ASX release **10 April 2019**

Investor briefing transcript

Attached is a copy of the transcript from Pioneer Credit Limited's (ASX:PNC) teleconference held on Wednesday 10 April 2019, presented by Managing Director, Keith John and Chief Financial Officer, Leslie Crockett (with minor edits).

The teleconference follows the release of a market update on Tuesday 9 April 2019 and was provided as a question and answer session based on that document.

Investor and media enquiries:

Keith R. John
Managing Director
Pioneer Credit Limited
P: 08 9323 5001
E: krjohn@pioneercredit.com.au

Mr Leslie Crockett
Chief Financial Officer
Pioneer Credit Limited
P: 08 9323 5008
E: lcrockett@pioneercredit.com.au

PIONEER CREDIT LIMITED (ASX: PNC)

TRANSCRIPT OF TELECONFERENCE HELD ON 10 APRIL 2019

Keith John: Thank you and good morning. By way of introduction, this morning on the call from Pioneer we have Lisa Stedman my Chief Operating Officer, Sue Symmons, Company Secretary and General Counsel, and Leslie Crockett, Chief Financial Officer.

I would also like to welcome members of the Board who have dialled in today, our advisors, and all shareholders and interested persons that have joined the call this morning.

The intention today is to open the floor to questions from you with respect to Pioneer's presentation released to the market yesterday afternoon.

The essence of the presentation is that we have now considered the alternative method, amortised cost, for classification and valuing our Purchased Debt Portfolios (PDP) and present you with a comparison between that method and fair value through profit or loss which Pioneer uses. Prior to opening the floor though perhaps let me highlight a few matters.

Firstly, irrespective of where the industry, Courts or others settle with respect to classification going forward, Pioneer will report using both methods for at least the next two periods. This will facilitate comparability for users of the accounts. By that I mean true comparability will only be available when there is full and complete disclosure in accounts for all market participants. Pioneer has always provided this, and it will now do that also for amortised cost.

Secondly - an important point to call out at the beginning of this call. To be clear, both methods must reforecast future cash flows at each reporting date. There are in essence only two differences between the methods. Number one, under fair value through profit or loss, the initial measurement is the investment or the price paid for a PDP. Under amortised cost, it is the price paid plus the transaction costs.

The other difference is the rate used to discount or present-value the cash flows. Fair value is benchmarked to market, and amortised cost is set at inception. Pioneer has always sought to benchmark to cautious markets. We disclose our discount rate and that is currently 20.1%. We provide significant comparisons in our accounts with respect to how movement to this could affect value.

Finally, both methods have value movements up or down in the re-estimation of future cash flows. It is the same re-estimation under both methods.

In short, let me open the floor with this. Under amortised cost for Pioneer Credit, liquidations do not change. The amount of cash we report at the end of this year will be exactly the same under both methods. Cash flows do not change. They will be the same under both methods. And over the life of an asset, profitability does not change. They are the same under both methods.

As we have highlighted in our presentation, having completed our preliminary assessment we now expect that net profit after taxation for FY19 will be similar under both methods.

I will now open the floor. A copy of this call's transcript will be released to ensure all market participants have the benefit of today's discussion.

With that I invite your questions.

QUESTIONS

Question 1: We hear that you use your discount rate of 20%. That would compare with the internal rate of return method that uses the internal rate of return on purchase, which is typically a lot higher than that. So why would not the fair value method bring forward to P&L profits during the life of the asset compared to the other method? Hence, how can you say that your profits are unchanged?

Response: **Leslie Crockett:** The requirement under amortised cost is to calculate an effective interest rate based on the fair value at inception and the expected future cash flows over the life of the asset. The fair value, as we have said is commonly based on the transaction price in our industry for PDPs (plus transaction costs) under amortised cost. To calculate the effective interest rate it is the internal rate of return (IRR) against the estimate of cash flows at inception. Where that estimate of cash flows at inception gives you an effective interest rate (EIR) equivalent to the discount rates that occur under fair value, you will get the same results.

