Paragon Banking Group PLC

Financial Results for six months ended 31 March 2018

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2018 H1 results highlights

Strong lending growth with improved shareholder returns, alongside major medium term transition programme

Strong operational performance

- New lending – £1.0 billion (+28.9%)
  - Buy-to-let – £0.7 billion (+20.6%)
  - Buy-to-let pipeline of £0.8 billion providing strong momentum into H2
  - Commercial Lending – £269.3 million (+49.0%), further products added
- Retail deposit funding £4.3 billion (+82.6%)
- PM25 securitisation at record pricing

Enhancing returns with strong capital base

- Operating profits up 4.7%
- Underlying EPS +8.7% and RoTE at 13.3%
- Statutory EPS and RoTE (after fair value movements) +15.6% and 13.9%
- Increase in DPS +17.0% – 2.5x 2018 cover target
- Further £25.0 million of share buy-backs completed in period
- CET1 strong at 15.5% – Total Capital at 18.2%

Strategic development

- Bank restructuring completed in October 2017
- M&A
  - Acquisition of Iceberg in December 2017
- Senior Management changes
  - Fiona Clutterbuck replaced Bob Dench as Chairman with effect from 10th May 2018

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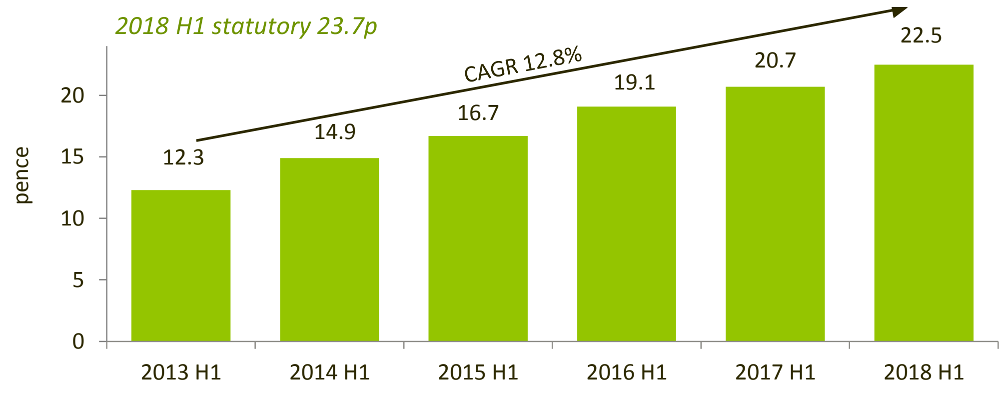
Strong financial delivery alongside major medium term transition programme

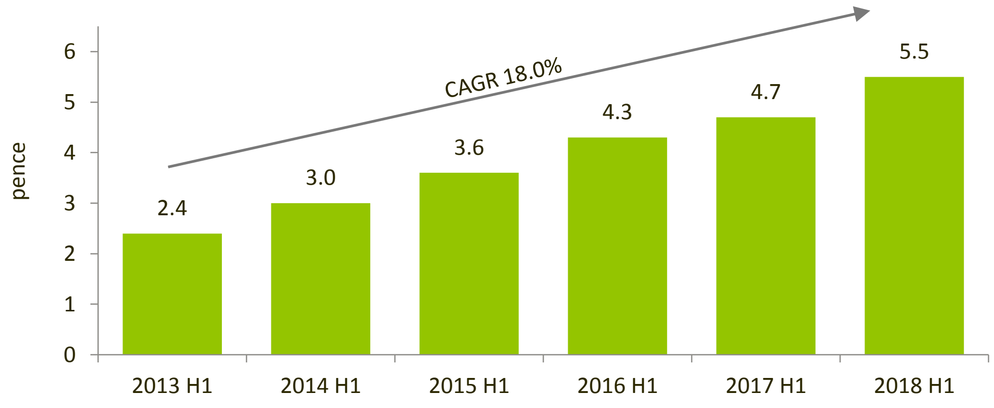
- Total lending over last 5 years £7.2 billion
- Significant investment in start-ups to deliver income diversification
- 3 acquisitions completed
- Bank formed 2014 - restructured 2017 to subsume Group
- Majority of growth retail funded - securitisation optionality maintained (PM25)
- All achieved whilst …
  - Maintaining earnings momentum
  - Continued delivery of outstanding credit metrics
  - Cumulative buy-back of £190 million since 2015
  - Dividend cover ratio of 2.5 times planned for 2018

Underlying earnings per share *

2018 H1 statutory 23.7p

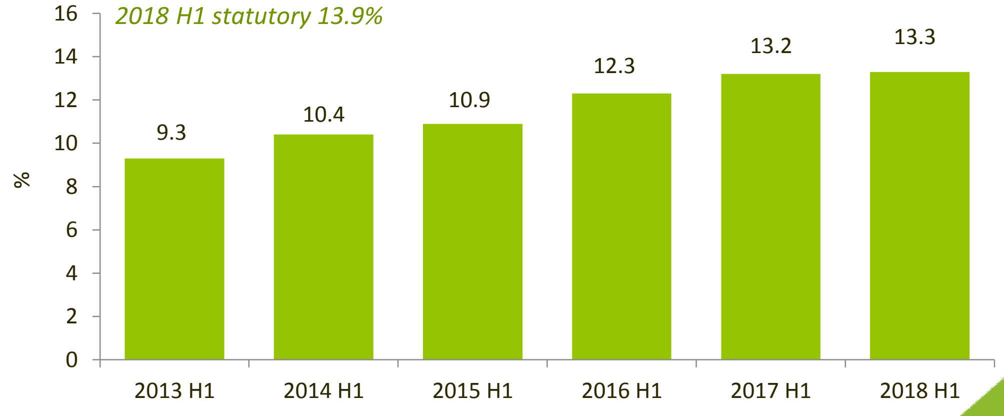


Dividend per share



Underlying Return on Tangible Equity *

2018 H1 statutory 13.9%



** Excludes fair value gains/losses*

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Section 1

Financial Results

For six months ended 31 March 2018

Richard Woodman
Chief Financial Officer

Profitability

NIM growth and strong credit performance underpin profit growth

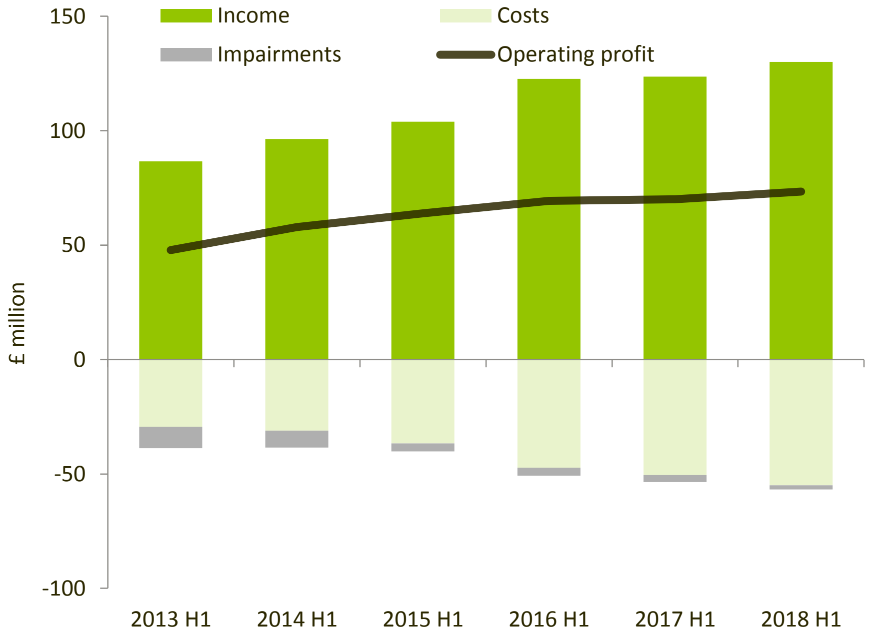
- Total income increased by 5.2%
- Net interest margin improved to 2.16%, with further progression expected with growth of new product lines
- Average loan book up 3.7% to £11.2 billion

- Cost:income ratio 42.2% reflects re-organisation and early stage of development for new lending businesses
- Costs £54.9 million (FY guidance £105 million to £115 million)

- Operating profit CAGR of 8.9% (2013-2018)

- Further improvement in bad debts, down to 3bp

Operating profits



Operating profits					
2013 H1	**2014 H1**	**2015 H1**	**2016 H1**	**2017 H1**	**2018 H1**
£47.9m	£57.9m	£63.9m	£69.4m	£70.1m	£73.4m

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Segmental performance

Segments re-aligned from 2017

- Three operating segments:
  - **Mortgages**
    (buy-to-let, residential and second charge mortgages)
  - **Commercial Lending**
    (motor finance, asset finance, structured lending and development finance)
  - **Idem Capital**
    (acquired portfolios and closed legacy consumer portfolios)
- Segmental disclosures enhanced to detail income statement, yield, portfolio movements and KPIs

Six months ended 31 March 2018 (£ m)

