4FINANCE H1 2019 UNAUDITED RESULTS CONFERENCE CALL

Moderator: Oyvind Oanes
3 September 2019
3:00 p.m. GMT

OPERATOR: This is Conference #: 5367679.

Operator: Good afternoon, ladies and gentlemen; and thank you for standing by. Welcome to 4finance first half 2019 results conference call.

At this time, all participants are in listen-only mode. There will be a presentation followed by a question-and-answer session, at which time, if you would like to ask questions just press “star,” “1” on your telephone and wait for your name to be announced.

I must advise you that this conference is being recorded today, Tuesday, 3 September 2019.

I would like to hand the conference over to your first speaker today, Oyvind Oanes, Chief Executive Officer. Please go ahead, sir.

Oyvind Oanes: Thank you, Lorel, and welcome, everyone, to the 4finance first half year 2019 results call.

This is Oyvind Oanes speaking, the CEO of 4finance Group; and with me today are as usual, our CFO, Paul Goldfinch; our CRO, Julija Lebedinska-Litvinova; and James Etherington, our Head of Investor Relations.

This will actually be Julija's last call for 4finance as she has decided to move on to new challenges outside the Group. We, therefore, also have our incoming CRO, Martin Muransky, with us here today.

Martin joins us from the role of Chief Credit Officer at TBI Bank and is, hence, very familiar with the Group.

As usual, we would like to start the call today with a short operational update for the first six months of the year, including the key financial KPIs, as well as with a recap and update on our strategic priorities.

We would also like to present the brief status review of the ongoing regulatory changes in some of our markets before going into a deeper review of the financial results and the loan portfolio.

If you could all please turn to page 4 of the presentation, you will see that we have delivered a solid performance across most key financial indicators in the reporting period.

We continue to see a stable overall performance in our largest online markets – Denmark, Poland and Spain, as well as TBI Bank – driven by strong underlying demand for our products.

In those markets we delivered a stable performance for the period year-on-year in terms of both volumes and interest income.

You might have seen from our announcement back in June that we have now surpassed the EUR 7 billion milestone in total issued loan volume.

We're very encouraged by the increasing performance of our nearprime business in Spain, and we will be adding another partner in addition to Fintonic in Q4 that should see the segment grow further.

As indicated earlier, we are taking a prudent approach to the rollout of instalment loans in the sub-prime segments across our businesses, particularly in our Polish operation where we are cautiously evaluating our approach going forward given some of the dynamics in that market.

TBI Bank continues to deliver good growth in the various segments, including a growing SME portfolio. The Bulgarian online business is being integrated with the bank providing synergies and supporting the overall digital lending strategy.

We are seeing our businesses in Sweden, Finland and Latvia impacted by recent regulatory changes, and we continue to work hard on adjusting our products and business models accordingly. The Latvian business is actually performing well under the new regulatory regime, and we've just introduced a brand new product in Finland last weekend as the new regulations came into force.

The total year-on-year decline in interest income for the reporting period that you can see on this page is largely driven by the fact that we decided to exit three markets as part of our rationalisation efforts and also discontinue some products in certain markets due to regulatory changes in 2018.

However, pre-tax profit is up 11 percent year-on-year, the risk indicators are broadly stable, and we have seen a 17 percent reduction in operating costs versus last year.

If you now turn to the next page, please, page 5. This slide is a recap of the key focus areas in 2019, and in line with our two-pillar strategy of optimising the existing franchise whilst diversifying and growing new businesses.

In terms of optimising the existing franchise we continue our relentless focus on execution across the online businesses, including cost optimisation, synergies and efficiency gains in our operational processes. The new Group Chief Operations Officer has joined and will be driving various initiatives in this space.

As already mentioned, we are carefully assessing, developing and growing our instalment loan and credit line businesses in selected markets in our network; and we continue to review growth opportunities in some of our smaller markets, including multiple partnership models.

In terms of the ‘Diversify and Grow’ agenda, the ‘4finance Next’ unit that we introduced on the last call has been established and staffed, and the team is now working on a range of partnership and near-prime opportunities across several of our markets; and we should be able to talk more about these in the upcoming calls.

As stated previously, successfully entering the near-prime segment is not just about lowering interest rates; and this dedicated resource will help us to better understand the medium-term opportunities, like partnerships or point-of-sale lending specific to our selected markets.

We have a dedicated page on the various funding initiatives later in the presentation, so I will not go into this topic in detail here, other than to say that we have seen some encouraging progress over the past quarter.

