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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 Tuesday 26 February 2019 and presented by Managing Director, Keith John and Chief Financial Officer, Leslie Crockett (with minor edits).

The Briefing followed the format of the 1HY19 Results Presentation released to the market on 25 February 2019, and the attached transcript is intended to be read in line with the 1HY19 Results Presentation.

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PIONEER CREDIT LIMITED (ASX: PNC)

TRANSCRIPT OF INVESTOR BRIEFING HELD ON 26 FEBRUARY 2019

The following transcript is intended to be read in line with the 1H19 Results Presentation released on Monday 25 February 2019.

Keith John: Welcome everyone to the Pioneer Credit first half results presentation conference call. I'm pleased to be talking to you this morning.

Clearly, the first half was a challenging half for Pioneer and one where we have made some changes to the operation and some tactical changes as we've gone through our business. I wanted to start by saying that looking at our Company in the context of just one half is not going to give you the full picture of what is happening with our business. What we have chosen to do, is what we generally do every year in our business, and that is, test and challenge our operation through the first half. If those changes are successful and if they work, then we use those in the second half and we continue to grow our business. The other is to remain disciplined in the way that we price.

I'll talk through the impacts of those on the business in the first half, which clearly, we have called out we are disappointed with, but also which we have clearly called out we have a plan to recover from and a logical path to deliver on the full year expectations of the market and what we have guided since August 2018, when we first provided our guidance to you and for which we re-affirm today.

Slide 3

Turning to slide 3 - a highlight of the first half financials. Liquidations were $50.5 million, up 9.6%. It's a tad below what we had been expecting but it is not unreasonable and certainly good growth based on the prior corresponding period. Pioneer typically has a skew towards the second half.

In relation to PDP investments, these are materially lower than what we had expected for the half going into the year, but for good reason. We invested $31.4 million during the first half, which was down about 29% on 1H18.

EBITDA was at $24.3 million, is continuing to show our strong cash generation and flat on the prior corresponding period. Net profit, of course, is at $5.5 million, down 33%. Leslie, during his part of the presentation, will talk through that number in particular. With respect to the full year, we are maintaining and reaffirming today our guidance. Liquidations of at least $120 million, PDP investment of $80 million, of which 90% is under contract, EBITDA of at least $65 million and NPAT of at least $20 million. It is important to point out that Pioneer has never missed on its guidance to the market. It does not intend to during this period and we'll demonstrate to you why and how we will deliver that number coming up.

Slide 4

On slide 4, we talk through some of the things that have occurred through the half. One is to test and challenge strategies through operations. We've always explained that if there is a challenge with this business, and at some point in time there will be, that it will occur because of what we do. By that I mean it is because we are continually trying to improve what we do in our business and clearly, that has an impact on operations. Generally, and most of the time that is a positive impact and we've seen that over the years as our cash has continued to accelerate. In the current period, it just has not accelerated as fast as we would have liked it to. We will recover that during the second half.

As we've said, there were strategies tested. These strategies resulted in lower liquidations and the impact of that is about $4.5 million in deferred liquidations for the half. These are not liquidations that are lost, they are simply deferred to subsequent periods. Importantly, as we have called out since the beginning of our listed journey, originators are continuing to prioritise Pioneer's differentiated offerings. At the very start of our journey, we spoke about – very, very clearly - why we were differentiated and the things that made us different and allowed us to deal at the different level and on different terms to the market and to the banks. The Hayne Royal Commission has accelerated that, but during the period, there was some realignment from some of our vendors into the timing it took them to bring their accounts to market or into their sale program with us.

We could have done what so many others do, which is short-term purchasing at inflated prices, to simply pump these results. We're a business of discipline. It does not happen at Pioneer Credit and did not happen during this period. Subsequently, we had our lowest period in some time of investment - $31 million. This has an impact on liquidations but the payback is very significant and will be with us for years to come because our investment price is some 20% lower than what we have paid over the past three years.

