# Half-Yearly Financial Report

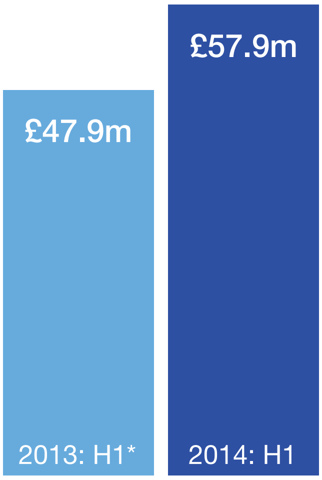
The Paragon Group of Companies PLC

Six months ended 31 March 2014

paragon

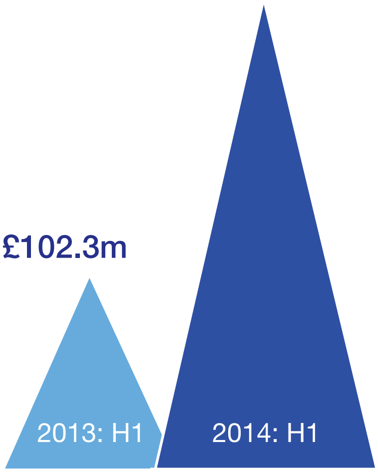
# Contents

# Financial highlights




Underlying pre-tax profit** up by

**20.9%**

buy-to-let advances up

**163.2%**

Buy-to-let lending pipeline **£348.1m** at 31 March 2014

**25.0%**

increase in interim dividend to 3.0p (2.4p in 2013: H1)

**19.0%**

increase in earnings per share to 15.0p (12.6p in 2013: H1)*

Pre-tax profit

**£58.2m**

up from £48.8m in 2013: H1*

Shareholders' funds

**£909.9m**

up from £819.9m at 31 March 2013

**£121.9m**

invested in consumer loan portfolios by Idem Capital in the period

* Restated. See Note 2
** See Note 7

*"Paragon has continued to make excellent progress during the first half of the financial year. The successful launch of Paragon Bank and its initial range of car finance and deposit products marks a milestone in the on-going diversification of the Group's income streams and funding sources.*

*With the Group's three business lines, it remains well positioned for further growth in the second half of the year and opens a new phase in the Group's expansion as a specialist lender."*

*Nigel Terrington - Chief Executive*

# Interim management report

The Group's trading performance in the six months ended 31 March 2014 has been strong and, during the period, a significant strategic milestone has been achieved with the launch of Paragon Bank PLC. The Group's key performance metrics maintain recent trends: organic cash generation remains strong; redemptions remain low; and, across the portfolio, credit performance is strong, in line with our expectations.

Underlying profit, before movements in fair values for hedging instruments, was 20.9% higher at £57.9 million (note 7), compared with £47.9 million (restated – see note 2) for the first half of 2013. The increase was due primarily to profits from acquired loan portfolios and from the increased level of originated assets. Profit on ordinary activities before taxation was 19.3% higher at £58.2 million, compared with £48.8 million (restated) for the first half of 2013 after fair value movements.

Earnings per share were 19.0% higher at 15.0p (2013 H1 (restated): 12.6p) and the Group's return on equity (note 26) increased to 10.5% from 9.5% in the first half of the previous year.

During the period, growth has been achieved in Paragon Mortgages, where buy-to-let loans of £269.3 million were completed, and in our Idem Capital portfolio acquisitions business, which invested £121.9 million, net of secured external funding. In addition, Paragon Bank launched its first products in the car finance sector in February 2014.

The first six months of the year have also seen a significant diversification of funding to support current and future business growth. The Group completed a securitisation transaction, Paragon Mortgages (No. 19) PLC, in March, reducing further the cost of funding for Paragon Mortgages and, for the first time since 2007, refinancing mortgages from an older securitisation, First Flexible No. 4 PLC. One of the Group's existing warehouse facilities was extended on improved terms and, in addition, a new facility of £100.0 million, increasing warehouse capacity to £550.0 million, was agreed in April. Idem Capital completed its first dedicated funding line in the period, raising £130.6 million to finance a portfolio purchase, followed, after the end of the period, by the agreement of a £55.0 million facility financing existing assets. Both of these funding lines are secured on specific assets of Idem Capital, with no recourse to other Group assets. Finally, the Company completed its second retail bond offering in February, a £125.0 million issue maturing in 2022, which, together with our organic cashflow, will support growth across all business areas.

In light of these results and in accordance with our policy to target a full year dividend cover of 3.0 to 3.5 times by 2016, the Company will pay an interim dividend of 3.0p per share (H1 2013: 2.4p per share), a total of £9.2 million (H1 2013: £7.2 million), on 25 July 2014 to all shareholders on the register on 4 July 2014.

## FINANCIAL REVIEW

Total operating income increased by 11.3% to £96.4 million (2013 H1 (restated): £86.6 million).

Net interest income increased by 8.9% to £87.0 million from £79.9 million (restated) for the first half of 2013, the increase arising from origination of mortgage loans and investment in consumer finance loan assets which, in both amount and margin, exceeded the level of redemptions during the period. Overall, margins increased compared to the same period last year, with reduced first mortgage funding costs offsetting the impact of increased utilisation of debt finance for investment by Idem Capital.

Other operating income was £9.4 million for the period, compared with £6.7 million for the first half of 2013. The increase of 40.3% from the first half of 2013 reflects, principally, a higher level of third party fee income as a result of the numbers of third party assets brought under the Group's administration in this and the preceding period.

Operating expenses increased by 5.4% to £31.0 million from £29.4 million for the first half of 2013, principally as a result of increased staff numbers to service the loan portfolios administered by Idem, but also as a result of the operational costs of Paragon Bank, where costs will exceed associated revenues whilst the business becomes established. Strong income growth, however, resulted in the cost:income ratio reducing to 32.2% from 33.9% for the comparable period last year (note 5). The Board remains focused on controlling operating costs through the application of rigorous budgeting and monitoring procedures.

The charge of £7.5 million for loan impairment has reduced from that for the first half of 2013 (2013 H1: £9.3 million). As a percentage of loans to customers (note 12) the impairment charge has reduced to 0.08% compared to 0.11% in the first half of 2013. The Group has seen positive trends in arrears performance over the period, with the incidence of new cases reducing and customers correcting past arrears, whilst increasing property values have served to reduce overall exposure to losses on enforcement of security.

Cash flows from the Group's securitisation vehicle companies and the acquired portfolios remain strong, financing, alongside debt raisings, investments in further loan portfolios, the capital requirements of Paragon Bank and credit enhancement for mortgage originations. Free cash balances were £169.4 million at 31 March 2014 (2013 H1: £173.8 million) (note 15).

Yield curve movements during the period resulted in hedging instrument fair value net gains of £0.3 million (2013 H1: £0.9 million net gains), which do not affect cash flow. As the fair value movements of hedged assets or liabilities are expected to trend to zero over time, this item is merely a timing difference. The Group remains economically and appropriately hedged.

Corporation tax has been charged at the rate of 21.6%, compared with 23.0% for the first half of last year, reflecting, principally, a lower UK Corporation Tax rate.

Profits after taxation of £45.6 million have been transferred to shareholders' funds, which totalled £909.9 million at 31 March 2014.

Following the authorisation of Paragon Bank in the period, the Board conducted a review of its internal reporting requirements and a new segmental reporting format has been adopted.

- Paragon Mortgages includes revenue, in the form of interest and ancillary income, from the Group's first mortgage operations and from assets remaining in other, legacy, portfolios.
- Idem Capital includes revenue generated from assets purchased by the Group's debt investment business, Idem Capital Holdings Limited and third party loan administration activity.
- Paragon Bank includes revenue generated from the Group's regulated banking business, Paragon Bank PLC.

An analysis of the Group's financial assets by type is shown in note 12.

The underlying profits of these business segments are detailed fully in note 7 and are summarised below.

| | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 (restated) £m |
|---|---|---|
| **Underlying profit / (loss)** | | |
| Paragon Mortgages | **39.8** | 33.3 |
| Idem Capital | **21.2** | 15.3 |
| Paragon Bank | **(3.1)** | (0.7) |
| | **57.9** | 47.9 |

In November 2013, the Group acquired the freehold of its head office building, which it had occupied under the terms of a sale and leaseback agreement. The cash consideration paid was £23.7 million and, on the completion of the transaction, the leasehold fixed asset included within Property, Plant and Equipment at £5.4 million and the related lease creditor of £10.2 million included within financial liabilities were both extinguished. The resulting credit of £4.8 million was offset against the purchase consideration recorded.