Question 1 cont'd: I thought the market for that internal rate of return was sort of between 30% and 40%, not around 20%. So if you buy things and bring them to book at 20% you're just getting an uplift on day one through your P&L.

I understand the cash flows are absolutely the same under both scenarios, that's axiomatic. But it's just really the accounting for P&L and therefore the impact on your balance sheet.

Response: **Leslie Crockett:** The first thing is, I'm not aware of any disclosure around the discount rates you've quoted. The second part is, to some extent you have answered the question yourself. If the price was set at inception and a set of cash flows is the same under both methods at inception the IRR and therefore the EIR must be the same.

Question 1 cont'd: Right, but not 20%

Response: **Leslie Crockett:** If the IRR that occurs for a given price and a set of the future cash flows is 20%, that will be the EIR.

Question 1 cont'd: Yes, absolutely, yes. So when you say cautious market conditions, where do we look for those parameters? Where would you shine the light for us to understand what cautious market rates are?

Response: **Leslie Crockett**: What we are referencing there is when we benchmark, we have a basket of comparable rates for our products. We will have a mix of, for example, different credit cards or personal loans in our PDP. We will benchmark them to comparative rates in the market but for caution we will always select the highest of those rates.

Question 2: Just a follow up to that question. I do struggle with the analysis here on the gross IRR. You're indicating that the benchmark to market and the discount rate for the amortised cost method, I guess the rate is broadly the same, which implies your gross IRR is 20%. But you're still generating an implied accounting PDP return of greater than four times. Under that dynamic that would, I guess, imply a significantly inverted collections profile or an incredibly long data collections profile. Under the amortised cost method I would have thought an implied return multiple greater than four times would imply a gross IRR of close to 60%. I'm struggling to see how the discount rate on your fair value analysis and then on your amortised cost could actually be comparable.

Response: **Leslie Crockett:** We have provided extensive fair value disclosures in our accounts and we don't state in those disclosures that our valuation under fair value is based on a four times multiple. Under both methods there's gains and losses and under both methods the requirement to estimate cashflows every period is the same. Within our portfolio we have had some returns at four times and greater and we have had some that is not. We have made clear that under both methods over the life of the same PDP, the cashflow and therefore the profit returns are the same and under neither method is there a linear and simple relationship between multiple and change in value (CIV) or amortisation or any other type of expensing rate that's implied; and there are many moving parts to this.

Under fair value CIV is a direct output from a period end valuation. A similar principle applies under amortised cost, although it's impairment, gains or losses that occur on amortised cost and those would need to be included in the calculation of any implied amortisation rate as a direct output from an amortised cost calculation. Our presentation has illustrated that expensing rates are more directly related to product mix and our disclosed long term portfolio pricing and purchasing profile that we've got in the presentation again today has been consistent. The period end valuation processes we've used, which are fully disclosed in the accounts are robust, and is part of the accounts that is subject to audit with the Key audit matters in our audit opinion evidencing the rigour with which the audit of the accounts was performed.

As we have said, while our detailed analysis continues, our preliminary assessment on this has assisted us to develop an expectation that under both methods profit and value will be similar. We have said we will do both to facilitate comparability and with fullness of time that will be provided.

Question 2 cont'd: I mean if I add up since listing all the amortisation charge put through and the gross revenue, that implies, your accounting profits implies I guess, a return multiple of more than four times. I guess I'm struggling with this because the accounting policies are materially different. One, your fair value accounting, you can arbitrarily choose a discount rate. Under the effective interest rate method you don't have that ability. You've basically got to imply an IRR or a gross IRR. I think what you are indicating here is that a gross IRR on your book is similar to the 20% arbitrary rate that you chose under the old method which would imply - therefore you're implying the gross IRR on your PDPs is only 20% then. Is that what you are indicating?

