# Half-yearly financial results

Six months ended 31 March 2011

The Paragon Group of Companies PLC

# Agenda

# Financial results

Six months to 31 March 2011

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# Financial highlights

| | 2010:H1 £m | 2011:H1 £m | % change |
|---|---|---|---|
| Pre-tax profit | 29.3 | **39.5** | 34.8% |
| Of which: | | | |
| Exceptionals | 0.5 | **0.0** | |
| Fair value | (0.9) | **1.1** | |
| Underlying profit | 29.7 | **38.4** | 29.3% |
| Tax rate | 28.0% | **27.8%** | |
| Dividend per share (interim) | 1.20p | **1.35p** | 12.5% |
| Earnings per share | 7.1p | **9.7p** | 36.6% |
| Shareholder funds @ 31 March | £664.6m | **£715.2m** | 7.6% |

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# H1:H1 analysis

| | 2010:H1 £m | 2011:H1 £m | 2010:H1 – 2011:H1 % change |
|---|---|---|---|
| Income | 77.4 | 74.5 | (3.7)% |
| Expenses | (21.0) | (22.8) | 8.6% |
| Impairments | (26.7) | (13.3) | (50.2)% |
| Cost:income | 27.1% | 30.6% | |
| Underlying profit | **29.7** | **38.4** | |

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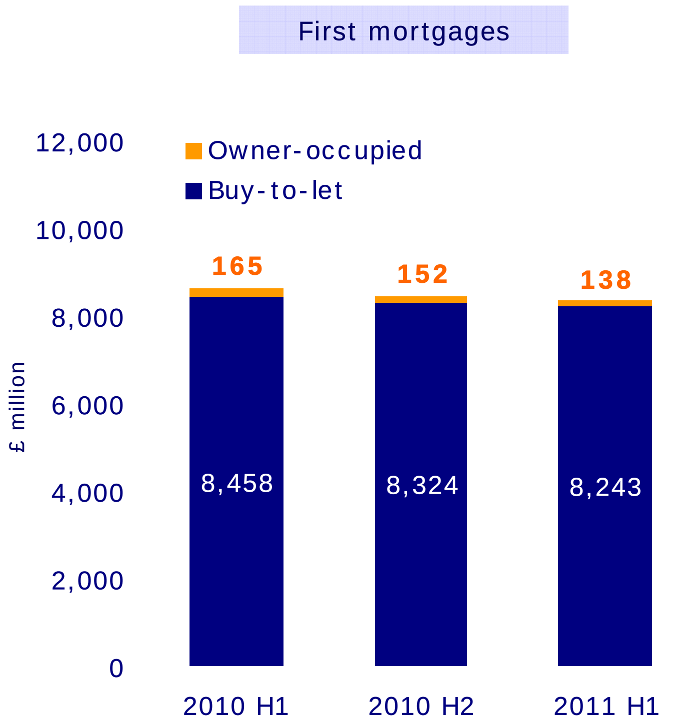
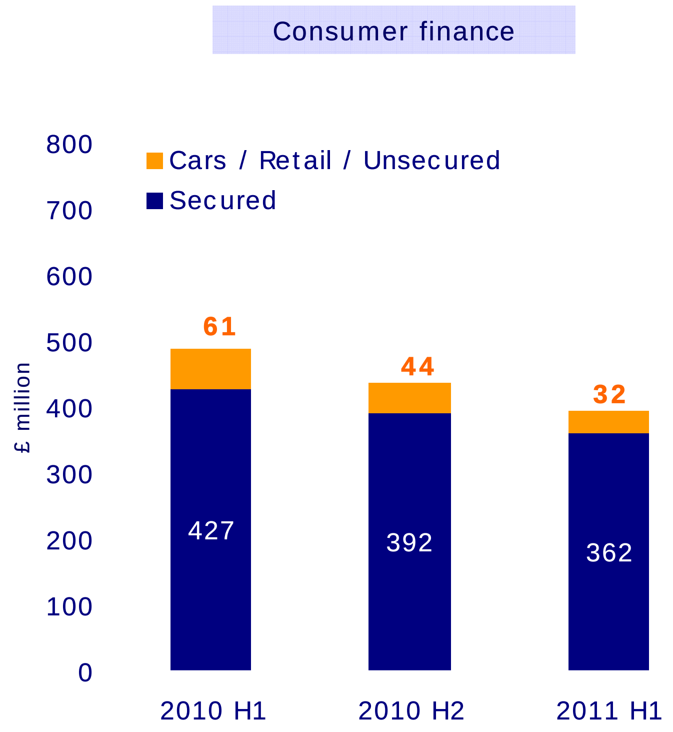
# H2:H1 analysis



