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Investor briefing transcript

Attached is a copy of the transcript from Pioneer Credit Limited's (ASX:PNC) investor briefing held on Tuesday 27 February 2018 and presented by Managing Director, Keith John and Chief Financial Officer, Leslie Crockett (with minor edits).

The Briefing followed the format of the 1H18 Results Presentation released to the market on 27 February 2018, and the attached transcript is intended to be read in line with the 1H18 Results Presentation.

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PIONEER CREDIT LIMITED (ASX: PNC)

TRANSCRIPT OF INVESTOR BRIEFING HELD ON 27 FEBRUARY 2018

The following transcript is intended to be read in line with the 1H18 Results Presentation released at 8.16 am (AEDT) on Tuesday 27 February 2018.

Keith John: Good morning and thank you for joining us today. In particular, I would like to welcome our Board who are joining us on the call today. Michael Smith, my Chairman. Our Chair of Audit and Risk, Andrea Hall, Mark Dutton, an independent non-executive, and Ann Robinson who has formally joined the Board from today as well. Also thank you to my executive and leadership team for joining us and for what is another outstanding half from Pioneer. Joining me presenting today will be Leslie Crockett, Chief Financial Officer.

I'll now take you through the highlights. Leslie will take us through the financial statements, and then I'll close with the operations of the business.

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During the half, we increased our senior debt facility to $130 million with our existing banking syndicate. This was part of the facility that we had structured with those groups previously so that we had the scope to expand as opportunity came about. We've certainly seen those opportunities happen over the last period and look forward to that continuing.

Through the period, we also finalised our personal loan product offering. I'll talk to that later and what that means for the business. We also launched Pioneer Path, our personal finance mobile app - a very important part of our engagement strategy with both new customers and also, of course, our valued existing customers.

Just recently we also appointed Acacia Partners and Westpac Institutional Bank as joint lead managers for a medium-term debt raising. We've foreshadowed this to the market previously. We are a long way through that process now and I'll touch on that a little bit later on in the call.

Most importantly, is what we have actually achieved in the half in terms of the financial outcomes. I'm very pleased to say today that we've had record cash generation with EBITDA at $24.3 million, up some 60% on the prior corresponding period.

We invested just on $44 million in the period. We're very pleased with that. Much of that came very late in the piece and some of that you'll see sitting in our creditors. We've today also upgraded our guidance with respect to investment for the full year to $80 million. I'll talk a little bit more about that later on, but certainly a great platform for us to continue our growth not just through this year, but into 2019 as well.

We are exceptionally pleased with our record half year net profit after taxation of $8.1 million, up 93% on prior corresponding period, and 24% on the last half and, along with the cash generation, validates what we've been saying to the market, and the strategy that we've been discussing with the market for quite a number of years now.

Leslie Crockett: Good morning. It is my pleasure to provide some key insights into our half year financial result commencing with our earnings outcomes presented on **page 4**.

Pioneer today announced its results for the half year ended 31 December 2017, reporting the achievements of significant growth in PDP liquidations to underpin the increase reported in net revenue, and net profit after taxation. We are pleased to confirm that the directors' today declared a fully franked interim dividend of 6.62 cents per share which will be paid on 27 April 2018.

Our Directors' Report presented with the financial statements this morning highlighted that this has been our strongest first half ever. As noted by Keith, we are very pleased to upgrade our net profit after tax guidance for the full year to at least $17 million.

We have highlighted over previous reporting periods that earnings are weighted to the second half of the financial year, and that over time this earning skew would reduce and normalise. Our results to date for FY18 show that we have in the first half, recorded 48% of our upgraded profit guidance - a proportion of full year earnings that has steadily improved over the past four full years from as low as 21% in our first year of public reporting.

Importance of earnings represented through sustainably growing liquidations has been a recurring theme for Pioneer, and on **page 5**, the significant growth in EBITDA and gross operating cashflow is clearly illustrated.

Annualised EBITDA in prior financial years has been perceived in some commentary to have flatlined. It's pleasing to demonstrate that the disciplined investment in these earlier years in both excellent customer service and skilled support people is yielding the anticipated returns evidenced by the solid performance in liquidation and cash generation.

