Cover slide

Operator

Welcome to Oportun Financial Corporation's Second Quarter 2024 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 2024 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, expense savings measures, statements regarding our senior secured term loan 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, 2024. 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 2024 financial supplement and the appendix section of the second quarter 2024 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 archived 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

Slide 4 [Earnings Overview]

Thanks, Dorian, and good afternoon, everyone. Thank you for joining us.

Overall, I'm pleased with our second quarter results and the progress we are making towards our long-term profitability targets. In addition, we further focused our business on our core competencies by signing an LOI to sell our credit card business and entering into a new collaboration with Western Union that provides access to millions of new potential customers at a lower acquisition cost.

Let me start by talking about our strong Q2 credit performance, with a focus on five key points that reflect the fine tuning of our credit box:

- First, our annualized net charge-off rate was 12.3%, which was 23 bps better than last year's level.
- Second, when measured in dollars, our quarterly net charge-offs declined year-over-year for the third consecutive quarter, in this instance by 10%.
- Third, a key component of how we've been able to improve credit performance has been to decrease average loan sizes, which declined 21% year-over-year in Q2, or by $852 per loan.
- Fourth, the actions we've taken to improve credit are clearly paying off.
    - As you can see on **Slide 8** of our earnings presentation, the losses on our front-book are approximately 400 basis points lower, twelve-plus months after disbursement, than losses on our back-book.
    - More importantly, as you can see on **Slide 9**, we've added a breakout of our annualized net charge-off rate for the quarter by front-book versus back-book. In Q2, the back book had an annualized net charge-off rate of 21.2% while the front book was at 10.6%, which is within the 9 to 11% net charge-off range that we are targeting in our unit economics model.
- Finally, I'm pleased with the progress we continue to make with our 30-plus day delinquencies, which were down 30 bps to 4.96%. That's the second consecutive quarter of year-over-year declines, and we know that lower delinquencies bode well for future credit performance.
- In summary, we feel good about the quality of the credit we are originating in this environment.

Slide 10 [Steadily trending towards a return to originations growth]

That leads me to the next highlight of Q2 – our steady progress towards getting back to portfolio growth. As you can see on **Slide 10**, we've had several consecutive quarters of origination levels that were lower than the prior year's levels. These negative growth rates have been driven by our stated focus on quality, not quantity, of originations; we have been laser focused on conservative underwriting and improving our loss rates. At this time, the diminishing back book and the solid performance of our front book, which I just covered, have given us confidence that we are making high quality loans. Given these facts, we are pleased to be returning to the normal seasonal pattern for originations growth. While Q2 originations were 10% lower year-over-year, we expect Q3 originations to be roughly flat to last year's levels.

Slide 11 [Operating expenses and Adjusted Opex ratio sharply down]

The next highlight of Q2 was the significant progress on cost reduction actions. Our GAAP operating expenses were $109 million, down 20% year-over-year, and Adjusted Operating Expenses were $94 million, which is the lowest level in the last 3 years. We are much more efficient today than we were when we initiated significant cost reductions in the third quarter of 2022. Since Q2 2022, our adjusted operating expenses, excluding non-cash and non-recurring charges, have declined by 35%, while our Adjusted OpEx ratio as a percentage of owned principal balance has improved by almost 900 basis points. We achieved an all-time low in Q2 2024 with an Adjusted OpEx ratio of 13.8%. We expect to make improvements in our Adjusted OpEx ratio in the future through continued strong financial discipline and are reiterating our expectation to reduce GAAP operating expenses to $97.5 million or below by the fourth quarter.

Slide 4 [Earnings Overview]

And finally, we were profitable for the second consecutive quarter on an Adjusted Net Income basis at $3.2 million and drove a significant year-over-year improvement in Adjusted EBITDA. At $30 million, our Adjusted EBITDA reflected 109% year-over-year growth.

In summary, I'm proud of how the team executed in Q2 and pleased that we continue to make good progress in the 2024 business recovery. More importantly, the positive trends in credit performance and originations, combined with our lower expense levels, mean we are positioned to improve upon our performance in the second half, setting up a strong runway heading into 2025.

Before I turn the call over to Jonathan, I want to share two additional pieces of good news.