The information on related party transactions required by DTR 4.2.8(1) of the Disclosure and Transparency Rules is given in note 28, and a summary of the principal risks and uncertainties faced by the Group is given on page 33.

# REVIEW OF OPERATIONS

## Paragon Mortgages

Paragon Mortgages is one of the longest established lending brands in the buy-to-let mortgage market. Alongside its sister brand, Mortgage Trust, Paragon Mortgages maintains a significant presence for the Group in this growing sector of the UK mortgage market. Trading activity in the first six months of the year has been strong, with the segment contributing £39.8 million to underlying Group profit (2013 H1 (restated): £33.3 million), an increase of 19.5%.

Total loan assets of the segment at 31 March 2014 were £8,707.6 million, 2.0% higher than the £8,533.3 million a year earlier, of which £8,414.2 million were buy-to-let mortgage assets (31 March 2013: £8,179.8 million).

### Buy-to-let

Buy-to-let completions increased by 163.2% to £269.3 million for the period (2013 H1: £102.3 million). Further expansion of the Group's mortgage capacity, supported by improvements in funding costs, has enabled us to increase business volumes significantly and has resulted in a pipeline of new business of £348.1 million at the end of March 2014, compared to £231.9 million at the end of September 2013 (31 March 2013: £241.2 million).

Data released by the Council of Mortgage Lenders ('CML') indicates continued robust growth in buy-lo-let lending, with completions for the six months ended 31 March 2014 of £12.4 billion, some 45.9% up on the same period in 2013 (2013 H1: £8.5 billion). Strong tenant demand continues to support private rented sector investment. The English Housing Survey for 2012-13, recently published by the Department for Communities and Local Government, found that the private rented sector in England now provides a home for 18.0% of households and has eclipsed the social rented sector for the first time since the 1960s.

These conditions continue to benefit Paragon Mortgages' business. New loans continue to be of high quality, with a good affordability profile, low average loan-to-value ratios and strong customer credit profiles. Overall arrears performance continues to be exemplary. The percentage of buy-to-let loans three months or more in arrears continues to fall, standing at 0.30%, including acquired loans and receivership cases but excluding portfolios held for sale, at 31 March 2014 (31 March 2013: 0.40%, 30 September 2013: 0.35%). This remains below the comparable figure for the buy-to-let industry of 0.95% at the same date, as reported by the CML (31 March 2013: 1.22%, 30 September 2013: 1.16%).

The number of properties with a receiver of rent appointed reduced by 7.0% to 1,306 at 31 March 2014 (31 March 2013: 1,405). At the end of March 2014, 96.3% of the properties available for letting in the receiver of rent portfolio were let (31 March 2013: 94.6%, 30 September 2013: 94.8%).

### Other assets

The Paragon Mortgages segment includes income generated from other, legacy, loan books, including owner-occupied mortgages, car loans, secured consumer loans and unsecured consumer loans. Save for the management of these books in run-off, there has been little activity in recent years in these areas. These assets form a very small part of the segment's results, when compared to buy-to-let assets, performing in line with our expectations. Their values are shown below.

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m |
|---|---|---|---|
| Owner-occupied mortgages | **66.6** | 85.4 | 77.4 |
| Secured loans | **218.8** | 256.8 | 237.7 |
| Unsecured loans | **8.0** | 11.3 | 9.6 |
| | **293.4** | 353.5 | 324.7 |

Although the Group has returned to car finance lending and has plans to return to other consumer markets, this will be through Paragon Bank and will be reported under that segment.

## Idem Capital

Idem Capital is one of the top consumer debt buyers in the UK. In addition to assets acquired in its own right, Idem, through Moorgate Loan Servicing and Arden Credit Management, services loans for third parties and for co-investment partners. The contribution of Idem Capital to underlying profit for the period was £21.2 million (2013 H1: £15.3 million), an increase of 38.6%.

A number of potential investment opportunities are currently under review and the Group's track record in loan servicing, risk management and portfolio investment, combined with access to a range of funding sources, positions it well to continue to exploit similar opportunities as they arise in future.

### Portfolio investment

Idem Capital invests in loan portfolios either as principal, where it acquires assets in its own right, or as co-investor alongside other partners. Co-investing has the potential for higher returns where the Group also derives income from servicing the loans within the underlying portfolio. Investments are made only after significant due diligence work on portfolios and sensitivity testing of potential returns.

During the period Idem Capital invested £121.9 million of Group funds and £130.6 million of external funding in loan portfolios, purchasing £225.3 million of secured loan assets and £27.2 million of unsecured loan assets (2013 H1: £57.6 million, comprising £36.7 million of unsecured loan asset purchases and £20.9 million as a co-investor). The outstanding value of Idem investments at 31 March 2014 was £418.6 million (31 March 2013: £175.2 million) with performance in line with our expectations.

### Loan servicing

Idem Capital's third party loan servicing business operates through Moorgate Loan Servicing and its division, Arden Credit Management, utilising our core administration and collections skills. Our experience in loan management, established over many years, has enabled us to offer this service to third party clients, providing significant added value to the performance of their loan portfolios. Servicing contracts add volume to the Group's servicing operations and enhance earnings, with little or no capital investment.

During the period Moorgate Loan Servicing has assumed the servicing of a further portfolio, comprising 26,300 accounts (2013 H1: 29,600 accounts). At 31 March 2014 the Group managed 169,760 accounts on behalf of third parties (31 March 2013: 162,607), 41.2% of the total managed by the Group (31 March 2013: 45.4%).

## Paragon Bank

On 18 February 2014 the Group launched its banking subsidiary, Paragon Bank PLC, following authorisation by the Prudential Regulation Authority ('PRA'). The Bank will offer savings and loan products, broadening competition and choice in the UK banking market. The Group provided initial capital of £12.7 million to the Bank and expects to provide additional capital over time to support growth.

Paragon Bank, regulated by the PRA and by the Financial Conduct Authority ('FCA'), is a wholly owned subsidiary of the Company. It is led by Managing Director Richard Doe, previously Chief Executive of ING Direct UK, together with an experienced banking and consumer finance management team and Board of Directors.

The initial focus of operations for Paragon Bank has been the establishment of distribution arrangements for its car finance lending products through brokers and car dealers, under the Paragon Car Finance brand.

The bank recently commenced a soft launch of its savings products which are expected to be available to the wider public in a few months. Personal loans will be offered through intermediaries and are expected to be launched later in 2014. Other consumer and small business finance products, including buy-to-let products, will be developed in due course.

## Regulation

The European Directive on credit agreements relating to residential property, which imposes additional disclosure and other requirements for all mortgage lending to consumers secured on residential property, has now been adopted and must be implemented into domestic law by March 2016. The UK Government has negotiated an exemption from the Directive for buy-to-let lending and we will continue to maintain an active dialogue with the UK regulatory authorities as the Directive is implemented.

Paragon Bank is regulated by the PRA, FCA and the Bank of England and the Group is subject to consolidated supervision. With effect from April 2014, responsibility for the regulation of consumer credit, including second charge mortgage lending, passed from the Office of Fair Trading to the FCA, which has recently published conduct of business rules for the sector. These rules apply to the Group's current and proposed consumer lending operations, to our third party servicing activities and to our closed consumer finance books.

The Group companies involved in these regulated activities have applied for, and received, interim permissions under the new consumer credit regime from the FCA and will apply for full authorisation by 2015, within the timescales set out by the regulator.

We believe that the Group is well placed to deal with the regulatory changes currently in progress.

# FUNDING REVIEW

During the period the Group has made significant progress in diversifying its financing, increasing capacity and reducing borrowing costs. New funding lines were developed for all of its operations and a further retail bond issue added to the Group's central funding.

