

# Half-Year Financial Results

The Paragon Group of Companies PLC



Six months ended 31 March 2015

paragon

# Agenda



Section 1

Financial Results

Section 2

Strategy and Business Development

Appendices

Introduction to Paragon  
Company overview

# Highlights

## **10.4% growth in operating profits to £63.9 million**

- Further improvement in RoE to 10.8%

## **All operating divisions showing strong performance**

- Buy-to-let lending up 65.7%, strong momentum continues
  - Buy-to-let pipeline doubled and provides significant H2 momentum
- Excellent performance from Idem Capital extant portfolio with additional £20.9 million of investments
- Paragon Bank origination flows building momentum

## **Funding capacity increased and further diversified**

- Paragon Bank retail deposit total of £165.0 million at 31 March 2015 – deposits now over £250 million
- Securitisation programme funding capacity materially increased by access to Euro investors
- Warehouse capacity enhanced to £750 million
- Investment grade corporate rating assigned by Fitch

## **Capital management focus**

- 20% increase in dividend in line with cover targets
- Share buy-back programme progressing in line with expectations

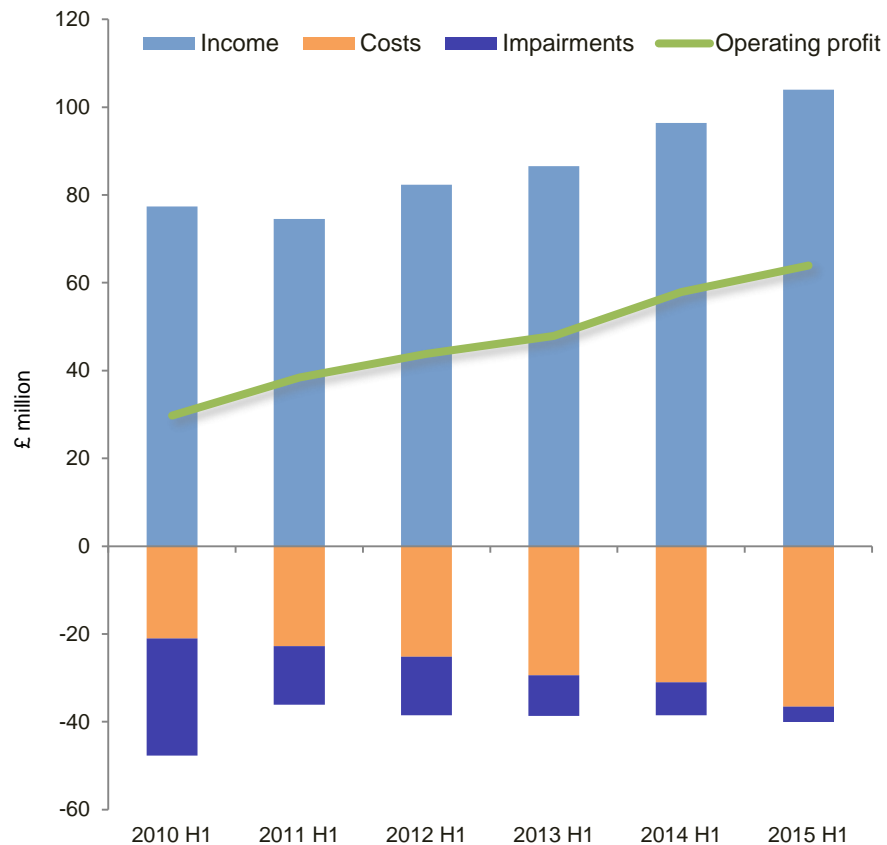
# Financial Results

Six months ended 31 March 2015



# Operating profits

Operating profits increased by 10.4%



## Interest income growth and credit performance driving progress on operating profits

- Net interest margin up from 1.96% to 2.09%
- Other income reduced from £9.4 million to £6.8 million
- Average balances up 4.6% to £9,362.1 million

- Operating profit CAGR of 16.5%

- Efficient operating model – underlying cost:income ratio 30.9%

- Bad debts improve to 7bp from 16bp annualised

# Segmental profit trends

## Delivering strong growth



- Operating profit - up 12.3% to £44.7 million (2014 H1: £39.8 million)
- Growth in loan assets - £9.0 billion (2014 H1: £8.7 billion)

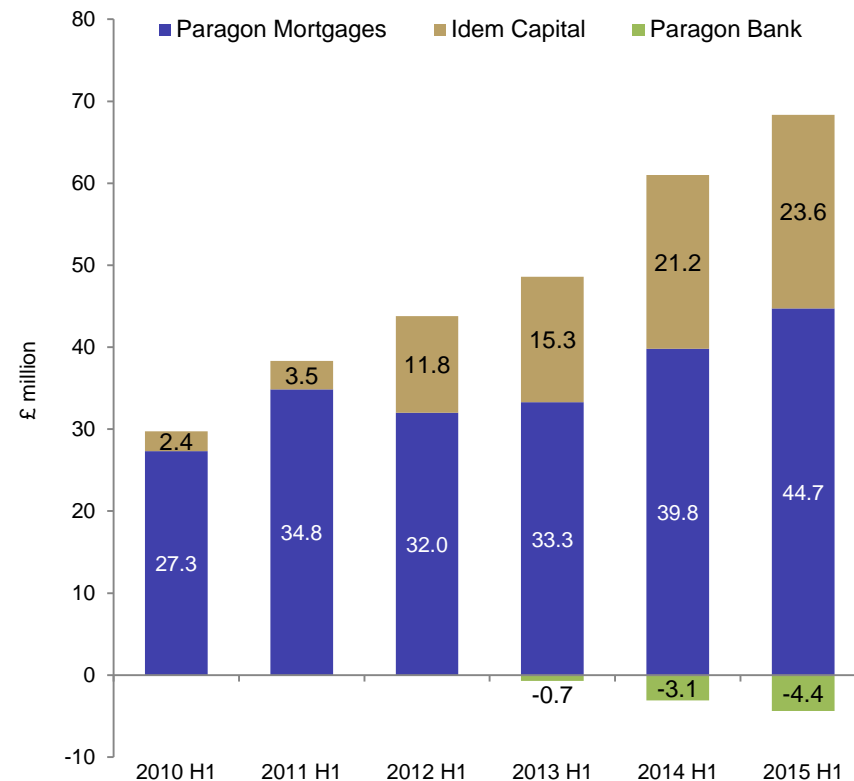


- Strong profit growth – up 11.3% to £23.6 million (2014 H1: £21.2 million)
- 84 month ERC - £546.6 million and 120 month ERC - £639.2 million



- £4.4 million (2014 H1: £3.1 million) loss reflects start-up expenses in line with expectations
- Momentum building on loan origination - £85.6 million (2014 H1: £0.3 million)

Operating profits increased by 10.4%



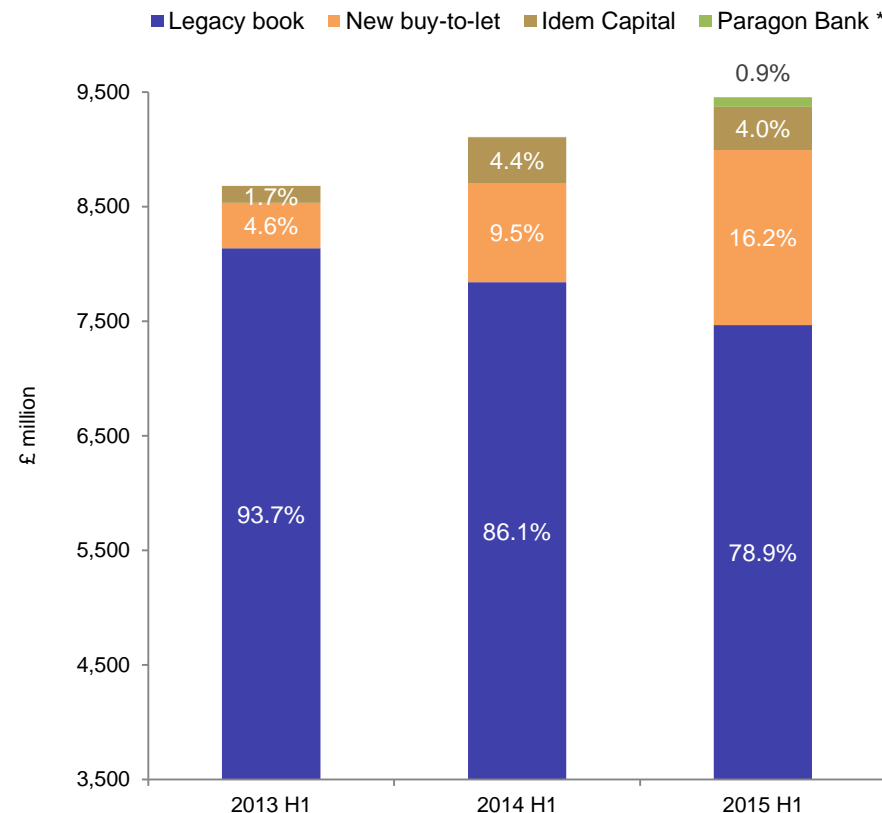
(2010 to 2012 unaudited; 2013 restated)

