interim report 2001

The Paragon Group of Companies PLC

paragon

Chairman's Statement

Strong growth in both profits and new lending was again the main feature of the Group's performance over the six months to 31 March 2001. Profit before tax increased by 12.3% to £18.3 million (2000 H1: £16.3 million) and earnings per share increased to 13.0p (2000 H1: 11.3p). During the period, the Group acquired Colonial Finance (UK) Limited, adding a presence in the retail finance markets to our existing operations and, as a result, new loan originations increased by 66% to £371.9 million (2000 H1: £224.1 million). Excluding Colonial business, new loan originations grew by 47% to £329.1 million. By 31 March 2001, net loan assets were approaching £2 billion, compared with approximately £1.57 billion at 31 March 2000, an increase of 27%.

I am pleased to report that your Board has declared an interim dividend of 1.9p per share, payable on 31 July 2001. This gives an increase of 11.8% from last year's interim dividend of 1.7p.

Net interest income grew by 19.3% to £37.1 million (2000 H1: £31.1 million), the improvement in margins reflecting the continuing increase in consumer finance assets as a proportion of total loans to customers, and the favourable interest rate environment as the outlook has switched to one of easing since the autumn. Other operating income also increased to £6.9 million, up 6.2% from the first half of 2000 (£6.5 million).

Operating costs were £17.8 million, compared with £15.4 million for the corresponding period in 2000. At the year end we reported that operating expenses were expected to rise as we integrate the business of Colonial Finance (UK) Limited. The maintenance of tight cost control has contained the increase in costs such that the cost to income ratio has risen only marginally, to 40.5% from 40.1% last year. We expect the downward trend in the ratio to resume next year.

Provisions for losses were £7.9 million for the period, compared with £5.9 million for the first half of 2000. The increase reflects the increased proportion of the lending book attributable to consumer finance, where higher provisions are compensated by higher margins and, also, the overall increase in loan assets. Across all our new business areas the books are performing in line with our expectations, supported by a consistent application of our prudent credit policies.

After providing for corporation tax at a charge rate of 20%, which we anticipate will apply for the year, and providing for the proposed interim dividend, shareholders' funds at 31 March 2001 were £150.2 million.

The Group has continued to be actively engaged in the securitisation market. A £340 million securitisation backed by loans originated by Paragon Mortgages was completed in April 2001 under the name Paragon Mortgages (No. 3) PLC. This issue was rated by Standard and Poor's and by Moody's and was attractively priced. Indeed, the quality of Paragon's originations has resulted in some of the junior bonds in earlier issues being recently upgraded from their original rating. Work is currently underway to complete a securitisation of consumer finance loans, which will include secured and unsecured consumer finance assets (including loans acquired with the purchase of Colonial Finance (UK) Limited) and car finance loans.

Review of Operations

The business has two principal divisions, Consumer Finance and First Mortgages.

Consumer Finance

The Consumer Finance division operates in three areas of the consumer finance market: retail finance, personal finance and car finance.

Retail Finance

The acquisition of Colonial Finance (UK) Limited on 16 October 2000 advanced our plans to develop a point-of-sale retail finance capability, concentrating on the furniture and carpet sectors, to complement the Group's consumer finance activities. After making a provisional fair value adjustment of approximately £12 million at the time of acquisition to bring the provisioning and interest recognition policies into line with our own approach, Colonial added personal loans of some £96 million and retail loans of some £64 million to the Group's portfolio.

At the time of acquisition the administration of the personal and retail loan books of Colonial was carried out by two outsourcing companies. After reviewing the operation of the two books the collection and administration of the personal loan portfolio, numbering over 19,000 accounts, was transferred to our experienced in-house teams on 1 May. Administration of the retail portfolio remains with the extant outsourcing company, with whom we are working closely. The staff and business of Colonial have now been integrated within the Group and the retail loans business was rebranded in January under the name Paragon Retail Finance, to coincide with the January Furniture Show. The personal loans portfolio has been integrated within Paragon Personal Finance, our established personal lending division.

New retail finance loans advanced in the period from acquisition to 31 March 2001 amounted to £41.5 million. The division currently has retailer relationships with just over 2,000 outlets. Our immediate task is to expand the distribution to achieve the desired level of growth in this business area. To this end discussions are currently in progress with a number of other retailers in order to increase this number and, in turn, increase the level of market penetration.

Personal Finance

During the period Paragon Personal Finance advanced £93.8 million (2000 H1: £73.4 million), an increase of 27.8% from the level achieved during the corresponding period last year. By 31 March 2001 the net loan book (excluding the acquired Colonial assets) was £404.4 million, 14.8% higher than at 30 September 2000 (£352.4 million).

We continue to be encouraged by the increasing volumes achieved by the secured personal finance product, in respect of which completions were £50.7 million during the six months to 31 March 2001, compared with £27.8 million in the first half of 2000. Reflecting the quality of this portfolio we have placed increasing emphasis on this product in our relationships with our finance brokers, to take a greater proportion of secured rather than unsecured loans during the period.

