Paragon Banking Group PLC

Record profits and strong momentum

Financial results

Twelve months ended 30 September 2021

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Business developed at pace during FY21

Financial performance

- Operating profit £194.2 million, up 61.8% on 2020. Pre-provision profit up 12.6%
- Underlying EPS +62.5%
- Stable asset yields and lower deposit costs supporting improving NIM trajectory
- Underlying RoTE 14.7%
- Dividend at 26.1p in line with policy

Strong new business growth

- Net loan growth 6.1%
- Period end pipelines strong
- Deposit balances +18% year-on-year with broader channel penetration
- Technology investment accelerated with cloud / digital first strategy

Robust balance sheet

- Green Tier-2 bond issued – almost 300 basis points below previous Tier-2 bond rate
- Impairment overlays broadly unchanged from 2020 levels, LTVs reduced and credit performance strong
- Transformation of funding structure completed
- Capital strong, CET1 15.4%, further IRB progress
- £50 million buyback programme announced

Key priority evolution

	2020 / Pandemic	2021 / Recovery
People	• High protection focus with enhanced employee engagement • Excellent operational resilience and agility	• Hybrid model planning well advanced • Safety always paramount • Strong employee engagement scores
Customers	• Government support programmes • CBILS / BBLS • Payment holidays	• Payment holidays successfully unwound • Continued support through RLS • Enhanced service proposition
Capital	• Capital ratios strengthened • Resilient balance sheet performance	• Strong capital accretion • Dividends fully recovered • Buyback programme extended • Further IRB development
Franchise	• Significant customer and intermediary engagement • Technology investment maintained	• Reputation enhanced • Stronger growth agenda • Accelerated digitalisation

Financial results

Twelve months ended 30 September 2021

Richard J Woodman

Chief Financial Officer

Income statement

£ million	2021	2020	Change	
Net interest income	310.5	278.1	+11.7%	Favourable margin and volume effects
Other income	14.4	17.0	(15.3%)	Serviced portfolios running down
Total operating income	324.9	295.1	+10.1%	
Operating expenses	(135.4)	(126.8)	+6.8%	Share based led
Pre-provision profit	**189.5**	**168.3**	**+12.6%**	
Impairments	4.7	(48.3)		Write-backs model-led, overlays broadly maintained
Operating profit	**194.2**	**120.0**	**+61.8%**	
Fair value net gains / (losses)	19.5	(1.6)		Mainly yield-curve related
Profit before taxation	**213.7**	**118.4**	**+80.5%**	
Reported earnings per share	**65.2p**	**36.0p**	**+81.1%**	Enhanced by buy-back programme

Segmental results

Pre-provision profits up 15.4% in Mortgage Lending and 16.2% in Commercial Lending, Idem drag reducing

Underlying £ million	Mortgage Lending	Commercial Lending	Idem Capital	Central	Total
Total operating income (2021)	225.3	102.5	20.5	(23.4)	324.9
Change (v 2020)	+28.8	+10.5	(6.2)	(3.3)	+29.8
Operating expenses	(17.4)	(23.9)	(5.1)	(89.0)	(135.4)
Change	(1.0)	+0.5	+1.2	(9.3)	(8.6)
Pre-provision profit	**207.9**	**78.6**	**15.4**	**(112.4)**	**189.5**
Change	+27.8	+11.0	(5.0)	(12.6)	+21.2
Provisions for losses	5.9	(2.9)	1.7	-	4.7
Change	+31.7	+18.8	+2.5	-	+53.0
Operating profit	**213.8**	**75.7**	**17.1**	**(112.4)**	**194.2**
Change	+59.5	+29.8	(2.5)	(12.6)	+74.2

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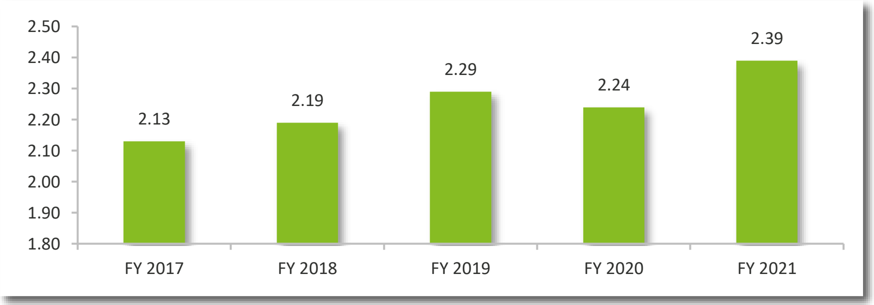
Net interest margin

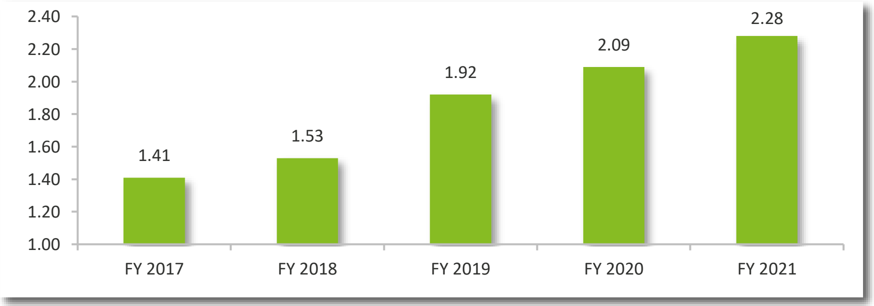
Structural NIM accretion returns after base-rate led drop in 2020

- Upwards margin trajectory resumed
- New mortgages carry higher margins than legacy book
- Commercial asset margins wider still
- Idem run-off effect substantially reduced
- Savings performance driving material cost of funds benefits
- Further progress expected in 2022 – scale influenced by profile of potential base rate movements
- Earnings growth from net assets at higher rates

NIM progression – Group (%)



NIM progression – Group excluding Idem Capital (%)



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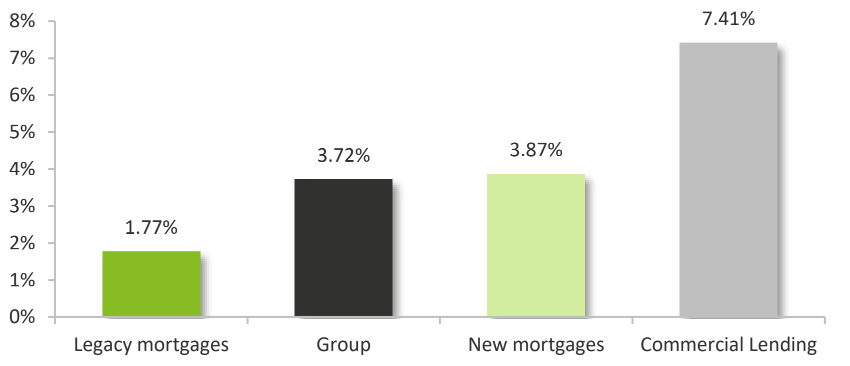
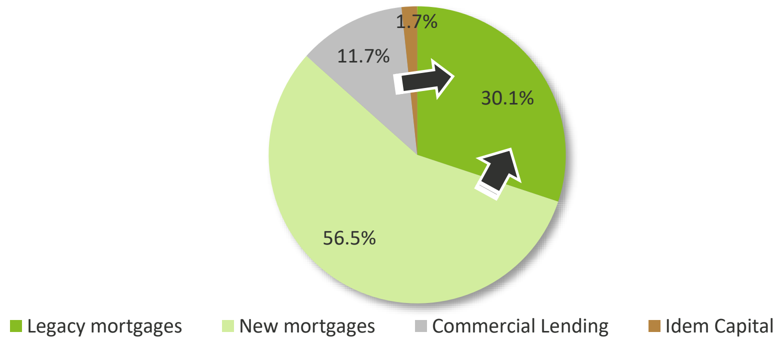
Structural improvement in NIM

