Paragon Banking Group PLC

Building a specialist bank

Financial results

12 months ended 30 September 2019

2019 – financial results highlights

Building a specialist bank

Financial highlights

- Underlying operating profits up 5.0% to £164.4 million
- Underlying EPS up 6.0% to 51.1 pence
- Dividend per share up 9.3% to 21.2 pence
- Underlying RoTE 14.6%
- Strong returns in Mortgages and Commercial Lending segments more than offset Idem Capital income fade
- NIM up 8bp to 229bp
- Continued low cost of risk at 7bp

Diversified lending

- New lending £2.5 billion (2018: £2.3 billion) +8.5%
- Mortgages new advances £1.56 billion
  - 88.8% specialist BTL completions
  - Year-end BTL pipeline over £0.9 billion
- Commercial Lending new advances £0.97 billion
  - SME lending growth up 14.6%
  - Development finance up strongly, reflecting first full year ownership of Titlestone
- Idem Capital discipline continues
- Customer retention improved
  - BTL redemptions drop from 10.3% to 8.6% pa
- Net loan growth 7.0% (ex residual sale)

Capital and funding

- Savings franchise broadened
  - Deposit balances up 20.7% to £6.4 billion
  - Capacity enhanced
  - Cost of deposits stable
- £364.3 million securitisation completed
- First legacy SPV residual sold, generating exceptional gain
- Disciplined capital management
  - £26.5 million buy-back executed
- Year-end CET1 13.7% (13.4% fully loaded)

Financial results

12 months ended 30 September 2019

Richard J Woodman
Chief Financial Officer

Income statement

£million	2019	2018	Change	
Net interest income	278.4	256.5	+8.5%	Structural shift generates margin and volume improvements
Other income	19.2	19.3	(0.5%)	Broadly stable – lower redemption fees
Total operating income	297.6	275.8	+7.9%	
Operating expenses	(125.2)	(111.9)	+11.9%	Full year Titlestone and project spend
Impairments	(8.0)	(7.4)	+8.1%	7bp cost of risk
Underlying profit before tax	**164.4**	**156.5**	**+5.0%**	
Fair value net gains / (losses)	(15.1)	1.2		Swap rate impacts on pipeline hedging
Disposal of residual	9.7	-		PM12 residual sale
Portfolio sale	-	23.8		Exceptional Idem Capital disposal in 2018
Profit before taxation	**159.0**	**181.5**		

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Balance sheet

£million	2019	2018	Change (%)	
Mortgages	10,344.1	10,473.5	(1.2%)	Reflects £0.7 billion PM12 disposal
Commercial Lending	1,452.1	1,133.2	+28.1%	Led by development finance and SME lending
Idem Capital	389.9	521.1	(25.2%)	Strong cash flow amortising portfolio
Loans and advances to customers	**12,186.1**	**12,127.8**	**+0.5%**	
Cash	1,225.4	1,310.6	(6.5%)	
Other assets	984.0	1,076.7	(8.6%)	
Total assets	**14,395.5**	**14,515.1**	**(0.8%)**	
Capital and reserves	1,108.4	1,095.9	+1.1%	Net of buy-backs, dividends and pension move
Retail deposits	6,391.9	5,296.6	+20.7%	Further funding diversification
Tier-2 bond	150.0	150.0	-	
Retail bonds	297.5	297.5	-	First maturity December 2020
Asset backed loan notes	5,206.9	6,490.3	(19.8%)	PM12 disposal
Central bank facilities	994.4	1,024.4	(2.9%)	TFS and ILTR
Other liabilities	246.4	160.4	+53.6%	
Total liabilities and equity	**14,395.5**	**14,515.1**	**(0.8%)**	

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Segmental results

Core business line contributions more than offset by expected Idem Capital earnings fade

Underlying £million	Mortgages	Commercial Lending	Idem Capital	Central	Total
Total operating income (2019)	184.6	76.0	55.7	(18.7)	297.6
Change (v 2018)	+19.4	+32.9	(32.8)	+2.3	+21.8
Operating expenses	(15.7)	(25.0)	(7.9)	(76.6)	(125.2)
Change	(0.8)	(3.8)	+2.5	(11.2)	(13.3)
Provisions for losses	(1.0)	(7.2)	0.2	-	(8.0)
Change	+4.5	(5.2)	+0.1	-	(0.6)
Contribution	**167.9**	**43.8**	**48.0**	**(95.3)**	164.4
Change	+23.1	+23.9	(30.2)	(8.9)	+7.9

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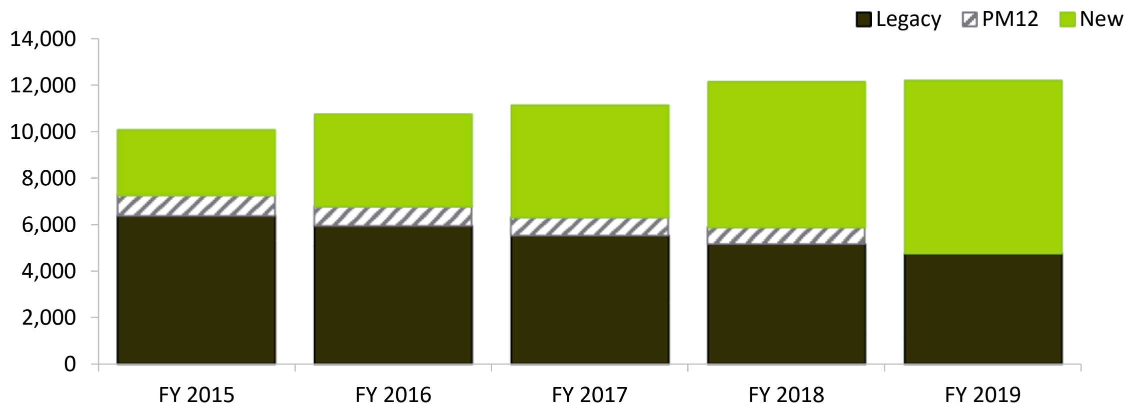
Diversified loan growth

Originations £million	2019	2018	Change
Mortgages	1,564.4	1,623.2	(3.6%)
Commercial Lending	968.0	710.0	+36.3%
Idem Capital	4.2	83.4	(95.0%)
Total	**2,536.6**	**2,416.6**	**+5.0%**

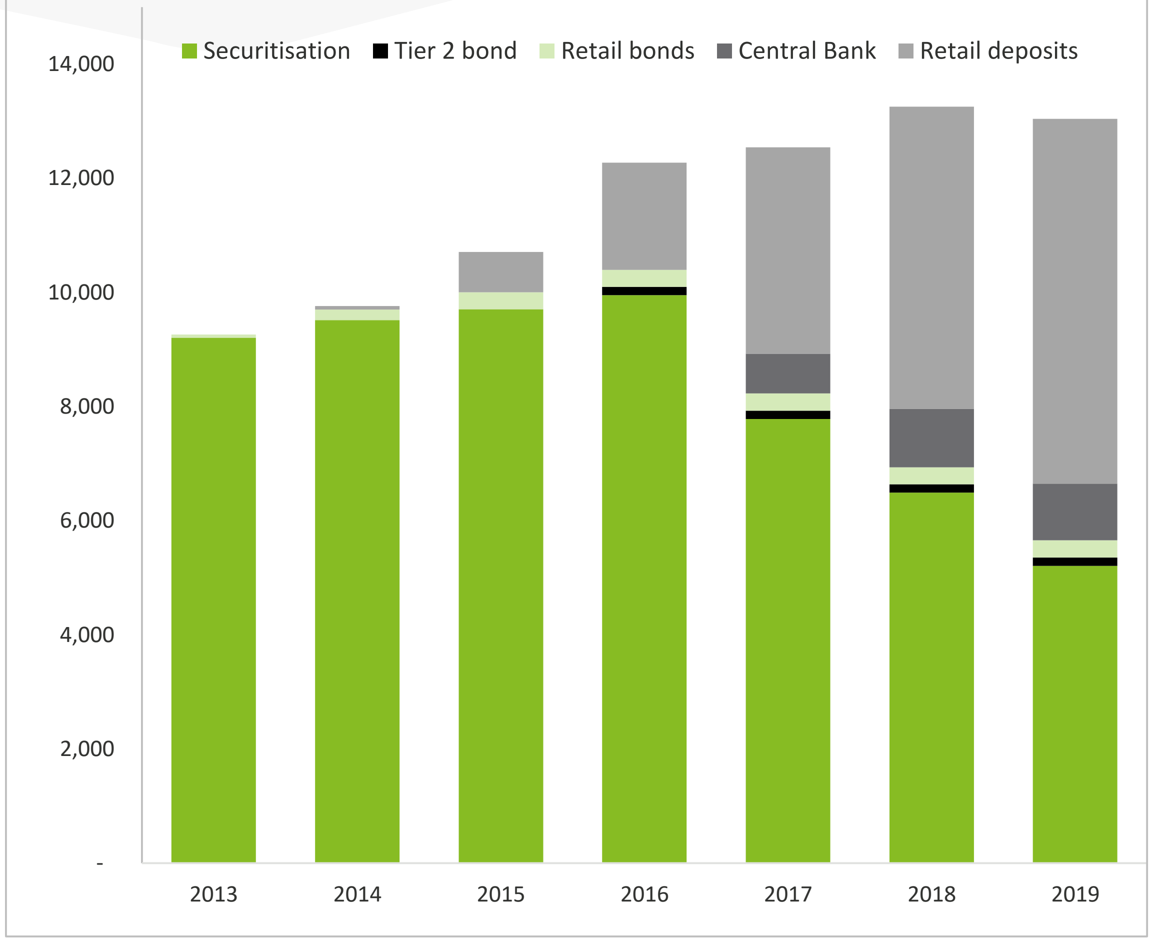
Total – loans and advances to customers (£m)



