Paragon Banking Group PLC

Resilient in an uncertain environment – rebuilding momentum

Financial results

12 months ended 30 September 2020

paragon

Resilient performance, momentum rebuilding

Financial performance

- Operating profit £120 million, down 27% year-on-year
- COVID impairment charge dominant effect but materially lower in H2
- Underlying RoTE 9.8%; CET1 up 0.6% to 14.3%
- Dividend reinstated in line with existing policy

Operational performance

- Strong operational resilience, supporting customers through the crisis
- Stable technology with notable developments
- Net loan book +3.7%, with good customer retention
- Deposits +23% to £7.9 billion, strengthened franchise, lower funding cost
- 2021 will bring challenges, but we are prepared

Growing momentum

- New lending volume down 19% year-on-year, now back to pre-COVID levels
- Rate reduction impact on H2 NIM broadly unwound
- IRB phase one successfully completed

Adapted to COVID-19 with speed and resilience

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Protecting our people and supporting the community

- 90%+ working from home within 4 days of lockdown
- Focused on supporting wellbeing
- No redundancies or use of furlough, recruitment continued
- Enhanced charity support activities

Supporting customers and partners

- Stable technology throughout with significant new deliveries implemented
- Products and services fully available
- Payment holidays were 21% of book, now c1%
- £25.9 million CBILS/BBLS; focus on existing customers
- Resources enhanced to meet 2021 challenges

Rapid reaction with revised priorities

Protecting our capital

- 14.3% CET1 ratio, +0.6% year-on-year
- 99% of loan book secured and low risk
- Risk appetite tightened

Enhancing our franchise

- Growing our reputation in specialist SME, development finance markets, building on leadership in specialist BTL
- Bespoke approach to underwriting, coupled with willingness to provide support has enhanced position in the crisis
- Accelerating technology transformation supporting developments

Culture, sustainability and customers supporting our purpose

Our purpose:

Supporting the ambitions of the people and businesses of the UK by delivering specialist financial services

Culture

- Our culture is unique, which we fiercely protect
- Wide-ranging development programme
- Comprehensive wellbeing support to boost physical, emotional and financial wellbeing
- Equality, Diversity and Inclusivity Network launched
- 'Women Ahead 30% Club' cross-company mentoring scheme
- The Women's Association increasing visibility of women in the workplace
- Employees actively involved in a wide-range of volunteering and charity partnerships
- 60% increase in employee communications

Customers

- A programme of customer engagement surveys and data collection to ensure optimal approaches to customers' individual situations are identified
- Expanded Insight team to augment our customer understanding
- Focused support for vulnerable customers
- NPS +61 for new savings customers
- 88% of new savings customers would consider taking a further savings product
- 7 out of 10 landlords rated Paragon's Covid-19 support as 'good' or 'excellent'
- 68% of mortgage intermediaries rated Paragon's service during the pandemic as 'better than other lenders'

Sustainability

- Increased focus on environmental impacts
- Climate change risk management enhanced and data captured
- Environmental customer initiatives under consideration
- Commercial exposures – analysis of high-carbon intensity of particular transition risks
- Risk framework – disclosures, metrics and targets under review

Financial results

12 months ended 30 September 2020

Richard J Woodman
Chief Financial Officer

Income statement

£ million	2020	2019	Change	
Net interest income	278.1	278.4	(0.1%)	2019 benefits from higher Idem Capital income
Other income	17.0	19.2	(11.5%)	End of term gains and servicing fee run-off
Total operating income	295.1	297.6	(0.8%)	
Operating expenses	(126.8)	(125.2)	+1.3%	Little change year-on-year
Impairments	(48.3)	(8.0)	+503.8%	COVID related 39bp cost of risk
Underlying profit before tax	**120.0**	**164.4**	**(27.0%)**	
Fair value net gains / (losses)	(1.6)	(15.1)		FV losses revert to zero over time
Disposal of residual	-	9.7		Securitisation residual sale in 2019
Profit before taxation	**118.4**	**159.0**	**(25.5%)**	

Segmental results

COVID impairment charges and Idem Capital amortisation offset strong pre-provision profit growth in core divisions

Underlying £ million	Mortgage Lending	Commercial Lending	Idem Capital	Central	Total
Total operating income (2020)	196.5	92.0	26.7	(20.1)	295.1
Change (v 2019)	+11.9	+16.0	(29.0)	(1.4)	(2.5)
Operating expenses	(16.4)	(24.4)	(6.3)	(79.7)	(126.8)
Change	(0.7)	+0.6	+1.6	(3.1)	(1.6)
Pre-provision profit	**180.1**	**67.6**	**20.4**	**(99.8)**	**168.3**
Change	+11.2	+16.6	(27.4)	(4.5)	(4.1)
Provisions for losses	(25.8)	(21.7)	(0.8)	-	(48.3)
Change	(24.8)	(14.5)	(1.0)	-	(44.4)
Contribution	**154.3**	**45.9**	**19.6**	**(99.8)**	120.0
Change	(13.6)	+2.1	(28.4)	(4.5)	(54.1)

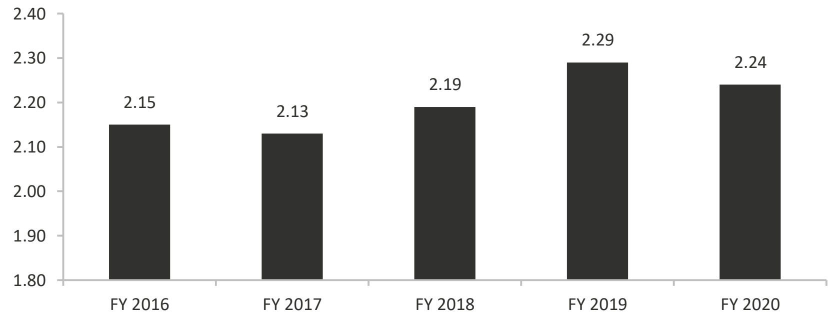
- Pre-provision profit (excluding Idem Capital) up 18.7% Y/Y

Segmental influences on NIM

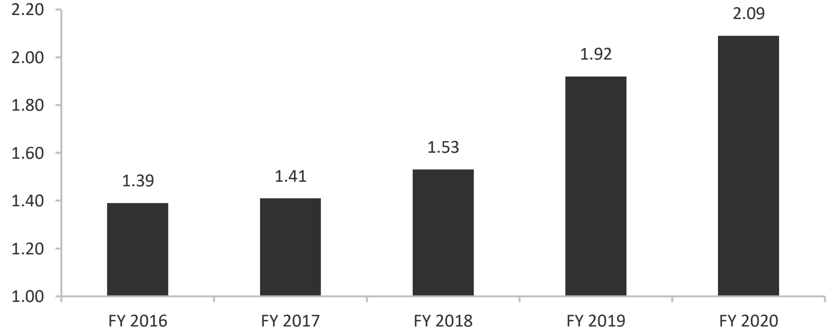
Influence of base rate reductions felt in H2 – unwinding by year end

- NIM dropped to 213bp in four months following the base-rate led asset reprice – largely recovered by September
- Lower base rates generate lower earnings on net assets
- Immediate impact on variable rate assets as full rate cut passed on and fixed rate assets only reprice via hedging costs
- Liability pricing gradually reduced in H2 as SPVs repriced and deposit costs fell in stages
- Assisted at end of period by TFSME drawings
- Underlying structural NIM progression remains with Commercial Lending and new BTL pricing exceeding that on back-book assets

NIM progression – Group (%)



NIM progression – Group excluding Idem Capital (%)

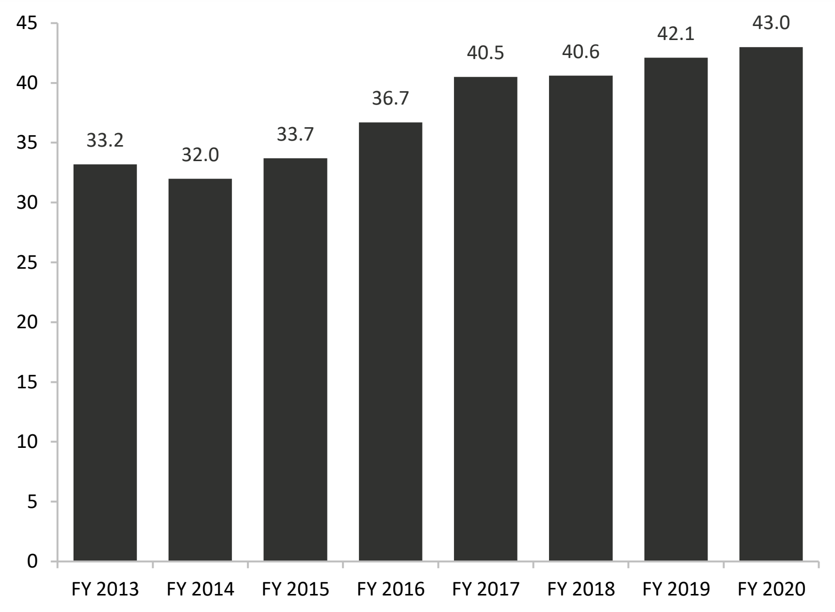


Operating expenses

Cost:income broadly stable at 43%

- Slower income growth in H2
- Favourable cost movements:
  - Variable remuneration reduced (cash and share based)
  - COVID pushed certain projects into 2021
  - Travel/accommodation spend down due to lockdown
- Higher cost movements:
  - High profile projects (such as IRB maintained)
  - Strong deposit growth sees associated administration cost up 28% year-on-year

Underlying cost:income ratio (%)