| | 2010:H1 £m | 2010:H2 £m | 2011:H1 £m | 2010:H1 – 2011:H1 % change | 2010:H2 – 2011:H1 % change |
|---|---|---|---|---|---|
| Income | 77.4 | 70.5 | 74.5 | (3.7)% | 5.7% |
| Expenses | (21.0) | (21.6) | (22.8) | 8.6% | 5.6% |
| Impairments | (26.7) | (12.5) | (13.3) | (50.2)% | 6.4% |
| Cost:income | 27.1% | 30.6% | 30.6% | | |
| Underlying profit | **29.7** | **36.4** | **38.4** | | |

# Segmental loan assets

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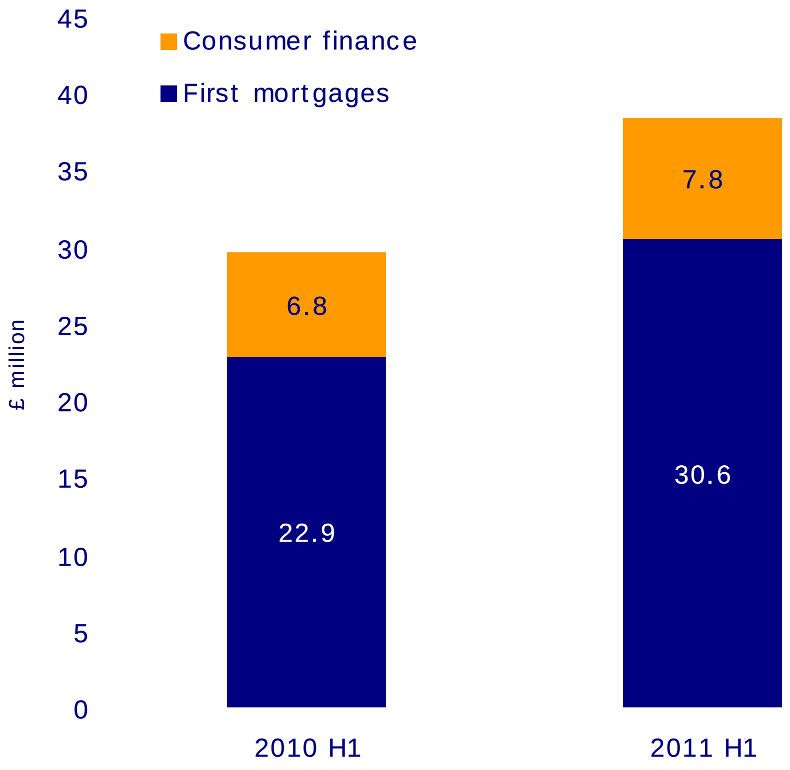
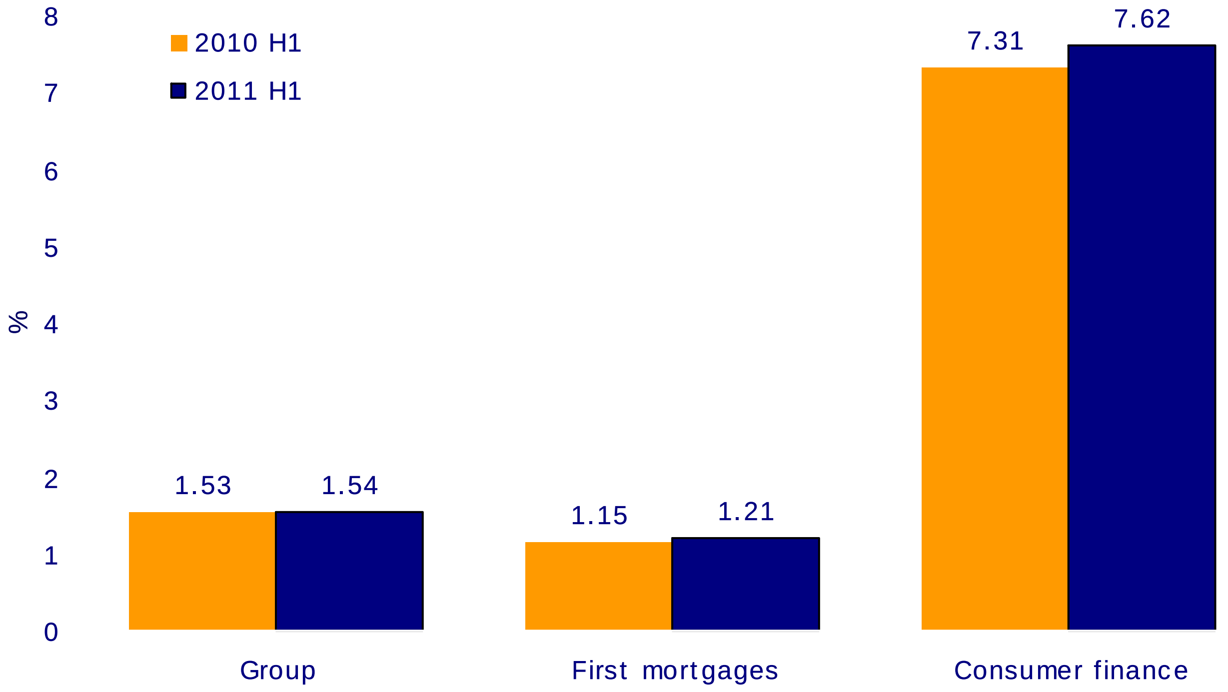
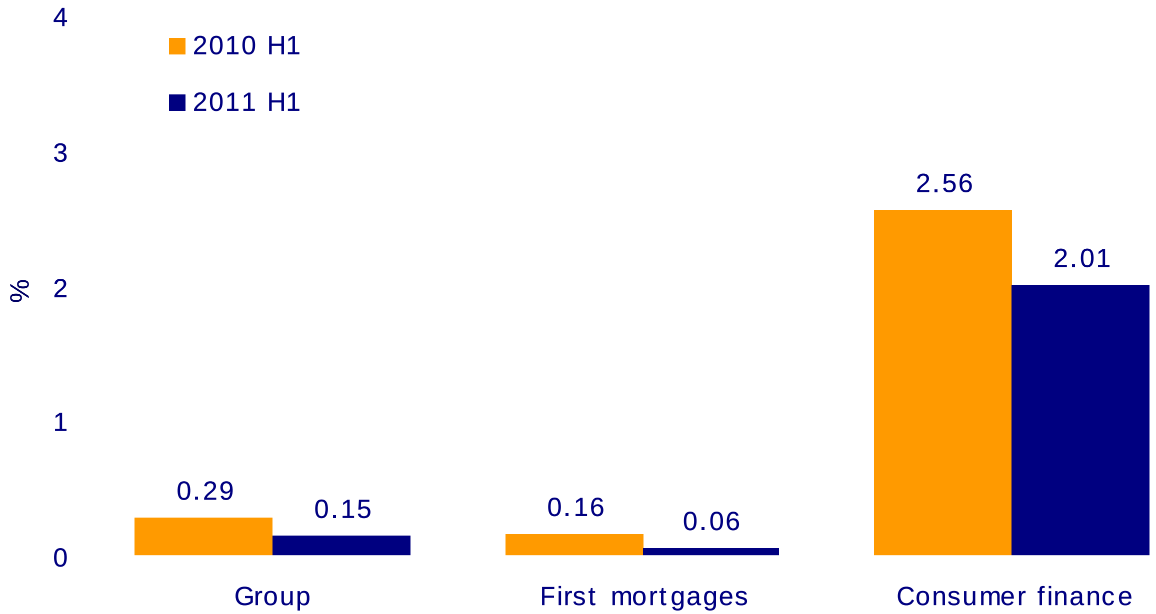
# Segmental profit analysis