Our approach to building long term relationships, and the active differentiation as a preferred purchaser has, as is highlighted in our half year reports, resulted in Pioneer fully contracting 100% of our forecast customer portfolio investments for this financial year.

Accordingly, we have confirmed the increase to our FY18 PDP investment guidance to $80 million, all of which is contracted.

The investment outflows are serviced through free cashflow generated by PDP liquidations as well as proceeds from our extended financing facilities. This purchasing result has been driven by market conditions where price expectations have continued normalising for Pioneer. While this may be different to what others are experiencing in the market, Pioneer, as the differentiated purchaser, has been consistently rewarded in the prices and volume we invest at.

We expect the price of portfolios to Pioneer to continue to decrease modestly, although it is unlikely that there will be any additional investment in FY18 beyond what we've already secured.

The focus of our team will be to secure the appropriate customer accounts, as well as the vendor product and volume mix to continue to underpin our growth in future periods.

Sustainable earnings growth has been achieved once again on the back of a cautious PDP valuation in which we continue to apply a 9% downward calibration to the modelled forecast output which significantly reduces this forward looking forecast.

A cautious approach is also taken to the application of discount rates to the present value calculation, as has always been part of the discipline of Pioneer. We have maintained our recent cautious discount rate of 20.1% overall.

The balance sheet metrics presented on **page 6** highlights that the company remains well funded through reinvestment of cashflow generated as well as access to modestly geared debt funding facilities. Our portfolio investment facility of $120 million remains in place, $22.7 million of which remains undrawn.

Importantly, our capital management initiatives provide a clear pathway for Pioneer to continue to participate in growth initiatives, and to take advantage of new and expanded relationship opportunities the changing market provides. To achieve our desire to diversify our funding mix and tenure and to support the expected growth in our recently launched personal loan offer, we expect to settle in the near term on a $40 million Over the Counter Bond.

This initiative has been jointly managed by Acacia Partners, and Westpac Institutional Bank with the documentation process including agreements from senior banks now largely complete, and the corner stone investor engagement process progressing.

We will update the market more fully on this once it's completed, which we expect to be during March.

Thank you all for your kind attention and interest today on these financial highlights.

Keith John: **Page 7**

Investment Discipline - as always there is much talk in our market about rising prices for PDPs, competition, overheating and the like. As we have clearly articulated now for a number of years, these are generally not circumstances that seem to affect Pioneer. We do see them but Pioneer's differentiated strategy, Pioneer's engagement with the vendors, Pioneer's unique and valued treatment of consumers means that we are increasingly dealing with the institutions on a level that we don't think others are. Quite clearly in times where there is focus on social licence of banks and financial institutions - there is a royal commission going on - funders are much more interested in the treatment of their consumers and how their brands are being portrayed than simply getting the highest price.

If you are able to differentiate your service and continue to do that over a number of years then you will be rewarded in that regard. Pioneer is absolutely in that bracket and continues to work very hard to ensure that its operations support that, and our vendor partners also continue to see that and value that differentiation.

With respect to our PDP investment, today we've upgraded that to $80 million. You will see that there is a slight decrease from last year in price. This is despite forward flow increasing again as a proportion of our investments through the period. As always, capital preservation is our number one priority when we are investing. It's all very well to buy anything you can. In our business we focus very, very firmly on ensuring that our capital is preserved and by that then we will get an appropriate return over time. If we are unable to get that appropriate return and we risk our capital unduly then we simply would not do a transaction.

It is for that reason that Leslie has said that we don't expect to see any material increase or any other increase in investment this year because we want to make sure that we bed down what we have. we continue to manage well within our means and we continue to grow in an appropriate manner.

As always our portfolio continues to be built with only the highest quality customers which are generated as tier one consumers. That is, they are not credit impaired when they were originated. We have absolutely no payday loans, no SACC accounts, which for all intents and purposes are exactly the same as payday loans, and we have absolutely no MACC accounts. We also don't buy bankruptcy or telco or utility accounts. Our business is focused on quality.

