4finance Q3 2022 results Conference Call

Tuesday, 22nd Nov 2022

Participants

Kieran Donnelly – CEO

James Etherington – CFO

Marek Kujawa – CRO

Kieran Donnelly: Thank you, and thank you everyone for dialing in. This is Kieran Donnelly, the CEO of 4finance. I'm joined by James, our chief financial officer, and Marek, our chief risk officer. We've had a very solid nine months and the third quarter, has continued that performance and I think that our business, as we all remember we had to sell the Polish business back in April and we had the purchase of a business in the Philippines. And I think we've had very good transition in both of those transactions, and that is all now showing up in our results. We talk about EBITDA often and or I should even say always, we don't really talk about profitability so much, but profitability is up 26% year on year in the nine-month period. And of course, profitability is important and it's not just about EBITDA, but the EBITDA does come first. We had a 28 million quarterly adjusted EBITDA number with a 39% margin delivered for the nine months. So again, solid EBITDA performance over the time. And again, taking into account the transition from the Polish business transitioning through to the purchase of the Philippines business I think we've managed quite well through those things and really appreciate the team for managing through that.

Interest income growth continues from our continuing products and our overall interest income is steady as we move forward. And on our like-for-like business, growth in the online like-for-like business loan issuance is up third quarter 17% over the second quarter year on year it's 17% year on year up and 11% over the second quarter. So the strong growth continues. And what this really also translates to is not just increase in interest income, but our portfolio growth. So as we're growing, even though we have a short-term product. With this kind of growth rates, we're able to grow the portfolio, which gives us a larger base of interest income to earn more interest-earning assets to back up our debt that we've issued. All of this has been delivered while we've streamlined cost and continue to look to opportunities to streamline our cost base.

Very good news on the dividend from TBI front. We've been waiting. You've been waiting. We've all been waiting for dividends from TBI Bank for quite a long time, which were held up by the regulators, both European-wide and then Bulgaria itself after the pandemic and during the pandemic and after the passing of it. But we have received ten million of dividends from TBI Bank, and we expect to receive another ten million in the very near future. TBI itself is doing very well, the footprint continues to grow. They're doing very well in Greece. Another record quarter in origination and also the portfolio giving a strong base of earning assets. All of this has been accomplished as well in a stable risk experience, which Marek will talk about more as we go forward.

If you go on to the next slide, which is slide number four. A little bit more about TBI bank loan issuance is up 35% year on year and it's driving revenue and profit increase. A lot of this growth is coming from there's really three drivers of it, Greece has been very positive launch. We've signed up 1500 partners already and we're doubling the lending business there month on month. It's now over a million euro per month, so that's a driver of growth. The lending app and we're not just a lending app, it's a whole banking app for our customers in Bulgaria and Romania is also our fastest growing channel. It's up 300% year on year and we continue to add more self-service functions there. But also and I think we have talked about this in the past, but worth emphasizing is that our smart pricing model, which is not just about the price we charge, but the limits we grant our customers, is allowing us to say yes to many customers where before we either we're too expensive for a larger size loan or we were saying no, because we weren't able to go down in scale size. So this broadened our base and has really allowed us to increase our business without increasing our risk experience.

We continue to digitalize our business more and more. We're going to be launching a new consumer-driven card, which is our orange card. It'll come out in January, and this is really a debit card with credit features and very much focused on point-of-sale interaction and client acquisition. On the loan purchase side from the online Lithuanian business, TBI over this year has brought about 25 million of loans and continues to do so. So that which we worked on many years is working very well right now and it's a good business for the Lithuanian company, which is underwriting and originating these loans and it's a good asset for TBI's growth in their profitability. So this has been a big win-win for us. As I mentioned, the ten million Euro dividend has been paid and a further ten million planned, as soon as we have the first half 2022 profit booked into capital. And that process is happening right now and then we will have another ten million dividend.

For those of you who like to look at the book value of the bank and the kind of asset, what assets are backing our debt, the book value is now up to 185 million. When we purchased the bank back in 2016, the book value was some 75 million. The revenues are up 32% year on year, which is giving us a revenue growth rate of just about 20%. And we have over 600,000 active customers with a lot of growth now coming in, our fastest growth channel being the digital app. I mentioned before, the like on like this is very important to us so even though we have a lot of new initiatives and things that we're trying to do, it's important that the core is healthy of the business. And our core business, what we've been doing for years continues to grow. And this has really been a lot of hard work, a lot of attention to detail.

But as you can see here that I'm on slide five, the circle around those bar charts there on the left-hand chart, that nice growth rate over the years. Yes, this is growth over a low from pandemic times, but we've continued that throughout 2021 and now growth in 2022 over 2021. And you can see that that loan issuance is also growing across the board. James, would you please take over here from here?

