Aldermore

# Press release

10 August 2017

# Aldermore Group PLC

## Half Year 2017 Results

**32% increase in profit before tax to £78m (H1 2016: £59m)**
- Operating income up 17% to £150m (H1 2016: £128m)
- Underlying cost to income ratio[1] improved to 44% (H1 2016: 46%) while continuing to invest in the Group

**Delivering a high-teens return on equity**
- Return on equity of 19% (H1 2016: 16%)
- Basic earnings per share grew by 45% to 14.9p (H1 2016: 10.3p)

**Continued strong, profitable organic growth and robust credit control across the diversified portfolio**
- Excellent loan origination; up by 10% to £1.6bn (H1 2016: £1.5bn)
- Loan growth of 8% to £8.1bn (FY 2016: £7.5bn), with healthy pipeline at £0.8bn (H1 2016: £0.7bn)
- Business Finance loans +8% to £1.9bn; Mortgages +9% to £6.2bn
- Net interest margin in line with guidance at 3.5% (H1 2016: 3.6%)
- Continued secure and well controlled credit performance; cost of risk 14bps (H1 2016: 20bps)

**Continued strong organic capital generation**
- CET1 capital ratio up 30bps to 11.8% (FY 2016: 11.5%)
- Anticipate delivering a CET1 above 12% by FY17, enabling the Board to consider the payment of dividends
- Total capital ratio of 14.9% and leverage ratio of 6.9% (FY 2016: 15.6%, 7.0%) with £40m Tier 2 notes called in May
- Tangible book value per share up 9% to 167p (FY 2016: 153p)

**Further strategic progress**
- Announced investment in SME Broker AFS demonstrates our commitment to the broker market and provides strategic opportunities to enhance returns
- Continuing focus on dynamic service, enhancing our proposition to intermediaries in both Business Finance and Mortgages through our “we back you” campaign
- Continue to delight our customers, with Net Promoter Score (“NPS”) increasing to +44 (2016: +43)

**Phillip Monks OBE, Chief Executive Officer, commented:**
“We have made excellent progress during the first half of 2017, building on our track record of delivery in loan growth, deposit growth and profitability, leaving us well positioned entering the second half with a strengthened capital position and a strong pipeline of new lending.

“We have continued to adopt a balanced approach to growth through strong organic origination and a consistent, robust approach to risk management. We approved £1.6bn of new customer loans in the period taking total lending to customers to more than £8.1bn.

“SMEs play a vital role in the UK’s economic prosperity and we remain focused on helping them access the working capital and investment funding they need to succeed. Business Finance lending grew by 8% during the first half of the year and our agreed investment in AFS, one of the UK’s largest asset and commercial finance introducers, highlights our continued commitment to this market. Mortgage lending increased by 9%, to £6.2bn, as we continue to serve landlords, first time buyers and the self-employed.

“We are delighted with the performance and strategic progress made so far in 2017. Whilst we remain vigilant to the risks posed by the economic uncertainty facing the UK, continued earnings and balance sheet momentum provide us with greater resilience and position us well to capitalise on further strategic opportunities.”

[1] Underlying basis excludes goodwill impairment of £4.1m (pre-tax and post-tax) in 2016. No exceptional items have been recognised with respect to 2017 financial results.

## Enquiries


| **Analysts** | **Media** |
|---|---|
| Martin Adams | Holly Marshall |
| Tel: +44 (0) 20 8185 3108 | Tel: +44 (0) 20 3553 4828 |
| Ryan Jones | Tom Baldock – Lansons |
| Tel: +44 (0) 20 8185 3146 | Tel: +44 (0) 786 010 1715 |


A live webcast of the analyst presentation will be broadcast on our IR website www.investors.aldermore.co.uk at 9:30am on 10 August 2017 and is available via a listen only conference call by dialling +44 (0) 20 3059 8125. An indexed version of the webcast will be made available on the website shortly after the event.

## Press release contents

# Summary financials

| Income statement (£m, underlying[1,2] basis) | HY 2017 | HY 2016 | Movement % |
|---|---|---|---|
| Net interest income | 135.6 | 115.6 | *17* |
| Other income | 14.0 | 12.1 | *16* |
| Operating income | 149.6 | 127.7 | *17* |
| Underlying[2] expenses | (65.9) | (58.1) | *(13)* |
| Impairments | (5.6) | (6.4) | *13* |
| Underlying[2] profit before tax | 78.1 | 63.2 | *24* |
| Goodwill impairment | - | (4.1) | - |
| Statutory profit before tax | 78.1 | 59.1 | *32* |
| Tax | (20.3) | (16.9) | *(20)* |
| Statutory profit after tax | 57.8 | 42.2 | *37* |

## Key financial ratios[1] (%, unless stated)

| | | HY 2017 | HY 2016 | Movement |
|---|---|---|---|---|
| *Margin* | Gross interest yield | 4.93% | 5.43% | *(0.50)pp* |
| | Cost of funding | 1.45% | 1.85% | *0.40pp* |
| | Net interest margin | 3.48% | 3.57% | *(0.09)pp* |
| *Efficiency and returns* | Underlying[2] cost to income ratio | 44.1% | 45.5% | *1.4pp* |
| | Effective tax rate[3] | 26.0% | 28.6% | *2.6pp* |
| | Underlying[2] return on equity | 18.8% | 18.0% | *0.8pp* |
| | Statutory return on equity | 18.8% | 16.3% | *2.5pp* |
| *Credit quality* | Cost of risk (annualised) | 0.14% | 0.20% | *0.06pp* |
| *Shareholder value* | Basic earnings per share (pence) | 14.9p | 10.3p | *4.6p* |
| | Diluted earnings per share (pence) | 14.8p | 10.3p | *4.5p* |
| | Shares in issue at period end (million) | 344.9m | 344.7m | *0.2m* |

| | | 30 Jun 2017 | 31 Dec 2016 | Movement |
|---|---|---|---|---|
| *Credit quality* | Non-performing loans (“NPL”) ratio | 0.43% | 0.47% | *0.04pp* |
| *Balance sheet strength* | Loan to deposit ratio | 110% | 112% | *(2)pp* |
| | Fully loaded CRD IV CET1 ratio | 11.8% | 11.5% | *0.3pp* |
| | Fully loaded CRD IV total capital ratio | 14.9% | 15.6% | *(0.7)pp* |
| *Shareholder value* | Tangible book value/share (pence) | 167p | 153p | *14p* |

## Balance sheet (£m)

| | 30 Jun 2017 | 31 Dec 2016 | Movement |
|---|---|---|---|
| Loans and advances to customers | 8,107.7 | 7,477.3 | *8%* |
| Customer deposits | 7,345.9 | 6,673.7 | *10%* |

[1] For details of Alternative Performance Measures (“APMs”) please refer to the glossary on page 61
[2] Underlying basis excludes goodwill impairment of £4.1m (pre-tax and post-tax) in 2016. No exceptional items have been recognised with respect to 2017 financial results.
[3] The effective tax rate for 2016 is impacted by the goodwill impairment which is not allowable for tax purposes.

# CEO review

## Banking as it should be

The credit crunch which began ten years ago, revealed the UK’s high-street banks to be failing their customers. Aldermore was founded in 2009 specifically to address institutionalised weaknesses in service and culture among the UK’s large banks and we have sought since then to challenge the status quo, empowering more people across Britain to seek and seize opportunities in their professional and personal lives by providing “banking as it should be”. In doing so, we are addressing a market opportunity that is as real today as it was in the aftermath of the global financial crisis. In fact, as the market has matured, companies and individuals have increasingly recognised that a different kind of banking experience is not only possible but available.

As a specialist bank, we don’t compete head on with the traditional banks in their main markets. We go beyond their one-size fits all approach by employing specialist underwriters to understand our customers’ circumstances, and by making sure we offer a service that works for them. We operate in carefully selected segments where we have the necessary experience and expertise to deliver strong and sustainable risk-adjusted returns through responsible lending. We benefit from a modern infrastructure and an efficient distribution model, working with approved specialist intermediaries, direct with customers and via partner relationships avoiding the need for a costly branch network.

## A strong start to the year

We have made a strong start to 2017, continuing to build on our track record of consistent delivery and performance. Against a backdrop of ongoing economic uncertainty and increasing competitive pressure we have remained focused on our strategic priorities to be ‘Customer driven’ in our approach, ‘Simply delivered’ through an efficient and scalable operating model and ‘Securely managed’ in our approach to risk across the Group.

In the first half of 2017 we have made progress in broadening our customer proposition, enhancing our service promise and developing new market opportunities. We have continued to generate further operating leverage, whilst investing in the business, and we have maintained a well-controlled approach to risk management, which along with the benign credit environment has resulted in continuing low levels of loan impairments and arrears.

This strong start to the year supports our confident outlook for the remainder of 2017, enabling us to enhance our financial guidance.

## Continuing commitment to UK businesses, homeowners, landlords and savers

Net loans to customers increased by £0.6bn, or 8%, to £8.1bn, driven by organic origination, across both Business Finance and Mortgages where, respectively, £0.6bn and £1.0bn of new customer loans were provided.

In Business Finance we help small businesses to access working capital and acquire the assets and equipment they need to grow by providing invoice and asset finance facilities. In Asset Finance we have leveraged our efficient broker-led distribution model to build a market leading position in this channel and we have also diversified routes to market via wholesale channels direct with funders, which together contributed to growth in lending of 8% to £1.7bn.

Across our Mortgages franchise we grew lending by 9% to £6.2bn. This was led by robust growth in Buy-to-Let (“BTL”) lending, up 15% to £3.8bn. As expected, growth was particularly strong in Q1, as we converted the large pipeline of customers with which we closed 2016. In SME Commercial Mortgages, our expertise in underwriting multi-let investment properties resulted in loan growth of 1% to £0.9bn. In our Residential Mortgages business, where we have strong positions within market niches, lending reduced by 1% to £1.5bn, reflecting increased competition and a higher pace of redemptions, particularly among Help to Buy customers.

Loan growth continues to be primarily funded by our award-winning deposit franchise. The performance of our savings business is driven by our straightforward and transparent proposition and our promise that savers get “great returns effortlessly”. Our dynamic online franchise enables customers to tailor products to their needs and our straightforward approach means we don’t use teaser rates. This approach drove an increase in deposits of 10% to £7.3bn in the first half of 2017.

# CEO review continued

## Double-digit earnings growth continues

Statutory profit before tax rose 32% to a record first half high of £78m, driven by our growing franchises, a healthy net interest margin of 3.5% and further improvement in operational leverage, reflected in a cost to income ratio of 44%. Our management of risk remains robust and central to our lending decisions which, together with the benign economic environment experienced over the first half of 2017, resulted in our cost of risk declining to 0.14% and less than 0.5% of our loans by value being classed as non-performing.

## Strong organic capital generation and shareholder returns

After becoming capital accretive during 2016 we have continued to generate strong levels of organic capital over the first half of 2017 with our fully loaded CRD IV CET1 ratio increasing by 0.3% to 11.8%. We expect our CET1 capital ratio to continue rising to above 12% by the end of 2017.

Overall, the Group generated earnings per share of 14.9p and a return on equity of 19%.

## Strategic priorities

As we seek to enhance the sustainability of returns, our strategic priorities will continue to be delivering growth, increasing efficiency and further strengthening our robust approach to risk management.

### Customer driven: Helping more customers to seek and seize opportunities

Our focus remains on growth in large markets through diverse pools of customer demand, where we can operate as a service-focused specialist lender to meet customers' needs.

*Highlights in H1 2017:*

- Further growth in originations with £1.6bn lent across Business Finance and Mortgages. Total customer numbers also continued to grow to over 230,000, while our customer advocacy continued to improve with our NPS now at +44
- Agreed 48% minority stake in AFS, one of the largest introducers to asset and commercial finance funders in the UK. The investment provides Aldermore with strategic options to enhance our proposition within the broker market and leverage expertise in adjacent markets. We will continue to assess inorganic opportunities to develop our franchise
- Further developed our service proposition to intermediaries across both Business Finance and Mortgages, including enhanced service commitments, increased relationship management and digital upgrades
- Awarded 'Best Service from a Buy-to-Let provider' and Highly Commended as 'Best Service from a Business Bank' by Business MoneyFacts and named 'Best Cash ISA Provider' at MoneyNet's Personal Finance Awards

### Simply delivered: Developing our scalable, effective and efficient operating model

Aldermore benefits from a simple system architecture and an efficient online broker-led distribution model as opposed to a costly branch network. We continue to invest in key capabilities and technology, optimising our operating model to support the delivery of growth with enhanced levels of service, capability and efficiency.

*Highlights in H1 2017:*

- We continued to generate greater operational leverage in the business, bringing the underlying cost to income ratio down further to 44% while continuing to invest in franchise capability
- We have continued to invest in digital technology and enhancements across the bank, including an upgraded Asset Finance broker portal, and enhancing system functionality to support product development
- We are reviewing the Group's organisational structure to ensure we are operating as efficiently as possible

# CEO review continued

**Securely managed: maintaining a diverse and well controlled business model**

As a specialist underwriter, our ability to understand our customers' circumstances and the value of underlying assets is a source of competitive advantage. Growth is controlled and supported by a consistent risk appetite and robust risk management framework, which drives our prudent approach across all areas of the Group.

*Highlights in H1 2017:*

- Our credit quality remained well within our appetite as we incurred a cost of risk of 14bps and maintained non-performing loans below 0.5% of our portfolio, supported by benign credit conditions
- We consistently originate in line with centrally controlled underwriting standards including affordability stress tests and monthly re-scoring of the portfolio
- We have completed enhancements to our credit risk models and have entered a parallel run phase as part of our ongoing work to become IFRS 9 compliant ahead of the January 2018 implementation date

## A confident outlook

Delivering another great performance reinforces confidence in our ability to continue growing both our business and our capability. However, we are not complacent and we remain alert to the risks presented by the ongoing economic uncertainty in the UK. No concerning trends have emerged within our loan portfolios, but we remain vigilant to any emerging risks in our environment and will continue to appropriately balance growth, risk and returns across the Group, with our priority continuing to be the delivery of high-teens returns.

The Group's cost of risk has remained low and well controlled over the first half of 2017 reducing to 14 basis points. While we remain alert to any deterioration in credit conditions and continue to expect an upward normalisation of impairments over the medium term, we now anticipate the cost of risk for 2017 to be below our medium term range of between 25 – 35 basis points.

Our loan growth of 8% during the first half, achieved with a broadly stable net interest margin, gives us confidence in the delivery of our guided range of 10 – 15% growth for the year. The exact level of lending will depend on market conditions and the continuing opportunity to lend within our prudent risk appetite and to our targeted level of returns. However, we enter the second half of the year in a strong position with a healthy pipeline of £0.8bn, up 8% on the first half of 2016.

Strong loan growth over the first half of the year has driven further operating leverage, demonstrated by an improvement in the cost to income ratio, while continuing our investment in the business. We continue to anticipate an increase of £15 – £20m on the 2016 underlying cost base in 2017 and for the cost to income ratio to trend below 40% over the medium term.

Consistent delivery means that we now anticipate generating sufficient capital to reach a CET1 ratio of above 12% by the end of 2017. As previously stated, at this level, the Board will be in a position to consider the payment of dividends while taking into account growth opportunities available, anticipated changes in capital requirements and the prevailing economic environment.

## In conclusion…

I'm delighted with the continued strategic and financial progress that Aldermore is making across the Group. We have performed very strongly over the first half of the year, delivering a 19% return on equity and I would like to thank all of our colleagues who have worked so hard to deliver on our strategy and build on the success we have achieved to date. Together I am confident that we can continue delivering further value for our customers and generating strong, sustainable returns for our shareholders.

**Phillip Monks OBE, Chief Executive Officer**

# Financial review

## Loans to customers are up 8% so far in 2017, with originations up 10% versus H1 2016

Loan growth in the first six months of 2017 was driven by origination across both our Business Finance and Mortgages divisions as we continue to build our diversified portfolio. This growth in originations exceeded redemptions of £1bn in the period resulting in the Group's net lending to customers surpassing £8.1bn at the end of June 2017.

Net lending in Business Finance grew by 8% to £1.9bn, primarily driven by Asset Finance, up 8% to £1.7bn as our expertise in a broad range of asset classes allowed us to maintain our strong position in the broker-channel and to grow our wholesale proposition by 50%. Invoice Finance also grew 8% to £166m as the business continues to focus on enhancing returns through invoice discounting for small businesses and structured finance.

In Mortgages, net loans increased by 9% to £6.2bn. Commercial Mortgages grew by 1% to £0.9bn despite having tightened our appetite for development-based lending following the EU referendum in 2016. In Buy-to-Let, we entered the year with a strong pipeline of applications as a result of the market-wide changes in affordability tests, which combined with our broad customer offering, has enabled us to grow lending by 15% to £3.8bn. Residential Mortgages reduced by 1% to £1.5bn as we continue to see redemptions on the large number of mortgages written two years ago.

## Deposit growth of 10%, as £947m Term Funding Scheme ("TFS") utilised to date

Deposits grew 10% to £7.3bn in the first half of 2017 with the mix remaining broadly stable (70% from retail; 30% from SME and corporate customers).