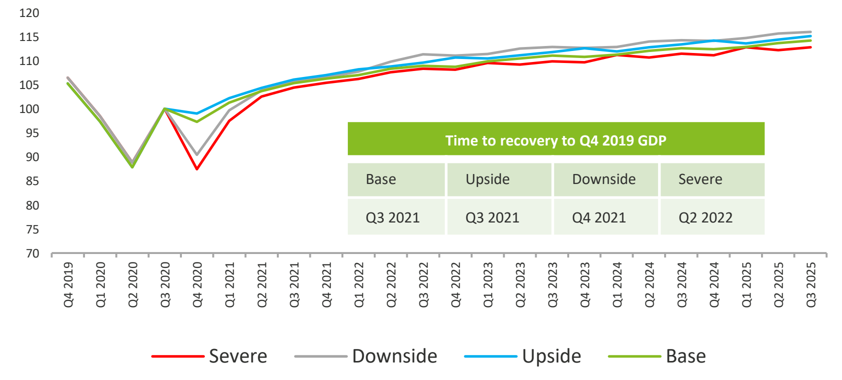
Multiple economic scenarios

- Four scenarios updated from HY:20, weightings consistent with H1:20
- Lockdown 2 assumed to cause GDP decline in Q4
  - Baseline FY:20 -10.2%, FY:21 +10.6%
- Previous impacts assumed on HPI and unemployment shifted to right not changed
- Unemployment peak at 7.6% in Baseline, 9.0% in Severe
- House prices proved extremely resilient, in part a function of stamp duty changes. Outlook remains uncertain and prudent approach taken in impairment modelling
- Implemented floors on PDs and extended payment holiday balances moved into stage 2

Scenarios

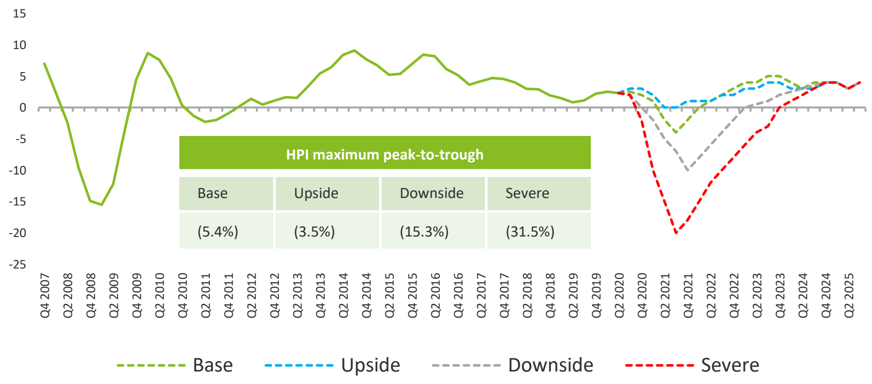
	Base	Upside	Downside	Severe
Weighting	40%	10%	35%	15%
Impact of 100% weighting	£67.4m	£58.0m	£82.4m	£134.3m
Variance to reported	(£14.4m)	(£23.8m)	+£0.6m	+£52.5m

Scenario GDP profile (Q3:20 index = 100)



Time to recovery to Q4 2019 GDP			
Base	Upside	Downside	Severe
Q3 2021	Q3 2021	Q4 2021	Q2 2022

House price change (%)



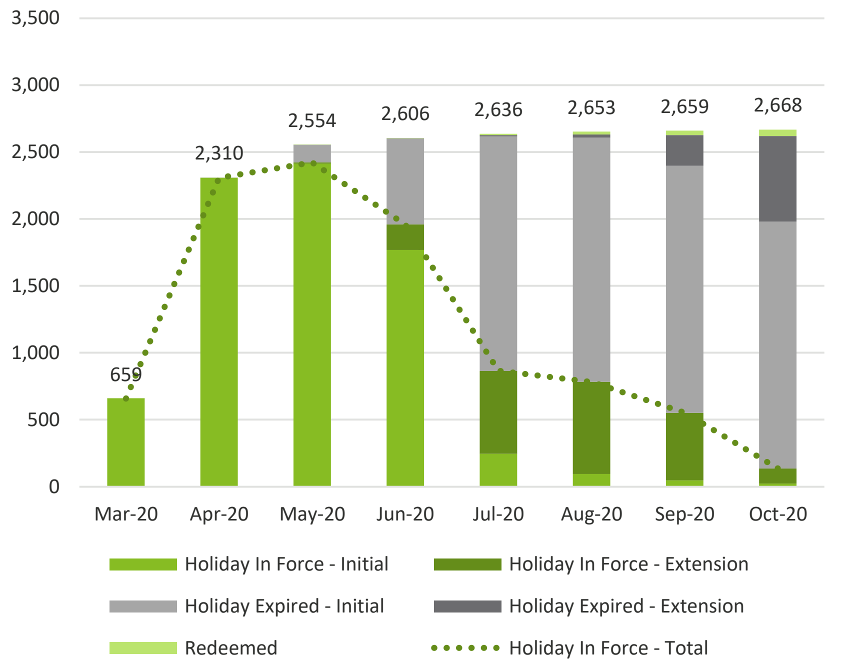
HPI maximum peak-to-trough			
Base	Upside	Downside	Severe
(5.4%)	(3.5%)	(15.3%)	(31.5%)

Payment holiday overview

Extensive customer support given – strong subsequent recovery

- Rapid escalation of payment holidays seen in March and April
- Approximately 30% of these ended up taking extensions for a second three-month period
- Customer engagement (direct and survey-based) strong throughout
- Level down to £136.0 million at October month-end
- Little initial take-up of payment holidays post-Lockdown 2 announcement – but will be closely monitored

Payment holiday population (£m)



Impairments

Post Model Adjustments added to reflect Covid-19 policy response

- Models are forward-looking, reflecting anticipated impacts of forecast economics
- Implication is that historic/current economics are reflected in current impairments
- Policy reaction generating lagged response
- PMA added for lagging effects and also enhanced PDs for single payment holiday accounts and extended payment holiday accounts; the latter moved to Stage 2 for impairment purposes
- Actual default emergence remains benign
- Portfolio coverage ratio up 88.2% to 0.64%
- LTV of BTL book 65.8% v 67.5% in 2019

Impairment overlay

	2019 Year End (£m)	2020 Interim (£m)	2020 Year End (£m)
Calculated provision	£41.9	£42.7	£62.0
Overlay	-	£24.0	-
PMA (for payment holidays and lagged effects) *	-	-	£19.8
Total	**£41.9**	**£66.7**	**£81.8**
Coverage ratio	0.34%	0.53%	0.64%

* PMA – Post Model Adjustments

Indexed credit behavioural scores by portfolio

	Sept-19	Sept-20
Buy-to-let		
New	100.0	100.6
Legacy	100.0	100.4
New second charge mortgages	100.0	100.6
Legacy second charge and Idem Capital assets	100.0	104.1
Motor finance	100.0	101.5

Group capital

paragon

Improving capital position with material headroom over regulatory requirement

Group consolidated capital	
Core Equity Tier-1 capital *	£991.2m
Tier-2 capital	£150.0m
Total capital resources	**£1,141.2m**
Credit risk	£6,318.1m
Operational risk	£544.3m
Market risk	-
Other	£85.7m
Total risk exposure	**£6,948.1m**
CET1 ratio *	14.3%
Total capital ratio (TCR)	16.4%

Group consolidated leverage ratio	
Tier-1 equity *	£991.2m
Leverage exposure **	£13,993.1m
UK leverage ratio *	7.1%

* Including IFRS 9 transitional relief of £42.3m, adjusted for dividends and subject to verification

** Excludes qualifying central bank claims in accordance with rule modification applied to UK Leverage Ratio Framework

Capital ratios

- CET1 and TCR remain strong
- Capital surplus over regulatory requirement exceeds £0.2 billion
- Capital requirements reduced following reduction in CCyB to 0%
- Capital SREP scheduled for later in 2020
- Fully loaded CET1 and TCR are 13.7% and 15.9% respectively