	Mortgages	Commercial Lending	Idem Capital	Central	Total
Interest income	145.1	19.6	46.8	1.8	213.3
Interest expense	(67.3)	(7.3)	(5.2)	(12.2)	(92.0)
Net interest	**77.8**	**12.3**	**41.6**	**(10.4)**	**121.3**
Other income	3.8	4.7	0.3	0.0	8.8
Total income	**81.6**	**17.0**	**41.9**	**(10.4)**	**130.1**
Operating expenses	(7.4)	(10.5)	(4.8)	(32.2)	(54.9)
Bad debts	(1.9)	(0.3)	0.4	0.0	(1.8)
Operating profit	**72.3**	**6.2**	**37.5**	**(42.6)**	**73.4**
Loans and advances to customers	**10,119.5**	**680.1**	**547.1**	**0.0**	**11,346.7**

Six months ended 31 March 2017 (£ m)

	Mortgages	Commercial Lending	Idem Capital	Central	Total
Total interest	135.8	16.1	51.1	0.8	203.8
Interest expense	(62.3)	(5.1)	(5.8)	(17.1)	(90.3)
Net interest	**73.5**	**11.0**	**45.3**	**(16.3)**	**113.5**
Other income	4.3	5.5	0.4	0.0	10.2
Total income	**77.8**	**16.5**	**45.7**	**(16.3)**	**123.7**
Operating expenses	(6.6)	(10.2)	(5.3)	(28.3)	(50.4)
Bad debts	(2.7)	0.3	(0.8)	0.0	(3.2)
Operating profit	**68.5**	**6.6**	**39.6**	**(44.6)**	**70.1**
Loans and advances to customers	**9,795.3**	**468.8**	**676.1**	**0.0**	**10,940.2**

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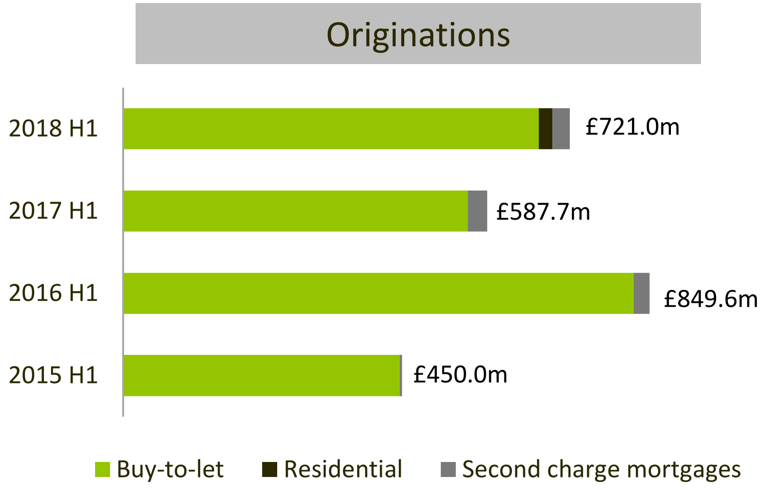
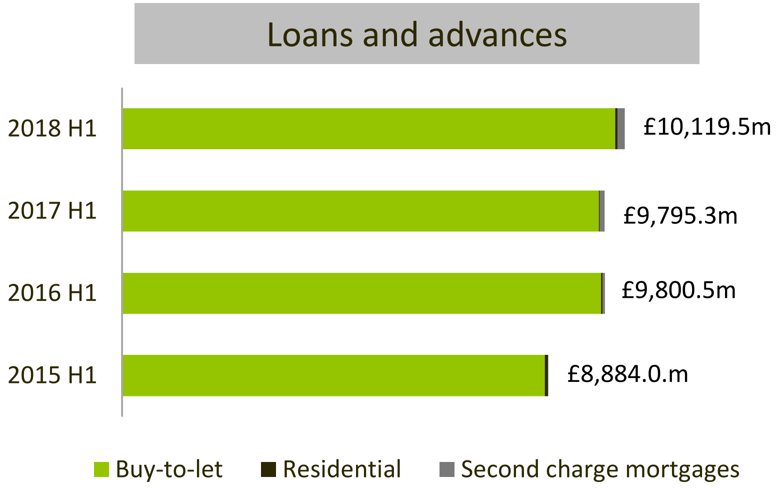
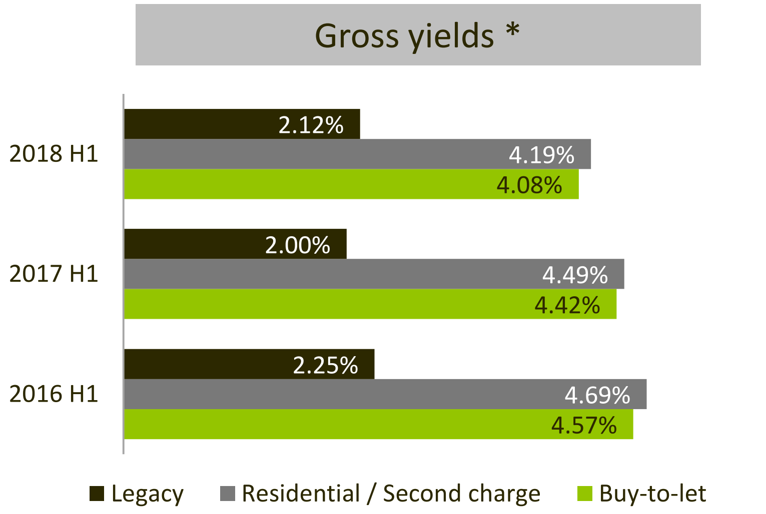
Mortgages

Profit contribution of £72.3 million in 2018 H1

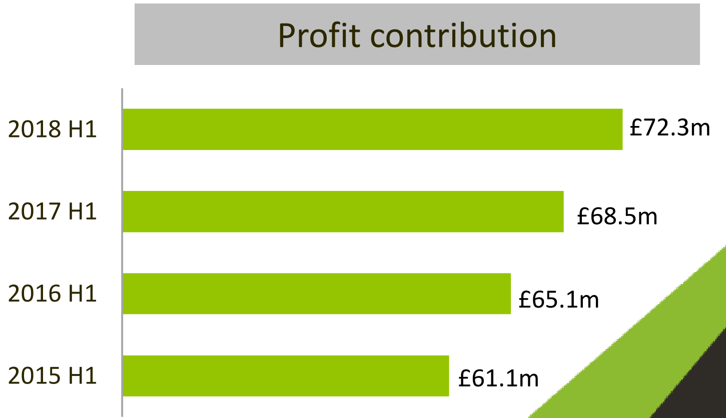
- Profit contribution of £72.3 million (2017 H1: £68.5 million)
- Buy-to-let yield progression reflects stable new business yields in the period and increasing propensity for existing customers to opt for competitive fixed rate retention products
- Majority of new lending funded by retail savings deposits, with tactical approach to further securitisation
- Credit performance remains strong







* Interest receivable divided by average monthly balances, annualised



- Core product is buy-to-let lending
- Small-scale second charge mortgage business
- Specialist residential lending remains in pilot phase

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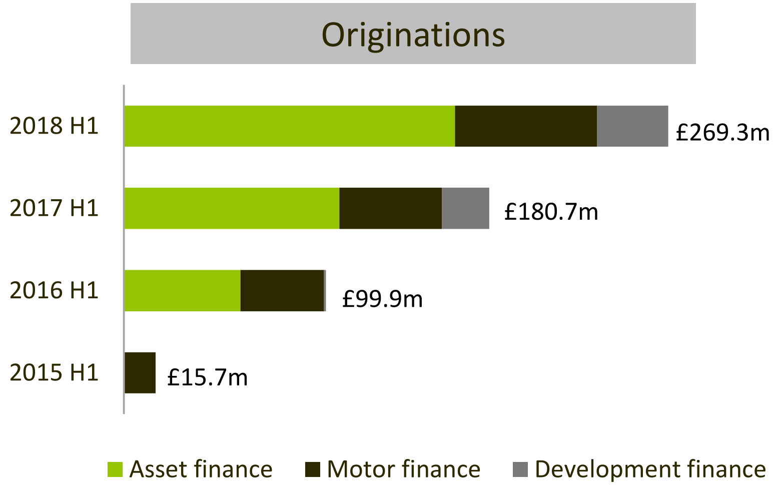
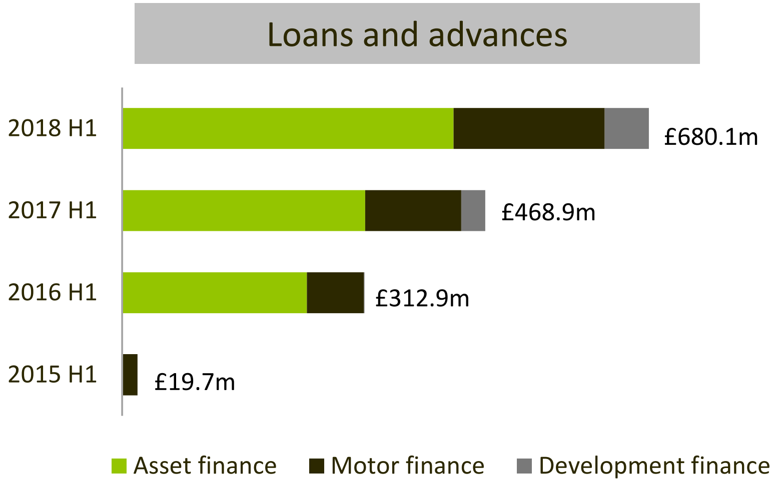
Commercial Lending

