

Paragon Banking Group – 2024 Half year results

Nigel Terrington, Paragon

Slide 1

A very good morning and welcome to Paragon's 2024 interim results presentation ... covering the first six months of our financial year.

Slide 2: Agenda

We will, as normal, run through the financial and operational performance in detail and provide you with our view on the outlook as well, of course, leaving plenty of time for your questions. But before we get into the detail, let me spend a few minutes looking at the key highlights.

Slide 3: Strong operational and financial performance

The first six months of this year have again shown another strong financial and operational performance. As you can imagine we are delighted with these results reflecting the growing specialist franchise of the Group, the resilient nature of our business and the continued strong progress in our purpose driven strategy of supporting our customers in achieving their ambitions.

All our key metrics are either in line with or above our expectations and, in many areas, we now expect to deliver full year outturns at the top end of the ranges or above the guidance provided at the 2023 year end.

Underlying operating profits for the first six months increased by over 13% to £146.3 million, which delivered a Return on Tangible Equity of 20.8%. There have clearly been some benefits arising from the transition to a higher rate environment - some of which are temporary, but some are permanent - and our guidance of achieving a Return on Tangible Equity towards the top end of the 15-20% range for 2024 is reconfirmed.

Earnings per share increased by over 17%, benefitting from our share buy-back programme.

Strong internal capital generation is a genuine strength of our business - 140 basis points in the first six months - as are our capital ratios, supporting our growth ambitions and the further buy-back of up to £50 million announced today, on top of the £50 million completed in the first half of the financial year.

The loan book growth was expected to be relatively dull this year due to the disruption in markets seen in 2023. However, we are running comfortably above our expectations set at the beginning of the year and, with pipelines rebuilding, we now expect this will give a healthy flow of new business in the second half.

Indeed, pipelines for both Buy-to-Let and Development Finance have recovered well from their September 2023 position. Buy-to-Let is up 47% and Development Finance 21%. And, with strong customer retention levels continuing, we are confident the loan book growth will be stronger than we had originally expected.

The deposit book has seen outstanding growth year-on-year, strengthening our franchise in this space and enabling us to accelerate the repayment profile of our TFSME borrowings which have now reduced to £1.45 billion currently from the £2.75 billion in September. Effectively, nearly half repaid in eight months.

NIM has expanded strongly in recent years to over 3% on the back of the rise in interest rates and the structural shift in income driven by our diversification strategy. We had expected NIM to plateau in 2024 which was reflected in the year end guidance. However, to date we are outperforming, with NIM for H1 at 319 basis points. And, we now expect to come in above our previous guidance range for the year as a whole.

In terms of operating costs, despite our ongoing technology transformation programme and the new Bank of England levy, we still expect to deliver in line with our cost guidance and maintain our excellent cost:income ratio.

The credit performance was again excellent and, notwithstanding the environment, we only required a charge of 14 basis points for the year. And, we have still maintained a prudently positioned balance sheet provision of 51 basis points at the end of March.

It is clear that 2024's first half performance is strong but this is not a one-year-wonder. It is a reflection of the disciplined strategic focus and the progress achieved over the 10 years since the bank's formation in 2014.

Slide 4: The 10-year view – consistent strategic delivery

As you can see from these charts, we have delivered great progress, with a consistent track record over the last decade.

Operating profits have increased by 153% and, with strong capital generation including today's announcement, we have returned over £1 billion to our shareholders through a combination of dividends and buy-backs. Loan growth has been managed carefully and the structural changes, due to our diversification strategy and interest rate normalisation, have moved margins from 2% to 3%.

Our commitment to a high-quality customer base has resulted in an average impairment charge of 10 basis points across the decade, notwithstanding Brexit, COVID, interest rates climbing from 10 basis points to 525 basis points, together with the tough inflationary environment of the last few years.

The 10-year image of strong, consistent growth and a robust financial and operational performance is clearly evident from these slides as is the consequence of the long-term commitment to running our business prudently, with an unswerving focus on specialist markets, seeking to optimise good risk adjusted returns, backed by a high quality loan book, through-the-cycle experience ... and a deep understanding of the markets in which we operate and the customers we serve.

I will now hand over to Richard to look at the period's performance in detail.

Richard Woodman, Paragon

Slide 5: Financial overview

Thank you, Nigel.

Slide 6: Income statement

I'll start with our income statement. You will see that total income for H1 was up 12% on H1 last year, pre-provision profits were up 14.8% and operating profits were 13.5% higher.

Our fair value amortisation was lower year-on-year, resulting in statutory profits being 138.4% higher than in H1 23.

Underlying earnings (which excludes fair values) rose 17.4% to 49.9 pence per share – the growth in earnings exceeding underlying profit growth because of the impacts of our share buy-backs.

Slide 7: Segmental results

When looking at the results segmentally we see a slightly more uneven picture, with continued strong earnings performance in Mortgages and further gains on excess liquidity in the central area. However, we did see a small decline in earnings from our Commercial segment in the six months. This latter point largely reflects lower asset-side margins in the higher interest rate environment, which I will touch on shortly.

Slide 8: Net interest margin

Following the extremely strong margin performance in the second half of last year, we were anticipating a bigger reduction in H1 24 than we have actually seen, with base rates stabilising and with the rate increases in the quarter to September driving higher deposit rates as the deposit beta developed.

Instead, we have seen a stronger performance than we expected, albeit the spread for the period was still 2 basis points below the peak we saw in the second half of last year.

We have now completed the £1.2 billion net free reserve hedge that I flagged at the year-end. This hedge carries an average term of 4 years and is effectively delivered by not hedging a portion of the buy-to-let book that is equivalent in size to our tangible net assets.

Buy-to-let asset-side spreads have continued to be strong, but as I mentioned on the summary, spreads in our commercial business have been tighter at higher rates. We have also found that our development finance facilities have been taking longer to reach practical completion – so “in and out” fees are being spread over a longer period, effectively lowering the net yield.

