4FINANCE H1 2018 UNAUDITED RESULTS CONFERENCE CALL

Moderator: Oyvind Oanes
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OPERATOR: This is Conference #4655337

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to today's 4finance Unaudited First Half 2018 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 and one on your telephone and wait for your name to be announced.

I must also advise you that this conference is being recorded today, Thursday, the 6th of September 2018. And I would now like to hand the conference over to your speaker today, Oyvind Oanes. Please go ahead.

Oyvind Oanes: Thank you, Sara, and welcome everyone to the 4finance first half results call. My name is Oyvind Oanes and I'm the new CEO of the 4finance group. With me today are our CFO, Paul Goldfinch, our CRO, Julija Lebedinska-Litvinova, and James Etherington, our Head of Investor Relations.

In addition, I've also invited Mark Ruddock to join us as part of the leadership transition process and to help answering any questions you may have on the reporting period.

I would also like to take this opportunity actually to thank Mark for his leadership and great contribution over the past year or so and for being very helpful and supportive for me during my first few weeks in the company. I believe in his role, he has laid the right foundation for the future success of the company and started several key initiatives to enable us to evolve our business model going forward. Mark, as you will be aware of, will continue to be part of 4finance in a supervisory board role.

Now, before we jump into the material, allow me also to quickly introduce myself. I joined 4finance on the 1st of August from the role as CEO of Swiss fintech, Numbrs, and before that I spent almost 20 years in the retail banking and consumer finance industry working for GE Capital, BAWAG P.S.K., and Raiffeisen Bank International's online banking subsidiary ZUNO where I also held the role as CEO.

In other words, I believe I've seen the industry from multiple angles, a consumer finance player, an incumbent bank, a challenger bank, and lately also fintech, and believe I have now joined the company where I can combine the best of all worlds.

Then, to the actual presentation and if I could ask you to turn to Page 4. And today we would like to start with a quick recap on the overall opportunity for 4finance and why we believe we have a unique opportunity to continue to be a market leader in the changing consumer credit space.

Now, globally, the estimated size of the segment that we label underserved is about 2.6 billion people. These are consumers that mostly do not have access to retail lending products. Basically, because banks and other financial service institutions struggle to get their heads around how to assess this segment's credit worthiness based on historic processes and models. With the revolution happening in technology and especially in affordable computing power as well as access to much more and new types of data, we can unlock an opportunity here to look at this segment in completely new ways.

With 10 years of experience in alternative lending and having built significant scale across multiple geographies and different product categories, as well as having gained deep knowledge and expertise in areas such as scoring, data analytics, and online/mobile distribution, we believe we are uniquely positioned to take a leading role here.

Now, if I could ask you to turn to Page 5, you will see that we continue to improve across all key financial indicators. Paul will talk more about these in a few minutes, but I believe it's worth pointing out our strong growth and interest income, up 15 percent year-over-year.

This was fueled by significant growth in instalment loan volume, and interest income for this strategically important product category is actually up 50 percent, as well as by the continued strong performance at TBI Bank growing interest income at about 30 percent year-over-year.

The strong growth in interest income, coupled with a continued focus on controlling costs, translates into pre-provision operating profit of €87.7 million for the reporting period, which is up seven percent year-over-year. We now have two quarters of portfolio performance data following the adoption of IFRS 9 and Julija will explain later on that we're seeing very comfortable and stable levels on a gross NPL ratio as shown on this page.

Turning now to Page 6. We continue to make good progress on the key initiatives on both the ‘optimise existing business’ agenda as well as the ‘build for the future’ agenda. As indicated on previous calls, we will constantly and carefully review the performance of our portfolios, products and markets.

This approach led us to make a couple of tough decisions already in August, stopping new online business origination in both Romania and in Georgia, driven by tightening regulatory environments in both markets. While these were necessary actions to take in order to protect our overall franchise, I guess it's fair to say that we are more excited about the progress we're seeing on building the foundation for the future.

As you would know, we're going through a major transformation of our infrastructure platform and the first beta is now underway with our new near-prime product (Friia) that we will be launching in Sweden towards the end of the fourth quarter this year.

