Oportun

Second Quarter 2023 Conference Call Script

Tuesday, August 8, 2023

Cover slide

Operator

Welcome to Oportun Financial Corporation's Second Quarter 2023 Earnings Conference Call. All lines have been placed on mute to prevent background noise. After the speakers' remarks, there will be a question-and-answer session. Today's call is being recorded. For opening remarks and introductions, I'd like to turn the call over to Dorian Hare, Senior Vice President of Investor Relations. Mr. Hare, you may begin.

Slide 2

Introduction: Dorian Hare, Senior Vice President, Investor Relations

Thanks, and hello everyone. With me to discuss Oportun's second quarter 2023 results are Raul Vazquez, Chief Executive Officer, and Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer. I'll remind everyone on the call or webcast that some of the remarks made today will include forward-looking statements related to our business, future results of operations and financial position, planned products and services, business strategy and plans and objectives of management for our future operations. Actual results may differ materially from those contemplated or implied by these forward-looking statements, and we caution you not to place undue reliance on these forward-looking statements. A more detailed discussion of the risk factors that could cause these results to differ materially are set forth in our earnings press release and in our filings with the Securities and Exchange Commission under the caption, "Risk Factors," including our upcoming Form 10-Q filing for the quarter ended June 30, 2023. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events other than as required by law.

Also on today's call, we will present both GAAP and non-GAAP financial measures, which we believe can be useful measures for the period-to-period comparisons of our core business, and which will provide useful information to investors regarding our financial condition and results of operations. A full list of definitions can be found in our earnings materials, available at the investor relations section on our website. Non-GAAP financial measures are presented in addition to, and not as a substitute for, financial measures calculated in accordance with GAAP. A reconciliation of non-GAAP to GAAP financial measures is included in our earnings press release, our second quarter 2023 financial supplement and the appendix section of the second quarter 2023 earnings presentation, all of which are available at the investor relations section of our website at investor.oportun.com. In addition, this call is being webcast, and an archive version will be available after the call, along with a copy of our prepared remarks. With that, I will now turn the call over to Raul.

Raul Vazquez, Chief Executive Officer

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Thanks, Dorian and good afternoon, everyone. Thanks for joining us. Today, I'll discuss our second quarter financial performance and update you on Oportun's areas of focus.

Let me begin with five highlights from our Q2 performance.

First, we returned to profitability in Q2 with $2 million in Adjusted Net Income, driven by strong top-line performance and the steps that we took earlier this year to streamline our operating expenses. We've now reported positive Adjusted Net Income in 11 of the last 12 quarters. Our Adjusted EBITDA, which also turned positive at $4 million, was within our guidance range and, more importantly, we expect to deliver $35 to $40 million in Adjusted EBITDA in Q3.

Second, our credit outlook is improving as a result of our tightened credit posture. Our Annualized Net Charge-Off Rate of 12.5% outperformed our guidance due to effective collection and recovery efforts as well as our tighter credit standards. We expect Q2 to have been the peak level, and we project that our loss rate will decline by approximately 80 basis points in Q3 based upon our midpoint guidance. As a reminder, we initiated our credit tightening in July of 2022 due to the heightened inflation present at that time, and are continuing to see improvements within our portfolio.

Third, we're seeing the tangible benefits and results of our cost savings initiatives. You'll recall that we enacted a combined set of initiatives in February and May to produce $126 to $136 million in annualized expense savings. Those actions are taking hold and resulted in total operating expenses of $136 million for Q2, a 7% sequential and a 14% year-over-year decline.

Fourth, we increased revenue by 18.0% and set a new quarterly record of $267 million, while expenses were down 14% year-over-year. This demonstrates the resilience of our business and also highlights the impact of our efforts to increase yield; we see yield continuing to rise in the second half of the year.

Finally, since our last earnings call we've entered into two new whole loans sale agreements that validate the quality of our originations and will provide a total of up to $700 million of additional liquidity and funding over the next year.

I'm pleased with our performance and grateful for the efforts of our team to produce a strong quarter. Our focus remains on creating a leaner and more efficient company and we're excited about the second half of 2023, which Jonathan will detail for you when he provides guidance.

Slide 4

Before handing off to Jonathan, I want to spend a few minutes reiterating our strategic priorities and how we're allocating our spending to the two most proven and profitable parts of the business: Unsecured Personal Loans, and our Savings product which is key to our member engagement platform.

85% of our corporate expense is allocated to the core Unsecured Personal Loan product, which is appropriate for the largest and most proven component of Oportun. We will continue to leverage data, technology, and AI to grow it at prudent levels and enhance this product's profitability.

Approximately 10% of our corporate expense is allocated to our Savings product and our member engagement platform, which continues to be profitable on a cash flow basis at that level of investment. Within this category we're leveraging our new Oportun Mobile App, fully launched in Q1, which will drive increased cross-selling, higher conversions and lower customer acquisition costs over time. I'm pleased to share that 550,000 members have now signed up to use the app, with more to come now that we'll start marketing it more broadly and have translated the app into Spanish.