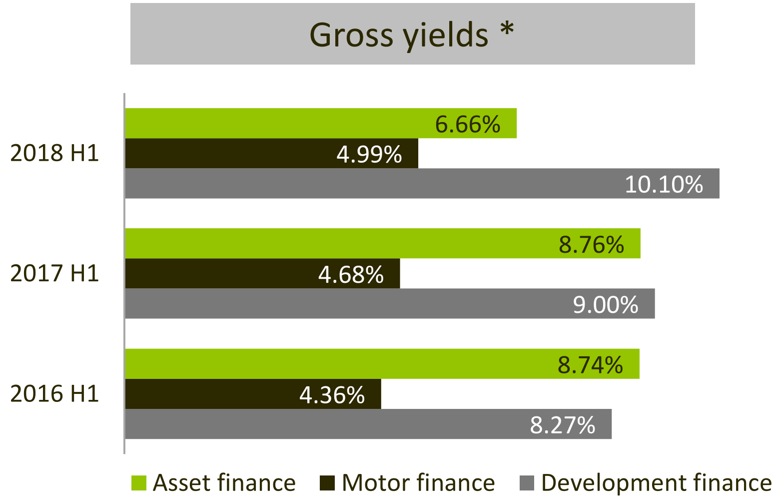
Profit contribution of £6.2 million in 2018 H1

- Profit contribution of £6.2 million (2017 H1: £6.6 million)
- Reflects run-off of higher yield historical asset finance portfolios and competitive pricing for new deals
- Bad debts remain at immaterial levels
- Start-up costs incurred for new business lines, first structured lending deal in April 2018 will support revenue growth in H2

- Developing product range, providing a comprehensive suite of services to address needs of consumers and poorly served UK SME market
  - Motor finance – specialists covering cars, light commercial vehicles, motorhomes and caravans
  - Asset finance – leasing and hire purchase finance solutions in specialist UK SME market segments
  - Development finance – competitive property development finance up to value of £10 million in London, South-East, North and Midlands, with distribution expanding
  - Structured lending - senior debt to UK non-bank financial institutions







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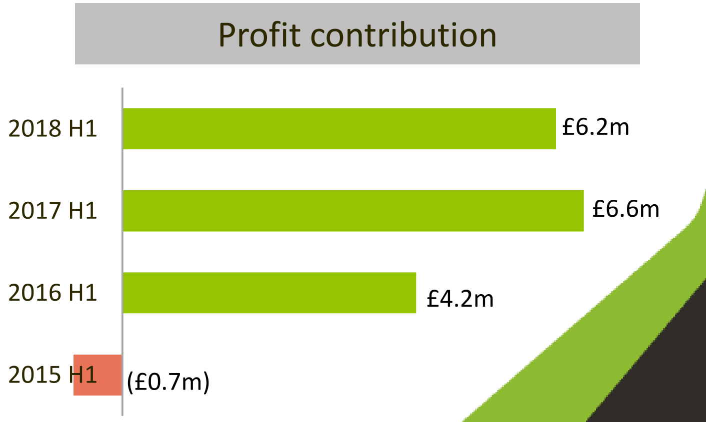

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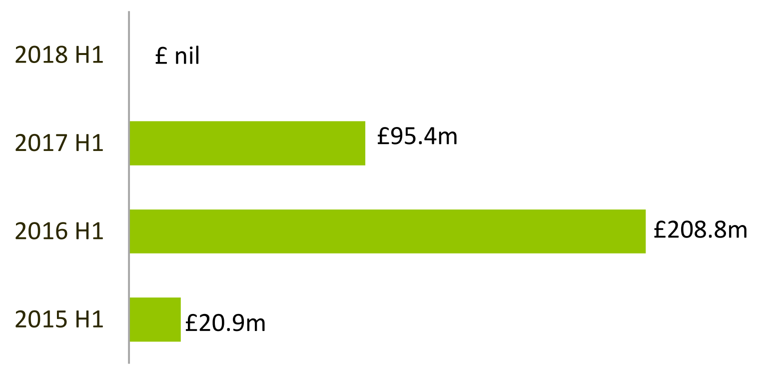
Idem Capital

Profit contribution of £37.5 million in 2018 H1

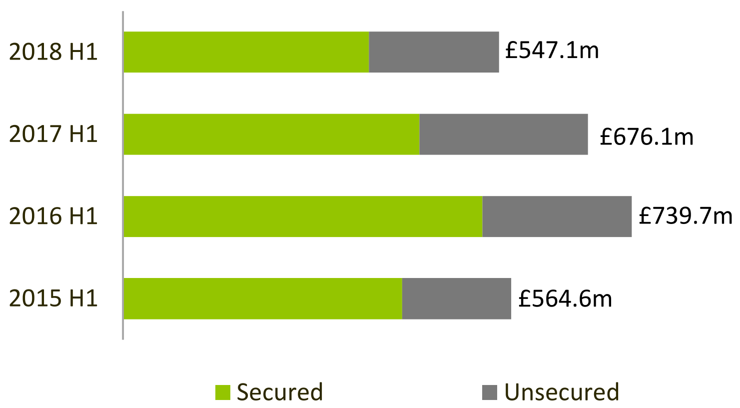
- Profit contribution of £37.5 million (2017 H1: £39.6 million)
- Idem Capital portfolio reflects run-off of historical portfolios and continued strong cash generation

- Acquires and services consumer loan portfolios
  - Idem Capital – leading UK consumer debt purchaser, acquiring and servicing loan portfolios, including first and second mortgages, as well as unsecured loan assets
  - Legacy portfolios – pre-2008 Group-originated consumer secured and unsecured loan portfolios
- Legacy portfolios managed by same servicing function as acquired consumer loans
- Capital deployed in Idem Capital lower than 2017 levels but portfolios performing strongly

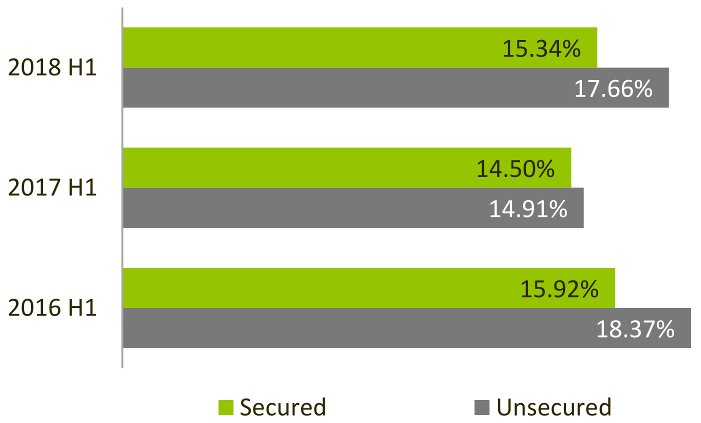
Investments



Loans and advances



Gross yields *



* Interest receivable divided by average monthly balances, annualised

Profit contribution

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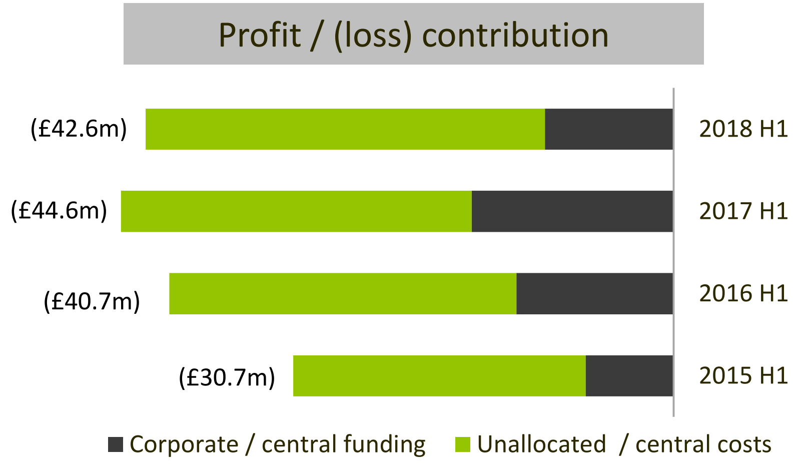
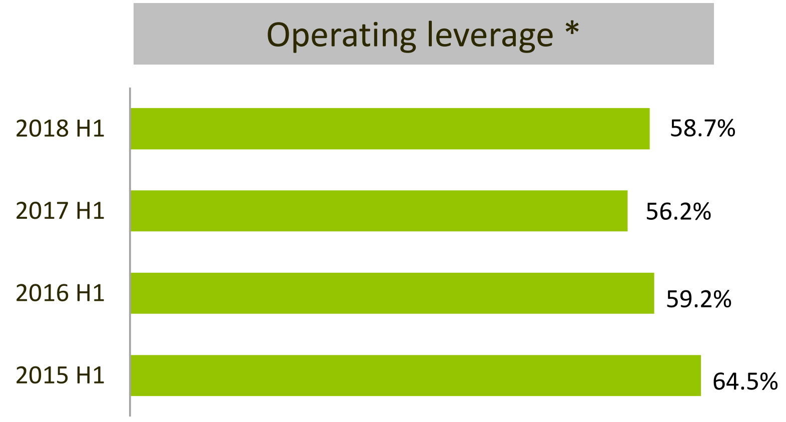
Central