In an environment where others are talking about increased prices or challenges and increased competition for volume, this clearly flies in the face of what the market believes to be happening and is again demonstration of Pioneer's differentiated offerings, focus on discipline in the long-term and on the ability for it to continue to trade at price points which others think are not possible. This price excludes our low-value portfolios and our utilities portfolios so it is for the same products from the same vendors. It's a very important part, which continues to underpin our business, and will continue to pay us rewards into the future years.

Slide 5

Part of the reason why we've been successful in securing price points at the way we have, is because our continued investment in compliance and we've increased that even more through the half. That is compliance and infrastructure investment is part of our strategy to put Pioneer even further ahead than others that it might compete with for the product.

Finally, with respect to the tactical changes through the period with our personal loans, we've put those on hold pending a couple of things. One is regulatory clarity. Whilst we're not covered by the senate enquiry, in an environment where there is significant lack of clarity around responsible lending and other obligations, our view has always been prudent and in this period, what we have decided to do and what we've elected to do is to pull back from lending until that clarity is provided.

The other important aspect of this is our ROI. In an environment where we are purchasing at some 20% less cost than previously, obviously the ROI and the swing to earnings skews much more heavily in favour of our core acquisitions portfolios. So, we've elected to skew our capital towards that and that will remain in place until we either see that skew return or normalise and we get clarity from regulators with respect to lending obligations.

Slide 6

With respect to the path to FY19 guidance, there's a few critical points to make. It looks like a significant increase from $50 million to $120 million within a year. This is not an increase that we have not delivered on in the past. You will see from slide 6 that the liquidation split, half on half, is consistent with what we have done in the past and is certainly some way away from the most aggressive split that we've had in the past. So, this is something that our operation has delivered in the past and it is something that our operation will deliver this half. As we focus on our operational strategy, we've realigned that strategy back to where we were so we can deliver on the number, the emphasis on core operations with lending on hold as we've explained.

In terms of our investment, our investment discipline remains. We do not buy simply to meet short-term expectations. Our business is a medium to long-term business, focused on sustainable earnings and that is what you see in this presentation and what you see demonstrated consistently from us as a Company. We have numerous discussions underway with new vendors, in both existing and new segments and should we be able to conclude those in a manner that is beneficial to our shareholders, then we will do that and we will keep the market informed, as we always do.

Finally, we spoke just recently about our entry into the utilities market. Like everything we do, we start small. It is a small investment of some $2.5 million over the course of 12 months. It will not have a material impact on our earnings through the period, but it will give us the opportunity to test and learn and ensure that we can grow into this segment in a manner that is beneficial, and a manner that is consistent with the way that we treat our customers, so that we can continue to expand our profitability. Again, we'll keep the market updated with respect to that.

Leslie Crockett: **Slide 7**

Good morning all.

As Keith has noted, Pioneer has released our financial results for the half-year ended 31 December 2018.

While we achieved nearly 10% growth in cash receipted from PDP liquidations, we were disappointed with our bottom line result and we have taken tangible action to address this with a logical path to achieving guidance.

EBITDA remains an important headline metric for Pioneer with a clear linkage to the generation of operating cash flow. This has maintained steady on prior comparative period. PDP liquidations growth has been maintained and we will talk further to the profit impact of our investment in the business in this first half.

We confirm that the directors have declared a fully franked interim dividend of 4.31 cps, which will be paid on 26 April 2019.

Slide 8

Our investment outflows are serviced through free cash flow generated by PDP liquidations as well as proceeds from our extended financing facilities.

We demonstrate the importance of cash earnings on slide 8 with EBITDA and gross operating cash flow steady.

Keith has pointed out our lowest PDP investment in this half in recent memory albeit noting we have secured 90% of our guided $80m purchasing, meaning we see a strong contribution to the portfolio in the second half of well-priced and quality customer accounts.

Slide 9

To provide clarity on the composition of our result we have presented a profit bridge which on slide 9 makes clear the solid contribution of PDP liquidations to revenue growth period on period.

