4FINANCE Q1 2019 UNAUDITED RESULTS CONFERENCE CALL

Moderator: Oyvind Oanes
29 May 2019
3:00 p.m. GMT

OPERATOR: This is Conference #8190865

Operator: Good afternoon ladies and gentlemen and thank you for standing by and welcome to today's 4finance First Quarter 2019 Results conference call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session, at which time if you wish to ask a question, you will need to press star one on your telephone.

And I must advise you that this conference is being recorded today, 29 of May 2019. I would now like to hand the conference over to your speaker today Oyvind Oanes. Please go ahead sir.

Oyvind Oanes: Thank you, Ron and welcome everyone to the 4finance First Quarter 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.

We would like to start the call today with a short operational update for the first quarter of the year, including key financial KPIs as well as with a recap and update on a strategic roadmap. 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 our financial results and the loan portfolio.

If you could all please turn to Page 4 of the presentation, you will see that we continue to deliver a fairly solid performance across most key financial indicators.

If we look at our core online markets: Poland, Spain and Denmark, as well as TBI Bank, we continue to see strong underlying demand for our products and we delivered a stable performance for the quarter year-on-year in terms of both volumes and interest income.

Some of our smaller markets like Bulgaria, Armenia and the LatAm markets also performed well in the quarter, and actually grew revenue by around 20 percent year-on-year.

We're seeing our businesses in Sweden, Finland and Latvia impacted by recent and upcoming regulatory changes and we're working hard to adjust our products and business models accordingly, as we've proven we can do in other markets. For example, in Lithuania where we're continuing to grow our near-prime loan portfolio.

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

Before we talk more about our financial performance indicators in a few minutes, but I wanted to point out that we continue to have strong cost focus, and despite the fact that we have seen income come down, we managed to drive the cost income ratio in the right direction by delivering an 18 percent operational cost reduction year-on-year in the first quarter.

If you now turn to the next page please, Page 5, this slide is a recap and is a high-level illustration of how we are evolving and broadening our business model into new segments and products, and pursuing a strategy of becoming a 'multi-segment, multi-product consumer credit specialist'.

We continue to optimise and adapt our strategy in the sub-prime business by moving away from the historic focus on short-term lending to more longer-term lending products like instalment loans and credit line products, still serving a need in the underbanked and underserved segments in a fair and transparent way.

The SPL new issuance volume was down 24 percent year-on-year and now represents only 22 percent of the Group's net receivables, down from 30 percent at the end of Q1 last year. We're also making progress on the second pillar of our strategy – moving into the near-prime segments.

And as already mentioned, we're seeing encouraging results with a repositioning in Lithuania; our growing partnerships with *Fintonic* in Spain; and with a new product in Sweden that we're slowly ramping up.

If you now turn to the next page, Page 6, you will see that the key focus areas in 2019 continue to be consistent with this two pillar strategy. In terms of optimising existing business, we continue our relentless focus on execution across the online businesses, including cost optimisation and efficiency gains in our operational processes.

We have hired a Group Chief Operating Officer who will join us in August and help driving various initiatives in this space. We're also carefully assessing, developing and growing our instalment loan and credit line business in selected markets in our network. And we continue to review growth opportunities in some of our smaller markets including a partnership model in Mexico, currently in pilot.

As already indicated on previous calls, there will be further adjustments to our products in Latvia and Finland driven by regulatory changes.

In terms of 'Diversify and Grow' agenda, we are creating a new unit within the Group that we call '4finance Next', and have hired a handful of professionals who will focus on working with our country teams to develop near-prime offerings and partnership opportunities.

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

And in line with this, we have revised our IT strategy to focus the implementation of new technology on the near-prime and partnership opportunities whilst giving more efficient support to our core markets and

also let our smaller markets transition to low-cost, local Software-as-a-Service solutions where available.

As indicated on previous calls, we're pursuing two key initiatives related to our funding strategy. The first pilot on our new securitisation platform should go live in June, and a cross-border loan funding initiative with TBI Bank is planned for later this year. TBI Bank is also showing good progress on their ‘next-generation digital lending’ strategy as we covered in detail on the last call.

Please now turn to Page 7. Before handing it over to Paul, I wanted to give a brief update on some of the upcoming regulatory changes. The first part of the regulatory changes in Latvia came into force in January, and we made adjustments to our products to make sure we were compliant. Our core SPL product was transformed into ‘minimum-to-pay’ credit line, and after slow start in January, we have seen good results since then. More changes will come into force in July and we're in process of making the necessary adjustments.

The approved changes to APR regulation in Romania were ruled unconstitutional by the Constitutional Court and will therefore not come into force. A new proposal, actually similar to the original one, has recently been published, but the likelihood and timing for this is uncertain.