Aggregate deposit pricing relative to benchmarks, that is, after any hedging costs on our fixed rate bonds and ISAs, has been better than anticipated, and my next slide gives a little more colour on the key movements since the last year end.

Slide 9: Deposit spreads

When compared to the spot position at September 2023, the funding spread to benchmark has reduced for both fixed rate bonds and variable rate deposits, the former after reflecting the hedging costs associated with those bonds. Fixed rate spreads have tightened by 11 basis points and variable rates by 51 basis points as the deposit beta has developed.

However, after a very strong skew to fixed rate savings during 2023, the first half of 24 has seen our deposit mix move back to a more variable rate focus. Overall, the spot deposit spread to Sonia has narrowed from an annualised 63 basis points in September to 45 basis points at the end of March.

Slide 10: Operating expenses

Moving on to costs. In aggregate these remain in line with expectations, even after absorbing £1.7 million pounds of Bank of England levy costs following the change in approach made in the period.

Our change programme continues apace, with an upgraded buy-to-let broker portal about to go live and other programmes at different levels of development.

This digitalisation progress will be an important element in maintaining our tight focus on cost efficiency, evidenced by the 36.5% cost to income ratio reported for the half year. As noted on the slide, we are maintaining our cost guidance for the year at below £180 million, and this includes the Levy.

Slide 11: Economic outlook

We continue to position ourselves at the conservative end of macro estimates for the scenarios that drive our impairment calculations.

Additionally, we have maintained the same scenario mix, with 50% on the downside and 10% up. The base scenario carries a 40% weighting.

It is worth noting that our base case for interest rates is that the rate cutting cycle starts in later in the summer with rates trending down to 3.5% during our financial year 2026.

Slide 12: Impairments

The multiple economic scenarios summarised on the previous page drive both the probability of defaults and the loss on those projected defaults, together with the expected losses on currently defaulted loans.

With a largely secured balance sheet, the different scenario weightings have a less pronounced effect on our impairment postings than they would for a lender with more unsecured exposures.

The main movement in the period relates to the higher level of arrears and accounts in receivership in the legacy, variable rate buy-to-let portfolio. The old book now represents just 22% of our total buy-to-let loans.

The combination of the provisions on these accounts and the economic modelling resulted in H1 impairments being £2.8 million above those calculated for H1 23.

Slide 13: Capital movements

Underlying capital generation for the first half remained strong, and equated to 1.4% of CET1.

Fair value movements and the near-final IFRS9 transitional adjustment-unwind utilised 0.4% of this, loan book growth used 0.6%, dividends 0.4% and the H1 buyback a further 0.7%.

The period end CET1 was 14.7%, and our £150 million Tier 2 bond takes our total capital ratio to 16.6%. We still have no AT1s in our capital stack.

Slide 14: Group capital

Our capital position remains materially above our regulatory requirement, which supports both future growth and capital management.

While our IRB process with the PRA remains ongoing and with the final Basel 3.1 rules yet to be finalised, we face quite a fan-chart of potential capital outcomes going forward, depending on the final calibration and timing of the various approaches. To be prudent, our capital planning currently assumes that Basel 3.1, as detailed in last year's CP, will be binding from July 2025.

Within this however, the dynamics of our portfolio – both by asset class and through the mix effects within buy-to-let, have seen the potentially adverse impact from Basel 3.1 reduce to 2.1% of CET1 compared to the 2.3% I reported last summer.

Slide 15: Capital management

Our strong preference is to invest our surplus capital in growth (both organic and inorganic), but we have been running a strategy that incorporates both growth and capital management since 2015, with our share buy-back reducing the share count by around a third since that date.

Having completed the £50 million buy-back initially earmarked for FY24, we have announced that we expect to buy-back up to an additional £50 million pounds worth of shares in the second half of this year.

Thank you.

Nigel Terrington, Paragon

Slide 16: Business performance review and strategic priorities

Thank you, Richard.

Let me turn our attention to how the business has progressed against our key strategic priorities and provide you with our view on the outlook for the period ahead.

Slide 17: Strategic pillars

We have shared with you previously how we focus on these five priorities and how they are interconnected and supported by our structural pillars of:

- Our strong customer-focused culture
- Our passionate and committed people who hold such incredible values
- And our strong financial foundations with a high-quality customer base, strong capital and significant liquidity

Turning now to how we have performed against these individual strategic priorities.

Slide 18: Strategic priorities delivery

As expected, new lending volumes were tempered this year due to the disruption in 2023 whilst prioritising margin and risk over growth. However, we outperformed the market and delivered a loan book growth of 4.8% and a strong recovery in pipelines. We are definitely seeing more confidence beginning to emerge from our customers and business partners, particularly in the Buy-to-Let and Development Finance divisions. These products typically have long lead times so the growing pipelines bode well for H2 growth prospects and beyond.

Furthermore, long term we see more resilience in the specialist markets and believe they will continue to outperform the mainstream markets in the years to come.

Our diversification strategy is an important ingredient in exploiting operational leverage and broadening the sources of income. Banking has a high fixed cost operating model which has risen over the years as regulation has increased. Consequently, broadening and growing the revenue base is important. Commercial Lending now represents 48% of new lending and its profit contribution is approaching £51 million, up from £14 million in 2020.

Our technology transformation programme has accelerated this year. We now have over 90% of our core and support systems based in the Cloud and we are systematically transforming our customer-facing platforms across every part of the Group, enhancing our customer experience and further improving cost efficiencies and operating leverage. We are increasingly turning our focus to API connectivity, utilising multiple data sources, building partnerships and continuing the next level of our vision to be a technology-enabled specialist bank.

2024 will see the delivery of a number of new exciting platform changes, including a re-platforming of our mortgage origination system which will continue to strengthen our market position and better support our customers. This will make it quicker and simpler for our customers to progress from application to offer, streamlining the process and ensuring an improved customer experience. We continue to run a number of Generative AI pilots across areas of the Group and there are parts of the business where Machine Learning AI is already actively used and well established. Whilst we are still in the early stages, the opportunities to utilise this technology in the future look exciting.

