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Investor briefing transcript

Attached is a copy of the transcript from Pioneer Credit Limited's (ASX:PNC) investor briefing held on Thursday 24 August 2017 and presented by Managing Director, Keith John and Chief Financial Officer, Leslie Crockett.

The Briefing followed the format of the FY17 Results Presentation released to the market on 24 August 2017, and the attached transcript is intended to be read in line with the FY17 Results Presentation.

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PIONEER CREDIT LIMITED (ASX: PNC)

TRANSCRIPT OF INVESTOR BRIEFING HELD ON 24 AUGUST 2017

The following transcript is intended to be read in line with the FY17 Results Presentation released at 12:43pm (AEDT) on Thursday 24 August 2017.

Keith John: Good afternoon to all who have joined us today and thank you for your continued interest in Pioneer Credit Limited. I'm joined today by my Chief Financial Officer, Leslie Crockett, and Company Secretary and General Counsel, Sue Symmons. Since listing in 2014, we've been diligent in our approach to leading not just our industry, but the broader, small, diversified financial sector in market disclosure. Following feedback from you, we have today taken that disclosure even further, by presenting, among other metrics, our return multiples by vintage, our cumulative cash generation to investment, and a comprehensive expensing rate comparison on product mix. Pioneer has the confidence in its people, processes, and conservatism, to publish, and be measured against these important metrics, which will be unique for this sector in the Australian market place. We've also continued to publish the weighted average price of the portfolios we invest in. Like all the metrics we present, we removed those that inappropriately skew outputs or investment price. These are where we've invested in portfolios at very low prices. By excluding those very low price portfolios, you get a very real measure of the financials, and in this case, the weighted average investment price of Pioneer. Where we report payment arrangements, we do so taking into account default rates and all other realistically possible negative factors, again, so you can see the lowest expected realistic return. We will, of course, all be pleased to exceed these returns and my team are working hard to achieve that.

Into the presentation and starting on **page four** are the highlights of the year for FY17, which we were very pleased with.

- FY17 produced our largest PDP investment to date of $69.6 million - a fabulous achievement, in particular at the price points which we continue to invest at, and demonstrating how credible the Pioneer story is and how well regarded our servicing platform and differentiated offering is.
- We signed a new $110 million senior debt facility with our two banks.
- We invested in a New Zealand portfolio for the first time with a subsidiary of an Australian bank, again underpinning how highly regarded Pioneer is.

- We completed, with your strong support, an oversubscribed $20 million equity raising in April, which allowed us to invest in a significant inventory PDP worth about $14 million, which we forecast very strong returns on.
- We also signed a partnership agreement with Rewardle to exclusively market our lending products to their membership base of some 2.3 million consumers.

All of this rolled up into a strong performance with $35 million in EBITDA and a record net profit after taxation of $10.8 million. I'll now hand you over to Leslie, who'll take you through the financials in detail.

Leslie Crockett: Good afternoon all, and it is my pleasure to provide a summary of the key highlights of the financial year. As Keith has mentioned, Pioneer today announced its full year results for the year ended 30 June 2017, achieving another strong year of growth with increases in net revenue and a record net profit after tax. With the delivery of a record FY17 result, it is important that it is accurately represented in the context of our prior year result reporting.

At Pioneer, we continue to hold ourselves accountable to the higher standards in terms of transparency and complete reporting and we've therefore called out and explained on **page five**, in some detail, the more appropriate classification of PDP liquidations, which resulted in a need to reclassify an element of prior year disclosures in order that the current year growth metrics have real context.

Debt purchase agreements provide for circumstances where a vendor partner may buy back accounts from Pioneer under certain circumstances and also include instances where Pioneer may sell accounts back to the vendor. These have been historically described as recourse arrangements. A review of our agreements this year, in light of our increasing materiality arising on a cumulative historical basis and due to the growth in volume and diversity of purchasing has resulted in a determination of more appropriate classification of these PDP liquidations.

The classification now brings Pioneer reporting in line with local and international comparatives. While the adjustment does not represent a prior year error in the technical sense, it has been determined important enough to draw your attention that the FY16 comparative liquidations of PDPs now reflects cash receipted of $1.5 million. Correspondingly, the purchasing outflows are now reported at the full acquisition cost.

