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interim report 2003

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The Paragon Group of Companies PLC

Chairman's Statement

Profits, assets and lending volumes grew strongly during the six months to 31 March 2003. Profit before tax increased by 14.1% to £23.4 million (2002 H1: £20.5 million) and earnings per share increased to 16.1p (2002 H1: 14.4p). New loan originations increased by 29.7% to £563.9 million (2002 H1: £434.9 million). At 31 March 2003, net loan assets were £2,746.5 million, compared with £2,521.3 million at 30 September 2002, and £2,291.7 million at 31 March 2002, an increase of 19.8% over the year.

Your Board has declared an interim dividend of 2.6p per share, payable on 31 July 2003 to shareholders on the register on 4 July 2003. This gives an increase of 23.8% from last year's interim dividend of 2.1p consistent with our policy, as outlined in my year-end statement, of moving towards dividend cover more in line with our sector over time.

Total operating income was similar to the level for the first half of last year at £48.9 million (2002 H1: £48.5 million). Within that, net interest income was £35.9 million (2002 H1: £39.7 million). The reduction reflects the continued change in our lending mix towards secured products, with 81% of advances in the period being secured on residential property (2002 H1: 70.2%). The reduction in net interest income was compensated by increased fee income on these products, with other operating income increasing to £13.0 million (2002 H1: £8.8 million).

Operating costs were £16.7 million, compared with £17.7 million for the corresponding period in 2002. The continuing focus on operating costs reported in our recent statements has resulted in the cost to income ratio improving from 36.5% in the first half of 2002 to 34.2% for the six months ended 31 March 2003. We continue to focus on efficiency improvements to secure further reductions in this ratio.

Provisions for losses of £8.8 million for the period were in line with our expectations (2002 H1: £10.3 million) and reflect the shift in the mix of our portfolio towards a greater proportion of secured lending. 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 22%, which we anticipate will apply for the year, and providing for the proposed interim dividend, shareholders' funds at 31 March 2003 were £215.9 million.

Review of Operations

FIRST MORTGAGES

The first mortgage business has continued to grow strongly. At 31 March 2003 the Paragon Mortgages book was £1,636.7 million, an increase of 36.7% from £1,197.7 million at 31 March 2002. Total advances increased by 37.9% to £330.9 million, from £240.0 million for the corresponding period last year. Our high credit standards have resulted in a portfolio of high quality, with very low arrears levels.

Despite mixed indicators from the housing market, the private rented sector has remained busy. Paragon Mortgages has enjoyed record levels of new buy-to-let applications, resulting in historically high commitment levels on applications outstanding. Nearly all of the activity we have seen is on the part of "professional landlords", these being customers who evidence a good track record in residential lettings stretching back a number of years. Recent indications of a cooling in the housing market have coincided with some strong signals from the private rented sector with the RICS, ARLA and our own surveys indicating improved rental demand and a marked stabilisation of rental returns and values. Professional landlords in particular are viewing the nervousness in the owner occupied sector as a signal to purchase better value properties and capitalise on the increase in demand as potential first time buyers and people between homes delay their buying decisions.

The buy-to-let pipeline suggests that demand will remain strong for the foreseeable future regardless of concerns elsewhere in the economy and current trading remains buoyant.

We have recently extended our product range by offering commercial investment property loans sourced through existing relationships. A dedicated warehouse facility has been arranged to permit a cautious entry into this market. This new product will enable us to widen the services which we are able to provide to our professional buy-to-let property investors, many of whom have commercial property investments in addition to their residential portfolios.

The NHL book reduced to £202.5 million at 31 March 2003, from £230.5 million at 30 September 2002 and recorded a satisfactory performance over the period.

CONSUMER FINANCE

At 31 March 2003 the Consumer finance book stood at £859.9 million, 10.0% up from £781.7 million at 31 March 2002.

Personal finance

After advancing new loans of £133.4 million in the period (2002 H1: £90.1 million), the Paragon Personal finance book stood at £573.9 million, compared with £518.8 million at 31 March 2002 (an increase of 10.6%). In keeping with the stance that we outlined in our 2002 statement, we have increased secured lending volumes (up 92.7% to £126.0 million, compared to £65.4 million H1 2002) while unsecured volumes have continued to decline.