Source: Paragon Banking Group PLC

Diversified funding

Funding by type (£m)



Source: Paragon Banking Group PLC

Net interest income

Structural NIM improvement continues

Overall

- Underlying NIM increased by 8bp to 229bp, reduced by 1bp given IFRS9 income recognition approach on Stage 3 assets (cost of risk reduced £ for £)

Mortgages

- Charging rates stable on new BTL lending
- **Front book** NIM wider than legacy portfolio

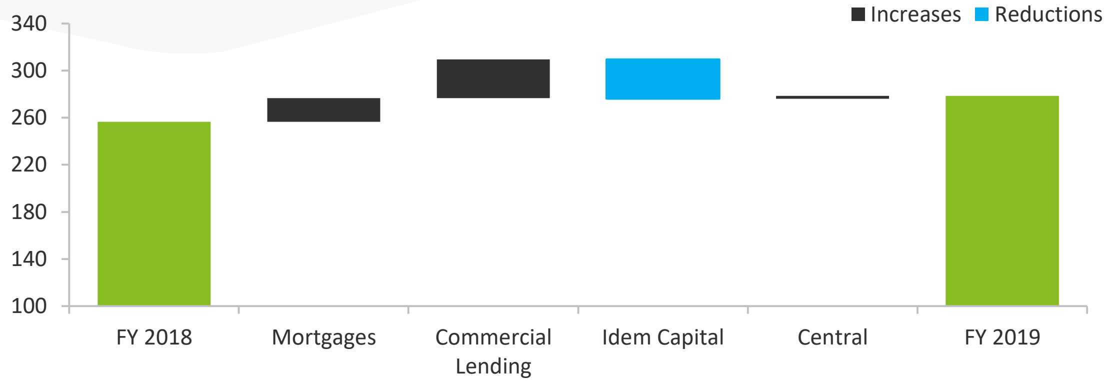
Commercial Lending

- Strong growth, improving margins and focus on capital allocation
- Fastest growing segments are development finance (post Titlestone acquisition) and SME lending

Idem Capital

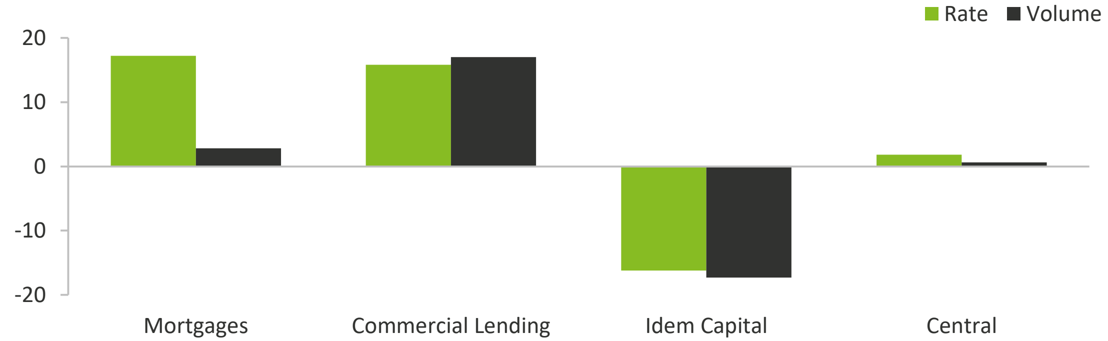
- Portfolio amortisation approximately 30% per annum
- New business expectations limited given prevailing risk / reward conditions and preferred opportunities in Commercial Lending
- Portfolio continues to perform strongly

Net interest income (£m)



Source: Paragon Banking Group PLC

Rate and volume influences (£m)



Source: Paragon Banking Group PLC

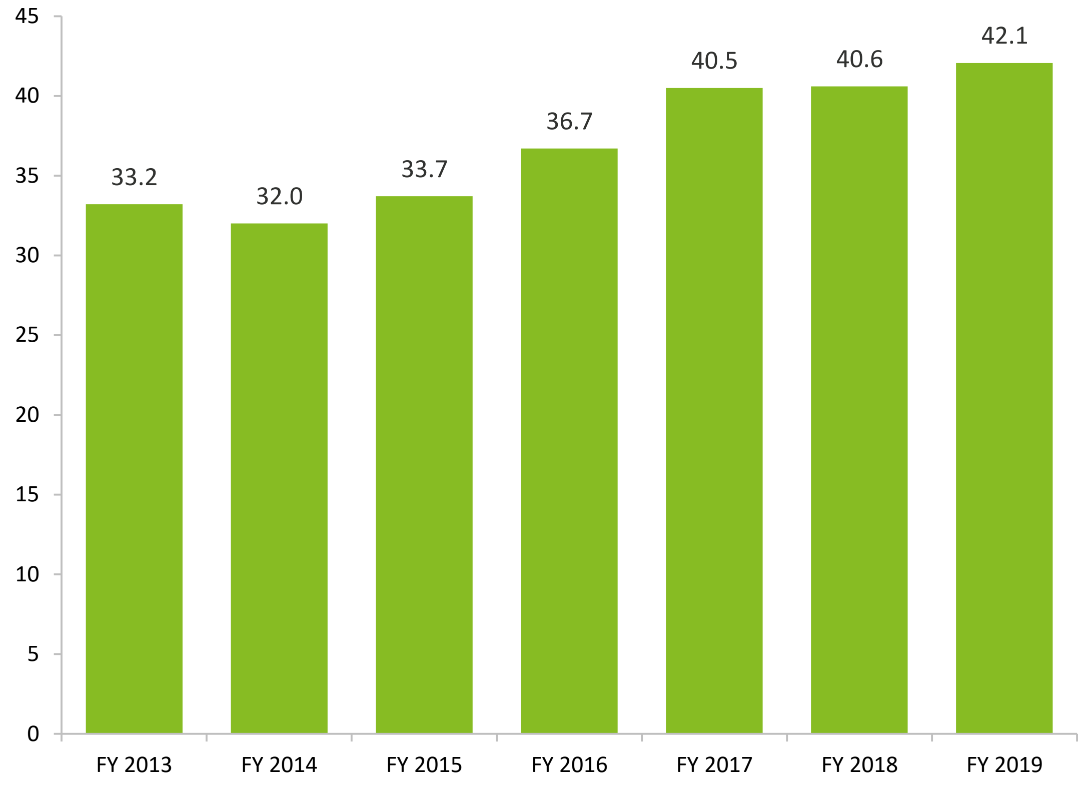
Operating expenses

Full year Titlestone costs and ongoing project spend

- Cost:income ratio increased year-on-year
  - Full year impact of Titlestone
  - Continued investment in technology / infrastructure
  - Project costs include ongoing support for IRB application (circa £2.4 million in 2019 and will repeat in 2020)

- Cost:income ratio influenced by strategic developments
  - Portfolio and residual sales have been +ve for EPS and RoTE, but -ve for CIR
  - Further IT and project expenditure planned for 2020 and 2021
  - Flat Idem Capital performance in 2019 would have made underlying cost:income ratio 38.7%
  - Low 30% cost:income ratio diminished as a near term target; enhanced RoTE remains primary objective
  - Significant operational leverage still expected to be achieved over the longer term

Underlying cost:income ratio (%)



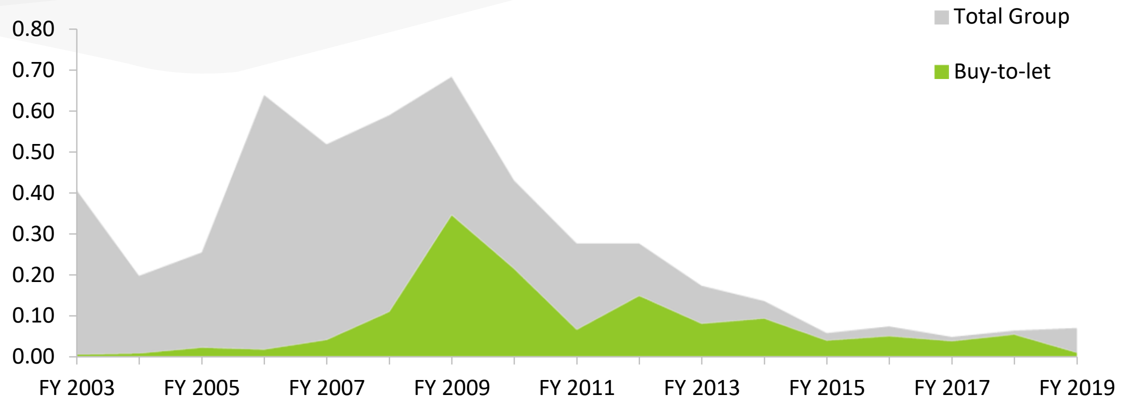
Source: Paragon Banking Group PLC

Credit performance

Strong credit performance maintained

- First year under IFRS9. Economic scenarios re-weighted to a net downside case given year end uncertainties
- Cost of risk reduced by 1bp given reduced income recognition on stage 3 assets
- Stable performance from new portfolios reflects maintenance of tight credit standards