Investment in compliance and infrastructure in the first half has eroded this contribution. As Keith has outlined, we believe this was important in the context of continuing to differentiate positively and ensure we have responded to industry trends impacting our vendor partners.

Interest paid has exceeded the prior year comparative by over two times as a result of the subordinated medium term note impacting the composition of our borrowing and therefore on our weighted average cost of debt.

Slide 10

Additional context to the importance of cash earnings is provided by means of the cash bridge outlined on slide 10 which illustrates the period since our year of listing in 2014. The significant contribution of operating cash flow from PDP liquidations is clear - which along with the disciplined allocation of debt to investment in a quality portfolio provides the foundation for continued growth in the business.

Our Appendix 4D lodged last evening noted that there has been a qualification of the review conclusion at the half year.

The auditor's view is that sufficient and appropriate information is not yet available for them to determine whether the Group's accounting policy to classify PDPs at FV is appropriate.

We highlight this because we think it is important to understand these are reviewed accounts, albeit not audited.

PwC's review report has alerted users that there is an alternative approach. We provide additional disclosure on this in note 10 of the financial statements.

No clear determination by PwC either way has been made and we note that in the event Pioneer determined there was required to be a move to amortised cost, it is entirely possible that this may result in no decrease in reported profits, a decrease in profits or an increase in profits.

We feel their view is cautious and is understood in this context. The Company has determined an appropriate approach and along with others, is in dialogue with the Regulator to ensure appropriate reporting continues to be provided.

The review conclusion states that with the exception of not yet being able to determine if the accounting policy is appropriate, they have not become aware of any matter that makes them believe that the half-year financial report is not in accordance with the Corporations Act 2001 including giving a true and fair view of the Group's financial position as at 31 December 2018 and of its performance for the half-year ended on that date.

Under the amortised cost method there remains a requirement for entities to disclose the fair value of the PDPs and we would be able to continue to report this metric - including for financier covenant purposes.

For clarity we do not present with any unforeseen challenges with our financier undertakings should a move to amortised cost be determined to be appropriate. Our financiers are fully informed with respect to the qualification with the results release.

The Company extended its senior financier purchasing facilities during the year by $10m, on terms that are unchanged and now has a cash advance facility limit of $130m with borrowings drawn of $109.6m and a remaining capacity of $20.3m as at 31 December 2018.

Slide 11

Slide 11 illustrates the gearing head room and highlights that the company remains well positioned to support growth from the perspective of capital management.

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

Keith John: **Slide 12**

Thank you Leslie. On slide 12 we again reiterate our Pioneer principles and talk about our culture. Pioneer's culture has been something that has underpinned this business, not just in the way that we communicate with you in the very clear way and the very honest and open way with the market but also with our vendors in the way that they know what we are doing as a business, how we perform, what they can expect from us and also with our customers and the way that we deal with them. Our principles are the backbone of this business and are representative or drive the quality that exists and the integrity that underlines who we are as a Group.

Slide 13

Slide 13 really does highlight why we are able to invest at the price points that we continue to talk about and have clearly demonstrated this half as being materially different to other commentary that we've seen. Our culture, number one, inclusive and empowering. PDP selection - we have a strict investment discipline. We simply do not buy to meet short term expectations of others. Our focus as a management team is about driving medium to long term returns to the whole of the business. There is no-one in the executive of this business that has any STI or any alignment to driving a short term result. We are only about strengthening and growing over the medium to long term. Pioneer has never defaulted on a PDP agreement.

Vendor brand protection - No payday loans and a unique, unblemished compliance record. That is something that the risk teams and the credit teams within quality institutions understand and value. Our customer relationships are evidenced by an increasing net promoter score, now up to plus 19, quite a remarkable result when you consider the general state of a consumer when we buy them. A liquidation profile up to 10 years and as I said, long term incentives that vest over five years. The decisions we make today are the ones that our executives get rewarded on in five years' time, not tomorrow. So we need to be there and we need to be making good decisions for the medium to long term.

