Cover slide

Operator

Welcome to Oportun Financial Corporation's Third 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 third 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 September 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 third quarter 2024 financial supplement and the appendix section of the third 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 the progress demonstrated by our third quarter results. The four headlines from the quarter, in my view, were: lower charge-offs, return to growth, continued cost reduction, and higher profitability.

1. First, we had lower charge-offs.
    a. Our annualized net charge-off rate was 11.9%, which was 26 basis points better than the lower end of our guidance range. When measured in dollars, our quarterly net charge-offs declined year-over-year for the fourth consecutive quarter, in this instance by 6%.
    b. I'm also pleased with the progress we continue to make with our 30-plus day delinquencies, which were down 34 basis points year-over-year to 5.2%. That's the third consecutive quarter of year-over-year declines.
    c. Improvement in our credit performance is being driven in part by our implementation of our V12 credit model, which leverages the performance data of our portfolio over the last two years under higher inflation. We started using V12 to underwrite new borrower applications in January and recently implemented V12 to underwrite applications from returning borrowers, so we expect to see further improvements in credit performance in 2025.
2. Second, we're ready to return to originations growth. After several consecutive quarters of origination levels that were lower than the prior year's levels, originations at $480 million during Q3 were virtually flat year-over-year. This is despite continuing to de-risk the business by decreasing average loan sizes, which were down 18% year-over-year from $3,975 to $3,244.
3. Third, we've continued progress on expense reduction actions. Our 3Q GAAP operating expenses were $102 million, down 17% year-over-year, and we are reiterating our expectation to reduce GAAP operating expenses to $97.5 million or less by the fourth quarter.
4. And fourth, each of these factors led to higher profitability. We generated $31 million of Adjusted EBITDA, more than doubling last year's level and exceeding the top end

of our guidance range by 21%. Q3 was also our third consecutive quarter of Adjusted Net Income profitability.

I mentioned at the start of the year that we would see our business recover significantly, which we have delivered with improving trends in profitability, credit performance, originations and expense reductions. Additionally, the macro backdrop has also improved this year, with economists' expectations for a recession significantly diminishing, with resilient growth and ongoing low-unemployment, and with the Fed now having initiated a rate cut cycle that's expected to continue into next year. As we near the end of 2024, we are well positioned to deliver an even better 2025.

We've recently executed two transactions that were critical towards that end. First, we closed the sale of our credit card portfolio today. As we shared previously, the transaction will be $2 million Adjusted EBITDA accretive this quarter, and $11 million Adjusted EBITDA accretive for full year 2025.

Second, as we announced on October 29th, we executed an agreement to fund a $235 million 4-year senior term loan facility that will replace our existing corporate financing facility. This reflects a key milestone towards strengthening our balance sheet and enhancing our operational flexibility, thereby improving our financial results.

As we said in March, we had been evaluating refinancing options for the existing facility, given scheduled increases in the asset coverage ratio covenant requirements. We weren't going to be in compliance with the existing facility's ACR covenant, which limited operational flexibility to enhance shareholder value and didn't reflect operational improvements in the business. The new facility replaces the ACR covenant with an Adjusted EBITDA-based leverage covenant that rewards accretive decisions and recognizes cash flow generation. With the closing of our credit card sale, a necessary condition, we expect the new term loan to fund this week. In connection with providing the term loan, the lenders will receive approximately 4.86 million penny warrants which equals 9.8% of the fully-diluted shares outstanding of the Company, excluding out-of-the-money options, on a pro-forma basis.

Even with the dilution impact from the newly issued warrants, we expect to drive increased profitability on a per share basis through focusing on our core products, maintaining expense discipline, and improving credit performance. I'd like to reiterate our preliminary full year 2025 expectations that we released at the end of last month. They are:

- Diluted EPS between $0.25 and $0.50;
- Adjusted EPS between $1.00 and $1.25; and
- an annualized net charge-off rate between 11% and 12%

In addition to our positive view of 2025, our full year 2024 outlook continues to show that, after a strong start to this year, our second half performance will be even better than the first half.

In summary, I'm proud of how the team executed in Q3 and pleased that with the credit card sale behind us and the refinancing transaction expected to close this week, we can turn our focus towards a strong close to 2024 and significantly improving our profitability and credit performance in 2025.

With that, I will turn it over to Jonathan for additional details on our financial performance, credit performance, and guidance. Jonathan will also update you on how this translates to progress towards our longer term unit economics objectives.

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

Slide 7 [Third Quarter Highlights]

Thanks Raul, and good afternoon everyone. As Raul mentioned, we're pleased with the progress demonstrated by our third quarter results and we're looking to carry that positive momentum into the fourth quarter and 2025.

As shown on **Slide 7,** Oportun delivered total revenue of $250 million, and we were profitable on an adjusted basis for the third consecutive quarter with Adjusted Net Income of $0.9 million, for Adjusted EPS of $0.02.

While maintaining prudent credit discipline, originations of $480 million were down only 1% year-over-year. Sequentially, originations were up 10%, aligning with the typical seasonal pattern for a ramp throughout the year.