First mortgages cost of risk (%)

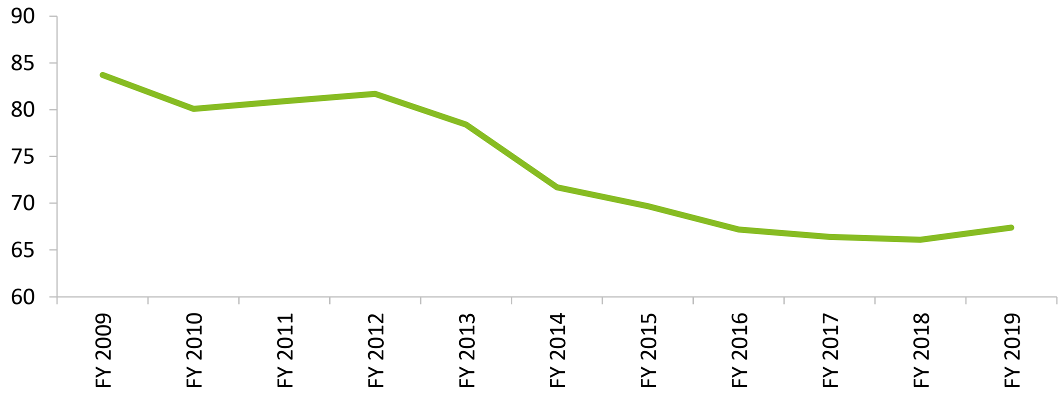


Source: Paragon Banking Group PLC

IFRS 9 provisions (£m)

	Mortgages	Commercial Lending	Idem Capital	Total
Stage 1	9,847.7	1,376.7	158.2	11,382.6
Stage 2	378.2	64.6	15.7	458.5
Stage 3	129.3	8.2	30.4	167.9
POCI	15.7	13.3	190.0	219.0
Gross loan book	**10,370.9**	**1,462.8**	**394.3**	**12,228.0**
Impairment provisions	**26.8**	**10.7**	**4.4**	**41.9**
Coverage ratio	**0.26%**	**0.73%**	**1.12%**	**0.34%**

Average BTL LTV (%)



Source: Paragon Banking Group PLC

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Below the line items

Falling rates impact fair values and pension deficit, residual disposed of at a premium

Fair value movements

- Three broad categories in September balance sheet
  - Mid month inceptions – swaps taken out and FV adjustments to the point they enter the hedge
  - Cancelled swaps
  - Hedge ineffectiveness – essentially a function of the pipeline and will reverse as swaps mature
- Full year **charge £15.1 million**

Gain on residual sale

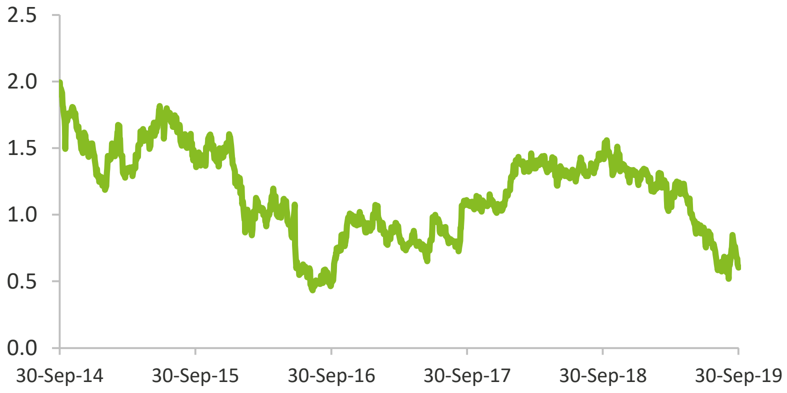
- Residual interest in PM12 (legacy securitisation) sold in June 2019
  - **Gain of £9.7 million** over carry value and inter-company items
  - Accelerates steady run-off of low yield, legacy assets
  - Capital generated utilised in part for buy-back, £26.5 million invested in second half of financial year

Pension deficit

- Deficit on DB scheme increased from £19.5 million in September 2018 to £34.5 million
  - Main drivers are mortality assumptions, reduced discount rate and strong asset performance during year
  - Discount rate of 1.85% compares to 2.95% at September 2018
  - Sensitivity is approximately £3.3 million per 10bp of discount rate move
  - Full year deficit increase **£15.0 million**

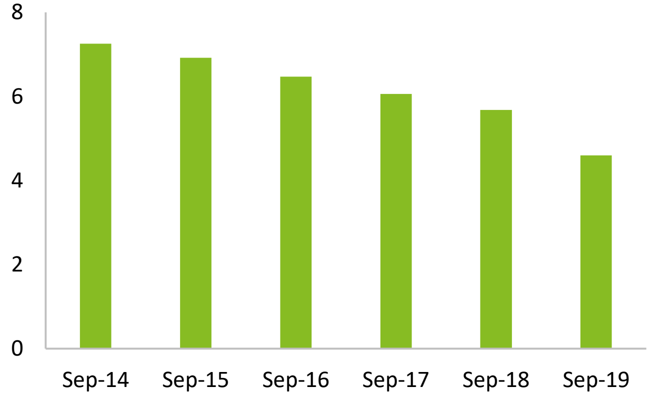
Unusual scale of non-cash, fair value item means dividend cover ratio below normal 2.5 times level
Cover ratio of around 2.5 times remains as core policy

5 year swap rate trends (%)



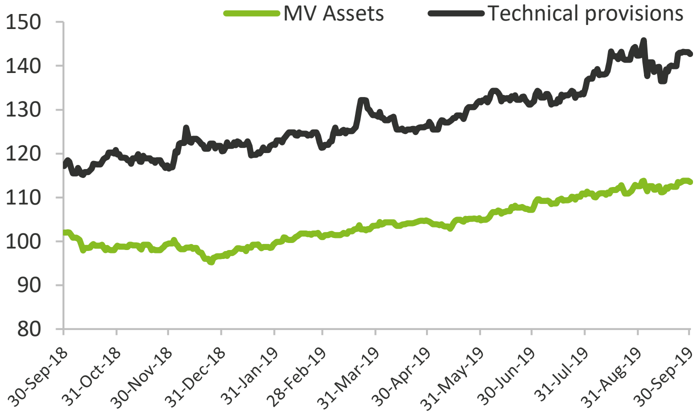
Source: Barclays Bank PLC

Legacy portfolio movements (£bn)



Source: Paragon Banking Group PLC

Pension – assets and liabilities (£m)



Source: Paragon Banking Group PLC

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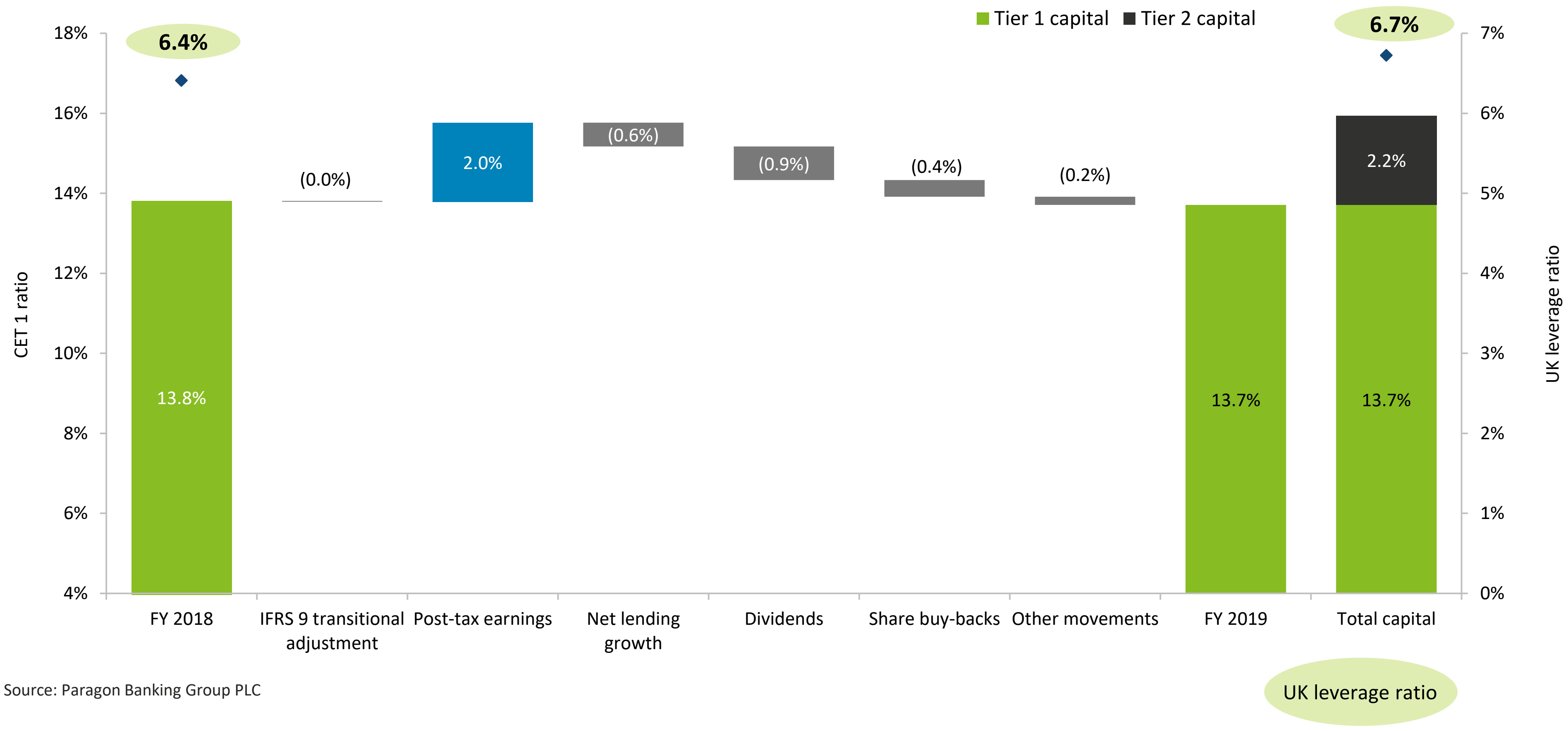
Capital bridge