Slide 14

On slide 14, you will see very, very clearly the material decrease in price that has occurred through the half. This price excludes the very low value portfolios that we might have bought in the period and the utilities portfolios which are generally of lower price than others. So we are giving you a comparative to our traditional portfolios. The price decrease is representative of some 20%. It is material.

Slide 15

We expect it to continue for some time and we understand and value that our vendors are recognising increasingly, particularly in a post Hayne environment, that customer treatment must come first and that Pioneer is the clear leader with respect to that. All of that translates to our payment arrangement portfolio. You can see that it has grown through the period, up from $257 million at June 2018 to $295 million in February. It is slightly below where we were at the AGM but nothing that is not within the normal movements that occur within our business.

Importantly, across that are two key metrics to call out. One that we were alert to, a seven basis point decrease in the arrears. We keep aware of that. The other is the average monthly payment increasing from $211 to $239 through the period. We are alert to this. We are not a business that puts our customers under pressure, but clearly our customers want to pay back the money that's due and we make sure that we balance that with appropriate treatment of those customers, so there has been a material increase over the last few years and we keep a cautious eye on that.

Slide 16

Sustainable cash generation. You will notice in 2018 that 56% of our liquidations came from accounts less than one year old and importantly, we needed to turn that around and the reason we needed to turn it around is because we need to continue demonstrating that there is depth across all of our portfolio. We have done that in a very material way and as we have expected and as we highlighted to you at our last update - 49% of our liquidations came from accounts less than one year old, showing really solid growth across the balance of our portfolio.

We do caution, in the event that we ramp our investment in future periods, you may see that year one contribution increase again. We have no plans at this stage to ramp our investment, though clearly with growing the business we will do that when we are certain that any increased investment is repeatable. By that I mean if we increase our investment to $100 million, we need certainty that we can continue to invest at that level for at least two to three years. When we are certain of that and we feel we are not far away from it, then we will announce back to the market and keep you informed as we always do and then we will move with caution through that growth phase.

Slide 17

On slide 17, we talk through our cumulative cash generation and importantly you can see the exponential growth of the cash generation over our cumulative investment. You should continue to see that and clearly it's important that we generate more cash than we invest. That's how we make our money, but we're very happy with the way that our cash continues to grow in this business.

Slide 18

On Slide 18, in our personal loans, we talk to the portfolio. There are some very quick metrics there and I don't propose spending much time on it. Arrears are very low as you would expect. As I mentioned, in short, once we have certainty from regulators and we can better balance our ROI opportunities against PDPs, we will re-enter this space at that stage but very happy with the book that we've written to date and the quality of the customer accounts that fit within that.

Slide 19

Finally onto FY19 outlook. Prior to starting, I want to acknowledge my team and all of the work that they have put in and our Board over the course of the last 12 to 18 months. Whilst we might be a tad bit disappointed with the result that we have today, the underlying quality that exists in our business is very strong. It is impressive and it will pay us back in periods to come. There has been a significant amount of work that has gone into doing that and I acknowledge in particular Leslie Crockett, my CFO, Sue Symmons, my General Counsel, Lisa Stedman, my Chief Operating Officer and the rest of the team at Pioneer.

In terms of our outlook - Innovation - as we have called out on slide 19, we will continue to invest in new operational strategies. None of this is different to what we have done in the past and that is absolutely what we've called out to everyone whenever we've had the opportunity to meet and talk. Some of those strategies work and some of them don't and we pivot them to meet our commitments to the market, but we will continue to test new strategies throughout our life in a controlled manner. Our InDebted machine learning platform pilot has commenced. We've got 20 people working on that at the moment and it’s expected to run at least to the end of this financial year.