# Net interest margin

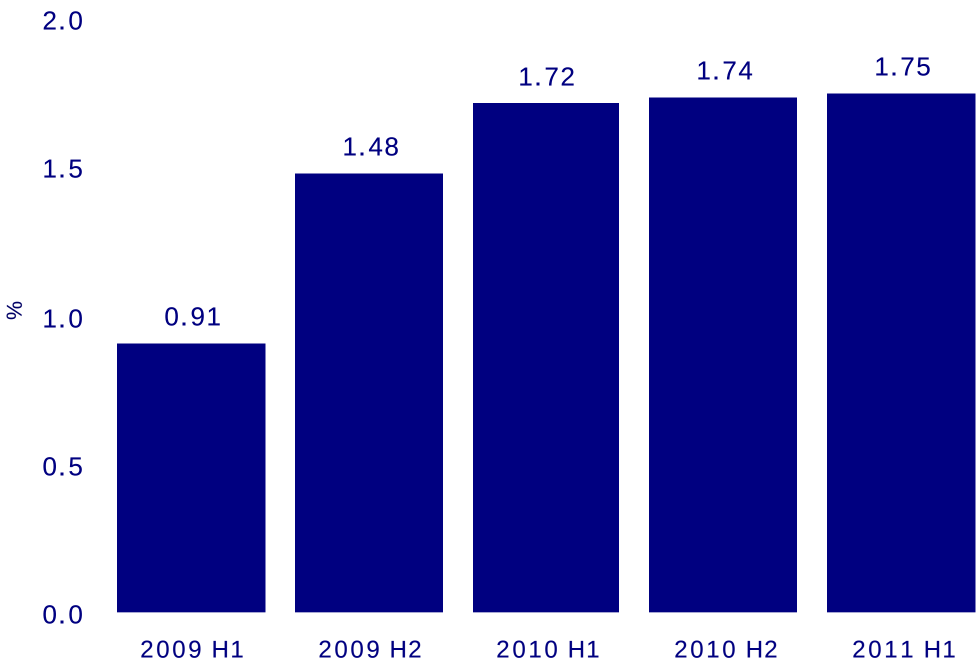


# Impairment charge as % of total loan assets



# Cash margins

- Free cash balances at 31 March 2011: £179.7 million (2010 H1: £128.1 million)



# Strategy

# Strategic objectives

**Strategic objectives**

**Optimise embedded value**

**New lending**

**Develop new income sources**

# Strategic objectives

**Strategic objectives**

**Optimise embedded value**

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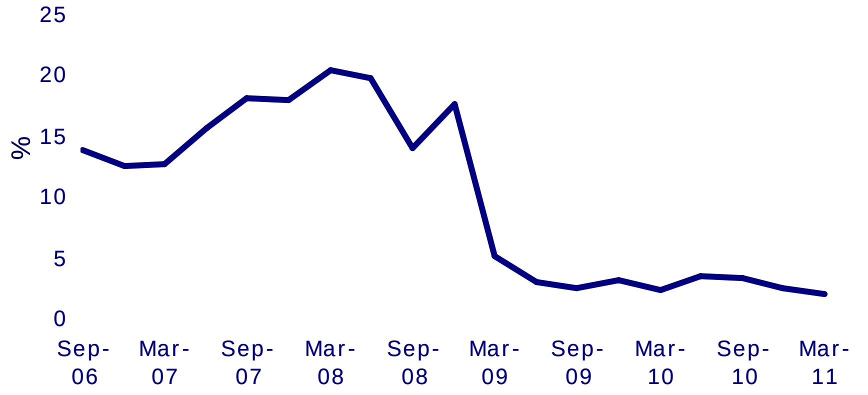
# Customer retention

