<u>Cover slide</u>

Operator

Welcome to Oportun Financial Corporation's First 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.

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Introduction: Dorian Hare, Senior Vice President, Investor Relations

Thanks, and hello everyone. With me to discuss Oportun's first 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 March 31, 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 first quarter 2023 financial supplement and the appendix section of the first 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 script 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 first quarter financial performance, share how we're managing through this dynamic macroeconomic environment by minimizing costs and maximizing efficiency, and provide an update on our strategic initiatives.

Let me begin with our Q1 performance.

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We generated total revenue of $260 million, exceeding our guidance range and up 21% year-over-year, reflecting higher than anticipated average daily principal balance and higher non-interest income from our Savings product.

Our first quarter annualized net charge-off rate of 12.1% also outperformed our guidance range of 12.5% plus or minus 15 basis points. As a reminder, starting last July, we began to significantly tighten our underwriting standards to address the impact of inflation on our members. We're pleased that the first payment defaults and delinquencies on our post-July vintages continue to perform near or better than 2019 pre-pandemic levels.

Finally, by driving higher revenue and exercising disciplined expense management, we produced a narrower Adjusted EBITDA loss of $24 million compared to the $49 to $44 million loss guidance range that we provided. We are focusing on Adj EBITDA in 2023 because it demonstrates the cash flow generation capability of the business and it is not impacted by swings in fair value. Jonathan will cover Q1 Adjusted Net Income and the impact of non-cash fair value mark-to-market changes.

Overall, we made good progress this quarter. There is still work to be done, and the entire team is focused on driving more value for our shareholders.

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Let me shift now to how we are managing the business in this uncertain macroeconomic environment. The headline is that we are taking a conservative stance and are focused on the things that we can control, while carefully monitoring the economic environment. I'll go into more detail regarding what that means for us, starting with expenses.

First, we're fully committed to optimizing our cost structure. We delivered a 48% Q1 adjusted operating efficiency ratio, over 1,300 basis points better than Q1 2022 and our third consecutive quarterly record for efficiency. However, we believe additional expense reductions are necessary to ensure Oportun is best positioned for sustainable, profitable growth.

In addition to the cost reduction measures we enacted in February, we announced today that we are taking further measures to lower our expenses and optimize our efficiency. Specifically, we are reducing our expense base by another 255 employees, as well as further reducing contractor and vendor spending. These reductions mean our corporate staff, which excludes retail and contact center agents, will decline by an additional 19%.

Aggregated with the actions we took in Q1, we have reduced our corporate staff by 28% this year. These actions will generate annualized savings of $78 to $83 million, which combined with the February actions, will result in total annualized savings of $126 to $136 million by the end of the year.

I want to highlight the work we've done to reduce costs in a few ways.

- In terms of our 2023 operating expense forecast, we expect that all the expense reduction efforts will translate to Q4 2023 OpEx of approximately $125 million, for a new run-rate cost base when we exit 2023 of approximately $500 million.
- We can also look at opex ratio, which is our ratio of annualized operating expenses to owned principal balance. As you can see on **slide 6,** our adjusted opex ratio was 16.4% in 1Q23, a 370 basis point improvement from 20.1% in 1Q19. Our 1Q23 adjusted Opex ratio would have been 14.7%, pro forma for the cost reductions.
- Finally, we can compare the growth in our expense base to the growth in revenue and the portfolio. On an absolute basis, we expect that our anticipated annualized 4Q23 expense base will 38% above 2019 operating expenses, whereas our full year 2023 revenue guidance will be 62% to 67% higher than 2019 total revenue, and the owned portfolio is 101% higher than 2019.
- There are unique considerations with each metric, but all of these metrics highlight the work we've done to position the business for future success.

Let me now shift to our thinking on originations in this environment. As we've been sharing for several quarters, we are focused on quality, not quantity of originations. That was evident in our Q1 originations of $408 million, which were down notably from the same period last year.

I've already shared that we are pleased with the performance of our originations since we tightened our credit standards in July 2022. That said, we believe it's prudent in this uncertain environment to be conservative with our level of originations, and we've continued to tighten credit since our last earnings call in March. As such, our current view for origination levels this year is lower than what we envisioned when we last spoke to you. Although we are not providing guidance on originations this year, I am sharing this directional perspective with you to give you a more comprehensive sense of how we're managing the business and to help you understand the guidance that Jonathan will share with you a bit later.