The Finnish Parliament adjusted and approved the proposal on Consumer Credit regulation that now includes a nominal interest rate cap of 20 percent. We're making changes to our products and systems to be ready with a new customer proposition by the time the new regulation comes into force in September.

As for Poland, the Ministry of Justice published a new proposal in February suggesting to bring non-bank lending under the supervision of the Polish FSA, and also make some adjustments to the current pricing caps. The legal process and consultations are ongoing, which we're taking part in, but in our opinion, it is too early to say something about the final outcome and potential timing of the implementation.

New regulations will come into effect in Denmark in July, which means that consumer credit companies will also be supervised by the Danish FSA and

will have to obtain a license by the end of the year. We have no concerns about this and look forward to working with the Danish FSA.

The Bulgarian National Bank recently finished a review of the banking sector, focused on capital buffers for each individual bank. We were pleased to receive positive feedback on TBI Bank's risk management and other internal processes. And the additional capital buffer requirement of only 75 basis points is at the low-end of the range for the sector, and reflects TBI Bank's stability and sustainability.

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

And 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: Thanks, Oyvind and greetings to everyone on the call today. If we move now to Slide number 9.

Today, I'll present the satisfactory set of financial results for the opening quarter of 2019. We can report another relatively stable quarter of interest income in which we generated over €106 million. And while this is a 6 percent decrease in income from the prior quarter, it largely reflects the results of market and product exits made throughout the course of 2018.

The results also reflect some seasonality in income in a couple of European markets, and it took us until mid-February to adjust our Latvian products to new regulations which came into force at the beginning of the year.

The core online markets of Poland, Spain, Denmark and Czech Republic continue to perform well with results in line with that of the prior year. These markets remain highly profitable for the group.

TBI continues to develop well, and the bank reported another strong quarter in both interest income, up 8 percent year-on-year, and net profit up 50

percent year-on-year. We're happy to report a further reduction in operating costs and I'll cover this in more detail on Slide 11.

Our post-provision operating profit and adjusted EBITDA results are down on the prior year by 11 percent and 8 percent respectively, but this is in part due to the €7 million of debt sale income reported in the first quarter of 2018.

Our overall portfolio size and associated NPL ratios remain relatively stable and Julija will cover this in some detail shortly. The Group continues to produce strong operating cash flow and we do not need to tap the capital markets this year to meet our business plans.

We finished Q1 with over €120 million of cash in the online business and we also now hold $45 million of the U.S. dollar 2022 bonds which we have repurchased over the course of the last few quarters. We intend to pay the $68 million of U.S. dollar bonds which mature in August out of cash on hand.

At the end of March, TBI bank also declared and paid its first dividend totalling €8 million. And, subsequent to the quarter end, we've made bond coupon payments in May of approximately €23 million. We continue to progress on our funding diversification projects, and we'll launch the pilot for our securitisation initiative in June. And finally, we're pleased we finalised the 2018 external audit with our new auditors, PKF, in late April.

Turning to Slide 10, which provides a country level breakdown of the Group's interest income. Interest income is down 14 percent year-on-year and there's little change in the composition of the graph from the prior quarter.

Poland remains our largest market, generating approximately 27 percent of the Group's income across our SPL and IL products, with Spain and Denmark also significant contributors across multiple products.

Combination of these three markets plus TBI's presence in Bulgaria and Romania generates over 75 percent of the Group's interest income, up from 70 percent in the first quarter of 2018.

Turning now to Slide 11, we continue to be satisfied with the progress and improving the efficiency of our cost base. Operating costs decreased by €4 million in the first quarter of this year, to total just under €50 million, the lowest quarterly total since the acquisition of Friendly Finance and TBI Bank in 2016. Part of this decrease is however related to the introduction of IFRS 16 and the associated switch in cost lines from rent to depreciation and interest expense.

The Group's cost to income ratio of 52 percent represents a 2 percent year-on-year improvement and the ratio also remains relatively consistent with the prior quarter despite the drop in income. We continue to actively focus on headcount with a further 4 percent reduction of employees in the quarter.

Headcount is down 18 percent year-on-year, consistent with the overall year-on-year reduction in the cost base. And you'll note on this slide that Friendly Finance costs are no longer reported separately, with the integration of their business now complete, and Slovakia reported within the online business.

If we turn now to Slide 12, which lists six of our quarterly key performance indicators. We start 2019 with satisfactory levels of both interest income and adjusted EBITDA, and while our adjusted interest coverage ratio metric reduced to 2.0 times for the period, on a 12 month basis we're well above the covenant threshold at 2.5 times. And our overall equity position continues to improve, with the equity to net receivables ratio climbing to 30 percent.

We turn now to Slide 13. Our online loan issuance in Q1 totaled €260 million. And, while this is down 6 percent from the prior quarter, similar to the drop in interest income, this reflects a combination of market and product exits plus some seasonal softness in a couple of markets. We did, however, see an increase in the quarterly instalment loan issuance, up 5 percent from the prior quarter.

