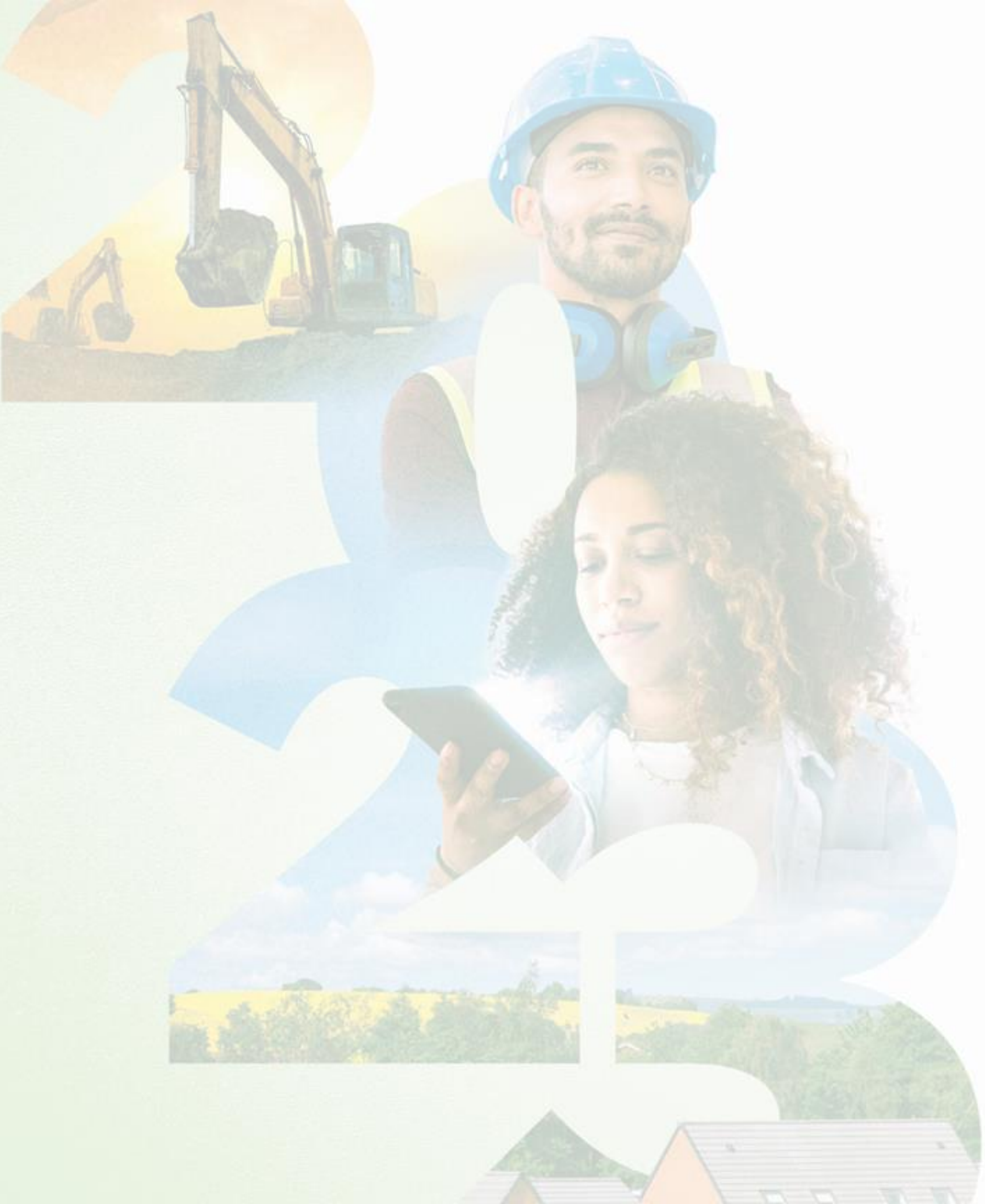
Paragon Banking Group PLC

Financial results twelve months ended 30 September 2023



Agenda

Financial overview

Richard Woodman, Chief Financial Officer

Strategy overview

Nigel Terrington, Chief Executive Officer

Conclusions

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Strong performance enhancing our specialist franchise

Purpose …

… to support the ambitions of the people and businesses of the UK by delivering specialist financial services

- Strong and growing franchise in specialist banking
- Widening NIM, adjusting to higher rate environment
- High quality loan book delivering exemplary performance
- Strong internal capital generation supporting growth, progressive dividend and share buy-back programme, further £50 million announced today
- Continuing digitalisation investments delivering efficiency benefits and enhanced customer proposition

Strong operational and financial performance

Financial performance

- Underlying operating profit £277.6 million, up 25.4% on 2022
- Pre-provision profit up 25.6%
- Underlying EPS +34.8%
- NIM 3.09%, +40bps on 2022
- Cost:income ratio 36.6%
- Underlying RoTE 20.2%
- Full year dividend 37.4p; DPS +30.8% on 2022

Loan and deposit growth

- Net loan growth 4.7%
  - Mortgage Lending +4.7%
  - Commercial Lending +4.8%
- Deposit balances +24.3% year-on-year

Prudential ratios

- Strong liquidity, average LCR 191%
- Over 94% of deposits FSCS insured
- Capital strong, CET1 15.5%, IRB continuing to progress, TNAV £5.79 / share
- Further £50 million 2024 share buy-back programme announced

Financial overview

Richard J Woodman
Chief Financial Officer

Income statement

£ million	2023	2022	Change
Net interest income	448.9	371.2	+20.9%
Other income	17.1	17.2	(0.6%)
Total operating income	466.0	388.4	+20.0%
Operating expenses	(170.4)	(153.0)	+11.4%
Pre-provision profit	**295.6**	**235.4**	**+25.6%**
Impairments	(18.0)	(14.0)	+28.6%
Underlying operating profit	**277.6**	**221.4**	**+25.4%**
One-off items	-	4.6	
Fair value net gains / (losses)	(77.7)	191.9	
Profit before taxation	**199.9**	**417.9**	**(52.2%)**
Reported earnings per share	**68.7p**	**129.2p**	**(46.8%)**
Underlying earnings per share	**94.2p**	**69.9p**	**+34.8%**

- Rate environment supports above trend margin performance
- Reflects continued platform investment and broader inflation
- Cautiously positioned economic scenarios
- Gain from Idem Capital unsecured portfolio sale in FY22
- FV gains on pipeline hedges reverse over time
- Include FV items, dividend and performance focus on underlying

Segmental results

Strong operating performance in both segments, Commercial Lending contribution exceeding £100 million

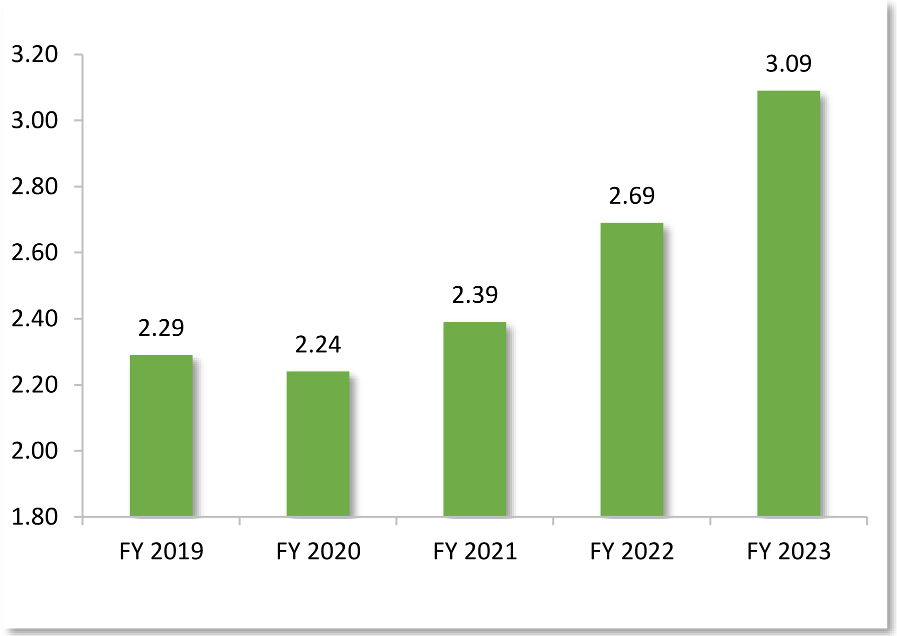
Underlying £ million	Mortgage Lending	Commercial Lending	Central	Total
Total operating income (FY 2023)	283.2	147.2	35.6	466.0
Change (v FY 2022)	+24.6	+26.2	+26.8	+77.6
Operating expenses	(26.2)	(26.4)	(117.8)	(170.4)
Change (v FY 2022)	(1.8)	(1.5)	(14.1)	(17.4)
Pre-provision profit	**257.0**	**120.8**	**(82.2)**	**295.6**
Change (v FY 2022)	+22.8	+24.7	+12.7	+60.2
Provisions for losses	**(10.4)**	**(7.6)**		**(18.0)**
Change (v FY 2022)	(5.8)	+1.8		(4.0)
Underlying operating profit	**246.6**	**113.2**	**(82.2)**	**277.6**
Change (v FY 2022)	+17.0	+26.5	+12.7	+56.2

