The Paragon Group of Companies PLC

interim report 2002

Chairman's Statement

Growth in profits, assets and lending volumes was again the key feature of the Group's performance over the six months to 31 March 2002. Profit before tax increased by 12.0% to £20.5 million (2001 H1: £18.3 million) and earnings per share increased to 14.4p (2001 H1: 13.0p). New loan originations increased by 16.9% to £434.9 million (2001 H1: £371.9 million), with the emphasis of lending continuing to shift towards loans secured on residential property (70.2% of advances compared to 57.1% H1 2001). At 31 March 2002, net loan assets were £2,288.8 million, compared with £2,146.3 million at 30 September 2001, and £1,995.7 million at 31 March 2001, an increase of 14.7% over the year.

In view of these strong results your Board has declared an interim dividend of 2.1p per share, payable on 31 July 2002. This gives an increase of 10.5% from last year's interim dividend of 1.9p consistent with our progressive dividend policy.

Net interest income grew by 7.0% to £39.7 million (2001 H1: £37.1 million) and other operating income also increased, to £8.8 million, up 27.5% from the first half of 2001 (£6.9 million), in part reflecting increasing insurance penetration on advances.

Operating costs were £17.7 million, compared with £17.8 million for the corresponding period in 2001. The focus on operating costs outlined in the year end statement has resulted in the cost to income ratio improving from 40.5% in the first half of 2001 to 36.5% for the six months ended 31 March 2002 and we expect to make further improvements to this ratio during the remainder of the financial year.

Provisions for losses of £10.3 million for the period were in line with our expectations (£7.9 million 2001 H1), reflecting increased charges against the consumer finance assets as this portfolio has grown. In all our new business areas the books are performing to plan, and we have seen no deterioration in credit quality across the portfolio.

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 2002 were £181.1 million.

The Group continues to be actively engaged in the securitisation market. In December 2001 a £244.7 million securitisation backed by secured and unsecured personal loans, car finance and retail credit loans was completed under the name Paragon Personal and Auto Finance (Nº 2) PLC. A £500 million securitisation backed by loans originated by Paragon Mortgages was completed in March 2002 under the name Paragon Mortgages (Nº 4) PLC. Both issues were rated by Standard and Poor's, Moody's and Fitch and were attractively priced. Work is currently in progress to repackage the old book loans under the one vehicle company, Homeloans (Nº 4) PLC. Completion of this transaction is anticipated shortly.

In February 2002 the Group entered into a new £400 million warehouse facility for the funding of originations pending securitisation. This facility, which is rated by Moody's Investors Service, is available to support loan originations until February 2005.

Review of Operations

FIRST MORTGAGES

The first mortgage business has continued to grow strongly. At 31 March 2002 the Paragon Mortgages book was £1,197.7 million, an increase of 33.2% from £899.1 million at 31 March 2001. Total advances increased by 48.6% to £240.0 million, from £161.5 million for the corresponding period last year. Our high credit standards have resulted in a portfolio of high quality, with very low arrears levels within the book.

Current trading remains buoyant. In April 2002 the business recorded its highest level of completions to date at over £50 million and, with the pipeline of business in progress at an all-time high, we are confident of further volume growth in the second half of the financial year.

Recent evidence from the housing market suggests that we are in a period of strong house price growth. There are many factors that have contributed to this: good affordability driven by the low cost of borrowing; a significant and growing shortage of supply in housing; and a benign outlook for the economy. Leading commentators disagree on the prognosis, but some moderation of house price inflation in the medium term is likely.

Undoubtedly the strong performance of housing assets has played a key role in encouraging many new buy-to-let landlords into the market for the first time, particularly when compared to the poor recent performance of equities. These novice landlords, less experienced in property selection, have contributed to over-supply in certain geographical locations and for certain property types. However, as illustrated in the latest reports from FPD Savills and The Association of Residential Letting Agents, whilst prime central London property may have been the subject of some over-investment (and a fall in demand following the events of 11 September), the situation in the rest of the country is more balanced.

Paragon's product and service focus remains on the more experienced property investors, accounting for some 80% of new business flows. There are a number of benefits in such an approach; professional investors have an established track record and consider demand and yield issues when buying property (eschewing property "hot spots" where yields may be low); they manage property more proactively (usually personally rather than through an agent); and they have a portfolio of properties rather than just one or two, and therefore a spread of risk. As a result, they are less vulnerable to a correction in the property market than over extended owner occupiers or amateur landlords, and our portfolio is underweight in areas of higher property values. London property, for example, comprises only 13% of our book compared to a CML average for the private rented sector of 28%.