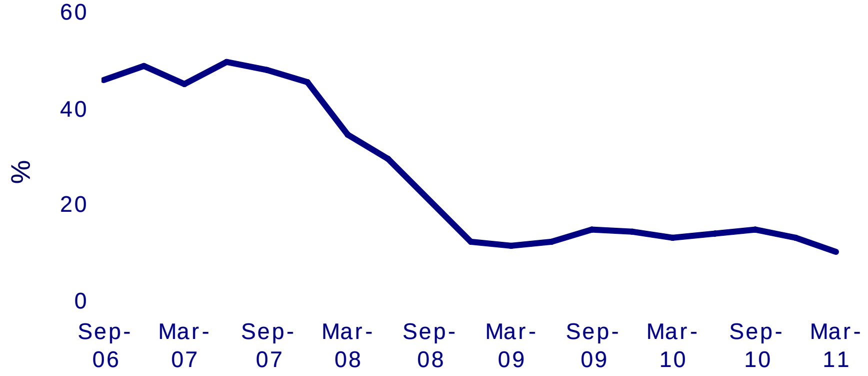
**Optimise embedded value**

- Buy-to-let redemption rates remain below 3% (historically c20%+)
- Product availability in market remains restricted
- Paragon's pre-credit crunch products highly competitive
- Landlords retain long-term investment horizon
- Strong tenant demand
- Rents continue to rise

Paragon buy-to-let redemption rate




Paragon secured redemption rate

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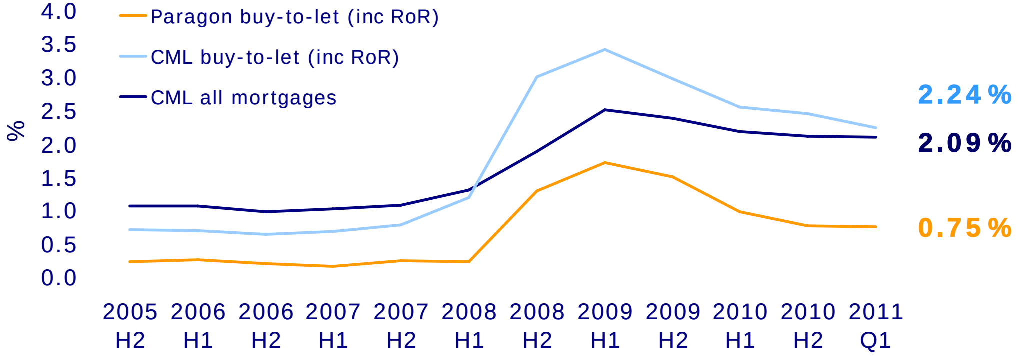
# Credit quality

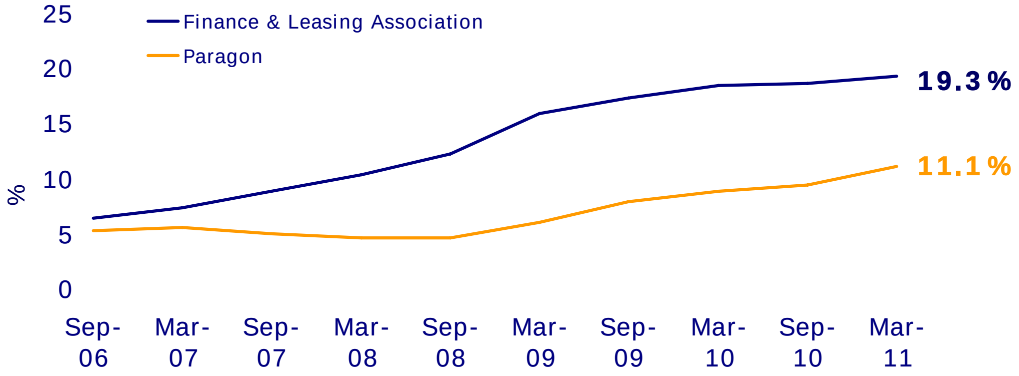
**Optimise embedded value**

- Paragon assets continue to significantly outperform wider industry
    - Buy-to-let 3 months + arrears fell to 75 bp
    - 88% buy-to-let 3 months + arrears are subject to Receiver of Rent
- Second charge arrears cash collections remain strong

BTL 3 months + arrears




Second charge 2 months + arrears




**Source: Council of Mortgage Lenders / Finance & Leasing Association / Paragon**

# Impact of rising interest rates

**Optimise embedded value**

- Interest rate outlook
  - Base rate at historic low, but will inevitably rise
  - Likely to remain low given fiscal tightening and recovery concerns
- Portfolio profile
  - Existing buy-to-let portfolio originated when average base rate = 4.6%
  - Tenant demand and rental yields remain strong
  - Current interest to rent cover ratio (ICR) c300% (c170% @ origination)
- Impact of interest rates on net assets
  - Capital invested in financial assets largely held in cash
  - Return will rise as interest rates rise
  - Every 1% interest rate rise = c£7 million in net interest income