New books continue to generate higher yields than the legacy portfolio

Evidenced via higher yields in new portfolio

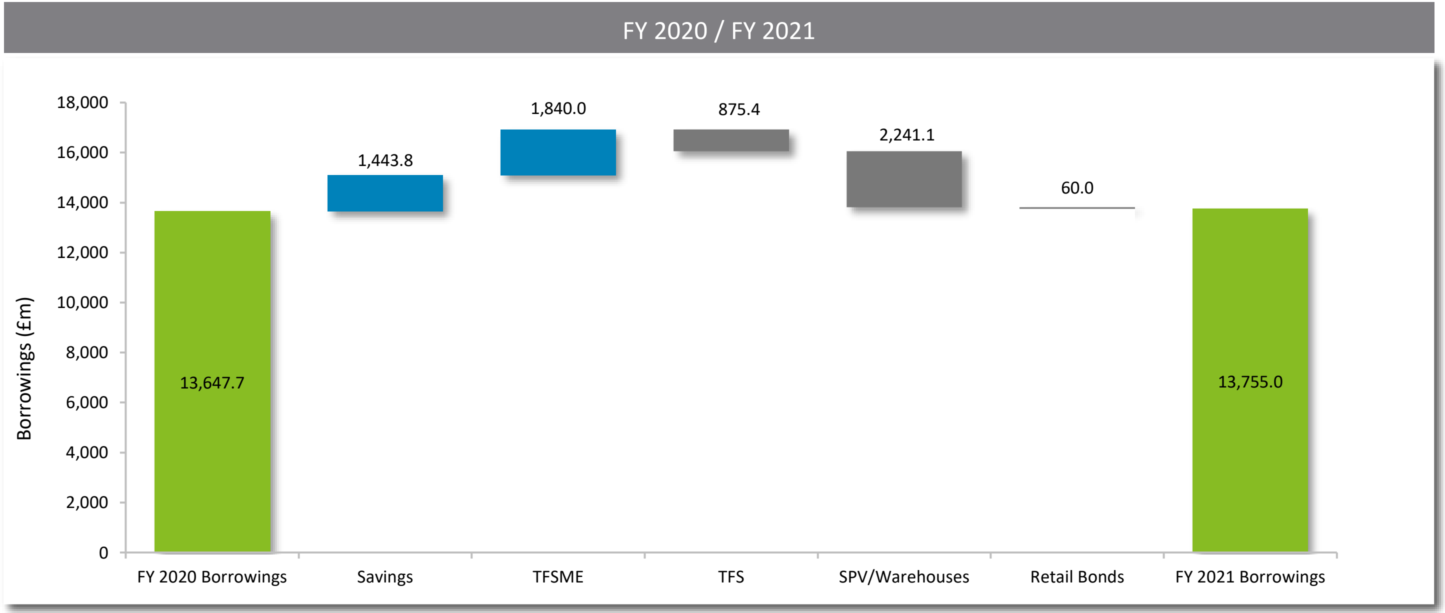


Swapping lower margin legacy book for higher margin BTL / SME



Funding bridge

Savings growth and TFSME drawings support growth and TFS / legacy securitisation repayment



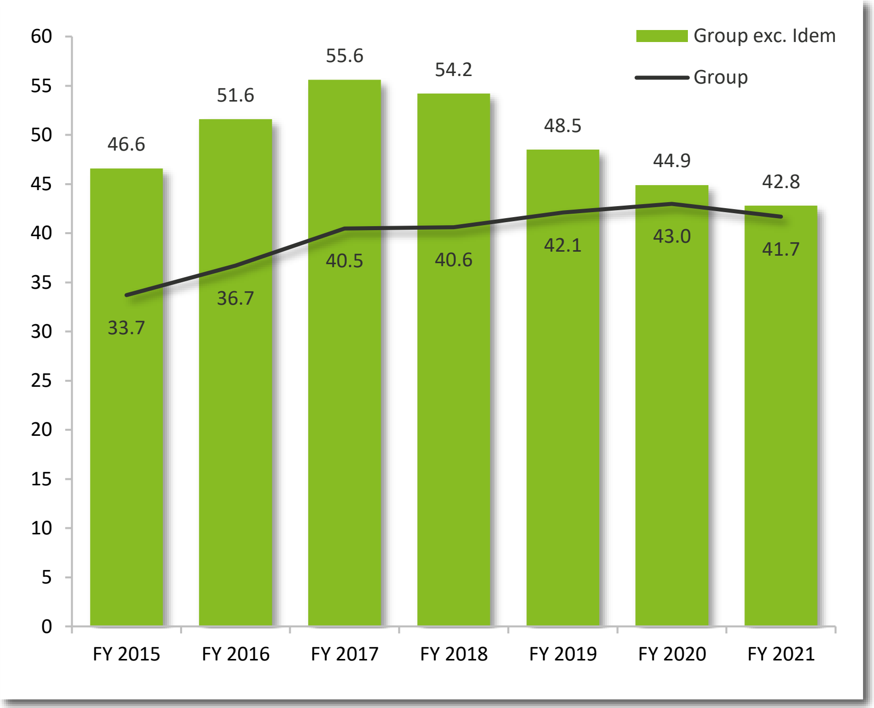
- Savings growth remains the key strategic funding mechanism
- Refinancing legacy SPVs adds encumbrance capacity

Operating expenses

Income growth outstripping pace of operating expenses expansion

- Continued investments in projects and technology
- Share based costs drive bulk of movement in 2021
- Material change programme underway across the business
- Control and monitoring costs continuing to rise
- Savings-related overheads growing with the deposit book
- Idem run-off effect diminishing:
  - Idem cost income dilution reduced from 15.1ppts in 2017 to 1.1ppts in 2021
- Opportunity for further operating leverage

Underlying cost:income ratio (%)



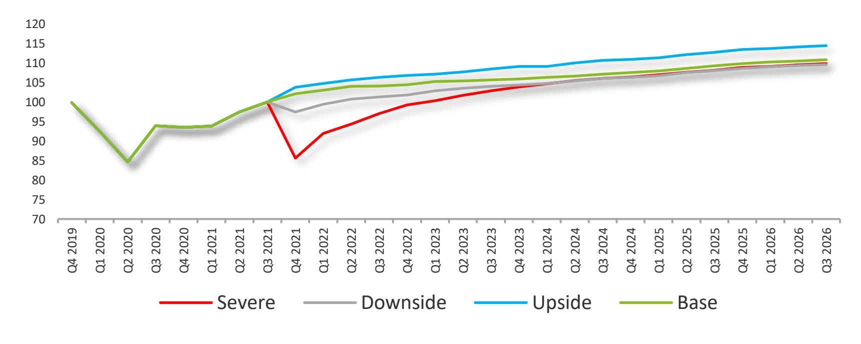
Economic outlook

Improved economic outlook, uncertainty remains

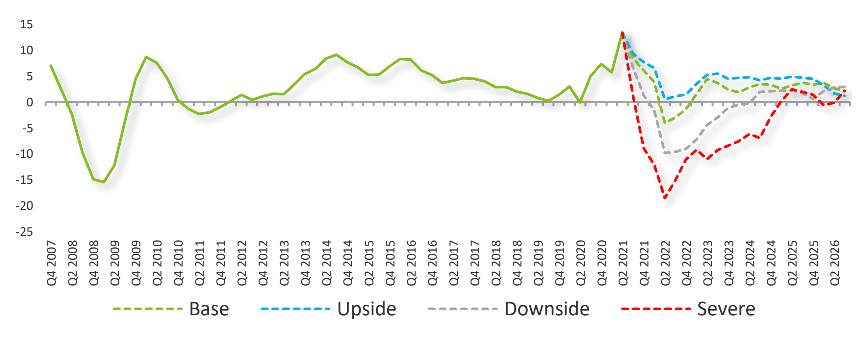
- Four scenarios updated from September 2020, severe = BoE 2021 stress
- Unemployment peak at 5.5% in Baseline, 11.9% in Severe
- House prices proved extremely resilient, in part a function of stamp duty changes. Outlook remains uncertain and prudent approach taken in impairment modelling, severe assumptions harsher than BoE 2021 stress
- PMAs maintained
- PMAs to be updated as evidence from end of furlough and government support schemes emerges

Scenarios				
	Base	Upside	Downside	Severe
Weighting	40%	10%	35%	15%
Impact of 100% weighting	£52.7m	£47.1m	£68.1m	£106.1m
Variance to reported	(£12.7m)	(£18.3m)	+£2.7m	+£40.7m

Scenario GDP profile (Q3:21 index = 100)



House price change (%)



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Impairments

Write-back in 2021 driven by improved economic scenarios

- Underlying modelling reflects improving macro environment, particularly house prices
- PMAs determined at portfolio level and allocated to individual loans through PD overlays
- Disclosures show impacts of weighting approach when compared to pre-Covid levels
- Portfolio-wide credit performance remains strong

	Transition weights no PMAs	2021 weights no PMAs	2021 weights full PMA
Central	40%	40%	40%
Upside	30%	10%	10%
Downside	25%	35%	35%
Severe	5%	15%	15%
Total provision	**£38.2m**	**£46.0m**	**£65.4m**
Coverage ratio	0.28%	0.34%	0.49%