Internal capital generation has continued to be strong in the first six months where the Group delivered a 1.4% accretion to CET1. This is a powerful and sustainable strength of the Group and provides the ability to both support growth and enhance returns to shareholders. With today's announcement we will, once complete, have returned a total of £533 million via buy-backs since 2015 whilst also delivering £493 million by way of dividends ... and as I mentioned earlier ... including today's announcement, this brings a total of in excess of £1 billion returned to shareholders.

Finally, we remain committed to doing the right thing as part of sustainability strategy and we're on course to achieve operational Net Zero by 2030. Since 2019 we have improved our operational emissions, reducing them by 42%.

Our financed emissions, however, are based on our customers' assets and therefore much harder to reduce, particularly given the change in the government's stance last year. This is an industry-wide challenge and will require Government policy to help deliver the changes needed. However, we continue to take steps to help our customers and EPC's rated A to C is a growing share of the mortgage book.

In our development finance business, we are seeing a positive response to our Green Homes Initiative, and to this end, we recently increased it from £200 million to £300 million.

This scheme incentivises developers to build EPC A-rated properties through reduced funding costs. We have been pleased with the take up of the scheme, with a number of developments now complete and homeowners enjoying their energy-efficient properties.

The General Election may see a revised government strategy but, whatever happens, we will continue to provide, develop and extend our products to support our customer's own sustainability objectives.

Let's now turn to the performances of each of the business lines – starting with Buy-to-Let.

Slide 19: Mortgages – continued focus on professional landlords driving loan book growth

2023 witnessed a weak housing market with activity off 29% to levels last seen around the time of the Financial Crisis. The Buy-to-Let market was not immune with mortgage lending across the sector reducing by 49% year-on-year which, given lead times, has affected H1 volumes, leaving new business levels lower than the equivalent period last year.

However, after 2 years of negative sentiment, H1 has witnessed a more optimistic outlook, particularly for professional landlords who themselves are taking an increasing share of this market. This is reflected in our own customer research, with 37% of portfolio landlords telling us that they plan to increase the size of their portfolios during 2024. Our Buy-to-Let pipeline has increased by 47% to £874 million since the year end and has strengthened further since 31st March.

We have continued to see strong levels of customer retention, with over 80% of our customers with maturing fixed rate mortgages going on to take a new product with us, enabling the buy-to-let loan book to grow by 4.5% with our post financial crisis book largely focused on professional landlords growing by over 10%.

This result wasn't an accident. We re-engineered a Customer Retention proposition two years ago, introduced a comprehensive customer communication programme and extended increased flexibility to allow our customers to plan their funding needs well ahead of time.

There is clear evidence that amateur landlords, which are more likely to be focused in our legacy book, have been exiting the market whereas professionals have been looking to invest and benefit from the excess of rental demand over supply.

Indeed over 40% of our new business flow is typically from a house purchase rather than a remortgage and we see our landlord customers generating healthy rental yields, particularly in the specialist property segments, where we are market leaders, benefiting from the expertise that our unique in-house property valuation team provide.

Population forecasts and demographic trends, such as the increase in single-person households, immigration and the inadequate supply of alternative social housing, will continue to create a high and sustained demand for rental property. Our role here is to support landlords to provide homes for those who want or need a home to rent.

There is therefore a clear bifurcation in customer behaviour that can be seen in the customer retention chart in the middle of this slide ... where we have seen strong growth in the so-called new book, up over 10% whereas the legacy portfolio has contracted by nearly 12% year-on-year to £2.9 billion.

We have an award-winning strong franchise in Buy-to-Let and continue to invest to strengthen this further. We have been working on a new proposition, a cloud-based digital platform to support our new business activities which we expect to go live in H2 and which we expect will deliver considerable benefits to our intermediary business partners and customers, whilst further improving efficiency.

So, whilst volumes in H1 were weaker ... as we expected ... the pipeline is now stronger and we expect our full year mortgage lending to be towards the top end of the previous guidance range.

Slide 20: Mortgages – proven resilience of business model through-the-cycle

We continue to use extensive data analytics in our Buy-to-Let business, supporting our comprehensive underwriting process, in-life portfolio monitoring as well as the IRB programme where the extent and depth of our data is unrivalled in the UK and which acts as a clear differentiator in our decision-making processes, including those for IRB.

Mortgage arrears have ticked up over the last year, but from a very low base. Virtually all this increase is located in the legacy book, which is largely variable rate, highly seasoned largely amateur landlords but with good LTVs. The average LTV on the portfolio stands at 63.5% and only 4.4% is

greater than 80% LTV. The flow rate into new arrears has now started receding, as the interest rate cycle peaked, suggesting a plateauing in arrears will emerge in the near future.

We are conscious that affordability has been in the spotlight in this higher interest rate environment. We have always operated conservative stress testing in this area and have applied it rigorously throughout, including employing tests over and above regulatory requirements. And it is clear that although debt service costs are higher, rents have kept pace, leaving the current debt service ratio - the ICR in the pipeline currently standing at above 200%.

We will now look at our Commercial business lines.

Slide 21: Commercial Lending provides increased diversification and structural NIM expansion

As I said earlier, Commercial Lending has been the means by which we have been able to diversify our business over a number of years, in pursuit of our key strategic priorities. Whilst Commercial Lending represents 14% of the loan book, it represents 48% of new business volumes and 27% of income.

Additionally, Commercial Lending is not one homogenous product line but a number of different businesses providing further diversification in itself and, within SME Lending, there is a broad spectrum of customers, including SMEs, corporates and even the UK Government, covering a range of sectors from construction to logistics, from agriculture to education, manufacturing to transport and many, many others.

Turning now to each Commercial Lending Line.

Slide 22: Development Finance

As signalled previously, we expected that our Development Finance division was likely to see weaker activity in 2023 due to the combination of supply chain disruption, cost growth and the uncertainty of the environment, including the potential softness in house prices. However, there are particularly long lead times in this sector due to extended planning processes and the facility drawdown phase being aligned to the actual construction of the underlying properties.