This reclassification is cumulative across prior periods. All reporting in the financial statements and the presentation material to follow is based off these recaps by prior year numbers. Our record results for the financial year ended 30 June 2017 demonstrates a year of growth in sustainable earnings while ensuring a responsible attitude to expense management and considered investment in both excellent customer service and skilled support people.

Page six illustrates that our recently upgraded FY17 guidance was exceeded. PDP investments were $69.6 million. A net profit after tax has been finalised at $10.8 million. While our PDP evaluation approach remains cautious, significant increases in key FY17 earnings measures include:-

- net revenue up 18% to $56.3 million,
- EBITDA up 12% to $35 million,
- EBIT up 13% to $17.4 million, and
- net profit after tax up 14% to $10.8 million.

Pleasingly, these metrics demonstrate the growth in real cash earnings with an increase in investing in our most important resource, which are our people. This investment in FY17 underpins the future performance expectations, which Keith will talk to later in the presentation.

Of note is the continued payment of our dividend at 50% of net profit after tax. This year on a relative basis, earnings per share and dividends per share are largely flat as a result of the further shares issued through the over subscribed equity placement and the rights issue completed in April 2017.

We are pleased to confirm that the directors have today declared a fully franked final dividend of 5.28 cents per share, taking the total dividends per share for FY17 to 9.50 cents.

The final dividend will be paid on 4 October.

As I mentioned, our earnings growth has been achieved once again on the back of a cautious PDP valuation approach and on **page seven**, we provide important insights into our growing high quality payment arrangement book. The sustainable cash annuity contribution of our payment arrangement customers is fundamental to our ability to confidently forecast our outlook as Keith will describe further. The metrics provided here are for scheduled payment arrangements only to ensure we demonstrate the high quality of the customer base and the large average balance empirically demonstrates a significant point of difference for Pioneer at over $12,500 per customer account. Having a quality payment arrangement book helps underscore the stability of the fair value valuation model, which has been further developed this year with the assistance of external, as well as the growing internal statistics, analytics and credit risk expertise in our business. The predictive power of the numerous models used to measure our portfolios is enhanced by assessing some 269 key customer behaviour characteristics, evidenced in the data underlying the portfolio's performance.

As part of our cautious valuation bias, we have continued to apply a 9% downward calibration to the model output, which significantly reduced the forward-looking forecast.

A cautious approach has always been part of the discipline of Pioneer and will continue to be going forward.

The valuation is then presented based on discounting this cautious forecast to a present value using a discount rate across the model of 20.1%. We continue to cap the modelled expected future cash receipts to a maximum 10-year liquidation period.

Fair value reporting in our financial statements remains a Key Audit Matter for our auditors PricewaterhouseCoopers. Their detailed and informative audit opinion is included in our financial statements and provides insight into the details of the independent audit approach they have taken to address their audit requirements on the valuation.

As highlighted on **page eight**, during the year Pioneer executed on a variety of capital management and funding initiatives to ensure the Company continues to grow while maintaining a healthy balance sheet. This included completing on a new three year, $110 million facility, syndicated by Bankwest and Westpac. There remains $26.3 million of headroom to fund further growth in PDP investment.

In addition, as Keith mentioned, a successful $20 million equity raising was completed at $2.00 a share in April. This incorporated an oversubscribed $15 million placement to institutional and sophisticated investors and a $5 million fully underwritten non-renounceable rights issue to existing shareholders.

Pioneer remains cautious in our gearing of our debt management and we close out the year with significant headroom on all bank covenants, with our borrowings to PDP value ratio at 48.88%, noting the caution in the PDP valuation I described earlier. Significant growth in net assets this year is reported on the back of the quality investments made while maintaining disciplined capital management.

Before we move back to Keith, who will be providing some important insights into our strategic performance initiatives, on **page nine** we highlight that Pioneer has enjoyed its strongest year of PDP investment to date with approximately $55 million in forward flow and traditional portfolios and an additional approximately $14 million invested on a significant discrete PDP investment in April.

EBITDA remains an important metric for us. We've been pleased to record growth of 12% on this, in a year in which we, at the same time, invested in growth in quality people in both customer service and in our technical support team.