Looking forward, we expect online loan issuance to stabilise at these levels and grow in the second half of 2019. TBI Bank’s loan issuance of €69 million for the first quarter is 13 percent up from the prior year, and while it is down on the prior quarter, this is seasonal and fully in line with expectations.

The overall mix of the portfolio remains well-balanced between online and TBI Bank. And now, I'll hand to Julija, the Chief Risk Officer of the Group to take you through the following more detailed slides on our asset quality.

Julija Lebedinska-Litvinova: Thank you, Paul. Good morning, good afternoon everyone on the call. I'm now on the slide number 14, analysis of net impairments and cost of risk.

Net impairment for the period amounted to €32.4 million. It consists of €35.9 gross impairment, €3.6 million recoveries from written off loans and €0.1 million debt sale negative gain.

Gross impairments are historically the lowest post IFRS 9 adoption, and it is a function of declined sales and discipline on the quality of new originations. Overall, it was managed well throughout the quarter with some exceptions related to the Polish market.

We observed worsening of credit quality in some channels that was addressed through tightening of underwriting policy, adjustments to acquisition policy and strengthening of collections policy. However, we potentially may consider further improvements depending on the results of the first round.

Recoveries of written off loans are lower than in prior quarters, but this is in line with decreasing write-off stock, both due to lower inflows and due to intensive clean-up through debt sales in Q3 & Q4 of last year.

Modest income from debt sales this quarter is due to extensive debt sales in prior quarters and the fact that some of Q1 planned debt sales flipped over to Q2.

Debt sales remain an important strategic tool for us and act as the final stage of our collections strategy. We continue to see demand for our portfolios. Quite regularly we execute repeated deals with the same cooperation partners, and we have several long-lasting relationships in the form of forward flow deals.

Our expectation for 2019 debt sale income is significantly lower compared to 2018 debt sale income due to several reasons. First, debt sale income in

2018, especially in the first half of 2018, benefited from the move to IFRS 9 and equity adjustment at the beginning of the year. This effect is very minor now, given that a very insignificant part of portfolio consists of loans issued prior to IFRS 9 adoption. Second, for more efficient management of gross impairment under IFRS 9 regime, we execute accelerated collection strategy since the beginning of 2018. We entered forward flow relationships in several markets, and now we sell earlier; but if an asset is sold earlier, net book value is higher, and debt sale income, which effectively is the difference between price and net book value, is lower.

To sum up, we do not expect to sell significantly less in 2019 compared to 2018. Neither we expect to receive less cash, of course if compared across active markets, but ageing structure of sold portfolios in 2019 is significantly different from the ageing structure of those sold in 2018, and net book value is different as well. Thus, debt sale income is expected to be lower. The result of debt sales are impacting gross impairments in 2019 and can be less seen explicitly on the debt sale income line this year.

Cost of risk is slightly up compared to previous quarter. Uptick is experienced in online operations and partially related to debt sales delayed to Q2 and quality worsening mentioned before.

TBI Bank's cost of risk is impressively low this quarter at 4.5 percent level and it is driven by almost full exit of bad quality of originations of the second half of 2017 which we discussed on prior calls. And the second driver behind this improvement is collections efficiency. It improved significantly. We observed better productivity. We have a new system. We have a more skilled team and some other improvements in place in Q1.

Underwriting and collections strategies remain key tools for successful credit risk management. We continued relentless work on improvement of existing credit default, anti-fraud and collections models. We also started to explore area of biometrical data analysis, as we see that there is a potential that it can improve the discriminative power of our models.

GDPR is very restrictive as it relates to analysis and usage of biometrical data, and given that we have full respect to data privacy, so far we limited our pilots to some specific geographies only.

I now turn to the next slide, asset quality and provisioning. NPL ratio grew to 20.4 percent for the Group and the uptick is observed both in TBI Bank and online operations. TBI Bank is experiencing increase for the last two quarters in a row, and we expect NPL ratio to decline in the second quarter of this year when planned debt sale will be executed.

Online NPL increase is coherent with the cost of risk performance and has the same root causes as explained before.

Impairment allowance remains high at 21.7 percent of gross portfolio. Impairment allowance covers the NPL book at 106 percent. Provisioning policy remains reasonably conservative without changes. That's it from me. I pass it back to Oyvind.

Oyvind Oanes: Thank you, Julija. So before we open it up for questions, let me try and summarise the key takeaways from today's presentation.

We continue to deliver a fairly solid performance across most financial key indicators, with a quarterly interest income well above €100 million and adjusted EBITDA at around €30 million.

If we look at our core online markets, Poland, Spain and Denmark, as well as TBI Bank, we continue to see strong underlying demand for the products, and we delivered a stable performance for the quarter year-on-year in terms of both volumes and interest income.