Net interest margin

Structural NIM performance boosted by higher rate environment

- Margin benefit switches from asset to liability side at higher rates
- Stronger returns on free capital – increasingly being hedged to protect NIM if rates re-trace (£0.3 billion of £1.2 billion eventual hedge in place at year end)
- Outperformed historical 5-10bp per annum structural accretion rates
- EIR balances across the Group total £20 million – capping reversion rate assumptions has avoided balances escalating in higher rate environment

NIM progression – Group (%)



Net interest margin (2)

Recent margin levels materially outperform longer term structural NIM accretion

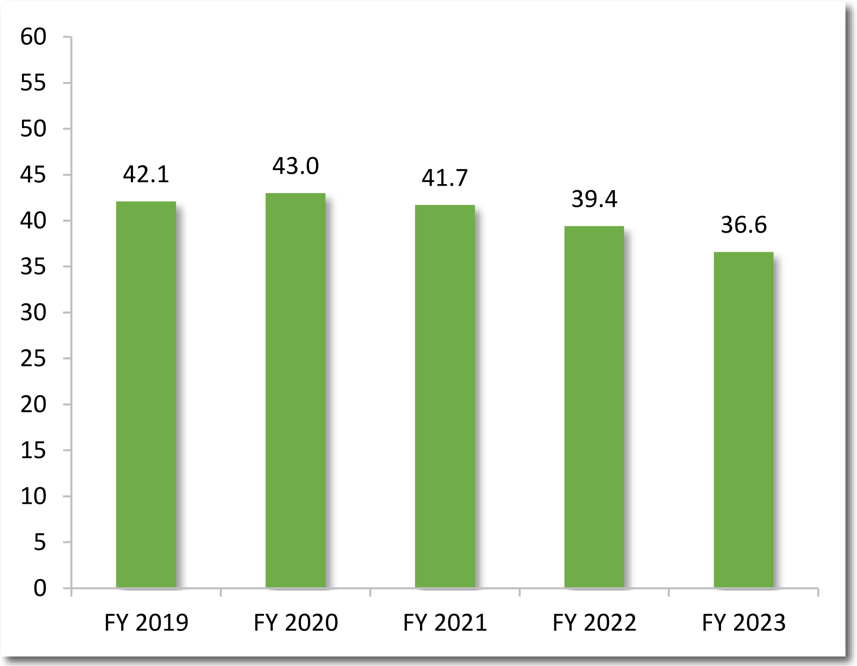
- From 2019 we have highlighted underlying NIM accretion in the 5-10bp range
- 2023 actual is 60bp above the bottom of this range and 40bp above the top
- Compared to 2019, SONIA rate applied to tangible equity in 2023 gives a circa 25bp tailwind
- Near term, expect NIM to move back to trend as asset and liability spreads normalise and if rates reduce, but remain in a 3.0-3.1% range in 2024 v 3.21% in H2:23
- Medium term the structural mix benefits remain given Commercial NIM c3x Mortgage NIM and new book BTL NIM > legacy book NIM
- Net free reserve hedge supports earnings on equity in medium term

Operating expenses

Operating costs in line with expectations

- Year-on-year cost growth 11.4%
- Annual IT cost increased from £14.9 million in 2019 to £24.4 million in 2023 as we invest in a digitalised platform, with minimal capitalisation
- Cost efficiency remains a key priority, alongside spreading fixed costs over a broader earnings base
- 2024 costs expected to be circa £180 million

Underlying cost:income ratio (%)



Economic outlook

Multiple Economic Scenarios reflect a cautious outlook

- Conservative MES position
- Maintained even balance of base/upside and downside/severe scenarios to reflect ongoing uncertainty
- Downside/severe mix held at 30/20
- Main changes from 2022 MES relate to GDP, HPI and CPI

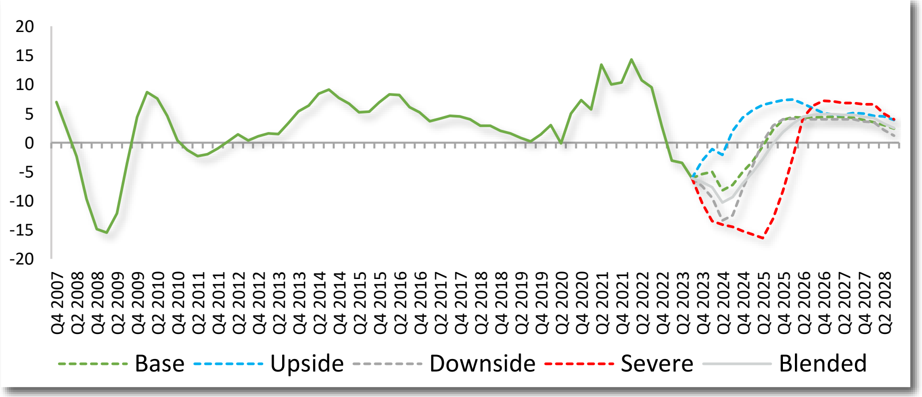
Scenarios

	Base	Upside	Downside	Severe
Weighting	40%	10%	30%	20%
Impact of 100% weighting	£67.4m	£59.0m	£73.4m	£95.8m
Variance to reported	(£6.2m)	(£14.6m)	(£0.2m)	+£22.2m

2024 assumptions compared

Forecast for quarter ended 30 September 2024	2023 MES	2022 MES
GDP	(0.6%)	1.4%
CPI	6.1%	4.2%
Unemployment	5.8%	6.0%
House prices	(9.4%)	(0.1%)

House price change (%)



Impairments

Resilient loan book with small increase in coverage level year-on-year

- Main impairment driver is the MES rather than non-performing loan levels; coverage up YoY
- Next generation IFRS 9 models support reduction in judgmental overlays
- LTV increase reflects house price declines in 2023
- New BTL portfolio performance exemplary, some arrears increase in variable rate legacy portfolio

Impairment overlay

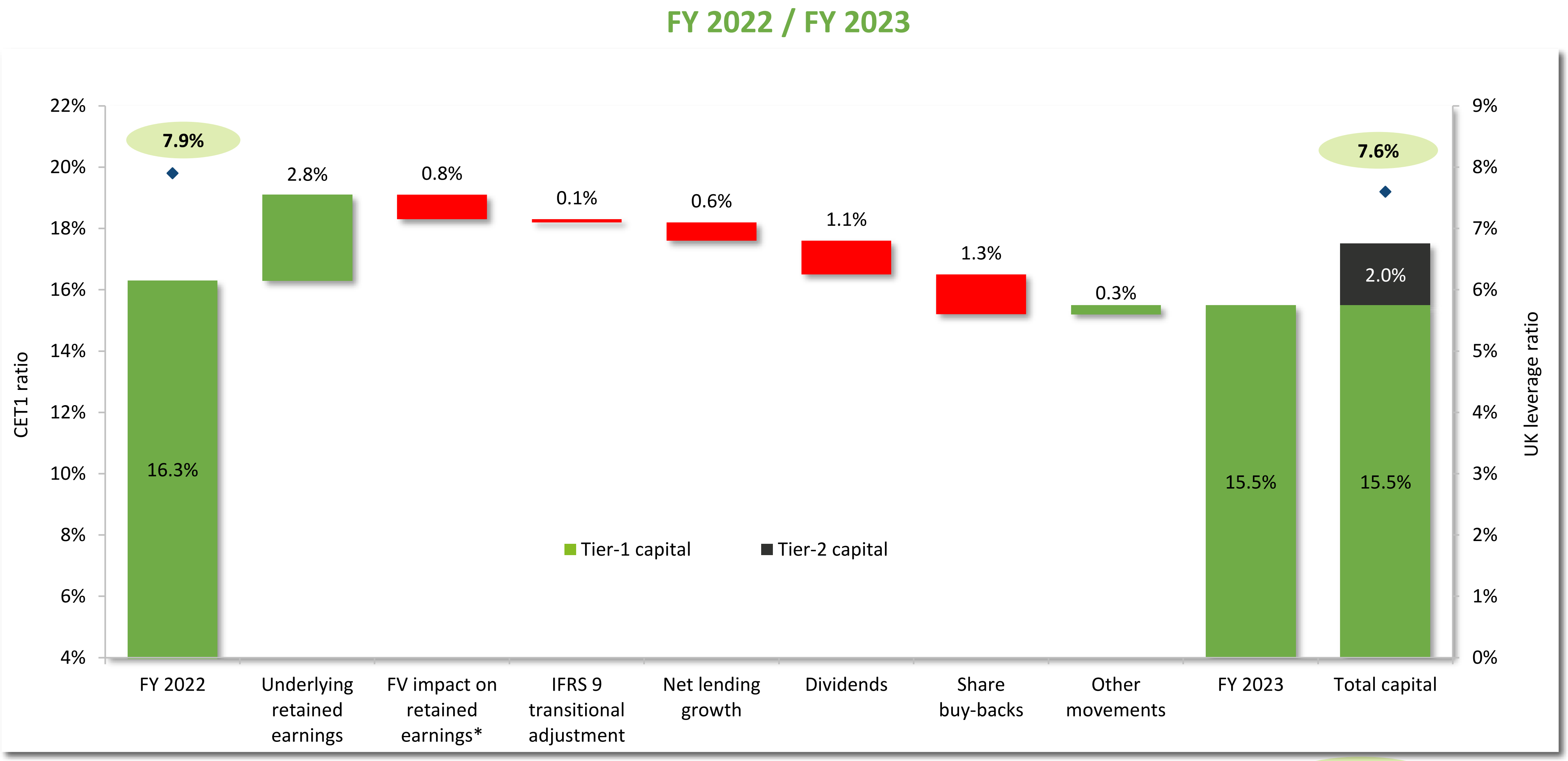
	FY 2020 (£m)	FY 2021 (£m)	FY 2022 (£m)	FY 2023 (£m)
Calculated provision	£62.0	£46.0	£48.5	£67.1
Judgmental overlay	£19.8	£19.4	£15.0	£6.5
Total	**£81.8**	**£65.4**	**£63.5**	**£73.6**
Coverage ratio	0.64%	0.49%	0.44%	0.49%
BTL portfolio LTV	65.8%	61.2%	57.9%	62.8%