On **page 8** we're today announcing that for the first time in our industry we have entered into a forward flow agreement for LMI residuals. This is a fantastic growth opportunity for Pioneer and one that falls absolutely in our sweet spot. That is, consumers that have gone through a hardship and need to be treated appropriately and value a relationship that is focused on long term outcomes that are good for the consumer and good for us. This agreement has come after considerable due diligence by both the vendor and by Pioneer. We have spent an inordinate amount of time making sure what we're investing in is absolutely what we expected to invest in and that the vendor absolutely understands the value that Pioneer brings to the relationship.

It is because of that we were chosen to enter into this industry-first forward flow agreement. We expect the returns on this to meet or exceed our ROE hurdles exactly as you would expect from us as well. It is the precursor to what we think is a great opportunity for us to deal with other providers of LMI and for banks that self-insure to take those products off them. On the right-hand side we have some basic stats. This is a very new agreement given that it only started in November. Up until the end of the year, we've acquired some 603 accounts with 8% of those already committed on a payment arrangement despite us only having them for an average of 35 days. So a really solid engagement with those consumers from the get-go and certainly meeting our expectations that, as always, we cautiously model.

The other pleasing thing about these consumers is the average monthly payment arrangement is some 1.6 times higher than the balance of our portfolio. So really high quality consumers who have had a circumstance in their life as happens to many people in Australia. Pioneer has got a great opportunity now to work with these consumers to continue to grow them and also to continue to grow our business and this new relationship that we have.

Page **9** talks through our customer portfolio and the mix that exists within that. A very simple page but very important in terms of addressing any perception that there might be a geographical risk. Clearly, Pioneer has a portfolio that is largely representative of the geographic distribution of Australia. Subsequently that protects us significantly from any periods of downturn that might exist in areas that are struggling. Of course it is good that mining services are coming back and mining is starting to pick up. That's certainly a little spot that we expect might add some value to us over the next couple of periods.

As you can see, we've got 19 vendor partners. It was only a few years ago where we had only dealt with two of the banks and most of that was with one. Now 64% of our portfolio is made up across all of the four big banks. We're really pleased with that.

On **page 10** we talk through our payment arrangement growth. Certainly through this period we would have liked to have done a little bit better out of our payment arrangements. We set a very ambitious target to grow our payment arrangements by 5% a month. We didn't achieve that through this period but much of that has been because we've been focusing on on-boarding all of the new portfolios that we have acquired as well as ensuring that our existing Payment Arrangement (PA) portfolio continues to perform.

Data analytics is as always increasing our ability to view our consumers and those most likely to benefit from a PA. Certainly that continues for us. We've had 16% growth in PAs since June.

We are still pleased with that number of course but we will continue to shoot for our ambitious targets. We certainly expect our PA growth to accelerate in the second half. Pleasingly though that number is now just shy of 20,000 consumers and some $250 million of performing book. As always our number is net of the break rate not including things that we expect to happen. This is actually the performing part of our book and does not include future interest.

Page 11 talks about liquidations and you can see that coming through in our cash flow and obviously with the improved EBITDA. It was our strongest first half liquidations to date. Now clearly that's a number that we want to change in respect of wanting to make that more balanced in future periods. But it is a reflection of the very significant ramp in purchasing over the last year. Because of that, it makes up a greater proportion.

On the right-hand side you will see the top two bars – 2-3 years and more than 3 years at 12% and 14% respectively. Whilst that number has decreased as a percentage of our liquidations, the dollar value is more significant than what it was in FY17. So we're very pleased with how that's performing. On the left-hand side you can see our cumulative cash generation continues to open up. We are now increasing the cash generation at a faster rate each period, something we look to continue to do.

Our return multiples on **page 12** continue on track. We are very pleased with the way things are going and in particular with the periods of FY13 to FY16 where each of those multiples have increased as you'd expect them to do off the top of a really positive and strong contribution through the first half. We continue to focus on our payment arrangements as I said and we continue to work on liquidating across all vintages that exist within our book. Again the committed part of our return is net of historical break rates and of future interest receivables. So giving you the most cautious and most realistic expectation of the results that we will print for you.