We're also making solid progress on the work on our new funding platform that will allow us to diversify our funding sources over time, which is a prerequisite for our efforts to evolve the company towards the near-prime segment. Although we're taking a prudent approach to the rollout of our instalment loan product in multiple markets, you can see from the graph on the right hand side of this page that a transformation is taking place moving away from SPL over time.

Now, turning to Page 7, I wanted to close off my introduction by talking a bit about our efforts to ensure we have a sustainable business acting as a responsible lender. Comparing with what I have seen working for larger regulated banks, I would claim that 4finance very much has a bank-like setup when it comes to governance including a strong compliance function, well-defined policies and procedures, and a robust supervisory board.

We're also making continued investments into AML and GDPR as we prepare ourselves for increased focus from regulators across our markets. Our aim is really to be ahead of the game when it comes to adjusting our business model to changing regulations and we believe we're on the right path in several of our markets in terms of engaging more actively and in a meaningful way with the various authorities and regulatory bodies.

Last but not least, putting customers first and offering transparent and convenient products as well as helping customers when they get into difficulties, remain key to our continued strive to be best in class on responsible lending.

Now, with that I would hand over to Paul who will walk you through the next few pages, reviewing the financial performance for the period in more detail. Paul, please.

Paul Goldfinch: Thanks, Oyvind, and good afternoon, good morning to everybody on the call today. If we move to slide number nine, I'm pleased to present what is yet another quarter of solid financial results which reflect the strategic decisions we've made and implemented over the last 12 months.

In terms of our four key P&L indicators shown here on the slide, we enjoyed another near-record quarter of interest income in which we generated slightly over €122 million. And while this was just under one million less than in Q1, it is a solid 15 percent up on the prior year.

And while our pre-provision operating profit in the quarter of €36 million was significantly impacted by FX losses incurred, our adjusted EBITDA metric, which excludes these losses, reached a record high of €42 million in the quarter and above €74 million for the first half, which is five percent up on the prior year.

This is the first year-on-year increase in four quarters despite the introduction of IFRS 9 this year. The profit before tax however is significantly down on the prior year due primarily to FX losses in the quarter of €15 million and the increase in provisioning year-on-year. In terms of our top-line income performance, there's a very stable quarter across our European core online countries.

And although the contribution from Friendly Finance is reduced as we rationalise operations in several markets, we saw a further increase in the contribution from our instalment loan business with interest income increasing by six percent to €26 million in the quarter.

However, we've taken a more conservative approach to instalment loan growth in key markets, adjusting acceptance rates and marketing spend which in turn has reduced the quarterly issuance following fairly significant growth in issuance over the past three quarters.

TBI Bank, again, produced a solid set of quarterly results and very much in line with our expectations with €18 million in interest income, stable with the prior quarter, being 31 percent up year-to-date on the prior year.

We continue to see the benefits of our various cost efficiency and optimisation measures with a further two million reduction in our quarterly cost base which in turn has contributed to a further improvement in the cost-income ratio to 53 percent.

Now, on the topic of cost in Q2, we've reflected FX losses of €14.7 million. As a business which operates in some 15 markets, we carry a number of open currency exposures and during the course of the quarter, we've witnessed a significant devaluation in the Argentinean peso which has lost 40 percent of its value.

Additionally, caused in part by macro events in Turkey, there's been increased volatility and short-term weakness in both the euro to dollar and correlated EM currencies such as the Polish zloty which is our largest non-euro business.

We actively manage all our currency exposures and hedge where it's commercially appropriate. Subsequent to the quarter end, we've taken steps to fully hedge our residual U.S. dollar exposure.

During the course of the quarter we generated strong operating cash flow due to improved underlying cash profitability as well as the reduced rate of IL issuance and the reduction in Friendly Finance portfolios.

We're in good position in terms of our overall liquidity to fund our ongoing transition into longer-term lending products and we also continue to make pleasing progress in key funding initiatives in particular with our loan securitisation platform.

This platform will unlock alternative external funding sources which as we grow our instalment loan portfolio and offer lower APR products is vital to the ongoing sustainability of the business.