Impairment overlay

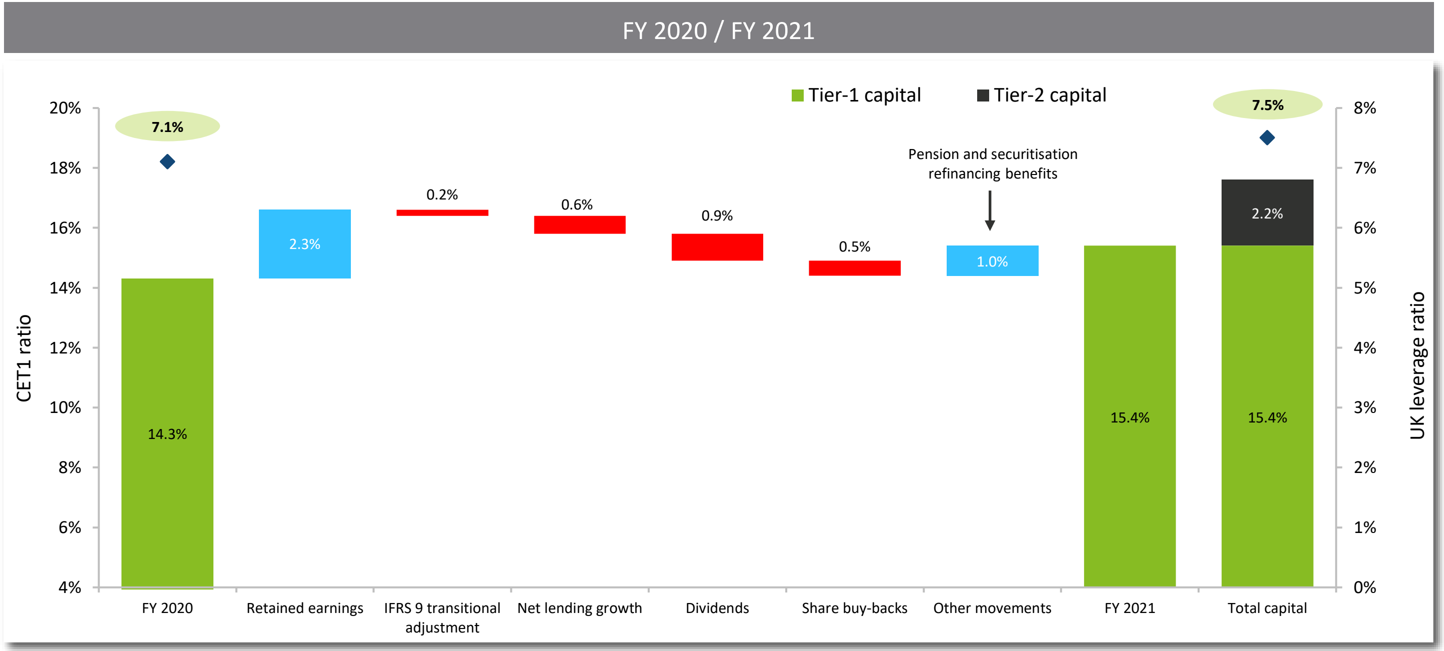
	2019 (£m)	2020 (£m)	2021 (£m)
Calculated provision	£41.9	£62.0	£46.0
PMA *	-	£19.8	£19.4
Total	**£41.9**	**£81.8**	**£65.4**
Coverage ratio	0.34%	0.64%	0.49%

* PMA – Post Model Adjustments

Indexed credit behavioural scores by portfolio

	Sep-20	Sep-21
Buy-to-let		
New	100.0	100.3
Legacy	100.0	101.0
New second charge mortgages	100.0	99.8
Legacy second charge and Idem Capital assets	100.0	102.7
Motor finance	100.0	101.3

Capital movements during the period



UK leverage ratio

Group capital

Capital strength supports growth and optimisation options

Capital ratios

- CET1 and TCR remain strong
- Capital surplus over regulatory requirement exceeds £0.4 billion (reflects CCyB at 0%)
- Capital requirements reduced following C-SREP
- Pillar 2A reduced from 2.79% to 0.84% year-on-year
- Fully loaded CET1 and TCR are 15.1% and 17.3% respectively

IRB

- Phase 2 underway for BTL
- Development finance models to be submitted in early 2022
- IRB remains a key element in improving our competitive position

Group consolidated capital	
Core Equity Tier-1 capital *	£1,055.8m
Tier-2 capital	£150.0m
Total capital resources	**£1,205.8m**
Credit risk	£6,247.1m
Operational risk	£576.0m
Market risk	-
Other	£13.7m
Total risk exposure	**£6,836.9m**
CET1 ratio *	15.4%
Total capital ratio (TCR) *	17.6%

Group consolidated leverage ratio	
Tier-1 equity *	£1,055.8m
Leverage exposure **	£14,120.2m
UK leverage ratio *	7.5%

* Including IFRS 9 transitional relief of £29.7m, adjusted for dividends and subject to verification

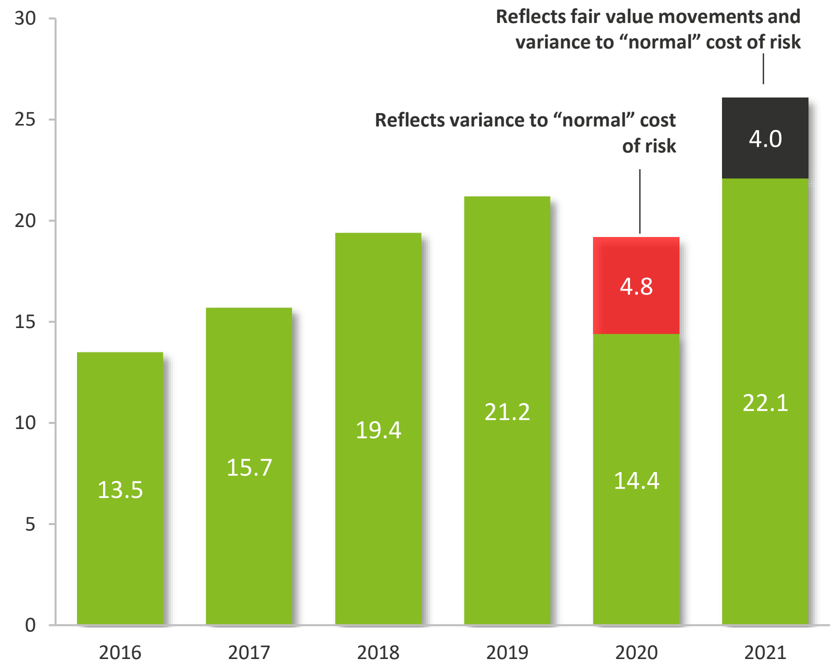
** Excludes qualifying central bank claims in accordance with rule modification applied to UK Leverage Ratio Framework

Dividend per share

Progression reflects underlying performance, strong fair values and impairment reversals

- 2020 dividend per share impacted by:
  - Fair value movements (-ve)
  - Heightened cost of risk
  - Covid impacts on business momentum
- 2021 dividend per share inflated by:
  - Fair value movements (+2.3p) – fair values usually excluded from underlying performance but strong capital position and momentum underpins decision to include
  - Cost of risk variance to pre-Covid level of 7bp (+1.7p)

Dividend per share (pence)



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Strategy overview

Nigel S Terrington
Chief Executive

Our strategic priorities

Growth

Diversification

Digitalisation

Capital management

Sustainability

Our strategic pillars

A customer focused culture
Expert knowledge and experience, supported by proprietary insight, data and analytics ensuring a deep understanding of our specialist customers and markets.

A dedicated team
An experienced, skilled and engaged workforce, and a unique culture underpinned by eight values.

Strong financial foundations
Prudentially strong, with a low risk approach to lending, reducing volatility of earnings and enhancing sustainability of dividends.

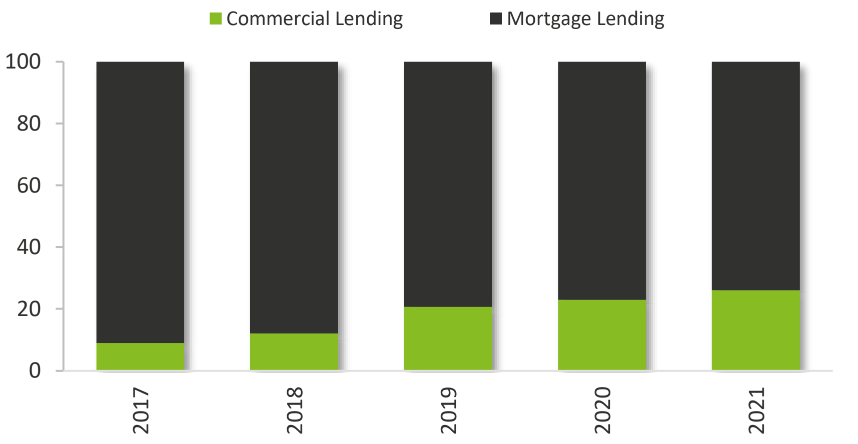
Strategic priorities – growth

- 12.6% CAGR in new lending delivered since 2016
- Continued focus on specialist markets
- Operational leverage creates potential for strong growth with improving efficiency
- IRB creates further growth opportunities
- Maintaining our disciplined risk appetite

