Virgin Money IPO

Our team of experts take a closer look at Virgin Money.

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Virgin Money IPO

Andrew Gibson, Head of Research 10 November 2014

Quick Facts:

Founded: 1995

Customers: Over 4 million

Staff: 2,800

Revenue: £210 million (first half 2014)

Underlying profit: £59.7 million (first half 2014)

Current Ownership: Virgin Group 47%, Wilbur Ross 45%, Abu Dhabi investment fund 6%

Estimated value: £1.25 billion to £1.45 billion

Branson's back! Britain's best known billionaire is set to float Virgin Money on the London Stock Exchange.

A unique and trusted brand

Virgin is one of the world's most recognised and respected brands.

Richard Branson has successfully positioned Virgin as an underdog that cares about its customers, taking on the established players who deliver poor value products.

As Branson has previously said "I've had great fun turning quite a lot of different industries on their head and making sure those industries will never be the same again, because Virgin went in and took them on."

In the mid-1990s Richard Branson was looking for the next industry to shake-up, having already successfully taken on the music and airline industries. He then set his sights on the banks…

In typical Virgin style, Branson's aim was to give customers what they actually wanted: easy-to-understand, good value products and great service.

Initially Virgin formed various joint ventures with existing players such as RBS and Norwich Union under different brands (Virgin One, Virgin Direct). In 2000 the Virgin Money brand was formed and in 2002 the different ventures were consolidated.

Virgin also expanded its operations internationally, launching in Australia and South Africa, where it continues to grow today.

Branson bags a bargain

While Virgin Money has been an innovator from the start (pioneering online comparison sites, the offset mortgage, index tracking PEPs), its growth was held back because it wasn't a fully-fledged bank.

But a big breakthrough came when Northern Rock was put up for sale. In November 2011, it was announced that Virgin Money would buy Northern Rock plc for £747 million, far below the £1.4 billion the government had injected into it in the prior year.

The price tag would rise to almost £1 billion if certain conditions were met, but still meant the taxpayer made a loss of £400 million (best case). The government had initially hoped to make a £100 million profit.

Just to be clear, the part of Northern Rock that Virgin Money bought was the "good bank" – which included 75 branches, £16 billion of savings and £14 billion of quality mortgages. The government is still holding onto Northern Rock's "bad bank" – a waste dump of toxic mortgages that's already had £21 billion of taxpayers money pumped into it. Remember Northern Rock's 125% mortgage?

Put simply, Virgin Money acquired all the best bits of Northern Rock at a huge discount.

To appease the government, Virgin agreed to make no compulsory redundancies for 3 years and to keep the existing branch network. It was an easy political concession to make.

When the sale was agreed Chancellor George Osborne stated "It represents value for money, will increase choice on the high street for customers and safeguard jobs in the north-east".

We agree with all three points, but it was Branson who got the value for money not the taxpayer!

That's by no means a dig at Branson. At the time, there were not many big investors who had the money and quite frankly the courage, to buy a bank. Branson had both.

Northern Rock was not just a bargain, the deal made a lot of sense.

The CEO of Virgin Money, Jayne-Anne Gadhia, said at the time "The great thing about this business combination is that the two businesses lock together very well."

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"Virgin Money has credit cards, insurances and investments, and Northern Rock has mortgages, savings and current accounts."

The acquisition has fuelled Virgin Money's rapid expansion and given it the size and scale to take on the big boys.

Who owns Virgin Money?

Virgin Money is presently owned by a several investors. Virgin Group, Richard Branson's holding company, is the largest shareholder, with a 47% stake.

Wilbur Ross, an American billionaire, also owns a 45% stake. Ross has a 30 year track record of investing in turnaround situations at knock-down prices.

At the time of investing in Virgin Money, he was specifically looking for mortgages and mortgage companies – which were out of favour with investors and therefore at cheap prices. Virgin's brand and growth strategy caught his eye. The investment enabled Virgin Money to fund the Northern Rock deal and accelerate its plans of becoming a full-service retail bank.

While Virgin Money's IPO will see the two key investors reduce their stake, both are expected to remain large shareholders in the company.

How profitable is it?

Virgin Money pre-tax profits grew more-than-four fold to £59.7 million in the first half of this year. Revenue (which banks call 'income') also saw good growth, increasing 28% to £210 million.

Virgin Money looks to be massively outperforming the wider market.

In its 2013 annual report, it showed that Virgin's savings balances grew 17% versus 5% for the market in general.

Mortgages also outran the opposition with 17% growth versus only 1% for the market. Importantly, its mortgage book also appears healthy - after all anyone can lend money, it's getting it back with interest that's the challenge.

Virgin's average loan-to-value stands at around 60% (meaning an average of 40% home equity) with those over 3 months in arrears only 0.3% of the book.

Savings and mortgages remain Virgin's core products, representing 65% of profits (as at 2013). Credit cards come next at 22% and other complementary products (pensions, investments, insurance) make up the remaining 13%.

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The big product development of this year is Virgin's launch of a current account. Current accounts are the bedrock of banking products, from which many other products are cross-sold. We see this as an important step for Virgin and a platform for further growth.

While some would point out that getting customers to switch banks is never easy, Virgin has been gaining market share. It has a powerful brand in an industry where trust is almost non-existent.

To illustrate the point, a 2012 survey by consumer watchdog Which? revealed that Barclays was Britain's least trusted brand. At the other end of the spectrum, Virgin came in as Britain's 5th most trusted brand.

All of the UK's big four banks are tainted by mis-selling scandals and greedy past practices. Whereas Virgin has a clean slate.

There are other 'challenger' banks that have popped up in recent years. But they generally lack scale or brand awareness, with the exception perhaps of Tesco Bank. However, Tesco has its hands full with its faltering grocery business and funnily enough in the same Which? survey it came in as Britain's second least trusted brand behind Barclays.

Overall, Virgin Money has a solid platform from which to grow: a fantastic brand, millions of existing customers, an expanding product suite and a market crying out for a bank they can trust.

IPO overview

The most popular IPOs are when investors already know the name and know what they do. Royal Mail and Poundland are two recent examples of this and both were very successful IPOs.

We believe Virgin Money has the makings of another very popular IPO.

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