James Etherington: Thanks Kieran. So on Slide 6 we have the overall issuance. This shows again the good pace of loan issuance in recent months across the business, including TBI with another record quarter at the bank, and the Philippines.

So for interest income, we've again delivered nearly 80 million euros of interest income for the quarter. You see the growth in TBI there, and within online - if you take out the small amount we had from Poland in early Q2 - actually that online interest income has grown quarter on quarter, with Latvia, Sweden and the Czech Republic in particular contributing to that.

So on slide 7, the interest income remains well diversified – the main changes here are the Philippines portion growing as Poland reduces, and again no market is more than a quarter of the total.

I mentioned it last quarter but worth flagging again that in our total revenue we also have fee & commission income in the bank that's growing, and the Poland loan. Plus we've reduced interest expense. So while interest income is up 11% year on year, the overall revenue is actually up 19% year-on-year and Q3 was again slightly higher than Q2 and Q1. So it remains a solid performance on the income generation side.

Moving to Slide 8 on costs, we've kept that cost/income ratio stable in Q3 and below 50%. There have been some good cost reductions year-on-year, but we're more focused on trying to now hold that cost base steady – which we've managed to do in Q3.

There will be some costs that increase that we have less control over, so we have to work extra hard at being efficient in the areas we can control and trying to optimise that given the inflationary pressures we see in our markets. And that is a big focus for us in the current budget process.

Turning to Slide 9, we've continued to build that financial track record this year. We've delivered another solid quarterly profit bringing year to date profit after tax to 35 million, already above the full year figure for last year. We've maintained our margins and are up 14% on Adjusted EBITDA for the 9 months. The equity ratios reflect the dividend payment made in July, but in general these ratios have been keeping pace with the asset growth. And I'd highlight in particular the interest coverage level of 2.8 times, which we've maintained from Q2 and this is the highest level it's been in recent years.

Now I'll hand over to Marek to talk more about the portfolio and asset quality.

Marek Kujawa: Thank you, James. Good afternoon, all. Let's talk about risk numbers. Starting from Slide ten. Like previous quarters, we continue to observe growth of net receivables at the end of third quarter equals €810 million, which means 10% increase quarter to quarter. 82% of those loans were consumer loans. We also observed improvement of NPL ratio to 9.6 from 11.3 at the end of 2021.

Moving to Slide 11. We continue to keep good and stable quality of the loan portfolio over the quarters. As you can see on the vintages, all vintages are almost in line. The paragraph represents actual product portfolios belonging to the group, so it's excluding Poland and including Philippines. Also, historical portfolio behavior.

Now let's move to Slide 12. In Q3, we observe the increase of net impairment charges that was expected due to increase of Philippines portfolio as well as lower spot deposit effect comparing to the previous quarters. Actually, Q3 net impairment charges equals €25.8 million, and we continue at an active forward flow and spot sales transactions. That's all sure from my side. Thank you, and I'm passing to James.

James Etherington: Thanks Marek what I hope you can hear. Apologies if the audio quality is not good, I'll do my best.

Thanks Marek. So on Slide 13 with our EBITDA breakdown, the Q3 result at 28 million total is a bit lower than Q2 but above the Q1 proforma and still I think a very solid quarter, particularly given the portfolio growth. It's consistent with our run-rate of around 110 million in annual EBITDA. And the online business is again bringing around 15 million for the quarter, so around double the bond interest expense.

So as of Q3 we have net debt of around 280 million, and around 2.5 times debt to overall EBITDA.

As you know we have a loan outstanding to our parent company 4finance Group. This is performing and we've already had significant interest payments this year of EUR 9m on that loan. Recently we've been in discussions about a partial repayment. This is not yet finalised but the aim would be to reduce by around half, to below 30 million euros, and a good portion of that – again around half - would be in the form of our bonds. So if we can complete this it would achieve two important things of reducing the loan balance and also further reducing leverage to around 250 million of net debt. And that's illustrated in the table with potential year end numbers proforma for this.

So we've made good progress in our credit metrics with the 9M numbers and hope to improve things further.

Also on our bonds, we finalised the listing process for the 2026 bonds on the Oslo Stock Exchange in October, so both bonds are listed on regulated markets.

With that I'll pass back to Kieran.

