Aldermore

Press release

2 March 2017

Aldermore Group PLC

2016 Results

Underlying profit before tax[1] up 34% to £133m (2015: £99m)

- Reported profit before tax increased by 36% to £129m (2015: £95m)
- Underlying cost/income ratio[1] further improved to 45% (2015: 51%) demonstrating scale benefits and cost control

Delivering a high-teens return on equity

- Underlying return on equity[1] of 18.0% (2015: 20.6%)
- Basic earnings per share grew by 11% to 25.2p (2015: 22.7p)

Continued strong, profitable organic growth and robust credit control across the diversified portfolio

- Excellent loan origination; up by 24% to £3.2bn (2015: £2.6bn)
- Loan growth of 22% to £7.5bn (31 December 2015: £6.1bn)
- Asset Finance +17%; SME Commercial Mortgages +12%; Buy-to-Let +38%; Residential Mortgages +7%
- Strong net interest margin at 3.5% (2015: 3.6%)
- Continued robust credit performance; cost of risk at 23bps (2015: 19bps) in line with expectations

Strong capital position maintained

- Total capital ratio of 15.6% (31 December 2015: 15.1%)
- CET1 capital ratio of 11.5%, up from 11.0% at H1 2016 (31 December 2015: 11.8%)
- Tangible book value per share 21% to 153p (31 December 2015: 126p)

Continuing to delight our customers

- Net Promoter Score increased 14 points to +43 from +29 in 2015
- 94% of customers who reviewed Aldermore online would recommend us
- Awards in the year include 'Leasing and Asset Finance Provider of the Year' (NACFB), 'Best Specialist Mortgage Lender' (Your Mortgage) and 'Best Business Savings Provider' (Moneynet)

Phillip Monks OBE, Chief Executive Officer, commented:

"2016 was another remarkable year for the Group. We've continued our track record of delivering strong growth, achieving record underlying profitability of £133m before tax, up 34%. This has been achieved whilst maintaining a healthy net interest margin of 3.5%, and by using the scalability of our operations to become even more efficient.

"More than 220,000 businesses and individuals now choose Aldermore for their banking needs and in 2016 the amount we lent to customers increased by £1.3bn to £7.5bn, driven by record levels of organic origination across both our Mortgage and Business Finance divisions. Our straightforward savings business grew by 16%, with around 30% of balances coming from businesses. Growth has been achieved across our diversified portfolio whilst maintaining a robust approach to risk management.

"The Group maintains a strong capital position and, as planned at IPO, the Bank reached the key milestone of becoming capital self-sufficient in the second half of 2016.

"We generated an underlying return for our shareholders of 18% in 2016 and we remain focused on continuing to deliver returns around this level over the medium term. We have made a strong start to 2017, continuing to balance growth, risk and returns across the Group."

[1] Underlying basis excludes goodwill impairment of £4.1m (pre-tax and post-tax) in 2016 and IPO related costs of £4.1m pre-tax and £3.4m post-tax in 2015.

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A live webcast of the analyst presentation will be broadcast on our IR website www.investors.aldermore.co.uk at 9:30am on 2 March 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] basis)	**FY 2016**	**FY 2015**	**Movement %**
Net interest income	239.4	198.9	*20*
Other income	28.1	25.8	*9*
Operating income	267.5	224.7	*19*
Underlying[1] expenses	(119.2)	(115.5)	*(3)*
Impairments	(15.5)	(10.4)	*(49)*
Underlying[1] profit before tax	132.8	98.8	*34*
IPO costs	-	(4.1)	-
Goodwill impairment	(4.1)	-	-
Statutory profit before tax	128.7	94.7	*36*
Tax	(35.2)	(16.4)	*(115)*
Statutory profit after tax	93.5	78.3	*19*

Balance sheet (£m, at 31 December 2016)			
Loans and advances to customers	7,477.3	6,144.8	*22*
Customer deposits	6,673.7	5,742.0	*16*

Key financial ratios (%, unless stated)				
Margin	Gross interest income yield	5.26%	5.49%	*(0.23)pp*
	Cost of funding	1.74%	1.85%	*0.11pp*
	Net interest margin	3.51%	3.63%	*(0.12)pp*
Credit quality	Cost of risk	0.23%	0.19%	*(0.04)pp*
	Non-performing loans (NPL) ratio[2]	0.47%	0.45%	*(0.02)pp*
Efficiency and returns	Underlying[1] cost to income ratio	44.6%	51.4%	*6.8pp*
	Effective tax rate[3]	27.4%	17.3%	*(10.1)pp*
	Underlying[1] return on equity	18.0%	20.6%	*(2.6)pp*
	Statutory return on equity	17.2%	19.7%	*(2.5)pp*
Balance sheet strength	Loan to deposit ratio	112%	107%	*5pp*
	Fully loaded CRD IV CET1 ratio	11.5%	11.8%	*(0.3)pp*
	Fully loaded CRD IV total capital ratio	15.6%	15.1%	*0.5pp*
Shareholder value	Tangible book value/share (pence)	153p	126p	*21.4%*
	Basic earnings per share (pence)	25.2p	22.7p	*11.0%*
	Diluted earnings per share (pence)	**25.2p**	**22.6p**	*11.5%*
	Shares in issue at period end (million)	**344.7m**	**344.7m**	-

[1] Underlying basis excludes goodwill impairment of £4.1m (pre-tax and post-tax) in 2016 and IPO related costs of £4.1m pre-tax and £3.4m post-tax in 2015.
[2] Non-performing loans ratio is calculated as individually impaired loans as a percentage of gross loans at the period end.
[3] The effective tax rate for 2016 is impacted by the introduction, from 1 January 2016, of the UK bank surcharge levied on profits above £25m as well as the goodwill impairment which is not allowable for tax purposes.

CEO review

Banking as it should be

The key drivers of our performance in 2016 are rooted in our purpose. Since the Bank was founded in 2009, we have sought to challenge the status quo and empower 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 both possible and 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 each individual, 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, using an approved network of specialist intermediaries and, increasingly, direct relationships with customers online or by telephone, without the need for a costly branch network.

A record year

It is with great pride that we are reporting another record year for Aldermore, demonstrating continued progress on the journey we described at IPO. I am particularly pleased that we were able to deliver such a strong performance despite the uncertainty presented by the UK’s referendum on EU membership. While the full political and economic implications of this decision are as yet unknown, the UK economy has remained resilient to date, and we continue to closely monitor our operating environment for any change.

Throughout the year, the Group has performed well and customer confidence remained high. We ended the year with strong growth, a robust credit performance and a healthy pipeline, giving us confidence that we are well positioned for further success.

Continuing commitment to UK businesses, homeowners, landlords and savers

Net loans to customers increased by £1.3bn, or 22%, to £7.5bn at the end of 2016, driven by record levels of organic origination. This record performance was seen across both Business Finance and Mortgages where, respectively, £1bn and £2bn of new customer loans were provided.

In Business Finance, we focus in both the asset finance and invoice finance markets. In Asset Finance we have leveraged our efficient broker-led distribution model to build a market leading position in this channel. Our specialist underwriting advantage in transport, plant & machinery, and other areas of expertise, enabled us to grow net lending by 17% to £1.6bn during 2016.

Across our Mortgages franchise we grew lending by 24% to £5.7bn. This was led by our broad customer offering in Buy-to-Let (BTL) which enabled us to grow BTL lending by 38% to £3.3bn. In SME Commercial Mortgages, where we have particular expertise in underwriting multi-let investment properties, lending grew by 12% to £930m. In our Residential Mortgages business we are committed to truly understanding our customers’ circumstances which, with our focus on creditworthy segments of the market, enabled us to grow lending by 7% to £1.5bn.

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 transparent approach means we don’t use teaser rates. This approach drove an increase in deposits of 16% to £6.7bn in 2016. Business customers provide both c30% of this balance and a high level of advocacy, with 97% of customers surveyed saying they would recommend Aldermore to others.

Profit before tax up by over a third

Reported profit before tax rose 36% to a record high of £129m, driven by continued benefits from our growing franchises, a healthy net interest margin of 3.5% and further improvement in operational leverage reflected in the cost to income ratio falling below 45%. Our management of risk remains robust as demonstrated in our cost of risk at just 0.23% and less than 0.5% of our loans by value being classed as non-performing.

CEO review continued

Enhanced balance sheet strength and strong shareholder returns

2016 was also an important year in further strengthening our balance sheet. While our fully loaded CRD IV CET1 ratio reduced by 0.3% to 11.5% over 2016, we reached the point of capital self-sufficiency in the second half of the year when our ratio rose by 0.5%. This increase was driven by record levels of profitability and was in line with our guidance at IPO. We expect our CET1 capital ratio to continue rising in the coming years as we deliver strong, sustainable earnings.

Overall, the Group generated underlying earnings per share of 26.4p and an underlying return on equity of 18%, or 20% prior to the impact of the 8% bank tax surcharge introduced in 2016.

Strengthening the team

The excellent progress seen in 2016 is the result of the experience and effort that everyone at Aldermore puts into supporting customers on a daily basis and for this I extend gratitude to all my colleagues across the Group.

During the year I was delighted to welcome three new members to the Executive team. Christine Palmer joined us as Chief Risk Officer, Dana Cuffe joined as Chief Operating Officer and Rob Divall joined as the Group HR Director. All of my new Executive colleagues have tremendous experience in their fields and it is a real testament to the business and the progress we have made that we can continue to attract such high calibre executives, who share our vision and can help successfully drive us forward.

Strategic priorities

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

1. Customer-driven: Helping more customers to seek and seize opportunities

We will continue helping more customers across Britain to seek and seize opportunities, whether that's growing their business, buying their first home or securing a fair return on their savings. Our focus remains on serving diverse pools of customer demand and adjacent markets, where we can operate as an agile, service-focused specialist player in large markets, providing us with multiple levers for growth.

Highlights in 2016:

- 2016 was a record year for originations with over £3bn lent across Business Finance and Mortgages. Total customer numbers also reached an all-time high at over 220,000, while our customer advocacy continued to improve as NPS grew from +29 to +43
- We received further recognition for our service, products and expertise in 2016, winning awards across all of our franchises, including 'Leasing and Asset Finance Provider of the Year' (NACFB), 'Best Specialist Mortgage Lender' (Your Mortgage) and 'Best Business Savings Provider' (Moneynet)
- Our market-leading breadth of offering in Buy-to-Let helped us support more landlords than ever, as we grew customer numbers by 25% to c20,000, originating over £1.2bn of loans, despite the increased market complexity
- We continued to serve specialist segments of the residential mortgage market and invested in enhancing our propositions, including those for the self-employed and first time buyers
- We also invested in developing our retention strategy in Mortgages, providing greater choice and support for customers looking for their next product

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

Aldermore benefits from modern, scalable systems 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 2016:

- We generated greater operational leverage in the business, bringing the underlying cost to income ratio below 45%
- As well as introducing new Executives we also bolstered the wider teams during 2016, strengthening expertise across the Group including a new Head of Enterprise Risk, Chief Information Officer and Chief Data Officer
- We progressed a number of improvement initiatives over the year, including enhanced digital capability, process simplification, platform upgrades and a refresh of our brand and customer segmentation

3. Securely managed: maintaining a diverse and low-risk business model

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

Highlights in 2016:

- Our credit quality remained well within our appetite as we incurred a cost of risk of 23bps and maintained non-performing loans below 0.5% of our portfolio
- We continue to originate in line with centrally controlled underwriting standards, including stress testing affordability, before going on to re-score the portfolio on a monthly basis
- We made a number of enhancements to our credit risk models through our on-going work to become IFRS9 compliant ahead of the January 2018 implementation date

An ever-evolving market

Aldermore is focused entirely in the UK so what happens in the local economy matters to us. In 2016, the vote to leave the European Union (EU) created elevated levels of political and economic uncertainty. This uncertainty manifested itself in volatile financial markets and lower expectations for future UK economic growth, to which the Bank of England responded by lowering the base rate and enhancing quantitative easing by launching the Term Funding Scheme (TFS).

For Aldermore, the effect of the lower base rate was broadly neutral whilst the TFS presents us with an opportunity to access funding at a lower cost. The UK economy has remained resilient in the face of the uncertainty and we have seen no material change in customer confidence or demand for loans. We continue to closely monitor our operating environment for any change.