In addition to the continued growth of the core lending business, TBI Bank is also showing good progress on their next generation digital lending strategy, as we covered in detail a couple of calls ago.

The bank's digital POS lending business is now coming up to speed with new partners signed, and generating over 10,000 applications per month.

Please now turn to page 6. Before handing it over to Paul, I wanted to give a brief status update on some of the ongoing regulatory changes.

The second part of the regulatory changes in Latvia came into force in July, and we made further adjustments to our new ‘minimum-to-pay’ credit line product, complying with the APR cap of 25 percent while introducing an optional fast disbursement fee. The uptake in the first couple of months is above expectations, and we are getting positive customer feedback.

Last weekend, on the 1st of September, a new regulatory regime on consumer lending came into force in Finland. This includes a 20 percent interest rate cap as well as limits to certain fees that can be charged.

Our Finnish team has worked very hard over the past months to build a completely new customer proposition. We have now a product we call a ‘mini Instalment Loan’. This is a short-term instalment product with ticket sizes from EUR300 up to EUR700, and repayment in four instalments. It also includes an optional fast delivery fee, similar to what we have in Latvia.

The new product is set up on an outsourced Software-as-a-Service platform. We're very excited to see how the product will be perceived by the Finnish customers, and believe the product can serve as a blue-print for shorter-term instalment loans in a number of other markets of our network.

As for Poland, the Ministry of Justice proposed a new draft bill in June suggesting to bring non-bank lending under the supervision of the Polish FSA, and also make some significant adjustments to the current pricing caps. The proposal was sent to the European Commission for review, and we expect to see feedback by the end of this month when the official suspension period lapses. We continue to take an active part in the ongoing discussions and consultations, but, in our opinion, it is difficult to say something about the final outcome and potential timing of the implementation, especially given the fact that there will be elections in Poland in the middle of October.

We understand that the uncertainty over Polish regulation is a key topic for investors. From our side we continue to optimise our short-term Vivus product, and this is doing well currently. And, as indicated, we are anyway reviewing our approach to instalment loans. We remain positive on the overall Polish market opportunity, and are confident of having a strong and profitable business in Poland going forward.

Changes to regulations came into effect in Denmark in July, which means that consumer credit companies are now also supervised by the Danish FSA, and we'll have to apply for a license by the end of the year. We have no concerns about this, and look forward to working with Danish FSA. The new government has indicated that they want to introduce further regulations of the industry; however, the discussions are at a very early stage, and no draft and/or timeline has been proposed yet. We are actively contributing to these discussions and political consultations, and are happy to see that we are being invited to the table when the topic is being debated.

All in all, we keep following the situation closely in all relevant markets, and continue to be confident based on past experience that we will be able to adjust and adapt our products and business model when and if that will be required.

With that, I will now hand it over to Paul who will talk you through the next few pages reviewing the financial performance for the period in more detail.

Paul Goldfinch: Thank you Oyvind; and greetings to everybody on the call today. If we move to slide 8, today I'll present another stable set of financial results for the second quarter of 2019.

We have reported another solid quarter of interest income in which we've generated almost EUR107 million, a slight increase over the first quarter. And while this is down some 13 percent year-on-year, interest income, like a number of our year-on-year comparatives, has been impacted by the product and market exits that took place throughout 2018.

Our core online markets, Poland, Spain, Denmark and the Czech Republic, continue to perform well with results in line with the prior year; and this group of markets remains highly profitable.

As Oyvind highlighted earlier, TBI continued its positive business development reporting another strong quarter in both interest income, which is up 8 percent year-on-year, and net profit, which is up 85 percent year-on-year.

We also continue to be pleased with the growth in some of our smaller markets and products. Our operating costs remain at historically low levels and considerably below the prior year. And I'll cover these in more detail on slide 10.

Our adjusted EBITDA result of EUR33 million is up strongly on the prior quarter, as is our profit before tax of EUR15.2 million. This result is also 11 percent higher than the prior year, in part due to FX losses incurred last year. Our overall portfolio size and associated risk metrics remain very stable; and Julija will cover these in some detail shortly.

The Group continues to generate strong operating cash flow, and we finished the second quarter with over EUR105 million of cash in the online business. This was then subsequently utilised to fully repay the $68 million of U.S. dollar bonds which matured last month.

Turning now to slide 9 which provides a geographical breakdown of the Group's interest income. Poland and Spain remain our largest markets, generating approximately 45 percent of the Group's income across our SPL and IL products. However, leading positions in the Nordic and Baltic markets plus TBI's strong presence in Bulgaria and Romania, also ensure we have a very well diversified interest income as a Group.