To provide the basis for further expansion of this business, we have increased the number of introducers through whom we accept personal loans applications to 179 from 155 during the period and endeavoured to offer imaginative products to advance our competitive position. Competition in the market for direct loans has pushed returns on affinity business down to levels which fall short of our requirements and we are currently restructuring our affinity arrangements to bring returns up to acceptable levels. Timeshare, however continues to yield very satisfactory returns and we expect further growth in our activity in this market.

Car Finance

During the period, Paragon Car Finance advanced £75.1 million (2000 H1: £40.5 million), an increase of 85.4%. At 31 March 2001 the net loan book was, at £169.6 million, 32.1% higher than at 30 September 2000 (£128.4 million). Whilst the overall car market remained subdued for most of the period, there have been recent signs of recovery. The level of new car registrations showed an increase at the end of the calendar year, suggesting an improvement in the level of consumer confidence, although a recovery in demand for new and used car finance has yet to be seen.

Recent consolidation activity amongst companies participating in car finance and indeed the prospect that two of the largest players in the industry might combine has added to uncertainty amongst car dealers over the future competitive supply of finance to support sales. That uncertainty has contributed to the further penetration of Paragon Car Finance amongst dealerships. As a means of broadening distribution, Paragon Car Finance recently entered into a joint venture agreement with a major business introducer and a number of additional similar arrangements are currently under discussion. Such arrangements have the advantage of securing distribution and volumes. In addition, a number of new product initiatives are currently under consideration.

First Mortgages

At the year end, following a strong recovery of business volumes in the second half of 2000, we reported that the strength of Paragon's position in the Buy to Let market gave us confidence for strong growth in the current financial year. Indeed, Paragon Mortgages has enjoyed the most successful half year since its launch in 1994. Completions in the six months to 31 March 2001 were £161.5 million, compared to £110.2 million for the first half of 2000, representing an increase of 46.6%. At 31 March, the Paragon Mortgages book was £899.1 million, an increase in balances of 13.7% from £790.8 million at 30 September 2000. With pipeline business at 31 March at record levels, we anticipate lending volumes in the second half will also be strong. It is noteworthy that our Financial Adviser Confidence Tracking index for the mortgage market increased in the first quarter of 2001 to its highest level since 1999.

During the period Paragon Plus, our eCommerce landlord portal, was successfully launched, offering tenant referencing, a variety of insurance products, legal help and on-line information to existing Paragon customers and new customers alike. Paragon Plus is a platform for the first in what we intend to be a series of ancillary products developed to increase and enhance the transactional relationship between Paragon Mortgages and its property investor customers. In addition a new product has been launched enabling landlords to finance the purchase and refurbishment of property to let, capitalising on tax breaks announced in the Chancellor's budget statement and receiving considerable press coverage.

The high quality of mortgages for Buy to Let properties, which by March accounted for 99% of all completions, combined with the relatively unattractive returns expected from the retail mortgage sectors for the foreseeable future, led to Paragon's recent withdrawal of all retail mortgage products. In reality, our activity in the retail sectors has been low in recent years but the benefits of the focus this change has given the business are considerable, as all new product development, distribution and servicing initiatives are now concentrated on meeting the wider needs of the landlord.

The significance of the NHL book to the Group continues to decline. Balances at 31 March were £347.3 million, compared with £398.1 million at 30 September. The redemption level during the period equates to an annualised rate of 21%, slightly less than the rate of 22% recorded during the previous year. During the period cash receipts from NHL customers in arrears were 99.1% of the amounts contractually due, compared to 103.6% in 2000.

Conclusion

In the six months to 31 March 2001 the Group has continued to enjoy strong organic growth, steady growth of profits and has successfully acquired and integrated Colonial Finance (UK) Limited, adding a further line to our business activities. Our task now is to continue the profitable expansion of our businesses by delivering regular product innovations to meet the needs of our ever increasing range of customers, while maintaining the very high service levels which have been achieved across all our business areas.

Although the US economy is clearly slowing down, the prevailing view amongst economists is that the UK is well placed to maintain growth, albeit at lower levels in the short term than might have been expected a year ago. In rebuilding Paragon's business over the past six years we have sought to structure our operations to accommodate the inevitable cyclical nature of the economy, focusing on high quality underwriting, supported by our highly regarded collections operation and securitised matched funding. We believe, therefore, that our businesses are well positioned to deal with both the opportunities of building on recent successes and meeting the inevitable challenges in a strong and robust manner.

We remain confident about the outlook for the remainder of the year.