	Transition weights no PMAs	2023 weights no PMAs	2023 weights full PMA
Central	40%	40%	40%
Upside	30%	10%	10%
Downside	25%	30%	30%
Severe	5%	20%	20%
Total provision	**£61.1m**	**£67.1m**	**£73.6m**
Coverage ratio	0.41%	0.45%	0.49%

Indexed credit behavioural scores by portfolio

	Sep-22	Sep-23
Buy-to-let		
New	100.0	100.7
Legacy	100.0	99.5
Second charge mortgages	100.0	99.8
Motor finance	100.0	100.7

Capital movements during the period



* 2022 full-year fair value credit was worth 2% of CET1

UK leverage ratio

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Group capital

Capital generation remains strong

Capital ratios

- 15.5% CET1 represents a strong surplus over regulatory minimum (>£300 million)
- Group has no AT1 in capital structure
- Tier 2 bond matures in 2026
- £50 million share buy-back announced for 2024

IRB

- Good engagement with PRA throughout 2023 with accreditation process ongoing
- Buy-to-let represents the first asset class in the Group's IRB roadmap

Basel 3.1

- Little development in the year. Implementation delayed until at least mid-2025 and final, post consultation, proposals expected in Q2 2024

Group consolidated capital	
Core Equity Tier-1 capital *	£1,188.9m
Tier-2 capital	£150.0m
Total capital resources	**£1,338.9m**
Credit risk	£6,884.9m
Operational risk	£740.2m
Market risk	-
Other	£43.6m
Total risk exposure	**£7,668.7m**
CET1 ratio *	15.5%
Total capital ratio (TCR) *	17.5%

Group consolidated leverage ratio	
Tier-1 equity *	£1,188.9m
Leverage exposure **	£15,579.3m
UK leverage ratio *	7.6%

* Including IFRS 9 transitional relief of £13.5m, adjusted for dividends and subject to verification

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

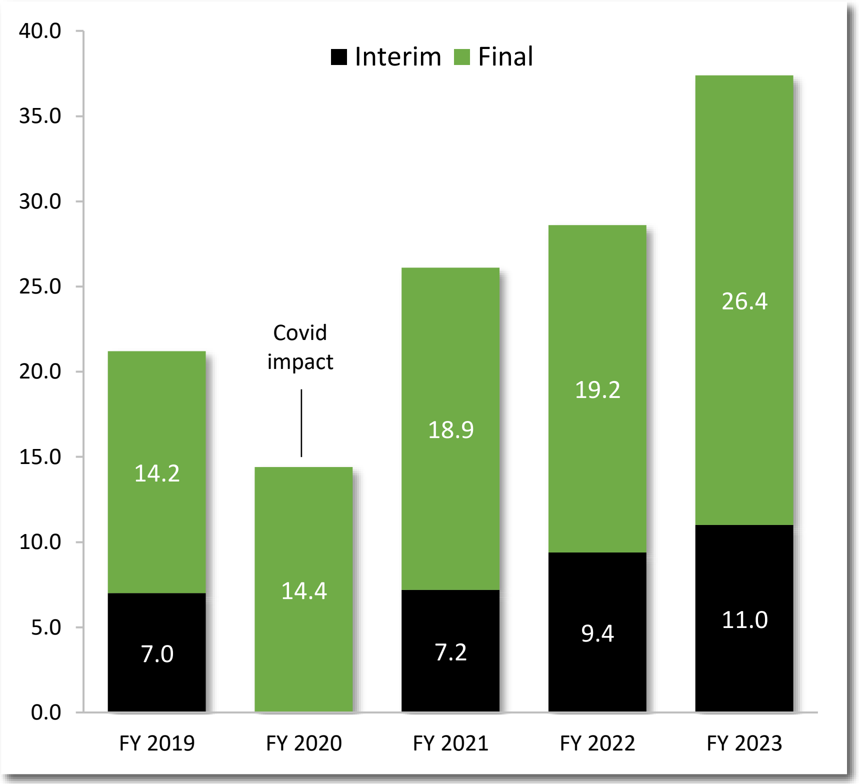
Capital management

Dividend per share up 30.8%

New £50 million share buy-back announced for 2024

- Dividend per share continues to be based on underlying earnings and benefits from share buy-back
- £483 million of share buy-backs completed / announced since 2015
- Capital generation is higher in a lower growth higher rate environment

Dividend per share (pence)



Business performance review and strategic priorities

Nigel S Terrington
Chief Executive Officer

Strategic pillars

Our strategy is driven by our purpose and helps us achieve our vision to become the UK's leading technology-enabled specialist bank and an organisation of which our employees are proud

We have five clear strategic priorities underpinned by three strategic pillars

Growth	Diversification	Digitalisation	Capital management	Sustainability

Our strategic pillars

- A customer-focused culture
- A dedicated team
- Strong financial foundations

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Strategic priorities delivery

Growth

- 6.4% reduction in new lending v 2022, 15.6% higher than 2021 …
- … but 4.7% loan book growth delivered

Diversification

- Commercial Lending 37.5% of Group's 2023 new lending
- Commercial Lending profit contribution £113.2 million (2020: £43.9m)

Digitalisation

- Technology transformation accelerating
- 84% core and support systems Cloud-based
- Further re-platforming to be delivered in 2024

Capital management

- Basel 3.1 and IRB create uncertainties, yet …
- Internal capital generation 2.8% supporting strong loan book growth … and
- Further £50 million share buy-back programme announced. £483 million share buy-backs since 2014/5

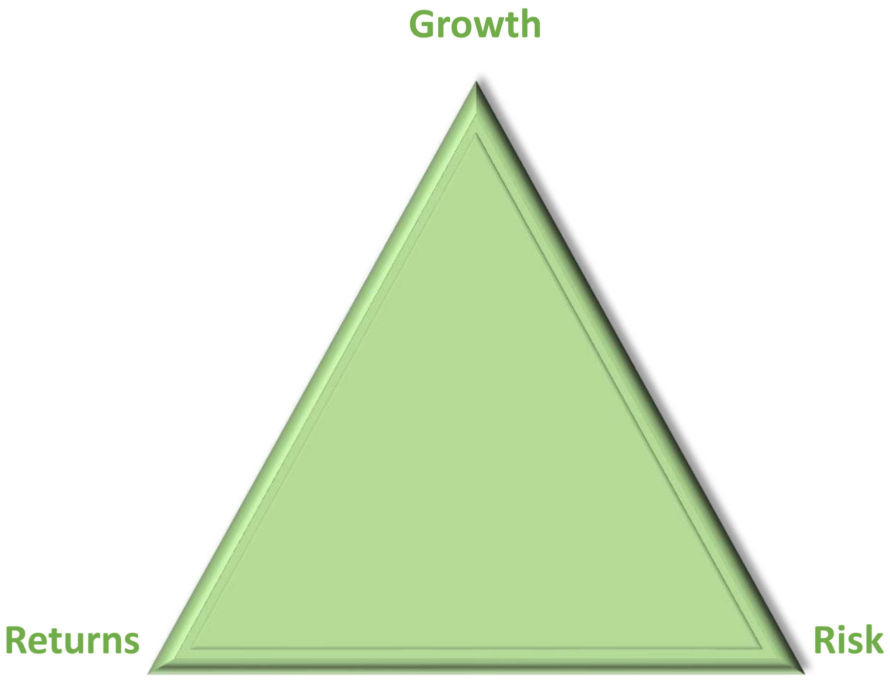
Sustainability

- Good progress towards operational net zero by 2030
- 42% reduction in operational footprint emissions from the 2019 baseline
- Expanding green product range

Operating model equilibrium – driving sustainable longer-term returns

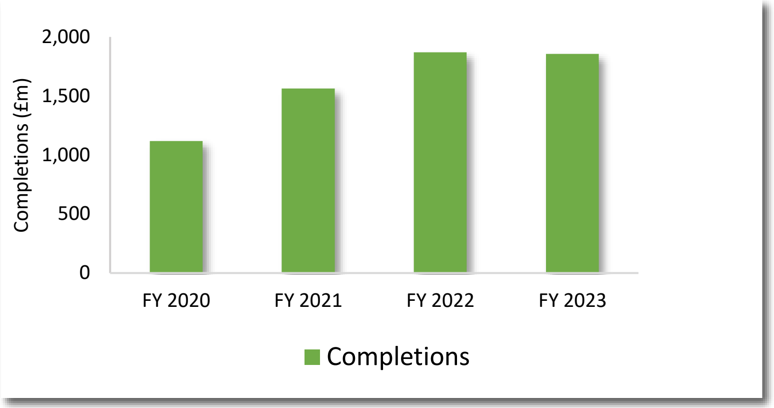
Medium term underlying RoTE target 15% – delivered