# Loan portfolio and investments

## New portfolios represent growing proportion of Group assets

- New buy-to-let loan book grew 76.2% on 2014
- Legacy buy-to-let book amortising at 3.8% but remains dominant part of balance sheet
- Idem Capital investments of £20.9 million
  - Balance sheet outstandings £406.9 million (2014 H1: £418.6 million)
- Paragon Bank originations increasing
  - £61.9 million of buy-to-let lending
  - £19.5 million of consumer lending
  - Balance sheet outstandings £85.6 million
- Growth in pipeline will accelerate change in mix

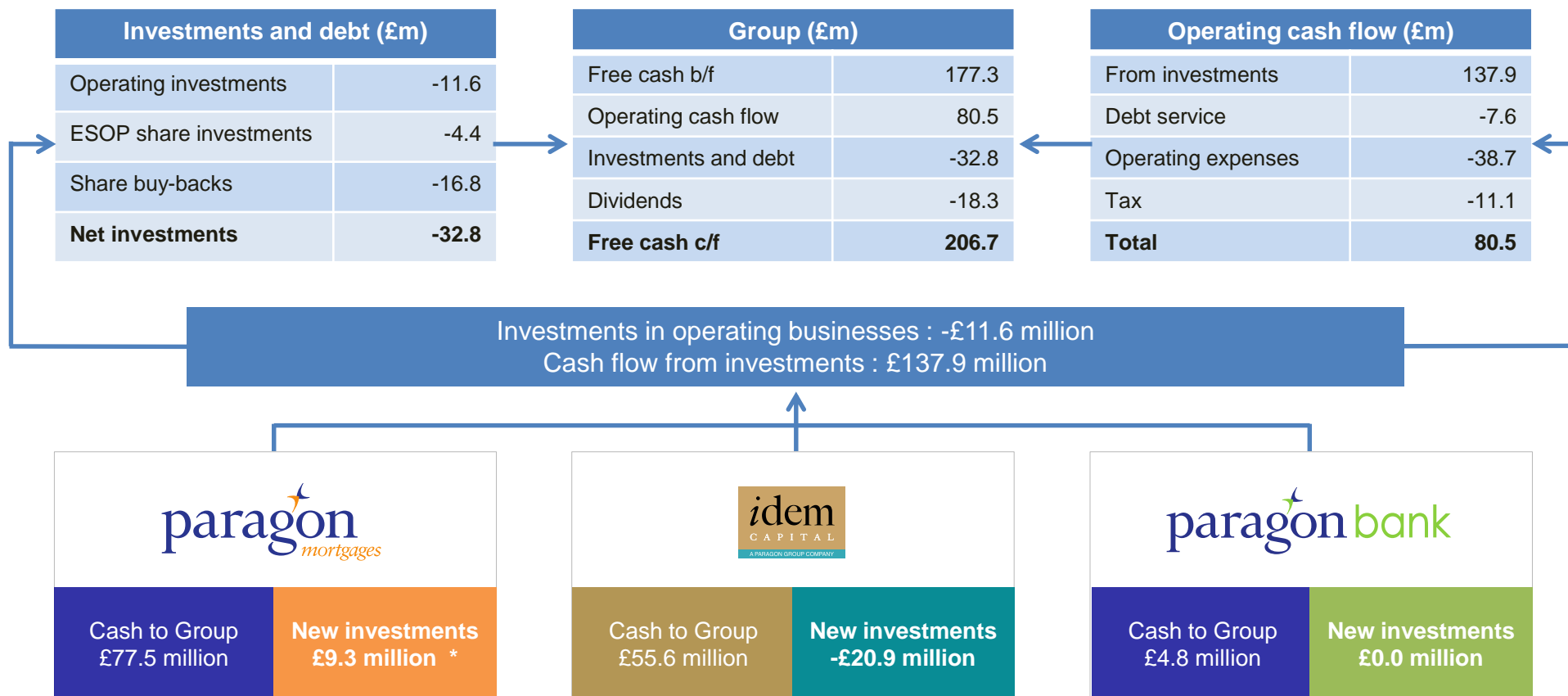
Loan book at 31 March 2015



\* Includes buy-to-let funded by Paragon Bank

# Group cash flow

## Operating cash flow exceeds £80 million for 2015 H1



\* Net inflow due to timing of PM22 in March 2015



# Capital and leverage

## Conservative capital and debt positions generate material balance sheet capacity

Group consolidated capital	
Core Tier 1 capital *	£933.5 m
Tier 2 capital	£48.4m
Risk exposure (RWA and operational risk)	£4,784.0m
CET1 ratio *	19.5%
Total capital ratio	20.5%

Group consolidated leverage ratio	
Tier 1 equity *	£933.5m
Balance sheet assets and off balance sheet items	£11,571.7m
Leverage ratio	8.1%

Group solo net debt	
Corporate debt	£295.2m
Free cash	£206.7m
Net debt position	£88.5m

\* Adjusted for proposed dividend

### Paragon Bank capital requirements

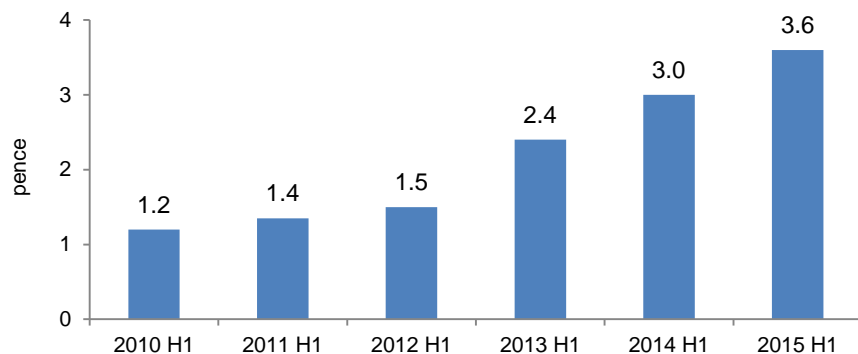
- Paragon Bank has an Individual Capital Guidance (ICG) level set by the PRA
- This, with planned balance sheet development, drives the scale of annual capital injections from Group
- Paragon Bank's initial ICG level reflects its position as a start-up
  - ICG expected to reduce over coming years as PRA's SREP (Supervisory Review & Evaluation Process) reviews for Paragon are completed
  - Likely to mitigate further capital requirements despite expectation of strong balance sheet growth

# Key financials

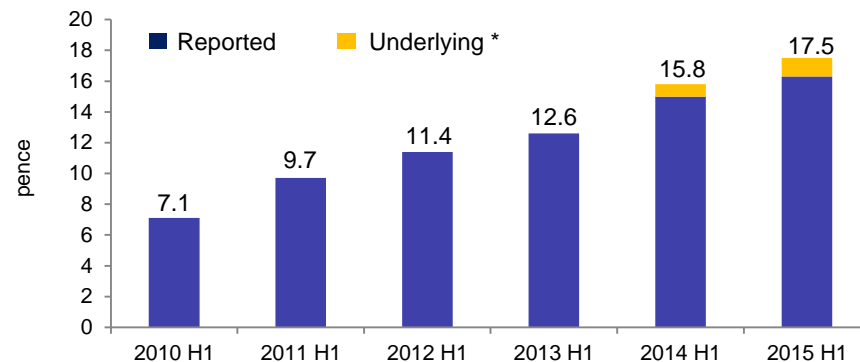
## Progress on key financial metrics

- Trend growth in EPS maintained
  - Underlying EPS up 10.8% YoY
- Dividend growth up 20% in line with targeted cover ratio
- Continued growth in RoE

