Funding Circle

Half Year Results Q&A

9th September 2021

Samir Desai: Good morning and thank you for joining us for our H1 2021 results. Today, you have me Samir Desai, Founder and CEO, Oliver White, CFO and Lisa Jacobs, CEO Designate, joining the call. We are here to talk about our H1 2021 results, I will introduce the results and talk to the first section on our model, Oliver will cover the financials, and Lisa will talk to our priorities and future growth initiatives, but before we start, as you will have seen from the statement this morning, I have decided that after 12 years I will step back from being CEO from the first of January 2022 and move to a new role as a Non-Executive Director on our Board. Lisa Jacobs, our UK Managing Director, will become our new CEO. I have made this decision at a time when I believe, as you will see from these results and those over the previous six months, that the business is in the strongest position it has ever been. Lisa and I have worked closely together for 9 years, she has done an amazing job running our largest business and I am delighted she will become our new CEO. She is the best person to take the business to the next level in this exciting phase for the company. I also want to reiterate that I am not leaving the business and remain fully committed to Funding Circle as a founder, Board member and shareholder.

Samir Desai: I truly believe that we are entering the most exciting period of growth for our business over the next few years, both in our core business and new products, and I am looking forward to supporting Lisa and the team in my new role. Now let's get on to the H1 results, which I'm pleased to say represent a very strong period for Funding Circle.

Samir Desai: 2021 has seen us continue the strong momentum we experienced in the second half of 2020. Our Loans under Management reached a record level of approximately £5bn in H1 and we recorded originations of £1.6bn. In the UK, originations were up 109% year-on-year. Our technology platform is continuing to revolutionise the small business borrowing experience and now 60% of loan applications receive an instant decision, up from 50% at the end of the year. We have increased our expectations of loan returns on our platform for the second consecutive time. Covid was an unprecedentedly severe recession for small businesses, and the improving loan performance expectations demonstrate the quality and resilience of the loans we generate on our platform. We also continue to see high levels of demand from institutions to fund loans. This all translates into a very strong financial performance. The group delivered total income of £120.6m, up 19% year-on-year. We reached profitability for the first time in H2 2020 and I'm pleased to say we exceeded expectations in H1 2021 to deliver £53.3m of AEBITDA and £35.5m operating profit, and have now been profitable for a full 12 month period. This all results in strong growth in net assets to £254.1m.

Samir Desai: Looking ahead, we are seeing a number of exciting structural trends that really benefit Funding Circle and we will talk about these later on. In particular this year we have continued to see the acceleration in the adoption of online small business lending, which will benefit Funding Circle not just through the second half of 2021 but beyond. Following the Covid government guarantee programmes we have transitioned to operate our core loan product alongside the Recovery Loans Scheme in the UK as well as the existing SBA programme in the US. We will continue to roll out our Instant Decision Lending platform with a long-term target of 80% of loan decisions automated. We are also leveraging our technology platform to launch a number of exciting new solutions including embedded finance via an API, our new Flexipay product which launched recently and has had exciting initial results and we have opened up a waitlist for our Charge Card product. The group has an attractive financial profile: powered by the UK, we expect to be AEBITDA profitable on an ongoing basis and will invest in additional growth opportunities.

Samir Desai: Our mission at Funding Circle is to build the place where small businesses get the funding they need to win. We do this by delivering an amazing experience for small businesses, powered by machine learning and technology.

Samir Desai: At Funding Circle we have a long term strategy and you can see from the chart on the left hand side of the slide that we have consistently grown our Loans under Management whatever the economic environment. Additionally, there are a number of structural trends that have accelerated as a result of Covid and we stand to benefit from going forward. We are seeing a significant acceleration in the adoption of online borrowing. There continues to be strong demand from investors to fund loans despite the impact of Covid, demonstrating the quality and performance of our loans and the resilience of our platform. Small Businesses have ongoing financing needs to support their business as they exit Covid, and finally Government support, not just in the UK and US, but across every country in the world for small businesses, has shown how strategically important they are to economic growth.

Samir Desai: Small business lending is underserved by traditional lenders. On average, it represents less than 2% of bank balance sheets, but small businesses are 50% of GDP and 70% of employment. Small businesses are underserved as there is a big disconnect between how much the financial system cares about this type of lending and how much we as society care about it and that is why Funding Circle exists.

