paragon

The Paragon Group of Companies PLC

Interim Report 2004

Chairman's statement

During the six months ended 31 March 2004, the Group has enjoyed further strong growth in profits and lending volumes and has now completed the integration of Mortgage Trust (formerly Britannic Money) which was acquired on 30 June 2003.

During the period, profit before tax increased by 41.5% to £33.1 million (2003 H1: £23.4 million) and earnings per share increased to 22.4p (2003 H1: 16.1p). Total advances increased by 81.8% to £1,025.4 million (2003 H1: £563.9 million). Of these, 92% were secured on residential property (2003 H1: 81%). At 31 March 2004, net loan assets, inclusive of those held by the off-balance sheet companies managed by Mortgage Trust, were £5,600.4 million (note 7), compared with £5,287.1 million at 30 September 2003 and £2,746.5 million (prior to the acquisition of Mortgage Trust) at 31 March 2003.

As a result of the growth achieved, your Board has declared an interim dividend of 3.9p per share, payable on 30 July 2004 to shareholders on the register on 2 July 2004, an increase of 50.0% from last year's interim dividend of 2.6p per share.

The growth in the loan book increased net interest income by 14.8% to £41.2 million from £35.9 million for the corresponding period last year. Other operating income was £18.8 million (2003 H1: £13.0 million), an increase of 44.6% resulting from the growth in fees and commissions arising from increased new business and the growth of the book.

Operating expenses, excluding the £2.7 million credit for amortisation of negative goodwill, were £22.7 million, compared with £16.7 million for the corresponding period in 2003. The cost : income ratio, at 37.8%, increased from 34.2% for the first half of 2003 (note 4) as a result of the inclusion of the full costs of Mortgage Trust during the period. Excluding Mortgage Trust, the cost : income ratio decreased from 34.2% to 33.7% (note 4).

Prior to acquisition on 30 June 2003, Mortgage Trust had incurred substantial losses as a result of poor margins on loans being serviced by a high cost operation. Our focus since acquisition has been to discontinue low margin business whilst introducing operational efficiencies to reduce the cost base. By 31 March 2004 substantially all of the support and administrative functions of Mortgage Trust's Epsom operation had been transferred to the Group's offices in Solihull and London. The number of staff employed at Epsom has been reduced from 247 at the time of acquisition to 103 by 31 March and further reductions have been effected subsequent to the period end. The resulting cost savings will impact favourably on the cost : income ratio in the second half of the year. Including the amortisation of goodwill, Mortgage Trust contributed £7.2 million to the Group's profit before tax during the six months ended 31 March 2004.

The reduction in the charge for provisions for losses to £6.9 million for the period (2003 H1: £8.8 million) is in line with our expectations and reflects the shift in our lending in recent years in favour of more credit defensive products. The books continue to perform to plan across all our new business areas, with no deterioration in credit quality across the portfolio.

After providing for corporation tax at a charge rate of 23%, which we anticipate will apply for the year, and providing for the proposed interim dividend, retained profits of £21.0 million have been transferred to shareholders' funds.

Review of operations

First mortgages

Total first mortgage completions by Paragon Mortgages and Mortgage Trust were £797.7 million for the six months to 31 March 2004, an increase of 141.1% from £330.9 million advanced by Paragon Mortgages in the corresponding period of 2003. At 31 March 2004, total first mortgage assets, including those managed by Mortgage Trust, were £4,648.4 million, an increase of 152.7% from £1,839.2 million at 31 March 2003.

New lending by Paragon Mortgages increased by 57.9% to £522.4 million whilst Mortgage Trust advanced new loans of £275.3 million, over 91% of which were buy-to-let, the remainder relating to the tail of owner occupied completions on products discontinued shortly after our acquisition of the business.