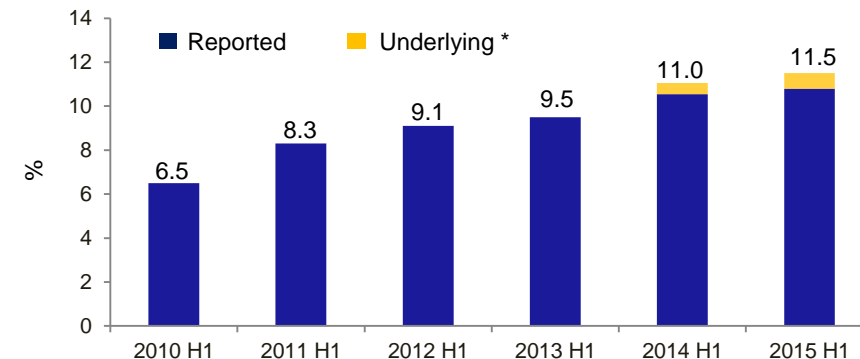
## Interim dividend per share



## Earnings per share



## Return on equity

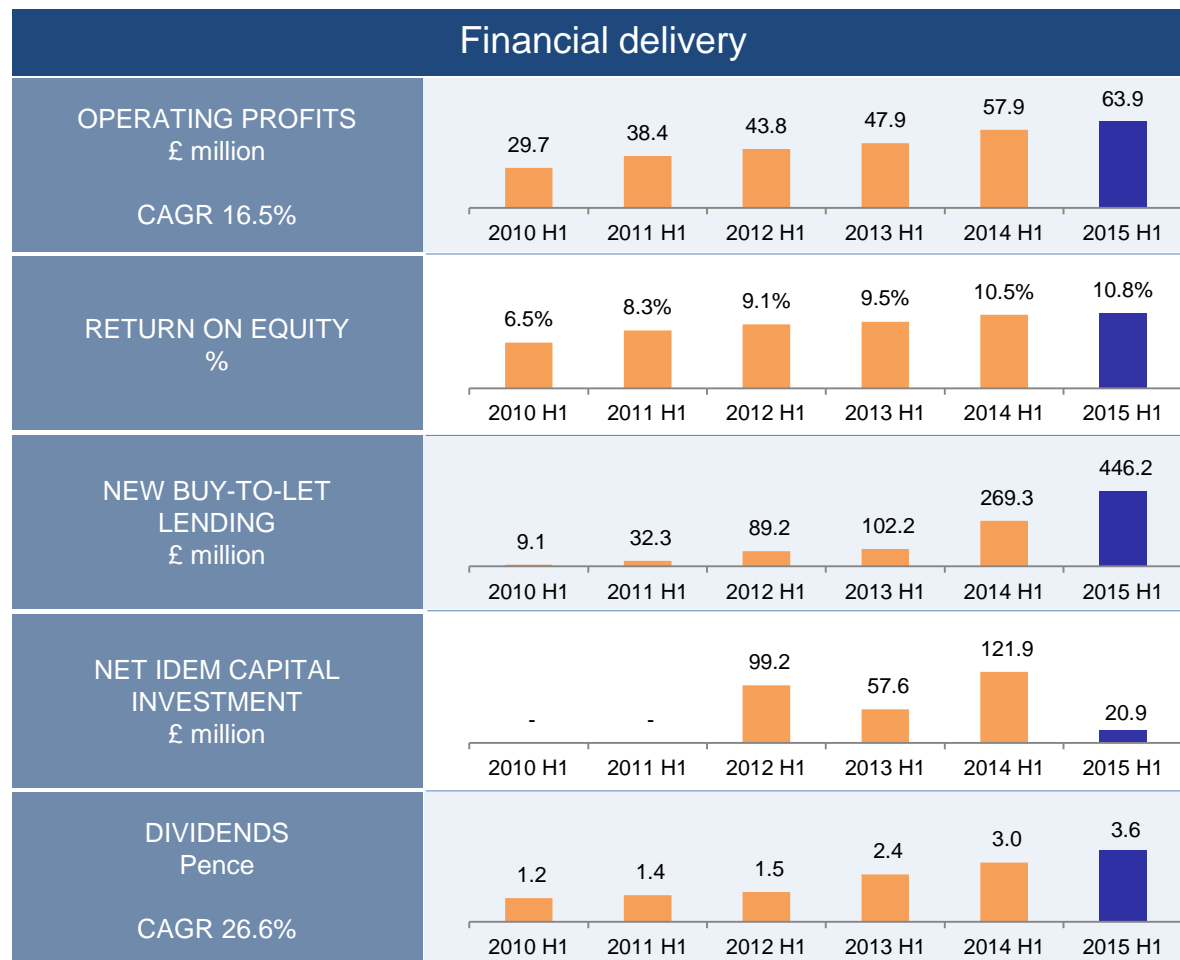


\* Underlying excludes impact of Paragon Bank

# Strategy and Business Development



# Strategy delivery



## Strategic priorities

- Clear focus on specialist lending products
- Environment presenting increasing opportunities
- Strong and continuous focus on:
  - Mortgage and consumer sectors
  - Data analytics
  - Risk management
  - Low cost model
- Driving diversification of:
  - Income streams
  - Funding sources
- Strong growth with sustainability
- Improving shareholder returns
- Disciplined capital management

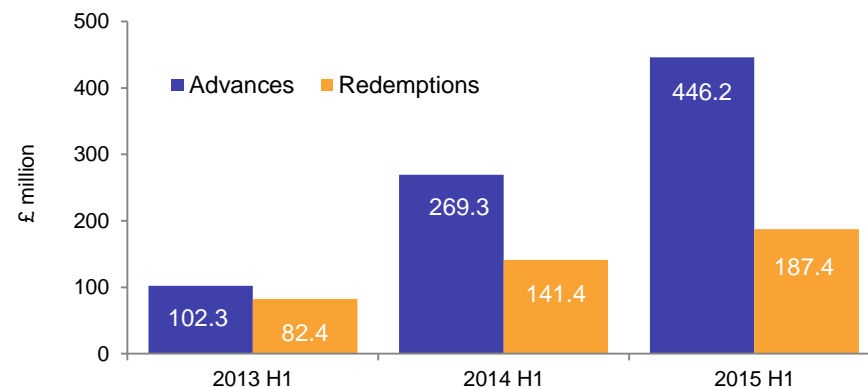
# Paragon Mortgages – new lending

## New buy-to-let lending contributing increasing share of interest income

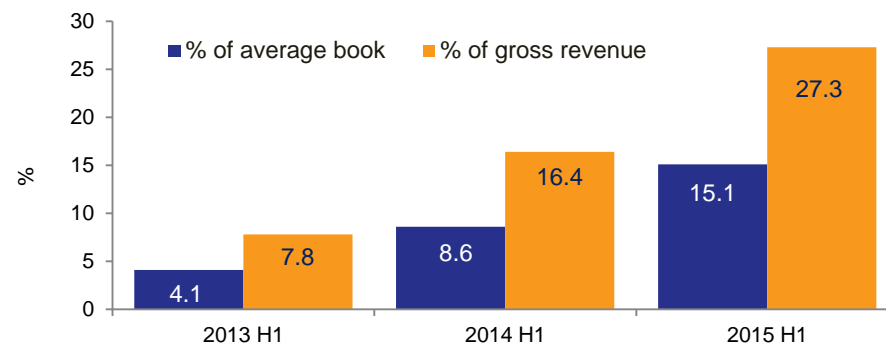
- Increased buy-to-let lending of £446.2 million (2014 H1: £269.3 million) – 14% advanced by Paragon Bank
- Stronger funding capacity provides support to deliver broader product reach, broader geographic reach and enhanced distribution
- Segmental margin enhanced despite carry cost of 2014 bond issue
- Credit quality remains exemplary
- Redemptions remain low
  - Legacy portfolio 3.8%
  - New portfolio 7.3%



## Buy-to-let activity



## New Paragon Mortgages lending proportion of loan book and revenue



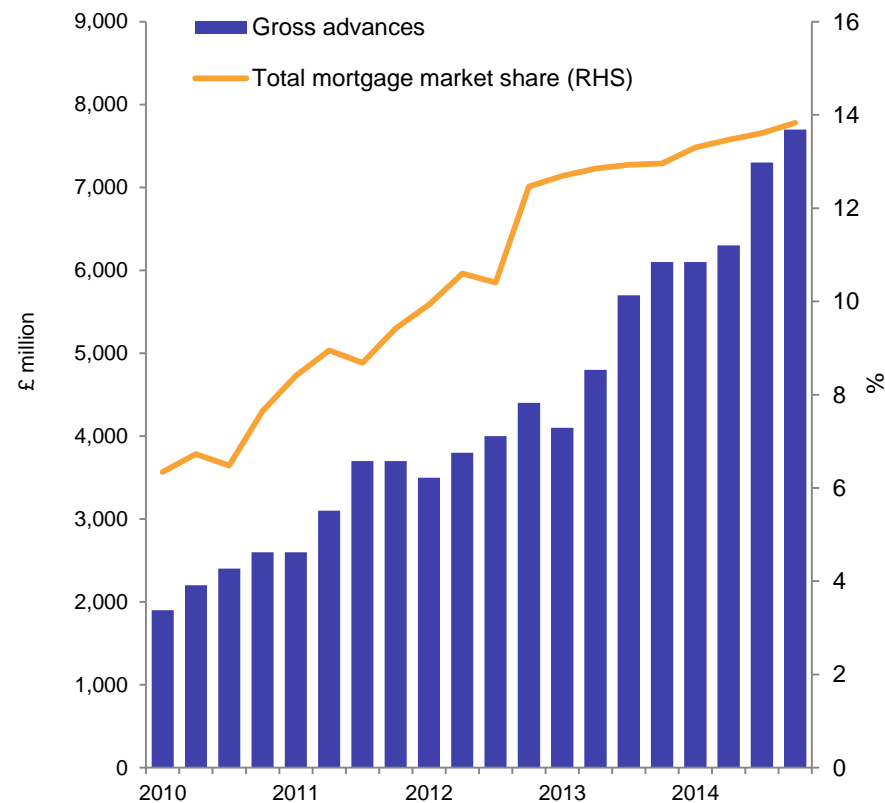
# Paragon Mortgages – outlook

## Growing market share in a growing market

### Underlying strong demand in PRS

- MMR adding structural change to mortgage market
  - Buy-to-let market experiencing strong growth
    - Up 32.4% in 2014 to £27.4 billion (2013: £20.7 billion)
    - Still materially below pre-crisis levels (2007: £45.7 billion)
  - Savills forecast number of households in PRS will rise by 1.2 million homes by 2019, 24% of stock
- 
- Pipeline at 31-Mar-15 up by 101.5% - £701.4 million (2014: £348.1 million)
    - Paragon Bank - 30% of pipeline
  - Material step-up expected in H2