On **page 13**, for some time now we've been talking about personal lending. We've been on what seems like a journey of forever to get this product to market. But it's really, really important for people to understand why it's taken us so long to do what others seem to do so quickly. This reporting season has really highlighted to me the one thing I keep saying all the time - anyone can give away money. Getting paid is another thing entirely. We've seen losses and impairments through the lending sector through this half. Having in place the right disciplines, the right structures and the right processes which we have now invested many millions of dollars in, is critical to ensuring success in the lending market.

Pioneer has done all of the hard work including running a lengthy pilot program on a white label basis to prove up the way that we are running our business the way that we expect it to run and to get us ready for this day where we've commenced personal lending. We are very pleased that has happened. I can tell you that from our modelling perspective we've been exceptionally cautious with the way we originate. We are also exceptionally cautious with the way that we forecast losses and the way that we build in risk into our models.

That will remain for some time. Once we have proved it up, once we have a book of scale, once we are delivering results then we will start readjusting those limits if it is appropriate. But for the time being, as always we expense everything we can. We take the most cautious view that we can and then we proceed down a path very, very carefully.

As I said we've commenced on-balance sheet lending. We've got a great process which you can actually view online - a digital application and approval process - which we are very, very happy with, and which our team have put an exceptional amount of work into. We have data on over 200,000 financial consumers across our business that we use where appropriate in our modelling, in addition to a complete suite of data. We don't just rely on credit bureau scores to make a decision. We don't just rely on our data. We don't just rely on bank statements to make a decision. We use all of the data and more to make an informed decision about the consumers to make sure we're lending to the right people.

We also have a senior product team, all with extensive bank experience. We've been building that team out for quite some time. They are very focused on ensuring that we deliver the right outcomes to the consumers, and also the right outcomes to Pioneer.

As I said, we are risk-aware. It is about sustainable lending and it's about engagement strategy that is good for both Pioneer and for the consumer. We want these consumers to shop with us forever. This is not a one-off product, and the only way they will do that is if we deliver them value and if Pioneer get value from the relationship as well.

We believe we can do that. We believe we are doing that. We believe we have demonstrated that clearly over the past few years, and we're very focused on that. We have three initial offerings for those customers on their pathway to prime, and we're targeting a $30 million book by the end of December this year. We haven't provided any updates for market as yet as to the size of the book or the performance. It is too early to do that at this stage, but at the full year results we expect to be able to do that.

One of the hallmarks of this business is the discipline with which we operate, the caution with which we operate, and the engagement and the equity that management has in the business. On **page 14** we talk through that, and our view of our role as custodians of shareholder wealth. It's not simply enough to punt it and grow it. That is not what we do. Our role in the very first instance is to protect that wealth and grow it appropriately over time.

It takes time. We think we've proven that we're very good at it, and we will continue to work hard to prove that and to value the equity that you and your clients invest in Pioneer. Part of that is the way that we incentivise our team. Last year, we removed almost every short term incentive within this business, with the exception of one or two people, and their STI is very simply based on two things. One is a revenue number and the other is ensuring that our compliance regime remains intact. If we have something that goes askew with compliance, then quite clearly the STIs are not in place.

Outside of that, the entire executive and senior management team are invested in the equity, both personally in what they have bought on market and also with respect to rights that have been granted them, which vest over a period of up to five years. So as you can see now, with all of the vesting and all of the prior programs, some 35% of the vesting occurs in 2020 and 26% in 2021.

So our team are aligned to the long-term value creation for all shareholders and, quite simply, if we do not perform, then that equity will not be worth what it should be worth and our people will not be receiving the bonus that might have been achieved or might have been paid otherwise. We think it's very, very important.

Further, our performance and indeterminate rights have so far only ever been acquired on market. So we are preserving the capital that exists within the business. Management, of course, as detailed on **page 14,** owns just shy of 18% of the equity on a fully-diluted basis.

