NatWest Group plc
Q4 2023 Results Fixed Income Call Transcript
1pm (GMT), 16th February 2024
Hosts: Katie Murray, CFO and Donal Quaid, Group Treasurer

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Slide 2: Welcome

Katie Murray Good afternoon everyone. Thank you for joining our full year Fixed Income results presentation. I'm joined today by Donal Quaid, our Treasurer, and Paul Pybus, our Head of Debt IR.

I will take you through the headlines for 2023 before moving on to some of the financials for the fourth quarter.

Donal will take you through the balance sheet, capital and liquidity and then we'll open up for questions.

Slide 3: Our business has delivered RoTE of 17.8%

Starting with the full year performance on slide 3.

Income excluding all notable items was 14.3 billion, up 9.8%, and in line with our guidance we gave last quarter.

Operating expenses rose 4% to £8 billion including £7.6 billion of other operating expenses.

Together this contributed to taking our cost to income ratio below 52%.

The impairment charge was £578 million or 15 basis points of loans, in line with our guidance.

Taking all of this together, we delivered operating profit before tax of £6.2 billion.

Profit attributable to ordinary shareholders was £4.4 billion.

And return on tangible equity was 17.8%

Today we announced a final dividend of 11.5 pence, bringing the total dividend for the year to 17 pence.

Slide 4: 2024 priorities to deliver returns

Turning to slide 4.

We have set out business priorities for 2024 that Paul covered in the equity call this morning.

Our focus is on creating sustainable long-term value and we have three key priorities – all focussed on driving returns.

Our first priority is to continue to grow our three franchises in a disciplined way, building on strong market positions, targeting growth in areas with attractive returns.

Our second priority is to drive bank wide simplification to make it easier for our customers to do business with us, improve productivity and drive significant efficiencies and operating leverage.

Our third priority is to deploy capital efficiently and maintain strong risk management in order to drive capital generation.

So, as you can see, we are very focussed on levers we can control.

But the macro environment, driven by expected reduction in interest rates and continuing changes in customer behaviour, which I will cover in more detail later, means that we are adjusting our target for return on tangible equity.

We now expect to deliver RoTE greater than 13% in 2026, whilst operating with a CET1 ratio in the range of 13-14%.

Slide 5: Strong financial performance

Turning to the fourth quarter on slide 5, using the third quarter as a comparator.
Income excluding all notable items was 3.4 billion, down 2.0%.
Operating expenses were £2.2bn including the annual UK bank levy.
The impairment charge decreased to £126million or 13 basis points of loans.
And profit attributable to ordinary shareholders was £1.2 billion.

Slide 6: FY'23 income and Bank NIM in line with guidance

Turning now to our 2023 income performance on slide 6.

Full year Income, excluding all notable items, was 14.3 billion and Bank Net Interest Margin was 304 basis points.

Net interest income was 12.1% higher, benefitting from favourable yield curve movements partially offset by the change in deposit volume and mix.

Non-interest income, excluding notable items, grew 2.5%, supported by increased customer activity and higher income from the markets business.

Turning to the fourth quarter, underlying net interest income was £2.7 billion, broadly stable versus the third quarter.

Non-interest income fell 6.9% reflecting seasonally lower trading and other income.

Bank Net Interest Margin reduced by 8 basis points to 286 basis points, which includes a 3 basis point drag from notable items.
As expected, the rate of margin compression was slower than in the third quarter.

Going forward we will report Group Net Interest Margin which presents statutory Group Net Interest Income as a proportion of all Average Interest Earning Assets.

Full year Group Net Interest Margin increased 31 basis points year on year to 212 basis points as a result of higher deposit margins, net of passthrough and mix changes, and lower mortgage margins.

Slide 7: Key drivers of income in 2024

I'd now like to talk about our income outlook for 2024 on slide 7.

As we think about income into 2024, interest rate changes, associated passthrough and the second order impacts on customer behaviour are the key considerations and they remain difficult to predict.

To summarise, the 4 key income drivers today are:

First, our plan assumes the Bank of England will start to reduce interest rates from May, reaching 4% by the end of 2024.

We assume this will be reasonably spread out and in 25 basis points increments, though actual outcome may be different.