Slide 12 [Letter of intent signed to sell Credit Card portfolio]

First, I'm pleased to announce that we've signed a non-binding, letter of intent to sell our credit card portfolio to a leading credit card marketer and servicer. The transaction will simplify our product portfolio and enhance our focus on our three core products: unsecured personal loans, secured personal loans and our award winning *Set & Save* savings product. We ran a competitive sales process that resulted in multiple bids, and we selected the best proposal. Based upon this proposal, we expect to sell the credit card portfolio for 70% of the receivables balance of current and less than 30-day delinquent receivables as of the closing date. We are in documentation now and currently expect to close by the end of the third quarter.

The initiation of the transaction triggered a $36 million unfavorable one-time fair value mark to our credit card portfolio, for an approximately $26 million reduction in stockholders equity. We expect the sale to have an approximately $11 million negative impact on 2024 revenue due to no longer earning revenue on the sold receivables. However, we expect the sale to be accretive by $4 million to Adjusted EBITDA this year, as lower credit losses and operating expenses more than offset the loss in revenue. We expect 2025 Adjusted EBITDA favorability resulting from the credit card sale to be approximately $11 million.

Slide 13 [New lending collaboration with Western Union announced]

Second, I'm excited to share the details of our new lending collaboration with Western Union, a leader in cross-border money transfers with 90% global brand recognition. Under the agreement, we have the potential to reach their millions of customers, who are similar to our own. Structured like our other lending-as-a-service agreements, it only requires us to pay for leads when a loan that has met our underwriting criteria has been funded. This is a significant opportunity to add new applicants to our originations funnel and generate incremental new loan volume under our current credit standards.

Slide 4 [Earnings Overview]

With that, I will turn it over to Jonathan for additional details on our second quarter financial performance as well as our third quarter and full year guidance. Jonathan will also discuss how this translates to progress towards our longer term unit economic objectives.

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

Slide 6 [Second Quarter Highlights]

Thanks Raul, and good afternoon everyone. As Raul mentioned, we had a strong second quarter and are positioned to improve upon our performance in the second half of the year. The anticipated sale of the credit card portfolio and exciting new lending-as-a-service collaboration with Western Union are integral milestones towards focusing the business on our core products, further reducing our expense base and growing profitably over the long-term.

As shown on **Slide 6,** Oportun delivered total revenue of $250 million, and we were profitable on an adjusted basis for the second consecutive quarter with Adjusted Net Income of $3.2 million, for Adjusted EPS of $0.08.

Continuing to operate under a conservative credit posture, originations of $435 million were down 10% year-over-year. Sequentially, originations were up 29%, aligning with the typical seasonal pattern for growth after the first quarter.

Total revenue of $250 million declined by 6%, driven principally by an 8% decline in our average daily principal balance under our conservative credit posture, partially offset by price increases as portfolio yield increased 167 basis points year-over-year, improving to 33.9%.

Net revenue was $60 million, down 49% year-over-year, primarily due to the one-time $36 million unfavorable fair value mark to our credit card portfolio that Raul mentioned, along with the total revenue decline and higher interest expense.

Our total net decrease in fair value of $136 million was primarily driven by current period charge-offs of $84 million and the credit card fair value mark. To elaborate on the impact of selling the credit card portfolio, the agreed upon price at 70% of the receivables being sold reflects the highest offer that we received as part of our strategic review process, thus setting the new fair value mark.

Interest expense of $54 million was up $13 million year-over-year. This was primarily driven by increased debt outstanding and an increase in our cost of debt to 7.7% versus 5.6% in the year-ago period, reflecting the higher rate environment.

Turning now to operating expenses and efficiency, we continue to see the benefits of our cost reduction initiatives. Our $109 million in total operating expenses in Q2 reflected a 20% decrease from the prior-year period, while including a $6 million impairment of the right-of-use asset for our Bay Area headquarters and $2 million in workforce optimization expenses relating to reductions in force we enacted in the second half of May. We will continue to drive our cost structure lower in the second half of 2024, and remain on track to achieve $97.5 million in Q4 GAAP operating expenses.