Turning now to slide 10, we're pleased with the progress we're making in both the overall reduction of our cost base and improving our efficiency. And while operating costs increased by EUR0.5 million in the second quarter to total just over EUR50 million, the quarterly result includes the obligatory payment to the state deposit guarantee fund which TBI makes each year.

We continue to actively focus on headcount with a further 3 percent reduction of employees in the quarter; and total headcount is down 14 percent year-on-year and almost 25 percent from the high point in 2017.

A part of the year-on-year cost decrease is however related to the introduction of IFRS 16, and the associated switch in cost lines from Rent to Depreciation and Interest.

We have launched a number of further cost optimisation measures in the summer as part of our ongoing program of work; and we look forward to updating you all with their progress over the upcoming quarters.

Turning now to slide 11, which lists six of our quarterly key performance indicators. We finished the second quarter of 2019 in a very good position with solid levels of both adjusted EBITDA and profit before tax; and our overall equity position continued to improve with the equity/receivables ratio climbing to 32 percent.

While the adjusted interest coverage metric reduced to 2.1 times for the period, on a 12-month basis we are well above the covenant threshold at – 2.7 times.

If we turn now to slide 12, which is a new slide we've introduced this quarter to highlight the progress we're making in terms of our funding strategy.

And, as I stated earlier, we have fully repaid the U.S. dollar bonds which matured in August. The bond markets remain a key source of funding for the Group, and we have commenced our early stage preparations for the refinancing of the 2021 Euro bonds.

The size and approach to this exercise will, however, be somewhat dependent on our progress with other key funding initiatives. We expect to commence portfolio sales of online Polish instalment loans to TBI in early Q4; and the expansion of these portfolio sales across other European markets is a key strategic priority for the Group over the upcoming quarters.

We successfully piloted our securitisation SPV in June, and we are now working on some partnership opportunities with other banks for some of our future near-prime markets.

Our overall capital position continues to improve, and we declared a EUR5 million dividend in August which was utilised by the parent company to reduce the level of related party loans.

Turning now to slide 13, our online loan issuance in Q2 totalled EUR263 million, bringing year-to-date issuance to EUR523 million. And while this is somewhat down against the prior year, this, like other year-on-year comparatives, is obviously impacted by last year's product and market exits.

TBI loan issuance of EUR78 million for the second quarter is more than 25 percent higher than the prior year, and is also up 14 percent on the prior quarter. And our online quarterly instalment loan issuance also remains very stable. The overall mix of the portfolio remains nicely balanced between online and TBI.

And I'll now ask Julija, the Chief Risk Officer, to take you through the following more detailed slides on our asset quality and the dynamics of our impairment charge.

Julija Lebedinska-Litvinova: Thank you, Paul. Good morning, good afternoon, everyone, on the call. Let me cover risk part of the presentation. I am on slide number 14, analysis of net impairment and cost of risk.

Net impairment for the quarter is at the level of EUR28.1 million, of which EUR37.3 million is gross impairment, EUR5.7 million positive net debt sale proceeds, EUR3.4 million positive recoveries from written-off assets.

Gross impairment overall is lower than last year, but includes some extra gross impairment in the first half of 2019 booked for Polish instalment loan product. We saw adverse trends in some metrics, but it was limited and we have dealt with it now. As Oyvind indicated, we will limit volumes sold within the existing sub-prime instalment product in the next quarters as well.

Gains from debt sales are significantly higher than in previous quarter and broadly within expectations. As explained on the last call, we had challenges with some deals in the first quarter, and some of them flipped over to Q2. Overall, first half of the year debt sales result is sustainable.

Declining trend of post write-off recoveries is in line with outstanding volume of written-off assets, which declined given lower inflows since beginning of 2018, and extensive recovery activities, mainly through debt sales, in 2019 as well as in the past year.

Net impairment is broadly on plan except Polish instalment product mentioned before. Net impairment trend is in line with declining size of online gross receivables, growing trends of the bank receivables, and stable quality of originations in most segments.

Cost of risk in the second quarter is showing declining trend at the Group level; however, there is different performance if we investigate the online versus bank split.

Online cost of risk in the first half of 2019 is at the level of 27.2 percent, an improvement compared to Q1 of 28.9 percent, but significant growth compared to the first half of 2018.

As indicated, extra provisions in the first half of 2019 drive the uptick in online cost of risk. Declining size of online receivables, which is in the denominator of the metric, is also contributing to the trend.

