Paragon Banking Group PLC

Financial results

Six months to 31 March 2023

Strong performance and well positioned

Purpose …

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

- Strong performance despite challenging environment
- Healthy trading volumes and good momentum with upgraded guidance
- Continued prioritisation of NIM and high credit standards
- Strong capital and liquidity supporting further growth, progressive dividend and increase in share buy-back programme
- Digital transformation driving further customer proposition benefits alongside greater efficiency gains

Well positioned to deal with challenging environment

Strong operational and financial performance

Financial performance

- Operating profit £128.9 million, up 22.2% on H1 2022
- Pre-provision profit up 27.7%
- Underlying EPS +28.0%
- NIM 2.95%, +38bps on H1 2022
- Cost:income ratio 38.1%
- Underlying RoTE 18.7%
- Interim dividend 11.0p; DPS +17.0% on H1 2022

Strong new business growth

- Net loan growth 4.6%
  - Mortgage Lending +3.3%
  - Commercial Lending +13.9%
- Deposit balances +20.5% year-on-year

Robust balance sheet

- Strong liquidity, average LCR 168%
- Over 94% of deposits FSCS insured
- Capital strong, CET1 15.6%, IRB continuing to progress, TNAV £5.35 / share
- 2023 share buy-back programme extended to £100 million

Financial overview

Richard J Woodman
Chief Financial Officer

Income statement

£ million	2023 H1	2022 H1	Change
Net interest income	212.4	175.2	+21.2%
Other income	7.9	6.5	+21.5%
Total operating income	220.3	181.7	+21.2%
Operating expenses	(83.8)	(74.9)	+11.9%
Pre-provision profit	**136.5**	**106.8**	**+27.7%**
Impairments	(7.6)	(1.3)	+484.6%
Underlying operating profit	**128.9**	**105.5**	**+22.2%**
Fair value net gains / (losses)	(82.5)	38.1	
Profit before taxation	**46.4**	**143.6**	**(67.7%)**
Reported earnings per share	**16.4p**	**44.4p**	**(63.1%)**
Underlying earnings per share	**42.5p**	**33.2p**	**+28.0%**

Strong margin growth supported by volume growth

Reflects inflationary impacts and digitalisation spend

Cost of risk 10bp

FV gains on pipeline reverse over time

Underlying profit growth augmented by share buy-back benefit

Segmental results

Strong performance from both divisions

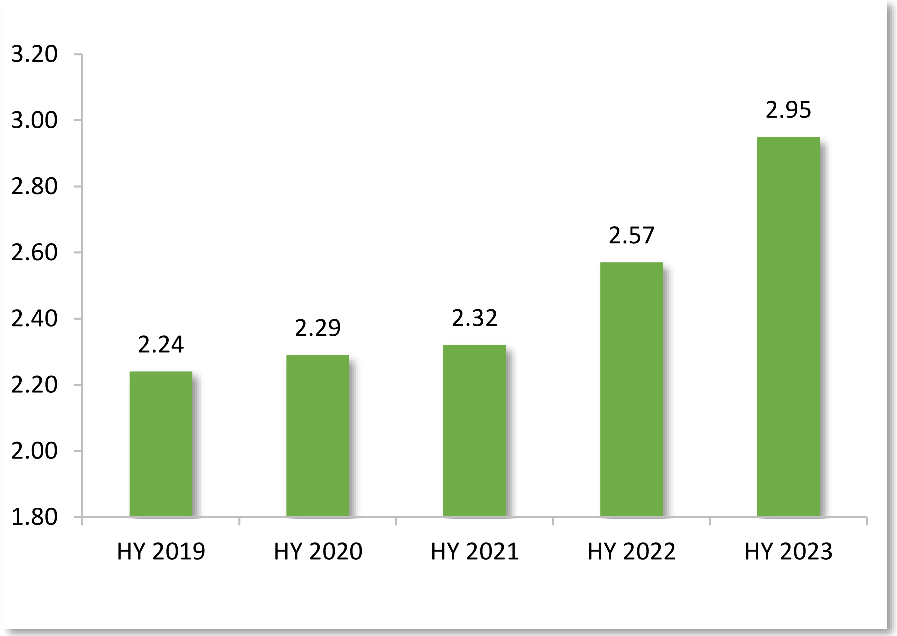
Underlying £ million	Mortgage Lending	Commercial Lending	Central	Total
Total operating income (H1:23)	136.6	72.2	11.5	220.3
Change (v H1:22)	+13.7	+15.8	+9.1	+38.6
Operating expenses	(12.3)	(13.3)	(58.2)	(83.8)
Change (v H1:22)	(0.4)	(0.5)	(8.0)	(8.9)
Pre-provision profit	**124.3**	**58.9**	**(46.7)**	**136.5**
Change (v H1:22)	+13.3	+15.3	+1.1	+29.7
Provisions for losses	**(5.4)**	**(2.2)**		**(7.6)**
Change (v H1:22)	(7.3)	1.0		(6.3)
Underlying operating profit	**118.9**	**56.7**	**(46.7)**	**128.9**
Change (v H1:22)	+6.0	+16.3	+1.1	+23.4

Net interest margin

Structural margin progression accelerated by rate environment

- Sub-SONIA priced savings augmenting margins
- Commercial Lending book (with higher yields) growing faster than Mortgage portfolio
- Full year guidance lifted at Q1 and further upgraded now to 300 basis points

NIM progression – Group (%)

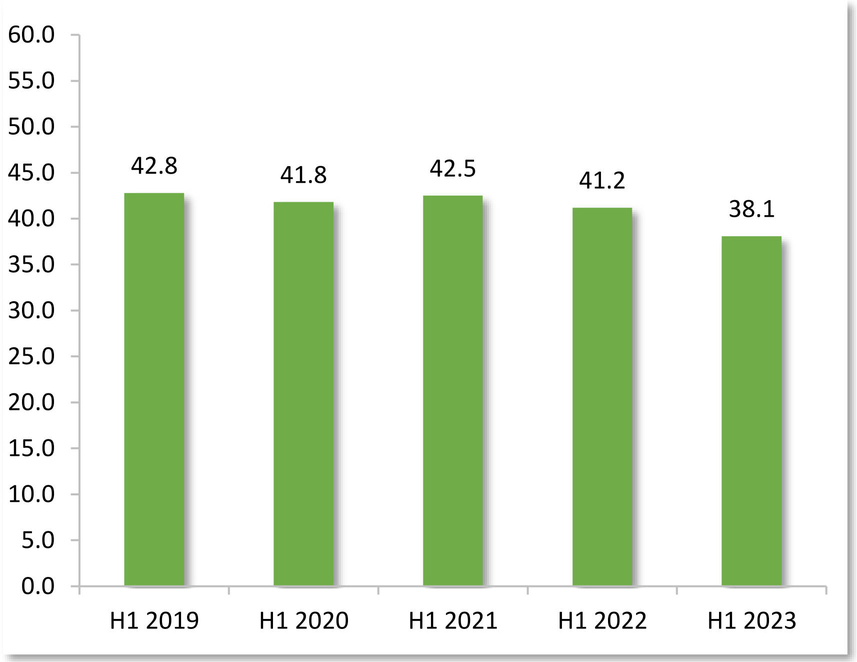


Operating expenses

Cost:income ratio below 40% despite inflationary environment and continued investment

- Year-on-year cost growth 11.9%
- Headcount of 1,537 as at 31 March 2023
- Continued focus on digitalisation to improve proposition and increase efficiency over time
- Combined system spend (people/software and capex £11.2 million)
- Circa £170 million cost guidance for 2023 re-confirmed

Underlying cost:income ratio (%)



Economic outlook

Impairment charge reflects economic volatility in H1 and cautious economic forecasts

- Four scenarios updated from September 2022
- Maintained even balance of base/upside and downside/severe scenarios to reflect ongoing uncertainty
- Downside/severe mix maintained at 30/20
- Short-term GDP and house price weakness are key inputs to the impairment models