On **Page 15** is the outlook for the rest of this financial year. There are a couple of key themes:-

1. On balance sheet lending portfolio. We're in the market now with an up to $40 million bond and we expect to close that out during March. Leslie has given you some of the details on that.
2. Commencement of lending. We're targeting a book of $30 million by the end of December this year. As I said, we will give you an update at the full year results presentation on what that book looks like, how it's growing, and also the quality of it, which of course is very important.

In terms of investment, the changing market dynamics continue to provide new and expanded opportunities for Pioneer. We're working very hard to make sure that the market, as it continues to expand, understands who we are, what we are, and what we stand for. We think we're doing a good job of that. We will continue to keep working hard at that, and we'll continue to keep bringing opportunities to Pioneer that we think add value to our business. I can assure you that if it doesn't, we do not just engage in growth for growth's sake.

That said, we've been very fortunate this year. We've had the opportunity to grow a new relationship. We've also had the opportunity to establish a couple of new relationships and the opportunity to extend some contracts a little earlier than expected. Investment now sits at $80 million contracted for the full year. As we said, we do not expect there to be any increase for the balance of this year. Finally, as Leslie said, we're pleased to upgrade our net profit after tax guidance for the full year to at least $17 million.

That concludes my part of the presentation. We will now open for questions.

QUESTIONS

Question 1: Is the $40 million debt raising specifically being done to support the personal lending book, or will you be able to use that throughout the business?

A. Leslie Crockett: We are well-progressed with the $40 million over-the-counter bond. It is intended to fund both existing business and primarily the personal loan portfolio. I think the key point is there's no specific constraints in that respect, other than, of course, respecting the covenants and undertakings that will come with that raising.

Question 2: Where are you at in terms of current existing loan books and where do you think you'll finish at the end of February?

A: Leslie Crockett We have not provided any guidance with respect of progression on the loan book, and we will be providing that update at the year end.

Question 3: In your notes to the Accounts, you flagged that there's another 50-odd staff that you intend to hire over the next six months. Can you comment on what parts of the business these would be in?

A: Keith John: It's across both businesses. We don't really segregate our team out. We expect them to have capabilities to work in both parts of our business, because the data that we use for those consumers is very similar across both parts of the business. What we're looking to do is to be able to better understand our consumers so that we can touch them at more appropriate times, rather than just having a scattergun approach if you have no analytics in your business, and to deliver accounts and customers to our account managers in a way that they can better service them.

So if I know that an account manager can handle three accounts today and two tomorrow, rather than having a system whereby I give them five each day because that's the number we do in our business, I can actually give them the accounts in a manner that they can actually work at so we can get better outcomes for everyone.

Question 4: Can I clarify how many new staff you had over the last year? Obviously the team has been growing as has the business. Is this similar cost growth that has been accelerating, or are you able to call out what you think the annualised step-up in the cost base will be?

A: Keith John: I think you can assume the step-up is not dissimilar to what we've experienced in the past.

<u>Question 5:</u> You mentioned that when we were discussing PDP purchases and the outlook, what your intentions are for FY18. You mentioned for future periods that you're targeting to increase it modestly for future periods? I know there's no guidance out there, but can you just clarify what was said?

A: Leslie Crockett: We haven't specifically guided FY19 and won't be in a position to do that. Obviously we'll update that at the year end results. I think it's entirely reasonable to expect some growth there, but from a cautious modelling perspective, I think a reasonable position, without any information to the contrary, is to expect it not to reduce from FY18 at $80 million.

<u>Question 6:</u> The arrangement you got for LMI, how much was deployed in the first half in PDP investment and what's the forward flow expectation for deployment in the second half?

A: Keith John: The forward flow commenced in November. Outside of that, we don't specifically disclose what we're investing with each particular party. Needless to say that in the context of our purchasing this year and our portfolio overall, it's an exceptionally reasonable and cautious number.

<u>Question 7:</u> I guess I'm just trying to get a feel for how big that market could be for you. In a forward flow basis, is there an up-front payment to get access to a big book, or was it just a standard forward flow up-front? Just to get a feel for how big that book of business could actually be in the future.

