

Funding Circle Holdings plc

FY20 Results

25 March 2021

Transcript



Samir Desai: Good morning. It has been an extraordinary period for Funding Circle and I feel really proud of the huge difference we've been able to make for tens of thousands of small businesses during this period. We have proven the power of our model, taking our machine learning and technology platform to a new unmatched level, and have a number of attractive growth opportunities going forward. 2020 was a year of two halves. In the first half, we spent time responding to COVID, moving our team to remote working, and supporting small businesses through what was a difficult period for them. In the second half, we saw strong demand from investors and small businesses to access funds. In particular, in our UK business, we saw originations of £1.5 billion, up 91% year on year.

Samir Desai: Our technology platform is truly transforming the small business borrowing experience and we've reached our target of having instant decisions for 50% of loan applications. I'm pleased to say, we now expect all cohorts of loans to deliver a positive return despite the severity of the recession caused by COVID. I'm proud that we have not only survived during this period, but thrived, and proven the resilience of our unique model. The group was profitable in the second half of the year, delivering £20 million of Adjusted EBITDA and around £7 million of operating profit. In the UK in particular, we delivered £28.6 million of Adjusted EBITDA and £21.3 million of operating profit.

Samir Desai: We finished the year with robust net assets of £218 million. Looking ahead, we are seeing a number of exciting structural trends that really benefit Funding Circle and I'll talk about those in a minute. As we move into 2021, we will operate our core loan product alongside the Recovery Loan Scheme in the UK and bank SBA loans 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 will also leverage our technology to launch a number of new solutions to help small businesses, which I'm excited to talk to you about later. The group has an attractive financial profile going forward. Powered by the UK, we expect to be Adjusted EBITDA profitable and will invest in additional growth opportunities.

Samir Desai: We see a number of structural trends that have accelerated during COVID that will benefit our business going forward. 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. We are seeing a significant acceleration in the adoption of online borrowing. There has been a 5x increase in searches for online business loans in the UK in 2020. Strong demand from investors despite the severe recession has demonstrated the quality and performance of our loans and the resilience of our platform. I'm really pleased to say that during 2020, we were able to aggregate more than £2.5 billion of investor capital to lend to small businesses in the UK and US. Small businesses expect to have ongoing financing needs. 40% of small businesses that we've surveyed have said that they expect to require finance in the next 12 months, primarily for growth or investment as economies reopened. And we've seen the similar data in surveys by the Bank of England and the Fed.

Samir Desai: Our mission 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. 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. There's a big disconnect between how much the financial system cares about this type of lending and how much we all as society care about it. But for a disruptive technology business like us, this is a very large addressable market and opportunity.

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 £11.5 billion of loans we've lent to small businesses since 2010, 700,000 loan applications, data on 750 million repayment events, and we have 26 million small businesses in our data lake. Our 8th generation machine learning models are three times as predictive as traditional Commercial Bureau scores. And this is creating a huge competitive moat for our business.

Samir Desai: This is all powered by what I believe is the best technology and team dedicated to small business lending. We use the latest technologies, with continuous deployment, that enables us to scale quickly, efficiently and securely without being burdened by large legacy systems. We have built a proprietary data lake with 2 billion data points in it, containing data on 26 million small businesses. And this is used for our machine learning risk models and also highly targeted marketing. We have a team of 300 engineers, product managers and data scientists and we are investing to grow this team and our machine learning and technology platform capabilities in 2021.

Samir Desai: Our technology platform is revolutionising small business lending. Borrowers can apply in 6 minutes, 50% 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 low interest rates for borrowers comparable or cheaper than banks. It is the combination of the amazing experience we deliver on our machine learning and technology platform with low cost loans funded by investors, that is the incredible innovation that Funding Circle has created.

Samir Desai: This technology delivers huge benefits to our customers but also to Funding Circle. We have reached 50% of loan decisions automated, and we've set a long-term target of having 80% of loan decisions automated. Instant Decision Lending delivers a number of benefits 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 are driving operating leverage in our business. In the second half of 2020, UK loan originations were up 91% year on year without us adding any additional headcount. This technology also allows us to launch new products, which we will begin to do in the next 12 months, and I'll talk 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 very little marketing costs associated with the repeat loans. Over 51% of operating income in the UK came from existing customers in 2020, which improves the quality of income and increases the strong moats around our business.