## Paragon Mortgages funding

The Group funds its mortgage originations through revolving warehouse facilities, a £250.0 million facility provided by Macquarie Bank and a £200.0 million facility provided by the wholesale division of Lloyds Bank, which was renewed on improved terms in January 2014 and is now available for drawing until June 2016. In addition, in April 2014, a further facility of £100.0 million was agreed with Natixis. Total warehouse capacity within the Group is now £550.0 million, supporting our growth plans in the buy-to-let market.

Paragon Mortgages uses these warehouse facilities to fund mortgage loans prior to arranging term funding in the securitisation markets. In March 2014, the Group completed a £350.0 million securitisation, through Paragon Mortgages (No. 19) PLC ('PM 19'). PM 19 comprises £313.2 million of A notes, £15.8 million of B notes and £14.0 million of C notes at margins of 85, 120 and 160 basis points over three month LIBOR respectively. These notes were rated by Fitch, Standard and Poor's and Moody's. £7.0 million of D notes were retained by the Group, which also invested £10.5 million in the first loss fund, bringing the Group's total investment in PM 19 to £17.5 million, or 5.0% of the issue amount.

PM 19 financed recent buy-to-let originations from Paragon Mortgages as well as £66.6 million of first mortgage loans refinanced from an earlier securitisation, First Flexible No. 4 PLC, the first refinancing of legacy assets in a new Paragon Mortgages securitisation since 2007.

The average margin on the PM 19 notes of 90 basis points was much improved on those for the preceding securitisations Paragon Mortgages (No. 18) PLC and Paragon Mortgages (No. 17) PLC of 125 basis points and 146 basis points respectively, completed in the previous financial year.

The improved pricing of the PM 19 transaction reflected the strong credit profile of the Group's buy-to-let assets, our experience as an issuer of high quality bonds in the mortgage backed securities market and the general improvement in market conditions for issuers of this type of security. This was the Group's 57th securitisation since pioneering the methodology in 1987.

## Idem Capital funding

In January 2014 a Group company, Idem Capital Securities (No. 1) s.à r.l., issued £130.6 million of sterling floating rate notes to Bank of America Merrill Lynch International Limited. These notes bear interest at a rate of one month LIBOR plus 3.00% and the proceeds of the issue were used to part-fund the purchase of a portfolio of UK second charge residential mortgage loans, on which the borrowing is secured.

Following the period end, in April 2014, a Group company, Idem First Finance Limited, entered into a £55.0 million bank facility with Goldman Sachs Bank USA. The facility, which bears interest at a rate of one month LIBOR plus 3.75%, was used to re-finance existing Idem Capital unsecured loan assets, previously funded intra-group, and is secured on those assets.

These structured borrowings, on a limited recourse basis, are the first completed by Idem Capital, broadening its sources of finance and demonstrating its ability to access third party funding.

## Paragon Bank funding

The lending operations of Paragon Bank will be funded through retail deposits. The bank recently commenced a soft launch of these products, which are expected to be available to the wider public in a few months. We will report further on the progress of this operation following the year end.

## Central funding

In February 2014, the Group issued £125.0 million of 6.125% sterling bonds due January 2022. The bonds, listed on the London Stock Exchange Order Book for Retail Bonds, were issued to provide additional working capital for the Group. This was the second transaction under a £1.0 billion Euro Medium Term Note Programme announced in January 2013, following the previous issuance of £60.0 million in March 2013. The bonds allow us to diversify our funding base and extend the tenor of our borrowings.

Further details of the borrowings described above are given in note 21.

# CONCLUSION

In addition to strong earnings growth, the Group has made excellent progress in all areas of its business strategy during the period, increasing business volumes, acquisitions and funding. Buy-to-let lending activity has increased strongly, with further lending growth expected in the second half of the year. Idem Capital has substantially increased its portfolio through significant investments in the period and is actively engaged in reviewing potential acquisitions. The retail bond programme and increased warehouse capacity provide access to funding to support future growth in all our businesses.

The launch of Paragon Bank has provided a platform for the Group to re-enter the car finance market and, in due course, to recommence other consumer lending and SME products and extend its buy-to-let offering. Across the Group, our businesses are well placed to take advantage of opportunities for further growth and the Board remains confident of the Group's prospects for the remainder of the current financial year.

# Statement of directors' responsibilities

The directors confirm that, to the best of their knowledge:

- the condensed financial statements have been prepared in accordance with International Accounting Standard 34 – 'Interim Financial Reporting';

- the Interim Management Report includes a fair review of the information required by Section 4.2.7R of the Disclosure and Transparency Rules, issued by the UK Listing Authority (indication of important events that have occurred during the first six months of the current financial year and their impact on the condensed financial statements and description of the principal risks and uncertainties for the remaining six months of the financial year); and

- the Interim Management Report includes a fair review of the information required by Section 4.2.8R of the Disclosure and Transparency Rules, issued by the UK Listing Authority (disclosure of related party transactions that have taken place in the first six months of the financial year and that have materially affected the financial position or the performance of the enterprise during that period; and any changes in the related party transactions described in the last annual report which could do so).

Approved by the Board of Directors and signed on behalf of the Board.

**JOHN G GEMMELL**
Company Secretary
20 May 2014

# Condensed financial statements

## CONSOLIDATED INCOME STATEMENT

**For the six months ended 31 March 2014 (Unaudited)**

| | Note | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 (restated) £m | Year to 30 Sep 2013 (restated) £m |
|---|---|---|---|---|
| Interest receivable | | **143.9** | 133.5 | 269.0 |
| Interest payable and similar charges | | **(56.9)** | (53.6) | (108.0) |
| **Net interest income** | | **87.0** | 79.9 | 161.0 |
| Other operating income | 4 | **9.4** | 6.7 | 16.6 |
| **Total operating income** | | **96.4** | 86.6 | 177.6 |
| Operating expenses | | **(31.0)** | (29.4) | (58.9) |
| Provisions for losses | | **(7.5)** | (9.3) | (15.2) |
| **Operating profit before fair value items** | | **57.9** | 47.9 | 103.5 |
| Fair value net gains | 6 | **0.3** | 0.9 | 1.3 |
| **Operating profit being profit on ordinary activities before taxation** | | **58.2** | 48.8 | 104.8 |
| Tax charge on profit on ordinary activities | 8 | **(12.6)** | (11.2) | (20.1) |
| **Profit on ordinary activities after taxation** | | **45.6** | 37.6 | 84.7 |

| | Note | **Six months to 31 Mar 2014** | Six months to 31 Mar 2013 (restated) | Year to 30 Sep 2013 (restated) |
|---|---|---|---|---|
| Dividend – Rate per share for the period | 18 | **3.0p** | 2.4p | 7.2p |
| Basic earnings per share | 9 | **15.0p** | 12.6p | 28.2p |
| Diluted earnings per share | 9 | **14.6p** | 12.1p | 27.3p |

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

Comparative information has been restated for the change in accounting standards described in note 2.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

**Six months ended 31 March 2014 (Unaudited)**

| | Note | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 (restated) £m | Year to 30 Sep 2013 (restated) £m |
|---|---|---|---|---|
| Profit for the period | | **45.6** | 37.6 | 84.7 |
| **Other comprehensive income / (expenditure)** | | | | |
| *Items that will not be reclassified subsequently to profit or loss* | | | | |
| Actuarial gain / (loss) on pension scheme | 22 | **3.4** | (15.4) | (2.2) |
| Tax thereon | | **(0.7)** | 3.5 | - |
| | | **2.7** | (11.9) | (2.2) |
| *Items that may be reclassified subsequently to profit or loss* | | | | |
| Cash flow hedge (losses) / gains taken to equity | | **(0.7)** | 2.4 | 1.2 |
| Tax thereon | | **0.2** | (0.6) | (0.2) |
| | | **(0.5)** | 1.8 | 1.0 |
| Other comprehensive income / (expenditure) for the period net of tax | | **2.2** | (10.1) | (1.2) |
| Total comprehensive income for the period | | **47.8** | 27.5 | 83.5 |

Comparative information has been restated for the change in accounting standards described in note 2.