- Dynamic calibration of strategic levers to external environment and risk appetite shape the delivery
- Fundamental banking inter-relationships are growth, returns and risk. Balance is key
- Any single one can be achieved in the short-term
- Risk standards and NIM are the priority
- Consistent delivery, stability and sustainability are key to our long-term strategy and success

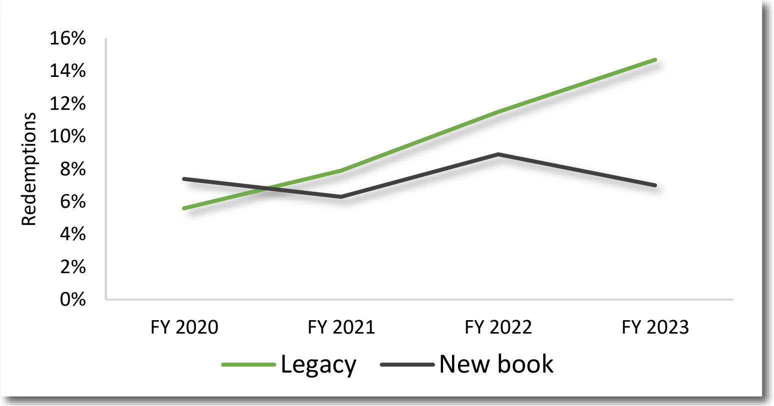


Mortgages – Continued focus on professional landlords driving loan book growth

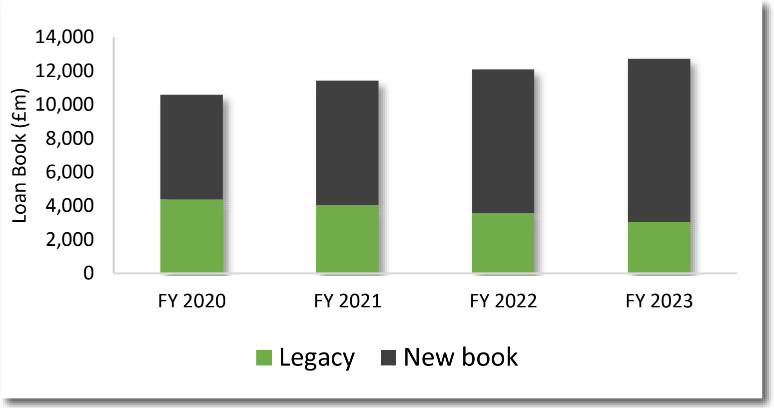
Specialist new business (£m)



Redemptions (% of book)



Net loan book (£m)



New lending

- Year dominated by high levels of price volatility, opened with mini-budget crisis plus 7 base rate rises across the financial year
- Specialist lending completions 98.8% (2022: 97.9%)
- £1,879.9 million advances (2022: £1,909.0m -1.5%)
- Pipeline £594.6 million (down from £1,256.0m at 2022 -52.7%)
- Professionalisation of BTL market an increasing feature

Redemptions

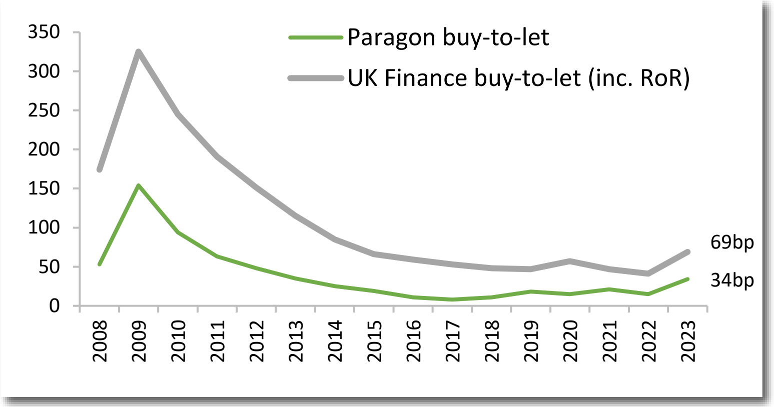
- Redemption rates between legacy (amateur) and new book (professional) clearly bifurcating
- 80% maturing professionals being retained

Net loan book

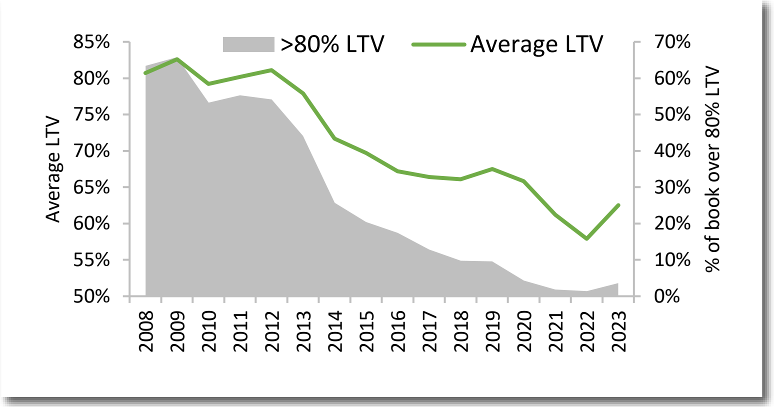
- £12.7 billion, up 5.2% on 2022
- New book at £9.7 billion, up 13.4%
- Legacy book now £3.0 billion (2022: £3.6bn), down 14.5%

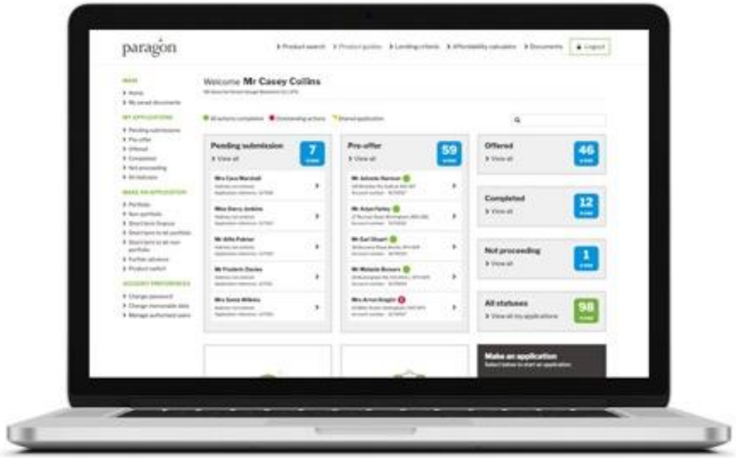
Mortgages – Proven resilience of business model through-the-cycle

Arrears rate 3mths+ (bp)



Average LTV





Through-the-cycle experience

- Arrears consistently outperform market
- Increase largely concentrated in legacy portfolio, new book exemplary
- Experienced team with deep through-the-cycle knowledge
- In-house regional surveyors provide unique unrivalled property insight

Low risk

- Average LTV 62.8% (Sept-08: 80.7%)
- Portfolio LTV greater than 80%, 3.6% (Sept-08: 63.4%)
- New business ICR remains resilient, reflecting rising rents and higher interest rates
- Pipeline affordability profile
    - Rental yield 6.7%
    - Mortgage rate 5.2% (+ fees)
    - LTV 67%
    - ICR 190%
    - Rents over 5 years +31%

Technology and proprietary data analytics

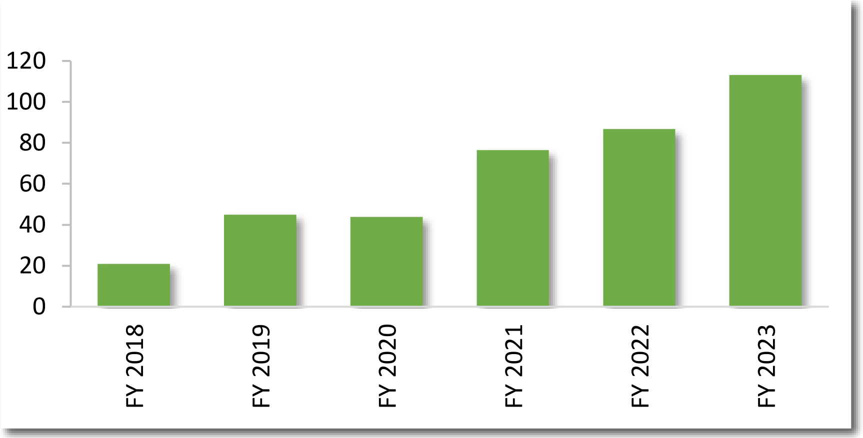
- Over 600 million data points per month
- Intermediary portal now widely employed
- Customer portal launched
- New business cloud-based re-platforming in process
- 25+ years of data inform:
    - Underwriting
    - Pricing
    - Stress testing
    - A key differentiator for IRB

Commercial Lending provides increased diversification and structural NIM expansion