We continued to diversify our sources of funding, utilising cost effective sources offered by the Bank of England, including the TFS and Indexed Long Term Repo scheme ("ILTR") with £947m and £100m respectively drawn as at the end of June. The Group also repaid all Funding for Lending Scheme on-balance sheet liabilities in the period.

The underlying mortgages within our Oak 1 securitisation continued to be repaid as reflected in the 18% reduction in the Residential Mortgages Backed Security balance. The balance of subordinated liabilities also reduced as £40m of Tier 2 securities issued five years previously were called in May 2017.

| | **30 Jun 2017 £m** | **31 Dec 2016 £m** | **Movement %** |
|---|---|---|---|
| Retail deposits | 5,116.5 | 4,766.8 | *7* |
| SME deposits | 1,825.9 | 1,647.2 | *11* |
| Corporate deposits | 403.5 | 259.7 | *55* |
| **Customer deposits** | **7,345.9** | **6,673.7** | ***10*** |
| | | | |
| Funding for Lending Scheme ("FLS") | - | 354.8 | - |
| Term Funding Scheme ("TFS") | 946.5 | 396.1 | *139* |
| Indexed Long Term Repo scheme ("ILTR") | 100.2 | - | - |
| Residential Mortgages Backed Security ("RMBS") | 107.1 | 130.6 | *(18)* |
| Deposits by banks | 8.5 | 0.7 | *1114* |
| Subordinated liabilities | 60.4 | 100.0 | *(40)* |
| **Wholesale funding** | **1,222.7** | **982.2** | ***24*** |

# Financial review continued

## Profits up 32% demonstrating continued strong, sustainable returns

Profit before tax for the period increased by 32% to £78.1m (H1 2016: £59.1m) as we maintained healthy net interest margins across a larger loan book. Adjusting for the £4.1m goodwill impairment in the first half of 2016, profit before tax on an underlying basis increased by 24%. The post-tax profit for the period stood at £57.8m, a 37% increase over the first half of 2016.

The return on equity generated in the period was 18.8%, in line with our commitment to delivering returns in the high teens. The half year 2017 basic earnings per share were 14.9p and 14.8p on a fully diluted basis.

## Operating income increases 17% as average net loans rise 20%

Compared to the first half of 2016, interest income grew by 9% to £192m for the first half of 2017 driven by continuing net loan growth. The Group's average gross yield reduced by 50bps to 4.93%, primarily as a result of the lower rate environment but also as a result of competition in Asset Finance and a slight change in business mix, with the comparatively lower yielding Buy-to-Let portfolio growing at a faster pace than other portfolios.

Despite the balance sheet growth, interest expense reduced by 6% to £56m. The Group's diversified funding base benefitted from a lower cost of deposits combined with access to the Bank of England's TFS, which together helped drive the Group's cost of funding down by 40bps to 1.45%.

As a result, the Group's net interest income rose by 17% to £136m while the net interest margin reduced slightly by 9bps to 3.48%, in line with guidance.

Net fee and other operating income decreased by 7% to £12m driven mainly by a shift away from factoring business in our Invoice Finance portfolio.  Movements on derivative contracts were the primary driver in a £2.8m increase on the net derivatives and disposal of debt securities line.

| | **HY 2017** | **HY 2016** | **Movement** |
|---|---|---|---|
| | **£m** | **£m** | **%** |
| Interest income | 192.0 | 175.6 | *9* |
| Interest expense | (56.4) | (60.0) | *6* |
| Net interest income | 135.6 | 115.6 | *17* |
| Net fee and other operating income | 12.0 | 12.9 | *(7)* |
| Net derivatives and disposal of debt securities | 2.0 | (0.8) | *n/a* |
| **Operating income** | **149.6** | **127.7** | ***17*** |
| | | | |
| Average net loans | 7,792.5 | 6,811.1 | *14* |
| Gross interest income yield (%) | 4.93 | 5.43 | *(0.50)pp* |
| Cost of funding (%) | 1.45 | 1.85 | *0.40pp* |
| Net interest margin (%) | 3.48 | 3.57 | *(0.09)pp* |

# Financial review continued

## Greater operating leverage despite investment to support the Group's strategy

Our simple operating model and efficient distribution network of brokers supported us in further leveraging our capabilities, with operating income growing by 17%, while underlying cost growth was controlled to 13%. This resulted in our underlying cost to income ratio declining by 1.4 percentage points to 44.1%.

Operating expenses rose by 6% to £65.9m in the first half of 2017 compared to the same period in 2016. Given its material and one-off nature, costs related to the impairment of goodwill in our Invoice Finance business in 2016 are removed from our financial metrics to provide an 'underlying' view of our performance. On this basis, underlying costs grew 13%, in line with management expectations, and is reflective of the investment made in both the recruitment of colleagues to further support growth and enhance risk management, and expenditure on strategic, regulatory and mandatory projects.

| | **HY 2017** | **HY 2016** | **Movement** |
|---|---|---|---|
| | **£m** | **£m** | **%** |
| Administrative expenses | 62.3 | 54.6 | *(14)* |
| Provisions | 1.0 | 1.3 | *23* |
| Depreciation and amortisation | 2.6 | 2.2 | *(18)* |
| Underlying operating expenses | 65.9 | 58.1 | *(13)* |
| Goodwill impairment | - | 4.1 | *100* |
| **Operating expenses** | **65.9** | **62.2** | *(6)* |
| | | | |
| Underlying cost to income ratio (%) | 44.1% | 45.5% | *1.4pp* |

## Loan impairments fall as cost of risk reduces to 14bps

We continue to apply a robust approach to risk management and this, combined with a benign credit risk environment, has resulted in our cost of risk remaining low at 0.14%. Impairments reduced by 13% to £5.6m, within which our collective charge fell by 34% to £1.9m primarily reflecting increased conservatism applied to the loss emergence period for mortgages made in 2016. Individual impairments remained low increasing by 6% to £3.7m.

| | **HY 2017** | **HY 2016** | **Movement** |
|---|---|---|---|
| | **£m** | **£m** | **%** |
| Individual | 3.7 | 3.5 | *(6)* |
| Collective | 1.9 | 2.9 | *34* |
| **Impairments** | **5.6** | **6.4** | ***13*** |
| | | | |
| Cost of risk (%) | 0.14% | 0.20% | *0.06pp* |

Further information on the Group's credit risk can be found on pages 11 to 26.

# Financial review continued

## Capital continues to build as profit outstrips balance sheet growth and seasonal costs

After growing CET1 in the second half of 2016, the Group is continuing to build capital with 30bps of CET1 capital accreted in the first half of 2017 bringing the CET1 ratio to 11.8%. This growth reflects the generation of £58m of profit after tax in the period, partly offset by a £300m, or 7%, growth in Risk Weighted Assets ("RWAs") and the post-tax AT1 coupon of £6.6m, payable annually in April.

The 7% growth in RWAs reflects loan growth of 8%, the difference being a lower risk-weighting density due to the portfolio having a greater proportion of mortgages which typically receive a lower risk-weighting relative to other loans, and an increase in the Basic Indicator Approach ("BIA") Operational Risk charge which is updated in the first quarter of each year and is a function of the average of the last 3 years' net operating income.

The Group's total capital ratio reduced by 68bps to 14.9% in the first half of 2017 as £40m of Tier 2 securities were called, while the Group's leverage ratio remains significantly above forthcoming regulatory minimums at 6.9%.

We have completed enhancements to our credit risk models and entered a parallel run phase as part of our ongoing work to become IFRS 9 compliant ahead of the January 2018 implementation date. This takes us closer to the sophistication required for an Internal Ratings-Based approach ("IRB") to capital which may help to mitigate the risk of future changes in capital requirements. Whilst pursuing IRB in the context of IFRS 9, we will continue to monitor the cost and benefits of transition, as the regulatory changes and timeframes for implementation become clear.

| | **30 Jun 2017** | **31 Dec 2016** | **Movement** |
|---|---|---|---|
| | **£m** | **£m** | **%** |
| Shareholders' equity | 604.8 | 552.0 | *10* |
| Intangible assets | (28.3) | (26.1) | *8* |
| Prudential valuation adjustments | (0.1) | (0.1) | - |
| **CET 1 capital** | **576.4** | **525.8** | ***10*** |
| **AT1 capital** | **74.0** | **74.0** | **-** |
| **Tier 2 capital** | **75.9** | **113.1** | ***(33)*** |
| **Total capital** | **726.3** | **712.9** | ***2*** |
| | | | |
| Asset Finance | 1,194.3 | 1,105.7 | *8* |
| Invoice Finance | 113.6 | 104.3 | *9* |
| SME Commercial Mortgages | 1,087.3 | 1,125.9 | *(3)* |
| Buy-to-Let | 1,447.5 | 1,277.4 | *13* |
| Residential Mortgages | 535.6 | 560.7 | *(4)* |
| **Lending credit risk weighted assets** | **4,378.3** | **4,174.0** | ***5*** |
| Operational risk charge | 410.7 | 308.5 | *33* |
| Other | 87.4 | 93.6 | *(7)* |
| **Total Risk weighted assets** | **4,876.4** | **4,576.1** | ***7*** |
| | | | |
| **Fully loaded CRD IV CET1 ratio (%)** | **11.8** | **11.5** | *0.3pp* |
| Fully loaded CRD IV Tier 1 capital ratio (%) | 13.3 | 13.1 | *0.2pp* |
| **Fully loaded CRD IV Total capital ratio (%)** | **14.9** | **15.6** | ***(0.7)pp*** |
| | | | |
| **Leverage ratio (%)** | **6.9** | **7.0** | *(0.1)pp* |

# Financial review continued

## Credit risk

Credit risk is the risk of financial loss arising from the borrower or a counterparty failing to meet their financial obligations to the Group in accordance with agreed terms. The risk primarily arises from our lending activities as a result of defaulting mortgage, lease or loan contracts. Although credit risk arises from our loan book, it can also arise from treasury investment and off-balance sheet activities.

The credit risk section of this report includes information on the following:

1. The Group's maximum exposure to credit risk
2. Credit quality and performance of loans
3. Forbearance granted through the flexing of contractual agreements
4. Diversity and low concentrations within our loan portfolio
5. The value of assets against which loans are secured and details of provisioning coverage
6. Information on credit risk within our treasury operations

**1. The Group's maximum exposure to credit risk**

The following table presents our maximum exposure to credit risk of financial instruments on the balance sheet and commitments to lend before taking into account any collateral held or other credit enhancements. The maximum exposure to credit risk for loans, debt securities, derivatives and other on-balance sheet financial instruments is the carrying amount, and for loan commitments the full amount of any commitment to lend that is either irrevocable or revocable only in response to material adverse change.

Our net credit risk exposure grew by 9% in the first six months of 2017. This was in line with the growth in loans and advances to customers, our largest credit risk exposure, of 8% to £8,135.6 million.

| | Note | **30 June 2017** | **31 December 2016** |
|---|---|---|---|
| ***Included in the statement of financial position:*** | | **£m** | **£m** |
| Cash and balances at central banks | | 368.1 | 116.4 |
| Loans and advances to banks | | 94.7 | 67.2 |
| Debt securities | | 712.7 | 664.5 |
| Derivatives held for risk management | | 19.1 | 12.4 |
| Loans and advances to customers | 13 | 8,135.6 | 7,504.7 |
| Other financial assets | | 0.8 | 2.9 |
| | | **9,331.0** | **8,368.1** |
| Commitments to lend | 20 | 809.2 | 968.8 |
| **Gross credit risk exposure** | | **10,140.2** | **9,336.9** |
| Less: allowance for impairment losses | 13 | (27.9) | (27.4) |
| **Net credit risk exposure** | | **10,112.3** | **9,309.5** |

# Financial review continued

## Credit risk continued

### 2. Credit quality and performance of loans

The Group has maintained low levels of impairment reflecting both the controlled approach to risk management and the benign economic environment. The tables below provide our gross lending of £8,135.6 million split by credit risk exposure on the following basis:

A. Whether they are performing (neither past due nor individually impaired)
B. Payments missed, but no impairment is required (past due but not individually impaired)
C. Loans against which an impairment has been recorded, for example, as a result of payments having been missed (individually impaired)

| 30 June 2017 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| A Neither past due nor individually impaired | 1,693.7 | 168.4 | 930.8 | 3,809.3 | 1,457.3 | 8,059.5 |
| B Past due but not individually impaired | 4.6 | - | 8.7 | 11.8 | 15.9 | 41.0 |
| C Individually impaired | 6.6 | 2.9 | 5.9 | 11.5 | 8.2 | 35.1 |
| | **1,704.9** | **171.3** | **945.4** | **3,832.6** | **1,481.4** | **8,135.6** |

| 31 December 2016 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| A Neither past due nor individually impaired | 1,569.2 | 155.9 | 921.6 | 3,308.4 | 1,470.8 | 7,425.9 |
| B Past due but not individually impaired | 3.3 | - | 6.9 | 13.2 | 19.8 | 43.2 |
| C Individually impaired | 9.3 | 3.6 | 7.8 | 8.7 | 6.2 | 35.6 |
| | **1,581.8** | **159.5** | **936.3** | **3,330.3** | **1,496.8** | **7,504.7** |

[1] The above analysis includes Property Development.

The three categories shown above are further analysed over the following pages.

Due to the more bespoke nature of the Property Development business the analysis in the following sections of the report exclude the portfolio from a number of tables indicated with a footnote. Gross Property Development exposure at 30 June 2017 was £235 million (31 December 2016: £230 million), and net exposure was £234 million (31 December 2016: £229 million).

## **Credit risk** continued

### A. Loans and advances that are neither past due nor individually impaired

The credit quality of assets that are neither past due nor individually impaired is assessed internally as follows:

| 30 June 2017 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| Low risk | - | - | 389.2 | 3,129.8 | 1,062.1 | 4,581.1 |
| Medium risk | 1,320.9 | 8.8 | 298.8 | 642.8 | 353.0 | 2,624.3 |
| High risk | 372.7 | 159.6 | 8.0 | 36.7 | 42.2 | 619.2 |
| **Total** | **1,693.6** | **168.4** | **696.0** | **3,809.3** | **1,457.3** | **7,824.6** |
| **Fair value of collateral held** | **1,157.0** | **167.1** | **696.0** | **3,807.9** | **1,457.3** | **7,285.3** |

| 31 December 2016 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| Low risk | - | - | 368.6 | 2,710.7 | 1,083.8 | 4,163.1 |
| Medium risk | 1,282.4 | 6.9 | 315.8 | 523.4 | 345.4 | 2,473.9 |
| High risk | 286.8 | 149.0 | 7.1 | 74.3 | 41.6 | 558.8 |
| **Total** | **1,569.2** | **155.9** | **691.5** | **3,308.4** | **1,470.8** | **7,195.8** |
| **Fair value of collateral held** | **1,102.8** | **155.8** | **691.5** | **3,308.3** | **1,470.8** | **6,729.2** |

[1] This analysis excludes Property Development.

The categorisation of high, medium and low risk is based on internal grading models utilised in portfolio monitoring. The models are used to generate a consistent Group-wide approach for the grading of customer credit risk exposures for all lending businesses and provide a relative internal ranking of risk. Drivers for the grade mapping include external credit reference agency risk scores, property valuations and qualitative factors. The relative measure of risk reflects a combined assessment of the probability of default by the customer and an assessment of the expected loss in the event of default.

The resulting classification of balances between low, medium and high is consequently driven by a combination of the Probability of Default ("PD") and Loss Given Default ("LGD") grades as further explained. A matrix of eighteen PD (fifteen of which apply to accounts that are not past due) and ten LGD grades determine the category within which each loan is categorised, i.e. those accounts that have a low PD and low LGD are graded as 'low'. Those graded 'high' will be accounts that have either a high PD and/or high LGD.

## Credit risk continued

### B. Loans and advances that are past due but not individually impaired

As at 30 June 2017, there was a balance of £41.0 million in relation to loans where customers had missed one or more repayments but no specific loss had yet been recognised. This represented a 5% decrease in the first half of 2017, despite the 8% growth in net loans in the period.

The table below provides further analysis according to the number of months past due:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| - Up to 2 months past due | 32.6 | 35.6 |
| - 2 to 3 months past due | 8.4 | 7.6 |
| **Total** | **41.0** | **43.2** |
| *Fair value of collateral held* | *39.8* | *42.3* |

### C. Loans and advances that have been individually impaired

Individually impaired balances are as follows:

| 30 June 2017 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| Impaired but not past due | 0.8 | - | 0.3 | 1.7 | 0.1 | 2.9 |
| Past due less than 3 months | 1.6 | - | 1.7 | 1.0 | 1.3 | 5.6 |
| Past due 3-6 months | 2.1 | - | 3.2 | 3.8 | 3.5 | 12.6 |
| Past due 6-12 months | 1.3 | 0.7 | 0.4 | 3.2 | 2.5 | 8.1 |
| Past due over 12 months | 0.8 | 2.2 | 0.3 | 1.8 | 0.8 | 5.9 |
| | **6.6** | **2.9** | **5.9** | **11.5** | **8.2** | **35.1** |
| *Of which: Possessions* | *0.7* | *-* | *0.6* | *5.4* | *0.2* | *6.9* |
| *Non-performing Loan Ratio (%)* | *0.39* | *1.69* | *0.62* | *0.30* | *0.55* | *0.43* |

| 31 December 2016 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| Impaired but not past due | 1.0 | - | 2.4 | 0.5 | 0.1 | 4.0 |
| Past due less than 3 months | 2.5 | 0.6 | 0.2 | 1.5 | 0.6 | 5.4 |
| Past due 3-6 months | 3.1 | 0.1 | - | 2.8 | 3.8 | 9.8 |
| Past due 6-12 months | 2.0 | 1.0 | 1.2 | 3.2 | 1.4 | 8.8 |
| Past due over 12 months | 0.7 | 1.9 | 4.0 | 0.7 | 0.3 | 7.6 |
| | **9.3** | **3.6** | **7.8** | **8.7** | **6.2** | **35.6** |
| *Of which: Possessions* | *0.7* | *-* | *0.6* | *5.5* | *0.2* | *7.0* |
| *Non-performing Loan Ratio (%)* | *0.59* | *2.26* | *0.83* | *0.26* | *0.41* | *0.47* |

[1] The above analysis includes Property Development.

