paragon

interim report 2000

The Paragon Group of Companies PLC

finance for people

Chairman's Statement

I am pleased to report further strong growth in the first half of the current financial year. In the six months to 31 March 2000 we have increased profit before tax by 11% to £16.3 million (1999 H1: £14.7 million), increased loan completions by 19.5% and put in place the funding arrangements to finance our planned long-term business volumes.

Given the progress made by the Group I am pleased to report that your Board has declared an interim dividend, payable on 31 July 2000 to shareholders on the register at 30 June 2000, of 1.7p per share, (1999 H1: 1.5p), an increase of 13.3% from last year's interim dividend.

We have continued to build our asset base by the consistent application of our prudent lending criteria. During the six months, total new loan originations were £224.1 million (1999 H1: £187.5 million) and at 31 March 2000 loans to customers, net of provisions, were £1,548.1 million, compared with £1,419.4 million at 31 March 1999, an increase of 9% in the year. The high growth in originations was achieved despite the prolonged Christmas and Millennium celebrations resulting in a longer than usual winter lull in business volumes. The increase in assets, combined with careful margin management, has increased net interest income to £31.1 million (1999 H1: £27.4 million) for the period, an increase of 13.5%.

Other operating income, at £6.5 million, is broadly unchanged from the first half of 1999 (£6.6 million), despite the loss of rental income following the disposal of the Group's freehold property in Solihull in April 1999. If net rental income is excluded, other operating income for the first half of 1999 was £5.8 million, an increase of 12% from the first half of 1999 on a like for like basis, reflecting an increase in insurance commissions and in fees for third party servicing.

Operating expenses, at £15.4 million, are 10.5% lower than for the first half of 1999 (£17.2 million) and reflect our continuing focus on cost efficiencies in each of our business areas.

The charge for provisions for losses, at £5.9 million (1999 H1: £2.1 million), was in line with our expectations and relates primarily to the unsecured loan book. These loans, particularly the older unsecured loan accounts acquired with the purchase of Universal Credit from Lloyds TSB, carry higher margins in order to offset the increased risks of default from this type of lending. As such, an element of the provision relates to interest which we consider to be irrecoverable, but which has been charged to accounts, and which is, therefore, included in interest income.

As I reported in my interim report last year, the profitability of the Group has reduced brought forward tax losses to the point where the charge is now rising towards full corporation tax rates. Consequently a charge of £3.2 million is included in respect of the period, an effective tax rate of 20%.

The Group remains active in the securitisation market and in February successfully completed a £185 million issue through a subsidiary company, Paragon Mortgages (Nº 2) PLC on competitive terms. This was the thirty-third public securitisation by the Group.

In my full year statement I commented that we would be addressing the long-term funding implications of our planned business levels. In March we replaced our corporate banking facility with a new five year £140 million facility, which now gives us the funding to support our planned asset growth for the foreseeable future.

Year 2000

In our annual report for the year ended 30 September 1999 we reported that we had completed all necessary upgrading and testing of in-house systems required to address the effects of the year 2000 date change and undertaken a review of our key business relations.

I am pleased to report that the Group encountered no problems with its systems as a result of the change of date, and we do not foresee any such occurrences in the future.

The total cost for this exercise was £759,000, of which £65,000 was incurred in the half year ended 31 March 2000. No further costs are expected and this expenditure represents a saving of £41,000 on the estimate in the annual report.

Business Review

First Mortgages

At 31 March 2000 the Paragon Mortgages book stood at £703.3 million (a 31.8% increase on the balance of £533.8 million at 31 March 1999) after advances of £110.2 million during the six months then ended (1999 H1: £121.9 million). While a number of our competitors have reduced their pricing and credit standards, it is our view that in seeking to achieve sustained long-term profitability we should maintain our margins and continue the application of high credit and underwriting standards, a policy which continues to be borne out by excellent arrears performance.