In the second quarter, our sales and marketing expenses were just over $16 million, down 15% year-over-year. And, I'm pleased to share that our CAC of $122 was a new low for us as a public company, down 25% year-over-year, driven by our cost discipline.

For the quarter, we recorded Adjusted Net Income of $3 million, compared to $6 million in the prior-year quarter, and adjusted EPS of $0.08 versus $0.17. The decline was principally driven by lower revenue due to lower average daily principal balance, partially offset by higher yield and lower adjusted operating expenses.

Adjusted EBITDA, which excludes the impact of fair value mark-to-market adjustments on our loan portfolio and notes, was $30 million in the second quarter. This reflected a year-over-year increase of $16 million, or 109%, driven by our sharply reduced cost structure and lower net charge-offs on a dollar basis. Our Adjusted EBITDA performance exceeded the high-end of our guidance range by $13 million, primarily on lower than anticipated operating expenses. We were able to lower our operating expenses by enacting the previously announced $30 million of annualized expense reductions more expediently than anticipated. Lower charge-offs also contributed to our Adjusted EBITDA outperformance.

Slide 14 [Credit Performance]

Now, let me discuss Q2 credit performance. Our Annualized Net Charge-Off rate was 12.3%, as compared to 12.5% in the prior-year period. I'd also note that dollar net charge-offs declined 10% year-over-year from $93 million to $84 million.

Our 30-plus day delinquency rate declined year-over-year by 30 basis points and sequentially by 28 basis points to 4.96%. As of the end of July, 30-plus delinquencies remained below 2023. Our 30-plus day delinquencies measured in dollars declined 13% year-over-year from $156 million to $135 million.

Slide15 [Capital and Liquidity]

Regarding our capital and liquidity, as shown on **Slide 15**, net cash flows from operating activities for the second quarter were a record $108 million, up 5% year-over-year.

As of June 30, total cash was $237 million, of which $73 million was unrestricted and $164 million was restricted. I'd note that these liquidity levels are after having paid down $17 million of corporate debt during the quarter. Further bolstering our liquidity was $523 million in available funding capacity under our warehouse lines and remaining whole loan sale agreement capacity of $181 million.

Slide 16 [Demonstrated access to capital markets]

I'm also pleased to share that since quarter-end we signed a new warehouse agreement for $245 million to fund our unsecured and secured personal loan activity into 2027. Since June of last year, Oportun has raised over $1.6 billion in diversified financings including whole loan sales, securitizations and warehouse agreements from fixed income investors and banks, based upon the strong performance of recent vintages and their confidence in our business model.

Before I move on, I want to share with you that we are making good progress in discussions involving refinancing our senior secured term loan, and we'll provide an update when we have a final arrangement to share.

Slide 17 [Guidance]

Turning now to our guidance as shown on **Slide 17**, our outlook for the second quarter is:

- Total Revenue of $248 to $252 million
- Annualized net charge-off rate of 12.3% plus or minus 15 basis points
- Adjusted EBITDA of $23 to $26 million

I'd note that the owned portfolio is projected to decline in Q3 by 10% year-over-year. As you can see on **Slide 18,** were our loan portfolio to remain flat or to grow by 10% year-over-year during 3Q24, our expectations for our annualized net-charge off rate would be 120 basis points and 220 basis points lower, respectively.

Our Q3 Adjusted EBITDA guidance at the midpoint reflects almost 70% year-over-year growth. Our Q3 Adjusted EBITDA guidance is down from Q2 due to anticipated higher interest expense and a seasonal increase in marketing expenses. It is also worth noting that our Q2 Adjusted EBITDA benefited from our completing operating expense reductions sooner than planned in the quarter.

Our guidance for the full year is:

- Total Revenue of $995 million to $1.01 billion
- Annualized net charge-off rate of 12.1% plus or minus 30 basis points
- Adjusted EBITDA of $84 to $92 million

While this revised full year guidance reflects total revenue and Adjusted EBITDA uplifts of $5 million and $3 million respectively at the midpoints, it also reflects expectations for our annualized net charge-off rate to be 20 basis points higher than our prior guidance at the midpoint, which represents approximately $5 million of additional charge-offs in the second half of the year, largely driven by the performance of our back book.