Strategic priorities – diversification

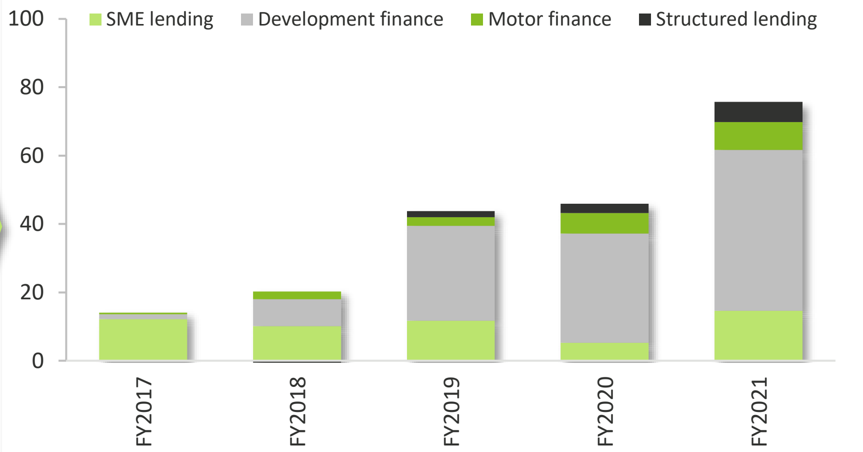
- Commercial Lending contribution almost fully offset Idem amortisation, but Idem run-off largely complete
- Commercial Lending is not a single product line – comprises four sub-divisions, development finance, SME lending, motor finance and structured lending
- SME lending itself has multiple product lines

Growth divisions' share of contribution (%)



Aggregate contribution from two divisions grown 99.2% since 2016

Operating profit by Commercial Lending sub-segment (£m)



Commercial Lending driving diversification and growth

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Strategic priorities – digitalisation

- Multi business line programme with segmental roll-out accelerated
- Cloud-based, but with modular, best-in-class delivery

Delivered …
- Savings technology platform managing 3rd party relationships
- Mortgage Portal
- SME Portal
- Surveyors' Platform

Delivering …
- Digital capacity across all areas
- Open API access
- Re-engineering new business processing
- Enhanced automation
- Enhanced data management
- Improved operational capacity
- Better customer service proposition

Alongside continuing investment to upgrade operational resilience

Strategic priorities – capital management

- IRB
  - Good progress as we move through various modules
  - Enhancing risk management capabilities, improving capital/risk alignment
  - Offering risk-based segmental pricing opportunities

- Basel 3.1 likely deferral to 2025

- Significant shareholder returns continued in FY21
  - Total capital repatriated (dividends + buybacks) total £624.9 million since 2015
    - £316.9 million dividends declared since 2015
    - £308.0 million buybacks since 2015
  - 40% pay-out ratio policy
  - New £50 million buyback programme announced on top of £40 million from last financial year

- Surplus capital over regulatory minimum exceeds £400 million

- No AT1 issuances to date

- Significant capacity remains to support growth ambitions

Strategic priorities – sustainability

Sustainability is central to our long-term success and it influences every aspect of our business

- Reducing the impact our own operations have on the environment
- Ensuring we have a positive effect on our stakeholders and communities
- Delivering sustainable lending through our product offering and markets in which we operate

Key milestones in 2021:

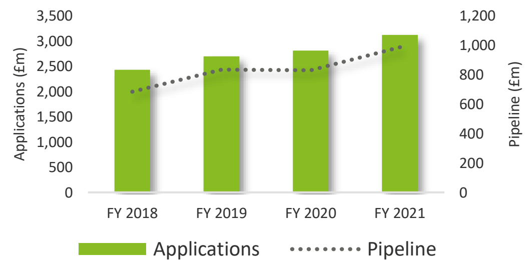
- ✓ Signed up to become a TCFD supporter
- ✓ First UK bank to successfully issue £150 million in Tier 2 Green Bonds
- ✓ Introduction of a range of sustainable mortgage products
- ✓ Extended our motor vehicle lending to include battery electric vehicles
- ✓ Launched our Sustainability Committee
- ✓ Formed ESG and Climate Risk teams
- ✓ Achieved gender diversity targets
- ✓ Publication of our inaugural Sustainability Report

Paragon's inaugural Sustainability Report

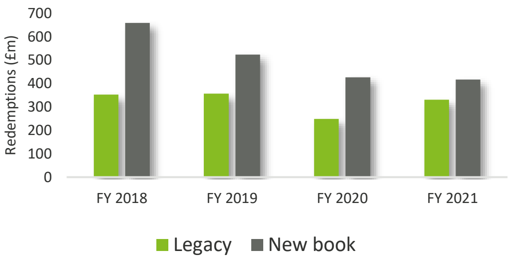
Buy-to-let

Strong new business flows and improving margin

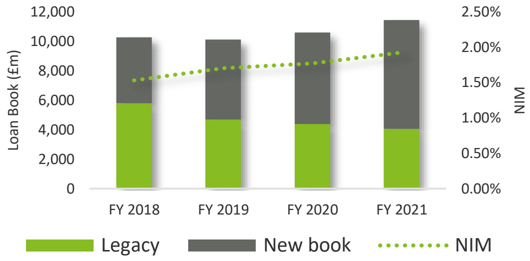
Specialist new business (£m)



Redemptions (£m)



Net loan book and margin (£m)



New lending

- £1,614.4 million advances (FY20: £1,205.4 million)
- Pipeline £1,008.1 million, up from £868.1 million at FY20
- Specialist lending completions 97% (FY20: 93%)

Redemptions

- Better customer retention
- Overall rate increased from 6.6% to 6.9%, influenced by higher redemptions on legacy book
- Modest tick-up ahead of scheduled end to SDLT holiday

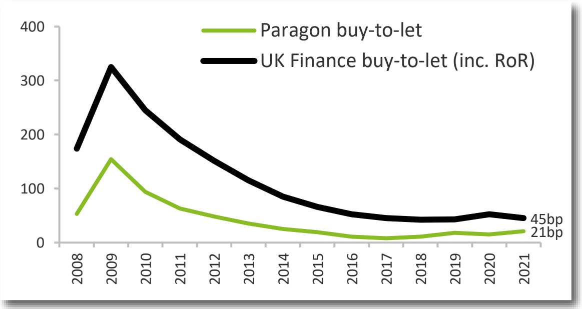
Net loan book

- £11.4 billion, up 7.9% on FY20
- Post-2010 book up 19.0% on FY20
- Buy-to-let NIM 1.93% (FY20: 1.77%)
- Legacy book now £4.0 billion (FY20: £4.4 billion)

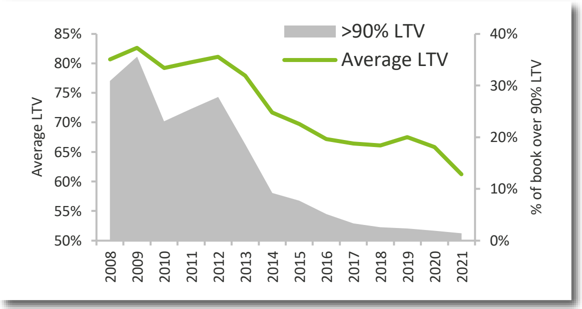
Proven resilience of business model through the pandemic

Continued low arrears and strong asset coverage

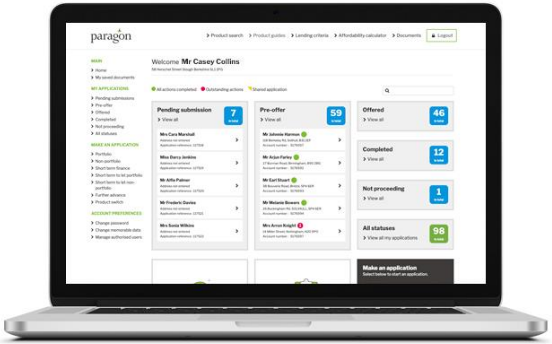
Arrears rate – 3mths+ (bp)



Average LTV



Source: UK Finance, Paragon Banking Group PLC



Low risk

- Asset backing transformed since 2008
- Average LTV 61.2% (Sept-08: 80.7%)
- LTV greater than 90%, 1.4% (Sept-08: 30.9%)
- LTV greater than 80%, 1.9% (Sept-08: 63.4%)

Multi-cycle experience

- Experienced team with through-the-cycle sector knowledge
- In-house surveyors provide unrivalled property insight

Technology and proprietary data analytics

- 650 million data points per month
- Intermediary portal
- New business re-engineering on new platform
- 25 years of data inform:
  - Underwriting
  - Pricing
  - Stress testing
  - IRB process

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Commercial Lending provides increased diversification

Higher yield Commercial Lending division experiencing strong volume growth

- Key element in the diversification strategy
- Record year of new originations at £971.5 million (2020: £790.8 million, 2019: £968.0 million)
- Commercial segment now accounts for 37% of new advances, 12% of loans on balance sheet and 26% of segmental contribution to central costs – we expect this mix to evolve further
- Strong yield is key to structural NIM improvement, providing attractive through-the-cycle risk adjusted returns