Jonathan Perry
Executive Chairman
22 May 2001

Consolidated Profit and Loss Account

for the six months ended 31 March 2001 (Unaudited)

	Six months to 31 March 2001 £m	Six months to 31 March 2000 £m	Year to 30 September 2000 £m
Interest receivable	112.9	88.6	186.4
Interest payable and similar charges	(75.8)	(57.5)	(124.1)
Net interest income	37.1	31.1	62.3
Other operating income	6.9	6.5	14.0
Total operating income	44.0	37.6	76.3
Operating expenses	(17.8)	(15.4)	(30.6)
Provisions for losses	(7.9)	(5.9)	(10.2)
Operating profit being profit on ordinary activities before taxation	18.3	16.3	35.5
Tax charge on profit on ordinary activities	(3.6)	(3.2)	(7.0)
Profit on ordinary activities after taxation	14.7	13.1	28.5
Equity dividend	(2.2)	(2.0)	(4.4)
Retained profit	12.5	11.1	24.1
Dividend – Rate per share	1.9p	1.7p	3.8p
Basic earnings per share	13.0p	11.3p	25.1p
Diluted earnings per share	12.7p	11.2p	24.9p

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 2001 (Unaudited)

		31 March 2001 £m	31 March 2000 (restated) £m	30 September 2000 (restated) £m
Assets employed:				
Fixed assets				
	Tangible assets	3.5	3.2	3.6
	Loans to customers	1,995.7	1,567.9	1,697.2
	Investment in own shares	4.8	2.8	4.8
		2,004.0	1,573.9	1,705.6
Current Assets				
	Stocks	9.5	13.1	11.5
	Debtors falling due within one year	6.6	6.4	8.9
	Cash at bank and investments	177.1	175.9	145.3
		193.2	195.4	165.7
		2,197.2	1,769.3	1,871.3
Financed by:				
	Equity shareholders' funds	150.2	124.6	137.7
	Provisions for liabilities and charges	2.6	3.8	3.7
Creditors				
	Amounts falling due within one year	34.0	27.3	30.5
	Amounts falling due after more than one year	2,010.4	1,613.6	1,699.4
		2,197.2	1,769.3	1,871.3

The interim financial information was approved by the Board of Directors on 22 May 2001.

Consolidated Cash Flow Statement
for the six months ended 31 March 2001 (Unaudited)

	Six months to 31 March 2001 £m	Six months to 31 March 2000 (restated) £m	Year to 30 September 2000 (restated) £m
Net cash inflow from operating activities	**39.0**	28.1	58.0
Taxation	**(1.3)**	–	(1.3)
Capital expenditure and financial investment			
Net increase in loans to customers	**(153.1)**	(81.4)	(222.9)
Other	**(0.4)**	(0.1)	(3.3)
Acquisitions and disposals	**0.9**	–	–
Equity dividends paid	**(2.4)**	(2.3)	(4.2)
Management of liquid resources	**7.5**	(47.8)	(9.9)
Financing	**150.1**	84.5	171.5
Increase/(decrease) in cash in the period	**40.3**	**(19.0)**	**(12.1)**

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

Operating profit	**18.3**	16.3	35.5
Provision for losses	**7.9**	5.9	10.2
Depreciation	**0.5**	0.5	1.3
Amortisation of broker commissions	**6.9**	4.7	12.7
Payments against provisions	**–**	(0.4)	–
Decrease in stock	**0.2**	1.2	0.8
Decrease in debtors	**4.2**	1.8	–
Increase/(decrease) in creditors	**1.0**	(1.9)	(2.5)
	39.0	**28.1**	**58.0**

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

Increase/(decrease) in cash in the period	**40.3**	(19.0)	(12.1)
Cash inflow from increase in debt	**(150.1)**	(84.5)	(171.4)
Cash movement from change in liquid resources	**(7.5)**	47.8	9.9
Movement in net debt	**(117.3)**	(55.7)	(173.6)
Loans acquired with subsidiary	**(162.4)**	–	–
Opening net debt	**(1,547.9)**	(1,374.3)	(1,374.3)
Closing net debt	**(1,827.6)**	**(1,430.0)**	**(1,547.9)**

Notes to the Interim Financial Information

For the six months ended 31 March 2001 (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 2000. The results for the businesses of Colonial Finance (UK) Limited have not been separately disclosed on the face of the profit and loss account due to their integration with the rest of the Group.

2. An interim dividend of 1.9p per share is proposed, payable on 31 July 2001 with a record date of 29 June 2001.

3. 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 2001 the weighted average number of ordinary shares outstanding was 112.8 million (2000: 116.3 million). For the year ended 30 September 2000 the weighted average was 113.3 million.

4. 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 2001 the adjusted weighted average number of ordinary shares outstanding was 115.7 million, (2000: 117.1 million). For the year ended 30 September 2000 the adjusted weighted average was 114.6 million.

5. The balance sheets at 31 March 2000 and 30 September 2000 have been adjusted to include the unamortised commission balances within 'Loans to Customers' rather than 'Other debtors' as it is felt that this represents a more appropriate classification. As a consequence of this the amortisation of these balances has been classified as a non cash movement within operating profit for the purposes of the cash flow statement.

6. The figures shown above for the year ended 30 September 2000 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, 2001.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants
Birmingham
22 May 2001