Response: **Leslie Crockett:** I think there's a bit of a misconception there that we get to choose an arbitrary discount rate. The valuation requirements under fair value are covered by a specific accounting standard which is called AASB13 *Fair Value Measurement* and it requires that there is an approach taken to apply discount rates based on market comparable rates. I don't think it's fair to say that it's an arbitrarily chosen rate. Our assessment on this is that for a given set of prices, for a given set of PDPs and for a given set of cashflows which are the same for a given set of PDPs, the discount rates will be similar. The concept of simple straight-line assumptions on amortisation or expensing rates is flawed.

Question 2 cont'd: Sure, I guess but what you are indicating here, because you did use a discount at 20%, what you're indicating is that the gross IRR under the amortised cost method, the effective interest rate that you're setting in inception is a gross IRR of around about 20%. Is that right?

Response: **Leslie Crockett:** The only way that would be different is if for any reason the relationship between price and the estimated future cashflows is different.

Question 3: This is a complicated area. I guess the vast majority of shareholders wouldn't have any idea of what it's about. My question is this. If you say that - and I just add to that, as shareholders we are reliant on management and the Board to ensure that the accounting treatment is in accordance with good standards and protocols. My question is this, you say that both methods are the same both in terms of cashflow and ultimate profitability. If that's true then why has the market downgraded the price so much?

Response: **Keith John:** I can't talk for the market to the extent that I can't talk to how the market prices stock up or down. Clearly there are two matters that have challenged investors with respect to our half year report. The first is the perception of underperformance for the first half. Now we've addressed that. We have reaffirmed guidance when we released that report, we reaffirmed guidance early last week and we have reaffirmed guidance again today. With respect to the market expectation we've been very clear about our commitment to the market and about what we expect to deliver.

The second is with respect to qualification and this was certainly a material matter from the feedback that we have had. The qualification was not with respect to value and it was not with respect to cash or profitability. It was with respect to the determination method used, or the classification method used, to value the assets. What it said clearly was that the auditor as yet did not have enough information in the market. We have responded to the market today we have considered the alternative method, albeit our work continues with respect to that, we expect to continue to provide more clarity as time goes on. But as we have stated, our expectation is that profits will be similar and the balance sheet will be similar under both methods which we will disclose for the full year.

Question 4: You've partially answered that Keith. The first question was really around qualification. Given as you say the qualification was placed upon the accounts based on the uncertainty regarding the actual scoping, if you like, or which way the standard is going to fall there because some uncertainty in a market place around fair value versus amortised cost. Now that your preliminary work has indicated there's unlikely to be a material difference is there scope to re-engage with the auditor or along those lines to have that looked at? That's the first question.

Response: **Keith John: T**here's scope to do anything. I mean, I think where we've landed as a Group and with our auditor and we're working collaboratively with them, is that there is no utility in re-issuing accounts. The numbers won't change by simply re-issuing them and the profitability and the balance sheet construct and so forth and the outcomes for that would be the same. So, no utility in doing that. What we're focused on is what we do from here. What is true is that at the moment there is a lot of work being done around the world with respect to the appropriate method of classification. There are other groups around the world and one of them has reported using a tier one auditor now that has shifted a material part of its assets to fair value. Our discussions continue with both ASIC and with PWC with respect to the appropriate method. We are working through that. It's a collaborative process. We are comfortable to report under both methods, which is why we're going to do it. The reason we have not adopted amortised costs is because the Board has to determine itself the appropriate method with all of the evidence it has in front of us. To date every bit of evidence considered by the Board points to fair value.

Now, we are alert to the challenges this might create, but that is our obligation and the Board is exceptionally strongly focused on making sure that we execute our duties so that the information presented to you is as required under the standard and is the most useful. But, like we said, for the time being we will report under both methods so there is no ambiguity and that people have a very, very clear view of what Pioneer looks like irrespective of classification.

Question 4 cont'd: The second question you sort of touched on a bit there too Keith was regarding balance sheet. I read a newspaper article just yesterday about concerns about the balance sheet with Pioneer Credit and the like. I mean on our numbers your ratios are coming down. I think your covenant is set at 55%, your internal is at 50% and you're running at 45%. I mean can you just give us any more insights into any aspects of balance sheet that may be stressed or otherwise because I'm just trying to understand that a bit better.

