Paragon Banking Group PLC

Record profits and strong new business momentum

Financial results

Six months ended 31 March 2021

paragon

Active period for business development

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Financial performance

- Operating profit £82.9 million, up 44.9% on H1:20
- Underlying EPS +43.2%
- Stable asset yields and lower deposit costs supporting improving NIM trajectory
- Provisions sharply lower with coverage maintained
- Dividend at 7.2p in line with policy

Strong new business growth

- Recovery in core lending markets with growing momentum
- Period end pipelines strong with cautious risk appetite maintained
- Deposit balances +25% year-on-year with broader channel penetration

Robust balance sheet

- Green Tier-2 bond issued – almost 300 basis points below previous Tier-2 bond rate
- Securitisation refinancing delivering capital, LIBOR transition and NIM benefits
- CET1 16%, good IRB progress
- Capital strong – £40 million share buy-back announced

Key priorities

Protecting our people

- 90%+ working from home throughout
- Wellbeing support maintained
- Return-to-office in pilot – safety always the priority

Supporting our customers and partners

- Payment holidays reduced to negligible levels
- CBILS/BBLS extended primarily to existing customers
- Early signatory to new Government-backed Recovery Loan Scheme

Protecting our capital

- Prudent impairments and strong capital ratios

Enhancing our franchise

- Strong customer and intermediary engagement – enhanced reputation
- Market share growth
- Growing diversification across portfolio and within product lines
- Increasingly technology enabled – investment in digital platforms as we continue to improve customer experience, efficiency and data analytics

Financial results

Six months ended 31 March 2021

Richard J Woodman
Chief Financial Officer

Income statement

£ million	2021 H1	2020 H1	Change	
Net interest income	147.5	141.4	+4.3%	Supported by attractive deposit pricing
Other income	7.2	8.3	(13.3%)	Serviced portfolios running down
Total operating income	154.7	149.7	+3.3%	
Operating expenses	(65.8)	(62.5)	+5.3%	H1:20 reductions not repeated in H1:21
Pre-provision profit	**88.9**	**87.2**	**+1.9%**	
Impairments	(6.0)	(30.0)	(80.0%)	Coverage levels are unchanged
Underlying profit before tax	**82.9**	**57.2**	**+44.9%**	
Fair value net gains / (losses)	13.5	(0.1)		Strong recovery reflecting yield curve dynamics
Profit before taxation	**96.4**	**57.1**	**+68.8%**	

Segmental results

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Continued strong growth in core Mortgage and Commercial Lending divisions

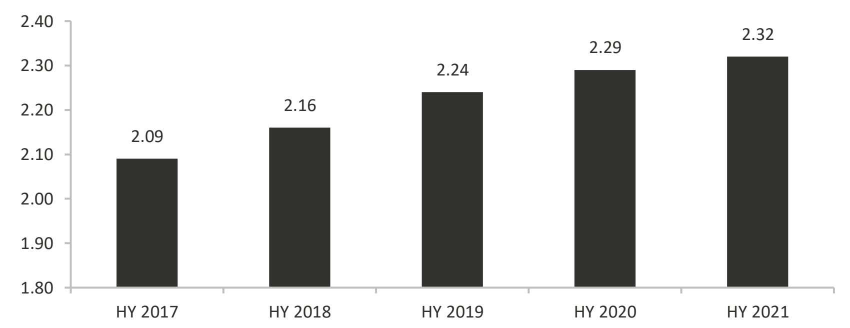
Underlying £ million	Mortgage Lending	Commercial Lending	Idem Capital	Central	Total
Total operating income (H1:21)	106.0	50.6	11.0	(12.9)	154.7
Change (v H1:20)	6.9	7.2	(2.5)	(6.6)	5.0
Operating expenses	(8.7)	(11.7)	(2.5)	(42.9)	(65.8)
Change	(0.3)	1.1	0.7	(4.8)	(3.3)
Pre-provision profit	**97.3**	**38.9**	**8.5**	**(55.8)**	**88.9**
Change	6.6	8.3	(1.8)	(11.4)	1.7
Provisions for losses	(4.9)	(1.3)	0.2	-	(6.0)
Change	8.9	14.2	0.9	-	24.0
Contribution	**92.4**	**37.6**	**8.7**	**(55.8)**	82.9
Change	15.5	22.5	(0.9)	(11.4)	25.7

Net interest margin

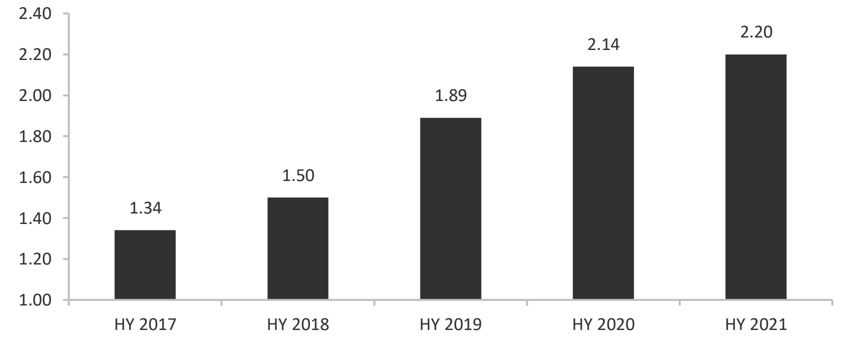
Deposit-led pricing improvements accelerated NIM recovery from H2:20

- New business yields have remained stable in core divisions
- Continued amortisation of low-yielding legacy portfolio
- Deposit volume up strongly, attractively priced
- Relative Idem Capital headwind reduced as portfolio amortises
- TFSME drawings increased and TFS repaid
- Gains from wholesale funding refinancing offset Tier-2 tender costs
- Following slide demonstrates key themes

NIM progression – Group (%)



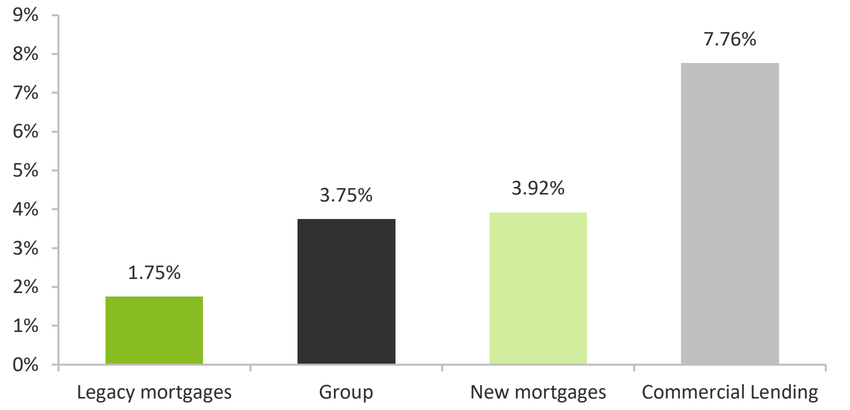
NIM progression – Group excluding Idem Capital (%)



Structural improvement in NIM

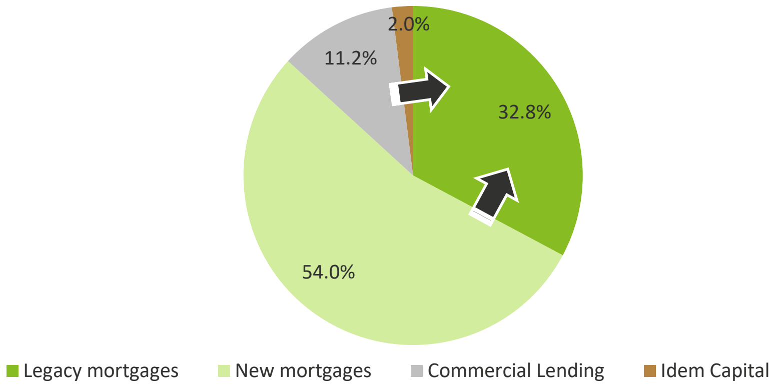
Direction of travel renewed after base rate impacts in 2020

Evidenced via higher yields in new portfolio



Swapping lower margin legacy book for higher margin BTL / SME

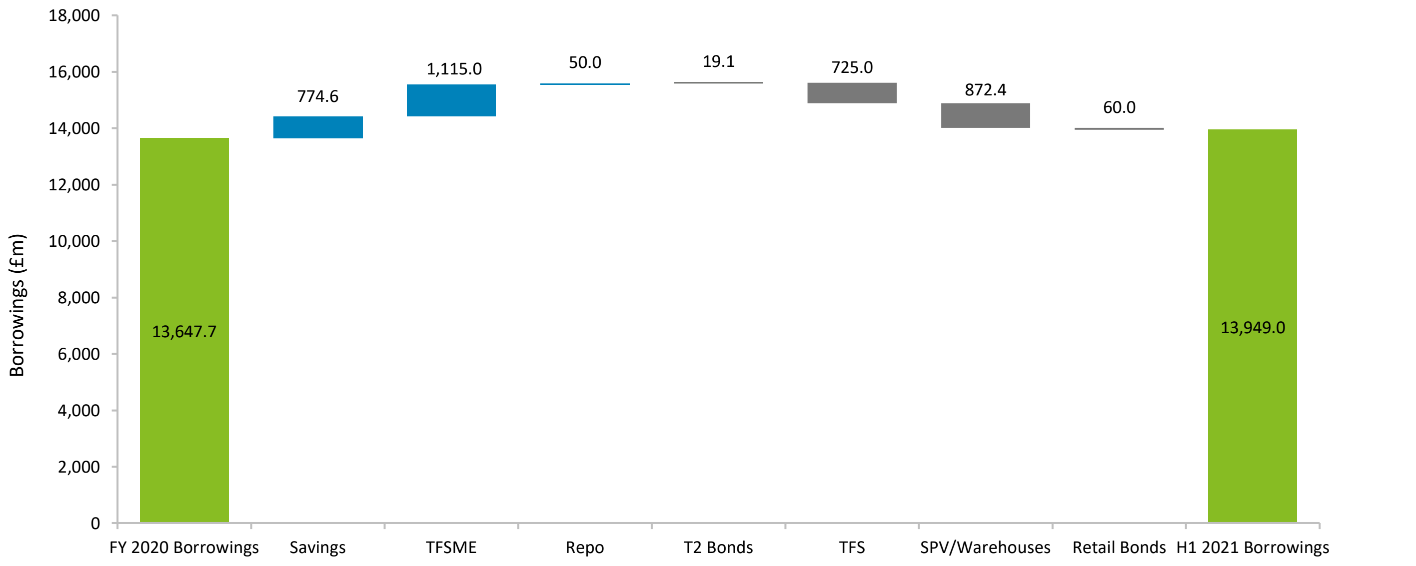
Drag from Idem Capital materially less significant from 2021