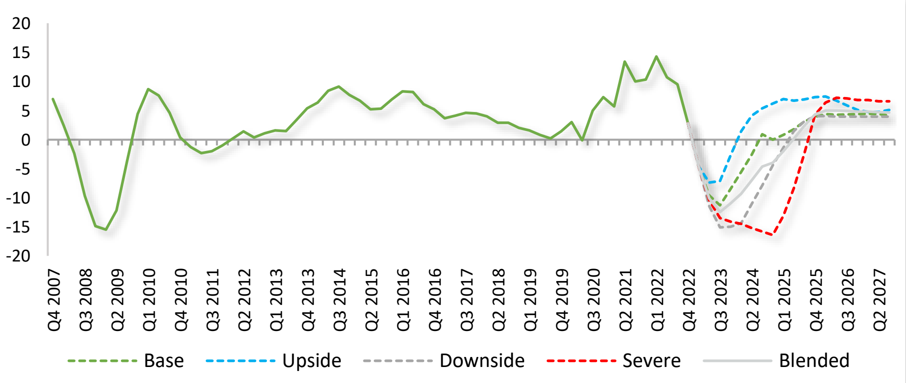
Scenarios

	Base	Upside	Downside	Severe
Weighting	40%	10%	30%	20%
Impact of 100% weighting	£60.8m	£55.1m	£68.5m	£89.2m
Variance to reported	(£7.4m)	(£13.1m)	+£0.3m	+£21.0m

2023 assumptions compared

Forecast for quarter ended 30 September 2023	H1:23 MES	2022 MES
GDP	(1.7)%	(1.1)%
CPI	8.0%	11.9%
Unemployment	4.8%	5.3%
House prices	(12.5)%	(8.2)%

House price change (%)



Impairments

Performance benign – however cautious economic outlook

- Greater proportion of impairment covered by core models given cautious MES
- Judgmental overlays reduced to £10 million
- Coverage level increased marginally to 47 basis points
- Credit scores stable year-on-year

	Transition weights no PMAs	H1 2023 weights no PMAs	H1 2023 weights full PMA
Central	40%	40%	40%
Upside	30%	10%	10%
Downside	25%	30%	30%
Severe	5%	20%	20%
Total provision	**£52.3m**	**£58.2m**	**£68.2m**
Coverage ratio	0.36%	0.40%	0.47%

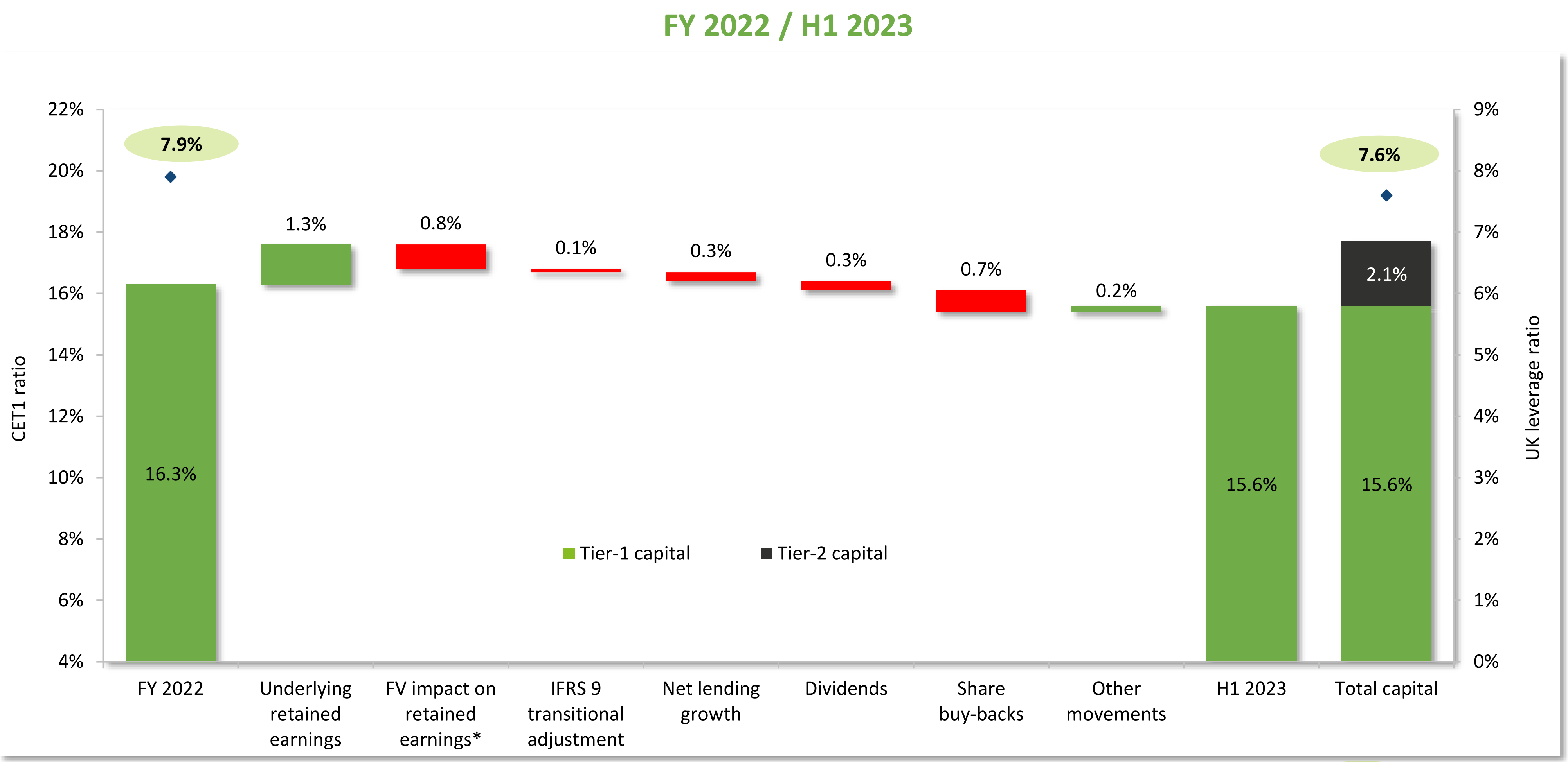
Impairment overlay

	FY 2020 (£m)	FY 2021 (£m)	FY 2022 (£m)	H1 2023 (£m)
Calculated provision	£62.0	£46.0	£48.5	£58.2
Judgmental overlay	£19.8	£19.4	£15.0	£10.0
Total	**£81.8**	**£65.4**	**£63.5**	**£68.2**
Coverage ratio	0.64%	0.49%	0.44%	0.47%
BTL portfolio LTV	65.8%	61.2%	57.9%	62.5%

Indexed credit behavioural scores by portfolio

	Mar-22	Mar-23
Buy-to-let		
New	100.0	100.5
Legacy	100.0	100.4
Second charge mortgages	100.0	99.8
Motor finance	100.0	101.4

Capital movements during the period



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

UK leverage ratio

Group capital

Capital position strong, share buy-back upsized

Capital ratios
- 15.6% CET1 represents a strong surplus over regulatory minimum
- Group has no AT1 in capital structure
- Tier 2 bond matures in 2026
- Buy-back programme extended to £100 million

IRB
- Fully validated responses to informal PRA feedback to be completed ahead of Summer
- Phase 3 ready for external review
- Roll-out plan to be reviewed once Basel 3.1 rules formalised

Basel 3.1
- Responded to Consultation Paper
- As drafted, the CP's impact would be 2.3% of CET1

Group consolidated capital	
Core Equity Tier-1 capital *	£1,170.4m
Tier-2 capital	£150.0m
Total capital resources	**£1,320.4m**
Credit risk	£6,776.8m
Operational risk	£633.1m
Market risk	-
Other	£70.0m
Total risk exposure	**£7,479.9m**
CET1 ratio *	15.6%
Total capital ratio (TCR) *	17.7%

Group consolidated leverage ratio	
Tier-1 equity *	£1,170.4m
Leverage exposure **	£15,322.1m
UK leverage ratio *	7.6%

* Including IFRS 9 transitional relief of £13.3m, adjusted for dividends and subject to verification

