Operator

Welcome to Oportun Financial Corporation's Second Quarter 2022 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.

Introduction: Dorian Hare, Senior Vice President, Investor Relations

Thanks, and hello everyone. With me to discuss Oportun's second quarter 2022 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, 2022. 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 measures is included in our earnings press release, our second quarter 2022 financial supplement and the appendix section of the second quarter 2022 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 script of our prepared remarks. With that, I will now turn the call over to Raul.

Raul Vazquez, Chief Executive Officer

Thanks, Dorian and good afternoon, everyone. Thank you for joining us. Today, I'd like to discuss our second quarter financial performance, followed by an update on how the macroeconomic environment is impacting Oportun and its members, and close with an update on our strategic initiatives.

I'm pleased with our results for the second quarter. Let me start by sharing the headlines:

- We achieved second quarter originations of $878 million, up 103% from the second quarter of 2021.
- Originations growth continued to be driven by high demand for our loans, including our expansion into new states where we are taking share.
- We delivered revenue of $226 million, up 63%, along with adjusted net income of $3.8 million, for adjusted EPS of $0.11.
- We delivered a solid quarter of credit results, as evidenced by our annualized net charge-off rate of 8.6%, in line with last quarter and the midpoint of our prior guidance.
- Overall, we've had a very strong first half of 2022.

Since the end of the quarter, however, we've observed that the weakening macroeconomic environment, including higher inflation and gas prices, has started impacting our members more than it previously had.

Credit is the most important metric in our business and as we said on the last earnings call, we've been tightening since the third quarter of 2021. Since the end of the second quarter, we have seen an uptick in delinquencies, particularly among borrowers with lower free cash flows and those with smaller loans with shorter maturities. We expect this to lead to increased charge-offs in the second half of 2022. We have taken further swift actions towards tightening our credit standards to address the rising delinquencies. Let me provide further details.

- We're reducing our exposure to new borrowers and increasing our exposure to more profitable, returning borrowers, who have already successfully repaid at least one loan to

Oportun. In July, 35% of our loans were to new borrowers as compared to 51% in the first quarter. Returning borrowers have materially lower loss rates compared to new borrowers, so we expect this action will help us return losses to our target range.

- Additionally, we have taken further steps to responsibly increase our portfolio yield to offset increased cost of funds.

- Finally, we are focused on a significant reduction of Operating Expense growth. We now expect our operating expense in the second half of the year to be flat compared to the first half of the year.

Oportun is taking these steps now to put the company on the strongest possible footing to achieve our long-term objectives while advancing our mission.

The revised full year guidance that Jonathan will detail with you today will feature higher revenue, reflecting our strong first half portfolio growth. However, we are lowering our full year originations guidance to reflect the additional credit tightening actions we have already implemented. We are also upwardly revising our full-year charge-off guidance by 80 basis points and lowering our profit expectations, which we believe is prudent given the weakening macroeconomic environment.

While in the short-term we are making necessary changes, our long-term strategic priorities have not changed. Let me tell you about our progress on our three strategic priorities for the year that support our long-term outlook for profitable and sustainable growth.

Our first strategic priority is to grow our members. We ended the second quarter with 1.8 million members up from 1.7 million at the end of last quarter, a 38% annualized growth rate, so we are very pleased with the pace of member growth.

Our second strategic priority is to increase multi-product relationships with our members. In the second quarter products grew at an annualized rate of 45%, faster than our member growth of 38%.

Our third strategic priority is enhancing our platform capabilities to meet the everyday financial needs of hardworking people. We continue to make progress towards creating a seamless, Unified App to increase growth in members and products. We anticipate this Unified App will:

- Increase Oportun and Digit member multi-product relationships by enabling seamless access to all products in one multi-tab app;

- Increase Digit membership by bringing the app to the center of the expanding Oportun ecosystem; and

- Increase member satisfaction leading to increased brand loyalty.

We currently intend to be in the market in the testing phase with our Unified App during the fourth quarter. This and other aspects of the Digit integration continue to progress nicely.

