H1 Results 2018

WIRES Conference Call
Held at the offices of the Company
280 Bishopsgate London EC2N 4RB
on Friday 3 August 2018

FORWARD-LOOKING STATEMENTS

This transcript includes certain statements regarding our assumptions, projections, expectations, intentions or beliefs about future events. These statements constitute "forward-looking statements" for purposes of the Private Securities Litigation Reform Act of 1995. We caution that these statements may and often do vary materially from actual results. Accordingly, we cannot assure you that actual results will not differ materially from those expressed or implied by the forward-looking statements. You should read the section entitled "Forward-Looking Statements" in our H1 Results announcement published on Friday 3 August 2018.

RBS

Ross McEwan, Chief Executive

Ewen Stevenson, Chief Finance Officer

Introduction

Good morning, ladies and gentlemen, today's conference call will be hosted by Ross McEwan, RBS Chief Executive. Please go ahead, Ross.

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Ross McEwan, Chief Executive

Thanks very much and I've also got Ewen with me this morning. So, thanks for joining the call.

Look, we're pleased with the progressed we've made in the first half of 2018. And see, these are the good set results in more uncertain and highly competitive environment. We've built on a good start of the year and delivered a further quarter of profitability in Q2, with a profit before tax of £613 million and a bottom line profit of £96 million.

For the first half, the bank delivered a profit before tax of £1.8 billion and a bottom line profit of £888 million. These figures include a £1 billion charge related to the settlement in principle of the US Department of Justice, which we announced in May.

We're pleased to be announcing an intention to declare our first dividend in 10 years, subject to final settlement for the Department of Justice. Our intention is to pay an initial 2p interim dividend, building overtime to around a 40 percent payout ratio. We remain committed to our 2020 financial targets of sub 50 percent cost to income ratio and 12 percent or greater return on tangible equity.

Our sector is undergoing significant change and we are positioning ourselves well to compete. We continue to rebalance investment from physical assets into our digital infrastructure. We still have a lot more to do to achieve our ambition of being the best bank for customers in the UK and the Republic of Ireland. However, with our major legacy issues largely behind us, we’re able to fully focused on closing this gap.

Now, in terms of the results at a group level, excluding NatWest Markets, central items and one-offs. Income is stable compared to the first half of the year. This is not unexpected given the low interest rate environment and more uncertain macro economy and the competitive pressures that we are facing.

And NatWest Markets income was down £175 million against our first half 2017. This reflected the turbulence in the European bond markets in the second quarter and it is compared to a very strong first half of last year.

Across the bank, costs are down, by a £133 million or 3.6 percent compared to the first six months of 2017. And this excludes the VAT release that was in our accounts in 2017.

Our capital position is very strong, with a common equity tier 1 capital ratio of 16.1 percent. This includes the negative impact of the pension contribution, the settlement in principle of the Department of Justice and the intended dividend payment. Excluding these items, our common equity tier 1 ratio increased 110 basis points in the quarter.

We continue to support customers in the UK and the Republic of Ireland. We've delivered gross new mortgage lending of £13.3 billion in the UK PBB business since December of 2017, and that's despite the competitive environment.

Increased total customer deposits in UK PBB by £7.5 billion of 4.3 percent, since the first half of last year, and this compared to market growth rate of 2.5 percent. We've grown lending to the SMEs in the UK business banking area ahead of the market and at 1.5 percent on the first half of last year and we've continued to support commercial banking customers with over £90 billion in loans and advances. The NatWest Markets has helped customers both here and internationally raised £130 billion in debt capital markets in the first half of this year.

Overall, we are going in the markets that we like and within risk appetite. But we still have work to do, to get what was going to be the Williams & Glyn branch network into shape and further downsizing of the Royal Bank of Scotland network and England and Wales will take place by year end. This Royal Bank network in England and Wales aside, we are now in a position where the size and shape of that branch network, will be stable until at least 2020.

