the low take up of payment holidays in Vanquis only peaking at 3.5% and now below 1.2%. Our customers clearly see their credit card as an important credit facility in their day to day lives. 23% of customers taking a payment holiday ended up in another form of forbearance after the holiday period ended.

We will continue to monitor future applications for payment holidays which, in theory, can be made up to the end of October this year. Looking at the current levels of take up this remains particularly low.

Slide 18 looks at the payment holidays taken in Moneybarn. They saw a much more material take up of payments than Vanquis. This is partly due to the fact that this option was offered by Moneybarn very actively. This was important since our Moneybarn customers are in the most not homeowners and therefore their car finance payment is the largest one of loan cost per month that they face.

Nearly all will also need their car for going to work. Interestingly, 24% of those taking holiday have moved into another form of forbearance after the holiday ended so similar to Vanquis.

Slide 19, evidence of the material reduction in new business that I talked about earlier. It shows the picture both in terms of intensity and in terms of volume. So it's not unexpected to see that the tightening has also led to reduction in new bookings for the month.

Slide 20 looks at the same metrics but for Moneybarn. The risk reduction in new business in [quarter 2] is also well evidenced by Moneybarn and has also led to improving volumes due to the move towards more near prime lending, which is a [inaudible] than the subprime lending. This demonstrates a very strong relationship with introducers which has strengthened during lockdown through the fact that Moneybarn remained open for business where many did not.

Slide 21 shows our robust coverage ratios. These remained robust and improved from 2019. As you will all know, prime lenders such as the high street banks hold significantly low coverage levels of impairment provisions usually measured in low single digit percentages. Examples of this are Barclays coverage in H1 2019 [inaudible] was 1.8% but now increased to 2.5%, an increase of nearly 1.5 times. Lloyds nearly doubled their coverage to 1.4% of receivables.

These lenders are also much more highly leveraged on their capital due to the very slim RWA on their predominantly consumer mortgage loan [books], which also offer slim net interest margins. They all generally benefit from the [inaudible] government guarantee that systemically [inaudible] demands. In contrast, our business model delivers high net interest margins, has very high impairment coverage with low levels of capital leverage.

Slide 22. This shows the impact of COVID-19 and the macroeconomic outlook on our businesses.

Slide 23 then goes on to look at the effect of our ECLs. This slide is quite important. The waterfall of the ECL shows that the result is that we're near £1 billion within our

balance sheet for impairments. We've taken a prudent and cautious view when assessing the outlook from employment in the UK with a peak severe unemployment level in 2021 at 14.1%. This compares with others at very much the top end of forecast for unemployment.

If we were to use the 14.1% as a 100% weighted scenario the additional impairment charge we would have to provide for in addition to the £73 million as you can see on the left hand side would be an additional £95 million. So whilst this is a theoretical number it also shows the fact that within our £250 million excess capital that this is easily accommodated.

Slide 24 on receivables really confirms the messages that we've been talking about earlier on this call. The reason for the receivables is clearly down to the lockdown and, obviously, the fact that we remained open during the lockdown for Moneybarn.

Slide 25 provides a waterfall for our CET1 from the end of 2019. Again, unsurprisingly, you can see the impact of the post-tax loss as well as the dividends cancelled. IFRS 9 transition amortisation continues and leaves us with £705 million of CET1 which equates to 35.4% of a CET1 ratio with £215 million of excess which is a very strong position for any bank of our size and nature.

Slide 26. This really starts talking about something that I'm very keen on which is not just the strength of our CET1 ratio but also scoring the optimisation of our capital stack and the improvement of the group return on equity through the use of Tier 2 capital, for example, and then maybe potentially, AT1s as an alternative to CET1 only.

It's interesting to note also that our Tier 2 capacity currently around £125 million over and above our CET1 and therefore in addition to our £215 million additional capital that we have not been deploying in [inaudible] as yet. So the growth that we could achieve with the additional forms of debt capital would be very attractive too.

Slide 27 is really about the focus on our balance sheet and how we manage liquidity. The slide shows that in quarter 2, quarter 3, the improvement in both the cost and the undrawn capacity of the group's non-consumer deposit funding have increased quite significantly. The removal of the VREQ that Malcolm mentioned earlier in quarter 3 has been instrument in improving both the cost and diversity of funding in the group. We will continue to optimise both cost and diversity of funding.