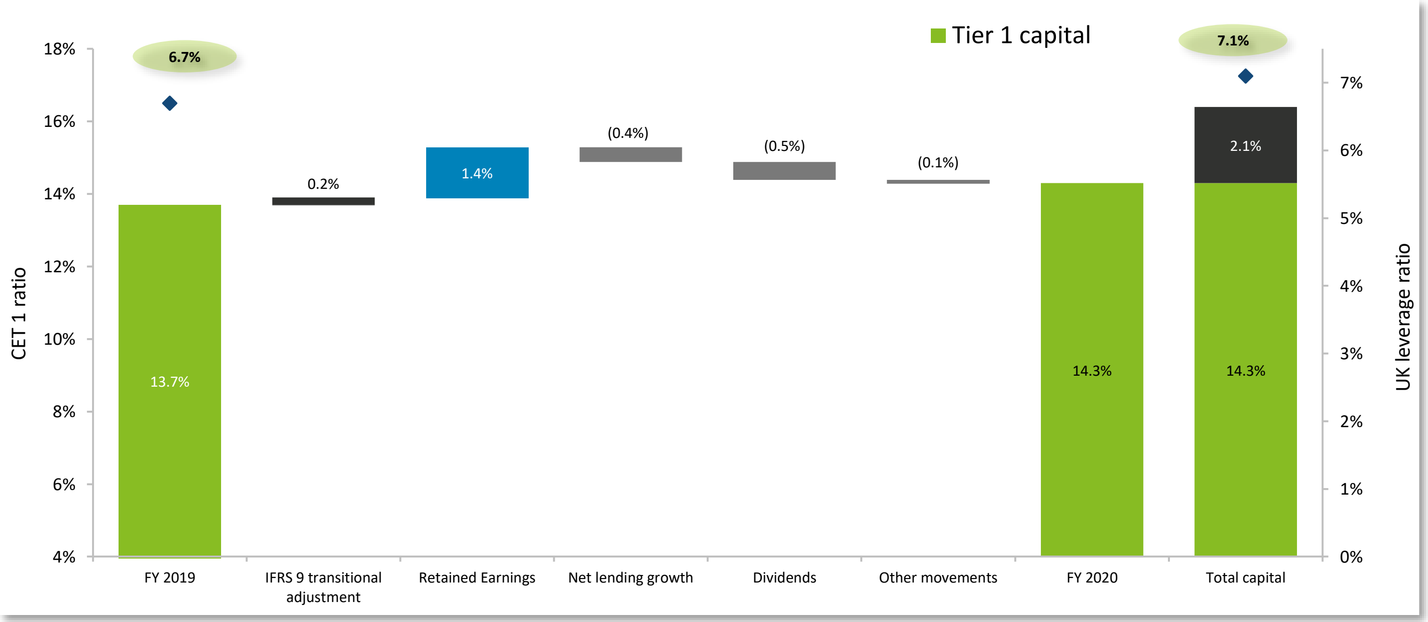
IRB

- Module 1 submitted in March 2020, Phase 1 successfully completed, now commencing Phase 2 of the process
- Broader portfolio roll-out to follow

Capital bridge

Year-on-year capital accretion after reflecting dividend, loan growth and impairments

FY 2019 / FY 2020



UK leverage ratio

Strategy overview

Nigel S Terrington
Chief Executive

Crisis reinforced our key strategic pillars and disciplines

Strategic pillars

- Experience and data driven
- Low-risk
- Specialist
- Focused and customer centric
- Technology enabled
- Levelling the playing field

Culture

Sustainability

Customers

Strategic disciplines

- **Self-funding**
- **Prudentially strong**
- **Diversified**
- **ROTE**≥15%

Buy-to-let

Focused, specialist and customer-led approach to buy-to-let, increased use of technology

New lending

- £1.2 billion advances (2019: £1.5 billion)
- Mid-March onwards volumes impacted
- Pipeline £868.1 million, down from £911.7 million at end of FY:19, £789.8 million at H1:20
- Specialist lending completions 93% (2019: 89%)

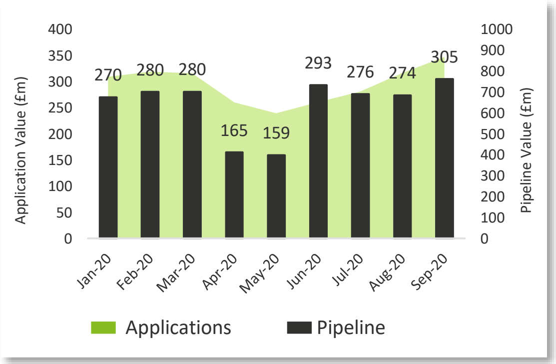
Redemptions

- Better customer retention
  - More professionals/complex
  - Increased long term fixed rates
  - COVID-19
  - Better customer retention activities
  - Overall rate dropped from 8.6% to 6.6%

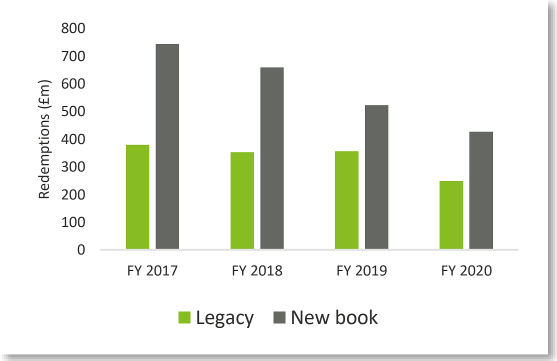
Net loan book

- £10.6 billion, up 4.8% on 2019
- Buy-to-let NIM 1.77% (2019: 1.70%)
- Legacy book now £4.4 billion (2019 – £4.7 billion)

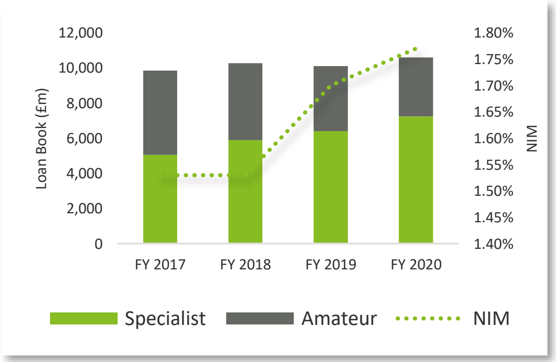
Application flow and pipeline (£m)



Redemptions (£m)



Net loan book and margin (£m)



Proven resilience of business model through COVID

Low risk, experience and data led buy-to-let proposition

Low risk

- Asset backing transformed since 2008
- Average LTV 65.8% (Sept-08: 80.7%)
- £6.7 billion surplus landlord equity
- LTV greater than 90%, 1.9% (Sept-08: 30.9%)
- LTV greater than 80%, 4.2% (Sept-08: 63.4%)
- Improving margins boosting risk adjusted returns

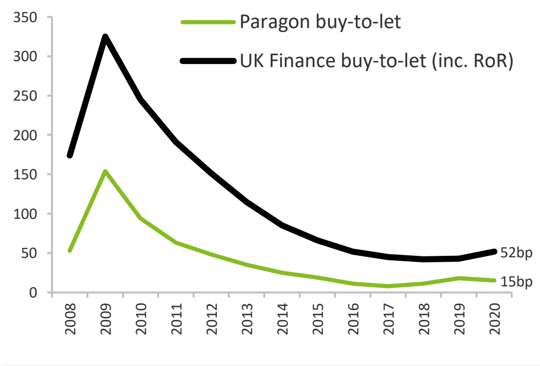
Experience and data led

- Experienced team with through-the-cycle sector knowledge
- In-house surveyors provide unrivalled property insight
- 25 years of data inform underwriting, pricing, stress testing and IRB process

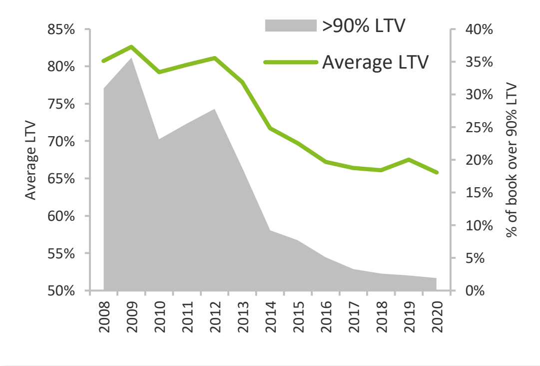
Payment holidays

- 21% of customers at first lockdown
- Landlords took a precautionary stance at the outset
- Close customer engagement throughout
- Reduced to c1%
- Negligible take-up of extended programmes

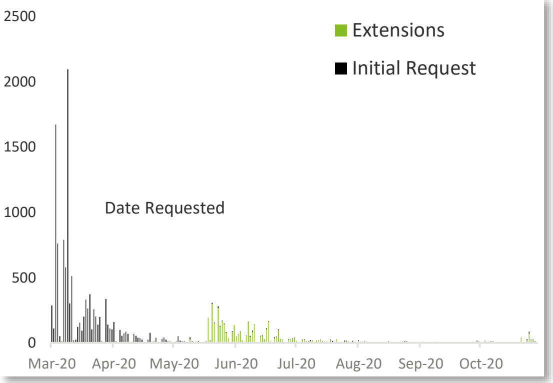
Arrears rate – 3mths+ (bp)



Average LTV



New and extended payment holidays



Source: UK Finance, Paragon Banking Group PLC

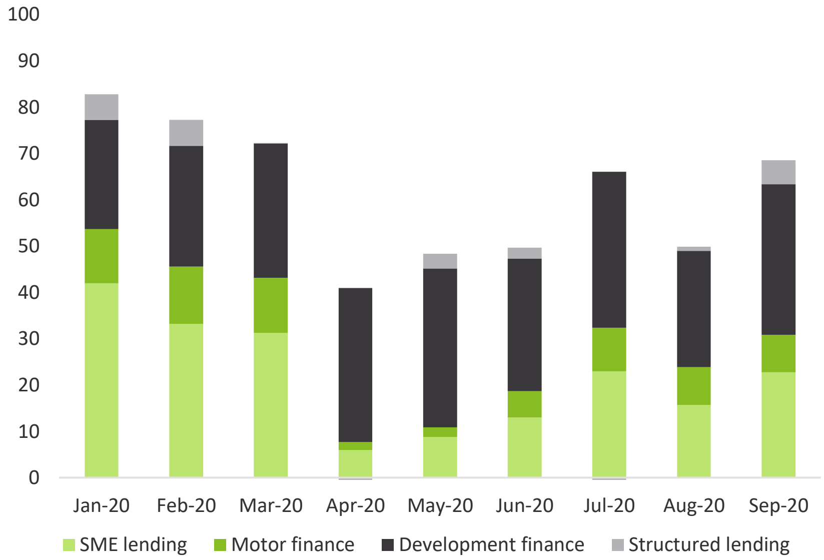
Commercial Lending provides increased diversification

Resilient performance in COVID shock

- Commercial Lending is a key pillar in our diversification strategy
- Business grown through combination of organic and inorganic means
- Acquisitions focused on acquiring deep industry experience and capability, not scale
- Technology combined with deep knowledge of asset valuations and industry segments enabling low risk expansion into SME lending
- Development finance and structured lending focused on delivering high returning, low risk asset origination