As mentioned above, the traditional Christmas and New Year dip in application and completion levels was more prolonged this year but completions recovered strongly towards the end of the period. There is anecdotal evidence that the mortgage market, generally, has been adversely affected by increased interest rates and uncertainties as to their future course, although that is not yet evidenced in market statistics which tend to lag the current experience. Again, in the private rented sector, the combination of increasing interest rates and rising house prices has had a dampening effect on demand, particularly amongst amateur landlords. However, the long-term fundamentals of the buy to let market, which now accounts for the majority of the Group's mortgage lending, are sound and we expect current uncertainties to be temporary.

There have been a number of developments in the use of eCommerce by Paragon Mortgages for enhancing product distribution. These are described more fully below. In addition we are currently considering a number of new opportunities, including products aimed at the more professional investor, which we expect to be launching shortly. We remain very confident, however, in the long-term prospects for the private rented sector as a significant contributor to our future business volumes.

We continue to be encouraged by the market's views of our service quality. Recent results from our regular intermediary surveys record an improvement in Paragon's service delivery against a number of our key competitors.

The announcement by the Treasury on mortgage regulation during the period has created an element of confusion. Mortgage lenders will have to contend with a patchwork of rules and regulations while mortgage advice will remain unregulated. However, in view of the high standards that we adopt, we remain confident that the regulatory requirements will be accommodated by Paragon with relative ease. More than half of our front line staff have either qualified, or are in the course of qualifying for, the new Certificate in Mortgage Advice and Practise (CeMAP) which is likely to become the benchmark qualification for mortgage professionals in future.

The NHL portfolio, the balances on which were £444.6 million at 31 March 2000, continues to decline in importance to the Group's accounts, now representing less than one third of the Group's loan assets. The ratio of payments received to those contractually due averaged 106% on the arrears book during the period.

Car Finance

During the period, Paragon Car Finance advanced £40.5 million (1999 H1: £27.7 million), despite it being a period in which the car market has been depressed and plagued with uncertainties over the future direction of car prices. The book total increased by 88% to £96.4 million over the twelve months since 31 March 1999.

The long-awaited report by the Competition Commission following its study of new car prices has done little to remove the uncertainties over the future trend in car prices in both the new and used car sectors, although it is considered that it may serve to underpin residual values going forward. We are confident that with our strong and developing dealer network and our procedures for monitoring dealer performance, we can continue the profitable growth of this business.

We have removed unproductive dealers from our panel with the effect that, in combination with increased business levels from our major dealers, application levels rose strongly towards the end of the period and the conversion rate from applications to completions has improved significantly, with a consequential operating cost benefit. We will continue to reconfigure the dealer network regularly to maximise the quality of business received.

Personal Finance

During the period Paragon Personal Finance advanced £73.4 million (1999 H1: £37.9 million). After a temporary reduction in volumes over the Christmas and New Year period, volumes grew strongly towards the end of the period. By 31 March

2000 the net loan book was, at £298.7 million, 21% higher han at 31 March 1999.

During the period a number of changes were made to our processes to improve the system links with our brokers with he objective of reducing the amount of effort wasted in underwriting cases which are subsequently declined. This has led to mproved operating efficiencies and to an improved rate of conversion from application to offer.

The Paragon Personal Finance web site has now been estabished and we are now rolling out affinity branded sub-sites inked to some of our affinity business partners. The first successful deal was with Chelsea Football Club and we anticipate that others will follow in coming months.

The secured loan product which was launched last summer has been successful, completing £28 million of new business n the period. We aim to improve our penetration of the market by growing the support from our main relationship brokers and adding new ones.

During the next six months we will be moving the new business areas of the unsecured lending business, which currently are located in Victoria, so that the entire operation will be located at new office space in Solihull. The cost of this exercise was provided for in the accounts for the year ended 30 September 1999. This will complete the operational ntegration of the personal finance business and will enable further cost efficiencies.

eCommerce

The focus of the Group's eCommerce initiative, since we launched the original Paragon Mortgages web site in 1996, has been to use the new medium as a means of building on and delivering to our customers more efficiently the existing strengths of the business.