Total revenue of $250 million declined by 7%, driven principally by a 7% decline in our average daily principal balance under our conservative credit posture.

Our total net decrease in fair value of $132 million was primarily driven by current period charge-offs of $82 million and a $35 million non-cash mark on our ABS notes, due to their weighted average price increasing from 96.0% to 97.8%, as benchmark interest rates declined and credit spreads tightened significantly. As a reminder, we elected last year to stop fair valuing our new debt financings and expect their fair value impact to be minimal by the end of 2025 as the prior financings near maturity.

Interest expense of $56 million was up $9 million year-over-year, primarily driven by an increase in our cost of debt to 7.8% versus 6.3% in the year-ago period, reflecting the higher rate environment.

Net revenue was $63 million, down 26% year-over-year, primarily due to the total revenue decline, non-cash marks on our ABS notes and higher interest expense.

Turning now to operating expenses and efficiency, we continue to see the benefits of our expense reduction initiatives. Our $102 million in total operating expenses in Q3 reflected a 17% decrease from the prior-year period.

For the quarter, we recorded Adjusted Net Income of $1 million, a $13 million improvement compared to the prior-year quarter, and adjusted EPS of $0.02 up $0.33 versus last year. The improvement was principally driven by our sharply reduced cost structure.

I want to take a moment to emphasize that our Adjusted Net Income provides a future run rate view of our GAAP net income by removing non-recurring items and the mark-to-market on our ABS notes, which will be almost entirely gone after 2025. As you can see on **Slide 8**, we would have been GAAP profitable on a year-to-date basis excluding non-recurring and non-cash impacts relating to fair value marks on our ABS notes, the write-down of our credit card portfolio triggered by our agreement to sell it, and other non-recurring charges. Similarly for the third quarter, our GAAP net loss was $30 million, driven by the $35 million non-cash mark on our ABS notes.

Adjusted EBITDA, which excludes the impact of fair value mark-to-market adjustments on our loan portfolio and notes, was $31 million in the third quarter. This reflected a year-over-year increase of $17 million, or 117%, driven also by our sharply reduced cost structure along with lower net charge-offs on a dollar basis, partially offset by higher interest expense. Our Adjusted EBITDA performance exceeded the high-end of our guidance range by $5 million, primarily on lower than anticipated net charge-offs.

<u>Slide 9 [Credit Performance]</u>

Let me now shift to more details on our strong Q3 credit performance, another key sign of progress:

- Our front book of loans originated since July 2022 continues to perform quite well, while our back book of loans underwritten prior to then continues to roll off.
    - As you can see on **Slide 10** of our earnings presentation, the losses on our front book twelve-plus months after disbursement continue to run approximately 400 basis point lower than losses on our back-book. And, our 3Q23 vintage, which has now been on our books for twelve months has shown the lowest losses of any front book vintage so far.
    - Furthermore, you can see our annualized net charge-off rate for the quarter by front-book versus back-book on **Slide 11**. In Q3, the front book had an annualized net charge-off rate of 10.4%, which is within the 9 to 11% net charge-off range that we are targeting in our unit economics model.
- Finally, as you can see on **Slide 9**, in addition to our charge-offs declining 6% year-over-year, I'm pleased with the progress we continue to make with our 30-plus day

delinquencies, which were down 34 basis points to 5.2%. That's the third consecutive quarter of year-over-year declines. And, our October 30-plus delinquencies remained below 2023 as well.
- In summary, we continue to feel good about the quality of the credit we are originating.

Slide 12 [Ready to return to originations growth]

As you can see on **Slide 12**, we've had several consecutive quarters of origination levels that were lower than the prior year's levels due to conservative underwriting and our focus on improving our loss rates. However, we are now ready to return to originations growth within our targeted credit quality range, and I'm pleased that at $480 million during Q3 originations were virtually flat year-over-year. This is despite continuing to de-risk the business by decreasing average loan sizes, which are down 18% year-over-year from $3,975 to $3,244.

You should expect our 4Q24 originations to grow not only sequentially in line with seasonal patterns but also to grow in the 10% range year-over-year, which is another sign of the progress we're making in our business recovery. It is also currently our intent to grow full year 2025 originations above 2024 levels.

Slide 13 [Operating expenses and Adjusted Opex ratio sharply down]

I'd also like to further highlight the significant progress we've made on cost reduction actions. We are much more efficient today than we were when we initiated significant cost reductions in the third quarter of 2022. Since then, our adjusted operating expenses have declined by 34%, while our Adjusted OpEx ratio as a percentage of owned principal balance has improved by 860 basis points. Our Adjusted OpEx ratio of 13.9% remained close to last quarter's record low-level. We expect to continue to make improvements in our Adjusted OpEx ratio in the future through continued strong financial discipline along with a return to originations growth and, as Raul said, we are reiterating our expectation to reduce GAAP operating expenses to $97.5 million or less by the fourth quarter.

Slide 14 [Capital and Liquidity]

Regarding our capital and liquidity, as shown on **Slide 14**, net cash flows from operating activities for the third quarter were a record $108 million, up 1% year-over-year.