Samir Desai: Since 2010, we have originated £11.5 billion of loans to over a 100,000 small businesses. I'm also pleased today to announce, that we launched our Economic Impact Report with research from Oxford Economics. This showed that the lending through the Funding Circle platform in 2020 created and sustained 135,000 jobs and added £10 billion to GDP, demonstrating the huge economic impact our platform is delivering. 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, our loans are £80,000 and the average term of the loan is around 50 months. I'm really proud of the impact we've been able to have in supporting businesses like Wild Card Brewery. On the day the lockdown started, they opened an e-commerce store, and actually over the past year have been able to grow by 12% and Funding Circle have played an important role in supporting them. And we hear these stories from a number of different small businesses right the way across the UK and US. And in many ways, this is really why I started the business in the first place, to actually help get money to small businesses during times of economic stress.

Samir Desai: We are reaching a level of scale, brand awareness and customer satisfaction in the UK that is unmatched by other fintechs. We are the third largest CBILS loan provider in the UK and have approved £2.6 billion of loans since we joined the program. We have brand awareness of around 50%, which is significantly higher than other fintechs, 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 always come back to Funding Circle first in the future. Once they experienced this way of borrowing, they never want to go back.

Samir Desai: We have £4.2 billion of loans under management funded via a platform model. We are strategically focused on having a diverse mix of investors on the platform and this served us well during COVID. The largest group of investors on the platform are Asset Managers, who represent 36% of loans under management. Banks represent 35% of loans under management. Our bond program represents around 12% of loans under management. Retail represents 11% of loans under management, down from 23% in 2019. And the remainder is made up of national entities, including Development Banks and Councils, and funds that we manage. Funding Circle's equity represents only 3% of loans under management. Funding Circle only invests its own equity where it makes the platform model stronger. And we expect absolute amounts of equity invested to be around or below year-end 2020 levels of £118 million.

Samir Desai: 2020 has given us lots of momentum in the business and the Funding Circle Flywheel is driving 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, which in turn drives higher conversion and 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. I'm just going to hand over to Oliver now to talk about the financials.

Oliver White: Thank you, Samir. I'm proud to be presenting my first set of full year results of Funding Circle, especially as we've achieved a number of important profitability and growth milestones. Let's begin by looking at the group results and overview. Here we show in the first two columns the performance in H1 and in H2 2020, along with FY 2020 compared to 2019 on the right-hand side of the page. Not only was 2020 year of two halves as Samir mentioned but it is worth remembering the dynamics we saw in H1. Pre-pandemic, both the US and the UK had very strong starts to the year. This was followed by a pause in originations as the business responded to COVID and became accredited to government guarantee programs in both the UK and the US and then ramped up those programs by the end of the half. In the UK, CBILS continued throughout 2020. In the US, the PPP scheme initially ended early August.

Oliver White: Working down the table, loans under management ended the year at a record 4.2 billion up from 3.7 billion in 2019. Loans under management was driven by increasing originations. In 2020, originations were 2.7 billion up from 2.35 billion in 2019. This was enabled by an extremely robust performance in H2 with a very encouraging performance in the UK with CBILS and notwithstanding, there being no further PPP in the US for the majority of H2. H1 origination of 1.1 billion was marginally down in H1 2019 and reflected the mix of a strong start and then an adjustment period to the pandemic and the government schemes. Operating income, which is all the income we earn aside from the income from our investment vehicles, was broadly flat year-on-year. This was despite the origination and loans under management growth and due to the lower initial yields in the PPP scheme in the US where we initially followed a referral model. The origination economics as a CBILS scheme and the PPP scheme, once Funding Circle was able to participate in the Fed's PPP Liquidity Facility, or similar to the economics of the core product. This can be seen with the operating income performance in H2.