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# Regulation

**Optimise embedded value**

- Developing regulatory environment
- Second charge mortgages to be regulated by FSA – however, significant delays expected
- Further MMR consultation expected this Summer
- Will include increased prudential requirements for non-deposit taking lenders offering regulated mortgages
  - Capital requirement not material
  - No specific liquidity test
- Buy-to-let
  - HM Treasury regards regulation of buy-to-let as inappropriate
  - EU Directive relating to residential property in drafting stage
  - Unclear whether EU regulation will be extended to buy-to-let
- Paragon already FSA authorised for mortgages and insurance; well placed to be fully compliant with likely regulatory framework

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# Strategic objectives

**Strategic objectives**

**New lending**

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# New lending

**New lending**

- New lending commenced 28 September 2010
- Significant focus during initial phase towards re-establishing brand and distribution
  - Ongoing intermediary roll-out programme
  - Major networks being engaged
  - Online distribution recently launched
  - Deliberately very tight credit standards at launch
- Delivery through two distinct brands focussing on experienced investors
  - Paragon Mortgages targeting large-scale landlords
  - Mortgage Trust, re-launched April 2011, targeting mainstream market
- High quality new originations
  - Average LTV 68.9%
  - Average ICR 159.7%
- Strong growth in H2 lending expected
  - Significant conversion improvements since launch
  - Pipeline now £94.7 million

| Buy-to-let | At 31-03-11 £m | At 20-05-11 £m |
|---|---|---|
| Advances | 29.6 | 50.2 |
| Pipeline | 92.0 | 94.7 |
| Redemptions | 90.4 | 112.9 |

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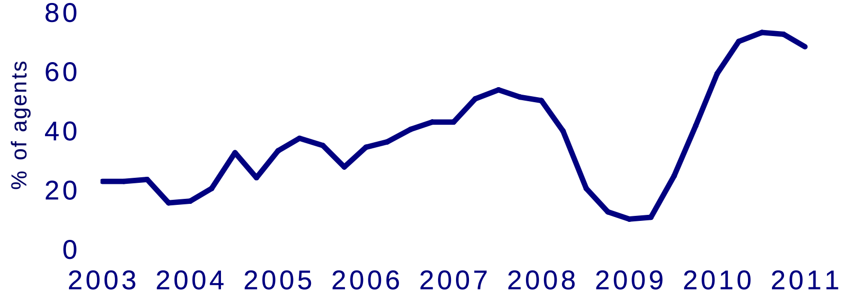
# Balance of supply and demand

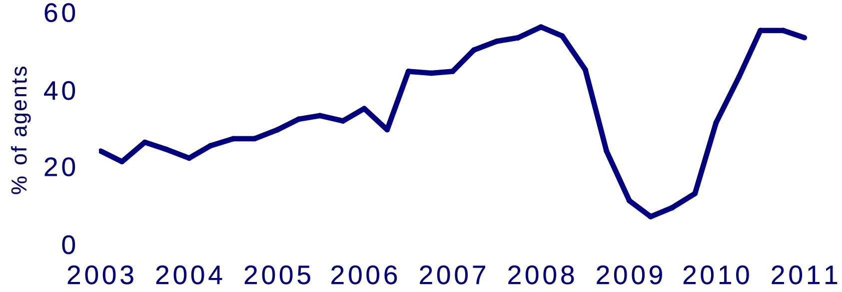
**New lending**

- Demand for private rented property strong
  - 68% of ARLA agents reported more tenants than properties in Q1 2011
  - Proportion of ARLA agents reporting increase in achievable rent levels has risen sharply