Our overall eCommerce strategy is threefold, to establish electronic integration and improve processes in our new business divisions, so as to enable volume growth without corresponding cost increases, to develop new channels making full use of the Internet (such as the link with Chelsea FC, mentioned earlier and the Rapid Remortgage on which I report below), and to work on new value adding initiatives which reflect our core competencies.

The revised Group web site was launched in November 1999 and covers a wide range of information in respect of the Group. Paragon Mortgages, Paragon Car Finance and Paragon Personal Finance all offer the facility for online quotations, applications and related tools. From 1 April 2000, all Paragon Mortgages customers have had the facility to obtain their mortgage statements on-line.

Paragon Mortgages now has arrangements in place with a number of Internet sites, in particular Eloan, Charcolonline, Fish4, IFonline and Assuresoft. In addition, we launched a new product during the period, the Rapid Remortgage, direct to the public through a dedicated web site, www.rapid-remortgages.com. The Rapid Remortgage is the first mortgage product where we use a genuine on-line application form in preference to printed forms and where we see the web site as the primary means of providing introducers and direct customers with product details, illustrations and an application process. Surveys have reported a significant increase in intermediaries with access to the Internet over the last six months.

Currently we are working on an Internet portal focused on the private rented sector, offering a full range of services to landlords and tenants. The main purposes of this portal will be to give landlords access to a range of services, the development of a tenant site on which properties will be registered by landlords and the provision of additional services to both landlords and tenants.

A number of further initiatives are being worked on in connection with the three business areas.

Conclusion

In the last six months the Group has continued to progress, with growth in our distribution base, in the products we offer and in overall business volumes. We continue to focus on prudent underwriting of all lending and on tight cost control. We are excited by the opportunities and challenges presented in our market place, particularly in the area of eCommerce. We look forward to further growth and the further development of the Group in all of its business activities.

Jonathan Perry
Executive Chairman
22 May 2000

Consolidated Profit and Loss Account

for the six months to 31 March 2000 (Unaudited)

	Six months to 31 March 2000 £m	Six months to 31 March 1999 £m	Year to 30 September 1999 £m
Interest receivable	88.6	86.4	167.6
Interest payable and similar charges	(57.5)	(59.0)	(112.2)
Net interest income	31.1	27.4	55.4
Other operating income	6.5	6.6	12.7
Total operating income	37.6	34.0	68.1
Operating expenses	(15.4)	(17.2)	(31.0)
Provisions for losses	(5.9)	(2.1)	(5.8)
Operating profit	16.3	14.7	31.3
Profit on sale of fixed assets	–	–	2.5
Profit on ordinary activities before taxation	16.3	14.7	33.8
Tax charge on profit on ordinary activities	(3.2)	(1.5)	(3.5)
Profit on ordinary activities after taxation	13.1	13.2	30.3
Dividend	(2.0)	(1.7)	(4.0)
Retained profit	11.1	11.5	26.3
Dividend – Rate per share	1.7p	1.5p	3.4p
Basic earnings per share	11.3p	11.4p	26.1p
Diluted earnings per share	11.2p	11.3p	25.8p

There have been no recognised gains or losses other than the profit for the periods shown.

The results for the periods shown above relate entirely to continuing operations.

Consolidated Balance Sheet

at 31 March 2000 (Unaudited)

		31 March 2000 £m	31 March 1999 £m (restated)	30 September 1999 £m
Assets employed:				
Fixed assets				
	Tangible assets	3.2	21.9	3.6
	Loans to customers	1,548.1	1,419.4	1,482.5
	Investment in own shares	2.8	2.8	2.8
		1,554.1	1,444.1	1,488.9
Current Assets				
	Stocks	13.1	15.0	14.5
	Debtors falling due within one year	26.2	17.7	22.8
	Cash at banks and in hand	175.9	111.1	147.2
		215.2	143.8	184.5
		1,769.3	1,587.9	1,673.4
Financed by:				
Equity shareholders' funds		124.6	98.7	113.5
Provisions for liabilities and charges		3.8	2.2	4.2
Creditors				
	Amounts falling due within one year	27.3	27.9	27.0
	Amounts falling due after more than one year	1,613.6	1,459.1	1,528.7
		1,769.3	1,587.9	1,673.4

The interim financial information was approved by the Board of Directors on 22 May 2000.