- Business resilient during the crisis, originations in September back to c81% of pre-COVID levels, 98% in October
- Investment in new technology to step-up in 2021

Commercial Lending new business (£m)



* Includes operating leases

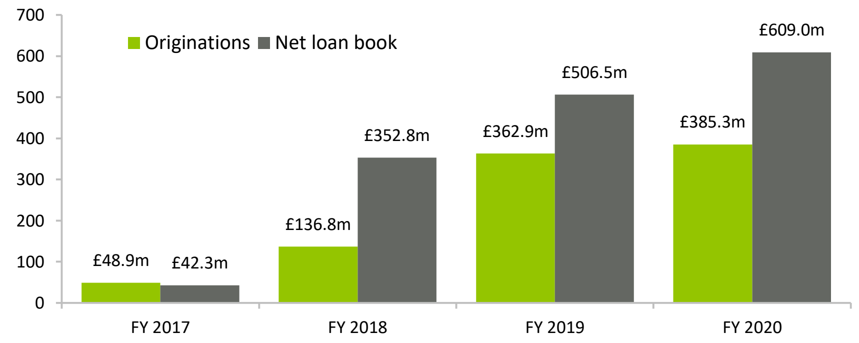
Commercial Lending – development finance

Continued growth with conservative approach

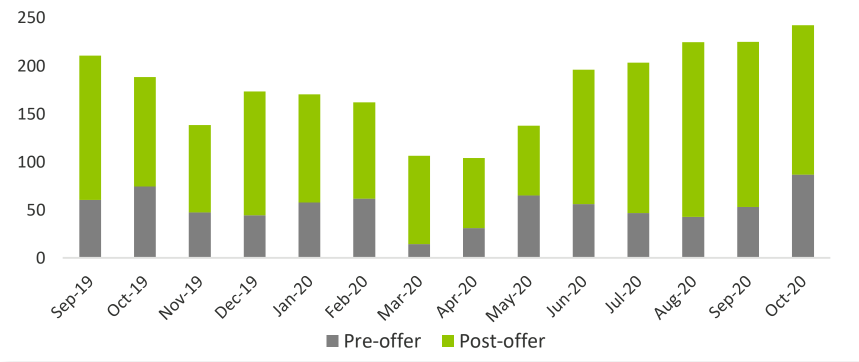
- Key differentiators for Paragon
  - Experienced team
  - Broad product range
  - Efficient delivery platform
- Growth through retaining existing clients and building client base – approximately 50% of new facilities are from existing relationships
- Average facility is £4.8 million at 62.2% of GDV
- Residential construction sector remains strong

- Limited site closures during Lockdown 1 and construction encouraged to remain open in Lockdown 2
- Modest forbearance in lockdowns, now zero
- 2021 planned developments
  - Expanding relationship management teams
  - Broadening distribution

Originations and loan book growth (£m)



Development finance pipeline (£m)



Commercial Lending – SME lending

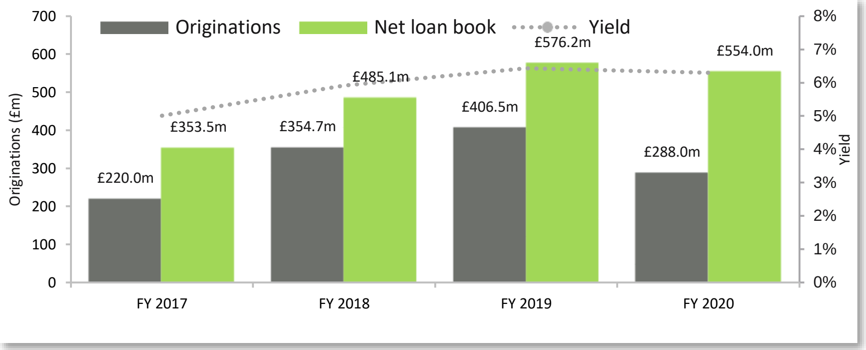
Broad-based proposition

- Serving SMEs, local authorities and professions through both direct and broker channels

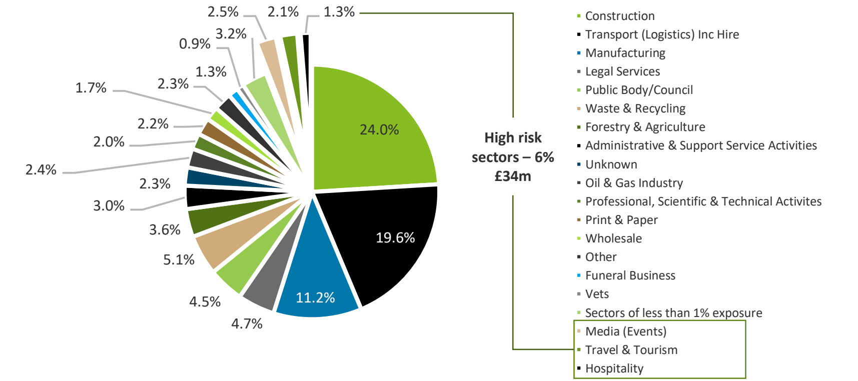
- 90% of assets are secured, 10% unsecured focused on legal services
- Limited exposure to higher risk sectors
- At peak, 45.8% of book on capital payment holidays, now 2.1%
- CBILS and BBLS focused on supporting existing customers

- Lending volumes largely recovered to pre-COVID levels
- Digital transformation project underway to enhance capability, add capacity and support franchise expansion

Originations and loan book growth (£m)



Exposure by sector

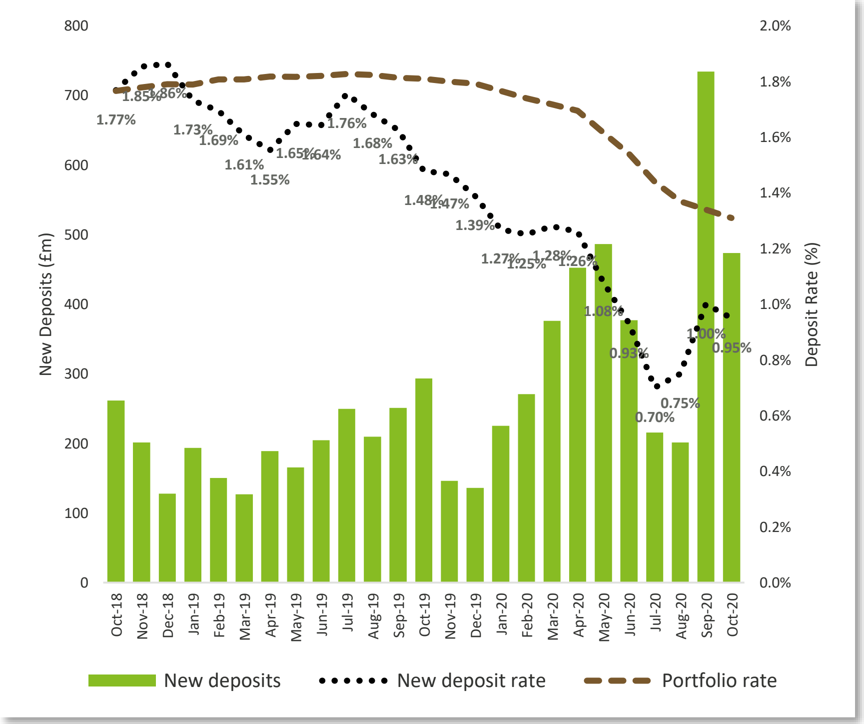


Retail savings – levelling the playing field

Boosting capacity and capability

- Continued strong growth in deposits – now £8.1 billion at end of October, +26.5% from FY:19, with material fall in pricing
- Capability – investing in data analytics to optimise customer service, volume and price
- Capacity – growing active deposit pools by product and channel
  - Full suite of savings products with award winning ISAs
  - Use of third party channels, supplemented by Monzo and Revolut relationships
  - Invested in technology to facilitate further expansion of capacity
  - Opportunity to expand into SME products
- Technology to level playing field with big banks over time
  - Open banking provides opportunity to break down barriers to entry
  - >£510 billion of retail savings earning <0.25%*
  - Chance to flatten the deposit cost curve with big banks
- Positive front-book, back-book dynamic
  - Portfolio cost of deposits 1.34% at Sept-20 (Sept-19: 1.81%)
  - Cost of new deposits averaged 0.90% in Q4:20
- Funding strategy supplemented with in-house securitisation capability
- Access to TFSME allows us to support SME customers

New deposits (£m) / deposit rate (%)



* CACI as at August 2020

Strategic focus and values reinforced by COVID-19 pandemic

Rapid reprioritisation underpinned strong financial and operational resilience

- Provided substantial support to customers to help them through the pandemic
- Our values and support for colleagues unchanged, emphasis on well-being and safety
- Delivered a resilient financial and operational performance alongside continued investment in developing the business
- Prudential strength supports dividend reinstatement at policy levels
- Strategic pillars and disciplines remain unchanged
- RoTE ≥ 15% reconfirmed

Well positioned to deliver our strategy in an uncertain environment

- Capital and liquidity are strong
- Balance sheet credit defensive, built on data and deep through-the-cycle experience
- Growth to resume
- 2021 will still hold challenges but well prepared
- Planning underway for a new environment
  - Technology plans accelerated
  - Operating models – a new way of working
- Further opportunities will emerge as the world settles to a new order