# Financial review continued

## Credit risk continued

Against the above individually impaired balances at 30 June 2017 of £35.1 million (31 December 2016: £35.6 million), the fair value of collateral was £30.5 million (31 December 2016: £28.8 million). We always seek to pursue timely realisation of collateral in an orderly manner and do not use the collateral for our own operations.

The year to date movement in impaired loans is as follows:

| 2017 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| At 1 January | 9.3 | 3.6 | 7.8 | 8.7 | 6.2 | 35.6 |
| Classified as impaired during the period | 4.6 | 0.4 | 1.2 | 6.8 | 4.5 | 17.5 |
| Transferred from impaired to unimpaired | (2.2) | (0.1) | - | (1.9) | (1.8) | (6.0) |
| Amounts written off | (2.7) | (0.4) | - | (0.1) | - | (3.2) |
| Repayments | (2.4) | (0.6) | (3.1) | (2.0) | (0.7) | (8.8) |
| **At 30 June 2017** | **6.6** | **2.9** | **5.9** | **11.5** | **8.2** | **35.1** |

| 2016 | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m | Total £m |
|---|---|---|---|---|---|---|
| At 1 January | 6.7 | 2.9 | 7.9 | 6.4 | 4.1 | 28.0 |
| Classified as impaired during the period | 7.3 | 2.1 | 1.0 | 3.5 | 3.1 | 17.0 |
| Transferred from impaired to unimpaired | (0.3) | - | (1.0) | (1.1) | (0.7) | (3.1) |
| Amounts written off | (4.4) | (1.4) | (0.1) | (0.1) | (0.1) | (6.1) |
| Repayments | - | - | - | - | (0.2) | (0.2) |
| **At 31 December 2016** | **9.3** | **3.6** | **7.8** | **8.7** | **6.2** | **35.6** |

[1] The above analysis includes Property Development.

# Financial review continued

## Credit risk continued

**3. Forbearance granted through the flexing of contractual agreements**

Forbearance is defined as any concessionary arrangement that is made for a period of three months or more where financial difficulty is present or imminent. It is inevitable that some borrowers experience financial difficulties which impact their ability to meet their obligations as per the contractual terms. We seek to identify borrowers who are experiencing financial difficulties, as well as contacting borrowers whose loans have gone into arrears, consulting with them in order to ascertain the reason for the difficulties and to establish the best course of action to bring the account up to date. In certain circumstances, where the borrower is experiencing financial distress, we may use forbearance measures to assist the borrower. These are considered on a case-by-case basis and must result in a fair outcome. The forbearance measures are undertaken in order to achieve the best outcome for both the customer and the Group by dealing with financial difficulties and arrears at an early stage.

The most widely used methods of forbearance are temporarily reduced monthly payments, loan term extension, deferral of payment and a temporary or permanent transfer to interest only payments to reduce the borrower's financial pressures. Where the arrangement is temporary, borrowers are expected to resume normal payments within six months. Both temporary and permanent concessions are reported as forborne for twenty four months following the end of the concession. In all cases, the above definitions are subject to no further concessions being made and the customers' compliance with the new terms.

Forbearance levels remain low, with the volume of forborne accounts by payment status shown in the tables below:

| **30 June 2017** | **Asset Finance £m** | **Invoice Finance £m** | **SME Commercial Mortgages[1] £m** | **Buy-to-Let £m** | **Residential Mortgages £m** | **Total £m** |
|---|---|---|---|---|---|---|
| A Neither past due nor individually impaired | 4.4 | 10.5 | 18.1 | 1.9 | 5.1 | 40.0 |
| B Past due but not individually impaired | 0.3 | - | 6.3 | - | 1.0 | 7.6 |
| C Individually impaired | 0.4 | 0.5 | 5.2 | - | 1.1 | 7.2 |
| | **5.1** | **11.0** | **29.6** | **1.9** | **7.2** | **54.8** |

| **31 December 2016** | **Asset Finance £m** | **Invoice Finance £m** | **SME Commercial Mortgages[1] £m** | **Buy-to-Let £m** | **Residential Mortgages £m** | **Total £m** |
|---|---|---|---|---|---|---|
| A Neither past due nor individually impaired | 3.2 | 10.4 | 23.8 | 1.4 | 4.9 | 43.7 |
| B Past due but not individually impaired | - | 0.6 | 0.2 | 0.3 | 1.5 | 2.6 |
| C Individually impaired | 0.1 | 0.1 | 0.3 | 0.3 | 1.4 | 2.2 |
| | **3.3** | **11.1** | **24.3** | **2.0** | **7.8** | **48.5** |

[1] This analysis excludes Property Development.

# Financial review continued

## Credit risk continued

As at 30 June 2017, we had undertaken forbearance measures as follows in each of our segments:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| **Asset Finance** | | |
| Capitalisation | 2.3 | 1.3 |
| Reduced monthly payments | 0.3 | 0.2 |
| Loan-term extension | 0.8 | 0.3 |
| Deferred payment | 1.7 | 1.5 |
| **Total Asset Finance** | **5.1** | **3.3** |
| Forborne as a percentage of the total divisional gross lending book (%) | 0.30% | 0.21% |
| **Invoice Finance** | | |
| Agreement to advance funds in excess of normal contractual terms | 11.0 | 11.1 |
| **Total Invoice Finance** | **11.0** | **11.1** |
| Forborne as a percentage of the total divisional gross lending book (%) | 6.42% | 6.96% |
| **SME Commercial Mortgages**[1] | | |
| Temporary or permanent switch to interest only | 29.6 | 24.3 |
| **Total SME Commercial Mortgages** | **29.6** | **24.3** |
| Forborne as a percentage of the total divisional gross lending book (%) | 3.13% | 2.60% |
| **Buy-to-Let** | | |
| Temporary or permanent switch to interest only | 0.8 | 0.7 |
| Reduced monthly payments | 1.0 | 1.0 |
| Deferred payment | 0.1 | 0.3 |
| **Total Buy-to-Let** | **1.9** | **2.0** |
| Forborne as a percentage of the total divisional gross lending book (%) | 0.05% | 0.06% |
| **Residential Mortgages** | | |
| Temporary or permanent switch to interest only | 4.4 | 4.5 |
| Reduced monthly payments | 1.7 | 2.0 |
| Deferred payment | 1.1 | 1.3 |
| **Total Residential Mortgages** | **7.2** | **7.8** |
| Forborne as a percentage of the total divisional gross lending book (%) | 0.49% | 0.52% |
| **Total forborne** | | |
| Total capitalisation | 2.3 | 1.3 |
| Total reduced monthly payments | 3.0 | 3.2 |
| Total loan-term extension | 0.8 | 0.3 |
| Total deferred payment | 2.9 | 3.1 |
| Total agreement to advance funds in excess of normal contractual terms | 11.0 | 11.1 |
| Total temporary or permanent switch to interest only | 34.8 | 29.5 |
| **Total forborne** | **54.8** | **48.5** |
| **Total forborne as a percentage of the total gross lending book (%)** | **0.67%** | **0.65%** |

[1] This analysis excludes Property Development.

When forbearance is granted to a borrower on a specific exposure, all exposures which are connected with that borrower, e.g. by reason of common ownership, are deemed as forborne for reporting purposes.

# Financial review continued

## Credit risk continued

### 4. Diversity and low concentrations within our loan portfolio

Aldermore continues to pursue a diversified portfolio. As shown below, we monitor concentration of credit risk by segment, geography, sector and size of loan:

**Credit concentration by segment**

Details of our net lending by segment are as follows:

| | 30 June 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| Asset Finance | 1,697.4 | 21 | 1,573.4 | 21 |
| Invoice Finance | 166.2 | 2 | 154.1 | 2 |
| SME Commercial Mortgages[1] | 938.9 | 12 | 929.9 | 12 |
| Buy-to-Let | 3,827.1 | 47 | 3,326.0 | 45 |
| Residential Mortgages | 1,478.1 | 18 | 1,493.9 | 20 |
| | **8,107.7** | **100** | **7,477.3** | **100** |

[1] The above analysis includes Property Development.

**Credit concentration by geography[1]**

An analysis of our loans and advances to customers by geography is shown in the table below:

| | 30 June 2017 % | 31 December 2016 % |
|---|---|---|
| East Anglia | 9.7 | 9.6 |
| East Midlands | 6.2 | 6.1 |
| Greater London | 20.2 | 20.7 |
| North East | 1.5 | 2.6 |
| North West | 10.8 | 10.7 |
| Northern Ireland | 0.3 | 0.2 |
| Scotland | 5.1 | 4.9 |
| South East | 20.1 | 19.9 |
| South West | 9.8 | 9.5 |
| Wales | 3.0 | 2.9 |
| West Midlands | 7.2 | 6.7 |
| Yorkshire and Humberside | 6.1 | 6.2 |
| | **100.0** | **100.0** |

[1] The above analysis includes Property Development.

# Financial review continued

## Credit risk continued

### Credit concentration by sector

An analysis of our loans and advances to customers by sector is shown in the table below:

| | 30 June 2017 % | 31 December 2016 % |
|---|---|---|
| Agriculture, hunting and forestry | 1.0 | 1.1 |
| Construction | 4.7 | 4.4 |
| Education | 0.1 | 0.1 |
| Electricity, gas and water supply | 0.5 | 0.5 |
| Financial intermediation | 1.9 | 1.7 |
| Health and social work | 0.3 | 0.3 |
| Hotels and restaurants | 0.3 | 0.3 |
| Manufacturing | 2.9 | 3.1 |
| Mining and quarrying | 0.2 | 0.2 |
| Private households with employed persons | 0.8 | 0.8 |
| Public administration and defence; compulsory social security | 0.1 | 0.1 |
| Real estate, renting and business activities | 19.6 | 19.2 |
| Residential | 61.3 | 61.9 |
| Transport, storage and communication | 3.8 | 3.8 |
| Wholesale & retail trade; repair of motor vehicles, motorcycles & personal household goods | 2.5 | 2.5 |
| | **100.0** | **100.0** |

[1] The above analysis includes Property Development.

### Credit concentration by quantum of exposure

An analysis of loans and advances to customers by quantum of exposure is shown in the table below:

| 30 June 2017 | Asset Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m |
|---|---|---|---|---|
| £0 - £50k | 658.8 | 2.0 | 28.6 | 13.8 |
| £50 - £100k | 371.0 | 21.2 | 558.4 | 248.7 |
| £100 - £150k | 172.5 | 27.6 | 529.2 | 403.5 |
| £150 - £200k | 105.6 | 24.1 | 465.2 | 294.3 |
| £200 - £300k | 118.5 | 50.2 | 871.9 | 321.1 |
| £300 - £400k | 69.5 | 35.9 | 582.8 | 119.8 |
| £400 - £500k | 47.0 | 36.1 | 274.2 | 22.7 |
| £500k - £1m | 74.9 | 122.1 | 359.7 | 51.0 |
| £1m - £2m | 44.8 | 151.2 | 90.8 | 3.2 |
| £2m+ | 34.8 | 234.9 | 66.3 | - |
| **Total** | **1,697.4** | **705.3** | **3,827.1** | **1,478.1** |

[1] The above analysis excludes Property Development.

## Financial review continued

### Credit risk continued

**Credit concentration by quantum of exposure** continued

| 31 December 2016 | Asset Finance £m | SME Commercial Mortgages[1] £m | Buy-to-Let £m | Residential Mortgages £m |
|---|---|---|---|---|
| £0 - £50k | 639.7 | 2.9 | 25.4 | 15.9 |
| £50 - £100k | 361.3 | 24.7 | 518.1 | 252.9 |
| £100 - £150k | 145.4 | 31.7 | 480.6 | 414.9 |
| £150 - £200k | 96.1 | 26.1 | 400.5 | 299.6 |
| £200 - £300k | 107.4 | 52.3 | 709.1 | 314.1 |
| £300 - £400k | 54.9 | 36.7 | 457.5 | 120.7 |
| £400 - £500k | 40.3 | 40.1 | 219.1 | 21.4 |
| £500k - £1m | 79.6 | 119.0 | 306.3 | 51.2 |
| £1m - £2m | 34.2 | 140.2 | 116.0 | 3.2 |
| £2m+ | 14.5 | 227.1 | 93.4 | - |
| **Total** | **1,573.4** | **700.8** | **3,326.0** | **1,493.9** |

¹ The above analysis excludes Property Development.

**5. The value of assets against which loans are secured and details of provisioning coverage**

The principal indicators used to assess the credit security of performing loans are loan-to-value ("LTV") ratios for SME Commercial, Buy-to-Let and Residential Mortgages.

***SME Commercial Mortgages[1]***

Loan-to-value on indexed origination information on our SME Commercial Mortgage portfolio is set out below:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| 95-100% | 0.4 | 0.4 |
| 90-95% | 0.4 | 0.5 |
| 85-90% | 1.3 | 0.7 |
| 80-85% | 0.2 | 1.7 |
| 75-80% | 11.0 | 12.1 |
| 70-75% | 48.2 | 34.8 |
| 60-70% | 164.4 | 153.2 |
| 50-60% | 201.0 | 211.9 |
| 0-50% | 278.4 | 285.5 |
| | **705.3** | **700.8** |
| Capital repayment | 472.6 | 568.4 |
| Interest only | 232.7 | 132.4 |
| | **705.3** | **700.8** |
| Average loan-to-value percentage | 52.45% | 51.74% |

¹ The above analysis excludes Property Development.

# Financial review continued

## Credit risk continued

***Property Development***

We use "loan-to-gross-development-value" as an indicator of the quality of credit security of performing loans for the Property Development portfolio. Loan-to-gross-development-value is a measure used to monitor the loan balance compared with the expected gross development value once the development is complete. Average loan-to-gross-development-value at origination for Property Development loans at 30 June 2017 was 60 percent (31 December 2016: 58 percent).

***Buy-to-Let***

Loan-to-value on indexed origination information on our Buy-to-Let Mortgage portfolio is set out below:

| | **30 June 2017 £m** | **31 December 2016 £m** |
|---|---|---|
| 100%+ | 0.4 | - |
| 95-100% | 0.3 | 0.4 |
| 90-95% | 5.3 | 9.6 |
| 85-90% | 14.4 | 14.8 |
| 80-85% | 95.1 | 136.5 |
| 75-80% | 587.8 | 461.4 |
| 70-75% | 786.0 | 561.2 |
| 60-70% | 1,147.5 | 984.3 |
| 50-60% | 701.9 | 669.6 |
| 0-50% | 488.4 | 488.2 |
| | **3,827.1** | **3,326.0** |
| Capital repayment | 267.9 | 251.1 |
| Interest only | 3,559.2 | 3,074.9 |
| | **3,827.1** | **3,326.0** |
| Average loan-to-value percentage | 64.18% | 63.21% |

# Financial review continued

## Credit risk continued

***Residential Mortgages***

Loan-to-value on indexed origination information on our Residential Mortgage portfolio is set out below:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| 100%+ | 0.2 | 0.2 |
| 95-100% | 10.6 | 17.2 |
| 90-95% | 150.3 | 139.9 |
| 85-90% | 160.3 | 178.4 |
| 80-85% | 158.6 | 170.4 |
| 75-80% | 147.2 | 166.1 |
| 70-75% | 171.5 | 172.8 |
| 60-70% | 265.8 | 251.4 |
| 50-60% | 178.0 | 168.4 |
| 0-50% | 235.6 | 229.1 |
| | **1,478.1** | **1,493.9** |
| Capital repayment | 1,300.7 | 1,303.1 |
| Interest only | 177.4 | 190.8 |
| | **1,478.1** | **1,493.9** |
| Average loan-to-value percentage | 68.79% | 69.48% |

Lending at higher LTV bandings continues to be largely as a result of the Group's participation in mortgage guarantee schemes. We participated in the Help to Buy ("HTB") mortgage guarantee scheme, which covered lending with an LTV over 85%, until the retirement of this scheme at the end of 2016. Following the cessation of the HTB scheme we have introduced the Mortgage Indemnity Guarantee ("MIG") product to cover all new lending over 80% LTV (excluding fees).