Now, let me share with you more detail regarding our progress across our newer products:

- For our **secured personal loan product**, we ended the second quarter with $100 million in receivables, up 620% year-over-year. In April, we expanded our secured personal loan product to Arizona, and in May, to New Jersey. Our secured personal loan growth continues to benefit from the fact that it is offered through the same acquisition funnel along with our unsecured personal loans.

- We also saw good progress this quarter from our **credit card** product. Receivables grew 511% year-over-year to $119 million and we now have more than 193 thousand members who have an Oportun branded credit card.

Finally, we have also continued to make great progress with our Lending-as-a-Service offering. During the second quarter, we scaled our **Lending-as-a-Service** network to include 294 partner locations, up from 108 a year ago, and we still expect to complete 2022 with over 500 partner locations. Additionally, our partnership with Sezzle, a Buy Now, Pay later company and our first digital LaaS relationship, remains on track to launch in the second half of the year.

With that, I'd like to turn it over to Jonathan for additional details on our financial performance and our revised guidance.

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

Thanks, and good afternoon everyone. As Raul mentioned, we're pleased with our second quarter results, and we have adapted our focus to continue to deliver responsible and profitable growth in light of how the weakening macroeconomic environment, including higher inflation and gas prices, has started impacting our members since the end of the second quarter.

In the second quarter, we generated $226 million of total revenue, and $3.8 million of Adjusted Net Income, or $0.11 of Adjusted EPS. Our aggregate originations were $878 million, up 103% year-over-year and ahead of our guidance of between $825 and $850 million for the quarter. Loan application volume and origination demand remains high, and we will continue to grow our originations responsibly in the back half of the year.

Total revenue of $226 million was up 63% year-over-year, also above our expectations, and reflected higher receivables due to increased originations. We expect continued growth as we focus on serving more returning customers which will drive our growth in total revenue.

Net revenue was $145 million, up 21% year-over-year. Net revenue improved from the prior year period due to higher total revenue, partially offset by a greater decrease in fair value.

Interest expense of $17 million was up 41% year over year, primarily driven by increased debt issuance to fund our growth, partially offset by the decrease in our cost of debt to 3.0% versus 3.3% in the year-ago period. At the end of the second quarter, 76% of our debt was fixed rate, providing us with protection from rising interest rates.

For our net change in fair value, we had a $63 million net decrease in fair value, which consisted mainly of a $12 million mark-to-market net decrease on our loans and our debt and current period charge-offs of $55 million.

For the mark-to-market, the fair value price of our loans decreased to 102.2% as of June 30, and resulted in a $35 million mark-to-market decrease.

The $44 million mark-to-market increase in our asset-backed notes resulted from a 156 basis point decrease in the weighted average price to 94.8%, due to the increase in interest rates and credit spreads during the quarter.

Turning to expenses, our second quarter total operating expense was $158 million, an increase of 43% as compared to the prior-year quarter. Adjusted operating expense, which excludes stock-based compensation expense and certain non-recurring charges, increased 45% year-over-year to $140 million, growing slower than total revenue which grew 63%. As Raul mentioned, we are reducing our operating expense growth rate going forward, targeting second half operating expense to be flat versus the first half of the year.

Our customer acquisition cost was $134, down 12% from the prior-year period due to higher demand for our loans.

We delivered adjusted net income of $3.8 million, compared to $17 million in the prior-year quarter, and adjusted EPS of $0.11 versus $0.56, respectively. For the first half of the year, adjusted net income was $56 million, representing 93% year-over-year growth, and adjusted EPS was $1.70, representing 73% year-over-year growth.

Adjusted EBITDA was a $4.5 million loss in the second quarter, a $9.0 million decrease compared to a gain of $4.5 million in the prior-year quarter. For the first half of the year, adjusted EBITDA was $29 million versus $2.2 million in the prior year period.

Adjusted Return on Equity was 2%, versus 14% in the prior-year quarter. For the last twelve months, Adjusted ROE averaged 19%.

Turning now to credit, our second quarter results showed we managed our credit well to deliver outcomes in line with our prior guidance. Our annualized net charge-off rate was 8.6%, compared to 6.4% in the prior-year period. As a reminder, last year's charge-off rate was abnormally low due to strong consumer balance sheets including the impact of government stimulus amidst the pandemic. As of June 30, our 30+ day delinquency rate was 4.3%.