However, although new drawings were weaker, the existing facilities continued to roll out their build programmes, supporting robust cash drawings, leaving the loan book higher, approaching 11% year-on-year.

Margins are tighter year-on-year in this division ... not unusual at this stage of the cycle ... although remain the widest across the Group and underpinning excellent risk adjusted returns. The new business pipeline, similar to mortgages, has started to grow again - up 21% since the year end, reflecting the change in sentiment I previously mentioned.

Our product range has broadened recently with new initiatives supporting housebuilders in the build-to-rent and purpose-built student accommodation sectors - both specialist products - and in markets witnessing strong customer demand.

The portfolio is performing well in credit terms - a product of the high-quality developers we choose to work with and the rigorous standards we apply to the underwriting. Some facilities need careful management from time to time but our cautious underwriting, good LTVs and a highly experienced team see the portfolio performing well and with high degrees of resilience.

Slide 23: SME Lending

Notwithstanding the environment, our SME Lending division performed robustly with stable origination flows and an increase in the loan book to £780 million of over 6%. The competition has been pricing aggressively but we have been disciplined, instead choosing to prioritise risk and return over growth.

We have continued to invest in new technology in this area. 80% of new business goes through our new SME lending business portal, using AI, which assesses over 4,000 pieces of customer data with each application, including access to customers' current account information as part of the underwriting and in-life monitoring processes. Auto-decisioning has also been introduced using this extensive customer data but calibrated against our experienced risk and credit analysts.

This enables decisions to be reached faster and funds to land in our customers' accounts within hours, rather than days, increasing their confidence and supporting them to expand their businesses and achieve their ambitions. It also enables our team to focus on more complex cases, ultimately offering an all-round better service.

Despite higher business insolvencies across the UK as a whole, the portfolio is performing incredibly well and there is no evidence of credit deterioration or any concerns emerging from the early warning indicators.

Turning now to the remaining areas of the Commercial division.

Slide 24: Motor Finance and Structured Lending

Although Motor Finance business flows were softer compared to last year, the loan book growth was strong, up 9% year-on-year, with success being particularly evident in the leisure vehicle markets - one of the more strongly performing sub-sectors we target. The portfolio is resilient and, as with SME, we are seeing a strong and robust credit performance.

The Motor Finance industry has been focused on the FCA investigations into commission structures. We have a high-quality book with low complaint levels. Whilst there has been an increase in complaints following the high-profile publicity, for us they remain low. It is not possible to make any forecasts but, with the quality of our loan book, the guard-rails we had in place on commission structures, our late market entry and market share of only 0.1% ... if there is any exposure, it will be small.

Finally Structured Lending, which provides asset backed lending to non-bank specialist firms, has had a strong period in terms of activity, with a 22% increase in the loan book and delivering good customer retention. Its new business pipeline is strong and we anticipate healthy growth in 2024. As seen elsewhere, the credit performance here is exemplary.

Our Commercial Lending divisions are regarded as more cyclical in nature than Mortgages but have performed particularly resiliently in this more challenging economic environment and, with a NIM approaching 6%, it provides the Group with a strong risk-adjusted margin and structural NIM benefit as there is much further growth expected in the years ahead.

Turning now to our funding ...

Slide 25: Strong deposit growth with attractive cost of funding

Our Savings division has been a significant beneficiary of the rising interest rate environment where our cost of funds has moved from circa 100 basis points above Sonia to now being sub-Sonia. We have also seen a significant shift in demand from customers with a material increase in flows into fixed term products, although this structural shift has now slowed.

We have provided good pass-through rates to our customers from the higher rate environment ... and ensured this approach, combined with excellent customer service, has enabled high retention rates to exist. Our Net Promoter Score has been consistently strong alongside good Trustpilot reviews with a rating of 4.7 out of 5.

The deposit book is up over 24% year-on-year and stands at £14.8 billion as at 31 March and has continued its strong growth trajectory since then on the back of an extremely active ISA season. Only two years ago our balances stood at £10 billion and as such we are one of the fastest growing savings franchises in the UK.

We have continued to strengthen our franchise, enhancing flows in both our direct-to-market proposition and through our third-party platform relationships with Hargreaves Lansdown, Monzo, Revolut and many others.

New technology has already played an important role in the development of our Savings division and will continue to be a crucial driver to growth, with further initiatives under development.

Of course, we can also access wholesale funding where the Group has a long history in the securitisation markets and a strong investment grade rating. However, whilst the debt capital markets are in good health and pricing has improved, it still remains unattractive to us at present. We are working on a covered bond programme and this has the potential to support wholesale issuance at pricing comfortably inside mortgage-backed securitisation costs.

However, you will have seen that we have issued mortgage-backed securities this year but they have all been fully retained and are being used as collateral for contingent funding lines including Repo facilities.

The strength of our liquidity position and, the strength of our Savings franchise, has meant that we have been able to accelerate the repayment of the TFSME programme. We had repaid £900 million by the end of March with a further £400 million repaid since then, bringing current outstandings down to £1.45 billion. Our accelerated repayment profile will continue into H2 as we seek to get well ahead of the market before the maturity dates in October 2025.

There have of course been deposit beta increases in H1 as we expected, and we anticipate this to continue in H2 as TFSME gets repaid across the market ... and this impact is fully embedded in our NIM guidance for 2024.

So in conclusion...

Slide 26: Conclusions

The first half of 2024 witnessed an outstanding financial and operational performance with customers showing resilience and renewed confidence. The disruption created by the significant interest rate volatility and the month-on-month rate rises led to new business flows weakening in H1. But this was expected and allowed for in the original guidance. However, the clear positive change in

customer sentiment, combined with the strength of our franchise and the depth of our customer relationships has led to a more optimistic outlook for our H2 new lending activity.