The strong growth in secured lending has been achieved by broadening the support base without relaxing credit quality. Advanced technology continues to play a key role in establishing closer relationships with our intermediaries, resulting in increasing demand for our products and services.

Retail Finance

There has been a slowdown in activity within the retail finance sector during the period due to weakening consumer confidence. Paragon Retail Finance has however maintained its niche market position in the face of a highly competitive environment, advancing loans of £32.4 million (2002 H1: £42.9 million). Since the year-end all the administration of this book, which was previously outsourced, has been brought in-house, enhancing front-end service to retailers. The transfer should bring long term cost savings and improved flexibility.

We believe the difficult conditions in the retail finance market will persist for the remainder of the year but we are confident of retaining our market position and of benefiting from the eventual recovery in consumer confidence.

Car Finance

At 31 March 2003 the Paragon Car Finance book stood at £237.5 million, compared with £201.1 million at 31 March 2002, an increase of 18.1%. In difficult trading conditions, Paragon Car Finance advanced new business of £66.6 million in the period (2002 H1: £61.8 million), which was in line with our expectations. Given current market volatility and further tightening of our credit criteria, our plans do not anticipate growth in this book in the second half of the financial year.

Paragon Car Finance continues to focus on providing high quality, flexible and value adding products to its customers, supported by a strong service quality. We continue to work on enhancing the basis of the relationship with our distributors, employing a combination of technology and personal contact.

CONCLUSION

Strong organic growth, combined with prudent management of the loan portfolio and sound cost control, has underpinned growth in profits. Our strategy of emphasising secured products, with 81% of advances in the period being secured on residential property, positions us well to face a potential softening in the UK economy. We continue to develop new products, to expand our distribution and to explore acquisition opportunities.

We remain confident of developing Paragon's business and of meeting our objectives for the financial year.

Jonathan Perry
Executive Chairman
20 May 2003

Consolidated Profit and Loss Account

for the six months ended 31 March 2003 (Unaudited)

	Six months to 31 March 2003 £m	Six months to 31 March 2002 £m	Year to 30 September 2002 £m
Interest receivable	**120.0**	114.9	230.0
Interest payable and similar charges	**(84.1)**	(75.2)	(157.1)
Net interest income	**35.9**	39.7	72.9
Other operating income	**13.0**	8.8	20.6
Total operating income	**48.9**	48.5	93.5
Operating expenses	**(16.7)**	(17.7)	(34.6)
Provisions for losses	**(8.8)**	(10.3)	(12.9)
Operating profit being profit on ordinary activities before taxation	**23.4**	20.5	46.0
Tax charge on profit on ordinary activities	**(5.1)**	(4.1)	(9.4)
Profit on ordinary activities after taxation	**18.3**	16.4	36.6
Equity dividend	**(3.1)**	(2.5)	(6.0)
Retained profit	**15.2**	13.9	30.6
Dividend – Rate per share	**2.6p**	2.1p	5.1p
Basic earnings per share	**16.1p**	14.4p	32.1p
Diluted earnings per share	**15.9p**	14.0p	31.4p

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

Consolidated Balance Sheet

at 31 March 2003 (Unaudited)

		31 March 2003 £m	31 March 2002 (Restated) £m	30 September 2002 £m
Assets employed:				
Fixed assets				
	Tangible assets	**3.9**	3.3	3.4
	Loans to customers	**2,746.5**	2,291.7	2,521.3
	Investment in own shares	**11.0**	6.2	9.3
		2,761.4	2,301.2	2,534.0
Current assets				
	Stocks	**4.4**	6.8	5.3
	Debtors falling due within one year	**7.2**	7.4	7.7
	Cash at bank and investments	**202.8**	316.7	247.1
		214.4	330.9	260.1
		2,975.8	2,632.1	2,794.1
Financed by:				
	Called-up share capital	**11.8**	11.8	11.8
	Share premium account	**65.5**	65.3	65.5
	Merger reserve	**(70.2)**	(70.2)	(70.2)
	Profit and loss account	**208.8**	177.1	193.7
	Equity shareholders' funds	**215.9**	184.0	200.8
	Provisions for liabilities and charges	**0.8**	2.3	0.6
	Creditors			
	Amounts falling due within one year	**37.6**	39.4	43.7
	Amounts falling due after more than one year	**2,721.5**	2,406.4	2,549.0
		2,975.8	2,632.1	2,794.1

