Oportun
First Quarter 2022 Conference Call Script
Monday, May 9, 2022

Operator
Welcome to Oportun Financial Corporation's First 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, SVP of Investor Relations. Mr. Hare, you may begin.

Introduction: Dorian Hare, Senior Vice President, Investor Relations
Thanks, and hello everyone. Some of you are aware that I started in this role a few weeks ago, and I am very excited to be joining you today for my first earnings call while leading Oportun's investor relations effort. With me to discuss Oportun's first 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 March 31, 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 operation. A full list of definitions and reconciliations 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 first quarter 2022 financial supplement and the appendix section of the first 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.

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Raul Vazquez, Chief Executive Officer

Thanks, Dorian. Jonathan and I are glad to have you here, and I know you are keen to get to know our investment community.

Good afternoon, everyone, and thank you for joining us. I'm incredibly proud of our record results for the first quarter, which reflected the power of our product offerings and exceeded all of our expectations. As you know, we have very ambitious goals for 2022, so we are pleased that the year is off to a great start.

Let me start by sharing the headlines:

- We achieved record first quarter originations of $800 million, up 139% from the first quarter of 2021.
- Originations continued to be driven by our expansion into new states where we are taking share. New borrowers represented over 51% of our total loans, up from 40% a year ago.
- We delivered record revenue of $215 million and adjusted net income of $53 million, for adjusted EPS of $1.58 and adjusted ROE of 34%.
- We are continuing to deliver strong credit performance, as evidenced by our annualized net charge-off rate of 8.6% which was on par with the prior-year quarter and was 17 basis points better than the midpoint of our expectation.
- Given the favorable trends in our business, we are raising our full year 2022 guidance.

Now, let me tell you about our progress on our three strategic priorities for the year that support our outlook for strong, profitable and sustainable growth.

Our first priority is to grow our members. We ended the first quarter with 1.7 million members up from 1.5 million at the start of the year, a 48% annualized growth rate for the quarter, so we are very pleased with the pace of member growth.

Our second strategic priority is to increase multi-product relationships with our members. As a proof-point of our ability to do so, in the first quarter products grew at an annualized rate of 58%, faster than our member growth of 48%. Additionally, at the end of the first quarter, 12% of our members with an Oportun credit card also had a personal loan with Oportun, which is up from 7% at the start of the year. We also began developing multi-product relationships across our credit and digital banking products during the first quarter and are enthusiastic about expanding this aspect of our business as a growth lever.

Our third strategic priority is enhancing our platform capabilities to meet the everyday financial needs of hardworking people. In our last earnings call, we talked about creating a seamless, integrated acquisition funnel across all our products to increase member conversion and decrease cost of member acquisition. In Q1, we made important progress toward that vision as we began offering Digit products to our applicants whom we were not yet able to approve for a loan, as well as to current and previous loan customers. I'm also happy to announce that the Digit integration into our credit card funnel went live a couple of weeks ago. While there is more work required this year to create a fully-integrated funnel, we are beginning to gather valuable learnings from members we have started serving with multiple products.

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

- The growth of our **unsecured personal loan** product continues to benefit from our expansion across the nation. As of the end of the first quarter, our personal loans were available in 39 states, and we plan further geographic expansion this year. I want to emphasize how differentiated this geographic expansion is for us compared to other fintechs that have already had nationwide operations. By introducing our superior customer value proposition in new geographies, we are taking share from other lenders who have never had to compete with Oportun. In addition, having access to new members allows us to grow selectively, without having to expand the credit box. We are seeing strong growth in states such as Pennsylvania, North Carolina, Michigan, Virginia, and Ohio. Overall, we have added more than 22 million potential members in the 27 states we have entered with MetaBank through the end of the first quarter.

- For our **secured personal loan product**, we ended the first quarter with $79 million in receivables, up 1,375% year-over-year and on track to meet our year-end target of $140 million. In April, we also expanded our secured personal loan product to Arizona. 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, providing a proof point for the low member acquisition cost opportunity that a single unified acquisition funnel for all Oportun products will offer in the future.

- We also saw excellent progress this quarter from our **credit card** product. Receivables grew 996% year-over-year to $90 million, also on track to meet our year-end goal of $150 million. We now have more than 153 thousand members who have an Oportun branded credit card.

- We have also continued to make great progress with our Lending-as-a-Service product. During the first quarter, we scaled our **Lending-as-a-Service** network to include 284 partner locations, up from 28 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. We are in discussions with multiple potential partners to expand our Lending as a Service channel, including both retail and fully digital businesses.

- Finally, our Digit integration is progressing nicely. We are now offering Digit products at multiple points in the Oportun application and servicing experiences, and we have enabled Oportun members to obtain our Digit products at a discount. All of these activities are being conducted while of course, honoring our members' privacy preferences.