2016 also saw the announcement or introduction of a number of changes to regulation and legislation directly relevant to Aldermore and our customers. As first set out in 2015, a tax surcharge of 8% applicable to banks' profits exceeding a £25m threshold was introduced from 1 January 2016, resulting in a higher tax bill for Aldermore than would have otherwise been incurred. A 3% Stamp Duty Land Tax surcharge was also applied to purchases of second homes and Buy-to-Let properties from 1 April 2016. Aside from elevating completions during Q1, the changes did not materially affect demand in 2016, as our customers, notably professional landlords, tend to have longer investment horizons over which the additional cost can be recovered.

CEO review continued

In 2017, we expect the majority of our customers and chosen markets to remain largely unaffected by any notable legal or regulatory change. In Buy-to-Let meanwhile, we will see the implementation of several changes; amended affordability tests from January 2017, the beginning of a phased reduction in mortgage interest tax deductibility from April 2017; and changes to the rules applied to underwriting portfolios of Buy-to-Let properties from September 2017. It is too early to accurately predict how the market will respond to these changes. However, whilst there remains a shortage of housing stock and new homebuilding continues to lag Government targets, the fundamentals supporting demand remain strong. Whilst regulatory changes to underwriting and affordability testing could reduce the overall rate of market growth, we expect to benefit from the anticipated increase in professionalisation of demand and to continue outgrowing the market, building on our small market share.

A confident outlook

The process of Britain's exit from the EU may result in economic conditions deviating from current forecasts but for 2017 there is unlikely to be any material impact. We expect to continue delivering a return on equity in the high teens over the medium term, through a combination of focused loan growth, margin management and the robust control of both operational expenses and risk.

As we deliver on the first priority of our strategy, we expect to grow our loan book by between 10% and 15% in 2017 with further growth thereafter and the portfolio mix remaining broadly stable. The exact pace of growth will be dependent on our ability to grow within our prudent risk appetite, while delivering strong and sustainable returns.

As expected, we are seeing incremental signs of lower pricing within our chosen lending markets, primarily driven by a lower cost of funding across the sector. Our blended cost of funds is anticipated to continue to fall into 2017 as we further utilise the Bank of England's Term Funding Scheme and deposits gradually mature on to the lower rates currently seen across the market. We therefore expect the combined effect of these dynamics to result in our net interest margin remaining broadly stable at around 3.5% in 2017.

Our ability to differentiate through the specialist nature of our underwriting, service and brand, positions us well versus competitors and we will continue to invest in further enhancing our service and digital capabilities to maintain and build upon this advantage.

We expect the cost of ongoing investment, which includes mandatory projects such as preparatory work for IFRS9 and General Data Protection Regulation (GDPR), coupled with further strengthening of our teams in support of our strategy, to result in an increase in underlying costs of between £15m and £20m in 2017. Project expenditure is also expected to result in a larger balance of intangible assets. However, in line with our second strategic priority, operating model enhancements will increase efficiency and operating leverage consistent with our cost to income ratio further declining to below 40% over the medium term.

In line with our third strategic priority, we plan to maintain the credit quality of the book such that we would expect to incur an annual cost of risk of between 25 and 35bps over the medium term. Further information on the effect of changes to IFRS9 on the recognition of impairments will be provided closer to its January 2018 implementation.

We are delighted with the Group's performance in 2016 and remain positive on our outlook notwithstanding the economic uncertainty and potential changes to regulatory capital requirements. The Board will therefore continue to consider the payment of dividends while taking into account the growth opportunities available, anticipated changes in capital requirements, and once the Group's CET1 ratio is above 12%.

In conclusion…

I'm delighted that our record performance in 2016 continues to demonstrate delivery against our business plan and targets and I would like to thank our customers, colleagues and shareholders for their continued support.

We have clear strategic priorities to further create and unlock value across the business, as we continue to serve and delight our customers and generate strong and sustainable returns for our shareholders.

Phillip Monks OBE, Chief Executive Officer

Financial review

Loans to customers up 22% with originations at record levels

2016 loan growth was driven by record levels of origination across both our Business Finance and Mortgages divisions at over £1bn and £2bn respectively, as we continue to build our diversified portfolio. This record level of originations was partly offset by £1.8bn of redemptions in the year. This level of redemptions represents almost a third of the loan portfolio at the start of the year, and an 83% increase on redemptions in 2015, reflecting the growing maturity of the business.

Net loans to customers reached £7.5bn (31 December 2015: £6.1bn), as the number of customers grew by 17% to over 80,000 with more UK businesses, homeowners and landlords choosing Aldermore to serve their borrowing needs.

Business Finance up 15% to £1.7bn

Asset Finance grew by 17% to £1,573m as our expertise in a broad range of asset classes allowed us to maintain our market leading position in the broker-channel and grow our wholesale proposition by 60%.

Invoice Finance continued to focus on returns, moving toward larger invoice discounting for small businesses and structured finance, and away from lower value factoring business. This refocusing was reflected in the 4% decline in loans to £154m, whilst driving an increase in segmental profits of over 50%.

Mortgages increased 24% to £5.7bn

SME Commercial Mortgages saw a growing proportion of customers engaging with us directly, reflecting our growing reputation for expertise and service. This contributed to loan growth of 12% to £930m in 2016, despite tightening our appetite for development-based lending following the EU referendum.

In Buy-to-Let, our broad customer offering enabled us to grow lending by 38% to £3,326m. This strong growth also reflects our operational agility, as we took advantage of the market spikes in the first quarter, ahead of the introduction of an increase in stamp duty, and in the fourth quarter when we successfully took share in an active market.

In Residential Mortgages, our approach to understanding the detailed circumstances of each customer enabled us to grow lending by 7% to £1.494m. This growth was driven by £466m of originations which, over the year, more than offset a high level of redemptions on Help to Buy mortgages written 2 years ago when Aldermore was the first to market with the product.

	31 Dec 2016 £m	**31 Dec 2015 £m**	**Movement %**
Asset Finance	1,573.4	1,346.7	*17*
Invoice Finance	154.1	160.8	*(4)*
SME Commercial Mortgages	929.9	829.2	*12*
Buy-to-Let Mortgages	3,326.0	2,417.9	*38*
Residential Mortgages	1,493.9	1,390.2	*7*
Net loans to customers	**7,477.3**	**6,144.8**	***22***
Asset Finance	994.2	893.0	*11*
Invoice Finance	41.7	35.1	*19*
SME Commercial Mortgages	435.1	427.6	*2*
Buy-to-Let Mortgages	1,289.2	673.1	*92*
Residential Mortgages	466.0	582.3	*(20)*
Originations	**3,226.2**	**2,611.1**	***24***

Financial review continued

Deposit-led funding model, with balances rising 16%

Our funding strategy remains deposit-led, whilst we actively manage wholesale sources, such as Government and central bank schemes, to provide diversification and drive an efficient cost of funds. As at 31 December 2016, our loan to deposit ratio was in line with management expectations at 112% (31 December 2015: 107%).

Our dynamic and innovative online savings franchise, which provides award-winning savings products to c140,000 customers, grew by 16% to £6.7bn (31 December 2015: £5.7bn), benefitting from strong rates of retention at c70%. SME deposits of £1.6bn (31 December 2015: £1.4bn) and our Corporate deposits of £260m (31 December 2015: £156m) now represent almost a third of all deposits.

Wholesale funding increased by 54% to £982m (31 December 2015: £636m) and predominantly consists of on-balance sheet funding via repurchase agreements of Funding for Lending Scheme (FLS) Treasury Bills, drawings through the Term Funding Scheme (TFS) and our Residential Mortgage Backed Security (RMBS).

As at the end of 2016, under the Bank of England's SME lending extension of FLS, the Group had on-balance sheet funding of £355m. We were also the first bank to utilise the Bank of England's newly launched TFS, with £396m of funding having been accessed by the end of 2016.

The outstanding balance on our RMBS as at 31 December 2016 stood at £131m (31 December 2015: £194m). This reduction reflects the capital repayments on the underlying mortgages.

Other wholesale funding predominantly consists of Tier 2 debt capital of £100m (31 December 2015: £38m). In October 2016, £60m subordinated loan notes were successfully issued with a maturity date in 2026 and a call option in 2021. This added to our existing Tier 2 notes which were issued in 2012 and have an option to call in May 2017.

	31 Dec 2016 £m	**31 Dec 2015 £m**	**Movement %**
Retail deposits	4,766.8	**4,186.3**	*14*
SME deposits	1,647.2	**1,399.4**	*18*
Corporate deposits	259.7	**156.3**	*66*
Customer deposits	**6,673.7**	**5,742.0**	***16***
Funding for Lending Scheme	354.8	**398.6**	*(11)*
Term Funding Scheme	396.1	**-**	-
Residential Mortgage Backed Security	130.6	**193.9**	*(33)*
Subordinated liabilities	100.0	**38.1**	*162*
Other liabilities	0.7	**5.2**	*(87)*
Wholesale funding	**982.2**	**635.8**	***54***

Financial review continued

Profits up 36% demonstrating continued strong, sustainable returns

Profit before tax for the year increased by 36% to £128.7m (2015: £94.7m) as we maintained healthy margins across a larger loan book. Excluding £4.1m for both the goodwill impairment in 2016[1] and the 2015 pre-tax IPO related costs, the underlying profit before tax increased by 34% to £132.8m (2015: £98.8m).

The tax charge for the year increased by 115% to £35.2m (2015: £16.4m). This increase reflects greater profitability as well as the introduction of the 8% bank corporation tax surcharge on taxable profits above £25m from 1 January 2016. The effective tax rate of 27% in 2016 (2015: 17%) comprises the standard 20% corporate tax rate plus the 8% surcharge. Statutory profit after tax therefore increased by 19% to £93.5m (2015: £78.3m).

The return on equity generated in the period was 17.2%, or 18.0% on an underlying basis, and was in line with our commitment to delivering returns in the high teens. The 2016 basic earnings per share was 25.2p, on both a basic and fully diluted basis.

Operating income increases 19% as average net loans rise 24%

During 2016 interest income grew by 19% to £358.2m driven by continuing net loan growth. The Group's average gross yield fell slightly to 5.3% (2015: 5.5%), primarily as a result of the lower rate environment and competition in Asset Finance and a change in mix with the comparatively lower yielding BTL portfolio growing at a faster pace than other portfolios.

Interest expense increased by 17% to £118.8m as we funded our lending growth. We also continued to benefit from a diversified funding base, with access to lower cost Government schemes, which helped support a reduction in our average cost of funds to 1.7% (2015: 1.9%).

As a result, the Group's net interest income increased by 20% to £239.4m (2015: £198.9m) while, as expected, the net interest margin remained broadly stable at 3.5% (2015: 3.6%). Net fee and other operating income rose by 12%, reflecting a higher volume of property valuations as a result of new mortgage lending.

	FY 2016 £m	**FY 2015 £m**	**Movement %**
Interest income	358.2	300.4	*19*
Interest expense	(118.8)	(101.5)	*(17)*
Net interest income	239.4	198.9	*20*
Net fee and other operating income	28.7	25.6	*12*
Net derivatives and disposal of debt securities	(0.6)	0.2	-
Operating income	**267.5**	**224.7**	***19***
Average net loans	6,811.1	5,473.0	*24*
Net interest margin (%)	3.51%	3.63%	*(12)pp*
Gross interest income yield	5.26%	5.49%	*(0.23)pp*
Cost of funding	1.74%	1.85%	*0.11pp*

[1] See page 48 for further information.

Financial review continued

Growth in operating expenses controlled to a 3% rise

Operating expenses were well controlled, increasing by 3% to £123.3m (2015: £119.6m), in line with management expectations. Within this, administrative expenses rose by 5% to £113.1m (2015: £107.9m), primarily reflecting the recruitment of colleagues to further support growth and enhance risk management.

Provisions of £0.8m in 2016 were 65% lower than in 2015 due to the payment of the capital element of the Financial Services Compensation Scheme (FSCS) levy having now been completed by the banking industry. Depreciation and amortisation was consistent with last year at £5.3m (2015: £5.3m).

Given their material and one-off nature, costs related to our IPO in 2015 and the impairment of goodwill related to our Invoice Finance business in 2016 are removed from our financial metrics to provide an 'underlying' view of our performance.

Our modern scalable systems and efficient broker network supported us in further leveraging our capabilities, with operating income growing by 19%, while underlying cost growth was controlled to just 3%. This resulted in our underlying cost to income ratio declining by 6 percentage points to 45% (2015: 51%).