Regarding our capital and liquidity, as of June 30, total cash was $134 million, which increased to $154 million at the end of July. Additionally, net cash flow from operations for the second quarter was $53 million, up 49% year over year. Our Debt-to-Equity ratio was 3.9x. And as of July 31st, $548 million of our combined $750 million in warehouse lines was undrawn and available to fund our growth.

We have maintained our track record of consistent access to the capital markets. In May, we completed a $400 million securitization, and in July completed an additional $400 million securitization. Our ability to complete these securitizations in the face of a challenging macro environment reflects investor confidence in Oportun and frees up warehouse capacity to support the funding of the originations we are projecting for the remainder of the year.

Turning to our expectations for the rest of 2022, we will remain focused on prudent growth, by tightening credit and instituting the cost reductions that Raul mentioned.

In terms of guidance, our outlook for the third quarter is:

- Aggregate originations of between $650 and $675 million;
- Total Revenue of between $240 and $245 million;
- Adjusted Net Loss between ($4) and ($2) million; and
- Adjusted EPS between ($0.12) and ($0.06)

Our updated guidance for the full year is:

- Aggregate originations of between $3.15 and $3.18 billion;
- Total Revenue between $930 and $940 million;
- Adjusted Net Income between $40 and $45 million; and
- Adjusted EPS between $1.19 and $1.34

Given our focus on prudent growth in this current macroeconomic environment, we are reducing our forecast for year-end secured personal loan receivables from $140 million to $130 million, and for year-end credit card receivables from $150 million to $130 million.

We're closely monitoring all of the macroeconomic developments that factored into our guidance, including inflation, consumer confidence, unemployment rates, wage growth, interest rates and economic growth. Although a number of our larger states have announced stimulus for consumers in light of increased pricing pressures, we have not specifically factored this into our forecast models.

I'd note that while credit tightening has already been implemented and future loans we make will meet these new standards, we do expect increased charge-offs over the next two quarters, as Raul talked about. For the third quarter, we are guiding to 9.8% annualized net charge-offs, plus or minus 15 basis points. For the full year, we are increasing our guidance by 80 basis points to 9.6% net charge-offs plus or minus 15 basis points. Approximately 20 basis points of the increase in rate for the full year is reflective of the denominator effect of credit tightening leading to reduced origination amounts and lower average daily receivables. It is important to keep in mind that because the average life of our portfolio is only 0.90 years, the portfolio will turn over more than once per year. This means that the loans we have started originating under tighter credit standards will make up the vast majority of the portfolio a year from now. While we expect to have elevated loss rates for the third and fourth quarters of this year, our current projection is that losses will start decreasing in the first quarter of 2023 and return to our target 7 to 9% range within a year.

We manage the business for consistent, profitable growth and are tightening our underwriting standards and managing expense growth as appropriate in the uncertain economic environment. It's notable that with the exception of 2020, we've been profitable every year going back to 2016 and our guidance reflects that 2022 will be another profitable year for Oportun.

Part of how we've been able to achieve this profitability is through our strong risk adjusted yields. While Oportun delivers significant savings compared to alternatives for our members, for instance payday loans being 9 times more expensive, the business generated a gross yield of 32.3% during the first half of this year. Accounting for our now-anticipated full-year 2022 net charge-off rate of 9.6% at the midpoint, our risk adjusted yield is currently 22.7%. After servicing fees of 5%, a strong 17.7% unlevered contribution yield remains. This provides a solid base for sustainable profitability on an annual basis.

In summary, I'm pleased that we delivered another solid quarter and that we still expect to deliver a profitable 2022 despite the challenges in the macro environment.

With that, I will now turn it back over to Raul for some final comments before we open the line for questions.

Raul Vazquez, Chief Executive Officer

Thanks, Jonathan.

I want to thank all of the employees at Oportun for a strong first half of the year. Our mission to provide inclusive, affordable financial services that empower our members to build a better future has never been more pertinent, and will continue to guide us and drive our financial results.

As the macroeconomic environment has weakened, we have taken prudent measures to tighten our credit exposure and reduce our expense growth. We have confidence in our ability to navigate the current environment, and the adjustments we are currently making will position us well for continued profitable growth in 2023 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.