The interim financial information was approved by the Board of Directors on 20 May 2003.

Consolidated Cash Flow Statement

for the six months ended 31 March 2003 (Unaudited)

	Six months to 31 March 2003 £m	Six months to 31 March 2002 £m	Year to 30 September 2002 £m
Net cash inflow from operating activities	**45.9**	47.4	92.9
Taxation	**(7.5)**	(2.4)	(7.8)
Capital expenditure and financial investment			
Net increase in loans to customers	**(248.8)**	(167.4)	(413.4)
Other	**(2.8)**	(1.9)	(5.8)
Equity dividends paid	**(3.5)**	(2.7)	(5.1)
Management of liquid resources	**55.6**	64.0	8.2
Financing	**172.4**	212.1	354.8
Increase in cash in the period	**11.3**	149.1	23.8

(1) Reconciliation of operating profit to net cash flow from operating activities			
Operating profit	**23.4**	20.5	46.0
Provision for losses	**8.8**	10.3	12.9
Depreciation	**0.6**	0.4	1.1
Amortisation of broker commissions	**15.2**	14.6	28.3
Decrease in stock	**0.3**	0.1	0.3
Decrease/(increase) in debtors	**0.5**	0.5	(0.2)
(Decrease)/increase in creditors	**(2.9)**	1.0	4.5
	45.9	47.4	92.9

(2) Reconciliation of movement in cash with movement in net debt			
Increase in cash in the period	**11.3**	149.1	23.8
Cash inflow from increase in debt	**(172.4)**	(211.0)	(353.6)
Cash movement from change in liquid resources	**(55.6)**	(64.0)	(8.2)
Movement in net debt	**(216.7)**	(125.9)	(338.0)
Opening net debt	**(2,299.2)**	(1,961.2)	(1,961.2)
Closing net debt	**(2,515.9)**	(2,087.1)	(2,299.2)

Notes to the Interim Financial Information

For the six months ended 31 March 2003 (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 2002.

2. The balance sheet as at 31 March 2002 has been restated to reflect the change in accounting policy adopted in the group accounts for the year ended 30 September 2002 whereby the treatment of brokers' commissions paid on mortgage loans was changed, so that such balances are amortised over the penalty period of the related loan, instead of being treated as an expense at the point of completion of the loan. It was considered that this treatment is more appropriate as it is more consistent with the treatment of broker commissions paid on other types of loan, and with practice within the industry. The balance sheet at 31 March 2002 has been adjusted to include the unamortised commission balances within 'Loans to Customers'. The effect of this adjustment is to increase the balance of loans to customers at 31 March 2002 by £2.9m. The effect on the result for the period is immaterial.

3. An interim dividend of 2.6p per share is proposed, payable on 31 July 2003 with a record date of 4 July 2003.

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 2003 the weighted average number of ordinary shares outstanding was 113.6 million (2002: 114.1 million). For the year ended 30 September 2002 the weighted average was 114.1 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 2003 the adjusted weighted average number of ordinary shares outstanding was 115.0 million, (2002: 116.9 million). For the year ended 30 September 2002 the adjusted weighted average was 116.4 million.

6. The figures shown above for the year ended 30 September 2002 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 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 2003 which comprises the profit and loss account, the balance sheet, the cash flow statement and related notes 1 to 7 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.

This report is made solely to the company in accordance with Bulletin 1999/4 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the company those matters which we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company for our review work, for this report or for the conclusions we have formed.

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 are 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 2003.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants
Birmingham
20 May 2003