We expect to pass through changes to interest rates to our customer deposit rates, but the quantum and timing is subject to competition as well as contractual terms and conditions.

The Second driver is deposit volumes and mix.

Overall, we expect deposit balances to follow a similar pattern to 2023, reducing in the first quarter due to annual tax payments, and then some recovery after that, subject of course to market dynamics.

We anticipate less change in deposit mix than we experienced in 2023.

Third, we expect the hedge to deliver a tailwind in 2024, despite a reducing hedge notional, and for the strength of this tailwind to increase into 2025 and 2026 as volumes stabilise.

Finally, on the asset side, we experienced significant mortgage margin pressure in 2023, as our mortgage customers refinanced onto higher rates at a tighter margin.

This headwind continues to moderate, and we expect the mortgage book margin to stabilise around the middle of 2024, although this is dependent on markets dynamics.

Taking all this together, we expect 2024 income excluding notable items to be in the range of £13.0 - £13.5 billion.

Slide 8: Delivered FY'23 cost guidance, expect broadly stable in FY'24

Turning now to Costs on slide 8.

Other operating expenses were £7.6 billion for 2023, in line with our guidance.

That's up 4.6% on the prior year, mainly due to staff costs including the average annual wage increase of 6.4% and a one-off payment in January this last year to support colleagues with the rising cost of living.

In 2024, we expect to hold other operating expenses broadly stable.

In order to keep costs broadly stable from here we will continue our strong track record of mitigating inflation by making cost savings.

Slide 9: Disciplined approach to growth

Turning to the asset side of the balance sheet on slide 9.

We are pleased to have delivered another year of balanced lending growth across the Group.

Gross loans to customers across our three businesses increased 2.6%, or £9.1 billion, to £359 billion.

During the first half we delivered strong mortgage growth whereas in the second half we delivered strong corporate loan growth, as we took a disciplined approach to capital allocation in a competitive and dynamic market.

During the fourth quarter customer loans across our 3 businesses increased by £1.1 billion

Taking Retail Banking together with Private Banking, Mortgage balances reduced by £500 million as customer repayments offset new lending.

Mortgage flow share for the full year was 14%, reducing to 10.5% in the fourth quarter as we managed the balance sheet in a smaller more competitive market.

Our stock share increased from 12.3% at the start of the year to 12.7% at the end.

Unsecured balances increased by a further £300 million in the quarter to £15.8 billion, reflecting strong demand for credit cards.

In Commercial & Institutional, gross customer loans increased by £1.4 billion.

Within this, the Corporate and Institutions segment increased £2.2 billion, partly offset by companies continuing to pay down government scheme borrowing.

Slide 10: Well diversified, high-quality loan book

Turning to our loan book composition on slide 10.

We have a well-diversified prime loan book that is performing well.

Over half of our Group lending consists of mortgages, with an average Loan to Value of 55%, and around 70% on new business.

We monitor the impact of higher rates on customers closely after they refinance and whilst arrears have increased slightly, they still remain low.

Our personal unsecured lending is less than 4% of Group lending and is performing in line with expectations with good quality new business.

Across our wholesale portfolios, our corporate book and other exposures such as Commercial Real Estate remain well diversified and are still performing well.

And we are not in scope for the FCA review into motor finance.

Slide 11: 15bps impairment in FY'23, macroeconomic assumptions slightly improved

Moving to impairments and our economic assumptions on slide 11.

We have reviewed and updated our economic scenarios, including forecasts and relative weightings.

Our weighted-average expectations for GDP are slightly improved in 2024, but with a small decline in 2025.

We also anticipate a slight deterioration in levels of employment in both 2024 and 2025.

Our balance sheet provision for Expected Credit Loss includes £429 million of Post Model Adjustments for economic uncertainty.

We remain comfortable with 93 basis points as coverage of the book which continues to perform well.

We reported a net impairment charge of £578 million for the full year, equivalent to 15 basis points of loans.

The current performance of the book combined with our updated economic outlook means we are expecting a loan impairment rate below 20 basis points in 2024.

Slide 12: Delivering attractive returns to shareholders

Turning to guidance on my final slide.