	FY 2016 £m	FY 2015 £m	Movement %
Administrative expenses	113.1	107.9	*(5)*
Provisions	0.8	2.3	*65*
Depreciation and amortisation	5.3	5.3	-
Underlying operating expenses	119.2	115.5	*(3)*
IPO costs	-	4.1	-
Goodwill impairment	4.1	-	-
Operating expenses	**123.3**	**119.6**	***(3)***
Underlying cost / income ratio (%)	45%	51%	*6pp*

Loan impairments rise while cost of risk remains low at 23bps

We maintain a robust approach to risk management and this, combined with a relatively benign credit risk environment, has resulted in our cost of risk remaining low and below expectations at 0.23%. Impairments increased by 49% to £15.5m (2015: £10.4m), within which our collective charge grew by 31% to £4.7m (2015: £3.6m) reflecting the growth of the loan book and a further degree of caution reflecting increased economic uncertainty following the UK's vote to leave the EU. Individual impairments of £10.8m were 58% higher than 2015 due to 2016 having seen impairments taken in relation to a relatively small number of exposures, whereas 2015 was abnormally low in this regard.

	FY 2016 £m	FY 2015 £m	Movement %
Individual	10.8	6.8	*(59)*
Collective	4.7	3.6	*(31)*
Impairments	**15.5**	**10.4**	***(49)***
Cost of risk (%)	0.23%	0.19%	*(4)pp*

Capital Management

A robust capital position after the Group became capital generative in the second half of 2016

The Group maintains a strong capital position and after becoming capital generative in the second half of 2016, closed the year with a fully loaded CRD IV total capital ratio of 15.6% (31 December 2015: 15.1%) and a CET1 ratio of 11.5% (31 December 2015: 11.8%). These movements reflect the profit after tax of £93.5m, offset by growth in Risk Weighted Assets (RWAs) of £883m and the post-tax AT1 coupon of £6.6m, payable annually in April. The total capital ratio also benefits from the issuance of £60m Tier 2 Notes in October 2016.

RWAs increased by 24% reflecting loan growth of 22% and the increase in the Basic Indicator Approach (BIA) Operational Risk charge which is updated in the first quarter each year based on the average of the last 3 years' net operating income. The Group's leverage ratio at 7.0% (31 December 2015: 7.2%) remains significantly above forthcoming regulatory minimums. The marginal reduction in the year is mainly due to growth in lending assets, partially offset by growth in retained earnings.

As of 1 January 2017, Aldermore's total CET1 requirements under normal operating conditions, which include PRA ICG and Pillar 2B requirements, as well as the phased in CRD IV buffers, are higher than the 7% AT1 conversion level.

We are on track with enhancements to our credit risk models through our work to become IFRS9 compliant for January 2018 when the new accounting standard is introduced. 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. We will continue to monitor the cost and benefits associated to moving to IRB, as the regulatory changes and timeframes for implementation become clear.

Capital resilient under stress

We periodically test the Group's resilience to severe, but plausible adverse scenarios. This process supports calibration of our stress loss buffer, ensuring we are able to withstand an economic downturn over our 5 year planning horizon. The outcome of this process is a key input into other Group processes, including the setting of our risk appetite, the assessment of our capital adequacy and our assessment of risk-adjusted returns.

In 2016, this process included the supervisory H2 2016 Annual Cyclical Scenario in addition to Aldermore's internal scenario. This scenario includes; a rapid fall in property prices, with residential property values declining by 32% and commercial by 42%; an economic downturn with a cumulative 4.3% reduction in GDP; unemployment rising to almost 10%; the BoE base rate falling to 0%; and inflation running at 3.4%.

Under this severe scenario, higher impairments including the effect of changes to IFRS9, operational risk losses and other detrimental factors would reduce our projected CET1. However, at its lowest point post Management actions, the CET1 ratio is expected to be around 8.5%, remaining above the 7% level at which our AT1 security converts to equity and significantly above our current CET1 PRA requirement and CRDIV buffers at 1 January 2017.

Financial review continued

Capital Management continued

	31 Dec 2016 £m	31 Dec 2015 £m	Movement %
Shareholders' equity	552.0	459.6	*20*
Intangible assets	(26.1)	(24.0)	*9*
Prudential valuation adjustments	(0.1)	-	-
CET 1 capital	**525.8**	**435.6**	***21***
AT1 capital	**74.0**	**74.0**	**-**
Tier 2 capital	**113.1**	**48.6**	***133***
Total capital	**712.9**	**558.2**	***28***
Asset Finance	1,105.7	937.6	*18*
Invoice Finance	104.3	112.3	*(7)*
SME Commercial Mortgages	1,125.9	914.5	*23*
Buy-to-Let	1,277.4	903.1	*41*
Residential Mortgages	560.7	502.2	*12*
Lending credit risk weighted assets	**4,174.0**	**3,369.7**	***24***
Operational risk charge	308.5	204.8	*51*
Other	93.6	118.5	*(21)*
Total risk weighted assets	**4,576.1**	**3,693.0**	***24***
Fully loaded CRD IV CET1 ratio (%)	**11.5**	**11.8**	***(0.3)pp***
Fully loaded CRD IV Tier 1 capital ratio (%)	**13.1**	13.8	*(0.7)pp*
Fully loaded CRD IV total capital ratio (%)	**15.6**	**15.1**	***0.5pp***
Leverage ratio (%)[1]	**7.0%**	**7.2%**	***(0.2)pp***

[1] The year end 2015 leverage ratio was restated to 7.2% in the published Pillar 3 disclosures following finalisation of off-balance sheet exposures.

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 arises from our lending activities as a result of a defaulting mortgage, lease or loan contracts. Although credit risk arises from our loan book, it can also arise from 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. Details of provisioning coverage and the value of assets against which loans are secured
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 24% in 2016. This was broadly in line with net loans and advances to customers, our largest credit risk exposure, having grown by 22% to £7,504.7m.

	2016 £m	**2015 £m**
Included in the statement of financial position:		
Cash and balances at central banks	116.4	105.3
Loans and advances to banks	67.2	94.2
Debt securities	664.5	606.1
Derivatives held for risk management	12.4	6.7
Loans and advances to customers	7,504.7	6,165.5
Other financial assets	2.9	0.4
	8,368.1	**6,978.2**
Commitments to lend	968.8	556.0
Gross credit risk exposure	**9,336.9**	**7,534.2**
Less: allowance for impairment losses	(27.4)	(20.7)
Net credit risk exposure	**9,309.5**	**7,513.5**

Credit risk continued

2. Credit quality and performance of loans

The tables below provide a split of our £7,504.7m credit risk exposure to loans gross of impairments, on the basis of:

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 where a loss has been accounted for, for example, as a result of payments having been missed (individually impaired)[1]

2016	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages[2] £m	Buy-to-Let Mortgages £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**

2015	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages[2] £m	Buy-to-Let Mortgages £m	Residential Mortgages £m	Total £m
A. Neither past due nor individually impaired	1,344.7	163.2	819.0	2,402.8	1,373.0	6,102.7
B. Past due but not individually impaired	2.7	-	6.5	10.7	14.9	34.8
C. Individually impaired	6.7	2.9	7.9	6.4	4.1	28.0
	1,354.1	**166.1**	**833.4**	**2,419.9**	**1,392.0**	**6,165.5**

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

The analysis in this section of the report excludes the Property Development portfolio from a number of tables where it is not relevant (marked with a footnote). Gross property development exposure at 31 December 2016 was £230 million (31 December 2015: 184 million), and net exposure was £229 million (31 December 2015: £179 million).

[1] During 2016, loans which are individually impaired and less than 3 months in arrears have been included within individually impaired loan disclosures. As such, 2015 comparative disclosures in respect of the impaired balances on pages 15 to 24 have been re-presented on this basis.

[2] The above analysis includes Property Development.

Financial review continued

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 analysed internally as follows:

2016	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages[1] £m	Buy-to-Let Mortgages £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**

2015	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages[1] £m	Buy-to-Let Mortgages £m	Residential Mortgages £m	Total £m
Low risk	49.1	-	281.7	1,864.9	907.4	3,103.1
Medium risk	1,204.6	12.9	351.4	503.0	432.2	2,504.1
High risk	91.0	150.3	7.0	34.9	33.4	316.6
Total	**1,344.7**	**163.2**	**640.1**	**2,402.8**	**1,373.0**	**5,923.8**
Fair value of collateral held	**960.6**	**160.7**	**592.7**	**2,402.8**	**1,373.0**	**5,489.8**

[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 grading 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 up to date accounts) and ten LGD grades determine the category within which each loan is categorised, i.e. those accounts that have a low PD and/or LGD are graded as ‘low’. Those graded ‘high’ will be accounts that have either a high PD and/or high LGD.

- Probability of Default refers to the probability of a customer or counterparty defaulting, which is typically taken as three payments past due, within the next 12 months. A default probability model predicts this probability by using credit scores along with financial, behavioural and qualitative inputs.
- Key components of the Loss Given Default are the propensity to “cure”, that is the likelihood/propensity for a defaulting account to be restored to a performing status, and the level of security held in relation to the credit exposure. The level of security varies, ranging from a small number of very short term unsecured loans in the Asset Finance business, to highly secured loans on residential property within the Residential Mortgages business. The valuation method for assets is specific to the nature of the collateral and includes indexation for property valuations.

Credit risk continued

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

As at the end of 2016 there was a balance of £43.2m relating to loans where customers had missed one or more repayments but no specific loss had yet been taken. This represented a 24% increase in 2016, which was broadly in line with the 22% growth in net loans in the year.

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

	2016 £m	**2015 £m**
- Up to 2 months past due	35.6	28.4
- 2 to 3 months past due	7.6	6.4
	43.2	**34.8**
Fair value of collateral held	*42.3*	*35.2*

C. Loans and advances that have been individually impaired

Individually impaired balances are further analysed as follows:

2016	**Asset Finance £m**	**Invoice Finance £m**	**SME Commercial Mortgages[1] £m**	**Buy-to-Let Mortgages £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*
NPL Ratio %	*0.59*	*2.26*	*0.83*	*0.26*	*0.41*	*0.47*

2015	**Asset Finance £m**	**Invoice Finance £m**	**SME Commercial Mortgages[1] £m**	**Buy-to-Let Mortgages £m**	**Residential Mortgages £m**	**Total £m**
Impaired but not past due	1.4	-	0.9	1.3	-	3.6
Past due less than 3 months	1.2	0.1	-	-	0.1	1.4
Past due 3-6 months	1.2	0.2	3.4	2.8	3.3	10.9
Past due 6-12 months	1.3	0.5	-	1.6	0.5	3.9
Past due over 12 months	1.6	2.1	3.6	0.7	0.2	8.2
	6.7	**2.9**	**7.9**	**6.4**	**4.1**	**28.0**
Of which: Possessions	*0.8*	-	-	-	*0.4*	*1.2*
NPL Ratio %	*0.49*	*1.75*	*0.95*	*0.26*	*0.29*	*0.45*

[1] The above analysis includes Property Development.

The fair value of collateral held against the above individually impaired balances at 31 December 2016 of £35.6m (31 December 2015: £28.0m) was £28.8m (31 December 2015: £23.4m). We always seek to pursue timely realisation of collateral in an orderly manner and do not use the collateral for our own operations.

Financial review continued

Credit risk continued

The in-year movement in impaired loans is analysed as follows:

2016	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages £m	Buy-to-Let Mortgages £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 30 December 2016	**9.3**	**3.6**	**7.8**	**8.7**	**6.2**	**35.6**

2015	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages £m	Buy-to-Let Mortgages £m	Residential Mortgages £m	Total £m
At 1 January	5.0	6.3	7.1	4.4	3.3	26.1
Classified as impaired during the period	4.3	1.3	2.8	4.9	3.5	16.8
Transferred from impaired to unimpaired	(0.7)	-	(0.1)	(0.8)	(0.7)	(2.3)
Amounts written off	(1.9)	(4.6)	(1.7)	(0.9)	(0.2)	(9.3)
Repayments	-	(0.1)	(0.2)	(1.2)	(1.8)	(3.3)
At 31 December 2015	**6.7**	**2.9**	**7.9**	**6.4**	**4.1**	**28.0**

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 mortgage or SME finance 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.