## Buy-to-let industry – quarterly lending



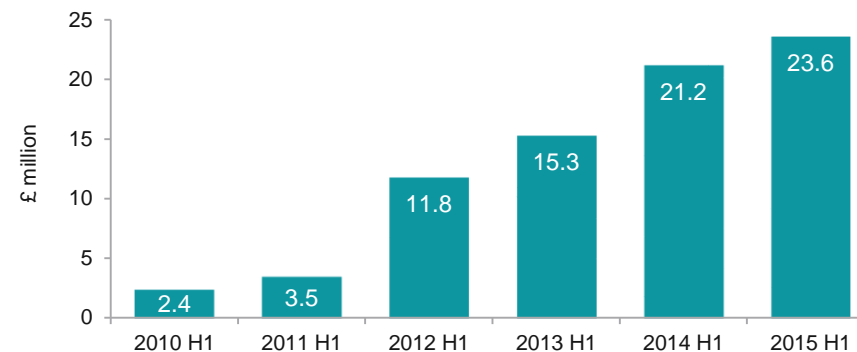
Source: Council of Mortgage Lenders

# Idem Capital

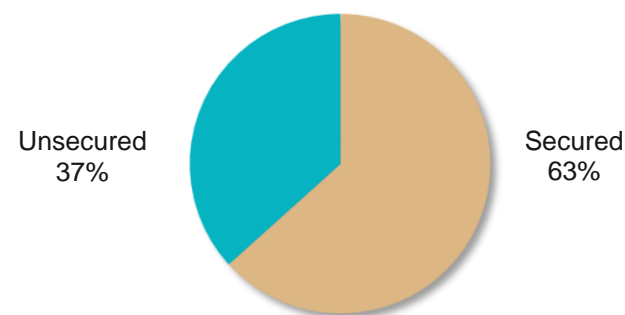
- Strong contribution to Group profit
  - £23.6 million in 2015 (2014 H1: £21.2 million)
  - 36.9% of Group profits
- Cumulative cash flow 105.8% (2014: 103.4%) of underwriting estimate
- £20.9 million net investment (2014 H1: £121.9 million)
  - Additional £8 million committed
- Balance sheet carrying value £406.9 million (2014 H1: £418.6 million)



## Idem operating profit



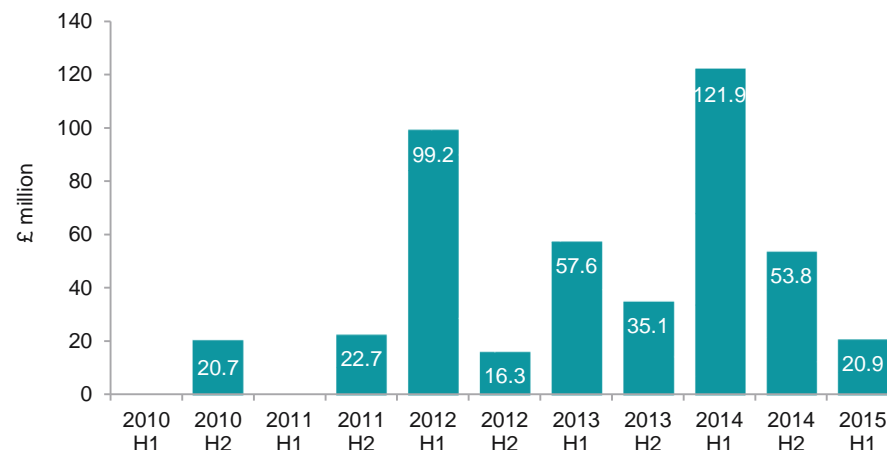
## Loans managed – carrying value



# Idem Capital – outlook

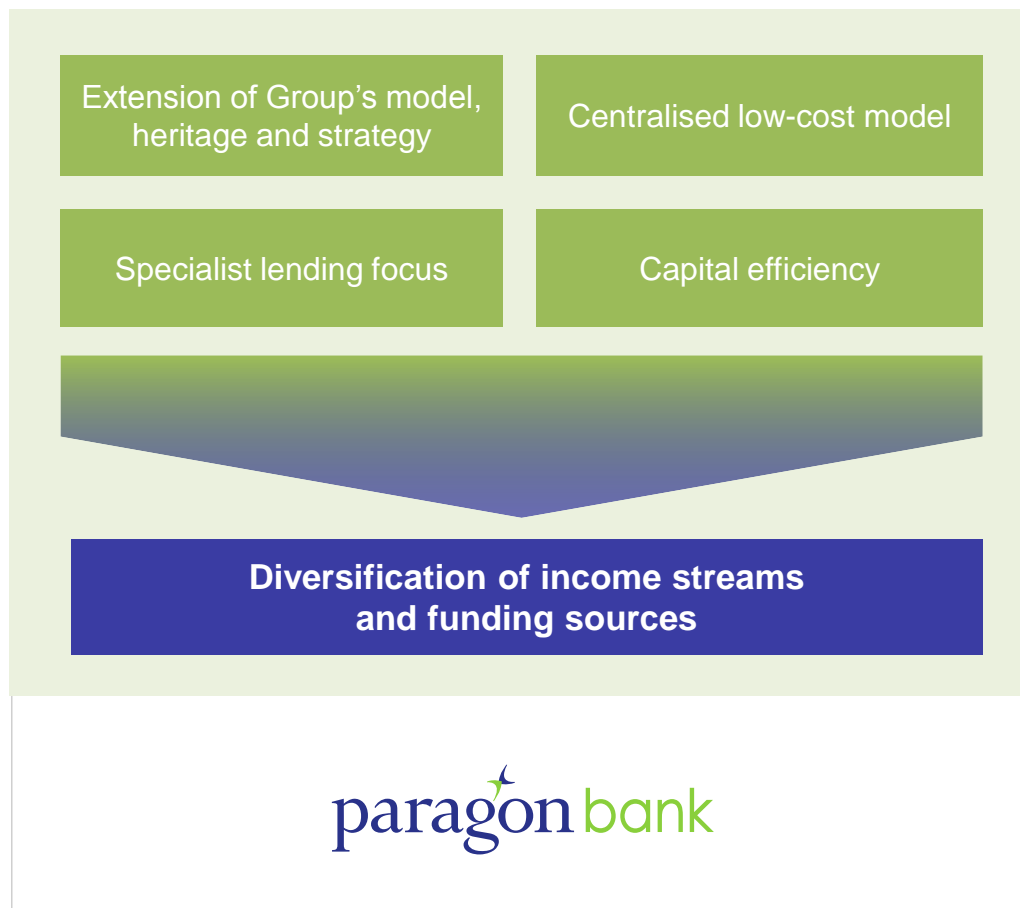
- Continued focus on performing and semi-performing consumer debt
- Vendor behaviours influencing structure of market
  - Smaller panels
  - Larger but less frequent paying debt trades
  - Continued flow arrangements for NPLs
- Emergence of new entrants, bigger ticket transactions, our pricing and credit disciplines maintained
- Pipeline remains strong in both number and value terms
- Over medium term:
  - Consumer lending levels expected to increase by 4% per annum to 2018 (Ernst & Young), supporting supply
  - Future debt flow expected to be enhanced by regulatory and accounting changes (IFRS 9)

Net Idem Capital investment





# Paragon Bank - strategy

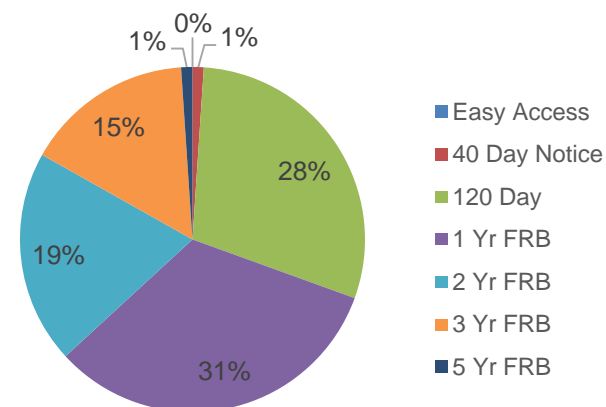


- Highly experienced banking team in place
- Low cost operating model
  - Utilising Paragon Group's established infrastructure for servicing, IT and support functions
- Specialist lending expertise
  - Benefitting from Group's extensive experience across multiple asset classes
- Access to funding
  - Low cost deposit gathering through direct channel
- Key component of diversification strategy

# Paragon Bank

- Established retail deposit raising activity
  - £165.0 million of deposits raised since launch at end March 2015
  - Current deposit balances over £250 million
  - Pricing management controlled flow, significant capacity available
- Three lending product lines launched
  - Cars
    - Distribution building over time, fragmented market
    - New lending - £15.7 million
    - Lending growth to build over medium term
  - Secured
    - Distribution building over near term
    - New lending - £3.8 million
  - Buy-to-let
    - Accessing Group distribution
    - New lending - £61.9 million
    - Complementary product range enhances funding capacity
    - Pipeline £207.7 million

