Cover slide

Operator

Welcome to Oportun Financial Corporation's Fourth 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 fourth 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, 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-K filing for the year ended December 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 fourth quarter 2023 financial supplement and the appendix section of the fourth 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 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.

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Raul Vazquez, Chief Executive Officer

Slide 3 [Earnings Overview]

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

Today, I'll discuss our fourth quarter performance and update you on our progress in key areas of the business.

Let me begin with four highlights of our Q4 performance.

- First, we generated revenue of $263 million to close full year 2023 with a record $1.1 billion, up 11%.
- Second, our Q4 annualized net charge-off rate was 12.3%, 50 basis points better than last year. In addition, for the first time since 2022, our quarterly net charge-offs, measured in dollars, were lower than the prior year.
- Third, our GAAP operating expenses were $129 million, down 15% year-over-year. We met our stated GAAP OpEx goal for the quarter of $125 million when $7 million of non-recurring severance relating to cost actions announced on our Q3 earnings call are backed out.
- Finally, Adjusted EBITDA was $6 million and represented a $40 million year-over-year increase.

Overall, our team executed well in the quarter, and Jonathan will provide more details on our Q4 performance shortly.

Turning the page to 2024, I'm pleased that we're seeing early signs of a business recovery taking shape, driven by the strategic decisions and operational changes we made in 2023. I'll now share the three areas of improvement that I find most promising.

I'll start with credit and four positive dynamics we are seeing related to our credit performance.

- First, as you can see on **Slide 6** of our earnings presentation, loss rates are approximately 400 basis points lower for our front book of loans in comparison to our back book loans. As a reminder, the back book of loans are loans originated prior to the first material tightening in July of 2022; the front book of loans represents originations since then. You can also see on **Slide 7** that the back book shrank to 21% of our owned principal balance at the end of the fourth quarter, but disproportionately accounted for 53% of our gross charge-offs. The good news is that the impact of the back book will continue to diminish throughout 2024 as we currently forecast our back book to shrink to 3% of our owned principal balance at the end of this year.
- Second, our 1-29 days delinquencies are below 2023 levels. This bodes well for future 30+ day delinquency performance and, more importantly, charge-offs in the second half of the year. The last time the early-stage buckets were running below the prior year was three years ago, when 2021 was below 2020.

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- Third, Secured Personal Loans finished 2023 with annualized net charge-off levels that were approximately 350 bps better than our Unsecured Personal Loan product. We plan on growing our Secured Personal Loan portfolio this year as part of our strategic priority to identify sources of high quality originations.
- Finally, just over a year ago, we launched our integrated Oportun Mobile App by leveraging the Digit Savings app platform. We now know that borrowing members who use our app have exhibited approximately 45% lower 30-plus day delinquencies three months post-disbursement than those who have not yet signed up to use the app. We plan to increase the visibility, promotion and adoption of our Mobile App in 2024.
- Improving credit outcomes is a key priority, so we will continue our conservative underwriting stance and focus on enhancements to underwriting models, servicing efforts, and our mobile app.

The second promising area is expense management.

- As I mentioned earlier, we met our Q4 OpEx goal and, as you can see on **Slide 8** of our earnings presentation, we are significantly more efficient today than we were when we became a public company four years ago.
- Adjusted OpEx as a percentage of Average Managed Principal Balance was appreciably down to 12.5% in Q4 2023 vs 18.1% in Q4 2019.
- Fortifying our core business and unit economics are priorities for 2024 and I will share additional decisions we've made in these areas in a few minutes.

The third and final promising area of improvement that I want to highlight is funding.

- Our most recent $200 million securitization, which closed in February, was ten-times oversubscribed.
- At an 8.4% weighted average interest rate, its cost is 160 basis points less than the securitization we executed in October 2023.
- In my view, this signifies the confidence investors have in the credit quality of our originations as well as the improvement and strength of our business model.

Again, I'm encouraged by all these signs of improvement, but there's still work ahead to fully realize our business recovery.