## CONSOLIDATED BALANCE SHEET

**31 March 2014 (Unaudited)**

| | Note | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|---|
| **Assets employed** | | | | | |
| **Non-current assets** | | | | | |
| Intangible assets | 10 | **8.2** | 9.0 | 8.5 | 9.1 |
| Property, plant and equipment | 11 | **23.4** | 10.2 | 9.6 | 10.7 |
| Financial assets | 12 | **9,884.1** | 9,849.6 | 9,715.3 | 9,505.2 |
| | | **9,915.7** | 9,868.8 | 9,733.4 | 9,525.0 |
| **Current assets** | | | | | |
| Other receivables | | **6.6** | 7.7 | 7.6 | 7.3 |
| Short term investments | 14 | **0.5** | - | - | - |
| Cash and cash equivalents | 15 | **716.3** | 561.4 | 587.3 | 504.8 |
| | | **723.4** | 569.1 | 594.9 | 512.1 |
| Total assets | | **10,639.1** | 10,437.9 | 10,328.3 | 10,037.1 |
| **Financed by** | | | | | |
| **Equity shareholders' funds** | | | | | |
| Called-up share capital | 16 | **307.1** | 304.3 | 306.2 | 301.8 |
| Reserves | 17 | **649.5** | 564.6 | 614.7 | 550.2 |
| Share capital and reserves | | **956.6** | 868.9 | 920.9 | 852.0 |
| Own shares | 19 | **(46.7)** | (49.0) | (47.6) | (48.5) |
| Total equity | | **909.9** | 819.9 | 873.3 | 803.5 |
| **Current liabilities** | | | | | |
| Financial liabilities | 20 | **1.0** | 2.7 | 3.0 | 2.0 |
| Current tax liabilities | | **10.1** | 10.9 | 5.9 | 13.3 |
| Other liabilities | | **35.4** | 37.9 | 36.2 | 36.7 |
| | | **46.5** | 51.5 | 45.1 | 52.0 |
| **Non-current liabilities** | | | | | |
| Financial liabilities | 20 | **9,659.6** | 9,529.6 | 9,383.4 | 9,159.0 |
| Retirement benefit obligations | 22 | **12.2** | 29.1 | 15.7 | 13.9 |
| Deferred tax | | **10.6** | 6.8 | 9.9 | 7.6 |
| Other liabilities | | **0.3** | 1.0 | 0.9 | 1.1 |
| | | **9,682.7** | 9,566.5 | 9,409.9 | 9,181.6 |
| Total liabilities | | **9,729.2** | 9,618.0 | 9,455.0 | 9,233.6 |
| | | **10,639.1** | 10,437.9 | 10,328.3 | 10,037.1 |

The condensed financial statements for the half year were approved by the Board of Directors on 20 May 2014.

## CONSOLIDATED CASH FLOW STATEMENT

**For the six months ended 31 March 2014 (Unaudited)**

| | Note | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 £m | Year to 30 Sep 2013 £m |
|---|---|---|---|---|
| Net cash flow (utilised) / generated by operating activities | 23 | **(246.4)** | 37.9 | (31.9) |
| Net cash (utilised) by investing activities | 24 | **(25.7)** | (1.0) | (1.6) |
| Net cash generated by financing activities | 25 | **401.5** | 19.1 | 115.2 |
| **Net increase in cash and cash equivalents** | | **129.4** | 56.0 | 81.7 |
| Opening cash and cash equivalents | | **585.9** | 504.2 | 504.2 |
| **Closing cash and cash equivalents** | | **715.3** | 560.2 | 585.9 |
| Represented by balances within | | | | |
| Cash and cash equivalents | 15 | **716.3** | 561.4 | 587.3 |
| Financial liabilities | | **(1.0)** | (1.2) | (1.4) |
| | | **715.3** | 560.2 | 585.9 |

## CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

**Six months ended 31 March 2014 (Unaudited)**

| | Note | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 £m | Year to 30 Sep 2013 £m |
|---|---|---|---|---|
| Total comprehensive income for the period | | **47.8** | 27.5 | 83.5 |
| Dividends paid | 18 | **(14.6)** | (13.5) | (20.7) |
| Net movement in own shares | | **0.9** | 2.0 | 0.9 |
| Deficit on transactions in own shares | | **(0.8)** | (2.5) | (0.4) |
| Charge for share based remuneration | | **1.6** | 1.4 | 3.1 |
| Tax on share based remuneration | | **1.7** | 1.5 | 3.4 |
| **Total movements in equity in the period** | | **36.6** | 16.4 | 69.8 |
| Opening equity | | **873.3** | 803.5 | 803.5 |
| **Closing equity** | | **909.9** | 819.9 | 873.3 |

# SELECTED NOTES TO THE ACCOUNTS
**For the six months ended 31 March 2014 (Unaudited)**

## 1. GENERAL INFORMATION

The condensed financial statements for the six months ended 31 March 2014 and for the six months ended 31 March 2013 have not been audited.

The figures shown above for the years ended 30 September 2013 and 30 September 2012 are not statutory accounts. A copy of the statutory accounts for each year has been delivered to the Registrar of Companies. The auditors reported on those statutory accounts and their reports were unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498 (2) or 498 (3) of the Companies Act 2006.

Sections of this half-yearly report, including but not limited to the Interim Management Report, may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

A copy of the half-yearly financial report will be posted to shareholders and additional copies can be obtained from the Company Secretary, The Paragon Group of Companies PLC, 51 Homer Road, Solihull, West Midlands, B91 3QJ.

This half-yearly financial report is available on the Group's website at www.paragon-group.co.uk.

## 2. ACCOUNTING POLICIES

The condensed financial statements are presented in accordance with the requirements of International Accounting Standard 34 – 'Interim Financial Reporting'.

The Group prepares its annual financial statements in accordance with International Financial Reporting Standards as endorsed by the European Union. Except as noted below, the condensed financial statements have been prepared on the basis of the accounting policies set out in the Annual Report and Accounts of the Group for the year ended 30 September 2013, which are expected to be used in the preparation of the financial statements of the Group for the year ending 30 September 2014.

### New accounting standards

IFRS 10 – 'Consolidated Financial Statements' and IFRS 12 – 'Disclosure of Interests in Other Entities' form part of the new IFRS regime for consolidation, and are applicable to the Group's accounts for the first time in the year ending 30 September 2014. The adoption of these standards does not change the entities included within the consolidated accounts from those presently consolidated, nor do consolidated results presented under the new standards differ from how they would formerly have appeared.

IFRS 13, which has been adopted in the preparation of the condensed financial information, applies to the Group's accounts from the year ending 30 September 2014. It sets out new guidance on the establishment of fair value for accounting purposes and applies to all amounts in the Group's financial statements presented at fair value. The adoption of this standard has had no material impact on the Group's results or financial position.

In compiling this condensed financial information, the directors have adopted the revision to IAS 19 – 'Employee Benefits', which applies to the Group's accounts for the year ending 30 September 2014. While this revision does not affect the calculation of the deficit in the Group's defined benefit pension plan, shown in the balance sheet, the presentation of the movements in that balance in the income statement and statement of total comprehensive income is amended.

In particular:

- The funding cost of the plan liabilities and the expected return on the plan assets are no longer recognised in 'Interest Payable' and Interest Receivable' respectively. Instead the funding cost of the net deficit is recognised in interest payable, at the rate which would previously have been applied to the scheme's total liabilities.
- The administrative costs of the plan are no longer included in the calculation of service cost, which is included within wages and salaries, but are instead calculated as a separate annual cost, included in 'Operating Expenses'.
- The actuarial gain or loss will reflect any movements in the deficit no longer reflected in the income statement.
- As a deferred tax asset is recognised on the deficit, movements in deferred tax in current year income and reserves are adjusted to reflect the new accounting.