Analysis of forborne accounts by payment status is shown in the tables below:

2016	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages £m	Buy-to-Let Mortgages £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**

2015	Asset Finance £m	Invoice Finance £m	SME Commercial Mortgages £m	Buy-to-Let Mortgages £m	Residential Mortgages £m	Total £m
A. Neither past due nor individually impaired	1.1	1.8	10.6	1.9	3.7	19.1
B. Past due but not individually impaired	-	-	1.5	0.7	1.3	3.5
C. Individually impaired	0.1	-	1.2	-	0.7	2.0
	1.2	**1.8**	**13.3**	**2.6**	**5.7**	**24.6**

Financial review continued

Credit risk continued

As at 31 December 2016, we had undertaken forbearance measures as follows in each of our segments:

	2016 £m	2015[1] £m
Asset Finance		
Capitalisation	1.3	-
Reduced monthly payments	0.2	0.3
Loan-term extension	0.3	0.1
Deferred payment	1.5	0.8
Total Asset Finance	**3.3**	**1.2**
Forborne as a percentage of the total divisional gross lending book (%)	0.21%	0.09%
Invoice Finance		
Agreement to advance funds in excess of normal contractual terms	11.1	1.8
Total Invoice Finance	**11.1**	**1.8**
Forborne as a percentage of the total divisional gross lending book (%)	6.96%	1.12%
SME Commercial Mortgages		
Temporary or permanent switch to interest only	24.3	13.3
Total SME Commercial Mortgages	**24.3**	**13.3**
Forborne as a percentage of the total divisional gross lending book (%)	2.60%	1.60%
Buy-to-Let		
Temporary or permanent switch to interest only	0.7	1.5
Reduced monthly payments	1.0	0.8
Deferred payment	0.3	0.3
Total Buy-to-Let	**2.0**	**2.6**
Forborne as a percentage of the total divisional gross lending book (%)	0.06%	0.10%
Residential Mortgages		
Temporary or permanent switch to interest only	4.5	3.5
Reduced monthly payments	2.0	0.8
Deferred payment	1.3	1.4
Total Residential Mortgages	**7.8**	**5.7**
Forborne as a percentage of the total divisional gross lending book (%)	0.52%	0.41%
Total forborne		
Total capitalisation	1.3	-
Total temporary or permanent switch to interest only	29.5	18.3
Total reduced monthly payments	3.2	1.9
Total loan-term extension	0.3	0.1
Total deferred payment	3.1	2.5
Total agreement to advance funds in excess of normal contractual terms	11.1	1.8
Total forborne	**48.5**	**24.6**
Total forborne as a percentage of the total gross lending book (%)	0.65%	0.40%

[1] 2015 SME Commercial Mortgages balance has been re-presented following a review of exposures classified as forborne.

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

Credit risk continued

4. Diversity and low concentrations within our loan 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:

	2016		2015	
	£m		£m	
Asset Finance	1,573.4	21%	1,346.7	22%
Invoice Finance	154.1	2%	160.8	3%
SME Commercial Mortgages[1]	929.9	12%	829.2	13%
Buy-to-Let	3,326.0	45%	2,417.9	39%
Residential Mortgages	1,493.9	20%	1,390.2	23%
	7,477.3	**100%**	**6,144.8**	**100%**

[1] 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:

	2016	2015
	%	%
East Anglia	9.6	9.4
East Midlands	6.1	6.2
Greater London	20.7	19.3
North East	2.6	2.8
North West	10.7	11.4
Northern Ireland	0.2	0.1
Scotland	4.9	4.9
South East	19.9	19.0
South West	9.5	9.8
Wales	2.9	3.2
West Midlands	6.7	7.2
Yorkshire and Humberside	6.2	6.7
	100.0	**100.0**

Credit concentration by sector

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

	2016	2015
	%	%
Agriculture, hunting and forestry	1.1	1.2
Construction	4.4	4.2
Education	0.1	0.1
Electricity, gas and water supply	0.5	0.5
Financial intermediation	1.7	1.4
Health and social work	0.3	0.2
Hotels and restaurants	0.3	0.3
Manufacturing	3.1	3.8
Mining and quarrying	0.2	0.2
Private households with employed persons	0.8	1.0
Public administration and defence; compulsory social security	0.1	-
Real estate, renting and business activities	19.2	18.6
Residential	61.9	61.5
Transport, storage and communication	3.8	4.1
Wholesale & retail trade; repair of motor vehicles, motorcycles & personal household goods	2.5	2.9
	100.0	**100.0**

Financial review continued

Credit risk continued

Credit concentration by quantum of exposure

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

	2016				2015			
	Asset Finance £m	SME Commercial Mortgages[1] £m	Buy-to-Let Mortgages £m	Residential Mortgages £m	Asset Finance £m	SME Commercial Mortgages[1] £m	Buy-to-Let Mortgages £m	Residential Mortgages £m
£0 - £50k	639.7	2.9	25.4	15.9	578.8	4.0	20.7	21.1
£50 - £100k	361.3	24.7	518.1	252.9	307.6	25.6	453.7	240.0
£100 - £150k	145.4	31.7	480.6	414.9	136.8	29.1	410.0	396.2
£150 - £200k	96.1	26.1	400.5	299.6	78.0	23.1	323.0	274.3
£200 - £300k	107.4	52.3	709.1	314.1	83.9	53.3	450.5	278.7
£300 - £400k	54.9	36.7	457.5	120.7	45.6	33.7	281.1	104.9
£400 - £500k	40.3	40.1	219.1	21.4	31.0	36.5	145.5	24.1
£500k - £1m	79.6	119.0	306.3	51.2	52.5	117.7	209.0	45.7
£1m - £2m	34.2	140.2	116.0	3.2	27.9	140.4	79.2	5.2
£2m+	14.5	227.1	93.4	-	4.6	186.5	45.2	-
Total	**1,573.4**	**700.8**	**3,326.0**	**1,493.9**	**1,346.7**	**649.9**	**2,417.9**	**1,390.2**

5. Details of provisioning coverage and the value of assets against which loans are secured

The principal indicators used to assess the credit security of performing loans are loan-to-value 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:

	2016 £m	2015[2] £m
95-100%	0.4	0.4
90-95%	0.5	-
85-90%	0.7	1.1
80-85%	1.7	1.3
75-80%	12.1	8.5
70-75%	34.8	19.0
60-70%	153.2	134.7
50-60%	211.9	209.4
0-50%	285.5	275.5
	700.8	**649.9**
Capital repayment	568.4	505.8
Interest only	132.4	144.1
	700.8	**649.9**
Average loan-to-value percentage	51.74%	52.39%

[1] The above analysis excludes Property Development.
[2] Indexation methodology has been enhanced during 2016 hence the 2015 balances have been re-stated in accordance with the enhanced methodology.

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 drawn compared against the expected gross development value once the development is complete.

Buy-to-Let

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

	2016 £m	2015 £m
100%+	-	0.6
95-100%	0.4	5.1
90-95%	9.6	18.5
85-90%	14.8	14.5
80-85%	136.5	51.6
75-80%	461.4	219.1
70-75%	561.2	323.5
60-70%	984.3	735.1
50-60%	669.6	528.8
0-50%	488.2	521.1
	3,326.0	**2,417.9**
Capital repayment	251.1	228.4
Interest only	3,074.9	2,189.5
	3,326.0	**2,417.9**
Average loan-to-value percentage	63.21%	60.52%

Residential Mortgages

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

	2016 £m	2015 £m
100%+	0.2	6.6
95-100%	17.2	55.2
90-95%	139.9	200.5
85-90%	178.4	166.2
80-85%	170.4	153.6
75-80%	166.1	138.9
70-75%	172.8	121.5
60-70%	251.4	218.3
50-60%	168.4	145.5
0-50%	229.1	183.9
	1,493.9	**1,390.2**
Capital repayment	1,303.1	1,188.0
Interest only	190.8	202.2
	1,493.9	**1,390.2**
Average loan-to-value percentage	69.48%	72.29%

Financial review continued

Credit risk continued

Lending at higher LTV bandings is largely as a result of the Group's participation in the Help to Buy Scheme, with in excess of 90% of the portfolio where the loan-to-value is above 85% having an associated government guarantee reducing the Group's risk exposure. As at 31 December 2016, 96% of the exposures with loan-to-value in excess of 85% relate to the Help to Buy Scheme (31 December 2015: 89%). The Help to Buy guarantee portfolio, which makes up the majority of the Help to Buy book, had an average indexed loan-to-value of 87% (31 December 2015: 91%). As at 31 December 2016, the average indexed loan-to-value of the non-Help to Buy owner occupied book is 61% (31 December 2015: 64%).

Invoice Finance

In respect of Invoice Finance, collateral is provided by the underlying receivables (e.g. trade invoices). As at 31 December 2016, 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 62.30% (31 December 2015: 64.99%).

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.

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 31 December 2016, the total amount of such unsecured lending was £40.7 million (31 December 2015: £30.3 million).

Group impairment coverage ratio

Impairment coverage is analysed as follows:

Coverage ratio	2016 £m	2015 £m
Gross loans and advances	7,504.7	6,165.5
Of which individually impaired	35.6	28.0
Impaired as a % of gross loans and advances	0.47%	0.45%
Allowance for losses - individual provisions	14.3	10.2
Coverage	**40.17%**	**36.43%**

The coverage ratio has increased during the year as the result of a small increase in the number of loans specifically provided for (see Note 13).

Financial review continued

Credit risk continued

6. Information on credit risk within our treasury operations

Credit risk exists with treasury assets where we have acquired securities or placed cash deposits with other financial institutions. The credit risk of treasury assets is considered 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 31 December 2016 and at 31 December 2015, 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.

	2016 £m	2015 £m
Cash and balances at central banks and loans and advances to banks		
- Rated AAA	-	105.3
- Rated AA+ to AA-	139.3	29.6
- Rated A+ to A-	35.6	48.7
- Rated BBB+	8.7	15.9
	183.6	**199.5**
High quality liquid assets included in the liquidity buffer		
- Rated AAA	430.9	396.7
- Rated AA+ to AA-	163.2	134.5
- Rated A+ to A-	-	-
- Rated BBB+	-	-
Debt securities: Asset backed securities		
- Rated AAA	70.4	71.8
- Rated AA+ to AA-	-	-
- Rated A+ to A-	-	3.1
- Rated BBB+	-	-
	664.5	**606.1**
Derivatives held for risk management purposes		
- Rated AAA	-	-
- Rated AA+ to AA-	2.6	1.4
- Rated A+ to A-	6.1	2.0
- Rated BBB+	3.7	2.3
- Rated BBB	-	1.0
	12.4	**6.7**
	860.5	**812.3**

Funding and Liquidity risk management

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 risks, 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.

Analysis of the liquidity buffer

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

	2016 £m	2015 £m
Bank of England reserve account and unencumbered cash and bank balances	118.4	104.8
UK gilts and Treasury bills, Supranational bonds and Covered bonds (level 1 eligible)	554.0	505.9
Treasury bills held under the FLS scheme	294.8	349.0
Covered bonds (level 2 eligible)	36.8	20.8
Asset backed securities	70.4	74.8
Total liquidity buffer	**1,074.4**	**1,055.3**
As a % of funding liabilities	13.54%	15.75%

Our liquidity buffer ensures the Group holds sufficient liquidity under stressed conditions. Our ability to monitor stress and ongoing commitments to our balance sheet has considerably improved in the last 12 months with the introduction of a new liquidity reporting tool "QRM" which allows daily granular reporting, providing greater confidence in understanding the balance sheet. We also have further access to liquidity through pre-positioned collateral with the Bank of England (until drawn would remain off-balance sheet so not included within the calculation), providing further comfort.

Financial review continued

Segmental analysis: Asset Finance

	FY 2016 £m	FY 2015 £m	Movement %
Net interest income	59.4	51.8	*15*
Net fees and other income	4.2	4.3	*(2)*
Operating income	**63.6**	**56.1**	***13***
Administrative expenses	(12.9)	(12.0)	*(8)*
Impairment losses	(5.6)	(4.8)	*(17)*
Segmental profit	**45.1**	**39.3**	***15***
Net loans to customers	**1,573.4**	**1,346.7**	***17***
Organic origination	994.2	893.0	*11*
Gross interest income yield (%)	6.0	6.3	*(0.3)*
Net interest margin (%)	4.1	4.3	*(0.2)*
Cost of risk (%)	0.38	0.40	*0.02*

Asset Finance predominantly supports 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 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 by over £200m to £1.6bn, an increase of 17% driven by organic origination of £1bn, 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 significant number of asset classes. We have also expanded our wholesale proposition, up c60% year-on-year. Net interest income was up 15% in the year to £59.4m, with NIM down slightly to 4.1%, driven by changes in mix and tenure, including the expansion of our wholesale channel.

Impairments remained low at £5.6m (2015: £4.8m), with the cost of risk remaining broadly flat at 38bps, reflecting the high quality book backed by high-levels of tangible collateral. The overall segmental profit increased 15% to £45.1m (2015: £39.3m).

Market and Strategy

The asset finance market was worth c£29bn of gross originations in 2016, growing by 7% year-on-year. Aldermore operates as a leader within the £5bn broker segment (which grew 9%) providing both straightforward forms of asset finance, in addition to complex and structured deals which play to our specialist underwriting advantage. We are also increasing our share of smaller transactional deals and “soft assets”, which grew 15% year on year.