Gross operating cash flow as reported here strips out the non-cash expenditure, which is predominantly on share based payments. This is up 14%, which demonstrates the real operational efficiency we've achieved while importantly growing both the liquidation performance reported for the year and also the quality and depth of our payment arrangement book. Our reported operating activity cash inflow is after tax and interest paid, as well as working capital movements.

This year working capital has reflected some more significant strategic initiatives, including the growth in our legal practice revenue streams. In addition, the movement reflects the natural working capital cycle occurring at year-end with some of our significant relationship partners.

While the impact on operating activity inflow as reported is considered an abnormal movement this year and is a step change from the past, occasioned by the growth initiatives we've undertaken this year, we believe we will continue to see trade accounts receivable arising in the normal course of business.

We also note here the significance of the support we receive from our valued investors this year, with our funding base including the oversubscribed equity raising in April.

Thank you all for your kind attention and interest today on the financial highlights. I'll now pass back to Keith to continue the presentation.

Keith John: Thank you Leslie. Obviously one of the reasons that you're invested in Pioneer Credit is because of what our future holds, not what we've just done in the past. So, I'm very pleased with what FY17 was for Pioneer. It had all the hallmarks of what we think makes a great business which is discipline in the way that we run our business, investment in the future and expensing the cost that comes with that, which is significant, and setting ourselves up for growth which is certainly what we're looking forward to doing in FY18.

On **page 10**, we talk all the time about our leadership principles and culture which are at the very heart of Pioneer Credit and one of the hallmarks of this business and the things that make it truly great and one of the things that will underpin our success in the years to come. For us our leadership principles embody everything that we're doing across six key aspects, which are measured at every part of our organisation. For those of you that have been to Pioneer, you'll understand that we measure calls with our account managers talking about customers against our leadership principles, right through to my executive team and the way that we deal with the people within our business and the way that we deal with you as well, in terms of total transparency, total honesty and a complete picture so that you have a very full understanding of Pioneer Credit about what it does, the way it measures what it does, and also what you can expect from it in the future.

On **page 11**, we start talking about how Pioneer is different, and it's a really important part of our business for you to understand. Firstly, in PDP selection, as you're aware, Pioneer only invests in tier-one customer portfolios. Generally speaking they are banking and finance related with a preference for credit cards and personal loans. We do not and have not ever invested in Part IX accounts, bankruptcy accounts, telecommunications, or utilities and we have absolutely no payday, SACC or MACC accounts in our portfolio. We are about building a portfolio of quality consumers that we can rehabilitate over time and that we can then grow with into the future.

It's taken a long time to build this portfolio and the quality of it is entirely demonstrable through the results that we've seen up until today and will in the future. In the way that we bargain for PDPs, as you know, Pioneer Credit is relationship based, and also based on our differentiated service offering. There is no future in us being the highest priced payer of portfolios. If we can significantly or sufficiently demonstrate that we are different to others and that there is a reason for brand and image conscious banks to be investing with us and selling to us at a lower price point, but again, one that is a long term sustainable price, then that's a very good position for us to be in. As we've seen, with the shake out in the banking sector, and also in our sector, the weight of opportunities coming to Pioneer has increased over the last few years. Our liquidation profile is, of course, a little bit longer than some of our competitors because our portfolios consist of better quality customers with higher average balances. So it may take us a little longer, but as you'll see in future slides, we also expect that the liquidation will be more material from a multiple perspective.

On **page 12**, we talk through a couple of the key considerations for our vendors. One is purchase certainty. Pioneer employs a strict discipline. We always have. Going back a couple of years ago, we had almost no growth in PDPs while we sat out and while the market was shaking out what seemed like higher prices to us, and ones that weren't sustainable. That has now turned around and our ability to invest at the price points that we're comfortable at, has opened up even further. Subsequently, Pioneer has never defaulted on a PDP agreement. This is almost unique in this sector. From a bank's perspective, they want people that can complete contracts for the long term and Pioneer has a reputation for doing so. Then to brand protection, as we said, no low quality customer accounts, no part IX, no bankruptcy, no telecommunications or utilities and absolutely no payday, SACC or MACC.