For 2024 we now expect to come in towards the top end of our guidance which, to remind you is £1.3 to £1.6 billion for Buy-to-Let and for Commercial Lending £1 to £1.2 billion ... and if this market sentiment remains, we would expect stronger growth in 2025.

NIM has widened, partly due to the structural mix in the balance sheet and partly due to the transition to a higher interest rate environment. We are running ahead of expectation so far in 2024 but deposit betas have increased and much of TFSME has still to be repaid. Nevertheless, we are confident the year as a whole will now deliver a performance above 310 basis points which was the top end of our previous guidance range.

The credit performance continues to be resilient and operating costs are being well controlled notwithstanding the ongoing technology investment programme and we reconfirm that we expect operating costs will not exceed £180 million, a year-on-year increase of 5.6%.

The 2023 underlying operating profit was the highest in the Group's history and, in 2024 so far, we have made further progress and we expect to deliver on our guidance of Return on Tangible Equity towards the top end of the 15-20% range. As has been seen, we generate strong levels of capital and the buy-back programme has been enhanced this year, showing our ongoing commitment to managing our capital base for the benefit of our shareholders.

Whilst the economic backdrop is more optimistic in 2024, there are ongoing political and geopolitical uncertainties, and now we have a General Election in a month's time. But we have built a robust and high-quality series of franchises and we firmly believe specialist lending markets will continue to outperform the wider sector, and we are confident in our long-term ambitious growth plans.

We continue to want to diversify our business, spreading the sources of income and defraying the fixed cost structures that inevitably exist in a highly regulated sector. We believe Basel 3.1 could well prove to be challenging for some small and mid-tier banks. Whilst we await the final outcomes, we are also increasingly turning our attention to the opportunities that may emerge from the long expected and, perhaps much needed consolidation in the sector, and we are incredibly well positioned in this regard.

So, while 2024 may continue to have an uncertain backdrop, our business is in great shape. We have a high-quality customer base and a strong balance sheet and we stand ready to react to opportunities and any challenges as and when they arise.

Thank you, ladies and gentlemen. We are now happy to take questions.

Q&A

Benjamin Toms, RBC

Thank you for taking my questions. I'm conscious that your new, updated NIM guidance of greater than 310 basis points for FY24 can imply quite a wide range of H2 outcomes.

You give a sensitivity on slide 9. Thank you, that slide is really useful of the sensitivity to how tightening and deposit spreads might impact the NIM - sensitivities based on the performance you saw in H1. Is that the right way to think about the compression and NIM in H2 ie should be similar to that seen in H1? And, is the H2 NIM the best case estimate for the NIM in 2025?

And then secondly, just in relation to the last comments you made around diversification, your buy-to-let volumes are picking up again, which is great for balance sheet growth, but it means it's more difficult for you to achieve the diversity you desire. Can you just give an update or a bit more colour on what you were talking about in terms of the opportunities that may arise, whether it's bolt on or whether it's kind of larger transactions?

And, how close do you think you are to being on that long run rate to being an MREL qualifying bank?

Thank you.

Nigel Terrington, Paragon

Okay so there's a lot of questions in there. If we miss one, then I'm sure you'll let us know.

Richard will cover the NIM. But, there's one thing we won't do. We won't give guidance on 2025. We'll come back and talk to you about that at the year end. So if you give that, I'll pick up on the on the others.

Richard Woodman, Paragon

Yes, so I think that's a good proxy. If you look at the same sort of progress that we saw from September to March in terms of a March to September 24 approach that's probably the way we're looking at things. In terms of the deposit point, that 18 basis points – if you like, spot deposit tightening clearly hasn't been translated through to a similar reduction in NIM in H1 and that's because we had a stronger for mortgage margins. In large part, a lot of the old book re-prices on a SONIA basis and so that's a lagging indicator. So, when base rates stopped going up in September, we were still seeing margin widening - if you like - in the mortgage book in the following quarter. That won't be repeated so you could see a slightly faster reduction than two basis points in the net position for H2 hence the guidance.

Nigel Terrington, Paragon

So yes you're right, we have seen good recovery in pipelines which will feed through to stronger organic growth in H2 and beyond.

So the capital question is complex because there's a number of moving parts in there - not least which is Basel 3.1 - which we await the outputs from that. We expect that will be delayed. It was due to be announced by the end of June but clearly we're in the closed season for government at the moment and I would imagine - not that anyone has told us - but the PRA is going to want to engage with a new government - if there is one post election - in terms of the timing of that. So it certainly won't happen before the original deadlines or the original expected deadline. And then, it could well

be pushed back and the further it gets pushed back, it's not out until the final quarter of the year. I wouldn't be surprised if the Basel 3.1 implementation date gets pushed back from July 2025 to a later date. But again, this is this is my supposition. It's not anything that anyone's told us from the Bank or the government.

We're also going through our IRB process, which I'm sure Richard will can give you an update on that in a second, but it continues. And, when you look at our capital accretion, our capital accretion is strong - you know 1.4% in the first half of the year. If you just double that as a proxy that gives you the strength of the internal capital generation that we can provide. Typically, what we found is that the capital generation has exceeded the realistic ability to achieve loan book growth on that. So, you know, the loan book growth utilisation of that, it generates more hence we have plenty of room for buybacks. So, there's lots of complexity around the various moving parts of the capital requirements there.

In terms of the M&A message that then flows from that, you've seen that we've not been frightened of doing that. In fact, our commercial division has been built on a series of acquisitions that were made then integrated into the business. Are we interested in growing our business? Yes. I don't think it's changed in the last six months since we saw you last. We have been for some period of time but we are very careful in what we look at and so, if something comes along then great, if it doesn't then we've got a great organic plan behind it as well. Anything we do is going to have to be set against a very high bar of standards that we set for our own business. So, could it be small bolt-ons? Yes. Could it be something bigger? Yes. So nothing is ruled in and nothing is ruled out in that regard.

In terms of MREL, we understand the rules, we understand where the trajectory is, we do have engagement with the bank on understanding the application of that and I think for the duration of our plans that you have and you have out there, you should build no expectation of MREL within that.