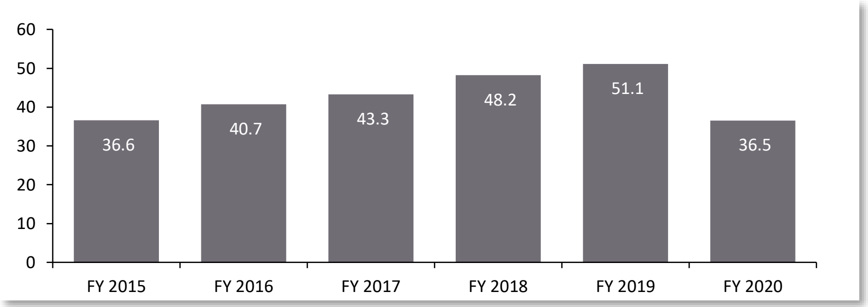
Appendix

Building a specialist bank

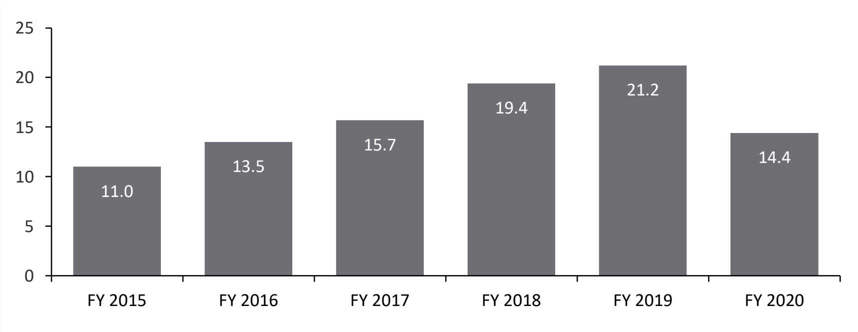
COVID-related impairments impacted financial outturn, but Group remains profitable and resilient

- Expected Credit Loss approach under IFRS 9 accelerates impairment recognition as soon as economic expectations worsen

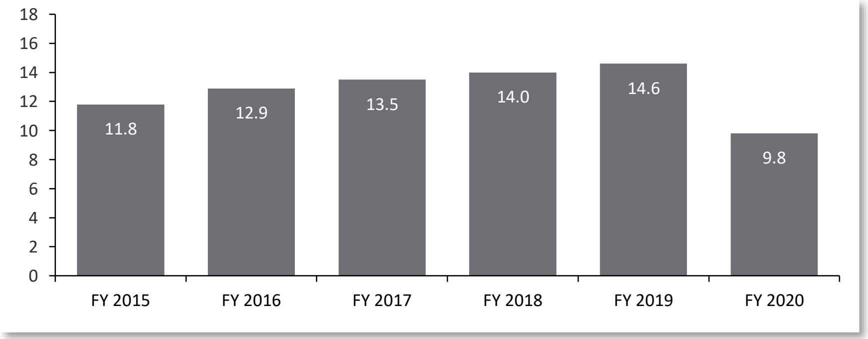
Underlying earnings per share (pence)



Dividend per share (pence)



Underlying return on tangible equity (%)

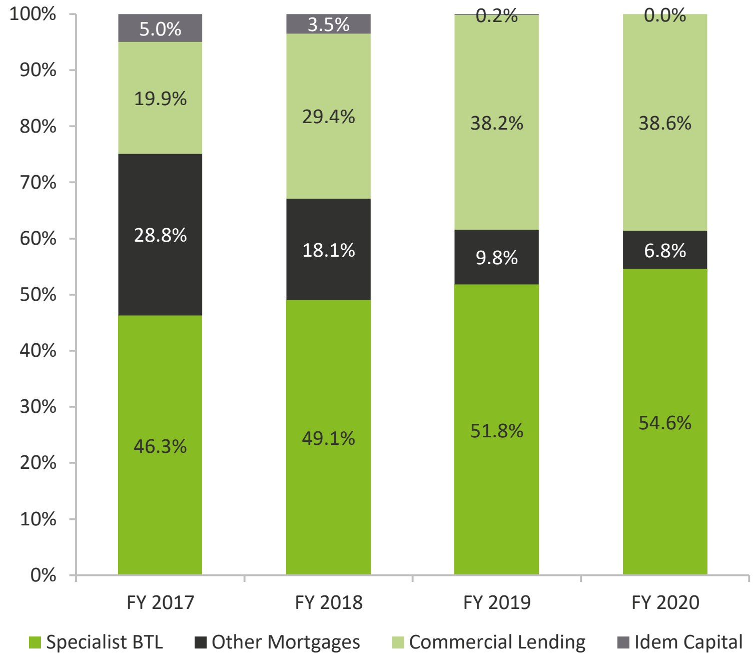


Building a specialist bank

Specialist lending focus continues

- Commercial Lending and specialist BTL dominate new business flows
- Specialist distribution
- Bespoke operating models
- Stronger margins
- Stronger defensive qualities
- Strong credit focus

Significant shift in flow of new loan originations in 3 years (%)

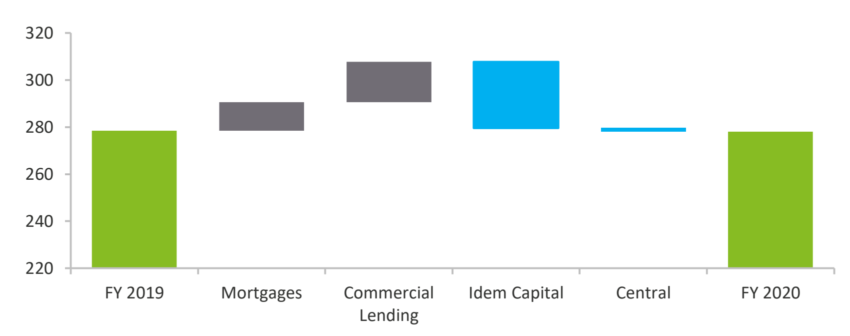


Net interest income

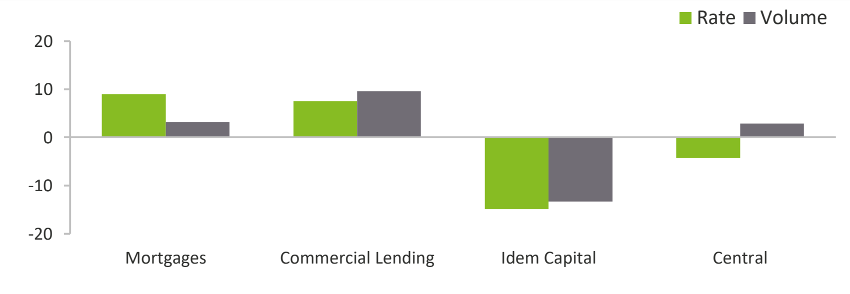
Income dynamics in growth segments remain attractive

- Positive rate and volume effects in both Mortgage Lending and Commercial Lending
- Absorbing adverse impact from H2 base rate impacts on variable rate loan book
- Idem Capital amortisation maintained – higher yielding assets running off first
- Commercial Lending performance reflects particularly strong development finance performance
- Creates structural underlying NIM enhancement

Net interest income (£m)



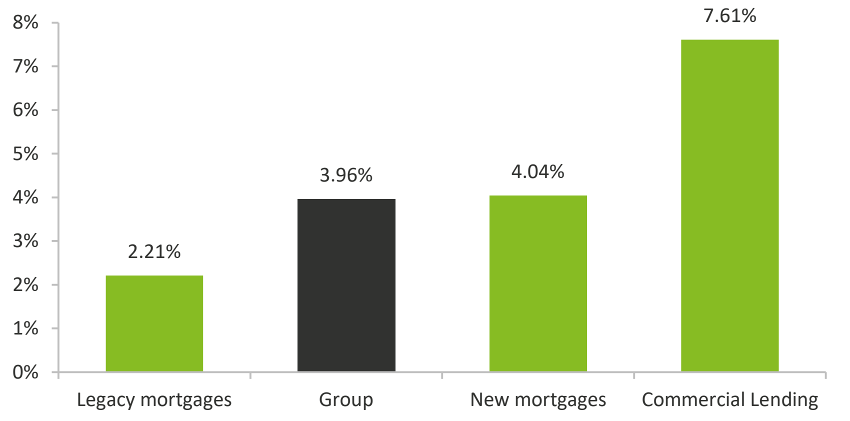
Rate and volume influences (£m)



Structural improvement in NIM

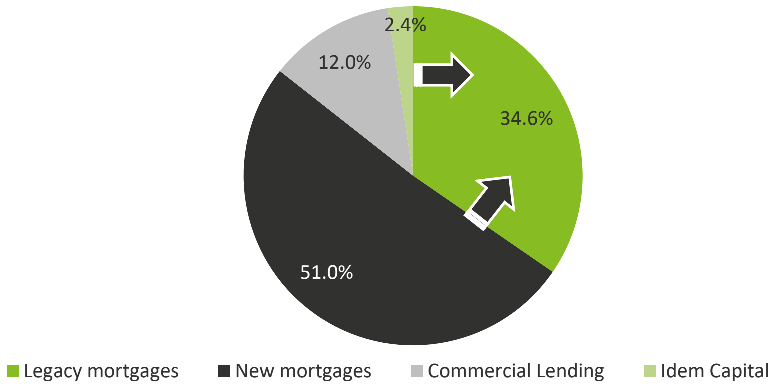
Front:back-book dynamics generate underlying NIM enhancement