Finally, I'd like to tell to you about how well Oportun is positioned to both meet the needs of our hardworking members and create shareholder value in the current macro environment. Our members are benefiting from a strong job market and in our 16 years of lending, we have found that a robust employment environment is the leading driver of both origination levels and the health of our loan portfolio.

I've never been more confident about our ability to grow the company and create long-term shareholder value by providing inclusive, affordable financial services that empower our members to build a better future. I'll now turn the call over to Jonathan who will walk you through a more in-depth discussion of our financial results and provide our outlook for the second quarter and full-year. Jonathan?

Jonathan Coblentz, Chief Financial Officer & Chief Administrative Officer

Thanks, and good afternoon everyone. As Raul mentioned, we generated record results in the first quarter, and 2022 is off to a great start.

In the first quarter, we generated $215 million of total revenue, and $53 million of Adjusted Net Income, or $1.58 of Adjusted EPS. Our aggregate originations were $800 million, up 139% year-over-year and well ahead of our expectation of $625 million. Loan application volume and originations have remained strong since the end of the quarter, and we expect continued strength in aggregate originations throughout 2022.

Total revenue of $215 million was up 59% year-over-year, also well above our expectations, and reflected higher receivables due to increased originations. We expect continued strong origination volume across all of our credit products to drive increased growth in total revenue throughout the year.

Net revenue was $205 million, up 86% year-over-year. Net revenue improved from the prior year period due to higher total revenue, consistent interest expense and greater increase in fair value.

Interest expense of $14 million was up 1% year over year, primarily driven by increased debt issuance to fund our growth, partially offset by the decrease in our cost of debt to 2.6% versus 3.9% in the year-ago period. As a reminder, last year we locked in $1.4 billion of fixed-rate, term asset-backed funding at a weighted average interest rate of 2.2% and negotiated better terms on our $750 million warehouse lines of credit. At the end of the first quarter, 73% of our debt was fixed rate, providing us with protection from rising interest rates.

For our net change in fair value, we had a $4 million net increase in fair value, which consisted mainly of a $41 million mark-to-market net increase on our loans and our debt, a $16 million cumulative mark adjustment related to the sale of $228 million in loans through the structured loan sale at the end of the quarter and current period charge-offs of $51 million.

For the mark-to-market, the fair value price of our loans decreased to 104.1% as of March 31, and resulted in a $17 million mark-to-market decrease.

The $58 million mark-to-market increase in our asset-backed notes resulted from a 353 basis point decrease in the weighted average price to 96.3%, due to the increase in interest rates and credit spreads during the quarter.

Turning to expenses, our first quarter total operating expense was $147 million, an increase of 39% as compared to the prior-year quarter. Adjusted operating expense, which excludes stock-based compensation expense and certain non-recurring charges, increased 42% year-over-year to $133 million, growing more slowly than total revenue and net revenue which grew 59% and 86%, respectively year-over-year, thus increasing our profit margins. The increase in expense was primarily related to the addition of $15 million of Digit operating expenses, post-merger, which were not present in the prior-year quarter. We also increased our investment in technology to enhance our platform and increased marketing spend to drive growth in new markets where we are taking share.

Our customer acquisition cost was $151, down 27% from the year-ago period. This decrease was partially driven by our investment in AI, which has increased the efficiency of our marketing programs and the reduction of our cost base achieved through last year's rationalization of our retail network. Furthermore, as our business continues to become more digital-first, we have decided to close 27 retail locations this year which will save almost $20 million of operating expenses over the next five years. In the first quarter, we took a $600 thousand charge relating to these closures and expect an additional $1.5 million charge in the second quarter.

Our net income was $46 million, well above the $3 million in net income generated in the prior-year quarter. This equated to earnings per diluted share of $1.37, a significant increase from $0.10 in the first quarter of 2021.

On a non-GAAP basis, we delivered adjusted net income of $53 million, more than quadrupling $12 million in the prior-year quarter, and adjusted EPS of $1.58 versus $0.41, respectively.

Adjusted EBITDA was $34 million, a $36 million increase compared to a loss of $2 million in the prior-year quarter.

Adjusted Return on Equity was 34%, versus 11% in the prior-year quarter. For the last twelve months, Adjusted ROE was 21%.

Turning now to credit, our first quarter results were further evidence of our portfolio's continued strength and our ability to manage credit and deliver specific outcomes. Our annualized net charge-off rate was 8.6%, equivalent to the prior-year period and 17 bps better than our midpoint guidance. As of March 31, our 30+ day delinquency rate would have been 4.1% had we not sold $228 million of loans, or approximately 9% of our owned portfolio, at the end of the quarter. The loan sale reduced the denominator of the delinquency calculation, increasing our reported 30+ day delinquency rate from 4.1% to 4.5%. In comparison, our 30+ day delinquency rate was 24 basis points higher than the 3.9% level as of December 31, 2021.