As at 30 June 2017, 98% of the exposures with an LTV in excess of 85% relate to either HTB (31 December 2016: 96%) or MIG. The average indexed LTV for mortgages with a guarantee was 87% (31 December 2016: HTB – 87%). As at June 2017, the average indexed LTV of the non-mortgage guarantee owner occupied book is 60% (31 December 2016: 61%).

***Invoice Finance***

In respect of Invoice Finance, collateral is provided by the underlying receivables (e.g. trade invoices). As at 30 June 2017, the average advance rate against the fair value of sales ledger balances which have been assigned to the Group, net of amounts considered to be irrecoverable, is 61.6% (31 December 2016: 62.3%).

In addition to the value of the underlying sales ledger balances, we will wherever possible, obtain additional collateral before offering invoice finance facilities to a client. These may include limited personal guarantees from major shareholders, charges over personal and other business property, cross guarantees from associated companies and unlimited warranties in the case of frauds or certain other breaches. These additional forms of security are impractical to value given their nature.

***Asset Finance***

In respect of Asset Finance, collateral is provided by our rights and/or title to the underlying assets which we are able to repossess in the event of default. Where appropriate, we will also obtain additional security such as parent company or personal guarantees.

# Financial review continued

## Credit risk continued

Asset Finance also undertakes a small volume of unsecured lending where we have obtained an understanding of the ability of the borrower's business to generate cash flows to service and repay the facilities provided. As at 30 June 2017, the total amount of such unsecured lending was £46.6 million (31 December 2016: £40.7 million).

**Group impairment coverage ratio**

Impairment coverage is as follows:

| Coverage ratio | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| Gross loans and advances | 8,135.6 | 7,504.7 |
| Of which individually impaired | 35.1 | 35.6 |
| Impaired as a % of gross loans and advances | 0.43% | 0.47% |
| Allowance for losses - individual provisions | 12.4 | 14.3 |
| **Coverage** | **35.3%** | **40.2%** |

The total value of individually impaired loans has decreased despite the growth in lending portfolios. This reflects both our controlled approach to credit risk management and the benign economic environment, resulting in a lower coverage ratio.

## Financial review continued

### Credit risk continued

**6. Information on credit risk within our treasury operations**

Credit risk exists where we have acquired securities or placed cash deposits with other financial institutions as part of our treasury portfolio of assets. We consider the credit risk of treasury assets to be relatively low. No assets are held for speculative purposes or actively traded. Certain liquid assets are held as part of our liquidity buffer.

**Credit quality of treasury assets**

The table below sets out information about the credit quality of treasury financial assets. As at 30 June 2017 and at 31 December 2016, none of the treasury assets were past due or impaired. The analysis presented below is derived using ratings provided by Standard and Poor's (see below disclaimer for further details) and Fitch. The worst rating from the credit agencies for each of the counterparties is used as the basis for assessing credit risk of treasury financial assets.

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| **Cash and balances at central banks and loans and advances to banks** | | |
| - Rated AAA | - | - |
| - Rated AA+ to AA- | 385.1 | 139.3 |
| - Rated A+ to A- | 21.8 | 35.6 |
| - Rated BBB+ | 55.9 | 8.7 |
| | **462.8** | **183.6** |
| **High quality liquid assets included in the liquidity buffer** | | |
| - Rated AAA | 480.0 | 430.9 |
| - Rated AA+ to AA- | 163.0 | 163.2 |
| - Rated A+ to A- | - | - |
| - Rated BBB+ | - | - |
| **Debt securities: Asset backed securities** | | |
| - Rated AAA | 69.7 | 70.4 |
| - Rated AA+ to AA- | - | - |
| - Rated A+ to A- | - | - |
| - Rated BBB+ | - | - |
| | **712.7** | **664.5** |
| **Derivatives held for risk management purposes** | | |
| - Rated AAA | - | - |
| - Rated AA+ to AA- | 4.3 | 2.6 |
| - Rated A+ to A- | 11.1 | 6.1 |
| - Rated BBB+ | 3.7 | 3.7 |
| - Rated BBB | - | - |
| | **19.1** | **12.4** |
| | **1,194.6** | **860.5** |

# Financial review continued

## Funding and Liquidity risk

Liquidity risk is the risk that we are not able to meet our financial obligations as they fall due, or can do so only at excessive cost.

To protect the Group and its depositors against liquidity risk, we maintain a liquidity buffer which is based on our liquidity needs under stressed conditions. The liquidity buffer is monitored on a daily basis to ensure there are sufficient liquid assets at all times to cover cash flow movements and fluctuations in funding, enabling us to meet all financial obligations and to support anticipated asset growth.

The components of the Group's liquidity buffer are shown below:

| | **30 June 2017 £m** | **31 December 2016 £m** |
|---|---|---|
| *Level 1* | | |
| Bank of England reserve account and unencumbered cash and bank balances | 358.5 | 118.4 |
| UK gilts and Treasury bills, other Sovereign, Supranational and Covered bonds | 603.1 | 554.0 |
| Treasury bills held under the FLS scheme | 204.8 | 294.8 |
| *Level 2* | | |
| Covered bonds | 36.5 | 36.8 |
| Asset backed securities | 69.7 | 70.4 |
| **Total liquidity buffer** | **1,272.6** | **1,074.4** |
| *As a % of funding liabilities* | *14.5%* | *13.5%* |

Our liquidity buffer ensures the Group holds sufficient liquidity under stressed conditions. We monitor stress and ongoing commitments to our statement of financial position on a daily basis. We also have access to liquidity through pre-positioned collateral with the Bank of England (until drawn, this remains off-balance sheet so is not included within the calculation).

## Interest rate and market risk

Interest rate risk is the risk of loss through mismatched asset and liability positions which are sensitive to changes in interest rates. Interest rate risk consists of asset-liability gap risk and basis risk.

### Asset-liability gap risk

Where possible, we seek to match the interest rate structure of assets with liabilities creating a natural hedge. Where this is not possible, we enter into interest rate swap transactions to convert the fixed rate exposures on loans and advances, customer deposits and available for sale securities into variable three month LIBOR liabilities.

Given timing differences and the price of hedging small gaps, it is not cost effective to have an absolute match of variable rate assets and liabilities. The risk exposure of the overall asset-liability interest rate profile is monitored against approved limits using changes in the economic value of the balance sheet as a result of a modelled 2 percentage point shift in the interest yield curve.

The impact of a 2 percentage point shift in the interest yield curve is as follows:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| 2% shift up of the yield curve: | | |
| As at period ended | (8.9) | (7.0) |
| Average of month end positions reported to ALCO | (6.4) | (3.7) |
| 2% shift down of the yield curve: | | |
| As at period ended | 3.6 | 1.8 |
| Average of month end positions reported to ALCO | 2.1 | 0.9 |

## Financial review continued

### Segmental analysis: Asset Finance

| | HY 2017 £m | HY 2016 £m | Movement % |
|---|---|---|---|
| Net interest income | 32.4 | 29.9 | *8* |
| Net fees and other income | 2.6 | 1.7 | *53* |
| **Operating income** | **35.0** | **31.6** | *11* |
| Administrative expenses | (6.6) | (6.3) | *(5)* |
| Impairment losses | (1.9) | (2.4) | *21* |
| **Segmental profit** | **26.5** | **22.9** | ***16*** |
| Origination | 583.3 | 509.3 | *15* |
| Gross interest yield (%) | 5.4 | 6.2 | *(0.8)pp* |
| Net interest margin (%) | 4.0 | 4.2 | *(0.2)pp* |
| Cost of risk (%) | 0.24 | 0.34 | *0.1pp* |
| | **30 Jun 2017 £m** | **31 Dec 2016 £m** | **Movement %** |
| Net loans to customers | 1,697.4 | 1,573.4 | 8 |

Asset Finance predominantly supports the growth of SMEs, providing financing for capital investment in business critical assets. Leveraging our depth and breadth of expertise, we finance a wide array of assets such as plant and machinery, commercial vehicles, technology, office equipment and cars. This flexibility enables us to meet the needs of customers of all sizes across key industries. In addition, we offer wholesale, receivables purchase and block discounting facilities to smaller finance companies and brokerages enabling them to extend credit directly to SMEs.

**Performance**

Net loans to customers were up £124m to £1.7bn, an increase of 8% driven by organic origination of £0.6bn, extending our Asset Finance franchise to c50,000 small UK businesses.

We maintain a leadership position in the competitive broker-introduced market, supporting a range of customer segments across a broad range of asset classes. We have also expanded our wholesale proposition, up 50% to £150m compared with the six months to June 2016, including a small number of large deals with target clients. Net interest income increased 8% to £32.4m driven by lending growth, with the NIM down slightly to 4.0%, driven by competitive dynamics and the increased use of our wholesale channel. Other income grew by 53% to £2.6m driven primarily by an increase in documentation fees.

Impairments were low at £1.9m (H1 2016: £2.4m), driving the cost of risk down by 10bps to 24bps, reflecting the high quality book backed by high-levels of tangible collateral. The overall segmental profit increased 16% to £26.5m (H1 2016: £22.9m).

**Outlook**

Asset Finance has made a strong start to the year, growing lending balances by 8% and progressing strategic initiatives to support medium term growth. We continue to maintain underwriting and return standards, despite competition from new entrants and consolidation activity among intermediaries.

Aldermore is well positioned to manage and capitalise on these competitive dynamics, as demonstrated by our agreed investment in AFS Group Holdings, and is expected to continue to generate robust new lending growth via both the broker and wholesale channels over the second half of the year.

# Financial review continued

## Segmental analysis: Invoice Finance

| | HY 2017 £m | HY 2016 £m | Movement % |
|---|---|---|---|
| Net interest income | 2.4 | 2.2 | *9* |
| Net fees and other income | 6.6 | 7.2 | *(8)* |
| **Operating income** | **9.0** | **9.4** | *(4)* |
| Administrative expenses | (4.7) | (5.3) | *11* |
| Impairment losses | (0.2) | (1.0) | *80* |
| **Segmental profit** | **4.1** | **3.1** | ***32*** |
| Origination | 23.8 | 18.9 | *26* |
| Net revenue margin (%) | 11.3 | 11.9 | *(0.6)pp* |
| Net interest margin (%) | 3.0 | 2.8 | *0.2pp* |
| Cost of risk (%) | 0.27 | 1.27 | *1.0pp* |

| | 30 Jun 2017 £m | 31 Dec 2016 £m | Movement % |
|---|---|---|---|
| Net loans to customers | 166.2 | 154.1 | 8 |

Invoice Finance helps the UK's SMEs to unlock working capital and vital cash flow for their businesses, providing facilities ranging from vanilla invoice discounting and full-service factoring to more bespoke structured products requiring Aldermore's in-house expertise.

**Performance**

Performance trends in Invoice Finance have shown continued momentum as a result of our strategy to consolidate and focus on larger discounting facilities to small businesses, demonstrated by a 32% increase in segmental profit.

Invoice Finance has a relatively short lifecycle compared to the Group's other portfolios, with strong growth in originations of 26% translating to net lending growth of 8% to £166.2m (2016: £154.1m). An 8% reduction in fee income to £6.6m reflects our continuing focus toward invoice discounting and structured finance and away from lower value and labour intensive factoring business, which has also contributed to a more than 10% reduction in administrative expenses.

Impairments have fallen by 80% to £0.2m, significantly reducing the cost of risk to 0.27%, down 1.0pp reflecting the improved credit profile of the portfolio.

**Outlook**

The refocused strategy in Invoice Finance continues to generate strategic and financial benefit, through a higher quality customer base and greater returns. Given the nature of the portfolio balances we anticipate modest growth over the second half of 2017 as new specialist proposition development, such as football finance, offsets the planned attrition from the factoring business.

## **Financial review** continued

### Segmental analysis: SME Commercial Mortgages

| | HY 2017 £m | HY 2016 £m | Movement % |
|---|---|---|---|
| Net interest income | 26.4 | 23.7 | *11* |
| Net fees and other income | 0.2 | 0.6 | *(67)* |
| Operating income | **26.6** | **24.3** | *10* |
| Administrative expenses | (1.4) | (1.8) | *22* |
| Impairment losses | (0.6) | (1.2) | *50* |
| **Segmental profit** | **24.6** | **21.3** | ***16*** |
| Origination | 150.3 | 209.9 | *(28)* |
| Gross interest yield (%) | 6.7 | 6.9 | *(0.2)pp* |
| Net interest margin (%) | 5.6 | 5.4 | *0.2pp* |
| Cost of risk (%) | 0.13 | 0.27 | *0.14pp* |
| | **30 Jun 2017 £m** | **31 Dec 2016 £m** | **Movement %** |
| Net loans to customers | 938.9 | 929.9 | 1 |

Our SME Commercial Mortgages business works with a panel of specialist intermediaries and direct with customers to provide mortgages for experienced property investors, small business owners and regional property developers. Our mortgages cover a variety of premises, including shops, warehouses, industrial units, residential developments and offices.

**Performance**

New lending reduced by 28% to £150m, whilst net loans to customers grew by just over 1% to £939m (2016: £930m), reflecting in part our decision to refine our risk appetite following the Brexit vote and the focus of operational capacity toward Buy-to-Let in response to the surge in customer demand.

The net interest margin expanded by 0.2% to 5.6% reflecting favourable funding conditions which, combined with growth of the portfolio, has driven an 10% increase in operating income to £26.6m (H1 2016: £24.3m).

Impairments over the first half of 2017 have reduced by 50% compared to the first half of 2016 to £0.6m, driving a reduction in the cost of risk of 0.14pp to 0.13%, reflecting a low level of specific charges and the increase in the emergence period to 12 months applied to collective provisioning during the first half of 2016. The book remains backed by high quality tangible collateral with loan-to-value, excluding Property Development, of 52% (2016: 52%). Our Property Development business had £234m of net loans outstanding at the year end, with a loan-to-gross-development-value at origination of 60%. In total, the segmental profit for SME Commercial Mortgages increased by 16% to £24.6m in the first half of 2017 (H1 2016: £21.3m).

**Outlook**

Our investment in our intermediary Centre of Excellence over the first half of the year has enhanced the service we provide to brokers and this should support the business in the second half of the year and beyond. Competition continues to intensify in SME Commercial Mortgages as new entrants seek to take market share. We will continue to adhere to our clear and controlled standards of underwriting and will remain focused on the delivery of sustainable risk-adjusted returns.

# Financial review continued

## Segmental analysis: Buy-to-Let Mortgages

| | HY 2017 £m | HY 2016 £m | Movement % |
|---|---|---|---|
| Net interest income | 56.4 | 40.9 | *37.9* |
| Net fees and other income | 1.9 | 2.3 | *(17.4)* |
| Operating income | **58.3** | **43.2** | *35.0* |
| Administrative expenses | (6.1) | (4.7) | *(29.8)* |
| Impairment losses | (2.0) | (0.9) | *(122.2)* |
| **Segmental profit** | **50.2** | **37.6** | ***33.5*** |
| Origination | 695.3 | 518.6 | *34.1* |
| Gross interest yield (%) | 4.5 | 4.9 | *(0.4)pp* |
| Net interest margin (%) | 3.2 | 3.2 | - |
| Cost of risk (%) | 0.10 | 0.07 | *(0.03)pp* |

| | 30 Jun 2017 £m | 31 Dec 2016 £m | Movement % |
|---|---|---|---|
| Net loans to customers | 3,827.1 | 3,326.0 | 15.1 |

Our Buy-to-Let ("BTL") business provides a holistic offering for the UK's private property investors, catering for both individual and corporate landlords, simple to complex properties, including Houses in Multiple Occupation and from single property investments to large professional portfolios.

**Performance**

Buy-to-Let had a very strong start to the year, growing net loans by 15% to £3.8bn, driven by organic origination of £0.7bn, up 34%. Growth was particularly strong over the first quarter, due to the spike in applications seen during the final quarter of 2016, as customers sought to secure mortgages ahead of PRA changes to affordability testing.

As previously communicated, Q2 2017 saw a lower level of originations due to the Group's initial conservative interpretation of new affordability tests. We have since revised our approach to balance prudent risk management with a competitive proposition, which has supported the return of applications to what is considered a more normal level.

This strong first half lending growth and broadly stable margin have driven a 38% increase in net interest income driving operating income up 35% to £58.3m, slightly offset by a £0.4m reduction in other income, due to fee discounts on new lending.

The £1.4m increase in administrative expenses is driven by growth to support new lending and an increased allocation of operational resources to support the strong loan growth delivered during the first half of the year.

Cost of risk has increased modestly to 0.10% but remains low with impairments of £2.0m (H1 2016: £0.9m). The quality of the book remains robust. The average loan balance in the portfolio is just £175k, with an indexed LTV of 64%. The segmental result demonstrates excellent progress, growing by over a third to £50.2m (H1 2016: £37.6m).

**Outlook**

As expected, the changes to personal tax relief and affordability testing have reduced the rate of growth in the overall buy-to-let market. However, the fundamentals supporting the market remain strong and are increasingly favouring specialist lenders like Aldermore who can continue to build on small market shares, capitalising on the anticipated professionalisation of investors in the market.

We outperformed the market over the first half of the year and are well positioned to continue to do so over the second half, as forthcoming changes to underwriting standards with regard to professional portfolio landlords are likely to favour the human approach adopted by specialist lenders.