The effect of these restatements is shown below.

| | As originally reported £m | Restatement £m | As restated £m |
|---|---|---|---|
| **Six months ended 31 March 2013** | | | |
| Interest receivable | 135.4 | (1.9) | 133.5 |
| Interest payable | (55.3) | 1.7 | (53.6) |
| Net interest receivable | 80.1 | (0.2) | 79.9 |
| Operating expenses | (29.3) | (0.1) | (29.4) |
| Profit before tax | 49.1 | (0.3) | 48.8 |
| Tax charge | (11.3) | 0.1 | (11.2) |
| **Profit on ordinary activities after taxation** | 37.8 | (0.2) | 37.6 |
| Actuarial gain on pension scheme | (15.7) | 0.3 | (15.4) |
| Tax thereon | 3.6 | (0.1) | 3.5 |
| **Total comprehensive income** | 27.5 | - | 27.5 |
| **Year ended 30 September 2013** | | | |
| Interest receivable | 272.6 | (3.6) | 269.0 |
| Interest payable | (111.3) | 3.3 | (108.0) |
| Net interest receivable | 161.3 | (0.3) | 161.0 |
| Operating expenses | (58.6) | (0.3) | (58.9) |
| Profit before tax | 105.4 | (0.6) | 104.8 |
| Tax charge | (20.2) | 0.1 | (20.1) |
| **Profit on ordinary activities after taxation** | 85.2 | (0.5) | 84.7 |
| Actuarial gain on pension scheme | (2.8) | 0.6 | (2.2) |
| Tax thereon | 0.1 | (0.1) | - |
| **Total comprehensive income** | 83.5 | - | 83.5 |

The adoption of the revised standard has no effect on the consolidated balance sheet or cash flow statement of the Group.

## Going concern basis

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Interim Management Report on pages 5 to 10. The principal risks and uncertainties affecting the Group in the forthcoming six months, and the steps taken to mitigate against these risks, are described on page 33.

Note 5 to the accounts for the year ended 30 September 2013 includes an analysis of the Group's working capital position and policies, while note 6 includes a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Note 4 to those accounts discusses critical accounting estimates affecting the results and financial position disclosed therein. The position and policies described in these notes remain materially unchanged to the date of this half-yearly report, except as described in note 21. The Group has a formalised process of budgeting, reporting and review, which provides information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives.

The Group's securitisation funding structures ensure that a substantial proportion of the Group's originated loan portfolio is match-funded to maturity. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations financed through the Group's available warehouse facilities are refinanced through securitisation from time to time. None of the Group's debt matures before 2017, when the £110.0 million corporate bond is repayable. During the period the Group raised a further £125.0 million of working capital through the issue of retail bonds and obtained non-recourse funding for purchased loans for the first time. At 31 March 2014 the Group's available free cash balances were £169.4 million (note 15). As a consequence the directors believe that the Group is well placed to manage its business risks successfully.

After making enquiries, the directors have a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the half-yearly report.

## 3. SEGMENTAL RESULTS

Following the authorisation of its banking subsidiary in the year the Group conducted a review of its internal reporting requirements and concluded that the most relevant analysis of its business was that based on the entities within the Group generating its assets. This new format of reporting was adopted for internal use and therefore the segments presented in this condensed financial information have been determined in a similar way.

- Paragon Mortgages includes revenue, in the form of interest and ancillary income, from the Group's first mortgage operations and from assets remaining in other, legacy, portfolios.
- Idem Capital includes revenue generated from assets purchased by the Group's debt investment business, Idem Capital Holdings Limited and third party loan administration activity.
- Paragon Bank includes revenue generated from the Group's regulated banking business, Paragon Bank PLC.

Each of these businesses invests in consumer finance assets, and an analysis of the Group's financial assets by type is shown in note 12.

Dedicated financing and administration costs of each of these businesses are allocated to the segment and shared costs, and the financing costs of the Group's working capital invested, are allocated based on the segments' use of those resources.

Financial information about these business segments is shown below. Results for the six months ended 31 March 2013 and the year ended 30 September 2013 have been reanalysed on the basis of the new segments, as well as being restated for the change in accounting standard described in note 2.

**Six months ended 31 March 2014**

| | Paragon Mortgages £m | Idem Capital £m | Paragon Bank £m | Total £m |
|---|---|---|---|---|
| Interest receivable | 119.2 | 24.7 | - | 143.9 |
| Interest payable | (55.0) | (1.9) | - | (56.9) |
| Net interest income | 64.2 | 22.8 | - | 87.0 |
| Other operating income | 4.0 | 5.4 | - | 9.4 |
| Total operating income | 68.2 | 28.2 | - | 96.4 |
| Operating expenses | (20.9) | (7.0) | (3.1) | (31.0) |
| Provisions for losses | (7.5) | - | - | (7.5) |
| | 39.8 | 21.2 | (3.1) | 57.9 |
| Fair value net gain | 0.3 | - | - | 0.3 |
| Operating profit / (loss) | 40.1 | 21.2 | (3.1) | 58.2 |
| Tax charge | | | | (12.6) |
| Profit after taxation | | | | 45.6 |

**Six months ended 31 March 2013 (restated)**

| | Paragon Mortgages £m | Idem Capital £m | Paragon Bank £m | Total £m |
|---|---|---|---|---|
| Interest receivable | 116.1 | 17.4 | - | 133.5 |
| Interest payable | (53.3) | (0.3) | - | (53.6) |
| Net interest income | 62.8 | 17.1 | - | 79.9 |
| Other operating income | 3.5 | 3.2 | - | 6.7 |
| Total operating income | 66.3 | 20.3 | - | 86.6 |
| Operating expenses | (23.7) | (5.0) | (0.7) | (29.4) |
| Provisions for losses | (9.3) | - | - | (9.3) |
| | 33.3 | 15.3 | (0.7) | 47.9 |
| Fair value net gain | 0.9 | - | - | 0.9 |
| Operating profit / (loss) | 34.2 | 15.3 | (0.7) | 48.8 |
| Tax charge | | | | (11.2) |
| Profit after taxation | | | | 37.6 |

**Year ended 30 September 2013 (restated)**

| | Paragon Mortgages £m | Idem Capital £m | Paragon Bank £m | Total £m |
|---|---|---|---|---|
| Interest receivable | 231.6 | 37.4 | - | 269.0 |
| Interest payable | (106.9) | (1.1) | - | (108.0) |
| Net interest income | 124.7 | 36.3 | - | 161.0 |
| Other operating income | 7.0 | 9.6 | - | 16.6 |
| Total operating income | 131.7 | 45.9 | - | 177.6 |
| Operating expenses | (46.2) | (11.4) | (1.3) | (58.9) |
| Provisions for losses | (15.2) | - | - | (15.2) |
| | 70.3 | 34.5 | (1.3) | 103.5 |
| Fair value net gain | 1.3 | - | - | 1.3 |
| Operating profit / (loss) | 71.6 | 34.5 | (1.3) | 104.8 |
| Tax charge | | | | (20.1) |
| Profit after taxation | | | | 84.7 |

The assets of the segments listed above are:

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| Paragon Mortgages | **10,192.0** | 10,256.3 | 10,127.8 | 9,897.8 |
| Idem Capital | **434.4** | 181.6 | 200.5 | 139.3 |
| Paragon Bank | **12.7** | - | - | - |
| Total assets | **10,639.1** | 10,437.9 | 10,328.3 | 10,037.1 |

## 4. OTHER OPERATING INCOME

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m |
|---|---|---|---|
| Loan account fee income | **2.2** | 2.1 | 4.4 |
| Insurance income | **1.3** | 1.0 | 2.0 |
| Third party servicing | **5.5** | 3.3 | 9.5 |
| Other income | **0.4** | 0.3 | 0.7 |
| | **9.4** | 6.7 | 16.6 |

## 5. COST:INCOME RATIO

Cost:income ratio is derived as follows:

| | 31 Mar 2014<br>£m | 31 Mar 2013<br>(restated)<br>£m | 30 Sep 2013<br>(restated)<br>£m |
|---|---|---|---|
| Operating expenses (£m) | **31.0** | 29.4 | 58.9 |
| Total operating income (£m) | **96.4** | 86.6 | 177.6 |
| Cost ÷ Income | **32.2%** | 33.9% | 33.2% |

## 6. FAIR VALUE NET GAINS / (LOSSES)

The fair value net gain / (loss) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

## 7. UNDERLYING PROFIT

Underlying profit is determined by excluding from the operating result fair value accounting adjustments arising from the Group's hedging arrangements.

| | 31 Mar 2014<br>£m | 31 Mar 2013<br>(restated)<br>£m | 30 Sep 2013<br>(restated)<br>£m |
|---|---|---|---|
| **Paragon Mortgages** | | | |
| Profit before tax for the period (note 3) | **40.1** | 34.2 | 71.6 |
| Exclude: Fair value (gains) | **(0.3)** | (0.9) | (1.3) |
| | **39.8** | 33.3 | 70.3 |
| **Idem Capital** | | | |
| Profit before tax for the period (note 3) | **21.2** | 15.3 | 34.5 |
| Exclude: Fair value (gains) | **-** | - | - |
| | **21.2** | 15.3 | 34.5 |
| **Paragon Bank** | | | |
| (Loss) before tax for the period (note 3) | **(3.1)** | (0.7) | (1.3) |
| Exclude: Fair value (gains) | **-** | - | - |
| | **(3.1)** | (0.7) | (1.3) |
| **Total** | | | |
| Profit before tax for the period | **58.2** | 48.8 | 104.8 |
| Exclude: Fair value (gains) | **(0.3)** | (0.9) | (1.3) |
| Underlying profit before tax | **57.9** | 47.9 | 103.5 |

## 8. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

Income tax for the six months ended 31 March 2014 is charged at 21.6% (six months ended 31 March 2013: 23.0%, year ended 30 September 2013: 19.2%), representing the best estimate of the annual effective rate of income tax expected for the full year, applied to the pre-tax income of the period.