Our strategy for Mortgage Trust has led to the rationalisation of the product portfolio in favour of more profitable buy-to-let products and a complete withdrawal from the owner occupied sector. While this resulted in a temporary reduction in business volumes this is already reversing as Mortgage Trust's established introducers offer increasing volumes of buy-to-let applications and new introducers are brought on stream.

In both of the Group's first mortgage businesses the steady rise in application levels during the second quarter and pipeline levels at the end of the period auger well for lending volumes in the second half of the year.

Shortage of supply continues to be the most dominant feature of the UK housing market. Despite the strong growth in house prices, the relatively low cost of borrowing, which has been augmented by fierce competition amongst lenders in the commodity mortgage market, has kept affordability close to its long term average.

The Group's primary focus remains the experienced professional landlord and the record low level of first time buyers and structural constraints in the social rented sector have resulted in rental demand being maintained. Landlords have continued to expand their property portfolios to meet the growing demand. The shortage of affordable housing was a particular focus for the recent Barker Review of Housing Supply and it is clear that the private rented sector will need to play a central role in meeting future demand for more modest housing.

The NHL book reduced to £155.3 million at 31 March 2004, from £202.5 million at 31 March 2003 and recorded a satisfactory performance over the period.

Consumer finance

At 31 March 2004, the consumer finance book stood at £895.3 million, an increase of 4.1% from £859.9 million at 31 March 2003.

Personal finance

Secured personal finance advances were £146.0 million in the period (2003 H1: £126.0 million), an increase of 15.9% from the corresponding period last year. This growth has been achieved without relaxing credit quality and in the face of strong competitive pressure. We continue to benefit from strong introducer support, which we expect to underpin continued growth during the second half.

Sales aid finance

As we explained at the year end, we have continued to limit originations within the retail and car finance sectors, where returns have been inadequate. As a result, new loan advances by the division were £81.7 million, compared with £99.0 million for the corresponding period last year, the reduction in volumes being in line with plan. However, as the reduction in volumes has arisen from the removal of unprofitable distribution sources and products, the profitability of new business written has improved and should provide a base for further development. In particular, an enhanced retail finance sales and service proposition has been established to provide a platform for increased business, whilst in car finance we continue to focus our sales activity on the more profitable introducers.

Funding

During October 2003, the Group completed a £715 million securitisation by Paragon Mortgages (No. 6) PLC. The securitisation contained a £98 million pre-funding reserve which was used to purchase further mortgage assets from the Paragon warehouse in November 2003.

In January 2004 a further £500 million securitisation of Mortgage Trust originated assets was completed by First Flexible No. 6 PLC. The securitisation contained a £75 million pre-funding reserve which was used to acquire further mortgage assets from the Mortgage Trust warehouse facility in March 2004.

An £800 million securitisation by Paragon Mortgages (No.7) PLC is expected to complete on 26 May. This securitisation will include loans originated by both Paragon Mortgages and Mortgage Trust.

The notes issued from our recent securitisation transactions have been placed in the Sterling, US dollar and euro markets and favourable conditions have led to improved pricing.

The Group has been voted Best Issuer for Investor Reporting in the 2003 Structured Finance International Awards, from over twenty issuers nominated.

Conclusion

In my end of year statement I reported that our objectives for the current year were to complete the integration of Mortgage Trust and to continue to grow profitably our core lending divisions whilst maintaining our focus on cost control and our strong stance on credit quality. I am delighted with the progress we have made in the first six months of the year, particularly the integration of Mortgage Trust which has been transformed from a loss making business prior to our acquisition last year to a healthy contributor to Group profits.

As shareholders are aware, we have concentrated our efforts over recent years on the buy-to-let sector, primarily aiming our services at professional landlords. The credit record of this sector to date is markedly superior to that of the owner occupied sector. Despite this, buy-to-let lending continues to receive mixed reviews in the press. If market conditions were to deteriorate, we believe that our triple underwriting approach, encompassing a critical review of each property, likely rental cover and borrower covenant would see the buy-to-let sector, particularly in respect of professional borrowers, outperform other residential mortgage portfolios.