Turning to Slide 10 which provides a country level breakdown of the company's interest income. We're seeing very little change in the composition of the graphs from the last quarter.

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

And, as we've indicated, our online presence in Georgia will be wound down over the remainder of the year and we're also assessing the sustainability of our online presence in Romania. However, these two markets combined only generate just over four percent of interest income and very little in terms of net profitability.

We turn to Slide 11, we've seen a further three percent reduction in our overall cost base in the second quarter following a five percent decrease in the first quarter with operating expenses excluding depreciation, totaling €59 million in Q2.

There's also been an eight percent decline in group headcount over the course of the second quarter and the majority of the savings from this reduction will be reflected in the third quarter cost base.

And as highlighted in the last quarterly call, we've materially tightened our policies around IT capitalisation and the hurdle rate we apply. We consider the year-to-date impact on our operating costs compared to the prior year to be approximately €2 million.

The savings from the integration of Friendly Finance are now broadly reflected in our numbers and our focus now is on executing the wind down in Georgia in an efficient manner.

We continue to make enhancements to our marketing strategy and the introduction of new models which we use in analysing our above-the-line marketing spend has seen us materially reduce our cost per acquisition and overall spend in two key markets. We're now expanding utilisation of this model to other markets where we deploy this marketing channel.

We continue to identify and analyse areas of our business where efficiency gains can be made. While a number of these opportunities are linked to the rollout of our new IT platform, there are still areas where automation of processes will both improve efficiency and effectiveness and reduce inherent operational risk.

Turning to Slide 12 which highlights some of our key financial indicators. The first half results continue our strong track record of top-line growth in interest income. The €74 million in adjusted EBITDA for the period is at near record levels, and this in turn has seen our adjusted interest coverage ratio improve to 2.4 times, in line with the prior year.

Our equity-based ratios were influenced by year-end adjustments and IFRS 9 adjustments in January, but our equity to net receivables metric remains comfortably above bond covenant limits and has improved slightly over the course of Q2.

If we turn to Slide 13, our online issuance in Q2 totaled €306 million, down nine percent on Q1, but we remain six percent above the prior year comparative. This trend reflects the transition in our business into longer-dated IL products, and the reduction in the SPL issuance in Friendly Finance markets.

TBI consumer loan issuance was stable for the quarter and 12 percent above that of the prior year. Overall net receivables decreased slightly in the quarter, again, due entirely to the reduction in the short-dated SPL issuance.

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

Julija Lebedinska-Litvinova: Thank you, Paul. Good morning, good afternoon, everyone. I'm now on slide number 14. Net impairment is €26.9 million, a significant reduction compared to previous quarter, driven by record high debt sales which resulted in €14.3 million net debt sale proceeds.

We continue to observe high demand for our portfolios across several geographies. Gross impairments reduced compared to the previous quarter due to slowdown of instalment loan issuance and improvement of provisioning metrics across several markets.

Improvement is due to better mix between new and repeated customers or due to better quality of originated cohorts. Post write-off recoveries remain stable at €5 million level. Cost of risk in the second quarter is 15.1 percent. Improving trajectory is driven by debt sales and as a result, lower reserve requirements in post-default buckets. We expect this metric to rise a bit in the next quarter.

Risk management kept focus on optimisation of acquisition and underwriting policies in the second quarter to improve quality of new cohorts. Collection strategies were under continuous scrutiny as well: we're striving for the best possible return on each invested euro.

Strengthening of pre-collection strategies, implementation of a new dialler solution in several geographies, and acceleration of the process at later stages led to better collections efficiency in Q2 versus Q1 in 2018 and as well it led to reduction of collections costs in the first half of 2018 compared to the same period last year. I now move to my second slide.

Online NPL ratio is 22 percent and it's stable compared to the previous reporting periods. TBI NPL ratio has worsened to 16.6 percent. As signaled before, worsening is related to Romanian cash loan portfolio originated mainly in the second half of 2017.

Change in underwriting policy was implemented early this year as soon as we detected worsening in early indicators. And, now, for several periods in a row, we see stable and improved delinquency metrics.

At the same time strengthening of collections was made. It was made from strategy and skill set perspective. Now, we see that both of these changes positively affect provisioning metrics, but outside of Q2 period.