Funding bridge

Repositioning funding mix to support SMEs, de-risk LIBOR transition and retire legacy instruments

FY 2020 / H1 2021



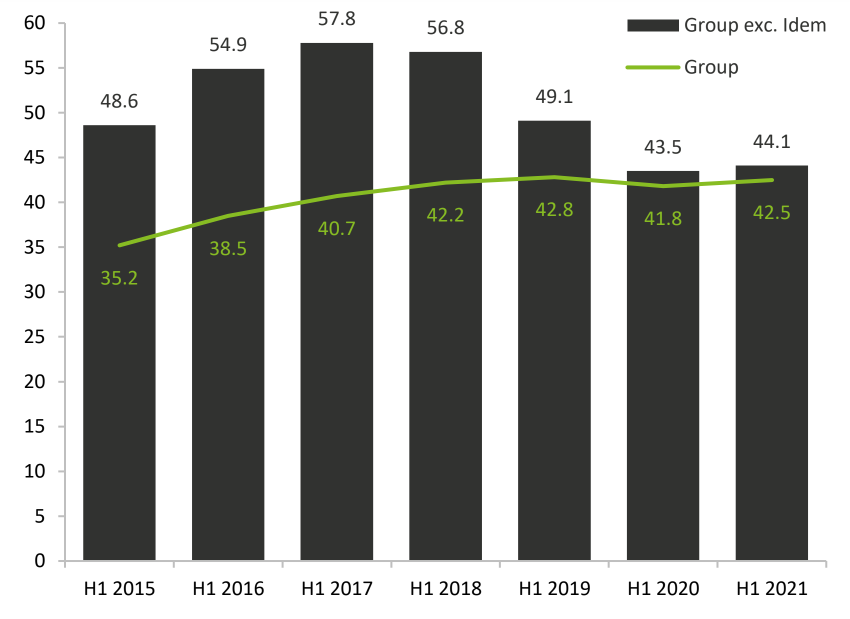
- TFS repayments replaced with TFSME drawings
- Savings book growth continues with further expansion of distribution channels
- Several legacy securitisations collapsed to aid LIBOR transition project and reduce encumbrance

Operating expenses

Op-ex returning to underlying trend level

- 2020 benefitted from reduced investment and variable remuneration costs
- Investment plans remain on track, with key projects underway in Mortgage and Commercial Lending divisions; Mambu deposit platform management system went live in the period
- Share price recovery moves share-based cost accruals back to more normal levels following a write back in H1:20 – average of H1:20 and H1:21 in line with prior periods
- Cost:income impacted from lack of new business volume in H2:20, volume trajectory now restored

Underlying cost:income ratio (%)



Economic outlook

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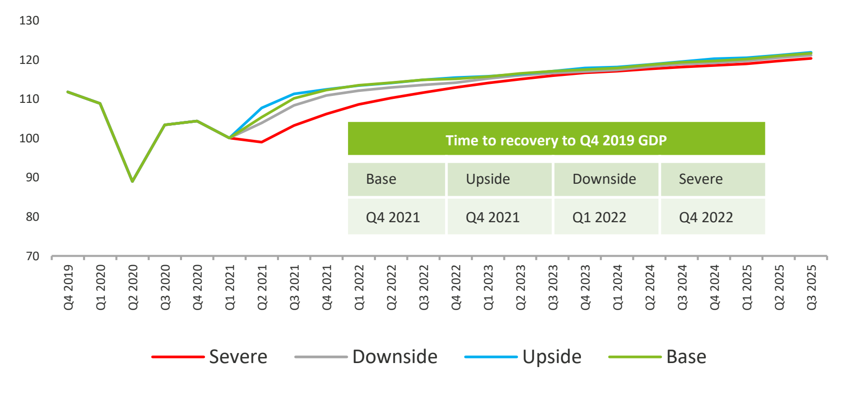
Prudent multiple economic scenarios

- Four scenarios updated from September 2020, severe = BoE 2021 stress
- Unemployment peak at 7.8% 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
- Payment holiday PD floors maintained, together with staging approach for extensions
- Additional PMA added, equivalent to 10% / 40% weighting for downside / severe scenarios – further details in impairment review

Scenarios

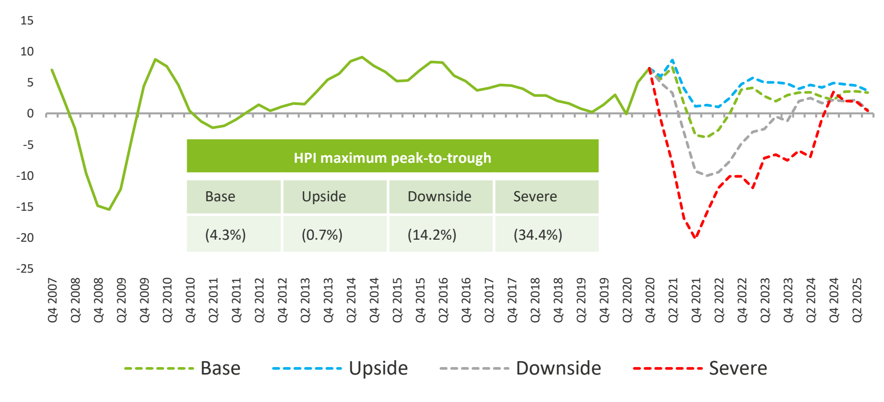
	Base	Upside	Downside	Severe
Weighting	40%	10%	35%	15%
Impact of 100% weighting	£68.2m	£58.4m	£87.9m	£123.7m
Variance to reported	(£14.2m)	(£24.0m)	+£5.5m	+£41.3m

Scenario GDP profile (Q1:21 index = 100)



Time to recovery to Q4 2019 GDP			
Base	Upside	Downside	Severe
Q4 2021	Q4 2021	Q1 2022	Q4 2022

House price change (%)



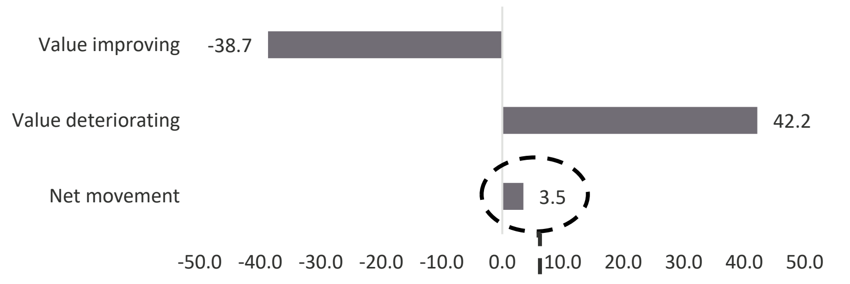
HPI maximum peak-to-trough			
Base	Upside	Downside	Severe
(4.3%)	(0.7%)	(14.2%)	(34.4%)

Payment holiday overview

Payment holidays almost fully exhausted

- £2.7 billion of balances in aggregate, now below £0.03 billion
- Focus on post-holiday performance and any associated stress
- Performance in post-furlough / SME-support environment monitored closely

Arrears movements on payment holiday customers since Feb-20 (£m)



No significant further stress detected on payment holiday population

Payment holiday population (£m)

Impairments

Cautious approach at interim, results in stable coverage

- Underlying modelling reflects improving macro environment
- Core PMA approach maintained from year-end position
- Additional PMA equates to weighting adjustment to reflect uncertainties over post-Covid performance
- Weightings and PMAs to be assessed once tangible evidence of Covid-recovery is seen
- Disclosures show impacts of weighting approach
  - Interim v 2020 year end v IFRS 9 transition

	Transition weights core PMAs	2021 weights core PMAs	2021 weights full PMA
Central	40%	40%	40%
Upside	30%	10%	10%
Downside	25%	35%	35%
Severe	5%	15%	15%
Total provision	**£64.0m**	**£73.4m**	**£82.4m**
Coverage ratio	0.50%	0.57%	0.64%

Impairment overlay

	2019 Year End (£m)	2020 Year End (£m)	2021 Interim (£m)
Calculated provision	£41.9	£62.0	£54.9
PMA (for payment holidays and lagged effects) *	-	£19.8	£27.5
Total	**£41.9**	**£81.8**	**£82.4**
Coverage ratio	0.34%	0.64%	0.64%