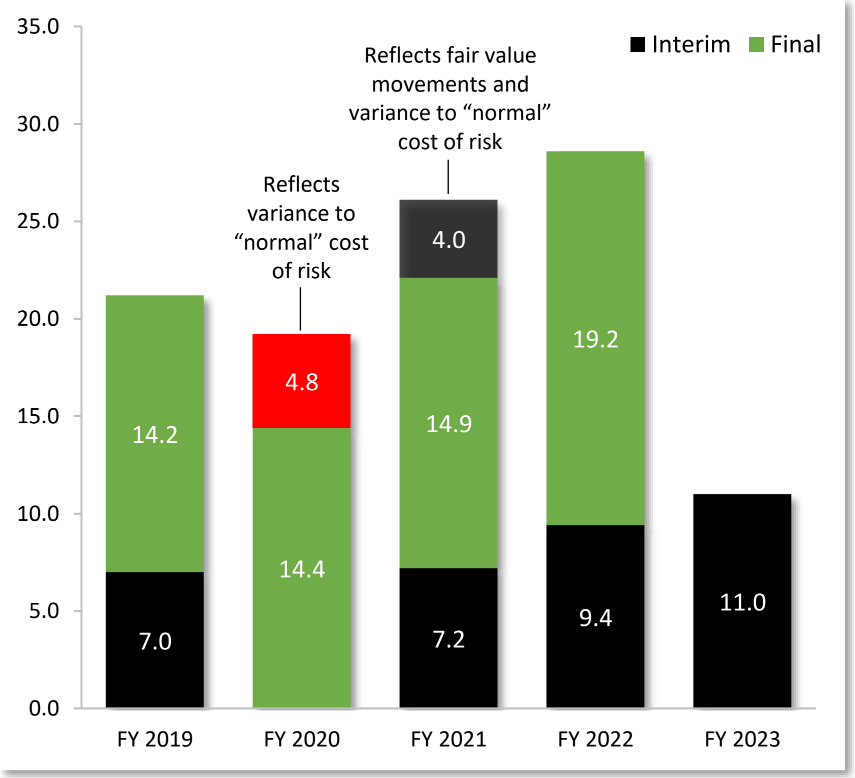
** Excludes qualifying central bank claims in accordance with rule modification applied to UK Leverage Ratio Framework

Dividend per share

Dividend per share up 17.0%

- Stronger than policy interim dividend designed to restore a more normal trend after Covid-related noise
- Policy would have resulted in dividend growth of 2.1% (50% of prior year final) compared to underlying operating profit growth of 22.2%
- Total dividend to remain around 2.5x covered by underlying earnings

Dividend per share (pence)



Business performance review and strategic priorities

Nigel S Terrington
Chief Executive

Strategic priorities

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

Strategic priorities

Growth

- 6.9% year-on-year growth in new lending
- 16.6% new lending CAGR since 2015

Diversification

- Commercial Lending 36.1% of Group's H1 2023 new lending
- Commercial Lending profit contribution £56.7 million (H1 2020: £13.7m)

Digitalisation

- Technology transformation accelerating
- 84% core and support systems Cloud-based
- Ongoing re-platforming roll-out programme

Capital management

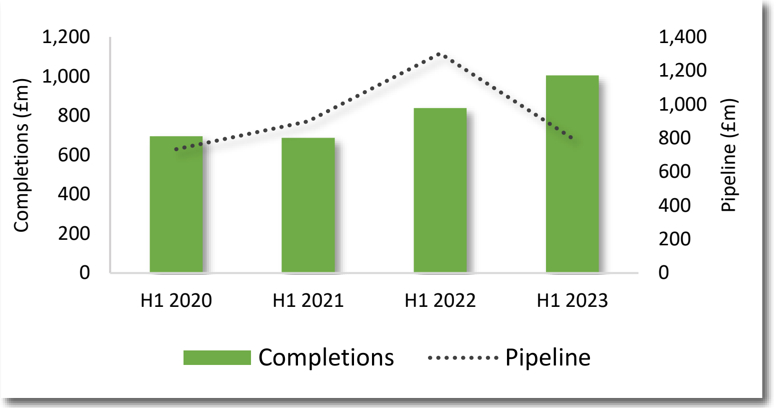
- Basel 3.1 and IRB create uncertainties, yet …
- H1 internal generation 1.3% supporting strong loan book growth … and
- Further buy-back programme. £383 million buy-backs since 2015

Sustainability

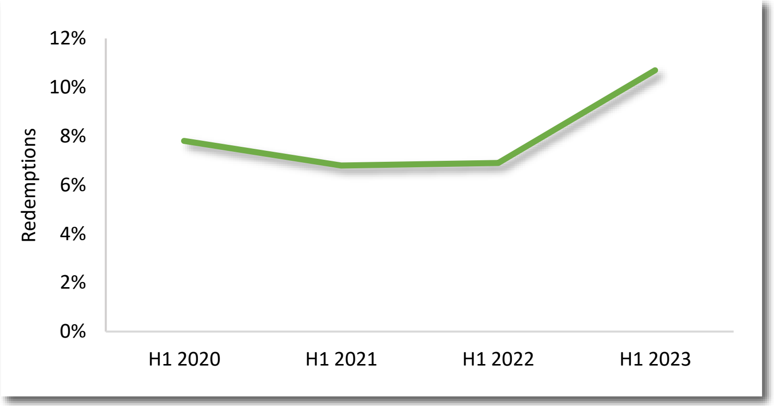
- Good progress towards operational net zero by 2030
- 39% improvement since 2019
- Expanding green product range

Continued focus on professional landlords driving loan book growth

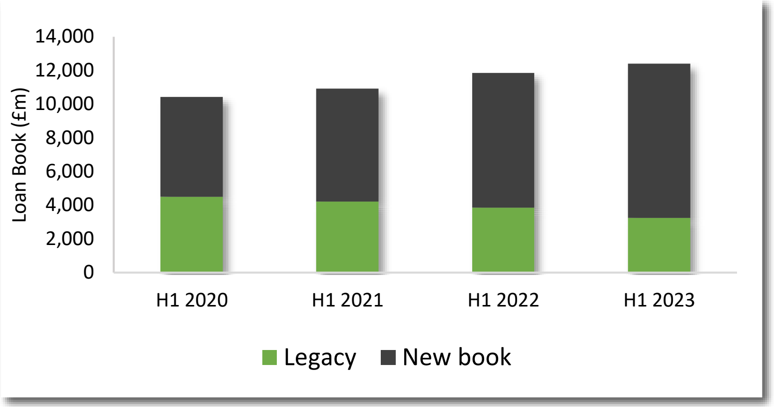
Specialist new business (£m)



Redemptions (% of book)



Net loan book (£m)



New lending

- Specialist lending completions 98.6% (H1 2022: 98.2%)
- £1,018.4 million advances (H1 2022: £854.6m +19.2%)
- Pipeline £810.9 million (down from £1,337.8m at H1 2022 -39.4%)
- Pipeline expanding, up another 10% since March

Redemptions

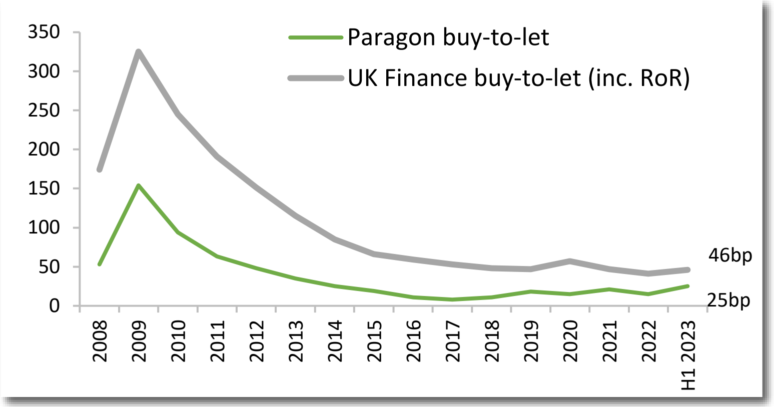
- Increase from H1 2022 (but below H2 2022)
- Skewed to legacy tracker book with annualised redemptions of 17.0%, new book largely professional remains low at 8.2%
- Maturing fixed rates 77% retained

Net loan book

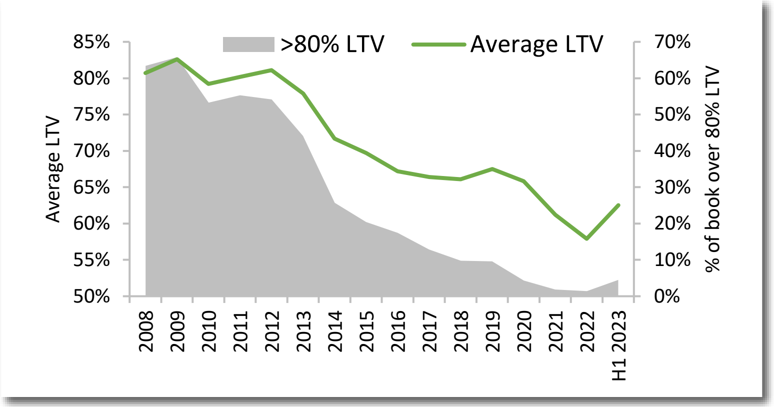
- £12.4 billion, up 4.6% on H1 2022
- New book at £9.1 billion, up 14.4%
- Legacy book now £3.2 billion (H1 2022: £3.6bn)