In 2024 we expect income, excluding notable items, to be in the range of £13 to 13.5 billion, and group operating costs, excluding litigation and conduct, to be broadly stable versus 2023, and the loan impairment rate to be below 20 basis points delivering a Return on Tangible Equity of around 12%

And to remind you in 2026 we expect to deliver a RoTE greater than 13% in 2026, whilst operating with a CET1 ratio in the range of 13-14%.

We are committed to delivering value for shareholders, so we maintain our pay-out ratio of around 40% for ordinary dividends with the capacity for buy-backs.

With that I'll hand over to Donal.

Donal Quaid Thanks Katie.

Slide 13: Treasurer's welcome

Good afternoon and thank you for joining today's call.

I will start by sharing some highlights for the full year before moving into more detail on the balance sheet covering deposits, liquidity, and capital. I will then give guidance on our funding plans for the year ahead.

Slide 14: Solid capital, MREL and leverage positions. Strong liquidity and diversified funding

Starting with the highlights on slide 14.

We ended the year with a strong capital, MREL and leverage position; comfortably above the regulatory minima with a CET1 ratio of 13.4%, a total capital ratio of 18.4%, a Leverage ratio of 5% and a total MREL ratio of 30.5%.

The group's funding is well diversified, with a strong retail, private and corporate deposit franchise as we ended the year with £419bn of customer deposits.

Our Liquidity Coverage Ratio was 144%, giving us a comfortable surplus over minimum requirements. Our Loan to Deposit ratio was 84% and our Net Stable Funding Ratio was 133%.

It was pleasing to see further progress on our credit ratings in April, with S&P upgrading all NatWest Group entities, recognising the Group's financial performance, robust balance sheet and solid funding and liquidity.

The 2023 Bank of England Stress Test once again highlighted NatWest Group's robust balance sheet given the significant de-risking completed over the last 10 years, providing further confidence that we are well able to withstand a severe shock and enabling us to support our customers and the UK economy.

And finally, last year, we successfully completed our funding plan with £4.6bn of issuance from the Holding Company across both Senior MREL and Tier 2 and £2.4bn from our operating company, NatWest Markets.

Thank you for your continued support for NatWest Group and NatWest Markets transactions.

Slide 15: Strong liquidity metrics and a high-quality portfolio

Turning to liquidity on slide 15.

Our liquidity position remains strong, with an LCR ratio of 144% at the end of Q4, reflecting around £45bn of surplus primary liquidity above minimum requirements.

We manage a high-quality liquid asset pool. Our total liquidity portfolio was £223bn, comprising primary liquidity of £148bn and secondary liquidity of £75bn.

Cash deposited with central banks represents 67% of total primary liquidity.

The remaining 33% mostly comprises highly rated Level 1 LCR securities with a smaller percentage of Level 2 LCR securities. The majority of our Liquidity Portfolio securities are held on the balance sheet at fair value.

Slide 16: Deposit migration is slowing in line with expectations

Looking at our customer deposits on slide 16.

We operate with a diverse deposit franchise, with a mix of retail, private and commercial deposits, across interest bearing and non-interest-bearing product offerings.

Customer deposits across our three core businesses were £419bn at the end of the year, resulting in a loan to deposit ratio of 84%.

In the fourth quarter, we saw a reduction in Commercial & Institutional balances of around £8bn driven by outflows from our larger Corporate and Institutional customers, as we actively managed low margin, low liquidity value deposits, in addition to normal year end flows.

Across Retail and Private, deposits grew by £4bn in the quarter, mainly in term accounts.

Non-interest-bearing balances were 34% of the total, down from 40% at the start of the year.

And customers continued to move balances to fixed term accounts but at a much slower pace than we saw in Q3. Fixed Term balances now represent 16% of our deposit mix, up from 6% at the start of the year.

We remain very focused on pro-actively managing our deposit base, with uncertainty on both the timing and magnitude of UK base rate cuts that will continue to impact customer behaviour.

Slide 17: Strong capital and leverage positions

Turning to our capital and leverage position on slide 17.

Our CET1 ratio at the end of the year was 13.4%, within our target range of 13-14%. We operate with 290bps of headroom above the Maximum Distributable Amount of 10.5%, which increased during 2023 as a result of the UK countercyclical buffer moving to 2%.