I look forward to reporting further progress after the end of the financial year.

Jonathan Perry
Chairman

26 May 2004

Consolidated profit and loss account

For the six months ended 31 March 2004 (Unaudited)

	Six months to 31 March 2004 £m	Six months to 31 March 2003 £m	Year to 30 September 2003 £m
Interest receivable	192.7	120.0	272.0
Interest payable and similar charges	(151.5)	(84.1)	(195.5)
Net interest income	41.2	35.9	76.5
Other operating income	18.8	13.0	31.0
Total operating income	60.0	48.9	107.5
Operating expenses			
Exceptional reorganisation costs	-	-	(3.9)
Other operating expenses	(22.7)	(16.7)	(37.9)
Amortisation of negative goodwill	2.7	-	2.1
Total operating expenses	(20.0)	(16.7)	(39.7)
Provisions for losses	(6.9)	(8.8)	(15.9)
Operating profit being profit on ordinary activities before taxation	33.1	23.4	51.9
Tax charge on profit on ordinary activities	(7.6)	(5.1)	(11.6)
Profit on ordinary activities after taxation	25.5	18.3	40.3
Equity dividend	(4.5)	(3.1)	(7.5)
Retained profit	21.0	15.2	32.8
Dividend – Rate per share	3.9p	2.6p	6.3p
Basic earnings per share	22.4p	16.1p	35.5p
Diluted earnings per share	21.6p	15.9p	34.8p

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

Consolidated balance sheet

31 March 2004 (Unaudited)

	31 March 2004 £m	31 March 2003 (restated) £m	30 September 2003 (restated) £m
Assets employed			
Fixed assets			
Intangible assets – negative goodwill	(16.1)	-	(18.8)
Tangible assets	3.6	3.9	4.2
Investments			
Assets subject to non-recourse finance	1,797.5		2,361.6
Non-recourse finance	(1,751.6)	-	(2,285.3)
	45.9	-	76.3
Loans to customers	3,909.2	2,746.5	3,051.3
	3,955.1	2,746.5	3,127.6
	3,942.6	2,750.4	3,113.0
Current assets			
Stocks	3.4	4.4	3.8
Debtors falling due within one year	10.6	7.2	9.4
Cash at bank and investments	345.9	203.0	295.3
	359.9	214.6	308.5
	4,302.5	2,965.0	3,421.5
Financed by			
Called-up share capital	12.0	11.8	11.9
Share premium account	68.6	65.5	67.6
Merger reserve	(70.2)	(70.2)	(70.2)
Profit and loss account	247.2	208.8	225.8
Share capital and reserves	257.6	215.9	235.1
Own shares	(11.5)	(10.8)	(9.8)
Equity shareholders' funds	246.1	205.1	225.3
Provisions for liabilities and charges	5.3	0.8	7.6
Creditors			
Amounts falling due within one year	45.9	37.6	128.0
Amounts falling due after more than one year	4,005.2	2,721.5	3,060.6
	4,302.5	2,965.0	3,421.5

The interim financial information was approved by the Board of Directors on 26 May 2004.

Consolidated cash flow statement

For the six months to 31 March 2004 (Unaudited)

	Six months to 31 March 2004 £m	Six months to 31 March 2003 £m	Year to 30 September 2003 £m
Net cash inflow from operating activities	55.0	45.9	108.2
Taxation	(10.6)	(7.5)	(14.4)
Capital expenditure and financial investment			
Net decrease / (increase) in assets subject to non-recourse funding	562.6	-	(78.2)
Net increase in loans to customers	(881.9)	(248.8)	(546.9)
Other	(1.8)	(2.8)	(2.1)
Acquisitions and disposals	-	-	(26.7)
Equity dividends paid	(4.2)	(3.5)	(6.6)
Management of liquid resources	(37.5)	55.6	(27.5)
Financing	331.5	172.4	613.6
Increase in cash in the period	13.1	11.3	19.4