# Financial review continued

## Segmental analysis: Residential Mortgages

| | HY 2017 £m | HY 2016 £m | Movement % |
|---|---|---|---|
| Net interest income | 24.5 | 22.8 | *7.5* |
| Net fees and other income | 0.8 | 0.9 | *(11.1)* |
| Operating income | **25.3** | **23.7** | *6.8* |
| Administrative expenses | (2.4) | (2.2) | *(9.1)* |
| Impairment losses | (0.9) | (0.9) | - |
| **Segmental profit** | **22.0** | **20.6** | *6.8* |
| Origination | 193.2 | 243.2 | *(20.6)* |
| Gross interest yield (%) | 4.7 | 5.4 | *(0.7)pp* |
| Net interest margin (%) | 3.3 | 3.1 | *0.2pp* |
| Cost of risk (%) | 0.12 | 0.12 | - |
| | **30 Jun 2017 £m** | **31 Dec 2016 £m** | **Movement %** |
| Net loans to customers | 1,478.1 | 1,493.9 | (1.1) |

Residential Mortgages serves creditworthy first-time buyers, the self-employed and professionals, who often fall outside the automated and inflexible lending criteria of some of the mainstream providers.

**Performance**

The Residential Mortgages portfolio reduced marginally over the first half of the year to £1.5bn (2016: £1.5bn), driven by a slower pace of origination and increased redemptions, in particular from a cohort of Help to Buy customers coming to the end of two-year fixed rates. Whilst overall originations declined, as operational focus was directed to Buy-to-Let, we have seen a strong uptake in our Mortgage Indemnity Guarantee ("MIG") product targeting customers with a deposit of less than 20%, which we introduced as a follow-on to the Government's Help to Buy scheme, which ended in 2016.

Stable lending balances and an expansion in the net interest margin by 20bps to 3.3% (H1 2016: 3.1%), helped support a 7% rise in operating income to £25.3m (H1 2016: £23.7m).

Impairments remained low at £0.9m (H1 2016: £0.9m), reflecting the relatively low levels of arrears and the continuation of the relatively benign credit environment. The overall segmental profit increased 7% to £22.0m (H1 2016: £20.6m).

**Outlook**

Residential Mortgages is expected to return to growth during the second half of 2017, supported by increased originations and ongoing activity to improve retention. Whilst competition for retail mortgages remains high, Aldermore has carved out core niches, including the self-employed and first time buyers. We also continue to look at options to develop into adjacent markets, such as lending in to retirement, which present additional levers for growth.

# Financial review continued

## Segmental analysis: Central Functions

| | HY 2017 £m | HY 2016 £m | Movement % |
|---|---|---|---|
| Net interest expense | (6.5) | (3.9) | *(66.7)* |
| Net fees and other income (expense) | 1.9 | (0.6) | *416.7* |
| Operating loss | **(4.6)** | **(4.5)** | *(2.2)* |
| Administrative expenses | (44.7) | (37.8) | *(18.3)* |
| Impairment of Invoice Finance goodwill | - | (4.1) | - |
| **Segmental loss** | **(49.3)** | **(46.4)** | *(6.3)* |

Central Functions includes the Group's Treasury function and Savings division as well as common costs which are not directly attributable to the operating segments. Common costs include central support function costs such as Finance, IT, Legal & Compliance, Risk and Human Resources.

**Performance**

Net interest income includes the interest expense relating to the Tier 2 notes and part of the income or expense arising from derivatives held at fair value in hedging relationships, neither of which are recharged to segments.

Net fees and other income predominantly includes the net expense or income from derivatives not currently recognised as being in hedging relationships and other financial instruments at fair value through profit or loss, and gains on disposals of available for sale debt securities.

Central administrative expenses increased by 18% to £44.7m (H1 2016: £37.8m), driven by the recruitment of colleagues over the second half of 2016 and at the start of 2017 as we invested to further support growth and risk management.

Goodwill of £4.1m arising on the acquisition of Absolute Invoice Finance (Holdings) Limited which was fully impaired in 2016.

The segmental result was a charge of £49.3m (H1 2016: charge of £46.4m).

**Savings and funding outlook**

Deposit pricing conditions have remained relatively stable over the first half of 2017, which is expected to continue into the second half. Deposit balances have grown strongly during the first half of the year, such that the loan to deposit ratio (110% end June 2017) is below our medium term guidance of 115 - 120%. We anticipate this increasing over the second half of the year as we continue to utilise the TFS to fund new lending.

# Risk report

## Principal risks

Effective risk management is a core component of the Group and is embedded throughout the organisation. The Board and senior management ensure that a strong risk culture is at the heart of everything we do, with risk appetite clearly defined and managed against. There has been no significant change to our business model or risk appetite, and our risk management framework has been enhanced during the six months to 30 June 2017. The following section summarises the principal risks and uncertainties that we inherently face, along with our approach to their mitigation.

| Principal risk | Mitigation |
|---|---|
| **Credit risk**<br>The risk that customers may be unable to make their loan repayments | • Continue to focus lending where we have specific expertise<br>• Limit concentration of lending by size, geography and sector<br>• Obtain appropriate level of security cover and perform affordability testing at origination<br>• Embed clear lending policies in each business area<br>• Regularly review performance against risk appetite<br>• Stress test the portfolio to test resilience |
| **Capital and liquidity risk**<br>The risk that we fail to hold sufficient or appropriate reserves to support growth, meet regulatory requirements, or repay obligations as they fall due | • Conduct stress testing on, and sensitivity analysis for both capital and liquidity<br>• Monitor capital adequacy position against internal targets and forecasts on a monthly basis<br>• Maintain an appropriate liquidity buffer based on stressed requirements<br>• Monitor the liquidity buffer on a daily basis<br>• Maintain and annually review the Contingency Funding Plan<br>• Conduct impact assessments of regulatory changes on an ongoing basis |
| **Market risk**<br>The risk that market movements adversely impact the Group | • Do not seek to take or expose the Group to market risk and do not carry out proprietary trading<br>• Match interest rate structures of assets and liabilities to create a natural hedge where possible<br>• Hedge unmatched interest rate exposures with derivative swap contracts |
| **Operational risk**<br>The risk of loss due to failure in processes, systems or human error, including outsourcing | • Embed and ensure all staff understand and follow the Operational Risk Management Framework<br>• Centrally analyse Risk Event Reporting and the Group's response to risk events<br>• Continue to invest in information security and cyber controls in line with our Cyber strategy<br>• Maintain our Third Party Supplier Framework which was implemented in 2017 |
| **Compliance, conduct and financial crime risk**<br>The risk of sanctions or financial loss as a result of a failure to comply with applicable laws, including anti money-laundering and the risk of causing unfair outcomes or detriment to customers | • Provide simple, straightforward and transparent products and operate solely in the UK market<br>• Embed and ensure all staff understand and follow clear policies, including Conduct Risk and Product Governance<br>• Continue to invest in staff training and supporting systems<br>• Perform horizon scanning and impact assessments to track regulatory change<br>• Unlike many other lenders, we do not have legacy conduct issues such as payment protection insurance litigation |
| **Reputational risk**<br>Failure to meet the expectations and standards of our customers, investors, regulators or other counterparties | • Ensure all governance committees have reputational risk considerations as a key part of their remit<br>• Maintain a dedicated team, Group Corporate Affairs, to monitor and help the business mitigate reputational risk under the executive direction of the Group CEO<br>• Ensure all employees remain aware of their responsibilities under the Bank's Reputational Risk Policy<br>• Maintain open and transparent relationships with regulators and other key stakeholder groups |

# Risk report continued

## Emerging risks

We define ‘emerging risks’ as those risks that may impact our future performance, compromise our existing strategy or threaten our business model. At this point, emerging risks include:

| Themes | Risk | What we are currently doing |
|---|---|---|
| **Regulatory Change/Intervention** | | |
| **Basel Committee on Banking Supervision (“BCBS”)** | In December 2015 the BCBS issued a second consultative document (Revisions to the Standardised Approach for Credit Risk) containing proposals to increase the capital requirements for certain asset classes including buy-to-let and commercial real estate lending. If these proposals were implemented as outlined, the capital requirements for these market segments would increase significantly and require the execution of management actions to mitigate their impact. | The IFRS 9 work on credit models takes us closer to the sophistication required for an IRB approach to capital, which may help mitigate the risk of future changes in capital requirements. We continue to assess a range of BCBS outcomes as part of our capital planning process and now anticipate final requirements by the end of 2017. |
| **IFRS 9** | New reporting requirements under IFRS 9 introduce forward-looking credit loss models which will lead to changes in the timing of impairment recognition. The risk is that the Group is unable to deliver full compliance before new regulation takes effect. | We are on track with enhancements required to support IFRS 9 and expect to be compliant with the new accounting standard for January 2018. We note regulators’ intention to phase-in the capital impact over several years. |
| **Buy-to-Let Mortgages**<br>**Tax changes and revised PRA underwriting standards** | The risk of an adverse impact on the buy-to-let market of changes to UK tax regime and failure to comply with regulatory expectations set out in the PRA Supervisory Statement on Buy-to-Let Underwriting Standards, issued in September 2016. | The buy-to-let market is changing following government and regulatory changes. Aldermore is responding to ensure it continues to provide appropriate products for our customers.<br>The second phase of changes to underwriting standards introduced by the regulator will be implemented by the 30 September 2017. |
| **General Data Protection Regulation** | New data protection regulation which strengthens and unifies data protection for all individuals within the European Union. It gives greater control to individuals on the use and processing of their personal data, with increased obligations on firms holding personal data. The risk is that the Group is unable to deliver the required change before the new regulation takes effect on 25 May 2018. | We have undertaken a gap assessment against the requirements and established a dedicated project to support compliance by May 2018. |
| **Payment Service Directive 2** | Introduction of strict security requirements for the initiation and processing of electronic payments and the protection of consumers' financial data across the EU. It will increase competition by making transaction data available to other service and payment providers. In addition to the regulatory and competition requirements, there is risk of a change in customer behaviour, which cannot be fully ascertained at this time. | Whilst Aldermore does not have accounts defined as ’payment accounts,’ we are awaiting further direction from the government to clarify regulatory expectations regarding the broader requirements.<br>We continue to observe the impact on competition and customer behaviour as the Directive is implemented. |

# Risk report continued

## Emerging risks continued

| Themes | Risk | What we are currently doing |
|---|---|---|
| **Economic and Political Environment** | | |
| **The UK's decision to leave the European Union** | Heightened economic and political risks following the UK's decision to leave the European Union. As a UK focused Group, we are protected from the more direct impacts of the Referendum such as access to European markets but we are exposed to the wider economic impacts. To date, we have seen no direct impact on either the lending or deposit sides of our business. | Uncertainty has increased following triggering of Article 50 and the outcome of the UK General Election. The Bank continues to monitor progress and will decide on any actions required as appropriate to our business model. |
| **International economic and political environment** | The geopolitical environment presents risks to global markets, including the impact of a new administration in the USA, modest growth in the EU and continued political risks in Russia and the Middle East. | There remains a possibility that material international events could adversely affect the UK economy and the sectors to which we lend. We manage these risks by maintaining a well-diversified product base and will continue to monitor developments. |
| **Exposure to real estate** | We have a substantial lending exposure to the residential, buy-to-let and commercial property sectors. Any property value falls, or an increase in unemployment, may lead to a rising number of defaults. | House price growth has slowed in the first half of the year and we remain vigilant to the potential impact on credit performance. Government and institutional guarantees continue to protect our higher loan-to-value residential mortgages. |
| **Interest rate environment** | The low interest rate environment, introduced to stimulate growth following the financial crisis, has persisted for longer than first expected. If interest rates are increased, unemployment may rise and loan servicing costs may increase which could cause an increase in credit losses. | We continue to monitor the external environment and will respond to any interest rate rises as appropriate. |
| **Competitive Environment** | | |
| **New entrants and increased competition** | The competitive landscape contains risks from new entrants, increased competition from incumbent lenders and disruptive products/software solutions potentially affecting both lending and deposit taking activities. The effect of this could result in lower volumes, higher customer attrition and/or lower net interest margins. | We continue to monitor the external environment and adapt accordingly. |
| **Technology Risk** | | |
| **Cyber-crime** | Cyber-crime is a significant threat in our increasingly interconnected world and exposes all businesses and in particular financial services companies to potential financial and reputational damage.<br><br>Cyber threats continue to evolve as demonstrated by high profile cases. Growth in the Group's customer base could increase its profile to potential cyber attackers. | This remains a key risk area and the Group continues to invest in security improvements in line with its Cyber Strategy. |
| **System failure / outsourcing** | The Group has a number of major outsource partners and critical supplier relationships which are key elements of the overall supply chain. The failure of one of these key partners could significantly impact the Group's customers, operations and reputation. | This is a continued focus during 2017 with the appointment of a new CIO and the enhancement of risk management practices to oversee the supplier estate. |

A more detailed review of principal and emerging risks is set out in the Risk Management section of the 2016 Annual Report on pages 33 to 35 and 106 to 139, which can be accessed via our Investor Relations website at www.investors.aldermore.co.uk.

# Financial statements

## Directors' responsibility statement

The Directors are responsible for preparing the interim financial report in accordance with applicable law and regulations.

We confirm that to the best of our knowledge:

- The condensed set of consolidated financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting, as required by DTR 4.2.4, as adopted by the European Union ("EU"); and
- The interim management report includes a fair review of the information required by:
  - DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the first half of the financial year and their impact on the condensed set of consolidated financial statements; and a description of the principal risks and uncertainties for the remaining half of the year; and
  - DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place in the first half of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

The Board of Directors, as listed below, represents those individuals responsible for these condensed consolidated interim financial statements.

Danuta Gray - Interim Chairman

Phillip Monks OBE – Chief Executive Officer

James Mack – Chief Financial Officer

Christine Palmer – Chief Risk Officer

John Hitchins

Chris Patrick

Robert Sharpe – resigned with effect 31 October 2017

Peter Shaw

Christopher Stamper

Cathy Turner

By order of the Board

**James Mack**

**Director and Chief Financial Officer**

9 August 2017

## Independent review report to Aldermore Group 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 30 June 2017 which comprises: the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated cash flow statement, the consolidated statement of changes in equity and related notes 1 to 23. 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 1, 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 enquiries, 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 30 June 2017 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**
Statutory Auditor
London
United Kingdom
9 August 2017

# Financial statements continued

## Consolidated income statement (unaudited)

**For the six month period ended 30 June 2017**

| | Note | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|---|
| Interest income | 4 | 192.0 | 175.6 |
| Interest expense | 5 | (56.4) | (60.0) |
| **Net interest income** | | **135.6** | **115.6** |
| | | | |
| Fee and commission income | 6 | 12.9 | 13.5 |
| Fee and commission expense | 7 | (3.8) | (3.8) |
| Net income/(expense) from derivatives and other financial instruments at fair value through profit or loss | 8 | 1.5 | (1.5) |
| Gains on disposal of available for sale debt securities | | 0.5 | 0.7 |
| Other operating income | 9 | 2.9 | 3.2 |
| **Total operating income** | | **149.6** | **127.7** |
| | | | |
| Provisions | | (1.0) | (1.3) |
| Impairment of goodwill | | - | (4.1) |
| Other administrative expenses | | (62.3) | (54.6) |
| Administrative expenses | 10 | **(63.3)** | **(60.0)** |
| Depreciation and amortisation | | (2.6) | (2.2) |
| **Operating profit before impairment losses** | | **83.7** | **65.5** |
| Impairment losses on loans and advances to customers | 13 | (5.6) | (6.4) |
| **Profit before taxation** | | **78.1** | **59.1** |
| Taxation | 11 | (20.3) | (16.9) |
| **Profit after taxation - attributable to equity holders of the Group** | | **57.8** | **42.2** |
| | | | |
| Basic earnings per share (pence) | 12 | 14.9p | 10.3p |
| Diluted earnings per share (pence) | 12 | 14.8p | 10.3p |

The notes and information on pages 43 to 60 form part of these financial statements.

The result for the period is derived entirely from continuing activities.

# Financial statements continued

## Consolidated statement of comprehensive income (unaudited)

**For the six month period ended 30 June 2017**

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| **Profit after taxation** | **57.8** | **42.2** |
| **Other comprehensive expense:** | | |
| *Items that may subsequently be transferred to the income statement:* | | |
| Available for sale debt securities: | | |
| Fair value movements | 0.4 | (1.0) |
| Amounts transferred to the income statement | (0.5) | (0.7) |
| Taxation | - | 0.4 |
| **Total other comprehensive expense** | **(0.1)** | **(1.3)** |
| **Total comprehensive income - attributable to equity holders of the Group** | **57.7** | **40.9** |

The notes and information on pages 43 to 60 form part of these financial statements.