Retail savings – product mix



Retail deposit distribution channels

- Aggregators
- Best buy tables
- PR activity
- Paid search

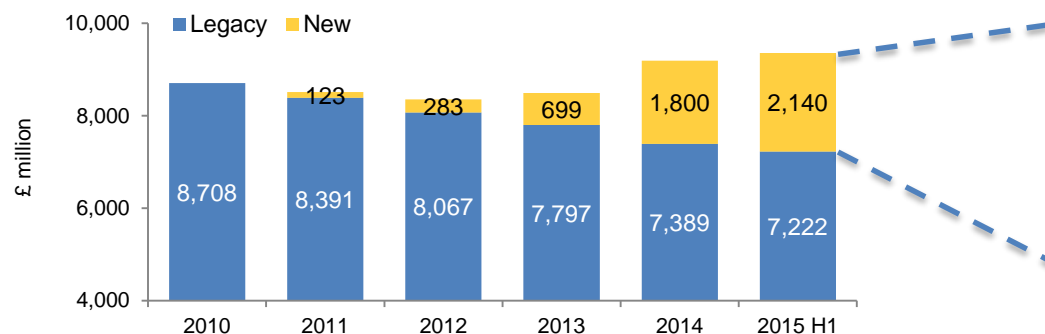
# Funding

## Significant step-up in funding capacity and diversification supporting growth plans

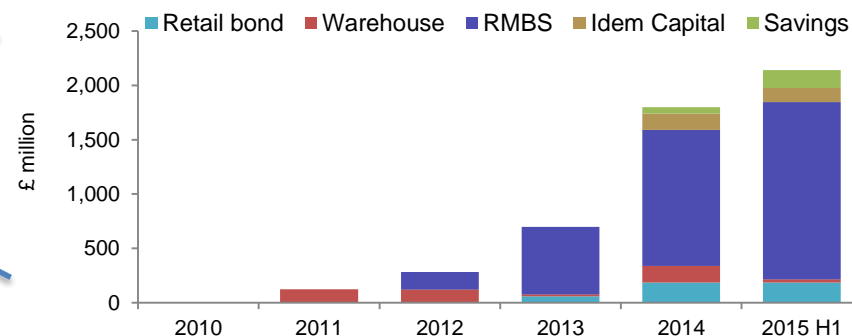
- Warehouse capacity increased to £750 million
- £879.2 million raised through securitisations over last 12 months
  - PM22 - accessed Euro markets to meet growing demand from European investors
  - PM22 - further significant step in strategy to broaden and diversify funding sources
- Retail deposit raising activity through Paragon Bank
  - £165.0 million of deposits raised since launch in June 2014
  - Initial targeted product range
  - Significant capacity via £1.8 trillion market
- Investment grade (BBB-) debt rating assigned by Fitch

- Paragon Bank
  - Advanced 14% of 2015 H1 buy-to-let lending
  - Advancing 30% of buy-to-let pipeline
  - Targeted to fund 50% of Group's new lending over medium term

### Funding mix



### Diversification of post 2008 funding



# Capital management focus

- Regulatory capital ratios strong
  - CET1 – 19.5%
  - Leverage ratio – 8.1%
- Material balance sheet capacity exists
- New lending and investments targeted to achieve 15% RoE
- Dividends
  - Further reductions in cover ratio to lower end of range targeted (3 to 3.5x by 2016)
- Initial £50 million share buy-back programme commenced in December 2014
  - £17.2 million acquired by 31 March 2015, now increased to £25 million
  - Programme update with FY15 results announcement

- 
- Strong growth capacity and opportunity
  - Improving RoE
  - Disciplined capital management

# Conclusion

## **Excellent year for lending growth and progress in Group's strategy**

- Strong financial performance
- Material uplift in buy-to-let new lending in H1
- Further material increase in buy-to-let lending expected in H2
- Paragon Bank delivering new lending opportunities
- Continued debt purchase opportunities but likely to remain lumpy

## **Strong capital base and debt capacity support growth**

- Significant progress in funding diversification plans
- Paragon Bank contribution to build over time
- European ABS investor base access significantly increases capacity
- Investment grade rating provides corporate debt access

## **Specialist lending markets provide significant growth opportunities**

## **Improving shareholders' return targeted**

- Ongoing improvements in RoE
- Disciplined capital management

# Half-Year Financial Results

The Paragon Group of Companies PLC



Six months ended 31 March 2015

paragon

# Appendices

# Introduction to Paragon





# Strategy

## UK's leading independent specialist lender

- 30 year track record, FTSE 250 with c£1.3 billion market capitalisation
- £10.5 billion of loan assets under management

## Industry leading underwriting and special servicing

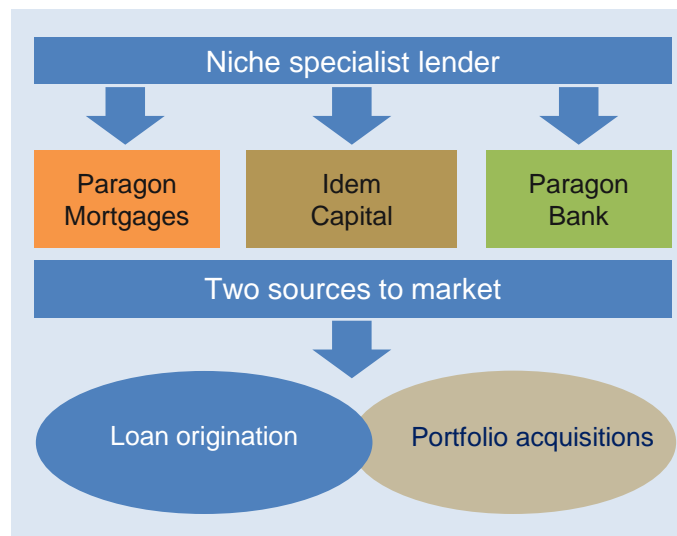
- Buy-to-let arrears significantly below industry averages
- Strong special servicing capabilities
- Comprehensive data analytics and risk management skills

## Experienced management team

- Stable management team with extensive through-the-cycle experience

## Significant growth opportunities

- Private Rented Sector in long-term structural growth
- Debt purchase market opportunities increasing
- Launched UK banking subsidiary



### Strategic priorities

- Clear focus on specialist lending products
- Environment presenting increasing opportunities

### Strong and continuous focus on:

- Mortgage and consumer sectors
- Data analytics
- Risk management
- Low cost model

### Driving diversification of:

- Income streams
- Funding sources

- Strong growth with sustainability
- Improving shareholder returns
- Disciplined capital management

# Profits

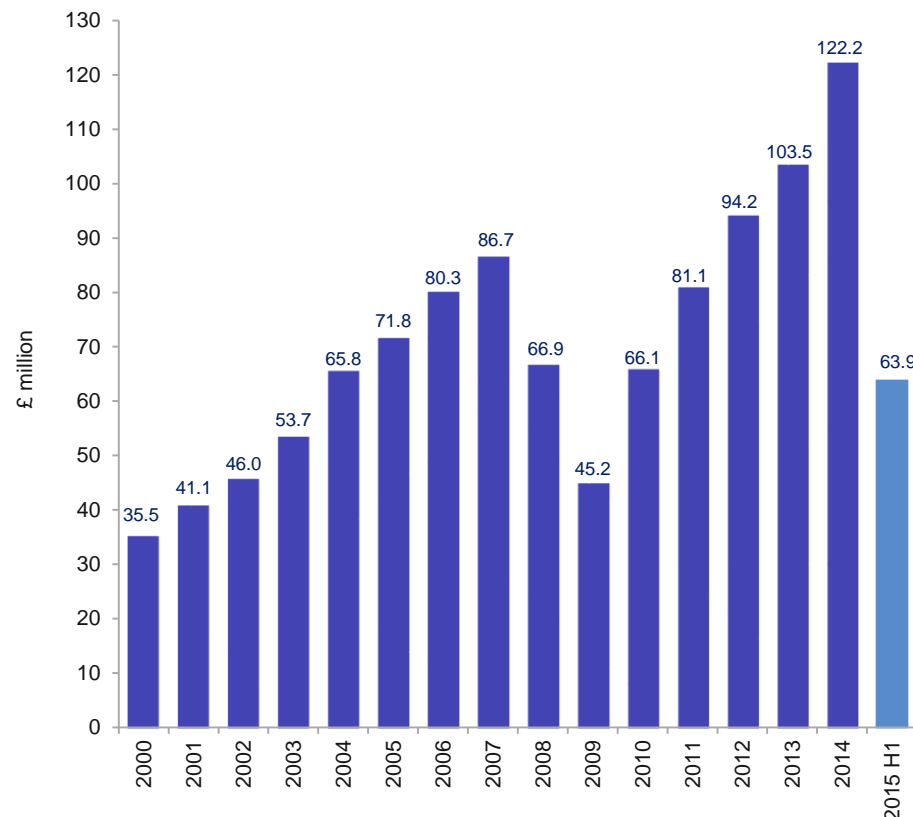
## Strong profit record

- Long track record, profitable through-the-cycle
- 2015 record H1 profits of £63.9 million
- Strong operational net cash flow over £80 million before investments and dividends
- Highly efficient model – underlying cost:income ratio 30.9%