Turning to credit in this environment, the performance of our portfolio has two distinct drivers: the post-July origination vintages, which we refer to as our front book, and the originations made prior to our significant credit-tightening, which we refer to as the back book.

The front book represents the loans that we have originated over the last 9 months and, despite continued inflation, is performing at levels that are near or better than 2019 performance.

The back book continues to represent the bulk of our delinquencies and charge-offs.

Our Q1 loss performance was 40 basis points better than the middle of our guidance range because our collections and analytics teams successfully managed the late-stage delinquency buckets, thereby keeping those delinquent loans from turning into Q1 losses.

We continue to carefully manage the back book, but some of the loans that didn't charge-off in Q1 continue to be delinquent and, in light of much lower tax refunds this year, some of the expected Q1 losses may simply shift into Q2. Therefore, our Q2 guidance reflects a higher level of losses than Q1, but the top-end of our full year guidance for losses has not changed.

Wrapping up my comments on credit, given that the average life of our back book loans is only 1 year, I am confident that we will successfully work through this challenge in 2023. To quantify this for you, our forecast reflects that the level of pre-July underwritten loans on our balance sheet will decrease from $1.6 billion at the end of the first quarter, to $1.2 billion at the end of the second quarter and to $0.7 billion at the end the year.

The final point I want to share regarding how we are managing the business in this environment relates to pricing. We are reaffirming our view that portfolio yield at the end of this year will 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 and keeping our members' loan payments very close to what they're used to paying. Our low first payment default rates and delinquency rates of recent vintages indicate that our pricing decisions are not impacting credit performance.

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Before turning things over to Jonathan, I want to spend a few minutes discussing our strategic initiatives and how we're allocating capital in this environment.

First and foremost, we're allocating capital to the two most proven and profitable parts of the business.

As you can see on **slide 7** of our earnings presentation, 85% of our G&A spend is allocated to the core unsecured personal loan business, which we believe is appropriate for the largest and most profitable component of our business. We will continue to leverage data, technology, and AI to grow it at prudent levels and enhance its profitability in future years.

Approximately 10% of our G&A spend is allocated to our Savings product, which is profitable on a cash flow basis at that level of investment.

Second, we're maintaining optionality for future growth opportunities with minimal current investment.

Our strategy to develop and offer a suite of financial products to drive higher member lifetime values and more profitable relationships was validated by the initial levels of member adoption and early financial results. That said, we have reduced the levels of capital allocated across all those products to approximately 5% of our total G&A in the near-term, and will prudently ramp up growth initiatives when the macroeconomic backdrop inevitably improves.

In summary, while we continue to carefully monitor the economic environment, we are focused on the things we can control – expense levels, prioritization of our core business, conservative originations, collections efforts, and pricing. We plan to extend this approach to each of these areas into 2024 and anticipate that our sharply reduced cost structure, lower credit losses and pricing initiatives will fortify our business economics and substantially enhance our margins and efficiency. For the remainder of 2023, we plan to maintain our conservative stance, which will be reflected in our guidance given the uncertain environment.

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

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

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Thanks, and good afternoon everyone. As Raul mentioned, Oportun delivered solid performance in the first quarter versus our expectations. I am optimistic that Oportun will emerge as a more sustainably profitable business, given our front book's strong performance, our more efficient cost structure, and shrinking back book.

In the first quarter, we generated $260 million of total revenue, up 21% year-over-year, as shown on **slide 8**, and $88 million of Adjusted Net Loss, or $2.60 of Adjusted net loss per share. Higher net charge-offs, non-cash fair value mark-to-market declines and higher interest expense drove the earnings decline, partially offset by revenue growth and lower operating expenses.

Our aggregate originations were $408 million, down 49% year-over-year, reflecting our ongoing credit tightening actions and our focus on high-quality originations.

Net revenue was $5 million, down 98% year-over-year primarily due to non-cash charges including a net change in fair value decline of $216 million. This included the non-cash impact of declining fair value mark-to-market adjustments on our ABS notes and our loans of $86 million, and net charge-offs of $92 million. Higher interest expense also contributed to the net revenue decline, which was partially offset by the higher total revenue.

The fair value price of our loans decreased to 100.3% as of March 31, and resulted in a $37 million mark-to-market decrease. The reduction in fair value of our loans was driven by an increase in our assumption for remaining cumulative charge-offs, due to higher charge-offs on our back book, partially offset by a lower discount rate due to lower interest rates and tighter credit spreads for our ABS notes.