# Financial statements continued

## Consolidated statement of financial position (unaudited)

**As at 30 June 2017**

| | Note | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | | 368.1 | 116.4 |
| Loans and advances to banks | | 94.7 | 67.2 |
| Debt securities | | 712.7 | 664.5 |
| Derivatives held for risk management | | 19.1 | 12.4 |
| Loans and advances to customers | 13 | 8,107.7 | 7,477.3 |
| Fair value adjustment for portfolio hedged risk | | (11.2) | (3.5) |
| Other assets | | 3.2 | 3.1 |
| Prepayments and accrued income | | 4.8 | 3.4 |
| Deferred taxation | 11 | 8.4 | 11.2 |
| Property, plant and equipment | | 3.6 | 3.1 |
| Intangible assets | | 28.3 | 26.1 |
| **Total assets** | | **9,339.4** | **8,381.2** |
| **Liabilities** | | | |
| Amounts due to banks | | 1,055.2 | 753.8 |
| Customers' accounts | 14 | 7,345.9 | 6,673.7 |
| Derivatives held for risk management | | 27.3 | 35.8 |
| Fair value adjustment for portfolio hedged risk | | (1.4) | (1.2) |
| Other liabilities | | 24.7 | 25.0 |
| Accruals and deferred income | | 24.6 | 27.0 |
| Current taxation | | 15.1 | 9.7 |
| Provisions | | 1.7 | 0.8 |
| Debt securities in issue | 15 | 107.1 | 130.6 |
| Subordinated notes | 16 | 60.4 | 100.0 |
| **Total liabilities** | | **8,660.6** | **7,755.2** |
| **Equity** | | | |
| Share capital | 17 | 34.5 | 34.5 |
| Share premium account | | 73.4 | 73.4 |
| Contingent convertible securities | | 74.0 | 74.0 |
| Capital redemption reserve | | 0.1 | 0.1 |
| Available for sale reserve | | 1.7 | 1.8 |
| Retained earnings | | 495.1 | 442.2 |
| **Total equity** | | **678.8** | **626.0** |
| **Total liabilities and equity** | | **9,339.4** | **8,381.2** |

The notes and information on pages 43 to 60 form part of these interim financial statements.

These financial statements were approved by the Board and were signed on its behalf by:

**Phillip Monks OBE**
**Director**
9 August 2017
Registered number: 06764335

**James Mack**
**Director**
9 August 2017

# Financial statements continued

## Consolidated statement of cash flows (unaudited)

**For the six month period ended 30 June 2017**

| | Note | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before taxation | | 78.1 | 59.1 |
| Adjustments for non-cash items and other adjustments included within the income statement | 19 | 8.4 | (4.7) |
| (Increase) in operating assets | 19 | (645.7) | (687.6) |
| Increase in operating liabilities | 19 | 963.0 | 738.4 |
| Income tax paid | | (9.8) | (12.6) |
| **Net cash flows generated from operating activities** | | **394.0** | **92.6** |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of debt securities | | (243.8) | (192.0) |
| Proceeds from sale and maturity of debt securities | | 176.5 | 55.5 |
| Capital repayments of debt securities | | 17.4 | 43.4 |
| Interest received on debt securities | | 4.1 | 7.6 |
| Purchase of property, plant and equipment and intangible assets | | (5.3) | (4.1) |
| **Net cash used in investing activities** | | **(51.1)** | **(89.6)** |
| | | | |
| **Cash flows from financing activities** | | | |
| Repayment of subordinated debt | | (40.0) | - |
| Capital repayments on debt securities issued | | (23.6) | (38.2) |
| Coupon paid on contingent convertible securities | | (8.9) | (8.9) |
| Purchase of own shares by employee benefit trust | | - | (0.9) |
| Interest paid on debt securities issued | | (0.6) | (1.1) |
| Interest paid on subordinated notes | | (5.1) | (2.6) |
| **Net cash used in financing activities** | | **(78.2)** | **(51.7)** |
| | | | |
| **Net increase/(decrease) in cash and cash equivalents** | | **264.7** | **(48.7)** |
| | | | |
| Cash and cash equivalents at start of the period | | 140.9 | 149.4 |
| Movement during the period | | 264.7 | (48.7) |
| **Cash and cash equivalents at end of the period** | **19** | **405.6** | **100.7** |

# Financial statements continued

## Consolidated statement of changes in equity (unaudited)

| | Share capital | Share premium account | Contingent convertible securities | Capital redemption reserve | Available for sale reserve | Retained earnings | Total |
|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m |
| **Period ended 30 June 2017** | | | | | | | |
| **As at 1 January 2017** | 34.5 | 73.4 | 74.0 | 0.1 | 1.8 | 442.2 | 626.0 |
| Total comprehensive income | - | - | - | - | (0.1) | 57.8 | 57.7 |
| Transactions with equity holders: | | | | | | | |
| - Share-based payments, including tax reflected directly in retained earnings | - | - | - | - | - | 1.7 | 1.7 |
| - Coupon paid on contingent convertible securities, net of tax | - | - | - | - | - | (6.6) | (6.6) |
| **As at 30 June 2017** | **34.5** | **73.4** | **74.0** | **0.1** | **1.7** | **495.1** | **678.8** |
| **Period ended 31 December 2016** | | | | | | | |
| **As at 1 July 2016** | 34.5 | 73.4 | 74.0 | 0.1 | (2.3) | 388.9 | 568.6 |
| Total comprehensive income | - | - | - | - | 4.1 | 51.3 | 55.4 |
| Transactions with equity holders: | | | | | | | |
| - Share-based payments, including tax reflected directly in retained earnings | - | - | - | - | - | 2.0 | 2.0 |
| **As at 31 December 2016** | **34.5** | **73.4** | **74.0** | **0.1** | **1.8** | **442.2** | **626.0** |
| **Period ended 30 June 2016** | | | | | | | |
| **As at 1 January 2016** | 34.5 | 73.4 | 74.0 | 0.1 | (1.0) | 352.6 | 533.6 |
| Total comprehensive income | - | - | - | - | (1.3) | 42.2 | 40.9 |
| Transactions with equity holders: | | | | | | | |
| - Share-based payments, including tax reflected directly in retained earnings | - | - | - | - | - | 1.6 | 1.6 |
| - Own shares adjustment | - | - | - | - | - | (0.9) | (0.9) |
| - Coupon paid on contingent convertible securities, net of tax | - | - | - | - | - | (6.6) | (6.6) |
| **As at 30 June 2016** | **34.5** | **73.4** | **74.0** | **0.1** | **(2.3)** | **388.9** | **568.6** |

## Notes to the consolidated financial statements

### 1. Basis of preparation

*a) Accounting basis*

These consolidated interim financial statements have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with IAS 34 "*Interim Financial Reporting"* as adopted by the EU. These consolidated interim financial statements should be read in conjunction with the Group's 2016 Annual Report and Accounts, which have been prepared in accordance with International Financial Reporting Standards as adopted by the EU ("IFRSs").

The comparative financial information for the year ended 31 December 2016 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that period have been delivered to the Registrar of Companies in England and Wales. The former auditor has reported on those accounts. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The consolidated interim financial statements were approved by the Board of Directors on 9 August 2017.

*b) Basis of consolidation*

The consolidated interim financial statements incorporate the consolidated results of Aldermore Group PLC ("the Company") and its subsidiaries (including Aldermore Bank PLC) which are entities controlled by the Company (jointly referred to as "the Group").

*c) Going concern*

The consolidated interim financial statements are prepared on a going concern basis, as the Directors are satisfied that the Group has the resources to continue in business for the foreseeable future (which has been taken as 12 months from the date of approval of these consolidated interim financial statements). In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including the current state of the balance sheet, future projections of profitability, cash flows and capital resources and the longer term strategy of the business.

The Group's capital and liquidity plans, including stress tests, have been reviewed by the Directors. The Group's forecasts and projections show that it will be able to operate at adequate levels of both liquidity and capital for the foreseeable future, including a range of stressed scenarios, taking management actions into account as appropriate. After making due enquiries, the Directors believe that the Group has sufficient resources to continue its activities for the foreseeable future and to continue its expansion, and the Group has sufficient capital and liquidity to enable it to continue to meet its regulatory requirements as set out by the Prudential Regulation Authority ("PRA").

*d) Accounting policies*

The accounting policies are consistent with those applied by the Group in the 2016 Annual Report and Accounts. There have been no changes to these policies during the six month period ended 30 June 2017.

*e) Future accounting developments*

There are a number of standards, amendments and interpretations which have been issued by the International Accounting Standards Board ("IASB") but which have not yet been endorsed by the EU. The most significant of these is IFRS 9: "*Financial Instruments"*, the planned replacement for IAS 39: "*Financial Instruments: Recognition and Measurement"*. Others include IFRS 15: "*Revenue from contracts with customers"* and IFRS 16: "*Leases"*.

## Notes to the consolidated financial statements continued

**1. Basis of preparation** continued

**IFRS 9: "*Financial Instruments*"**, endorsed by the EU on 22 November 2016, is effective for annual periods beginning on or after 1 January 2018. The standard includes requirements for classification and measurement of financial assets and liabilities, hedge accounting and the impairment of financial assets. There is a requirement to apply the standard retrospectively. However, no prior period restatement is necessary. An adjustment will be reflected in opening retained earnings at the start of the period when IFRS 9 is first adopted.

The Group's IFRS 9 programme continues with its cross-functional representation from (but not limited to) Finance, Risk and IT. Progress is regularly reported to the IFRS 9 Steering Group and the Audit Committee and the programme continues to be sponsored by the Chief Financial Officer, Chief Risk Officer and Chief Operating Officer.

We are making good progress towards IFRS 9 compliance, with the expected credit loss models built and parallel run started. Additionally, the target operating model has been defined and the majority of the updated accounting and credit risk policies have been drafted and are progressing through the appropriate governance forums.

The financial impact of IFRS 9 will be quantified during the parallel run and is expected to be disclosed no later than in the financial statements for the year ending 31 December 2017. Further information detailing the effect of IFRS 9 can be found in the 2016 Annual Report and Accounts.

**IFRS 15: "*Revenue from contracts with customers*"** provides a principles-based approach for applying the concept of recognising revenue for performance obligations as they are satisfied. The Standard was endorsed on 29 October 2016 and will be effective for annual reporting periods beginning on or after 1 January 2018 and will impact our treatment of fees and commissions and other operating income. We have completed a review of the fees and commissions within the Invoice Finance and Asset Finance businesses, where the majority of the impact is expected to be, and are extending the review to include our Mortgage businesses. Once the review is complete, we will be able to assess the impact. However, it is currently thought to be immaterial.

**IFRS 16: "*Leases*"** was released by the IASB on 13 January 2016 as a replacement for IAS 17: "*Leases*". The Standard will be effective for annual reporting periods beginning on or after 1 January 2019, with early application being permitted for companies that also apply IFRS 15. The impact for the Group is currently being assessed. A significant change will be the inclusion of a "right of use asset" within the statement of financial position in respect of the benefit the Group receives where it leases assets under operating leases, together with a financial liability in respect of the obligation to make operating lease payments. Within the income statement, an operating charge will be reflected in respect of the use of the asset together with interest expense in relation to the financing, replacing the current operating lease charges included in administrative expenses.

*f) Presentation of risk and capital disclosures*

The disclosures prepared under IFRS 7: "*Financial instruments: disclosures"* have been included within the Risk section in the Financial Review on the following pages: wholesale funding note on page 7 and credit risk, liquidity and funding and interest rate and market risk notes pages 11-26. The Principal and Emerging risks are described in the Risk report on pages 33-35.

## Financial statements continued

### Notes to the consolidated financial statements continued

**2. Use of estimates and judgements**

The preparation of financial information requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The judgements and assumptions that are considered to be the most important to the portrayal of the Group's financial condition are those relating to loan impairment provisions and effective interest rates ("EIR"). Share-based payments have been previously considered a key judgement. However, the estimates and assumptions are well understood and we no longer consider them to be critical as there is no significant risk of any changes resulting in a material adjustment during the next year.

***a) Loan impairment provisions***

Loan portfolios across all divisions of the Group are reviewed on at least a monthly basis to assess for impairment. In determining whether an impairment provision should be recorded, judgements are made as to whether there is objective evidence that a financial asset, or portfolio of financial assets, is impaired as a result of loss events that occurred after recognition of the asset and by the reporting date. The calculation of impairment loss is management's best estimate of losses incurred in the portfolio at the statement of financial position date and reflects expected future cash flows based on both the likelihood of a loan or advance being written-off and the estimated loss on such a write-off.

At 30 June 2017, gross loans and advances to customers totalled £8,135.6 million (31 December 2016: £7,504.7 million), against which impairment allowances of £27.9 million (31 December 2016: £27.4 million) have been made (see Note 13). The Group's accounting policy for loan impairment provisions on financial assets classified as loans and receivables is described in the Group's 2016 Annual Report and Accounts (Note 2g). Impairment allowances are made up of two components, those determined individually against specific assets and those determined collectively. Of the impairment allowance of £27.9 million at 30 June 2017, £12.4 million (31 December 2016: £14.3 million) relates to individual provisions and £15.5 million (31 December 2016: £13.1 million) relates to collective provisions. The section below provides details of the critical elements of judgement within the loan impairment calculations. Less significant judgements are not disclosed.

(i) Individual

Individual impairment allowances are established against the Group's individual financial assets that are judged by management to be impaired. The determination of individual impairment allowances requires management to make significant estimates and assumptions involving matters such as local economic conditions, the financial status of the customer and the realisable value of the security held. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances. Consequently, these allowances can be subject to variation as time progresses and when the circumstances of the customer and the valuation of realisable collateral become clearer.

(ii) Collective

The collective impairment allowance is also subject to estimation uncertainty and, in particular, is sensitive to changes in economic and credit conditions including house prices, unemployment rates, interest rates, borrowers' behaviour and consumer bankruptcy trends. All of these factors can influence the key assumptions detailed below. However, it is inherently difficult to make a judgement on how changes in one or more of these factors might impact the collective impairment allowance.

## Notes to the consolidated financial statements continued

**2. Use of estimates and judgements** continued

The key assumptions used in the collective impairment model are: Probability of Default ("PD"), the Loss Given Default ("LGD") and the loss Emergence Period ("EP") (the time between a trigger event occurring and identifying the loans as individually impaired). An additional element is included within the collective provision to reflect fraud losses that are incurred as at the reporting date but are yet to be individually identified.

The Group uses two types of underlying models to calculate the LGD depending on the availability of default data. For SME Commercial Mortgages, Buy-to-Let and Residential Mortgages, the models use a range of assumptions and estimates to derive an expected LGD. The key assumptions and estimates are based on management expertise and are validated against available data. For Asset Finance and Invoice Finance, the models are empirical models which use historical loss data to determine the risk drivers behind the loss.

This allows the portfolios to be segmented into homogenous buckets to derive an LGD. Further details in respect of assumptions and details of the sensitivity of the estimate to changes in significant assumptions are as follows:

*Probability of Default:*

The PD estimate is based on external individual customer credit rating information updated for each reporting date. This external credit rating information gives a PD in the next 12 months where 'default' is defined as loans which are 2 months or more in arrears ("2 MIA") and incorporates credit information from a broad range of financial services products for each customer.

Management make an estimate so as to adjust the external data to reflect both the individual nature of the Group's lending and the Group's policy of classifying loans which are 3 months or more in arrears ("3 MIA") as 'impaired'. This adjustment is achieved by using two management assumptions: firstly a 'conversion rate' that reflects how many of the loans which fall into 2 MIA will also fall into 3 MIA; and secondly, a scalar that adjusts the external PDs to reflect the individual nature of the Group's lending.

- A 10 per cent. absolute increase in the 'conversion rate' assumed by management between 2 MIA and 3 MIA (e.g. a PD increasing from 50 per cent. to 60 per cent.), when the loans are considered to be individually impaired would increase the impairment allowance by £0.3 million.
- A 10 per cent. relative reduction in the scaling factors applied to external data in order to arrive at PDs appropriate to the individual nature of lending being undertaken would increase the impairment allowance by £0.6 million.

*Loss Given Default:*

The model estimates the LGD from the point of repossession of the asset. Not all cases that are 3 MIA will reach repossession. Management therefore adjust the model by applying their estimate of the percentage of accounts 3 MIA that will reach repossession.

- A 10 per cent. absolute reduction in this assumption would decrease the impairment allowance by £1.1 million.

The LGD is also sensitive to the application of the House Price Index ("HPI") and Forced Sale Discount ("FSD") future estimates which affect the underlying value of the collateral which is expected to be received.

- A 10 per cent. relative reduction in the HPI would increase the overall impairment allowance by £2.1 million.
- A 5 per cent. absolute increase in the FSD would increase the overall impairment provision by £1.5 million.

## **Notes to the consolidated financial statements** continued

**2. Use of estimates and judgements** continued

For the Asset Finance and Invoice Finance model, the most sensitive estimate is the absolute LGD value calculated.

- A 10 per cent. relative increase in the LGDs applied would increase the impairment allowance by £0.4 million.

*Emergence Period:*

The Group's collective models estimate the expected losses for the next 12 months. For Asset Finance and Invoice Finance these expected losses are then scaled back, using the emergence period, to reflect the level of incurred loss as at the reporting date. The emergence period is the time taken from the trigger event (such as a job loss) to the Group identifying the loan as impaired.

The emergence period varies by segment and requires management to make judgements due to the limited data available.

- A further three month increase in emergence periods for Asset Finance and Invoice Finance would increase the impairment allowance by £5.0 million.

***b) Effective interest rate ("EIR")***

IAS 39 requires interest earned to be measured under the EIR method. Management must therefore make estimates about the expected future life of each type of instrument and hence the expected related cash flows. The accuracy of the EIR would therefore be affected by unexpected market movements resulting in altered customer behaviour and inaccuracies in the models used compared to actual outcomes.