The pace of change and how our customers interact with us is stark. In the last 12 months, cheque usage is down 16 percent on the first half of '17. Only 3 percent of cheque books we've send out were being used. So we stopped automatically sending out check books for new accounts. Branch counter transactions are down 7 percent. Volumes of calls to our contact centres reduced by 11 percent. But at the same time, the shift to digital channels continues at pace. Our mobile app capability improved in the first six months of this year and we now have 6 million regular mobile app users, that's up 20 percent on the first half of last year.

Over 80 percent of our commercial customers now regularly interact with us through a digital channel. And the volume of conversations with our artificial intelligence chatbot - Cora, continues to grow across the bank. It's gone from 360,000 interactions in the first quarter, it's now doubled. So, Cora's interactions in the second quarter was 650,000. It takes us to over a million conversations in 2018 already.

Our investment in digital functionality is helping us lower costs, improve our controls, protect and grow income streams and most importantly, deliver a better customer experience. We are committed to build on the solid progress that we have made.

Today's results demonstrate the investment case for this bank. A pre-tax profit of £1.8 billion, a bottom line profit of £888 million and excluding the impact of RMBS, a return on equity of 10 percent. We see this as a good performance given the uncertain operating environment and a highly competitive market.

Added to this, we have announced today our intention to declare a dividend 2p, subject to reaching a final settlement with the Department of Justice. And as we've said, our ambition is to reach a payout ratio of around 40 percent overtime.

We know that customer advocacy is not where it should consistently be in this bank. With our legacy issues largely behind us, my team are fully focus on delivering innovative solutions, which will improve our performance and deliver better service to our customers.

I'd like to thank all of our customers and shareholders for their support during what has been a long decade. But with the turnaround of the bank almost fully complete, we can now invest in the future of this bank.

And with that, I'll hand over to Ewen.

But before doing so, I would just like to give me thanks to Ewen for his support over the last four years. Ewen has played key role in the turnaround of this bank. Ewen.

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Ewen Stevenson, Chief Finance Officer

Thanks, Ross, and thanks for the kind words at the end.

Good morning, all. Profitable again in Q2, despite large legacy RMBS provisions. And excluding those provisions, if you look at the underlying return on equity in the first half, it was around 10 percent.

Our income continues to be underpinned by volume growth where we're choosing to grow. It was a better quarter for us in mortgage origination, 11.5 percent flow share, this is 10 percent stock share and continuing good growth in our personal business and private banking deposit franchises.

Cost continue to reduce, underpinned by our ongoing shift towards digital distribution and digital processes. Impairments remained low, only 9 basis points in the first half. But we do remain cautious on the outlook for credit.

Turning to our 2020 financial targets, a 12 plus percent return on tangible equity and a sub 50 percent cost income ratio. To achieve this, our income forecasts are a mix of benefits from improved rates and relatively modest underlying income growth. While the rate outlook has deteriorated a bit in Q2, it remains better than we had built into our forecast at the end of last year. And we certainly welcome yesterday's base rate rise. But with the Brexit deadline approaching, there remained a lot of uncertainty and the balance risk on income I think is skewed to the downside.

For operating costs, we previously said that we expected 2018 cost reduction to lower than trend and we do expect cost reduction to therefore be higher in both 2019 and 2020. With strategic costs, we have previously said that we expect this to total £2.5 billion over the next two years. Nothing really to update on here. We had £350 million in the first half and we expect this to be higher in the second half.

And on conduct costs, our first half results were heavily impacted by the additional £1 billion, Department of Justice settlement charge. These were partially offset by £241 million recovery we had in Q2, on one RMBS indemnity recovery. But away from this, we can clearly see now that legacy conduct costs are trending lower.

On capital distributions, as you've seen and heard from Ross, subject to signing with the DOJ, we intent to pay an interim dividend of 2p per share, that's around 12 basis points of core tier 1. And we also expect that we our existing core equity tier 1 capital buffers, the need to normalise our capital ratios through additional distributions.We don't anticipate considering this until 2019. Obviously, with the full consultation and approval required from the PRA, in due course and dependent on a clean bill of health from this year's stress test.