I'm pleased that we are able to increase our full-year revenue guidance, driven by our yield enhancements and commitment to identifying high-quality originations, despite the expected $11 million negative revenue impact from selling the credit card portfolio. Creating a strong runway into 2025, our Adjusted EBITDA guidance at the midpoint also implies that our second half will be over 70% higher than our first half, and we expect to generate markedly higher Adjusted Net Income in the second half as well.

Slide 19 [Unit Economics]

Before handing the call back to Raul to close, I'd like to update you on our progress towards what we believe long-term investor returns for Oportun could look like. While our long-term targets are GAAP targets, I'll be using Adjusted metrics for comparison, since they remove non-recurring items and provide a better sense of our future run rate.

As a reminder, our personal loan business has a 32% average APR, even while we deliver value to our borrowing members that we believe is better than alternatives. When non-interest income is added, primarily from our savings product, we see a 36% total revenue yield target as a percentage of owned principal balance to be sustainable. As of Q2, we are already at our total revenue yield target.

In our unit economics model, we are targeting an 8% cost of funds and a 9-11% annualized net charge-off rate, to generate a 17-19% risk adjusted yield. For Q2, we did report 8% cost of funds, but our charge-off rate of 12% was above the target range, impacted by our average daily principal balance declining 8% year-over-year under our conservative credit posture. However, I want to remind you again that if you remove the backbook from our Q2 performance, the annualized net charge-off rate for the front book was 10.6%, already within our long-term target range. Lastly, our 14% risk adjusted yield for 2Q24 also included 2% of unfavorable non-cash fair value marks.

Finally, assuming target operating expenses over the long-term of 12.5% of owned principal balance, we see a 3 to 4% return on assets as attainable. In Q2 we made progress towards this target by delivering a 13.8% adjusted operating expense ratio, while guiding to further cost reductions in the second half of the year.

In summary, our Adjusted ROE for 2Q24 was 4% in comparison to our 20-28% long-term target.

Slide 20 [Key drivers to reach ROE target]

On **Slide 20** you can see the three key drivers we've identified to grow Adjusted ROE from 4% to our 20-28% long-term target:

1. First, we're seeking to reduce our annualized net charge-off rate from 12% to 9-11%, and expect to do so by eliminating of our back book, driving ongoing performance improvements from the roll-out of our V12 credit model and prudently growing our loan portfolio by 10-15% over time.
2. Second, we're seeking to reduce our adjusted operating expenses as an annualized percentage of owned principal balance from 13.8% to 12.5%. We're on our way to attaining that by achieving our $97.5 million GAAP operating expense target for 4Q, maintaining cost discipline with our simplified product portfolio into 2025 and beyond, and also benefiting from the tailwind of conservative portfolio growth and resulting scale; and
3. Third, we're seeking to reduce our debt to equity leverage ratio from 7.9:1 to 6:1. We expect to do so by continuing to allocate our free cash flow towards debt repayment as we have in recent quarters, including our expected repayment of the $38 million remaining on our corporate financing facility secured by our securitization residuals before the end of January. We also expect to increase our stockholders equity by returning to and maintaining GAAP profitably.

I am confident in our ability to make progress towards our 20 to 28% ROE target over the next several years by executing on these key drivers.

Raul, back over to you.

Cover slide [Closing Remarks]

Raul Vazquez, Chief Executive Officer

Thanks, Jonathan.

To close, I'd like to emphasize three points:

- First, we're pleased with our second quarter performance and our momentum going into the second half, where we expect to generate Adjusted EBITDA levels that are over 70% higher than the first half and to be markedly more profitable on an Adjusted Net Income basis
- Second, we further focused our business on our core competencies by:
    - Agreeing to an LOI to sell our credit card portfolio, which enables us to focus on our three core products; and
    - Forming a new lending collaboration with Western Union
- Third, we've made strong progress towards our long-term profitability targets by:
    - Improving credit outcomes, as evidenced by our front book generating a loss rate of 10.6%, which is already within our target 9-11% range
    - Reducing operating expense as a percentage of our owned principal balance

To wrap up, I want to thank the Oportun team for their solid execution in Q2 and their ongoing commitment to our mission of empowering members to build a better future.

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.