As a reminder, our sophisticated A.I.-driven underwriting algorithms allow us to manage our credit exposure on a highly granular basis. Our fully-centralized and fully-automated credit model consists of over one thousand different end nodes, each of which represents a different gradation of credit risk, enabling us to make adjustments on a node-by-node basis to target desired outcomes. We have further enhanced our underwriting capability by incorporating cash flow information from banking data, a new and highly predictive alternative data source that we have not previously leveraged. Additionally, we are in the process of implementing machine learning models to enhance the efficiency of our collections, which will allow us to further optimize borrower outcomes and achieve better credit results.

We continue to be very pleased with the credit quality of the loans we are booking, while simultaneously adding to our membership. As Raul mentioned, our growth through geographic expansion is a key differentiator and will allow us to be more selective in underwriting because of access to new markets. For example, we've actually been tightening our underwriting standards since the third quarter of last year and continued to make some adjustments through the first quarter of this year. We've also been allocating our marketing spend across channels to optimize for credit outcomes. While taking these prudent measures, our strong growth in new loans continues to drive our performance. In the first quarter, new loans represented 51% of total loans originated as compared to 40% in the prior-year quarter, as we continued to expand in new geographic markets and take share.

Most of the new borrowers we are adding today will become future returning borrowers who will be less expensive to acquire, will safely qualify for larger loans on average, and are expected to have lower charge-off rates. To give you a sense of this, in the first quarter our average loan size to a new borrower was $3,100 as compared to $5,100 for a returning borrower, and net charge-off rates for returning borrowers have been running at approximately two-thirds the rate for new borrowers. In short, new member growth in 2022 sets us up for continued success in 2023 and beyond.

Regarding our capital and liquidity, as of March 31, total cash was $171 million. Additionally, net cash flow from operations for the first quarter was $39 million. Our Debt-to-Equity ratio was 3.3x. And, $273 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 March during a choppy market, we successfully closed a structured loan sale, which was an amortizing asset backed securitization that included the sale of the residual cash flows. Through this transaction, we sold loans at an attractive price while reducing our balance sheet and credit exposure. And, we are currently in the market with a $400 million securitization, which we expect to price this week, which will free up significant warehouse capacity to fund the strong growth in originations we are projecting for the remainder of the year.

Given the rising rate environment, we are enacting select pricing actions with respect to new loan originations, while remaining committed to growing our membership base, taking share, and maintaining a 36% APR cap. On average, these pricing actions will increase portfolio yield by 65 basis points this year, helping to offset higher cost of funds.

Turning to our expectations for the rest of 2022, we will continue to leverage multiple vectors for growth including the expansion of our addressable market, products, channels and digital banking capabilities. We expect this growth to accelerate over time, as our annualized member growth is combined in the future with expanded multi-product relationships.

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

- Aggregate originations of between $825 and $850 million;
- Total Revenue of between $214 and $218 million;
- Adjusted Net Income between $2 and $4 million; and
- Adjusted EPS between $0.06 and $0.12

I want to point out that the reason our second quarter adjusted net income and adjusted EPS guidance is below our first quarter results is due to timing differences with respect to the net change in fair value caused by the increase in interest rates. However, the trends in our business remain strong, as demonstrated by the fact that we are taking up each of our full year guidance metrics including adjusted net income and adjusted EPS.

Our updated guidance for the full year is:

- Aggregate originations of between $3.45 and $3.50 billion;
- Total Revenue between $910 and $930 million;
- Adjusted Net Income between $83 and $87 million; and
- Adjusted EPS between $2.45 and $2.56

We are maintaining our forecast for $140 million of year end receivables for our secured personal loans, and maintaining $150 million for credit cards.

We expect our second quarter annualized net charge-off rate to be 8.6% plus or minus 10 basis points, and we are reaffirming our expectation for the full year net charge-off rate to be 8.8% plus or minus 15 basis points.

In summary, I'm pleased that we delivered a terrific quarter and that our outlook for the remainder of 2022 remains strong. And, I believe that the exceptional growth in members, originations and total revenue that we are seeing so far this year will set us up for a great 2023.

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

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Raul Vazquez, Chief Executive Officer

Thanks, Jonathan.
Before I open up the call for questions, I wanted to share with you that our 2021 corporate responsibility & sustainability report will be released soon. With that in mind I wanted to share with you some of the ways in which Oportun enables a better financial future for our members.

- Oportun has extended more than $12 billion of credit to hardworking individuals, saving them over $2 billion in interest and fees.

- Likewise, our digital banking platform has helped members effortlessly save more than $7.2 billion through the application of its A.I.-driven algorithms. Digit members have annually, on average, set aside over $3,000 as rainy day funds.

We were pleased to share with you in our prepared remarks how Oportun is off to a strong start this year, which combined with our ongoing ability to execute on our strategic initiatives has allowed us to raise our full year 2022 guidance. 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.