pioneer credit

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Investor briefing transcript

Attached is a copy of the transcript from Pioneer Credit Limited's (ASX:PNC) investor briefing ("Briefing") held on Monday 27 February 2017 and presented by Managing Director, Keith John and Chief Financial Officer, Leslie Crockett.

The Briefing followed the format of the 1H17 Results Presentation released to the market on Friday, 24 February 2017, and the attached transcript is intended to be read in line with the 1H17 Results Presentation.

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About Pioneer

Pioneer Credit is a financial services provider, specialising in acquiring and servicing unsecured retail debt portfolios.

Pioneer began life as a financial services provider to people in financial difficulty. Today, with more than 160,000 customers, we continue to focus on helping people get their finances back on track.

In 2016, we commenced the next chapter in our growth story, with the launch of a range of products for our customers including personal loans, small business loans and car loans. We work with them to achieve their financial goals including home ownership, using loans we broker back through our valued banking partners.

For further information about Pioneer Credit see www.pioneercredit.com.au

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PIONEER CREDIT LIMITED (ASX: PNC)

TRANSCRIPT OF INVESTOR BRIEFING HELD ON 27 FEBRUARY 2017

The following transcript is intended to be read in line with the 1H17 Results Presentation released at 1:31pm (AEDT) on Friday, 24 February 2017.

Keith John: Thank you all for joining. My name is Keith John, I'm also joined today by my CFO, Leslie Crockett and Company Secretary and General Counsel, Sue Symmons. We're going to walk through the presentation predominantly led by myself and Leslie and then have questions towards the end of the presentation.

If we turn to Page 3 of the presentation there's a corporate snapshot of where we are in terms of our capital structure currently and the key highlights about our operating business. We continue to be as we've always been, a specialist acquirer and servicer of tier one retail customer accounts with a focus predominantly on big bank accounts, which are predictable and repeatable and entirely understandable with a high propensity to heal. We operate a unique and customer-centric service platform that is increasingly important in today's environment. We've seen that with some of the commentary by other participants in the markets lately, and it's flowing through to us now in terms of extra volume that we're seeing at price points that we are comfortable with purchasing at.

We have our set of leadership principles, which are critical to the way that we run this business and the standards we expect of our people, all of which underpin our customer-centric service platform, which is a key differentiator to us as participants in this market. We continue with our offices in Perth and Manilla notwithstanding that we've expanded and bought a portfolio now in New Zealand for the first time. We don't have an office in New Zealand and won't be opening a servicing platform there as we can adequately and fully service the New Zealand portfolio from within our existing operation. We now have portfolios spread across Australia and New Zealand.

Pleasingly over the last six months what we have seen is an increase not only in the share price but also in the liquidity of our stock. I have remained the largest shareholder at about 15 percent. There were no issues of shares in the period except for the Dividend Reinvestment Plan so there is just shy of 50 million shares on issue and an enterprise value at the end of the half of $166 million.

On to Page 4, which is an update on the Australian retail debt sale market. This is almost exclusively sourced from Kessler Debt Advisory, which is the predominant debt broker in Australia. Across 2016 we saw

growth in investment in portfolios of 53 percent up from 2013. With the emergence of a debt broker in this sector we've seen lots of smaller banks, telcos and utilities come to market as they're able to sell them in an affordable and an efficient manner. Previously it was a very expensive process for them to take stock to the market. So that has been a great source of new opportunities in the market. Banking and finance volumes however, were predominantly flat so they continue to tick along at what the banks refer to as “system growth”. That is, a couple of percent a year in growth. Most of the issuers are now transitioning to forward flows. Even the smaller issuers that previously sold spot or inventory type books are now transitioning to forward flow. This is good for Pioneer as it gives us predictability in the work streams coming into our business in what we are seeing and how we grow our head count and obviously in the revenues that flow from that.

There have been lots of smaller buyers coming to the market but the market share continues with a few of the key buyers, which includes Pioneer. Pricing has been high. We've spoken for some time about how pricing has been at levels that we’re not entirely comfortable with growing market share. This was the case through 2015 and 2016 where we spent $40 million and $42 million. This year it's entirely different. Towards the end of last financial year we saw a marked shift in the way that other purchasers were behaving and through the expectation of the banks, where they became much more focused on compliance and brand and reputation. Quality servicing is exactly where Pioneer differentiates itself.

As can be seen on slide 4, of all the considerations for people when they're selling debt, protection of brand and reputation remain number one. Compliance is number three and price is number four. So while price is a consideration, the ability for us to continue to buy at attractive price points, continue to differentiate ourselves from other participants and for us to continue to be a provider of choice for the banks, has been solid. Our strong position continues, particularly as we see the increased focus on the banks from regulators and the talk of banking royal commissions etc. This puts Pioneer in a good position through this year and for the next couple of periods.