Evidenced via higher yields in new portfolio



Swapping lower margin legacy book for higher margin BTL / SME

Drag from Idem Capital materially less significant from FY 2021



Provisions by stage and segment

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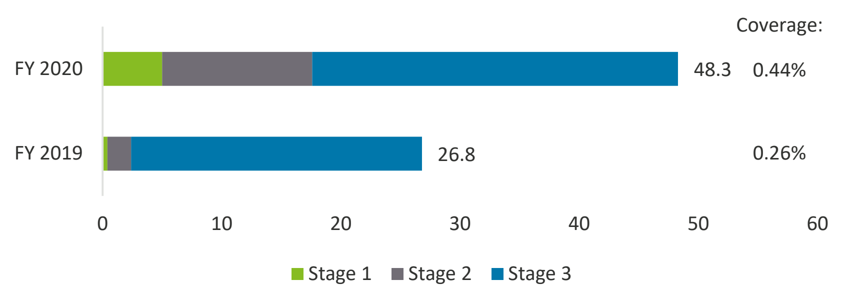
IFRS 9 impairments

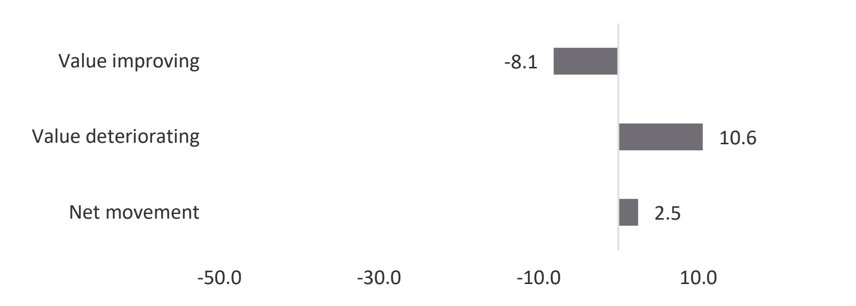
	Mortgage Lending	Commercial Lending	Idem Capital	Total
Stage 1	9,822.6	1,384.2	122.9	11,329.7
Stage 2	903.2	132.3	9.9	1,045.4
Stage 3	127.0	20.2	28.9	176.1
POCI	15.0	6.7	140.3	162.0
Gross loan book	**10,867.8**	**1,543.4**	**302.0**	**12,713.2**
Stage 1	5.0	17.0	0.2	22.2
Stage 2	12.6	3.0	0.2	15.8
Stage 3	30.7	8.2	4.5	43.4
POCI	0.0	0.4	0.0	0.4
Impairment provisions	**48.3**	**28.6**	**4.9**	**81.8**
Stage 1	0.05%	1.23%	0.16%	0.20%
Stage 2	1.40%	2.27%	2.02%	1.51%
Stage 3	24.17%	40.59%	22.28%	24.65%
POCI	0.00%	5.97%	0.00%	0.25%
Coverage ratio 2020	**0.44%**	**1.86%**	**1.59%**	**0.64%**
Coverage ratio 2019	**0.26%**	**0.73%**	**1.12%**	**0.34%**

Impairments – Mortgage Lending

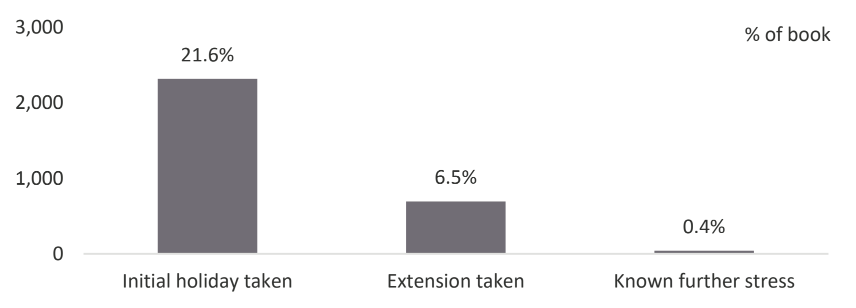
IFRS 9 provisions (£m)



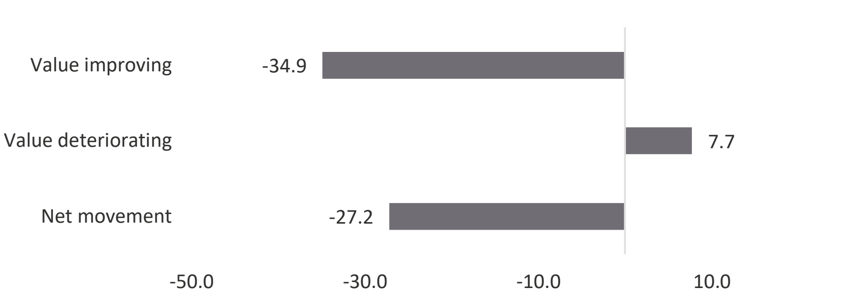
Arrears balance movements on non-payment holiday customers (£m)



Initial, extended and ongoing COVID forbearance



Arrears balance movements on payment holiday customers (£m)

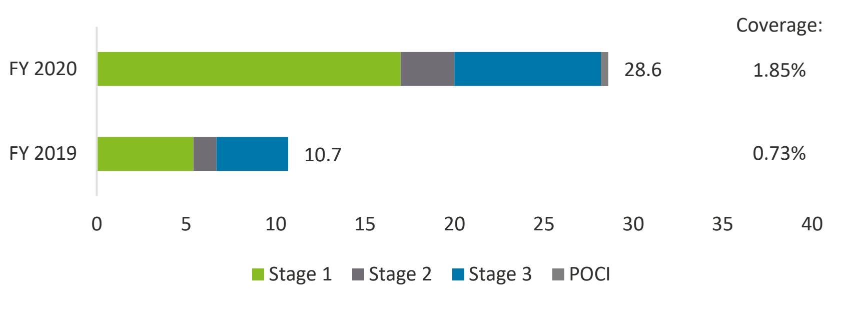


Total Mortgage Lending segment book value £10.8 billion

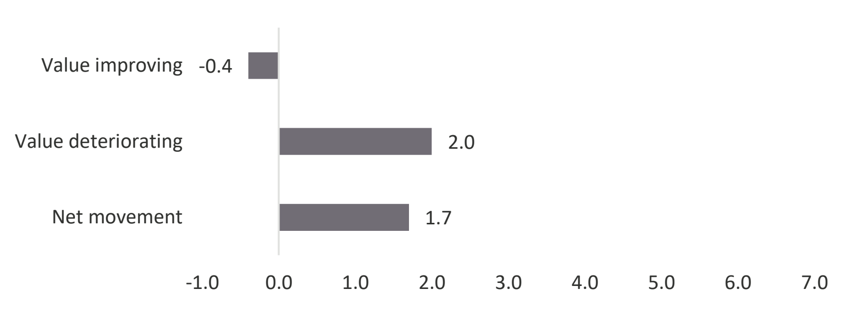
Data as at 11 November 2020

Impairments – Commercial Lending

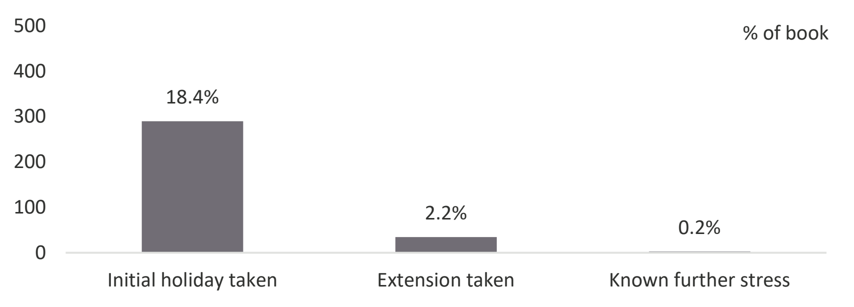
IFRS9 provisions (£m)



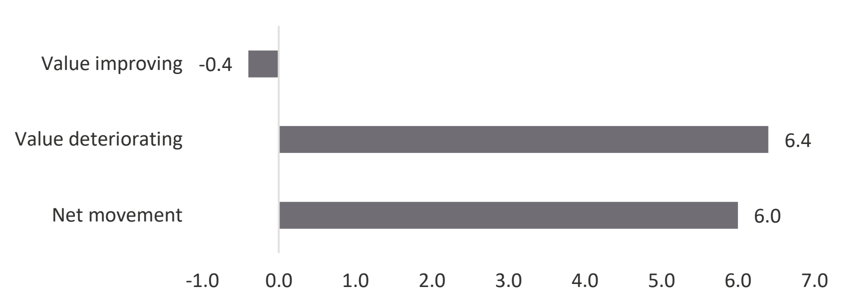
Arrears movements on non-payment holiday customers (£m)



Initial, extended and ongoing COVID forbearance (£m)



Arrears movements on payment holiday customers (£m)