M&A opportunities - we have spoken about this. They are plentiful, but so far, those that have settled have been materially beyond what our view of value is. It won't always be the case, but again, we're not a business that will move just because we should be seen to be doing something. We're a business that moves because it makes absolute certain value or delivers absolute certain value for our shareholders. Industry consolidation has begun and we expect that to increase. Pioneer has a deep leadership team across multiple disciplines and they are ready to be deployed into acquisitions should we be able to finalise one on terms that we are comfortable with.

Slide 20

Finally, changing market dynamics drive relationships for Pioneer as a provider of differentiated services.

Our lowest first half investment price in over three years and continued demonstration of our ability to invest on attractive terms. Unequivocally, originators are choosing Pioneer's quality over price. We expect this to continue.

Our investment guidance remains at $80 million. There are significant opportunities for us to invest today. We do not expect to increase through FY19. It is not prudent at the moment. As we have said, it must be clearly sustainable and repeatable for us to do that, and we expect that we're not far from that and it's likely in future periods. As that occurs we will keep you informed.

Finally, we reiterate our FY19 guidance. An 18% increase in liquidations to at least $120 million, 20% increase in EBITDA to at least $65 million and a 14% increase in net profit after taxation to at least $20 million.
I thank you for listening to the presentation for our results and now invite any questions.

QUESTIONS

Question 1: Could I just get a bit clarity in terms of when you think the auditor might make a decision in terms of the fair value method of accounting that you use, and also how attached to that methodology you actually are. I'm not sure in terms of how the amortisation method would work for you guys, but if I used a similar rate to your competitors you would have made a loss in the first half of '19 and probably barely make a profit for FY19 in total. So I was just wondering if you could give us some clarity on that.

Response: **Keith John:** Firstly with respect to using a similar rate to our competitors, we don't believe that's appropriate. We purchase entirely different asset types than what they do, and subsequently we have an entirely different liquidation profile to what they do, and it's impossible to compare the two at that level.

We believe that fair value is the appropriate method. We've taken significant advice on this on the whole way through and unequivocally what we know and what the auditor has opined on is that should a change be made to amortised costs, you must also report fair value which we do.

That said, there is no determination that we move to amortised costs or others move to fair value or the status quo remains. There is dialogue with the Regulator and should it become the case that anyone needs to move, I suspect that they will update the market at this stage, but we are very comfortable with our determination and clearly the value that exists within the business.

Question 2: You mentioned also a 20% level that you've been purchasing or less than. Could I just get clarity on that? Is that 20% below your previous level of purchases or 20% below where the rest of the market has been purchasing PDPs at?

Response: **Keith John:** Yes, that's 20% below our previous price point, which we've called that out on the slide 14.

Question 3: Could you make any sort of comments around the competitive landscape in terms of supply and demand. We have heard that some of your competitors are getting access to capital and may be being a bit aggressive in terms of their purchasing. I'm wondering how you're seeing things at the moment?

Response: **Keith John:** Undoubtedly, there's lots of commentary in the market with respect to what others are doing and access to capital and so forth and no doubt some of that is happening. It's a little bit difficult for us to comment with any certainty because no one else publishes with any detail what they're doing in the market and what is actually occurring in the price points at which they do that.

Our view is simply that Pioneer has ample opportunities to continue to invest. It could invest significantly more than where it is today at price points that we're very comfortable with and we suspect that that will become sustainable or repeatable. We just can't see it yet, but we're 99% of the way there. When we get 100% of the way there then we'll grow our investment through $80 million to a higher number.

Question 4: Thank you for the presentation. You mentioned that you don't do half-yearly targets which I understand and you do internal targets. How often are those internal targets reviewed and secondly, when Keith decided not to participate in the dividend reinvestment plan, how were the targets then tracked against that?

Response: **Keith John**: With respect to the first question, we have internal expectations. They're set at a Board level in April or May each year in a budgeting or through a budgeting process. Clearly we review those through the period, but if there was to be any reset it wouldn't occur until we have a view of the half, and then we'd communicate that obviously to a market. What we've communicated to the market today is that we continue to guide to $120 million in liquidations and a net profit and EBITDA that are on track with our original guidance, which obviously we're very comfortable with.