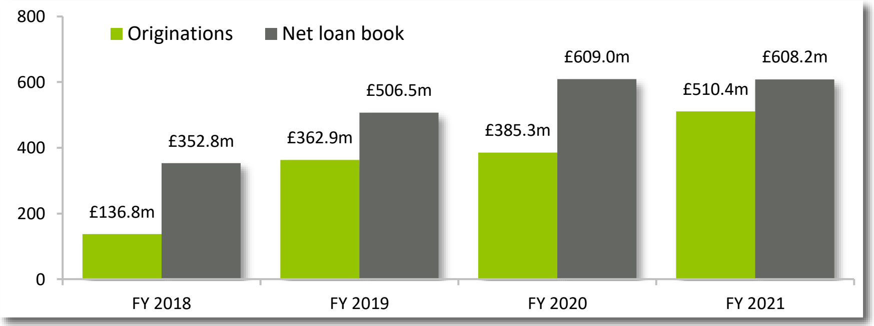
Commercial Lending new business (£m)

Commercial Lending – development finance

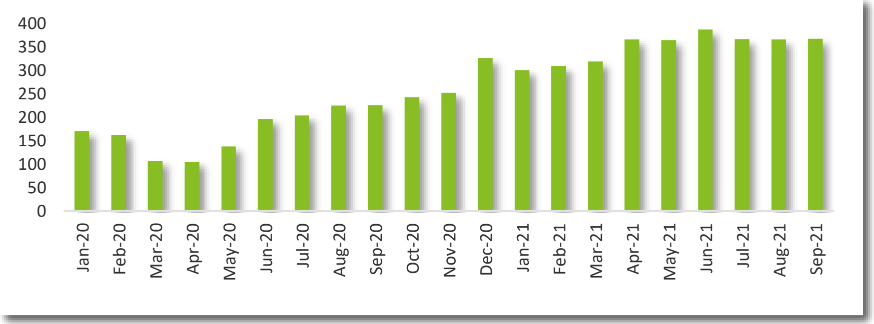
Strong drawdowns and pipeline

- Experienced team with expanded and enhanced geographical relationships
- Product offering being broadened to provide further lending options to experienced SME developers
- 2020 year end balance flattered by lower project completion during lockdown, more normal profile now resumed
- 2021 originations average 60.4% LGDV (2020: 58.3%)
- Portfolio LGDV % stands at 61.7%

Originations and loan book growth (£m)



Development finance pipeline (£m)



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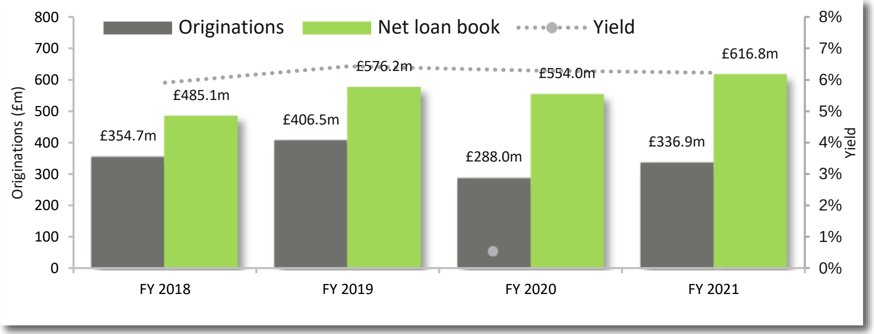
Commercial Lending – SME lending

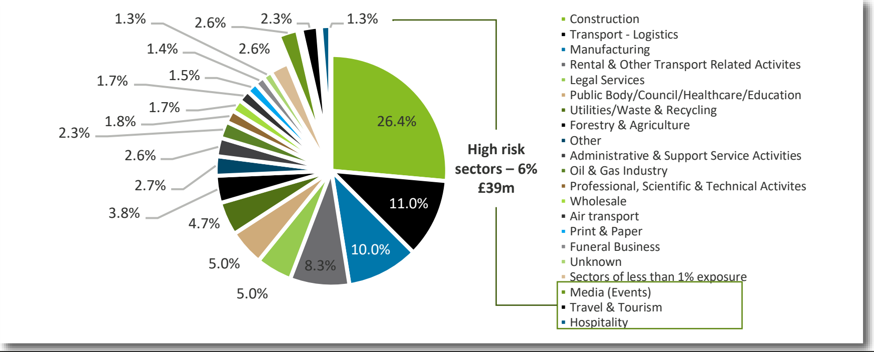
Steady progress in a more subdued market

- Government support measures (CBILS / BBLS / RLS) provided competition to traditional funding
- Non-Government new lending market 19% below pre-pandemic levels – Paragon outperforming sector
- Arrears fallen materially, payment holidays largely unwound
- Opportunity taken to accelerate development of new broker portal – to optimise flows when market fully recovers

Originations and loan book growth (£m)



Exposure by sector



Funding

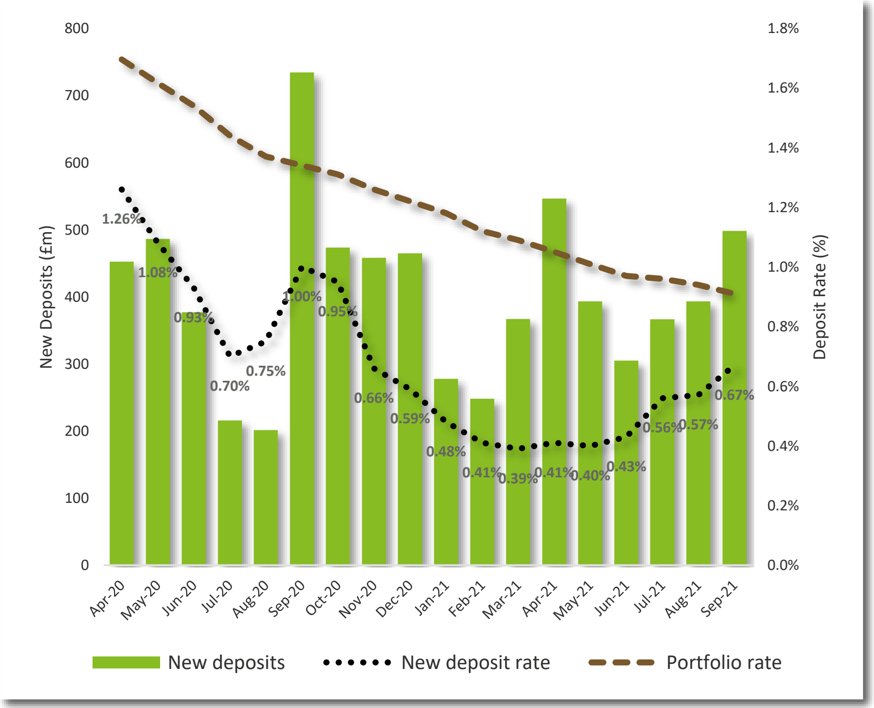
Increasing diversification enhancing pricing and growth potential

- Continued strong deposit growth, +18.4% year-on-year to £9.3 billion
- Favourable back book / front book dynamics
  - Cost of deposits 91bp at Sep-21 (Sep-20: 134bp)
- Building capability and capacity
  - Full suite including award winning ISAs
  - SME product launched
  - Growing customer behaviour data
  - Cloud-based platform to build third party relationships – supporting digital enablement
- Technology to level the playing field over time:
  - Open banking increasingly embedded
  - Estimates of savings market balances receiving sub 25bp grown to over £860 billion

Wholesale funding

- Repositioning strategy complete
- Refinanced over £2.1 billion of securitisations, delivering capital, LIBOR transition and NIM benefits
- Green Tier-2 bond issued

New deposits (£m) / deposit rate (%)



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Conclusions

Strong trading recovery

- Strong lending recovery with pipelines at near record levels
- Retention focus enhances loan book growth outlook
- Positive NIM trajectory set to continue for the foreseeable future
- Robust underlying asset quality, conservative stance on PMAs reassessed during FY22
- Well positioned to manage uncertainties

Strategic developments and opportunities

- Liability-side diversification delivering strong liquidity and broadening addressable market at lower funding costs. Proven track record in wholesale funding
- Cloud first, digital platform investment further improving customer experience, efficiency and decision making
- Organic growth potential alongside operating leverage
- Strong capital ratio supports growth – ability to optimise capital management

FY:22 guidance

- Mortgage Lending £1.7 billion +
- Commercial Lending £1.1 billion +
- NIM growth over 5bp
- Op costs low £150 million area