Samir Desai: Over the past 10 years, we have aggregated huge amounts of data and loan performance history, allowing us to develop incredibly sophisticated machine learning models. Our models include the £13 billion of loans we've lent to small businesses since 2010, 850,000 loan applications, data on 750 million repayment events, and we have built a proprietary data lake with 2 billion data points in it, containing data on 26 million small businesses. Our 8th generation machine learning models are three times as predictive as traditional Commercial Bureau scores, and this is creating a deep competitive moat around our business.

Samir Desai: Our technology platform is revolutionising small business lending. Borrowers can apply in 6 minutes, 60% of loan applications get a decision within 9 seconds and are funded within 24 hours. Through this process, we deliver high credit quality loans and competitive interest rates for borrowers, comparable or cheaper than banks. It is the combination of the experience we deliver on our machine learning and technology platform with loans funded by investors, that is the innovation that Funding Circle has created.

Samir Desai: This technology delivers huge benefits to our customers but also to Funding Circle. We reached 50% of loan decisions automated by the end of 2020 and I'm pleased today to announce we met another milestone, with approximately 60% of loan decisions in the UK receiving an instant decision. We are well on our way to reaching our long-term target of having 80% of loan decisions automated. Instant Decision Lending delivers a number of benefits, to customers but also to Funding Circle. We are seeing credit performance as accurate as non-Instant Decision Lending loans. We are using the same risk models developed over the past 10 years and credit performance has been strong. We're seeing higher conversion from borrowers. Getting an instant decision can improve borrower conversion by up to 25%. Lower processing costs and scalability from this technology are driving operating leverage in our business. In the first half of 2021, UK loan originations were up 109% year on year without us adding any additional headcount. This technology also allows us to launch new products, and you may have seen we launched FlexiPay to our existing customers recently and we will talk more about this a bit later.

Samir Desai: The great experience we deliver to small businesses leads to stable repeat rates and attractive unit economics. The graph on the left-hand side shows the average number of loans taken out by a small business, versus the months from taking the first loan. This shows very stable, predictable repeat rates across every quarterly cohort. The graph on the right-hand side shows the lifetime value divided by the marketing customer acquisition costs. This shows that we're profitable on a first loan basis after marketing costs and because of the stable repeat rates as borrowers take out more loans, our unit economics improve as there is very little marketing costs associated with the repeat loans. Over 48% of operating income in the UK came from existing customers in H1 2021, which improves the quality of income and increases the strong moats around our business.

Samir Desai: We are reaching a level of scale, brand awareness and customer satisfaction in the UK that is unmatched by other Fin Techs. We now have £4.1bn of Loans under Management which gives us approximately 4% market share. We have brand awareness of around 50%, which is significantly higher than other Fin Techs, and is approaching the level of the top four banks. In terms of customer satisfaction, we have net promoter scores of 83. That compares very favourably to the large banks and over 80% of customers tell us they would come back to Funding Circle first in the future. Once they experience this way of borrowing, they never want to go back.

Samir Desai: I am so proud of the huge economic impact our team is delivering. Since 2010, we have originated £13 billion of loans to over 120,000 small businesses. As we have talked about in the past, our Economic Impact Report with Oxford Economics showed that the lending through our platform in 2020 alone created and sustained 135,000 jobs and added £10 billion to GDP. Typical Funding Circle borrowers are not startups, they've been trading for an average of 12 years, have 8 employees, £1 million of revenue. On average, loans are £80,000 and the average term of the loan is around 50 months. An example is a business like Bird and Blend who saw a huge increase in demand during lockdown last year and managed to increase their headcount from 80 people to 100 during the last year. Supporting businesses like Bird and Blend are the reason we started Funding Circle in the first place and the team and I are as passionate about supporting them today as we have ever been. I'm now going to hand over to Oliver.

Oliver White: Thank you Samir. The diversification of our investor base is of strategic importance to Funding Circle. As the pie chart on the left hand side shows, our largest sources of funds are Asset Managers and Banks. The proportion of Banks is broadly stable and the proportion of Asset Managers has increased since December 2020, as new and existing investors participated in the high level of CBILs originations in the half. Within each of these segments, we maintain a diversified investor base. Retail continues to diminish as a proportion, now down to 7%. The Bond programme reduces through loan amortization and through the successful sale of the two US warehouses to an Asset Manager. National entities increase reflecting Funding Circle's participation in the US Federal Reserve's lending programme to facilitate lending to SMEs (the PPP LF programme). The right hand pie chart shows the proportion of the Loans under Management provided by Funding Circle's balance sheet. As a reminder, Funding Circle deploys its equity where it makes it's platform stronger. This may include limited co-investment and investment in new products. We see the ability to do this as a source of competitive advantage, we do not deploy capital with the sole purpose of deepening profit through investment returns. We intend to continue to recycle some of the investments over time as opportunity for realizations allow, as demonstrated by the previously announced sale of the US warehouses in June. Funding Circle's balance sheet now represents 2% of the total Loans under Management. This is £105m of equity, within the guardrail communicated at the Full Year results, of being less than the December 2020 level of £118m.