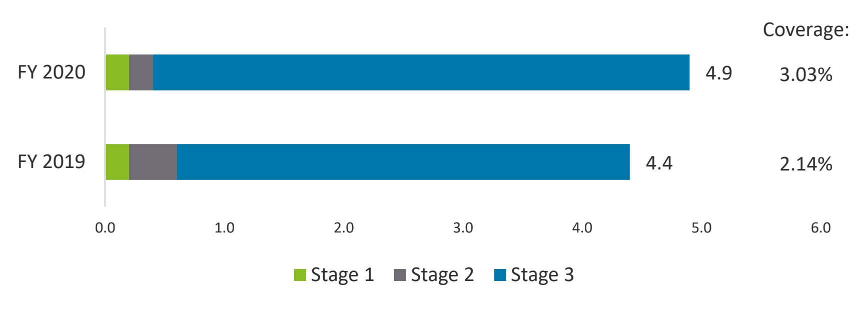


Source: Paragon Banking Group PLC, as at 11th November 2020

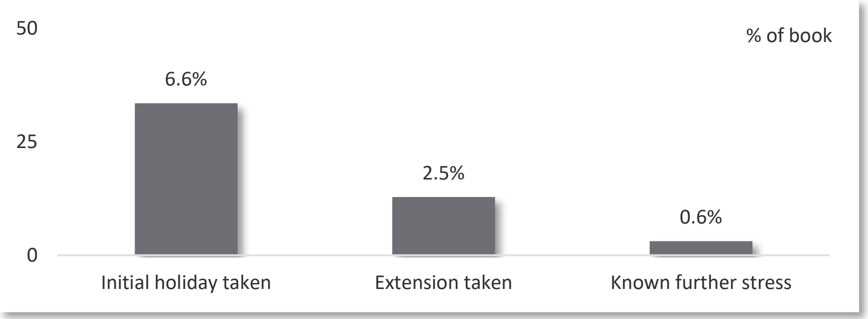
Impairments – Idem Capital

- For assets 'Purchased or Originated as Credit Impaired' ('POCI'), a large part of the Group's acquired assets in Idem Capital, the carrying valuation is based on expected cash flows discounted by EIR determined at point of acquisition
- Assets analysed in these charts by gross receivable (not net book value)
- POCI assets make up £190.0 million of Idem Capital's gross loan book as at 30 September 2020 while non-POCI assets account for remaining £204.3 million

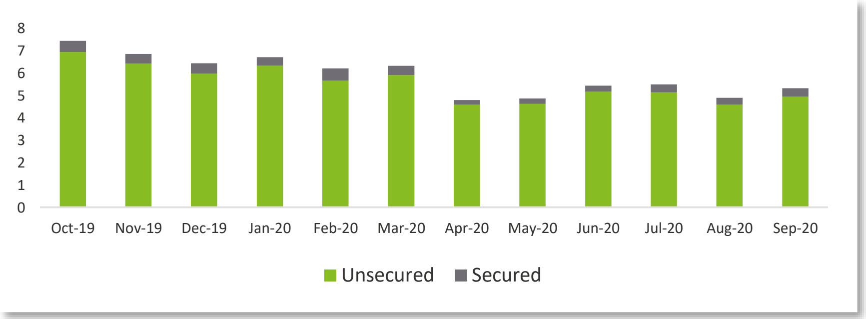
Non-POCI IFRS 9 provisions (£m)



Initial, extended and ongoing COVID forbearance (£m)



POCI loan cash flow trend (£m)

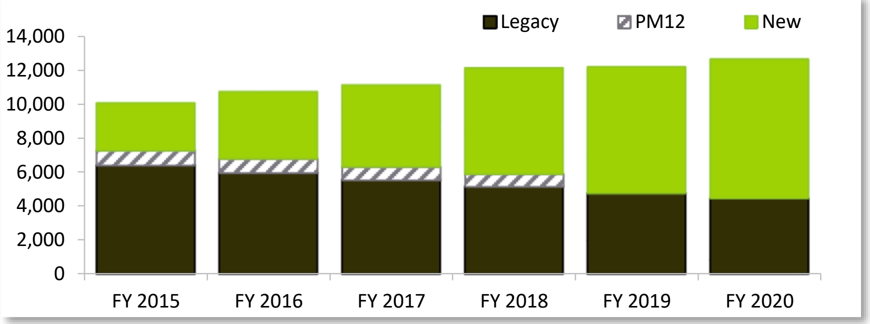


Diversification

Diversified loan growth

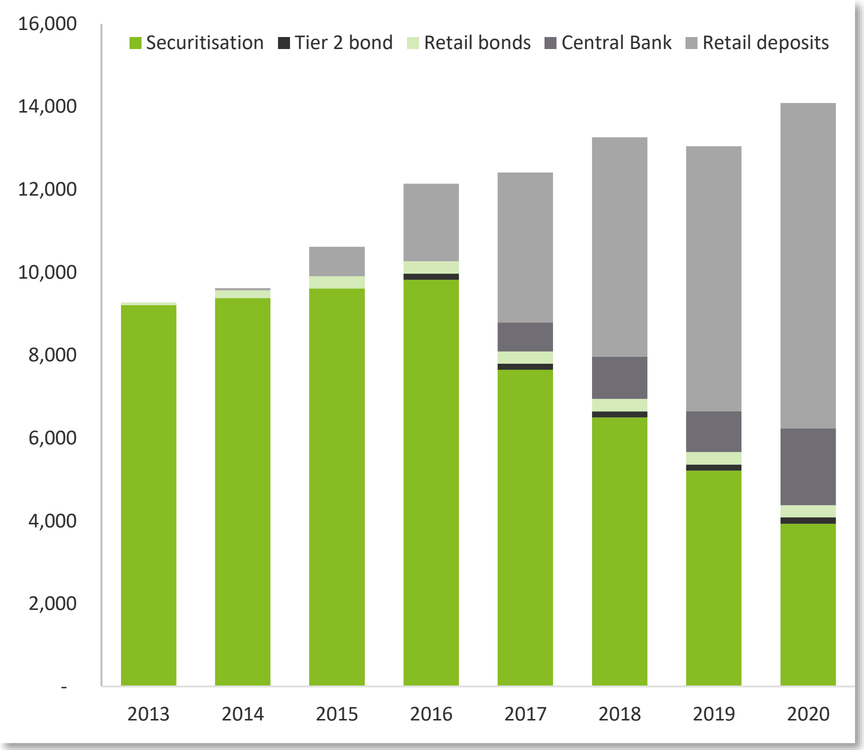
Originations £million	FY 2020	FY 2019	Change
Specialist BTL	1119.0	1315.1	(14.9%)
Other mortgages	140.7	249.3	(43.6%)
Commercial Lending	790.8	968.0	(18.3%)
Idem Capital	0.0	4.2	(100.0%)
Total	**2050.5**	**2536.6**	**(19.2%)**

Total – loans and advances to customers (£m)



Diversified funding

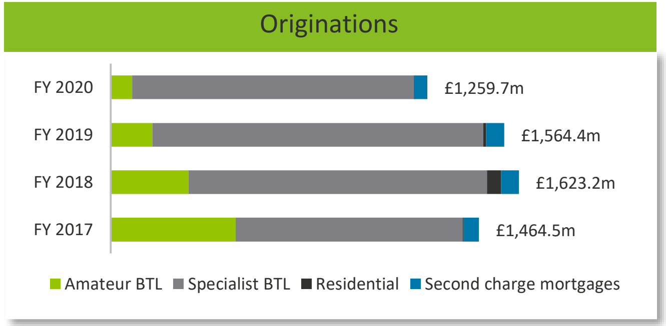
Funding by type (£m)

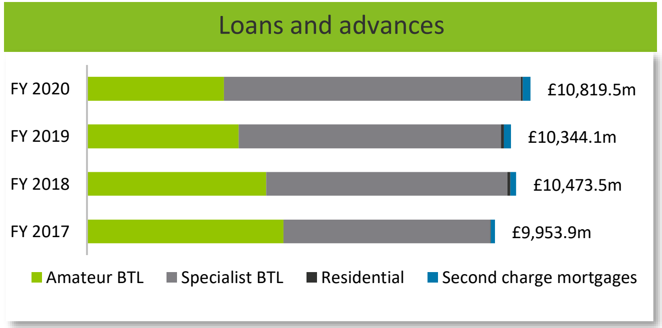


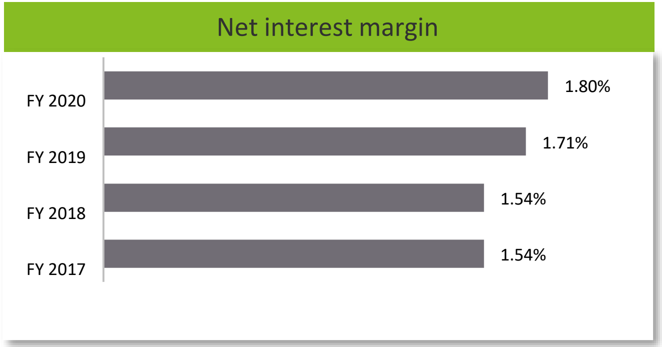
Mortgage Lending

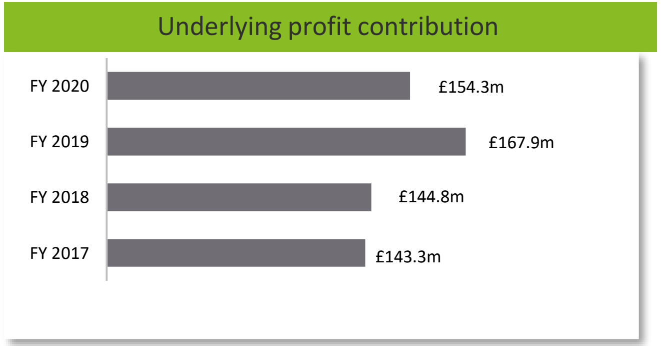
Pre-provision performance maintains progress, despite COVID-related drop in demand during lockdown

- Origination flows firmly focused on specialist business
- Pre-provision profit up 6.6% despite second half NIM effects from base rate changes
- Year end pipeline strong