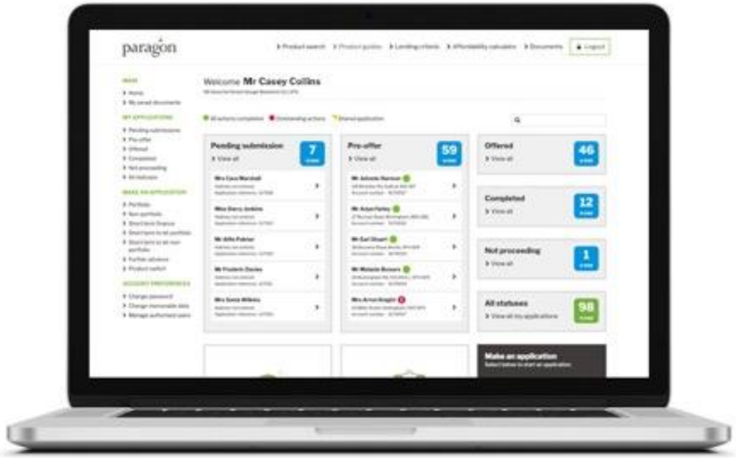
Proven resilience of business model through-the-cycle

Arrears rate 3mths+ (bp)



Average LTV





Through-the-cycle experience

- Arrears consistently outperform the market
- Experienced team with deep through-the-cycle knowledge
- In-house regional surveyors provide unique unrivalled property insight

Low risk

- Average LTV 62.5% (Sept-08: 80.7%)
- Portfolio LTV greater than 90%, 1.1% (Sept-08: 30.9%)
- Portfolio LTV greater than 80%, 4.5% (Sept-08: 63.4%)
- Strong affordability, ICR c200%

Technology and proprietary data analytics

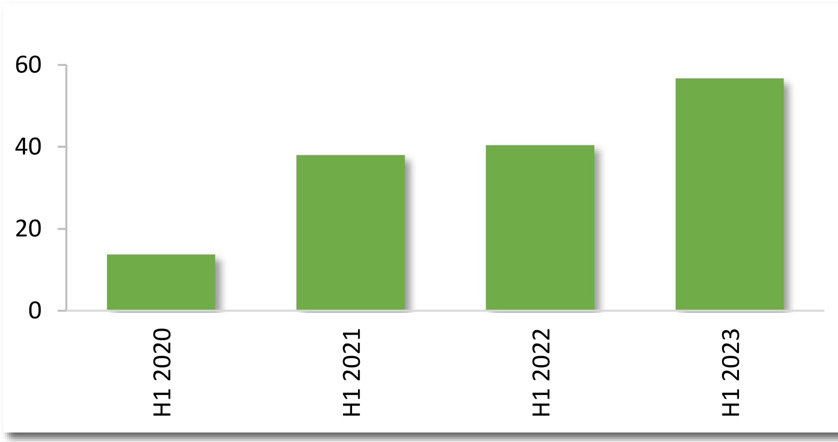
- Over 600 million data points per month
- Intermediary portal now widely employed
- New business cloud-based re-platforming in process
- 25+ years of data inform:
  - Underwriting
  - Pricing
  - Stress testing
  - IRB process

Commercial Lending provides increased diversification

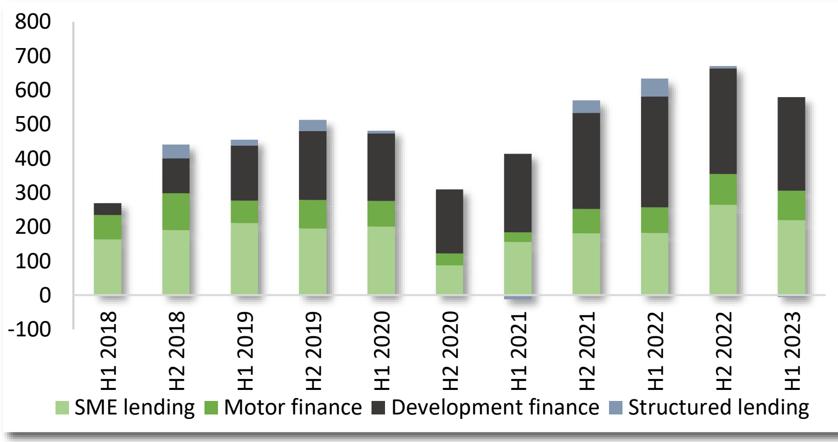
Robust growth in loan book

- 36% of Group's new lending
- H1 2023 profit contribution £56.7 million v £13.7 million in H1 2020
- 95% of the Commercial Lending book is secured
- No evidence of credit deterioration

Commercial Lending operating profit (£m)



Commercial Lending new business (£m)

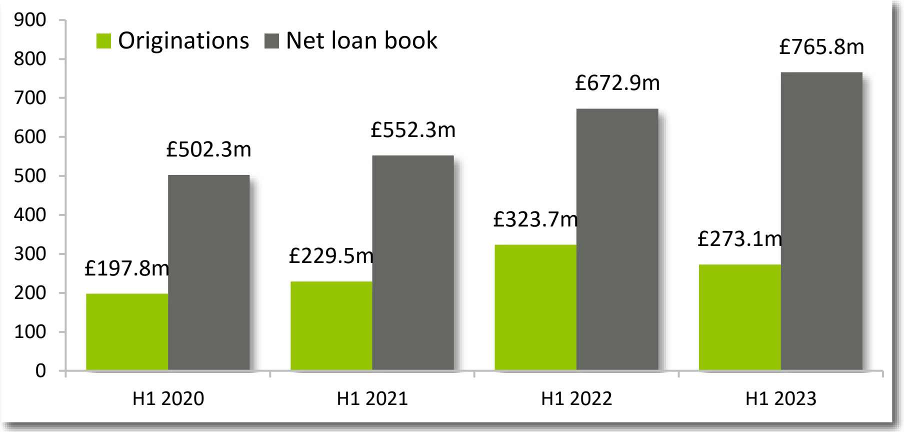


Commercial Lending – Development Finance

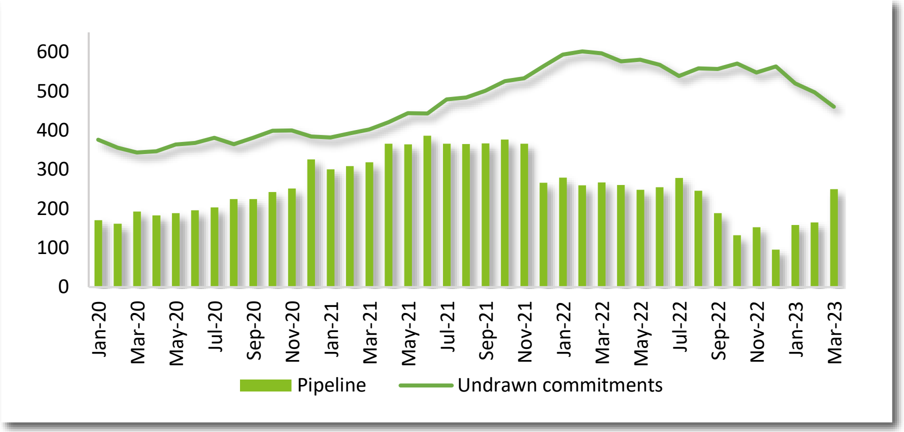
Proven track record across numerous cycles

- Volumes reduced to £273.1 million, as expected
- Loan book increased by 13.8% to £765.8 million
- Financing high-quality medium-sized developers
- End-to-end technology platform now fully installed
- Undrawn pipeline slowed, reflecting market conditions
- New business flows increasing since year-end
- Resilient credit performance

Originations and loan book growth (£m)



Development finance pipeline (£m)



Commercial Lending – SME Lending

New technology driving strong growth

Originations and loan book growth (£m)

- Volumes +21% to £220.0 million
- Loan book +15% to £735.3 million
- Over 72% of new business flows via new portal
- Further technology delivery in H2 2023
- Strong credit performance

Market share – asset finance

	Market (£bn)	Group (£bn)	Group (%)
H1 2018	£15.4bn	£0.16bn	1.0%
H1 2019	£16.9bn	£0.21bn	1.2%
H1 2020	£15.6bn	£0.20bn	1.3%
H1 2021	£14.8bn	£0.16bn	1.1%
H1 2022	£15.5bn	£0.18bn	1.2%
H1 2023	£17.9bn	£0.22bn	1.2%