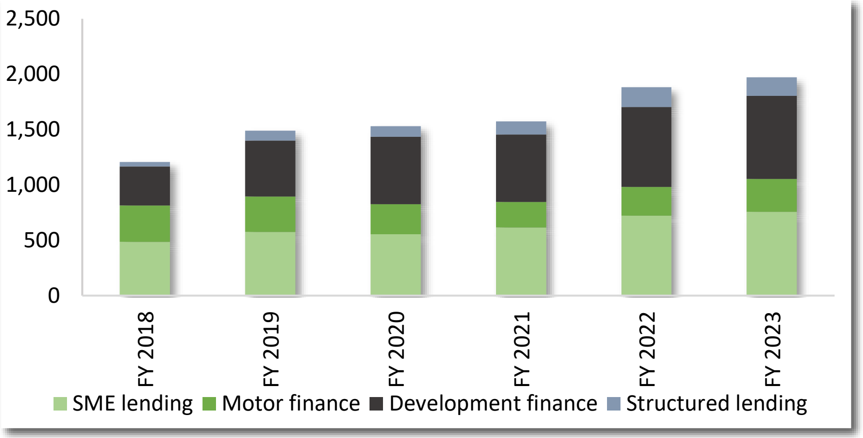
Profit contribution increased by 158% in three years

- 38% of Group's new lending
- 13% of Group loan book
- 32% of Group income
- 2023 profit contribution £113.2 million v £43.9 million in 2020
- 96% of Commercial Lending book is secured
- No evidence of credit deterioration

Commercial Lending operating profit (£m)



Commercial Lending new business (£m)

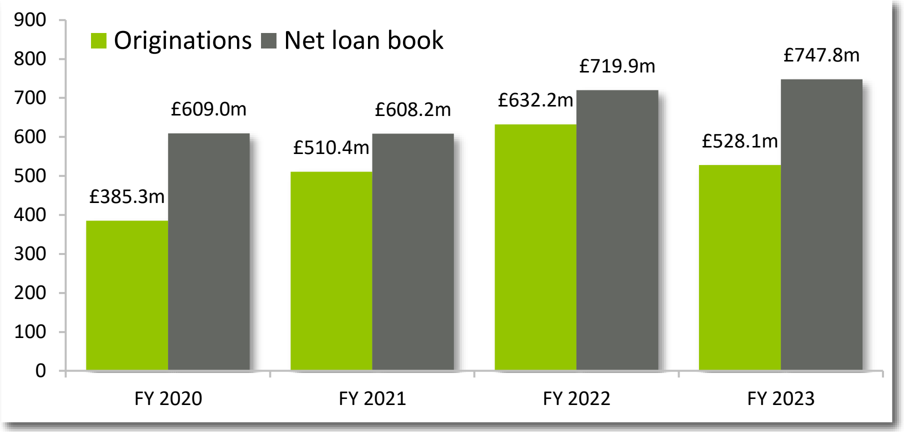


Commercial Lending – Development Finance

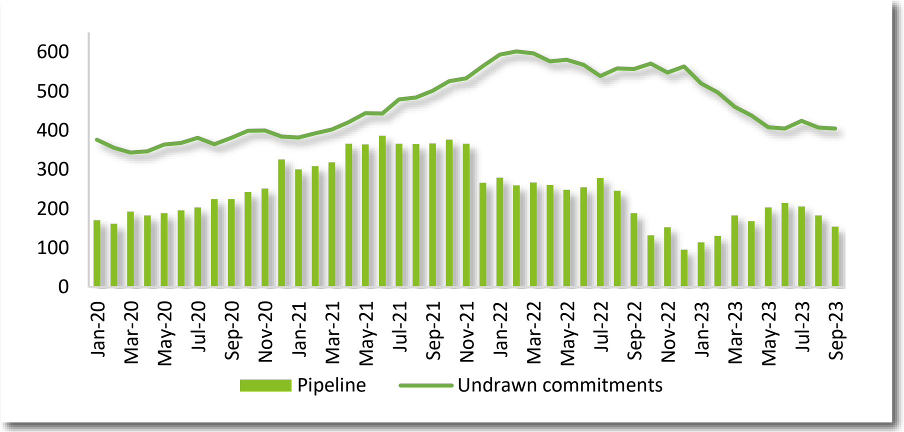
Through-the-cycle management maintains disciplined growth strategy

- Volume reduced to £528.1 million as expected, but…
- Loan book increased by 3.9% to £747.8 million
- Undrawn pipeline softened, with pricing discipline and risk maintained
- Excellent credit performance

Originations and loan book growth (£m)



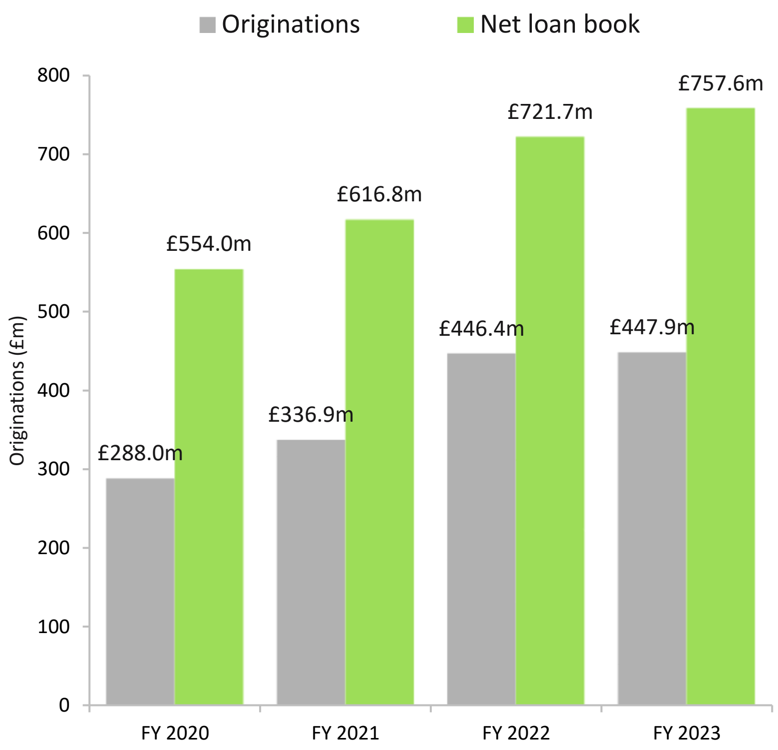
Development finance pipeline (£m)



Commercial Lending – SME Lending

Robust new business flows alongside disciplined pricing

Originations and loan book growth (£m)



- Volumes stable with strict pricing discipline
- Loan book +5.0% to £757.6 million
- Technology changes driving improving conversion rates
    - 80% application flow utilising digital portal
- Further developments in process

Commercial Lending – Motor Finance and Structured Lending

Robust flows continue to support diversification

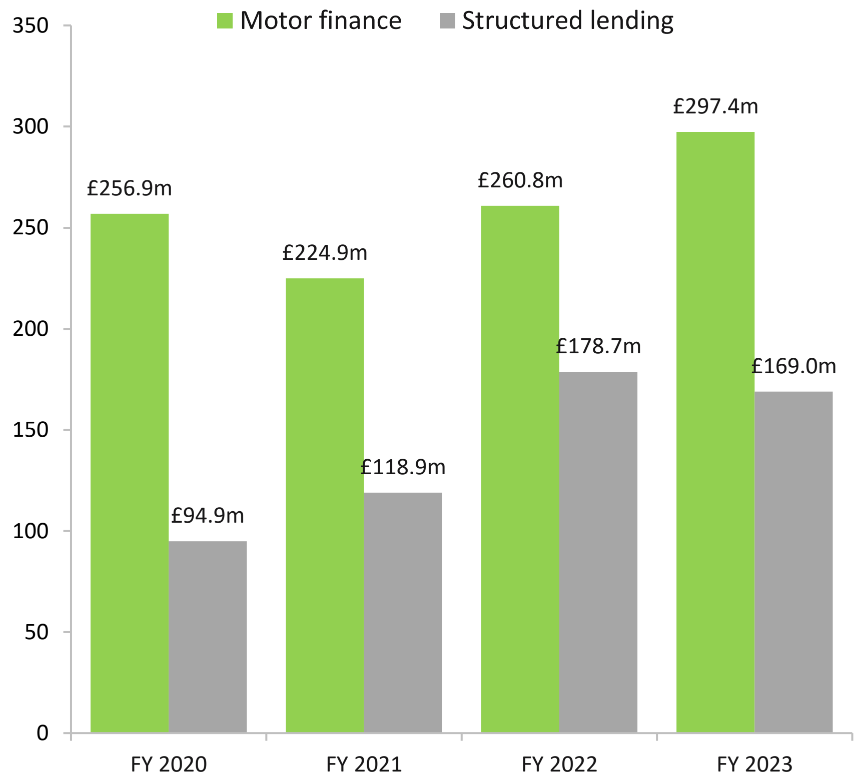
Motor Finance

- Volumes -2.4% to £162.2 million
- Loan book +14.0% to £297.4 million
- Targeting niche markets such as leisure sector delivering enhanced risk-adjusted returns
- Growing presence in EV market
- Strong credit performance

Structured Lending

- New facilities £65.0 million
- Loan book -5.4% to £169.0 million
- Encouraging pipeline, loan book growth expected
- Credit performance exemplary

Loan book growth – Motor Finance and Structured Lending (£m)



Strong deposit growth with improved cost of funding

Material change in customer behaviour into term deposits, underpinning improving cost of funds