To that end, we're announcing that we will continue to reduce our operating expenses this year by an additional $30 million on an annualized basis, bringing our total annualized cost reductions since Q2 2022, when we first started our expense management efforts, to a substantial $240 million. The 2024 full year guidance that Jonathan will share with you incorporates these actions, with lower OpEx levels generating significantly enhanced profitability.

Finally, in order to execute our plans for 2024 and beyond, we recently completed two amendments, one to our residual facility and the other to our senior secured term loan.

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- The amendment to our residual facility provides us with a three month principal payment holiday and extends the term to January 2025. We will make principal payments on the senior secured term loan in the amount equal to the payments that would have been made on the residual facility.
- The senior secured term loan amendment reduces the minimum asset coverage ratio, which is the ratio of our unrestricted cash and equity in some of our financing facilities to the outstanding debt. We needed to lower the escalating levels of this covenant for 2024, which were set before 2023's higher than expected losses and lower originations caused by credit tightening. Given the scheduled increases in the asset coverage ratio covenant levels for the remainder of 2024 and into 2025, we are currently evaluating refinancing options.

In summary, after a very challenging 2023, I am confident that we are on the right path to achieving a stronger position for the company, driven by the strategic decisions and operational changes we've announced today and have made over the last 12 months.

With that, I will turn it over to Jonathan for additional details on our fourth quarter 2023 financial performance as well as our first quarter and full year 2024 guidance.

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

Slide 10 [Fourth Quarter Highlights]

Thanks Raul, and good afternoon everyone. As Raul mentioned, we executed solidly in the fourth quarter. We are on track to substantially enhance our profitability in 2024 and beyond by being laser focused on our three differentiated core products alongside our ongoing cost reduction initiatives and our tight credit posture.

As shown on **Slide 10,** Oportun delivered total revenue of $263 million. The impact of net change in fair value and higher interest expense drove an Adjusted Net Loss of $21 million, or an Adjusted Loss Per Share of $0.54.

We continue to be focused on credit quality rather than quantity with originations of $437 million, which were down 28% year-over-year. Sequentially, originations were down 9% from the third quarter, with further tightening of our credit posture dominating traditional seasonal patterns for originations growth.

Despite lower originations, total revenue was virtually flat year-over-year due to 100 basis points higher portfolio yield resulting from our pricing increases along with higher non-interest income. Our credit tightening actions led to lower originations than previously anticipated, causing us to fall short of our 200 basis points year-over-year increase target. However, I'm pleased that our Q4 risk adjusted portfolio yield, which includes charge-offs,

increased year-over-year by a strong 155 basis points. We will continue to enhance yield while remaining committed to our 36% APR cap.

Net revenue was $72 million, down 50% year-over-year, due to unfavorable fair value mark-to-mark adjustments and higher interest expense.

Our total net decrease in fair value of $139 million was primarily driven by current period charge-offs of $91 million, marks on loans sold of $31 million and a mark-to-market adjustment on our asset backed notes of $24 million. Partially offsetting these unfavorable fair value drivers, the mark-to-market adjustments to our loan portfolio increased by $14 million due to a 60 basis points sequential increase in our loan portfolio's fair value to 102.0% on a decline in discount rate.

Before continuing, I want to point out a change we've made to the presentation of our loans receivable at fair value on the balance sheet. We previously recorded accrued interest and fees separately on the balance sheet and now these are included in loans receivable at fair value. We made this change so our financial presentation would be more consistent with other companies that fair value their loans. We have updated our historical balance sheet to reflect this change. To be clear, none of our aggregate numbers have changed. We've only combined two balance sheet line items, so this is a reclass and not a restatement. Given this change, the fair value prices for our loans now include the accrued interest and fees, and thus reflect higher figures than the prices excluding accrued interest and fees we have quoted in the past.

Interest expense of $52 million was up $16 million year-over-year. This was primarily driven by increased debt outstanding and the increase in our cost of debt to 7.1% versus 4.8% 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 previously announced cost structure optimization initiatives. Our $129 million in total operating expenses in Q4 reflected a 15% reduction from the prior-year period, and included a $7 million non-recurring charge for severance related to our previously announced headcount reductions. We made significant strides throughout 2023 in improving our quarterly operating expense run rate, and we will continue to drive our cost structure lower in 2024 with the $30 million of additional annualized operating expense reductions that Raul announced. Partially enabled by our streamlined product suite, we are now targeting $97.5 million in Q4 GAAP operating expenses.