Unlike online cost of risk, TBI cost of risk is declining and it is at the low 4.4 percent level. Quality of originations remains stable, but we observed improvement in collections efficiency over the course of the last two quarters. Given lagging effect of instalment impairment and growing sales volumes, we may expect some small increase for this metric later this year.

Now I move to the next slide, Asset Quality and Provisioning. NPL ratio is at the level of 17.9 percent, and it is an improvement quarter-on-quarter and year-on-year. Improvement is driven by online segment while TBI ratio remains stable.

The main reason behind the improvement is sale of EUR35 million of receivables from NPL portfolio. Relative metrics on inflows to NPL and recoveries through non-debt-sale activities remain stable quarter-on-quarter. Quality of originations and collections efficiency are also stable. Reserve coverage ratio is 20 percent for the Group with solid 113 percent NPL coverage ratio. Online NPL coverage is more conservative – it is 139 percent; and TBI NPL coverage is 78 percent, given near-prime segment of consumer lending and good collateral on SME portfolio in the bank.

Provisioning policy remains solid and without changes. That's it on risk. I pass it back to Oyvind.

Oyvind Oanes: Thank you, Julija. Before we open it up for questions, let me try and summarise the key takeaways from today's presentation. I'm now on page 16. We continue to deliver a solid performance across most key financial indicators with stable quarterly interest income well above EUR100 million, and adjusted EBITDA at EUR33 million, up 13 percent on the previous quarter, and the highest quarterly profit before tax in two years.

We continue to have a tight focus on cost and have initiated a further range of cost reduction initiatives, some of which have contributed to a reduction of 17 percent of our operating cost base year-on-year. And, as Julija explained, the overall asset quality is stable, and cost of risk in line with expectations.

While we are working hard to optimise our existing business franchise, we believe that we have a good set of strategic initiatives in place with focus on medium-term opportunities in the near-prime segment and with partnerships, as well as on diversification of our funding channels where we are starting to make progress.

As you would have seen from the report issued last week, we have been making a few important changes to our senior management team with new strong leaders coming in to the Chief Legal Officer, Chief Operations Officer and Chief Technology Officer roles, as well as the CRO role as indicated in the beginning of this call.

I would like to thank Julija for her great contribution to the Group over the past four years or so, including on these calls; and would like to wish her all the best for her next endeavours.

I'm very excited to have a fresh and very motivated team working with me to take the Company forward. Many thanks for your time and attention. We will now open up the floor to questions.

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. As a reminder, if you wish to ask questions just press "star," "1" on your telephone and wait for your name to be announced. If you want to cancel your request, just press the "hash" key.

Sir, your first question comes from the line of Frank Lehmann from Thelo Kapital. Please go ahead; your line is open.

Frank Lehmann: Good afternoon; and thank you very much for the presentation. A few questions, if I may. The first one touching on the refinancing – I understand that you have via TBI Bank a presence on the Raisin platform that brokers bank deposits through Europe. Can you tell me the approximate amount that you have achieved there and where you think this product might max out, or what's the target to raise on the Raisin platform for the next 12 months? That would be an interesting number to have.

Next question, I understand that you're engaged in bond buybacks; and besides what has been presented in the documents, have there been any more bond buybacks specifically on the dollar bond since 30th June? Can you comment on that?

And since we are at the bond buybacks, how much of the outstanding notional has actually been bought back by today?

And last question, on your tangible equity, I understand there's still a EUR60-odd million loan to the related party, and there was a transaction that you paid EUR5 million in dividends; and, apparently, it came back. Can you just shed a little bit more light on that transaction?

Thank you very much.

Oyvind Oanes: Thank you for your questions. Let me maybe just address the first question. I will hand it over to Paul to address the other questions. In terms of the Raisin platform, yes, we are absolutely on the Raisin platform as you indicated with TBI Bank. So we have that opportunity available to us.

We have been very careful with what we've raised on the platform for now simply because we haven't had the need for it; but when we now manage to ramp up the cross-border funding – we have a pilot ongoing in Poland and we'll be moving on to other Euro countries – we will definitely be looking at the Raisin platform as one place to raise cheap retail deposits.

So that is not something we have scaled up to date. It is something that is ready, and will be a source that we will tap into once we see the volumes increase in terms of cross-border financing of the online businesses from TBI.