Oliver White: Turning to our loan performance and the returns provided to these platform investors. We continue to see an improving outlook for Funding Circle loans. Our borrowers continue to be resilient and loan quality continues to be strong, notwithstanding the uncertain economic environment. Our projected returns shown here include a forward looking element. We continue to be prudent, forecasting ongoing stress, as government support and interventions phase out ongoing uncertainty continues. In the UK and also in the US, the latest forecast shows a continued improvement in expected returns for our investors, the UK shown on the left and the US on the right. For each annual cohort of originations we show how the expected returns have evolved. As you can see despite the unprecedented impact of the pandemic, even those cohorts most impacted are returning a 2% plus return to investors. This demonstrates the robustness through-the-cycle of the asset class that Funding Circle has developed

Oliver White: This slide illustrates how Funding Circle makes money. Within our Operating Income, we receive transaction fees and servicing fees. Transaction fees are charged to borrowers, are driven by origination volumes and account for nearly 60% of Total Income. Typical yield is c 5%. Servicing fee are more of an annuity stream charged to investors at ~~c~~ 1% per annum and driven by the Loans under Management. Servicing fees have increased over time as Loans under Management has grown. Together the transaction and servicing fee income make up around 80% of Funding Circle's total income. Investment Income is driven by our equity invested where it makes the platform stronger. The yield will depend on the nature of the investment and its risk/reward characteristics. Investment income represents one fifth of Total Income in H1 21. Over time, we expect operating income will make up a greater proportion of total income.

Oliver White: Turning now to Funding Circle's H1 financial performance. Let's begin by looking at the Group results in overview. Here we show the performance in H1 2021 alongside the comparatives of H1 2020 and H2 2020. H1 of 2021 saw a continuation of strong CBILS originations in the UK and the recommencement of the PPP programme in the US. CBILs ended at the end of March and PPP ended in May, with subsequent fulfillment under both programmes. June saw the restart of our core product in the US, and the restart of core and the new Recovery Loan scheme in the UK. Loans under Management was at a record £4.9bn, up from £4.2bn in H2 2020. Originations volumes were £1.635bn, slightly up from H2 2020. This strong volume performance was reflected in total income of £120.6m, up 19% year on year. AEBITDA is £53.3m and operating profit is £35.5m. This is the second consecutive half of positive operating profit. The overall profit performance demonstrates the power of Funding Circle's platform model. I am pleased to show the rate of profit conversion from income and conversion into a cash balance of £168m. Net Assets grew to £254m. As I am sure you will agree, these are a strong set of results, demonstrating continued progress. I will now explain these results in more detail

Oliver White: In the UK, Loans under Management grew to over £4bn, as the strong origination levels in H1 and prior periods flow through. Loans under Management is up 59% year over year and 25% H1 over H2 2020. Originations are at £1.381b. This is up 109% year on year and 5% down H1 over H2 2020 as the end of H1 21 saw the market transition from the CBILs programme. This strong volume performance feeds through into record income of almost £100m, up 67% year on year

Oliver White: The UK has continued the strong profitability seen in H2 2020 with an AEBITDA of £41m, a margin of 41% and operating profit of £31m. This impressive margin shows the power of Funding Circle's platform at scale. AEBITDA grew £12m from H2 2020 to H1 2021. Operating income grew £5m, Fair Value swung £9m, reflecting actual performance in the half and retaining a prudent forward view, and there was a small increase in marketing costs, reflecting higher brokers costs and marketing ahead of the return to core and launch of the RLS loans.

Oliver White: Turning to the US. US Loans under Management was £733m, down 9% year on year and slightly down on H2. This reflected the expected roll off of our pre Covid loans and the limited originations seen in H2, partially offset by new PPP originations. Of the £733m of Loans under Management, £333m are PPP loans. We anticipate these loans will be forgiven in H2 2021 and H1 2022. Originations in the half were £247m, primarily through the restarted PPP scheme. This programme had some different characteristics to the 2020 programmes. Average loan size was lower, but the yield per loan was higher. In H2 of 21, we helped 3 times the number of borrowers than in H2 2020. Total income was £20.2m. An additional £16m of PPP income was earnt in H1, less £1.5m of direct cost. As these loans are funded by the Federal Reserve's Liquidity facility, they are on Funding Circle's balance sheet, although with no Funding Circle equity invested. As these loans are not held for sale but will be forgiven by the US government, we are required to spread this transaction fee earnt over the expected life of the loans. This expected life is until the projected forgiveness of these loans. This £16m will be recognized in H2 2021 and H1 2022.

