Interim Report

Six months ended 31 March 2005

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CHAIRMAN'S STATEMENT

During the six months ended 31 March 2005, the Group enjoyed further strong profit growth, driven by continued growth in the loan portfolio, despite slower new lending activity in the period compared with the first half of 2004.

During the period, profit before tax increased by 9.1% to £36.1 million (2004 H1: £33.1 million) and earnings per share increased by 11.2% to 24.9p (2004 H1: 22.4p). Excluding the credit to the profit and loss account for goodwill, operating profit increased by 11.5% to £33.9 million (2004 H1: £30.4 million) (note 7).

At 31 March 2005, net loan assets were £6,087.0 million (note 8), compared with £5,600.4 million at 31 March 2004. This reflected loan redemptions significantly below the level of new advances, with strong growth in the buy-to-let portfolios more than compensating for the run-off of the owner-occupied first mortgage and unsecured consumer books. Total advances, at £817.9 million, were 20.2% lower than in the previous period (2004 H1: £1,025.4 million). Of these, 93.3% were secured on residential property (2004 H1: 92.0%).

The Board has declared an interim dividend of 5.2p per share, payable on 29 July 2005 to shareholders on the register on 1 July 2005, an increase of 33.3% from last year's interim dividend of 3.9p per share, thus accelerating our progress towards the achievement of a market level of dividend cover.

Net interest income increased by 11.7% to £46.0 million from £41.2 million for the corresponding period last year, reflecting the growth in the loan book, and also the lower cost of sales, principally commissions paid to business introducers. This compensated for the decrease in other operating income to £17.0 million (2004 H1: £18.8 million), similarly reflecting the impact of reduced activity on fees and commissions earned. The average net interest margin on the loan book was similar to 2004.

Operating expenses, excluding the £2.2 million credit for amortisation of negative goodwill, were £20.6 million, a reduction of 9.3% from £22.7 million for the corresponding period in 2004. The cost:income ratio, at 32.7%, decreased from 37.8% for the first half of 2004 (note 4) following completion of the integration of Mortgage Trust within the Group's operational structure last year and general improvements in operating efficiencies around the Group.

The Group has continued to implement its strategy of reducing exposure to unsecured consumer lending, focusing on growing its secured lending, principally of high quality buy-to-let assets. The number of accounts in arrears across the portfolios was lower as at 31 March 2005 than a year previously, both numerically and as a percentage of live accounts. The mortgage books performed well over the period and the performance of the buy-to-let book remains exemplary. However, as reported in our recent trading statement, the burden of increased interest rates, together with the normal seasonal expenditures, caused some deterioration in payment performance in the consumer portfolios, resulting in an increase in the charge for provisions for losses to £8.5 million for the period (2004 H1: £6.9 million).

After providing for corporation tax at a charge rate of 21%, which we anticipate will apply for the year, and providing for the proposed interim dividend, retained profits of £22.5 million have been transferred to shareholders' funds which were £291.3 million at 31 March 2005 (2004 H1: £246.1 million).

Review of Operations

FIRST MORTGAGES

Our strategy has been to grow the high quality buy-to-let first mortgage assets whilst running off the owner-occupied loans, the majority of which were originated by Mortgage Trust prior to acquisition. Total first mortgage completions were £637.2 million for the six months to 31 March 2005, compared with £797.7 million advanced in the corresponding period of 2004. At 31 March 2005, the Paragon Mortgages and Mortgage Trust buy-to-let portfolios had increased by 24.8% to £4,398.6 million from £3,524.6 million at 31 March 2004 whilst total first mortgage assets, including the owner-occupied loans, were £5,178.2 million, an increase of 11.1% from £4,662.1 million at 31 March 2004. The owner-occupied portfolio declined, as expected, by 31.5% between 31 March 2004 and 31 March 2005 from £1,137.5 million to £779.6 million.

The Paragon Mortgages loan book increased by 27.4% to £2,908.5 million at 31 March 2005 (2004 H1: £2,283.3 million), while Mortgage Trust had loans under management of £2,142.3 million (2004 H1: £2,223.5 million) of which buy-to-let loans totalled £1,519.9 million (2004 H1: £1,287.1 million), an increase of 18.1%. New lending by Paragon Mortgages was £464.8 million (2004 H1: £522.4 million) whilst Mortgage Trust advanced new loans of £172.4 million (2004 H1: £275.3 million).

Housing market activity has slowed since the summer of 2004 following a very busy period for the market in the wake of the war in Iraq and as a consequence of increased interest rates. The rate of house price growth has also slowed in recent months, with the evidence so far this year suggesting that the market is heading for a soft landing.