Gary Greenwood, Shore Capital

I just had a question around credit quality. I think you said that the flow into arrears was reducing and, therefore, should we think about the impairment ratio in H1 – I think it was 14 basis points - being at a peak and then it trending back down towards the 10 basis points long term average you spoke about. Obviously, note that your economic assumptions remain pretty conservative as well so I don't know if there's potentially scope to relax those as well and get a little bit of a kicker from those later in the year? Thanks

Nigel Terrington, Paragon

Let me just talk a bit about the dynamics of the way the arrears flow feeds through to the dynamics .. and then Rich, if you pick up on the in the application of it to the impairment charge.

So, if you look pretty much across everywhere in the Group it's great. I mean it's a really great story about how good the credit quality is - even some of the areas that you regard as a bit more cyclical, like SME.

The buy-to-let book has got two very different portfolios, the variable rate pre-financial crisis, largely amateur landlord portfolio, going back to pre-financial crisis, and then everything else. We call it the new book but it started post-financial crisis, so I don't know when new stops being new. But that book has experienced 14 base rate rises and, across a typical distribution curve, there's going to be some at the edges of those customers that will have found a stretched affordability as a consequence of that. The LTVs are low, so what you might have is a pickup in the PD but, actually the LD doesn't

change that much as a consequence. And, usually, what you find with those customers, there's a few idiosyncratic issues that tend to affect those customers that have struggled a bit but that haven't affected the portfolio. Hence you see it's somewhat isolated. But, the other thing is for every account that goes into three months in arrears, somewhere along the way, it missed a payment once and so one of the things that we will monitor through triangulation tables, and the way in which you look at the cohort analysis, is the degree to which accounts go from 0 to 1, 1 to 2, 2 to 3 and the propensity for that to happen has slowed down. So, that whilst you saw the arrears going up, you kind of would expect that to plateau and maybe even ease off if the environment remains unchanged.

Richard Woodman, Paragon

So, the way we operate the buy-to-let business, we use receiver of rent as a process to make sure that, if there is an issue, we can stand between the landlord and the tenant to make sure that we secure cashflow. So, we do that very robustly, very swiftly in terms of our arrears management processes. The consequence of that though is that when we appoint the receiver, that account goes into Stage 3 and we provide accordingly.

So, what you tend to find within the buy-to-let book is, you provide early and then release at your leisure afterwards. If you like, when you get the valuations in, you end up returning quite a lot of the property back to the landlord when they resolve whatever their issue is or you get an accelerated realisation of the security.

So, that works quite neatly but what it does mean is that you provide quickly and then release. So, that's one of the reasons for the increase you've seen in in the first half. So, if the potential for doing a little bit more of that means that you could see some more in H2 and then then it goes away. But, overall we're still very close with that strong credit position ... but you could see some ... a little lumpiness in the impairment piece.

On one of the charts that I showed, it details what the impacts of the application of our current economic scenarios would be if we use the weightings on IFRS 9 that we had when we first went on to IFRS 9 in 2018 and remove the PMAs and, I think, from memory the number is about a £14 million adjustment.

Now, we don't hold PMAs at those higher weightings likely. You know, there's a lot of uncertainty out there and we try to position ourselves generally conservatively in terms of our provisioning. So, we're not looking to do a quick release in H2 to bolster the numbers. We take a conservative stance. The economics today though are better than we're forecasting. So, you know, house prices on a spot basis are probably about 3% above the level that we're implying in those numbers.

Ed Frith, KBW

Can I just bring you back to the question of capital. I hear what you're saying about earnings generating 140 basis points but, if you put in growth, if you put in the dividend, and growth is going to be arguable picking up so the problem that net-net you're not actually generating much in terms of surplus capital - which is fine. I don't have a problem with that, I'm not a buyback obsessive or anything which I know some of my peers are, but the actual surplus generation is reasonably limited.

And so, I guess in that context, you've also got some very big moving parts around IRB, around the fair value adjustments, around Basel 3. So, the key points to me ... Firstly, how much of the fair value adjustment is still in there. How much is capital today bolstered by the fair value which we're going to lose I guess over the next 5 years or was it 3 years? And, secondly an IRB, can you give us some idea of roughly what your best guess is in terms of the potential IRB benefit? And then finally, if you

don't get IRB, how low are you happy to see your capital ratio go in the event of Basel 3? I mean pro forma, we're down to about I guess 12 or 12.5? Are you comfortable with that? Would you be happy to see it go lower than that? Thanks.

Richard Woodman, Paragon

So if you just look at earnings less growth less our dividend (at policy), you're accreting 0.4-0.5% of CET1 in a six month period. So, if you assume that Basel 3.1 happens in July next year, we'll have two more periods so 1% higher. I actually think that it's remote that it'll happen in July next year now. I think that it will take the industry at least together from the point that the rules established to actually have the systems and everything else ready to do it. So, I think the general election puts that back realistically some time. So, as Nigel said, we've not had the confirmation of that from the Bank of England but it seems fairly obvious that that will be the implication. So, strong ongoing earnings, that core position. As I mentioned on Basel 3.1 impacts earlier, they've reduced about 0.2% year-on-year just because of the mix effects of the portfolio. That will continue with the type of business we're writing and with the run-off of the originally high loan to value extant book - you know the original valuations of the legacy book were in the 85-95% range so they get very badly treated under Basel 3.1 where you're looking back at the original valuations rather than an index that's running off at a double digit percentage rate. So, that automatically will bring that that figure a little lower.

I made the point that we don't have a plan today to AT1 but it's part of a capital stack that almost all of our peers carry and it's one that we have the platform ready to go. So, you know we have all the shareholder approvals. So, in terms of managing the overall tier one position, it's another tool that we have at our disposal and we have the strong rating to support that. So, that capital accretion is good.