* PMA – Post Model Adjustments

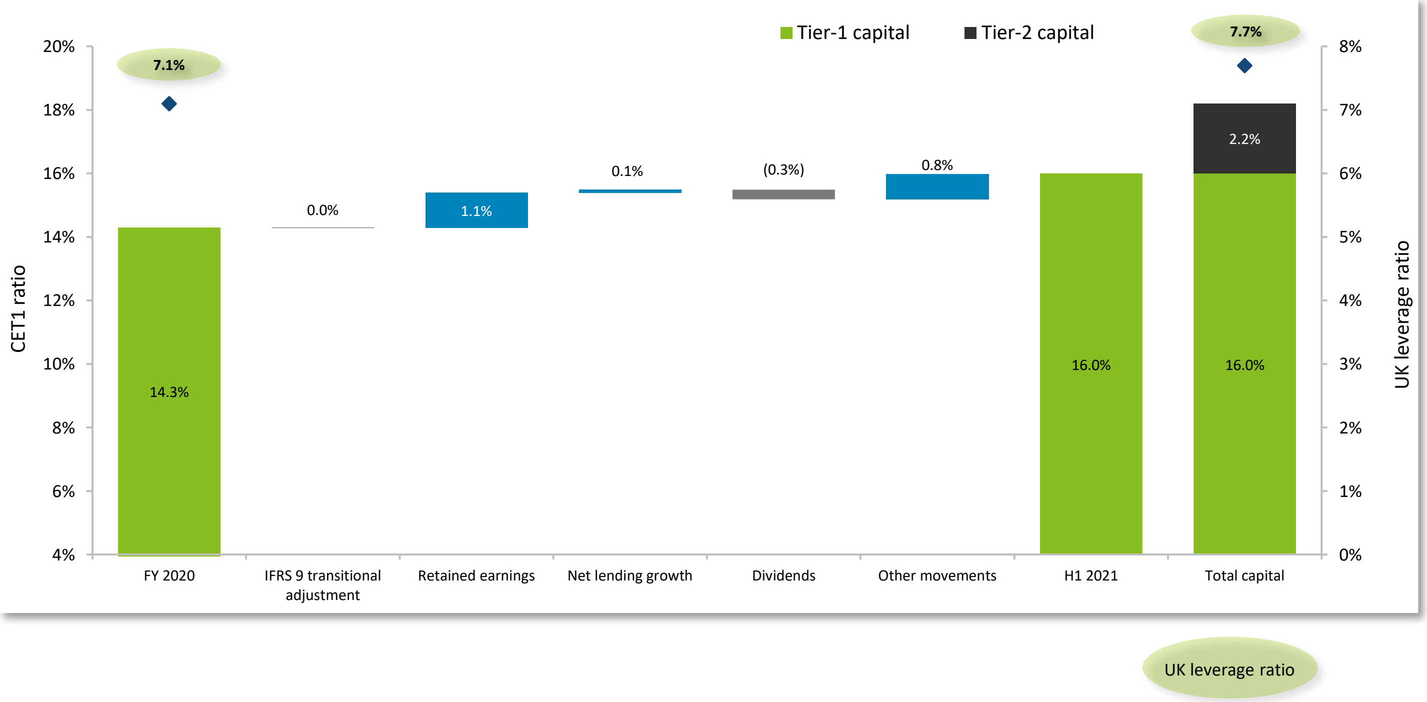
Indexed credit behavioural scores by portfolio

	Mar-20	Mar-21
Buy-to-let		
New	100.0	100.7
Legacy	100.0	100.8
New second charge mortgages	100.0	101.0
Legacy second charge and Idem Capital assets	100.0	104.2
Motor finance	100.0	102.3

Capital movements during the period

Combination of strong earnings and improved balance sheet structuring underpin ratio enhancement

FY 2020 / H1 2021



Group capital

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Capital ratios enhanced and regulatory surplus increased following 2020 C-SREP

Group consolidated capital	
Core Equity Tier-1 capital *	£1,057.3m
Tier-2 capital	£146.5m
Total capital resources	**£1,203.8m**
Credit risk	£6,052.2m
Operational risk	£544.3m
Market risk	-
Other	£19.5m
Total risk exposure	**£6,616.0m**
CET1 ratio *	16.0%
Total capital ratio (TCR) *	18.2%

Group consolidated leverage ratio	
Tier-1 equity *	£1,057.3m
Leverage exposure **	£13,754.1m
UK leverage ratio *	7.7%

* Including IFRS 9 transitional relief of £41.4m, 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 £0.4 billion (reflects CCyB at 0%)
- Capital requirements reduced following C-SREP
  - Pillar 2A reduced from 2.96% to 0.86% year-on-year
- Fully loaded CET1 and TCR are 15.5% and 17.7% respectively

IRB

- Phase 2 underway for BTL
- Development finance slotting approach expected to be submitted to PRA in early 2022
- IRB remains a key element in our levelling-up strategy

Strategy overview

Nigel S Terrington
Chief Executive

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%

A long-term sustainable business

Our approach to sustainability

Sustainability is central to our long-term success and it influences every aspect of our business
At Paragon, sustainability means:

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

We focus on six key priorities:

Helping customers

- Customer support through Covid
- Insight team augments customer understanding
- Supporting vulnerable customers

Working better

- Equality, Diversity and Inclusion (EDI) Network
- Gold Investors in People accreditation
- Comprehensive employee wellbeing programme

Supporting communities

- Employee volunteer scheme
- Charity of the year chosen by employees
- Donations to local charities

Caring for our environment

- Green Charter outlines environmental commitments
- Aligned to principles of ISO14001:2015
- FTSE4Good accreditation

Lending sustainably

- Green Bond issued in 2021
- Green further advance range in BTL
- EPC A-C buy-to-let mortgage product
- Climate change designated as a principal risk for the Group

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

Buy-to-let

Strong recovery in lending, aided by stamp duty holiday, at even more conservative LTVs

New lending

- £714.9 million advances (H1:20: £752.4 million)
- Pipeline £926.7 million, up from £789.8 million at end of H1:20, £868.1 million at FY:20 with stronger yield
- Specialist lending completions 96% (2020: 92%)

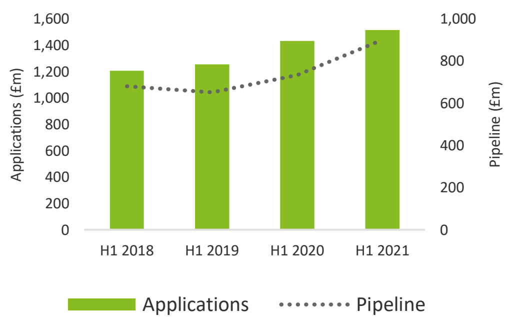
Redemptions

- Better customer retention
  - Overall rate dropped from 7.8% to 6.8%
  - Modest tick-up ahead of scheduled end to SDLT holiday

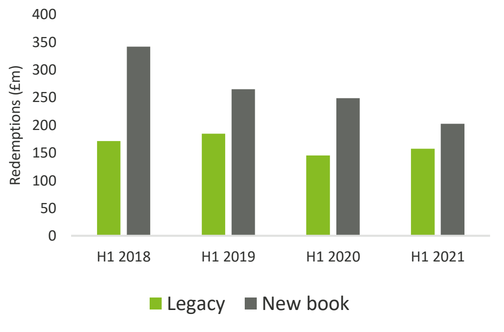
Net loan book

- £10.9 billion, up 4.7% on H1:20
- Buy-to-let NIM 1.85% (H1:20: 1.81%)
- Legacy book now £4.2 billion (H1:20: £4.5 billion)

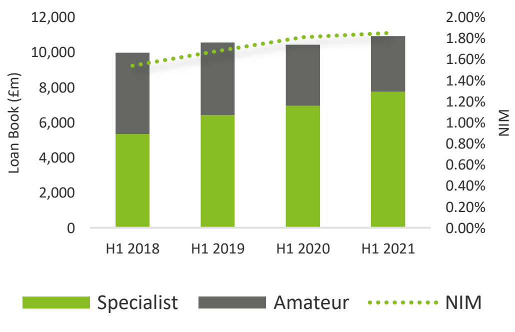
Specialist new business (£m)



Redemptions (£m)



Net loan book and margin (£m)



Proven resilience of business model through the pandemic

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

Low risk

- Asset backing transformed since 2008
- Average LTV 64.4% (Sept-08: 80.7%)
- LTV greater than 90%, 1.7% (Sept-08: 30.9%)
- LTV greater than 80%, 2.9% (Sept-08: 63.4%)
- Improving margins boosting risk adjusted returns
- Payment holidays reduced to negligible levels

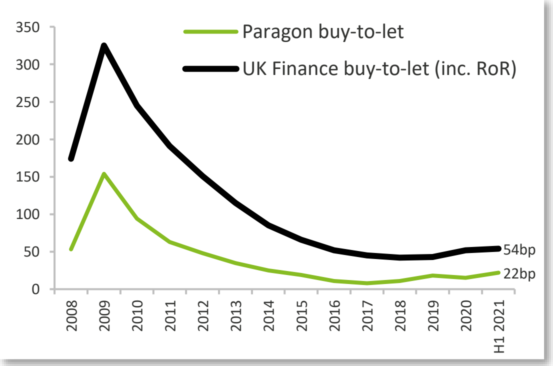
Multi-cycle experience

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

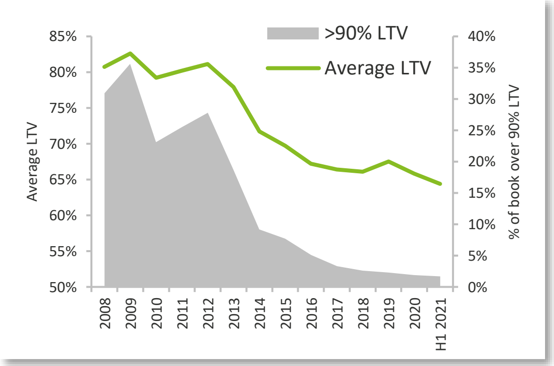
Technology and data analytics

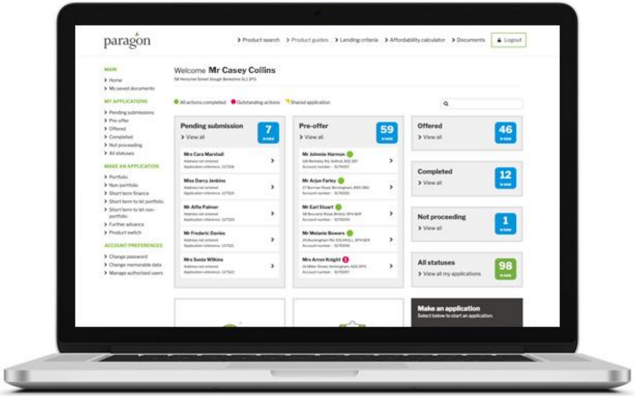
- 750 million data points per month
- Intermediary portal
- New business re-engineering on new platform
- 25 years of data inform:
  - Underwriting
  - Pricing
  - Stress testing
  - IRB process