We've continued close and positive cooperation with our regulators. This will help deliver better value to our customers as they continue their journey with us to a much better everyday life. I would like to hand back to Malcolm.

Malcolm Le May
Chief Executive Officer

I hope those of you listening found that financial update interesting and informative. Turning to slide 29, you can see here our purpose and culture which I implemented in 2019 which we've embedded and you've obviously heard me discuss before. This is central to what we want to achieve here at Provident, how we want to operate and,

indeed, why we need to exist. I believe it's really proven its worth this year and creates a business advantage for us as a group.

In my view, our purpose is now beginning to resonate just as strongly externally as it is internally. As regulators and government worked out how to respond to the pandemic various consultative forums were created to help the financial services sector steer a path through it. I was asked to join the Consumer Finance Forum which is chaired by John Glen, the Economic Secretary to the Treasury. Also the FCA and UK financier roundtables chaired by Chris Woolard who is the interim FCA CEO.

I was representing Provident and the sector but I think two years ago we wouldn't have had a seat at that table so I think that's the progress that both we and acceptance of our sector is making. Our involvement here shows that the government and the regulators feel our customers are important. I think it shows that they feel we may have changed. It does give us a seat at the top table to fight for our customers in the sector right through the pandemic and beyond. I think this is going to be very important if we're going to help our customers going forward.

As shown earlier on slide 4 and here again now, Provident's biggest opportunity is the sheer size of the subprime market in the UK. As I said before this is a market with approximately 10 to 12 million adults at present which is about 1 in 5 of the working population. With about 1.5 to 2 million customers moving in and out each year. I take no pleasure in this statement because no one ever wanted a pandemic but our market will grow because of it so the opportunity for growth at Provident will increase.

Also what is becoming clearer as the pandemic progress is that funding is being held back or withdrawn from the sector. Going forward it's likely that demand for responsible lending in our market will grow just as supply is reducing. Not a great public policy outcome and nor helpful for our customers. The size of growth in the market due to the pandemic is obviously going to be difficult to quantify.

But that said, the new customers will have the same characteristics and traits as the old as highlighted on the right hand side of this slide. They'll need a specialist partner such as Provident to deliver them the tailored product and services that they want. Provident is the leading specialist credit provider for these customers and if we did not exist alternative options for these customers would be severely limited.

Slide 31 sets out our vision for the future underpinned by a number of growth and efficiency initiatives. The slide was first presented at the Capital Markets Day and this shows the progress that we're making. Vanquis Bank is relaunching their loan proposition next year, expanding its white label partnerships, and developing a self-employed proposition, all of which will deliver growth.

Moneybarn is focused on core market growth, expansion of distribution through lead generators, and moving further in towards the near prime market. All of which, again, will deliver growth. CCD's key growth initiative this year was the successful roll out of Provident Direct for home credit. This hybrid product has been a great success and implemented far sooner than we anticipated with take up being significantly above forecast following its rapid roll out in the earlier of the second quarter. Its take up has, in effect, digitalised the home credit collection operations with remote collections reaching in excess of 90% in April and May.

Turning to group, as you know, our medium term aim is to create a bank for the underserved. This has not changed but our focus is now on achieving cost and capital efficiencies as shown in the Moneybarn securitisation and the successful bond retender. Therefore ensuring that we have a balance sheet to take us through the pandemic allows us to support our customer through responsible lending and also to fund future business growth.

Finally, slide 32. Provident, in my view, has performed robustly during the first half of the year and demonstrated its resilience. In fact, we have performed better than we modelled when the COVID-19 epidemic first struck. The key to this performance was down to the decision that we made right at the outset that we would manage what we could control and consequently our focus was on customers and colleagues and ensuring that we had the strongest possible capital and funding position going into the pandemic and the unknowns that it was to present.

Turning to our focus for the second half of the year and next, we will need to rebuild and grow our receivables books and invest in our digital offering to ensure that we have the best digital customer journeys in place. We are in a good position as we enter the second half of the year. The business has been tested. Our strategy has stood up. We are delivering on our Capital Markets Day promises and our capital and funding is very strong. Our customer base is more resilient than most and exhibits some degree of countercyclicality.