On the flipside, we want to provide great service to our customers. We have introduced net promoter score into our business and have a +13 score which is quite remarkable for any sector, but particularly when you consider the hardship that some of our customers have faced and are facing, and the difficult times that some of our people have with working with these consumers to get them back on track. They do a remarkable job.

Our unique compliance record remains exactly that, unique. We have never had a negative outcome with an ombudsman, never had a reportable systemic issue and have never had a regulatory enforceable undertaking. All of those things resonate with the credit risk teams inside banks and other institutions as they're looking for partners that are different to others and that will represent their brands well. Pioneer is the only group that can say those three things, and it's one of the few groups entrusted with banking customers in this country.

On **page 13**, we have a slide on "expensing rate". I'll caution upfront that this is an illustrative slide based on our understanding of the market, and what we understand is what a business might have in their portfolio liquidations. But to walk you through it, Pioneer only invest in banking and finance product and what we are saying to you is that we expect to get a multiple of four times. This has an inferred "expensing rate" of about 25%.

In other businesses, they are buying mixed portfolios which include banking and finance, part IX and bankruptcy, telecommunications, utility and payday. Were those portfolios liquidated in the proportion that we have taken you through today, to 100%, a 51% expensing rate would result were it to happen in Pioneer at the moment. Pioneer does not invest in those portfolios. It invests in banking only, but the distinction is important and the clarity around why our CIV expensing rate is what it is, is important.

On **page 14**, I talk through the vendor investment mix, again another really important part about the growth and the success of Pioneer.

When we listed in 2014, our single largest client was 77% of our investment that year. We had five vendors. If you look at where we are now, the largest customer we have or the largest vendor we have represents just 32% of our business, and we have nine vendors this year. This demonstrates the broad acceptance of Pioneer into the banking fraternity and to the finance sector, and the resilience that comes into our purchasing programs, because of the diverse vendor base that we have.

On **page 15**, we talk through the geographic distribution of our consumer base and you'll see a new addition this year - which is near 3% of consumers that we own are in New Zealand. So, a really diverse portfolio spread across Australia in geographical proportion to the population, which gives us a resilience into the way that we liquidated various parts of the economy go through their various stages.

On **page 16**, we talk through the weighted average investment price. There are a couple of things to point out in particular in this slide. On the graph on the right hand side, the yellow bars are bank forward flow. This graph shows that this year is the largest investment we've ever had from the bank forward flow program. It's really important. Weighted average investment price remains below the 20-cent limit materially and demonstrates our ability to continue to invest at long-term sustainable prices and ones that underpin the return metrics of Pioneer Credit.

In addition, our average investment price excludes low value secondary and non-core portfolios that we've invested in since inception. These are very lowly priced portfolios, which we know would skew the price down and not give you the information you need to make an informed decision about Pioneer Credit.

So, as usual, we've provided you with the quality information that you expect, but also the cautious discipline that you expect from Pioneer Credit around the way that it reports to you.

On **page 17**, for the first time ever for Pioneer and also for the first time in this market, we are reporting on the multiples that are achieved within our business against the year in which they are purchased, or which we've invested.

You'll see from this that we are on track to target our 0.8 times investment multiple within the first year and 1.4 times investment multiple within two years. We also have a target of four times our investment multiple over 10 years, and you can see on the graph at FY13, in a period that's only five years ago, we're exceeding a 2.3 times multiple. The discipline that we've demonstrated over the years underpins our ability to achieve these multiples. It's also backed up of course by our service offering, and our ability to connect with consumers and have them work with us and us with them to get great outcomes for them.

With respect to the forecast payment arrangements, these are net of historical break rates and other downward factors to present to you the most cautious value of the expected liquidations. It also does not include accruing interest, which will become payable in future. We expect these returns to continue to rise in a material sense, over the coming period, and we will continue to report them to you so you can measure us against them.

On **page 18**, there are two graphs. The one on the right hand side is the historical graph, updated obviously for FY17, which you've seen before, showing the contribution of our portfolios to this year's result. They're all in line with expectations.

On the left hand side, cumulative cash and liquidations, you can see that over the last couple of years, cash is exceeding the investment, including current year, at an increasing pace. We expect that to increase in the future periods and certainly expect to see a material shift in that gap and the uplift of cash in FY18 and we look forward to updating the market with respect to that at the next reporting period.