A critical estimate in determining EIR is the expected life to maturity of the Group's SME Commercial, Buy-to-Let and Residential Mortgage portfolios, as a change in these estimates will impact the period over which the directly attributable costs and fees, reversionary income and any discount received on the acquisition of mortgage portfolios are recognised as part of the EIR.

A review of the critical estimates for determining EIR was undertaken at 30 June 2017. No overall adjustment was considered necessary in these financial statements as a result of the review.

A change in the estimated expected lives to extend the expected lives of the SME Commercial, Buy-to-Let and Residential Mortgage portfolios by six months would have the effect of reducing the cumulative profit before tax recognised as at 30 June 2017 by £1.1 million (30 June 2016: £1.8 million reduction). Included within this sensitivity of £1.1 million, is a £2.5 million cumulative reduction in profit relating to acquired portfolios (30 June 2016: £2.9 million reduction) due to a change in the unwind of the discount which is partially offset by a £1.4 million cumulative increase in profit relating to the organic portfolios (30 June 2016: £1.1 million increase).

A 0.5 per cent. increase in the rate of early redemptions, expressed as a percentage of the outstanding balance, in respect of the Asset Finance portfolio would have the impact of reducing cumulative profit before tax recognised as at 30 June 2017 by £0.5 million (30 June 2016: £0.4 million reduction).

## Financial statements continued

### Notes to the consolidated financial statements continued

**3. Segmental information**

The Group's reportable operating segments remain consistent with those disclosed in the 2016 Annual Report and Accounts.

**Segmental information for the period ended 30 June 2017**

| | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages £m | Buy-to-Let £m | Residential Mortgages £m | Central Functions £m | Total £m |
|---|---|---|---|---|---|---|---|
| Interest income – external customers | 44.4 | 3.2 | 31.1 | 80.5 | 34.6 | (1.8) | 192.0 |
| Interest expense – external customers | - | - | - | - | - | (56.4) | (56.4) |
| Interest (expense)/income – internal | (12.0) | (0.8) | (4.7) | (24.1) | (10.1) | 51.7 | - |
| Net fees and other income – external customers | 2.6 | 6.6 | 0.2 | 1.9 | 0.8 | 1.9 | 14.0 |
| **Total operating income** | **35.0** | **9.0** | **26.6** | **58.3** | **25.3** | **(4.6)** | **149.6** |
| Administrative expenses including depreciation and amortisation | (6.6) | (4.7) | (1.4) | (6.1) | (2.4) | (44.7) | (65.9) |
| Impairment losses on loans and advances to customers | (1.9) | (0.2) | (0.6) | (2.0) | (0.9) | - | (5.6) |
| **Segmental result** | **26.5** | **4.1** | **24.6** | **50.2** | **22.0** | **(49.3)** | **78.1** |
| Tax | | | | | | | (20.3) |
| **Profit after tax** | | | | | | | **57.8** |
| Assets | 1,697.4 | 166.2 | 938.9 | 3,827.1 | 1,478.1 | 1,231.7 | 9,339.4 |
| Liabilities | - | - | - | - | - | (8,660.6) | (8,660.6) |
| **Net assets/(liabilities)** | **1,697.4** | **166.2** | **938.9** | **3,827.1** | **1,478.1** | **(7,428.9)** | **678.8** |

**Segmental information for the period ended 30 June 2016**

| | Asset Finance £m | Invoice Finance £m | SME Commercial Mortgages £m | Buy-to-Let £m | Residential Mortgages £m | Central Functions[1] £m | Total £m |
|---|---|---|---|---|---|---|---|
| Interest income – external customers | 44.2 | 3.4 | 30.4 | 63.3 | 36.6 | (2.3) | 175.6 |
| Interest expense – external customers | - | - | - | - | - | (60.0) | (60.0) |
| Interest (expense)/income – internal | (14.3) | (1.2) | (6.7) | (22.4) | (13.8) | 58.4 | - |
| Net fees and other income – external customers | 1.7 | 7.2 | 0.6 | 2.3 | 0.9 | (0.6) | 12.1 |
| **Total operating income** | **31.6** | **9.4** | **24.3** | **43.2** | **23.7** | **(4.5)** | **127.7** |
| Administrative expenses including depreciation and amortisation | (6.3) | (5.3) | (1.8) | (4.7) | (2.2) | (41.9) | (62.2) |
| Impairment losses on loans and advances to customers | (2.4) | (1.0) | (1.2) | (0.9) | (0.9) | - | (6.4) |
| **Segmental result** | **22.9** | **3.1** | **21.3** | **37.6** | **20.6** | **(46.4)** | **59.1** |
| Tax | | | | | | | (16.9) |
| **Profit after tax** | | | | | | | **42.2** |
| Assets | 1,498.2 | 155.3 | 926.0 | 2,704.0 | 1,515.7 | 946.5 | 7,745.7 |
| Liabilities | - | - | - | - | - | (7,177.1) | (7,177.1) |
| **Net assets/(liabilities)** | **1,498.2** | **155.3** | **926.0** | **2,704.0** | **1,515.7** | **(6,230.6)** | **568.6** |

[1] Central Functions administrative expenses of £41.9 million includes an impairment charge of £4.1 million in relation to Invoice Finance goodwill.

# Financial statements continued

## Notes to the consolidated financial statements continued

**4. Interest income**

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| **On financial assets not at fair value through profit or loss:** | | |
| On loans and advances to customers | 193.7 | 177.9 |
| On loans and advances to banks | 0.3 | 0.5 |
| On debt securities | 4.8 | 5.9 |
| | **198.8** | **184.3** |
| **On financial assets at fair value through profit or loss:** | | |
| Net interest expense on financial instruments hedging assets | (6.8) | (8.7) |
| | **192.0** | **175.6** |

Included within interest income on loans and advances to customers for the six months ended 30 June 2017 is a total of £2.0 million (30 June 2016: £1.5 million) relating to impaired financial advances.

Included within net interest expense on financial instruments hedging assets for the six months ended 30 June 2017 are fair value gains of £8.0 million (30 June 2016: losses of £10.8 million) on derivatives held in qualifying fair value hedging arrangements, together with losses of £7.7 million (30 June 2016: gains of £8.9 million) representing changes in the fair value of the hedged item attributable to the hedged interest rate risk on loans and advances to customers, and net interest payable on the hedging of derivatives of £7.1 million (30 June 2016: £6.8 million).

**5. Interest expense**

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| **On financial liabilities not at fair value through profit or loss:** | | |
| On customers' accounts | 48.7 | 54.6 |
| On amounts due to banks | 1.2 | 3.9 |
| On debt securities in issue | 0.8 | 1.3 |
| On subordinated notes | 5.5 | 3.3 |
| | **56.2** | **63.1** |
| **On financial liabilities at fair value through profit or loss:** | | |
| Net interest income on financial instruments hedging liabilities | (0.3) | (4.0) |
| Other | 0.5 | 0.9 |
| | **56.4** | **60.0** |

Included within net interest income on financial instruments hedging liabilities for the six months ended 30 June 2017 are fair value losses of £1.2 million (30 June 2016: gains of £4.7 million) on derivatives held in qualifying fair value hedging arrangements, together with gains of £0.2 million (30 June 2016: losses of £3.7 million) representing changes in the fair value of the hedged item attributable to the hedged interest rate risk on customers' accounts, and net interest receivable on the hedging of derivatives of £1.3 million (30 June 2016: £3.0 million).

## **Notes to the consolidated financial statements** continued

### 6. Fee and commission income

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Invoice finance fees | 5.6 | 5.9 |
| Valuation fees | 1.7 | 2.4 |
| Documentation fees | 1.5 | 1.3 |
| Other fees | 4.1 | 3.9 |
| | **12.9** | **13.5** |

### 7. Fee and commission expense

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Introducer commissions | 0.7 | 0.8 |
| Legal and valuation fees | 1.6 | 1.5 |
| Company searches and other fees | 0.8 | 0.5 |
| Credit protection and insurance charges | 0.7 | 0.6 |
| Other | - | 0.4 |
| | **3.8** | **3.8** |

### 8. Net income/(expense) from derivatives and other financial instruments at fair value through profit or loss

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Net gains/(losses) on derivatives | 4.1 | (14.4) |
| Net (losses)/gains on available for sale assets held in fair value hedges | (2.6) | 12.9 |
| | **1.5** | **(1.5)** |

### 9. Other operating income

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Disbursements, collect out and other invoice finance income | 2.9 | 3.1 |
| Other | - | 0.1 |
| | **2.9** | **3.2** |

## Notes to the consolidated financial statements continued

### 10. Administrative expenses

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Staff costs | 38.1 | 35.2 |
| Legal and professional and other services | 11.2 | 10.5 |
| Information technology costs | 8.7 | 5.2 |
| Office costs | 2.6 | 2.2 |
| Provisions | 1.0 | 1.3 |
| Other | 1.7 | 1.5 |
| Impairment of goodwill | - | 4.1 |
| | **63.3** | **60.0** |

Included within Staff costs there are expenses relating to permanent staff and contractors, travel and subsistence and staff recruitment which were previously reported within other costs.

During the first half of 2016, the Invoice Finance goodwill was fully impaired and an impairment charge of £4.1 million was recognised in the income statement.

### 11. Taxation

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Current tax on profits for the period | 17.4 | 12.0 |
| Prior year adjustment | - | 4.1 |
| **Overall current tax on profits for the period** | **17.4** | **16.1** |
| Deferred tax | 2.9 | 0.8 |
| **Total tax charge** | **20.3** | **16.9** |

Current tax on profits reflects UK corporation tax levied at a rate of 19.25% for the year ending 31 December 2017 (year ended 31 December 2016: 20.00%) and the Banking surcharge levied at a rate of 8% on the profits of banking companies chargeable to corporation tax after an allowance of £25 million per annum.

The deferred tax asset at 30 June 2017 of £8.4 million has been calculated at an overall rate of 25.75%. This is based on substantively enacted tax rates at the statement of financial position date. These are expected to apply when the temporary differences giving rise to the deferred tax are expected to reverse. The deferred tax assets relate largely to temporary differences between capital allowances and depreciation.

There were no unrecognised deferred tax balances at 30 June 2017 (30 June 2016: £nil).

## Notes to the consolidated financial statements continued

### 12. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to ordinary shareholders of the Group by the weighted average number of ordinary shares in issue during the period.

| | Period ended 30 June 2017 | Period ended 30 June 2016 |
|---|---|---|
| Profit after taxation - attributable to equity holders of the Group (£million) | 57.8 | 42.2 |
| Coupon paid on contingent convertible securities, net of tax (£million) | (6.6) | (6.6) |
| Profit attributable to ordinary shareholders of the Group (£million) | 51.2 | 35.6 |
| Weighted average number of ordinary shares in issue (million) | 344.5 | 344.7 |
| Basic earnings per share (p) | 14.9p | 10.3p |

The ordinary shares in issue used in the denominator in the calculation of basic earnings per share are the ordinary shares of the Company.

| | Period ended 30 June 2017 | Period ended 30 June 2016 |
|---|---|---|
| Weighted average number of ordinary shares in issue (million) (basic) | 344.5 | 344.7 |
| Effect of share based payment awards | 1.8 | 0.4 |
| Weighted average number of ordinary shares in issue (million) (diluted) | 346.3 | 345.1 |
| Diluted earnings per share (p) | 14.8p | 10.3p |

The calculation of diluted earnings per share has been based on the same profit attributable to ordinary shareholders of the Group as for basic earnings and the weighted average number of ordinary shares outstanding after the potential dilutive effect of share based payment awards to Directors and employees.

### 13. Loans and advances to customers

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| Gross loans and advances | 8,135.6 | 7,504.7 |
| less: allowance for impairment losses | (27.9) | (27.4) |
| | **8,107.7** | **7,477.3** |
| **Amounts include:** | | |
| Expected to be recovered more than 12 months after the reporting date | 6,990.9 | 6,466.4 |

During 2017, the Group took advantage of the HM Treasury Indexed Long Term Repo scheme. The accounting for this scheme follows that described in the Group 2016 Annual Report and Accounts Note 2(d) Term Funding Scheme.

At 30 June 2017, loans and advances to customers of £650.7 million (31 December 2016: £1,066.2 million) were pre-positioned with the Bank of England for use with HM Treasury Funding for Lending Scheme and the Indexed Long Term Repo scheme. These loans and advances were available for use as collateral within the Schemes, against which at the reporting date, £204.8 million of UK Treasury Bills drawn under the Funding for Lending Scheme (31 December 2016: £650.0 million) with £100.0 million (31 December 2016: nil) drawn against the Indexed Long Term Repo scheme.

At 30 June 2017, loans and advances to customers of £1,544.3 million (31 December 2016: £578.7 million) were pre-positioned with the Bank of England and HM Treasury Term Funding Scheme. These loans and advances were available for use as collateral with the Scheme against which £946.5 million (31 December 2016: £396.1 million) had been drawn at the reporting date.

## Notes to the consolidated financial statements continued

### 13. Loans and advances to customers continued

At 30 June 2017, loans and advances to customers include £130.5 million (31 December 2016: £148.7 million) which have been used in secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Oak No. 1 PLC, a securitisation vehicle consolidated into these financial statements. All the assets pledged are recognised within the statement of financial position as the Group retains substantially all the risks and rewards relating to the loans.

*Allowance for impairment losses*

| | Individual £m | Collective £m | Total £m |
|---|---|---|---|
| **Six months ended 30 June 2017** | | | |
| Balance as at 1 January 2017 | 14.3 | 13.1 | 27.4 |
| *Impairment loss for the period:* | | | |
| Charge to the income statement | 1.9 | 3.7 | 5.6 |
| Unwind of discounting | (0.7) | (1.3) | (2.0) |
| Write-offs net of recoveries | (3.1) | - | (3.1) |
| **Balance as at 30 June 2017** | **12.4** | **15.5** | **27.9** |

| | Individual £m | Collective £m | Total £m |
|---|---|---|---|
| **Six months ended 31 December 2016** | | | |
| Balance as at 1 July 2016 | 10.6 | 12.5 | 23.1 |
| *Impairment loss for the period:* | | | |
| Charge to the income statement | 7.3 | 1.8 | 9.1 |
| Unwind of discounting | (0.7) | (1.2) | (1.9) |
| Write-offs net of recoveries | (2.9) | - | (2.9) |
| **Balance as at 31 December 2016** | **14.3** | **13.1** | **27.4** |

| | Individual £m | Collective £m | Total £m |
|---|---|---|---|
| **Six months ended 30 June 2016** | | | |
| Balance as at 1 January 2016 | 10.2 | 10.5 | 20.7 |
| *Impairment loss for the period:* | | | |
| Charge to the income statement | 3.5 | 2.9 | 6.4 |
| Unwind of discounting | (0.6) | (0.9) | (1.5) |
| Write-offs net of recoveries | (2.5) | - | (2.5) |
| **Balance as at 30 June 2016** | **10.6** | **12.5** | **23.1** |

### 14. Customers' accounts

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| Retail deposits | 5,116.5 | 4,766.8 |
| SME deposits | 1,825.9 | 1,647.2 |
| Corporate deposits | 403.5 | 259.7 |
| | **7,345.9** | **6,673.7** |
| | | |
| Amounts repayable within one year | 5,930.6 | 5,397.1 |
| Amounts repayable after one year | 1,415.3 | 1,276.6 |
| | **7,345.9** | **6,673.7** |

## Notes to the consolidated financial statements continued

### 15. Debt securities in issue

Debt securities in issue are repayable from the reporting date in the ordinary course of business as follows:

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| In more than one year | 107.1 | 130.6 |

Debt securities in issue with a principal value of £107.6 million (31 December 2016: £131.2 million) are secured on certain portfolios of variable and fixed rate mortgages through the Group's securitisation vehicle, Oak No. 1 PLC. These notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgage customers in respect of the underlying assets. There is no obligation for the Group to make good any shortfall. The carrying value relating to the underlying assets are contained in Note 13.

### 16. Subordinated notes

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| **Subordinated notes** | 60.4 | 100.0 |

In May 2017, the Group exercised its option to require the holders of the £40 million subordinated 12.875 per cent. loan notes issued in 2012 to redeem the notes at par value.

### 17. Share capital

| | 30 June 2017 £m | 31 December 2016 £m |
|---|---|---|
| **Type** | | |
| Ordinary shares of £0.10 each | 34.5 | 34.5 |
| | **34.5** | **34.5** |

Ordinary shares have full voting rights, dividend rights and distribution rights in the event of sale or wind up.

During 2017, an additional 180,654 shares were allotted to an Employee Benefit Trust ("EBT") in order to satisfy the vesting of nil-cost options granted under the Deferred Share Plan ("DSP"). The DSP is the deferred part of the Annual Incentive Plan as described in the Remuneration Report of the 2016 Annual Report and Accounts. On 31 March 2017, the first tranche of the Recruitment Award vested and an option over 93,235 shares already held by the EBT became available for exercise.

When awards such as the DSP and Recruitment Award, vest any shares held by the EBT are considered to be held on behalf of the awardee and are no longer reflected within these financial statements. Any shares which are held by the EBT in respect of awards which still have to vest as at the reporting date, are recorded as a deduction from retained earnings.