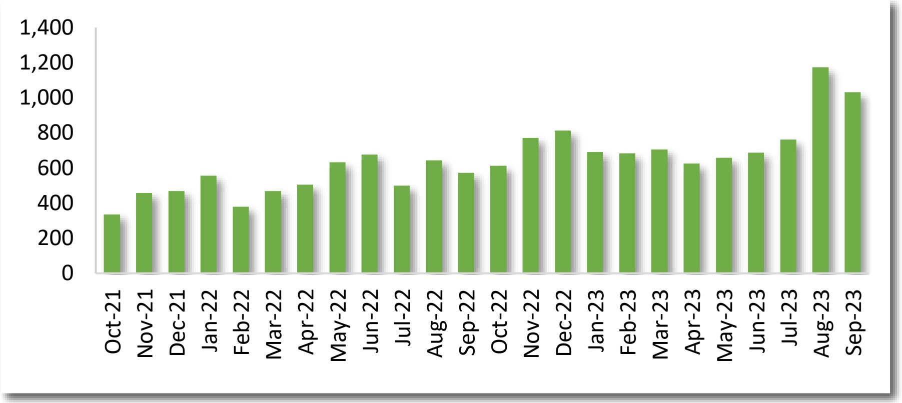
Adapting to higher rate environment

- Continued strong growth in deposit book – £13.3 billion, +24.3%
- Higher rates changing customer behaviour
- £3.4 billion flow into term
- Sub-SONIA pricing continuing

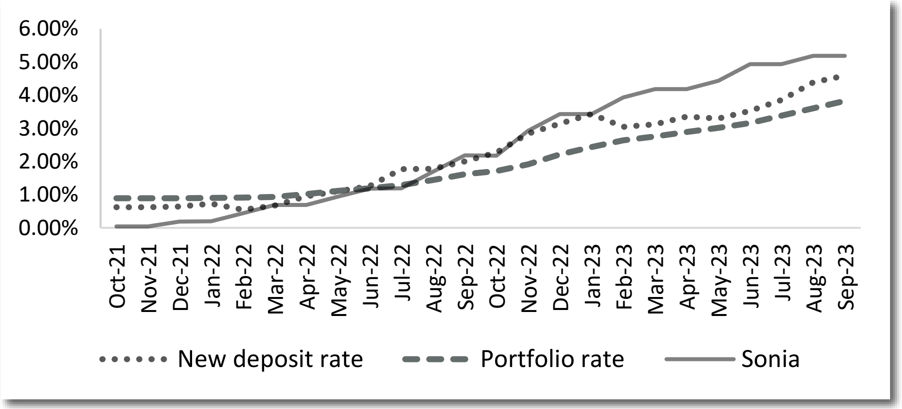
Wholesale

- Fitch investment grade rating BBB+
- Covered bond programme under development
- TFSME early repayments underway – £400 million by 31/12/23

New deposits (£m)



Deposit rate vs SONIA



Conclusions

FY:24 guidance summary

Volumes:

- Buy-to-let £1.3 – £1.6 billion
- Commercial £1.0 – £1.2 billion

NIM 3.0-3.1% range

Operating costs circa £180 million

RoTE medium-term target 15-20% – 2024 towards top end of range

2023 trading performance

- Outstanding financial performance
- Loan book growth and NIM widened
- Tight cost control
- Exemplary credit performance
- £100 million share buy-back delivered
- DPS up 30.8% on 2022 and £50 million new share buy-back programme announced

Outlook

- Strong capital ratios and internal capital generation
- High quality loan book with prudent provisioning
- Economy and demand weaker but loan book growth expected – structural market share opportunities remain
- Credit and pricing discipline will always be maintained
- Further technology changes to come – significant benefits are expected
- Well-positioned for the environment

Appendix

Strategic priorities – sustainability

Our 2023 Responsible Business Report sets out our ESG strategy and the progress we've made during the year

- £904.6 million new lending to EPC A-C properties supported by our range of green mortgages
- In Development Finance, funding for Green Homes initiative doubled to £200 million
- 42% reduction market-based emissions compared to the 2019 baseline
- Decarbonisation assessment carried out at our Head Office and EPC rating improved
- Employee engagement reached 90% (2021: 87%)
- Group-wide Sustainability Charter launched for our people

ESG ratings

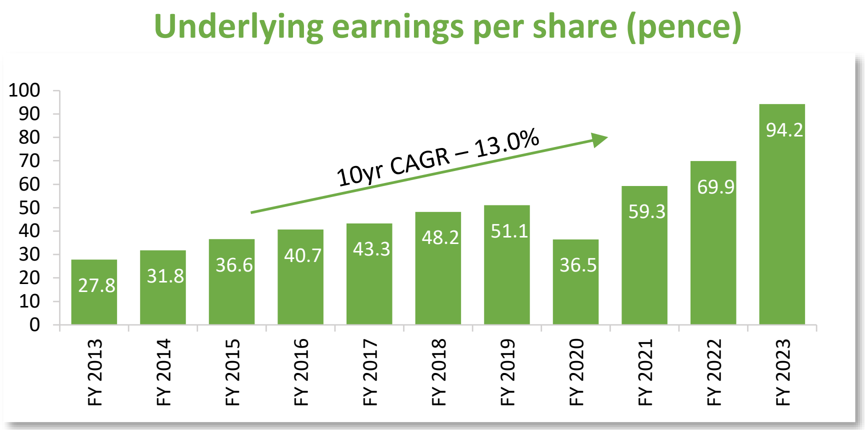
Following investor feedback, we are most actively engaging with the following ESG rating agencies:

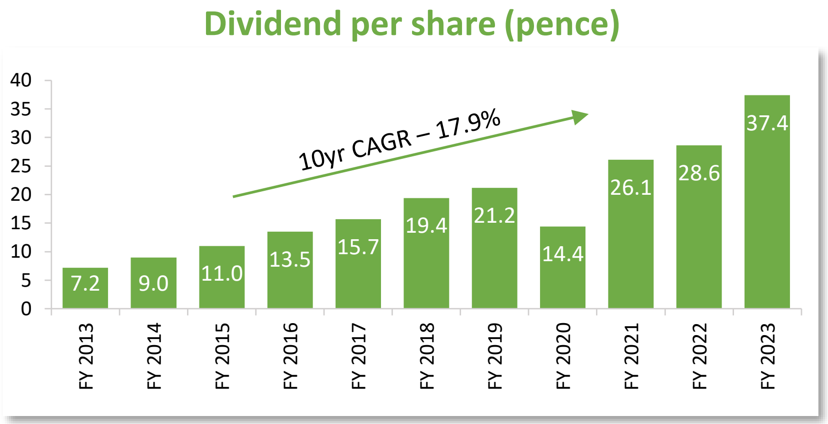
	Rating scale	Our rating
CDP	A-F	C
ISS	A+ - D-	C
MSCI	AAA-CCC	AA
SUSTAINALYTICS	0-100	15.7/100

