TSB Banking Group plc

2014 Half Year Results

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H1 Key Highlights

Local banking for Britain

- ✓ IPO successfully completed
- ✓ H1 performance in line with expectations
- ✓ Strategic delivery on track

Significant developments in H1 2014

January → June

- 1st Jan: TSB switches to Transitional Services Agreement (TSA) with LBG for provision of IT and Ops services
- 28th Feb: LBG provides TSB with £3.4bn Mortgage Enhancement portfolio to enhance profitability by £230m over c.4 years
- 31st Mar: Partners transferred to TSB; £63.7m one-off gain recognised from withdrawal from DB pension schemes
- 1st May: Issued £385m Tier 2 securities to LBG
- 19th May: Issued 445m ordinary shares (bringing total number to 500m) for £200m to LBG
- 25th Jun: Formal admission of TSB shares to LSE

Strategy delivering deposit growth whilst Franchise lending balances continue to reduce as expected

£bn	Jun-14	Dec-13	change
Mortgages	17.07	17.70	*(3.6%)*
Unsecured	2.04	2.08	*(1.6%)*
Business Banking	0.27	0.32	*(15.7%)*
Franchise Lending	**19.38**	**20.10**	***(3.6%)***
Mortgage Enhancement	3.11	-	-
Customer Lending	**22.49**	**20.10**	***11.9%***
Current accounts	7.09	6.50	*9.1%*
Savings	16.61	16.60	-
Customer Deposits	**23.70**	**23.10**	***2.6%***
Group LDR	**94.9%**	**87.0%**	***7.9pp***
Franchise LDR	**81.8%**	**87.0%**	***(5.2)pp***

- **Customer lending up driven by purchase of Mortgage Enhancement but as expected...**
  - Lower Franchise Mortgages as no access to the mortgage intermediary market
  - Decrease in Unsecured primarily reflects seasonal trends
  - Business Banking reduction given re-direction of certain customers back to LBG
- **‘Classic Plus’ current account campaign drives deposit growth**
- **LDR positions Franchise business for self-funded growth**

Strong capital base to support future Franchise growth

£m	Jun-14	Dec-13	change
CET1 / T1 capital	1,593	1,182	*35%*
Tier 2 securities	383	-	-
Total capital	1,976	1,182	*67%*
RWAs	5,668	6,215	*(8.8)%*

CET1 / T1 capital ratio	**28.1%**	**19.0%**	***9.1pp***
CET1 / T1 capital ratio (pro forma)	**18.2%**	**-**	***-***
Total capital ratio	**34.9%**	**19.0%**	***15.9pp***
Leverage ratio	**5.9%**	**4.6%**	***1.3pp***

- Increase in capital ratios driven by capital injections, retained profits
- Lower RWAs due to:
  - Lower Franchise lending
  - Unsecured lending on Standardised approach
  - Offset by Mortgage Enhancement
- Pro-forma reflects:
  - Franchise lending moves to full IRB basis
  - Change to calculation of operational risk RWAs

Franchise management profit reduced as expected, statutory profit increased from one-off pension gain

£m	H1 2014	H2 2013	change
Total income	431.0	421.9	*2.2%*
Operating expenses	(333.5)	(271.1)	*(23.0%)*
Impairment	(50.5)	(56.2)	*10.1%*
Franchise management profit	**47.0**	**94.6**	***(50.3%)***
Mortgage Enhancement	31.6	-	-
Group management profit	**78.6**	**94.6**	***(16.9%)***
Withdrawal from DB schemes	63.7	-	-
Derivatives and hedge accounting	0.2	(39.3)	-
Derivative fair value unwind	(14.0)	(6.6)	-
Statutory profit before tax	**128.5**	**48.7**	***163.9%***
Tax	(26.7)	(5.2)	-
Statutory profit after tax	**101.8**	**43.5**	***134.0%***

- **Lower Franchise management profit:**
  - Income up given lower deposit costs following re-pricing
  - Higher standalone cost base
  - Impairment reflects improving environment
- **H1 Operating expenses not fully representative of full year run-rate as:**
  - Recruitment continues
  - Investment spend skewed to H2
- **Higher statutory PBT driven:**
  - One off gain from exit from DB pension schemes
  - Lower accounting volatility

Increased income driven by purchase of Mortgage Enhancement and reduced deposit costs