Arrears rate – 3mths+ (bp)



Average LTV





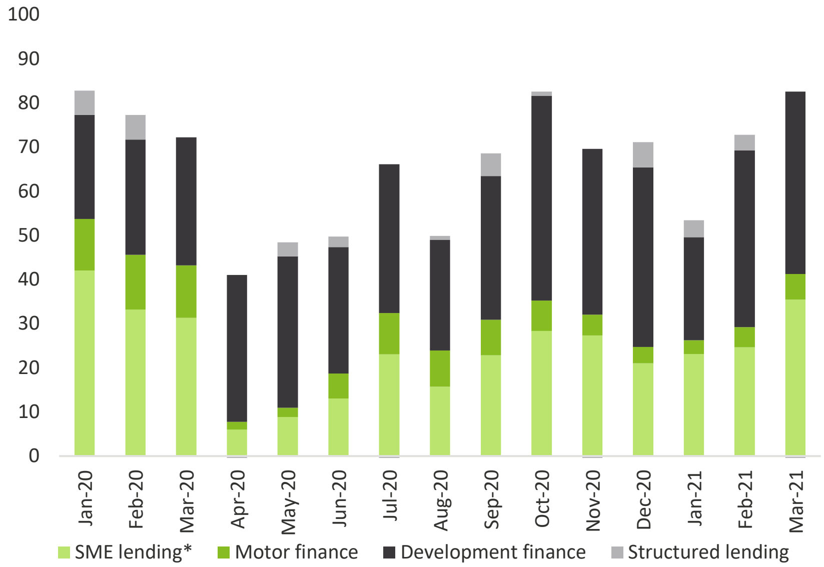
Source: UK Finance, Paragon Banking Group PLC

Commercial Lending provides increased diversification

Recovery from H2 lows, strongest in development finance

- Key component of diversification strategy
- Commercial Lending volumes more severely impacted by the pandemic, but recovering strongly
- H1:21 new business volumes £402 million v £310 million in H2:20 and £481 million in H1:20

Commercial Lending new business (£m)



* Includes operating leases

- Development finance less impacted by lockdowns; volumes recovered quickly and ended the first half strongly
- SME lending focused on supporting customers in the pandemic and has been building its digital proposition
- Motor finance and structured lending focused on asset management during the pandemic, staying close to customers and providing support when needed. Both now back to pre-pandemic strategy of portfolio growth, maintaining acceptable yields

Commercial Lending – development finance

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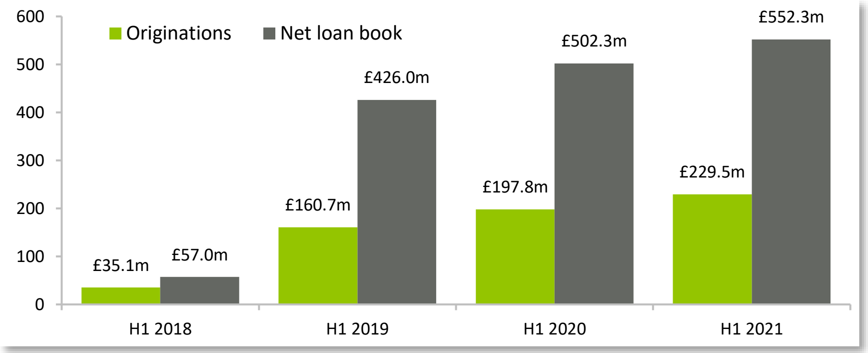
Steady progress on originations and portfolio growth

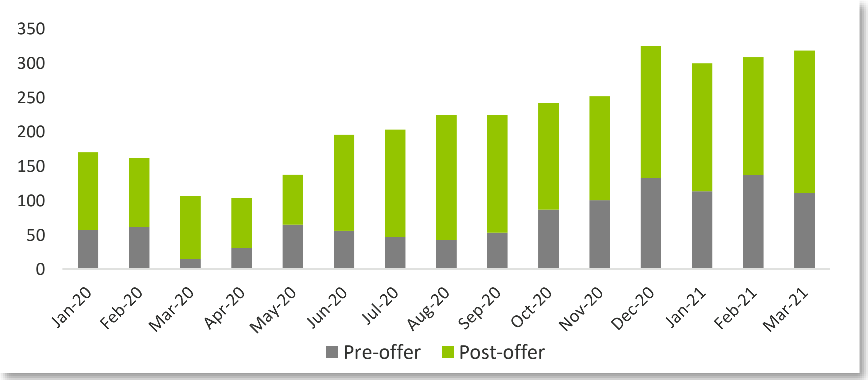
- Team expanded with reputation strengthened during the pandemic
- Period end pipeline strong
- Residential construction sector remains strong
- Structural shift in demand for housing post-pandemic supports outlook

- Average facility is £4.6 million at 62.4% of GDV
- Credit performance exemplary
- Preparations for IRB accreditation well advanced

Originations and loan book growth (£m)



Development finance pipeline (£m)

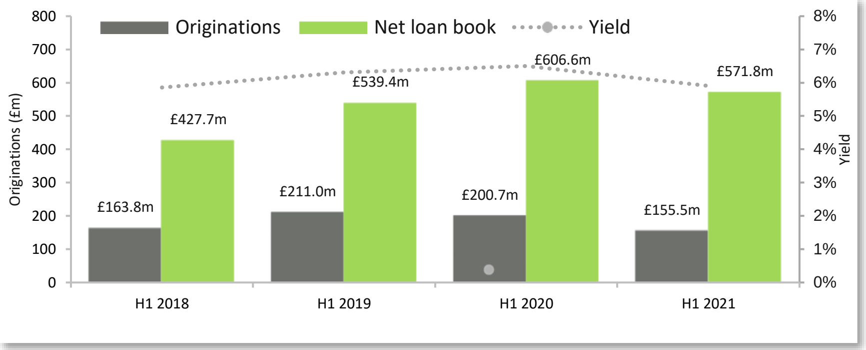


Commercial Lending – SME lending

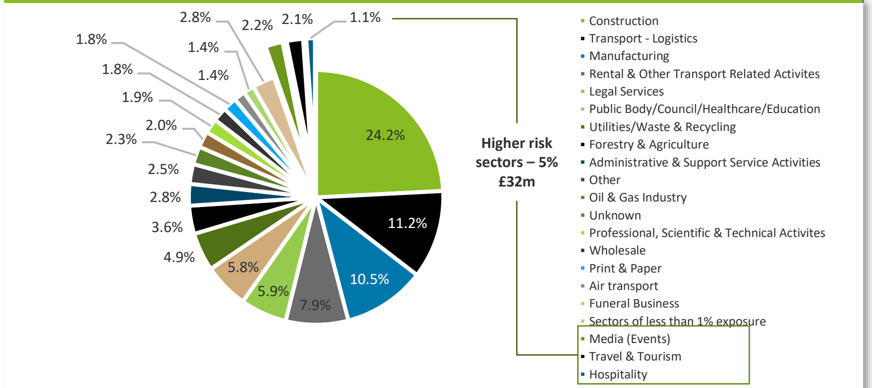
Slower recovery reflects general environment and underweight position on CBILS

- SME lending most impacted by the pandemic as customers "furloughed assets" and used CBILS/BBLS to supplement / replace existing lending
- Took supportive but cautious approach to CBILS/BBLS; focused on helping existing customers. Combined balances sub £60 million
- Segments most impacted by the pandemic are a small % of the book
- SME lending support of 46% of book at the peak, now 1%
- Accredited with Recovery Loan Scheme
- Digital platform under development
    - Intermediary portal with data-driven decisioning
    - Over 3,000 pieces of data used in underwriting process
- SME confidence and demand returning – H2 expected to see outperformance compared to 2020

Originations and loan book growth (£m)