Oliver White: In the half, the US is AEBITDA positive for the first time. This is primarily driven by the investment AEBITDA of £20.9m including a £7.8m Fair Value gain, again reflecting H1 performance and retaining a prudent forward view but also a £5m gain from the sale of the US Warehouses. Operating AEBITDA was negative £9.1m, but this is after the impact of the aforementioned PPP transaction fee deferral of £14.5m. Operating Profit is a positive £3.8m.

Oliver White: Putting this together for Funding Circle as a whole, H1 of 2021 saw record loans under management of close to £5bn, up 33% year on year and originations of £1.6bn, in line with H2 2020. Total income of £120.6m, is up 19% year on year and in line with H2 20 total income. Strong Loans under Management and originations has led to Operating income of £94.5m; up from £64.8m in H1 20 and £90.9m in H2 20. In line with our expectations, Investment income has reduced over time due to natural roll-off of the loans within these investment vehicles.

Oliver White: This top line performance feeds through into Group AEBITDA of £53.3m, up from a loss of £84m in H1 2020 and £20.3m profit in H2 2020. Operating AEBITDA is up at £19.1m and Investment AEBITDA, reflecting fair value gains, is up at £34.2m. Compared to H2 2020, fee income is up £4m, investment income down £4m, Fair Value swings £30m, and costs improve by £3m, with a small increase in marketing more than offset across other cost lines. Operating profit grows to £35.5m up from £7.2m in H2 of 2020.

Oliver White: Turning to costs. Operating expenses have continued to be actively and tightly managed. H1 costs were in line with H2 2020 and 12% down year on year. As anticipated marketing costs are slightly up on H2 at 29% of operating income, but are down year on year. We are beginning to see the return to more normal levels of marketing spend and expect to see broadly this level of marketing spend continuing.

Oliver White: Net Assets are £254.1m, up £37m since end December, as the profit converts into net asset growth. The net asset position includes cash of £168m up £65m from the December 20 cash balance of £103m. Within the net assets, are equity investments of £105m. Funding Circle deploys its equity where it makes the platform stronger. This may include limited co-investment and investment in new products. Our absolute equity invested at June 2021 is £105m. This is within the guardrail we communicated at the Full year results of no more than the equity invested at that time of £118m. I would now like to hand over to Lisa to take you through our ongoing priorities and new products.

Lisa Jacobs: Thank you Oliver. Today's results are another example of the strength of the Funding Circle business model. I am privileged to have been asked to lead Funding Circle into this next exciting stage of growth, and over the next few slides I will show that there are a number of future growth opportunities to be excited about. I know many of you on this call and I look forward to working with you again, but for those who I don't know, I look forward to meeting you in future. A little bit about my background, I've been with Funding Circle for 9 years, firstly as Chief Strategy Officer and most recently as MD of the UK business. It has been really inspiring to see the business grow and evolve over the last 9 years. We have achieved a great deal as a company so far, but there is still so much more to come.

Lisa Jacobs: As I look ahead to the future, we exited 2020 with a great deal of momentum and I am pleased that we have been able to continue this during the first half of this year The Funding Circle Flywheel drives significant competitive advantage. As we get more repeat customers on the platform, this generates more data. This feeds into our machine learning models, which improve. This allows us to deliver a better borrowing experience with more automation, less documents required, faster decisioning, and that in turn drives higher conversion, lower costs, and more operating leverage in the business. This technology allows us to launch new products, which expands the size of our ecosystem, which in turn leads to more repeat customers and more data.

Lisa Jacobs: Since Covid we have seen an acceleration in a number of structural trends, which benefit Funding Circle, and we've proven the power and resilience of our model. In the UK, following the completion of CBILs we are operating our core, non-guaranteed loans for borrowers as well as the Recovery Loan Scheme for other borrowers. We were the first FinTech platforms to be accredited to the Recovery Loan Scheme and we’re proud to be playing our part to help businesses at this time. Our other priority for this year in the UK is launching new products using our technology platform to help solve more small business problems and I’ll talk about this more over the next few slides. In the US, now that the PPP has finished we are originating government guaranteed loans through the SBA on behalf of banks. Alongside this, we continue to operate our referral model for borrower needs outside these offerings, partnering with other providers, given the scale and diversity of the US lending ecosystem.