Source: FLA/Paragon

Commercial Lending – Motor and Structured Lending

Strong growth with good momentum providing further diversification

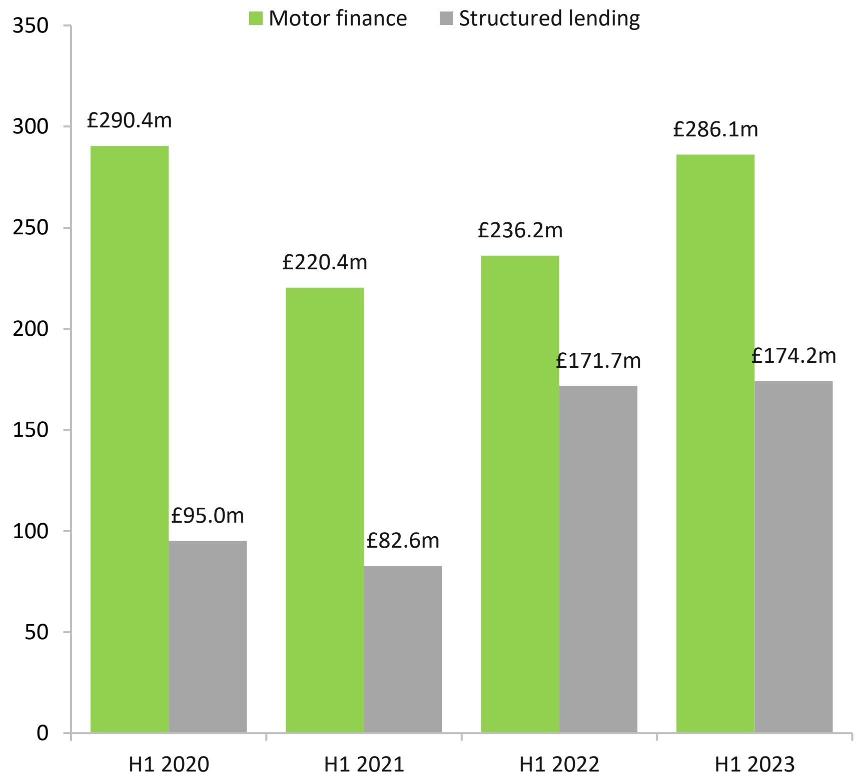
Motor Finance

- Volumes +13.9% to £86.2 million
- Loan book +21.1% to £286.1 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 £10.0 million
- Loan book +1.5% to £174.2 million
- Pipeline strong
- 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

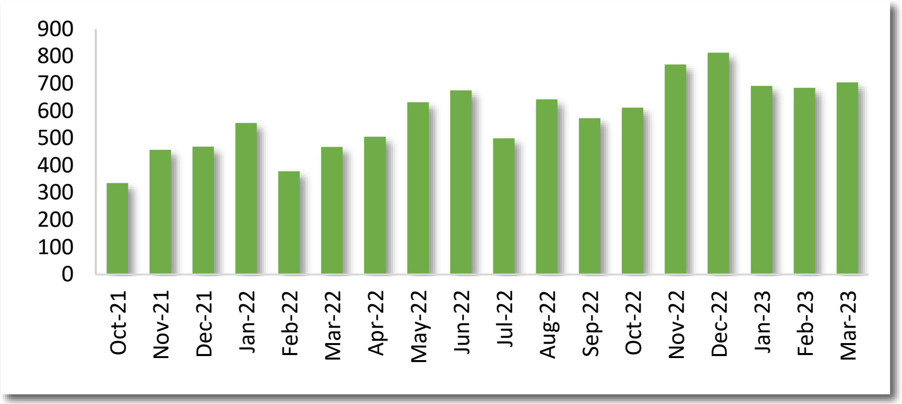
Adapting to higher rate environment

- Continued strong growth in deposit book – £11.9 billion, +20.5%
- Higher rates have changed customer behaviour
- £1.7 billion flow into fixed term
- Funding costs now sub-SONIA
- Further growth in term flows expected going forward

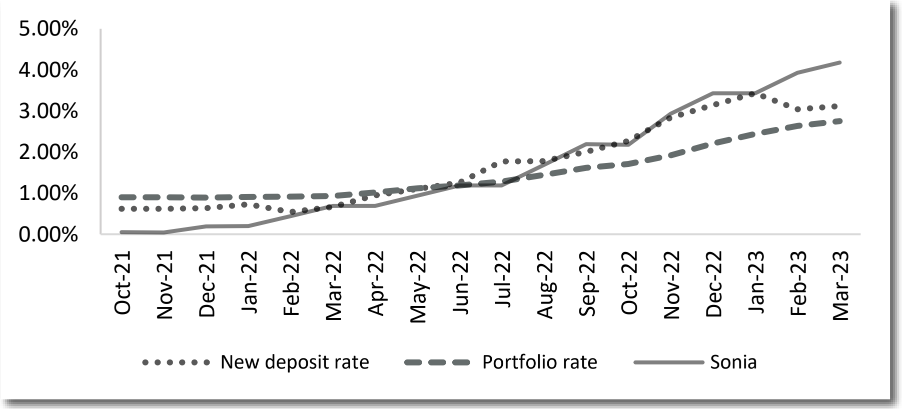
Wholesale

- Fitch rating re-confirmed at BBB+
- RMBS pricing improving

New deposits (£m)



Deposit rate vs SONIA



Conclusions

Strong H1 performance and upgraded FY guidance

FY:23 guidance update

Volumes:

- Buy-to-let upgraded £1.75 – £1.9 billion (30-Sept: £1.6-£1.9bn)
- Commercial Lending £1.1 – £1.3 billion (re-confirmed)

NIM c300 basis points
(30-Sept: c290 bps)

Operating costs £170 million area

>15% RoTE target

Share buy-back programme increased to £100 million

2023 trading performance

- Strong financial performance
- Loan book growth and NIM widening
- Resilient credit performance
- Tight cost control
- Share buy-back increased to £100 million

Outlook

- Strong capital ratios and internal capital generation
- High quality loan book with robust provisioning
- Good momentum with specialist markets set to outperform
- Upgraded guidance
- Significant technology developments delivered – further progress expected
- Well positioned for the environment

Appendix

Strategic priorities – digitalisation

Paragon is on a multi-year journey of investing in digital platforms for our customers

Our digitalisation journey is designed to:

- Complement our deep underwriting expertise with faster decision-making processes
- Enhanced servicing capabilities by empowering customers to access what they need and when they need it
- Improve efficiency, resiliency and security of our product offerings
- Provide a multi-channel approach recognising intermediaries as our key partners in many of our businesses
- Delivering versatile and flexible platforms which are modular, cloud-based and API enabled

Delivered as part of digitalisation

- Savings platform which is API enabled, scalable and providing products to nine third parties
- Mortgage portal empowering customers to product switch
- SME lending portal providing a wide array of products which are continually updated
- Development finance end-to-end platform enabling complex transactions to be completed seamlessly
- Support systems including new finance cloud-based ledger, surveyor platform and Infrastructure capabilities

Digitalisation future pipeline

- Revamped mortgage customer servicing portal making it easier for buy-to-let landlords to review their portfolio
- Enhancements to SME lending portal to increase speed of approval of decisions
- 84% of core and support platforms are already cloud-based, remaining applications in progress
- Further mortgage transformation work underway based on customer feedback

Strategic priorities – sustainability

Commitment to achieve net zero by 2050 – subject to Government policy and industry

Set target to be operationally net zero by 2030

Bankers for NetZero

MISSION ZERO COALITION

TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

PCAF Partnership for Carbon Accounting Financials

FTSE4Good

SUSTAINABLE BOND MARKET LONDON STOCK EXCHANGE

Progress in H1

- Sustainable product development continues:
  - In Development Finance, funding for Green Homes initiative expanded
  - In Motor Finance, further extended credit policy to include electric light commercial vehicles
- Engagement with our larger BTL customers on their plans for proposed EPC requirements
- Good progress towards operational net zero by 2030
- 35% improvement of operational footprint since 2019
- Annual climate change scenario exercise set for Board approval in July 2023

Business in the Community – The Prince's Responsible Business Network – Race at Work Charter signatory

Mindful Employer

disability confident COMMITTED

Living Wage Employer

30% Club GROWTH THROUGH DIVERSITY

Women in Finance Charter

INVESTORS IN PEOPLE | Platinum

ESG ratings

We are most actively engaging with the following ESG rating agencies:

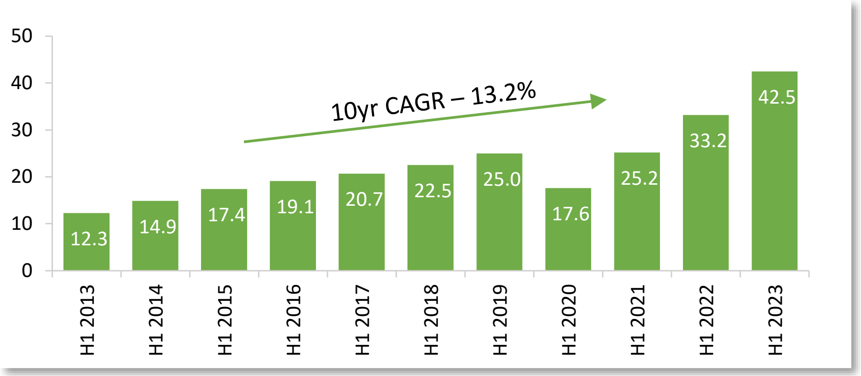
	Rating scale	Our rating
CDP	A-F	C
ISS	A+ - D-	C
MSCI	AAA-CCC	AA
S&P Global	0-100	40/100
SUSTAINALYTICS	0-100	17.4/100

Underlying return on tangible equity

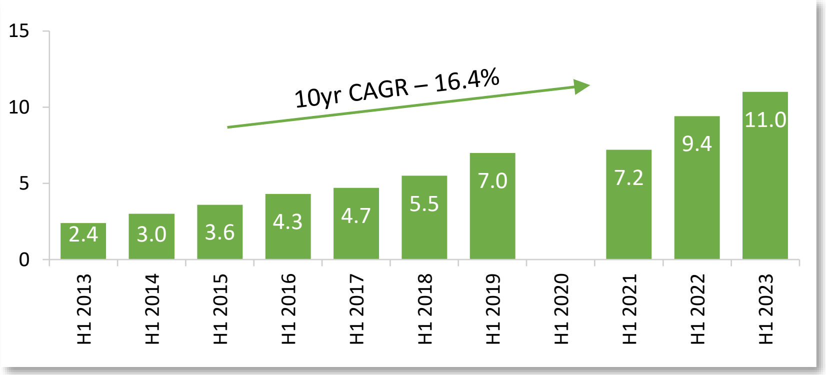
Strong growth in key ratios

- Longer term trends restored after Covid-period interruption

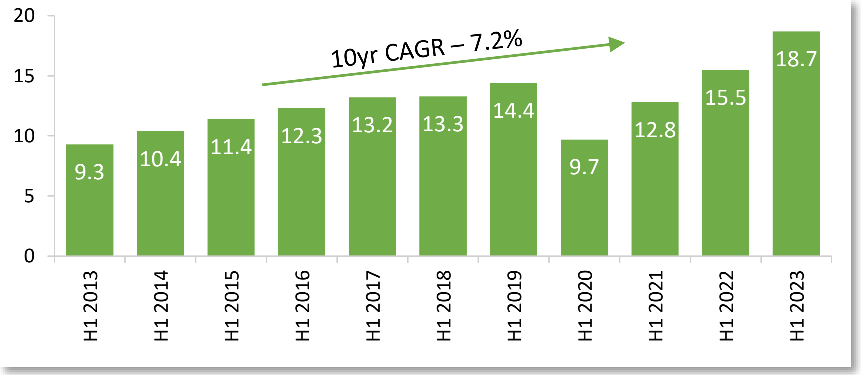
Underlying earnings per share (pence)



Dividend per share (pence)



Underlying return on tangible equity (%)

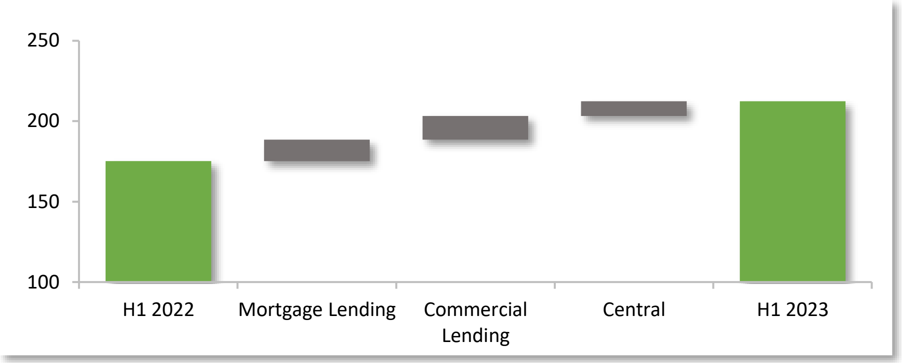


Net interest income

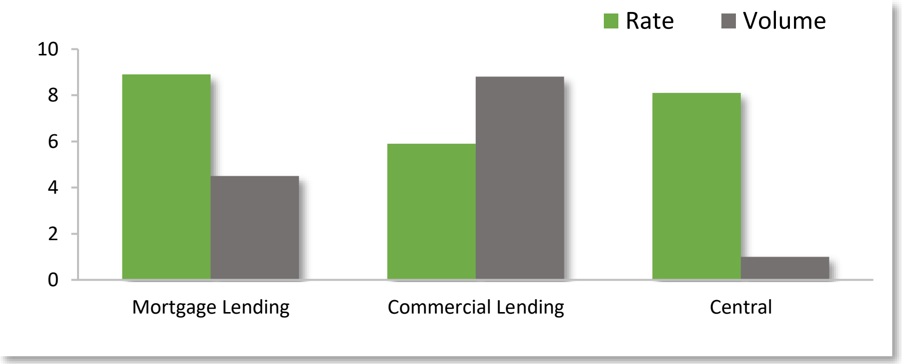
Wider margins and higher volumes driving net interest growth

- NII growth higher in all divisions
- Rate and volume effects remain positive

Net interest income (£m)



Rate and volume influences (£m)

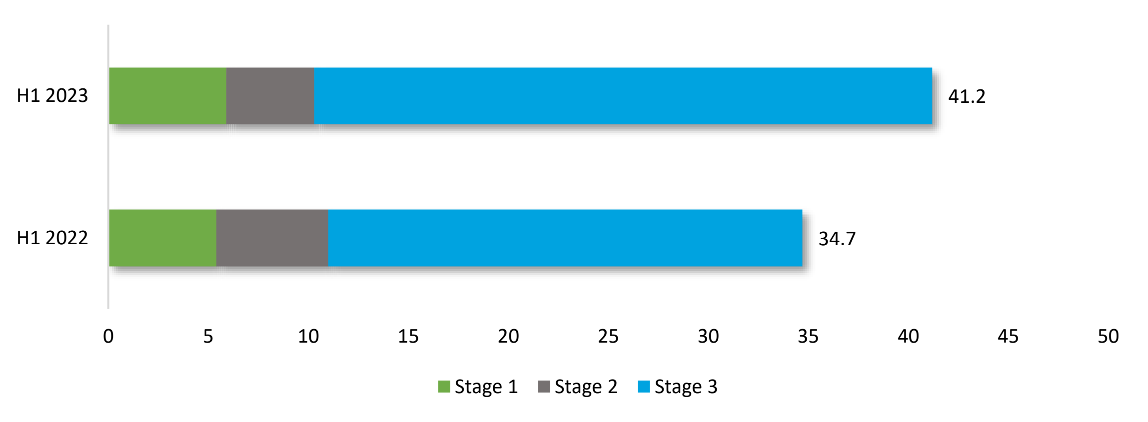


Provisions by stage and segment

IFRS 9 impairments	Mortgage Lending	Commercial Lending	Total
Stage 1	11,779.6	1,828.7	13,608.3
Stage 2	701.8	130.1	831.9
Stage 3	134.5	23.0	157.5
POCI	18.6	6.8	25.4
Gross loan book	**12,634.5**	**1,988.6**	**14,623.1**
Stage 1	5.9	15.7	21.6
Stage 2	4.4	2.6	7.0
Stage 3	30.9	3.9	34.8
POCI	0.0	4.8	4.8
Impairment provisions	**41.2**	**27.0**	**68.2**
Stage 1	0.05%	0.86%	0.16%
Stage 2	0.63%	2.00%	0.84%
Stage 3	22.97%	16.96%	22.10%
POCI	0.00%	70.59%	18.90%
Coverage ratio H1 2023	**0.33%**	**1.36%**	**0.47%**
Coverage ratio H1 2022	**0.28%**	**1.18%**	**0.40%**