Little change year-on-year – capital allocation focused on Mortgages and Commercial Lending

FY 2018 / FY 2019



Source: Paragon Banking Group PLC

Group capital

Strong ratios maintained – 1.3% of CET1 distributed via dividend or buy-back

Group consolidated capital	
Core Equity Tier-1 capital *	£922.0m
Tier-2 capital	£150.0m
Total capital resources	**£1,072.0m**
Credit risk	£6,093.2m
Operational risk	£516.6m
Market risk	-
Other	£114.0m
Total risk exposure	**£6,723.8m**
CET1 ratio *	13.7%
Total capital ratio (TCR)	15.9%

Group consolidated leverage ratio	
Tier-1 equity *	£922.0m
Leverage exposure **	£13,706.4m
UK leverage ratio *	6.7%

* IFRS 9 transitional relief, adjusted for proposed dividend and subject to verification

** Excludes qualifying central bank claims in accordance with rule modification applied to UK Leverage Ratio Framework

Capital ratios

- CET1 and TCR remain strong
- Capital requirements up by £75.6 million in 2019 due to market-wide CCoB and CCyB requirements
- Capital SREP scheduled for summer 2020

Risk weightings

- Standardised approach – portfolio risk weights re-confirmed in H1

IRB

- Consultation paper (CP21/19) issued in September formalises requirement to embed future EBA regulation into bank IRB models during 2020
- All material points covered in Paragon's models but Board will ensure full compliance before making application

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Building a specialist bank

Nigel S Terrington
Chief Executive

Delivering our strategic vision

To be the leading specialist bank supporting UK consumers, property investors, homeowners and small businesses

Strategic priorities

- **Specialisation**
  focusing on building strong positions in our chosen markets
- **Diversification**
  developing our range of savings and lending products in existing and new markets
- **Growth**
  seeking opportunities for growth with specialist products, both organically and through acquisition
- **Capital management**
  recycling capital to reinvest in the business and enhance shareholder returns
- **Sustainability**
  ensuring our operations have a positive effect on our stakeholders and communities with which we interact

Delivery

- Clear and dedicated customer focus
- Strong, identifiable culture and values
- Through-the-cycle experience and active employee engagement
- Data analytics supporting bespoke customer engagement
- Increasingly technology enabling
- Robust model / low risk appetite

Outcomes

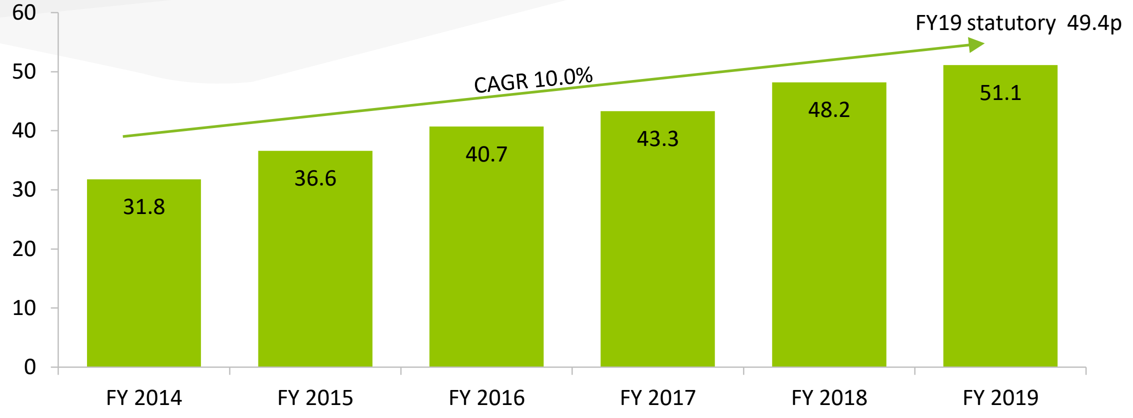
- Fair valued products and services for our customers
- Value creation for stakeholders
- Driving up RoTE
- Sustainable growth

Building a specialist bank

Long-term sustainable delivery with change

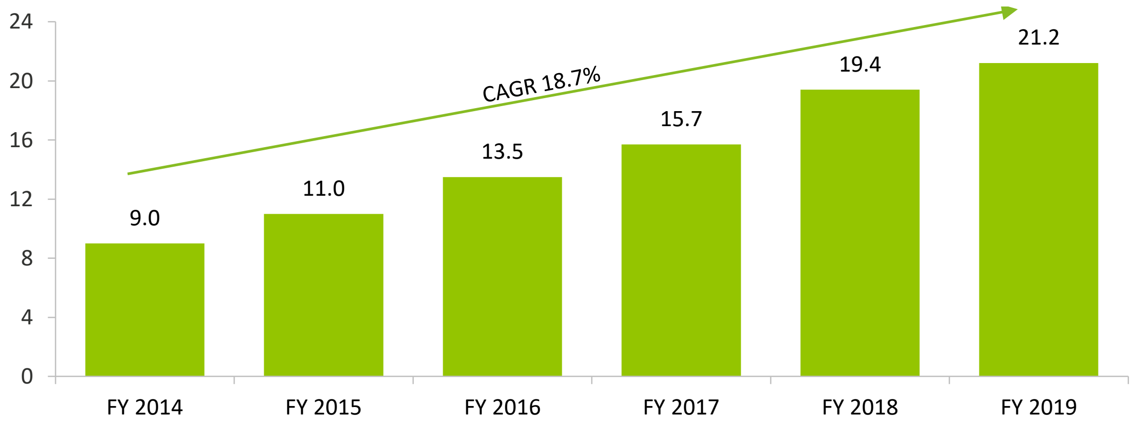
- Strategic transformation whilst improving returns
  - Bank formation and subsequent restructuring
  - 4 acquisitions
  - 5 start-ups
  - Technology investments
  - Capital management
  - Embedding IRB approach

Underlying earnings per share (pence)



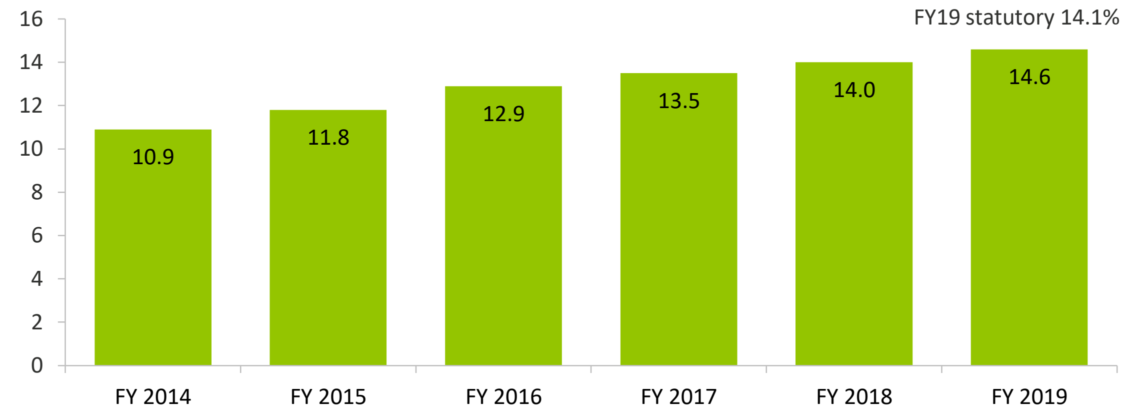
Source: Paragon Banking Group PLC

Dividend per share (pence)



Source: Paragon Banking Group PLC

Underlying Return on Tangible Equity (%)