Over the course of our journey as a listed business, one of the things that I've spoken about at length is the ability to have or the need to have an invested management, one that is aligned alongside shareholders and one that is committed to the long term sustainable growth of the business, and to the quality of the assets that it buys.

Page 19 - Pioneer is unique in this regard. Management is the single largest shareholder in the business. On a diluted basis, management owns just north of 20% of the capital of the business. A good portion of that comes through our equity incentive plan, of which we've got 14 participants. As you'll note from our announcement in July, we've removed short term incentives from the business, with the exception of the Chief Operating Officer and selected direct reports of hers such that there's only a fixed base salary for the rest of KMP and for the rest of the senior management team.

This is really important to ensure we are investing and rewarding only the long-term sustainable performance of this business, particularly given that the assets that we buy roll off over an extended period of time. As such, the rights that we have vest over years three to five. For example, with the Chief Risks Officer's award, 60% of his rights vest in year five. It is a long time to be aligned and to receive an incentive, but entirely appropriate so that we are focused on driving the right return metrics for all of our shareholders.

In addition to that, we made available to our four most senior executives a a loan agreement this year to acquire shares, which they have done to the tune of 250,000 shares each, and a near on $600,000 loan each, which they are repaying back to the business with interest. There's security against all of their holdings, so, this is the business that has exceptionally strong commitment from its people, and exceptionally strong alignment to the financial outcomes which we commit to you each year.

On **page 20**, we continue to talk through new product and what's happening in that world for us, in particular the expansion into new market sectors, where we're looking to leverage our skill, and expertise and infrastructure into adjacent market sectors. This of course is predominantly into the lending business to our rehabilitated customer base. We're also looking to extend that to our strategic partnerships, principally with Rewardle in the first instance where they have a reach of over 2.3 million consumers. Part of our engagement with those consumers is through our new offering, Credit Place, which deepens the customer's understanding of their financial health and provide free credit score and financial literacy education to our consumers.

We are well progressed with significant funding for growing our personal loan offering to the existing and new customer base. There are still some significant commercial agreements, which are in the final days of being settled, with the intention that we'll provide you with a full update at the AGM, which will be on 27 October this year.

That said, our Connect business is targeting breakeven on a run rate business by the end of FY18. For those that aren't aware, Pioneer does not capitalise expenses, unless they are genuinely assets or infrastructure type assets, where we invest in new products and new development. They are fully expensed and that includes, the Connect program, which we've been running now for a couple of years. So, we expect that expense to reverse next year and for it to become a contributing part of our business, with a full update and a full strategy to be explained to you at the AGM.

Finally to the outlook for FY18 on **page 21**.

- From an operational perspective, we will continue to grow our new financial products under our partnerships with Rewardle and Goldfields Money.
- We will continue to assess new PDPs and rollover existing PDP agreements early and hopefully also with greater volume.
- We will continue to use our usual discipline with the way that we approach PDPs by looking at every opportunity to learn as much as we possibly can and we will only invest where there is a great outcome or we can be certain of a great outcome for our shareholders.
- From an investment perspective at the PDP level, changing market dynamics will provide new and expanded relationship opportunities for us. We've certainly taken advantage of those over the past few months and the way that the year's looking for us, so much so that as we talk today, we've got investment contracted at $65 million for the period, with a target of $70 million for FY18. From a guidance perspective, clearly with the investments that we've made in the workforce expansion from the last year, we expect to underpin stronger earnings growth for us, which looks like a 48% increase in earnings expected with FY18 net profit after taxation forecast of at least $16 million.

I thank you very much for your attention during this presentation.

QUESTIONS

Question 1: Could I just get a little bit of clarity in terms of your expectations around the CIV customer charge or expense rate for 2018? Do you expect it to be stable and over what sort of time frame do you expect that to track towards that 25% that you mentioned before?

A: Keith John : The 25% is indicative, of course. We do expect CIV to remain stable, which would tend to indicate that we're performing slightly ahead of that four times multiple, and certainly we're looking to obviously continue to deliver on that. For the time being if you keep running it at about 23.1% that would be a reasonable expectation for the market. Again, though, we will continue to demonstrate discipline and we will be very cautious with the way that we approach valuation and measurement of the portfolios.