## 9. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

| | | 31 Mar 2014 | 31 Mar 2013 (restated) | 30 Sep 2013 (restated) |
|---|---|---|---|---|
| Profit for the period (£m) | | **45.6** | 37.6 | 84.7 |
| Basic weighted average number of ordinary shares ranking for dividend during the period (million) | | **304.0** | 299.8 | 300.5 |
| Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (million) | | **8.2** | 10.7 | 9.9 |
| Diluted weighted average number of ordinary shares ranking for dividend during the period (million) | | **312.2** | 310.5 | 310.4 |
| Earnings per ordinary share | - basic | **15.0p** | 12.6p | 28.2p |
| | - diluted | **14.6p** | 12.1p | 27.3p |

## 10. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

| | 31 Mar 2014 £m | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| Goodwill | **1.6** | 1.6 | 1.6 | 1.6 |
| Computer software | **1.3** | 1.6 | 1.4 | 1.4 |
| Other intangibles | **5.3** | 5.8 | 5.5 | 6.1 |
| Total assets | **8.2** | 9.0 | 8.5 | 9.1 |

## 11. PROPERTY, PLANT AND EQUIPMENT

On 4 November 2013, the Group acquired the freehold in its head office building, which it had occupied under the terms of a sale and leaseback agreement. The cash consideration paid was £23.7m and costs and stamp duty were £1.0m. On the completion of the transaction the leasehold fixed asset, included in fixed assets at a net book value of £5.4m, and the related lease creditor, included in financial liabilities at £10.2m, were both extinguished.

The new freehold asset was therefore recognised on acquisition at a cost of £19.9m, the net of these amounts.

## 12. FINANCIAL ASSETS

| | Note | 31 Mar 2014 £m | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|---|
| First mortgage loans | | **8,497.6** | 8,283.7 | 8,401.8 | 8,295.6 |
| Consumer loans | | **608.3** | 398.1 | 399.7 | 399.0 |
| Loans to customers | | **9,105.9** | 8,681.8 | 8,801.5 | 8,694.6 |
| Fair value adjustments from portfolio hedging | | **(0.1)** | 0.4 | - | 1.1 |
| Investments in structured entities | | **20.6** | 26.7 | 23.8 | 9.1 |
| Derivative financial assets | 13 | **757.7** | 1,140.7 | 890.0 | 800.4 |
| Total assets | | **9,884.1** | 9,849.6 | 9,715.3 | 9,505.2 |

The Group's loan assets and investments in structured entities at 31 March 2014, analysed between the segments described in note 3, were as follows:

| | 31 Mar 2014 £m | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| **Idem Capital** | | | | |
| First mortgage loans | **16.8** | 18.5 | 17.5 | 19.0 |
| Consumer loans | **381.2** | 130.0 | 152.4 | 107.3 |
| Loans to customers | **398.0** | 148.5 | 169.9 | 126.3 |
| Investments in structured entities | **20.6** | 26.7 | 23.8 | 9.1 |
| Total investment in loans | **418.6** | 175.2 | 193.7 | 135.4 |
| **Paragon Mortgages** | | | | |
| First mortgage loans | **8,480.8** | 8,265.2 | 8,384.3 | 8,276.6 |
| Consumer loans | **226.8** | 268.1 | 247.3 | 291.7 |
| Loans to customers | **8,707.6** | 8,533.3 | 8,631.6 | 8,568.3 |
| Investments in structured entities | **-** | - | - | - |
| Total investment in loans | **8,707.6** | 8,533.3 | 8,631.6 | 8,568.3 |
| **Paragon Bank** | | | | |
| First mortgage loans | **-** | - | - | - |
| Consumer loans | **0.3** | - | - | - |
| Loans to customers | **0.3** | - | - | - |
| Investments in structured entities | **-** | - | - | - |
| Total investment in loans | **0.3** | - | - | - |
| **Total** | | | | |
| First mortgage loans | **8,497.6** | 8,283.7 | 8,401.8 | 8,295.6 |
| Consumer loans | **608.3** | 398.1 | 399.7 | 399.0 |
| Loans to customers | **9,105.9** | 8,681.8 | 8,801.5 | 8,694.6 |
| Investments in structured entities | **20.6** | 26.7 | 23.8 | 9.1 |
| Total investment in loans | **9,126.5** | 8,708.5 | 8,825.3 | 8,703.7 |

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IAS 39 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERC values for the Group's purchased assets are set out below, analysed by the balance sheet line on which they appear. These are derived from the same models and assumptions used in the EIR calculations.

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| **Carrying value** | | | | |
| Loans to customers | **398.0** | 148.5 | 169.9 | 126.3 |
| Investments in structured entities | **20.6** | 26.7 | 23.8 | 9.1 |
| | **418.6** | 175.2 | 193.7 | 135.4 |
| **84 month ERC** | | | | |
| Loans to customers | **559.2** | 253.2 | 272.6 | 219.5 |
| Investments in structured entities | **29.1** | 34.8 | 31.7 | 13.4 |
| | **588.3** | 288.0 | 304.3 | 232.9 |
| **120 month ERC** | | | | |
| Loans to customers | **669.2** | 290.5 | 313.3 | 250.7 |
| Investments in structured entities | **36.4** | 45.5 | 40.6 | 13.4 |
| | **705.6** | 336.0 | 353.9 | 264.1 |

## 13. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

| | Note | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|---|
| Derivative financial assets | 12 | **757.7** | 1,140.7 | 890.0 | 800.4 |
| Derivative financial liabilities | 20 | **(0.7)** | (2.5) | (1.3) | (4.6) |
| | | **757.0** | 1,138.2 | 888.7 | 795.8 |
| Of which: | | | | | |
| Foreign exchange basis swaps | | **757.4** | 1,140.1 | 889.6 | 799.5 |
| Other derivatives | | **(0.4)** | (1.9) | (0.9) | (3.7) |
| | | **757.0** | 1,138.2 | 888.7 | 795.8 |

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate.

## 14. SHORT TERM INVESTMENTS

This amount represents treasury bills and other liquid securities held as part of the liquidity requirement of Paragon Bank PLC. As such they are designated as 'Available for Sale', as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement' and are consequently shown at market value.

## 15. CASH AND CASH EQUIVALENTS

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets is not immediately available, due to the terms of the warehouse facilities and the securitisations. Cash held in the Group's banking subsidiary is subject to regulatory rules covering liquidity and capital adequacy, and is shown as 'Bank Cash' below.

'Cash and Cash Equivalents' also includes balances held by the Trustees of the Paragon Employee Share Ownership Plans which may only be used to invest in the shares of the Company, pursuant to the aims of those plans.