Exposure by sector



Funding

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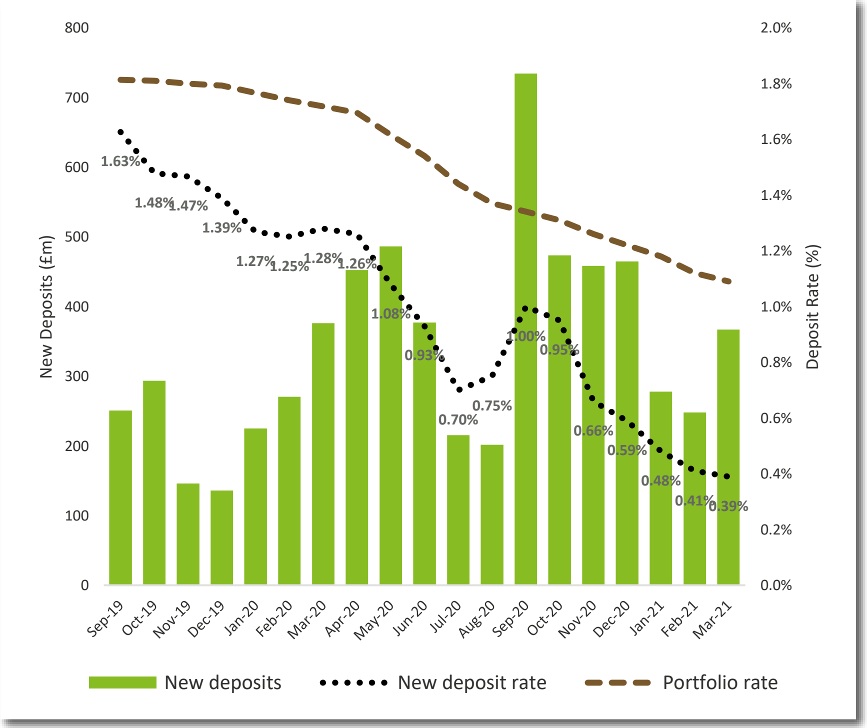
Retail savings – material development in scale at attractive price

- Strong half for deposit franchise – £8.6 billion at end of March +10% from Sept-20
- Positive front book / back book dynamics
  - Cost of deposit 1.08% at Mar-21 (Sept-20: 1.34%)
  - Further reductions expected
- Outperformance evidences strategy to build capability and capacity
  - Full suite of savings products with award winning ISAs
  - Third party relationships provide multi-channel distribution capability
  - Mambu platform live; provides cloud-based digital capability to supplement existing systems and provide options as the world becomes increasingly digital
- Technology to level the playing field with big banks over time
  - Open banking becoming more embedded within UK banking
  - Now an estimated £0.8 trillion of savings deposits paying ≤0.25%
  - Chance to flatten the deposit cost curve with the big banks

Wholesale funding

- Acceleration strategy
- Refinanced over £800 million of securitisations – delivering capital, LIBOR transition and NIM benefits
- Green Tier-2 bond issued – almost 300 basis points below previous Tier-2 bond rate

New deposits (£m) / deposit rate (%)



Strategic conclusions

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Strong trading recovery

- Strong lending recovery with pipelines at near record levels
- Asset quality performance driven by through-the-cycle experience
- Positive NIM trajectory set to continue for the foreseeable future
- Customer retention supporting enhanced loan book growth

Strategic developments and opportunities

- Increasingly strong specialist lending franchise
- Liability-side diversification delivering strong liquidity and broadening addressable market at lower funding costs
- Digital platform investment further improving customer experience, efficiency and decision making
- Strong capital ratio supports growth and ability to react to opportunities

FY guidance

- BTL volumes expected c£1.5 billion
- Commercial Lending volumes to exceed £900 million
- Full year NIM expected to be over 235 basis points
- Full year costs unchanged at around £138 million

15%+ RoTE target reconfirmed

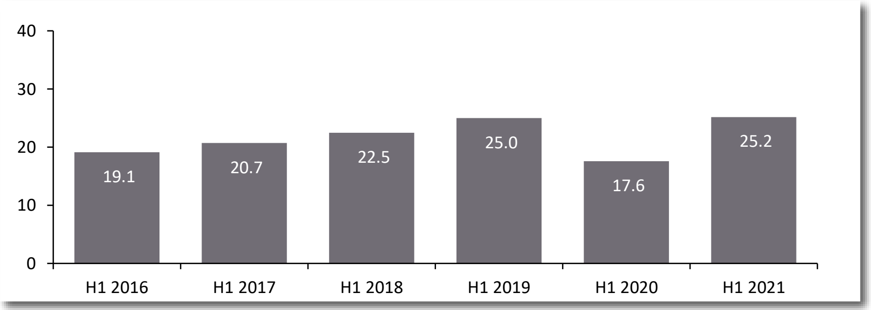
Appendix

Building a specialist bank

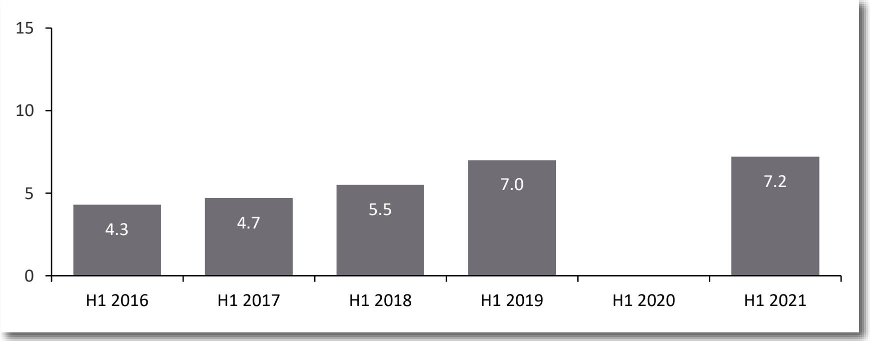
Strong recovery from Covid-impacted 2020

- Earnings growth delivered with no impairment writeback
  - H1:21 impairment £6.0 million v £4.9 million in H1:19
- Interim dividend reflects 50% of 2020 final
- Underlying RoTE reflects strong capital accretion since 2019

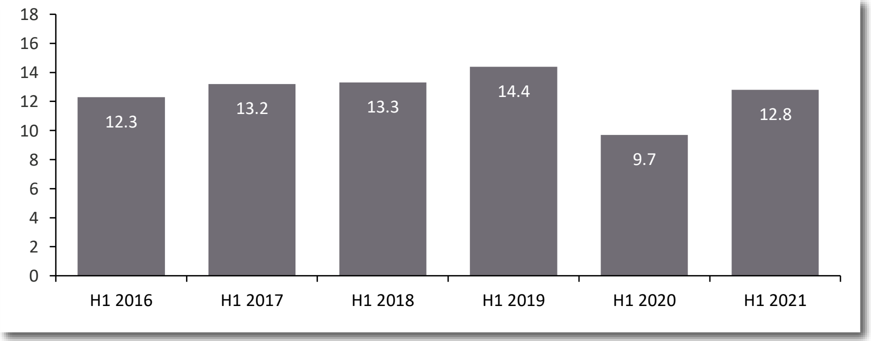
Underlying earnings per share (pence)



Dividend per share (pence)



Underlying return on tangible equity (%)

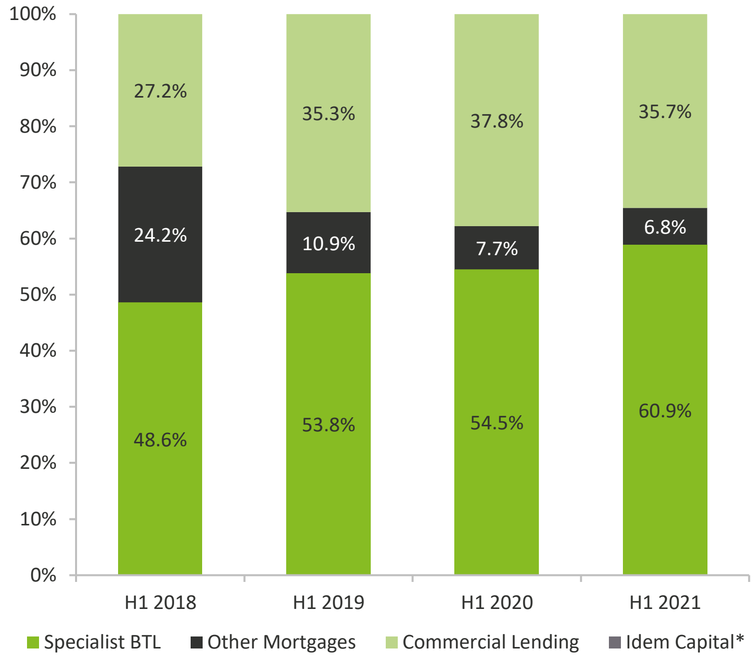


Building a specialist bank

Slower recovery in SME and motor finance volumes in H1:20 slowed longer term trend growth in Commercial Lending division

- Property-related lending experienced a faster recovery than consumer and SME
- Residential, second charge and amateur buy-to-let all de-emphasised, with the focus on specialist buy-to-let in Mortgage Lending

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



* Note that Idem Capital deals in 2018 and 2019 both took place in H2

Net interest income

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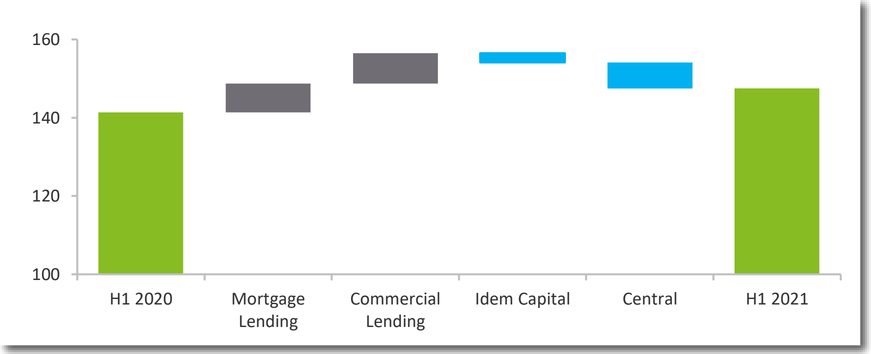
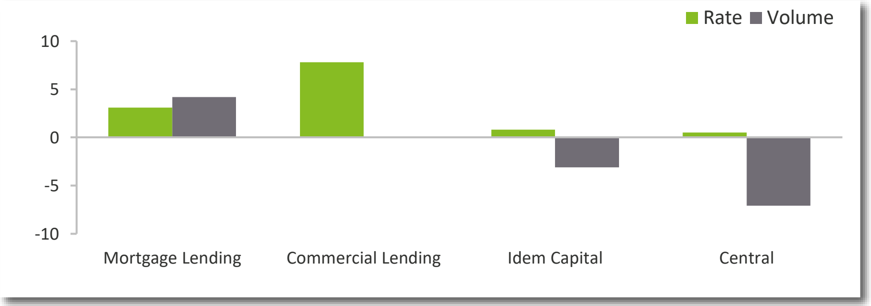
Continued NII enhancement in core businesses