Source: Paragon Banking Group PLC

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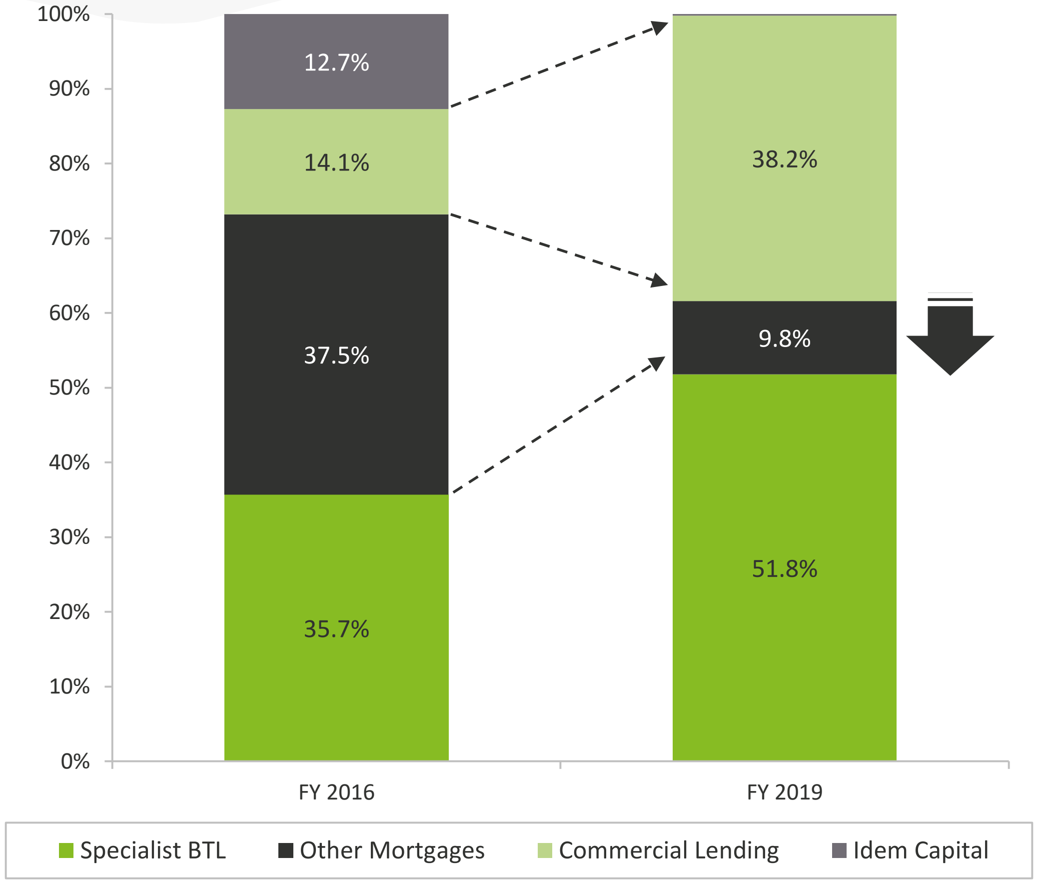
Building a specialist bank

Increasingly focused on specialist BTL and SMEs

- Specialist focus avoids low return commoditised sectors
- As a specialist we seek to achieve a deeper understanding of:
  - The markets in which we operate
  - The customers we serve
  - The products we offer
  - The services we provide
  - The risks we incur
- Supporting UK consumers, property investors, homeowners and small businesses' financing needs
  - Extensive product suite
  - Enhancing distribution and service through technology
  - Highly experienced customer engagement still crucial

Significant shift in flow of new loan originations in 3 years (%)



Source: Paragon Banking Group PLC

Buy-to-let

Market

- Despite fiscal and regulatory changes, BTL volumes remained robust
- Remortgage activity continues to dominate (71.4%)
- Purchase activity increasingly focused towards specialist landlords

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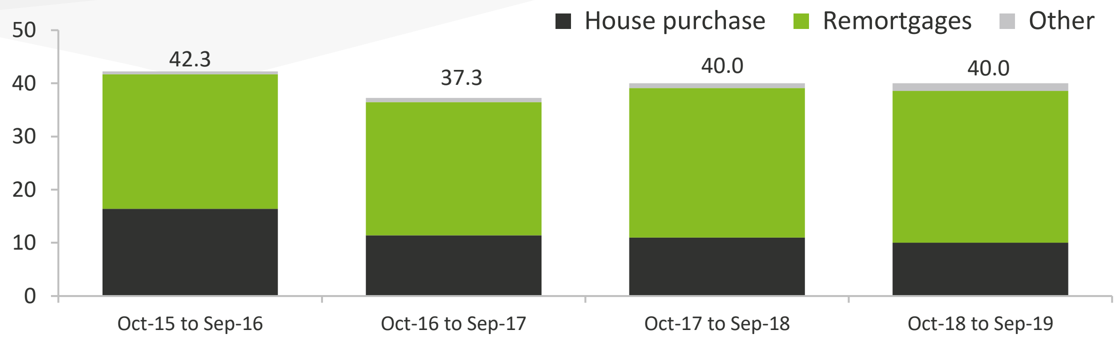
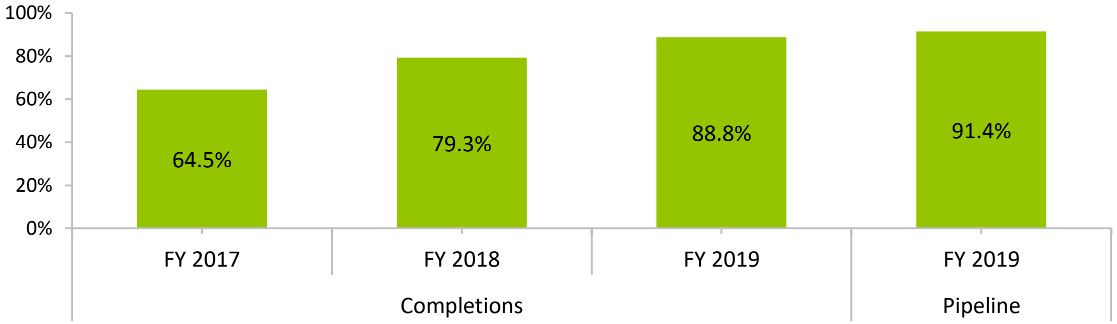
- BTL new lending £1.48 billion down 1.0% year-on-year
  - Specialist +10.9%
  - Amateur –46.6%
- New technology platform significantly improving intermediary experience (NPS+60)
- New business margins remain robust
- Pipeline +17.0% at £911.7 million

BTL gross mortgage lending (£bn)



Source: UK Finance

% of specialist BTL lending



Source: Paragon Banking Group PLC

Supporting the housing needs of Britain's renters

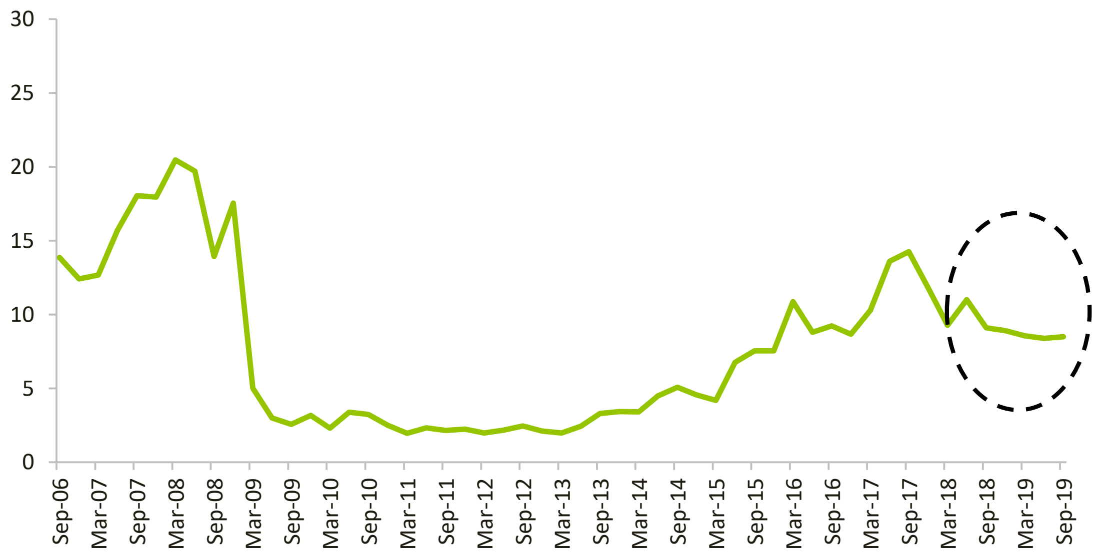
Buy-to-let

Keeping our customers for longer

- Redemption levels broadly flat in H2 2019
- Specialist landlords showing improved loyalty
    - Improved retention strategies – direct and broker initiatives
    - 5 year products extending redemption profile
- Expect lower redemption levels trend to continue

- Net loan book growth excluding PM12 disposal of 6.0%, up from 5.3% in FY 2018 and 3.0% in FY 2017
- Net loan book growth excluding pre 2010 legacy and PM12 was 21.1% in FY 2019

BTL redemptions (%)