So, to summarise, we're happy with our first half results set against the backdrop of less supportive operating conditions, an attributable profit for the first half, including remaining profitable in Q2 despite significant legacy conduct provisions. Further, RWA reductions in Q2 meant that we continue to have a very healthy core tier 1 ratio, 16.1 percent post the dividend. We have remained confident on our 2020 financial targets. And subject to signing with the DOJ, we really are delighted to be able to intent to pay an interim dividend. It's been a long journey back for us.

Ross and I particularly wanted to say many thanks to all of our employees for their really hard work over recent years across the bank to deliver this. While it's a modest 2p per share with our existing core tier 1 capital buffers and expected further capital build, we do expect distributions to materially grow from here.

Thanks. And with that, if we could now open for some Q&A.

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Ross McEwan
Thank you Ewen.

Sharon, open for questions, please.

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Operator

Thank you, Ross. Ladies and gentlemen, if you would like to ask a question, please press the "star" key followed by the digit "1" on your telephone keypad. We will pause for a moment to give everyone an opportunity to signal for questions.

Your first question comes from Max Colchester, Wall Street Journal. Please go ahead.

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Ross McEwan

Hi, Max.

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Ewen Stevenson

Hi, Max.

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Max Colchester, Wall Street Journal

Hi, both of you.

Congratulations. I didn't think I'd ever be asking you about dividend but – I – just on that, can you just explain what exactly it's subject to? Can you just lay that out so that I understand exactly and maybe just talk about how you envision it ramping and to what extent this still requires sort of UK regulatory sign-off?

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Ross McEwan, Chief Executive

Well, first off, the – there is only one condition left and that is a final settlement. We've got an in principle agreement, and that just needs to be what I've described as papered and that's what we are waiting for. But we don't anticipate any changes to it other than we have to, you know, sign the agreement when it gets here.

Ewen, any other comments from you?

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Ewen Stevenson, Chief Finance Officer

Yes. No comment. I think the PRA was obviously very comfortable with what we're saying today. So, as soon as we get that agreements signed, we intended to clear the interim dividend. In terms of future distribution, that's obviously subject to their approval and we'll look to revisit that, I think once we're through the stress test results later this year.

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Max Colchester, Wall Street Journal

OK. Thanks.

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Operator

And your next question comes from the Lawrence White, Thomson Reuters. Please go ahead.

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Ross McEwan, Chief Executive

Lawrence, hi.

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Lawrence White, Thomson Reuters

Hi. Good morning, guys. So, on the capital distribution, you sort of alluded to the fact that there might be more than just the dividend. Can we assume that that would most likely in a form of buy-backs and what would be the timing on that? And then just secondly, if you could tell us a little bit more what you mean by the medium-term, in terms of building up the dividends? Thanks.

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Ross McEwan, Chief Executive
Maybe if I start and then hand over Ewen. We're also talking about specials and / or buybacks.

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Lawrence White, Thomson Reuters
OK.

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Ross McEwan, Chief Executive
Not just buybacks. I mean, if you have a look at our capital position today, 16.1 was the very large legacy issues. You know, we are in a very strong position. That continues to build as we continue to make profits and also rundown further RWAs. So, we are in a very healthy capital position. Our intention has always been to get capital back into the hands of the shareholders, where ee don't need it.

There are a couple of things that we are – we will wait to see, one the stress test at the of this year and how we perform on that. Then we are running into a more uncertain time with Brexit, which we'd also want to have a quiet look at before we start making major capital distributions, that we're clearly signalling today. But we do need to get capital back into the hands of our shareholders.

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Ewen Stevenson, Chief Finance Officer
Yes. I think, Lawrence, when you look at that 40 percent payout ration in the medium-term, you know, I would certainly expect us to be in the order of about 40 percent payout ratio over the time we got to 2020. But in addition to that, I think if you look at the existing capital buffers, north of 16 percent today, we've said our long-term core tier 1 target is 13. We will continue to increase capitals that we certainly expect unless there's very adverse outcomes out of Brexit to be in a position to make some very healthy capital distributions from 2019 onwards.

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Lawrence White, Thomson Reuters
Great. Thanks.

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Operator
And your next question comes from the line of Stefania Spezzati from Bloomberg News. Please go ahead.

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Ross McEwan
Hi, Stefania.