Our UK leverage ratio decreased by 40 basis points to 5%, leaving around 115bps of headroom above the bank of England minimum requirement. The decrease was due to an increase in lending across our retail and commercial businesses, and a reduction in core equity Tier 1 capital from shareholder distributions and share buybacks as we moved to within our target range of 13-14%.

The slide also shows the impact of the Other Systemically Important Institution buffer for NatWest Holdings that results in a Group risk add-on for NatWest Group of 1.2%. Although not part of minimum regulatory requirements or combined buffer requirements for NatWest Group, it is included in our minimum supervisory requirements.

Slide 18: Good capital generation supporting strong contributions

Looking at the drivers of the CET1 ratio on slide 18.

In 2023 we generated 154 basis points of capital before the impact of non-recurring notable items and RWA model updates.

This net capital generation was offset by distributions to shareholders, equivalent to 195 basis points.

Risk Weighted Asset's increased by £6.9bn in the year to £183bn primarily driven by increases in credit risk exposures in Commercial and Institutional and Retail Banking. £3bn was due to model updates, and operational risk RWAs were £1.1bn higher following the annual recalibration.

These increases are partly offset by a £4 billion reduction relating to the phased withdrawal from the Republic of Ireland. Our exit from the Republic of Ireland is now largely complete and we received dividends of €1.1bn from UBIDAC including a 300m EUR in the fourth quarter.

We continue to expect RWAs to be around £200bn at the end of 2025, including the impact of Basel 3.1 and further CRD IV model developments.

This is subject to final rules on credit and output floors, which we expect later this year.

Slide 19: Total Capital and MREL above requirements

Turning to our total capital and MREL positions on slide 19.

Our total capital ratio for the year is 18.4%. Given our CET1 target range of 13-14%, we expect to continue operating with optimal levels of AT1 and Tier 2 capital relative to our minimum requirements.

We currently have an AT1 ratio of 2.1% with £3.9bn of securities outstanding. Two of these securities, with a total nominal of $2.65bn USD, have their first call in 2025.

Our Tier 2 ratio is 2.9% with £5.3bn of securities outstanding.

Our total MREL continues to look healthy at 30.5%, significantly higher than our risk weighted asset requirement.

Slide 20: In 2024, expect issuance to be active from HoldCo and OpCo, across multiple asset classes

Turning to our 2024 funding requirements on slide 20.

From NatWest Group, we expect our senior MREL issuance to be in the range of £4-5bn this year, primarily to refinance maturing securities.

On capital we plan to be active in both Tier 2 and AT1 this year.

On Tier 2, we expect to issue between £1-2bn.

On AT1, we are guiding up to £1bn of issuance this year providing flexibility for both forecast increases in RWA's and looking ahead to our two upcoming calls next year.

Actual issuance, as always, will be subject to both the evolution of risk weighted assets and market conditions.

In support of our funding requirements, we plan to be active in the USD, GBP, Euro, and Yen markets from our Holding Company.

From our operating company, NatWest Markets will have senior unsecured funding requirements of £3-5bn in 2024, primarily to refinance maturing legacy debt, of which we have already issued €2.5bn EUR in January in a dual tranche transaction.

Finally, we will also consider a covered bond transaction of up to £1bn from NatWest Bank, given the upcoming maturity in May this year of our last remaining outstanding covered bond under the programme.

With that I'll hand back to Katie.

Katie Murray Thank you Donal.

Slide 22: Delivering attractive returns to shareholders

So, to conclude:

Our priority is to continue supporting our customers in an uncertain macroeconomic environment.

We are pursuing opportunities for targeted growth across our businesses with a focus on returns as we strike a balance between volume and margin.

By combining this disciplined approach to growth with tight cost control and efficient capital allocation we plan to drive strong capital generation so that we can both reinvest in the business and continue making attractive distributions to shareholders.

With a pay-out ratio of around 40% and capacity for buybacks, we remain fully committed to creating sustainable long-term value for shareholders.

With that, we'll open the call for questions.

Q&A

Operator Our first question is a pre-submitted question. Can you talk through your timing expectations on AT1 issuance this year?

Katie Murray Donal, do you want to take that?