That all being said, we need to remain cautious about what may happen in the second half of the year as the macro environment is still very uncertain. As you can see on the slide, the key variables will be a deterioration in the UK economy, the withdrawal of the furlough, and probably a rise in unemployment. We cannot predict the short term but in my view we are well positioned for the medium and longer term. We are the largest provider in the subprime market. We hold a dominant market position in credit cards, car finance, and home credit.

The subprime market will also grow because of the pandemic and it looks like the supply of credit into the market is reducing. In my view, we have the strategy, the capital strength and funding, market position, product distribution, and management team and culture to grow Provident and to create the bank for the underserved. At the same time delivering attractive long term sustainable returns for our investors over the medium to longer term.

Thank you for listening. We will now take questions which will be coordinated by Jess, our moderator. Could you please, if you want to ask a question, state your name and the firm and then Neeraj and I will do our best to answer them? Thanks.

Q&A Session

Gurjit Kambo - (JP Morgan)

Good morning. Thank you for the presentation. I have three questions. The first question is within home credit clearly you've been able to remote lend and remote collect. Is there a view that maybe this can transition to the model of the future? Do you

need to really return to a home based model given that it's working? Just linked to that, in terms of the reduction in the CEMs by 300 people is that going to link to potentially how you're looking at the model going forward? So that's the first question.

The second one is just in terms of £74 million in payments that you said you've taken related to COVID-19 and the macro outlook, just to be clear, is that based on the base case scenario on slide 23 for unemployment or is that based on a combination of down side and more severe? The final one is can you give us any indication of what percentage or what number of your customers have been furloughed during the last few months? Thank you.

Malcolm Le May

Right, three very good questions. I will answer the first one and Neeraj can answer the second and I'll come back on the third. Yes, in terms of home credit, has been changes that we've been forced to make - changed in any way the models of the future.

I think lending to this segment of society will always require an element of face-to-face contact, both for origination and in some cases, collection. So while I think that Provident Direct will probably be more - as a percentage, a more significant part of the business than perhaps we might have thought when we first were planning to roll it out at the beginning of this year, I still think that there will need to be an element of face-to-face contact for two very good reasons.

One is that a number of our customers want it. At this end of the social spectrum, there is an element of people actually liking to have a face-to-face contact with people. It doesn't apply to all of our customers in home credit but it does apply to a number of them.

Secondly, when customers do fall on difficult times and payments are not coming through remotely, you will need to have a face-to-face interface with them. So I think that we will undoubtedly be seeing a greater percentage of, if you like, digitalisation featuring in the model going forward but equally, I think you won't get rid of the face-to-face contact all together.

In answering your second question about the resizing of the CEMs, in part it is making sure that we have - we are operating as efficiently as we can do but also, it does reflect the fact that there has been an element of greater digitalisation on the collection side of things.

So I think that's an answer to the first question. Neeraj, do you want to answer the question on the £74 million impairments and whether or not - the base case and how it works?

Neeraj Kapur

Yes, sure. What you'll see in the [inaudible] our accounts, is a table on the macroeconomic provisions which shows that the weightings that are given to the base upside, downside and severe downside. So the base case is weighted at 50%, upside at 10%, downside at 35% and severe downside at 5%. Taking those weightings and applying them to the unemployment macro-indicators, we come up with the - that is how you get to the £74 million.

The other point that I made was, if you take the 14.1% peak unemployment for 2021 and use that theoretically as a 100% scenario, that £74 million that we've included would be increased by a further £95 million, being the very worst case.

Gurjit Kambo - (JP Morgan)

Okay, thank you.

Malcolm Le May

Then in answering to the question about what percentage of customers have been furloughed, we don't have any accurate statistics on that because obviously, as long as customers are paying, normally whether it's in terms of their monthly repayments on the credit card or repaying their loans at a Moneybarn or indeed in the CCD, we wouldn't know whether they had or hadn't been furloughed.

I think it's reasonable to assume a significant percentage of them have been furloughed.

The only related stat I can give you is that we've done a very small survey of customers in Vanquis relatively recently, to ask them if they or anyone in their family have become unemployed as a result of the pandemic. That was running at around 4% and I think it was running - the last test was 7%. But that was a very small sample, so I'm not sure you can extrapolate that.