As of September 30, total cash was $229 million, of which $72 million was unrestricted and $157 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 $483 million in available funding capacity under our warehouse lines and remaining whole loan sale agreement capacity of $24 million.

During the third quarter we closed two new committed personal loan warehouse facilities, totaling $552 million. We also executed a new $223 million ABS transaction that was seven times oversubscribed and priced at an 8.07% weighted average interest rate, consistent with our unit economics targets. And, in October we facilitated a securitization of our whole loans purchased by Castlelake, which priced at a 7.27% weighted average interest rate. While the only economics Oportun will receive from the latter ABS transaction is a servicing fee, the further tightening of credit spreads for ABS backed by our loans should benefit us in the future.

We expect the corporate debt refinancing that closes this week will improve Oportun's operational and balance sheet flexibility. We are committed to deleveraging, which we believe is in the best interest of shareholders, as part of the refinancing. At closing, we will repay our residual financing facility, which had a $22 million outstanding balance as of the end of 3Q, and we are required to pay down without prepayment penalty at least $40 million under the new term loan facility by January 31st, 2026. We also have the option to repay without prepayment penalty an additional $10 million under the new term loan facility at any time, and another $10 million after the first anniversary of its closing. The required amortization combined with the voluntary penalty free prepayments will allow us to reduce our corporate debt balance to $175 million prior to the new term loan's maturity. Given that we have consistently repaid $5.7 million of corporate debt every month this year, we are confident in our ability to continue to de-lever over the next two years.

Slide 15 [Guidance]

Turning now to our guidance as shown on **Slide 15**, our outlook for the fourth quarter is:

- Total Revenue of $246 to $250 million
- Annualized net charge-off rate of 11.8% plus or minus 15 basis points
- Adjusted EBITDA of $28 to $30 million

The potentially slight sequential decline in total revenue implied by our 4Q guidance from 3Q's $250 million total revenue is driven primarily by the sale of the credit card portfolio. Adjusted EBITDA is expected to slightly decline from 3Q due to a seasonal increase in marketing expenditures.

We expect our fourth quarter to feature strong year-over-year improvement in our Annualized net charge off rate, where our midpoint guidance implies a reduction of approximately 50 basis points from last year's 12.3%. We also expect Adjusted EBITDA to markedly improve year-over-year, where our midpoint guidance implies an almost tripling from last year's $10 million. Furthermore, we expect our GAAP EPS and Adjusted EPS to markedly increase year-over year.

I'd note that although we expect Q4 originations to grow in the 10% range, we expect the average daily principal balance in Q4 to decline in the 8% range year-over-year as a result of prior credit tightening actions. As you can see on **Slide 16,** were our loan portfolio to remain flat or to grow by 10% year-over-year during 4Q24, our expectations for our annualized net charge-off rate would be 90 basis points and 190 basis points lower, respectively.

I'd also like to call out that we expect 4Q24 interest expense to be around $75 million, up from $56 million in Q3 due to a one-time $18 million non-cash charge from the write-off of deferred financing costs relating to the repayment of the current corporate financing facility as part of the refinancing, and to a lesser degree the repayment of the residual financing facility. This will impact our Q4 GAAP financial results but will be excluded from our adjusted results.

Our guidance for the full year is:

- Total Revenue of $997 million to $1.001 billion
- Annualized net charge-off rate of 12.0% plus or minus 10 basis points
- Adjusted EBITDA of $92 to $94 million

Our full year 2024 Adjusted EBITDA expectation at the midpoint of $93 million reflects a level almost five times last year's $19 million.

Our revised full year 2024 guidance reflects 10 basis points of improvement in our annualized net charge-off expectations at the midpoint from what we previously guided to in August.

Slide 17 [Unit Economics]

Before handing the call back to Raul, I'd like to update you on our progress towards our long-term unit economics targets. While our long-term targets are GAAP targets, I'll be using Adjusted metric actuals for comparison, since they remove non-recurring items and provide a better sense of our future run rate. We made solid progress in Q3, as evidenced by our 11 percentage point year-over-year improvement in Adjusted ROE, driven principally by cost reductions.

We will continue to focus on improving our credit performance, reducing expenses as a percentage of owned principal balance and reducing leverage on our journey to reach our 20 to 28% ROE target.

Raul, back over to you.

Cover slide [Closing Remarks]

Raul Vazquez, Chief Executive Officer

Thanks, Jonathan.

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

- First, we're pleased with the progress demonstrated by our third quarter performance and our momentum thus far into the second half. We expect to generate second half Adjusted EBITDA levels at our guidance midpoint that are almost 90% higher than the first half, and to also be markedly more profitable on an Adjusted Net Income basis.
- Second, with the completion of the credit card sale and refinancing of our corporate debt, we see no impediments to the full recovery of our business; and
- Finally, our momentum is quite strong heading towards 2025, where we expect that improved credit performance, ongoing cost discipline, and a return to originations growth will enable us to generate $1.00 to $1.25 in Adjusted EPS and an Adjusted ROE in the teens.

To wrap up, I want to thank all of our team members - in our retail locations, our contact centers, and our corporate employees - for their commitment and contributions.

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.