The $49 million mark-to-market increase in our asset-backed notes, which contributed negatively towards our earnings, resulted from a 158 basis point increase in weighted average price to 94.1%.

Interest expense of $39 million was up $25 million year-over-year, primarily driven by increased debt issuance, and the increase in our cost of debt to 5.5% versus 2.6% in the year-ago period.

Turning to expenses, we maintained strong discipline with Adjusted Operating Expenses declining 8% sequentially and 5% year-over-year. As you can see on the right side of **slide 8,** Adjusted Operating Efficiency at 48% was an improvement of over 1,300 basis points year-over-year. This figure will continue to improve as the $126M to $136M in annualized run rate savings from our cost optimization efforts take hold over the course of the remainder of this year.

In the first quarter, our sales and marketing expenses were $19 million, down 10% sequentially and down 44% year-over-year as part of our expense discipline. Our customer acquisition cost was $192, up 27% from the prior-year period as lower marketing expenditures were offset by lower aggregate originations due to credit tightening. Our CAC varies with origination volumes, given the fixed costs associated with our retail network.

As I indicated on our prior earnings call, we expected the non-cash fair value mark-to-market to cause us to have a loss in the first quarter of 2023. For the quarter, we recorded an adjusted net loss of $88 million, compared to a $53 million net profit in the prior-year quarter, and an adjusted net loss per share of $2.60 versus a prior-year net earnings per share of $1.58.

Adjusted EBITDA was negative $24 million in the first quarter, a $58 million decrease compared to $34 million in the prior-year quarter, but better than our guidance range of negative $49 to negative $44 million. The year over year decline was primarily driven by higher net charge-offs and interest expense, along with the impact of loan sales.

We believe that our profitability will be markedly improved during the remaining three quarters of 2023, as reflected in the guidance that I will share in a few minutes.

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Now, let me provide detail regarding Q1 credit performance. Our first quarter annualized net charge-off rate was 12.1%, compared to 8.6% in the prior-year period and 12.8% in the fourth quarter. While the 70 basis points sequential decline outperformed our expectations in Q1 and the back book continues to comprise the bulk of our losses, our guidance will reflect that, as Raul covered, shifting previously-expected losses will cause charge-offs to be higher in Q2.

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Regarding our capital and liquidity, as of March 31, total cash was $202 million, of which $74 million was unrestricted and $128 million was restricted. Additionally, net cash flow from operations for the first quarter was $77 million, up 99% year over year, which supported net debt repayment including required ABS note amortization, along with loan originations. These activities resulted in a $2 million decline in total cash during the first quarter. Also as of March 31, $315 million of our combined $720 million in warehouse lines were undrawn and available.

Last week we borrowed the second $25 million on the up to $75 million upsizing of the senior secured term loan. As previously contemplated and discussed on our prior earnings call, the consideration for the second draw included penny warrants for common stock representing approximately 2.5% of the company. The funds are fulfilling their purpose of increasing our liquidity position amidst an uncertain macroeconomic backdrop, while we mange our back book portfolio downward.

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Turning now to our guidance, our outlook for the second quarter is:

- Total Revenue of $250 to $255 million;
- Annualized net charge-off rate of 12.8% plus or minus 15 basis points
- Adjusted EBITDA of $2 to $7 million

Our guidance for the full year is:

- Total Revenue of $975 million to $1 billion, in-line with our prior guidance
- Annualized net charge-off rate of 11.6% plus or minus 40 basis points, with the high-end maintained and the low-end increased by 20 basis points from our prior guidance
- Adjusted EBITDA of $70 to $75 million, up approximately $17 million at the midpoint from our prior guidance, driven by $40 million in new expense reductions to be captured this calendar year, partially offset by higher net-charge offs and non-corporate interest expense.

Before I turn the call back over to Raul, I want to share with you that I have confidence that our decision to significantly reduce our expense base and maintain a conservative origination stance will allow us to navigate the current environment and become a more sustainably profitable business.

Raul, back over to you.

Raul Vazquez, Chief Executive Officer

<u>Cover slide</u>

Thanks Jonathan. As we've communicated, while we performed solidly and made progress in the first quarter, we remain highly cognizant of the uncertain macro environment and the related credit implications. The leadership team and I have made the necessary adjustments to create a more efficient and more profitable business. With the significant expense reductions we spoke about today, Oportun has enhanced its cash flow in comparison to our prior forecast, which we expect will carry over 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.