A: Keith John: When we work out the total size of the prize, we can come to market and let them know in August. Certainly there are many financial institutions that have LMI residuals within Australia. Many of those are talking to us at the moment and once we work out how significant it could be, we'll certainly let everyone know.

<u>Question 8:</u> It looks like you've got about $36 million of face value being 600 accounts at $60,000 each.

A: Keith John: Yes

<u>Question 9:</u> Would it be safe to assume that the cents in the dollar is less than $0.20 per dollar chart, it's right down the bottom of that equation that you're paying per face value?

A: Keith John: I can’t comment on that as you know I wouldn't but thank you for the question. We haven't discussed what they look like but needless to say they’re very high quality and we're very pleased with them. I think the fact that we have 8 to 10% on payment arrangement after such a short period of time is indicative of them being of higher quality rather than lower quality.

Question 10: Well done. Absolutely super effort there and continued trends since listing so a great outcome. Is the LMI that you've signed this initial agreement with, a bank or an industry insurer?

A: Keith John: Unfortunately, we're unable to disclose what institution or what type of institution we have acquired those from. Needless to say, as I have said before, the quality is exceptionally high and we're very happy to see that book performing.

Question 11: On the personal loan front, great to see it getting underway now. I don't think anyone's going to be too upset that you've taken a bit longer to do that especially given the growth that has come from the PDP side anyway. Now that it is up and running, if we can do some basic numbers on applying interest rates to loan book size, where do you see Pioneer's aspirational goals in terms of the personal loan book size over the coming years?

A: Keith John: We think there's a tremendous opportunity for that to become a very material part of our earning. Ultimately diversifying our revenue stream until we have something that is an equal contributor to PDP we think is possible, though I caution that it is some 4-5 years away in a realistic sense. What we're aiming to do is to make sure we put in place the foundations to grow a book that is meaningful, that we understand and that has as little risk as possible sitting within it so that it's entirely predictable in the outcomes that flow from it and of course that our capital is not unduly risked. So we'll start small and hopefully by the end of this calendar year we'll have some really solid performing data and a book of $30 million. We will continue to grow it from there and once we get a little bit more comfortable then the intention will be that we'll open the gate slowly and we get a little bit more volume but we're a few years off getting to that level.

Question 12: I think previously you guided on the personal loan side being breakeven on an annualised basis at June 30 this year. Is that still a reasonable target?

A: Keith John: We guided towards Pioneer Credit Connect as a whole being break even and this includes broking. Where we are now is it is likely we won't be breakeven because of the investment that we're putting back into analytics into growing the product and the contribution or the cost allocation that will occur from that. With the business performing as well as it is with cash opening up as well as it is, we continue to invest ahead of the curve so that we can reap the rewards a little further down the track.

Question 13: A quick comment on LVR capacity. With your gearing now at 51.1% I note that's the third half year in a row where it's been above your internal limit of 50%. How will that shape out in the course of the year noting that it's already down 3% across that year?

A: Keith John: We changed our view on that as a ceiling to a target going back to the last half year but it certainly remains our target. By the end of the financial year we expect to see it sitting within the target level.

Question 14: I imagine that the bond is included in the LVR calculation and tthere's no quasi equity or assumptions around that?

A: Keith John: There are no quasi equity assumptions around the bond.

Question 15: In terms of the consumer lending book, can you let us know in terms of percentage of customers that are already part of your PDP book or that have come from that as opposed to new customers?

A: Keith John: We haven't released any data with respect to that at this stage but we certainly expect to in the future. What I can say to you though is that none of the customers in our personal loans are debt consolidation on existing customers. By that I mean they will have completed their arrangement and obligations to Pioneer before they are afforded a new product. So very clearly they must have completed, we must understand them, they must demonstrate capacity, the ability to manage and the ability to repay and the ability to grow before we would consider them in any event. As we get down the path and once we've got something meaningful to talk to, we'll certainly be doing that. We've invested an incredible amount of time in the relationship with our consumers and we expect a meaningful contribution from that part of our business into the new product.

Question 16: How much of the $130 million facility was undrawn?

A: Leslie Crockett: $22.7 million.

END OF TRANSCRIPT