Consolidated Cash Flow Statement

for the six months to 31 March 2000 (Unaudited)

	Six months to 31 March 2000 £m	Six months to 31 March 1999 £m	Year to 30 September 1999 £m
Net cash inflow from operating activities	18.2	14.8	33.2
Taxation	–	–	(1.3)
Capital expenditure and financial investment			
Net increase in loans to customers	(71.5)	(42.7)	(109.5)
Other	(0.1)	(1.0)	19.1
Equity dividends paid	(2.3)	–	(3.8)
Management of liquid resources	(47.8)	(13.7)	23.7
Financing	84.5	(23.6)	45.2
(Decrease)/increase in cash in the period	(19.0)	(66.2)	6.6

(1) Reconciliation of operating profit to net cash flows from operating activities.

Operating profit	16.3	14.7	31.3
Provision for losses	5.9	2.5	5.8
Depreciation	0.5	0.9	1.6
Payments against provisions	(0.4)	–	–
Decrease in stock	1.2	0.4	1.1
Increase in debtors	(3.4)	(1.0)	(6.9)
(Decrease)/increase in creditors	(1.9)	(2.7)	0.3
Net cash inflow from operating activities	**18.2**	**14.8**	**33.2**

(2) Reconciliation of movement in cash with movement in net debt.

(Decrease)/increase in cash in period	(19.0)	(66.2)	6.6
Cash (inflow)/outflow from (increase)/decrease in debt	(84.5)	24.0	(44.8)
Cash movement from changes in liquid resources	47.8	13.7	(23.7)
Movement in net debt	(55.7)	(28.5)	(61.9)
Opening net debt	(1,374.3)	(1,312.4)	(1,312.4)
Closing net debt	**(1,430.0)**	**(1,340.9)**	**(1,374.3)**

Notes to the Interim Financial Information

For the six months ended 31 March 2000 (Unaudited)

1. The interim financial information, which has not been audited, has been prepared on the basis of the accounting policies set out in the group accounts for the year ended 30 September 1999.

2. The balance shown as provisions in the balance sheet at 31 March 1999 has been restated by being disclosed separately from creditors in accordance with Financial Reporting Standard 12 – 'Provisions, contingent liabilities and contingent assets'.

3. An interim dividend of 1.7p per share is proposed, payable on 31 July 2000 with a record date of 30 June 2000.

4. The basic earnings per share figures have been calculated by dividing the profit attributable to shareholders (being the profit on ordinary activities after taxation) by the weighted average number of ordinary shares outstanding during the period. For the six months ended 31 March 2000 the weighted average number of ordinary shares outstanding was 116.3 million (1999: 115.7 million). For the year ended 30 September 1999 the weighted average was 116.0 million.

5. The diluted earnings per share figures have been calculated by adjusting the weighted average number of shares outstanding for the effects of all dilutive potential ordinary shares. For the six months ended 31 March 2000 the adjusted weighted average number of ordinary shares outstanding was 117.1 million, (1999: 116.7 million). For the year ended 30 September 1999 the adjusted weighted average was 117.0 million.

6. The figures shown above for the year ended 30 September 1999 are not statutory accounts. A copy of the statutory accounts has been delivered to the Registrar of Companies, contained an unqualified audit report and did not contain an adverse statement under sections 237 (2) or 237 (3) of the Companies Act 1985.

7. A copy of the Interim Statement will be posted to shareholders and additional copies can be obtained from The Paragon Group of Companies PLC, St. Catherine's Court, Herbert Road, Solihull, West Midlands, B91 3QE.

Independent Review Report to The Paragon Group of Companies PLC

Introduction

We have been instructed by the company to review the financial information set out on pages 4 to 7 and we have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by the directors. The Listing Rules of the UK Listing Authority require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 31 March, 2000.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants
Birmingham
22 May 2000

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