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

	Six months to 31 March 2004 £m	Six months to 31 March 2003 £m	Year to 30 September 2003 £m
Operating profit	33.1	23.4	51.9
Provision for losses	6.9	8.8	15.9
Depreciation	0.7	0.6	1.9
Amortisation of broker commissions	19.1	15.2	33.6
Amortisation of negative goodwill	(2.7)	-	(2.1)
Charge for long term incentive plan	0.7	-	0.2
Decrease in stock	0.2	0.3	0.5
(Increase) / decrease in debtors	(1.2)	0.5	(0.1)
(Decrease) / increase in creditors	(1.8)	(2.9)	6.4
	55.0	45.9	108.2

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

	Six months to 31 March 2004 £m	Six months to 31 March 2003 (restated) £m	Year to 30 September 2003 (restated) £m
Increase in cash in the period	13.1	11.3	19.4
Cash inflow from increase in debt	(330.7)	(172.4)	(612.3)
Cash movement from change in liquid resources	37.5	(55.6)	27.5
Change in net debt arising from cash flows	(280.1)	(216.7)	(565.4)
Non-recourse finance acquired with subsidiary	-	-	(2,212.7)
Loans acquired with subsidiary	-	-	(53.4)
Movement in net debt	(280.1)	(216.7)	(2,831.5)
Opening net debt	(5,130.2)	(2,298.7)	(2,298.7)
Closing net debt	(5,410.3)	(2,515.4)	(5,130.2)

Notes to the interim financial information

For the six months ended 31 March 2004 (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 2003, except as disclosed in note 2.

2. The balance sheets as at 31 March 2003 and 30 September 2003 have been restated to reflect the implementation of UITF Abstract 38 – 'Accounting for ESOP Trusts' which requires that shares held by the trustee of the Group's share option schemes are shown on the balance sheet as a deduction in arriving at Equity Shareholders' Funds, rather than as investment in own shares within fixed assets, as was required by the previous UITF Abstract 13, which has now been withdrawn. The impact of this change on the profit and loss account and the cash flow statement is immaterial for both periods.

3. An interim dividend of 3.9p per share is proposed, payable on 30 July 2004 with a record date of 2 July 2004.

4. The cost : income ratio for the six months ended 31 March 2004 is calculated by dividing operating expenses, excluding the amortisation of negative goodwill (£2.7m – 2003: £nil), of £22.7m (2003: £16.7m) by total operating income of £60.0m (2003: £48.9m) to give 37.8% (2003: 34.2%). The cost : income ratio for the six months ended 31 March 2004 excluding Mortgage Trust is calculated by dividing operating expenses of £16.5m (2003: £16.7m) by total operating income of £49.0m (2003: £48.9m) to give 33.7% (2003: 34.2%).

5. 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 2004 the weighted average number of ordinary shares outstanding was 113.9 million (2003: 113.6 million). For the year ended 30 September 2003 the weighted average was 113.4 million.

6. 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 2004 the adjusted weighted average number of ordinary shares outstanding was 118.3 million, (2003: 115.0 million). For the year ended 30 September 2003 the adjusted weighted average was 115.8 million.

7. Net loan assets includes Loans to Customers shown on the face of the balance sheet of £3,909.2m (2003: £2,746.5m) and similar assets subject to non-recourse finance arrangements of £1,691.2m (2003: £nil).

8. The figures shown above for the year ended 30 September 2003 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.

9. 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 2004 which comprises the profit and loss account, the balance sheet, the cash flow statement and related notes 1 to 9 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 2004.

Deloitte & Touche LLP.

Deloitte & Touche LLP
Chartered Accountants
Birmingham

26 May 2004

The Paragon Group of Companies PLC
St Catherine's Court Herbert Road Solihull West Midlands B91 3QE
Tel: 0121 712 2323 Fax: 0121 711 1330 http://www.paragon-group.co.uk