Over the long term, we expect demand in the private rented sector to continue to grow as a result of population growth and changing demographic dynamics over the next 20 years. Our view has been supported recently by the conclusion of the influential Housing Futures 2012 Report, from the Centre of Economics and Business Research, that the private rented sector would have to grow by 40% over the next 10 years in order to meet demand for rental property.

The NHL book reduced to £268.4 million at 31 March, from £306.3 million at 30 September. Although steadily declining in significance, this book continues to be carefully managed and recorded a satisfactory performance over the period.

CONSUMER FINANCE

At 31 March 2002 the Consumer Finance book stood at £781.7 million, up from £714.3 million at 31 March 2001.

Retail Finance

Whilst retail sales volumes have been buoyant, instalment credit has remained subdued across the market. Against this background, Paragon Retail Finance produced a satisfactory performance in line with plan, advancing loans of £42.9 million, compared with £41.5 million for the first half of the previous year.

During this period the business has concentrated on developing its relationships with the larger furniture buying groups and on amending our terms of business with retailers that produce an inadequate return. This should ensure the business is well placed to take advantage of a pick-up in demand for instalment credit.

Personal Finance

At 31 March 2002 the Paragon Personal Finance book stood at £518.8 million, compared with £479.5 million at 31 March 2001 (an increase of 8.2%), after advancing new loans of £90.1 million in the period (2001 H1 £93.8 million). In keeping with the stance that we outlined in our 2001 statement, we have boosted secured lending volumes (up 29% to £65.4 million, compared to £50.7 million H1 2001) at the expense of unsecured volumes.

Lending volumes were strong towards the end of the period and during April and, with positive feedback from our brokers on new secured product initiatives, we expect further growth during the second half of this financial year.

Car Finance

At 31 March 2002 the Paragon Car Finance book stood at £201.1 million, compared with £169.6 million at 31 March 2001, an increase of 18.6%. During the period the business has extended further its dealership distribution, but the difficult conditions for used car finance that we reported at the year end have continued. Advances of £61.8 million in the period, whilst ahead of plan, were at a similar level to the second half of 2001, itself a subdued period, and below the £75.1 million advanced in the corresponding period last year.

However, we expect business volumes to improve in the second half of this financial year as used car finance picks up. This is supported by recent trading, with advances exceeding £15 million in each of the past two months.

CONCLUSION

Strong organic growth combined with prudent management of the loan portfolio in the six months to 31 March 2002 has underpinned further growth in profitability for the Group. The outlook for the UK economy now looks more benign than it has over the past few months, but with the recovery both here and in the US still fragile, it remains appropriate to maintain the cautious stance to unsecured lending that we have adopted over the past year. We shall therefore continue to emphasise secured lending in our business mix.

The Group's available cash resources remain high and we continue to explore acquisition opportunities to further our strategic objectives. In the meantime, trading activity remains at high levels, the Group having advanced £91.3 million of new business in April, and we remain confident of meeting our objectives for the financial year.

F W (Bill) Hulton

It was with regret that we announced recently the resignation due to ill-health of Bill Hulton, the senior non-executive director on the Board. Bill has served the Company and its shareholders for nine years with a unique blend of intelligence, business acumen, critical analysis and unfailing good humour. We thank him for his outstanding contribution to Paragon.

Jonathan Perry
Executive Chairman
21 May 2002

Consolidated Profit and Loss Account

for the six months ended 31 March 2002 (Unaudited)

	Six months to 31 March 2002 £m	Six months to 31 March 2001 £m	Year to 30 September 2001 £m
Interest receivable	**114.9**	112.9	229.7
Interest payable and similar charges	**(75.2)**	(75.8)	(156.9)
Net interest income	**39.7**	37.1	72.8
Other operating income	**8.8**	6.9	15.3
Total operating income	**48.5**	44.0	88.1
Operating expenses	**(17.7)**	(17.8)	(35.6)
Provisions for losses	**(10.3)**	(7.9)	(12.0)
Operating profit being profit on ordinary activities before taxation	**20.5**	18.3	40.5
Tax charge on profit on ordinary activities	**(4.1)**	(3.6)	(8.2)
Profit on ordinary activities after taxation	**16.4**	14.7	32.3
Equity dividend	**(2.5)**	(2.2)	(5.0)
Retained profit	**13.9**	12.5	27.3
Dividend – Rate per share	**2.1p**	1.9p	4.2p
Basic earnings per share	**14.4p**	13.0p	28.5p
Diluted earnings per share	**14.0p**	12.7p	27.8p

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 2002 (Unaudited)