Consolidating our leadership in the broker market will be driven by our on-going investment programme in digital capability, aimed at enhancing our service offering by making it simpler for brokers to deal with us, especially in less complex cases. This capability can then be leveraged into new market adjacencies, including the £9bn vendor finance market.

The market is likely to remain competitive in 2017, driven by new entrants and consolidation in the broker channel, and we expect to see a continued trend toward wholesale deals. However, customer demand remains robust, with Aldermore well-positioned as market leaders to take our natural share of a growing market.

Financial review continued

Segmental analysis: Invoice Finance

	FY 2016 £m	FY 2015 £m	Movement %
Net interest income	4.8	5.3	*(9)*
Net fees and other income	14.2	15.2	*(7)*
Operating income	**19.0**	**20.5**	***(7)***
Administrative expenses	(10.3)	(14.5)	*29*
Impairment losses	(1.7)	(1.5)	*(13)*
Segmental profit	**7.0**	**4.5**	***56***
Net loans to customers	**154.1**	**160.8**	***(4)***
Organic origination	41.7	35.1	*19*
Net revenue margin (%)	12.1	12.0	*0.1*
Net interest margin (%)	3.0	3.1	*(0.1)*
Cost of risk (%)	1.08	0.88	*(0.20)*

Invoice Finance provides working capital solutions for UK SMEs, ranging from vanilla invoice discounting and full-service factoring to more tailored customer solutions requiring Aldermore's in-house expertise.

Performance

Performance trends in Invoice Finance have shown significant improvement as a result of our strategy to consolidate and focus on larger discounting facilities to small businesses, demonstrated by a 56% increase in segmental profit.

Invoice Finance has a relatively short lifecycle compared to the Group's other portfolios, whilst net lending declined slightly by 4% in 2016 to end the year at £154.1m (2015: £160.8m), 19% growth in originations reflects our continuing focus toward invoice discounting and structured finance and away from lower value factoring business.

Fee income of £14.2m declined by £1m as we refocused and managed down customer numbers, reducing overall operating income by 7% to £19.0m. Administrative expenses were reduced by almost a third, reflecting management action to increase efficiency and focus the customer base, whilst broadly maintaining overall net lending balances.

Impairments remain low, increasing by £0.2m to £1.7m, with a cost of risk at 108bps.

Market and Strategy

The Invoice Finance business continues to offer a vital working capital solution for Britain's small businesses and provides a valuable contribution to the Group, as well as the potential for further opportunities for lending to small businesses.

We will continue to deploy a focused strategy, targeting key clients through enhanced sales capability, where we can develop relationships and support client growth. As we grow the client base and net lending, we will continue to drive efficiencies in the operating structure and enhance profitability.

Financial review continued

Segmental analysis: SME Commercial Mortgages

	FY 2016 £m	FY 2015 £m	Movement %
Net interest income	45.4	34.2	*33*
Net fees and other income	1.3	0.8	*63*
Operating income	**46.7**	**35.0**	***33***
Administrative expenses	(3.1)	(4.8)	*35*
Impairment losses	(2.9)	(2.0)	*(45)*
Segmental profit	**40.7**	**28.2**	***44***
Net loans to customers	**929.9**	**829.2**	***12***
Organic origination	435.1	427.6	*2*
Gross interest income yield (%)	6.6	6.5	*0.1*
Net interest margin (%)	5.2	5.0	*0.2*
Cost of risk (%)	0.33	0.29	*(0.04)*

Our SME Commercial Mortgages business provides mortgages for investment in shops, warehouses, industrial units and offices, or for residential Property Development (PD), distributed via financial intermediaries and directly to customers.

Performance
In 2016, we grew net loans to customers by 12% to £930m (2015: £829m) driven by robust organic origination, partially offset by increased redemptions. Approximately 75% of originations were introduced via specialist brokers, with whom we have strong relationships. A further c25%, engaged with us directly, as we continue to see a growing volume of repeat business.

The net interest margin increased slightly by c21bps to 5.2% which, combined with momentum in loan growth, has driven a 33% increase in operating income to £46.7m (2015: £35.0m). The reduction in operating expenses over the year reflects our focus on improving operating leverage as well as the greater allocation of operational resources to other Mortgages segments in 2016 to support growth.

Despite impairments in 2016 including greater prudence in collective provisioning, they remained low at £2.9m (2015: £2.0m), reflecting the low levels of arrears and continued relatively benign credit environment. The book remains backed by high quality tangible collateral with loan to value, excluding PD, of 62% (2015: 63%). Our PD business had £229m of loans outstanding at the year end, with a loan to gross development value at origination of 58%. In total, the segmental profit for SME Commercial Mortgages increased by 44% to £40.7m in 2016 (2015: £28.2m).

Market and Strategy
The commercial mortgage market was worth c£43bn in originations during 2016, of which Aldermore represented less than 1%, focused on multi-let commercial investment property loans and property development to experienced regional developers.

Aldermore differentiates itself through its specialist underwriting capability and strong service proposition, enabling us to generate strong margins. Our commercial underwriters work closely with customers and our approved panel of c1,000 specialist brokers to understand the property use, the tenant covenant and the local market dynamics to underwrite effectively, and earn a premium.

The segments in which we operate are expected to remain competitive. However, we will continue to deploy our specialist underwriting advantage in our core niches. Specialist brokers will continue to be our priority route through which we serve our customers, but we will also seek to continue to expand our direct origination capability.

Financial review continued

Segmental analysis: Buy-to-Let Mortgages

	FY 2016 £m	FY 2015 £m	Movement %
Net interest income	90.4	73.3	*23*
Net fees and other income	6.8	3.0	*127*
Operating income	**97.2**	**76.3**	***27***
Administrative expenses	(10.7)	(9.0)	*(19)*
Impairment losses	(3.4)	(1.3)	*(162)*
Segmental profit	**83.1**	**66.0**	***26***
Net loans to customers	**3,326.0**	**2,417.9**	***38***
Organic origination	1,289.2	673.1	*92*
Gross interest income yield (%)	4.7	5.0	*(0.3)*
Net interest margin (%)	3.1	3.3	*(0.2)*
Cost of risk (%)	0.12	0.06	*(0.06)*

Buy-to-Let (BTL) provides a comprehensive proposition catering for both individual and corporate landlords, simple to complex properties, including Houses in Multiple Occupation and from a single property investment to large portfolios.

Performance
We significantly outperformed the market in 2016, growing net loans by 38% to £3.3bn, driven by a 92% increase in organic origination to £1.3bn. This strong growth also reflects our operational agility, as we took advantage of the market spikes in the first quarter, ahead of the introduction of an increase in stamp duty, and in the fourth quarter when we successfully took share in an active market.

Strong lending growth and a broadly stable net interest margin drove a 23% increase in net interest income to £90.4m (2015: £73.3m). Operating income was up 27% to £97.2m, with fee income benefitting from record application numbers, as we grew our customer base by 25% to c20,000.

The £1.7m increase in administrative expenses is driven by an increased allocation of operational resources to support the strong loan growth delivered in the year.

A modest increase in the cost of risk to 12bps is in line with expectations and remains low. The increase is partly driven by increased prudence in collective provisioning as we extended emergence periods by 3 months to reflect increased economic uncertainty. The quality of the book remains robust, with average loan balances of just £170k across the portfolio and an indexed LTV of 63%. The segmental result demonstrated excellent progress, growing by 26% to £83.1m (2015: £66.0m).

Market and Strategy
The BTL market was worth c£41bn in 2016, representing c14% of the overall mortgage market. Aldermore is a mainstream player in BTL and took a c3.2% market share of originations in the year but with an overall market share of c1% in this market, we have clear headroom for growth. Our proposition offers market-leading breadth of offering for all landlords, but our clear differentiation is at the specialist end of the market with professional landlords (more than 3 properties), who represent c60% of our portfolio. Our distribution strategy is primarily broker-led, but with a growing proportion of customers, c20% in 2016, engaging with us directly. We have a diverse geographic footprint, but a bias towards the strong rental markets in Greater London and the South East.

The fundamentals supporting demand in the BTL market remain strong. There remains a shortage of housing stock and new housebuilding continues to lag Government targets. Whilst regulatory changes to personal tax relief, underwriting and affordability testing are expected to reduce the overall rate of market growth, we expect to benefit from the increased professionalisation of demand and to continue outgrowing the market, building on our small market share.

Segmental analysis: Residential Mortgages

	FY 2016 £m	FY 2015 £m	Movement %
Net interest income	49.6	43.8	*13*
Net fees and other income	1.9	2.2	*(14)*
Operating income	**51.5**	**46.0**	***12***
Administrative expenses	(4.5)	(5.1)	*12*
Impairment losses	(1.9)	(0.8)	*(138)*
Segmental profit	**45.1**	**40.1**	***12***
Net loans to customers	**1,493.9**	**1,390.2**	***7***
Organic origination	466.0	582.3	*(20)*
Gross interest income yield (%)	5.3	5.6	*(0.3)*
Net interest margin (%)	3.4	3.7	*(0.3)*
Cost of risk (%)	0.13	0.07	*(0.06)*

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 grew by 7% in 2016 to £1.5bn (2015: £1.4bn), driving net interest income up by 13%. This growth was driven by £466.0m of originations which were lower than in 2015 (2015: £582m) due to a greater focus on buy-to-let in 2016. Originations in 2016 were partly offset by redemptions increasing to £365.6m (2015: £171.8m), which was weighted to the second half of the year due to the maturity of the high-yielding first cohort of Help to Buy mortgages written in mid-2014.

The net interest margin reduced by c30bps to 3.4% (2015: 3.7%), driven by a number of factors, including the reduction in the base rate and the redemption of high-yielding first cohort of Help to Buy customers indicated above.

The reduction in operating expenses over the year reflects our focus on improving operating leverage as well as the allocation of operational resources between the Mortgage segments to support loan growth, which is based on origination activity and net loan balances. Despite increased prudence in collective provisioning, impairments remained low at £1.9m (2015: £0.8m), reflecting the relatively low levels of arrears and continued benign credit environment. The overall segmental profit increased 12% to £45.1m (2015: £40.1m).

Market and Strategy
The residential mortgage market was worth c£205bn in originations during 2016, of which Aldermore represented just 0.2%, focused on specialist sub-segments, including first time buyers, the self-employed and professionals. We are differentiated through our use of specialist underwriting capabilities which complement modern credit rating engines. Our system-driven approach automatically completes basic checks, creates a case file, and highlights areas for further review, enabling our human underwriting team to make better informed credit decisions, with greater efficiency.

The mortgages platform, operated across all three Mortgages segments, underwent an upgrade during 2016, driven by requirements from the Mortgage Credit Directive but also providing an opportunity for us to enhance system functionality, including the development of a product switching portal, which will enable future growth in our target segments going forward.

Aldermore operates as a small player in specific niches and we are confident that we can continue organic origination-led growth within the large residential market. Specifically, the Mortgage Indemnity Guarantee (MIG) product that we introduced to follow-on from the Government's Help to Buy Mortgage Guarantee scheme, and a package of measures to enhance our proposition and service to the self-employed market are expected to drive increased origination activity.

Financial review continued

Segmental analysis: Central Functions

	FY 2016 £m	FY 2015 £m	Movement %
Net interest income	(10.2)	(9.5)	*(7)*
Net fees and other income	(0.3)	0.3	*(200)*
Operating income	(10.5)	(9.2)	*(14)*
Administrative expenses	(77.7)	(70.1)	*(11)*
IPO-related costs	-	(4.1)	-
Impairment of Invoice Finance goodwill	(4.1)	-	-
Segmental loss	**(92.3)**	**(83.4)**	***(11)***

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 11% to £81.8m (2015: £74.2m), driven by the recruitment of colleagues as we invested to further support growth and risk management.

At the end of 2015, we held goodwill of £4.1m related to the acquisition of Absolute Invoice Finance (Holdings) Limited which was supported using a Fair Value less Cost of Disposal methodology. During 2016, as a result of the general fall in market values of financial services businesses following the EU referendum, management concluded the goodwill balance was fully impaired and a charge of £4.1 million has been recognised in the income statement.

The segmental result was a charge of £92.3m (2015: charge of £83.4m).

Savings market and strategy

The market for savings in 2016 continued to be dominated by a backdrop of low and falling interest rates from a lower base rate and reduced competition for funding in response to Bank of England funding schemes. In particular, the SME savings market remains highly attractive given the opportunity for non-traditional providers to offer a demonstrably better customer proposition – both in terms of rate and experience.