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Stefania Spezzati, Bloomberg
Hi. Good morning, both. I was wondering if you could elaborate a little bit more on the timeline. So, when do you expect actually to have the final settlement with the DOJ? Thanks.

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Ross McEwan, Chief Executive
Look, we don't have an answer to that one today. It's really in the hands of the DOJ to get – to bring that conclusion. So, we haven't got a good answer to that one, Stefania.

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Stefania Spezzati, Bloomberg
OK. Thanks.

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Operator
And your next question comes from the line of Iain Withers, The Telegraph. Please go ahead.

Ross McEwan, Chief Executive
Hi, Iain.

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Ewen Stevenson, Chief Finance Officer
Hi, Iain.

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Iain Withers, The Telegraph
Hi. Hi, good morning. Just a quick one. You kind of flag the environment is more uncertain highly competitive, can you just expand on that and how concerned are you on Brexit and its potential impact on your customers? Thanks.

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Ross McEwan, Chief Executive
Yes. A couple of things happening in the marketplace. Obviously, the big one being Brexit and just the uncertainty around what the arrangements will be. You know, we're eight months away. So, that is bearing down on the economy and you're seeing as the economy is running now, probably the slowest rates for the last nine to ten years. And that really is around uncertainty.

The other thing that is happening, the mortgage market is very, very competitive. The – what customers are receiving as an offer out there from banks is very good rates, given the competition in this marketplace. So, that is also bearing down on the needed interest margin and compressing it.

So, you know, some interesting times. Highly competitive market place and high levels of uncertainty that the – you know, that this is happening outside, that's impacting particularly larger commercial customers.

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Ewen Stevenson, Chief Finance Officer
And if you look at the Bank of England forecast that were put out yesterday. You know, next year, the central case for next year and the year after look very

much like this year, you know, weak growth but still growth, just under 2 percent and employment remaining low, inflation remaining under control.

If we're in that type of environment, I think it will be fine for our customers and the banking sector generally. But there's an unusual degree of volatility around that outcome, given that we're looking at everything from Brexit not happening through a very disruptive WTA scenario under some circumstances.

So, we're having to sort of be cautious, we're keeping our liquidity ratios high, we're keeping our capital position strong and we are being cautious on the outlook for credit.

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Iain Withers, The Telegraph
Cool. Thanks.

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Operator
Thank you. And your next question comes from the line of Lucy White, Daily Mail.

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Ross McEwan
Hi, Lucy.

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Lucy White, Daily Mail
Hi, hi. Ross, I think you mentioned that there will be further downsizing of the branch network before the end of the year. Is this beyond the 162 branches that were already announced to be closed and is this – the case of closure is going to be slowing down before the end of year?

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Ross McEwan, Chief Executive
Yes. The only piece that we haven't concluded is – what was going to be the Williams and Glyn branch network and we're just working through that at the moment as to what the network in England and Wales should be. We are – we have concluded the shape of our Royal Bank of Scotland network up in Scotland, obviously, and also the NatWest in England and Wales. That has now been settled with the announcements around the closures this year but it's really just around what was going to be Williams and Glyn, and we're looking to have that concluded by the year end so that we have a very stable and strong branch network going into 2019.

We're also committing, well, at the time we get to the end of the year. We – you know, that position will remain until we get into 2020. Physical distribution is very important to us. You know, we're going to have one of the largest branch networks still after these changes. But there is a big change from customers going from, you know, physical distribution into digital and you've seen that in our results today, the number of customers that are using the mobile channels now is just ever increasing, and we expect that will continue.

So, the investment for the bank whilst it – will be in our branch network because it's important, more and more it will be across into the digital channels because that's where customers have gone.

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Lucy White, Daily Mail
Thanks.

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Operator
Thank you. Ladies and gentlemen, if you'd like to ask a question, please press "star and 1" on your telephone keypad.

Your next question comes from the line Harry Wilson, The Times. Please go ahead.

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Ross McEwan, Chief Executive
Hi, Harry.

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Ewen Stevenson, Chief Finance Officer
Hi, Harry.