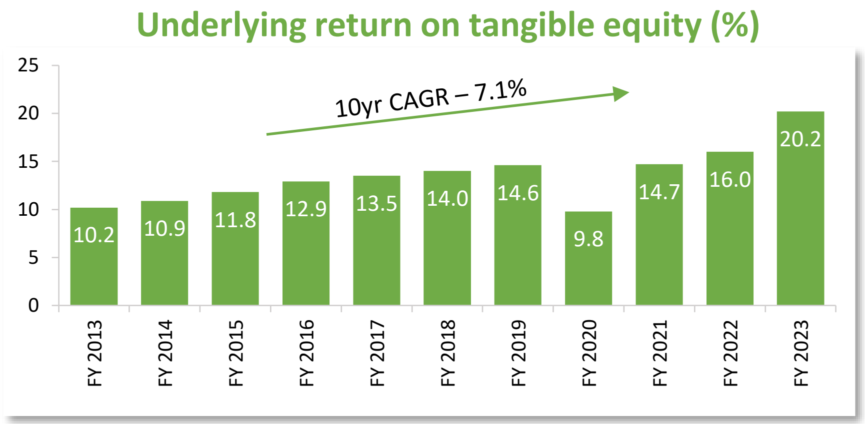
Longer term trends

Consistent delivery over the long term

- 2023 metrics outperforming longer term trend





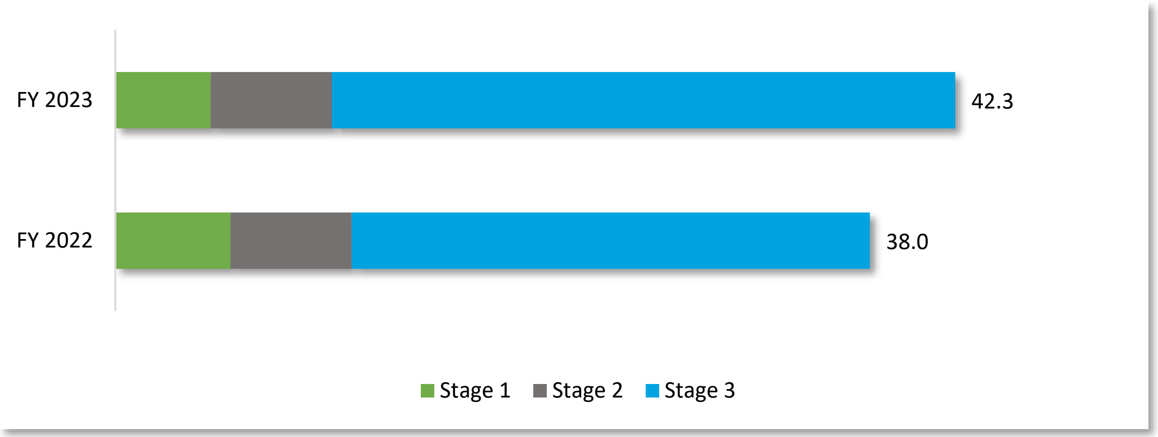


Provisions by stage and segment

IFRS 9 impairments	Mortgage Lending	Commercial Lending	Total
Stage 1	12,159.7	1,812.6	13,972.3
Stage 2	625.0	119.8	744.8
Stage 3	142.2	63.8	206.0
POCI	17.7	7.1	24.8
Gross loan book	**12,944.6**	**2,003.3**	**14,947.9**
Stage 1	4.8	14.8	19.6
Stage 2	6.1	3.3	9.4
Stage 3	31.4	8.4	39.8
POCI	0.0	4.8	4.8
Impairment provisions	**42.3**	**31.3**	**73.6**
Stage 1	0.04%	0.82%	0.14%
Stage 2	0.98%	2.75%	1.26%
Stage 3	22.08%	13.17%	19.32%
POCI	0.00%	67.61%	19.35%
Coverage ratio 2023	**0.33%**	**1.56%**	**0.49%**
Coverage ratio 2022	**0.31%**	**1.34%**	**0.44%**

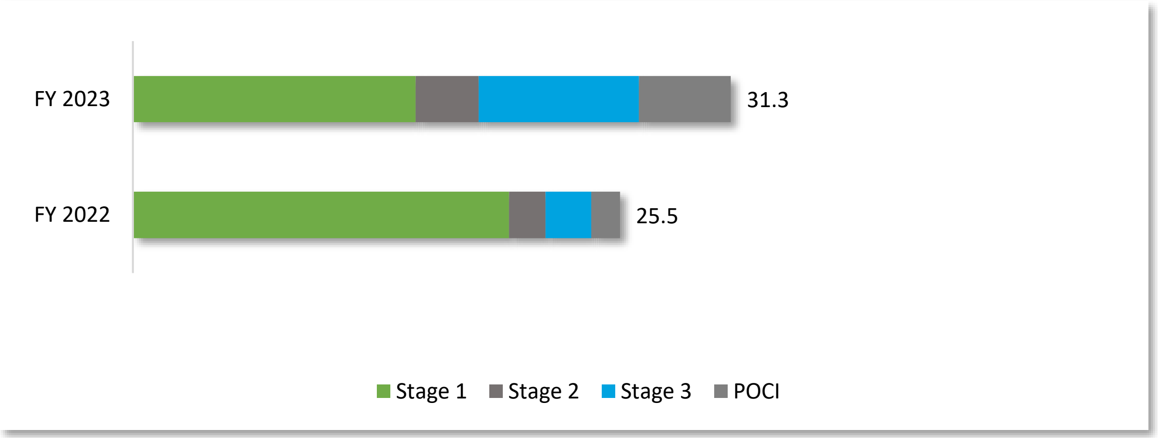
Impairments

IFRS 9 provisions (£m) – Mortgage Lending



- Stage 1 overlays reduced from £15.0 million to £6.5 million

IFRS 9 provisions (£m) – Commercial Lending



Portfolio impairment movements

Impairments £million	Brought forward	P&L charge	W-off / Other	Carried forward
FY 2021	81.8	-3.1	-13.3	65.4
FY 2022	65.4	15.8	-17.7	63.5
FY 2023	63.5	19.1	-9.0	73.6

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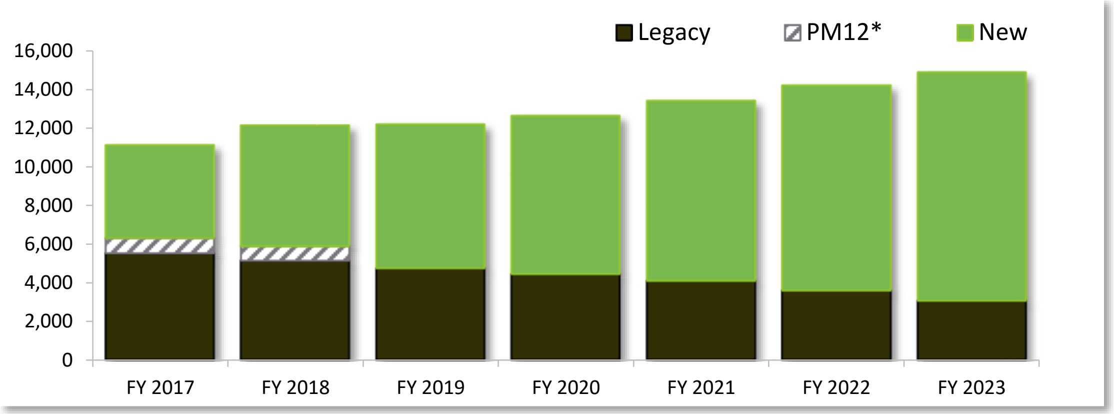
Diversification

Diversified loan growth

Originations £million	2023	2022	Change
Specialist BTL	1,857.6	1,869.5	(0.6%)
Other mortgages	22.3	40.5	(44.9%)
Commercial Lending	1,128.7	1,304.7	(13.5%)
Total	**3,008.6**	**3,214.7**	**(6.4%)**

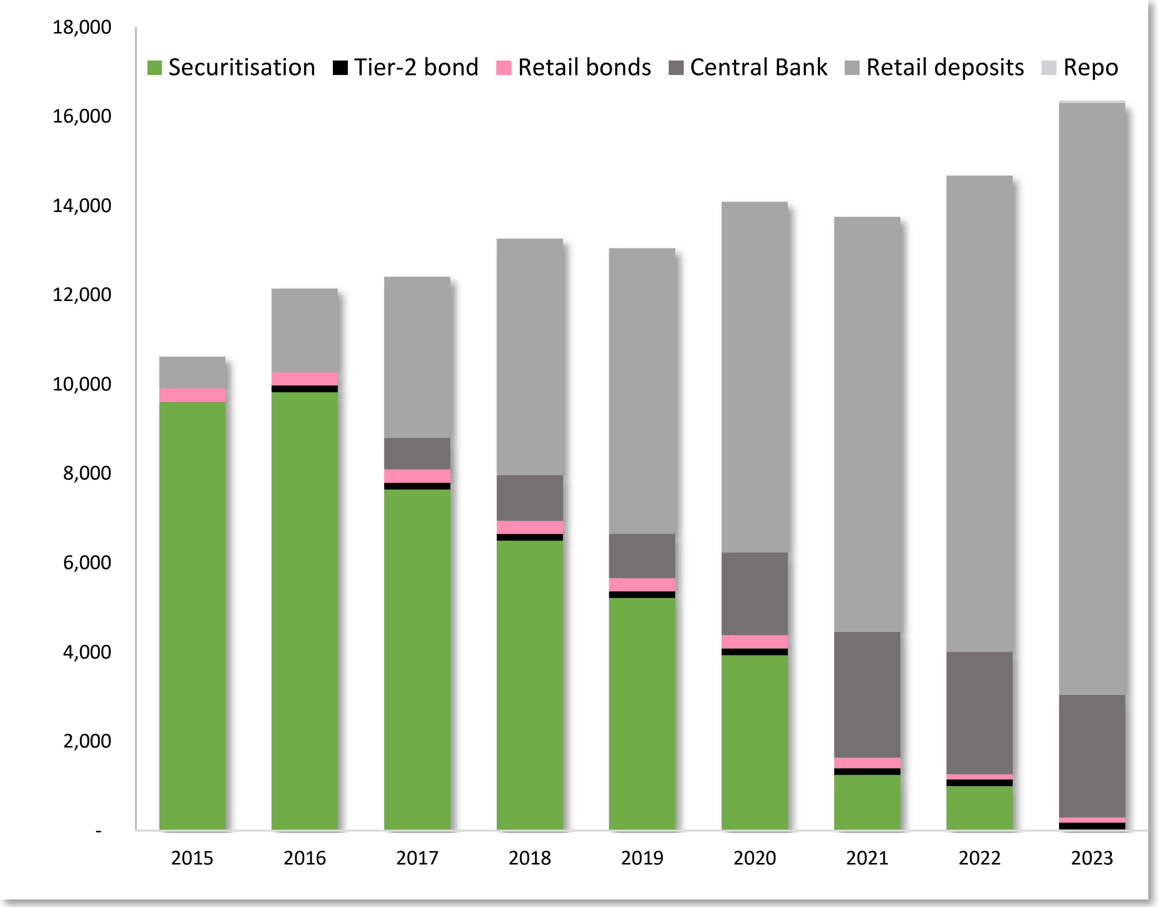
Total – loans and advances to customers (£m)