Clearly, the other area of course is payment holidays. We've given you the stats on that. I think this is something that we will see more of later in the year in terms of going into more data on that.

Gurjit Kambo - (JP Morgan)

That's great. Thank you very much, guys.

John Cronin - (Goodbody)

Good morning guys and thanks for taking my questions. The first one, if I could come back to the substantial deposits billed. I'm thinking there in terms of that excess liquidity deployment and more particularly around your previously expressed ambitions to potentially bring Moneybarn into the ring fence.

Does that early build and deposit balances position you in a better context for that conversation with the regulator? If there was anything further to say on that at this point, whether it be in relation to timing or expectations more broadly, that would be helpful.

My second question is just to pick up further on the provisioning point. Can you give us a feel for the granularity in an internal modelling context? I guess what I'm referring to particularly is I appreciate you've gone with a pretty harsh unemployment assumption relative to consensus economist forecasts, as I see them at least.

Most relevant clearly in the case of Vanquis and Moneybarn, but I would like to understand a little better in terms of how your models cope with the very particular impact that COVID-19 is having on certain sectors of the economy and how that's enshrined in your modelling in relation to the [disaffected] customers in the service industry, to which there may be a bias and so on. So to just get some comfort on - colour, rather, on that point in relation to your modelling and confidence in your provisioning as a result.

Then finally, if I could invite you to make some comments on the competitive landscape and how that has been evolving, particularly since the onset of the pandemic and that might, in time, crystallise possible M&A prospects or even substantive organic business build, separate to what you're seeing as customers trickle in to the sub-prime sector more broadly. That would be appreciated, thank you.

Malcolm Le May

I will have a stab at questions one and three and I'll let Neeraj talk about the provisioning. I think yes, we are in an extremely liquid position. We've also said our longer term objective is to build a bank for the underserved. Clearly, having the ability to utilise retail deposits to fund other business - other appropriate businesses within the Group, is something that is on our agenda.

Obviously, this is a journey which we had to go down with both the PRA and others. It is clear that there would be an interest in economic advantage of funding Moneybarn utilising other forms of capital than the traditional route which we've used, which as you know is a revolving credit facility and third-party external bonds.

In fact, you've already seen at the start of this year, starting with the securitisation program [inaudible] business, that's something we will continue. As, indeed, we will look at utilising, if we can, retail deposits to fund that loan book going forward.

It's not something, John, that will happen overnight. It's something we will require extensive discussions with the PRA but clearly, in terms of the medium-term, it's something we've got to look at properly. With their consent, I would like to explore it further. It's really been put on hold from a discussion in the last few months because of the circumstances we're facing.

I will hand - I will let Neeraj answer the question on provisioning and the granularity on that then I will come back with some comments on the competitive landscape. Neeraj? Are you there?

Neeraj Kapur

Hi, John. Yes. Just on the modelling. So the granularity obviously goes down to customer level and then goes into the actual loan itself. We - the way that we model is very much predicated on the probability of default and that probability of default has been affected quite materially by the macroeconomic indicators that we've used. As you say, they are - seem to be more prudent than the average.

In terms of how we look at each and every customer, that is something which would be ultimately more difficult to actually assess whether we think somebody in a particular industry is more likely to default or not because as long as they are paying, then it's difficult to start increasing that default level without seeing any evidence of that likelihood of default.

So we're relying on the macro and that's why we've taken a more prudent view of the macro, to give us that buffer, if you like, against those kind of movements in the economy.

We do find that, certainly if you look at our CCD business, it isn't correlated to macroeconomic indicators and it is very much driven by collections activity and the

number that pay-on-time versus those that don't. So that continues and we monitor that very, very closely to understand our impairment levels.

John Cronin - (Goodbody)

Thank you, that's very [helpful].

Malcolm Le May

So that's the question on provisioning. In terms of the competitive landscape and how that may evolve, I think the first and foremost - the first point I make is, as I said in my comments earlier, this is a very large sector numerically by number of customers, 10 to 12 million people. In fact, the current pandemic is likely to - certainly in the short term - expand that.