£m		H1 2014	H2 2013	change
FRANCHISE	Net interest income	356.5	345.0	*3.3%*
	Other income	74.5	76.9	*(3.1)%*
	Management income	**431.0**	**421.9**	***2.2%***
	Banking NIM	3.62%	3.49%	*13bps*
MORTGAGE ENHANCEMENT	Net interest income	34.1	-	-
	Other income	(1.9)	-	-
	Management income	**32.2**	-	-
	Banking NIM	3.16%	-	-
GROUP	Net interest income	390.6	345.0	*13.2%*
	Other income	72.6	76.9	*(5.6)%*
	Management income	**463.2**	**421.9**	***9.8%***
	Banking NIM	3.58%	3.49%	*9bps*

(1) Added Value Accounts

- Higher Franchise NII reflecting deposit re-pricing offsetting:
  - Competition in unsecured market
  - Higher 'Classic Plus' balances than anticipated
- Franchise other income driven by AVAs[1] off sale in branch
- Franchise NIM remains in line with Q1 and guidance
- Mortgage Enhancement contributed c. 80% of income growth in period

Economic environment and strong control of credit risk driving improvement in asset quality

£m	H1 2014	H2 2013	change
Mortgages	**(0.6)**	4.3	-
Unsecured	**48.2**	47.5	*(1.5%)*
Business Banking	**2.9**	4.4	*34.1%*
Franchise impairment	**50.5**	**56.2**	***10.1%***
Mortgage Enhancement	0.6	-	-
Group impairment	**51.1**	**56.2**	***9.1%***

%	H1 2014	H2 2013	change
Mortgages	**(0.01)**	0.05	*6bps*
Unsecured	**4.50**	4.32	*(18)Bps*
Business Banking	**1.88**	2.53	*65bps*
Franchise AQR	**0.51**	**0.57**	***6bps***
Mortgage Enhancement	**0.05**	-	-
Group AQR	**0.47**	**0.57**	***10bps***

- Mortgages recovery reflects improved economic environment (particularly HPI)
- Unsecured impairment and AQR higher given increased provision rates while we embed new recoveries function but underlying trends remain encouraging
- Business Banking driven by a smaller book
- Impaired loans at 1.0% of total gross lending while coverage ratio increased to 41.6% from 40.1%

The outlook for 2014…

COSTS	c.£700m of costs expected in 2014, lower than previous guidance due to controlled ramp up of recruitment and investment as well as some underlying cost reductions
ASSET QUALITY	Asset quality has benefited from the improved economic environment which is expected to remain favourable
FRANCHISE MARGIN	Broadly flat in line with H1 2014

TSB's strategy is one of growth

Grow current accounts

- Use TSB's substantial distribution capability to grow market share of current accounts by consistently taking >6% share of gross flow over a five year period

Grow customer lending

- Grow Franchise customer lending by 40-50% over a five year period, most notably through re-entry into the intermediary mortgage channel

Enhance TSB proposition

- Deploy TSB's considerable digital capability
- Build greater consideration of the TSB brand
- Deliver a differentiated customer experience

Reaching double digit ROE in circa five years, benefiting from a higher rate environment

Early strategic progress is encouraging

Grow current accounts

- Strong customer response to TSB's 'Classic Plus' current account
- Share of current account gross flow[1] 9.2% in latest quarter

Grow customer lending

- Mortgage Market Review reforms implemented
- Creation of TSB's intermediary mortgage capability on track for launch in Q1 2015

Enhance TSB proposition

- Every employee now a 'Partner' in the business
- 84% of new current accounts[2] registering for online banking
- Brand consideration[3] increased from 12% to 18%; NPS[4] improved 8pp since prior quarter

(1) CACI Current and Savings Account Market Database (CSDB) which includes current, packaged, youth student and basic bank accounts, and new account openings exclude account upgrades . Membership of CSDB changed in Jan 2014. Three month average with a two month lag (Feb-Apr 2014). (2) three month average. (3) Non customer PCA Brand Consideration. Q2 2014 vs. Q4 2013 (4) Net Promoter Score (NPS) is based on the question "On a scale of 0-10, where 0 is not at all likely and 10 is extremely likely, how likely is it that you would recommend TSB to a friend or colleague?" NPS is the percentage of TSB customers who score 9-10 minus the percentage who score 0-6.

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