Source: Paragon Banking Group PLC

Supporting the housing needs of Britain's renters

Commercial Lending – development finance

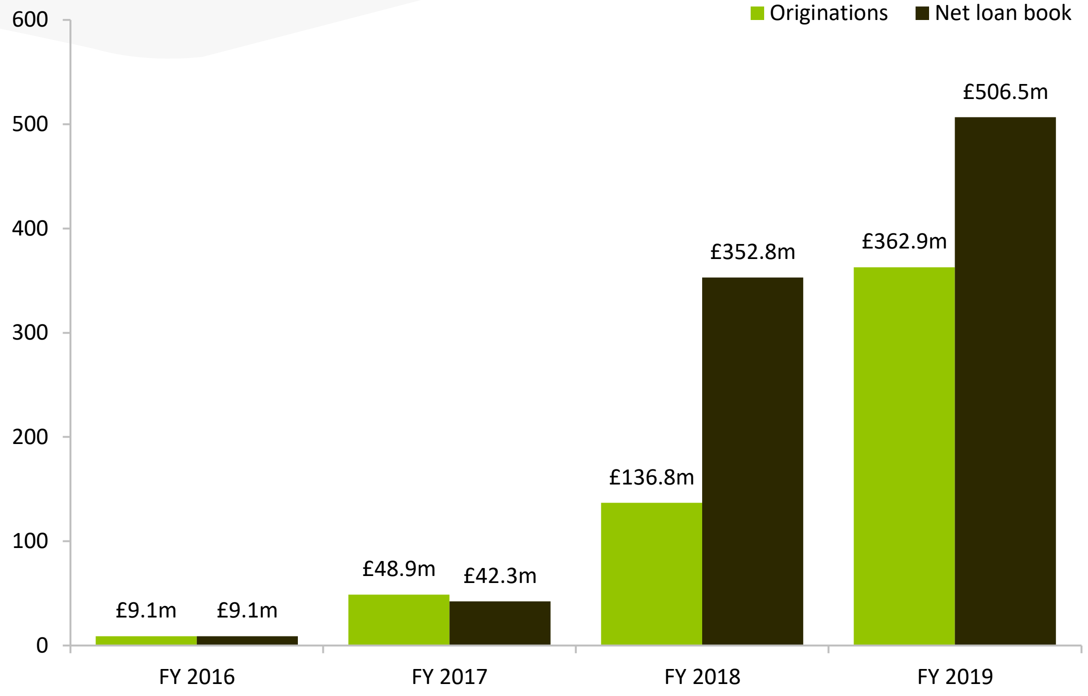
Building on solid foundations

- Integration of Titlestone and legacy Paragon platforms completed
- Originations of £362.9 million up 13.1% on pro-forma FY 2018 levels
- Some uncertainty due to Brexit
  - Credit and pricing discipline maintained
- Undrawn facilities £294.8 million, strong pipeline (FY18: £215.2 million)
- Further growth planned through broadening geographical footprint and selective expansion of management capacity
- **Will not chase volumes at expense of risk or returns**

Titlestone / development finance

- Targeting small and medium sized developers
- Experienced management team with 30+ years' experience
- Service-led proposition, originated mainly through direct relationship channels
- Average facility size £4.4 million
- Average LTV 65.4%

Originations and loan book growth (£m)



Source: Paragon Banking Group PLC

Helping to meet the UK's housing needs

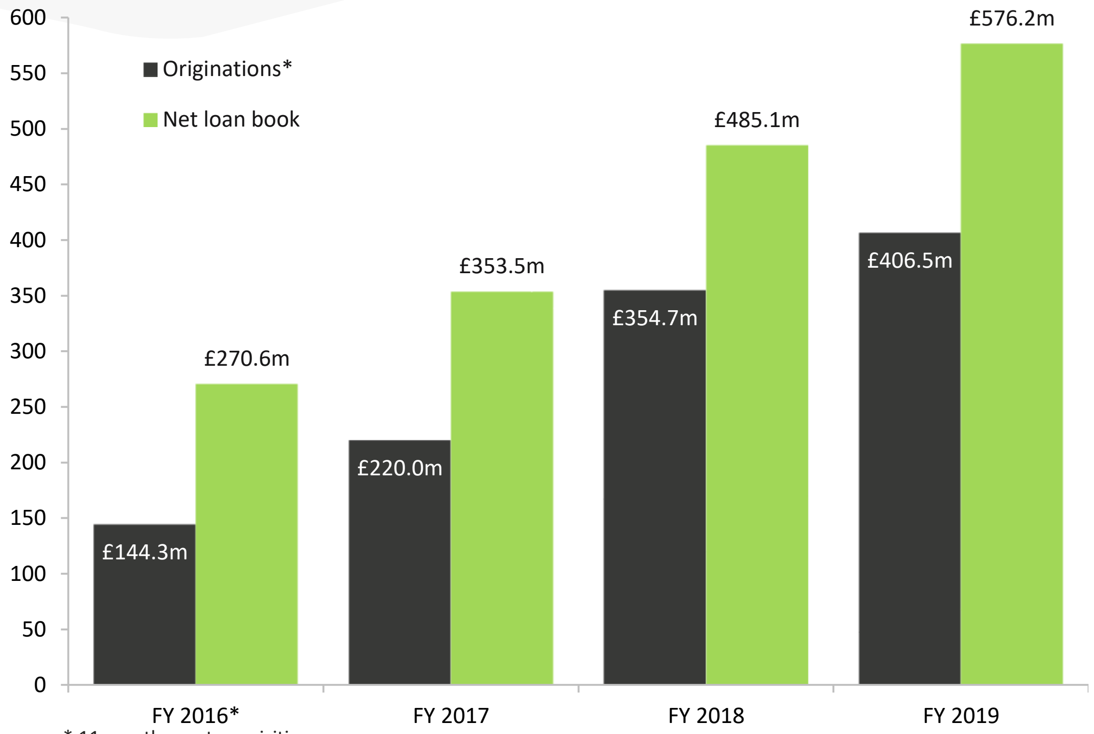
Commercial Lending – SME lending

Improved service delivery with enhanced yields

- Business successfully re-focused to support mid-market businesses
- Rebranded Asset Finance to SME lending
- New business flow £406.5 million, +14.6% year-on-year
- Improved performance delivered through enhanced service levels at stronger yields
- Investment underway to build end-to-end proposition, speed up customer journey, improve service and deepen addressable market
- Market share c1% – big opportunity to grow
- Strong underwriting and asset management capabilities central to risk and control framework

- SME lending integration of three acquisitions
  - Five Arrows
  - Premier Asset Finance
  - Iceberg
- Strong multi channel capability – broker, distributors, direct

Originations and loan book growth (£m)



* 11 months post acquisition

Source: Paragon Banking Group PLC

Supporting the UK's small businesses

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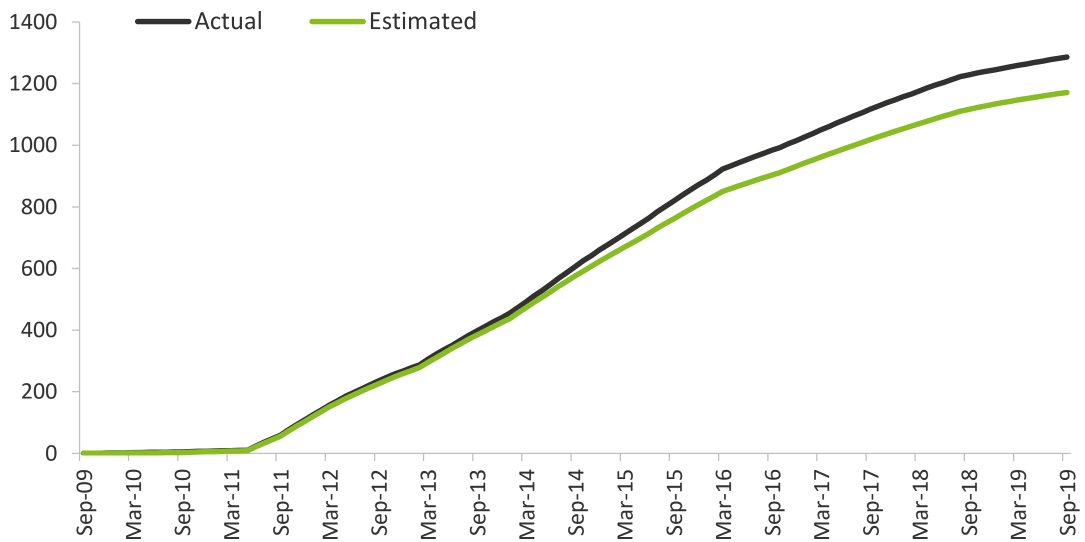
Idem Capital

Opportunistic investments whilst maintaining strict pricing and quality discipline

- Portfolio continues to perform well – cash flow 109.8% of expectations
- Market remains highly competitive. Pricing has softened a little but still remains high
- Maintained disciplined approach to pricing and quality – marginal RoTE below hurdle rate - capital allocated elsewhere
- Division structured with low fixed costs
    - Centralised consumer servicing employees reduced from 399 in 2014 to 214 through natural attrition and redeployment across the Group
    - Management team supporting wider Group activities

Cumulative portfolio cash flow (£m)