Oliver White: Investment income, which is the investment income less investment expense attributable to the various investment vehicles, increased sharply year-on-year. This is because of various ABS programs only commenced during 2019. In 2020, we retained a number of these investments longer than we had intended, as our strategy is to sell these vehicles. Accordingly, 2020 reflected both a full year of investment income and also at a higher level than originally intended. The reduction H2 over H1 is due to the natural roll-off of the loans within these vehicles. In total, total income was 222 million for the year, up from 177 million in 2019. In H2, we saw a more normal level of fair value adjustments at negative 22.2 million, and our investment Adjusted EBITDA was a positive 7.7 million. It

is important that we consider the net of the investment income and the fair value adjustment. In H1, we recorded the heightened fair value adjustments due to the impact of the economic stress caused by the pandemic on our investments. Our forward view of economic stress, which feeds into the calculation of fair value, is substantially unchanged from our view as of half year.

Oliver White: Costs, both expenses above AEBITDA and expenses below AEBITDA reduced substantially, both 2020 over 2019 and in H2 compared to H1. Exceptionals reflect the costs of actions taken in developing markets and in the US. The group recorded a full-year Adjusted EBITDA loss of 63.8 million, up from 27.5 million in 2019, and an operating loss of 106.3 million, up from 84.7 million in 2019. This was primarily driven by the fair value adjustment seen in H1 of negative 96 million or negative 59.7 million, after taking into account the investment income earned. The majority of this adjustment we ascribed to the economic impact of the pandemic and which, of course, we did not see a repetition of in H2. The operating loss was also impacted by the 18.7 million of exceptionals. Very encouragingly, in the second half of the year, the group recorded its first AEBITDA profitable half. We have an AEBITDA of 20.3 million and also its first operating profit, we have an operating profit of 7.2 million. Overall, I'm very pleased with the financial performance during a challenging year. The actions we have taken show our commitment to delivering profitability for the company whilst we continue to see many exciting future opportunities. I will now break down these group figures in more detail.

Oliver White: I will begin with the UK business. As you will see, the UK is the engine of the Funding Circle group. We have an advantage position in the market, have scale, and have been Adjusted EBITDA profitable since 2018. The slide shows a top line of loans under management of originations and total income. Working from left to right: Full year loans under management and originations both grew strongly 2020 compared to 2019, up 27% at 3,271 million and up 36% to 111 million, respectively. H1 originations were impacted by the pause in business as the pandemic hit and the adjustment to support the CBILS program. This pleasing group has reflected in total income, up 37% year-on-year at 152.9 million. Within the total income, operating income grew 20 million with an increase in the proportion coming from servicing fees, and investment income also grew 20 million.

Oliver White: This slide shows Adjusted EBITDA on operating profit for the two halves of 2020 and full year 2020 in 2019. The UK is Adjusted EBITDA profitable for 2020, even after absorbing the H1 of fair value adjustment. This is the third year our UK business has been Adjusted EBITDA profitable. We are profitable in H2, we have an Adjusted EBITDA of 28.6 million, a margin of 31% and the UK recorded its first half of operating profit with an operating profit of 21.3 million.

Oliver White: Turning to the US, the payment protection program in the US launched in April 2020, with Funding Circle participating by the end of April. Initially, we originated loans and refer to selector partners for funding. In June, we became eligible to participate in the PPPLF. The PPP Liquidity Facility enables banks and non-banks to access Federal Reserve funding to support PPP loans. Participating in the PPPLF meant that the origination economics of PPP are

broadly similar to that of our core product. Prior to participation, our partnership model led to lower yields.

Oliver White: PPP ended on August the 8th. Following the ending of the scheme, the market was dislocated with borrower expectation of a new government scheme suppressing demand. Despite steady growth through H2 in our referral business, and relaunching our core product at the end of the half, originations in H2 was subdued. These dynamics can be seen in the overall year-on-year decrease in originations of 7% and LuM of 11%. And also in the H1 originations up 28% year-on-year, due to the strong pre-pandemic start to the year and the PPP scheme, followed by subdued H2 originations with a wider market uncertainty. Total income is up 20% year-on-year at 63 million driven by the year-on-year increase in investment income of 25 million.

Oliver White: The US recorded a full-year Adjusted EBITDA loss of 62.4 million, up from negative 22 million in 2019 and an operating loss of 83.6 million, up from negative 29.9 million in 2019. This was mainly driven by the fair value adjustment seen in half one of negative 61 million or negative 41 million after reflecting the investment income earned. Our losses in H2 are much reduced compared to H1, notwithstanding the subdued trading performance. This is due to both the non-recurrence of the pandemic related fair value adjustment and to the positive impact of the cost actions announced early July to rightsize the US business. Developing markets, so Germany and the Netherlands, now are breakeven following the actions we announced in March and successfully executed during the year to move to more of a referral model.