Central funding and support functions

- Tier-2 and retail bond issues support Group liquidity requirements
- Diversification and lending growth providing economies of scale
- Operating leverage to reduce as new activities reach critical mass
- IRB project investment and IT costs behind 2018 H1 cost growth

- As well as common costs, Central includes Group's Treasury function and Consumer Savings business, which are responsible for raising finance on behalf of lending segments
- Common costs include central support function costs, such as Finance, IT, Legal and Compliance, Risk, Marketing and Human Resources



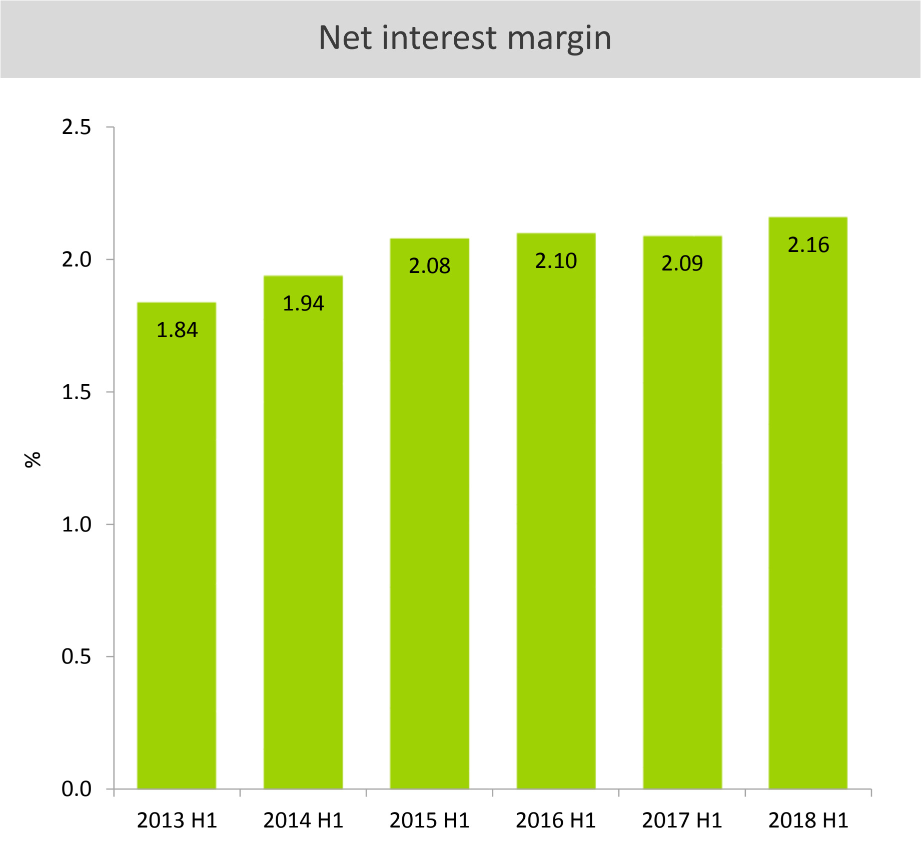


* Central operating costs as a proportion of total operating costs

Net interest margin

Further NIM enhancements as legacy BTL portfolio runs off

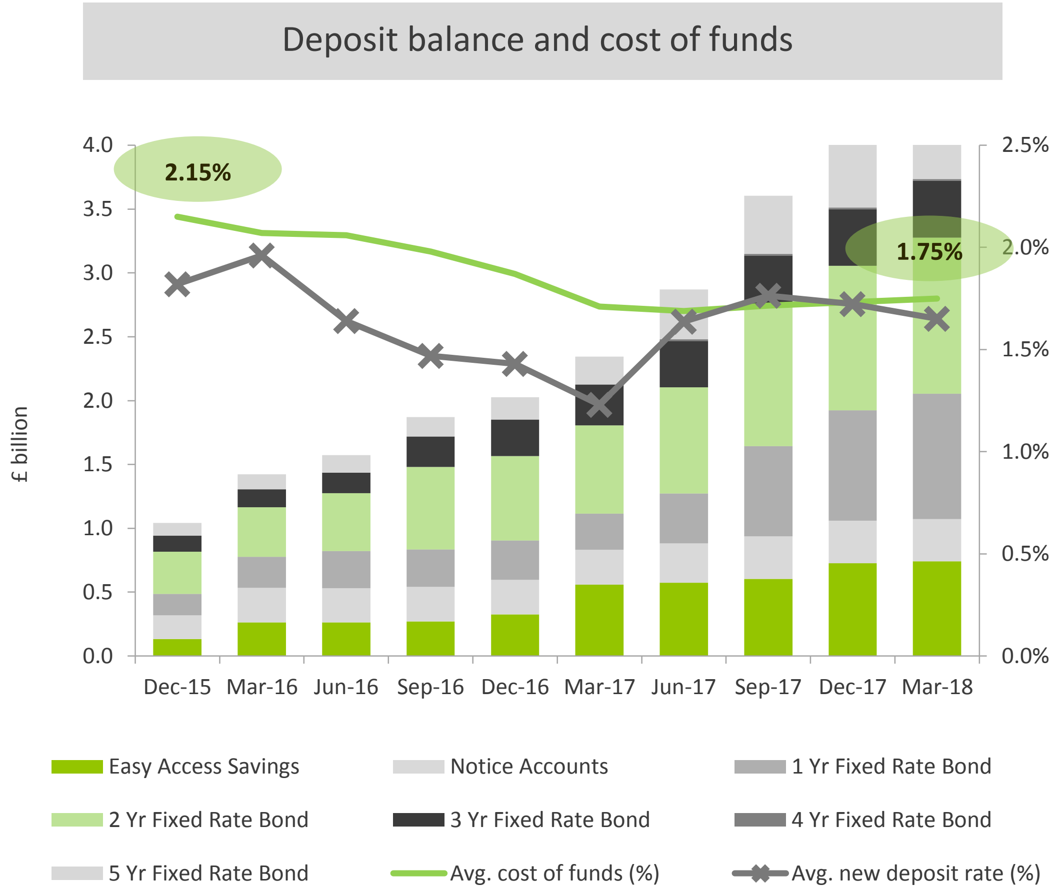
- NIM improved to 2.16% in 2018 H1
- TFS drawings of £944.4 million following closure of scheme
- Main area of volatility arises from timing of Idem Capital purchases



Retail savings deposits

Central to funding strategy – supported by tactical securitisation

- Balance sheet growth building on savings deposit foundations
- Savings balances £4.3 billion
- Second quarter growth slower given planned securitisation
- Portfolio savings costs marginally higher year-on-year
- No end-of-TFS cliff edge evident yet in market pricing
  - Average variable rate 1.30%
  - Average term deposit rate 1.90%
- ISA products now account for 17.9% of the portfolio
- Average deposit balance £31,900
- 83% term or notice accounts
- 98.2% benefitting from FSCS protection

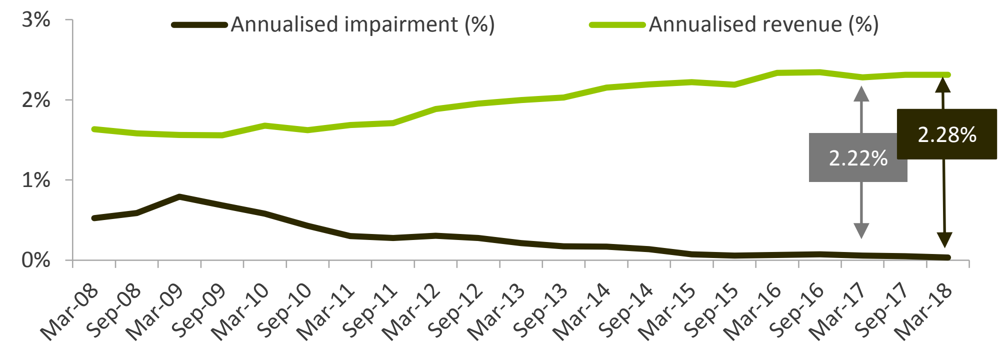


Risk adjusted margin and lead credit indicators

Continued strong risk metrics

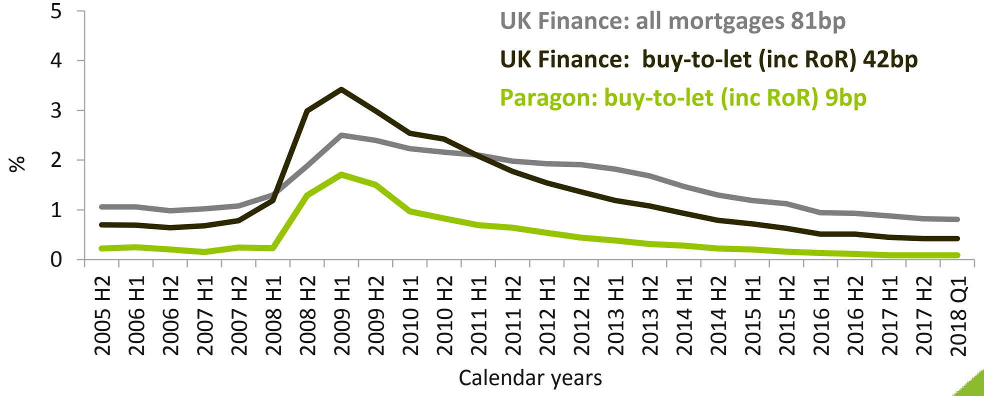
- Risk adjusted margin stood at 2.28%
- Arrears performance on BTL portfolio remains exemplary at 9bp
- Updated lead indicator behavioural scores reveal no emerging signs of stress across portfolios