We're maintaining optionality for future growth opportunities by allocating only 5% of our corporate expense on developing the rest of our product suite. Consistent with our focus on operating efficiently, we have decided to phase out our checking account product so we can shift resources to more accretive products.

We will continue to evaluate our other products and initiatives to ensure they are the best use of resources and capital.

In summary, I'm proud of the team's strong execution and continued focus on driving shareholder value while delivering on our mission to empower our now more than 2 million members to build a better future.

With that, I will turn it over to Jonathan for additional details on our second quarter financial performance and our updated 2023 guidance.

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

Slide 7

Thanks Raul, and good afternoon everyone. As Raul mentioned, Oportun delivered strong performance in the second quarter. We achieved these results by continuing to take a conservative stance, focused on the things we can control.

As shown on **Slide 7,** Oportun delivered record total revenue of $267 million and returned to profitability, delivering $2 million of Adjusted Net Income.

For originations, we continue to be focused on quality rather than quantity. That was evident in our Q2 aggregate originations of $485 million, which were down 45% year-over-year, yet up 19% from the first quarter as we were able to make more high-quality loans. In particular, we drove the sequential growth by successfully marketing to our best customers.

Total revenue of $267 million, for year-over-year growth of 18%, outperformed our guidance range due to higher than anticipated originations and higher portfolio yield as our pricing increases have started to take effect. Our 32.2% portfolio yield increased by 83 basis points from Q1 to Q2.

We remain on track for year-end portfolio yield to be approximately 200 basis points higher than the level at the end of 2022. We have increased yield while remaining committed to our 36% APR cap without burdening our members with significant changes to their payment amounts.

Net revenue was $119 million, down 18% year-over-year, primarily due to higher Net Charge-Offs and higher interest expense compared to 2022.

Interest expense of $41 million was up $24 million year-over-year, primarily driven by increased debt issuance, and the increase in our cost of debt to 6.0% versus 3.0% in the year-ago period.

The fair value price of our loans increased to 100.7% as of June 30, and resulted in a $14 million mark-to-market increase.

This was essentially offset by a $13 million mark-to-market increase in our asset-backed notes, which contributed negatively towards our earnings, resulting from a 5 basis point increase in weighted average price to 94.1% and continued amortization of several of our ABS deals.

For our net change in fair value, we had a $106 million net decrease, which consisted mainly of current period charge-offs of $93 million.

Turning now to operating expenses and efficiency, as Raul mentioned earlier, we are seeing the benefits of the actions that we've taken to optimize our cost structure. Our 43.4% Adjusted Operating Efficiency, an improvement of 1,860 basis points year-over-year, set our fourth consecutive post-IPO record. Our $136 million in total operating expenses during Q2 was the lowest quarterly figure we've reported since 2021. Driven by our expense savings measures enacted earlier this year, which included a 28% reduction in our corporate staff, we remain on track to further reduce our operating expenses to approximately $125 million in the fourth quarter. And, we expect to maintain this strong expense discipline into 2024 and beyond.

I'd like to highlight for you on **Slide 8** how our expense reductions indicate that Oportun is now significantly more efficient. Our opex ratio, or annualized operating expenses to average daily principal balance, was 18.2% as of 2Q23, 330 basis points better than the quarter prior to our IPO.

Our adjusted opex ratio, which excludes stock-based compensation expense and certain non-recurring charges, was even lower at 15.5% for 2Q23.

In the second quarter, our sales and marketing expenses were $19 million, flat sequentially and down 41% year-over-year as part of our expense discipline.

For the quarter, we recorded Adjusted net income of $2 million, compared to a $4 million net profit in the prior-year quarter, and an adjusted EPS of $0.06 versus a prior-year net earnings per share of $0.11.

Adjusted EBITDA was $4 million in the second quarter, a sequential improvement of $29 million compared to last quarter's $24 million Adjusted EBITDA loss. On a year over year basis, it reflected a $9 million increase compared to the negative $4 million in Adjusted EBITDA we reported in the prior-year quarter, driven by our revenue growth and cost discipline.

Slide 9

Now, on **Slide 9**, let me discuss Q2 credit performance. Our Annualized Net Charge-Off Rate of 12.5% was 13 basis points below the low end of our guidance range, due to effective collection and recovery efforts. This compared to 8.6% in the prior-year period and 12.1% in the first quarter. As a reminder, we anticipated the sequential increase in net charge-off rate due to seasonality and a shift in late-stage delinquencies. While Q2 losses were higher than Q1, our risk adjusted yield, which deducts charge-offs from portfolio yield, increased by 40 basis points to 19.7%. Additionally, I'm pleased by the 80 basis point sequential improvement we expect in our loss rate at the midpoint of our Q3 guidance, which I'll detail for you shortly.

As a reminder, the credit performance of our portfolio has two distinct drivers: the post-July 2022 origination vintages, made over the last 12 months after our significant credit-tightening, which we refer to as our front book. And also the originations made prior, which we refer to as our back book.