Paul Goldfinch: And, Frank, I'll pick up on the remaining two questions. In terms of the bond buy backs: since the last report we have not gone into the market and purchased any more bonds. In total, we have repurchased $45 million of the 2022 U.S. dollar bonds. Up until last week, obviously, we were in a closed period in terms of reporting. We don't have any immediate plans to go back into the markets, but obviously that option is available to us at any time. And just to clarify in terms of the dividend that was paid, yes, we declared a EUR5 million dividend in August; and the shareholder, which is 4finance Group S.A., returned that as a simple interest payment on its related party loan. So that's what that transaction was. Sorry. I should have been a little bit clearer in the speech.

Frank Lehmann: All right. Thank you very much for that.

Operator: Sir, your next question comes from the line of Otto Dichtl from Stifel Nicolaus Europe. Please go ahead; your line is open.

Otto Dichtl: Yes. Hello. Could I just ask about the Polish regulatory challenge? I understand obviously it's difficult to call the exact outcome; but could you maybe talk a little bit about what your plans would be if the last proposals would be implemented because they look like a worst-case regulation for you?

Oyvind Oanes: OK. Thank you for the question. Let me try and answer that question. Obviously, as you would know, there has still not been a decision made that we will have new regulations in Poland, so we're still in a period of reviewing, discussing that potential upcoming regulation.

Why I am saying that is obviously because that is a process that we've seen in Poland multiple times over the last few years. There's been a lot of discussion, but ultimately not much has changed.

So obviously we're hopeful that will be the outcome this time as well. But to your point, should this go through and the new regulation come in as proposed, first of all, we would have, we believe, up to six months to make the necessary adjustments to the products and the business model.

But you are absolutely right – this will have an impact to our business. We have to admit that. What has been proposed is a fairly dramatic drop in some of the pricing caps.

And as I alluded to earlier in my speech, we would have to make some changes to the instalment loan product that we're anyway going through at the moment.

We believe that our short-term SPL business, however, will be less impacted by this regulation and will be viable, sustainable and profitable even under the new regulatory regime, if and when that comes in.

Being specific in terms of the actual financial impact at this stage would not be the right thing to do on this call. We obviously work with multiple scenarios. But, yes, it will have an impact if this would come in.

Otto Ditchl: OK. Thank you.

Operator: Once again, if you would like to ask a question, please press “star,” “1”; and if you want to cancel your request, just press the “hash” key.

And another question comes from the line of Georges Gedeon from Antler. Please go ahead; your line is open.

Georges Gedeon: Yes. Hi. I just have two questions. One you touched upon which is regarding the refinancing. You've taken care of the 2019 bonds obviously; now it's reimbursed. What about the 2021 and 2022 bonds?

Are you going to try to be proactive in dealing with that? I heard your response about using TBI, but if you can expand on that? That's my first question.

The second question is with regard to the loans to related parties. What's the point of keeping these loans? Can't you just turn them into payments in kind or get rid if you want of any cash impact just to simplify from the corporate governance, but also to simplify the picture here?

Paul Goldfinch: Hi. It's Paul here. We'll take your questions. In terms of the refinancing, yes; as you've said, we have now fully repaid the dollar bonds that matured last month, so our focus is indeed on refinancing the Euro bonds in particular, which mature in May 2021. As we've said in the presentation it's still at the very early stages of refinancing, as you've alluded. A year after that we also have just over EUR244 million worth of dollar bonds which mature.

So I think we will look to crystallise what we want to do in terms of refinancing as we go through our budgeting cycle in Q4, and then we marry that against our growth plans in terms of near-prime businesses and also how fast our alternative funding sources are growing and developing over time. So it's a little bit early to say right now exactly what that mix of funding would be and what the size would be; but we hope to give you some more colour on that in the next one to two quarters.

In terms of related party loans, we've simplified the related party loans over the last couple of years. Just by way of background these have been in place for a number of years. Historically, the firm distributed retained earnings as a loan rather than a dividend. We have switched that approach two to three years ago, so that's why those loans have not grown in size. And, in fact, they've been reducing in overall size over the last one to two years. The bond covenants restrict things like cash in kind and things like that to remove them; but we are actively managing them. They're all performing. We have no issues with any of them, and we'll look to see the overall quantum of our related party loans continue to track downwards over time.

Georges Gedeon: OK. Thank you.

Operator: Once again, if you would like to ask question, just press “star,” “1”; and if you want to cancel your request, just press the “hash” key.

Sir, there are no more questions at this time. Please continue.

Oyvind Oanes: OK. So if there are no further questions, we would like to thank you once again for calling in today. And we look forward to catching up again before the year-end.

We're also looking to visit our investors in London and New York in the coming months; so please get in touch with James and the team if you would like to meet up.
Thank you and goodbye.

Operator: This concludes your conference for today. Thank you for participating. You may now all disconnect.

END