## Robust balance sheet

- £952.5 million equity base
- Robust and diversified funding strategy

## Long-term profit trends



# Core businesses

## Leveraging our underwriting and servicing expertise

### Paragon Mortgages

- Leading independent buy-to-let lender – niche, specialist strategy
- Market leading credit standards
- Distribution primarily via intermediaries

paragon  
mortgages

mortgage  
trust

### Idem Capital

- Leading UK consumer debt purchaser
- Over 20 years experience in loan management – serviced c1.5 million accounts
- Contributed 36.9% to 2015 H1 Group profits

idem  
CAPITAL  
A PARAGON GROUP COMPANY

moorgate  
loan servicing

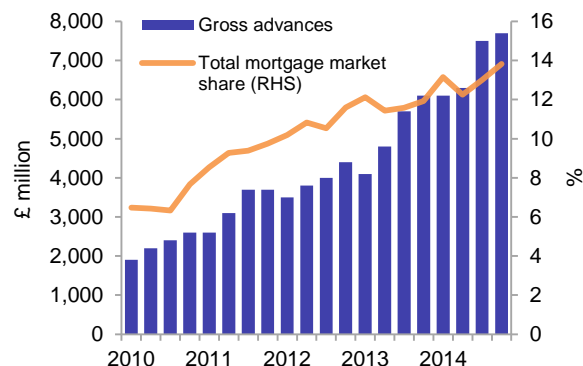
### Paragon Bank

- Launched - 18 February 2014
- Car finance loans launched
- Savings launched - June 2014
- Secured loans and buy-to-let launched - September 2014
- No branch network
- Utilises Group services to optimise cost efficiency

paragonbank  
paragoncar finance  
paragonpersonal finance

# Growth opportunities

## Buy-to-let industry – lending

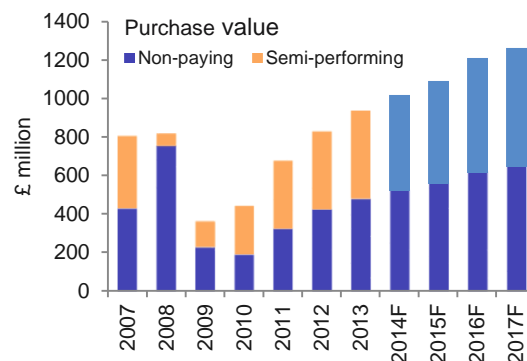


Source: DCLG / Council of Mortgage Lenders

### Paragon Mortgages

- Buy-to-let market experiencing strong growth
  - Up 32.4% in 2014 to £27.4 billion (2013: £20.7 billion)
- Strong rental demand and improving landlord confidence
- PRS now accounts for 19.4% of English housing – second largest housing stock

## Debt purchase market

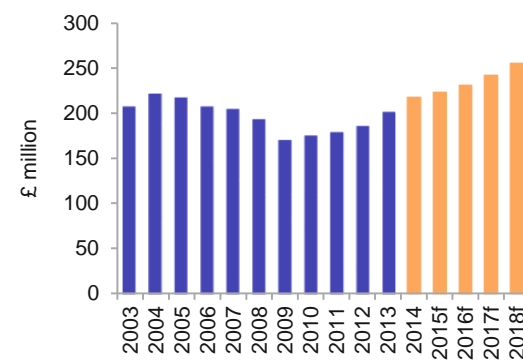


Source: OC&C

### Idem Capital

- Well established £1 billion+ pa core debt purchase market - forecast for strong growth
- Additional bank de-leveraging sales take opportunities to £2 billion+ pa
- Market participants
  - Specialist debt buyers
  - Banks
  - Hedge funds
  - Bond funds
- Debt availability increasing to support asset purchases and refinance existing assets
- Growing proportion of paying-debt sales

## UK consumer finance market



Source: FLA / Datamonitor

### Paragon Bank

- Positive economic outlook
- 40% of UK savings through online facilities
- Consumer finance market expected to increase by £39 billion to reach £255 billion by 2018
- Paragon Bank anticipating regulatory changes ahead of the market
- Car finance market £31.4 billion in 2014 up 17.9% year-on-year
- Secured loan market grew by 34.6% to £548 million

# Company overview



# Group overview

## Key facts

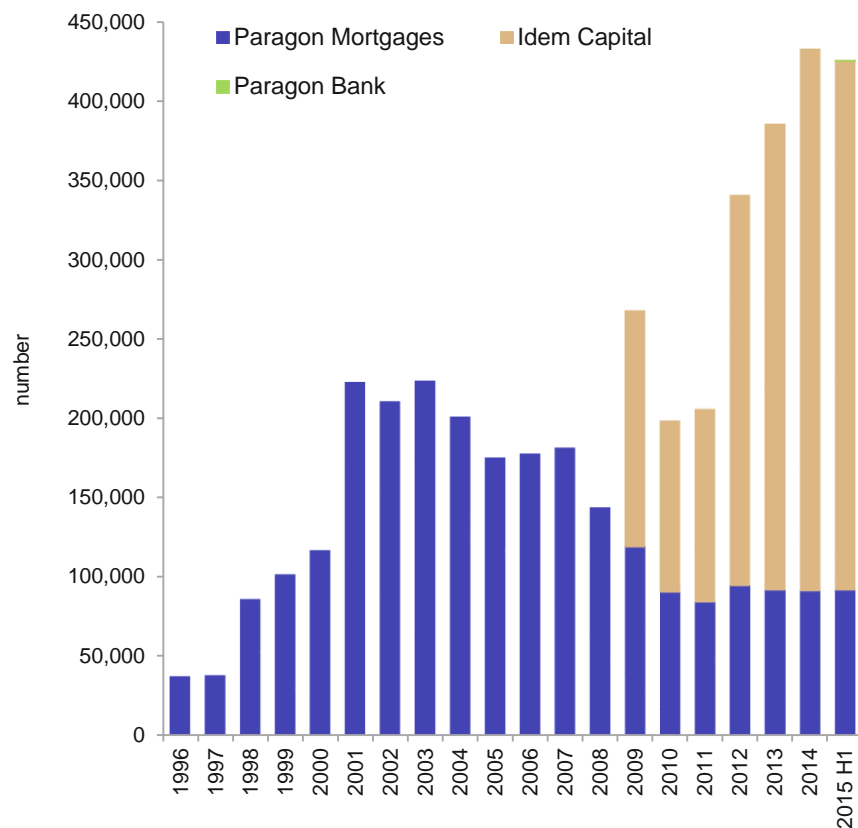
Established	1985
AUM	£10.5 billion
NAV	£952.5 million
Index	FTSE 250
Market cap	c£1.3 billion
Employees	1,029
Location	HQ: Solihull, West Midlands

## History

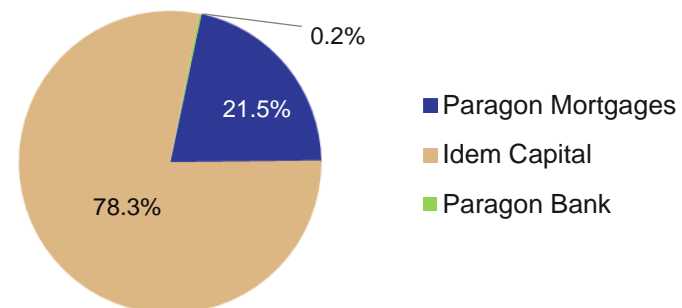
1985	Launched as a specialist lender, fully listed on LSE
1986	Acquired first loan portfolio
1987	Completed first securitisation in UK mortgage market
1995	Launched first buy-to-let products
2002	Admitted to FTSE 250
2003	Acquisition of Mortgage Trust (c£2 billion portfolio)
2009	Launched Idem Capital and Moorgate Loan Servicing
2010	Re-commenced buy-to-let lending
2011	First post-credit crunch securitisation launched
2013	First retail bond raised £60 million
2014	Second retail bond raised £125 million
2014	UK banking subsidiary launched
2014	Idem Capital-specific funding raised