Donal Quaid Yeah, happy to take that. So, on AT1, what we said is the guidance is for up to £1 billion, primarily for two reasons, as I said, to give flexibility on the trajectory of risk-weighted assets over the next 12 to 24 months. You know our guidance is £200 billion of risk-weighted assets by the end of 2025.

And then secondly, to give some thought to our upcoming AT1 calls. We start thinking about that 12 months in advance. So, our first call is August '25 of next year. That's the 8% with a nominal of $1.15 billion. So, I think I'd be very, very flippant. It's up to 1 billion. If market conditions are conducive, it's something we will consider, most likely in the second half of the year.

Katie Murray Thanks, Donal.

Donal Quaid Thank you.

Operator Thank you. Our next question comes from Robert Smalley of UBS. Robert, if you'd like to unmute and ask your question.

Katie Murray Hi, Robert.

Robert Smalley Hi, everyone. Thanks for doing the call at an accessible time for us in the States. Two questions.

First on loan loss provision, you delivered on a very low loan loss provision for 2023. The number's only up slightly in the guidance for 2024. Other than some tweaks in macro-outlook, are there any other changing themes behind that, even though we come up to the same place, roughly?

And my second question is on deposits. As you grow market share in deposits, how are you judging the quality of the marginal deposits that you're getting? And by that, I mean, do you look at it in terms of deployment opportunity or how many products this depositor uses across the system? I'm sure it's a mix, but could you rank your priorities for us? Thank you.

Katie Murray Yeah, sure. Thanks. I'll take the first one and then Donal will jump in on the deposit piece.

So, if you look at our impairments, 15 basis points this year, less than 20 for next year. I mean, really very stable in terms of how they're looking.

There's been a few kinds of dynamics going on. I think one of the interesting things is around what we've done with the PMA. If I look at the PMA last year end, it was at 411. And actually, this year, it's a little bit higher at 500.

So, there will be a little bit of a feature, I suspect, of some unwind next year. We've always said it will be very cautious on that. Though in reality, that would bring your number back rather than have it increase slightly. So, there's no change in methodology. But I do think the unwind of that PMA will be interesting.

Earlier in this year, with all of the cost-of-living issues, we had increased it a little bit. And I think as our economics have improved a little, we'll wait to see how things evolve through the quarters. So, you will see a bit of that. But other than that, the methodology is as it has always been. Donal?

Donal Quaid Yeah, it's a good question, Robert, on the marginal value of deposits. I think there's a number of different factors as you laid out. I think probably the two key ones for me is liquidity value and then the stability of that deposit from liquidity value perspective.

So, I think it is all quite linked back to our, I suppose, the importance of our customer and primacy relationships across not just retail, but our corporate and private business as well. But yeah, liquidity and stability value would be key.

Operator Thank you very much. Our next question comes from Sharada Patel of Citi. If you'd like to unmute and ask your question.

Katie Hi, Sharada.

Sharada Patel, Citi Hi, thanks all for the call.

So, my first question would be around asset quality, similar to the previous question, but just thinking into the underlying cost of risk and particularly on the corporate loan book. So, what kind of indicators are you looking at and what's your thoughts for 2024?

And then my second question would be around the LCR and what you kind of think is your correct steady state level of LCR and obviously related to that, your liquid assets as we look ahead into 2024 and beyond. Thank you.

Katie Murray Yep, sure. Thanks very much.

So, look, as we look at the indicators, I mean, within the corporate book, we obviously have this concept of heightened monitoring. And then as people go into heightened monitoring is where we give them more attention within our restructuring units. And then ultimately, whether they crystallise as a kind of a risk of a credit loss.

And there's quite some good, we give you in the accounts in that section, really quite a lot of good information. You can see the details of how we run that piece within there, but it's very much working with the customers, seeing where they're having problems, seeing whether we should approach them about their issues in terms of their flows through their accounts or whether many of them will come to us automatically.

If I look at the impairment losses that we had this year, it was 94 million for the year in commercial and institutional, down from last year at 122. I'm not going to break down the less than 20 bps into kind of segment by segment, but what those levels of numbers tell you is that they are incredibly low for commercial and institutional business.

We've had the real absence of what we call tall trees, so some kind of single name losses. That's because a lot of the de-risking we've done through the book over the years, but it's also because of the real health and quality of the book as they continue to work their way through the kind of economic turbulence. And given that we see economics improve a little bit, they will definitely be part of our impairment narrative next year, but they come from a very strong position.