Kieran Donnelly: Thank you, James. Thank you, Marek. So just to summarize, because really, we'd love to get to your questions as soon as possible. That's why we tried to move quickly so that we have more time for the Q&A. We're happy to have delivered strong growth and net profit, 26% increase year on year. Strong growth in the loan portfolio across the business, both in the bank and in the online business. The bank continues to grow very well and very above, above budget, or above planned performance increase. So things moving quite well there. The business itself we have very solid credit metrics, as James was just describing, a run rate of about 110 in EBITDA, our reduced debt, our diversification of our business. And if we're looking at our online portfolio, which again is growing, we've grown it by 10%. It's now up to about 170 million, a TBI book value of 185 million. If we just look at those two things versus our net debt position, we're in a very good asset coverage as well as the cashflow to service our coupon. Dividends we're very happy to have received and as I said, we have another 10 million on the way. So that is also very good movement our investment into TBI is not only giving us nice asset growth. We're also now with the regulation out of the way, we're able to get dividends out of the company, which is quite good for us. So we'd like to open up to Q&A and. If the operator could please open up the lines.

Edward Davis, WiseAlpha: Just a very quick one for you. Just your views on the Romanian economy going forward into 2023.

Kieran Donnelly: Well, I think on the Romanian ground yes, there are challenges there. I think some of those developments will be challenges for some of them are going to be opportunities as the economy goes forward. It has had a direct impact on us in our cost of funding in Romania. So that we've already seen, and we've already adjusted to on that side. As we've noted, we haven't seen any particular decrease in our risk experience. So that's been stable on the Romanian side. So I think the most important impact is how it's impacting the cost of borrowing and the FX exposure. So that's more of what we see happening for us in Romania.

Edward Davis: Thank you.

Ezequiel Freylejer, Altio Capital:

Thank you. Hello. How are you? Congratulations on the strong performance. I would like to inquire more on Slide 12 on the impairment charges or the increase that we have seen over the last two quarters. I understand the Philippines plays a role in it, but taking a side Philippines, this could be a reflection of the economies in Europe, or you think that is stabilized? Are you restricting more your underwriting policies? And where do you see a level? Do you see this will stabilize and start to decrease again?

Kieran Donnelly: Sure. I'll let Marek take that question. I reserve the right to jump in on Marek as I often do. But go on. Go ahead.

Marek Kujawa: No problem. The thing is like I said, talking about this Slide 12, for the third quarter there are two main reasons. One, Philippines. Philippines is obvious, but the second one was, as you can see on the graph, there was a lack of that spot debt sales that we used to have in third quarter. From the growth impairment perspective, the uptick in slide is like one million euro, yes? So the remaining part comes from the lack of debt sales. Now, coming to your second part of your question of the quality. We haven't observed deterioration on a risk portfolio coming from the whatever you can call crisis inflation, higher cost of living. And this is visible on our vintages, that the shape of vintages and average vintages are almost in the same place are behaving very, very similar. It means we are having stable portfolio. Of course, we are monitoring this portfolio all the time, if we see some small deviation, we are reacting. Basically, our goal is to keep growing, having all under control.

Ezequiel Freylejer: Okay. Just to follow up because we cannot see the vintage, of course, there are two recent Q2 and Q3 that's why the question for 2022. So how do you see the recently I mean, because the crisis has started to play a role more in Q2 and Q3. That's why I kind of see that trend from the vintage analysis.

Marek Kujawa: Okay. Q2 and Q3 is like a very short period of time to show NPL 90 plus. So those vintages, 90 plus DPD. So those vintages are just not material. Q2 is just like a three MOBs and they are in line, Q3 no MOBs for default. We are of course having other measures like DPDs. It also does not observe any variation that you could say is coming from the crisis or from the economic situation.

Ezequiel Freylejer: Okay, perfect, and then the last question is when you will see again taking aside Philippines and these start the impairment charges to decline. And I recall in previous call that you said that of course one this is stabilized will be close to 15,16. You feel, I mean towards that target going forward and when do you see that that that trend will come back to 15 or 16?

Marek Kujawa: Well, I will say that as we expected stabilizing already in fourth quarters the question is for the answer. If we could go to 15, 16 strongly depends on our plan of sales and growth, because once we're growing, then the impairment charges has to catch us up somehow after two or three quarters. So once, if we have actually quite fast for the next year for growth, then we can expect this impacted charge impairment charges will be still stable or even slightly increasing because we are also looking good from the perspective of profits that we have. So the charges itself as a good measure, we should always compare it to the revenue.

Ignacio Ponce Ocampo, Altio Capital: Hello, good afternoon. How are you guys?

Kieran Donnelly: Hi, Ignacio. Hi. Hey, how are you?

Ignacio Ponce Ocampo: One question. How big is the portfolio in the Philippines?

Kieran Donnelly: Portfolio in the Philippines. Marek, you have that number please. Or James.