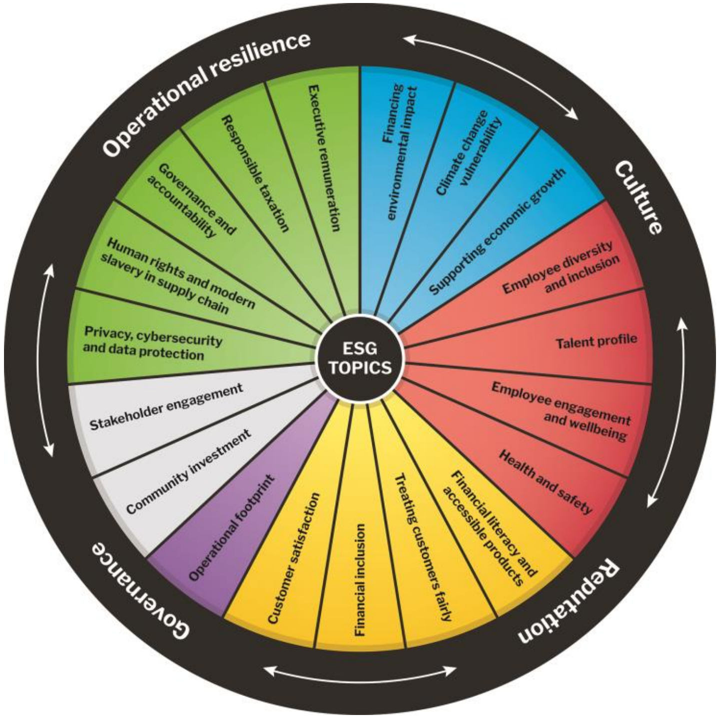
- 15%+ RoTE target

Technology enabled specialist bank – 15%+ RoTE target

Appendix

A long-term sustainable business

Our ESG landscape



Helping customers

- Insight team augments customer understanding
- Increased awareness vulnerable customers
- 650 million+ items of customer data analysed each month

Building a strong team

- Further progress on Equality, Diversity and Inclusion
- Gold Investors in People accreditation
- Comprehensive employee wellbeing programme and in-house support team

Minimising our footprint

- Increased focus on reducing environmental impacts of our business activities
- 100% renewable energy at owned sites
- FTSE4Good accreditation

FTSE4Good

Contributing to our communities

- Employee volunteer scheme
- Charitable contributions and money raised in 2021: £73,000+

Lending sustainably

- Understanding impact of our lending on the climate
- Green Bond issued in 2021
- Launched range of sustainable mortgage products and lending on electric vehicles

Doing business responsibly

- Structured online learning for all employees throughout the year
- Comprehensive Anti-bribery and Corruption, Human Rights and Modern Slavery policies
- Supplier Code of Conduct

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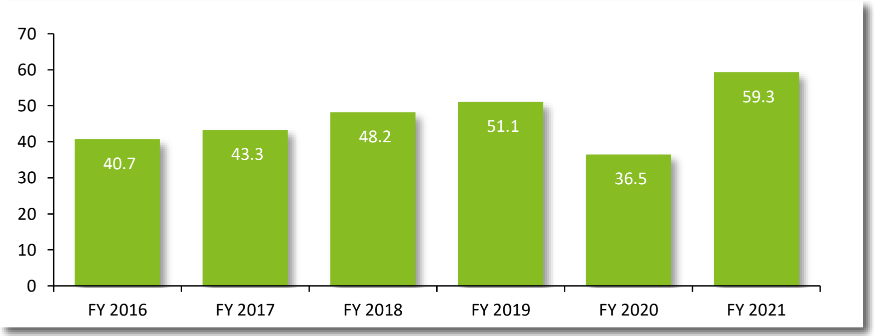
Underlying return on tangible equity

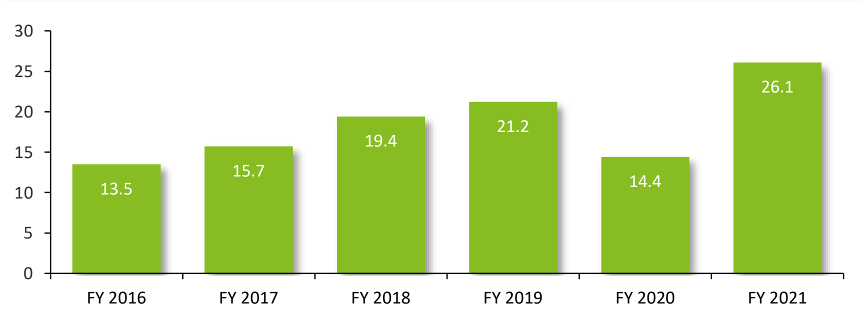
Strong recovery after Covid interruption

- Steady earnings growth trend resumed
- 14.7% RoTE

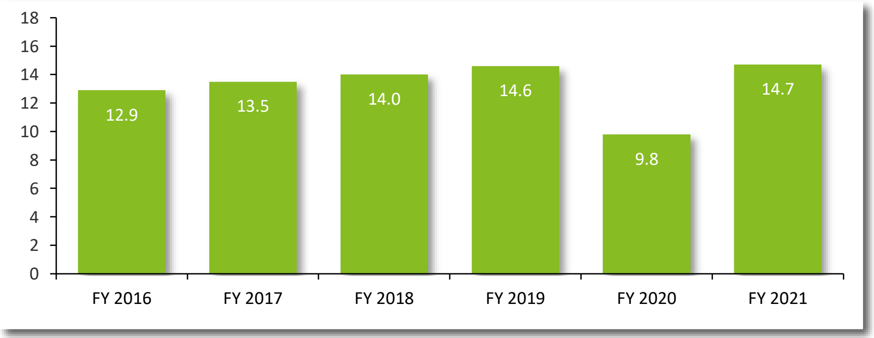
Underlying earnings per share (pence)



Dividend per share (pence)



Underlying return on tangible equity (%)

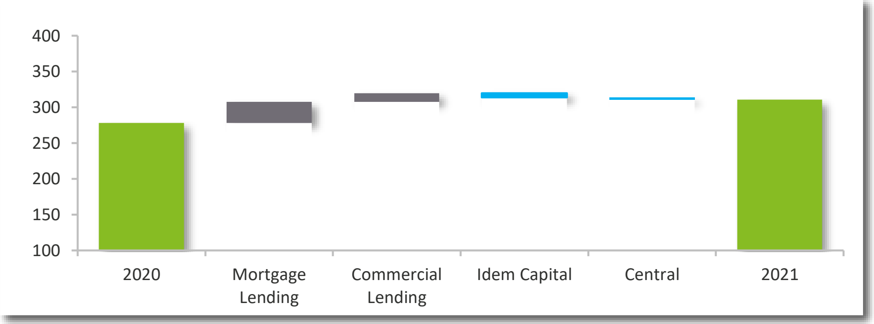


Net interest income

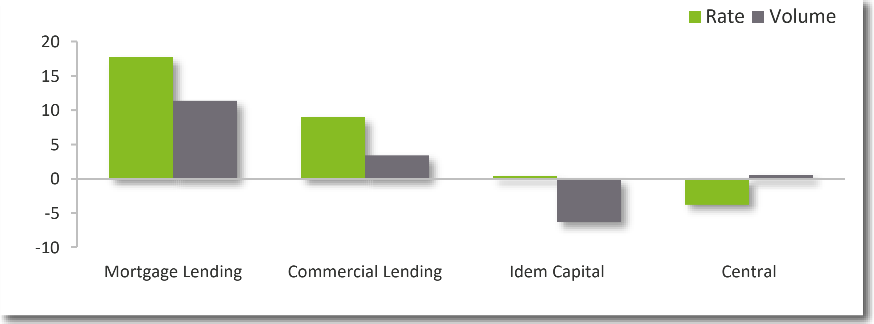
Progress in key divisions

- Mortgages and Commercial Lending seeing higher volumes and wider margins
- Idem drag effect reducing as portfolio amortises

Net interest income (£m)



Rate and volume influences (£m)



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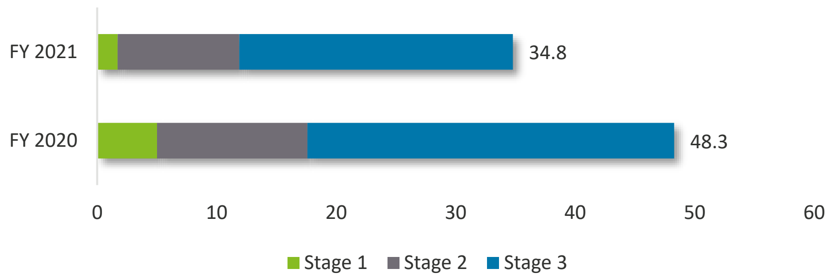
Provisions by stage and segment