Uncertainty elsewhere in the housing market has, however, had positive effects on the buy-to-let market. Market data, and our own survey evidence, indicate that tenant demand has been on the increase in most regions and for most types of property. This has created upward pressure on rents which in turn has resulted in an increase in yields for landlords. At the same time there is less competition for property as it comes onto the market which has meant that landlords have been able to secure good deals on new acquisitions, thus again impacting positively on yields.

Survey evidence continues to suggest that landlords are taking a long-term view of their investments, rather than seeking to crystallise speculative gains. In our own buy-to-let portfolio, we have seen little evidence of landlords selling properties, indeed, compared to the previous year, redemption rates have fallen.

Application levels across our buy-to-let businesses were weaker towards the end of 2004 and during the early part of 2005, partly the result of general housing market uncertainties and partly due to the disruptive impact of the introduction of mortgage regulation. Since then, trading activity has been strong both at Paragon Mortgages and at Mortgage Trust, with the result that the new business pipelines have rebuilt strongly since February. This bodes well for lending volumes in the second half of the year.

Looking further ahead, the prospects for the buy-to-let market remain strong and demand for private rented property is expected to increase, the eligibility of residential property for Self-Invested Personal Pensions ("SIPPs") from 2006 may also have a positive effect on demand. In anticipation, we have recently announced a joint venture with James Hay, the UK's leading provider of

SIPPs to provide, jointly, a range of products to support buy-to-let investors who wish to place residential property investments into their SIPP.

The credit profile of our buy-to-let portfolio remains exceptionally high, evidenced by the continuing low arrears rate compared to the mortgage market as a whole and negligible losses.

CONSUMER FINANCE

The consumer finance market has been more challenging in the six months to 31 March 2005 than in the corresponding period last year. Rising interest rates and a weaker housing market have resulted in an adjustment to borrower behaviour, with a consequential reduction in consumer finance business volumes. The Group has maintained its tight credit stance in the face of strong competitive pressure. This resulted in a 3.1% reduction in the Consumer Finance book which, at 31 March 2005, stood at £908.8 million, compared with £938.3 million at 31 March 2004.

Personal Finance

Revisions to the Consumer Credit Act and the introduction of regulation over insurance business have had an adverse effect on volumes as introducers have struggled to adapt systems and working practices to ensure compliance. These disruptive effects appear now to be receding, although higher interest rates have had an impact on the appetite of consumers for further borrowing. This is unlikely to change over the remainder of the year. We continue to be cautious in our lending approach and have tightened criteria in anticipation of the changing economic environment. Accordingly secured personal finance advances were £125.4 million in the period (2004 H1: £146.0 million). These advances were secured on UK residential property.

We continue to manage the run-off of the unsecured personal loan portfolio. Net balances were £190.7 million at 31 March 2005 compared to £226.8 million at 31 March 2004. The impact of interest rates and pressures on personal cash flow over the Christmas period led to a deterioration in payment performance for some customers in arrears, although we saw a recovery during March and April as borrowers caught up on their missed payments.

Sales Aid Finance

In line with our strategy outlined in the year end results, we have continued to focus upon profitability in the car and retail finance sectors as opposed to volume. New loan advances by the division were £55.2 million, compared with £81.7 million for the corresponding period last year.

The profitability of both businesses within Sales Aid Finance has improved during the half year along with the profile and quality of the business received due to the removal of unprofitable relationships and the tightening of credit standards. The principal focus of the division going forward is the generation of new sources of profitable business.

FUNDING

The Group continued to be an active issuer in the capital markets during the period. During October 2004, the Group completed a £1.0 billion securitisation by Paragon Mortgages (No. 8) PLC, the largest Paragon transaction to date. The securitisation contained a £270 million cash reserve which was used to fund additional buy-to-let assets in March 2005.

In December 2004 a £300 million securitisation of secured consumer loans was completed by Paragon Secured Finance (No. 1) PLC. The securitisation contained a £59 million cash reserve which was used to fund additional second mortgage assets in April 2005. In May 2005, a £450 million securitisation of secured and unsecured consumer loans was completed by Paragon Personal and Auto Finance (No. 3) PLC.

In April 2005 the Group issued £120 million 7% callable subordinated notes due 2017. This inaugural transaction provides long term capital at attractive pricing and improves the flexibility available to the Group in its capital management.