- Mortgage Lending sees further growth and margin enhancement
- Commercial lending focused on margin enhancement, average balances unchanged from H1 2020
- Idem Capital cash flow strong, volume variance reflects portfolio run-off
- Central cost reflects excess liquidity and corporate funding

Net interest income (£m)



Rate and volume influences (£m)



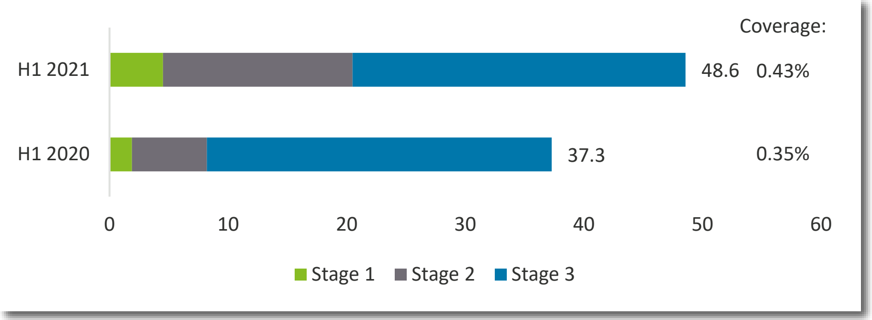
Provisions by stage and segment

IFRS 9 impairments

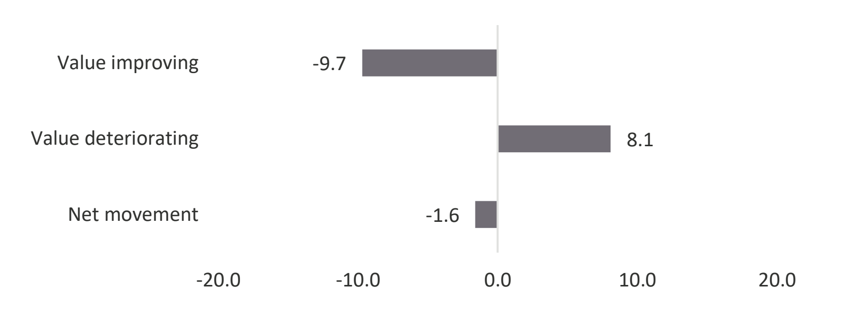
	Mortgage Lending	Commercial Lending	Idem Capital	Total
Stage 1	10,063.9	1,352.0	107.2	11,523.1
Stage 2	980.0	79.8	7.4	1,067.2
Stage 3	121.3	17.7	27.7	166.7
POCI	14.0	6.7	121.0	141.7
Gross loan book	**11,179.2**	**1,456.2**	**263.3**	**12,898.7**
Stage 1	4.5	17.3	0.2	22.0
Stage 2	16.0	2.7	0.3	19.0
Stage 3	28.1	8.7	4.2	41.0
POCI	0.0	0.4	0.0	0.4
Impairment provisions	**48.6**	**29.1**	**4.7**	**82.4**
Stage 1	0.04%	1.28%	0.19%	0.19%
Stage 2	1.63%	3.38%	4.05%	1.78%
Stage 3	23.17%	49.15%	15.16%	24.60%
POCI	0.00%	5.97%	0.00%	0.28%
Coverage ratio H1 2021	**0.43%**	**2.00%**	**1.79%**	**0.64%**
Coverage ratio H1 2020	**0.35%**	**1.59%**	**1.53%**	**0.53%**

Impairments – Mortgage Lending

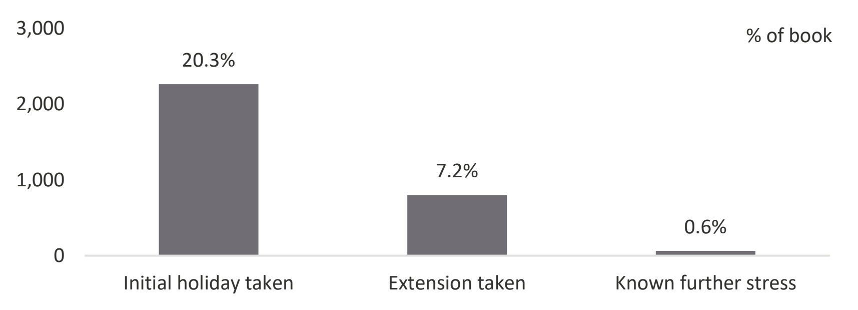
IFRS 9 provisions (£m)



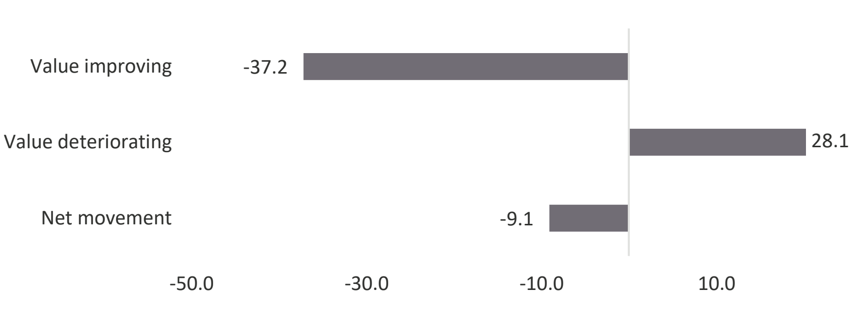
Arrears balance movements on non-payment holiday customers (£m)



Initial, extended and ongoing Covid forbearance



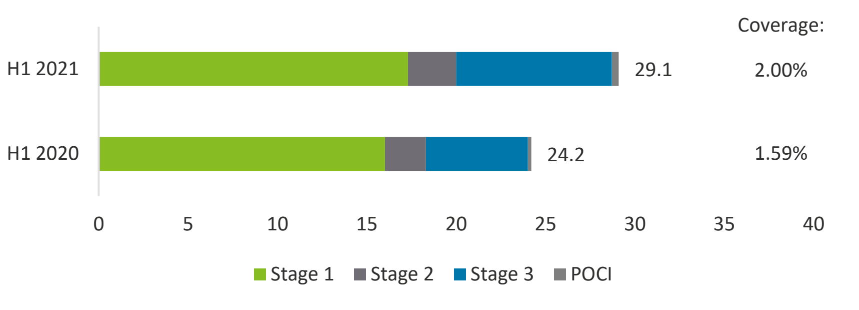
Arrears balance movements on payment holiday customers (£m)



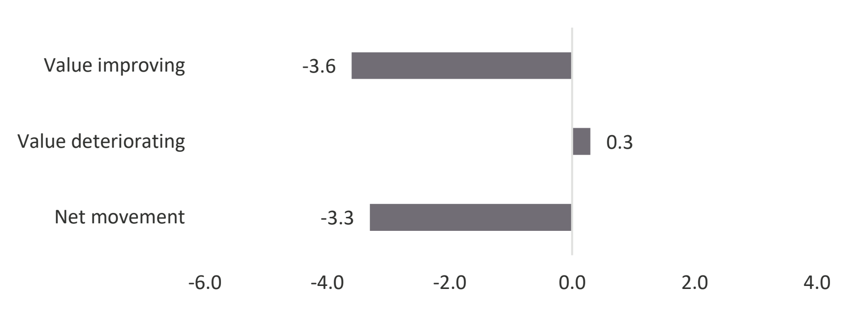
Data as at 30th April 2021

Impairments – Commercial Lending

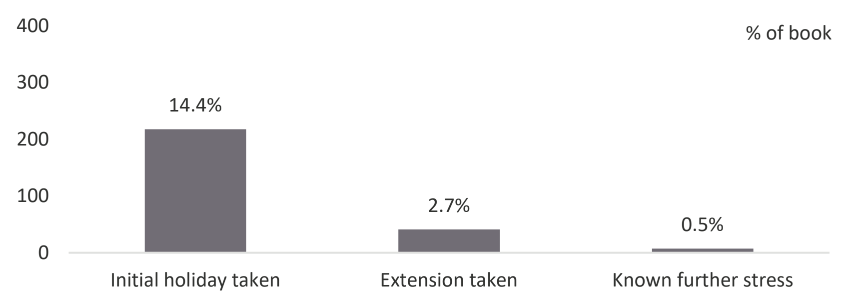
IFRS 9 provisions (£m)



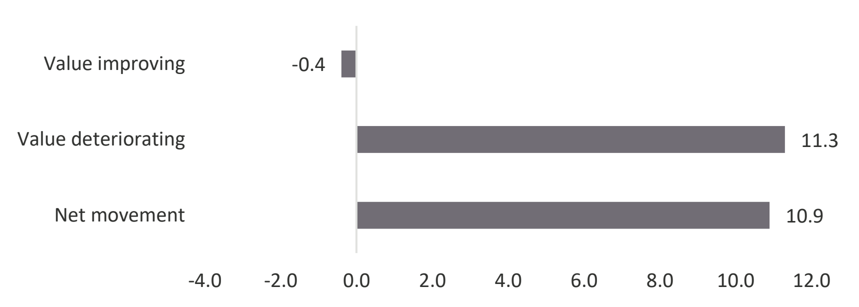
Arrears movements on non-payment holiday customers (£m)