Leslie Crockett: Good morning all, thank you for joining us and your continued interest in Pioneer. You'll all be aware we lodged our 4D and financial statements, reviewed by PwC, on Friday. Slide 5 lists our performance highlights for this half, in particular growth in PDP liquidations is up eight percent to $30.8 million. Pleasingly for us as we enter the second half, we have become very well positioned from a purchasing perspective, having locked away and secured forward flow through 2017. This has allowed us to upgrade our guidance on purchasing to $53 million.

The other key element worth mentioning from a profit and loss perspective is the continued caution in our change in value expensing

rates. This was 21.7 percent through FY16 and 22.5 percent for this first half.

We have, consistent with our intention on dividends, declared a dividend equating to 50 percent of profits.

From a balance sheet perspective, Slide 6, the key highlight for the half was continuing our journey with Bankwest. We've had a relationship with Bankwest since prelisting, and this year brought Westpac into the syndicate. We've now entered a $100 million three-year facility syndicate with Bankwest and Westpac. Approximately $63 million dollars was drawn as at 31 December with about $36 million therefore undrawn. This greatly assists our positioning in the pricing cycle that Keith has described earlier.

From a gearing perspective we remain comfortably within our covenants bearing in mind that the covenants are set on a cautious fair value.

From a shareholder return perspective, Slide 7, once again Pioneer has declared a fully franked dividend of 4.22 cents per share, that's up 17 percent on pcp. This represents 50 percent of profits for the period.

Keith John: Thanks Leslie. On Page 8 we run through PDP valuation and payment arrangement metrics. These are obviously critical to the way that we construct the balance sheet in our business and the way they flow through to our P&L. Important to note that we maintained our consistent and cautious approach to valuation. For those that have heard Leslie and I present before, we talk about a negative assumption bias where we try and look at the lowest set, or the worst set case of scenarios rather than the best set case of scenarios. We then use regression modelling to project the expected liquidations and then we calibrate that down by nine percent straight off the top for model risk and macroeconomic risk. We then use a discount rate of 20.1 percent to present value the expected cash flows. Note that there has been no change to the calibration rate or the discount rate for the present value through the period.

Like Leslie said, PwC continue as independent auditors and certainly worked with us through this period in working through fair value and ensuring that that caution remains. This is a critical part of what Leslie and I see in our roles.

In terms of payment arrangements, the number of customers on a payment arrangement has grown by just about 12 percent, which we're very pleased with. The average arrangement balance is important to call out because it's approximately ten and a half thousand dollars, and it goes to the quality of the customers that we're buying. Others in the sector have average payment arrangement balances of three to five thousand dollars and this is because they include telcos, utility and the like. We focus only on the tier one banking customers which subsequently have a higher balance. They also have a longer pay back

period so while we don’t recover all of our money in year one, we certainly recover lots of money over a 10-year period, and I'll take you through how that liquidates shortly.

Our interest rate across that portfolio, which contributes to accrued customers, is at 12.9 percent. It's down slightly from where we have been previously. Part of this is a reflection of decreasing interest rates and customer expectations around that. Part of it is our rewards program, which we run typically through the Christmas holiday period where we provide interest rate discounts to our customers in response to their good payment histories over the preceding 12 months. Of course, interest does not accrue to our top line or to our P&L. It accrues from the perspective of the customer but we don’t take any benefit of that until it's actually receipted into our bank account.

And also pleasingly, the instalment completion rate continues at 97 percent. This means that the customers that we re-originate, that is the customers that go through our platform, are re-originated properly. We put them on sustainable arrangements. This underpins our service offering, our differentiated customer strategy and our compliance and brand protection and shows that we’re originating these customers at least as well as the banks do, who have a similar instalment completion rate. This is a very pleasing metric.

On Page 9, cash flow generation, while we only invest in the portfolios that we've described, tier one portfolios and ones that we understand well, how we generate cash flow is very important. We generate cash flow that is at least as good as what we see in the marketplace with a multiple of approximately 0.8 times our invested money in year one and up to 1.4 times in or by the end of year two. This metric shows that we’re recovering money quickly and we've got good pay back on our capital invested so that we continue to reinvest that back into the growth of our business. And pleasingly, you'll see through the half that our liquidations from our book are continuing to grow. And that’s a really important metric because you want to make sure that we’re not just taking what appears to be easy money at the front end. We’re working with these consumers, we’re working through the good times and the bad times and we’re liquidating through the life of a portfolio and underpinning the real value that exists across the Pioneer business. That’s continuing to grow and we expect to see good solid growth in the second half of FY17.