We are - so there's a need for credit for that segment of the community and actually, particularly I think as we go further into the economic problems that this pandemic is causing, I think one of the great advantages we have relative to our competition is that we are financially robust and that is in no small part because we have got a bank within our Group.

I think we've also got the ability to access, both through that and also our broader financial position, different sources of capital to fund - for fund growth. It's not for me to comment on the position of others in the sector but I think certainly at the high-cost, short-term credit end of the sector, some of the other listed companies have issued R&S statements saying - outlining some of the challenges they face.

We've obviously been seeing that at the home collected credit end of the market. The guarantor loans market where there are two principal players, one of whom has been attracting a lot of publicity about its circumstances but equally, none of them really have the financial robustness that we seem to have.

Equally, on the credit card side of the business, you know there aren't really, other than at the nearer prime end of the market, where you can argue that Cap One and maybe Barclay's have got a product, there aren't anybody, really other than NewDay who is competing against us and they're funded again differently.

They're dependent on the securitisation markets. The government hasn't given any particular access to capital to these chaps and so I think that is one of the things that is constraining their growth, in my personal belief. I don't know their details.

But I think, where I feel is that we are in a position to grow organically because of that opportunity. Certainly, at the moment, you look at the challenges we've outlined during this call that we still face in the back half of this year and possibly in the first quarter of next year. I think we've got plenty to keep ourselves occupied with, without getting excited about M&A.

So we'll just have to see how things evolve during the course of the next nine to 12 months in that regard.

John Cronin - (Goodbody)

Thank you.

Gary Greenwood - (Shore Capital)

Morning. I've got three questions, please. So the first one...

Malcolm Le May

It seems to be a trend going, doesn't it?

Gary Greenwood - (Shore Capital)

Yes, yes. I think it's the analysts' done thing where you've got to ask three questions. So I'll ask my three, anyway. So the first one was just on the VREC. So good to see that the restriction was lifted there. [Inaudible] useful if you reminded us exactly what the sort of restriction entailed and therefore, as a result of that being lifted, what the increased flexibility that you've got within the group is now?

Then secondly, on IFRS 9 and the capital position. So obviously the capital position has improved a lot in the first half of the year. I'm guessing that the end of the June core tier one ratio, is probably a peak if loan growth picks up in the second half of the year and also, I'd expect some IFRS 9 conditional relief run-off.

So obviously, there's a mechanical run-off there but I presume there's also some run-off as defaults come through, so if you could just give us some colour on how you see that core tier one ratio evolving going forward.

Then last one, just a question on slide 21, just looking at the provision coverage for the coverage ratios relative to the first half of last year have gone up for Vanquis and CCD but it's come down at Moneybarn, even though it's up on the position at the end of the year. So I'm just trying to understand why the movement versus the first half of last year. Thanks.

Malcolm Le May

Okay, I'll answer the first one and then Neeraj can answer the second two questions. The VREC was put in place in late 2016 and you'll recall back at that time, we were under an investigation from the FCA and there was uncertainty about the change of model in CCD, which was - turned out to be Project Accelerate, which obviously as we all well know, didn't go well and led to the difficulties later in 2017.

It required us to get consent from the PRA for any capital or other distributions from the Bank to the broader part of the Group. So it effectively ring fenced the Bank from the group.

The listing, I think is - and you'll have to check with the PRA. The listing is indicative of, I think, a belief that the - from the government's perspective, the Group is being well governed and therefore, whilst we would always still consult with the PRA, we have that much more flexibility to move funds around within the group.

I guess that's evidenced by having had the VREC lifted, the fact that we could take an inter-company loan of some £75 million funded by our retail deposits and basically use that to redeem £75 million in bonds.

Now that, to put that into context, we were able to buy those bonds at a discount as Neeraj said. So there's a capital - a small capital gain doing that but more importantly, going forward, it meant the effective interest on those - on that form of funding, was reduced from 8.25% down to about 1.7%, I think it is. So there's a clear economic gain.

The extent that we used the fact that we have got the Bank and the Group going forward is something that we will always do in consultation with the PRA, clearly. But I have already talked about how it may have ramification for how we form Moneybarn in the future.

I think it also - it's just good business management to use it and - but I think under the rules, and Neeraj can comment on this, that you have a large lending limit that any bank has and that can lend up to 25% of its capital to any single entity. That's something that having the Bank in the Group, to the extent that we can do that in collaboration with the PRA, we should utilise going forward when we can.