To accelerate our strategic initiatives with focus on medium-term opportunities in the near-prime segment and with partnerships, we have established a dedicated unit ‘4finance Next’ and adjusted our technology platform initiatives accordingly.

We continue to believe that the opportunity for our company is significant. We have a strong foundation with our core business, and we believe we are in a unique position to address the needs of current and new customer segments. Many thanks again for your time and attention. We will now open up the floor to questions.

Operator: Thank you and ladies and gentlemen, if you wish to ask a question, please press star one on your telephone. And if you wish to cancel your request,

you may press the hash key. Once again, star and one if you wish to ask a question.

Operator: Thank you, we have questions. And it comes from the line of Rumen Ivanov. Please ask your question.

Rumen Ivanov: Hello, good afternoon and thank you very much for the presentation. I just wanted to make sure that I heard clearly. Paul, did you say that you have bought as much as $45 million of your bonds?

Paul Goldfinch: That's correct. Yes, we bought $15 million in Q1 and we bought $5 million subsequent to the end of the quarter.

Rumen Ivanov: OK.

Paul Goldfinch: And we obviously hold some from last year.

Rumen Ivanov: Right. And have you disclosed, or can you disclose which bonds you have bought into?

Paul Goldfinch: Yes, sure. Yes, we can. It's all in the U.S. dollar 2022 bonds.

Rumen Ivanov: Do you plan to cancel the notes?

Paul Goldfinch: No. No, we have no plan to cancel them.

Rumen Ivanov: OK, I see. And kind of ‘bigger picture’ sort of question, I'm looking at Slide 16 where you describe current level of the financial situation, interest income of around €100 million, adjusted EBITDA of €30 million.

The return on equity now of 4finance is the lowest that I kind of remember it. It's about €10 million of sort of ‘normal’ net income. What is the path to stronger profitability?

If you have €100 million of revenue, €50 million of operating costs, €30-€35 million of provisions, right? And interest is, call it, so far it's been €15 million, I guess it's going to come down. The company is not making very much money in the bottom line. How would that change?

Oyvind Oanes: Yes, thank you for the question. I think the answer to that is obviously fairly complex and there are multiple drivers that we are focusing on to improve that over time.

Now, the first quarter is a bit of a special quarter as we heard both from Julija around debt sales and as we also heard from Paul. But I think in the longer term, we are in a transition away from the incumbent business into new segments, new products and we'll see some impacts on that in the short term.

But obviously, we believe that once we are through with some of that transition, we start scaling up the new business opportunities that we are identifying in the near-prime segment. And we also manage to get some of our cost initiatives even further underway, including also reducing our funding costs by getting these initiatives that we're now piloting of up and running and scaled up.

Ultimately, these things altogether will and should improve our profitability over time. But I do underline that these are multiple initiatives that are taking place and will all take some time until we see the full effect of all of them.

Rumen Ivanov: OK. Thank you very much.

Operator: Thank you and our next question comes from the line of Gianluca Bellino. Please ask your question.

Gianluca Bellino: Hi, thank you for taking my question. This is Gianluca Bellino from Sempera Partners. I'd like to have some more colour regarding the securitisation project and maybe the amount and how these fit in your overall funding diversification in the future, in the long term? Thanks.

Paul Goldfinch: Sure, thank you for the question. We have multiple funding initiatives underway at the moment. In-house, we're looking at selling portfolios of our loans to TBI Bank. We are fairly advanced in that initiative and we are just in the final stages now of speaking with the regulator and getting the various approvals, et cetera. And then we are hoping in the next sort of one to two quarters that we'll be able to sell some portfolios of loans across to the Bank and then that would effectively utilise their deposit funding for those portfolios.

And externally, we've created an SPV which will help with a third-party investor: we'll be selling portfolios of single payment loans to that SPV and then the investor will be buying notes in the SPV. That's the securitisation facility at the moment which we're conducting a pilot of over the next month. Again, it's going to be something that will be iterative and build up slowly over the course of the next two to three quarters. And it will help further diversify our funding away from a full reliance on bonds.

Gianluca Bellino: And can you give us an idea in the longer-term, what will be the size of the securitisation?

Paul Goldfinch: It's difficult to say. I mean we don't see that becoming the primary source of funding. I think bonds will remain at this stage the primary source of our funding. I think initially, we're targeting one of our Nordic portfolios to sell across to the SPV, and I think we have a sort of a modest target of around €10 to €15 million on that.

And then as and when we prove that model and both ourselves and the investor are comfortable in how that's working then we will look to scale that across to other markets. We think we can take that up to €40 to €50 million over the medium term.

Gianluca Bellino: OK, thank you. Thank you very much.

Operator: Thank you. There are no further 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 wish you a good summer. Thank you. Bye-bye.

Operator: Thank you. That does conclude our conference for today. Thank you all for participating. You may all disconnect.

END