Slide 10

The front book, despite continued inflation, is performing at levels that are near or better than 2019. You can see this on **Slide 10** of our materials, which shows that first payment defaults are coming in at roughly half of the level that they were prior to credit tightening, and have since then tracked closely with pre-pandemic levels.

Slide 11

You can also see the strong performance of the front book on **Slide 11**, which shows that both the loss and delinquency rates for recent loan vintages are tracking lower than their respective pre-pandemic vintages.

I'd also like to point out that we've continued to improve the credit quality of our originations. The percentage of underwritten loans with Vantage scores of 660 or greater was 33% for 2Q22, but increased to 40% during 4Q22 and to 47% during 2Q23. This demonstrates our success at attracting and underwriting higher credit quality borrowers.

The back book continues to represent the bulk of our delinquencies and charge-offs, but also continues to shrink. The back book declined by over $300 million in the second quarter to $1.3 billion, and is anticipated to further decline to $0.7 billion as of year-end. As the guidance I will share with you shortly suggests, we expect to see losses come down in Q3 and Q4.

Slide 12

Regarding our capital and liquidity, our business is generating a record amount of cash flow from operations and we've seen our cash position build since the end of the quarter. Net cash flow from operations for the second quarter was a record $103 million, up 93% year over year, which supported net debt repayment including required ABS note amortization, along with loan originations. As of June 30, total cash was $202 million, of which $73 million was unrestricted and $129 million was restricted. As we've started to sell whole loans again, total cash increased to $209 million as of July 31st, of which $86 million was unrestricted and $123 million was restricted.

Turning now to funding, as Raul mentioned, we recently entered into two new whole loan flow sale agreements. During the second quarter, we entered into a new agreement to sell up to $300 million of whole loans over 12 months to funds managed by Neuberger Berman. Through July, we've already sold $75 million of loans through this arrangement. Furthermore, earlier this month, we entered into a separate agreement to sell up to $400 million of whole loan loans over twelve months to Castlelake. Together we expect these two agreements will provide $700 million, a substantial amount in funding, positioning us to originate more of the high-quality, profitable loans that we have been making.

These loan sales are being accounted for as asset-backed borrowings on our balance sheet, using amortized cost methodology, rather than fair value. In fact, we've made the decision to account for all new debt we issue in the future at amortized cost, which we believe will reduce our earnings volatility over time.

Slide 13

Turning now to our guidance as shown on **Slide 13**, our outlook for the third quarter is:

- Total Revenue of $260 to $265 million;
- Annualized net charge-off rate of 11.7% plus or minus 15 basis points
- Adjusted EBITDA of $35 to $40 million

Our guidance for the full year is:

- Total Revenue of $1.045 billion to $1.055 billion, $62.5 million higher than our prior guidance at the midpoint
- Annualized net charge-off rate of 11.7% plus or minus 30 basis points, with the high-end of the range maintained and the low-end increased by 20 basis points from our prior guidance; and
- Adjusted EBITDA of $70 to $75 million, consistent with our prior guidance

We did not increase our full year Adjusted EBITDA guidance despite increasing revenue guidance, because more of our total revenue is coming from higher origination fees, which are shown in revenue but not reflected in Adjusted EBITDA until the origination fees are received from principal collections over time.

I want to highlight for you that our guidance reflects we will generate Adjusted EBITDA of $90 to $95 million in last two quarters of 2023, which is more than we generated over the prior sixteen quarters combined as a public company. I'm optimistic that as the business continues to scale and we continue to reap the benefits of underwriting and cost discipline, we will continue to see sustainable, profitable growth and significant value creation for our shareholders.

Raul, back over to you.

Raul Vazquez, Chief Executive Officer

Slide 14

Thanks, Jonathan.

Before I open up the call for questions, I wanted to highlight that we recently released our 2022 Corporate Responsibility & Sustainability report, and share some of the ways in which Oportun is focused on addressing the biggest challenges facing U.S. consumers.

- Oportun has extended more than $15.5 billion of credit to hardworking individuals while helping to establish more than 1.1 million credit histories.
- Likewise, our Savings product has helped our members effortlessly save more than $8.9 billion, with the average member using our savings product setting aside over $1,800 annually.
- We recently surpassed 2 million members, and our services are available in all 50 states;
- And, our employees are passionate about giving back to the communities in which we operate and where we live, having volunteered around 3,500 hours since 2020 and supported 572 nonprofits.

As you can see on **Slide 14,** we received various recognitions during 2022 including for the high degree of trust with which we engage with our customers, the sustainability of how we operate, and our use of A.I. for the betterment of our members.

Cover slide

In closing, I want to share with you how proud I am of how the company performed during the quarter and amidst our significant cost cutting efforts. Our people have proven to be highly resilient and are continuing to deliver excellence for our members and shareholders.

I also want to reiterate that I'm very pleased with our second quarter progress which signifies the emergence of a leaner, more profitable Oportun. And, we've laid the foundation to carry this strong momentum into 2024 and beyond.

With that, Operator, let's open up the line for questions.

[**Question & Answer Session]**

Conclusion: Raul Vazquez, Chief Executive Officer

Thanks again for joining us on today’s call. We look forward to speaking with you again soon.