Risk adjusted margin



Indexed credit behavioural scores by portfolio		
	Mar-17	Mar-18
Buy-to-let assets: New	100.0	100.8
Legacy	100.0	100.4
New second charge mortgage assets	100.0	99.2
Legacy second charge and Idem Capital assets	100.0	103.9
Motor finance assets	100.0	99.8

BTL 3 months+ arrears



Source: UK Finance / Paragon

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Capital and leverage

Strongly capitalised balance sheet underpins growth options

Group consolidated capital	
Core Equity Tier-1 capital *	£886.1m
Tier-2 capital	£153.8m
Total capital resources	**£1,039.9m**
Credit risk	£5,145.5m
Operational risk	£464.9m
Market risk	-
Other	£103.9m
Total risk exposure	**£5,714.3m**
CET1 ratio *	15.5%
Total capital ratio	18.2%

Group consolidated leverage ratio	
Tier-1 equity *	£886.1m
Leverage exposure **	£13,041.2m
UK leverage ratio *	6.8%

* Adjusted for proposed dividend and subject to verification

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

Capital ratios

- CET1 reduced to 15.5%
- Total capital ratio remains strong at 18.2%
- UK leverage ratio strong at 6.8%
- Medium term CET1 target 13.0%
- £25 million buy-back completed in 2018 H1

Risk weightings

- Group remains on Standardised Approach
- Revised Basel-weightings to impact from 2022
- IRB project progressing as planned
  - Application to PRA still anticipated in early 2019

IFRS 9

- IFRS 9 not applicable until 2019 FY
- Initial impact disclosures at 2018 FY

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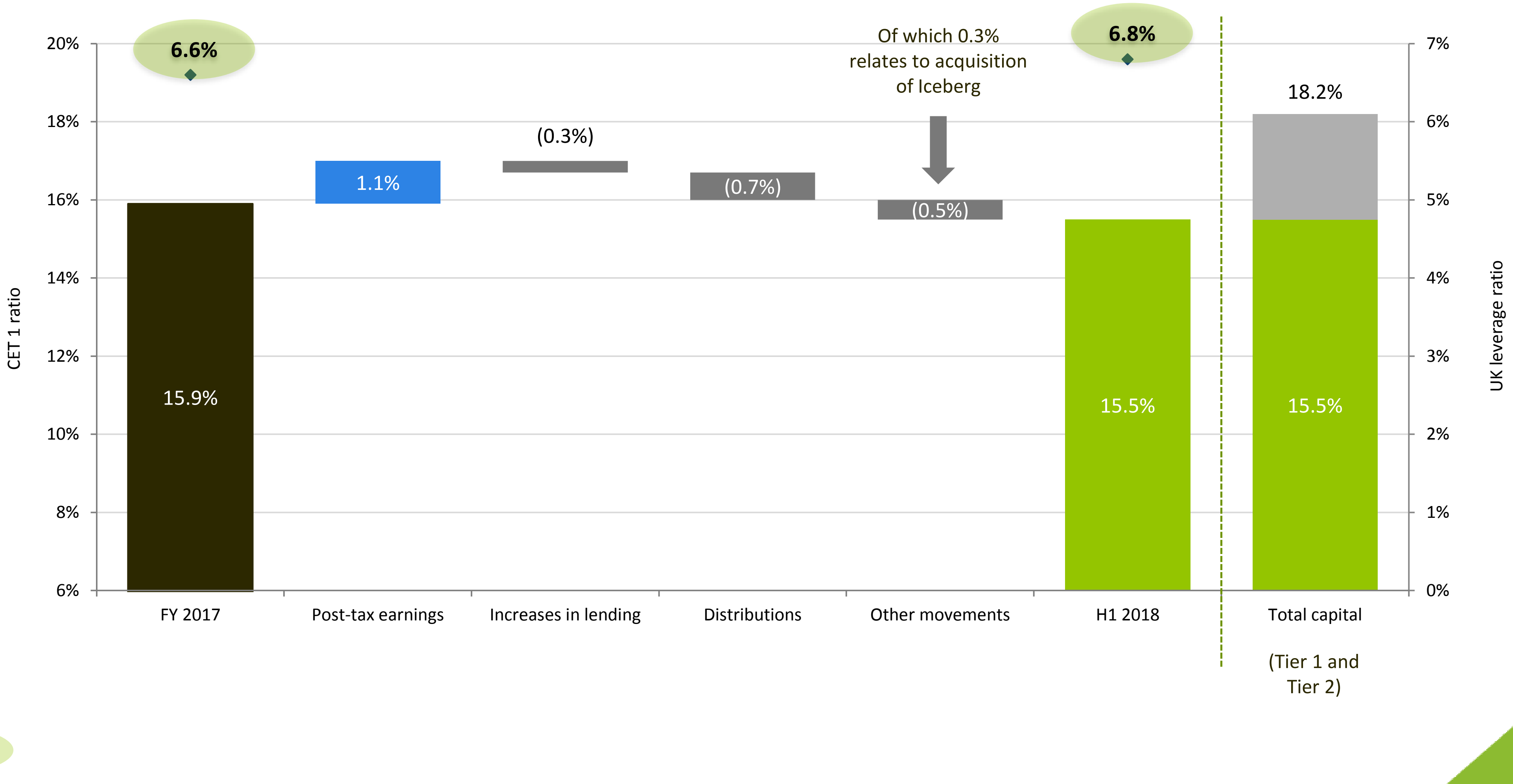
Capital ratios and progression

Profitability supporting growth and capital return



Dividends 0.3% and buy-backs 0.4%

Guidance

Item	Original 2018 FY guidance	Updated 2018 FY guidance	Comment
Mortgages *Volumes*	£1.6 billion +	Unchanged	Combined buy-to-let, residential and second charge mortgage volumes still expected to exceed £1.6 billion
Commercial Lending *Volumes*	£0.5 billion +	**£0.6 billion +**	Addition of flows from Iceberg acquisition underpin increase in guidance
NIM	+5 to 10bp	**+5bp**	Future effects from volatility around Idem Capital purchases
Costs	£105m to £115m	Unchanged	Cost expectations unchanged for 2018
Dividends	Cover to move to 2.5 times, interim DPS to be 50% of prior year final dividend	Unchanged	Interim dividend of 5.5 pence per share is 50% of 2017 final dividend of 11.0 pence

Idem Capital expected to remain "lumpy"