So that's the VREC question. Now, if you want to tackle the question on IFRS 9 and also the one on coverage on slide 21?

Neeraj Kapur

Sure. Thanks, Gary, for your questions. IFRS 9 and capital, I think that's very good point. I think our view is that the IFRS 9 charge going forwards, and therefore the impact in capital, will come from growth, hopefully, as we've moved back to the balance sheet that we had before the COVID crisis started.

Depending on the rapidity of that, will depend - will determine the amount of IFRS 9 charge that we'll have to take and clearly, as you will have seen in other settings, that the rate of that, the speed of that increase in receivables, determines the amount of charge and therefore, the steeper that curve, the more charge that we'll take. That kind of is the story of IFRS slowing, as you see it.

In terms of the economic outlook, as we said, we've upfront taken the impact for the book that we have today and whilst that is at a raised unemployment macroeconomic forecast level, that will then impact the new business as well, at that level as we grow our books until the macroeconomic indicators hopefully come to - come downwards in terms of size of unemployment.

If they were to increase, which is obviously a possibility, then clearly, we would have to set aside more IFRS 9 for that occurrence.

Does that answer your question, Gary?

Gary Greenwood - (Shore Capital)

Yes, it was more just around how the core tier one ratio will evolve from here as well because this [inaudible] with IFRS 9 transition [inaudible] there.

Neeraj Kapur

Sorry, yes.

Gary Greenwood - (Shore Capital)

So I presume there's a balance sheet growth and the transition relief rolls off, then if the core tier one ratio comes down, then just in terms of how - the sort of trend really, in terms of how that comes down?

Neeraj Kapur

Yes and I think there's two parts to that as well, is that as you quite rightly say, the CET1 ratio will start coming downwards from its 35.4%. Clearly, it's very high on that basis. However, if we start seeing the reverse of that, which is that receivables don't grow or even decline, which is obviously not something that we would hope would happen or expect. But if that were to happen, the CET1 ratio could in fact go up, even with the transitional charges et cetera on the basis that our book would then create the CET1 coming back from receivables not being there.

So those are the two outcomes. The most likely that we're planning for is the fact that CET1 will start coming downwards as we utilise - and if you look at the amount of excess capital we've got, it's £215 million versus around £1 billion of additional or excess liquidity, those two things are in close agreement in terms of the amount of capital versus the amount of liquidity that we hold.

We also have the ability to raise tier two capital, around £125 million of that which, again, drives additional receivables growth and IFRS 9 capacity as we go forwards.

You would have noted that I did use the word, investing in IFRS 9, rather than just seeing it as a cost because I think in that scenario that we start seeing increased receivables, we have to consider the fact that the IFRS 9 impact is something that just comes with that territory.

As that rate of change slows, you're going to see the profitable nature of that but especially taken with the tightening of credit that we've evidenced in our presentation.

Gary Greenwood - (Shore Capital)

Okay and then just on slide 21, the provisioning on Moneybarn. The reduction from 24% to 19% in terms of coverage?

Neeraj Kapur

Yes, I think there's a number of reasons that that has changed, is that H1'19 and that's interesting because the real thing was the H1'19 moving to the H2'19 level is the real story. The story there is around the timing of credit criteria and the increase in the book itself so that the coverage was on a broader base and as that book starts growing out, you're starting to see the impacts of that diversity of customer base.

The - as you saw on the slide 20, the change in risk of new business in Moneybarn is actually very significant and that's why I put those slides in there. So I think that if you take into account the change in risk appetite from H1, so at the beginning of '19 through to the end of '19, followed by what we're now doing which is even a further improvement in the risk, then the '19 sat - in terms of its - in terms of that context, is a much higher coverage than you'd expect to see.

Gary Greenwood - (Shore Capital)

That's great, thank you, very much.

Freddie Sleiffer - (KBW)

Hi, good morning. I also have three questions, please. Firstly on provisions. Your total ECL as a percentage of stage three loans stayed roughly flat at 104% from the year end

at 105%. Just wondering why you decided to keep that coverage flat and what would need to happen for that coverage to expand?