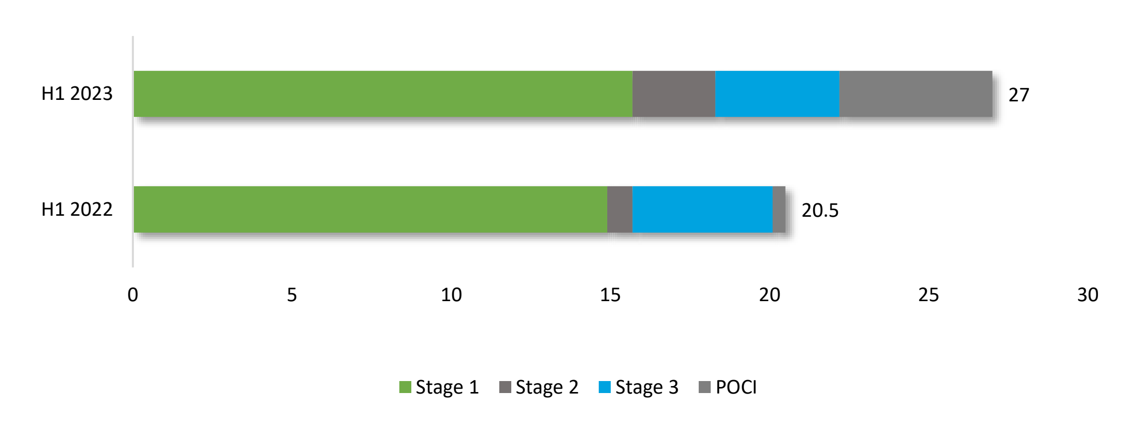
Impairments

IFRS 9 provisions (£m) – Mortgage Lending



- Overlays stand at £10.0 million
- MES impacts most material on Stage 3 assets, in particular house price assumptions

IFRS 9 provisions (£m) – Commercial Lending



Portfolio impairment movements

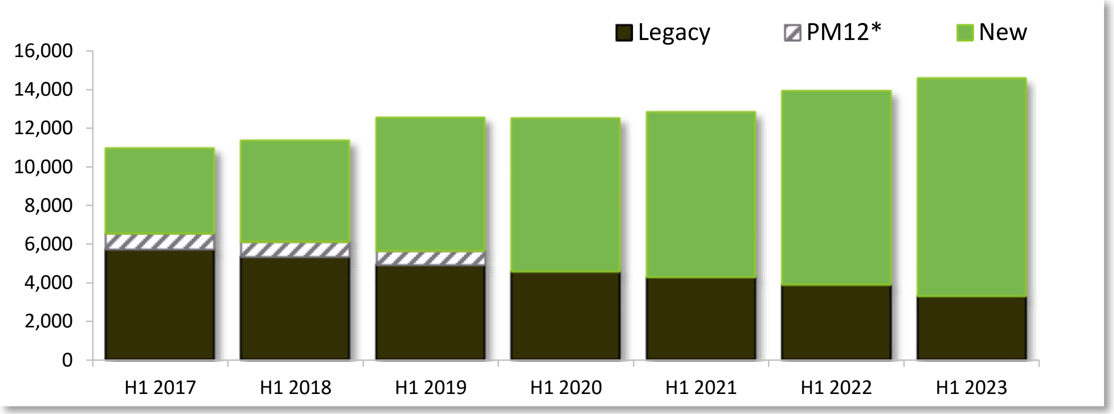
Impairments £million	Brought forward	P&L charge	W-off / Other	Carried forward
H1 2021	81.8	6.7	-6.1	82.4
H1 2022	65.4	2.4	-12.6	55.2
H1 2023	63.5	8.7	-4.0	68.2

Diversification

Diversified loan growth

Originations £million	H1 2023	H1 2022	Change
Specialist BTL	1,004.5	838.8	+19.8%
Other mortgages	13.9	16.5	(15.8%)
Commercial Lending	574.4	634.2	(9.4%)
Total	**1,592.8**	**1,489.5**	**+6.9%**

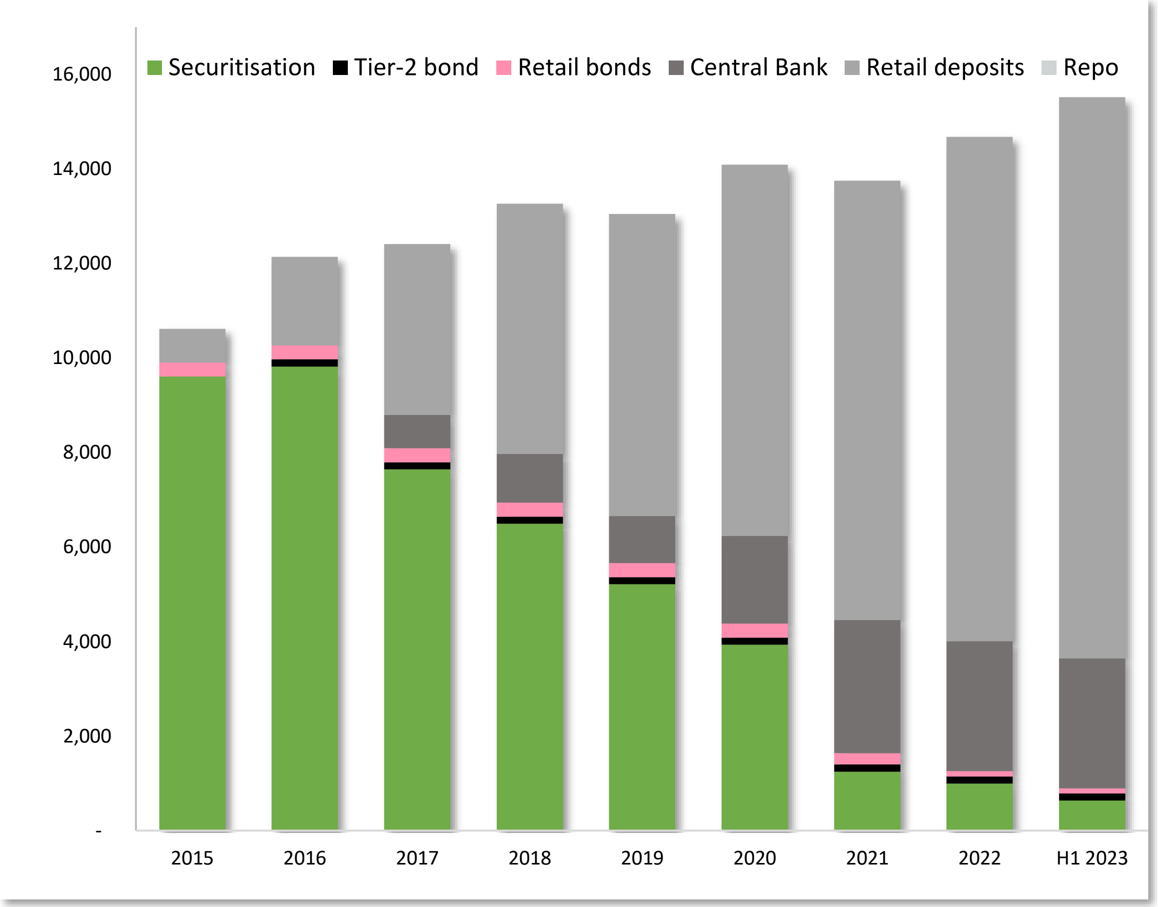
Total – loans and advances to customers (£m)



* Assets now off-balance sheet under management

Diversified funding

Funding by type (£m)