IFRS 9 impairments

	Mortgage Lending	Commercial Lending	Idem Capital	Total
Stage 1	10,303.7	1,504.2	92.5	11,900.4
Stage 2	1,206.4	66.4	6.3	1,279.1
Stage 3	120.0	19.0	25.3	164.3
POCI	13.4	6.9	104.0	124.3
Gross loan book	**11,643.5**	**1,596.5**	**228.1**	**13,468.1**
Stage 1	1.7	12.9	0.4	15.0
Stage 2	10.2	1.0	0.1	11.3
Stage 3	22.9	13.6	2.4	38.9
POCI	0.0	0.2	0.0	0.2
Impairment provisions	**34.8**	**27.7**	**2.9**	**65.4**
Stage 1	0.02%	0.86%	0.43%	0.13%
Stage 2	0.85%	1.51%	1.59%	0.88%
Stage 3	19.08%	71.58%	9.49%	23.68%
POCI	0.00%	2.90%	0.00%	0.16%
Coverage ratio 2021	**0.30%**	**1.74%**	**1.27%**	**0.49%**
Coverage ratio 2020	**0.44%**	**1.85%**	**1.62%**	**0.64%**

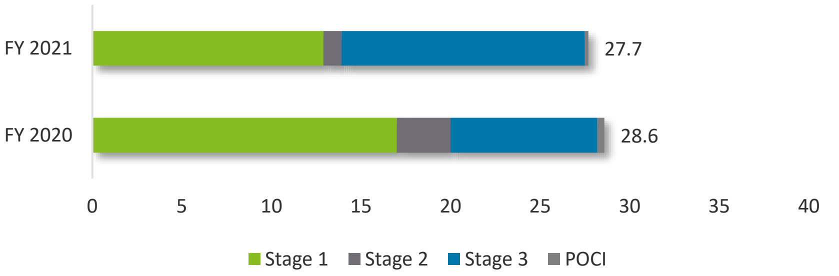
Impairments

IFRS 9 provisions (£m) – Mortgages



- Portfolio and economic performance underpins lower impairment levels in 2021

IFRS 9 provisions (£m) – Commercial Lending



Portfolio impairment movements

Impairments £million	Brought forward	P&L charge	W-off / Other*	Carried forward
2019	54.2	8.0	-20.3	41.9
2020	41.9	48.3	-8.4	81.8
2021	81.8	-4.7	-11.7	65.4

* Other includes the derecognition of certain assets in 2019

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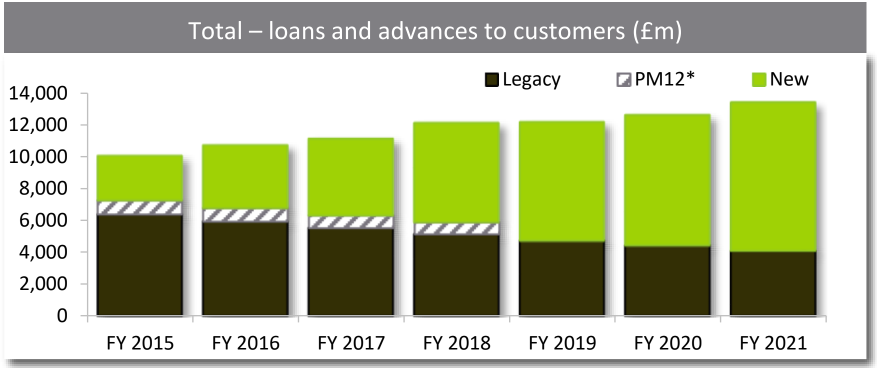
Diversification

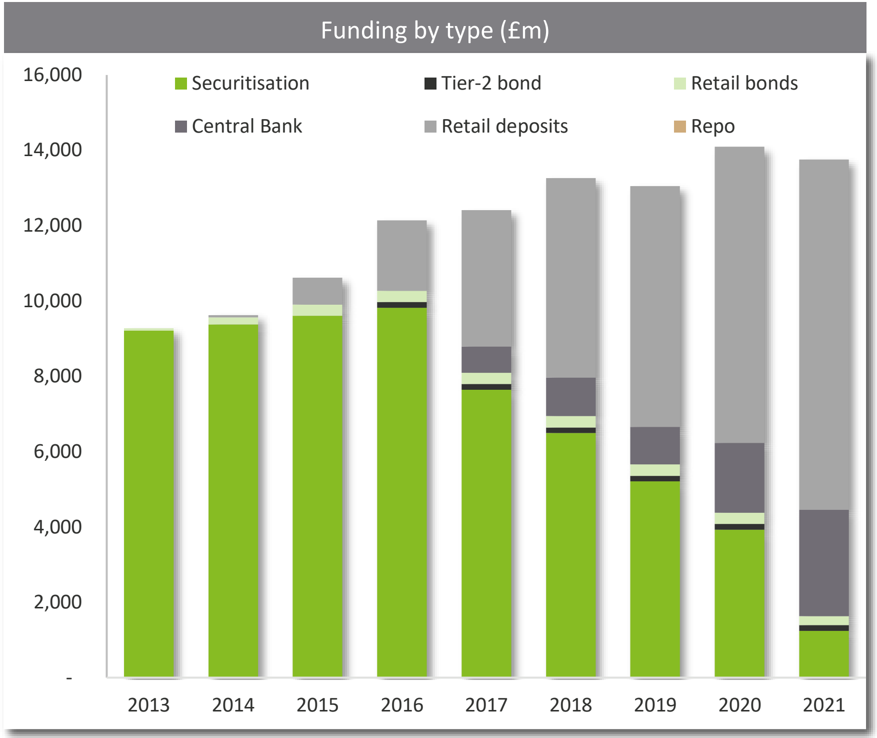
Diversified loan growth

Originations £million	**2021**	**2020**	**Change**
Specialist BTL	1,562.2	1,119.0	+39.6%
Other mortgages	67.8	140.7	(51.8%)
Commercial Lending	971.5	790.8	+22.9%
Idem Capital	0.0	0	0.0%
Total	**2,601.5**	**2,050.5**	**+26.9%**



* Assets now off-balance sheet under management

Diversified funding



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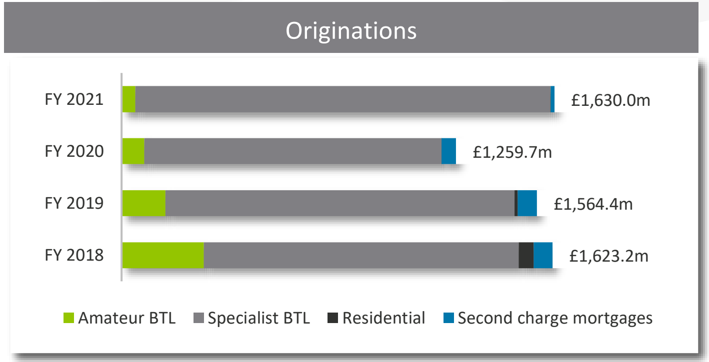
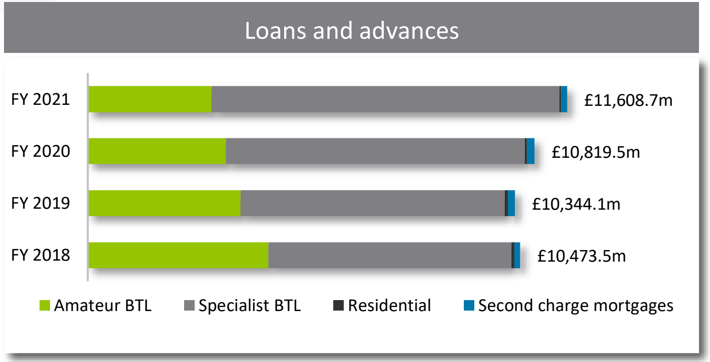
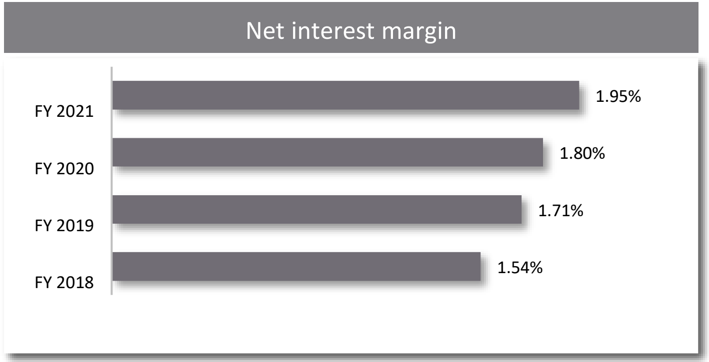
Mortgage Lending

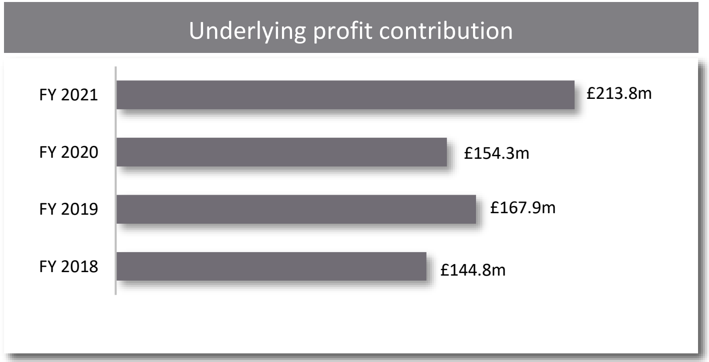
Increasingly BTL focused

- BTL originations have a specialist focus
- Second mortgage origination stopped from half year
- Divisional NIM enhancement