The total 'Cash and Cash Equivalents' balance may be analysed as shown below:

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| Free cash | **169.4** | 173.8 | 170.8 | 127.7 |
| Securitisation cash | **532.6** | 385.9 | 414.1 | 374.9 |
| Bank cash | **11.9** | - | - | - |
| ESOP cash | **2.4** | 1.7 | 2.4 | 2.2 |
| | **716.3** | 561.4 | 587.3 | 504.8 |

## 16. CALLED-UP SHARE CAPITAL

Movements in the issued share capital in the period were:

| | **Six months to 31 Mar 2014 Number** | Six months to 31 Mar 2013 Number | Year to 30 Sep 2013 Number |
|---|---|---|---|
| **Ordinary shares of £1 each** | | | |
| At 1 October 2013 | **306,213,215** | 301,841,614 | 301,841,614 |
| Shares issued | **895,068** | 2,475,993 | 4,371,601 |
| At 31 March 2014 | **307,108,283** | 304,317,607 | 306,213,215 |

During the period the Company issued 860,000 shares at par (Six months ended 31 March 2013: 2,475,993; year ended 30 September 2013: 3,975,993) to the trustees of its ESOP Trusts in order that they could fulfil their obligations under the Group's share based award arrangements. It also issued 35,068 shares (Six months ended 31 March 2013: nil; year ended 30 September 2013: 395,608) to satisfy options granted under sharesave schemes for a consideration of £36,884 (Six months ended 31 March 2013: £nil; year ended 30 September 2013: £398,281).

## 17. RESERVES

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| Share premium account | **64.1** | 64.1 | 64.1 | 64.1 |
| Merger reserve | **(70.2)** | (70.2) | (70.2) | (70.2) |
| Cash flow hedging reserve | **1.2** | 2.5 | 1.7 | 0.7 |
| Profit and loss account | **654.4** | 568.2 | 619.1 | 555.6 |
| | **649.5** | 564.6 | 614.7 | 550.2 |

## 18. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the period:

| | **31 Mar 2014 £m** | 31 Mar 2013 £m | 30 Sep 2013 £m |
|---|---|---|---|
| Final dividend for the year ended 30 September 2013 of 4.8p per share | **14.6** | - | - |
| Final dividend for the year ended 30 September 2012 of 4.5p per share | **-** | 13.5 | 13.5 |
| Interim dividend for the year ended 30 September 2013 of 2.4p per share | **-** | - | 7.2 |
| | **14.6** | 13.5 | 20.7 |

An interim dividend of 3.0p per share is proposed (2013: 2.4p per share), payable on 25 July 2014 with a record date of 4 July 2014. The amount expected to be absorbed by this dividend, based on the number of shares in issue at the balance sheet date is £9.2m (2013: £7.2m). The interim dividend will be recognised in the accounts when it is paid.

## 19. OWN SHARES

| | 31 Mar 2014 £m | 31 Mar 20123 £m | 30 Sep 2013 £m |
|---|---|---|---|
| **Treasury shares** | | | |
| At 31 March 2014 and 1 October 2013 | **39.5** | 39.5 | 39.5 |
| **ESOP shares** | | | |
| At 1 October 2013 | **8.1** | 9.0 | 9.0 |
| Shares purchased | **-** | 0.5 | 0.5 |
| Shares subscribed for | **0.9** | 2.5 | 4.0 |
| Options exercised | **(1.8)** | (2.5) | (5.4) |
| At 31 March 2014 | **7.2** | 9.5 | 8.1 |
| Total at 31 March 2014 | **46.7** | 49.0 | 47.6 |
| Total at 1 October 2013 | **47.6** | 48.5 | 48.5 |
| **Number of shares held** | | | |
| Treasury | **668,900** | 668,900 | 668,900 |
| ESOP | **1,004,876** | 3,057,337 | 1,931,890 |
| Balance at 31 March 2014 | **1,673,776** | 3,726,237 | 2,600,790 |

## 20. FINANCIAL LIABILITIES

| | 31 Mar 2014 £m | 31 Mar 2013 £m | 30 Sep 2013 £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| **Current liabilities** | | | | |
| Finance lease liability | **-** | 1.5 | 1.6 | 1.4 |
| Bank loans and overdrafts | **1.0** | 1.2 | 1.4 | 0.6 |
| | **1.0** | 2.7 | 3.0 | 2.0 |
| **Non-current liabilities** | | | | |
| Asset backed loan notes | **8,071.5** | 7,994.5 | 7,893.2 | 7,580.9 |
| Corporate bond | **110.0** | 110.0 | 110.0 | 110.0 |
| Retail bonds | **183.1** | 59.4 | 59.1 | - |
| Finance lease liability | **-** | 9.4 | 8.6 | 10.2 |
| Bank loans and overdrafts | **1,294.3** | 1,353.8 | 1,311.2 | 1,453.3 |
| Derivative financial liabilities | **0.7** | 2.5 | 1.3 | 4.6 |
| | **9,659.6** | 9,529.6 | 9,383.4 | 9,159.0 |

The finance lease which arose from a sale and leaseback transaction on the Group's head office building was extinguished during the period, as described in note 11. Details of changes in the Group's borrowings since the year end are given in note 21 below. Further details of derivative financial instruments are given in note 13.

## 21. BORROWINGS

All borrowings described in the Group Accounts for the year ended 30 September 2013 remained in place throughout the period.

On 18 March 2014 a Group company, Paragon Mortgages (No. 19) PLC, issued £343.0m of sterling mortgage backed floating rate notes to external investors at par. £313.2m of the notes were class A notes, rated AAA by Standard and Poor's and Fitch and Aaa by Moody's, £15.8m were class B notes, rated AA by Standard and Poor's and Fitch and Aa2 by Moody's and £14.0m were class C notes rated A by Standard and Poor's, A+ by Fitch and A1 by Moody's. The average interest margin above LIBOR on the notes was 0.90% and the proceeds were used to pay down existing warehouse debt and £66.6m of the £70.4m securitisation debt of First Flexible No. 4 PLC, which was satisfied in full in April 2014. The Group retained £7.0m of D notes and also invested £10.5m in the first loss fund, bringing its total investment to £17.5m, or 5.0% of the issued notes.

On 31 January 2014 a Group company, Idem Capital Securities (No. 1) s.à r.l. issued £130.6m of sterling floating rate notes to Bank of America Merrill Lynch International Limited. These notes bear interest at a rate of one month LIBOR plus 3.00%. The proceeds of the issue were used to part-fund the purchase of a portfolio of UK second charge residential mortgage loans, on which the borrowing is secured.

Following the period end, on 2 April 2014, a Group company, Idem First Finance Limited, entered into a £55.0m bank facility with Goldman Sachs Bank USA. The facility was used to refinance existing Idem Capital unsecured loan assets and is secured on those assets. This facility bears interest at a rate of one month LIBOR plus 3.75%.

Following the period end, on 30 April 2014, a Group company, Paragon Sixth Funding Limited, entered into an additional £100.0m bank facility with Natixis. This facility is available for a twelve month period, which will be extended to 24 months if a refinancing target is met in the first twelve months. This facility bears interest at a rate of one month LIBOR plus 1.40% and brings the total warehouse capacity to £550.0m.

As with the Group's existing securitisation borrowings, these financings are structured so that payments of interest and principal are limited to cash generated from the funded assets and there is no recourse to other Group funds. Therefore the issue of these new borrowings do not impact on the liquidity risk of the Group.

In January 2014 the £200.0m warehouse facility provided to Paragon Fifth Funding Limited by Lloyds Bank was renewed and is now available for drawing until June 2016. The interest margin above LIBOR reduced from 2.75% to 1.75%.

During the period the Group issued £125.0m of sterling bonds under the £1,000.0m Euro Medium Term Note Programme inaugurated in February 2013. These bonds are listed on the London Stock Exchange, carry a fixed interest rate of 6.125% per annum and are repayable in January 2022, but are callable at the option of the Company. This issue raised £123.9m of cash, net of issue costs.

Repayments made in respect of the Group's borrowings are shown in note 25.

## 22. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2014 has been calculated on a year-to-date basis, using the latest actuarial valuation for IAS 19 purposes at 30 September 2013. There have been movements in financial market conditions since that date, requiring an adjustment to the actuarial assumptions underlying the calculation of the defined benefit obligation at 31 March 2014. In particular, over the period since the 30 September 2013 actuarial valuation, the discount rate has increased by 0.10% per annum, whereas expectations of long term inflation have increased by 0.05% per annum. The net effect of these changes has resulted in a decrease in the value of the defined benefit obligation at 31 March 2014. The impact of the change in actuarial assumptions has been recognised as an actuarial gain in other comprehensive income.