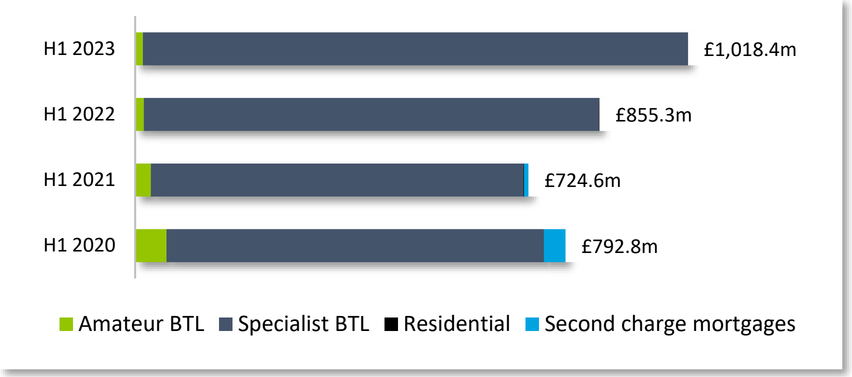


Mortgage Lending

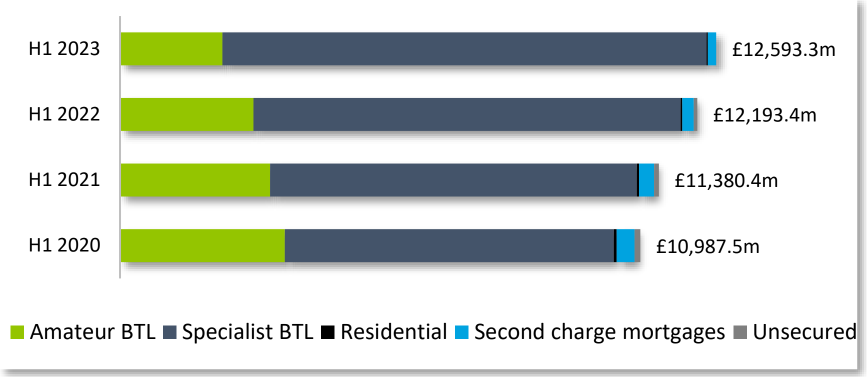
Non-BTL portfolios in run-off

BTL progress driving volume, margin and profit growth

Originations



Loans and advances



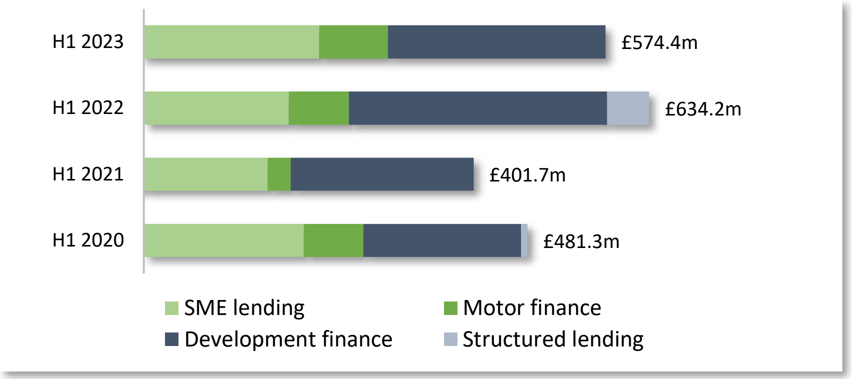
Net interest margin

Underlying profit contribution

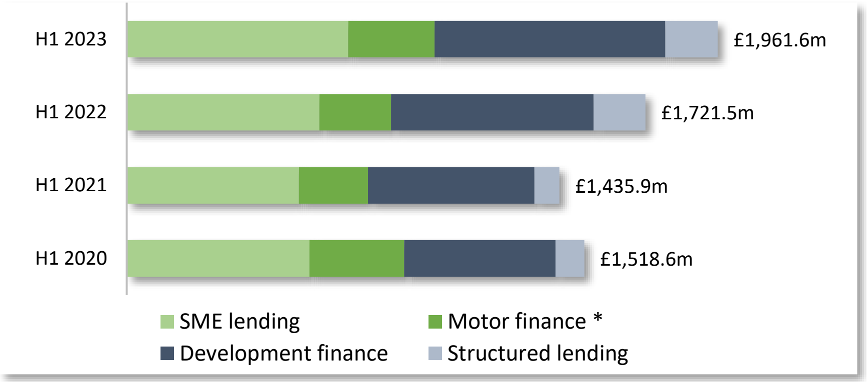
Commercial Lending

Trend profit, book and NIM growth despite small reduction in new business flow

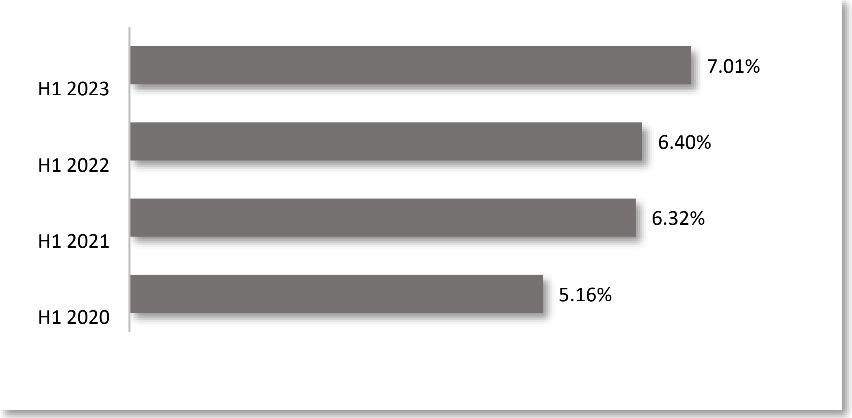
Originations



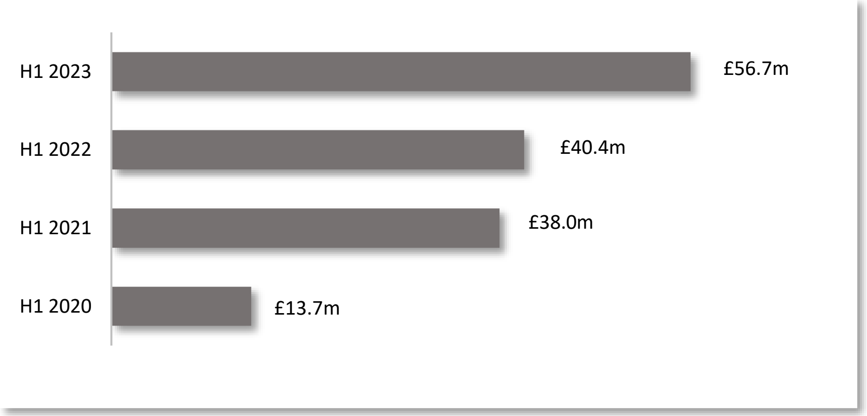
Loans and advances



Net interest margin



Underlying profit contribution



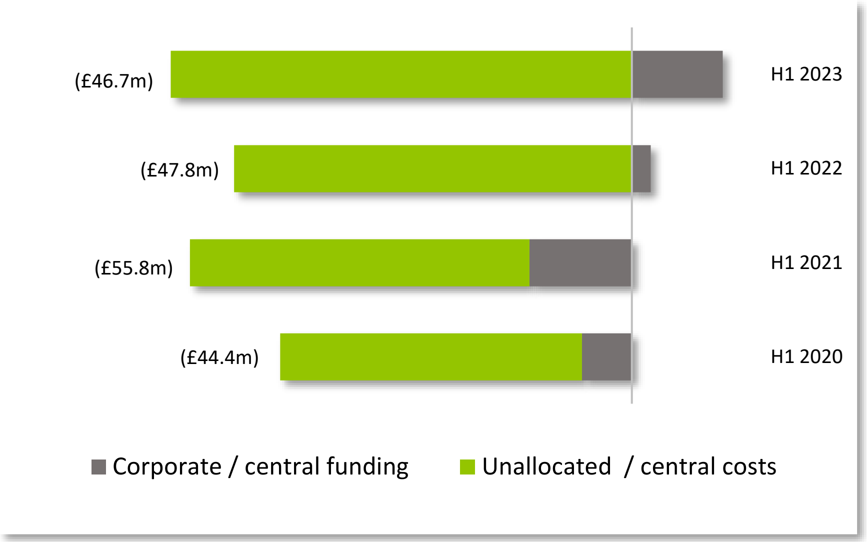
* Motor finance includes the Olympus portfolio

Central

Cost growth more than offset by favourable central funding benefits

- Growth in Op-Ex reflects inflation and digitalisation progress
- Rate environment strongly positive for central segment, which bears the costs / benefits of surplus liquidity

Underlying profit / (loss) contribution



Balance sheet

£million	H1 2023	H1 2022	Change (%)
Mortgage Lending	12,593.3	12193.4	+3.3%
Commercial Lending	1961.6	1721.5	+13.9%
Loans and advances to customers	**14,554.9**	**13,914.9**	**+4.6%**
Cash	2,275.4	1,500.4	+51.7%
Other assets	490.1	335.7	+46.0%
Total assets	**17,320.4**	**15,751.0**	**+10.0%**
Capital and reserves	1,360.4	1,279.7	+6.3%
Retail deposits	11,875.9	9,853.7	+20.5%
Tier-2 bond	149.3	149.1	+0.1%
Retail bonds	112.3	112.2	+0.1%
Securitisation funding	631.6	1,348.4	(53.2%)
Central bank facilities	2,750.0	2,850.0	(3.5%)
Other liabilities	440.9	157.9	+179.2%
Total liabilities and equity	**17,320.4**	**15,751.0**	**+10.0%**

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