Oliver White: Putting this together for Funding Circle as a whole, 2020 saw record loans under management of 4.2 billion, up 13% year on year, and record originations of 2.7 billion, up 17% year on year. With total income of 222 million, up 25% year on year.

Oliver White: 2020 was an exceptional year with the unprecedented impact of COVID-19. Full year Adjusted EBITDA of negative 63.8 million and operating profit of negative 106.3 worsen year on year, primarily driven by the H1 fair value adjustment of negative 96. Within the overall performance, the operating Adjusted EBITDA loss reduced from 37.9 million in 2019, to 11.8 million in 2020. This is the yellow box on the left hand side of the chart. Very encouragingly, we were Adjusted EBITDA and operating profitable in H2. Adjusted EBITDA was 20.3 million, a 17% margin. Both operating and investment Adjusted EBITDAs were profitable. Operating profit was 7.2 million in the half. I'm very happy with this performance and it demonstrates increasing scalability and operating leverage within the Funding Circle platform.

Oliver White: Talking now to costs. Operating expenses have been actively and tightly managed. Operating costs are shown on the left hand side of the slide. As you have seen, the restructuring actions announced in March, executed during the year have brought developing markets to break even profitability. In July, we announced a rightsizing of the US business, with technology centralised in the UK, and moved more activities to our Denver center from San Francisco. Overall, year-on-year operating expenses have reduced 12% to 191 million, and H2 over H1 also reduced 12%. Marketing, shown on the right of the slide, has

reduced from 42% as a percent of operating income in 2019, down to 30% in 2020. This is due to reduced brand spend, improved efficiency, and tight control.

Oliver White: Looking now at the performance of our loans portfolio as a whole. The chart on the right shows a flow of borrowers missing payments for the first time. After an initial spike in April, the flows remained low and stable despite the second and subsequent waves of COVID-19 and resultant further lockdowns and restrictions. The chart on the left looks at our stock of borrowers. As of December, over 93% of borrowers are making payments. This has slightly improved since the half year. Overall, our borrower population have proved resilient throughout the impact of the pandemic, and we have seen no significant impact of the second and subsequent waves on the pandemic.

Oliver White: This resilience flows into the returns to our investors. All investor cohorts in both the UK and the US show a positive return in the latest projection, the green bar to the right of the three. This is a slight improvement to our projections at half year, where one US cohort was forecast to make a small loss. It's important to note we have not substantially revised our future macro projections. We continue to see an economic impact of the pandemic out until end 2022. The improvement has been driven by the actual performance seen in H2. This positive return to our investors in both geographies in all cohorts, at the time of an exceptional period of economic stress, is testament to the strength of our model and the performance of our borrowers.

Oliver White: Moving on from our external investors to Funding Circle's own balance sheet. We end the year with a robust net asset position of 218 million, including 103 million of cash. Net assets impacted at half year with a fair value adjustment, but have increased slightly by year end. We have included in the appendix more detailed analysis of our balance sheet and the various investment vehicles, consistent with our disclosure at the half year. Let me take a minute to explain the role of equity investments in our business model and the level of that going forward. Going forward, I see the absolute level of Funding Circle equity invested to be around or below the year end 2020 level of 118 million. As a reminder, Funding Circle deploys its equity where it makes the platform stronger. This may include limited co-investments or investment in new products.

Oliver White: 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 for investment returns, though we do anticipate these investments will ordinarily be profitable. As we saw in H2 2020, the investments Adjusted EBITDA, so investment income net of expenses and less the fair value adjustment, contribute to the positive 7.7 million. We intend to recycle the investments over 2021, as opportunities for realisation allow. As previously discussed, the majority of these investments we hold for sale. We will continue to leverage some of our co-investments as appropriate. I'd now like to hand back to Samir.

Samir Desai: Thanks, Oliver. I'm going to spend a few minutes talking about our priorities for 2021 and then looking ahead at future growth opportunities. Over the past 12 months, 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.