Provisioning coverage is 23.7 percent and our NPL book across the group is covered at 118 percent. This ratio is different between consumer and commercial book, significantly higher in consumer book and lower in commercial, because commercial book, part of TBI portfolio, is secured book.

Provisioning policy remains strong and solid and fully aligned with the processes across the whole credit cycle. I'll now pass it back to Oyvind.

Oyvind Oanes: Thank you, Julija. Before we open it up for questions, let me try to summarise the key takeaways from today's presentation, and I'm now on Page 16 of the material. We saw that the opportunity for our company is significant. We have a strong platform and we believe we are in a unique position to address a large underbanked segment.

The key financial performance indicators for the first half of 2018 show a strong top-line growth, improving our interest income by 15 percent year-over-year, and generating a solid EBITDA for the reporting period as Paul could report.

We're making good progress on our operational agenda, making some tough calls when we have to, while driving the various strategic initiatives forward. The new IT platform is well underway, and we are carefully piloting new near-prime products.

I'm excited about the opportunity and I believe we're on the right track. I also look forward to meeting all key investors face-to-face over the next few months.

James will be setting this up and the meetings with the rating agencies have already been scheduled for early October which I'm also looking forward to. Many thanks for your time and attention and I will now open up the floor to questions.

Operator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. As a reminder, if you wish to ask a question please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the hash. And your first question comes from the line of Nick Dimitrov, from Morgan Stanley. Please ask your question, your line is open.

Nick Dimitrov: Hi there. I have a few questions. So the first one is going to be on Slide 6, where you have shown the transformation of your portfolio that is increasingly being dominated by instalment loans which are of a longer tenor.

So my question is how are you going to be managing volatility going forward, considering the fact that shrinking the balance sheet very quickly will not be available anymore just because that the tenor of the assets is longer now?

Paul Goldfinch: Yes. Thank you very much for your question. I think it's a very valid question and a good one. We have been issuing instalment loans in a number of markets for quite a few years now and it's only very recently we've taken an approach to go for much longer dated instalment loans.

And as we've reflected in Q1 and now in Q2, we're doing it very cautiously in a number of our markets and indeed we've slowed down issuance in Q2 to let the issuance in Q1 and Q4 of last year, where we increased, season and look to the overall performance and quality.

So we continue to do that as per normal business. We are fairly advanced in how we look at that portfolio and we continue to track it very carefully.

Nick Dimitrov: But, in terms of amounts of liquid assets that you're going to hold on the balance sheet and stuff like that, are we going to see something change compared to the way the balance sheet was managed previously?

Paul Goldfinch: No, I don't believe so. No, we don't.

Nick Dimitrov: OK. So my next question is going to be on something that's been very topical in the British press recently, that's primarily the demise of the payday lender Wonga. From what I understand, there's been a couple of basic issues there.

One is that supposedly Wonga wasn't checking the affordability of these loans which was a requirement under the U.K. law and then there's been a number of complaints which eventually led to the bankruptcy of the lender.

I was wondering whether there were any questions from what happened there or any takeaways that you think are pertinent to your business and how are you different than Wonga?

Mark Ruddock: Nick, it's Mark here, maybe I can answer that question. I think over the last year you've certainly heard from me a sensitivity to being a responsible lender, in particular looking very closely at the way in which we manage affordability assessments and those sorts of checks.

And the reason why I was sensitive to those things was because I was aware of the risks of not doing them. As you may remember, I came from Wonga. These issues were primarily U.K. focused, and were driven by the behavior of the early days of Wonga. In the international business of Wonga (including our markets at 4F) we have not seen these types of issues.

So I think that this firm is doing three things to mitigate those risks.

Number one, we keep a constant eye on things like affordability and risk assessment so that we ensure we do not lend to people who cannot afford to pay us back. I think you're right in pointing out that there are risks there.

Number two, as we look at the makeup of our products, we are moving away from some of the more problematic high velocity, high-cost short-term lending products that got Wonga into trouble.

And number three, I think we have developed and continue to develop a very close regulatory relationship. And I think the firm sees that kind of constructive regulatory engagement as very important going forward.