In relation to the annual portfolio liquidations by investment date, we don’t typically guide an exact number for customer liquidations but it’s just north of $70 million. While it is more about getting the right result for the consumer today and our money will come in the future, we’re expecting some good growth through the second half.

In terms of product development, Page 10, we are really happy with the way things are going. Customer offering is in a test and learn phase for us. Firstly, it’s about delivering products to our consumers that they can

understand; secondly, that they need and value; and thirdly, in a manner which is pleasurable for them to receive. We want them to have a good experience. As I keep explaining to people in our business, the next time you sell someone something is the first time you get the opportunity to sell to them again, so make sure that we actually give them a great experience so that they will choose to buy off us again in the future. Our business is very much about making sure the delivery and the fulfilment process is on track.

Our primary brand in that respect is Pioneer Credit Connect and this is looking at working with our consumers that have paid off their account. As I mentioned, at the moment we're doing a test and learn type scenario where through our Credit Place offering we're testing against a thousand customer units per time at various age brackets and at various characteristics so we can understand when is the best time to be providing solutions to our consumers and what is the best manner to do that. This is something that we believe will really add to the Pioneer brand and the Pioneer offering over the longer term.

Pioneer Credit Connect is increasingly attracting new consumers. What we've found is our good customer treatment and the way that we grow our consumers has actually led to them referring us to other people across their relationships.

Credit Place offers free credit scores to consumers. It allows them to understand their credit history and also how they might go about improving their financial health. We've built in some very small educational offerings and it's really about growing consumers over time. And to use the snowball analogy, we acquire these consumers when they're at their smallest and they're in trouble and over time we work with them, we improve their financial health, they pay us back. And then we want to grow them through products so that they can ultimately go on and reach their financial goals, which for many people of course is to acquire a home.

We currently have four primary offerings. Personal loans, which we're offering to our emerging prime customers. There are no pay day loans, no SACC or MACC loans. It is genuine personal loans with an average interest rate of about 15 percent. This is being done through our partnership with Goldfields Money so it's currently off balance sheet, for us.

Home loans are being brokered back through a range of partners including our PDP vendors. It's been a really important development in our relationship with some of those vendors as they understand that Pioneer is such a good operator that we not only acquire customers in a really efficient manner and service them very well, but we also re-originate products that the bank can continue selling to them in the future. Of course, that underpins our value proposition back to the banks. We're not just an acquirer of customers now, we're also a

distributor for them in instances and something that continues to grow Pioneer's differentiation.

Car loans and small business loans are being offered through our other partners to our customers. And across all of those product offerings we've had meaningful growth through the half. We haven't produced any actual metrics yet as it's much more about how we're fulfilling the customer requirements and making sure that delivery channels are appropriate and a pleasant experience for our customers. We will further update the market at our full year results.

On Page 11, I am highlighting employee alignment. I've spoken before about one of the critical things in this business is to make sure that we have an executive that is lined up alongside your money and your client's money. And by lined up I mean lined up for the duration of an asset type not for the next year. We want to make sure that our people are incentivised for the long term. And that means that they must be sure that we're actually going to get appropriate payback on the money we invest and make an adequate return just as we've committed to you through your ownership of Pioneer. Senior management owns on a fully diluted basis about 19.2 percent of Pioneer. My equity is 15.1 percent and a little bit more once rights are included. Importantly, every member of my executive team has purchased stock on market so their capital is aligned with yours. I don't think there's another business in the sector that can say that.

The other part is our equity incentive plan, they are performance rights not options and they vest over a period from years two to five. The most significant of which vests 60 percent in year five for my chief risk officer. So it's showing that people need to be here for a length of time and we need to be performing to make sure that rights are actually earned rather than just having a free kick in years one or two and then leaving someone else holding the can when things go poorly. We don't expect that to happen in this business obviously and we spend a lot of time making sure we are laser-like focused on the returns that we provide, the assets that we buy and understanding them. And if there is not 100 percent alignment amongst my executive team, which also forms my investment committee, then we simply don't invest. So there's a very diverse group of people making sure that we get a great outcome for all of the shareholders and the stakeholders in this business.