* Assets now off-balance sheet under management

Diversified funding

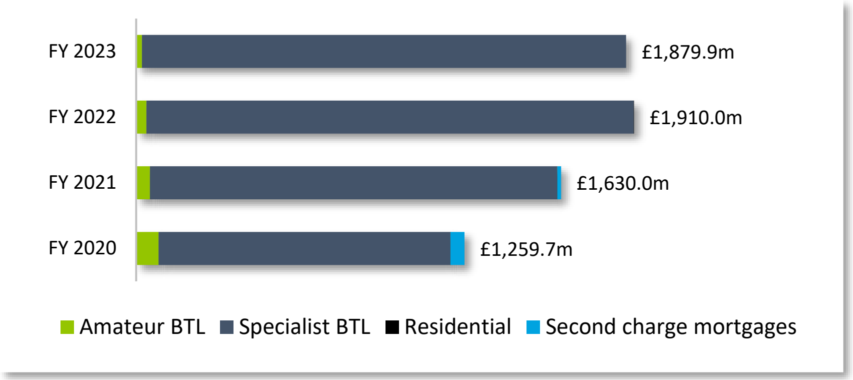
Funding by type (£m)



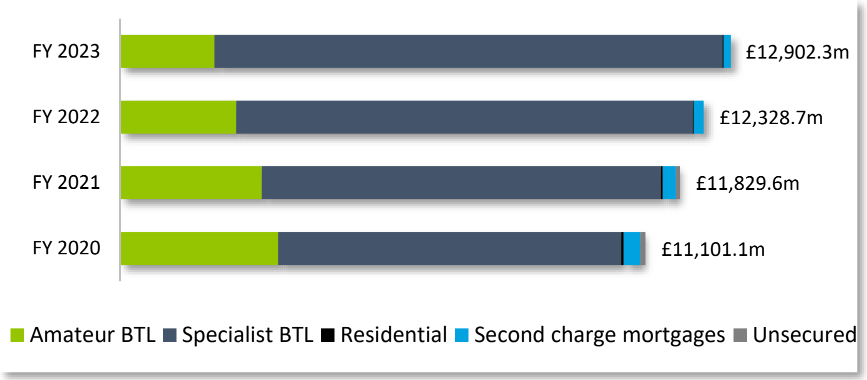
Mortgage Lending

Steady originations, strong retentions and higher margin

Originations



Loans and advances



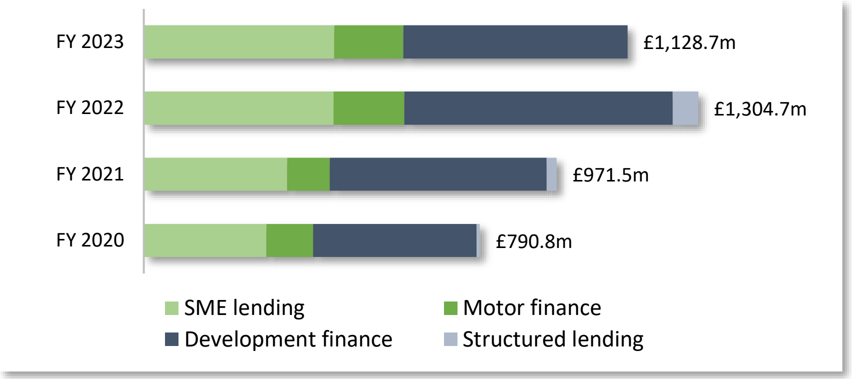
Net interest margin

Underlying profit contribution

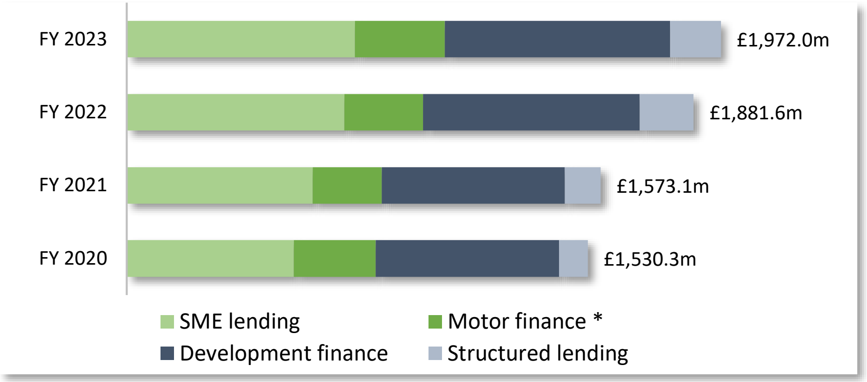
Commercial Lending

Growth in profit contribution reflects diversification benefits

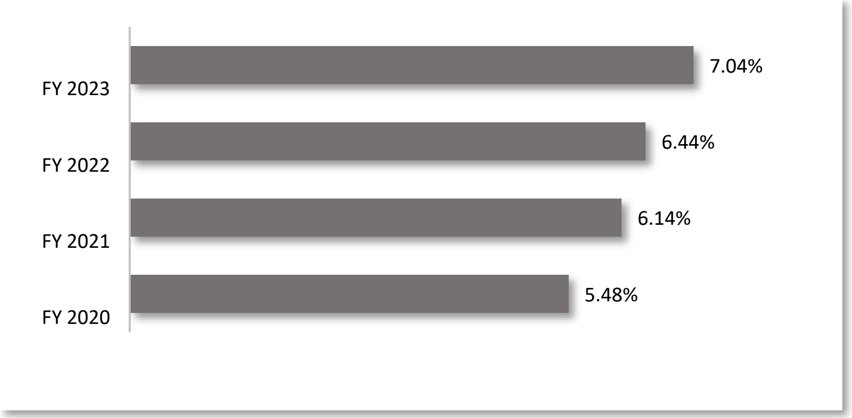
Originations



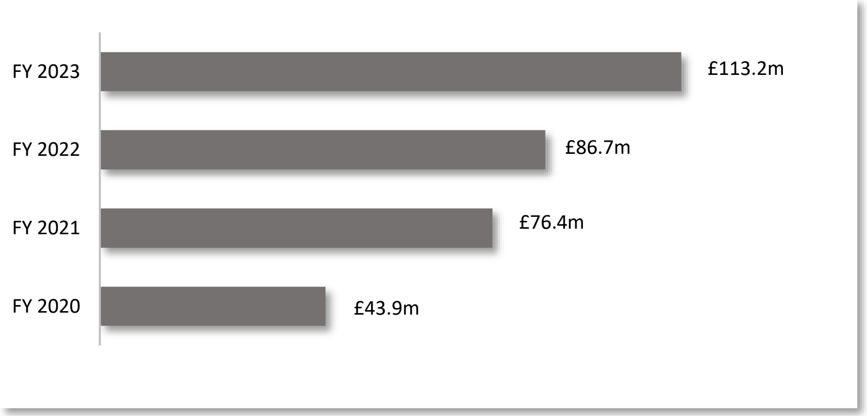
Loans and advances



Net interest margin



Underlying profit contribution



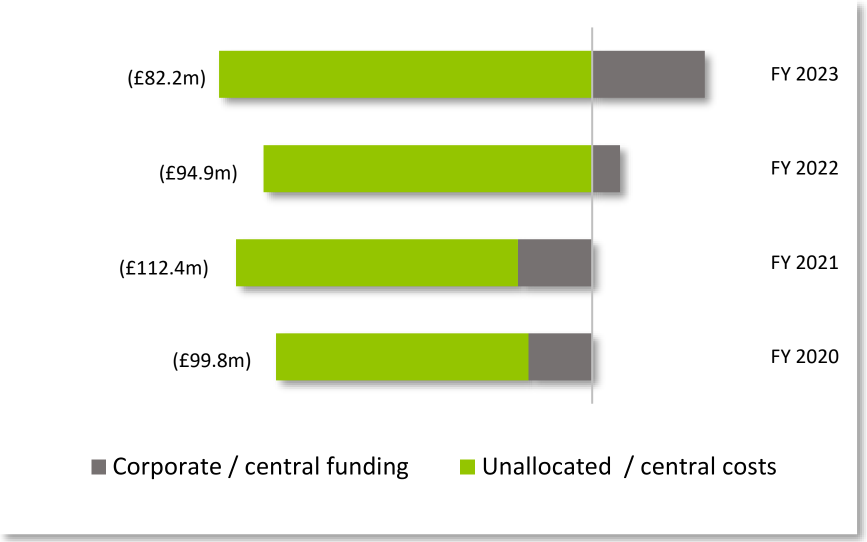
* Motor finance includes the Olympus portfolio

Central

Funding benefit from surplus liquidity and return on net assets

- Central area carries the cost of the Group's tech spend, together with savings operations' costs

Underlying profit / (loss) contribution



Balance sheet

£million	2023	2022	Change (%)
Mortgage Lending	12,902.3	12,328.7	+4.7%
Commercial Lending	1972.0	1,881.6	+4.8%
Loans and advances to customers	**14,874.3**	**14,210.3**	**+4.7%**
Cash	2,994.3	1,930.9	+55.1%
Other assets	551.6	512.4	+7.7%
Total assets	**18,420.2**	**16,653.6**	**+10.6%**
Capital and reserves	1,410.6	1,417.3	(0.5%)
Retail deposits	13,265.3	10,669.2	+24.3%
Tier-2 bond	145.8	149.2	(2.3%)
Retail bonds	112.4	112.3	+0.1%
Securitisation funding	28.0	995.3	(97.2%)
Central bank facilities	2,750.0	2,750.0	+0.0%
Other liabilities	708.1	560.3	+26.4%
Total liabilities and equity	**18,420.2**	**16,653.6**	**+10.6%**

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