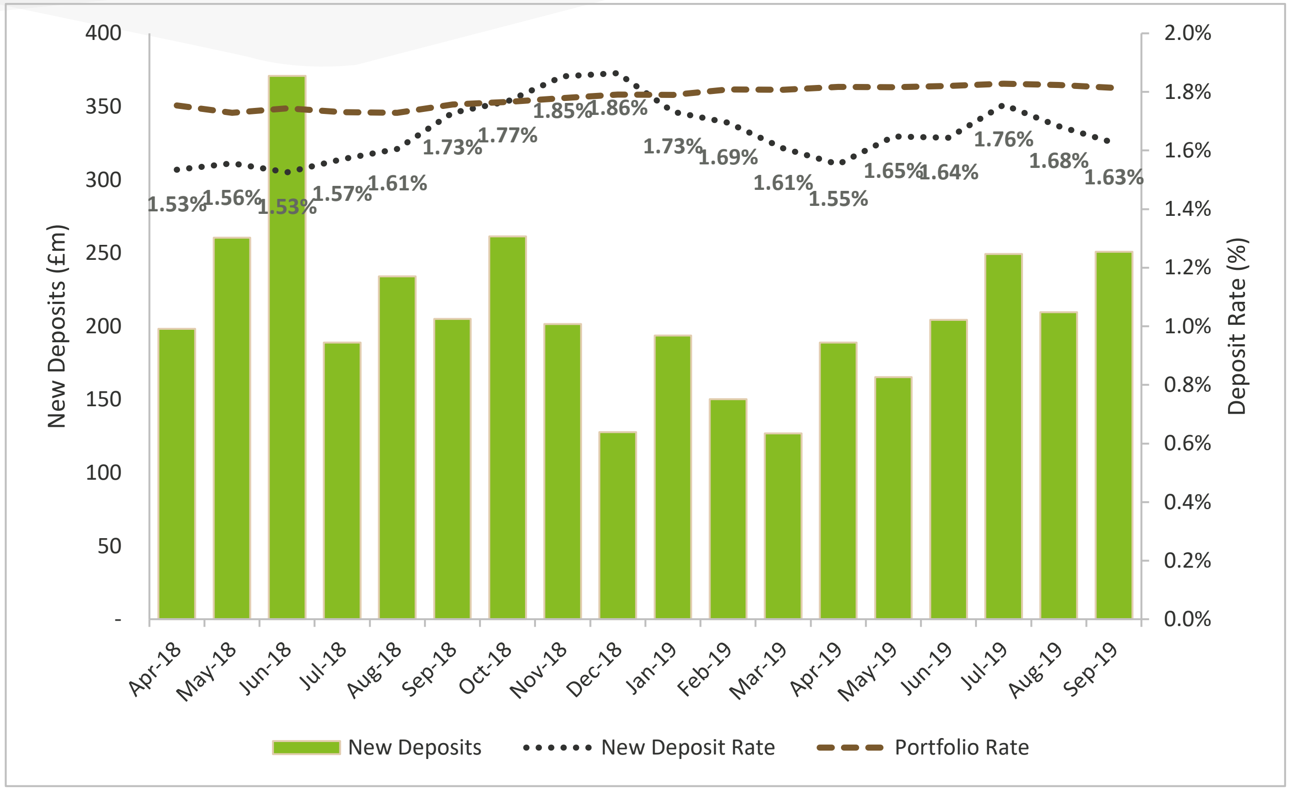
Source: Paragon Banking Group PLC

Building a deposit franchise

Expanding our addressable market in a changing market

- Built strong franchise
  - £6.4 billion balances
  - Broad product range
  - Outstanding service proposition (NPS +65)
- Expanding our addressable market and capability
  - Expanding product, customer and channel to build capacity
  - New platform relationship (Hargreaves Lansdown, Monzo, Flagstone) **– more to come**
  - Product range extended (postal, balance size, lifetime ISAs) **– more to come**
  - Investing further in capability - people, data and knowledge
  - Improving pricing control
- New disruptive market model is emerging
  - Platforms now sit between High Street, Wealth Managers and Challengers
  - Easier to manage money attacking convenience issues
  - Open Banking could present a further £800 billion plus opportunity
  - Flattening the deposit cost curve

New deposits (£m) / deposit rate (%)



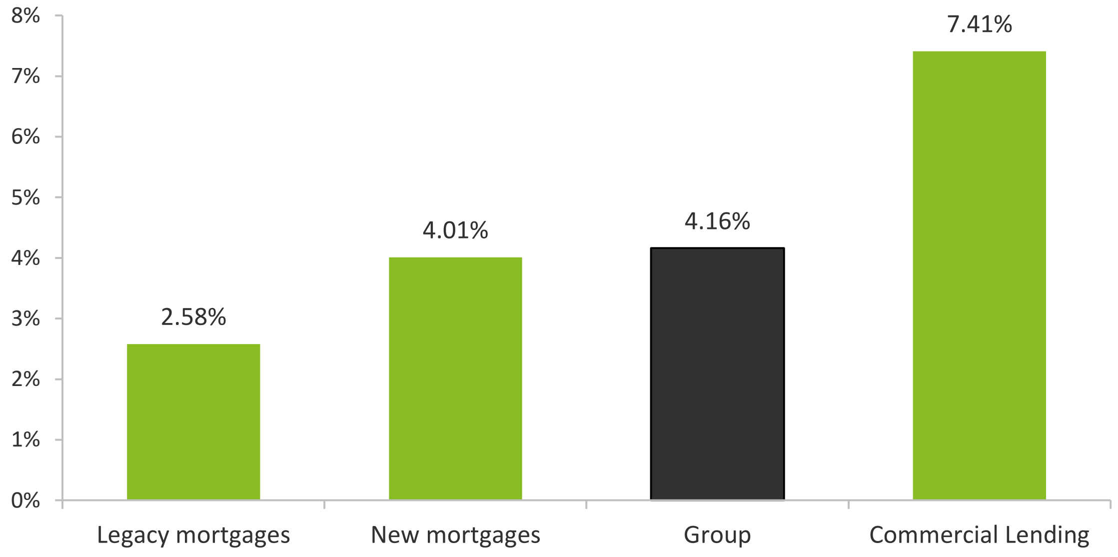
Source: Paragon Banking Group PLC

Award winning deposit franchise

Structural improvement in NIM

Our front book / back book structural dynamic is rare in today's UK banking market

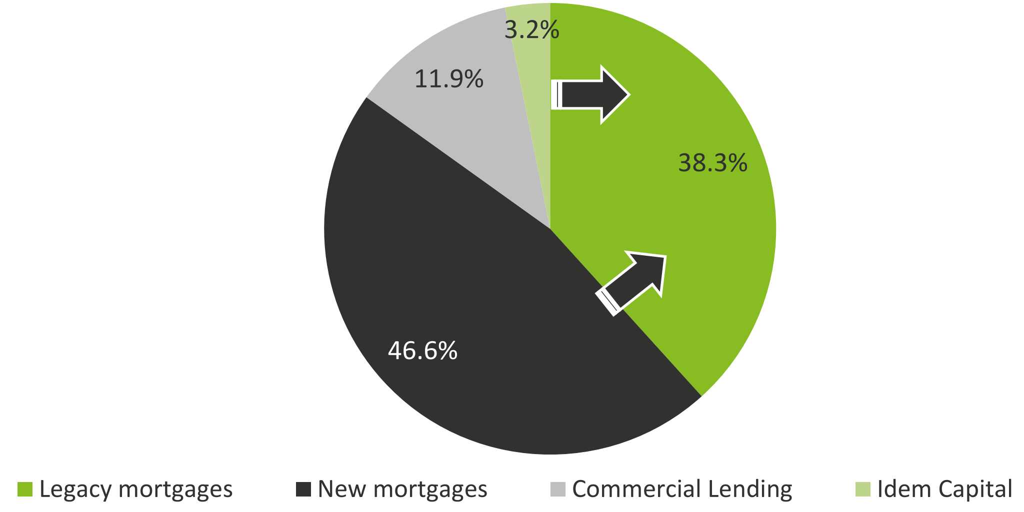
Evidenced via higher yields in new portfolio



Source: Paragon Banking Group PLC

Swapping lower margin legacy book for higher margin BTL / SME

Drag from Idem Capital materially less significant from FY 2021



Source: Paragon Banking Group PLC

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Conclusion

A low risk disciplined banking model that continues to deliver …

- Solid financial progress – underlying profit up 5% to £164.4m
- Strong new lending growth, focused on optimising risk and return
- Continued asset diversification and increased specialisation
- Deposits increased 20.7% to £6.4 billion with technology investment enhancing service and broadening distribution capability
- Underlying RoTE at 14.6%
- Strong track record of returning cash to shareholders

… with increasing opportunities for growth

- Disciplined and risk conscious, particularly in this environment
- Position of strength – strong asset quality, capital and liquidity
- Improving NIM a focus
    - Structural NIM improvements to continue
    - Further opportunities for specialist lending growth
    - Deposit capacity to improve liability margins
- Transformation still in process – operational leverage to be delivered over time
- Confident in achieving medium term RoTE target of >15%

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Appendix

Mortgages

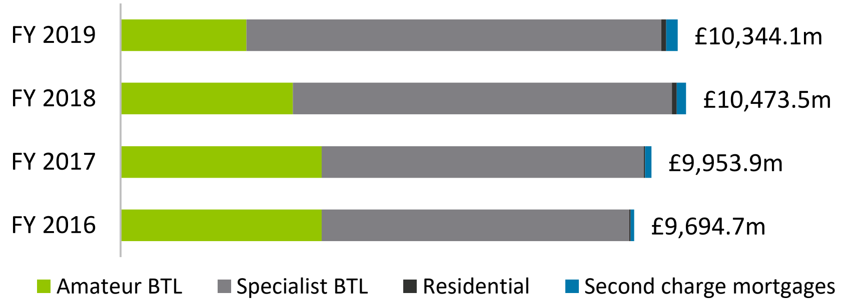
Steady underlying growth and structural NIM improvement