Donal, LCR.

Donal Quaid Yeah, LCR. I think it's very, very hard to say what a steady state is because we're happy to run obviously a higher LCR if it's made up of high-quality liquid deposits that add income value as well. And I suppose when we look across again, similar to the last question across our three core franchises, if we continue to grow our deposit base there in an income generative manner, I'm very, very happy to run a higher LCR on the back of that. We have said kind of historically we'd always look to run an LCR above 130%.

That's kind of a very rough guide and I would probably stick to that. I think one thing to remember is upcoming TFSME refinancing requirements. So, at the moment, a number of, I'm probably afraid to say, our LCR ratios are inflated by our TFSME drawings. For us, it's a small component, 12 billion, about 4 billion of that's repaid at the end of 2025 with the remaining elements about 8 billion in Q1 '27.

And then in terms of trajectory of liquid assets, I think that would primarily be a function of movements in our deposit base over the next year or two.

But yeah, you know, I think above a 130% LCR is probably a good level to think of.

Sharada Patel Thank you. That's helpful.

Operator Our next question was pre-submitted. Could you elaborate on what is driving expected income decrease in 2024? It's a large fall from the £14.3 billion you've just reported for 2023.

Katie Murray Yeah, sure. Absolutely. And thanks very much for the question. I guess the way that I think about it is there's four main things that you should keep in mind about that.

The first, you know, and clearly the most impactful is the base rate reductions and then the associated pass-through that we have on deposits as those reductions come through. In our numbers, we've assumed five base rates starting in May and a further four cuts coming through in 2025.

Clearly, the timing of rates may be different from what we were imagining. But certainly, that's been one of the drivers of that move from where we are now to the 13 to 13.5.

Secondly, deposit volumes and mix. We do expect deposit volumes to fall a little in Q1 as a result of the tax payments and thereafter move broadly in line with the market.

Third, the structural hedge. You know, as deposits stabilise in the middle of the year, we do start to see the structural hedge adds kind of more income into the second half of the year. And so, and a very good kind of yields. Although the absolute size of

the hedge will fall, given the yield differential that's coming on, it will expect that to be quite valuable in 2024 and really growing in value as we move into 25 and 26.

And then finally, the last thing, mortgage volume and margin. We do expect the book margin to stabilise in the middle of 2024. We talked about it getting to 80 basis points by the end of the year, and that's where we've landed. We're now routing at around 70 bps. So, there'll be a bit of movement, but it's not as significant as we've seen in the past.

But overall, expecting the shape of income to improve as we go through the year with the second half stronger than the first overall.

Thanks very much.

Operator Our next question is, your MREL ratio has come down steadily, I think from 36% to 37% to 30.5% today. Is 30.5% your steady state, given your minimum requirements?

Donal Quaid Happy to take that one, Katie.

Katie Murray Very happy.

Donal Quaid I think thereabouts around 30% feels about right. The key driver of that reduction over the last few years has really been the reduction in our CET1 ratio, and given now that we're kind of operating within our 13% to 14% range of 13.4% at year end, I think that 30% total MREL ratio is a good guide as I look forward.

Katie Murray Thank you.

Operator Our next question is, is your guidance for covered bonds driven by the upcoming TFSME repayments?

Donal Quaid I'll take that one, Katie.

No, it's probably fair to say. So, in terms of covered bonds, again, we've guided to up to a billion. The way I look at that is we only have one covered bond outstanding under our existing programme. So, this time last year, we had three outstanding, we've had two maturities in the last 12 months. The last bond outstanding matures in May of this year.

And I think we're quite conscious of the fact that our covered bond investor base is different to our investor base from a HoldCo and OpCo perspective as well. And it is, I think, 2019 since we last issued a covered bond. So, it's really to keep that programme live as I look ahead into 2024.

Operator Thank you very much for your questions, I would now like to hand back to Katie for any closing comments.

Katie Murray Super, thanks very much indeed and thanks very much for your involvement today and obviously for your continuing support as we continue to issue what is a well-received programme.

We look forward to meeting you in the coming months. Thanks very much and we will speak again formerly in July.

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