More tenants than properties




Increase in rent levels

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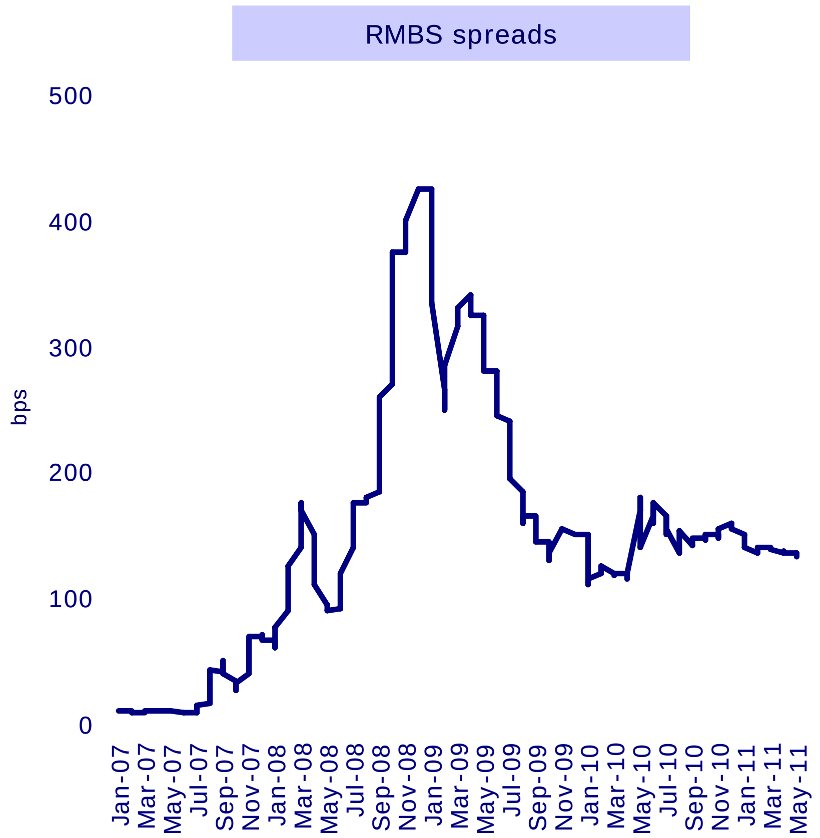
Source: Association of Residential Letting Agents

# New lending - funding

**New lending**

- £200 million warehouse facility with Macquarie
- RMBS market displayed significant improvement in 2010
- Momentum maintained in 2011 despite Eurozone crisis
  - February:
    - Santander - £2.0 billion
  - March:
    - Skipton - £1.2 billion
    - Lloyds - £1.3 billion
  - April:
    - Northern Rock - £1.3 billion
    - Lloyds - £3.7 billion
  - May:
    - Santander - £3.75 billion
- Securitisation plans remain on track




**Source: Royal Bank of Scotland**

# Strategic objectives

Strategic objectives

Develop new income sources

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# New sources of income

**Develop new income sources**

- New initiatives (loan servicing, portfolio acquisitions) continue to make good progress
- Contributed £3.5 million – up 46% on H1:2010
- 52% of accounts under management serviced on behalf of 3rd parties
    - Majority consumer finance loans
- Additional 50,000 loan accounts serviced from July 2011

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# Idem Capital

**Develop new income sources**

- Further portfolio investment
  - c£7 million investment
  - 50,000 unsecured loan accounts
  - Acquired in partnership with 3rd party investment company
- Total investment to date
  - £30.1 million portfolio purchase investment
  - First mortgage, second mortgage and unsecured asset classes
  - Portfolios performing well and exceeding return target (IRR 15%)
  - Profit generation broadly equivalent to originating c£600 million mortgages
- Further portfolios currently under review
- Substantial number of UK banking assets regarded as non-core
  - £250 billion of all UK mortgage assets
  - Early deals more likely to be consumer finance assets
  - Operational and technology capacity exists
  - Capital capacity exists

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idem CAPITAL

# Capital management

**Develop new income sources**

- Progressive dividend policy, c10% growth per annum
- Capital available to support:
  - Working capital requirements
  - New lending programme
  - Acquisition of loan portfolios
- Growth and investment plans will achieve greater capital optimisation, enhancing RoE

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# Conclusion

- Existing portfolio performing well
  - Excellent profits
  - Strong cash flow position
- Successful new lending re-launch, flow will build over time
  - Private Rented Sector strong with good long-term prospects
- Exciting portfolio acquisition opportunities to deploy capital at target IRRs

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