Question 2: So if we think about customer liquidations then for just a little bit, you're probably looking at something beyond $100 million for 2018. Would that be fair?

A: Keith John: We haven't released the liquidations number, but certainly there's a material uplift in expectations for this year and we'll absolutely be doing our best to crack $100 million for sure.

Question 3: Can I just ask about the operating costs, then. As the business grows, you're obviously going to need more staff and there are going to be higher expenses that will go towards that liquidation process as well. But can you just give us a bit of a feel for how those operating costs might look like into next year, maybe around your employee base for starters?

A: Leslie Crockett: One of the important metrics for us is the EBIT margin, which is exactly for that reason. So, as Keith touched on, through FY16 and FY17, we have had the investments in support office growth, and in addition in the second half of FY17, a significant growth in headcount in customer service personnel and the investment in training in that. That does cause, from a financial perspective at least, somewhat of a drag on EBIT efficiency. So those EBIT margins that have closed for FY17, we've been pretty pleased with in terms of representing the efficiency of our liquidation against that investment. As we continue to invest in the diverse income streams in Pioneer Credit, we'll of course continue to invest in people, but I think it's fair to say the EBIT margins you're seeing there, represent where we'll be in the short to medium term.

Question 4: I'd like to get a better idea around the first half/second half weighting for the PDP purchases anticipated in FY18 and whether you've put any thought to the magnitude of the figure for FY19 yet.

A: Keith John: As it stands, it's going to be broadly 50-50 in terms of investment for this half, given we've been successful in contracting so much early on. We do not expect to do any sort of material uplift from the $70 million, based on what we understand in the market today and the opportunities that we can see that exist for the next period. In terms of FY19, whilst we certainly haven't come out with anything of course, I suspect from where we sit today it would be disappointing not to do a similar level to FY18, though it's obviously very early in the piece and understanding what happens from a competitive perspective in terms of pricing will be important, going forward. We are reasonably confident that we're sitting in a nice period, and of course we've already got a reasonable amount of investment for FY19, under contract.

Question 5: I see based on your bank covenants and your current equity position and where your payout ratio is at, you can quite comfortably fund FY18 at a $70 million level but depending on a range of variables, of course, by the time you hit FY19, it may start to become tight based on where your credit facility is at. Do you envisage, potentially, scope to get an increase in your credit facility in FY19, if things are going according to plan, given that the ratio that they target will likely come down?

A: Leslie Crockett: You're absolutely right from the perspective of funding FY18. Very comfortable in that respect and it's been great to have that journey with Bankwest and with Westpac joining our syndicates. The way we look at capital management is as long as we remain disciplined from the perspective of the debt we take on, relative to the cautious value of the PDP asset, we see no end of appetite in that respect in terms of stepping forward into FY19 and beyond. Obviously, we'll be looking at a variety of ways of looking at both debt and equity funding going forward, but I've got no concerns, based on the current conditions, that we'll have any difficulty with that through the two to three year forecast period.

Question 6: You mentioned that your focus is on rehabilitating clients and potentially getting new revenue streams. Can you just add a little bit more colour, because even though it's off a low base, you seem to be growing the services revenue quite quickly. Please talk through what's driving that significant uplift and where do you think that part of the business could go?

A: Keith John: We haven't provided segment reporting at this stage, given the relative size of course of the services part, though fair to say that the greater proportion or the significant proportion of that services revenue is from our Sphere Legal division, who have been doing some fantastic work with a range of partners across the country. One of the things that we work on at Pioneer is not just having a single point of relationship with anyone that we deal with, rather, having multiple relationships across every aspect of our business, with as many partners as we can. Sphere is completing a range of work for some of the big banks, down to some of our smaller vendor partners, through to some of the new fintechs. It's not all recovery based, so that's growing out reasonably nicely.

On the Connect side, certainly, at the moment, that's a drag on earnings, and it is a material drag on earnings, because it's expensed and it's a very costly part of the business to set up. But we expect that to turn around quite quickly, particularly in the second half of the year and into FY19. So, hopefully, at the AGM, we'll be able to provide some more explicit detail about what that will look like to shareholders, once we've just settled the last couple of commercial points with some of our partners.

END OF TRANSCRIPT