# Segmental loan assets

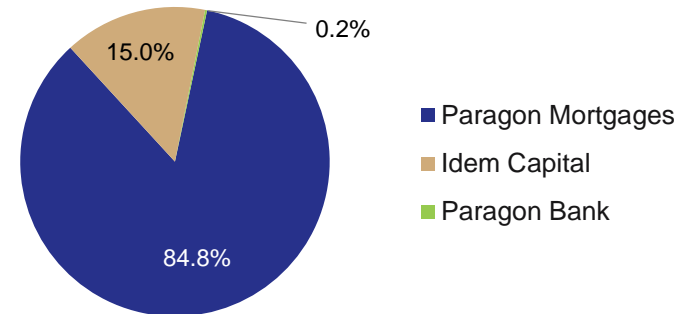
## Total accounts under management



## Accounts under management - number

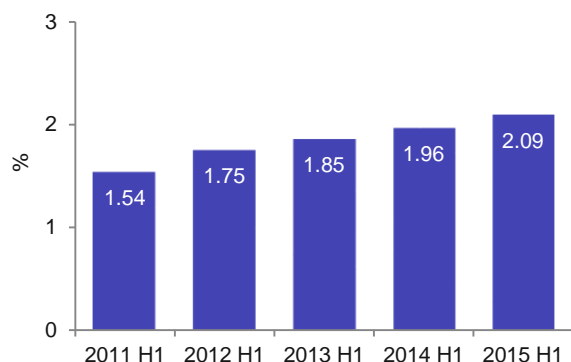


## Accounts under management - value



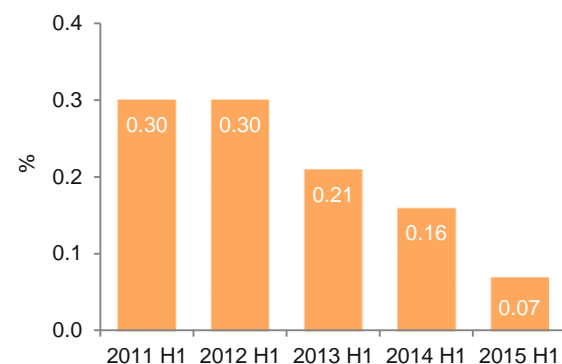
# Key financials

Net interest margin



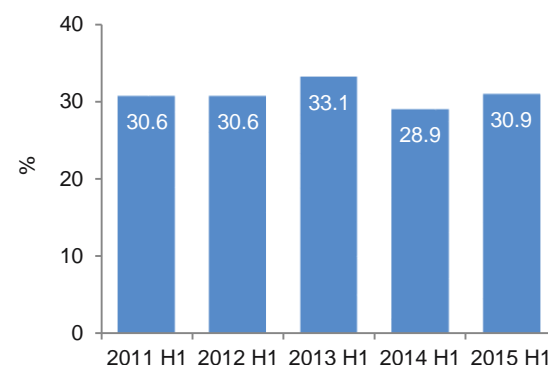
- Wider margin on new mortgage loans
- Idem Capital assets delivering strong cash flows
- New financing on improved terms
- Paragon Bank's retail deposit funding improving margins

Impairments as % of total loan asset (annualised)



- Charge reduces to £3.5 million (2014: £7.5 million)
- Nil impairment charge on Idem Capital as asset performance greater than expectations

Cost:income ratio (underlying)



- Cost:income ratio remains a key strategic differentiator for Paragon
- Cost:income ratio reflects Paragon Bank start-up costs



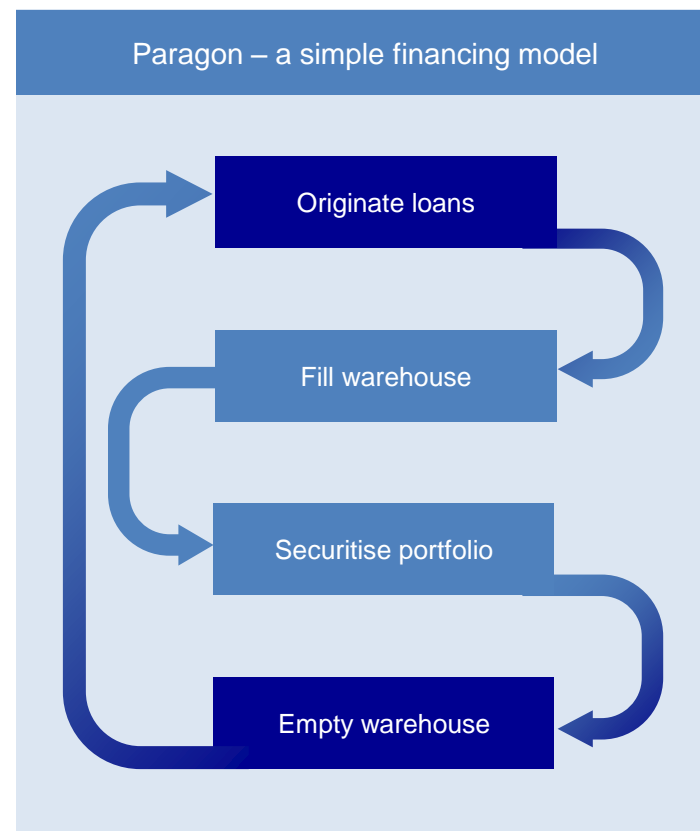
# Diversified funding strategy

- Paragon Group – holding company debt
  - Subordinated £110 million corporate bond – April 2017 maturity – 3.729%
  - Subordinated £60 million retail bond – December 2020 maturity – 6.0%
  - Subordinated £125 million retail bond – December 2022 maturity – 6.125%
  - Investment grade rating (BBB-) to support future debt issuance
- Portfolio purchases
  - Assets held in limited recourse SPVs
  - Funded from Group's free cash resources / structured debt
- Retail deposit taking

# Securitisation

## Programme increased in scale

- Extant assets - £9.5 billion funded through 22 limited recourse wholly owned SPVs
- New origination
  - £750 million warehouse facilities
  - After a few months, assets transferred to securitisation vehicle
- Successful securitisation programme re-established
  - *July 2014*                      PM20      £319.0 million – A notes LIBOR + 68bp  
£24.0 million – B notes LIBOR + 100bp
  - *November 2014*            PM21      £217.9 million – A Notes LIBOR + 80bp  
£17.7 million – B notes LIBOR + 140bp
  - *March 2015*                PM22      €164.0 million – A Notes EURIBOR + 50bp  
£151.7 million – B notes LIBOR + 80bp  
£12.0 million – B notes LIBOR + 135bp

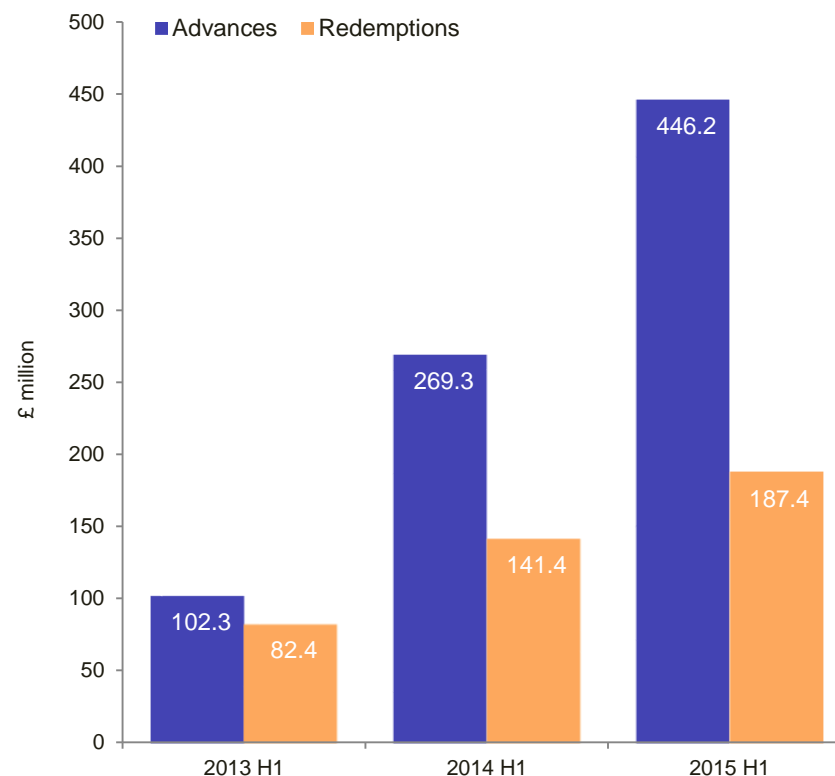


# New lending – buy-to-let

## Significant increase in buy-to-let lending

- Buy-to-let lending increased to £446.2 million (2014: £269.3 million)
- Total new lending since return to market £1,784.1 million
- Pipeline at 31 March 2015 up by 101.5% - £701.4 million (2014: £348.1 million)
- Credit quality remains strong
  - New buy-to-let portfolio
    - Average LTV 67.0%
    - Average ICR 158.0%
  - Arrears fell to 20bp (2014: 30bp)
  - Redemptions remain low

## Buy-to-let activity



# Group buy-to-let – new lending

**Robust growth in private renting and diversified funding expands Group's buy-to-let proposition through Paragon Mortgages and Paragon Bank**