Medium term targets

- Cost:income ratio low 30%s
- RoTE >15%
- Core Equity Tier-1 capital 13%

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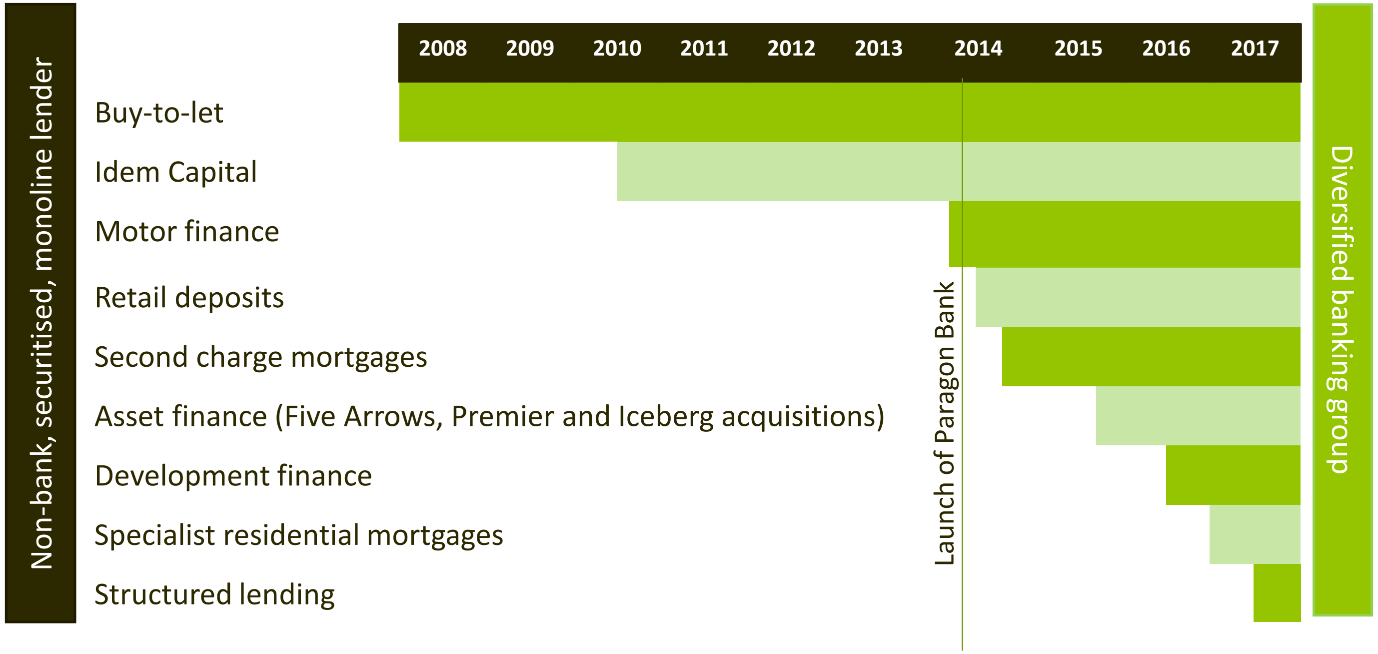
Section 2

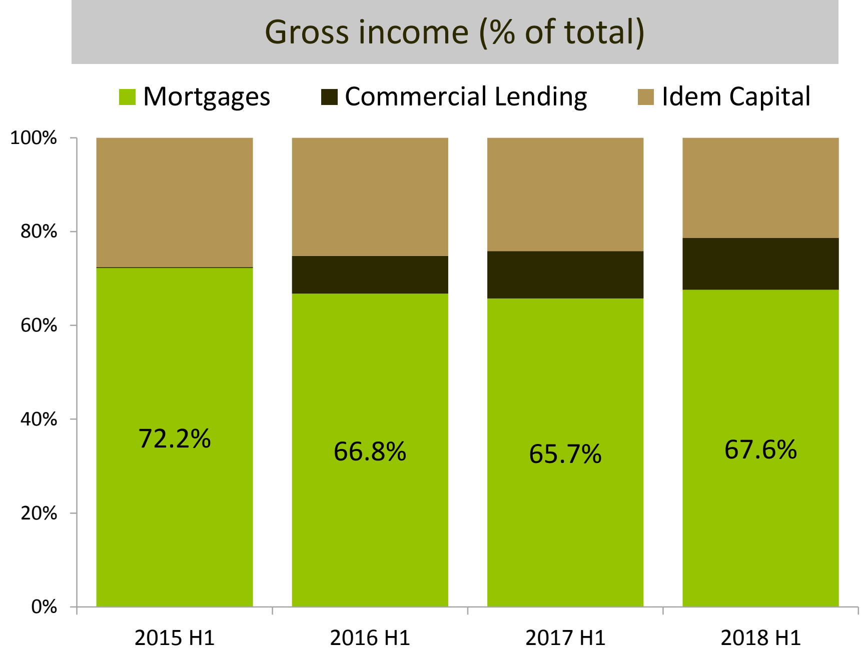
Business Development

Nigel Terrington
Chief Executive

Increasing product diversification

New income streams delivering strong growth





Excludes central segment

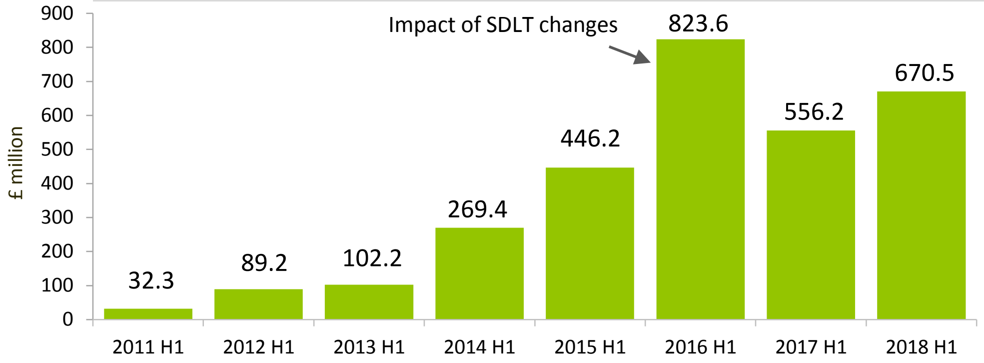
- Income diversification increasing faster than balance sheet given wider margins on new assets

Mortgages – buy-to-let new lending

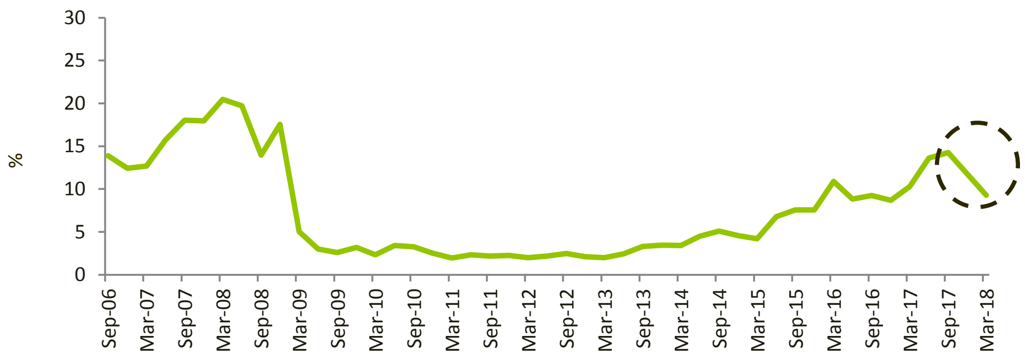
Volumes building in professional landlord sector

- Lending up 20.6% (to £0.7 billion) on 2017, in line with guidance
- Significant growth in complex / professional during 2018 H1 benefitting from fiscal and regulatory changes
- Pricing environment
  - Simple / amateur pricing competitive reflecting wider mortgage market
  - Complex / professional pricing more robust
- Redemption levels slowing
  - Improved retention strategies
  - 5 year products extending redemption profile

Group buy-to-let completions



Buy-to-let redemptions (%)



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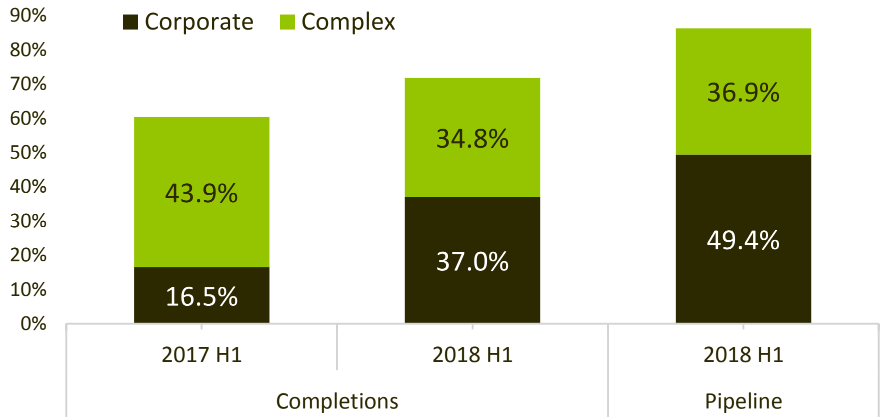
Mortgages – buy-to-let outlook

Increasing opportunities to grow market share

- Strong year-on-year growth and market share gains expected focussed on complex / professional landlords
- 2 year SDLT anniversary potential to create remortgage spike
- Pipeline increased to £787.6 million, 30.4% higher than year end

% of specialist buy-to-let lending



Total specialist buy-to-let lending

	Completions		**Pipeline**
	2017 H1	**2018 H1**	**2018 H1**
Corporate	£91.6m	£248.0m	£389.2m
Complex	£244.2m	£233.4m	£290.8m
Total	£335.8m	£481.4m	£680.0m
% of total	60.4%	71.8%	86.3%