Question 5: You didn't participate in the FY18 final dividend reinvestment plan so I just wonder at what point did you make that decision and how was the business doing versus the targets? Did you know that this half was not going to be so good when you opted not to participate?

Response: **Keith John:** These are entirely separate matters and I don't comment with respect to my family's election to participate in a plan or not to participate in a plan, but I can assure you that they are entirely independent and not something that are decided upon within the context of the financial performance of the business.

Question 6:	Just wondering how are you finding the arrears compared to the tough consumer out there, considering obviously clearly house prices are on the nose and continue to be on the nose?
Response:	**Keith John:** Clearly the consumer is challenged. Not necessarily sure they are any more challenged today in our books than they have been in the immediate past. The very vast majority of our customers, well in excess of 90%, do not own a home so they've not been affected by any falling house prices. But it's a challenging environment. We're seeing a mixed response from the consumer and you will have seen from our payment arrangements the average payment balance has increased so that continues to fly in the face of what we hear about the consumer, but is consistent with a consumer that seeks to pay down its debt and get ahead. So we're happy about that. I don't have a better answer for you at this stage, other than to say that we're alert and cautious to what the consumer's doing, and whilst it's a tough environment we're broadly happy with where liquidations are and again we'll deliver on this year's commitment to the market.
Question 7:	I'm a bit concerned that the net profit after tax for the half was \$5 million but your forecast for the full year is in excess of \$20 million. Humphrey Appleby would say that's possibly a bit of a heroic assumption going from \$5 million in the first half to a second half net profit after tax of \$15 million. How confident are you really of that and if so, is that \$15 million - can that be forecasted for each half going forward beyond the current half?
Response:	**Keith John:** With respect to how confident are we - entirely, otherwise we wouldn't have released it. It's a number that has been endorsed by not just the management but also the Board and there's a clear pathway to delivering on that. With respect to what happens in subsequent halves, we don't provide commentary certainly this early in the piece, but we're very comfortable that the business will continue to grow from where we are today, though like I said, it's a tad bit early to be commenting on what will happen in the first half of 2020.I think our responsibility is to deliver to the market what our commitment is for the second half of 2019 and then we can absolutely talk with both confidence and excitement about what FY20 holds for us.
Question 8:	Just a second and maybe a comment - and I want to be a bit blunt here - in that you mentioned that you're always informing the market, and I've always been impressed about management's guidance of under-promising and over-delivering

and I've been very, very happy with that. I must admit I have been shaken with this last announcement. I believe you could have announced your tactical realignment to the market earlier. I had no sense of that at all.

Also I think you could have relayed the net profit after tax for the half, which is down, what, a third, to the market earlier. I'm sure you would have known that before the last couple of days. So I am disappointed and I think the market will probably be disappointed and somewhat shaken by that.

Response: **Keith John:** I appreciate your comments and I share your disappointment and - to the extent that's possible, we apologise for that. That's not what we seek to do. We don't provide half-on-half guidance so that's why we haven't released to the market with respect to where we are or why we didn't release to where we were at the AGM which is at the end of November.

That said, December was somewhat worse than what we had expected and we didn't think the number would be this either and subsequently it would have been moot were we to do that.

Our obligation is to deliver - and I'm not discounting your comments. I appreciate them and share them - our obligation is to deliver to the market a full year result. Pioneer is a business that has made a commitment to deliver a full year result, and has made a commitment to purchase at particular levels and short-term-ism does not make us successful and won't drive us.

So notwithstanding your comments that's our obligation and that's what we're focused on and that's what we've reaffirmed today as something that we will deliver to the market over the course of the next four or five months.

Question 9: You just mentioned there that December was worse than expected. How is January and February tracking then?

Response: **Keith John:** We are very comfortable with where we are with respect to January and February and we're in line with where we need to be to deliver the full year.

END OF TRANSCRIPT