On the next page, Page 12, is the outlook. I've spoken for some time now about what I think is going to happen in the market and what I believe will emerge in terms of the competitive landscape. I think we're now here. That is, as competitors continue to pay up, and competitors have paid up for some time now, ultimately what happens is there's a day of reckoning or a period of reckoning where that comes back and three things generally happen. One is they start spending less money. The second is they start saying that they're going to go harder at

consumers, that they're going to take more legal action against consumers. Thirdly they're going to start being a debt collector rather than a servicer of customer accounts. As soon as that happens the banks do one thing and one thing only. They go to where they know that they're safe, and that's where Pioneer comes into it. We're seeing that happen now very clearly, and for Pioneer it's a great outcome. It opens up opportunities for us to increase our investment with the banks at a price point which we're very comfortable at. It's also opening up M&A opportunities which we've spoken about for some time. We've said that it's important to be patient in this game and we think that this year is likely to be the year where we'll see some opportunities. We've spoken of the changing market dynamics, which are providing increased opportunities for people like Pioneer. We're very focused on making sure that 1) we continue to operate in the way that we've operated and continue to differentiate ourselves, and 2) that we position ourselves so that we can take advantage of opportunities that make complete sense for us as a company.

To do that we're expanding our customer service team through this period now by about 100 FTEs. For anyone that has been involved with our business you'll know that there is a long period in our business to bring people to become profitable because of the differentiation of our service and the offering that we put back to our consumers. We have two weeks in the classroom, 10 weeks on the floor and then three months of additional support through our business. It takes about five or six months for someone to become cash flow positive for us. This is a big investment this half in growing our capacity. That means that our NPAT is still guided to at least $10.5 million and we won't be seeing anything materially shift up at this stage with respect to that, but it will certainly position us for 2018 to take on more volume and to take on some other opportunities, which is what we've been doing.

The three points on that;

1) Our focus firmly remains on recruiting those that are a cultural fit for Pioneer. Western Australia at the moment is an attractive place to be recruiting people particularly as the mining downturn and other pressures continue in this state. There's been a very solid pool of quality candidates so far and we remain focused on making sure that we get those that meet the leadership principles and culturally fit Pioneer so that we can continue our great story.

2) There are strong KPIs in place to ensure quality standards are held up across that team and certainly across the operational team there's huge focus on making sure that we adhere to those.

3) And as I said, no measurable impact to FY17 earnings at this stage.

We've spent a lot of money on our credit analytics team. We've increased this team over the course of the last year, and we're now

using that expert team to improve customer liquidation through better understanding of customer capacity, propensity to pay and workflow optimisation. And obviously also retaining our focus on growing customer financial capacity over time.

This is not a business that's about extracting as much money as it possibly can today, this is about a business that is growing a consumer so that they will continue to always shop with us and always choose us. And we'll get a really nice return from that and they'll have a great experience from it as well.

On the final page in terms of guidance, as Leslie mentioned we've upgraded our purchasing guidance or investment guidance this year to at least $53 million, that is already contracted. This is very pleasing. Any additional investment from here will really only be if we're going to get better than historical returns. So we're really focused on making sure that we're buying sharper than ever for any new opportunities. We think there will be some opportunities, although as we've always been, we'll be disciplined in our approach as to how we look at those. And finally to confirm our net profit after taxation of at least $10.5 million for the full year, which we're happy to confirm and look forward to delivering through the rest of this period.

That concludes the presentation.

Questions Received:

1. *You mentioned expected liquidations are calibrated down by nine percent, you also mentioned the discount to present value remains unchanged. Just looking at those two elements I assume that we should expect a similar expense rate in the second half to be broadly similar to that of FY16 as well?*

Response – Keith John: We certainly don't see it dipping into the 21s again, so we think it ticks up from here. And we'll certainly be maintaining our approach, which is we'll be as cautious as we possibly can be. We obviously need to have that ticked off by the auditors and they're certainly not allowing us to be conservative, or ultra-conservative is probably a description more apt for us. Our focus remains on being as cautious as possible and seeing that number tick up a little bit more.

2. *Are there any sort of changes that you're looking at implementing or thinking about with regard to analytics? Any sort of refinements there that you're thinking about at the moment?*

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Response – Keith John: Every day. We brought Tony Bird in who was previously one of the senior guys at CBA and prior at Bankwest to head that team. He's spent a lot of time building that team out with a senior analytics manager out of CBA also joining us with people from across the banking sector and bureaus and so forth with experience across the world. So what we've really focused on is making sure that firstly, the team is expert and secondly, that we're employing only the very best people in there. There's a lot of work to go, we are essentially rebuilding the business at a data site from the ground up again. I suspect this is a never ending process. We are also implementing a new data warehouse through this period, which will help us with our analytics and make that more efficient than it might have been in the past. So lots of improvements, some of it focused on operational improvements and some of it focused on understanding consumers for new products and also more precise pricing of opportunities.

Keith John: Finally, thank you all for joining the call. By all means if you have any queries after this call or at any time my team, and in particular Leslie Crockett, Sue Symmons and I, are available to take those. Our details are on the presentations. Thank you for your support and I wish you all a great day.