James Etherington: Hey, Ignacio, we're just under ten million, so it's around about nine million of net loans to the Philippines.

Ignacio Ponce Ocampo: So how big was the hit on the Philippines then? On the Associated with the graph on page 12.

James Etherington: I don't know. I wouldn't describe it as a hit. I think it is one that has a relatively higher impairment ratio in portfolio. Also, we have a more conservative write-off approach in the Philippines where we do that at 60 days. So we are kind of harsher, if you like, on the running provisioning for Philippines, which is why that portfolio level's a bit lower. So it contributes a bit more on the top line on interest income and also on the provision line.

Ignacio Ponce Ocampo: So from their gross impairment, how can you split up? How much was Philippines? How much was, say, like Spain, and the other markets that you operate in?

James Etherington: Yeah. I mean, we don't publish it separately, obviously but yeah, if we have a look at the Philippines then I guess that it contributed, some five to six million there in impairments for the quarter.

Kieran Donnelly: Remember, the portfolio size is not indicated because these are short-term loans. So during the first quarter and the Philippines, the model is that the first loan we issue is a ten-day loan and the second loan would be a 30-day loan. So the amount of turnover over the course of a 90-day period, of course of a quarter, if the portfolio at the end is nine million. At that time, we could have issued, there during that time, say, 25 or 20, because the ten-day loans are short. So let's just say, for example if you have a portfolio of nine million during a three-month period, you would have issued close to 20 to 23 million of loans. And that first ten-day loan has a quite high default rate. And then for the second loan, it brings it down. So that first loan is your entry level of your client acquisition. So some of that risk cost is actually a client acquisition cost that we have.

So when you're looking at your–that's why actually slide 11 is much more important than the previous question we had about those vintages not showing up because they're 90 plus. A very good point, very observing question. But we do not rely, as Marek was saying, just on 90-day plus or NPLs, we're looking at first payment defaults, measured at five days, 15 days, 30 days second payment, default. So our risk indicators are quite immediate and they're multiple times per month because we're issuing every day. So we're having maturities basis. So we have a lot of real-time data that's coming in that's indicating the direction of risk.

When you're looking at your net impairment charge per quarter, this number is actually a difficult way to steer off of it. If you're using your first payment default and your vintage analysis, this is a much better way for us to be able to manage risk and follow risk. Impairment charge per quarter grows as the business is growing and the cost of risk. Again, the switch from Poland to the Philippines is part of that change in risk. And as Marek said also, we had a number of debt sales that shifted that normally would have been we expected to close them during the third quarter in saying they will be coming in in the fourth quarter. So I think the net impairment charge by quarter is of course, it's an accounting reality. I don't actually see it as the best indication of risk. What we're looking at is vintage analysis. First payment defaults at five days, 15 days, 30 days. These are better indications of risk because they adjust with the portfolio. And we are not setting risk targets. Also, as Marek said, just to emphasize, we are setting profitability targets. So increases in risk, we say the risk in the Philippines is much higher than what we used to have in Poland. But the Philippines business seems to be on track to be more profitable than where the Polish business was with less risk. So we're managing the profitability to positive cash flow. Not to a risk number.

Ignacio Ponce Ocampo: What sort of rates can you charge in the Philippines?

Kieran Donnelly: Effectively, we're charging 30% per month. Like we do in Spain.

Ignacio Ponce Ocampo: So this acquisition goes down on ten-day loan impairments are good enough level for you to manage for profitability in your eyes?

Kieran Donnelly: Absolutely. Okay. Thank you.

Kieran Donnelly: First of all, I want to thank everyone for dialing in. I'd like to thank our whole team here at 4finance, for all the hard work in delivering these results. And I'd also say that while we haven't seen any discernible change in risk experience this far, sales continue despite this cost-of-living crisis that everyone talks about. We are monitoring very closely, on a daily basis, our portfolios, our customer experience, our sales. The feedback we get from our call centers, to track. And as I said, we haven't seen that doesn't mean we're relaxed. It just means it means we are watching, and we are ready to quickly respond to any increase in risk. But we're also equally ready to take advantage of opportunity that as a lender, as a subprime lender these market conditions also provide very interesting opportunities for us to grow the business. So we're very much on our toes at this moment for both the risk side and for the opportunity side as we move forward. And our balance sheet is in very good shape. Our cash position is in very good shape, so I think we're well poised to take advantage of the situation and at the same time protect the downside. Thanks again for calling in. Really appreciate your support, your questions. And please don't feel limited to just these calls as an opportunity to reach out to us. Send an email, call, we're happy to answer any questions people have.

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