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Harry Wilson, The Times
Good morning, guys. I was just going back to Brexit. Can I assume from what you're saying, have you activated your contingency plans for a no deal Brexit? And Ross, can I just ask, are you committing now your medium-term future to RBS? I mean, what – have you given any signal to the Board now in terms of how long you intend to stay?

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Ross McEwan, Chief Executive
Well, first off on the Brexit piece. We're clearly developing an operation in Amsterdam and repurposing the license of that operation for our markets business. And also, our Western European large corporate client's business, and that's progressing. I don't see that changing. We're building that operation at the moment. It's going to be about 150 people.

So, you know, we are progressing our plans. We haven't yet started moving customers across there, but we are getting ready for that and we'll see what the outcome of the negotiations are. We are making an absolute assumption that there is going to be no passporting, that's been quite clear that that's not going to happen. So, we have to therefore give alternatives for our customers. So, yes, Harry, that is happening.

On myself, – I've got a plan through the 2020 for this organisation. We've still got plenty to do. Whilst, the big conduct litigation and major parts of the restructuring of the bank away from 38 countries down to that 12 is nearly complete. We've got a lot work to do around getting this bank into good shape for customers, and that's where the focus is now going to be through 2020.

Harry Wilson, The Times

Thank you.

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Operator

And your last question comes from the line of Julia Kollewe from The Guardian. Please go ahead.

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Ross McEwan, Chief Executive

Hi, Julia.

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Ewen Stevenson, Chief Finance Officer

Hi, Julia.

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Julia Kollewe, The Guardian

Good morning. A couple of questions, please. On Brexit, you were just saying it doesn't look like you’re going to get passporting. What about the other two models that are being floated, mutual recognition or enhanced equivalence? Can you indicated what your preferences are and where do you think it's likely to go. And secondly, on the credit quality – sorry, on the outlook for credit, you said you remain cautious, can you spell that out, especially in light of the rate hike yesterday, please? You sound a bit more cautious than Lloyds earlier this week, but maybe that's just my impression.

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Ross McEwan, Chief Executive

That's all right. First on Brexit, my view here is let's just get the answer so we can all build to it, and I think that's the important piece to get certainty and we'll leave those negotiating it to get it there. We've feed into the UK Finance, our views on what needs to happen and let's see what happen. So, my view is just literally at some certainty. I think that's what the industry needs.

On credit, we remain cautious. I mean, you have a look at the environment that is created through uncertainty, we don't what it will be. So, what the outcomes will be. You are seeing very, very low impairments running through all bank books at the moment. And at some point in time, you know, if there is a deterioration in the environment and much lower growth, will flow through into impairments and we've remained cautious as an organisation and from one that went broke ten years ago, I think you'd expect us to be probably at the cautious end, as opposed to others and we will remain there.

So, you know, we're holding high levels of liquidity, we're holding high levels of capital for any eventuality, and that's what I think people should expect from a well-run bank.

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Julia Kollewe, The Guardian
Thanks.

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Ewen Stevenson, Chief Finance Officer
We've been very open with the market that we think through the cycle, we would expect to see 30 to 40 basis points of loan loss impairments. We're currently running below 10. So, we do expect impairments to tick up from here.

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Julia Kollewe, The Guardian
Thanks.

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Ross McEwan, Chief Executive
OK. Sharon, thanks for running the call.

I think what you could see from these results, these are a very good set of results in tough conditions. Profit before tax £1.8 billion, bottom line profit £888 million and that's after taking a £1 billion DOJ provision. 2p dividend, the intent to pay a 2p dividend announced and, you know, it comes off the back of a 16.1 percent common equity tier 1.

The bank itself is running well. If you have a look at stripping out the Department of Justice fine. You know, return on tangible equity of over 10 percent. We're in a strong position to support this economy and the big legacy issues are behind us. So, we are now focusing on improving this bank for customers and delivering much better returns for our shareholders.

Thanks very much for your time this morning.

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Ewen Stevenson, Chief Finance Officer
Thank you.

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Operator
Ladies and gentlemen, that will conclude today's call. Thank you for your participation. You may now disconnect.

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Ross McEwan, Chief Executive
Thanks, Sharon.

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