Response: **Keith John: C**learly we don't respond to media reports, but I'm more than happy to talk about our balance sheet. The balance sheet is strong. There is no requirement to raise capital. There are no covenant pressures. There is no covenant pressure whether we adopt fair value or we adopt amortised costs. There is no funding pressure and there is a normal expectation that our banks will continue to support us and roll over contracts in the normal course of business and there's nothing to suggest otherwise in our engagement with them. We are entirely comfortable with where we're at. We are entirely comfortable with where we are as a business and curiously and understandably in some parts questions get raised when share prices drop, but operationally this business is performing strongly and we are very comfortable with where we're at and we are pleased with what we see in front of us.

Does that provide you the clarity?

Question 4 cont'd: Yes. I think we're reasonably comfortable with it. I do think it's just trying to understand what the views of the marketplace are, where

	they're coming from and what sort of data they might be using to form those views.
Response:	**Keith John:** Well I can assure you that from anyone that's commented publicly about us or spoken to the market, not one of those people has rung and engaged with the Company. I find it amazing that anyone could make anything that's considered an informed comment without having engaged with the Company first. As can be seen from the call today and as many of the people on this call will know, we are an open book. If you have a question, we are more than happy to answer it. If you have a question, we are more than happy to take your phone call and we will provide full information to the extent that it's publicly disclosed and run through that. Where it requires disclosure because of mis-information then we're more than happy to address that.
Question 5:	Just in relation to the cashflows. If I can refer you to the 2018 cashflow accounts. What I struggle with is that your cashflow, first line, $105 million received from liquidations and the second line is the payments to suppliers and then you have to go to investing activities and acquisition of financial assets, the $84 million. I'm just struggling to understand how one cashflow is in the investing and the other is in the operating.
Response:	**Leslie Crockett:** The simplest answer is that it is the requirement under cashflow standard reporting. Perhaps a more full answer is the requirements to include cashflows from PDP liquidations in operating activities is because that's the operations of the Company. The requirement to disclose the payments for PDPs and investing activities is because it's by way of the nature of a long term investment given the PDPs will liquidate over a long term period.
Question 5 cont'd:	So if you look at the $105 million that is a collation of PDPs over the previous x number of years. Is that correct?
Response:	**Leslie Crockett:** For a cashflow statement at a 12 month period it is the liquidations for the preceding 12 months.
Question 5 cont'd:	But why is the acquisition not really part of the cashflow of the operating activities?
Response:	**Leslie Crockett:** It's the nature of statutory disclosure requirements for a long term investment and the PDP that will liquidate into the future.
Question 6:	I just wanted to know why the auditors are requiring more information. This wouldn't be the first time that you'd be reporting to the market.

Response: **Keith John:** I think it's fair to say that the Company has provided all of the information it can. There is engagement with the regulator, there are differing views in the market and the first instance of application of the standard in the mandatory form was for this reporting period for Pioneer. With ambiguity in the market they've said that they require further information. I would like to give you a more precise answer than that. What I can tell you is that we're working through that with the auditors and with the regulators and we hope to land on a position soon. But again, irrespective, we will report under both methods and that should satisfy everyone with respect to what's in our accounts.

Question 6 cont'd: Does this mean then that there are issues with the regulator?

Response: **Keith John:** Not at all.

Question 7: Sorry guys, just a follow up. On this presentation has the auditor agreed with your preliminary assessment that there's no difference between the accounting policies or is this something that hasn't been discussed with the auditor?

Response: **Leslie Crockett:** I think we should be clear that the presentation is not audited. The audit will progress through the year end process and the nature of this presentation is an update based on our preliminary assessment.

Keith John: Thank you to everyone that joined the call today - I thank you for your time. We hope that the update to the market provides the clarity that the market has been looking to receive and should you have any further queries of course we invite you to call the Company direct. Have a good day.

END OF TRANSCRIPT