In terms of the fair values, almost all of the fair value adjustment that we saw previously - the pipeline that that fair value is reflected against - those loans have now completed. So, that is now amortising quite evenly now over the next five years. There's not a shock to come. There was a bit of a hit in October and the beginning of November when swap rates fell very rapidly and those loans were still in the pipeline. So, that was why the amortisation for this first half was a little higher than normal, but you'd be expecting an annualised £20-25 million pounds in last few years - and we can forecast that quite well. That's not to say a new flow in six months time will not have its own fair value effects - it could equally be positive or negative. So, from what we see at the moment, that capital position looks pretty robust and on a 3.1 basis, if it went in next July with the share buyback, you'd still probably be looking at 13% CET1 ... with the accretion of the extra 1% net earnings over that period.

Ed Frith, KBW

OK, but obviously with the fair value headwinds, it's not going to be 1%. Those continue for the next five years.

Richard Woodman, Paragon

But, it's thereafter you're accreting ... £25 million pre-tax is something £17-18 million post-tax. You're making 140 basis points of CET1 so it's pretty marginal.

Nigel Terrington, Paragon

It's 140 basis points for a half year so it's 280 for the full year.

Richard Woodman, Paragon

I think one of the other areas to look at, in particular for H1 this year, is that our development finance business was strong and that carries 150% risk weight. Now, I think to assume that in relative terms that degree of growth happens in that same book at each point over the next two or three periods ... it would be great if it does because I think we'll be looking at a much bigger upgrade than 140 basis points of CET1 being created from the earnings ... but again that's a feature of this last period as well.

Ed Frith, KBW

But you mentioned 13%. Is that a number that we should feel that you, as a management team, you wouldn't want to get much below that?

Nigel Terrington, Paragon

We're not giving the guidance as to our target CET1 until Basel 3.1 has landed and IRB has landed. So, only then, when all the moving parts of the E have settled could we make sense of what the target number should be. We'll have to come back at that point.

Richard Woodman, Paragon

But also flipping onto IRB, we've had a lot of engagement with the PRA in this last period but we're not at liberty to say what we think it's going to do. To be blunt, the final calibration will be down to the regulator and there's no point in us front-running that.

You know, if we didn't think that it was going to add benefits to us in general capital management / risk management and bluntly on those capital ratios, you wouldn't be doing it. So, our core assumption is that IRB will be the basis for the Group going forward but it's a question of timing.

Sanjena Dadawala, UBS

Two questions please. First, on the costs. So, retaining the £180 million guidance while observing the 1.7 Bank of England levy, if you could talk about what's better in the underlying costs to help drive that and how should we think about medium term growth there?

And, then secondly, coming back to the NIM performance in the half - just a 2 basis points reduction - and you mentioned some of the drivers, but could you touch a bit more upon the divisionals, especially on the commercial side which didn't do as well.

Nigel Terrington, Paragon

So, in terms of the costs, we gave that guidance of £180 million and, despite the Bank of England levy that was expected at the time, you know we've absorbed that cost within that target as it were.

So, why is our costs doing well? I think they are and I think one of the things - bear in mind banking has a really high fixed cost structure and it's increased over the years where regulatory costs have gone up and created layer upon layer of additional costs. So, when you were able to achieve growth but you're not necessarily adding to the fixed cost structure below, you see the operating leveraging dropping through to the bottom line. So you see our cost income ratio has come down to 36.5% from a from a figure. If you go back to maybe 10 years ago, it is where you saw the cost income ratio was then. You saw it went up understand and has then come down. And, I think that going up was a consequence of being a bank, the banking sector becoming more regulated and thirdly four

acquisitions that then went through a process of integration. So, all of that has created that dynamic to come through.

On the way through now, what we have is there's a lot of time, effort and money being spent on technology. You heard me talking about that a little earlier. Richard takes a very, very prudent approach to capitalisation in that he doesn't like it ... and, the consequence is, the amount of capitalised asset we hold on the balance sheet is very low.

So, that means two things. One is you don't have a dangling debit about to come in the years to come through depreciation charges. Equally, it does mean that costs are going through the P&L now.

So, most of our IT costs are expensed not capitalised. So, what you then see is that's all being managed in this process as well.

Do we have the full benefits of technology at the moment? No, not remotely. This is a long term project if you were, series of projects, and each of them have got various degrees of implementation - some of which have happened, some of which we're in mid process and some of which have not even started yet. So, this is a long term transformation of our business. Clearly there's a lot of benefits going through to the customer experience, the broker experience ...but one of the benefits is actually improving efficiency as well.

So, a lot of things we do and a lot of the things we focus on are about ensuring that we have a very sharp eye on the cost management of the business.

Richard Woodman, Paragon

On margins, we've been very transparent in terms of the three divisions. And, what we don't do is subsidise the mortgage and commercial divisions by the out-performance on the central piece in terms of general funding.

So, for example, on Development Finance, as rates have gone up, we probably passed on 2.5-3% in terms of the 5% increase in base rates in terms of new business pricing over the last 12 or 18 months. So, the inception margins on the asset side for that business has been much reduced but we're getting a big benefit in the central area.

So, we're not uncomfortable at all with that margin profile but it's just one that people need to understand.

I think just the spreading of those fees because of the slightly elongated process that we're seeing ... you know, we're only looking at about an extra 3 months in terms of the average time it's taking to get to practical completion but that's probably moved our NIM in the commercial area by 5 basis points in the period. So again, all of these things have impacted. We would expect that to reverse.

So unless UK housebuilding has the same issues in five years time as today, I think you ought to get back to a more normalised process for those developments so that ought to come back.

But, I think when you're looking at the overall P&L, it is important to look at the Group position because the reality is that the actual NIM performance for the Group is also driven by those strong liquidity flows that we have centrally.

Portia Patel, Canaccord

Can I just ask on the Bank of England levy, is that a charge that repeats in the second-half and what factors will influence the quantum of the charges going forward in future years?

And secondly, I assume it's not material to you but, if you could just confirm whether you have been affected by the Borrowers in Financial Difficulty Review which some of your peers are reporting with respect to motor finance that would be helpful?