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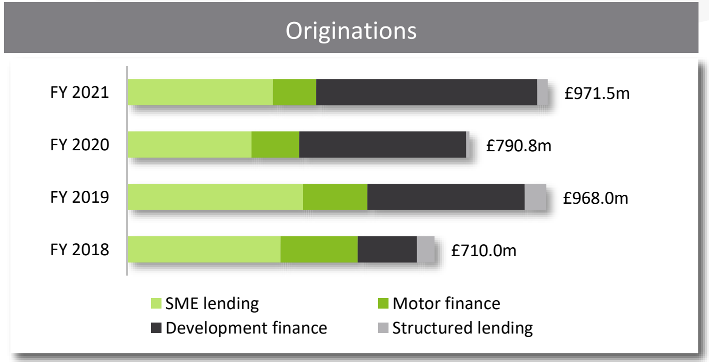
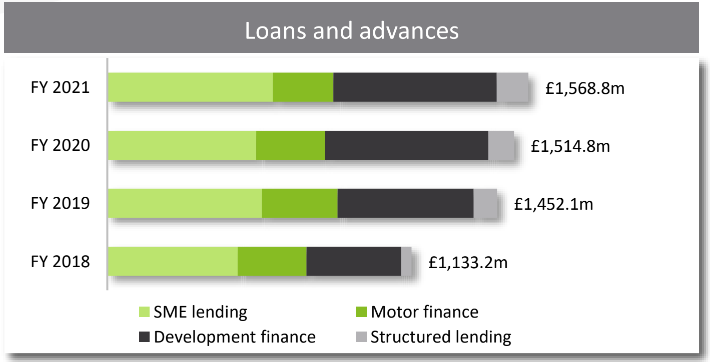
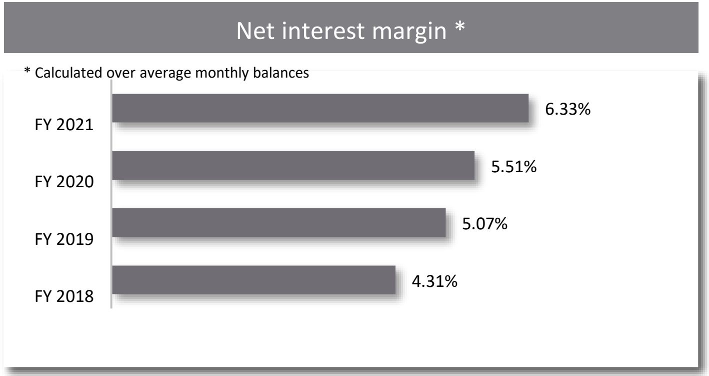
Commercial Lending

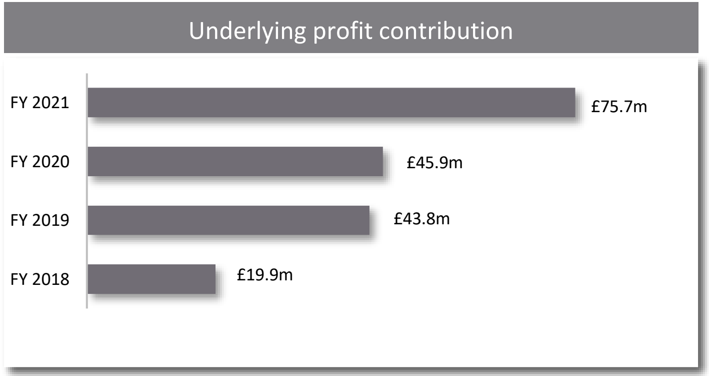
Record volumes

- Delivering growth in volumes and associated margins







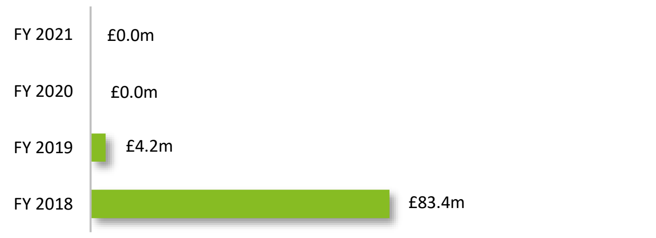


Idem Capital

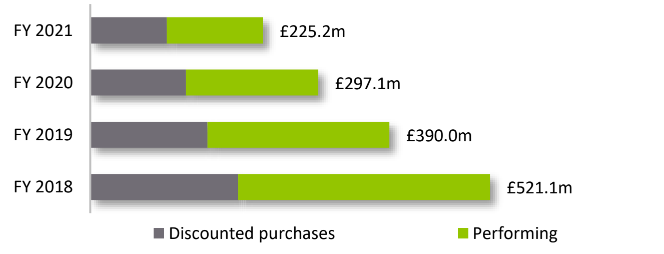
Steady portfolio amortisation

- Cash generation remains stable

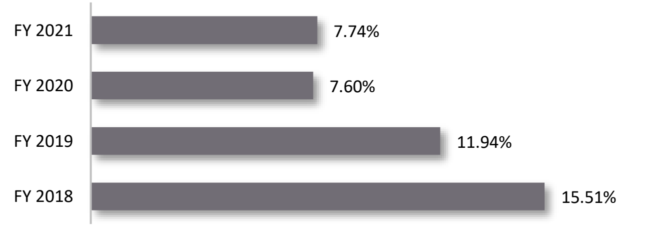
Investments



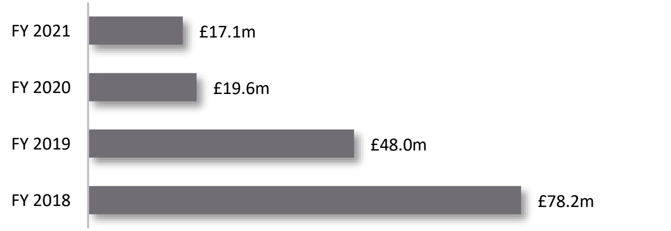
Loans and advances



Net interest margin



Underlying profit contribution

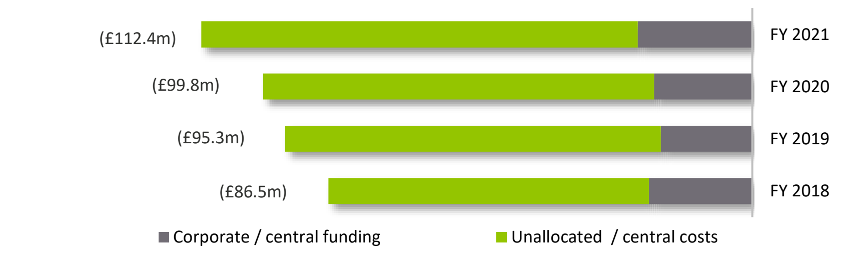


Central

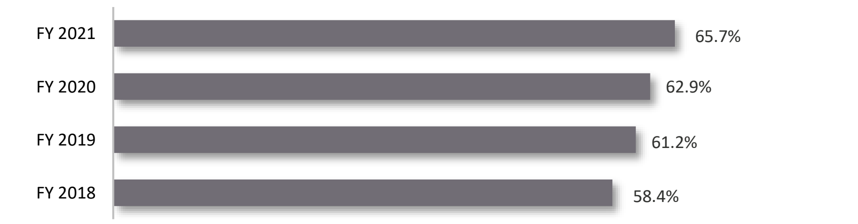
Cost growth focused on central areas

- Projects, IT developments, increasing control and risk expenditure

Underlying profit / (loss) contribution



Underlying operating leverage*



* Central operating costs as a proportion of total operating costs

Balance sheet

£million	2021	2020	Change (%)
Mortgages	11,608.7	10,819.5	+7.3%
Commercial Lending	1,568.8	1,514.8	+3.6%
Idem Capital	225.2	297.1	(24.2%)
Loans and advances to customers	**13,402.7**	**12,631.4**	**+6.1%**
Cash	1,360.1	1,925.0	(29.3%)
Other assets	374.2	949.1	(60.6%)
Total assets	**15,137.0**	**15,505.5**	**(2.4%)**
Capital and reserves	1,241.9	1,156.0	+7.4%
Retail deposits	9,300.4	7,856.6	+18.4%
Tier-2 bond	149.0	149.8	(0.5%)
Retail bonds	237.1	296.8	(20.1%)
Securitisation funding	1,246.0	3,928.3	(68.3%)
Central bank facilities	2,819.0	1,854.4	+52.0%
Other liabilities	143.6	262.7	(45.3%)
Total liabilities and equity	**15,137.0**	**15,505.5**	**(2.4%)**

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