In the fourth quarter, our sales and marketing expenses were just over $18 million, down 15% year-over-year.

For the quarter, we recorded Adjusted net loss of $21 million, compared to a $5 million net profit in the prior-year quarter, and an adjusted net loss per share of $0.54 versus prior-year net earnings per share of $0.14. The decline in adjusted profitability was primarily driven by non-cash fair value marks and higher interest expense.

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Adjusted EBITDA, which excludes the impact of fair value mark-to-market adjustments on our loan portfolio and our notes, was $6 million in the fourth quarter. This reflected a strong year-over-year increase of $40 million, driven by our sharply reduced cost structure.

Slide 11 [Credit Performance]

Now, on **Slide 11**, let me discuss Q4 credit performance. Our Annualized Net Charge-Off Rate of 12.3% was at the midpoint of our guidance range. This compared to 12.8% in the prior-year period.

Our 30+ day delinquency rate increased year-over-year by 30 basis points to 5.9%. In addition to what Raul mentioned earlier on 1-29 day delinquencies improving, we've recently seen our 30+ delinquency rates begin to decline, and we expect this trend to continue. Based upon data through last week, we expect the first quarter 30+ day delinquency rate to be between 5.1% and 5.3%.

These improved delinquency trends are not surprising, given that the percentage of underwritten loans with Vantage scores of 660 or greater increased to 51% during Q4'23, up from 33% for Q2 '22 prior to the start of our tightening actions.

Slide12 [Capital and Liquidity]

Regarding our capital and liquidity, net cash flow from operations for the fourth quarter remained near record levels at $106 million, up 20% year over year. Furthermore, I'm pleased that our resilient top line performance and sharply reduced cost structure allowed for this operating cash flow to fully finance our $97 million in cash used in investing activities, principally loan disbursements net of repayments, and net debt repayment of $3 million.

As of December 31, total cash was $206 million, of which $91 million was unrestricted and $115 million was restricted. Further bolstering our liquidity was $409 million in available funding capacity under our warehouse lines and remaining whole loan sale agreement capacity of $317 million.

In continuing to ensure that Oportun is funded to grow in a responsible and sustainable fashion, since quarter end, we closed a $200 million asset backed securitization. This financing brings our total executed funding agreements since June to almost $1.2 billion.

Before I leave our discussion of capital and liquidity, I want to inform you that we're making good progress evaluating strategic options for our credit card product, and expect to have an update for you soon.

Slide 13 [Revised Adjusted profitability Metrics]

Before providing you with our initial guidance relating to 2024, I wanted to update you on two changes we are making this year to the adjusted performance metrics we provide to the investment community, as shown on **Slide**

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13. First, going forward, we will be excluding the impact of fair value mark-to-market adjustments on our Asset-Backed Notes at Fair Value from Adjusted Net Income and Adjusted EPS. Second, we are adjusting our calculation of Adjusted EBITDA to be more in line with those of other companies in our space. Now, let me share more detail with you regarding the rationale for each decision.

Our decision to update our Adjusted Net Income calculation is driven by our election last year to stop fair valuing our new debt financings. By the end of 2025, nearly all our existing Asset-Backed Notes at Fair Value will have been paid off, so there will be no mark-to-market adjustment for our debt after that time. Between then and now, we expect to recognize, on a GAAP basis, $94 million of negative mark-to-market adjustments as our asset-backed debt, currently valued at 95.0%, converges to par at maturity. This $94 million reduction in pre-tax earnings is a reflection of the higher interest rate environment, rather than an indicator of the health of our business, so going forward we will be backing it out from our Adjusted Net Income and Adjusted EPS metrics. Additionally, for Adjusted Net Income, beginning in Q1'24 we will no longer be adding back Acquisition and Integration related expense since our acquisition of Digit closed over two years ago.