I have never felt better about where the business is, or more excited about the opportunity going forward. In the UK, we will operate core loans for borrowers that do not require a guarantee. We will operate the Recovery Loan Scheme for other borrowers once the CBILS program ends. We also intend to launch new products using our technology platform to help solve more small business problems. In the US we will expand our core loans once PPP finishes. We will originate government guaranteed loans through the SBA on behalf of banks alongside this. We will 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.

Samir Desai: 10 years of research and development have created an inflection point for Funding Circle, and I'm incredibly excited about the potential going forward. Over the years, we have aggregated huge amounts of data, built incredibly sophisticated machine learning models, and used technology to create a user experience for small businesses that is unmatched by other providers. This year, we'll get to the point where we can deliver a fully automated loan, with money in a customer's account within 15 minutes, a massive step change from where we were when we started the business 10 years ago. In 2021, we will launch an Application Programming Interface, or API, that will enable us to natively embed our Instant Decision Lending technology into partners' websites and platforms. We will focus on partnering with finance brokers, accounting software providers, and payments companies. Integrating with partners will increase the distribution of Funding Circle products, while servicing small business needs wherever they are.

Samir Desai: Our mission is to build the place where small businesses get the funding they need to win, and we deliver this powered by machine learning and technology. We have spoken to a number of customers to understand their funding problems, and it is clear that we can, and they want us to do more with them. In the next 12 months, we will launch new solutions to help solve more small business funding problems. We will launch a payment finance product that will help small businesses spread the cost of bills over a 3 month period. And we will also launch a card product to help small businesses finance their day-to-day spending. New products will drive more frequent usage of our platform by small businesses, which will make it an increasingly integral part of their lives, and also reinforce and drive more usage of our long term loan products. I'm incredibly excited about the opportunities to grow our core loan product and to augment it with these new products going forward. I'm now going to hand over to Oliver, who will take us through the full outlook.

Oliver White: Thank you, Samir. Turning to 2021. I'd like to start by saying that we take our forward guidance very seriously and that we're very thoughtful in choosing what we say about our 2021 guidance. Looking forward, we have some very exciting tailwinds as we've discussed, but there are also some real near term uncertainties. COVID-19 has changed the SME lending landscape. Over the past 12 months, we've seen an acceleration on the adoption of online borrowing. Through our use of machine learning and our technology platform, we are well placed to capture this enlarged opportunity going forward.

Oliver White: I'm very pleased to say we've made a strong start to trading so far this year. Loans under management and originations over the full year will depend on

how fast the UK and the US economies open up, alongside related macro factors such as competition and borrow demand. We expect there will be an initial reduction on lending from Q2 onwards as we transition to operating our core product alongside the government guarantee programs in the UK and the US. We are very confident we will deliver positive Adjusted EBITDA for the full year, with profitability skewed towards H1. We are very well-placed to take advantage of the opportunities this coming year offers.

Oliver White: We are hugely excited about the opportunities for Funding Circle on the medium term. As Samir has discussed, 2020 has seen accelerated changes are benefiting Funding Circle, and progress and positive proof points on our business model and technology platform.

Oliver White: Taking a step back, this is how we see Funding Circle. The established UK business is the engine of Funding Circle. The UK represented 70% of group total income in 2020. Our business offers operational leverage, is Adjusted EBITDA on operating profit profitable and has been Adjusted EBITDA profitable since 2018. It's also cash generative. Growth opportunities in our core market continue over the medium term.

Oliver White: The UK engine enables Funding Circle to pursue additional growth opportunities. The US is five times the size of the UK market, but our business there is at an earlier stage of development. The PPP scheme will provide a boost of volumes and revenues in early 2021. Post-PPP, as we invest to grow market share, the US will likely be AEBITDA loss-making for the next few years. We are very excited about the scale of the opportunity the US offers. We will carefully manage the level of investment in the US.

Oliver White: There is a big but early stage opportunity to support more customers by leverage our technology platform into new adjacent products. There will be beta launches in 2021, but with small income contribution initially, stepping up in the future, following successful rollout.

Oliver White: Following the restructure to a referral model in H1 2020, the developing markets business is now breakeven. Overall, the group, powered by the UK will be Adjusted EBITDA profitable going forward, and we will continue to invest in additional growth opportunities.

Oliver White: Thank you. This is now the end of the presentation.