- BTL new advances stable
- Specialist residential lower as guided
- Redemptions lower (8.6% v 10.3%)
- NIM favourable as low yield legacy book amortises
- New BTL margins stronger in 2019 reflecting lower swap costs and lower customer attrition

Originations

Source: Paragon Banking Group PLC

Loans and advances



Source: Paragon Banking Group PLC

Net interest margin

Source: Paragon Banking Group PLC

Underlying profit contribution

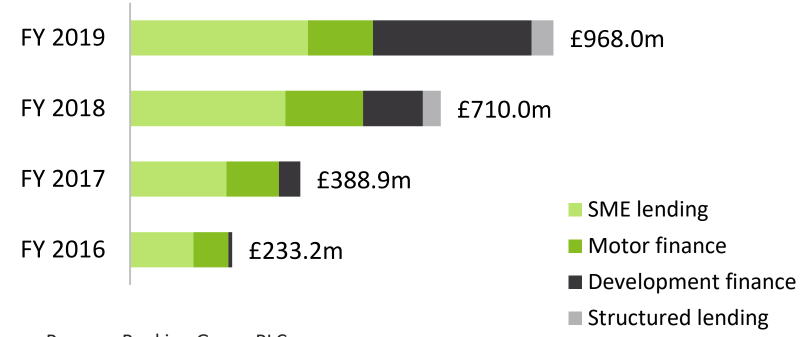
Source: Paragon Banking Group PLC

Commercial Lending

Divisional development accelerated by 2018 Titlestone acquisition

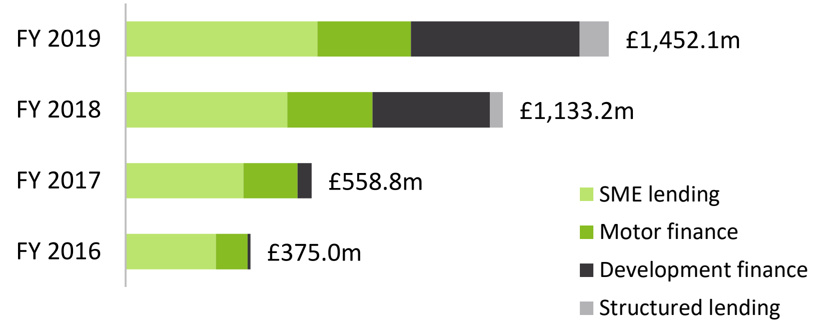
- Development finance advances up 165.3% given full year effect of Titlestone
- Motor finance advances 16.3% lower with focus on yield improvement
- Steady improvement in SME lending with further investment in origination and servicing capabilities
- NIM improvement reflects mix change (Titlestone acquisition impacts), rate of improvement expected to slow going forward

Originations



Source: Paragon Banking Group PLC

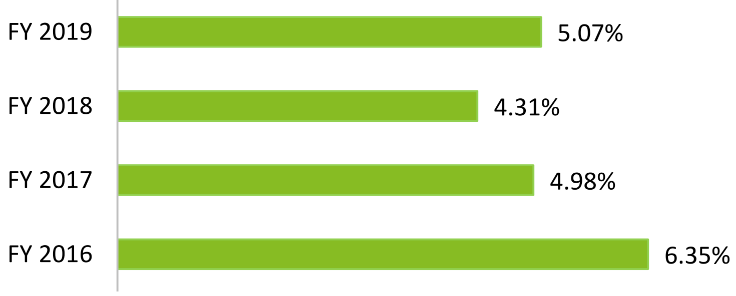
Loans and advances



Source: Paragon Banking Group PLC

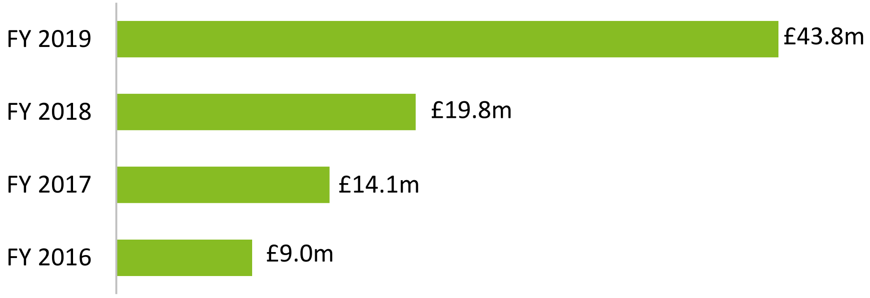
Net interest margin *

* Calculated over average monthly balances



Source: Paragon Banking Group PLC

Underlying profit contribution



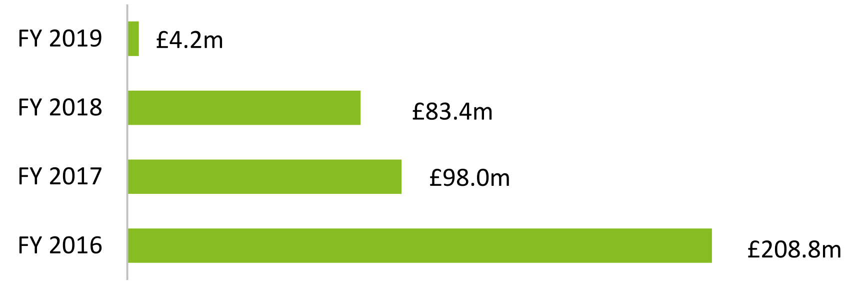
Source: Paragon Banking Group PLC

Idem Capital

Portfolio amortising quickly given strong cash performance

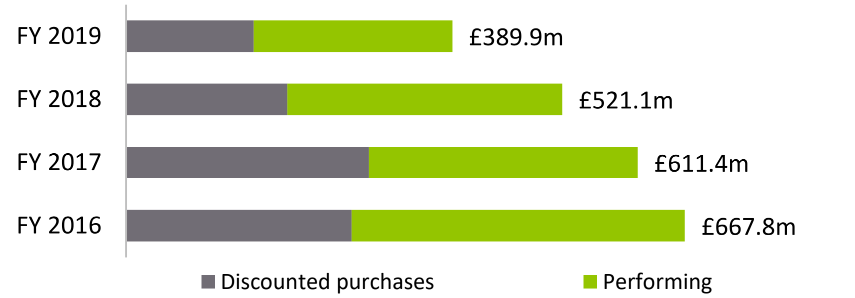
- NIM reduction reflects September 2018 portfolio sale and portfolio amortisation
- Unsecured loans -30.1% year-on-year, secured -21.3%
- Underlying trend set to continue as capital allocated to stronger returns in Commercial Lending segment. Headwind reducing over time
- Focus on augmenting origination flows (mortgages and commercial) rather than discounted consumer assets while risk / return profile remains unattractive

Investments



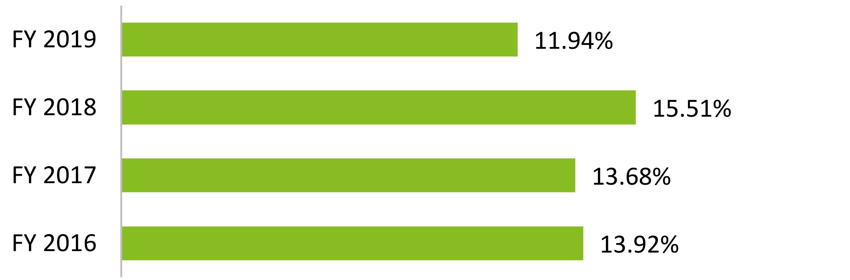
Source: Paragon Banking Group PLC

Loans and advances



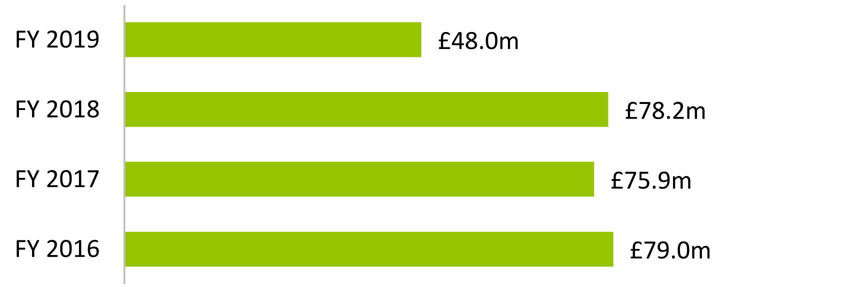
Source: Paragon Banking Group PLC

Net interest margin



Source: Paragon Banking Group PLC

Underlying profit contribution



Source: Paragon Banking Group PLC

paragon

Central

Central funding stable, but costs higher reflecting project spend

- Next corporate debt maturity scheduled in December 2020
- Central costs include technology spend and IRB project expenditure
- Management incentives across the Group financed here

Underlying profit / (loss) contribution

Source: Paragon Banking Group PLC

Underlying operating leverage*

Source: Paragon Banking Group PLC

* Central operating costs as a proportion of total operating costs

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