We continue to focus on small businesses where insight and research demonstrates a clear customer demand and market opportunity. Inflationary pressures in the economy suggest that we may have reached the bottom of the interest rate cycle and base rate movements are more likely to be upwards. This, together with increases in the annual ISA allowance (to £20,000) and FSCS deposit protection limit (to £85,000), means the outlook for savings customers is positive.

Risk report

Our approach to risk
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.

Our framework and principles for managing risk
The Risk Management Framework outlines the process by which we identify, manage, monitor and report risks to which the Group is exposed. The framework is supported by supplemental frameworks, policies, processes and procedures which ensure that the Group's risks are managed appropriately.

We operate within the context of the UK legal and regulatory environment (as well as European law adopted and supported by UK regulators). The Legal and Compliance functions ensure that we are aware of both current and upcoming legal or regulatory requirements. Reporting of any forthcoming changes to regulation or law is routinely made to the relevant committees for awareness, impact and action.

We manage risk in line with the following principles:
Franchise Preservation - The protection of our reputation and franchise is paramount. Everything we do is guided by the principle of putting the customer at the centre of what we do. It informs our business strategy, the way in which we do business, and the manner in which we treat our customers and other stakeholders.

Strong Risk Governance - Risk is managed using the three lines of defence principle – separating risk origination from risk oversight and risk assurance. Governance is provided through a formal committee process, including the Board Risk and Audit Committees.

Independent Risk Oversight and Challenge - The Risk function provides risk oversight and challenge, independent of the businesses and functions, with a reporting line to the Board Risk Committee. It is the basis of the second line of defence.

Defined Risk Appetite - A clearly defined Risk Appetite Framework is in place which allows the setting of detailed risk appetite and reporting metrics for principal risks.

Risk Management and Control - Risks are identified, managed, monitored and reported against pre-determined risk appetite where appropriate. All are subject to governance and controls. Responsibility for the identification, assessment, measurement, monitoring and management of the risks rests with the first line of defence, being the business units and functions.

Our strong culture of risk awareness and accountability
The Board ensures that the Group actively embraces a strong risk culture, where all staff are accountable for the risks they take. The Board leads in setting the risk appetite and ensuring that the Risk Management Framework is fully embedded with a strong focus on the adherence to risk appetite in all metrics. Staff performance management and reward practices all have key risk inputs, and a focus on risk management in their design. The Group aims for employees to be risk aware, and to strike the right balance between delivering on objectives, individual accountability, and maintaining a safe and secure business adhering to risk appetite.

Principal risks
There are a number of risks we inherently face when operating in line with our business model and strategy. These principal risks and uncertainties and how we seek to mitigate their effects are summarised below.

Credit risk
The risk that customers may be unable to make their loan repayments.

Mitigation
- Focus lending where we have specific expertise
- Limit concentration of lending by size, geography and sector
- Obtain appropriate level of security cover and perform affordability testing at origination
- Embed clear lending policies in each business area
- Regularly review performance against risk appetite
- Stress test the portfolio to test resilience

Risk report continued

Capital and liquidity risk
The risk that we fail to hold sufficient or appropriate reserves to support growth, meet regulatory requirements, or repay obligations as they fall due.

Mitigation

- Stress testing and sensitivity analysis of both capital and liquidity
- Monthly monitoring of capital adequacy position against internal targets and forecasts
- Maintenance of a liquidity buffer based on stressed requirements
- Daily monitoring of liquidity buffer
- Maintenance and annual review of the Contingency Funding Plan
- On-going review, analysis and impact assessment of regulatory changes

Market risk
The risk that market movements adversely impact the Group.

Mitigation

- We do not seek to take or expose the Group to market risk and we do not carry out proprietary trading
- We match interest rate structures of assets and liabilities to create a natural hedge where possible
- Unmatched interest rate exposures are hedged with derivative “swap” contracts

Operational risk
The risk of loss due to failure in processes, systems or human error, including outsourcing.

Mitigation

- Embed and ensure all staff understand and follow the Operational Risk Management Framework
- Analysis of Risk Event Reporting and follow up actions
- Monitoring of the Operational Risk profile, and risk event reporting
- Continuing to invest in information security and cyber controls following our Cyber strategy
- Implementation of a Third Party Supplier Framework

Compliance, conduct and financial crime risk
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.

Mitigation

- The Group provides simple, straightforward and transparent products and operates solely in the UK market
- Embed and ensure all staff understand and follow clear policy frameworks and policies including Conduct Risk and Product Governance
- Continued investment in staff training and supporting systems
- Horizon scanning and impact assessment to track regulatory change

Reputational risk
Failure to meet the expectations and standards of our customers, investors, regulators or other counterparties.

Mitigation

- All governance committees have reputational risk considerations as a key part of their remit
- Group Corporate Affairs monitors reputational risk, under the executive direction of the Group CEO
- All employees are aware of their responsibilities under the Bank’s Reputational Risk Policy
- Maintaining open and transparent relationships with regulators and other key stakeholder groups

Emerging risks

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

Basel Committee on banking supervision

- In December 2015 the BCBS issued a second consultative document (Revisions to the Standardised Approach for Credit Risk) containing, amongst others, 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

- In 2016 we conducted an impact assessment of the proposed changes, followed by scenario analysis including feasible management actions. The Bank also undertook a feasibility study on transitioning from Standardised to an Internal Ratings Based (IRB) approach to capital. This included a gap analysis against current regulatory requirements and has informed our thinking into possible responses, including the possibility of applying for regulatory approval to operate in an IRB environment, once the new capital rules are published

- The IFRS9 work on credit models (see Emerging Risks IFRS9) takes us closer to the sophistication required for an IRB approach to capital which may help to mitigate the risk of future changes in capital requirements. We will continue to monitor the cost and benefits associated to moving to IRB, as the regulatory changes and timeframes for implementation become clear

IFRS9

- New reporting requirements under IFRS 9 introduce forward looking credit loss models which will lead to changes in the timing of impairment recognition. The requirement, which comes in to effect from 1 January 2018, requires the development of new risk models. The risk is that the Group is unable to deliver these before new regulation takes effect

- In 2016 we assessed the impact of IFRS 9 and have initiated a project to ensure compliance with the new standard ahead of its proposed implementation date of 1 January 2018.   We are on track with enhancements to our credit risk models and expect to be IFRS9 compliant ahead of January 2018 when the new accounting standard is introduced

Buy To Let Mortgages - Tax changes and revised PRA underwriting standards

- Potentially adverse impact on buy-to-let market of changes to UK tax regime and failure to comply with expectations of the regulator set out in PRA Supervisory Statement on Buy-to-Let Underwriting Standards issued in September 2016

- In 2016 we continued monitoring buy-to-let business levels. We also amended our buy-to-let affordability calculation (interest cover ratio and stress rate) in December 2016 to meet expectations in PRA’s supervisory statement. Further review of PRA’s expectations in terms of portfolio landlords and use of personal income in affordability calculation, with expectation that all changes to approach considered necessary will be introduced by the 30 September 2017 deadline

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 sheltered 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

- In 2016 the Group incorporated these risks in stress testing conducted during the year. The Group will continue to monitor the situation and decide on an appropriate response, based on internal scenario planning, as the situation develops

Risk report continued

International economic and political environment

- The geopolitical environment presents risks to global markets, including the impact of a new administration in the USA, deflationary concerns in the EU and continued political risks in Russia and the Middle East

- We have monitored these risks, and the UK economy has remained robust in the face of these domestic and global headwinds. As a UK-focused business we have not felt any adverse consequences across our trading franchise

- The medium-term outlook is unclear and there remains a possibility that material international events could adversely affect the UK, in addition to any EU exit impacts. These could act as a drag on the UK economy and affect the sectors to which we lend. We aim to manage these risks by maintaining a well-diversified product base, and remaining firmly focused on the UK

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 increase in unemployment may lead to a rising number of defaults

- The Group continued to monitor and manage the performance of our real estate backed lending, and identified no significant change in performance in 2016. We also continued to enforce our underwriting criteria, which includes affordability testing at the point of origination. The risks are expected to remain unchanged in 2017

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, or growth slows, unemployment may rise and loan servicing costs may increase which could cause an increase in credit losses

- We conducted specific stress testing on our loan portfolio and maintained strict underwriting criteria, which includes stressing affordability rates at interest rates above those being paid today

- We will continue to monitor the external environment and respond to any interest rate rises as appropriate

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 volume, higher customer attrition and/or lower net interest margins. The risk of competition has been incorporated in our forward planning process and the external market is monitored on a consistent basis. We will continue to monitor the external environment and adapt accordingly

Cyber-crime

- Cyber-crime is a significant threat in our increasingly interconnected world and exposes all businesses and in particular financial services companies to financial as well as reputational damage

- Cyber threats continue to evolve as demonstrated by high profile cases. The increased size of the Group, and growing customer base, increases the profile of the Group to would-be cyber attackers. During 2015, and continuing into 2016, we strengthened our defences against cyber-crime

- We have a cyber-risk response plan, which involves working with our technology partners, and ensures that there is a practical response and appropriate escalation. Looking forward into 2017 and beyond, this remains a key risk area and the Group will continue to invest in ongoing security improvements

System failure / outsourcing

- The Group has a number of major outsource partners and critical supplier relationships who are key elements of the overall supply chain. The failure of one of these key partners could significantly impact the Group's operations and reputation. The Group has controls in place in relation to sourcing and on-boarding suppliers. In 2016 work was begun to further enhance the supplier management framework with continued focus during 2017 as the updated framework is implemented across the supplier estate

Consolidated income statement

For the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Interest income	4	358.2	300.4
Interest expense	5	(118.8)	(101.5)
Net interest income		**239.4**	**198.9**
Fee and commission income	6	30.0	25.2
Fee and commission expense	7	(7.5)	(7.0)
Net expense from derivatives and other financial instruments at fair value through profit or loss	8	(4.4)	(2.1)
Gains on disposal of available for sale debt securities		3.8	2.3
Other operating income	9	6.2	7.4
Total operating income		**267.5**	**224.7**
Provisions	16	(0.8)	(2.3)
Costs in respect of initial public offering		-	(4.1)
Impairment of goodwill		(4.1)	-
Other administrative expenses		(113.1)	(107.9)
Administrative expenses	**10**	**(118.0)**	**(114.3)**
Depreciation and amortisation		(5.3)	(5.3)
Operating profit before impairment losses		**144.2**	**105.1**
Impairment losses on loans and advances to customers	13	(15.5)	(10.4)
Profit before taxation		**128.7**	**94.7**
Taxation	11	(35.2)	(16.4)
Profit after taxation - attributable to equity holders of the Group		**93.5**	**78.3**
Basic earnings per share (pence)	12	25.2p	22.7p
Diluted earnings per share (pence)	12	25.2p	22.6p

The notes and information on pages 42 to 52 form part of these financial statements.

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

Consolidated statement of comprehensive income

For the year ended 31 December 2016

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Profit after taxation	**93.5**	**78.3**
Other comprehensive income/(expense):		
Items that may subsequently be transferred to the income statement:		
Available for sale debt securities:		
Fair value movements	7.6	(0.9)
Amounts transferred to the income statement	(3.8)	(2.1)
Taxation	(1.0)	0.6
Total other comprehensive income/(expense)	**2.8**	**(2.4)**
Total comprehensive income attributable to equity holders of the Group	**96.3**	**75.9**

The notes and information on pages 42 to 52 form part of these financial statements.