So, yes, Wonga is on our minds for sure. I think it is a cautionary tale for the industry. But, again, I think over the last year or so, you've heard us deal with this a number of times and move the firm in the direction we think is more sustainable.

Nick Dimitrov: Got it. Got it. Thank you. So, one question on capital and I'm looking at Slide 12, we have equity to assets ratio and I've done my own calculations doing the more conservative tangible equity for tangible assets ratio.

So there's been a decline there, right, and then the big driver has been IFRS 9 which I understand and I applaud the fact that you changed the practice of how you account for NPLs and so on and so on.

But when I look at capital, right, there is the bank and there is the non-bank, and the reality is that pretty much all of the capital is being trapped in the bank. So the non-bank is very thinly capitalised. Can you kind of share your comments on this statement?

Paul Goldfinch: I wouldn't necessarily say that all of the capital was trapped within TBI Bank at all. The other adjustment we took at the end of the year, and we thought very carefully as a management group and the supervisory board before doing so, was to write off a number of intangible assets at the end of the year, which also had an impact on our overall capital.

So what you're seeing there in terms of our capital is very much what we consider to be a low point at the time we made those adjustments at year-end.

We obviously had a view on the outlook of the business and we felt that this would be a historical low and we could afford to make those adjustments. So we feel comfortable where the equity situation is at the moment and you can see it's improving quarter-on-quarter and we believe it will continue to do so throughout the course of this year.

Nick Dimitrov: OK. OK, and going back to TBI Bank, I was wondering whether you've been able to realise a lot of the benefits of owning a bank.

Obviously, the bank is being regulated by the Bulgarian regulators so it's not very easy to kind of take a full advantage of it. But were you able to kind of transfer any assets to the bank in order to fund them more cheaply with local deposits? If you can give us some information on that.

Paul Goldfinch: Sure. I mean that's certainly one of the key benefits of owning a European bank with a European banking license.

As we've mentioned on the call, we continue to make a lot of progress in terms of our funding initiatives and this is clearly one of them. The IT platform to do securitisation is essentially ready and we're continuing to explore working together with TBI in terms of making this sort of internal securitisation possible.

It's taking longer than what we had hoped and the primary reason behind that is really to try and align our internal systems, our loan management systems, with that of TBI, which is very different but we continue to work on that as a very high priority and that is certainly one of the alternative funding sources we're looking at through the course of 2018 and more so into 2019.

Nick Dimitrov: Understood. And my last question is going to be again on TBI, I saw somewhere they started collecting deposits in Germany through one of the online platforms there. Do you expect that eventually to be transformational or this is just like an incremental type of funding source for you?

Paul Goldfinch: You're absolutely right. We're now connected into the Raisin platform in Germany. I think, again, we have no urgent need for huge funding sources in TBI at the moment but I believe over the medium to long term we actually see that as transformational.

Nick Dimitrov: OK, got it. Thank you.

Operator: Thank you and your next question comes from the line of Ashraf Farag, individual. Please ask your question, your line is open.

Ashraf Farag: Yes, thanks for the presentation. I want to ask a question, I am a holder of the bonds which will end in August 2019. So my question is, you are planning to pay it or is there any calling options or you will going to pay on the date of maturity which is August 2019 for the bonds with 11.75 interest rate?

Paul Goldfinch: We will repay those at maturity.

Ashraf Farag: You will repay at maturity. No options for calling or ...

Paul Goldfinch: That's correct, yes.

Ashraf Farag: Yes, all right. My other question in the report there is a clause stipulated in 4finance report for six months result, I didn't understand it. I want to clarify it with you.

You said that in April 2017, 4finance have issued U.S. with US$325 million of 10.75% notes, and IFRS 9 adjustment as of January 2018 resulted in a euro 5.2 million decrease to the carrying value from the revaluation at the original effective interest rate of the proportion of U.S. dollars 2022 bond carried from the original U.S. 2019 bond to be amortised over remaining life of bond by interest expenses.

I didn't got it. I didn't understand this clause. I have a clarification, is this will affect the bonds value maturity interest?