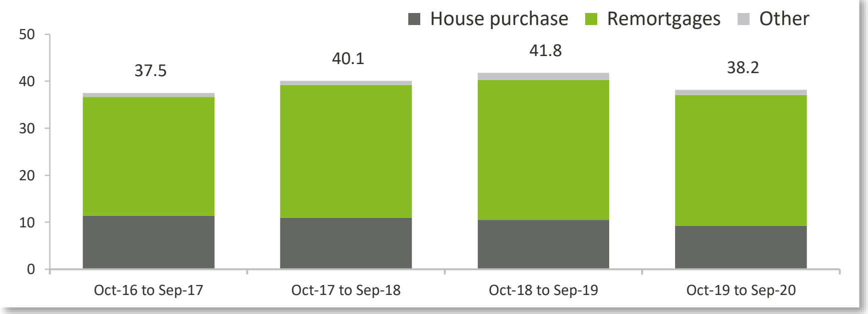


Buy-to-let

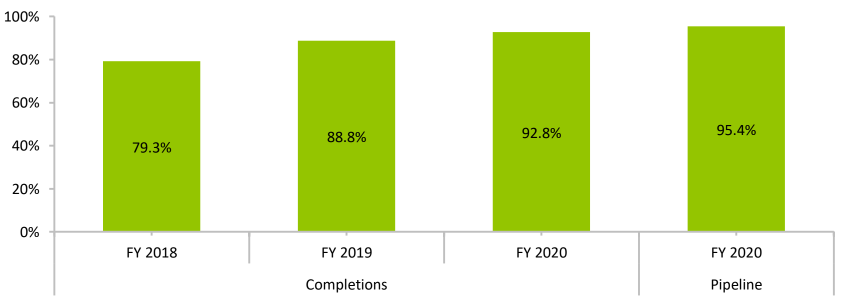
Market-wide volumes reflect Paragon's experience

- Market saw lower demand from April – June
- Paragon's specialist focus maintained – evidenced in new business volumes and pipeline

BTL gross mortgage lending (£bn)



Specialist BTL lending (%)

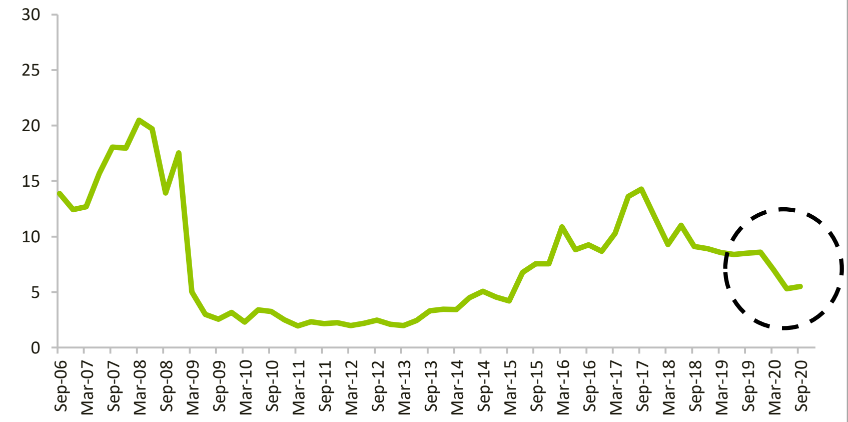


Supporting the housing needs of Britain's renters

Keeping our customers for longer

- Further reductions in annualised redemption rates
- Historic peak driven by amateur products and strong refinance market
- Strong retention
- Longer average lives from 5-year fix business

BTL redemptions (%)



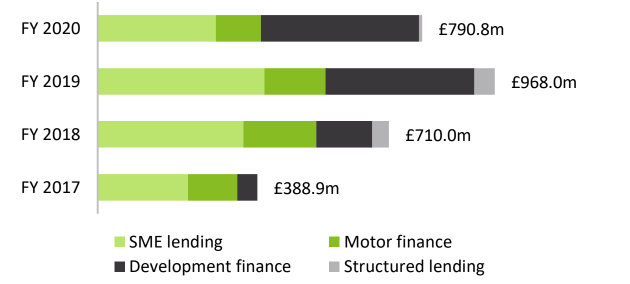
Supporting the housing needs of Britain's renters

Commercial Lending

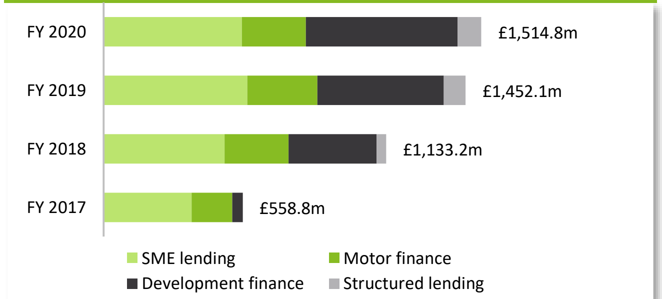
COVID-interruption stalls underlying strong progress

- New business volumes below 2019 peak
- Pre-provision profit up 32.5%
- Continued margin enhancement

Originations



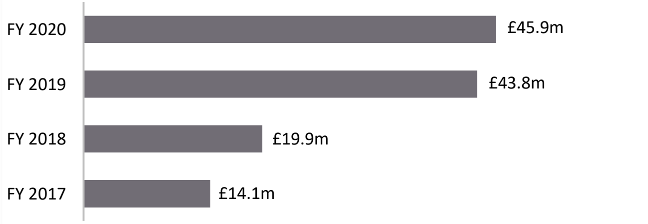
Loans and advances



Net interest margin *

* Calculated over average monthly balances

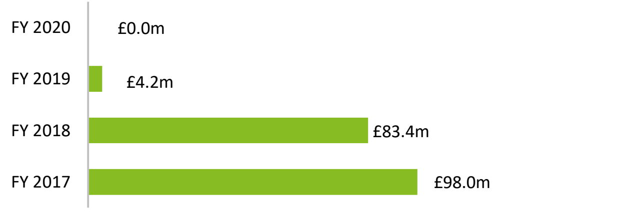
Underlying profit contribution



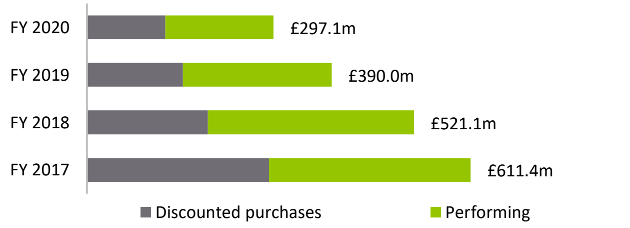
Portfolio amortisation rate maintained

- Run-off fastest in high yield books
- Cash flow impacted during lockdown but rebounded strongly
- No extra EIR adjustments made beyond the £3.6 million at the half-year
- Cumulative Idem Capital cash outperformance v underwriting model stands at 109%

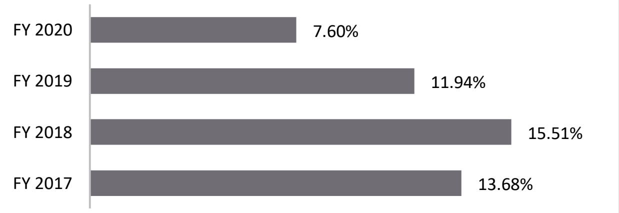
Investments



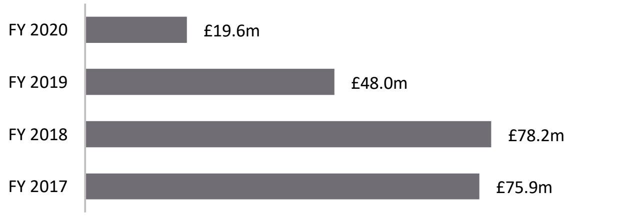
Loans and advances



Net interest margin



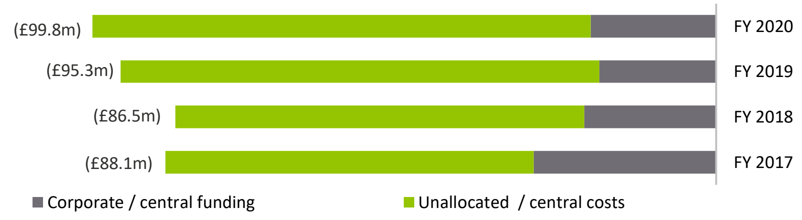
Underlying profit contribution



Central overheads increased year-on-year

- Costs include £1.6 million increase in savings administration expenses, which varies with portfolio size rather than inflation

Underlying profit / (loss) contribution



Underlying operating leverage*

* Central operating costs as a proportion of total operating costs

Balance sheet

£million	2020	2019	Change (%)	
Mortgages	10,819.5	10,344.1	+4.6%	Steady growth. H2 completions slower but pipeline rebuilt
Commercial Lending	1,514.8	1,452.1	+4.3%	SME and Motors books most impacted by COVID impacts on demand
Idem Capital	297.1	389.8	(23.8%)	Continued amortisation
Loans and advances to customers	**12,631.4**	**12,186.1**	**+3.7%**	
Cash	1,925.0	1,225.4	+57.1%	Materially higher liquidity levels held throughout 2020
Other assets	949.1	984.0	(3.5%)	
Total assets	**15,505.5**	**14,395.5**	**+7.7%**	
Capital and reserves	1,156.0	1,108.4	+4.3%	TNAV £3.91 per share at year end
Retail deposits	7,856.6	6,391.9	+22.9%	Deposit flows strong and at better pricing
Tier-2 bond	150.0	150.0	-	
Retail bonds	297.5	297.5	-	
Asset backed loan notes	3,928.3	5,206.9	(24.6%)	Continued repackaging of legacy deals
Central bank facilities	1,854.4	994.4	+86.5%	TFSME drawings of £910 million
Other liabilities	262.7	246.4	+6.6%	
Total liabilities and equity	**15,505.5**	**14,395.5**	**+7.7%**	

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