Then secondly, on the consumer credit provision, what are the main levers that you can pull on and will prioritise when we get some more economic certainty in order to get to that break-even point? Is there any indication you can give on the timeline of this?

Then just lastly, once more a numbers question. What was the interest rate covenant amended to? I believe it was set at two times before and is this valid until the end of the year or is this a permanent change?

Malcolm Le May

Okay, that seems to be consistent and Neeraj and I will split the three questions up. So he can answer the first and third and I'll answer the second one. The first question is on the provisions, Neeraj, can you get that one?

Neeraj Kapur

Yes, sure. So you're talking about stage three, Freddie. So stage three has remained roughly at the same because of the fact that obviously the customers that find themselves in stage three have basically remained of very similar size and nature. Also taking into account the holiday in that, some of these customers would have taken.

Some of these customers would have taken a holiday in stage two and therefore not moved to stage three so not getting that normal movement.

The increase - the improving credit quality has been something that has been occurring in the beginning - from the beginning of H1'20, so it's not something that we're not expecting to see because that stage three coverage remains reasonably flat.

It's the earlier stages that clearly impacted by the macroeconomic impact, which has been quite material and that is - that has been - if you look at the bridge that we provided on macro - on the ECL on slide 23, that you'll see that the main makeup has been the reduction of ECL from volume drops and receivables that come out of our book.

That has actually been higher than the amount of the increase due to new business that we put on during the period. So that is how that's manifest itself into stage three from your perspective.

Malcolm Le May

So the second question was around the CCD, the timeline. As you know and as we much publicised, we had been intending that business to get back to breakeven this year. In fact, it was on track up until the end of the first quarter before the pandemic hit but clearly, as I said, we're not looking for that to be break even this year.

One of the reasons we're concentrating so heavily on collections is that for us to lend to a customer in that business, they have to be up to date and as I think you'll appreciate, Freddie, it's a very seasonal business.

Therefore, we need to be in a position that - and I think we will be in a position that when we go into the all-important fourth quarter where there's significant cyclicity in taking out new loans which builds the receivables balance at the beginning of each year - for the beginning of each year, we have to have a busy Christmas period.

So that's why we've been concentrating so hard on making sure we can collect and are collecting efficiently. So the extent to which that is successful in the fourth quarter is critical to its return to health.

Clearly, also, as things stand at the moment, we don't see any reason why, with the way lending is beginning to rebuild, that should be impeded but for another, dare I say it, massive outbreak of COVID-19 where everyone has to go back into lockdown. We'll have a much clearer picture on that, I think, by the time we get to our fourth quarter.

So, then the final question you asked was on the interest coverage ratio. Neeraj, do you want to just talk about how we've changed that and moved it out?

Neeraj Kapur

Yes, just - I mean, obviously, we don't disclose fully exactly the ins and outs of our covenants but what I can say is that the interest cover covenant has been waived to the end of this year and from there on, it's at a much reduced level to make sure that it meets the requirements that our banks can see that we'd be able to make. So it's very accommodating.

Freddie Sleiffer - (KBW)

Okay, thank you very much.

Portia Patel - (Canaccord)

Thanks very much. My question is about payment holidays. I was just noticing in the next two, three accounts, you note a 50% reduction in the forecast activation of payment holidays in the second half which will reduce the interim impairment charge by about £30 million.

I was just wondering if you could provide some colour on what the forecast activation of payment holidays is for the second half and should that turn out to be different from your assessment, should we be thinking about provision relief this come year end? Thank you.

Malcolm Le May

Neeraj, do you want have a - [inaudible] questions for me. Anything with a P in front of it is for you, okay? Provisions and points

Neeraj Kapur

Yes, all right. Thanks, Portia. Yes, so we have taken a reasonably prudent view on holidays. In terms of our H2 view of holidays, we've clearly got what we'd already seen in terms of the ways that we had forecast in H1 for holidays. We will be reviewing the way that our H2 will formulate out on the basis that we are seeing quite a large drop in that take up at the moment.

The issue that we have, and as Malcolm pointed out earlier, is our customers have until the end of October to decide to take the payment. One of the things that we're quite mindful of is the amount of payment that is yet to come as the furlough payments come to an end and as more employers make decisions around redundancies and that becomes more crystallised.