The defined benefit plan assets have been updated to reflect their market value at 31 March 2014. In particular, over the period since 30 September 2013 the Plan assets have achieved results in excess of the assumptions made at 30 September 2013. The difference between the expected and actual return on assets has been recognised as an actuarial gain in other comprehensive income.

## 23. NET CASH FLOW FROM OPERATING ACTIVITIES

| | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 (restated) £m | Year to 30 Sep 2013 (restated) £m |
|---|---|---|---|
| Profit before tax | **58.2** | 48.8 | 104.8 |
| Non-cash items included in profit and other adjustments | | | |
| Depreciation of property, plant and equipment | **0.9** | 1.1 | 2.1 |
| Amortisation of intangible assets | **0.6** | 0.5 | 1.2 |
| Foreign exchange movements on borrowings | **(131.5)** | 338.2 | 88.8 |
| Other non-cash movements on borrowings | **1.9** | 3.9 | 5.9 |
| Impairment losses on loans to customers | **7.5** | 9.3 | 15.2 |
| Charge for share based remuneration | **1.6** | 1.4 | 3.1 |
| Net (increase) / decrease in operating assets | | | |
| Loans to customers | **(308.7)** | (14.1) | (136.8) |
| Derivative financial instruments | **132.3** | (340.3) | (89.6) |
| Fair value of portfolio hedges | **0.1** | 0.7 | 1.1 |
| Other receivables | **(0.7)** | (0.4) | (1.3) |
| Net (decrease) / increase in operating liabilities | | | |
| Derivative financial instruments | **(0.6)** | (2.1) | (3.3) |
| Other liabilities | **(1.5)** | 0.9 | (1.1) |
| Cash (utilised) / generated by operations | **(239.9)** | 47.9 | (9.9) |
| Income taxes (paid) | **(6.5)** | (10.0) | (22.0) |
| **Net cash flow (utilised) / generated by operating activities** | **(246.4)** | 37.9 | (31.9) |

## 24. NET CASH FLOW USED IN INVESTING ACTIVITIES

| | **Six months to 31 Mar 2014 £m** | Six months to 31 Mar 2013 £m | Year to 30 Sep 2013 £m |
|---|---|---|---|
| Purchases of property, plant and equipment | **(24.9)** | (0.6) | (1.0) |
| Purchases of intangible assets | **(0.3)** | (0.4) | (0.6) |
| Increase in short term investments | **(0.5)** | - | - |
| **Net cash (utilised) by investing activities** | **(25.7)** | (1.0) | (1.6) |

## 25. NET CASH FLOW FROM FINANCING ACTIVITIES

| | Six months to 31 Mar 2014 £m | Six months to 31 Mar 2013 £m | Year to 30 Sep 2013 £m |
|---|---|---|---|
| Shares issued | **0.1** | - | 0.4 |
| Dividends paid (note 18) | **(14.6)** | (13.5) | (20.7) |
| Issue of asset backed floating rate notes | **468.5** | 193.1 | 459.1 |
| Repayment of asset backed floating rate notes | **(160.0)** | (118.7) | (237.5) |
| Issue of retail bonds | **123.9** | 59.4 | 59.0 |
| Capital element of finance lease payments | **-** | (0.7) | (1.4) |
| Movement on bank facilities | **(16.4)** | (100.0) | (143.8) |
| Purchase of shares (note 19) | **-** | (0.5) | (0.5) |
| Sale of shares | **-** | - | 0.6 |
| **Net cash generated by financing activities** | **401.5** | 19.1 | 115.2 |

## 26. RETURN ON EQUITY

Return on equity is defined by the Group by comparing the profit after tax for the period to the average of the opening and closing equity positions and is derived as follows:

| | 31 Mar 2014 £m | 31 Mar 2013 (restated) £m | 30 Sep 2013 (restated) £m | 30 Sep 2012 £m |
|---|---|---|---|---|
| Profit for the period | **45.6** | 37.6 | 84.7 | 72.2 |
| **Divided by** | | | | |
| Opening equity | **873.3** | 803.5 | 803.5 | 742.0 |
| Closing equity | **909.9** | 819.9 | 873.3 | 803.5 |
| Average equity | **891.6** | 811.7 | 838.4 | 772.7 |
| Return on equity (annualised) | **10.5%** | 9.5% | 10.1% | 9.3% |

## 27. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair values have been determined for all derivatives, listed securities and any other financial assets and liabilities for which an active and liquid market exists.

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are, principally, present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate. The principal inputs to these valuation models are LIBOR benchmark interest rates for the currencies in which the instruments are denominated, sterling, euros and dollars. The cross currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. In order to determine the fair values the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued. Management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors.

For assets and liabilities carried at fair value, IFRS 7 requires that the measurements should be classified using a fair value hierarchy reflecting the inputs used, and defines three levels. Level 1 measurements are unadjusted market prices, level 2 measurements are derived from observable data, such as market prices or rates, while level 3 measurements rely on significant inputs which are not derived from observable data.

As described above the valuations of the Group's derivatives are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 13. The short term investments described in note 14 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements. The Group had no financial assets or liabilities in the half year ended 31 March 2014 or the year ended 30 September 2013 valued using level 3 measurements.

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost, are not materially different from their book values because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset on a quarterly basis. While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

In the absence of a liquid market in loan assets the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers and have concluded that the carrying value of these assets, determined on the amortised cost basis, is not significantly different from the fair value of the assets derived on a discounted cash flow basis.

## 28. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2014, the Group has continued the related party relationships described in note 59 on page 145 of the Annual Report and Accounts of the Group for the financial year ended 30 September 2013. Related party transactions in the period comprise the compensation of the Group's key management personnel, transactions with the Group Pension Plan and fees paid to a non-executive director in respect of his appointment as a director of the Corporate Trustee of the Group Pension Plan. There have been no changes in these relationships which could have a material effect on the financial position or performance of the Group in the period.

Save for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2014.

# Independent review report

## to The Paragon Group of Companies PLC

## INTRODUCTION

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2014 which comprises the income statement, the statement of comprehensive income, the balance sheet, the cash flow statement, the statement of movements in equity and related notes 1 to 28. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to it 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 half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting,' as adopted by the European Union.

## OUR RESPONSIBILITY

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

## SCOPE OF REVIEW

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2014 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

**Deloitte LLP**
Chartered Accountants and Statutory Auditor
Birmingham, United Kingdom
20 May 2014

# Principal risks and uncertainties

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance over the remaining six months of the financial year and could cause actual results to differ materially from expected and historical results. In the opinion of the directors these risks have not changed materially from those described in section A2.2 of the last annual report and accounts of the Company for the year ended 30 September 2013. These risks are summarised below.

## ECONOMIC ENVIRONMENT

Further deterioration in the general economy may adversely affect all aspects of the Group's business. Adverse economic conditions might increase the number of borrowers that default on their loans, or adversely affect funding structures, which may in turn increase the Group's costs and could result in losses on some of the Group's assets, or restrict the ability of the Group to develop in future.

Changes in interest rates may adversely affect the Group's net income and profitability.

## CREDIT RISK

As a primary lender the Group faces credit risk as an inherent component of its lending and asset purchase activities. Adverse changes in the credit quality of the Group's borrowers, a general deterioration in UK economic conditions or adverse changes arising from systematic risks in UK and global financial systems could reduce the recoverability and value of the Group's assets.

## FUNDING RISK

The Group relies on its access to sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory or governmental action, this might result in the scaling back or cessation of some business lines.

## OPERATIONAL RISK

The Group's activities subject it to operational risks relating to its ability to implement and maintain effective systems to process the high volume of transactions with customers. A significant breakdown of the IT systems of the Group might adversely impact the ability of the Group to operate its business effectively.

## COMPETITOR RISK

The Group faces strong competition in all of the core markets in which it operates. There is a danger that its profitability and/or market share may be impaired.

## GOVERNMENTAL, LEGISLATIVE AND REGULATORY RISK

The market sectors in which the Group operates, and the capital markets from which it obtains much of its funding, are subject to significant legislative and regulatory oversight and intervention by United Kingdom Government, European Union and other regulatory bodies. To the extent that such actions disadvantage the Group, when compared to other market participants, they present a risk to the Group.

## MANAGEMENT

The success of the Group is dependent on recruiting and retaining skilled senior management and personnel.

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