Paul Goldfinch: No. No, I mean, it doesn't impact the key fundamentals of the bond, so there's no impact for bondholders. This is an IFRS 9-specific accounting adjustment where we needed to use the old interest rate, so therefore the liability is lower.

It is fairly complex and fairly technical, and if you'd like a little bit more detail in terms of those adjustments that we took in January, I'm happy for you to contact myself and James offline and we can we can run through that or provide you with some more details.

Ashraf Farag: So in simple terms if I want to ask you it doesn't affect the bond, it doesn't affect the maturity, it doesn't affect that main bondholders?

Paul Goldfinch: No, it doesn't. No.

Ashraf Farag: All right. OK, many thanks for your response and I really appreciate your efforts and hoping all the success for the company.

Paul Goldfinch: Thank you very much.

Operator: Thank you, and there are no questions at this point. But once again if you wish to ask a question please press star one on your telephone. And your next question comes from the line of Otto Ditchtl from Stifel Nicolaus Europe Limited. Please ask your question, your line is open.

Otto Ditchtl: Yes. Hello. I was wondering if you could maybe comment a bit more on the impact of the foreign currency markets in the countries you operate in, considering you have this 12 million charge in the second quarter and, of course, the significant volatility in FX markets. So I'm just wondering if there's any guidance of the impact of that for the third quarter. Thank you.

Paul Goldfinch: Sure. Thank you very much for the question. In terms of Q3, I think, we've seen a little bit of a rebound from the lows in terms of the end of Q2. Although, I'm sure as you know, the currency markets remain very volatile.

Q3 is not over. I would hate to make some form of prediction in terms of what's going to happen in the next month or so. As I did mention, we have hedged the residual U.S. dollar exposure.

I think you've seen that the Argentinian peso has further depreciated over the course of Q3 but our net exposure now is already at the low millions level anyhow in terms of euros. So I think to date we're seeing somewhat of a recovery, but again the quarter is not over at the stage.

Otto Ditchtl: Thank you.

Operator: Thank you. And your next question comes from the line of Frank Lehmann from Thelo Kapital. Please ask your question. Your line is open.

Frank Lehmann: Yes. Hello. Good afternoon and thank you for taking my question. Actually, two of them, first one is about a few years ago I asked the question in one of the calls, what's the long-term strategy of the company? Are you planning an IPO? Are you having any thoughts?

What's going to happen there? Are you just going to grow with the capital you generate? What are the ideas? Is there anything you can share with us what the shareholders have been thinking about here?

And the second question, a more practical one, how are you going to exit Romania and Georgia? Are you going to thinking about selling the portfolios to these collection companies? Are you just running it down? What's the timing of that?

Can you tell us what your thoughts are on how you get out of these assets? Are just going to sit there and let it run down and observe what the portfolio is going to do and maybe sell at the end? I would just like to learn a little bit more about that. Thank you.

Paul Goldfinch: Maybe I'll take the second question first in terms of how we manage these wind downs in these markets. Firstly, what we do is we will cease new lending and then for a period of time we will continue to issue to repeat clients, and then essentially over time as that dies down the portfolio will naturally liquidate itself.

We do look where appropriate to sell portfolios and we've done so in both markets in the past. And if the opportunity arises to make profitable debt sales in those two markets, we'll do so and that will be our approach in those two markets.

Frank Lehmann: OK.

Paul Goldfinch: And in terms of, perhaps, the overall strategic direction of the firm, I think at some stage in the future that the supervisory board and the current ownership structure would like to see some form of equity event.

You probably get the same answers we gave a couple of years ago that it's much more in terms of the medium term. We have no immediate plans for any form of equity event in the next little while.

Frank Lehmann: All right, thank you very much. Best of luck.

Paul Goldfinch: Thank you.

Operator: Thank you. And there are no further questions at this point. Please continue.

Oyvind Oanes: OK, so if there are no further questions, again, thank you very much for your time and for the questions, and as I said a little earlier I look forward to meeting the key investors and having deeper discussions over the next few weeks and months.

Operator: That does conclude your conference for today. Thank you for participating. You may now disconnect. Speaker, please stand by.

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