CAPITAL MANAGEMENT

The Board regularly reviews the appropriate level of capital to support its current loan portfolios and to ensure that its business plans can be met. In this respect, the Board has regard to a number of factors, including the capital needed to support planned business generation over the medium term, the risk characteristics of the portfolio and the capital being returned to the Group as loans on the book mature.

As a result of a similar review in 2002, the Board decided to increase dividends progressively ahead of earnings growth in order to reduce dividend cover over the medium term. Since that time, dividends have increased annually at roughly double the rate of earnings growth.

Whilst our new business generation targets remain stretching, the Group's portfolio continues to generate capital. We have also reduced the portfolio's risk profile by our disciplined restructuring of the portfolio from unsecured towards secured lending, which is less demanding on the Group's capital. Consumer loans, as a proportion of the portfolio, have been reducing year on year from 36% in 2002 to 15% as at 31 March 2005. Within this the unsecured personal loan book has been declining in absolute terms since the product was withdrawn and as loans have redeemed, from £319.9 million at 30 September 2002 to £190.7 million at 31 March 2005, 3% of the total loan book.

Considering all these factors, the Board has identified that there is surplus capital available for distribution to shareholders and has decided that, in addition to increasing the interim dividend by 33.3%, thus accelerating the Group's progress towards the objective of achieving a market level of dividend cover within two years, the Company should also set aside up to £20 million to repurchase shares from the market. This will be completed within the authority granted to the Company by shareholders at the 2005 Annual General Meeting.

The Board will continue to keep under review the appropriate capitalisation of the business.

CONCLUSION

The outlook for landlords remains positive with increased rental demand translating into higher rents and improving yields. Survey evidence and our own experience suggests landlords are continuing to take a long-term view of their property investments. Whilst trading volumes were subdued throughout the winter months, redemption rates have fallen leading to continued strong growth in the portfolio. Further, application flows have recovered well since February, a trend which has continued into the second half year leading to strong growth in the pipeline of business awaiting completion. This bodes well for completion volumes in the second half of the year.

The Board remains confident that the Group will meet its business objectives for the year.

Jonathan Perry
Chairman

25 May 2005

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE SIX MONTHS ENDED 31 MARCH 2005 (UNAUDITED)

	Six months to 31 March 2005 £m	Six months to 31 March 2004 £m	Year to 30 September 2004 £m
Interest receivable	240.9	192.7	412.0
Interest payable and similar charges	(194.9)	(151.5)	(331.4)
Net interest income	46.0	41.2	80.6
Other operating income	17.0	18.8	40.2
Total operating income	63.0	60.0	120.8
Operating expenses			
Other operating expenses	(20.6)	(22.7)	(43.9)
Amortisation of negative goodwill	2.2	2.7	5.2
Total operating expenses	(18.4)	(20.0)	(38.7)
Provisions for losses	(8.5)	(6.9)	(11.1)
Operating profit being profit on ordinary activities before taxation	36.1	33.1	71.0
Tax charge on profit on ordinary activities	(7.6)	(7.6)	(16.3)
Profit on ordinary activities after taxation	28.5	25.5	54.7
Equity dividend	(6.0)	(4.5)	(11.0)
Retained profit	22.5	21.0	43.7
Dividend - Rate per share	5.2p	3.9p	9.6p
Basic earnings per share	24.9p	22.4p	48.0p
Diluted earnings per share	23.9p	21.6p	46.2p

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

31 MARCH 2005 (UNAUDITED)

	31 March 2005 £m	31 March 2004 £m	30 September 2004 £m
ASSETS EMPLOYED			
Fixed assets			
Intangible assets - negative goodwill	(11.8)	(16.1)	(14.0)
Tangible assets	3.7	3.6	3.4
Investments			
Assets subject to non-recourse finance	1,341.2	1,797.5	1,557.7
Non-recourse finance	(1,297.8)	(1,751.6)	(1,520.3)
	43.4	45.9	37.4
Loans to customers	4,842.5	3,909.2	4,492.5
	4,885.9	3,955.1	4,529.9
	4,877.8	3,942.6	4,519.3
Current assets			
Stocks	3.2	3.4	3.4
Debtors falling due within one year	7.5	10.6	8.8
Cash at bank and investments	452.5	345.9	402.5
	463.2	359.9	414.7
	5,341.0	4,302.5	4,934.0
FINANCED BY			
Called-up share capital	12.0	12.0	12.0
Share premium account	69.5	68.6	68.8
Merger reserve	(70.2)	(70.2)	(70.2)
Profit and loss account	293.8	247.2	270.1
Share capital and reserves	305.1	257.6	280.7
Own shares	(13.8)	(11.5)	(12.3)
Equity shareholders' funds	291.3	246.1	268.4
Provisions for liabilities and charges	4.5	5.3	5.6
Creditors			
Amounts falling due within one year	77.8	45.9	66.4
Amounts falling due after more than one year	4,967.4	4,005.2	4,593.6
	5,341.0	4,302.5	4,934.0

The interim financial information was approved by the Board of Directors on 25 May 2005.