Lisa Jacobs: The new solutions we have been working on in the UK are a particular source of pride to me. I have seen first-hand the level of innovation and creativity across the team to get us to a stage where we are ready for beta testing. Our new API will allow us to natively embed our Instant Decision Lending technology into partners' websites and platforms. We have been building the technology since the beginning of the year and we’re now in the sandbox testing phase with about 5 initial partners. These are in the commercial finance space initially and through 2022 we expect to on-board new partners and optimise the API.

Lisa Jacobs: We’re focused on helping solve more problems for our customers and the new products will help support small businesses to manage a number of cashflow and payments challenges. These new products also deliver a number of benefits to us as a platform. Firstly, they bring us into a more frequent part of customers’ lives. Typically our existing customers use our core loan product every 1-2 years, but FlexiPay and Card brings us more into daily and monthly usage. This extra usage enables us to accept more customers who in time graduate to longer term core loan products which supports growth in the core lending. Additionally, the market is huge in this space, we estimate over £1 trillion is the addressable market for UK small businesses and finally these products align with our mission as a company.

Lisa Jacobs: At our results in March we spoke about launching a payment finance product that will help small businesses spread the cost of bills over a 3 month period, and today I am really proud to say that FlexiPay is now live and in beta testing for our existing customers. This is a unique payment product offered, empowering small businesses to buy now and pay later. It's powered by our machine learning and technology platform and businesses can apply within minutes and access up to £30,000 immediately. They can then settle any outstanding invoices instantly for a one-off 3% fee and spread the repayment over 3 months interest free.

Lisa Jacobs: We launched FlexiPay in beta earlier this quarter and whilst it is still early days the feedback has been really positive. Firstly you can see on the right hand side of this slide that we have customers across the entire UK that are starting to access FlexiPay and the feedback shows that this is a product that customers feel can significantly help them to manage their payments to suppliers. I wanted to highlight two examples. Both Livity from Intrit and Carl from Advanced Joinery were two of the first users of FlexiPay and both spoke about how using FlexiPay enables them not just to manage their cashflows but also to manage and improve their relationships with their own suppliers, which could then lead to better terms in the future.

Lisa Jacobs: Finally, I wanted to spend a minute on our card product. As Samir mentioned in March, we are planning to launch a Business Charge Card product to help small businesses finance their day-to-day spending. The wait list is open and we are now well on our way for a 2022 launch. I hope that shows you the progress we are making with these new products and the possible opportunities going forward. I wanted to finish by saying how excited I personally am about our future. We have come a long way in the last 11 years, and the business today is the strongest it has ever been, but our best days are certainly still to come. I look forward to updating you all on our progress in the future and hopefully meeting you all in due course. Now I'd like to hand back to Oliver who will take us through the outlook.

Oliver White: Thank you Lisa. Turning to the full year outlook. The business performed strongly in H1 and the financial performance was above expectations. We are mindful of the uncertain economic environment however. In line with our expectations, there has been an initial reduction in lending as we have transitioned to operating our core loan product alongside government guarantee programmes in the UK and the US. As the economic environment becomes clearer, we anticipate an acceleration in lending and we are well placed to capture this going forward. We continue to expect AEBITDA will be skewed towards H1, with an expectation of H2 AEBITDA profit in the low single digit millions

Oliver White: As a reminder of how we think about Funding Circle in the medium-term. The UK is the engine of Funding Circle. It represents 80% of group total income. The business continues to offer operational leverage, is AEBITDA and Operating Profit profitable and indeed has been AEBITDA profitable since 2018. It is also cash generative. The UK business has strong growth opportunities in the core market over the medium term. Additionally we have growth opportunities in the US and in new products. The US is five times the size of the UK market but at an earlier stage of development. PPP provided a boost to volumes and revenues in H1 of 21 post PPP as we invest to grow market share, the US will likely be AEBITDA loss making for the next few years. We will carefully manage that level of investment. New products represent a big but early stage opportunity to support more customers by leveraging our technology platform. We announced the beta test of FlexiPay. These new products will generate a small income contribution initially, stepping up in the future following a successful roll out. For the group as a whole, powered by the UK, we expect to be AEBITDA profitable on a go forward basis and will invest in additional growth opportunities. Thank you