Consolidated statement of financial position

As at 31 December 2016

	Note	31 December 2016 £m	31 December 2015 £m
Assets			
Cash and balances at central banks		116.4	105.3
Loans and advances to banks		67.2	94.2
Debt securities		664.5	606.1
Derivatives held for risk management		12.4	6.7
Loans and advances to customers	13	7,477.3	6,144.8
Fair value adjustment for portfolio hedged risk		(3.5)	1.1
Other assets		3.1	1.4
Prepayments and accrued income		3.4	5.1
Deferred taxation		11.2	16.4
Property, plant and equipment		3.1	3.4
Intangible assets	14	26.1	24.0
Total assets		**8,381.2**	**7,008.5**
Liabilities			
Amounts due to banks		753.8	405.1
Customers' accounts	15	6,673.7	5,742.0
Derivatives held for risk management		35.8	35.4
Fair value adjustment for portfolio hedged risk		(1.2)	(0.8)
Other liabilities		25.0	21.9
Accruals and deferred income		27.0	25.7
Current taxation		9.7	12.5
Provisions	16	0.8	1.1
Debt securities in issue	17	130.6	193.9
Subordinated notes	18	100.0	38.1
Total liabilities		**7,755.2**	**6,474.9**
Equity			
Share capital	19	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		1.8	(1.0)
Retained earnings		442.2	352.6
Total equity		**626.0**	**533.6**
Total liabilities and equity		**8,381.2**	**7,008.5**

The notes and information on pages 42 to 52 form part of these financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Cash flows from operating activities			
Profit before taxation		128.7	94.7
Adjustments for non-cash items and other adjustments included within the income statement	20	11.3	9.1
(Increase) in operating assets	20	(1,332.8)	(1,317.9)
Increase in operating liabilities	20	1,284.5	1,368.1
Income tax paid		(31.5)	(20.2)
Net cash flows generated from operating activities		**60.2**	**133.8**
Cash flows from investing activities			
Purchase of debt securities		(298.4)	(414.0)
Proceeds from sale and maturity of debt securities		161.7	279.0
Capital repayments of debt securities		87.5	32.9
Interest received on debt securities		12.9	10.5
Purchase of property, plant and equipment and intangible assets		(11.2)	(7.3)
Net cash used in investing activities		**(47.5)**	**(98.9)**
Cash flows from financing activities			
Proceeds from issue of shares		-	75.0
Issuance costs of Initial Public Offering		-	(2.7)
Proceeds from exercise of warrants		-	5.6
Proceeds from the issue of subordinated debt		60.0	-
Issuance costs of subordinated debt		(0.6)	-
Capital repayments on debt securities issued		(63.6)	(85.7)
Purchase of own shares by Employee Benefit Trust		(0.9)	-
Coupon paid on contingent convertible securities		(8.9)	(3.5)
Interest paid on debt securities		(2.0)	(3.0)
Interest paid on subordinated notes		(5.2)	(5.2)
Net cash used in financing activities		**(21.2)**	**(19.5)**
Net (decrease)/increase in cash and cash equivalents		(8.5)	15.4
Cash and cash equivalents at start of the year		149.4	134.0
Movement during the year		(8.5)	15.4
Cash and cash equivalents at end of the year	**20**	**140.9**	**149.4**

Consolidated statement of changes in equity

	Note	Share capital £m	Share premium account £m	Contingent convertible securities £m	Capital redemption reserve £m	Warrant reserve £m	Available for sale reserve £m	Retained earnings £m	Total £m
Year ended 31 December 2016									
As at 1 January		34.5	73.4	74.0	0.1	-	(1.0)	352.6	533.6
Total comprehensive income		-	-	-	-	-	2.8	93.5	96.3
Transactions with equity holders:									
- Share-based payments, including tax reflected directly in retained earnings		-	-	-	-	-	-	3.6	3.6
- Own shares adjustment	19	-	-	-	-	-	-	(0.9)	(0.9)
- Coupon paid on contingent convertible securities, net of tax		-	-	-	-	-	-	(6.6)	(6.6)
As at 31 December		**34.5**	**73.4**	**74.0**	**0.1**	**-**	**1.8**	**442.2**	**626.0**
Year ended 31 December 2015									
As at 1 January		23.7	-	73.7	-	2.2	1.4	277.9	378.9
Total comprehensive income		-	-	-	-	-	(2.4)	78.3	75.9
Transactions with equity holders:									
- Capital reorganisation prior to IPO		6.3	-	-	0.1	-	-	(6.4)	-
- Share issue proceeds from IPO		3.9	71.1	-	-	-	-	-	75.0
- Share issuance costs		-	(2.7)	-	-	-	-	-	(2.7)
- Share-based payments, including tax reflected directly in retained earnings		-	-	-	-	-	-	3.4	3.4
- Coupon paid on contingent convertible securities, net of tax		-	-	-	-	-	-	(2.8)	(2.8)
- Tax credit on AT1 issue costs		-	-	0.3	-	-	-	-	0.3
- Exercise of share warrants		0.6	5.0	-	-	(2.2)	-	2.2	5.6
As at 31 December		**34.5**	**73.4**	**74.0**	**0.1**	**-**	**(1.0)**	**352.6**	**533.6**

Notes to the consolidated financial statements

1. Basis of preparation

The financial information set out in the financial statements on pages 37 to 52 does not constitute the Group's statutory accounts for the years ended 31 December 2016 and 2015. Statutory accounts for 2015 have been delivered to the Registrar of Companies, and those for 2016 will be delivered in due course. The auditor has reported on both sets of accounts; their reports were (i) unqualified, (ii) did not include reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

These results have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB'), and as adopted by the European Union ('EU').

The Directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of the approval of the financial statements. Accordingly, they continue to adopt the going concern basis in presenting and preparing the financial statements.

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, EIR and Invoice Finance goodwill.

Notes to the consolidated financial statements continued

3. Segmental information

The Group's reportable operating segments are consistent with those disclosed in the 2015 Annual Report and Accounts. Further details regarding the operating segments are available in the 2016 Annual Report and Accounts.

Segmental information for the year ended 31 December 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	87.3	7.0	58.4	135.6	75.7	(5.8)	358.2
Interest expense – external customers	-	-	-	-	-	(118.8)	(118.8)
Interest (expense)/income – internal	(27.9)	(2.2)	(13.0)	(45.2)	(26.1)	114.4	-
Net fees and other income – external customers	4.2	14.2	1.3	6.8	1.9	(0.3)	28.1
Total operating income	**63.6**	**19.0**	**46.7**	**97.2**	**51.5**	**(10.5)**	**267.5**
Administrative expenses including depreciation and amortisation	(12.9)	(10.3)	(3.1)	(10.7)	(4.5)	(81.8)	(123.3)
Impairment losses on loans and advances to customers	(5.6)	(1.7)	(2.9)	(3.4)	(1.9)	-	(15.5)
Segmental result	**45.1**	**7.0**	**40.7**	**83.1**	**45.1**	**(92.3)**	**128.7**
Tax							(35.2)
Profit after tax							**93.5**
Assets	1,573.4	154.1	929.9	3,326.0	1,493.9	903.9	8,381.2
Liabilities	-	-	-	-	-	(7,755.2)	(7,755.2)
Net assets/(liabilities)	**1,573.4**	**154.1**	**929.9**	**3,326.0**	**1,493.9**	**(6,851.3)**	**626.0**

[1] Central Functions administrative expenses of £81.8 million includes an impairment charge of £4.1 million in relation to Invoice Finance goodwill.

Segmental information for the year ended 31 December 2015

	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	75.7	7.6	44.8	111.0	66.4	(5.1)	300.4
Interest expense – external customers	-	-	-	-	-	(101.5)	(101.5)
Interest (expense)/income – internal	(23.9)	(2.3)	(10.6)	(37.7)	(22.6)	97.1	-
Net fees and other income – external customers	4.3	15.2	0.8	3.0	2.2	0.3	25.8
Total operating income	**56.1**	**20.5**	**35.0**	**76.3**	**46.0**	**(9.2)**	**224.7**
Administrative expenses including depreciation and amortisation	(12.0)	(14.5)	(4.8)	(9.0)	(5.1)	(74.2)	(119.6)
Impairment losses on loans and advances to customers	(4.8)	(1.5)	(2.0)	(1.3)	(0.8)	-	(10.4)
Segmental result	**39.3**	**4.5**	**28.2**	**66.0**	**40.1**	**(83.4)**	**94.7**
Tax							(16.4)
Profit after tax							**78.3**
Assets	1,346.7	160.8	829.2	2,417.9	1,390.2	863.7	7,008.5
Liabilities	-	-	-	-	-	(6,474.9)	(6,474.9)
Net assets/(liabilities)	**1,346.7**	**160.8**	**829.2**	**2,417.9**	**1,390.2**	**(5,611.2)**	**533.6**

[1] Central Functions administrative expenses of £74.2 million includes costs in relation to the Group's Initial Public Offering of £4.1 million.

Notes to the consolidated financial statements continued

4. Interest income

	2016 £m	2015 £m
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	364.0	305.4
On loans and advances to banks	0.7	0.7
On debt securities	12.4	11.1
	377.1	**317.2**
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	(18.9)	(18.5)
Net interest income on debt securities designated at fair value	-	1.7
	358.2	**300.4**

Included within interest income on loans and advances to customers for the year ended 31 December 2016 is a total of £3.4 million (31 December 2015: £3.2 million) relating to impaired financial advances.

Included within net interest expense on financial instruments hedging assets are fair value losses of £0.3 million (31 December 2015: gains of £2.7 million) on derivatives held in qualifying fair value hedging arrangements, together with losses of £4.4 million (31 December 2015: losses of £6.1 million) representing changes in the fair value of the hedged item attributable to the hedged interest rate risk on loans and advances to customers.

5. Interest expense

	2016 £m	2015 £m
On financial liabilities not at fair value through profit or loss:		
On customers' accounts	109.8	91.6
On amounts due to banks	2.6	2.8
On debt securities in issue	2.3	3.5
On subordinated notes	7.7	6.5
	122.4	**104.4**
On financial liabilities at fair value through profit or loss:		
Net interest income on financial instruments hedging liabilities	(5.6)	(4.5)
Other	2.0	1.6
	118.8	**101.5**

Included within net interest income on financial instruments hedging liabilities are fair value gains of £2.1 million (31 December 2015: losses of £1.8 million) on derivatives held in qualifying fair value hedging arrangements, together with gains of £0.4 million (31 December 2015: gains of £2.3 million) representing changes in the fair value of the hedged item attributable to the hedged interest rate risk on customers' accounts.

6. Fee and commission income

	2016 £m	2015 £m
Invoice Finance fees	11.9	12.6
Valuation fees	7.0	4.1
Documentation fees	2.8	3.2
Other fees	8.3	5.3
	30.0	**25.2**

7. Fee and commission expense

	2016 £m	2015 £m
Introducer commissions	1.5	1.7
Legal and valuation fees	3.4	2.7
Company searches and other fees	1.3	1.6
Credit protection and insurance charges	1.3	0.8
Other	-	0.2
	7.5	**7.0**

Notes to the consolidated financial statements continued

8. Net expense from derivatives and other financial instruments at fair value through profit or loss

	2016 £m	2015 £m
Net (losses)/gains on derivatives	(6.5)	5.0
Net(losses) on assets designated at fair value through profit or loss	-	(0.2)
Net gains/(losses) on available for sale assets held in fair value hedges	2.1	(6.9)
	(4.4)	**(2.1)**

9. Other operating income

	2016 £m	2015 £m
Disbursements, collect out and other invoice finance income	6.2	6.4
Other	-	1.0
	6.2	**7.4**

10. Administrative expenses

	Note	2016 £m	2015 £m
Staff costs		64.3	62.1
Legal and professional and other services		21.8	25.8
Information technology costs		10.9	7.3
Office costs		5.0	4.9
Provisions	16	0.8	2.3
Other		11.1	11.9
Impairment of goodwill		4.1	-
		118.0	**114.3**

Included in other administrative expenses are costs relating to temporary staff of £4.4 million (31 December 2015: £5.0 million), travel and subsistence of £3.0 million (31 December 2015: £3.2 million) and staff recruitment of £1.5 million (31 December 2015: £1.6 million).

Administrative expenses of £114.3 million for the year ended 31 December 2015 included £4.1 million of one-off costs associated with the Group's initial public offering.

11. Taxation

	2016 £m	2015 £m
Current tax on profits for the year	33.1	25.1
(Over)/under provision in prior periods	(2.2)	1.1
Total current tax	**30.9**	**26.2**
Deferred tax	4.3	(9.8)
Total tax charge	**35.2**	**16.4**

In 2016 the effect of the new banking surcharge is included in the current year tax charge. A tax charge of £1.0 million in respect of the fair value movements in available for sale debt securities has been shown in other comprehensive income during the year ended 31 December 2016 (31 December 2015: £0.6m credit). A tax credit of £2.3 million (31 December 2015: £1.0 million) has been reflected directly in equity in respect of tax relief for contingent convertible securities coupon costs.

The tax assessed for the year is different to that resulting from applying the standard rate of corporation tax in the UK of 20% (31 December 2015: 20.25%). The differences are explained below:

	2016 £m	2015 £m
Profit before tax	**128.7**	**94.7**
Tax at 20% (2015: 20.25%) thereon	25.7	19.2
Effects of:		
Expenses not deductible for tax purposes	1.0	0.7
Under provision in previous period	0.2	0.2
Deferred tax rate adjustment	0.4	(3.7)
Effect of new tax surcharge	7.9	-
	35.2	**16.4**

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 year.