Initial, extended and ongoing Covid forbearance (£m)



Arrears movements on payment holiday customers (£m)

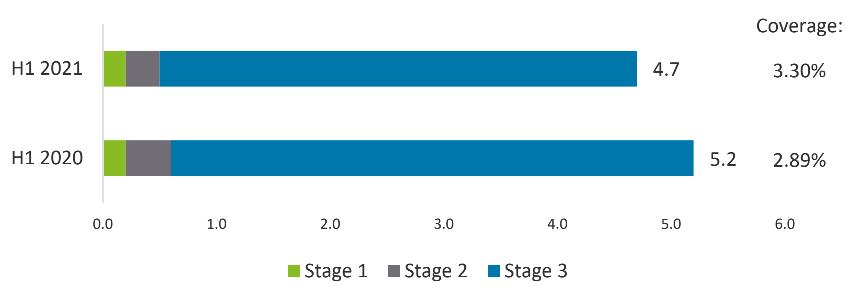


Data as at 30th April 2021

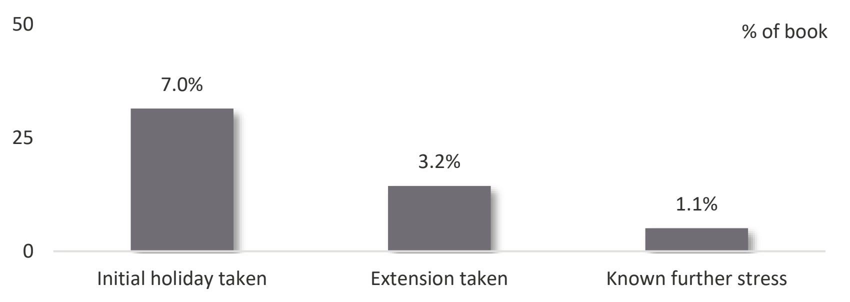
Impairments – Idem Capital

- 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 £121.0 million of Idem Capital's gross loan book as at 31 March 2021 while non-POCI assets account for remaining £142.3 million

Non-POCI IFRS 9 provisions (£m)



Initial, extended and ongoing Covid forbearance (£m)



POCI loan cash flow trend (£m)

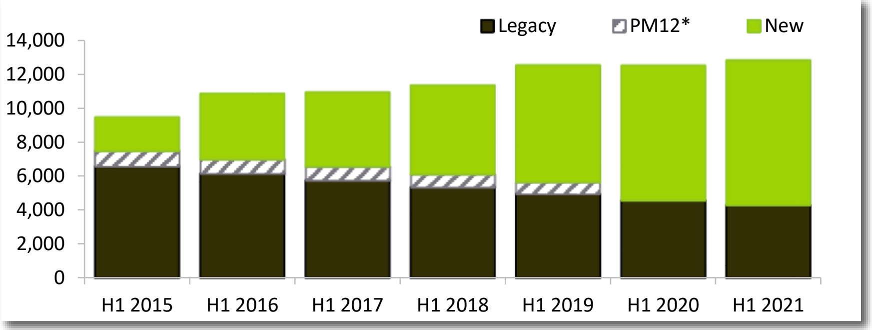
Diversification

paragon

Diversified loan growth

Originations £million	H1 2021	H1 2020	Change
Specialist BTL	686.2	694.6	(1.2%)
Other mortgages	38.4	98.2	(60.9%)
Commercial Lending	401.7	481.3	(16.5%)
Idem Capital	0.0	0	0.0%
Total	**1,126.3**	**1,274.1**	**(11.6%)**

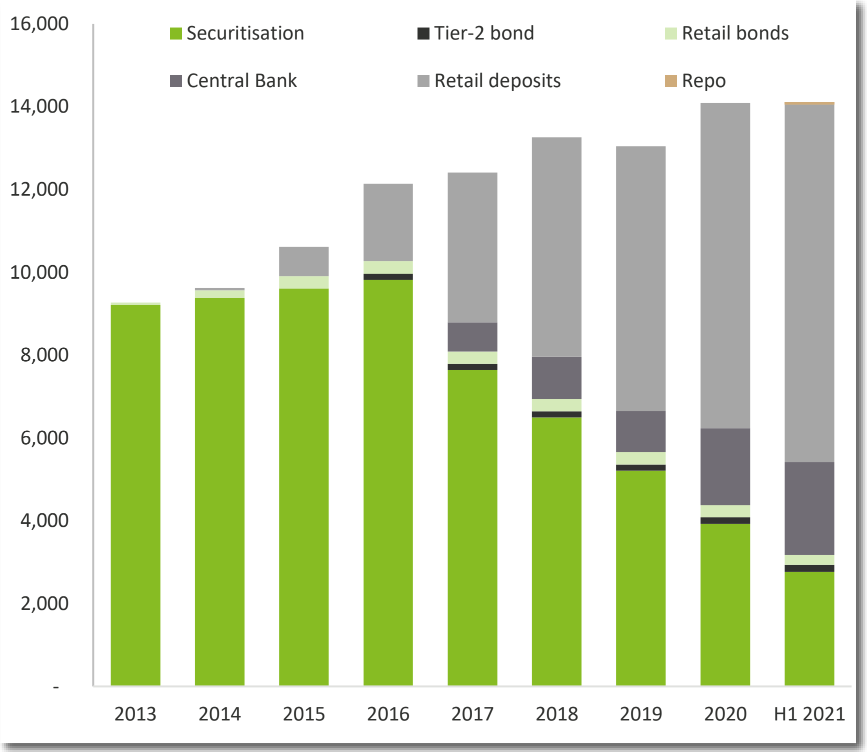
Total – loans and advances to customers (£m)



* Assets now off-balance sheet under management

Diversified funding

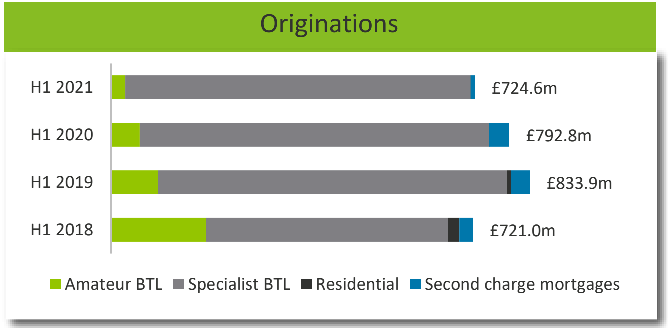
Funding by type (£m)

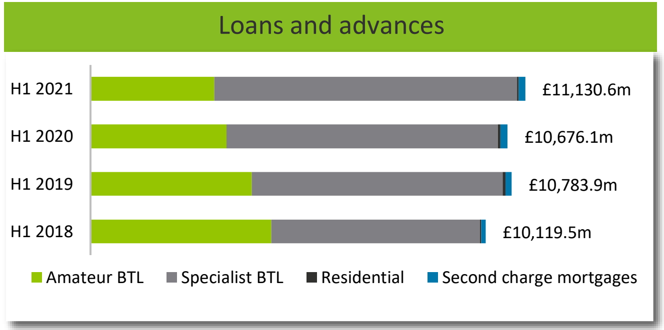


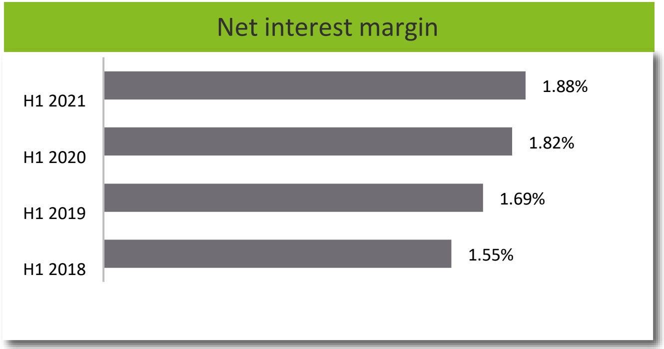
Mortgage Lending

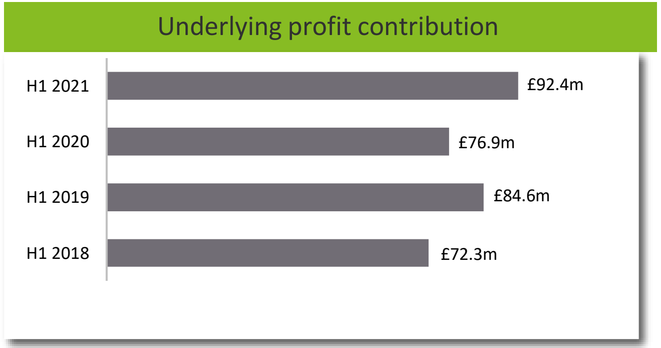
Loan book up 4.3% year-on-year despite Covid interruption in H2:20

- Volumes recovered and margins strong
- Impairments £8.9 million lower than H1:20