CONSOLIDATED CASH FLOW STATEMENT

FOR THE SIX MONTHS TO 31 MARCH 2005 (UNAUDITED)

	Six months to 31 March 2005 £m	Six months to 31 March 2004 £m	Year to 30 September 2004 £m
Net cash inflow from operating activities	66.6	55.0	129.3
Taxation	(1.6)	(10.6)	(14.6)
Capital expenditure and financial investment			
Net decrease in assets subject to non-recourse funding	216.5	562.6	800.2
Net increase in loans to customers	(377.3)	(881.9)	(1,485.2)
Other	(0.7)	(1.8)	(0.8)
Acquisitions and disposals	2.0	-	-
Equity dividends paid	(6.5)	(4.2)	(8.6)
Management of liquid resources	(48.8)	(37.5)	(85.7)
Financing	151.5	331.5	686.5
Increase in cash in the period	1.7	13.1	21.1

1. Reconciliation of operating profit to net cash inflow from operating activities

	Six months to 31 March 2005 £m	Six months to 31 March 2004 £m	Year to 30 September 2004 £m
Operating profit	36.1	33.1	71.0
Provision for losses	8.5	6.9	11.1
Depreciation	0.4	0.7	1.6
Amortisation of broker commissions	17.9	19.1	37.2
Amortisation of negative goodwill	(2.2)	(2.7)	(5.2)
Charge for long term incentive plan	0.6	0.7	0.9
(Increase) / decrease in stock	(0.1)	0.2	-
Profit on sale of subsidiary	(0.9)	-	-
Decrease / (increase) in debtors	1.2	(1.2)	0.7
Increase / (decrease) in creditors	5.1	(1.8)	12.0
	66.6	55.0	129.3

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

	Six months to 31 March 2005 £m	Six months to 31 March 2004 £m	Year to 30 September 2004 £m
Increase in cash in the period	1.7	13.1	21.1
Cash inflow from increase in debt	(151.7)	(330.7)	(687.2)
Cash movement from change in liquid resources	48.8	37.5	85.7
Movement in net debt	(101.2)	(280.1)	(580.4)
Opening net debt	(5,710.6)	(5,130.2)	(5,130.2)
Closing net debt	(5,811.8)	(5,410.3)	(5,710.6)

NOTES TO THE INTERIM FINANCIAL INFORMATION

FOR THE SIX MONTHS ENDED 31 MARCH 2005 (UNAUDITED)

1. The interim financial information for the six months ended 31 March 2005 and for the six months ended 31 March 2004 has not been audited.

2. The interim financial information has been prepared on the basis of the accounting policies set out in the group accounts for the year ended 30 September 2004.

3. An interim dividend of 5.2p per share is proposed, payable on 29 July 2005 with a record date of 1 July 2005.

4. The cost:income ratio for the six months ended 31 March 2005 is calculated by dividing operating expenses, excluding the amortisation of negative goodwill (£2.2m - 2004: £2.7m), of £20.6m (2004: £22.7m) by total operating income of £63.0m (2004: £60.0m) to give 32.7% (2004: 37.8%).

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 2005 the weighted average number of ordinary shares outstanding was 114.2 million (2004: 113.9 million). For the year ended 30 September 2004 the weighted average was 113.9 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 2005 the adjusted weighted average number of ordinary shares outstanding was 119.0 million (2004: 118.3 million). For the year ended 30 September 2004 the adjusted weighted average was 118.3 million.

7. The operating profit for the period excluding goodwill comprises the operating profit of £36.1m (2004: £33.1m) less the credit for the amortisation of negative goodwill of £2.2m (2004: £2.7m).

8. Net loan assets includes Loans to Customers shown on the face of the balance sheet of £4,842.5m (2004: £3,909.2m) and similar assets subject to non-recourse finance arrangements of £1,244.5m (2004: £1,691.2m).

9. The figures shown above for the year ended 30 September 2004 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.

10. 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 2005 which comprises the profit and loss account, the balance sheet, the cash flow statement and related notes 1 to 10 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 2005.

Deloitte & Touche LLP
Chartered Accountants
Birmingham

25 May 2005

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