So there may well be still a view that those holidays start increasing again as we get closer to the end of October and it may well be that there is no real impact. So we have, as you quite rightly say, taken a prudent stance on both holidays and the macroeconomic outlook and both of those things, if they were to transpire to be better, would potentially look to release on that basis.

However, we are also expecting, if that were the case, that the amount of new business that we would be taking on at that time, would then lead to an increase in total provision models due to the rate of increase that we'd expect to see in much more benign circumstances.

So I know it's not a definitive answer but you're right in what you're thinking by seeing that there are other compensating factors that then drive the IFRS 9 charge back up again, even though it's not for the reasons of the holiday.

Portia Patel - (Canaccord)

Thank you, that's helpful. Just to be clear, in terms of the assumptions for the payment holidays, did you say your assumptions are consistent with the end of H1 level and have you budgeted for an increase come the end of furlough?

Neeraj Kapur

No, I think we've taken a reasonably consistently from what we'd assumed in H1, which was more prudent than we saw.

Portia Patel - (Canaccord)

Thank you.

Ian White - (Autonomous)

Good morning. Thanks for the presentation. Just a few follow ups from me, please. A couple on capital. So I know you've mentioned a couple of times in the presentation the idea of optimising the capital based through lower quality capital instruments. Can you see that as a viable strategy given market conditions today? Or is that something that you're flagging as an opportunity post COVID, so over the next 12 months? Can I just understand the timing around when that strategy could be put into action, please? That's question one.

Question two, also on capital. I noted the cut in the - to the two capital requirements. It looks like basically on a look-through basis, you basically had the pension add on removed but the conduct and operational risk add-ons that were applied with FY17 results, basically are still there.

Is there anything you could share in terms of how that conversation went with the regulator around those add-ons? Basically, what would you need to do - obviously for the - over a medium term perspective now, in order to have those add-ons removed or should we think of that - I think it was 6.8 percentage points that were added at FY17. It was just a long-term requirement of being a non-prime lender, basically, under the PRA's framework. That would be question two.

Then just finally, a clarification on costs. I think you said you plan to repay money taken under the furlough scheme and it should be expected some incremental cost in

2H as a result of that, basically, if you have shift costs from 1H to 2H and could you just tell us how much that would be, please?

Malcolm Le May

Okay, I'll take the last one first. I mean, we - basically as I said - I think as I said earlier, we weren't looking to take a lot for furloughing the total. If we'd gone to the whole year, which we haven't done, obviously, we'd have taken about £3 million. So - but the amount we're repaying is substantially less than that because we haven't claimed that much.

Do you want to talk, Neeraj, to the first question on the capital notification timing?

Neeraj Kapur

Yes. Yes and I think you're quite right in what you say is that the move to using tier 2 for example, would be dependent on market conditions and the availability at price of that type of capital and we will assess that between now and over the next 12 months also, to see whether that is available.

If it is available, we might choose to use it and obviously we would be using that - we would be looking at the market conditions of our customer base as well in understanding how much of such capital would be relevant to us.

So it's more about flagging the fact that we haven't, to date, used such instruments. There is a market for them. That market is currently open and we would have to assess where we fit into it.

So that's the first question and the second question around...

Malcolm Le May

The two.

Neeraj Kapur

For the two sides of the equation. Well I think that as you'd expect is that whilst the regulators are coming up with their current total capital requirement for the Group, have actually not really changed much. Which is unsurprising in that the current conditions do not lead regulators to start significantly reducing people's capital requirements.

So I think in a way, it's the fact that as you kindly pointed out, it doesn't look particularly materially reduced, is because of the fact that the conditions just aren't there for it.

As we carry on through the planned period over the next three years and hopefully past the COVID crisis, then those discussions with the PRA will continue and as we've seen with the VREC removal, which I think has been a really big concession by the PRA during this period when other parts of the total capital requirement will hopefully start coming downwards too.

Ian White - (Autonomous)

That's clear. Thank you.

Malcolm Le May

I think that's the end of the conference. Thank you very much indeed everybody for dialling in and listening and we obviously will update you at the next appropriate date but don't hesitate to call Owen or Neeraj or myself if there are any questions that we haven't thought of as of now. Thank you very much, again, for listening. I appreciate it. Thank you.

[End]