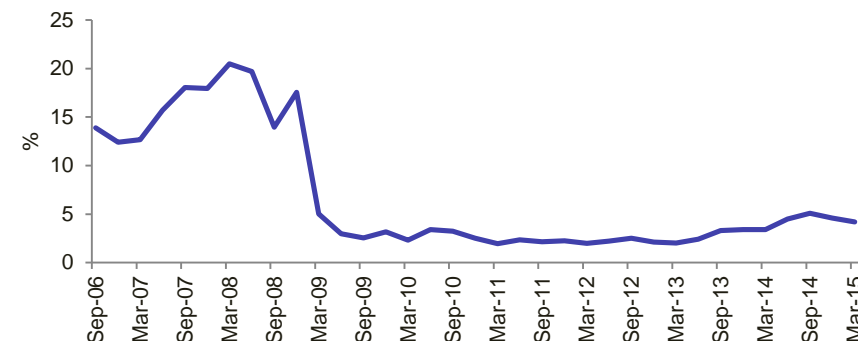
	Completions in period			Pipeline			Loan balances		
£ million	6 months ended 31-3-14	Year ended 30-9-14	6 months ended 31-3-15	31-3-14	30-9-14	31-3-15	31-3-14	30-9-14	31-3-15
Paragon Mortgages	269.3	656.1	384.3	348.1	369.5	493.7	8,414.2	8,575.6	8,749.2
Paragon Bank	-	0.5	61.9	-	45.3	207.7	-	0.5	62.1
Total	269.3	656.6	446.2	348.1	414.8	701.4	8,414.2	8,576.1	8,811.3

# Portfolio performance

## Buy-to-let and Idem Capital portfolios performing strongly

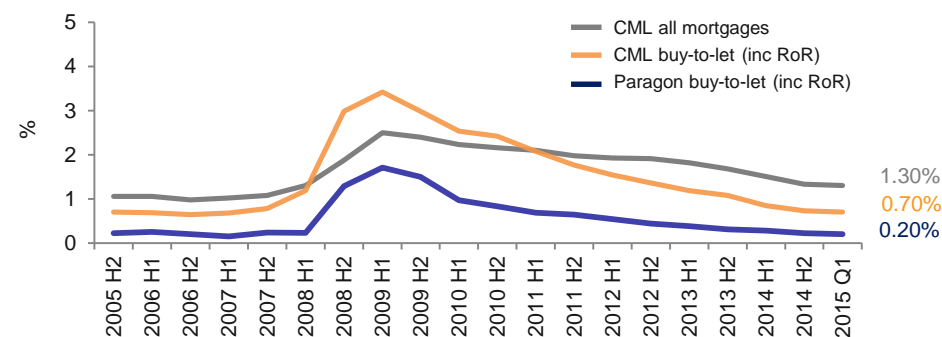
- Buy-to-let redemptions remain low at 4.4% (2014: 3.4%)
- Buy-to-let credit performance remains strong  
- 3 months+ arrears fell to 20bp (2014: 30bp)
- Cash flows from acquired Idem Capital assets remain ahead of expectations at 105.8%

### Buy-to-let redemptions



Source: Council of Mortgage Lenders

### Buy-to-let 3 months+ arrears

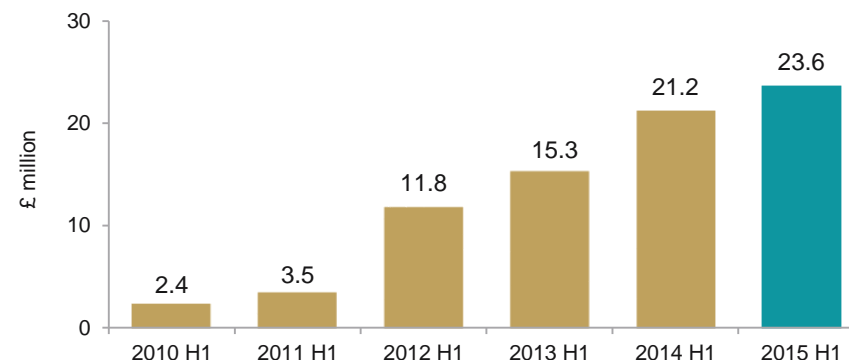


Source: Council of Mortgage Lenders

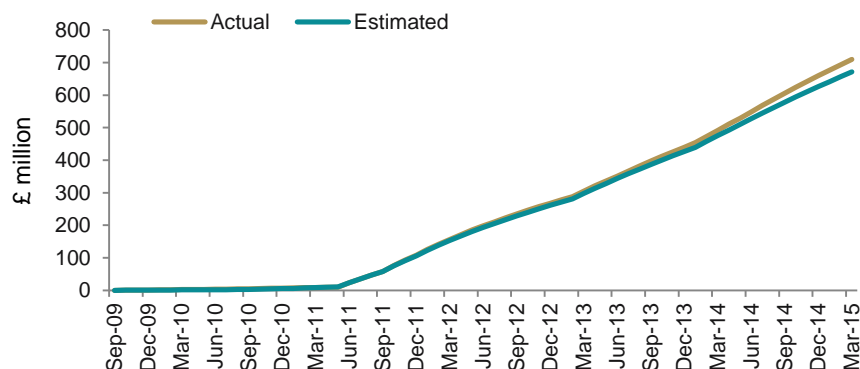
# Idem Capital is a leading UK consumer debt buyer

- Significant driver of Group profit
  - Contribution of £23.6 million in 2015 (2014: £21.2 million)
- Portfolio investments
  - £20.9 million invested in unsecured accounts in 2015 H1
  - Outstanding investment value at 31 March 2015 - £406.9 million
- Strong pipeline of large scale further acquisition opportunities
  - Business-as-usual is increasingly paying-debt sales
  - Bank de-leveraging process ongoing
  - Servicing standards more important in new regulatory environment
- Cumulative cash flow improves to 105.8% of underwriting estimate
- Increasing emergence of substantial performing/mortgage deals

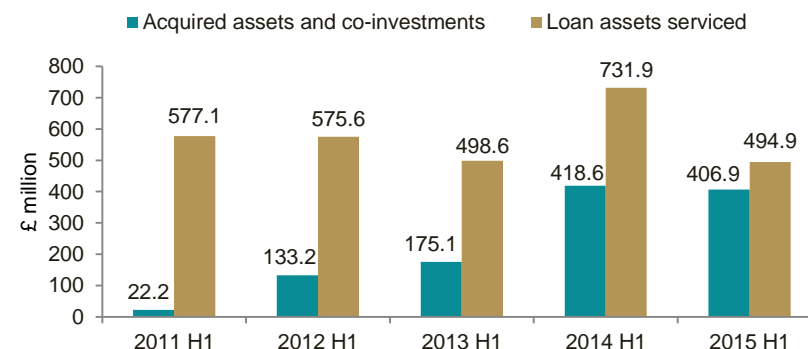
Idem Capital operating profit



Cumulative cash flow on Idem Capital portfolios



Idem Capital income generation



# Exposure to rising interest rates

## Pre 2007 buy-to-let legacy portfolio

- Well seasoned
- High ICRs (current estimate 3.8 times on average)
- LTV average 73.1%

## Post 2010 buy-to-let new lending

- Very high credit quality
- LTV average 67.0%
- Average ICR 158.0%
- Strong additional non-property income
- 90% of new flow is fixed rate

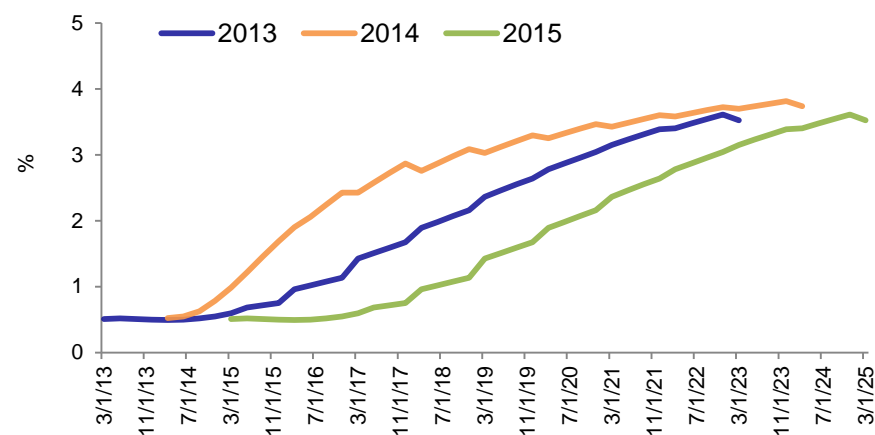
## Second mortgage portfolio

- House price appreciation and capital repayments continue to erode risk of loss
- Average seasoning of over 8.0 years

Above covers 98% of Group loan assets

- Likely to see slow and graduated interest rate increases
- High quality loan portfolios mitigate risk of rate rises

## Expected future interest rates



Net assets generate higher income at higher interest rates c£11m benefit to NII per 1% increase in interest rates

# Regulation

Regulatory environment in UK witnessed significant changes in recent years, raising challenges for domestic financial institutions – this is expected to continue

Paragon's approach focused on anticipating regulatory developments, preparing well in advance and successfully managing through regulatory change to the benefit of our customers, franchise and financial performance

## Buy-to-let

- EU Mortgage Credit Directive to be implemented by March 2016
  - Buy-to-let will only apply to very narrow part of market

## Consumer finance

- CCA responsibilities transferred from OFT to FCA
  - Full authorisation in process
- Second mortgage loans to be supervised by FCA subject to MCOB variant with effect from March 2016

## On-going changes in capital requirements

- Basle Risk Weighting Review
  - IRB v standardised
- Significant capacity, even under standardised basis



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