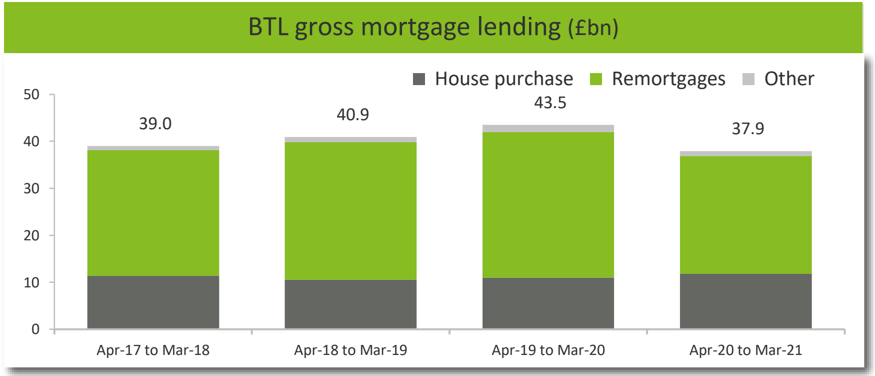


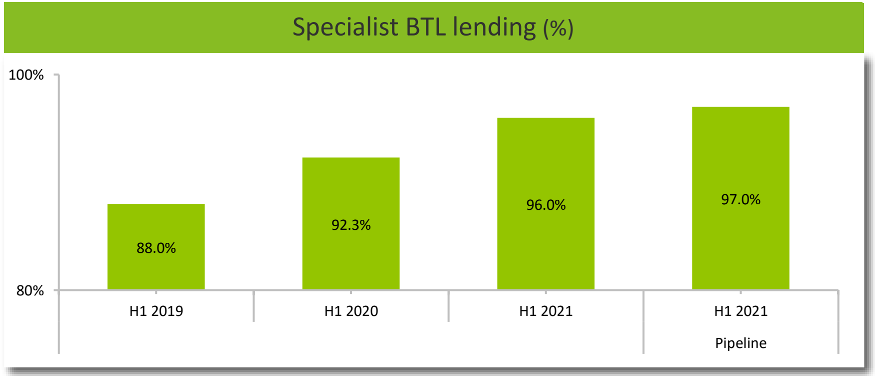


Buy-to-let

Strong demand for specialist BTL

- Strong market-wide volumes
- Paragon's focus remains in specialist segment
- Pipeline maintains this trend

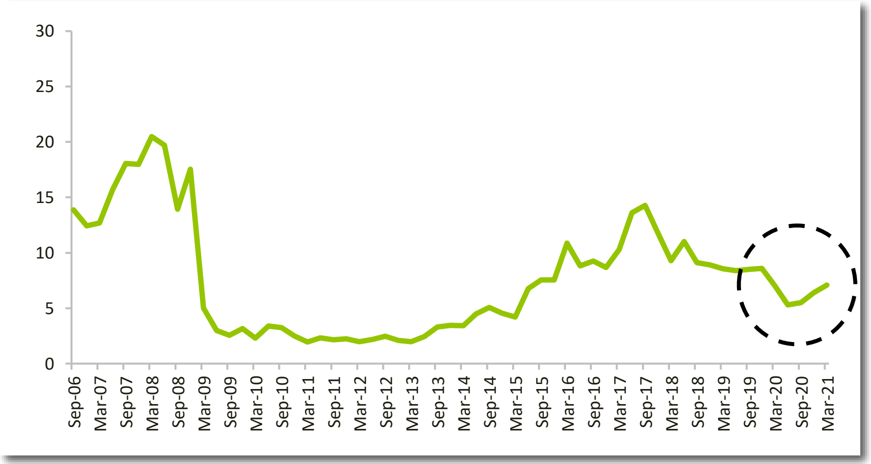




Stronger retention levels year-on-year

- Annualised redemptions down from 7.8% to 6.8%
- Modest increase in March 2021 alongside planned SDLT holiday end

BTL redemptions (%)

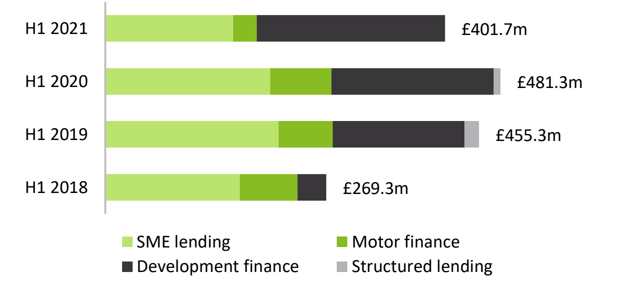


Commercial Lending

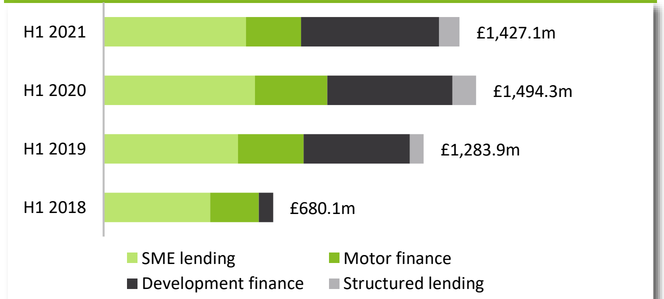
Strong growth in operating income and materially lower impairments

- Operating income up 16.6% year-on-year
- Impairments down 91.6%

Originations

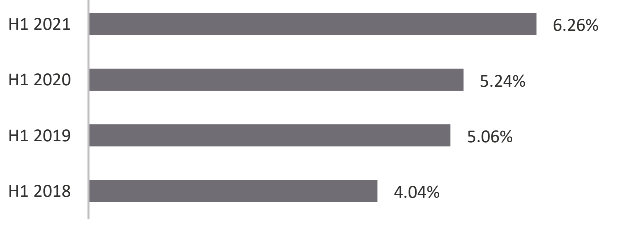


Loans and advances

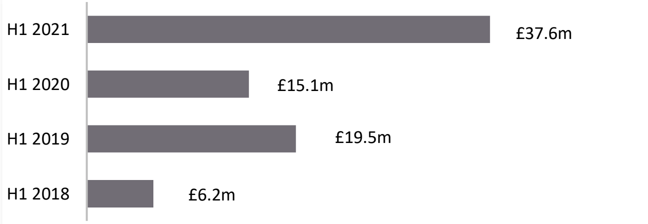


Net interest margin *

* Calculated over average monthly balances



Underlying profit contribution

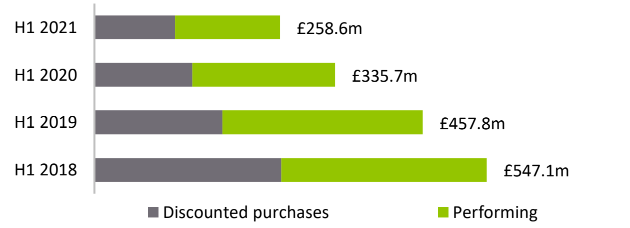


No further haircut to expected cash collections

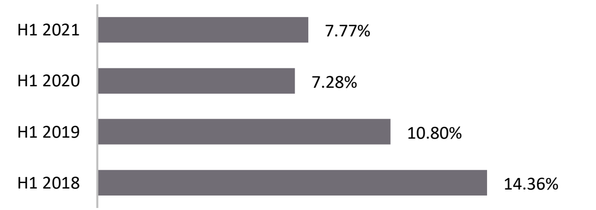
- 2020 suffered from a £3 million adjustment to EIR, reflecting lower anticipated cash receipts
- No adjustment in HY:21
- “Drag” effect on Group NIM reducing

Investments

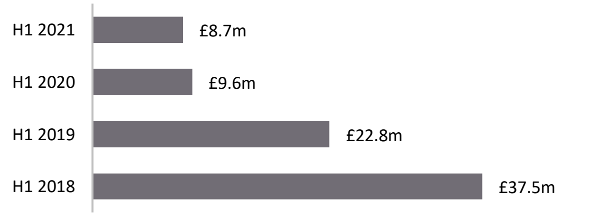
Loans and advances



Net interest margin



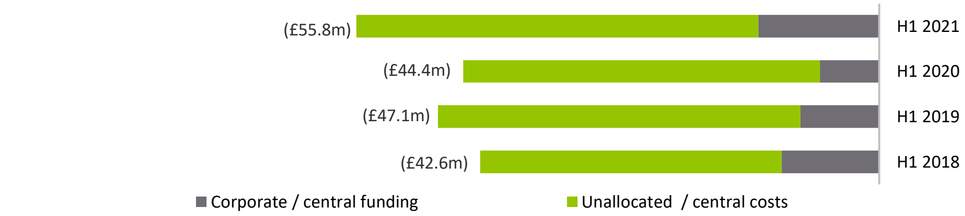
Underlying profit contribution



Higher central funding and operating costs

- Central funding costs impacted by high liquidity levels post onset of Covid
- Central overheads incorporate project costs and share-based expenses (reflecting share price growth and reversing 2020's position)

Underlying profit / (loss) contribution



Underlying operating leverage*

* Central operating costs as a proportion of total operating costs

Balance sheet

£million	H1 2021	H1 2020	Change (%)
Mortgages	11,130.6	10,676.1	+4.3%
Commercial Lending	1,427.1	1,494.3	(4.5%)
Idem Capital	258.6	335.7	(23.0%)
Loans and advances to customers	**12,816.3**	**12,506.1**	**+2.5%**
Cash	2,103.0	1,206.8	+74.3%
Other assets	569.5	976.3	(41.7%)
Total assets	**15,488.8**	**14,689.2**	**+5.4%**
Capital and reserves	1,203.8	1,122.0	+7.3%
Retail deposits	8,631.2	6,911.9	+24.9%
Tier-2 bond	168.3	149.7	+12.4%
Retail bonds	237.0	296.6	(20.1%)
Securitisation funding	2,767.0	4,766.5	(41.9%)
Central bank facilities	2,244.4	1,199.4	+87.1%
Other liabilities	237.1	252.1	(6.0%)
Total liabilities and equity	**15,488.8**	**14,698.2**	**+5.4%**

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