Mortgages – residential mortgages

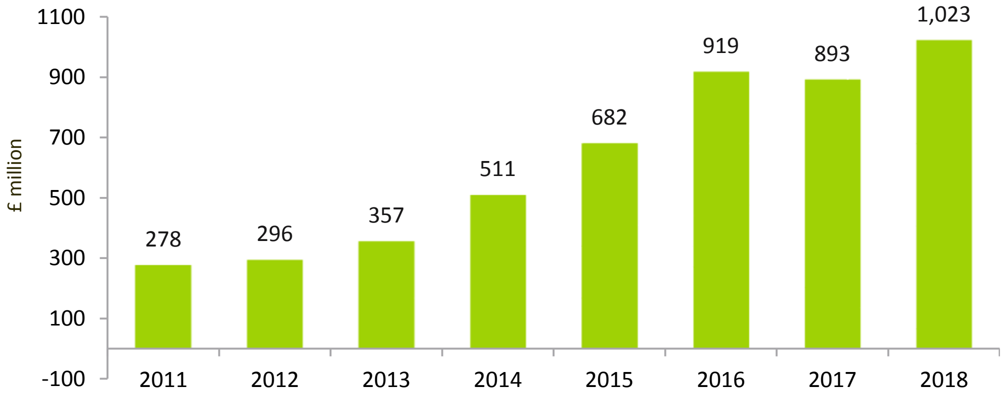
Second charge mortgages

- Clear focus on prime lending
- £27.9 million of new lending (2017 H1: £31.1 million)
- Excellent credit profile, average LTV 65.5%
- Increasing regulatory attention

Specialist residential mortgages

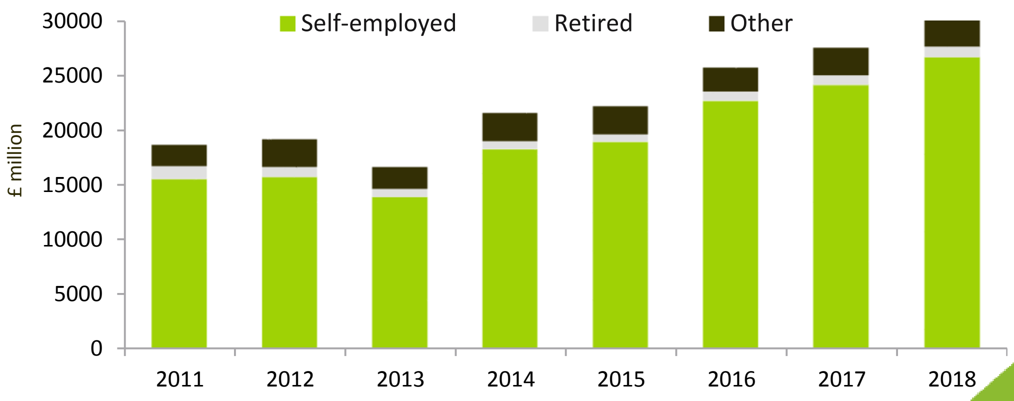
- Continued development of pilot offering, with £22.6 million of new lending
- Increasing opportunities following structural changes in mortgage market
- Mainstream lenders now focused on simplicity of propositions and streamlined underwriting
- Serving self-employed, complex income cases and those borrowing into retirement

Second charge mortgage market
12 months to March



Source: Finance & Leasing Association

Specialist residential mortgage market
12 months to March



Source: UK Finance

Commercial Lending - asset finance

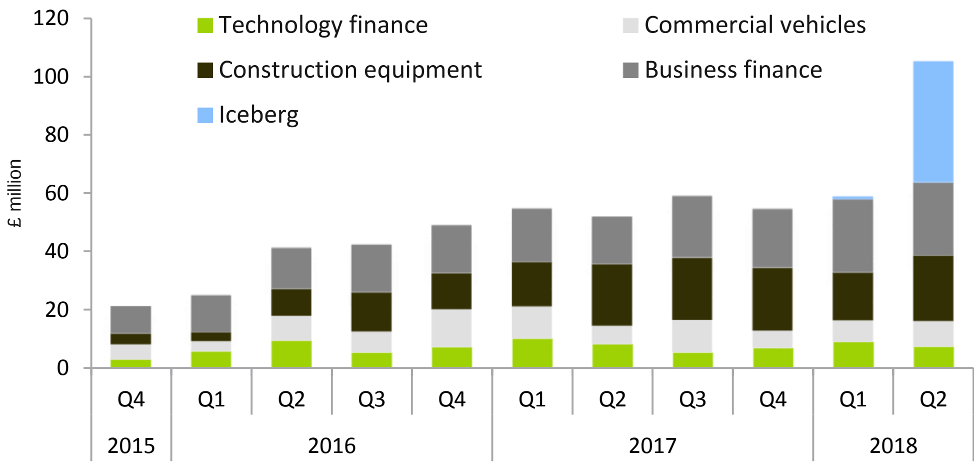
Further distribution and product development delivered

- New business volumes £163.8 million, up 53.7% year-on-year
- Lower yields due to …
  - Mix effect, transition from Tier 3 to Tier 2
  - Competitive environment, but disciplined stance maintained

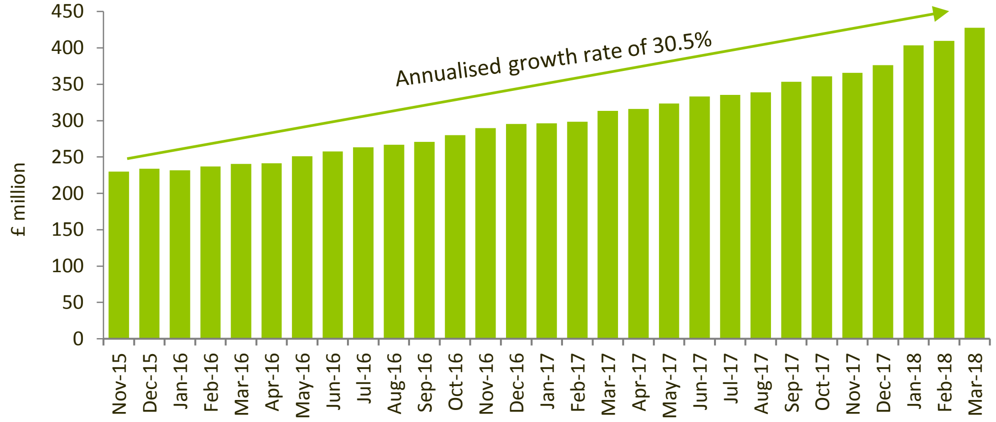
However, back book margins converging with new business yields to deliver sustainable income growth

- Strong credit standards

Asset finance – new originations



Asset finance – portfolio growth



Broader-based specialist platform established

- Increasing addressable market through a stronger broker proposition
- Launch of professions financing through acquisition of Iceberg in December 2017

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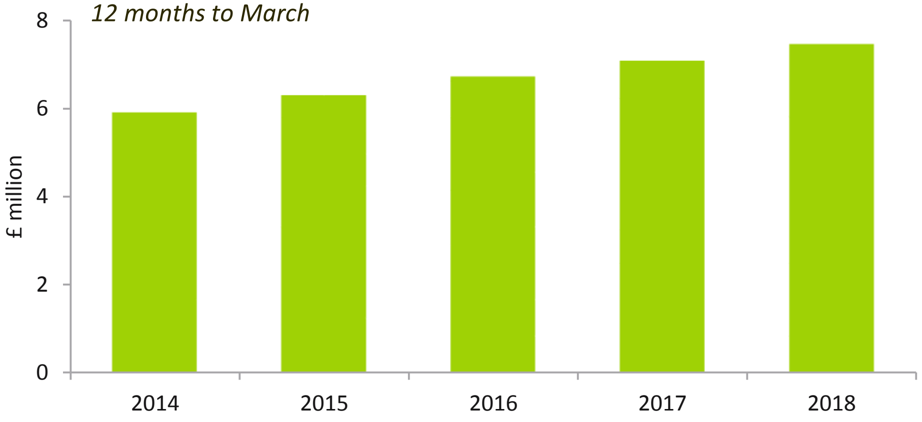
Commercial Lending - motor finance

Excellent lending growth whilst broadening product proposition

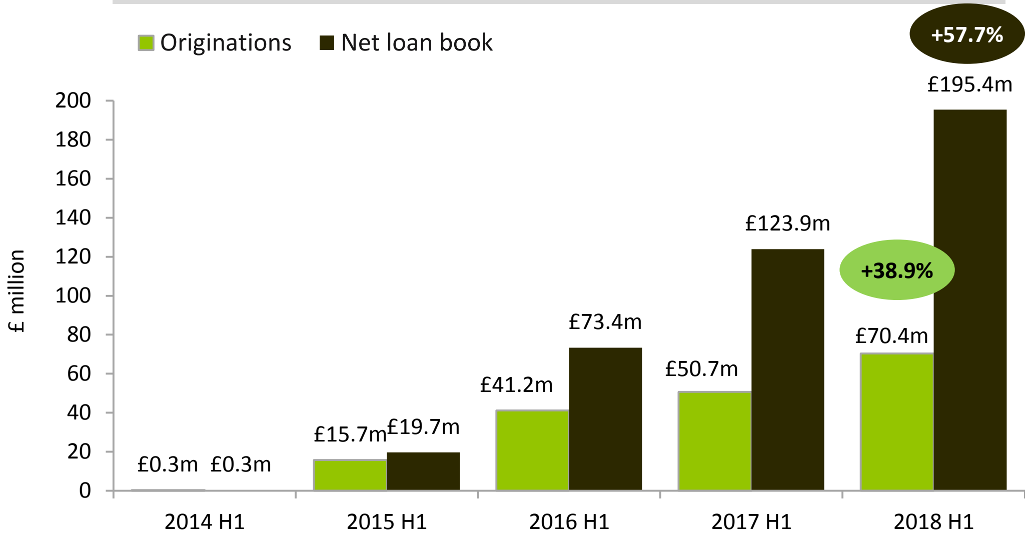
- Although new car sales weak, second hand sales remain more resilient
- Motor finance market up 5.3%
- Regulatory concerns over consumer credit – tighter affordability rules from FCA will disadvantage bigger competition