As at 30 June 2017, the EBT held 372,944 shares (31 December 2016: 466,179 shares) which had not vested and which are recorded as a deduction from retained earnings.

As at 30 June 2017, there were 344,920,238 ordinary £0.10 shares in issue resulting in share capital of £34,492,024 (31 December 2016: 344,739,584 and £34,473,958 respectively).

## Notes to the consolidated financial statements continued

### 18. Share-based payments

The share-based payment charge, excluding tax reflected directly in retained earnings, comprises:

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Share plans issued up to 31 December 2016 | 1.3 | 1.1 |
| Share plans issued up to 30 June 2017 | 0.4 | 0.3 |
| | **1.7** | **1.4** |

Details of existing share plans can be found in Note 37 to the 2016 Annual Report and Accounts. New awards have been granted in 2017 under the Performance Share Plan, Restricted Share Plan and Deferred Share Plan. The new awards have been granted on the same basis as previous awards, other than the targets for Earnings Per Share in relation to the awards made under the Performance Share Plan. The total IFRS 2 charge to be recognised in respect of the 2017 share plans over the vesting period is estimated as £3.6 million.

The first tranche of the awards granted under the Deferred Share Plan in 2016 and the first tranche of the Recruitment Award both vested during the period as described in Note 17.

### 19. Statement of cash flows

*(a) Adjustments for non-cash items and other adjustments included within the income statement*

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Depreciation and amortisation | 2.6 | 2.2 |
| Impairment of goodwill | - | 4.1 |
| Amortisation of securitisation issuance cost | 0.2 | 0.2 |
| Discount accretion on subordinated notes | 0.5 | 0.7 |
| Impairment losses on loans and advances | 5.6 | 6.4 |
| Unwind of discounting | (2.0) | (1.5) |
| Write-offs net of recoveries | (3.1) | (2.5) |
| Net (gains) on disposal of available for sale debt securities | (0.5) | (0.7) |
| Net losses/(gains) on available for sale assets held in fair value hedges | 2.6 | (12.9) |
| Interest expense on subordinated notes | 5.0 | 2.5 |
| Interest income on debt securities | (4.8) | (5.9) |
| Interest expense on debt securities in issue | 0.6 | 1.1 |
| Equity settled share-based payment charge | 1.7 | 1.6 |
| | **8.4** | **(4.7)** |

## Notes to the consolidated financial statements continued

### 19. Statement of cash flows continued

*(b) Increase in operating assets*

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Loans and advances to customers | (630.9) | (656.8) |
| Loans and advances to banks | (14.5) | (13.8) |
| Derivative financial instruments | (6.7) | (5.8) |
| Fair value adjustments for portfolio hedged risk | 7.7 | (8.9) |
| Other operating assets | (1.3) | (2.3) |
| | **(645.7)** | **(687.6)** |

*(c) Increase in operating liabilities*

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Amounts due to banks | 301.4 | (78.3) |
| Customers' accounts | 672.2 | 796.0 |
| Derivative financial instruments | (8.5) | 22.1 |
| Fair value adjustments for portfolio hedged risk | (0.2) | 3.7 |
| Other operating liabilities | (1.9) | (5.1) |
| | **963.0** | **738.4** |

*(d) Cash and cash equivalents*

| | Period ended 30 June 2017 £m | Period ended 30 June 2016 £m |
|---|---|---|
| Cash and balances at central banks | 368.1 | 34.6 |
| Less restricted balances | (9.6) | (8.7) |
| Loans and advances to banks | 47.1 | 74.8 |
| | **405.6** | **100.7** |

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash on demand and overnight deposits, classified as cash and balances at central banks (unless restricted), and balances within loans and advances to banks as shown in the table above.

### 20. Commitments and contingencies

As at 30 June 2017, the Group had undrawn commitments to lend of £809.2 million (31 December 2016: £968.8 million). These relate mostly to irrevocable lines of credit granted to customers.

*Legislation*

As a financial services group, Aldermore Group PLC is subject to extensive and comprehensive regulation. The Group must comply with numerous laws and regulations which significantly affect the way it does business. Whilst the Group believes there are no unidentified areas of failure to comply with these laws and regulations which would have a material impact on the financial statements, there can be no guarantee that all issues have been identified.

## Notes to the consolidated financial statements continued

### 21. Related parties

Related party transactions and transactions with key management personnel ('KMP') in the six month period to 30 June 2017 are similar in nature to those for the year ended 31 December 2016. Details of those transactions can be found in the Group's 2016 Annual Report and Accounts.

Transactions with KMP remain consistent with those disclosed at 31 December 2016. KMP at 30 June 2017 continue to comprise Directors of the Group and members of the Executive Committee.

There were new share based payment transactions that occurred during the six month period ended 30 June 2017 and a number of KMP were granted share awards in the Group. In total, KMP were granted awards over an additional 1,267,755 shares.

### 22. Financial instruments and fair values

The following table summarises the classification and carrying amounts of the Group's financial assets and liabilities:

| 30 June 2017 | Loans and receivables £m | Available for sale £m | Fair value through profit or loss (required) £m | Fair value hedges £m | Liabilities at amortised cost £m | Total £m |
|---|---|---|---|---|---|---|
| Cash and balances at central banks | 368.1 | - | - | - | - | 368.1 |
| Loans and advances to banks | 94.7 | - | - | - | - | 94.7 |
| Debt securities | - | 712.7 | - | - | - | 712.7 |
| Derivatives held for risk management | - | - | 19.1 | - | - | 19.1 |
| Loans and advances to customers | 8,107.7 | - | - | - | - | 8,107.7 |
| Fair value adjustment for portfolio hedged risk | - | - | - | (11.2) | - | (11.2) |
| Other assets | 0.8 | - | - | - | - | 0.8 |
| **Total financial assets** | **8,571.3** | **712.7** | **19.1** | **(11.2)** | **-** | **9,291.9** |
| Non-financial assets | | | | | | **47.5** |
| **Total assets** | | | | | | **9,339.4** |
| | | | | | | |
| Amounts due to banks | - | - | - | - | 1,055.2 | 1,055.2 |
| Customers' accounts | - | - | - | - | 7,345.9 | 7,345.9 |
| Derivatives held for risk management | - | - | 27.3 | - | - | 27.3 |
| Fair value adjustment for portfolio hedged risk | - | - | - | (1.4) | - | (1.4) |
| Other liabilities | - | - | - | - | 23.1 | 23.1 |
| Debt securities in issue | - | - | - | - | 107.1 | 107.1 |
| Subordinated notes | - | - | - | - | 60.4 | 60.4 |
| **Total financial liabilities** | **-** | **-** | **27.3** | **(1.4)** | **8,591.7** | **8,617.6** |
| Non-financial liabilities | | | | | | **43.0** |
| **Total liabilities** | | | | | | **8,660.6** |

## Notes to the consolidated financial statements continued

### 22. Financial instruments and fair values continued

| 31 December 2016 | Loans and receivables £m | Available for sale £m | Fair value through profit or loss (required) £m | Fair value hedges £m | Liabilities at amortised cost £m | Total £m |
|---|---|---|---|---|---|---|
| Cash and balances at central banks | 116.4 | - | - | - | - | 116.4 |
| Loans and advances to banks | 67.2 | - | - | - | - | 67.2 |
| Debt securities | - | 664.5 | - | - | - | 664.5 |
| Derivatives held for risk management | - | - | 12.4 | - | - | 12.4 |
| Loans and advances to customers | 7,477.3 | - | - | - | - | 7,477.3 |
| Fair value adjustment for portfolio hedged risk | - | - | - | (3.5) | - | (3.5) |
| Other assets | 2.9 | - | - | - | - | 2.9 |
| **Total financial assets** | **7,663.8** | **664.5** | **12.4** | **(3.5)** | **-** | **8,337.2** |
| Non-financial assets | | | | | | **44.0** |
| **Total assets** | | | | | | **8,381.2** |
| | | | | | | |
| Amounts due to banks | - | - | - | - | 753.8 | 753.8 |
| Customers' accounts | - | - | - | - | 6,673.7 | 6,673.7 |
| Derivatives held for risk management | - | - | 35.8 | - | - | 35.8 |
| Fair value adjustment for portfolio hedged risk | - | - | - | (1.2) | - | (1.2) |
| Other liabilities | - | - | - | - | 20.9 | 20.9 |
| Debt securities in issue | - | - | - | - | 130.6 | 130.6 |
| Subordinated notes | - | - | - | - | 100.0 | 100.0 |
| **Total financial liabilities** | **-** | **-** | **35.8** | **(1.2)** | **7,679.0** | **7,713.6** |
| Non-financial liabilities | | | | | | **41.6** |
| **Total liabilities** | | | | | | **7,755.2** |

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented in the statement of financial position at fair value. The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments.

| | 30 June 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | Carrying value £m | Fair value £m | Carrying value £m | Fair value £m |
| Cash and balances at central banks | 368.1 | 368.1 | 116.4 | 116.4 |
| Loans and advances to banks | 94.7 | 94.7 | 67.2 | 67.2 |
| Loans and advances to customers | 8,107.7 | 8,200.4 | 7,477.3 | 7,613.0 |
| Other assets | 0.8 | 0.8 | 2.9 | 2.9 |
| **Total financial assets** | **8,571.3** | **8,664.0** | **7,663.8** | **7,799.5** |
| | | | | |
| Amounts due to banks | 1,055.2 | 1,055.2 | 753.8 | 753.8 |
| Customers' accounts | 7,345.9 | 7,359.7 | 6,673.7 | 6,705.9 |
| Other liabilities | 23.1 | 23.1 | 20.9 | 20.9 |
| Debt securities in issue | 107.1 | 108.1 | 130.6 | 131.9 |
| Subordinated notes | 60.4 | 63.1 | 100.0 | 101.8 |
| **Total financial liabilities** | **8,591.7** | **8,609.2** | **7,679.0** | **7,714.3** |

## Notes to the consolidated financial statements continued

**22. Financial instruments and fair values** continued

The following table provides an analysis of financial assets and liabilities held on the consolidated statement of financial position at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

| 30 June 2017 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Derivatives held for risk management | - | 19.1 | - | 19.1 |
| **Debt securities:** | | | | |
| Asset-backed securities | - | 69.7 | - | 69.7 |
| UK Gilts and Supranational bonds | 445.5 | - | - | 445.5 |
| Corporate bonds | - | - | - | - |
| Covered bonds | 197.5 | - | - | 197.5 |
| | **643.0** | **88.8** | **-** | **731.8** |
| **Financial liabilities:** | | | | |
| Derivatives held for risk management | - | 27.3 | - | 27.3 |
| | **-** | **27.3** | **-** | **27.3** |

| 31 December 2016 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Derivatives held for risk management | - | 12.4 | - | 12.4 |
| **Debt securities:** | | | | |
| Asset-backed securities | - | 70.4 | - | 70.4 |
| UK Gilts, other Sovereign and Supranational bonds | 392.1 | - | - | 392.1 |
| Corporate bonds | 29.7 | - | - | 29.7 |
| Covered bonds | 172.3 | - | - | 172.3 |
| | **594.1** | **82.8** | **-** | **676.9** |
| **Financial liabilities:** | | | | |
| Derivatives held for risk management | - | 35.8 | - | 35.8 |
| | **-** | **35.8** | **-** | **35.8** |

Level 1: Fair value determined using quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Fair value determined using directly or indirectly observable inputs other than unadjusted quoted prices included within Level 1 that are observable.

Level 3: Fair value determined using one or more significant inputs that are not based on observable market data.

The fair values of UK Gilts, other Sovereign bonds, Supranational bonds, Corporate bonds and Covered bonds are based on quoted bid prices in active markets.

The fair value of asset-backed securities are based on indicative prices provided by market counterparties, but before relying on these prices, the Group has obtained an understanding of how the prices were derived to ensure that each investment is assigned an appropriate classification within the fair value hierarchy.

## Notes to the consolidated financial statements continued

### 22. Financial instruments and fair values continued

The fair values of derivative assets and liabilities are determined using widely recognised valuation methods for financial instruments such as interest rate swaps and use only observable market data that require little management judgement and estimation. Credit value and debit value adjustments have not been applied as the derivative assets and liabilities are largely collateralised.

**Fair value measurement – financial assets and liabilities held at amortised cost**

All the fair values of financial assets and liabilities carried at amortised cost are considered to be Level 2 valuations which are determined using directly or indirectly observable inputs other than unadjusted quoted prices, except for debt securities in issue which are Level 1 and loans and advances to customers which are Level 3.

**Fair value of transferred assets and associated liabilities**

*Securitisation vehicle*

The Bank has previously transferred the beneficial ownership of a number of loans and advances to customers to a securitisation vehicle as described in the Group's 2016 Annual Report and Accounts. The loans and advances fail the derecognition criteria and consequently, these loans remain on the balance sheet of the seller. The results of the securitisation vehicle are consolidated in to the results of the Group. There has been no change in the relationship with the securitisation vehicle since 31 December 2016.

The table below shows the carrying value and fair value of the assets transferred to the securitisation vehicle and its associated liabilities. The carrying value presented below is the carrying amount recorded in the consolidated Group accounts. Some of the notes are held internally by the Group and as such are not shown in the consolidated statement of financial position of the Group.

| Oak No. 1 PLC | Carrying amount of transferred assets not derecognised £m | Carrying amount of associated liabilities £m | Fair value of transferred assets not derecognised £m | Fair value of associated liabilities £m | Net position £m |
|---|---|---|---|---|---|
| **30 June 2017** | **130.5** | **107.1** | **137.4** | **108.1** | **29.3** |
| 31 December 2016 | 148.7 | 130.6 | 155.0 | 131.9 | 23.1 |

### 23. Post balance sheet events

Aldermore Group PLC has agreed, subject to regulatory approval, to acquire a minority stake (48 percent) in AFS Group Holdings Limited, an introducer to asset and commercial finance funders in the UK. In 2016, the AFS Group originated approximately £210 million in lending (up from c£167 million in 2015), with the AFS Group generating net revenues of approximately £1.3 million. The intention is to account for the investment as an associate. The acquisition is expected to complete in H2 2017.

There have been no material post balance sheet events.

# Glossary of Alternative Performance Measures

**Average loans:** A simple average of the opening and closing loan balances for the period.

**Gross interest yield:** Annualised interest received on assets as a percentage of average loans.

**Cost of funding:** Annualised interest paid on liabilities as a percentage of average loans.

**Net interest:** The difference between interest received on assets and interest paid on liabilities after taking into account the effect of hedging derivatives.

**Net Interest Margin ("NIM"):** Net interest income as a percentage of average net loans.

**Net revenue margin:** Total operating income as a percentage of average loans.

**Cost to income ratio:** Administrative expenses including depreciation and amortisation divided by total operating income.

**Underlying cost to income ratio:** Administrative expenses, depreciation and amortisation, excluding any significant one-off or non-recurring expenses, divided by total operating income.

**Statutory return on equity ("ROE"):** The ratio of profit attributable to shareholders for the year (after tax) to average shareholders' equity, expressed as a percentage.

**Underlying return on equity ("ROE"):** The ratio of profit for the year (after tax), excluding any significant one-off or non-recurring expenses to average shareholders' equity, expressed as a percentage.

**Cost of risk:** Cost of risk is defined as credit impairment losses divided by average net loans for a given period.

**Basic earnings per share:** The profit attributable to equity shareholders divided by the number of ordinary shares in issue.

**Diluted earnings per share:** The profit attributable to equity shareholders divided by the number of shares in issue adjusted for any future dilutive effects of share-based payments.

**Non-performing loans ratio ("NPL"):** Individually impaired loans expressed as a percentage of gross loan balances at the period end date.

**Loan to Deposit Ratio:** The ratio of net loans to customers as a percentage of customer deposits.

**Fully loaded CRD IV:** Reflects end state Capital Requirements Directive IV rules, post any applicable transitional provisions.

**Fully loaded CRD IV Common Equity Tier 1 ("CET1") capital:** A measure of capital that is predominantly common equity as defined by the Capital Requirements Regulation. CET 1 capital is the highest quality capital and comprises of share capital, share premium, capital redemption reserve, available for sale reserve and retained earnings. The book values of goodwill and intangible assets as well as other regulatory adjustments are deducted from Common Equity Tier 1 capital for the purposes of capital adequacy.

**Risk Weighted Assets ("RWA"):** A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with Basel III.

**Fully loaded CRD IV CET1 ratio:** The ratio of fully loaded CRD IV CET 1 capital to Risk Weighted Assets.

**Additional Tier 1 Capital ("AT1"):** Fixed Rate Reset Additional Tier 1 Perpetual Securities issued by the company.

**Tier 2 capital: T**he Group's subordinated notes and collective impairment allowance (for exposures treated on a Basel III standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.

**Fully loaded CRD IV total capital:** The sum of CET1, AT1 and Tier 2 capital.

**Fully loaded CRD IV total capital ratio:** The ratio of fully loaded CRD IV total capital to Risk Weighted Assets.

**Tangible book value per share:** The total net asset value excluding intangible assets and AT1 notes as a ratio of ordinary shares in issue.

**Net promoter score:** An external scoring system that measures the willingness of customers to recommend a company's products or services to other people.