With respect to Adjusted EBITDA, we are simplifying our calculation to be more consistent with the calculations of other companies in our space. Going forward, we will no longer adjust for origination fees, net, since this is not an adjustment we see other companies making in their calculation of Adjusted EBITDA. Origination fees on our loans are fully earned at the time of disbursement and are non-refundable, and we no longer feel that we need to adjust our EBITDA to reflect the timing difference in the receipt of that cash.

Had we applied these changes for 2023 reporting, full year Adjusted Net Income would have been $53 million higher at an adjusted net loss of $71 million. However, had we applied these changes for 2022 reporting, full year Adjusted Net income would have been $152 million lower at an adjusted net loss of $83 million.

Full year Adjusted EBITDA for 2023 would have been $17 million higher at $19 million, while full year Adjusted EBITDA for 2022 would have been $27 million higher at $17 million.

Slide 14 [Guidance]

Turning now to our guidance as shown on **Slide 14**, our outlook for the first quarter is:

- Total Revenue of $233 to $238 million;
- Annualized net charge-off rate of 12.1% plus or minus 15 basis points
- Adjusted EBITDA of $(14) to $(12) million

Our guidance for the full year is:

- Total Revenue of $975 million to $1 billion,

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- Annualized net charge-off rate of 11.9% plus or minus 50 basis points,
- Adjusted EBITDA of $60 to $70 million

With respect to our adjusted EBITDA guidance, which is on our new calculation basis, this guidance would have been $(20) to $(18) million for first quarter 2024 and $27 to $37 million for full year 2024, had we not changed our calculation.

Slide 15 [Unit Economics]

Before handing the call back to Raul to close, I'd like to share with you what we believe long-term investor returns for Oportun could look like.

The unit economics of our Personal Loans business are quite strong at over a 32% APR, even while we deliver value well-in excess of what the alternatives are for our borrowing members.

Add to that non-interest income, predominantly from our savings product, and we see a 36% total revenue yield as a percentage of principal balance to be sustainable.

Conservatively assuming an 8% cost of funds and a 9-11% annualized net charge-off rate, a 17-19% risk adjusted yield remains.

And, assuming operating expenses over the long-term of 12.5% of owned principal balance, we see a 3 to 4% return on assets as attainable. Lastly, with a 6-to-1 debt-to-equity ratio enabled by our robust risk adjusted yield and diversified funding sources, we see the potential for a very strong 20-28% ROE over the long-term.

Given the significant changes and improvements we have made to strengthen our business and tighten our product focus, we see ourselves making progress towards this goal over the next several years.

Raul, back over to you.

Cover slide [Closing Remarks]

Raul Vazquez, Chief Executive Officer

Thanks, Jonathan.

Before I wrap up, I want to publicly welcome our two newest independent board members, Carlos Minetti and Mohit Daswani, who joined Oportun's Board of Directors in February.

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- Carlos Minetti has more than 35 years of experience in consumer lending and credit risk, including most recently as President, Consumer Banking, at Discover Financial Services, a position he held from 2010 to 2023.
- Mohit Daswani is the Chief Financial Officer of ThoughtSpot, Inc., an A.I.-powered analytics company. His prior experiences include executive roles at Square and PayPal, as well as time in the investment banking and private equity industries.

We are pleased to have them on the Board and are already leveraging their backgrounds in consumer finance, along with their extensive executive and public company experience.

While we still have work to do to establish the type of long-term profitability that Jonathan just talked about, we've laid the foundation for recovery in 2023 and we expect 2024 to be a defining step in our journey towards sustainable, profitable growth.

From a strategy perspective, we are guided by our focus on holistically addressing two of the most fundamental challenges to financial health and resilience - access to responsible and affordable credit, and adequate savings.

We will do so with our streamlined product assortment of Personal Loans, Secured Personal Loans and Savings, and by executing on our three top strategic priorities - improving credit outcomes, fortifying our business economics, and identifying high-quality originations.

We are optimistic about 2024 due to our disciplined expense management, February's $200 million securitization, and, more importantly, the promising Q1 credit trends.

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.

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