Consumer used hire purchase and lease purchase market



Source: Finance & Leasing Association

Motor finance originations



- £70.4 million new lending as business continues its development phase with expanding network distribution (2017 H1: £50.7 million)
- Increasingly targeted niche product proposition
- Loan book £195.4 million (2017 H1: £123.9 million)
- Strong credit performance evident

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Commercial Lending – development finance and structured lending

Development finance

- Loan book £57.0 million from standing start in 2016
- Momentum building, committed pipeline of £109.6 million
    - Strong and stable yields
- Average loan to GDV of 60.1%
- Demand to remain strong for foreseeable future – Government policy supportive

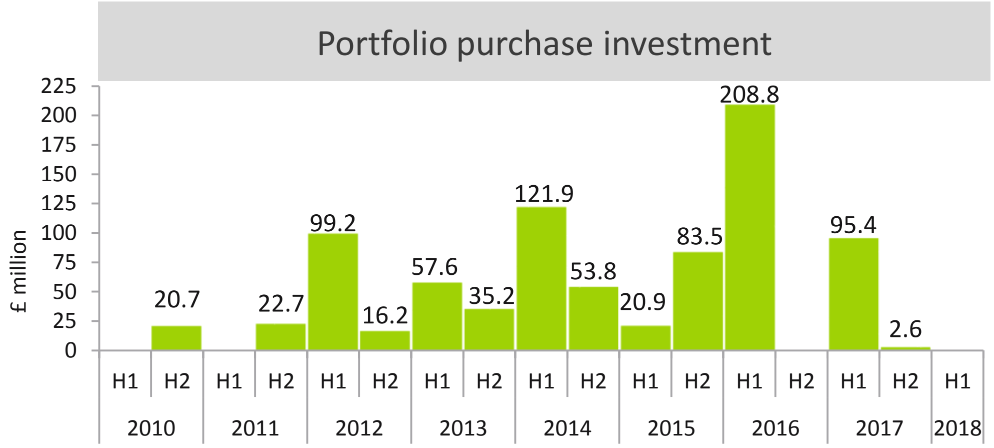
Structured lending

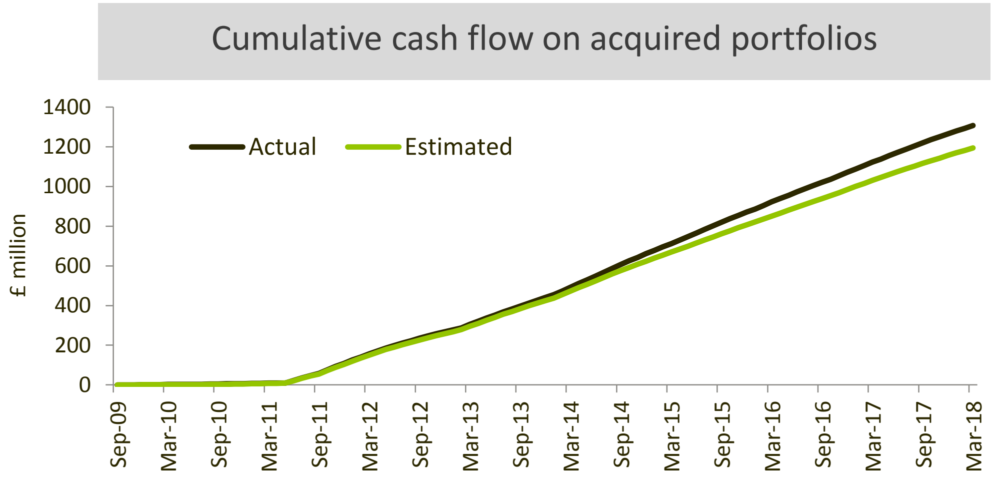
- Senior debt to non-bank financial institutions
- Addressing certain segments where Paragon is potentially underweight, or has no exposure, preferring to work with recognised industry experts rather than organically build business
- Loans fully secured on known asset classes – mortgages, consumer and commercial finance
- First deal secured in April 2018, in collaboration with British Business Bank
- Strong pipeline with a number of deals planned for 2018 H2
- Should breakeven next year

Idem Capital

Strong financial performance in a highly competitive market

- Portfolio performance remains exemplary
  - Cumulative cash flow now 109.4% of underwriting estimate
- Market remains highly competitive, but strict discipline over credit and pricing has been maintained
- Longer term growth opportunities remain





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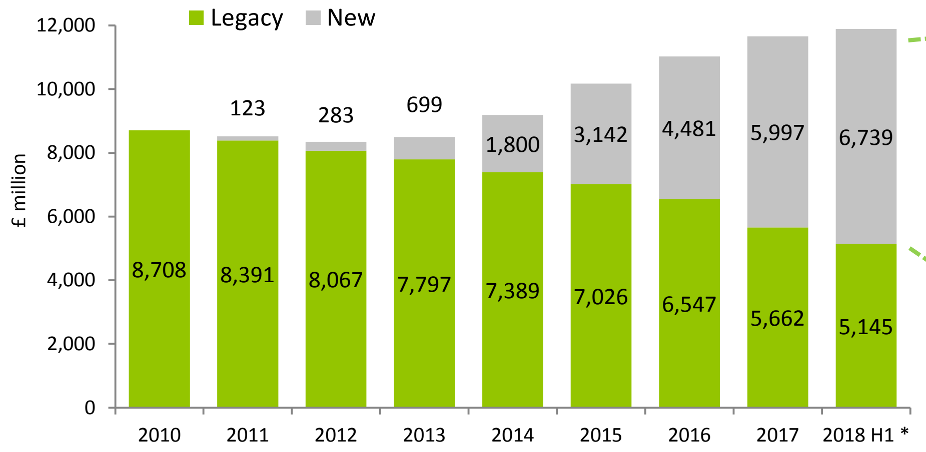
Increasingly diversified funding strategy

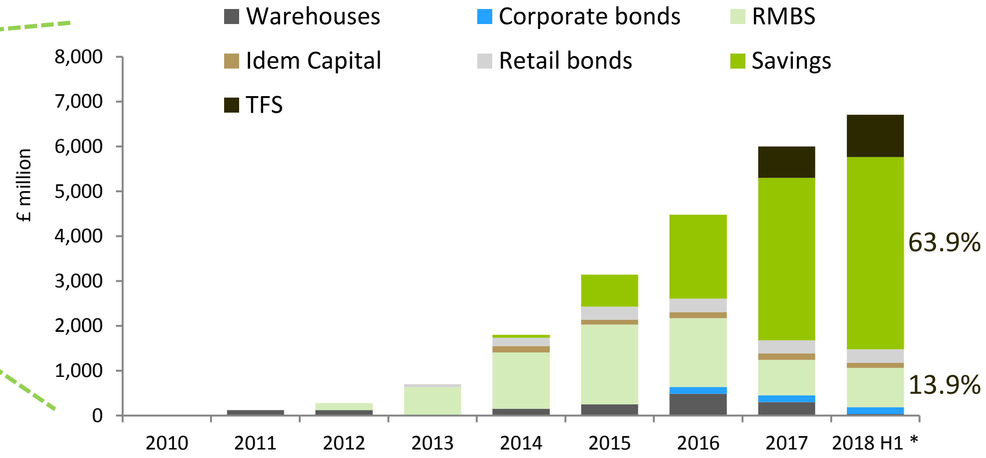
Capacity and breadth of funding increasing

Funding mix



** Includes PM25 completed in April 2018*

Diversification of new funding mix



** Includes PM25 completed in April 2018*

- Improving deposit franchise – now covers over 60% post-2010 funding
  - £4.3 billion retail deposits outstanding
  - 78% retention rate
  - Net Promoter Score +62 (2017 FY: +59)

- Long-term senior debt upgraded to BBB; subordinated debt BBB-
- PM25 April - Paragon's first securitisation as a banking group and a return to market following 2 year absence
  - £725 million securitisation (£289 million retained) is largest since 2008 and at lowest pricing
- TFS drawings increased to £944 million prior to scheme close (2017 H1: £275 million)

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Conclusion

Strong delivery against major medium term transition programme

Strong loan growth with increasing specialisation	Increasing income stream diversification	Enhancing operational leverage	Improving capital and funding efficiency

- Major medium term transition in progress
  - Product diversification enhances income and reduces concentration risk
  - Up-front investment has been required but creates significant operational leverage
  - Growing income will drive down cost:income and enhance RoTE over time
  - Improved confidence, more robust business model and stronger cash flows support enhanced shareholder returns

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Paragon Banking Group PLC

Financial Results for year ended 31 March 2018

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