



Fixed Interest



Paragon Group PLC 6% 28/08/24 - Buy

17th August 2015

Issue Price	100
Credit Rating	BBB-
Risk Rating	Medium
GRY	6%

The Issuer:

Paragon Group of Companies Plc (“Paragon”) is a FTSE 250-listed company with a market capitalisation of approximately £1.3bn. Founded in 1985, it is predominantly a Buy-to-Let (BTL) specialist with smaller operations in consumer debt and banking.

The Business

The Group has three principal business operations:

1-Paragon Mortgages

Paragon is one of the longest established lending brands in the BTL mortgage market with approximately 12% of the market. The background of robust growth in private renting and BTL is providing a strong platform for further growth. The company specialises in lending to professional landlords - those who run their property empires as a business rather than as an add-on to their day-to-day jobs. This is reflected in the arrears book, which currently stands at a very low 0.35%. This compares favourably with the Council of Mortgage Lenders average 1.16% rate for BTL and 1.75% rate for all mortgages. In other words, BTL mortgages are safer than ordinary mortgages and Paragon’s arrears ratio is exceptionally good. Finally, Paragon has stress tested their professional landlords and they do not start to get in trouble

by failing to cover payments with rental income until base rates get to between 7% and 8%.

2-Idem Capital

This division is one of the top consumer debt buyers in the UK, specialising in buying partially-performing portfolios from banks who wish to divest. This is obviously a much riskier business but impairments are low and the business is highly profitable.

3-Paragon Bank

Provides the Group with diversification of both income streams and funding sources, operating in the car finance, secured personal loans and BTL mortgage markets funded by retail savings products.

Financing

Paragon’s finances and future outlook are healthy. With financial liabilities of £9bn and shareholder funds of £952.5m, it has a strong liquidity ratio of 9.5% - way above the 3% minimum set by the EU.

The company also raises funds in the wholesale market by issuing securitised debt. They build up a basket of mortgages in a “warehouse” which is funded by loan facilities totalling £450m from Lloyds Bank and Macquarie Bank. Once they have a sufficient pool, typically £200m-£300m - these mortgages are securitised and sold. The warehouse having been emptied Paragon starts to fill it again with newly originated loans and the circle continues. By funding their book in the securitised debt market Paragon both obtains cheap funding and also removes virtually all liquidity risk.



Fixed Interest (cont)

Credit Analysts View:

The bond is rated BBB- by credit rating agency Fitch, making the issue investment grade and indicating that the issue is of good credit quality, though adverse economic conditions could lead to a weakened capacity of the issuer to meet its financial commitment.

Terms of the bond:

Denomination

The bond has a face value of just £100, although it is not possible to purchase for less than £2,000 nominal during the Offer Period. Thereafter, the bonds can be bought and sold in multiples of just £100.

Coupon

The bond pays a 6% coupon in two semi-annual instalments in arrears on 28th February and 28th August in each year until the bonds mature.

Redemption

Subject to credit risk, the bonds will be repaid at par on the maturity date, 28th August 2024.

Dealing

The bonds are traded on the London Stock Exchange's electronic Order Book for Retail Bonds (ORB), which was launched in response to private investor demand for easier access to trading bonds with the aim of providing a transparent and efficient mechanism for UK retail investors to access the bond markets. The bonds are tradeable instruments and prices are quoted in the market during trading hours. The bonds can be sold before maturity on the ORB and the prices are supported by several prominent investment firms in a market-making capacity.

Stamp Duty

No UK stamp duty is payable on the purchase or transfer of the bond or on its redemption.

Security

The bond is senior, unsecured debt of Paragon. This means that if Paragon becomes insolvent, you may recover your investment in priority to subordinated debt holders and shareholders of Paragon. However, you could still lose some or all of the money you have invested.

Summary:

Paragon's business is very straight forward and easy to understand. For the investor, the offer presents an opportunity to gain exposure to the BTL lending and consumer finance markets, both areas that have seen sustained growth in the seemingly persistently low-rate monetary environment.

The senior ranking of the bond implies that the bond offers a good risk/return ratio. The debt/equity ratio of 0.25 is attractive and there is a covenant on the bonds restricting the ratio to 0.50.

Looking at the performance of the ordinary shares provides a useful indication as to what the market thinks of the underlying business and the stock has risen 19% over the last 12 months to 410p. The average broker target amongst the investment banking community is 505p, suggesting 24% potential upside in the stock from these levels.

Previous Paragon bonds have risen above par and are now yielding below the 6% coupon offered by this issue. That bodes well for investors and we rate the issue a strong buy.



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