	2016	**2015**
Profit after taxation - attributable to equity holders of the Group (£ million)	93.5	78.3
Coupon paid on contingent convertible securities, net of tax relief (£ million)	(6.6)	(2.8)
Profit attributable to ordinary shareholders of the Group (£ million)	**86.9**	**75.5**
Weighted average number of ordinary shares in issue (million)	344.5	332.4
Basic earnings per share (p)	25.2p	22.7p

The ordinary shares in issue used in the denominator in the calculation of basic earnings per share are the ordinary shares of the Company since the share reorganisation that occurred on the Company's admission to the LSE on 13 March 2015.

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. The share warrants, giving rise to dilution for the first half of 2015, were exercised on 9 September 2015 and new shares were issued and listed on the London Stock Exchange.

	2016	**2015**
Weighted average number of ordinary shares in issue (million) (basic)	344.5	332.4
Effect of share warrants prior to their exercise	-	2.2
Effect of share-based payment awards	0.7	0.1
Weighted average number of ordinary shares in issue (million) (diluted)	345.2	334.7
Diluted earnings per share (p)	25.2p	22.6p

13. Loans and advances to customers

	2016 £m	2015 £m
Gross loans and advances	7,504.7	6,165.5
less: allowance for impairment losses	(27.4)	(20.7)
	7,477.3	**6,144.8**
Amounts include:		
Expected to be recovered more than 12 months after the reporting date	6,466.4	5,345.5

At 31 December 2016, loans and advances to customers of £1,066.2 million (31 December 2015: £1,445.5 million) were pre-positioned with the Bank of England and HM Treasury Funding for Lending Scheme. These loans and advances were available for use as collateral with the Scheme, against which £650.0 million of UK Treasury Bills had been drawn as at the reporting date (31 December 2015: £750.0 million).

At 31 December 2016, loans and advances to customers of £578.7 million (31 December 2015: £nil) 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.

At 31 December 2016, loans and advances to customers include £148.7 million (31 December 2015: £206.5 million) which have been used in secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Oak No. 1 PLC which is a securitisation vehicle consolidated into these financial statements. The carrying value of these loans on 10 April 2014, when the beneficial interest was transferred, was £362.3 million. These loans secured £333.3 million of funding for the Group. All the assets pledged are retained within the statement of financial position as the Group retains substantially all the risks and rewards relating to the loans.

Allowance for impairment losses as follows:

	Individual £m	Collective £m	Total £m
Year ended 31 December 2016			
Balance as at 1 January	10.2	10.5	20.7
Impairment loss for the year:			
Charge to the income statement	10.8	4.7	15.5
Unwind of discounting	(1.3)	(2.1)	(3.4)
Write-offs net of recoveries	(5.4)	-	(5.4)
Balance as at 31 December	**14.3**	**13.1**	**27.4**

	Individual £m	Collective £m	Total £m
Year ended 31 December 2015			
Balance as at 1 January	14.0	8.5	22.5
Impairment charge for the year:			
Charge to the income statement	6.8	3.6	10.4
Unwind of discounting	(1.6)	(1.6)	(3.2)
Write-offs net of recoveries	(9.0)	-	(9.0)
Balance as at 31 December	**10.2**	**10.5**	**20.7**

Notes to the consolidated financial statements continued

14. Intangible assets

	Computer systems £m	Goodwill £m	Total £m
Cost			
1 January 2016	24.8	12.6	37.4
Additions	10.3	-	10.3
Write-off	-	(4.1)	(4.1)
31 December 2016	**35.1**	**8.5**	**43.6**
1 January 2015	19.2	12.6	31.8
Additions	5.6	-	5.6
31 December 2015	**24.8**	**12.6**	**37.4**
Amortisation			
1 January 2016	13.4	-	13.4
Charge for the year	4.1	-	4.1
31 December 2016	**17.5**	**-**	**17.5**
1 January 2015	9.2	-	9.2
Charge for the year	4.2	-	4.2
31 December 2015	**13.4**	**-**	**13.4**
Net book value			
31 December 2016	**17.6**	**8.5**	**26.1**
31 December 2015	11.4	12.6	24.0

Goodwill arose on the acquisitions of Ruffler Holdings Limited (subsequently renamed Aldermore Holdings Limited), Base Commercial Mortgages Holdings Limited and Absolute Invoice Finance (Holdings) Limited. For the purpose of impairment testing, goodwill is allocated to the Group's operating segments with the aggregate amount allocated to each segment is as follows:

	2016 £m	2015 £m
SME Commercial Mortgages	8.5	8.5
Invoice Finance	-	4.1
	8.5	**12.6**

At 1 January 2016, the Invoice Finance goodwill was fully supported using the Fair Value less Costs of Disposal ("FVLCD") method. During 2016, as a result of the general fall in market values of financial services businesses following the EU referendum, management concluded the goodwill balance was fully impaired and a charge of £4.1 million has been recognised in the income statement.

The Value in Use ("VIU") for SME Commercial Mortgages was determined by discounting the future cash flows to be generated from the continuing use of the segment. VIU at 31 December 2016 has been determined in a similar manner as at 31 December 2015.

Key assumptions used in the calculation of VIU were the following:

- Cash flows were projected based on past experience, actual operating results and the five year business plan (31 December 2015: the five year business plan). Cash flows after the planning period were extrapolated using a constant growth rate of 2 per cent (31 December 2015: 2 per cent) into perpetuity.
- A pre-tax discount rate of 13.0 per cent (31 December 2015: 13.0 per cent) was applied in determining the recoverable amounts for the SME Commercial Mortgage operating segment. These discount rates were based on the weighted average cost of funding for the segment, taking into account the Group's regulatory capital requirement and expected market returns for debt and equity funding, then adjusted for risk premiums to reflect the systemic risk of the segment.

IAS 36 requires an assessment of goodwill balances for impairment on an annual basis, or more frequently if there is an indication of impairment. An impairment charge should be recognised where the recoverable amount from the segment is less than the

14. Intangible assets continued

carrying value of the goodwill. Under IAS 36, the recoverable amount is the greater of either the VIU of a business or its Fair Value less Costs of Disposal ("FVLCD").

The VIU of the SME Commercial Mortgages segment is significantly above the carrying value of the attributable goodwill and net assets. The Group estimates that reasonably possible changes in the above assumptions are not expected to cause the recoverable amount of SME Commercial Mortgages to reduce below the carrying amount.

15. Customers' accounts

	2016 £m	2015 £m
Retail deposits	4,766.8	4,186.3
SME deposits	1,647.2	1,399.4
Corporate deposits	259.7	156.3
	6,673.7	**5,742.0**
Amounts repayable within one year	5,397.1	4,288.8
Amounts repayable after one year	1,276.6	1,453.2
	6,673.7	**5,742.0**

16. Provisions

	Financial Services Compensation Scheme £m	Customer redress £m	Total £m
1 January 2016	1.1	-	1.1
Utilised during the year	(1.1)	-	(1.1)
Provided during the year	0.8	-	0.8
31 December 2016	**0.8**	**-**	**0.8**
1 January 2015	1.2	0.8	2.0
Utilised during the year	(2.3)	(0.9)	(3.2)
Provided during the year	2.2	0.1	2.3
31 December 2015	**1.1**	**-**	**1.1**

Financial Services Compensation Scheme ("FSCS")

In common with all regulated UK deposit takers, the Group's principal subsidiary, Aldermore Bank PLC, pays levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays net of any recoveries it makes using the rights that have been assigned to it.

The FSCS provision at 31 December 2016 of £0.8 million (31 December 2015: £1.1 million) represents the interest element of the compensation levy for the 2016/2017 scheme year (31 December 2015: interest levy for the 2015/2016 scheme year).

Customer redress

The Group has a small number of loans which are regulated under the Consumer Credit Act ("CCA") and had identified that, following changes to the CCA in 2008, certain letters and statements were sent to customers that did not fully comply with the requirements prescribed by the CCA. Accordingly, these customers were entitled to redress for interest and fees charged on the relevant loans as a result of this technical non-compliance notwithstanding there is unlikely to have been any customer detriment. Remediation payments to customers impacted were completed during the year ended 31 December 2015.

Notes to the consolidated financial statements continued

17. Debt securities in issue

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

	2016 £m	2015 £m
In more than one year	130.6	193.9

Debt securities in issue with a principal value of £131.2 million (31 December 2015: £194.8 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. Further disclosure relating to the underlying assets is contained in Note 13.

18. Subordinated notes

	2016 £m	2015 £m
Subordinated notes	100.0	38.1

During 2012, the Group issued £40 million subordinated 12.875% loan notes, repayable in 2022, with an option for the Group to redeem after five years. The interest rate is fixed until May 2017. The loan notes were issued at a discount and are carried in the statement of financial position at amortised cost using an EIR of 18.597%. In addition to the loan notes, a warrant was issued by the Group's parent company, Aldermore Group PLC. The warrants were valued at £2.2 million, and this was treated as a warrant reserve within equity. On 9 September 2015, the warrants were exercised resulting in 5.5 million ordinary £0.10 shares being issued.

On 28 October 2016, the Group issued £60 million subordinated 8.50% loan notes, repayable in 2026, with an option for the Group to redeem after five years. The interest rate is fixed until October 2021. The loan is carried in the statement of financial position at amortised cost using an EIR of 8.9%.

19. Share capital

	2016 £m	2015 £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 June 2016, an Employee Benefit Trust ("EBT") purchased 466,179 of Aldermore Group PLC's ordinary £0.10 shares from the market for consideration of £0.9m. Purchases were made to enable the Group to meet a future share-based payment obligation in respect of the recruitment award. These purchases constitute own shares held by a Group EBT and are recorded against retained earnings within equity.

At 31 December 2016, there were 344,739,584 ordinary £0.10 shares in issue resulting in share capital of £34,473,958 (31 December 2015: 344,739,584 and £34,473,958 respectively).

Notes to the consolidated financial statements continued

20. Statement of cash flows

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

	2016 £m	2015 £m
Depreciation and amortisation	5.3	5.3
Impairment of goodwill	4.1	-
Amortisation of securitisation issuance cost	0.4	0.5
Discount accretion on subordinated notes	1.6	1.4
Impairment losses on loans and advances	15.5	10.4
Unwind of discounting	(3.4)	(3.2)
Write-offs net of recoveries	(5.4)	(9.0)
Net losses on debt securities designated at fair value through profit or loss	-	0.2
(Gains)/losses on hedged available for sale debt securities recognised in profit or loss	(2.1)	6.9
Net gains on disposal of available for sale debt securities	(3.8)	(2.1)
Interest expense on subordinated notes	6.1	5.1
Interest income on debt securities	(12.4)	(12.8)
Interest expense on debt securities in issue	1.9	3.0
Equity settled share-based payment charge	3.5	3.4
	11.3	**9.1**

(b) (Increase) in operating assets

	2016 £m	2015 £m
Loans and advances to customers	(1,339.2)	(1,341.9)
Loans and advances to banks	9.5	14.4
Derivative financial instruments	(5.7)	1.5
Fair value adjustments for portfolio hedged risk	4.6	6.1
Other operating assets	(2.0)	2.0
	(1,332.8)	**(1,317.9)**

(c) Increase in operating liabilities

	2016 £m	2015 £m
Amounts due to banks	348.7	99.2
Customers' accounts	931.7	1,283.0
Derivative financial instruments	0.4	(18.8)
Fair value adjustments for portfolio hedged risk	(0.4)	(2.3)
Other operating liabilities	4.1	7.0
	1,284.5	**1,368.1**

(d) Cash and cash equivalents

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. The following balances have been identified as being cash and cash equivalents.

	2016 £m	2015 £m
Cash and balances at central banks	116.4	105.3
Less restricted balances	(9.6)	(7.5)
Loans and advances to banks	34.1	51.6
	140.9	**149.4**

Restricted balances comprise minimum balances required to be held at the Bank of England as they are not readily convertible to cash in hand or demand deposits. Loans and advances to banks as at 31 December 2016 include £10.9 million held by the securitisation vehicle, Oak No.1 PLC, which is not available to the other members of the Group (31 December 2015: £10.9 million).

Notes to the consolidated financial statements continued

21. Commitments and contingencies

At 31 December 2016, the Group had undrawn commitments to lend of £968.8 million (31 December 2015: £556.0 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.

22. Related parties

Related party transactions are transactions with key management personnel ('KMP') and those in the year ended 31 December 2016 are similar in nature to those for the year ended 31 December 2015. Details of such transactions can be found in the Group's 2016 Annual Report and Accounts. KMP at 31 December 2016 continue to comprise Directors of the Group and members of the Executive Committee.

23. Post balance sheet events

There have been no material post balance sheet events.