Nigel Terrington, Paragon

No, nothing on the Borrowers in Financial Difficulties. We do have borrowers, some of them end up in financial difficulty but we think we do a good job in looking after them.

Richard Woodman, Chief Financial Officer

On the levy, that's it for this financial year but there will be another charge next on the levy. The absolute scale of that is set annually though by the Bank of England. They will tell us what the aggregate levy needs to be and then it's divided up across the deposit takers. So, our hope is that it grows at a sensible level next year but it's not in our gift.

Nigel Terrington, Paragon

Any more questions?

Jason Napier, UBS

Two please. The first is on deposit growth – very, very strong growth. TFSME repayment. Some of the larger banks are muttering darkly about the upcoming liquidity requirements of some of the sector. I wonder if you could talk a little bit about how sensitive the NIM outlook is to those sorts of issues as others come to refinance - whether you think you can recover that through the asset side? whether maybe you'd have lower volume growth and so on? So, you know, very strong performance to date. How does the TFSME repayment fit into you future plans?

And then secondly, on the credit side of the balance sheet. You know, as you've said phenomenal credit risk numbers through the cycle and a very sharp rate cycle. What has happened to acceptance rates on credit through this? Have you been attenuating the risk that you've been taking? Is there room for more risk appetite as demand comes back – assuming demand comes back as rates start to fall? If you could just talk a little bit about the embedded risk in the portfolio and how that might have changed over time?

Nigel Terrington, Paragon

So, in terms of what we highlight, and the guidance that we've given for NIM, bakes in an expectation of some tightening as a consequence of that TFSME refinancing. So, in one sense we got ahead of the curve. We're kind of looking about wondering where everyone else is and we're kind of happy that we got ahead of the curve but it doesn't mean we're immune from some of the pressures from the sector if that comes about. So that's what we have allowed for within the forward guidance on the on NIM side.

It's an interesting point about if the industry as a whole does feel some pressure and I think I saw your note from your second favourite client after us talking about this the other day, where actually the view is that if there is some liability cost increase, there will be an ability to pass that on through wider asset spreads. I think our asset spreads have been pretty resilient in this period.

I think what becomes a little more challenging is actually the volatility. You know one week the market is going rates are coming off, next week ... rates are not coming off. And you've seen 30-40 basis points on the five year swap movement within a month taking place.

I know appreciate going back to the time of the budget that would have been a delight just to have 30-40 basis points but there's still quite a lot of volatility and it does require careful management between the business lines and the treasury teams in ensuring that we don't either overexpose ourselves on the swap side in the pre hedging or on the asset side ... because you can you can get caught on that. So it does require a lot of careful management.

So, whilst we think there is a risk of some spread compression, we've baked that in. Do we think if it becomes more than that, is there an ability to recover some of that on the asset side? Yes, there probably will be because, if you look at these things, obviously you've got asset markets and liability markets in various different areas but they all come connected at one point back to the banking system and they're all driven back to your return on capital requirements. So, there is a there is a there is a common link back.

In terms of risk appetite, our risk appetite changed during COVID. We certainly tightened up things during that period and I would say we're probably just about back to where we were pre-COVID now ... but it's been a slow step to recovery.

If you look at those credit numbers, they are outstanding. Not outstanding in one year but outstanding in 10 years. So, could we be accused of being too prudent? It has been levelled at us but you know what? Banking is a long term game and we have highly leveraged balance sheets. All banks have highly leveraged balance sheets. Get small things wrong in a bank, they become big things at the bottom line. So we're not looking to change our risk appetite in any material way as a consequence of that.

Ed Frith, KBW

Could I ask about buybacks because one of the leading lights in the sector has now said that his share price is too expensive to buy back shares and I guess you stand out as one of the very few banks in Europe that is buying back shares materially above book value. Do you think about it that way at all? Do you make a judgement on the value of your shares when you're doing buybacks? Or, is it more of a sort of mechanical process and how do you compare buybacks versus special dividends and how do you decide how to balance the two because it would be interesting to know how the thought process goes?

Richard Woodman, Paragon

So with the buyback v specials, we like the optionality with a buyback. Every time that we've announced one, we say we'll do up to [a certain amount]. Back in 2018, we bought Titlestone, the development finance business. We stopped the buyback half way through the process because we wanted the capital to deploy on growth rather than being committed. The special dividend is all done in one go. So you get a little bit more flexibility around the buyback.

We do monitor the price very carefully and, when we're looking at it, we look at the opportunity cost of doing something with that cash. We've not been at a position yet where we feel that the capital that we're buying back is holding us back in terms of deploying it in growth. That would be an example of where you probably wouldn't do the whole buyback, you would do something else instead.

The alternative is just a cash return and where our plans show us - to our point earlier - continuing to be very capital generative - on that basis, you're getting a material return back from the buyback.

It probably wouldn't be as high as the RoTE for the whole Group. So, it's about £7.50, we get the equivalent of 13-14% return ... you'd have to do something similar with that same money to get to breakeven. So, it's something that we keep under review but we're not at the point yet where you'd say it's uneconomic.

Nigel Terrington, Paragon

The other way to look at it is ... we just reported a 20% return on equity. If you think that's sustainable in the 15-20% range ... and yes we're trading above book ... but actually the implied cost of capital relative to those two data points still suggests the cost of capital is quite high.

Richard Woodman, Paragon

I guess market sentiment may change over time but we see a lot of our shareholders after each set of results and the overwhelming feedback has been ... we like the buyback. It's not a huge number, it's 5-6% of the value in a year so, at that level, I think quite a lot of them appreciate having the bid because there have been liquidity issues with a number of funds investing in small-mid caps. So, again at the margin, it's got some qualitative benefits as well.

Nigel Terrington, Paragon

Any more questions from the room or the webcast?

Thank you very much for your attention this morning. As you would gather, we're delighted with the results and of course we're very happy to answer any of your questions. Richard has set aside the rest of today and tomorrow to talk to you if that's of interest and, if not, then just have a have a great day. Thank you.