		31 March 2002 £m	31 March 2001 £m	30 September 2001 £m
Assets employed:				
Fixed assets				
	Tangible assets	**3.3**	3.5	3.2
	Loans to customers	**2,288.8**	1,995.7	2,146.3
	Investment in own shares	**6.2**	4.8	4.8
		2,298.3	**2,004.0**	**2,154.3**
Current Assets				
	Stocks	**6.8**	9.5	8.9
	Debtors falling due within one year	**7.4**	6.6	7.9
	Cash at bank and investments	**316.7**	177.1	231.5
		330.9	**193.2**	**248.3**
		2,629.2	**2,197.2**	**2,402.6**
Financed by:				
	Called-up share capital	**11.8**	11.6	11.7
	Share premium account	**65.3**	62.5	63.5
	Merger reserve	**(70.2)**	(70.2)	(70.2)
	Profit and loss account	**174.2**	146.3	161.1
	Equity shareholders' funds	**181.1**	150.2	166.1
	Provisions for liabilities and charges	**2.3**	2.6	2.3
	Creditors			
	Amounts falling due within one year	**39.4**	34.0	37.6
	Amounts falling due after more than one year	**2,406.4**	2,010.4	2,196.6
		2,629.2	**2,197.2**	**2,402.6**

The interim financial information was approved by the Board of Directors on 21 May 2002.

Consolidated Cash Flow Statement

for the six months ended 31 March 2002 (Unaudited)

	Six months to 31 March 2002 £m	Six months to 31 March 2001 £m	Year to 30 September 2001 £m
Net cash inflow from operating activities	**47.4**	39.0	80.5
Taxation	**(2.4)**	(1.3)	(5.7)
Capital expenditure and financial investment			
Net increase in loans to customers	**(167.4)**	(153.1)	(321.6)
Other	**(1.9)**	(0.4)	(0.8)
Acquisitions and disposals	**–**	0.9	0.3
Equity dividends paid	**(2.7)**	(2.4)	(4.7)
Management of liquid resources	**64.0**	7.5	(51.1)
Financing	**212.1**	150.1	339.2
Increase in cash in the period	**149.1**	**40.3**	**36.1**

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

Operating profit	**20.5**	18.3	40.5
Provision for losses	**10.3**	7.9	12.0
Depreciation	**0.4**	0.5	1.2
Amortisation of broker commissions	**14.6**	6.9	20.1
Decrease in stock	**0.1**	0.2	0.3
Decrease in debtors	**0.5**	4.2	2.9
Increase in creditors	**1.0**	1.0	3.5
	47.4	**39.0**	**80.5**

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

Increase in cash in the period	**149.1**	40.3	36.1
Cash inflow from increase in debt	**(211.0)**	(150.1)	(338.1)
Cash movement from change in liquid resources	**(64.0)**	(7.5)	51.1
	(125.9)	(117.3)	(250.9)
Loans acquired with subsidiary	**–**	(162.4)	(162.4)
Movement in net debt	**(125.9)**	(279.7)	(413.3)
Opening net debt	**(1,961.2)**	(1,547.9)	(1,547.9)
Closing net debt	**(2,087.1)**	**(1,827.6)**	**(1,961.2)**

Notes to the Interim Financial Information

For the six months ended 31 March 2002 (Unaudited)

1. The interim financial information, which has not been audited, has with the exception of deferred tax been prepared on the basis of the accounting policies set out in the group accounts for the year ended 30 September 2001. The interim information has been prepared applying FRS 19, "Accounting for Deferred Tax" which is effective for accounting periods ending on or after 22 January 2002. This change has no impact on the result disclosed for the period and no restatement of the comparative figures for 31 March 2001 and 30 September 2001 is required.

2. An interim dividend of 2.1p per share is proposed, payable on 31 July 2002 with a record date of 28 June 2002.

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 2002 the weighted average number of ordinary shares outstanding was 114.1 million (2001: 112.8 million). For the year ended 30 September 2001 the weighted average was 113.4 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 2002 the adjusted weighted average number of ordinary shares outstanding was 116.9 million, (2001: 115.7 million). For the year ended 30 September 2001 the adjusted weighted average was 116.2 million.

5. The figures shown above for the year ended 30 September 2001 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.

6. A copy of the Interim Statement will be posted to shareholders and additional copies can be obtained from The Company Secretary, 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 for the six months ended 31 March 2002 which comprises the profit and loss account, the balance sheet, the cash flow statement and related notes 1 to 6 together with the reconciliation of operating profit to net cash flow from operating activities and the reconciliation of movement in cash with movement in net debt. 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 directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which 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 the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. 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 United Kingdom 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 2002.

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21 May 2002